

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

In the Matter of Laclede Gas Company's Purchased Gas Adjustment for 2004-2005	) ) )	<b><u>Case No. GR-2005-0203</u></b>
In the Matter of Laclede Gas Company's Purchased Gas Adjustment for 2005-2006	) )	<b><u>Case No. GR-2006-0288</u></b>

**STAFF'S RESPONSE**

**COMES NOW** the Staff of the Missouri Public Service Commission, by and through the Commission's General Counsel pursuant to § 386.071, RSMo, and Commission Rule 4 CSR 240-2.040(1), and, in Response to the Commission's Order Directing Filing of June 4, 2009, states that Paragraph III.8 of the Stipulation and Agreement referred to by the Commission requires that Laclede produce the requested information in order to allow Staff to determine whether or not Laclede is improperly acting to artificially inflate its cost-of-service as a mechanism by which to require its captive ratepayers to subsidize its unregulated operations. In further response, Staff states as follows:

1. This matter is a Purchased Gas Adjustment/Actual Cost Adjustment (PGA/ACA) case, which is a species of rate case.
2. Approximately seventy percent of a customer's bill is the gas cost portion, so careful scrutiny of Laclede's gas purchasing practices is important.
3. Because of the volatility of natural gas prices, the costs and rates related to the commodity have been removed from the traditional cost-of-service ratemaking proceeding and are treated separately. Briefly stated, gas customers pay rates based upon forecast prices; an annual, after-the-fact true-up process

either credits them for any overpayment or charges them for any underpayment. The forecast rates are subject to periodic adjustment as the natural gas market changes.

4. The Missouri Supreme Court has described the PGA/ACA process:<sup>1</sup>

Natural gas distribution companies . . . are allowed to recoup approved costs for obtaining natural gas from their suppliers as part of the rate they charge their customers. Periodically, the PSC conducts an Actual Cost Adjustment (ACA) review to determine what costs public utilities are allowed to recover from their customers. As part of this effort, the PSC staff conducts a "prudence review" to evaluate the utility's contracts with its suppliers. The staff then decides whether the costs associated with the contracts should be disallowed in whole or part.

The present controversy arises from Staff's attempts to obtain information from Laclede as part of its prudence review of Laclede's gas costs in the Actual Cost Adjustment phase of this case.

5. The Commission, in its Order referred to above, directed Staff, Laclede and the Public Counsel to "further explain their positions that Section III, numbered paragraph 8, and Section IV, numbered paragraph 1, of this Stipulation and Agreement either operate or do not operate to require Laclede to provide the requested information."<sup>2</sup>

6. The Stipulation and Agreement in question, filed in Case No. GM-2001-342, sets out the conditions under which Laclede was permitted to organize itself as an unregulated holding company owning a regulated operating subsidiary and certain unregulated subsidiaries.

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<sup>1</sup> *State ex rel. Riverside Pipeline Co., L.P. v. PSC of Mo.*, 165 S.W.3d 152, 153-154 (Mo. banc 2005).

<sup>2</sup> *Order Directing Filing*, issued June 4, 2009, at page 1.

7. It wasn't so very long ago that energy utilities were forbidden to organize and operate in this fashion because of brazen abuses that contributed to the economic dislocation referred to now as the Great Depression.<sup>3</sup> As the nation endures the current economic dislocation, it is worth remembering the conduct that led to the prohibition against public utility holding companies.

8. One aspect of that conduct was the "milking" of cash from regulated operating companies through "questionable intercompany transactions" with unregulated affiliates, resulting in unnecessarily high rates for consumers.<sup>4</sup> As the Missouri Supreme Court has recognized, the Commission has attempted to respond to:

the emergence of a profit-producing scheme among public utilities termed "cross-subsidization," in which utilities abandon their traditional monopoly structure and expand into non-regulated areas. This expansion gives utilities the opportunity and incentive to shift their non-regulated costs to their regulated operations with the effect of unnecessarily increasing the rates charged to the utilities' customers. *See United States v. Western Elec. Co.*, 592 F.Supp. 846, 853 (D.D.C.1984) ("As long as a [public utility] is engaged in both monopoly and competitive activities, it will have the incentive as well as the ability to 'milk' the rate-of-return regulated monopoly affiliate to subsidize its competitive ventures....").<sup>5</sup>

9. In Case No. GM-2001-342, wherein Laclede sought authorization to configure itself as an operating company wholly-owned by a holding company,

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<sup>3</sup> See the Public Utility Holding Company Act of 1935 (PUHCA), 15 U.S.C. §§ 79 to 79z-6.

<sup>4</sup> *Public Utility Holding Company Act of 1935: 1935-1992*, Energy Information Administration (EIA), United States Department of Energy (January 1993), at page 5. One stakeholder group described PUHCA as "the only law that prevent[ed] utility holding companies from subsidizing unregulated business activities from profits obtained from their regulated business activities and captive customers." Union of Concerned Scientists at [www.ucsusa.org/clean\\_energy/solutions/big\\_picture\\_solutions/public-utility-holding.html](http://www.ucsusa.org/clean_energy/solutions/big_picture_solutions/public-utility-holding.html), accessed on June 9, 2009.

<sup>5</sup> *State ex rel. Atmos Energy Corporation v. Public Service Commission*, 103 S.W.2d 753, 763-764 (Mo. banc 2003).

Staff warned the Commission of the possibility of abuses arising from the new structure and suggested conditions that, if properly implemented, would permit Laclede to restructure while protecting Laclede's captive customers from abuse.

10. In this regard, Staff filed the prepared testimony of expert financial analyst, Ronald L. Bible. Mr. Bible testified, based upon his analysis of Laclede's application, that:

The application as filed has a detrimental impact on Laclede's customers. The application should, however, be approved with the proposed insulating conditions that remove the detrimental affect of Laclede's request. \* \* \* In the absence of insulating conditions, the business risk and financial risk of the unregulated operations will be transferred to the regulated utility. This will increase the cost of capital for the regulated utility with no offsetting benefit to the ratepayer. Increasing the cost of capital will result in a detriment to the ratepayer.<sup>6</sup>

In order to ameliorate this perceived public detriment, Mr. Bible recommended that the Commission condition its approval of Laclede's application upon the following condition:

The Holding Company will provide the Commission Staff, upon request and with appropriate notice, all information needed to verify compliance with the conditions authorized in this proceeding and any other information relevant to the Commission's ratemaking, financing, safety, quality of service and other regulatory authority over Laclede Gas Company.<sup>7</sup>

11. Staff also filed the prepared testimony of expert regulatory auditor Stephen M. Rackers in Case No. GM-2001-342. Much of Mr. Rackers' testimony related to the need for Staff access to records of Laclede, its parent and affiliates

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<sup>6</sup> Bible, Direct Testimony, Case No. GM-2001-342, at pages 2-3.

<sup>7</sup> *Id.*, at 9.

following the restructuring in order to ensure that Laclede's Missouri customers suffered no detriment. Mr. Rackers testified that

Organizational separation of Laclede's current regulatory operations will also hinder the Commission's discovery powers regarding information related to activities engaged in with affiliates. For example, after the reorganization, Laclede may seek to object to certain discovery on the basis that particular records and employees are no longer under the control of the Company.<sup>8</sup>

In order to ameliorate this perceived public detriment, Mr. Rackers recommended that the Commission condition its approval of Laclede's application upon the following condition:

The books, records and personnel of Laclede Gas Company, the holding company, affiliates and any service company, if formed, will be made available to the Staff and OPC at reasonable times

a. Laclede Gas Company, the holding company, affiliates and any service company, if formed, will not object on the basis that the production of records or personnel is not subject to Commission authority and jurisdiction or are not in the control or custody of Laclede Gas Company.

b. Laclede Gas Company, each affiliate and the holding company will maintain records supporting its affiliated transactions for at least five years.<sup>9</sup>

12. On August 14, 2001, this Commission issued its *Order Approving Stipulation and Agreement and Approving Plan to Restructure* in Case No. GM-2001-342. In that Order, the Commission stated:

The stipulation and agreement filed in this case contains certain conditions. These conditions are intended to protect the Missouri customers of Laclede. The conditions relate to such matters as financial constraints, access to information, prior authorization from the Missouri Public Service Commission for

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<sup>8</sup> Rackers, Direct Testimony, Case No. GM-2001-342, at page 5.

<sup>9</sup> *Id.*, at Sch. 2-2.

mergers and acquisitions, method of cost allocation, and reporting requirements. Staff supports the stipulation and agreement and recommends that the Commission approve it. The Office of the Public Counsel is also a signatory of the stipulation and agreement.

13. Staff supported Laclede's application to reorganize on the basis of the "safeguards" obtained from Laclede by negotiation and memorialized in the Stipulation and Agreement that is the subject of this Response. Those "safeguards" included these provisions:

**III.8:**

The Laclede Group, Inc and Laclede Gas Company agree that the Commission has, and will continue to have, the authority after the Proposed Restructuring to regulate, through the lawful exercise of its current statutory powers, any direct or indirect transfer or disbursement of earnings from Laclede Gas Company to an affiliate that would jeopardize the Company's ability to meet its utility obligations. The Laclede Group, Inc, and Laclede Gas Company also agree that the Commission has the authority, through the lawful exercise of its ratemaking powers, to ensure that the rates charged by Laclede Gas Company for regulated utility service are not increased as a result of the unregulated activities of Laclede's affiliates and Laclede agrees, consistent with such standard, that rates should not be increased due to such activities.<sup>10</sup>

**IV.1:**

The Laclede Group, Inc. and Laclede Gas Company shall provide the Staff and Public Counsel with access, upon reasonable written notice during normal working hours and subject to appropriate confidentiality and discovery procedures, to all written information provided to common stock, bond, or bond rating analysts, which directly or indirectly pertains to Laclede Gas Company or any affiliate that exercises influence or control over Laclede Gas Company or has affiliate transactions with Laclede Gas Company. Such information includes, but is not limited to, reports provided to, and presentations made to, common stock analysts and bond rating analysts. For purposes of this condition, "written" information includes but is not limited to, any written and

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<sup>10</sup> Stipulation & Agreement, Case No. GM-2001-342, at page 7.

printed material, audio and videotapes, computer disks, and electronically stored information. Nothing in this condition shall be deemed to be a waiver of The Laclede Group, Inc.'s or Laclede Gas Company's right to seek protection of the information or to object, for purposes of submitting such information as evidence in any evidentiary proceeding, to the relevancy or use of such information by any party.<sup>11</sup>

14. Staff supported Laclede's application to reconfigure based upon its belief that the public interest could be protected from the abuses likely to arise from the holding company structure through the imposition of appropriate conditions. As the testimony of Mr. Bible and Mr. Rackers demonstrates, a crucial element among those conditions was Staff's *unencumbered* access to information. In the absence of such access, Staff advises the Commission that the public interest is necessarily at risk.

15. It is Staff's position that Paragraphs III.8 and IV.1 of the Stipulation and Agreement, as well as the Stipulation and Agreement taken as a whole and understood in the context of Staff's concerns as stated in Case No. GM-2001-342, require Laclede to provide the requested information. Staff's purpose, as it has stated repeatedly in the pleadings filed in this matter, is to determine whether "Laclede imprudently shifted profit to LER at the expense of Laclede's captive customers."<sup>12</sup>

16. Staff's concern is that Laclede entities may be engaged in a systematic program of improper "cross-subsidization" by shifting non-regulated costs to regulated operations, and shifting profits properly earned by Laclede to

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<sup>11</sup> *Id.*, at pages 7-8.

<sup>12</sup> Staff's *Motion for Reconsideration*, filed May 1, 2009, at page 1 and elsewhere in that pleading.

LER, with the effect of unnecessarily increasing the rates charged to Laclede's captive customers. The information sought will answer that concern.

**WHEREFORE**, Staff prays that the Commission will order that the requested discovery be had; and such other and further relief as may be just in the circumstances.

Respectfully submitted,

s/ Lera L. Shemwell  
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**Certificate of Service**

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this **10<sup>th</sup> day of June, 2009**, on the parties of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case.

s/ Lera L. Shemwell