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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Authority to Increase Rates for its Gas Distribution Service.	)	Case No. 07-829-GA-AIR
In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Approval of an Alternative Rate Plan for its Gas Distribution Service.	)	Case No. 07-830-GA-ALT
In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Approval to Change Accounting Methods.	)	Case No. 07-831-GA-AAM
In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Approval of Tariffs to Recover Certain Costs Associated with a Pipeline Infrastructure Replacement Program Through an Automatic Adjustment Clause and for Certain Accounting Treatment.	)	Case No. 08-169-GA-ALT
In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Approval of Tariffs to Recover Certain Costs Associated with Automated Meter Reading and for Certain Accounting Treatment.	)	Case No. 06-1453-GA-UNC

OPINION AND ORDER

The Commission, considering the above-entitled applications, the testimony, the applicable law, the proposed stipulation, and other evidence of record, and being otherwise fully advised, hereby issues its opinion and order.

APPEARANCES:

Jones Day, by David A. Kutik, North Point, 901 Lakeside Avenue, Cleveland, Ohio 44114-1190, Mark A. Whitt, Meggan A. Rawlin, and Andrew J. Campbell, 325 John H. McConnell Boulevard, Suite 600, Columbus, Ohio 43215-2673, and Jean A. Demarr, 1201 East 55th Street, Cleveland, Ohio 44101, on behalf of The East Ohio Gas Company d/b/a Dominion East Ohio.

Vorys, Sater, Seymour & Pease, LLP, by W. Jonathan Airey and Gregory D. Russell, 52 East Gay Street, Columbus, Ohio 43216-1008, on behalf of the Ohio Oil & Gas Association.

Vorys, Sater, Seymour & Pease, LLP, by M. Howard Petricoff and Stephen M. Howard, and Michael J. Settineri, 52 East Gay Street, Columbus, Ohio 43216-1008, on behalf of the Integrys Energy, Inc.

Schwarzwald & McNair, LLP, by Todd M. Smith, 616 Penton Media Building, 1300 East Ninth Street, Cleveland, Ohio 44114, on behalf of Utility Workers Union of America, Local G555.

John M. Dosker, 1077 Celestial Street, Suite 110, Cincinnati, Ohio 45202-1629, on behalf of Stand Energy Corporation.

Bell & Royer Co., LPA, by Barth E. Royer, 33 South Grant Avenue, Columbus, Ohio 43215-3927, on behalf of Dominion Retail, Inc.

David C. Reinbolt and Colleen L. Mooney, 231 West Lima Street, P.O. Box 1793, Findlay, Ohio 45839-1793, on behalf of Ohio Partners for Affordable Energy.

Chester, Wilcox & Saxbe, LLP, by John W. Bentine, Mark S. Yurick, and Matt White, 65 East State Street, Suite 1000, Columbus, Ohio 43215-4213 and Vincent A. Parisi, 5020 Bradenton Avenue, Dublin, Ohio 43017, on behalf of Interstate Gas Supply, Inc.

The Legal Aid Society of Cleveland, by Joseph P. Meissner, 1223 West 6th Street, Cleveland, Ohio 44113, on behalf of The Neighborhood Environmental Coalition, The Empowerment Center of Greater Cleveland, Cleveland Housing Network, and The Consumers for Fair Utility Rates

Sheryl Creed Maxfield, First Assistant Attorney General of the State of Ohio, by Duane W. Luckey, Section Chief, by Stephen A. Reilly and Anne L. Hammerstein, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio 43215, on behalf of the staff of the Public Utilities Commission of Ohio.

Janine L. Migden-Ostrander, Ohio Consumers' Counsel, by Joseph P. Serio, Larry S. Sauer, and Gregory J. Poulos, Assistant Consumers' Counsel, 10 West Broad Street, Columbus, Ohio 43215-3485, on behalf of the residential utility consumers of The East Ohio Gas Company d/b/a Dominion East Ohio.

OPINION:

I. HISTORY OF THE PROCEEDINGS:

The applicant, The East Ohio Gas Company d/b/a Dominion East Ohio (DEO or company), is a natural gas company as defined by Section 4905.03(A)(6), Revised Code, and a public utility as defined by Section 4905.02, Revised Code. DEO distributes and sells natural gas to approximately 1,200,000 customers in approximately 400 eastern and western Ohio communities (Staff Ex. 1, at 1). DEO's current base rates were established by the Commission in Case No. 93-2006-GA-AIR, Opinion and Order (November 3, 1994).

On July 20, 2007, DEO filed its notice of intent to file an application to increase its rates for gas distribution service in its entire service area subject to the jurisdiction of the Commission. By entry of August 15, 2007, the Commission approved the requested test year of January 1, 2007, through December 31, 2007, and the date certain of March 31, 2007. The Commission also granted DEO's request to waive certain of the standard filing requirements for various financial and informational data.

On August 30, 2007, DEO filed applications for approval of an increase in gas distribution rates, for approval of an alternative rate plan for its gas distribution service, and for approval of an application to modify certain accounting methods, in Case Nos. 07-829-GA-AIR (07-829), 07-830-GA-ALT (07-830), and 07-831-GA-AAM (07-831), respectively. On December 13, 2006, DEO filed an application in Case No. 06-1453-GA-UNC (06-1453), requesting approval of tariffs to recover, through an automatic adjustment mechanism, costs associated with the deployment of automated meter reading (AMR) equipment. On February 22, 2008, DEO filed an application in Case No. 08-169-GA-UNC (08-169) requesting approval of: tariffs to recover, through an automatic adjustment mechanism, costs associated with a pipeline infrastructure replacement (PIR) program; its proposal to assume responsibility for and ownership of the curb-to-meter service lines; and the accounting authority to defer the costs associated with the PIR program for subsequent recovery. By entry of April 9, 2008, the Commission, *inter alia*, granted DEO's request to consolidate these five cases.

By entries issued April 9, 2008, and June 27, 2008, the motions to intervene filed by the following entities were granted: the Neighborhood Environmental Coalition, the Empowerment Center of Greater Cleveland, the Cleveland Housing Network, and the Consumers for Fair Utility Rates (jointly, Citizens' Coalition); the Ohio Energy Group (OEG); Interstate Gas Supply, Inc. (IGS); Dominion Retail, Inc. (Dominion Retail); Stand Energy Corporation (Stand); Utilities Workers Union of America, Local G555 (Local G555); Integrys Energy Services, Inc. (Integrys); the Ohio Oil and Gas Association (OOGA); the Office of the Ohio Consumers' Counsel (OCC); Ohio Partners for Affordable Energy (OPAE); Industrial Energy Users-Ohio (IEU-Ohio); and the city of Cleveland (Cleveland). By entry issued April 9, 2008, the Commission also granted a motion to admit David C. Rinebolt to practice *pro hac vice* on behalf of OPAE. On June 19, 2008, and July 28, 2008, IEU-Ohio and OEG, respectively, filed notices of withdrawal from these proceedings.

Pursuant to Section 4909.19, Revised Code, the Commission's staff conducted an investigation of the matters set forth in DEO's applications in 07-829, 07-830, 07-831, and 06-1453 and, on May 23, 2008, staff filed its written report of investigation of those applications. Objections to the staff report were filed by Cleveland, DEO, OCC, Citizens' Coalition, Integrys, and OPAE. On May 23, 2008, the report of conclusions and recommendations of the financial audit of DEO by Blue Ridge Consulting Services, Inc., was filed. On June 12, 2008, staff filed its written report of investigation of DEO's application in 08-169. Objections to the staff report in 08-169 were filed by DEO and OCC. A prehearing conference was held on July 8, 2008.

By entries issued June 27, 2008, and July 31, 2008, ten local public hearings were scheduled throughout the company's service territory. The evidentiary hearing commenced on August 1, 2008, and concluded on August 27, 2008. On August 22, 2008, a stipulation was filed in these matters, resolving all of the issues in these cases with the exception of the issue of the rate design. Signatories to the stipulation are DEO, staff, OCC, OPAE, Citizens' Coalition, OOGA, Stand, and Cleveland. On October 10, 2008, DEO, staff, and OOGA filed a notice of substitution of Joint Exhibit 1-A to the stipulation. On October 14, 2008, the signatory parties to the stipulation filed late-filed Exhibit 1-C to the stipulation, which is a revised schedule A-1 containing the revenue requirement agreed to in the stipulation.[1] Initial briefs were filed on September 10, 2008, by DEO, staff, OCC, OPAE, Citizens' Coalition, OOGA, and Cleveland. Reply briefs were filed on September 16, 2008, by DEO, staff, OCC, OPAE, OOGA, and Cleveland. An oral argument, on the issue of the rate design, was held before the Commission on September 24, 2008.

1 All of the signatory parties agreed to the filing of this exhibit, with the exception of Citizens' Coalition, which could not be reached.

II. SUMMARY OF THE EVIDENCE AND DISCUSSION:

A. Summary of the Local Public Hearings

Ten local public hearings were held in order to allow DEO's customers the opportunity to express their opinions regarding the issues in these proceedings. Those hearings were held in the following cities: Youngstown on July 28, 2008, and August 19, 2008; Lima on July 29, 2008; Canton on July 31, 2008; Akron on July 31, 2008, and August 21, 2008; Cleveland on August 4, 2008; Geneva on August 4, 2008; Marietta on August 5, 2008; and Garfield Heights on August 18, 2008. At those hearings, public testimony was heard from 57 customers in Youngstown, 15 customers in Lima, 10 customers in Canton, 31 customers in Akron, 17 customers in Cleveland, 15 customers in Geneva, 9 customers in Marietta, and 32 customers in Garfield Heights. At each public hearing, customers were permitted to testify about issues in theses cases. In addition, some customers who were opposed to the proposals signed forms indicating that they were at the hearing and they opposed the proposals. In addition to the public testimony, several hundred letters were filed in the case docket by customers stating opposition to the applications in these cases.

The principal concern expressed by customers, both at the public hearings and in letters, was in response to a recommendation made by the staff pertaining to the appropriate rate design that the company should apply in order to recover the recommended revenue requirement in these proceedings. Staff recommended that the Commission approve a rate structure primarily based on a fixed distribution service charge and a small volumetric rate, rather than the current method of recovery that applies a minimal customer service charge and relatively high volumetric rates (Staff Ex. 1 at 34). In general, the vast majority of those who testified or wrote letters requested that the staff recommendation not be adopted. The principal concern expressed by those customers involved their expectation that the change in rate design and the increase in rates would negatively impact low-income customers, the elderly, and those on fixed incomes. Those customers noted that they also face increases in other utility charges, gasoline, food, and medical expenses and that the proposed increase would cause undue hardship. In addition, at all of the public hearings, representatives of low-income groups testified as to the degree to which such customers would be negatively affected by the rate increase. Many other witnesses expressed concern that the change in rate design would cause low-use customers to subsidize high-use customers. Some witnesses pointed out that they had invested in conservation and weatherization measures for their homes and that, under the proposed change in rate design, their monthly bills would increase even though their gas use would remain low or decrease. Several other witnesses submitted that their gas usage was minimal and that increasing the customer charge as proposed by staff would be detrimental to them. Witnesses also argued that the proposed increase in rates is not justified in light of the company's positive financial position.

B. Summary of the Proposed Stipulation

As noted previously, the parties to these proceedings entered into a stipulation that was filed on August 22, 2008. The only issue not resolved in the stipulation is the proposed rate design which was litigated and is expressly reserved in the stipulation for the Commission's determination. A new rate design is recommended by the staff, DEO, and OOGA, but opposed by OCC, Citizens' Coalition, Cleveland, and OPAE. The remaining parties take no position on the rate design issue. Pursuant to the stipulation, the parties agree, *inter alia*, that:

(1) The parties entered into the stipulation notwithstanding any objections filed on June 23, and July 25, 2008,[2] to the staff reports of investigation filed May 23, and June 12, 2008.

(2) DEO should be granted a net base rate revenue increase of $40,500,000. The signatory parties agree that DEO's current rates are no longer sufficient to yield a reasonable compensation for the services rendered and are, therefore, unreasonable. The recommended total net base rate revenue increase of $40,500,000 provides reasonable compensation for the services rendered. The total revenue requirement reflects 8.49 percent as a reasonable rate of return on rate base.

(3) Unless otherwise specifically provided for in the stipulation, all rates, terms, conditions, and any other items shall be treated in accordance with the staff reports. If any proposed rates, terms, conditions, or other items set forth in DEO's applications are not addressed in the staff reports, the proposed rate, term, condition, or other item shall be treated in accordance with the applicable application.

(4) The parties agree that the rate design issue, which is characterized as fixed versus volumetric and/or a sales decoupling rider versus straight fixed variable, is not resolved in the stipulation and will be decided by the Commission after the issue is fully litigated.

2 On September 2, 2008, Cleveland filed a letter clarifying that its objections, which were filed on June 20, 2008, should be included in this provision of the stipulation.

(5) The revenue increase includes $5,500,000 for base rate funded demand-side management (DSM) programs for low-income customers. In addition to low income DSM expenditures that will be recovered through base rates, additional annual DSM expenditures of $4,000,000 will be recovered though a DSM rider applicable to customers served under the General Sales Service (GSS) and Energy Choice Transportation Service (ECTS) rate schedules, for a total annual DSM commitment of $9,500,000. DEO shall convene, within two months of the approval of this stipulation, a DSM collaborative comprised of DEO, staff, OCC, OPAE, and representatives of other parties. The collaborative shall enter into a contract by March 31, 2009, to implement said programs. DSM applications seeking recovery for DSM funding through the DSM rider, over and above the current $4,000,000 commitment, may be filed at any time the collaborative deems an increase in ratepayer funding is reasonable and prudent. If an increase in the DSM rider is granted, DEO's transportation migration riders, Part A and B, shall be increased by the amount necessary to recover an equivalent amount for funding DEO's participation in Gas Technology Institute research programs, up to $600,000 per year.

(6) By December 31, 2008, DEO shall provide $1,200,000 of shareholder-funded assistance to those organizations set forth in the stipulation, to help DEO's customers in the areas of payment assistance and education regarding the efficient use of natural gas.

(7) The staff's recommended percentage allocation of the revenue increase by rate schedule class shall be used to apportion the net base rate revenue increase to rate schedules.

(8) Firm storage service rates shall be adjusted to reflect increased gas storage migration costs, but these amounts shall not be treated as a part of the base rate increase. The portion of firm storage service revenues reflecting such costs shall be credited to amounts that would otherwise be recovered by transportation migration rider, Part B.

(9) The investigation fee set forth in paragraph 23 of the company's proposed rules and regulations, relating to meter tampering, shall be $112.

(10) A late-payment charge (LPC) of 1.5 percent on overdue balances (a) will be credited toward amounts that would otherwise be recovered

through the uncollectibles expense rider; (b) will not be imposed if the amount due is paid by the time the next bill is generated; (c) will not be imposed on customers participating in the percentage of income payment plan (PIPP) or the PIPP arrearage crediting program; and (d) will not be assessed to customers participating in a short-term payment plan or budget billing plan, provided they make the minimum payment required under the plan by the bill due date. (However, if the customer does not pay the full plan amount, the LPC will be charged only on the payment plan arrearage.)

(11) Security deposits shall be billed in three equal installments, to be paid concurrently with the monthly bill.

(12) No later than six months after approval of the stipulation, DEO shall complete studies on the feasibility of providing adjusted bill due dates to allow customers the option of having the due date on the bill coincide with the time when they are most capable of paying the bill, and reducing fees charged to customers who pay their bills through authorized agents, by telephone, by credit card, and through the internet.

(13) To the extent that any of the items enumerated in paragraphs (10) through (12) above are addressed in Case No. 08-723-AU-ORD, *In the Matter of the Commission's Review of Chapters 4901:1-17 and 4901:1-18, and Rules 4901:1-5-07, 4901:1-10-22, 4901:1-13-11, 4901:1-15-17, 4901:1-21-14, and 4901:1-29-12 of the Ohio Administrative Code*, the outcome of that rulemaking proceeding shall govern.

(14) The firm receipt point and commodity exchange revenue sharing mechanism proposed by DEO shall be implemented, and the customer revenue portion shall be credited to amounts that would otherwise be collected through the PIPP rider.

(15) The period in which DEO must remit payments to natural gas marketers for the purchase of receivables billed from the DEO's customer care system (CCS) shall be extended from 14 to 30 days. DEO shall remit 100 percent of the value of supplier receivables, less any unpaid supplier balances, by writing a check or executing a wire transfer weekly for accounts billed from the CCS and monthly for accounts billed from the special billing system. Such payments shall be made approximately 30 days after the accounts have been billed.

(16) The $3,720,000 of test year off-system transportation and storage revenue shall not be credited to amounts that would otherwise be recovered through the transportation migration rider, Part B.

(17) The staff recommendations with regard to the PIR application in 08-169 shall be adopted with the following modifications:

(a) DEO shall assume ownership of and responsibility for all customer-owned service lines (including effectively coated lines) whenever such lines are separated from the main line and a pressure test is required before the line can be returned to service.

(b) DEO may implement the PIR program and PIR cost recovery charge mechanism for an initial five-year period or until the effective date of new base rates resulting from the filing of an application to increase base rates, whichever comes first. At that time, DEO may request continuation of the PIR program beyond the initial term, and the other signatory parties retain all rights with respect to any positions taken in future PIR filings by the company.

(c) OCC shall be provided an opportunity for meaningful participation with the company and staff in annual PIR previews and PIR cost recovery procedures and any other PIR-related process or proceeding that impacts the scope of the PIR program and/or the cost recovery of the PIR program. Beginning within one month of Commission approval of this stipulation, and annually thereafter, in conjunction with the annual PIR preview, DEO, staff, OCC and other interested parties will be given the opportunity to review the PIR program plan as proposed by DEO for the upcoming year.

(d) By August 2012, DEO shall perform studies assessing the impact of the PIR program on safety and reliability, the estimated costs and benefits resulting from acceleration of the pipeline replacement activity, and DEO's ability to effectively and prudently manage, oversee, and inspect the PIR program. Such studies shall be provided to the signatory parties and considered in the annual PIR post-audit procedure. Should OCC decide to engage an auditor independently for the PIR post-audit procedure, DEO agrees to cooperate and provide the information needed to conduct a meaningful audit.

(e) DEO shall revise its proposed allocation methodology to identify and allocate more precisely the costs associated with investments undertaken in the PIR program. The Commission will determine the appropriate allocation of such costs.

(f) Any savings relative to a baseline level of operation and maintenance expenses associated with leak detection and repair processes, department of transportation inspections of inside meters that may no longer be necessary if meters are relocated outside, and corrosion monitoring expenses shall be used to reduce the fiscal year-end regulatory asset eligible for recovery through the PIR cost recovery charge. DEO shall work with staff and OCC to develop an appropriate baseline for those expenses.

(g) Any request for re-authorization of the PIR program shall be filed in accordance with then-applicable law and shall include all applicable due process protections.

(18) The staff's recommendations with regard to the AMR application in 06-1453 shall be adopted. Within three months of the approval of this stipulation, DEO shall work with staff and OCC to develop an appropriate baseline from which meter reading and call center savings will be determined and such quantifiable savings shall be credited to amounts that would otherwise be recovered through the AMR costs recovery charge.

(19) For purposes of calculating the AMR cost recovery charge and the PIR cost recovery charge, the rate of return on rate base for calculation of such charges shall be the rate of return specified in this stipulation.

(20) DEO shall evaluate the feasibility of separating the residential and nonresidential GSS/ECTS classes for purposes of rate design and will share with the signatory parties the results of the feasibility study before including in its next base rate application a class cost of service study that separately assesses those classes.

(21) DEO shall file tariff sheets to implement the provisions of this stipulation and commitments made to the OOGA in accordance with the letter attached as Joint Exhibit 1-B.

(Jt. Ex. 1).

C. Consideration of the Stipulation

Rule 4901-1-30, O.A.C., authorizes parties to Commission proceedings to enter into stipulations. Although not binding on the Commission, the terms of such an agreement are accorded substantial weight. See, *Consumers' Counsel v. Pub. Util. Comm.*, 64 Ohio St.3d 123, at 125 (1992), citing *Akron v. Pub. Util. Comm.*, 55 Ohio St.2d 155 (1978). This concept is particularly valid where the stipulation is unopposed by any party and resolves almost all of the issues presented in the proceeding in which it is offered.

The standard of review for considering the reasonableness of a stipulation has been discussed in a number of prior Commission proceedings. See, e.g., *Cincinnati Gas & Electric Co.*, Case No. 91-410-EL-AIR (April 14, 1994); *Western Reserve Telephone Co.*, Case No. 93-230-TP-ALT (March 30, 1004); *Ohio Edison Co.*, Case No. 91-698-EL-FOR et al. (December 30, 1993); *Cleveland Electric Illum. Co.*, Case No. 88-170-EL-AIR (January 30, 1989); *Restatement of Accounts and Records (Zimmer Plant)*, Case No. 84-1187-EL-UNC (November 26, 1985). The ultimate issue for our consideration is whether the agreement, which embodies considerable time and effort by the signatory parties, is reasonable and should be adopted. In considering the reasonableness of a stipulation, the Commission has used the following criteria:

(1) Is the settlement a product of serious bargaining among capable, knowledgeable parties?

(2) Does the settlement, as a package, benefit ratepayers and the public interest?

(3) Does the settlement package violate any important regulatory principle or practice?

The Ohio Supreme Court has endorsed the Commission's analysis using these criteria to resolve issues in a manner economical to ratepayers and public utilities. *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.*, 68 Ohio St.3d 547 (1994), (citing *Consumers' Counsel*, supra, at 126). The court stated in that case that the Commission may place substantial weight on the terms of a stipulation, even though the stipulation does not bind the Commission (*Id.*).

The signatory parties agree that the stipulation is supported by adequate data and information, represents a just and reasonable resolution of certain issues in these proceedings and is the product of lengthy, serious bargaining among knowledgeable and capable parties (Jt. Ex. 1 at 2). In support of the stipulation, Jeffrey A. Murphy, Director of Rates and Gas Supply for DEO, testified that the signatory parties to the stipulation regularly participate in regulatory matters before the Commission and represent a broad range of interests, including the company, staff, various consumer groups, a major natural gas marketer, and a natural gas producer (DEO Ex. 1.4 at 3). Upon review of the terms of the stipulation and the attached schedules and tariffs, the Commission believes that the parties engaged in comprehensive negotiations prior to signing the agreement. Therefore, based on our three-prong standard of review, we find that the first criterion, that the process involved serious bargaining by knowledgeable, capable parties, is met.

Mr. Murphy testified that the stipulation, as a package, benefits ratepayers and the public interest. According to the witness, the $40,500,000 net base rate revenue increase agreed to in the stipulation represents a $30,000,000 reduction from the increase requested by DEO in its application. In addition, Mr. Murphy notes that the stipulation provides for two new initiatives, the AMR and PIR programs, which will enhance service and safety. The witness further states that, among other things, the stipulation benefits customers by protecting low-income customers and providing for a substantial increase in the funding of programs to assist customers, i.e., the DSM program (DEO Ex. 1.4 at 4-6). Upon review of the stipulation, we find that, as a package, with the modification discussed later in this opinion and order, it benefits the ratepayers and the public interest. The Commission notes, however, that, while the stipulation may serve to benefit the immediate needs of the parties, it may not advance the public's longer term interest in promoting energy efficiency and conservation. The Commission is concerned that declining block rate structures, such as that embodied in the parties' stipulation for the Large Volume General Sales Service and Large Volume Energy Choice Transportation Service rate classes, may not encourage efficient use. While it is incumbent upon the Commission to balance competing policy interests, energy efficiency and conservation concerns have garnered amplified Commission attention. In the interest of timely resolution of a matter to which all parties have agreed, however, the Commission is willing to accept this stipulation.

Finally, the signatory parties agree that the stipulation violates no regulatory principle or precedent (Jt. Ex. 1 at 2). Upon consideration, the Commission finds that there is no evidence that the stipulation violates any important regulatory principle or practice and, therefore, the stipulation meets the third criterion. Accordingly, we find that the stipulation entered into by the parties should be adopted, as modified herein.

The Commission notes that the parties have agreed, in the stipulation, to adopt staff's recommendations related to AMR. Specifically, the parties agreed that, within three months of the Commission's approval of this stipulation, DEO shall work with staff and OCC to develop an appropriate baseline from which meter reading and call center savings will be determined and such quantifiable savings shall be credited to amounts that would otherwise be recovered through the AMR cost recovery charge. While the Commission acknowledges that DEO is already involved in the deployment of AMR technology, advanced metering infrastructure (AMI) technology offers additional benefits to both customers and the company that may warrant consideration by the Commission. DEO acknowledged that it had not conducted any evaluation of partnering with electric utilities or purchasing services from electric companies that may deploy AMI and have a service territory overlapping with that of DEO (August 25, 2008, Tr. at 79). Accordingly, the Commission directs DEO to conduct a review and report back to the staff within 180 days of this order on the technical capability of DEO's advanced metering system to take advantage of communications systems and services that could become available with parallel electric utility deployment of AMI and on the potential consumer and utility benefits and costs associated with utilizing enhanced AMI communications systems and services.

D. Summary of the Rate Design Issue

1. Background and General Arguments

The only outstanding issue in this case is the appropriate rate design. In its initial filings, DEO proposed that a sales reconciliation rider (SRR) be applied to the company's sales and ECTS rate schedules. Initially, the SRR would be set at zero and, on the first of November of each year, the rider rate would be revised after approval by the Commission (App. Par. 7). In the application, the company stated that the reduced gas consumption attributable to energy conservation inhibits DEO's ability to earn the Commission-approved revenue requirement, because there is an over-reliance on volumetric rates and an understatement of the costs that do not vary with usage. According to the application, the SRR would address this problem and would eliminate DEO's disincentive to support energy conservation measures through DSM by decoupling the linkage between customer usage and the company's opportunity to receive revenue requirements based on its cost of providing utility service. DEO also notes that a move to a straight fixed variable (SFV) rate design would eliminate the problem entirely. DEO explained that, as proposed in the application, the SRR was modeled after the mechanism approved by the Commission in *In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc., for Approval Pursuant to Revised Code Section 4929.11, of a Tariff to Recover Conservation Expenses and Decoupling Revenues Pursuant to Automatic Adjustment Mechanisms and for Such Accounting Authority as May be Required to Defer Such Expenses and Revenues for Future Recovery Through Such*

Adjustment Mechanisms, Case No. 05-1444-GA-UNC, Supplemental Opinion and Order (June 27, 2007) (*Vectren*) (App. Alt. Reg. Exs. A and B; DEO Ex. 1.0 at 40-42).

In the staff report, it was noted that, under the traditional rate design for gas companies, which consists of a minimal customer service charge and a volumetric rate, the gas utilities have seen the recovery of the distribution costs deteriorate as the volume of gas used has decreased. Therefore, staff recommended, as a replacement for DEO's proposed SRR, a change in the rate structure policy that is based on a fixed distribution service charge. According to the staff report, this rate design would reduce the revenue deterioration in a time of reduced consumption, would reduce the need for frequent rate cases, and would alleviate the need for a decoupling mechanism, such as the SRR proposed in the initial application, which requires frequent reconciliations (Staff Ex. 1 at 34-36).

As noted previously, the stipulating parties agreed that the rate design issue, characterized as fixed versus volumetric and/or a sales decoupling rider versus straight fixed variable, is not resolved through the stipulation and would be submitted to the Commission for a decision (Jt. Ex. 1 at 4). DEO points out that all of the parties agree that some form of decoupling mechanism is required for DEO. However, the parties disagree on the specific design of the mechanism (DEO Br. at 1-2).

DEO and OOGA have joined staff in the rate design recommended in the staff report for a fixed distribution service charge. Therefore, DEO, staff, and OOGA advocate the adoption of a modified SFV or levelized rate design which allocates most of the fixed costs of delivering gas to a monthly flat fee, with the remaining fixed costs being recovered through a variable or volumetric component (Staff Ex. 1 at 34-36; Jt. Ex. 1 at 4; Jt. Ex. 1-A). The modified SFV proposal would be applied to DEO's GSS and ECTS rate schedules and would limit eligibility to customers consuming less than 3,000 thousand cubic feet (mcf) per year. In addition, the proposal would be phased in over a two-year period (DEO Ex. 1.4 at 7).

Under this proposed modified SFV rate design, DEO's current $5.70 and $4.38 residential fixed customer charges, as well as the $1.2355 and $1.1201 per mcf charges, for DEO's East Ohio and West Ohio Divisions, respectively, would be eliminated. Instead, residential customers would pay a flat monthly fee of $12.50 in year one and $15.40 in year two, but with a corresponding lower usage component to recover the remaining fixed distribution costs. Under the levelized rate design proposal, the monthly volumetric charge in year one would be $0.648 per mcf for the first 50 mcf and $1.075 per mcf over 50 mcf. In year two, the volumetric charge would be $0.378 per mcf for the first 50 mcf and $0.627 per mcf over 50 mcf (Staff Ex. 1 at 34-36; Jt. Ex. 1 at 4; Jt. Ex. 1-A; DEO Ex. 1-4 at 7-

8).[3] According to DEO, the proposal is termed a "modified" SFV because the rates proposed in Joint Exhibit 1-A do not recover all of DEO's fixed costs in the fixed monthly customer charge. DEO explains that, under the modified SFV, for the average customer using 99.1 mcf per year, only 71 percent of the annual base rate revenues will be provided by the $12.50 fixed monthly charge and, in year two, only 84 percent of the annual base rate revenues will be provided by the $15.40 monthly charge (DEO Ex. 1.4 at 8).

The modified SFV rate design is opposed by OCC, Citizens' Coalition, Cleveland, and OPAE, who advocate for keeping the current low residential customer charge and high volumetric rates. They argue that, if a decoupling mechanism is to be adopted, the appropriate design is a decoupling rider, such as the SRR that was initially proposed in DEO's application, rather than the modified SFV or levelized rate design recommended by DEO, staff, and OOGA (Jt. Ex. 1 at 4; OCC Br. at 3). The remaining parties in this case take no position on the rate design issue (Jt. Ex. 1 at 4).

DEO states that there are no statutory provisions expressly related to rate design. The company notes that both the SFV approach advocated by staff, DEO, and OOGA, and the rider approach advocated by the consumer groups are consistent with the results of the cost-of-service study, provide DEO with its revenue requirement, and do not violate any statute or decision of the Ohio Supreme Court. Therefore, DEO submits that the Commission should decide which rate design is best by considering which is most consistent with the fundamental regulatory principles and policies of the Commission (DEO Br. at 2-3). DEO's witness, Mr. Murphy, testified that DEO's operation and maintenance expenses, as well as other elements of the cost of service for the company, are predominantly fixed in nature and do not vary with usage (DEO Ex. 1.4 at 9). According to staff, the distribution facilities required to serve a small residence are, typically, the same as those required to service a large residence (Staff Ex. 1 at 34). DEO and staff submit that the SFV rate design is more consistent with the principle of cost causation, which supports recovering the fixed costs in a more fixed manner (Tr. IV at 83; DEO Br. at 5; Staff Ex. 1 at 34). DEO points out that the SRR rate design advocated by the consumer groups requires customers to pay a higher portion of the fixed costs during the heating season, which is inconsistent with the manner in which the costs are incurred; therefore, DEO posits that the rider design does not embody the degree of cost causation inherent in the SFV rate design (DEO Br. at 6). Mr. Murphy points out that the current $5.70 fixed charge provides only 30 percent recovery of the company's authorized base rate revenue (Tr. IV at 89). However, under the SFV rate design, in year two, DEO will recover 84 percent of it base rate revenues in the fixed charge (DEO 1.4 at 8). To ensure that DEO is financially stable and able to invest in its pipeline system, OOGA states that it is essential

[3] On October 10, 2008, DEO, staff, and OOGA filed a letter clarifying that the volumetric charges set forth in Jt. Ex. 1-A were updated in the proposed tariffs filed on October 8, 2008, to reflect the revenue requirement agreed to in the stipulation.

that DEO's fixed costs for operating and maintaining its system be separated from the costs for the volume of gas transported, and points out that this is accomplished by the SFV rate design (OOGA Br. at 5). In addition, DEO, staff, and OOGA note that the modified SFV is consistent with the levelized rate design approved by the Commission in *In the Matter of the Application of Duke Energy Ohio, Inc., for an Increase in Rates, for Approval of an Alternative Rate Plan for Gas Distribution Service, and for Approval to Change Accounting Methods,* Case Nos. 07-589-GA-AIR, 07-590-GA-ALT, and 07-591-GA-AAM, Opinion and Order (May 28, 2008) (*Duke*) (DEO Ex. 1.4 at 8-9; Staff Br. at 2; OOGA Br. at 4).

Finally, OPAE maintains that the SFV rate design undermines the traditional regulatory balance and renders the utility virtually risk free by allowing DEO to recover 84 percent of its revenue requirement in year two (OPAE Br. at 6). However, DEO argues that it faces economic risks under the SFV rate design, citing, as an example, the fact that three out of four of DEO's largest customers filed for bankruptcy (Tr. VI at 43). In addition, DEO submits that the reduced rate of return found in the stipulation reflects the reduced risk to the company (Tr. VI at 47).

2. Conservation

OCC, OPAE, Cleveland, and Citizens' Coalition argue against the SFV rate design, stating that it violates Sections 4929.02 and 4905.70, Revised Code, and the state policy to promote conservation (OCC Br. at 2; OPAE Br. at 3; Cleve. Br. at 3; Cit. Coal. Br. at 9 and 12). OCC, OPAE, and Cleveland believe that the SFV rate design provides a disincentive for conservation and decreases the natural gas price signal that encourages customers to conserve (OCC Ex. 21 at 10-11; OCC Br. at 2; OPAE Br. at 3; Cleve. Br. at 9-10). Furthermore, Cleveland argues that approval of the SFV rate design will impede the development of DSM innovation in Ohio (Cleve. Br. at 10). OCC, OPAE, and Cleveland believe that the SFV proposal penalizes those customers who made energy efficiency investments and leads to less energy efficiency by lessening consumer incentives for self-initiated efficiency and increases the period of time for payback on the investments in hard economic times (OCC Ex. 21 at 13-15; OCC Br. at 2; OPAE Br. at 3; Cleve. Br. at 7). According to Cleveland, the fixed cost nature of the SFV rate design diminishes the value of a customer's reduction in consumption through energy conservation, because a smaller amount of the customer's bill is determined by the volumetric rate (Cleve. Br. at 7). OCC believes that because the SFV rate design reduces costs to high-use customers, those customers will be encouraged to use more gas (OCC Reply Br. at 8).

In response to the allegation that a reduction in the variable rate will render conservation futile, DEO and staff argue that the gas cost is, and will remain, the largest charge on most bills and, thus, will be the primary driver for customers' conservation decisions (DEO Br. at 7; Staff Ex. 3 at 3-4). DEO points out that OCC's witness, Mr.

Radigan, agrees that the total bill is the "biggest driver of usage decision" (DEO Br. at 7; Tr. V at 23). Therefore, DEO reasons that conservation is not discouraged by the SFV rate design and conserving customers will reap the full value of gas cost savings under this rate design (DEO Br. at 7). Staff also notes that, if the volumetric rate is artificially inflated beyond its cost basis, as is the case with the SRR proposal, a customer's analysis of the payback for conservation is skewed, which will cause the customer to overinvest in conservation, thus exacerbating the underrecovery of DEO's fixed costs (Staff Ex. 3 at 4-5). DEO maintains that the SFV proposal accomplishes the goal set forth in Section 4929.02, Revised Code, by aligning the interests of DEO and its customers with respect to energy efficiency and conservation (DEO Br. at 10). DEO and staff argue that, by lessening the tie between a customer's usage and DEO's revenues, the SFV rate design eliminates the primary disincentive to DEO's support of conservation measures (DEO Br. at 10; Staff Ex. 3 at 5). DEO contends that its willingness to nearly triple its DSM funding pursuant to the stipulation is evidence that the SFV better aligns DEO's interest in promoting conservation with that of its customers than does the SRR alternative promoted by the consumer groups (DEO Br. at 10).

3. Price Signals and Simplicity

DEO believes that the SFV proposal further supports the policy goals of Section 4929.02, Revised Code, because the more accurate price signals will improve market operation and customer participation. DEO also notes that, consistent with Section 4929.02, Revised Code, the SFV rate design will avoid subsidies, such as the subsidization of conservation services and of low-usage customers by normal- and high-usage customers, which would occur under the SRR proposal (DEO Br. at 11-12).

Furthermore, DEO contends that the SFV model advances the state energy policy, as modified by Am. Sub. Senate Bill No. 221, which was signed into law May 1, 2008 (DEO Ex. 1.4 at 8). DEO and staff believe that the SFV rate design sends better price signals to customers (DEO Ex. 1.4 at 9; Staff Br. at 4). As DEO explains, the company's non-gas costs are primarily fixed and the SFV rate design would accurately communicate to customers the fact that DEO's costs to serve them are primarily fixed. On the other hand, according to DEO, the current rate design sends the misleading price signal that the company's costs vary with monthly usage. According to DEO, this misleading signal would not be cured if the rider advocated by the consumer groups is adopted (DEO Br. at 6). In addition, DEO avers that the inevitability of true-ups associated with the SRR makes it more difficult for customers to make decisions based on the price of distribution. For example, with the SRR, a customer saving in one period by conserving may have to pay a rate increase in a subsequent period in order to offset the impact on the base rate revenues (DEO Ex. 1.4 at 10; DEO Br. at 7).

DEO offers that the SFV rate design is straightforward and achieves simplicity because a fixed charge collects most fixed costs and a per-unit charge mostly collects costs that vary with usage (DEO Br. at 8). DEO points out that OCC's witness, Mr. Radigan, agrees that levelized rates are easier for customers to understand and that a decoupling rider is harder to explain that the SFV rate design (Tr. V at 21; DEO Br. at 9). DEO and staff note that not only is the rider proposal hard to explain but it is complex to execute because it will require additional, and potential contentious, proceedings before the Commission (DEO Br. at 9; Staff Ex. 3 at 6). In addition, staff notes that the SFV approach eliminates the need for carrying charges associated with deferred recoveries, such as those required by the SRR proposal (Staff Ex. 3 at 6; Staff Br. at 2).

4. Customer Usage

With regard to customer use, DEO advocates that the modified SFV rate design is preferable to the SRR supported by the consumer groups because the SFV design addresses the issue of declining use per customer by permitting a greater recovery of fixed charges in a demand rate rather than a usage rate (DEO Ex. 1.4 at 8; Tr. VI at 12). According to DEO's witness, Mr. Murphy, "DEO's average weather-normalized use per customer ("UPC") declined at a moderate rate of 1-2% per year until prices began to rise substantially, culminating in a year-over-year UPC decline of over 6% when prices reached their all-time peak during the 2005-2006 winter..." (DEO Ex 1.0 at 41). Staff agrees that the continued deterioration in consumption results in DEO underrecovering revenues associated with fixed costs (Staff Ex. 1 at 34).

OPAE and OCC argue that neither DEO nor the staff supports the assertion that declines in the customer usage per capita resulted in DEO failing to meet the revenue requirement authorized in DEO's prior rate case, let alone the new revenue requirement. OPAE believes that there is no justification for an SFV rate design other than a financial advantage for DEO (OPAE Br. at 2; OCC Reply Br. at 5).

OCC is concerned that low-usage customers may drop off the system if the SFV rate design is approved (OCC Ex. 21 at 12-13; OCC Br. at 2). If this occurs, OCC contends that DEO will lose revenues, which it will attempt to collect from the remaining customers in a future rate case (OCC Reply Br. at 5-7). Cleveland points to Mr. Radigan's testimony to support its contention that low-usage customers will bear a disproportionately greater increase in their natural gas bills if they maintain their current usage patterns (Cleve. Br. at 8; OCC Ex. 21 at 12). Cleveland believes that this could have an even greater impact on low-income and elderly customers with fixed incomes (Cleve. Br. at 8). According to OCC, the SFV rate design is regressive toward low-usage customers, some of which are low- or fixed-income customers (OCC Ex. 21 at 11-12; OCC Br. at 2). Furthermore, OCC submits that the SFV rate design results in low-usage residential customers, who will see an increase in their fixed monthly charge, subsidizing high-usage non-residential customers, who will see a decrease in their fixed monthly charge (OCC Br. at 9-10). Cleveland states that it opposes any rate design which, in the event customers conserve gas or are low-use customers, guarantees DEO recovery (Cleve. Br. at 3).

5. Impact on Low-Income Customers

Turning now to the concern for low-income customers, OPAE argues that low-income users will be harmed if the SFV rate design is adopted. Furthermore, OPAE believes that adoption of the SFV rate design will create pressure for low-income customers that have not previously sought assistance to request it (OPAE Br. at 5).

DEO states that the average usage for DEO's residential customers is 99.1 mcf per year and the average usage for DEO's PIPP customers is 131 mcf per year (Tr. IV at 18-19). DEO argues that the record reflects that both PIPP and non-PIPP low-income customers use more gas than the average residential DEO customer uses (DEO Reply Br. at 10). Using the average PIPP usage as a proxy for low-income customers, staff witness Steve Puican testified that, on average, low-income customers in DEO's territory are not low-usage customers. Therefore, staff concludes that, because low-income customers are more likely to be high-usage customers, it is reasonable to conclude that low-income customers are more likely to actually benefit from the SFV rate design (Staff Ex. 3 at 7; Staff Br. at 14).

OCC disagrees with staff's assumption that the average usage of PIPP customers is an appropriate proxy for the average usage of non-PIPP low-income customers (Staff Ex. 3 at 7; OCC Br. at 11). OCC witness Colton, referring to data from the United States Census Bureau, United States Department of Energy, Department of Labor, and the Energy Information Administration, counters that PIPP is not an appropriate proxy for low income customer usage (OCC Ex. 22 at 10-36; OCC Br. at 11). Mr. Colton believes that, in addition to the level of consumption to determine if the average low-income customer is a low-usage customer, Mr. Puican should have considered the size and density of the customers' housing units, because both are related to income level (OCC Ex. 22 at 34-35). Citing Mr. Colton's testimony, Cleveland argues that, because of their limited means, low-income customers likely live in smaller dwellings and use less gas than wealthy homeowners in larger homes (Cleve. Br at 8; OCC Ex. 22 at 10-21). When looking at usage and density, Mr. Colton concludes that the SFV rate design shifts costs from the higher-income households to the lower-income households (OCC Ex. 22 at 34-35).

DEO rebuts OCC's argument stating that an analysis of a valid proxy for the low-income non-PIPP customers reveals that those customers, on average, will save money in the first year of the transition to SFV and see an increase of only $0.43 per month in year two (DEO Ex. 1.5 at 4). DEO submits that the testimony and analysis of OCC's witness, Mr. Colton, should be rejected because it is fundamentally flawed in that it relied on nationwide and statewide data that is not specific to DEO's territory and the facts in this case. Further, DEO avers that Mr. Colton incorrectly assumes that annual gas expenditures and consumption are equivalent (DEO Reply Br. at 13). OCC and OPAE discount DEO's attempt to rebut Mr. Colton's conclusions (OCC Br. at 13; OPAE Br. at 4).

6. Cost-of-Service Study for GSS class

With regard to DEO's cost-of-service study for the GSS class, OCC argues that DEO's study does not support charging GSS class customers uniform rates under the SFV rate design. OCC explains that the GSS class is comprised of non-homogenous residential and non-residential consumers with widely varying usage. OCC points out that the average residential customer uses 99.1 mcf per year, the average non-residential customer uses 390 mcf per year, and the largest consumption in the GSS class is in excess of 5,000 mcf per year (OCC Br. at 6-7; Tr. IV at 18). According to OCC, under the SFV rate design, no user should pay more than their appropriately allocated share of fixed costs; however, the record does not establish that all customers in the GSS class place the same burden on the system. OCC maintains that, without more detail in the cost-of-service study, it is undetermined who is actually responsible for the fixed costs that are recovered through the SFV rate design. OCC believes that the same fixed charge should not be levied on the residential customers and the non-residential large users, i.e., those in excess of 300 mcf per year, in the GSS class. OCC advocates that a new class of service study should be done which separates the customers in the GSS class into more homogeneous groups. OCC notes that, while this cost-of-service study will be done prospectively pursuant to the stipulation, this future event will not help low-use residential customers harmed by the SFV rate design (OCC Br. at 7-8).

DEO maintains that the SFV rate design is supported by cost-of-service studies (DEO Ex. 1.4 at 9). Contrary to OCC's assertions regarding the cost-of-service studies, DEO states that OCC's witness Mr. Radigan, conceded that DEO's cost-of-service study was reasonably conducted and followed generally accepted guidelines for such studies (OCC Ex. 21 a 21). Furthermore, DEO's witness Andrews believes that, if any subsidy is taking place, it is the non-residential customers within the GSS class that are subsidizing the residential customers (Tr. 1 at 235 and 237). In fact, according to Mr. Andrews, the inclusion of the non-residential customers in the GSS class is a benefit to the residential customers because it ends up lowering the costs to serve the GSS class as a whole (Tr. 1 at 219).

7. Gradualism

Referring to the doctrine of gradualism, according to OCC, this doctrine of rate design will be violated if the SFV concept is approved (OCC Ex. 21 at 15-17; OCC Br. at 2). OCC states that the increase of the customer charge, by $8.12 in year one and $11.02 in year two, will cause harm to DEO's residential customers and the regulatory process. OCC, the Citizens' Coalition, and Cleveland argue that, in deciding the rate design issue, the Commission should take into consideration the public outcry at the local public hearings and in the letters submitted in these dockets that oppose the SFV rate design (OCC Br. at 14; Cit. Coal. Br. at 1; Cleve. Br. at 5). The Citizens' Coalition submits that the Commission should take into consideration the fragile economic situations of DEO's customers, as evidenced in the testimony provided at the public hearings, when deciding if the customers should be subject to the rate shock that the Citizens' Coalition maintains will be caused by adoption of the SFV rate design (Cit. Coal. Br. at 6). OCC also maintains that the SFV rate design will have a more extreme impact on customer bills than would the SRR decoupling proposal which provides for the reconciliation of revenue (OCC Ex. 21 at 17-19; OCC Br. at 2). OPAE states that the SRR strikes an appropriate balance between the customers who deserve a refund when increased sales result in over-earning, while at the same time protecting DEO from reductions in sales due to weather, conservation, efficiency, and price volatility (OPAE Br. at 7).

DEO and staff advocate that the SFV proposal contains measures that satisfy the principle of gradualism. DEO submits that the two-year phase-in of the SFV rates will give the affected customers an opportunity to adjust to the elimination of past subsidies. Furthermore, DEO and staff emphasize that, under the SFV proposed rates, DEO will only be recovering 84 percent of its annual base-rate revenues in year two and 16 percent of the fixed costs will still remain in the volumetric rates (DEO Br. at 12-13; DEO Ex. 1.4 at 8; Staff Br. at 12). In addition, DEO notes that the increase in funding for DSM spending set forth in the stipulation from $3,500,000 to $9,500,000, with an additional $1,200,000 supporting low-income programs and consumers, is another way the potential impact of the SFV proposal is being mitigated (DEO Br. at 13).

E. <u>Consideration of the Rate Design Issue</u>

The Commission notes initially that the parties in these proceedings agree that DEO's rates are no longer sufficient to yield a reasonable compensation for the services rendered by the company. Furthermore, there is also no dispute in this case as to the amount of the increase in revenues needed to allow DEO to earn a fair rate of return on its investment (Jt. Ex. 1 at 3).

The only issue left for the Commission to decide is the design of the rates that DEO should bill to GSS/ECTS customers in order to collect the revenues agreed to in the settlement. Several months ago, we were faced with this same issue in the *Duke* case and, in that case, we determined that it was time to reevaluate traditional natural gas rate design. In the past, natural gas utilities provided both the natural gas itself and the infrastructure and services to deliver it. Now customers can choose a natural gas supplier separate from the distribution utility which delivers it. Historically, natural gas rate design included a modest customer charge which only covered a portion of the fixed costs, such as metering charges, but recovered other fixed charges through a volumetric rate that added to the cost of the natural gas itself. We also noted in *Duke*, as we do in these cases, that conditions in the natural gas industry have changed markedly in the past several years. The natural gas market is now characterized by volatile and sustained price increases, causing customers to increase their efforts to conserve gas. The evidence of record documents the sales-per-customer trend in recent years and reflects that, when prices began to rise substantially, DEO's average weather-normalized use per customer declined each year by over six percent (DEO Ex 1.0 at 41; Staff Ex. 1 at 34). Under traditional rate design, the ability of a utility, like DEO, to recover its fixed costs of providing service hinges in large part on its actual sales, even though the company's costs remain fairly constant regardless of how much gas is sold. Thus, a negative trend in sales has a corresponding negative effect on DEO's ongoing financial stability, its ability to attract new capital to invest in its network, and its incentive to encourage energy efficiency and conservation.

The Commission has determined previously, and does so again today, that a rate design which separates or "decouples" a gas company's recovery of its cost of delivering the gas from the amount of gas customers actually consume is necessary to align the new market realities with important regulatory objectives. We believe it is in the interest of all customers that DEO has adequate and stable revenues to pay for the costs of its operations and capital and to ensure the continued provision of safe and reliable service. We further believe that there is a societal benefit to promoting conservation by removing from rate design the current built-in incentive to increase gas sales. A rate design that prevents a company from embracing energy conservation efforts is not in the public interest. A strict application of cost causation would "decouple" throughput and recovery of fixed costs, thus eliminating any disincentive to promote conservation.

Additionally, the stipulation provides $9,500,000 for DSM projects under the stipulation is critical to our decision in this case (Jt. Ex. 1, at 4). The Commission has long recognized that conservation and efficiency should be an integral part of natural gas policy. To that end, the Commission has recognized that DSM program designs that are cost-effective, produce demonstrable benefits, and produce a reasonable balance between reducing total costs and minimizing impacts on non-participants are consistent with Ohio's economic and energy policy objectives. In the stipulation, the parties have agreed to fund DSM programs for low-income customers as well as to convene, within two months, a DSM collaborative comprised of DEO, staff, OCC, OPAE, and representatives of other parties. We laud the parties for this agreement and we encourage DEO to make cost-effective weatherization and conservation programs available to all low-income consumers and to ramp up such programs as rapidly as reasonably practicable. Furthermore, we encourage the collaborative to address additional opportunities to achieve energy efficiency improvements and to consider programs which are not limited to low-income residential consumers. As part of its review, the collaborative should develop energy efficiency program design alternatives and should consider those alternatives in a manner that strikes a balance between cost savings and any negative ratepayer impacts. The energy efficiency programs should also consider how best to achieve net total resource cost and societal benefits; how to minimize unnecessary and undue ratepayer impacts; how process and impact evaluation will be conducted to ensure that programs are implemented efficiently; how to capture what otherwise become lost opportunities to achieve efficiency improvements in new buildings; how to minimize "free ridership" and the perceived inequity resulting from the payment of incentives to those who might adopt efficiency measures without such incentives; and how to integrate gas DSM programs with other initiatives. Noting that the stipulation establishes a collaborative and a threshold related to reasonable and prudent DSM spending above the current $4,000,000 commitment, the Commission directs that the collaborative shall file a report within nine months of this order, identifying the economic and achievable potential for energy efficiency improvements and program designs to implement further reasonable and prudent improvements in energy efficiency.

In evaluating whether the strict application of cost causation principles would result in a disproportionate impact on economically vulnerable customers, we consider low-income users, some of whom may also be on fixed incomes. We are persuaded that the majority of low-income customers actually use more natural gas, on average, than those customers whose means place them above 175 percent of the federal poverty level. Thus, low-income customers, on average, would actually enjoy lower bills under the strict application of cost causation principles.

Having determined that a new decoupling rate design is appropriate, we must decide which is the better choice of two methods: a levelized rate design (that is, SFV), which recovers most fixed costs up front in a flat monthly fee, or a decoupling rider (that is, SRR), which maintains a lower fixed customer charge and allows DEO to offset lower sales through an adjustable rider.

On balance, the Commission finds that the modified SFV rate design advocated by DEO, staff, and OOGA is preferable to a decoupling rider. Both methods would address revenue and earnings stability issues in that the fixed costs of delivering gas to the home will be recovered regardless of consumption. Each would also remove any disincentive by the company to promote conservation and energy efficiency. The levelized rate design, however, has the added benefit of producing more stable customer bills throughout all seasons because fixed costs will be recovered evenly throughout the year. In contrast, with a decoupling rider, as favored by OCC, OPAE, the Citizens' Coalition, and Cleveland, customers would still pay a higher portion of their fixed costs during the heating season when their bills are already the highest, and the rates would be less predictable since they could be adjusted each year to make up for lower-than-expected sales.

A levelized rate design also has the advantage of being easier for customers to understand. Customers will transparently see most of the costs that do not vary with usage recovered through a flat monthly fee. As we noted in *Duke*, customers are accustomed to fixed monthly bills for numerous other services, such as telephone, trash, internet, and cable services. A decoupling rider, on the other hand, is much more complicated and harder to explain to customers. It is difficult for customers to understand why they have to pay more through a decoupling rider if they worked hard to reduce their usage; the appearance is that the company is penalizing them for their conservation efforts.

The Commission also believes that a levelized rate design sends better price signals to consumers. Under the current rate structure, the rate for delivering the gas to the home is only about 30 percent of the total bill; therefore, the largest portion of the bill, the other 70 percent, is for the gas that the customer uses (Tr. IV at 89). This commodity portion, the cost of the actual gas used, is the biggest driver of the amount of a customer's bill. Therefore, we believe that the gas usage will still have the biggest influence on the price signals received by the customers when making gas consumption decisions, and customers will still receive the benefits of any conservation efforts in which they engage. While we acknowledge that there will be a modest increase in the payback period for customer-initiated energy conservation measures with a levelized rate design, this result is counterbalanced by the fact that the difference in the payback period is a direct result of inequities within the existing rate design that cause higher-use customers to pay more of their fair share of the fixed costs than low-use customers.

The levelized rate design also promotes the regulatory objective of providing a more equitable cost allocation among customers, regardless of usage. It fairly apportions the fixed costs of service, which do not change with usage, among all customers, so that everyone pays his or her fair share. Customers who use more energy for reasons beyond their control, such as abnormal weather, large number of persons sharing a household, or older housing stock, will no longer have to pay their own fair share plus part of someone else's fair share of the costs.

We turn now to the issue raised by the parties regarding intra-class cost allocation. The foundation of rate design is that each customer bears his or her proportionate share of the costs for providing the utility services. We conclude that the costs at issue are principally fixed. We are convinced that, while no cost of service analysis can perfectly allocate costs, a strict cost causation analysis of the facts in this matter leads to the conclusion that each GSS/ECTS customer should bear an equal proportion of the distribution costs. We do note, however, that, while the GSS/ECTS rate classes could be more precisely drawn, to the extent that there is an intra-class subsidy there is evidence that it may be from nonresidential users to residential users.

Our analysis does not end there, however. Before strictly applying cost causation, we must consider and balance other important public policy outcomes of rate design. Would strict application of cost causation discourage conservation? Would it disproportionately impact economically vulnerable consumers, including both low-income customers and those on a fixed income? Will customers understand the rate design? Does it generate accurate price signals? Can it be implemented without rate shock – that is, with sensitivity to gradualism? On balance, what style of rate design will result in the best package of possible public policy outcomes?

We find today that it is in the public interest to move to a levelized rate design as soon as practicable. DEO and the staff have proposed a modified SFV rate design to be adopted over two years. We find that the first two years of that schedule should be adopted. In adopting this portion of their joint recommendation, we note that continuation of the inclining block volumetric rate will exacerbate any intra-class subsidy between nonresidential and residential users. It will, however, also provide modest incentive for customer-initiated conservation measures. As there is some agreement that this is a reasonable step toward a levelized rate design, we adopt the proposal for the first two years only. However, the Commission continues to believe that an expeditious transition to a full straight fixed variable rate design is the appropriate approach and notes that the phased-in rates provided in the stipulation will allow DEO to recover only 84 percent of its fixed costs in the fixed distribution service charge during the second year and beyond.

Therefore, the Commission is approving the first two years of this transition, however, prior to approval of rates for rates of the third year and beyond the Commission believes that a review of the cost allocation methodologies for the GSS/ECTS classes is appropriate. Therefore, DEO is directed to complete the cost allocation study required in the stipulation within 90 days of this order. Upon completion, DEO should submit a report and recommendation regarding whether the GSS/ECTS classes are appropriately comprised of both residential and nonresidential customers or whether the classes should be split. DEO shall also provide, if the recommendation is to split the classes, a recommended cost allocation per class. Upon review of the cost allocation study, the Commission will be establishing a process that will be followed to determine the appropriate rates in year three and beyond, as soon as practicable.

The Commission is sensitive to the impact of any rate increase on customers, especially during these tough economic times. We believe that the modified SFV rate design is a move toward correcting the traditional design inequities, while mitigating the impact of the new rates on residential customers, by maintaining a volumetric component to the rates for this first year. The additional cost allocation information will provide us the opportunity to reassess whether it is appropriate to separate the residential and non-residential consumers in these classes before establishing rates for the second year and beyond. However, even with these measures, we are concerned with the impact on low-income, low-use customers.

As noted in the *Duke* case, the Commission recognizes that, with this change to rate design, as with any change, there will be some customers who will be better off and some customers who will be worse off, as compared with the existing rate design. The levelized rate design will impact low-usage customers more, since they have not been paying the entirety of their fixed costs under the existing rate design. Higher-use customers, who have been overpaying their fixed costs, will actually experience a rate reduction. Customers in the middle ranges will see only the impact of the increase agreed to by the parties; they will see no additional impact as a result of the Commission choosing the levelized rate design.

The Commission is concerned with the impact that the change in rate structure will have on some DEO customers who are low-income, low-use customers. One of the major concerns raised by customers at the local hearings held in these matters was the effect a levelized rate design would have on low-use customers with low incomes. As a result, the Commission believes that some relief is warranted for this class of customers. In the *Duke* case, we approved a pilot program available to a specified number of eligible customers, in order to provide incentives for low-income customers to conserve and to avoid penalizing low-income customers who wish to stay off of programs such as PIPP. We emphasized in the *Duke* case that the implementation of the pilot program was important to our decision to adopt a levelized rate design in that case. Therefore, the Commission finds that DEO should likewise implement a one-year low-income pilot program aimed at helping low-income, low-use customers pay their bills.

As in the *Duke* case, the customers in the low-income pilot program shall be non-PIPP low-usage customers, verified at or below 175 percent of the poverty level. DEO's program should provide a four-dollar, monthly discount to cushion much of the impact on qualifying customers. This pilot program should be made available one year to the first 5,000 eligible customers. DEO, in consultation with staff and the parties, shall establish eligibility qualifications for this program by first determining and setting the maximum low-usage volume projected to result in the inclusion of 5,000 low-income customers who are determined to be at or below 175 percent of the poverty level. The Commission expects that DEO will promote this program such that, to the fullest extent practicable, the program is fully enrolled with 5,000 customers. Following the end of the pilot program, the Commission will evaluate the program for its effectiveness in addressing our concerns relative to the impact on low-use, low-income customers.

In addition, the Commission is cognizant of the reduction in risk assumed by the company as a result of the rate design approved by the Commission. This, in conjunction with the testimony heard in local hearings and, most importantly, taking notice of deteriorating economic conditions, leads us to alter downward the approved rate of return by 20 basis points, to 8.29 percent.

As a final matter pertaining to the rate design, the Commission would note that OCC makes the argument in its brief that DEO failed to request approval of the SFV rate design in its initial application and failed to provide adequate notice to its customers of the SFV rate design, as required by Sections 4909.18, 4909.19, and 4904.43, Revised Code (OCC Br. at 2-3). DEO and staff point out that the SFV rate design was not proposed in the application, but was recommended by the staff in the staff report that was issued eight months after the application was filed. Therefore, DEO and staff maintain that the statute did not require that the notice of the application reference the SFV and that the authority relied on by OCC is inapplicable (DEO Reply Br. at 1-2; Staff Reply Br. at 2-3). The Commission agrees that the support cited by OCC in its brief is not applicable. As OCC pointed out in its brief, Section 4909.18, Revised Code, requires that the substance of DEO's initial application be disclosed in the publication (OCC Br. at 5). Essentially, OCC is maintaining that, in order to comply with the statute, the company must republish notice simply because the company is now supporting the staff's proposal in the staff report of investigation in this case. The Commission finds that OCC's contention is without merit. Furthermore, as OCC acknowledges in its brief, the notice for public hearing did appropriately state that one of the issues in the case was the rate design and included straight fixed variable (OCC Br. at 6).

III. <u>RATE DETERMINANTS</u>:

As proposed under the stipulation, the value of DEO's property used and useful in the rendition of gas service as of the date certain is $1,404,744,493. The Commission finds the rate base stipulated by the parties to be reasonable and proper, and adopts the valuation of $1,404,744,493 as the rate base for purposes of these proceedings.

The stipulation recommends that rates be approved that would enable DEO to earn a rate of return of 8.49 percent. As noted above, the Commission believes that the rate of return should be reduced by 20 basis points to 8.29 percent. The Commission finds that a rate of return of 8.29 percent is fair and reasonable for DEO. We will, therefore, authorize a rate of return of 8.29 percent for purposes of these cases.

Applying a rate of return of 8.29 percent to the value of the used and useful property as of the date certain results in required operating income of $116,453,318. Under the stipulation, the parties agreed that the adjusted operating income of DEO during the test year was $93,250,390. This results in an income deficiency of $23,202,928, which, when adjusted for uncollectibles and taxes, results in a revenue increase of $37,476,976. Therefore, we find that a revenue increase of $37,476,976 is reasonable and should be approved.

IV. TARIFFS:

As part of its investigation in this matter, the staff reviewed the company's various rates and charges, and the provisions governing terms and conditions of service. On October 8, 2008, the company filed proposed tariffs which reflect the agreement of the parties to the stipulation. In addition, the tariffs filed on October 8, 2008, include provisions for the modified SFV rate design proposed by DEO, staff, and OOGA. DEO indicated that these proposed tariffs will be substantially identical to the final compliance tariffs that will be filed with approved rates and appropriate effective dates inserted if the final order does not require alteration of the terms and conditions contained therein. The Commission has reviewed the proposed tariffs and found that they correctly incorporate the provisions of the stipulation and the modified SFV rate design. The proposed tariffs filed on October 8, 2008, should be approved, subject to modification to reflect the rate of return approved by this opinion and order. Therefore, the Commission finds that DEO should file, in final form, four, complete, printed copies of the final tariff, as modified, with the Commission's docketing division, consistent with this order. The effective date of the increase shall be a date not earlier than the date upon which final tariffs are filed with the Commission and the date on which DEO files proposed tariffs addressing the low-income pilot program. The new tariffs shall be effective for service rendered on or after such effective date.

With regard to the tariffs addressing the low-income pilot program required by this order, the Commission finds that DEO should file proposed revised tariffs in accordance with our directives for this pilot, as set forth in this order. Upon review of the tariffs, the Commission will issue an entry approving the tariffs implementing the pilot program.

FINDINGS OF FACT:

(1) On July 20, 2007, DEO filed a notice of intent to file an application for an increase in rates. In that notice, the company

requested a test year beginning January 1, 2007, and ending December 31, 2007, with a date certain of March 31, 2007.

(2) By Commission entry issued August 15, 2007, the test year and date certain were approved.

(3) On August 30, 2007, DEO filed applications requesting approval for an increase in gas distribution rates, for an alternative rate plan for its gas distribution service, and to modify certain accounting methods, 07-829, 07-829, 07-830, and 07-831, respectively. On December 13, 2006, DEO filed an application, 06-1453, for approval of an automatic adjustment mechanism, associated with the deployment of AMR equipment. On February 22, 2008, DEO filed an application, 08-169 for approval of an automatic adjustment mechanism to recover costs associated with its PIR program. By entry of April 9, 2008, the Commission, *inter alia*, granted DEO's request to consolidate these five cases.

(4) The Commission granted intervention to Citizens Coalition, OEG, IGS, Dominion Retail, Stand, Local G555, Integrys, OOGA, OCC, OPAE, IEU-Ohio, and Cleveland. On June 19, 2008, and July 28, 2008, IEU-Ohio and OEG, respectively, filed notices of withdrawal from these proceedings.

(5) The Commission granted a motion to admit David C. Rinebolt to practice *pro hac vice* on behalf of OPAE.

(6) On May 23, 2008, the report of conclusion and recommendations of the financial audit of DEO by Blue Ridge Consulting Services, Inc., was filed.

(7) On June 12, 2008, staff filed its written report of investigation with the Commission in 07-829, 07-830, 07-831, and 06-1453.

(8) Objections to the staff report in 07-829, 07-830, 07-831, and 06-1453 were filed by Cleveland, DEO, OCC, Citizens Coalition, Integrys, and OPAE.

(9) On June 12, 2008, staff filed its written report of investigation of 08-169 with the Commission.

(10) Objections to the staff report in 08-169 were filed by DEO and OCC.

(11) Local public hearings were held as follows: Youngstown on July 28, 2008 and August 19, 2008; Lima on July 29, 2008; Canton on July 31, 2008; Akron on July 31, 2008, and August 21, 2008; Cleveland on August 4, 2008; Geneva on August 4, 2008; Marietta on August 5, 2008; and Garfield Heights on August 18, 2008.

(12) DEO published notice of the local public hearings and the evidentiary hearing.

(13) A prehearing conference was held on July 8, 2008.

(14) The evidentiary hearing commenced on August 1, 2008, and concluded on August 27, 2008.

(15) On August 22, 2008, as supplemented on October 14, 2008, a stipulation was filed in these matters which resolved all outstanding issues except the issue of rate design. Signatories to the stipulation include DEO, staff, OCC, OPAE, Citizens' Coalition, OOGA, Stand, and Cleveland.

(16) Initial briefs were filed by OCC, DEO, OPAE, Cleveland, Neighborhood Coalition, OOGA, and staff on September 10, 2008. Reply briefs were filed by DEO, staff, OCC, OPAE, OOGA, and Cleveland on September 16, 2008.

(17) An oral argument was held before the Commission on September 24, 2008, on the issue of rate design.

(18) The company filed proposed revised tariffs and proof of publication of the application and the hearings.

(19) The value of all of the company's property used and useful for the rendition of service to its customers affected by this application, determined in accordance with Section 4909.15, Revised Code, is not less than $1,404,744,493.

(20) Applying a rate of return of 8.29 percent results in required operating income of $116,453,318. Under the stipulation, the parties agreed that the adjusted test year operating income was $93,250,390. This results in an income deficiency of $23,202,928, which, when adjusted for uncollectibles and taxes, results in a revenue increase of $37,476,976.

(21) DEO's proposed revised tariffs are consistent with the discussion and findings set forth in this opinion and order and shall be approved, except for modification based on our adjustment of the rate of return. DEO shall file in final form, four, complete printed copies of the final tariff consistent with this order.

(22) DEO should file proposed revised tariffs addressing the low-income pilot program.

(23) DEO should conduct a review and report back to the staff within 180 days on the technical capability of DEO's advanced metering system.

(24) That the DSM collaborative should file a report within nine months of this order identifying the economic and achievable potential for energy efficiency improvements and program designs to implement further reasonable and prudent improvements in energy efficiency.

CONCLUSIONS OF LAW:

(1) DEO is natural gas company as defined by Section 4905.03(A)(6), Revised Code, and a public utility as defined by Section 4905.02, Revised Code.

(2) The company's application was filed pursuant to, and this Commission has jurisdiction of the application under, the provisions of Sections 4909.17, 4909.18, and 4909.19, Revised Code, and Chapter 4929, Revised Code, and the application complies with the requirements of these statutes.

(3) Staff investigations were conducted and reports duly filed and mailed, and public hearings held herein, the written notice of which complied with the requirements of Sections 4909.19 and 4903.083, Revised Code.

(4) The stipulation submitted by the parties, as modified on this opinion and order, is reasonable and, as indicated herein, shall be adopted.

(5) The existing rates and charges for service are insufficient to provide the applicant with adequate net annual compensation and return on its property used and useful in the provision of service.

(6) A rate of return of 8.29 percent is fair and reasonable under the circumstances of this case and is sufficient to provide the applicant just compensation and return on its property used and useful in the provision of service to its customers.

(7) The company is authorized to withdraw its current tariffs and to file, in final form, revised tariffs which the Commission has approved herein.

ORDER:

It is, therefore,

ORDERED, That the joint stipulation filed on August 22, 2008, as modified in this opinion and order, be approved in accordance with this opinion and order. It is, further,

ORDERED, That, in accordance with this opinion and order, DEO conduct a review and report back to the staff within 180 days on the technical capability of DEO's advanced metering system. It is, further,

ORDERED, That the application of DEO for authority to increase its rates and charges for service be granted to the extent provided in this opinion and order. It is, further,

ORDERED, That, consistent with this opinion and order DEO shall file a cost of service study within 90 days. It is, further, ORDERED, That, consistent with this opinion and order, the DSM collaborative file a report within nine months of this order identifying the economic and achievable potential for energy efficiency improvements and program designs to implement further reasonable and prudent improvements in energy efficiency. It is, further,

ORDERED, That DEO implement a one-year low-income pilot program consistent with this opinion and order and file proposed revised tariffs addressing the low-income pilot program. It, is further,

ORDERED, That DEO be authorized to file in final form four complete copies of the tariff consistent with this opinion and order (other than the requirement for a low-income pilot program) and to cancel and withdraw its superseded tariffs. DEO shall file one copy in its TRF docket (or may make such filing electronically as directed in Case No. 06-900-AU-WVR) and one copy in this case docket. The remaining two copies shall be designated for distribution to the Rates and Tariffs, Energy and Water Division of the Commission's Utilities Department. It is, further,

ORDERED, That the effective date of the new tariffs shall be a date not earlier than all of the following: the date of this opinion and order; the date upon which four complete, printed copies of final tariffs are filed with the Commission; and the date on which DEO files proposed tariffs addressing the low-income pilot program. The new tariffs shall be effective for service rendered on or after such effective date. It is, further,

ORDERED, That DEO shall notify all affected customers via a bill message or via a bill insert within 30 days of the effective date of the tariffs. A copy of the customer notice shall be submitted to the Commission's Service Monitoring and Enforcement Department, Reliability and Service Analysis Division, at least 10 days prior to its distribution to customers. It is, further,

ORDERED, That nothing in this opinion and order shall be binding upon the Commission in any future proceeding or investigation involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further, ORDERED, That a copy of this opinion and order be served on all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Paul A. Centolella

Ronda Hartman Fergus

Valerie A. Lemmie

Cheryl L. Roberto

CMTP/SEF:ct

Entered in the Journal

OCT 1 5 2008

Reneé J. Jenkins
Secretary