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August 15, 2002

Missouri Public Service Commission
Attn: Secretary of the Commission
200 Madison Street, Suite 100
P.O. Box 360
Jefferson City, Mo. 65102-0360

FILED[3]
AUG 1 5 2002
Missouri Public Service Commission

RE: Case No. GR-2001-382

Dear Mr. Roberts:

Enclosed for filing in the above-referenced case are an original and the appropriate number of copies of a RESPONSE TO ORDER DIRECTING FILING REGARDING THE FILED RATE DOCTRINE on behalf of Kansas Pipeline Company.

Copies of this filing have on this date been mailed or hand-delivered to counsel of record. Thank you for your attention to this matter.

Sincerely,

Jeffrey A. Keevil

JAK/er
Enclosures
cc: counsel of record

BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

FILED[3]

AUG 1 5 2002

Missouri Public Service Commission

In the Matter of Missouri Gas Energy's Purchased Gas Adjustment Tariff Revisions To be Reviewed in its 2000-2001 Actual Cost Adjustment.	))))	Case No. GR-2001-382

RESPONSE TO ORDER DIRECTING FILING REGARDING THE FILED RATE DOCTRINE

COMES NOW Kansas Pipeline Company ("KPC") and for its Response to the Commission's Order Directing Filing dated July 16, 2002, which allowed the parties until August 15, 2002, to make a filing regarding how the filed rate doctrine applies to Staff's proposed MKP/RPC adjustment, states as follows:

On or about May 31, 2002, Staff filed its recommendation in this case (the "Recommendation"), which included its "MKP/RPC Pipeline Adjustment[1]" for MGE's ACA period being addressed in this case, namely, the 2000-2001 ACA period. During this ACA period, MGE took service from KPC pursuant to the Riverside I agreement. The Commission will recall from Case No. GR-96-450 that the Riverside I agreement was negotiated and entered into at the same time as the Mid-Kansas II agreement; indeed, in its Report and Order dated March 12, 2002, in Case No. GR-96-450 the Commission recognized that the Mid-Kansas II, Riverside I, and Riverside II agreements constituted a "package of contracts." (Order at 11). The FERC accepted the Riverside I agreement as a nonconforming service agreement effective May 11, 1998 (87 FERC ¶ 61,020); clearly

[1] "On November 2, 1995, the [FERC] issued an order finding that the natural gas pipeline system composed of KansOk, Kansas Pipeline Partnership, and Riverside [Pipeline Company, L.P.], and operated by Kansas Pipeline Operating Company, constituted one interstate pipeline system subject to the [FERC's] jurisdiction" (87 FERC ¶ 61,020), which resulted in Kansas Pipeline Company.

then, during the subject ACA period, service was being provided pursuant to this agreement. The basis for Staff's proposed MKP/RPC Adjustment in its Recommendation appears to be that in Staff's opinion the rates paid by MGE pursuant to the Riverside I agreement were "excessive transportation charges when compared to Williams." (quoting from Staff's Recommendation). However, the Riverside I agreement was accepted by FERC as a nonconforming service agreement, and FERC had allowed KPC to charge MGE the rates reflected in that agreement. *See* 87 FERC ¶ 61,020. Under these circumstances, Staff's proposed adjustment, based on its belief that the rates contained in the Riverside I agreement were "excessive transportation charges when compared to Williams" is clearly barred under the filed rate doctrine.

The filed rate doctrine "holds that interstate power rates filed with FERC or fixed by FERC must be given binding effect by state utility commissions determining intrastate rates." *Nantahala Power & Light Co. v. Thornburg,* 476 U.S. 953, 962 (1986). In *Nantahala* (at 963) the United States Supreme Court quoted an earlier Supreme Court case, *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.,* 341 U.S. 246 (1951), as follows:

> [The complaining company] can claim no rate as a legal right that is other that the filed rate, whether fixed or merely accepted by the [FERC], and not even a court can authorize commerce in the commodity on other terms.
>
> We hold that the right to a reasonable rate is the right to the rate which the [FERC] files or fixes, and that, except for review of the [FERC's] orders, the court can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one.

The Supreme Court went on to say that "[o]nce FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A State must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority. Moreover, **the filed rate doctrine is not limited to 'rates'** *per se*[2]: 'our inquiry is not at an end because the orders do not deal in terms of prices or volumes of purchases.'(emphasis added)[citing *Northern Natural Gas Co. v. Kansas Corporation Commission,* 372 U.S. 84 (1963)" *Nantahala* at 966. Furthermore, the "filed rate doctrine ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates. When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate. . . .Such a "trapping" of costs is prohibited." *Nantahala* at 970.[3] For further federal discussion of the filed rate doctrine, *see, e.g., Mississippi Power & Light Co. v. Mississippi ex rel. Moore,* 487 U.S. 354 (1988).

The Missouri Court of Appeals has recognized that the filed rate doctrine holds that interstate rates fixed by FERC must be given binding effect by state commissions determining intrastate rates; that the doctrine applies to costs which "are FERC-approved costs associated with the procurement of gas from wholesale suppliers;" and that the doctrine "prohibits a state regulatory commission from 'trapping' FERC-approved costs by preventing a distributor from fully recovering those costs from its retail customers." *State ex rel. Associated Natural Gas Company v. Public Service Commission*, 954 S.W.2d 520, 530-531 (Mo. App. 1997). More recently the Court of Appeals has stated

[2] Remember that the FERC accepted the Riverside I agreement itself as a nonconforming agreement.
[3] The filed rate doctrine applies equally to natural gas as well as electricity. *See Nantahala* at 964-965.

that "[u]nder the 'filed rate doctrine' the States may not prohibit MGE or other local distribution companies from, in turn, passing on . . .FERC-approved costs to their customers. [citing *Mississippi Power and Light Co. v. Mississippi ex rel. Moore,* 487 U.S. 354, 101 L. Ed. 2d 322, 108 S. Ct. 2428 (1988); *Nantahala Power and Light Co. v. Thornburg,* 476 U.S. 953, 90 L. Ed. 2d 943, 106 S. Ct. 2349 (1986).]" *State of Missouri ex rel. Midwest Gas Users' Association v. Public Service Commission,* 976 S.W.2d 485, 489 (Mo. Ct. App. 1998). Therefore, the filed rate doctrine prevents the Commission from ordering any portion of Staff's proposed disallowance which represents a FERC-approved rate since to do so would prevent MGE from fully recovering such costs from its customers, thereby constituting a prohibited "trapping" of costs.

Even the Commission has previously recognized that "pursuant to the 'filed rate doctrine' enunciated in *Nantahala* and *Mississippi Power*, the states are preempted from barring the recovery by the LDC of the wholesale rates charged to it by its wholesale supplier pursuant to tariffs approved by the FERC." *American-National Can Company v. Laclede Gas Company,* 30 Mo. P.S.C. (N.S.) 32, 35 (1989). Based on all the foregoing, Staff's proposed MKP/RPC Adjustment, as set forth in Staff's Recommendation, based on Staff's opinion that the rates paid by MGE pursuant to the Riverside I agreement were "excessive transportation charges" is clearly barred by the filed rate doctrine. However, the foregoing does not address the Pike County doctrine, which will be discussed below.

In the Commission's Order Directing Filing dated July 16, 2002, the Commission requested that the parties "should indicate whether the Pike County doctrine as set out in *Pike County Light & Power Co. v. Pennsylvania Public Utility Commission,* 77 Pa. Commw. 268, 465 A.2d 735 (1983) would apply to Staff's proposed adjustment." In

Pike County the Commonwealth Court of Pennsylvania stated that "while the FERC determines whether it is against public interest for [the FERC-regulated company] to charge a particular rate in light of its costs, the [state utility commission] determines whether it is against the public interest for [the retail company] to pay a particular price **in light of its alternatives**." (emphasis added). 465 A.2d at 738. The doctrine has also been stated to be that "state regulatory agencies . . .have the authority to review the prudence of a local distribution company's decision to enter into a particular contract[4] **when a less costly alternative is available**. *American-National Can Co. v. Laclede Gas Co.,* 30 Mo. P.S.C. (N.S.) 32 (1989), quoting, *Pike County Light and Power Co. v. Pennsylvania Public Utility Comm'n,* 77 Pa. Commw. 268, 465 A.2d 735 (1983)." (emphasis added) *State of Missouri ex rel. Midwest Gas Users' Association v. Public Service Commission,* 976 S.W.2d 485, 489 (Mo. Ct. App. 1998).[5]

As can be seen from the foregoing, the applicability of the Pike County doctrine depends on the availability of less costly alternatives for the LDC. In the present case, MGE had no less costly alternatives, so Pike County does not apply. Rather than refer herein to the extensive record evidence in Case No. GR-96-450 which supports this

[4] The issue of whether the 1996 Stipulation, addressed in Case No. GR-96-450, precludes such a review of the "Missouri Agreements" as defined under the Stipulation (which includes the Riverside I agreement) is currently pending in the Circuit Court of Cole County, Missouri, and KPC does not intend by this pleading to take any position concerning the interpretation of that Stipulation inconsistent with the position it took in Case No. GR-96-450 or which it has taken in the Circuit Court review proceeding. However, this issue is separate from the issue of whether Staff's proposed adjustment is barred by the filed rate doctrine, and the Commission can (and should) determine that the proposed adjustment is barred by the filed rate doctrine independent of the Stipulation.

[5] In *American-National Can Co. v. Laclede Gas Co.,* 30 Mo. P.S.C. (N.S.) 32 (1989), the Commission stated the doctrine to be that "states may inquire into the prudence of the LDC in entering into a given contract when less costly alternatives were available."

statement, KPC will instead refer simply to the portions of the Commission's Report and Order which support this proposition.[6]

In the "Background of the Dispute" section of its Report and Order dated March 12, 2002, at pages 10-11, in Case No. GR-96-450, the Commission stated:

> In July of 1993, Western Resources decided to sell its Missouri natural gas properties to Southern Union Company. The Commission approved that transaction on December 29, 1993, subject to the terms of a unanimous stipulation and agreement. MGE, as a division of Southern Union Company, began operations on February 1, 1994. Along with the other assets and liabilities of Western Resources, Mid-Kansas I and Riverside/WR Transportation Agreement I were assigned from Western Resources to Southern Union.
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> * * *
>
> In order to settle the federal lawsuit and to end the withholding of payments, Southern Union and the Bishop Group entered into several new contracts to replace Mid-Kansas I and Riverside/WR Transportation Agreement I. That new package of contracts included Mid-Kansas II, Riverside I, and Riverside II.

Later in the Report and Order, at pages 15-16, the Commission found that:

> MGE could not simply walk away from, and thereby breach its contract with Mid-Kansas/Riverside. That contract was legally enforceable and was binding upon MGE through the year 2009. MGE might have attempted to buy-out the remaining term of the contract but the cost of such a buy-out would have been enormous. Testimony indicated that the net present value of the revenue from the Mid-Kansas I agreement and the Riverside Transportation Agreement [*i.e.*, the Riverside/WR Transportation Agreement I] would have exceeded $100,000,000. Mid-Kansas/Riverside would certainly have demanded a very large sum for agreeing to permit MGE to buy its way out of the contract. Moreover, if MGE had bought its way out of the agreements with Mid-Kansas/Riverside it would still have had to contract with Williams to replace the capacity it had on the Mid-Kansas/Riverside pipeline. In effect, MGE would have been paying for the same capacity twice. The costs of extracting itself from its contractual obligations to Mid-Kansas/Riverside would have exceeded any savings that MGE might have

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[6] In addition to the following, competent and substantial evidence was presented on the record in Case No. GR-96-450 that neither the rates nor the service under Staff's Williams' comparison was actually comparable, as the Commission recognized (*See* Order at page 29). This furthers supports the proposition that no less costly alternative was available to MGE.

> realized from transporting more gas at lower rates on the Williams pipeline.

At page 17 of the Report and Order the Commission reaffirmed its finding that MGE "was contractually bound to Mid-Kansas/Riverside until 2009." Similarly, in the Conclusions of Law of its Report and Order, on page 29, the Commission stated:

> Staff's attempt to draw a direct comparison between the transportation rates charged by Williams and Mid-Kansas/Riverside are overly simplistic. In effect, Staff is arguing that MGE was in the position of a motorist choosing whether to buy gasoline from one service station at $1.10 per gallon, or from a second station at $1.20 per gallon. Staff claims that MGE was imprudent because it purchased gasoline at $1.20 per gallon, rather than $1.10 per gallon. However, MGE is not in the same position as a motorist free to choose between competing service stations. As the Commission has previously found, the fact that MGE was contractually obligated to purchase natural gas from and through the Mid-Kansas/Riverside pipeline cannot be ignored. Therefore, it was not economically possible for MGE to purchase the extra natural gas from the Williams pipeline.

The Commission has previously determined, quite correctly, that at the time the Riverside I agreement was negotiated and entered into, MGE was already contractually obligated to Mid-Kansas/Riverside (*i.e.*, KPC in the instant ACA period) through the year 2009, and that no less costly alternatives were available to MGE. Accordingly, the Pike County doctrine does not apply to save Staff's proposed adjustment.

In conclusion, the Pike County doctrine does not apply so as to permit Staff's proposed adjustment. However, the Riverside I agreement and rates charged pursuant thereto having been accepted and approved by FERC, the filed rate doctrine does apply to prohibit Staff's proposed MKP/RPC Adjustment and the Commission should find accordingly.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing pleading was served by placing same in first-class mail, postage paid, or by hand-delivery, to counsel for parties of record on this 15th day of August, 2002.