COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

MODIFICATIONS TO LOUISVILLE GAS AND ELECTRIC COMPANY'S GAS SUPPLY CLAUSE TO INCORPORATE AN EXPERIMENTAL PERFORMANCE-BASED RATEMAKING MECHANISM	) CASE NO. 97-171

ORDER

IT IS ORDERED that Louisville Gas and Electric Company ("LG&E") shall file the original and 8 copies of the following information with the Commission no later than June 4, 1997, with a copy to all parties of record. Each copy of the data requested should be placed in a bound volume with each item tabbed. When a number of sheets are required for an item, each sheet should be appropriately indexed, for example, Item 1(a), Sheet 2 of 6. Include with each response the name of the witness who will be responsible for responding to questions relating to the information provided. Careful attention should be given to copied material to ensure that it is legible. If the information cannot be provided by the stated date, LG&E should submit a motion for an extension of time stating the reason a delay is necessary and a date by which the information will be furnished. Such a motion will be considered by the Commission.

1. Refer to page 5 of Background and Purpose of Filing, the second sentence of the second paragraph, which states, "Each of these components contains a benchmark." Does Part D -- Off-System Sales Component contain a benchmark? If not, did LG&E intend for it to contain a benchmark, now or in the future? If not, why not?

2. Refer to page 6 of Background and Purpose of Filing where the proposed sharing ratio of 50/50 is discussed. Why should LG&E share 50 percent of revenues in return for taking on part of the risk that the ratepayers have historically borne 100 percent?

3. Refer to page 11 of Background and Purpose of Filing where the possible hiring of additional staff or consultants is discussed. Is LG&E proposing to net any procurement-related salary expense increases against Performance Based Ratemaking ("PBR") revenues? Provide an estimate of the cost of such increases.

4. Will the cost of gas sold through off-system sales flow through the Gas Cost Recovery ("GCR") mechanism prior to the Off-System Sales Index Factor ("OSSIF") being calculated, or will the total cost be contained in the OSSIF itself and netted against revenue? Describe what LG&E believes should happen and why it should happen if the OSSIF results in a net loss.

5. Refer to page A-4 of Attachment A.

a. Why does LG&E propose to use a 24 month average to calculate the Historical Reservation Fees ("HRF")?

b. Does LG&E consider this average to be a reasonable benchmark for current reservation fees? Explain the rationale.

c. Explain why HRF is based upon the most recent 24, rather than 12, months of data.

d. Explain why the Benchmark Gas Cost ("BGC") is calculated on an annual basis, rather than on a quarterly or monthly basis.

e. LG&E states that the Benchmark Gas Commodity Costs ("BMGCC") "is to be calculated on a monthly basis and accumulated for an annual period ending October 31 of each year" and "the HRF will be adjusted each year based on the most recent 24 months of data ended October 31 of the preceding year." Explain why Total Annual Benchmark Gas Commodity Costs ("TABMGCC") and HRF should not be contemporaneous.

f. Explain the manner in which HRF will be adjusted, based on the most recent 24 months of data ended October of the previous year.

6. Refer to Attachment A, at the bottom of page A-4.

a. Explain why Purchases in Excess of Firm Daily Contract Quantities ("PEFDCQ") is only calculated for delivery points, and not supply area or other points along the pipelines connected with LG&E. Could LG&E make purchases at points other than delivery points? Explain.

b. If gas purchases captured by PEFDCQ were to be purchased at a point other than a delivery point, how would LG&E account for the costs of bringing the gas to the city gate? Explain.

c. Under an incentive plan, is it reasonable to assume that LG&E may purchase pipeline capacity and non-firm commodity gas (separately or in combinations) to serve itself or in trade to other utilities (or marketers) in order to serve itself? If so, explain how these actions will affect the value of PEFDCQ and whether the Delivery Area Index ("DAI") would be the appropriate price index. If not, explain why not.

7. Refer to page A-5 of Attachment A.

a. Why is a separate benchmark being established for PEFDCQ?

b. Why would LG&E not have sufficient incentive to do better than the benchmark otherwise established for the commodity cost of gas? Explain.

c. Does LG&E consider the BMGCC to be unreasonably low absent the benchmark adjustment for excess purchases? Explain.

d. Why is it reasonable to establish a separate benchmark for purchases that occur so infrequently? Explain.

e. What was the actual cost of excess purchases for the 12 months ended October 31, 1996?

f. Does LG&E expect to make excess purchases at approximately the same level in the future as it has in the last two years?

8. Refer to Attachment A, page A-5, footnote number 2.

a. LG&E states that it "will typically only make purchases in excess of firm daily contract quantities during extreme weather or emergency conditions when pipeline capacity and supply are scarce." This statement is based on historical purchasing patterns. If LG&E were under an incentive program, why would it not avail itself of this option more frequently? Explain.

b. Provide examples of the non-traditional supply areas and transportation methods that are not available under firm contracts that may be used to maintain system reliability and explain how each will or is estimated to affect the value of PEFDCQ.

9. Refer to Attachment A, page A-6. LG&E states, "Each index used to calculate the SAIs will reflect some aspect of the pricing benchmark criteria related to the zone of purchase and the time of purchase."

a. Explain the manner in which each index accomplishes this.

b. Which particular aspects of the pricing benchmark criteria will be reflected by each index? Explain.

10. Refer to Attachment A, pages A-6 through A-8. DAI and Supply Area Index ("SAI") are weighted averages of 3 and 4 price indices respectively, where the weights are equal.

a. Explain why it is appropriate to combine different prices whose respective units are not the same.

b. Explain why it is appropriate to weight the respective prices equally.

11. Refer to Attachment A, page A-8. Explain why it is appropriate to use CNG Transmission Company as the pricing basis for PEFDCQ gas.

12. Refer to pages A-9, A-15, and A-25 of Attachment A.

a. Provide a detailed list and associated cost estimate of the financial transactions and administrative costs anticipated with risk management. This list should include all the possibilities and should not be limited to items and costs known at this time.

b. What financial hedging instruments is LG&E considering or planning to use? Cite all hedging mechanisms that have been considered by LG&E and the pros and cons of each.

13. Refer to the second paragraph of page A-11 of Attachment A.

a. Who is the third-party capacity holder from whom LG&E has secured incremental transportation delivery service and on what pipeline is the capacity held?

b. Why did LG&E contract for this incremental capacity?

c. Why was pipeline capacity increased from 193,663 to 199,913 MMBtu per day?

d. Will the actual cost of the third-party capacity be compared to the proxy pipeline ("PPL") benchmark? Explain.

14. Refer to Attachment A, page A-12. List and explain what non-traditional transportation service alternatives are and how they work.

15. In determining the PPL benchmark, how will LG&E decide which pipeline to use in establishing the rate?

16. Refer to page A-21 of Attachment A. Would the PPL be subject to the same deferral as that proposed for pipeline transportation rates placed into effect subject to refund? Explain.

17. Does LG&E contract firm capacity for 100 percent of its firm supply? Will it continue to do so?

18. Describe LG&E's existing contracts for pipeline capacity, including length of contract and termination date.

19. Provide a copy of LG&E's strategic gas supply plan for the period of the proposed pilot.

20. Provide LG&E's most recent long-term forecast of supply needs.

21. Would it be more appropriate to calculate the Benchmark Monthly Gas Transportation Cost ("BMGTC") based on winter/summer entitlements rather than on an annual basis? Explain.

22. Is LG&E proposing to establish a benchmark for capacity release? If so, why does the proposed tariff not reflect the formula suggested on page A-16 of Attachment A? Explain.

23. Refer to the discussion of establishing a benchmark for capacity release beginning on page A-16 of Attachment A. Why is establishing a historical benchmark for capacity release any more problematic than establishing a historical benchmark for reservation fees? Explain.

24. Provide LG&E's historical capacity release activity, by month, expressed in dollars and Mcf, since it first began releasing capacity.

25. Explain LG&E's statement on page A-16 that it should not be required to absorb any costs if the revenue subject to sharing does not exceed the threshold amount.

26. Refer to Attachment A, page A-19. Explain how determining the seasonal market penetration percentage using the 12-month period prior to the beginning of the PBR period avoids the problem of using a historical benchmark. Will the market penetration percentage reflect weather and price fluctuations which occurred in the previous 12-month period? If so, explain how the threshold would establish the appropriate benchmark for capacity release without normalizing weather and price fluctuation.

27. Why is a separate benchmark necessary for No Notice Storage ("NNS")? Given the structure of the No Notice Storage Index Factor ("NNSIF"), couldn't NNS be used as a tool to achieve the lowest possible Actual Gas Cost?

28. Refer to Attachment A, page A-23. Why has LG&E limited the application of the storage mechanism to NNS storage? Explain how an on-system storage mechanism could work.

29. Refer to Attachment A, page A-23, lines 5-8. Is it usually the case that gas purchased to replace gas withdrawn from storage is less expensive than winter pipeline purchases? If not, provide demonstrating documentation.

30. Refer to Attachment A, page A-25. How will LG&E determine gas supply cost associated with NNS injections?

31. Explain why the benchmark for NNS storage is based on gas cost during the month of withdrawal instead of the commodity index during the month of injection. Consider in your explanation the fact that virtually all injections take place during the summer months because of limited injection rights during the winter months.

32. Is it LG&E's policy to maximize the usage of its storage facilities regardless of the ratemaking methodology? Explain.

33. Is the purpose of NNS to make up for the shortage in gas deliverability from LG&E's on-system storage? If yes, what choice will LG&E have to change the deliveries from the storage or Texas Gas NNS?

34. Explain the effect the capacity release and off-system sales components of the PBR will have on the availability of interruptible sales and transportation services to LG&E's customers.

35. For 1995 and 1996, provide by month the amount in Mcf of interruptible sales and transportation which occurred on LG&E's system.

36. How will LG&E ensure that ratepayers do not pay for excess capacity or pay extra demand charges to make more capacity available for off-system sales transactions?

37. Provide the annual capacity costs LG&E has incurred for each of the last five years.

38. Describe how LG&E determines the amount of capacity it must obtain to meet its peak needs.

39. Describe the different kinds of off-system sales transactions that LG&E anticipates making.

40. If LG&E makes sales intended to correct an over-supply situation on its system for which it might be penalized by the pipeline, will it include these sales in the sharing mechanism?

41. Will LG&E market its own off-system sales program or will it contract with some other entity to manage it?

42. Would LG&E make off-system sales or release capacity to an affiliate under any circumstances? Explain.

43. How is the incremental cost determined in the calculation of the Out of Pocket Gas Costs and the Out of Pocket Transportation Costs? How is replacement cost determined in the Out of Pocket Storage Costs?

44. Refer to Attachment B, page B-1, the sample calculation of savings for 1995 and 1996. If LG&E already has a proven history of "beating the market," would it be more appropriate to incorporate a graduated sharing mechanism which would reflect LG&E improvement over its past performance? Explain.

45. Refer to Attachment B, page B-1. Recalculate the Total Savings or (Expenses) for 1995 and 1996 in each of the following ways:

a. Price NNS storage at the commodity index during the month of injection.

b. Remove the separate benchmark for NNS.

c. Remove the separate benchmark for PEFDCQ from the BMGCC.

46. Estimate savings and expenses during the proposed experimental PBR program period. Explain.

47. Is the volume of the gas purchased for injection into LG&E's storage included in PBR Part A calculations? If yes, what is the incentive of having PBR Part C mechanism in the program?

48. Provide complete details of how revenues and expenses associated with both off-system sales and capacity release will be identified and reported for internal and external monitoring purposes. Include all internal instruction manuals, as well as

underlying studies, data, calculations, etc., which explain how costs are specifically identified and charged or allocated to these activities.

49. Provide a breakdown, by Uniform System of Accounts ("USoA"), of all expenses LG&E anticipates incurring in its performance of the activities anticipated in each Part, A, B, C, and D, of the proposed performance-based mechanism. This information should be provided in the form of an annual financial budget or forecast developed to support the proposed three year pilot PBR.

50. Does LG&E propose to impute an income tax effect in its determination of the costs associated with each of the parts of the proposed performance-based mechanism? Why or why not?

51. Does LG&E anticipate that any of the costs currently being recovered through its base rates will be allocated to gas costs in order to fully reflect the costs of performance under the proposed incentive program?

a. If yes, provide these expenses by USoA account for each of the three years of the pilot.

b. If no, why not?

52. If a purchaser of capacity or gas defaults on its obligation to LG&E, is it LG&E's proposal that the default amount serve to reduce the amount of revenues available for sharing under either of the proposals? Why or why not?

53. Provide a journal, spreadsheet, log or other methodology that LG&E will maintain on each part of the proposed PBR. The information provided should disclose the costs, any revenues generated and the basis for those items so that the net

revenues or savings generated, and the sharing mechanisms proposed, can be monitored, measured and reported to the Commission.

54. Discuss the impact that a higher rate or return on these targeted incentives will have on the projected overall earnings of LG&E. Include an explanation of how LG&E would view the earnings on these activities in relation to the overall rate of return when determining when to seek an adjustment in its rates. Provide this information on both a total company and a stand-alone gas utility basis.

55. For the period ended December 31, 1996 provide the actual return on rate base and capital on both a total company and a stand-alone gas utility basis. Provide supporting schedules which show how the rate base, capital structure, and operating income were determined under each basis. Include the projected income from the proposed PBRs in income along with other pro forma adjustments with a complete explanation and all workpapers supporting the adjustments.

Done at Frankfort, Kentucky, this 16th day of May, 1997.

PUBLIC SERVICE COMMISSION

For the Commission

ATTEST:

Don Mills

Executive Director