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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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| In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc., for Authority to Amend its Filed Tariffs to Increase the Rates and Charges for Gas Services and Related Matters. ) | Case No. 07-1080-GA-AIR |
| In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc., for Approval of an Alternative Rate Plan for a Distribution Replacement Rider to Recover the Costs of a Program for the Accelerated Replacement of Cast Iron Mains and Bare Steel Mains and Service Lines, a Sales Reconciliation Rider to Collect Differences between Actual and Approved Revenues, and Inclusion in Operating Expenses of the Costs of Certain Reliability Programs. ) | Case No. 07-1081-GA-ALT |
| In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc., for Continued Accounting Authority to Defer Differences between Actual Base Revenues and Commission-Approved Base Revenues Previously Granted in Case No. 05-1444-GA-UNC and Request to Consolidate with Case No. 07-1080-GA-AIR. ) | Case No. 08-632-GA-AAM |

OPINION AND ORDER

The Commission, considering the above-entitled applications, hereby issues its opinion and order in this matter.

APPEARANCES:

McNees, Wallace & Nurick, LLC, by Samuel C. Randazzo, Gretchen J. Hummel, Lisa McAlister, and Joseph M. Clark, 21 East State Street, 17th Floor, Columbus, Ohio 43215-4228, and Lawrence K. Friedeman, Vice President and Deputy General Counsel, P.O. Box 209, Evansville, Indiana 47709-209, on behalf of Vectren Energy Delivery of Ohio, Inc.

Sheryl Creed Maxfield, First Assistant Attorney General of the state of Ohio, by Duane W. Luckey, Section Chief, and Werner L. Margard III 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 Maureen R. Grady Joseph P. Serio, and Michael E. Idzkowski, Assistant Consumers' Counsel, office of the Ohio Consumers' Counsel, 10 West Broad Street, Columbus, Ohio 43215, on behalf of residential utility consumers of Vectren Energy Delivery of Ohio, Inc.

David C. Rinebolt, 231 West Lima Street, P.O. Box 1793, Findlay, Ohio 45839-1793, on behalf of Ohio Partners for Affordable Energy.

Vorys, Sater, Seymour & Pease, LLP, by W. Jonathan Airey and Gregory D. Russell, 52 East Gay Street, Columbus, Ohio 43216-1008, on behalf of Honda of America Mfg., Inc.

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

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

Trent A. Dougherty, Director of Legal Affairs, 1207 Grandview Avenue, Suite 201, Columbus, Ohio 43212-3449, on behalf of the Ohio Environmental Council.

## OPINION:

### I. History of the Proceedings

Vectren Energy Delivery of Ohio, Inc., (VEDO or the Company) is a natural gas company as defined in Section 4905.03(A)(6), Revised Code, and a public utility as defined in Section 4905.02, Revised Code. As such, VEDO is subject to the jurisdiction of the Public Utilities Commission in accordance with Sections 4905.04 and 4905.05, Revised Code.

On November 20, 2007, VEDO filed applications for an increase in gas distribution rates and for approval of an alternative rate plan. A technical conference regarding VEDO's applications was held on February 5, 2008.

On May 23, 2008, VEDO filed an application for continued accounting authority to defer differences between actual base revenues and commission approved base revenues, as previously granted by the Commission.

A written report of the Commission staff's (Staff) investigation was filed on June 16, 2008. Objections to the Staff Report were timely filed by VEDO, the Ohio Consumers' Counsel (OCC), Honda of America Manufacturing, Inc. (Honda), Ohio Partners for Affordable Energy (OPAE), and the Ohio Environmental Council (OEC). Motions to intervene were filed by OCC, Honda, OPAE, OEC, Interstate Gas Supply, Inc. (IGS), and Stand Energy Corporation (Stand). Intervention was granted to these parties by the attorney examiner on August 1, 2008.

On July 18, 2008, a prehearing conference was held. The evidentiary hearing was held on August 19, 2008, through August 25, 2008, and on August 27, 2008, August 28, 2008, September 2, 2008, September 9, 2008, and September 15, 2008. Sixteen witnesses testified on behalf of VEDO, five witnesses testified on behalf of OCC, and five witnesses testified on behalf of Staff.

Local public hearings were held on September 3, 2008, in Sidney, Ohio; on September 4, 2008, in Dayton, Ohio; and on September 8, 2008, in Washington Court House, Ohio.

A stipulation (Stipulation) was filed on September 8, 2008, signed by VEDO, OCC, OPAE and Staff (Signatory Parties). Post-hearing briefs were filed by VEDO and Staff. A joint post-hearing brief was filed by OCC and OPAE,. Reply briefs were filed by VEDO, Staff, OCC and OPAE.

## II. Summary of the Stipulation

The Stipulation was intended by the Signatory Parties to resolve certain issues in this proceeding (Joint Ex. 1). The Stipulation includes, *inter alia,* the following provisions:

(1) The Signatory Parties agree that VEDO should receive a revenue increase of $14,779,153 with total annual revenues of $456,791,425.

(2) The Signatory Parties agree that the value of all of VEDO's property which is used and useful for the rendition of gas service to customers, as of the date certain of August 31, 2007, is $234,839,282.

(3) The Signatory Parties agree that VEDO is entitled to a rate of return of 8.89 percent.

(4) The proposed tariffs attached to the Stipulation as Stipulation Exhibit 2 should be approved by the Commission and be effective for all services rendered after the date final approved tariffs are filed with the Commission.

(5) The stipulated revenue requirement includes $4 million in customer-funded energy efficiency programs, of which $1.1 million is allocated to low-income weatherization funding. The Signatory Parties further agree to the establishment of an Energy Efficiency Funding Rider (EFFR), initially set at $0.00, applicable to Rate Schedules 310, 315, 320 and 325. The Signatory Parties also agree that the Vectren Collaborative, originally established in *In re Vectren Energy Delivery of Ohio, Inc.*, Case No. 05-1444-GA-UNC, Supplemental Opinion and Order (June 28, 2007), will monitor the implementation of the energy efficiency programs approved as proposed in the application in this case and, at least annually, will consider and make recommendations regarding additional program funding, as well as reallocation of funding among programs. The Company will submit, and the Collaborative will support, an application to establish an EFFR charge to provide a minimum of $1 million to be used to continue funding for the low-income weatherization program for customers whose income is between 200 percent and 300 percent of the poverty level.

(6) The Signatory Parties agree that the Sales Reconciliation Rider-A proposed by the Company to recover the deferral amount authorized in Case No. 05-1444-GA-UNC should be approved and that the initial rate should be set at the rate contained in Stipulation Exhibit 2 (Joint Ex. 1, Stipulation Ex. 2).

(7) The Signatory Parties agree that the Commission should provide the Company with accounting authority to continue deferring for future recovery the difference between weather-normalized actual base revenues and Commission-approved base revenues in the same manner as previously authorized in Case No. 05-1444-GA-UNC, as requested in Case No. 08-632-GA-AAM, and that such deferred amounts should be recovered by Sales Reconciliation Rider-A.

(8) The Company agrees to continue funding the low-income conservation program created pursuant to Case No. 05-1444-

GA-UNC, from October 1, 2008, until the effective date of rates approved in this proceeding.

(9) The Signatory Parties agree that the Company should be authorized to establish a Distribution Replacement Rider (DRR) to enable the recovery of and return on investments made by the Company to accelerate implementation of a bare steel and cast iron main replacement program at a pre-tax rate of return of 11.67 percent. The DRR shall be in effect for the lesser of five years from the effective date of rates approved in this proceeding or until new rates become effective as a result of the filing by the Company of an application for an increase in rates under Section 4909.18, Revised Code, or the filing of a proposal to establish rates pursuant to an alternative method of regulation under Section 4929.05, Revised Code.

(10) The Signatory Parties agree that the revenue distribution shown on Stipulation Exhibit 5 (Joint Ex. 1, Stipulation Exhibit 5) shall be used to develop rates and charges ultimately approved by the Commission in this proceeding.

(11) The Signatory Parties agree that the rate design issues associated with rate schedules 310 and 315 are not resolved by the Stipulation and will be fully litigated and submitted to the Commission for its consideration and resolution.

(12) The Stipulation resolves all contested issues raised in Case Nos. 07-1080-GA-AIR, 07-1081-GA-ALT, 05-1444-GA-UNC and 08-632-GA-AAM, except for those issues specifically identified as being reserved for separate resolution by means of litigation or otherwise.

III. Evaluation of the Stipulation

Rule 4901-1-30, Ohio Administrative Code, authorizes parties to Commission proceedings to enter into stipulations. Although not binding on the Commission, the terms of such agreements are accorded substantial weight. *See Consumers' Counsel v. Pub. Util. Comm.*, 64 Ohio St. 3d 123, 125 (1992), *citing Akron v. Pub. Util. Comm.*, 55 Ohio St. 2d 155 (1978). This concept is particularly valid where the stipulation is supported or unopposed by the vast majority of parties 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., Dominion Retail v.*

*Dayton Power and Light,* Case Nos., 03-2405-EL-CSS et al., Opinion and Order (February 9, 2005); *Cincinnati Gas & Electric Co.,* Case No. 91-410-EL-AIR, Order on Remand (April 14, 1994); *Ohio Edison Co.,* Case Nos. 91-698-EL-FOR et al., Opinion and Order (December 30, 1993); *Cleveland Electric Illum. Co.,* Case No. 88-179-EL-AIR, Opinion and Order (January 31, 1989). 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 (1997)(*quoting 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.

Based upon our three-prong standard of review, we find that the first criterion, that the settlement process involved serious bargaining by knowledgeable, capable parties, is met. Counsel for VEDO, OPAE, OCC and Staff have been involved in many cases before the Commission, including a number of prior cases involving rate issues. Further, a review of the terms of the Stipulation, and the schedules and tariffs filed with the Stipulation, shows that the parties engaged in comprehensive negotiations, resolving all outstanding issues except rate design (Staff Ex. 3a at 3).

The Stipulation also meets the second criterion. As a package, it advances the public interest by resolving a majority of issues raised in this proceeding without incurring the time and expense of further litigation. Moreover, the testimony in the record indicates that the Stipulation establishes a fair and reasonable revenue requirement with an increase in base rates of approximately 3.34 percent (Staff Ex. 3a at 3). At the hearing, Staff witness Puican testified that the stipulated rate of return of 8.89 percent includes a 25 basis point reduction to the return on equity component, in order to take into consideration the reduction in risk to the Company which may result from the Commission's adoption of one of the rate designs proposed by the Company, Staff, or OCC (Tr. IX at 11-12).

Further, the Stipulation extends shareholder funding of VEDO's low-income conservation program and provides for a significant expansion of funding for energy efficiency programs. The Stipulation provides for $4 million in funding for energy efficiency programs, including $1.1 million in funding for low-income weatherization programs. The Commission notes that the energy efficiency programs will be monitored on an ongoing basis by the Vectren Collaborative, which was first established under Case No. 05-1444-GA-UNC. The Stipulation also establishes a distribution system replacement program to accelerate the replacement of VEDO's aging distribution systems and provides for oversight of this program. Finally, the Stipulation establishes a program to address the safety concerns of prone-to-fail risers with a schedule to replace such risers and adopts a proposal for VEDO to assume ownership and repair responsibility for customer service lines (Staff Ex. 3a at 3-4).

Finally, the Stipulation meets the third criterion because it does not violate any important regulatory principle or practice (Staff Ex. 3a at 4).

Our review of the Stipulation indicates that it is in the public interest and represents a reasonable resolution of the issues in this case. The Commission finds the stipulated rate of return of 8.89 percent, requiring an increase of $14,779,153 in revenues, to be fair, reasonable, and supported by the record and will adopt the stipulated revenue increase and rate of return for purposes of this proceeding. We will, therefore, adopt the Stipulation in its entirety.

## IV. Rate of Return and Authorized Rates

The Signatory Parties stipulated to a net operating income of $11,270,763 for the test year ending May 31, 2008. Application of this dollar return to the stipulated rate base of $234,839,282 results in a rate of return of 4.80 percent. Such a return is insufficient to provide VEDO with reasonable compensation for the natural gas service it renders to its customers.

The parties have agreed to a recommended rate of return of 8.89 percent on a stipulated rate base of $234,839,282, requiring a net operating income of $20,877,212. Adding the stipulated revenue increase of $14,779,153 to the stipulated test year revenues of $442,012,272 produces a new revenue requirement of $456,791,425, an increase of 3.34 percent (Joint Ex. 1, Stipulation Exhibit 1, Schedule A-1).

## V. Rate Design

The Stipulation left the issue of rate design unresolved. VEDO has proposed a residential rate design that reflects gradual movement toward a straight fixed variable (SFV) rate design over a period of two rate case cycles. Because this two-step approach would include a volumetric component in rates, the Company also proposes a transitional decoupling rider (SRR-B) which would recover the difference between the actual revenues collected under the proposed rates and the stipulated revenue requirement in this case (Co. Ex. 9b at 3-5).

According to VEDO, the evidence demonstrates that a rate design that recovers the fixed costs of providing distribution service through the customer charge is warranted, based on the goal of setting rates based upon the cost of providing service (Co. Ex. 9b at 5; Staff Ex. 3 at 8-9). VEDO notes that OCC's witness Coulton agreed that a basic principle of ratemaking is that rates should reflect costs and that one set of customers should not be charged for costs that a different set of customers caused a utility to incur (OCC Ex. 2 at 21-22). VEDO also contends that the record shows that a rate design that collects fixed costs through a volumetric charge provides customers with a misleading price signal about costs that can be avoided by reducing consumption (Co. Ex. 9b at 5, 8; Staff Ex. 3 at 4-5).

VEDO argues that, based on these traditional ratemaking principles, its proposal to establish a residential rate design based on implementation of full SFV has compelling advantages over any other proposal. VEDO notes that, if the Commission were to adopt a two-stage transition to a full SFV without the proposed decoupling rider, the rates at the stipulated revenue level would be an average year-round customer charge of $16.04, with a volumetric charge that would produce the remainder of the residential revenue requirement in the first year, and an average year-round full SFV rate of $18.37, with no volumetric charge, in the second year (Co. Ex. 9b at 11-13; Tr. VIII at 11).

OCC and OPAE argue that a decoupling mechanism with a low customer charge accomplishes the same goal and is superior to the SFV rate design because it sends appropriate price signals and allows customers to have better control over their gas bills. OCC and OPAE claim that a decoupling mechanism would retain the current lower fixed monthly charge of $7.00; in contrast, OCC and OPAE claim that customers would not understand a structure based upon two seasonal charges, as proposed by the Company. OCC and OPAE believe that a decoupling mechanism such as the mechanism approved by the Commission in Case No. 05-1444-GA-UNC would protect VEDO from any decline in average use that was not weather-related. Moreover, OCC and OPAE contend that a traditional decoupling mechanism is superior to SFV because it is symmetrical and provides equal protection from changing sales volumes to both customers and the Company.

OCC and OPAE also claim that the SFV rate design sends the wrong price signal to consumers by telling customers that it does not matter how much they consume; their gas distribution bill will be relatively the same. OCC and OPAE claim that the SFV design does not encourage conservation because it reduces the volumetric rate while increasing the fixed customer charge. OCC and OPAE allege that the SFV rate design would lengthen the payback for energy efficiency investments because a greater portion of the bill will be recovered through the fixed customer charge and a smaller portion of the bill through the volumetric charge. OCC notes that Staff witness Puican testified that charging a volumetric rate to recover fixed costs provides an artificial price signal (Tr. VI at 27-28), but OCC claims that, if the goal is to achieve maximum conservation, then the best price signal is one that includes the largest volumetric charge and the lowest fixed charge.

OCC and OPAE also claim that the adverse impacts of the SFV rate design on low-usage customers are also harmful to low-income customers because it requires them to pay more to subsidize high-volume users. OCC and OPAE cite to the testimony of OCC witness Coulton for the proposition that an SFV rate design has the effect of disproportionately increasing bills to low-income customers (OCC Ex. 2 at 31). OCC and OPAE argue that VEDO and Staff improperly assume the SFV rate design to be beneficial to low-income customers who are not on PIPP. OCC and OPAE rely upon the testimony of OCC witness Coulton, who testified that the average energy use of PIPP customers is higher than the average energy use of PIPP customers plus non-PIPP low-income customers. OCC and OPAE claim that this demonstrates that low-income customers are not high energy users (OCC Ex. 2 at 27).

OCC and OPAE argue that the PIPP population is not an appropriate surrogate for the entire low-income population because of the basic nature of the PIPP program which requires a household to pay a percentage of its income to the utility in order to maintain service. As a result, the PIPP program excludes a substantial number of households that have lower energy bills but are still low-income customers (OCC Ex. 2 at 27). Instead, OCC and OPAE rely upon the testimony of OCC witness Coulton, who claimed that lower income households use less natural gas than higher income households (OCC Ex. 2 at 30).

Further, OCC and OPAE claim that the Company and Staff proposals related to the customer charge violate the doctrine of gradualism. OCC notes that the Staff does not rely upon any formula or overriding principle when applying gradualism (Tr. VI at 36). OCC faults Staff for not providing a more transparent explanation for its support of the SFV rate design. OCC believes that a more gradual introduction of SFV is needed in order to lessen the impact on customers.

Finally, OCC and OPAE claim that the SFV rate design contradicts Ohio law. OCC and OPAE allege that the SFV rate design does not promote customer efforts to engage in the conservation of natural gas and instead encourages the increased usage of natural gas because the SFV rate design reduces costs for high-use customers (OCC Ex. 3 at 21). Thus, OCC and OPAE claim that the SFV rate design violates the state policy codified in Section 4929.02(A)(4), Revised Code.

VEDO responded to three issues raised by OCC: the price signal and its effect on conservation, the impact on low-income customers, and gradualism. With respect to price signals and their impacts on conservation, VEDO contends that conservation will reduce only the customer's commodity cost and that an appropriate and fair rate design will reflect precisely that and will permit a customer to make investment decision on a valid economic analysis. VEDO cites to the testimony of Staff witness Puican, who stated that:

> Customers will always achieve the full value of the gas cost savings regardless of the distribution rate. . . . Artificially inflating the volumetric rate beyond its cost basis skews the analysis and will cause over-investment in conservation . . . which exacerbates the under-recovery of fixed costs that the utility must then recover from all other customers.

(Staff Ex. 3 at 3.)

VEDO also alleges that OCC and OPAE incorrectly argue that the interests of low-income customers must prevail in any conflict over rates among residential customers. In addition, VEDO claims that the evidence shows that a fully implemented SFV rate design benefits low-income customers and that the OCC and OPAE position will cause low-income customers to have higher bills (Co. Ex. 8a at 12-16). The Company notes that, although OCC's witness did testify that an SFV rate design would adversely impact low-income customers, the record demonstrates that the witness based his testimony on unreliable data (Co. Ex. 8a at 11). Instead, VEDO argues that it prepared a study demonstrating that PIPP customers, on average, use more gas than the average of all residential customers (Co. Ex. 8a at 17). Further, the Company notes that Staff witness Puican agreed that the usage data of PIPP customers was the best available proxy for all low-income customers (Staff Ex. 3 at 7; Tr. VI at 35). Moreover, the Company presented, on rebuttal, a study that the Company claims directly rebutted OCC's witness and demonstrated that low-income customers in VEDO's service area consume, on average, more natural gas annually than all but the highest income residential customers in its service area (Co. Ex. 8a at 12-14).

With respect to OCC's arguments concerning gradualism, VEDO notes that the stipulated revenue increase in this case for residential customers is only 4.42 percent. The Company contends that, because the Commission has held that gradualism must be considered in reviewing the overall increase rather than a specific component such as the customer charge, an overall increase of less than five percent does not violate the principle of gradualism. *In re Vectren Energy Delivery of Ohio, Inc.*, Case No. 04-571-GA-AIR, Entry on Rehearing (June 8, 2005) at 5.

Staff argues that the record in this case demonstrates that the SFV rates are reasonable, understandable, and send the proper price signal to customers. Staff contends that the SFV rates follow cost-causation principles and reduce a subsidy that exists under current rates. Staff claims that the current rate design, which recovers most of the Company's fixed distribution costs through a rate that varies with usage, distributes more of the fixed costs to higher users of natural gas. Staff claims that SFV rates more evenly distribute fixed costs by increasing the portion of those costs recovered through a fixed rate component, thereby matching fixed and variable cost recovery with the costs actually incurred (Staff Ex. 3 at 4-5).

Staff further argues that the SFV rate design does not disproportionately impact low-income customers because the rate effects of the SFV rate design are not impacted by the income of individual ratepayers. Further, Staff believes that the record shows that many low-income customers would benefit from an SFV rate design. Staff contends that, based upon the higher usage levels of PIPP customers, many of these customers will benefit from the SFV approach (Staff Ex. 3 at 6-7).

Finally, Staff argues that the SFV rate design sends the appropriate price signal to customers. Staff claims that including fixed costs in a variable rate distorts price signals. Staff argues that, since SFV rate design aligns fixed costs with fixed rate components and variable costs with variable rate components, it provides better price signals for customers' investment decisions (Staff Ex. 3 at 4). Thus, Staff argues that, because the SFV rate design provides better information and results in more informed consumer decisions, it is a benefit, rather than a detriment, to consumers and conservation.

In three recent cases, the Commission has addressed the question of whether to adopt a levelized rate design (i.e., SFV), which recovers most fixed costs through a flat monthly charge, or a decoupling rider or sales reconciliation rider (SRR), which maintains a lower customer charge and allows the utility to offset lower sales through an adjustable rider. *See In re Duke Energy Ohio, Inc.*, Case No. 07-589-GA-AIR et al., Opinion and Order (May 28, 2008); *In re The East Ohio Gas Company, dba Dominion East Ohio*, Case No. 07-829-GA-AIR, et al., Opinion and Order (October 15, 2008); *In re Columbia Gas of Ohio, Inc.*, Case No. 08-72-GA-AIR, Opinion and Order (December 3, 2008). Consistent with our previous decisions, and recognizing that the stipulated rate of return includes a reduction to the return on equity to account for risk reduction associated with rate design change, the Commission finds, on balance, that a levelized rate design is preferable to a decoupling rider. Both methods address revenue and earnings stability issues in that the fixed costs of delivering gas to consumers will be recovered, regardless of whether consumption is reduced. Accordingly, both methods remove any disincentive to the utility to promote conservation and energy efficiency. However, a levelized rate design has the added benefit of producing more stable customer bills throughout the year because fixed costs will be recovered evenly throughout the year. In contrast, with the SRR proposed by OCC and OPAE, consumers would pay a higher portion of their fixed costs during the heating season when overall natural gas bills are already at their highest, and rates would be less predictable because they are subject to annual adjustments to recover lower-than-expected sales.

Moreover, the levelized rate design has the advantage of being easier for customers to understand. Customers will see most of the costs that do not vary with usage recovered through a flat monthly charge. As we noted in *Duke* and in *DEO*, customers are accustomed to fixed monthly bills for numerous other services, such as telephone, trash collection, internet, and cable services. An SRR, on the other hand, is much more complicated and difficult to explain to customers. It would be difficult for customers to understand why they would have to pay more through a decoupling rider if they have worked hard to reduce their consumption; it may appear to customers that the utility is penalizing customers for their conservation efforts.

Moreover, as we noted in *DEO*, the Commission believes that a levelized rate design sends better price signals to consumers. The possible response of consumers to an increase in the customer charge, i.e. dropping gas service entirely and switching to a different fuel, is much less likely to occur than consumers changing their level of gas usage in response to a change in the volumetric rate. When a utility is entitled to recover costs in excess of its costs for providing the next increment of gas service, a more economically efficient rate design is one that recovers these additional costs largely through a change that has little impact on consumer behavior.

Customers will not be misled into believing that reductions in consumption will allow them to avoid the fixed costs of the distribution system, as feared by Staff. However, the commodity portion of a customer's bill, the actual cost of gas the gas used, will remain the biggest driver of the bill. In fact, commodity costs comprise 75 to 80 percent of the total bill (Tr. III at 68). Therefore, we believe that the gas usage will still have the biggest influence on the price signals received by customers when making gas consumption decisions and that customers will still receive the appropriate benefits of any conservation efforts.

Additionally, the provision of $4 million in base rates for energy efficiency projects under the stipulation and its commitment for an additional $1 million through a subsequent filing are critical to our decision in this case. 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 energy efficiency 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 energy efficiency programs for low-income customers as well as to convene a collaborative to monitor the implementation of energy efficiency programs approved as proposed in the application and to consider and make recommendations regarding additional program funding or possible reallocation of funding among programs. We laud the parties for this agreement and we encourage VEDO 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 energy efficiency programs with other initiatives. The Commission directs that the collaborative shall file a report within nine months of this order, identifying the economic and achievable potential for energy efficient improvements and program designs to implement further reasonable and prudent improvements in energy efficiency.

Moreover, the Commission notes that the evidence in the record of this case does not support the conclusion that low-income customers are low-usage customers. VEDO presented testimony using actual census data for its service area, demonstrating that low-income customers in VEDO's service area consume, on average, more natural gas annually than all but the highest income residential customers in its service area (Co. Ex. 8a at 12-14). Further, it is undisputed that PIPP customers use more natural gas than the average of all residential customers (Co. Ex. 8a at 17). Staff witness Puican recommended the use of PIPP customers as the best available proxy for low-income customers (Staff Ex. 3 at 7; Tr. VI at 35). Although OCC's witness Coulton testified that his analysis indicated that low-income customers were also low-usage customers, Mr. Coulton based his analysis upon monthly surveys conducted by the Census Bureau, using data which the Census Bureau cautioned may be unreliable (Tr. V at 56-63; Co. Ex. 8a at 11); thus, Mr. Coulton's testimony regarding whether low-income customers are also low-usage customers is of little probative value in this proceeding. We find that the record demonstrates that low-income customers, on average, would actually enjoy lower bills under the levelized rate design.

We also find that the levelized rate design promotes the regulatory principles of providing a more equitable cost allocation among customers, regardless of usage. It fairly apportions the fixed costs of service among all customers so that everyone pays their fair share. Customers who use more energy for reasons beyond their control, such as abnormal weather, a 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.

Nonetheless, as we noted in *Duke* and *DEO*, we recognize that, with this change in rate design, as with any change, there will be some customers who will be better off and some customers who will be worse off, in comparison to the existing rate design. The levelized rate design will impact low-usage customers more than high-usage customers, since they have not been paying the entirety of their fixed costs under the existing rate design. High-usage customers, who have been paying more than their share of the fixed costs, will actually experience a reduction in their gas bills.

The Commission is concerned, however, with the impact that the change in rate structure will have on some VEDO customers who are low-income, low-usage customers. The Commission believes that some relief is warranted for this class of customers. In previous cases, 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 have emphasized that the implementation of the pilot program was important to our decisions to adopt a levelized rate design in that case. Therefore, the Commission finds that VEDO should likewise implement a one-year, low-income, pilot program aimed at helping low-income, low-usage customers pay their bills.

As in the prior cases, 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. VEDO'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 for one year to the first 5,000 eligible customers. VEDO, 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 VEDO 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-usage, low-income customers.

Having decided that the Commission will approve a levelized rate design rather than an SRR, we will address whether to adopt a partial SFV, which includes a volumetric component, or to move directly to a full levelized rate design. According to the evidence in the record, a residential customer charge of $18.37 would produce the full residential revenue requirement stipulated to by the Signatory Parties (Tr. VIII at 11-12). The fixed rate of $18.37 would allow the Commission to completely eliminate the volumetric charge for distribution service, which would eliminate the collection of any fixed distribution costs through the volumetric rate. However, as we have noted in other recent decisions, the Commission is sensitive to the impact of any rate increase on customers, especially during these tough economic times. We note that we have previously approved a sales decoupling mechanism for VEDO in Case No. 05-1444-GA-UNC, which represented an initial step in transitioning VEDO away from traditional rate design and included efforts toward conservation. We believe that a gradual move to the SFV rate design will continue our effort to help to correct the traditional design inequities while mitigating the impact of the new rates on customers by maintaining a volumetric component to the rates for the first year.

We recognize that VEDO proposed that the residential customer charge be set at $10.00 per month during the summer months of the first year and at $16.75 per month during the winter months of the first year. (Tr. III at 11.) We do not believe that a seasonal difference is appropriate, especially in light of the increased rates that such an approach would cause during the time of year when bills are otherwise the highest. However, we are willing to use the average of those two figures as the customer charge during the first year following this issuance of this opinion and order. Therefore, the customer charge during the first year will be set at $13.37 per month, with a volumetric rate to allow VEDO to collect the authorized revenue requirement. After the first year, the customer charge will adjust to the full $18.37 per month, with no volumetric rate.

## V. Tariffs

As part of its investigation in this matter, Staff reviewed the various rates, charges, and provisions governing terms and conditions of service set out in VEDO's proposed tariffs. Further, revised tariffs which comply with the Stipulation were submitted by the Signatory Parties (Joint Ex. 1, Stipulation Exhibit 2). Upon review, the Commission finds VEDO's proposed tariffs reasonable, except for the phase-in of the SFV rate design that is required by this opinion and order. Therefore, VEDO shall file proposed tariff pages in compliance with this opinion and order, for Commission approval, reflecting rates that will result in collection of the authorized revenue requirement.

## VI. Other Issues

OCC and OPAE argue that VEDO failed to provide adequate notice to customers of the proposed second-stage SFV rates, as required by Sections 4909.18(E), 4909.19, and 4909.43(B), Revised Code. Specifically, OCC and OPAE allege that VEDO's notice of intent (PFN) filed under Section 4909.43, Revised Code, is inadequate because VEDO's second stage rates for certain customers do not match the rates in VEDO's application. OCC and OPAE also claim that VEDO's published notice is defective because it did not include the second-stage rates for certain residential customers.

VEDO argues that OCC and OPAE have not demonstrated that the PFN lacks substantial compliance with the requirements of Section 4904.43, Revised Code. VEDO further claims that OCC and OPAE lack standing to raise issues regarding the sufficiency of the PFN, which is required by statute to be served upon municipalities in the utility's service area; VEDO believes that only these municipalities would have standing to raise claims regarding the PFN. Finally, VEDO argues that OCC and OPAE have not demonstrated any harm to residential customers resulting from the differences rates in the published notice and VEDO's application and that OCC and OPAE have cited to no authority that these differences warrant a new notice and new hearing.

Staff also claims that OCC and OPAE lack standing to raise claims regarding the adequacy of the notice contained in the PFN. Staff further argues that VEDO substantially complied with the letter and spirit of Section 4909.43, Revised Code, in its PFN; Staff claims that the differences in the volumetric rates in the PFN and the volumetric rates in the VEDO's application amount to $0.21 per year for a residential customer using 1000 Ccf per year and that these differences are so negligible as to be meaningless from a customer's perspective.

The Commission notes that the Supreme Court has held that the published notice must include the "substance" of the application which the Court defined as "the essential nature or quality" of the proposal. *Committee against MRT v. Pub. Util. Comm.* (1977), 32 Ohio St. 2d 231, 233. The Court later expanded upon its decision in *MRT*, stating that:

> The notice requirement of the statute as discussed by this court in *MRT* . . . is not an unreasonable one. It requires only that the notice state the reasonable substance of the proposal so that consumers can determine whether to inquire further as to the proposal or intervene in the rate case.

*Ohio Association of Realtors v. Pub. Util. Comm.* (1979), 60 Ohio St. 2d 172, 176.

The notices at issue in this proceeding stated the reasonable substance of VEDO's proposal and provided sufficient information for consumers to determine whether to inquire further into the proposal or intervene in the case. As the Staff points out, the differences in the PFN and the application are negligible. Further, the published notice provided sufficient information to consumers to understand that VEDO had proposed a new rate design along with its proposed increase in rates so that consumers could determine whether to inquire further into the case or to intervene. Accordingly, the Commission finds that the notices at issue substantially comply with the applicable statutes.

FINDINGS OF FACT:

(1) On November 20, 2007, VEDO filed applications for an increase in gas distribution rates and for approval of an alternative rate plan.

(2) A technical conference regarding VEDO's applications was held on February 5, 2008.

(3) On May 23, 2008, VEDO filed an application for continued accounting authority to defer differences between actual base revenues and commission approved base revenues, as previously granted by the Commission.

(4) A written report of the staff's investigation was filed on June 16, 2008. Objections to the Staff Report were timely filed by VEDO, OCC, Honda, OPAE, and OEC. Motions to intervene were filed by OCC, Honda, OPAE, OEC, IGS, and Stand.

(5) Intervention was granted to OCC, Honda, OPAE, OEC, IGS, and Stand by the attorney examiner on August 1, 2008.

(6) On July 18, 2008, a prehearing conference was held.

(7) Local public hearings were held on September 3, 2008, in Sidney, Ohio; on September 4, 2008, in Dayton, Ohio; and on September 8, 2008, in Washington Court House, Ohio.

(8) Notice of the local public hearings was published in accordance with Section 4903.083, Revised Code.

(9) The evidentiary hearing was commenced on August 19, 2008 and continued on August 20 through August 25, 2008, August 27, 2008, August 28, 2008, September 2, 2008, September 9, 2008, and September 15, 2008.

(10) On September 8, 2008, a Stipulation was filed on behalf of VEDO, OCC, OPAE, and Staff.

(11) The Signatory Parties stipulated to a net operating income of $11,270,763 for the test year ending May 31, 2008.

(12) Income of $11,270,763 represents a 4.80 percent rate of return on the stipulated rate base of $234,839,282.

(13) The stipulated gross annual revenue to which VEDO is entitled for purposes of this proceeding is $456,791,425. The Signatory Parties stipulated to a gross revenue increase of $14,779,153 which should produce a net operating income of $20,877,212. A net operating income of $20,877,212 represents a rate of return of 8.89 percent on a rate base of $234,839,282.

(14) A rate of return of 8.89 percent is fair and reasonable under the circumstances presented by this case and is sufficient to provide the Company with just and reasonable compensation and return on the value of its property used and useful in furnishing the service described in the application.

(15) The Stipulation was the product of bargaining among knowledgeable parties, benefits ratepayers and the public interest, and does not violate any important regulatory principles or practices. The Stipulation is reasonable and should be adopted.

CONCLUSIONS OF LAW:

(1) VEDO's applications were filed pursuant to, and this Commission has jurisdiction over the applications under, the provisions of Sections 4909.17, 4909.18, 4909.19, 4929.05, and 4929.11, Revised Code. The application complies with the requirements of those statutes.

(2) A staff investigation was conducted and a report 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.

(3) The ultimate issue for the Commission's 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 the stipulation, the Commission has used the following criteria:

> Is the settlement a product of serious bargaining among capable, knowledgeable parties?
>
> Does the settlement, as a package, benefit ratepayers and the public interest?

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

(4) A rate of return of 4.80 percent does not provide VEDO with reasonable compensation and return on its property used and useful in the rendition of natural gas services.

(5) It is reasonable and in the public interest to transition, over a phase-in period, to an SFV rate design, as set forth in this opinion and order.

ORDER:

It is, therefore,

ORDERED, That the Stipulation filed on September 8, 2008, be approved. It is, further,

ORDERED, That VEDO comply with all of the requirements and obligations stated in the Stipulation. It is, further,

ORDERED, That the application of VEDO 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 VEDO implement a one-year, low-income, pilot program consistent with this opinion and order. It is, further,

ORDERED, That VEDO shall file, for Commission approval, proposed tariffs consistent with this opinion and order. 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

GAP/vrm

Entered in the Journal

JAN 0 7 2008

Reneé J. Jenkins
Secretary