BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

LeRoy Koppendrayer	Chair
Ellen Gavin	Commissioner
Marshall Johnson	Commissioner
Phyllis A. Reha	Commissioner
Gregory Scott	Commissioner

In the Matter of the Complaint of Pro-Corn, LLC Against Aquila, Inc. (Formerly UtiliCorp United, Inc.)

ISSUE DATE: March 21, 2003

DOCKET NO. G-007,011/C-02-1602

ORDER APPROVING WITHDRAWAL OF COMPLAINT AND OPENING TWO NEW DOCKETS

PROCEDURAL HISTORY

On September 25, 2002, Pro-Corn, LLC (Pro-Corn) filed a Complaint against Aquila, Inc. (formerly UtiliCorp United Inc.) (Aquila) including a Request for Emergency Relief alleging, among other things, that Aquila has threatened to discontinue a balancing service to Pro-Corn, will require Pro-Corn to purchase balancing services from Cornerstone Energy (Cornerstone) and has refused to enter into an end user allocation agreement with Pro-Corn and Northern Natural Gas Company (Northern).

Pro-Corn requested that the Commission: 1) require Aquila to continue to provide its daily balancing service, as previously provided, and 2) direct Aquila to enter into an end user allocation agreement between Aquila, Pro-Corn and Northern. Further, Pro-Corn requested that the Commission require Aquila to cease and desist in its proposed sale and transfer of assets and services to Cornerstone until the Commission can investigate the transaction.

On October 4, 2002, Pro-Corn filed amendments to the Complaint. The Amended and Restated Complaint, dated October 7, 2002, requested that the Commission: 1) require Aquila to provide daily balancing service, but modified its request to provide this on a regulated or unregulated basis, and 2) direct Aquila to enter into an end user allocation agreement between Aquila, Pro-Corn and Northern. Emergency relief in the form of a cease and desist order was not requested.

On October 15, 2002, Aquila submitted comments asking, among other things, that the Commission not require Aquila to provide a regulated large volume balancing service (LVDBS) nor require Aquila to provide an end user allocation service (EUAS).

On October 15, 2002, the Department of Commerce (DOC) filed comments indicating that the Commission has both the jurisdiction and the authority to investigate the allegations in the complaint.

On October 22, 2002, Pro-Corn filed reply comments.

On December 4, 2002, Otter Tail Energy Services Company (OTESCO) filed comments supporting the large volume customer's right to enter into an end user allocation agreement and the need for a default large volume balancing service to be offered by Aquila.

On December 23, 2002, Aquila filed supplemental initial comments in response to the comments of OTESCO.

On February 3, 2003, Pro-Corn filed a Stipulation and Settlement between Pro-Corn and Aquila providing that Pro-Corn and Aquila will enter into an end user allocation agreement with Northern. Also, Pro-Corn requested that its complaint be dismissed.

On February 6, 2003, this matter came before the Commission.

FINDINGS AND CONCLUSIONS

I. Background

Pro-Corn is an ethanol producer and consumes approximately 730,000 Mcf of natural gas per year. Pro-Corn purchases transportation services (regulated local distribution services) from Aquila; these services carry natural gas from the city gate to the Pro-Corn plant on Aquila's distribution system. Pro-Corn also purchased unregulated balancing services from Aquila.

Pro-Corn was notified by Aquila that after October 1, 2002, Aquila would no longer provide balancing services. Aquila indicated that Cornerstone may provide the type of balancing services previously provided by Aquila. U.S Energy Services (USES), the gas purchase agent for Pro-Corn, proposed that Aquila and Pro-Corn enter into an end user allocation agreement with Northern which would enable Pro-Corn to subscribe to a balancing service (system management service) provided by Northern and would provide a functional equivalent to local distribution company (LDC) balancing. When Aquila refused to enter into the end user allocation agreement Pro-Corn filed its complaint.

II. The Complaint

Pro-Corn alleged, among other things, that Aquila did the following:

- switched its gas balancing service from a regulated to an unregulated service without the contract being submitted to or approved by the Commission;
- planned to discontinue its balancing service to Pro-Corn without Commission authorization;
- intended to force Pro-Corn to purchase regulated gas from Aquila in the absence of a balancing service provided by Aquila or to require Pro-Corn to purchase balancing services from Cornerstone;
- refused to enter into an end user allocation agreement with Pro-Corn and Northern; and
- entered into an affiliate party transaction with its executive employees to effect the sale of Aquila assets to Cornerstone without notice or approval by their customers or the Commission.

Pro-Corn requested that the Commission require Aquila continue to provide its daily balancing service as previously provided, direct Aquila to enter into an end user allocation agreement between Pro-Corn, Aquila and Northern, and order Aquila to cease and desist its proposed sale and transfer of assets to Cornerstone until the Commission can investigate.[1]

III. The Resolution between Aquila and Pro-Corn

Aquila and Pro-Corn entered into a Stipulation and Settlement that provided, among other things, that Aquila enter into an end user allocation agreement with Pro-Corn and Pro-Corn dismiss its complaint against Aquila. Pursuant to the settlement agreement, all disputes and issues raised between Pro-Corn and Aquila in Pro-Corn's complaint were mutually settled.

IV. Commission Action on Pro-Corn's Request to Withdraw its Complaint

The Commission recognizes and encourages settlement between the parties and will allow the complaint to be withdrawn. However, the Commission recognizes that there may be other similarly situated customers that may benefit from entering into an end user allocation agreement with Aquila. In order to facilitate the use of end user allocation agreements by others, the Commission will require that Aquila treat all future requests for such end user allocation agreements in a nondiscriminatory manner. The Commission will take no further action on the issue of end user allocation agreements at this time and will close this docket.

V. Providing Large Volume Daily Balancing Services

A. Comments of Aquila

Aquila argued that it should not be required to provide a regulated large volume daily balancing service (LVDBS). It stated that it conducted a thorough review of its transportation tariffs in response to complaints by PAM Natural Gas Company[2] and, as a result of that review, believed that a regulated balancing service was not necessary because gas marketers can provide a balancing service without being part of a local distribution company. Aquila suggested that Cornerstone was an example of this.

Further, Aquila argued that a regulated large volume balancing service would pose an unnecessary risk for regulated sales customers. It argued that the risk would arise because a marketer could intentionally obtain inadequate supplies and rely on the LDC to absorb the imbalances and/or penalties which, within limits, would be covered by the balancing service. A regulated balancing service would shield the transportation customer from scheduling charges, allowing the marketer to game the system by purposely under or over delivering each day based on price. Unless the

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[1] The request for a cease and desist order appeared only in the original Complaint, it was not included in the Amended and Restated Complaint of Pro-Corn.

[2] *In the Matter of an Application by Peoples Natural Gas Company, a division of UtiliCorp United Inc. to Amend its Firm and Interruptible Transportation Tariffs*, Docket No. G-011/M-97-1048, ORDER APPROVING AMENDED TARIFF, AS MODIFIED, AND REQUIRING FURTHER REVISION OF TARIFF, January 16, 1998.

regulated balancing service had stringent controls on the marketer and was priced adequately to cover such risks, the regulated sales customers would end up paying for costs imposed by transportation customers.

Aquila argued that this kind of gaming could be prevented if an unregulated marketer provided both the gas supply and balancing for Aquila's transportation customers. In such a situation there would be no incentive for the marketer to abuse the system because pipeline imbalance penalties would be charged to the marketer.

Aquila argued that to protect its system against possible gaming by marketers, the regulated balancing service would need to be nearly as expensive as the marketer's potential avoided storage costs, which would eliminate the economic advantage of buying the service.

B. Comments of OTESCO[3]

OTESCO filed comments arguing that Aquila needs to offer both end user allocation agreements and a default large volume daily balancing service in order to meet the needs of its large volume customers who wish to purchase their gas supplies from an unregulated supplier. It argued that a regulated large volume daily balancing service was critical for customers who wished to purchase their gas supply bundled at the city gate rather than purchasing pipeline transportation, balancing and storage from the pipeline using an end user allocation agreement and separately purchasing commodity supplies.

OTESCO stated to the Commission at the hearing that it has several small customers with large volumes but it is unable to offer them balancing services because it is too small to do so. It argued that its customers need to be able to obtain balancing services from Aquila, rather than being only able to get this service from Cornerstone, which is a competitor of OTESCO.

OTESCO argued that Aquila's position that providing a balancing service to large volume end users will put undue risks on the captive firm customers is not supported by fact. It argued that the large volume end users were the easiest customers for Aquila to provide balancing for because their loads were easily monitored with telemetering and therefore easily balanced. If the large volume end users are in balance it makes it easier to calculate the sales service customers deviation from nominations. Unless Aquila fails to recover its expense to provide the large volume balancing service, providing this service cannot cause a risk to the captive customers.

Further, OTESCO argued that Aquila's argument that the end user and marketer could game the system by under or over nominating supplies based on the daily price spread between the first of the month index and the daily cashout price is also not supported in fact. It argued that all penalties and punitive cashout costs associated with under or over nomination of volumes versus actual usage would be charged by the upstream pipeline to the end users thus extinguishing the opportunity to take advantage of the spread.

[3] OTESCO is a wholly owned subsidiary of Otter Tail Corporation. It serves a number of industrial end users on Aquila's distribution systems in Minnesota.

OTESCO also argued that the fact that Cornerstone has acquired Aquila's unregulated marketing business from Aquila and is prepared to offer balancing services to large volume end users on the Aquila System is of no comfort to the end users which OTESCO represents and provides commodity deliveries to. Cornerstone is a start-up company without a history to support its service capabilities and is therefore a perceived risk to deliver on their contracted services.

C. Commission Action on a Large Volume Balancing Service

The Commission will require Aquila to offer a regulated Large Volume Daily Balancing Service. The Commission has recognized in the past that LDC balancing services serve the public interest by facilitating the effective use of transportation services. In the Commissions' last comprehensive review of Aquila's (then UtiliCorp/Peoples) transportation tariffs, the Commission urged the Company to file a balancing services tariff:

> An LDC balancing service is not a complete substitute for the discipline encouraged by the possibility of incurring penalties. Subscription to a balancing service may provide some customers with a way to mitigate against incurring balancing penalties. The Commission agrees with PAM that Peoples should be encouraged to offer an LDC balancing service to its customers, and notes that NSP (in docket No. G-002/M-96-102) received authorization to offer a balancing service modeled on Northern's SMS service.

In the Matter of an Application by Peoples Natural Gas Company, a Division of UtiliCorp United Inc. to Amend its Firm and Interruptible Transportation Tariffs, Docket No. G-011/M-97-1048, ORDER APPROVING AMENDED TARIFF, AS MODIFIED, AND REQUIRING FURTHER REVISION OF TARIFF, January 16, 1998, at 6.

It is now clear that a balancing tariff is necessary, and the Commission will move beyond encouraging one to requiring one. Aquila's transportation customers that purchase gas from marketers such as OTESCO need to be able to purchase balancing service from the regulated utility, rather than being forced to go to their marketer's competitor, in this instance Cornerstone, to purchase this service.

Further, the Commission is not persuaded that the only way that possible gaming of the system could be prevented would be to have an unregulated marketer provide both the gas supply and balancing. Rather, the Commission recognizes that a service could be developed that would minimize these potential risks. For these reasons, the Commission will require Aquila to work with the DOC, Pro-Corn and OTESCO to develop a regulated Large Volume Daily Balancing Service.

VI. Aquila's Sale of its Shipper Services to Cornerstone

A. Comments of Aquila

The sale of Aquila's Shipper Services to Cornerstone closed on September 30, 2002. Aquila stated that it decided to exit the Shipper Services business for several reasons including: 1) it recognized that the capital markets consider such an enterprise to be risky, thus adversely affecting Aquila's ability to raise capital, 2) it recognized that operating both regulated and unregulated enterprises was potentially harmful to regulated utility enterprises, and 3) it desired to focus its activity on regulated utility enterprises.

When the employees staffing Shipper Services learned of Aquila's intent to exit the business, several employees approached Aquila with an offer to purchase this business, including the Shipper Services contracts.

Aquila argued that this was a sale of an unregulated business enterprise that did not involve any transfer of regulated utility operating assets to an unaffiliated entity.[4] Further, Aquila argued that this transaction was not an affiliate transaction in that Aquila has no ownership interest in Cornerstone and the two companies have no overlapping officers or directors. Although Cornerstone is owned by former Aquila employees, Aquila argued that because there are no overlapping directors, Aquila does not exercise any control over Cornerstone.

B. Comments of the DOC

The DOC stated that the complaint of Pro-Corn made several allegations that, if true, provided reasonable grounds for the Commission to investigate.

Specifically, Pro-Corn in its complaint alleged that Aquila negotiated a sales/purchase transaction between itself and certain of its employees which resulted in the purported transfer of certain assets of a regulated entity, Aquila, to a non-regulated entity, Cornerstone. The DOC argued that, given the Commission's jurisdiction over both affiliated interest transactions and property transfers, the Commission has reasonable grounds to issue a "Show Cause Notice" requiring Aquila to explain why the sale and transfer of assets is not subject to regulatory approval.

C. Commission Action On the Sale to Cornerstone

The Commission agrees with the DOC that there are reasonable grounds for the Commission to require Aquila to show cause why this sale and transfer of assets is not subject to regulatory approval. The Commission will so order. Certainly, the nature of the transaction and the possible continuing links between the two entities raise questions of whether the sale and asset transfer was subject to prior Commission review.

VII. Review of all LDC Agency Services Programs

Comments of the parties specifically addressed the issues discussed above. The parties made further comments that addressed other issues and raised the question of whether an investigation into LDC agency services was warranted.

A. Comments of Pro-Corn

Pro-Corn alleged that Aquila misrepresented its non-regulated Swing Service balancing service as a regulated service and then discontinued offering this service when it sold its Shipper Services to Cornerstone. It questioned whether the balancing service Aquila offered could be clearly understood by Aquila customers as being included within the scope of unregulated agency services.

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[4] See Minn. Stat. §§ 216B.48 and 216B.50.

B. Comments of OTESCO

OTESCO believed that Aquila's Gas Supply Services Group commingled the balancing of their unregulated shipper services transportation customers with their captive firm and interruptible sales customers.

C. Comments of Aquila

Aquila, in response to Pro-Corn's comments, argued that its Swing Select balancing service has never been a regulated service.

D. Comments of the DOC

The DOC stated that Aquila's Swing Select service was never a regulated service. However, the DOC argued that the Commission could investigate whether Aquila either offered a regulated service without Commission approval or represented that the non-regulated services were subject to regulation.

E. Commission Action

The Commission recognizes that there are several open contested case proceedings involving Aquila and the Commission declines to open a general investigation of LDC agency services at this time. Such a general investigation, with no clear direction and scope, is not in the interest of administrative efficiency.

ORDER

1. The Commission hereby approves Pro-Corn's withdrawal of its Complaint against Aquila and closes this docket.

2. Aquila shall treat all future requests for end user allocation agreements on a nondiscriminatory basis.

3. Aquila is required to offer a regulated Large Volume Daily Balancing Service. To this end, Aquila is required to, and Pro-Corn, OTESCO and the DOC are requested to, participate in jointly developing and submitting a regulated large Volume Daily Balancing Service for Commission review within 60 days from the date of this Order. This issue is assigned to Docket No. G-007,011/M-03-276, *In the Matter of a Filing by Aquila, Inc. to Establish a Large Volume Daily Balancing Service.*

4. Aquila shall show cause within 30 days of this Order why the sale of its gas merchant business to Cornerstone Energy is not subject to regulatory review. This issue is assigned to Docket No. G-007,011/CI-03-277, *In the Matter of an Investigation into Aquila, Inc.'s Sale of its Shipper Services.*

5. The authority to establish or change time periods for filings in this docket and any other docket stemming from this proceeding is hereby delegated to the Commission's Executive Secretary.

6. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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