BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Regulation of the	)	
Purchased Gas Adjustment Clause	)	Case No. 04-220-GA-GCR
Contained Within the Rate Schedules of	)	Case No. 05-220-GA-GCR
Vectren Energy Delivery of Ohio, Inc.	)	

OPINION AND ORDER

The Public Utilities Commission of Ohio (Commission), having considered the record presented in this matter, relevant provisions of the Revised Code, Chapter 4901:1-14, Ohio Administrative Code (O.A.C.), and the Stipulation and Recommendation filed by certain of the parties to these proceedings, hereby issues its Opinion and Order.

APPEARANCES:

McNees, Wallace & Nurick LLC, by Samuel C. Randazzo and Gretchen J. Hummel, Fifth Third Center, 21 East State Street, Suite 1700, Columbus, Ohio 43215-4228, on behalf of Vectren Energy Delivery of Ohio, Inc.

Janine Migden-Ostrander, Ohio Consumers' Counsel, by Joseph P. Serio, Assistant Consumers' Counsel, 10 West Broad Street, Suite 1800, Columbus, Ohio 43215, on behalf of the residential customers of Vectren Energy Delivery of Ohio, Inc.

Chester, Wilcox & Saxbe, LLP, by John W. Bentine and Bobby Singh, 65 East State Street, Columbus, Ohio 43215, on behalf of Interstate Gas Supply, Inc.

Marc Dann, Attorney General of the State of Ohio, Duane W. Luckey, Senior Deputy Attorney General, by Werner L. Margard, III, and Thomas Lindgren, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio 43215-0573, on behalf of the Staff of the Commission.

OPINION:

I. Introduction

Pursuant to Section 4905.302, Revised Code, the Commission was directed to promulgate rules that establish a purchased gas adjustment clause to be included in the rate schedules of gas or natural gas companies subject to the jurisdiction of the Commission. As a result, the Commission established Chapter 4901:1-14, O.A.C., which is designed to separate the cost of gas from all other costs incurred by a gas or natural gas company subject to the jurisdiction of this Commission and to provide for each company's recovery of such costs. Section 4905.302, Revised Code, further directs the Commission to establish investigative procedures, including periodic reports, audits, and hearings, to examine the arithmetic and accounting accuracy of the gas costs reflected in the company's gas cost recovery (GCR) rates and to review each company's production and purchasing policies and their effect upon GCR rates.

Vectren Energy Delivery of Ohio, Inc. (Vectren) is a natural gas company as defined by Section 4905.03(A)(6), Revised Code. Accordingly, Vectren is a public utility as set forth in Section 4905.02, Revised Code, and is, therefore, subject to Commission jurisdiction under Section 4905.302, Revised Code, and Rule 4901:1-14-08, O.A.C.

Pursuant to Rule 4901:1-14-07(A), O.A.C., the Commission caused the financial audit of Vectren to be conducted. Pursuant to the entry issued October 6, 2004, in Case No. 04-220-GA-GCR (04-220 or 2004 GCR audit), the financial auditor reviewed Vectren's GCR rates in effect November 1, 2003 through October 31, 2004. By entry issued September 14, 2005, in Case No. 05-220-GA-GCR (05-220 or 2005 GCR audit), the Commission established the audit period in that proceeding as November 1, 2004 through April 30, 2006. The September 14, 2005 entry also consolidated Vectren's 2004 and 2005 GCR audit proceedings.

Deloitte & Touche, LLP (D&T or financial auditor) performed the 2004 and 2005 GCR financial audits of Vectren. D&T filed the 04-220 financial audit report on July 15, 2005 (Commission-Ordered Ex. 2); the 04-220 uncollectible expense recovery mechanism report on August 31, 2005 (Commission-Ordered Ex. 3); and the 05-220 financial audit report and the 05-220 uncollectible expense recovery mechanism report on August 18, 2006 (Commission-Ordered Exs. 2-A and 3-A, respectively).

On August 24, 2005 and October 12, 2005, the Commission issued entries as a part of the 2004 GCR audit, that established the management/performance (m/p) audit review period, selected the m/p auditor, and set the due date for the m/p audit report. Utilities International Inc. (UII) was selected as the m/p auditor. UII reviewed Vectren's management policies and procedures in effect from November 1, 2002 through October 31, 2005 and filed the m/p audit report on August 16, 2006 (Commission-Ordered Ex. 1).

On March 16, 2005, the Office of Ohio Consumers' Counsel (OCC) filed a motion to intervene in the 2004 GCR audit case. OCC's motion to intervene was granted by entry issued June 17, 2005. OCC filed a motion to intervene in the 2005 GCR audit on October 2, 2006. The 2004 and the 2005 GCR audit proceedings were consolidated with Vectren's gas forecasting case by entry issued July 17, 2005.[1] The Commission finds OCC's motion for

1 Case No. 05-120-GA-FOR, *In the Matter of the Long-Term Forecast Report of Vectren Energy Delivery of Ohio, Inc. and Related Matters.*

intervention in the 2005 audit proceedings to be reasonable. Accordingly, OCC's request for intervention is granted.

Interstate Gas Supply, Inc. (IGS) filed motions to intervene in the 2004 and 2005 GCR audit proceedings on July 19, 2005 and September 30, 2005, respectively. IGS is a certified competitive natural gas supplier with customers in Vectren's distribution service area. IGS contends that as a part of these proceedings the financial auditor will review Vectren's compliance with the Commission's orders in Vectren's 2002 and 2003 GCR cases,[2] as well as issue recommendations regarding this audit period. IGS states that the Commission's decisions in prior GCR proceedings raise issues that affect the customer choice markets, retail competition and Vectren's system operations. Thus, IGS claims that the Commission's decision in these GCR proceedings may adversely impact IGS business interest and affect IGS's ability to compete in the market. The Commission finds IGS's motion for intervention in these audit proceedings to be reasonable and, therefore, the request for intervention in the 2004 and 2005 GCR audit proceedings is granted.

On September 29, 2006, Vectren filed the direct testimony of Jerrold L. Ulrey (Vectren Exhibit 1), Perry M. Pergola (Vectren Exhibit 2), and Scott E. Albertson (Vectren Exhibit 3). On October 10, 2006, IGS filed the direct testimony of Kraig Lotter (IGS Exhibit 1).

Pursuant to Rule 4901:1-14-08(A), O.A.C., and by entries issued October 6, 2004, August 24, 2005 and September 14, 2005, the 2004 and 2005 GCR audits proceedings were scheduled for a consolidated hearing to commence on October 17, 2006. The hearing was called and continued until November 2, 2006 to allow the parties additional time to negotiate a resolution of the issues. Vectren filed its proofs of publication, as required by Rule 4901:1-14-08(C), O.A.C, on October 25, 2006 and December 8, 2006 (Late-filed Vectren Ex. 4).

On December 15, 2006, Vectren and the Staff filed a Stipulation and Recommendation (Joint Exhibit 1, Stipulation) resolving all but one of the issues raised in these GCR proceedings. By memorandum filed January 8, 2007, IGS filed a revised executed signature page, including its signature, for the GCR Stipulation. IGS states that it supports the Stipulation filed by Vectren and the Staff on December 15, 2006. OCC did not sign the Stipulation.

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2 Case No. 02-220-GA-GCR, *In the Matter of the Regulation of the Purchased Gas Adjustment Clause Contained Within the Rate Schedules of Vectren Energy Delivery of Ohio, Inc. and Related Matters* (02-220); and Case No. 03-220-GA-GCR, *In the Matter of the Regulation of the Purchased Gas Adjustment Clause Contained Within the Rate Schedules of Vectren Energy Delivery of Ohio, Inc. and Related Matters* (03-220).

II. Audit Reports

A. Financial Audit Reports

Pursuant to the entries issued October 6, 2004, June 17, 2005, August 24, 2005, September 14, 2005 and November 3, 2005 and Rule 4901:1-14-07(C), O.A.C., D&T filed the Certificates of Accountability on July 15, 2005 and August 18, 2006. The Certificates of Accountability affirm that D&T examined Vectren's GCR reports which support the GCR rates for the months November 2003 through April 2006 (Commission-Ordered Exhibits 2 and 2A). D&T concluded that, based on its examination on a test basis, Vectren fairly determined, in all material respects, the GCR rates for the period November 1, 2003 through April 30, 2006 in accordance with the financial procedural aspects of Chapter 4901:1-14, and related appendices of the O.A.C., and properly applied the GCR rates to customer bills. In Vectren's previous GCR audit 03-220, the financial auditor noted that clerical errors were made. In this audit, D&T followed-up to determine if those errors were properly corrected. D&T concluded that Vectren has properly corrected any errors identified in previous GCR proceedings.

Further, D&T concluded that Vectren's unaccounted-for gas (UFG) for the 12 months ended October 31, 2004 and the 18 months ended April 30, 2006, are below the five percent ceiling imposed by the Commission. Case No. 86-2011-GA-ORD, *In the Matter of the Amendment of Chapter 4901:1-14, Ohio Administrative Code, Concerning the Exclusion of Unreasonable Amounts of Unaccounted-for Gas From the Gas Cost Recovery Rates*, Entry (March 8, 1988) and Entry on Rehearing (April 27, 1988).

B. Management/performance audit

As part of the m/p audit, UII reviewed Vectren's organizational structure, gas supply management and planning, gas transportation, operational policies and procedures, gas procurement strategies and gas purchasing polices to determine their associated impact on Vectren's GCR rates. After a thorough audit, UII made eight recommendations. As discussed in Section III of this Order, Stipulation and Recommendation, Vectren has agreed to comply with six of the recommendations.

In addition to the recommendations that Vectren stipulated to, UII also recommended that Vectren: (1) consider offering a flat bill option for GCR customers, to further mitigate gas price volatility; and (2) that Vectren refund the costs incurred for the five percent reserve margin included in its rates for the period November 1, 2002 through October 2003.

Vectren witness Ulrey offered direct testimony in regard to the flat bill option. Vectren agreed to review and consider a flat bill option for GCR customers. However, Vectren noted that offering a flat bill option requires substantial amounts of analysis and development and exposes Vectren to risks associated with hedging the flat bill commitments to customers. Further, Vectren notes that the company currently offers customers budget billing which establishes a fixed monthly payment with a true-up to actual bill amounts annually (Vectren Ex. 1, 6-7). The signatory parties to the Stipulation did not include this recommendation in the Stipulation but claim to have negotiated a resolution to all issues raised in the cases except as to the disallowance of cost associated with the five percent reserve margin. The Commission recognizes, as Vectren asserts, that the company offers a budget bill option to its residential customers, pursuant to Rule 4901:1-18-04, O.A.C. Accordingly, the Commission concludes that in light of the Stipulation negotiated by the parties that there is no need to further address this recommendation.

UII also recommended a disallowance of $831,740 for the costs associated with the five percent reserve margin for the period November 2002 through October 2003. This is a contested issue between the parties and will be addressed in detail below.

III. Stipulation and Recommendation

As previously noted, Vectren, Staff and IGS filed a Stipulation resolving all but one of the issues raised in the 2004 and 2005 GCR cases. In the Stipulation, the signatory parties agree:

(1) Vectren shall examine its peak day design criteria to determine the appropriateness of the criteria's applicability and values for use in modeling Vectren's peak day sendout for gas supply planning purposes. Vectren will provide the parties a report setting forth its findings and meet with Staff and OCC to discuss changes to the forecast criteria, if appropriate.

(2) Vectren shall perform a statistical analysis on its late winter peaking criterion to evaluate the appropriate date for retention of storage ratchets.

(3) Vectren shall remove the storage carrying costs from its base rates and, on a going-forward basis, recover its actual storage carrying costs through the GCR. Carrying charges associated with the actual monthly balances of gas currently in storage shall be accrued at a rate of 10 percent per year, pursuant to Rule 4901:1-14-05, O.A.C., for purposes of determining the

delivered cost of natural gas subject to recovery through the company's GCR rates. The signatory parties agree that the Commission should approve the calculation methodology set forth in Exhibit A of the Stipulation, the revised tariffs set forth in Exhibit B of the Stipulation, and the methodology for the calculation of the storage costs to be included in the GCR as set forth in Exhibit C to the Stipulation. Further, the signatory parties agree that the base rate revenue reductions, as calculated in Exhibit A, shall also be reductions to the base rate revenues for those rate schedules subject to the sales reconciliation rider.

(4) Vectren shall include, as a part of its internal audits scheduled during the next year, a review of its gas supply process profiles and procedures, focusing on document control.

(5) Vectren shall modify its curtailment procedures to include loss of gas supply by a choice supplier and will amend the company tariff, as set forth in Exhibit D to the Stipulation.

(6) Vectren shall conduct further analysis of its review of the expansion of propane vaporization capacity to displace pipeline or storage capacity.

(7) Vectren's purchasing policies satisfy the requirements of Rule 4901:1-14-07(D), O.A.C. Vectren's procurement practices and policies during the audit period were prudent and reasonable.

(8) Vectren fairly determined the GCR rates for the audit periods, in all material respects, in accordance with the financial and procedural requirements of Chapter 4901:1-14, O.A.C., and properly applied such rates to customer bills.

(9) Vectren's level of UFG for the twelve months ended October 31, 2004 and for the 18 months ended April 30, 2006, is below the maximum reasonable level established by the Commission.

(10) Vectren appropriately accounted for and billed its uncollectible expense rider rate for the 12 month periods ended December 31, 2004 and December 31, 2005.

IV. Disputed Issue

By Opinion and Order issued June 14, 2005 in Case No. 02-220-GA-GCR, and affirmed by Entries on Rehearing issued August 10, 2005 and December 21, 2005, the Commission concluded that "Vectren's implementation of a five percent reserve margin during the audit period was not prudent, reasonable or necessary" given Vectren's very conservative design day criteria, the availability of excess capacity, and the additional contracts entered into by Vectren (WDS-1 and WDS-3) during the m/p audit period (Opinion and Order at 35-36). In the current m/p audit, UII determined that, during the winter of 2003, Vectren continued to add capacity to meet its five percent reserve margin by purchasing capacity from Columbia Gas via its winter delivery service (WDS-5) and from Texas Gas (WDS-6), in conjunction with its already conservative design day criteria. Under these contracts, Vectren purchased 34,000 dekatherms (Dth) per day of capacity. UII calculates that $831,740 of the capacity costs should be disallowed in light of the Commission's conclusion regarding the reserve margin (Commission Ordered Ex. 1, p. 30-32).

As previously noted, the signatory parties to the Stipulation were not able to reach a resolution of this issue and have requested that the Commission address this matter. On January 3, 2007, OCC filed its brief on the disputed issue. Vectren filed its reply brief on January 12, 2007 setting forth its position.

A. Vectren's position

Vectren filed the direct testimony of Perry M. Pergola (Vectren Ex. 2) on September 29, 2006. Mr. Pergola testifies that Vectren should not be required to refund GCR customers for its decision to retain a five percent reserve margin for the period November 1, 2002 through March 31, 2003. Mr. Pergola asserts that, as Vectren argued in the 02-220 GCR audit, a small reserve of firm transportation is consistent with industry practice. Further, the witness states that as a provider to customers that depend on Vectren for service, Vectren should be able to exercise its expertise and a reasonable level of discretion in making sure the company is able to reliably serve its customers. Further, Mr. Pergola contends that Vectren has addressed the criticisms Vectren received in the 02-220 m/p audit as to the company's forecast process, the oversight of its portfolio administrator, the compensation paid to the portfolio administrator and competitively bid the portfolio management services, as recommended. Vectren witness Pergola states that UII did not criticize Vectren's forecast methodology in the current proceeding. Further, Pergola notes UII's overall assessment of Vectren's GCR performance as being "at a minimum, on par with other Ohio gas distribution companies." Vectren argues that, according to UII's analysis comparing the ProLiance Energy, LLC (ProLiance)[3] portfolio management contract to the bid contract with Sequent Energy, the ProLiance contract yielded a relative benefit of $3,104,105 to GCR customers. Vectren contends that the $3,104,105 benefit GCR customers received outweighs the $831,740 attributable to the five percent reserve margin and, therefore, a cost disallowance is unwarranted.

The witness states that Vectren was not made aware, prior to the winter of 2002-2003, that the five percent reserve margin was viewed as an imprudent cost to GCR customers. However, once Vectren was made aware of the risk of disallowance, the company acted immediately to discontinue contracting for the reserve margin (Vectren Ex. 2 at 2-7). Vectren requests that the Commission recognize that the company has reconfigured its interstate capacity portfolio during the audit period, reducing demand cost since its first year in operation by approximately $8 million and providing annual savings to GCR customers. Vectren notes that it has initiated and successfully implemented a comprehensive price volatility mitigation program to reduce the impact of natural gas commodity price fluctuations on customer bills. Further, Vectren notes that in January 2003 the company implemented and has continued to foster the expansion of a choice program for GCR customers. Vectren argues that the five percent reserve margin provided the company a margin of flexibility and assurance of deliverability of supply in the event a choice supplier defaulted. Vectren argues that, for this reason alone, the use of the reserve margin should be viewed differently in this proceeding than in 02-220. Vectren contends that for all these reasons, the disallowance of the costs for the five percent reserve margin during this audit period is not warranted or based on good regulatory policy.

On brief, Vectren argues that there is no record evidence to support the reserve margin disallowance recommended by the auditor during this audit period. Vectren contends that the Commission cannot disallow recovery of gas procurement costs unless it explicitly finds arithmetic errors or imprudent or unreasonable procurement practices. Section 4905.302, Revised Code. Vectren states that the Commission assesses the prudence of a utility company's decision using a process developed in Case No. 86-12-GA-GCR, *In the Matter of the Regulation of the Purchased Gas Adjustment Clause Contained Within the Rate Schedules of Syracuse Home Utilities Company, Inc. and Related Matters,* Order at 10 (December 30, 1986) (*Syracuse*). According to Vectren, the recommended disallowance does not properly follow the *Syracuse* prudence assessment guidelines. Vectren contends that UII recommended the disallowance absent any consideration of the circumstances of the relevant audit period. Vectren notes that UII concluded that the finding of

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3 ProLiance is a joint venture between Citizen's Gas & Coke Utility (an Indiana local distribution company) and Vectren Corporation, Vectren's parent. ProLiance was Vectren's portfolio administrator during the 02-220 m/p audit period.

imprudence resulting in cost disallowances in the 02-220 m/p audit is not present in this case.[4]

Vectren points out that UII found Vectren's gas supply management and procurement standards to be acceptably close to what UII considers to be best practices in the industry and recognized that Vectren exercised its capacity reduction rights in the ProLiance agreement to save customers $1.435 million, reconfigured its capacity portfolio and reduced annual demand costs by $8.0 million (Commission Ordered Ex. 1 at 29, 31-33). Vectren notes that UII acknowledged that Vectren received better than market value for its available capacity from ProLiance and that Vectren's commodity hedging program performed very well, from a cost perspective, during the audit period and saved customers $25 million. Vectren argues that these factors relate directly to the capacity reserve margin issue for this audit period and must be considered when evaluating Vectren's overall performance and the recommended disallowance. Therefore, Vectren asserts that the auditor can not rebut the presumption that Vectren's gas procurement policies and practices during the audit period were prudent and reasonable.

Vectren reminds the Commission that, with the implementation of the choice program in January 2003, the company was faced with some uncertainties--customer load migration, choice customers returning to GCR sales service, and the potential for choice supplier defaults. Vectren argues that under such circumstances, the company's decision to shed capacity, thereby reducing cost by $1.4 million while maintaining a small reserve margin, was reasonable (Commission Ordered Ex. 1 at 32-33). Vectren argues that a review of the company's overall gas supply management, to provide reliable and cost-effective service, as required by the GCR audit process, does not support the disallowance of the reserve margin cost.

B. OCC's position

On January 3, 2007, OCC filed its brief regarding the disallowance of costs associated with the five percent reserve margin. First, OCC states that OCC participated in the settlement discussions and neither supports nor opposes the Stipulation.

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4 Vectren argued in its rehearing application in 02-220 that the Commission's decision to disallow the costs associated with the five percent reserve margin was inappropriately based on: (1) a *de novo* review of the company's long-term forecast, (2) the Commission's refusal to recognize the economic benefits of the capacity reduction rights contained in the portfolio management agreement with ProLiance, (3) the Commission's refusal to recognize the access to capacity for third-party suppliers at no risk to customers, and (4) the Commission's rejection of the actual value of Vectren's portfolio management agreement. Vectren appealed the Commission's decision in 02-220 to the Ohio Supreme Court and the Court affirmed the Commission's decision. See *Vectren Energy Delivery of Ohio, Inc. v. Pub. Util. Comm.*, 113 Ohio St.3d 180 (2007).

OCC argues that the Commission must follow the precedent of 02-220 regarding the disallowance for the reserve margin. OCC argues that each of the arguments set forth by Vectren witness Pergola is easily rebutted. OCC states that the Commission already concluded that the five percent reserve margin is redundant in conjunction with Vectren's overly conservative planning. OCC proclaims that, despite Vectren's claim that the $831,740 cost is relatively small to offset the risk of loss of service on a cold day, even a relatively small additional cost is a violation of law and rule. Further, OCC states that such reasoning is not the legal standard to be applied.

OCC recognizes that Vectren should have some discretion to make decisions regarding the provision of reliable service to its customers. However, OCC contends that the whole purpose of the GCR review process is to ensure that Vectren's discretionary decisions are fair, just and reasonable, and prudent for the customers who have to pay the cost arising from those decisions. OCC applauds Vectren for complying with the concerns raised by prior m/p auditors and for no longer contracting for a reserve margin once Vectren became aware of the potential risk of disallowance but argues that those matters do not impact the issue in dispute. OCC claims that responding to an m/p auditor's concerns is merely complying with Commission requirements and such does not negate the fact that Vectren engaged in practices that have previously been determined to be unfair, unjust, unreasonable and imprudent. Similarly, OCC proclaims that a company's compliance with a Commission order can not be used as justification for other actions that are unfair, unjust, unreasonable and imprudent. OCC states that Vectren's reconfiguring of its interstate capacity portfolio, which resulted in an approximately $8.0 million reduction in demand cost, was in response to the GCR requirements and is separate from the five percent reserve margin issue. OCC states that each issue should be judged on its own merit. Similarly, according to OCC, the $1.4 million demand cost savings associated with the choice program or Vectren's implementation of a volatility mitigation program does not negate the imprudence of the reserve margin costs. OCC contends that the implementation of the price volatility program is an attempt to meet the requirement that Vectren's purchasing practices and polices be fair, just, reasonable and prudent and result in minimum prices.

C. IGS's position

IGS asserts that, to the extent that the Commission orders a disallowance of the costs associated with the five percent reserve margin, the refund should be apportioned between GCR customers and IGS. IGS states that prior to the implementation of Vectren's amended Balancing Cost Rider effective November 1, 2005, Vectren was recovering the costs associated with both operational balancing and the reserve margin from choice suppliers.[5] IGS contends that the amended Balance Cost Rider eliminated the costs of the five percent reserve margin capacity and reduced certain cost components for operational balancing to be proportionate to the benefits received by choice suppliers, among other things unrelated to this issue. IGS calculates that it paid $113,946.52 in Balancing Cost Rider expenses from November 2002 through October 2003. Further, IGS estimates that 50 percent of the Balancing Cost Rider expense amount is attributable to the five percent reserve margin. Therefore, IGS argues that $56,978 of the proposed $831,740 disallowance for the five percent reserve margin should be refunded to IGS (IGS Ex. 1 at 3-5).

V. COMMISSION DISCUSSION AND CONCLUSIONS

A. Five percent reserve margin

Section 4905.302, Revised Code, entitles natural gas companies to recover all actual gas costs unless there is sufficient evidence to support a Commission finding of an arithmetic error, imprudence, or unreasonableness in the company's gas procurement practices and policies. Section 4905.302(E), Revised Code, provides the basis under which a natural gas company can be prohibited from collecting its gas costs. Section 4905.302(E), Revised Code, states:

> The commission shall not at any time prevent or restrain such costs as are distributable under this section from being so distributed, unless the commission has reason to believe that an arithmetic or accounting inaccuracy exists with respect to such a distribution or that the company has not accurately represented the amount of the cost of a special purchase, or has followed imprudent or unreasonable procurement policies and practices, has made errors in the estimation of cubic feet sold, or has employed such other practices, policies, or factors as the commission considers inappropriate.

However, when deciding whether the company has engaged in imprudent or unreasonable or inappropriate policies or practices, additional analysis is required. In 1980, the Commission concluded that the reasonableness of decisions made by utility management involved the following evaluation:

> One area encompasses the facts and circumstances known or reasonably anticipated at the time the decision was made and whether such facts and

5 Case No. 02-1566-GA-ATA, *In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. to Establish a Gas Choice Program*, Joint Stipulation and Recommendation, Exhibit B, Original Sheet No. 15-F, Balancing Cost Rider dated June 25, 2002 and approved by the Commission with certain modifications by Order issued August 22, 2002; Entry issued December 7, 2005.

> circumstances were taken into proper consideration in the decision-making process. A second area involves the inquiry of whether any intervening circumstances occurred or facts become known which impacted the initial decision's results, whether such intervening factors caused or should have caused management to re-think the initial decision, and whether any action or nonaction in light of the intervening factors was appropriate. A third area is an examination of the actual results achieved by virtue of the decision.

Case No. 79-234-EL-FAC, *In the Matter of the Regulation of the Fuel Cost Adjustment Clause Contained within the Rate Schedules of the Ohio Power Company and Related Matters*, (Subfile A), Entry on Rehearing (October 15, 1980) (*Ohio Power*). Additionally, in that same decision, the Commission noted that the weight to be afforded each area of consideration will vary on an issue-by-issue basis, depending on the type of decision made and how long ago it occurred.

As recognized by Vectren, in 1986 the Commission stated that an assessment of the prudence of utility decisions should be conducted under the following guidelines:

(1) There should exist a presumption that the decisions of utilities are prudent.

(2) The standard of reasonableness under the circumstances should be used.

(3) Hindsight should not be used in determining prudence, although consideration of the outcome may legitimately be used to overcome the presumption of prudence.

(4) Prudence should be determined in a retrospective, factual inquiry.

Syracuse, Order at 10 (December 30, 1986). The *Ohio Power* decision and the factors set forth in the *Syracuse* case continue to be the appropriate process under which utility management decisions must be evaluated.

Vectren adds five percent to its calculated gas capacity requirements to determine the total supply requirements. Vectren states that the reserve margin is needed to accommodate capacity failures, demand forecast inaccuracies, choice supplier defaults and the return of choice customers to Vectren's standard offer service. Vectren offers no justification for the level of the reserve margin. Nonetheless, pursuant to the guidelines just discussed, we must presume that the five percent reserve margin is prudent. Thus, the burden of producing evidence to rebut the presumption that the five percent reserve margin is reasonable shifts to UII and OCC.

The Commission agrees with OCC that Vectren's compliance with the financial and m/p audit recommendations ordered in previous audit proceedings, in and of themselves, are not justification for the five percent reserve margin and the associated costs. However, key to the Commission's consideration of the need for the reserve margin is the company's peak day forecast. As the Commission did in 02-220, we must determine if the reserve margin is prudent, reasonable, and necessary, in light of Vectren's design day calculations and the circumstances during the audit period.

UII recognized that Vectren has made efforts to improve its peak day forecasting methodology as recommended by the two previous m/p auditors (Exeter and Liberty Consulting). In fact, UII agrees with Vectren (contrary to the recommendation of Liberty) that Vectren is in fact using the proper National Oceanic and Atmospheric Administration (NOAA) weather data for wind speed and temperature (Commission Ordered Ex. 1 at 36). However, UII analyzed the probability of Vectren's peak day criteria over the past 30 years and has raised questions concerning Vectren's design day criteria. The analysis determined that a day colder than 79.5 heating degree days (HDD) will occur once every 27.9 years, which is equivalent to a probability of 3.6 percent. The m/p auditor concluded that such is substantially consistent with Vectren's calculation of a probability of 3.7 percent. However, a consultant hired by Vectren, Itron, implemented a different methodology than Vectren or UII and found the probability of a temperature of 80 HDD to be 6.7 percent.[6] Despite the differences in methodology, UII concludes that Itron's study appears to indicate that Vectren's peak design temperature is less conservative than it really is statistically. Further, UII notes that Vectren's peak day design criteria also includes the prior day temperature and wind speed, which has the effect of making its peak day design potentially far more conservative than the 3.7 percent probability calculated by Vectren.[7]

UII confirmed that Vectren's peak day design is more conservative than the company claims by comparing actual weather conditions over the past 30 years with Vectren's design conditions and actual sendout. The m/p auditor determined that the conditions experienced on the coldest day in 30 years have a recurrence of one in 72.7 years, or a probability of 1.4 percent, and produced a lower sendout than Vectren's design.

6 Vectren has employed two consultants to assist with the evaluation of its forecasting data and methodology: Regional Economic Research, Inc. (RER) and Itron.

7 UII therefore recommends, and Vectren agrees, to determine the joint probability analysis of the simultaneous occurrence on a cold day of its design day temperature, prior day temperature and wind speed.

The m/p auditor also determined that the second coldest day had a recurrence of once in 31.7 years, or a 3.2 percent probability, and had yet a lower sendout. Further, the m/p audit report noted that on neither of these days did the wind speed nor prior day temperature approach Vectren's design. UII states that the evidence strongly supports a conclusion that Vectren is carrying a "statistical reserve margin" of 3.9 percent although UII admitted that it lacked the tools and statistical expertise to make such definitive statement. Offsetting its conclusions regarding Vectren's peak day design, UII also determined that, inherent in Vectren's forecasting is a slight under-forecasting bias (Commission Ordered Ex. 1 at 30-31, 35-41). For these reasons, the Commission concludes that Vectren's forecast for the period November 2002 through October 2003 continued to be very conservative.

The Commission concludes that UII considered Vectren's implementation of a choice program, the company's forecasting and the five percent reserve margin when the m/p auditor recommended an $831,740 disallowance in capacity cost (Commission Ordered Ex. 1 at 5-6, 30). Accordingly, we disagree with Vectren's claims that there is no record evidence to support the recommended disallowance. We further note that UII, in the course of its review of Vectren, criticized the recommendations of previous m/p auditors and the regulatory process. Therefore, we believe that, if UII thought the Commission's disallowance in 02-220 for the five percent reserve margin was unreasonable, UII would have stated such. UII, however, recommends the capacity cost disallowance. Thus, the Commission finds that Vectren has failed to support the use of its five percent reserve margin during the m/p audit period.

OCC urges the Commission to follow the precedent established in 02-220. As the Commission did in 02-220, we have undertaken an evaluation of whether the reserve margin is prudent, reasonable, and necessary, in light of Vectren's design day calculations and the circumstances during the first year of the audit period. Although, we recognize that, since the 02-220 m/p audit, Vectren has implemented a customer choice program, the implementation of the choice program does not sufficiently justify a five percent reserve margin without further explanation by Vectren. The Commission concludes that Vectren's implementation of a five percent reserve margin, in combination with a very conservative peak day design during the audit period, was imprudent and unreasonable. We, therefore, adopt the recommendation of the m/p auditor to disallow $831,740 in capacity costs. Furthermore, in light of this disallowance, to the extent such costs were paid by choice suppliers or customers, the refund should be appropriately allocated. Vectren shall, therefore, work with Commission Staff to develop an appropriate allocation method, within the next 90 days.

B. Stipulated Issues

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 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. In reviewing a stipulation, the Commission's primary concern is whether the stipulation is in the public interest.

The standard of review for considering the reasonableness of a stipulation has been discussed in a number of prior Commission proceedings. *See, e.g., Ohio-American Water Co.*, Case No. 99-1038-WW-AIR (June 29, 2000); *The Cincinnati Gas & Electric Co.*, Case No. 91-410-EL-AIR (April 14, 1994); *Ohio Edison Co.*, Case No. 91-698-EL-FOR *et al.* (December 30, 1993). The ultimate issue for the Commission's consideration is whether the stipulation, 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 utilizes 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 559 (1994) (citing *Consumers' Counsel, supra*, at 126). In *Industrial Energy Consumers*, the Court stated that the Commission may place substantial weight on the terms of a stipulation, even though the stipulation does not bind the Commission (*Id.*).

Based on our three-prong standard of review, we find that the first criterion, that the process involved serious bargaining by knowledgeable, capable parties, has been met. The parties to these negotiations have been involved in many cases before the Commission, including a number of GCR proceedings. We note that three of the four parties in this proceeding signed the Stipulation. The fourth, OCC, neither supports nor opposes the Stipulation but confirms that OCC did participate in the discussions that led up to the Stipulation.

The Stipulation filed in these proceedings also meets the second criterion. As a package, the Stipulation advances the public interest by resolving all but one of the issues raised by the financial and m/p auditors in these matters.

Finally, the Stipulation does not violate any important regulatory principle or practice. In the Commission's consideration of these matters, we believe that Vectren accurately determined and billed the GCR rates during the audit periods and accurately applied those rates to customers' bills during the audit periods. Upon review of the Stipulation filed in these proceedings, we conclude that the terms and conditions contained in the Stipulation filed December 15, 2006 represents a reasonable resolution of the issues in these cases. Accordingly, the Stipulation should be adopted in its entirety.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

(1) Vectren is a natural gas company as defined by Section 4905.03(A)(6), Revised Code, and, pursuant to Section 4905.02, Revised Code, Vectren is a public utility subject to the jurisdiction of the Commission.

(2) Section 4905.302, Revised Code, and Rule 4901:1-14-08, O.A.C., require this Commission to review the purchased gas adjustment clause contained within the tariffs of each gas and natural gas company on an annual basis unless otherwise ordered by the Commission.

(3) By entries issued October 6, 2004 and September 14, 2005, the Commission initiated these proceedings for the review of Vectren's purchased gas adjustment clause, as defined by Section 4905.302(A)(1)(a), Revised Code.

(4) The Commission granted intervention to OCC and IGS.

(5) Vectren published notice of the hearings in these matters pursuant to Rule 4901-14-08(C), O.A.C., and filed proof of publication with the Commission on October 25, and December 8, 2006.

(6) D&T conducted the financial audits of Vectren, as required by Section 4905.302(C), Revised Code, and Rule 4901:1-14-07, O.A.C., and filed its audit reports on July 15, 2005 and August 18, 2006. D&T also filed the audit reports on Vectren's

uncollectible expenses recovery mechanism on August 31, 2005 and August 18, 2006.

(7) Hearings were held in these GCR proceedings on October 17, 2006 and November 2, 2006, at the offices of the Commission.

(8) Vectren, IGS and the Staff filed a Stipulation on December 15, 2006, resolving all except one of the issues in this case.

(9) The Stipulation, to the extent it addresses Vectren's 2004 and 2005 GCR cases, is reasonable, based upon the evidence of record, and should be adopted.

(10) Vectren accurately computed its GCR rates in accordance with the provisions of Chapter 4901-1-14, O.A.C., during the audit period.

(11) Vectren's GCR rates were accurately applied to customer bills during the audit period.

(12) Vectren's purchasing policies satisfy the requirements of Rule 4901:1-14-07(D), O.A.C., and Vectren's procurement practices and policies during the m/p audit period were prudent and reasonable, except as discussed herein.

ORDER:

It is, therefore,

ORDERED, That OCC's motion for intervention in the 2005 GCR audit proceeding and IGS's motion for intervention in the 2004 and 2005 GCR audit proceedings are granted. It is, further,

ORDERED, That Vectren refund $831,740 for capacity costs associated with the five percent reserve margin. Vectren shall, therefore, work with Commission Staff to develop an appropriate allocation method, within the next 90 days. It is, further,

ORDERED, That the next auditor selected to conduct an audit of Vectren, review Vectren's complaince with the requirements of the Stipulation and the ordered refund and perform the analysis set forth in this Opinion and Order. It is, further, ORDERED, That the Stipulation entered into by Vectren, IGS and the Staff and filed on December 15, 2006, to the extent that the Stipulation addresses Vectren's 2004 and 2005 GCR cases, is adopted in its entirety. It is, further,

ORDERED, That a copy of this Order be served upon Vectren and its counsel, OCC, IGS and all other interested persons of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Paul A. Centolella

Ronda Hartman Fergus

Valerie A. Lemmie

Donald L. Mason

GNS/vrm

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Reneé J. Jenkins
Secretary