COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF COLUMBIA GAS OF KENTUCKY, INC. TO CONTINUE ITS GAS COST INCENTIVE ADJUSTMENT PERFORMANCE BASED RATE MAKING MECHANISM	)))))	CASE NO. 2024-00012

O R D E R

On January 31, 2024, Columbia Gas of Kentucky, Inc. (Columbia Kentucky), a local distribution company (LDC), filed its application to extend its Performance Based Ratemaking (PBR) mechanism for a five-year period, extending through March 31, 2029.[1] Accompanying the amended application was testimony from Columbia Kentucky's Director of Government and Regulatory Affairs, Judy M. Cooper, as well as the testimony of Patrick Pluard, NiSource's Director of Portfolio Optimization. By Commission Order issued March 1, 2024, the application was rejected on the basis that it sought to amend the PBR mechanism without giving notice to customers as required by 807 KAR 5:011, Section 8.

On March 8, 2024, Columbia Kentucky filed a motion to amend its application to withdraw the portions of the application and supporting testimony related to provisions for modification of the Transportation Cost Incentive (TCI) component of the PBR mechanism. Columbia Kentucky also requested a three-year extension, as opposed to the five-year extension originally requested in its application, with no changes to the PBR

[1] Application, Direct Testimony of Judy Cooper (Cooper Direct Testimony) at 8.

mechanism as previously approved in Case No. 2020-00378.[2] By Commission Order on March 11, 2024, Columbia Kentucky's motion to amend its January 31, 2024, PBR mechanism filing was granted. The amended PBR mechanism application was deemed filed on March 8, 2024, and Columbia Kentucky was permitted to keep the mechanism in place through October 31, 2024. On October 31, 2024, the Commission entered an Order allowing the PBR mechanism to remain in effect in its current form until the Commission entered a final Order in this matter.

On April 9, 2024, the Commission issued an Order establishing the procedural schedule in this case. No parties requested intervention. On May 8, 2024, and June 5, 2024, Columbia Kentucky filed responses to two rounds of requests for information from Commission Staff. Columbia Kentucky subsequently requested a decision on the written record. This matter is now before the Commission for a decision on the record.

LEGAL STANDARD

Pursuant to KRS 278.040(2), the Commission has exclusive jurisdiction over the regulation of rates and services of utilities in Kentucky. Furthermore, under KRS 278.190(3), a utility bears the burden of proof to show that the proposed tariff is just and reasonable.

BACKGROUND

Columbia Kentucky's current PBR mechanism was approved by the Commission in Case No. 2020-00378 for a three-year period.[3] The current PBR mechanism is comprised of three components—a monthly Gas Cost Incentive (GCI) mechanism, an

[2] Case No. 2020-00378, *Electronic Application of Columbia Gas of Kentucky, Inc. to Extend its Gas Cost Incentive Adjustment Performance based Rate Making Mechanism* (Ky. PSC June 6, 2022), Order.

[3] Case No. 2020-00378, June 6, 2022 Order at 11.

Off-System Sales incentive (OSSI) mechanism, and a Transportation Cost Incentive (TCI).[4] In its current form, the GCI mechanism compares Columbia Kentucky's actual natural gas costs against daily, weekly, and monthly gas prices indices for each pipeline on which Columbia Kentucky buys natural gas. The OSSI mechanism calls for sharing, based on the percentages discussed below, of revenues net of costs from off systems sales, other than those revenues generated by operational sales.

The TCI generally benchmarks the demand costs at the Federal Energy Regulatory Commission (FERC) approved rates for the demand quantities contracted for and the volumetric costs at the FERC approved rates of the actual volumes delivered against the actual demand and volumetric costs of gas transportation on each pipeline. However, the TCI mechanism benchmarks purchases made pursuant to the discounted rate on the Columbia Gas Transmission pipeline against the discounted rate, grossed up by the percentage increase in the FERC rate since the PBR mechanism was established.[5]

Variances between Columbia Kentucky's actual costs and the benchmarks, in addition the OSSI component of the PBR mechanism, are shared between shareholders and ratepayers on a sliding scale consisting of two bands. The first band covers amounts ranging from 0 to 4.5 percent of Columbia Kentucky's Actual Gas Costs, as defined in the tariff, and is shared 70 percent to ratepayers and 30 percent to shareholders. The second band covers amounts greater than 4.5 percent and is shared 50/50 between ratepayers and shareholders.[6]

[4] Amended Application (filed Mar. 8, 2024) at 4.

[5] Case No. 2020-00378, June 6, 2022 Order at 2-3, and 10-12.

[6] Columbia Kentucky's Gas Tariff, P.S.C. KY No. 5., Ninth Revised Sheet No. 50, Original Sheet No. 50d.

Columbia Kentucky asserted that the PBR mechanism rewarded "good stewardship of assets along with standard benchmarking of purchase activity to appropriately incentivize Columbia Kentucky to outperform the established benchmarks."[7] Specifically, when speaking about the GCI mechanism, Columbia Kentucky argued that by benchmarking its actual purchases against the daily, weekly, and monthly market price figures, Columbia Kentucky was incentivized to balance natural gas purchases against the cost of storage options.[8] Despite acknowledging negative performance of the GCI in certain months, Columbia Kentucky asserted that the gas cost savings it had achieved since the last extension of the PBR mechanism indicated that the GCI did not need to be modified moving forward.[9]

Likewise, Columbia Kentucky did not recommend any changes to its OSSI mechanism.[10]

Similarly, for the TCI mechanism, Columbia Kentucky's amended application includes no proposed changes to the benchmark calculation. Columbia Kentucky indicated that the TCI is designed to capture and share between Columbia Kentucky and its customers any value realized by Columbia Kentucky in negotiating capacity contracts at rates less than the maximum rates approved by FERC. Columbia Kentucky indicated

[7] Amended Application, Amended Direct Testimony of Patrick Pluard (Amended Pluard Direct Testimony) at 12.

[8] Amended Pluard Direct Testimony at 7-8.

[9] Amended Pluard Direct Testimony at 8.

[10] Amended Pluard Direct Testimony at 8.

that it also captures release revenues, except for administrative and Rate Schedule SVAS capacity releases.[11]

Since the Commission's last approved extension of the PBR mechanism, Columbia Kentucky reported customer share savings of $2,556,045 for the 2020/2021 year; $3,826,981 for the 2021/2022 year; and $6,491,820 for the 2022/2023 year.[12] Columbia Kentucky reported the following total savings during the last three years of its PBR mechanism:[13]

Year	GCI Savings	TCI Savings	OSSI Savings	Total Savings	Total Actual Costs	Percentage
20/21	$545,470	$2,883,987	$1,369,024	$4,798,481	$40,940,277	11.72 %
21/22	$617,600	$5,843,431	$638,630	$7,099,661	$69,287,589	10.25 %
22/23	$1,160,764	$7,763,810	$2,504,569	$11,429,144	$108,409,320	10.54 %

Columbia Kentucky acknowledged that there would be some incentive to lower gas costs in the absence of the PBR mechanism, but asserted that the PBR mechanism provides proper incentives to Columbia Kentucky to reduce the cost of gas beyond the average benchmark and beyond what those costs would otherwise be absent a PBR mechanism.[14] Furthermore, Columbia Kentucky stated that the "PBR establishes a predetermined framework that provides a constant, reinforceable structure for all stakeholders to be able to verify the gas supply portfolio is being optimized at the transactions level".[15]

[11] Amended Application at 4.

[12] Columbia Kentucky's Response to Commission Staff's First Request for Information (Staff's First Request) (filed May 8, 2024), Item 9.

[13] Amended Pluard Direct Testimony, Attachment A.

[14] Columbia Kentucky's Response to Staff's First Request, Item 5.

[15] Columbia Kentucky's Response to Staff's First Request, Item 4.

DISCUSSION

Cost-based rates for investor-owned utilities are set at a level to allow the utility to recover all of its reasonable expenses and provide its shareholders an opportunity to earn a fair return on invested capital.[16] The Kentucky LDCs' Gas Cost Recovery (GCR) mechanisms provide for full recovery of the actual cost of gas, with the LDC retaining no profit and sustaining no financial losses on gas purchase transactions. The significance of Columbia Kentucky's PBR mechanism is that it allows Columbia Kentucky to recover not only the actual gas costs incurred, but also a portion of calculated savings if gas costs are lower than defined benchmarks. It likewise requires Columbia Kentucky to return to its customers a portion of calculated losses if gas costs exceed the benchmarks. The ultimate goal of the PBR mechanism is to reduce the overall rates paid by Columbia Kentucky's customers, while maintaining supply reliability, by incentivizing Columbia Kentucky to lower the gas costs.

If the PBR mechanism does not result in lower customer costs than would have otherwise been paid in the absence of the PBR mechanism, then the PBR mechanism would not serve its intended purpose and, therefore, would not be justified. Further, using the PBR mechanism to share savings that Columbia Kentucky would have otherwise realized in the absence of the PBR mechanism would not be justified by the purpose of the mechanism. In fact, even savings actually arising from the PBR mechanism should only be shared with the utility to the extent necessary to incentivize the desired behavior.

[16] Case No. 2017-00481, *An Investigation of the Impact of the Tax Cuts and Job Act on the Rates of Atmos Energy Corporation, Delta Natural Gas Company, Inc., Columbia Gas of Kentucky, Inc., Kentucky American Water Company, and Water Service Corporation of Kentucky* (Ky. PSC Dec. 27, 2017), Order at 1–2; *see also Com. ex. rel. Stephens v. South Central Bell Tel. Co., 545 S.W.2d 927, 931* (Ky. 1976) ("Rates are non-confiscatory, just and reasonable so long as they enable the utility to operate successfully, to maintain its financial integrity, to attract capital and to compensate its investors for the risks assumed.").

Additional sharing of gas cost savings would not serve the purpose of the PBR mechanism and would not be reasonable.

Columbia Kentucky was unable to identify any economic or scientific studies that demonstrate that PBR mechanisms change utilities' behavior in a way that reduces gas costs for customers of LDCs generally.[17] Rather, as noted above, Columbia Kentucky argued that its ability to share in the PBR savings creates an incentive for it to generate gas cost savings and that its PBR savings demonstrate that it actually has generated savings as compared to the market.

The Commission agrees that the ability to share in the PBR savings provides an incentive for Columbia Kentucky to generate savings and that Columbia Kentucky has been able to beat prices paid by others for both gas and transportation services, so there is some evidence to support the argument that Columbia Kentucky's PBR mechanism actually results in savings for customers. However, as Columbia Kentucky acknowledged, a utility would have some incentive to take advantage of opportunities in the market to reduce gas costs below benchmark prices even if the PBR mechanism were eliminated, because the Commission has the authority to review and disallow gas costs that are found to be unreasonable. In fact, as the Commission explained in Columbia Kentucky's most recent PBR case, Columbia Kentucky engaged in such cost saving behavior by negotiating discounted transportation rates in the absence of an incentive offered by its PBR mechanism.[18] Thus, the fact that the PBR mechanism provides an

[17] *See* Columbia Kentucky's Response to Staff's First Request, Item 7.

[18] *See* Case No. 2020-00378, June 6, 2022 Order at 8-9 (explaining how the addition of the TCI component to the PBR mechanism initially increased customer costs by sharing significant variances between actual and benchmark costs that preexisted the mechanism with Columbia Kentucky).

incentive, and that Columbia Kentucky does obtain gas and transportation services below costs paid by others does not necessarily establish that the PBR mechanism results in savings for customers.

When approving an extension of Columbia Kentucky's PBR mechanism in Case No. 2020-00378, the Commission recognized the difficulty of developing proof that incentives result in savings and was reluctant to eliminate Columbia Kentucky's PBR mechanism in its entirety due to potential unforeseen effects on customer costs.[19] Thus, despite weaknesses in Columbia Kentucky's evidence as to the necessity of the PBR mechanism in generating gas cost savings, the Commission found that the PBR mechanism should be extended but that the savings shared with Columbia Kentucky through the mechanism should be reduced by adjusting the sharing bands, and reasoned, among other things, that:

> [The] minor adjustment to the sharing band should allow the Commission to monitor the effects, if any, of reducing the incentives offered under the mechanism without risking unforeseen consequences of eliminating the PBR mechanism outright.[20]

The evidence presented by Columbia Kentucky in this matter indicates that the reduction of the sharing of PBR savings with Columbia Kentucky in Case No. 2020-00378 did not negatively affect customer's gas costs. Specifically, in Columbia Kentucky's 2022/2023 program year,[21] the first year that the modified PBR mechanism was in place,

[19] Case No. 2020-00378, June 6, 2022 Order, footnote 29.

[20] Case No. 2020-00378, June 6, 2022 Order at 11.

[21] Columbia Kentucky's program year for the PBR extends from April through March and is updated annually via Columbia Kentucky's Gas Cost Adjustment reports filed around the end of April or beginning of May period.

Columbia Kentucky achieved total PBR savings of $11,429,144, which represented about 10.54 percent of total actual gas costs, whereas Columbia Kentucky achieved total PBR savings of $4,798,481 and $7,099,661, or 11.72 percent and 10.25 percent of total actual gas costs, in Columbia Kentucky's 2020/2021 and 2021/2022 program years, respectively. While there was limited time for the changes made in Case No. 2020-00378 to be reflected in program years before this matter was filed,[22] Columbia Kentucky remarked that the Commission's modification in the sharing benchmark in Case No. 2020-00378, did not change the utilities gas acquisition activities.[23] Thus, the Commission finds that the prior reduction to Columbia Kentucky's share of gas cost savings increased the savings to customers while not disincentivizing Columbia Kentucky's efforts to procure reliable supply at a lower cost.

As in Case No. 2020-00378, the Commission does not believe that it would be prudent to simply eliminate Columbia Kentucky's PBR mechanism in its entirety at this time despite weaknesses in Columbia Kentucky's evidence, because doing so could have potential unforeseen effects on customer costs.[24] However, Columbia Kentucky has failed to establish that all of the savings shared through the PBR mechanism arose from the mechanism or that the extent of the sharing in the current PBR mechanism is

[22] The Order in Case No. 2020-00378 was entered in June 2022 whereas program year 2022/2023 began in April 2022.

[23] Columbia Kentucky's Response to Commission Staff's Second Request for Information filed June 5, 2024), Item 2.

[24] The Commission recognizes that establishing whether and the extent to which a particular incentive influences behavior is not an easy task. Further, the Commission's ability to encourage lower costs in the absence of the PBR mechanism, through the threat of disallowing unreasonable costs, is limited by the number and complexity of gas procurement transactions and legal restrictions on its ability to disallow FERC approved costs. Thus, simply eliminating the incentives offered by the PBR mechanism in their entirety could unintentionally increase the costs passed on to customers.

necessary to serve the purpose of the PBR mechanism. As noted above, PBR savings should only be shared with the utility to the extent necessary to incentivize the desired cost savings behavior. Thus, the Commission finds that the PBR mechanism should be extended but finds it reasonable that the savings shared with Columbia Kentucky through the mechanism should be incrementally reduced by adjusting the sharing bands, which will allow the Commission to monitor the effects, if any, of reducing the incentives offered under the mechanism without risking unforeseen consequences of eliminating the PBR mechanism outright.

Without any studies or analyses of the effects of PBR mechanisms on the cost of natural gas for customers,[25] it is difficult to establish the extent to which savings should be adjusted to serve the purpose of the mechanism. However, in Case No. 2020-00378, the Commission adjusted the sharing bands by 2.5 percent such that variances between actual costs and benchmarks were only shared 50/50 between customers and Columbia Kentucky (as opposed to 70/30) when PBR savings exceeded 4.5 percent of actual gas costs as opposed to 2.0 percent,[26] and as noted above, the change had no effect on Columbia Kentucky's gas procurement activities. In fact, based on the PBR savings reported by Columbia Kentucky in fiscal years 2020/2021, 2021/2022, and 2022/2023, even if all variances were only shared at a 70/30 split with customers receiving the benefit from and being responsible for 70 percent of the variances, Columbia Kentucky would have received about $1,439,544, $2,129,898, and $3,428,743 in shared PBR savings in each of those years to incentivize its efforts to procure reliable supply at a lower cost gas

[25] Columbia Kentucky's Response to Staff's First Request, Item 7.

[26] Case No. 2020-00378, June 6, 2022 Order at 3-4, 10-11.

cost savings. Thus, the Commission finds that it would be reasonable to make an additional incremental adjustment to the sharing band like that made in Case No. 2020-00378 such that variances ranging from 0 to 6.5 percent of Columbia Kentucky's Actual Gas Costs will be shared 70 percent to customers and 30 percent to shareholders and variances greater than 6.5 percent will be shared 50/50 between customers and shareholders, and therefore, finds that this adjustment to the sharing band should be made. This adjustment should allow the Commission to continue monitor the effects, if any, of reducing the incentives offered under the mechanism without risking unforeseen consequences of eliminating the PBR mechanism outright.

Having reviewed the evidence of the record and being otherwise sufficiently advised, the Commission finds that Columbia Kentucky's PBR mechanism should be extended, as modified herein, through March 31, 2027. The Commission notes that previous Orders in this case permitted Columbia Kentucky to keep the PBR mechanism in place, without modification, until a final Order was entered in this matter. Thus, the modifications to the mechanism required by this Order should become effective as of the date of the entry of this Order.

The Commission further notes that while Columbia Kentucky's PBR mechanism was previously extended through March 31, 2024, in Case No. 2021-00378, as it had been in previous cases, that Columbia Kentucky's PBR tariff does not include explicit language indicating its term or expiration. This creates confusion and ambiguity regarding the nature of an application to extend Columbia Kentucky's PBR mechanism without any other modification and the status of the mechanism during the pendency of the case.[27] To avoid such confusion in the future, the Commission finds that Columbia Kentucky's tariff should be modified to explicitly indicate the date that the approved PBR mechanism expires. This will necessitate Columbia Kentucky filing a tariff modifying the term as part of future reviews in order to extend the mechanism regardless of whether Columbia Kentucky proposes any other modifications to its PBR mechanism, but it will provide procedural clarity regarding the status of Columbia Kentucky's PBR mechanism during the pendency of the case.

Furthermore, going forward, Columbia Kentucky should ensure that it provides notice of PBR mechanism extensions or modifications pursuant to 807 KAR 5:011, Section 8, or obtains any appropriate deviation.[28] Due to the variable nature of the natural gas market and its relation to set PBR benchmarks, the Commission and customers should receive adequate notice in order to have the opportunity to review the appropriateness of extending or modifications of a calculated rate.

In future PBR cases, the Commission will continue to evaluate Columbia Kentucky's PBR mechanism for reasonableness, and the Commission may realign, modify, or terminate the PBR mechanism. The Commission notes that the burden is on the utility to submit sufficient and necessary information into the record to establish that a proposed extension or modification is reasonable. Therefore, in Columbia Kentucky's next PBR case, Columbia Kentucky should file testimony and any supporting documentation to further support that Columbia Kentucky's PBR mechanism provides

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[27] The status of the mechanism in this matter during the pendency of the case was resolved with orders allowing it to remain in place during the pendency of the case.

[28] *See* Order (Ky. PSC Mar. 11, 2024) at 3.

fair, just and reasonable rates. Columbia Kentucky should be prepared to discuss the benchmarks and PBR components at length and provide quantifiable evidence to support the benefit of the PBR mechanism, including a discussion of the effects, if any, of modifications to the PBR mechanism in this case and Columbia Kentucky's last PBR case.

IT IS THEREFORE ORDERED that:

1. Columbia Kentucky's proposal to extend the PBR mechanism with no modifications is denied.

2. The current gas cost sharing calculation shall be modified as required herein, so that variances from 0 to 6.5 percent of Columbia Kentucky's Actual Gas Cost are shared 70 percent to ratepayers and 30 percent to shareholders, with sharing thereafter allocated 50/50 between Columbia Kentucky and its ratepayers.

3. Columbia Kentucky's PBR mechanism, with the modifications required herein, is approved and effective on the date of this order through March 31, 2027.[29]

4. Columbia Kentucky's PBR tariff shall be modified to explicitly state the date the PBR mechanism approved and extended herein expires.

5. In the next PBR case, Columbia Kentucky shall file an evaluation report on the results of the PBR from April 1, 2021, through the most recent month available at the time of filing, for the Commission to review and determine whether the PBR should be continued, modified, or terminated. This evaluation report shall be considered in any proceeding established to continue, modify, or terminate the PBR mechanism.

[29] Previous Orders allowed the mechanism to remain effective without modification pending this Order.

6. In the next PBR case, Columbia Kentucky shall also file testimony and any supporting documentation to assist the Commission in determining whether Columbia Kentucky's PBR should be continued, modified, or terminated.

7. Any request for extension of Columbia Kentucky's PBR shall be filed no less than four months before the March 31, 2027, expiration date.

8. Within 20 days of the date of this Order, Columbia Kentucky shall file with this Commission, using the Commission's electronic Tariff Filing System, revised tariff sheets setting out the PBR tariff revision approved herein, including its expiration date, and reflecting that they were approved pursuant to this Order.

9. This case is closed and removed from the Commission's docket.

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PUBLIC SERVICE COMMISSION

Chairman

John Will Stacy

Commissioner

Mary Pat Regan

Commissioner

ATTEST:

Linda Bridwell RP

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ENTERED

JAN 8 2025

jdc

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