GAS COLLABORATIVE MEETING
November 6, 1997

Collaborative members in attendance:

Becky Merola
Jim Doutt
David Boehm
Ann Louise Chevront
David Brown-Kinloch
Mark Thessin
Carol Raskin
Steve Byars
Greg Ferguson
Glenn Jennings
Kip Bowmar
Jim Gaynor
Ken Magyar
Gerald Ballinger
Drew Fellon

Vice Chairman Ed Holmes welcomed the collaborative members and other participants and opened the meeting with comments. He noted that, because the Collaborative had not fully covered several issues in the previous meeting, the time has been extended for today's meeting from 9:00 a.m. to 2:00 p.m.

Commissioner Holmes stated that if draft legislation has been prepared by the December meeting of the Collaborative, it would be useful for the Collaborative to have a copy for review.

Commissioner Holmes also reported that deregulation of electric and gas utilities was a topic of the Shakertown Roundtable on November 5. The public and opinion leaders are fully aware that changes are occurring and that large challenges lie ahead.

Ralph Dennis reminded collaborative members to file comments by December 1. Non-members should intervene if they wish to file comments.

Jerry Borchert--what information has been issued about the public meetings? What were the results of the Owensboro and Louisville meetings? What will be the impact of the recent nomination of Chairman Breathitt to FERC?

Ed Holmes--Concerning the nomination of Chairman Breathitt, the Commission remains very supportive of the Collaborative effort.

Mark Thessin--what issues did the people raise at the public meetings?

Ralph Dennis--the participants were concerned largely about cost and reliability of service. (A listing of questions and comments from the Louisville meeting was distributed by Ralph Dennis.)

UNIVERSAL SERVICE

Should marketers have to serve anyone who requests service?

B. Merola--need to have a funding service mechanism for a default service provider to make the marketer indifferent as to who he is serving. In Massachusetts 7 different agencies provide funding for low income customers, are working on having funds going to marketers. In Columbia of Ohio's program, PIP customers were bid out as a pool. The RFP required that the gas cost be less than Columbia's GCR cost. In Massachusetts, they are working to aggregate these funds (LIHEAP, state funds, PIP, etc.)

Jim Doutt--In Ohio, each customer pays into PIP fund, including low income persons.

Ralph Dennis--what should KY do since, other than LIHEAP, there is no funding in place?

Jim Doutt--the default supplier might be responsible for providing service.

Carol Raskin--if a customer could not pay, would he get cut off?

Jim Doutt--the marketer would warn the customer and have the choice of cutting him off or not after a period of a few months. KY does not have PIP. The PSC has rejected PIP as a matter of policy. Some states require the marketer to provide service, and some do not. In the pilots, the customer has to be in good standing, ore he has to stay with his LDC.

A. Chevront--PIP discussion doesn't address general body of customers.

C. Raskin--default service does address other customers.

G. Jennings--what about the LDC as fall-back service provider if no longer performing the merchant function?

B. Merola--most states, such as New York, are having LDCs exit the merchant function and have default service providers.

G. Jennings--Where do the funds come from?

B. Merola--most utilities have bad debt expense which can cover such needs.

D. Kinloch--opposed to segregating customers that have problems into separate classes. Energy conservation can reduce the problem. Georgia to some extent covers the problem in its universal service provisions, there is no bias against certain groups of customers. (Has a problem with including main extensions in universal service.) A surcharge on the bill should pay for universal service. It is a good idea to require suppliers to serve all customers, but this does not necessarily prevent red-lining. Each utility has a surcharge for uncollectibles and a surcharge for DSM. It could be rolled all in together. A fund would remove the incentive to red-line.

E. Holmes--how do you ensure universal marketing?

D. Kinloch--if universal service covers uncollectibles, there is no incentive to red-line.

C. Raskin--in the ASAP program in Louisville, the customer is required to pay a share of his bill; funds are paid up front as long as the customer pays timely. The funding issues need to be discussed head on, perhaps in legislation.

D. Kinloch--some customers may have worse service and perhaps higher costs.

J. Gaynor--low income customers can be put into a pool, will be better off.

D. Kinloch--fears that pool rates will go up if uncollectible costs are not spread over all customers.

J. Gaynor--there are 2 issues in universal service: 1) universal service in the larger sense of service to those who did not make a choice, and 2) service to those who cannot pay.

B. Merola--pooling aggregates customers, mechanism spread over all customers.

G. Jennings--is the mechanism applied to everyone, or just residential customers?

B. Merola--the Ohio PIP is recovered based on throughput. In other states, legislation addresses the problem. Depends on funding mechanism.

D. Boehm--industrial customers should not participate in funding of PIP-type program. They are not the beneficiaries of PIP. The costs should stay with the class that generates the costs.

S. Byars--if there is a surcharge on gas bills that is not also on electric bills, this might hurt the competitiveness of gas. Universal service should be addressed by legislation as a separate issue.

G. Jennings--it should address all competitive fuel, not just electric.

D. Kinloch--uncollectibles are already in rates.

G. Jennings--uncollectibles in rates now are a known quantity, built into rates in a company's last rate case.

D. Kinloch--an assistance program is needed to ensure uncollectibles don't get out of hand.

G. Jennings--it can create a social problem as well as a business problem if there's a fund available to dump in.

C. Raskin--a program might make service more widely available to people who can't afford it now.

E. Holmes--will customers switch because of added funding?

S. Byars--this issue will affect new customers.

D. Boehm--we're talking about an income problem, not an energy problem.

D. Kinloch--already included in rates through uncollectibles.

D. Boehm--every industry has uncollectibles in its cost, its not provided for up front. What is universal service? Something that will add a surcharge only to gas cost, then

to electric cost also?
Should marketers serve all customers?

B. Merola--must be indifferent.

G. Jennings--anybody playing should be required to serve all customers.

C. Raskin--its not enough to say they must serve. They may still cherry pick through marketing, may not offer same cost.

M. Thessin--guaranteed service should be required. If red-lining occurs, it will be self-policing, others will turn them in.

J. Doutt--we're assuming LDCs will want to exit the merchant function. Only 25 percent of those who can choose go with other suppliers.

J. Gaynor--disagrees that marketers should have to serve customers; this creates a utility obligation.

B. Merola--agrees.

D. Kinloch--all the more reason for not changing the present system. Cannot allow low income customers to be exploited by marketers.

J. Gaynor--in a competitive situation, they would be disconnected just like today. No funding source exists now to prevent disconnection.

B. Merola--pilots show gas cost lowered for customers.

C. Raskin--pilots are manipulated situations.

B. Merola--most are phase-ins to competition.

D. Kinloch--price is not representative of the open market.

G. Jennings--even more critical if the LDC is not in the merchant function. Who supplies people who marketers don't want to serve?

D. Boehm--does this address other customers and what happens if their gas doesn't get to them?

R. Dennis--some marketers suggested supplier of last resort could be a marketer.

R. Dennis--the question was whether universal service should be made an issue. There seems to be an issue concerning whether universal service is more appropriately an issue for the Commission or for the General Assembly.

TAX ISSUES

S. Byars--the biggest issue is that what we now collect might not be collected in unbundling. Utilities collect or pay franchise fees, school tax, and sales tax on non-residential customers. We have seen an impact already on industrial transport. Franchise fees are only collected on commodity, not throughput.

B. Merola--this is a very state-by-state issue, addressed depending on the size of losses.

G. Jennings--some customers could pay as much as 12 percent in taxes. There is a real risk for the local taxing authorities; if utility bills are cut in half, revenues will also be cut in half. Sales tax is driven by utility service, i.e., the amount used. On Delta's system, large industrials quit paying on the commodity component and now pay only on the transportation component.

Charlotte Quarles (Rev. Cabinet)--Taxes may be collected on tangibles and on service, or both. If unbundled, it will become more difficult to tax the commodity, especially when sold by an out-of-state company. An out-of-state supplier may claim that Ky. Tax is an interference with interstate commerce. The Revenue Cabinet may have to collect the tax from all users rather than from the LDC as is now done. The legislature has been hesitant to tax services. We need a good definition of "residential" in some legislation so everyone knows how to administer the tax. The tangible will continue to be taxed as a use tax if residentials purchase from marketer. Commercial customers will take on sales tax responsibility now collected by the LDC.

G. Ballinger--same problems concerning franchise fees. The fee is charged on service. If the company stops providing half of its service, then revenues decrease by half.

G. Jennings--now commercial and industrial distribution are taxed.

C. Quarles--you shouldn't be collecting a tax on a service.

C. Quarles--who owns gas in storage, how is it accounted for?

G. Ferguson--storage in state is owned by LDCs who store their own gas, pipelines who are storing gas for others.

C. Quarles--we want tax neutrality so everyone pays tax, whether buying from an LDC or from a marketer.

R. Dennis--The July report speaks of the need for revenue neutrality. Does going to unbundling guarantee tax revenue losses?

B. Merola--guaranteeing revenue neutrality takes away some of the benefit of competition to customers. Unbundling will benefit customers by resulting in lower-cost gas.

G. Ballinger--not concerned about revenue decreases because of lower gas cost, concerned about total tax avoidance.

D. Boehm--industry has always been looked to as a source of revenue to make up for a decline in revenues. Is concerned that a change in policy will increase cost of gas to industrial customers.

D. Kinloch--industry is now avoiding taxes. The difference is that, before, industry was buying from the LDC, and now it is not.

D. Boehm--it is not clear how you achieve revenue neutrality class by class when changing the structure of revenue, e.g. PIP.

Rev. Cabinet--taxes should be neutral and easy to administer.

Ralph--is it not an issue that marketers' prices will be lower because of lower taxes?

D. Fellon--marketers can collect taxes if the system is set up that way. We collect taxes and submit them in each state as required. We don't have a guaranteed market, however, and shouldn't have the same obligations as an LDC.

G. Jennings--today, Delta has franchise, school, and state sales tax. If you buy from someone else, your tax bill will be different. This is both a revenue problem and a competition problem.

D. Fellon--the LDC should be indifferent because of the GCR, shouldn't care about loss of sales service.

G. Ballinger--school tax is the more significant issue. Cities do not want a system that allows entities to get out of paying taxes. Cities and schools haven't awakened to the problem of tax revenue loss. Must be able to collect the same revenue for schools and local taxing authorities.

G. Jennings--there has been a decrease in revenue from the loss of some industrial and commercial customers, but it has been masked by economic growth. This is an issue that will have to be solved by the legislature.

S. Goins (Dept. Of Ed.)--most school ditricts probably don't realize the possible extent of the problem with revenues.

B. Merola, G. Ballinger--should pursue percentage neutrality, not revenue neutrality.

B. Merola--taxes have been an issue in other states, but the issue has not held up the unbundling proces. The states have addressed the tax isues after unbundling.

S. Goins--must solve tax problem before any other unbundling takes place, already a situation of revenue loss.

C. Quarles--Corporate income and propoerty taxes are taxes that LDCs pay today. There will be a decline in income tax with out-of-state marketers.

??--No, because of pass-through. Property tax collection should be the same. With unbundling should get the same amount of corporate income taxes.

Rev. Cabinet--Ky. would also tax marketers. They have a leasehold interest.
We will see a decrese in tax revenues. Out-of-state marketer has no physical presence in the state. Ky. doesn't have a "doing business" standard of tax collection. That could change so that physical presence is not required.

G. Jennings--there are some in-state marketers. If these lose business to out-of-state marketers, there will be loss of revenue.

Rev. Cabinet--hoping that PSC will certify marketers so they can get names for taxing purposes. Largest component of preoperty tax is for schools.

B. Merola--tax collection is not an insurmountable problem.

C. Raskin, D. Boehm--no one is crying out for unbundling.

Discussion of the reality vs. the theory of competition.

D. Boehm--industrial deregulation hs lowered costs for everyone.

S. Goins--shouldn't residential customers be educated that lower costs my or may not result?

B. Merola--in other states, they are saving.

CAPACITY ASSIGNMENT

J. Gaynor--should be voluntary according to the plan the LDC formulates. Required assignment does not facilitate a competitive market. The LDC does need to recover its costs. Solution of the problem should depend on the LDC's plan.

M. Thessin--will have to collect costs through assignment or surcharge.

G. Ferguson--expanation of the meaning of stranded costs: Company has to have either storage or pipeline capacity in order to meet firm demand. If the company is not going to be in the market or loses half its load to marketers, then it is left with these prudently-incurred costs. LDCs should be held whole.
G. Jennings--stranded costs also include gas supply contracts (along with capacity and storage.) Also cost of service, i.e. administrative costs.

D. Fellon--prudency is also an issue.

Should capacity go with the customer?

B. Merola--No, it stifles the market. Transportation is the key to being competitive; mandatory assignment forces the marketer to use the LDC's transportation path. Areas in which capacity assignment is mandatory have not grown much. Some areas have found various ways to mitigate costs. These include off-system sales and posting capacity on electronic bulletin boards. Enron is opposed to LDCs doing off-system sales. This is rebundling.

G. Jennings--the case to watch over the coming 18 months is Georgia. Georgia will allocate capacity to marketers, and then to customers.

C. Quarles--why do LDCs want to compete?

G. Jennings--some say the issue is not economics, but only customer choice.

J. Borchert--if LDCs are going to compete, they should be required to do so through an affiliate--no special deals. It is a conflict of interest otherwise.

B. Merola--yes, otherwise there is too much chance for cross-subsidization. Should not allow "streaming."

G. Jennings--the PSC has the responsibility for reviewing cross-subsidization. It flies in the face of customer choice if you tell the customer he can't choose the LDC as his supplier.

J. Gaynor--question is whether an LDC can sell competitively while being regulated under GCA regulations.

G. Jennings--LDCs can help keep marketers honest. It is important for an LDC to be a player.

S. Byars--Legislation should not mandate or set a date certain for unbundling or mandate the LDC getting out of the merchant function, but should leave choice of participation to the individual company.

G. Jennings--if allowed to choose, some LDCs would choose to unbundle and some would choose not to. Also, LDCs would differ in electing to leave the merchant business or not.

D. Fellon--if an LDC chooses not to unbundle, its customers have been given no choice.

C. Raskin--if LDCs cannot compete, how is Ky going to ensure that its customers get gas?

R. Dennis--under deregulation, will there still be curtailment plans?

D. Boehm--not sure how it would work. If the LDC is taken out, who ensures supplies? This is of concern to everyone. If the LDC is taken out, it will have to maintain the ability to provide some amount of gas. What is the amount? 10 percent? 20 percent? Last winter, some marketers failed. The system worked because unbundling had not fully become fact. Have to be careful to maintain the backstop. There is potentially a very high price for consumers. Everyone would be seeking gas at the worst time.

C. Raskin--default is unpredictable. What about reliability? Gas is a necessity.