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August 18, 1997

Mr. Ralph Dennis
Staff Assistant
Kentucky Public Service Commission
730 Schenkel Lane
Frankfort, KY 40602

Dear Ralph:

Enron Capital & Trade Resource Corp. (Enron) appreciates the opportunity to provide comments regarding the report entitled Natural Gas Unbundling in Kentucky: Exploring the Next Step.

As an independent marketer Enron is comprised of a number of business entities which are subsidiaries of Enron Corp. In the natural gas industry Enron's activities include buying and selling gas in North America, procedures, supplying gas to LDC's and municipalities, industrial, commercial and residential end users, electric generation loads, and other consumers, as well as offering price hedging and risk management services. Needless to say, Enron is very interested and wishes to be an active participant in "exploring the next step" in Kentucky.

Mr. Ralph Dennis
August 18, 1997
Page Two

In addition to attending the public meeting on August 22, 1997, Enron submits the attached comments for your review. If you should have any questions about the aforementioned information prior to the meeting, please give me a call.

Respectfully yours,

Becky L. Merola
Manager, Government Affairs
ENRON CORP.
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ENRON CAPITAL & TRADE RESOURCES CORP.
GAS UNBUNDLING COMMENTS
KENTUCKY PUBLIC SERVICE COMMISSION

August 18, 1997

Enron Capital & Trade Resources Corp. (Enron) offers these comments to the Kentucky Public Service Commission (Commission) in advance of the August 22, 1997 public meeting in Frankfort. As an initial matter, Enron commends the Commission for "Exploring the Next Step Towards Customer Choice." It is appropriate that the Commission and interested parties evaluate the regulatory status of the gas industry in Kentucky and for the Commission to provide its LDCs with leadership and vision. The following represents Enron's comments and recommendations relating to major gas unbundling issue areas. Enron expects many more issues will arise during the public meeting and Enron looks forward to exploring those issues with the Commission and interested parties as they arise.

LDC Services Must Be Unbundled

Enron supports the establishment of rates, terms and conditions of transportation service that will enable all consumers in the state of Kentucky to choose their gas supplier. LDCs must be required by the Commission to offer, on an unbundled basis, the various service components which historically have comprised bundled sales service. These unbundled services should include transportation, gas supply, storage, billing, balancing, back up service, emergency service, metering and any other service component which could be offered on an a la carte basis to customers. This unbundling process will bring greater efficiencies to the market as customers select only those services they require and service providers will increasingly develop products demanded by the market. The purpose of competition is to allow a robust marketplace to have its varying needs met by the offering of numerous service choices by numerous service providers. Since bundled sales service is the only service option for many Kentucky consumers, obviously, they would benefit the most from the unbundling process and a proliferation of choices. Consumers will not be well served, however, if they are merely offered by the utility a new arrangement of services that either rebundle in an inefficient manner services that are not desired by consumers, or else only offer a choice of gas supply purchasing options. In these instances of token unbundling there is little or no opportunity for consumers to experience savings. Enron believes that neither Kentucky consumers nor the Commission would be well served by allowing such superficial unbundling to effectively displace or delay true competition.

Consistent with unbundling, Enron also submits that the Commission should prohibit natural gas utilities from entering into special contracts or "streaming" transactions, which provide terms different from those authorized by a tariff. Special contracts is another way to rebundle the costs of transportation and gas supply so that it is not possible to determine which of these services is being discounted. This type of contract makes it impossible to assure the provision of comparable service at the local distribution level. Such contracts thereby inhibit effective competition among different gas supply options. If utilities want to compete for sales in the competitive markets, they should utilize a separate affiliate with separate facilities and books of accounts.

Non-Utility Marketers Should Be Provided Access to LDC-Held Resources

If non-utility marketers are to fairly compete in the marketplace, they will need the opportunity to take released pipeline capacity and storage capacity from the LDC. Since utilities presently have or control the capacity and storage it follows that LDCs should unbundle and provide non-utility energy service providers with access to those resources or assets at the marketers option. Capacity access can be provided through releases and storage can be made available through unbundled storage tariffs in addition to releases. As addressed below, providing non-utility energy service providers with access to these resources also has the benefit of mitigating stranded costs from unbundling.

However, it should be noted that the marketer should not be required to take the capacity and/or storage. If a marketer is required to source their gas supplies and transportation just like the utility, then marketers must charge like the utility. Therefore, the marketer must be able to open source supply and transportation. One would expect that if open sourcing can produce savings new choice programs around the country would be using it. That, in fact, is exactly what is taking place in unbundling programs in Maryland, Massachusetts and Ohio. For example, originally the CG&E FT program utilized mandatory capacity assignment. The program though never captured a significant share of the market and for the last year or two was actually shrinking. CG&E has since asked for and received permission in its new choice program to go to voluntary capacity assignment.

The LDC Merchant Function Should Not Be Continued

Enron strongly urges the Commission to set a time frame for Kentucky LDCs to exit the merchant function. The gas commodity segment of the industry is highly competitive at the well head, thus, there is no reason why distribution companies should be suppliers of gas to consumers. The costs LDCs incur for providing gas commodity are a pass-through. As a result, there is reduced incentive for LDCs to minimize these costs. Some LDCs may argue that they should be allowed to remain as a competitor selling gas in the marketplace. There is, however, a greater concern that LDCs will attempt to leverage their monopoly position as gas distributors over the competitive gas supply market thereby rendering the market for gas commodity uncompetitive. The only way for LDCs to participate in the merchant role and not raise anti-competitive concerns is for them to do so through an unregulated marketing affiliate. As discussed below, effective and enforceable standards of conduct are necessary to ensure that the market's competitiveness is not adversely affected by less than arm's-length transactions between utilities and their unregulated affiliates.

As part of the LDCs' exit from the merchant function, their obligation to serve will be replaced with an obligation to deliver the gas transported by others on their distribution systems. Each LDC should be indifferent to this change if they currently have tariffs that reflect the true cost of distribution service, without built-in subsidies. After all it is the investment in its distribution system – not the merchant function -- that provides each LDC with an opportunity to earn its rate of return on its investment.

Enron recognizes that the obligation to serve has triggered certain social costs which are undoubtedly embedded in the cost-of-service of utilities. Although Enron believes this issue is best left to the legislature for resolution, an alternative that could be considered is the system relied on in many states to provide automobile insurance to the high risk pool. This would involve the creation of a universal service fund, funded by a volumetric surcharge on all volumes of gas sold to consumers in Kentucky. Alternatively, suppliers could submit bids to serve the high risk pool.

The Commission Should Adopt Utility Affiliate Standards of Conduct

In order to prevent potential market abusive practices between utilities and their unregulated affiliates, the Commission should adopt comprehensive standards of conduct that address areas that could negatively impact a competitive marketplace. For instance, such rules should require utilities to apply all tariff provisions in an equal and non-discriminatory basis. Such standards should also preclude "special" contracting practices between utilities and their affiliates, such as right of first refusal provisions, streaming, exclusive provider agreements, shared customer data bases privately-negotiated commodity provisions and common sales forces. These standards should include additional reporting and informational disclosure requirements for utilities to facilitate Commission monitoring of the marketplace. Many other provisions should be included in the utility affiliate standards of conduct which, while not listed here, form a crucial part of a framework aimed at preventing market abusive practices.

A necessary part of utility affiliate standards of conduct is that such standards have enforcement provisions that allow the Commission to prevent a utility affiliate that violates the rules from conducting business behind the city gate of its utility. The availability of such a powerful enforcement provisions would ensure that the standards are taken seriously and are an effective deterrent to market abusive practices.

Stranded Costs Should Be Mitigated

Generally, any costs attributable to unbundling will either be gas supply costs or capacity/storage costs which were incurred by the LDC to provide merchant service to its customers under sales tariffs. On the other hand, the costs of holding capacity and storage can be mitigated by releasing capacity contracts to marketers and the market in general, in addition to offering storage on an unbundled or release basis to customers and their agents. Part of the capacity needed in the past to serve the bundled market may be needed in the future to provide new services and combinations of service to customers.

Unbundling Implementation Time Frame

Enron believes that effective unbundling can be implemented in a relatively short time frame. If the Commission issues an order requiring LDCs to file tariffs in compliance with a regulatory framework that offers unbundled services to customers by early 1998, the Commission could have working competition in place by mid 1998 for the 1998-99 winter heating season.

Consumer Issues

Experience in many other states has shown that all customers have the opportunity to experience savings from unbundling. In sum, Columbia of Ohio's customer choice program has saved Toledo area customers who have chosen to transport approximately $1 million since April 1, 1997. In addition, Columbus Public Schools who are not required to choose standby have not only been reliably served but also saved millions of dollars since they began using a marketer. Finally, Ohio's low-income customers participating in the Percentage of Income Payment Plan (PIPP) put out for bid the gas supply function for the entire rate class within Columbia of Ohio's service territory. The winning bid for gas supply came in far below the GCR (Ohio's Gas Cost Recovery mechanism) price for the class, thus, these customers received lower priced gas from an unbundled marketplace than would have occurred under traditional rate of return regulation. Kentucky consumers would stand to receive a similar benefit if the market were unbundled. Social costs embedded in current LDC rate structures can be addressed through a number of methods in the aggregate and could be implemented either through regulatory rules or legislation.

Consumer issues should not present an insuperable barrier to competition, especially since it is the consumers who will benefit the most from the proposed restructuring proposed herein. Although it may be possible to phase-in competition to certain customer rate classes, Enron believes that it is preferable to open all customers classes to choice and savings as soon as possible. Considering the substantial savings all customer classes may receive from competition, it seems unconscionable to delay the advent of unbundling and competition. Accordingly, any proponents of delay should carry a heavy burden of proof that such delays are truly in the public interest and are not a smoke screen for perpetuating monopoly service in a potentially competitive market.

Conclusion

Enron believes that the Commission has shown far-sighted wisdom in Exploring Kentucky's Next Step Toward Customer Choice. Kentucky has the opportunity step forward and begin the unbundling process to make real consumer choice and savings available. Enron urges the Commission to advance the cause of consumers and other supporters of a competitive marketplace by unbundling further LDC rates and services. Enron looks forward to discussing these comments and those of other interested parties at the August 22nd meeting.