

ISSUE DATE: April 20, 1998

DOCKET NO. G-002/AI-98-71

ORDER APPROVING CONTRACT AS MODIFIED, SETTING REPORTING
REQUIREMENTS, AND GRANTING VARIANCE

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Edward A. Garvey
Joel Jacobs
Marshall Johnson
LeRoy Koppendrayner
Gregory Scott

Chair
Commissioner
Commissioner
Commissioner
Commissioner

In the Matter of a Request by Northern States Power Company for Approval of an Umbrella Agreement with Energy Masters International, Inc. for the Short Term Sale and Purchase of Natural Gas

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PROCEDURAL HISTORY

On January 9, 1998 Northern States Power Company (NSP or the Company) filed a request for approval of an umbrella sales and purchase agreement, dated January 1, 1998, with its wholly owned subsidiary, Energy Masters International, Inc. (EMI). The Company also requested a variance from Minn. Rules 7825.2100, which requires Commission approval before utilities execute contracts with their affiliates.

On February 12, 1998 PAM Natural Gas, LLC (PAM) filed comments recommending denying the requested variance, “disallowing” transactions under the contract prior to its approval, and requiring monthly reporting of all transactions under the contract.

On February 13, 1998 the Department of Public Service (the Department) filed comments which recommended approving the contract, with amendments and clarifications to which the Company had agreed. The Department also recommended granting the variance and requiring annual reporting.

On April 2, 1998 the matter came before the Commission.

FINDINGS AND CONCLUSIONS

I. The Legal Standard

Transactions between public utilities and their affiliates are governed by Minn. Stat. § 216B.48 and Minn. Rules, parts 7825.1900 - 7825.2300. All such transactions, except those involving amounts under \$50,000 or 5% of the utility’s capital equity, whichever is smaller, require Commission approval. The burden is on the utility to establish that the contract is reasonable and consistent with the public interest.

Contracts between utilities and their affiliates are not effective or valid until the Commission approves them. The Commission has continuing supervisory control over the contracts' terms and may disallow rate recovery of their costs if actual experience shows that contract terms were or are unreasonable. Minn. Stat. § 216B.48, subd. 6.

A petition for approval must normally include documentation of the cost of providing the goods or services which are the subject of the contract. It must also include a copy of the proposed contract, a list and narrative description of all outstanding contracts between the utility and the affiliate, an explanation of why the contract is in the public interest, a description of any competitive bidding process used in awarding the contract, and an explanation of any decision not to use competitive bidding. Minn. Rules, part 7825.2200 B.

Utilities are required to maintain detailed records of their transactions with affiliates, including ledgers and documentation showing on a monthly basis all payments made under each contract and the cost to the affiliate of providing the good or the service for which each payment was made. Minn. Rules 7825.2300.

II. The Contract at Issue

The contract at issue will permit NSP to conduct the following transactions with EMI:

- (1) purchase natural gas from EMI on a short-term, interruptible basis;
- (2) sell natural gas to EMI on a short-term interruptible basis;
- (3) exchange or swap gas supply with EMI;
- (4) sell peaking or back-up supply services to EMI;
- (5) engage in capacity release transactions with EMI;
- (6) provide propane storage service to EMI;
- (7) provide fuel oil and propane sales service to EMI.

The contract is in the standard form developed by the Gas Industry Standards Board, and the procedures NSP will use to buy, sell, or swap supply or capacity are designed to ensure that EMI will be treated in the same way as any other gas supplier. For example, before NSP can buy from EMI, it must have three offers from non-affiliates, and EMI's offer must be the lowest. To sell to EMI, NSP must have three other bids, and EMI's must be the highest.

The Company stated that historically EMI has supplied approximately 15 hundredths of one percent of its total gas supply and that the Company did not expect that to change under the umbrella agreement.

The Company agreed to revise the terms of the contract and its "transaction principles," its in-house procedural guidelines for transactions with EMI, to meet Department expectations for arms-length transactions.

III. The Issues

None of the persons commenting on this contract challenged the contract or any of its terms on their merits. (The Company had earlier revised several terms to allay concerns raised by the Department.)

The contested issues were whether the Company should file monthly or annual reports on transactions under the contract, whether the Commission should approve the contract as of the date it was signed or as of the date it was approved, and whether the Commission should “disallow” transactions completed under the contract prior to its approval.

PAM, an energy marketing company, urged the Commission to require monthly reporting of NSP/EMI transactions as an added safeguard against self-dealing. PAM also urged the Commission to deny NSP’s request to approve the contract as of the date it was executed and to “disallow” any transactions under the contract before the date it was approved by the Commission.

The Department believed ratepayers were adequately protected by annual reporting, in part because purchases from EMI would show up in the Company’s monthly purchased gas adjustment reports, permitting prompt detection of any anomalies. The Department saw nothing to be gained by denying the requested variance and recommended approving the contract as of the date it was signed.

The Company argued that the minuscule amount of gas it bought from EMI did not justify monthly reporting and claimed that the need for flexibility in the deregulated wholesale marketplace justified approving the contract as of the date it was signed.

IV. Commission Action

A. Reporting Requirements

The Commission agrees with the Department and the Company that at this point annual reporting will adequately protect ratepayers and the public.

At present NSP buys a minuscule portion of its gas supply from EMI, making monthly reporting unnecessary. While this could change, any significant change would be reflected in the Company’s monthly purchased gas adjustment reports.

Furthermore, NSP will maintain the detailed monthly information on all transactions under the contract required under Minn. Rules 7825.2300. This information will permit rapid reconstruction of all dealings between the two companies, should the need arise.

The Commission believes these two mechanisms will provide adequate notice of any change in circumstances that might make monthly reporting necessary. In the mean time, it is not in the public interest to require more burdensome reporting requirements than current circumstances demand.

B. Contract Approval

This contract is clearly in the public interest and merits approval. To get the best prices in the competitive wholesale gas market, most utilities need as many and as wide a range of potential suppliers as possible. This is especially true in the interruptible market, at issue here, where reliability can take a back seat to price. Similarly, utilities seeking to balance supply and demand need as many potential customers for excess supply and excess capacity as possible.

Of course, preventing preferential treatment of affiliates is critical for ratepayer protection and for an efficient wholesale market. The Commission agrees with the persons who commented, however, that the safeguards in the contract and in the utility's internal transaction principles will accomplish that goal, with monitoring by the Department and the Commission.

C. Effective Date of Commission Approval

Although the Commission's rules require pre-execution approval of contracts with affiliates, it is not uncommon, since the federal deregulation of wholesale gas markets, for the Commission to vary the rules and approve contracts effective as of the date they were signed. Typically, they are signed subject to Commission approval and are executed in advance to secure the advantages of speed, flexibility, and efficiency so valued in the competitive market.

The Commission will approve this contract, effective as of the date it was signed, because it is clearly in the public interest and because it would benefit no one to enforce the literal language of the rule.

The Commission will not, at least on the basis of this record, disallow rate recovery of the cost of any transaction completed before Commission approval, as urged by PAM. Under the terms of the contract, completing any transaction with EMI would depend upon EMI being the highest bidder for gas sold and the lowest bidder for gas bought. Disallowing such transactions and imputing the prices that would otherwise have applied would only increase total costs to ratepayers.¹

Of course, disallowance, in terms of disallowing rate recovery, remains an option for the Commission, should later developments require it. The Commission has continuing supervisory authority over utility contracts with affiliates and can disallow rate recovery of payments thereunder after the contracts have been approved, if actual experience demonstrates that the payments were or are unreasonable. Minn. Stat. § 216B.48, subd. 6.

For all these reasons, the Commission will grant the requested variance under Minn. Rules 7829.3200 and approve the contract effective as of the date it was signed.

ORDER

1. The contract at issue is approved, subject to the revisions in the contract and the revisions in the transaction principles recommended by the Department and agreed to by the Company.

¹While the Commission does not discount the availability of harsher remedies, which PAM may have intended by the term "disallow," such remedies are not appropriate here and raise issues of equity which need not be analyzed in this case.

2. The Commission hereby varies Minn. Rules, part 7825.2100 and approves the contract as of January 1, 1998.
3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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