

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

The Staff of the Missouri Public Service Commission,)	
)	
Complainant,)	
v.)	Case No. GC-2011-0098
)	
Laclede Gas Company, Laclede Energy Resources, The Laclede Group)	
Respondents.)	

LACLEDE GAS COMPANY’S ANSWER TO STAFF’S SECOND AMENDED COMPLAINT, MOTION TO DISMISS COUNTS I AND V, AND COUNTERCLAIM

COMES NOW Laclede Gas Company (“Laclede” or “Company”), and files this Answer to Staff’s Second Amended Complaint, Motion to Dismiss Counts I and V, and Counterclaim, and in support thereof, state as follows:

On October 6, 2010, the Staff filed a complaint against Laclede and two of its affiliates. On October 7, Staff filed an amended complaint, and the Commission approved Staff’s request for leave to amend by order dated November 12, 2010. On November 8, 2010, Laclede filed an Answer and Motion to Dismiss the original complaint.

Staff filed a second amended complaint (herein so called) on November 22. On December 3, 2010, the Commission issued an order granting Staff leave to file its second amended complaint and directing Laclede to respond by December 10.

In the Introduction to the Second Amended Complaint, Staff reminded the Commission that the Staff initially drafted the Affiliate Transaction Rules (the “Rules”), that the Staff supports the Rules as written, and that the Staff seeks to enforce compliance with the Rules. (Second Amended Complaint, pp. 1-2) Laclede confirms Staff’s role in drafting the Rules, and agrees that the Rules should be supported by the parties and

enforced. The primary problem that has fomented so much litigation¹ over this matter has been Staff's steadfast refusal to apply these same Rules to the pricing of affiliate transactions between Laclede and its affiliate, Laclede Energy Resources, Inc. (LER). Rather, Staff has ignored the Rules' pricing standards and substituted in their place Staff's own pricing standards under the guise of "prudence." Laclede is, and has been, not only willing, but insistent upon, being judged by the Rules that were drafted by the Staff, approved by the Commission and upheld by the courts. Contrary to Staff's claim that Laclede is trying to shift the focus away from the Rules, Laclede is actually trying to shift the focus *onto* the Rules.

Staff's Second Amended Complaint contains five counts. The first count makes no allegation that a law or rule has been violated and Laclede will move herein to have Count I dismissed. Counts II-IV allege that (i) Laclede's Cost Allocation Manual ("CAM") violates the asymmetrical pricing provisions of the Rules; (ii) Laclede has not obtained Commission approval of the CAM; and (iii) Laclede has not submitted the CAM annually to Staff. Laclede denies each of these allegations as set forth herein. Finally, in Count V, Staff claims that Laclede violates the section of the Rules prohibiting the utility from providing preferential information to its affiliate, by alleging that a senior officer in the organization has access to information on multiple affiliates. Staff does not allege any particular preferential treatment, but states that as a matter of law, common officers and directors have unavoidable conflicts of interest. Laclede moves to dismiss this count for failing to state a claim, as common officers and directors are necessarily contemplated by the Rules and permitted to exist.

¹See Case Nos. GR-2008-0140; GR-2006-0288; GR-2005-0203; GC-2011-0006.

As with any business, Laclede seeks certainty that its practices, in this case affiliate transactions, comply with the law as set forth in the Commission's Rules and the Company's CAM. In this case and the other related cases, Laclede hopes to obtain the Commission's confirmation that its approach to pricing and documenting affiliate transactions is satisfactory.

ANSWER

Introduction Section

1. Laclede admits that the Complaint is brought by Staff. The remainder of paragraph 1 is a legal conclusion to which no response is required.

2. Laclede admits that it is a utility and serves approximately 630,000 customers in eastern Missouri. The allegation that Laclede is a monopoly is a superfluous allegation apparently meant to be pejorative. Without a more definitive statement of what Staff means by its use of this term, Laclede can neither admit nor deny Staff's assertion.

3. Laclede admits the allegations in paragraph 3.

4. Paragraph 4 contains legal conclusions to which no response is required. To the extent a response is required, Laclede admits that it is a gas corporation and a public utility as defined in Chapter 386 RSMo.

5. Laclede admits the allegations in paragraph 5.

6. Laclede states that the allegations of paragraph 6 are not directed to it, and further states that Laclede Group's 10K filing speaks for itself. Laclede admits that Laclede Group subsidiaries are wholly owned.

7. Laclede states that the allegations of paragraph 7 are not directed to it.

Count I

8. Paragraph 8 states a legal conclusion to which no response is required. To the extent that any answer is required, Laclede states that the statute speaks for itself.

9. Laclede states that paragraph 9 offers a legal conclusion to which no response is required. To the extent that any answer is required, Laclede denies the allegations of paragraph 9.

10. Laclede states that the Rules cited speak for themselves and denies the remainder of paragraph 10.

11. Paragraph 11 states a legal conclusion to which no response is required. To the extent any answer is required, Laclede denies the allegations of paragraph 11.

12. Laclede states that the Stipulation and Agreement in Case No. GM-2001-342 speaks for itself.

13. Laclede states that the Stipulation and Agreement in Case No. GM-2001-342 speaks for itself.

14. Paragraph 14 states a legal conclusion to which no response is required. To the extent that an answer is required, Laclede states that the *Atmos* case (*State ex rel. Atmos Energy Corp. v. Public Service Comm'n*, 103 S.W.3d 753 (Mo. 2003)) speaks for itself.

15. Paragraph 15 states a legal conclusion to which no response is required. Laclede further states that the *Atmos* case speaks for itself.

16. Paragraph 16 appears to be largely repetitive of paragraph 15. Accordingly, paragraph 16 also states a legal conclusion to which no response is required. Laclede further states that the *Atmos* case speaks for itself.

17. Laclede states that the Rule cited speaks for itself.

18. Paragraph 18 states a legal conclusion to which no response is required. Laclede further states that the Rule speaks for itself.

19. Paragraph 19 states a legal conclusion to which no response is required. Laclede states that the Rules and the Stipulation and Agreement in Case No. GM-2001-342 speak for themselves, and denies the remainder of paragraph 19.

20. Paragraph 20 states a legal conclusion to which no response is required. To the extent that an answer is required, Laclede denies the allegations of paragraph 20.

Count II

21. Laclede adopts its answers to paragraphs 1 – 20 as if fully set forth herein.

22. Laclede denies the allegations of paragraph 22. Laclede alleges that it is in compliance with both the Rules and its Cost Allocation Manual (CAM).

23. Paragraph 23 states a legal conclusion to which no response is required. To the extent that an answer is required, Laclede denies the allegations of paragraph 23.

24. Laclede denies the allegation contained in paragraph 24. Laclede addresses this allegations regarding asymmetrical pricing in detail below.

First and foremost, Laclede declares that it has taken Fully Distributed Cost (FDC) into account in pricing gas supply sales and purchases with LER. Laclede has previously explained its approach to Staff.² Staff clearly understands and supports the reasoning behind this approach, as Staff's own witness, Mr. David Sommerer, testified to

² See for example p. 4 of Laclede's Objection to Staff Information Requests filed on March 19, 2009 in Case No. GR-2006-0288, wherein Laclede stated "This [CAM] rule sensibly sets the affiliate transaction price at a 'fair market price.' This makes sense as a protection for utility ratepayers because it requires Laclede to pay LER no more than Laclede would pay other gas marketers that it does business with. While the Rules also refer to Laclede's fully distributed cost (FDC) as a factor, the CAM recognizes that, for purposes of gas supply transactions, calculating Laclede's FDC is not a meaningful exercise because Laclede does not produce gas supplies for itself, but buys them from marketers like LER. Therefore, Laclede's FDC is, for all practical purposes, equivalent to the fair market price."

at a recent Atmos hearing. Based on these facts, Laclede is surprised that Staff even questioned the Company's approach, much less filed a complaint over it. Nevertheless, Laclede will endeavor to again explain its rationale below.

In working with Staff to prepare the CAM, and in amending it in 2004, Laclede has tried to find a common sense method to conduct gas supply affiliate transactions in accordance with the Rules. Since its creation in 2001, the CAM has specifically addressed gas supply affiliate transactions, providing for the pricing of such transactions to be based on Fair Market Price (FMP). It excludes a reference to FDC, because in the context of purchasing or selling gas supply, FDC is meaningless. The explanation for this begins with the concept that FDC vs. FMP is really a "make or buy" decision. If, for example, a utility is buying a widget from its affiliate, the Rules prevent the utility from paying FMP to the affiliate if the utility could make, or build, the widget itself for less. With respect to gas supply, Laclede doesn't produce or manufacture gas. Laclede does not own wellhead supply. This fact alone is enough to dispense with FDC, since Laclede cannot accomplish a make or buy decision if it doesn't make the product. A further look into the analysis serves to confirm this position. Since Laclede is not a producer, the Company instead buys its gas from gas marketing companies at FMP for delivery to Laclede's customers. If we pretend that Laclede's purchase price for this gas is really its cost to "make" the commodity, then FDC is the same thing as FMP, which is the purchase price Laclede would pay to acquire gas from an unaffiliated entity. If we stop here, then $FMP = FDC$, and we can dispense with an FDC analysis and just concentrate on FMP. However, by definition, FDC would require Laclede to load onto that purchase price its direct and indirect costs. Adding any costs to FDC would necessarily cause FDC to exceed FMP.

The same reasoning that led Laclede to this conclusion in 2001 was described by Staff witness David Sommerer on October 20, 2010, at a hearing in an Atmos ACA case, Case No. GR-2008-0364. (*See* Tr. 197-98) In sum, when a utility does not produce a product itself, then FDC is by definition going to be equal to or greater than FMP, and therefore the proper pricing standard for such an affiliate transaction is FMP.

The same goes for the sale of gas supply by a utility to its affiliate. When a utility is selling a widget to its affiliate, if the utility makes the widget, the Rules prevent the utility from charging only FMP to the affiliate, if it cost the utility more than FMP to make the widget. Since again Laclede does not produce gas, it does not have a cost to make or produce gas supply from which to form an FDC that can be compared to the FMP of the gas sale to the affiliate. Therefore, for purposes of a utility selling gas supply to its affiliate, FMP is again the proper standard. The same reasoning applies to releases of pipeline capacity, as the Staff agreed in a Utilicorp case.³ However, out of an abundance of caution, Laclede did make an effort to reintroduce FDC into these capacity release transactions when Laclede updated its CAM in 2004, but has found that FMP and FDC produce equivalent results for such transactions as well.⁴

In summary, for most gas supply transactions, the CAM requires only an FMP analysis, because Laclede has determined, as has Staff, that FDC either does not exist for these transactions or is greater than or equal to FMP. Hence, both FMP and FDC have been taken into account, as required by the Rules. Laclede therefore has not requested a

³ Case No. GE-2000-639, *Order Approving Unanimous Stipulation and Agreement*, issued October 17, 2000.

⁴ Following the decision in the *Atmos* case, Laclede updated its CAM and sent the updated CAM to Staff, among others, in March 2004 (the “2004 CAM”).

variance and does not believe it needs a variance, because the CAM is applying the Rules in both letter and spirit.

25. Paragraph 25 states a legal conclusion to which no response is required. To the extent that an answer is required, Laclede adopts its response to paragraph 24 above.

26. Paragraph 26 states a legal conclusion to which no response is required. Laclede further states that the Rules cited in paragraph 26 speak for themselves. To the extent an answer is required, Laclede adopts its response to paragraph 24 above.

27. Paragraph 27 states a legal conclusion to which no response is required. Laclede denies the implication in Paragraph 27, that Laclede has made up its own rules to price affiliate transactions. This implication is sadly ironic, as it is actually the Staff that has driven a spate of unnecessary litigation by admittedly inventing its own standard for pricing affiliate transactions.

28. Paragraph 28 states a legal conclusion to which no response is required. To the extent that any answer is required, Laclede denies the allegations of paragraph 28, and adopts its response to paragraph 24 above.

29. Paragraph 29 is a hypothetical to which no response is required. To the extent a response is required, Laclede states that the Rules speak for themselves; and denies the remainder of paragraph 29.

30. Paragraph 30 states a legal conclusion to which no response is required. Laclede further states that the Rule cited in paragraph 30 speaks for itself.

31. Laclede asserts that it has complied with the Rules and its CAM and denies that it needs a variance.

Count III

32. Laclede adopts its answers to paragraphs 1 – 31 as if fully set forth herein.

33. Laclede denies the allegations of paragraph 33.

34. Paragraph 34 states a legal conclusion to which no response is necessary.

Laclede further states that the Rule cited speaks for itself.

35. Laclede states that paragraph 35 is repetitive of paragraph 33, and accordingly denies the allegations in paragraph 35.

Count IV

36. Laclede adopts by reference its answers to paragraphs 1 – 35 as if fully set forth herein.

37. Laclede admits that it has provided its CAM annual report to Staff on an annual basis. Laclede denies that it has not submitted its CAM annually to Staff. Since providing the CAM to Staff in December 2001, Laclede referred Staff to that CAM until 2004. Upon updating the CAM, Laclede provided the updated version to Staff in March 2004. The 2004 CAM is unchanged and has been in Staff's possession now for more than six years.

38. Laclede denies the allegations in paragraph 38. Laclede provided an updated CAM to Staff in March 2004.

39. Laclede denies the allegations in paragraph 39.

Count V

40. Laclede adopts by reference its answers to paragraphs 1 – 39 as if fully set forth herein.

41. Paragraph 41 states a legal conclusion to which no response is required. Laclede further states that the Rules cited in paragraph 41 speak for themselves. To the extent an answer is required, Laclede denies the allegations in paragraph 41.

42. Laclede states that the Rules speak for themselves, and that paragraph 42 does not fully and accurately quote from the Rules.

43. Laclede states that the Rules defining corporate support services speak for themselves, and denies the remainder of paragraph 43.

44. Paragraph 44 attempts to state a legal conclusion, to which no response is required. Laclede further states that the Rules speak for themselves. Laclede is without sufficient information to either admit or deny the remaining allegations and therefore denies the same.

45. Laclede denies the allegations in paragraph 45.

46. Laclede denies the allegations in paragraph 46.

AFFIRMATIVE DEFENSES

47. For its affirmative defenses, Laclede asserts that the Staff should be estopped from asserting that the CAM violates the Rules retrospectively, given the degree to which the CAM is a product of Staff's own prior actions. After all, it was the Staff which agreed to and actively promoted the use of the CAM to govern the pricing of affiliate transactions. It was the Staff which recommended that the CAM include provisions for determining the FMP -- the very kind of provisions that are now claimed to be inconsistent with the Rules. It was also the Staff which insisted that Laclede include the CAM in its corporate Code of Conduct, train its employees to adhere to the provisions of the CAM at all times, and subject its employees to discipline, including termination, for failure to adhere to the CAM. Finally, as stated in paragraph 37 above, Staff has had the CAM in its possession since 2001, and has had the CAM in its current form since 2004. So the Staff has had countless opportunities over the past nine years to advise the Company of any alleged deficiencies in the CAM, including the ones which it now

claims violate the Rules. Despite having told the Company years ago that it would review the CAM page by page and alert Laclede to any problems it perceived, the Staff never articulated to the Company the kind of deficiency it says now exists in the CAM. In fact, until this latest complaint, the Staff has not taken issue with the Company's claims in pleadings and during oral argument that the Rules and Laclede's CAM require that such transactions be based on FMP. To the contrary, the Staff itself has repeatedly taken the position in both Laclede and Atmos ACA cases that FMP is the relevant standard.⁵

48. Laclede asserts the defense of laches.

49. Laclede asserts the defense of performance, as contrary to Staff's allegations, Laclede has taken FDC into account in pricing affiliate transactions.

50. Laclede asserts that the Staff's claim that the CAM violates the Rules represents an impermissible collateral attack on the Commission's Order in Case No. GM-2001-342, which explicitly approved and required the use of the CAM to govern transactions between Laclede and LER. It also represents an equally impermissible attack on the provisions of Laclede's approved tariff sheets, which since 2001 have provided that the CAM should be used for purposes of pricing gas supply sales made to an affiliate.

**MOTION TO DISMISS COUNTS I AND V FOR FAILURE TO STATE A CLAIM
UPON WHICH RELIEF CAN BE GRANTED**

50. Laclede moves to dismiss Count I of the Second Amended Complaint. The allegations in Count I are merely a stream of legal conclusions, quotes and citations

⁵ Laclede notes that Staff accurately defines FMP in many of its pleadings, while at the same time distorting the concept and application of FMP beyond all recognition by, for example, claiming that the FMP of a sale by an affiliate to the utility equals the affiliate's acquisition cost.

to various legal sources. There are virtually no facts alleged in Count I, much less any facts that, if true, stated a claim upon which relief could be granted. Count I makes no claim that Laclede did or failed to do anything that violated a law, or rule, order or decision of the Commission, as required by Section 386.390.1 RSMo. Pursuant to 4 CSR 240-2.070(6), Laclede requests that the Commission dismiss Count I for failing to state a claim upon which relief can be granted.

51. Laclede also requests that the Commission dismiss Count V of the Second Amended Complaint. Laclede adopts the arguments made in the motion to dismiss filed by LER and Laclede Group on November 30, 2010. Again, Staff makes no factual allegations which, if true, would constitute a violation of the Rules cited by Staff, 4 CSR 240-40.015(2)(B) and (C). These rules state that the utility shall not provide “preferential service, information or treatment” to an affiliate over another party, including information pertaining to specific customers. Count V contained no factual allegations which, if true, showed that Laclede had given such preferential treatment to LER or any other affiliate.

52. Instead, the Staff claims that the mere existence of a common officer or director creates an unavoidable conflict. This cannot be true for two reasons: first, in promulgating the Rules, the Commission must have known that in any multi-affiliate organization, the affiliates must ultimately report to a common executive officer at or near the top of the organization. The Commission simply could not have approved affiliate rules in a manner that created an automatic violation of those rules. Second, the Rules themselves provide an exception to the preferential treatment prohibition for the provision of corporate support functions. These functions include oversight and

governance.⁶ In alleging that an officer or director has oversight and governance responsibilities over Laclede and one of its affiliates, the Staff is merely describing a status that is permitted under the Rules. Assuming the truth of the matter, such an allegation cannot state a claim upon which relief may be granted, and Laclede therefore requests that Count V be dismissed.

53. Finally, Staff did not comply with Commission Rule 2.070(5)(E), because Staff failed to state whether it had directly contacted Laclede on the issues “about which complaint is being made.” Had Staff made the required statement, Laclede contends that the answer should be no, because Staff has never directly discussed with Laclede the issue of FDC in connection with Laclede’s gas supply transactions with LER. While Laclede has endeavored to discuss affiliate transactions with Staff numerous times over the past decade, and has in fact met with Staff on several occasions, Staff has never raised the issue about which it has now complained.⁷ Further, Staff has always accepted Laclede’s annual reference to the CAM, and has never asked Laclede to annually submit a CAM that Staff already has. While Laclede notes these shortcomings for the record, Laclede does not seek to rely on them as a basis for seeking dismissal of the entire case at this time.

⁶ In quoting the Rules’ definition of “corporate support services” in paragraph 42 of the Second Amended Complaint, the Staff omitted the term “governance.”

⁷In all fairness, Laclede should disclose that in a meeting between the parties on September 7, 2010, a Staff member did appear to begin speaking about the CAM and the Rules, but this Staff member was immediately shushed by another Staff member, so the matter never came to light.

COUNTERCLAIM

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. In various Laclede ACA cases, Staff has made recommendations, asserted disallowances and sought discovery, all in direct conflict with 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”). Because Staff does not have a good faith, nonfrivolous argument for its position, Staff is violating 4 CSR 240-2.080(7) (“Rule 2.080(7)”), which states as follows:

By presenting or maintaining a claim, defense, request, demand, objection, contention, or argument in a pleading, motion, brief, or other document filed with or submitted to the commission, an attorney or party is certifying to the best of the signer’s knowledge, information, and belief, formed after an inquiry reasonable under the circumstances that –

(A) The claim, defense, request, demand, objection, contention, or argument is not presented or maintained for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;

(B) The claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;

(C) The allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

(D) The denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.⁸

4. As the target of the audits that are being conducted contrary to both the Rules and the CAM, and in violation of Rule 2.080(7) through the pleadings filed by Staff, Laclede has a direct interest in this counterclaim, and is aggrieved by Staff's violations. By unlawfully applying the Rules and the CAM, Staff has caused Laclede to unnecessarily expend a great deal of resources, has threatened Laclede with a substantial loss of gas costs and has threatened Laclede with the loss of the ability to conduct business with its affiliate, LER, which is a potential customer for Laclede's off-system sales and capacity releases, and is also a potential vendor of Laclede's gas supply. By its actions, Staff has interfered unlawfully with the business relationship of LER and Laclede, a relationship that, under both the Rules and the CAM, is otherwise lawful. The facts alleged herein will demonstrate that Staff is violating Rule 2.080(7)(A) by harassing Laclede and increasing its cost of litigation so as to accomplish Staff's goal of eliminating affiliate transactions, and is violating Rule 2.080(7)(B) by making frivolous arguments in support of its positions.

FACTS

⁸ Commission Rule 2.080(7) is derived from Missouri Rule of Civil Procedure 55.03(c). Rule 55.03(d) provides for sanctions for violating 55.03(c). However, the Commission rules have no corresponding penalty.

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 non-regulated operations.” (4 CSR 240-40.015; PURPOSE) The Rules 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, the purpose of the CAM was to “preserve and supplement existing protections against improper cross-subsidization between Laclede Gas Company and its affiliated entities.” 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 until 2010, Staff never objected to 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. 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 similar times at similar locations and for a similar duration. The CAM goes on to state that if such transactions don’t 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. Staff has completely ignored the Rules promulgated by this Commission as well as the Company's CAM. It has effectively taken the position that Laclede should purchase gas supply from LER not at a fair market price, nor at Laclede's fully distributed cost, but at **LER's** cost. In other words, Staff contends that, despite the requirements of the Rules and the CAM, LER should sell gas supply to Laclede at LER's cost and thus, without any opportunity to earn a profit typically associated with the sale of gas to Laclede by unaffiliated, independent marketers.

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, but at that price **plus** any profit that LER may earn on its resale of the gas supply. In other words, Staff contends that, despite the requirements of the Rules and the CAM, LER should be precluded from the opportunity that unaffiliated independent gas marketers have to earn profits on gas supply they acquire from Laclede for resale.

10. Under these scenarios, Laclede, for all practical purposes, is being punished after the fact for conducting business with LER in a manner that is perfectly lawful under, and even dictated by, the Rules and the CAM. The natural effect of Staff's unlawful position is to prevent any transactions from taking place between Laclede and LER, whether or not such transactions are beneficial to those parties or their customers. This position blatantly conflicts with the Rules and the CAM, which clearly permit

affiliate transactions to occur so long as they are priced in accordance with those documents.

11. Staff's position is in direct contradiction to the statement made by its own general counsel, Kevin Thompson, who stated at an 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."

12. 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 and in pursuit of its goal of eliminating affiliate transactions, Staff has violated Rule 2.080(7)(A) and (B).

1. Mr. Sommerer's Sworn Testimony on Behalf of Staff Conflicts with the Rules and violates Rule 2.080(7)

13. Staff has not yet filed testimony in Laclede's pending ACA proceedings. However, Staff witness David 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 on Staff's behalf was true and correct to the best of his knowledge and belief. In this case, Staff had 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 arose from 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.

14. Atmos issued a Request for Proposal to its gas supply marketers for its gas supply needs during the subject ACA Period. AEM was awarded the gas supply contracts for the Hannibal/Canton and the Butler systems.⁹ (Sommerer Direct testimony, p. 8)

15. 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)

16. 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)

17. However, despite the clear application of the Rules to this 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 sworn position is that the fair market price of Atmos’ purchase of gas supply was AEM’s cost to provide gas to Atmos. (Sommerer Direct testimony, p. 6)

18. Staff’s witness ignored the requirements of the Rules and instead applied his own approach to affiliate transactions. His sworn testimony was that:

⁹ 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 not only patently false, but is not warranted by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law. 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.

19. 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 is well aware that the effect of asserting this position on behalf of the Staff is to drive the affiliate (in this case, AEM) out of the competition for Atmos’ business, at the expense of Atmos’ Hannibal and Butler customers, who would have to pay more for Atmos to hire the second place finisher in the RFP, rather than the winner, AEM.

20. In other words, despite the clear language of the Rules, Mr. Sommerer appears to believe that it is more important to depart from the Rules to the detriment of Hannibal and Butler customers than to permit an affiliate transaction to occur. In circumstances when 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

21. Staff witness Sommerer further stated that AEM's profit and loss statement shows that "AEM's fair market value [i.e., cost] for gas supply was less than 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.

22. In connection with this position, however, Staff seeks to discover the affiliate's cost of gas so Staff can impose that cost as the fair market price of 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 meant 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, which is the fair market price of that gas supply at the time and place of sale.

23. At a hearing in Case No. GR-2008-0364 on October 20, 2010, Staff witness Sommerer again testified that in Staff's view the utility's fair market price equals the affiliate's fair market price. This is just another way of saying that the affiliate is precluded from ever earning a profit on a transaction with the utility, which is emphatically not the standard in the Rules.

2. Staff's Positions in Laclede ACA cases

24. Staff's positions on Laclede-LER affiliate transactions in Laclede's recent ACA cases is 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 price affiliate transactions in a manner that eliminates any opportunity for the affiliate to profit, regardless of the fair market price of 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 eliminate such profits, notwithstanding the clear prescription of the Rules and Laclede's CAM.¹⁰

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

25. The Staff filed its Recommendation in this case on December 31, 2009. 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.

26. Staff further stated in its Recommendation 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 to acquire the supply." (*Id.*) This

¹⁰ Complainant Laclede objected to Staff's data requests on the grounds that they were irrelevant to the Rules' pricing standards.

pricing standard is directly in conflict with the Rules and the CAM. Staff's assertion of this standard in its pleadings is frivolous, and thus in violation of Rule 2.080(7).

27. 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

28. The Staff filed its Recommendation in this case on December 31, 2008. In this Recommendation, Staff addressed, among other things, a supply contract wherein LER sold Laclede 20,000 MMBtu per day into the Trunkline pipeline in Texas during the winter of 2006-07. Staff contended that Laclede should suffer 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, emphasis added)

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 Staff contends that 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**

29. 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, or Laclede's cost, 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)

30. 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 determine 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 contention that a non-regulated affiliate shall not earn a profit on a transaction with a regulated utility. 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.

31. In this same period, Staff 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. In filing pleadings that pursued its own rationale, and ignoring the Rules and the CAM, Staff has violated Rule 2.080(7) to the detriment of Laclede (and LER), which relied on these documents as the guidelines for transacting business with an affiliate.

32. Finally, on October 25, 2010, Staff filed a pleading in Case No. GC-2010-0006, in which Staff again admitted that its position on Laclede affiliate transactions is that Laclede should buy gas from LER at LER's acquisition price, and that any profit realized on sales of gas by Laclede to LER should inure to the benefit of ratepayers.

Once again, this pleading reflects a standard that is emphatically not the standard in either the Rule or Laclede's Commission-approved CAM.

RELIEF REQUESTED

33. Laclede seeks an order from the Commission finding that (i) Staff has violated Commission Rule 2.080(7)(A) and (B) by harassing Laclede and driving up its cost of litigation with its unlawful, unwarranted and frivolous approach to pricing affiliate transactions so as to eliminate them; and (ii) Staff has misapplied the Rules and CAM and has attempted to eliminate affiliate transactions notwithstanding the fact that the Rules permit them. Laclede further seeks an order from the Commission directing Staff (i) to cease violating Rule 2.080(7), cease taking positions in clear conflict with the Rules and the CAM and 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 reasonably required to ensure compliance with the Rules and CAM, as provided in those documents. In these transactions, 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

34. 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's pleadings, contentions and actions are clearly and obviously contrary to the Rules and the CAM by virtue of Staff's imposing its own

pricing standard for affiliate transactions rather than the standard provided in the Rules. Notwithstanding these numerous contacts, Staff has not changed its position and knowingly and wantonly continues to contravene the Rules and the CAM in violation of Rule 2.080(7).

JURISDICTION OF THE COMMISSION

35. This Complaint alleges a violation of Commission Rule 2.080(7), based upon pleadings filed with the Commission concerning the 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 accept Laclede's Answer to the Staff's Second Amended Complaint, dismiss Counts I and V of that complaint, find in Laclede's favor on its Counterclaim, grant the relief requested in paragraph 33 hereof, and grant such other and further relief to which Laclede is justly entitled.

Respectfully submitted,

/s/Michael C. Pendergast

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Certificate of Service

The undersigned certifies that a true and correct copy of the foregoing pleading was served on the Staff and on the Office of Public Counsel on this 10th day of December, 2010 by United States mail, hand-delivery, email, or facsimile.

/s/ Gerry Lynch