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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc., for Authority to Amend its Filed Tariffs to Increase the Rates and Charges for Gas Services and Related Matters.	:	Case No. 07-1080-GA-AIR
In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc., for Approval of an Alternative Rate Plan for a Distribution Replacement Rider to Recover the Costs of a Program for the Accelerated Replacement of Cast Iron Mains and Bare Steel Mains and Service Lines, a Sales Reconciliation Rider to Collect Differences between Actual and Approved Revenues, and Inclusion in Operating Expenses of the Costs of Certain Reliability Programs.	:	Case No. 07-1081-GA-ALT

TESTIMONY
OF
STEPHEN E. PUICAN

RATES & TARIFFS / ENERGY & WATER DIVISION IN THE UTILITIES DEPARTMENT OF THE PUBLIC UTILITIES COMMISSION OF OHIO

1. Q. Would you please state your name and business address?

A. My name is Stephen E. Puican. My business address is 180 East Broad Street, Columbus, Ohio.

2. Q. What is your present employment?

A. I am currently employed as Co-Chief of the Rates & Tariffs / Energy & Water Division in the Utilities Department of the Public Utilities Commission of Ohio ("PUCO").

3. Q. Would you outline your academic and professional qualifications?

A. I received a B.A. degree in Economics from Kent State University in 1980 and an M.A. degree in Economics from Ohio State University in 1983. I was employed by the Ohio Department of Development, Division of Energy, from May 1983 until October 1985 at which time the functions of that Division were incorporated into the PUCO. I have been employed in several positions at the PUCO since that time and have been Co-Chief of the Rates & Tariffs / Energy & Water Division since May 2005. Prior to that, I had been Chief of the Gas and Water Division since 1999. In both my current and previous positions I have been responsible for oversight of the Utilities Department's natural gas staff which includes responsibility for all GCR cases, as well as other areas relating to natural gas such as contracts, certain tariff provisions, and certain rate case issues. I have also been involved in the development and evolution of Ohio's customer choice programs. Prior to my current position I was responsible for directing Staff investigations into electric utilities' Demand-Side Management ("DSM") programs and have submitted testimony in numerous proceedings relating to evaluation of DSM programs.

4. Q. What is the purpose of your testimony in this proceeding?

A. I am testifying in response to several objections to the Vectren Energy Delivery of Ohio (Vectren) rate case Staff Report raised by various parties to this proceeding.

5. Q. The Office of the Ohio Consumers' Counsel (OCC) objection 52, Ohio Partners for Affordable Energy (OPAE) objection VI, and the Ohio Environmental Council (OEC) all object to the Staff's proposed Straight Fixed Variable (SFV) rate design on the grounds that it fails to encourage conservation and adversely affects the Company's energy efficiency efforts. Do you agree with these objections?

A. I do not agree. When evaluating customer incentives to conserve, one needs to look at the total variable rate a customer faces and not just the distribution rate. Vectren used a gas cost rate of $9.686 per Mcf in its application and regardless of which rate design is ultimately approved in this proceeding, the variable component of base rates will be relatively small in comparison to the cost of the gas itself. Customers will always achieve the full value of the gas cost savings regardless of the distribution rate. I believe most customers make conservation decisions based on their total bill rather than by an explicit cost/benefit analysis based solely on the variable portion of rates, particularly given the volatility of the gas cost component.

The following table shows the monthly changes to the Vectren GCR since January 2008:

	GCR Rate	Change
Jan-08	$ 9.0321	
Feb-08	$ 9.3528	$0.3207
Mar-08	$ 9.6352	$0.2824
Apr-08	$11.4243	$1.7891
May-08	$12.0829	$0.6586
Jun-08	$13.2304	$1.1475
Jul-08	$14.0774	$0.8470
Aug-08	$13.7565	($0.3209)

The volatility includes a one month increase of $1.79 per Mcf from March to April of this year and an overall increase of $4.7244 per Mcf since January. Given these types of extreme fluctuations, I believe customers recognize the imprecision of any payback analysis and will incorporate that uncertainty into their energy efficiency investment decisions.

Even assuming customers conduct this type of payback analysis, including fixed costs in a variable rate distorts the price signals customers face. The variable component of rates should reflect a utility's true avoided costs, *i.e.* the costs that a utility does not incur with a unit reduction in sales. The SFV rate design satisfies this condition by more closely matching fixed and variable cost recovery to those actual costs incurred. Artificially inflating the volumetric rate beyond its cost basis skews the analysis and will cause an over-investment in conservation. This exacerbates the under-recovery of fixed costs that the utility must then recover from all other customers.

Customer incentives to conserve must also be considered within the context of the change in incentives the SFV rate design provides the Company. OCC and OPAE and OEC all support a rate design that ties a Company's recovery of its fixed costs to sales volumes. To artificially require the Company to recover its fixed costs through the volumetric rate creates a disincentive for the Company to promote energy efficiency. Staff is proposing a rate design that eliminates this disincentive. The relatively small potential disincentive for customers to conserve due to the reduction in the volumetric rate is more that offset by the removal of the Company's disincentive to actively promote and fund energy-efficiency.

6. Q. OCC objections 53 and 55 and the OEC object to the Staff's rejection of a proposed Sales Reconciliation Rider (SRR) in favor of the SFV rate design. OCC objection 55 also claims the Staff's proposal is contrary to the State policy of conservation as noted in R.C. 4929.02 and R.C. 4905.70. Do you agree with these objections?

A. No I do not. I believe the SFV rate design achieves a better result than the proposed reconciliation rider would. The SFV rate design is a straightforward solution that removes the inherent disincentives under traditional rate design so that LDCs can promote energy-efficiency. It is an economically logical concept that eliminates the need for the annual true-ups required by the SRR approach. The SFV provides a level of certainty that the SRR approach does not. It recovers costs as incurred by the LDC and eliminates the need for carrying costs associated with deferred recoveries. The annual true-ups required by the SRR invite contentious proceedings as parties argue about such things as the details of weather-normalization methodologies. It would invite parties to argue for restrictions on full recovery or to seek other types of concessions. In contrast to the SRR proposal, the straightforward application of SFV is easier for customers to understand and it promotes timely recovery of costs without the need for annual true-up proceedings. Regarding whether SFV is consistent with the Revised Code sections cited in the objection, I have been advised that this is a legal conclusion and I thus have no response.

7. Q. OPAE objection VI, OCC objections 47 and 52 and the OEC all object to the Staff Report's SFV rate design proposal on the grounds it adversely impacts low-use and low-income customers. Do you agree with these objections?

A. The shift to the SFV rate design will result in low-usage customers seeing a higher total bill and high-usage customers seeing a lower total bill than would occur with a continuation of the current rate design. However the impact on low-use customers must be considered within the context of the rationale for the movement to the SFV rate design discussed above. In regard to low-income customers, I do not agree with the objection. Company witness Overcast's testimony Exhibit No. HEO-1, Schedule 2, compared the average annual usage of Vectren's PIPP customers with the usage of non-PIPP residential customers. The data shows that, for the 12 months ending

September 2007, PIPP customers' average usage was 110.9 Mcf and non-PIPP residential customers' average usage was 81.5 Mcf. Although PIPP customer usage may not be a perfect representation of all low-income customer usage, it is the best readily available proxy. The usage data indicates that low-income customers are, on average, not low-usage customers. Because high-usage customers will benefit from the SFV rate design, and low-income customers are more likely to be high-usage customers, it is reasonable to conclude that low-income customers are actually more likely to benefit from SFV.

8. Q. OPAE objection VII objects to the need for a decoupling mechanism since the Staff Report has not demonstrated that use per customer will continue to decline. Do you agree with this objection?

A. No. Whether or not use per customer has reached a "plateau" it is not realistic for a natural gas utility to undertake the type of investment in Demand-Side Management that OPAE, OCC and OEC propose without addressing the impact that investment will have on the Company's earnings. We have seen significant reductions in per customer usage in recent years as a response to increasing commodity prices. One cannot expect a utility to actively contribute to an acceleration of that decline through DSM programs without compensating the Company for the revenue erosion that the DSM programs, by definition, will cause. That decoupling can be done through the true-up mechanism proposed by the Company, through directly compensating the utility for the DSM program impacts (*i.e.* "lost revenues"), or through appropriate rate design as proposed by Staff. I believe the SFV rate design is the most efficient and accurate way to accomplish that goal.

9. Q. **OPAE objection V objects that the Staff Report did not propose restrictions to fixed cost recovery through either the SFV or the SRR. Do you agree with this objection?**

A. No. The recommendation to move to a SFV rate design is based on a belief that this rate design more accurately aligns rate recovery to the types of costs are that actually incurred. It is unnecessarily punitive to impose arbitrary conditions to that cost recovery that would cause the utility to earn less than the fixed costs they were authorized to recover.

10. Q. **OCC objection 44 objects to recovery of the deferrals through Rider SRR-A over a one-year period. Should the Commission allow recovery of these deferrals over OCC's objections, they would be recovered over a two-year period. Do you agree with the objection?**

A. I think there is some merit to this objection. If the deferrals had been contemporaneously recovered through an existing rider rather than deferred, the recovery would have been over two-years. I agree with OCC's objection.

11. Q. OCC objections 45, 46 and 54 all object to the Staff Report's justification of the SFV rate design based on declining use per customer. The objection claims there are errors in the data Staff relied on to reach this conclusion. Do you agree with the objection?

A. Without knowing what the supposed errors are I cannot respond to these objections. At this point I stand by the information presented in the Staff Report.

12. Q. OCC objection 51 objects to the SFV rate design on the grounds it violates the principles of gradualism and guarding against rate shock. Do you agree with this objection?

A. No. Staff recognizes this is a significant change in rate design but I believe the benefits of (1) eliminating Vectren's disincentive to promote energy conservation while obviating the need for a decoupling mechanism, (2) more closely aligning the fixed-cost nature of distribution service with recovery of those costs and (3) potentially deferring the need for future rate cases, argues in favor of the SFV rate design. Even though one could argue that all distribution costs are fixed costs, as a concession to the principle of gradualism, Staff has not recommended elimination of the variable component altogether, and has also maintained a block rate structure in which very high use customers pay a higher marginal rate. As I stated above, some customers will pay more and some will pay less as a result of this change in rate design but I don't believes this constitutes a violation of the principles of gradualism and guarding against rate shock.

13. Q. OCC objection 49 objects to the Staff Report's support of the recovery of the Distribution Replacement Rider (DRR) through a fixed monthly charge. OCC objects to this as an SFV-type rate design which it believes is not economically efficient, discourages conservation, and puts an unfair burden on low-use residential customers. Do you agree with this objection?

A. No. I disagree with these characterizations of the SFV rate design as I have discussed elsewhere in this testimony. I will not restate those arguments here, but will refer to that testimony as my response to this objection.

14. Q. OCC objection 50 objects to the Staff's recommendation that PIR deferrals be permitted to accrue Post-in-Service Carrying Charges (PISCC) and that, if permitted, it should be limited to Vectren's long-term cost of debt as determined in this rate case. Do you agree with this objection?

A. It was Staff's intent that the PISCC be limited to the cost of debt as determined in this rate case. To that extent I agree with the objection.

15. Q. OCC's objection 41 objects to recovery of the accelerated distribution replacement program through the Distribution Replacement Rider. OCC objects that these costs have not been demonstrated permissible under either statute or prior Commission decisions and that such automatic recovery is a

disincentive for Vectren to hold down the program costs. OCC further objects that Staff failed to follow an alternative recovery procedure as proposed in the Eagle Energy Report. Do you agree with these objections?

A. I will not address whether the DRR is permissible under the statutes as I have been advised that this is a legal issue. Staff has recommended approval of the DRR based on the conclusion that the accelerated replacement program will help to ensure greater pipeline safety and a more reliable system. Without the DRR cost recovery rider, the program could only be financed through traditional base rate proceedings. This would make it difficult to finance an "accelerated" program. Although they were the result of stipulated agreements, the Commission has authorized a similar rider for Duke Energy Ohio in Case Nos. 01-1228-GA-AIR and 07-589-GA-AIR. Contrary to the OCC's objection, this rider is not an "automatic recovery" of costs. The Staff Report recommends procedures for an annual review of all costs before they are included in the Rider. The OCC and other interested parties participate in these annual reviews and are free to challenge any costs they believe are inappropriate. Our experience with the Duke riders gives me a great deal of confidence that these annual reviews effectively monitor cost recovery.

Regarding the Eagle Energy recommendation, my understanding is that they are proposing to depreciate the remaining life of the pipe being replaced over the presumed 20 years of the distribution replacement program. This accelerated depreciation (from 55 years to 20 years), according to Eagle, will generate an additional $942,000 annual revenue stream which could be used to finance the replacement program over the next 20 years. Calculating the difference between a 55 year depreciation rate and a 20 year rate and then applying that difference to the remaining depreciable existing asset is arbitrary and doesn't recognize the actual remaining lives of the those assets. According to Vectren's objection 48, most of the cast iron and bare steel designated for replacement is, in fact, fully depreciated. Further, any revenues generated through this accelerated depreciation would not have any relation to the actual costs that will be incurred in the implementation of the replacement program. As a result, I do not believe it is a practical alternative to the proposed Distribution Replacement Rider.

16. Q. OCC objection 42, objects to the Staff recommendation that the infrastructure replacement program and DRR be authorized for an initial eight-year term. OCC believes, should the program be authorized, it should be for an initial four-year term or until the Company's next rate case whichever comes first. Do you agree with this objection?

A. First, as a clarification, the Staff Report recommended the initial approval be for eight years or the Company's next rate case, whichever comes first. I disagree with the objection that initial approval be for a four year period. Whether or not eight years is the optimal length of time, I believe four years is too short a period of time over which to adequately evaluate the program.

17. Q. Vectren objections 32 and 33 object to the Staff Report not recommending approval of the Sales Reconciliation Rider – B (SRR-B). Vectren objects that the Staff's proposed rate design is not a full SFV rate in that it includes a volumetric component. Vectren claims that the SRR-B is necessary for it to have a reasonable opportunity to earn its revenue requirement. In the alternative, Vectren proposes a full SFV rate design with no volumetric component. Do you agree with this objection?

A. The statements in the objection are factually correct. As I discussed above however, Staff is not recommending total elimination of the variable component of the SFV rate design in recognition of the principle of gradualism. In addition, one of the benefits of SFV that we have continually stressed is the elimination of the need for a decoupling mechanism. To superimpose the SRR-B on top of the Staff's proposal would eliminate one of the motivations for the move to the SFV rate design. I understand the Company's concern about the risk associated with recovery of their revenue requirement being partially dependent on the volumetric rate, but I believe this relatively small additional risk is a reasonable amount for the Company to retain.

18. Q. Vectren objection 36 (a), objects that the Staff Report incorrectly represents that the average annual DRR cost for residential and Group 1 customers on rate schedules 320 and 325 is $7.05 which translates to a monthly charge of $0.73. Do you agree with this objection?

A. Yes. The Staff Report erroneously referred to these as the average annual and monthly costs per customer. They should have been referred to as the incremental annual and monthly costs.

19. Q. Vectren objection 36 (b), objects that the amount of the proposed cap on annual increases to the monthly DRR charge is insufficient to recover the replacement of prone-to-fail risers. Do you agree with this objection?

A. The Staff Report attempted to account for this unknown cost by increasing the cap on annual increases to the monthly DRR charge from $0.73 (now revised to $0.68) per month to $0.90 per month. Unless Vectren can demonstrate that that increase is insufficient to recover its riser replacement costs I will stand by the $0.90 monthly cap.

20. Q. Vectren objection 36 (c) objects to the monthly DRR cap to the extent it was not clear if the Post-in-Service Carrying Charges recommended in the Staff Report would apply also to costs that are incurred but are not includable in the next DRR adjustment due to the cap.

A. Staff did not intend that costs that are unrecoverable in one period due to the cap would be carried over to the next period. Staff's intent was the Vectren manage their annual expenditures such that the capped amount would be sufficient for full recovery. Staff did not intend that unrecovered balances could be carried over year-to-year.

21. Q. Vectren objection 37 objects that the Staff Report appears to include riser investigation costs in base rates while also proposing recovery via the DRR. Vectren proposes these costs be included in the DRR. Do you agree with this objection?

A. Yes, I agree these costs should be recovered through the DRR rather than base rates. The Staff will make the appropriate adjustment to its proposed revenue requirement.

22. Q. Vectren objection 20 objects to the Staff Report's recommendation that shareholders contribute $1 million to its conservation program as a commitment related to the proposed alternative regulation plan. Vectren states that all of its alternative regulation proposals are consistent with cost-of-service ratemaking provisions of Section 4909.15, Revised Code. Do you agree with this objection?

A. No. The accelerated distribution replacement program was appropriately filed as part of an alternative regulation plan. As discussed in the Staff Report, Administrative Code Section 4901:1-19-05(C)(3) requires an applicant filing such a plan to include a commitment to customers in support of the state policy as defined in Revised Code Section 4929.02 which deals with Ohio's energy policy. The Staff Report's recommendation of a shareholder contribution of $1 million per year for customer conservation efforts represents an appropriate level of commitment to meet that requirement. I stand by the Staff Report's recommendation.

23. Q. Does this conclude your direct testimony?

A. Yes, it does.

PROOF OF SERVICE

I hereby certify that a true copy of the foregoing Prefiled Testimony of Stephen E. Puican, submitted on behalf of the Staff of the Public Utilities Commission of Ohio, was served by regular U.S. mail, postage prepaid, hand-delivered, and/or delivered via electronic mail, upon the following parties of record, this 22nd day of August, 2008.

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