COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

LOUISVILLE GAS AND ELECTRIC COMPANY'S PROPOSED RENEWAL AND MODIFICATION OF ITS PERFORMANCE-BASED RATEMAKING MECHANISM	))))	CASE NO. 2014-00476

ORDER

On December 30, 2014, Louisville Gas and Electric Company ("LG&E") applied to extend and modify its existing gas cost performance-based ratemaking mechanism ("PBR"). The Commission approved the current PBR mechanism in Case No. 2009-00550 for a five-year period expiring October 31, 2015.[1] The currently approved program benchmarks LG&E's gas costs against three components: (1) the Gas Acquisition Index Factor ("GAIF"), which benchmarks actual commodity costs against prices published by *Inside FERC's Gas Market Report* for monthly purchases, *Natural Gas Week* for weekly purchases, and *Platt's Gas Daily* ("*Gas Daily*") for daily purchases, and benchmarks supply reservation fees against LG&E's average reservation fees from the previous two years; (2) the Transportation Index Factor ("TIF"), which benchmarks LG&E's pipeline transportation costs against the Federal Energy Regulatory Commission's approved transportation rates of LG&E's two

[1] Case No. 2009-00550, *Request of Louisville Gas and Electric Company for Modification and Extension of Its Gas Supply Cost Performance-Based Rate-Making Mechanism* (Ky. PSC Apr. 30, 2010). LG&E's PBR was first approved in Case No. 1997-00171, *Modifications to Louisville Gas and Electric Company's Gas Supply Clause to Incorporate an Experimental Performance-Based Rate-Making Mechanism* (Ky. PSC Sept. 30, 1997).

interstate pipeline suppliers, Texas Gas Transmission ("Texas Gas") and Tennessee Gas Pipeline Company; and (3) the Off-System Sales Index Factor ("OSSIF"), which benchmarks sales of gas, transportation and storage services against LG&E's out-of-pocket costs to make such sales.

Variances between LG&E's actual costs and the benchmarks are shared between shareholders and ratepayers on 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 ratepayers and shareholders in favor of the ratepayers. The second band covers variances greater than 4.5 percent and is shared 50/50. During the period covered by the current mechanism (PBR years 2011 through 2014[2]), LG&E achieved total savings of $33,815,425, with LG&E retaining $10,650,364 and ratepayers credited with the remaining $23,165,061.[3]

LG&E responded to one request for information from Commission Staff. There are no intervenors in this proceeding. The case now stands submitted for decision.

ISSUES

LG&E proposes to modify the current PBR mechanism by making certain changes to the GAIF component of the mechanism. LG&E proposes to revise the calculation of the Delivery Area Index ("DAI") to account for shifts in the natural gas supply market which, according to LG&E, make the Dominion Transmission, Inc. ("Dominion") price postings currently relied upon no longer reasonable as benchmarks

[2] PBR years 2011 through 2014 cover the time period November 1, 2010, through October 31, 2014, the first four years of the current five-year term.

[3] Application, Report on LG&E's Gas Supply Cost Performance-Based Ratemaking Mechanism ("Report") at 2.

for supplies delivered to its city gate. LG&E states that using a more robust calculation to determine the benchmark price will enable it to benchmark delivered gas cost in a more meaningful fashion, given the market dislocation caused by the advent of Marcellus shale gas, which has suppressed the Dominion price posting.[4] LG&E proposes to replace the Dominion prices with prices for East Texas – North Louisiana Area, Texas Gas, zone 1, and Appalachia – Lebanon Hub.[5] LG&E states that it has not used the DAI component of the GAIF during the current PBR mechanism review period.[6]

LG&E also proposes to modify the GAIF by seasonalizing the Supply Zone Firm Quantity Entitlement Percentage used in the calculation of the Benchmark Gas Commodity Costs for the Supply Area Index ("SAI") and the DAI. LG&E states that this will cause the calculation to reflect that its pipeline services and supply zone entitlements are seasonal, which will result in benchmarks more closely matching the supply zone entitlements available to it.

LG&E proposes to revise the GAIF by using the *Gas Daily* mid-point posting instead of averaging the high and low postings from *Gas Daily.* LG&E characterizes this change as eliminating a redundant step, which will simplify the calculation.[7] In response to a Staff request for information to confirm that the two methods produced

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[4] Response to Commission Staff's Initial Request for Information ("Staff's First Request"), Item 6.

[5] Application, Red-Lined Tariff Sheets Reflecting Proposed Modifications to LG&E's Tariff P.S.C. Gas No. 9, Sheet No. 87.4.

[6] Report at 13.

[7] *Id.* at 14.

similar results, LG&E provided a comparison of the SAI calculations using both the current and proposed methodologies.[8]

LG&E proposes no modifications to the TIF or OSSIF components of the PBR mechanism.

The final modification proposed by LG&E in its Application concerns the sharing mechanism used to allocate between customers and the company any savings or expenses up to 4.5 percent of the benchmarked gas cost. The current mechanism provides for variances from the actual cost benchmark ranging from 0 to 4.5 percent to be shared 75/25 in favor of ratepayers, with the second band made up of variances over 4.5 being shared 50/50 between ratepayers and LG&E. In light of the risk levels inherent in its gas-supply cost mechanism, LG&E proposes to share gas cost variances up to 2 percent of the benchmark with ratepayers, with the sharing established at 70/30 in favor of ratepayers, and to share 50/50 with ratepayers in variances over the 2 percent level.[9]

Although not proposed in its Application, in response to Staff's First Request, Item 5, LG&E stated it would be receptive to the removal by the Commission of that component of the PBR mechanism that benchmarks Historical Reservation Fees ("HRF"). Removal of the HRF component from the GAIF would make the risk levels more comparable with those experienced by Columbia Gas of Kentucky ("Columbia")

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[8] Response to Staff's First Request, Item 8.

[9] Report at 15.

and Atmos Energy Corporation ("Atmos") under their respective PBR mechanisms, according to LG&E.

ANALYSIS

LG&E has been able to demonstrate that it has pursued more aggressive gas-purchasing measures as a result of the PBR mechanism. As a result of the PBR, LG&E has continued to develop, pursue, and manage creative supply arrangements, increased risk-taking, and has been given the incentive to negotiate intensively to improve cost performance and maintain reliability. For the GAIF and TIF PBR components, LG&E experienced net savings during the first four years of the five-year extension. For the OSSIF component, LG&E experienced net savings for two years, and did not incur net expenses the other two years. LG&E has provided evidence sufficient to show that it has been successful in outperforming benchmarks and lowering cost, to the benefit of its customers as well as its shareholders.

LG&E has also provided evidence sufficient to show that its proposed modifications to the GAIF will result in the calculation of more meaningful gas cost benchmarks. In response to a Staff request for information, LG&E provided calculations for the PBR reporting period showing a comparison of gas cost savings as currently calculated, and as calculated using its proposed modifications. The comparison showed that the modifications would result in a reduction to the calculated total gas cost savings, which would decrease LG&E's share of PBR savings. The Commission notes that the actual cost of gas to LG&E's customers as recovered through the Gas Supply Cost ("GCS") would not be impacted by the change, other than LG&E's sharing portion possibly being less, as shown in LG&E's sample calculations.

With regard to LG&E's proposal to increase its initial sharing portion over a narrower range, the Commission believes that a change from the current sharing levels to a 70/30 sharing of variances from 0 to 2 percent is too abrupt. In recognition of the increased and changing risks discussed by LG&E in its Application and responses, the Commission finds there is good cause to reduce the range for initial sharing to 0 to 3 percent, with no change to the current 75/25 sharing allocation. The Commission also finds that the current 50/50 sharing of variances greater than 4.5 percent should continue for variances greater than 3 percent.

Concerning LG&E's response regarding the removal of the HRF benchmark, the Commission agrees that it would be appropriate to do so, as historical levels of supply reservation fees may not be representative of what LG&E would be able to achieve in the future, and could be outside its control. No other elements of LG&E's PBR mechanism are based on historical benchmarks, and the fact that a similar element is not included in the mechanisms of Columbia and Atmos indicates that it is reasonable to remove this component of the GAIF.

SUMMARY

The Commission, based on the evidence of record and being otherwise sufficiently advised, finds that:

1. Modifying the PBR mechanism as LG&E has proposed with regard to the GAIF component calculations, including the removal of the HRF benchmark, is reasonable and should be approved.

2. The modification to the gas cost sharing calculation as proposed by LG&E should be denied.

3. The current gas cost sharing calculation, which allocates 25 percent of gas cost variances from 0 to 4.5 percent to LG&E, should be modified so that LG&E receives 25 percent of variances from 0 to 3 percent, with sharing thereafter allocated 50/50 between LG&E and its customers.

4. The tariff revisions included with LG&E's application are reasonable and should be approved, with the exception of the provision related to the sharing percentage as set out at the bottom of Sheet No. 87.8, which should be revised to reflect the change from 4.5 percent to 3 percent as found reasonable herein.

5. The mechanism should be continued as revised herein for five years, through October 31, 2020. The Commission finds that the previously ordered PBR reporting requirements should be revised, and that the PBR report should be filed annually as opposed to quarterly. The annual PBR report should be filed concurrent with LG&E's filing to reflect the effect of the PBR in its GSC Application for rates effective February 1 of each year.

IT IS THEREFORE ORDERED that:

1. LG&E's proposal to modify its current PBR and associated tariff sheets are approved as proposed, with the exception of the sharing calculation which is revised as discussed herein.

2. LG&E's current PBR mechanism, with the modifications approved herein, is extended for five years through October 31, 2020.

3. Within 60 days of the end of the fourth year of the five-year extension, LG&E shall file an evaluation report on the results of the PBR for the first four years of

the extension period. This report shall be considered in any proceeding established to continue, modify or terminate the PBR mechanism.

4. LG&E shall file annual reports of its activity under the extended PBR including the same information it provided during the previous PBR period.

5. Within 20 days of the date of this Order, LG&E shall file with this Commission, using the Commission's electronic Tariff Filing System, revised tariff sheets setting out the PBR tariff revisions approved herein, including the removal of the HRF benchmark, and reflecting that they were approved pursuant to this Order.

6. All documents filed in the future pursuant to ordering paragraphs 3 and 4 herein shall reference this case number and shall be retained in the utility's general correspondence file.

By the Commission

ENTERED
JUN 30 2015
KENTUCKY PUBLIC
SERVICE COMMISSION

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