

Exhibit No.:
Issue: **Affiliate Pricing
Standards and
Laclede's
Counterclaim**

Witness: **Michael T. Cline**

Type of Exhibit: **Direct Testimony**
Sponsoring Party: **Laclede Gas Company**
Case No.: **GC-2011-0098**
Date Testimony
Prepared: **March 22, 2011**

LACLEDE GAS COMPANY

GC-2011-0098

DIRECT TESTIMONY

OF

MICHAEL T. CLINE

DIRECT TESTIMONY OF MICHAEL T. CLINE

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- Q. Please state your name and address?
- A. My name is Michael T. Cline and my business address is 720 Olive Street, St. Louis, Missouri 63101.
- Q. What is your present position?
- A. I am Director of Tariff and Rate Administration at Laclede Gas Company (“Laclede” or “Company”).
- Q. Please state how long you have held your present position, and briefly describe your responsibilities.
- A. I was promoted to my present position in August 1999. In this position I am responsible for administration of Laclede's tariff. In addition, I perform analyses pertaining to Laclede's purchased gas costs and various federal and state regulatory matters which affect Laclede.
- Q. Please describe your work experience with Laclede prior to assuming your current position.
- A. I joined Laclede in June 1975 and have held various positions in the Budget, Treasury, and Financial Planning departments of the Company. In 1987, I began work in areas related to many of my duties today.
- Q. What is your educational background?
- A. I graduated from St. Louis University in May 1975, with the degree of Bachelor of Science in Business Administration, majoring in economics.
- Q. Have you previously submitted testimony before regulatory bodies?

1 A. Yes. I have submitted testimony in numerous proceedings before this
2 Commission which I have identified in Schedule MTC-1 that is attached to this
3 testimony. I have also testified before the Illinois Commerce Commission and the
4 Federal Energy Regulatory Commission.

5 **PURPOSE OF TESTIMONY**

6 Q. What is the purpose of your testimony in this proceeding?

7 A. The purpose of my direct testimony is to explain how the Company considered
8 fully distributed costs in determining the pricing standard for gas purchases and
9 sales with its affiliate, Laclede Energy Resources, Inc. (“LER”). My testimony
10 will also support Laclede’s counterclaim in this case in which Laclede has alleged
11 that Staff’s approach to pricing affiliate transactions for gas sales and purchases is
12 directly contrary to the pricing standards endorsed by the parties to the
13 Company’s Cost Allocation Manual (“CAM”) and the Commission’s affiliate
14 transaction rules (the “Rules”).

15 **ASYMMETRICAL PRICING STANDARDS**

16 Q. In paragraph 24 of the Staff’s complaint, the Staff alleges that Laclede’s CAM
17 “does not require Laclede to use asymmetrical pricing for transactions with its gas
18 marketing affiliate.” What is your understanding of this allegation?

19 A. The Rules require the pricing of affiliate transactions to be based on a comparison
20 between fair market price (FMP) and the utility’s fully distributed cost (FDC).
21 The pricing of the transaction will be based on the standard that is most beneficial
22 to the utility’s sales customers. This is known as the asymmetrical pricing
23 standard. The CAM dictates that Laclede use fair market price (FMP) for gas

1 supply purchases and sales with its affiliate. Hence, the Staff alleges that
2 Laclede is not complying with the asymmetrical pricing standard.

3 Q. Do you agree that Laclede's CAM ignores FDC in pricing gas supply affiliate
4 transactions?

5 A. No, I do not agree. As Laclede has previously explained to Staff, Laclede has
6 taken FDC into account in pricing gas supply sales and purchases with LER, and
7 consistent with Staff's own belief, Laclede has concluded that FDC does not
8 apply to these types of transactions. Rather, the FMP-FDC comparison will
9 always result in a pricing standard based on FMP.

10 Q. What was the basis for Laclede's conclusion?

11 A. Laclede believes that the Rules' application of FDC and FMP in effect amounts to
12 a "make or buy" decision. If, for example, a utility is buying a widget from its
13 affiliate, the Rules prevent the utility from paying FMP to the affiliate if the utility
14 could make, or build, the widget itself for less. However, with respect to gas
15 supply, Laclede doesn't produce or manufacture gas. Laclede also does not own
16 wellhead supply. So Laclede does not have a "cost" or FDC to provide the gas to
17 itself. This fact alone should be enough to dispense with FDC, since Laclede
18 cannot engage in a make or buy decision if it doesn't make the product.

19 Q. Is there another reason why FDC should not apply?

20 A. Yes. If we assume that Laclede's cost to "make" gas is actually its purchase price
21 to acquire the commodity from an unaffiliated entity, then FDC is really the same
22 thing as FMP. If this "pretend" FDC is going to just be equivalent to FMP, then
23 there is no reason to continue to pursue the pretense.

1 Q. You stated earlier that your consideration of FDC in these transactions is
2 consistent with Staff's own belief in this area. Please explain

3 A. At a hearing in an Atmos ACA case, Case No. GR-2008-0364, on October 20,
4 2010, Staff witness David Sommerer agreed that when a utility does not produce a
5 product itself, then FDC is by definition going to be equal to or greater than FMP,
6 and therefore the proper pricing standard for such an affiliate transaction is FMP.

7 Q. Does FDC apply when Laclede sells gas to LER?

8 A. No. Since Laclede does not produce gas, it does not have a cost to make or
9 produce gas supply from which to form an FDC that can be compared to the FMP
10 of the gas sale to the affiliate. Therefore, for purposes of a utility selling gas
11 supply to its affiliate, FMP is again the proper standard. However, it should be
12 noted that Laclede's tariffs already provide rules on how Laclede must account
13 for off-system sales of gas. Therefore, Laclede's CAM correspondingly provides
14 that such tariffs set a minimum pricing for Laclede's off-system sales to its
15 affiliate.

16 Q. Please summarize your testimony on this issue.

17 A. Laclede has taken both FMP and FDC into account in determining the pricing of
18 affiliate gas purchases and sales, as required by the Rules. Laclede has
19 determined, as has Staff, that FDC either does not exist for these transactions or is
20 equivalent to FMP. As a practical matter then, FMP provides the proper outcome
21 of an FMP-FDC comparison. So for gas purchase and sale transactions, the CAM
22 appropriately requires only an FMP analysis, subject to Laclede's tariff on off-
23 system sales.

1 **LACLEDE’S COUNTERCLAIM**

2 Q. What is the nature of Laclede’s Counterclaim in this case?

3 A. In various Laclede ACA cases, Staff has made recommendations, asserted
4 disallowances and sought discovery, all in direct conflict with the Rules and the
5 CAM.

6 Q. How have Staff’s positions conflicted with the Rules and the CAM?

7 A. The Rules dictate (i) that a utility buy a good or service from its affiliate at not
8 more than the lesser of FMP or the FDC to the utility to provide the good or
9 service for itself; and (ii) that a utility sell a good or service to its affiliate at not
10 less than the greater of FMP or the utility’s FDC. I discussed earlier how the
11 FMP-FDC comparison boils down to FMP as the appropriate standard for gas
12 purchases and sales. But instead of following these rules, the Staff has taken the
13 position that Laclede should purchase gas supply from LER not at FMP, nor at
14 Laclede’s FDC, but at **LER’s** cost. In other words, Staff contends that, despite the
15 requirements of the Rules and the CAM, LER should sell gas supply to Laclede at
16 LER’s cost and thus, without any opportunity to earn a profit typically associated
17 with the sale of gas to Laclede by unaffiliated, independent marketers. In its
18 January 17, 2011 Reply to Laclede’s counterclaim Staff admitted that its position
19 is that Laclede should buy gas from LER **at LER’s acquisition price**.

20 Q. What is Staff’s position on Laclede’s sales of gas supply to LER?

21 A. Staff has also taken the position that Laclede should sell gas supply to LER not at
22 FMP or FDC, but at that price **plus** any profit that LER may earn on its resale of
23 the gas supply. In other words, Staff contends that, despite the requirements of

1 the Rules and the CAM, LER should be precluded from the opportunity that
2 unaffiliated independent gas marketers have to earn profits on gas supply they
3 acquire from Laclede for resale. Again, in its January 17, 2011 Reply to
4 Laclede's counterclaim Staff admitted that its position is that any profit realized
5 by LER on gas it purchased from Laclede should inure to the benefit of Laclede's
6 ratepayers.

7 Q. What is the effect of Staff's position?

8 A. The natural effect of Staff's position is to prevent any transactions from taking
9 place between Laclede and LER, whether or not such transactions are beneficial
10 to those parties or their customers. This position blatantly conflicts with the Rules
11 and the CAM, which clearly permit affiliate transactions to occur so long as they
12 are priced in accordance with those controlling instruments.

13 Q. Staff has stated that this is simply a case where Laclede does not agree with
14 Staff's interpretation of the Rules. Do you agree?

15 A. No. While I am not an attorney, I am a college graduate with an economics
16 degree and more than 30 years experience with tariffs and regulatory matters. I
17 can understand how Staff may prefer a policy that effectively eliminates affiliate
18 transactions, but I simply cannot reconcile Staff's position with any reasonable
19 reading of the Rules and the CAM. The FMP of a transaction between a buyer
20 and a seller just cannot be viewed as the seller's cost. They are two separate
21 things, and Staff's view that such an outcome is warranted by the fact that the
22 seller and buyer are affiliates ignores the rules that are already in place to govern

1 such transactions. Staff's position is not an interpretation of the Rules, but a
2 method for imposing a different rule.

3 Q. How has Staff expressed its position?

4 A. Staff has expressed its positions in a number of Laclede ACA and complaint
5 cases. Staff witness David Sommerer has filed testimony in ACA proceedings
6 involving Atmos Energy Corporation ("Atmos"), in which he made essentially the
7 same arguments he has asserted against Laclede. On March 12, 2010, Mr.
8 Sommerer filed direct testimony in an Atmos ACA case, Case No. GR-2008-
9 0364. A true and correct copy of this testimony is attached hereto as Attachment
10 MTC-2.

11 Q. What did Mr. Sommerer testify to in the Atmos case?

12 A. Mr. Sommerer testified that in those instances (and apparently only in those
13 instances) where Atmos, the utility, purchased gas from AEM, its affiliate, "fair
14 market value" was established not by Atmos' competitive bidding process, but
15 instead by the affiliate's cost. In other words, Mr. Sommerer's position is that the
16 fair market price of Atmos' purchase of gas supply from AEM was AEM's cost of
17 acquiring the gas supply, without any compensation for the services provided or
18 risks undertaken by AEM to obtain and provide the gas to Atmos. Mr.
19 Sommerer described this self-invented standard in the following way:

20 "Profits are disallowed because LDC's do not mark up the price of gas
21 to their customers. What is to be passed through in the PGA charge is
22 the actual invoiced cost of gas. If Atmos had purchased the gas itself,
23 instead of through its affiliate, the actual cost of the gas, without
24 profit, would be the basis for the Purchased Gas Adjustment charge to
25 customers."
26

1 Staff witness Sommerer went on to state in his testimony that AEM’s profit and
2 loss statement shows that “AEM’s fair market value [i.e., cost] for gas supply was
3 less than what it charged its regulated parent Atmos. This means that AEM has
4 profited...” Further, at a hearing in Case No. GR-2008-0364 on October 20,
5 2010, Staff witness Sommerer again testified that in Staff’s view the utility’s fair
6 market price equals the affiliate’s cost to obtain the gas it sold to the utility.

7 Q. Is this approach to pricing gas purchases consistent with the Rules?

8 A. No. Nowhere in the Rules can it be reasonably interpreted that fair market price
9 is equivalent to the affiliate’s cost. Again, the effect of Staff’s position is that an
10 affiliate is precluded from ever earning a profit on a transaction with the utility, a
11 result which is emphatically contrary to the standard in the Rules as evidenced by
12 the Rule’s clear language and the fact that such a standard would effectively
13 preclude the very kind of affiliate transactions which the Rules explicitly permit.

14 Q. Is such a standard inconsistent with other provisions of the Rules?

15 A. Yes. As I stated, Mr. Sommerer only applies this “acquisition cost” standard in
16 those instances where an affiliate wins a competitive bidding process. If, in
17 contrast, an unaffiliated supplier wins then the fair market price of the gas supply
18 as demonstrated by the results of the competitive bidding process controls. This
19 highly discriminatory application of different standards for pricing such
20 transactions is also contrary to the non-discrimination standards of the Rules
21 which prohibit a utility from treating affiliated and non-affiliated marketers
22 differently.

23 Q. What are Staff’s positions in Laclede’s ACA cases?

1 A. Staff's positions on Laclede-LER affiliate transactions in Laclede's recent ACA
2 cases is the same as in Mr. Sommerer's sworn testimony in the Atmos case
3 discussed above. In a Staff Recommendation filed on December 31, 2009 in Case
4 No. GR-2008-0387, covering Laclede's 2007-08 ACA Period, Staff repeated its
5 self-invented pricing standards: "One way of assessing the fair market value of
6 affiliated agreements is to look at the elements of the underlying supply that was
7 used to fulfill LER's obligation to provide firm service." Staff further stated in
8 its Recommendation that "Just because an affiliate transaction is at index prices, it
9 does not mean that this is the fair market value of the service being received."
10 Rather, Staff states that the "fair market value of the gas may be more
11 appropriately stated as the price LER paid to acquire the supply." This pricing
12 standard is directly in conflict with the Rules and the CAM.

13 Q. Has Staff taken similar positions in other Laclede ACA cases?

14 A. Yes. In Staff's Recommendation filed on December 31, 2008 in Case No. GR-
15 2008-0140, covering Laclede's 2006-07 ACA Period, Staff addressed, among
16 other things, a supply contract wherein LER sold Laclede 20,000 MMBtu per day
17 into the Trunkline pipeline in Texas during the winter of 2006-07. Staff
18 contended that Laclede should suffer a \$651,650 disallowance in connection with
19 this contract. Staff asserted this disallowance based on its theory that the affiliate
20 should not be permitted to earn a profit in a transaction with the utility, regardless
21 of whether the transaction was competitively priced.

22 "Laclede has not provided LER's invoices and contracts that underlie
23 the supply sold to Laclede Gas Company. Without this
24 documentation, the Staff is unable to ascertain the fair market value of
25 this affiliate transaction. *Although the index used represents the*

1 *market price for firm gas in the vicinity of the delivery points, the Staff*
2 *is unable to verify LER’s acquisition price and whether LER derived*
3 *further value beyond the payments required in the LGC/LER*
4 *contracts.” (December 31, 2008 Staff Recommendation, p. 11,*
5 *emphasis added)*
6

7 Thus, the fact that the pricing is market-based -- a fact that brings the transaction
8 squarely into compliance with the Rules and the CAM -- is of no consequence to
9 a Staff focused on its own unauthorized criteria: that Laclede’s purchase price
10 should match LER’s cost.

11 Q. Are there other examples of Staff applying this unauthorized standard?

12 A. Yes. In Case No. GR-2005-0203, pertaining to the 2004-05 ACA Period, Staff
13 asserted a disallowance against Laclede of \$1.7 million pertaining to the
14 Company’s 2004-05 ACA period. This proposed disallowance arose from two
15 consecutive gas supply agreements, the first from April 2004 through March
16 2005, and the second from April 2005 through March 2006. Under these
17 agreements, LER sold baseload gas to Laclede. Rather than reviewing the market
18 price of the transactions, or Laclede’s cost, Staff focused on **LER’s** cost to acquire
19 the gas supply that was sold to Laclede. As in the other cases, Staff was
20 concerned that LER could acquire gas at a lower price than the sale price to
21 Laclede, *i.e.* earn a return on the sale. Staff stated that this “could result in gains
22 for LER that should be allocated to Laclede...”

23 Q. Did the Staff maintain this position in the following 2005-06 ACA Period covered
24 by Case No. GR-2006-0288?

25 A. Yes. For the second year of the two gas supply agreements discussed above,
26 Staff again declined to determine a fair market price for this transaction, as

1 required by the Rules, but instead complained that Staff had limited access to
2 LER information that Staff believes is needed to “understand how LER allocates
3 gas supply to various deals.” Again, Staff sought LER’s cost data, not to follow
4 the dictates of the Rules or the CAM, but rather to enforce its own contention that
5 a non-regulated affiliate should not earn a profit on a transaction with a regulated
6 utility.

7 Q. Did the Staff indicate in any other forum that it was not inclined to follow the
8 pricing standards set forth in the CAM?

9 A. Yes. Staff’s counsel, Steven Reed, confirmed the Staff’s disregard for the CAM
10 at a March 26, 2009 oral argument in these cases, where he stated that the
11 Company’s compliance with the pricing standards set forth in the CAM was not
12 determinative because “The investigation isn’t into compliance with the CAM.
13 The investigation is whether Laclede paid too much to LER for the gas they
14 bought.” This demonstrates once again that Staff’s pricing standard is untethered
15 from any recognizable standard. It is instead a completely ad hoc, self-invented
16 standard that reflects Staff’s particular notion of fairness at a given point in time.

17 Q. Has Staff taken this position in Laclede cases other than ACA cases?

18 A. Yes. There are a number of examples. On October 25, 2010, Staff filed a
19 pleading in Case No. GC-2010-0006, in which Staff again admitted that its
20 position on Laclede affiliate transactions is that Laclede should buy gas from LER
21 at LER’s acquisition price, and that any profit realized on sales of gas by Laclede
22 to LER should inure to the benefit of ratepayers. Once again, this pleading

1 reflects a standard that is emphatically not the standard in either the Rule or
2 Laclede's Commission-approved CAM.

3 Q. In your opinion, is Staff's argument, that Laclede should enter into gas sale and
4 purchase transactions with LER at LER's cost, made in good faith?

5 A. Staff's position is so far removed from any reasonable interpretation of the FMV
6 provisions in the Rules and CAM that I cannot see how it could possibly be made
7 in good faith.

8 Q. What effect has Staff's conduct had on Laclede and its ratepayers?

9 A. By failing to comply with the Rules and the CAM it endorsed, Staff has caused
10 Laclede to unnecessarily expend a great deal of resources, has threatened Laclede
11 with a substantial loss of gas costs and has threatened Laclede with the loss of the
12 ability to conduct business with its affiliate, LER, which is a potential customer
13 for Laclede's off-system sales and capacity releases, and is also a potential vendor
14 of Laclede's gas supply. By its actions, Staff has also interfered with the business
15 relationship of LER and Laclede, a relationship that, under both the Rules and the
16 CAM, is otherwise lawful. Staff is harassing Laclede and increasing its cost of
17 litigation so as to accomplish Staff's goal of eliminating affiliate transactions. At
18 the same time, Staff's conduct doubly punishes the public by diverting resources
19 from other lawful regulatory purposes and by needlessly driving up litigation
20 expenses that, whether incurred by the Commission Staff or the Company, are
21 ultimately reflected in customer rates.

22 Q. Does this conclude your direct testimony?

23 A. Yes, it does.

**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,)	
)	
)	Respondents.

AFFIDAVIT

STATE OF MISSOURI)
) SS.
CITY OF ST. LOUIS)


Michael T. Cline, of lawful age, being first duly sworn, deposes and states:

1. My name is Michael T. Cline. My business address is 720 Olive Street, St. Louis, Missouri 63101; and I am Director-Tariff & Rate Administration of Laclede Gas Company.
2. Attached hereto and made a part hereof for all purposes is my direct testimony, on behalf of Laclede Gas Company.
3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.



Michael T. Cline

Subscribed and sworn to before me this 22nd day of March, 2011.



Notary Public



**MPSC CASES IN WHICH TESTIMONY WAS FILED
BY MICHAEL T. CLINE**

GC-2011-0006 – Staff Complaint
GR-2010-0171- Laclede Rate Case
GT-2009-0026- Gas cost portion of bad debts
GR-2007-0208- Laclede Rate Case
GR-2005-0284-Laclede Rate Case
GT-2003-0032 - School Aggregation
GR-2002-356 - Laclede Rate Case
GT-2003-0117- Catch-up/Keep-up
EC-2002-1 - UE d/b/a AmerenUE
GR-2001-629 & GT-2001-662-Laclede Rate Case
GR-2001-387/GR-2000-622-Laclede ACA
GR-99-315 – Laclede Rate Case
GT-99-303 – Laclede GSIP
GO-98-484 – Laclede Price Stabilization
GR-98-374 – Laclede Rate Case
GR-96-193 – Laclede Rate Case
GA-96-130 – MPC
EO-96-15 – UE Class Cost Service
GC-96-13 – Industrials v. Laclede
GR-94-328 – Laclede PGA Rate Design
GO-94-318 – MGE PGA issues
GM-94-252 – MPC/UtiliCorp
GR-94-220 – Laclede Rate Case
GR-93-149 – Laclede’s ACA
GR-92-165 – Laclede Rate Case
GA-90-280 – InterCon Gas
GA-89-126 – MPC
GR-84-161 – Laclede Rate Case
GR-83-233 – Laclede Rate Case
GR-82-200 – Laclede Rate Case
GR-81-245 – Laclede Rate Case

Exhibit No.:
Issue: *Affiliated Transaction*
Witness: *David M. Sommerer*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Direct Testimony*
Case No.: *GR-2008-0364*
Date Testimony Prepared: *March 12, 2010*

MISSOURI PUBLIC SERVICE COMMISSION
UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

DAVID M. SOMMERER

ATMOS ENERGY CORPORATION

CASE NO. GR-2008-0364

Jefferson City, Missouri
March 2010

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

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Schedule MTC-2

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DIRECT TESTIMONY OF
DAVID M. SOMMERER**

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1 **DIRECT TESTIMONY**
2 **OF**
3 **DAVID M. SOMMERER**
4 **ATMOS ENERGY CORPORATION**
5 **CASE NO. GR-2008-0364**

6 Q. Please state your name and business address.

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

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

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

11 Q. Please describe your educational background.

12 A. In May 1983, I received a Bachelor of Science degree in Business and
13 Administration with a major in Accounting from Southern Illinois University at Carbondale,
14 Illinois. In May 1984, I received a Master of Accountancy degree from the same university.
15 Also, in May 1984, I sat for and passed the Uniform Certified Public Accountants
16 examination. I am currently a licensed CPA in Missouri. Upon graduation, I accepted
17 employment with the Commission.

18 Q. What has been the nature of your duties while in the employ of the
19 Commission?

20 A. From 1984 to 1990, I assisted with audits and examinations of the books and
21 records of public utilities operating within the state of Missouri. In 1988, the responsibility
22 for conducting the Actual Cost Adjustment (ACA) audits of natural gas utilities was given to
23 the Accounting Department (now referred to as the Auditing Department). I assumed

1 responsibility for planning and implementing these audits and trained available Staff on the
2 requirements and conduct of the audits. I participated in most of the ACA audits from early
3 1988 to early 1990. On November 1, 1990, I transferred to the Commission's Energy
4 Department. Until November of 1993, my duties consisted of reviews of various tariff
5 proposals by electric and gas utilities, Purchased Gas Adjustment (PGA) reviews, and tariff
6 reviews as part of a rate case. In November of 1993, I assumed my present duties of
7 managing a newly created department called the Procurement Analysis Department. This
8 Department was created to more fully address the emerging changes in the gas industry
9 especially as they impacted the utilities' recovery of gas costs. My duties have included
10 managing the five member staff, reviewing ACA audits and recommendations, participating
11 in the gas integrated resource planning project, serving on the gas project team, serving on the
12 natural gas commodity price task force, and participating in matters relating to natural gas
13 service in the state of Missouri. In July of 2006, the Federal Issues/Policy Analysis Section
14 was transferred to the Procurement Analysis Department. That group analyzes filings made
15 before the Federal Energy Regulatory Commission (FERC).

16 Q. What knowledge, skill, experience, training or education do you have in these
17 matters?

18 A. I have been assigned and testified in many PGA and ACA proceedings. I have
19 reviewed numerous ACA filings and have evaluated the purchasing practices of various Local
20 Gas Distribution Companies (LDC) in Missouri. I have also attended conferences and
21 seminars related to the natural gas futures market and other natural gas issues.

22 Q. Have you previously testified before this Commission?

1 A. Yes. A list of cases and issues in which I have filed testimony is included as
2 **Schedule 1** of my testimony.

3 Q. Did you make an examination and analysis of the books and records of Atmos
4 Energy Corporation (Company or Atmos) in regard to matters raised in this case?

5 A. Yes. I have examined these records in the context of the issues I am
6 addressing in this case.

7 **BACKGROUND**

8 Q. Please provided a background for this case.

9 A. The Procurement Analysis Department (Staff) reviewed Atmos Energy
10 Corporation's (Atmos or Company or LDC) 2007-2008 Actual Cost Adjustment (ACA)
11 filings, in Case No. GR-2008-0364, for the former territories of Associated Natural
12 Gas (ANG), (Areas B, K and S), United Cities Gas (Areas P and U) and Greeley Gas
13 (Area G). In the context of this testimony, the term Local Distribution Company or LDC is
14 referring to Atmos Energy Corporation, the regulated utility. Staff's analysis consisted of a
15 review and evaluation of the Company's billed revenues and its natural gas costs for the
16 period of September 1, 2007, to August 31, 2008. A comparison of billed revenue recovery
17 with actual costs will yield either an over-recovery or under-recovery of the ACA costs.

18 Staff performed an examination of Atmos' gas purchasing practices to determine the
19 prudence of the Company's purchasing decisions. Staff also conducted a hedging review to
20 determine the reasonableness of the Company's hedging plans for this ACA period. Staff
21 conducted a reliability analysis of the Company's estimated peak day requirements and
22 capacity levels to meet those requirements. Staff's Recommendation in Atmos Energy

1 Corporation's 2007-2008 Actual Cost Adjustment was filed December 28, 2009. Please refer
2 to the "Definition of Terms" in the attached Schedule 2.

3 **EXECUTIVE SUMMARY**

4 Q. Please provide an executive summary.

5 A. The issues in this case have been resolved with the exception of Staff's
6 proposed disallowance regarding Atmos' transactions with its affiliated marketing company.
7 Staff proposes an adjustment of (\$349,015) for the Hannibal area and an adjustment of
8 (\$13,964) for the Butler area related to the affiliated transactions between Atmos Energy
9 Corporation (Atmos or Company or LDC) and Atmos Energy Marketing, LLC (AEM).
10 Affiliate transactions require greater scrutiny because they are not arms-length transactions.
11 The gas supply transactions that Atmos entered into with its unregulated marketing affiliate,
12 AEM, have raised serious doubts as to their reasonableness and prudence.

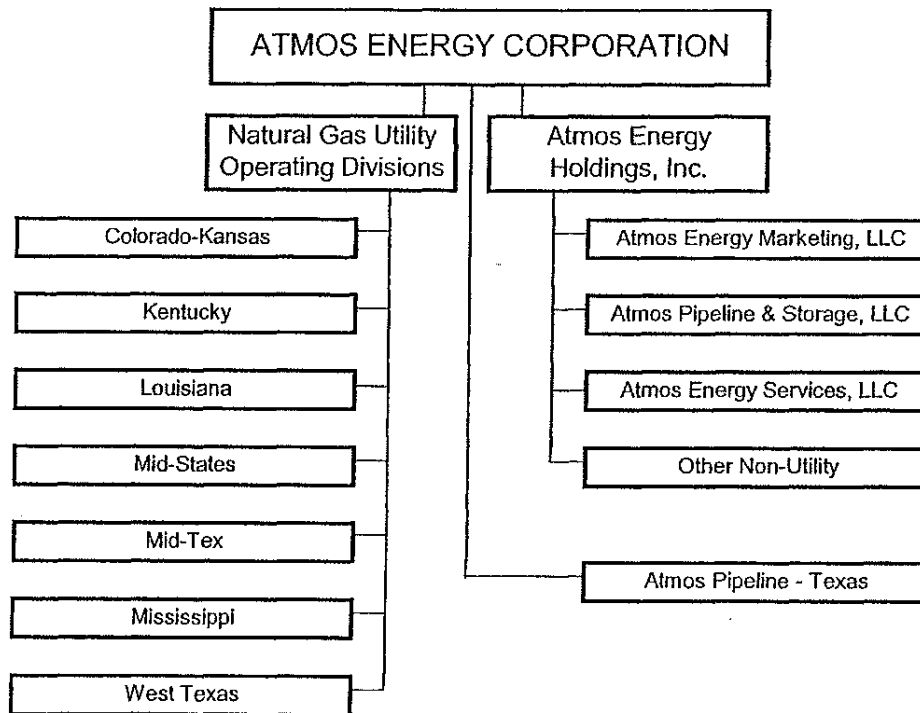
13 **Atmos Corporate Structure**

14 Atmos operates in many different state jurisdictions and aggregates its various state
15 operations into larger divisions. The Missouri LDC operations are part of Atmos' Mid-States
16 division and its Colorado-Kansas division. Atmos is the sole owner of Atmos Energy
17 Holdings, Inc. which in turn is sole owner of AEM. See Diagram 1 below, illustrating the
18 structure. The profits of AEM flow to its parent, Atmos, which has ultimate decision making
19 control over its LDC's operations as well as its subordinate affiliates, including AEM.

20 **Atmos' ability and incentive to maximize profits of its unregulated operations**

21 Because Atmos may allege a fiduciary duty to maximize its profits for its
22 shareholders, including the profits of unregulated affiliate AEM, there exists a built-in conflict
23 between Atmos' duty to maximize shareholder profits and its obligation to prudently obtain

1 reasonably priced gas supplies for its regulated LDC operations. Transactions between Atmos
2 and its unregulated affiliate AEM are governed by the Commission's Affiliate Transaction
3 rules 4 CSR 240-40.015 and 40.016.
4



5
6 Diagram 1

7 **The affiliate transactions rule**

8 In its review of transactions between Atmos, the LDC, and its unregulated affiliate
9 AEM, Staff must consider whether such transactions provided a financial advantage to the
10 affiliated entity, to the detriment of customers of Atmos the LDC. While the Commission's
11 Affiliate Transaction Rule, 4 CSR 240-40.015, Section (2)(A), is not the only basis for
12 determining prudence of transactions, the Commission's rule states that a regulated gas
13 corporation shall not provide a financial advantage to an affiliated entity. It further defines

1 how such transactions are to be priced to prevent giving a financial advantage to an affiliate.
2 This pricing requires the regulated entity to compensate the affiliate for goods or services at
3 the lesser of the fair market price or the fully distributed cost to the regulated gas corporation
4 to provide the goods or services for itself. When the Staff considers Atmos' (the LDC) fair
5 market value for a particular portfolio of supply, it is reasonable and necessary for Staff to
6 question why the LDC's fair market value would be any different than AEM's fair market
7 value.

8 Q. Please explain Staff's adjustment in this case.

9 A. The reason the Staff made the adjustment in this case is that the customers in
10 the Hannibal and Butler areas should not have to pay for more than "fair market value" for
11 their gas. While the fair market value could normally be determined by review of an arms-
12 length transaction, when the purchase is from an affiliate, a request-for-proposal (RFP)
13 process does not necessarily mean the result is the true fair market value.

14 Staff determined the amount of the disallowance based upon an AEM opinion of how
15 much profit AEM made on its gas supply transactions with Atmos the LDC. The AEM
16 spreadsheet showing AEM's profit calculation was adjusted by the Staff for what Staff
17 believes to be a reasonable alternative to the AEM profit calculation. The main difference
18 between AEM's assessment of profits and Staff's recalculation of those profits relates to how
19 daily gas profits are considered in the calculation. The Staff supports this disallowance
20 because it brings the costs passed through the ACA to a level that better reflects a reasonable
21 fair market value which is composed of AEM's costs for whatever types of supply and
22 transportation combinations that AEM has decided to use to fulfill its firm sales contract with

1 Atmos the LDC. Please refer to the attached Highly Confidential Schedule 3 for Staff's
2 adjustments.

3 The reason Staff chose to quantify a disallowance when additional discovery is
4 necessary is partly because of Staff's experience with its previous discovery in Atmos' prior
5 (2006-2007) ACA period. Questions surrounding these transactions were also asked in the
6 2006-2007 ACA case. In several instances, Atmos objected. The Staff did not pursue the
7 additional AEM information because the 2006-2007 case settled for a monetary amount. Had
8 the parties not settled, the Staff would have pursued further discovery, though it could have
9 been a long and difficult process.

10 The Staff does not believe that its discovery rights in this contested case are cut off at
11 the time ordered by the Commission for the Staff to file its ACA recommendation, just as
12 Staff's discovery rights do not end after Staff files Direct testimony. The Company has
13 ultimate control over all of its documents and the Staff can timely file its recommendation
14 based only on the information the Company chooses to provide in response to Staff's data
15 requests. The Staff has raised the question of the prudence and the reasonableness of Atmos'
16 gas supply transactions with its unregulated affiliate AEM. At the time the Company filed its
17 ACA and the Staff subsequently filed its recommendation, the Company had not attested to or
18 provided any testimony on any of its gas costs. In the process of making its ACA
19 recommendation, the Staff has identified and raised the issue of the prudence and
20 reasonableness of Atmos' affiliate transactions. Now, the Company needs to come forward
21 with evidence to defend its gas costs through direct testimony with full recognition that
22 further discovery by any party to the case may be forthcoming.

1 **SUMMARY OF STAFF'S ACA RECOMMENDATION REGARDING AFFILIATED**
2 **TRANSACTIONS**

3 Q. Please summarize Staff's ACA recommendation regarding affiliate
4 transactions.

5 A. For the 2007-2008 ACA period ending August 2008 Atmos had the
6 following affiliated supply and Asset Management Arrangements (AMA). These
7 agreements were executed between Atmos Energy Corporation (Atmos) and Atmos Energy
8 Marketing, LLC (AEM).

- 9 1. The Piedmont system AMA effective 11-1-06 to 10-31-07.
- 10 2. The Hannibal/Canton supply-only agreement effective 4-1-07 to 3-31-08
11 and 4-1-08 to 3-31-09.
- 12 3. The Greeley AMA effective 4-1-07 to 3-31-09.
- 13 4. The Butler system supply-only agreement effective 11-1-07 to 10-31-08.

14 The Staff's proposed adjustments are for affiliated transactions between Atmos and AEM in
15 the Hannibal area and the Butler area.

16 The Hannibal/Canton supply agreement was effective during the entire ACA period.
17 The Butler supply agreement was effective during the last 10 months of the ACA period.
18 These are supply-only agreements, meaning that AEM provided the entire supply during the
19 effective dates, but did not use the transportation or storage contracts under its Asset
20 Management Agreements.

21 Atmos issued a Request For Proposal (RFP) for its gas supply needs for the
22 Actual Cost period under review. Atmos awarded contracts to its affiliate Atmos Energy
23 Marketing (AEM) in several Missouri service areas. In addition to the prudence standard, the
24 Staff applied the affiliate transaction costing standards as required by the Commission's
25 Affiliate Transaction Rules. These costing standards require Atmos the LDC to buy

1 services from its affiliate at the lesser of fair market value or the LDC's fully distributed cost
2 (4 CSR 240-40.015, Affiliate Transactions).

3 Atmos' position is that a RFP process sets the fair market value for a particular
4 transaction. Staff contends that its inquiry into the fair market value of what AEM paid for its
5 gas supply and/or transportation is relevant to determining Atmos' fair market value.

6 The Staff had requested underlying supporting documentation for these transactions.
7 AEM provided some but not all of the requested information. AEM, through its parent Atmos,
8 provided Staff with an analysis of its Profit and Losses (P&L) for the Hannibal and Butler
9 areas. This analysis provided the underlying gas packages procured by AEM for serving
10 Atmos the LDC. However, this analysis only included the profits and losses for baseload
11 packages of gas that Atmos provided in its documents. Staff's analysis expands on AEM's
12 P&L statement and includes the P&L for additional gas volumes provided by AEM to Atmos
13 (daily and/or swing volumes) for the Hannibal and Butler areas. AEM's P&L calculation did
14 not include the additional gas it supplied to Atmos. AEM's P&L spreadsheet misstated a
15 December 2007 index price and Staff corrected the misstatement in Staff's calculation. AEM
16 also assessed demand charges as expenses in its P&L statements that Staff then restated as
17 profits. Based on these corrections, Staff proposed an adjustment of (\$349,015) for the
18 Hannibal area and an adjustment of (\$13,964) for the Butler area. These adjustments account
19 for the profits earned by AEM on its gas supply deal with Atmos the LDC. Profits are
20 disallowed because LDC's do not mark up the price of gas to their customers. What is to be
21 passed through in the PGA charge is the actual invoiced cost of gas. If Atmos had purchased
22 the gas itself, instead of through its affiliate, the actual cost of the gas, without profit, would
23 be the basis for the Purchased Gas Adjustment charge to customers.

1 The AEM information that Atmos provided to Staff was mainly limited to a
2 spreadsheet that showed AEM's characterization of the revenues and costs associated with the
3 Missouri affiliated gas deals. The chief reason why Staff has inquired into the fair market
4 value of the gas supplies that AEM provided to Atmos (the LDC) is that it is possible for
5 AEM to use high risk interruptible or spot gas, in addition to interruptible transportation, to
6 fulfill its firm service obligation with Atmos the LDC. Staff can not discern from AEM's
7 analysis whether AEM's obligations to Atmos were fulfilled by firm or interruptible supplies
8 to the LDC.

9 Q. Why do you make this distinction?

10 A. The fair market value for firm gas supplies is different from the market value
11 for interruptible or spot gas supplies with interruptible transportation.

12 One of Staff's concerns in this ACA case is the large number of transactions between
13 Atmos (the LDC) and its unregulated marketing affiliate AEM. Though SEMO is the largest
14 district, Atmos did not award most of its business to AEM. That is not, however, the case
15 with most of the other Atmos Missouri service areas (Butler, Greeley, Hannibal/ Canton).

16 The end result of Atmos' RFP process is that Atmos awarded the majority of its
17 Missouri gas purchasing business to AEM. Further serious doubt regarding the prudence of
18 the transactions between Atmos and AEM is raised by AEM's P&L spreadsheet because it
19 shows AEM's fair market value for gas supply was less than what it charged its regulated
20 parent Atmos. This means that AEM has profited Atmos' shareholders to the detriment of
21 Atmos' captive ratepayers.

22 Q. Why do arms-length transactions presumed to show fair market value but
23 affiliate transactions do not?

1 A. Arms-length transactions are between two separate entities each with their own
2 interests driving the transaction. In contrast, the transactions between Atmos and AEM are
3 not “arms-length” transactions. AEM and Atmos share limited resources on access to liquidity
4 and counterparty credit exposures. The same cannot be said for unaffiliated transactions.
5 At some point in Atmos’ organizational structure, there is common oversight of both Atmos
6 the LDC operations and the operations of AEM. These companies share a corporate parent
7 that is interested in benefitting the unregulated operations. The same cannot be said of
8 unaffiliated transactions. For example, unlike dealings between Atmos and an unaffiliated
9 third party such as BP, Conoco Phillips, or some other supplier, the nature and design of
10 compensation and bonuses can have a bearing on both Atmos and AEM’s common
11 transactions. For example, the time and quantity of day to day nominations can influence the
12 profitability of affiliated AEM and Atmos transactions. That is not the case with unaffiliated
13 transactions. Because affiliate transactions are not done at “arms length”, Atmos must provide
14 to Staff more thorough and clearly identified documentation in support of the deals Atmos
15 made with AEM and the deals AEM made with its suppliers. This documentation would
16 allow Staff to more thoroughly evaluate the fair market value of those transactions. Based
17 upon Staff’s experience with discovery in this and the previous case, it became apparent that
18 extraordinary measures are going to be required to obtain additional AEM information
19 regarding the affiliated transactions. As in the previous case, the Staff based its disallowance
20 in this case on the best information it had available at the time it filed its recommendation.
21 Staff intends to conduct further inquiry of these affiliated transactions based on Atmos' direct
22 testimony.

1 Q. How are issues of pay structure and executive compensation relevant to this
2 case?

3 A. The issue regarding the alignment of Atmos and AEM management interests
4 through a common compensation structure is illustrated by EXCERPTS from Atmos Energy
5 Corporation's 2009 Proxy Statement. As it relates to this testimony, Atmos describes in its
6 Proxy Statement that earnings are a key driver in setting incentive compensation for Atmos
7 executive management and that AEM earnings impact Atmos earnings.

8 Annual Incentive Compensation. We believe it is important to provide
9 our named executive officers with a financial incentive to maximize the
10 Company's financial performance each year. Through our Annual
11 Incentive Plan for Management ("Incentive Plan"), we provide our
12 named executive officers, along with other officers, division presidents
13 and other key management employees, an opportunity to earn an annual
14 bonus based upon the Company's actual financial performance each
15 year. The Incentive Plan, which has been designed to comply with
16 Section 162(m) of the Internal Revenue Code, is based on our ability to
17 achieve a target level of earnings per share ("EPS") each year. The
18 EPS performance measurement is the lynchpin of both our annual and
19 long-term compensation programs. The HR Committee believes that
20 EPS is the most appropriate measurement of our financial performance
21 both on an annual and long-term basis, as it reflects the growth of both
22 our regulated and nonregulated operations. EPS is also one of the most
23 well-known measurements of overall financial performance, which is
24 commonly used by financial analysts as well as the investing public.
25 The committee believes that utilization of this measurement as the basis
26 for our incentive compensation programs aligns the interests of the
27 participants in the Incentive Plan and the LTIP, including our named
28 executive officers, with the interests of our shareholders (*emphasis*
29 *added*).

30 The target EPS goal also took into account earnings expected from our
31 nonregulated operations, including earnings from the provision of
32 natural gas management and marketing services to municipalities, other
33 local gas distribution companies and industrial customers as well as the
34 provision of natural gas transportation and storage services to certain of
35 our natural gas distribution divisions and third parties (*emphasis*
36 *added*).

1 There can be no doubt that Atmos management has a strong interest in maximizing the profits
2 of its non-regulated operations that provide gas supply services to its regulated LDC
3 operations

4 Q. Are you aware of whether Atmos conducts affiliated transactions with AEM in
5 other states?

6 A. Yes. In addition the Staff has monitored recent Atmos' transactions with AEM
7 in the states of Tennessee, Georgia, Kansas, Virginia, and Illinois where Atmos provides
8 regulated gas service.

9 **FAIR MARKET VALUE AND CHOICE OF TYPES OF GAS SUPPLY**

10 Q. Are there any other issues regarding how Atmos chooses its gas supply and the
11 implications of those decisions on fair market value?

12 A. A major policy issue related to Atmos' RFP process and the determination of
13 fair market value is the question of how AEM's choice of gas suppliers and types of supply,
14 and the risk inherent in those types of supply, may impact the prices paid by Atmos'
15 customers. This raises serious questions upon examining the prudence of these decisions.
16 For example, are the AEM suppliers the same suppliers that lost the bid in the original Atmos
17 RFP process? If the AEM suppliers are different than the suppliers bidding into the Atmos
18 RFP process, then why is that? Without answers to these questions, then Staff's examination
19 of the prudence of Atmos' gas supply decisions is thwarted and incomplete.

20 As an illustration, consider the following example. Assume that suppliers A, B,
21 and C, are simply not bidding into Atmos' RFP, but they routinely supply AEM. Are those
22 suppliers not on Atmos' approved list as creditworthy suppliers? Are those suppliers on
23 AEM's creditworthy counterparty list? In examining the prudence of Atmos purchases, Staff

1 can not overlook that Atmos' gas supply department and AEM brokers are dealing with the
2 same gas suppliers and the same transportation markets. AEM makes money on buying
3 gas more cheaply than it sells it. AEM's profits go to Atmos' shareholders. In turn, Atmos
4 (the LDC) passes its gas costs to the ratepayer. Staff's concern becomes whether Atmos and
5 AEM are truly dealing fairly so that the captive ratepayers are assured Atmos makes its best
6 efforts to obtain the lowest possible cost for firm gas supplies for consumers.

7 Q. Does this conclude your direct testimony?

8 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of PGA/ACA filing of Atmos)
Energy Corporation for the West Area (Old) Case No. GR-2008-0364
Butler), West Area (Old Greeley), Southeastern)
Area (Old SEMO), Southeastern Area (Old)
Neelyville), Kirksville Area, and in the)
Northeastern Area)

AFFIDAVIT OF DAVID M. SOMMERER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)


David M. Sommerer, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 14 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.



David M. Sommerer

Subscribed and sworn to before me this 12th day of March, 2010.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 08, 2012
Commission Number: 08412071



Notary Public

CASES WHERE TESTIMONY WAS FILED

DAVID M. SOMMERER

COMPANY	CASE NO.	ISSUES
Missouri Gas Energy	GR-2009-0355	PGA tariff
Laclede Gas Company	GT-2009-0026	Tariff Proposal, ACA Process
Missouri Gas Utility	GR-2008-0060	Carrying Costs
Laclede Gas Company	GR-2007-0208	Gas Supply Incentive Plan, Off-system Sales, Capacity Release
Laclede Gas Company	GR-2005-0284	Off-System Sales/GSIP
Laclede Gas Company	GR-2004-0273	Demand Charges
AmerenUE	EO-2004-0108	Transfer of Gas Services
Aquila, Inc.	EF-2003-0465	PGA Process, Deferred Gas Cost
Missouri Gas Energy	GM-2003-0238	Pipeline Discounts, Gas Supply
Laclede Gas Company	GT-2003-0117	Low-Income Program
Laclede Gas Company	GR-2002-356	Inventory, Off-System Sales
Laclede Gas Company	GR-2001-629	Inventory, Off-System Sales
Laclede Gas Company	GR-2001-387	ACA Price Stabilization
Missouri Gas Energy	GR-2001-382	ACA Hedging/Capacity Release
Laclede Gas Company	GT-2001-329	Incentive Plan
Laclede Gas Company	GO-2000-394	Price Stabilization
Laclede Gas Company	GT-99-303	Incentive Plan
Laclede Gas Company	GC-99-121	Complaint PGA
Laclede Gas Company	GR-98-297	ACA Gas Cost
Laclede Gas Company	GO-98-484	Price Stabilization
Laclede Gas Company	GR-98-374	PGA Clause
Missouri Gas Energy	GC-98-335	Complaint Gas Costs

COMPANY	CASE NO.	ISSUES
United Cities Gas Company	GO-97-410	PGA Clause
Missouri Gas Energy	GO-97-409	PGA Clause
Missouri Gas Energy	GR-96-450	ACA Gas Costs
Missouri Public Service	GA-95-216	Cost of Gas
Missouri Gas Energy	GO-94-318	Incentive Plan
Western Resources Inc.	GR-93-240	PGA tariff, Billing Adjustments
Union Electric Company	GR-93-106	ACA Gas Costs
United Cities Gas Company	GR-93-47	PGA tariff, Billing Adjustments
Laclede Gas Company	GR-92-165	PGA tariff
United Cities Gas Company	GR-91-249	PGA tariff
United Cities Gas Company	GR-90-233	PGA tariff
Associated Natural Gas Company	GR-90-152	Payroll
KPL Gas Service Company	GR-90-50	Service Line Replacement
KPL Gas Service Company	GR-90-16	ACA Gas Costs
KPL Gas Service Company	GR-89-48	ACA Gas Costs
Great River Gas Company	GM-87-65	Lease Application
Grand River Mutual Tel. Company	TR-87-25	Plant, Revenues
Empire District Electric Company	WR-86-151	Revenues
Associated Natural Gas Company	GR-86-86	Revenues, Gas Cost
Grand River Mutual Telephone	TR-85-242	Cash Working Capital
Great River Gas Company	GR-85-136	Payroll, Working Capital
Missouri-American Water Company	WR-85-16	Payroll

DEFINITION OF TERMS

Some basic terminology is necessary to explain the AEM calculation and Staff's subsequent adjustments to the AEM worksheet.

AMA or Asset Management Agreement often means a contract where the Local Distribution Company turns over its gas transportation and storage contracts to an outside vendor with the goal of maximizing the use of the idle capacity.

Supply-only agreement typically means an outside vendor has agreed to provide supply, sometimes the entire supply, but is not borrowing the LDCs transportation and storage contracts.

Baseload gas generally refers to gas that is pre-ordered and flows every day of the month on an equal basis.

Daily gas usually means gas that is sought out on short notice and may only flow for one or a few days.

Swing gas usually means gas that can be called upon on short notice and may only flow for a few days, if at all.

Spot gas often means gas that is purchased day to day, with little advance notice and may or may not be available.

First of Month (FOM) index pricing usually refers to a practice of setting a gas price based upon a monthly published price that is in effect for an entire month. The price itself is usually composed a sample of actual monthly transactions.

Gas Daily Average (GDA) index pricing typically refers to a published price that is applicable to a particular day.

NYMEX price refers to a price set by the futures market as traded on the New York Mercantile Exchange.

Demand Fee or charge often refers to a fixed fee that is paid to reserve gas supply and might be based upon the maximum daily quantity of gas reserved.

Field Zone transportation usually refers to the part of an interstate pipeline's transportation system that is close to the wellhead or supply basins.

Market Zone transportation refers to the part of an interstate pipeline system that is closer to the market or demand areas that a pipeline serves.

Upstream and Downstream refers to how close to the production or supply area the pipeline is. The upstream part of a pipeline is closer to the production area or field zone area, while the downstream part of a pipeline generally refers to the market area.

P&L – Profit & Loss of a particular deal or transaction. Revenues minus costs

WACOG – Weighted Average Cost of Gas, usually meaning various packages of gas at various prices weighted by their associated volumes.

HAVEN – A demarcation between the field zone and the market zone on the Panhandle Eastern Pipeline Company (PEPL) system.

NAESB – North American Energy Standards Board, a gas standards developer for many of the common contracting and transportation standards used in the gas industry

NAESB base agreement – standardized contract developed by NAESB

Firm Service – This is a form of gas or transportation service that is higher in priority than interruptible, and usually is the last to be curtailed.

Interruptible Service – A form of gas or transportation service that is usually less expensive than firm service and is a lower priority of service.

Basis – A price difference between different gas supply areas.

Supply Basin – A gas supply area or region

SCHEDULE 3

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY