BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

The Staff of the Missouri Public Service Commission, Complainant, v. Laclede Gas Company, Respondent.	)))))))	Case No. GC-2011-0006

COUNTERCLAIM OF LACLEDE GAS COMPANY

COMES NOW Laclede Gas Company ("Laclede" or "Company"), pursuant to Section 386.390 RSMo. and 4 CSR 240-2.070, and for its Counterclaim states as follows:

THE PARTIES

1. Laclede is a Missouri corporation that is in good standing, and is a public utility operating under the jurisdiction of the Missouri Public Service Commission ("Commission"). Laclede's principal place of business is at 720 Olive Street, St. Louis, Missouri 63101. Laclede is represented by its undersigned counsel, whose address, electronic signature, telephone number and facsimile number are all provided on the signature page below. Laclede provides utility service in Missouri in the City of St. Louis and ten counties in Eastern and Southern Missouri.

2. Staff is the Staff of the Missouri Public Service Commission. Staff's business address is 200 Madison Street, P.O. Box 360, Jefferson City, Missouri, 65102.

NATURE OF THE COUNTERCLAIM AND LACLEDE'S INTEREST IN THE COUNTERCLAIM

3. Through the actions of its Procurement Analysis Department in purporting to audit the gas costs of Laclede in certain ACA proceedings, and specifically by the work of Mr. David Sommerer who manages that department, Staff has made

recommendations, asserted disallowances and sought discovery, all in direct violation of the Commission's lawfully approved Affiliate Transaction Rules (the "Rules") for gas corporations, 4 CSR 240-40.015 and 40.016, and of the Company's Cost Allocation Manual ("CAM") that has been developed in compliance with both the Rules and the Stipulation and Agreement approved by the Commission in Case No. GM-2001-342 (the "Stipulation and Agreement").

4. As the target of the audits that are being conducted in violation of the Rules and the CAM, Laclede has a direct interest in the Counterclaim and is aggrieved by Staff's violations. Staff has violated the Rules and provisions of the CAM and thereby harmed and continues to harm Laclede by forcing it to expend unnecessarily a great deal of time and resources defending itself.[1] Further, Staff's violations have threatened Laclede with a substantial disallowance of gas cost recovery. Finally, in exceeding its authority and by violating the Rules and provisions of the CAM, Staff's positions have effectively threatened and interfered with Laclede's lawful ability to conduct business with its affiliate, LER, which is both a potential and substantial customer for Laclede's off-system sales and capacity releases, and a reliable and competitive vendor of Laclede's gas supply.

FACTS

5. The Rules were promulgated in 1999 and became effective in 2000. They were approved by this Commission "to prevent regulated utilities from subsidizing their

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[1] In an attempt to support its unlawful positions, Staff has also tied up the time and resources of the Commission itself by seeking a broad swath of LER documents unrelated to LER's transactions with Laclede. Accordingly, Laclede has been forced to defend before the Commission and in the courts Staff's unwarranted attempts to obtain documents that are well beyond the scope of the documents necessary to determine whether Laclede's transactions with LER comply with Rules and the CAM.

non-regulated operations." (4 CSR 240-40.015; PURPOSE) The Rules primarily accomplish this by dictating (i) that a utility buy a good or service from its affiliate at not more than the lesser of fair market price or the fully distributed cost to the utility to provide the good or service for itself; and (ii) that a utility sell a good or service to its affiliate at not less than the greater of fair market price or the fully distributed cost to the utility. (4 CSR 240-40.015(2)(A))

6. As an adjunct to the Rules and the Stipulation and Agreement, the purpose of the CAM is to "preserve and supplement existing protections against improper cross-subsidization between Laclede Gas Company and its affiliated entities." (CAM, p. 1) The CAM was originally prepared in 2001 through the joint efforts of Staff and Laclede. In 2004, Laclede updated the CAM and provided the updated version to Staff. The updates did not fundamentally change the CAM, but rather provided clarification on a few points. Staff was in possession of the 2004 CAM at all times throughout the matters at issue in the Complaint and corresponding ACA cases, and Staff has never objected to either the original or updated terms of the CAM.

7. While the CAM's pricing standards mirror those of the Rules, the CAM provides more definition and practical detail in certain matters, including how to determine the fair market price of gas supply purchases and sales.[2] The CAM defines the "fair market price" of a gas supply purchase or sale as the average price of similar transactions between Laclede or other firms and non-affiliated entities entered into at

[2] The fair market price is the same as the cost of gas to Laclede. This is because Laclede does not produce gas supplies for itself, but buys them in wholesale markets from many marketers, including LER. Therefore, Laclede does not have a fully distributed cost of producing gas supply for itself. The absence of fully distributed cost is recognized by the CAM, which focuses on fair market price to determine the appropriate pricing of a gas supply affiliate transaction.

similar times at similar locations and for a similar duration. The CAM goes on to state that if such transactions do not exist, Laclede will then turn to industry accepted index prices published by entities such as *Gas Daily* or *Inside FERC* to determine a fair market price. The common sense goal of the Rules, as fleshed out by the CAM, is to protect ratepayers by ensuring that the pricing of affiliate transactions is similar to that of comparable non-affiliate transactions.

8. In the ACA proceedings, Staff has completely ignored both the Rules promulgated by this Commission and the Company's CAM. Through the assertions and sworn testimony of Mr. Sommerer, Staff has effectively taken the position that Laclede should purchase gas supply from LER not at a fair market price as established by the Rules and the CAM, but rather at ***LER's*** cost. Since Laclede purchases gas supply from unaffiliated marketers at market prices, which presumably includes compensation for the marketer, the effect of Staff's approach is to require Laclede to either discriminate against LER in comparison to unaffiliated marketers, or pay LER a market price for gas ***and*** absorb the compensation that LER would have lawfully earned to supply the gas to Laclede. Staff's position conflicts with the CAM, the Rules and the decisions of the Commission, and renders transactions between Laclede and LER economically infeasible in an arbitrary and discriminatory manner, regardless of LER's reliability and price competitiveness as a supplier.

9. Staff has also effectively taken the position that Laclede should sell gas supply to LER not at the higher of fair market price or Laclede's fully distributed cost, as established by the Rules and the CAM, but at that price ***plus*** any profit that LER might or could earn on its resale of gas supply. In other words, Staff contends that, despite the

requirements of the Rules and the CAM, and regardless of whether Laclede ratepayers would benefit by reducing gas procurement costs, Laclede would be required to reimburse the PGA for all profit lawfully earned by LER on such transactions. Again, the additional costs Laclede would have to incur for profits earned by LER makes it economically infeasible for Laclede to sell gas or release capacity to LER. Laclede asserts that imposing such an economic disincentive against releasing capacity to a potential shipper, even an affiliated one such as LER, constitutes undue discrimination under the Federal Energy Regulatory Commission's capacity release rules and open access policies.

10. Contrary to Staff's position, this Commission, through a rulemaking process, has determined that affiliate transactions are permitted so long as they are priced in accordance with its Rules. Because the transactions at issue have already occurred, Staff is effectively proposing to punish Laclede after the fact for conducting business with LER in a manner that was perfectly lawful, as contemplated by the Rules and the CAM. The natural consequence of Staff's unlawful position is to rewrite the Rules and CAM, after the fact, to penalize Laclede for entering into transactions with LER, whether or not such transactions comply with the law, and without regard to whether the transactions are beneficial to the parties or their customers.

11. Staff's position that affiliate transactions should be allowed only on impossible pricing terms is, in reality, nothing more than an unlawful unauthorized attempt to prohibit lawful transactions. Indeed, Staff's own general counsel, Kevin Thompson, explicitly recognized that Staff's proposal to price such transactions at the

affiliate's cost of gas would have this very effect when he stated during oral argument in Case Nos. GR-2006-0288 and GR-2005-0203 on October 1, 2009, that:

> "We understand, as Mr. Pendergast said, LER wouldn't sell the gas to Laclede if there wasn't some markup. I understand that. I think Staff understands that."

Staff's position on affiliate pricing is not warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law. By presenting and maintaining claims against Laclede based on this unlawful position, Staff has made misrepresentations to the Commission, violated Commission Rules, and violated the Stipulation and Agreement approved by the Commission in Case No. GM-2001-342, pursuant to which the CAM was created.

1. Mr. Sommerer's Sworn Testimony on Behalf of Staff Violates the Rules and the CAM

12. Although Staff has not yet filed testimony in Laclede's pending ACA proceedings, Mr. Sommerer has filed testimony in ACA proceedings involving Atmos Energy Corporation ("Atmos"), in which he made essentially the same arguments he asserted against Laclede. On March 12, 2010, Mr. Sommerer filed direct testimony in an Atmos ACA case, Case No. GR-2008-0364. A true and correct copy of this testimony is attached hereto as Attachment 1. Mr. Sommerer swore that this testimony is true and correct to the best of his knowledge and belief. In that case, Staff proposed disallowances of approximately $360,000 in gas costs incurred by Atmos to provide gas supply to the Hannibal and Butler, Missouri areas. These disallowances were imputed on affiliate transactions between Atmos and its affiliate, Atmos Energy Marketing, LLC ("AEM"). (Sommerer Direct testimony, p. 4) These disallowances apply to Atmos' gas costs incurred during Atmos' 2007-08 ACA Period.

13. Atmos had issued a Request for Proposal to its gas supply marketers for its gas supply needs during the subject ACA Period. After a competitive bidding process, AEM was awarded the gas supply contracts for the Hannibal/Canton and the Butler systems.[3] (Sommerer Direct testimony, p. 8)

14. Mr. Sommerer conceded that "Transactions between Atmos and…AEM are governed by the Commission's Affiliate Transaction Rules 4 CSR 240-40.015 and 40.016." (Sommerer Direct testimony, p. 5) Mr. Sommerer further conceded that the pricing provisions of the Rules require the utility to compensate its affiliate at the lesser of the fair market price or the fully distributed cost to the regulated gas corporation to provide the goods or services for itself. (Sommerer Direct testimony, pp. 6, 8-9)

15. Mr. Sommerer understood that Atmos' position is that an RFP process sets the fair market price for a particular transaction. (Sommerer Direct testimony, p. 9)

16. However, despite the clear application of the Rules to that situation, Mr. Sommerer insisted that "fair market value" was established not by a competitive bidding process, but instead by the affiliate's cost. Mr. Sommerer's legal position, contained in sworn testimony, is that the fair market price for a utility's (Atmos) purchase of gas supply was the affiliate's (AEM) cost to provide gas to Atmos. (Sommerer Direct testimony, p. 6) Mr. Sommerer's position is not only unlawful, but ignores the fact that Atmos avoided all of the risks, costs and procurement efforts assumed by AEM.

17. As he has done in Laclede's ACA cases, Mr. Sommerer ignored the requirements of the Rules and instead applied his own unlawful approach to affiliate transactions. His sworn testimony was that:

[3] Atmos filed testimony indicating that AEM was awarded these contracts because AEM's bid was the best and lowest bid, a fact that Mr. Sommerer did not dispute.

> "Profits are disallowed because LDC's do not mark up the price of gas to their customers. What is to be passed through in the PGA charge is the actual invoiced cost of gas. If Atmos had purchased the gas itself, instead of through its affiliate, the actual cost of the gas, without profit, would be the basis for the Purchased Gas Adjustment charge to customers." (Sommerer Direct testimony, p. 9)

Mr. Sommerer's testimony is patently wrong. If Atmos had purchased the gas in question from an unaffiliated supplier, two aspects of that transaction undoubtedly would be true: (1) Atmos would have paid more to the unaffiliated supplier than it paid to AEM; and (2) the unaffiliated supplier would have had an opportunity to profit from the sale of gas to Atmos. Mr. Sommerer incorrectly assumes that because Atmos does not (and cannot) mark up the cost of gas purchases in its PGA, that no profit is made by the upstream gas supplier to Atmos, whoever that may be. ***Mr. Sommerer's position is wrong as a matter of law.***

18. Mr. Sommerer is a CPA who has been employed at the Commission for 26 years, and has managed the Procurement Analysis Department since its inception in 1993. He should be well aware that the effect of asserting this position on behalf of the Staff would be to prevent the affiliate (in this case, AEM) from competing for the utility's business, at the expense of the utility's customers, who would have to pay more for Atmos to purchase gas from the second-place finisher in the RFP, rather than the low bidder.

19. Despite the clear language of the Rules, Mr. Sommerer appears to believe that it is more important to violate the Rules to the detriment of customers than to permit an affiliate transaction to occur. In other words, in circumstances where the utility affiliate is the lowest cost provider, thereby benefitting utility ratepayers, Mr. Sommerer

appears to be ***more*** concerned about whether a utility affiliate earns a profit on the transaction.

20. Mr. Sommerer further states that AEM's profit and loss statement shows that "AEM's fair market value [i.e., cost] for gas supply was <u>less</u> that what it charged its regulated parent Atmos. This means that AEM has profited…" (Sommerer Direct testimony, p. 10) Nowhere in the Rules can it be reasonably interpreted that fair market price is equivalent to the affiliate's cost or that any potential profits are prohibited.

21. In connection with this position, however, Staff sought to discover the affiliate's cost of gas so Staff could improperly impose that cost as the fair market price for the sale of that gas. Therefore, Staff requested from Atmos and AEM the underlying documentation for purchases by AEM from its suppliers, in order to determine AEM's cost. Mr. Sommerer complained that AEM provided some but not all of this requested information. (Sommerer Direct testimony, p. 9) Mr. Sommerer stated that obtaining this documentation would "allow Staff to more thoroughly evaluate the fair market value of those transactions." (Sommerer Direct testimony, p. 11) What Mr. Sommerer means is that it would allow him, on behalf of Staff, to impose his own pricing standard -- the affiliate's cost to acquire gas supply -- rather than the pricing standard required by the Rules (and in Laclede's case, the CAM), which is the fair market price of that gas supply at the time and place of sale to the utility.

2. Staff's Positions in Laclede ACA cases

22. Staff's positions on Laclede's affiliate transactions with LER in Laclede's recent ACA cases are the same as in Mr. Sommerer's sworn testimony in the Atmos case discussed above. As in the Atmos case, it is clear that Staff's goal is to prohibit affiliate

transactions by pricing them in a manner that requires the utility to absorb any profit earned by the affiliate from such transactions. Also, as in the Atmos case, Staff seeks to obtain information on LER's transactions with non-affiliated third parties so that it can attempt to calculate LER's profits, and thereby require Laclede to absorb such profits, notwithstanding the clear prescription of the Rules and Laclede's CAM.[4]

a. Case No. GR-2008-0387; Laclede's 2007-08 ACA Period

23. The Staff filed its Recommendation in this case on December 31, 2009, signed by David Sommerer, as Project Coordinator, and Robert S. Berlin, as Staff Counsel. In this Recommendation, Staff identified no affiliate transactions for disallowance. Nevertheless, Staff repeated its extralegal pricing standards: "One way of assessing the fair market value of affiliated agreements is to look at the elements of the underlying supply that was used to fulfill LER's obligation to provide firm service." (December 31, 2009 Staff Recommendation at p. 10). Although Staff claims the affiliate's cost is meaningful to determine the fair market price of a transaction, Staff never inquires into the cost of non-affiliated suppliers to determine whether Laclede's payment to those suppliers represented a fair market price and never explains why external market pricing information from published indexes or other unaffiliated suppliers is not sufficient to establish the fair market price.

24. Instead, Staff simply asserts in its Recommendation, without one scintilla of support, that "Just because an affiliate transaction is at index prices, it does not mean that this is the fair market value of the service being received." Rather, Staff states that the "fair market value of the gas may be more appropriately stated as the price LER paid

[4] Complainant Laclede objected to Staff's data requests on the grounds that they were irrelevant to the Rules' pricing standards.

to acquire the supply." (*Id.)* This pricing standard is directly in conflict with the Rules and the CAM.

25. Regarding discovery matters, Staff opined that the documentation "supporting" affiliate transactions needs to be "clearly identified" and provided to Staff to determine the "true market value" for those transactions. (*Id.*) These are simple euphemisms for Staff's pursuit of affiliate information from which it can wring out any profit found in affiliate transactions.

b. Case No. GR-2008-0140; Laclede's 2006-07 ACA Period

26. The Staff filed its Recommendation in this case on December 31, 2008, signed by David Sommerer, as Project Coordinator, and Steven C. Reed, as Staff Counsel. In this Recommendation, Staff addressed, among other things, a supply contract wherein LER sold Laclede 20,000 MMBtu per day into the Trunkline Gas pipeline in Texas during the winter of 2006-07. Staff proposed a $651,650 disallowance in connection with this contract. Staff asserted this disallowance based on its theory that the affiliate shall not earn a profit in a transaction with the utility.

> "Laclede has not provided LER's invoices and contracts that underlie the supply sold to Laclede Gas Company. Without this documentation, the Staff is unable to ascertain the fair market value of this affiliate transaction. Although the index used represents the market price for firm gas in the vicinity of the delivery points, the Staff is unable to verify LER's acquisition price and whether LER derived further value beyond the payments required in the LGC/LER contracts." (December 31, 2008 Staff Recommendation, p. 11)

Thus, the fact that the pricing is market-based, a fact that brings the transaction squarely into compliance with the Rules and the CAM, is of no consequence to a Staff focused on its own unauthorized criteria: that Laclede's purchase price should match LER's cost. Accordingly, Staff focused its discovery on LER's transactions with unrelated third parties to acquire the gas supply that was sold to Laclede. In the absence of LER's cost data, Staff seeks to punish Laclede by applying a lower mid-continent gas price from Oklahoma as a proxy for what LER should have charged Laclede, when the gas supplies clearly were not sourced from the mid-continent region, but instead originated at higher cost points in Texas.

c. Case No. GR-2005-0203; Laclede's 2004-05 ACA Period; Case No. GR-2006-0288; Laclede's 2005-06 ACA Period

27. In Case No. GR-2005-0203, Staff asserted a disallowance against Laclede of $1.7 million pertaining to the Company's 2004-05 ACA period. This proposed disallowance arose from two consecutive gas supply agreements (the first from April 2004 through March 2005, and the second from April 2005 through March 2006). Under these agreements, LER sold baseload gas to Laclede. Rather than reviewing the market price of the transactions, Staff focused on LER's cost to acquire the gas supply that was sold to Laclede. As in the other cases, Staff was concerned that LER could acquire gas at a lower price than the sale price to Laclede, *i.e.* earn a return on the sale. Staff stated that this "could result in gains for LER that should be allocated to Laclede…" (Case No. GR-2005-0203, Staff Recommendation, filed December 28, 2006, p. 10) Staff also declared in its Recommendation that "There is no justifiable reason why Laclede's marketing affiliate should be profiting from the commodity side of this bundled supply deal." *Id.* He added that:

> "Laclede has offered no logical (sic) reason for this transaction to occur. Laclede holds the transportation, Laclede's buying power is greater than LER's, and Laclede has access to the same supply basins as LER. *Id.*

In other words, according to Staff, there is no reason for Laclede to purchase any gas supply from LER because, in Staff's unsubstantiated opinion, Laclede could buy the gas cheaper than LER could supply it. In addition to completely overlooking the stark distinctions between the roles played by gas utilities versus gas marketing companies, Staff reached this conclusion without even conducting an analysis of whether the transaction met the pricing standards of the Rules and the CAM. Staff's view is that it is Staff's opinion, and its opinion alone, that determines whether an affiliate transaction is priced correctly.

28. The ACA Period covered by Case No. GR-2006-0288 continued the second year of the two gas supply agreements discussed above. Again, Staff declined to establish a fair market price for this transaction, as required by the Rules, but instead complained that Staff had limited access to LER information that Staff believes is needed to "understand how LER allocates gas supply to various deals." (Case No. GR-2006-0288, Staff Recommendation, filed December 28, 2007, p. 8). Again, Staff sought LER's cost data, not to follow the dictates of the Rules or the CAM, but rather to enforce its own rule that gas supply transactions between a utility and its non-regulated affiliate should be priced at the cost to the affiliate and not at the fair market price of the transaction with the utility, as provided by the Rules and the CAM. Staff's counsel, Steven Reed, confirmed the Staff's disregard for the CAM at a March 26, 2009 oral argument in these cases, where he stated that "The investigation isn't into compliance with the CAM. The investigation is whether Laclede paid too much to LER for the gas they bought." For this ACA period, Staff asserted a disallowance against Laclede of $2.8 Million.

29. In this same period, Staff also identified one or more transactions in which Laclede sold gas to LER. The Rules and CAM would dictate that these sales be made at not less than the fair market price. However, Staff again ignored the fair market price of

such transactions, as the Rules and CAM require, and instead sought information from Laclede that would indicate whether LER earned a profit on reselling the gas bought from Laclede. Laclede submits that any gas that it sells off-system to an unaffiliated marketer is likely to be resold by that marketer at a profit, so there is nothing alarming about the marketer earning a profit on such off-system sales. Moreover, in suggesting that such an outcome is inappropriate, Staff is once again seeking to make it impossible for Laclede to conduct such lawful transactions by ensuring that Laclede absorbs any profit lawfully earned by its affiliate, in contrast to all other sales of gas or capacity in the wholesale market. In pursuing such an approach, Staff has violated the Rules and the CAM to the detriment of Laclede (and LER), which relied on these documents as the guidelines for transacting business with an affiliate.

RELIEF REQUESTED

30. Laclede seeks an order from the Commission finding that (i) Staff has violated Commission Rules and the Company's CAM by its unlawful and unwarranted approach to pricing affiliate transactions; and (ii) Staff has misapplied the Rules and CAM and has attempted effectively to eliminate affiliate transactions notwithstanding the fact that the Rules expressly permit them.

31. Laclede further seeks an order from the Commission directing Staff (i) to cease violating the Rules and the CAM and to follow the law as set forth in those documents; (ii) to assess affiliate transactions, including those described herein, based on a normal and reasonable interpretation of "fair market price," as fleshed out in the CAM, and being basically the price at which two non-affiliated entities would transact business; and (iii) to limit its data requests and other discovery to information necessary to ensure

compliance with the Rules and CAM, as provided in those documents. That would include the information necessary to determine the fair market price of transactions, and not information concerning the affiliate's cost or profit.

LACLEDE'S CONTACTS WITH STAFF

32. Laclede has had numerous contacts with Staff on this issue over the past three years, both in writing and orally. Laclede has filed numerous pleadings in multiple venues, repeatedly insisting that Staff is violating the Rules by imposing its own pricing standard rather than the standard provided in the Rules. Notwithstanding these numerous contacts, Staff has not changed its position and has in fact supplemented its proposed disallowances in the ACA cases discussed above by filing the Complaint in this case. While Laclede is responding with this Counterclaim, the Company is nevertheless continuing to discuss the affiliate transaction issue with Staff with the hope of resolving outstanding litigation and ultimately reaching a mutual understanding regarding compliance with the Rules and the CAM.

JURISDICTION OF THE COMMISSION

33. This Counterclaim alleges a violation of the Commission's Affiliate Transaction Rules and the Company's CAM. The Commission has jurisdiction over this matter pursuant to Section 386.390.1 RSMo. and 4 CSR 240-2.070, which states that complaints may be made by any person or public utility who feels aggrieved by a violation of a statute, rule, order or decision of the Commission.

WHEREFORE, Laclede respectfully requests that the Commission find in Laclede's favor on this Counterclaim, grant the relief requested in paragraph 31 hereof, and grant such other and further relief to which Laclede is justly entitled.

Respectfully submitted,

/s/Rick Zucker

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Certificate of Service

The undersigned certifies that a true and correct copy of the foregoing Counterclaim was served on the Staff and on the Office of Public Counsel on this 22nd day of September, 2010 by United States mail, hand-delivery, email, or facsimile.

/s/ Gerry Lynch