COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

SIGMA GAS CORPORATION	Complainant	)
		)
vs.		) Case No.
		)
B.T.U. GAS COMPANY, INC.	Defendant	) 04-00018

BRIEF OF SIGMA GAS COMPANY

Sigma filed its Complaint against BTU Gas Company on January 14, 2004 alleging that BTU was providing natural gas service to Sigma's former customers and that it had extended its facilities to serve areas and customers that had previously been served by Sigma. This extension of service was undertaken without any approval by the Commission and in disregard of the Commission's statutes and regulations related to extension of service and facilities.

The evidence presented by Sigma shows that BTU is currently serving a number of customers that Sigma formerly served and continues to be able to serve. That service by BTU is based on the extension of facilities that were not approved by the Commission.

Sigma became the owner of the former Salyersville Gas Company as a result of the bankruptcy of the city's gas system in 1993. The acquisition of Salyersville by Sigma was approved by the Commission in Case No. 93-349, dated December 15, 1993. The Agreement of Purchase and Sale of Assets transferring the Salyersville system to Sigma described the property conveyed:

"All right, title and interest in the entire natural gas system owned by Seller located in and around the city of Salyersville, Kentucky...located within or without its territorial boundaries...owned by Seller pursuant to or upon which the System was constructed and operated."

The map introduced at the hearing as Staff Exhibit 1 generally depicts this boundary as the orange line (HT, p. 35)

In 1994, BTU was investigated by the Commission to determine if it was operating a distribution gas system. By Order dated September 21, 1994, the Commission found BTU to be a LDC and required it to submit tariffs and to comply with all applicable regulations. Previously, BTU had operated as a gathering system. With the exception of seven (7) customers in the Dixie Avenue area, the customers served by BTU at that time and the service area included in BTU's territory were outside the Salyersville city limits. See Staff Report appended to Order of April 27, 1994, Case No. 92-220.

There is no dispute that BTU is serving Sigma's customers and is doing so through facilities extended without Commission approval. The testimony of BTU's operations manager, Richard Williams, substantiates the allegations of Sigma. For example, he admitted serving the Magoffin County Courthouse and extending facilities to that building. (Hearing Transcript, p.62) Yet, Sigma had facilities on the property and was capable of providing service. (HT, pp. 18, 50) He admitted to serving the Teen Scene and extending facilities to do so. (HT, pp. 66-67) Sigma had previously served this customer. (HT, p.19). He admitted to serving Tommy Howard and the Magoffin County Garage and Recycling

Center. (HT, pp. 76, 81) He admitted to serving Tommy Bailey (HT, p. 81). He admitted to serving H. C. Prather. (HT, p. 81) He admitted to serving Tom Frazier and Jim Hoskins. (HT, p. 82) He admitted to serving Burke Arnett. (HT, p. 68) These customers, with few exceptions, are those listed by Sigma on its Hearing Exhibit filed on July 12, 2004. Mr Williams also admitted to extending service to Vint Dyer in the Dixie area in 2000. (HT, p. 74)

Based on the admissions of Mr. Williams, BTU has taken customers from Sigma and has extended facilities to do so. Neither action was with Commission authorization. BTU did not file an application for a certificate of convenience and necessity for these extensions and admitted that the extensions did not meet the criteria for an ordinary extension. (HT, p. 72)

BTU claims that it only spent a few thousand dollars to make these extensions and that they did not amount to a material effect on the company's financial condition. BTU Response to PSC Order of February 23, 2004, Item 2 says that 1500 feet of pipe was installed to the courthouse at a cost of $2,205.00 and 200 feet of pipe was installed in the west end of Salyersville at a cost of $200.00. Finally, a $325.00 extension was made to the Teen Scene. However, in spite of Mr. Williams disclaimer that the information in BTU's PSC Annual Report is incorrect, (HT, p. 83), there is a significant increase in utility plant reported from the years 1995 through 2003. In 1995 BTU had 135 customers and Total Gas Plant In Service of $204,575.00. In 2003 BTU had 412 customers and Total Gas Plant In Service of $317,208.03. This $112,633 addition to gas plant and addition of customers remains unexplained by Mr. Williams.

The Commission dealt with a similar situation involving an LDC attempting to serve a customer of another LDC. in the Order dated July 10, 1996 in Case No. 96-015: "The Application of Columbia Gas of Kentucky, Inc. for an Order Issuing a Certificate of Convenience and Necessity to the Extent Required to Construct a Pipeline to Service Cooper Tire, Inc." In that case, Columbia attempted to extend pipeline facilities to a customer then being served by Delta Natural Gas, Inc. Columbia claimed that it could extend its facilities as an ordinary extension because the customer, Cooper Tire, had requested service. In this case, Mr. Williams claims that several of the customers he is serving requested service from BTU. (HT, p. 62, 66, 68)

The same statute and regulation involved in the Cooper case are at issue in this one.

KRS 278.020 provides, in pertinent part:

> (1) No person, partnership, public or private corporation, or combination thereof, shall begin the construction of any plant, equipment, property or facility for furnishing to the public any of the services enumerated in KRS 278.010, except. . .ordinary extensions of existing systems in the usual course of business, until such person has obtained from the Public Service Commission a certificate that public convenience and necessity require such construction.

807 KAR 5:001, § 9(3), reads as follows:

> Extensions in the ordinary course of business. No certificate of public convenience and necessity will be required for extensions that do not create wasteful duplication of plant, equipment, property or facilities, or conflict with the existing certificates or service of other utilities operating in the same area and under the jurisdiction of the commission that are in the general area in which the utility renders service or contiguous thereto, and that do not involve sufficient capital outlay to materially affect the existing condition of the utility involved, or will not result in increased charges to its customers.

The Commission found in the Cooper case that the construction was not an ordinary extension because it would conflict with the existing service of Delta. While in the Cooper situation, the facilities had not been extended, BTU has in this case already extended its facilities to serve customers of Sigma. Mr. Williams admitted that the extensions did not meet the standards of an ordinary extension, because he was aware Sigma had facilities in the vicinity of the extensions. (HT, p. 73)

As the responses to the Commission's data requests show, there will be a direct impact on Sigma of the loss of customers to BTU. There is no evidence of Sigma's inability to serve or unwillingness to serve any of these customers. Applying the standard of Cooper to this case, the construction by BTU is a duplication of Sigma's facilities that interferes with its existing adequate service. "Since the construction will duplicate Delta's existing facilities and will interfere with Delta's existing obligation to serve the industrial park, the extension is clearly not in the ordinary course." (Cooper, page 4). The same can be said of BTU's extension of its facilities in this case.

If the construction is not an ordinary extension, it must fall within the limitations of KRS 278.020. One of the issues in determining whether a certificate of convenience and necessity should be issued is whether there is wasteful duplication. Wasteful has been defined as meaning an excess of capacity over need as well as an excessive investment in relation to productivity or efficiency and an unnecessary multiplicity of physical properties. Kentucky

Utilities Company v. Public Service Commission, Ky., 252 S.W.2d 885 (1952). "This statutory standard, as defined by the courts, is the standard which guides the Commission... "Application of Kentucky CGSA, Inc. for a Certificate of Convenience and Necessity to Construct a Cell Site", Case No. 96-081, Order of February 4, 1997, p.5.

In this case, Sigma has facilities in the area of BTU's extensions, has served those customers since its acquisition of the Salyersville Gas Company, and has facilities on the property where some of the customers are located. Any facility constructed by BTU duplicates the existing facilities of Sigma. According to the Commission's Order in Administrative Case No. 297, "In the matter of An Investigation of the Impact of Federal Policy on Natural Gas to Kentucky Consumers and Suppliers", dated May 29, 1987, at page 56, only ". . . if there is a void in the system which can be remedied most efficiently by the construction of facilities by someone other than the LDC...", it should [additional construction of facilities] be allowed." There is nothing in the record in this case which indicates there is a void in Sigma's system. There is no evidence in the record in this case which indicates that the existing facilities of Sigma are incapable of providing service to the customers in Salyersville.

The only rationale provided by BTU for the construction of the facilities is that the customers specifically requested service from BTU and that facilities were constructed to permit BTU to fulfill these requests. The issue of customer preference is certainly one which the Commission should and has considered. However, that preference has not been a determining factor in a physical bypass

of an existing utility service. This case does not present a situation where two utilities have existing facilities in place which are capable of serving a customer. In that situation, customer preference or customer selection of its supplier may be a factor for consideration. If there are two competing utilities with facilities already in place on the customer's property, the Commission has allowed the customer to choose the utility provider:

> "KOG's proposed service to the apartment buildings does not constitute a physical bypass of Columbia which would require certification. The existence of competition between two utilities to serve these loads that are residential in nature and equally accessible to both utilities is not the kind of uneconomic bypass contemplated by Administrative Case No. 297. There would be no duplication of facilities other than service connections to the customers and no shifting of costs contrary to the public interest." "Columbia Gas of Kentucky, Inc. v. Kentucky-Ohio Gas Company", Case No. 92-489, Order of July 2, 1993, pp. 1-2.

In contrast to the situation involving KOG, in this case only one utility had facilities in place to serve the customer – Sigma and the other – BTU – illegally constructed facilities. When one utility has facilities in place and another must construct facilities in order to serve, the potential customer should not be able to dictate to the Commission by its choice the determination of "public interest".

The Commission in the Cooper Order said: "This 'customer choice' dilemma was also addressed by the Commission in Administrative Case No. 297 wherein we stated that where both utilities were serving in the vicinity and were equally situated to serve the customer, customer preference could be considered. Clearly, Columbia and Delta are not equally situated with respect to

providing service to this customer." (Cooper Order, p. 6, fn 10). That is also true of this case. Sigma complied with the Commission's prior orders about service to Salyersville. BTU did not. BTU has improperly extended facilities into areas specifically acquired by Sigma and served for many years. By circumventing the Commission's rules for extension of service, BTU has interfered with Sigma's service and operations. BTU should not be rewarded for this disregard of Commission procedure and Sigma's customers should not be penalized with higher rates. As Mr. Branham testified, there will be a significant economic impact on Sigma from the loss of these customers. See Revised Exhibit 5 listing the loss of customers and revenue associated with that loss. Also, Mr. Branham testified that there is the potential for the rates of the remaining customers to increase due to the fixed debt associated with a loan from the Department of Local Government. (HT, p. 23).

Granting BTU approval to serve the customers and areas in question in this case will greatly broaden the parameters of LDC bypass and undermine the limitations on duplication of facilities and the requirements of certificates of convenience and necessity. It will encourage willful disregard of Commission regulations and allow the very things that the Commission has attempted to avoid in its pronouncements in Administrative Case 297 and in its orders involving wasteful duplication of facilities.

BTU is picking off selective customers, which otherwise could be served by the existing facilities of Sigma. If any utility is allowed to roam the state and select customers to serve, which are otherwise capable of being served by the

LDC in place, then cream skimming becomes a viable option for a number of companies. The obvious effect of such activity is the under utilization of existing facilities and the narrowing of the definition of public interest to that of customer interest. Other ratepayers, particularly residential, will have to subsidize such inefficiencies. "Public interest" cannot be reduced to the interest of one individual customer.

This position was initially addressed in Administrative Case 297, Order of May 29, 1987, page 63:

> "The Commission finds that a utility proposing physical bypass of an LDC in order to accommodate the use of natural gas by an end-user should be required to make an application to this Commission requesting a certificate of convenience and necessity to bypass the LDC. No construction of any sort should be permitted before the certificate proceedings are completed. The commission finds this necessary to prevent duplication of facilities and to protect the public interest."

Other factors associated with utility construction were considered in Kentucky Utilities Co. v. Public Service Commission, 252 S. W .2d 885 (Ky. 1952) ("KU"). There East Kentucky RECC made application for a certificate of convenience and necessity authorizing construction of an electric generating station and transmission lines to supply electric power to member cooperatives. Kentucky Utilities Company and other electric utility companies which at the time were supplying power to the member cooperatives intervened and objected to the issuance of the certificate. The Commission granted the certificate and KU and the other utilities appealed the action of the Commission to the Franklin

Circuit Court. It sustained the order and the matter was appealed to the Kentucky Court of Appeals, then our highest court. The court said, "We will address our attention to the question whether the Commission gave proper consideration to the essential elements that enter into the matter of convenience and necessity." (Id. at 889). The Court then said :

> "...It is obvious that the establishment of convenience and necessity for a new service system or a new service facility requires first a showing of a substantial inadequacy of existing service, involving a consumer market sufficiently large to make it economically feasible for the new system or facility to be constructed and operated.
>
> Second, the inadequacy must be due either to a substantial deficiency of service facilities, beyond what could be supplied by normal improvements in the ordinary course of business; or to indifference, poor management or disregard of the rights of consumers, persisting over such a period of time as to establish an inability or unwillingness to render adequate service.
>
> The above two factors have relation to the need of particular consumers for service. However, our concept of the meaning of "public convenience and necessity," as expressed in our decisions in previous cases embodies the element of absence of wasteful duplication, as well as a need for service. (Citations omitted)
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> Therefore, a determination of public convenience and necessity requires both a finding of the need for a new service system or facility from the standpoint of service requirements, and an absence of wasteful duplication resulting from the construction of the new system or facility.
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> At first impression, it might appear that the two requirements are in reality only one, because there could not be a need for a new service system or facility if the construction of the system or facility would result in wasteful duplication. This impression would be correct if "duplication" is considered as having only the meaning of an excess of capacity over need. However, we think that 'duplication' also embraces the meaning of an excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties, such as right of ways, poles and wires.(Id. at 890).

The court concluded that in order to demonstrate the existence of public convenience and necessity for new construction, the utility proposing such construction must prove that there is a need for the new facilities and an absence of wasteful duplication resulting from their construction.

In a subsequent case, the Court of Appeals confirmed its reasoning in KU in a decision involving another rural electric, Big Rivers Electric Cooperative. Kentucky Utilities Company v. Public Service Commission, 390 S. W .2d 168 (Ky. 1965) ("Big Rivers"). That case involved a request by Big Rivers RECC for a certificate of convenience and necessity for the construction of an electric generating plant, transmission lines and an interconnection line to provide service to its member co-operatives. Again, Kentucky Utilities Company and other electric utilities objected to the issuance of the certificate. The Commission granted the application and both the Franklin Circuit Court and the Court of Appeals affirmed the decision. Following the earlier KU decision, the Commission and the courts found that there was an inadequacy of service (and thus a need for the proposed facilities) and an absence of duplication of facilities. The request for the certificate was granted.

"KU" and "Big Rivers" are still the essential decisions on the meaning of public convenience and necessity requiring the construction of new facilities. Applying the factors set forth in those decisions to BTU's activities in this proceeding, this Commission can reach only one conclusion: BTU's construction results in wasteful duplication of facilities. It is uncontradicted that Sigma's facilities are adequate to meet the gas requirements of the affected customers.

Thus, there is no inadequacy of service and no need for BTU's facilities. If BTU is permitted to utilize the extensions it installed, there will be an excess of capacity over need. In addition, there will be an excessive investment by BTU and Sigma, taken together, in relation to productivity or efficiency because there will be duplicate investment to provide service to the same areas and customers. Finally, there will be an unnecessary multiplicity of physical properties because BTU's extensions will duplicate Sigma's existing pipelines and duplicate its other facilities. See, Big Rivers, supra, at 174.

Thus, applying the present, controlling standards in Kentucky, BTU must be denied use of the contested facilities because it has not and cannot demonstrate an existing inadequacy of service (need for the facilities) or that there will be no wasteful duplication of facilities. While there have been other court decisions since Big Rivers on the subject of certificates of convenience and necessity, they have uniformly followed KU and Big Rivers. See, for example, Brandenburg Telephone Company v. South Central Bell Telephone Company, 506 S.W.2d 513,516-517 (Ky. 1974): "...the law is settled that another utility cannot be authorized to serve the area [certificated to another utility] in the absence of a showing of a substantial inadequacy of existing service. ..".

Apart from the specific issue of duplication of service, the Commission has since "KU" and "Big Rivers" examined the standards governing wasteful duplication of facilities in the context of competition, service areas and the issuance of certificates of convenience and necessity. The Commission issued the final order in Administrative Case No. 297 on May 29, 1987, after soliciting

input from numerous affected parties. The issues of competition among LDCs and service areas were specifically discussed by the Commission at pages 55 and 56 of the Order in Administrative Case No. 297. The Commission stated:

> "The Commission finds it undesirable to designate a precise geographical area for each utility's service area. Although the Commission will not establish maps for natural gas service areas, any user of natural gas is assumed to be a customer of the distribution company serving other residential, commercial and industrial customers in the vicinity. Likewise, any new customer would be presumed a customer of the LDC. This will allow the LDC first opportunity to serve customers and promote use of the LDC's facilities, yet the territories will remain open to provide access to competition. ..[T]he Commission is merely presuming that the LDC has the ability to serve any customers that may locate within a reasonable proximity of its existing facilities. The ultimate decision on whether the LDC or a competing utility will provide the service remains with the Commission. This practice does not differ from current practice, nor does it differ from what might occur if service areas were established. The Commission intends for the existing distribution facilities to be used optimally. If there is a void in the system which can be remedied most efficiently by the construction of facilities by someone other than the LDC, it should be allowed. However, this policy merely recognizes that the LDC generally has the facilities in place that can be used economically to meet normal growth and demand for gas within a given locale. Administrative Case No. 297, Order at 55-56.

Thus, the LDC serving other customers in the vicinity of a new customer would serve the new customer if that LDC has the ability to do so. Construction of new facilities will only be allowed where there is a void in the LDC's system which could be remedied most efficiently by such construction. This determination is consistent with the rulings of the "KU" and "Big Rivers", supra, decisions.

The Commission next addressed the standards for the issuance of certificates of convenience and necessity in Administrative Case No. 297 in the context of physical bypass of LDCs' facilities by other suppliers of natural gas.

The Commission states on pages 63 and 64:

> ". . . a utility proposing physical bypass of an LDC in order to accommodate the use of natural gas by an end-user should be required to make application to this Commission requesting a certificate of convenience and necessity to bypass the LDC. No construction of any sort should be permitted before the certificate proceedings are completed. The Commission finds this necessary to prevent duplication of facilities and to protect the public interest...Following a determination that any proposed construction does not represent a duplication of facilities, and that the proposed bypass is in the public interest, a certificate of convenience and necessity may be issued under the terms of KRS 278.020."

Here, there has been no suggestion that Sigma does not have the ability to serve. Thus, under Administrative Case No. 297, "KU" and "Big Rivers", Sigma not BTU should continue to serve the disputed areas. Indeed, there is a presumption under Administrative Case No. 297 that Sigma should serve all customers in the area of its existing facilities.

An ancillary issue of this illegal construction is the effect it has on the protection of public safety and the Commission's ability to assure the proper construction standards are met. 807 KAR 5:001(22) sets forth the minimum standards for installation of gas facilities. Because BTU has not obtained approval for its construction, compliance with these standards cannot be verified. Continued use of these facilities poses a risk that would not exist had the appropriate procedures been followed. Allowing the use of these facilities, that have not been inspected, places the Commission in the precarious position of knowingly allowing possibly unsafe facilities to provide service in the most populated areas of Salyersville.

In addition to the issue of improper extension of facilities and service to Sigma customers, Mr. Williams discussed several situations that create another issue. BTU is serving several customers as if it is operating as a gathering system. For example, on page 59 of the Hearing Transcript, Mr. Williams describes the gas sales to Tom Frazier. He says that Mr. Frazier is entitled to free gas because he owns a well. BTU is transporting gas from that well to Mr. Frazier. Mr. William's testimony reveals that BTU is attempting to operate as a gathering system, not a local distribution system. A gathering system is one that collects and transports gas from a well or wells to a transportation pipeline for distribution. It does not distribute gas to ultimate users. Yet, BTU is attempting to combine its distribution system with various gathering lines in order to get "free" gas to the owners of those wells.

All customers of BTU are distribution customers. They must be provided the same service as all other customers. BTU cannot operate as a integral part of its distribution system a "gathering system" that serves only the well owner. Additionally, BTU cannot extend facilities under the guise of a gathering system to circumvent the requirements of a certificate of convenience and necessity.

Mr. Williams admitted to the same activity in providing service to H.C. Prather. (HT, p. 68) He said BTU drilled a well on Mr. Prather's property and then extended a line to serve his property.[1]

There is no statutory definition of a gathering line. However, 807 KAR 5:026(1)(5), which relates to end user service from a gathering line defines that

[1] Apparently, Mr. Williams believes that BTU is still a gathering system and operates it as such. See comment on p. 71 of the Hearing Transcript.

term as "any pipe which carries uncompressed gas and which is used to gather gas from a producing gas well." A local distribution company is defined in KRS 278.504:

> Local Distribution Company
>
> (3) ...means any utility or any other person, other than an interstate pipeline or an intrastate pipeline, engaged in transportation or local distribution of natural gas and the sale of natural gas for ultimate consumption, **but shall not include any part of any pipeline primarily used for storage or gathering or low pressure distribution of natural gas;** (Emphasis added)

Based on these definitions, BTU cannot operate a portion of its system as an LDC and part as a gathering system. The two are not compatible. Simply because someone has a well that can supply BTU does not allow that customer to receive free gas as if service were being provided pursuant to KRS 278.485. Either a customer is being served by an LDC or it is being served by a gathering system as a farm tap customer. Because the gas from these local wells supplies all of BTU's customers, any gas from those wells becomes part of the LDC gas supply. An extension of the LDC's pipeline to transport gas from a particular well to a particular customer does not qualify as a gathering line. This position was stated by the Commission in Administrative Case 297, Order of May 29, 1987, page20:

> "In summary, any utility selling gas to the public, whether it has historically been considered as producer, transporter, LOC, or otherwise, is subject to full rate-base and facilities regulation. The Commission considers the public to be one or more end-users. The sale of gas to the public supersedes other business activities of a utility and subjects it to aforesaid level of regulation. For example, a pipeline company or producer that

generally transports gas, but which sells some of its gas to an end-user, will be considered a distributor and seller of natural gas."

Therefore, BTU's service to Mr. Frazier and Mr. Prather is improper because it treats them as if they were gathering system customers when in fact they are nothing more than customers of an LDC.

It is obvious that BTU is operating its gas system in a manner that ignores or disregards the Commission's regulations. It has systematically extended its facilities into areas that have been and continue to be served by Sigma. Attempting to circumvent regulatory controls, BTU has attempted to benefit from gathering system classification, in spite of the Commission's order in Case 92-220 that it is an LDC.

For these reasons, BTU should be prohibited from using any facility extended to Sigma's customers and service areas. This is the remedy that the Commission imposed in Case No. 10419, "Delta Natural Gas Company, Inc. vs. Tranex Corporation", Order of July 16, 1990. In that case, the Commission found that facilities had been extended to serve a customer of Delta's without a certificate of convenience and necessity having been obtained. Consequently, the Commission ordered that the service to the customer be terminated and use of those facilities to cease. BTU should also be prohibited from any additional extension of its facilities to serve any existing customer of Sigma as being a wasteful duplication of utility facilities and should be prohibited from extending any facility without prior Commission authorization. .

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Certificate:

I certify that a copy of this Brief was served on Karen Chrisman Box 1100 Frankfort, KY 40601 by first class mail, the 16th day of August, 2004.

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