COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

NOTICE OF GAS COST ADJUSTMENT FILING OF CITIPOWER, LLC	))	CASE NO. 2005-00319

O R D E R

On August 1, 2005, Citipower, LLC ("Citipower") submitted a Gas Cost Adjustment ("GCA") filing which included a $3.00 per Mcf gas marketing fee ("fee") from its affiliate, Citigas, LLC ("Citigas"). On August 18, 2005, the Commission suspended the proposed GCA in order to gather further information on the proposed fee. The Office of the Attorney General ("AG") requested and was granted intervention. Citipower responded to two rounds of discovery and participated, with the AG and Commission Staff, in a telephonic informal conference on February 10, 2006.

The $3.00 per Mcf fee is included in a contract between Citipower and Citigas. Under the terms of the contract, Citigas will provide all natural gas supply required by Citipower, on demand, from whatever source necessary. The contract bases the gas price on an agreed-upon index price plus a transportation/supply guarantee fee. The transportation/supply guarantee fee is specified by the contract as the fee charged by Citigas to transport and guarantee a supply of gas to Citipower. The contract also states that the fee will be adjusted each year based on the average general Consumer Price Index ("CPI"). Staff confirmed during discovery that the transportation/supply guarantee fee is the same charge as the gas marketing fee included in the GCA filing.

The fee is designed to cover the costs associated with an 11.5 mile pipeline that Citipower transferred to Citigas in Case No. 2004-00444.[1] In providing cost justification for the fee, Citipower stated that it is based on the original cost of the pipeline spread over 10 years with a 10 percent return. The fee also includes $75,000 in costs for operating a compressor, as well as administration costs, management costs, and the risk of loss for transporting the gas supply, all of which are Citigas's responsibility.[2] Citipower later clarified the circumstances under which the fee would be applied in its supplemental response to Staff's question during the telephonic conference. Citigas will charge the fee only if it must reverse the normal flow of gas on the pipeline in order to supply Citipower.[3] Citipower asks that the fee be pre-approved in order to aid Citigas in financing arrangements, supply guarantees and operations.

DISCUSSION

The Commission has considered three main issues presented in the proceeding: (1) the appropriate amount of the fee; (2) how and when the fee can be charged to Citipower's ratepayers; and (3) the manner, if any, in which the fee can be adjusted. Each of these issues is addressed in the following sections of this Order.

[1] Case No. 2004-00444, Application of Citipower, LLC for Approval of Reorganization Proposal, Order dated April 14, 2005.

[2] Response to Item 2(a) of the Commission Staff's First Data Request to Citipower, LLC, received November 2, 2005.

[3] Under normal conditions, the gas flows north-to-south from Citipower to Citigas. The proposed contract establishes a contingency arrangement in the event Citipower's normal sources of supply are insufficient to meet its demand.

Amount of the Fee

The pipeline is not regulated by the Federal Energy Regulatory Commission and is owned by an affiliate of Citipower; therefore, the amount Citigas charges Citipower falls under this Commission's jurisdiction pursuant to KRS 278.2207, KRS 278.272 and KRS 278.274. In reviewing the cost justification provided by Citipower, the Commission notes that the 10 percent return on the original cost of the pipeline proposed by Citigas is somewhat greater than the overall returns granted by the Commission in gas utility rate cases in recent years. In those cases, since 2004, the Commission has granted overall returns ranging between 6.79 and 8.10 percent, with the average return granted being 7.60 percent. In order to account for Citipower's smaller size and the risks it identified, the Commission finds a return of 9.0 percent to be reasonable.[4]

The Commission also finds Citipower's proposal to use 10 years for depreciation to be unreasonable. A gas pipeline would typically be depreciated over a much longer expected life, such as 40 years, which Citipower referenced in a data response.[5] Allowing for the 5 years that have elapsed since the construction of the pipeline, the Commission finds that the annual depreciation should be based on the remaining 35 years of the pipeline's expected life and its net book value as identified by Citipower.[6]

[4] The only support offered for the proposed return is Citipower's response to Item 4 of Staff's Second data request, which states "Citigas management considers a 10% return and 10 year amortization a conservative return on investment."

[5] Response to Item 5 of Staff's second data request.

[6] Supplemental response to Informal Telephone Conference, Item 2(a), received February 24, 2006.

Finally, while the Commission agrees that costs related to Citigas's operation of the pipeline should be considered, Citipower provided inadequate support to justify the $2,500 in miscellaneous costs included in the total costs of $75,000. Based on the findings set forth herein, the Commission has recalculated the fee and determined that it should be established at $1.96 per Mcf, based on Citipower's annual gas purchases.

<u>Charging the Fee to Retail Customers</u>

Citipower will need to charge its customers the fee only when Citigas reverses the flow of gas on its pipeline to deliver gas to Citipower. Only after this event has occurred, can Citipower determine the actual amount to recover from its customers. The Commission finds that Citipower should be allowed to recover the cost it incurs under the fee, on an after-the-fact basis, through the Actual Adjustment component of its GCA. This will allow it to incorporate the actual cost incurred under its contract with Citigas as part of its GCA. When filing a GCA to recover the fee, Citipower will need to file appropriate documentation, including, but not limited to: (1) a detailed explanation for why it was necessary to purchase from Citigas; (2) any documentation provided by Citigas to notify Citipower of the need to reverse the flow of gas in the pipeline; and (3) a copy of Citigas's invoice showing the actual volumes delivered to Citipower and the amount charged for the fee.

<u>Adjusting the Fee Charged Retail Customers</u>

Citipower's contract with Citigas proposes to adjust the fee each year based on changes in the CPI. Citipower states that it agreed to this clause because the CPI is the most efficient and stable indication of consumer and market costs, is published by the federal government and used widely by industry. Citipower further states that this clause would prevent the need to require a contract renegotiation and costly approval process.[7]

While the Commission takes note of these arguments, it is bound by statute to review and approve the rates charged by utilities. Pursuant to KRS 278.180, no change shall be made by any utility in any rate except upon 30 days' notice to the Commission, stating plainly the changes proposed to be made and the time when the changed rates will go into effect. In addition, using the CPI to adjust a rate only addresses those costs covered by the index, it does not review the entire set of costs included in the fee and adjust those accordingly. Therefore, the Commission finds that Citigas's fee should not be adjusted based on annual changes in the CPI.

IT IS THEREFORE ORDERED that:

1. The gas marketing fee proposed by Citipower is denied.

2. A revised gas marketing fee of $1.96 per Mcf is approved.

3. The fee shall not be adjusted annually based on the CPI.

4. The fee shall be recovered after-the-fact through the Actual Adjustment component within Citipower's GCA mechanism.

5. Citipower shall, within 30 days from the date of this Order, file a revised version of its contract with Citigas, which incorporates all the changes necessary to reflect the Commission's findings and decision in this proceeding.

[7] Response to Item 2(b) of the Staff's first data request, received November 2, 2005.

Done at Frankfort, Kentucky, this 31st day of March, 2006.

By the Commission

ATTEST:

Executive Director