

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION OF THE IMPACT OF )  
FEDERAL POLICY ON NATURAL GAS TO ) ADMINISTRATIVE  
KENTUCKY CONSUMERS AND SUPPLIERS ) CASE NO. 297

O R D E R

On July 2, 1987, the Commission issued its Order granting the Motions and Petitions for Clarification and Rehearing as filed by GTE Products Corporation ("GTE"), National Southwire Aluminum Company ("NSA"), Kentucky Industrial Utility Customers ("KIUC"), Southern Gas Company, Inc., ("Southern"), Delta Natural Gas Company, Inc., ("Delta"), and Western Kentucky Gas ("WKG"). The Commission allowed 45 days for filing of comments on the issues raised in the Motions and Petitions. Subsequently, Inland Gas Company, Inc., ("Inland") requested clarification of its status.

Comments were filed by Columbia Gas of Kentucky, Inc., ("Columbia"), the Attorney General's office ("AG"), Delta, Entrade Corporation ("Entrade"), KIUC, Louisville Gas and Electric Company ("LG&E"), Southern, Texas Oil and Gas Corporation ("Texas Oil and Gas"), and WKG. The Commission hereby grants the requests of Southern and WKG to accept their out-of-time comments.

ISSUES ON REHEARING

Citing numerous uncertainties at the federal level, WKG recommended that the Commission issue an Interim Order pending

issuance of a final Order by the Federal Energy Regulatory Commission ("FERC").<sup>1</sup>

The Commission is acutely aware that changes occur every day in the natural gas industry, and it is involved in many such developments. There are numerous cases before the FERC and in the courts that could significantly impact Kentucky consumers and suppliers. The Commission's responsibility is to manage this period of transition, and in this proceeding it has established ground rules to do so.

The Commission will monitor the effectiveness of its regulatory approach considering changing circumstances. If the Commission determines its approach is not sufficiently effective, it will be opened for review, modified, or replaced as dictated by changing circumstances.

#### PSC JURISDICTION

The initial level of discussion concerning the Commission's regulatory approach is the wellhead. Texas Oil and Gas is of the opinion that the Commission failed to recognize common practices of the oil and gas exploration industry that could become subject to undue hardship.<sup>2</sup> Southern shared the opinion that as presently formulated, a Kentucky producer owning a pipeline would have to technically restructure its operations to avoid becoming a

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<sup>1</sup> WKG response to Commission's Order dated July 2, 1987, page 1.

<sup>2</sup> Texas Oil and Gas response to the Commission's Order dated May 29, 1987, page 1.

"transporter," "utility," and "common carrier."<sup>3</sup> GTE also expressed concern for the effect on a producer's gathering lines.<sup>4</sup>

Pursuant to KRS 278.470, every company receiving, transporting, or delivering a supply of natural gas for public consumption is declared to be a common carrier. The Commission, pursuant to KRS 278.505, may require transportation by intrastate pipelines or local distribution companies ("LDCs") with unused or excess capacity. The definitions of both intrastate pipeline and LDC exclude any part of any pipeline primarily used for storage or gathering or low pressure distribution of natural gas.

The Commission therefore clarifies its Order entered May 29, 1987, to the extent that the part of any pipeline dedicated to storage or gathering or low pressure distribution of natural gas is not required to offer nondiscriminatory transportation of gas. Such activities are typically related to production which the Commission discussed on page 19 of its May 29, 1987, Order.

The next level of regulatory activity involves transporters. Delta requested clarification of the Commission's statement at pages 19-20 of the May 29, 1987, Order that the rates charged for transportation may be determined in the marketplace while referencing a fixed rate for transportation on pages 54 and 74.<sup>5</sup>

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<sup>3</sup> Southern response to Commission's Order dated July 2, 1987, page 9.

<sup>4</sup> Petition of GTE for Clarification or Rehearing, June 17, 1987, page 2.

<sup>5</sup> Delta response to Commission's Order dated July 2, 1987, page 1.

KRS 278.505 requires transportation rates to be fair and reasonable. The Commission is requiring transporters to file their rates. However, as the Commission stated at page 20 of its May 29, 1987, Order, competition in the market may allow transportation to be somewhat self-regulating. A transporter provides a service of moving natural gas, not buying the gas and then reselling. Should the judgment of a transporter be in error in setting its transportation rates, the transporter itself bears the consequences. In contrast, an LDC provides many services in addition to transportation so that a thorough review of an LDC's rate structure is necessary to properly assign costs and risk in rates to customer classes and shareholders.

The final level of regulatory activity concerns distributors and sales of gas to end-users. The Commission reiterates that the sale of gas to the public, that is, one or more end-users, supersedes other business activities and subjects a utility to full rate-base and facilities regulation. The Commission is accommodating end-users that may seek an alternative source of supply and is making no changes in its regulation of a producer's sales rates. However, a producer would be required to obtain a certificate of convenience and necessity to make a direct tap with an end-user, excluding the provisions of KRS 278.485, as the direct connection constitutes physical bypass of an LDC.

Accordingly, all utilities, including Inland, should file their current tariffs, system maps, and a description of business activities as previously ordered.

### Subsidiary Operations

Delta expressed concern that a review by the Commission of a subsidiary operation should be confidential due to the competitive nature among similar services.<sup>6</sup> Delta further questioned the Commission's statement that information known to the subsidiary must be available to other brokers.<sup>7</sup> Entrade clarified this itself in stating that information Delta, the LDC, makes available to its nonregulated subsidiary must also be available to other brokers and dealers.<sup>8</sup> This would normally consist of available transportation capacity and rates of the LDC transporter. Obviously, this does not include business information of the subsidiary. The Commission maintains that in the interest of fair competition, information of the LDC made known to the subsidiary must also be available to other brokers and dealers.

### ACQUISITION PRACTICES

According to Southern, the Commission should make a clarification to "indicate more specifically how the Commission does plan to implement its statutory policy."<sup>9</sup> Southern would have the Commission impose certain requirements on LDCs regarding the use

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<sup>6</sup> Delta response to Commission's Order dated July 2, 1987, page 2.

<sup>7</sup> Ibid., page 2.

<sup>8</sup> Entrade response to Commission's Order dated July 2, 1987, page 1.

<sup>9</sup> Southern response to Commission's Order dated July 2, 1987, page 12.

of Kentucky produced gas. Southern is of the opinion that the Commission makes no concrete efforts to facilitate greater use of natural gas produced in Kentucky pursuant to KRS 278.507(1).<sup>10</sup>

The Commission is implementing the statute exactly as KRS 278.507(2) allows by requiring transportation of gas by LDCs and transporters and by maintaining rates and charges for transportation.

The Commission will use the acquisition reviews established in this case as a means to examine the use of natural gas produced in Kentucky. The Commission will be encouraging the use of natural gas produced in Kentucky "where this can be done without detriment to the customers of utilities under the jurisdiction of the Commission."<sup>11</sup>

#### TRANSPORTATION

##### Tariffs

Pursuant to KRS 278.505, the Commission is requiring non-discriminatory transportation of natural gas by LDCs and transporters. The Commission is further requiring that LDCs and transporters maintain their tariffs on file with the Commission. While LDCs are subject to all regulatory requirements under KRS Chapter 278 and the Commission's regulations, transporters are subject to an abbreviated form of regulation. The Commission is imposing only that amount of regulation it deems necessary to assure adherence to the fair, just, and reasonable requirements of

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<sup>10</sup> Ibid., page 11.

<sup>11</sup> Kentucky Revised Statutes Chapter 278.507(2).

KRS 278.030. Transporters are not relieved to any extent from the Commission's safety regulations.

A transporter is required to obtain a certificate of convenience and necessity for construction of facilities, including a tap that would provide the means for an end-user to physically bypass an LDC. Transporters must file and maintain schedules of rates and conditions of service. The Commission will not require cost-of-service studies for a transporter's charges with the initial filing of its tariff; however, the Commission does reserve the right to request information it finds appropriate. The rates charged by a transporter will become effective without suspension if after 30 days public notice the Commission has not received a showing by an intervenor sufficient to justify a suspension and if the Commission determines that the rates are fair, just, and reasonable. The burden of proof rests with the transporter to show that capacity does not exist and that a connection cannot be made at a specifically requested location. Transporters will be required to submit annual reports to the Commission prepared according to generally accepted accounting principles. The annual filing should include an income statement, balance sheet, statement of changes in financial position, gross earnings, and the number and type of customers served. Transporters are not obligated to conform to the Commission's remaining directives to LDCs set forth on pages 53-55 of its May 29, 1987, Order. The complaint procedures pursuant to KRS 278.260 remain available to a transporter's customers.

## BYPASS

The Commission differentiates supply bypass and physical bypass. As GTE stated, both of these types of bypass involve gas-on-gas competition.<sup>12</sup> The Commission clarifies, as GTE requested,<sup>13</sup> that its discussions on bypass are not directed toward the use of a fuel other than natural gas.

On page 63 of its May 29, 1987, Order the Commission found that any utility proposing to physically bypass an LDC should obtain a certificate of convenience and necessity. Ordering paragraph Number 9 of this same Order stated, "Any user of natural gas is presumed to be a customer of the distribution company serving other residential, commercial, and industrial end-users in the area."<sup>14</sup>

Southern sought clarification that a facility extended to an end-user who is not a current user of natural gas and who demonstrates no interest in future purchases would not be considered a bypass.<sup>15</sup> The Commission has determined that such circumstances do necessitate a certificate filing. As the AG pointed out, "(w)hether the end-user has no intention of purchasing natural gas

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<sup>12</sup> Petition of GTE for Clarification or Rehearing, June 17, 1987, page 2.

<sup>13</sup> Ibid.

<sup>14</sup> Commission's Order dated May 29, 1987, page 70.

<sup>15</sup> Petition of Southern for Clarification or Rehearing, June 18, 1987, pages 1-2.



from the LDC may be a factor to be examined in the certificate proceedings."<sup>16</sup>

In the May 29, 1987, Order, the Commission found "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 application ... requesting a certificate of convenience and necessity to bypass the LDC."<sup>17</sup> The Commission further explained that an end-user who builds, owns, operates, and controls a pipeline for its sole use is not subject to regulation. GTE asked the Commission to clarify whether the end-user becomes a utility subject to other requirements imposed on utilities by statute, regulation, or order.<sup>18</sup> While the end-user's facilities will fall under the Commission's safety requirements when connected to a utility supplier, the Commission does not find the end-user to be a utility.

The Commission's interpretation of the "utility supplier" required to file the application for a certificate to physically bypass an LDC was questioned by KIUC.<sup>19</sup> The interpretation is critical as to whether it includes an interstate pipeline. The real issue is whether the Commission is requiring an interstate pipeline to obtain a certificate to physically bypass an LDC.

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<sup>16</sup> AG response to Commission's Order dated July 2, 1987, page 4.

<sup>17</sup> Commission's Order dated May 29, 1987, page 63.

<sup>18</sup> Petition of GTE for Clarification or Rehearing, June 17, 1987, page 1.

<sup>19</sup> Motion of KIUC for Rehearing or in the Alternative for Clarification, June 18, 1987, page 3.

LG&E,<sup>20</sup> Columbia,<sup>21</sup> and Delta<sup>22</sup> interpreted a utility supplier to include an interstate pipeline. NSA requested clarification that the Commission is not attempting to assert jurisdiction over the facilities of interstate pipelines.<sup>23</sup> KIUC sought clarification that the Commission specifically did not intend facilities connected to interstate pipelines for transportation of interstate spot-market gas moving in interstate commerce to be subject to certificate proceedings.<sup>24</sup>

As Columbia pointed out, "KIUC attempts to make a distinction between direct sales by interstate pipelines and transportation on behalf of end-users by interstate pipelines."<sup>25</sup> KIUC does not dispute the certificate requirements for a direct sale of gas by an interstate pipeline.<sup>26</sup> However, regarding transportation, it is KIUC's opinion that the certificate in question would be for "facilities for the interstate transportation of gas and the

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<sup>20</sup> Response of LG&E to KIUC's Motion for Clarification or Rehearing, July 2, 1987, page 3.

<sup>21</sup> Columbia response to Commission's Order dated July 2, 1987, pages 9-10.

<sup>22</sup> Delta response to Commission's Order dated July 2, 1987, pages 2-3

<sup>23</sup> NSA Petition for Clarification or Rehearing, June 17, 1987, page 2.

<sup>24</sup> Motion of KIUC for Rehearing or in the Alternative for Clarification, June 18, 1987, page 3.

<sup>25</sup> Columbia response to Commission's Order dated July 2, 1987, page 4.

<sup>26</sup> Motion of KIUC for Rehearing or in the Alternative for Clarification, June 18, 1987, pages 5-6.

regulation of such construction has been preempted by the Federal government pursuant to the Natural Gas Act." <sup>27</sup> KIUC cites the first part of Section 1(b) of the Natural Gas Act as defining the federal authority.<sup>28</sup> LG&E cites the second part of Section 1(b) of the Natural Gas Act in stating that "the Natural Gas Act does not apply to the facilities used for any local distribution, whether sales or transportation."<sup>29</sup> As the AG pointed out, both KIUC and LG&E use Panhandle Eastern Pipeline Company v. Michigan Public Service Commission, 341 U.S. 329 (1951), and Panhandle Eastern Pipeline Company v. Public Service Commission of Indiana, 332 U.S. 507 (1947), to support their interpretations of the Natural Gas Act.<sup>30</sup>

In the opinion of the AG, it is unclear whether the states' ability and legal authority to regulate this aspect of bypass has been preempted by the federal government and that it would be premature for the Commission to withdraw its jurisdiction over interstate pipelines engaged in transportation or sales to end-users.<sup>31</sup> The issue is one of essentially local concern. This Commission is best situated to examine the issues in a certificate proceeding. A clear distinction cannot be made between a tap for

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<sup>27</sup> Ibid., page 4.

<sup>28</sup> Ibid.

<sup>29</sup> Response of LG&E to KIUC's Motion for Clarification or Rehearing, July 2, 1987, page 3.

<sup>30</sup> AG response to Commission's Order dated July 2, 1987, page 6.

<sup>31</sup> Ibid.

transportation and a tap for a direct sale as the same facility could be used for both purposes. The Commission clarifies that the term "utility supplier" does include an interstate pipeline. The utility supplier is that entity connecting directly with the end-user and is thus providing the distribution function.

For example, in instances where an end-user constructs facilities to tie into an interstate pipeline, the interstate pipeline, as the utility, must make application for a certificate of convenience and necessity for the tap. Should a third party propose to own the pipeline connecting the end-user and the interstate pipeline, that third party would be considered an intrastate pipeline or transporter. The third party would become subject to the Commission's jurisdiction. A certificate would be required for the third party to construct the pipeline or the tap that will directly serve the end-user.

The issuance of a certificate to an interstate pipeline to physically bypass an LDC by connecting directly with an end-user does not subject the interstate pipeline to the full scope of this Commission's regulations. The interstate pipeline will only be required to submit annual reports on its service to end-users in Kentucky. The required reports shall be the same as those required for transporters.

Southern asked the Commission to "grandfather" existing bypass facilities and operations.<sup>32</sup> The Commission will not

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<sup>32</sup> Southern response to Commission's Order dated July 2, 1987, page 13.

require current bypass operations to make certificate applications for those facilities in full use and operation as of May 29, 1987. These facilities and operations should, however, be reported to the Commission along with the filing of information required of all utilities.

#### ORDERS

IT IS THEREFORE ORDERED that the following clarifications be made to the Commission's Order of May 29, 1987. All other aspects of the Order remain in full force and effect.

1. The part of any pipeline dedicated to storage or gathering or low pressure distribution of natural gas shall not be required to offer nondiscriminatory transportation of natural gas.

2. Transporters shall comply with the abbreviated form of regulation set out herein.

3. The term "utility supplier" shall include an interstate pipeline.

4. Entities with existing bypass operations in full use and operation as of May 29, 1987, shall file their rates, system maps, and description of operations with the Commission. A certificate of convenience and necessity shall not be required until such time as the present agreements have been terminated.

Done at Frankfort, Kentucky, this 23rd day of October, 1987.

**PUBLIC SERVICE COMMISSION**

*Richard D. Menan, Jr.*  
Chairman

*[Signature]*  
Vice Chairman

*[Signature]*  
Commissioner

**ATTEST:**

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**Executive Director**