Exhibit No.:	
Issue:	*Affiliated Transactions*
Witness:	*David M. Sommerer*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Surrebuttal Testimony*
Case No.:	*GR-2009-0417*
Date Testimony Prepared:	*August 11, 2011*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

DAVID M. SOMMERER

ATMOS ENERGY CORPORATION

CASE NO. GR-2009-0417

Jefferson City, Missouri
August, 2011

** **Denotes Highly Confidential Information** **

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TABLE OF CONTENTS OF

SURREBUTTAL TESTIMONY OF

DAVID M. SOMMERER

LIST OF SCHEDULES

SURREBUTTAL TESTIMONY

OF

DAVID M. SOMMERER

ATMOS ENERGY CORPORATION

CASE NO. GR-2009-0417

Q. Please state your name and business address.

A. David M. Sommerer, P.O. Box 360, Jefferson City, MO. 65102.

Q. By whom are you employed and in what capacity?

A. I am the Manager of the Procurement Analysis Department with the Missouri Public Service Commission (Commission).

Q. Are you the same David M. Sommerer who filed direct and rebuttal testimony in this case?

A. Yes.

EXECUTIVE SUMMARY

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to address the rebuttal testimony of Rebecca Buchanan, Atmos Energy Corporation's (Atmos or Company or LDC) witness in this case.

Q. Do you agree with the broad characterizations Ms. Buchanan has summarized on page 1 and 2 of her testimony about the purpose of her testimony?

A. No. The Staff has raised a serious doubt about the prudence of the gas cost incurred. Furthermore the Company has failed to dispel those doubts. The burden is on the Company to demonstrate the reasonableness of its affiliate transactions. The Company has generally not kept contemporaneous detailed records regarding the affiliated supplies allocated to and away from the transaction. This information is needed to determine the fair market price of the gas supplies provided. The Company's RFP had few bidders. The bid responses signaled the need for further examination of the gas service provided to the Hannibal/Bowling Green area. Case No. GR-2008-0364 provided substantial evidence that the level of service ** ________________________ **. In short, this case, as with the previous one, shows Atmos' failure to keep records required by the affiliate rules and it failure to scrutinize its RFP bid results and transaction confirmations.

Atmos should have kept records of allocated gas supplies related to the transaction. It did not identify or record the specific AEM gas supplies that went to Missouri, Illinois or to transport customers. In addition, Atmos should have observed and acted upon bidder confusion over a perceived requirement to ** ____________________________________ ____ ____________ **, as this RFP did, it can lead to higher bids than might otherwise have been submitted in an RFP with clear design features. Atmos had ample opportunity to use long-standing information gained from Missouri and other jurisdictions to improve the effectiveness of its RFP to establish fair market price.

Simply put, the RFP is unable to yield a complete and accurate assessment of fair market value (fair market price) in this situation. Because the RFP does not attract many bids or close bids, the RFP's ability to set value is limited. ** ________________________ ____ **. Without close bid responses, the RFP loses credibility.

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In addition, the Atmos business model excludes the common LDC practice of buying multiple packages of gas directly from multiple natural gas suppliers. As a result, AEM's acquisition cost has become even more relevant to Staff's evaluation of fair market price.

Q. Do you agree with Ms. Buchanan's sole reliance on bidding through its RFP process to set fair market price of gas supplies?

A. No. Although the Affiliate Rules encourage competitive bidding, there are other additional requirements under the Rules. The Company must not engage in any action that would provide a financial advantage to its affiliate not available to a non-affiliate. The Affiliate Rules impose specific recordkeeping requirements that must be followed. My understanding of the affiliate rules, on advice of counsel, is that the existence of a competitive RFP bid process, though encouraged, does not trump or void the other requirements of the rule.

FULLY DISTRIBUTED COST

Q. On pages 4 and 5 Ms. Buchanan discusses the Company's view that its fully distributed cost exceeds what it determines to be the market price of gas supplies. Do you agree?

A. No. Atmos has testified that its LDC operations are unable to replicate the services of a natural gas marketing company (Buchanan Rebuttal, page 7, lines 7 to 14). Atmos by its own admission is the largest pure natural gas LDC in the U.S. Atmos' claim that it is unable to buy gas supplies from the same suppliers in the competitive market that AEM buys from is not believable. I have attached **Schedule 1** that compares and contrasts Atmos approach to buying gas to the buying approach of a typical Missouri LDC. As shown, a typical Missouri LDC buys gas from several different suppliers for a service area. It also utilizes various baseload and swing supply packages to construct a portfolio of gas that is designed to meet the needs of customers for varying load conditions. Atmos does not do this.

Atmos uses one supplier to provide supplies for a particular service area like the Hannibal/Bowling Green system. It is a bundled, one source, full-requirements, supply-only service. Thus, baseload gas, swing gas, and daily gas are all bundled and awarded to a single supplier for the contract term. The kind of fair market price that would be yielded from a more traditional practice is not available from Atmos' RFP structure.

Finally, I explain the benefits of the Asset Management Agreement (AMA), which is not used in the Hannibal area. An AMA is an RFP design that Atmos uses in its other Kentucky/Midstates Division service areas. The AMA still uses one supplier to meet all the supply needs of a service area for the contract term. However, the LDC's transportation and storage is turned over to the Asset Manager in order to derive additional value for the Asset Manager when the LDC's capacity is idle. For that value, the Asset Manager typically provides a discount to the traditional supply cost of the LDC which can translate into better pricing for ratepayers.

The key distinction between Atmos', business model and the typical Missouri LDC is that Atmos does not engage or directly access multiple gas producers/marketers in its highly structured RFP process. It does not select the best baseload package(s), the best swing package(s), and daily priced package(s), but is limited to a single bundled agreement. Atmos LDC does not directly access the competitive market like AEM does or like a typical LDC. Atmos has characterized its gas supply department as having none of the features of its affiliate gas marketer AEM. Unlike Atmos, the typical Missouri LDC creates a portfolio of various types of gas supply and directly negotiates and contracts with counterparties in the natural gas market for month-long and daily gas supplies. The Atmos RFP, in this case, is a supply-only RFP where the "winner takes all" for the entire duration of the awarded supply contract.

Q. Has Atmos recently provided any new information regarding a FDC calculation?

A. Yes, Atmos has recently provided an FDC calculation. ** ____________

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________________________ **.

Q. Do you agree that the Atmos calculation fairly represents FDC?

A. No. My testimony on FDC is that it generally represents what Atmos could have acquired the goods or services (specialized supplies) for itself had it chosen to do so. The Atmos business model has created a situation where the gas buyers do not deal directly with the market on a disaggregated basis, like the typical Missouri LDC.

Atmos has not calculated its FDC because Atmos did not provide the cost information that shows the costs that the LDC's gas buyers could have acquired the gas for had the LDC's buyers procured the same gas supplies as AEM's buyers had done in a competitive market.

Furthermore, Staff cannot validate the FDC because there is no cost information available that shows what the LDC's gas buyers could have acquired the gas for had the LDC's buyers procured the supplies using typical Missouri LDC buying practices.

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ATMOS COMPETITIVE BIDDING PROCESS/ RFP PROCESS

Q. Do you agree with the statement on page 5, lines 3-5 of Ms. Buchanan's surrebuttal that it is more prudent for Atmos to solicit proposals from gas marketers through a competitive bidding process?

A. Not entirely. I fall in line with the Georgia staff's testimony that the RFP might offer some protection, but tends to suffer from a lack of vigorous competitive bidding. As noted, in the 2005 GPSC testimony:

> "…However, this protection is effective only if a reasonable number of bidders respond to the RFP solicitation. Past experience would indicate, perhaps because of the Company's limited capacity portfolio, that vigorous competitive bidding may not be obtained." (Docket No. 20258-U Direct Testimony of Jamie Barber & Richard Lelash)

The RFP alone does not establish the fair market price, or a prudent price for that matter. My rebuttal testimony explains that Atmos' RFP for Hannibal area relies on a very few widely dispersed bids as Atmos' determinant of fair market price/value. The bidders perceptions of the RFP are reflected in the wide bid dispersion and those same bidders have valued the requested service at entirely different service levels. Atmos failed to correct the cause of the wide bid dispersion and the variability of service level bid. Atmos failed to seek possible alternatives that could have yielded more bidders, better prices, and more consistent bid results.

Q. Do you agree with Ms. Buchanan's statement on page 8, lines 4-6, that "…the price at which sellers are willing to sell to the LDC, simply isn't the same as the price at which sellers are willing to sell to gas marketers"

A. No. That statement is not supported and cannot be accepted at face value. To illustrate, an LDC service area can be reduced to such a small service area that it will not interest enough bidders to offer a valid fair price. The service requested in the RFP may be interpreted by bidders to require such a high degree of flexibility for the LDC (the Buyer) that potential suppliers may avoid bidding or may overcompensate by bidding a higher cost to accommodate the extra features requested by the LDC. The increased flexibility requested by the LDC for its gas supplies translates into a bigger price tag and that price is reflected in a higher cost bid. That has happened here. Furthermore, Atmos asserts that its LDC cannot replicate how AEM acquires gas supply in a competitive market. Atmos also asserts it has no obligation to explain how AEM acquires its supply because AEM is unregulated. The affiliate rules require and provide for complete transparency.

Q. On page 8, Ms. Buchanan discusses Atmos' RFP in other states. What do you say in response?

A. Staff believes she is implying that the Atmos RFP process has been approved in other states and that by association other states limit their prudence review to only the RFP. As I testified before, the RFP is but one part of the prudence review process. The RFP does not give a complete picture.

Atmos has stated time and time again that the only meaningful way it can optimize its gas supply assets is to turn them over to an asset manager in the form of an asset management arrangement (also discussed further below). Please see a sampling of the discussion of asset management arrangements from other Atmos jurisdictions shown in **Schedule 2**. As I pointed out in Direct, page 11 and Rebuttal testimony, page 9, 10 and 13, in this case, Atmos has a peculiar feature in its RFP that cedes its rights ** ________________________________ ___________________ ** – a feature found in asset management arrangements (AMA). However, this case does not involve an asset management arrangement – this case involves a

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supply-only RFP. Atmos' ceding of its right to nominate gas ** ____________ ______ ** in a supply-only agreement passes a value opportunity to its affiliate. The opportunity was also available to nonaffiliated companies; however its value may have been negligible and uncertain if the unaffiliated companies are risk averse and could not find a way to profit from daily versus monthly pricing.

Atmos' failure to bid its RFP out with an AMA alternative shows one of several options that could have brought in additional bidders for the Hannibal area. An AMA alternative may have brought the bids down below the "low bid" quoted by the affiliate. The lack of an AMA alternative shows how RFP design features impact the bid prices received. Because Atmos' case rests on an RFP that attracted ** ________________________ ____________ ** is not robust and not deserving of the absolute reliance that Atmos gives it. Furthermore, the ** ____ ** and were not in the same neighborhood of bid values. This is surprising because most of the bid value is really just the price index itself. The index does not vary between bidders and the relevant value is typically the amount the supplier bids *<u>in addition</u> to* the index. These results demonstrate that Atmos' RFP is not robust. ** ______________________________ ____ **.

Q. How does the wide dispersion of market values quoted by bidders to the RFP and the supply contracts that are ultimately awarded demonstrate weaknesses in the RFP process?

A. As shown in my rebuttal testimony, there is such a large difference between the ** ____ ____ **.

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In further support, I have attached **Schedule 3 - HC,** which compares the various transaction confirmations signed by Atmos for the Hannibal area for a period of 4 years. The transaction confirmation is the underlying document that memorializes the terms of the transaction in the form of a contract. In this case, it shows the ultimate service that the supplier is obligated to provide. Generalized RFP communications do not show the actual contracted service. Over the 4 year period, 3 different vendors supplied gas pursuant to transaction confirmations responsive to the same RFP.

Q. Please explain the schedule's significance.

A. The schedule shows that the same RFP can generate differing interpretations on what is being requested in the RFP. It shows that Atmos' RFP process is not straightforward and not robust. ** ____
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______________________________ **.

Under the same RFP design, Atmos accepted the lowest priced bid, but with differing swing supply obligations for its affiliated supplier. ** ______________________
____
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**.

In addition, AEM had the ** **.

Q. Ms. Buchanan asks on page 10, “Do the affiliate transaction rules prohibit an affiliate from making a profit on a transaction with a regulated utility.” How do you respond?

A. There is no requirement in the affiliate rules that prohibits an affiliate from making a profit, nor do the rules have any provisions that guarantee a profit.

Q. Ms. Buchanan states on page 10, lines 19 and 20, that I have not taken into account the fact the additional Atmos personnel and resources would be necessary to provide such gas supply service. Do you agree?

A. No. The information originally provided by AEM only included direct non-specific gas costs, not overheads. Staff’s discovery directed to AEM should have yielded all relevant costs from Atmos’ perspective that pertained to the transaction. Recently, AEM has quantified an after-the-fact assessment of its overheads that it believes are attributable to the transaction. **Schedule 4 - HC.** This amount, *without any assessment of a return*, was approximately $64,000. Staff reviewed AEM’s calculation for general accuracy and reasonableness.

Q. What is the significance of the $64,000 overhead calculation?

A. The Staff has consistently maintained that if AEM is able to produce data that might mitigate the Staff's adjustment then the Staff would evaluate and consider that data. Therefore Staff is willing to accept an offset of $64,000 to Staff's proposed adjustment, bringing Staff's net disallowance to $337,226 ($401,226.61 - $64,000 = $337,226.61).

Q. On page 11, Ms. Buchanan discusses burden of proof. On lines, 18 through 21, she asserts the affiliate contract has saved Missouri customers "hundreds of thousands of dollars annually". Do you agree?

A. No, I strongly disagree. Atmos' claim that its vigorous, robust, competitive RFP process resulted in "hundreds of thousands of dollars" of savings is unsupported and not logical. The facts show that Atmos attracted few unaffiliated bids out of large pool of bidders and that the bid responses were "hundreds of thousands of dollars" higher than AEM's bid. Staff has shown in this case and in the record in Case No. GR-2008-0364 that AEM has ** ____ **. The results show that AEM has interpreted the swing and baseload requirements differently than nonaffiliated vendors. Atmos should have modified its RFP design to yield more bidders - bidders that are "competitive" to the level of service Atmos needed, rather than allowing its low bidder AEM to define the level of service that it provided to Atmos.

Q. Has the Staff made recommendation to Atmos on improving its RFP?

A. Yes. The Staff suggested that the RFP requirements be split into field-only versus HAVEN requirements. Another recommendation was for Atmos to test an option of setting minimum baseload obligations for itself rather than issuing a full-requirements, full swing, "one size fits all" RFP. Another alternative that should have been considered was the use of an asset management agreement (AMA). Staff's request that Atmos consider both an AMA and supply-only option was included in the Stipulation and Agreement in Case No. GR-2007-0403. Atmos was well aware of this approach from using AMAs in its other jurisdictions. Another option was to consider combining various Missouri service areas for the purpose of generating more bidder interest in the areas that had very few bids.

Q. On page 13, Ms. Buchanan takes exception with Staff's statement that AEM and Atmos share limited resources on access to liquidity and counterparty credit exposures. What is your comment regarding this issue?

A. AEM's parent, Atmos Energy Holdings, is capable of entering into loans to/from Atmos. My understanding of the management of counterparty risk, based in part on some of AEM's own procedures, is that once a certain amount of business is consumed and transacted, it limits the amount of additional business that might be done with a particular counterparty. Staff's point is not that AEM and Atmos had a common cash account. Staff's point is that Atmos and AEM potentially share the same limited access to counterparty business.

Q. How does Ms. Buchanan address concerns about incentive compensation programs and their potential impact on affiliate transactions?

A. On page 14, Ms. Buchanan discusses the notion that the Missouri transactions are so small that in the big picture of Atmos' overall net income, any motivating affect of a program common to both Atmos and AEM should not matter.

Q. How do you respond to that?

A. As I stated in the previous case, the affiliate deals in other jurisdictions, when added to Missouri, represent a significant level of business to Atmos. On a cumulative basis,

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the transactions between AEM and Atmos are not immaterial. The common incentive remains.

Q. On page 15 Ms. Buchanan takes “great offense” with the discussion of Earnings Per Share issues in the context of affiliated transactions. How do you respond?

A. I have raised the issue that the compensation program is based upon the entire Atmos organization, and AEM is a significant part of that organization’s earnings. When AEM’s earnings rise, the rising tide not only lifts all boats, but also creates the appearance of a conflict of interest. I have not asserted that gas buyers at Atmos LDC are working behind the scenes to improperly award business to AEM.

Q. On page 16 and 17 Ms. Buchanan posits the idea that the RFP responses can be made to derive actual costs and can lead to setting fair market price/value. How do you respond?

A. Atmos knows that its bid analysis only yields hypothetical costs. In a misguided attempt to bolster the notion that the RFP is the sole determinant of fair market price/value, Atmos has run a “what might have been” calculation addressing what it would have cost Atmos had Atmos awarded its business to an unaffiliated third party. As the evidentiary record shows in Case No. GR-2008-0364, AEM had requested nominations changes from Atmos to help out AEM’s supply situation. I am skeptical that an independent third party, contractually obligated to provide primary firm service would have asked Atmos LDC to readjust downward its nominations as AEM had asked Atmos in the last case.

Q. On page 18 and 19 Ms. Buchanan discusses the idea that I may be attempting to “mislead the Commission” into thinking that AEM simply did not respond to Staff’s request for information. How do you respond?

A. The Staff confirmed that AEM had no information responsive to its request for records required under the rule. Staff has confirmed that the requested information was not available in its standard reports and is simply not available.

Q. Do you agree that the rule itself doesn't have a record-keeping requirement for gas supplies that are sold by an affiliated marketing company to a LDC?

A. No. The requirement is clear to me from a plain reading of the rule. The rule requires documentation of the costs associated with affiliated transactions that are incurred by the affiliated entity and charged to the regulated entity. AEM incurred costs associated with the affiliated transaction. Those costs included gas supply costs and various overhead costs that support the acquisition of those upstream gas supplies. Those costs were ultimately charged to the regulated entity. In fact, as an additional safeguard, Atmos could have incorporated into its contract with AEM the requirement that AEM provide cost records associated with the transaction.

Q. On page 20, Ms. Buchanan tries to draw a distinction between an "allocated cost" and costs related to gas supplies. How do you respond?

A. Gas supplies are allocated or assigned to specific transactions. This is foundational to the records requirement for marketing affiliates. I believe that Atmos was aware of these record-keeping requirements back when the rule was first proposed. In its initial comments about the rule, Atmos said,

> "*Both proposed rules would impose extensive record keeping requirements on both gas corporations and their affiliates. Compliance with these requirements would be unduly cumbersome and expensive and as such, will ultimately increase the cost of providing service to customers. Consequently, they may discourage transactions between utilities and their affiliates to the ultimate detriment of*

> *ratepayers who would lose the benefit of the economies of scale from such transactions*"
> (See **Schedule 5** for the initial Atmos comments in Case No. GX-99-444)

Q. How do you respond to Ms. Buchanan's supply reliability discussion on page 21?

A. Ms. Buchanan pointed out that Staff is not proposing a supplier reliability adjustment as it had in Case No. GR-2008-0364. However, the fact that this was a critical issue in the previous case does have a bearing on this case. Because AEM had ** ______ ______________________________ **. The fact that the Staff only quantified harm up to $85,000 in higher gas replacement costs in the last case does not mean that the harm could not have been greater. The level of service bid directly affects the price/value of the service provided.

Q. Are you suggesting that Atmos LDC adjusted its nominations in Case No. GR-2008-0364 because it was dealing with its affiliate?

A. No. But the fact that Atmos adjusted its nominations at AEM's request was amply demonstrated in Case No. GR-2008-0364. In that case, AEM was free to supply its other customers at the expense of Atmos LDC having to draw down storage to serve the

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Hannibal area – only to make up that gas later in the winter at a higher cost to ratepayers through the PGA.

Atmos may tolerate supply interruptions from all suppliers, whether affiliated or not. However, the practice of not following up with the supplier regarding its firm delivery obligation is one that not only insulates a supplier from its performance obligation, if that supplier is an affiliate, the parent company may benefit by the affiliate serving higher margin customers.

Q. Please explain.

A. The evidence in Case No. GR-2008-0364 showed that Atmos adjusted its nominations to accommodate its affiliate's request. In that case, the force majeure or pipeline critical period did not result in a cutting of all firm supplies in the same manner. Higher priority firm was the last to be cut. The facts of the last case showed that Atmos LDC pulled gas from storage – more than was planned – because it reduced its nominations. Atmos reduced its nominations at the request of AEM, not the pipeline. The record shows that AEM had ample supplies to meet its LDC contracts but AEM still requested its affiliate LDC to make substantial cuts to its nominations.

Q. You've used the term "work with" in this proceeding, and the last. Do you mean that in a pejorative way?

A. No. It is absolutely appropriate for all shippers, including an LDC, to "work with" its pipeline, and its gas suppliers in a time of crisis. But in a time of crisis, it is appropriate and reasonable for the LDC to insist that its supplier meet its obligations under a firm service agreement. Not all firm gas is cut in time of crises. The record in Case

No.GR-2008-0364 shows that Butler's gas had to flow through the HAVEN outage and that Butler had only minimal cuts over a few days attributed to the force majeure event.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Atmos Energy Corporation`s	)	
Purchased Gas Adjustment	)	File No. GR-2009-0417
	)	
	)	

AFFIDAVIT OF DAVID M. SOMMERER

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

David M. Sommerer, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 17 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

David M. Sommerer

David M. Sommerer

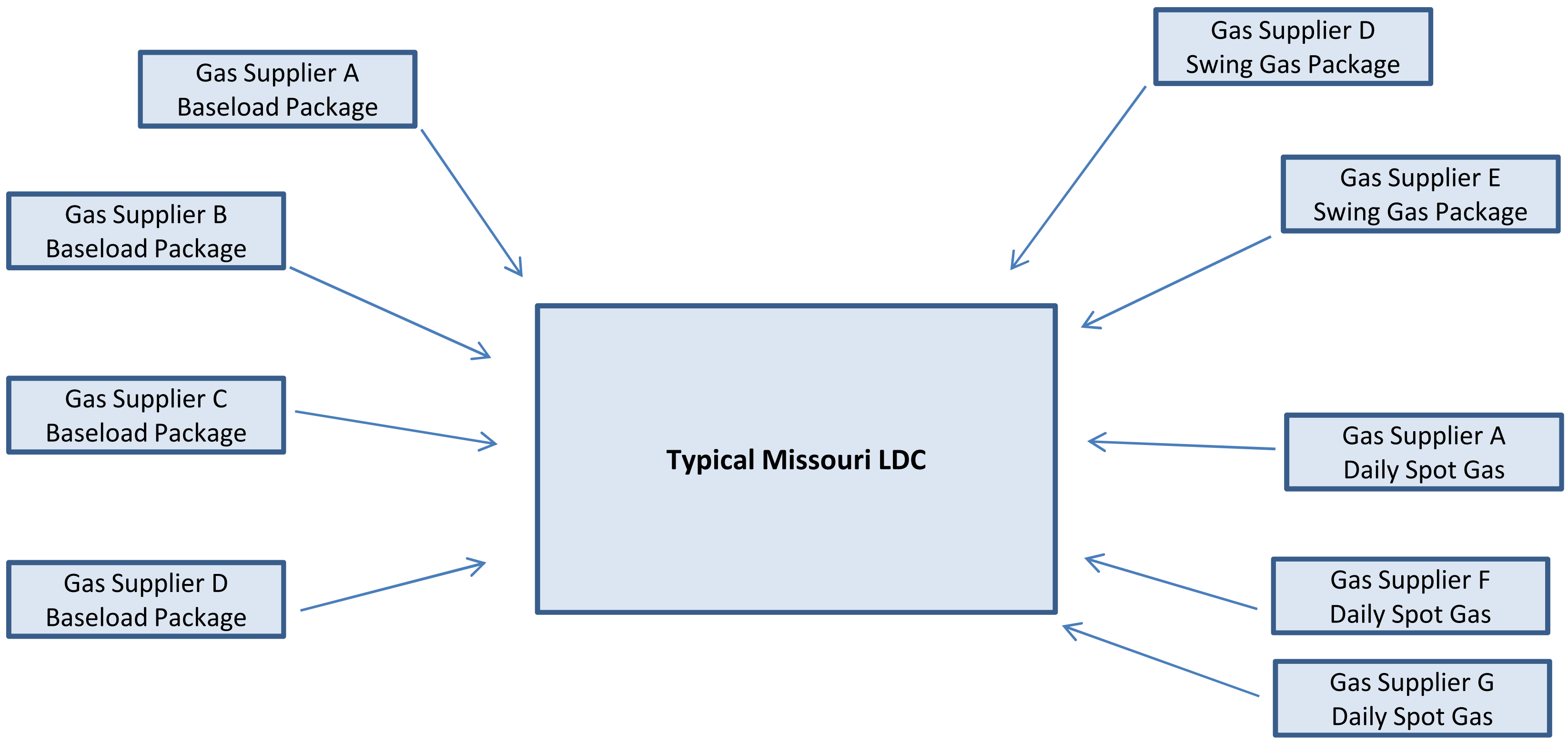
Subscribed and sworn to before me this 11th day of August, 2011.

Nikki Senn

Notary Public

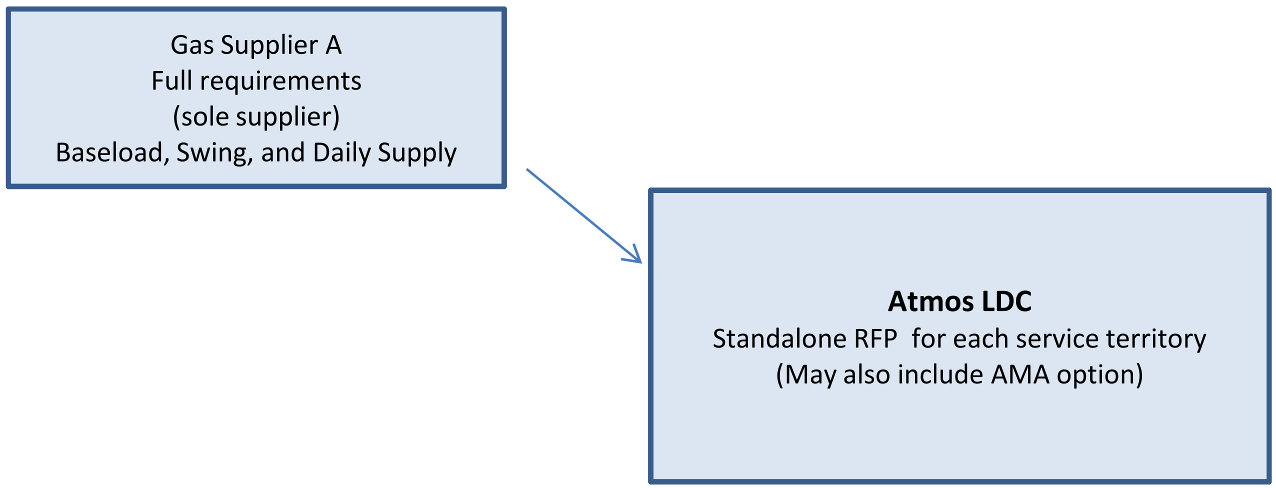
NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

TYPICAL MISSOURI LDC



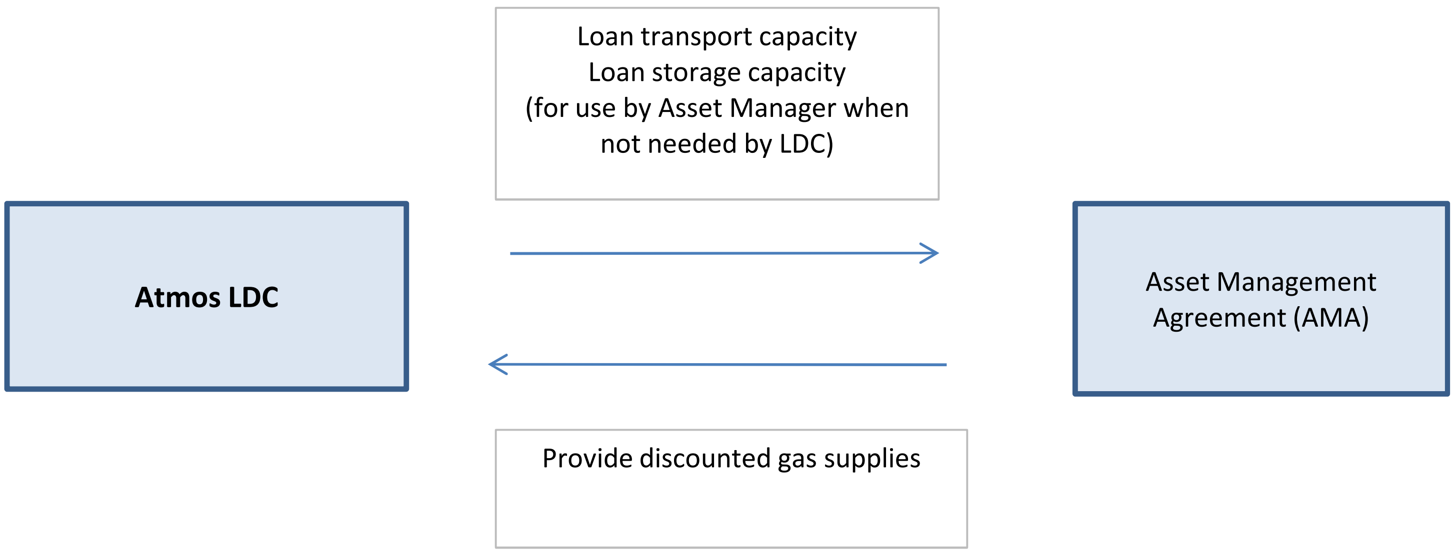
(The number of packages of each type supply will vary depending on the size of the LDC service area, flexibility of LDC storage resources, and/or pricing.)

TYPICAL ATMOS RFP (SUPPLY-ONLY)



SCHEDULE 1 - 2

TYPICAL ATMOS AMA



SCHEDULE 1 - 3

Discussion of Asset Management Arrangements From Other Jurisdictions

GEORGIA

An excerpt from the GPSC staff testimony from Docket 20258 follows.

Page 24 and 25 of GPSC20258-U staff testimony.

> ***Q.As mentioned earlier, the Company currently utilizes AEM to provide the management of its gas supply portfolio. What effect does such asset management have on the Company's cost of gas?***
> ***A.*** *AEM's role in the Company's procurement involves various trade-offs in overall procurement effectiveness. An asset manager typically can better manage gas supply and capacity resources. This is accomplished through specialized staff, a broader trading base, and a broader array of potential counter-parties.*
> *A downside to asset management is the gas utility's abrogation of various procurement functions to such a degree that it cannot meaningfully offer an alternative of in-house capacity management and general gas procurement. Another downside is that asset management can create conflicts of interest between a gas utility and its asset manager, particularly when the asset manager is an affiliate entity.*

In Georgia Case No. 20258-U, in the testimony of Georgia staff, it is stated:

> Q. *"What type of agreement are Atmos and AEM operating under?*
> *A. Under the current agreement, AEM is allowed to utilize the transportation and storage assets of Atmos and in return provides deliver gas supply at a discount to Atmos.*
> *Q. Was this Agreement a result of a RFP issued by Atmos for the 2004-2005 Plan Year?*
> *A. Yes. From the 2004-2005 Gas Supply Plan, the Company issued two separate RFPs one bundled which included commodity and asset management and the other RFP was for commodity only. AEM was the winning bidder for the RFP."*

IOWA

March 2007 Iowa order from Docket No. SPU-07-01,

> Atmos states that because the costs associated with interstate pipeline capacity, transportation, and storage are borne by Atmos' customers as part of the PGA, Atmos has an obligation to reduce PGA costs for its customers wherever and whenever it safely and reliably can. Without the asset management plan, Atmos asserts that customers would be required to pay for full capacity costs all year even

though the full capacity is not utilized for the delivery of gas to customers in warmer months.

Atmos indicates it could use periodic capacity release and bidding provisions of the Federal Energy Regulatory Commission (FERC) to mitigate costs, however, Atmos' Iowa operations are not large enough to yield significant amounts. Atmos contends the asset management arrangement allows it to extract additional value from interstate pipeline capacity and storage assets.

According to Atmos, the asset management contract between Atmos and Atmos Energy Marketing, LLC (AEM), provides for a stable, discounted commodity price for Atmos, and AEM is entitled to use Atmos' capacity and to retain any revenue from interim capacity releases.

VIRGINIA

Order issued June 2008 (CASE NO. PUE-2008-00021)

Atmos represents that it does not have the internal resources or the access to energy markets necessary to manage its capacity and storage assets effectively to maximize their value. In addition, Atmos represents that while it has the ability to purchase commodity gas supply for itself, it believes that obtaining bundled commodity procurement and asset management services from a professional asset manager offers substantive benefits in the form of a higher asset management fee, more stable commodity prices for Atmos' full requirements on a firm basis, and certain functional services that Atmos does not have to perform itself Atmos represents that AEM, which was awarded the proposed GSAM Agreement after making the best bid in an open and competitive bidding process, has the expertise in gas supply, planning, procurement and administration that will allow it to meet all of Atmos' gas supply and asset management needs.

KENTUCKY

(Case No. 2005-00321) KPSC, Supplement data request, Office of the Attorney General Data

Request No. 1.

QUESTION: What role does asset management play in gas supply apart from a performance based rate?

RESPONSE:
The asset management model has been utilized by Atmos Energy since inception of the Performance Based Rate mechanism in 1998.
Under this model, the Company arranges to receive full requirements supply from a single entity who also manages the Company’s assets from day to day.
The asset manager is afforded the opportunity to optimize the assets not needed by the utility from time to time and generate revenues from on-system and off-system utilization *of* the idle assets. As a result, the
Company and its customers are able to glean savings by affording asset management rights to the **full** requirements supplier.

SCHEDULE 3 and 4

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY

Douglas C. Walther
Attorney

ATMOS

June 30, 1999

FILED

JUL 1 1999

Missouri Public Service Commission

VIA FEDERAL EXPRESS

Mr. Dale Hardy Roberts
Secretary / Chief Regulatory Law Judge
Missouri Public Service Commission
301 W. High Street, Suite 530
Jefferson City, MO 65101

Re: Case No. GX-99-444
In the Matter of the Proposed Affiliate Transaction Rules for Gas Utilities

Dear Mr. Roberts:

Enclosed for filing in the above-referenced matter are an original and fourteen copies of the Initial Comments of United Cities Gas Company and Greeley Gas Company. A copy of the Initial Comments has been mailed this date to the Office of Public Counsel.

Thank you for your attention to this matter.

Sincerely,

Douglas C. Walther

Douglas C. Walther
Senior Attorney

DCW/vgp
Enclosures

cc: Office of Public Counsel
James M. Fischer, P.C.

P. O. Box 650205 Dallas, Texas 75265-0205 972-934-9227

FILED
JUL 1 1999
Missouri Public
Service Commission

STATE OF MISSOURI

PUBLIC SERVICE COMMISSION

In the Matter of the Proposed Affiliate Transaction Rule for Gas Utilities	))	Case No. GX-99-444
In the Matter of the Proposed Marketing Affiliate Transaction Rule for Gas Utilities	)))	Case No. GX-99-445

INITIAL COMMENTS OF UNITED CITIES

GAS COMPANY AND GREELEY GAS COMPANY

COMES NOW United Cities Gas Company and Greeley Gas Company, divisions of Atmos Energy Corporation, (hereinafter 'United Cities" and "Greeley"), and submits the following comments in response to the rules proposed by the Missouri Public Service Commission on June 1, 1999.

I.

INTRODUCTION

On June 1, 1999, four rules addressing transactions with affiliates were proposed by the Missouri Public Service Commission. The proposed rules include one addressing affiliate transactions by gas corporations and one addressing affiliated transactions between gas corporations and their marketing affiliates.

United Cities and Greeley appreciate the opportunity to comment on the proposed rules. United Cities and Greeley believe that the Commission currently possesses all necessary authority to address any concerns it has with regard to transactions between utilities and their affiliates. Therefore, the rules do not appear to be necessary. Further, United Cities and Greeley believe that the issues raised in the proposed rules would be best addressed in a broader context that examines the future structure of the gas industry. Nevertheless, it is the position of United Cities and Greeley that if any rules are implemented, they should be based on the objective of providing high quality service to ratepayers at the best possible value. To that end, it has always been and will continue to be the objective of United Cities and Greeley to provide the best service possible at an affordable price. To achieve that, it is critical that United Cities and Greeley have the flexibility to secure goods and services from the best source, whether that source is from within the company, an affiliate or an outside source. United Cities and Greeley do not believe that it would be in the best interests of Missouri ratepayers to constrain utilities in a manner that will prevent them from focusing their efforts and resources on providing the best possible service at the lowest possible price.

II.

COMMENTS ADDRESSING BOTH THE PROPOSED AFFILIATE TRANSACTION RULE AND THE PROPOSED MARKETING AFFILIATE TRANSACTION RULE

1. DEFINITIONS

A. Affiliate Transactions

In both of the proposed rules, the definitions of "affiliate transaction" include "all transactions carried out between any unregulated business operation of a regulated gas corporation and the regulated business operations of a gas corporation." The proposed rules are unclear as to exactly what constitutes the *"unregulated operations of a regulated gas corporation."*

Consequently, it is unclear exactly what activities of a regulated gas corporation would fall within the purview of the rules. The proposed rules should be clarified so the parties have an opportunity to address the intent of the Commission as it relates to the scope of the rule.

B. Preferential Service

Both of the proposed rules define "preferential service" as "information, treatment or actions by the regulated gas corporation which places the affiliated entity at an unfair advantage over its competitors." This definition, which is critical in defining the scope of the rule, is ambiguous, over-broad and lacks a proper focus. In the event the Commission decides that a definition should be included in a rule, it should be more precise so it can provide proper guidance as to what type of conduct is actually prohibited or restricted. It is the position of United Cities and Greeley that any rule that is unclear with regard to the specific actions it intends to encompass within its scope is fundamentally unfair. The language currently contained in the proposed rules could be construed to encompass virtually any type of activity involving a regulated gas corporation and its affiliates thereby making both compliance and enforcement extremely difficult.

2. STANDARDS

A. Asymmetrical Pricing

Both of the proposed rules state that a regulated gas corporation shall not provide a "financial advantage" to an affiliated entity. The rules provide definition to the term "financial advantage" by imposing an asymmetrical pricing mechanism and providing that any transactions falling outside that mechanism result, by definition, in a financial advantage to an affiliated entity. The pricing standards provide that a regulated gas corporation shall be deemed to provide a financial advantage to an affiliate, if it purchases goods or services from an affiliate above the lesser of the fair market price or the fully distributed cost to the regulated gas corporation to provide the goods and services for itself. Conversely, a regulated gas corporation shall be deemed to provide financial advantage to an affiliate if it sells goods or services to an affiliate below the greater of fair market price or fully distributed cost to the regulated gas corporation.

Any regulatory scheme based on asymmetrical pricing is unnecessary, counter-productive and contrary to sound economic principles. The pricing standards in the proposed rules would not permit market based transactions between the utility and its affiliates and would therefore discourage a utility from acquiring the best goods and services available if they are offered by an affiliate. Such a basis for pricing is based on unsound economic principles in that it fails to recognize market based factors and consequently may result in uneconomic service choices.

An economically sound pricing standard should allow consideration of what the cost would be to obtain the goods, services or assets from third parties. The pricing standards in the proposed rules are not applied to transactions with other vendors used by utilities and there is no valid reason to apply them to transactions with affiliates. For example, if the rent paid by a utility for a building owned by an affiliate is no higher than a third party would charge, sound economic policy and equity seem to dictate that fair market value should be the proper charge for that rent.

Additionally, affiliate pricing standards based on asymmetrical pricing could have unintended consequences. For example, in a situation where an affiliate is seeking to purchase a good or service from a utility and the fully distributed costs exceed market price, (with the affiliate being required to pay fully distributed cost) a rational affiliate will likely seek other providers from which to purchase the good or service if such providers are available. This will result in the utility and its ratepayers losing the economic benefit of the transaction. Similarly, in a situation where a utility seeks to purchase products or services from an affiliate and the fully distributed cost for the good or service is below market price, it would be in the economic interest of the affiliate to sell the product or service to an entity to whom it could charge market price. The utility would then have no choice but to acquire the goods and services from another entity at market price. This would provide absolutely no benefits to ratepayers and accomplish nothing more than discouraging transactions between utilities and their affiliates.

In short, the presumed objective of the standards in the proposed rule is to maximize the economic gain to utilities from affiliate transactions with the benefits being passed on to the ratepayers. However, the reality is that, at best, they will have no impact on a utility's profit and, at worst, have a negative impact on the utility's bottom line by discouraging transactions that would otherwise benefit utilities and their ratepayers.

United Cities and Greeley understand that the Commission believes certain safeguards may be necessary to ensure that ratepayers and competition are not adversely affected by affiliated transactions. However, caution needs to be exercised to ensure that utilities and their affiliates are not discouraged from such transactions thereby eliminating the opportunity for economies of scale from such transactions that benefit ratepayers by decreasing the cost of doing business. Standards of conduct should not impede the ability of any competitors, be it utilities, affiliates or other marketers to achieve the economies that will result in lower prices and better service to customers.

B. No Preferential Treatment

Proposed standards Section 2(B) of the Affiliate Transaction Rule and Section 3(B) of the Marketing Affiliate Transaction Rule both provide that a "regulated gas corporation shall conduct its business in such a way so as not to provide any preferential service, information or treatment to an affiliated entity over another party at any time." The language in this proposed standard is so broad that it would operate as nothing more than a statement of general principle. As stated above in the discussion addressing the definition of "preferential service", the term as currently defined is so ambiguous that it provides no guidelines as to what conduct is actually restricted or prohibited. The term as used in the context of this standard has the same flaws.

C. <u>Information Requested by Customers</u>

Proposed rules Section 2(D) of the Affiliate Transaction Rule and Section 3(D) of the Marketing Affiliate Rule would require gas corporations to provide information to customers about the availability of other non-affiliated entities that provide the same good or service if a customer requests information from a gas corporation about goods and services provided by an affiliate. This goes well beyond what is required to protect competition and would actually require utilities to perform a basic marketing function for non-affiliated competitors by providing customers with their name and the service they provide. Many of these competitors, particularly in the gas marketing area, are large nationally recognized corporations with enormous marketing capabilities and as such, they certainly do not need any special protection from the Commission. Further, none of them will be subject to similar requirements thereby providing them with a competitive advantage.

3. <u>EVIDENTIARY STANDARDS</u>

Proposed rules Section 3(A) of the Affiliate Transaction Rule and Section 4(A) of the Marketing Affiliate Transaction Rule would provide that when a gas corporation makes a purchase from an affiliated entity, it would be required to either obtain a competitive bid or demonstrate why competitive bids are unnecessary or appropriate. This provision is unnecessary and would be unduly burdensome to comply with. As stated previously, it is the position of United Cities and Greeley that the Commission already has the requisite authority to address any concerns it has with regard to affiliated transactions. However, if the Commission sees the need for certain safeguards, United Cities and Greeley do not understand how requiring competitive bids or documentation as to why they are unnecessary will achieve that end. The Commission can evaluate these transactions in the context of rate cases to ensure that ratepayers are being protected and that affiliates are not being favored over competitors. In addition, it would take more time and be more administratively burdensome to effectuate affiliate transactions if the requirement were implemented. In short, this requirement would increase the time and expense of compliance, while providing ratepayers with no safeguards that do not already exist. A clear example of this is lease rates. If a utility leases space from an affiliate, it should not be required to go out and bid for the space just to demonstrate that the rent charged by the affiliate is comparable to or lower than the going lease rate.

Additionally, proposed Section 3(C) of the Affiliate Transaction Rule and 4(C) of the Marketing Affiliate Transaction Rule provide a list of four items that a utility must show for each affiliate transaction. They include a demonstration that the gas corporation considered all costs incurred to complete the transaction; calculated the costs relevant to the transaction; allocated joint and common costs appropriately; and adequately determined the fair market value. United Cities' and Greeley's comments regarding the proposed competitive bidding requirements are equally applicable to those proposed requirements. In short, the requirements are unnecessary in light of the Commission's existing authority.

4. <u>RECORD KEEPING REQUIREMENTS</u>

Both proposed rules would impose extensive record keeping requirements on *both gas corporations and their affiliates. Compliance with these requirements would* be unduly cumbersome and expensive and as such, will ultimately increase the cost of providing service to customers. Consequently, they may discourage transactions between utilities and their affiliates to the ultimate detriment of ratepayers who would lose the benefit of the economies of scale from such transactions.

5. COST ALLOCATION MANUALS

Both proposed rules would require Cost Allocation Manuals. While the rules do not provide much in the way of specifics concerning Cost Allocation Manuals, United Cities and Greeley have some general comments on this issue. First, if a Cost Allocation Manual(s) is accepted by the Commission, the allocations contained in them should be deemed accepted for ratemaking purposes. Fundamental fairness dictates that if a cost allocation methodology is accepted by the Commission prior to implementation, it should be accepted for ratemaking purposes. In fact, if the allocation methodology is not accepted for ratemaking purposes, United Cities and Greeley question why a Cost Allocation Manual is necessary. Second, any rule requiring a Cost Allocation Manual should contain language clarifying that the information required to be included in the manual need only be provided for Missouri jurisdictional operations and not on a company-wide basis for multi-jurisdictional utilities. Third, any rule should provide that an incidental non-regulated service should be treated as regulated for purposes of cost allocation if the total revenues of all incidental activities do not exceed 10% of total utility company revenue. United Cities and Greeley believe that the 10% limit is appropriate, if the administrative costs of implementing these guidelines are not to become overly burdensome.

6. VARIANCES

Proposed rules Section 9 of the Affiliate Transaction Rule and Section 10 of the Marketing Affiliate Transaction Rule contain provisions for requesting variances from the rules. In addition to these provisions, United Cities and Greeley believe that any rule adopted by the Commission should provide for an automatic variance for affiliate transactions of multi-jurisdictional utilities that do not impact their Missouri jurisdictional operations.

III.

COMMENTS ADDRESSING THE MARKETING AFFILIATE TRANSACTION RULE

1. NON-DISCRIMINATION STARDARDS OF CONDUCT FOR MARKETING AFFILIATES

Section 2 of the proposed marketing affiliate rule contains a number of standards of conduct. United Cities and Greeley have concerns with a number of the proposed standards.

A. Proposed Section 2(G) provides that all gas corporation employees dealing directly with the consuming public shall be physically separated from a marketing affiliate and shall not provide a marketing affiliate any general and administrative support service unless the regulated gas corporation offers such service on identical terms to any entity that is not a marketing affiliate. United Cities and Greeley have several concerns with this proposed standard.

First, it is not necessary to require physical separation between utilities and marketing affiliates. This would merely result in unnecessary costs to comply while failing to address the underlying issue. If the Commission believes that such a safeguard is necessary, the approach should be to require that the utility and marketing affiliate function separately to the maximum extent practicable. If any abuse occurs, the Commission can address it through its existing authority. Further, the Commission could require that costs be allocated as it deems appropriate.

United Cities and Greeley also believe that this proposed standard is unrealistic, impractical and unworkable. For example, it is not realistic to expect that a gas corporation that makes available to its marketing affiliate general and administrative services such as accounting, legal and human resources should be required to offer such services to competitors of the affiliate. Such arrangements would simply be impractical and could even present serious ethical issues for services such as legal. Further, there is no evidence of any adverse impact on competitors simply because an affiliate and utility are not physically separate or because a utility provides certain services to an affiliate.

The ultimate result of a standard such as this would be the loss of economies of scale that result from affiliate transactions by discouraging such transactions or making them too difficult or impractical to complete. Caution needs to be exercised to ensure that utilities and their affiliates are allowed to realize economies of scale and scope that benefit ratepayers by decreasing the cost of doing business. Standards of conduct should not operate to impede the ability of any competitors, be they utilities, affiliates or other marketers to achieve economies that will result in lower prices and better service. Moreover, affiliates of utilities are not the only entities in the market that have unique competitive characteristics. Marketers affiliated with non-utility companies may experience economies resulting from distinctive competitive qualities in areas such as diverse customer base, purchasing power, name recognition and marketing. Standards that prohibit utility affiliates from experiencing the benefits of such economies, but allowing them to run to other competitors, benefit certain competitors, but harm competition. United Cities and Greeley do not believe that is what the Commission desires to accomplish with standards of conduct.

B. Section 2(H) of the proposed rule provides that non-regulated employees will have no more access to employees of the regulated gas corporation than any non-affiliated entity. United Cities and Greeley oppose this proposed standard. First, it is vague and over-broad and as such, it is not clear how it would be complied with or enforced. Second, there is simply no basis for a generic conclusion that interaction between employees of utilities and their affiliates constitutes or results in non-competitive behavior.

C. Section 2(I) of the proposed rule provides that a marketing affiliate shall not in any way relate to the consuming public that it is part of the regulated entity. United Cities and Greeley oppose this proposed standard. Such a restriction is unnecessary since there is no evidence that the utility name or affiliation provides any competitive advantage to an affiliate. However, assuming only for the sake of argument that such a benefit exists, it is important to bear in mind that many competitors in the gas market will have the ability to use the widely recognized names and logos of their corporations without any restrictions. Further, competitors that are not utility affiliates would be free to form alliances that would allow them to leverage expertise and other resources. As noted above, many of these potential competitors are large, nationally recognized corporations which, in addition to their instantly recognized names and logos, have large corporate marketing and administrative services available. These competitors are clearly not in need of any special protection from utilities and their affiliates.

Standards of Conduct should not restrict or enhance the ability of any entity in the market to compete since it is competition that will result in lower prices and better service to consumers. Further, restrictions of this nature could result in consumers being unaware of who they are dealing with in the marketplace. United Cities and Greeley do not believe that standards of conduct should operate in a manner that would deprive consumers of information necessary to make decisions. This is a clear example of a standard whose intent is to level the playing field between all marketing companies, but whose impact would be to put the utility and its marketing affiliate at a competitive disadvantage.

D. Section 2(J) of the proposed rule would require a regulated gas corporation to charge its marketing affiliate and/or its customers rates no lower than the fully distributed cost for any general and administrative support service provided and that any such support service shall be made available to all non-affiliated market entities. United Cities and Greeley have the same concern with this proposed standard as it does with proposed standard 2(G). It is simply unrealistic to expect utilities to make administrative and support services available to competitors of its affiliates, particularly at no lower than fully distributed cost. Additionally, the proposed standard fails to recognize that any incremental contributions to the utility's fixed costs resulting from affiliated transactions are beneficial to ratepayers.

E. Section 2(P) of the proposed rule would require a regulated gas corporation to maintain records when it is made aware of any marketing complaint against an affiliated entity. United Cities and Greeley find this standard inconsistent with many of the other proposed standards to whose intent is to create a separation between utilities and affiliates. Requiring utilities to keep records on matters relating to affiliates appears contrary to that intent.

F. Section 2(R) of the proposed rule would require utilities to provide customers with a list of all marketers operating on its system in the event a customer requests information about a marketer. This proposed standard goes well beyond what is necessary to protect competition and like Standard 2(D) of the Affiliate Transaction Rule and 3(D) of this proposed rule, would actually require utilities to perform a basic marketing service for non-affiliated competitors by providing their name and the service they provide to customers. As discussed previously, these competitors clearly do not need this type of special protection.

IV.

CONCLUSION

Many of the requirements in the proposed Affiliate Transaction Rule and Marketing Affiliate Transaction Rule would operate to protect certain competitors in the market at the expense of competition. United Cities and Greeley urge the Commission as it considers these rules to bear in mind that it is full competition that will result in lower prices and the highest quality service to ratepayers. Restricting the ability of utility affiliates to compete on a level playing field and discouraging affiliated transactions will not achieve that end.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document has been hand-delivered or mailed, postage prepaid, this 30th day of June 1999 to:

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