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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR PERFORMANCE BASED GAS RATES) CASE NO 2005-00031

ATTORNEY GENERAL'S COMMENTS

LG&E proposes a continuation of its current gas supply performance based rate. Only two changes are proposed: first, that the term for which the rate is to be in effect be expanded from four to five years, and second, that the incentive sliding scale be changed to allow it a greater reward at every achievement level measured against the same benchmarks now in place. If the PBR is continued, no increase of incentives is appropriate.

From the consumers' point of view, the PBR continues to appear to be a creature of assumed rather than actual savings that may well do nothing more than give the Company a chance to earn in an area in which it was previously precluded from earning; the cost of gas. As the Company freely admits, there is absolutely no way to measure results under the PBR in terms of real savings to consumers in gas price cost.[1] Instead, all measurement compares the customers' gas cost to the established benchmarks with savings against the benchmarks being presumed to show savings to the customers. Never will the consumer know that the incentive mechanism results in a lesser actual gas cost to him or her than that which he or she would have paid absent the incentive mechanism under gas purchasing practices that are reasonable in the

[1] See, Response to Attorney General's First Data Request Dated February 9, 2005, Question 3 where the Company responds "...it is not possible to determine what gas supply costs might have been incurred in the absence of the PBR Mechanism...," and Question 4, where it responds "...a benchmarking mechanism is established because it is not possible to determine what gas supply costs might have been incurred in the absence of the PBR mechanism...."

gas market as it exists today. Assumption, presumption, and guesswork should not substitute for an actual showing of benefit to the customer in a time when gas costs are at an all time high.

1. No increase in the incentive is warranted if the PBR mechanism is retained.

LG&E presents the risk it assumes as the ground for increasing its incentive share under the mechanism. No increase is warranted. In the absence of the performance based mechanism, the cost of gas resulting from any reasonably prudent purchasing practice would be solely at the risk of the consumer as the company is entitled to recover the cost of gas. It is the incentive performance mechanism itself that creates the risks that the Company is being paid to assume.[2] Neither the customer (who will never know that the cost of gas resulting from the performance mechanism is actually cheaper than the cost of gas absent the mechanism) nor the Commission has imposed an obligation on the Company to operate under a performance based rate. The risks, therefore, are completely self-imposed. That alone indicates there is no reason to increase the incentives.

Were that alone not sufficient reason to refuse to increase the incentive paid to LG&E in the event the performance rate is continued, it must be combined with the fact that LG&E cannot point to anything or any way in which an increase in the incentive given to the company would result in added benefits for the ratepayer. It is unable to identify ways in which it would act differently were the incentive different from what it now is. It is unable to point to greater savings that might be achieved. It very clearly states and restates that strategies and practices that once worked may not work again and that there is no guarantee that any practice will produce savings. In Response to Commission Staff's Second Data Request Dated March 3, 2005, Question 2 (c) LG&E says,

[2] Response to Commission Staff's First Data Request Dated February 9, 2005, Question 1.

> When LG&E implements a strategy to create savings under the PBR mechanism, there is no guarantee that the strategy will produce savings under the mechanism. Some of the strategies and associated actions...have not always proven successful. Some strategies have proven very successful, but may not continue to be successful in the future. There is no single purchasing strategy that can be successful in any and all potential market scenarios. LG&E undertakes a variety of purchasing strategies which enable it to achieve savings for customers under a variety of market conditions because it does not know what market conditions will ultimately materialize and be used to measure its performance.[3]

LG&E also says, "Even if the benchmarks and sharing mechanism remain unaltered, LG&E may discontinue certain activities (or initiate new activities) depending upon their value in the marketplace relative to the risk (and cost) required to achieve savings through those activities."[4] Under the circumstances described, there is no bona fide reason to increase LG&E's incentive.

2. The undiscounted FERC rate is not an appropriate benchmark.

Moreover, the benchmarks are unduly high. Utilizing the FERC approved rate as the benchmark, and therefore as the basis for the presumed performance in the absence of the PBR, is inappropriate in light of LG&E's obligation to engage in least cost reliable gas supply purchasing. As LG&E states, the FERC rate is the rate utilized only in the "absence of negotiation or the absence of a competitive situation from which to negotiate."[5] It is a fact that the LG&E territory has more than one pipeline. Therefore, it is in a position to negotiate discounted rates. Its personnel to negotiate rates are paid for by customers. LG&E would be derelict in its duty to engage in least cost purchasing were it not to negotiate competitive rates available as a result of the presence of more than one pipeline.

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[3] Also See, Response to Attorney General's First Data Request Dated February 9, 2005, Question 11 where LG&E says, "the actions which LG&E undertook in the past (and the associated risks) may or may not be relevant for the future."

[4] Response to Attorney General's First Data Request Dated February 9, 2005, Question 12.

[5] Response to Attorney General's First Data Request Dated February 9, 2005, Question 5.

The presence of multiple pipelines with their potential to allow large customers to bypass LG&E altogether is the reason given for allowing large customers who could bypass LG&E to pay rates less than the rates indicated by cost of service studies in general rate cases. For those potential bypass customers, so long as variable costs are recovered and a contribution is made to fixed costs, the rate is considered adequate even if it is well below the rate indicated by a cost of service study. The share of a general rate increase that is not recovered from bypass-likely large customers is, instead, recovered from all other customers. Thus, customers are assigned an added burden due to the presence of the pipelines in general rates. Therefore, the customers rather than LG&E should also reap the benefit those same pipelines represent in the gas supply clause. The customers should be awarded the full benefit of negotiated discounts from the FERC approved rates in the gas supply clause rather than giving any portion of the discounted rate to LG&E.

3. If the PBR is continued, the longer term is acceptable if it presents savings opportunities resulting from longer term purchases that are not available in a shorter term program. Longer term purchases may render the short term market benchmark inappropriate.

LG&E proposes to increase the term of the PBR to five years. One of the stated reasons for doing so is that this might allow savings from purchases of longer term gas supply. This presents the question of whether it is appropriate to measure a longer term purchases against the short term market benchmarks now in place.

If the benchmark is appropriate and if savings can be achieved with longer term purchases, a purchasing strategy using longer term purchases should not be discouraged simply as a function of the length of time that is to pass until the next review of the PBR. However, regardless of how much time is to pass until the next review of the PBR, there will be a point when longer term purchases would exceed the review period. This unavoidable fact raises a

question as to whether the extension of the term to encourage cost saving longer term purchases is actually productive or whether that issue might better be addressed in some other way.

Conclusion

On the one hand, gas supply performance based rates benefits for the consumer are always based on the presumption that the benchmarks established in the mechanism accurately represent the utility's performance absent a PBR and that, therefore, beating the benchmarks is indicative of actual savings. But that is a presumption, not a demonstration of fact. Savings to customers over what those customers would have paid under standard prudent gas purchasing practices can never be factually demonstrated. On the other hand, gas supply performance based rates clearly benefit a utility by allowing an opportunity for added earnings in an area where it otherwise had none. Because the benefit is demonstrable for the utility and but only presumed for the customer, the PBR not an appropriate rate and should not be continued.

If it is continued, every incentive should be as low as possible and the benchmarks should be carefully reexamined to afford the consumer a benchmark that accurately reflects what the utility's performance should be under reasonably prudent purchasing practice absent the PBR.

Respectfully submitted

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NOTICE OF FILING AND CERTIFICATE OF SERVICE

Notice is hereby given that the original and ten true copies of the foregoing have been filed with the Executive Director of the Kentucky Public Service Commission by hand delivery to 211 Sower Boulevard, Frankfort, Kentucky 40601, this the 28th day of March, 2005. I further certify that this same day the parties have been served by mailing a true copy, postage prepaid, to Counsel of Record as follows:

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