June 21, 2010

RE: AN INVESTIGATION OF NATURAL GAS RETAIL COMPETITION PROGRAMS
Case No. 2010-00146

Dear Mr. DeRouen:

Enclosed please find and accept for filing the original and ten (10) copies of Louisville Gas and Electric Company’s Testimony of J. Clay Murphy and Pamela L. Jaynes, pursuant to the Order dated June 8, 2010 in the above referenced docket.

Should you have any questions please contact me at your convenience.

Sincerely,

[Signature]

Rick E. Lovekamp
cc: Parties of Record
COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION OF NATURAL GAS RETAIL COMPETITION PROGRAMS

CASE NO: 2010-00146

TESTIMONY OF
J. CLAY MURPHY
DIRECTOR – GAS MANAGEMENT, PLANNING, AND SUPPLY
LOUISVILLE GAS AND ELECTRIC COMPANY

Filed: June 21, 2010
Q. Please state your name and business address.

A. My name is J. Clay Murphy and my business address is 820 West Broadway, Louisville, Kentucky.

Q. By whom are you employed and in what capacity?


Q. What is your role as Director – Gas Management, Planning, and Supply?

A. I am responsible for overseeing the procurement of natural gas supplies and pipeline transportation services for LG&E, end-use natural gas transportation services, and regulatory issues related to LG&E’s pipeline transportation service providers. I am also involved in a number of other regulatory and planning activities and initiatives related to LG&E’s natural gas business.

Q. What is your educational background and work experience?

A. I graduated from Bellarmine College in Louisville, Kentucky, with a B. A. degree in Accounting in 1979. I graduated from Indiana University in Bloomington, Indiana, with an M.B.A. in 1981. I was employed by LG&E in the same year in the Rate Department, where I remained until 1986 when I transferred to the newly created Gas Supply Department. I became manager of that department in 1989 and director in 2000. A statement of my education and work experience is contained in Appendix A.

Q. Have you previously testified before the Kentucky Public Service Commission (“Commission”)?

636 on Kentucky Consumers and Suppliers of Natural Gas.” I have also submitted testimony in previous rate proceedings, including Case Nos. 2000-00080, 2003-00433, and 2008-00252, as well as in other proceedings before this Commission.

Q. Is anyone else providing testimony on behalf of LG&E in this proceeding?
A. Yes. Pamela L. Jaynes, Gas Supply Manager, is providing testimony on relevant matters based on a review of the Energy Information Administration (“EIA”) report entitled “Status of Natural Gas Residential Choice Programs by State as of December 2009” released on May 17, 2010 (hereinafter “2009 EIA Report”). Specifically, Ms. Jaynes’ testimony will describe unbundling and retail choice experiences in other jurisdictions, with a focus on customer gas cost savings and potential areas of concern.

Q. What is the purpose of your testimony in this case?
A. I will begin by stating LG&E’s position as it relates to retail choice and any expansion of current natural gas transportation programs. I will continue with an overview of the regulated natural gas local distribution company (“LDC”) in its role as a seller of natural gas to retail customers; provide comments upon the elements that should be considered in expanding natural gas retail choice programs found on pages 4 and 5 and in Appendix B in the Commission’s Order of April 19, 2010, in this case; and address certain other issues related to the subject of this proceeding.

Q. Please describe LG&E’s gas distribution business.
A. LG&E’s gas business is committed to providing safe and reliable natural gas service, quality customer service, and reasonable rates. In particular, LG&E strives to work with its customers to resolve service and payment issues. LG&E’s gas distribution business serves approximately 317,000 gas customers in Jefferson County and 16 surrounding
counties. LG&E’s gas distribution assets include approximately 4,200 miles of gas
distribution pipe, over 380 miles of transmission pipe, and five underground gas storage
fields. For the 12 months ended April 2009, LG&E’s annual throughput volume was
about 44 Bcf. About one quarter of LG&E’s throughput was gas transported for large
volume commercial and industrial customers; about half was gas sold to residential
customers; and about one quarter was gas sold to commercial customers. Therefore, the
bulk of LG&E’s annual throughput is to high-priority, space-heating customers. LG&E
is somewhat unusual among LDCs in that it owns and operates a large amount of on-
system underground gas storage, which provides about half of LG&E’s winter sales
volumes.

I. LG&E’s POSITION ON RETIAL CHOICE AND EXPANDED UNBUNDLING

Q. What is retail choice?

A. Retail choice is, generally speaking, the expansion of gas supply options to residential
customers. Retail choice could also include the expansion of transportation options to
smaller commercial and industrial customers. It differs from current gas transportation
programs that offer these options only to large volume customers who are generally less
in need of the consumer protections that must be afforded to smaller volume customers.

Q. What is the position of LG&E with regard to retail choice and the expansion of
current gas transportation programs to include those residential, commercial and
industrial customers that do not currently have the ability to select an alternate gas
supplier?
LG&E believes that retail choice programs or further unbundling should not be mandated by the Commonwealth of Kentucky. Such action prevents a comprehensive discussion of the many aspects of unbundling and its impact on each LDC and its customers. Furthermore, LG&E believes that the adoption of a gas retail choice program or the expansion of any current gas transportation programs should be left to the discretion of the LDC that must implement, manage, and administer the program. Because a disproportionate assignment of risk falls on the LDC in administering, managing, and operating its system under any broadened unbundling program, it should be up to the LDC to design and implement such program(s) at its discretion. This position is basically consistent with the findings of Administrative Case No. 367 initiated by the Commission in 1997.¹

Are there any corollaries associated with this position?

Yes. First, any retail choice program or any expansion of existing transportation programs should leave the LDC indifferent in terms of net revenue, i.e., a change in customer gas supply options should not be at the expense of either the LDC or its customers. Second, any LDC that voluntarily opens its system or expands gas transportation offerings should be able to tailor its unbundling program(s) to its particular circumstances so as to maintain reliable gas service for all customers. Third, not only may LDCs need to tailor their unbundling programs, different transportation programs offered by the same LDC may have different characteristics and provisions.

Should utilities and utility consumers be concerned about extending choice to smaller customers?

¹ See Order in Administrative Case No. 367 dated July 1, 1998.
A. Yes, and for several reasons. Broadening the availability of natural gas transportation programs in general poses a number of concerns for LDCs and their customers. These concerns include potential exposure to higher costs and decreased reliability. Significantly, responsibility for the very product which utilities are obligated to provide to their customers is removed from their management and passed to a third party. Consequently, the natural gas component of the service provided by LDCs - and the price at which it is sold – is removed both from the purview of the LDC and the Commission. The cost of gas is the largest component of the bill, typically accounting for between 60% and 80% of a typical residential customer’s bill. Expanded unbundling offers no guaranteed reduction in gas costs for consumers yet brings with it potential exposure to risks associated with decreased reliability and increased operating costs. These could portend adverse impacts on customer satisfaction.

Q. Will customers see savings with retail choice programs?

A. Not necessarily. There is no guarantee that customers will save money. As Ms. Jaynes discusses in her testimony, the marketer’s offer may be higher than the LDC’s price. This should perhaps come as no surprise because both the LDC and the unregulated marketers are purchasing gas in the same marketplace – yet the LDC may recover only its actual gas supply costs while the marketer may make a profit on the gas it sells. Additionally, all customers may be required to bear the cost of expanded unbundling on the theory that choice is better – even though customers that remain with the LDC may not have caused the LDC to incur the cost of these programs. As a result of expanded unbundling initiatives such as retail choice, all customers could be exposed to stranded costs, transition costs, and “supplier of last resort” costs, as well as increased billing
costs, uncollectible costs, and customer-handling costs. There will also be costs associated with handling customer complaints, regulatory proceedings, and marketplace enforcement. LDCs will have decreased flexibility to manage their procurement activities in ways that now allow them to optimize system operations and provide lower gas costs to all customers. Some may wonder if unbundling could be a move away from efficiency.

Q. Are there other risks associated with offering retail choice programs that the LDC may be required to shoulder?

A. Yes. The LDC must administer the program to maintain system reliability and step into the breach if the marketer fails to deliver. The LDC could become the “supplier of last resort” if the marketer fails to follow through on its commitments. The LDC may also be required to bill customers on behalf of the marketer and assume the risk of any bad debt or uncollectibles created as a result of the marketer’s business activities. Consequently, the marketer’s business may be conducted on a playing field largely supported by the LDC. Importantly, the marketer may earn a profit on the sale of the natural gas – the same natural gas for which the LDC may only recover its costs.

Q. Should the Commission be concerned about transferring the merchant function to unregulated marketers?

A. Yes. Residential choice and the expansion of transportation options could greatly diminish the Commission’s ability to regulate prices offered to consumers, ensure that prices are fair, just and reasonable, and foster a marketplace that operates efficiently and reliably.

Q. Does anyone clearly benefit from expanded unbundling?
A. Yes. The marketer gains the opportunity to earn a profit on the sale of natural gas to the same customers to whom the LDC sells gas at no profit. The marketer’s opportunity to benefit is greater the more it can rely upon the LDC to assume the marketer’s business risks by managing the gas system, invoicing customers, and performing credit and collection functions for the marketer. The marketer’s business model, particularly as described in recent legislation before the Kentucky General Assembly, relies largely upon the infrastructure created and managed by the LDC.

Q. What have been the recent trends in retail choice program participation where such programs exist?

A. Retail choice is floundering in most states, except where the LDC’s merchant function has been or is being eliminated – leaving the retail customer with no effective choice except that of an unregulated marketer. The 2009 EIA Report and similar previous EIA reports indicate that residential participation in customer choice programs has been relatively flat over the last several years. Ms. Jaynes discusses this in greater detail in her testimony.

II. STRUCTURE OF NATURAL GAS MARKETPLACE IN THE U.S. AND KENTUCKY

Q. Please describe the national marketplace for natural gas.

A. The U.S. wholesale natural gas marketplace is not subject to price regulation. This has been the case since 1993 when the Natural Gas Wellhead Decontrol Act of 1989 eliminated all remaining price regulation of wellhead sales and allowed the market to
determine the price of natural gas at the wellhead. As such, the market price of natural gas responds to perceived changes in supply and demand. Importantly, the Federal Energy Regulatory Commission ("FERC") and other federal agencies do regulate the natural gas marketplace in order to foster market transparency and help ensure that prices are openly arrived at and markets are functioning well.

Q. **What about the interstate transportation of natural gas from the production area to the LDC?**

A. FERC regulates the rates and services offered by natural gas interstate pipeline companies. Importantly, FERC also helps ensure that the marketplace for natural gas transportation activities functions in an open and transparent manner by establishing rules and regulations that govern how parties must conduct business.

Q. **Has the Commission provided any guidance on how it expects LDCs in Kentucky to purchase the natural gas supplies that they re-sell to customers?**

A. Yes. That guidance is generally embodied in the orders from two administrative cases – Administrative Case No. 297 and Administrative Case No. 384.

Q. **What guidance was provided by the Commission in Administrative Case No. 297?**

A. In Administrative Case No. 297 the Commission affirmed that LDCs should "obtain gas at market clearing prices" and maintain "the reliability of supply to those customers dependent on firm supply service" indicating that LDCs should "seek to obtain the least-cost reliable supply of natural gas."2

Q. **What guidance was provided by the Commission in Administrative Case No. 384?**

A. In Administrative Case No. 384 the Commission enhanced the earlier guidance provided in Administrative Case No. 297 by stating that "LDCs should maintain their objective of

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procuring wholesale natural gas supplies at market clearing prices, within the context of maintaining a balanced natural gas supply portfolio that balances the objectives of obtaining low cost gas supplies, minimizing price volatility and maintaining reliability of supply.”

Q. Do these Commission orders apply to marketers?
A. No. The Commission cannot review a marketer’s purchasing processes or the purchase transactions that result therefrom. The Commission can neither approve nor reject the prices charged by marketers to consumers.

Q. Do these Commission orders act as a guide to LG&E as it secures the gas supplies required by its sales customers?
A. Yes. In accordance with the Order of the Commission in Administrative Case Nos. 297 and 384, LG&E seeks to purchase the most economical gas supplies available consistent with maintaining reliability of supply and mitigating price volatility.

Q. Must LDCs in Kentucky integrate the Commission’s regulatory guidance into its natural gas and interstate pipeline contracting activities in order to serve its retail sales customers?
A. Yes. LDCs synthesize regulatory guidance, market conditions, and gas system requirements into an overall supply plan that addresses the many divergent concerns of customers, regulators, and the LDC itself in order to provide reliable service to customers at a reasonable price. LDCs recognize the importance of system reliability even under the most extreme conditions. They strive to achieve reliability by securing and managing appropriate levels of pipeline capacity and storage. They contract for and manage gas supplies from credit-worthy and reliable gas suppliers. Some LDCs also manage on-

system storage to reliably serve their customers. As they conduct these supply management activities, LDCs recognize the need to secure gas at a price that is reflective of market conditions and in a manner that reasonably mitigates price volatility.

Q. Please describe generally how LDCs in Kentucky now recover the natural gas costs that they incur on behalf of sales customers.

A. The natural gas sales service provided by LDCs is regulated by the Commission. Typically, each LDC has some form of purchased gas adjustment ("PGA") mechanism. This mechanism generally provides for the dollar-for-dollar recovery of all prudently incurred gas supply costs. These costs include the cost of the gas commodity itself as well as the transportation of that gas via interstate pipelines from the production area to the LDC. PGA mechanisms also provide for changes in the tariffed gas commodity rate at regular intervals and generally contain true-up mechanisms to ensure that the over- or under-collection of gas costs in one period are returned to, or collected from, sales customers in subsequent periods.

Q. Is this structure generally applicable to LG&E?

A. Yes. LG&E’s PGA mechanism is called a Gas Supply Clause ("GSC") and is a part of LG&E’s tariff approved by the Commission. LG&E’s GSC recovers the costs to purchase the natural gas commodity and the pipeline capacity necessary to transport it to LG&E, as well as the cost of gas injected into or withdrawn from its storage. Pursuant to that tariff, LG&E’s GSC is filed with the Commission on a quarterly basis subject to Commission approval.4

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4 LG&E’s GSC changes quarterly effective with service rendered on and after February 1, May 1, August 1, and November 1 of each year. The Gas Cost Actual Adjustment ("GCAA") covers over- and under-collections for the previous 12 months and remains in place for a year from the effective date. The Gas Cost Balance Adjustment ("GCBA") aggregates any remaining over- or under-collections not resolved by the GCAA into a single
Q. What are your conclusions about the current structure of the marketplace?

A. The current structure provides transparency and protection to consumers. LDCs secure and manage natural gas supplies in a highly competitive marketplace. LDCs are guided by Commission orders in prudently purchasing natural gas supplies, interstate pipeline transportation, and storage on behalf of customers. LDCs have the flexibility to manage their procurement activities in ways that now allow them to optimize system operations and provide lower gas costs to all customers. LDCs are required to sell natural gas at cost. This transparent market structure benefits customers by providing them with safe and reliable natural gas service at a fair, just, and reasonable price.

III. RECENT LEGISLATIVE PROPOSALS IN KENTUCKY

Q. Have there been any recent legislative initiatives to change the current structure of the natural gas marketplace in Kentucky?

A. Yes. This proceeding is being conducted as a result of the Kentucky General Assembly’s request found in House Joint Resolution No. 141. That joint resolution grew out of the introduction in the General Assembly of two bills (House Bill No. 542 and Senate Bill No. 154), both of which would have mandated LDCs in the Commonwealth of Kentucky to expand current gas transportation programs. House Bill No. 542 would have mandated gas retail choice by expanding gas transportation programs down to the residential level, while Senate Bill No. 154 was more focused on small commercial and industrial customers.

factor that remains in effect for a single quarter. The Refund Factor ("RF") credits customers with any cash refunds received from suppliers.
Q. Has the Commission proposed exempting any LDCs from an expansion of unbundling programs?

A. Yes. In Appendix B of its April 19, 2010, Order, the Commission indicated its position that not all utilities should be required to participate if legislation is approved that mandates the expansion of current LDC transportation programs:

*Item 18:* Only major incumbent utilities with a certain minimum number of customers should be required to participate. Smaller utilities should not be required to participate.

Given the considerable cost, administrative burden, and risks associated with these programs, it seems reasonable to exempt smaller utilities. For some of the same reasons, it seems advisable to leave the expansion of unbundling programs to the discretion of each LDC.

Q. How would the transportation programs described in recently proposed legislation differ from the transportation programs currently in place for large volume gas customers?

A. They are strikingly different in costs, administrative burden, and risks.

Q. Please describe the current large volume transportation programs offered by LG&E.

A. Large volume gas transportation customers are at risk for their own gas supplies and are required to manage and acquire their own supplies within the parameters of the applicable rate schedule. Under its large volume transportation program, LG&E provides firm transportation service from the city-gate (the point where the customer delivers the gas to the LDC for the customer’s account) to the customer’s facility. If the customer electing service chooses not to purchase its own gas supply, or if the customer fails to
deliver all or any part of its requirements, LG&E has no obligation to provide natural gas supplies, storage, or pipeline transportation services (or any associated balancing services) to the customer. These large customers typically use natural gas at a higher load factor and at more predictable rates because they tend to use gas primarily for process purposes. On LG&E’s system, these customers are required to have telemetry installed which allows both the customer and LG&E to monitor actual usage in order to better manage gas supplies. Because of the small number of these large volume customers, it is feasible to physically isolate these customers if they fail to deliver the appropriate volume of gas required for their facility. Due to the relatively small number of customers in these programs, administration costs such as enrolling customers, natural gas tracking, and billing are less onerous than they would be under an expanded unbundling program. Additionally, LG&E is only required to bill these large customers for charges under LG&E’s tariff. LG&E is not required to bill customers on behalf of marketers so it has no obligation to collect and/or purchase the marketer’s receivables. Consequently, large volume transportation programs can be considerably less burdensome in terms of cost and risk than the smaller volume transportation programs contemplated in this proceeding.

Q. How do the transportation programs outlined in House Bill No. 542 and Senate Bill No. 154 differ from these large volume transportation programs?

A. These programs would apply to high priority space-heating customers. Space-heating customers require significant hourly and daily load balancing. Space-heating customers (because their loads vary significantly with weather) put greater hourly and daily demands on the gas distribution system. Unlike large customers that secure their own gas
supplies, smaller customers, such as high priority residential space-heating customers, cannot make alternate arrangements if their marketer fails to deliver (like a factory closing or switching to fuel oil). Because of the large number of residential and small commercial customers, it would be infeasible to physically isolate individual customers from the gas system in the event that their gas supplies are not delivered by marketers – assuming it were even possible to ignore the basic needs of high priority space-heating customers. Due to the potential for a large number of customers to participate in the programs described in proposed legislation, the implementation and ongoing administrative costs of these programs can be expected to be significantly higher than for more limited large volume transportation programs. Additionally, other aspects of these expanded unbundling offerings such as billing requirements; purchase of receivables; capacity allocation; and “supplier of last resort” options increases the exposure of both the LDC and its customers to risks.

IV. ELEMENTS TO BE ADDRESSED AS A PART OF ANY RETAIL UNBUNDLING SCHEME

Q. What items will you address in this section?

A. In the event that a LDC does choose to provide gas supply options to its customers by either offering retail choice or otherwise expanding gas transportation programs, the Commission has outlined a number of items on pages 4 and 5 of its April 19 Order that should be addressed and which are similar in scope to those outlined in its July 1, 1998, Order in Administrative Case No. 367. Those items are:
1. The role of the Commission in a competitive marketplace  
2. The obligation to serve  
3. The supplier of last resort  
4. Alternative commodity procurement procedures  
5. Non-discriminatory access to services offered  
6. Codes of conduct for marketers and affiliates of regulated utilities  
7. Billing which should include the desirability of the purchase of receivables  
8. Certification of suppliers  
9. Transition costs  
10. Stranded costs  
11. Uncollectibles  
12. Disconnections  
13. Steps necessary to maintain system integrity  
14. Access to pipeline storage capacity  
15. Impacts of new natural gas retail competition programs on existing utility services and customers  

There are some additional items that I will also address in the course of discussing these items and at the conclusion of my testimony.

The role of the Commission in a competitive marketplace

Q. What will be the role of the Commission in the event of expanded unbundling?

A. Clearly, the Commission will have an additional administrative burden with respect to expanded unbundling. The Commission will have increased regulatory duties with respect to the marketplace as a whole, and the Commission will have a larger number of market participants to regulate. Like FERC, the Commission will have the duty to regulate the marketplace to ensure that it is open and transparent to all participants, and that markets open to this new kind of “competition” do not disadvantage certain classes of customers. The Commission will have increased duties with respect to enforcing the marketer’s obligation to serve and will have the responsibility for ensuring that marketers are certified as physically, financially, and technically capable of serving customers. The Commission could also have more complaints to manage and resolve as the number of participants in the marketplace increases. As has happened in other jurisdictions, there
may be an increase in the number of proceedings as the Commission addresses unbundling programs and the potential modifications to them.

The obligation to serve

Q. How will the obligation to serve be affected by such unbundling programs?
A. The “obligation to serve” is a fundamental concept of the utility industry that requires a utility to provide service to all who desire it without undue discrimination. Regulated utilities have been subject to the obligation to serve in exchange for their monopoly service territory. Although retail unbundling results in both regulated and unregulated market participants, the “obligation to serve” will apply to both regulated utilities (LDCs) and unregulated entities (marketers). For regulated utilities (LDCs), the obligation to serve will remain basically unchanged, requiring the LDC to connect a customer and provide non-discriminatory service pursuant to the terms and conditions of its tariff. Under these new unbundling schemes, the obligation to serve will also be applied to unregulated entities (marketers), requiring the marketer to provide service on a non-discriminatory basis. These obligations to serve for both the LDC and the marketer are the foundation for providing service in a partially deregulated environment, and it is in the public interest that fair, just and reasonable rates be available to all customers.

The supplier of last resort

Q. What is meant by the “supplier of last resort”?
A. The “supplier of last resort” is generally the LDC that must stand in readiness with adequate pipeline capacity, storage, and gas supplies to serve customers in the event that the marketer fails to deliver natural gas. Such definition is consistent with Appendix B of
the Commission's April 19, 2010, Order, where it references the following item with respect to the "supplier of last resort":

**Item 13:** The utility must be statutorily designated as the supplier of last resort.

Essentially, the utility is by default the "supplier of last resort" because of the unique position in which it stands as operator of the gas system.

**Q.** Are there costs and risks associated with acting as "supplier of last resort"?

**A.** Yes. Acting as the "supplier of last resort" will require the LDC to have gas supplies, pipeline capacity, and storage on hand that could create duplicative costs (that would not otherwise be incurred) in order to ensure reliable service to all customers.

In Appendix B of its April 19, 2010, Order, the Commission references the following item with respect to the "supplier of last resort":

**Item 20:** The statute should state that costs incurred by the utilities relating to being the supplier of last resort (capacity assignment, for example) should be charged to marketers as appropriate.

The costs associated with being the "supplier of last resort" should be recoverable because, absent any expansion of unbundling, the "supplier of last resort" costs would not have been incurred by the LDC. Recovery of these costs from marketers makes sense because they will be the only clear beneficiary of expanded unbundling initiatives and are the origin of the risk that must be managed by the LDC in its new role as "supplier of last resort." These "supplier of last resort" costs will be incurred and should be recoverable through the term of the unbundling program.

**Alternative commodity procurement procedures**

**Q.** Are there alternative commodity procurement procedures that LDCs should consider with respect to further unbundling?
A. Not necessarily. As discussed above, current commodity procurement procedures used by LDCs are the product of Commission guidance. Current regulatory processes ensure that the Commission is able to review LDC procurement activities in order to ensure that the prices charged to customers are fair, just, and reasonable. The ability of the Commission to review not only the price but the underlying process also provides transparency.

Q. Are you aware of any alternate commodity procurement procedures being used in connection with unbundling programs?

A. Yes. For example, in Ohio where some LDCs have chosen to exit the merchant function, some LDCs may utilize a Standard Service Offer ("SSO"). The purpose of the SSO mechanism is to serve the residual portion of the LDCs customers that have hitherto declined to select a marketer. Although LDCs may use this supply procurement methodology as a transition to exiting the merchant function, the scheme ultimately excludes more traditional natural gas suppliers in favor of retail choice marketers only. Ms. Jaynes discusses the SSO more fully in her testimony.

Q. Does LG&E offer any alternate commodity procurement procedures?

A. LG&E believes that current procurement methods result in low cost gas supplies for customers. However, this proceeding seems more focused on how gas is sold, rather than how it is procured. Currently, regulation favors a single uniform gas commodity rate applicable to all customers determined in the PGA mechanism. LDCs may want to propose offering natural gas supplies to customers at different rates rather than a single average rate embodied in the LDC’s PGA mechanism.\footnote{For example, the LDC may want to offer different gas commodity rates based on the customer’s load factor; alternatively, the LDC may want to offer gas to interested customers at a fixed price over a given term.} Approving proposals by LDCs to
offer more than a single rate for gas supplies could allow the LDC to offer more options to customers.

**Non-discriminatory access to services offered**

**Q.** How will the Commission ensure non-discriminatory access to services offered by the LDC?

**A.** Any new services offered by the LDC will need to be the subject of detailed tariffs and agreements filed with and approved by the Commission. As it has done traditionally, the LDC will provide service on a non-discriminatory basis to its customers (including any marketers who may be customers for some of these new services) within the terms and conditions of the approved tariffs.

**Codes of conduct for marketers and affiliates of regulated utilities**

**Q.** How will the Commission ensure non-discriminatory access to services offered by the marketer?

**A.** The Commission must ensure the obligation to serve by imposing codes of conduct on all marketers and enforcing them through a certification process. Such codes should be designed to prevent misleading and harmful conduct by marketers. Appropriate codes of conduct combined with a marketer certification process should be designed to help ensure that services are offered by marketers on a non-discriminatory basis.

In Appendix B of its April 19, 2010, Order, the Commission references the following items with respect to a marketer code of conduct in order to provide consumer protection and maintain reliability:

**Item 4:** The marketer must be subject to the consumer complaint process.
Item 7: The marketer should be required to file a code of conduct in a filed tariff or follow a code of conduct established and approved by the Commission and set forth in the utility’s tariff.

Item 9: The marketer must be prohibited from unreasonably discriminating against customers as set forth in KRS 278.170.

Item 11: The marketer must be prohibited from transferring customers without customer approval.

Item 19: Marketers should be required to clearly list and advertise all price offerings. The specifics and parameters of all offers should be easily understood. Perhaps the format of offers should be set forth.

While not a comprehensive list, each of the above items is worthy of inclusion in a code of conduct. Significant customer confusion will inevitably loom in the wake of increased gas transportation options for smaller customers. Moreover, some marketers operating in retail choice markets have been found guilty of taking advantage of customers by “slamming” them or misleading them through deceptive or misleading marketing practices. Ms. Jaynes discusses some of these deceptive marketing practices in her testimony. Codes of conduct should be constructed to clearly describe activities that are forbidden and not tolerated and to provide for financial or other penalties if infractions occur.

Q. Are additional rules required to govern the relationship between an LDC and its affiliated marketer?

A. The Commission’s Order in Administrative Case No. 369, dated February 18, 2000, governs the relationship between the LDC and its affiliate(s), and the affiliate rules and regulations put in place as a result of that case are adequate in their application to utilities and their affiliates. The rules established therein do not apply to marketers unless they are affiliated with a Kentucky LDC.
Billing which should include the desirability of the purchase of receivables

Q. How should customers be billed if transportation programs are approved for smaller customers?

A. First, let me explain how billings and receivables are handled for LG&E’s transportation program offered under Rate Schedule FT. LG&E is responsible for metering customer use and billing the customer all of the charges under its tariff. These charges include the administrative charge, the distribution charge, and any other charges assessed pursuant to the tariff. The marketer bills the customer directly pursuant to any agreement between the marketer and the end-use customer. LG&E does not have access to, and does not need to have access to, these charges by the marketer. LG&E collects its own charges from the customer pursuant to its tariff, and the marketer is responsible for collecting its own charges. As such, LG&E does not assume the responsibility for either collecting the charges of the marketer or the risk for any bad debt that may arise from a failure to collect by the marketer. LG&E only has risk and responsibility related to its own charges.

In Appendix B of its April 19, 2010, Order, the Commission references the following item with respect to billing, which seems to encompass the preferences of the marketer and the unbundling scenario contemplated by House Bill No. 542:

**Item 17:** The utility should be required to include the gas cost charged by the marketer in its regular customer bills. The marketer will pay a reasonable cost to the utility for this service.

LDCs should not automatically be required to provide billing services for the marketer. It should be at the option of the LDC to provide billing services for the marketer, to bill only the LDC’s charges, or some combination of both. Details regarding billing
processes should be included in any LDC proposal to unbundle its services. However, all prudently incurred billing costs must be recoverable by the LDC. Recovery of these costs from marketers makes sense because they will be the only clear beneficiary of expanded unbundling initiatives and are the origin of the risk that must be managed by the LDC. It is important to note that the level of these costs may vary substantially by LDC. Additionally, each LDC should be allowed to continue billing large volume customers pursuant to current billing processes.

Q. **How does a purchase of receivables ("POR") mechanism work and what does it accomplish?**

A. My understanding is that the LDC remits to the marketer all or some portion of the marketer’s charges irrespective of the amount collected from the customer. The POR mechanism isolates the marketer from credit and collection functions. The marketer’s risk of collection is transferred to the LDC. Importantly, the LDC takes on that risk (and may be exposed to incremental risk) even though it did not establish the price paid by the customer in the first place. Other alternatives could include having either the marketer bill the customer directly for the marketer’s charges or developing allocation procedures that allocate partial payments by customers between the marketer and LDC in the event that the LDC bills the charges for both parties.

Q. **Did you say that the LDC pays the marketer “all or some portion” of the amount charged by the marketer to the customer?**

A. Yes. In some POR programs, the LDC “discounts” the amount that the LDC remits to the marketer by a percentage that presumably reflects the actual uncollectible or bad debt level and other associated costs of the LDC.
Q. Why do marketers favor billing by the LDC combined with a POR mechanism?

A. Marketers likely favor such a combination because they do not have to develop a costly billing infrastructure themselves. The combination of the two alleviates the need for the marketer to develop credit and collection infrastructure or to assume billing and collection responsibility. Having the LDC bill the customer and having the LDC use a POR program significantly mitigates the costs that the marketer might otherwise assume in its business operations.

Q. Will combined billing necessarily benefit customers?

A. Combined billing could be confusing to customers by making it difficult for them to distinguish the charges of the marketer from those of the LDC. Customers electing an alternate supplier might expect to see a clear reduction in their LDC bill that would indicate that they are no longer purchasing gas from the LDC.

Q. Will there be added costs to modify existing billing systems and credit and collection procedures?

A. If the LDC is required to provide billing services to the marketer, I am certain there will be costs to modify existing billing and related systems. In addition, such billing modifications, like the other aspects of broadened unbundling, will take time to properly implement. Such costs will presumably be treated as a transition cost as discussed elsewhere in my testimony.

Q. How might the cost of billing system modifications be mitigated?

A. Limiting the information that must be included related to the marketer’s charges and limiting the types of prices and number of programs offered by the marketer may help mitigate billing costs. Similarly, imposing limits on the timing and frequency of the
customer’s switch either from the LDC to a marketer or from one marketer to another may also help mitigate costs, for example, by imposing an annual sign-up date effective with the customer’s meter reading date

Q. Has the Commission suggested any other market safeguards that would impact LDC billing?

A. Yes. In Appendix B of its April 19, 2010, Order, the Commission references the following item with respect to billing:

    Item 21: The Actual Cost Adjustment (the over- or under-recovery of the utility’s Expected Gas Cost) should continue for choice customers for 12 months after the switch to a marketer.

This means that the over- and under-collection that occurred when the customer was purchasing natural gas from the LDC under a sales rate schedule will either be credited or charged to the customer for some period after the customer has chosen to purchase natural gas from a marketer. While this requirement seems equitable, it will necessitate billing system modifications that could add to transition costs. This guideline appears to assume that the customer does not switch back and forth between the LDC and one or more marketers in less than a year’s time. Details would need to be resolved on how to bill customers moving back and forth from the LDC to the marketer.

Certification of suppliers

Q. Will marketers need to be certified?

A. Yes. In the same way that an LDC scrutinizes the capabilities of its suppliers, the Commission will have to scrutinize the abilities of marketers because individual transportation customers will likely not have that ability. Periodic review and re-determination of the marketer’s certification by the Commission may also be advisable.
Properly certifying marketers may be one way in which to mitigate the number of 
disputes between marketers and customers with which the Commission may need to deal.
Properly certifying marketers may mitigate the LDC’s risks associated with being the 
“supplier of last resort.”

Q. **What guidelines should apply to marketer certification?**

A. In Appendix B of its April 19, 2010, Order, the Commission references the following 
item with respect to supplier certification:

*Item 1*: The Commission should have some regulatory oversight over the 
marketer and must be able to certify the marketers upon a finding of financial, 
technical and managerial expertise.

*Item 2*: The marketers must be required to renew their certificates to operate in 
Kentucky every two years.

*Item 3*: The marketer must maintain official corporate information on file with the 
Commission and should file a tariff setting forth the terms and conditions of 
service.

*Item 5*: The Commission must be allowed to assess penalties against the marketer 
if the marketer fails to: (a) abide by contractual terms with the customer or the 
utility; or (b) follow any rules established by the Commission, whether for safety, 
billing, reporting, general practices, etc.

*Item 6*: The potential penalty should include the authority to revoke, suspend, 
modify, limit, or condition the certification and should include the authority to 
assess a monetary penalty payable to the General Fund as with penalties assessed 
against regulated utilities.

*Item 8*: The marketer should be subject to KRS 278.130, KRS 278.140, and KRS 
278.150, which provide for annual reports and payment of annual assessments.

*Item 10*: The marketer must be prohibited from transferring certificates to operate 
as marketer without Commission approval.

*Item 12*: The marketer must be prohibited from abandoning or terminating 
contracts with a utility without providing at least 60 days' notice to the 
Commission, and the Commission must grant approval of such termination.
Item 16: The marketer must be required to file monthly rates with the Commission and the rates must be made available to customers.

Clearly, the level of detail and consideration given to these nine items shows that the Commission is aware of and concerned with some of the potential repercussions of opening Kentucky’s retail markets to unregulated marketers and retail gas choice schemes.

Q. Why is marketer certification important?

A. With the Commission certifying and approving marketers, the Commission will control the process for scrutinizing marketers to ensure credit-worthiness, reliability, capabilities, and overall fitness to act as a natural gas provider. This is important because the suppliers that the LDC selects are currently a key element in ensuring the overall reliability of the system. Even a customer not selecting a marketer could be adversely impacted as a result of the actions of these retail choice marketers – *e.g.*, if one of these marketers fails to deliver appropriate quantities of natural gas to the LDCs system. If the LDC must cover the marketer’s failure to deliver, withdrawing the marketer’s certificate may not be an adequate remedy for a failure to perform. Costs incurred as the result of such a failure must be recoverable. Therefore, the goal should be to create a system for marketer certification that will result in a selection of suppliers that have financial and other characteristics that will help to prevent degraded system reliability. Subsequent to marketer certification by the Commission, the marketer should also be required to register with the LDC in whose territory the marketer wishes to operate in order to establish contractual, surety, and other relationships.

Q. Are there other conditions that the Commission may want to consider with respect to marketers operating in Kentucky?
A. The Commission may want to consider marketer reciprocity rules which could require
that a marketer affiliated with an LDC should not be able to participate in expanded
unbundling programs in Kentucky unless its affiliated LDC is also unbundled to the same
degree as that of the Kentucky LDC whose customers it wishes to serve.

Transition costs

Q. Will there be transition costs associated with expansion of gas transportation
options and how will these costs be recovered?

A. For the purpose of this testimony, “transition costs” are those costs that are incurred by
the utility as it implements changes designed to facilitate retail unbundling or otherwise
expand unbundled transportation options in its service territory. Transition costs will
inevitably arise if an LDC expands gas transportation options to smaller customers in its
service territory.

Q. What kinds of costs could arise as changes are implemented?

A. It is impossible to foresee and estimate all of the transition costs that will arise. However,
certain categories of costs appear common in other states that have unbundled.
Educational costs will surely arise as consumer information materials and educational
processes are developed to address the various aspects of retail choice programs. These
educational efforts are necessary because customers are unfamiliar with, and have never
had the responsibility for, choosing a gas supplier. Similarly, LDC employees will need
to be adequately trained to explain this new option to eligible customers. LDC
employees will also need to be able to answer billing and other questions that customers
might have about the gas transportation service they have chosen in lieu of sales service.
These activities will create incremental training and other administrative costs for LDCs.
The Commission will likely want to review and approve these educational materials. In
Appendix B of its April 19, 2010, Order, the Commission references the following item
with respect to educational materials:

**Item 15:** Customers must be provided educational materials from the utility and the marketer.

Clearly, educational materials and processes are necessary to reduce customer confusion
and are costs that the LDC would not have incurred in the absence of expanding gas
transportation options.

Other significant transition costs will likely be incurred to modify billing systems and
related reporting processes, to create new gas tracking systems and electronic bulletin
boards, as well as to establish new credit, collection, and payment procedures. None of
these costs would have been incurred by the LDC absent the expansion of unbundling
options. At this juncture, it is not possible to estimate the level and duration over which
such costs might be incurred.

Q. **Will these transition costs gradually be eliminated?**

A. Certain kinds of transition costs may eventually be eliminated. Such costs might include
those incurred to modify LDC billing systems to accommodate marketer billing (if that is
the option chosen) or the costs of educational programs. However, it is possible that, as a
result of an unbundling initiative, some costs will be on-going and will result in a
permanently higher level of costs. These higher costs could result from the increased
burdens placed on the LDC by further unbundling, such as on-going billing costs and
credit and collections efforts. These costs could also include additional personnel, new
operating systems, or internet website costs to facilitate nomination and other data
interchange. These kinds of incremental costs should be considered for inclusion in any
billing charge imposed by the LDC for these kinds of services to be performed for the marketer.

Q. Should the LDC be able to recover these transition costs?
A. Yes. To the extent that the utility incurs any transition costs they should be recoverable.

Stranded costs

Q. What are stranded costs and how might they arise?
A. "Stranded costs" are those costs arising from contracts or items included in rate base and incurred by the LDC on behalf of customers but which might no longer be required in the wake of retail choice or expanded unbundling options for customers. These costs arise as a result of consumers electing to purchase natural gas from a marketer and not the LDC. These costs could include interstate pipeline capacity (including storage), on-system storage assets, and gas supply agreements. Pipeline capacity costs are probably the largest potential stranded costs – depending on the design of the unbundling program.

Q. Are there ways to mitigate potential stranded costs?
A. One way in which to mitigate potential stranded costs and to promote supply reliability may be the mandatory assignment of the LDC’s interstate pipeline capacity on a recallable basis. I have discussed mandatory capacity assignment elsewhere in my testimony.

Q. Should the LDC be able to recover these stranded costs?
A. Yes. Like transition costs, stranded costs should be recoverable.

Importantly, both transition costs and stranded costs could be the source of significant "hidden costs" associated with the expansion of gas transportation programs. These
“hidden costs” could increase the rates of all customers in order to provide customers with the ability to choose – whether or not they actually choose to choose.

Stranded costs, like transition costs, should be recoverable from the beneficiaries of any unbundling program. It seems unreasonable to make customers pay for the ability to choose – whether or not they choose a marketer. Assigning cost responsibility to all customers because of the action of a few would seem to be at odds with the cost causation principles of utility rate making. Recovery of these costs from marketers makes sense because they will be the only clear beneficiary of expanded unbundling initiatives and are the origin of the risk that must be managed by the LDC.

**Uncollectibles**

Q. **How will uncollectibles be managed?**

A. Today, some level of the LDC’s uncollectible amounts is either reflected in the LDC’s base rates or recovered elsewhere by the LDC. If an unbundling plan is adopted, uncollectibles will be managed based on the billing and collection procedures adopted under the LDC’s unbundling plan.

Today, for customers served under Rate Schedules FT and TS, LG&E is responsible for collecting only utility charges from customers. The marketer is responsible for collecting its charges. If the billing scenario outlined by the Commission in Item 17 – suggesting the billing of marketer charges by the LDC – is combined with a POR program, it will be up to the LDC to manage any uncollectibles arising from its charges and the charges of the marketer.

**Disconnections**

Q. **How will disconnections be managed?**
A. Today, for customers served under Rate Schedule FT, if LG&E is unable to collect its utility charges from customers, the utility can disconnect service. If the marketer is unable to collect, it may cease delivering gas to the LDC for the customer’s account without asking any permission of the LDC.

If, however, under a retail choice program, LDCs bill and collect revenues for marketers, the LDC will likely remain responsible for physical disconnection and reconnection of customers for non-payment. The LDC may also require the authority to disconnect a customer for non-payment of the marketer’s charges.

Steps necessary to maintain system integrity

Q. What actions will need to be taken to maintain system integrity?

A. Maintaining reliability is one of the key concerns of LDCs with regard to the institution of customer choice programs. Most customers do not even think about reliability when thinking about their LDC. Homeowners and businesses alike presume that the right amount of gas will be there on the right hour of the right day. Few customers, if any, realize the considerable efforts undertaken by LDCs in order to ensure that they are delivering a safe and reliable product for the customer to use. In the event of further unbundling, the LDC needs to be able to continue to procure and manage interstate pipeline capacity in order to reliably meet system loads under design conditions.

In order to maintain system integrity, the LDC will need to be able to retain operational control. As a part of maintaining system reliability, an LDC may propose to release its pipeline capacity to participating marketers on a mandatory and recallable basis. Marketers must be required to accept any capacity released by the LDC under such a program. The LDC may also need to specify the amount that the marketer must deliver.
on a given day given the load profile of the customers it is serving. Even then, it may not be possible to ensure reliability to the same degree as is presently the case. In any case, the LDC will need to retain the management of storage injections and withdrawals and other storage activity.

Lastly, marketer certification by the Commission will be essential in ensuring that only responsible entities will be participating in any expanded unbundling programs.

Q. Should the LDC be able to secure some form of surety from marketers similar to the surety that the LDC secures from its own suppliers as well as from other customers?

A. Yes. LDCs should also be able to obtain acceptable surety from marketers participating in any extension of gas transportation options. LDCs typically require surety from their gas suppliers, and this case should be no different. In fact, the Commission recognized this need in Appendix B of its April 19, 2010, Order, when it referenced the following:

*Item 14:* The utility should be allowed to require the marketer to post a performance bond or other evidence of financial security in the event of abandonment. The method for calculating the amount of the bond should be set forth by statute or regulation.

However, a pledge of the marketer’s receivables under a POR program is not adequate surety. For example, a marketer’s receivables may not be large enough or of an adequate quality to cover potential costs in the event a marketer abandons its customers or fails to deliver natural gas to the LDC on behalf of customers. Surety of credit-worthiness by marketers is an important means of ensuring gas system reliability as is continued control by the LDC over capacity planning and contracting; gas storage operations; and general gas system operations.

Access to pipeline storage capacity

Q. How will access to pipeline capacity (including storage) be handled?
A. The development of new tariffs designed to implement the unbundling programs proposed by each LDC will likely provide their own complexities. Under some unbundling scenarios it may be necessary to establish complicated formulae to determine how much storage and pipeline capacity will be allocated to each marketer based on the level and type of customers subscribing to that marketer's offerings. These formulae-driven allocations may need to reflect system load factors, complex storage ratchets and operating parameters, as well as contractual rights and obligations of the LDC. Maintaining access to adequate pipeline capacities and services combined with properly operating storage assets within defined parameters is essential to maintaining overall system integrity. Carving up storage and creating entitlements among numerous entities is fraught with complexities and uncertainties. The daily deliveries of marketers participating in an unbundling program likely will be much more complex to manage than simply dividing annual customer consumption by 365 days and then scheduling uniform daily pipeline deliveries – leaving the LDC to balance all the daily and hourly swings. Diminishing the ability to operate storage on an integrated basis could be an essay in sub-optimization and expose all parties to higher costs and diminished reliability.

Q. Are there federal regulatory guidelines established by FERC regarding the release of pipeline capacity?

A. Yes. All capacity releases (including those associated with a retail choice program) must be performed in conjunction with all applicable FERC regulations governing capacity release, including those embodied in FERC Orders 712 and 712-A. Absent compliance with FERC Orders and other requirements, it will be necessary to obtain the necessary FERC waivers of its requirements in this regard.
Impacts of new natural gas retail competition programs
on existing utility services and customers

Q. Can expanded unbundling or retail choice programs be expected to impact existing utility services and customers?

A. Yes. In order to accommodate any new programs, existing programs will likely need to change. Currently, LG&E offers two transportation services, one pursuant to Rate Schedule FT and the other pursuant to Rate Schedule TS. Under Rate Schedule TS, LG&E provides qualifying large volume customers who wish to purchase their own gas supplies with standby sales service. By contrast, under Rate Schedule FT, LG&E provides qualifying customers with gas transportation service. LG&E has no obligation to provide customers served under Rate Schedule FT with standby sales service. LG&E does not secure interstate pipeline capacity, gas supplies, or storage capacity for customers served under Rate Schedule FT. Consequently, LG&E has no obligation to provide these customers with natural gas and does not act as the “supplier of last resort.” Large volume customers are generally more equipped to handle decisions and risks associated with procuring their own gas supplies and interstate pipeline capacity.

Customers served under Rate Schedule FT are subject to daily balancing requirements enforced through Operational Flow Orders (“OFOs”), must have daily telemetry capabilities, and are subject to a cash-out mechanism for over- and under-deliveries.

Q. Why may changes to current transportation services be required?

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6 Currently, almost all of LG&E’s transportation customers are served pursuant to Rate Schedule FT.

7 When an Operational Flow Order (“OFO”) is issued to customers served under Rate Schedule FT, the daily balancing tolerance is reduced from +/- 10% and, depending on the kind of OFO issued the customer either (1) may not use more gas than it is delivering to LG&E for its facility, or (2) may not use less than it is delivering to LG&E for its facility. In the first case, takes by the customer greater than the customer’s deliveries to LG&E is subject to a charge equal to $15.00 plus a daily market price of gas for each Mcf greater than the volume it delivered to LG&E. In the second case, takes by the customer less than the customer’s deliveries to LG&E is subject to a charge equal to $15.00 plus a daily market price of gas for each Mcf less than the volumes it delivered to LG&E.
Expanded unbundling options could decrease the flexibility that the LDC uses to operate its system. Flexibility currently available to existing transportation customers may be needed by other customers with higher service priorities, thus requiring tariff changes.

What kinds of changes might be required?

A. The requirements for qualifying for service under Rate Schedule FT would not change. However, it may be necessary to reduce daily balancing tolerances; add the concept of critical notices in addition to OFOs; or, without changing the rate schedule, to increase the frequency and/or duration of OFOs. It may also be necessary to define the manner in which gas must be delivered to LG&E, such as by requiring that customers match hourly deliveries to LG&E with their hourly use or to use a specific pipeline for the delivery of gas. Although some elements of LG&E’s tariffs may need to be changed to accommodate expanded unbundling, LG&E does not see Rate Schedule FT being subject to changes in the billing or collection procedures discussed above.

Without a doubt, LG&E’s current curtailment rules would need to be significantly overhauled, for example, in order to accommodate new tariffed services and customer service priorities. Rate Schedules TS and AAGS (an interruptible sales rate schedule) may need to be eliminated, significantly modified, or frozen.

OTHER ELEMENTS TO BE ADDRESSED AS A PART OF ANY RETAIL UNBUNDLING SCHEME
Q. Are there other issues that the Commission may want to consider as it reviews the implication of expanding natural gas unbundling or offering retail choice in Kentucky?

A. Yes. In this section, I propose to discuss those issues which include: franchise fees and school taxes; and effective competition.

Q. Are there concerns about the impact of further unbundling on the collection of franchise fees and school taxes?

A. Yes. There may be concerns by local communities that rely upon franchise fees paid by LDCs and school tax revenues collected by LDCs. Franchise agreements typically contain language that calculates the franchise fee based on a set “percent of gross receipts per year from the Company’s sale of natural gas to all entities inside the City’s corporate limits that are served under the Company’s residential and commercial revenue classifications….” Even if an LDC collects the marketer’s charges on the LDC’s regular invoice, there are two potential concerns. First, such revenue collected to cover the marketer’s charges would not be “from the Company’s sale of natural gas.” Second, service rendered by marketers may not be considered service “under the Company’s residential and commercial revenue classifications” as specified in the franchise agreements. Both of those issues would seem to call into question, and perhaps preclude, the LDC from charging a franchise fee based on the marketer’s sale of natural gas, even though the LDC collected the money. The impact on school tax revenues is a bit more uncertain. School taxes are authorized by state statute. It is unclear whether or not a retail choice and expanded gas transportation options program would have a negative
impact on school tax revenues. The Commission may want to obtain an opinion from the
Attorney General’s Office to gain more clarity on the matter.

Q. What is “effective competition” and how can the Commission be assured that the
markets behind the various LDCs that have expanded gas transportation options
will have effective competition?

A. The definition of “effective competition” can be elusive. In some respects, it may be
defined as the presence of several marketers in a given marketplace. However, effective
competition cannot necessarily be linked to specific levels of participation in a given
unbundling program. Low participation levels might be explained by a general lack of
customer interest or the absence of customer savings. Modifying the marketplace with
the purpose of promoting participation rates should not be the focus. Creating a “level
playing field” is not about “out-sourcing” the marketer’s business functions to the LDC
in the name of “effective competition.”

Q. Should LDCs be required to exit the merchant function in order to foster effective
competition?

A. No. Removing the regulated alternative removes the performance benchmark and the
competition in one step. Once there is no regulated benchmark, there can be no
determination of savings. Maintaining a viable regulated merchant function can be one
of the safeguards to maintaining effective competition.

VI. CONCLUSION
Q. What are your overall conclusions regarding expansion of natural gas transportation programs in Kentucky?

A. Ultimately, the purpose of this proceeding is to address a theoretical – the ability to choose in and of itself. Is giving customers the ability to choose for the sake of choice a purpose of regulatory change – particularly with no certainty of benefits and with the potential for exposure to increased costs and risks?

LG&E is concerned that a further expansion of unbundling will expose customers to increased costs and risks that may not be commensurate with the benefits – if any. Because so many of the risks to implement such programs fall on the LDC, it is LG&E’s position that the implementation of retail choice programs should be at the discretion of each LDC.

Q. Does this conclude your testimony?

A. Yes, it does.
VERIFICATION

COMMONWEALTH OF KENTUCKY  
COUNTY OF JEFFERSON  

The undersigned, J. Clay Murphy, being duly sworn, deposes and says he is the Director – Gas Management, Planning, and Supply for Louisville Gas and Electric Company, that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

J. CLAY MURPHY

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 21st day of June, 2010.

Roshelle W. Garven (SEAL)
Notary Public

My Commission Expires:
Feb. 28, 2010
APPENDIX A

J. CLAY MURPHY
Director – Gas Management, Planning, and Supply
Louisville Gas and Electric Company
820 West Broadway
Louisville, Kentucky 40202

PROFESSIONAL EXPERIENCE:
LOUISVILLE GAS AND ELECTRIC COMPANY
   Director – Gas Management, Planning and Supply (7/00 – Present)
   Manager – Gas Supply (12/89 – 7/00)
   Gas Supply Coordinator (10/86 – 12/89)
   Rate Analyst (10/81 – 10/86)

EDUCATION:
INDIANA UNIVERSITY
   Bloomington, Indiana (8/79 – 5/81)
      Master of Business Administration

BELLARMINE COLLEGE
   Louisville, Kentucky (8/75 - 5/79)
      Bachelor of Arts with Major in Accounting
COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of: )

AN INVESTIGATION OF ) CASE NO: 2010-00146
NATURAL GAS RETAIL )
COMPETITION PROGRAMS )

TESTIMONY OF
PAMELA L. JAYNES
GAS SUPPLY MANAGER
LOUISVILLE GAS AND ELECTRIC COMPANY

Filed: June 21, 2010
Q. Please state your name and business address.
A. My name is Pamela L. Jaynes and my business address is 820 West Broadway, Louisville, Kentucky.

Q. By whom are you employed and in what capacity?
A. I am the Gas Supply Manager for Louisville Gas and Electric Company (“LG&E”).

Q. What is your role as Gas Supply Manager?
A. I am responsible for the development of LG&E’s natural gas supply plans. Among other activities, I am responsible for the determination of supply and interstate pipeline transportation requirements, bid parameters and contract specifications, as well as monitoring regulatory and market developments.

Q. What is your educational background and experience?
A. I graduated from Indiana University Southeast in New Albany, Indiana, with a B.S. degree in Business in 1987. In 1988, I was employed by LG&E in the Rate Department, where I remained until 1991 when I transferred to the Gas Supply Department. I became Gas Supply Manager in 2002. A statement of my education and work experience is contained in Appendix A.

Q. Are you the only witness for LG&E sponsoring testimony in this proceeding?
A. No. J. Clay Murphy, Director – Gas Management, Planning, and Supply, will also be providing information covering LG&E’s position on retail choice and expanded unbundling, industry structure overview, recent legislative proposals in Kentucky, and elements related to retail unbundling that need to be addressed.
Q. What is the purpose of your testimony in this case?

A. The purpose of my testimony is to describe recent trends related to natural gas retail choice programs, including information indicating the status of these programs in terms of the number of states with programs, customer participation, marketer participation, customer benefits (i.e., savings), and customer concerns regarding marketer behavior. Much of the information presented herein is drawn from a report found on the website of the Energy Information Administration ("EIA") entitled "Status of Natural Gas Residential Choice Programs by State as of December 2009" released May 17, 2010, hereinafter "2009 EIA Report."¹ The facts and trends associated with retail choice programs do not present a compelling case for further natural gas unbundling in Kentucky.

I. CUSTOMER RETAIL CHOICE PARTICIPATION LEVELS

Q. Are residential customers actively participating in retail choice programs?

A. According to information found in the 2009 EIA Report, participation by customers in retail choice programs can vary widely from state to state. Participation in retail choice programs can also vary widely by local distribution company ("LDC") within each state. While participation in these programs across the U.S. grew from 13.5% of eligible participants in 2008 to 14.7% of eligible participants in 2009, the majority of this growth is the result of increased participation levels in Ohio and New York. In general,

participation by customers in retail choice programs in the other 19 states and the District of Columbia has floundered.

Q. **How many customers in the U.S. are participating in retail choice programs?**

A. According to the 2009 EIA Report, about 5.1 million (15%) of the approximately 35 million residential customers that have access to retail choice programs are participating in these programs. This means that about 29.9 million, or 85% of eligible customers, have elected not to participate in these programs. Both the number of residential customers eligible and the percent participating have remained relatively stagnant over the last few years.

Q. **Is participation in retail choice programs growing?**

A. While the total number of residential customers enrolled in choice programs has grown over the last few years, it has grown in relatively small increments. For example, about 445,000 more residential customers were participating in retail choice programs in 2009 than in 2008. As a result, participation in retail choice programs increased from 13.5% in 2008 to 14.7% in 2009. Importantly, 85% of the year-over-year growth of 445,000 customers occurred in only two states: Ohio (278,968 customers) and New York (98,576 customers). Interestingly, choice is growing in the two states where the LDCs appear to be exiting the merchant function, thus eliminating the LDC as a choice for customers.

Q. **How many states have retail choice programs?**
A. According to the 2009 EIA Report, twenty-two states (about 40%) including the District of Columbia have residential retail choice programs. This means that twenty-nine states (about 60%) do not have retail choice programs.2

Q. What states have the highest participation levels in retail choice programs?

A. Georgia and Ohio accounted for more than 60% of customers enrolled in residential retail choice programs at the end of 2009.3 This may not be surprising considering that customers in Georgia can no longer choose Atlanta Gas Light ("AGL") as their natural gas supplier and instead must choose a third-party marketer. Additionally, most retail customers in Ohio can no longer choose to purchase gas pursuant to a regulated Gas Cost Recovery ("GCR") price offered by the LDC as a regulated merchant. Instead, the customers of three Ohio LDCs4 that have chosen to exit the merchant function must choose between an alternative marketer's price and a Standard Service Offer ("SSO") or similar price offering. The SSO price is the product of an auction process whereby marketers participating in a specific LDC's program can bid to be an SSO supplier. I discuss some of the details of the SSO later in my testimony.

II. MARKETER RETAIL CHOICE PARTICIPATION LEVELS

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2 Two of these 29 states had pilot programs but discontinued those programs. According to the EIA 2009 Report's website, both Delmarva Power (Delaware) and Wisconsin Gas Company discontinued their pilot programs in 2001 because of declining customer and marketer participation.

3 This percentage can be calculated as follows: (1,461,748 customers in Georgia + 1,665,256 customers in Ohio / 5,140,706 total customers enrolled in retail choice).

4 The three Ohio LDCs are Dominion East Ohio, Columbia Gas of Ohio, and Vectren Energy Delivery.
Q. What does EIA data suggest about marketer participation in retail choice programs?

A. EIA data indicates that there are many marketers licensed in the U.S. to serve residential customers. However, actual participation by marketers varies greatly by state and by LDC program within each state. There may be several marketers to choose from in some residential retail choice programs, but little or no choice of marketers in other retail choice programs. According to the 2009 EIA Report, as of December 2009, the U.S. had 110 marketers licensed and actively serving residential customers. However, these 110 marketers are not licensed and active in each state that has natural gas retail choice programs. In fact, very few marketers are active in more than one state. According to the 2009 EIA Report, about 80% of marketers are active in only one state and about 90% of marketers are active in only one or two states.\(^5\)

Q. What is the participation level of marketers in retail choice programs by state and by LDC?

A. Participation by marketers in residential retail choice programs varies greatly by state. For example according to the 2009 EIA Report\(^6\), of the 22 states (including the District of Columbia) that have retail choice programs, four states have ten or more residential marketers, seven states have between five and nine residential marketers, nine states (including the District of Columbia) have fewer than five residential marketers, and two states have no residential marketers. The only states with ten or more marketers are

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\(^5\) According to EIA data, of the 110 active marketers in the U.S., 46 of those marketers (40%) are active only in the state of New York.

Illinois, Michigan, New York, and Ohio. Participation by marketers in retail choice programs can also vary by LDC within each state. For example, according to the 2009 EIA Report, as of December 2009, there are ten residential marketers in the state of Michigan but not all ten marketers are active in each of the state’s retail choice programs.\(^7\)

**Q.** What are some of the factors that may be influencing customer participation levels in retail choice programs based upon your review of the 2009 EIA Report?

**A.** Many factors may contribute to state retail choice participation levels, such as whether or not the LDC effectively remains in the merchant function; the extent to which programs are subsidized by LDCs or customers; savings realized by customers; and customer satisfaction with marketers. In order to better understand what may be impacting participation levels in some states, it is necessary to take a closer look at what is going on in those states. According to the 2009 EIA Report, some of the states that appear to be more “active” in terms of participation levels and regulatory initiatives to foster retail choice programs include Georgia, New York, Pennsylvania, and Ohio. Following is some more detailed information for each of these states.

### III. RETAIL CHOICE IN GEORGIA

**Q.** What percentage of Georgia customers are participating in retail choice programs?

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\(^7\) According to the 2009 EIA Report, Consumers Energy has ten marketers serving residential customers, DTE Energy has nine, SEMCO has three, and Michigan Gas Utilities has only one.
A. According to the 2009 EIA Report, about 81% of residential and commercial customers are participating in retail choice in Georgia. These participants are located in AGL’s service area. The other investor-owned utility in the state, Atmos Energy (formerly United Cities Gas), has chosen not to unbundle its gas services at the residential level.

Q. According to the 2009 EIA Report, what events may have impacted retail choice program participation in Georgia?

A. Georgia was the leader in promoting retail choice programs. According to the 2009 EIA Report, since October 1999, all residential gas customers in AGL’s service area have had access to retail choice. Perhaps the biggest factor influencing consumer participation in Georgia retail choice programs was AGL’s decision to leave the merchant function effective October 1, 1999. As a result, all residential natural gas customers (approximately 1.5 million) and all commercial customers (approximately 94,000) in AGL’s service territory can no longer choose to purchase gas from the LDC. These customers must purchase their natural gas supply directly from a marketer. Given that over 80% of natural gas customers in Georgia are located in AGL’s service area, AGL’s decision to leave the merchant function significantly impacts customer participation levels in Georgia and contributes to the current residential and commercial combined participation level of 81% in that state.

Q. Did AGL Resources make any announcements related to retail choice programs prior to the time that AGL exited the merchant function?

A. On July 15, 1998, AGL Resources (AGL’s parent) announced that it had entered into a joint venture with Piedmont Natural Gas Company, Inc. and Dynegy, Inc. to provide
competitive services to the Southeast market under the name SouthStar Energy. In that announcement, AGL stated that

SouthStar Energy will initially market energy products and services to targeted industrial and commercial customers throughout the Southeast and will offer residential and small business energy services to customers within Georgia as that market opens to competition in November, 1998.

SouthStar currently does business as an unregulated marketer in Georgia under the brand name “Georgia Natural Gas.” As an unregulated marketer, Georgia Natural Gas can mark-up the natural gas it sells to customers, something AGL could not do in the regulated merchant function.

Q. Has retail choice in Georgia faced challenges?
A. Yes, retail choice in Georgia has faced challenges over the years. For example, according to the 2009 EIA Report, concerns about the billing practices of some marketers and the high prices to residential customers in the winter of 2000-2001 led to passage of the Natural Gas Consumers’ Relief Act in April 2002. This legislation includes a consumer bill of rights and gives the Georgia Public Service Commission (“GAPSC”) the authority to issue emergency orders, such as price regulations, if it determines that market conditions are no longer competitive. According to the 2009 EIA report, another challenge to Georgia’s retail choice programs occurred in January 2006 when legislation was proposed to re-regulate the retail gas market (Georgia House Bill 1108 and Georgia

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9 See http://www.atlantagaslight.com/Home/EstablishServiceChooseAMarketer/MarterContactInformation.
10 Additionally, AGL Resources owns Sequent Energy Management which serves the needs of utilities, marketers, retail aggregators, municipalities, and large industrial customers. (See http://www.aglresources.com/about/wholesale.aspx). Sequent has been acting as the asset manager for AGL since 2003. (See http://atlantagaslight.com/Universal/Pressroom/2006.aspx.)
Senate Bill 448). Proposed legislation would have prohibited marketers from renewing contracts and returned customers to AGL, who would again have served as the regulated supplier and transporter. (According to the 2009 EIA Report, similar bills were rejected in 2000, 2001, and 2002.)

IV. RETAIL CHOICE IN NEW YORK

Q. What percentage of New York customers are participating in retail choice programs?

A. According to the 2009 EIA Report, with the exception of a few small utility companies, retail choice is offered statewide in New York. About 17% of residential and commercial customers in that state are participating in retail choice programs. The remaining 83% of these customers continue to choose to purchase natural gas from their LDC.

Q. According to the 2009 EIA Report, what events may have impacted retail choice program participation in New York?

A. According to the 2009 EIA Report, in 1998, the New York Public Service Commission (“NYPSC”) ordered LDCs to exit the merchant function over a transition period of three to seven years. At that time, LDCs were directed to cooperate with marketers to encourage competition. Despite the original intention of the NYPSC that all LDCs exit the merchant function, all New York LDCs remain in the merchant function.

Q. What challenges have retail choice programs in New York faced?
According to the 2009 EIA Report, retail choice programs in New York have faced challenges over the years, particularly with respect to low participation levels. According to the 2009 EIA Report, a preliminary report was issued by the NYPSC in July 2001. That report concluded that the transition to a competitive retail market would take much longer than expected. The report recommended that utilities eventually be forced to exit the retail market but acknowledged that the market was not sufficiently competitive to support this change.

What are some of the actions taken by the NYPSC to encourage retail choice participation?

According to the 2009 EIA Report, the NYPSC issued policy statements in 2004 that outlined strategies to boost participation in competitive markets. Among these strategies were continuing the option to have utilities handle billing for marketers and encouraging the utility to purchase a marketer’s accounts receivable without recourse. According to the NYPSC’s Order in Case 07-M-0458,

Additional measures promoting retail markets were implemented through utility rate plans and included outreach and education efforts intended to inform consumers about retail competition, promotion of retail access advertising and customer migration, market expos, energy fairs, market match programs, and the designation of an ombudsman by each utility to respond to marketer concerns. Utilities also tracked the progress of efforts to promote retail access by surveying customers’ awareness of competitive alternatives and marketers’ satisfaction with utility performance. Some utilities were awarded a customer migration incentive, allowing them to earn monetary rewards based on their success in promoting retail competition, often measured by the number of their customers that migrated to marketers or success in
achieving customer awareness metrics scored by performance on
customer surveys.11

According to the 2009 EIA Report, several LDCs also began offering supplier referral
programs in 2006 to encourage customer participation in retail choice programs.

Q. **What is a “Supplier Referral Program?”**

A. In New York, Supplier Referral Programs are programs whereby the LDC enrolls a
residential or small non-residential customer in its retail choice program and if the
customer has not selected a specific marketer, the LDC assigns the customer to a
marketer. The marketer chosen by (or assigned to) the customer provides the customer
with an introductory discount, typically for a two month period.12

Q. **Does the New York LDC absorb the costs for these programs and the other
measures it must take to promote retail choice?**

A. Until recently, the NYPSC’s policy was for customers to pay the costs incurred by LDCs
to operate Supplier Referral Programs and other retail choice promotional programs. In
2008, the NYPSC determined that the retail market was well enough established that
customers should no longer pay the costs of most retail choice promotional programs. As
a result, most of these costs are now borne by marketers. In support of this decision, the
NYPSC stated that “[m]oreover, subsidization is inconsistent with competitive market
operations as subsidies distort the functioning of competitive markets. Eliminating

11 State of New York Public Service Commission Case 07-M-0458 “Proceeding on Motion of the
Commission to Review Policies and Practices Intended to Foster the Development of Competitive Retail Energy
Markets”, Order dated October 27, 2008, pp. 6-7, referring to previous actions taken to promote competition.
subsides will leave a market where competitors can be judged on the merits of their offers and the quality of their products, without assistance from utilities or ratepayers.\textsuperscript{13}

V. RETAIL CHOICE IN PENNSYLVANIA

Q. What percentage of Pennsylvania customers are participating in retail choice programs?

A. According to the 2009 EIA Report, all customers in the state of Pennsylvania are eligible to participate in retail choice programs. About 7\% of all residential and commercial customers combined in Pennsylvania are participating in retail choice programs. Conversely, about 93\% of residential and commercial customers combined are not participating in these programs.

Q. According to the 2009 EIA Report, what challenges have retail choice programs faced in Pennsylvania?

A. According to the 2009 EIA Report, competition for natural gas supply has been allowed state-wide in Pennsylvania since the enactment of the Natural Gas Choice and Competition Act in 1999. Despite efforts to increase participation in retail choice programs, these programs continue to face challenges, particularly with respect to low participation levels. As of December 2009, the 2009 EIA Report indicates that only

about 7% of residential customers and 10% of commercial customers are participating in retail choice programs.

Q. What actions have been taken by the Pennsylvania Public Utility Commission ("PAPUC") in an effort to increase participation in retail choice programs?

A. According to the 2009 EIA Report, in 2004, the PAPUC began an investigation to evaluate the competitiveness of natural gas supply services in the state. In 2008, the PAPUC approved a two-year action plan to encourage marketer participation in choice programs. The first phase of the plan created an Office of Competitive Oversight within the PAPUC, development of legislative changes dealing with capacity assignment and release, and expansion of the purchase of receivables program. The second phase is in progress and will include rulemakings to address the concerns of LDCs and marketers regarding retail choice programs. The PAPUC also committed to undertake a review in five years to evaluate the success of its initiatives.\(^\text{14}\)

VI. RETAIL CHOICE IN OHIO

Q. What percentage of Ohio customers are participating in retail choice programs?

A. According to the 2009 EIA Report, about 88% of customers in Ohio have access to retail choice. About 58% of all eligible residential and commercial customers combined in Ohio are participating in retail choice programs.

Q. According to the 2009 EIA Report, what events may be impacting retail choice participation in Ohio?

A. According to the 2009 EIA Report, competition for natural gas supply began in Ohio in 1997 when three LDCs began offering retail choice programs. Legislation to further promote these retail choice programs was enacted in 2001. Among other things, that legislation allows communities to purchase natural gas through aggregation programs. Local governments may choose an “opt-in” or “opt-out” form of aggregation. These aggregation programs may be one factor contributing to participation levels in this state.

Q. Which type of government aggregation program is commonly found in Ohio?

A. It appears that many governmental aggregation programs are “opt-out” programs. These programs must be approved through a voter referendum by the citizens of a local government. Under “opt-out” programs, any resident in a local government jurisdiction with an approved “opt-out” program must purchase natural gas from the marketer selected by the local government, unless (1) the resident has already selected another marketer, or (2) the resident takes action to “opt-out” of the program so that they can either select another marketer or remain with the LDC. As an example, customers who want to “opt-out” must return a post card to the marketer; otherwise they are considered to have “opted-in.” This type of program might be considered by some as a legalized “slamming” program operated by the local government whereby customers are switched from their LDC to a marketer without the customer’s affirmative choice. (I discuss “slamming” later in my testimony.)

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15 See http://www.cantonohio.gov/?pg=368.
Q. Are there any benefits to these “opt-out” programs?

Marketers likely find these programs beneficial because they may significantly reduce the
marketing cost that would otherwise be required to attract a large number of customers.
These programs do not guarantee any benefit in terms of savings for customers.
However, according to one Ohio local government’s website “Opt-Out programs are the
most common types of aggregation programs because they lead to higher participation
that usually results in lower rates.”\textsuperscript{16} Importantly, if customers are automatically enrolled
unless they take some action, then participation rates will rise. The local government
may be able to get a lower price from the selected marketer if it has higher participation
levels and therefore more volume to purchase. However, if this stands to reason, then it
would also indicate that further unbundling may not be efficient, as the LDC should be
able to get an even better price purchasing natural gas for its entire service area.

Q. What other events may be impacting retail choice participation in Ohio?

A. Participation in Dominion East Ohio’s (“Dominion”), Columbia Gas of Ohio’s and
Vectren Energy Delivery’s service areas may be impacted by the decision of each LDC to
exit the merchant function. As a result, if a customer does not choose a marketer, then
the customer must purchase natural gas pursuant to the LDC’s Standard Service Offer
(“SSO”) or Standard Choice Offer (“SCO”) as applicable.\textsuperscript{17} Therefore, the SSO or SCO
replaces the LDC’s GCR rate on non-choice customer bills.

Q. What is a SSO, and how is it different from a SCO?

\textsuperscript{16} Ibid.
\textsuperscript{17} The use of the term SSO and SCO may vary by LDC and the LDC’s current phase of exiting the merchant function.
According to Dominion’s website, the gas cost rates pursuant to the SSO and the SCO are currently the same per Mcf; however, these offers apply to customers based on certain customer characteristics. SSO customers are not assigned to a marketer, while SCO customers are assigned to a specific marketer, but pay the same monthly variable SCO rate regardless of the assigned marketer. Both the SSO and SCO rates change monthly and are calculated by adding the NYMEX close for the prompt month to the Retail Price Adjustment.

Q. How are SSO/SCO marketers, as well as the Retail Price Adjustment, determined?

As referenced in Mr. Murphy’s testimony, the process used to purchase gas sold pursuant to the SSO/SCO is considerably different than the process that is currently used by LDCs to purchase natural gas sold pursuant to their GCR mechanisms. My understanding is that the SSO/SCO is determined through an “auction” process that is performed by an “independent auction manager.” The only suppliers that can participate in the auction are alternative natural gas marketers that are certified marketers in the LDC’s retail choice program. The certified marketer’s bid must be in the form of NYMEX plus a Retail Price Adjustment stated in dollars per Mcf. The results of the auction are filed with the Public Utility Commission of Ohio ("PUCO").

Q. What is the purpose of the Retail Price Adjustment?

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19 The price of natural gas traded on the New York Mercantile Exchange ("NYMEX") can be used as an index for pricing natural gas.
The "Retail Price Adjustment" compensates marketers for all of their costs of providing service for the entire term of the SSO/SCO. Such costs may include, but are not limited to, all pipeline demand and variable costs and gas commodity costs incurred by the marketer to meet the needs of the SSO/SCO customers; LDC system balancing, lost and unaccounted for percentage retention (including company use); annual standard Btu values; hedging costs, if any; and all other aspects of cost and risk relating to the provision of SSO/SCO service. The Retail Price Adjustment also includes the marketer's profit margin.

Q. Do any of the LDCs in Ohio that have decided to leave the merchant function have unregulated marketing affiliates that are participating in the LDCs’ retail choice programs?

A. Yes. In Ohio, marketer Vectren Source operates in the service area of Vectren, as well as Columbia Gas of Ohio, Dominion East Ohio, and Duke Energy. In Ohio, marketer Dominion East Ohio Energy operates as an unregulated marketer in the service areas of Dominion East Ohio, as well as Columbia Gas of Ohio. Both Vectren Source and Dominion East Ohio Energy can earn a profit on the sale of natural gas; their respective LDCs cannot. Having an affiliated marketing company may have provided an incentive for these two LDCs to exit the merchant function.

Q. You have provided some information related to events that have occurred in four states with higher retail choice participation rates. What is going on in the other 18 states or districts that offer residential retail choice programs?

A. Some of these states have pilot retail choice programs and others have permanent programs. In a few of these states, regulatory actions have been taken to spur marketer and customer interest in these programs. Nevertheless, there has been very little (if any) growth in retail choice participation in most of these states. For example, from the 2008 EIA report to the 2009 EIA report, participation in these 18 states combined grew by only about 70,000 customers. Most of that growth between 2008 and 2009 (about 43,000 customers) occurred in Michigan as participation levels reached about 11% returning to earlier 2002 levels.\textsuperscript{21}

Q. Does the EIA report provide any insight into why choice may be floundering in some of states?

A. Yes, potential reasons for low residential participation are included in the 2009 EIA report for some states. For example, the 2009 EIA report indicates that low customer participation in California (less than 1%) may be due to low marketer participation potentially caused by “high transaction costs and the difficulty in offering competitive rates to core customers.”\textsuperscript{22} In New Mexico where combined residential and commercial participation is less than 1%, customers continue to purchase natural gas from their LDC “in large part because marketers have been unable to compete with the LDCs’ prices.”\textsuperscript{23}

VII. OTHER FACTORS INFLUENCING CUSTOMER PARTICIPATION

\textsuperscript{22} See 2009 EIA Report – California.
\textsuperscript{23} See 2009 EIA Report – New Mexico.
Q. **Will customers save money by participating in a retail choice program?**

A. As described by the Illinois Citizens Utility Board ("CUB") on its website, when choosing an unregulated marketer,

> You’re simply gambling that the unregulated supplier will do a better job buying gas than the utility. Sadly, you would need a crystal ball to determine whether any of these plans are big winners.24

While customers may experience savings from time to time, retail choice does not guarantee customer savings, and can result in customers paying higher costs for natural gas over time as illustrated by experiences in Kentucky and Illinois.

Q. **Have customers in Kentucky experienced savings as a result of retail choice?**

A. Columbia Gas of Kentucky ("CGK") has had a pilot retail choice program since 2000. CGK’s 2009 “Customer Choice Program Annual Report” filed on June 1, 2009, with the Kentucky Public Service Commission ("KYPSC") in Case No. 2008-00195 indicates that customers participating in CGK’s retail choice program have lost (not saved) money over the lifetime of the program. CGK’s estimates that as of March 2009, choice customers combined have paid about $3.8 million more than they would have paid if they had stayed with the LDC. The loss experienced by customers participating in the CGK retail choice program increased by $13.5 million in the course of a single year, from $3.8 million in the 2009 report to $17.3 in the 2010 report. Given that about 32,400 customers participate in the program, the average loss per customer was $417 for a single year.

Q. **Have customers in Illinois experienced savings as a result of retail choice?**

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A. According to the 2009 EIA Report, retail choice programs are being offered by three LDCs in the state of Illinois providing over 75% of residential and commercial customers in that state with access to choice. The Illinois Citizens Utility Board ("CUB") estimates the benefits of marketer offers as a service to consumers.²⁵ The CUB’s “Gas Market Monitor”, an online service, tracks offers in the retail choice programs in Illinois, and has found that “most of the offers peddled by unregulated natural gas suppliers in northern Illinois to date are bad deals compared with utility rates.”²⁶ The “Gas Market Monitor” provides a monthly snapshot of how hundreds of plans have fared in Illinois since 2003.²⁷ As of May 12, 2010, the CUB estimates that 92% of about 3,600 plans offered would have produced higher costs when compared to LDC offerings rather than savings for customers. On average, these plans would have produced higher costs of about $661 per plan. The findings by the CUB may partially explain why participation in choice programs is low in Illinois despite the fact that three LDCs in that state have had retail choice programs since 2002. According to the 2009 EIA Report, as of December 31, 2009, only about 10% of eligible residential and commercial customers combined are participating in these programs.

Q. Can EIA data be used to determine if residential customers are saving money through retail choice programs?

²⁵ According to the website of the CUB, the CUB was created by the Illinois General Assembly in 1983. The CUB is a non-profit, non-partisan organization whose mission is to represent the interests of residential utility customers across the state of Illinois.
A report prepared by EIA may provide some insight into whether or not residential customers are saving money in retail choice programs. Table 24 of the EIA's “Natural Gas Annual 2008” (published March 2010) sets forth the “Average Price of Natural Gas Delivered to Residential and Commercial Sector Consumers by Local Distribution and Marketers in Selected States, 2007-2008” (“EIA Table 24”). That table sets forth average residential price data for the following eight states: Florida, Georgia, Maryland, New Jersey, New York, Ohio, Pennsylvania and Virginia, and indicates that for 2008, on average, the price charged by marketers to residential customers was higher than the price charged by LDCs. Specifically, based on a simple average of the prices charged in these eight states, the average marketer price of $17.76 per Mcf was higher compared to the average LDC price of $16.44 per Mcf.

What other factors may be influencing customer satisfaction levels and therefore participation in retail choice programs?

The activities of marketers can lead to customer dissatisfaction and influence the level of customer participation in retail choice programs. Some of those activities include deceptive marketing practices; "slamming;" failure to honor contractual terms; and failure to deliver. These types of activities have occurred from time to time in various states since the inception of retail choice programs in the late 1990s and are still occurring in some programs today despite continued efforts by state legislatures and

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commissions to put consumer protection legislation and marketer codes of conduct in place.

Q. Can you provide an example of a state where these activities may be occurring?

A. Yes, Georgia provides such an example. In response to consumer requests for information indicating marketer performance, the GAPSC posts the monthly “Gas Marketer Scorecard” which reflects the number of complaints and general questions about marketers received by the GAPSC during each month in the categories of “Billing,” “Service,” and “Deceptive Marketing Practices.”

Q. What are some examples of deceptive marketing practices associated with retail choice programs?

A. One example of deceptive marketing practices occurred recently in Illinois. According to its website, the CUB has received complaints of misleading marketing practices by marketers. In March 2008, the CUB, American Association of Retired Persons (“AARP”) Illinois, and Citizen Action Illinois filed a complaint with the Illinois Commerce Commission (“ICC”) alleging that U.S. Energy sent employees door-to-door circulating “bogus petitions” to lower their natural gas bills. In addition, the complaint claims that these U.S. Energy employees told gas customers that they worked either for regulated utilities or the government. These advocacy groups requested the ICC to ban U.S. Energy’s alleged tactics, eliminate illegally high “exit” fees, fine the company up to $10,000 for each violation of the Illinois Alternative Gas Supplier Law, and consider

29 See http://www.psc.state.ga.us/consumer_corner/cc_gas/scorecard.asp.

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revoking the firm’s certification in the State. In April 2010, the ICC fined U.S. Energy (now doing business in Illinois as “Just Energy”) for violations of the Alternative Gas Supplier Law. The ICC also directed this marketer to take other actions intended to reduce customer complaints such as improving independent third-party sales verification procedures; ensuring marketing materials are completely accurate and distortion free; and refraining from offering employee commissions based in any way on an act or omission that violates any law, regulation or order of the ICC.31

Q. What action has been taken by the Illinois General Assembly to recognize that misleading marketing has been a problem in that state’s retail choice programs?

According to the 2009 EIA Report, in 2009, the Illinois General Assembly enacted the Amended Alternative Gas Supplier Law (Illinois Senate Bill 171) in response to a growing number of constituent complaints regarding misleading marketing strategies by alternate gas marketers. This amendment requires clear disclosure of prices, terms, and conditions of all products and services in marketers’ sale solicitations. In addition, the legislation prohibits marketers from misrepresenting their affiliation with a gas utility, governmental body, or consumer group, and provides consumers the right to cancel ten days after the gas utility notifies them of a switch to a marketer and ten days after the date of the first bill if customers find that the marketer’s service is not as promised.

Q. Can you provide an example of an action taken by a state commission to address misleading marketing practices by retail choice marketers?

A. Yes. In October 2008, the NYPSC adopted new standards for gas marketers that require, among other things, a “Consumer Disclosure Statement” on the first page of every sales agreement, which will include the most important terms of the marketer’s agreement. The statement will contain the contract’s term and termination fee provisions; training of marketing representatives; protocols for in-person and telephone contacts with customers; added measures for protecting non-English speaking customers; and processes for handling customer complaints and resolving disputes arising from marketing activities.32

This action was taken in response to customer complaints about misrepresentations by marketers that they were affiliated with local utilities as well as what actual savings customers could expect.33

Q. Can you provide another example of misleading marketing practices by retail choice marketers?

A. Yes, another example of misleading marketing practices occurred recently in Michigan. In 2008, the Michigan Public Service Commission (“MIPSC”) filed a formal complaint against the marketer Universal Gas and Electric Corporation (“UGE”) in response to escalating complaints from customers regarding its marketing practices. Some of the complaints were that UGE used misleading or false representations to secure residential customer authorization to switch to UGE; made misrepresentations regarding the amount of savings a customer would initially realize by switching to UGE; failed to clearly inform customers that contracts were for five years; and failed to inform customers of

their right to cancel the contract within 30 days and of the $250 early termination fee for cancellation after 30 days. According to the 2009 EIA Report, the MIPSC reached an agreement with UGE in April 2009 requiring among other actions that UGE offer to either terminate contracts with certain customers without charge or give a $50 credit to customers who choose to remain with UGE. UGE must limit its gas supply contracts to one- and two-year terms and limit its cancellation fees. UGE must also submit its marketing materials to the PSC for approval and revise its contract terms as set forth by the Michigan PSC.

Q. Can you provide an example of “slamming” by a marketer?

A. Since the inception of retail choice programs, the “slamming” of customers by some marketers has been a problem in various states. The term “slamming” is used when a customer is transferred to a retail marketer without that customer’s consent. According to the 2009 EIA Report, one example of slamming occurred recently in Georgia. In May 2009, the GAPSC penalized Stream Energy for “slamming.” Stream Energy did not admit wrongdoing but agreed to pay penalties to resolve customer allegations that their service had been switched to Stream Energy without their consent.

Q. Can you provide an example of a marketer defaulting on its contracts?

A. One example of a marketer defaulting on its contracts occurred in Illinois. According to the 2009 EIA Report, in 2005, Santanna Energy Services (“Santanna”) defaulted on all of its fixed-rate plans with customers in Illinois and transferred customers to its variable rate

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plan, saying it had become commercially impracticable to continue those plans.\textsuperscript{35} The Illinois Attorney General filed a lawsuit against Santanna in October 2005 charging the marketer with violations of the Illinois Consumer Fraud and Deceptive Business Practices Act for allegedly misrepresenting its fixed price rate offer when soliciting customers. An agreement was reached between the parties in November 2006. This agreement, valued at just over $8 million, includes $3.3 million in restitution payments to Illinois consumers.\textsuperscript{36}

Q. Can you provide an example of a marketer failing to deliver?

A. Yes, according to the 2009 EIA Report, the sharp increase in natural gas prices during 2005 made it uneconomic for at least one marketer in New Jersey to honor its contracts with consumers. At that time, South Jersey Energy, an affiliate and major marketer in South Jersey Gas Company’s service area, returned its customers to regulated utility sales service. Additionally, several retail marketers failed to deliver natural gas during 2000 and 2001 when a sharp increase in natural gas prices occurred. For example, according to \textit{Gas Daily}, beginning in August 2000, Energy Max failed to deliver gas for customers in Ohio and Perry Gas failed to deliver gas for customers in Georgia. Beginning in October 2000, Iroquois Energy Management failed to deliver gas for customers in New York and Mountain Energy failed to deliver gas for customers in Kansas and Missouri. Beginning in December 2000, Nicole Energy Services failed to deliver gas for customers in Kentucky and Ohio and Kentucky Natural Gas failed to deliver gas for customers in

\textsuperscript{35} See http://www.citizensutilityboard.org/utilityprofiles.php. Select “Santanna Energy Services” as “Gas Utility.”


**Q.** In addition to impacting customers, does a marketer’s failure to deliver supply on behalf of customers also impact the customer’s LDC?

**A.** Yes. In a retail choice program environment, marketers certified by state commissions are selected by customers to replace the LDC’s traditional suppliers. When a marketer defaults, this is particularly concerning to the impacted LDC who is by necessity and circumstance the supplier of last resort. The LDC must maintain the reliability of its system despite the marketer’s failure to deliver natural gas.

**VIII. CONCLUSION**

**Q.** Based on your review of the 2009 EIA Report and other sources, do you see a compelling case to require further unbundling in Kentucky based on the experiences of other states?

**A.** No. I have reviewed the state-by-state 2009 EIA Report with a particular focus on the retail choice programs in states where regulatory or other actions have been taken to encourage higher participation levels. A closer look at some of those states indicates that participation levels have been increased as a result of the LDC exiting the merchant

\textsuperscript{37} "Gas Daily" dated January 22, 2001, pp. 3-4.
function. In states where LDCs have remained in the merchant function, participation in these programs tends to be low suggesting that customers have selected the LDC as their natural gas supplier. Additionally, retail choice programs have produced a variety of customer complaints while they do not guarantee savings for customers. Given the likelihood of low participation based on the experience of most states, and the significant costs, as well as risks that may be incurred to implement further unbundling, requiring and creating retail choice programs does not appear to be a meaningful, efficient, or effective use of the customer’s, the LDC’s, or the Commission’s resources.

Q. Are you suggesting that LDCs should be prevented from further unbundling?

No. As indicated in Mr. Murphy’s testimony, each LDC should be allowed to make its own decision on further unbundling, as well as to design any new transportation service based on the particular characteristics of the LDC.

Q. Does this conclude your testimony?

A. Yes, it does.
VERIFICATION

COMMONWEALTH OF KENTUCKY  )  SS:
COUNTY OF JEFFERSON  )

The undersigned, Pamela L. Jaynes, being duly sworn, deposes and says she is the Gas Supply Manager for Louisville Gas and Electric Company, that she has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of her information, knowledge and belief.

PAMELA L. JAYNES

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 21st day of June, 2010.

Rashelle W. James (SEAL)
Notary Public

My Commission Expires:

Feb. 28, 2014
PAMELA L. JAYNES
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