BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of Associated Natural Gas Company of Fayetteville, Arkansas, for authority to file a tariff reflecting a change in rates for its Missouri customers pursuant to the provisions of the Company's PGA clause on file with the Commission.	)))))))	Case No. GR-90-38, et al.

REPORT AND ORDER

Issue Date: July 14, 1995

Effective Date: August 14, 1995

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of Associated Natural Gas Company of Fayetteville, Arkansas, for authority to file a tariff reflecting a change in rates for its Missouri customers pursuant to the provisions of the Company's PGA clause on file with the Commission.	)	Case No. GR-90-38, et al.

APPEARANCES

Jeffrey L. Dangeau, Attorney at Law, P.O. Box 1408, Fayetteville, Arkansas 72702-1408, for Associated Natural Gas Company.

Gary W. Duffy, Attorney at Law, Brydon, Swearengen & England, P.O. Box 456, 312 East Capitol, Jefferson City, Missouri 65102, for Associated Natural Gas Company.

Lewis R. Mills, Jr., Deputy Public Counsel, P.O. Box 7800, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the Public.

William M. Shansey, Assistant General Counsel, and **Thomas R. Schwarz, Jr.**, Senior Counsel, P.O. Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

ADMINISTRATIVE LAW JUDGE: Elaine E. Bensavage

REPORT AND ORDER

Procedural History

The contested issues in these cases are the outgrowth of a review by the Staff of the Missouri Public Service Commission (Staff) of the Actual Cost Adjustment (ACA) filings of Associated Natural Gas Company of Fayetteville, Arkansas (ANG) for the 1988-1989, 1989-1990, 1990-1991, and 1991-1992 ACA time periods, which were docketed in, respectively, Case No. GR-90-38, Case No. GR-90-106, Case No. GR-91-208, and Case No. GR-92-104. These filings contained ACA factors which adjusted the Purchased Gas Adjustment (PGA) for the ACA periods in question. The earliest of the cases, Case No. GR-90-38, originated with the filing of a PGA tariff by ANG on August 18, 1989, with a subsequent Order Approving Interim Rates issued effective September 1, 1989.

On June 15, 1990, the Commission consolidated Case No. GR-90-38 with Case No. GR-90-52, in which ANG filed tariffs to change its base rates to implement an increase in annual revenues of $3,300,051. The consolidation was subsequently severed on September 12, 1990, upon motion of the Staff, due to the illness and incapacitation of a key Staff witness, and the consequent inability of the Staff to complete its audit and prepare testimony for the ACA issues of Case No. GR-90-38. On October 31, 1990, the Commission issued an Order Approving Interim Rates, effective November 1, 1990, in Case No. GR-90-106 and Case No. GR-90-38. Subsequently these cases remained inactive for a period of time for a number of reasons, including the illness of the witness referenced above, and the lack of other available personnel to conclude the audit in Case. No. GR-90-38, although Staff's periodic PGA recommendations continued. In the interim, new ACA filings were docketed in Case No. GR-91-208 and Case No. GR-92-104.

On August 21, 1992, Staff moved to consolidate Case No. GR-90-38, Case No. GR-90-106, Case No. GR-91-208, and Case No. GR-92-104. Staff requested the consolidation because it had contracted with an out-of-state consultant to act as an auditor and conduct a prudence review for all four outstanding ACA periods, and sought to limit the amount of time the consulting auditor would have to spend out-of-state at the business offices of ANG in Fayetteville, Arkansas. The Commission granted the consolidation and issued a protective order on September 9, 1992. Staff's consultant concluded his audit and prudence review, and Staff filed its recommendation regarding the 1988-1989, 1989-1990, and 1990-1991 ACA periods on February 26, 1993. On March 1, 1993, Staff filed its recommendation for the 1991-1992 ACA period. ANG filed its responses to Staff's recommendation on April 5, 1993.

After the parties' attempts to resolve the outstanding issues failed, Staff filed a motion for a procedural schedule. On September 16, 1994, the Commission issued an Order Adopting Proposed Procedural Schedule, which set a hearing date of January 31 to February 1, 1995. On January 13, 1995, the parties filed a Hearing Memorandum. In the Hearing Memorandum, the parties indicated that they had resolved four issues, as follows:

- Staff is no longer pursuing a $121,049.45 adjustment listed under Take-or-Pay Costs-SEMO.
- The parties agree that ANG's ACA balances should be adjusted upward to reflect the cost of three invoices received from Arkla Energy Resources subsequent to the conclusion of Staff's field work.
- ANG agrees to modify Sheet 16C, Section I 9(a) of its PGA tariff.
- ANG agrees to make a separate, thirty-day tariff filing, to reflect all the changes occurring as a result of FERC Order 636.

On January 31, 1995, a hearing commenced pursuant to the procedural schedule, and concluded on February 1, 1995. Simultaneous initial and reply briefs were filed thereafter by ANG and Staff.

Rulings

On January 30, 1995, Staff filed a Motion to Strike Surrebuttal Testimony, asking the Commission to strike the surrebuttal testimony of ANG witness John Randolph Underwood in its entirety, and the surrebuttal testimony of ANG witness Rodney Pennington from page 4, line 3 to page 10, line 7, and from page 11, line 12 to page 18, line 14. The motion was subsequently orally argued at the hearing, and was taken with the case for decision. At the hearing Staff cross-examined witnesses Underwood and Pennington, subject to its motion to strike.

Staff states that it filed its recommendations for the 1988-1991 ACA periods on February 23, 1993, and for the 1991-1992 ACA period on March 1, 1993. Staff contends that Mr. Pennington's testimony analyzes the 1990 SEECO contract, discusses the prudence of ANG's actions, and offers an opinion as to the future of the Request for Proposal (RFP) process in the gas industry, all of which Staff alleges could and should have been presented in ANG's direct testimony, and which serves solely to bolster and reiterate matters previously presented in ANG's direct testimony. Staff also maintains that Mr. Underwood's testimony includes a new analysis based upon information which Mr. Underwood contends was reasonably available to ANG in 1990, which Staff claims is irrelevant as an after-the-fact attempt to justify decisions made by ANG over four years ago. In addition, Staff references its inability to conduct discovery concerning the new analysis.

ANG responds that it could not be expected to respond to Staff's rebuttal testimony until after the rebuttal was filed. ANG also asserts that the testimony of witnesses Underwood and Pennington was intended to counter the perceived deficiencies in the testimony of Staff's rebuttal witness, Steven W. Ruback, namely that Mr. Ruback did not use the proper standard, did not consider the market conditions at the time of ANG's decision, and incorrectly suggests that RFPs were necessary to adequately review the contract.

Initially the Commission observes that the PGA/ACA procedure in effect provides a company with notice of Staff's position via the Staff recommendation prior to the time for the filing of the Company's direct testimony. In this case the record reflects that ANG had knowledge of Staff's position over a year prior to the hiring of witnesses Underwood and Pennington. In turn these witnesses were hired anywhere from one to four months in advance of the deadline for ANG's direct testimony, which arguably provided enough time for the testimony of these witnesses to be incorporated in the Company's direct testimony.

However, the Commission's rule defines surrebuttal testimony in 4 CSR 2.130(12)(C) as follows: "Surrebuttal testimony and schedules must be limited to material which is responsive to matters raised in another party's *rebuttal testimony* and schedules and are not to merely bolster or reiterate matters previously presented by direct or rebuttal testimony and schedules." (Emphasis added.) Given this, it can be argued that ANG's testimony is at least technically in compliance with the Commission's rule. In addition, while Staff noted the lack of an opportunity to do discovery, it did not indicate what information it would have sought or how the lack of that information would impede its ability to effectively cross-examine the witnesses in question, nor did it indicate that it considered other remedies or that other remedies would be inadequate.

While Staff's motion has some merit, the Commission must note that the line between proper surrebuttal testimony and testimony which should have been included in a party's direct testimony is often a fine one. The Commission is not inclined to grant the harsh remedy of striking testimony in a case as close as this one, absent some showing of specific prejudice to the moving party. Thus, the Commission will deny Staff's Motion to Strike Surrebuttal Testimony.

For the clarity of the record, the Commission notes that late-filed Exhibit No. 13 was never in fact filed or received into evidence. At the hearing Staff and ANG entered into an agreement that ANG would not object to the admission of a Staff exhibit consisting of ANG's responses to Staff's data requests on condition that ANG be given 10 days to review the exhibit and file a supplemental exhibit in the event the Company found the responses to be incomplete. Exhibit No. 13 was reserved for this possible late-filed exhibit, but no late-filed exhibit was ever received by the Commission.

Findings of Fact

The Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact:

ANG is a local distribution company operating in the State of Missouri in three districts, the Kirksville District, Butler District, and Southeast Missouri (SEMO) District. ANG is a division of Arkansas Western Gas Company (AWG) of Fayetteville, Arkansas. AWG and SEECO, Inc. (SEECO) a gas production company, are both operating companies wholly owned by Southwestern Energy Company (SWE).

The Commission has reviewed and considered all of the evidence and argument presented by the various parties in this case. Due to the volume and detailed nature of the evidence submitted, some evidence and positions on certain matters may not be addressed by the Commission. The failure of the Commission to mention a piece of evidence or the position of a party indicates that, while the evidence or position was considered, it was not found to be relevant or necessary to the resolution of the issue involved.

Past Gas Purchasing - SEMO (SEECO Contract)

At issue is a ten-year long-term contract for a firm, fixed-price swing gas supply entered into between ANG and an affiliate production company, SEECO. Staff claims that ANG failed to provide adequate documentation of the prudence of this contract. Staff's witness calculated the spot price for gas during the first two years of the contract, from October 1990 to August 1991, and from September 1991 to August 1992, then compared the spot price with the contract price to determine the premium being paid under the contract. Using this analysis, the premium paid above the spot price for the first year of the contract was determined to be 54 cents per Mcf including gathering costs and 46 cents per Mcf without gathering costs, while the premium paid above the spot price for the second year of the contract was determined to be 56 cents per Mcf including gathering costs and 48 cents per Mcf without gathering costs. Staff admits that some premium is appropriate for this type of contract, but contends that it is impossible to determine whether the premium paid under the contract is reasonable, due to the lack of information and contemporaneous documentation. Staff therefore recommends disallowance of the entire premium amount, which it calculates to be $1,617,080.82 for the 1990-1991 ACA period, and $1,391,938.36 for the 1991-1992 ACA period, for a total of $3,009,019.18.

ANG, on the other hand, emphasizes the benefits of the SEECO contract. ANG points out that the SEECO contract provides ANG's customers with superior reliability, as the gas is obtained from the Arkoma Basin, which has a good track record and known reserves. SEECO itself has a good reputation with no curtailments. In addition, ANG provided a calculation of the cost savings resulting from its decision to convert its firm sales contracts with Texas Eastern Transmission Corporation (Texas Eastern or TETCO), its previous gas supplier, to firm transportation instead. ANG also provided through its witness Mr. Underwood an after-the-fact analysis which purportedly showed that the price paid under the SEECO contract was actually at the low end of the range of reasonableness with respect to the price which could be expected to have been paid for a comparable gas supply during the period in question. ANG contends that Staff has made no showing of any unreasonable actions on the part of the Company, and is in effect penalizing ANG without making a sustainable finding of imprudence. ANG also maintains that Staff has applied an improper standard in both its use of a least-cost standard and emphasis on the lack of a RFP process, and suggests that Staff is availing itself of hindsight instead of considering the circumstances existing at the time of ANG's decision-making.

It is clear from a reading of the briefs that the parties have a difference of opinion regarding who bears the burden of proof. ANG states that its actions are entitled to a presumption of prudence until such time as Staff raises a serious doubt about the prudence of the costs in question. ANG insists that because Staff has not identified an appropriate price for the contract, Staff of necessity cannot make a showing of imprudence on the part of ANG. Staff, on the other hand, claims that the burden is on ANG to prove that its contract costs are just and reasonable. Staff contends that once a serious doubt has been raised as to the prudence of an expenditure, the burden of dispelling those doubts and proving the prudence of the expenditure rests with the utility.

All charges for gas service must be just and reasonable. §393.130.1, RSMo 1994. The burden of proof is on the gas corporation to show that a proposed rate increase is just and reasonable. §393.150.2, RSMo 1994. In explaining how the burden of proof operates, the Commission in a previous decision involving Union Electric Company's Callaway Nuclear Power Plant has cited approvingly from a federal district court case:

> Edison relies on Supreme Court precedent for the proposition that a utility's cost are presumed to be prudently incurred. However, the presumption does not survive "a showing of inefficiency or improvidence." As the Commission has explained, "utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures were prudent...However, where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, than the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent." (Citations omitted).

Re Union Electric, 27 Mo. P.S.C. (N.S.) 183, 193 (1985) (quoting ***Anaheim, Riverside, etc. v. FERC,*** 669 F. 2d 779, 809 (D.C. Cir. 1981)).

In a similar vein, the Commission in ***Union Electric*** also elucidated the appropriate standard to be used in judging a company's conduct, citing favorably from a decision of the New York Public Service Commission:

> [T]he company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company. (Citation omitted).

Union Electric at 194 (quoting ***Consolidated Edison Company of New York, Inc.,*** 45 P.U.R. 4th 331 (1982). The Commission went on to explain the standard as follows: "The Commission will assess management decisions at the time they are made and ask the question, 'Given all the surrounding circumstances existing at the time, did management use due diligence to address all relevant factors and information known or available to it when it assessed the situation?' In accepting a reasonable care standard, the Commission does not adopt a standard of perfection. Perfection relies on hindsight. Under a reasonableness standard relevant factors to consider are the manner and timeliness in which problems were recognized and addressed." ***Id.***

The SEECO contract provides firm, fixed-price swing gas supply for a period of 10 years, with a contract annual quantity of 6,500,000 MMBtu, or 70 percent of ANG's purchases for system supply in its integrated Southeast Missouri and Arkansas Districts, and a maximum daily quantity of 30,000 Mcf per day. The contract contains a take-or-pay (TOP) provision which allows ANG to take make-up gas for a period of five years from the time the TOP costs were incurred. Make-up may also be extended after termination of the contract. The initial price under the contract is $1.90 per MMBtu. There is also a provision which allows an annual price renegotiation if requested by one of the parties. If the parties cannot agree, the price becomes the average of the three highest prices paid by ANG on new contracts taken from Franklin and Johnson Counties, Arkansas, under similar terms and market conditions, in the ninth, tenth, and eleventh months of the preceding contract year, adjusted for comparability.

In addition, the contract contains what may be referred to as a "regulatory out" provision, which may be invoked if regulatory action prohibits ANG from recovering the full amount of its purchased gas cost through rates charged to its customers. In that event, SEECO may choose to pay the limited price. If SEECO is unwilling to continue sales under the limited price, ANG may choose to discontinue takes, attempt to resolve the matter to SEECO and ANG's mutual satisfaction, or continue to pay the contract price. Absent the foregoing, the contract will be terminated. There is also what may be referred to as a "market out" provision, which may be invoked if ANG cannot market some or all of its gas due to the price. ANG can suggest a lower price, based on a price which ANG is then offering for its system supply on new contracts under similar terms, if the price has been accepted under at least three contracts. SEECO may either accept the lower price or terminate the contract.

ANG provided evidence of three written responses to telephone inquiries regarding gas supply. Written responses were received from Vesta Energy Company, dated November 3, 1988, offering to supply gas for a two-year period from December 1, 1988 to November 30, 1990; from Arkansas Gas Marketing, Inc., dated November 1, 1988, offering to supply gas for a one-year period from December 1, 1988 to November 30, 1989; and from Arkla Energy Marketing Company, dated October 20, 1988, offering to supply gas for a two-year period from November 1, 1988 to October 31, 1990. ANG also provided the above-referenced cost analysis of the savings resulting from its decision to convert its firm sales contracts with Texas Eastern to firm transportation instead. In addition, ANG also provided the above-referenced after-the-fact analysis by Mr. Underwood, attempting to show the SEECO contract price to be at the low end of the range of reasonableness.

Mr. Ted F. Knight, witness for ANG, testified that ANG requested bids by telephone from several gas marketers and from one large producer in the Arkoma Basin other than SEECO. Mr. Knight could not recall if ANG had contacted any other gas marketers than the three which had submitted written responses, could not recall whether a ten-year term was requested in the telephone solicitations, or whether any time period at all was specified, and could not recall whether there were follow-up negotiations on the written responses. Mr. Knight was not aware of any other communications regarding ANG's inquiry pertaining to gas supply, other than the telephone solicitations and letters received in response. When asked whether the necessity of a ten-year term was determined before or after the written proposals were received, the witness responded that both had occurred at about the same time, in late 1989; however, the written requests were received in October and November of 1988. No specific analyses were performed by ANG to determine the value of the premium paid for swing service and long-term commitment.

Staff's witness, Stephen W. Ruback, testified that he used a least-cost standard because of the affiliate relationship between SEECO and ANG, and stated that he believed a RFP process should have been used by ANG prior to making its gas purchasing decisions. Mr. Ruback conceded that the failure to use a RFP process by itself does not make the process used by ANG unreasonable. However, he indicated that the failure to use a RFP process, in conjunction with a ten-year contract containing a last-look provision, the lack of an accepted methodology to calculate the premium, the existence of an affiliated relationship, the inability to compare long-term contracts, and the absence of a contemporaneous cost study or a possible rate of return calculation requires disallowance of the contract premium.

All of the parties are essentially in agreement that ANG's decision to convert from firm sales to firm transportation on Texas Eastern was beneficial to the Company. Similarly, all the parties essentially agree that the three written proposals are not comparable to the SEECO contract. However, the parties disagree on the conclusions which they would draw from this fact. ANG suggests that the absence of comparable contract proposals proves that SEECO was the only supplier who could meet its needs, while Staff argues that the absence of comparable contract proposals suggests the use of a flawed process in ANG's gas purchasing decision-making. The Commission finds that the evidence supports Staff's interpretation. While recognizing that gas purchasing decision-making is an ongoing process, the Commission notes that the written proposals were obtained in 1988, at least two years before the execution of the contract with SEECO. The gas industry was in flux at this time, and to a great extent still is. Thus a two-year time period could make a significant difference in what contract terms gas suppliers would be willing to offer.

While the Underwood analysis was based on information which should have been reasonably available to ANG, there was no indication that ANG was actually aware of this information or considered it, however informally, in its decision-making, notwithstanding that no formal analysis was performed. Mr. Underwood admitted that his analysis was not the best method to use, and that he would not use it in the future, but would solicit bids instead. In addition, Staff witness Ruback indicated that while the Underwood analysis -- if performed before-the-fact rather than after-the-fact -- would have provided something different to "bite down on," there would still be a need to review the underlying assumptions and premises contained in the analysis. These could include the appropriateness of using future strip prices on the NYMEX Exchange in October of 1990 to reasonably estimate future costs; the appropriateness of the basis differential; the relevance of Canadian contracts to Arkoma contracts; the appropriateness of the inclusion of a deficiency payment; knowledge of which contracts relied upon were in the public record and which were in confidential records; and knowledge of the appropriate premium for fixing a long-term price. The Commission finds that the Underwood analysis is an after-the-fact analysis with little probative value to aid in a resolution of this issue.

Moreover ANG repeatedly claims that its system is unique and that SEECO was the only gas supplier able to meet its needs, but offers little evidence in support of either fact. By their very nature, most local distribution companies (LDCs) require firm, swing service. Although mention is made of ANG's load factor, ANG never adequately explains why it is unique among Missouri LDCs. Nor did ANG provide any convincing evidence that SEECO was the only provider which could meet its needs. ANG did provide testimony that the market for gas supply in 1990 was thin. The Commission accepts that the market was in fact thin at this time. However, the existence of a thin market argues all the more strongly for a concerted effort to obtain information or bids from as many potential gas suppliers as possible. ANG appears to be inviting the Commission to defer to its knowledge of the gas market at the time in question. This is an invitation which the Commission must decline. While the Commission does not discount the value of ANG's general knowledge and experience in the gas industry, the Commission must acknowledge that this is a claim which may be made by any operating utility, however efficiently or poorly run. General knowledge and experience in the gas industry is insufficient, without more, to demonstrate the reasonableness of a utility's gas purchasing decision-making, particularly where the decision involves a long-term contract for 70 percent of the utility's requirements. This is so regardless of whether the ultimate gas purchasing transaction is with an affiliated company, but is even more cogent when an affiliate is involved.

ANG was certainly on notice that the Staff would pay special attention to contracts involving affiliated transactions, as ANG had received through its attorney a memorandum so stating from Dale W. Johansen of the Staff, regarding Staff's ACA review process, dated October 24, 1990, months before the SEECO contract was reduced to writing in the first quarter of 1991. This memorandum also stated that regardless of supplier, a company's gas cost shall be considered prudent if that cost does not exceed the delivered cost available from comparable alternative suppliers. Exh. 2, Schedule TFK-3. The Commission is in general agreement with Staff's memorandum, but stresses that the very existence of a transaction involving a corporate affiliate triggers a heightened scrutiny on the part of the Commission. Thus the level of scrutiny is generally higher for affiliated transactions, although the actual standard applied is the same as for nonaffiliated transactions. However, while the Commission on the whole agrees with Staff's memorandum, it must emphasize that the standard requires a company to meet its burden of proving the thoroughness and soundness of the company's processes undertaken to assure itself that its gas costs should not reasonably be expected to exceed the cost of gas available from alternative suppliers from whom comparable price and non-price terms and conditions, as well as external benefits, may be obtained. In addition, a management audit report prepared by Ernst and Young found the 1990 SEECO contract by its very nature not to be an arms-length contract, and suggested that it would be beneficial to have in the future guidelines documenting negotiations, including guidelines for obtaining other bids. Exh. 7, pp. V-12, V-16.

Staff witness Ruback testified that he repeatedly asked ANG for any information or documentation upon which he could base an opinion as to the reasonableness of the premium paid on the SEECO contract, including, as a last resort, a request for rate of return information relating to SEECO's rate of return on its contract with ANG. There was in evidence a letter from Arthur Anderson and Company to Mr. Gregory D. Kerley of SWE dated April 2, 1993, which stated in pertinent part, "In our opinion, it is not possible to develop in a meaningful manner the information requested by the MPSC Staff regarding the rate of return and cost information related to SEECO's contract obligation to provide a long-term supply commitment and swing service to ANG." Exh. 12. The letter went on to summarize the reasons for this conclusion. The Commission has reviewed this exhibit and finds that the objections to the provision of the information on rate of return based on its lack of meaningfulness are not valid given the purpose for which the information was sought.

The purpose of obtaining rate of return information for SEECO in this context is not to calculate SEECO's cost of service, or to determine SEECO's appropriate rate of return, or to set rates; the Commission does not regulate SEECO. Rather, the purpose of requesting the rate of return information is to obtain the best estimate of SEECO's rate of return and determine whether that rate is obviously and unarguably out of line with what could be considered reasonable, to the extent that an inference could be drawn that the SEECO contract is not beneficial to ANG. Conversely, the opposite could be inferred -- i.e., that the SEECO contract is reasonable -- if the SEECO rate of return is within the "ball park" of what could be considered reasonable. Such an approach to analyzing an affiliated transaction is not unique, and if this information had been provided, it may well have assisted ANG in meeting its burden of proof. As was stated in ***Re Southwestern Bell Telephone Company***, 1 Mo. P.S.C. (N.S.) 692, 709 (1949): "[T]he fact that the affiliate company is shown not to have made an excess profit from its dealings with its subsidiary or affiliate does have some evidentiary value, and if such does have evidentiary value, then in the absence of strong contradictory evidence the proof made is sufficient to sustain the applicant's burden." The Commission cautions, however, that while it agrees that a rate of return calculation for an affiliate would have some evidentiary value in evaluating an affiliate transaction, it would not necessarily by itself be sufficient to sustain a utility's burden of proof.

The Commission finds that ANG's failure to contemporaneously evaluate other gas suppliers prior to entering into the SEECO contract, in conjunction with its failure to document its gas purchasing practices, including its evaluation of the premium to be paid under the SEECO contract, renders its past gas purchasing practices during the ACA periods in question imprudent. The Commission has expressed its belief in the need for formal procedures for the evaluation of suppliers and bids with respect to gas purchasing as long as ago as 1989. In that case, the Commission stated that, "Without formal procedures there can be no effective review." ***Re The Kansas Power and Light Company,*** Case No. GR-89-48, Report and Order, issued December 29, 1989, at 7. More recently, the Commission has elaborated: "[T]he Commission expects the LDC to be able to provide the necessary economic analysis and documentation to support any action it takes that it claims will benefit its gas purchasing practices or increase the reliability of its gas supply." ***Re The Kansas Power and Light Company,*** Case Nos. GR-90-40 and GR-91-149, Report and Order, issued May 26, 1993, at 7. Obviously, the need for contemporaneous analysis and documentation is especially clear in the circumstance of a transaction between affiliates. In making the above finding of imprudence, the Commission is not using hindsight, but rather, finds ANG's actions to be unreasonable at the time they were made during the 1990-1991 and 1991-1992 ACA periods.

The Commission also has serious reservations about the wisdom of certain aspects of the SEECO contract itself. Nevertheless, the Commission need not pass on this question, as the Commission has already found ANG's actions in entering into the contract to be imprudent.

Given the Commission's finding of imprudence, the next tier of inquiry is to determine whether ANG's gas costs should be reduced for ratemaking purposes as a result thereof, and if so, in what amount. The Commission is faced with two polar extremes regarding the recovery of gas costs: ANG argues for inclusion of the entire amount of its gas costs under the SEECO contract, while Staff recommends disallowance of the entire premium amount above the spot price. The Commission has reviewed the evidence and its options, and determines that as it cannot find ANG's gas costs to be just and reasonable, as required by statute, §393.130.1, RSMo 1994, it would be inappropriate and unwarranted to allow ANG to include in rates its full gas costs. To do so would reward ANG for its imprudent conduct.

ANG by its actions created a situation wherein there was insufficient evidence or information available from which to calculate an appropriate premium above spot price which would be just and reasonable. The Commission determines that there was no lack of diligence by Staff in seeking information and attempting to quantify an appropriate premium; rather, Staff's inability to do so resulted from the actions of ANG. To allow ANG its full gas costs under these circumstances would not only reward ANG for its imprudent conduct, but could also encourage other utilities to create or manipulate situations so that insufficient evidence or information exists from which other parties can formulate positions on the justness and reasonableness of the utility's proposed rates.

The Commission has also considered Staff's recommendation that the entire premium amount be disallowed. Everyone is in agreement that some premium above the spot price is appropriate. In addition, benefits flowed from ANG's decision to convert from firm sales to firm transportation on the Texas Eastern system. Under these circumstances, the Commission finds that it would not be appropriate to disallow the entire premium amount, unless there is no evidence upon which to base a decision which is fairer to all parties concerned.

The Commission acknowledges that there is a dearth of evidence in the record which would lend itself to a precise division of the allowable versus the nonallowable portion of the premium above spot. Many of the articulated benefits to the SEECO contract -- insulation from a large portion of FERC Order 636 transition costs, limitation of TOP exposure, improvement of the mix of gas sources, and enhancement of supply security -- could not be quantified at the time of the hearing. Thus this avenue for determining an appropriate premium amount is not available to the Commission.[1]

The Commission finds that of the evidence presented which would support a disallowance of some but not all of the premium amount, the soundest evidence is that of Staff witness Ruback, who testified that one-half of the premium amount would be an appropriate number to be paid above the spot market price. The witness qualified his answer by stating that he could not point to an analysis from which the one-half figure was derived. However, on recross based on questions from the Bench, Mr. Ruback denied that his was an arbitrary number designed to, in effect, "split the baby." Rather, he testified that his number was what he thought was fair based on his analysis of the whole record, including the totality of the circumstances.

While the above testimony may be in the nature of an expert proffering his judgment of what would be fair given a certain set of circumstances, the Commission believes that this testimony yields a reasonable approximation of the disallowable portion of the premium amount, and is consistent with other evidence, however marginal or incomplete, of what an appropriate premium should be. There was evidence, for example, that the premium for a fixed-price contract could range from $0.05 to $0.10

---

[1]It is important to note, however, that these benefits are not unique to the SEECO contract, but are the result of ANG's early switch from firm sales to firm transportation on the Texas Eastern system. Thus the same benefits would presumably accrue if ANG had a supplier other than SEECO, so long as the Company made the same early switch away from sales on Texas Eastern.

per MMBtu. There was also evidence that ANG paid a gathering charge of $18.3 per Mcf under the SEECO contract, although the spot indices used to determine the premium amount were "into the pipeline" prices, and thus already included gathering costs.

In addition, there was evidence that the demand charge, which is a component of the premium, ranges from $0.20 to $0.30. This demand charge premium is a premium to provide firm service and long-term service. It also provides a portion of the premium for flexibility. There was also testimony by ANG's witness Mr. Knight that he did not consider the SEECO contract to be a true fixed-price contract, as the price is redetermined annually rather than fixed for the entire length of the term. Given the above, the Commission is of the opinion that $0.20 to $0.30 reflects an appropriate premium for most of the major components of the contract requiring the payment of a premium. This in turn is consistent with the recommendation of Mr. Ruback that only half of the premium amount be allowed, as one-half of a premium of $0.54 is $0.27, which falls within the range of $0.20 to $0.30.

The Commission is very aware that the evidence cited above was presented for a purpose other than the one for which the Commission has utilized it, namely as a surrogate for an appropriate premium. The Commission is also aware that the evidence made reference to an adjustment for load factor. Nevertheless, the Commission determines that it can be inferred from this evidence that an allowance of one-half of the SEECO contract premium, as proposed by Mr. Ruback, represents a fair premium under the totality of the circumstances in this case.

It is important for the Commission to again stress the paucity of evidence and the lack of documentation in this case. Indeed, the major evidence of what an appropriate premium under the SEECO contract might be came in response to questions from the Bench. Without this evidence, the only alternative available to the Commission would have been the disallowance of the entire premium amount. Such a paucity of evidence and lack of documentation is unacceptable even where the gas purchasing transaction is with an unaffiliated company, but is even less acceptable and less comprehensible where an affiliate transaction is involved. The Commission also notes that as a practical matter it may be very difficult to prove the prudency of an affiliate transaction without the functional equivalent of an RFP process.

Thus, the Commission finds for all of the reasons stated above that ANG's actions in entering into the SEECO contract were imprudent, and that ANG has failed to meet its burden of proving that its gas costs under the contract are just and reasonable, therefore the Commission determines that one-half of the premium amount under the SEECO contract should be disallowed and not considered in the computation of ANG's appropriate ACA factor.

Future Gas Purchasing - SEMO (SEECO Contract)

Staff recommends that the Commission require ANG to utilize a comprehensive RFP process to obtain gas supply for SEMO in the future. The SEECO contract contains both a "regulatory out" and "market out" provision. Under the "regulatory out" provision, in the event of regulatory action which prohibits ANG from recovering the full contract price for purchased gas through the rates charged to its customers, SEECO would have the choice to continue sales under the limited price. If SEECO is unwilling to continue sales at the limited price, ANG would have the option to either discontinue takes, attempt to resolve the matter to SEECO and ANG's mutual satisfaction, or continue to pay the contract price. If none of these options are chosen, the contract will be terminated. Under the "market out" provision, in the event ANG cannot market its purchased gas due to price, ANG can notify SEECO and SEECO may continue to provide gas to ANG at such a lower price as would enable ANG to market such gas. The lower price may not be less than that which ANG is offering on new contracts under similar terms for its systems supply, provided that the lower price has been accepted under at least three contracts. If the lower price is acceptable to SEECO, then the lower price will become the contract price. If the lower price is not acceptable to SEECO, SEECO shall have the right to terminate the contract. It is this later provision, which allows a lower price to be based upon prices obtained from other suppliers, which Staff refers to as a "last look" provision.

Staff recommends that in the future ANG begin a comprehensive solicitation of gas supply through a RFP process. According to Staff, ANG should write the RFP in a manner which requires respondents to properly respond to the Company's need for firm, swing service, but should not write it so restrictively as to hinder innovation and creativity. The RFP should be issued to at least 40 prospective suppliers. After receipt of the bids, the Company should conduct a comparative analysis which evaluates all the responses in terms of both price and non-price factors, to whittle down the list to a short list of bids. In addition, Staff states that ANG should then conduct a detailed cost analysis of each proposal to determine the cost of each gas supply under the Company's expected dispatch conditions, using a dispatch model which replicates expected load conditions. The Company should calculate the expected cost of each supply under varying load factor assumptions. Finally, Staff contends that ANG should enter into further negotiation with the suppliers to improve the responsiveness of any of the bids on the short list.

Staff acknowledges that using the RFP process may result in the abrogation of the contract between ANG and SEECO, but claims that this is necessary in order for ANG to take advantage of the existing competitive environment in the gas supply industry. Staff explains that because of the "last look" provision in the SEECO contract, absent Commission action ordering the use of the RFP process and the restructuring of the contract to eliminate the "last look" provision, ANG would be unable to obtain serious bids for its gas supply, as the "last look" provision would have a chilling effect on potential bidders. If bidders know that SEECO could always obtain the gas supply contract by matching the lowest bid, bidders will not in the first instance be inclined to participate in the bidding process. In addition, Staff notes that it is difficult or impossible for the Staff to obtain quotes for gas supply, as potential suppliers will be aware that Staff is not a serious buyer, thus this avenue is not available to Staff as a method for determining the reasonableness of ANG's gas costs. For these reasons, Staff states that the same problems with respect to the evaluation of the prudency of ANG's gas supply for the 1990-1991 and 1991-1992 ACA periods will occur again in the future.

As a basis for the Commission's authority to require ANG to use a RFP process in the future, Staff cites to ***May Department Stores Co. v. Union Electric Light & Power Co.***, 107 S.W.2d 41 (Mo. 1937), ***State ex rel. Capital City Water v. P.S.C.***, 850 S.W.2d 903 (Mo. App. 1993), and ***Educational Employees Credit Union v. Mutual Guaranty Corporation***, 821 F. Supp. 1294 (E.D.Mo. 1993).

ANG maintains that the rights of the parties under the SEECO contract are protected by Article I, Section 10 of the United States Constitution (Contract Clause), and Article I, Section 13 of the Missouri Constitution, both of which prohibit laws impairing the obligations of contracts. ANG reiterates the benefits of the SEECO contract, and stresses that there is absolutely no evidence in the record to indicate that ANG's gas costs would be reduced by abrogating the contract. ANG cautions that the "regulatory out" clause does not allow for a bidding process; rather, only one of three things can happen: SEECO can sell its gas at the lower price established by the Commission for the time period in question, ANG can continue buying gas under the contract at the contract price, knowing that it will not be allowed to recover the full price from the ratepayers, or the contract will be canceled. Thus, requiring the use of a RFP process would almost certainly require the abrogation of the contract. Moreover, ANG has already improved its price redetermination and documentation process, as part of the implementation of recommendations made in a 1992 Ernst and Young management audit. ANG presented testimony that the Company currently uses a RFP process for its other gas supply, and that information relating to the cost of gas from alternate, unaffiliated suppliers has been used for price redeterminations under the SEECO contract in 1993 and 1994, including the use of projected index prices.

The Commission has reviewed the cases cited by Staff, and finds that of those cases, ***Educational Employees Credit Union v. Mutual Guaranty Corporation***, 821 F. Supp. 1294 (E.D.Mo. 1993) contains a specific and detailed analysis of the parameters of the Contract Clause. This case suggests that under certain circumstances, state law will not violate the Contract Clause even when the state law has in fact operated as a substantial impairment upon a contractual relationship.

The Commission finds, as argued by ANG, that adoption by the Commission of Staff's position requiring the use of a RFP process by ANG for the Company's future gas purchases will entail the abrogation of the contract between ANG and SEECO, as Staff's proposal does not even remotely fall within any of the options contained in the contract's "regulatory out" provision.[2] The Commission further finds that requiring the use of a RFP

---

[2]The Commission is aware that it has no authority to construe a contract in a way that is binding upon the parties to the contract. *See* ***May Department Stores,*** 107 S.W.2d at 49. However, where the Commission has authority to act, it may look to the terms of a contract in the exercise of its ratemaking authority.

process and the modification of the "last look" provision by ANG during the remaining term of the SEECO contract will result in a substantial impairment of that contract, as SEECO will be deprived of the benefit of its bargain, ie., the certainty of a market for its gas at a price determined by the contract, or redetermined under the circumstances and through use of the methods prescribed by the contract. However, the Commission need not decide whether the relief sought by Staff falls within the circumstances under which impairment of a contract would not violate the Contract Clause, as explained in the ***Educational Employees Credit Union*** case.

The Commission is of the opinion that Staff's proposal assumes that damage will flow from the imprudent SEECO contract in the future. In addition, Staff's argument regarding its inability to obtain serious quotes appears to ask the Commission to mandate ease of regulatory review. While the Commission agrees that a formal RFP process is in most instances an appropriate and adequate tool for gas purchasing decisions, and shares Staff's concern regarding the evaluation of any damages which might flow from the imprudent SEECO contract in the future, the Commission determines that it is both inappropriate and unnecessary to require ANG to use a RFP process and modify the "last look" provision for its future gas purchases during the remaining life of the contract. The chilling effect feared by Staff might still exist, although perhaps to a lesser extent, if the Commission took the action recommended by Staff, as alternate gas suppliers may be unwilling to do business with ANG because of the added layer of regulatory uncertainty suggested by an abrogation of the SEECO contract. To the extent that alternate gas suppliers have other customers with whom they may contract, those gas suppliers may be reluctant to enter into an agreement with a company whose past gas supply contract was abrogated by the Commission, under the theory that this represents an added risk of the same thing happening to the new contract.

The Commission finds that because ANG has the burden of proof and burden of persuasion with respect to the reasonableness of its future gas purchasing decisions, it is unnecessary to take the action requested by Staff. Since ANG has the ultimate burden of proof, ease of regulatory oversight is not in itself a sufficient reason to require ANG to abrogate the SEECO contract and use a RFP process in its stead. In addition, ANG should be given the opportunity to demonstrate in a future case that no damage has occurred as a result of the imprudent SEECO contract in a different ACA period. The Commission again cautions, however, that it may be very difficult for ANG to prove the prudency of its gas costs under the SEECO contract -- absent unusual circumstances such as greatly increased spot market prices -- without the functional equivalent of a RFP process.

Finally, in presenting its position on this issue Staff has suggested that ANG at least be required to use a RFP process at the end of the SEECO contract term. ANG witnesses Knight and Pennington both stated that they did not know whether a RFP process would be appropriate at that time, since they did not know what the market would be like then, nor what changes would have taken place in the industry in the interim. While the Commission generally encourages the use of a RFP process, the Commission is unwilling to speculate as to the nature of the natural gas industry in four or five years' time, or the need for a RFP process as a prerequisite to prudent gas purchasing decisions, thus the Commission deems it more appropriate to abstain from making a decision on what ANG should do at the end of the contract term until the issue is raised at an appropriate time and in an appropriate forum.

For all of the foregoing reasons, the Commission determines that it should not require ANG to enter into a RFP process and modify the "last look" provision during the remainder of the term of the SEECO contract, and that it should not render a decision as to whether to require ANG to enter into a RFP process after the expiration of the term of the SEECO contract.

Transportation Take-Or-Pay Costs

ANG's TOP costs incurred for its three Missouri districts during the period from September 1988 through August 1989 were not included in its ACA factor in Case No. GR-90-38. These TOP costs were later rolled forward into subsequent cases, with the uncollected portion rolled forward into the computation of the ACA factor in subsequent filings. The ACA factor was not applied to interruptible transportation volumes for the SEMO and Kirksville Districts[3], and TOP costs were not collected from interruptible transportation customers[4]. The parties generally agree that ANG allocated too large a portion of TOP costs to interruptible sales customers, and that some of those costs should be allocated to interruptible transportation customers instead. However, during the four ACA periods under review in this proceeding, ANG did not bill interruptible transportation customers for any TOP costs because the Company did not have a provision in its tariffs that provided for recovery of TOP costs from these customers.

Staff claims that an undercollection of TOP costs and an overstatement of the applicable ACA factor resulted from the nonapplication

---

[3]There are no transportation customers in the Butler District.

[4]At various points in the record, both Staff and ANG alternately refer to "interruptible transportation customers" and "transportation customers." The Commission does not view these terms as necessarily interchangeable, and thus will continue to refer to interruptible transportation customers. Since this dispute is primarily legal rather than factual, the outcome of the Commission's decision should apply with equal force to firm transportation customers.

of TOP costs to interruptible transportation customers. Staff states that it opposes the recovery of past interruptible transportation TOP costs because there was no tariff in existence to collect these costs for all four of the ACA periods being reviewed. The adjustments made by Staff reflect the exclusion of the interruptible transportation TOP allocations. According to ANG, there are approximately $700,000 of TOP costs to be recovered from these customers.

ANG maintains that the prospective recovery of TOP costs from interruptible transportation customers is not retroactive ratemaking in that the costs are used to set rates for the future. ANG also states its belief that these costs are recoverable so long as the ACA periods to which the costs pertain are still open, and points out that it is not aware of any deadline with respect to recovery of these costs. In addition ANG contends that following Staff's recommendation will result in the illegal trapping of FERC-approved costs, in violation of the federal preemption doctrine under the Supremacy Clause of the United States Constitution, Article VI, Clause 2.

ANG's witness Ricky A. Gunter testified that ANG should be permitted to collect TOP costs from interruptible transportation customers because the costs were ones which the Company had no choice but to incur. Mr. Gunter opined that the costs could be deferred and held on the books until recovery is determined, however long a period of time that might be. The witness further stated that recovery of the interruptible transportation TOP costs is appropriate because the Commission has previously ruled that TOP costs are 100 percent recoverable through the PGA mechanism.

Reference was also made to a Staff recommendation issued in Case No. GR-90-84, which states as follows: "It is the Staff's position that if companies seek recovery of TOP amounts through the regulatory process in Missouri, it should be done only in the context of the ACA audit which covers the period to which such charges apply." Exh. 8, p. 2. ANG states that it believed issues related to interruptible transportation TOP recovery would be addressed during its ACA cases, and thus immediately took steps to include in the open ACA cases the TOP costs which had been previously paid. ANG believed that as long as the ACA periods were open there would be no issue raised about the ultimate recovery of all TOP costs. When asked why a tariff filing for recovery of TOP costs for interruptible transportation customers had not yet been made, Mr. Gunter testified that the Company had directed its attention to other pressing matters before it between then and now, such as a rate case and a management audit.

ANG contends that the recovery of TOP costs from interruptible transportation customers is not retroactive ratemaking because of the Commission's decision in ***American-National Can Company v. Laclede Gas Company,*** 30 Mo. P.S.C. (N.S.) 32 (1989). ANG also claims that following the Staff recommendation will result in the illegal trapping of costs approved by the FERC, and cites a number of cases in support of that proposition, including ***Nantahala Power and Light Company v. Thornburg,*** 476 U.S. 953 (1986) and ***Mississippi Power and Light Company v. Mississippi ex rel. Moore,*** 487 U.S. 354 (1988).

Nantahala and ***Mississippi Power and Light*** do indeed stand for the general proposition that under the Supremacy Clause states are barred from "trapping" FERC-approved costs. However, FERC itself is not the source of federal law; rather, the United States Congress is the author of the statutes which give FERC its authority. FERC itself is bound by the filed rate doctrine, as was held in **Columbia Gas Transmission Corporation v. FERC,** 831 F. 2d 1135 (D.C. Cir. 1987), and ***Associated Gas Distributors v. FERC***, 893 F. 2d 349 (D.C. Cir. 1989).

In the ***Columbia Gas*** case, the court explains that the rule against retroactive ratemaking is derived from the provisions of the Natural Gas Act requiring sellers of natural gas to file their rates with the Commission, and states that these provisions form the basis for the "filed rate doctrine." ***Columbia Gas*** at 1140. The court goes on to cite a United State Supreme Court case for the proposition that the Natural Gas Act bars a regulated seller of natural gas from collecting a rate other than the one filed with the Commission, and prevents the Commission itself from imposing a rate increase for gas already sold. ***Id.*** In applying this law to the facts of the case before it, the court concluded: "Although the parties have mounted an extensive semantic battle over whether the FERC orders amount to retroactive ratemaking (or rate authorization), the effect of the orders is quite clear: downstream purchasers are expected to pay a surcharge, over and above the rates on file at the time of sale, for gas they had already purchased. However described, this constitutes a retroactive rate increase that we find to be prohibited by the NGA [Natural Gas Act]." ***Id.***

Similarly, in the ***Associated Gas*** case, the court held that FERC violated the filed rate doctrine:

> We agree with petitioners that the purchase allocation mechanism and its direct charge violate the filed rate doctrine. The Commission's attempted distinction of *Columbia Gas* is unpersuasive. Under *Columbia Gas*, the relevant question is not which costs are "current" and which are "past." Rather, the appropriate inquiry seeks to identify the purchase decisions to which the costs are attached. After making this inquiry, we have little doubt that the mechanism at issue violates the filed rate doctrine....As in *Columbia Gas*, "the effect of [these orders] is quite clear: downstream purchasers [such as petitioners here] are expected to pay a surcharge, over and above the rates on file at the time of sale, for gas they had already purchased."
>
> ....
>
> [B]oth the *Columbia Gas* orders and the mechanism before us undermine the purpose of the filed rate doctrine. As we said

in *Columbia Gas*, "[p]roviding the necessary predictability is the whole purpose of the well established 'filed rate doctrine' . . . ."

Associated Gas at 355-356.

The Commission thus determines that federal preemption is inapplicable to the case before us. Rather, the Commission finds that federal caselaw supports Staff's position. While federal caselaw is instructive, the Commission must also look to the law of the State of Missouri. Missouri statutory law contains provisions similar to the provisions in the Natural Gas Act, which form the basis of the filed rate doctrine. Section 393.140(11) grants to the Commission the power to require every gas corporation to file with the Commission and keep open to public inspection schedules showing all rates and charges. §393.140(11). The statute then goes on to say: "No corporation shall charge, demand, collect or receive a greater or less or different compensation for any service rendered or to be rendered than the rates and charges applicable to such services as specified in its schedule filed and *in effect at the time;* ..." (Emphasis added). ***Id.***

In addition, in ***State ex rel. Utility Consumers Council v. P.S.C.,*** 585 S.W.2d 41 (Mo. banc 1979), the Missouri Supreme Court held, in the context of a surcharge, that costs cannot be collected if a proper tariff is not on file. That case dealt with a tariff which was expressly made effective for only a two-year period. The tariff also provided that costs could not be recovered until after a 60-120 day time lag. The tariff expired and was replaced with a new tariff which reduced the time lag. Costs were incurred by the utility in the final months of the first tariff which were not collectible under the old tariff because it expired before the necessary lag-time had elapsed, and the Commission enacted a surcharge to allow the utilities to collect these expenses. The Missouri Supreme Court stated, "They [the costs] were uncollected because they were not collectible under the terms of the old FAC before it expired....To permit them to collect additional amounts simply because they had additional past expenses not covered by either clause is retroactive ratemaking,....Since the surcharge thus enabled the utilities to collect monies not collectible under the rate filed at the time the expenses intended to be recoverable under the surcharge were incurred, the utilities have no vested right in the monies collected." ***Utility Consumers Council*** at 59.

The Commission finds that ANG may not collect from its interruptible transportation customers TOP costs incurred but not billed because of the lack of a tariff authorizing the Company to do so. ANG may only recover TOP costs incurred after the effective date of an appropriate tariff authorizing collection of TOP costs from interruptible transportation customers. To hold otherwise would be prejudicial to ANG's customers. In this regard the Commission is persuaded by the approach of the federal court in ***Associated Gas,*** which indicated that the appropriate inquiry seeks to identify the purchase decisions to which the costs are attached. The petitioners in ***Associated Gas*** successfully argued that had the utility's customers known of the charges, they could have altered their decisions and reduced their gas costs, and the court emphasized notice to the customers in rendering its decision.

It is important to note, however, that the Commission's decision in this proceeding does not abrogate its previous decision in ***American-National Can Company v. Laclede Gas Company.*** In ***American-National Can Company***, the Commission held that TOP costs are gas costs; Laclede's tariff provides for recovery of these TOP costs; passthrough of these TOP costs does not constitute retroactive ratemaking; and interruptible customers should be required to pay TOP costs, as they receive the benefits of lower spot market prices associated with the TOP charges. ***American-National Can Company*** at 36-37. As part of its determination that passthrough of TOP charges via a PGA mechanism does not constitute retroactive ratemaking, the Commission specifically stated, "*In this case* the TOP costs being charged Respondent by its supplier are the basis for setting the rates to be charged customers in the future." (Emphasis added). ***Id.*** at 36. ANG argues that the recovery of TOP costs from interruptible transportation customers is not retroactive ratemaking in that the costs are used to set rates for the future. However, because ANG has not and cannot recover these TOP costs due to a lack of appropriate tariff, whether the cost information is used to set rates in the future is irrelevant. It is perhaps easier to think of this issue as one involving retroactive tariffing rather than retroactive ratemaking, although the two are effectively the same. There is no purer form of retroactive ratemaking then to charge a customer for service rendered at a point in time at which no tariff for that charge existed.

The Commission is mindful that changes in FERC policy may create a slight lag period before appropriate tariffs can be implemented. This merely underscores the need for LDCs to monitor the activities of FERC. Certainly ANG was on notice as of October 19, 1989, the date of the ***American-National Can Company*** decision, that passthrough of its TOP charges would be permitted via its PGA mechanism, and that interruptible customers should pay their share of TOP costs, yet ANG has waited over five and one-half years and still has not filed an appropriate tariff to collect TOP charges from its interruptible transportation customers. The situation in which ANG finds itself has been aptly described by Staff in its reply brief: "Here ANG has constructively 'trapped' itself by not filing appropriate tariffs to collect the federal charges at the state level and thus run afoul of the filed rate doctrine and the proscription against retroactive ratemaking." Staff Reply Brief at 23.

For the foregoing reasons, the Commission determines that TOP costs which should have been recovered from interruptible transportation customers but which to date have not been recovered because of the lack of an appropriate tariff may not be recovered by ANG, either now or in the future. TOP charges incurred after the effective date of an appropriate tariff authorizing collection of these costs from interruptible transportation customers may be recovered in the future on a prospective basis.

PGA Tariff Changes

As part of the schedules attached to the direct testimony of ANG's witness Ricky A. Gunter, ANG filed illustrative tariffs consisting of ANG's Purchased Gas Adjustment Tariff, Sheets 16-16m, and ANG's Transportation Tariffs, Sheet 74 for the SEMO District, Sheet 11D for the Kirksville District, and Sheet 15D for the Butler District. The illustrative tariffs contain provisions allowing recovery of TOP costs from transportation customers, as well as tariff modifications recommended by Staff, and some minor typographical corrections. ANG requests that the TOP cost recovery tariff for transportation customers be implemented in this docket, or that the Commission direct ANG to file appropriate tariff modifications addressing this TOP recovery in a separate proceeding.

ANG explains that it attached the illustrative tariffs to Mr. Gunter's direct testimony out of concern that it could be barred from recovery of its TOP costs for the period in question if the matter were not addressed before the closing of the ACA periods. ANG refers to a Staff recommendation issued in Case No. GR-90-84 which states as follows: "It is the Staff's position that if companies seek recovery of TOP amounts through the regulatory process in Missouri, it should be done only in the context of the ACA audit which covers the period to which such charges apply." Exh. 8, p. 2. ANG urges that for purposes of administrative efficiency, the Commission should approve the concept embodied in the illustrative tariffs, as Staff has had an opportunity to review all tariff modifications and has suggested no specific changes.

Staff responds that it does not believe this is the appropriate docket for addressing tariff language. Staff recommends that ANG file tariffs containing a recovery mechanism for current and future TOP costs, with a 30-day effective date. However, Staff stresses that the tariff should authorize recovery only of current and future TOP costs, and not TOP costs which the Company has incurred, but not billed because its tariff did not provide the authority to do so. In addition, Staff adds that it does have changes it wishes to see made in the tariff language, but believes that the appropriate time to address those issues is when the tariffs are actually filed.

The Commission has reviewed ANG's illustrative tariffs and the testimony and arguments of the various parties on this issue, and finds that ANG's tariffs for TOP recovery should be filed as separate 30-day tariffs. The Commission notes that its review of the illustrative tariffs revealed potential ambiguities in some of the tariff language, thus a separate tariff filing will provide an appropriate forum for review of the tariffs. A separate tariff filing will also provide notice to interested parties and allow for their participation. Thus, the Commission will direct ANG to file 30-day tariffs which include a mechanism to recover TOP costs from transportation customers, which should be filed within 30 days of the effective date of this Report and Order. The Commission cautions, however, that as the Commission has found against ANG with respect to the issue of transportation TOP costs, the tariffs to be filed by ANG should not include provisions for recovery of past costs which the Company has incurred for the period during which ANG had no tariff authorizing TOP recovery.

The Commission also notes that as one of the issues resolved in this case, Staff recommended and ANG agreed to make a 30-day tariff filing reflecting changes resulting from FERC Order 636. While the Commission will not order ANG to make such a filing, the Commission encourages ANG to do so at the earliest possible time.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law:

ANG is a public utility subject to the jurisdiction of the Commission pursuant to Chapters 386 and 393 of the Missouri Revised Statutes, RSMo 1994. Pursuant to §393.130.1, RSMo 1994, all charges for gas service must be just and reasonable. The burden of proof is on the gas corporation to show that a proposed rate increase is just and reasonable, as required by §393.150.2, RSMo 1994. ACA filings affect the amount charged for gas service based on a company's actual cost of gas.

The standard to be used in reviewing ANG's past gas purchasing practices and the gas costs it seeks to pass on to ratepayers is whether the actions taken by ANG were prudent at the time those decisions were made. *See **Re Union Electric***, 27 Mo. P.S.C. (N.S.) 183, 193-194 (1985). Based upon the Commission's findings of fact in these cases, the Commission concludes that Staff's use of a least cost standard, to the extent that there exist substantive differences between this standard and the prudency standard, did not effect the outcome of these cases, as the Commission used the prudency standard referenced above in arriving at its factual determinations. The Commission also concludes that ANG's gas purchasing practices were imprudent, and that ANG has failed to meet its burden of proving that the charges made under its ACA filings are just and reasonable. In addition, the Commission concludes that a disallowance of one-half of the premium above spot prices paid by ANG under the SEECO contract is just and reasonable.

With respect to ANG's future gas purchasing practices and Staff's recommendation relating thereto, the Commission concludes that since ANG will have the burden of proof in any docket relating to its future gas purchasing practices, it is unnecessary to dictate in these dockets what those practices should be. Further, the Commission concludes that ANG should be given an opportunity to prove that the imprudent SEECO contract did not result in any damages in a different ACA period.

As to ANG's ability to collect TOP costs from its interruptible transportation customers, the Commission concludes based on ***Columbia Gas Transmission Corporation v. FERC,*** 831 F. 2d 1135, 1140 (D.C. Cir. 1987) and ***Associated Gas Distributors v. FERC***, 893 F. 2d 349, 355-356 (D.C. Cir. 1989) that the federal preemption doctrine does not apply to the Commission's actions in these cases. Moreover, the Commission concludes that charges for gas service may not be collected unless a tariff authorizing the charge was in effect at the time the gas service was rendered, based on the provisions of §393.140 (11), RSMo 1994, and the analysis of the Missouri Supreme Court in ***State ex rel. Utility Consumers Council v. P.S.C.,*** 585 S.W.2d 41, 58-60.

Furthermore, the Commission concludes that it cannot approve the illustrative tariffs attached to the direct testimony of ANG, consisting of ANG's Purchased Gas Adjustment Tariff, Sheets 16-16m, and ANG's Transportation Tariffs, Sheet 74 for the SEMO District, Sheet 11D for the Kirksville District, and Sheet 15D for the Butler District, as such an action would circumvent one of the purposes of the thirty-day tariff filing procedure, which provides notice to interested parties of what rates or regulations a company is seeking to implement. Additionally, the Commission concludes that in any event it could not approve the portions of the tariffs which seek recovery of past TOP costs from interruptible transportation customers for costs which ANG has incurred, but which to date have not been recovered from those customers due to the lack of an appropriate tariff, based on the Commission's findings and conclusions with respect to the transportation TOP cost issue in these cases.

IT IS THEREFORE ORDERED:

1. That Associated Natural Gas Company be and is hereby ordered to adjust its ACA balances for the 1990-1991 ACA period by $808,540.41, which is one-half of Staff's proposed adjustment of $1,617,080.82, in accordance with this Report and Order.

2. That Associated Natural Gas Company be and is hereby ordered to adjust its ACA balances for the 1991-1992 ACA period by $695,969.15, which is one-half of Staff's proposed adjustment of $1,391,938.36, in accordance with this Report and Order.

3. That Associated Natural Gas Company may not recover from interruptible transportation customers take-or-pay costs which have been incurred in the past but not recovered from those customers due to the lack of a tariff authorizing the recovery of take-or-pay costs from interruptible transportation customers.

6. That Associated Natural Gas Company be and is hereby ordered to adjust its ACA balances for all four ACA periods, 1988-1989, 1989-1990, 1990-1991, and 1991-1992, to eliminate the amount of take-or-pay costs which should have been recovered from interruptible transportation customers.

5. That Associated Natural Gas Company be and is hereby ordered to file tariffs with a thirty-day effective date, which are in compliance with this Report and Order and which include a mechanism to recover current and future take-or-pay costs from transportation customers, within thirty days of the effective date of this Report and Order.

6. That this Report And Order shall become effective on August 14, 1995.

BY THE COMMISSION

David L Rauch

David L. Rauch
Executive Secretary

(S E A L)

Mueller, Chm., McClure, Kincheloe and Crumpton, CC., Concur and certify compliance with the provisions of Section 536.080, RSMo 1994.

Dated at Jefferson City, Missouri, on this 14th day of July, 1995.