COMMONWEALTH OF KENTUCKY
BEFORE THE KENTUCKY PUBLIC SERVICE COMMISSION

Informal Public Meeting to Discuss Natural Gas Unbundling in Kentucky: Exploring the Next Step Toward Customer Choice.

Opening Comments of Western Kentucky Gas Company,
a division of Atmos Energy Corporation ("Western")

INTRODUCTION

Western very much appreciates the opportunity to respond to the Commission's invitation to participate in these informal discussions. Mr. Ralph Dennis has articulated the various issues clearly and thoughtfully. His comprehensive coverage of the positions held by each stakeholder regarding customer choice is timely, informative, and appreciated by Western.

Pursuant to the Commission's request, comments are herewith tendered in the spirit of constructive dialogue. Western offers a brief review of its unbundling experience in Kentucky; its general position on the concept of customer choice; comments on the issues specifically identified in Staff's report; and, comments on the questions raised in Staff's letter dated August 8, 1997, regarding the direction the Commission should take if it decides to pursue unbundling and residential customer choice.

Historical Overview

Western first offered transport options over ten years ago. Today over 50% of Western's throughput is transport. During the past ten years, Western has taken care to structure its transport program to protect the interests of non-participating customers and believes that a residential/small commercial customer choice program involves significant new challenges and costs. Additionally, Western has discussed internally plans to lower the volumetric qualification for transportation as a measured approach towards complete open access. As it relates to residential customer choice, Western's current customer information system is inadequate to handle mass transportation transactions. However, we are in the process of acquiring and installing a new customer information system (CIS), which with some modifications should be capable of facilitating a residential transport program.

Western's General Position on Customer Choice

Greater competition in the natural gas business, like the competition which resulted from the deregulation of other industries, is being pushed forward by economics, technology, and to some degree by customer expectation. Western believes that in order to continue to successfully compete in the marketplace, it must turn the challenges of increased competition into opportunities and take action to meet new competitive initiatives head on.

Western has already begun to take action. In March of 1997, Western announced a 12-month plan to enhance the quality of its customer service to better meet customer needs and to prepare the company to meet future changes in the utility industry. The plan included several fundamental steps. Beginning in 1997, the company will create a network of payment centers through an arrangement with a national vendor at grocery stores, convenience stores, and other locations in towns where Western currently has offices. These payment centers will offer extended hours and a convenient place for customers to pay their bills. Following the opening of the payment centers; the local business offices will no longer take over the counter payments or handle routine walk-in customer transactions. The local offices will focus on field operation such as service calls, maintenance, and construction activities. Western also is currently in the process of restructuring its operation through consolidation of its field operation in preparation to meet the demands and expectations of its customers in what is expected to be an increasingly competitive marketplace. Even though some consolidation will occur, Western will continue to keep a strong presence in the communities it serves by continuing to focus on working with local government officials, chambers of commerce, economic development boards, and other entities to help the communities grow. Western recognizes the industry is changing swiftly and as a result is in the process of acquiring and installing a new customer information system, which with modification should even be capable of facilitating a comprehensive residential transportation unbundling program. This conversion process will take a minimum of several years. Currently, Western's customer information system is inadequate to handle such a program. It was designed to handle customer service information in the same manner generally that all LDCs handled this type of information prior to the concept of residential customer choice. In spite of this drawback, Western favors customer choice with qualifications. We are concerned about the issues that relate to system reliability, service administration, and economy.

Unbundling programs must be designed in a way that will: (1) bring tangible benefits to those participating in the program and not disrupt or threaten residential gas service; (2) the benefits must not be at the expense of other system users; (3) such a program should be flexible in order to recognize not only the difference between LDC service areas, but also the difference in customers' attitudes towards energy usage. Western agrees that a "one size fits all" approach to residential unbundling programs would ignore the many differences between Kentucky LDCs; (4) programs at this time should be optional for LDCs. Western does not object to other Kentucky LDC's participating in such programs after appropriate approval has been received; and (5) will allow recovery of stranded costs related to the changes in the natural gas distribution business which result from unbundling and customer choice programs must be recovered from system participants.

Issues Identified in the Report (in the order they appeared)

A. Whether residential unbundling is in the public interest.

Western's position is a qualified maybe. Choice has value in itself. But there may be more financial cost than benefit. Small customer demand for gas supplier choices is not clearly evident. Some significant technology / administrative problems need to be resolved first. Lower income customers may be worse off as a result of customer choice.

B. How will a residential transport program benefit the customer?

Western foresees no clear economic benefit. Transaction and commodity costs are low now with most gas cost prices tied to index market rates. Commodity cost savings for residential customers are not obvious. In fact, transaction costs may possibly increase as a result of the creation of "middlemen" adding fees for brokering services or re-packaging of existing services.

C. What should be the manner and pace of residential unbundling?

Western believes that the Commission or the Legislature if deemed necessary should develop flexible policy statements on unbundling after considering all stakeholders' interests. Individual LDCs should be free to propose and implement company specific programs on a case by case basis. The Commission should confirm that benefits exceed costs before imposing mandatory unbundling. In any event, all unbundling and customer choice programs should be phased in to allow work to continue on issues which will arise as a result of the industry changes. We do not oppose the choice by a LDC to exit the merchant function. LDCs must be allowed to make this strategic choice given the capital they have at risk. We believe that our residential customers should have this option of choice. We believe that many customers may not want to choose between a number of competing gas suppliers. The pace by which the option of choice is offered to residential customers should be determined between the LDC and the Commission on a company-by-company basis so that the unique circumstances of each LDC can be examined. In this regard one size will not fit all LDCs. Any unbundling by a date certain should be mutually set between the LDC and the Commission.

D. How should LDC's gas cost be reviewed?

Assuming that the merchant function is still in place after unbundling (which it should be optional), Western believes the current procedures are adequate and efficient. Increased regulatory burdens would be movement in the wrong direction and could add new expenses.

E. Do incentive programs have value?

Western believes that incentive programs have value as an option to traditional gas cost oversight. Risk and reward opportunities should be symmetrical. One of Atmos Energy Corporation's other operating divisions, United Cities Gas Company, is actively involved in two important, experimental performance based regulation (PBR) programs. In both Tennessee and Georgia we have implemented experimental programs examining the benefits of measuring the performance of our gas procurement and capacity management functions in relation to the market. To the extent that we are able to acquire gas supplies below the market price, as measured by external price indices, shareholders are allowed to retain a portion of that saving to encourage performance. The Tennessee PBR experiment has recently concluded and achieved all of the program's objectives. This result was confirmed by a study by an independent consultant hired by the Tennessee Regulatory Authority (TRA). Substantial savings were passed onto customers and a similar program has been initiated by, another Tennessee LDC, Piedmont Natural Gas. We now have a filing before the Tennessee Regulatory Authority to make our program permanent. We believe that a PBR applicable to gas costs can be an effective program in keeping down the costs of gas to ratepayers. PBR can also be used in an unbundled environment to encourage gas utilities to keep their distribution costs as low as possible. The Georgia legislation mandated that a LDC electing to unbundle would implement a PBR on its non-gas costs of service ('pipes' business). The legislation also promoted the use of PBR for companies not electing to unbundle as well.

F. Are incentive programs a substitute for unbundling?

It is Western's belief that incentive programs are not direct substitutes. Both are intended to improve results but incentive programs applicable to those LDCs that want to maintain merchant service, lack the element of choice.

G. Are marketing affiliate guidelines needed?

Western has maintained a marketing affiliate and an open transportation program for a decade and therefore we believe that with the exception of a complaint procedure, which the Commission could adopt through a rulemaking, specific guidelines are not needed at this time.

H. Will lower gas cost result from a residential customer choice ("RCC") program?

Competition as a principle is supposed to lower prices. Marketers are able to use financial tools, which may not be available to LDCs under current regulatory requirements. However, there is no clear evidence to suggest gas cost will be lower on a continuing basis for low volume residential users.

I. If gas cost is not lower, is "choice' alone justification for unbundling?

If the customer perceives that there is value because of choice then there is that undetermined value. If a customer believes there is benefit in having many choices as to how the bill is structured or guaranteed, then there is that undetermined value. Western believes there will be added costs, administrative burdens, potential customer confusion, and reliability risks. If gas commodity unbundling is simply a piece of a larger trend of unbundling individual services (gas, cable, electricity, home security) to be rebundled by marketers, that trend should be allowed to mature before the PSC requires, if it would, disassembly of reliable, economical and understandable procedures for providing an essential service to the public.

J. Will customer choice add another layer of administrative cost?

Western believes it will. Also it may adversely affect reliability and customer satisfaction.

K. Will only marketers benefit from unbundling?

Western believes marketers will be a principal beneficiary. Also pipelines may also benefit as a result of being more efficient with capacity. Unfortunately, most customers will not be able to tell whether they are better off or not.

L. Will reliability be impaired?

Western supports the principle of supplier responsibility. Certification and demonstration of financial reliability are important first steps to underwriting gas system reliability. Financial safety features like irrevocable letters of credit, cash deposits, or performance bonds coupled with non-monetary penalties like revocation of contracts for nonperformance should assist in preventing service standards from being compromised through unbundling. Western believes that it must retain sole authority to perform interruption of services to ensure service to firm residential ('essential use') customers. Absent these measures, Western believes reliability may be impaired. As a result of implementing these measures reliability costs could increase in order to protect against interruptions.

M. Identify LDC service elements that can be provided by alternative suppliers.

Western believes only the gas commodity should be unbundled initially. Other components, such as billing, peaking, stand-by, meter reading, or rebundling can be developed later but may involve additional stranded costs. These services could be regulated during a transition period during which marketers may evaluate the benefits of LDC services. Eventually, the marketer should be able to choose whether or not he wants to continue to utilize the services offered by the LDC. To the extent that the LDC has incurred costs to accommodate unbundling on its system, the LDC should be assured recovery of any prudently incurred costs which have been stranded by migration of marketers off the system of the LDC (e.g., CIS or billing).

N. Are there lower cost suppliers that would participate in unbundling?

There are a multitude of suppliers all around the country. Some may be lower cost gas providers and some may be higher. Marketers have traditionally participated in high load factor markets and may not choose to participate in low load factor residential markets. Clearly, industrial customers have achieved economic benefits as a direct result of unbundling their transport and merchant services. Hopefully, all customers will benefit from competition in the natural gas industry. The means to that end, however, may be very different among LDCs. The Commission is aware of the differences in service requirements of industrial versus residential/small commercial customers. We view with caution broad statements that all customers will achieve the same successful unbundling experiences that industrial customers enjoy. We are not certain that the benefits of unbundling to our small volume customers outweigh the risks. Western is currently unaware of any marketers that are lower gas cost providers. Our supply bidding process is competitively driven to produce the lowest cost.

O. Would unbundling create greater choice from increased service options?

Western does not believe increased service options will result but does not rule out the possibility. Residential customers need a specific product: affordable, reliable energy primarily for heat. Unbundling into pieces that have to be reassembled to produce that product may not create meaningfully different choices.

P. Will unbundling foster technology improvements?

It is possible that gas measurement technology will improve, but at a cost. It is unlikely that residential customers would ever need real time metering, though. Unfortunately, unbundling on the interstate systems has greatly diminished the financial support of the Gas Research Institute. Therefore technology improvements may take a back seat as a result of unbundling.

Q. Are pilot programs appropriate?

Recognizing that customer choice is a growing issue, we see pilot programs as a preferred option to mandates. One important benefit of a pilot is the knowledge and experience gained in managing our own systems and customer processes in an unbundled environment. A pilot will also be a beneficial educational exercise for customers. To date, we have not participated in a small customer unbundling pilot. Given the complexity of the changes inherent with unbundling, a pilot program may be the best option for us at this time. Pilot programs not only have an appropriate function as an affordable learning vehicle, but also are easier to "unwind" if not successful.

R. Should the LDC be the supplier of last resort?

The issue of standby service capability is an important one. Western believes that the marketer takes on the 'obligation to serve' a customer by virtue of the elective contract entered into between the customer and the marketer. The role of the gas utility would be to facilitate that choice by establishing systems allowing delivery of service. The LDC may or may not be the supplier of last resort and should not be forced to assume this role without proper compensation. However as a practical matter, short of a system failure, the LDC must physically provide gas to residential customers whose supplier fails, abandons or rejects providing service on demand. If this service is regulated, the LDC should be fully compensated by the non-performing supplier or their customers on a "for profit" basis. If an unregulated supplier were providing this service, it would not be doing it on a non-profit basis. This service should be treated like any other service. If the utility is mandated to function as a supplier of last resort and must commit to new supplier contracts and pipeline capacity to perform this function, the costs should be recovered from marketers on the system.

S. Should customers be able to jump back and forth between the LDC and the marketers?

Only if the customer pays for the ability.

T. Who should ensure the collection of state and local taxes?

Western realizes that this is more likely a legislative issue. However, except to the extent legally required, the LDC should not be forced to be the only tax collector. We believe that the current tax structures applicable to the bundled merchant service provided by LDCs are not fully applicable to suppliers of merchant-only service. The consequence is an unfair advantage to the marketer, a burden to the LDC's merchant customers and injury to state and local government revenue collections. The Commission should evaluate the extent to which ratepayers and taxing authorities are impacted by industry restructuring. It may be that legislation, which establishes a Btu consumption tax, in lieu of sales taxes, is appropriate to ensure that marketers share in this responsibility. Each unbundled service provider should be individually responsible for compliance with tax obligations, which ultimately belongs to the customer.

U. How should stranded costs be dealt with?

All prudently incurred costs should be recoverable. Stranded costs should be minimized to the fullest extent possible through assignment to the substitute merchant or liquidation, and dependent upon rate design stranded costs would be minimized. For example, under a straight-fixed variable (SFV) cost assignment, upstream assets as well as distribution assets might be fully assigned. SFV aside, there is still the possibility that upstream capacity contracted by LDCs could be at risk if marketers are not required to accept an assignment of those assets. To the extent which we are required to change our CIS systems to accommodate unbundling and billing for marketers, we could also incur some stranded costs if marketers choose to directly bill end users. Stranded costs will be company-specific and may not lend themselves well to generalization between companies. Any stranded costs should be properly supported by identifying the facilities and associated costs. The LDC should also identify those conditions, which have changed which may create a legitimate need for supplemental mechanisms for recovery of costs incurred under changed but previously valid assumptions and social contract obligations.

V. How should customer education be achieved?

The LDC along with the PSC and other affected stakeholders should assure sufficient time and information is allowed to give consumers a basis to make informed choices. The cost should be recovered from customers as part of the program perhaps as a surcharge to all system users.

W. Should LDCs be allowed to remove their gas purchases from the Gas Cost Adjustment (GCA) mechanism if commodity sales are unbundled on their system?

This would serve as an incentive for LDCs to remain in the commodity sales business because it would allow LDCs to compete more effectively with marketers by reducing or eliminating the wait on regulatory lag to change costs (prices). If LDCs are to remain in the commodity sales business, they should have a GCA mechanism available. However, as stated above, it is proper to have this mechanism subject to an incentive program.

X. Should the line extension regulation requiring LDCs to provide each prospective customer 100 feet of main without change be eliminated?

No, but it should be reviewed in light of the change in the industry should unbundling become a reality in Kentucky.

Y. Should customer choice programs allow competition between LDCs?

Yes, for the gas commodity. Western believes that duplicative facilities would be wasteful and it is doubtful the customer would realize any savings. On the commodity side, if customers are free to choose any gas supplier, why would an LDC be excluded from the sale of the commodity.

Z. Should LDCs be required to exit the merchant function?

No. LDCs that wish to compete with marketers in the merchant function should not be prohibited. Western plans to remain in the merchant function at this time. We are not opposed to customer choice, and therefore we believe that customers should be provided with the choice to purchase a bundled product. At present, we see no discernible trend among customers advocating the more complicated service structure which further unbundling will produce. Not all customers want to put up with the disruptions and inconvenience of telemarketing, which have become staples of competition in the telecommunications industry. We support the right of the LDC to exit the merchant function if it chooses.

AA. Should marketers be required to conform to a code of conduct as a prerequisite to being allowed to participate in a customer choice program?

Yes, this would assist in preserving system reliability. Marketers should be subject to certification based on technical and financial standards. If established by the Commission rather than the LDC, the Commission should promulgate rules which require a marketer to apply for certification and which state the criteria to be used in determining an applicant's capabilities. The extent to which a marketer must assume responsibility for obligations formerly performed by the utility, the Commission should determine the depth of marketer certification standards. The criteria should seek to ensure the same reliability and high quality of gas service provided to customers, without imposing unnecessary barriers to market entry. These standards could be similar to those established by the pipelines following FERC Order 636. Marketers should demonstrate financial acceptability to the pipeline. The Commission should place its primary rulemaking emphasis on certifying only the most reputable marketers and oversight necessary to monitor and discipline nonperformance. With respect to Commission oversight, marketers should not be able to refuse service to any customer applying for new service. All marketers should also be under a continuous obligation to advise the Commission in advance of or upon immediate knowledge of any change in financial capabilities, which would substantially degrade its ability to meet its firm service obligations. The Commission could adopt rules prohibiting a marketer with a history of legal violations or which has falsified information on its application. The Commission should establish application fees and other fees as necessary to recover its ongoing costs of regulating marketers if it takes this approach.

BB. Should marketers like LDCs be required to publish their residential rates?

No. Companies should not be required to publish rates that are part of an unregulated service.

CC. Should all stakeholders in a customer choice program be required to participate in a statewide universal service fund?

It will be very difficult, on the one hand, to initiate a pro-competitive policy whereby price becomes a major feature contested between service providers and, on the other hand, dictate price ceilings to ensure 'affordability'. A reasonable expectation of a pro-competitive policy should be that prices will be no less affordable than they are today. If so, then new, low-income programs would not seem appropriate. The Commission should maximize the chances of success of a pro-competitive policy by not burdening it with subsidies. If government intends to establish standards of service affordability, it should do so outside the regulation of utilities. Any social program should be administered by government not utilities or marketers. A more important question may be the issue of how will the Commission address serving those customers that are less desirable to serve because of poor credit or nonpayment? In this regard, when customers lose the valuable protection of regulatory oversight, unbundling may very well impair progress to achieve broad access to an efficient and cost effective energy source. We would encourage the Commission to look at establishing a fund for high-risk customers supported by the contributions of all stakeholders to ensure its success. Certainly no competitor should be able to escape participation in such a program. The utility can perform this administrative service for profit for all gas marketers to ensure customers do not escape their debts by just switching their account to another marketer. If competition is to exist fairly in this industry, the tax avoidance break enjoyed by unregulated marketers today must be eliminated.

DD. Should "human needs" customers be allowed to choose interruptible service over firm service?

Certain "human needs" customers such as schools could benefit by cheaper interruptible service. Each "human needs" issue should be dealt with on a case-by-case basis.

EE. Are consumers likely to be less protected from fraud if gas suppliers are no longer regulated as a result of customer choice programs?

Absent supplier certification measures, yes. The greater the extent to which the Commission can ensure that the most reputable gas suppliers are certified, the more likely that gas suppliers will not fail its obligation to the customer. Some form of oversight either directly by the Commission or through the LDC should lessen the opportunities for customer fraud by a gas supplier. At a minimum the oversight responsibility should be focused on the following: firm gas supply performance, establishing minimum hours of service for customers contacts, connections, switching and disconnection requirements and moratoriums, complaint or dispute handling procedures, emergency reporting procedures, and, 'slamming' prohibitions. A set of 'slamming' rules could be based on those established for the telephone industry. Western encourages the Commission to avoid requiring the LDC to act as a policeman in this regard, unless the LDC is fully compensated for providing this service. Western believes an orderly transition from the "status quo" to residential unbundling is very necessary. Pilot programs are Westerns chosen transition vehicle at this time. Western believes pilot programs and orderly transition go hand in hand.

FF. Would incentives to LDCs, in lieu of further unbundling, be appropriate if a sharing with ratepayers mechanism was used?

Western is open to the performance based ratemaking concept. Please see our response to Question E.

GG. Should all utilities' customers (electric and gas) be used to fund state conservation and DSM programs?

Western is currently in the first year of a three-year DSM pilot program designed for low-income customers. Western believes that if a universal service fund is created as a result of customer choice, energy conservation and DSM programs could be funded by the same mechanism because inefficient energy utilization should be of concern to every stakeholder.

HH. Who should maintain operation and control of the LDC system?

Western believes the LDC is responsible for assuring that gas supplies, if delivered to the city gate, is redelivered to the customer in a safe manner. The important issue is that the LDC's capacity should transfer with the customer not the supplier.

II. Should LDCs have the right to access another shipper's gas during a time of "need"?

Yes, the term "need" must be specifically defined to include system reliability issues. Western does not support the adoption of a "buyer beware" philosophy if a life-threatening situation arose as a result of a customer choice failure.

JJ. What is Western's position on disconnection in an unbundled environment?

This function should remain with the LDC. Western will follow the Commission's rules on service disconnection as detailed in its tariff on file with the Commission.

KK. Should the terms and conditions of Western's transportation tariff be changed to allow small commercial customers who have the ability to arrange for their own supply?

Western is currently evaluating lowering the minimum volumetric requirement and aggregation of accounts for small commercial customer to allow choice of gas suppliers.

Comments on the Staff Letter of August 8, 1997

Pursuant to the Staff's letter of August 8, 1997, Western believes that the Commission already has the necessary enabling legislation it needs to pursue further the issue of unbundling and residential customer choice. However, if the Commission wishes to begin to regulate non-utility natural gas suppliers, a legislative extension of the commission's authority may be needed. It is questionable as to whether or not gas suppliers fit the definition of a gas utility as defined in KRS 278.010 (3)(b) and (c); a common carrier as defined in KRS 278.470; or an intrastate pipeline or local distribution company, as defined in KRS 278.504 (1)(2) and (3).

With the exception of legislative action necessary for taxes, Western's position is that an administrative docket is not necessary except or unless the Commission envisions adopting rules that would serve as guidelines, vis-a-vie the Commission's rules for implementing an integrated resource plan / demand-side management program to achieve approval of any unbundling or customer choice program. If this is the case, Western believes a rulemaking administrative docket is premature. Given the fact that currently there seems to be no demand by Kentucky residential customers to choose their gas suppliers, Western believes the Commission has the time to study unbundling and customer choice programs if and when they are filed by LDCs. The Commission thereby retains its flexibility to decide whether or not or how to allow a LDC to implement a particular program. Western favors a cautious approach by the Commission with regard to unbundling and customer choice rulemaking. Any rulemaking at this time would be a large, resource intensive undertaking, which would require several months to complete. Western believes that complete unbundling and total residential customer choice might take several years to implement. Western is already evaluating a plan to lower its volumetric qualification for transportation as a means to expand the development of open access on its system. At the present, Western has no plans to exit the natural gas merchant function.

Conclusion

Western supports the concept of customer choice, but believes it should be limited initially to voluntary, gas commodity only, pilot programs. The Commission should review these programs on a case-by-case basis.

If this Commission immediately decided that all residential and small commercial customers could receive significant benefits through unbundling and, therefore, required all LDCs to unbundle their systems today, Western could not comply at least for a period of several years. Our current customer information system does not presently have the flexibility to handle greatly expanded "unbundled transportation" service. The current system, although very efficient for its present use, was not designed to accommodate an extensive business process change such at this. However, we are working very hard to perform and compete in a marketplace, with an emphasis on customer choice, in the near future through our enhanced customer service initiatives.