COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

COLUMBIA GAS OF KENTUCKY, INC.'S, TARIFF FILING TO MODIFY ITS SPECIAL AGENCY SERVICE	)))	CASE NO. 10111

O R D E R

On December 4, 1987, Columbia Gas of Kentucky, Inc., ("Columbia") filed Second Revised Sheet No. 7-D of its Special Agency Service ("SAS") Tariff to allow it to use multiple tier pricing under its agency program.

Agency service was approved on an experimental basis for one year on May 2, 1986, in Case No. 9529, The Application of Columbia Gas of Kentucky, Inc., for Approval of a Special Interim Agency Service. Columbia had proposed the special interim agency service ("SIAS") schedule to serve commercial and industrial customers that had installed alternate fuel capability. Columbia had proposed to purchase gas as agent for individual customers, as well as continuing to purchase gas for system supply. In its May 2, 1986, Order, the Commission expressed concern that this purchasing practice could present a potential conflict of interest. But the Commission was also concerned about local gas distribution companies losing sales to alternate fuels in light of then declining oil prices. Another factor in the Commission's decision to approve the SIAS schedule was that there was no transportation capacity directly available at that time on the

Columbia Transmission system for commercial and industrial customers in Kentucky. Thus, Columbia's transportation service, Schedule DS, could not provide adequate service to compete with alternate fuels. The Commission expressed its concern that any price reduction to retain individual customers not be so great as to eliminate the benefit to the system of retaining the load. Columbia's proposal to charge SIAS customers a commodity rate no less than that of the highest portion of Columbia's shopping volumes was considered a potential safeguard against conflict of interest problems.

Columbia began selling gas under the SIAS schedule in June 1986. Beginning in February 1987 Columbia separated its SIAS pricing into two tiers. Tier 1 was to compete with #2 oil and Tier 2 was to compete with all other alternate energy sources. Tier 2 prices were lower than Tier 1 prices and in at least two months were below the cost of agency supply gas. The weighted average of Tier 1 and Tier 2 prices was always above the cost of agency supply gas.

On April 28, 1987, the Commission reopened Case No. 9529 to consider extending the SIAS schedule beyond its May 2, 1987, expiration date. On September 30, 1987, the Commission approved the now Special Agency Service ("SAS") schedule. The September 30, 1987, Order eliminated the expiration date of the schedule, extended the agency service to customers who would otherwise bypass Columbia's system and take gas from another supplier and approved the relaxing of other tariff provisions. In its Order, the Commission did order Columbia to cease using two-tier pricing and expressed certain concerns regarding two-tier pricing. Columbia's two-tier pricing scheme could result in marginal revenues falling below marginal gas costs. Tier 2 sales provide marginal revenues. They are sales that would not be made at system prices or even at reduced Tier 1 prices. The marginal gas costs are the most expensive of the agency purchases. System purchases are to be made first and include the lowest cost spot market volumes, agency purchases are then to be made at higher spot market prices. To the extent that Tier 2 prices and, thus, marginal revenues fall below the marginal cost of gas, the agency fee contribution to the system customer will be reduced.

Columbia, in its application in this case, asked to be allowed to assign the least expensive agency gas supplies to the customers with the least expensive alternate fuels. Without authority for multiple tier pricing, Columbia said it would price all agency sales at a price to maximize throughput. Given Columbia's pricing to maximize throughput, multiple tier pricing will produce greater revenues and agency fee contribution to system ratepayers than uniform pricing.

After reviewing the record in this case and being advised, the Commission is of the opinion and finds that:

1. Multiple tier pricing may provide greater agency fee contribution to other system ratepayers than single level pricing. Multiple tier pricing should be approved and Columbia should attempt to maximize the benefit from agency sales to other system ratepayers.

2. No sales should be made under the SAS Tariff at a price less than the most expensive of the agency purchases plus the required agency fee. Under any multiple tier arrangement, the lowest cost agency gas supplies should be assigned to the highest price agency sales and the highest cost agency gas supplies should be assigned to the lowest price agency sales. This may provide a minimal safeguard against cost reductions to retain load that are so great as to eliminate any benefit to system ratepayers of retaining the load.

3. Columbia should file monthly reports detailing the operation of the SAS schedule, including customers participating, their alternate fuels and prices per mmbtu, volumes nominated with price per Mcf and per mmbtu, volumes delivered with price per Mcf and mmbtu, agency fees billed, related transportation revenues and prices, reconciliation of nominations and deliveries and all spot market purchases broken down by supplies and price and allocated to system and agency sales. At the end of each quarter, the report should include an estimate of the costs to provide the SAS service and support for that estimate.

4. The Commission has approved several flexible rate schedules to give Columbia reasonable tools to meet alternate fuel competition and the threat of physical bypass. These schedules include Rate Schedule DS, Delivery Service, Rate Schedule AFDS, Alternate Fuel Displacement Service, and Rate Schedule SAS. The Commission is concerned that the operation and interaction of these tariffs work to the benefit of the general body of

ratepayers. Therefore, Columbia should include the following information in its Rate Schedule SAS monthly reports:

a. For all sales to customers with No. 2 fuel oil as an alternate fuel, a comparison of the SAS rate charged to the AFDS rate and support for differences.

b. For all situations where transportation rates are flexed for SAS customers, integrated support for the levels of the SAS rate and the flexed transportation rate.

5. Columbia should file a summary report of the operation of the SIAS and SAS schedules from inception to date including all types of information listed above in Findings 3 and 4.

IT IS THEREFORE ORDERED that:

1. Columbia's proposed SAS, Special Agency Service, schedule be and it hereby is approved, subject to the pricing restrictions set out in Finding 2.

2. Columbia shall file with this Commission monthly reports including such information as found reasonable herein.

3. Within 30 days of the date of this Order Columbia shall file with this Commission a summary report of the operation of the SIAS and SAS schedules including such information as found reasonable herein.

4. Within 30 days of the date of this Order Columbia shall file with this Commission tariffs for Special Agency Service as authorized herein.

Done at Frankfort, Kentucky, this 4th day of March, 1988.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director