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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 Approval, Pursuant to Revised Code Section 4929.11 of a Tariff to Recover Conservation Expenses and Decoupling Revenues Pursuant to Automatic Adjustment Mechanisms and for Such Accounting Authority as May Be Required to Defer Such Expenses and Revenues for Future Recovery through Such Adjustment Mechanisms. | ) | Case No. 05-1444-GA-UNC |

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# PHASE II
# INITIAL BRIEF
# OF THE
# OFFICE OF THE OHIO CONSUMERS' COUNSEL

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**April 23, 2006**

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## I. INTRODUCTION

There are a number of issues raised in this phase of the proceeding that the Public Utilities Commission of Ohio ("Commission" or "PUCO") must address. They are:

**Does the Commission have jurisdiction to approve the Stipulation filed on January 12, 2007 ("Amended Stipulation")?** No. Both the Commission and Vectren, a local natural gas distribution company serving 300,000 residential consumers in the Dayton area, have failed to comply with the mandatory provisions of Chapter 4929 and R.C. 4909.18. Moreover, the Commission has no jurisdiction to allow Vectren to implement the alternative regulation plan while it remains subject to rate of return regulation. This is contrary to R.C. 4929.01(A) *et seq.*

**Can the Commission use accounting authority under R.C. 4905.13 or authority under R.C. 4929.05 to approve decoupling?** No. If a utility like Vectren is suffering from reduced revenues it needs to follow the Ohio statutes that permit it the opportunity to recover additional revenues. That statute is R.C. 4909.18. *et seq*.

**Should decoupling be adopted by the Commission on a stand-alone basis?** No. If a utility is to benefit from decoupling there should be a significant *quid pro quo* by the utility that benefits ratepayers. Otherwise the decoupling is not in the public interest. Additionally, there is no precedent or rationale in Ohio for disregarding the discrete ratemaking provisions of R.C. 4909.15, in favor of a mechanism that effectively guarantees dollar for dollar recovery of residential and general service sales revenue.

**Does the Amended Stipulation present a reasonable resolution of the issues presented in Vectren's application?** No. The Amended Stipulation fails to satisfy all three criteria historically used by the Commission to determine the reasonableness of stipulations. Additionally, the Amended Stipulation grants Vectren extreme regulatory freedom while requiring minimal commitments, yielding an unreasonable end result.

**What is the next step to be taken?** The Office of the Ohio Consumers' Counsel ("OCC") recommends, on behalf of residential consumers, that the issues raised by Vectren's application be addressed in a more appropriate forum, such as Vectren's upcoming rate case. The Commission should order Vectren to cease booking deferred revenues, and the deferred revenues already booked should be reversed. The Company should re-engage its efforts as soon as possible to provide additional low-income weatherization programs for the enlarged scope of Vectren's "low-income" customers.

This includes implementing cost-effective energy efficiency programs available to all residential customers.

**What if the Commission determines, notwithstanding OCC's arguments to the contrary, that it has jurisdiction to implement decoupling?** In the event the Commission determines that it has the statutory authority to approve the alternative rate plan, the Commission should consider modifying the Amended Stipulation in a number of respects. Modifications should include:

- Increased company funding to support vigorous energy efficiency programs that can help customers reduce their energy costs. Dr. Kushler testified that an adequate minimum base funding level would be $4.67 million over two years.[1] This was the level of funding implemented in the original April 7 Stipulation.

- A cap on the amount of decoupling generated revenues Vectren can collect. An absolute dollar cap is preferable to a straight percentage cap. OCC recommends that decoupling revenues collected from residential customers over a two year period be no greater than $7.5 million. Once the cap is reached, the collection of decoupled revenues, the rider, and the tariff should terminate.

- Assurance that the Company will not book any more revenue deferrals until the Company begins implementing the low-income programs that are the *quid pro quo* for the decoupling.

- An alternative rate plan will reduce Vectren's business risk thereby decreasing Vectren's investors' required return.[2] In order to reflect that reduced risk, the Company's rate of return in its upcoming rate case should be adjusted.[3]

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[1] OCC Ex. F at 4.

[2] PUCO Staff made a recommendation in the CG&E alternative gas regulation proceeding that is consistent with the notion that rate or return is impacted by the rider rate recovery -- "Finally, staff is recommending this limited approval of the AMRP program with the expectation that the additional rate recovery does not result in an annual return on average common equity in excess of that approved in this proceeding. Staff further recommends periodic reviews be conducted to ensure this condition is met." Staff Report at 79.

- A stay-out provision for future rate increases. A two year stay-out provision, consistent with the term of the demand-side management ("DSM") program, is recommended. This stay-out provision would be applied after rates are set in Vectren's upcoming base rate proceeding.

## II. PROCEDURAL HISTORY

Vectren filed this case in 2005, under R.C. 4929.11, ostensibly to propose a demand-side management (energy efficiency) program to benefit consumers. Over time it has become clear that this application was never really so much about demand-side management. It was, however, a way for Vectren to obtain an extremely favorable ratemaking mechanism called "decoupling," under the guise of DSM. This ratemaking mechanism significantly increases Vectren's ability to recover sales revenues from residential and general service customers.

On December 14, 2005, OCC moved to intervene on behalf of Vectren's residential customers and requested a procedural process for the application. OCC's intervention was granted. During the next four to five months OCC engaged in good faith negotiations with the Company, endeavoring to obtain significant demand-side management programs for residential customers. During that time frame, OCC engaged in informal discovery, receiving various information that provided additional details and updates on the Company's proposal.

Soon thereafter, a stipulation was reached between OCC, Vectren, and Ohio Partners for Affordable Energy (OPAE). The Staff of the PUCO did not sign the

[3]A full analysis would be required in the proceeding to determine an appropriate reduction to the return on equity. For example, one way of calculating the reduction to equity would be to take the differential between A-rated and Baa rated utility bonds and the return implied by the difference between observed betas of the gas utility industry and the Company's beta. Alternatively, one could reduce the Company's return on equity by a set amount of basis points, e.g. 100 basis points.

stipulation. Consumers for Fair Utility Rates and the Neighborhood Environmental Coalition ("Citizens Coalition"), an intervenor in the proceeding,[4] did not sign the stipulation, but did not oppose it either. In its September 13, 2006 *Opinion and Order*, the Commission unilaterally changed the stipulation and eliminated any meaningful demand-side management program but left in the revenue decoupling mechanism. It appeared the Commission had little regard for the considerable effort and thought that went into the stipulation to carefully balance consumer and utility interests.

The stipulation modified by the Commission was unrecognizable from OCC's perspective. Gone was the DSM portfolio, replaced by a paltry $2 million energy efficiency program directed solely to low-income customers. The low-income energy efficiency program was adopted without a showing of net economic benefit (the purported reason the other DSM programs were rejected). The low-income program approved appeared to be the same low-income program already in place, albeit with an additional $2 million funding coming from the Company, instead of ratepayers.

Notably, the decoupling mechanism, freely awarded to Vectren for automatic rate increases, arose from the ashes. This time it was not used as a tool to implement more DSM, but was an independent means to address Vectren's declining sales (unrelated to Company sponsored DSM). The Commission claimed its authority for approving the modified stipulation came from Revised Code Chapter 4929, the gas alternative regulation statutes.

Not all parties to the stipulation accepted the PUCO's modifications. On December 8, 2006, the OCC filed a Notice of Withdrawal and Termination, as permitted

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[4] Citizens Coalition filed a motion to intervene on March 3, 2006. Its intervention was granted on March 16, 2006.

under paragraph 13 of the April 7 Stipulation. In its Notice of Withdrawal, OCC exercised its right to a hearing, consistent with the April Stipulation.

On December 21, 2006, a revised Stipulation and Recommendation was filed by VEDO, OPAE, and the Staff ("Signatory Parties") which requested the Commission to affirm the September 13, 2006 *Opinion and Order*. The Signatory Parties to the December 21, 2006 Stipulation urged the Commission to approve the December 21 Stipulation without further hearing. These Signatory Parties, without OCC or Citizens Coalition, did not represent the interests of Ohio's residential consumers -- nor did they represent the interest of any ratepaying customer. Thus, it was not especially surprising that they found it possible to "settle" for huge automatic rate increases (via decoupling) for Vectren's nearly 300,000 consumers.

On December 29, 2006, the Attorney Examiner determined that the original Stipulation of April 7, 2006 should be terminated, due to OCC's Notice of Withdrawal and Termination. Additionally, the Attorney Examiner ordered a hearing to consider the new "alternative rate plan." The Attorney Examiner also ruled that the Signatory Parties' December 21 Stipulation would not be approved. The Signatory Parties were ordered to file a document to set out the terms of the December 21 Stipulation.

On January 12, 2007, VEDO, OPAE and the PUCO Staff filed an "Amended Stipulation." This Amended Stipulation merely reiterated the Signatory Parties' desire to reinstitute the Commission's *Opinion and Order* but provided more detail. Neither OCC nor Citizens' Coalition, both intervenors representing consumers, were involved in or attended the negotiations that led to the filing of the Amended Stipulation. It is this

Amended Stipulation that was the subject of the March 28, 2007 evidentiary hearing. And it is this Amended Stipulation that the Commission must now review.

## III. STANDARD OF REVIEW

Under Rule 4901-1-30, of the Ohio Administrative Code ("O.A.C."), any two or more parties may enter into a stipulation resolving issues and then present that stipulation to the Commission for approval. In considering whether a stipulation is reasonable, the Commission has applied the following criteria: First, is the stipulation the product of serious bargaining among capable, knowledgeable parties? Second, does the settlement, as a package, benefit ratepayers and the public interest? And, third, does the settlement package violate any important regulatory principle or practice?[5]

The Ohio Supreme Court has endorsed these criteria to evaluate the reasonableness of settlements.[6] The Court has noted however, that a stipulation does not divest the Commission of its responsibility to determine just and reasonable rates: "A stipulation entered into by the parties present at a commission hearing is merely a recommendation made to the commission and is in no sense legally binding upon the commission. The commission may take the stipulation into consideration, but must determine what is just and reasonable from the evidence presented at the hearing…."[7]

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[5] This criteria was first used by the Commission in the 1984 Zimmer case. *In the Matter of the Restatement of the Accounts and Records of the Cincinnati Gas & Electric Company, the Dayton Power and Light Company and Columbus Southern Ohio Electric Company*, Case No. 84-1187-EL-UNC.

[6] *Consumers' Counsel v. Pub. Util. Comm.*, 64 Ohio St. 3d 123, 125(1992), citing *Akron v. Pub. Util. Comm.*, 55 Ohio St. 2d 155, 157 (1978).

[7] *Duff v. Pub. Util. Comm.*, 56 Ohio St.2d 367, 379 (1978).

In this proceeding the Commission must also look beyond the three prong test. Under the alternative regulation statute, the Commission is bound to balance the regulatory freedom requested with the commitments made by Vectren. If that balance is not achieved, then the Commission must either disprove the plan, or alter it so that the freedom and the commitments are commensurate. While that balance was present in the original April 7, 2006 settlement, it was not present in the subsequent stipulations and amended stipulations entered into without consumer representation.

## IV. ARGUMENT

### A. The Commission does not have jurisdiction to approve the Amended Stipulation when the statutory requirements of R.C 4929.05 were not met.

It is well settled that the Commission is a creature of statute and may exercise no power, authority, or jurisdiction beyond that conferred upon it by statute.[8] In this proceeding the jurisdiction of the Commission is limited by the plain language contained within the confines of R.C. 4929 *et seq.* – the gas alternative regulation provisions. That unambiguous language sets forth distinct mandatory requirements of an alternative regulation plan. Those mandatory requirements were not fulfilled, leading to only one conclusion: The Commission cannot approve the Amended Stipulation.

#### 1. Vectren's request for an alternative rate plan was not filed as part of an application under R.C. 4909.18.

The Company initially sought approval of the sales reconciliation rider ("SRR") under R.C. 4929.11. R.C. 4929.11 is a provision within Chapter 4929, the gas alternative

[8] *See* for example, *Cincinnati v. Pub. Util. Comm.*, 96 Ohio St. 270, 274 (1917), *Ohio Central Tel. Corp. v. Pub. Util. Comm.*, 166 Ohio St. 180, 182 (1957), *Penn Central Transportation Co. v. Pub. Util. Comm,*, 35 Ohio St. 2d 97, 99 (1973).

regulation chapter of the Revised Code. That provision gives the Commission discretion to grant or deny applications for automatic adjustment mechanisms. Under the statute, the Commission may allow an automatic adjustment mechanism under certain limited conditions. Automatic adjustments may be made to the company's rates that fluctuate in accordance with changes in specific costs. It was under the authority of R.C. 4929.11, in the context of a stipulation, that the OCC agreed to implement the decoupling.

In a February 7, 2006 *Entry*, the Attorney Examiner determined that the Company's request would be considered a request for an alternative rate plan under R.C. 4929.05. No party to the proceeding filed an interlocutory appeal of the Examiner's ruling. The Commission in its *Opinion and Order* adopted the R.C. 4929.05 standards and approved the decoupling mechanism. This order of the Commission vested OCC with a ripe opportunity to request rehearing. OCC applied for rehearing, claiming in part, that the Commission had no jurisdiction to approve the stipulation under R.C. 4929.05. Rehearing was denied and OCC perfected its appeal on January 8, 2007.[9]

The Commission remained firm that this case would be governed by R.C. 4929.05. The Attorney Examiner ruled that the Amended Stipulation would be treated as an alternative gas regulation plan. This time, OCC filed an interlocutory appeal of the Attorney Examiner ruling. It was denied.

R.C. 4929.05 provides that the Commission is permitted to use the alternative rate making method for gas companies only when considering an application "filed pursuant to section 4909.18 of the Revised Code." The statute reads as follows: "(A) As part of an application filed pursuant to section 4909.18 of the Revised Code, a natural gas

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[9] OCC's appeal was recently dismissed by the Ohio Supreme Court on grounds that the underlying proceeding in this case is still ongoing.

company may request approval of an alternative rate plan. After notice, investigation, and hearing and after determining just and reasonable rates and charges for the natural gas company pursuant to section 4909.15 of the revised code…"

Under R.C. 4929.05, the Commission was permitted to use alternative rate-making methods to set rates for gas companies only "as part of an application filed pursuant to section 4909.18 ***." The language of the statute needs no interpretation. There is no ambiguity. Where there is no ambiguity, the Commission, must apply, not interpret: "When the language of a statute is plain and unambiguous and conveys a clear and definite meaning there is no occasion for resorting to the rules of statutory interpretation. To interpret what is already plain is not interpretation, but legislation, which is not the function of the courts, but of the general assembly…."[10] The Commission erred here when it approved the decoupling mechanism under the guise of an alternative rate plan. It had no authority to do so.

The Supreme Court of Ohio addressed this same issue in its holding in a 1996 appeal from a Commission order involving a similar statutory provision in the telephone alternative regulatory chapter of the Revised Code. In *Time Warner v. Pub. Util. Comm.,*[11] the statute in question was R.C. 4927.04(A). At that time,[12] R.C. 4927.04(A) contained almost identical language to that contained in R.C. 4929.05. R.C.4927.04(A) stated that "[I]n considering an application pursuant to section 4909.18, the rates and

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[10] *Sears v. Weimer,* 143 Ohio St. 312, 317 citing 37 Ohio Jurisprudence, 514, Section 278.

[11] 75 Ohio St. 3d 229 (1996).

[12] R.C. 4927.04 was amended shortly after the Supreme Court's decision, and the amendments permitted Ohio Bell to enact its alternative regulation plan. *See In the Matter of the Implementation of Substitute Senate Bill 306 or Substitute House Bill 734 of the 121st General Assembly,* Case No. 96-532-TP-UNC Settlement Agreement (May 22, 1996).

charges for basic local exchange service... may be established by the Commission...by a method other than that specified in section 4909.15 of the revised code...." Time Warner challenged the Commission's approval of Ohio Bell's alternative rate plan because it was filed under R.C. 4927.04, and not as part of an R.C. 4909.18 application.

The Ohio Supreme Court reversed the Commission's decision. It ruled that the Commission was only permitted to use the alternative regulation statutes when the applicant was seeking to increase rates, pursuant to R.C. 4909.18:

> It follows that Ameritech's application did not trigger the commission's use of alternative rate treatment under R.C. 4927.04(A) and the commission exceeded the scope of its authority when it used non-traditional rate setting methods to set Ameritech's rates. Accordingly, the commission's exercise of authority under R.C. 4927.04(A) was unlawful and its opinion and order should be reversed.[13]

*Time Warner* is directly applicable to the case at hand. Here, as in *Time Warner*, the Commission has exceeded the scope of its authority by approving a decoupling rate increase mechanism under the alternative gas regulation statute when Vectren has not filed a R.C. 4909.18 application.

The Signatory Parties believe this statutory defect can be cured by incorporating standard filing requirements from Vectren's *last* rate case into the record, three years later in *this* case. They are wrong. First, it is completely inconsistent with the plain language of R.C. 4929.05. Vectren's R.C. 4909.18 application was made on May 28, 2004, almost three years ago. It did not request approval of an alternative rate plan "as part of" its 2004 application. Moreover, Vectren has failed to file a R.C 4909.18 application in this case.

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[13] 75 Ohio St. 3d at 241.

It is difficult, if not impossible, to assess the merits of an alternative rate plan without having a complete base rate review. Indeed, the Commission itself acknowledged this in the *Dominion East Ohio Gas* case, and ordered such a review prior to proceeding into later phases of the plan: "The consumer groups' call for a complete base rate review is a legitimate concern. The Commission finds that, before proceeding into Phase 2, we shall consider changes in expense and rate base items to insure that there are no duplicative costs imbedded in the rates customers will pay."[14]

There are logical, if not compelling, reasons for requiring filings of alternative rate plans "as part of" an R.C. 4909.18 application. Under the process required by R.C. 4929.05, the Commission would have a mountain of current information required by a R.C. 4909.18 application. That information, as prescribed by R.C. 4909.18(A) through (F), would entail a report of property used and useful in rendering service, a complete operating statement of its last fiscal year, "showing in detail all its receipts, revenues, and incomes from all sources, all of its operating costs and other expenditures," a statement of income and expense anticipated, a statement of financial condition, and "such other information as the commission may require in its discretion."

Additionally, the filing of a R.C. 4909.18 application would trigger a mandatory staff investigation, under R.C. 4909.19: the "commission shall at once cause an investigation to be made of the facts set forth in said application and the exhibits attached thereto and of the matters connected therewith." Furthermore, a lengthy discovery

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[14] *In the Matter of the Application of the East Ohio Gas Company, dba Dominion East Ohio for Approval of a Plan to Restructure Its Commodity Service Function*, Case No. 05-474-GA-ATA, *Opinion and Order* at 17 (May 26, 2006).

process would be established, permitting interested parties the ample rights of discovery guaranteed by R.C. 4903.082.

In sum, detailed information would be produced that would ensure that the Commission could determine if the alternative rate plan is in the public interest. The "public interest" standard has been one applied in numerous telephone alternative regulation proceedings.[15] Additionally, such a standard has been discussed in at least one R.C. 4929.04 gas exemption proceeding.[16] There a proposed stipulation was analyzed to determine if it was a reasonable proposal under R.C. 4929.04 that "could benefit consumers without exposing them to undue risk."[17]

The statutory requirements of R.C. 4929.05 cannot be ignored. The need to ensure that the Commission complies with the process set forth under R.C. 4929.05 is great. Vectren's approximately 300,000 customers could be burdened with a sizeable rate increase. Vectren's stipulation should be rejected.

**2. The Commission failed to order an investigation of the filing and the PUCO Staff failed to issue a staff report of investigation.**

Moreover, Staff's other attempts to meet mandated statutory provisions of R.C. 4929.05 must also fail. That a rate increase under R.C. 4909.18 cannot be granted without a Commission investigation, is uncontroverted. R.C. 4909.19 requires one: "Within a reasonable time as determined by the commission *after the filing of such*

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[15] The public interest standard in fact is written into the telephone alternative regulation statute -- R.C. 4927.03(A)(1).

[16] *In the Matter of the Application of the East Ohio Gas Company, dba Dominion East Ohio for Approval of a Plan to Restructure Its Commodity Service Function*, Case No. 05-474-GA-ATA, *Opinion and Order* at 17.

[17] *Id.*

*application,* a written report shall be made and filed with the commission." R.C. 4929.05 incorporates an R.C. 4909.18 filing as a jurisdictional condition. Additionally, R.C. 4929.05 reiterates the need for an investigation to be conducted: "after notice, investigation, and hearing...."

The PUCO Staff believes that it can meet the requirements of R.C. 4909.19 by introducing the Staff Report from the last case. The requirement that Staff investigate and file a report "after the filing of such application" refers to the application presently before the Commission, not the application filed in 2004. The 2004 investigation clearly was not conducted after the filing of the application in this case.

Had Vectren filed this case as an alternative rate plan, as the Commission insists that it is, the Staff report would relate to an investigation of that filing. Thus, another important statutory requirement under R.C. 4929.05 has been disregarded. The Amended Stipulation should be rejected.

**3. The Commission failed to establish just and reasonable rates for Vectren.**

R.C. 4929.05 also requires a finding of just and reasonable rates, under the traditional ratemaking formula of R.C. 4909.15: "After notice, investigation, and hearing, and after determining just and reasonable rates and charges for the natural gas company pursuant to section 4909.15 of the Revised Code, the public utilities commission shall authorize the applicant to implement an alternative rate plan..." There has been no finding here of "just and reasonable rates" pursuant to R.C. 4909.15.

The Signatory Parties believe the Commission approved just and reasonable rates in the prior rate case stipulation, three years ago. This, however, has no bearing on whether the statutory requirements are met in this case. Their belief is convenient because it permits a streamlined approach assuring expedited consideration of Vectren's application. This belief, however, ignores the fact that the more than three year old test year snapshot is static and does not account for *any* operational or financial changes in the company or in the financial markets. In fact, Vectren expects to file another rate case in the near future, which suggests *ipso facto* that their rates cannot be presumed to be just and reasonable!

The PUCO Staff has not investigated or produced a report in this proceeding that addresses whether Vectren's current rates, set pursuant to a prior rate case stipulation, are just and reasonable today. Yet, the PUCO Staff, Vectren, and OPAE are willing to make one discrete piecemeal adjustment to the regulatory formula to compensate Vectren for its customers' reduced gas usage. This is a slippery slope that the Commission should not travel down and one which the General Assembly has not endorsed.

While the General Assembly established a presumption for telephone and railroad companies that rates established within two years are reasonable and lawful,[18] it did not extend this presumption to gas or electric companies. The principle of statutory construction -- *expressio unius est exclusio alterius* -- the expression of one thing is the exclusion of another -- is applicable here. Existing Vectren rates, established over three years ago, are not *prima facie* reasonable or lawful.

There was no determination of Vectren's just and reasonable rates under R.C. 4909.15 in this proceeding. Nor does the Commission's determination in the previous rate case amount to an assumption that the rates previously established are just and

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[18] R.C. 4909.03.

reasonable today. Therefore, the Commission, in failing to comply with the mandatory provisions of R.C. 4929.05, is without jurisdiction to approve the Amended Stipulation.

### 4. The alternative rate plan was not properly noticed under R.C. 4909.19 and 4909.43(B).

Notice is a crucial mandatory component to the alternative regulation process. It is the statutory prerequisite to the Commission's considering the Amended Stipulation under R.C. 4929.05(A) -- "[a]fter notice, investigation, and hearing...." That the notice required under R.C. 4929.05(A) is the same notice required under R.C. 4909.18 is axiomatic. R.C. 4929.05 begins with "[a]s part of an application filed pursuant to R.C. 4909.18 of revised code...."

An application filed under R.C. 4909.18 must be noticed at the time the application is filed and must be substantial, as expressed in R.C. 4909.19: "[u]pon the filing of any application for increase provided for by section 4909.18 of the Revised Code the public utility shall forthwith publish the substance and prayer of the application...." R.C. 4909.19 directs notice to the customers who will be affected by the rate increase. Under this statute the Company must give notice by publishing the gist of the application, for three consecutive weeks, in newspapers generally circulated throughout the utility's service territory.

There are also other notice requirements associated with an R.C. 4909.18 filing as well. R.C. 4909.43(B) pertains to notice that must be given to municipalities, before the rate application is filed, if the rate increase application affects the municipality. Under R.C. 4909.43(B): "[n]ot later than thirty days prior to the filing of an application pursuant to section 4909.18 or 4909.35 of the Revised Code, a public utility shall notify, in writing, the mayor and legislative authority of each municipality included in such application of the intent of the public utility to file an application, and of the proposed rates to be contained therein."[19]

Thus, to properly consider the Amended Stipulation as an alternative regulation plan, the Commission must determine whether these notice provisions have been satisfied. They have not.

The Company failed to provide notice to the municipalities affected, as required by R.C. 4909.43(B), thirty days before its November 28, 2005 application was filed. Notice to the public was not made either, at the time of the application, under R.C. 4909.19. In fact there has been no notice whatsoever of this alternative rate plan—a plan that will increase rates to customers beginning in fourth quarter 2007.

The only evidence of notice before this Commission relates to the proofs of publication showing that Vectren published notice of the local public hearings that were held in this case.[20] These notices were ordered by Attorney Examiner *Entry* of February 27, 2006.

Notice of local hearings in this case does not equal notice required under R.C. 4909.19 and R.C. 4909.43(B). First, the local public hearing notice, supplied by Vectren in spring of 2006, was not timely under either R.C. 4909.19 or R.C. 4909.43(B). R.C. 4909.19 requires notice at the time of the filing. The time of the filing was November 28, 2005. Under R.C. 4909.43(B) notice must be given prior to the rate application filing.

Second, even if the timing of the "notice" can be overlooked (which it cannot) it is clear that any notice provided of the local public hearings is insufficient to satisfy the

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[19] *See* also Ohio Adm. Code 4901:1-19-05(A)(1) which contains notice provisions related to alternative regulation filings that seems to mirror the notice provisions of R.C. 4909.43(B).

[20] Late filed exhibit 5.

notice provisions of R.C. 4909.19 and R.C. 4909.43(B). Nowhere in the local public hearing notices is the "substance and prayer" of the application described as required under R.C. 4909.19. Nor do the local public hearing notices contain "the proposed rates to be contained therein," as required under R.C. 4909.43(B).

Vectren has presented no proof that it has complied with the notice requirements of either R.C. 4909.19 or 4909.43(B). Vectren will claim that because it did not file its application as an alternative rate application, it did not have to meet any notice requirements of R.C. 4929.05. Even if this simplistic argument is given some credence, it should still fail. For on February 7, 2006, the Attorney Examiner ruled that it would consider Vectren's application as an alternative plan under R.C. 4929.05. That *Entry* transformed Vectren's filing and in doing so created statutory requirements for Vectren to fulfill. One of those requirements, even if unspecified by *Entry*, was notice.

Vectren has failed to satisfy the notice requirements of R.C. 4929.05. These are statutory requirements that cannot be waived. Thus, the Commission is without jurisdiction to approve the alternative regulation plan because another mandatory condition has not been met -- notice.

### 5. Vectren failed to sustain its burden of proving it has complied with R.C. 4929.02.

Under R.C. 4929.05 the Commission cannot approve an alternative rate regulation plan unless it finds that the utility has complied with, *inter alia*,[21] R.C. 4929.02. Additionally, the Commission must determine that the company will substantially

[21] Vectren is also required to provide evidence that it has complied with R.C. 4905.35. That is a provision that prohibits discrimination—"undue or unreasonable preference" and "undue or unreasonable prejudice or disadvantage." It has not provided any new information on how the Amended Stipulation complies with this section of the Revised Code.

comply with R. C. 4929.02 after its alternative regulation plan is implemented. Under R.C. 4929.05(B), the utility has the burden of proving it has met these conditions.

Although prior testimony filed by Vectren responded to these statutory requirements, that testimony was directed to a materially different plan than the Amended Stipulation. Hence, it cannot be relied on to support the present alternative regulation plan because the testimony is not based on the plan at issue in this proceeding.

For instance the prior stipulation of April 7, 2006, as well as the application of November 28, 2005, was based on a portfolio of energy efficiency programs that did, consistent with R.C. 4929.02(A)(5), encourage innovation and market access for cost-effective supply and demand-side natural gas services and goods. Moreover, under the prior stipulation (and the November 28 application) the portfolio approach to energy efficiency would facilitate the state's competitiveness in the global economy, as required by R.C. 4929.02(A)(10).

The Amended Stipulation plan does not contain a portfolio of DSM programs. It implements a single program which will reach very few of the Vectren customers.[22] Demand-side management services and goods will not be encouraged or promoted by the present plan. Implementation of the low-income weatherization plan will not facilitate the state's competitiveness in the global economy, another one of the policies found in R.C. 4929.02. Nor is it clear that any of the other polices delineated in R.C. 4929.02 will be fulfilled under the Amended Stipulation. Vectren has offered no evidence in this regard.

[22]The Company will contend that they have also implemented a Nexus on-line audit tool that will provide customers with added benefits. Tr. 37-39. That tool was implemented in January 2007, and is not offered as a program under the Amended Stipulation.

Since there is no evidence that the Amended Stipulation will meet the terms of R.C. 4929.02 the Commission cannot approve the alternative rate plan. This is another reason why the Commission is without jurisdiction to approve the Amended Stipulation plan as filed.

### B. The Commission has no jurisdiction to allow Vectren to implement an alternative regulation plan under Revised Code 4929.01(A) while it remains subject to rate of return regulation.

Under the alternative regulatory scheme established under Revised Code Chapter 4929, a natural gas company may file a "method, alternate to the method of section 4909.15 of the Revised Code, for establishing rates and charges." This Commission has recognized, in the context of alternative telephone regulation, that alternative regulation means just that -- either alternative regulation or rate of return regulation, not both:

> Reiterating our finding in Case No. 00-1532-TP-COI, it should be emphasized that alternative regulation is an alternative to rate base/rate-of-return, revenue requirements regulation. In exchange for more flexible regulation, a utility must cap basic local exchange rates. By opting for alternative regulation and foregoing its opportunity to earn the authorized return on investments, the utility takes on additional risk while maintaining its obligations to the public.[23]

Vectren's alternative regulatory filing, however, encompasses a scheme whereby Vectren is subject to both rate of return (per case no. 04-571-GA-AIR) and alternative rate regulation. Vectren is not taking on additional risks here in exchange for the flexible regulation the Company is seeking. Instead, if approved, Vectren's business risks will be

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[23] *In the Matter of the Application of Cincinnati Bell Telephone Company for Approval of an Alternative Rate Form of Regulation Pursuant to Chapter 4901:1-4, Ohio Administrative Code,* Case No. 04-720-TP-ALT *Finding and Order* at 13 (June 30, 2004).

reduced without a commensurate reduction in its authorized rate of return. Vectren has not foregone its opportunity to earn its authorized return on investment. There is no cap being placed on Vectren's rates. In fact, Vectren is expected to file a rate base case in the near future. Tr. 230. This duality of regulation is not permissible under regulatory practices and principles which underlie the Revised Code, in particular Revised Code 4929.01(A) *et seq.*

The alternative rate regulation plan proposed by Vectren permits it to have the best of both worlds -- flexibility to automatically recover rate increases from customers and the opportunity to earn the authorized return assured under traditional rate regulation. The plain language of R.C. 4929 *et seq.* does not permit such an interpretation. And, such a windfall surely was not contemplated by the General Assembly when the alternative gas regulation statutes were drafted.

### C. The Commission cannot use either accounting authority or authority under R.C. 4929.05 to circumvent the ratemaking provisions of R.C. 4909.15 and R.C. 4909.18.

In this proceeding the Commission has permitted Vectren to continue the accounting[24] while this case is pending, under its R.C. 4905.13 authority. In authorizing the accounting, the Commission has facilitated an unauthorized rate increase to customers. Vectren, having secured these accounting changes, is seeking permission here, as part of an alternative rate plan, to raise customer rates by implementing a rider to recover reduced revenues due to decreased customer usage.

The Commission cannot use either accounting or a rider approved under R.C. 4929.05 to circumvent the ratemaking provisions of R.C. 4909.15 and R.C.

[24] The accounting consists of tracking and booking the revenue differential -- the difference in actual revenues received and weather normalized and adjusted revenues authorized in the last case.

4909.18. If a utility is suffering from reduced revenues, it needs to follow the Ohio statutes that permit it the opportunity to recover reduced revenues -- R.C. 4909.18. Under that statute, any utility desiring to modify or increase existing rates "shall file a written application with the Commission." The written application then triggers a series of steps that must be followed, culminating in an ultimate finding of "just and reasonable rates" for the utility. Vectren, however, has chosen not to make a R.C. 4909.18 application.

Vectren's failure to seek recovery of revenues under R.C. 4909.18 cannot be cured by either an accounting entry or by running to jump aboard the R.C. 4929.05 bandwagon. The Commission does not have authority to make Vectren "whole" -- compensating dollar for dollar for reduced revenues associated with declining customer usage -- between rate cases. It cannot be done by accounting authority. It cannot be done, in this case, by alternative gas regulation authority. The General Assembly did not deign it appropriate or necessary to permit utilities a guarantee of collecting revenues authorized in prior rate cases. The Commission cannot act to directly contravene what the General Assembly determined to be appropriate in Ohio.

### D. The decoupling mechanism should not be adopted on a stand-alone basis because it is not in the public interest and contravenes R.C. 4909.15 and 4909.18.

Dr. Kushler testified that the decoupling mechanism should not be implemented without significant DSM investment: "If the utility is to benefit from the decoupling, there should be a significant commitment by the utility that benefits customers. Therefore, I would always recommend that any approval of decoupling be combined with a requirement for substantial offering and funding of effective customer energy efficiency programs. This ensures that customers, who are paying for the decoupling, will benefit from the ability to participate in energy efficiency programs and customers in general will benefit by reducing the total costs of natural gas consumption."[25]

Staff, however, supports decoupling with no linkage to DSM. Staff's position on gas DSM has not changed over the years, but its view of decoupling most certainly has. Several years ago, in fact, the PUCO Staff rejected decoupling altogether. In the previous Vectren rate case, Vectren proposed a similar decoupling mechanism (Tr. 166), called the equalized sales adjustment, and Staff opposed it. At that time, Staff witness Puican testified it was inappropriate. Tr. 166.

Staff Witness Puican's current testimony reflects a "softening" of the Staff's earlier position on decoupling. Tr. 173. Staff now is not opposed to a decoupling mechanism on a stand alone basis, with no linkage to DSM funding. *Id.*, Tr. 189.

Staff's apparent change of heart is derived in large part on the fact that Vectren has experienced a "very substantial" drop in use per customer since the last rate case. Tr. 190. With such volatility, the Staff now considers a decoupling mechanism as a more appropriate way to proceed rather than having Vectren file multiple rate cases. Tr. 192-194. Staff concedes that value to ratepayers under this approach is the "regulatory efficiency over time that will decrease the need for multiple rate cases." Tr. 192. Such value, however, is not evident here as Vectren intends to file for a rate increase during the summer of 2007. Moreover, when weighing the cost of a rate case against the automatic recovery of dollars from ratepayers, the cost of decoupling exceeds the rate case expense by a significant margin.

[25] OCC Exhibit F at 12.

What is in the public interest, OCC contends, is the opportunity within the context of a full fledged rate proceeding, to contest the justness and reasonableness of all aspects of rates, not just one isolated piece of the rate formula. The rate case process assures a full and open process and a determination of just and reasonable rates. That process has not occurred here, nor has the Commission concluded that Vectren's rates are just and reasonable.

Not only is adopting a decoupling mechanism on a stand-alone basis not in the public interest, but it also contravenes R.C. 4909.18 and R.C. 4909.15, the traditional ratemaking statutes. Witness Puican acknowledges that the Commission is moving away from strictly adhering to a test year approach: "And it is (the SRR), frankly consistent with the way the Commission has been doing things recently, as we've seen with the best example being the bad debt rider. As customer debts—as company debts went up because of high gas prices, rather than strictly adhering to, well, this is a base rate item, so you can't touch it, the Commission decided that there was some value to establishing that as a rider and allowing companies to recover their actual costs..."

This new-found approach to decoupling, and other issues bearing upon the financial condition of the utilities, while interesting, ignores one huge impediment: the ratemaking statutes of R.C. 4909.18, 4909.19 and 4909.15. What Witness Puican suggests is that the Commission has the power to disregard the test period concept in setting rates. The PUCO Staff seems to believe that the way around the test period concept (and the rate case filing requirements) is through various riders. The mere fact that the Commission is approving these riders lately, does not and should not lend legitimacy to such clearly unlawful acts. As the Supreme Court of Ohio has often noted, the Commission is a creature of statute, possessing no power other than that specifically granted to it by the General Assembly.[26] It cannot facilitate utilities' attempts to evade statutory requirements.

Under traditional ratemaking statutes in Ohio, the public utilities commission "in fixing and determining just and reasonable rates" must apply a detailed, comprehensive, and mandatory ratemaking formula according to R.C. 4909.15.[27] R.C. 4909.15(A) requires the PUCO to make a series of determinations -- the valuation of the utility's property in service as of date certain, a fair and reasonable return on that investment, and the expenses incurred in providing service during the test year. R.C. 4909.15(C) addresses test period expenses as well as revenues. R.C. 4909.15(C) unequivocally provides that the utility's revenues and expenses shall be determined during the test period. The test period follows directly from the date the utility chooses to file for its rate increase. It is, unless otherwise ordered, six months before the application is filed and six months after the application is filed.[28]

The Commission does have authority to make adjustments to test-period revenues under R.C. 4909.15 (D)(2) to "smooth out anomalies" in test period data.[29] Such authority, however, is limited:

[26] *Cincinnati v. Pub. Util. Comm.*, 96 Ohio St. at 274.

[27] *Columbus Southern Power Company v. Pub. Util. Comm.*, 67 Ohio St.3d 535, 537 (1993), citing *Gen. Motorists Corp. v. Pub. Util. Comm.*, 47 Ohio St.2d 58 (1976).

[28] The test period may be different if authorized by the Commission, but may in no event end more than nine months after the date the application is filed. R.C. 4909.15(C).

[29] *Columbus Southern Power*, 67 Ohio St. 3d at 539.

> It is our view that R.C. 4909.15(D)(2)(b) is designed to allow the commission to make minor adjustments to rates ascertained by the statutory formula when the criteria upon which rates are based are skewed for one reason or another. Thus, under R.C. 4909.15(D)(2)(b), the commission may smooth out anomalies in the ratemaking equation that tend to make the test year unrepresentative for ratemaking purposes.[30]

It is well settled that such adjustments are "exceptions" and "ad hoc tinkering with the statutory formula is not be become the rule."[31]

The decoupling mechanism does more than "smooth out anomalies" in the test period data. It is a major ratemaking adjustment that virtually guarantees Vectren will recover 100% of its residential and general service revenues approved in the last case.[32] The decoupling mechanism seeks to essentially pull one distinct component out of Vectren's rates -- revenues -- and adjust for it.

Clearly, what is envisioned is an extra-judicial test year adjustment that violates the test year concept preserved in R.C. 4909.15. Staff Witness Puican acknowledges as much: "Just as when you pull out any former base rate item out of base rates and put it into a rider, yes, that is technically inconsistent with the test year concept..." Tr. at 193.

There is no precedent or rationale in Ohio for disregarding the discrete provisions of R.C. 4909.15 in favor of a mechanism that effectively guarantees dollar for dollar recovery of residential and general service sales revenues. R.C. 4909.15 does not permit it. R.C. 4905.13 does not permit it. R.C. 4929.05 does not permit it.

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[30] *Consumers' Counsel v. Pub. Util. Comm*, 67 Ohio St. 2d 153, 166 (1981) (where the court disallowed the amortization of cancelled plant expenses as a test year adjustment).

[31] *Dayton Power & Light Co. v. Pub. Util. Comm.*, 4 Ohio St. 3d 91, 95 (1983) (where the court refused to overturn a PUCO ruling that excluded a post-test year wage adjustment).

[32] Vectren still bears the risk of weather on sales because it is not authorized in Ohio to make weather related adjustments to revenues.

The Ohio Supreme Court, almost twenty five years ago, expressed this same conclusion-- that a utility could only recover costs through the legally available mechanisms--when it denied Cleveland Electric Illuminating Company the ability to amortize balances related to four terminated nuclear units. There the Court noted that capital invested in failed projects that was not otherwise recoverable under the ratemaking formula, could not be wedged into rates where there was no explicit statutory provision:

> It has been argued, these are perilous times for the utility industry and if therefore in order to attract and retain investment capital, utilities must not only be granted a fair and reasonable rate of return pursuant to statute but must also be assured the return of capital invested in failed projects that would otherwise not be recoverable under the ratemaking formula, then the commission and the utilities should petition the General Assembly to enact changes in the ratemaking structure so as to provide this extra modicum of protection for investors. Absent such explicit statutory authorization, however, the commission may not benefit the investors by guaranteeing the full return of their capital at the expense of ratepayers.[33]

In this proceeding, Vectren is asking for more than a fair and reasonable rate of return under the statute. Here Vectren seeks regulatory assurance to recover essentially 100% of the residential and general service sales revenues approved by the Commission in the last rate case. The present statutes of the Revised Code do not permit such recovery. The Public Utilities Commission should heed the holding of the Supreme Court, and deny Vectren the ability to use a decoupling mechanism on a stand alone basis, or otherwise. If change is needed, it must come from the General Assembly, not the Commission.

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[33] *Consumers Counsel v. Pub. Util. Comm.*, 67 Ohio St. 2d 166(1983).

### E. The Amended Stipulation should not be adopted because it does not reasonably resolve the issues presented.

The Amended Stipulation can not fulfill the reasonableness requirement under the commission's three prong test. None of the prongs are met by the Amended Stipulation and thus, the stipulation does not reasonably resolve the issues before the Commission.

#### 1. The settlement was not a product of serious bargaining.

The first prong to the Stipulation test is not met. The settlement was not a product of serious bargaining among capable, knowledgeable parties. The rationale behind the test is that when parties with discrete and conflicting interests reach agreement in a case, a balancing of competing interests is achieved. Compromise among parties is especially pertinent to evaluating a particular settlement package.

Here, however, the settlement merely reflects the Signatory's Parties accepting the Commission's September 13, 2006 *Opinion and Order*. "Bargaining" in even the loosest sense of the word was not going on. OPAE had received what it wanted -- weatherization dollars would be flowing to its members -- the weatherization providers. The Company had received what it wanted -- the ability to recoup 100% of the revenue from lost sales associated with reduced customer usage. The PUCO Staff, as a representative of the Commission, was merely seeking to reaffirm the Commission's findings, and perhaps rescue it from further legal proceedings. All of these parties were undoubtedly interested in one thing alone -- affirming the Commission's *Order*. There was no bargaining -- the Signatory Parties merely accepted the Commission's *Order*, as most had earlier indicated they would do.[34]

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[34] *See* Vectren Memorandum in Response to OCC Application for Rehearing (October 23, 2006) and the letter filed by OPAE on that very date.

Nor were there diverse interests represented by these Signatory Parties. Diversity of interest is an essential component to assure that a stipulation is reasonable. Diversity of interests secures the natural give and take of adverse negotiating parties. The Commission itself has found that diversity of interests in negotiations is strong testimony to the reasonableness of the settlement package.[35]

Here, however, the only interests that were diverse were the interests of customers who would pay increased rates under the decoupling rider -- and those customers were never directly represented in the stipulation and negotiations. OCC and the Citizens Coalition, the only representatives in the case of rate-paying customers, were not included in any negotiations leading up to this Amended Stipulation.

Stipulations that result from exclusionary negotiations should be disfavored. The Supreme Court in *Time Warner v. Public Utilities Commission of Ohio* warned the Commission that exclusionary settlement negotiations are suspect: "We have grave concerns regarding the commission's adoption of a partial stipulation which arose from the exclusionary settlement proceedings."[36] In *Time Warner* the partial stipulation arose from settlement talks from which an entire customer class was intentionally excluded. Here, as well, there were no negotiations that included representatives of any customer class that will end up paying the increased rates under the Amended Stipulation.

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[35] *In the Matter of the Restatement of the Accounts and Records of the Cincinnati Gas & Electric Company, The Dayton Power and Light Company and Columbus & Southern Ohio Electric Company,* Case No. 84-1187-EL-UNC *Opinion and Order* at 7 (November 26, 1985).

[36] 75 Ohio St.3d 229, footnote 2 (1996).

In a 2004 holding the Court reiterated its *Time Warner* admonition applied where "an entire customer class" was excluded from settlement negotiations.[37] Most recently, in a 2006 appeal from the PUCO, the Court reversed a partial stipulation opposed by residential customers, based in part upon the absence of customer support.[38]

Given the facts of the instant case, the exclusion of OCC and Citizens Coalition from the Amended Stipulation negotiations was the exclusion of an "entire customer class." Since no ratepaying customer is a signatory party, the Commission should find the stipulation deficient and incurable, consistent with the Ohio Supreme Court precedent.

### 2. The settlement does not as a package benefit ratepayers and the public interest.

Under the second stipulation criterion, the Amended Stipulation must also fail. As Vectren Witness Ulrey testified, in order to determine whether the settlement meets the second criteria, one must consider the settlement costs and the benefits -- to the ratepayers and the company. Tr. at 47. The majority of the benefits, however, accrue to Vectren, while the majority of the costs are thrust upon Vectren's customers.

Under the Amended Stipulation, the most significant cost to Vectren is a $2 million contribution to weatherization. But the $2 million is just $1.3 million net of tax to Vectren. Tr. at 49. Other costs to the Company were described by Vectren Witness Ulrey as "incremental" and not quantified. Tr. at 50.

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[37] *Constellation New Energy v. Pub. Util. Comm.*, 104 Ohio St. 3d 530, 535-536(2004).

[38] *Ohio Consumers Counsel v, Pub. Util. Comm*, 109 Ohio St. 3d 326, 2006 Ohio 2110. par. 17-19. There the Court also noted that OPAE, who had signed the stipulation, operates a weatherization program, and does not represent ratepaying customers, a distinction that should not be lost in this proceeding.

While the costs to Vectren are hardly sizeable, the benefits for Vectren that are derived from the Amended Stipulation are considerable.[39] Vectren will be permitted to profit from an unprecedented regulatory mechanism called "decoupling." Decoupling is an extraordinary mechanism that permits Vectren to collect from customers the cumulative differences between actual base revenues collected and the base revenues authorized in the last Vectren case ("decoupled revenues"). Vectren has *always* been at risk for whether it recovered revenues lost through reduced customer usage. If approved by this Commission, decoupling revenues will now be collected from Vectren's customers through the Sales Reconciliation Rider.

The SRR provides more than an opportunity to VEDO to recover the revenues authorized in the last rate case. It practically guarantees, for at least two years, dollar for dollar recovery of residential and general service revenues authorized in Vectren's last rate case.[40] Vectren Witness Ulrey testified that Vectren's gas margins -- gas utility revenue less cost of gas sold -- were expected to grow from the Ohio decoupling. Gas margins affect Vectren's utility earnings and thus influence earnings per share. Tr. at 50-51. In fact, the SRR has a dollar for dollar impact on the overall gas margins of Vectren. Tr. at 57. According to OCC Exhibit B, the company is expecting a \$3-\$4 million increase in gas margins in 2007 over 2006 margins solely attributed to decoupling. The increase to gas margins could even be greater if the SRR variance increases due to decreased customer usage. Tr. at 54.

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[39] *See for example*, Vectren Corporation's Chief Financial Officer, Niel Ellerbrook's remarks in the December 13, 2006 News Release "Vectren Issues Initial 2007 Earnings Guidance": "Our utility business will benefit from new rate design and conservation program orders recently implemented for our Ohio and Indiana North gas utility territories…" OCC Exhibit MGK-5, Request for admission 35.

[40] *See* Tr. at 203-207.

The importance of the decoupling mechanism to Vectren is inextricably linked to the declining average gas use per customer. According to Vectren, today's residential customers are using about 14 mcf less gas than they were using during 2004, the test period in Vectren's last case. Tr. at 60-61. Admittedly, the decoupling is "meant to reduce the adverse impact of declining use per customer on the Company's margins." Tr. at 69.

Presently the risk of recovering those authorized sales revenues is shouldered by Vectren. With decoupling Vectren is no longer subject to this risk. As Vectren Witness Ulrey testified, there was no rate case mechanism in the company's last case that would restore the actual gas margins to the rate ordered gas margins. Tr. 61-62. Nor is there or has there been any mechanism under traditional ratemaking statutes (Chapter 4909) or the gas alternative ratemaking statutes (Chapter 4929) that eliminates the utility's risk of declining customer usage and the risk that the utility will not recover its authorized revenues. *Id.* Under current Ohio law, a utility must file for an increase in rates to mitigate such revenue losses. This, however, the Company chose not to do.

As the risk of diminished sales shifts away from Vectren under decoupling, it is picked up by Vectren's customers. When Vectren filed its application in 2005, the costs of decoupling to residential customers was originally estimated to be $2 million per year. As the case progressed, the cost estimates increased to $3.6 million per year. At the hearing in March, 2007, the costs appeared to be soaring even higher. A mere five months of residential SRR variances (October 2006 through Feb. 2007) have topped $1.8 million and general service SRR variances have reached over $300,000.[41] Although the

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[41] Tr. at 80-81, OCC Ex. D.

Company does not currently know the cost of its decoupling proposal, it estimates, for calendar year 2007 the cost will be $7.6 million. Tr. at 77-78.

In exchange for the costs of decoupling the Company's customers receive very little. According to OCC Witness Kushler, while the low-income weatherization funding "may be a starting point for DSM it should not be the ending point."[42] Such a small conservation program will not provide sufficient benefits on the whole to customers.[43]

Dr. Kushler concludes that the Amended Stipulation does not benefit ratepayers and is not in the public interest: "...the stipulation provides only a very small energy efficiency program that will not provide sufficient benefits on the whole to customers. Additionally the stipulation affords Vectren the tremendous benefits of a decoupling mechanism, paid for by residential and commercial customers. Given the significant investment by Vectren customers, in the form of the decoupling mechanism, there should be reasonable and commensurate benefits to customers. This is absent from the January 12 Stipulation."[44] In fact, if the Signatory Parties are only concerned with making the Company whole (and not with providing energy efficiency tools to customers), a cheaper alternative is having Vectren purchase a financial insurance product to manage its risks.

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[42] OCC Ex. F at 3.

[43] *Id.* at 2. Moreover, the weatherization program is viewed by some, including Staff Witness Puican, as not equivalent to DSM. Tr. at 169-171. The Commission appears to recognize this, and according to Mr. Puican, that is why such programs need not provide a net economic benefit. The net economic standard instead was applied by the Commission to the DSM programs proposed under the April 7 Stipulation. The *quid pro quo* for decoupling under that Stipulation was real energy efficiency programs that could reduce overall costs for all customers.

[44] OCC Ex. F at 2-3.

Consequently, the Commission should find that the Amended Stipulation wholly fails to meet the second prong of the stipulation test. It is not in the public interest and does not benefit ratepayers as it is currently structured.

### 3. The settlement package violates important regulatory principles and practices under R.C. 4909.15 and R.C. 4929.02.

The Amended Stipulation fails to satisfy the third stipulation criterion as well. This criterion requires the Commission to determine whether the stipulation package violates regulatory practices or principles. Dr. Hall, the author of the three prong settlement standard used by the PUCO, explained that the third prong requires one to scrutinize the regulatory policies and determine whether such policies should be waived: "[A] regulatory body cannot let those over whom it has cognizance bootstrap waivers of its rules and policies. Thus, the elements of a settlement package must be examined with respect to: 1) its consistency with the rules, regulations, and policies of the regulatory body; or 2) whether a waiver is justified in light of the overall settlement package."[45] Thus, "a settlement that bargains away some important regulatory principle or practice may be unacceptable."[46]

The Amended Stipulation is inconsistent with a number of rules and policies of the PUCO, including rules and policies underlying both traditional and alternative regulation. And because there are so few benefits from the Amended Stipulation, a waiver cannot be justified.

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[45] Testimony of Dr. Hall, Exhibit A at 6 (October 29, 1985), submitted in Case No. 84-1187-EL-UNC.

[46] *Id.*

As earlier discussed, the decoupling mechanism violates the test period concept found in R.C. 4909.15. It allows Vectren to adjust its rates to enable it to recover 100% of its residential and general service revenues approved in its last rate case. The ratemaking formula of R.C. 4909.15 does not permit such an adjustment.

If, however, the Commission is reviewing the stipulation under the non-traditional R.C. 4929 alternative gas regulation statutes, why does it matter that traditional ratemaking concepts such as "test period" are being violated? Under R.C. 4929.05 the only permissible way for an alternative rate plan to be considered is "as part of an application filed pursuant to section 4909.18 of the Revised Code," after rates have been determined pursuant to R.C. 4909.15. Thus, clearly these traditional ratemaking concepts are important and should not be disregarded by the Commission in applying the third prong of the stipulation test.

Moreover, other regulatory principles established under the gas alternative ratemaking statutes are being violated or disregarded. Under R.C. 4929.05(A)(1) the Commission must determine, among other things, that Vectren is substantially complying with the state policies, including those contained in R.C. 4929.02. There are ten state policies delineated in that statute. Three of those policies bear repeating here: providing "adequate, reliable and reasonably priced" natural gas service, encouraging demand side natural gas services, and facilitating the states' competitiveness in the global economy.

Adequate and reasonably priced gas service, a laudable and appropriate state policy, is not being advanced under the Amended Stipulation. Considerable rate increases will be forced upon Vectren's customers as a consequence of the Amended Stipulation. Whether this will result in reasonable gas service rates cannot be known.

For, without a full R.C. 4909.18 filing, and the entailing investigative process, the reasonableness of increased rates cannot be determined.

The state policy seeking to encourage demand side natural gas services, is clearly not being met under the Amended Stipulation. The Amended Stipulation fails to offer any substantial DSM programs to Vectren's customers. Rather, the Amended Stipulation is structured to provide Vectren with unprecedented protection from revenue loss, without requiring any significant DSM for all its residential customers.

Nor does the Amended Stipulation, with its minimal DSM program, advance the state's competitiveness in the global economy, a policy maintained under R.C. 4929.02, and recently reinforced by Governor Strickland's Executive Order.[47] Instead the Amended Stipulation ignores the potential DSM opportunities and the positive impact DSM can have on the economy of the state. Instead of focusing on programs that can have a great impact in terms of reducing consumption, the program in place has a different goal – to weatherize the homes of low-income customers. While this is a laudable goal, this does not advance the state's competitiveness in the global economy. Nor does it accomplish the goals that true demand-side management are intended to address.

Dr. Kushler testified that the drain on the states' economy to pay for imported gas is a whopping $5 billion a year -- "that is essentially the same as taking an extra $2.5 billion dollars away from the Ohio economy each year."[48] According to Dr. Kushler, energy efficiency can be a powerful strategy to tackle this problem. Energy efficiency

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[47] *See* Dr. Kushler's testimony at 13-14, OCC Exhibit F, where he concludes that the stipulation does not comport with the executive order of Governor Strickland.

[48] OCC Exhibit F at 6.

can directly reduce the amount of gas imports. And, energy efficiency programs can produce additional net economic benefits in terms of total employment and payroll within the state.[49]

Dr. Kushler testified, however, that Vectren's minimal approach to DSM fails to address Ohio's unhealthy dependence on natural gas imports.[50] Minimal energy efficiency efforts will not advance Ohio's competitiveness in the global economy.

Accordingly, the Commission is bound to conclude that the Amended Stipulation is inconsistent with both traditional ratemaking and the gas alternative ratemaking policies. When the overall settlement package is evaluated, one must conclude that it does not justify waiving these regulatory policies and practices. And so the Amended Stipulation fails to satisfy the third criterion of the reviewing standard.

**4. The Amended Stipulation unreasonably allows Vectren considerable regulatory freedom that is not commensurate with Vectren's minimal commitments to R.C. 4929.02.**

In 1996, the alternative gas regulation provisions of Chapter 4929, Revised Code were codified. Under section 4929.10 the Commission was directed to adopt rules to carry out Chapter 4929. The enabling rules were developed in PUCO Docket No. 96-700-GA-ORD, and were established as O.A.C. provisions 4901:1-19 *et. seq.*

O.A.C. 4901:1-19-05, as well as the implementing Commission orders, make clear that a gas utility's alternative rate plan must include specific commitments to fulfill the state's policies set forth in R.C. 4929.02. Moreover, the Commission further advised it would be weighing the commitments against the regulatory freedom sought: "the

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[49] OCC Exhibit F at 6-7.

[50] OCC Exhibit F at 5-8.

further the deviation from traditional rate of return/rate base regulation, the more the commitments should relate to items which are no longer tied to traditional cost of service ratemaking principles...."

In response to this ruling, a number of utilities applied for rehearing, claiming that the Act did not require any commitments. The Commission, nonetheless, reiterated its finding that commitments were required and would be balanced against the regulatory freedom sought: "The rules require that the gas company filing an alternative rate plan to include in its application commitments to carry out the state's policy with a description of what specifically the gas company will change in its operations to further that policy. Contrary to the position of the Gas Companies, the Commission maintains that it is incumbent upon those seeking to move away from rate of return/rate base regulation to further the state policy set forth in Section 4929.02, Revised Code. The further the deviation, as we stated in our Finding and Order, the more the commitments to the state policy as set forth in the statute need to be."[51]

Five years would pass before the Commission could apply these rules and its holdings to a gas alternative regulation plan. On July 31, 2001, the Cincinnati Gas & Electric Company ("CG&E") filed the first (and only other) alternative gas regulation plan under R.C. 4929.05. Notably, CG&E's alternative rate plan was filed as part of its application for a rate increase, consistent with R.C. 4929.05. In the alternative rate plan, CG&E proposed an annually adjusted rider to implement an accelerated mains

[51] *In the Matter of the Adoption of Rules to Carry Out the Provisions of Amended Substitute House Bill 476 as Enacted by the 121st General Assembly*, Case No. 96700-GA-ORD *Entry on Rehearing* at 9 (May 22, 1997).

replacement program. Like the Vectren proposal in this proceeding, CG&E's rider, as proposed, was not capped.

Although CG&E's alternative rate application was later dismissed by the Commission, at the behest of CG&E, the PUCO Staff nonetheless issued a staff report that analyzed the alternate rate plan.[52] A review of that Staff Report[53] reveals that the Staff properly focused on the very same standard discussed by the Commission five years earlier. That standard, which framed the PUCO Staff's analysis, focused on the extent of the commitment weighed against the freedom CG&E was requesting from traditional ratemaking procedures.[54] Based on its analysis, the Staff Report recommended only limited approval of the plan, in line with the "conservative level of the commitments proposed."[55]

This same analysis, -- looking at the degree of commitment compared to the regulatory freedom requested -- should be applied here. It is the analysis required under R.C. 4929.05, and the analysis used by the PUCO Staff in the only other gas alternative rate case filing.

When this analysis is utilized here, it is evident that the degree of commitment is extremely minimal. How does the Amended Stipulation provide for changes in Vectren's operations to further the policies of R.C. 4929.02? The record conspicuously lacks any

[52]After being precluded from questioning Staff Witness Puican on the CG&E case, OCC proffered evidence related to the Staff's analysis of the alternative regulation plan. Tr. at 226-229. The Attorney Examiner took administrative notice of the Staff Report, pages 70-73. Tr. at 229.

[53]The portions of the Staff Report related to alternative regulation were prepared under the supervision of Staff Witness Puican. *See* Staff Report at i.

[54] *In the Matter of the Cincinnati Gas & Electric for Approval of an Alternative Regulation Plan for its Gas Distribution Service*, Case No. 01-1478-GA-ALT, Staff Report at 72 (January 18, 2002).

[55] *Id.* at 79.

details in this regard. The only change in operations made by Vectren as part of the Amended Stipulation is that Vectren will be funding $2 million ($1.3 million net of tax) in low-income weatherization.

In exchange for its minimal commitment to further R.C. 4929.02 policies, Vectren is seeking extensive freedom from traditional regulation. To call the change "radical" as did Staff Witness Puican in 2004,[56] is not an overstatement. Indeed the record is replete with statements by Vectren's CFO, Niel Ellerbrook, lauding the PUCO's innovative regulation.[57] Although Staff Witness Puican now asserts that the non-traditional decoupling mechanism is not "radical," he still concurs that: (1) it is a new approach (2) it "clearly benefits VEDO by removing one layer of uncertainty in the recovery of their revenue requirement" (3) "[n]o other natural gas utility in Ohio has a similar benefit (4) the SRR would be the "first time ... that the Commission would approve a rider that would include a component of the company's profit."[58]

Under traditional regulation, if Vectren wanted to recover the revenues it is losing from reduced customer usage, it would be required to file a complete R.C. 4909.18 filing and go through the rate case process described in Chapter 4909. Discovery, disclosure, and detailed information are the hallmarks of the R.C. 4909.18 process. No single issue

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[56] *See 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 Service and Related Matters* Case No. 04-571-GA-AIR, Staff Report at 59 (November 24, 2004), admitted into the record in the present case. Tr. 6.

[57] *See* OCC Ex. F, MGK-5 at Request to Admit 37, 38, 39 (where Mr. Ellerbrook describes the decoupling order as a "fundamental change to the ratemaking paradigm" and expresses pleasure at being "among the first companies in the country to establish a rate mechanism that will allow us to encourage our Ohio customers to conserve energy.").

[58] Surrebuttal of Staff Witness Puican at 2 (April 21, 2006), Staff Exhibit 2.

is isolated for adjudication -- the utilities' entire rate base, expenses, revenues, and rate of return are subjected to investigation.

Not so under the brave new world sought by Vectren. The Amended Stipulation permits single issue ratemaking, without a single glance back. Extreme? Yes. Advantageous to Vectren? Yes. Worthy, when balanced against the commitments under the stipulation? No.

## V. OCC'S RECOMMENDATIONS

OCC recommends that the issues raised by Vectren's application including the appropriate level of DSM funding and a recovery mechanism for lost revenues should be addressed in a more appropriate forum, such as Vectren's upcoming rate case. In that proceeding alternative rate plans can be evaluated as the General Assembly envisioned, in the context of the entire rate case application. Then not just one element of Vectren's rates will be singled out for adjustment.

In the meantime, since the Commission does not have authority to approve the decoupling mechanism, either under R.C. 4929.05, R.C. 4905.13, or R.C. 4909.18, it follows that neither can it authorize the Company to book the revenue differential. The Commission should thus order the company to cease immediately all the deferrals.

If there is no significant DSM commitment from Vectren, it should not have the ability to benefit from the decoupling.[59] Thus, Vectren should be ordered to reverse the accounting deferrals it has created over the last five months. OCC supports Vectren re-engaging its efforts to provide additional low-income weatherization programs for the enlarged scope of Vectren's "low-income" customers.

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[59] *See* testimony of Dr. Kushler at 12-14.

If the Commission determines it has jurisdiction to approve the alternative rate plan, which OCC strongly believes it does not, the Commission should nonetheless modify the Amended Stipulation for even if it clears the regulatory jurisdictional hurdles earlier discussed, it still must ensure that the Amended Stipulation is in the public interest and benefits ratepayers. Toward this end, OCC suggests, at a minimum, that the following modifications to the Amended Stipulation be made:

- Increased company funding over the $2 million in the Amended Stipulation, to support vigorous energy efficiency programs that can help customers reduce their energy costs. As Dr. Kushler testified, an adequate minimum base of funding would be $4.67 million over two years.[60] This was the funding level implemented in the original April 7 Stipulation.

- A cap on the amount of decoupling generated revenues Vectren can collect. An absolute dollar cap is preferable to a straight percentage cap. OCC recommends that decoupling revenues collected from residential customers over a two year period be no greater than $7.5 million. Once the cap is reached, the collection of decoupled revenues, the rider, and the tariff should terminate.

- Assurance that the Company will not book any more revenue deferrals until the Company begins implementing the low-income programs that are the *quid pro quo* for the decoupling.

- An alternative rate plan will reduce Vectren's business risk thereby decreasing Vectren's investors' required return. In order to reflect that reduced risk, the Company's rate of return in its upcoming rate case should be adjusted.[61]

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[60] OCC Ex. F at 4.

[61] A full analysis would be required in the proceeding to determine an appropriate reduction to the return on equity. For example, one way of calculating the reduction to equity would be to take the differential between A-rated and Baa rated utility bonds and the return implied by the difference between observed betas of the gas utility industry and the Company's beta. Alternatively, one could reduce the Company's return on equity by a set amount of basis points, e.g. 100 basis points.

- A stay-out provision for future rate increases. A two year stay-out provision, consistent with the term of the DSM program, is recommended.[62] This stay-out provision would be applied after rates are set in Vectren's upcoming base rate proceeding.

## VI. CONCLUSION

There will be great harm to Vectren's residential customers if the Amended Stipulation or the SRR component on a stand-alone basis, is adopted. In the Amended Stipulation Vectren has "settled" with the PUCO Staff and OPAE for automatic uncapped rate increases for customers, by virtue of the SRR rider. Vectren achieved such a settlement without the signature of any representative of rate paying customers. Those in this case directly representing rate paying customers refused to sign the Amended Stipulation, and for good cause.

What Vectren seeks the PUCO to do (or re-do) via the rate increase mechanism of the SRR (with no corresponding benefit of comprehensive DSM) is unprecedented in Ohio regulation (as the PUCO's own witness acknowledges) and not contemplated under any provision in Ohio law. For the reasons set forth herein, the Commission should reject outright the Amended Stipulation, as it has no jurisdiction to approve it. Vectren should withdraw its application, and pursue this issue in the context of its next rate case application.

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[62] PUCO Staff earlier in this proceeding recommended a stay-out provision. Staff Witness Puican Testimony at 8 (March 20, 2006).

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## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Phase II Initial Brief by the Office of the Ohio Consumers' Counsel was served by electronic mail to the persons listed below, on this 23rd day of April 2007.

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