BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Authority to Change Accounting Methods.	)))	15-1238-GA-AAM

RESPONSE OF
VECTREN ENERGY DELIVERY OF OHIO, INC.
TO STAFF RECOMMENDATION

I. INTRODUCTION

On June 30, 2015, Vectren Energy Delivery of Ohio, Inc. (VEDO) filed its application seeking authority to defer "the known and measureable impact on fixed-cost recovery resulting from the recent rise and potential ongoing volatility in the heating value of natural gas." (Appl. at 1.) On December 17, 2015, Staff filed its recommendation that VEDO's application be denied. VEDO disagrees that Staff's rationale provides a reasonable ground for denying the application, and it accordingly files this response.

II. ARGUMENT

VEDO appreciates Staff's efforts reviewing and filing comments on the application. Staff acknowledges that the primary points of VEDO's application are sound: the heat content of natural gas on VEDO's system has risen; VEDO cannot control this increase; and it has led to ongoing, uncontrollable revenue loss. Staff nevertheless recommends denial, but the countervailing reasons are either inconsistent with recent Commission precedent or simply incorrect.

The issue presented is not an example of an unforeseen and uncontrollable increase in a post-rate-case operating cost that causes the utility financial detriment, but instead highlights an emergent flaw in the assumptions underlying the rates as designed in VEDO's last rate case. At the time of the rate case, VEDO's rates gave it the opportunity to bill and recover approved operating costs. The shale-gas-driven rise in BTU content has rendered CCF-based rates an inherently flawed method of billing customers for the energy they use. This design defect creates material revenue volatility that can and should be addressed to restore to VEDO a fair opportunity to collect the reasonable and intended level of revenues to fund its operations. VEDO respectfully requests that the Commission consider this response and approve its application.

A. Staff's recommendation either accepts or does not contest the primary factors that justify deferral.

When VEDO's last rate case was filed and approved, no one foresaw the impact that Utica and Marcellus shale production would have on the heat content of the natural gas on VEDO's system. VEDO can do nothing to control the increases in BTU levels, and these increases reduce volumetric throughput and volumetric fixed-cost recovery. While VEDO's fixed-cost recovery from residential customers is not impacted due to straight-fixed-variable rate design, VEDO continues to recover significant fixed costs from all other customers via volumetric (CCF-based) charges. As VEDO anticipated, BTU levels exceeding those at the time of the rate case have continued since VEDO filed its application. From July 2015 through November 2015, the weighted average BTU content of the gas on VEDO's system was 1069 BTU/CF, reaching as high as 1074 BTU/CF in a single month.

Staff contests none of these factors, nor the basic proposal for calculating the heat-content-related CCF throughput reduction and corresponding revenue loss. Staff has "verified that there has been an increase in BTU content since the last rate case filed in 2007." (Staff Comments at 3.) It "agrees that any increases in BTU content in the gas entering its system is largely outside of VEDO's control." (*Id.*) It does not contest "that an increase in heat content may have an impact on the volumes of gas used by its customers." (*Id.*) And it acknowledges that VEDO is experiencing revenue loss "attributable to the higher BTU content." (*Id.*)

B. Staff's rationale for denying VEDO's application presents significant legal or factual problems.

These facts, investigated and accepted by Staff, support approving VEDO's application. Yet Staff recommends denial. Its reasons for doing so are either incorrect factually or inconsistent with Commission precedent.

1. Appliance inefficiencies do *not* impact, mitigate, or otherwise distort the heat-content impact on volumetric throughput and revenue.

The lead reason given by Staff for rejecting VEDO's application is that "none of the customer equipment that uses the natural gas is one hundred percent efficient," and "that some volume of gas, regardless of its heat content, is not burned and is lost through venting." (*Id.*) According to Staff, this means that VEDO's revenue loss is not "exclusively attributable to the higher BTU content." (*Id.*) Because this issue was not explored through discovery or data requests, VEDO has not previously had the opportunity to respond to the merits of this argument. As VEDO will demonstrate, Staff's rationale is factually incorrect and does not provide a reasonable basis for rejecting VEDO's application.

First, Staff is incorrect that VEDO experiences revenue loss associated with end-use efficiency losses. All end-use equipment requires a certain amount of energy to operate. Some energy is used, and some is lost due to inefficiencies. But, importantly, all energy that is delivered to the end-use equipment is metered. So unburned gas, of whatever quantity, has no impact on VEDO's revenue. Staff does not state that appliance efficiency has *changed* in some measurable way across VEDO's system since the rate case.

Staff also suggests that due to efficiency, the heat-content impact differs from one piece of end-use equipment to the next, making it impossible to generalize regarding the system-wide impact. This is not true. Heat-content reductions in volumetric throughput are *independent* of, and *do not vary* with, differences in appliance efficiency.

Whether appliances are high-efficiency or low-efficiency, they require lesser volumes of gas to operate as heat content increases. In fact, the impact of heat-content reduction on volumetric throughput is indifferent to variations in efficiency. This can be demonstrated mathematically. Assume for example two appliances, both requiring 1000 BTU per hour to operate; one is 80% efficient, the other is 60% efficient. To obtain the necessary energy, the 80% efficient appliance requires 1250 BTU (1000/0.8) and the 60% efficient appliance requires 1667 BTU (1000/0.6). As the following calculation shows, despite the difference in efficiency, each appliance experiences an *identical* reduction in throughput as BTU content increases:

- 80%: a 1250 BTU requirement with 1070 BTU/CF gas equates to 1.168 CF at the meter; a 1250 BTU requirement with 1020 BTU/CF gas equates to 1.225 CF at the meter.
    - 1.168/1.225 = 0.953, or a 4.7% reduction in measured volume due to the higher heat content.
- 60%: a 1667 BTU requirement with 1070 BTU/CF gas equates to 1.558 CF at the meter; a 1667 BTU requirement with 1020 BTU/CF gas equates to 1.634 CF at the meter.
    - 1.558/1.667 = 0.953, or a 4.7% reduction in measured volume due to the higher heat content.

The example above yields the same results regardless of the assumed efficiency of the appliance. Moreover, regardless of the heat content or equipment efficiency, any side-by-side illustrative comparison (even one that, as here, assumes drastic differences in efficiency) will yield identical results in terms of differences in metered gas (CF).

This example confirms that regardless of efficiency, an appliance needs a certain amount of *energy* to operate, and the richer the gas is in energy, the less volume the appliance needs to operate. The amount of the throughput reduction does not vary whether the equipment is high- or low-efficiency. Rather, the metered throughput varies by the ratio of the actual BTU to the BTU basis upon which base rates were established (*i.e.*, 1020/1070 or 0.953 in the previous example).

Efficiency variations neither mitigate nor distort the impact of the increase in BTU content on volumetric throughput and fixed-cost recovery, and thus provide no basis for rejecting VEDO's application. VEDO appreciates the Commission's consideration of the Company's response to this technical issue raised by Staff in its filed comments.

2. VEDO's heat-content-related revenue loss is material, and much greater than other deferrals approved by the Commission.

Staff also recommends denial based on its opinion that an annual revenue impact of 1% is "not material" and "will not have a significant impact on VEDO's financial position." (*Id.*) This recommendation is inconsistent with Commission precedent, and cannot be reasonably adopted.

As VEDO explained in its application, the Commission has repeatedly (and recently) approved deferral authority in response to annual impacts of approximately 1% or less on annual operating revenue. *See, e.g.*, *In re Appl. of Columbia Gas of Ohio*, Case No. 12-3224-GA-AAM, Finding & Order at 3–4 (Oct. 30, 2013) (approving deferral of $4.5 million over four years; Ohio revenue in 2012 over $837 million); *In re Appl. of Cincinnati Bell Tel. Co.*, Case No. 96-0899-TP-ALT, Opin. & Order at 22 (Apr. 9, 1998) (approving stipulation containing rate-adjustment clause that "deemed to have a 'material impact'" certain events if "result[ed] in a net increase or decrease in . . . annual Ohio jurisdictional revenues of not less than 0.25%," *see* Stip. at 24–25); *In re Appl. of Columbia Gas of Ohio*, Case No. 14-1615-GA-AAM, Finding & Order at 20 (Dec. 17, 2014) (approving deferral application over objection that deferral would constitute between 1.75% and "possibly less" than 1% of annual operating revenue, *see* OCC Comments at 6).

Although the Commission has not yet ruled on the request, just a few weeks prior to opining that VEDO's projected revenue impact is immaterial, Staff recommended approval of deferral authority by Duke Energy Ohio for one-time bill-format costs of $922,848. (*See* Case No. 15-855-EL-AAM, Staff Comments at 2 (Dec. 2, 2015).) According to the recommendation, Staff considered the question whether "the requested costs to be deferred [were] of a material nature," but it raised no concerns regarding this issue. (*Id.*) Duke's *one-time* financial impact of $922,848 is significantly less than VEDO's *annual* impact of an estimated $1 million to $1.3 million. And Duke's annual Ohio operating revenue is exponentially higher than VEDO's ($1.07 billion to $154 million). A similar—and even smaller—deferral request has been approved for DP&L. *See In re Appl. of DP&L*, Case No. 14-2042-EL-AAM, Finding & Order at 3 (Apr. 8, 2015) (approving deferral of $500,000; 2014 operating revenue was $1,470,883,915; deferral approximately three hundredths of a percent of annual revenue).

Whether these deferrals differ on other grounds is irrelevant to materiality; materiality is simply a question of proportion. It would be arbitrary and unreasonable for the Commission to deny a larger deferral request on the basis of materiality, while at the same time approving much smaller requests. Given that numerous precedents clearly demonstrate that a 1% revenue impact is material, VEDO does not understand how its application could possibly fail on this basis. Denying VEDO's application for this reason would be arbitrary.

3. The length of the deferral period is no obstacle to approval.

Staff also states that it "believes that it is very likely that VEDO will seek to reauthorize its DRR program and, therefore, it will file a base rate application prior to the end of 2017." (*Id.*) In Staff's view, this period of revenue loss "is temporary and . . . relatively short in duration," which in Staff's view also supports denial. (*Id.*)

To VEDO's knowledge, the length of the period in which costs are to be deferred has not historically been a factor considered by the Commission in reviewing deferral requests. But either way—and assuming for the moment that the revenue loss will last only until an order is issued in a rate case filed by the end of 2017—the Commission has approved a number of deferrals covering three years or less. *See, e.g.*, *In re DP&L*, Case No. 14-2042-EL-AAM, Finding & Order at 3 (Dec. 16, 2015) (approving deferral of costs to be incurred over no more than one-and-a-half-year period; costs were ordered on March 26, 2014, and estimated date of implementation no later than August 2015); *In re Ohio Gas Co.*, Case No. 15-222-GA-AAM, Finding & Order at 6 (July 29, 2015) (approving deferral of costs incurred over timeline of less than three years: costs to be incurred beginning in 2014 and to continue through mid-2016); *In re VEDO*, Case No. 07-294-GA-AAM, Finding & Order at 5–6 (Dec. 19, 2007) (approving expenses to be incurred over a period of less than three years: costs ordered on April 13, 2005, and estimated to conclude before end of 2007); *see also In re Duke Energy Ohio*, Case No. 15-855-EL-AAM, Staff Recommendation at 2–3 (Dec. 2. 2005) (recommending approval of deferral of bill-format costs that appear to have been incurred over less-than-one-year period; costs had been ordered March 26, 2014, and application for approval of "expenses . . . that were made" was filed November 21, 2014).

The foregoing cases show that even a three-year deferral period is no obstacle to approval. But VEDO would point out that the period of revenue loss will likely exceed three years. Thermal billing presumably requires Commission approval, and if a rate case is filed in late 2017, that approval would likely not be issued until late 2018 at the earliest.[1]

In short, the length of the expected deferral period is no basis for denying VEDO's application. If anything, the reference to the timing of a future remedial rate-case filing acknowledges that a problem exists that must be fixed at the first available opportunity to restore fair and equitable rates. Staff relies on speculation regarding both the timing and outcome of

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[1] Even a four-year period understates the actual harm: although VEDO is only requesting a deferral as of the beginning of 2015, BTU content began rising in 2012 and spiked in July 2014.

future filings to justify inaction. On the contrary, the problem exists, and it can and should be fixed now.

4. There is no way to manage the impact of heat-content levels.

Staff concludes by stating that "VEDO has both the opportunity and the responsibility to mitigate the financial impact of the lost operating revenue due to the higher Btu content gas by reducing its annual operating expenses." (*Id.*)

As a general proposition, this statement is undoubtedly true—every utility always has the opportunity and responsibility to manage costs. This is why normal ebbs and flows in expense items are not typically permitted for deferral. But this point is inapt here. Even Staff conceded that VEDO *cannot control* the BTU content of gas entering its system. This is not a test-year cost that fluctuates and can be controlled or offset by active management. It is a new development, not even a cost increase per se, but essentially a sales and revenue reduction stemming from volumetric rates.

VEDO is already offsetting cost increases in areas like pipeline safety and labor. VEDO is managing these increases that have occurred since its last rate case, as it should. VEDO cannot manage around the increase in BTU content. As VEDO explained, the physical composition of gas on VEDO's system depends on nationwide flow patterns and is not affected by any given supplier's contract with a pipeline. Requiring VEDO to simply absorb an uncontrollable revenue loss until the next rate case ignores the very nature of the issue and ignores the materiality of the impact on fixed-cost recovery.

This issue is known, measureable, and can be remedied by the Commission. There is no reason not to resolve this issue now, and the only present remedy available to VEDO is the one proposed. VEDO has shown that none of the reasons presented by Staff supports denying relief. The Commission should approve VEDO's application.

III. CONCLUSION

For the foregoing reasons, VEDO respectfully requests that the Commission consider these comments and approve its application.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of this Response was served by electronic mail to the following persons on this 28th day of December, 2015:

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