**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

The Staff of the Missouri Public Service Commission,	)	
Complainant,	)	
v.	)	**Case No. GC-2006-0491**
Missouri Pipeline Company, LLC; and Missouri Gas Company, LLC,	)	
Respondents.	)	

REPLY POSTHEARING BRIEF

OF

THE MUNICIPAL GAS COMMISSION OF MISSOURI

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COMES NOW the Municipal Gas Commission of Missouri ("MGCM"), pursuant to the Commission's January 12, 2007 Order Establishing Briefing Schedule, and respectfully submits its Reply Posthearing Brief.

I. OVERARCHING ISSUE

In its Initial Brief, MGCM advised the Commission not to have its attention "diverted by pipeline discussion of agency agreements and load factors."[1] As predicted, the pipelines resort to such red herring issues in order to avoid addressing the substantive documentary evidence provided by Staff.

Section 3.2(b) of the pipeline tariffs provides that "the lowest transportation ***rate charged*** to an affiliate shall be the maximum rate that can be charged to non-affiliates."[2] The Commission should therefore ask itself, what would be the best evidence of the "rate charged to an affiliate"? Given the obvious answer to this question and anticipating the Commission's needs in deciding this matter, Staff provided the Commission with copies of numerous invoices documenting the rates charged by the pipelines to its affiliate,

[1] MGCM Initial Brief at page 13.
[2] Exhibit 70, Sheet No. 6, Section 3.2(b); Exhibit 71, Sheet No. 6, Section 3.2(b).

Omega Pipeline Company.[3] These invoices provide irrefutable evidence that the pipelines gave their marketing affiliate (Omega) a transportation discount in order to provide it a competitive advantage in the non-regulated gas sales industry. "The information in these [invoices] show MPC and MGC charged Omega lower rates for the same transportation service to the same location on the pipelines than they charged non-affiliated shippers."[4]

Noticeably, despite their obvious presence in the record, the pipelines continue to ignore such invoices and instead implore the Commission to focus on transportation contracts.[5] By focusing on the rates that ***should be charged*** as reflected in the agreements and not the rates ***actually charged*** in the invoices, the pipelines create the "apples to oranges" comparison which it later bemoans.[6]

What the Commission should realize is that, while the transportation contracts may be evidence of the amount that ***should be charged***, the invoices are evidence of the rates that ***were charged***. Again, MGCM advises the Commission not to be tricked by the pipelines' reliance on the contracts. By ignoring the non-issues raised by the pipelines and, instead, focusing solely on the invoices, the Commission will be better able to manage the record in this case and come to an informed decision in favor of the Staff.

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[3] Exhibit 67, page 3. "The 'lowest transportation rate charged to an affiliate' is the criterion for the maximum rate that can be charged to non-affiliates, not the alleged terms in transportation contracts. Staff is relying on invoices it obtained from MPC and MGC for its assertion that MPC and MGC are violating their tariffs in this respect." Exhibit 67, Appendix C are ***invoices*** associated with Omega service to Emhart Glass. Exhibit 67, Appendix D are ***invoices*** associated Omega service to Fort Leonard Wood. Exhibit 67, Appendix E are ***invoices*** associated Omega service to city of Cuba, G-P Gypsum and Willard Asphalt.
[4] Exhibit 67, page 8.
[5] Similarly, the expert testimony of pipeline witnesses John and Smith relied solely upon transportation agreements provided by the pipelines. See Smith Rebuttal Testimony, I "address the validity and appropriateness of the following ***Omega gas sales and transportation agreements***." (Exhibit 303, page 2). While Smith reviewed the contracts in order to determine the amount that should have been charged, Smith did not review the invoices to determine the amount that was charged. In like fashion, pipeline witness John focused solely on the transportation agreements. (Exhibit 300, page 24).
[6] Initial Brief at page 26.

II. SPECIFIC ISSUES

A. PIPELINE CLAIMS THAT OMEGA CONSISTENTLY PAID THE HIGHEST RATE OF ANY SHIPPER ON THE PIPELINES' SYSTEMS ONLY APPLIES TO TRANSPORTATION SERVICE TO FORT LEONARD WOOD.

In its Initial Brief, the pipelines claim that its affiliate "consistently paid the highest rate of any Shipper on the Pipelines' systems."[7] In their effort to justify this incorrect assertion, the pipelines rely solely on testimony that was prepared by reference to rates that ***should have been charged*** under transportation agreements, not by reference to rates that ***were charged*** in the invoices. Nevertheless, it is apparent that the chart provided on page 22 of the pipelines' Initial Brief does not actually support the proposition that Omega paid the highest rate of any shipper on the pipelines. Rather, armed with the knowledge provided by the invoices, one can easily deduce "the rest of the story."

Regarding the rates charged on the Missouri Gas Company ("MGC"), the pipelines claimed that Omega paid a transportation rate of **____________**. This rate provides the sole basis for the pipelines claim that Omega was charged the "highest rate" of any shipper on the pipeline. The pipelines fail to note, however, that this transportation rate was associated ***solely*** with regards to transportation of gas to Fort Leonard Wood.[8] Obviously, given that Fort Leonard Wood was at the terminal end of the MGC system, it is logical that Omega should pay the highest rate.

Interestingly, while Omega is charged the highest rate on the pipeline associated with service to Fort Leonard Wood, this rate still represents a significant discount off the

[7] MPC / MGC Initial Brief at page 21.
[8] Exhibit 67, pages 2 and 5.

maximum tariffed rate that was charged to ONEOK when it provided gas to the Fort.[9] Specifically, the MGC tariffed rates for service to Fort Leonard Wood are: (1) a $18.10 / Dth reservation charge and (2) a $0.55 commodity rate.[10] Again, applying the 25% load factor, this equates to the total transportation rate of $2.9303 / Dth reflect in the pipelines' Initial Brief. In order to allow Omega to win the natural gas business on the Fort, however, MGC provided Omega a **__________** discount in the commodity rate for a total transportation rate of **___________**.[11] Of this **_________** commodity rate discount provided by MGC, Omega passed **___________** of the discount on to Fort Leonard Wood.[12] While not the entirety of the competitive advantage provided by MGC, this discount was enough to allow Omega to wrestle the Fort's natural gas business from ONEOK.[13]

B. WHEN PROVIDING SERVICE TO OTHER ENTITIES ON THE PIPELINE, OMEGA IS CHARGED THE LOWEST RATES ON THE PIPELINE.

Despite pipeline claims that Omega is charged the highest rate on the system, it is apparent that this statement is only true associated with service to Fort Leonard Wood. Where it provides service to other entities on the pipeline, however, Omega was charged the ***lowest*** rate of any shipper on the pipeline. For instance, although cleverly labeled as Cuba to avoid hint that the rate is actually an affiliate discount rate, the lowest rate on the

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[9] Exhibit 85, page 8; Exhibit 67, page 5. "Omega pays a lower rate to MGC for delivery to the Fort than the prior non-affiliated gas supplier, ONEOK Marketing." "The invoices in my Appendices A and B show MPC and MGC charged ONEOK maximum tariff rates for natural gas delivery to Fort Leonard Wood."
[10] Exhibit 70, Sheet No. 5.
[11] Exhibit 19, page 26.
[12] Exhibit 37, page 4. While Omega was provided a **_________** discount in the commodity rate by the pipelines, Omega only passed **_________** of this discount through to Fort Leonard Wood. Therefore, Omega was pocketing **__________** for each Dth of gas transported on MGC.
[13] Taking Fort Leonard Wood's business away from ONEOK was not enough for Mr. Ries. He continued to seek collection of the full reservation charge reflected in ONEOK's agreement with the pipeline for the six month termination notice period. When confronted with a request by ONEOK for the pipelines' contract with Omega to serve Fort Leonard Wood, Mr. Ries misleadingly informed ONEOK that the Omega arrangement includes **____ ____**. Needless to say, **_____________ ____ ________**

pipeline was provided to Omega associated with its transportation of gas to the city of Cuba. As reflected in the invoices, Omega was charged a $13.1766 / Dth reservation rate and a **___________** commodity rate for service to the City of Cuba.[14] Given the calculation undertaken by the pipelines to account for a 25% load factor, it is apparent that Omega, not the City of Cuba, was provided the lowest rate on the MGC system.[15] This low affiliate rate was ***not*** passed on to the City of Cuba. Rather, the City of Cuba was charged a total transportation rate of **_________**.[16]

C. PIPELINE CLAIMS THAT OMEGA PAYS THE HIGHEST RATE ON THE SYSTEM DOES NOT ACCOUNT FOR THE DISCOUNTED **INTERRUPTIBLE** RATES PROVIDED TO OMEGA.

As reflected, *supra*, the pipelines' claims that its affiliate (Omega) pay the highest rate on the system only applies to the ***firm*** transportation service provided by the pipelines, associated with Omega's service to Fort Leonard Wood. In those instances in which the pipelines provide ***firm*** transportation service associated with Omega's service to entities located on other portions of the pipeline (i.e., the city of Cuba), Omega pays the lowest rates on the pipeline.[17] Similarly, where the pipelines provide ***interruptible*** service for Omega to serve **__________** and **______________**, Omega again pays the lowest rates on the pipeline.[18]

MGC tariffs provide an interruptible rate consisting of $1.3765 / Dth and, since there is no guaranteed capacity associated with interruptible service, there is no

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[14] Exhibit 19, page 24; Exhibit 67, Appendix E.
[15] ($13.1766 / Dth) * (12 months) ÷ (365 days) ÷ (.25 load factor) = $1.7328 / Dth reservation charge + **_________** commodity rate = **___________** total transportation charge.
[16] Exhibit 22.
[17] See Section B discussing Omega's affiliate discount associated with the provision of ***firm*** service to the city of Cuba.
[18] Exhibit 67, page 3. "Appendices N and O compare firm transportation service and rates to interruptible transportation service and rates. Such a comparison is meaningless in the context of Staff assertions in this complaint. This is because firm transportation service is distinct from interruptible transportation service. The difference is reliability."

reservation charge.[19] Where the interruptible service is associated with Omega's provision of service to either **__________** and **________________**, Omega is provided a significant discount. For instance, invoices sent by the pipelines to its affiliate (Omega) associated with interruptible service to **___________** reflect a rate of **____________**.[20]

D. PIPELINE CLAIMS THAT THE CITY OF CUBA HAS A DISCOUNTED RATE FOR TRANSPORTATION ARE INCORRECT AND BASED UPON A FAKE DOCUMENT DESIGNED TO MISLEAD THE COMMISSION.

Recognizing the consequences of providing discounts to an affiliate, the pipelines claim that the discount was not actually provided to an affiliate, but was provided to the city of Cuba. In its brief, the pipelines untruthfully claim that the discounted rate was not provided to Omega, but was actually a "discounted rate for shipping gas" that was provided to the city of Cuba.[21] In support of this claim the pipelines cite to Exhibit 26.

As indicated in MGCM's Initial Brief, Exhibit 26 is a document created after the fact to mislead the Commission and cover-up evidence of affiliate discounts. As thoroughly discussed in MGCM's Initial Brief, overwhelming evidence supports the claim that this is not an actual pipeline document. Comparison with other properly executed contracts (i.e., Exhibit 25 – previous pipeline contract with Cuba; Exhibit 27 – pipeline contract with Waynesville; and Exhibit 28 – previous pipeline contract with Waynesville) reveal several inconsistencies which mandate a conclusion that this agreement was never executed and was actually created after the fact. First, unlike ***all*** the other properly executed agreements, the claimed contract with Cuba was never signed by the Mayor. Second, unlike ***all*** the other properly executed agreements, the claimed contract with Cuba was never even formatted for signature by the Mayor. By including

[19] Exhibit 19, page 24; Exhibit 70, Sheet No. 16.
[20] Exhibit 19, page 25; Exhibit 67, Schedule E.
[21] Initial Brief at page 23.

such formatting without the corresponding signature, the pipelines knew that flags would be raised. Therefore, the pipelines omitted the signature line for the Cuba mayor and hoped the oversight would go undetected. Third, the document letterhead incorrectly reflects the true identity of the pipeline. As of the date of the claimed contract, Missouri Pipeline Company no longer operated as a corporation. On December 3, 2002, the Commission approved the reorganization of Missouri Pipeline Company from a corporation to a limited liability company. This approval was effective on December 12, 2002. As reflected on the letterhead on Exhibit 28, Missouri Pipeline Company was already holding itself out as a LLC a mere 6 days after the reorganization approval. Nevertheless, Exhibit 26, the pipelines' claimed contract with Cuba allegedly executed eight months after the reorganization, inexplicably indicates that the pipeline is a corporation. Given the explicit bar in Section 347.020(2) against a limited liability company using any name which contains the word or abbreviation for corporation or incorporated, it is unlikely that Mr. Ries suddenly used the wrong letterhead. Rather, it is apparent that this document was a hastily prepared attempt, created after the fact and modeled after Exhibit 25, to make the Commission believe that no affiliate discount actually existed.

As indicated, invoices from the pipeline to its marketing affiliate clearly reflect that the discounted rate was provided to Omega and never passed on to the city of Cuba.

E. PIPELINE CLAIMS THAT DISCOUNTS WOULD NOT PERMIT THEM TO RECOVER PRUDENTLY INCURRED COSTS ARE UNFOUNDED.

At page 27, the pipelines engage in a last gasp assertion commonly heard by the Commission. Specifically, the pipelines claim that any reduction in rates to reflect the discounts provided by the pipelines to its affiliate "would not allow the Pipelines to recover costs prudently incurred and would be detrimental to Shippers and end users in the long run."[22] Furthermore, the pipelines claim that such adjustments would be improper ratemaking. The flaws in this argument are readily apparent.

First, this docket is not a ratemaking. Chapters 386 and 393 provide two methods for the Commission to engage in ratemaking: (1) through a complaint proceeding under Section 386.390 or (2) the file and suspend method in Section 393.140(11). In contrast to those two dockets, this docket was established to hear a complaint by the Staff to have the Commission enforce the pipelines' currently approved tariffs. ***<u>This is not ratemaking!</u>*** Gateway purchased these pipelines with full knowledge of the tariffs. Upon acquisition it adopted those tariffs. It clearly understood the ramifications of providing affiliate discounts as prohibited by its tariffs. And, in its effort to leverage its control of monopoly pipeline service into the competitive natural gas supply business, it elected to provide such discounts. The reduction in transportation rates to all other shippers is the relief mandated by its tariffs. It should not be allowed to now claim that this relief is overly harsh. Such claims are akin to the child crying about being an orphan after murdering his parents. The ramifications were known prior to the action and the pipelines moved forward of their own volition.

Second, there is no evidence to support an assertion, let alone a finding of fact, that a reduction in non-affiliate rates would not allow the pipelines to recover prudently incurred costs. There has not been any evidence as to the level of pipeline expenses, the current receipt of revenues, the pipelines' capital structure, the cost of debt or the appropriate return on equity. Without such evidence it is impossible for anyone to know whether the discounted rates will allow the pipeline to recover prudently incurred costs.

Third, the pipelines have been fully aware of the implications of its affiliate abuses as well as Staff's assertions that such discounted rates should be made applicable

[22] Initial Brief at page 27.

to all current shippers. On September 6, 2006, Staff filed the testimony of Robert Schallenberg in which he concludes that the pipelines "reduced the maximum tariff rates that can be charged to a non-affiliate for transportation service, by virtue of rates MPC and MGC charged their affiliate, Omega, for transportation service."[23] As such, the pipelines have been on notice for almost six (6) months of the possibility that its current rates would be reduced. The pipelines could have filed a rate proceeding to ensure that rates would adequately recover prudently incurred costs. To date, the pipelines have not availed themselves of the protections offered by Section 393.140(11).

Fourth, by their claim that the discounted rate provided to its affiliate would not "allow the Pipelines to recover costs prudently incurred", the pipelines explicitly admit that they violated the Commission's affiliate transaction rule. Commission rule 4 CSR 240-40.015 addresses affiliate transactions for gas utilities. Subsection (2)(A) of that rule provides:

> A regulated gas corporation shall not provide a financial advantage to an affiliate entity. For the purposes of this rule, a regulated gas corporation shall be deemed to provide a financial advantage to an affiliate entity –
>
> 2. It transfers information, assets, goods or services of any kind to an affiliate entity below the greater of –
>
>   A. The fair market price; or
>
>   B. The fully distributed cost to the regulated gas corporation.

By its brief, the pipelines admit that the discounted rate provided to its affiliate would not be sufficient to allow the pipeline to recover its prudently incurred costs. This is an explicit admission that the discounted rate was not above the "fully distributed cost to the regulated gas corporation."

[23] Exhibit 19, page 27.

Finally, the pipelines operate under a standing eighteen year old Commission order to file a rate case to determine the appropriateness of current rates, both tariffed and discounted. On August 1, 1989, at the time that it was granted a certificate of convenience and necessity, Missouri Pipeline Company was ordered "to file a permanent rate case on or before two (2) years after the pipeline goes in service."[24] Clearly, there were sufficient revenues from non-affiliate shippers on the pipeline to cover the pipelines' expenses plus allow it to offer significant discounts to its affiliates. Given that these non-affiliate revenues were sufficient to cover all pipeline costs, the question necessarily arises as to whether those rates are excessive. Furthermore, MGCM notes that rates are currently set on the initial level of rate base prior to any depreciation. Recognizing that this rate base has now experienced 18 years of depreciation, that rate base is significantly lower. No attempt has been made to reduce the regulated rates to account for this depreciated rate base.

In order to address these eighteen year old rates and in order to ensure that the discounted rates are sufficient to cover prudently incurred expenses and, similarly, are not excessive, MGCM urges the Commission to order the pipelines to file a permanent rate proceeding within thirty (30) days of the effective date of the Report and Order in this complaint proceeding. Given the limited number of customers on the pipeline as well as the fact that the financial books for 2006 are likely already closed, it is not unreasonable to expect the company to prepare a rate proceeding in that period of time.

III. CONCLUSION

In its Initial Brief, the pipelines attach an email sent by pipeline President David Ries on August 23, 2002. In his email, Mr. Ries attempts to comfort the Staff against any belief that he might engage in discriminatory treatment between non-affiliates and his

[24] *In re: Missouri Pipeline Company*, Case No. GA-89-126, Report and Order, issued August 1, 1989.

affiliate marketing company. Mr. Ries notes, "[t]he primary objective here is to make sure that the pipelines are collecting a fair share of the revenue as possible within their tariffs without making the retailers uncompetitive."[25] Less than five years later we now understand that such suggestions were mere lip service. Five years of affiliate abuse has virtually removed any semblance of competition in the natural gas marketing business on this pipeline. Where marketers (e.g., ONEOK, Cornerstone Energy, etc.) once openly competed for customers, competitive advantages provided to Omega have pushed those entities out of the arena. This docket affords the Commission the opportunity to correct these past transgressions and put all competitors on equal footing.

As indicated in its Initial Brief and the earlier portions of this brief, MGCM reminds the Commission that the best evidence of the rate charged by the pipelines to its affiliate are the invoices sent by the pipelines to the affiliate. These invoices provide in abundant detail the ongoing utilization of affiliate discounts to allow Omega to better compete in the non-regulated gas sales market. Commission approved tariffs provide a ready remedy for this pattern of affiliate abuse – reduction in the maximum to non-affiliate shippers to that level charged to the pipelines' affiliate. MGCM respectfully urges the Commission to make findings consistent with the testimony of Robert Schallenberg and the positions advanced in this brief.

[25] Initial Brief on last page.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing pleading by email, facsimile or First Class United States Mail to all parties by their attorneys of record as provided by the Secretary of the Commission.

David L. Woodsmall

Dated: February 20, 2007