 Docket Room

**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

In the Matter of the Application of Kansas Gas)
Service Company, a Division of ONEOK, Inc.)
For Commission Determination for the Rate) Docket No. OO-KGSG-420-RTS
Treatment of Discounted Service Agreements)
Entered Into to Meet Competitive Alternatives.)

COMMENTS OF UTILICORP UNITED INC.

COMES NOW UtiliCorp United Inc. (UCU) d.b.a. Peoples Natural Gas Company and Kansas Public Service and files its comments on the rate treatment of discounted service agreements. From time to time the Kansas Corporation Commission Staff (Staff) has sponsored adjustments in various rate proceedings that imputes lost revenue from discounted rates. UtiliCorp's comments will focus on the idea of imputing lost revenue from discounted rates,

Revenue Imputation is a Disincentive

Staff apparently feels that the utility has no real incentive to minimize lost revenue from discounted rates. In UCU's last rate case at Docket No.193,787-U, Staff witness Joe Williams proposed to impute one half of the discounted margins in order to "... provide improved incentive for vigorous negotiation if discounting is required". In the same case, Staff witness Janet Buchanan proposed to "...expose shareholders to the effects of discounting" by requiring

the shareholders to absorb a portion of any revenue shortfall associated with discounted rates.

UtiliCorp has a very strong incentive to “negotiate vigorously” with each and every customer. Every penny discounted is a penny lost until the next rate case. Every penny discounted is another barrier to acceptable financial returns, which is what the shareholders are ultimately after. UtiliCorp is an investor-owned utility; it is motivated to earn a return on its investment, to make a profit. Any discounting of rates works against that profit motive. Shareholders are at risk for all lost revenue due to discounted rates. Rates are discounted only when load retention is threatened.

Charging tariff rates for all transportation customers would be nice, but it is unrealistic. The close proximity to other pipelines provides Kansas customers with many choices. Flexible rates level the playing field against unregulated alternatives. Physical bypass is a real threat to UtiliCorp, and flexible rates allow UCU to compete and retain system throughput.

Core customers (captive customers without alternative supply choices) benefit from discounted rates. System throughput is important for the recovery of the utilities’ system costs. While discounted rates provide lower revenue than full tariff rates, the variable costs are covered and some contribution is made to the fixed costs associated with that customer. If no discounting of rates was allowed, some customers would be lost completely, leaving only the core customers to pay the system costs.

Staff’s apparent position is to allow flexible rates, but require the utility shareholders to absorb a portion of any revenue shortfall associated with

discounted rates. Shareholders have already “absorbed” the full impact of any discounted rates between rate cases. Why would they want to be permanently punished by having revenue imputed that can never be recovered? If adopted, this policy of revenue imputation would act as a disincentive. Utilities would be less inclined to retain a customer by discounting their rate if required to absorb part of the revenue shortfall in establishing new rates. This policy would incent the utility to lose the customer rather than be penalized for discounting the rate to retain the customer. It would force the core customers to bear the entire burden of the system costs, rather than only a portion of them, which are now being paid by the large volume customer with a discounted rate.

Prior Commission Approval

The Commission has recognized that competition exists in Kansas, especially for large volume customers. The Commission’s Order in Docket No. 85-PNTG-237-RC, dated April 23, 1986, states:

Recent changes in the natural gas industry have enhanced the impact of competition in the natural gas markets. These changes include a current over-all surplus of supply, certification of new intrastate utilities, the adoption of Order 436 by the Federal Energy Regulatory Commission, increased activity in non-utility brokerage services and, most recently, steep decline in oil prices. The increased competitive pressure threatens to do irreparable damage to the traditional markets which have historically sustained the viability of local distribution companies and intrastate pipelines in Kansas.

Since the mid 80’s this Commission has encouraged competition in an effort to bring delivered prices down. The Commission’s Order at Docket No. 142,683-U, dated January 11, 1985, states, “The Commission believes that the

competitive pressures placed on both competing suppliers and producers will result in a benefit to Kansas customers.”

The Commission has also recognized the detrimental affects to the utility if the utility is not allowed to compete on a level playing field. UtiliCorp’s large industrial base near Wichita is somewhat unique in that the area is saturated with competing pipelines. Large volume customers that account for a significant portion of UCU’s throughput have several sources of supply. Load retention is critical for cost recovery. The Commission acknowledged the competitive pressure on UCU in 1986 in its Order in Docket No. 85-PNTG-237-RC which states, “. . .the Commission recognizes the potential for lost sales and the resultant shift in fixed cost to captive or remaining customers due to the increasingly competitive environment in which PNG operates.”

The Commission has been receptive to flexible rates in order for LDCs to compete with alternative supply sources. The Commission approved UCU’s first flexible transportation tariff in 1987. That approval allowed negotiation of transportation rates between the then currently approved sales margin and \$.24 per Mcf. But, even this flexibility proved to be insufficient to retain some of the largest industrial customers served by UCU. As more and more competitive pressure developed for the largest industrial customers, UCU found it needed rates lower than \$.24 per Mcf to retain the largest industrial customers. In 1992, the Commission allowed UCU to lower the minimum commodity transportation rate to \$.02 per MMBtu.

The Commission has clearly seen the value in allowing discounted rates. The Commission’s 1987 Order at Docket No. 85-PNTG-237-RC justified flexible

rates because the Commission recognized that the discounted rate: 1) may “reflect something closer to the actual cost of providing service”, 2) allows the utility to respond to market forces, and 3) is required as a matter of fairness. Without flexible rates, the utility is at a distinct disadvantage in competing with interstate pipelines.

Double Jeopardy

UtiliCorp believes that revenue imputation is a form of punishment. The Commission has approved all of the rates charged for sales and transportation services. To impute revenue that “should have been” collected if tariff rates were charged requires a major assumption that tariff rates “could have been” charged.

Imputation of revenue implies that the utility has no motivation to extract the highest rate possible when negotiating a transportation contract, and therefore should be penalized. While this imputation does not affect the customer (i.e. there is no retroactive ratemaking issue with the customer), imputed revenues penalize the utility in that it has no chance of recovery.

The utility’s shareholders have already absorbed any lost revenue associated with discounted rates. Imputed revenues during the next rate setting process would only serve to punish the shareholders, without any mechanism to recover the imputed revenue. This is double jeopardy, the shareholders lose twice.

The past allowance of flexible rates by this Commission is a policy statement. Any change in this policy would have to be forward looking. As a practical matter, how would existing contracts with discounted rates be handled? If existing contracts are affected, the utility is incented to cancel the contracts,

lose the customer altogether, and file another rate case to recover its “stranded costs”.

Procedural Due Process

The Commission approved flexible tariffs for UtiliCorp beginning in 1987. In the only instance where UtiliCorp has had to deviate from these tariffs via a special contract, that contract has been approved by the Commission. To accept Staff's revenue imputation position is to make a finding that UtiliCorp has acted imprudently in reaching either a discounted rate within its approved tariffs or in reaching a discounted rate within a special contract and that all future negotiations for discounted rates are assumed imprudent. Such a finding, without a full hearing to examine whether UtiliCorp acted prudently given the specific circumstances of each discount, is a clear violation of UtiliCorp's constitutional procedural due process rights. Speculation that all future negotiations will be imprudently conducted is an egregious violation of UtiliCorp's constitutional procedural due process rights.

In addition, such a finding would be a violation of UtiliCorp's Commission approved tariffs. A non-agreed-to or non-litigated change would be tantamount to retroactive rate making. Simply put, the imputation of revenue based upon revenue that might have been collected is based upon a major and insupportable assumption that different flexible tariff rates should have been in place. The fallacy in such assumptions is readily apparent.

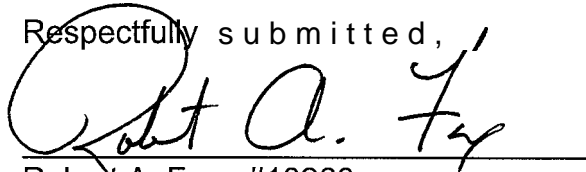
There has been no evidence offered into the record to support any assumption that UtiliCorp has had, and in the future will have, no real incentive to minimize lost revenue from discounted rates. To the contrary, several

Commission orders (discussed supra) recognize that a clear incentive does exist. There has been no evidence of imprudence offered against UtiliCorp in any rate proceeding regarding discounted rates. Without substantial competent evidence to support a, basis for Staff's imputation scheme, the Commission cannot institute it or a similar imputation scenario without a clear and substantial violation of UtiliCorp's legal rights.

CONCLUSION

No rational basis has been shown to support Staff's proposed revenue imputation. To the contrary, the Commission has, on numerous occasions, acknowledged the need for rate flexibility in certain situations. This need has not diminished. Revenue imputation is unnecessary, unwarranted and is a clear violation of legal rights and interests.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Robert A. Fox", is written over a horizontal line. The signature is stylized and cursive.

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VERIFICATION

STATE OF KANSAS)
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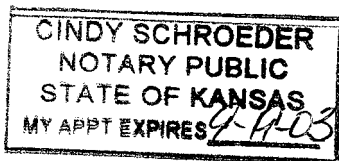
Robert A. Fox, being duly sworn upon his oath, deposes and states that he is one of the attorneys for UtiliCorp United Inc., d/b/a Peoples Natural Gas; that he has read and is familiar with the foregoing Comments of UtiliCorp United Inc. filed herewith; and that the statements made therein are true to the best of his knowledge, information and belief.


Robert A. Fox

Subscribed and sworn to before me this 15th day of March, 2000.

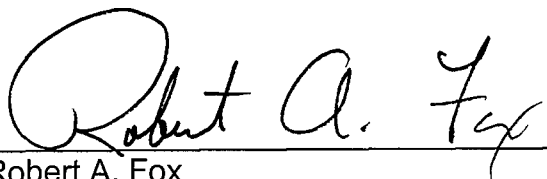

Cindy Schroeder
Notary Public

My Appointment Expires:



CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of March, 2000, true and correct copies of the above and foregoing Comments of UtiliCorp United Inc. were deposited in the United States mail, first-class postage prepaid, properly addressed to the attached list of parties.

A handwritten signature in black ink that reads "Robert A. Fox". The signature is written in a cursive style with a large, looped initial "R".

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