

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO**

DOCKET NO. 00D-261G

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IN THE MATTER OF THE PETITION OF K N WATTENBERG TRANSMISSION, LLC, FOR A DECLARATORY ORDER THAT THE COLORADO PUBLIC UTILITIES COMMISSION HAS NO JURISDICTION OVER ITS DELIVERY LATERAL WHICH INTERCONNECTS WITH THE TRANSMISSION LINE OF COLORADO INTERSTATE GAS COMPANY AND IS USED TO DELIVER GAS TO TWO INDUSTRIAL USERS FOR WHOM THE LATERAL WAS BUILT.

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DOCKET NO. 00A-635G

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IN THE MATTER OF THE APPLICATION OF K N WATTENBERG TRANSMISSION LIMITED LIABILITY COMPANY FOR SUCH AUTHORITY AS MAY BE NECESSARY FOR THE COMMISSION TO ASSUME THE EXERCISE OF REGULATORY SUPERVISION OVER THE TRANSPORTATION OF INTERSTATE GAS THROUGH A FIVE-MILE LATERAL FROM AN INTERCONNECTION WITH THE TRANSMISSION PIPELINE OF COLORADO INTERSTATE GAS COMPANY TO TWO INDUSTRIAL CUSTOMERS LOCATED ON THE OUTSKIRTS OF THE CITY OF FORT MORGAN, COLORADO, INCLUDING: 1) A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY, 2) AUTHORIZATION TO PROVIDE SUCH SERVICE IN ACCORDANCE WITH EXISTING CONTRACT TERMS, CONDITIONS AND RATES, AND/OR 3) SUCH OTHER AUTHORITY AS THE COMMISSION MAY FIND TO BE NECESSARY OR DESIRABLE.

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**COMMISSION DECISION DENYING  
EXCEPTIONS, WITH CLARIFICATION**

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Mailed Date: May 17, 2004

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# **I. BY THE COMMISSION**

## **A. Statement**

1. This matter comes before the Commission for consideration of Exceptions to Decision No. R03-0831 (Recommended Decision). In that decision, the Administrative Law Judge (ALJ) recommended that the Commission grant a Certificate of Public Convenience and Necessity (CPCN) to Applicant K N Wattenberg Transmission, LLC (KNW) to provide gas transportation service to Leprino Foods Company (Leprino) and Excel Corporation (Excel) (collectively Customers) in Fort Morgan, Colorado. In arriving at his recommendation, the ALJ concluded that the gas transportation service previously provided by Intervenor the City of Fort Morgan<sup>1</sup> (City or Fort Morgan) to Leprino and Excel was substantially inadequate. Pursuant to § 40-6-109(2), C.R.S., Fort Morgan, Intervenor Public Service Company of Colorado (Public Service), and Commission Staff (Staff) have filed Exceptions to the Recommended Decision.

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<sup>1</sup> The City operates a municipal gas utility in and around Fort Morgan (discussion *infra*).

The Colorado Association of Municipal Utilities as *Amicus Curiae* filed its Brief in support of the Exceptions of Fort Morgan. KNW, Leprino, and Excel filed responses in opposition to the Exceptions. Fort Morgan and Public Service filed responses to Staff's Exceptions, and Staff filed its response to the Exceptions by Fort Morgan and Public Service.

2. Now being duly advised in the premises, we deny all Exceptions. We affirm the Recommended Decision and now grant a CPCN to KNW for operation of its pipeline to provide gas transportation service to Leprino and Excel.

**B. Procedural History**

3. These cases essentially concern a dispute between the City and KNW as to whether KNW will continue to provide gas transportation service to Leprino and Excel in the Fort Morgan area. In Docket No. 00D-261G, KNW requested a declaratory order that its ownership and operation of the pipeline serving the Customers did not make it a public utility subject to the Commission's jurisdiction; in Docket No. 00A-635G, KNW alternatively requested a CPCN to serve the Customers in the event we determined that KNW is a public utility subject to our jurisdiction.

4. The City operates a municipal gas pipeline utility in and around the Fort Morgan area, and Leprino and Excel are located entirely within the municipality. In fact, Fort Morgan previously provided gas transportation and sales service to these customers. Leprino is a manufacturer of dairy products; Excel is a beef processor. Both customers use substantial amounts of natural gas in their production processes. The City has estimated that at one time Leprino and Excel accounted for approximately 25 percent of its gas utility operations. In 1996, KNW, over objections by the City and under authority issued (but subsequently vacated) by the

Federal Energy Regulatory Commission (FERC), constructed a pipeline in the Fort Morgan area to provide gas transportation service to Leprino and Excel, thereby displacing service previously provided by the City.

5. In Decision No. C02-1224 (November 1, 2002), we resolved a number of issues regarding KNW's requests in these dockets. We determined: (1) KNW, by virtue of its ownership and operation of the pipeline serving the Customers, is a public utility subject to the Commission's jurisdiction; (2) the regulated monopoly principle, which generally prohibits the duplication of public utility facilities in a service territory, applies in this proceeding even though the City, as a municipal public utility, is exempt from Commission regulation; and (3) we are legally empowered to grant a CPCN to KNW to serve Leprino and Excel if we determine that the City was unwilling or unable to provide adequate service to the Customers. Decision No. C02-1224 remanded the matter to the ALJ for further investigation regarding the adequacy of the City's transportation service.

6. The ALJ conducted further hearings, and, in the Recommended Decision, concluded that Fort Morgan's transportation service to Leprino and Excel was substantially inadequate; therefore, the Commission should grant a CPCN to KNW to enable it to provide gas transportation service to the Customers. First, the ALJ determined that the transportation rates charged by Fort Morgan to the Customers cannot form a basis for finding inadequate service. Recommended Decision, pages 12 and 13. As noted above, at one time the City provided gas transportation service to the Customers. The City began providing service to Excel in 1990, and to Leprino in 1996. Initially, Fort Morgan charged \$.20/Mcf for transportation service. However, in November 1995 the City more than tripled this rate to \$.67/Mcf. After that rate increase, the

Customers approached KNW and suggested that it build a new pipeline to serve them. KNW, under authority (now vacated) issued by FERC, constructed the pipeline and began providing transportation service to Leprino and Excel in June 1998. The ALJ concluded that a finding of inadequate service cannot be based upon the City's rates, because such a finding would be inconsistent with the regulated monopoly principle. This conclusion is not challenged on Exceptions.

7. Second, the ALJ determined that the City had refused to provide firm transportation service to Leprino and Excel. Recommended Decision, pages 7, 8, 13, and 14. The ALJ found that, just prior to the start-up of its new plant, Leprino specifically requested that the City amend its transportation contract to clarify that Leprino's service would be "firm." The City refused to change the contract, and, in fact, represented to Leprino that transportation service was interruptible. In addition, the ALJ examined Fort Morgan's transportation tariff (quoted on page 10 of the Recommended Decision) and concluded that, according to the tariff, transportation service was interruptible. Under that tariff Fort Morgan reserved the right to deny or terminate transportation service if: (1) adequate capacity did not exist on the City's system to render the service; (2) continuation of transportation service would adversely affect the rates, terms, or conditions of service to the sales customers; (3) a change in the rates, terms, or conditions of wholesale service to transporter by a gas supplier would make it inappropriate to continue the service; or (4) such service posed a hazard to public safety. These conditions, according to the ALJ, indicated that the City's transportation service was discretionary and interruptible.

8. Finally, the ALJ determined that interruptible transportation service is not adequate service for the Customers. Recommended Decision, pages 14 and 15. The ALJ pointed out that both Leprino and Excel deal with perishable foods and neither had alternate fuel capability. As such, the Customers demonstrated a legitimate business need for firm transportation service. Fort Morgan responded that, in fact, transportation service to the Customers had never been interrupted. However, the ALJ determined that the fact that there were no interruptions did not mean that the Customers had suffered no consequences. For example, the ALJ noted, the City was not privy to the business considerations and strategies Leprino and Excel were forced to take to deal with the threat of interruption. Recommended Decision, page 14.

9. Based upon these considerations, the ALJ concluded that the City had provided unreasonable and inadequate service to the Customers. Consequently, the Commission should issue a CPCN to KNW to provide service to Leprino and Excel.

## **II. EXCEPTIONS FILED BY STAFF**

10. Staff agrees with the ALJ's conclusion that KNW be granted a CPCN; however, Staff disagrees with the ALJ's premise for granting such a CPCN. Apparently, Staff disagrees that the Commission can find substantial inadequacy of service based upon the service provided to only two customers. Staff appears to suggest that a finding of substantially inadequate service must be based upon the service provided by a public utility to the public in general. Staff also notes that KNW actually built the subject pipeline pursuant to FERC authority, but this Commission now has jurisdiction over the pipeline under the Hinshaw Amendment, 15 U.S.C. § 717(c). In these proceedings, Staff asserts, the Commission is "stepping into FERC's shoes"

and has simply accepted a "hand-off" of jurisdiction from FERC. According to Staff, the Commission's refusal to grant a CPCN to KNW would constitute a failure to exercise regulatory jurisdiction over the pipeline, and that failure would result in reversion of jurisdiction to FERC.

11. Staff argues that, instead of issuing a CPCN here based upon a finding of substantial inadequacy of service (by Fort Morgan), the Commission should use a "bypass analysis." Staff's "bypass" analysis holds: In this case, two regulatory authorities, the Commission and the City, have jurisdiction to authorize utility service to the Customers. Notably, the Commission has the authority to issue a CPCN to KNW even though the City is providing utility service in the area, and even though the Customers are located within the Fort Morgan municipal boundaries. Because the Commission has overlapping jurisdiction with the City, the Commission may permit the Customers to obtain service from KNW without violating the regulated monopoly principle. Staff urges the Commission to issue a CPCN relying upon this "bypass analysis," asserting that denial of a CPCN would result in reversion of jurisdiction over the KNW pipeline to FERC.

12. We deny Staff's Exceptions. We note that Staff's bypass analysis has no precedent in Colorado. Certainly, Staff cited no authority for its assertion that permitting a customer to bypass an existing serving utility would not violate the regulated monopoly principle, and we are unaware of any such authority. In our view, allowing a customer to bypass an existing public utility (without a finding of substantially inadequate service) is precisely what is forbidden under the principle of regulated monopoly. The ALJ considered whether a CPCN should be issued here based upon the adequacy of the City's service to Leprino and Excel in accordance with our order

of remand (Decision No. C02-1224). We reject Staff's suggestion to issue a CPCN on grounds other than the adequacy of the City's service.<sup>2</sup>

### **III. EXCEPTIONS FILED BY THE CITY AND PUBLIC SERVICE**

#### **A. Overview**

13. Gas pipeline utilities in Colorado are subject to the principle of regulated monopoly. That principle generally prohibits the duplication of pipeline facilities in an area by providing for exclusive service territories for public utilities. *Public Service Company v. Public Utilities Commission*, 765 P.2d 1015 (Colo. 1998). However, under the principle of regulated monopoly, the Commission is empowered to certify another public utility for an area already served by an existing utility, if the existing utility is unable or unwilling to provide adequate service. The test of adequacy of service is not perfection. Instead, in order to certify a new utility for an area already served by an existing utility, the Commission must find that the present service is substantially inadequate. *RAM Broadcasting of Colorado, Inc. v. Public Utilities Commission*, 702 P.2d 746, 750 (Colo. 1985); *Ephraim Freightways, Inc. v. Public Utilities Commission*, 380 P.2d 228, 232 (Colo. 1963).

14. The main arguments in the Exceptions filed by the City and Public Service concern the service adequacy issue. In Decision No. C02-1224, the Commission ruled that the regulated monopoly principle<sup>3</sup> applies, but the Commission could grant a CPCN to KNW if the

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<sup>2</sup> In addition, we observe that important elements of Staff's argument (*e.g.*, that the Commission may certificate duplicative utility service within a municipality [absent a finding of substantially inadequate service] without violating the regulated monopoly principle, and refusal to grant a CPCN to KNW would result in reversion of jurisdiction over KNW's facilities to FERC) are beyond the scope of proper Exceptions to Decision No. R03-0831. In Decision No. C02-1224 (pages 13 through 15 and 25 through 30), we rejected such arguments. We also directed that requests for reconsideration of those rulings should be filed only after our decision on the remanded proceedings (*i.e.*, the instant order). See Decision No. C02-1224, ordering paragraph 4.

<sup>3</sup> Section 40-5-101, C.R.S., and associated case law.

City provided substantially inadequate service to the Customers. In that decision the Commission remanded the matter back to the ALJ to determine: 1) the validity of specific evidence related to service adequacy; and 2) whether these service adequacy issues warrant the award of a CPCN to KNW.

15. We agree with all findings and the disposition of the case established in the Recommended Decision, except as discussed herein. We concur with the ALJ that the City failed to provide firm transportation service, a service which is essential to Leprino and Excel, and that this service inadequacy warrants the award of a CPCN to KNW. We agree with the City and Public Service that one of the ALJ's findings related to service adequacy should be rejected. However, an analysis of the Commission's rules leads to an additional Commission finding regarding the inadequacy of the City's service.

16. Gas transportation service is now the backbone of many industrial and commercial businesses, such as Leprino and Excel. This is the first case in Colorado that provides a ruling on the transportation service adequacy issues raised in this Docket. The "substantial" inadequacy that is necessary to allow a second utility into a monopoly service territory is to be determined by the Commission on a case-by-case basis, giving proper weight to all evidence. Regardless of the many circumstances in this case that distract from service adequacy considerations, it is essential that we maintain a transportation service adequacy standard here that is consistent with the Commission's rules and well established industry standards.

17. The Commission and the parties have expended considerable effort to evaluate the City's service adequacy. The ALJ held hearings and evaluated evidence before finding the City's

service to be substantially inadequate. The City refused to provide firm transportation, as demonstrated by its tariffs and other evidence in the record. Although the City claims that its transportation is, and always has been, “firm,” an analysis of the service shows that it is inadequate when compared with industry standards. Further, the City intentionally broke commitments that it previously made to the Customers, and two City directors of utilities represented the City’s Transportation Service as interruptible. The City’s actions here are inconsistent with the commitment that is necessary in providing firm service. Because the City was not willing to provide firm transportation, KNW’s firm transportation service does not duplicate the City’s utility service. The City’s failure to provide adequate transportation service meets the substantial inadequacy test (for purposes of granting a CPCN to KNW) established in case law associated with § 40-5-101, C.R.S., and warrants the award of a CPCN to KNW. We reiterate that our decision here is based on the facts and circumstances of this case, and any determinations in similar cases in the future must be made based on the individual merits of those cases.

**B. The Commission’s Transportation Rules**

18. The Exceptions filed by the City and Public Service reveal two areas where the Commission’s transportation rules, 4 *Code of Colorado Regulations* (CCR) 723-17, are relevant. In the first area, the City and Public Service take exception to the ALJ’s finding that KNW offered superior service because the City’s residential service has a higher interruption priority than its industrial transportation service, as well as the ALJ’s consideration of this fact in assessing the City’s service adequacy. In the second area, the City argues that the transportation rules specifically allow transportation service to be interrupted. Furthermore, the rules do not require utilities subject to the Commission’s jurisdiction to provide firm transportation service.

The rules only require utilities to provide transportation to the "extent of available capacity." A Commission ruling that the City provided inadequate transportation service because it was interruptible would amount to applying a new rule to the City. Alternatively, the Commission would be holding the City to a higher standard than applies to jurisdictional utilities.

19. First we point out that Commission Rule 4 CCR 723-17 requires jurisdictional utilities to provide transportation service:

4.1 – Each LDC and IWP shall file with the Commission within sixty (60) days after the effective date of these rules, tariffs setting forth the rates, or rate design methodology, terms, and conditions for providing gas transportation. [Rules were effective May 30, 1991.]

20. Next, Commission Rule 4 CCR 723-17-2.4 contains the following requirements:

**2.4 INTERRUPTIONS AND CURTAILMENTS OF NATURAL GAS SERVICES**

(a) An interruption shall be in accordance with the same system of class-by-class priorities as is applicable to sales customers under the public utility's sales tariffs.

(b) Within each class, a transportation customer may be interrupted on an equitable basis, consistent with system constraints. Within a locale, a transportation customer shall be interrupted on a fair and reasonable basis consistent with local conditions.

21. Rule 2.4(a) requires utilities to use the same interruption priorities between classes for transportation service as it uses between sales customer classes. That is, utilities are required to prioritize interruptions between industrial, commercial, and residential classes in the same manner for transportation service as they do for sales service.

22. Rule 2.4(b) states that utilities can only interrupt transportation customers on an equitable basis within a class (*i.e.*, residential, commercial, or industrial classes). That is, transportation customer interruptions must be equitable when considering other customers within the same service class, consistent with system constraints. The rule goes on to require transportation customers within a locale to be interrupted on a fair and reasonable basis.

23. With respect to the first area where the Commission's Rules are relevant, we agree with the City and Public Service that the ALJ improperly found that the residential service priority contained in the City's tariffs could be used to show that KNW's transportation is superior to the City's transportation service. Rule 2.4(a) explicitly requires jurisdictional utilities to maintain class-by-class priorities, such as residential over industrial. This is important, as the implementation of transportation service should not interfere with long-standing policy to interrupt industrial customers before certain other classes to protect the health, safety, and welfare of residential customers, at a minimum. We agree with the City and Public Service that such class-by-class priorities cannot be used as a basis for determining whether the City's transportation service is firm.

24. In its Exceptions, the City points out that Rule 2.4(b) allows transportation service to be interrupted. However, Rule 2.4(b) also establishes the requirement that the utility must treat transportation customer interruptions equitably with other customers in the class. The record clearly establishes that the City held industrial sales at a higher priority than industrial transportation. Leprino provides a well-documented description of its choice to purchase the more expensive sales service rather than the City's transportation service. Leprino's choice to purchase the more expensive sales service, as well as an analysis of the City's tariff provisions

discussed below, demonstrate that the City offered transportation service that was subordinate to sales service for the industrial customer class. While the Commission's rules do not explicitly require "firm" transportation service, and allow transportation service to be interrupted, the rules require interruption on an equitable basis within a class. The transportation tariffs for the two Commission-jurisdictional local distribution companies (LDC) associated with this case, Public Service and Kinder Morgan, Inc. (Kinder Morgan),<sup>4</sup> provide examples of reasonable interpretations of Rule 2.4(b).

25. Public Service's tariffs explicitly establish interruption priorities between industrial sales and industrial transportation at the same level. In pertinent part, Public Service's Tariff Sheet T16 states:

**PRIORITY OF SERVICE**

Unless conditions otherwise warrant, Firm Gas Transportation Service shall have priority over interruptible Gas Transportation Service. The Capacity Interruption of gas deliveries in whole or in part under this tariff shall not be the basis for claims for damages sustained by Shipper or Receiving Party.

Specific interruption of transportation service shall be made in the following order:

(a) Authorized Imbalance Resolution Gas under Firm and Interruptible Transportation Service Agreements prorated based on confirmed Nominations for each Shipper;

(b) Authorized overrun deliveries in excess of the Peak Day Quantity under Firm Transportation Service Agreements and the Maximum Daily Transportation Quantity under Interruptible Transportation Service Agreements prorated based on confirmed Nominations;

(c) All other interruptible transportation service at a discounted rate by order of the rate being paid by Shipper for the transportation service from lowest to highest. If two or more Shippers are paying the same discounted rate then the Capacity Interruption shall be prorated based upon confirmed Nominations;

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<sup>4</sup> Kinder Morgan, Inc., who is affiliated with KNW, provides distribution utility service in Colorado that is jurisdictional to the Commission.

(d) All interruptible transportation service at the standard rate prorated on the basis of confirmed Nominations;

(e) **All firm transportation service in accordance with the same system of class-by-class priorities as is applicable to Company's sales customers;\***

(f) Nothing in this provision shall limit Company's right to interrupt service as necessary in order to ensure system integrity or to reflect the operational characteristics of Company's system.

26. Kinder Morgan's tariffs also provide interruption priorities in this same manner.

In pertinent part, Kinder Morgan's tariff Sheet No. 123 states:

#### PRIORITIES FOR INTERRUPTION OF SERVICE

##### PRIORITY 1 (Highest Priority – Firm **Sales or Firm Transportation**)\*

Requirements of persons using natural gas in dwellings for residential purposes, including apartment buildings and other multi-unit buildings, and requirements of small commercial consumers (including public and private institutions and local, state and federal governmental agencies) having requirements on a peak day of less than fifty (50) Mcf for purposes other than those involving manufacturing or electric power generation, including all requirements:

- (1) in a school, defined as a facility the primary function of which is to deliver instruction to regularly enrolled students in attendance at such facility;
- (2) in a hospital, defined as a facility the primary function of which is delivering medical care to patients who remain in the facility, including nursing and convalescent homes;
- (3) for police and/or fire protection and in sanitation and correctional facilities.

##### PRIORITY 2 (Second Highest Priority – Firm **Sales or Firm Transportation**)\*

Any use of natural gas which has been certified by the Secretary of Agriculture as an essential agricultural use under Section 401(b) of the Natural Gas Policy Act unless the Commission, in consultation with the Secretary of Agriculture determines, by rule or order that the use of an alternative fuel is economically practicable and reasonably available. The definition of "alternative fuel" shall be that stated in 18 CFR 281.303(b) as amended from time to time. Peak day

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\* Bold typeface added to emphasize that the tariff identifies Sales OR Transportation as equal.

volumes shall be based on current requirements unless such volumes exceed contract or certificate limitations.

**PRIORITY 3 (Third Highest Priority – Firm Sales or Firm Transportation)\***

All uses by commercial consumers having requirements on a peak day of fifty (50) Mcf or more except for boiler fuel use by commercial consumers having requirements on a peak day of more than three hundred (300) Mcf, and all industrial consumers for feedstock and process needs having requirements on a peak day of not more than five hundred (500) Mcf and for ignition fuel and flame stabilization for boilers when fired by other fuels. An industrial consumer requiring gas for ignition fuel and flame stabilization shall not take more gas for this purpose than is required for safe operation of its plant but shall not take more gas on any day than the volume shown in Priority 3 as peak day requirement.

**PRIORITY 4 (Fourth Highest Priority – Firm Sales or Firm Transportation)\***

- (1) Essential Industrial Process and Feedstock uses of consumers having a peak day requirement in excess of five hundred (500) Mcf.
- (2) Firm Service for which there is no end use information or firm service not specified in any other priority.

**PRIORITY 5 (Fifth Highest Priority – Interruptible Sales or Interruptible Transportation)\***

- (1) Receipts, transportation, and deliveries of requirements for boiler fuel use by industrial and commercial customers having requirements for such use on a peak day of more than three hundred (300) Mcf and deliveries of requirements for other industrial uses having a peak day requirement for such use of more than five hundred (500) Mcf and,
- (2) Any service provided on an interruptible basis.

27. Both Public Service and Kinder Morgan provide residential service that has a higher priority than industrial service, consistent with Rule 2.4(a), and establish industrial sales and industrial transportation priorities that are exactly equal, consistent with Rule 2.4(b). In contrast, the City provides industrial sales service at a higher priority than its industrial

transportation service.<sup>5</sup> We find that the City's transportation service does not meet the requirements of Rule 2.4(b).

28. Next, we discuss the City's assertion that the rules only require utilities to offer transportation service "to the extent of available capacity." The City relies on Rules 2.3 and 2.3(a), which state:

### 2.3 DETERMINATION OF AVAILABLE CAPACITY

The obligation to provide transportation shall be subject to reasonable capacity constraints.

- (a) In determining whether capacity is available to provide requested transportation, a public utility shall take into account all conventional methods of delivering natural gas through its system, including fronthaul, compression, exchange, flow reversal, backhaul, and displacement. The public utility is not required to perform exchanges or displacements over segments of its system which are not physically connected.

29. However, Rule 2.3(b) states:

- (b) In the event that available capacity is inadequate to provide the requested transportation, the public utility shall provide the necessary facilities pursuant to an agreement by the parties for payment consistent with the public utility's extension policies.

30. Rule 17-4.2(e)(2)(H) requires each utility to establish a line extension policy in its tariff. A line extension policy typically obligates the utility to install facilities up to a specific cost level. If the facilities required to serve the customer exceed this cost, then the customer

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<sup>5</sup> We recognize that Public Service and Kinder Morgan provide interruption priorities between industrial sales and transportation that are "equal," even though Rule 2.4(b) requires interruption on an "equitable" basis. As stated in the Recommended Decision, Leprino and Excel do not have alternate fuel capability and have a legitimate need for firm service. Therefore, the City's practice of offering either firm sales or interruptible transportation service to its industrial customers cannot meet the requirement of Rule 2.4(b) to interrupt on an equitable basis within a class. *See* section E, Adequacy of City's transportation service, for a detailed discussion of the City's interruptible transportation service.

must pay for costs in excess of the specified cost level. The utility's obligation to serve all customers within its service territory is fulfilled, in an equitable manner, through this line extension policy. Each jurisdictional utility has the obligation to offer necessary capacity to all customers, under sales or transportation service.

31. The City is not within the Commission's jurisdiction, and is not required to comply with Commission rules. However, we find the City's argument to be without merit that the Commission is creating a new rule or is holding the City to a higher standard than applies to jurisdictional utilities. Further, the Commission's rules and examples of LDC service priorities provide benchmarks that can be used to determine the reasonableness of the City's service. The City's transportation service is inadequate when compared against these benchmarks.

**C. Requirement to Offer Transportation Service**

32. Although the City claims that its transportation service has always been "firm," it provides a separate argument that its service is adequate even if it were not firm. The City and Public Service assert that the City was not required to provide firm transportation service because it provided firm sales service. The availability of firm sales service to the Customers means that the City's service was adequate regardless of the type of optional transportation service it provided (firm or interruptible), or even if it provided no transportation service at all. We reject this argument. Transportation service is a standard offering for gas utilities, including interstate pipelines and LDCs.

33. Federal rules require all interstate pipeline companies to provide only transportation service. In 1985, FERC Order 436 required interstate pipelines to provide transportation service in addition to wholesale sales service. In 1992, FERC Order 636 mandated

the separation of commodity sales from transportation service. Interstate pipelines must offer transportation service and are prohibited from offering sales service. An unregulated affiliate of the interstate pipeline can sell gas commodity in competition with other suppliers, but interstate pipelines must deliver the gas through transportation service.

34. As is demonstrated in KNW's tariffs, FERC implemented this transportation-only policy through a system designed around firm transportation, with an explicit prioritization of service (*i.e.*, primary firm, secondary firm, interruptible). The City's sales service gas is transported through Colorado Interstate Gas Company under FERC-jurisdictional tariffs. As a transportation customer itself, the City is certainly familiar with the FERC-mandated interstate transportation, including its interruption prioritization policy and industry terminology.

35. As stated previously, the Commission's transportation Rule 17 requires jurisdictional utilities to provide transportation service, and requires utilities to interrupt transportation service on an equitable basis within a class. Though the City is not bound by our rules or federal standards, they provide a reasonable benchmark for utility service.

36. Leprino and Excel do not have alternate fuel capability and have a legitimate need for firm service. Further, both Leprino and Excel testified that they operate in competitive markets with very narrow profit margins. It would unfairly penalize the Customers if their only firm service option was for sales service, while their competitors can avail themselves of firm gas transportation service as a standard offering from interstate pipelines and LDCs.

37. Most industrial customers in Colorado, as well as nationwide, currently subscribe to transportation service. All interstate transmission service is provided through transportation,

Commission rules require LDCs to offer transportation service, and the Customers demonstrated a legitimate need for firm transportation service. Therefore, we find that the availability of firm sales service does not relieve the City of its duty to provide firm transportation service within its monopoly service territory.

**D. Rate Arguments**

38. The City and Public Service argue that, in fact, the dispute here is not about whether the transportation service was adequate, but about the rates for the service. The Commission cannot grant a CPCN to KNW based on a complaint about rates, thus allowing the Customers to choose their utility provider.

39. We agree that rates were a significant factor in this case. The ALJ correctly ruled on the rate issues. In paragraph 23 of the Recommended Decision, the ALJ states:

The purpose of the inquiry on remand is to determine whether Fort Morgan was providing adequate service to Leprino and Excel. The parties have addressed the question of whether the rates being charged by Fort Morgan could constitute inadequate service [footnote omitted]. After reviewing the applicable cases and the arguments submitted by the parties, the undersigned concludes that Fort Morgan's rates cannot form a basis for making a finding of inadequate service. *The Town of Fountain v. PUC*, 447 P.2d 527 (Colo. 1968) presented facts significantly different from those at issue here. *Fountain* had failed to extend its facilities, charging customer contributions to make required service extensions in an amount such that it was tantamount to a denial of service. This contrasts with the City here constructing an operating facility without requiring customer construction contributions. As Fort Morgan notes, the City set its rates through the normal ratemaking process, and those rates were never appealed. Fort Morgan states its argument as follows:

Fort Morgan is not aware of any case where a utility has been deemed to have denied service to customers based on its lawfully set rates. The implications of such a finding would be staggering. It would allow any customer to leave any utility's system because the customer found a better

rate. That kind of result is anathema to the regulated monopoly principle. [footnote omitted].

40. We agree that the regulated monopoly principle prohibits customers from choosing between utilities based on rates alone.

41. Although we agree that rates were a factor in the Customers' decision to pursue an alternate provider, we do not agree that the Commission is then precluded from considering evidence regarding service adequacy. The regulated monopoly principle requires that the Commission eliminate a duplication of service in favor of the first utility, but only if this utility is able and willing to serve. This service adequacy condition in the regulated monopoly principle is necessary as an integral component of monopoly service. If a utility is unable or is unwilling to provide a necessary service, then a monopoly territory is intolerable. Regardless of the significance of rate issues in this case, we must assess the adequacy of the City's service with full diligence.

42. Although we do not consider the level of the City's rates in determining service adequacy, some of the City's actions in implementing the rates demonstrate inadequate service.

43. For example, we note the ALJ's finding that the City broke its agreement with the customers regarding the level of rates, and we consider this action in assessing the City's service adequacy.

44. We also note the ALJ's finding that Leprino wanted and needed firm service, but was forced to take the cheaper interruptible transportation service when the rates were more than tripled.

45. That the City refused to meet with Leprino and Excel is another fact tending to show inadequate service. On one occasion, Leprino and Excel scheduled a meeting with the City Council and Mayor. After the Customers' personnel traveled from out of town, the Mayor and City Council refused to meet with the Customers' representatives. Although customers cannot choose between utilities to obtain a cheaper rate, we find that the City's actions in administering the service are consistent with a finding of inadequate service.

**E. Adequacy of City's Transportation Service.**

46. The City argues that, regardless of whether its transportation service is characterized as firm or interruptible, the City was (and is) willing and was (and is) capable of providing adequate transportation service to the Customers. The facilities directly serving the Customers were built specifically to serve the Customers, and the City is willing to expand the facilities if necessary. The Customers were never interrupted, nor was there ever a threat of interruption. In fact, the City even provided gas supply when the Customers' supplier failed. The City argues that its transportation service was not interruptible, but comparable to the firm transportation provided by KNW and other companies. The City's tariff reserved the right for the City to interrupt service to the Customers in order to protect the interests of its retail (sales) customers. The City asserts that these are reasonable provisions and consistent with practice by other companies. For example, utilities commonly give priority (in the event of necessary interruptions) to residential and small commercial customers.

47. The facts related to the City's interruption record and its providing back-up supply are consistent with both firm and interruptible service. The City received payment for the back-up service it provided, a practice that is consistent with interruptible and firm service. That the

City did not actually interrupt service does not make the service “firm,” as “interruptible” service can be provided without actual interruption for substantial periods of time. In general, these facts and arguments do not support a determination that the City’s service was firm. We agree with the ALJ’s assessment of this issue in paragraph 28 of the Recommended Decision:

Staff and Fort Morgan take the position that interruptible service cannot in this instance be inadequate because Fort Morgan never interrupted service. Yet both Excel and Leprino have a distinct need for firm service. The fact that there was no interruption does not mean that Excel and Leprino have not suffered consequences. For example, neither Staff nor Fort Morgan are privy to the business considerations and strategies that Excel and Leprino were forced to take in order to deal with the threat of interruption. . . .

48. The City argues that the ALJ made an improper finding in the last sentence of this statement. We disagree. Although the City never threatened to interrupt the Customers, its tariffs and representations made by two City directors that the service was interruptible could reasonably result in the Customers taking steps to deal with a potential interruption. The ALJ did not find that such events were part of the record; rather he explained that the Customers could be affected by the City’s interruptible transportation service, even in the absence of a direct threat of interruption.

49. One significant difference between firm and interruptible transportation service relates to the utility’s commitment to provide the service in the future. This concept is described in KNW witness Kaup’s testimony, on pages 95 and 96 of the June 7, 2001 transcript:

Firm transportation service is that service which the transporter has determined it has capacity to provide on a consistent basis and for which it has obligated itself by contract to provide. Firm service commitments cannot subsequently be denied or terminated simply to the discretion of the transporter. . . .

Interruptible transportation service is that service which transporter at any time may deny or terminate in whole or in part in the exercise of its discretion and in order to provide service to other customers for whom the pipeline system capacity

has been reserved. Interruptible service is a service that the transporter has no firm obligation to provide.

50. Witness Kaup's description of firm service accurately describes a utility's obligation to serve the customers within its service territory. Under firm service, the utility commits that it will provide the service in the future. In contrast, if a utility provides interruptible service, it reserves the right to stop providing the service in the future. For transportation service, the utility establishes its commitment to provide service in the future in its tariffs and transportation contracts. We agree with the ALJ's assessment of the City's tariffs, in paragraph 25 of the Recommended Decision:

While Fort Morgan urges that its tariffs provide service that is just as firm as KNW's, the terms of the tariffs indicate otherwise. KNW's tariffs evidence a firm commitment to provide present and future service and discuss interruptions in service which appear to be temporary in nature. The Fort Morgan tariffs, on the other hand, allow it to terminate[footnote omitted] service whenever adequate capacity does not exist, with no obligation to expand facilities or to continue to serve the shipper. This failure to commit to present and future service is indicative of interruptible rather than firm service. In addition, the City's tariffs allow for termination of transportation service if it would adversely affect the rates, terms, and conditions of service to the transporter's retail customers. Again, this does not show a commitment to continuous firm service but rather service at the convenience of the City. Finally, the discretion given to the City to terminate service if a change in the rates and/or terms and conditions of wholesale service to transporter makes it inappropriate to continue the transportation service is further indicative of the discretionary nature of this service. KNW's tariffs, on the other hand, appear to incorporate more standard *force majeure* type conditions of a temporary nature, with an indication of intent to continue service beyond temporary curtailments.

51. We agree with the ALJ's analysis. The City's tariff language allows it the discretion to permanently discontinue service, while KNW's tariff contains *force majeure* language that is more temporary in nature.

52. We disagree with the City that the only difference between its tariff and KNW's tariff is that the City provides service to retail sales customers. Contrary to the City's assertion that the capacity termination clause in its tariffs is the same as KNW's capacity curtailment clause<sup>6</sup> and Public Service's capacity interruption clause, we find that these comparisons reinforce the ALJ's findings. Whether or not the KNW and Public Service clauses are located within the *force majeure* sections of the tariffs, those clauses contemplate a short-term disruption of service that is consistent with temporary conditions. The City's termination clause implies a more permanent discontinuance of service.

53. We further disagree with the City's statement that its transportation is not "at its convenience." We find that the terms in its tariff go beyond the typical *force majeure* tariff language. For example, as discussed previously it is proper to grant a priority to certain classes (*e.g.*, residential), but holding industrial sales at a higher priority than industrial transportation goes beyond standard terms.

54. Further, we agree with the ALJ's finding that the City, through two different Directors of Utilities, represented that its transportation service was interruptible, and that it denied Leprino's request to insert the word "firm" in its transportation contract. We disagree with the City's assertion that the City directors' use of the term "interruptible" only meant that the City could not guarantee that the gas would be delivered at the City gate. As a customer of an interstate pipeline, the City certainly understands the meaning of the terms "interruptible" and "firm" in the gas industry. We further reject the City's assertion that it refused to insert the word "firm" in the contract only because the language would be confusing. If the location in the

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<sup>6</sup> The City points out that this clause is not contained in the *force majeure* section of KNW's tariff.

contract were the problem, the City could have stated elsewhere in the contract that the transportation service was firm. Leprino initially chose to subscribe to the higher priced sales service because it required firm service. Leprino's documentation of discussions and correspondence with the City and its initial choice to purchase the more expensive sales service<sup>7</sup> provide credible evidence that the City offered either firm sales service or interruptible transportation service.

55. The Commission explicitly directed the ALJ to assess the adequacy of the City's transportation service, and to make a ruling on whether these issues warrant an award of a CPCN to KNW. The ALJ then held hearings to investigate service adequacy. The ALJ is in the best position to assess the credibility of witnesses, review records, and question the witnesses. Therefore we give significant weight to the ALJ's findings and ultimate conclusion that the City's transportation service was interruptible.

56. The City notes that it installed pipeline facilities, in large part, to serve the Customers. However, the City built these facilities as a part of its agreement for the Customers' facility expansions in Fort Morgan. The City later broke this agreement. As discussed previously, a fundamental principle that establishes firm transportation service is a commitment to provide service into the future. The City knowingly and willingly broke its agreement with the Customers, and maintained tariffs that explicitly allow the City to terminate transportation service to the Customers. Although the City installed facilities as a part of its efforts to entice the Customers to expand their business in Fort Morgan, the City's subsequent actions demonstrate a deliberate and intentional avoidance of future service commitment. While the City installed

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<sup>7</sup> See Section F, Voluntary Choice of Transportation, for a detailed discussion of this issue.

necessary capacity so that it was *able* to serve the Customers, it intentionally withheld firm transportation, demonstrating that it was *unwilling* to provide a necessary service.

**F. Voluntary Choice of Transportation**

57. The City argues that the Customers voluntarily chose the City's transportation service as reflected in the disputed tariff. Therefore, they waived any right to argue that the service is inadequate.

58. We agree with the ALJ that the Customers' choice to enter transportation service was not a waiver of their right to argue that the service was inadequate. As stated in the Recommended Decision, Leprino initially opted for the more expensive firm system supply, but had to take interruptible transportation after the City more than tripled the rate. Leprino clearly demonstrated that it wanted and needed firm service, but was forced to take the cheaper interruptible transportation service when the rates were more than tripled. Although Excel did not request firm service, both of the Customers have a legitimate need for firm service, as neither has back up supply capability.

**G. Failure to Exhaust Administrative Remedies**

59. The City asserts that the Customers failed to exhaust administrative remedies that were available. According to the City, the Customers should have exercised the established procedures such as submitting informal and formal complaints with the City to address any concerns with the City's service instead of recruiting KNW to build a new pipeline. The City further claims that the Customers only complained to the City about rate issues, and not the adequacy of the City's transportation service.

60. We disagree. Leprino discussed the firm transportation issue with two City utility representatives, but the City refused to provide firm transportation. Leprino and Excel then worked together with KNW to build the pipeline. The Customers did raise the issue with the City, and we disagree that they had the obligation to then raise their concerns to the City at a different level. Further, the Customers did try to raise rate concerns at a higher level in the City by initiating a meeting with the Mayor and City Council, but they refused to meet with the Customers. It is not reasonable to expect the Customers to raise issues at multiple levels in the City. In any case, we agree with the ALJ that KNW did not have an interest in the City's proceedings, and this argument is not applicable to the KNW CPCN proceeding.

#### **H. Policy Arguments**

61. The City and Public Service make a general "cream-skimming" policy argument. They state that affirming the Recommended Decision on the grounds that the City provided inadequate transportation service because the service was interruptible (*e.g.*, subordinate to sales service) will subvert the regulated monopoly principle. Under this principle, public utilities have an obligation to serve everyone. Affirming the Recommended Decision would allow "boutique" pipeline companies or "designer gas services" to cream-skim the most attractive customers (high load-industrial customers) by building pipelines to serve only them.

62. We disagree with this argument. If a utility is unwilling to provide a necessary service, an alternate supplier is benefiting the public by providing the service. Because the City refused to provide firm transportation, KNW is not duplicating any monopoly protected service. Therefore, the cream-skimming argument does not apply. In a case where the first utility is willing and able to provide a service, the regulated monopoly principle prohibits a second utility

from providing “boutique” services. Rather than subverting the regulated monopoly principle, our ruling here clarifies that transportation is an essential utility service that is included within the regulated monopoly principle.

63. Public Service also argues that affirming the Recommended Decision will set a precedent that would allow duplicative facilities where a customer shows a “legitimate business need” for any new service in an effort to obtain service from another provider. We disagree. KNW offered and the City refused to offer firm transportation service. As discussed in Section C, Requirement to Offer Firm Transportation, this service is a standard utility offering for interstate pipelines and LDCs. Our decision does not endorse “ostensibly new services,” but allows customers to receive standard utility service.

64. If we deny KNW’s CPCN application, we would condone the City’s actions of intentionally withholding a necessary service. Such a ruling would mean that transportation service is not afforded the same regulatory protections that are applicable to the traditional utility sales service. Alternately, the ruling would mean that the Commission has no authority to consider service inadequacy in any CPCN application where the utility states that it is able and willing to serve, regardless of the facts associated with the utility’s service. CONCLUSION

65. The Commission has never before ruled on service adequacy issues associated with transportation service, and it is our duty to provide a ruling that is consistent with our rules and industry standards. The record in this case demonstrates that the City refused to offer firm transportation service to customers who have a legitimate need for firm service. The City refused to insert the word “firm” in its transportation contracts. Two City Directors of Utilities stated that the City’s transportation service is interruptible. The City maintained tariffs that allow it to

terminate transportation service in a manner inconsistent with firm service. The Mayor and City Council refused to meet with the Customers, after the Customer representatives traveled in from out of town. The City intentionally broke an agreement with the Customers, and its administration of utility service is consistent with a finding of inadequate service. KNW met its burden to show that the City withheld a necessary service, contrary to well-established federal transportation standards and Commission rules for LDCs, thus warranting the award of a CPCN to KNW.<sup>8</sup>

#### **IV. ORDER**

##### **A. The Commission Orders That:**

1. The Exceptions to Decision No. R03-0831 by Staff of the Commission are denied consistent with the above discussion.
2. The Exceptions to Decision No. R03-0831 by the City of Fort Morgan are denied consistent with the above discussion.
3. The Exceptions to Decision No. R03-0831 by Public Service Company of Colorado are denied consistent with the above discussion.
4. K N Wattenberg Transmission Limited Liability Company is granted a certificate of public convenience and necessity to provide gas transportation service to Leprino Foods Company and Excel Corporation in Fort Morgan, Colorado through its existing pipeline as of the

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<sup>8</sup> KNW's response to the Exceptions and the *amicus* brief by CAMU raise arguments beyond the scope of proper Exceptions to the Recommended Decision. Specifically, those pleadings raise issues that we decided in Decision No. C02-1224. And, as noted above, we previously ruled that requests for reconsideration of Decision No. C02-1224 should be filed after our decision on remand (*i.e.*, this order). Therefore, we do not address these arguments made by KNW and CAMU.

effective date of this Order. K N Wattenberg Limited Liability Company shall file tariffs to serve Leprino Foods Company and Excel Corporation within 30 days after the effective date of a final Commission order in these dockets. The tariffs shall include cost-based rates and the terms and conditions of service.

5. The 20-day period provided by § 40-6-114(1), C.R.S., to file an application for rehearing, reargument, or reconsideration to this Decision and Decision No. C02-1224 shall begin on the first day after the Mailed Date of this Commission Order.

6. This Order is effective on its Mailed Date.

**B. ADOPTED IN COMMISSIONERS' WEEKLY MEETING  
May 12, 2004.**

THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF COLORADO



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Commissioners