COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

ORDER ON REHEARING

On December 4, 1987, Columbia Gas of Kentucky, Inc. ("Columbia") filed a proposed tariff which would allow the use of multiple tier pricing under Columbia's Special Agency Service ("SAS") program. Columbia's proposal would allow it to charge different prices to different groups of customers within the SAS program. Columbia would assign the least expensive SAS supplies to customers with the least expensive alternate fuels. Columbia stated its intent to price SAS sales with or without multiple tier pricing at levels which maximize throughput.

On March 4, 1988, the Commission approved Columbia's multiple tier pricing but placed restrictions on that pricing. The Commission expressed concern that any price reduction to retain individual customers not be so great as to eliminate the benefit to system ratepayers of retaining the load. Therefore, no sales were to be made at less than the marginal cost of gas, the marginal cost being the most expensive spot-market purchases in a given month. Columbia was also ordered to file a summary report on the operation of the SAS program, including its relationship to other flexible rate schedules.

On March 24, 1988, Columbia asked for reconsideration of the March 4, 1988 Order. Columbia stated that the fundamental purpose of the SAS program was to retain load that otherwise would be lost and that the pricing restrictions made it far more likely that loads would be lost to No. 6 fuel oil. Columbia requested that the Commission eliminate the pricing restrictions or, as an alternative, return to the use of a single price based on the average cost of SAS gas. On April 13, 1988, the Commission granted reconsideration to review the pricing restrictions, to allow Columbia to address the Commission's concerns about sales at less than the marginal cost of spot market gas, and to review a previously requested summary report on the operations of the SAS program.

On April 21, 1988, Columbia filed a motion for a stay of the March 4, 1988 Order until the Commission had completed its reconsideration of the Order. The motion was granted on April 25, 1988.

On May 13, 1988, Columbia filed its summary report of the operation of the SAS schedule and its interaction with Columbia's other flexible rate schedules. Columbia and the Commission Staff held an informal conference on September 8, 1988 to discuss the summary report, SAS reporting requirements, and multiple tier pricing. On November 7, 1988, Columbia filed an embedded cost allocation study for SAS and responded to questions raised at the conference. The cost allocation study showed, at rates proposed

in Case No. 10201,[1] a range of rates of return for SAS customers of 7.65 percent to 16.89 percent. The difference in rate of return was due to differing methods of allocating investment in mains to rate classes. In comparison, the study showed a range of rates of return for other transportation customers of 8.73 percent to 17.45 percent. The overall rate of return for all rate classes in the study was 11.84 percent.

In the summary report, Columbia stated that it would prefer to use the SAS schedule rather than flexing its transportation rate under Schedule DS or its sales rate under Schedule AFDS, since the SAS price covers all costs of the program, while flexing causes a reduction in revenues that must be made up from other sources. From Columbia's standpoint, this is true. Flexing sales and transportation rates downward does cause a reduction in revenues. However, reducing rates for alternate fuel customers through the SAS program does not reduce Columbia's total revenues, despite the fact that SAS customers are paying lower prices and providing less revenue than they would as regular sales customers. Columbia's total revenues are not reduced because the SAS price reduction is not achieved by lowering Columbia's margin but rather by allocating cheaper gas supplies to SAS customers. Thus, the SAS revenue reduction is automatically made up by other customers paying a higher cost of gas. However, these other customers may

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1 Case No. 10201, An Adjustment of Rates of Columbia Gas of Kentucky, Inc.

benefit by keeping a SAS customer on the system as long as the customer makes a contribution to fixed costs.

A concern of the Commission is that since Columbia does not bear any of the lost revenues under the SAS program, it might not negotiate aggressively with SAS customers to maximize the contribution to fixed costs. This concern has previously been addressed in two ways. First, when the SAS program was originally approved, the Commission required all SAS sales to be priced at the SAS average cost of gas plus an agency fee. Further price concessions had to be made through flexing the transportation rate. Second, in the March 4, 1988 Order, the Commission concluded that an appropriate pricing limit was the SAS marginal cost of gas. If Columbia was unable to keep a customer by charging the marginal cost of gas plus a minimum flexed transportation rate, the lost revenues would be fully balanced by avoidable costs and neither the ratepayers nor the shareholders would be worse off by losing the customer.

In asking for reconsideration of the pricing restriction, Columbia emphasized that the purpose of the SAS program is to retain load and that the SAS program provides a significant contribution to fixed costs when transportation revenues are considered. On March 23, 1989, Columbia and the Commission Staff held an informal conference to discuss the consideration of transportation revenues and the means by which such revenues might impact the pricing restrictions on the SAS program. Subsequent to

that conference, on April 20, 1989, Columbia filed a revised SAS draft tariff which included transportation revenues and certain changes recommended by Staff. After the Staff filed its comments on the draft tariff, Columbia filed a revised draft on May 22, 1989. Comments on the revised draft, filed on June 5, 1989, indicated Staff's willingness to recommend approval of the revised draft tariff subject to a minor wording change.

The Commission remains concerned that price concessions to retain individual customers not be so great as to raise questions of equity or possibly eliminate the benefit to the system of retaining the load. However, the Commission also realizes that the market for natural gas sales to industrial customers is highly competitive. Both physical bypass of Columbia's system to other gas supplies and fuel switching to No.6 fuel oil are real risks resulting in load loss. After further consideration, the Commission is of the opinion that the restriction on SAS sales at less than the marginal cost of gas may overly limit the usefulness of SAS and that Columbia may need greater flexibility in any given month to keep a customer on the system. Therefore, the restriction will be modified to include consideration of transportation revenues and will require costs and revenues to be averaged over a 12-month period. Thus, sales to a SAS customer would have to be priced so that revenues including the charge for transportation would at least cover the marginal cost of SAS gas plus a five cent per Mcf agency fee. Each sale need not meet this test as long as total SAS sales to a customer over a 12-month period meet the test. These modifications will protect against

SAS sales at prices that fail to at least recover avoidable costs, but will give Columbia greater flexibility to make short-term concessions in order to keep a customer and to allocate revenue between transportation charges and SAS gas cost recovery. To help maintain Columbia's incentive to negotiate aggressively with SAS customers, Columbia will be required to demonstrate annually to the Commission that the SAS program is not being subsidized by other ratepayers and that it is making a contribution to fixed costs.

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

1. The restriction on SAS sales at less than the marginal cost of gas should be modified to allow consideration of transportation revenues associated with those sales and to require that costs and revenues should be averaged over a 12-month period.

2. The revised SAS tariff, filed May 22, 1989, should be approved for service on and after the date of this Order, subject to the following modification: Sheet No. 7-D, lines 5 through 8, should state "Columbia will attempt to maximize the contributions of the agency fee to other customers. When necessary, Columbia may vary this fee to effectively compete with any alternate energy source, provided that, on an annual basis. . . ."

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 allocation to system and agency sales.

4. Once a year, Columbia should file a report for the 12 months ended June 30 showing the program's contribution to fixed costs, including an estimate of the overall rate of return from the SAS program for that year, with detailed support for the estimate.

5. Once a year, Columbia should perform a marginal cost test for sales to each SAS customer for the 12 months ended June 30. The test will compare each customer's SAS revenues, including transportation revenues, with the cost of the highest priced SAS gas purchases. If SAS sales to any customer fall short of recovering this cost, Columbia will return this shortfall to its system supply customers through a reduction in its gas cost adjustment. The results of such tests should be filed with the yearly report described in Finding 4.

IT IS THEREFORE ORDERED that:

1. Columbia's revised SAS, Special Agency Service, tariff be and it hereby is approved, subject to the conditions set out in Findings 1 and 2.

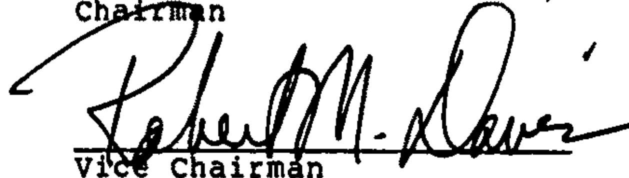
2. Columbia shall file with this Commission monthly and annual reports including such information as required in Findings 3 through 5 of this Order.

3. Within 30 days of the date of this Order, Columbia shall file with this Commission its approved tariff for Special Agency Service as authorized herein.

Done at Frankfort, Kentucky, this 18th day of July, 1989.

PUBLIC SERVICE COMMISSION

Chairman



Vice Chairman

Commissioner

ATTEST:

Executive Director