COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF COLUMBIA GAS OF KENTUCKY, INC. TO IMPLEMENT A NEW SMALL VOLUME GAS TRANSPORTATION SERVICE, A GAS PRICE HEDGING PLAN, AN OFF-SYSTEM SALES AND CAPACITY RELEASE REVENUE SHARING MECHANISM, AND A GAS COST INCENTIVE MECHANISM	)	CASE NO. 2004-00462

O R D E R

Columbia Gas of Kentucky, Inc. ("Columbia") filed this application in response to our October 8, 2004 Order in Case No. 1999-00165[1] regarding the continuation of its voluntary Customer Choice Program ("Choice Program"). With input from third-party natural gas suppliers ("marketers") participating in its existing pilot Choice Program, Columbia has proposed a new pilot Choice Program to become effective April 1, 2005. The current Choice Program is scheduled to terminate on March 31, 2005. In addition to a new Choice Program, Columbia proposes a new off-system sales and capacity release revenue sharing mechanism, a gas cost incentive mechanism ("GCIM") and a gas price hedging program. Intervenors in this case are the Attorney General of the Commonwealth of Kentucky ("AG"), Interstate Gas Supply, Inc. ("IGS"), MX Energy ("MX"), the Lexington-Fayette Urban County Government ("LFUCG"), and the Community Action Council of Fayette, Bourbon, Nicholas and Harrison Counties.

[1] Case No. 1999-00165, The Tariff Filing of Columbia Gas of Kentucky, Inc. to Implement a Small Volume Gas Transportation Service, to Continue its Gas Cost Incentive Mechanisms, and to Continue its Customer Assistance Program.

The procedural schedule in this proceeding provided for two rounds of discovery on Columbia, written comments by the intervenors on Columbia's application, and reply comments by Columbia. The AG, IGS, and MX filed comments to which Columbia filed reply comments.

The procedural schedule also allowed parties to request a hearing or informal conference. LFUCG and IGS requested an informal conference, which was held March 15, 2005. None of the parties requested a formal hearing. There were no requests for additional information as a result of the informal conference and the case now stands submitted for decision.

BACKGROUND

With Commission approval, Columbia voluntarily implemented a pilot Choice Program in the fall of 2000, which was scheduled to run until October 31, 2004. The program gives small volume customers (volumes of less than 25,000 Mcf annually) the choice of selecting a third-party natural gas supplier. However, Columbia continues to be responsible for the delivery function and is the supplier of last resort in the event a supplier fails to make its required gas deliveries. Since its implementation, the pilot program has undergone changes, one of which extended its term to March 31, 2005.

At present, nearly 30 percent (roughly 41,000) of eligible small volume customers are enrolled in the pilot Choice Program. Columbia states that, through October 31, 2004, its customers had saved $13.5 million on the gas commodity component of their bills by participating in the program. Columbia has filed annual reports to keep the Commission apprised of the activity levels in the pilot Choice Program.

In this case, Columbia proposes a new pilot program, to run through March 31, 2009. The primary changes in the new program relate to the assignment of pipeline capacity to marketers, the capacity costs that this assignment eliminates for Columbia ("stranded costs"), the elimination of a mechanism to recover these costs, and the increase in the fees charged to marketers by Columbia to cover the costs of administering the program. With no stranded costs, which were being funded with revenues from off-system sales, Columbia requests to re-establish an off-system sales and capacity release revenue sharing program similar to what it had in place prior to implementing the pilot Choice Program. Under its proposal, which it requests be made permanent, Columbia and its customers will share equally (50-50) in the revenues realized from off-system sales and capacity release activities.

Columbia's proposed GCIM is a summer (April - October) commodity program in which its gas purchases will be compared against a benchmark. Columbia proposes to share the difference between actual gas costs and the benchmarked costs equally with its sales customers. Columbia proposes that the term of the GCIM run through October 31, 2008. Under its proposed hedging program, for which it proposes a term that will run through March 31, 2009, Columbia will purchase a portion of its required winter gas volumes through futures contracts or by negotiating fixed prices in physical gas supply contracts with gas suppliers.

ISSUES

No intervenor has voiced an objection in this proceeding to the proposed Choice Program. In its comments, MX suggested some changes to the proposed program. In response to these comments and informal discussions with MX and IGS, Columbia

amended its application to (1) increase the number of billing rates in its billing system for an individual marketer from 12 to 24, (2) modify the manner in which the Off-System Sales Capacity Release Adjustment factor is credited to Choice Program customers, and (3) restate the Balancing Calculation in its proposed tariff to reflect the impact of its most recent Gas Cost Adjustment filing, which became effective March 1, 2005.

The AG objects to various aspects of the other components of Columbia's filing. To some extent, his objections are similar to objections he has made in cases involving the gas cost performance-based rate-making ("PBR") proposals of Louisville Gas and Electric Company ("LG&E") and Atmos Energy ("Atmos") and the gas hedging plans of Atmos, Delta Natural Gas Company, and The Union Light, Heat and Power Company.

Specific AG Objections

The AG objects to the proposed equal sharing ratio for the off-system sales and capacity release mechanism and to Columbia's request that it be appoved permanently. He states that the sharing ratio should be weighted in favor of customers as are the ratios included in the LG&E and Atmos PBRs. He argues that no incentive program, including Columbia's off-system sales and capacity release mechanism, should be approved on a permanent basis.

The AG disagrees with the manner in which Columbia proposes to benchmark its gas purchases under the GCIM. As in the LG&E and Atmos PBR cases, he contends that Columbia has not shown that the proposed benchmark is reasonable. He argues that, if the GCIM is implemented, Columbia should be required to report the prices that customers would have paid absent the mechanism and how its prices compare to the benchmark in order to demonstrate that the GCIM produces a benefit to customers.

The AG opposes the proposed gas price hedging program on the grounds that: (1) price incentive programs, which create incentives for local distribution companies ("LDCs") to participate in volatile gas commodity markets, and hedging programs, which are intended to reduce price volatility, have conflicting goals and should not operate simultaneously; (2) the costs of a hedging program should not be borne totally by ratepayers unless there is a clear showing of an economic benefit to ratepayers; and (3) Columbia's proposal reflects a "mechanistic" approach which does not allow it to take advantage of downward trends in market prices.

Columbia's Response - Off-System Sales and Capacity Release

Columbia notes that its previous off-system sales and capacity release programs included sharing ratios of 65-35 or 75-25 with it receiving the smaller ratio. The 65-35 ratio was in effect prior to the current pilot Choice Program while the 75-25 ratio was approved in conjunction with approval of the current Choice Program. Columbia states that the proposed higher company sharing ratio is needed in order to provide a greater incentive to participate in something that is not a core segment of an LDC's regulated business. In arguing for a higher company sharing ratio, Columbia points out that it does not propose to share in any reductions or savings in pipeline demand costs, which distinguishes its proposal from the LG&E and Atmos PBRs.

Columbia claims that its experience with off-system sales and capacity release activities supports its position that its program no longer needs to be considered a pilot program. It contends that removing the "pilot" designation will eliminate the need for its periodic requests to the Commisssion for authority to renew a program that benefits it

and its customers. In the alternative, Columbia states that it would accept continuing the program as a pilot and linking its term to the term of the Choice Program.

Columbia's Response - Gas Cost Incentive Mechanism

Columbia argues that its proposed commodity price benchmark under the GCIM is reasonable and is the appropriate benchmark for its gas supply purchases. The proposed benchmark reflects prices from the NYMEX closing contract as published in Platt's Inside FERC's Gas Monthly Report for the months and locations at which it negotiates its purchases. Columbia states that it can provide an annual report that includes details of purchases, benchmark calculations for each purchase location, and the cumulative effect on gas costs to customers.

Columbia's Response - Gas Price Hedging Plan

Columbia states that, contrary to the AG's assertions, reducing volatility is not the purpose of its hedging program. Rather, the program's purpose is to reduce the effect of winter price spikes in the wholesale market on retail customers. Columbia states that it is willing to provide reports on its program to permit the Commission and interested parties to determine whether they believe the program is meeting its objective.

Columbia argues that, since its program merely involves pricing gas months in advance of delivery rather than hours or days in advance of delivery, there is little cost compared to programs involving call options or other financial instruments. However, as the results of the plan accrue entirely to customers, Columbia believes that the costs should also accrue to customers. As to the AG's criticism that its hedging plan is "mechanistic," Columbia states that the plan is designed to avoid speculation and create

a more diversified portfolio that will result in more price certainty and less extreme winter price spikes.

DISCUSSION

The written comments of the parties, Columbia's amendments to its application, and the views expressed at the March 15, 2005 informal conference reflect that all outstanding issues regarding Columbia's new voluntary Choice Program have been resolved to the satisfaction of the parties. The Commission believes the proposed program contains protections for customers, both those that participate and those that continue to receive service as sales customers of Columbia. Therefore, we find that Columbia's pilot Choice Program should be approved as proposed, with the Commission continuing to receive annual reports from Columbia as have been filed on the current pilot Choice Program. In order that the Commission may improve its monitoring of the program, those reports should also be expanded to include the number of complaints Columbia receives about the program along with a narrative description of the nature of the complaints.

As stated earlier, the AG objects to the other components in Columbia's application. In support of his objections, the AG expressed concern at the March 15, 2005 informal conference that a decision on the programs to which he objects might be rushed due to the need to expedite a decision on the proposed Choice Program. He stated that the programs to which he objects should be decided separately from the

Choice Program, emphasizing that his primary concern was that his positions on the contested issues be given adequate and serious consideration by the Commission.[2]

The issues in this proceeding concerning the proposed off-system sales and capacity release mechanism, GCIM, and gas price hedging program are complex issues that merit the Commission's full consideration. However, these issues are not without precedent in Kentucky as they have been addressed in other cases before the Commission in recent years.

Having considered the arguments regarding Columbia's proposals, we conclude that an adequate record has been developed and that this record supports the approval of those proposals, subject to one modification and two conditions. The modification is that the off-system sales and capacity release revenue sharing mechanism should be approved as a pilot for a term which matches the term of the new pilot Choice Program. The conditions involve the reporting that will be required of Columbia concerning its GCIM and its gas price hedging plan. We will require that Columbia file an annual report on the GCIM that contains the same information as it proposed in its response to the AG's written comments.[3] As the GCIM summer season extends from April through October, Columbia's report should be filed by November 30 of each year. On the hedging plan, we will require that Columbia file an initial report and a final report on its

[2] Columbia's position is that the four components of its application constituted a comprehensive gas supply package and should be decided as such.

[3] See the February 24, 2005 Reply Comments of Columbia Gas of Kentucky, Inc. at 9.

hedging activities for each heating season, as required of the other jurisdictional LDCs with hedging plans, rather than a single annual report as Columbia proposed.[4]

SUMMARY

Columbia has requested to implement a new voluntary pilot Customer Choice Program, to which none of the parties object. Columbia has also requested to implement an off-system sales and capacity release revenue sharing mechanism, a gas cost incentive mechanism, and a gas price hedging plan, all of which the AG objects to in some fashion. No other party expressed a position on any of these three programs. The Commission has considered the issues related to the programs proposed by Columbia and concludes that, with some minor changes, they should be approved.

IT IS THEREFORE ORDERED that:

1. Columbia's new voluntary pilot Customer Choice Program is approved as proposed. Columbia shall file annual reports on the program as described herein and shall file its scheduled annual report on its existing pilot program by June 1, 2005.

2. Columbia's new off-system sales and capacity release revenue sharing mechanism is approved as proposed except that it will operate as a pilot with a term that runs through March 31, 2009, which matches the term of the new Choice Program.

3. Columbia's gas cost incentive mechanism is approved as proposed for a term that runs through October 31, 2008. Columbia shall file annual reports on its GCIM as described herein with the first report due by November 30, 2005.

[4] Columbia's initial hedging report should be filed with its report on the GCIM. Its final report should be filed with the annual report on its Customer Choice Program.

4. Columbia's gas price hedging program is approved as proposed for a term that runs through March 31, 2009. Columbia shall file initial and final reports on its hedging plan each year as described herein. Its first report on its hedging activity shall be filed by November 30, 2005.

5. Within 20 days from the date of this Order, Columbia shall file its revised tariffs for the programs approved in this Order showing the date issued and that they were issued by authority of this Order.

Done at Frankfort, Kentucky, this 29th day of March, 2005.

By the Commission

ATTEST:

Executive Director