

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

KENTUCKY WEST VIRGINIA GAS COMPANY,)
APPLICATION NO. 16195503164)
through 16193503361;)
16071503362)
through 16195503538;) CASE NO. 8742
and 16119503544)
through 16119504194)
FOR A DETERMINATION PURSUANT TO THE)
NATURAL GAS POLICY ACT OF 1978)

ORDER

Introduction

During the last year, Kentucky West Virginia Gas Company ("Kentucky West") has filed several groups of applications with the Kentucky Department of Mines and Minerals ("Mines and Minerals") (PSC Nos. 769, 770 and 776) for classification of certain natural gas production wells pursuant to Public Law 95-621, the Natural Gas Policy Act of 1978 ("NGPA"). Kentucky West seeks the classification of approximately 1500 of its wells as devonian shale wells (NGPA Section 107(c)(4)) or stripper wells (NGPA Section 108). In accordance with the duties conferred upon it by the NGPA and in accordance with 807 KAR 5:031, the Commission must review the applications and the recommendations of Mines and Minerals and must issue an order to be forwarded to the Federal Energy Regulatory Commission ("FERC") approving the recommendations provided that all evidence available is consistent with the recommendations.

Background

Due to the highly unusual circumstances surrounding the applications, the number of wells involved, and the impact which the new classifications could have on the natural gas prices paid by Kentucky West's Kentucky customers, the Commission ordered, on its own motion, that Kentucky West appear with all interested parties at a formal conference to discuss the various matters related to Kentucky West's applications. The conference was held on December 21, 1982, at the Commission's offices in Frankfort, Kentucky.

All intervenors participating in the conference were opposed to the Commission's approval of Kentucky West's applications. In expressing their concerns for the Kentucky West rate payers (both those who purchase gas directly from Kentucky West and those who purchase gas from Kentucky West's wholesale customers), these parties urged the Commission to limit the rate increases allowed Kentucky West by denying the requested well certifications. Citing recent increases of dramatic proportions in consumer prices, each opponent to Kentucky West's applications questioned the ability of the consumer to pay for natural gas at these prices.

Kentucky West cited federal and state regulations requiring the Commission to approve the applications based on Mines and Minerals' review of engineering and geological data and the resulting recommendations. Kentucky West also explained the circumstances surrounding the applications. In late 1981, the United States Court of Appeals for the Fifth Circuit reversed a lower court decision in the case of Mid-Louisiana Gas Company v. Federal

Energy Regulatory Commission, 664 F. 2d 530 (1981), ("Mid-La.").

In doing so, the Fifth Circuit disapproved longstanding policy of the FERC regarding the pricing of intracorporate transfers of natural gas. Before Mid-La., these transfers were not eligible for NGPA pricing (FERC Order 58) and thus were regulated on a "cost of service" basis by the FERC. The Fifth Circuit determined in Mid-La. that intracorporate transfers of natural gas fell within the NGPA definition of "first sale" and thus were eligible for NGPA classification of its wells affected by the decision even though there was a petition for a writ of certiorari to the United States Supreme Court. The courts and the FERC have allowed the implementation of Mid-La. pending a Supreme Court decision expected sometime this summer. The difference between the cost of service rate (about \$1.80/mcf) and the NGPA rate (devonian is deregulated/ stripper is about \$3.54/mcf) is substantial. Kentucky West has proposed to charge about \$5.30/mcf for its devonian gas.

Findings

At the request of the Commission, Kentucky West filed, on January 24, 1983, a memorandum in support of its application. In the memorandum, Kentucky West asserted, as it did during the conference, that only geological and engineering tests as specified by the NGPA could be used by any agency in determining well classifications and that no other criteria could be considered. Kentucky West urged the prompt approval of its applications by the Commission on the basis of Mines and Minerals' recommendations.

A letter from a representative of the Kentucky Municipal League, an intervenor in this matter, has indicated that the League

reluctantly agrees with Kentucky West's position. Title I of the NGPA and 18 CFR Parts 272 and 274 of the regulations implementing the NGPA clearly establish the requirements for obtaining well classifications. The state regulation, 807 KAR 5:031, establishes the review and approval procedure for the Commission and for Mines and Minerals.

The Commission finds that Kentucky West has followed the established procedures and that it has no basis to challenge the geological and engineering data filed with its applications. Thus, the Commission finds that it must approve Kentucky West's applications based on the recommendations of the Kentucky Department of Mines and Minerals and to transmit same to FERC for their approval.

This finding is a source of frustration to the Commission. It is hoped that Kentucky West will limit the rate increases which may result from these classifications. Some producers of natural gas from devonian shale wells (certified by the Commission) drilled in 1978 are charging their customers at least \$0.30/mcf less than Kentucky West proposes to charge. Kentucky West drilled the majority of the wells for which it seeks certification in the 1930's and 1940's. These wells cost less to drill 40 years ago than do wells today and have, doubtless, been profitable to Kentucky West since they began producing. The Commission is of the opinion that exhorbitant profits for producers and transporters of natural gas are unwarranted and unduly burdensome for natural gas consumers and questions laws which allow such profits and resulting consumer burdens. Because the Commission is of the

opinion that the statutes as interpreted by the Fifth Circuit are inequitable and detrimental to the public welfare, the Commission has approved the applications with regret.

Should the Supreme Court reverse the Mid-La. decision, the classifications made effective by this order (and the expected FERC approval) will be meaningless. In that instance, Kentucky West will be required to reduce its rates to the more reasonable cost of service level and to make refunds with interest as appropriate. Further, should Congress or the FERC take any action to broaden the authority of state commissions in the pricing of interstate natural gas, this Commission will certainly consider appropriate action.

Order

Based on the above-stated findings, the Kentucky Public Service Commission HEREBY ORDERS that the recommendations of the Kentucky Department of Mines and Minerals be and they hereby are adopted and that the record upon which the recommendations were based be and it hereby is incorporated by reference herein.

IT IS FURTHER ORDERED that a copy of this order, together with the entire record upon which this decision was based, be forwarded to the Federal Energy Regulatory Commission as prescribed by 18 CFR 274.104.

Done at Frankfort, Kentucky, this 10th day of February, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary