COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF	**)**	
LOUISVILLE GAS AND ELECTRIC	**)**	
COMPANY FOR RENEWAL AND	**)**	**CASE NO. 2023-00411**
PROPOSED MODIFICATIONS OF ITS	**)**	
PERFORMANCE-BASED RATEMAKING	**)**	
MECHANISM	**)**	

TESTIMONY OF
PAMELA L. JAYNES
DIRECTOR – GAS MANAGEMENT, PLANNING, AND SUPPLY
LOUISVILLE GAS AND ELECTRIC COMPANY

Filed: December 29, 2023

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 Director – Gas Management, Planning, and Supply for Louisville Gas and Electric Company ("LG&E").

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

A. I am responsible for overseeing the procurement and management of natural gas supplies and interstate pipeline gas transportation services for LG&E. These natural gas supplies and pipeline transportation services are designed to meet the needs of LG&E's firm retail gas sales customers. I also oversee the coordination and management of LG&E's natural gas transportation services for large gas customers who purchase their own gas supplies and pipeline transportation services. I am also involved in regulatory and other 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 Indiana University with a B. S. degree in Business Management in 1987. I was employed by LG&E in 1988 in the Rate and Economic Research Department, where I remained until 1991 when I moved to the Gas Management, Planning, and Supply Department. I became manager of that department in 2002 and director in 2021. 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")?

A. Yes. I submitted written testimony in the Commission's Case No. 2010-00146, "An Investigation of Natural Gas Retail Competition Programs". I have also sponsored data responses in LG&E's previous gas supply cost Performance-Based Ratemaking ("PBR") mechanism proceedings, specifically Case Nos. 2021-00028, 2019-00437, 2014-00476, and 2009-00550. I also am responsible for determining the gas supply and interstate pipeline transportation cost estimates that support LG&E's quarterly Gas Supply Clause filings and responding to questions related to these filings, such as the recent data requests related to the retirement of LG&E's Doe Run storage field in Case No. 2023-00089.

Q. What is the purpose of your testimony in this case?

A. The purpose of my testimony is to adopt and support LG&E's PBR evaluation report for the PBR years ending in 2021 through 2023 as well as LG&E's application for a proposed renewal of its PBR including some minor modifications to the mechanism. As detailed in my testimony and the PBR evaluation report, LG&E's PBR provides LG&E with an incentive to achieve gas supply cost savings for its customers by outperforming benchmarks. The incentive component of the PBR mechanism allows LG&E to share in the savings (or expenses) achieved under the mechanism thereby encouraging LG&E to achieve lower gas costs for customers.

Q. Please summarize LG&E's PBR evaluation report.

A. LG&E's PBR evaluation report discusses the continuing applicability of performance-based ratemaking mechanisms and describes the principles that LG&E has used in designing its PBR mechanism. The report goes on to discuss the results achieved under each of the three components of the mechanism (gas acquisition, gas transportation, and off-system sales) and the sharing of any savings (or expenses) between LG&E and its customers. The report concludes with a discussion of the renewal and minor modifications that LG&E is proposing for its gas supply cost PBR mechanism in this proceeding.

Q. Please summarize the total savings achieved by LG&E for the three PBR years included in the report.

A. The total savings achieved by LG&E for the three PBR years included in the report is $31,607,018. Pursuant to the PBR sharing mechanism, customers received cost savings of $19,892,120, and the company earned the right to recover $11,714,898.

Q. Please describe the modifications that LG&E is proposing to the PBR mechanism and the reasons for those modifications.

A. In addition to proposing a renewalof the PBR mechanism that extends the tariff for four more years through October 31, 2028, LG&E is proposing to modify the Transportation Index Factor (TIF) component, the Off-System Sales Index Factor (OSSIF) component, and a reporting requirement of the PBR. LG&E is proposing to modify the TIF component of the PBR to remove language related to financial hedging costs, gains and losses because these costs are not likely to occur during the PBR renewal period. LG&E is proposing modifications to the OSSIF component of the PBR to remove language related to the provision of storage services and to remove Out-of-Pocket Storage Costs and Out-of-Pocket Underground Storage Costs from the Out-of-Pocket Costs (OOPC) formula because LG&E does not plan to use either its on-system or off-system storage to make off-system sales during the PBR extension period. LG&E is also proposing to remove the last sentence in the definition of Out-of-Pocket Gas Costs and Out-of-Pocket Transportation Costs because LG&E only makes off-system sales using its firm contracts. Finally, LG&E is proposing to remove the last sentence of the "Review" section requiring LG&E to include proposed modifications to the PBR (if any) in the review report. LG&E instead proposes to continue to file a separate application with the Commission to renew, propose modifications, or terminate the PBR in the future.

Q. Why does LG&E continue to support the concept of gas supply cost PBR mechanisms?

A. LG&E continues to support voluntary, well-constructed PBR mechanisms that benchmark gas costs in a transparent and objective way because they can produce results that are superior to the traditional prudence standard. This is the case because PBRs include a risk/reward mechanism that incents the local distribution company ("LDC") to beat the benchmarks and places the LDC at risk if those results are not achieved. Importantly, customers do not bear additional risk associated with supply reliability, nor do they bear any incremental operating and maintenance costs to achieve those results. Customers ultimately pay lower costs with, rather than without, a PBR mechanism. The Commission also acknowledged in its Order in Case No. 2021-00028, that there is evidence to demonstrate that LG&E's PBR mechanism provides savings to customers as follows:

> *For instance, as argued by LG&E, its ability to share in savings is a form of positive reinforcement whereas the requirement that it share in costs is a form of negative reinforcement, both of which influence behavior in both persons and organizations. Further, LG&E can show that it has outperformed its gas cost benchmarks*

which are based on certain prices on the pipelines from which LG&E receives wholesale gas.[1]

Q. In the absence of a PBR mechanism, what guidance will drive LG&E's gas procurement activities?

A. Absent a gas supply cost PBR mechanism, LG&E will follow the otherwise applicable guidance provided by the Commission in its Orders in Administrative Case No. 297 and amplified in Administrative Case No. 384 which states, that "LDCs should maintain their objective of 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.[2]" The guidance provided in the PBR differs from this guidance in that it encourages the LDC to outperform the market-based benchmarks if possible and includes an incentive to encourage this outcome. The PBR mechanism also provides an additional tool for the Commission to review LG&E's gas costs and the effectiveness of its gas procurement practices.

Q. In the absence of a PBR mechanism, how might LG&E's approach to gas procurement change?

A. Absent the PBR mechanism, LG&E may lose its competitive approach to gas procurement. The well-designed PBR benchmarks provide clear, tangible guidance that drives both the daily and long-term gas supply planning process. This guidance, and the potential to create savings or expenses under the mechanism, encourages LG&E to perform extensive market

[1] *See* Commission Order in Case No. 2021-00028 dated November 29, 2021, at p. 6

[2] *See* Commission Order in Administrative Case No. 384 dated July 17, 2001, at p. 18

research, be innovative, and take manageable risks. It encourages supply optimization and intense focus on making the best procurement decisions possible. It encourages a competitive approach to gas procurement that results in dissatisfaction when decisions do not produce the savings expected for customers and satisfaction when decisions do produce the savings expected for customers. Absent the PBR's benchmarks and risk/reward mechanism, it will be difficult to maintain a competitive approach to procurement and the benefits for customers that result from that competitive approach. If there are no benchmarks, there is no metric to beat. If there is no risk/reward mechanism, there is no incentive to out-perform the traditional prudence standard.

Q. In the absence of a PBR mechanism, how might LG&E's gas procurement activities change?

A. Prior to the implementation of the PBR, LG&E could not foresee many of the innovations and optimization activities that have been encouraged by its PBR mechanism. Similarly, LG&E cannot fully evaluate the impact of either discontinuance or modification of its PBR. Absent the PBR, LG&E would continue to procure reliable, least cost gas supplies, but it will be more risk averse. For example, some activities that LG&E may be less likely to undertake include capacity release, off-system sales, and modification of its planned storage withdrawal or injection schedule. LG&E would be less likely to enter into purchase agreements that increase risk. For example, LG&E might be more likely to purchase supply daily at a daily price index rather purchase baseload gas for the month at a first-of-month price because first-of-month priced supply carries the risk of ultimately being more expensive than daily priced supply. It is not possible to determine if this daily procurement strategy would result in higher or lower costs for customers, but it would subject customers to more price volatility. There are also some activities that LG&E may be more likely to consider absent the PBR as currently configured. Those activities include the procurement of fixed price physical gas, certified responsibly produced gas, and renewable natural gas. These types of purchases are currently discouraged by the PBR mechanism because they could result in costs that are greater than the PBR benchmarks.

Q. In the absence of a PBR mechanism, should LG&E be expected to continue to generate cost savings?

A. No. Absent the PBR, there are no benchmarks to determine savings. Regardless, there is no guarantee that LG&E can generate savings in the future compared to the PBR benchmarks. This is true whether the PBR mechanism is discontinued or extended. Going forward, LG&E expects it to be more challenging to create savings under the PBR mechanism. With respect to the GAIF component, some suppliers are not willing to offer a discount. Other suppliers may offer a discount or desired transaction structure from time-to-time depending on market conditions, the supplier's portfolio, and other unknown considerations such as the price other market participants are willing to pay. For example, the current lower price environment may reduce a supplier's incentive to offer a discount, as well as the level of any discount offered. Additionally, there is increasing competition for natural gas from power generators and Liquified Natural Gas (LNG) export facilities who may be willing to pay a higher price for natural gas. This competition may result in LG&E having to pay a premium to the market index price for natural gas. Additionally, LG&E may have to pay a premium to the market index price during periods of colder weather, to acquire delivered supply, or during periods of interstate pipeline maintenance. LG&E may also have to purchase gas from a higher priced supply area due to maintenance on its system that prevents purchases from a lower priced supply area. With respect to the TIF component, pipelines are becoming more fully subscribed providing them with less incentive to offer discounts. Additionally, if LG&E requires additional pipeline capacity in the future, it may have to pay a rate higher than the pipeline's tariff rate if the pipeline is required to build facilities. LG&E voluntarily assumes the risk of creating expenses under the PBR mechanism in exchange for the opportunity to share in savings created under the mechanism. In the absence of the PBR mechanism, the prudence standard should be the market price LG&E must pay for reliable natural gas and the FERC-approved tariff rates for pipeline transportation service.

Q. In the absence of a PBR Mechanism, would operation and maintenance ("O&M") costs be lower?

A. No, O&M costs would not be lower, nor have they been higher because of the PBR Mechanism. LG&E's PBR mechanism does not change the procurement activities that LG&E is required to perform; it changes how LG&E performs those procurement activities.

Q. Can a single PBR mechanism be constructed that fits all LDCs?

A. No. As early on as its Order in Administrative Case No. 384, the Commission recognized that a one-size-fits-all PBR mechanism is not appropriate for all LDCs.[3] Each PBR must be tailored to the individual circumstances of the LDC, but the over-arching principles in designing the PBR should be the same. Those four principles are a least cost acquisition standard, a cost/benefit test, maintaining reliable service, and an integrated behavior standard. LG&E discusses those four principles in its PBR Report attached as Exhibit PLJ-

[3] See Order in Administrative Case No. 384 dated July 17, 2001, at p. 7.

1. While the benchmarks might necessarily be different, the sharing mechanism should be similar for each PBR as they are today. For example, the current savings/expense sharing mechanism of each LDC with a PBR in Kentucky provides for 30%/70% sharing up to a specified percentage of total gas costs, with 50%/50% sharing above that threshold.

Q. When was the structure of LG&E's current savings/expense sharing mechanism determined?

A. The structure of LG&E's current PBR savings/expense sharing mechanism was determined by the Commission in Case No. 2019-00437. In that case, the Commission modified LG&E's savings/expense sharing mechanism in two ways. The first modification increased the percentage used to calculate the first tier of savings/expenses from 2% to 4.6%. The Commission selected 4.6% after considering the average savings achieved by LG&E compared to total gas costs for PBR Years 19, 20, 21, and 22. The second change increased LG&E's sharing percentage for the first tier of savings from 25% to 30%.

Q. Did the Commission's changes to the savings/expense sharing mechanism in Case No. 2019-00437 impact LG&E's incentive to create savings for customers?

A. Yes. The increase in the percentage used to calculate the first tier of savings/expenses from 2% to 4.6% was discouraging to LG&E because it is now more difficult to reach a level where the company can share savings with customers 50%/50%. For example, at the time this change was determined by the Commission (October 2020), LG&E had only achieved savings greater than 4.6% of total gas costs for about a third of its 22 historical PBR years, as shown in Exhibit PLJ-2. However, the Commission's decision to increase LG&E's sharing percentage for the first tier of savings (up to 4.6% of total gas costs) from 25% to 30% somewhat offset the negative impact of the higher 4.6% threshold because most of the savings created by LG&E fall in the first tier of the sharing mechanism, and LG&E now shares in a slightly larger percentage of those savings.

Q. Should the savings/expense sharing mechanism be modified in this proceeding?

A. No. LG&E believes that the current savings/expense sharing mechanism is effective in encouraging LG&E to create gas costs savings for customers. In particular, the 4.6% threshold that must be exceeded to share savings 50%/50% with customers nearly matches the average gas cost savings of 4.7% that LG&E has achieved over the 26 years of the mechanism.[4] So, the 4.6% threshold provides a challenging, but not impossible goal for LG&E to achieve prior to sharing incremental savings with customers 50%/50%. While LG&E achieved a somewhat higher average percentage of savings (7.11%) for PBR Years 24, 25, and 26, this higher level of savings is partially the result of a natural gas market that produced higher prices and/or price volatility during PBR Years 24 and 25 due to weather and other market factors that impacted national gas supply/demand levels. As a result, LG&E's purchasing strategy created greater savings for customers than it might have if prices had been lower and/or there had been less price volatility. For example, Winter Storm Uri occurred in February 2021 (PBR Year 24) causing an unprecedented increase in gas prices from the first of the month to a few days after President's Day weekend. As an illustration, the *Platts Gas Daily* midpoint price for Texas Gas Lebanon Hub (Zone 4) was $2.615/MMBtu on February 1, then rose to $6.540/MMBtu on February 12, rose again to $52.060/MMBtu on February 13, 14, 15, and 16, before falling to $18.900/MMBtu on February 17 and $16.655/MMBtu on February 18. Through its purchasing strategy, LG&E was able to mitigate customer exposure to higher gas prices in February 2021 resulting in

[4]See Exhibit PLJ-2, Summary of Gas Supply Cost Performance-Based Ratemaking Savings/(Expenses).

significant GAIF savings under the PBR for this month. While mid-month price increases are not unusual, this level of mid-month price increase is atypical. PBR Year 25 was also unusual in that prices were consistently higher than those seen in the last 15 years due to gas production levels that struggled to match gas demand, low national storage inventory levels, a warmer-than-normal summer that increased gas demand for power generation, and record levels of LNG exports. As an illustration of consistently higher prices, the *Platts Gas Daily* midpoint price for Texas Gas, Zone 1 averaged about $4.25/MMBtu for the winter (November through March), about $6.85/MMBtu for the summer (April through October) and $5.80/MMBtu for the PBR Year 25. Comparatively, the average annual Texas Gas, Zone 1 price for PBR Year 24 and PBR Year 26 was about $3.40/MMBtu and $2.70/MMBtu respectively.

Q. What is your recommendation in this proceeding?

A. The Commission should approve the renewal requested for a four-year extension of LG&E's PBR mechanism through October 31, 2028, with the proposed modifications, because the PBR mechanism aligns the interests of LG&E and its customers with the goal of lowering gas costs. Instead of focusing the Company's efforts on merely recovering prudently incurred gas costs, the PBR mechanism will focus the Company's efforts on out-performing benchmarks (which act as a surrogate for prudently incurred costs) and reward both LG&E and its customers for LG&E's supply optimization efforts. LG&E requests that the Commission authorize the extension of its PBR mechanism by no later than June 1, 2024. Authorization by this date will allow LG&E adequate time to plan its gas supply portfolio and supply strategies prior to the mechanism becoming effective November 1, 2024.

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 Director – Gas Management, Planning, and Supply 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

PAMELA L. JAYNES

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 28th day of December, 2023.

Caroline J. Davison

(SEAL)

______________________ Notary Public

Notary ID #: KYNP6386

My Commission Expires:

January 22, 2027

CAROLINE J. DAVISON
NOTARY PUBLIC
STATE AT LARGE, KENTUCKY

APPENDIX A

PAMELA L. JAYNES

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 (06/21 – Present)
Manager – Gas Supply (12/02 – 06/21)
Lead Gas Supply Specialist (04/97 – 12/02)
Gas Supply Coordinator (08/94 – 04/97)
Senior Gas Supply Analyst (02/91 – 08/94)
Rate Analyst (02/88 - 02/91)

EDUCATION

INDIANA UNIVERSITY SOUTHEAST

New Albany, Indiana (5/87)

Bachelors of Science Business Management

LOUISVILLE GAS AND ELECTRIC COMPANY REPORT TO THE KENTUCKY PUBLIC SERVICE COMMISSION ON GAS SUPPLY COST PERFORMANCE-BASED RATEMAKING MECHANISM

December 29, 2023

On January 29, 2021, Louisville Gas and Electric Company ("LG&E" or "the Company") filed with the Kentucky Public Service Commission (hereinafter "Commission") a report on its gas supply cost Performance-Based Ratemaking ("PBR") mechanism. On November 29, 2021, the Commission issued its Order in Case No. 2021-00028 approving LG&E's current PBR mechanism through the end of October 31, 2024. In accordance with that Order, LG&E is required to submit to the Commission an evaluation report on the results of the PBR mechanism within sixty days after October 31, 2023. The current PBR mechanism remains in effect through October 31, 2024, pending a subsequent Commission Order modifying or extending the current PBR mechanism.

In this report, LG&E first addresses the success and applicability of its PBR mechanism as an incentive to outperform benchmarks and achieve lower gas costs for customers. Next, LG&E assesses its performance under the three components of its current PBR mechanism. Finally, LG&E proposes to renew its PBR tariff for four years and proposes certain modifications to the current PBR mechanism.

SUCCESS AND APPLICABILITY OF GAS SUPPLY COST PBR MECHANISM

Performance-based ratemaking mechanisms began to be applied to purchased gas costs in the 1990s. These mechanisms were an alternative to retail choice programs and were designed to incentivize local distribution companies ("LDCs") to optimize their gas supply portfolios within the prevailing marketplace to provide lower gas costs to customers without diminishing reliability. While the marketplace has experienced changes over time, LG&E's PBR mechanism has been consistent in successfully encouraging LG&E to outperform benchmarks, achieve measurable gas supply cost savings, and provide lower gas costs to its customers with no decrease in reliability.

Performance-based ratemaking mechanisms contain two components: (1) the component that establishes the benchmarks against which results are to be measured and (2) the component that allocates the results. The benchmarks establish the kind of behavior that should be rewarded and are a key part of the mechanism. Concurrent benchmarks against which to compare results ensure that the mechanism reflects evolving market conditions. These benchmarks must be carefully constructed to ensure that appropriate behavior is incented, and inappropriate behavior is not encouraged. Properly constructed benchmarks align the interests of the LDC and its customers. The second component (the sharing mechanism) allocates the results (savings or expenses) by establishing the reward that an LDC receives for outperforming the benchmarks and undertaking risks associated with achieving lower gas costs for customers.

During the period covered by this report (that is, from November 1, 2020, and through October 31, 2023), LG&E achieved $31,607,018 in savings under the current PBR mechanism. Of the total savings, LG&E retained $11,714,898, and the remaining portion of $19,892,120 was credited to customers through collection of lower gas supply costs. Attached as Appendix A is a summary of LG&E's PBR results showing by PBR Year the total savings, the customer and shareholder portions, and the total actual gas supply costs benchmarked under the mechanism. Attached as Appendix B is a monthly summary by component for Year 24 (the 12 months ended October 31, 2021), Year 25 (the 12 months ended October 31, 2022), and Year 26 (the 12 months ended October 31, 2023). The supporting work papers were previously filed as Post-Case Correspondence by LG&E as annual PBR mechanism reports required by Paragraph 3 of the Commission's November 29, 2021 Final Order, in Case No. 2021-0028.

LG&E's PBR mechanism, which measures performance against established benchmarks, is understandable and easy to calculate and yet complex enough to reflect market realities. It encourages LG&E to develop, pursue, and manage supply arrangements and undertake risks commensurate with potential rewards to achieve lower gas costs without diminishing reliability.

LG&E's PBR mechanism benefits both customers and shareholders. The PBR mechanism encourages LG&E to outperform benchmarks resulting in the provision of lower cost and reliable natural gas service to customers. Shareholders benefit from the PBR mechanism through the sharing mechanism which rewards shareholders for the assumption of certain risks associated with optimizing performance under the PBR mechanism. These risks include, but are not limited to, contracting risks, storage management risks, supply management risks, transportation management risks, and credit risks. And of course, there is the risk the LDC would share in expenses that might result under the mechanism, a risk that would not exist absent the PBR mechanism itself.

LG&E's PBR mechanism establishes meaningful and objective benchmarks against which to measure LG&E's performance. The benefits associated with LG&E's PBR mechanism are quantifiable, measurable, and verifiable. The PBR mechanism provides continued Commission oversight of LG&E's gas supply purchasing activities by enabling the Commission to objectively measure LG&E's performance.

LG&E's PBR mechanism continues to provide incremental benefits to customers, which might not otherwise be available to them. These incremental benefits are the result of outperforming benchmarks that are concurrent with actual performance. Results are not measured in comparison to past performance because the market for natural gas and pipeline services changes over time. Likewise, LG&E's PBR mechanism does not diminish service reliability. The continuation of the PBR mechanism as proposed in this filing will encourage LG&E to continue to optimize its gas supply portfolio and produce benefits for customers.

LG&E used four principles in designing its PBR mechanism, and they continue to remain applicable. These principles are:

- A cost/benefit test;
- A least cost acquisition standard;

- The maintenance of reliable service; and
- An integrated behavior standard.

Cost/benefit test: By specifying benchmarks, LG&E's PBR mechanism establishes the cost/benefit test to determine the effectiveness of LG&E's procurement activity. The benchmarks, which are established prior to the beginning of the operation of the PBR mechanism, are objective benchmarks that are intended to incent the utility to perform as desired. The benchmarks provide a meaningful framework for measuring and reviewing performance. LG&E's performance is measured by comparing actual costs to benchmark costs to determine the savings or expenses resulting under the PBR mechanism.

Because it is not possible to determine what LG&E would have done in the absence of the PBR mechanism and the incentives it provides, it is necessary that the PBR mechanism be properly constructed. The benchmarks incorporated in the PBR mechanism can be used as a surrogate for the results LG&E would have achieved in the absence of the incentives the PBR mechanism provides. These benchmarks encourage and set expectations for the behavior that must occur to achieve customer benefits that surpass the prudence standard.

Least cost acquisition standard: The goal of least cost acquisition is one of the most important reasons to encourage the use of PBR mechanisms in general, and LG&E's PBR mechanism specifically. LG&E's PBR mechanism incorporates a "least cost acquisition" standard in purchasing natural gas supplies and pipeline transportation services. The sharing mechanism of LG&E's PBR mechanism encourages LG&E to purchase low cost and reliable gas supplies and pipeline transportation services from among all the supplies and pipeline transportation services available to LG&E.

The Commission supplemented the regulatory guidance originally embodied in Administrative Case No. 297 when, in Administrative Case No. 384, the Commission stated that LDCs "should maintain their objective of 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."[1] LG&E's PBR mechanism encourages LG&E to achieve these goals.

Maintenance of reliable service: LG&E's PBR mechanism recognizes the importance of reliability in contracting for and managing its natural gas supply and pipeline service arrangements. The benchmarks incorporated into LG&E's PBR mechanism support a portfolio that provides reliable yet flexible supply management. LG&E's PBR mechanism does not provide incentives that could encourage LG&E to take risks that reduce reliability in order to achieve lower costs.

Integrated behavioral standard: A PBR mechanism must be constructed to ensure that it encourages and incents the appropriate behavior in creating cost savings for customers and rewards the LDC for the risks it has undertaken in designing and optimizing its gas supply portfolio to produce lower costs. An integrated behavioral standard requires that a PBR mechanism be well reasoned, inclusive, and balanced. An integrated behavioral standard recognizes that a PBR mechanism should be designed to minimize all gas supply cost elements over the course of the annual contracting cycle, not simply to minimize a discrete component or components of gas supply costs. Likewise, the components of the PBR mechanism should be balanced so that one objective (such as least cost) is not encouraged to the detriment of other equally important objectives (such as reliability).

LG&E's PBR mechanism is well reasoned in that it contains objective and meaningful benchmarks. LG&E's PBR mechanism is balanced and does not encourage savings under one component over savings under another component. This is supported through the application of uniform sharing percentages across all components of the PBR mechanism.

Designing a flexible PBR mechanism that can provide meaningful incentives over the term of the PBR mechanism is essential. LG&E's PBR mechanism does not encourage a rigid, narrow approach to contracting for gas supply or related services. Instead, it provides

[1] *See* Order in Administrative Case No. 384 dated July 17, 2001, at p. 18.

LG&E with the flexibility to explore pricing arrangements that may become available in the evolving marketplace.

The purpose of any incentive mechanism, such as LG&E's gas supply PBR mechanism, is to encourage and reward a desired behavior. Any changes to the incentive mechanism will result in behavioral changes. Similarly, absent a PBR mechanism, behavior will also change. For that reason, any modifications to LG&E's PBR mechanism should encourage and reward desired behavior, preserve the reliability of gas supply, yield least cost gas supply, and be integrated. Without considering these standards, modifications to the benchmarks could have unintended behavioral results that adversely impact benefits accruing to customers.

ASSESSMENT OF GAS SUPPLY COST PBR MECHANISM BY COMPONENT

LG&E's PBR mechanism is comprehensive. The three basic components of LG&E's PBR mechanism are the Gas Acquisition Index Factor ("GAIF"), the Transportation Index Factor ("TIF"), and the Off-System Sales Index Factor ("OSSIF").

> The sum of the savings or expenses from these three components is subject to an asymmetrical sharing mechanism (which includes a threshold) that allocates any savings or expenses between shareholders and customers. Additionally, customers realize all the benefits from the PBR mechanism during the PBR period.[2] After the PBR period, a recovery factor is placed into effect the following February so that LG&E may recover its share of any savings which it has achieved from, or refund any expenses to, customers.

[2] A PBR period covers the 12 months from November 1 through October 31 of the following calendar year and coincides with gas industry contracting practices.

<u>Gas Acquisition Index Factor ("GAIF")</u>

The GAIF component of the PBR mechanism benchmarks LG&E's actual commodity costs against a calculated benchmark representative of the market price of gas by using various industry-recognized price postings as applied to total actual purchase volumes. The GAIF benchmark is reflective of the fact that LG&E can purchase natural gas supplies from a number of supply zones on different pipelines at various times under a variety of pricing arrangements.

Currently, LG&E's supply area natural gas purchases for transportation by Texas Gas Transmission LLC ("Texas Gas" or "TGT") are benchmarked in three zones on Texas Gas's system: Zone SL, Zone 1, and Zone 4. It is in these zones that LG&E currently has firm pipeline receipt point entitlements. LG&E also has firm transportation capacity entitlements on the system of Tennessee Gas Pipeline Company, LLC ("Tennessee" or "TGPL"). LG&E currently has firm pipeline receipt point entitlements in Tennessee's Zone 0 supply area. LG&E can also buy natural gas volumes for delivery to its city gate.

The indices used by LG&E in its PBR mechanism are published by *Energy Intelligence Natural Gas Week*, *Platts Gas Daily*, and *Platts Inside FERC's Gas Market Report*. These three publications represent recognized sources of natural gas pricing information available in the industry; these indices provide pricing data specifically related to the supply zones accessed by LG&E. LG&E does not (and is not currently required to) provide any pricing information to these publications. Therefore, LG&E does not influence the determination of these indices.

Importantly, LG&E's PBR mechanism encourages it to optimize its purchases across the purchase locations accessible by LG&E. The GAIF benchmark is constructed to recognize that LG&E may purchase natural gas supplies from a variety of supply zones throughout the month. As a result, the PBR mechanism encourages LG&E to optimize its purchase of natural gas from the lowest priced supply zone(s).

LG&E's benchmarking mechanism encourages and allows it the opportunity for reward if it manages gas purchases to achieve actual gas costs less than the benchmark. LG&E is encouraged to enter a variety of reliable and flexible gas supply contracting agreements in order to optimize performance.

Historical Performance

Under the GAIF component of the PBR mechanism, LG&E has achieved total savings related to its gas commodity costs of $25,200,643, broken down as follows: $10,331,954 for the 12 months ended October 31, 2021; $11,549,113 for the 12 months ended October 31, 2022; and $3,319,576 for the 12 months ended October 31, 2023.

Transportation Index Factor ("TIF")

The TIF component of the PBR mechanism benchmarks LG&E's actual pipeline transportation costs against the transportation tariff rates filed with and approved by the Federal Energy Regulatory Commission ("FERC") by either Texas Gas or Tennessee, as applicable. The TIF benchmark is reflective of the way interstate pipelines contract for firm pipeline transportation service.

LG&E's transportation costs include firm services purchased from Texas Gas and Tennessee that help ensure that LG&E has reliable natural gas supplies to serve the requirements of its firm customers. For firm services, pipelines generally charge a two-part demand/commodity transportation rate which is established and regulated by FERC. These FERC-approved tariff rates provide a fair and objective benchmark against which to measure the savings achieved by LG&E as a result of the PBR mechanism.

In some circumstances, it may be possible to extract a discount from an interstate pipeline based upon market conditions, capacity availability, type of service, or a particular competitive situation. However, interstate pipelines are not required to discount their capacity and may decline to do so even if they have capacity available which remains unsold at the FERC-approved tariff rate. In the case of Texas Gas and Tennessee, both pipelines have become more fully subscribed over the last few years due to an increase in demand from power generators and liquified natural gas (LNG) export facilities. As circumstances evolve over time, the level of the discounts that pipelines are willing to offer (if any) may also change. Therefore, LG&E can continue to make a good faith effort to negotiate transportation service discounts, but there is no guarantee that a discount will be achieved, or that the discount achieved will be lower than a previously negotiated discount. LG&E's PBR mechanism encourages it to secure discounts when available to provide lower gas costs for customers.

LG&E's gas transportation cost benchmarking mechanism focuses on all pipeline transportation costs, not just some costs. LG&E's mechanism adopts an integrated behavioral approach, which encourages it to reduce gas transportation costs by locking in longer-term discounts for customers and taking advantage of shorter-term capacity release opportunities that won't diminish reliability.

Historical Performance

Under the TIF component of the PBR mechanism, LG&E has achieved total savings related to its pipeline transportation costs of $6,298,835, broken down as follows: $2,104,853 for the 12 months ended October 31, 2021; $2,105,596 for the 12 months ended October 31, 2022; and $2,088,386 for the 12 months ended October 31, 2023.

<u>Off-System Sales Index Factor ("OSSIF")</u>

The OSSIF component of the PBR mechanism benchmarks LG&E's off-system sales against the out-of-pocket costs incurred to make such sales. The OSSIF benchmark is reflective of the way LG&E makes off-system sales transactions and objectively measures savings achieved by LG&E as a result of these opportunistic transactions.

An off-system sale is the resale of natural gas supplies to customers other than LG&E's retail customers. Such parties generally include marketers or producers not on LG&E's distribution system.

Historical Performance

Under the OSSIF component of the PBR mechanism, LG&E has achieved total savings related to its gas commodity costs of $107,540, broken down as follows: $107,540 for the 12 months ended October 31, 2021; $0 for the 12 months ended October 31, 2022; and $0 for the 12 months ended October 31, 2023.

Summary

In order to maximize savings under its PBR mechanism, LG&E continues to investigate and initiate new purchasing strategies, respond to changing market conditions, and explore gas supply alternatives and opportunities that it might not otherwise have. LG&E has sought to achieve savings under the GAIF portion of the PBR mechanism by optimizing and managing natural gas supplies. LG&E has sought to achieve savings under the TIF portion of the PBR mechanism by seeking pipeline discounts and optimizing pipeline capacity. LG&E has sought to achieve savings under the OSSIF portion of the PBR mechanism by making off-system transactions to creditworthy third parties when the opportunity arises.

PROPOSED RENEWAL OF AND MODIFICATIONS TO GAS SUPPLY COST PBR MECHANISM

LG&E's current gas supply cost PBR mechanism was approved for a term of four years. This report shows that during Years 24, 25, and 26 (the first three years covered by the current mechanism), LG&E's PBR mechanism resulted in savings for customers. Therefore, LG&E proposes to renew its PBR mechanism for an additional term of four years, that is, through October 31, 2028. Such a term will encourage LG&E to achieve meaningful benefits for customers because it will allow for a longer-term focus on performance optimization. The market for natural gas and interstate pipeline services is a continually evolving one. LG&E's gas supply strategies have evolved and must continue to evolve with the market to continue to achieve positive results under the PBR mechanism. LG&E's current PBR mechanism is generally flexible enough to allow it to respond appropriately. As such, LG&E is not proposing any changes to the GAIF or the sharing mechanism included in its current PBR mechanism. LG&E is proposing modifications to the TIF and OSSIF as redlined in the tariff sheets attached as Exhibit 1 in the Application. These changes are not substantial and will update the mechanism to better reflect current market costs and transaction opportunities.

LG&E is proposing to modify the TIF component of the PBR mechanism to remove language related to financial hedging costs, gains and losses. This language is being removed because these costs are unlikely to occur during the PBR mechanism renewal period.

LG&E is proposing to modify the OSSIF component of the PBR mechanism to remove language related to the provision of storage services and to remove Out-of-Pocket Storage Costs and Out-of-Pocket Underground Storage Costs from the Out-of-Pocket Costs (OOPC) formula because LG&E does not plan to use either its on-system or off-system storage to make off-system sales during the PBR mechanism renewal period. LG&E is also proposing to remove the last sentence in the definition of Out-of-Pocket Gas Costs and Out-of-Pocket Transportation Costs because LG&E only makes off-system sales using its firm contracts.

LG&E is also proposing to remove the last sentence of the "Review" section requiring it to include proposed modifications to the PBR (if any) in the review report. LG&E instead proposes to continue to file a separate application with the Commission to renew, propose modifications, or terminate the PBR in the future.

LG&E also requests that the Commission authorize the renewal of its PBR mechanism by no later than June 1, 2024 because LG&E will issue Requests for Proposals (RFPs) in mid-

June for supply transactions that will become effective November 1, 2024. Authorization by the requested date will allow LG&E adequate time to adjust its gas supply portfolio and supply strategies prior to the mechanism becoming effective November 1, 2024.

Lastly, LG&E proposes to file a report and assessment of the PBR mechanism that becomes effective November 1, 2024, if approved, according to a timeline that is the same as that included in its current PBR mechanism (that is, within sixty (60) days of October 31, 2027).

Appendix A

Summary of Gas Supply Cost Performance-Based Ratemaking Results

By PBR Year

	(1)	(2)	(3)	(4)	(5)
Year	*Total Savings*	*Customer Portion **	*Shareholder Portion **	*Total Actual Gas Supply Costs*	*Percentage By Year*
					(1) / (4)
24	*$12,544,347*	*$7,546,000*	*$4,998,347*	*$138,459,368*	*9.06%*
25	*$13,654,709*	*$8,632,135*	*$5,022,574*	*$196,171,749*	*6.96%*
26	*$5,407,962*	*$3,713,985*	*$1,693,977*	*$109,782,974*	*4.93%*
	$31,607,018	*$19,892,120*	*$11,714,898*	*$444,414,091*	*7.11%*

** Savings/Expenses are shared 30% to Company and 70% to Customer up to 4.6% of benchmarked costs; above 4.6% savings/expenses are shared 50%/50%.*

Appendix B

Summary of Gas Supply Cost Performance-Based Ratemaking Activity

For Year 24

(November 1, 2020 through October 31, 2021)

	PBR-GAIF	*PBR-TIF*	*PBR-OSSIF*	*Total*
Nov. 2020	*$482,325*	*$205,351*	*$0*	*$687,676*
Dec.	*$388,232*	*$172,682*	*$0*	*$560,914*
Jan. 2021	*$451,762*	*$172,682*	*$107,540*	*$731,984*
Qtr. Subtotal	*$1,322,319*	*$550,715*	*$107,540*	*$1,980,574*
Feb.	*$5,757,383*	*$172,682*	*$0*	*$5,930,065*
Mar.	*$140,306*	*$172,682*	*$0*	*$312,988*
Apr.	*$138,478*	*$172,682*	*$0*	*$311,160*
Qtr. Subtotal	*$6,036,167*	*$518,046*	*$0*	*$6,554,213*
May	*$58,905*	*$172,682*	*$0*	*$231,587*
Jun.	*$514,066*	*$172,682*	*$0*	*$686,748*
Jul.	*$423,926*	*$172,682*	*$0*	*$596,608*
Qtr. Subtotal	*$996,897*	*$518,046*	*$0*	*$1,514,943*
Aug.	*$359,659*	*$172,682*	*$0*	*$532,341*
Sep.	*$1,309,469*	*$172,682*	*$0*	*$1,482,151*
Oct.	*$307,443*	*$172,682*	*$0*	*$480,125*
Qtr. Subtotal	*$1,976,571*	*$518,046*	*$0*	*$2,494,617*
Total	*$10,331,954*	*$2,104,853*	*$107,540*	*$12,544,347*

Summary of Gas Supply Cost Performance-Based Ratemaking Activity

For Year 25

(November 1, 2021 through October 31, 2022)

	PBR-GAIF	*PBR-TIF*	*PBR-OSSIF*	*Total*
Nov. 2021	*$1,704,628*	*$166,580*	*$0*	*$1,871,208*
Dec.	*$884,741*	*$166,580*	*$0*	*$1,051,321*
Jan. 2022	*$501,016*	*$166,580*	*$0*	*$667,596*
Qtr. Subtotal	*$3,090,385*	*$499,740*	*$0*	*$3,590,125*
Feb.	*$1,115,521*	*$202,980*	*$0*	*$1,318,501*
Mar.	*$730,461*	*$188,590*	*$0*	*$919,051*
Apr.	*$1,078,865*	*$184,581*	*$0*	*$1,263,446*
Qtr. Subtotal	*$2,924,847*	*$576,151*	*$0*	*$3,500,998*
May	*$824,949*	*$175,105*	*$0*	*$1,000,054*
Jun.	*$677,167*	*$166,580*	*$0*	*$843,747*
Jul.	*$936,576*	*$188,280*	*$0*	*$1,124,856*
Qtr. Subtotal	*$2,438,692*	*$529,965*	*$0*	*$2,968,657*
Aug.	*$686,888*	*$166,580*	*$0*	*$853,468*
Sep.	*$1,611,807*	*$166,580*	*$0*	*$1,778,387*
Oct.	*$796,494*	*$166,580*	*$0*	*$963,074*
Qtr. Subtotal	*$3,095,189*	*$499,740*	*$0*	*$3,594,929*
Total	*$11,549,113*	*$2,105,596*	*$0*	*$13,654,709*

Summary of Gas Supply Cost Performance-Based Ratemaking Activity

For Year 26

(November 1, 2022 through October 31, 2023)

	PBR-GAIF	*PBR-TIF*	*PBR-OSSIF*	*Total*
Nov. 2022	*$326,455*	*$210,028*	*$0*	*$536,483*
Dec.	*$397,425*	*$163,528*	*$0*	*$560,953*
Jan. 2023	*$824,001*	*$163,528*	*$0*	*$987,529*
Qtr. Subtotal	*$1,547,881*	*$537,084*	*$0*	*$2,084,965*
Feb.	*$226,095*	*$185,928*	*$0*	*$412,023*
Mar.	*$189,501*	*$214,678*	*$0*	*$404,179*
Apr.	*$119,653*	*$169,528*	*$0*	*$289,181*
Qtr. Subtotal	*$535,249*	*$570,134*	*$0*	*$1,105,383*
May	*$194,853*	*$163,528*	*$0*	*$358,381*
Jun.	*$127,830*	*$163,528*	*$0*	*$291,358*
Jul.	*$226,566*	*$163,528*	*$0*	*$390,094*
Qtr. Subtotal	*$549,249*	*$490,584*	*$0*	*$1,039,833*
Aug.	*$246,561*	*$163,528*	*$0*	*$410,089*
Sep.	*$141,474*	*$163,528*	*$0*	*$305,002*
Oct.	*$299,162*	*$163,528*	*$0*	*$462,690*
Qtr. Subtotal	*$687,197*	*$490,584*	*$0*	*$1,177,781*
Total	*$3,319,576*	*$2,088,386*	*$0*	*$5,407,962*

Louisville Gas And Electric Company
Summary of Gas Supply Cost Performance-Based Ratemaking Savings/(Expenses)

Year	12 Months Ended October 31	Total Savings	Customer Portion	Shareholder Portion	AGC	TAAGTC	TAGSC	Percentage By Year	Percentage By Mechanism
1	1998	$7,349,641	$3,875,504	$3,474,137	$94,240,133	$27,939,188	$122,179,321	6.02%	
2	1999	$4,797,171	$2,640,334	$2,156,837	$90,261,954	$27,202,696	$117,464,650	4.08%	
3	2000	$7,471,980	$4,200,697	$3,271,283	$146,658,497	$26,663,567	$173,322,064	4.31%	
4	2001	$12,531,160	$6,429,736	$6,101,424	$216,965,156	$28,540,921	$245,506,077	5.10%	4.88%
5	2002 *	$5,994,221	$4,495,666	$1,498,555	$117,371,041	$27,895,137	$145,266,178	4.13%	
6	2003 *	$13,570,936	$9,610,649	$3,960,287	$224,956,761	$26,170,439	$251,127,200	5.40%	
7	2004 *	$8,980,737	$6,735,553	$2,245,184	$220,159,259	$26,648,595	$246,807,854	3.64%	
8	2005 *	$10,806,867	$8,105,150	$2,701,717	$316,248,284	$26,289,056	$342,537,340	3.15%	3.99%
9	2006 *	$17,132,325	$11,722,944	$5,409,381	$254,243,816	$26,358,931	$280,602,747	6.11%	
10	2007 *	$10,222,856	$7,667,142	$2,555,714	$247,276,734	$25,660,403	$272,937,137	3.75%	
11	2008 *	$11,385,951	$8,539,463	$2,846,488	$339,601,745	$25,781,094	$365,382,839	3.12%	
12	2009 *	$6,981,170	$5,235,878	$1,745,292	$163,384,089	$25,103,662	$188,487,751	3.70%	
13	2010 *	$7,561,557	$5,671,168	$1,890,389	$166,570,096	$25,216,695	$191,786,791	3.94%	4.10%
14	2011 *	$10,805,501	$7,429,231	$3,376,270	$154,717,503	$25,414,064	$180,131,567	6.00%	
15	2012 *	$10,961,586	$6,699,576	$4,262,010	$83,298,659	$25,037,635	$108,336,294	10.12%	
16	2013 *	$6,192,465	$4,644,349	$1,548,116	$129,873,248	$23,337,263	$153,210,511	4.04%	
17	2014 *	$5,855,873	$4,391,905	$1,463,968	$177,361,401	$23,543,863	$200,905,264	2.91%	
18	2015 *	$3,927,025	$2,945,269	$981,756	$115,185,281	$23,559,620	$138,744,901	2.83%	4.83%
19	2016 **	$3,852,257	$2,651,816	$1,200,441	$72,317,573	$24,440,703	$96,758,276	3.98%	
20	2017 **	$3,866,311	$2,770,344	$1,095,967	$87,078,396	$24,546,688	$111,625,084	3.46%	
21	2018 **	$5,862,580	$3,865,848	$1,996,732	$99,669,947	$24,937,832	$124,607,779	4.70%	
22	2019 **	$7,145,317	$4,432,832	$2,712,485	$90,607,727	$24,082,126	$114,689,853	6.23%	
23	2020 **	$6,032,401	$3,630,056	$2,402,345	$57,806,087	$24,041,301	$81,847,388	7.37%	5.05%
24	2021 ***	$12,544,347	$7,546,000	$4,998,347	$114,299,415	$24,159,953	$138,459,368	9.06%	
25	2022 ***	$13,654,709	$8,632,135	$5,022,574	$172,329,241	$23,842,508	$196,171,749	6.96%	
26	2023 ***	$5,407,962	$3,713,985	$1,693,977	$84,100,853	$25,682,121	$109,782,974	4.93%	7.11%
	1998 - PRESENT	$220,894,906	$148,283,230	$72,611,676	$4,036,582,896	$662,096,061	$4,698,678,957	4.70%	4.70%

* Savings/Expenses are shared 25% to Company and 75% to Customer up to 4.5% of benchmarked costs; above 4.5% savings are shared 50%/50%.
** Savings/Expenses are shared 25% to Company and 75% to Customer up to 3.0% of benchmarked costs; above 3.0% savings are shared 50%/50%.
*** Savings/Expenses are shared 30% to Company and 70% to Customer up to 4.6% of benchmarked costs; above 4.6% savings are shared 50%/50%.