

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

In the Matter of the Laclede Gas Company's
Request to Increase Its Revenues for Gas Service

File No. GR-2017-0215

In the Matter of the Laclede Gas Company d/b/a
Missouri Gas Energy's Request to Increase Its
Revenues for Gas Service

File No. GR-2017-0216

REPLY BRIEF OF THE ENVIRONMENTAL DEFENSE FUND

Pursuant to the Missouri Public Service Commission's ("Commission") May 24, 2017 Order Adopting Procedural Schedule and Delegating Authority, the Environmental Defense Fund ("EDF") respectfully submits its Reply Brief in the above captioned proceedings concerning Laclede Gas Company's ("Laclede") and Missouri Gas Energy's ("MGE") (collectively, "Company" or "Spire") request to increase revenues for gas service.

I. INTERESTS OF EDF

Spire argues that the primary objective of EDF's recommendation is to "stymie completion of the Spire STL Pipeline project."¹ To correct the record, and as made clear during the hearing, EDF's sole source of opposition to the Spire STL Pipeline is that its owners seek to tax captive retail ratepayers for unneeded new pipeline capacity, rather than allow bona fide market forces to dictate need. In fact, with the exception of Spire STL Pipeline LLC's ("Spire STL") application to the Federal Energy Regulatory Commission ("FERC"), EDF has *never* filed a protest against a pipeline developer's certificate application. EDF's work has been primarily focused on increasing efficiencies between the gas and electric industries, including "the utilization of existing capacity to the maximum extent possible before undertaking possible

¹ Spire Initial Brief at 53.

duplicate or redundant . . . facility modifications or expansions.”² However, where, as here, a utility has abandoned the best interests of its customers in favor of increasing shareholder returns by investing in an unneeded project that will result both in environmental and economic harm, requests for increased regulatory oversight are warranted.

Rather than “misusing this state regulatory proceeding,” as suggested by Spire,³ EDF is simply providing its perspective as a national organization involved in several proceedings across the country regarding affiliate-backed new pipeline capacity. As expressed during the hearing, a substantial portion of the gas pipeline network is being built on the backs of retail customers.⁴ FERC relies on precedent agreements to demonstrate need for new pipeline capacity and assumes legitimate market forces (as would exist between arms-length parties) will provide the necessary discipline against unneeded projects. This logic breaks down with the affiliate model, such as the Laclede/Spire STL transaction, which assigns all risk to retail ratepayers and all rewards to parent company shareholders. The Spire STL Pipeline could not be built but for Laclede’s subscription. Laclede cannot demonstrate any new load growth, and a substantial number of pipelines already serve the St. Louis region at rates lower than those advertised by Spire STL.⁵ To address the risks embedded in Laclede’s affiliate transaction, EDF has provided the Commission with a set of tools to keep ratepayers protected, while at the same time allowing Laclede and its parent to make any investment decisions they deem fit, however unwise those

² Tr. (Volume 19) at page 1991, lines 11-14.

³ Spire Initial Brief at 53.

⁴ Tr. (Volume 19) at page 1806, lines 4-5.

⁵ The MRT capacity has a cost of \$0.1845 per Dth/d (*see* Exhibit No. 650 at page 20, line 12), whereas Spire STL’s open season announced a daily maximum recourse rate on the Spire STL Pipeline of \$0.23 to \$0.27 per Dth/d. Exhibit No. 650, Schedule EDF-07 at page 3.

decisions may be. Given that Missouri ratepayers will soon be faced with an approximately \$30 million annual cost for the next 20 years,⁶ EDF submits that this is an issue well worth the Commission's attention in this proceeding.

II. ARGUMENT

A. Should LAC have new PGA/ACA tariff provisions pertaining to costs associated with affiliated pipeline transportation agreements?

Yes, the Commission should adopt the proposed PGA/ACA tariff provisions set forth in the Direct Testimony of Greg Lander at Schedule EDF-03 to reflect recent trends in the natural gas market and to protect ratepayers from any unreasonable costs associated with affiliated pipeline transportation agreements. These provisions will ensure that ratepayers are kept indifferent to capacity or supply decisions made at the corporate level by shielding ratepayers from any unreasonable costs, particularly those which may result from affiliate transactions such as the precedent agreement between Laclede and Spire STL.

Contrary to Spire's criticism,⁷ EDF's proposal is consistent with the long-standing regulatory principles and practices governing the Commission's treatment of gas supply and transportation costs.⁸ The core principle in evaluating both gas supply and transportation

⁶ Tr. (Volume 19) at page 1998, lines 7-8.

⁷ Spire Initial Brief at 53-54. In response to Staff's claim that EDF's proposal "could result in a major overhaul of the way the PGA/ACA process is handled in Missouri" (Staff Initial Brief at 36), EDF submits that there have been substantial changes in the natural gas market, as well as Spire's contracting strategies, to warrant such change. As demonstrated in EDF's Initial Brief, the decades-old PGA/ACA process did not contemplate the mere pass-through of interstate affiliate agreement costs without any customer protections. EDF Initial Brief at 9-13.

⁸ In explaining the ACA process, Spire cites to *Associated Natural Gas Company v. Public Service Commission*, 954 S.W.2d 520, 523 (Mo. App. W.D. 1997). Spire Initial Brief at 53-54. That case involved the purchase of gas supply costs, which are separate and apart from gas transportation costs. The latter can involve, as is the case with the Laclede/Spire STL contract, the building of large infrastructure at significant cost. Moreover, that decision was

decisions is cost.⁹ EDF's proposal, accordingly, would assess the all-in cost of each of Laclede's gas supply portfolio components and determine what changes, if any, would be necessary at renewal time or otherwise.¹⁰ This methodical analysis is certainly more straightforward and objective than the amorphous weighing of "reliability and diversity" benefits put forward by Laclede.¹¹ Moreover, given that affiliate transactions do not enjoy a presumption of prudence,¹² EDF's proposal would help guide the Commission and Staff in evaluating Laclede's gas supply portfolio decisions, which are becoming more nuanced with the rise of regulated utility affiliate-backed agreements.¹³

Spire and Staff conflate the issues before the Commission in this proceeding with those issues to be decided by the Commission in a future PGA/ACA proceeding.¹⁴ EDF has submitted

issued more than two decades ago, well before the rise of interstate affiliate transportation agreements. Furthermore, the "fundamental rights" of utility management to make investment decisions are not unfettered rights. As demonstrated by the record evidence in this case, Commission action is needed to protect against the inherent risk embedded in Laclede's affiliate transaction.

⁹ Mo. Rev. Stat. § 393.130.

¹⁰ Exhibit No. 650 at page 11, lines 12-15.

¹¹ Exhibit No. 650, Schedule EDF-08 at page 1 ("The specific impact of the inclusion of Spire STL Pipeline's transportation charges in LAC's PGA/ACA will depend on a variety of factors to be determined. Accordingly, a definite amount cannot be provided at this time. Any consideration of the impact of Spire STL Pipeline LLC, however, will also need to be put into the larger and more meaningful context of its impact on the overall cost of delivered gas to LAC as a result of greater supply diversity and the opportunities such diversity creates to access supplies from sources that may be more favorably priced, as well as its impact on enhancing supply reliability.").

¹² Exhibit No. 426, Schedule AA-S-3 at page 1 ("Due to the inherent risk of self-dealing, the presumption of prudence utilized by the PSC when reviewing regulated utility transactions should not be employed if a transaction is between a utility and the utility's affiliate.").

¹³ EDF Initial Brief at 10-11.

¹⁴ Spire Initial Brief at 55 (stating that EDF's proposal "does not take into consideration a number of factors, including capacity turn-back opportunities, Standards of Conduct bidding requirements, and increases in other pipeline rates that would have to be evaluated in order to determine what impact his formula might have on gas costs."); *see also* Staff Initial Brief at

a set of proposed PGA/ACA tariff revisions to be adopted in this proceeding. The testimony of Greg Lander explains how those tariff revisions *could* be applied in a future ACA proceeding.¹⁵ Circumstances may, and will likely, change before Laclede seeks to recover the costs associated with its Spire STL transportation agreement. For that reason, EDF proposed *illustrative hypotheticals* demonstrating how its proposal could apply in the future. That future proceeding will, as it has in the past, require the important role of Staff in determining whether Laclede was prudent in entering into the Spire STL/Laclede transaction.¹⁶ And it certainly would not impinge upon the role of the Commission, or hinder the Commission, from evaluating prudence with the benefit of Staff's expertise.

The most troubling admission in Spire's Initial Brief is that "[t]he evaluation formula recommended by Mr. Lander is, of course, designed to make service from Spire STL Pipeline economically problematic."¹⁷ A similar statement was made in the Rebuttal Testimony of Spire witness Mr. Weitzel: EDF's "revisions to the Company's PGA/ACA mechanism...would make it difficult, if not impossible, for the Company to take service from that pipeline."¹⁸ Both of these claims deserve further scrutiny from the Commission. The crux of EDF's proposal is that

36-37.

¹⁵ Exhibit No. 650 at page 11, lines 17-21.

¹⁶ Staff's claim that the rolling five year period would "not be very ratepayer friendly" (Staff Initial Brief at 37) ignores how that mechanism would work in practice. Under EDF's proposal, recovery of the Spire STL/Laclede contract costs in any year are limited to gas costs through Spire STL Pipeline, plus an amount through Spire STL Pipeline up to the First of Month ("FOM") Benchmark. This cap would protect ratepayers from any unreasonable transportation costs and thus, contrary to Staff's assertion, is very ratepayer friendly. The rolling five-year period allows Laclede to make up for prior under-recoveries against the FOM and have a pot of dollars available for future under-recoveries. Meanwhile, ratepayers are kept indifferent as they are shielded if under-recoveries expire within the five years, as they would be refunded in five years when over-recoveries would be returned to ratepayers.

¹⁷ Spire Initial Brief at 54.

¹⁸ Exhibit No. 16 at page 2, lines 21-22.

ratepayers should not be required to pay for 365-day per year capacity backed by an agreement with an affiliate, if all that is needed is capacity to meet a peak winter need. Given Laclede's lack of load growth, ratepayers should not be assessed exorbitant amounts of transportation costs when cheaper and more efficient options exist. Spire's Initial Brief and Mr. Weitzel's testimony signal to the Commission that absent a subsidy from ratepayers, Spire would not have made this corporate-wide bet.¹⁹ These statements underscore the importance of adopting EDF's proposal as a means to protect ratepayers from the uneconomic decisions that would otherwise favor shareholders at the expense of ratepayers.²⁰

B. Should a working group be created following this rate case to explore ideas for modifying the LAC and MGE CAM?

The Commission should adopt the proposed changes to Laclede's Cost Allocation Manual and Gas Supply and Transportation Standards of Conduct as set forth in the Direct Testimony of Greg Lander at Schedule EDF-06. In the event the Commission declines to adopt these changes, it should direct Laclede to revise its Cost Allocation Manual and Standards of Conduct no later than six months after the Commission issues its report and order in this rate case.

There is unanimous agreement that Spire's corporate structure has changed significantly in the last few years.²¹ There is also unanimous agreement that such evolution warrants

¹⁹ Exhibit No. 651 at page 2, lines 20-21.

²⁰ *Id.* at page 2, lines 23-24. EDF's proposal would not make it impossible for Spire STL to build any new pipelines. Rather, it would appropriately allocate any unreasonable costs of an unneeded pipeline to shareholders. EDF submits that if the pipeline were truly needed and will result in the purported benefits cited by Spire STL, then Laclede should have no issue adopting tariff revisions that will ultimately protect its customers.

²¹ Staff Initial Brief at 39; OPC Initial Brief at 18; EDF Initial Brief at 5; Tr. (Volume 19) at page 1791.

commensurate changes to the utility's Cost Allocation Manual.²² The sole remaining questions are (1) what changes are needed and (2) when should those changes be made.

EDF has put forth one common sense change to the Standards of Conduct. Because those Standards do not currently govern transportation transactions, EDF proposes to update the Standards using the existing framework governing the gas supply transactions.²³ There are several compelling reasons why those standards need to be updated, most notably that transportation transactions can subject customers to exorbitant costs²⁴ and Spire has announced a future business strategy to invest in more pipelines.²⁵ EDF agrees with Staff that such changes “would not necessarily mean the ultimate decision to purchase pipeline capacity was a prudent one.”²⁶ EDF also agrees that “any changes to the transportation bidding requirements would not be applied retroactively to the Spire STL Pipeline.”²⁷ Regarding Spire's opposition to the changes, Spire states that “the application of such standards to the far different analysis required for procuring pipeline capacity would create obstacles to obtaining such capacity on a reasonable basis and put these critical resources at risk.”²⁸ There is simply no weight to this claim, given that the St. Louis region already enjoys excess pipeline capacity from pipelines unaffiliated with Laclede.²⁹ For these reasons, the Commission should adopt EDF's proposed changes to the

²² Staff Initial Brief at 39; OPC Initial Brief at 15-16; EDF Initial Brief at 19-22; Tr. (Volume 19) at page 1791.

²³ Exhibit No. 650, Schedule EDF-06 at pages 1-2; *see also id.* at pages 3-4 (proposing similar revisions for short term purchases).

²⁴ Exhibit No. 241 at page 5, lines 1-8.

²⁵ Exhibit No. 650, Schedule EDF-09 at page 3.

²⁶ Staff Initial Brief at 40.

²⁷ *Id.*

²⁸ Spire Initial Brief at 55-56.

²⁹ Exhibit 650, Schedule EDF-02 at page 11.

Standards of Conduct.

The record is replete with examples showing Laclede's inability or refusal to comply with the Affiliate Transactions Rule.³⁰ It follows that the Company would be resistant to any changes to the Cost Allocation Manual or Standards of Conduct that would augment its evidentiary or record-keeping burden. Furthermore, a working group would not compel the Company to make any changes.³¹ If the Commission deems a working group the appropriate forum to address the Cost Allocation Manual and Standard of Conduct deficiencies, then at a minimum, it should provide guidance as to the revisions it expects the Company to make, including how Spire should correct the fact that its Standards of Conduct do not currently apply to transportation transactions.

C. Should an independent third-party external audit be conducted of all cost allocations and all affiliate transactions, including those resulting from Spire's acquisitions, to ensure compliance with the Commission's Affiliate Transactions Rule, 4 CSR 240-20.015?

Yes, the Commission should order that an independent third party external audit be conducted of all cost allocations and all affiliate transactions to ensure the Company's compliance with the Commission's Affiliate Transaction Rule. That review should include a finding as to whether the Spire STL/Laclede arrangement complies with the rule, and the Commission should provide interested parties the opportunity to review and comment on the audit report.

Both EDF and OPC have demonstrated Laclede's long history of non-compliance with the Affiliate Transactions Rule.³² This demonstration—alone—should warrant a third party

³⁰ OPC Initial Brief at 19-20; EDF Initial Brief at 23-24.

³¹ Tr. (Volume 19) at page 1862, lines 10-13.

³² OPC Initial Brief at 19-21; EDF Initial Brief at 23-24.

review.³³ In addition, as observed by OPC, “[o]ther than limited rate case reviews, no audit of Spire’s cost allocations and affiliate transactions has been conducted in many years, **if at all.**”³⁴ The record evidence unequivocally demonstrates that a sufficient review of affiliate transactions certainly did not take place in the instant proceeding. For example, none of the witnesses (for the Company, OPC or Staff) performed an analysis of whether the Laclede/Spire STL affiliate arrangement complies with the Affiliate Transactions Rule.³⁵ The “renowned firm and highly experienced team”³⁶ hired by Spire proved to be the opposite at the hearing. As one example, that team posited that additional “complimentary” standards would provide further perspective on the determination of affiliate charges for a gas utility.³⁷ One of those complimentary standards, FERC Order No. 707, explicitly declined to expand the scope of those regulations to the natural gas industry.³⁸ Mr. Flaherty admitted he was not aware of this fact during the hearing, calling into question how closely he in fact read and considered that order.³⁹ More

³³ In contrast to the compelling reasons in favor of conducting an independent third party review, Spire has not, and cannot, put forward a compelling reason negating the need. As a last resort, it seeks to distract the Commission by citing to Ms. Azad’s purported lack of knowledge with the Affiliate Transaction Rule, and Mr. Hyneman’s inclusion of news articles summarizing Staff’s Investigation Report in Case No. GM-2016-342.³³ The Commission should dismiss these claims for what they are—red herrings—and proceed with the most prudent course of action to address Laclede’s repeated non-compliance with the rule: an independent third party review.

³⁴ OPC Initial Brief at 19.

³⁵ Tr. (Volume 19) at page 1849 (Spire witness Mr. Flaherty admitting he did not analyze the transaction); *id.* at page 1862-63 (Spire witness Mr. Krick admitting he did not analyze the transaction); *id.* at page 1928 (OPC witness Ms. Azad admitting she did not analyze the transaction).

³⁶ Spire Initial Brief at 56.

³⁷ Exhibit No. 47 at page 23, line 12 to page 27, line 21.

³⁸ *Cross-Subsidization Restrictions on Affiliate Transactions*, Order No. 707, 122 FERC ¶ 61,155 at P 32 (2008).

³⁹ Tr. (Volume 19) at page 1851, lines 4-8.

importantly, Mr. Flaherty’s analysis “was not intended to evaluate the sufficiency of Spire Missouri’s CAM or Spire Missouri’s implementation of that manual, nor was it intended to determine the company’s compliance with the Commission’s Affiliate Transactions Rule.”⁴⁰ The independent third party review would correct these deficiencies by undertaking a comprehensive review of both the Company’s cost allocations and affiliate transactions.

Finally, other jurisdictions have recognized the importance of independent third party reviews in ensuring utilities’ compliance with the law. As noted by OPC, “the New York Public Service Commission initiated a cost allocations review of National Grid that identified \$24.75 million in over-charges that were then credited back to New York ratepayers.”⁴¹ This suggests that an independent review can result in significant protections for consumers. If the independent review of Laclede results in similar findings, that would help to offset the \$30 million in annual costs Laclede customers will have to pay for service on Laclede’s affiliate pipeline.

III. CONCLUSION

For the reasons identified in EDF’s Initial Post-Hearing Brief and Reply Brief, the Commission should adopt EDF’s proposed changes to the PGA/ACA tariff and Cost Allocation Manual to ensure sufficient safeguards are in place to protect customers against unreasonable affiliate transportation costs. The Commission should also order that an independent third party audit be conducted of all Spire cost allocations and affiliate transactions, including the Laclede/Spire STL arrangement, to ensure compliance with the Affiliate Transactions Rule.

⁴⁰ OPC Initial Brief at 18 (citations omitted).

⁴¹ OPC Initial Brief at 23 (citing Tr. at page 1956).

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Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing pleading has been served by electronic means on all parties on the Commission's most recent service list in this proceeding.

/s/ Natalie Karas