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 Sheets Reflecting PGA Changes to be Reviewed in the Company's 1993-1994 Actual Cost Adjustment.	)))))	Case No. GR-94-228

REPORT AND ORDER

Issue Date: July 31, 1996

Effective Date: August 13, 1996

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APPEARANCES

Gary W. Duffy, Brydon, Swearengen & England, P.C., 312 East Capitol Avenue, Post Office Box 456, Jefferson City, Missouri 65102-0456, for Missouri Gas Energy, a division of Southern Union Company.

Martin J. Bregman, General Attorney-Regulation, Western Resources, Inc., 818 Kansas Avenue, Post Office Box 889, Topeka, Kansas 66601,

and

Donald D. Barry, Attorney at Law, 5340 West 17th Street, Post Office Box 4816, Topeka, Kansas 66604, for Western Resources, Inc., d/b/a Gas Service, a Western Resources Company.

Richard S. Brownlee, III, Hendren and Andrae, 235 East High Street, Post Office Box 1069, Jefferson City, Missouri 65102, for Williams Natural Gas Company.

Richard W. French, French & Stewart Law Offices, 1001 Cherry Street, Suite 302, Columbia, Missouri 65201,

and

James P. Zakoura, Smithyman & Zakoura, Chartered, 7300 West 110th Street, Overland Park, Kansas 66210, for Mid-Kansas Partnership and Riverside Pipeline Company, L.P.

Stuart W. Conrad, Finnegan, Conrad & Peterson, 1209 Penntower Building, 3100 Broadway, Kansas City, Missouri 64111, for Midwest Gas Users Association.

Douglas E. Micheel, Senior Public Counsel, Office of the Public Counsel, Post Office Box 7800, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

Jeffrey A. Keevil, Deputy General Counsel, and **Penny G. Baker**, Deputy General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the staff of the Missouri Public Service Commission.

ADMINISTRATIVE LAW JUDGE: **Joseph A. Derque, III.**

REPORT AND ORDER

Procedural History

These cases were established for the purpose of receiving the actual cost adjustment (ACA) filing of Western Resources, Inc. (WRI) for the 1993-94 adjustment period, extending from July 1, 1993 through February 1, 1994, and the ACA filing of Missouri Gas Energy, a division of Southern Union Company (MGE) for February 1, 1994 through June 30, 1994. 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.

On December 21, 1995, the Commission issued an order consolidating these cases, as the issues were interrelated, and setting a procedural schedule. After lengthy discovery and negotiation, two separate stipulations and agreements were filed and accepted by the Commission, settling all areas of dispute save the two matters finally litigated, fully briefed, and submitted to the Commission on June 28, 1996.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The positions and arguments of all parties have been considered by the Commission in making this decision. Failure to reflect a piece of evidence, position, or argument of any party to this litigation in this Report And Order in no way indicates that the Commission has failed to consider relevant evidence, but indicates only that the omitted matter was not considered relevant to the decision or outcome. In

addition, the Commission will not present each party's version of the facts in this Report And Order, but will make its own independent findings, on substantial and competent evidence of record, upon which its decision will be based.

The evidence reflects a substantial amount of proprietary and highly confidential information has been entered in this case, some of which is necessary to the decision herein. The Commission will refer to these confidential details only generally in its decision. Failing to refer to an exact detail or number does not, in any way, indicate that the proprietary or highly confidential information was not considered substantial and competent information by the Commission.

WRI and its successor in interest, MGE, are local natural gas distribution companies, regulated by the Commission and serving customers in and around the metropolitan Kansas City area as well as other areas in western Missouri. During the ACA period in question, from July 1, 1993 through June 30, 1994, MGE purchased the Missouri holdings of WRI, save the Palmyra District, which is not in issue in this case. MGE became the certificated operator of that service area on February 1, 1994.

Testimony reveals that OXY USA, Inc. (OXY) is a marketing subsidiary of Occidental Petroleum Company, a wellhead producer of natural gas. During 1988 WRI negotiated a long term contract for gas supply from OXY. Late in 1992 WRI chose to renegotiate this contract, prior to its expiration. The contested issues in this matter involve this renegotiated gas supply contract which OXY and WRI signed on January 20, 1993 (hereafter referred to as the "new OXY contract").

The new OXY contract is one of relatively long term in the industry. The contract calls for maximum daily quantities (MDQ) of gas, to be delivered to the transportation pipeline, and a maximum annual

quantity (MAQ). The commodity and demand components of the contract price are based on an arithmetical average of the spot index prices reported each month by *"Inside FERC's Gas Market Report"* for various transportation pipelines operating in the production area. The contract contains no take-or-pay provision. Monthly nomination of daily quantities is provided for under the contract, with an additional provision for 48-hour advance adjustment of those daily amounts.

The Staff has raised two issues regarding the prudence of this contract. The first involves the renegotiated cost of the commodity itself, while the other concerns additional transportation charges incurred by WRI, and subsequently MGE, as the result of delivery changes made by OXY. The Commission will consider these issues separately.

1. Commodity Cost Issue

Late in 1992, WRI began negotiations with OXY, which resulted in the execution of the new OXY contract, signed in January 1993. This contract replaced a previous supply contract with OXY, which was set to expire. WRI requested that the original contract be terminated and the new OXY agreement put in its place.

The Staff alleged that the new OXY contract resulted in imprudent expenditures in excess premiums paid to OXY by comparison with the original OXY contract and other supply agreements. The Staff has proposed a disallowance of $154,061.32, at a maximum, based on a comparison with a contract between WRI and GPM Gas Corporation, negotiated under a bidding process. Alternatively, the Staff proposed a minimum adjustment of $98,746.27, based on a comparison with the original OXY contract.

The Staff points out that the new OXY contract was formalized without the benefit of a competitive bidding process. By comparison the

Staff testimony reveals that, at a later time period, WRI negotiated a "very similar" contract with a reduced premium through the bidding process.

The Staff maintains that, in their particulars, the old and new OXY contracts are essentially the same. The Staff notes that, while the commodity cost in the new OXY agreement is slightly lower than the commodity cost in the original agreement, the demand component and near-maximum use of the contract by WRI cause the cost of the new contract to be higher than the cost of the original agreement. The Staff maintains that $98,746.27 is the difference in cost between the old and new OXY agreements for the ACA period in question.

WRI and MGE testimony indicates that WRI and MGE hold a portfolio of gas supply contracts from various producers and/or marketers. These contracts are arranged by amount and need, and are generally defined as base, swing, and peak. Terms of these agreements can vary widely as to the amount of gas taken, price, availability, additional charges, and types of service.

WRI testified that, at the time the new OXY contract was negotiated, WRI was using a computer-generated model of its contract portfolio in order to obtain the most efficient and reliable contract blend. WRI testified that the new OXY contract, which it considered, and used as, a swing contract, fit appropriately in its computer model. This was due to the fact that the new OXY contract was relatively flexible on a daily basis, which flexibility could be used without incurrence of take-or-pay costs.

While the Staff has attacked the prudence of the new OXY agreement, the evidence comparing the provisions of the two OXY contracts, particularly their pricing elements, has not raised a sufficiently serious concern for the Commission to dispute the judgment exercised by WRI.

The WRI and MGE portfolio of gas contracts was divided into categories to be used for different purposes at different times and seasons. In this case, the original OXY contract and GPM contract, as compared to the new OXY agreement, were not alike in detail. The contracts were quite dissimilar in their provisions, in the amount of gas contracted for, and in the time period in which those contracts came into play.

The evidence fails to adequately account for the substantial differences that exist between the various supply contracts which the Staff attempts to use for comparison purposes, and, further, fails to show any reliable measure to ascertain the value of services, included or omitted, in the various contracts. Finally, the Staff's evidence fails to clearly show the differences in contract terms and pricing between the contracts. The dissimilarity of the various agreements, in form and use, makes accurate comparison almost impossible, even if a value were attached to various contract provisions and services, because of the purpose and time of use of the various contracts.

In the final analysis, WRI and MGE have shown, by credible evidence as set out above, sufficient reason to renegotiate the OXY agreement at the time. WRI and MGE have shown that the new OXY agreement is an appropriate part of the WRI/MGE contract portfolio, that the contract is used appropriately, and that the new OXY agreement contains provisions favorable to MGE and WRI not present in the original agreement which offer increased flexibility and low commodity cost.

The Commission finds the evidence insufficient to support a finding of imprudence regarding the new OXY contract.

2. Transportation Charges

The Staff has proposed an additional net adjustment for third party transportation charges of $500,032.94 paid to OXY under the new contract. The Commission finds the facts causing this proposed adjustment to be as follows.

Subsequent to the execution of the new OXY agreement, beginning with the November 1993 monthly nomination period, OXY informed WRI that it had the contractual right under the new agreement to specify at which location or locations it would deliver the contract gas for transportation to the WRI service area.

OXY further informed WRI that it would deliver the required contract amounts exclusively to the Rawlins-Hesston pipeline at Rawlins, Wyoming, for transportation to WRI through the Rawlins-Hesston interconnection with the Williams Natural Gas Company (WNG) main line. Some speculation was made in the evidence as to the reason OXY took such a position, but such information is, at base, irrelevant to the subsequent reaction of WRI and, later, MGE to this demand.

As a result of OXY's insistence that the full amount of contract gas be taken only at the Rawlins-Hesston delivery point, WRI, and subsequently MGE, were only able to transport on the WNG pipeline through the Rawlins-Hesston interconnection. WRI found itself lacking the transportation capacity on the WNG system to take the full amount of contract gas required. To make matters worse, no additional capacity was available from WNG, and the pertinent portions of the WNG system do not, up to this time, have any extra capacity available.

WRI elected, therefore, to purchase the necessary extra transportation capacity from OXY, which had obtained it on the open market. The result was that WRI and MGE paid an additional $500,032.94 in

transportation charges as a result of OXY's insistence, under the new contract, that it had a contractual right to specify Rawlins-Hesston as the sole point of delivery of its gas.

The evidence, as set out above, is largely undisputed as to the facts of the occurrence, actions of WRI at the time, amount of extra transportation charges paid, and the relevant language of the contract itself.

The relevant language of the new OXY agreement remains highly confidential and is omitted from this Report And Order, but has been entered into evidence in this case.

The Staff maintained that since the new OXY agreement sets forth a number of specific delivery points, WRI should have had great flexibility in receiving the contract gas at various points on the WNG system. The Staff did not believe that WRI and MGE have provided appropriate justification for the incurrence of the extra third-party transportation charges.

WRI argued that under the new OXY agreement it was generally the responsibility of the buyer to obtain the necessary capacity to transport the purchased gas on the WNG system. WRI alleged that the contract provisions allowed OXY to designate the locations on the WNG system at which the gas would be delivered for transportation. Even though WRI objected to the action by OXY to restrict the delivery of gas to the Rawlins-Hesston point, OXY insisted that WRI take all of the gas at that point or take none. The use of the extra capacity was necessary to move the gas to Missouri since WRI, despite its best efforts, had been unable to obtain the necessary capacity on the open market. Therefore, WRI was forced to purchase extra capacity, the Missouri allocation of which totals $500,032.94.

The companies argued that, faced with OXY's demands, they had little choice but to purchase the extra transportation capacity on the WNG system from OXY. WRI consulted with its legal counsel regarding the matter, and, after some negotiation, agreed to purchase the additional transportation. In short, WRI argued that it could see no other reasonable recourse under the terms of the agreement.

The contract terms are vague in regard to the various rights and remedies of the parties. However, it is the opinion of the Commission that OXY had the contractual right to specify the sole delivery point of the gas as it did, and that WRI acted reasonably, under the circumstances, in agreeing to purchase the extra transportation in order to ensure an adequate supply of gas for the winter heating season.

Therefore, given the language of the contract, the Commission finds competent and substantial evidence that the companies acted reasonably and with due diligence in this matter. The Commission will deny the Staff's proposed adjustment in this matter.

Conclusions of Law

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

WRI and its successor in interest, MGE, are public utilities engaged in the provision of natural gas service to the general public in their designated service territory in the state of Missouri and, as such, are subject to the jurisdiction of the Commission pursuant to Chapters 386 and 393, R.S.Mo. 1994.

The Commission has the authority, under Sections 393.130 and 393.150, R.S.Mo. 1994, to set just and reasonable rates for the provision of natural gas service in the state of Missouri.

The above-stated sections also provide for the parties to challenge the prudence of decisions underlying commodity-related gas costs.

The standard adopted by the Commission for determining the prudence of an action by a regulated utility is one of reasonable care. ***In Re Union Electric Co.***, 27 Mo. P.S.C. (N.S.) 183, 194 (1985), states:

> "'. . . the company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering the company had to solve its problems prospectively rather than in hindsight.'" (Quoting ***In Re: Consolidated Edison Company of New York, Inc.***, 45 P.U.R.4th (1982)).

> " . . . 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?'"

Orders of the Commission must be based on substantial and competent evidence, taken on the record as a whole, and must be reasonable and not arbitrary, capricious, or contrary to law. In this regard, in making its determinations as to adjustments to the ACA balance which are just and reasonable, the Commission has considered all relevant evidence and determines, as set out in the findings of fact, the following:

In regard to the proposed adjustments by the Staff regarding alleged excessive gas commodity costs in the new OXY agreement, the Commission does not find substantial and competent evidence to make a finding of imprudence and does not find substantial and competent evidence supporting an adjustment.

In regard to the proposed adjustment of $500,032.94 in excess third party transportation charges, the Commission does not find substantial and competent evidence on the record, considering all circumstances

at the time, to show that WRI, and subsequently MGE, did not act with reasonable care, as set out in detail in the body of this order.

IT IS THEREFORE ORDERED:

1. That the proposed adjustment by the Staff of the Commission for alleged excess commodity costs is denied.

2. That the proposed adjustment by the Staff for third party transportation charges in the amount of $500,032.94 is denied.

3. That this Report And Order shall become effective on the 13th day of August, 1996.

BY THE COMMISSION

David L Rauch

David L. Rauch
Executive Secretary

(S E A L)

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

Dated at Jefferson City, Missouri,
on this 31st day of July, 1996.