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**

INITIAL POST-HEARING 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, as amended by the January 4, 2018 Order Extending Time for Briefs, the Environmental Defense Fund ("EDF") respectfully submits its Initial Post-Hearing 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.[1]

I. INTRODUCTION

Laclede's portfolio planning decisions warrant increased scrutiny from this Commission. Utilities across the country, including Laclede, have taken advantage of an investment strategy to develop pipeline infrastructure whereby they impose natural gas transportation costs on captive retail customers while their affiliate pipeline developers garner returns in excess of risk for the new pipeline build. Under this model, Laclede customers will pay Laclede's affiliate—Spire

[1] EDF's Initial Brief responds to three issues from the November 29, 2017 "List of Issues, Order of Witnesses, Order of Cross-Examination and Order of Opening Statements": (1) Should LAC have new PGA/ACA tariff provisions pertaining to costs associated with affiliated pipeline transportation agreements? (2) Should a working group be created following this rate case to explore ideas for modifying the LAC and MGE CAM? (3) 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? For all other issues not included in this Initial Brief, EDF does not take a position.

STL Pipeline LLC ("Spire STL")—for firm transportation capacity for every hour of every day for the next 20 years on the Spire STL Pipeline, a proposed 66-mile interstate pipeline in Illinois and Missouri. In addition to these reservation fees, Spire STL has requested, and the Federal Energy Regulatory Commission ("FERC") routinely approves, a 14% return on equity for pipeline investment. While it is certainly Spire's prerogative to explore new investment strategies, the pursuit of earnings growth must be balanced against the inherent risk embedded in its affiliate transaction. That risk is clear and present here, where Laclede has committed its ratepayers to a significant and costly long-term contract despite the fact that it cannot demonstrate any new load growth and the St. Louis region already enjoys excess capacity from other pipelines (in fact, Laclede is turning back long-standing capacity on a pipeline serving the same market). The Commission has the opportunity in this proceeding to ensure that sufficient safeguards are in place in order to protect against adverse and avoidable impacts to Laclede's ratepayers.

The evidence in this proceeding unequivocally demonstrates that the current regulatory oversight structures are insufficient in protecting against unreasonable affiliate transportation costs. Some states require utilities to seek prior Commission approval before entering into a long-term transportation contract with an affiliate; Missouri does not. Laclede maintains that the Purchased Gas Adjustment ("PGA")/Actual Cost Adjustment ("ACA") process is sufficient to protect customers because this Commission can disallow costs that were not prudently incurred. Laclede, however, will not seek to recover the costs associated with its affiliate Spire STL agreement through that process until after the pipeline is placed into service (as proposed, likely in the 2019-2020 timeframe). Such retrospective analysis is problematic as it overlooks the economic and environmental harm that will result from building a pipeline that is ultimately not

needed.

The natural gas market has changed significantly since the PGA/ACA process was first implemented in 1962, long before the emergence of risk shifting as a consequence of affiliate transportation agreements. In fact, Laclede's proposal to seek cost recovery of an interstate affiliate transportation agreement through the PGA/ACA process, without any customer protections, would be the first of its kind in Missouri. An approximate $30 million annual cost—for the next 20 years—deserves tailored and significant scrutiny from this Commission.

The Commission's Affiliate Transactions Rule similarly fails to protect ratepayers against the risk of unreasonable costs. While that rule provides certain safeguards, an analysis of whether Laclede has complied with the rule will not occur until after the Spire STL Pipeline has been built. This after-the-fact analysis poses the same problematic concerns as the retroactive PGA/ACA review and ignores the consequences that could arise from building a pipeline that is ultimately not needed, including: use of eminent domain to seize private land; environmental impacts from the construction and operation of the pipeline; increased transportation rates from the affiliate agreement; and the potential downgrading of Spire's parent due to Spire STL's risky investments (which, in turn, could lead to higher borrowing costs for ratepayers). Moreover, Laclede enjoys an inherent informational advantage when it comes to the record-keeping aspects of the Affiliate Transactions Rule. As was demonstrated during the hearing, in the past, Laclede has been less than forthright in providing information and has used confidential designations as an unwarranted shield. In addition, Laclede's Cost Allocation Manual and Gas Supply Standards of Conduct are sorely outdated, failing to recognize the drastic transformation of the Spire corporate structure in the past few years and failing to incorporate consideration of the risk inherent in affiliate transportation transactions. Federal oversight is also no cure, as FERC has

been reluctant to look beneath the terms of precedent agreements, including affiliate agreements, for the requisite market need its Certificate Policy requires. In short, state and federal regulatory structures have not kept pace to ensure sufficient oversight of this emergent affiliate investment strategy, leaving no prudency review of the proposed contract and investment decision until it is too late.

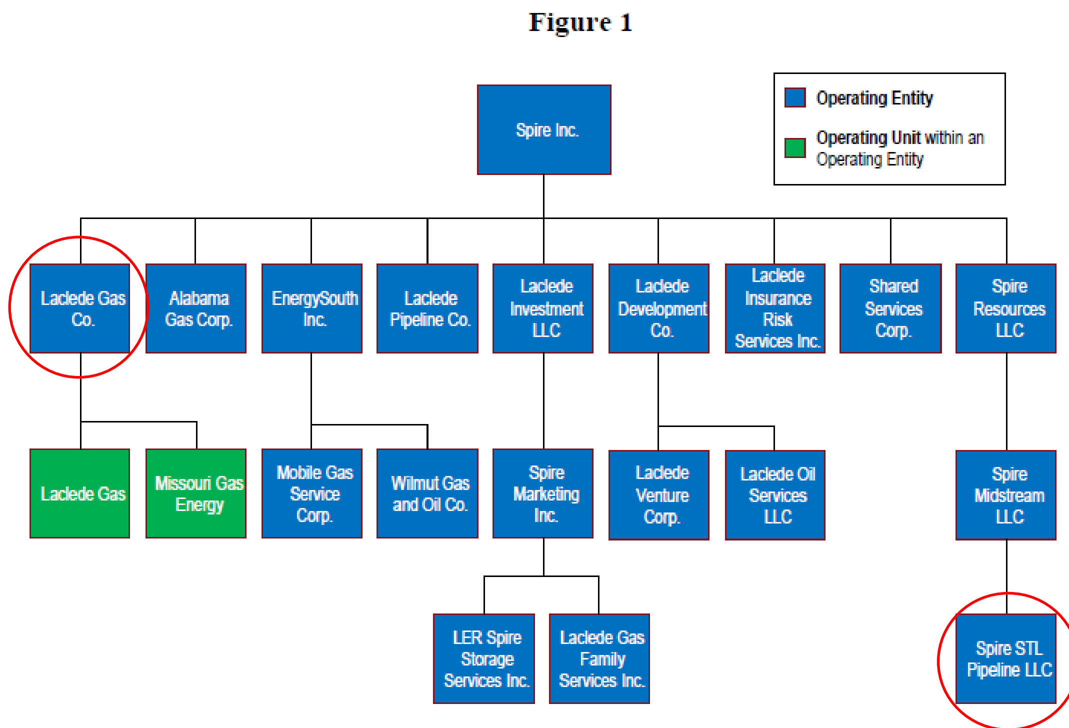
EDF presented the Commission with a new set of regulatory tools to protect against such threats. Its proposed changes to the PGA/ACA tariff would allow for a more quantitative and comprehensive review of Laclede's supply portfolio, assessing the cost-effectiveness of each component in the gas supply portfolio. These changes would, for example, prevent Laclede from seeking to recover the costs associated with 365-day per year capacity paid to an affiliate when all that is needed is capacity to meet a peak winter need. EDF's proposed mechanism ensures that ratepayers will be protected from unreasonable transportation costs, while at the same time providing the Company with notice today as to its anticipated cost recovery.

EDF's proposed changes to Laclede's Cost Allocation Manual make clear that the Standards of Conduct should also apply to natural gas transportation transactions. Today, those standards only refer to gas supply transactions, not transportation. As Laclede's affiliate Spire STL Pipeline continues to explore opportunities to develop new pipeline infrastructure, updated standards are needed to ensure customers are protected. For all of the above reasons, the public interest compels the Commission to ensure sufficient safeguards are in place to protect customers against unreasonable affiliate transportation costs by adopting EDF's proposed changes to the PGA/ACA tariff and Cost Allocation Manual.

II. BACKGROUND

The instant proceeding is the Company's first rate case since 2013. In recent years, Spire's corporate structure has evolved in significant ways. For example, in 2016, Spire, Inc. formed several new entities, including Spire Resources LLC, Spire Midstream, LLC, Spire STL Pipeline LLC.[2] As indicated in the figure below,[3] Spire Inc. now encompasses twenty different operating entities:

Figure 1



Not only does this evolution complicate the issue of cost allocation among Spire entities, but it also presents Spire, Inc. with additional opportunities to enter into affiliate transactions. As one

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2 Tr. at page 1861, lines 15-24.

3 Exhibit No. 47 (Flaherty Rebuttal Testimony) at page 34.

example, in 2016, Spire STL entered into a precedent agreement[4] with Laclede for firm natural gas transportation on a proposed new 400,000 Dth/d interstate pipeline in Missouri and Illinois.[5] Under the proposed arrangement, Laclede customers will pay approximately $600 million to Spire STL over the course of the twenty year contract.[6] Laclede's decision to take service from the proposed Spire STL Pipeline has implications for other aspects of its gas supply portfolio, including the fact that it will turnback (i.e., not renew) a significant amount of capacity on Enable Mississippi River Transmission ("MRT") if its affiliate pipeline is built.[7]

In its application to obtain a certificate for public convenience and necessity from FERC, Spire STL points to its affiliate agreement with Laclede in order to demonstrate market need.[8] Several entities, including this Commission, have protested that application, arguing, among other things, that Spire STL has not sufficiently demonstrated need for the new project.[9] Once FERC approves Spire STL's application and Laclede begins taking service on the Spire STL Pipeline, Laclede will seek to recover the costs of transportation service on the new pipeline from this Commission as part of the PGA/ACA process.[10]

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[4] Precedent agreements set forth the commercial, financial, and operational terms for new pipeline build, committing the pipeline developer to build the project and the shipper to purchase the expansion capacity. Once a pipeline is approved and placed into service, the terms of a precedent agreement are carried over to an agreement for transportation service and the pipeline provides service to the shipper pursuant to these terms, along with any applicable tariff requirements. Thus, any charges for service flow through the transportation agreement once the pipeline is placed into service.

[5] Exhibit No. 650 (Lander Direct Testimony), Schedule EDF-07 at page 1.

[6] Tr. at page 2009, lines 7-14.

[7] Exhibit No. 650 (Lander Direct Testimony), Schedule EDF-02 at page 5.

[8] *Id.*, Schedule EDF-07 at page 2.

[9] Tr. at page 2020, line 12.

[10] Exhibit No. 650 (Lander Direct Testimony), Schedule EDF-08 at page 1.

III. LEGAL FRAMEWORK

A. PGA/ACA Process

Utilities recover gas costs from customers pursuant to a two-part mechanism known as the PGA/ACA process. In the PGA portion, a utility files annual tariffs in which it estimates its costs of obtaining gas, including transportation, over the coming year. The PGA amounts are then included in customers' bills over the ensuing 12 months.[11] The utility then files for an adjustment, or ACA, if its actual cost is different than projected in its PGA filing. The ACA allows the Commission to correct any discrepancies between the costs billed and the costs actually incurred.[12] When an ACA is received, Commission Staff audits the utility's gas purchases made during the ACA period in question. As part of the review, Staff evaluates whether the rates paid by consumers for natural gas sold during the period were "just and reasonable."[13] This review "may" include whether affiliate transactions comply with the Affiliate Transactions Rule.[14]

B. Affiliate Transactions Rule

When a regulated gas corporation engages in a business transaction with an affiliated entity, it is required to abide by the affiliate transaction rules set forth in the Missouri Code of State Regulations.[15] The rules require utilities to satisfy certain evidentiary standards and record keeping requirements for affiliate transactions. Section 240-40.015 prohibits a regulated gas corporation from providing a financial advantage to an affiliated entity:

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[11] Exhibit No. 426 (Azad Surrebuttal Testimony), Schedule AA-S-3 at page 3.

[12] *Id.*

[13] *Id.* (citing § 393.130.1).

[14] Tr. at page 1884, lines 11-17.

[15] 4 CSR § 240-40.015-40.016.

> For the purposes of this rule, a regulated gas corporation shall be deemed to provide a financial advantage to an affiliated entity if –
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> 1. It compensates an affiliated entity for goods or services above the lesser of –
> A. The fair market price; or
> B. The fully distributed cost to the regulated gas corporation to provide the goods or services for itself …[16]

Unless a variance is obtained, the rule also requires a regulated gas corporation to obtain competitive bids for services (or demonstrate why competitive bids were neither necessary or appropriate); document the fair market price and fully distributed cost of services; and demonstrate that it considered all costs incurred to complete the transaction, calculated the costs at times relevant to the transaction, allocated all joint and common costs appropriately, and adequately determined the fair market price for the services.[17]

C. Cost Allocation Manual and Standards of Conduct

The Affiliate Transactions Rule obligates gas corporations to include in an annual Cost Allocation Manual the criteria, guidelines, and procedures it will follow to be in compliance with the rule.[18] Laclede last updated its Cost Allocation Manual in 2013 as part of a settlement in Case Nos. GC-2011-0098, GR-2005-0203, GR-2006-0288, GR-2008-0140, GR-2008-0387, GR-2010-0138, GR-2011-0055, and GR-2012-0133.[19] Appended to the Cost Allocation Manual are Gas Supply and Transportation Standards of Conduct.[20] Among other issues, those standards govern Laclede's purchases of gas supplies for multi-month periods and less than one month

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[16] *Id.* at § 240-40.015(2)(A).

[17] *Id.* at § 240-40.015(3)(C).

[18] *Id.* at § 240-40.015(2)(E).

[19] Exhibit No. 650, Schedule EDF-05.

[20] *Id.*, Schedule EDF-05 at page 42.

periods, off-system sales, and releases of transportation or storage capacity. The Standards do not currently govern purchases of transportation capacity.

IV. 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.

1. Laclede's Tariff Should Be Revised in Light of Contemporaneous and Evolving Market Conditions and Contracting Strategies

The PGA/ACA mechanism was initially introduced into Missouri in 1962.[21] Since that time, and particularly in the last decade, the natural gas market has undergone significant change in large part due to access to abundant shale gas supply. This transformation has impacted the gas supply portfolio decisions of Local Distribution Companies ("LDCs") such as Laclede.

As explained in Greg Lander's direct testimony, not all natural gas capacity is the same. LDCs' gas supply portfolios are comprised of both supply reliability capacity and supply diversity capacity. Supply reliability capacity is that capacity which both connects directly to the

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[21] *In the matter of the investigation of certain PGA-related issues involving Missouri Gas Energy*, Case No. GO-94-318 Phase II, January 31, 1996 Order at p. 38.

Company's distribution system and is required to meet peak design-day firm demand.[22] Supply diversity capacity is that capacity which either does not connect directly to the Company's distribution system (i.e., upstream pipeline capacity which feeds supply reliability capacity) or pipeline capacity which is directly connected to the Company's distribution system but which is in excess of capacity required to meet peak design-day firm demands.[23]

Supply diversity capacity is less necessary to LDCs today than in the past for three primary reasons: (1) LDCs acquired most of their supply diversity capacity through the conversion of merchant pipeline agreements to transportation only agreements at a time when the gas market was less developed than it is today; (2) there has been a significant proliferation of hundreds of liquid market hubs at which gas is bought and sold on an all-in delivered basis; and (3) large wholesale gas marketing companies acquire and manage upstream capacity in ever more creative ways to segment LDCs' capacity and make use of it two to three times over.[24] These factors have increasingly led many LDCs to turn back (i.e., not renew) upstream supply diversity capacity.[25]

It is against this historical backdrop that Laclede's gas supply portfolio decisions must be analyzed. At a time when other LDCs are choosing not to renew upstream supply diversity capacity, Laclede has committed its customers to firm transportation on its affiliate Spire STL Pipeline for the next 20 years. Implicitly acknowledging that the agreement will not result in customer savings, Laclede maintains that the Spire STL Pipeline will provide certain reliability

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[22] Exhibit No. 650 (Lander Direct Testimony) at page 7, lines 1-2.

[23] *Id.* at page 7, lines 6-10.

[24] *Id.* at page 8, line 28 to page 10, line 3.

[25] *Id.* at page 9, lines 23-26.

and diversity benefits.[26] Under that rationale, Laclede could sign up for service on every pipeline in the St. Louis region. Laclede concedes that pipeline transportation alternatives in lieu of capacity on Spire STL Pipeline could provide similar benefits, but asserts that none could provide all of the diversity, reliability, and operational benefits afforded by Spire STL Pipeline.[27] But it is not clear how diversity, reliability, and operational benefits could be measured in an objective way and such an analysis seems to ignore the core consideration in the relevant statute—cost.[28] Laclede also states that the Spire STL Pipeline could allow Laclede to retire its aging on-system liquid propane facility,[29] but does not explain why 350,000 Dth/d on a new affiliate pipeline is needed to replace the 163,200 Dth/d of existing propane deliverability. As demonstrated by Laclede's decision to enter into the Spire STL precedent agreement, it is evident that LDCs' gas supply management decisions are becoming more nuanced and therefore require an updated regulatory paradigm in order to be properly assessed.

EDF's proposed revisions to the PGA/ACA tariff provide the Commission with a new set of tools to better assess the prudency of costs that are ultimately passed through the PGA/ACA process. Because not all gas transportation capacity is the same, the proposal first groups Laclede's capacity into a supply reliability bucket and a supply diversity bucket.[30] Each

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[26] *Id.*, Schedule EDF-08 at page 1.

[27] *Id.*, Schedule EDF-02 at 5 ("While pipeline transportation alternatives in lieu of capacity on STL Pipeline may be able to provide one or more benefits to Laclede's customers, none of the pipeline alternatives available to Laclede at the time of its decision to contract on STL Pipeline could provide all of the flexibility, diversity, reliability and operational benefits to customers afforded by STL Pipeline.").

[28] Mo. Rev. Stat. § 393.130.

[29] Exhibit No. 650 (Lander Direct Testimony), Schedule EDF-02 at page 4.

[30] *Id.* at page 5, lines 10-11.

component of Laclede's portfolio would next be ranked by assessing the all-in cost.[31] If a new contract is introduced into the ranking process such as to replace Laclede's propane-air capacity, the all-in cost of the propane would be calculated and compared to the all-in cost of the new contract.[32] Laclede would then be permitted to recover the lesser of: (1) the all-in cost times the design-winter usage of the propane capacity or (2) the all-in cost of the new replacement capacity times the same usage.[33] The purpose of the ranking process is to assess the relative cost-effectiveness of each existing component of the portfolio and determine whether, at renewal time or otherwise, each component should be maintained, swapped-out for another more cost-effective component, or dropped altogether as excessive or unnecessary.[34]

The proposal would allow for the following treatment of Spire STL contract costs.[35] First, regarding the supply reliability component of the transaction, EDF's proposal would allow Laclede to recover costs associated with the capacity reservation charge associated with 163,200 Dth/d on the new pipeline. This 163,200 Dth/d of contracted for Spire STL capacity is equivalent to the propane air facility's daily output, and Laclede has said that the new Spire STL capacity will allow it to retire its aging propane facility.[36] Allowing Laclede to recover just the

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[31] The all-in cost is the sum of all fixed and variable charges, including the gas commodity, associated with each asset or contract divided by the units of throughput. *Id.* at page 5, lines 12-15.

[32] *Id.* at page 5, lines 16-23.

[33] *Id.* at page 5, lines 24-26.

[34] *Id.* at page 11, lines 12-15.

[35] EDF proposes that its ranking analysis be incorporated into the PGA/ACA process as part of this proceeding. The actual ranking and analysis would occur in a future PGA/ACA docket. *Id.* at page 11, lines 17-21. This proposed cost recovery is illustrative and would need to be revisited at the time Laclede actually seeks to recover the costs associated with its Spire STL transportation agreement.

[36] *Id.*, Schedule EDF-02 at page 4.

quantity of natural gas associated with the design winter quantity of propane would protect ratepayers against an all-in cost of year-round affiliate pipeline capacity to meet a peak design-winter need.[37]

Regarding the supply diversity component of the Spire STL arrangement, Laclede would be allowed to recover the demand charges on any additional Dth/day (above the 163,200 Dth/d) in an amount defined as either the Turnback Allowance plus the First of Month ("FOM") Benchmark or just the FOM Benchmark, as the circumstances may warrant.[38] The Turnback Allowance is the cost savings per Dth/d of any turned back capacity that Laclede may experience as a result of not renewing any pipeline capacity to which it currently subscribes, such as capacity on MRT.[39] To the extent the new Spire STL capacity allows for gas supply purchases through that capacity at prices below the FOM, then Laclede can additionally recover the difference between the FOM benchmark and the cost of gas per Dth purchased capacity that replaced the MRT turned back capacity.[40] This proposal would permit Spire, Inc. the freedom to make investment and contracting decisions, while at the same time leaving ratepayers no worse off than they would have been had those decisions not been made.[41]

As demonstrated above, the significant transformation of the natural gas market and Laclede's evolving contracting strategies warrant commensurate changes to Laclede's tariff. EDF's proposal provides the Commission with an additional framework with which to analyze Laclede's gas supply portfolio to ensure that ratepayers are protected from any unreasonable

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[37] Exhibit No. 650 (Lander Direct Testimony) at page 19, lines 12-16.

[38] *Id*.

[39] *Id.* at page 19, lines 28-29.

[40] *Id.* at page 20, line 28 to page 21, line 2.

[41] *Id.* at page 23, lines 5-9.

costs associated with affiliate agreements. For these reasons, the Commission should adopt the proposed PGA/ACA tariff provisions set forth in the Direct Testimony of Greg Lander.

2. Costly Affiliate Arrangements Demand Heightened Regulatory Oversight

The Missouri Supreme Court has recognized that "[a]s long as a [utility] is engaged in both monopoly and competitive activities, it will have the incentive as well as the ability to 'milk' the rate-of-return regulated monopoly affiliate to subsidize its competitive ventures."[42] Indeed, the very purpose of Missouri's Affiliate Transaction Rule is to thwart rate hikes due to cross subsidization between a regulated gas corporation and its affiliates.[43] However, any review of whether Laclede has complied with the Affiliate Transactions Rule (as well as any prudency review in the ACA) will take place after the Spire STL Pipeline has been placed into service and Laclede takes service on that pipeline pursuant to a transportation agreement. Such retrospective analysis is ineffectual as it functionally would ignore the harms that will result from building a pipeline that is ultimately not needed. There are a myriad of impacts that simply cannot be undone—ranging from environmental degradation to the potential mothballing or abandonment of other pipelines' facilities.[44]

The Laclede/Spire STL arrangement is just one example of a larger national trend where retail captive customers are footing the bill for new and possibly excess and/or redundant pipeline infrastructure, at the same time that affiliate pipeline developers enjoy returns in excess of risk.[45] The misfortune of this trend is that it prevents customers from truly realizing the benefits of the

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[42] Exhibit No. 426 (Azad Surrebuttal Testimony), Schedule AA-S-3 at page 11 (citing *United States v. Western Elec. Co.*, 592 F. Supp. 846, 853 (D.D.C. 1984)).

[43] *Id.*, Schedule AA-S-3 at pages 11-12.

[44] Exhibit No. 650 (Lander Direct Testimony), Schedule EDF-02 at page 31.

[45] *Id.*, Schedule EDF-09.

shale revolution—cheaper gas costs.[46] Any benefits associated with cost savings from shale production are at risk of being eviscerated by expensive and unnecessary long-term transportation arrangements. The confidential Surrebuttal testimony of Anne Crowe highlights the magnitude of the Spire STL/Laclede contract costs:

> LAC's pipeline reservation costs for the 2015-2016 ACA period were approximately ** ________ **. The addition of Spire STL Pipeline capacity reservation charges will be an increase of approximately ** _______ ** which is roughly ** _____ ** of LAC's pipeline reservation costs. LAC will have to either have its gas delivered to Spire STL Pipeline by a third party or it will have to reserve capacity on REX. If Spire were to reserve an equivalent amount of capacity on REX for the five winter months only at the reservation rate of LAC's current ** _______ **, Staff estimates the combined cost of Spire STL and REX to be ** ________ ** which is about ** _____ ** of LAC's pipeline reservation costs.[47]

Thus, on its face, the very terms of the transaction demonstrate inappropriate risk-shifting: customers will be subjected to an exorbitant increase in transportation costs, while Spire shareholders will reap the benefits of the 14% return on equity FERC routinely grants for new pipeline infrastructure.[48] As was explored during the hearing, Laclede has not previously sought to recover the costs of an interstate affiliate transportation agreement through the PGA and ACA.[49] The one example cited by Staff witness Ms. Crowe, involving MGE and Panhandle,[50]

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[46] Exhibit No. 15 (Weitzel Direct Testimony) at page 29, lines 14-15 ("shale production has been hugely beneficial for customers in terms of reducing the relative level of natural gas prices").

[47] Exhibit No. 241 (Crowe Surrebuttal Testimony – Confidential) at page 5, lines 1-8.

[48] Tr. at page 1802, lines 3-5.

[49] *Id.* at page 1886, lines 1-7.

[50] MGE and Panhandle became affiliates long after the original service contracted for by MGE's predecessor came into service. Tr. at page 1886, lines 16-19. This is very different than the facts of the instant situation where the affiliate pipeline was formed by the LDC's parent to provide an investment opportunity for the parent, Spire Inc.

included certain conditions that capped total customer costs.[51] Unlike MGE, Laclede has proposed no cap on the costs it should be allowed to recover from customers. All of these factors point to the need for Commission action in this case.

Simply put, EDF's proposal allows recovery of affiliate transportation costs capped at the FOM Benchmark less the costs of gas acquired through the capacity.[52] The PGA/ACA revisions put the Company on notice—today—as to the anticipated cost recovery associated with its affiliate arrangement, as opposed to two years in the future when Laclede seeks to recover the costs. As was discussed during the hearing, "market rules known in advance of market activities lead to better outcomes than changes in market rules after the fact."[53] Where, as here, Laclede is seeking to add a significant amount of capacity to the system at great cost to customers without a prior demonstration of need, the Company should be put on notice as to the amounts it will be allowed to recoup from customers.

3. FERC's Regulation of Interstate Pipeline Rates is Insufficient in Protecting Against Affiliate Self-Dealing

The Commission has previously highlighted the critical role of FERC in reviewing transportation charges that are ultimately passed through the PGA/ACA:

> The PGA/ACA mechanism was initially introduced into Missouri in 1962 by Laclede Gas Company. At that time, most gas costs handled through the PGA/ACA mechanism were subject to FERC approval. The fact that the rates paid by Missouri LDCs for gas were set by the FERC supports use of the PGA/ACA mechanism . . . Transportation charges from interstate pipelines are set by the FERC. In addition, transition costs and take-or-pay costs which flow through the PGA result from FERC actions. The Commission concludes that a substantial portion of the cost of gas continues to be subject to FERC regulation

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[51] Tr. at page 1886, line 8 to page 1887, line 4.

[52] Exhibit No. 650 (Lander Direct Testimony) at page 17, lines 23-25.

[53] Tr. at page 2000, lines 11-14.

> and the PGA/ACA mechanism continues to fit well with the underlying nature of the gas costs incurred by LDCs.[54]

Thus, in the past, FERC's role in regulating transportation charges was an important consideration for the Commission in determining that the PGA/AGA remain just and reasonable mechanisms.

While reliance on FERC's oversight of transportation charges may be appropriate in some instances, that is not the case for costs associated with affiliate transportation contracts to support new pipeline build. The regulatory framework of the Natural Gas Act does not specify any comprehensive or centralized planning requirement for new pipelines.[55] Rather, FERC is confined to the strictures of section 7(c) of the Natural Gas Act and the guidance set forth in its 1999 Certificate Policy Statement.[56] The economic theory underpinning the Certificate Policy Statement is that market forces will appropriately inform the question of whether a new pipeline is needed. Over time, FERC has found, time and again, that precedent agreements constitute significant evidence of market demand.[57]

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[54] *In the matter of the investigation of certain PGA-related issues involving Missouri Gas Energy*, Case No. GO-94-318 Phase II, January 31, 1996 Order at p. 38.

[55] *Transcon. Gas Pipe Line Co., LLC*, 158 FERC ¶ 61,125 at P 27, n.38 (2017) ("Unlike under the Federal Power Act with respect to the regulation of electric transmission lines and electric markets, Congress has not authorized the Commission to plan either a regional or national natural gas pipeline system. Under section 7(c) of the NGA, the Commission shall issue a certificate for any proposal found to be required by the public convenience and necessity.").

[56] *Certification of New Interstate Natural Gas Pipeline Facilities*, Statement of Policy, 88 FERC ¶ 61,227, at p. 61,748 (1999), *order clarifying statement of policy*, 90 FERC ¶ 61,128, *order further clarifying statement of policy*, 92 FERC ¶ 61,094 (2000) ("Certificate Policy Statement").

[57] Certificate Policy Statement at p. 61,747. *See also Kinetica Deepwater Express, LLC*, 160 FERC ¶ 61,129 at P 9, n.25 (2017) (noting that "the Commission routinely relies on precedent agreements for *firm service* as evidence of market demand for new interstate pipelines") (emphasis in original).

FERC has historically declined to review the terms of precedent agreements between affiliates unless there is evidence of self-dealing.[58] In fact, in a recent order, FERC declined to look at the terms of several affiliate agreements, finding that "any attempt by [FERC] to look behind the precedent agreements [in a certificate] proceeding might infringe upon the role of state regulators in determining the prudence of expenditures by the utilities that they regulate."[59] This finding demonstrates there is a gap in regulatory oversight of these affiliate agreements: while this Commission is, in part, relying on FERC's regulation of interstate pipeline rates to confirm their reasonableness as part of the PGA/ACA process, FERC is declining to look at the specific terms of affiliate precedent agreements in approving new pipeline infrastructure. This Commission has protested Spire STL's application, requesting that FERC not prejudge the terms of the precedent agreement and arguing that Spire STL has not sufficiently demonstrated need for the new project.[60] However, once FERC grants Spire STL's certificate application, this Commission will be limited in reviewing whether Laclede was prudent in contracting with Spire when compared to other alternatives.[61] The cure for this gap in state and federal oversight is to ensure sufficient regulatory safeguards are in place in advance. EDF's proposal does just that, providing Laclede with notice as to the amounts it will be able to recover from customers and protecting customers against the threat of unreasonable affiliate transportation costs.

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

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[58] *Florida Southeast Connection, LLC*, 154 FERC ¶ 61,080 at P 84 (2016).

[59] *Mountain Valley Pipeline, LLC*, 161 FERC ¶ 61,043 at P 53 (2017).

[60] Tr. at page 2020, lines 11-13.

[61] *Pike County Light and Power Co. v. Penn. Pub. Util. Comm'n*, 77 Pa. Cmwlth 268 (1983).

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.

1. EDF's Proposed Revisions to the Standards of Conduct Will Protect Customers Against Future Unreasonable Transportation Costs

Appended to Laclede's Cost Allocation Manual are Gas Supply and Transportation Standards of Conduct ("Standards of Conduct").[62] The stated purpose of the Standards of Conduct is "[t]o assist in ensuring that energy-related transactions between Laclede Gas Company…and its affiliates are conducted in a manner fully consistent with the interests of the Company's utility customers, including their interest in having such transactions priced and accounted for in a reasonable and appropriate manner…"[63] Section A of the Standards of Conduct pertains to purchases of gas supplies (i.e., the commodity of gas). The Standards of Conduct do not currently apply to gas transportation contracts or govern affiliate transportation transactions.

As demonstrated by the Laclede/Spire STL arrangement, the costs associated with transportation agreements can be significant.[64] Moreover, Spire Inc. has announced "an interest in doing more pipeline investments similar to the STL pipeline"[65] (i.e., agreements between Laclede and an affiliate developing pipeline capacity for Laclede). The current Standards of

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[62] Exhibit No. 650 (Lander Direct Testimony), Schedule EDF-05 at page 42.

[63] *Id*.

[64] Exhibit No. 241 (Crowe Surrebuttal Testimony – Confidential) at page 5, lines 1-8.

[65] Exhibit No. 650 (Lander Direct Testimony), Schedule EDF-09 at page 3.

Conduct are ineffective in protecting customers against these types of transactions. At the hearing, Spire witness Mr. Krick agreed with the statement that the Company's Cost Allocation Manual should be revised from time to time as the company's corporate structure and contracting strategies evolve.[66] However, Laclede's Cost Allocation Manual and Standards of Conduct do not reflect its current practices, and the Company proposed no changes to either in this case.

Using the existing framework of the gas *supply* Standards of Conduct, EDF's proposal extends the same requirements to pipeline *capacity* (i.e., transportation). Schedule EDF-06 presents EDF's redline changes to the current Sections A and B of the Standards of Conduct, to adapt those sections for use in addressing acquisition of transportation capacity by Laclede from an affiliate. For example, regarding purchases of transportation capacity for periods longer than 1 month, EDF proposes the following:

1. Laclede will acquire multi-month ~~gas supplies~~ transportation capacity in accordance with a competitive bidding process in which requests for proposals (RFP's) are submitted by Laclede to a list of eligible ~~suppliers~~ Transportation Service Providers currently connected to or able to directly connect to Laclede ~~at the various supply locations connected~~ or connected to the pipelines on which Laclede holds firm transportation or through another competitive bidding process. For any exceptions to the competitive bid and award process, Laclede will have a documented process for the supply approval and award process, including (a) justification requirements, (b) authorization process, (c) contemporaneous documentation requirements (for internal Company information and external communications with suppliers), and (d) effective monitoring and controls.

2. Such RFP process shall be open to all ~~gas suppliers~~ Transportation Service Providers who wish to bid. The intent is **to gain the broadest practical participation by eligible ~~suppliers~~ Transportation Service Providers in submitting competitive ~~supply~~ transportation capacity bids for the ~~supply location(s) where~~ transportation capacity Laclede ~~purchases gas~~ seeks to contract for, purchase, or otherwise acquire**. Once such a process is reasonably developed and appropriately implemented and effectively monitored and controlled, the results of that process are intended to establish the fair market price for the purchase. Laclede shall provide with its annual CAM report submission an explanation of any credit, performance or other criteria that Laclede takes into consideration in determining which ~~suppliers~~ Transportation Service Providers are sent RFPs as part of the RFP process.

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[66] Tr. at page 1850, lines 9-13.

3. In the event a ~~gas supply~~ transportation capacity contract for firm ~~gas supply~~ transportation capacity is awarded to an affiliate as a result of the RFP or other competitive bidding process, the affiliate shall be held to the same performance requirements as non-affiliated ~~suppliers~~ Transportation Service Providers.

4. In the event a ~~gas supply~~ transportation capacity contract is awarded, Laclede shall maintain the following contemporaneous documentation: (a) any diversity, credit, or reliability-related ~~volume~~ capacity limitations placed on the maximum ~~volumes~~ capacity Laclede will purchase from an individual ~~supplier~~ Transportation Service Provider ~~or from any one supplier on a specific pipeline (broken down by baseload, combo, and swing)~~; (b) an explanation of the diversity, credit and/or reliability-related reasons for imposing such limitations; (c) a description of the process used to transmit the ~~supply~~ transportation capacity request to all eligible ~~suppliers~~ Transportation Service Providers, evaluate bids, and negotiate final prices and terms; (d) a list of all ~~suppliers~~ Transportation Service Providers that were sent each RFP;(e) a complete summary of all bids received and all prices accepted, together with copies of all underlying documents, contracts and communications; (f) a summary and explanation of ~~suppliers~~ Transportation Service Providers disqualified for credit, performance or other criteria, and (g) a copy of the policy or procedure employed by Laclede for awarding contracts in instances where an affiliate and an unaffiliated ~~supplier~~ Transportation Service Provider have offered identical pricing terms. For phone calls or texts, Laclede shall maintain contemporaneous logs documenting the discussions and decisions.

5. In the event a ~~gas supply~~ transportation capacity contract is awarded to an affiliate ~~at a location in~~ for a transportation capacity path between a receipt area and a delivery area over which no other contracts were awarded, the Company shall maintain contemporaneous documentation showing that the affiliate's bid price was equal to or lower than the bids received from non-affiliated suppliers, and that any upward or downward adjustment in the final contract price was justified by changes in the market.

6. In the event a ~~gas supply~~ transportation capacity contract is awarded to an affiliate ~~at a location at~~ for a transportation capacity path between a receipt area and a delivery area over which Laclede also awarded ~~gas supply~~ transportation capacity contract(s) to non-affiliated ~~suppliers~~ Transportation Service Providers, the Company shall maintain contemporaneous documentation showing that the price established under the contract awarded the affiliate was within or lower than the range of prices established under contracts awarded to entities other than the affiliate.

7. If the affiliate's bid price or contract price does not meet the criteria in paragraphs 5 or 6, Laclede may not award the ~~gas supply~~ transportation capacity contract to the affiliate, unless the Company can demonstrate and contemporaneously document that a more favorable bid was rejected for legitimate reasons relating to the rejected bidder or bidders' creditworthiness, performance history (or lack thereof), or other consideration bearing on the fitness and reliability of the bidder to provide the requested service.

8. In the interests of optimizing the competitive benefits of the RFP process, the RFP will permit ~~suppliers~~ Transportation Service Providers to propose alternative ways of satisfying

> the basic quantity, reliability, receipt, delivery and pricing terms of the RFP in addition to those specifically contemplated by the RFP, provided that the RFP shall explicitly advise ~~suppliers~~ Transportation Service Providers that proposing such alternatives is permissible. The RFP may also utilize ranges for such quantity, reliability, receipt, delivery and pricing terms. In the event any such alternative produces a supply arrangement that is at least as favorable in its basic terms as other initial bids received by the Company during the RFP process then there shall be no need to rebid the proposed supply arrangement. In the event the Company itself makes a material change in the basic quantity, reliability, receipt, delivery or pricing terms of the RFP, or changes the range applicable to such terms, after initial bids have been received then the proposed supply arrangement shall be rebid.[67]

These proposed changes would apply on a going-forward basis to any future affiliate transportation capacity acquisitions.[68]

Should the Commission decline to adopt EDF's proposed changes to the Standards of Conduct, it should open a separate docket at the conclusion of this case to investigate possible revisions to the Cost Allocation Manual and Standards of Conduct. As suggested by OPC, the Commission should require Laclede to file for approval of an updated Cost Allocation Manual no later than six months after the Commission issues its report and order in this rate case.[69]

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

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

[68] Exhibit No. 651 (Lander Surrebuttal Testimony) at page 5, lines 12-13.

[69] Exhibit No. 425 (Hyneman Surrebuttal Testimony) at page 26, lines 7-8.

Commission should provide interested parties the opportunity to review and comment on the audit report.

1. Laclede's Repeated Lack of Compliance With the Affiliate Transaction Rule Necessitates a Third Party Review

Laclede's relationship with the Affiliate Transactions Rule is a tale of resistance and non-compliance. Laclede first challenged the Commission's authority to promulgate the rules in 1999, arguing, among other things, that the Commission "acted outside its authority because the rules impose record keeping requirements on both the utilities and their affiliates."[70] The Supreme Court of Missouri swiftly dismissed this claim, affirming the Commission's authority to promulgate the rules and police compliance of the rule through the maintenance of records of certain transactions.[71] Since their promulgation, a laundry list of complaints has been asserted against Laclede regarding its lack of compliance:

- The Cost Allocation Manual that Laclede adopted in 2004 did not comply with the Commission's Affiliate Transaction Rule. "Staff repeatedly expressed its concerns with the 2004 CAM to Laclede Gas after the Commission's Affiliate Transaction Rules became effective in mid-2003. Staff's expressions of concern were unavailing. Eventually, Staff filed a complaint on October 6, 2010 (Case No. GC-2011-0098), alleging that Laclede's CAM failed to comply with the Commission's Affiliate Transaction Rules; that Laclede failed to obtain Commission approval of its CAM; and that Laclede failed to annually submit its CAM to Staff."[72]

- As explained in the surrebuttal testimony of Mr. Charles Hyneman, "As a member of Staff's Auditing Department from 1993 to 2015 I became aware of the Staff's serious concerns with Laclede's affiliate transactions over a period of several years. The Staff had particular concerns with Laclede's lack of compliance with the affiliate transaction rule. The Staff also had serious concerns with Laclede's failure to adhere to its transparency commitments made to the Commission related to its transactions with Laclede's affiliates…."[73]

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[70] *State ex rel. Atmos Energy Corp. v. Pub. Serv. Comm'n of* Missouri, 103 S.W.3d 753, 763 (2003).

[71] *Id.* at 764.

[72] Exhibit No. 425 (Hyneman Surrebuttal Testimony), Schedule CRH-S-7 at page 28.

[73] Exhibit No. 425 (Hyneman Surrebuttal Testimony) at page 28, lines 6-11.

- OPC witness Mr. Hyneman expanded upon these concerns at the hearing, noting: "my first exposure to Laclede's affiliate transaction…was in a GR-2005-0203 case where Staff requested an affiliate invoice and Laclede made claims that it didn't have access…to the invoice and it was a long, drawn-out case where Staff could not obtain affiliate invoices for gas."[74]

- In Staff's Revenue Requirement Cost of Service Report in Laclede's 2010 general rate case, Case No. GR-2010-0171, Staff stated at page 53, "The Staff has serious concerns that the Company's policies, procedures and methods for its allocation of costs to its various affiliates is inadequate to prevent Laclede Gas' customers from paying expenses that are related to affiliates."[75]

- In Staff's Investigation Report in Case No. GM-2016-0342, Staff found that, among other violations, Spire and its family of corporation have not complied with the condition to "maintain records supporting its affiliated transactions for at least five years."[76]

- During the hearing, Staff witness Ms. Crowe detailed concerns regarding Laclede's documentation of the gas supply procured from their marketing affiliate at the time, LER.[77]

As demonstrated by this non-exhaustive list, there are numerous examples showcasing Laclede's inability or refusal to comply with the Affiliate Transactions Rule. This persistent pattern of violations illuminates the risk of avoidable costs imposed on Laclede customers underscoring the importance of an independent third party review.

That review should also include an assessment of whether the Spire STL/Laclede transaction complies with the Affiliate Transaction Rule. In its order affirming the Commission's authority to promulgate the rules, the Supreme Court observed that the new rules "are a reaction to the emergence of a profit-producing scheme among public utilities termed 'cross-subsidization,' in which utilities abandon their traditional monopoly structure and expand

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[74] Tr. at page 1910, lines 2-8.

[75] Exhibit No. 425 (Hyneman Surrebuttal Testimony) at page 28, lines 12-16.

[76] *Id.*, Schedule CRH-S-7 at page 23.

[77] Tr. at page 1885, lines 7-10.

into non-regulated areas. This expansion gives utilities the opportunity and incentive to shift their non-regulated costs to their regulated operations with the effect of unnecessarily increasing the rates charged to the utilities' customers."[78] The Supreme Court foresaw the very same concern raised by the Laclede/Spire STL transaction, which highlights the importance of including this transaction within the scope of the independent audit. Given Laclede's prior record of non-compliance, the Commission should require that the independent audit be completed before Laclede seeks to recover costs of the Spire STL capacity contract in the PGA/ACA process.

2. The Structure of the Affiliate Transactions Rule Provides Laclede with an Inherent Informational Advantage

The crux of the Affiliate Transactions Rule is the obligation on gas corporations to retain robust records of certain affiliate transactions.[79] These record-keeping requirements, in practice, provide an inherent informational advantage to utilities which this Commission must redress. In order to confirm that Laclede has complied with the rule, it is necessary for Staff and interested parties to obtain and review the relevant documentation. OPC witness Ms. Azad detailed significant concerns she faced when conducting her assessment of affiliate transactions in this case, noting "significant delays and inadequacies in responses to discovery requests, as well as overuse of confidentiality designations by Spire."[80] Ultimately these challenges prevented her (and others seeking to protect ratepayer interests) from the data necessary to conduct the analysis at the level of detail required to assess the cost-effectiveness of the utility's affiliate transactions, as she

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[78] *State ex rel. Atmos Energy Corp. v. Pub. Serv. Comm'n of Missouri*, 103 S.W.3d 753, 763-64 (2003).

[79] 4 CSR 240-40.015(4)-(6).

[80] Exhibit No. 401 (Azad Direct Testimony) at page 5, lines 10-11.

originally anticipated.[81]

Laclede's proposed solution to these concerns—that parties can raise such issues in a discovery conference[82]—will lead to resource-intensive and protracted disputes.[83] The public interest would be better served by the Commission adopting the proposal set forth in Ms. Azad's testimony. Ms. Azad recommends that, as part of the independent third party audit, Spire should designate a specific company contact who will be available to coordinate discovery, and the timing of the audit should align with this contact's availability to ensure Spire has sufficient resources to respond to data request in a timely manner.[84]

For all of the above reasons, 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 findings 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. To protect the public interest, the Commission should require that the independent audit be completed before Laclede seeks to recover costs of the Spire STL capacity contract in the PGA/ACA process.

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[81] Tr. at page 1928, lines 7-10.

[82] *Id.* at page 1931, lines 18-25.

[83] Tr. at page 1910, lines 2-8.

[84] Exhibit No. 401 (Azad Direct Testimony) at page 5, line 19 to page 6, line 19.

V. CONCLUSION

For the reasons identified in this Initial Post-Hearing 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.

January 9, 2018

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*