

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF WESTERN	)	
KENTUCKY GAS COMPANY, A	)	
DIVISION OF ATMOS ENERGY	)	
CORPORATION, FOR APPROVAL OF	)	
THIRD PARTY GAS SUPPLY	)	CASE NO. 2002-00245
AGREEMENT AND FOR A DEVIATION	)	
FROM THE PRICING REQUIREMENTS	)	
OF KRS 278.2207	)	

O R D E R

In Case No. 2001-00317, the Commission approved a settlement agreement between the Office of the Attorney General and Atmos Energy Corporation ( Atmos ), formerly Western Kentucky Gas Company ( Western ), which modified Atmos s experimental gas procurement performance-based rate-making mechanism ( PBR ).<sup>1</sup> As part of the agreement, Atmos agreed to issue a Request for Proposal ( RFP ) for a new gas supply contract. Atmos issued an RFP for a new gas supply agreement to 18 prospective bidders on April 5, 2002, with a response deadline of April 25, 2002. Eight companies submitted timely responses to the Atmos RFP. Atmos chose the three lowest price bids for further analysis, two of which were from non-affiliated companies. The third was from Woodward Marketing, LLC ( Woodward ), an affiliated company. One of the non-affiliated companies offered the best bid, containing a greater discount

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<sup>1</sup> Case No. 2001-00317, Modification to Western Kentucky Gas Company, A Division of Atmos Energy Corporation, Gas Cost Adjustment to Incorporate an Experimental Performance Based Ratemaking Mechanism (PBR), Order dated March 25, 2002.

from the indices used as benchmarks in Atmos's PBR than the other two bids. After reviewing the low bidder's credit worthiness, Atmos requested that the low bidder supply a letter of credit to protect Atmos in case of default. When the low bidder would not provide the requested letter of credit, Atmos awarded the contract to the second lowest bidder, its affiliate, Woodward.

On June 28, 2002, Atmos filed its application for approval of its third-party gas supply agreement with Woodward and for a deviation from the affiliate pricing requirements of KRS 278.2207.

The proposed contract with Woodward has a term of 4 years during which Woodward will supply gas to Atmos for a discount below the benchmarks established in Case No. 2001-00317. Woodward, as an Atmos affiliate, is subject to KRS 278.2207(1)(b), which requires that services or products provided by an affiliate be priced at the affiliate's fully distributed costs but in no event greater than market. Pursuant to KRS 278.2207(2), Atmos requests a deviation from the requirements of KRS 278.2207(1)(b), arguing that, while the competitive nature of the bidding process may not allow Woodward's price to reflect its fully distributed costs, the same process assures that Woodward's price will not exceed the market price.

Based on the confidential bid analysis information submitted by Atmos, the Commission finds that the low bidder's financial condition was cause for legitimate concern. The low bidder has a low credit rating, a stock price that has fallen significantly, and well publicized liquidity problems. Given its inability to provide the requested letter of credit, the Commission believes that Atmos's decision to not award

the low bidder the contract is appropriate, particularly given its previous experience in a somewhat similar situation.

Atmos's previous gas supply contract was originally awarded to Noram Energy Services ( Noram ), a company later acquired by Reliant Energy ( Reliant ). Soon after its acquisition of Noram, Reliant informed Atmos that it could not continue to supply gas under the contract's discounted price and offered to buy out the contract. Atmos contacted Woodward, the second lowest bidder in response to the original RFP, to see if Woodward would honor its original bid. Woodward agreed and was chosen as Atmos's replacement supplier.<sup>2</sup> Given Atmos's experience with Noram/Reliant, it is clear that contracting with a firm possessing the ability to perform and provide reliable service under the terms of the contract is an issue that is as important as obtaining a favorable price under the contract.

In addition to reviewing the record of this proceeding, we find it appropriate to take administrative notice of the recent report issued by Liberty Consulting Group ( Liberty ), which reviewed Atmos's RFP and its affiliate relationship with Woodward as part of the gas procurement management audit of Kentucky's major gas distribution utilities it performed for the Commission during 2002. Initially, Liberty expressed some concern with the completeness of Atmos's RFP and the information Atmos provided in response to bidders' data requests. After completing its review, however, Liberty concluded that Atmos's bidding process and its award of the contract to Woodward

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<sup>2</sup> The Commission reviewed Atmos's decision to accept Reliant's buyout and select Woodward as its replacement supplier in Case No. 1999-00445, A Formal Review of Western Kentucky Gas Company's Decision to Terminate a Natural Gas Sales, Transportation and Storage Agreement with Noram Energy Services, Inc. and Enter into a Natural Gas Sales, Transportation and Storage Agreement with Woodward Marketing, L.L.C. (Order dated April 14, 2000).

were acceptable. Liberty's discussion of this matter is contained in Chapter Three of the Atmos/Western section of its audit report.

Consistent with Liberty's analysis, and based on the information submitted by Atmos in response to the Commission Staff's data requests, we find that Atmos's RFP process and its ultimate award of the gas supply contract to Woodward are acceptable. Therefore, the Commission will approve the third-party gas supply agreement between Atmos and Woodward. However, we find that Atmos's RFP and its bidding procedures should be improved prior to its next solicitation of gas supply and supply management services, as discussed below. We find that, at a minimum, the information that was requested by prospective bidders regarding daily system throughput, daily operation of on-system storage facilities, and operation of pipeline storage facilities should be included in any future RFPs for gas supply and supply management services. We also find that all supplemental information requested should be provided to all prospective bidders.

In addition to approving the gas supply agreement, we find Atmos's request for deviation from KRS 278.2207(1)(b) to be reasonable and in the public interest since the sole lower-cost alternative to Woodward posed an unacceptable risk, and market rates are demonstrated by alternative bids.

IT IS THEREFORE ORDERED that:

1. Atmos's contract with Woodward is hereby approved.
2. Atmos's request for a deviation from KRS 278.2207 is granted.

3. Atmos shall expand and modify any future RFPs it issues for a third-party gas supplier and shall respond to prospective bidders requests for information in a manner consistent with that set forth in this Order.

Done at Frankfort, Kentucky, this 3<sup>rd</sup> day of December, 2002.

By the Commission

ATTEST:

  
Executive Director