Approved: Date 2-19-01

MINUTES OF THE SENATE UTILITIES COMMITTEE.

The meeting was called to order by Chairperson Senator Stan Clark at 9:30 a.m. on February 14, 2001 in Room 231-N of the Capitol.

All members were present except:

Committee staff present: Raney Gilliland, Legislative Research
Emalene Correll, Legislative Research
Bruce Kinzie, Revisor of Statutes
Lisa Montgomery, Revisor of Statutes
Ann McMorris, Secretary

Conferees appearing before the committee:
James G. Flaherty, Attorney, Greeley Gas Company, Ottawa
John W. Hack, Atmos Eneergy Corporation, Dallas, Texas
Andrea C. Crane, VP, The Columbia Group, Inc. Ridgefield, CT
Joe White, Director of Utilities Division of Kansas Corporation Commission

Others attending: See attached list

Chair Clark opened hearing on:

S.B. 190 - Natural gas public utilities, performance-based ratemaking

Proponents:

James G. Flaherty, Attorney, Greeley Gas Company, Ottawa (Attachment 1)
John W. Hack, Atmos Energy Corporation, Dallas, Texas (Attachment 2)

Opponents:
Andrea C. Crane, VP, The Columbia Group, Inc. Ridgefield, CT (Attachment 3)
Joe White, Director of Utilities Division of Kansas Corporation Commission (Attachment 4)

Chair opened for questions. Questions were asked on sharing of profits, deregulation, consumers' lack of knowledge on the provider of their gas, indices reliability to determine prices, statistics on savings by PBRs and on what cost basis they were calculated.

Chair closed hearing on **SB 190**.

Due to the lack of time, hearings on **SCR 1606, SB 111 and SB 112** were not held. Chair indicated the hearings on these bills would be held on Friday, February 16 when the committee met following adjournment of the Senate.

Next meeting of the Senate Utilities Committee will be held on February 15.

Adjournment.

Respectfully submitted,

Ann McMorris, Secretary

Attachments - 4

SENATE UTILITIES COMMITTEE GUEST LIST

DATE: **February 14, 2001**

Name	Representing
[illegible]	KCC
James G. Flaherty	Greeley Gas Company
John Hack	Greeley Gas Company
Bob Alderson	Atmos Energy
Jim Bartling	Greeley Gas Co
Roger Nash	Greeley Gas Co.
Jack Glaves	P-H-Weyher - KM & Ofy
Don Deneault	Dof A / DFM
Don Balch	Dof A / DFM
Joe Fritton	Dof A / DFM
Nancy Sargent	League Women Voters
Tracy Morris	" " " Jo Co
Nancy Jefferis	" " " Jo Co.
Ferry Nuckolls	KCC
Anne Tymeson	KCC
Andrea Crane	Columbia Group

SENATE UTILITIES COMMITTEE GUEST LIST

DATE: **February 14, 2001**

Name	Representing
Ron Gaches	GBBA
Mike Reecht	AT&T
Bill Sneed	PNM
JOHN C. BOTTENBERG	WEST. RES.
Patrick J Hurley	KCPL

TESTIMONY OF JAMES G. FLAHERTY ON BEHALF OF GREELEY GAS COMPANY A DIVISION OF ATMOS ENERGY CORPORATION BEFORE THE SENATE UTILITIES COMMITTEE IN SUPPORT OF SENATE BILL 190 DATED FEBRUARY 14, 2001

Good morning. My name is Jim Flaherty. I am an attorney from Ottawa, Kansas. I represent Greeley Gas Company before the Kansas Corporation Commission (KCC). As you have heard in the past few weeks, Greeley Gas Company is a local distribution company (LDC) that serves over 117,000 customers spread throughout Kansas. Greeley is a division of Atmos Energy Corporation of Dallas, Texas. Atmos serves over 1 million natural gas customers in 11 states.

Greeley is here this morning to support SB 190. I also have Mr. John Hack with me today who will also be testifying in support of SB 190. Mr. Hack is Director of Gas Supply Planning for Atmos and is responsible for purchasing natural gas for Greeley and the other operating divisions of Atmos. Mr. Hack will be testifying as to Atmos' success under performance- based ratemaking in Tennessee, Kentucky and Georgia.

My testimony today will address the following three questions:

- Does an LDC need to take some financial risk or responsibility for the price of natural gas it buys for its customers?

- If an LDC needs to take some financial risk or responsibility for the price of natural gas it buys for its customers, how can the current regulatory scheme be modified to achieve that goal?

- What role does the legislature play in addressing this question?

To answer questions one and three, the legislature only needs to look at what has occurred since you have been in session this year. Natural gas customers are saying LDCs need to take some financial responsibility for the price of natural gas they buy for their customers. Customers are looking directly at the legislature to answer this question.

SB 190 provides what Greeley believes is an answer to how the current regulatory scheme can be modified to make sure an LDC is financially responsible if the price of gas it buys for its customers is higher than the price other buyers are paying for gas. Although the modification contained in SB 190 is not the panacea or total answer to high natural gas prices, it will make an LDC financially responsible for the price of gas that it buys for its customers, and it will have the effect of lowering the commodity portion of the customers' bill.

As you have previously heard over the last several weeks, under the current regulatory scheme an LDC is required to file its gas supply contracts and transportation contracts with the KCC. Those gas supply and transportation contracts can be reviewed by the KCC at the time they are filed. However, normally those gas supply and transportation contracts are reviewed in an LDC rate case, sometimes years after the fact. Even when they are reviewed at the time they are filed, they are rarely pre-approved by the KCC.

Under the current regulatory scheme the LDC is allowed to recover its actual cost of gas through a monthly PGA or COGR, which is based upon estimated sales for the month multiplied by the

price the LDC pays for the gas it has bought for its customers. At the end of a 12 month period the LDC has either under-collected or over-collected its actual cost of gas, and an adjustment is made through an ACA factor that is added or subtracted over the following 12 month period.

Under the current regulatory scheme:

- if the LDC pays a price higher than what other buyers are paying for gas on a particular day or in a particular month, the LDC is normally allowed to collect that higher price from its customers, subject only to the KCC's after-the-fact prudence review in a future rate case.

- if the LDC pays a price lower than what other buyers are paying for gas on a particular day or in a particular month, the LDC is required to pass on the lower price to its customers.

- the LDC which buys gas at a price higher than what other buyers are paying for gas is treated the exact same way as the LDC which buys gas at a price lower than what other buyers are paying for gas.

The signal sent to the LDC under the current regulatory scheme is obvious. There is little financial risk or responsibility to the LDC when it comes to purchasing gas for its customers. The risk that is present is an after-the-fact prudence review which, as discussed below, provides for a regulatory scheme that restricts innovation.

SB 190 makes a simple change to the current regulatory scheme to make LDCs assume some

financial risk and responsibility for the price of gas which they buy for their customers. It provides a regulatory scheme which promotes, not restricts, innovation. Under SB 190, the LDC is still allowed to collect the cost of gas through a monthly PGA or COGR by multiplying the estimated sales by the price of gas. Under SB 190, the under-collection or over-collection of the gas costs through the 12 month period is also still carried over to the following 12 month period. That part of the current regulatory scheme remains unchanged by SB 190. What does change is that the price of gas which the LDC buys for its customers is compared with the reported price of gas that other buyers are paying for gas on the same pipeline and is also compared to the price of gas that other buyers nationally are paying for gas. The average of the published pipeline indexes and the NYMEX price of gas becomes the benchmark by which to compare how well or poorly the LDC is performing. This is done for daily, monthly and long term gas supply contracts using the various indexes or group of indexes.

The LDC will keep track as to how well or how poorly it is performing based upon what other buyers in the market are doing. At the end of a 12 month period, if the LDC has outperformed the other buyers in the market, in that the LDC was able to buy gas for its customers below the benchmark, the amount below that benchmark or savings would be shared on a 50-50 basis with the customers and the LDC's shareholders. However, at the end of the year, if the LDC has underperformed compared to the other buyers in the market, in that it was unable to buy gas for its customers at or below the benchmark, the amount above the benchmark or the additional costs would be shared on a 50-50 basis with the customers and the LDC's shareholders.

Under this simple modification to the current regulatory scheme, LDCs which buy gas for their

customers at a price higher than the benchmark are automatically penalized without the need for an after the fact prudence review. LDCs which buy gas for their customers at a price lower than the benchmark are rewarded. This type of performance-based regulation sends the proper signals to LDCs. It promotes innovation and penalizes poor performance.

A similar type of mechanism would apply to the LDC's ability to resell transportation and storage capacity to the secondary market that the LDC may not be using during non-peak days.

There is one additional question which probably needs to be addressed. Some critics to performance-based ratemaking argue LDCs should not have to be rewarded in order to buy gas for their customers at a price lower than what other buyers are paying for gas, or that there should only be a penalty side of the performance-based ratemaking mechanism. Having a performance-based mechanism which only penalizes an LDC, limits and deters innovation and proper risk taking. LDCs are not willing to take the risk of being second guessed after-the-fact for their purchasing decisions. Having a mechanism, like what we have under the current regulatory scheme, where LDCs which outperform and underperform are treated in the same manner, also sends the wrong signal. Having a performance-based mechanism which both penalizes the LDC which is underperforming and rewards the LDC which is outperforming the market will promote innovation and send the proper signal.

As you will hear from Mr. Hack, in those states where Atmos has been provided an opportunity to operate under a performance-based rate mechanism, the company has been willing to accept the financial risk and responsibility in an effort to buy gas for its customers that is lower than

what other buyers on the applicable pipeline and in the country are paying for gas.

On behalf of Greeley Gas Company, I would request that you give SB 190 favorable consideration. Thank you for the opportunity to testify this morning. I will be happy to answer any questions.

TESTIMONY OF JOHN W. HACK ON BEHALF OF GREELEY GAS COMPANY A DIVISION OF ATMOS ENERGY CORPORATION BEFORE THE SENATE UTILITIES COMMITTEE IN SUPPORT OF SENATE BILL 190 DATED FEBRUARY 12, 2001

My name is John W. Hack. My business address is 5430 LBJ Freeway, Dallas, Texas 75240. I am employed by Atmos Energy Corporation ("Atmos") as Director of Gas Supply Planning. Atmos' operating divisions serve approximately 1,100,000 gas customers in 11 states east of the Rocky Mountains. Greeley Gas Company ("Greeley") is an operating division of Atmos, which operates in Colorado, Kansas, and Missouri.

One of my principal duties is gas supply management for Atmos' Greeley division. I am responsible for all gas supply and system supply transportation arrangements involving the interstate and intrastate pipelines which deliver gas to the Greeley system. This includes pipeline capacity arrangements, gas supply acquisition planning, contract negotiations and day-to-day administration. I supervise five professional employees who assist me in assuring that Greeley is provided an economical and reliable supply of natural gas for its customers. These employees are comprised of a gas supply administrator and four gas supply analysts.

I have been employed by the Company since 1969 and have held numerous positions both with Atmos and Western Kentucky Gas (Western), another division of Atmos. During the time at Western (July, 1969 through October, 1990), I held positions of Gas Controller, Supervisor of Gas Control, Supervisor of Gas Control and Rates, Manager of Gas Rates, and Manager of Gas Supply Administration. Since transferring to Atmos, I have held the positions of Director

of Gas Supply Kentucky, Director of Interstate Gas Supply, Director of Gas Supply Operations and my current position of Director of Gas Supply Planning.

The purpose of my testimony is to share with you Atmos' experiences in operating under a Performance-Based Rate Making Mechanism (PBR) in other states.

A PBR is a rate structure intended to give financial risk and responsibility to a natural gas utility to manage its upstream commodity costs to attain additional savings for its service customers. The industry has evolved considerably from the times of long-term gas supply contracts, and has a variety of new tools available to manage costs. While these new tools provide opportunities to reduce gas costs, they also bring with them, as in any commodity market, risks and responsibilities.

Atmos Energy has PBR's in place in the following jurisdictions:

State	Atmos Division
Kentucky	Western Kentucky Gas Company
Georgia	United Cities Gas Company
Tennessee	United Cities Gas Company

The following is a brief discussion of each PBR mechanism in the order noted above:

Kentucky - Western Kentucky Gas Company ("WKG").

The PBR for WKG is structured in three major parts: Gas Commodity Savings, Transportation Costs, and Capacity Release. The PBR establishes benchmarks for WKG under each part.

The Commodity Benchmark is established using four major published indices: **1)** The NYMEX closing price for natural gas contracts for the respective month of flow, **2)** The *Inside FERC* gas market first of the month index for the appropriate pipeline, **3)** *Natural Gas Weekly* index for the appropriate pipeline, and **4)** the average of all *Gas Daily* published midpoint indices for the appropriate pipeline.

These four indices are then weighted equally to calculate a single benchmark price. This includes benchmarks for supply area and delivery area (citygate delivered gas) purchases each month. The utility's monthly purchases are then compared against the appropriate benchmark to determine any savings / costs.

The Transportation Benchmark was established by using the pipeline's FERC approved rates for each pipeline serving WKG. Any negotiated discounts which WKG could achieve would then be considered as savings against the benchmark.

The Capacity Release benchmark is based on a complicated calculation to determine NORMAL and REASONABLE capacity release annual value. Any capacity release savings which WKG can attain greater than the normal and reasonable benchmark are considered as part of the savings associated with the PBR.

The savings against benchmark for the three areas above are then totaled together, and shared 50/50 between the utility's ratepayers and its shareholders. The total annual shared savings filed for WKG since July 1998 are as follows:

July 1998 to October 1998	$1,307,456
November 1998 to October 1999	$4,948,255
November 1999 to October 2000	$2,363,530

Georgia - United Cities Gas Company ("UCG").

The PBR for UCG is structured in two major parts: Gas Commodity Savings and Capacity Release savings. The PBR establishes benchmarks for UCG under each part.

The Commodity Benchmark for UCG in Georgia is presented in two parts. First, a reasonable market priced benchmark is established by averaging the following

indices for the appropriate pipeline / supply area: *Inside FERC* gas market first of the month index and *Natural Gas Intelligence* ("NGI") first of the month index for supplies based on first of the month pricing. For daily purchases *Gas Daily* Midpoint indices for the day of purchase are averaged for the respective month. UCG must be able to achieve gas cost savings of plus or minus 2 percent (the 'deadband range' between 98 and 102 percent) before any commodity savings or costs can be shared under the PBR mechanism.

The Capacity Release component does not include a benchmark, but rather establishes a sharing percentage of 85% to the ratepayers and 15% to the shareholders.

Though UCG reflected some savings under the PBR in past years, the 'deadband' of plus or minus 2 percent coupled with higher commodity costs has reduced the reported commodity savings for the current year. The total annual shared savings filed for UCG since April 1998 are as follows:

April 1998 to March 1999	$ 241,304
April 1999 to March 2000	$ 183,169
April 2000 to November 2000	$ 85,726

<u>Tennessee - United Cities Gas Company ("UCG").</u>

The PBR for the State of Tennessee (United Cities Gas) is structured in two major parts. The benchmarks are established each month and applied to the total transactions for each month, rather than a transaction-by-transaction basis.

Gas Procurement Incentive Benchmark is based upon the following indices: a simple average of the appropriate pipeline price indices published in *Inside FERC Gas Market Report, Natural Gas Intelligence*, and NYMEX close for a particular month. Daily purchases are compared to the appropriate pipeline *Gas Daily* index for the first business day of gas flow. Long term purchases, i.e., a

term more than one month, will be adjusted for the Company's rolling three year average premiums for long term contracts. Citygate purchase prices are adjusted for the avoided transportation costs that would have been paid if the upstream capacity were purchased versus the demand charges actually paid to the Supplier.

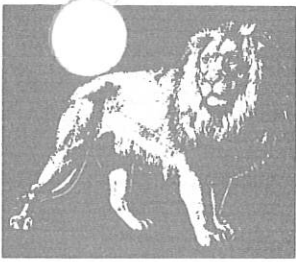
A monthly "deadband" of 97.7% to 102% of the total of the benchmark amounts is calculated. If the total commodity cost of gas in a month is within the deadband, there are no shared savings or costs. If the total commodity cost of gas is outside the deadband, the savings or costs are shared on a 50%/50% basis between the Company and the Customers.

Capacity Management Incentive Mechanism - Should there be capacity available for release, the Company has the ability to release capacity on a long term or short term basis. The proceeds are shared with the Company's customers. The Company's share is 10%, the Company's customers' share is 90%.

There is a current cap on the overall incentive savings or costs of $1.25 million annually to the company. The total annual shared savings / costs filed for UCG - Tennessee since April 1999 are as follows:

April 1999 to March 2000	$ 1,463,878
April 2000 to September 2000	$ 385,255

Thank you for the opportunity to present testimony today in support of SB 190. I Will be happy to answer any questions.



THE
COLUMBIA
GROUP
INC.

SENATE UTILITIES COMMITTEE
S.B. 190

ANDREA C. CRANE
VICE PRESIDENT
THE COLUMBIA GROUP, INC.

Thank you for the opportunity to address you today. My name is Andrea C. Crane and I am Vice President of The Columbia Group, Inc., a consulting firm that specializes in utility regulatory matters. I have worked in the utility area since 1984 and I have served as an expert witness before state utility commissions since 1989. I have testified in approximately 110 utility cases in fourteen states and the District of Columbia. I have testified several times before the Kansas Corporation Commission ("Commission"). I have been invited to present comments by the Citizens' Utility Ratepayer Board.

I am here to speak in opposition to the changes in legislation proposed in Senate Bill 190. These changes would require the Kansas Corporation Commission to allow utilities to file a performance based ratemaking ("PBR") mechanism for gas commodity costs and it specifies the indices to be used in any such filing.

Utility companies are currently charged with the obligation to provide safe and adequate utility service at just and reasonable rates. The regulatory framework is based upon the premise that in return for the right to a monopoly service territory and the right to charge rates based on a required rate of return, the utility companies will take all reasonable measures to provide service at the lowest reasonable cost. This is the quid pro quo on which regulation is based.

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Senate Utilities Committee
February 14, 2001
Attachment 3-1

aol.com

Utility rates are not based on a reimbursement system. Rates are set based on historic costs adjusted to reflect known and measurable changes. Once rates are established, utility shareholders get to keep any over-earnings that may occur. Conversely, if the utility under-earns, it has the option of requesting rate relief from the Commission.

Under the original regulatory scheme, gas costs, like all other costs incurred by the utility, were set prospectively. Utilities then had an opportunity to over-earn or under-earn based on actual market conditions and the degree to which costs were controlled. In the face of rising gas costs, the utilities claimed that including the cost of gas in base rates made it increasingly difficult for them to earn their authorized return. Accordingly, they successfully petitioned regulatory commissions to permit a dollar-for-dollar recovery of all costs incurred in the procurement of gas. To eliminate the risk to gas utilities associated with rising gas prices, regulatory commissions agreed to permit dollar-for-dollar recovery of gas costs through a purchased gas adjustment ("PGA") clause as long as the utility was prudent in its gas procurement practices. Such dollar-for-dollar recovery of prudent gas costs has been guaranteed since 1977 in Kansas.

As the result of the implementation of gas cost adjustment clauses, we evolved from setting bundled gas rates where the utility had an opportunity to earn its authorized return, to a true-up mechanism permitting dollar-for-dollar recovery for actual gas costs. The current PBR proposal would take us another step and permit the gas procurement function to serve as a profit center for the utility, where "rewards" are given for meeting what should be the inherent obligation of the utility.

One of the rationales for a PBR advanced by the local distribution companies ("LDCs") is that they are taking on risk in procuring gas since the Commission could disallow certain costs as imprudent during a review of its gas cost adjustment clause. I reject this position for two reasons. First, this argument assumes that if the utility's actions are actually imprudent, ratepayers should still be responsible for these costs. Why in the world should we permit imprudent costs to be passed on to ratepayers by monopoly franchise holders? Second, in practice, state regulatory commissions almost never disallow gas purchases as imprudent. The practice of most regulatory commissions is to give the benefit of the doubt to the utility when determining if a particular gas purchase was prudent. I am unaware of any circumstances in Kansas whereby the Commission has actually disallowed gas procurement costs on the basis of imprudence.

Another argument often made by utilities is that under a PBR mechanism, ratepayers are assured of a competitive gas price and that benefits of competition will automatically flow to them. However, this is already true under current regulation. The LDCs are currently making their gas purchases in a competitive market and passing those actual costs on through the PGA. Therefore, ratepayers are already receiving the benefit of a competitive wholesale gas market. There is no need to introduce a PBR in order to provide competitive benefits to ratepayers.

Another objection that I have to the PBR legislation is that it is voluntary in nature, meaning that the LDCs that choose to participate will be those who stand to benefit from it at the expense of the ratepayers. This benefit arises from the ability of certain LDCs to consistently beat the market price or index. It seems likely that the utilities that cannot beat the index will simply not file a PBR and that companies that can

beat the index will take advantage of the opportunity to increase their earnings under the PBR.

A further concern that I want to bring to your attention is the proposed indices contained in the bill. The bill specifies that Gas Daily indices be used as the benchmarks for daily gas purchases, while seasonal and monthly purchases would be based on a simple average of Inside FERC's Gas Market Report, published by McGraw Hill, Natural Gas Intelligence, and NYMEX indices. There is no support, however, for the use of these indices. We do not know how the utilities are currently performing relative to these indices nor do we know the extent to which these indices reflect a realistic market price target for the gas utilities in Kansas. The use of these indices is similar to saying that the Prime Lending Rate is all that an observer needs to know about the market rate of interest. A given company may know that its costs tend to be the Prime Rate minus a point, while another knows its costs are Prime plus two points. Likewise, a large LDC may know its costs tend to be 2% below the market indices.

While these indices may be beneficial in providing some general knowledge about gas prices and general trends in the gas markets, it does not follow that they have validity for ratemaking purposes. Another concern is that using the indices as ratemaking tools may itself cause changes in purchasing behavior that will influence the index. For example, the use of different indices could have the impact of providing an incentive to move the utility toward a long or short-term purchasing strategy that will allow it to beat the index by the greatest amount, when in fact the utility should be pursuing a purchasing strategy that will result in the lowest overall cost for ratepayers.

The most serious flaw with the use of these indices is that we do not know how the Kansas LDCs have performed in the past relative to these indices. As previously discussed, if gas utilities are taking seriously their obligations to provide safe and adequate service at the lowest reasonable cost, then there should be no difference in purchasing behavior once a PBR mechanism is adopted. The basic assumption inherent in the legislation is that the LDCs will do a better job purchasing gas under a PBR mechanism and that ratepayers will share in some of these benefits. However, since we do not know how current purchases compare with the indices, neither the Commission nor the Legislature will ever be able to evaluate the ultimate impact of a PBR mechanism on ratepayers.

For long-term contracts, the proposed legislation requires an adjustment based on a "utility's rolling three-year average premium paid to ensure long-term supply availability during peak periods." Assuming that purchasing behavior can be influenced by incentives, the use of a three-year rolling average premium would actually provide a disincentive for the utilities to reduce the costs of these longer-term contracts. Moreover, it has not been definitively demonstrated that any premium exists for long-term contracts and in fact there is inconclusive data on this issue.

The current regulatory system allocates 100% of the gains or losses versus market prices to ratepayers because the PGA clause simply passes the actual cost of gas on to consumers. This system protects consumers from paying in excess of cost for their gas supply. The proposed system will require them to pay cost-plus for the gas delivered to them. This occurs because the market index price has been set without an understanding of the historic purchase performance of the LDCs versus the index, and the voluntary

nature of the program makes it likely that only LDCs that can beat the index will participate in the PBR program. Therefore, consumers will pay the cost of the gas, plus a premium equal to 50% of the difference between the actual cost of the gas and some poorly understood index.

The proposed legislation also diminishes consumer protections with respect to affiliated interest transactions. The proposed legislation provides an incentive for LDCs to pay higher prices to affiliates because it provides that 50% of the excess cost will be borne by ratepayers via the sharing mechanism. Further, these contracts will not be subject to regulatory review or to a competitive bidding process. In fact, there is no limit on the amount that an LDC could pay to an affiliate for gas under a PBR mechanism. This is especially troublesome since ratepayers will be responsible for paying 50% of the cost above the index and this transaction will not be subject to any Commission oversight or review. This is a major diminishment in consumer protection versus the current system which does provide for the review of such contracts, even if such reviews do not ordinarily occur. The possibility that a review could occur is in itself a powerful consumer protection that would be eliminated under a PBR mechanism.

The proposed legislation also provides for a sharing of net incentive benefits related to the marketing of off-peak, unutilized transportation and storage capacity on upstream pipelines in the secondary market. However, ratepayers are paying 100% of the costs for firm transportation and storage capacity on these pipelines. Under this bill, they would pay 100% of the costs of these facilities but would receive only half of the benefits if unutilized transportation and storage were sold to third parties. This is clearly a bad deal for ratepayers and it is patently unfair.

The bill is also potentially flawed with regard to financial instruments. With regard to financial instruments, the bill states that "any savings or costs will flow through the commodity cost component of the gas procurement incentive mechanism." However, it does not state whether "costs" relate solely to net purchases above market (i.e. negative savings) or if "costs" also include the actual amount paid for the financial instrument. If the former, then ratepayers could bear 100% of the costs for the underlying financial instrument while receiving only 50% of any resulting savings. If any savings resulting from financial instruments is to be shared with shareholders, then shareholders should also bear a portion of any costs for financial instruments associated with gas costs.

Even if one disagrees with my position that a PBR mechanism should be unnecessary under the current regulatory framework, there is still no benefit to the proposed legislation. The Commission already has the ability to approve and implement a PBR if it finds that such a mechanism is in the public interest. In fact, a PBR was first conditionally approved by the Commission in January 1997 for United Cities Gas Company, although that company later withdrew its request for a PBR.

Subsequent to that case, the Commission initiated another docket to review the issues that are the subject of the proposed legislation. In its Order in Docket No. 00-GIMG-425-GIG, issued November 1, 2000, the Commission found deficiencies in some of the same proposals that are the subject of this legislation. For example, the Commission found serious flaws with the indices that were proposed in that case, finding that utilities had failed to demonstrate that the use of these indices would result in net benefits to ratepayers. While the Commission acknowledged that some witnesses in that case believed that there was some justification for the benchmarks, the Commission's

Order goes on to state that "These witnesses also agreed that the validity of the proposed benchmarks was uncertain and that they may have to be adjusted over time as more information is developed on the performance of LDCs as compared to index prices." The indices in the proposed legislation are similar to those reviewed by the Commission. However, the legislation does not provide any flexibility for adjustment should these indices prove to be unreasonable.

The Commission's Order in Docket No. 00-GIMG-425-GIG does permit LDCs to file for a PBR. But it reserves for further review the reasonableness of the specific indices that may be proposed by an LDC, finding that:

> ...the applicable pipeline indices or surrogate pipeline indices are to be determined in the separate tariff filing made by utilities choosing to participate in the program. The relationship of the approved contract price range to the indices will also be determined in the tariff filing. As part of this review, the Commission requires utilities making pilot program tariff filings to provide specific historical pricing data for the utility and to make a comparison of that data with the particular indices proposed by the utility.

The Commission's Order appropriately recognizes that information on historic purchasing practices is critical in order to select an appropriate benchmark and to evaluate the effectiveness of any PBR program. The proposed legislation fails to provide for this important review.

In its Order in Docket No. 00-GIMG-425-GIG, the Commission also required competitive bidding for all long-term and seasonal gas supply contracts. Competitive bidding would not be required if the proposed legislation is adopted. The elimination of a competitive bidding requirement is especially troublesome when significant amounts of gas are being procured from affiliates.

Under the current purchased gas adjustment mechanism for recovery of gas costs, all prudently-incurred costs are recovered by the utility. While the Commission has indicated that it is difficult to review all gas supply contracts, it does not follow that this responsibility should be relinquished and instead replaced with a PBR mechanism. A review of current gas supply contracts could be undertaken by using sampling techniques to choose selected contracts for review, particularly contracts with affiliates since the LDCs have a greater incentive to pay higher prices to their affiliates than to third-party suppliers. Alternatively, published indices could be used as informal benchmarks to determine which contracts should be reviewed in greater detail.

However, even if the legislature believes that a PBR mechanism is warranted, the proposed legislation is unnecessary. The Commission has a process for reviewing and implementing PBR mechanisms for gas commodity costs. It has directed significant resources toward a review of this issue and its Order recognizes that there are certain flaws in the adoption of specific benchmarks that have not yet been resolved. The procedures outlined in the Commission's Order provide some protection to ratepayers that is lacking in the proposed legislation, such as requiring utilities to provide historic cost information and to justify the use of a specific index. The Commission's Order also provides some protection against subsidies to affiliates by requiring competitive bidding in the case of seasonal and monthly contracts.

This proposed bill will eliminate current consumer protections and will transfer the purchasing function, a function integral to the utility service being provided by the LDC, into a profit center at ratepayer expense. Moreover, this legislation is being proposed at a time when we are experiencing record-high gas prices. I urge the

Legislature to maintain the status quo and to reject the proposed bill. The Kansas Corporation Commission has already adopted a process for utilities to file for a PBR. The utilities should not be permitted to circumvent the jurisdiction of the Commission by proposing legislation based on concepts that the Commission has already found to be flawed. Thank you for your consideration.

BEFORE THE SENATE UTILITIES COMMITTEE
PRESENTATION OF THE
KANSAS CORPORATION COMMISSION
FEBRUARY 14, 2001
REGARDING SB 190

Thank you Chairman Clark and members of the committee. I am Joe White, Director of the Utilities Division of the Kansas Corporation Commission (KCC).

I am here today representing the KCC in opposition to SB 190. We find SB 190 unnecessary and adverse to the Commission's goal in developing policies and procedures which reflect the current natural gas purchasing practices of the Kansas Local Distribution Companies (LDCs).

In the Commission's Order in Docket No. 00-GIMG-425-GIG, November 1, 2000, the Commission allowed for LDCs to make application for Performance Based Rate (PBR) mechanisms. This is consistent with actions already taken and currently being reviewed in several other state regulatory Commissions. The PBR was specifically designed as a pilot program as part of the continuing review of the Purchased Gas Adjustment process currently being conducted by the KCC. The PBR was not intended to be mandatory for all LDCs, nor did the Commission feel it appropriate to codify certain indexes or benchmarks. It was determined that each LDC would make application based on its own purchasing demographics and with proper indexes and benchmarks established to reflect the LDCs operations. More importantly, reporting and filing guidelines would be established to properly evaluate the pilot program and the purchasing practices of the applicant LDC.

We feel SB 190 may be an attempt by some LDCs to usurp the Commission's authority to establish meaningful indexes and benchmarks and to avoid important reporting procedures which were established in the Stipulation and Agreement in Docket No. 00-GIMG-425-GIG signed by both staff and the LDCs.

The Commission is in the process of reviewing general policies with regard to Purchased Natural Gas, Fuel for Electric Power Generation, and Purchased Electric Power in Docket No. 106,850-U. PBRs are just a part of several solutions.

We feel it is better public policy to leave the issues addressed in SB 112 and SB 190 in the regulatory arena. This allows for evaluations to be made and rules and regulations established which will avoid unnecessary workload, allow for proper review and create the flexibility needed to analyze the costs to be passed through from a deregulated market. The Commission is very serious about its responsibility to establish procedures and policies that relate to this new deregulated market and to render decisions consistent with our overall regulatory objectives.

Thank you.