COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF COLUMBIA GAS OF KENTUCKY, INC. TO EXTEND ITS GAS COST INCENTIVE MECHANISM AND REVENUE SHARING MECHANISM	))))	CASE NO. 2012-00593

ORDER

On December 28, 2012, Columbia Gas of Kentucky, Inc. ("Columbia") filed its application seeking authority to continue its gas cost incentive mechanism ("GCIM") with no modifications through October 31, 2016, and to continue its off-system sales and capacity release revenue sharing mechanism ("OSS/CR RSM"), also with no modifications, through March 31, 2017. By Order entered March 27, 2013, the Commission found that Columbia's current GCIM and OSS/CR RSM, with no changes to any aspect of its calculations, should be approved for continued use pending a Final Order in this proceeding. Columbia responded to two rounds of Commission Staff Requests for Information. There are no intervenors in this proceeding. The record is now complete and the matter stands submitted for decision.

BACKGROUND

The Commission first approved Columbia's GCIM and OSS/CR RSM in Case No. 2004-00462.[1] The Commission conditioned its approval upon Columbia filing an annual report on the GCIM by November 30 of each year. By Order dated April 15,

[1] Case No. 2004-00462, *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* (Ky. PSC Mar. 29, 2005).

2009 in Case No. 2008-00433, the Commission approved an extension of Columbia's GCIM through October 31, 2012 and the OSS/CR RSM through March 31, 2013.[2]

The purpose of the GCIM is to measure the effectiveness of Columbia's gas purchasing efforts by defining a market standard, or benchmark price, and then allowing Columbia to share in the savings if it is able to purchase gas under the benchmark price.[3] Under the GCIM, the measurement of Columbia's performance against a market standard applies to all system supply gas purchases made by Columbia during the months of April through October, excluding those purchases made at the city gate. Winter supply purchases are excluded due to Columbia's concern with regard to creating possible financial incentives, real or implied, that might be in conflict with its obligation to provide reliable customer service. In each applicable month, Columbia's actual gas purchase costs are compared to the benchmark cost for the month. The resulting dollar amount for the month is shared 50/50 between Columbia and its sales customers through an adjustment to Columbia's Gas Cost Adjustment ("GCA"). There has been no change to Columbia's GCIM since it was first approved in 2004.

Columbia and its customers likewise share 50/50 in the revenues from off-system sales and capacity release pursuant to its OSS/CR RSM. The purpose of this mechanism is to create benefits for Columbia's customers and opportunities for Columbia to share the value resulting from its efforts. All Columbia sales customers

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[2] Case No. 2008-00433, *Application of Columbia Gas of Kentucky, Inc. to Extend Its Gas Cost Incentive Program and Its Off-System Sales and Capacity Release Sharing Mechanism* (Ky. PSC Apr. 15, 2009).

[3] If Columbia's gas purchases exceed the benchmark price, the excess cost is likewise shared 50/50 between it and its sales customers.

and CHOICE program participant customers receive the benefit of the OSS/CR RSM credits through an adjustment to the GCA.

Information provided by Columbia shows that, from 2005 through 2011, GCIM savings passed through to customers equaled approximately $2.14 million. OSS sharing with customers for that same period was approximately $12.3 million while CR sharing with customers was a little over $1.7 million.

In response to Commission Staff's Second Request for Information, Columbia stated that it has not considered changing its GCIM and OSS/CR RSM to provide for lesser initial sharing on its part up to a certain pre-established level of savings, with the ability to share 50/50 only after it has reached that threshold amount. According to Columbia, it considers establishing such thresholds, or benchmarks, for sharing as inappropriate because the mechanisms are dependent upon the natural gas commodity markets which are not well-predicted by past performance, and that establishing such thresholds would dilute the incentive.[4] Columbia stated that it was not aware that such a sharing mechanism has been approved for other jurisdictional Kentucky Local Distribution Companies ("LDCs"). Columbia likewise responded that it was not aware that the incentive mechanisms of other LDCs involve the establishment of a dead-band around some level of initial savings, or that those LDCs' mechanisms include more months than April through October as well as more elements of gas cost in their gas cost incentives, and that it had not considered making such changes in its own mechanisms.[5]

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[4] Response to Item 1 of Commission Staff's Second Request for Information, filed Aug. 19, 2013.

[5] Responses to Items 3-5 of Commission Staff's Second Request for Information, filed Aug. 19, 2013.

ANALYSIS AND CONCLUSION

The experimental Performance Based Rate ("PBR") Mechanisms of Louisville Gas and Electric Company ("LG&E") and Atmos Energy Corporation ("Atmos") preceded Columbia's GCIM and OSS/CR RSM. Both LG&E's and Atmos's mechanisms, as originally approved in 1997[6] and 1998,[7] respectively, benchmarked all components of gas cost and provided for a 50/50 sharing between customers and shareholders of the amounts by which gas costs varied from the benchmarks. The gas cost/gas procurement components contained in both PBRs are: (1) Gas Acquisition Index Factor ("GAIF"); (2) Transportation Index Factor ("TIF"); and (3) Off-System Sales Index Factor ("OSSIF"). Both TIF mechanisms as originally approved included capacity release revenues.

In 2001, in Case No. 2001-00017,[8] the Commission approved LG&E's request to extend its PBR for four years, still on an experimental basis, and approved modifications to the benchmarks and the sharing ratio. The sharing ratio for all components was modified to a sliding scale consisting of two bands. The first band covers variances from the benchmark ranging from 0 to 4.5 percent and is shared 75/25 between customers and shareholders in favor of the customers. The second band covers

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[6] Case No. 97-171, *Modification to Louisville Gas and Electric Company's Gas Supply Clause to Incorporate an Experimental Performance-Based Ratemaking Mechanism* (Ky. PSC Sept. 30, 1997).

[7] Case No. 97-513, *Modification to Western Kentucky Gas Company, a Division of Atmos Energy Corporation, Gas Cost Adjustment to Incorporate an Experimental Performance-Based Ratemaking Mechanism (PBR)* (Ky. PSC June 1, 1998).

[8] Case No. 2001-00017, *Modification to Louisville Gas and Electric Company's Gas Supply Clause to Incorporate an Experimental Performance-Based Ratemaking Mechanism* (Ky. PSC Oct. 26, 2001).

variances of greater than 4.5 percent and is shared 50/50. LG&E's PBR, as implemented in 1997, included capacity release as a subpart of the TIF component of its PBR. Because capacity release was an activity in which LG&E had engaged prior to the implementation of its PBR, the experimental PBR contained a capacity release threshold ("CRT") that LG&E had to exceed before shareholders could participate in any savings realized through capacity release activities. During the initial pilot, LG&E did not exceed the CRT and capacity release was discontinued as a component of LG&E's TIF in 2001. In 2005[9] and 2009,[10] the Commission approved extensions of the program with no changes to its components other than to add an additional Supply Area Index to the GAIF in 2009.

Also, in 2002, in Case No. 2001-00317,[11] the Commission approved a settlement between Atmos and the Attorney General of the Commonwealth of Kentucky to extend Atmos's PBR for four years, still on an experimental basis, with a sharing ratio involving two bands: 0 percent to 2 percent; and over 2 percent. The sharing ratio in the first band is 70/30 in favor of the customer and the sharing ratio for the second band is 50/50 based on Atmos contracting with a third party to manage its gas supply through a

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[9] Case No. 2005-00031, *Modification to Louisville Gas and Electric Company's Gas Supply Clause to Incorporate an Experimental Performance-Based Ratemaking Mechanism* (Ky. PSC May 27, 2005).

[10] Case No. 2009-00550, *Request of Louisville Gas and Electric Company for Modification and Extension of Its Gas Supply Cost Performance-Based Ratemaking Mechanism* (Ky. PSC Apr. 30, 2010).

[11] Case No. 2001-00317, *Modification to Western Kentucky Gas Company, a Division of Atmos Energy Corporation, Gas Cost Adjustment to Incorporate an Experimental Performance-Based Ratemaking Mechanism (PBR)* (Ky. PSC Mar. 25, 2002).

full requirements contract. The Commission approved the extension of the program, including the addition of an asset management factor to the GAIF in 2005,[12] and again in 2010 with the only revision being the elimination of two indices that are included in Atmos's benchmark calculation for its GAIF.[13]

The TIF in Atmos's PBR includes capacity release costs and revenues resulting from its full requirements gas supply contract. Capacity release is subject to the same 70/30 sharing up to two percent of net revenues, and the 50/50 sharing above two percent that applies to all the PBR components.

With respect to off-system sales, LG&E's OSSIF reflects its net revenues, or savings, from off-system sales transactions. If revenues realized exceed the costs of such transactions, there are savings to be shared between customers and shareholders. If costs exceed revenues, there are increased costs to be shared. Off-system sales sharing through the OSSIF was, as indicated above, initially 50/50, and in 2005 was modified to 75/25 in favor of customers up to 4.5 percent of revenues exceeding cost, and 50/50 sharing above 4.5 percent.

Atmos's OSSIF benchmarks its sales of gas, transportation capacity, and storage services against its out-of-pocket costs to make the sale. In 2005, as previously mentioned, the sharing between its customers and Atmos was revised from 50/50 to 70/30 up to two percent of net revenues, and 50/50 over two percent, for all components of the PBR.

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[12] Case No. 2005-00321, *Modification of Atmos Energy Corporation's Gas Cost Adjustment to Incorporate Performance-Based Ratemaking Mechanism* (Ky. PSC Feb. 8, 2006).

[13] Case No. 2010-00353, *Request of Atmos Energy Corporation for Modification and Extension of Its Gas Cost Adjustment Performance-Based Ratemaking Mechanism* (Ky. PSC Dec. 7, 2010).

Based on a review of the record in this proceeding, as well as a review of the evolution of PBR mechanisms in use by other Kentucky LDCs, the Commission finds that an extension of Columbia's GCIM and OSS/CR RSM should be approved without modification only through October 31, 2014 for the GCIM and only through March 31, 2015 for the OSS/CR. Columbia should perform a review of the PBR mechanisms discussed in this Order, as well as any other mechanisms or information available concerning best practices with regard to gas cost incentive mechanisms. At least six months before the March 31, 2015 expiration date of the OSS/CR RSM found reasonable herein, Columbia should file a request for any additional extension of its GCIM and OSS/CR RSM. Columbia's application for further extension of those mechanisms should include revised components based on the review required herein consistent with the components required/approved for LG&E and Atmos. Besides possible modifications to the 50/50 sharing included in its current mechanisms, the Commission also finds that Columbia should evaluate the inclusion of additional months in its GCIM mechanism, as opposed to continuing to limit the time period to April through October, and including elements of its gas cost other than just its gas commodity cost. Any further request to continue the mechanisms with no modification should include detailed evaluation and support for why such continuation is reasonable.

IT IS THEREFORE ORDERED that:

1. Columbia's request to extend its GCIM with no modifications through October 31, 2016 and to extend its OSS/CR RSM with no modifications through March 31, 2017 is denied.

2. Columbia's GCIM shall be extended through October 31, 2014 and its OSS/CR RSM shall be extended through March 31, 2015.

3. No later than September 30, 2014, Columbia shall file with the Commission its evaluation of other Kentucky LDCs' PBR mechanisms, as found reasonable and directed herein, along with any request to revise its incentive mechanisms or to continue them without modification. Either request shall be accompanied by detailed analyses of each component of the GCIM and OSS/CR RSM as proposed, including the reasonableness of the benchmarks, the reasonableness of the sharing between Columbia and customers, the reasonableness of the time period and gas cost components covered by the GCIM, and the risk Columbia assumes, and the cost involved in performing activities related to these incentives.

4. Columbia shall file its annual report regarding the GCIM and OSS/CR RSM on or before November 30, 2013.

5. Any documents filed pursuant to ordering paragraph 4 of this Order shall reference this case and shall be retained in the utility's general correspondence file.

By the Commission

ENTERED
OCT 25 2013
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

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