LG&E

an e·on company

Mr. Jeff Derouen
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

RECEIVED

SEP 22 2010

PUBLIC SERVICE COMMISSION

Louisville Gas and Electric Company
State Regulation and Rates
220 West Main Street
PO Box 32010
Louisville, Kentucky 40232
www.eon-us.com

Rick E. Lovekamp
Manager - Regulatory Affairs
T 502-627-3780
F 502-627-3213
rick.lovekamp@eon-us.com

September 22, 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 Rebuttal 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,

Rick E. Lovekamp

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**
	)	
	)	

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

Filed: September 22, 2010

REBUTTAL TESTIMONY OF J. CLAY MURPHY

I. INTRODUCTION

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. Have you previously filed testimony in this proceeding?

A. Yes. I filed direct testimony in this proceeding on June 21, 2010, on behalf of Louisville Gas and Electric Company ("LG&E").

Q. Are you the only witness for LG&E sponsoring rebuttal testimony in this proceeding?

A. No. Pamela L. Jaynes, Gas Supply Manager, is also submitting rebuttal testimony covering LG&E's position on retail choice and expanded unbundling and elements related to retail unbundling.

Q. What is the purpose of your testimony?

A. My testimony rebuts the direct testimony filed in this proceeding by Teresa L. Ringenbach on behalf of the Retail Energy Supply Association ("RESA"); Gregory F. Collins on behalf of Interstate Gas Supply, Inc., SouthStar Energy Services LLC, and Vectren Retail, LLC ("IGS"); and Messrs. John M. Dosker, Donald L. Mason, and Mark Ward on behalf of Stand Energy Corporation ("Stand Energy"). In supporting the expansion of retail choice, Stand Energy, RESA, and IGS (collectively referred to as "the marketers") have put forth flawed propositions regarding: (1) reliability, (2) cost, (3) value, and (4) the level playing field. The marketers' *reliability proposition* is that gas supply reliability will be unaffected by the expansion of retail choice. While the marketers cannot guarantee that supply reliability would not be impaired by the implementation of retail choice programs, it is LG&E's position that reliability could be jeopardized through the implementation of such programs. Retail choice programs typically require that a "supplier of last resort" stand behind these marketers so that someone is there who can hopefully pick up the pieces dropped by marketers. The marketers' *cost proposition* is that the new and incremental sets of costs and risks created by retail choice programs would be borne by all customers whether or not they participate in the retail choice program and purchase directly from marketers. While it is not evident from prices paid by consumers in those jurisdictions that do have retail choice programs that customers will pay lower prices, it is LG&E's position that the expansion of retail choice could impose new costs and risks on all customers whether or not they choose. The marketers' *value proposition* is that not only customers, but also LDCs, regulators, and the economy as a whole, will benefit from the expansion of retail choice. The marketers claim that their retail choice scheme will *inter alia* result in higher tax revenue for the state, increased services and jobs, increased consumer awareness and so forth. Marketers' value claims are unsubstantiated, and many run contrary to any potential for lower natural gas bills for consumers. The marketers' *level playing field proposition* is that marketers are disadvantaged in the current regulatory "regime." Certainly, with the expansion of retail choice, marketers would be permitted to extract greater profits from some customers because retail choice establishes an environment where customers could be overcharged for natural gas. From a public policy perspective, it is unclear how unleashing marketers on more consumers will be advantageous to anyone other than marketers, who stand to significantly increase their profits.

I will discuss each of these propositions, and the problems therewith, in detail below. LG&E is unable to comment on any of the positions that may or may not be held by MXenergy Inc.[1] or ProLiance Energy LLC[2] due to the fact that they declined to file any direct testimony in this case.

It is particularly noteworthy that it is not retail customers themselves, or the consumer advocacy groups such as AARP, the Association of Community Ministries, or the Community Action Council ("CAC"), who are clamoring for customer choice; rather, it is the marketers who are seeking to relax the regulatory framework so as to allow them entry into the market.

Q. Before discussing the various propositions noted above, please state whether or not LG&E's position has changed with regard to retail choice and the expansion of current gas transportation programs?

A. LG&E's position has not changed. Retail choice programs or further unbundling should not be mandated by the Commonwealth of Kentucky. Further unbundling will expose consumers to significant transition, stranded, regulatory, and other costs and risks with no guarantee of any benefit. Unbundling will increase risks borne by customers as a significant portion of the customer's

[1] See response of MXenergy Inc.'s to AARP's First Data Request, Question Nos. 1 and 2.
[2] See response of ProLiance Energy, LLC to AARP's First Data Request, Question Nos. 1 and 2.

natural gas bill will no longer be subject to Commission review. Price transparency will be obscured rather than enhanced. Unbundling should not be mandated based on the speculation that customers might find value (whether or not they save money), particularly given the risks involved and the losses experienced to date by customers in Kentucky and other states. Additionally, expanded unbundling will make it more difficult for LG&E to manage its system and maintain reliability. Implementing further unbundling will require significant time, effort, and money to create new tariffs and program materials, overhaul every aspect of the LDC's customer handling process, and manage on-going issues arising from these programs

To the extent that there may be any further unbundling, such unbundling should ensure that customers receive tangible, sustainable economic benefits; that system reliability not be diminished; that real and enforceable consumer protections be provided; that costs be appropriately assigned to responsible parties; and that the utility be rewarded for bearing the risks imposed upon it. For these reasons, 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. This position is basically consistent with the previous findings of Administrative Case No. 367 initiated by the Kentucky Public Service Commission ("Commission") in 1997.[3]

Q. Has LG&E considered the arguments offered by the marketers in deciding to maintain its position in this proceeding?

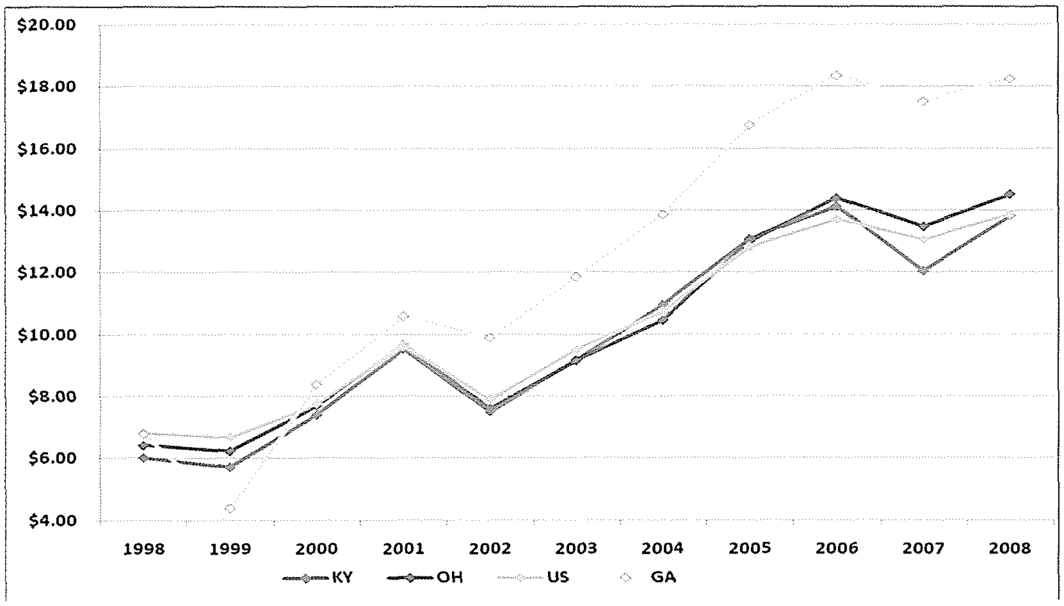
[3] See Order in Administrative Case No. 367 dated July 1, 1998.

A. Yes, LG&E has reviewed the information provided by the marketers in this proceeding and does not see a compelling reason to invert the retail market in Kentucky. Two of the states often cited as models for retail choice programs are Ohio and Georgia. Indeed, according to the report 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 the "2009 EIA Report") most of the customer participation in retail choice programs is occurring in these two states.[4] Nevertheless, the proof of the pudding is in the tasting, and numerous problems with the experiences in both of these states, as well as in other retail choice marketplaces, have already been cited.[5]

Significantly, a review of the average residential charges per Mcf (an all-in rate encompassing all the charges billed to residential customers) for those two states reveals something very interesting happening over the last ten years. From 1998 to 2001, Georgia, Ohio, and Kentucky tracked fairly closely the national average price per Mcf as reported by the EIA.[6] However, since 2001 the average rate in Georgia has climbed and remained significantly above the U.S. average. Since 2004 Ohio appears to have moved above the U.S. average as well. Admittedly, there may be more than one factor affecting the total all-in rate paid by these consumers, but given the significant portion of a customer's total bill that is comprised of gas costs, it is hard to imagine that retail choice is not negatively impacting the total prices paid by residential customers in Georgia and Ohio. By contrast, in the Commonwealth of Kentucky, where there is only one pilot

[4] See Rebuttal Testimony of Pamela L. Jaynes.
[5] Jaynes at pp. 7 - 29.
[6] See http://www.eia.gov/oil_gas/natural_gas/data_publications/natural_gas_monthly/ngm_historical.html.

residential choice program, residential prices have continued to closely track the U.S. average, as represented in the figure below.



Therefore, neither Ohio nor Georgia (for example) appears to be a model that Kentucky should consider for its natural gas consumers.

II. THE RELIABILITY PROPOSITION

Q. What is the reliability proposition put forth by marketers in this proceeding?

A. Generally speaking, the marketers seem to believe that reliability either "just happens" or will be taken care of by the LDC. In any case, it does not seem to be of concern to the marketers. In support of their reliability proposition, the marketers make several claims. First, the marketers claim that unbundling is easy. Second, they claim that the LDC's gas supply function is a non-core function.[7] Third, in their discussions about pipeline and storage capacity assets, they offer some palliatives intended to assuage concerns about reliability.

Q. Does LG&E agree with the reliability propositions put forth by the marketers?

A. No. For LDCs, ensuring that customers receive natural gas service is not an afterthought, it is what LDCs have always done and must continue to do if customers are to continue to receive the reliable service they have come to expect. Marketers do not want this ultimate responsibility for reliability and are content to appoint the LDC as the "supplier of last resort."[8] If Columbia Gas of Kentucky ("Columbia") is able to assert that its "Choice and non-Choice customers have experienced no difference in reliability, and Columbia has experienced no loss in its obligation to serve,"[9] it is because Columbia has taken the necessary actions in its role as the "supplier of last resort" to ensure reliability. In all retail choice programs, the "supplier of last resort" function obviates the need for marketers to perform. Failures by marketers to deliver adequate volumes of gas to meet customer loads are "managed" by the LDC who must balance customer loads and

[7] Collins at p. 4, and Ringenbach at p. 6. See also response of RESA to AARP's First Data Request Question No. 3.

[8] It is important to acknowledge the difference between a "supplier of last resort," a "provider of last resort," and the "obligation to serve." The "obligation to serve" is a fundamental concept of the utility industry that requires a utility to provide service to all in their service area who desire it without undue discrimination. In a retail choice environment, it applies to both the marketer and the LDC each in their respective roles. One aspect of the "obligation to serve" is the "supplier of last resort" which 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. Even though the LDC may remain the supplier of last resort, the LDC does not have an obligation to serve customers who do not pay for service. Another aspect of the "obligation to serve" is the "provider of last resort" which is the function that assists "slow-pay" and "no-pay" customers. The "provider of last resort" function may be separated from the supplier of last resort function so that the LDC continues to hold assets to serve customers, and "slow-pay" and/or "no-pay" customers are supplied by a third-party marketer.

[9] See response of Columbia to IGS's First Data Request Question No. 3.

step in if marketers fail to perform.[10] LG&E disagrees with the proposition of retail choice advocates that "reliability just happens." Consequently, LG&E does not relish the idea of operating its gas system as a backstop to cover activities by unregulated marketers. Importantly, all customers, whether or not they choose, have the potential to have their supply reliability affected by those who do choose.

Q. **What leads LG&E to believe that reliability is of little concern to marketers in developing unbundling plans or implementing retail choice programs?**

A. In part, that conclusion is based on claims by the marketers that unbundling is easy. Mr. Collins characterizes the implementation of a retail choice program or various aspects of retail choice as "simple"[11] or "not a complicated matter."[12] Stand Energy has a similar attitude. Mr. Mason states that "I do not think that there is a need to reinvent the wheel, *just* put into place in Kentucky the programs that have benefited consumers in Ohio and other states (*emphasis added*)."[13] Mr. Dosker adds that "[i]t is *not difficult* to design a natural gas transportation program that stands on its own merit and pays its own way (*emphasis added*)."[14] In reality, designing and implementing choice programs is neither "simple" nor "uncomplicated," and every "wheel" would need to be reinvented. This is the case because every LDC has its own set of operating parameters and characteristics. Additionally, nearly every aspect of customer interface would be modified by this change. And because each LDC has its own particular operating and other circumstances, the tariffs governing such expanded unbundling would

[10] Jaynes at pp. 27 - 28.
[11] Collins at pp. 6, 8, 9, and 12.
[12] Collins at p. 6.
[13] Mason at p. 10.
[14] Dosker at p. 15.

need to be tailored to the individual LDC. Experienced LDC operators might more appropriately characterize such retail choice as either a "sea change"[15] or as an "upheaval."[16]

Q. Does LG&E agree with the claims made by the marketers that reliability will not be impaired?

A. No. As evidenced by the number of proceedings undertaken in some states to constantly tinker with retail choice programs, it is not simple to develop or implement such programs. In particular, it is not simple to ensure that reliability will not be impaired by these programs. Maintaining system-operating pressure[17] is only one such aspect of ensuring reliability. Procuring and managing adequate gas supplies, interstate pipeline transportation capacity and storage to ensure that loads can be met under a variety of peak and off-peak daily and hourly load conditions are essential to maintaining the overall integrity and reliability of the gas system for customers. Maintaining system reliability in the wake of retail choice will be neither simple nor uncomplicated as has been suggested.

Q. How do the marketers portray the LDCs' gas supply function?

A. The marketers seem to believe that an LDC's gas supply function is a non-core function and that retail choice is really a blessing in disguise for LDCs. Ms. Ringenbach states that "[a] final benefit of moving the commodity function away from the utility is that it allows the utility to focus on managing its distribution assets. Refocusing the utility on its core business helps to improve safety and

[15] See response of Delta to the Commission's First Data Request, Question No. 1.
[16] Jennings at p. 13.
[17] Collins at p. 4.

streamline infrastructure costs and efforts."[18] Mr. Collins continues by stating that "[t]he primary role of the utility is to manage the distribution system, which is made up of the physical pipes that bring the natural gas to the consumers' homes, businesses, schools, and other locations."[19]

Q. Does LG&E agree with the characterization of an LDC's gas supply function as a non-core function?

A. No. The gas supply function at LG&E is an integral part of maintaining and ensuring reliable and economic service for customers. The gas supply function establishes design parameters and other criteria to ensure that customers can be served under a variety of operating and weather conditions. That function includes evaluating, acquiring, and managing the interstate pipeline transportation capacities used to bring gas to the LDC. LG&E also evaluates, acquires, and manages the gas supplies offered by producers and other suppliers that are delivered via interstate pipeline. These gas suppliers must meet credit-worthiness and other standards, including their ability to provide gas at key receipt points on interstate pipelines. Pipeline capacity and gas supplies both must be carefully managed in order to achieve low cost, reliable service. The gas supply function also requires the monitoring, participation, and negotiation in federal regulatory arenas to ensure that customers are not disadvantaged by changes to pipeline services or rates. LG&E's gas supply function also includes establishing and adhering to injection and withdrawal parameters for on- and off-system storage in order to maintain the long-term operating integrity of the storage fields as well as

[18] Ringenbach at p. 6.
[19] Collins at p. 4.

to mitigate costs and provide reliable service. These gas supplies and pipeline capacities must be acquired in the context of the guidelines provided by the Commission in Administrative Case Nos. 297 and 384 which promote low-cost, reliable service that mitigates customer exposure to price volatility. The gas supply function also includes working with large volume end-use customers to facilitate the delivery of their gas to and through LG&E's gas distribution system. Another aspect of the gas supply function involves planning and dealing with emergency and other situations that could affect reliability to sales and transportation customers. All of these functions are performed within the context of optimizing gas supplies, transportation services, and storage capacities to achieve and maintain reliable service at the lowest cost. Contrary to being a non-core function, the gas supply function plays an integral role in providing reliable and economical service to customers. Indeed, expanding retail choice would increase the LDC's distractions and hamper its "focus"[20] on this core function as well as the focus on other LDC functions.

Q. Do the marketers agree on even the rudiments of reliability, such as how to secure and manage interstate pipeline transportation capacity?

A. No. There is no agreement among the marketers on how to secure or manage capacity in an unbundled retail environment. For example, Stand Energy does not seem to favor the mandatory pipeline capacity assignment plan used by Columbia in its retail unbundling program.[21] Mr. Dosker adds that capacity release is inherently unreliable and indicates that "[r]eleased capacity is not a dependable

[20] Ringenbach at p. 6.
[21] Mason at p. 8 - 9.

method of transporting gas, especially during the winter heating season from November through March of each year because it is interruptible."[22]

Although initially not generally supportive of a pipeline capacity assignment program, Stand Energy later indicates that "[s]uppliers should have *pro rata* access to incumbent utility pipeline storage capacity (paid for by ratepayers) in direct proportion to the percentage of LDC gas load served by that supplier."[23] Mr. Collins states that "[w]hen competition for supply service is introduced, commensurate capacity and storage assets should follow choice customers; otherwise, there is a mismatch."[24] Mr. Collins continues: "the parties *simply* determine how much each customer utilizes on a peak day, matches that quantity of those contracts to the customers, and as the customers migrate to competitive supply service the capacity follows the customers so that there is always a match (*emphasis added*)."[25] Ms. Ringenbach similarly indicates that "capacity moves with the customers."[26]

Q. Can you summarize the marketers' proposals for the management of pipeline capacity in a retail choice program?

[22] Dosker at p. 4. Mr. Dosker is correct in that capacity subject to recall may be unreliable for the purposes of meeting firm load. It is, however, possible for capacity to be released on a non-recallable basis, or to have conditions associated with the recall, which recall may be tailored to meet the circumstances of the operation of a retail choice program. Presumably, this statement would imply that Stand Energy prefers to contract for capacity directly from the pipeline, but LG&E cannot determine that Stand Energy has been willing to secure firm capacity from the interstate pipeline in that manner for the customers it serves behind LG&E's system. A review of the pipeline capacity transactions for the last three years used by Stand Energy used to serve customers located behind LG&E's city-gate indicates that Stand Energy did not hold any firm capacity in its name for the purpose of making those end-use deliveries.

[23] See response of Stand Energy to the Commission's First Data Request, Question No. 1 regarding access to pipeline storage capacity.

[24] Collins at p. 8.

[25] Collins at p. 9. Mr. Collins also offers another alternative described on p. 9 which is strikingly similar to his first alternative in that the customer continues to use the capacity held by the LDC and the capacity is not released to the marketer on a recallable basis or otherwise.

[26] Ringenbach at p. 11.

A. Yes. The marketers present two fundamentally different proposals – one which would allow the marketer to arrange for pipeline capacity to the LDC's city gate and the other which would allow the marketer to use the capacity under contract to the LDC.

Q. What are LG&E's concerns with these two capacity management proposals?

A. Both proposals are problematic. Having to rely on the marketer to secure and manage the capacity could significantly diminish reliability because the LDC would not be able to control the amount of firm capacity under contract necessary to meet peak needs.[27] Similarly, the LDC could not determine the kind of capacity held in order to meet variable hourly and daily load conditions. Under those circumstances, it is possible that marketers would purchase capacity that may not be flexible enough to deliver natural gas to the LDC in a manner that meets the hourly and daily loads of customers on a firm basis. Therefore, allowing marketers to determine the amount and type of capacity required to serve customers could increase the costs and risks incurred by the "supplier of last resort."

Additionally, assigning the LDC's capacity so that it follows the customer appears on the surface to be a simple solution to capacity assignment. In actuality, this assignment eliminates the impact of load diversity that enables LDCs, as solitary capacity and supply managers, to minimize the costs borne by customers. It is important to understand that capacity is currently managed by LG&E on an integrated basis and not on a discrete customer-by-customer basis. Ultimately,

[27] See also Section IV of this Rebuttal Testimony for a related discussion of stranded costs as related to pipeline capacity use and assignment.

breaking up the capacity into discrete elements allocated on an individual customer basis will decrease efficiency, reduce flexibility, and increase costs. That is the case because the LDC's ability to optimize capacity and accompanying supply sources by taking advantage of load diversity would be effectively eliminated through such a discrete allocation of capacity.

Q. What is LG&E's position with respect to the management of pipeline capacity in a retail choice program?

A. LG&E believes that each LDC should be able to determine the optimum means of facilitating the management of deliveries to its system, whether through capacity released by the LDC to participating marketers or otherwise. Such determination should be made at the time the LDC designs its choice program, when the decision can be made in light of all aspects of the program with an eye towards preserving reliability and minimizing stranded or other costs.

Q. Why is LG&E so concerned about the issues surrounding reliability?

A. First and foremost, LG&E, like other LDCs, has considerable experience in maintaining system reliability and ensuring that adequate and economic gas supplies reach customers. The repercussions of a potential loss of reliability brought on by unbundling programs for an entity that "does not have any pipe in the ground in Kentucky"[28] pales by comparison with the repercussions for LDCs. LDCs do not operate "virtual" gas systems. LDCs have real pipe in the ground – real assets that they manage and customers for which they are responsible – where reliability can mean the difference between life and death.

[28] Dosker at p. 5.

Second, LG&E is concerned about the marketers' proposal to create a new market framework where LDCs do the real work of managing the system while marketers are content to profit from the sale of natural gas without worrying about reliability. The LDC would continue to have the same responsibility for reliability that it had prior to retail unbundling, but its ability to manage pipeline capacity, gas supplies, and storage to maintain system reliability could be significantly diminished.

III. THE COST PROPOSITION

Q. What is the cost proposition put forth by the marketers in this proceeding?

A. Generally speaking, the marketers seem to believe that new costs arising from retail choice or expanded unbundling options are either irrelevant or insignificant; that costs are "barriers" to the marketer preventing it from entering the market; and that costs need to be "fair." Importantly, the marketers advocate that the costs to implement retail choice programs be socialized among all customers – whether or not they actually choose. Lastly, at least one marketer mistakenly claims that the cost to provide transportation service to large transportation-only customers is the same as the cost to provide service to smaller and higher priority, space-heating residential and commercial customers.

Q. Does LG&E agree with the cost propositions offered by marketers?

A. No. Unlike LDCs, marketers are not concerned with the reasonableness of the costs to be borne by consumers or with appropriate cost recovery and rate design.

Q. Will new costs arise from retail choice initiatives?

A. Yes. As explained in my direct testimony, there are two broad categories of incremental costs that will arise as the result of implementing a retail choice program or as the result of expanded unbundling.[29] These two broad categories are stranded costs[30] and transition costs.[31] Almost all of the implementation costs fall within these two categories and could include: interstate pipeline capacity (including storage), on-system storage assets, gas supply agreements[32] as well as the educational costs,[33] billing and receivable handling costs,[34] and costs associated with the LDCs role as supplier of last resort.[35]

Q. Do these costs have the potential to be significant for LG&E?

A. Yes. The costs associated with LG&E's interstate pipeline capacity agreements are about $130 million through their unexpired terms. LG&E has in excess of $110 million in net rate base related to its gas storage facilities. Other potential stranded and transition costs (such as those related to educational costs, consolidated billing, purchase of receivables, and the supplier of last resort) cannot be fully estimated without knowing the final details of any retail choice plan, but are also likely to be in the millions of dollars.

Q. Do the marketers acknowledge these costs?

A. Some costs are acknowledged to a limited degree, but their significance is often dismissed and any cost responsibility is quickly shifted elsewhere. As with other

[29] The Community Action Council expressers concerns that stranded costs may be "harmful" to low-income customers. See response of CAC to IGS's First Data Request, Question No. 10.
[30] Murphy at pp. 30 – 31.
[31] Murphy at pp. 28 - 30.
[32] Murphy at p. 30.
[33] Murphy at pp. 28 - 29.
[34] Murphy at p. 24.
[35] Murphy at p. 6.

aspects of retail choice, Mr. Collins believes "that it is fairly *simple* to address so that no costs are 'stranded' with the utility (*emphasis added*)."[36] Ms. Ringenbach indicates that she finds it "difficult to formulate an opinion"[37] with respect to stranded or transition costs, but if there are any such costs, she believes "they are best handled in an individual utility proceeding to open the market."[38] In other words, these costs are reviewed on a case-by-case basis in the context of a new prudence review that will supersede any old gas cost recovery reviews.[39] Stand Energy offers a completely different (but no less erroneous) perspective by indicating that stranded and transition costs "should not be an issue" with its proposal to expand existing gas transportation programs.[40]

Q. What is the attitude of the marketers when it comes to their potential incurrence of those costs?

A. The marketers propose to construct an unbundling scheme where they can extract maximum profits from customers while incurring minimal costs for themselves. The marketers support the construction of a retail choice marketplace where they will be relieved from most of the costs and will be able to "leverage"[41] the customer handling, billing, receivables, and other "back office" infrastructure established by LDCs to minimize the risks and costs of the marketers. Ms.

[36] Collins at p. 6.
[37] Ringenbach at p. 17.
[38] Ringenbach at p. 17 - 18.
[39] See also Section IV of this Rebuttal Testimony for a related discussion of prudence reviews of LDC gas supply costs.
[40] See response of Stand Energy to the Commission's First Data Request, Question No. 1. Stand Energy's statement is clearly at odds with LG&E's experience. When customers shift from sales service to transportation service under Rate FT, all or some portion of the storage assets and/or pipeline capacity may be at least temporarily stranded and shifted to customers. By way of example, see LG&E's discussion of the "savings" associated with the transfer by the Kentucky State Reformatory and the Louisville "motel complex" discussed in Section IV of this Rebuttal Testimony.
[41] Collins at p. 11.

Ringenbach states that "[m]arket entry can be very costly especially if new billing systems need to be implemented."[42] Similarly, Mr. Collins supports this same proposition when he states: "POR helps to leverage utility billing systems, reduce redundancy, and send a clear message to consumers about *reliability* (*emphasis added*) of energy service that is supplied by competitive providers and delivered by utilities."[43] So, not only will the use of LDC billing and related systems by marketers alleviate marketers from investing in any infrastructure of their own while extracting maximum profits from gas sold to consumers,[44] it also provides marketers with an apparent *imprimatur* or "seal of approval" from the LDC.

Q. How do the marketers view charges to recover the costs of implementing and operating a retail choice program?

A. The marketers see the incurrence of these costs by either marketers or customers as "economic barriers to entry," not as something caused as a result of their advocacy for the implementation of retail choice. They regard costs in the same way as they regard volumetric thresholds – as barriers to their entry into the retail marketplace. For example, Mr. Mason regards "[h]igh volumetric thresholds required in order qualifying to transport gas, daily or annually [sic]"[45] as a barrier, as well as "high administration fees or high meter fees, or; mandatory assignment of interstate pipeline capacity which the utility wants to retain ownership rights to,

[42] Ringenbach at p. 15.
[43] This "clear message" could be intended to lull consumers into a false sense of security about making a "choice." Collins at p. 11.
[44] In the same way, marketers have sought to gain the confidence of customers by using under license the name of the LDC to market their unregulated gas supplies. Please reference to a discussion of that arrangement found in the Rebuttal Testimony of Pamela L. Jaynes.
[45] Mason at p. 7.

but don't necessarily need every day."[46] The cost avoidance schemes of marketers tie closely to their desired format for the "level playing field."[47]

Q. Are the marketers concerned with actual cost levels and the proper allocation of costs to the cost causers?

A. No. Marketers fail to address costs in terms of the level of costs incurred, cost causation, or cost responsibility. While they speak in terms of "fair" and "reasonable" practices, it is clear that these terms are not used in the traditional ratemaking sense of "fair, just, and reasonable" rates. Rather, the marketers use the terms in the context of enabling the marketers to "compete" against the incumbent, regulated merchant function in accordance with the marketers' vision of a "level playing field."

Q. Can you cite some examples that express the views of the marketers on cost levels and cost recovery?

A. Yes, several. Mr. Dosker says that "the amount and term of customer telemetry payments should be *reasonable* and not restrictive (*emphasis added*)."[48] Ms. Ringenbach indicates that "[t]ransportation held by the utility should be available at *fair* prices for *suppliers to use* (*emphasis added*)."[49] Again Ms. Ringenbach indicates that "[s]torage assets paid for by customers should be made available *to suppliers* at *reasonable* prices… (*emphasis added*)"[50] and "[a]ccess to storage capacity can be achieved through *reasonable* costs *to suppliers*… (*emphasis

[46] Mason at p. 7.
[47] See also Section V of this Rebuttal Testimony for a related discussion of how the marketers propose to construct their version of the "level playing field."
[48] Dosker at p. 10.
[49] Ringenbach at p. 15.
[50] Ringenbach at p. 15.

added)."[51] Furthermore, there are no assurances that these same "reasonable" costs and prices charged to suppliers will be passed on by marketers to consumers on a dollar-for-dollar basis.

Q. Can you cite some examples illustrating that the marketers are proponents of unbundling plan provisions that shift their business costs to LDCs or customers?

A. Yes. For example, in reference to billing and receivables programs, Ms. Ringenbach states that "[u]tility consolidated billing with purchase of receivables ('POR') is essential to any new market. This practice, which should be considered not just for small volume but also for all customer sizes, is most essential for the residential market. Market entry can be very costly especially if new billing systems need to be implemented."[52] Ms. Ringenbach is supported by Mr. Collins who after nearly two pages[53] of extolling the virtues of consolidated utility billing and a purchase of receivables program[54] finally strikes at the heart of the matter and states that it "allows competitive suppliers to enter the market with significantly lower initial costs…."[55] It also "eliminates the need for suppliers to assess the credit-worthiness of individual customers...."[56] He thereby avoids another cost of doing business for marketers by leaving that responsibility to the LDC.

[51] Ringenbach at p. 21.
[52] Ringenbach at p. 15.
[53] Collins at pp. 10 - 11.
[54] In the process, Mr. Collins introduces the concept of electronic data exchange required in order to foster his consolidated billing and purchase of receivables paradigm. Collins at p. 6. This would introduce another new cost not currently incurred.
[55] Collins at p. 11.
[56] See response of IGS to Duke's First Data Request, Question No. 5.

Q. On what do the marketers base their claim for access to the utility billing system?

A. As with pipeline capacity,[57] the marketers believe that the billing system should follow the customer. Ms. Ringenbach states that "customers who switch to a competitive supplier retain access to the billing systems and utility distributions systems that those customers have *paid for* (*emphasis added*)."[58] She also states that "customers have *paid for* the utility billing system and in return should continue to be granted access (*emphasis added*)."[59]

Q. Are these statements at variance with traditional ratemaking standards?

A. Yes. Under traditional ratemaking standards, prudently incurred costs are allocated to those that cause them. They are not based on some subjective "fairness" standard. Similarly, established utility practice indicates that assets do not belong to the customer but to the company. In *Board of Public Utility Commissioners v. New York Telephone Co.*, the U.S. Supreme Court ruled that

> "[c]ustomers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses or to capital of the company. By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company. Property paid for out of moneys received for service belongs to the company just as does that purchased out of proceeds of its bonds and stock."[60]

[57] See also Section III of this Rebuttal Testimony for a related discussion of pipeline capacity use and assignment.
[58] Ringenbach at p. 11.
[59] Ringenbach at p. 15.
[60] *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U. S. 23 (1926), 70 L. ed. at 813.

Therefore, as a matter of law, there is no entitlement by customers to access an LDC's billing system for the purpose of the LDC billing third-party gas charges, just as there is no entitlement to access interstate pipeline capacity.

Q. How will these new costs be recovered?

A. Presumably, any costs that are recovered would be spread among all eligible choice customers. Without socializing these costs amongst the broadest spectrum of customers, the marketers' ability to access new markets will be inhibited. Examples of incremental costs that may be charged to customers whether or not they choose an alternate supplier could include transition and stranded costs and may include on-going consolidated billing costs, receivables management costs, educational costs, increased costs to regulate the market, and other similar operational costs.[61]

Mr. Collins appears to indicate that the costs to operate a retail choice program are generally socialized among all similarly situated customers irrespective of whether or not they make that choice.[62] IGS indicates that "[s]ince all customers can benefit from the availability of a competitive market, whether or not they shop, [IGS] believe[s] that with some costs, and maybe a significant portion of those costs, it would be appropriate, although not mandatory, that the costs be *spread out over the entire class* (*emphasis added*)."[63]

[61] For example, Columbia states in its response to Question No. 2 of the Commission's First Data Request: "Transition and stranded costs identified in the early years of the Choice program included Columbia's pipeline demand costs, information technology costs, and consumer education costs. These costs amounted to approximately $32,708,000."

[62] See IGS's response to the Commission's First Data Request, Question No. 1, regarding transition costs.

[63] See response of IGS to the Commission's Second Data Request, Question No. 1. IGS does apparently take responsibility for those costs directly attributable to the needs of marketers such as "bill inserts" and "additional billing services…*beyond* a rate ready billing option (*emphasis added*)."

Ms. Ringenbach also seems to support the same broad allocation among all customers. For example, she indicates that "there are no extra costs for distribution simply because the customer switched."[64] She also indicates that "since all customers have access to systems after transition, many stranded costs are generally funded *by customers* or through sales of assets (*emphasis added*)."[65] Here again, the marketers assert that new costs to implement the retail choice programs from which marketers benefit will, by and large, be borne by customers. Ms. Ringenbach offers some further amplification by indicating that the "rate of return should be the same for shopping and non-shopping customers so the costs are the same."[66]

Q. How will the marketers' proposals affect customers?

A. Their proposals with respect to costs will mean that, like the reliability risks associated with retail choice, the actual costs to implement and operate the program will be shared amongst all customers – customers that choose and customers that do not. The marketers do not propose to segregate the risks and costs in such a way as to ensure that only choosing customers bear the risks and costs of these retail choice market schemes.

Q. Please describe some of the concerns expressed by the marketers with respect to current large volume transportation services.

A. LG&E offers a transportation-only service under Rate Schedule FT and a transportation service with standby sales service under Rider TS. Each transportation service has different characteristics and service attributes as

[64] Ringenbach at p. 15.
[65] Ringenbach at p. 18.
[66] See response of RESA to AARP's First Data Request, Question No. 14.

outlined in certain data responses of LG&E to Stand Energy.[67] Although current LDC tariff provisions are not the subject of this proceeding, LG&E feels the need to address certain misunderstandings and misstatements by Stand Energy. Some of these are with respect to balancing, telemetry, and other basic aspects of LG&E's tariffs.[68] However, the most problematic observations offered by Stand Energy are with respect to minimum consumption thresholds in transportation schedules. It needs to be made clear in the context of this proceeding that changing either the eligibility for existing transportation services or the character of service would have an impact on the costs assigned to, and the distribution rates and other charges for, a given rate schedule. As such, LG&E has no intention of changing the eligibility requirements of existing transportation rate schedules or riders.

Q. Please describe Rate Schedule FT.

A. Rate Schedule FT is a natural gas transportation-only service available to eligible customers. About 75 customers (accounting for about one quarter of LG&E's annual throughput) are served pursuant to Rate Schedule FT or related special contracts. LG&E's Rate Schedule FT contains minimum consumption thresholds of 50 Mcf/day. Specifically, the tariff language states that service under the rate

[67] See response of LG&E to Stand Energy's First Data Request, Question Nos. 1 and 9.

[68] Mr. Ward states that "[t]he other rate that is available is only for very large customers and requires an annual usage of 50,000 Mcf." (Ward at unnumbered p. 8.) This description of the availability of service under Rider TS is incorrect. Rider TS is a transportation rider to gas sales rate schedules under Rates CGS, IGS, and AAGS. In addition, the section regarding "Availability of Service" of Rider TS states in part: "Available to commercial and industrial customers served under Rate CGS and Rate IGS who consume either (a) an average of at least 50 Mcf each day during the billing cycle at each individual Delivery Point, or (b) 50,000 Mcf annually at each individual Delivery Point. Also available to customers served under Rate AAGS who consume at least 50 Mcf each day during the billing cycle at each individual Delivery Point." Therefore, the customer may qualify for standby transportation service either by using either 50 Mcf/day or by using 50,000 Mcf/year.

schedule is "[a]vailable to commercial and industrial customers who consume at least 50 Mcf each day at each individual Delivery Point."

Under Rate Schedule FT, LG&E provides firm transportation service from the city-gate (the point where the customer delivers the gas to LG&E for its account) to the customer's facility. If the customer electing service under Rate Schedule FT 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, storage, pipeline transportation services (or any associated balancing services) to the customer. Consequently, LG&E does not have resources available to provide firm balancing or other gas-related services to these customers. Customers served under Rate Schedule FT are at risk for their own supply and are required to acquire and manage their own supplies within the parameters of LG&E's Rate Schedule FT.

Q. Please describe the purpose of the minimum daily threshold under Rate Schedule FT.

A. The minimum daily volume requirement of 50 Mcf per day incorporated in Rate Schedule FT is intended to ensure that customers served under that rate schedule use gas primarily for processing and not space-heating. Allowing space-heating customers to transport under Rate Schedule FT poses risks with respect to LG&E's system reliability and integrity because LG&E would not have the resources and flexibility available to manage the hourly or daily imbalances that this class of customers imposes on its system. Extending Rate Schedule FT transportation service to predominantly temperature-sensitive space-heating customers, whose hourly and daily usage can fluctuate significantly during peak periods, could jeopardize LG&E's ability to meet its firm sales obligations. This is especially true when customers served under Rate Schedule FT may have inadequate or no resources to manage their own hourly and daily load variations. Additionally, the minimum daily volume requirement of 50 Mcf per day necessarily limits the number of customers served under Rate Schedule FT that may have to be physically isolated or curtailed to prevent a supply or other emergency. Under Rate Schedule FT, LG&E can issue an Operational Flow Order ("OFO") to protect system integrity. An OFO suspends "as-available" daily balancing service and requires Rate Schedule FT customers to follow a specific directive. If a customer fails to comply with an OFO directive, it incurs OFO charges, in addition to any other action that LG&E may be required to take. These other actions can include, for example, physically isolating or curtailing the customer in order to preserve system integrity. However, it would be impractical to physically isolate or curtail a large number of customers in the event of a supply or other emergency if unbundled transportation service were to be made available to a wider range of customers. In particular, it would be extremely difficult to physically isolate or curtail numerous space-heating customers. Another factor supporting the minimum daily volume requirement of 50 Mcf per day is that it limits the costs shifted to sales customers when customers elect service under Rate Schedule FT. Although LG&E has included certain provisions in Rate Schedule FT to mitigate cost shifting, the fact remains that as customers elect service under Rate Schedule FT, they decrease their contribution to fixed costs, and these costs are ultimately shifted to remaining sales customers. Therefore, increasing the number of customers eligible for service under Rate Schedule FT increases the potential for cost responsibility to be shifted to sales customers.

Q. Please describe some of the cost issues related to lowering the eligibility requirement and volumetric threshold currently associated with Rate Schedule FT.

A. Despite claims by Stand Energy that expanding gas transportation programs would have "no affect [sic] on existing utility services and customers,"[69] such is not the case. Lowering the threshold as a means to expanding eligibility under Rate Schedule FT would have serious and significantly negative consequences on both the LDC and its customers. The current threshold effectively limits service under Rate Schedule FT to gas customers served via high-pressure gas systems. This limitation is reflected in LG&E's costs-of-service analysis used to establish the rates for service. In Case Nos. 2003-0433, 2008-00252, and 2009-00549, LG&E reflected the allocation of costs associated with high-pressure (and not low and medium pressure) mains to this rate schedule in its cost-of-service study and proposed rates. Lowering the threshold for service under this rate schedule would effectively raise the costs allocated to this rate schedule by including low and/or medium pressure main costs where these costs are not now included.

Similarly, Rate Schedule FT specifically states that storage service is not provided: "Company will not be obligated to utilize its underground storage capacity for purposes of this service." The tariff goes on to specify that

[69] See response of Stand Energy to the Commission's First Data Request, Question No. 1.

"company will not be obligated hereunder to provide standby quantities for purposes of supplying such Customer requirements." In the same way that the minimum consumption threshold under the tariff helps to drive the allocation of distribution main costs, the fact that LG&E does not provide standby service (through storage or otherwise) drives the allocation of other costs (such as those related to storage).

Therefore, the character of service provided under a rate schedule drives the costs allocated to the rates. As indicated in LG&E's Direct Testimony dated June 21, 2010, LG&E does not intend to expand eligibility under Rate Schedule FT by lowering or otherwise changing the threshold.[70] Nor would LG&E propose to alter the character of service under this rate schedule.

Q. How are the marketers seeking to expand service under Rate Schedule FT?

A. Mr. Ward, testifying on behalf of Stand Energy, for example, complains that "any customer whose main use of natural gas is for space heating...will never qualify."[71] As Mr. Ward indicates, this would exclude schools. Rate Schedule FT is not the appropriate rate schedule for schools. Schools do not qualify for a reason: they need a different character of service from that provided under transportation services like Rate Schedule FT. Schools use natural gas almost exclusively for space heating, with relatively modest base load requirements.

Q. Should the transportation services and tariffs of each LDC be tailored to the particular circumstances of each LDC?

[70] Murphy at p. 36.
[71] Ward at unnumbered page 8.

A. Yes. The provisions of LG&E's transportation services (minimum volume requirements, balancing provisions, cash-out provisions, *etc.*) may differ from the provisions of transportation services of other Kentucky LDCs and are designed to meet LG&E's particular operating and other circumstances. In its May 29, 1987, Order in Administrative Case No. 297, the Commission acknowledged that transportation tariffs could differ on a case-by-case basis when it stated "[w]hile the Commission is requiring all Class A LDCs and other intrastate transporters of natural gas to file a nondiscriminatory transportation tariff, its precise form and conditions may vary."[72] LG&E's transportation services are designed to facilitate natural gas transportation service on LG&E's gas system while maintaining reliable service for sales customers.

Q. Does Stand Energy understand the need for the balancing requirements included in Rate Schedule FT?

A. No. Stand Energy fails to comprehend the purpose of OFOs in ensuring system balancing, and hence reliability. Mr. Dosker states that "[w]hen penalties are incurred by gas marketers, they should be based upon, and directly related to, actual interstate pipeline costs (penalties) incurred by the regulated utility. If no additional costs or penalties are incurred by the regulated utility, no penalties to the gas marketer should result. Any penalties imposed on gas marketers should be based only on the costs incurred by the regulated utility."[73] LG&E disagrees profoundly with this suggestion. The charges, if any, associated with balancing are intended to maintain the operational integrity of the gas system. Any time that

[72] Order in Administrative Case No. 297 dated May 29, 1987, at p. 53.
[73] Dosker at p. 9.

deliveries (nominations) on behalf of customers to the gas distribution system fail to match the receipts (consumption) by customers, there is potential for harm to the integrity of the gas distribution system. LG&E's transportation tariffs are designed to mitigate any subsidies between sales and transportation customers. For example, charges related to cash-out, daily imbalances, and OFO are some of the key elements in mitigating cross-subsidies. Without these kinds of provisions, sales customers would be exposed to significant financial harm as the result of over- or under-deliveries by transportation customers. In particular, the charges imposed by LG&E through the operation of OFOs are intended to incent certain kinds of behavior by the customer (or the customer's supplier) to ensure that the OFO is obeyed. As described in LG&E's fulsome response to Stand Energy's First Data Request, Question No. 1, these costs are credited to sales customers in order to eliminate the very cross-subsidies that Stand Energy would perpetuate by eliminating OFO and other balancing charges and provisions.

Q. Do you agree with Stand Energy's views on the telemetry requirements of Rate Schedule FT?

A. No. At first, Mr. Dosker offers quite commendatory comments with respect to telemetry and the value it brings. He states: "Stand Energy's experience is that the utility, the customer and the gas marketer/supplier can much better manage gas supply issues, especially on systems with daily balancing requirements, with real-time gas measurement (telemetry) from the customer's meter set."[74] Then despite the description of the obvious benefits of telemetry by Mr. Dosker, Messrs. Mason and Ward both suggest that LDCs "[n]ot require electronic meters

[74] Dosker at p. 10.

or telemetry or other special metering equipment for facilities using less than 10,000 Mcf/Year." [75] Mr. Ward then makes another suggestion that LDCs in Kentucky adopt a policy "that Electronic Flow Measurement (EFM) is not needed for customers using less than 100 Mcf/day."[76]

Telemetry is a very valuable tool indeed. Although telemetry offers value in measuring all large loads, it is absolutely essential given the character of service for loads served pursuant to LG&E's Rate Schedule FT. As previously explained, under LG&E's Rate Schedule FT, the customer is responsible for procuring the gas supplies needed to serve its loads. LG&E does not charge the customer for costs that would be otherwise associated with providing standby sales service (as under LG&E's Rider TS). Consequently, LG&E does not provide customers served under Rate Schedule FT with any firm services (balancing or otherwise) through either its interstate pipeline capacity or its on-system storage. Telemetry is an integral aspect to helping to monitor and ensure that customers served under Rate Schedule FT fulfill their supply requirements and thereby preserve the operational integrity of the gas system. LG&E believes that it is not only the size of the transportation load that matters but also the character of service provided by the LDC.

Q. In summary, does LG&E support the cost proposition advocated by the marketers in this proceeding?

A. No. LDCs appreciate the importance of keeping costs low. Retail choice will impose increased costs on customers. LDCs understand that increasing costs will

[75] Mason at p. 10 and Ward at unnumbered p. 13.
[76] Ward at unnumbered p. 11.

only drive down throughput. LDCs also appreciate the importance of assigning costs to the responsible party. Assigning costs to the appropriate parties is essential if investment decisions are to make sense over the long run. Shunting costs created by marketers onto customers (particularly the wrong customers) will institutionalize cross-subsidies.

IV. THE VALUE PROPOSITION

Q. What is the value proposition put forth by the marketers in this proceeding?

A. Generally speaking, the marketers seem to believe that retail choice or further unbundling necessarily creates value for all constituents, not only for customers, but also for LDCs, regulators, and the economy as a whole. LG&E is concerned that customers will end up paying higher costs for a program irrespective of whether or not they receive any tangible economic benefits. LG&E also sees no benefit to the LDC, but rather an increase in risks and costs in terms of system management. The marketers suggest that retail choice offers value in terms of the commodity supplies they provide, increased consumer awareness, increased consumer services, increased jobs, increased price transparency, increased accuracy of price signals to customers, decreased regulatory risk for LDCs, and increased gas supply production in the Commonwealth.

Q. What do the marketers claim as the primary benefit of retail choice?

A. Mr. Collins puts its most succinctly when he states the heart of the retail choice argument: "At its core the purpose of competition in the natural gas industry is to provide consumers with a choice of supplier."[77] He continues "competition only involves one aspect of that entire relationship: the potential for a customer to select an alternative supplier who then arranges for the procurement and transportation of the gas to the utility's city gate."[78] Despite what may sound like a noble goal, advocates for retail choice make their assertions without respect to any cost/benefit analysis, without respect to any risks assumed or imposed, without respect to concerns about reliability, without respect to any long-term tangible economic benefits to customers, without respect to potential customer confusion and exposure to potential misrepresentations, frauds, or indeed swindles.[79]

However, the true goal of marketers appears to be centered on achieving any value and benefit for themselves. Marketers are advocating for the right to sell natural gas to the customers of the LDC on a for-profit basis, and assuming almost none of the costs or attendant risks with which normal business activities are associated.

Q. Are there no economic benefits of which customers can be assured as a result of opening markets through retail choice?

A. There are no guaranteed economic benefits (savings or otherwise) for customers, and indeed none are promised. In fact, there is considerable evidence that retail choice will result in higher costs to customers. The evidence presented to the Commission from the EIA, the Illinois Citizens Utility Board, and closer to home

[77] Collins at p. 2.
[78] Collins at p. 4.
[79] The CAC attests that "many customers are confused by retail gas marketing terms and conditions and often feel misled or unfairly treated by marketers." Burch at pp. 2 - 3. See also response of CAC to IGS's First Data Request, Question No. 3.

in the retail choice experiment currently underway in the service territory of Columbia of Kentucky all point to higher costs, not lower costs for customers. Indeed, Mr. Collins indicates that "[m]aking cost comparisons between supplier prices versus utility regulated prices is not a good barometer of the success of a program"[80] – at least not a good measure of success for marketers.

Q. What about other benefits to consumers?

A. Other benefits cited include the ability of marketers to offer "fixed rate products" and of retail choice participants to lock in a fixed price. Mr. Collins dismisses the fact that Columbia's "customers likely paid higher rates than they would have if they remained with the utility" as the result of a "unique set of events."[81] Like Columbia,[82] Mr. Collins believes that "it is the ***opportunity*** to save money"[83] that is important. Conversely, it could be just as much an opportunity to make money by the marketers at the expense of consumers. For example, there is nothing to indicate that marketers will not refrain from hedging their gas supply commitments to consumers (either financially or physically),[84] and then, in order to refrain from losing money, defaulting on those deliveries if the market price exceeds the retail price offered to customers.[85] Indeed, Columbia experienced defaults early on in its program.[86] Of course, the LDC as the "supplier of last resort" is there to ensure that there is no diminution of reliability in terms of the service actually received by customers, but that does not mean that supply

[80] See response of IGS to the Commission's First Data Request, Question No. 3.
[81] See response of IGS to the Commission's First Data Request, Question No. 3.
[82] See also response of Columbia to the Commission's First Data Request, Question No. 4.
[83] See response of IGS to the Commission's First Data Request, Question No. 3.
[84] See response of RESA to AARP's First Data Request, Question No. 9.
[85] For a discussion of supplier defaults, see Jaynes at pp. 27 – 28. See also Section III of this Rebuttal Testimony for a related discussion of reliability concerns.
[86] Jaynes at pp. 26 - 28.

reliability is not jeopardized or that there are no costs associated with maintaining and enforcing that reliability.

Q. What about the claims made by Stand Energy that it has saved customers money?

A. Stand Energy has declined to provide any details regarding either the Kentucky State Reformatory or the Louisville "motel complex" that would enable LG&E to verify their otherwise unsubstantiated claims.[87] Furthermore, LG&E is unable to determine whether the savings Stand Energy claims to have saved result from gas costs alone (assuming that there are any savings) or whether some portion of their savings included the lower distribution costs for transportation-only service as compared to the otherwise applicable LG&E sales rate schedule.[88] Rather than

[87] See response of Stand Energy to LG&E's First Data Request, Question Nos. 1 and 2.

[88] Assuming that the comparison made by Stand Energy reflects both the non-gas and gas costs charges paid by the customer under sales service as compared to the non-gas and gas cost charges paid by the customer as a transportation customer, then the cost of gas paid by both customers exceeded LG&E tariffed gas cost that otherwise would have been applicable. Mr. Ward claims that the Kentucky State Reformatory "has saved $522,000 over what they would have paid LG&E." (Ward at unnumbered p. 5 and unnumbered pp. 8 – 9.) LG&E calculates that the Kentucky State Reformatory saved approximately $713,000 over the same period due to the differential in the distribution and customer charges covering transportation-only service under Rate Schedule FT as compared to those charges for sales service under Rate Schedule CGS (the rate under which the customer was served before switching to transportation). This savings of $713,000 cannot be credited to Stand Energy and may mean that the Kentucky State Reformatory paid Stand Energy $191,000 in gas commodity charges in excess of LG&E's tariffed gas commodity charges ($522,000 - $713,000). However, it is not possible to verify that estimate since Stand Energy has refused to provide its back-up calculations. In any case, and whether or not the analysis presented here is correct and whether or not the customer saved or lost money, the $713,000 in lower distribution charges has been shifted to residential and small commercial and industrial sales customers as a result of the transfer in rate schedules by the Kentucky State Reformatory. Mr. Ward also claims that a Louisville "motel complex" "has saved close to $35,000 over what they would have paid LG&E for tariff gas." (Ward at unnumbered p. 9.) LG&E calculates that the "motel complex" saved approximately $61,000 over the same period due to the differential in the distribution and customer charges covering transportation-only service under Rate Schedule FT as compared to those charges for sales service under Rate Schedule CGS (the rate under which the customer was served before switching to transportation). This savings of $61,000 cannot be credited to Stand Energy and may mean that the "motel complex" paid Stand Energy $26,000 in gas commodity charges in excess of LG&E's tariffed gas commodity charges ($35,000 - $61,000). However, it is not possible to verify that estimate since Stand Energy has refused to provide its back-up calculations. In any case, and whether or not the analysis presented here is correct and whether or not the customer saved or lost money, the $61,000 in lower distribution charges has been shifted to residential and small commercial and industrial sales customers as a result of the transfer in rate schedules by the "motel complex." Of

simply offering mere anecdotes, which cannot be independently verified, it is incumbent upon the marketers to demonstrate through a properly developed cost/benefit analysis with fully documented empirical data that enhanced customer choice programs would be in the public interest since it is the marketers who are advocating for a change in the retail marketplace. No such analysis has been presented.

Q. Do marketers make unsupported claims about consumer awareness?

A. Yes. For example, Ms. Ringenbach claims that "customers become more engaged in what appears on their energy bill. This in turn leads to customer concentration on not only price but on how energy is used."[89] She continues that "the mere recognition that 'choice' exists often prompts the customer to more closely scrutinize their [sic] options and thus make a more informed decision on their [sic] energy bill."[90]

Q. How does this statement comport with LG&E's experience?

A. This statement varies significantly with LG&E's experience that indicates that customers, in the absence of retail choice, are already focused on their energy bills. Furthermore, LG&E already offers an array of programs to help customers manage and make better choices about how they use energy, for example, through

course, Stand Energy's claims as to any savings are unverified and unsubstantiated. Even if Stand Energy's claims could be verified, the experience of these large volume customers could be expected to be very different from those of small customers because of the expected significant differences in the charges applicable to any new unbundling programs.

[89] Ringenbach at p. 5.

[90] Ringenbach at p. 5.

budget billing, home energy audits,[91] commercial audits,[92] HVAC programs,[93] and other energy efficiency activities.[94]

Q. Are LG&E's energy efficiency efforts accompanied by a customer education program?

A. Yes. All of these energy efficiency programs are supported through a customer education and public information program, which seeks to educate consumers about the need for energy efficiency and provide meaningful tools by which to accomplish the goal of using energy more wisely.

Q. Do the marketers make unsupported claims that unbundling leads to new activities, services and jobs?

A. Yes. The marketers' claims are self-aggrandizing rather than practical and speculative rather than factual. Ms. Ringenbach claims that retail choice "brings

[91] For example, for a $25 fee, LG&E will perform an on-site Residential Energy Audit, which determines where energy is being used in the household and the most cost-effective ways to save. Customers can also participate, at no fee, in an on-line residential audit, in which the customer accesses the tool through the E.ON U.S. website and enters information about the home and usage habits. The tool then utilizes the customer's actual historical energy usage and compiles a detailed report outlining the areas in which energy savings are possible.

[92] LG&E also performs on-site Commercial Audits, at no fee, for eligible customers. Along with a written report providing the details of the recommended energy conservation measures, the customer is also informed of Commercial Rebate Incentives available from LG&E.

[93] Also in place is an HVAC diagnostic and tune-up program targeted to residential and small commercial customers. This program educates customers about the energy efficiency gains possible when the HVAC unit is well-tuned and maintained, encourages customers to conduct regular maintenance on the unit, provides a diagnostic inspection, at a small fee to the customer, and then provides a network of qualified dealers who are available to perform a tune-up, if needed, also for a small fee. These HVAC dealers, along with dealers in the areas of lighting, insulation, windows, doors, duct work, motors, and pumps are also maintained on a Dealer Referral Network provided on the E.ON U.S. website available to all customers. This list has been developed to provide additional resources to customers who seek to make energy efficiency improvements but are not sure what dealers perform the type of work needed.

[94] LG&E has taken significant steps toward improving the energy efficiency of new homes being built in their service territories through the offering of a New Residential ENERGY STAR Construction program. This program educates builders and homebuyers on the energy savings potential with building above required building code to the ENERGY STAR level. The program also provides training and certification opportunities to Home Energy Rating System ("HERS") Raters, who are needed to certify the efficiency of the newly built homes and provides incentives to offset the cost associated with building to the ENERGY STAR level.

new business," "additional tax revenue," and "employment."[95] Indeed, in a response to a data request, Ms. Ringenbach indicates that "[n]o analysis has been done specific to Kentucky taxes. Any savings versus tax benefits would vary based on market conditions."[96] One wonders how the additional costs associated with all these new jobs and tax revenues will result in lower gas costs for customers. Ms. Jaynes discusses in her Rebuttal Testimony filed in this proceeding certain attributes of new business activities in Ohio as a result of retail choice.

Q. Can you provide an example of a claim made by a marketer that retail choice will enhance price transparency?

A. Yes. Mr. Collins claims that "vibrant competition is essential going forward, as a means of providing price transparency, timely price signals, and information upon which more efficient consumption decisions can be made by consumers in the Commonwealth."[97] He continues: "competition in the natural gas industry drives price efficiencies and price transparency.... Unlike the traditional rate paradigm which includes prior period adjustments, the price transparency and timely price signals resulting from market-based prices affords a consumer the opportunity to adjust behavioral consumption patterns when the adjustment yields the most benefit to the consumer."[98]

Q. Does LG&E agree with this assessment?

[95] Ringenbach at p. 5.
[96] See response of RESA to AARP's First Data Request, Question No. 2.
[97] Collins at p. 2.
[98] Collins at p. 3.

A. No. First, Mr. Collins ignores that price discovery is not conducted in the retail market but in the wholesale market. That is the market where supply and demand sets the price of natural gas.[99] Mr. Collins also ignores that this Commission has provided directives to ensure that LDCs purchase gas in a prudent manner by adhering to standards ensuring least cost acquisition and mitigation of volatility.[100] No process could be more transparent than that of the LDC's merchant function, with its attendant filings and disclosures to the Commission. Mr. Collins ignores the fact that prior period adjustments are at the very heart of what ensures that LDCs do not profit from reselling the gas that they buy on behalf of their customers. Unlike marketers, LDCs cannot profit directly from retail natural gas commodity sales to residential and other customers.

Q. Do the marketers claim that there is value in unbundling for LDCs?

A. Yes. The marketers see value for LDCs and the Commission in mitigating the procurement risks of LDCs and the review of those costs by the Commission. Ms. Ringenbach indicates that not only are LDCs subject to hindsight disallowance risk but that the Commission is challenged in its ability to perform this review: "Commission staff is also better able to track costs and spending on more straightforward non-market based items rather than conducting prudency

[99] Murphy at pp. 8 - 12.

[100] Murphy at p. 9 - 10. 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." 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 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."

reviews that must evaluate market movements through hindsight."[101] Mr. Collins provides his view of the hindsight regulatory regime apparently used by the Commission: "If the utility is deemed to have been reasonable and prudent in its commodity purchasing decisions, the costs will be allowed. However, if certain costs are found to be imprudent, the recovery of those costs will be disallowed. The regulatory risk associated with utility cost recovery can be minimized or eliminated to varying degrees depending on customer choice participation levels."[102] Ms Jaynes discusses in her Rebuttal Testimony filed in this proceeding gas cost disallowance activities in Ohio in the context of retail choice in that state.

Q. Does LG&E agree with the marketers' assessment that retail choice mitigates risk for LDCs?

A. No. While there is always the risk of regulatory disallowance of LDC gas costs, the advent of a retail choice or expanded unbundling program would not alleviate the LDC of imprudently managing the gas supplies on its system, either through its supplier of last resort function or otherwise. Furthermore, the Commission has provided LDCs guidance upon which they can rely in making their procurement decisions. That guidance mitigates the risk of disallowance to which LDCs might otherwise by subject through a hindsight review.[103] Indeed, additional prudence reviews are likely with further unbundling as the result of the incurrence of stranded or transition costs.[104]

[101] Ringenbach at p. 6.
[102] Collins at p. 11 - 12.
[103] See also, for example, the Rebuttal Testimony of Pamela L. Jaynes regarding the Kentucky Commission's 2002 gas procurement audit.
[104] See also Section III of this Rebuttal Testimony for a related discussion of stranded costs.

Q. What about claims that expanded unbundling will further the interests of gas produced in Kentucky?

A. Stand Energy suggests that the expansion of unbundling in Kentucky will somehow achieve benefits for both Kentucky producers and taxpayers that would not otherwise be achievable.[105] Specifically, Mr. Ward suggests that unbundling be tailored in order to "[p]romote and encourage the use of Kentucky produced natural gas supplies or eliminate LDC policies that preclude the use of Kentucky produced gas supplies."[106] The natural gas marketplace is a complex one, but because of the laws of supply and demand in the wholesale markets, gas prices will adjust themselves to achieve parity across all sources of supply.[107] Retail unbundling in Kentucky would not result in any more or any less gas produced in Kentucky moving to market than might otherwise be the case – unless the retail choice program were unduly tilted in favor of subsidizing Kentucky producers to the detriment of Kentucky's consumers.

Lastly, Kentucky already has a law on the books that furthers the interests of Kentucky produced gas in order "to facilitate greater utilization of the natural gas produced or available for production within the state, where this can be done without detriment to the customers of utilities" in Kentucky.[108] To that end, the Commission may either authorize or require the transportation of gas by intrastate pipelines or LDCs with system capacity not needed to meet their existing

[105] Ward at unnumbered pp. 11 – 12. Also see response of Stand Energy to the Commission's First Data Request, Question No. 7.
[106] Ward at unnumbered p. 13.
[107] Regional differences in natural gas prices ("basis") will remain a factor driven in part by transportation and other costs to move gas from one region to another.
[108] See KRS 278.506-507.

obligations.[109] Therefore, from this perspective, retail choice can provide no incremental "advantages"[110] by moving more Kentucky gas to market.

Q. In sum, do you agree that retail choice or other unbundling programs provide value?

A. No. The proposition offered by marketers that retail choice brings value to customers, the utility companies, or the Commonwealth is a spurious one. Only marketers are certain to receive any value from retail choice programs.

Q. Does retail choice and expanded unbundling further expose LDCs to risk?

A. Yes. Contrary to the value proposition offered by the marketers, LG&E is concerned that the higher unregulated prices charged by marketers will drive down consumption and decrease LDC throughput. Even the marketers point to this, for example, when Mr. Collins states that "[u]nlike the traditional rate paradigm which includes prior period adjustments, the price transparency and timely price signals resulting from market-based prices affords a consumer the opportunity *to adjust behavioral consumption patterns when the adjustment yields the most benefit to the consumer* (*emphasis added*)."[111]

Based on the price elasticity claims of these marketers and the higher prices expected as a result of retail choice, LDCs have reason to be concerned. Significantly, there are no guarantees that customers save money,[112] and there is considerable evidence to show that customers will pay more (*e.g.,* Illinois Citizens

[109] KRS 278.504(3) specifically exclude LDCs from being required to transport such gas using facilities "primarily used for storage or gathering or low pressure distribution of natural gas."
[110] Ward at unnumbered p. 11.
[111] Collins at p. 3.
[112] See response of IGS to the Commission's First Data Request, Question No. 3.

Utility Board, EIA, and Columbia).[113] LDCs have reason to be concerned that customers will indeed respond to these marketers' prices, and that those prices will be higher; and that system throughput will drop in response to these higher prices. And as throughput decreases, LDC rates will need to increase in order to recover the fixed operating costs of the LDC.

Q. So, in lieu of value, does LG&E believe that retail unbundling increases risks?

A. Yes. LG&E believes that retail choice and expanded unbundling shifts risks to LDCs and their customers. New risks are imposed upon LDCs through either retail choice or expanded unbundling programs, and any disallowance risk that might otherwise have been borne by the LDC is shifted to customers as a result of the Commission's inability to review the gas costs of marketers.

V. THE LEVEL PLAYING FIELD PROPOSITION

Q. What is the level playing field proposition put forth by the marketers in this proceeding?

A. Generally speaking, the marketers support their design for a "level playing field" so that their infrastructure costs are minimized and it is easier and cheaper for them to do business.[114] First, they propose that LDCs support the marketers'

[113] See Jaynes at pp. 19 - 22.

[114] LG&E discussed one item intended to level the playing field between LDCs that provide retail choice and those that do not. For a discussion of 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." See Murphy at p. 28. See also LG&E's response to the Commission's First Data Request, Question No. 2.

business model through LDC functions such as the supplier of last resort and as the marketer's agent for billing and receivables collection, thereby allowing marketers to ride on the coattails of the LDC. Second, the marketers want to denigrate the traditional LDC merchant function through their advocacy of the auction procurement process in order to eliminate the LDC as a potential competitor. The marketers support a level playing field for themselves, but the LDC is not one of the players with only certain functions relegated to it by marketers.[115] The clear goal is to make it easier for marketers to do business irrespective of the risks imposed on LDCs.

Q. Do the marketers offer other parameters of an unbundling program that are designed to make life easier for them?

A. Yes. Earlier I addressed the fact that the "supplier of last resort" function is required in order to facilitate retail choice programs devised by the marketers, potentially performed by LDCs as a part of their "obligation to serve."[116] In addition, the marketers also want LDCs to perform a consolidated billing function and a purchase of receivables program for marketers. Mr. Collins argues that this is appropriate because "the utility is in a unique position with respect to collection of receivables before it becomes bad debt, inasmuch as the utility is in sole possession of the ability to disconnect service for non-payment of bills."[117] Importantly, Mr. Collins' proposal thereby relieves marketers from any bad debt

[115] Mr. Collins also relegates other functions to the LDC: "The utility also reads the consumers' meters, answers emergency calls, issues bills, manages the monthly collections and receivables, manages the connection and disconnection process and generally operates the system to assure its integrity." See Collins at p. 4.

[116] See also Section II of this Rebuttal Testimony for a related discussion of the "supplier of last resort" function.

[117] Collins at p. 11.

responsibility and keeps the LDC as the proverbial "bad cop" that must collect past due amounts from customers and terminate the customer's service for non-payment.

Q. Do the marketers support consolidated billing combined with a purchase of receivables program as a component of the level playing field?

A. Yes. Both Ms. Ringenbach and Mr. Collins support consolidated billing with a purchase of receivables program indicating that such a combination provides for a "single payment and collection point."[118] Mr. Collins follows suit by adding that it allows more marketers to compete[119] and reduces the "hassle factor."[120]

Q. What is one of the potential reasons behind purchase of receivables programs?

A. While the marketers portray consolidated billing and the purchase of receivables as elements of a level playing field, they are really part of an out-sourcing scheme that alleviates marketers from developing, operating, and maintaining costly billing and collection systems. Mr. Collins acknowledges that these systems are costly to put into place. For example, he speculates that "establishing a receivables management system in any given market can exceed $500,000 and, depending on system complexity, can exceed $1,000,000."[121]

Additionally, as pointed out by Stand Energy, the purchase of receivables program is really just a means for the marketer to shift risks and costs back to the LDC. Stand Energy indicates that public institutions should be exempt from such

[118] Ringenbach at pp. 15 -16.
[119] Collins at p. 10.
[120] See response of IGS to Duke's First Data Request, Question No. 5.
[121] See response of IGS to AARP's First Data Request, Question No. 9.

purchase of receivables programs because "[t]here is no risk of default or non-payment by the customer."[122] Conversely, that must mean that there is risk of default by other customers, and, by including them in a purchase of receivables program, that risk and any costs to mitigate such risk is shifted back to the LDC by the marketer.[123] Indeed, the marketer declines even to perform its own customer credit assessment, leaving the LDC responsible for performing yet another function that the marketer finds unprofitable to perform.[124]

Q. And do the marketers also propose to overhaul the traditional LDC merchant function?

A. Yes. The marketers propose an alternate procurement mechanism for LDCs that would terminate the traditional merchant function of the LDC. In Ohio, this is called the Standard Service Offer ("SSO"). The marketers are very interested in mechanisms that set the LDC's price because this allows them to easily predict the price of their main competitor. A predictable LDC price makes it easier for the marketer to compete. The LDC price becomes a monthly NYMEX-driven price without any hedging or true-up features. Mr. Collins describes the SSO as without "prior period adjustments"[125] He is supported by Ms. Ringenbach who states that "when a [supplier of last resort] function is moved into an auction or

[122] See response of Stand Energy to the Commission's First Data Request, Question No. 1 regarding billing and the desirability of the purchase of receivables.
[123] Like the case that marketers make for value, higher marketer costs offer a real potential for higher bad debt costs. To the extent that the natural gas sold by marketers is higher than that of the LDCs, it is possible that the bad debt experience of the LDCs could be exacerbated, leaving the LDC responsible for bad debt created by marketers. This is similar in many respects to the risks imposed on LDCs of decreased throughput as the result of higher prices. See Section IV of this Rebuttal Testimony for a related discussion of the impact of higher prices on LDC throughput.
[124] See response of IGS to Duke's First Data Request, Question No. 5, wherein IGS indicates that the "adoption of a POR programs [sic] eliminates the need for suppliers to assess the creditworthiness of individual customers…."
[125] Collins at p. 3.

shifted [from the LDC] to suppliers, the catch up function for utility commodity service is removed."[126] The standard price offering advocated by Ms. Ringenbach is in the form of a "monthly adder+NYMEX format."[127] She also suggests that "true-ups and hedges" be eliminated.[128] Ms. Jaynes discusses in her Rebuttal Testimony filed in this proceeding the changes to the merchant function of Ohio LDCs designed to accommodate retail choice in that state.

Q. What is the context for these alternative procurement methods?

A. Ms. Ringenbach discusses these alternate procurement methods in the context of the LDC exiting the merchant function as is being done in Ohio. In fact, she shows a clear preference for such an exit. She characterizes it as "a relatively smooth glide path to introducing markets and choices to customers."[129] She advocates an auction because "[u]nder a wholesale auction the customer sees no change other than the rate they pay which is now market based monthly."[130] Mr. Collins also supports the SSO as a step towards greater "price transparency."[131] However, one might also argue that the customer is surreptitiously placed into the hands of the marketers through the auction process in a manner which may not be altogether transparent.

Q. How does the new SSO model comport with guidance previously provided by the Commission?

[126] Ringenbach at p. 13.
[127] Ringenbach at p. 13. Further details are included on this p. 13 and the following p. 14.
[128] Ringenbach at p. 13.
[129] Ringenbach at p. 13.
[130] Ringenbach at p. 13.
[131] Collins at p. 3.

A. The marketers' proposal differs from Commission guidelines in two important ways. First, it creates a mechanism that does not comply with the Commission's approved purchased gas adjustment mechanisms by eliminating the true-up mechanism – allowing LDCs to profit or lose on the sale of the gas commodity.[132] Second, it creates a mechanism that does not comport with the Commission's guidance on mitigating volatility to customers.

Q. Why would the marketers support such an auction proposition?

A. Essentially, it makes it easier for marketers to compete. If marketers can force LDCs to provide natural gas supplies under a predictable pricing methodology (*e.g.*, by tying the LDC's monthly price to NYMEX), marketers can provide gas supply products that may more easily compete with the LDC. Additionally, if marketers can eliminate the benchmark provided by the traditional merchant function of the LDC's purchased gas adjustment, marketers will not have to worry about perceptions with regard to whether or not customers saved money as compared to the LDC's offer. The LDC is *de facto* eliminated as a meaningful competitor. Mr. Collins describes much the same kind of "merchant function" paradigm.[133]

Q. How does the SSO described for unregulated marketers compare with the traditional LDC merchant function?

A. The SSO merchant function constructed by unregulated marketers and offered through the LDC does not allow true-up or hedging. However, at the same time, Mr. Collins calls "short-sighted" and "myopic" those who dismiss the value of a

[132] Murphy at p. 11.
[133] See response of IGS to the Commission's First Data Request, Question No. 1, regarding "Alternate commodity procurement procedures."

fixed price natural gas service offering[134] and continues that it is "presumptuous"[135] to focus on savings without also recognizing the value of a fixed price. Nevertheless, the SSO would bar hedging by LDCs to mitigate volatility in favor of a rate that changes monthly. In other words, unregulated marketers should be able to offer products to consumers that mitigate volatility, but the marketers' competitor, the LDC, may not even hedge a portion of the gas supply it sells to customers. This position offered by IGS seems contradictory.

Q. Does the SSO provide an effective choice for consumers?

A. No. Through the alternate purchase mechanism, called the SSO, marketers want to provide customers with a Hobson's choice – a choice that is really no choice at all. The participating marketers will be the suppliers under the SSO (as a surrogate merchant function for the LDC) and the suppliers and producers formerly used by the LDC will be excluded from participating. The supply diversity will decrease and the SSO customers will have *de facto* "chosen" a marketer whether they intended to do so or not.

Q. Is the level playing field proposition put forth by the marketers designed to promote a competitive marketplace in which retail choice can flourish?

A. No. The level playing field proposition advanced by the marketers is intended to enhance the financial interests of marketers at the expense of the LDC and consumers. The level playing field they advocate is one designed to enable them to ensure that LDCs bear the risks and burdens of the retail marketplace, burdens including over-hauling existing billing systems, providing back-up and balancing

[134] See response of IGS to the Commission's First Data Request, Question No. 3.
[135] See response of IGS to the Commission's First Data Request, Question No. 3.

service that marketers are either unable or unwilling to provide, and eliminating the LDC as a viable competitor by either eliminating or transmogrifying its merchant function in order to invalidate it as a benchmark against which marketers would otherwise need to compete. Without the LDC to support the level playing field, there would be no real game for marketers to play on their version of the new "level playing field."

VI. LG&E's GAS SUPPLY COST PERFORMANCE-BASED RATEMAKING MECHANISM

Q. Can you briefly describe the purpose of a gas supply cost performance-based ratemaking mechanisms.

A. Gas supply cost performance-based ratemaking ("PBR") mechanisms are designed to promote efficiency and least cost in the procurement of gas supplies by LDCs.

Q. Does LG&E have such a mechanism?

A. Yes. LG&E has had a gas supply cost PBR mechanism since November 1, 1997.

Q. Please describe LG&E's gas supply cost PBR mechanism.

LG&E's gas supply cost PBR mechanism encourages LG&E to outperform benchmarks in order to achieve low cost and reliable service to customers. Through the gas supply cost PBR mechanism, LG&E is required to assume certain risks and to the extent that LG&E is able to achieve benefits for customers, the Company is also able to benefit through the sharing mechanism which rewards shareholders for the assumption of those risks associated with maximizing performance under the gas supply cost PBR mechanism. These risks include, but are not limited to, contracting risks, storage management risks, supply management risks, transportation management risks, and credit risks. In contrast, retail unbundling imposes risks on the Company (and customers) for which neither are rewarded.

LG&E's gas supply cost PBR mechanism continues to provide incremental benefits to customers. It has resulted in measurable and quantifiable savings for customers. Likewise, LG&E's gas supply cost PBR mechanism does not diminish service reliability.

LG&E's gas supply cost PBR mechanism is comprehensive in that every dollar of gas supply cost is benchmarked. LG&E's gas supply cost PBR mechanism establishes meaningful and objective benchmarks against which to measure LG&E's performance.

Q. How does LG&E's gas supply cost PBR mechanism contrast to unbundling as proposed by marketers in this proceeding?

A. Unlike retail unbundling, which removes the gas costs that LDC customers pay from Commission jurisdiction and potentially subjects customers to higher gas costs, the benefits associated with LG&E's PBR gas supply cost mechanism are quantifiable, measurable, and verifiable. The gas supply cost 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 and review pertinent information.

LG&E's gas supply cost PBR mechanism has encouraged it to focus on promoting efficiency and innovation. LG&E's gas supply cost PBR mechanism has encouraged it to develop, pursue, and manage creative supply arrangements, increase risk-taking, and negotiate aggressively in order to improve cost performance and maintain reliability.

Retail unbundling has the very real potential to raise costs to consumers, create regulatory confusion and uncertainty, expose customers to manipulation, jeopardize reliability, remove costs from Commission oversight, and impose risks on all parties (except marketers) without a commensurate opportunity for reward.

By contrast, LG&E's gas supply cost PBR mechanism:

(1) Benefits LG&E's customers and shareholders;

(2) Enables LG&E to maintain and improve its position as an energy provider;

(3) Promotes successful cost management;

(4) Establishes an objective benchmark as a regulatory standard;

(5) Functions as a regulatory model that operates effectively in a highly competitive market; and

(6) Enables LG&E to maintain or improve service reliability.

Q. Please describe the principles used by LG&E in designing its gas supply cost PBR mechanism.

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

- A cost/benefit mechanism

- A least cost acquisition standard
- The maintenance of reliable service
- An integrated behavior standard

Q. Please explain the cost/benefit standard.

A. LG&E's performance is measured by comparing actual costs to benchmark costs to determine the savings or expenses resulting under the gas supply cost PBR mechanism. The benchmarks, which are objective, meaningful, and inclusive, incent the utility to perform as desired and provide a meaningful framework for measuring and reviewing performance.

Q. Please explain the least cost acquisition standard.

A. The goal of least cost acquisition is one of the most important supports for the use of gas supply cost PBR mechanisms in general, and LG&E's gas supply cost PBR mechanism specifically. LG&E's gas supply cost PBR mechanism incorporates a "least cost acquisition" standard in purchasing natural gas supplies and pipeline transportation services. LG&E is encouraged to purchase the lowest cost gas supplies and reliable pipeline transportation services from among all the supplies and pipeline transportation services available to the Company. This standard is based upon regulatory guidance originally embodied in Administrative Case No. 297, and reiterated in Administrative Case No. 384, when 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."[136] LG&E's gas supply cost PBR mechanism encourages the Company to meet and achieve these goals.

Q. Please explain the reliability standard.

A. LG&E's gas supply cost PBR mechanism recognizes the importance of reliability in contracting for natural gas supplies. The benchmarks incorporated into LG&E's gas supply cost PBR mechanism support a portfolio that provides reliable yet flexible supply management. LG&E's gas supply cost PBR mechanism does not provide incentives that could encourage it to take actions that reduce reliability in order to achieve lower costs.

Q. Please explain the integrated behavior standard.

A. A gas supply cost PBR mechanism must be constructed so as to ensure that it encourages and incents the appropriate behavior in creating cost savings for customers. An integrated behavioral standard requires that a gas supply cost PBR mechanism be well reasoned, comprehensive, and balanced. An integrated behavioral standard also recognizes that a gas supply cost PBR mechanism should be designed to minimize all gas supply cost elements, not to minimize a discrete component or components of gas costs.

Q. **What have been the Commission's findings with respect to LG&E's gas supply cost PBR mechanism?**

A. At the end of 2009, LG&E filed with the Commission in Case No. 2009-00550 seeking to renew the gas supply cost PBR mechanism. The Commission approved an extension of LG&E's gas supply cost PBR mechanism as filed and

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

stated that "LG&E has been able to demonstrate that it has pursued more aggressive gas purchasing measures as a result of the gas supply cost PBR mechanism. As a result of the PBR, LG&E has developed, pursued, and managed creative supply arrangements, increased risk-taking, and negotiated intensively to improve cost-performance and maintain reliability."[137]

Q. And does retail unbundling lack these objective standards?

A. Yes. Retail unbundling lacks these objective standards and subjects both LDCs and customers to risks without any commensurate rewards.

VII. CONCLUSION

Q. Do you believe that in this proceeding the Commission has fulfilled the specific requests made in House Joint Resolution 141?

A. Yes. The Commission has conducted a proceeding designed to obtain input from all interested parties and to seek through their collaborative efforts a fuller understanding of how unregulated retail marketplaces can and do work. As a part of that process, the Commission has thoroughly reviewed and sought input on each of the fifteen elements that were to be considered.[138] The goal of the review has been to conduct a thorough evaluation of the alternatives open for Kentucky to consider in ensuring that Kentucky's consumers continue to receive reliable gas service at fair just and reasonable rates, to determine if benefits could be derived from retail choice programs, and to ensure price transparency.

[137] See Commission Order in Case No. 2009-00550 dated April 30, 2010, at p. 3.
[138] See Commission Order in Case No. 2010-00146 dated April 19, 2010, at pp. 4 - 5.

Q. What alternatives are currently before the Commission?

A. Currently, the Commission has before it three alternatives as follows: (1) retail choice for all customers regardless of size, (2) expanded unbundling for non-residential customers, and (3) maintaining the *status quo* established in Administrative Case Nos. 297 and 367 by allowing each LDC to determine meaningful thresholds for transportation services.

Q. What is LG&E's recommendation?

A. LG&E recommends maintaining the *status quo*. LG&E does not believe that it has been remotely demonstrated that any benefits will actually be derived either for consumers or the Commonwealth. To the contrary, there is considerable evidence that retail choice programs or expanded unbundling could impose significant costs and risks on consumers and LDCs in Kentucky. LG&E continues to support the proposition that any retail choice programs be proposed at the discretion of the LDC consistent with the guidance promulgated by the Commission in its Order in Administrative Case No. 367.[139] If real benefits cannot be achieved that exceed the costs and risks imposed on consumers and the Commonwealth at large, then the proposed program should not be approved.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

[139] See Commission Order in Administrative Case No. 367 dated July 1, 1998.

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
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

J. CLAY MURPHY

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

Rashelle W. Gaines (SEAL)
Notary Public

My Commission Expires:
Feb. 28, 2014

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:	)	
	)	
AN INVESTIGATION OF	)	**CASE NO: 2010-00146**
NATURAL GAS RETAIL	)	
COMPETITION PROGRAMS	)	

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

Filed: September 22, 2010

REBUTTAL TESTIMONY OF PAMELA L. JAYNES

I. INTRODUCTION

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. Have you previously filed testimony in this proceeding?

A. Yes. I filed direct testimony in this proceeding on June 21, 2010, on behalf of Louisville Gas and Electric Company ("LG&E").

Q. What is the purpose of your testimony?

A. My testimony rebuts the direct testimony filed in this proceeding by Teresa L. Ringenbach on behalf of the Retail Energy Supply Association ("RESA"); Gregory F. Collins on behalf of Interstate Gas Supply, Inc., SouthStar Energy Services LLC, and Vectren Retail, LLC ("IGS"); and Messrs. John M. Dosker, Donald L. Mason, and Mark Ward on behalf of Stand Energy Corporation ("Stand Energy").

Q. Are you the only witness for LG&E sponsoring rebuttal testimony in this proceeding?

A. No. J. Clay Murphy, Director – Gas Management, Planning, and Supply, is also providing rebuttal testimony covering LG&E's position on retail choice and expanded unbundling and elements related to retail unbundling.

Q. Has the information provided by various parties during this proceeding altered your position on retail choice?

A. No. Direct Testimony has been filed in this proceeding by Teresa L. Ringenbach on behalf of RESA; Gregory F. Collins on behalf of IGS; and Messrs. John M. Dosker, Donald L. Mason, and Mark Ward on behalf of Stand Energy (collectively referred to as "the marketers"). The information provided by these marketers related to current retail choice programs in various states has provided little meaningful support for implementation of natural gas retail choice in Kentucky. Certainly the information provided by the marketers does not contradict information included in the Energy Information Administration ("EIA")'s extensive report entitled "Status of Natural Gas Residential Choice Programs by State as of December 2009" released May 17, 2010 (hereinafter "2009 EIA Report.")[1] LG&E continues to conclude that the facts and trends associated with retail choice programs do not present a compelling case for further natural gas unbundling in Kentucky.

II. PROGRAM PARTICIPATION AS AN INDICATOR OF SUCCESS

Q. Have programs in other states been used as models for retail choice in Kentucky?

A. Yes. In supporting the expansion of retail choice, the marketers have made observations about retail choice based on programs in other states. For example, Ms. Ringenbach refers to the states of Ohio, Michigan, New York, Pennsylvania,

[1] See http://www.eia.doe.gov/oil_gas/natural_gas/restructure/historical/2009/restructure.html.

Illinois, Massachusetts, Georgia, New Jersey, and the District of Columbia as states with fully open small volume choice programs.[2] She opines that "[a]lthough they all have successful programs, the switching levels vary in each state."[3] She also cites one Ohio LDC where 93% of the customers have "switched" to a marketer.[4] Mr. Collins cites the national statistics published in the 2009 EIA Report indicating that 15% of eligible customers were buying gas from retail choice marketers.[5] Indeed, the choice program switching rates vary so dramatically among states that it makes one pause to take a closer look at the reasons why switching rates might vary among the states that have these programs. It is also revealing to take a closer look at the total switching rate cited by the EIA.

Q. **What are the participation levels in each of the states cited by Ms. Ringenbach and do such levels necessarily indicate that the programs are a "success"?**

A. According to the 2009 EIA Report the residential and commercial combined participation rates for these states are as follows:

Eligible Customer Choice Participation %	
Georgia	100.0%
Ohio	58.4%
New York	17.1%
Michigan	11.6%
District of Columbia	11.3%
Illinois	10.1%
Pennsylvania	7.2%
New Jersey	3.1%
Massachusetts	1.2%

[2] Ringenbach at p. 5.
[3] Ringenbach at p. 5.
[4] Ringenbach at p. 6.
[5] Collins at p. 2.

The participation levels for most of these states suggest that customers are not flocking to these programs presumably because customers either do not foresee or have not experienced any benefits related to these programs. As evidenced by the data above, participation levels are below 12% in Michigan, the District of Columbia, Illinois, Pennsylvania, New Jersey, and Massachusetts.

Q. Do the higher participation levels in Georgia and Ohio indicate that customers are turning to choice programs because they are experiencing benefits?

A. No. The circumstances of the programs in both of these states dictate that the participation levels for these two states are not reflective of voluntary "switching levels" in these states. Importantly, as described in my Direct Testimony, most of the customers in Georgia cannot choose to purchase natural gas from their LDC.[6] In October 2009, Atlanta Gas Light chose to exit the merchant function leaving customers with no choice but to purchase natural gas from a marketer. Also as described in my testimony, certain actions in Ohio have eliminated the ability of most customers to choose to purchase natural gas acquired by the LDC through traditional purchasing practices.[7] For example, most of the major LDCs in Ohio have decided to exit the merchant function. In the event a customer of these LDCs does not select a marketer, the customer will have to effectively purchase natural gas from marketers anyway through the Standard Service Offer ("SSO").[8]

[6] Jaynes at p. 8.
[7] Jaynes at p. 16.
[8] While the Standard Service Offer ("SSO") and Standard Choice Offer ("SCO") are both billed by the LDC, they are not the result of the LDC's traditional merchant function. The SSO and SCO are the result of an auction held by a third party that only allows marketers certified in the choice program to participate.

Additionally, many customers were transferred from the LDC to a marketer through government "opt-out" programs which effectively switched customers to marketers on a more-or-less involuntary basis.[9] Since most customers in Georgia and Ohio do not have the opportunity to choose their LDC as their supplier, participation rates in these states are not reflective of voluntary customer "switching levels."

Q. Has the information provided by the marketers in this proceeding altered LG&E's evaluation of the success of retail choice programs in the United States?

A. No. The marketers in this proceeding have provided no evidence that contradicts the information found in the 2009 EIA Report. As described in my direct testimony, only about 5.1 million or 15% of the approximately 35 million residential customers eligible to participate in these programs are participating in these programs. About 3.1 million or 60% of the 5.1 million customers participating in these programs are in Ohio and Georgia. If the states of Ohio and Georgia are removed from EIA data, then for the remaining 20 states (including the District of Columbia) the participation level is 2 million customers or 7% of the approximately 31 million customers eligible to participate. This data suggests that the vast majority of eligible residential customers have chosen not to participate in retail choice programs unless they live in a state where the LDC no longer performs the traditional merchant function. Low participation levels would seem to suggest that customers are not interested in these programs and

As a result, the customers of an LDC that has an SSO/SCO are effectively purchasing natural gas from a marketer (or group of marketers) and not the LDC.

[9] Jaynes at p. 15.

that they are not successful as claimed. Given the costs to implement a retail choice program, and the lack of tangible benefits experienced by many states that have experimented with these programs, LG&E is not convinced that further unbundling makes sense for Kentucky.

III. OHIO AS A MODEL FOR RETAIL CHOICE PROGRAMS IN KENTUCKY

Q. Are the retail choice programs in Ohio successful?

A. Two marketers consistently point to Ohio as an example of a successful model for retail choice programs.[10] By some standards and from some viewpoints, the programs in Ohio have been successful. These programs are allowing three LDCs that want to leave the merchant function to achieve their goal. When LDCs exit the merchant function, customers are left with no choice but to purchase natural gas from an unregulated marketer. These programs have also been successful in allowing marketers (some of which are LDC affiliates or licensees[11]) to sell natural gas at a profit to customers in Ohio. However, LG&E questions the means undertaken in Ohio to achieve these goals and whether achievement of these goals has been beneficial to customers.

[10] For example, see Ringenbach at p. 5, 8, 10, 12, 17, 18, and 19, and response of IGS to the Commission's First Data Request, Question No. 1.

[11] Dan Gearino of the *Columbia Dispatch* reports that IGS Energy will use the name "Columbia Retail Energy" to market its gas contracts. See http://dailyme.com/story/2010081100002065/gas-supplier-igs-columbia.html.

Q. Why would an LDC want to exit the merchant function?

A. Two motives that might be suggested are the avoidance of regulatory prudence reviews and the opportunity to use unregulated affiliates to sell natural gas for a profit.

Q. Why might gas cost recovery reviews be driving Ohio's LDCs to exit the merchant function?

A. Ms. Ringenbach suggests that LDCs will be able to avoid gas cost audits (that may lead to cost disallowance) by the Commission and have no need to use company resources to purchase or manage the commodity. She also suggests that without gas cost review cases there would be fewer cases to take up Commission staff time so the remaining cases would be focused solely on distribution functions.[12]

Q. **Was the risk of gas cost disallowance a factor in Ohio LDCs exiting the merchant function?**

A. Reducing exposure to gas cost disallowances may have been a factor in the decision of some Ohio LDCs to exit the merchant function. For example, *Inside FERC's Gas Market Report* ("IFGMR") reported in June 2006 that an independent auditor of the LDC said that Dominion East Ohio's internal controls "are weak" and steps should be taken to improve documentation of the utility's gas-buying strategies.[13] The article also stated that the auditor "was unable to conclude that Dominion East Ohio's gas supplies were bought at the lowest reasonable price between November 1, 2003, and October 31, 2005." The article

[12] See responses of RESA to Duke's First Data Request, Question No. 5.
[13] See *Inside FERC's Gas Market Report*, June 2, 2006, at p. 21: "Independent auditor faults gas-buying practices of Dominion's Ohio distributor."

also reported that the auditor recommended that "the parent company conduct an independent examination of affiliate deals among Dominion East Ohio, Dominion Hope and Dominion Peoples – and their deals with third parties – to determine whether customers of Dominion East Ohio have been harmed as a result of possible inappropriate transferring of revenues and costs among these entities." As a result of this experience or similar experiences, reducing exposure to cost disallowance as a result of audits or other reviews by the Public Utility Commission of Ohio ("PUCO") may have been a factor in Dominion East Ohio's decision to exit the merchant function.

Q. Were prudence reviews a factor in Vectren Energy Delivery of Ohio's decision to leave the merchant function?

A. Avoiding prudence reviews and potential disallowances may have been a goal of Vectren Ohio in making its decision to exit the merchant function. According to a June 2005 article in *Gas Daily*, "[a]fter nearly three years of investigating Vectren Energy Delivery of Ohio's relationship with its subsidiary, ProLiance Asset Management Services, the PUCO on Tuesday ordered the utility to issue $9.6 million in rebates plus 10% interest to its 310,000 gas customers in the state."[14] According to the article, the PUCO order "resulted from an audit of the utility's gas purchases between November 2000 and October 2002."

Q. Were prudence reviews also a factor in influencing Columbia Gas of Ohio to exit the merchant function?

[14] See *Gas Daily*, June 16, 2005, p. 1: "Vectren ordered to issue $9.6 million in rebates." Also see http://www.pickocc.org/news/2005/pressrelease.php?date=06142005a.

A. The risk of disallowance may also have been a factor in Columbia Gas of Ohio's decision to exit the merchant function. In May 2009, a representative for the Company was quoted as saying Columbia "saw deregulation as an opportunity, not a threat. Columbia had long battled the image that its rates weren't competitive, which led to a contentious relationship with regulators and customers."[15]

Q. Do you agree with the assertion by the marketers that when LDCs exit the merchant function, LDC's benefit from reduced regulatory risks associated with gas cost recoveries and the Commission benefits by a reduction in proceedings?

A. Although Mr. Collins suggests that such is the case[16] and is supported by Ms. Ringenbach,[17] LG&E disagrees. If the LDC leaves the merchant function, the Commission will no longer need to review the LDC's gas cost purchases, but the LDC, the Commission, and other interested parties would be subject to a variety of new time-consuming proceedings related to retail choice. In addition to program reviews, renewals, and modifications, there would be reviews and regulatory risks associated with transition and stranded cost recovery. Ms. Ringenbach provides a small sampling of a variety of proceedings that have been necessary in the states of Michigan, New York, Pennsylvania, and Ohio as a result

[15] See "Taking heat: Deregulation held the promise of cheaper natural gas, but some consumers and advocates say marketers are taking advantage and regulators are letting them." by Dan Gearino, *Columbus Dispatch*, May 3, 2009.
[16] Collins at p. 12.
[17] Ringenbach at p. 6.

of choice programs.[18] Also, as described by Mr. Collins, "the Commission, more specifically its staff, typically provides a day-to-day contact point in responding to consumer inquiries, assisting with [sic] various entities with issues (consumer v. supplier, consumer v. utility, supplier v. supplier, supplier v. utility, utility v. supplier or some combination.")[19]

Q. Have gas supply acquisition concerns and disallowances similar to those experienced in Ohio also occurred in Kentucky?

A. No. In fact, in the Kentucky Commission's 2002 gas procurement audit report, Liberty Consulting recognized that LG&E's "very impressive record in keeping its rates down provides sound evidence on the excellent job done in the area of gas supply procurement and management."[20] At the same time the report recognized LG&E for "efficient and effective procurement and management of significant quantities of natural gas supplies;"[21] "very thorough" gas demand forecasting procedures;[22] and "commendable gas supply portfolio-planning procedures."[23] LG&E has made advances since that time recognizing the changing nature of the marketplaces in which it both buys and sells natural gas.

Q. Please discuss why the opportunity for unregulated affiliates to sell natural gas to customers may be encouraging Ohio's LDCs to exit the merchant function.

[18] See response of RESA to AARP's First Data Request, Question No. 13. Also, see response of RESA to Duke's First Data Request, Question No. 6 (Attachments 4, 5, and 8). Also, see CD-ROM provided by RESA with responses to First Data Request (Attachments 13 and 14).
[19] See response of IGS to the Commission's First Data Request, Question No. 1.
[20] "Audit of Five Major Kentucky Gas Local Distribution Companies" by Liberty Consulting, p. III.C.6.4.
[21] "Audit of Five Major Kentucky Gas Local Distribution Companies" by Liberty Consulting, p. III.C.2.7.
[22] "Audit of Five Major Kentucky Gas Local Distribution Companies" by Liberty Consulting, p. III.C.1.5.
[23] "Audit of Five Major Kentucky Gas Local Distribution Companies" by Liberty Consulting, p. III.C.1.6.

A. An LDC such as Dominion East Ohio or Vectren Energy Delivery of Ohio may choose to exit the merchant function in order to force customers to choose an alternative supplier in the hopes that its affiliated marketing company can attract these customers. Additionally, as further described in Mr. Murphy's testimony, when the LDC leaves the merchant function, marketers, including the LDC's affiliate, no longer have to compete with the LDC's price.

IV. THE STANDARD SERVICE OFFER

Q. Has LG&E expressed concerns about the Standard Service Offer used in Ohio?

A. Yes.[24] The SSO is a standard offer used by LDCs in Ohio to provide service to customers that have not elected an unregulated supplier. The SSO is provided through the LDC in lieu of the LDC's traditional merchant function price. The SSO 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 "Retail Price Adjustment" compensates marketers for all of their costs of providing service for the entire term of the SSO. 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 customers; LDC system balancing, lost

[24] Murphy at p. 19.

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 service. The Retail Price Adjustment also includes the marketer's profit margin.

Q. What about the assertion by IGS that the SSO auction process may be beneficial to customers?

A. Mr. Collins states that "based on Commission staff analysis, the competitive auction process in Ohio has consistently resulted in prices significantly lower than the G[as] C[ost] R[ecovery] alternative it replaced."[25] In making this comment, Mr. Collins appears to rely on two Dominion East Ohio auction reports prepared by PUCO.[26]

Q. Is it possible to know whether the SSO auctions have produced prices below the prices that would have been produced by the LDC's traditional merchant function under the same market conditions?

A. No. It is not possible to make a true apples-to-apples comparison of an SSO to the traditional gas cost recovery rate that would have been produced through the LDC's traditional merchant function. Significantly, because the SSO replaces the LDC's traditional gas cost recovery rate, these two prices do not exist for the same time period. Therefore it is impossible to say with certainty whether or not the SSO price for any period is higher or lower than the price customers would have paid during that same period if the LDC were still in the traditional merchant function.

[25] See response of IGS to the Commission's First Data Request, Question No. 1.
[26] See response of IGS to Duke's First Data Request, Question No. 2, which includes PUCO auction reports as Exhibit D.

Q. Did the PUCO staff conflate a benchmark to compare with the Retail Price Adjustment that resulted from the SSO auction?

Yes. According to the August 29, 2006 report, the PUCO staff said that it "attempted to characterize an auction outcome that would be considered reasonable and deserving of Commission approval. In order to determine an appropriate Retail Price Adjustment, available data were analyzed to identify how Dominion [East Ohio]'s GCR rate has differed from the NYMEX historically."[27] This process included the significant massaging of historical data[28] and a weighted average calculation[29] to determine a difference for a given period between the LDC's gas cost recovery rate and the NYMEX. PUCO performed an additional analysis relying on less historical data, but once again that data was adjusted.[30] The second analysis produced a higher difference than the initial analysis. The results of the two analyses produced a range against which the SSO auction results were measured.

Q. Was the PUCO pleased with its benchmark range and the results of the first auction?

A. Initially, yes. PUCO Staff seemed to believe that its benchmark range was reasonable when the first auction produced a Retail Price Adjustment adder less

[27] See response of IGS to Duke's First Data Request, Question No. 2, Exhibit D, PUCO report dated August 29, 2006, p. 1.

[28] In its August 29, 2006, auction report, PUCO describes how it adjusted Dominion East Ohio's historical data to account for the quarterly nature of Dominion East Ohio's price prior to November 2004. It also adjusted NYMEX data to reflect a one month lag. It also estimated adjustments for over- and under-recoveries acknowledging that "there is no precise methodology for accounting for these adjustments.".

[29] The weighted average calculation gives more weight to recent data and therefore recent market conditions which may or may not be indicative of current or future market conditions. This calculation makes it impossible to tell what the differences were for the individual years of data included in the analysis.

[30] PUCO Staff further refined the data by creating an additional subset of the data then removed the three lowest and three highest differences between the GCR rates and the NYMEX.

than the benchmark range, but they seemed less enthusiastic when the second auction produced a Retail Price Adjustment toward the high end of the benchmark range. Consequently, in its report on the second auction, the PUCO Staff downplayed the historical analysis used to determine the benchmark range saying that the historical analysis has "some validity" but any auction result should consider "current market conditions."[31] Therefore, it appears that PUCO recognizes that its historical analysis could be problematic and should not be used as the only factor to judge auction results.

Q. Is the SSO auction process and pricing concept used in any state other than Ohio?

A. While an auction process may be used in some states to support the provider of last resort function necessary for customers that marketers will not accept, LG&E is not aware of this process being used in any other state to determine a standard offer for customers that can, but do not, select a marketer. Apparently the auction process was considered in New York but rejected. Specifically, the New York Public Service Commission said that "[t]his strategy has never been implemented at any New York utility. With markets maturing, transferring load to ESCOs[32] through auctions would undermine our efforts, and the efforts of ESCOs and utilities, to educate customers regarding retail choice and would, consequently,

[31] See response of IGS to Duke's First Data Request, Question No. 2, Exhibit D, PUCO report dated July 22, 2008, p. 1.
[32] "ESCOs" or "Energy Service Companies" are unregulated gas marketers.

unduly interfere with the operation of those markets. No commentor supported continuing development of this strategy."[33]

V. ASSESSMENT OF CUSTOMER BENEFITS

Q. Is there any evidence that customers are saving money as a result of Customer Choice in Ohio?

A. According to information found in an October 2009 study provided by Ms. Ringenbach and prepared by Intelometry (hereinafter "Intelometry study"), it appears that at least in recent years, customers in Ohio have in total lost money because of gas choice.[34] That Intelometry study attempts to discredit two newspaper articles that appeared in the *Columbus Dispatch* on May 3, 2009. According to the Intelometry study, one article concluded "that customers have paid higher prices because of gas choice, specifically, that customers paid 7% more because they purchased from suppliers instead of the LDC" in 2007.[35] A related article cited in the Intelometry study indicated that "customers have overpaid by $796 million because of gas choice" from 2005 to 2008.[36]

[33] See response of RESA to Duke's First Data Request, Question No.6, Attachment 5, which includes a copy of the New York Order in Case No. 07-M-0458

[34] See response of RESA to AARP's First Data Request, Question No. 2, Attachment 1.

[35] See response of RESA to AARP's First Data Request, Question No. 2, Attachment 1, which includes a copy of the Intelometry study, which at p. 5 cites the following article by Dan Gearino: "Hard Sell: Persistent telemarketers press for gas contracts, and customers pay more." *Columbus Dispatch* May 3, 2009.

[36] See response of RESA to AARP's First Data Request, Question No. 2, Attachment 1, which includes a copy of the Intelometry study, which study at p. 5, cites the following article by Dan Gearino:"Taking Heat: Deregulation held the promise of cheaper natural gas, but some consumers and advocates say marketers are taking advantage – and regulators are letting them." *Columbus Dispatch* May 3, 2009.

Q. Who is Intelometry and why might they be so interested in downplaying these *Columbus Dispatch* articles?

A. According to Ms. Ringenbach, the Intelometry study was funded by her employer, Direct Energy, a marketer.[37] Also, according to Intelometry's website, "Intelometry is the premier provider of retail energy market software."[38] Any publication claiming that customers are not achieving savings through retail choice in Ohio could negatively impact the progress of retail choice in Ohio and other states. The spread of retail choice is critical to the business growth of both Direct Energy and Intelometry.

Q. How does the Intelometry study attempt to discredit the article that appeared in the *Columbus Dispatch* claiming that supplier prices in 2007 were 7% higher than the LDC price in 2007?

A. The Intelometry study primarily attempts to discredit this article by saying that both fixed and variable supplier offers should not be compared to LDC pricing.[39] Whether or not the customer chooses fixed or variable pricing from a marketer, the customer is making that choice as an alternative to the LDC's pricing. As such, it is reasonable to compare any alternative pricing that a marketer may offer to the price the customer would have paid the LDC. Such a comparison, particularly when made over time, provides customers with an indication of whether or not they are likely to benefit (such as by saving money) by purchasing

[37] See response of RESA to Duke's First Data Request, Question No. 1.
[38] See http://intelometry.com/Forms/Products.aspx.
[39] Interestingly, it is the marketers that have the most specific suggestions for ways in which the LDC price should be altered through the SSO., for example by eliminating true-ups and recompilations, by creating monthly price changes, by prohibiting the LDC from hedging, and by converting to a NYMEX + adder mechanism. See Collins at p. 3_and Ringenbach at p.13.

natural gas from a marketer. Secondarily, the Intelometry study tries to downplay losses experienced by customers as a result of fixed price offers by saying that "although fixed price offers are generally more expensive than variable price offers, this is to be expected given the additional risk born [sic] by suppliers that provide such products."[40] Thirdly, the Intelometry study attempts to discredit the EIA data used by the *Columbus Dispatch* by referring to an EIA footnote that basically says the data is not representative of what an individual customer might have obtained. LG&E agrees than an individual customer may have achieved savings during the time period reviewed, but that does not discredit the fact that on average customers experienced losses.

Q. How does the Intelometry study attempt to discredit the article claiming that Ohio's natural gas prices were $796 million above the national average from 2005 to 2008, implying that Ohio's natural gas choice program has been detrimental to customers?

A. The Intelometry study attempts to discredit this article's reliance on EIA data that represents "delivered residential gas prices" rather than trying to focus on just the cost of natural gas. However, the total average cost does reflect the true impact of the cost of retail choice on customers including transition costs, stranded costs and any other costs as well as gas costs. The Intelometry study also tries to discredit the use of recent data by the *Columbus Dispatch* saying that the newspaper would have gotten a different answer if it had used data from 1998 to 2004. Additionally, the Intelometry study disputes the newspaper's claim that

[40] See response of RESA to AARP's First Data Request, Question No. 2, Attachment 1, Intelometry study at p. 4.

Ohio natural-gas prices shot above the national average from 2005 to 2008 is an indication that retail choice is increasing costs for customers. It is important to look at how a state's average cost compares to the U.S. average over time as it phases in retail choice, particularly when the majority of customers in the state must purchase natural gas from a marketer or effectively from a marketer through an SSO. As pointed out in Mr. Murphy's Rebuttal Testimony, the increase in average cost paid by residential customers in Georgia over time is astounding when compared to the U.S. average. The average cost paid by residential customers in Ohio is also on the rise when compared to the U.S. average. By contrast, the average cost paid by residential customers in Kentucky has generally tracked the U.S. average.

Q. Does the Intelometry study offer other insights into the losses experienced by customers in Ohio?

A. Yes. The Intelometry study suggests that poor decision making by customers has caused customers to experience losses not savings. Specifically, the Intelometry study includes the unsupported statement that "if customers had selected the best available supplier variable price offer, total market savings would have exceeded $567 million."[41] The Intelometry study also suggests that losses associated with fixed price contracts are acceptable to customers because they received "the benefit of price certainty regardless of LDC price fluctuations." Therefore, the Intelometry study suggests that, if there is any reason that retail choice has failed to produce savings, it is because consumers have made poor choices. LG&E

[41] See response of RESA to AARP's First Data Request, Question No. 2, Attachment 1, Intelometry study at p. 4.

agrees that customers are responsible for the choices they make pursuant to a retail choice program. However, LG&E is concerned that even the best developed education program will not equip customers to perform the complicated and multilevel analyses needed to determine the benefits they are seeking, what offer might best achieve those benefits, and whether or not the desired benefits were actually achieved.

Q. Have government "opt-out" programs in Ohio saved customers money?

A. According to a March 27, 2010 article in the *Columbus Dispatch*, the Central Ohio Public Energy Council, the second largest consortium of suburbs in the state, paid a price that was higher than that offered by Columbia Gas of Ohio in 43 out of 63 months.[42] The article estimates that since the consortium began in 2005, "customers who had the city group plan that entire time and had average gas usage would have paid nearly $800 more than if they had gone with the utility." According to the article, "some residents had voiced concerns that the group's fixed-rate prices were too high and that the opt-out system for enrollment was confusing."[43] The program will end in October 2010 with customers either choosing a marketer or reverting to Columbia Gas of Ohio's SSO rate. In making the announcement to end the gas procurement program, the assistant city manager of Dublin, Ohio said "there's really not a need for government to be in it." While this "opt-out" program was not successful in saving customers money in most

[42] See http://www.dispatch.com/live/content/local_news/stories/2010/03/27/5-suburbs-ending-gas-deal-consortium.

[43] The consortium buys its gas from Dublin-based IGS Energy, working through a third party, Columbus-based American Municipal Power.

months, it was successful in switching customers to marketers without their active consent.

VI. NEW BUSINESS ACTIVITY AS A RESULT OF RETAIL CHOICE

Q. Has retail choice led to innovative new businesses in the state of Ohio?

A. Yes. In June 2010, the *Columbus Dispatch* reported a very interesting natural gas marketing scheme called "network marketing."[44] A company called Utility Choice International ("UCI") has borrowed the approach of multilevel marketers – such as Amway – and applied it to Ohio's deregulated natural gas market. Like many multilevel marketing plans, the company encourages agents to sign up other agents. This creates a tree in which a portion of commissions go to the recruiting agents. According to the *Columbus Dispatch*, "despite implications to the contrary,[45] the company offers customers no guarantee of lower gas bills, and it requires an up-front payment of up to $499 from those who want to become an agent. In return for the up-front payment agents have the opportunity to make up to $20,000 a month working from home. However, to make that amount, an agent would have to sign up more than 65,000 customers – roughly the same as the population of Lorain, Ohio and four times the company's current customer total.[46] The article reports that the use of this business model for energy contracts is well-

[44] See http://www.istockanalyst.com/article/viewnewspaged/articleid/4231638/pageid/2.
[45] The *Columbus Dispatch* article claims, contrary to UCI's assertions that there is "no guarantee of lower gas bills," that UCI's website says "Start saving today with UCI's attractive energy options!" and a recruitment flier says agents "simply save people money on their gas and electric bills."
[46] The *Columbus Dispatch* article states that Utility Choice has 15,000 customers and 2,000 independent sales agents in Ohio, Michigan, Pennsylvania and Kentucky, with most customers concentrated in Ohio.

established in other states. For example, Texas is home to several multilevel marketers that sell electricity. Carol Biedrzycki, a Texas consumer advocate quoted in the same article, "has found that these companies are more focused on marketing than providing customer service after the sale." She says: "I am not in favor of these companies doing business in Texas." It is highly suspect that the creation of such new business activity would be at all beneficial to customers in Kentucky.

Q. Have the marketers provided any supportable evidence of new business activity or tax revenue that has benefited the state of Ohio?

A. No. The Intelometry study provided by Ms. Ringenbach includes an unsupported claim that "at least 500 new jobs have been created in Ohio by the various market participants. These jobs contribute an estimated $46 million annually to the Ohio economy, translating to an estimated $184 million impact in the past 4 years alone." The only reference provided by Intelometry to support this claim is a report issued by the U.S. government related to the "American Recovery and Reinvestment Act of 2009."[47] This government report does not include any information related to natural gas retail choice programs or the state of Ohio. Indeed, one wonders why it would take 500 jobs to replace the function formerly performed by the three Ohio LDCs that have decided to exit the merchant function. This trade-off could suggest that the natural gas purchasing function in Ohio has become less efficient and more expensive as a result of retail choice programs.

[47] See response of RESA to AARP's First Data Request, Question No. 2, Attachment 1, Intelometry study, p. 15.

Q. Have any confusing or deceptive marketing practices occurred in Ohio?

A. Yes. In March 2009, *Gas Daily* reported that Dominion East Ohio Energy sent postcards to about 200,000 customers that were still buying their gas from the affiliated LDC, Dominion East Ohio, rather than participating in the Gas Choice Program.[48] According to the article, the postcard said in part, "You have been identified as a natural gas customer that will no longer receive gas supply from Dominion East Ohio beginning April 2009. Instead, your gas supply will be assigned to another company under the new Standard Choice Offer, or SCO. The SCO may not be the lowest price available. Please contact us today." Because the names of the utility and its affiliate are so close, about 100 customers called the utility and/or the Ohio Consumers' Counsel ("OCC") worried they might lose service in April 2009. To resolve a complaint by the OCC on behalf of customers, PUCO ordered Dominion East Ohio Energy to pay a forfeiture of $50,000.[49] Among other actions, the marketing company has to submit future marketing materials to the OCC and adhere to standards governing the use of the utility logo in future marketing materials.[50]

Q. Has the Ohio Consumers' Counsel expressed any concerns recently related to the potential for confusing marketing practices to occur?

A. Yes. Recently, the Ohio Consumers' Counsel said it will monitor a new situation whereby two separate companies will be using the Columbia brand name and logo

[48] See *Gas Daily*, March 17, 2009, p. 8: "Mailing by utility affiliate causes some customer confusion in Ohio."

[49] See http://www.pickocc.org/news/2009/pressrelease.php?date=10142009.

[50] Dominion East Ohio Energy also had to distribute a letter to customers who had agreed to a fixed-rate contract as a result of the postcard, giving them the option of voiding the contract without penalty and issue a separate letter to customers with variable-rate contracts reminding them they can switch suppliers at any time.

to provide natural gas to Ohio customers.[51] Columbia Gas of Ohio will continue to sell gas to customers. Additionally, IGS Energy, an unregulated supplier, has purchased a three-year license to use the "Columbia" name from NiSource, parent company of Columbia Gas of Ohio. IGS Energy will use the name "Columbia Retail Energy" to market its gas contracts. Financial terms of the deal were not disclosed. The state's consumer counsel advocate is worried that the similar names will be confusing to customers and has asked PUCO for a hearing to determine whether IGS Energy should be allowed to license the "Columbia" name.[52]

Q. Are you aware of any other confusing or deceptive marketing practices that have occurred in Ohio?

A. Yes. Attached as Exhibit 1 is a May 2009 *Columbus Dispatch* article that describes some customers as being unhappy that fixed-price contracts were renewed without their acknowledgement. One customer quoted in the article told the newspaper that "[h]e was upset that marketers are allowed to automatically renew contracts at different rates. For two years in a row, IGS Energy tried to renew him at a rate greater than the company was offering in public solicitations." The customer was upset when PUCO told him the marketer had done nothing wrong. Ohio law allows marketers to automatically renew a contract at a higher rate as long as the company notifies the customer in writing, usually via a postcard. The customer's response: "I think it's a total scam." This article also reported that the newspaper reviewed comments filed with PUCO and found that

[51] See http://dailyme.com/story/2010081100002065/gas-supplier-igs-columbia.html.
[52] See http://dailyme.com/story/2010082100001666/watchdog-objects-columbias-brand-sale-gas.html.

"hundreds of customers have complained about aggressive solicitations, misleading offers and high bills." An example of aggressive solicitation script used by one marketer is included in the *Columbus Dispatch* newspaper article attached as Exhibit 2 hereto.[53]

VII. CONCLUSION

Q. Does retail choice in Ohio present a compelling case for retail choice in Kentucky?

A. No. Participation levels in Ohio cannot be used as a gauge for the success of retail choice programs in that state. In Ohio, most LDCs are exiting the merchant function leaving customers without an effective choice. The SSO is not the same as the merchant function and is instead a surrogate process for assigning customers to marketers. There is no conclusive evidence that the SSO process is superior to the traditional merchant function. Furthermore, there appears to be considerable controversy about whether the consumers in Ohio are the recipients of benefits as a result of retail choice. Significant losses have been cited for consumers. Additionally, there is no evidence to verify or quantify anecdotal references to new business activity as a result of retail choice. Some new businesses that have arisen have been associated with confusing or deceptive

[53] Ohio is not the only state concerned about confusing and deceptive marketing practices. New York recently passed a law in order to improve consumer protection rules previously put in place by the New York Public Service Commission ("NYPSC") in 2008 and 2009. The new law is directed at preventing deceptive marketing practices which have occurred since the inception of retail choice programs in the state. According to the New York chair of RESA, prior to NYPSC rules becoming effective in 2008, there were some "unfortunate" and "deplorable" marketing practices used by marketing companies. See *Gas Daily*, August 27, 2010, p.1: "N.Y. marketers face customer protection rules."

marketing practices. These observations suggest that Retail choice in Ohio does not present a compelling case for retail choice in Kentucky.

Q. Does this conclude your rebuttal 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

PAMELA L. JAYNES

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

Rashelle W Gaines (SEAL)
Notary Public

My Commission Expires:
Feb. 28, 2014

EXHIBIT 1

The Columbus Dispatch

Taking heat

Deregulation held the promise of cheaper natural gas, but some consumers and advocates say marketers are taking advantage -- and regulators are letting them.

Sunday, May 3, 2009 3:36 AM

BY DAN GEARINO

THE COLUMBUS DISPATCH

LEONARDO CARRIZO | DISPATCI PHOTO

Anna Clark, 67, wound up witl high winter heating bills because of an automatically renewing natural-gas contract signed years ago by her late husband. Her daughter helped her cancel it.

Natural-gas deregulation was supposed to be a terrific deal for Ohioans: lower prices and more options.

More than a decade later, there is mounting evidence that customers are the losers in this setup. But regulators are largely unaware or unconcerned.

Deregulation opened the door for aggressive gas marketers who sell fixed-rate contracts. Consumers generally end up paying more than if they had stayed with Columbia Gas of Ohio, whose rates are regulated by the state.

"People are getting screwed," said Dave Rinebolt, executive director of Ohio Partners for Affordable Energy, an advocacy group for low-income customers.

His awareness of the situation is rare among regulators and consumer advocates. Most interviewed for this story said they were surprised by findings of *The Dispatch*'s investigation, which revealed:

• Ohio's natural-gas prices shot above the national average from 2005 to 2008, representing a total difference for customers of $796 million, based on a *Dispatch* analysis of federal Energy Information Administration data. Before that, Ohio's prices were below the national average for all but two years since 1967.

• Gas marketers -- companies that compete with Columbia and often bring natural gas to the market from other sources -- were supposed to help customers save money. But the federal energy agency says that marketers' average prices in Ohio were 7 percent higher than those of rate-regulated utilities in 2007, the most recent year for which statistics are available.

That means some people have overpaid to heat their homes by up to hundreds of dollars per month, often because of contracts that they did not understand, customer complaints show.

A proposal by Columbia Gas, if approved, would take deregulation a step further. Within a few years, this could lead to Columbia's exit from the retail business and require all customers to contract with a marketer.

A variety of factors can explain the changes in Ohio's natural-gas prices, but at least one thing is clear: Deregulation hasn't produced lower prices.

"I think there is a serious question of how much consumers have benefited," said Ken Costello, chief of the natural-gas section at the nonprofit National Regulatory Research Institute in Silver Spring, Md. "If they're not, why is it? The expectation was that customers would benefit from the competition."

Ohio was among the first states to open its gas market to alternative suppliers. Marketers, such as Direct Energy and IGS Energy, now supply nearly 50 percent of residential customers, the highest share in any state that provides such an option.

And yet, there has been little effort by anyone to assess whether the system has been good for Ohioans.

Anna Clark, 67, of Bucyrus, has never heard of deregulation. All she knows is that her gas bill for February was $647, and she can't afford to pay it.

"Nobody is taking advantage of my mother," said Clark's determined daughter, also named Anna Clark, who is helping her mother dig out from the heating bills. "It's not happening as long I'm around."

The elder Clark was bound by a contract signed years ago by her husband, who died of cancer in 2006. The fixed-rate contract with Houston-based Direct Energy included a provision to automatically renew it at a new rate when its term expired. Ohio didn't allow such deals before deregulation.

Clark didn't know about the contract until the rate and her bills shot up. Paying $1.59 per 100 cubic feet of natural gas before taxes and fees, her costs were 64 percent higher than those of Columbia customers.

Clark's home in Bucyrus

THE COST OF CHOICE

Today's coverage

- Columbia Gas' rate often best
  Sunday, May 3, 2009
- Graphic: Costlier gas
  Sunday, May 3, 2009
- Persistent telemarketers press for gas contracts, and customers pay more
  Sunday, May 3, 2009
- Some businesses saving money
  Sunday, May 3, 2009
- Graphic: How natural gas is processed, sold and delivered
  Sunday, May 3, 2009
- Gas consortium not paying off
  Monday, May 4, 2009

Her example is extreme but not isolated. Howard Berger, 84, of the Northwest Side, paid $416 in January under his fixed-rate contract with Dublin-based IGS Energy. Another IGS customer, Albert Lohri, 89, of the North Side, paid $394 for heat in December.

Thousands of people accepted gas marketers' aggressive sales pitches -- conducted over the phone, in person and through the mail -- and signed up for contracts that automatically renewed when they expired, and at whatever rate the marketer decided to charge.

Doug Austin, IGS vice president, said the company has "bent over backwards" to respond to customers' concerns. He said high rates are the result of high commodity prices last summer and fall, and not a reason to doubt the value of fixed-rate deals.

"Fixed rates are for protection against volatility," he said.

Lack of oversight

Government officials, including the Public Utilities Commission of Ohio and the Office of the Ohio Consumers' Counsel, have taken little action to set boundaries for marketers. That's clear, based on a review of a decade's worth of public comments, reports and actions from the agencies.

In fact, the agencies have repeatedly praised the system.

"Ohio has one of the most successful natural-gas-choice programs in the nation," the PUCO said in its 2008 year-in-review report.

Ohio Consumers' Counsel Janine L. Migden-Ostrander and her office are specifically charged with helping customers get lower utility rates, but she was unaware of the situation.

Presented with findings from this report, she found them "disturbing and very upsetting."

"We will take a closer look," she said. Critics suggest that she might have a blind spot for natural-gas marketers.

Before becoming the state's consumer advocate, Migden-Ostrander was a lawyer whose clients included natural-gas marketers. Before that, she was a lobbyist for Enron Corp., the company that pushed to ease government control over energy regulations and then famously went bankrupt.

"She used to represent marketers, and she thinks markets are a good thing," said Rinebolt, the advocate for low-income customers. That background has made her slow to realize the harmful effects of

- Graphic: Expensive gas Monday, May 4, 2009
- Gas free-for-all possible in Ohio Tuesday, May 5, 2009

Graphics

- Graphic: Plan participation
- Graphic: Costlier gas
- Graphic: How natural gas is processed, sold and delivered

By the numbers

6

The number of years since 1967 that Ohio's average residential gas price was above the national average. Those years were 1983, 2001 and 2005-08.

$4.4 billion

Ohio's 2008 residential spending on natural gas.

$796 million

The premium that Ohio residents paid from deregulation, he said, though he added that he doesn't doubt that she has good intentions.

From the start, she has used her office to promote "gas choice" as a boon for customers.

Since she took the job in 2004, Migden-Ostrander's office has issued about 360 news releases, only three of which were warnings about misleading solicitation practices by marketers. All three times, the messages were about Dominion East Ohio Gas, a rate-regulated utility like Columbia Gas but one that also operates a separate gas-marketing company.

She hasn't issued any similar message about companies that operate solely as gas marketers in Ohio.

Migden-Ostrander said it is "flat-out wrong" to suggest that her background has hurt her performance as the state's consumer advocate.

She continues to believe in deregulation, and she said that marketers can serve a vital function. "Having marketers at the heels of the utilities makes them better utilities," she said.

In fact, she has clashed with marketers a few times, such as in 2006, when her office filed a request for greater public disclosure of solicitation materials. She also asked marketers to take steps to ensure that consumer sign-ups are genuine.

Her counterparts in other states, including Illinois and Pennsylvania, have been more aggressive with marketers. This is one reason the Illinois governor just signed a package of consumer protections, including a $50 limit on fees for cancellation of contracts with marketers.

"Hundreds of thousands of consumers are paying substantially more than they should on their gas bills, often because unregulated suppliers misled them or didn't give them all the facts," said David Kolata, executive director of the Citizens Utility Board in Illinois, in a warning to consumers.

Ohio law gives the PUCO limited regulatory authority over marketers. The agency is responsible for licensing marketers and responding to customer complaints. In the past nine years, the PUCO has opened three investigations of marketers' solicitation practices.

Like the consumers' counsel, the PUCO has promoted gas choice and generally portrayed the initiative positively.

2005 to 2008 because the state's average residential gas rate was above the national average.

1.4 million

The number of Ohio residential customers who buy their natural gas from a marketer as opposed to a rate-regulated utility. Georgia is the only state with more.

48 percent

The share of Ohio residential customers who buy from gas marketers.

4.7 million

The number of residential customers in the country who buy from gas marketers.

30 percent

The share of the country's marketer customers who live in Ohio.

8

Ohio's rank in per-capita consumption of natural gas for 2006, the most recent year available. Texas was highest and Hawaii was lowest.

Source: Energy Information Administration

"We are the venue for complaints and, when we get them, we act on them," said PUCO Chairman Alan Schriber, who has led the agency since 1999. "And frankly, we don't have a whole lot" of complaints.

But *The Dispatch* found numerous complaints about marketers by reviewing customer comments filed with his agency.

Hundreds of customers have complained about aggressive solicitations, misleading offers and high bills. But the PUCO doesn't track complaints against marketers. It doesn't even separate them from general comments. The PUCO received nearly 3,000 pages of customer comments for the first four months of this year alone, with no indication of which are complaints.

The lack of oversight has led to frustration for customers. Chris Goddard, 40, a public-school teacher who lives in Gahanna, filed a complaint with the PUCO last year. He was shocked at the agency's response.

"They kind of shrugged their shoulders," he said.

He was upset that marketers are allowed to automatically renew contracts at different rates. For two years in a row, IGS Energy tried to renew him at a rate greater than the company was offering in public solicitations.

His first thought was, "Can they do this?" The PUCO told him the marketer had done nothing wrong. Ohio law, the PUCO said, allows IGS to automatically renew a contract at a higher rate as long as the company notifies the customer in writing, usually via a postcard. The customer needs to cancel the contract in writing before it takes effect or there may be a cancellation charge.

"I think it's a total scam," Goddard said.

How we got here

Ohio has allowed businesses to buy gas on the open market since the mid-1980s. In 1997, Columbia Gas began allowing residential customers the same kinds of choices.

The company saw deregulation as an opportunity, not a threat, said Jack Partridge, a longtime Columbia executive who is now company president. Columbia had long battled the image that its rates weren't competitive, which led to a contentious relationship with regulators and customers, he said.

Deregulation would help solve this public-relations problem, with almost no financial sacrifice.

The new competition would be for the natural gas itself, on which Columbia made virtually no profit. Columbia makes most of its profit on transportation fees, and the new marketers would have to pay to use Columbia's pipelines to deliver gas. Although Columbia would no longer have a monopoly on the sale of gas, it would be the only company transporting it.

"We tried to create legitimate win-wins for everybody," Partridge said.

The choice program began with a pilot project in the Toledo area and expanded to all of Columbia territory, including central Ohio, by 1998.

Deregulation was sold as a customer-friendly modernization of an antiquated system, said John Howat, senior policy analyst for the National Consumer Law Center in Boston. Enron was a leading proponent of this line of reasoning, he said.

"I sort of bang myself on the head and ask, 'What were we thinking?' " he said.

Politics also played a role. Ohio Republicans generally supported deregulation, and the party controlled the legislature and the governor's office throughout this period.

In the 1998 gubernatorial race, Republican Bob Taft, the eventual winner, supported expanding the choice program. Democrat Lee Fisher, who is now lieutenant governor and a U.S. Senate candidate, was more cautious, saying that the state needed to ensure that the system had "fair and honest management practices."

"This was the era when communism had fallen and the Berlin Wall was down," said Barbara Alexander, a Maine-based utility-policy consultant who works nationwide. "It was the American way to encourage competition."

The problem, she said, was the way Ohio wholeheartedly bought into this system and then put few resources into studying how well it had worked.

At first, deregulation was a net gain for customers, saving several million dollars in the first year, Partridge said. But he concedes that the savings have dwindled.

One of the top reasons, he said, is that marketers seem to have viewed the initial contracts as "loss leaders," with unsustainably low prices to build a base of customers. By now, the marketers' profit margins have "tightened up," and consumer savings are much harder to find, he said. Despite this, he continues to believe deregulation is good for Ohio.

The growing volatility of national energy prices also has played a role, he said. Natural-gas prices usec to peak in the winter, but the most recent peak was in July. This new unpredictability has made it more difficult for customers to know when to lock in prices.

Doing the right thing

With her daughter's help, Anna Clark has canceled her contract with Direct Energy.

Direct Energy spokeswoman Yvette Hamilton said she sympathizes with Clark's situation. She said a fixed-rate plan might not have been the best option for this household, and customers should shop around to find the plan that's best for them.

"Direct Energy really feels for this family," she said.

Two weeks after *The Dispatch* contacted Direct Energy, the company said it would send Clark a checl for $483 to help cover her heating costs.

That's not good enough for Clark's daughter. She notes that the rate of $1.59 per 100 cubic feet was higher than anything Direct Energy advertised to new customers last year.

But her mother isn't the type to get angry. Her living room is decorated with family photos, including many of her with her husband, and the wall clock is faced with a painted image of Jesus.

"I try to do right," she said.

And for her, that means she will tell her friends and family to avoid contracts like the one that has wiped out her finances.

dgearino@dispatch.com

Anna Clark has never heard of deregulation. All she knows is that her gas bill for February was $647, and she can't afford to pay it.

Hundreds of customers have complained about aggressive solicitations, misleading offers and high bills. But the PUCO doesn't track complaints against marketers. It doesn't even separate them from general comments.

• Telemarketers part of problem D1

EXHIBIT 2

The Columbus Dispatch

Columbia Gas' rate often best

Sunday, May 3, 2009 3:29 AM

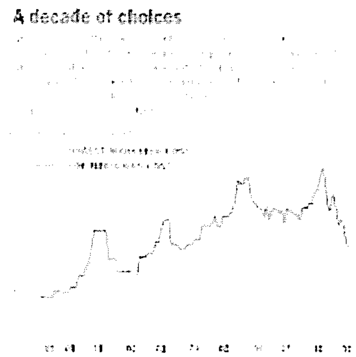
BY DAN GEARINO

THE COLUMBUS DISPATCH

With the benefit of hindsight, natural-gas customers can see how they could have gotten the best deal from Ohio's deregulated system.

But it's not easy.

The Dispatch reviewed 10 years of data from the Public Utilities Commission of Ohio, comparing the price of the rate-regulated utility, Columbia Gas of Ohio, with the least-expensive one-year fixed-rate contract offered by gas marketers. The prices include all taxes and fees.



Click here to enlarge

The Cost of Choice

Among the findings:

• Columbia has been the least-expensive option most of the time since early 2002, and the prices of fixed-rate contracts, such as those offered by gas marketers under the "Customer Choice" program, almost always rise and fall along with Columbia's. From 1999 to early 2002, the gas marketers' fixed-rate prices were often lower than the Columbia price each month.

• Considering this relationship between the Columbia price and fixed-rate prices, the only way a customer can save with a fixed price is if prices in the commodities market are about to rise, which customers have no way of knowing. Since 2001, there have been three notable upswings: in the summer of 2003, the winter of 2005-06 and the summer of 2008.

• The worst time to get a fixed-rate deal is when prices have been rising, such as last fall. And yet, many customers seek fixed rates when prices are rising because they want stability. What they might not realize is that they will almost certainly pay more in the long run.

• If consumers are interested in buying a fixed-rate contract, now might be as good a time as any. Prices have dropped every month this year and are lower than they've been in five years.

• If customers buy a one-year contract and then allow it to automatically renew, they will lose any of the timing advantages that might lead to savings. This is where many customers get tripped up because they don't notice the postcard from the marketer informing them of the automatic renewal, or they don't understand natural-gas prices well enough to realize that the new rate might not be in their best interest.

• Some of the best deals offered by natural-gas marketers are variable-rate contracts. Several companies, such as Volunteer Energy, routinely have lower prices than Columbia, although the rate changes every month along with Columbia's rate, so customers don't have the stability of a fixed rate. IGS Energy and Direct Energy sometimes offer deals with a guaranteed savings off the Columbia rate. These can be a good deal, as long as the customers realize that they must pay sales tax on top of the marketer rate, and that the contract terms will automatically change after a year.

• Prices follow no seasonal pattern. Utility analysts say that natural-gas prices used to peak in the winter and bottom out in the summer. However, the only time this happened since 1999 was in the winter of 2005-06. Despite this, marketers continue to promote plans in the summer by telling consumers that prices tend to spike with cold weather.

In response to the findings, marketers said the analysis doesn't give enough weight to the peace of mind that customers get from being able to plan for their heating costs with a fixed rate. They said the comparison with Columbia's price is unfair because fixed-rate customers are often choosing among fixed-rate offers, rather than between Columbia and fixed-rate offers.

The Dispatch created the chart accompanying this story using the "Apples to Apples" price reports published by the PUCO. The two lines represent Columbia's monthly variable rate and the least-expensive one-year deal for each month. More than a dozen marketers had the lowest price at one time or another.

The chart does not take into account the cost of cancellation fees, which some marketers charge for early withdrawal from a contract.

The format of the PUCO charts can be confusing. For example, the agency no longer includes sales tax for marketer contracts, which makes the contracts look less expensive. The prices on this chart are adjusted to include state sales tax.

The PUCO publishes the "Apples to Apples" reports as a service to customers. The agency's Web site, www.puco.ohio.gov, also has an interactive calculator to help compare the various offers.

dgearino@dispatch.com

From the script

A portion of a telemarketing script, supplied by a former employee, used to make calls on behalf of IGS Energy. This sample script depicts what telemarketers are supposed to tell those who say they don't want to sign up. The example is from Michigan:

• I'm not interested

I completely understand what you're saying! The reason for the call was to simply give you a fixed rate of *(number)* per ccf on your natural-gas usage all the way through *(date)*. *Michcon's* rate has increased *(number)*. The best part of the program is that *Michcon* will remain your gas company, which means that they'll still come on out and read your meter, deliver the gas to your home and bill you just like they always have. This is a free program with no cancellation fees or contracts to sign. The only difference you'll notice is your new fixed rate. Now, I did reach you

at ____ , is that correct?

• I don't want to change

I completely understand what you're saying! Just to let you know, no one can change from *Michcon*! They'll always be your utility company, which means they'll still read your meter, deliver the gas and bill you every month just like they always have. All you're doing here today is choosing IGS Energy as your supplier for your natural gas, which means we can offer you a fixed rate of *(number)* per ccf all the way through instead of continuing to pay *Michcon's* high rates. Now, once again, my first name is ____. What's yours?

• Send it to me in writing

I completely understand what you're saying! The reason we're calling today is to take the time to explain how the program works and to answer any questions you may have. This is a free program with no cancellation fees or contracts to sign, and once you enroll we'll send you a welcome letter that includes all of the terms I have told you about today so you can review it in the comfort of your own home. After you enroll, if you still have questions or decide to cancel, simply call our toll-free number and cancel with no questions asked. Now, what's the correct spelling of your last name?