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A report by the Staff of the Public Utilities Commission of Ohio

Suburban Natural Gas Company

08-216-GA-GCR

Financial Audit of the Gas Cost Recovery Mechanism for the Effective GCR Period March 1, 2006 to February 29, 2008

September 23, 2008

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CERTIFICATE OF ACCOUNTABILITY

Staff has completed the required audit of the Suburban Natural Gas Company (Suburban or the Company) ordered by the Public Utilities Commission of Ohio (PUCO or Commission), of the Gas Cost Recovery (GCR) rates for the three-month periods ended May 31, August 31, November 30, 2006, February 28, May 31, August 31, November 30, 2007, and February 29, 2008, for conformity in all material respects with the procedural aspects of the uniform purchase gas adjustment as set forth in Chapter 4901:1-14 and related appendices, Administrative Code, and the Commission Entry in Case No. 08-216-GA-GCR.

Our audit has revealed certain findings, as discussed in this audit report, which should be addressed in this proceeding. Staff notes that the Company has accurately calculated its Gas Cost Recovery rates for those three-month periods under investigation in accordance with the uniform purchase gas adjustment as set forth in Chapter 4901:1-14, Administrative Code, and related appendices, except for those instances noted in the audit report.

Staff has performed an investigation into these specific areas and respectfully submits its findings and recommendations.

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SECTION I

EXECUTIVE SUMMARY

Audit Work Program

This audit pertained to Suburban's SCOL and CORE systems. The audit investigation consisted of several components. Staff initially reviewed and evaluated relevant documents from within the Commission in preparation for the audit. Staff conducted investigative interviews with appropriate Company personnel at the Company's offices in Lewis Center and Cygnet, Ohio. Additionally, Staff submitted data requests and reviewed and evaluated the Company's responses to those requests to understand and evaluate the company's activities.

Recommendations

Unless otherwise stated in this report, Staff's review has shown that the Suburban Natural Gas Company accurately calculated its Gas Cost Recovery rates for the three-month periods that are discussed in this report. Following is a summary of Staff's recommendations contained in Chapters III through XI of this report:

- Staff recommends that the basis differential between Gulf and TCO be incorporated into Suburban's next evaluation of gas asset management offers.
- Staff again recommends that Suburban place in its combined GCR filings, the purchase volumes for the combined systems (CORE and SCOL) reflecting all volumes purchased on behalf of its GCR customers, net of transportation volumes.
- Staff recommends an adjustment for the period December 2005 through December 2007 of $111,661in the customers favor to recognize the difference between the annual lease payments billed to Suburban and the Company's revised "all-in" calculated lease payments for the same period.
- Staff recommends that Suburban further credit its GCR customers an additional $34,178 to recognize the costs not billed to a firm transportation customer for their utilization of the DEL-MAR pipeline.
- Staff recommends that Suburban continue to determine and monitor its changing load growth and daily, seasonal and annual load requirements needs. Suburban should formalize this evaluation through its first formal LTFR filing with the PUCO beginning in 2009.

SECTION II

INTRODUCTION

Suburban Natural Gas was founded in 1882 by Roland Hughes under the company name Consumer's Gas. The primary function of the company, originally, was to distribute natural gas to the villages of Cygnet, Dunbridge and Jerry City. A separate company, named Suburban Fuel Gas, was incorporated in 1929. In March of 1988, Consumer's Gas and Suburban Fuel Gas were merged to form Suburban Natural Gas.

The Suburban Natural Gas Company (Suburban or Company) is headquartered in Cygnet, Ohio. The company maintains and operates two distinct distribution systems, the "CORE" and the "SCOL" systems with operations and customer service centers in Cygnet, Ohio and Lewis Center, Ohio.

The northern system, CORE, serves Cygnet and the surrounding areas, including the counties of Henry, Lucas, Wood, and a portion of Hancock. This system is the older, traditional part of the Company's operations. It includes the distribution system formerly known as Consumers Gas, Inc., and has been in operation since the Company's inception in 1882. The CORE system operations are conducted out of the Cygnet office. As of the end of the audit period, approximately 5,681 customers were being served by the CORE system. The customers on this system were served under municipal ordinances (Home Rule) during the audit period.

The southern system, SCOL, serves Delaware and the northern Columbus markets and the surrounding areas, primarily in the counties of Delaware and Marion. This system is newer and has grown rapidly over the last 5 to 6 years. This system originated in 1988 through the development of a converted ARCO oil products pipeline, which was sold to ACO. ACO leased the pipeline to Suburban until 2006, when Suburban purchased it. The SCOL system operations are run out of the Lewis Center office.

By the end of the audit period, approximately 9,739 customers were being served by the SCOL system. In total, the combined CORE and SCOL systems serve approximately 15,420 customers. Approximately 1,174 customers have been added to Suburban's customer base during this 2-year GCR audit period. The Company projects annual customer additions of approximately 400-500 over the next several years.

In Case No. 94-938-GA-ATR, Suburban and Columbia Gas of Ohio (Columbia) stipulated to the exchange of certain facilities and customers in Northern Franklin and Southern Delaware counties to resolve disputes over new and planned residential developments. Under the terms of the stipulation, Suburban served and still serves a selected group of sales customers using Columbia's GCR and base rates, but they are customers of Suburban. Likewise, Columbia has a similar pool of customers whom it charges Suburban's applicable rates.

SECTION III

EXPECTED GAS COST

Staff has reviewed Suburban's calculations of its Expected Gas Cost (EGC) for the audit period. The EGC mechanism attempts to match future gas revenues for the upcoming quarter with the anticipated cost to procure gas supplies. It is calculated by extending twelve months of historical purchase volumes from each supplier by the rate that is expected to be in effect during the upcoming GCR quarter. The cost for each supplier is summed and the total is divided by twelve-month historical sales to develop an EGC rate to be applied to customer bills.

In Case No. 04-214-GA-GCR, the Commission approved a Staff recommendation for Suburban to combine its CORE and SCOL GCR filings because the Company's separate distribution systems were and continue to be served primarily by Columbia Gas Transmission Corporation (TCO) and utilize the same transportation and storage contracts, along with aggregation of their systems' requirements through a single asset manager. In early 2005, Suburban filed an application with the Commission in Case No. 05-216-GA-GCR to combine its two GCR filings into a single filing. The Commission approved Suburban's application to combine its filings on March 16, 2005. Suburban filed combined GCR rates for the entire audit period.

Supply Sources

As mentioned above, Suburban aggregates the SCOL and CORE system demand in determining its capacity and commodity requirements. During the first half of the audit period, Suburban utilized the asset management services of ProLiance Energy (ProLiance) under the terms and conditions of a Gas Sales Management and Agency Agreement (GSMAA). During this period of time ProLiance, while acting as agent for Suburban, purchased gas and delivered to the Company's city gates, on a firm basis. This provided for Suburban's systems requirements with a small discount on the monthly index price.

As a result of a recommendation in Case No. 06-216-GA-GCR, in which Staff stated it would review the analysis and effort to maximize the compensation and non-compensatory benefits achieved through the Company's GSMAA or other gas supply management agreements, Suburban issued a request for proposal (RFP) in February 2007 to solicit bids for management of natural gas supplies, transportation, and storage. Suburban received five responses with two of the responses containing no-bids. Bids were received from Montovano Associates, LLC (Montovano), Atmos Energy Marketing (Atmos) and ProLiance. Suburban reviewed the proposals and selected Atmos as its gas supply manager for the second half of the audit period, based on a larger discount from the commodity index, fixed monthly credit, increased maximum daily and seasonal storage quantities and lower prime plus adder for storage carrying costs as compared to the ProLiance bid. Starting April 2007, Suburban's procurement and nominations of gas volumes were performed by Atmos under a Base Contract for Sale and Purchase of Natural Gas agreement. The Montovano bid did not meet the Company's asset management needs of nominating and scheduling of volumes to its city gates.

During the audit, Suburban had under contract Firm Transportation Services (FTS-1) on Columbia Gulf Transmission (Gulf) and Firm Transportation Services (FTS), Firm Storage Service (FSS), and Storage Service Transportation (SST) agreements on Columbia Gas Transmission (TCO), which the Company assigned to either ProLiance or Atmos.

Suburban also purchased gas supplies for its SCOL system from Columbia Gas of Ohio (COH) at COH's prevailing GCR rates plus a transportation fee. Suburban purchased its supplies through two interconnects with COH. The two interconnects between Suburban and COH are Lazelle and Big Walnut. The supplies obtained by Suburban from COH were not procured or nominated by the Company's asset manager, but rather were purchased at its point of interconnection with COH.

Purchase Volumes

In Case No. 06-216-GA-GCR, the Commission approved Staff's recommendation that Suburban place in its GCR filings its monthly purchase volumes. Suburban did not file any monthly purchase volumes during this audit period.

Sales Volumes

Staff verified that Suburban's SCOL system sales volume totaled 1,918,637 Mcf for the audit period, which is an increase of 230,007 Mcf or 13.6% over the 2006 audit. Staff verified the CORE system sales volume total of 1,272,759, which is a decrease of 129,344 or 9.2% from the 2006 audit. Staff noted no errors in the computation of sales volumes contained within the Company's GCR filings.

Conclusion

Staff has reviewed the Company's evaluation of the bids that it received in response to its February 2007 RFP and it appears that the Atmos agreement provides some level of cost saving associated with the fixed monthly credit, the increased daily and seasonal storage capabilities and the lower prime plus adder for storage costs. Staff did find in its review of Suburban's evaluation that the Company did not consider the basis differential between Gulf and TCO indices. Staff examined the indices prices for Gulf and TCO from 2005 through 2007 and found that there was a substantial basis differential that directly effects Suburban's price at the city gate that was not incorporated into Suburban's analysis of the proposals.

In the calculation of purchase volumes, Staff relied on the purchased volumes contained on the TCO statements. However, Staff has been informed that the purchase volumes on the TCO invoice also contained transportation volumes. Staff's calculated purchase volumes reflected TCO invoices volumes net of transportation volumes plus COH deliveries.

Recommendation

Staff recommends that the basis differential between Gulf and TCO be incorporated into Suburban's next evaluation of gas asset management offers.

Staff again recommends that Suburban place in its combined GCR filings, the purchase volumes for the combined systems (CORE and SCOL) reflecting all volumes purchased on behalf of its GCR customers, net of transportation volumes.

SECTION IV

ACTUAL ADJUSTMENT

The Actual Adjustment reconciles the monthly cost of purchased gas with the EGC billing rate. It is calculated by dividing the total cost of gas purchases for each month of the three-month reporting quarter by total sales for those respective months. The result is the unit book cost of gas, which is the cost incurred by the Company for procuring each Mcf it sold that month. That unit book cost for each month is compared with the EGC rate, which was billed for that quarter. The difference between each monthly unit cost and the EGC, whether positive or negative, is multiplied by the respective monthly jurisdictional sales to identify the total of under or over recoveries of gas costs. The monthly under- or over-recoveries are summed and the Balance Adjustment is added or subtracted and then divided by the twelve-month historic jurisdictional sales to develop an Actual Adjustment rate to be included in the GCR for four quarters.

Errors in the Actual Adjustment calculation can result in incorrectly reported purchase gas costs, errors in the stated sales volumes and the use of the wrong EGC rate.

Staff has reviewed the applicable purchase invoices, sales volumes, and Company-prepared worksheets and noted no differences between the purchase gas costs that were filed and those verified by Staff in the course of this audit. Staff has recommended adjustments for the period of December 2005 through December 2007 as to the recovery of costs associated with the DEL-MAR lease payments, but has addressed these recommendations in *Section X, DEL-MAR PIPELINE*.

Recommendation

Staff has no recommendations for this section.

SECTION V

REFUND AND RECONCILIATION ADJUSTMENT

The Refund and Reconciliation Adjustment (RA) is used to pass through the jurisdictional portion of refunds received from gas suppliers and adjustments ordered by the Commission. Annual interest of ten percent (10 %) is applied to the net jurisdictional amount of the RA, which is then divided by twelve months of historic sales volumes to develop a per unit rate to be included in the GCR calculation for four quarters.

Staff has reviewed the calculations contained in each GCR filing within the audit period and verified the Commission ordered reconciliation of $(6,837.17) was refunded to customers over four consecutive quarters. Staff also verified that a check of $43,050 was received from Columbia Gas of Ohio (COH) for over-payment of costs. Suburban did not include the check in the RA, because the Company had previously reduced purchase gas costs by the amount of the check.

Recommendations

Staff has no recommendations for Suburban's RA calculation.

SECTION VI

BALANCE ADJUSTMENT

The Balance Adjustment (BA) mechanism corrects for under-or over-recoveries of previously-calculated AAs and RAs. The BA is calculated by subtracting the product of the respective AA and RA rates and the sales to which those rates were applied from the dollar amounts of the respective AA and RA previously included in the GCR and used to generate those adjustment rates. Because those adjustment rates themselves were derived by dividing the dollar amounts by historic sales, the BA calculation depicts the differences in revenues generated for each of these adjustment mechanisms using actual versus estimated sales. The sum of the differences for the AA and RA calculations is the total BA for the quarter, which is then placed as a line item into the AA calculation.

Errors detected in the BA generally are the result of incorrectly reported sales volumes, but also may be due to selecting an incorrect rate from previous AA and RA calculations.

Staff has calculated the Company BA and found that the proper rates and sales volumes were used throughout the audit period. Staff finds no errors in the Company's calculations.

Recommendation

Staff has no recommendations for Suburban's BA calculation.

SECTION VII

UNACCOUNTED-FOR GAS

Unaccounted-for gas (UFG) is the difference between gas receipts (purchases) and deliveries (gas sales or transportation). It is calculated on a twelve-month basis, ending in one of the low-usage summer months (August in the case of Suburban) so as to minimize the effects of unbilled volumes on the calculation. GCR Rule 4901:1-14-08 (F)(3), Administrative Code, specifies that the Commission may adjust the Company's future GCR rates as a result of UFG above a reasonable level, presumed to be no more than five percent (5%) for the audit period.

Staff examined Suburban's UFG for the twelve-month periods ending August 2006 and August 2007. Staff used the total receipts (Columbia Gas Transmission and Columbia Gas of Ohio) volumes less total deliveries (GCR sales and transportation volumes) with the difference then divided by the total receipts to arrive at the systems' average unaccounted-for gas rate. The results of Staff's calculation are shown in Table I below.

The GCR rule allows for up to 5% percent UFG.

Table I
System Average UFG Rates

12 Months Ended	Receipts (Mcf)	Deliveries (Mcf)	UFG (Mcf)	UFG %
August 2006	1,553,718	1,550,339	3,379	0.22%
August 2007	1,749,416	1,743,435	5,981	0.34%

Conclusions

Staff has noted in the EGC Section that it has incorporated in the Company's purchase volumes, volumes associated with transportation services due to the fact that Suburban does not place purchase volumes in its GCR filings. The Company's level of UFG reflects a slight positive.

Recommendations

Staff has no recommendations in this section.

SECTION VIII

CUSTOMER BILLING

An important component in the GCR process is the proper application of GCR rates to customer bills. In order to determine that Suburban properly applied its GCR and base rates during the audit period, Staff reviewed the Company's customer billing records. Using a stratified random sampling system, Staff selected 160 customers' bill records and verified the Company's calculation of the total bill for each record. Staff found no discrepancies, other than occasional rounding differences, in its comparison.

In order to verify that meter readings had properly been transcribed to the Company's billing records Staff reviewed 12 randomly-selected meter reading records from several months of the audit period, and compared them with the Company's customer billing records. This comparison disclosed no discrepancies.

Recommendations

Staff has no recommendations for Suburban's customer billing calculations.

SECTION IX

OPERATIONAL & MANAGEMENT ISSUES

Market Area

As mentioned previously, Suburban's distribution system is divided into two separate systems, the CORE and SCOL systems. The CORE system is located around the Cygnet, Ohio area in Northwestern Ohio, while the SCOL system is located around the Lewis Center, Ohio area in Northern Central Ohio.

The CORE system is the older, traditional service area of the Suburban system and has been in operation since the inception of the Company. The CORE system primarily serves Cygnet and the surrounding areas, including Henry, Lucas and Wood Counties, as well as a portion of Hancock County. The CORE system has maintained a relatively stable base of customers, increasing only slightly during the 2-year GCR audit period. The CORE system now serves approximately 5,681 customers, as of April 2008.

Suburban's newer system, the SCOL system, primarily serves Marion and Delaware counties. The SCOL system was developed to serve new load primarily off of the old ARCO products pipeline. The former ARCO products pipeline was converted to a natural gas pipeline by Suburban, and placed into operation beginning December 1988. The SCOL system is made up of approximately 9,739 customers, as of April 2008. The vast majority of Suburban's customer growth has been experienced on the SCOL system, which has experienced approximately an 8% increase in the number of customers served on this system during the course of the 2-year audit period. For the combined Suburban system (both the CORE and SCOL systems), the Company provides service to approximately 15,420 customers.

As a result of the Company's significant customer growth, especially in the Delaware, Lewis Center, and Polaris Center areas, it was recommended to Suburban in the 2006 audit "to be vigilant during the next several years to ensure that it is adequately planning for the rapid growth of its system." However, given changing market dynamics and overall economic conditions in Suburban's service area and the overall slowing in the previously fast-growing new home construction in the Delaware, Lewis Center, and Polaris Center areas Suburban should continue to monitor its changing load growth and daily and seasonal requirements.

Operations

In reviewing the Company's firm interstate pipeline capacity entitlements during the prior audit, Staff found that Suburban had substantially more firm interstate pipeline transportation and storage capacity under contract than it had in audits prior to 2006. The increase in the pipeline capacity entitlements was driven primarily by two factors. The first factor considered by the Company prior to the acquisition of pipeline capacity was the rapid growth of its customer base; the second factor considered by the Company was the availability of capacity from the interstate pipelines to its system. Due to the uncertainty of the availability of firm capacity, Suburban acquired additional firm transportation and storage services to address changing daily, seasonal, and peak day demands on its system.

Since the prior audit period, Suburban has undertaken efforts to obtain additional supply receipt points, and to further loop and integrate its SCOL system. In January 2006, Suburban added an additional receipt point into its system when it entered into a lease agreement with Del-Mar Pipeline Co. (Del-Mar). Del-Mar is an affiliated pipeline connecting Suburban to TCO. The agreement between Del-Mar and Suburban is for a 15-year term and provides Suburban with additional capacity to deliver TCO volumes to its city gate. With the addition of the Del-Mar Pipeline (discussion following in *Section X, DEL-MAR*), pending or potential capacity constraints on the SCOL system have diminished or disappeared.

Recommendations

Staff has no recommendations in this area.

SECTION X

DEL-MAR PIPELINE

In the fall of 2004, Suburban contacted Staff to discuss its growing system demands, its existing supply options, and potential supply alternatives to meet its system's needs. Suburban made it clear that without modification to its existing supply contracts with Columbia Gas of Ohio (COH) and/or a new supply option, the Company projected the demand on its SCOL system would meet or exceed its available supply sources by the winter of 2005 – 2006.

During these discussions, the Company presented Staff with its contractual entitlements for its two interconnects with COH. Suburban believed that COH would not increase the contractual entitlements. Suburban also discussed the leased ACO six-inch pipeline that connected its SCOL system into Columbia Gas Transmission (TCO) and ran from Marion County to Southern Delaware County. Suburban leased this six-inch pipe from ACO Pipeline. The six-inch diameter ACO Pipeline, as it was explained, was quickly approaching its capacity limitations and without a new supply source, Suburban's rapid growth on the SCOL system would stop. After discussion of the existing supply sources Suburban presented Staff with what it believed were its supply alternatives. Through the Company's analyses it determined that the least cost supply option for the SCOL system was the construction of a 12-inch diameter pipeline, approximately 20 miles in length from Marion County into Delaware County and a second connection to TCO.

On October 18, 2004, DEL-MAR Pipeline Co., LLC (DEL-MAR) was formed as a limited liability company for the purpose of financing and constructing the 12-inch pipeline.

On November 8, 2004, DEL-MAR filed its application for a certificate to construct the 12-inch natural gas pipeline for service in Delaware and Marion Counties with the Ohio Power Siting Board (OPSB). On February 18, 2005, OPSB issued its staff report of investigation "In the Matter of an Application by DEL-MAR Pipeline Co., LLC for a Certificate of Environmental Compatibility and Public Need for the DEL-MAR/Suburban Pipeline Project." In its report Staff recommended the pipeline be installed. On May 23, 2005, OPSB issued its Opinion and Order and Certificate of Public Need approving the construction of the proposed pipeline.

On March 21, 2005, in Case No. 05-380-GA-AIS, Suburban filed an application with the Commission for authority to enter into a long-term pipeline lease agreement with DEL-MAR. On June 08, 2005, the Commission granted Suburban the authority to enter into a lease obligation with DEL-MAR. On December 1, 2005, Suburban filed with the Commission a copy of the final executed lease. Also filed was documentation of the actual transfer of the pipeline from DEL-MAR to Suburban with a commencement date of December 1, 2005.

In Case No. 06-216-GA-GCR, Staff recommended that in the next audit any cost associated with the DEL-MAR lease agreement be examined. Staff, in the course of this audit, has examined the cost of constructing the DEL-MAR pipeline along with the lease payments, which Suburban has sought to recover by placing them in its GCR. Staff makes the following findings:

- The agreement between DEL-MAR and Suburban is for a 15-year term and provides Suburban with additional capacity to deliver TCO volumes to its city gate. The total cost to construct the DEL-MAR Pipeline was approximately $8.77 million, of which $954,000 was in the form of contributed right-of-way. Selected costs for the pipeline were $3.6 million in contractor fees, $2.5 million for steel pipe, and $2.7 million in other expenses such as legal, engineering, power siting fees, and mapping and surveying costs. Staff randomly selected invoices making up the $8.77 million total and determined that all expenses appeared to be incurred in the construction of the DEL-MAR Pipeline.

- In Case No. 05-380-GA-AIS, Suburban filed as Exhibit B the Base Rental amounts for the years one through fifteen (2006 – 2020). The lease payments increase on an annual basis starting in year one at $1,108,485 and increasing to $1,367,885 in year fifteen. Exhibit B referenced the December 17, 2004 pro forma (2004 pro forma) from which the Base Rental amounts were calculated.

- Also contained on Exhibit B are four primary adjustments to the Base Rental amounts (annual lease payments) to reflect the "all in" cost when the project was placed into service. The first adjustment to the annual lease payment had to do with the capital cost to recognize any increase in cost of the project above that contained in the 2004 pro forma. In the 2004 pro forma the estimated total construction cost was $8.4 million. As noted above the final "all in" capital cost was approximately $8.77, an increase of approximately $377,000. The second adjustment to "all in" cost was in the debt rate under the Huntington National Bank (HNB) loan. In the 2004 pro forma, the debt rate/interest rate that was utilized to calculate the monthly payment (principal and interest) was 5%. In February 2006, DEL-MAR locked in its debt rate at 7.53% an increase of 2.53% from the 2004 pro forma. The third adjustment in "all in" cost was for changes in property taxes or other taxes not based upon income. And the fourth adjustment in "all in" cost was to maintain the relationship between debt costs and equity cost at the time of any HNB debt rate adjustment, but not less than the 1.2 debt service ratio required by HNB.

- Staff has reviewed the DEL-MAR annual lease payment calculations using the "all in" costs for 2006 and 2007. Staff finds that due to the changing capital costs, debt rate, property taxes and the corresponding effects on the debt service ratio, DEL-MAR recalculated its annual lease payment five times in 2006. These recalculated "all in" annual lease payments started in January 2006 and ended in July 2006 and ranged from $1,262,500 to $1,292,899. The recalculated "all-in" annual lease payment for 2007 was 1,306,490.

- Staff also found in its review of DEL-MAR's "all in" calculations for 2006 and 2007 that incorporating the additional capital cost and higher debt rate into principal and interest costs for the years 2006 and 2007 increased from the 2004 pro forma level of $631,420 and 632,161 to a range of $734,854 to $768,408. Staff notes also that the book depreciation expense in the 2004 pro forma for years 2006 and 2007 increased from $185,000 to $217,794 – $219,194. In the 2004 pro forma, DEL-MAR depreciated the estimated capital costs of $8.4 million less the contributed right-of-way on a 40 year straight-line. It appears that for 2006 and 2007 DEL-MAR calculated depreciation on the "all-in" capital cost of $8.77 million inclusive of the contributed right-of-way.

- In the course of its audit, Staff has verified the amount billed by DEL-MAR to Suburban, property taxes, and principal and interest payments for 2006 and 2007. Below is Table II, which reflects some of the figures used by Staff for 2006 and 2007.

Table II

	2006	2007
Billed by DEL-MAR to Suburban	$1,290,491	$1,306,490
SG&A Expenses	$29,148	$27,769
Ohio Property Taxes	$101,764	$64,688
Principal and Interest Payments to HNB	$733,094	$755,926
Rate of Return on Contributed Capital	12.59%	12.78%

Transportation on Suburban's System

During the audit period Suburban provided transportation service to three customers. One of the transportation customers contracted for firm service and transported gas each month of the audit period. Two of the transportation customers transported only three months during the audit period, primarily at the beginning of the 2006 - 2007 winter heating season.

Conclusions

Staff received revised calculations from DEL-MAR reflecting the "all-in" costs for December 2005, along with 2006 and 2007.

In evaluating the DEL-MAR lease payments billed to Suburban during the audit period Staff used as a starting point the 2004 pro forma. Staff also received the Company's revised "all-in" DEL-MAR lease payment calculations for years 2006 and 2007, as shown below in Table III. These calculations fine tuned the initial "all-in" calculations reflecting actual property taxes paid, along with principal and interest payments over 25 months, but left the SG&A cost the same as the 2004 pro forma consistent with the language in the lease agreement.

In 2006 and 2007, Suburban's sales customers paid on a volumetric basis through the GCR the annual lease payments of the DEL-MAR pipeline. Staff believes that Suburban's transportation customer was responsible for a portion of the cost of the DEL-MAR pipeline. Staff believes all customers benefited through the addition of the DEL-MAR pipeline and its costs should be shared.

Table III

	2006	2007
Company revised "all-in" Lease Payments	$1,251,212	$1,276,243
SG&A Expenses	$25,000	$25,750
Ohio Property Taxes	$101,764	$64,688
Principal and Interest Payments to HNB	$735,068	$755,924
Rate of Return on Contributed Capital	11.47%	11.93%

Recommendations

Staff has reviewed the Company's revised "all-in" calculations and believes that these calculations accurately represent the initial payment (December 2005) and the years 2006 and 2007 as modified by the four primary adjustments contained in Exhibit B to the 2004 pro forma. Staff therefore recommends an adjustment for the year 2006 and 2007 of $69,523 in the customers' favor to recognize the difference between the annual lease payments billed to Suburban and the Company's revised "all-in" calculated annual lease payments for years 2006 and 2007. Staff recognizes that a portion of 2007 (September to December) falls in the 2010 audit period, but believes that it is better to address these months in this audit period than to postpone the adjustment to a future date.

Staff would also recommend that the lease payment for December 2005 be reduced to reflect the Company revised "all-in" calculated lease payment. For December 2005, DEL-MAR billed Suburban $103,043. The revised "all-in" calculated lease payment for December 2005 is $60,905, a reduction of $42,138 in the customers' favor.

The credit for December 2005 added to the credits for years 2006 and 2007 totals $111,661, in favor of Suburban's GCR customers.

Below in Table IV Staff has included a comparison of the amount billed by DEL-MAR to Suburban to the Company's revised "all-in" calculated annual lease payments and at the recommended adjustment amounts for 2006 and 2007.

Table IV

	2006	2007
Billed by DEL-MAR to Suburban	$1,290,491	$1,306,490
Company revised "all-in"	$1,251,212	$1,276,243
Difference between billed amount and Company revised "all-in"	$(39,278)	$(30,245)

Staff believes a portion of these annual lease payments should be paid by Suburban's transportation customers. Staff recommends that Suburban credit its GCR customers an additional $34,178.

The total credit to Suburban GCR customers attributable to the DEL-MAR lease is $145,839.

SECTION XI

SYSTEM GROWTH

As discussed previously, Suburban has experienced significant customer load growth over the past several years, and is likely to in the intermediate to long-term. Some of its shorter-term growth has been tempered in the past year over what had been experienced over the last few years prior, given present market conditions and overall economic conditions for it service area.

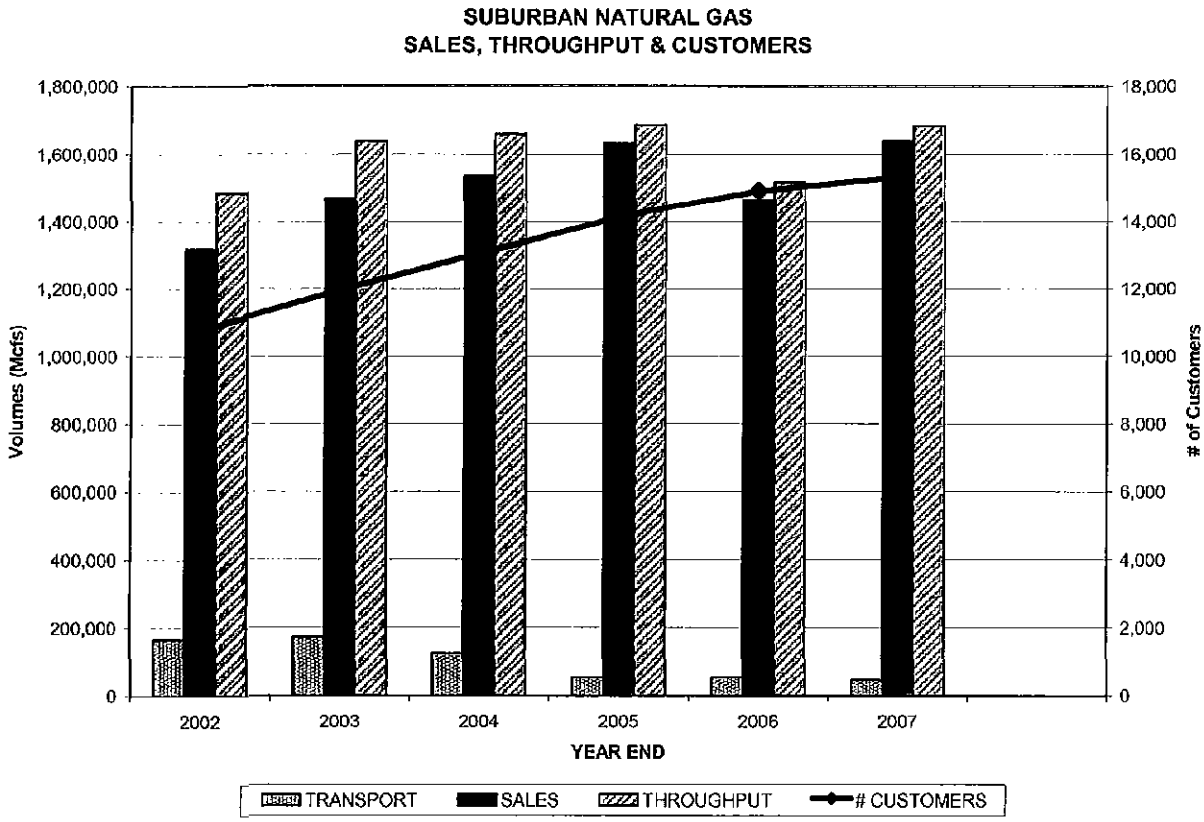
ANNUAL GROWTH

Examining data from Suburban's PUCO Annual Reports shows that over the past 6 years, Suburban's customer base has grown from a year-ending 2002 figure of 10, 786 customers to year-ending 2007 figure of 15,312 customers (see Chart I). This represents a 42% increase in the customer base.

Comparing those same years, Suburban's sales volumes have increased 24% and throughput has increased by 13%. However, transportation volumes have diminished significantly – by 73%. Keeping in mind that these volumes are not weather-normalized, the data still provides somewhat of an understanding of the significant changes taking place on Suburban's system.

Suburban has passed the 15,000 customer threshold which now changes some of the filing requirements for Suburban to make with the PUCO. For example, §4901:5-1-02 O.R.C., *Forms of long-term forecast report filing required* requires that a major utility furnishing gas to more than 15,000 customers within Ohio shall annually furnish a long-term forecast report (LTFR) to the Commission for its review.

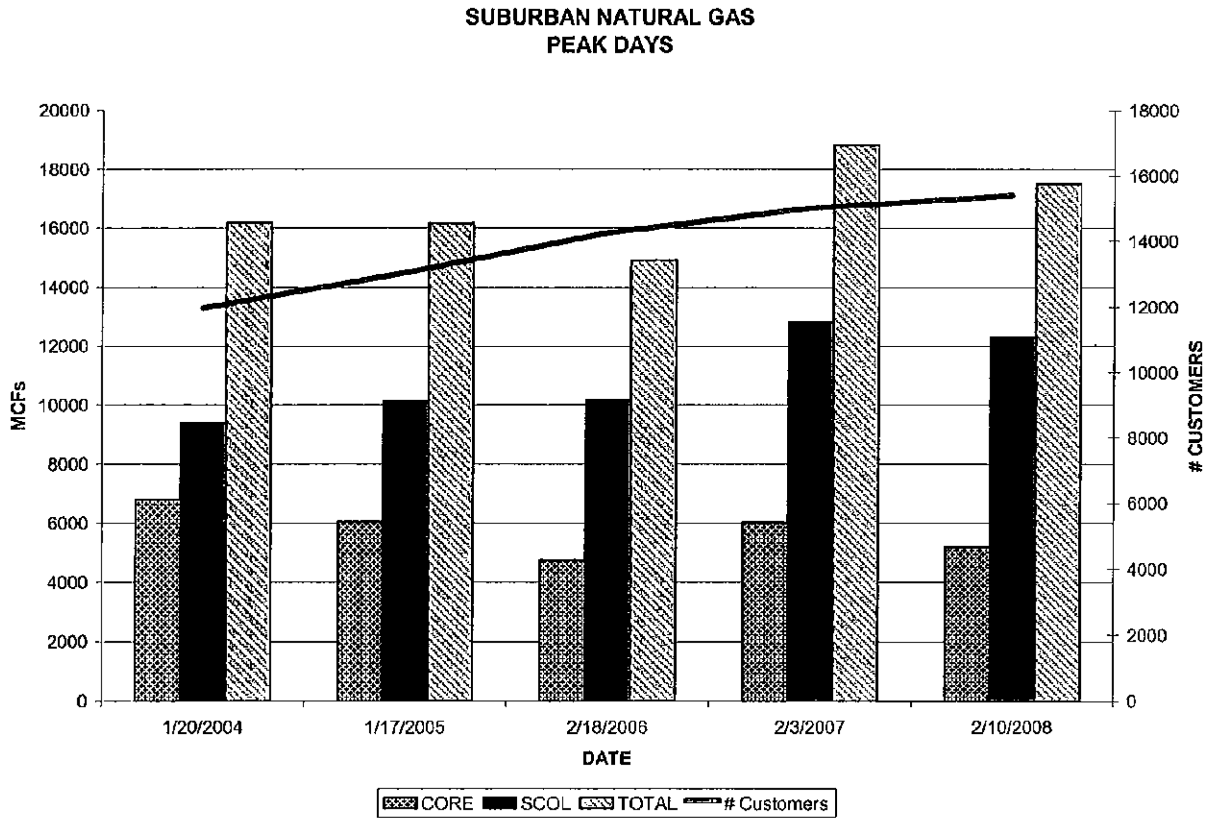
CHART I



PEAK DAY GROWTH

Examining the actual peak days experienced by Suburban over the past 5 years shows a relative upward trend in peak day throughput, particularly on the SCOL system. As the customer base has grown, the CORE system actually shows some overall decline (likely due to diminution of transportation volumes over time on that part of Suburban's system), while the SCOL system shows significant increases and an upward trend on system peak day throughput.

CHART II



Conclusions

Suburban continues to experience significant load growth on its SCOL system, and anticipates more modest load growth over the next several years. To address its load growth Suburban has secured sufficient firm capacity entitlement to meet the demands of its load growth and balancing requirements. As a result of this significant load growth, beginning in 2009, Suburban should be prepared to make its first formal LTFR filing with the PUCO.

Recommendations

Staff recommends that Suburban continue to determine and monitor its changing load growth and daily, seasonal & annual load requirements needs. Suburban should formalize this evaluation through its first formal LTFR filing with the PUCO beginning in 2009.