

IN THE SUPREME COURT OF THE STATE OF MISSOURI

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STATE ex rel. OFFICE OF THE PUBLIC)	
COUNSEL,)	
)	
Appellant,)	
)	
v.)	
)	
PUBLIC SERVICE COMMISSION OF)	Case No. SC92964
THE STATE OF MISSOURI,)	
)	
Respondent.)	
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**SUBSTITUTE BRIEF OF RESPONDENT PUBLIC SERVICE
COMMISSION IN RESPONSE TO SUBSTITUTE BRIEF FILED BY
OFFICE OF THE PUBLIC COUNSEL**

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Jurisdictional Statement

This case is before the Court on the Office of the Public Counsel's (Public Counsel) application for transfer under Missouri Supreme Court Rule 83.04. The Court granted transfer following an opinion by the Court of Appeals for the Western District (Western District) affirming a report and order issued by the Public Service Commission of the State of Missouri (Commission). The Commission's report and order found that Public Counsel had not overcome the presumption that Atmos Energy Corp. (Atmos) had acted prudently in its gas procurement practices.

Public Counsel appealed the Commission's decision directly to the Western District under Section 386.510, RSMo (2000) (West 2013). Atmos intervened as a respondent in the appeal. After the Western District affirmed the Commission's report and order, Public Counsel sought rehearing by the appellate court or a transfer to this Court. The Western District denied both rehearing and transfer. This Court ordered transfer to this Court. Jurisdiction is proper under Art. V, Sec. 10 of the Constitution of Missouri.

Statement of Facts

The Commission is responsible for the regulation of gas corporations in Missouri under Section 386.250.1, RSMo (2000). At the times relevant to this appeal, Atmos was a gas corporation regulated by the Commission. (L.F., p. 1358).¹ Public Counsel is the state

¹In 2012, Atmos sold its assets in Missouri to Liberty Utilities. (Commission Case No. GM-2012-0037).

agency that represents the interests of utility ratepayers in cases before the Commission and on appeal of Commission cases under Section 386.710, RSMo (2000).

Atmos acted as a local distribution company (LDC). (L.F., p. 1343). Atmos bought natural gas from gas suppliers and distributed the natural gas to its retail customers in Missouri. (L.F., p. 1343). Atmos does not produce gas and it does not buy gas directly from gas producers. (L.F., p. 1344). To serve its customers in Missouri, Atmos contracted with independent gas marketing companies to purchase natural gas which was then transported over interstate natural gas pipelines using its pipeline capacity. (L.F., p. 1344). Atmos held long-term contracts with various interstate pipelines for natural gas storage and transportation capacity to supply the firm natural gas requirement of its Missouri service areas. (L.F., p. 1344).

Atmos used independent natural gas suppliers to purchase its natural gas because it does not have the in-house expertise necessary to perform the functions necessary to perform the functions performed by the independent suppliers. (L.F., p. 1344). Atmos would have had to hire and train additional employee at great cost if it performed gas-purchasing functions itself. (L.F., p. 1345). The Commission found that Atmos best used its resources by focusing on its core area of competency, which was distributing natural gas to its customers. (L.F., p. 1345). Whether Atmos did its own gas marketing or not, the actual price of the gas and the gas transportation costs would be the same because those costs are determined by the market. (L.F., p. 1345).

The Commission's Staff (Staff) did not seek to disallow any of Atmos's gas costs associated with acquiring its gas supply by using non-affiliated independent gas

marketing companies. (L.F., p. 1346). Staff sought to disallow \$308,733 of costs for the Hannibal service area, for a contract that had been awarded to Atmos Energy Marketing, LLC (AEM). (L.F., p. 1342).² Staff's only true concern was with transactions between Atmos and AEM. (L.F., p. 1346). The Commission found that Atmos's fully distributed cost of providing gas marketing services through its own employees would be higher than the market price for those services as established in a competitive bidding process. (L.F., p. 1346).

In its competitive bidding process for gas marketing services, Atmos issued a request for proposal (RFP). (L.F., p. 1346). Interested parties submitted bids. (L.F., p. 1346). Atmos reviewed the bids and awarded the contract to the party that offered the best bid for reliable supply at the least cost. (L.F., p. 1346).

Atmos used this competitive bidding process for each of its eight Missouri service areas. (L.F., p. 1347). During the 2007-2008 Actual Cost Adjustment (ACA) period, Atmos awarded two contracts to its affiliate AEM. (L.F., p. 1347). The contracts awarded to AEM were for the Butler and Hannibal/Bowling Green service areas. (L.F., p. 1347). The other contracts were awarded to non-affiliated gas marketing companies. (L.F., p. 1347).

² Staff also initially proposed a disallowance for the Butler service area, the second contract awarded to AEM, but later withdrew its proposed disallowance because it was found that AEM actually lost money on the contract. (L.F., p. 1342).

For the period of 2004-2009, Atmos issued 48 RFPs for its Missouri gas supply. (L.F., p. 1347). AEM submitted the successful bid six times. (L.F., p. 1348). That number is consistent with the number of successful bids submitted by unaffiliated gas marketers. (L.F., p. 1347).

For the ACA period at issue, there were two overlapping RFP processes. (L.F., p. 1347). For the first RFP process, there were six unaffiliated bidders. (L.F., p. 1347). AEM submitted the lowest conforming bids. (L.F., p. 1347). The lowest conforming bid submitted by a non-affiliate was approximately \$346,000 higher than the bid submitted by AEM. (L.F., p. 1348). Staff's witness indicated at the hearing that he did not believe Atmos should have accepted the higher bid of the non-affiliate instead of the lower bid from AEM. (L.F., p. 1348). The actual cost paid to AEM under the contract was even lower than the amount of the bid. (L.F., p. 1348). Based on actual costs, Atmos paid less under its contract with AEM than it would have paid if had accepted a bid from a non-affiliate. (L.F., p. 1348).

AEM also submitted the lowest bid for the second RFP process at issue here. (L.F., p. 1348). The difference between the AEM bid and the lowest bid from a non-affiliate was slightly over \$100,000. (L.F., p. 1348).

The Commission found that the "fair market value" of the gas procured to serve ratepayers "can be defined as a price that a seller is willing to accept and a buyer is willing to pay on the open market in an arms' length transaction." (L.F., p. 1348). Staff and Public Counsel argued that this definition should not have been used here because transactions between Atmos and AEM are not arms' length transactions. (L.F., p. 1349).

Staff requested to audit AEM's records to determine the fair market value of the transactions. (L.F., p. 1349). Because AEM could not produce the records that Staff claimed it needed, Staff recommended disallowance of all the gross profits AEM earned on the transactions. (L.F., p. 1349).

The Commission rejected the argument put forward by Staff and Public Counsel because of the existence of the competitive bidding process. (L.F., p. 1349). "If AEM had not submitted a bid, or if had not submitted the lowest bid, there would be no question that the bidding process established the fair market value of the transaction." (L.F., p. 1349). Staff did not propose any disallowances based on any of the Missouri gas supply contracts where the lowest and best bid was submitted by a non-affiliate. (L.F., p. 1349). Staff agreed that the competitive bidding process would establish the fair market value for those transactions. (L.F., p. 1349).

"Assuming that the bidding process was fair and open, and no party has presented evidence to establish a serious doubt about the fairness of the bidding process, that bidding process established the fair market value for the affiliate transactions, just as it did for transactions with non-affiliated gas marketing companies." (L.F., p. 1349). The competitive bidding process ensured that Atmos (and ultimately its ratepayers) did not pay more for gas marketing services from its affiliate than it would have paid for those services provided by a non-affiliate. (L.F., p. 1349). The Commission found that without some indication of unfairness or a tendency to favor the affiliate in the competitive bidding process or some facts to establish some doubt about the bidding process itself,

there was no reason for the Staff to look beyond the bidding process to establish the fair market value of the transactions. (L.F., pp. 1349-50).

When it sent out its RFP for Missouri gas supplies, Atmos specified that “[a]ll gas supply is to be **firm and warranted** assuring that natural gas supply services will meet all contractual obligations without fail.” (L.F., p. 1351) (Emphasis in the original Atmos RFP). The RFP allowed bidders to use either a primary natural gas receipt point between Haven, Kansas or a secondary in-path receipt point between Haven and Atmos’s service area. (L.F., p. 1351). AEM chose to use a secondary receipt point in Louisburg, Kansas as allowed by the RFP. (L.F., p. 1351).

Primary firm delivery is the highest priority gas supply. (L.F., p. 1351). Secondary in-path delivery is just below primary firm delivery. (L.F., p. 1351). Although the Atmos RFP process requires firm gas supply, Staff and Public Counsel raised a concern that AEM possibly provided less than firm gas supply to Atmos. (L.F., p. 1352). “Staff points to several transaction confirmation documents for the period in which the statement service level under the contract was left blank as an implication that AEM was allowed to deliver less than firm gas.” (L.F., p. 1352). A witness from Atmos denied the implication. (L.F., p. 1352).

The Commission found that ratepayers benefited from the affiliate transaction because they would have had to pay higher costs if Atmos had accepted the gas supply bid of a non-affiliate. (L.F., p. 1365). The Commission found that Atmos was able to meet the gas needs of its customers at all times during the relevant contract periods and the no customer’s service was curtailed during that time. (L.F., p. 1356). There was no

demonstrable harm to ratepayers as a result of the gas supply agreement between Atmos and AEM. (L.F., p. 1367).

The Commission found that the record-keeping requirements of the affiliate transactions rules do not require AEM to keep records sufficient to allow Staff to determine the fair market value of gas supplies charged to Atmos when there is a competitive bidding process in place. (L.F., p. 1361). The Commission found that “no such gas supply costs have been charged to Atmos within the meaning of the regulation.” (L.F., p. 1361).

The Commission found that the record-keeping requirements relied on by Staff and Public Counsel apply to records about the allocation of costs common to both a regulated utility and its unregulated affiliate. (L.F., p. 1362). As an example, the Commission cited the regulated utility and its affiliate sharing the services of an outside accountant, where a portion of the total cost would be assigned to each entity using the accounting services. (L.F., p. 1362). “Those record-keeping requirements do not contemplate a situation where an affiliated company has simply sold a product to the regulated entity at a fair market price determined through an above-board competitive bidding process.” (L.F., p. 1362). Staff’s witness testified at the hearing that he did not know of any provision of the affiliate transaction rules that would require an affiliate such as AEM to maintain records that would allow Staff to determine the affiliate’s profits per transaction. (L.F., p. 1362).

The fair market price of gas marketing services is not set by any review of documents by Staff. (L.F., p. 1364). AEM does not even maintain the transactional

documents sought by Staff, nor is it required to. (L.F., p. 1364). The fair market price was established by the RFP process. (L.F., p. 1364). In some cases, but not all, the lowest and best bid was submitted by an affiliate. (L.F., p. 1364).

“Staff did not present any serious argument to suggest that Atmos could provide gas-marketing services for itself cheaper than if it did not use the services of gas marketing companies.” (L.F., p. 1363). Staff’s witness conceded that it did not propose any disallowance based on Atmos’s fully distributed cost. (L.F., p. 1363). There was no evidence that the competitive bidding process was adequate when Atmos contracted with unaffiliated companies but inadequate when it contracted with an affiliate. (L.F., p. 1364). “If it is less expensive for Atmos to purchase gas supplies through non-affiliated gas-marketing companies than to maintain its own staff of gas buyers, then there is no basis to believe that it should maintain such a staff of buyers only to avoid awarding a contract to its affiliated marketing company when that company happens to submit a bid lower than the bids submitted by the unaffiliated companies.” (L.F., p. 1364). The report and order does not show that Public Counsel presented independent evidence on this issue; only that Public Counsel supported Staff’s position. (L.F., pp. 1364-65).

Public Counsel filed a timely application for rehearing from the report and order. (L.F., pp. 1372-73). The Commission denied the application for rehearing. (L.F., pp. 1374-75). Public Counsel filed a timely notice of appeal to the Western District. (L.F., pp. 1377-84). The Western District affirmed the report and order. This Court accepted Public Counsel’s application for transfer.

Point Relied On

- I. The Commission’s report and order must be affirmed because it is lawful and reasonable within the meaning of Section 386.510, RSMo (2000) (West 2013) in that the report and order does not violate the affiliate transactions rule and it is based on competent and substantial evidence upon the whole record. (Responds to Point I of Public Counsel’s Points Relied On).**

Statutes

Section 386.500, RSMo (2000)

Section 386.510, RSMo (2000) (West 2013)

Section 393.130, RSMo (2000) (West 2013)

Section 393.140, RSMo (2000)

Cases

State ex rel. Atmos Energy Corp. v. Pub. Serv. Comm’n, 103 S.W.3d 753 (Mo.banc 2003)

State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm’n, 954 S.W.2d 520 (Mo. Ct. App. W.D. 1997)

Atmos Energy Corp. v. Office of Pub. Counsel, 389 S.W.3d 224 (Mo. Ct. App. W.D. 2012)

Regulations

4 C.S.R. 240-40.015

4 C.S.R. 240-40.016

Argument

- I. The Commission’s report and order must be affirmed because it is lawful and reasonable within the meaning of Section 386.510, RSMo (2000) (West 2013) in that the report and order does not violate the affiliate transactions rule and it is based on competent and substantial evidence upon the whole record.**

Standard of Review

On appeal of an order issued by the Commission, the reviewing court must determine whether the order is lawful and reasonable. Section 386.510, RSMo (2000) (West 2013). An order is lawful if the Commission’s actions were authorized by statute. *State ex rel. MoGas Pipeline, LLC v. Pub. Serv. Comm’n*, 366 S.W.3d 493, 495 (Mo.banc 2012) (internal citations omitted). Legal issues are reviewed *de novo*. *Id.* at 496. To be reasonable, the order must be supported by competent and substantial evidence. *Id.* The order must not be arbitrary and capricious and the order must not be an abuse of the Commission’s discretion. *Id.* The reviewing court does not reweigh the evidence and defers to the factual findings of the agency. *State ex rel. Ag Processing, Inc. v. Pub. Serv. Comm’n*, 120 S.W.3d 732, 735 (Mo.banc 2003). The Commission is entitled to the benefit of all reasonable inferences. *Id.*

A. The report and order complies with the affiliate transactions rules.

A public utility may have affiliates that engage in activities that are not subject to the

Commission's jurisdiction as long as those activities are kept "substantially separate" from the regulated activities of the public utility. Section 393.140(12), RSMo (2000). The Commission may adopt rules to ensure that a regulated utility does not grant any preferential treatment to an affiliate. *Id.* The Commission retains its authority over the regulated activities of the utility, including its ability to fairly apportion "capitalization, earnings, debts and expenses" between the regulated and unregulated affiliates. *Id.* The Commission's final orders of rulemaking adopting its affiliate transactions rules were upheld on appeal. *State ex rel. Atmos Energy Corp. v. Pub. Serv. Comm'n*, 103 S.W.3d 753, 765 (Mo.banc 2003). Properly adopted administrative rules are binding on the agency that adopted them. *State ex rel. Martin-Erb v. Mo. Comm'n on Human Rights*, 77 S.W.3d 600, 607 (Mo.banc 2002).

The affiliate transactions rules provide that a regulated gas corporation must obtain competitive bids when it purchases goods or services from an affiliate, unless the regulated utility demonstrates competitive bids were unnecessary. 4 C.S.R. 240-40.015(3)(A); 4 C.S.R. 240-40.016(4)(A). The Commission adopted 4 C.S.R. 240-40.016, entitled Marketing Affiliate Transactions, to govern certain transactions between regulated utilities and their marketing affiliates. The "asymmetrical pricing standard" set out in the rule is a proper exercise of the Commission's rulemaking authority under Section 393.140(11). *Atmos Energy Corp.*, 103 S.W.3d at 763. The rule provides for a "fair market price" that is the maximum price that a regulated utility may compensate its affiliate for the affiliate's goods or services and a minimum price that a regulated utility must charge an affiliate for providing goods or services to the affiliate. *Id.*

The rules also set out the “fully distributed cost.” 4 C.S.R. 240-40.015(1)(F).”

“Fully distributed cost” is defined as follows:

(F) Fully distributed cost means a methodology that examines all costs of an enterprise in relation to all the goods and services that are produced. FDC requires recognition of all costs incurred directly or indirectly used to produce a good or service. Costs that cannot be directly assigned or indirectly allocated (e.g., general and administrative) must also be included in the FDC calculation through a general allocation.

4 C.S.R. 240-40.015(1)(F). To avoid providing a financial advantage to an affiliate, a regulated utility may only compensate the affiliate at the lesser of the fair market price or the fully distributed cost of the good or service received. 4 C.S.R. 240-40.016(3)(A).³

Here, Atmos had to compensate AEM for gas-marketing services at the lower of the fair market value or the fully distributed cost of providing those services. The Commission found that Atmos’s fully distributed cost of providing gas marketing services through its own employees would be higher than the market price for those services as established in a competitive bidding process. (L.F., p. 1346). In some cases, an affiliate of AEM made the lowest bid for the provision of gas marketing services that Atmos could not cost-effectively provide for itself. (L.F., p. 1347). Acceptance of the AEM bids for the Hannibal/Bowling Green service area was appropriate under the fully distributed cost component of the affiliate transactions rule. Neither Staff nor Public

³ See also, 4 C.S.R. 240-40.015(2)(A).

Counsel sought disallowance of any costs based on Atmos's practice of contracting for gas marketing services rather than providing those services in-house. (L.F., p. 1349).

Neither Staff nor Public Counsel raised any objection to the use of gas marketing services from unaffiliated companies. (L.F., p. 1349).

The Commission found that the fair market value of the transactions in this case was established by the competitive bidding process Atmos used to obtain Missouri gas supply contracts. (L.F., p. 1349). The competitive bidding process established the fair market value of both the affiliate and the non-affiliate transactions during the relevant ACA period. (L.F., p. 1349). Because of the competitive bidding process, Atmos paid less for gas marketing services provided by an affiliate than it would have paid for the same services provided by a non-affiliate. (L.F., p. 1349). There was nothing in the record to indicate that there was any tendency for Atmos to favor its affiliate in the bidding process. (L.F., pp. 1349-50). There is also nothing in the record to show that there was any reason to doubt the bidding process itself. (L.F., p. 1350). In the absence of any evidence of irregularity, the Commission found that the Staff did not have any reason to look beyond the competitive bidding process to establish the fair market value of the transactions. (L.F., p. 1350). The fair market value component of the marketing affiliate transactions rule is satisfied.

The evidence in the record shows that the affiliate transactions in this case satisfied the standards set out in the affiliate transactions rule. The Commission's decision to reject the disallowance proposed by Staff and Public Counsel was lawful under both Section 393.140(12) and 4 C.S.R. 240-40.016. The report and order is

reasonable because it is based on substantial and competent evidence. The report and order must be affirmed on this point.

B. The record evidence shows that Atmos acted prudently in its transactions with AEM.

As a prerequisite to seeking judicial review, a party seeking such review must file an application for rehearing before the Commission. Section 386.500, RSMo (2000). “Such application shall set forth specifically the ground or grounds on which the applicant considers such orders to be unlawful, unjust or unreasonable. The applicant shall not in any court urge or rely on any ground not so set forth in the application for rehearing.” Section 386.500.2, RSMo (2000). An application for rehearing must be thorough, or the applicant risks waiving any grounds that do not appear in the application. *State ex rel. Pub. Counsel v. Pub. Serv. Comm’n*, 236 S.W.3d 632, 636 (Mo.banc 2007).

The application for rehearing filed by Public Counsel in this case is non-specific. Public Counsel alleges generally that the report and order is unlawful and unreasonable. (L.F., pp. 1372-73). The application for rehearing also states generally that the report and order is not supported by sufficient findings of fact. (L.F., pp. 1372). The application for rehearing does not specifically identify the issue of whether the gas supply contracts between Atmos and AEM were for firm gas supplies or interruptible gas supplies or how the nature of the gas supply contracts might affect the lawfulness or reasonableness of the report and order. Although the issue of the nature of the gas supply contracts is not properly before the Court, the Commission will address the issue on the merits.

Rates must be just and reasonable. Section 393.130.1, RSMo (2000) (West 2013). For natural gas utilities, gas costs are a component of rates that must be just and reasonable. *State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n*, 954 S.W.2d 520, 530 (Mo. Ct. App. W.D. 1997). In reviewing a natural gas corporation's recovery under its purchased gas adjustment/actual cost adjustment for gas costs, the Commission applies a prudence standard. *Id.* at 528. Under that prudence standard, there is a presumption that the utility has acted prudently. *Id.* If another party raises a serious doubt about the prudence of the utility's actions, the burden of proof shifts to the utility to show that it has acted prudently. *Id.* The standard is not based on hindsight, but on a reasonableness standard. *Id.* To disallow recovery, the Commission must find both that the utility acted imprudently and that the utility's imprudence harmed ratepayers. *Associated Natural Gas*, 954 S.W.2d at 530.

This prudence standard was applied in *Associated Natural Gas*, where the transactions at issue were transactions between affiliates. *Id.* at 522. In a case involving electric utilities, the court rejected the argument that the adoption of the affiliate transactions rule had shifted the burden of proof to the utility in cases where transactions between affiliates were involved. *State ex rel. Pub. Counsel v. Pub. Serv. Comm'n*, 274 S.W.3d 569, 578 (Mo. Ct. App. W. D. 2009). Both the affiliate transaction rule governing natural gas utilities and the affiliate transaction rule governing electric utilities have identical language providing that the affiliate transactions rules do not modify the legal standards regarding which party has the burden of proof in Commission proceedings. *Id.* See also, 4 C.S.R. 240-40.015(6)(C) and 4 C.S.R. 240-40.016(7)(C).

The Western district decided a closely related case about the transactions between Atmos and AEM during a different purchased gas adjustment/actual cost adjustment period. *Atmos Energy Corp. v. Office of Pub. Counsel*, 389 S.W.3d 224 (Mo. Ct. App. W.D. 2012). In *Atmos*, the Western District noted that there is no law to support Public Counsel's suggestion that an unregulated affiliate may not earn a profit on a transaction with a regulated affiliate. *Id.* at 232 (quoting *Pub. Counsel v. Pub. Serv. Comm'n*, 2012 WL 4069548 at * 6 (Sept. 18, 2012)). The Western District noted that affiliate transactions can be beneficial to ratepayers:

Assuming the bidding process was fair and open, and no party has presented evidence to establish a serious doubt about the fairness of the bidding process, that bidding process established the fair market value for the affiliate transactions, just as it did for the transactions with non-affiliated gas marketing companies. Because of the bidding process, Atmos, and ultimately the ratepayers, will pay no more for the services of the affiliated gas marketing company than they would have to obtain the same services from an unaffiliated gas marketing company. In effect, it is the non-affiliated gas marketing companies bidding in the open market that establish the fair market value for the bids won by AEM as much as they do for the bids won by non-affiliated bidders. Absent some showing of insider-dealing to favor an affiliate in the bidding process or some showing of facts that cast doubt on the bidding process itself, there is no need for Staff to search behind the bidding process to try to establish an independent fair market value for the transactions,

if any such determination were possible.

Pub. Counsel v. Pub. Serv. Comm'n, 2012 WL 4069548 at *6.

Staff and Public Counsel did not overcome the presumption that Atmos acted prudently. (L.F., p. 1367). The Commission found that no serious doubt about prudence had been raised, so the burden of proof never shifted to Atmos to prove it had acted prudently. The Commission also found that there was no justification for a disallowance of costs because there was no harm to ratepayers. (L.F., p. 1367). In addition to paying a lower rate under the AEM contract than they would have paid under a contract with a non-affiliate, the record also shows that the ratepayers did not suffer any negative consequences as a result of the contract between Atmos and AEM. Whether or not AEM earned a profit on the transaction has no bearing on whether or not Atmos's decision to purchase gas supplies from AEM was prudent. To the contrary, the record shows that AEM supplied the best service to Atmos at the least cost. The contract resulted in a benefit to Atmos ratepayers, who would have had to pay more for gas costs if Atmos had purchased gas supplies from an unaffiliated gas marketer.

Staff and Public Counsel suggest that because the space for the kind of gas service provided was left blank on some documents, it is possible that AEM supplied interruptible gas service instead of firm gas service. (L.F., p. 1352). The record does not support this supposition. The RFP sent out by Atmos clearly states that the type of service required under the contracts was firm and warranted. (L.F., p. 1351). An Atmos witness testified at the hearing that the service provided by AEM was for firm and warranted gas

supply. (L.F., p. 1352). The record does not contain any evidence that AEM supplied less than firm service to Atmos. (L.F., p. 1352).

Under the applicable prudence standard, the Commission's rejection of the cost disallowances proposed by Public Counsel and Staff are both lawful and reasonable. The report and order must be affirmed on this point.

C. Public Counsel misinterprets the documentation requirements of the affiliate transactions rules.

The Commission has the authority to adopt rules to govern transactions between affiliates. Section 393.140(12), RSMo (2000). The Commission's adoption of affiliate transaction rules has been upheld by this Court. *Atmos Energy Corp.*, 103 S.W.3d at 765. Those rules are binding on the Commission. *Martin-Erb*, 77 S.W.3d at 607.

The affiliate transactions rules impose certain record-keeping requirements on regulated utilities and their affiliates. In relevant part, the rules provide as follows:

Each regulated gas corporation shall ensure that its parent and any other affiliated entities maintain books and records that include, at a minimum, the following information regarding affiliate transactions:

1. Documentation of the costs associated with affiliate transactions that are incurred by the parent or affiliated entity and charged to the regulated gas corporation;
2. Documentation of the methods used to allocate and/or share costs between affiliated entities, including other jurisdictions and/or corporate divisions;

3. Description of costs that are not subject to allocation to affiliate transactions and documentation supporting the nonassignment of those costs to affiliate transactions.

4 C.S.R. 240-40.016(6)(A).⁴

The example given by the Commission of the kinds of records that must be kept under the rules are records of shared costs that are allocated between the regulated utility and an affiliate, such as when a service such as an outside accounting service is provided to both the regulated utility and the affiliate. (L.F., p. 1363). These recordkeeping requirements do not require either Atmos or AEM to keep records of the kind requested by Public Counsel and Staff. (L.F., p. 1364). There is no document Staff could review to establish the fair market price for the gas supplies provided by AEM. (L.F., pp. 1364-65). The fair market price is established through the competitive bidding process, not by any specific record kept by Atmos or AEM. (L.F., p. 1364). Staff's witness was unaware of any requirement in the rules that would obligate AEM to keep records that would show the affiliate's profits on a transaction-by-transaction basis. (L.F., p. 1362). Public Counsel's reliance on the record-keeping requirement of the affiliate transactions rule is misplaced.

The Commission's application of the recordkeeping requirements in the affiliate transactions was lawful and reasonable. The report and order must be affirmed on this point.

⁴ Identical language appears in 4 C.S.R. 240-40.015(5)(A).

D. There is substantial and competent evidence in the record to support the Commission's findings on the fully distributed cost issue.

An application for rehearing must set out with specificity the grounds on which the applicant seeks rehearing. Section 386.500.2, RSMo (2000). If the application does not specifically set out the grounds for rehearing, the applicant risks waiving those issues on appeal. *Pub. Counsel*, 236 S.W.3d at 636.

Public Counsel's application for rehearing does not specifically raise its allegation that the report and order is unreasonable because of the Commission's finding that no disallowance was sought under Staff's position on the fully distributed cost for Atmos to contract for gas supply services rather than providing those services in-house. Although the issue of whether the Commission reasonably refused a disallowance based on Staff's position about the fully distributed cost issue is not properly before the Court, the Commission will address the issue on the merits.

The fully distributed cost is an examination of the cost incurred in producing a good or service in relation to the good or service produced. 4 C.S.R. 240-40.015(1)(F). In a prudence review of a utility's fuel costs, there is a presumption that the utility acted prudently. *Associated Natural Gas*, 954 S.W.2d at 528. If another party raises a serious doubt about the prudence of the utility's conduct, the burden of proof shifts to the utility to prove that it acted prudently. *Id.* To disallow fuel costs under this standard, the Commission must find both that the utility acted imprudently and that the ratepayers were harmed by the imprudence. *Id.*

The presumption here is that Atmos acted prudently when it contracted with AEM and other non-affiliated gas suppliers. Atmos does not have employees who are able to perform gas marketing functions. (L.F., p. 1344). Hiring and training such employees would be very expensive for Atmos. (L.F., p. 1345). It is more efficient for Atmos to focus on natural gas distribution and leave gas marketing services to gas marketing companies that specialize in providing those services. An Atmos witness testified that its fully distributed cost of doing its own gas marketing would exceed the market price of obtaining those services through a competitive bidding process. (L.F., p. 1345).

Staff opined that it was “most remarkable that the largest natural-gas only distributor in the United States (per the company’s website) asserts that it does not have the resources to optimize PGA assets.” (L.F., pp. 1345-46). Staff did not, however, seek to disallow Atmos’s costs associated with getting gas marketing services from non-affiliates. (L.F., p. 1346). Staff also did not seek any disallowance based on a fully distributed costs argument. (L.F., p. 1346). The Commission found that Staff was only concerned with affiliate transactions and not with the utility’s decision to use outside gas marketing services. (L.F., p. 1346). The Commission also found that Atmos’s fully distributed cost of providing its own gas marketing services would be higher than the costs of obtaining those services through a competitive bidding process. (L.F., p. 1346).

Staff and Public Counsel did not meet their burden of raising a serious doubt that Atmos acted prudently by outsourcing its gas marketing needs. “Staff did not present any serious argument to suggest that Atmos could provide gas-marketing services for itself cheaper than if it did not use the services of gas marketing companies.” (L.F., p. 1363).

Staff's witness conceded that Staff did not propose any disallowance based on the company's fully distributed cost of gas marketing services. (L.F., p. 1363). Staff did not present any evidence that would demonstrate that the competitive bidding process was adequate when Atmos contracted with non-affiliates but inadequate when it contracted with an affiliate. "If it is less expensive for Atmos to purchase gas supplies through non-affiliated gas marketing companies than to maintain its own staff of gas buyers, then there is no basis to believe that it should maintain such a staff of buyers only to avoid awarding a contract to its affiliated marketing company when that company happens to submit a bid lower than the bid submitted by the unaffiliated companies." (L.F., p. 1364). The report and order does not reflect that Public Counsel presented any evidence on this issue and relied instead on Staff's evidence. (L.F., pp. 1364-65). Because Staff conceded at the hearing that it was not seeking any disallowance based on the fully distributed cost issue and because Public Counsel did not present any independent evidence on this issue, there was no need for the Commission to develop the record on fully distributed cost any further.

The Commission's finding that the utility's cost for contracting for gas marketing services at market rates was lower than the cost of providing those services for itself is supported by substantial and competent evidence in the record. The records shows that neither Staff nor Public Counsel raised any doubt that was serious enough to overcome the presumption that Atmos acted prudently in its gas purchasing. Because no serious doubt was raised, the burden of proof never shifted to Atmos to prove that its conduct was prudent. Because the report and order is reasonable, it must be affirmed on this point.

Conclusion

For the above reasons, the Commission requests that its report and order be affirmed in all respects. The Commission requests such other relief that the Court deems just.

Respectfully submitted,

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Certificate of Service and Compliance

I hereby certify that the foregoing Respondent's Brief of the Public Service Commission of the State of Missouri complies with the limitations contained in Rule 84.06(c) and that:

- (1) The signature block above contains the information required by Rule 55.03;
- (2) The brief complies with the limitations contained in Rule 84.04(b);
- (3) The brief contains 6,017 words, as determined by the word count feature of Microsoft Word.

I further certify that copies of the foregoing have been served by means of electronic filing to the following counsel of record on this 28th day of March, 2013.

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