COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

MODIFICATION TO WESTERN KENTUCKY GAS COMPANY, A DIVISION OF ATMOS ENERGY CORPORATION, GAS COST ADJUSTMENT TO INCORPORATE AN EXPERIMENTAL PERFORMANCE BASED RATEMAKING MECHANISM (PBR)	)	CASE NO. 2001-00317

O R D E R

In Case No. 1997-00513, the Commission approved an experimental gas procurement performance-based rate-making mechanism (PBR) for Western Kentucky Gas Company (Western).[1] The experimental PBR, approved as a 3-year pilot, benchmarked all components of Western s gas cost and provided for a 50/50 sharing between ratepayers and shareholders of the amounts by which Western s gas costs varied from the benchmarks. The gas cost/gas procurement components contained in the PBR are: (1) Gas Acquisition Index Factor (GAIF); (2) Transportation Index Factor (TIF); and (3) Off-System Sales Index Factor (OSSIF).

The GAIF includes Western s commodity costs, which are benchmarked based on the average of four indices, Gas Daily, Natural Gas Week, Inside FERC, and NYMEX closing prices. After the Commission approved the PBR mechanism, Western signed a full requirements gas supply contract with Noram Energy Services, Inc. and

[1] Case No. 1997-00513, Modification to Western Kentucky Gas Company, A Division of Atmos Energy Corporation, Gas Cost Adjustment to Incorporate an Experimental Performance-Based Ratemaking Mechanism, Order dated June 1, 1998.

later entered into a similar agreement with Woodward Marketing, L.L.C. (Woodward).[2] The contract excludes supply reservation fees and supplies gas to Western at a discount from the PBR benchmarks.

The TIF includes pipeline transportation costs, which are benchmarked against Western s pipeline suppliers FERC-approved transportation rates. Western s pipeline suppliers are Texas Gas Company, Tennessee Gas Pipeline Company, Trunkline Gas, Midwestern and ANR Pipeline. The release of pipeline capacity (capacity release), which is a sub-part of the TIF component of the PBR, is an activity in which Western had engaged prior to the implementation of the PBR. Therefore, the experimental PBR contained a capacity release threshold that Western had to exceed before shareholders could participate in any savings realized through capacity release activities. During the pilot, Western established a commission-based sales program within its gas supply contract that paid a 10 percent commission for each dollar of capacity released.

The OSSIF reflects Western s net revenues, or savings, from off-system sales transactions. If revenues realized exceed the costs of such transactions, there are savings to be shared between ratepayers and shareholders. If costs exceed revenues, there are increased costs to be shared. Western did not use this mechanism during the pilot period. In order to increase the value of the contract to bidders, Western assigned the management of its storage and transportation assets to the supplier who retained the benefit of any off-system sales.

[2] Case No. 1999-00447, A Formal Review of Western Kentucky Gas Company s Decision to Terminate a Natural Gas Sales, Transportation and Storage Agreement with Noram Energy Services, Inc. and Enter into a Natural Gas Sales, Transportation and Storage Agreement with Woodward Marketing, L.L.C.

As per the Order approving the pilot PBR, Western filed a report and testimony on the 3-year pilot on September 28, 2001.[3] For the pilot period, Western reported total savings realized under the PBR of $9 million. Because shareholders were not able to participate in any savings achieved as a result of capacity release activity, ratepayers retained $4.75 million of the total while shareholders received $4.25 million through Western s Gas Cost Adjustment Clause (GCA).

A procedural schedule was established that provided for two rounds of discovery, intervenor testimony and rebuttal testimony. The Attorney General of the Commonwealth of Kentucky (AG) is the only intervenor in this proceeding. A formal hearing was scheduled for February 19, 2002 but was cancelled by Order dated February 7, 2002, to allow Western and the AG to participate in settlement discussions. Commission Staff also participated in the discussions on a limited basis. On February 18, 2002, the parties filed a joint motion for approval of a Settlement Agreement (Settlement) resolving, to their satisfaction, the issues in this case. The Settlement is attached as Appendix A.

The parties agree that the Settlement is for the purposes of this case only and shall not be binding on the parties in any other proceeding before this Commission or in any court and shall not be offered or relied upon in any other proceeding involving Western or any other utility regulated by this Commission.

The parties urge the Commission to review and accept the Settlement in its entirety as a reasonable resolution of the issues in this proceeding. While the overall reasonableness of the Settlement is an important factor, the Commission is bound by

[3] By Order dated October 22, 2001, Western was authorized to continue the PBR for 60 days after the Commission has entered its final order in this case.

law to act in the public interest and review all elements of the Settlement. In determining whether the results of the Settlement are in the public interest and beneficial to the ratepayers, the Commission considered the fact that the Settlement is a unanimous agreement of the parties.

After review of the Settlement, an examination of the record, and being otherwise sufficiently advised, the Commission finds that the Settlement is reasonable. The following is a synopsis of the terms of the Settlement:

1. The Commission will accept the Report on the 3-year experimental PBR filed September 28, 2001.

2. Western s pilot PBR, as modified, will be extended for a period of 4 years.

3. Western will issue a Request for Proposal for a new gas supply contract.

4. The sharing mechanism will include two bands: (1) 0 percent to 2 percent; and (2) over 2 percent. If Western contracts with a third party to manage its gas supply, the sharing ratio in the first band will be 70/30 in favor of the ratepayer and the sharing ratio for the second band will be 50/50. If Western manages its own gas supply, the sharing ratio for the first band will be 75/25 in favor of the ratepayers, and the sharing ratio for the second band will be 50/50.

5. The GAIF will be the simple average of the indices for National Gas Week, Gas Daily, Inside FERC s Gas Market Report and the NYMEX. If the supply is managed in-house, the NYMEX will not be part of the benchmark.

6. Intra-month swing gas will be benchmarked against Gas Daily only.

7. The capacity threshold requirement will be eliminated from the TIF.

8. The OSSIF will be expanded to include off-system sales of storage services.

9. Western withdraws its request for the Storage Development and Cost Recovery Factor mechanism.

10. Western will extend its existing gas supply contract with Woodward until it either resumes management itself or contracts with a new supplier.

11. No later than 3 months from the first day of the month following the month the Order is entered, Western will report to the Commission that it has elected to manage its own gas supply needs or it will file an application for approval of a new third-party gas supply contract.

12. The effective date of the Commission s Order will be the first day of the month following the month in which the Commission enters its Order.

IT IS THEREFORE ORDERED that:

1. The Settlement set forth in Appendix A to this Order is hereby incorporated into this Order as if fully set forth herein.

2. The terms and conditions set forth in the Settlement are approved.

3. The tariff changes included in Exhibit 1 of the Settlement are fair, just and reasonable.

4. Any party wishing to exercise its right to withdraw from the Settlement shall notify the Commission in writing of its intent within 10 working days of the date of this Order.

5. If the Settlement is withdrawn due to any party s withdrawal from the Settlement, this Order is vacated without further Order of the Commission.

6. Within 20 days from the date of this Order, Western shall file with the Commission revised tariff sheets setting out the rates and tariffs approved herein. These tariff sheets shall show their date of issue, the effective date, and that they were issued by authority of this Order.

Done at Frankfort, Kentucky, this 25th day of March, 2002.

By the Commission

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2001-00317 DATED March 25, 2002