FILE

Columbia Exhibit No. 5

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Regulation of the Purchased Gas Adjustment Clause Contained Within the Rate Schedules of Columbia Gas of Ohio, Inc., and Related Matters.	))))	Case No. 05-221-GA-GCR
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PREPARED DIRECT TESTIMONY
OF SCOTT D. PHELPS
ON BEHALF OF COLUMBIA GAS OF OHIO, INC.

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PREPARED DIRECT TESTIMONY
OF SCOTT D. PHELPS

Q. Please state your name and business address.

A. My name is Scott D. Phelps. My business address is Post Office Box 117, 200 Civic Center Drive, Columbus, Ohio 43216-0117.

Q. By whom are you employed and in what capacity?

A. I am the Director, Gas Management Services, in the NiSource Corporate Services' Energy Supply Services Group, providing gas procurement services for Columbia Gas of Ohio, Inc.

Q. Please describe your professional and educational background.

A. In 1978, I joined Columbia Gas of Ohio, Inc. ("Columbia"), a subsidiary of Columbia Gas System, Inc. ("CGS") and now a NiSource subsidiary, as an Industrial Marketing Engineer. In that capacity, I was responsible for representing Columbia to its industrial and large commercial customers throughout Southeastern Ohio. In 1984, I became the Manager of Gas Transportation in the CGS distribution companies' Marketing Department. While in that role, I was responsible for developing and managing the on-system transportation processes for industrial and commercial customers of all of the CGS distribution companies. In 1989, I was promoted to Director, of the Gas Procurement process, and since that time, have had responsibilities related to natural gas contracting, acquisition, scheduling, invoice reconciliation, contract administration, off system sales and capacity release for the CGS distribution companies. I received my higher education at Michigan

Technological University, and earned my Bachelor's Degree in Civil Engineering while there.

Q. Have you previously testified before this Commission?

A. Yes. I have also testified before the public utility regulatory commissions in Pennsylvania, Maryland, Virginia, and Kentucky.

Q. What is the purpose of your testimony?

A. In my testimony, I will address two issues raised in the Management and Performance Audit of Gas Purchasing Practices and Policies of Columbia Gas of Ohio, Inc., ("Audit Report") filed in Case No. 04-221-GA-GCR by the McFadden Consulting Group, Inc. ("McFadden" or "the Auditor"). The first of these two issues involves the reporting of avoided costs related to the Company's off system sales transactions. The second issue pertains to the Company's Gas Price Hedging Plan ("Hedging Plan").

Q. On page 5-15 of the Audit Report, McFadden describes a situation in which, late in the audit period, the Auditor determined that it had not reviewed a particular aspect of the off system sales transactions, namely, avoided costs, to the desired degree. On page 5-17 of the Audit Report McFadden makes the following Recommendation in regard to the review of avoided costs.

> Therefore, McFadden Consulting recommends that the Company be required to prepare a detailed report on the avoided costs associated with each of the off-system sales transactions that occurred during November 2004 through October 2005. Such report should identify the avoided costs, how the avoided costs were treated for purposes of determining the Stipu-

> lation Sharing Mechanism, and how they were reflected in the Company's accounting records.
>
> The Company should also be required to provide such information for the next management/performance audit for any transactions that occur during that audit review period. The next management/performance auditor should review each of these transactions to determine the reasonableness of the avoided costs claimed by the Company. Specific attention should be given to avoided costs associated with transactions involving sales of incremental gas.
>
> If it is found that there were transactions which resulted in a loss, McFadden Consulting recommends that costs associated with them be borne by the shareholders and not recovered from COH's customers.

Would you like to comment on the recommendation made in this manner?

A. Yes, I will generally address the topic of avoided costs and state Columbia's position in terms of each concern and recommendation that the Auditor stated in its recommendation. As the Auditor points out in its Report, avoided costs are recognized in the Fourth Amendment to the Joint Stipulation and Recommendation as part of the calculation of off system sales margin. In the recommendation, the Auditor notes that the avoided costs reviewed by the Auditor occurred in the context of an incremental transaction and questions whether such a savings might be more likely with a flowing transaction.

Q. Is it more likely that avoided costs would occur in the context of a flowing sale, as opposed to an incremental sale?

A. No, the natural place for avoided costs to occur is in an incremental transaction. A flowing supply provides the base from which savings can be generated by an incremental transaction. Therefore, with the incremental transactions that resulted in the booking of avoided costs, there was associated previously flowing supply, and when the effect of the incremental transaction is overlaid or added to the known costs of the flowing supply, the overall costs of the supply is reduced. This reduction in overall costs is the avoided cost. The incremental transactions that result in the avoided cost impact do not add or detract from the total amount originally purchased. As a result, it is an incremental transaction that results in reduced costs to obtain the same volume originally and already purchased and flowing for Columbia's system supply.

Q. On Page 5-15 of the Audit Report, the Auditor also indicates some uncertainty as to whether or not the avoided costs were included in the sharing mechanism. Can you address this concern?

A. Yes, the avoided costs were included within the calculation of total margin from the off system sales transactions, and were included toward the Stipulation Sharing Mechanism. In addition, any time the margins or net revenues to be shared were discussed or presented during the audit, Columbia included all costs, credits, and revenues, including avoided costs into those values.

Q. In the Auditor's recommendation on this subject, it is recommended that a report be prepared of the avoided costs for the period November 2004 through October 2005. Would that be acceptable to Columbia?

A. As with other informational requests related to the audit, Columbia remains willing to provide such a report if required to do so.

Q. The Auditor recommends that Columbia also be required to provide such information in a report to the next GCR management/performance Auditor. Do you agree with such a requirement?

A. I do not believe such a mandate is necessary. During the course of any GCR Management/Performance audit, the auditor or any other active participant may request such a report through the normal process of interviews and interrogatories. There is no need to add more administrative requirements that need to be monitored and tracked, when an effective mechanism is already in place to satisfy the Auditor's concern.

Q. Finally, as part of this portion of its recommendation, McFadden recommends that in the next audit, the auditor should review transactions that result in avoided costs and determine their reasonableness, and that if transactions are found that "resulted in a loss," McFadden recommends that those losses be borne by the shareholders and not recovered from Columbia's customers. Do you agree with this portion of the recommendation?

A. Under the current Stipulation, and the Commission Order approving the Stipulation, Columbia's shareholders are already largely at risk for negative off system sales margins in the same way they are at risk for a failure to cover CHOICE®[1] program capacity costs. This is because Columbia retains the first $25 million dollars per year of off system sales and capacity release margins in return for Columbia taking all risk related to the recovery of the

[1] Customer Choice℠ is a service mark of Columbia Gas of Ohio, Inc. CHOICE® is a registered service mark of Columbia Gas of Ohio, Inc.

CHOICE programs capacity costs. Therefore, if any off system sales transactions result in a loss, then Columbia, and therefore the shareholders, already assume that risk.

Q. Do you have an objection with an auditor in a future case taking a close review of the avoided costs booked by Columbia to the transactions in question?

A. No.

Q. If during a future GCR Management/Performance audit, an auditor determined that, from its viewpoint, Columbia had miscalculated the avoided cost impact from a transaction or otherwise found that the avoided costs as determined were unreasonable, such that an apparently profitable transaction became an unprofitable transaction, what would your position be?

A. If, at the end of the completed audit process, the outcome was that the Public Utilities Commission of Ohio agreed with the auditor's conclusion, then it would seem appropriate that the total net revenue from the program be adjusted to remove the impact of the erroneous avoided cost. To the extent that such adjustment was found to impact the amount of dollars credited to customers, then those dollars should be provided to those customers through an adjustment to the sharing mechanism.

Q. Generally speaking, do you agree with the Auditor's assumption that transactions that result in a loss should be picked out of an incentive sharing mechanism and treated differently than transactions that have a positive result?

A. Definitely not. For several reasons, I disagree with the auditor's conclusion. First, the current Stipulation, as well as previous stipulations, do not segregate individual transactions within a program based on their degree of profitability. Rather, the program's net revenue from the entire program effort determines how much is booked and how that revenue is shared. The value of the program to customers and shareholders, like the value of other products in the business world that a company produces, is based on the results of the entire effort. Margins, positive or negative, of individual transactions are not and should not be cherry picked away from the whole. Such an action to remove less successful transactions while leaving in results of more successful transactions results in a poorly conceived change to, and an imbalance in, the risk/reward balance of the off system sales program embodied in the stipulation approved by the Commission.

Q. The Auditor also made a Recommendation with regard to Columbia's Gas Price Hedging Plan (the "Plan") on page 6-5 of its Audit Report. That recommendation was as follows.

> McFadden Consulting recommends the Company continue to seek acceptance of the proposed modifications in its Gas Price Hedging Plan.
>
> McFadden Consulting believes that using financial instruments is a reasonable evolution of the Gas Price Hedging Plan. It does not drastically alter the plan because financial instruments are just another tool that can be used to accomplish the same results.
>
> The main obstacle to using financial instruments is the concern that the Commission will not approve recovery of the costs through the GCR mechanism. This is a common concern throughout the industry. The Company would like to get approval in advance to include cost of the financial instruments, including gains and losses in the calculation of the GCR. Other parties apparently are reluctant to give such upfront approval. One option would be for the Company to modify its GCR tariff to specially identify the accounts for which costs are to be allowed to be recovered through the GCR. Such a listing of accounts would include those in which

the transaction costs, gains and losses are recorded in the formula for determination of deferred gas costs or AA as it is known in Ohio.

Would you also care to comment on the recommendation?

A. Yes I would. In Chapter 6 of the report, in sections 6.1 and 6.2, the Auditor provided an accurate description of Columbia's current Hedging Plan. In sections 6.3 and 6.4, the Auditor accurately portrays more recent discussions that have been held and Columbia's preliminary plans related to changing the Hedging Plan from one which is based upon using financial instruments instead of setting prices utilizing physical gas purchase contracts.

Q. Are there other aspects of Columbia's proposed changes to its Hedging Plan that were not focused on in the Auditor's report?

A. Yes, in describing Columbia's proposed changes to its Hedging Pan, the Auditor focused only on the change from fixed price physical gas contracts to financial (NYMEX natural gas futures) contracts. Indeed, Columbia plans to propose other changes to the Plan as well. For example, the current plan involves the generation and monitoring of Trigger Prices at which prices are set when market conditions allow. The proposed program however, utilizes a ratable approach to the timing the purchase of the hedge, such that the hedge is triggered by many dates through the course of time rather than on a few price positions.

Q. Do you agree with the Auditor's conclusions and recommendations with regard to the Hedging Plan?

A. Yes, Columbia agrees with the Auditor's findings, and plans to file an application in which Columbia will seek approval to use financial instruments. This application will describe

Columbia's Hedging Plan in a complete manner in order to minimize any potential misunderstandings in regard to this area of Columbia's gas supply process. As part of the filing Columbia will consider the Auditor's comments from the Audit Report, including McFadden's comments with regard to modifications that may be necessary in COH's GCR tariffs.

Q. Does this complete your Prepared Direct Testimony?

A. Yes, it does.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Prepared Direct Testimony of Scott D. Phelps was served upon all parties of record either by regular U.S. Mail this 29th day of November 2006.

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