Exhibit No.:	
Issues:	**MKP/RPC Pipeline Adjustment**
Witness:	**Dennis M. Langley**
Type of Exhibit:	**Rebuttal Testimony**
Sponsoring Party:	**Mid-Kansas Partnership/Riverside Pipeline Company, L.P.**
Case No:	**GR-96-450**

MID-KANSAS PARTNERSHIP/RIVERSIDE PIPELINE COMPANY, L.P.

REBUTTAL TESTIMONY

OF

DENNIS M. LANGLEY

MISSOURI GAS ENERGY

A division of

Southern Union Company

CASE NO. GR-96-450

Jefferson City, Missouri
December, 1998

REBUTTAL TESTIMONY OF

DENNIS M. LANGLEY

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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of the Missouri Gas Energy's Gas Cost Adjustment Tariff Revisions to Be Reviewed in its 1996-1997 Annual Reconciliation Adjustment Account	))))	Case No. GR-96-450

AFFIDAVIT OF DENNIS M. LANGLEY

STATE OF KANSAS)
) ss.
COUNTY OF JOHNSON)

Dennis M. Langley, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, considering of 33 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Dennis M. Langley

Dennis M. Langley

Subscribed and sworn to before me this 30 day of November, 1998.

FELICIA A. BODY
NOTARY PUBLIC
STATE OF KANSAS
MY APPT. EXPIRES 6-2-2002

Felicia A. Body

Notary Public

My commission Expires: 6-2-2002

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of Missouri Gas Energy's Gas Cost Adjustment	)	
Tariff Revisions to be reviewed in Its 1996-1997 Annual	)	Case No. GR-96-450
Reconciliation Adjustment Account	)	

PREPARED REBUTTAL TESTIMONY OF DENNIS M. LANGLEY

I. Introduction

Q. Would you please state your name, employment position, and employment address?

A. My name is Dennis M. Langley. I am President of Kansas Pipeline Operating Company. My employment address is 8325 Lenexa Drive, Suite 400, Lenexa, Kansas 66214.

Q. Please state your educational and employment background.

A. I received a Bachelor of Arts Degree, Master's Degree, and Juris Doctorate Degree from The Catholic University of America, located in Washington, D.C. I have taught at The Catholic University of America in Washington, D.C. (1973-1977). I served as Majority Counsel for the United States Senate Judiciary Sub-Committee from 1977-1978. Subsequent to serving as Majority Counsel, I was engaged in the private practice of law in Hutchinson, Kansas until approximately 1986. My private law practice was primarily focused on energy related matters.

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

A. The purpose of my testimony is to explain the merits of the Mid-Kansas II Agreement between Mid-Kansas Partnership (Mid-Kansas) and Missouri Gas Energy, a division of Southern Union (MGE), during the ACA period commencing July 1, 1996 through June 30, 1997. Additionally, my testimony will refute Staff's recommended disallowance of $4,532,449.60 of charges paid by MGE to Mid-Kansas during the subject ACA period. My testimony will be divided into five sections that explain how: (1) The prudence of the Mid-Kansas II Agreement was settled by virtue of a Stipulation and Agreement approved by the Commission on June 11, 1996, hence the Staff's investigation is precluded by prior agreement; (2) The entry of Mid-Kansas and Riverside Pipeline Company, L.P. (Riverside), as a gas supplier to the Kansas City market, was necessary for the development of stable, long term pipeline competition, hence the Staff's recommended disallowance fails to consider such development; (3) The development of pipeline competition significantly benefits natural gas consumers, hence the Staff's calculation fails to account for the financial benefits of competition, realized by Missouri ratepayers; (4) MGE exercised prudent business judgment when it executed the Mid-Kansas II Agreement, the Riverside I Agreement and the Riverside II Agreement, all on February 24, 1995, hence given the facts known at the time the Agreements were executed, MGE demonstrated prudent management; and (5) The Staff's comparison is incomplete, unfair, inaccurate and arbitrary, hence the Staff's recommended disallowance should be rejected.

II. Prudence of Executing the Mid-Kansas II Agreement Has Been Previously Settled

Q. Do you recall that in the ACA period from July 1, 1992 through June 30, 1993 the Commission, in GR-93-140, recommended a disallowance of $1,319,902.76 of charges paid by Western to Mid-Kansas/Riverside and that for the ACA period commencing July 1, 1993, through June 30, 1994, (Docket No. GR-94-101 and GR94-228) the Staff recommended an additional disallowance of $2,867,411.14 of charges paid by Western and MGE to Mid-Kansas/Riverside?

A. While it is not the purpose of my testimony to re-discuss the findings of the Commission's Order in GR-93-140, it should be noted that Mid-Kansas/Riverside appealed that decision and that decision was stayed by the Circuit Court of Cole County, Missouri, while GR-94-101 and GR-94-228 were still pending dockets. Mid-Kansas/Riverside provided a significant amount of testimony disputing the Commission's Order in GR-93-140 and the Staff's recommendation in GR-94-101 and GR-94-228. In those prior cases, ample testimony demonstrated that Mid-Kansas/Riverside's total costs were lower than the charges paid by Western and/or MGE to Williams. Mid-Kansas/Riverside took the position that Staff's calculations failed to account for the direct bill charges of Williams to Western and MGE for such cost items as "take or pay liabilities," PCB pollution clean up costs and other transition costs of interstate pipelines, which were occurring during the institution of open access under FERC Orders 436 and 636. Only by use of an apples to oranges methodology, which ignored more than $200 million of Williams billings actually paid for by Missouri customers, did Staff reach the erroneous conclusion that Mid-Kansas/Riverside rates were higher than Williams. By using an apples to apples comparison that included all costs paid by Missouri consumers, the staff conceded that our rates were materially lower than Williams' were. This error continues to be compounded by the pending case. Moreover, rate to rate comparisons are not the appropriate standard of prudence.

Q. Please continue.

A. Mid-Kansas/Riverside is a relatively small company. Quite frankly, miniscule, when compared to the large interstate pipelines. The disallowance ordered in GR-93-140, coupled with the Staff's threatened disallowance in GR-94-101 and GR-94-228 posed a serious financial threat to the continued existence of Mid-Kansas/Riverside. In discussions with Staff, it was apparent that they intended to apply inappropriate hindsight analysis in each subsequent ACA period when examining Mid-Kansas/Riverside charges to those of Williams. Mid-Kansas/Riverside simply could not have survived those continued disallowances. Therefore, I perceived that the risk of annual litigation with Staff continually imposed a real state of economic duress that justified an overall settlement of the pending dockets open before the MPSC. Most of all, Mid-Kansas/Riverside wanted to forever resolve the issue of prudence associated with the execution of contracts between Mid-Kansas/Riverside and Western/MGE. Such a resolution provided the only opportunity to protect the financial viability of Mid-Kansas/Riverside from ongoing Staff initiated litigation.

Q. Did the parties enter into a Settlement resolving those Dockets you mentioned?

A. Yes, after intense and prolonged negotiations, on or about May 2, 1996, the Missouri Public Service Commission Staff, MGE, Western, Mid-Kansas, Riverside and various other parties to the pending Dockets executed a Stipulation and Agreement prepared and drafted exclusively by MPSC's General Counsel, who expressly declined to allow Mid-Kansas/Riverside, or its counsel, to participate in the drafting and/or preparation of the Stipulation and Agreement. The Stipulation and Agreement, in summary, required Western and Mid-Kansas/Riverside to make a "Settlement Payment" collectively in the amount of $4 million, which was ultimately paid to MGE and passed through to the ratepayers of Missouri. A copy of that Stipulation and Agreement as well as the Order approving said Stipulation and Agreement are attached hereto as **Schedule DML 1**.

Q. Did you believe then and do you believe now that the Stipulation forever settled the prudence of the Mid-Kansas II and Riverside Agreements?

A. Absolutely. There is simply no way I would have committed $2,500,000.00 (Mid-Kansas' share of the $4,000,000.00 Settlement Payment) to resolve the prudence of the "Missouri Agreements" (which included the Mid-Kansas II Agreement), had I not believed the matter was settled forever.

Q. Is it your position that by virtue of the Commission approved Stipulation that the issue of the prudence surrounding the decisions made by MGE regarding the Mid-Kansas II Agreement was forever resolved?

A. Absolutely. Mid-Kansas/Riverside's portion of the settlement payment was $2.5 million, a sizeable sum indeed. I would never have authorized the payment of that sum of money as a stop gap measure. As I mentioned earlier, Mid-Kansas/Riverside was looking to resolve all the prudence issues on a go forward basis.

Q. Did you understand specific language in the Stipulation Agreement to resolve the prudence issue forever?

A. I believe paragraph 5 makes the intentions of the parties crystal clear. The first sentence of paragraph 1 is unambiguous when it says:

"As a result of this Stipulation and Agreement, this Signatories agree that neither the execution of the MKP/WR Sales Agreement and the Riverside/WR Transportation Agreement I, nor the decisions associated with the execution of the Missouri Agreements, shall be the subject of any further ACA prudence review."

Furthermore, the meaning of the Commission approved Stipulation was further explained when, in paragraph 5 of the Stipulation, the parties agreed that:

"The Missouri Agreements will be subject to compliance and operational review (as described herein) of the Staff for all periods on or after July 1, 1994..."

In other words, the parties agreed that the "compliance and operational review" referred to would be limited to issues involving the manner in which gas was taken or issues involving billing matters, such as billing or mathematical errors.

Q. Did you discuss the intention of the parties under the Stipulation and Agreement with the Commission Staff?

A. As I recall, Mr. Rob Hack, then General Counsel for the Commission, insisted on drafting the Stipulation. Prior to negotiating with Mr. Hack, during late 1995 and the first quarter of 1996, we tried to reach a Global Settlement with Staff regarding all matters, including a number of complicated issues pending before FERC. When those efforts failed, the parties initiated new negotiations solely focused upon pending matters in Missouri. This is when Mr. Hack insisted on drafting the settlement document and expressly declined my request to let our counsel participate in the drafting of the document. Mr. Hack explained that he denied my request, in part, due to Staff's problems with the manner in which we drafted the old Global Settlement (which addressed issues in Missouri and before the FERC). Based upon those difficulties, Mr. Hack insisted that he, and only he, be allowed to participate in the drafting of the new Stipulation and Agreement. Moreover, Mr. Hack made it clear that we were not to even submit suggested language changes. When we explained that the first draft of the Stipulation and Agreement, which Mr. Hack requested Tino Monaldo (General Counsel for Mid-Kansas) circulate among the parties, was unacceptable to us because it did not settle the issues in perpetuity, Mr. Hack said he was aware of our position, and that he would prepare the following draft which he believed would be acceptable to us. I explained that these continued proposed Staff disallowances, practiced each year without a fair comparison to Williams would have material adverse financial impacts upon Mid-Kansas/Riverside. I felt there was no choice but to resolve this matter with the sizeable payment of $2.5 million, which in conjunction with Western's payment of $1.5 million, created a $4 million settlement to the benefit of the Missouri ratepayers. I also explained that the then existing relationship between Mid-Kansas and MGE had been extended by virtue of the execution of the Riverside II Agreement (that Agreement provided for Riverside to construct a 30 mile lateral connecting MGE to Panhandle Eastern Pipeline Company south of Kansas City, a historic event as far as competition was concerned in the Kansas City area). The Riverside II Agreement signaled meaningful competition for a large quantity of supply volume from a source other than Williams. Furthermore, we were made aware that MGE submitted the Riverside II Agreement to the Commission Staff, under seal. Thus, Staff was aware that the charges for transportation under the Riverside II Agreement were substantially less than the rates being charged by Williams to MGE. Consequently, our negotiations included discussions acknowledging that, in future years, the average cost of transportation on the Mid-Kansas/Riverside facilities would provide a meaningful, low priced, competitive alternative supply to Williams. Therefore, I believe that because of the Riverside II Agreement, in conjunction with the Mid-Kansas II Agreement, Staff was convinced that MGE had appropriately used its buying power and leverage to negotiate prudent contracts for the Missouri ratepayers. I believed then and I believe today, that

Staff understood my motives for forever settling the prudence issue regarding the Mid-Kansas II Agreement. Until the Staff's recommendations for disallowance in this case came out in June of 1998, I had no reason to believe the Stipulation and Agreement meant anything other than a complete settlement of these issues forever. I was shocked, dismayed and disappointed by Staff's recommendation seeking to reverse the representations contained in the Stipulation and Agreement.

III. Mid-Kansas and Riverside: New Entrants to Kansas City

Q. When did Mid-Kansas and Riverside first enter into sales and transportation agreements with either MGE or Western Resources, Inc. (hereafter Western) with respect to the Kansas City area?

A. On January 15, 1990, Mid-Kansas (formerly known as Mid-Kansas Gas Gathering Company, L.P.) entered into a Gas Sales Agreement with Western (the local distribution company prior to MGE's acquisition from Western on February 1, 1994) which was amended effective October 3, 1991 (hereafter collectively Mid-Kansas I Agreement). On the same date, Riverside Pipeline Company, L.P. (Riverside) executed a transportation agreement with Western, which was also amended on October 3, 1991, (hereafter collectively the Riverside Transportation Agreement). Mid-Kansas and Riverside had the responsibility throughout this original agreement, to (1) obtain gas supplies at competitive market responsive price levels; (2) pay all applicable gathering and transport charges; (3) deliver its "warranted" supplies of gas from Oklahoma across Mid-Kansas' affiliated pipelines to Western at the point of interconnection in Wyandotte County, Kansas between Kansas Pipeline (Mid-Kansas' affiliate) and Riverside. Riverside, under the Riverside Transportation Agreement, transported natural gas from this point of interconnection in Wyandotte County, Kansas, to a point of delivery in Platte County, Missouri between the pipeline facilities of Riverside and the local distribution facilities of Western in Missouri. On January 31, 1994, MGE took assignment from Western of the Mid-Kansas I Agreement and Riverside Transportation Agreement.

Q. Was the entry of Mid-Kansas/Riverside into the Kansas City market easily achieved?

A. Absolutely not. In fact, just the opposite is true. The upstream pipelines with which Mid-Kansas contracted for transportation; KansOk Pipeline (KOP), Kansas Pipeline Partnership (KPP) and Riverside are affiliates (hereafter collectively the Pipelines) whose facilities were relatively new. The Pipelines' facilities were acquired and constructed in separate transactions from about 1985 to 1991. Most of the facilities were acquired crude oil pipelines, refurbished and converted to natural gas transmission. However some new construction of pipelines and compressor stations was required to complete the system. These acquisitions and new construction of facilities were financed by long term debt issued by institutional lenders, who relied upon our contract revenues as collateral.

However, the ability to sell and/or transport natural gas to Western, the then owner of the local distribution facilities in both Kansas City, Kansas and

Missouri, was extremely difficult. Williams Natural Gas in 1985 was the dominant supplier of gas and transportation in Kansas City. The Pipelines each and every attempt to enter the market was met with extreme resistance by Williams. Williams continually used regulatory and litigation tactics to stifle entry into Kansas City and raised the cost of entry by literally millions of dollars due to excessive legal fees and costly delays. For example, Williams opposed the KCC's certifications of KPP's predecessor companies (KPCLP and Phenix), then left its appeals of these decisions open for nearly three years but declined to prosecute them, keeping KPP's certificates under a legal cloud.[1] Williams also filed meritless and protracted litigation to prevent KPP from selling gas to Western's predecessor, allowing the litigation to languish so long that the federal court "weary of delay, wary of the potential for misuse of litigation, and desirous of achieving some progress in the case,"[2] dismissed it for lack of prosecution.[3] During this period Western repeatedly refused to deal with KPP, citing the threat of litigation from Williams.[4]

Williams also litigated extensively at the Federal Energy Regulatory Commission (FERC) to disrupt KPP's operations, seeking disapproval of rate applications and denial of Natural Gas Act (NGA) applications to provide interstate pipeline service. In one of the NGA matters, FERC noted that "[t]he harm WNG

[1] _Northwest Cent. Pipeline Corp. v. State Corp Comm'n_, No. 85-C-5535 (Johnson County Dist. Ct. Oct. 18, 1988); _Northwest Cent. Pipeline Corp. v. State Corp Comm'n_ No. 85-CU-1087 Shawnee County Dist. Ct. Oct. 17, 1988).
[2] _Northwest Cent. Pipeline Corp. v. Sate Corp Comm'n_ No. 86-1801 (D Kan. July 21, 1988) (order to show cause at 4).
[3] _Northwest Cent. Pipeline Corp v. Corp. Comm/n_, No. 86-1801 (D. Kan. Sept. 7, 1988) (order dismissing complaint).
[4] The United States Supreme Court has recognized that sham litigation can be used for anticompetitive purposes. _California Motor Transport Co. v. Trucking Unlimited_, 404 U.S. 508 (1972).

complains of, if it occurs at all, will be the result of competition in the transportation market ... We see no reason to shield an interstate pipeline, such as WNG, from similar competition." *Riverside Pipeline Company, L.P.*, 48 Fed. Energy Reg. Comm'n Rep. (cch) Sec. 61,309, at 62,016 (Sept. 18, 1989).

In both NGA matters, FERC denied Williams' requests for an evidentiary hearing. Moreover, in the rate case FERC rebuked at length the anti-competitive misuse of the litigation process by Williams (then known as Northwest Central) by stating:

> **Although the Commission encourages participation by interested parties in proceedings to establish rates of intrastate pipelines, it looks with disfavor on Northwest Central's apparent strategy in this proceeding to bar Phenix's [Mid-Kansas/Riverside's] entry into the NGPA section 311 market as a potential competitor. Far from aiding the Commission's determination of fair and equitable rates, Northwest Central has used incongruous positions, ill-defined "Questions," and innuendo as attempts to persuade us to disapprove Phenix's rate. Simply put, Northwest Central has not proposed a different rate or appropriate rate methodologies; it has tried only to negate Phenix's presentation in an apparent effort to eliminate competition from a new intrastate pipeline.**[5]

[5] 32 Fed. Energy Reg. Comm'n Rep. (CCH) at 61,268-64 (emphasis supplied).

Q. Why should this Commission care about the difficulties Mid-Kansas/Riverside and/or the Pipelines had to endure from Williams to get into the business of natural gas transmission?

A. The Commission should not ignore the efforts of Williams to stifle competition when it evaluates the decision of MGE to maintain Mid-Kansas as an alternative supplier. First, this Commission has, in the past, supported pro-competitive policies, and has supported Riverside's certification efforts.[6]

Second, Staff, in recommending a disallowance of charges paid by MGE to Mid-Kansas (which includes charges for transportation paid to Mid-Kansas on the Pipelines), compares the transportation component of the Mid-Kansas II Agreement to the firm transportation "rates" of Williams. This comparison is inappropriate for a number of reasons, which are set forth in detail in the Rebuttal Testimony of JohnB. Adger. However, it is fundamentally unfair to compare the Mid-Kansas transportation costs to Williams' rates when Mid-Kansas' cost of doing business was artificially increased by millions of dollars due to the predatory behavior of Williams. To observe how blatantly Williams attempted to stifle competition and then penalize Mid-Kansas and the Pipelines for persisting in their efforts, is tantamount to rewarding the incumbent supplier for raising barriers to competition. The signal sent to Williams and others would be clear – fight your competitors, raise their cost of doing business - because the new entrant

[6] See "Joint Answer of Missouri Public Service Commission and Kansas Corporation Commission to Request of Williams Natural Gas Company for Stay and Joint Motion of Missouri Public Service Commission and Kansas Corporation Commission to Afford Parties an Opportunity to Address Issues Presented by Williams' Request for Rehearing", FERC Docket No. CP89-485, July 21, 1989, at page 9.

will not be allowed to collect rates based on its regulatory approved cost of service rates.

Q. Do you characterize the Mid-Kansas I Agreement and Riverside Transportation Agreement as a "beachhead" for pipeline competition in Kansas City, Missouri?

A. Yes. The Kansas City, Missouri metropolitan area (on the Missouri side of the State line) has a peak day supply need for natural gas of well over 500,000 MMBtu. The Mid-Kansas I Agreement and Riverside Transportation Agreement, by contrast, were for a peak day delivery of 46,332 MMBtu. The Mid-Kansas and Riverside deliveries to MGE during the subject ACA period were less than 10% of the total, with Williams providing more than 90% of the deliverability in the described area. While certain important benefits could be realized by Kansas City, Missouri ratepayers at this modest level of competition, the much larger benefits of competition could not be realized by ratepayers in the Kansas City, Missouri area until the volume level of competition provided by Mid-Kansas/Riverside and the Pipelines increased dramatically. Once Mid-Kansas/Riverside had reached a volumetric limitation, the competitive effect and Williams' response to competition was dramatically reduced. To avoid this effect, Riverside and Mid-Kansas could not be artificially constrained to a market niche.

Q. Has this "beachhead" led to the further maturity of pipeline competition?

A. Yes it has. On February 24, 1995, Mid-Kansas and Riverside entered into three (3) agreements with MGE that further extended the benefits of pipeline competition to Missouri ratepayers.[7] In short, the "beachhead" established by the Mid-Kansas I and the Riverside Transportation Agreement allowed competition to develop further. Such structural market change obviously could not occur overnight, but these most recent agreements evidence that such development does indeed occur.

Q. Are any of these three contracts the subject matter of the disallowance recommended by Staff in GR-96-450?

A. It is my understanding that Staff is recommending a $4,532,449.60 disallowance of charges paid by MGE to Mid-Kansas under the Mid-Kansas II Agreement during the July 1, 1996 to June 30, 1997 period. However, Staff, to my knowledge, has not made any recommendation as to the Riverside I or Riverside II Agreements also executed on February 24, 1995.

IV. Benefits of Pipeline Competition

Q. What are the main benefits of pipeline competition?

A. Among the many benefits of competition, four significant benefits are: (1) Competition lowers prices; (2) Competition encourages cost minimization by producers; (3) Competition eliminates expenditures by monopolists that serve

[7] The Mid-Kansas II Agreement between MGE and Mid-Kansas. The Riverside I Agreement between

only to prevent, or raise barriers to, competitive entry; and (4) Competition increases customer choices. In this case, the Commission has the opportunity to affirm that pipeline competition is in the consumers' interest.

Q. What is the basis for your statement that competition lowers prices?

A. There is a great body of economic literature devoted to the study of the relationship between market concentration (the number of sellers) and market price. The numerous inter-industry empirical studies of relationships between prices and the presence of competitors provide strong support for the conclusion that the presence of competition has a downward effect on prices.[8] In fact, in the context of this proceeding, John B. Adger has testified that the execution of the Mid-Kansas II and Riverside II Agreements provided MGE with significant bargaining leverage vis-à-vis Williams.

Q. Are there other adverse effects on costs caused by monopolies and monopoly power?

A. Yes. Economists point to two primary sources of wastefulness (e.g., excessive costs) due to monopolists' behavior. First, without the threat from competition, a firm has no pressing need to minimize its costs of production. Second,

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MGE and Riverside. The Riverside II Agreement between Riverside and MGE. These Agreements are attached as schedules to the Rebuttal Testimony of Wendell C. Putman.

[8] For a recent summary of the literature, see: Inter-Industry Studies of Structure and Performance in *Handbook of Industrial Organization,* Volume 2, ed. Richard Schmalensee and Robert Willig (Amsterdam; North-Holland, 1990).

monopolists find it in their best interests (i.e., it is a profit-maximizing action) to maintain their monopoly position even if they initially must incur costs that would serve no purpose other than to deter potential entrants.

Q. Can regulation co-exist with competition and Missouri ratepayers still receive the benefits of pipeline competition?

A. Yes. Under traditional regulation, in those instances where pipelines were operated as monopolies, state regulators were required to take actions to ensure, as far as possible, that: (1) the monopoly powers of regulated firms were not exercised to make excess profits – i. e., that earnings were constrained to "just and reasonable" levels; and (2) that "allocations" of costs among a firm's activities and customers (rate design issues) were "fair." Competition among regulated monopolies is now considered by the Federal Energy Regulatory Commission (FERC) to be an essential tool and adjunct of regulation. In support of regulation, a competitive market structure is intended to ensure that what were formerly monopoly powers of particular pipeline companies are constrained and focused to facilitate market efficiency.

Q. Is it appropriate to both nurture existing competition, as well as seek to quantitatively expand it?

A. It is absolutely critical to do both. At the risk of stating the obvious, there cannot be pipeline competition without financially viable competitors. Therefore, it is crucial to nurture existing competitors in the market place. Further, for ratepayers in Kansas City, Missouri to obtain the greater potential benefits of pipeline competition, regulatory policies must be in place at both the FERC, as well as at the MPSC, to permit – and in fact encourage – the fledgling competitive marketplace to grow and gain maturity. By any measure, the existing contracts of Mid-Kansas and Riverside are good for ratepayers in the state of Missouri and additional benefits will be realized by Missouri ratepayers as these contracts, and future additional competitive contracts, are entered into and implemented in the state of Missouri. The most effective regulation for ratepayers in the state of Missouri is regulation that permits and encourages a competitive pipeline marketplace.

Q. In addition to the theoretical analysis of competition, what evidence exists that the presence of Mid-Kansas/Riverside and the Pipelines have had any real beneficial impact for the consumers of Missouri?

A. Mid-Kansas' entry into the Kansas City Market has provided over $120,000,000 in benefits to the ratepayers of Kansas City, Missouri (See **Schedule DML 2**, Analysis of Economic Benefits From Kansas Pipeline Group Competitive Sales And Transportation Of Natural Gas In The Kansas City Metropolitan Area, December 1992, with Addendum May 14, 1993). Additionally, as discussed in the Rebuttal Testimony of John B. Adger, the execution of the Riverside II Agreement averaged down the overall costs of the supply capacity made available by Mid-Kansas/Riverside to MGE. In fact, the simultaneous execution of the

Riverside II and Mid-Kansas II Agreement effectively lowered the cost of capacity to a level considerably below that on Williams (See **Schedule JBA 12**, attached to the Rebuttal Testimony of John B. Adger).

V. MGE Exercised Prudent Business Judgment in Executing Mid-Kansas II

Q. Under the applicable standards of the Missouri Public Service Commission, was the execution of the Mid-Kansas II Agreement between Mid-Kansas and MGE prudent?

A. Yes, it was. The Mid-Kansas II Agreement was prudent when measured against the standard of prudence historically used in Missouri.

Q. Would you please explain?

A. It is my understanding that the prudence standard utilized in the state of Missouri requires the examination of management decisions to be based upon information known and available at the time the decision is made. There is no "after the fact" or "20/20 hindsight" utilized in determining whether a particular action is prudent or imprudent. There cannot and should not be a cost disallowance when a local distribution company made efficient and competent decisions prior to implementation of a gas supply strategy (See Section II of the Rebuttal Testimony of Howard E. Lubow).

Q. Please describe why the purchasing strategy of Western and later MGE was prudent with respect to the Mid-Kansas II Agreement of February, 1995, and its predecessor agreements?

A. The execution of the Mid-Kansas II Agreement provided a critical alternate source of reliable transportation and gas supply that was committed at a time when the availability of supply, other than Williams, was uncertain. The historical services provided by MKP were competitive with or cheaper than Williams. The Mid-Kansas II Agreement provided MGE and its ratepayers a number of material advantages.

First, the spot index used to set the gas commodity cost was the TransOk spot index, an index historically significantly lower than the Mid-Continent spot index, a fact agreed to by Staff representative Thomas Shaw (See **Schedule DML 3-1**, Deposition Transcript of Thomas Shaw, page 55, lines 19-25 and page 56, lines 1-23).

Second, Mid-Kansas' historical charge above the higher Mid-Continent spot was reduced from 114% of the Mid-Continent spot index to 105% of the lower Transok spot index. So not only was the index used a lower cost index, but the charge above spot was reduced by nine percentage points. In fact, Schedules **JAWS 3** and **JAWS 4** to Joan Schnepp's Rebuttal Testimony establish that the Mid-Kansas II Agreement benefited the ratepayers during the subject ACA period in excess of $5,000,000.00 and over $12,000,000.00 from June 1, 1995 through May, 1998.

Third, the Mid-Kansas II Agreement gave MGE a transportation charge that was fixed for 14 years, except for a 2% escalator every three years. This fixed rate contract was a material advantage to MGE and its customers overthe Mid-Kansas I Agreement and the Riverside Transportation Agreement which set the transportation charge at the maximum approved tariff of Mid-Kansas' transporters (the Pipelines) as those rates may increase over time. In other words, under Mid-Kansas II, MGE and ratepayers were insulated from the risk of increased transportation rates for 14 years. Mid-Kansas bore the risk of all increased costs, including, but not limited to costs of complying with the Department of Transportation Safety Regulations, increased personnel costs, increased operating and maintenance costs, insurance costs, increased property taxes, and all other costs associated with upstream transportation. On the other hand, MGE and the ratepayers were not insulated from Williams transportation rate increases. As **Schedule DML 4** demonstrates, such rate increases have historically been frequent and financially material.

Essentially, MGE prudently and effectively used its buying power and negotiating leverage to successfully diversify their gas supply and transportation options. MGE has emphasized the critical importance of diversifying their supply portfolio (See **Schedule DML 5-1**, Deposition Transcript of Michael T. Langston, pages 40, lines 20-25 and page 41, lines 1-4). In fact, in a reliability report dated May 1, 1996, filed in GO-96-243, MGE explained that "given that approximately 90% of MGE's current capacity is provided by WNG, Williams, MGE has explored capacity replacement and incremental expansion opportunities on pipelines other than WNG in order to obtain greater diversity, flexibility, bargaining power and peak day reliability." (See **Schedule DML 6-1,** Deposition Transcript of Michael Wallis, page 44, lines 13-18). Moreover, Staff witness Mike Wallis noted that supply diversity is one critical objective in prudent management of gas supply (See Schedule DML **6-2**, Deposition Transcript of Michael Wallis, page 43, lines 23-25 and page 44, lines 1-2). The Mid-Kansas II Agreement assured that the policies of FERC and most states, including Kansas and Missouri, regarding competition would be implemented through a long-term commitment for a portion of the transportation market. The Mid-Kansas II Agreement continued some level of diversity and a hedge against the uncertainty and risks associated with continued reliance on Williams. That diversity and hedge against Williams was significantly expanded with the execution of the Riverside II Agreement. As stated earlier, the Riverside II Agreement provided MGE with an additional 150,000 MMBtu/day, or more than three times the capacity provided under the Mid-Kansas II Agreement.

In short, Staff representative Thomas Shaw and MGE witness, Michael T. Langston, concur that the provisions of the Mid-Kansas II Agreement provided material benefits to MGE and the Missouri ratepayers. In fact, Mr. Shaw could not state even one provision of the Mid-Kansas II Agreement that was not beneficial to MGE and the ratepayers compared to the Mid-

Kansas I Agreement. (See **Schedule DML 5-2**, Deposition Transcript of Michael T. Langston, page 28, lines 20-25. See also **Schedule DML 3-2**, Deposition Transcript of Thomas Shaw, page 58, lines 21-25).

Q. You have mentioned several reasons for MGE to have recommitted a long-term agreement with MKP. Were there any additional considerations that led the parties to recommit to a long-term agreement at this time?

A. Yes. A long-term agreement was essential to position Mid-Kansas and the Pipelines, as a credible long-term competitive alternative to Williams. The Mid-Kansas II Agreement put MGE in the position of having some degree of continued leverage over the pricing of Williams services. In order to provide that leverage it was necessary to maintain a viable threat that Mid-Kansas and its affiliates could expand its pipeline capacity. Maintaining that threat required a pipeline that was financially sound and capable of financing expansion. Furthermore, the Mid-Kansas I Agreement and the Riverside Transportation Agreement (with the expiration date in 2009) represented about 40% of Mid-Kansas/Riverside's transportation revenues and served as collateral to the mortgage held by several large institutional lenders. Mid-Kansas/Riverside had no authority or option to shorten that term. When MGE began its efforts in 1994 to seek concessions from Mid-Kansas/Riverside, I made it emphatically clear to MGE that outright termination of those agreements was not an option.

Q. Why was a continued alternate source of transportation important for competition to develop?

A. I must begin my answer with a reference to a time in history when Williams was virtually the sole supplier of both gas supply and pipeline capacity provided to Western (and its predecessors) in Kansas City, Missouri. In part, because of FERC's curtailment orders and curtailments by Williams, as well as Williams' ever-increasing prices during the 1970s and 1980s, analytical studies were commenced by Western during the late 1980s to develop alternatives to Williams' dominant position in the areas of gas supply pipeline transportation.

In 1987, Western retained an independent third party consultant, Stone & Webster, to review Western's local distribution system, and make recommendations. The Stone & Webster Report recommended various courses of action for Western to take to reduce the monopoly influence of Williams on the operations of Western. Similarly, in 1991, Western retained the consulting firm of Deloitte & Touche to analyze Western's pipeline system, as it related to the acquisition of gas and pipeline transportation capacity to reduce dependence upon Western's historical monopoly supplier, Williams.

Q. What was the purpose of MGE's predecessor, Western, for reviewing alternative pipeline suppliers as communicated to you by Western?

A. Western's purpose and desire was to develop meaningful, reliable, long lasting competition for its business and the benefit of the Missouri ratepayers. As stated to me, Western wanted a market where two or three pipeline competitors would be long term suppliers at competitive prices. These pipeline suppliers would then be given the opportunity to vigorously compete on a recurring basis for Western's business. However, this required physical connections with alternative suppliers, as well as at least a moderate level of business with such competitors to sustain their interest in then, Western, and now, MGE, as customers, and to sustain mature competition. It was against this backdrop that, after many months of negotiation, Western and Mid-Kansas in October of 1991 entered into agreements amending the original, Mid-Kansas I Agreement and Riverside Transportation Agreement. In addition, four additional contracts were entered into on October 21, 1991, between Western and the Pipelines (Pipeline Expansion Contracts). I personally participated, along with other company personnel, in many, many hours of analysis with Western personnel to develop additional alternatives for the provision of gas and pipeline transportation options for Western.

Q. You seem to be describing a process rather than an event in the development of competition in Kansas City, Missouri, is that correct?

A. Yes, it was. Competition, at reasonable prices, had to be brought into the Kansas City market place for the benefit of ratepayers of Kansas City, Missouri. But since there had not been any historical competition, it was incumbent upon Western, and later MGE, to use their purchasing power to create a competitive pipeline market place.

Q. Were the amendments in 1991 executed to ensure the establishment of an initial, moderate level of competition?

A. Yes, they were. As you will recall, Mid-Kansas entered into the original agreement on January 15, 1990. First deliveries under that agreement commenced on November 1, 1990, and were scheduled to conclude on December 31, 1992. Since Mid-Kansas, through the facilities of the Pipelines, provided the only existing alternative to what would otherwise be Williams' monopoly position into the heart of Kansas City, Missouri, for competition to continue, it was imperative that a longer and more permanent agreement between Western and Mid-Kansas/Riverside be negotiated on a reasonable basis. The extended term of the agreement was designed to signal to the market that competition would occur over the long term. This process led to the execution of the amended agreements with Mid-Kansas/Riverside, which provided for warranted gas supply services through October 31, 2009.

Q. What were the primary benefits to ratepayers of Kansas City, Missouri, under the amended agreements between Mid-Kansas/Riverside and Western?

A. First, Western would secure a proven, high quality and reliable pipeline supplier as a participant in its pipeline market place for an extended period (through 2009).

Further, pipeline transportation costs would be reasonable and competitive in that, without exception, such costs would be regulated by the FERC, and in the instance of any pipeline transportation on the pipeline systems of Kansas Natural Partnership and Kansas Pipeline, such prices for firm transportation service would also be regulated by the KCC. Additionally, the price of the gas commodity would be reasonable and competitive, as it was calculated under the Mid-Kansas I Agreement on a monthly market responsive basis, and was further pegged to a comparable percentage amount of a publicly posted index that was consistent with contracts of other suppliers of gas to Western. In addition, at the time Mid-Kansas and Western entered into the Amended Agreement, the pricing history of Mid-Kansas indicated that over the previous two year period, the charges from Mid-Kansas and Riverside were consistently less than the charges of Williams. Further, Western reasonably expected that the establishment of pipeline competition with Williams through the year 2009 would lead to future charges by Williams which were more responsive to market conditions. Finally, a discrete pipeline system into Kansas City, Missouri, offered an important alternate means of pipeline delivery for reliability purposes, i.e., an additional means of delivery in any instance that Williams was unable to deliver. The fact that the point of interconnection between Riverside and Western permitted the deployment of such supply throughout a very large part of Western's local distribution system added to the enhanced reliability feature of this discrete pipeline supply.

Q. Please continue.

A. In addition, in the period in which the amendment to the Mid-Kansas I Agreement was subject to negotiation, the natural gas industry was changing dramatically. Industry participants had little assurance as to how rates, transportation or sales would be conducted subsequent to FERC restructuring. The only outcome perceived to be inevitable from the dramatic process undertaken by Federal regulators was that the industry would change substantially. Nonetheless, the contract between Western and Mid-Kansas/Riverside was due to expire. In particular, as Williams' rates inevitably became more market-responsive due, in large part to the emergence of competition by Mid-Kansas, as well as the "open access" to gas markets instituted by FERC restructuring, the pricing marker (Williams' rate, less 15 cents) was obviously destined to be eliminated. Given the high probability that there would be no rate or service comparability (which was the subject of discussions at FERC) the speculative selection of another price marker, which might or might not have thereafter existed, would have been irresponsible.

Q. Although "hindsight" is not permitted in a prudence review, have the reasons for which the decision was made by Western to enter into the amended agreements, turned out to be correct?

A. Yes. Western secured for the Kansas City, Missouri market place a vigorous pipeline competitor for an extended term. Moreover, by virtue of the execution of the Mid-Kansas II Agreement and the Riverside II Agreement, MGE was ultimately successful in dramatically increasing pipeline competition in Kansas

City, Missouri. The commitment to alternative sources of supply exhibited by MGE in 1995, led to the dramatic increase in pipeline competition in Kansas City in 1997, with the operation of the new lateral by KN completing the Riverside II project. Based on the historic and regular rate increases of Williams, MGE's maintenance of existing alternative suppliers and pursuit of new alternatives (with the Riverside II project) should not be second-guessed now by Staff.

VI. Staff's Comparison of Mid-Kansas' Charges to Williams' Charges Were Incomplete, Unfair, Inaccurate and Arbitrary

Q Staff Witness, Michael Wallis appears to focus his concern on the transportation rates charged under the Mid-Kansas II Agreement. Are there any inadequacies in such a focus?

A. Yes. Those transportation rates have been deemed just and reasonable. Each of the Pipelines used by Mid-Kansas charges rates approved by a regulatory body. These Pipelines are Kansas Pipeline Partnership (KPP), KansOk Partnership (KOP) and Riverside Pipeline Company, L.P. (Riverside). KOP's and Riverside's rates, which were paid to Mid-Kansas by MGE under the Mid-Kansas II Agreement, were deemed just and reasonable by FERC. KPP's rates were deemed just and reasonable by the KCC in 1995. Thus, all components of the transportation charges under the Mid-Kansas II Agreement have been deemed just and reasonable. Furthermore, these same rates of KPP, KOP, and Riverside have all been recently evaluated by the FERC in Docket No. CP96-152-000. As a result of FERC's April 30, 1998, Order in the above-mentioned docket, KOP, KPP and Riverside were consolidated into one interstate entity with interstate rates found to be in the "public interest".[9] These are the same rates that were charged by Mid-Kansas to MGE under the Mid-Kansas II Agreement. Therefore, Staff, by recommending a disallowance, has effectively ignored the extensive rate proceedings of the KCC and FERC.

Q. Could you explain some of the inadequacies in Staff's comparison of Mid-Kansas' charges compared to Williams' charges?

A. Staff's comparison of Mid-Kansas' charges for transportation are all inclusive. That is, all of the transportation charges under the Mid-Kansas II Agreement are reflected in the reservation charges of the Pipelines. However, all of Williams' charges to MGE are not reflected in their rates or reservation charges. Both Mr. Langston for MGE and Mr. Shaw for Staff agree that Williams costs to MGE include items that are not in Williams' rates, and that these charges are still paid by MGE and have been, historically, and during the subject ACA period, passed on to the ratepayers (See **Schedule DML 4-3**, Deposition Transcript of Michael T. Langston, page 33, lines 8-23. See **Schedule DML 3-3**, Deposition Transcript of Thomas Shaw, page 50, lines 3-25 and page 51, line 1). These additional charges are called transition costs, take or pay liabilities, surcharges and other various names, but the bottom line is the cost of MGE acquiring transportation off Williams is significantly greater than just Williams' "rates." However, in comparing Williams' cost of providing transportation service to Mid-Kansas'

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[9] 83 F.E.R.C. P61,107

transportation component, Staff steadfastly and illogical refuses to make an accurate apples to apples comparison. Since the Missouri ratepayer pays all of these additional Williams non-rate costs, no sound reason exists to exclude them in a comparison to Mid-Kansas transportation charges to MGE, particularly when the Missouri ratepayers are paying both Williams' rate and non-rate charges.

Q. Are there other reasons why Staff's comparison is incomplete?

A. Another obvious reason that Staff's comparison of Mid-Kansas' charges and Williams' charges is unfair and inaccurate is Staff's failure to fully account for the cost savings MGE obtained under the commodity cost provisions of the Mid-Kansas II Agreement. Staff witness, Michael Wallis, stated that he compared Mid-Kansas' gas commodity charges to Williams' spot index plus 4% (See **Schedule DML 5-3**, Deposition Transcript of Michael Wallis, page 12, lines 6-24). He then claims to give Mid-Kansas credit for its commodity charges, which he admits are lower than the Williams spot index plus 4%. However, Mr. Wallis' methodology significantly understates the commodity credit that should have been allowed to Mid-Kansas.

Q. Please explain.

A. Under the Incentive Gas Cost Mechanism established by the Commission's Order in G0-94-318 (Attached as **Schedule DML 6**), this Commission created certain financial incentives for MGE to seek the lowest cost reliable gas supply. In doing so, the Commission established, in part, that to the extent that MGE's total gas costs during an ACA period did not exceed a certain benchmark plus 10%, then no prudence review could take place regarding gas purchasing decisions made by MGE. In other words, if MGE's gas costs were below the stated benchmark plus 10% the Commission would not review the prudence of any individual gas purchasing decision during the relevant ACA period.

Consequently, since it has been established that MGE's overall costs were below the benchmark during the subject ACA period, Mid-Kansas' gas cost charges could have been as high as 110% of the benchmark and MGE's gas purchasing decisions could not be subject to a prudence review. In light of this fact, Staff greatly underestimated the credit to be given to Mid-Kansas for its lower gas costs to MGE in offsetting Mid-Kansas' alleged higher transportation rates.

VII. Conclusion

Q. Could you please summarize your conclusions?

A. As fully discussed within the body of my testimony I believe that: (1) The prudence of the Mid-Kansas II Agreement was settled by virtue of a Stipulation and Agreement approved by the Commission on June 11, 1996; (2) The entry of Mid-Kansas and Riverside Pipeline Company, L.P. (Riverside), as a gas supplier for the Kansas City, Missouri area, was essential to the development of stable, long term pipeline competition; (3) Pipeline competition results in significant benefits for natural gas consumers; (4) MGE exercised prudent business judgment when it executed the Mid-Kansas II Agreement, the Riverside I Agreement and the Riverside II Agreement, all on February 24, 1995; and (5) Staff's calculation in their recommendation is incomplete, unfair, inaccurate and arbitrary. Based upon these findings, I strongly urge the Commission to reject the recommendation advanced by Staff.

Q. Does this conclude your testimony?

A. Yes it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Gas Service, a Western Resources Company, tariff sheets reflecting PGA changes to be reviewed in the Company's 1993-1994 Actual Cost Adjustment	)	Case No. GR-94-101
In the matter of Missouri Gas Energy's tariff revisions for the former Gas Service area (exclusive of the Palmyra area) to be reviewed in the Actual Cost Adjustment for the period February 1, 1994 through June 30, 1994	)	Case No. GR-94-228

STIPULATION AND AGREEMENT

Come now: (1) Western Resources Inc., f/k/a Gas Service Company ("WR"); (2) Missouri Gas Energy, a Division of Southern Union Company ("MGE"); (3) Riverside Pipeline Company, L.P. ("Riverside"); (4) Mid-Kansas Partnership ("MKP"); (5) the Staff of the Public Service Commission of Missouri ("Staff"); and (6) the Office of Public Counsel ("Public Counsel") (collectively the "Signatories") and enter into this Stipulation and Agreement ("Stipulation") by which they stipulate, agree, resolve, compromise and settle the matters set forth below as follows:

1. In Case No. GR-93-140 (covering the ACA period of July 1, 1992 through June 30, 1993) before the Public Service Commission of Missouri ("Commission"), Staff issued its recommendation on April 29, 1994 and the Commission held hearings related thereto on February 2 through February 3, 1995. On July 14, 1995, the Commission issued its Report and Order ("Report and Order"). On July 24, 1995, WR, MGE, Riverside and MKP filed Applications for Rehearing of the Commission's Report and Order. On September 18, 1995, the Commission denied the Applications for Rehearing. On September 29, 1995 Riverside/MKP and WR (on October 2,

1995) filed Petitions for Writ of Review respectively. On October 10, 1995, the Circuit Court of Cole County, Missouri issued a Stay of the Report and Order. MGUA also filed a Petition for Writ of Review. The appeals have been consolidated, briefs filed and the cases are pending in the Circuit Court of Cole County, Missouri as Case Nos. CV195-1163CC, CV195-1170CC and CV195-1242CC. Nothing in this Stipulation is designed to affect the status of Case No. CV195-1242CC, which is the appeal taken by MGUA.

2. In Case Nos. GR-94-101 and GR-94-228 before the Commission, Staff issued its recommendation on June 16, 1995. The ACA period of Case Nos. GR-94-101 and GR-94-228 is July 1, 1993 to June 30, 1994. GR-94-101 covers WR's PGA changes to be reviewed in its 1993/1994 Actual Cost Adjustment. Southern Union Company d/b/a MGE acquired most of WR's gas distribution properties in Missouri as of February 1, 1994. GR-94-228 includes the PGA costs and revenues for the five month period ending June 30, 1994. On March 1, 1994, United Cities Gas Company ("United Cities") acquired the remaining Missouri properties of WR, being the properties in the Palmyra District. Case No. GR-94-227 was established by the Commission to cover the ACA period for WR from February 1, 1994, through June 30, 1994. Case No. GR-94-227 has been held in abeyance pending the outcome of Case Nos. GR-93-140, GR-94-101 and GR-94-228. The basis on which United Cities and the Palmyra district are involved in these matters is that WR did not have a separate PGA/ACA for Palmyra. Therefore, costs related to Riverside/MKP are included in the amounts paid by Palmyra customers during the periods relative to GR-93-140 and GR-94-101. Customers in Palmyra have never actually received any gas from Riverside/MKP. Palmyra is served exclusively by Panhandle Eastern Pipe Line Company. WR, however, commingled the gas costs from Palmyra with the other districts in the administration of the PGA/ACA. As a result of that,

Palmyra residents paid costs which were established on Riverside/MKP amounts. Subsequent to February 1, 1994, no costs arising from Riverside/MKP have been allocated to the Palmyra District. As of March 1, 1994, United Cities had tariffs in effect establishing a PGA/ACA for Palmyra which did not include any Riverside/MKP amounts.

3. The Commission established Case No. GR-95-82 for the ACA period of July 1, 1994 to June 30, 1995. The Commission has also established Case No. GR-96-78 for the ACA period of July 1, 1995 to June 30, 1996.

4. Staff has reviewed the following Agreements between or among WR, MGE, Riverside and MKP.

A. Sales Agreement dated January 15, 1990, between WR and MKP, as amended on October 3, 1991, with a maximum daily quantity of 46,332 Mmbtu, hereinafter the "MKP/WR Sales Agreement". The MKP/WR Sales Agreement was further amended on February 24, 1995, and terminated as of May 31, 1995;

B. Transportation Agreement dated January 15, 1990, between WR and Riverside, as amended by letter agreement dated September 15, 1992, with a maximum daily quantity of 46,332 Mmbtu, hereinafter the "Riverside/WR Transportation Agreement I". The Riverside/ WR Transportation Agreement I terminated as of May 31, 1995;

C. Sales Agreement dated February 24, 1995, between MGE and MKP with a maximum daily quantity of 46,332 Mmbtu, hereinafter the "MKP II Interim Firm Gas Sales Contract". Service under the MKP II Interim Firm Gas Sales Contract commenced on June 1, 1995;

D. Transportation Agreement dated February 24, 1995, between MGE and Riverside with a maximum daily quantity of 46,332 Mmbtu, hereinafter the "Riverside/MGE Transportation Agreement I" which will become effective at a later date pursuant to the terms thereunder.

All of the above Agreements (A to D inclusive) may be collectively referred to herein as the "Missouri Agreements".

5. As a result of this Stipulation and Agreement, the Signatories agree that neither the execution of the MKP/WR Sales Agreement and the Riverside/WR Transportation Agreement I, nor the decisions associated with the execution of the Missouri Agreements shall be the subject of any further ACA prudence review. In addition, the Signatories agree that the transportation rates and gas costs charged pursuant to the Missouri Agreements shall not be the subject of any further ACA prudence review until the case associated with the audit period commencing July 1, 1996, and ending June 30, 1997. The Missouri Agreements will be subject to the compliance and operational review (as described herein) of the Staff for all periods on and after July 1, 1994, and MGE's ACA balance may be subject to adjustment as a result of such review.[1] The intent of the Signatories by this Stipulation and Agreement is that the Commission, in adopting this Stipulation and Agreement, issue

[1]As a result of the Commission's decision in Case No. GO-94-318, MGE is scheduled to have new tariffs in operation under an incentive PGA commencing July 1, 1996. Since those tariffs have not been submitted to the Commission, it is difficult to state with any certainty how they may relate to the settlement being effected by this Stipulation. However, it is the intention of the Signatories that to the extent there are gas cost (non-transportation) issues involving any of the Missouri Agreements which are relevant to the time periods after July 1, 1996, those amounts will come under the Incentive PGA provisions as approved by the Commission. As a result, any issues related to gas costs associated with the Missouri Agreements will be subject to the provision that unless MGE's costs subject to the Incentive PGA provisions to be filed rise to the level where a prudence review is triggered, there will be no prudence review of the Missouri Agreements.

an order holding that the transportation rates and gas costs charged pursuant to the Missouri Agreements shall not be disallowed by the Commission based on the reasons described above in this paragraph in Case Nos. GR-94-101, GR-94-227, GR-94-228, GR-95-82 and GR-96-78, and that the findings and conclusions regarding the prudence of the execution of the Missouri Agreements made by the Commission in Case No. GR-93-140 shall be compromised and settled as provided for herein. Although the prudence of entering into the MKP/WR Sales Agreement and the Riverside/WR Transportation Agreement I is finally settled by this Stipulation, additional questions may arise regarding the administration of the contracts by MGE and WR in Staff's compliance and operational review for all periods on and after July 1, 1994, as described above. Therefore, this Stipulation is not designed to preclude the Staff from making proposed adjustments regarding issues involving the manner in which gas is actually taken under the contracts (e.g., gas which was available under the contract was not taken for some reason) or issues involving billing matters (e.g., MGE paid more than was required under the contract due to a billing or mathematical error.) Further, as a consequence of the Commission adopting this Stipulation as provided herein, WR, Riverside/MKP, and MGE agree to make the necessary filings with the Circuit Court of Cole County, Missouri to dismiss the appeals they have taken from Case No. GR-93-140. These dismissals shall take place within ten days of the payments being made as scheduled in paragraph 7.A. As a consequence, WR and Riverside/MKP agree to pay the amounts which are owed due to Case No. GR-93-140 through the procedures described herein.

Nothing herein is to be construed as determining the rights, obligations, compliance or non-compliance with the terms and conditions of any contract between or among WR, MKP, Riverside, and MGE or any combination thereof. WR, MGE and Riverside/MKP agree that this Stipulation shall in no manner whatsoever be deemed to be admission of fault, responsibility or liability of any matter whatsoever by WR, MGE, Riverside and/or MKP. WR, MGE and Riverside/MKP agree that this Stipulation is purely and exclusively for the purpose of avoiding the cost of litigation and regulatory proceedings and is to be construed as that and nothing more.

6. In consideration of the foregoing and the mutual agreements contained herein, and conditioned on the issuance of a Commission Order adopting this Stipulation and Agreement in its entirety without change, WR and Riverside/MKP hereby agree to tender payments as provided below. A total of $4,000,000 ("the Settlement Payment") shall be paid to effect a settlement of all issues involving the prudence of the execution of the Missouri Agreements as specified in paragraph 5 in the following cases: GR-93-140, GR-94-101, GR-94-227, GR-94-228, GR-95-82 and GR-96-78. Of the $4,000,000 total, $1,150,000 will be paid by WR and $2,850,000 will be paid by Riverside/MKP as specified in paragraph 7 below. Of these amounts, $3,992,500 shall be paid to MGE and $7,500 to United Cities so that each can cause the respective amounts to be credited to their respective ratepayers through the ACA process by lowering the otherwise applicable ACA factors. In this regard, MGE and United Cities are simply conduits for the delivery of these funds to their ratepayers.

7. The Settlement Payment shall be made as follows:

A. $2,492,500 shall be paid on or before August 5, 1996 to MGE, which amount shall include all payments which may be due under the appeal of Case No. GR-93-140. Of such amount, WR shall pay $1,150,000 and Riverside/MKP shall pay $1,342,500. Under the currently effective PGA/ACA provisions, MGE would, in turn, make its ACA filing on or about August 10, 1996, at the Commission, which filing would reflect a credit of the amount received. Such credit will extinguish any and all obligations which MGE or WR or both have with regard to the findings and conclusions regarding the prudence of the execution of the Missouri Agreements made by the Commission in Case No. GR-93-140.

B. $7,500 shall be paid by Riverside/MKP on or before August 10, 1996 to United Cities, which shall, in turn, make a filing to reflect a credit of that amount in its next scheduled ACA filing with the Commission thereafter. Such credit shall extinguish any and all obligations which United Cities has regarding proposed disallowances by the Staff relating to the Missouri Agreements.

C. $1,500,000 shall be paid to MGE by Riverside/MKP on or before July 26, 1997. MGE shall, in turn, make an ACA filing at the Commission on or before August 1, 1997, which reflects a credit of that amount subject to the provisions of paragraph 7.D.

D. MGE is currently under order of the Commission in Case No. GO-94-318 (Phase II) to implement an Incentive PGA mechanism. Tariffs to do so are not yet due and have not been approved by the Commission. As a result of the uncertainty regarding what the structure of MGE's ACA may be in the future, all the parties can practically do at this time is state the intention that MGE will make a timely filing with the Commission proposing to credit that amount to its ratepayers through whatever functional equivalent of an ACA factor may exist at that time.

8. It is expressly stipulated and agreed by MGE, Riverside/MKP and Staff that the Settlement Payment shall be deemed to be a singular, lump sum, one time settlement payment made

in two installments as described in Paragraph 7 above; conversely MGE, Riverside/MKP and Staff agree the Settlement Payment is conclusively and irrebuttably NOT to be construed as multiple payments (even though the lump sum payment is being made in two installments) or as relating to disallowances for two (2) consecutive audit years, with respect to the provisions of any of the Missouri Agreements, as amended. MGE, Riverside/MKP and Staff agree that the Settlement Payment shall in no manner be deemed to be payments made for adjustments or disallowances in two consecutive ACA periods for the same or similar reasons or a denial of WR or MGE's right to recover amounts paid to MKP or Riverside in two consecutive ACA periods for the same or similar reasons.

9. None of the signatories to this Stipulation and Agreement shall have been deemed to have approved or acquiesced in any ratemaking or procedural principle or any method of cost determination or cost allocation, or any service or payment standard and none of the signatories shall be prejudiced or bound in any manner by the terms of this Stipulation in this or any other proceeding, except as otherwise expressly specified herein.

10. This Stipulation has resulted from extensive negotiations among the signatories and the terms hereof are interdependent. In the event the Commission does not approve and adopt this Stipulation in total, then this Stipulation shall be void and no signatory shall be bound by any of the agreements or provisions hereof.

11. In the event the Commission accepts the specific terms of this Stipulation, the Signatories waive, with respect to the issues resolved herein: their respective rights pursuant to

Section 536.080.1 RSMo. 1986 to present testimony,[2] to cross-examine witnesses, and to present oral argument and written briefs; their respective rights to the reading of the transcript by the Commission pursuant to Section 536.080.2 RSMo. 1986; and their respective rights to judicial review pursuant to Section 386.510 RSMo. 1986 in regard to a Commission order approving this Stipulation and Agreement.

12. If requested by the Commission, the Staff shall have the right to submit to the Commission a memorandum explaining its rationale for entering into this Stipulation. Each Party shall be served with a copy of any memorandum and shall be entitled to submit to the Commission, within five (5) days of receipt of Staff's memorandum, a responsive memorandum which shall also be served on all Parties. All memoranda submitted by the Parties shall be considered privileged in the same manner as are settlement discussions under the Commission's rules, shall be maintained on a confidential basis by all Parties, and shall not become a part of the record of the proceedings mentioned hereinabove or bind or prejudice the Party submitting such memorandum in said proceedings or in any future proceeding whether or not the Commission approves this Stipulation. The contents of any memorandum provided by any Party are its own and are not acquiesced in or otherwise adopted by the other signatories to the Stipulation, whether or not the Commission approves and adopts this Stipulation.

[2]The Signatories, the Midwest Gas Users Association and Williams Natural Gas agree that all of the testimony on the Riverside/MKP issue may be received into the record in Case Nos. GR-94-101 and GR-94-228 without the necessity of the respective witnesses taking the stand and, as a consequence, that the Commission need not rule on the contested motions to strike filed by Williams Natural Gas, WR and MGE.

The Staff shall also have the right to provide, at any agenda meeting at which this Stipulation is noticed to be considered by the Commission, whatever oral explanation the Commission requests, provided that the Staff shall, to the extent reasonably practicable, provide the other Parties with advance notice of when the Staff shall respond to the Commission's request for such explanation once such explanation is requested from Staff. Staff's oral explanation shall be subject to public disclosure, except to the extent it refers to matters that are privileged or protected from disclosure pursuant to any Protective Order issued in this case.

13. The terms of this Stipulation shall be binding on any successors and assigns of WR and Riverside/MKP and on the partners and general partners of Riverside/MKP.

14. In the event Riverside/MKP or any successor or affiliated entity fails to pay to MGE any of the amounts required herein, MGE shall be entitled to set off any such amounts against payments owed by MGE to Riverside/MKP or any successor or affiliated entity due to service taken by MGE under the MKP II Interim Firm Gas Sales Contract, the Riverside/MGE Transportation Agreement I and/or any successor agreements. Notwithstanding any other provision in this stipulation to the contrary, if such setoff is prevented from occurring or otherwise does not occur, in whole or in part, for any reason whatsoever, the Signatories agree that any amount owed to MGE by Riverside/MKP or any successor or affiliated entity pursuant to this Stipulation that is unpaid represents a regulatory disallowance under the above agreements.

Respectfully submitted,

Robert J. Hack, #36496
General Counsel
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
573/751-8705
573/751-9285 (fax)
ATTORNEY FOR THE STAFF OF
THE MISSOURI PUBLIC SERVICE
COMMISSION

by RJH
Martin J. Bregman
General Attorney, Regulation
Western Resources, Inc.
818 Kansas Avenue
P.O. Box 889
Topeka, Kansas
913/575-1986
913/575-8136 (fax)
ATTORNEY FOR
WESTERN RESOURCES, INC.

by RJH
Gary W. Duffy
Brydon, Swearengen & England
12 East Capitol Avenue
P.O. Box 456
Jefferson City, MO 65102
573/635-7166
573/635-3847 (fax)
ATTORNEY FOR MISSOURI
GAS ENERGY

by RJH
Douglas E. Micheel
Senior Public Counsel
Office of Public Counsel
P.O. Box 7800
Jefferson City, MO 65102
573/751-5560
573/751-5562 (fax)
ATTORNEY FOR THE OFFICE
OF THE PUBLIC COUNSEL

Richard W. French
French & Stewart Law Offices
1001 Cherry Street, Ste. 302
Columbia, MO 65201
573/499-0635
573/499-0639 (fax)

James P. Zakoura
Smithyman & Zakoura
650 Commerce Plaza 1
7300 West 110th Street
Overland Park, KS 66210
913/661-9800
913/661-9863 (fax)

ATTORNEYS FOR KANSAS PARTNERSHIP
AND RIVERSIDE PIPELINE, L.P.

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 2nd day of May, 1996.

Robert J Hack

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

At a session of the Public Service Commission held at its office in Jefferson City on the 11th day of June, 1996.

In the Matter of Gas Service, a Western Resources Company, Tariff Sheets Reflecting PGA Changes to be Reviewed in the Company's 1993-1994 Actual Cost Adjustment.	)	Case No. GR-94-101
In the Matter of Missouri Gas Energy's Tariff Sheets Reflecting PGA Changes to be Reviewed in the Company's 1993-1994 Actual Cost Adjustment.	)	Case No. GR-94-228

ORDER APPROVING STIPULATIONS AND AGREEMENTS

These cases were established for the purpose of receiving the Western Resources, Inc. (WRI) annual cost adjustment (ACA) filing for the 1993-94 adjustment period, extending from July 1, 1993, through February 1, 1994, and the Missouri Gas Energy (MGE) filing for the February 1, 1994, through June 30, 1994 portion of the 1993-94 period. MGE is a successor in interest to WRI, having undertaken the operation of the instant service area, excluding the Palmyra District, on February 1, 1994.

As the result of extensive negotiations between the parties, two Stipulations And Agreements were filed in this case, at separate times. Stipulation And Agreement #1, styled as "Unanimous Stipulation And Agreement," was filed on December 14, 1995, and purported to settle three of the five issues raised by the Staff in this litigation. Stipulation And Agreement #2, styled "Stipulation And Agreement," was filed on May 2, 1996, and purports to settle a fourth issue. The remaining issue of the five original issues was fully litigated on May 6 and 7, 1996, and will be

Servic List
Comb ng Case Nos.
GR-94 01 and GR-94-228
April . 1996

Richar S. Brownlee, III
P.O. B : 1069
235 E. igh Street
Jeffers . City , MO 65102

Stuart W. Conrad
1209 Penntower Office Center
3100 Broadway
Kansas City, MO 64111

Gary \ Duffy
Attorn at Law
P.O. B 456
Jeffers City, MO 65102

Doug Micheel
Office of the Public Counsel
P.O. Box 7800
Jefferson City, MO 65102

Rick F ich
French Stewart
E Cherry St., Ste 302
Colum , MO 65201

James P. Zakoura
Smithyman & Zakoura
650 Commerce Plaza
7300 West 110th Street
Overland Park, KS 66210

Martin Bregman
Western Resources, Inc.
P.O. B 889
818 Ka s Ave.
Topeka S 66601

finally submitted to the Commission for decision with the filing of reply briefs on June 28, 1996.

The five issues raised in this case, as set out by the parties in Stipulation And Agreement #1, are:

1. Assignment of Gas Supply Contracts;
2. Storage Inventory;
3. Take or Pay Account;
4. Mid-Kansas Partnership and Riverside Pipeline Company (Mid-Kansas/Riverside) Gas Supply Contract; and
5. OXY Petroleum Gas Supply Contract.

Stipulation And Agreement #1 deals with the first three of these issues.

Stipulation And Agreement #1

All parties to this matter were signatories to this agreement except intervenor Midwest Gas Users Association (MGUA). Stipulation And Agreement #1 is incorporated in this order as Attachment A.

In regard to the "Assignment of Gas Supply Contracts" issue, the Staff states, in paragraph B.2., that, as a result of the Commission's decision in Case No. GR-93-140, the proposed adjustment is not applicable and that the proposed adjustment will not be reflected in this decision.

In regard to the "Storage Inventory" issue, the Staff states that the settlement of this issue reflects the Staff's position that storage reservation charges should be treated as current gas cost expense rather than being included in the storage inventory balance. As a result, MGE has agreed to increase its recovery balance in Case No. GR-95-82 and simultaneously decrease its Williams Natural Gas Company (WNG) storage inventory balance in the amount of $1,067.066.20.

In regard to the issue styled "Take or Pay Account," the Staff has proposed two adjustments. The first adjustment concerns the allocation of WNG take or pay refunds and charges, and the second concerns an alleged error in the take or pay revenue recovery reported by MGE for the month of February 1994. After examination of the billings and refunds under applicable Federal Energy Regulatory Commission (FERC) dockets, the Staff agrees to withdraw its recommendation that the WNG take or pay charges be based on an allocation to MGE of 53.77 percent. MGE has also agreed to include an additional $56,299.80 as part of the beginning balance in its take or pay account for Case No. GR-95-82, settling the Staff's second concern.

After review of Stipulation And Agreement #1, and as a result of the operation of rule 4 CSR 240-2.115, the Commission considers Stipulation And Agreement #1 to be, in effect, unanimous.

The Commission has reviewed Stipulation And Agreement #1 and finds that no evidentiary hearing is necessary in this matter. The Commission finds Stipulation And Agreement #1 to be reasonable and in the public interest, and will approve the Stipulation And Agreement.

Stipulation And Agreement #2

On May 2, 1996, Stipulation And Agreement #2 was filed, signed by all parties except WNG and MGUA. MGUA and WNG have preserved a constitutional issue on the record in this matter involving the legality of the purchase gas adjustment (PGA) mechanism and, likewise, acceded to this stipulation without signature. In addition, in the on-the-record portion of this proceeding, both parties were given the opportunity to state their positions. In accordance with Commission rule 4 CSR 240-2.115, the Commission considers Stipulation And Agreement #2 to be unanimous in regard to the issue settled therein.

The heart of Stipulation And Agreement #2 is contained in paragraphs 5 through 8 of Attachment B, and purports to settle the issue styled "Mid-Kansas/Riverside Gas Supply Contracts." For purposes of this order, a brief summary of those settled matters will suffice.

In paragraph 5 the parties agree that various contracts, including the Mid-Kansas/Riverside-WRI sales agreement and a series of contracts referred to as the "Missouri Agreements" and detailed in Attachment B, paragraph 4, A through D, will not be subject to any further prudence review, and will not be subject to review of transportation rates and commodity costs until the annual audit period commencing July 1, 1996. The Missouri Agreements will be subject to compliance, operational review, and balance adjustment after July 1, 1994.

Continuing with paragraph 5, the parties request the Commission issue an order stating that the transportation rates and gas (commodity) costs charged pursuant to the Missouri Agreements shall not be disallowed for prudence reasons in this case and in Case Nos. GR-94-101, GR-94-227, GR-94-228, GR-95-82, and GR-96-78. The parties also provide for the settlement of Case No. GR-93-140, currently on appeal.

The Commission finds the settlement of issues in the Stipulations and Agreements, together with the settlement of multiple pending cases, to be appropriate for several reasons. The Commission is of the opinion that settlement of transitional contracts favoring the ratepayers, as in this case, are clearly in the public interest. Further, substantial and expensive litigation has been avoided, and MGE may now move forward in the administration of its incentive plan.

Paragraph 6 provides for payment by WRI and Mid-Kansas/Riverside in the total amount of $4,000,000.00, to be paid as specified in paragraph 7. The agreement provides for payment by WRI of $1,150,000.00

and payment by Mid-Kansas/Riverside of $2,850,000.00, all except $7,500.00 of which will be paid to MGE at various intervals, as specified in paragraph 7. MGE agrees to credit these payments to its ratepayers through the PGA mechanism or the functional equivalent at the time.

Paragraph 8 specifies the mechanics and treatment of the agreed-upon payments.

After review of Stipulation And Agreement #2, and as a result of the operation of rule 4 CSR 240-2.115, the Commission considers Stipulation And Agreement #2 to be, in effect, unanimous. The Commission finds the agreement to be reasonable and in the public interest and will approve the agreement.

The Commission incorporates the contents of both Stipulation And Agreement #1 and Stipulation And Agreement #2 into this order as if fully set out.

IT IS THEREFORE ORDERED:

1. That the Stipulations And Agreements set out as Attachments A and B to this order are hereby approved.

2. That this order shall become effective on the 21st day of June, 1996.

BY THE COMMISSION

David L Rauch

David L. Rauch
Executive Secretary

(S E A L)

Zobrist, Chm., McClure,
Kincheloe and Drainer, CC.,
concur.
Crumpton, C., absent.

ALJ: Derque.

ANALYSIS OF

ECONOMIC BENEFITS

FROM

KANSAS PIPELINE GROUP

COMPETITIVE SALES AND TRANSPORTATION OF NATURAL GAS

IN THE

KANSAS CITY METROPOLITAN AREA

DECEMBER 1992

WITH

ADDENDUM

MAY 14, 1993

John C. Dunn & Company

ANALYSIS OF

ECONOMIC BENEFITS

FROM

KANSAS PIPELINE GROUP

COMPETITIVE SALES AND TRANSPORTATION OF NATURAL GAS

IN THE

KANSAS CITY METROPOLITAN AREA

DECEMBER 1992

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ADDENDUM

MAY 14, 1993

I would appreciate your review of the combined study and the opportunity to discuss it with you at your convenience. We appreciate the opportunity to be of service in connection with this important assignment and hope that the reports will contribute in some small way to the continued success of Kansas Pipeline Group in reducing the total cost of natural gas in the Kansas City metropolitan area.

As I noted in my original correspondence to you, a significant amount of help was received from you and members of the Kansas Pipeline Group team in preparing this report. The report includes a number of summaries and consolidated analyses which are merely the tip of the iceberg as compared to the amount of work required to produce such summaries. Much of this work was done by Kansas Pipeline Group personnel and we appreciate this assistance.

Thank you again.

Sincerely,

John C. Dunn

After the initial report was delivered to you, it was established that several factors were emerging which could be considered as threats to continued economic benefits which were being generated by the Kansas Pipeline Group. These threats included the following:

- The possibility of limiting the growth of Kansas Pipeline Group and allowing the current competitive imbalance in the Kansas City natural gas market to continue.
- Regulatory reviews of gas acquisition policies which could cause the LDC to inappropriately avoid alternative supply and/or transportation choices to minimize short run regulatory risk.
- Predatory contract demands by WNG on its LDC customers which could have the potential to foreclose permanent and workable competition.
- Efforts by the LDC and WNG to capture some of the benefits of competition by negotiation or contract without the physical development of a permanent and workable competitive alternative.

It was concluded that if such threats became actualized, the competitive impact of Kansas Pipeline Group on the Kansas City area may be reduced, and WNG would once again be permitted to operate as a monopoly extracting unreasonable prices from Kansas City LDCs and, in turn, from the ultimate customers of the LDCs. The purpose of the addendum was to identify the threats and to the extent possible, by highlighting them, contribute to a recognition of their existence and a positive response to eliminate such threats.

The continued savings produced by the operation, competition, and competitive threat produced by the Kansas Pipeline Group detailed between the states is as follows:

Annualized Level of Customer Savings
Kansas City Metropolitan Area
December 1992

	Kansas	Missouri	Total
Annualized savings substitution of Kansas Pipeline natural gas and transportation	$ 629,193	$ 593,502	$ 1,222,695
Annualized savings competitive market prices	8,766,773	9,670,143	18,436,916
Total annualized savings	$9,395,966	$10,263,645	$19,659,611

The study also concluded that Kansas Pipeline played an important role in the community by adding new disposable income to the community which, when adjusted by the local economic multiplier, exceeded $250 million. Kansas Pipeline also created construction activity, added jobs, and did so without the benefit of tax abatement, government subsidy, or some other direct cost to the communities.

In addition, the pipelines significantly added to the pipeline capacity serving both Kansas City and Wichita and, as a consequence, positioned both communities for further economic development without increased costs for the transportation of additional levels of on- and off peak natural gas into the community.

The savings divided between Missouri and Kansas can be summarized as follows:

Historic Customer Savings
November 1986 - December 1991
State, Category, and Total

	Kansas	Missouri	Total
Substitution of Kansas Pipeline Group natural gas	$ 5,332,989	$ 580,413	$ 5,913,402
Substitution of Kansas Pipeline Group transportation	875,375	677,322	1,552,697
Competitive price constraint	57,438,443	62,526,805	119,965,248
Total	$63,646,807	$63,784,540	$127,431,347

The original report concluded that the savings continue to accrue at the date of the first report, December 18, 1992, at a rate of $19,659,000 per year. The continued savings were produced by the substitution of lower cost natural gas and transportation from the Group for WNG natural gas and transportation, and a continuation of price restraint by WNG in response to the competitive marketplace created by the operations of Kansas Pipeline Group.

John C. Dunn & Company

1020 KING STREET, SUITE 360
OVERLAND PARK, KANSAS 66210-1201
TELEPHONE 913-451-9330
TELECOPIER 913-451-2704

March 11, 1994

Mr. Wendell Putman
Executive Vice President
Kansas Pipeline Operating Company
8325 Lenexa Drive, Suite 400
Lenexa, Kansas 66214

Dear Wendell,

In 1992, Kansas Pipeline Group retained us to complete a comprehensive analysis of economic benefits which had been produced in the Kansas City area by the operation of the Group. That report was completed, reviewed and submitted to you in final form on December 18, 1992. Shortly thereafter, it became apparent that the economic benefits which were being produced by the Group were jeopardized by certain actions of the Group's competitor, Williams Natural Gas (WNG), and its main customer, Western Resources.

These new circumstances prompted the need to produce an "addendum" to the original report. The addendum, dealing with the threats to the developing competitive market for natural gas and natural gas transportation, was submitted to you in draft form on May 14, 1993. After comment and review, I have finalized the addendum. I have taken the liberty to combine the addendum and the original report into a single bound document.

I am transmitting herewith five bound copies of the report dated December 18, 1992 and the addendum dated May 14, 1993 for your files.

As more fully discussed in the original report, since starting operations in 1986, the Kansas Pipeline Group has produced more than $125 million in direct savings for natural gas customers in the Kansas City area. These savings are in reduced costs for natural gas and reduced fees for transportation services. In addition, these savings Kansas Pipeline produced have increased the regional level of economic activity by at least $250 million.

KANSAS PIPELINE GROUP

ANALYSIS OF ECONOMIC BENEFITS

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ANALYSIS OF

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FROM

KANSAS PIPELINE GROUP

COMPETITIVE SALES AND TRANSPORTATION OF NATURAL GAS

IN THE

KANSAS CITY METROPOLITAN AREA

DECEMBER 1992

WITH

ADDENDUM

MAY 14, 1993

Personally, I wish to thank you for the opportunity to complete this important analysis for Kansas Pipeline. This study has been a rewarding challenge and we appreciate the trust which you have placed in us in granting us the opportunity to do this study. Thank you again.

Sincerely,

John C. Dunn

JCD;bp
Enclosures

The report also discusses, but does not quantify, the fact that Kansas Pipeline has greatly increased the capability of the natural gas pipeline systems serving Kansas City. The increased capability reduces peak load interruptions for industrial and large commercial customers. This in turn improves economic activity as production is maintained at high levels during periods which would have been subject to peak interruption.

In addition, although no specific calculations have been made, it is apparent that Kansas Pipeline's decision to locate its headquarters in Kansas City will contribute to local economic activity.

In sum, Kansas Pipeline Group has had substantial positive impacts on Kansas City ranging from direct reductions in the cost of gas to additions to the employment base. As Kansas Pipeline's competitive activities intensify, the savings will increase and the level of community benefits will be enhanced.

The study shows that Kansas Pipeline is an important new asset to the community which will make it more viable and more attractive for businesses and a better place to live. Considering all of the benefits which have flowed to the city from the system, Kansas Pipeline Group ranks as one of the most important investments in the region this decade.

We would appreciate your review of the enclosed report and the opportunity to discuss its conclusions at your convenience. We appreciate the help which we have received from you and members of the Kansas Pipeline Group team in preparing this report. There is a substantial underlying analysis involving significant time and effort well beyond that implied by the summaries contained in the report. Much of that work was done by Kansas Pipeline Group personnel.

John C. Dunn & Company

1020 KING STREET, SUITE 360
OVERLAND PARK, KANSAS 66210-1201
TELEPHONE 913-451-9330
TELECOPIER 913-451-2704

December 18, 1992

Mr. Wendell Putman
Executive Vice President
Kansas Pipeline Operating Company
9200 Indian Creek Parkway, Suite 180
Overland Park, Kansas 66210

Dear Wendell,

Enclosed please find five copies of our report on the economic impact of Kansas Pipeline Group on the Kansas City metropolitan area.

As more fully discussed in the report, since starting operations in 1986, Kansas Pipeline Group has produced more than $125 million in direct savings for natural gas customers in the cost of natural gas and its transportation. The savings produced by Kansas Pipeline has increased the regional level of economic activity by at least $250 million.

The analysis shows that the benefits have been shared between Missouri and Kansas. It also shows that benefits continue to accrue at approximately $20 million per year in direct savings which increase the level of total economic activity by $40 million per year. The current level of savings is expected to grow rapidly as the system volumes increase. The annual economic impact will increase proportionately.

The economic impact of Kansas Pipeline on the community has the effect of a new productive expenditure by local governments of over $350 million. Of course, all of the investment in Kansas Pipeline has been non-governmental and the investment has been made without tax abatement or other incentives.

ANALYSIS OF ECONOMIC BENEFITS

FROM

KANSAS PIPELINE GROUP

COMPETITIVE SALES AND TRANSPORTATION OF NATURAL GAS

IN THE

METROPOLITAN KANSAS CITY AREA

EXECUTIVE SUMMARY

Prior to November 1986, Williams Natural Gas Company (WNG) held a monopoly over the pipeline delivery of natural gas into the metropolitan Kansas City area. WNG's substantially unrestrained activities caused natural gas prices in the Kansas City metropolitan area to be higher than would have been the case in a competitive environment. The monopoly also limited the benefits Kansas City received from the Federal Energy Regulatory Commission (FERC) restructuring of the natural gas pipeline and supply industries.

During November 1986, Kansas Pipeline Partnership (Kansas Pipeline) and its affiliates (Kansas Pipeline Group) began competitive delivery of natural gas in the Kansas City metropolitan area. Initial deliveries were to industrial customers in the metropolitan area, and deliveries to Kansas City's primary local distribution company, KPL Gas Service, followed the industrial deliveries almost immediately.

That development was a watershed for the natural gas business in Kansas City. First, it significantly reduced the cost of natural gas for customers who substituted Kansas Pipeline Group natural gas and transportation service for WNG natural gas and transportation service. Second, the competitive pressure held down the charges WNG made for its natural gas supply and natural gas transportation service. Third, it produced other significant economic effects which multiplied through the local economy.

By 1992, the cumulative benefits and savings have become substantial, materially impacting the Kansas City area economy and natural gas customers. The level of savings and the importance of Kansas Pipeline Group to the Kansas City area is expected to continue to grow as Kansas Pipeline Group adds to its facilities and widens the competitive front.

This report identifies some of the economic impacts of the Kansas Pipeline Group and quantifies two direct results -- savings caused by substituting Kansas Pipeline gas and transportation for WNG gas and transportation; and savings from the competitive restraint on WNG pricing.

In addition, prior to the emergence of Kansas Pipeline Group, the Kansas City area economy was in equilibrium. A component of that equilibrium was the structure of then current natural gas rates and the total cost of natural gas consumed at the equilibrium level of economic activity. When the financial benefits of Kansas Pipeline Group flow into the equilibrium as a reduction in the cost of gas, the savings is for the consumers of natural gas new discretionary income. The new income, when spent, multiplies through the economy significantly increasing the local level of economic activity. An estimate of this economic "multiplier" effect on local economic activity will also be calculated.

Finally, an estimate of the value of Kansas Pipeline Group as part of the infrastructure serving the metropolitan area will be developed. Prominent economic impacts, which cannot be readily quantified, will be briefly discussed.

Background

Prior to November 1986, the Kansas City metropolitan area's dominant local distribution company (LDC) obtained nearly 99 percent of its natural gas supply from a single pipeline supplier. The pipeline supplier monopoly caused Kansas City natural gas customers to pay inappropriately high prices for natural gas and related services. This arrangement also deprived natural gas customers of most of the benefits of the restructuring of the natural gas industry, much of the cost savings produced by competition for natural gas supply, and all the enhanced reliability and alternative services and supplies that would have been produced by multiple pipelines and suppliers.

In November 1986, Kansas Pipeline Group began delivering natural gas into the Kansas City area. These deliveries were the culmination of a process which began with the acquisition of an existing, but unused petroleum pipeline in 1984. Kansas Pipeline Group, through a series of construction and regulatory initiatives and over the strong regulatory and judicial opposition of WNG, converted the petroleum pipeline into a certificated natural gas pipeline system. The initial deliveries by the Kansas Pipeline Group were confined to Kansas City, Kansas industrial customers and to the gas distribution system of KPL Gas Service Company in the state of Kansas.

During September 1989, an affiliate, Riverside Pipeline Company L.P. (Riverside), obtained Federal Energy Regulatory Commission (FERC) permission to construct an interstate pipeline linking the Kansas facilities of Kansas Pipeline Partnership and the Missouri facilities of KPL Gas Service. With the creation of that link, the acquisition of other pipeline facilities in Kansas (Kansas Natural Partnership) and the construction of new pipelines in Oklahoma by another affiliate, KansOk Partnership, natural gas was brought into Kansas City, Missouri and Kansas from numerous Kansas sources as well as Oklahoma and Texas in direct competition with WNG.

A map of the current Kansas Pipeline Group natural gas pipeline system identifying each of the Kansas Pipeline Group entities is attached at the end of this executive summary.

Customer Savings From Kansas Pipeline Group Competition

Throughout its history, Kansas Pipeline Group has offered consistently lower prices for natural gas and natural gas transportation service than WNG. These lower prices produced direct savings for industrial customers which have substituted Kansas Pipeline Group natural gas and transportation services for WNG natural gas and transportation services. As KPL Gas Service began to take volumes from Kansas Pipeline Group, pursuant to regulatory practice, the lower Kansas Pipeline Group prices were passed first to all Kansas customers and, after Riverside was completed, to all Kansas City metropolitan customers of KPL Gas Service.

In addition to direct savings, displacement of WNG gas supply and transportation services put substantial competitive pressure on WNG as the incumbent pipeline supplier. This pressure caused WNG to reduce its cost of gas; to limit further price increases which it could have justified before the FERC; and to begin selective discounting of transportation rates into the Kansas City area[1].

WNG's competitive responses produced savings to metropolitan Kansas City natural gas users in addition to the direct savings from substituting lower-cost Kansas Pipeline Group transportation and natural gas for WNG transportation and natural gas.

Notwithstanding the competitive response by WNG, the Kansas Pipeline Group has been able to steadily increase the substitution of its natural gas and pipeline services, producing growing savings for the LDC and the LDC's residential, commercial and industrial customers. The dynamics of this process continue to increase the savings which is forecasted to continue to grow for the foreseeable future.

Calculation of Actual Savings

From the date of initial operation in November 1986 to December 31, 1991, the Kansas Pipeline Group's competitive effect can be summarized as follows:

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[1] By 1992, the targeted discounts offered by WNG reached 40 percent of published and authorized rates for at least one origin and destination pair.

Kansas Pipeline Group
Historic Customer Savings
November 1986 - December 1991

Year	Substitution of Kansas Pipeline Group Natural Gas	Substitution of Kansas Pipeline Group Transportation	Competitive Price Determination	Total
1986-1988	$2,496,969	$ 149,696	$ 61,363,773	$ 64,010,438
1989	1,704,291	48,234	17,770,141	19,522,666
1990	1,262,569	581,645	22,394,418	24,238,632
1991	449,573	773,122	18,436,916	19,659,611
Grand total	$5,913,402	$1,552,697	$119,965,248	$127,431,347

The savings produced by Kansas Pipeline Group can be considered as an incremental flow of new funds into the Kansas City economy. Prior to the operation of Kansas Pipeline Group, an economic equilibrium existed which included a natural gas component. The cost of the natural gas component was a drain or outflow of funds from the local economy. This is because the natural gas payment was comprised mainly of payments for natural gas and capital to a Tulsa based company.

When the Kansas Pipeline Group savings materialized, they were the equivalent of a new outside flow of funds adding to the local economic equilibrium. This is because the character of the funds flow was changed from one large non-discretionary outflow into two separate funds flows -- one smaller outflow and the remainder, a new discretionary funds flow available for expenditure locally[2]. A conservative regional multiplier effect for new discretionary funds is two times the impact amount to the level of cumulative economic impact. On this conservative basis, the economic impact of Kansas Pipeline Group on the regional economy is over $250 million[3].

In addition, Kansas Pipeline is a new taxpayer in the area paying property taxes, fees and other governmental charges. It also has made substantial investments and commitments for employees, materials, supplies and other operating expenses, most of which have large local components. These new expenditures are also subject to the multiplier effect as they flow through the

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2 The concept of the new funds flow has several parallels, some of which are more readily understandable. One, for example, is the existing housing stock in the local area. Prior to the 1992 decline in interest rates, most houses were financed and the level of payments associated with that financing was a component of the local economic equilibrium. When interest rates declined, many houses were refinanced and the difference between the new lower monthly payments and the older payments became new discretionary income to the individuals refinancing and in the aggregate, for all refinancing to the regional economy. This new discretionary income is the same as the new discretionary income caused by decreases in the cost of natural gas for the local economy.

3 This calculation assumes that all of the savings from the substitution of Kansas Pipeline natural gas and transportation are saved or reused within the regional economy. For residential, locally owned business and governmental units, this is entirely accurate. However, for some businesses which are parts of larger entities with ownership outside of the region, there is some flow of savings to the parent companies. This is because the savings are recorded as additional profits for the customers and usually some percentage of the new profits would flow to the parent company.

economy, albeit at a somewhat lower level of 1.8 times.

Allocation of Savings Between Kansas and Missouri

The total savings can be allocated between the customers in Missouri and Kansas for the period 1986 to 1991 as follows:

Kansas Pipeline Group
Historic Customer Savings[4]
Allocated Between Missouri and Kansas
November 1986 - December 1991

	Kansas	Missouri	Total
Substitution of Kansas Pipeline Group natural gas	$ 5,332,989	$ 580,413	$ 5,913,402
Substitution of Kansas Pipeline Group transportation	$ 875,375	$ 677,322	$ 1,552,697
Competitive price constraint	$57,438,443	$62,526,805	$119,965,248

Continuing Current Savings

It is expected that the current level of savings will grow as competition in the Kansas City natural gas market broadens. Part of the increased impact will be a result of an increase in the size of Kansas Pipeline Group physical facilities and the volumes it delivers. Part will be WNG's response to Kansas Pipeline

[4] Division by state on the basis of average price differentials for sales to both states.

Group's efforts.

As competition widens and becomes more intense, there will be further response by WNG. It is reasonable to expect responsive, competitive action by Kansas Pipeline Group, further responses by WNG, and a continuation of the downward ratcheting of prices for natural gas and for pipeline transportation services until a competitive equilibrium is established.

In any event, the cumulative savings of $119,965,248 realized by natural gas customers to date will continue to grow. A starting point to measure future annual savings is the current rate of savings generated by the competitive market. The current annual rate of savings is a follows:

Annualized Level of Customer Savings
For Natural Gas Customers
Kansas City Metropolitan Area

	Kansas	Missouri	Total
Annualized savings substitution of Kansas Pipeline natural gas and transportation	$ 629,193	$ 593,502	$ 1,222,695
Annualized savings competitive market prices	8,766,773	9,670,143	18,436,916
Total annualized savings	$9,395,966	$10,263,645	$19,659,611

Kansas Pipeline Group Community Value

So long as the regulatory environment permits reasonable competition to flourish and permits Kansas Pipeline Group to grow and develop, the savings produced through competition will continue to grow until a competitive equilibrium is reached. As savings grow and become more significant in the years ahead, Kansas Pipeline Group will be woven into the economic infrastructure as an asset of the community.

A conservative calculation of the current asset value of Kansas Pipeline Group to the metropolitan area can be made by valuing the stream of current savings and benefits produced for the area by Kansas Pipeline Group. This is the equivalent of calculating the amount of public investment necessary to produce the direct financial benefits generated by Kansas Pipeline Group. The calculation involves quantifying average annual savings created by Kansas Pipeline Group and capitalizing the amount to an asset value.

The calculation shows that the estimated value of the Kansas Pipeline Group to the metropolitan area is over $350 million based on 1992 savings and not including intangible benefits. If taxes paid and the impact on economic activity were taken into account, the amount would be much higher.

Other Economic Impacts

The direct dollar benefits of Kansas Pipeline Group are only part of its total impact on the Kansas City metropolitan area. For example, the gas supply system now serving Kansas City is the sum of the capacity of both WNG and Kansas Pipeline Group rather than just WNG. This change alone affords the City greater peak and annual gas supply capacity which means significant reductions in peak supply interruptions. For existing industrial consumers, this translates lower levels of fuel substitution and a higher level of activity associated with more continuous operation of industrial processes. This in turn promotes growth and economic development from increased industrial production and employment.

Significantly, benefits in this category have been produced at no additional cost to area natural gas consumers. To the contrary, these substantial economic benefits have been generated for Kansas City while the competitive influence of the Kansas Pipeline Group has been ratcheting down both the cost of natural gas and the cost of its transportation. This is in sharp contrast to the pattern of development which would have existed under the non-competitive, single supplier mode where any increment to supply or delivery capability would have caused new charges and costs to area consumers.

Also, natural gas consumers in the area enjoy the benefits of access to new natural gas supply areas. This puts pressure on the price of natural gas from gas-on-gas competition as producers compete for a new market. This also leads to an improved economic environment in the Kansas City area; increased employment and employment opportunities; and an operating environment where new business is attracted to the area due to favorable economics.

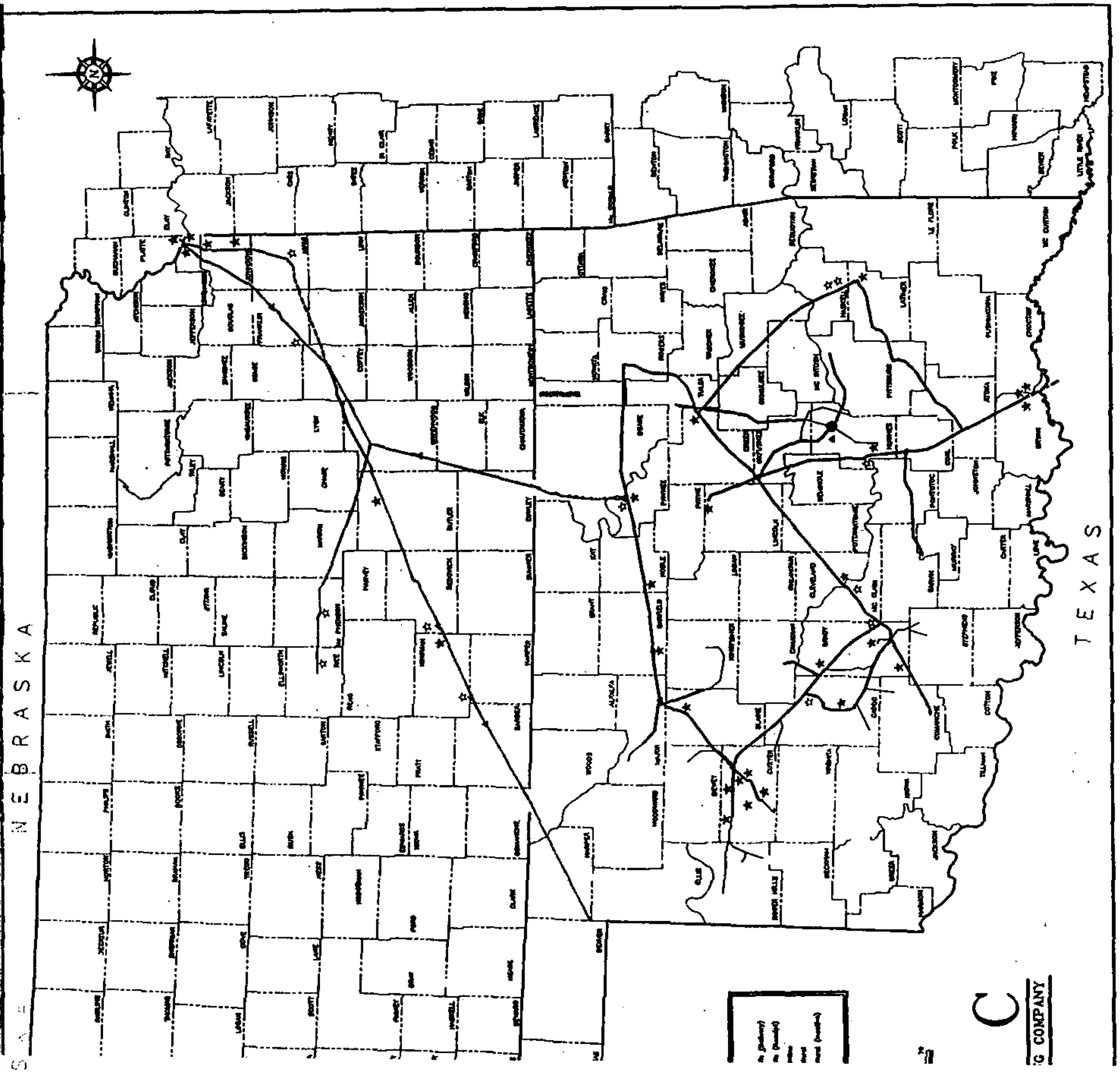
Finally, Kansas Pipeline Group has invested millions of dollars in plant and equipment in the region, all without the use of public funds, tax abatements or other special benefits from the community. Furthermore, in contrast to WNG, Kansas Pipeline Group has chosen to locate its headquarters within the service area. This directly increases local employment and creates new local opportunity.

Although the objective of this report is to measure total economic impact associated with the Kansas Pipeline Group on the metropolitan area, these secondary benefits cannot be assessed with the precision necessary to quantify their impact. It is clear, however, that while the measurable cumulative financial benefits are in the hundreds of millions of dollars, the indirect benefits in increased employment, improved economic environment and lower cost of doing business are at least as substantial. These add to the value of Kansas Pipeline Group and the benefits created by the Group for the Kansas City metropolitan area.

Conclusion

Kansas Pipeline Group has had a substantial positive impact on the Kansas City metropolitan area. It has invested millions of dollars in plant and facilities in the area; created access to new gas supplies; and provided less expensive transportation for natural gas than the incumbent monopolist. Savings realized by natural gas customers in the area have exceeded $125 million to date. The pipeline system is rapidly becoming integrated into the infrastructure supporting the local economy, and it continued to grow. Not only has the pipeline group had a significant impact on the level of economic activity (more than $250 million in increased economic activity), but is also the equivalent of a government financed investment of more than $350 million.

In sum, Kansas Pipeline Group is one of the most significant private investments to take place in the Kansas City metropolitan area in the last two decades. The benefits to the region which has caused Kansas Pipeline Group to be so important to the community continue and are expected to grow for the foreseeable future.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ANALYSIS OF ECONOMIC BENEFITS

FROM

KANSAS PIPELINE GROUP

COMPETITIVE SALES AND TRANSPORTATION OF NATURAL GAS

IN THE

METROPOLITAN KANSAS CITY AREA

Until November 1986, nearly 99 percent of the natural gas used in metropolitan Kansas City was supplied or transported by Williams Natural Gas Company (WNG). During November 1986, Kansas Pipeline Partnership (Kansas Pipeline) and related entities (Kansas Pipeline Group) began transportation and sale of natural gas within the state of Kansas to industrial customers. Starting in 1987 and on a permanent basis in November 1988, the Kansas Pipeline Group initiated sales and transportation to KPL Gas Service Company, the primary local distribution company (LDC) serving the Kansas City metropolitan area. These two actions by Kansas Pipeline Group were the first steps in changing a monopolistic, poorly functioning natural gas market toward a competitive solution.

The competitive influence of the Kansas Pipeline Group first became significant about the time the certification effort was begun in 1984 with application to the Kansas Corporation Commission (KCC). That influence of the threat of competition grew until Kansas Pipeline initiated competitive natural gas pipeline service. The impact has substantially expanded since that time.

The Kansas Pipeline Group competition for Kansas City markets produced substantial financial and economic benefits. From modest beginnings, the benefits have grown significantly. As the Kansas Pipeline Group broadens its competitive efforts, benefit levels will continue to increase. In addition, there are positive secondary economic impacts and multiplier effects that have impacted the community.

This report will identify the savings and the economic impact produced by the Kansas Pipeline Group. For purposes of this analysis, two major direct sources of savings have been identified and quantified. The first is the substitution of Kansas Pipeline gas and transportation for WNG gas and transportation. The second impact is competitive restraint on WNG pricing. The multiplier effect of these two categories of savings on the level of regional economic activity will also be estimated.

In addition, an estimate of the value of Kansas Pipeline Group to the metropolitan area, as part of the area infrastructure, will be calculated. Finally, economic impacts which are identifiable, but cannot be quantified, will be discussed.

Background

The Kansas City metropolitan area is the 25th largest metropolitan area in the United States with a 1990 population of 1,650,000. The metropolitan economy is service oriented[1] and growing. The city has a low cost of living,[2] affordable housing[3] and a well educated, highly motivated and relatively low cost work force. The metropolitan area is centrally located and served by three interstate highways[4]. There is also access to inland waterways via port facilities on the Missouri River. The economic environment in the city is good, population growth is near the national average[5] and unemployment rates are usually well below the national average throughout the economic cycle.

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[1] Over 50 percent of the area work force of about 900,000 is employed in the service sector including telecommunications, financial services and banking.

[2] The cost of living index for Kansas City is 97.6 for the second quarter of 1991. The U.S. average for this index is 100. Most major metropolitan areas' cost of living indexes are above 100.

[3] The city is ranked as the second most affordable housing market ranked by the National Association of Home Builders in a recent survey of 173 cities.

[4] There are only five U. S. cities served by three interstate highways. Kansas City, near the center of the country, has become a primary transportation hub.

[5] K.C. at 9.3 percent versus 9.8 percent nationally.

Local Demand Patterns For Natural Gas

The demand for natural gas in the Kansas City area is highly seasonal. Most natural gas is used for space heating purposes and domestic needs. The local economy's tilt toward service industries causes the non-residential load to have a U-shaped pattern over the calendar year (low in the summer and high in the winter). This commercial pattern is similar to the residential load pattern, but less pronounced. While there is a significant manufacturing sector in the metropolitan economy, the area may not have as great a heavy industry component as others of similar or greater size.

The "retail" natural gas supply to Kansas City metropolitan customers is dominantly provided by a single local distribution company (LDC), KPL Gas Service[6]. Until 1986, KPL Gas Service[7] had a single pipeline supplier, Williams

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6 Parts of the metropolitan area are served at retail by the Union Gas division of United Cities Gas and by Greeley Gas. KPL Gas Service provides service to more than 600,000 customers of an estimated total of slightly more than 650,000.

7 Prior to 1954, Cities Service Gas Company was the natural gas pipeline supplier to the Kansas City area. Its sister company, The Gas Service Company, was the local gas distribution company. In 1954, Cities Service Company divested The Gas Service Company. The Gas Service Company was publicly traded until 1983 when it was purchased by KPL. It was merged into KPL in 1985.

Natural Gas Company (WNG) and its predecessors[8]. This arrangement was unusual in that Kansas City was one of very few large cities with only one pipeline supplier of natural gas. Furthermore, until 1986 WNG might have been the only major FERC regulated pipeline other than Florida Gas Transmission which was not subject to meaningful competition.

KPL Gas Service Natural Gas Requirements

Prior to the acquisition of The Gas Service Company, KPL was primarily an electric utility. KPL also provided gas distribution service to an area in central Kansas. That system was supplied mainly with intrastate natural gas from Kansas production using, in part, KPL transmission lines. According to the KPL Gas Service's June 1992 PGA filing, 68 percent of total sales represents the former Gas Service properties. These are the sales subject to competition from Kansas Pipeline Group.

The firm supply volumes impacted by competition from the Kansas Pipeline Group can be measured from firm sales volumes by rate schedules[9].

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[8] There is a small delivery point in south Kansas City from Panhandle Eastern Pipeline (PEPL). However, that delivery point is inadequate to serve beyond a relatively modest contract amount and has minimal influence on the metropolitan area. Furthermore, PEPL has shown no interest in increasing the capacity of the delivery point or the delivery amount.

[9] The relevant rate schedules are GSk, GSf, RSm, GSm and GSo. Volumes sold by KPL Gas Service under these rate schedules specifically exclude

Those sales volumes for 1986 to 1991 by state are as follows:

KPL Gas Service Sales Volumes
1986 - 1991
Mcf

	1986	1987	1988	1989	1990	1991
Kansas						
Residential	41,164,235	40,182,827	42,946,966	42,790,719	48,169,524	42,783,565
Small commercial	17,840,274	16,791,576	17,413,091	17,304,916	16,393,457	15,595,946
Other	113,566	81,866	57,359	104,803	144,905	65,643
Subtotal	59,118,075	57,056,269	60,417,416	60,200,438	64,707,886	58,445,154
Missouri						
Residential	44,198,036	42,660,199	47,161,288	47,058,455	41,879,836	43,626,939
Small commercial	24,278,748	22,526,359	22,373,532	19,670,691	17,825,712	20,840,679
Subtotal	68,476,784	65,186,558	69,534,820	66,729,146	59,705,548	64,467,618
Oklahoma						
Residential	2,890,344	2,061,692	3,106,970	3,101,569	2,849,023	2,974,645
Small commercial	1,581,576	1,602,890	1,634,953	1,394,004	1,250,077	1,440,887
Subtotal	4,471,920	3,664,582	4,741,923	4,495,573	4,099,100	4,415,532
Total	132,066,779	125,907,409	134,694,159	131,425,157	128,512,534	127,328,304

In addition to sales volumes, transportation rates charged by WNG for KPL Gas Service and its transporting customers are subject to competitive impact. Total KPL Gas Service transportation volumes for 1986 to 1991 are as follows:

KPL Gas Service
Transportation Volumes[10]
1986 - 1991
Mcf

Year	Volumes
1986	5,752,000
1987	24,584,337
1988	37,424,153
1989	58,024,629
1990	72,623,241
1991	78,054,833

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volumes sold in central Kansas that are supplied through the "main system".

10 Transportation volumes listed in this table include transportation for the main system. Current reporting will not support a division of transportation volumes to each of the segments of the service area.

Although transportation customers on the KPL system benefit from the existence of Kansas Pipeline Group, the specific savings enjoyed by the transporters are not included in this analysis because competitive volumes cannot be identified.

The Kansas Pipeline Group

The Kansas Pipeline Group consists of five related pipeline entities, five partnerships and one incorporated operating company. Kansas Pipeline Partnership is a Kansas certificated intrastate pipeline with facilities in Miami, Johnson and Wyandotte counties and separate pipeline facilities originating in Coffee County traversing Franklin and Johnson counties and terminating in Wyandotte county[11].

The primary supplies to Kansas Pipeline are delivered through Kansas

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[11] In July 1984, the predecessor of Kansas Pipeline Partnership made application to the Kansas Corporation Commission (KCC) for Certificate of Convenience and Necessity as an intrastate pipeline. On January 11, 1985, the KCC issued a certificate authorizing Kansas Pipeline Partnership to transact business in the state of Kansas as a natural gas public utility company.

WNG initiated a multi-front attack on the Commission order, including appeals to the court system in the state of Kansas and Federal Court. Ultimately, these matters were successfully resolved.

In November 1986, Kansas Pipeline Company, LP commenced interruptible sale and transportation of natural gas for commercial and industrial customers in Kansas City, Kansas. In August 1988, Kansas Pipeline Partnership commenced the firm sale of natural gas pursuant to a contract with KPL Gas Service Company. Such natural gas was dedicated to the Kansas service area of KPL Gas Service.

Natural Partnership (Kansas Natural) which is an affiliated Kansas intrastate pipeline system extending across more than half the state of Kansas, traversing 12 counties and generally transporting from sources of supply in Kansas and Oklahoma.

KansOk Partnership (KansOk), is an affiliated Oklahoma intrastate pipeline system with facilities in Harper, Woods, Osage and Pawnee counties. KansOk is interconnected to the Transok, Inc. pipeline system in Oklahoma. KansOk delivers natural gas to Riverside Pipeline Company, L.P. (Riverside Pipeline) at the Oklahoma/Kansas state line. Riverside Pipeline redelivers that gas to Kansas Natural under FERC Section 311 authority. Transok is not affiliated with the Kansas Pipeline Group, but Kansas Natural holds a capacity lease of a portion of the Transok system.

Riverside Pipeline operates facilities crossing the state line between Woods County, Oklahoma and Comanche County, Kansas and between Osage County, Oklahoma and Cowley County, Kansas. It also owns and operates facilities between Wyandotte County, Kansas and Platte County, Missouri with physical facilities crossing the Missouri River at the state line[12]. Riverside

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[12] In March 1989, Riverside Pipeline Company, LP was formed and applied to FERC for certification as an interstate natural gas pipeline. At the same time, Kansas Pipeline Partnership applied for FERC authority to transport natural gas on behalf of Riverside. In September 1989, Riverside Pipeline received a

Pipeline is an interstate pipeline with appropriate FERC Certificates of Convenience and Necessity.

The four separate pipeline entities making up the Kansas Pipeline Group system are operated and managed by Kansas Pipeline Operating Company (KPOC), a Kansas corporation. KPOC's primary office is in Overland Park, Kansas near I-435 and Metcalf. From this office, KPOC controls, using state-of-the-art automation, the complete pipeline system of the Kansas Pipeline Group.

Williams Natural Gas Company

Williams Natural Gas Company (WNG) is an interstate natural gas transmission company which serves customers in six midwestern states including the Kansas City metropolitan area in both Missouri and Kansas, its chief market area.

The WNG system has a mainline delivery capacity of approximately 2.4 BCF[13] of gas per day. The WNG system is composed of approximately 5,900 miles of mainline and branch transmission lines and approximately 3,900

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certificate from FERC to provide Section 311 transportation service between the states of Missouri and Kansas. Subsequently, Riverside also obtained 311 authority for transportation between the states of Oklahoma and Kansas. The FERC issued an order approving Kansas Pipeline Partnership's application in November of 1989.

[13] The term BCF means billion cubic feet. MMCF means million cubic feet and MCF means thousand cubic feet.

miles of field and gathering pipelines. The WNG volumes for the years 1987 to 1991 are as follows:

Williams Natural Gas Company
Annual Throughput
TBTU[14]

		Transportation			Total
Year	Gas Sales	On-System	Off-System	Total	Throughput
1987	181	71	20	91	272
1988	154	120	33	153	307
1989	122	162	74	236	358
1990	84			235	319
1991	86			293	379

The throughput volumes include transportation by WNG for other pipeline companies. The data to isolate this type of transaction is not available for later years, but it is reported to be an increasingly important element of total throughput.

WNG's largest customer is KPL Gas Service. KPL Gas Service revenues amount to 73 percent of WNG revenue for 1989[15]. The primary

[14] Total system throughput increases are primarily due to new off-system demand and changes in weather. The average temperature in 1989 was 5 percent cooler than 1988, and 1988 was 13 percent cooler than 1987.

[15] KPL Gas Service constantly accounts for this level of WNG revenues. This demonstrates that KPL is not only an important customer of WNG but also that KPL has had no alternatives. WNG historically supplied more than 95 percent of KPL Gas Service's Kansas City metropolitan requirement.

deliveries to KPL Gas Service are in Zone 1 (Wichita, Kansas and areas west); and Zone 2, the eastern one-third of Kansas and Missouri. The primary delivery in Zone 2 is the Kansas City metropolitan area. The metropolitan area includes several communities in Johnson County, Kansas (e.g., Shawnee, Leawood, Overland Park, and Lenexa), Kansas City and the Fairfax industrial area on the Kansas side; and Kansas City, Raytown, Liberty, Lee's Summit, North Kansas City and Independence, among others, on the Missouri side.

Prior to the operation of the Kansas Pipeline Group, WNG had a regulatory and a defacto monopoly on pipeline delivery of natural gas to the Kansas City area. Most metropolitan areas have more than one pipeline supplier. Before FERC and KCC initiatives began to promote competition, the status quo was maintained as a result of administrative inertia which permitted a system of approved regulatory monopolies.

Additionally, WNG was in fact the only pipeline supplier of natural gas to the Kansas City area. As a result of the WNG monopoly position, the Kansas City area did not enjoy the full benefits of reorganization and restructuring of the natural gas pipeline industry and other FERC initiatives. The monopoly position also meant that Kansas City did not receive the benefits of declining natural gas prices at the wellhead due to the lack of competitive pressure on WNG and on WNG's wellhead suppliers[16].

Changing Regulatory Structure Of The Natural Gas Industry

Throughout the 1980s, federal and state regulators adopted new regulations designed to increase competition in the natural gas industry and multiply customer choices. Through this period of change, prices peaked in 1984 and there has been a pattern of declining cost for natural gas at the wellhead (the commodity), declining cost for its transportation and delivery to the city gate[17],

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[16] The relative restructuring impact on WNG is shown by the percent of WNG capacity reserved for its own sales. Prior to the recent FERC ordered restructuring of the industry, virtually 100 percent of all pipeline capacity was dedicated to pipeline sales of natural gas owned by or under contract to the pipeline. After significant efforts by FERC, 1991 pipeline capacity reports filed with FERC show about 36 percent of national pipeline capacity was dedicated to sales of non-pipeline natural gas. In contrast to the national situation, which reflects the average impact of FERC ordered restructuring and limited competition, only 12 percent of WNG capacity was dedicated to non-pipeline sales of natural gas (FERC Order 636). WNG is able to achieve this result (which is better than other pipelines) because WNG did not have the same level of competition pressure as other FERC regulated pipelines.

[17] The historic structure of the natural gas industry involved the acquisition of natural gas by a pipeline company at the wellhead and its delivery for a single or bundled price which included the cost of gas plus its transportation (and other services) to a city gate or a designated point of delivery to an LDC. The LDC was then responsible for moving the natural gas from the city gate to the meter of its customer on its distribution system.

The price in dollars per MCF at each level in the delivery process for 1980 to 1990 was as follows:

an increase in service offerings by various segments of the industry. The period has also been characterized by an unbundling of services or the offering of individual services not tied to companion transactions throughout the industry.

Federal Policy

The changes in federal policy were first discussed in the late 1970s and intensely pursued in the early 1980s. The first tangible result of those discussions was FERC Order 380. This order established a new rule designed to eliminate variable costs from the minimum commodity charge portion of natural gas pipeline sales tariffs. This change eliminated certain costs in the build up of minimum bills and customers choosing among pipeline suppliers. This rule was

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	Price		
Year	Wellhead	City Gate	Customer
1980	$1.59	$2.41	$3.13
1981	1.98	2.89	3.65
1982	2.46	3.60	4.46
1983	2.59	4.04	5.12
1984	2.66	3.89	5.13
1985	2.51	3.82	5.02
1986	1.94	3.58	4.60
1987	1.67	3.31	4.32
1988	1.69	3.24	4.31
1989	1.69	3.44	4.50
1990	1.72	3.54	4.59

effective on July 31, 1984.[18]

FERC Order 380 was followed by FERC Order 436 on October 9, 1985. This order was the first in a series of orders on pricing and access to pipeline services by the FERC. Order 436 had as its primary objective, opening access to transportation services offered by pipelines. It required pipeline companies to provide access to transportation services on a non-discriminatory basis to essentially all users of the pipeline system. The order also provided a conditional opportunity for customers of pipelines to reduce sales demands so that loads could be shifted from sales service to transportation service.

After substantial experience under Order 436, FERC determined that its objectives were not being realized and that some gas pipelines enjoyed and exploited competitive advantages. To ultimately realize the goals of Order 436, FERC issued Order 636 dated April 8, 1992. This order was designed to correct

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[18] The costs incurred by a pipeline company in transporting natural gas from the point of production to the city gate are partially fixed and partially variable. Fixed costs involve the costs associated with the pipeline facility, including depreciation, property taxes, and capital costs which do not change with volume of throughput. Variable costs include those costs that vary with the transport of natural gas.

When variable costs are paid as a part of a minimum bill or a monthly fee, they become excess profit to the pipeline company if the gas is not taken. In addition, they also become excess cost to the customer if the customer tries to substitute a different gas supply for that on which variable costs have already been paid. Thus, prepayment of variable costs reduces customer mobility.

the deficiencies in transportation service under Order 436. The order conclusively unbundles sales and transportation services offered by pipeline companies so that all customers are on an equal footing. It also creates customer access to the full array of pipeline services on an unbundled basis.

Missouri Policy

The Missouri Public Service Commission (MPSC) has been active in relevant FERC proceedings and, when cases have been brought before it, has consistently ruled in favor of competition as beneficial to end users. It has also ruled that competition serves the public convenience and necessity.

In Case No. GA-89-126, the request of Missouri Pipeline Company for a certificate as an intrastate pipeline, the Commission ruled that two suppliers would be beneficial to end users and transportation customers in the St. Louis area.[19] Furthermore, the Commission found that such beneficial results indicated the existence of a public need for alternative pipeline service. The Commission explicitly rejected arguments that competition would not reduce rates and that existing service, though non-competitive, was fully adequate as a regulated service. The Commission also concluded that there is no need to make a finding of a deficiency in existing service in order to facilitate competition and additional

[19] Missouri Pipeline proposed to offer competitive pipeline transportation service to St. Louis, Missouri.

service.

These findings by the Missouri Commission are consistent with previous Commission findings in MPSC Case No. GO-85-264, where the Commission compelled local distribution companies, subject to MPSC jurisdiction, to provide open access transportation service in furtherance of established federal policy increasing competition in the gas industry.

Kansas Policy

The Kansas Corporation Commission (KCC) has adopted a series of policies consistent with fostering a competitive environment in the natural gas industry. At each opportunity, to facilitate and enhance competition by certificating intrastate pipelines, the KCC has granted such certifications. In every case, the Commission has identified benefits relating to competition and has found that competition serves the public interest.

The KCC has also been active at FERC and has adopted a general principle that the interests of gas customers are best served if pipeline and distribution companies protect their markets by lowering consumers' charges as a result of meaningful competition, rather than protecting markets by relying on regulation or other administrative means.

WNG Regulatory And Pricing History

WNG has two distinct patterns of regulatory action before the FERC. Before the formation of Kansas Pipeline Group, WNG was very active in pursuing rate adjustments and maintaining revenues at a management targeted level. After the formation of Kansas Pipeline Group, WNG's regulatory efforts to increase price and maintain or increase revenues were significantly reduced. As expected, profitability is higher when WNG is actively increasing price than when price increase efforts are minimal.

WNG Regulatory Price History

Until the emergence of Kansas Pipeline, WNG's regulatory history was not exceptional as compared to other interstate pipeline companies. WNG increased its prices on a routine basis, filing rate cases as needed at FERC. Other than the effects of weather, the Williams' pipeline assets produced a reasonably stable pattern of returns.

The rate history of WNG and its predecessor, Cities Service Pipeline Company, can be demonstrated by the pattern of F2[20] rates. Between May 1978 and December 1986, WNG was involved in 18 RP dockets and 44 proceedings

[20] F2 is the city gate rate for firm service in the Kansas City zone (east of Wichita). F1 is the firm service rate for Wichita.

which had some impact on rates.[21] This amounts to about one adjustment every quarter throughout the period.

The steady succession of RP filings slowed only with the appearance of the Kansas Pipeline Group. This pattern shows that, prior to the appearance of Kansas Pipeline Group, WNG had or recognized no constraint on rates. This also implies that costs and earnings were at levels deemed appropriate by company management. The significant slowing of rate filings after the formation of Kansas Pipeline Group suggests market and competitive control of price rather than management control.

The Stipulation and Agreement Proceeding

In addition to the WNG rate case history, the recent major WNG activity at FERC is the Stipulation and Agreement (S&A) in FERC Docket RP 86-32 and the Amended S&A in Docket RP 86-68. The purpose of the S&A was to implement the provisions of FERC Order 436, providing for access to transportation service on the pipeline system or the initial unbundling of services. In the S&A, WNG permitted only modest conversion[22] and reduction

[21] Statement O(2) pages 14-20, WNG FERC filings.

[22] Conversion volumes are those volumes of firm natural gas supply that are converted from sales volumes under the F-2 rate to transportation volumes on the WNG system. The conversion anticipates that the volumes will remain on the WNG system, but that it will be transport volumes rather than sales volumes, and

privileges[23]. The total conversion and reduction privileges permitted in the S&A were as follows:

Williams Natural Gas Company
Stipulation and Agreement Provisions
Recap of Customer Conversion/Reduction Rights

Period	Cumulative Reduction F-2	Cumulative Conversion and/or Reduction F-2
Initial	10%	10%
11/1/88	30	30
11/1/89	30	37
11/1/90	30	43
11/1/91	30	49
11/1/92	30	55

The magnitude of this reduction, given the changes in the industry during the period in which the S&A was negotiated, are an indication of WNG's monopoly power in the Kansas City marketplace. The subsequent fact that WNG had less capacity than the average pipeline devoted to firm transportation confirms the conclusion that the S&A was an exercise in monopoly power by WNG.

it also anticipates, though not explicitly, that the volumes will be supplied from WNG's existing producer group.

23 Reduction volumes are those volumes which represent actual reductions in contract demand. The volumes are anticipated to be transported or become sales volumes of a competing pipeline supplier.

Kansas Pipeline Group
Regulatory and Pricing History

The Kansas Pipeline Group regulatory history has been limited to initial filings with appropriate regulatory agencies to obtain appropriate certificates and initial rates for each segment of the pipeline system. The Kansas Pipeline Group has not sought to increase rates or rate ceilings for any segment of the pipeline system since the initial rate setting. At the present time, there are no planned filings for rate increases or rate ceiling adjustments.

The absence of a substantial regulatory history indicates that the Kansas Pipeline Group companies operate as competitors rather than administrative monopolies.

Determination of Economic Impact
Framework Of Analysis

To analyze the impact of the Kansas Pipeline Group on the markets for natural gas, it is appropriate to divide the total pipeline supply market for natural gas into two segments. The first segment is KPL Gas Service. Kansas Pipeline Group sales and transportation for KPL Gas Service are ultimately distributed to customers almost entirely in Kansas City[24]. Regulatory practices

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[24] Deliveries from Kansas Pipeline Group to KPL Gas Service with destinations in Kansas are distributed to Kansas customers. If KPL Gas Service arranges for further transportation to Missouri via Riverside Pipeline, the natural gas is distributed to Missouri customers. Deliveries to either state are, for

provide that benefits related to such purchases or transportation are distributed to all of the distribution system customers in the state of final destination.

The second market segment is the industrial segment. Industrial customers can purchase natural gas, transportation of natural gas or both from the Kansas Pipeline Group. Savings related to such purchases, as compared to alternative sources, initially accrue to the sole benefit of the industrial customer initiating the transaction. Secondary or related benefits are also produced by "industrial" transactions but they are not directly reflected in the cost of gas. These benefits are reflected in the level of economic activity, the cost of doing business in Kansas City, and the general economic climate in the area.

The impact of the Kansas Pipeline Group transactions on both market segments is financial and non-financial. In the short run, the direct and immediate financial impacts of Kansas Pipeline Group competitive transactions can be classified into four segments:

1. Reductions in cost of gas from substitution of lower cost Kansas Pipeline Group gas for WNG "system" gas;

2. Savings from substitution of lower cost Kansas Pipeline transportation services for higher cost WNG transportation services;

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purposes of this analysis, consumed entirely in that state.

3. Competitive restraint on continued escalation of WNG's prices; and

4. Competitively induced discounting by WNG to retain market share.

The dollar amount of each element of savings is different for the LDC and for the industrial transportation customer and, under the current regulatory practice, there is no cross flow of savings. Transportation customers may also be direct purchase customers of KPL Gas Service and share in the savings generated in the LDC segment.

After the savings are established, there will be a calculation to give effect to the flow of new money into the local economy. This calculation is based on the fact that, prior to the emergence of Kansas Pipeline Group, there is an economic equilibrium which incorporates the cost and structure of then current natural gas rates. When the financial benefits of Kansas Pipeline Group are put into the equilibrium, the benefits ripple through the economy and multiply, becoming even larger. In economic literature, this process is called the multiplier effect.

In this analysis, a general level of economic activity multiplier will be applied to savings. In addition to the multiplier effect on savings, there are tax multipliers. The tax multiplier effect for taxes paid by Kansas Pipeline Group, or as a result of the change in the level of economic activity, have not been calculated.

The non-financial benefits which arise as a result of the competitive environment produced by the Kansas Pipeline Group have been identified as follows:

1. Increased pipeline area delivery capacity to the metropolitan area.

   a. Improved area growth potential without customer cost.

   b. Reduced interruption of supply at peak
      i. higher levels of output
      ii. higher levels of employment
      iii. improved economic environment and related growth.

2. Gas-on-gas competition by producers for the metropolitan market.

3. Improved balance in the metropolitan employment mix.

Presentation of Quantified Savings

The savings which have been produced by the competitive environment created by the Kansas Pipeline Group will be organized into the two market segments -- the LDC segment and the industrial segment. The savings will be accumulated for two time periods -- savings which accrued to the community during the period from the inception of Kansas Pipeline Group operation in November 1986 to December 31, 1991; and the annualized savings currently being generated by the operation of the system. Prospective savings will not be accumulated because those savings are expected to grow substantially as the competitive front on which the Kansas Pipeline Group operates is broadened, the size of the system increased and the sales and transportation of natural gas increased.

Kansas Pipeline Group Community Value

The savings created by the Kansas Pipeline Group for the Kansas City metropolitan area may be viewed as the product of a community asset for which the community has no actual investment. The pipeline group has become a valuable asset to the metropolitan area and is a part of the area's economic infrastructure. However, since the Kansas Pipeline Group had no cost to the metropolitan area, a measure of its value as an addition to the infrastructure can be developed by capitalizing the savings produced to the metropolitan area.

To calculate the value, the annualized savings produced by the Kansas Pipeline Group have been forecasted for a 10 year period. This forecast is based on the current rate of annualized savings and forecasted increases in the savings level of 15 percent per year for the first five years of the 10 year period, and 5 percent per year for the balance of the period.

The total savings over the 10 year period are then reduced to 1992 dollars using a present value factor of 6 percent. The present value balance spanning the 10 year period is then reduced to an average annual savings.

This average annual savings is then capitalized into a community investment value using the current municipal bond rate of 7.25 percent.

Calculation of Savings

To make the calculations, the savings have been classified into two elements for each of the two market segments. Each of the classifications will be calculated separately. Next, the savings from each classification will be accumulated into a total savings level for the two periods: the historic period from November 1988 to December 31, 1991, and the annualized rate of savings beginning at January 1, 1992.

Reduction in Gas Costs

The first element of savings is the substitution of lower cost Kansas Pipeline system supply for higher cost WNG system supply. For this calculation, system supply is defined as firm natural gas delivered to the KPL Gas Service system. The initial substitutions of Kansas Pipeline Group system supply for WNG system supply occurred in 1988 and continued through 1991 as follows:

System Supply
Mcf Price Comparison
WNG System and
Kansas Pipeline Group
November 1986 - December 1991[25]

Period	WNG System Supply	Kansas Pipeline Group System Supply	Difference
Nov.'86-Dec.'88	$2.9848	$2.29	$.69
Jan.'89-Dec.'89	3.2954	2.83	.47
Jan.'90-Dec.'90	3.7832	3.47	.31
Jan.'91-Dec.'91	3.8291	3.77	.06

The calculation of the historic savings generated by the substitution of Kansas Pipeline Group system supply for WNG system supply is as follows:

Kansas City Metropolitan Savings
Substitution of Kansas Pipeline Group System Supply
November 1986 - December 1991

Period	Savings Per Mcf	Mcf's Delivered	Total Savings
Nov.'86-Dec.'88	$.69	3,618,796	$2,496,969
Jan.'89-Dec.'89	.47	3,626,151	1,704,291
Jan.'90-Dec.'90	.31	4,072,803	1,262,569
Jan.'91-Dec.'91	.06	7,492,885	449,573

[25] Does not include interruptible sales. Based on WNG "excess" price as defined in WNG's FERC approved tariff through November 1989. All subsequent calculations based on WNG winter excess rate.

Savings decline from year to year because WNG's competitive response to Kansas Pipeline has been to hold the line on its prices for natural gas. As a result, most of the savings after the initial impact of Kansas Pipeline Group are reflected in lower WNG prices and not captured in this calculation.

Savings Produced by Kansas Pipeline Transportation

Similar to natural gas substitution, transportation on the Kansas Pipeline system has been substituted for transportation on the WNG system. In concept, this savings precisely parallels the savings produced by the substitution of lower cost Kansas Pipeline system supply for WNG system supply except that the service is being substituted rather than the "delivered" product[26]. Like the substitution of system supply, there are large transportation savings related to WNG's competitive response. The competitive impact will be captured in a separate calculation.

The difference between the transportation rates of WNG and Kansas Pipeline Group for the period November 1986 to December 1991 is as follows:

[26] When a single price is paid at the city gate for natural gas, that price represents the bundling together of the cost of gas and the transportation of the gas from the point of production to the city gate.

Transportation Rate Differential
WNG and Kansas Pipeline Group
Kansas City, Kansas Destination
November 1986 - December 1991

Period	WNG Transportation Rates[27]	Kansas Pipeline Group Transportation Charges[28]	Differential
Nov.'86-Dec.'88	$.31	$.22	$.09
Jan.'89-Dec.'89	.24	.17	.07
Jan.'90-Dec.'90	.25	.07	.18
Jan.'91-Dec.'91	.31	.23	.08

To calculate the impact of the substitution of Kansas Pipeline Group transportation for WNG transportation, the actual transported volumes are multiplied by the savings on Kansas Pipeline Group transportation. That calculation is as follows:

[27] Sources: 1986-1988 average ITS-2 rates as filed; 1989-1990, "Williams 1990 Financial and Operating Statistics"; 1991 "Williams Natural Gas FERC Form 2".

[28] Actual average transportation charge as collected.

Savings From Substitution of
Kansas Pipeline Group Transportation
For WNG Transportation
November 1986 - December 1991

Period	Mcf Transported	Savings Per Mcf	Total
Nov.'86-Dec.'88	1,663,284	$.09	$149,696
Jan.'89-Dec.'89	689,063	.07	48,234
Jan.'90-Dec.'90	3,231,360	.18	581,645
Jan.'91-Dec.'91	9,664,031	.08	773,122

Source: Volumes from Kansas Pipeline Group

As with the gas sales calculation, there is a substantial savings which is not reflected in the calculation. This savings is a result of the fact that WNG would have raised prices in the absence of competition. It will be reflected in the savings produced by competitive restraint.

Competitive Restraint on WNG Prices

The single most important impact caused by competition in the Kansas City natural gas pipeline market was that WNG could no longer set prices independent of the market under the shield of federal regulation. Rather, WNG had to begin to move the price of its products and services toward competitive levels. Before Kansas Pipeline Group forged a changed market structure for the pipelining of natural gas into the Kansas City metropolitan area, WNG and its connected producers constituted a closed system. In that closed system, the total amount of revenue generated by the system and the division of that revenue between the parties was subject to regulation by FERC. WNG sought and was granted frequent increases in price and total revenue by the appropriate federal regulatory authorities before the operation of Kansas Pipeline Group.

When Kansas Pipeline Group became a competitor for the products and services in the pipeline market for the Kansas City metropolitan area, WNG was forced to modify its prices toward competitive levels. It did this by slowing and stopping increases in prices which could have been obtained by regulatory action. The effect of this course of action over time is the same as a one time price reduction.

The effect of this course of action was to cause prices to be lower than they "could have been". Since price increases did not offset changes in expense, a second effect of this course of action was to reduce the profitability of the company.

WNG acquired the pipeline assets of Cities Service Gas Company which served the Kansas City metropolitan area in 1983. The assets were acquired in October 1983, and 1984 was the first full year of ownership. The levels of profitability produced in 1984 (full year of operation) and 1985 (pre-Kansas Pipeline) are reasonable indicators of normal income levels for the pipeline under

WNG ownership.

In 1986, Kansas Pipeline Group began deliveries. As Kansas Pipeline Group began deliveries, WNG's profitability measured as a percent of revenues or as a percent of assets declined substantially. The years since WNG has been operating in a competitive market have been much less profitable than the years during which it operated in the "unthreatened" closed system.

The history of WNG profit as a percent of revenues and as a percent of assets is as follows:

Williams Natural Gas Profitability
1984-1991

Year	Revenues	Operating Profit	Profit Percent of Revenues	Profit Percent of Assets
1983	$250.1	$27.2	10.88%	3.49%*
1984	958.0	98.9	10.32	12.56
1985	869.8	90.9	10.45	12.57
1986	666.5	47.9	7.19	6.86
1987	547.2	19.7	3.60	2.89
1988	504.4	38.3	7.59	5.30
1989	454.2	46.4	10.22	6.20
1990	382.1	-10.6	-2.77	-1.39
1991	408.6	40.9	10.01	5.56

* The results of a partial year's activity.
Source: "The Williams Companies, Inc. 1990 Financial and Operating Statistics"; 1991 "Williams Natural Gas FERC Form No. 2". 1991 data is not comparable to 1983-1990 published data.

Since WNG management has accepted their post-Kansas Pipeline Group pattern of profit performance in contrast to their far superior pre-Kansas Pipeline Group level of returns, it is reasonable to assume that this lower pattern of profitability is a function of the competitive environment which has been created by the entry of Kansas Pipeline Group into the market[29].

This fact is confirmed by WNG filings with the Securities and Exchange Commission where WNG has stated that although rates have been adjusted, it will not be able to realize a full return because discounting will be necessary to meet the competitive circumstances in its markets for natural gas[30].

Since the returns earned are lower than could have been, customers have saved the difference between the "possible" level of return and the realized return because of the competitive environment. This difference can be calculated by determining the amount of profitability which WNG was forced to forego as a result of the competitive impact and resulting restraint created by Kansas Pipeline Group.

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29 Recent WNG rate cases before FERC have been settled without full pursuit by WNG of higher rates. This supports this conclusion.

30 Form 10K, Williams Natural Gas Company for the year ended December 31, 1989, page 13. 1989 is the last year during which WNG filed a separate 10K.

Competitive Restraint Impact

The calculation involves the determination of the level of profit foregone as WNG transitioned from a closed monopoly system to the competitive system, the conversion of that amount to an Mcf margin. The margin can then be related to volumes transported and delivered to the Kansas City metropolitan area.

The first step in the analysis is a calculation of the revenues foregone as a result of competitive pressures. The calculation is based on the potential return on assets of 10.56 percent which is the average realized return for the period 1984-1985 reduced by 200 basis points. Shortfalls from the potential are considered savings produced by the competitive response. The shortfall or return suppression is then adjusted for income tax. The calculation for the period 1987 to 1991 is as follows:

Williams Natural Gas
Competitive Return Suppression
1987 - 1991

	Return on Assets				Before Tax
Year	Book	Potential	Return Suppression	Tax Factor	Return Suppression
1987	2.89%	10.56%	7.67%	1.538	11.80%
1988	5.30	10.56	5.26	1.538	8.09
1989	6.20	10.56	4.36	1.538	6.71
1990	5.68	10.56	4.88	1.538	7.51
1991	5.56	10.56	5.00	1.538	7.69

The book return for 1990, the year of the tight sands settlement, was (1.39) percent. The poor performance is at least in part a result of the settlement. The average return of 1988, 1989 and 1991 was used to remove the unusual impact.

The before tax return suppression times the year's asset base produces total return suppression for the year. The revenue suppression per Mcf can then be calculated as follows:

Williams Natural Gas
Competitive Revenue Suppression per Mcf
1987 - 1991

Year	Before Tax Return Suppression	Assets (Millions)	Revenue Suppression (000)	Sales and Transport (TBTU)	Total Revenue Suppression Per Mcf
1987	11.80%	$682.4	80,523	272	$.30
1988	8.09	723.3	58,515	307	.19
1989	6.71	748.9	50,251	358	.14
1990	7.51	763.4	57,331	319	.18
1991	7.69	735.6	56,568	379	.15

Source: 1990 "Williams Companies, Inc. Financial Operating Statistics"; 1991 "Williams Natural Gas FERC Form 2".

The final step in the calculation relates the savings to the Missouri and Kansas deliveries for rate schedules GSk, GSf, RSm, GSm, and GSo of KPL Gas Service Company. That calculation is as follows:

Williams Natural Gas[31]
Savings From Competitive Price Determinations
1987 - 1991

Year	Kansas Volumes (Mcf)	Savings Per Mcf	Kansas Savings	Missouri Volumes (Mcf)	Savings Per Mcf	Missouri Savings
1987	57,056,269	$.30	$17,116,881	65,186,558	$.30	$ 19,555,967
1988	60,417,416	.19	11,479,309	69,534,820	.19	13,211,616
1989	60,200,438	.14	8,428,061	66,729,146	.14	9,342,080
1990	64,707,886	.18	11,647,419	59,705,548	.18	10,746,999
1991	58,445,154	.15	8,766,773	64,467,618	.15	9,670,143

In the future, it is reasonable to expect that WNG's actual return on assets will increase. This does not mean that the savings from competitive market discipline is diminishing. More likely, it means that WNG will have realigned its intracorporate allocation of expenses to a level which reflects a more appropriate mix of operating expense and profitability for WNG.

This type of response is possible because under the closed market system in which WNG operated prior to the formation of Kansas Pipeline Group, management's primary objective was to maximize revenues. In that context, the expense which appeared on the WNG income statement was as important as its profitability since it partially determined revenue in the regulated context.

31 Volumes from chart on page 5 supra.

Discounts on Transportation Service

As stated by WNG in its 1989 Form 10K filing with the Securities and Exchange Commission, the company has been forced to competitively discount various rates in order to maintain volumes. Recently, WNG has offered a competitive discount which is directly targeted at a major Kansas Pipeline Group transportation path. This is not the first time such discounts have been offered and it is probable that more frequent discounts will be offered as the intensity of competition increases. The effect of historic discounts have been captured in the calculation of the revenue suppression from the competitive equilibrium.

Summary of Savings

Three classifications of savings have been identified and specific savings amounts have been calculated for each classification. The total savings which were determined for the three classifications for the period November 1986 through December 31, 1991 are as follows:

Summary of Savings
Kansas City Metropolitan Area
Competitive Effect of Kansas Pipeline Group

Period	Substitution of Kansas Pipeline Group Natural Gas	Transportation	Competitive Constraint on WNG	Total
Nov.'86-Dec.'88	$2,496,969	$ 149,696	$ 61,363,773	$ 64,010,438
Jan.'89-Dec.'89	1,704,291	48,234	17,770,141	19,522,666
Jan.'90-Dec.'90	1,262,569	581,645	22,394,418	24,238,632
Jan.'91-Dec.'91	449,573	773,122	18,436,916	19,659,611
Grand total	$5,913,402	$1,552,697	$119,965,248	$127,431,347

The going level of savings produced by the Kansas Pipeline Group on the Kansas City market for natural gas is at least equal to the level of savings for 1991. However, future Kansas Pipeline Group volume is expected to grow even more rapidly than the past. This makes the 1991 level of savings a very conservative estimate of continuing savings.

In addition, savings produced by selective discounting must be considered. If WNG adjusts transportation rates further to effectively compete, discount levels already established in some markets may spread throughout the system.

<u>Multiplier Effect</u>

At any point, regional economies establish an equilibrium where the total level of economic activity is a function of consumer, business, and government spending. Within individual regions, flows of funds to and from other regions add to or subtract from regional economic activities.

WNG's charges to the Kansas City region largely constitute a flow of funds out of the regional economy. This is because payments to WNG are for natural gas and capital payments in other areas.

To the extent that the flow of funds to WNG which goes out of the region is reduced, the amount of reduction will have the same impact as new spending into the region from another area. Savings in WNG's charges constitute additions to the level of economic activity as new discretionary income to the region's consumers. These savings then become subject to the economic multiplier for the region.

The multiplier effect is a principle of economics which states that increases in expenditures by any segment of the economy increase aggregate demand for goods and services within the economy in total. Once such aggregate demand is increased, a dynamic process follows where a single expenditure multiplies over an infinite number of periods in ever decreasing amounts. The final effect on the total level of economic activity is a multiple of the initial change in the level of expenditure.

This process describes the circumstance caused by the savings produced by Kansas Pipeline in the cost of natural gas. That savings becomes free cash flow to the regional economy and begins to reverberate through the economy, increasing total expenditure or the level of economic activity by some multiple of the original amount. That multiple has been estimated to range from 1.8 to 2.2[32] and since there is inevitably a certain amount of leakage in the regional economy to the adjoining areas, a multiplier of 2.0 has been used in the calculation.

When this multiplier is applied to the direct savings of $127.4 million, the result is an increase in the level of economic activity for the region of $254.8 million.

Kansas Pipeline Group Community Value

In addition to the direct savings created by the Kansas Pipeline Group for the Kansas City metropolitan area, the pipeline group has a value to the metropolitan area as an element of the area's infrastructure. This value can be measured by determining the amount of public investment which the community would be required to make to produce the level of annual savings currently being generated by the Kansas Pipeline Group.

To establish this value, the annualized savings produced by the Kansas

[32] In estimating the impact of the Bartle Hall addition on the Kansas City regional economy, a multiplier of 1.8 times was used by the Mid-America Regional Council. This multiplier related to wage and salary income which is less robust than pure additions to discretionary income.

Pipeline Group have been forecasted for a 10 year period. This forecast is based on the current annualized savings rate of $19.6 million forecasted to increase at 15 percent per year for the next five year period and 5 percent per year for the succeeding five year period.

The total savings over the 10 year period are then reduced to 1992 dollars using a present value factor of 6 percent. The present value balance spanning a 10 year period is then reduced to the average annual savings produced over the 10 year period.

This average annual savings is then capitalized into an investment value for the community using the current municipal bond rate of 7.25 percent.

This calculation produces a community value or asset value of the Kansas Pipeline Group to the metropolitan Kansas City are in excess of $350 million.

Secondary Benefits

In addition to the financial savings produced by Kansas Pipeline Group, a number of non-financial or secondary savings and benefits have been identified. These include:

1. Increased pipeline delivery capacity to the metropolitan area.
    a. Growth potential without customer cost.

b. Reduced interruption of supply at peak
    i. higher levels of output
    ii. higher levels of employment
    iii. improved economic environment and related growth.

2. Gas-on-gas competition by producers for the metropolitan market.

3. Improved balance in the employment mix.

Increased Pipeline Delivery Capacity

The addition of the Kansas Pipeline Group's system serving the Kansas City metropolitan area increases the capacity of all pipeline systems which serve Kansas City natural gas requirements. The additional pipeline makes it possible to deliver a greater volume of natural gas on peak to the Kansas City area. That in turn means that Kansas City interruptible customers will have fewer interruptions[33].

Significantly, this new pipeline capacity serving Kansas City had no cost to natural gas customers. This is in striking contrast to the historic

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[33] One classification of customers in the Kansas City area is the industrial interruptible customer. Those customers, in return for lower rates, have accepted the right of the pipeline to interrupt service when the demands of other customers require the pipeline to do so. This service interruption, since most of these customers are industrial customers, means that either alternative fuels must be used at higher cost or that production must be curtailed.

In either event, output becomes more expensive or is lower and employment is constrained. When more gas is supplied on peak, there is less substitution of alternative fuel, higher levels of employment and more profitability for the industrial customer.

circumstance where most additions to the capacity serving the system caused increases in rates for the customers on the system. Not only did Kansas Pipeline Group cause natural gas prices to decline, the incremental addition to system capacity was done at the same time.

In addition, there is a significant amount of gas-on-gas competition produced by the presence of the Kansas Pipeline Group in the Kansas City market. This is because Kansas Pipeline Group, as a result of various construction activities, has tied the Kansas City consumption markets into previously underutilized supply markets for natural gas. Those markets, in competing to establish sales of Oklahoma natural gas in the Kansas City area, must reduce price to displace traditional WNG sources of natural gas. This gas-on-gas competition produces lower overall prices for natural gas in the Kansas City metropolitan area.

Finally, the enhanced economic circumstances which result from the increased capacity and the gas-on-gas competition will alter the employment mix of the city. Kansas City has traditionally had a heavy representation in the service industries and a relatively light representation in the manufacturing field. Greater levels of manufacturing activities in the Kansas City area would balance the Kansas City employment mix and make the city more resistant to recession and business cycles. This change in balance should have a long run effect of improved natural gas supply and price in the Kansas City metropolitan area.

Conclusion

The impact of Kansas Pipeline Group on the Kansas City regional economy has been positive and substantial. Kansas Pipeline Group has caused reductions in the cost of natural gas and its transportation for residential, commercial and industrial users in the Kansas City area. It has increased the level of economic activity in the area, paid taxes, made substantial investments and located its operating and executive headquarters in the metroplex. Kansas Pipeline expects to continue to expand its operations and increase its throughput. This will result in even greater savings and benefits to the community.

In sum, Kansas Pipeline is an important new asset to the community which will make Kansas City both more viable and more attractive to businesses and individuals considering new locations. By any measure, Kansas Pipeline has been one of the most important new assets to the Kansas City community in the decade of the 1980s.

ADDENDUM

ANALYSIS OF ECONOMIC BENEFITS FROM KANSAS PIPELINE GROUP COMPETITIVE SALES AND TRANSPORTATION OF NATURAL GAS IN THE METROPOLITAN KANSAS CITY AREA

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EXECUTIVE SUMMARY

Kansas Pipeline Group is an affiliated group of partnerships and corporations providing competitive transportation and delivery of natural gas to the Kansas City natural gas market. In 1992, Kansas Pipeline Group commissioned a report to determine its impact on the Kansas City market for natural gas and natural gas transportation and the regional economy. The report examined the first five years of Kansas Pipeline Group's competitive entry into the Kansas City market and concluded that the Group was producing significant economic benefits for the Kansas City metropolitan area. Furthermore, even though full competition had not been achieved and the Kansas Pipeline Group was still in the developmental stage, significant benefits had already been produced during its short history. In addition, the prospects for even more significant future benefits was very real. The level of these benefits and the recipient by customer class is as follows:

Kansas Pipeline Group
Economic Impacts
Kansas City Metro Area
(Millions)

Savings	Direct: Residential and Small Commercial	Direct: Large Users	Direct: Subtotal	Economic Multiplier Savings	Grand Total
Historic 1986-1991	$120.0	$7.5	$127.5	$255.0	$382.5
Current embedded annual	17.4	2.2	19.6	39.2	58.8
Potential additional annual	26.7	3.3	30.0	60.0	90.0

The detail of the amounts is contained on Schedule 1 attached to the report and represents savings or reductions in price and increases in economic activity produced by Kansas Pipeline Group for the Kansas City area. The major beneficiary of the historical and ongoing direct savings are the residential and small commercial customers which realized 94 percent of the historic savings and 87 percent of the ongoing annual savings. The balance of the savings flowed to larger non-firm customers.

Since the December 1992 report, several threats have been identified which may erode or undermine the competitive environment and which may result in Kansas Pipeline Group being boxed into its market "niche" representing only 9 percent of the Kansas City regional market. The costs associated with permitting a monopolist control of the Kansas City market are as follows:

Annual Economic Cost of
WNG Monopoly of
Kansas City Natural Gas Transportation Market
(Millions)

Savings	Direct: Residential and Small Commercial	Direct: Large Users	Direct: Subtotal	Economic Multiplier	Grand Total
Embedded competitive savings	$13.8	$1.7	$15.5	$31.0	$46.5
Potential embedded competitive savings	26.7	3.3	30.0	60.0	90.0
Total annual savings	$40.5	$5.0	$45.5	$91.0	$136.5

The costs are a result of Williams Natural Gas (WNG), the incumbent pipeline supplier, with 91 percent market share and no competitive threat to its market power, asserting monopolistic control over pricing and service in the Kansas City natural gas transportation market. The threats which may lead to these excess economic costs include:

- The possibility of limiting the growth of Kansas Pipeline Group and allowing the current competitive imbalance in the Kansas City natural gas market to continue.

- Regulatory reviews of gas acquisition policies which could cause the LDC to inappropriately avoid alternative supply and/or transportation choices to minimize short run regulatory risk.

- Predatory contract demands by WNG on its LDC customers which could have the potential to foreclose permanent and workable competition.

- Efforts by the LDC and WNG to capture some of the benefits of competition by negotiation or contract without the physical development of a permanent and workable competitive alternative.

If such threats become actualized, the competitive impact of Kansas Pipeline Group may be reduced and WNG would once again be permitted to operate as a monopoly, extracting unreasonable prices from the Kansas City area LDCs and, in turn, ultimate customers of those LDCs.

ADDENDUM

ANALYSIS OF ECONOMIC BENEFITS FROM KANSAS PIPELINE GROUP COMPETITIVE SALES AND TRANSPORTATION OF NATURAL GAS IN THE METROPOLITAN KANSAS CITY AREA

A December 1992 report on the economic impact of Kansas Pipeline Group[1] on the Kansas City metropolitan area identified significant benefits to the metropolitan area from the competitive sales and transportation of natural gas by Kansas Pipeline Group. The report concluded, among other things, that since starting operations in 1986, Kansas Pipeline Group had produced direct savings to natural gas customers of $127.5 million of which residential and small commercial customers realized 94 percent or $120.0 million with the remaining $7.5 million flowing to larger non-firm customers. The report also identified an increase of at

[1] Kansas Pipeline Group is an affiliated group of partnerships and corporations focused on the competitive delivery of natural gas and pipeline transportation services for the Kansas City market. The backbone of the Group consists of the following natural gas pipeline entities: Kansas Pipeline Company, L.P., Kansas Natural Partnership, and KansOk Partnership (all intrastate pipeline companies), and Riverside Pipeline Company, L.P., an interstate pipeline company. Operations of the group are directed by KPOC (Kansas Pipeline Operating Company) from its headquarters and main control center in Overland Park, Kansas.

least $255 million in overall regional economic activity as a result of the activities of Kansas Pipeline Group. Finally, the report concluded that, at its current size and scope of operations, Kansas Pipeline Group was generating direct annual benefits (embedded savings) to the Kansas City metropolitan area of $19.6 million per year of which 89 percent or $17.4 million flowed directly to residential and small commercial with the balance of $2.2 million going to larger non-firm customers. The ongoing embedded savings also increased the level of economic activity in the region through the economic multiplier effect by $39.2 million per year.

In looking to the future, the report found that Kansas Pipeline Group had an entrepreneurial culture and a competitive attitude which would lead to continued growth in its sales and transportation of natural gas. The report anticipated further substantial increases in the level of sales and transportation of natural gas by Kansas Pipeline Group. It was concluded that as the current level of sales and transportation grew, the annual direct savings being generated by the system for the Kansas City area would grow from the current $19.6 million annual level to a conservatively higher level estimated at $50 million total or an additional $30 million, of which 89 percent or $26.7 million would flow to residential and small commercial and $3.3 million to larger customers. Furthermore, this incremental savings would increase the economic impact of the savings by the multiplier to a total level of $100 million or an additional $60 million.

However, the report conditioned its forecasts of the future growth of Kansas Pipeline Group and even the continuation of currently realized direct and indirect savings on a continuing commitment to competition by local distribution companies (LDCs) supported by state and federal regulatory authorities. Also the dominant LDC in the Kansas City market, although not specifically identified in the report, was assumed to develop a more progressive attitude toward nurturing competition consistent with regulatory trends at the state (KCC and MPSC), and federal (FERC and DOJ) levels, and currently identified benefits of competition.

Furthermore, although it was not explicitly identified, the maintenance and extension of the new regulatory policies developed by FERC and described in its Order 636 was recognized as a significant contributor to the continued production of growing economic benefits. This new FERC regulatory policy was designed:

> "to improve the competitive structure of the natural gas industry to facilitate the operation of a national wellhead market as envisioned by Congress in order to provide natural gas consumers with access to an adequate supply of clean and abundant natural gas prices. Moreover, the Commission is improving this competitive structure without undermining the reliability of service for pipeline customers by requiring pipelines to perform a "no-notice"

> transportation service. In short, the Commission is both promoting competition and protecting all gas consumer interests, especially with respect to the reliability and the pricing of services."[2]

It is important to recognize that the emphasis in the "re-regulation" of the pipeline industry doesn't involve direct intervention by regulatory authorities as in the case of market center formation[3], but rather the development and maintenance of a structure which is conducive to competition. To fully realize the benefits of pipeline-to-pipeline competition for Kansas City, the policies fostered by state PSCs[4] that promote local or intrastate competition are critical since

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[2] FERC Order 636, page 58.

[3] FERC Order 636 is usually described as focused on gas-on-gas competition rather than pipeline-on-pipeline competition or best cost end result. In fact, FERC believes that Order 636 creates a market structure where both gas-on-gas and pipe-on-pipe competition or total price competition will flourish. Martin Allday, Chairman of FERC, in a speech at the Conference on State Regulation in February 1992 said that "Market centers where pipelines come together, let producers attached to many pipelines sell gas to customers attached to many pipelines. Neither side has to deal only with partners connected to the same pipeline (and) . . . that improves competition." He went on to describe his expectation of the development of these market centers and the total gas cost competition they foster as powerfully driven by commercial dynamics without the need for regulatory mandate. Record of Proceedings, February 1992, U.S. Department of Energy, NARUC.

[4] Missouri and Kansas regulators have recognized the importance of both interstate and intrastate competition in the Kansas City area natural gas markets and both have endorsed and encouraged pipeline-to-pipeline competition and reform.

Kansas City has for all practical and realistic purposes only a single interstate supplier which exercises monopolistic pricing power.

Since the report in December 1992, it has become apparent that the emerging competitive environment which allowed the benefits of Kansas Pipeline competition in the first place is not entirely secure. Threats to the nascent competitive environment include:

- The possibility of allowing the current competitive imbalance in the Kansas City natural gas market to continue.
- Regulatory reviews of gas acquisition policies which could cause the LDC to inappropriately avoid alternative supply and/or transportation choices to minimize short run regulatory risk.
- Predatory contract demands by WNG on its LDC customers which could have the potential to foreclose permanent and workable competition.
- Efforts by the LDC and WNG to capture some of the benefits of competition by negotiation or contract without the physical development of a permanent and workable competitive alternative.

If any such threats become actualized, the results will be to reduce or eliminate the competitive threat and/or create a defacto monopoly for WNG. In such an event, WNG, given its prior pricing practices, would exercise its regained market power to increase its profits and to realize other corporate objectives, but the pipeline monopoly market in the Kansas City area would be smaller by the market share competitively captured by Kansas Pipeline Group prior to the change in market structure[5].

Furthermore, if WNG preserves its existing market share and effectively increases its market power by eliminating the risk of further market share penetration by Kansas Pipeline Group, it is reasonable to expect that new gains expected from growth in competition in the Kansas City natural gas markets would not materialize. This loss would be in addition to the erosion of embedded gains produced by Kansas Pipeline Group at the expense of WNG's previous level of monopoly profits. The primary evidence of such a change would be rising prices for natural gas and natural gas transportation[6] or falling prices long enough

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[5] This of course assumes that the market for natural gas in Kansas City continues to be served by two pipelines, WNG and Kansas Pipeline Group, and that the status quo is maintained. If by some chance, not even contemplated here, the entire market was returned to WNG as a total monopolist, all gains from competition already embedded and expected to materialize would be lost.

[6] The capacity of WNG to behave in a relatively unfettered manner is a function of the current FERC policy as outlined in Order 636 and the logical implications of the order. FERC's intention is to couple competition and regulation by maintaining a regulatory and business structure which will allow competition to flourish. Unfortunately, WNG is the incumbent interstate pipeline serving the metropolitan Kansas City area and without Kansas Pipeline Group, WNG is not subject to a competitive constraint. Without Kansas Pipeline Group, the much lessened constraint from regulators combined with WNG's historic ability to operate successfully within the regulatory process to produce monopoly profit creates the potential for monopoly abuse by WNG. Furthermore, regulation allows regulated entities to charge rates which collect "approved" costs from customers. From the regulated company's point of view, success involves getting most costs classified as approved costs. In contrast, competition permits only efficiently and appropriately incurred costs. Thus, regulation would typically approve a higher

to preserve market share in the face of aggressive competition followed by rising prices.

The Nature of Natural Gas Competition

Competition between pipelines for natural gas markets consists of a series of actions and reactions which culminate in a static state of economic equilibrium. Viewed through time, such competition is a dynamic process of action and reaction representing an evolving series of successive states of equilibrium. The Kansas City market for pipeline transportation and supply of natural gas was for many years a monopoly market with a sole supplier, WNG. This was the initial static state and, although undesirable, it was a market equilibrium.

As described in the December report, after a series of regulatory and construction initiatives, Kansas Pipeline Group entered the market[7]. The successful entry created the second static state which, at its inception, was in

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cost basis than could be collected from customers in a competitive market.

7 The competition for the market actually began when Kansas Pipeline Group announced its intention to operate as a transmission company serving the Kansas City market. WNG responded with a substantial administrative and judicial effort to block Kansas Pipeline Group from the market. This administrative effort can be characterized as a competitive response for an incumbent and it illustrates that competition and competitive behavior involves a wide range of actions not limited to price and service.

disequilibrium. WNG was the supplier to the entire market and a new entrant had a fixed amount of new capacity to serve the market. Through a series of initiatives including customer price and service advantages, Kansas Pipeline Group began to fill its system. At the same time, WNG, recognizing that all business earned by Kansas Pipeline was at its expense, responded with: i) regulatory and judicial blocking maneuvers; ii) lower prices; and iii) attempts to improve service options and customer relations. The process of vying for business in this stage would continue until a new static equilibrium was achieved when i) Kansas Pipeline's system achieved near capacity operations; and ii) further business opportunities adequate to prompt investment in additional facilities (capacity with which to compete for further market shares and which viewed from WNG's perspective, creates a dynamic and ever present threat of future market deterioration) were not present or forthcoming.

The new static equilibrium at the climax of the second state, like the static equilibrium which existed at the climax of the first state, has no tendency to change as a result of internal forces. All internal forces are in balance and the only progress[8] or change which would take place in the market is a result of

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[8] Movement which increases competition is considered progress in this context. Consistent with the views of contemporary economics, competition and competitive markets are considered efficient in that true underlying economic costs are reflected in prices which in turn are used by buyers in making consumption

external pressure such as the decision by Kansas Pipeline Group to increase capacity and market share by a new competitive initiative.

Absent a realistic opportunity for Kansas Pipeline Group to increase market share, the market will remain in a non-competitive equilibrium with Kansas Pipeline Group operating at capacity and supplying a market "niche", and WNG monopolizing the remaining market share which amounts to 91 percent of the market. Assuming Kansas Pipeline Group can be boxed into only this market "niche", the resulting equilibrium state provides no continuing competitive threat to WNG. Unless local distributors and Kansas Pipeline Group act to expand business relationships and move the market into the next stage, the static equilibrium defaults into a monopoly market because of the market power of the major supplier.

Currently, the Kansas City market is at a pivotal point. Local distributors and Kansas Pipeline Group are working to develop new alternatives to advance pipeline competition to a new level while WNG is working to negate or block opportunities for Kansas Pipeline Group so the market will stay at its

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decisions. This process produces an efficient allocation of resources consistent with maximum consumer welfare.

current equilibrium thereby defaulting to the original monopoly status[9]. Ideally from WNG's perspective, the market progress toward further competition needs to be limited so WNG can once again enjoy the benefits of monopoly power. In contrast, from the consumer's perspective, the market should progress toward additional competition and the reduction of market power by the monopoly transporter.

Viability of Competitive States

The competitive status of any market state falls on a spectrum from the classically defined, perfectly competitive market to its polar opposite, the single supplier monopoly market. Some market states are very persistent and some are fragile. The pipeline market serving Kansas City prior to the first efforts of Kansas Pipeline Group was a monopoly market. In a monopoly market, there is a single transporter, and that single transporter has the power to set prices, terms of service, and other conditions related to the sale of its product and service. Although WNG was regulated under the terms of the Natural Gas Act, that regulation provided for a "collection" of costs by the monopolist rather than a market setting of price. Because of historical entrenchment, the existence of a substantial institutional framework and the extraordinarily high barriers to entry,

[9] The effort to move forward by Kansas Pipeline and the WNG response to block, parallels the initial entry of Kansas Pipeline on the market.

this initial state was static and there was a very low probability that anything would alleviate this entrenched monopolistic power of the incumbent pipeline.

When Kansas Pipeline Group entered the monopoly market, the "threat" caused the monopolist, WNG, to reduce prices, seek to improve service, and to generally behave in a manner beneficial to consumers. If i) Kansas Pipeline Group reaches its operating capacity, and ii) its threat to increase market share can be effectively presented; then the competitive threat on WNG immediately diminishes. At the climax of this market stage, WNG still controls 91 percent of the market for natural gas. Kansas Pipeline Group, while supplying 9 percent of the market, is operating at capacity. Without additional incentive for Kansas Pipeline Group to expand and compete, Kansas Pipeline Group is not a threatening competitor since it cannot take further market share from WNG, and WNG is free once again to exert the full force of its monopolistic power.

To move the market into the next stage, it is necessary for WNG to be threatened again with loss of further market share. The only scenario in which this progress can occur is for Kansas Pipeline Group to increase its capacity to further competition. Furthermore, Kansas Pipeline Group's continued viability must be assured and it must have a large and secure beachhead from which it can competitively threaten WNG, compelling it to exercise market discipline. This development effectively sets the stage for the final market state where two relatively equal competitors vie for the "middle market" or uncommitted segment. It is only this stage that produces maximum benefits for the consumer.

Optimal LDC Strategy

The optimal LDC strategy should foster competition between the LDC's pipelines and maximize the number of supply areas sourced by such pipelines. The end result would be increased gas-on-gas competition within and between supply areas materially complimented by competition between pipelines to transport the supply to the LDC's markets.

While it would be desirable to have these circumstances, as the new competitive market for natural gas unfolds under the coupling of regulation and competition envisioned by federal and state regulatory bodies, Kansas City does not have adequate commitments of plant and facilities to achieve this state. The LDC, however, has the purchasing power which, if wisely used, could create the incentive to develop a full competitive natural gas pipeline infrastructure to serve the Kansas City market in an economically efficient manner. The LDC can do this by initially directing its purchases to an alternate pipeline in adequate amounts to nurture the development of the necessary, desirable and mature infrastructure. Once an infrastructure is in place and the pipelines are relatively equal competitors, there will inherently be aggressive competition by both pipelines to fill "excess" capacity with uncommitted load. This will produce the maximum benefit for the LDC and its customers[10].

Threats to the Competitive Environment

At least four new forces have been identified which jeopardize the competitive environment in which Kansas Pipeline Group currently operates.

Competitive Imbalance

The current natural gas and transportation pipeline system serving Kansas City is in a static equilibrium. Kansas Pipeline Group has entered the market and as a result of competitive behavior "filled" its pipeline system. Until further facilities are in place and operating, Kansas Pipeline Group cannot compete for additional business. In theory, Kansas Pipeline Group needs a reasonable business prospect to make substantial and additional investments to become active in the effort to attract new business. Without that business prospect, Kansas Pipeline Group will work to retain and serve its 9 percent of the Kansas City

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[10] The Department of Justice in evaluating markets for Sherman Act violations generally measures market power using the HHI Index. In a single supplier situation, the HHI Index is 10,000. In a multiple supplier situation, the HHI Index, which is the sum of the squares of the market shares of the relevant market participants, has a minimum level of 100 which is considered to be a perfectly competitive market. In a two supplier marketplace, each supplier must have or approach 50 percent market share in order to minimize the HHI Index and minimize the market power of each of the two participants.

market. WNG, with Kansas Pipeline boxed into a market "niche," would once again begin to act as a monopolist in its 91 percent market share and work to produce excess monopoly profits and reduce services. To remedy this competitive imbalance and advance the market into the next stage, Kansas Pipeline Group must have the opportunity to expand its market share in order to attract the capital necessary to make additions to plant and facilities. This will revitalize the competitive dynamic in the market and restore the full competitive threat to WNG's market dominance.

To progressively move the market development to the next stage, the LDC should encourage competition by facilitating Kansas Pipeline Group's growth and, in fact, should be prepared to nurture Kansas Pipeline until it is a viable and meaningful competitor permanently capable of exerting competitive pressure on WNG for significant parts of its market share. To do that, the LDC must recognize the risks of the current market imbalance, the potential of fuller competition, and the necessity for its proactive role in the development of real, workable, long-term competition.

Regulatory Risk Assessment

The second threat to the competitive environment is regulatory review of the LDC's gas acquisition practices. Under the initial single pipeline supplier arrangement to Kansas City, the LDC dealt only with WNG. Under those circumstances, it was not possible for the LDC to make a gas acquisition or transportation mistake. In the absence of any alternatives, the LDC acquired whatever product or service was available at whatever price and terms offered, subject only to FERC regulatory relief which, by its very nature, has been materially after the fact.

However, when a second supplier, Kansas Pipeline, entered the marketplace, the potential developed for the LDC to make reasonable gas acquisition and/or transportation decisions which in the short run, although appropriate, had the potential to result in a different cost of gas than that of the traditional supplier. This presented the LDC with the risk that the regulatory structure at the LDC level could evaluate such gas acquisition and/or transportation decisions negatively.

The LDC should consider the far more draconian risk presented by these reviews, if the LDC fails to proactively create a meaningful and permanent alternative, permitting the market to default to the monopoly stage. In fact, FERC Order 636 and the succession of orders leading to this pronouncement have demonstrated the benefits of competition in natural gas markets. The efficiency and efficacy of regulation without competition has been questioned and the superiority of coupling competition to regulation (as opposed solely to regulation) abundantly demonstrated. In this environment, the risk of not proactively assisting the development of a meaningful (non-niche) competitive transporter to avoid short-term PSC prudence review risk is an illusion, based on a regressive strategy, which would not withstand a comprehensive and thoughtful regulatory review[11].

LDCs will be required to demonstrate that they have obtained the best price for natural gas and pipeline service which, in the long-term, will be produced by the LDC which uses its buying power (purchasing natural gas and transportation services) to generate competition between suppliers and transporters, capturing for its customers the full promise of supply transportation and service competition.

To do this for the Kansas City market, the LDC must facilitate competition, treating the potential for competition as an opportunity. The LDC's market power should be used as part of a gas transportation and acquisition

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[11] This proposed adjustment which was dropped by the Staff after the annual savings from competition of $19.6 million per year related to only 9 percent market penetration by Kansas Pipeline Group. If Kansas Pipeline Group is permitted to aggressively compete and the market approaches some optimal supplier mix, it is conceivable that total savings associated with competition would amount to $50 million per year. Clearly, the regulatory risk associated with aggressive gas acquisition is "de minimis" as compared to the potential cost associated with in-action by the LDC in the development of a meaningful transportation alternative.

strategy to reduce cost and develop alternatives. This is in striking contrast to the short-sighted policy of "hunkering down" to avoid short-term regulatory audits which results because the LDC is placing itself in a position to have an economic choice. If the LDC does not act, future purchasing practice reviews shall not focus on the difference in gas price for a single period, but rather the long-term losses produced by the lack of the LDC action in generating competition. In fact, the mere size of those regulatory risks alone should be sufficient to cause the LDC to embrace competition and use its market power to develop competitive alternatives and options[12].

Contractually Limiting Competition

The competitive environment which has allowed Kansas Pipeline to produce significant savings for customers of natural gas and natural gas transportation could be eliminated if WNG was able to "lockup" the market for future sales and transportation of natural gas. To create the lockup, WNG would obligate its LDC customers to purchase all or substantially all uncommitted transportation. Such a lockup would create a defacto monopoly for WNG for its

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[12] The direct savings related to limited competition for the first few years of Kansas Pipeline Group's operations exceeded $125 million. As the level of competition in the Kansas City market increases, the magnitude of those savings will increase in proportion. The size of the savings suggests that LDC actions which would limit those savings could produce regulatory disallowances which might exceed the total value of the LDC.

current marketplace by freezing the movement of customers or sales between transporters. Under that defacto monopoly, the competitor, Kansas Pipeline, would be "frozen" out of the market since the LDC would be unable to choose between suppliers and take advantage of competitive offerings by alternate pipeline suppliers.

In an exercise of its still imposing monopoly power, WNG delivered ultimatums to its LDC customers requiring execution of "lockout" contracts as a requirement to preserve "rights" on the WNG system for natural gas transportation and storage capacity. Initially, WNG "required" the execution of five year lockout contracts -- certainly enough to kill the nascent competition in this market. Although FERC rejected these demands, it granted a one year lockout -- a period not fatal, but certainly not conducive to full and free competition.

While a period of one year is not fatal to competition, it does demonstrate that the emerging competition in the Kansas City market is still fragile. There is little doubt that five year lockouts would not only eliminate the competitive threat for the short term, but would drastically decrease WNG's risk of a long run competitive threat, since (once the opportunity to develop competition in the Kansas City market would have passed) reinvigorating a competitive alternative would be far more difficult (if not impossible) than implementing further competition at this point.

LDC Arranged Lockouts

In a mirror image of WNG's effort to lockup the market for natural gas transportation in the Kansas City area, the LDC in the Kansas City market could solicit contract offers from WNG designed to capture at least some of the benefits of competition for the LDC, primarily a lower price for transportation service, while avoiding the LDC's perceived short run regulatory risks from review of gas acquisition decisions.

Such an approach would be highly detrimental to the Kansas City market. First, while the benefits generated by the "contract" are promised for the life of the contract, it is apparent that WNG, once the competitive threat had passed, would have a substantial incentive to avoid its contractual obligations and once again exercise its monopoly power. Second, even if unsuccessful in the use of avoidance techniques, WNG becomes absolutely unfettered at the end of the contract when there is no contractual obligation and no competitor. There is no doubt that WNG as a monopolist with only regulatory constraints on its powers to extract monopoly rent would try to make up for lost time. Finally, through the period of the contract there would undoubtedly be i) numerous regulatory changes; ii) needs for new capacity; and iii) other changes in circumstance, each of which would give WNG an opportunity to chip around the edges of the contract and capture material elements of monopoly rent.

The most serious flaw in the "boxing in" of the Kansas Pipeline Group's niche position by an LDC/WNG contract which presumes WNG's monopolistic market share is the fact that the Kansas City market is at a critical point . . . the advantages of which would in all probability be lost forever. All of the economic resources necessary to create a competitive environment are currently in place. It has taken Kansas Pipeline Group millions of dollars, more than six years, and broad entrepreneurial efforts to reach this point. If the resources which present the opportunity for a competitive alternative for natural gas and natural gas transportation in the Kansas City market are dissipated, it is unlikely that Kansas City would readily find the opportunity to develop an alternative competitive transmission source[13]. Further, since there would be no competitive pipeline capacity, there would be materially less commitments by producers and others to bring competitive natural gas to the Kansas City market.

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[13] While in the narrowest view Kansas Pipeline represents an alternative transmission source, Kansas Pipeline also accesses new natural gas production areas and creates for the Kansas City market the potential for gas-on-gas and pipeline-on-pipeline competition at a level which would produce substantial long run benefits for the city.

The Impact of Reduced Competition

WNG still has a 91 percent share of the Kansas City market. If WNG solidifies its control over its 91 percent market segment or even some modestly smaller segment by anti-competitive contracting or other means, WNG will be a near monopolist with extreme market power in the Kansas City market. This means that WNG would again have the opportunity to extract monopolistic profit from its customers and, given its past performance, limit services and options to its customers by subordinating customer needs and requirements to WNG's own objectives.

Furthermore, because of WNG's substantial market power and because of the competitive imbalance in market share (WNG 91 percent, Kansas Pipeline Group 9 percent), a permanent partitioning of the marketplace or reduction in the competitive threat could undercut the viability of Kansas Pipeline Group. Kansas Pipeline Group remains quite small by the standards of the pipeline business. While progress has been substantial, competition in this market remains fragile and the Kansas Pipeline Group is a new company, in a hostile environment, facing an entrenched monopolist who claims that all customers in the market belong to it. To constrain or merely not support Kansas Pipeline Group may jeopardize its viability or its effect as a pipeline supplier to the Kansas City market and will certainly further solidify WNG's already strong position.

WNG Response to Limiting Competition

If, by virtue of restricting Kansas Pipeline Group to a "niche" market share, WNG is given the opportunity to once again become a monopolist in the Kansas City natural gas transportation market. It is certain that WNG will engage in the practices it previously used as a monopolist when its pricing practices generated monopoly revenue which proved unsustainable under competition. WNG management would move to load its existing stranded investment as well as its historical lost return onto remaining customers[14]. Management would also eliminate its current practice of discounting authorized rates to meet the competitive threat and, finally, the contribution from the pipeline to corporate overhead would almost certainly increase.

The Cost of Limiting Competition

The cost of diluting the competitive environment, limitation or partitioning of the market or any other change which would lessen the competitive threat for a meaningful segment of the Kansas City market for natural gas transportation, will occur in at least five areas:

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[14] This would require a regulatory initiative by WNG and there is no assurance of success. In fact, it is almost certain based on some FERC pronouncements that complete success is not possible.

- Continuation of the embedded annual savings of $19.6 million (historically achieved as a result of Kansas Pipeline Group's niche in the marketplace, coupled with the threat of additional market penetration) will be jeopardized.

- The related economic multiplier impact of two times the embedded savings (an additional $39.2 million per year) would likewise be jeopardized.

- Future growth in the level of competitive savings (an additional $30 million per year) shall be lost entirely.

- The additional economic multiplier effect caused by increases in the amount of annual savings (an additional $60 million per annum) will shrink in proportion to the loss of future growth in the embedded savings.

- Many of the supplemental non-price benefits produced by Kansas Pipeline will be lost or limited.

The loss of the current savings and the loss of the benefits from further competition assumes a change in market structure which leads to a withering of competition. It is also assumed that the loss will be spread to all customers on the system including the Kansas Pipeline Group customers[15] and the shrinkage in benefits will multiply as a rippling contraction throughout the regional economy in a mirror image of the way the embedded savings were increased through the economy by the economic multiplier effect.

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[15] Spreading the cost of restoring monopoly power of WNG to all of the customers is a result of the mechanics of the purchased gas cost adjustment. The clause spreads changes in average gas cost to the entire customer base.

Embedded Annual Savings

The December 1992 report on the impact of Kansas Pipeline identified a going level or current and continuing embedded rate of annual savings of $17.4 million flowing to residential and small commercial customers and $2.2 million flowing to larger non-firm customers resulting from the competitive effect of the Kansas Pipeline Group. This savings amount can be defined as the increment of monopoly profit eliminated by the competitive threat (and success) of Kansas Pipeline Group given the size of the market, Kansas Pipeline Group and WNG[16]. The savings is a result of the threat of continued competition from Kansas Pipeline Group and the effort of Kansas Pipeline Group to continue to attract volumes from WNG with more attractive prices, additional service and/or a combination of both. If this wasn't the case, it is reasonable to expect that WNG would price its product to recapture as much of the embedded annual savings, $17.4 million of savings flowing to the residential and small commercial and $2.2 million flowing to the larger non-firm customers, (which from WNG's point of view is $19.6 million in lost annual revenue) as possible from its remaining market share.

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[16] This level of savings was produced by Kansas Pipeline Group successfully attracting about 9 percent of WNG's non-mainline KPL Gas Service sales. Substantial potential for further savings exists in the remaining 91 percent market share.

To produce monopoly rent at this level, WNG would raise prices to the customer base which it controlled in an attempt to recover as much of the $19.6 million of lost revenue as possible. The feasibility of recapturing the entire $19.6 million of savings can be estimated by examining the initial derivation of the amount in the December report.

The December report identified the annual savings as comprised of two separate components:

Source of Savings	Amount
Savings from substitution of Kansas Pipeline natural gas and transportation	$ 1,222,695
Annualized savings from competitive market effect	18,436,916
Total annualized savings	$19,659,611

The element of the savings related to the substitution of natural gas is a result of combined gas-on-gas and pipe-on-pipe competition. Even after WNG establishes market dominance over 91 percent of the market, there should be significant regulatory reluctance to permit it to recapture the savings associated with gas-on-gas competition. Assuming that 75 percent of the substitution savings result from gas-on-gas competition, it is reasonable to assume that $917,000 or 75 percent of the total $1.2 million savings would be secure.

The second element of the savings, the competitive market effect is i) in part a function of stranded investment which is no longer earning a full return; and ii) in part a function of WNG's accepting as a competitive response to the threat of Kansas Pipeline Group reduced returns. On the other hand, that element of return which WNG lost as a result of competitive pressure would be subject to recapture from the remaining customers assuming it did not involve stranded investment.

To estimate the amount of potential recapture, it is reasonable to assume that WNG would argue that only a small portion of the total amount was related to stranded investment. This would enable WNG to try to reload onto remaining customers a substantial percent of the total loss, but WNG would be forced to achieve reload under a different guise. This is because there is a high probability that regulators, specifically FERC, will not authorize a reloading of lost income. Reloading is antithetical to competition theory, since it makes competition harmful to the customer. This is in direct opposition with the trend of recent FERC decisions which clearly uphold competition as the path to lower cost gas and transportation.

Because of the problems, recapture of lost profit will require more than one rate proceeding and it is reasonable to expect that WNG would be able to successfully argue that only 10 percent or so of the loss was related to stranded investment. Thus, it could successfully reload 75 percent to 90 percent of the lost return onto its remaining customer base without calling it "reload". This means that the total recapture by WNG would range from $14.7 million to $17.6 million. This represents a significant part of the original and ongoing savings generated by competition in the natural gas pipeline market serving Kansas City[17]. Unlike a situation in which there are two meaningful competitors capable of intensely competing for uncommitted market share, competition in this case (or the lack thereof) would provide no restraint whatsoever to the regulatory strategy of reload, because Kansas Pipeline Group would be "boxed" into its "niche" position of only a 9 percent market share without any possibility (or threat to WNG) of increasing its market share.

It is of vital importance to recognize the critical distinction between "re-load" opportunities available to WNG in a market where competition and regulation can be used to restrain "re-load"; versus a market in which competition is effectively removed (such as in the case if Kansas Pipeline Group is boxed into

[17] Because volume decreases with price increases in a monopolist's price produce disproportionate losses in economic welfare, i.e., the total welfare cost associated with an increase in price, is greater than the revenue associated with such increase. This loss is at the first level or in the direct market. When multiplier effects are considered, there is a much greater loss of economic welfare.

its 9 percent niche market share). In a market where competition and regulation both exert pressures on WNG, it really is of little import whether or not FERC would allow reload completely, in part or not at all, because the continuing threat represented by further meaningful WNG market share deterioration would supply a real competitive restraint to reload . . . a restraint which simply is not present if Kansas Pipeline Group is boxed into a 9 percent niche market share. In short, meaningful competition is a better antidote to "re-load" than regulation alone. This is not to say that regulatory prohibition and/or restrictions to "re-load" are not desirable and helpful in the formation of a truly competitive market; but it is to say that competition, coupled with regulation (or even without regulation) is the LDC's best defense to "re-load".

Economic Contraction Related to Lost Savings

As savings were originally generated for the Kansas City economy by the competition from Kansas Pipeline Group's entry into the market, those savings flowed through the economy and multiplied in effect as a result of the economic multiplier. The December 1992 report estimated that the original savings amount of $19.6 million per year would also produce a multiplier savings of two times that amount or $39.2 million per year. If the total savings are reduced from $19.6 million by $15.5 million (the average of the range), the economic impact of that reduction would be a contraction in regional economic activity of twice that amount.

<u>Growth in Annual Savings</u>

Limiting the threat of competition will jeopardize if not eliminate the growth in embedded savings which can be expected from continued competitive activity by Kansas Pipeline Group. If competition widens, it is reasonable to expect growth in embedded savings from three separate factors:

- Increased levels of business by Kansas Pipeline Group.
- Continued competitive response by WNG (reduction in WNG's remaining economic rent) in order to prevent even further deterioration of its market share.
- Increased economic multiplier benefits of about two times the direct growth in savings.

The growth in savings assumes that so long as there is an opportunity to produce a reasonable return from competition, there will be incentive for Kansas Pipeline Group to commit capital to capacity additions to move the competitive process into succeeding stages. As Kansas Pipeline Group works to attract new business to its system at each new stage of competition and as WNG strives to maintain its then existing level of business, customers will be offered better prices, better service, more options, and combinations of pricing, service and option packages designed to meet their needs and attract their business. Each time a sale moves from one transporter to another, it is presumed that better service and/or long-term savings will be produced. The savings from such transfers, the movement of the delivery of service to a lower priced supplier and the constant effort of the competitors to move sales to their side of the ledger, adds to the embedded annual rate of savings produced by the competition between Kansas Pipeline Group and WNG. If the competition is limited, all of this is lost.

As consumer decisions increase the embedded annual level of savings, flows of new free (uncommitted) funds in the region produce economic multiplier savings which are in proportion to the direct savings associated with these consumer decisions. The multiplier effect, as noted in the December 1992 report, is two times the annual rate of savings and as the direct savings grow, the dollar amount of the multiplier effect savings will grow proportionately.

Estimate of Growth in Savings

As previously discussed, the best possible market power outcome in a two supplier market is for each supplier to meet approximately 50 percent of market demand while maintaining the capacity to serve a much larger increment of the load. At the same time, in order to provide for a viable market with continued participation and competition by each supplier, it is essential that the LDC maintain the viability of both suppliers by committing to each a meaningful segment of the total market. One possible segmentation of the market by the LDC which would maximize the purchasing power of the LDC divides the entire market total into essentially three equal segments committing one segment to the incumbent supplier, WNG, and one to Kansas Pipeline Group. The remaining one-third market share, pivoted about the 50 percent market level, would be perpetually subject to competitive bid by the two pipelines. Such an arrangement should produce long run competition and the lowest possible cost to customers as a result of both the pipe-on-pipe competition which occurs in the market, and the gas-on-gas competition which is made possible and facilitated by the two pipelines and excess capacity[18].

To estimate the total savings related to further competition, the level of savings produced by the existing pipeline-on-pipeline competition can be extrapolated using a less than proportionate rate. Kansas Pipeline Group has captured 9 percent of the market and in the process produced an embedded annual savings for the Kansas City area of $19.6 million. If the optimal level of savings will be achieved by sharing the market equally between two suppliers, it is

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[18] The lowest possible cost to consumers is a function of two separate cost savings -- gas-on-gas competition and pipe-on-pipe competition. The existence of the new pipeline to Kansas City developed by Kansas Pipeline Group opens new production areas. This creates gas-on-gas competition and reduces the cost of gas embedded in customers' total cost. This savings is not measured in this calculation.

reasonable to assume that if that market sharing and the intense competition it implies is realized, there will be no further savings from competition once the two suppliers share the market. If 100 percent of the savings are produced when the market is shared between competitors on a 50/50 percent basis and if the change of 10 percent in the market share produced a $19.6 million annual savings, a straight line decline (extrapolation) in incremental savings from 100 percent to 50 percent would yield a total expected annual savings of $50 million[19].

Multiplier Impact of Growth in Savings

If the grand total savings produced by maximizing the competition in the Kansas City market amounts to $50 million and the incremental portion of that savings is an additional $30 million per year, that incremental portion will flow through the regional economy. As the incremental amount flows through the

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[19] This is a conservative estimate of the expected annual savings. While it is possible to assume that WNG will attempt to reload all of its lost revenue onto its existing or remaining customer base, it is more reasonable to assume that WNG would appropriately evaluate its circumstances and determine that it would become a competitor in the marketplace. To be a competitor, WNG would decide that costs must be cut, expenses trimmed, needless or excess capacity abandoned, and service produced to meet customer requirements at the lowest possible level. When companies make this type of commitment, extraordinary reductions in the cost of doing business can be realized. Naturally, WNG's response to the competitive threat may be so successful that it will in turn precipitate a response by Kansas Pipeline Group. If that is the case, it is reasonable to expect that competition will work to produce the most efficient pricing for natural gas transportation and sales for the Kansas City market.

economy, there will be a multiplier effect as the money is spent and respent. The December 1992 report estimated the multiplier effect at two times indicating that the level of economic activity will increase by an additional $60 million as a result of increases in total economic activity from the multiplier effect.

Secondary Benefits

The December 1992 report identified a number of secondary benefits related to the existence of the Kansas Pipeline Group. Those secondary benefits involved economic growth and improved economic activity associated with better supplies, better prices for natural gas during the year and on peak. If the competitive activities of Kansas Pipeline Group are limited, it is reasonable to expect that the secondary benefits would be lessened. Since many of the secondary benefits are related to the promise of a continuation of competition and occur in later time periods, if competition is constrained, those activities which have not yet taken place may be canceled as a result of constraints on competition.

Conclusion

The December 1992 report on the economic benefits produced by Kansas Pipeline Group for the Kansas City natural gas customers anticipated a growing annual savings to the customers from continued competitive activity in the marketplace. Since the issuance of that report, events which may limit or jeopardize continued competition in the Kansas City market for transportation and sale of natural gas have been identified. Four such forces which could partition the Kansas City market into two separate markets, one served by Kansas Pipeline Group and the other by WNG, were discussed. These forces are:

- The possibility of allowing the current competitive imbalance in the Kansas City natural gas market to continue.
- Regulatory reviews of gas acquisition policies which could cause the LDC to inappropriately avoid alternative transportation choices to minimize short run regulatory risk.
- Predatory contract demands by WNG on its LDC customers which could have the potential to foreclose permanent and workable competition.
- Efforts by the LDC and WNG to capture some of the benefits of competition by negotiation or contract without the physical development of a real and workable competitive alternative.

If such partitioning did take place, the level of savings produced by the competitive efforts of Kansas Pipeline Group for the market as a whole could be significantly reduced. If the change permits WNG to again function as a monopolist, the reduction in the benefits of Kansas Pipeline Group would be limited only by the disparity in pricing between Kansas Pipeline Group and WNG, and the elasticity of demand for natural gas of customers in the WNG market segment.

The reduction in competition would also lead to the loss of growth in the competitive savings which are anticipated from WNG's continued response to Kansas Pipeline Group's competitive threat and Kansas Pipeline Group's continued efforts to expand its segment of the market at the expense of WNG's remaining market share.

Finally, the indirect economic benefit of the direct savings, the multiplier effect, would also be lost. The indirect savings grow in proportion to the direct savings and are estimated to be at least two times the direct savings. Loss of growth would cause the loss of potential multiplier effects and loss of the embedded savings would cause an actual reduction in multiplier effects already realized.

In summary, the loss of savings produced by a failure to proceed with a competitive solution to the Kansas City pipeline market are as follows:

Kansas Pipeline Group
Economic Impacts
Kansas City Metro Area
(Millions)

	Direct				
Savings	Residential and Small Commercial	Large Users	Subtotal	Economic Multiplier Savings	Grand Total
Historic 1986-1991	$120.0	$7.5	$127.5	$255.0	$382.5
Current embedded annual	17.4	2.2	19.6	39.2	58.8
Potential additional annual	26.7	3.3	30.0	60.0	90.0

The detail of total savings is attached as Schedule 1 to the report. The historic savings includes savings from transportation for industrial customers in the amount of $1.6 million and savings from industrial sales in the amount of $5.9 million.

Given the substantial costs and the significant economic welfare loss associated with WNG's monopoly behavior and pricing, it is apparent that WNG should continue to be subjected to a competitive threat and the market structure which has permitted Kansas Pipeline Group to compete with WNG should be maintained and, to the extent possible, expanded to permit a widening of the competitive interface between Kansas Pipeline Group and WNG.

Kansas Pipeline Group
Historic Customer Savings
Competitive Price Determination
(By Customer Class)

	Kansas			Missouri			
Year	Residential	Small Commercial	Other	Residential	Small Commercial	Other	Total
VOLUME							
1987	40,182,827	16,791,576	81,866	42,660,199	22,526,359	0	122,242,827
1988	42,946,966	17,413,091	57,359	47,161,288	22,373,532	0	129,952,236
1989	42,790,719	17,304,916	104,803	47,058,455	19,670,691	0	126,929,584
1990	48,169,524	16,393,457	144,905	41,879,836	17,825,712	0	124,413,434
1991	42,783,565	15,595,946	65,643	43,626,939	20,840,679	0	122,912,772
DOLLARS							
1987	$12,054,848	$5,037,473	$24,560	$12,798,060	$6,757,908	$0	$36,672,848
1988	8,159,924	3,308,487	10,898	8,960,645	4,250,971	0	24,690,925
1989	5,990,701	2,422,688	14,672	6,588,184	2,753,897	0	17,770,142
1990	8,670,514	2,950,822	26,083	7,538,370	3,208,628	0	22,394,418
1991	6,417,535	2,339,392	9,846	6,544,041	3,126,102	0	18,436,916
Total	$41,293,521	$16,058,862	$86,060	$42,429,299	$20,097,506	$0	$119,965,249

SUMMARY:

Total Savings	1987-1991	1991
Residential	$83,722,821	$12,961,576
Small Commercial	36,156,368	5,465,494
Other Firm	86,060	9,846
Industrial Sales	5,913,402	449,573
Industrial Transportation	1,552,697	773,122
Total	$127,431,348	$19,659,611