COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF COLUMBIA GAS OF KENTUCKY INC. AND TOYOTA MOTOR MANUFACTURING, U.S.A., INC. FOR APPROVAL OF SPECIAL CONTRACT	))))	CASE NO. 9764

O R D E R

On November 13, 1986, Columbia Gas of Kentucky, Inc., ("Columbia") and Toyota Motor Manufacturing, Inc., ("Toyota") filed an application for approval of a contract for natural gas service. The significant terms included in the contract are: (1) The primary term of the agreement is for five years. (2) All natural gas purchased by Toyota during the primary term shall be either purchased from Columbia, transported by Columbia, or both. (3) Columbia will provide transportation service under the terms and conditions of its filed transportation rate schedules, and Toyota will not be required to demonstrate or affirm that any alternate fuel capability is installed in order to obtain such transportation. (4) Toyota will have an annual opportunity to increase or decrease the nominated firm daily volume of gas to be delivered, and will be responsible for the demand charges associated therewith.

The Attorney General's Utility and Rate Intervention Division ("Attorney General") intervened on December 1, 1986, and filed a motion for summary disapproval of the special contract on December

29, 1986. Columbia and Toyota filed responses on January 13 and 15, 1987, respectively. The Attorney General filed a reply to these responses on January 20.

The Attorney General's motion objects to the transportation provision of the contract, arguing that it is contrary to the settlement of the most recent Columbia rate case before the Commission, Case No. 9554, Notice of Adjustment of Rates of Columbia Gas of Ky., Inc., final order issued November 14, 1986. For the reasons explained below, the Commission will deny the Attorney General's motion and approve the contract submitted by Columbia and Toyota.

It is unfortunate that the debate over the wisdom of this contract has been entangled with the arrangements for funding the 32-mile natural gas pipeline that will serve Toyota. These arrangements were approved by the Commission in Case No. 9609, Application of Columbia Gas of Kentucky, Inc., for a Certificate of Public Convenience and Necessity to Construct a Natural Gas Pipeline. The results of Case No. 9609 were reflected in the settlement reached in Case No. 9554 by Columbia and all intervenors in the case, including the Attorney General and the Lexington-Fayette Urban County Government.

As a preliminary matter, the Commission will discuss the natural gas pipeline agreement embodied in these cases. Once the misunderstandings regarding this agreement are cleared up, the importance of approving the special contract for transporting gas through this pipeline should become clear.

All economic growth has costs and benefits. It is the responsibility of bodies like the Commission, and state and local governments to carefully distribute the benefits and burdens of growth among existing citizens and new arrivals. Toyota is one of these new arrivals. The expense of providing utility services to Toyota is one of the costs of its arrival. The thousands of jobs and heightened economic activity provided by Toyota and its associated industries constitute the benefits of its decision to locate in Kentucky.

The cost of the natural gas pipeline to the Toyota plant is approximately $9.8 million. Of that, $8 million is required to serve Toyota. The remaining $1.8 million is the cost of enlarging the pipeline to extend service to existing and future residents living near the pipeline. Columbia has stated that prior to the Toyota announcement it had planned to spend $1.9 million on its existing system to serve this body of customers. The advent of Toyota allowed this investment to be made at a slightly reduced cost.

There is a widespread misconception that this $9.8 million includes a cost overrun. We wish to make it unmistakably clear that as far as the Commission is concerned there is no cost overrun. The June 26, 1986, agreement between Columbia and the Commonwealth of Kentucky that was filed with this Commission in Case No. 9609 set forth the $9.8 million cost. There was no provision for cost overruns and no cost overruns have occurred. In short, the state was to provide $6 million of the cost of serving Toyota, and Columbia was to provide the remaining $2

million. In addition, Columbia was to provide $1.8 million for serving other customers and communities near the pipeline.

As we noted, the $1.8 million would have been spent by Columbia with or without Toyota. As a matter of policy, the crucial issue is whether it is fair for the ratepayers of Columbia to pay $2 million of the $8 million cost of serving Toyota. We believe that it is.

This treatment for Toyota is consistent with the treatment received by industrial customers in the past. A recent example is the 1984 pipeline extension agreement made by Columbia and the Clark Equipment Company of Georgetown. In that case all Columbia's customers paid 40 per cent ($383,000) of the cost of a $946,000 project serving that plant. The rest was paid by Clark Equipment. In the Toyota case, Columbia's customers are paying 25 per cent ($2 million) of the cost of the line. The $6 million contribution that Toyota would otherwise make is being paid by the state.

Local governments routinely use a similar approach for providing other public services. New sewer lines are a cost of growth. Yet existing taxpayers often pay a portion of the cost of these lines, particularly to large industrial customers. When, for example, the FMC Corporation came to Lexington in 1973, the total cost of its sewer lines was financed by a local government bond issue.

Aside from a few areas of the country with explicit anti-growth policies, this approach to providing public services is quite common. Whether it involves roads, sewers, or utilities,

existing residents are frequently called upon to pay a portion of new services, particularly services to large, attractive industrial customers. The reason, again, is that a new customer brings benefits as well as costs -- benefits that include new jobs and greater prosperity. In addition, by purchasing gas, water, electricity, and other utility services, the new customer helps pay for the fixed costs of providing these services for everyone. In the long run, this keeps rates down. It would be grossly unfair to ignore these benefits and treat Toyota differently than other similar customers.

What is the cost to the average residential ratepayer of paying for 25 per cent of the pipeline to Toyota? In the recently settled rate case, the cost netted out to approximately 3 cents per thousand cubic feet (mcf) of natural gas. But that included the entire $3.8 million over and above the state's $6 million contribution. Since $1.8 million of that $3.8 million would apparently have been spent anyway, the cost for Toyota alone is approximately 1.6 cents per mcf. A typical residential ratepayer over the course of a year will use an average of about 10 mcf of gas per month. That means the typical Columbia residential customer will pay about 16 cents per month for his or her portion of the Toyota pipeline. (The latest figures from Columbia indicate that the actual cost will be somewhat less.)

What benefits will these ratepayers receive for this contribution? A recent report by the University of Kentucky's Center for Business and Economic Research estimated that Toyota and its

satellite industries could bring as many as 35,000 new jobs and $4 billion in additional economic activity to Kentucky.

To sum up, the treatment that the Toyota pipeline received in Case No. 9609 and the Columbia rate case settlement last November represents a reasonable sharing of burdens and benefits. It is consistent with sound ratemaking principles, the provision of other public services, and the practices of many areas of the country.

We now move to the issue at hand: the proposed special contract between Columbia and Toyota. From the foregoing analysis it should be clear why a special contract of this kind is so appealing. If the investment by Columbia and its ratepayers in the pipeline to serve Toyota is reasonable, and we have concluded that it is, then this special contract -- if it is consistent with Commission regulations and policies -- will guarantee that for at least five years this pipeline will be used by Toyota. A contract can ensure that Columbia's ratepayers will receive a return on their investment through Toyota's sharing in the fixed costs of Columbia's entire natural gas system.

If the Commission were to reject an appropriate contract, then Toyota might go elsewhere for its natural gas service. In that case, the investment in the Toyota portion of the pipeline -- which is nearly half finished -- would be wasted.

To place the many issues surrounding this special contract in perspective, a certain amount of background is necessary. On June 13, 1986, Columbia filed an application for approval of the construction of a pipeline to serve Toyota and the Scott County area,

Case No. 9609. (The Attorney General did not participate in this case.) During its review of that application, the Commission requested a copy of the gas purchase contract between Columbia and Toyota. In response, Columbia filed and placed in the record of that case a letter dated August 29, 1986. The letter stated that negotiations were in progress and as soon as they were concluded the Commission would be notified of the results. From that date on, the Commission and anyone who reviewed the construction application would have been aware of the pending contract.

The reason Columbia and Toyota were negotiating a special contract is clear. Toyota is a new customer. Its needs are unusual. To meet the requirements of Toyota, Columbia agreed to supply and transport Toyota's natural gas. Columbia's current tariffs do not have a general open transportation provision. (Open transportation permits a customer like Toyota to purchase gas from whatever supplier it wishes. Its distribution company -- Columbia, in this instance -- agrees to transport that gas to the customer.)

Although the tariffs of Columbia do not contain an open transportation provision, other gas companies in the state have these provisions, for example, Western Kentucky Gas Company and Louisville Gas and Electric. Special transportation arrangements for Columbia customers are available through special contracts. Transportation provisions are common for industrial customers throughout Kentucky. According to Columbia, every one of its major industrial customers has some kind of transportation agreement.

In order to provide Toyota with open transportation, Columbia, in accordance with 807 KAR 5:011(13), entered into a special contract. By the terms of this contract, Columbia will receive gas revenues associated with Toyota as well as transportation revenues from Toyota at the full tariff rate of 41 cents per mcf. As a result, the rates of Columbia's other customers will be kept down because of the additional revenue associated with the large volumes of gas being purchased by and transported for Toyota. This contract is particularly favorable because other industrial customers that have alternate fuel capability -- the ability to use another fuel besides natural gas, with certain exceptions -- would be entitled under Columbia's tariffs to pay less than 41 cents per mcf, if they could demonstrate a competitive threat from an alternative energy supplier.

This highlights an area of confusion. The Attorney General contends that the special contract would permit Toyota to flex the 41 cent transportation rate downward. We disagree. Instead, we are in accord with the interpretation of the special contract contained in Columbia's memorandum of January 13. The special contract simply permits Toyota to receive transportation service under the full transportation rate. To qualify for a reduced rate, Toyota would have to meet all requirements of Columbia's tariff, which include establishing a competitive threat from an alternative energy supplier.

The special contract is clearly beneficial to Columbia, its ratepayers, and Toyota. It assures Toyota of transportation for

its gas, while assuring Columbia that it will receive the full transportation rate for all gas transported.

The open transportation concept has been carefully studied by the Commission during the extensive comment and hearing process that has taken place in Administrative Case No. 297, An Investigation of the Impact of Federal Policy on Natural Gas to Kentucky Consumers and Suppliers. In the draft order in that case, the Commission proposed establishing open transportation as the policy for all natural gas companies in Kentucky. In its comments on that order, the Attorney General fully supported the proposal.

The Commission intends to issue its final order in Administrative Case No. 297 in the near future. Since the findings in that order will address many of the same issues addressed in the special contract, we might have chosen to withhold our ruling on the special contract until that order was issued. We felt, however, that any further delay might tempt Toyota to seek another supplier for its natural gas. That would be a highly unfortunate development in light of the investment in serving Toyota already made by Columbia and its ratepayers.

We have been concerned by reports that the special contract provides Toyota with an unjustifiable discount for natural gas -- the number 42 percent has been used. This is flatly incorrect. Every major industrial customer of Columbia has, like Toyota, an agreement to transport gas. Each can seek to buy natural gas from suppliers at the lowest possible price and have it transported by Columbia. From this perspective, Toyota is being treated similarly to other members of its customer class. In fact, certain other

customers might be in a somewhat better position than Toyota by being able to meet all the requirements of the Columbia tariff and qualify for a lower gas transportation rate than Toyota's.

The nub of the Attorney General's complaint in this case is a misunderstanding that occurred during the settlement negotiations in Case No. 9554. This misunderstanding has led to the unfortunate and unnecessary uproar over Toyota's arrangements to obtain natural gas service. The Attorney General clearly believed that the parties to the settlement had agreed that there would be no exceptions to the alternate fuel requirement for transportation service, and that Toyota would thus be denied transportation service until such time as the Commission issued its final order in Administrative Case No. 297. Columbia and Toyota contend that they made no such blanket agreement. They believed that though the alternate fuel requirement was to be the general rule, an exception could be granted under a special contract.

We sympathize with the Attorney General. In retrospect, it would have been far better if Columbia and Toyota had made certain during the settlement conference that the Attorney General knew of the special contract negotiations. It was not enough to assume that the Attorney General was aware of these negotiations because notice of their existence had been given in August 1986 in another case (Case No. 9609).

We disagree with Columbia's contention in its memorandum of January 13 that the parties to the settlement agreement "were not entitled to be advised of ... the contract negotiations between Toyota and Columbia...." We disapprove of Columbia's position on

this issue and instruct the company that in all future settlement proceedings it should be as candid as possible with the parties about every relevant item.

Despite this regrettable misunderstanding, it is the Commission's responsibility to determine whether this special contract is fair, just, and reasonable. We cannot accept the narrow reading suggested by the Attorney General of our power to approve special contracts under 807 KAR 5:011(13). The authorities the Attorney General cites are not persuasive. Special contracts are indispensable for meeting the special needs of certain customers, where a proper showing is made. A general tariff can never anticipate every set of circumstances that may arise. The flexibility provided to the Commission by 807 KAR 5:011(13) is similar to the broad authority permitted the Commission under 807 KAR 5:011(14), which allows the Commission to deviate from its regulations for good cause.

By approving this special contract for Toyota we are not overturning the settlement in Case No. 9554, but simply granting an exception, for good cause, to the general rule. The Attorney General seeks to reopen the settlement agreement in order to allow the parties to explain their negotiating positions. To do so, however, would violate the very terms of the agreement, which provided that all parties waived their rights to rehearing or appeal once the Commission accepted the settlement. We cannot acquiesce to reopening the settlement.

After reviewing the record in this case, the Commission finds that the contract conforms with 807 KAR 5:011(13). The parties

recognize the need to modify generally applicable tariffs to accommodate the specialized needs of both Columbia and Toyota. This regulation is explicitly for that purpose. All filing requirements have been met and all provisions of the contract conform to the standards of the Commission.

The Commission also finds the contract is in the public interest. The requirements of the gas supply for Toyota differ from those usually recognized in the filed tariffs. In order to accommodate these needs, Columbia agreed to alter its transportation tariff. In exchange, Toyota agreed to purchase gas exclusively from or through Columbia for five years. Thus, each party to the contract has recognized the needs of the other and has accepted certain provisions which ordinarily are required of neither. Because of this agreement, all customers of Columbia will benefit. Quite clearly, the more gas Columbia sells or transports to Toyota, the more revenue will be produced. This will keep rates down for all other customers by reducing the portion of the revenue requirement that must be generated through their rates.

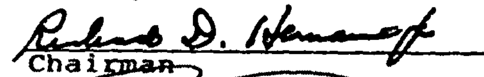
IT IS THEREFORE ORDERED that:

(1) The contract submitted by Columbia and Toyota is approved; and

(2) The motion of the Attorney General is denied.

Done at Frankfort, Kentucky, this 12th day of February, 1987.

PUBLIC SERVICE COMMISSION



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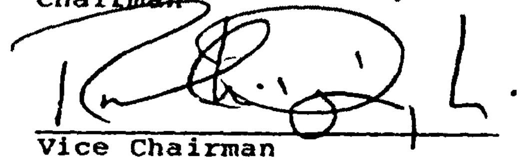

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