BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Gas Rates.	)))	Case No. 07-589-GA-AIR
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval of an Alternative Rate Plan for its Gas Distribution Service.	))))	Case No. 07-590-GA-ALT
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods.	)))	Case No. 07-591-GA-AAM

REPLY BRIEF OF OHIO PARTNERS FOR AFFORDABLE ENERGY

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March 24, 2008

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I. Introduction

A radical departure from rate design conventions should not be decided based on the limited record available in this case. Adoption of the modified straight-fixed variable rate design ("SFV") has profound implications. With base rate cases pending for the three other major natural gas utilities, the imposition of an untested rate design lacking record support in this case will become an issue in all three. A better approach would be to establish a collaborative to consider a variety of rate design methods that could address the needs of both the companies and customers as opposed to just the desires of the Staff of the Public Utilities Commission of Ohio ("Staff") and Company.

The record in this case fails to prove why an SFV, which raises rates for over half of Duke Energy Ohio's ("Duke" or "the Company") residential customers, is superior to other options available to accomplish the professed but unproven result of reducing the Company's risk of collection of its revenue requirement.[1] Ohio Partners for Affordable Energy ("OPAE")[2] respectfully

[1] Neither the Staff nor the Company have provided evidence on what percentage of residential or commercial customers will see rates increase as a result of the SFV. The Company witnesses cannot even agree on what the average usage is for customers. OCC has calculated the break-even point at 1,316 Ccf or 60.5% more gas than the average customer consumes. Thus it is reasonable to conclude that more than half of Duke's customers will pay more under the rate design. OCC Initial Brief at 47.

[2] The Office of the Ohio Consumers' Counsel ("OCC") incorrectly characterizes the purpose OPAE seeks to serve in this proceeding. In footnote 21, OCC quotes Joint Ex. 1 (Stipulation), footnote 3, describing OPAE as "a provider of weatherization and essential infrastructure services to the low income residential within DE-Ohio's service territory." That phrase describes People Working Cooperatively, an organization whose Articles of Incorporation state "[t]he purpose or purposes for which said corporation is formed are: To educate and train economically disadvantaged individuals to secure and retain employment…." OPAE's corporate purpose is much different and is similar to OCC's charter: to promote affordable energy policies and preserve access to essential energy services for all Ohioans. OPAE member organizations are

requests that the Commission not approve a fundamental change in utility rate design based on nothing more than opinions voiced by the Staff and Duke given the dearth of evidence that such change accomplishes its goal and complies with Ohio law and basic regulatory principals.

II. The Three-Part Test for Stipulations is Not the Appropriate Standard for Evaluating the Rate Design Issue.

Duke and the Staff aver that the stipulation was unanimous among the parties with the exception that OPAE and the Office of the Ohio Consumers' Counsel ("OCC") did not agree to the SFV rate design. This assertion is incorrect. As noted in Footnote 1 of the *Stipulation and Recommendation* filed by the parties to this case,

> "The Parties expressly agree that the issue of fixed vs. volumetric rate design and/or a sales decoupling rider is not intended to be resolved through this Stipulation and will be decided by the Commission following the hearing…."

Further, Footnote 7 establishes that "[t]he issue of fixed vs. volumetric rate design and/or a sales decoupling rider is not resolved through this Stipulation…." OPAE signed the Stipulation based on the understanding that the rate design issue was not a component of the Stipulation but was reserved for litigation. The Commission should not sanction a 'bait and switch' approach to settling cases or parties will be less inclined to resolve matters through a partial stipulation. The Commission has long encouraged settlements; it should not discourage them by permitting the mischaracterization of the position of parties as has occurred in the

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charged with advocating on behalf of their communities under the terms of 42 U.S.C. 670, *et.seq.*, which authorizes the creation of community action agencies.

briefs by the Staff and Duke.[3] Therefore, the three-part test for the reasonableness of stipulations is not properly applied to the SVF rate design issue, which must be decided upon its own merits, including the evidence of record, Ohio law and Commission precedent.

III. Argument

A. The Straight-Fixed Variable Rate Design violates Commission precedents.

Staff argues that "[s]imply because something has been done the same way for 30 years is not a valid reason to shy away from needed change." *Post-Hearing Brief Submitted on Behalf of the Staff of the Public Utilities Commission of Ohio* at 11 ("Staff Post-Hearing Brief"). Perhaps the Staff has forgotten that Commission precedent is relevant when considering significant changes to existing regulatory practices. The Commission must make its decisions based on the evidence of record, as well as Ohio law and Commission precedent. If a decision is not supported by the record, the law and precedent, it will not withstand judicial scrutiny. With regard to rate design, the Commission has made the following observation:

> "We believe that it is appropriate in this case to keep the customer charge at its current level in order to minimize rate shock that would otherwise be experienced by residential customers. Our decision is consistent with past cases where we have identified the principles of gradualism and rate continuity as important factors to be considered in setting rates." Opinion and Order, *In the Matter of the Application of The Cincinnati Gas & Electric Company for an Increase in Its Rates for Gas Service to All,* Case No. 95-656-GA-AIR, December 12, 1996 at 29.

[3] OPAE does not challenge the appropriate use of the three-part test for stipulations for the balance of the issues unanimously agreed to in this case.

As noted in OCC Exhibit 18 at WG-2, the precedent in Ohio ratemaking is to establish a low customer charge and raise it only in small increments. The Staff acknowledge that the “proposal is a significant departure from established rate design philosophy”. Staff Post-Hearing Brief at 10.[4]

Duke and the Staff attempt to distinguish the fixed charge established under an SFV from a customer charge to avoid thirty years of precedent. The argument is not compelling. The Staff acknowledges that the two charges are comparable but that the ‘customer charge’ is set artificially low. Even if, arguably, the customer charge were too low, raising it by 400% would not transmute it into something other than a customer charge. The Staff’s argument does not refute the obvious: the SFV proposal is so far removed from current practice that it is not comparable to anything. The precedent of low customer charges is applicable and the SFV violates precedent.

B. The SFV violates important ratemaking principles.

Duke and the Staff are somewhat selective regarding the ratemaking principles they seek to honor. Apparently cost causation, cost recovery, and ensuring a utility reaps its revenue requirement from captive customers are the only relevant principles. Obviously, Duke and the Staff are only interested in the ratemaking principles that favor the utility company. Other regulatory principles favor captive customers.

[4] See also the testimony of Staff Witness Puican, Tr. I at 203, noting that the SFV is a “significant change from the way rates had typically been allocated in the past.”

This limited perspective of the Company and the Staff ignores other critical considerations. In *Principles of Public Utility Rates,* Professor Bonbright lays out eight criteria for a desirable rate structure:

1. The related, "practical attributes of simplicity, understandability, public acceptability, and feasibility of application."
2. Freedom from controversies as to proper interpretation.
3. Effectiveness in yielding total revenue requirements under the fair-return standard.
4. Revenue stability from year to year.
5. Stability of the rates themselves, with a minimum of unexpected changes seriously adverse to existing customers.
6. Fairness of the specific rates in the apportionment of total costs of service among the different consumers.
7. Avoidance of "undue discrimination" in rate relationships.
8. Efficiency of the rate classes and rate blocks in discouraging wasteful use of service while promoting all justified types and amounts of use:
   (a) in the control of the total amounts of service supplied by the company;
   (b) in the control of the relative uses of alternative types of service….[5]

Taking each principle in turn, while the SFV rate design may be simple, understandable and feasible, the record is bereft of evidence that the public will accept this radical departure from ratemaking conventions. Staff acknowledges that it has not conducted nor reviewed any survey of customer opinions regarding the SFV. Customer testimony at the public hearings clearly opposes higher customer charges.[6] If there were some evidence of

[5] Bonbright, James C. *Principles of Public Utility Rates*, http://www.terry.uga.edu/bonbright/pdfs/principles_of_public_utility_rates.pdf

[6] *Post-Hearing Brief of the Office of the Ohio Consumers' Counsel* at 22-24 ("OCC Post-Hearing Brief").

customer acceptability it might satisfy the burden on the Company and Staff to justify a total disregard of precedent.[7] Alas, there is none.

The second principle is satisfied. In an SFV there is nothing to interpret, there is simply a bill. It is also clear that the SFV is intended to guarantee collection of around eighty percent (80%) of the revenue requirement even if customers use virtually no natural gas.[8] This arguably meets the stability goals of principles four and five. But traditional ratemaking focuses on the "opportunity to enjoy a fair rate of return."[9] The term of art is 'opportunity' not guarantee. OPAE will not speculate as to what types of changes in the market or natural gas consumption could occur which would require a change in how a utility serves its customers, who after all pay for everything. Suffice it to say that attempting to make a utility indifferent to changing circumstances is not fair and will prevent necessary evolution of the customer-utility relationship.[10] Moreover, the SFV lacks symmetry; it intends to insure the Company against revenue erosion but disproportionately raises bills on the majority of residential customers, those with low usage, to achieve that professed outcome. Balance is lacking.

The second clause of the fifth principle is also violated by the SFV. The Company and Staff acknowledge that more than half of Duke customers will

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[7] R.C. 4909.18 requires that "the burden of proof to show that proposals in the application are just and reasonable shall be upon the public utility."
[8] OCC Post-Hearing Brief at 70.
[9] Id. At 121-122.
[10] A perfect example is the huge increase in natural gas costs since 2000, which is arguably the proximate cause for this adventure in rate design. Yet while commodity costs have increases over 400%, the $3 million Duke will spend on demand side management after this case is decided is only $1 million higher than it was in 1996.

see an increase in costs on a per therm basis. OCC Post-Hearing Brief at 47. Increasing the rates of more than half the customers is certainly not a "minimum of unexpected changes seriously adverse to existing customers." Bonbright at 291. This is particularly true the smaller the user. It also minimizes the payback associated with conservation measures.[11] Low users have limited options for cost-effective improvements. The SFV reduces this and given current commodity prices will have the seriously adverse impact regulatory principles are designed to prevent.

The proposed SFV rate is not fair. It penalizes low users as noted above. It flips the percentage of distribution rates that are fixed with the variable component. The evidence in the case indicates that the impact of revenue erosion due to reductions in per customer use was fairly minimal, about seventeen percent (17.6%) of the revenue increase requested in the case. Tr. I at 241. That hardly justifies raising rates for more than half of all customers. The rate subsidizes large users, an outcome acknowledged by Staff and Duke alike. In fact, the parties proposing the SFV herald the subsidy for larger users. Duke Exhibit 29 at 12; Staff Exhibit 3 at 5.

The rate also will unjustly enrich Duke. The Company has consistently added new customers. OCC Exhibit 12; Tr. 1 at 145. There is no mechanism for a downward adjustment in the customer charge to offset the growth in

[11] Staff Witness Puican suggests that the impacts of the charge on conservation are minimal, but acknowledges the Staff has neither conducted nor reviewed studies of the impact of the SFV on conservation expenditures. Tr. I at 240 and 244.

revenues resulting from increases in the number of residential customers.[12] All the new customers will pay the excessive customer charge that is far beyond what is needed for Duke to earn its revenue requirement. Instead of providing an opportunity to recover its revenue requirement, the Company is almost certain to recover more than the revenue requirements assuming the number of customers continues to increase. Because of the negative impacts on small users and locking in an excessive revenue increase for Duke, the SFV is not fair, thus violating the just and reasonable standard.

The SFV discriminates against small users. They use less of the system. While the costs of the system may be fixed, small users still use a smaller proportion of those fixed costs. Moreover, smaller users tend to live in apartments or small homes in compact neighborhoods. This translates into less expensive distribution costs and lower meter reading costs because of customer density. Small users are different than large users. Treating different customers the same is discriminatory. That is why we have customer classes and relatively high volumetric charges. As commodity costs rise higher, there is a justification for applying the principal of cost causation on an intra-class basis. This is what traditional volumetric rates do. The SFV discriminates against those who put the least burden on the system.

[12] Duke and the Staff argue that distribution costs are ninety-nine point nine percent (99.9%) fixed. Tr. I at 159. The fixed costs are covered by the number of customers in the test year. The marginal cost of serving new customers is zero or is included in the base rates as a separate expense. So the high fixed charge paid by new customers is a revenue increase above the approved revenue requirement. Other options exist. A decoupling rider, for example, can be positive or negative, ensuring that the utility does not recover excessive revenue.

The elimination of a price signal which punishes large users encourages wasteful use of the system. There is no penalty for excessive consumption; instead it is subsidized. Duke and the Staff seek to distinguish the customer charge from the commodity charge and argue that the high and volatile cost of natural gas provides adequate incentive to prevent wasteful usage. But the SFV mitigates the financial impact of wasteful usage by reducing the cost per therm as consumption increases. These price signals need to be aligned. They are not aligned if an SFV is imposed and thus violates the principle of efficiency in rate design.

C. The SFV is inconsistent with sound public policy.

R.C. §4929.02 defines the policy of the State of Ohio as to natural gas services and goods. The SFV violates the requirement for reasonable prices contained in R.C. §4929.02(A)(2). Prices that favor large users and provide a disincentive for conservation are unreasonable. Increasing bills for over half of all residential customers to remedy 17.6% of a revenue shortfall is also unreasonable.

The SFV discourages "innovation and access for cost-effective supply- and demand-side natural gas services." R.C. §4929.02(A)(4). As noted above, the effect of the rate design is to subsidize consumption of less than half of the residential customers with consumption over the break-even point, reducing the price signal that encourages customers to conserve. It discourages customers above and below the break-even point from investing in conservation because it reduces the impact of efficiency savings by the percentage of costs that are fixed. This particularly affects small users who have fewer opportunities for cost-effective efficiency investments compared to larger users.

Beyond the provisions of statutes, public policy is best served by just and reasonable rates which are also required by Ohio law. R.C. §4909.15 and §4909.18. Reasonable rates are not the same as optimum rates. Bonbright at 34. Public policy requires reasonable rates. Primarily volumetric rates have long been held to be reasonable. They provide incentives for conservation by sending a price signal that is consistent for both components of a two-part rate. In comparison, the SFV is currently applied to individual companies in only a couple states. Perhaps those out-of-state utilities have been losing customers as well as seeing reductions in sales. The record does not make clear what problem the rate design was implemented to resolve and does not demonstrate that the situation in this case is analogous to the situation faced by the other Commissions.

The vast majority of the revenue increase requested in this case relates to the incorporation of the investments in upgrades to the distribution system financed through Rider AMRP into rate base, not the reduction of consumption per capita. The number of customers is increasing as is system throughput. Tr. I at 145-146. Neither the Company nor the Staff has demonstrated that usage per customer is the proximate cause of the revenue shortfall. As long as sales are higher and the number of customers is growing, the usage per capita has minimal impact of revenues. The occasional reduction in revenue caused by consumers reacting to extraordinary price spikes actually serves to align the interests of customers and utilities to stabilize prices through a variety of techniques, including conservation.[13] The NARUC *Resolution on Energy Efficiency and Innovative Rate Design,* quoted by Duke, ends with this admonishment: "…NARUC recognizes that the best approach toward promoting energy efficiency programs for any utility, State, or region may likely depend on local issues, preferences, and conditions."

III. Conclusion

As OPAE noted in its initial brief, the SFV is a solution in search of a problem. The vast majority of the revenue shortfall is caused by moving investments in systems upgrades financed by Rider AMRP into rate base, not by reductions in per capita usage. Duke can and regularly does file a rate case when revenue recovery lags. That gives customers a chance to review the books to ensure that rates remain just and reasonable and limit the profit a monopoly can extract. While rate cases cost money and require staff time, preventing a utility from over-earning millions of dollars is cost-effective and is a primary tool of the regulatory system.

[13] The more efficient a customer is, the lower the ability to respond to gas prices because there are fewer options to reducing usage. Thus, reduction in throughput will eventually plateau as efficiency in homes and appliances becomes the norm.

Duke started this case requesting decoupling, a rate design it felt was consistent with regulatory principles. Yet the Company is ambivalent about the design of rates so long as it earns its revenue requirement. Tr. 1 at 74. Decoupling accomplishes this single goal without discouraging conservation by individual customers since lost revenue is socialized across all customers. This is a reasonable outcome given the important public policy of promoting conservation. Properly designed, decoupling can also comply with the other seven principles of rate design.

The SFV violates at least thirty years of ratemaking precedent. It violates most of the basic principles of ratemaking. And it is bad public policy. The record evidence does not support adoption of the SFV, given that the record demonstrates a remarkable lack of study by the proponents of the impacts of the SFV on individual customers, conservation, and even revenue recovery by the Company. R.C. §4909.18 requires that "the burden of proof to show that proposals in the application are just and reasonable shall be upon the public utility." Duke has failed to meet that burden even with the assistance from the Staff. R.C. §4929.04(C), part of the Code that authorizes alternative regulation, requires that "The applicant shall have the burden of proof under this section."

Customers have interests in rate design that should be considered by the Commission prior to a radical change in rate design.[14] OPAE urges the Commission to reject the SFV, issue an order requiring compliance with current

[14] The Commission regularly establishes collaboratives and working groups when considering new policy issues like deregulation, alternative regulation, competition and choice, and the various issues raised by the Energy Policy Act of 2005.

rate design methodologies which comply with precedent, and begin a collaborative of all customers to take a comprehensive look at rate design, from the single issue riders for infrastructure investments and bad debt to the customer charge. Overturning long standing precedent requires far more record evidence, consideration and consensus than is established in this case.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Reply Brief* was served by electronic means upon the parties of record identified below on this 24th day of March, 2008.

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