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PUBLIC SERVICE COMMISSION

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,) CASE NO. 2004-00462
AN OFF-SYSTEM SALES AND CAPACITY)
RELEASE REVENUE SHARING MECHANISM,)
AND A GAS COST INCENTIVE MECHANISM)

COMMENTS OF THE ATTORNEY GENERAL

Pursuant to the Commission's Order of February 4, 2005, the Attorney General offers the following comments on Columbia Gas of Kentucky, Inc.'s ("Columbia or Columbia Gas") proposal pertaining to the continuation of the CHOICE program, the implementation of a hedging program, the continuation of Off-System Sales and Capacity Release revenue sharing, and the implementation of a Summer Gas Cost Incentive Mechanism ("GCIM").

Hedging

Columbia Gas has waited to propose a hedging plan until this Commission has shown such favor of hedging programs that there would be no chance the utility would bear any consequence if the program should fail to produce favorable results.[1] No measure of any actual reduction in volatility produced by Columbia's hedging programs for its fellow LDCs has been made, though such programs have been in use for various NiSource LDCs since as early as 1998. No measure of the expected reduction of volatility to be expected from this program for

[1] Response to Attorney General Data Request Set 1, Question 2.

Columbia Gas of Kentucky is proposed.[2] It seems then, that benefits of hedging are to be assumed rather than proven as now proposed and will continue to be assumed only absent any record keeping that demonstrates their effectiveness. Even though hedging is often compared to insurance, reporting on costs and benefits is appropriate in a hedging program because it is substantially more likely that a properly designed hedging program will be utilized: to wit, that the volatile market will require "claims to be made," so to speak. If no claims are made over time, either the hedging program is not sufficiently geared to the activity of the market or the market has become sufficiently lacking in volatility so as to render that particular hedging program useless. The program should be watched and adjusted as needed so that it will have the opportunity to benefit those paying for it. Unlike insurance, where it is hoped that no claim will ever be necessary, it is to be hoped that the hedging program produces active results – otherwise, it is just an added cost.

Further, hedging represents an absolute cost to the consumer under this Commission's approach. The Commission should reconsider its policy of assigning all costs of hedging to the ratepayer. The incentive rates sought by the utility encourage the utility to operate in volatile markets. They reward the utility for staying in the most volatile markets rather than encouraging gas supply purchasing practices that include the element of price stability. Despite that, consumers are required to pay for hedging programs to "insure" against the price volatility of the markets the utilities are simultaneously being incented to pursue. This is a Commission produced conflict that places an element of the risk of gas supply purchasing on consumers that previously rested on the utility. It is a policy that should not be continued through simultaneous encouragement of incentive rates and hedging.

[2] Response to Attorney General Data Request Set 1, Questions 8-2 and 1.

Finally, if the Commission does approve the hedging plan in whole or in part, it should require the removal of the mechanistic elements of the program for Columbia and require Columbia to pay heed to and take advantage of downward trends in the market by eliminating the floor/minimum volume hedged element of the proposed plan.[3] This is the approach the Commission has taken for Atmos. It is more favorable for the customers and should be used here.

Off-System Sales and Capacity Release Revenue Sharing

Columbia wants to make its Off-System Sales and Capacity Release revenue sharing incentive rates permanent. In support of this Columbia asserts that the programs have been assessed as pilots and that the CHOICE program stranded cost recovery through those rates is now complete. Therefore, Columbia contends that it is now appropriate to (1) make these incentive rates permanent and (2) to do so at the highest sharing ratio for Columbia's shareholders ever proposed or received by any utility.

First, no incentive program should ever be made permanent. Columbia admits that it cannot say that incented behavior produces an overall favorable result for the consumer.[4] In fact, though it is clear that the incentive rates allow added opportunities for Columbia to make profits not previously allowed in connection with gas purchasing and management, it is unable show that incentive rates produce favorable results for consumers by reducing the overall cost of gas to consumers below that which they would have paid absent the incentive rates. The benchmarks set are **assumed** to be appropriate. Beating those benchmarks is therefore **assumed** to be as good or better for the customer as the cost of gas under standard practice and management would have

[3] Response to Attorney General Data Request Set 1, Question 14.
[4] Response to Attorney General Data Request Set 1, Question 25

been. Not only are those assumptions imbalanced in their creation of a real opportunity to earn added profit for the company but only an assumed reduction of cost for the customer, they are assumptions that are only as valid as the market in which they are made. In a changing market[5] there is no assurance that benchmarks remain appropriate. In a changing market there is no assurance that sharing ratios established during one state of the market remain appropriate in another state of the market. Therefore, these rates should not be made permanent.

Second, the sharing ratios sought are inappropriate and punitive to the consumer. The rates asked by Columbia are as high as any ever awarded by this Commission, and higher than any awarded on reconsideration by the Commission of the programs for Atmos and LG&E.[6] Because it is impossible to show that incentive rates produce a real lowering of gas costs for customers, the incentives given, if any, should be lower rather than higher. Columbia has made no showing that the benchmarks should be eliminated and its sharing ratio increased. Its proposal seeks to change the sharing ratio now that there are no CHOICE engendered stranded costs to be recovered so that the company gets more of the revenue than the Commission found appropriate in the last consideration of this rate.[7] Columbia is now receiving incentives from marketers that were not previously available to it. There is absolutely no reason to penalize customers by also awarding Columbia a greater sharing ratio of off-system sales and capacity release revenues.

The Commission previously reasoned that as off-system sales may be made bundled with capacity paid for by ratepayers and as sales would be effected with resources developed by Columbia to provide a public utility service, it is appropriate to grant ratepayers the larger share

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[5] In Response to Attorney General Data Request Set 1, Question 24, Columbia states, "Markets change from year to year and from month to month."

[6] Response to Commission Staff's Request dated January 18, 2005, Question 5.

[7] At page 4 of its application, Columbia states that sales customers should not have increased costs as a result of the CHOICE program, but in seeking a higher sharing ratio for shareholders now that they do not get to retain all off-system revenues to offset CHOICE stranded costs, they are directly increasing the sales customers rates as a consequence of the CHOICE program.

of off-system sales revenues.[8] Columbia has stated that it would not devote the resources developed to provide utility services as aggressively if incentives are not given to it as it would if incentives are given to it saying:

> Without the proposed incentive mechanism, Columbia would continue to engage in reasonable capacity transactions as opportunities presented themselves, but would not devote the resources necessary to engage in a more aggressive capacity release marketing program if there were to be little or no return on the investment associated with such additional resources.[9]

Nowhere has Columbia shown that the "aggressive" marketing is paid for by the shareholders rather than by the ratepayers. Rather than continuing to reward a lackadaisical/belligerent attitude towards its responsibilities to its customers absent receipt an added "incentive" profit margin, the Commission should require the utility to fully devote the resources paid for by the ratepayers to the benefit of the ratepayers with either no added incentive for Columbia, or a lower incentive sharing ratio for Columbia than has been given in the past.

By like token, there is no reason to lower or eliminate the benchmark set for capacity release simply because Columbia has not been able to reach it. Columbia has not shown the flaw in the Commission's reasoning when it said that a benchmark serves to assure that the ratepayers are made whole.[10] Easy targets cannot produce savings sufficient to assume a benefit to the ratepayer great enough to offset the increase in incentive rewards paid.[11] The harder the benchmark is to achieve, the better the chance that beating that benchmark results in an actual reduction of cost for the ratepayer sufficient to match or exceed the added incentive rewards paid, thereby making the incentive rate a benefit for all stakeholders.

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[8] Order of July 31, 1996, *In the Matter of: the Tariff Filing of Columbia Gas of Kentucky, Inc. to Implement Gas Cost Incentive Rate Mechanisms*, Case No. 96-079, page 2.
[9] Response to Attorney General Data Request Set 1, Question 24.
[10] Order of July 31, 1996, *In the Matter of: the Tariff Filing of Columbia Gas of Kentucky, Inc. to Implement Gas Cost Incentive Rate Mechanisms*, Case No. 96-079, page 4.
[11] Response to Attorney General Data Request Set 1, Question 25.

Summer Gas Cost Incentive Mechanism (GCIM)

In the face of the highest summer gas costs ever, Columbia now proposes to ask customers to pay added incentive costs based on beating a benchmark that has little to do with outstanding performance and much to do with forces beyond Columbia's control.[12] Though the mechanism also requires Columbia to pay if it does not beat the benchmark, that aspect of the proposal does cure the defect presented by the fact that the benchmark does not represent an apples-to-apples comparison of Columbia's total summer purchasing practice and gas supply management and that it does not eliminate the impact of exogenous forces. The spot market moves at the whim of exogenous forces. Absent the development of a benchmark that clearly eliminates the impact of exogenous forces so that it is only gains in Columbia's efforts that are rewarded and losses in Columbia's efforts that are penalized, the proposal should be denied.

If the Commission does permit the proposal because it believes the benchmark to be sufficiently reflective of Columbia's total summer supply purchasing practice to constitute a valid goal to beat, then Columbia should be able to report what prices consumers would have paid absent the incentive mechanism as well as how prices have beaten the benchmark. This way, Columbia can demonstrate that the mechanism produces an overall benefit to the consumer as well as to the company. With such reporting, it will be not be necessary to simply assume ratepayer benefit from the fact that the benchmark has been beaten.

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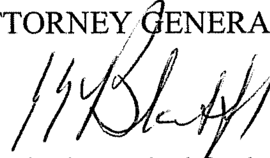
[12] Response to Attorney General Data Request Set 1, Question 27.

Continuation of the CHOICE program

Absent any negative effect on remaining Columbia sales customers, the CHOICE program constitutes a benefit for ratepayers.

Respectfully submitted,

GREGORY D. STUMBO
ATTORNEY GENERAL



Elizabeth E. Blackford
Assistant Attorney General
1024 Capital Center Drive, Suite 200
Frankfort, Kentucky 40601-8204
(502) 696-5453
betsy.blackford@ag.ky.gov

NOTICE OF FILING AND CERTIFICATION OF SERVICE

I hereby give notice that I have filed the original and ten true copies of the foregoing with the Executive Director of the Kentucky Public Service Commission at 211 Sower Boulevard, Frankfort, Kentucky, 40601 this the 14th day of February, 2005, and certify that this same day I have served the parties by mailing a true copy, postage prepaid, to the following:

STEPHEN B SEIPLE ESQ
COLUMBIA GAS OF KENTUCKY INC
200 CIVIC CENTER DRIVE
P O BOX 117
COLUMBUS OH 43216-0117

RICHARD S TAYLOR ESQ
CAPITAL LINK CONSULTANTS
225 CAPITAL AVENUE
FRANKFORT KY 40601

JAMES R COX ESQ
COX BOWLING & JOHNSON PLLC
8303 SHELBYVILLE ROAD
LOUISVILLE KY 40222-0000

LESLYE M BOWMAN ESQ
DIRECTOR OF LITIGATION
LFUGC DEPARTMENT OF LAW
200 EAST MAIN STREET
LEXINGTON KY 40507

JOE F CHILDERS ESQ
201 WEST SHORT STREET
SUITE 310
LEXINGTON KY 40507

TREVOR L EARL ESQ
REED WEITKAMP SCHELL COX & VICE
2400 CITIZENS PLAZA
LOUISVILLE KY 40202