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**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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PUCO

In the Matter of the Application of VEDO)
Energy Delivery of Ohio, Inc., for)
Authority to Amend its Filed Tariffs to) Case No. 07-1080-GA-AIR
Increase the Rates and Charges for Gas)
Services and Related Matters.)

In the Matter of the Application of VEDO)
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) Case No. 07-1081-GA-ALT
Accelerated Replacement of Cast Iron)
Mains and Bare Steel Mains and Service)
Lines, a Sales Reconciliation Rider to)
Collect Difference Between Actual and)
Approved Revenues, and Inclusion in)
Operating Expense of the Costs of Certain)
Reliability Programs.)

**INITIAL BRIEF
OF
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL AND
OHIO PARTNERS FOR AFFORDABLE ENERGY**

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I. INTRODUCTION

On September 28, 2007, Vectren Energy Delivery of Ohio, Inc. ("VEDO" or "the Company") filed a Notice of Intent to File an application for an increase in its gas rates and an application for approval of Alternative Rate Plan proposals in its Dayton and west central Ohio service area (VEDO's gas service area territory). VEDO subsequently filed its Application on November 20, 2007. The Application for a rate increase and an

alternative rate plan will affect all of the approximately 293,000 residential customers in VEDO's gas service territory.

On November 5, 2007, the Office of the Ohio Consumers' Counsel ("OCC"), on behalf of the residential customers of VEDO, moved the Public Utilities Commission of Ohio ("PUCO" or "Commission") to grant OCC's intervention in this case. On November 6, 2007, Ohio Partners for Affordable Energy ("OPAE") moved to intervene. OCC's and OPAE's Motion to Intervene was granted on August 1, 2008.

On June 16, 2008, the PUCO Staff's Report of Investigation ("Staff Report") was filed, as well as the Financial Audit Report rendered by Eagle Energy LLC. OCC filed its Objections to the Staff Report on July 16, 2008. OCC and OPAE filed Intervenor testimony in opposition to the Company's Application on July 23, 2008.

Prior to the hearing in this proceeding, the parties, including OPAE and OCC, entered into settlement discussions which resulted in a Stipulation and Recommendation ("Stipulation") that was filed on September 8, 2008. In the Stipulation, the parties agreed, in part, that the Company shall receive a revenue increase of \$14,779.153, receive total annual revenues of \$456,791,425, and have an opportunity to earn an overall rate of return of 8.89%. The Stipulation also included the parties' agreement to a Sales Reconciliation Rider-A ("SRR-A") to allow the Company to collect deferred revenues previously approved by the Commission in Case No. 05-1444-GA-UNC.

The Stipulation did not resolve certain issues, in particular, the issue of rate design. The Staff and Company proposal called for the implementation of a straight fixed variable ("SFV") rate design, which represented a significant departure from decades of PUCO precedent. OCC and OPAE opposed the SFV. Under the Stipulation, OCC and

OPAE reserved their right to litigate the rate design issue¹ and this SFV rate design issue became the central issue in the evidentiary hearing that commenced on August 19, 2008.

In the evidentiary hearing in these cases, OCC presented testimony opposing the Staff's recommended implementation of an SFV rate design, and also testimony demonstrating the adverse effect a Straight Fixed Variable rate design will have on low income customers, in particular.

Between September 3, 2008 and September 8, 2008, four public hearings were held. The locations of the hearings were Sydney, Dayton, and Washington Court House. At those hearings, various customers of VEDO spoke in opposition to the rate increase proposed and the SFV rate design proposed by the Company and the PUCO Staff.

II. SUMMARY

The PUCO is presented with a Stipulation that was signed or not opposed by all intervening parties in these cases. Specifically carved out from the settlement is the issue over which the parties could not reach agreement -- the issue of the rate design by which VEDO will bill residential customers to collect the revenues agreed to in the settlement.² The rate design issue involves whether VEDO's customers will receive a bill for gas distribution service based on a relatively high and unavoidable fixed monthly charge or a low fixed charge and a volumetric charges (per cubic foot of gas), to which they are accustomed.

¹ See Stipulation and Recommendation (Sept. 8, 2008), Paragraph 14.

² Id.

The PUCO Staff and the Company present the Commission with a proposal for rate design that drastically departs from thirty years of rate-making precedent. In making this proposal, Staff and the Company ignored the long-standing ratemaking principle of gradualism. In addition, this move towards an SFV rate design violates state policy regarding promotion of conservation and demand-side management ("DSM") investments, and should not be approved by the Commission.

The SFV rate design also benefits high-usage/high-income customers at the expense of low-usage/low-income customers.³ The Commission heard testimony from various VEDO residential customers at the local public hearings opposing the proposed rate design, received letters from customers opposed to SFV, and heard evidence at the hearing demonstrating that low-usage/low-income customers will be adversely affected by such a rate design.⁴ The Commission should therefore, in light of the foregoing, approve a more traditional rate design in lieu of the SFV approach propounded by the Staff and the Company.

III. NOTICE

VEDO failed to provide adequate notice to consumers of the Stage 2 SFV rates as required by R.C. 4909.18(E), R.C. 4909.19, and R.C. 4909.43(B). Therefore, the Commission cannot approve such rates.

"The fundamental requisite of due process of law is the opportunity to be heard."⁵

Due process for individuals is a constitutional right protected by the Fourteenth

³ See Direct Testimony of Hal Novak at 21.

⁴ Id.

⁵ *Grannis v. Ordean*, 234 U.S. 385, 394, 34 S.Ct. 779, 784 (1914), citing *Louisville & N.R. co. v. Schmidt*, 177 U.S. 230, 236 (1900); *Simon v. Craft*, 182 U.S. 427, 436 (1901).

Amendment. The opportunity to be heard can have no meaning however if one is not informed of the issues in contention and consequently can not make a decision as to whether to challenge or object to the matter.⁶

The Ohio General Assembly took steps to preserve an individual's right to be heard when it formulated the various provisions of the revised code. For instance when utilities seek to increase rates to customers in Ohio, the General Assembly deemed it necessary and appropriate to ensure that customers and the municipalities affected by the rate increase are accorded notice of the proposed rate application. Specifically, R.C. 4909.18(E), 4909.19, and 4909.43(B) impose notice requirements upon the utilities.

R.C. 4909.18(E) requires the utility to file a proposed notice for newspaper publication "fully disclosing the substance of the application" as an exhibit to the initial application to increase rates. Under R.C. 4909.19 upon the filing of the rate increase application, the utility shall "forthwith publish the substance and prayer of such application" once a week for three consecutive weeks in newspapers published and in general circulation in the utilities' service territory. Additionally, as provided for by R.C. 4909.43(B), the public utility seeking the increase is to notify the mayor and legislative authority of each municipality affected of the proposed rates to be contained in its application, thirty days prior to its filing.

The Ohio Supreme Court has addressed the proper content of a public notice required by R.C. 4909.18(E) and R.C. 4909.19 in a number of cases. Of particular note is

⁶See for example *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 313, 70 S. Ct. 652 (1950). where the Court noted that "[t]he right to be heard has little reality or worth unless one is informed that the matter is pending and can choose for himself whether to appear or default, acquiesce or contest."

the 1977 case of *Committee Against MRT*.⁷ In that proceeding the utility was seeking to implement an innovative measured service rate plan, but failed to mention the proposal in its newspaper notice to the public. The Supreme Court of Ohio concluded that under R.C. 4909.19, the utility was required to specifically mention its proposed measured rate service in its published notice. And because the utility failed to do so, the Court remanded the proceeding to the PUCO.

While the Court noted that there is no specific test or formula under R.C. 4909.19 that can be applied to determine if the substance and prayer of the application has been conveyed, it ruled that notice must be analyzed in light of the purpose of publication-- providing customers the opportunity to be heard:

From reading the notice published in their local newspapers, subscribers opposed to usage rates would not have known of the innovative plan being introduced by the utility, would not have had any reason to view the exhibits on file with the PUCO, nor would they have had any interest in participating in the hearings held before the commission. **Thus, because of the insufficient notice, appellants were not only denied an opportunity to present evidence at the hearings before the commission opposing the selection of the experimental area for measured rate service, but also were denied the opportunity to challenge the new rate service itself.**⁸

In a subsequent case, *Ohio Association of Realtors v. Pub. Util. Comm.*, the Ohio Supreme Court reaffirmed its earlier holding in *MRT v. Publ. Util. Comm.* and further elaborated on the notice requirements. There the Court found that the "essential nature or quality of the proposal" must be disclosed to those affected by the rate increase.⁹ Further

⁷ *Committee against MRT v. Pub. Util. Comm.*, 32 Ohio St.2d 231 (1977).

⁸ *Id.* at 234. (Emphasis added).

⁹ 60 Ohio St. 2d 172, 398 N.E.2d 784 (1979).

the court opined that “[t]he notice requirement of the statute as discussed by this court in *MRT, supra*, is not an unreasonable one. It requires only that the notice state the reasonable substance of the proposal so that consumers can determine whether to inquire further as to the proposal or intervene in the rate case.”¹⁰

In applying the rationale to the facts contained in the appeal by the Association of Realtors, the Court found that the utility’s failure to notice the proposal to change its business customers to a measured rate service violated R.C. 4909.19. “[T]he notice in the instant cause did not disclose the nature or quality of the proposal to those affected by the rate increase.”¹¹ And the Court was not convinced that the insufficient notice was cured by a subsequent mailing of measured service rate information within the utility bills to customers: “[T]his material submitted along with the regular customer billings cannot stand in the stead of the requirement of a reasonable statement of such rate amendment proposal to be placed in the legal notice.”¹² The Court went on to reverse the Commission and remanded the cause to the commission for purposes of reissuing appropriate notices under R.C. 4909.19 and conducting further hearings upon the application.

It is within the context of the Ohio Supreme Court holdings in *MRT* and *Association of Realtors* that this Commission must review the sufficiency of notice in this case. Here VEDO is seeking to implement a radical change in rate design whereby customer bills will be fundamentally changed—the fixed portion of the bills will be drastically increased and the volumetric portion decreased. It is indisputable that the move to the SFV rate design

¹⁰ *Id.* at 176.

¹¹ *Id.* at 175.

¹² *Id.*

methodology -- a rate design that will triple the fixed portion of the customer charge for VEDO's residential customers from \$7.00 per month to up to \$22.00 per month in a two stage process is a highly innovative and material change that required disclosure to customers.

A dramatic change will occur in Stage 2—where the customer charge is increased from the stage 1 level of \$16.75 to \$22.00 per month (winter rate) and \$10 per month (summer rate). VEDO seeks approval for these stage 2 rates to go into effect in 2010 and remain effective until the next set of approved rates. Tr. V at 25 (Ulrey). And yet, residential customers (Sales and Service under Rate 310 and 315) of VEDO failed to receive the statutorily required newspaper publication notice of the Stage 2 rates. Mr. Ulrey plainly admitted this: “That is correct, the legal notice that was ultimately published after review by the Commission did not include the Stage 2 rates.” Tr. V at 26.

Moreover, VEDO also failed to comply with the R.C. 4909.43(B) notice requirements to the mayors and legislative authorities in each of the municipalities affected by the rate increase. In the pre-filing notice for Stage 2 residential (Rates 310, 315) rates, VEDO published volumetric charges at a level that was less than the volumetric charges sought in its application.¹³

VEDO's notices, therefore, failed in a number of respects. First VEDO's notice failed to convey the substance and prayer of the proposal as required by R.C. 4909.18(E) and 4909.19. No Stage 2 rates were noticed, and yet the Company clearly sought approval

¹³ PFN Exhibit 3 (September 28, 2007) shows the Stage 2 volumetric charge noticed was \$0.07770 per Ccf for the first 50 Ccf, plus and \$0.06768 per Ccf for all Ccf over 50 Ccf. The application however reflects proposed rates of \$0.07791 per Ccf for the first 50 Ccf, plus and \$0.06788 per Ccf for all Ccf over 50 Ccf. See Company Exhibit E-1B.

of Stage 2 rates beginning in 2010. Second, VEDO failed to notify mayors and the municipalities of the correct Stage 2 volumetric rates that were to be contained in its application. Instead VEDO gave notice to the mayors of Stage 2 volumetric rates that were lower than those proposed in its application.

Notice of the Stage 2 rates was required to alert customers to the dramatic change to the rate design that they are facing with the move to SFV. VEDO's customers have never faced a similar increase or modification to their fixed customer charge. Because the proposed SFV rate design is such a dramatic change from the current rate design, absent sufficient notices, consumers would have no reason to inquire further about the details of the Company's Application. VEDO's customers and the mayors and municipalities affected by the rate increase were deprived of the ability to make a fundamental decision of whether to challenge or object to VEDO's filing. Their due process right—consisting of the opportunity to be heard—could not be effectively exercised because VEDO failed to provide adequate statutory notice.

Because VEDO failed to provide adequate statutory notice to customers and mayors under R.C. 4909.18 (E), 4909.19, and 4909.43(B), of its Stage 2 residential rates, the Commission is without authority to approve such rates. Notice is statutory and cannot be waived. The Commission must require VEDO, consistent with the Ohio Supreme Court holdings, to reissue notices and conduct further hearings upon the application after notices are properly issued. Only then can the commission consider the lawfulness and reasonableness of the Company's proposed Stage 2 SFV rates.

IV. CORE ARGUMENTS AGAINST STRAIGHT FIXED VARIABLE RATE DESIGN

This case marks the third instance of the straight fixed variable (“SFV”) rate design being proposed as an alternative to the current rate design methodology for the residential customers of a natural gas local distribution company (“LDC”). Although many of the core arguments against the SFV rate design are the same as those previously raised in the Duke Energy Rate Case (“Duke Rate Case”),¹⁴ and the Dominion East Ohio Case (“DEO Rate Case”),¹⁵ there are many factors in these cases that distinguish these cases from the Duke and DEO Rate Cases. Thus, these cases deserve full consideration without any presumption or predetermination that the SFV rate design is an appropriate policy of the Public Utilities Commission of Ohio (“PUCO”) that should be unilaterally imposed on all Ohio LDCs.

The PUCO should not be in a rush to impose the SFV rate design on VEDO’s residential customers. This rush to radically change the rate design is even more alarming in light of the fact that there are many fundamental questions that remain unanswered regarding the implications and impact of the SFV rate design upon customers -- especially low use and low income customers--even after all of the litigation and debate on this issue. These very questions were raised by the PUCO Commissioners at the April 23, 2008 Sunshine Meeting,¹⁶ and again at the September 25, 2008 Oral Argument before the PUCO in the DEO Rate Case. Therefore, it is unjust and unreasonable for the PUCO

¹⁴ *In re Duke Rate Case*, Case No. 07-589-GA-AIR.

¹⁵ *In re Dominion Rate Case*, Case No. 07-829-GA-AIR.

¹⁶ *In re Duke Rate Case*, Case No. 07-589-GA-AIR, OCC Application for Rehearing, at 28-30 (June 27, 2008).

to make this fundamental change to a long-standing rate design, at this time without having undergone the necessary due diligence of assuring that customers will not be unfairly harmed in the pursuit to guarantee the utility its revenues.

The following arguments are at the core of OCC's opposition to the SFV rate design and therefore, should be considered by the PUCO when deciding the appropriate rate design for VEDO's 293,000 residential customers:

- A. A decoupling mechanism with a low customer charge accomplishes the same goal, and is superior to the SFV rate design because it sends the appropriate price signals and allows customers to have better control over their gas bills;
 - B. The SFV rate design sends the wrong price signal to consumers by telling customers that it doesn't matter how much they consume—their gas distribution bill will be relatively the same;
 - C. The adverse impacts of the SFV rate design on low usage customers is also harmful to low-income customers because it has them paying more to subsidize high volume users;
 - D. The Company and Staff proposals on the customer charge violate the doctrine of gradualism;
 - E. The SFV rate design contradicts Ohio law;
 - F. The impact of lost customers and lost revenues should be studied prior to approving the SFV rate design and
 - G. Alternatives to SFV rate design proposed by VEDO and Staff should be considered.
- A. A decoupling mechanism with a low customer charge accomplishes the same goal, and is superior to the SFV rate design.**

As the proponents of a change in the rate design in this proceeding, VEDO and the Staff bear the burden of proving that the change is needed and that the proposed change is just and reasonable.¹⁷ Although the Company devoted hundreds of pages of

¹⁷ R.C. 4909.18 and R.C. 4909.19.

testimony and supporting schedules to the SFV rate design, the fact remains that the change to an SFV rate design is a knee-jerk over-reaction and an unnecessary and dramatic change. The goal of addressing the issue of declining average use per customer –the impetus for SFV--can be addressed in a more fair, reasoned and transparent manner through the use of a decoupling mechanism and maintaining the current fixed customer charge.

A decoupling mechanism is superior to the SFV rate design for a number of reasons. First of all, a decoupling mechanism would retain the current lower fixed monthly customer charge (\$7.00) that has a certain level of customer understanding and acceptance. In contrast, customers are likely to not understand the Company's proposed fluctuating winter/summer fixed customer charge proposed under the SFV approach.¹⁸

Mr. Overcast acknowledged that customer acceptance and understanding are regulatory principles,¹⁹ but he noted that VEDO had done no studies or analysis to determine if customers would understand the SFV rate design.²⁰ Nonetheless, without the benefit of any studies or analysis, Mr. Ulrey touted the SFV rate design as easier to understand than a decoupling mechanism.²¹ Remarkably, Mr. Ulrey was able to reach this conclusion without actually asking any customers.²² While Mr. Ulrey noted that customer education efforts could address the understanding and acceptance problem,²³ he

¹⁸ OCC Ex. 3 (Novak Direct Testimony) at 20.

¹⁹ Tr. Vol. IV (Overcast) at 16 (Aug. 25, 2008).

²⁰ Tr. Vol. IV (Overcast) at 16-17 (Aug. 25, 2008).

²¹ Tr. Vol. III (Ulrey) at 76-77 (Aug. 22, 2008).

²² Tr. Vol. III (Ulrey) at 103 (Aug. 22, 2008).

²³ Tr. Vol. III (Ulrey) at 67 (Aug. 22, 2008).

admitted that he did not have any specific education plan in mind. Instead, the Company would, in part, rely on the OCC and PUCO to do much of this education.²⁴

A decoupling mechanism would also address the issue of alleged reduced average use per customer which is a major factor underlying the Staff and Company rationale for supporting this change.²⁵ A decoupling mechanism, similar to the current SRR mechanism approved in Case No. 05-1444-GA-UNC for VEDO would protect the Company from any decline in average usage per customer that was not weather related.²⁶

An additional issue in the debate between the SFV rate design and decoupling is how they impact the incentive or disincentive to engage in conservation. Because both the SFV and decoupling mechanism separate the Company's sales from revenue recovery, either option removes the Company's disincentive to engage in conservation efforts.²⁷ However, from the customer perspective the decoupling mechanism is a superior alternative because it maximizes the potential reward and further encourages individual customer initiated conservation efforts.²⁸

In addition to providing greater conservation incentives, a decoupling mechanism is superior to the SFV rate design because it is symmetrical in nature and thus provides equal protection to the customer and the Company.²⁹ If the Company sells additional volumes beyond those factored into the rate approved level, then customers get a refund.

²⁴ Tr. Vol. III (Ulrey) at 100 (Aug. 22, 2008).

²⁵ Tr. Vol. III (Ulrey) at 30, 58 (Aug. 22, 2008); Ex. No. 9 (Ulrey Direct Testimony) at 5; Staff Ex. No. 3 (Puican Direct Testimony) at 7; Staff Report at 30; Staff Normalized UPC Chart at 33.

²⁶ Tr. Vol. III (Ulrey) at 55-56 (Aug. 22, 2008).

²⁷ Tr. Vol. III (Ulrey) at 30.

²⁸ OCC Ex. No. 3 (Novak Direct Testimony) at 21, 23.

²⁹ Tr. Vol. VI (Puican) at 26 (Aug. 28, 2008); Tr. Vol. III (Ulrey) at 40 (Aug. 22, 2008).

If the Company sells less volume than those built into rates, then it gets to collect revenues for the reduced sales. This basic fairness is missing in the SFV approach where there is no accountability to assure that the Company is not over-collecting from customers money to which they are not entitled. Such fairness outweighs any detriment to additional work or effort that a decoupling mechanism may require.

B. The SFV rate design sends the wrong price signal to consumers.

It is widely accepted that high natural gas prices generally send a signal to consumers that encourages conservation. The SFV rate design contradicts that basic message because it decreases the volumetric rate while significantly increasing the fixed portion.³⁰ At a time when VEDO's marginal costs for natural gas and energy prices generally are increasing,³¹ the SFV rate design sends the wrong price signal to customers. As consumers use more natural gas the per unit price decreases under the SFV design. The more an individual customer's actual usage moves away from average usage, the greater the impact -- whether an increase or decrease -- that customers will experience.³² Mr. Puican acknowledged that the lowest low use customers and highest high use customers will experience the greatest bill impact.³³ This is absolutely the wrong price signal to send consumers making decisions on the consumption of a precious natural resource.

³⁰ OCC Ex. No. 3 (Novak Direct Testimony) at 21.

³¹ Tr. Vol. III (Ulrey) at 59 (Aug. 22, 2008).

³² Tr. Vol. VI (Puican) at 34-35 (Aug. 28, 2008)

³³ Tr. Vol. VI (Pucian) at 34-35 (Aug. 28, 2008).

The SFV rate design fails to send the proper price signal to encourage conservation. The reasons the Company seeks to eschew its present rate design (consisting of a lower customer charge and a higher volumetric rate) in favor of SFV has to do with collecting a fixed amount of revenue, no matter what the weather conditions. It is not related to any desire for the customers to conserve.

Rates are set by the Commission in order to permit the Company an "opportunity" to collect a fair rate of return -- rates are not designed to "guarantee" the utility anything.³⁴ The opportunity to develop a more stable revenue stream can be addressed by the implementation of a decoupling mechanism with appropriate safeguards.

However the Company proposal would have the effect of taking weather out of the equation for a utility whose main business is directly related to the weather.³⁵ This would in turn practically guarantee the Company revenue requirements and shift the risk of weather to customers. Mr. Ulrey characterized this impact as stabilizing revenues.³⁶

The only conclusion that the Commission can reach is that the price signal from the SFV rate design is improper. Therefore, the SFV rate design should not be approved in these cases because the resulting rates would be unjust and unreasonable.

The SFV rate design lengthens the payback period for energy efficiency investments. Customers who have invested in energy efficiency measures such as additional home insulation, more efficient furnaces and water heaters (as a rational

³⁴ *Bluefield Water Works & Improvement Company v. Pub. Serv. Comm. of West Virginia*, 43S, Ct. 675, 692 (June 11, 1923) ("A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public * * *; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures.").

³⁵ Tr. Vol. III (Ulrey) at 55-56 (Aug. 22, 2008).

³⁶ Tr. Vol. III (Ulrey) at 55-56 (Aug. 22, 2008).

response to increasing gas costs (and in response to Ohio State policy)) will see their investment returns diminished and payback periods lengthened as a result of the change to an SFV rate design.³⁷ This is another reason that the SFV rate design discourages conservation.

This issue becomes even more important in light of the fact that many of the conservation efforts that customers have undertaken in the recent past were based on the current rate design which provided customers greater incentive to conserve. This is because the current rate design consists of a lower fixed customer charge and a higher volumetric charge. Hence customers could see a direct reduction in bills as a result of less usage under conservation. Customers made those conservation investment decisions in good faith and in reliance on the regulatory rate design in place at the time. It would be patently unfair to now change the rules that customers relied on.

A change to the SFV rate design will extend the payback period of energy efficiency investments because a greater portion of the bill will be recovered in the fixed charge and a smaller portion in the volumetric portion.³⁸ Mr. Puican dismissed this difference claiming that it was an artificial price signal.³⁹ However, Mr. Puican ignores the reality that if the goal is to achieve maximum conservation, then the best price signal is one that includes the largest volumetric charge and the lowest fixed charge. This is consistent with the fact that the actual commodity of gas still comprises the largest portion of a customer's total bill.

³⁷ OCC Ex. No. 3 (Novak Direct Testimony) at 21.

³⁸ Tr. Vol. VI (Puican) at 26 (Aug. 28, 2008).

³⁹ Tr. Vol. VI (Puican) at 26 (Aug. 28, 2008).

Mr. Puican attempted to defend his position by indicating that the artificial inflation of the volumetric charge beyond costs would lead to an over-investment in conservation.⁴⁰ However, despite this dubious claim, there is absolutely no evidence in the record of any instances of over-investment in conservation as a result of the current rate design.

The SFV rate design fails to offer customers the necessary incentives to invest in energy efficiency. The cost per unit under the SFV rate design declines as consumption grows which sends the wrong price signal, and the customers who invest in energy efficiency investments face longer payback periods.⁴¹ The Commission is faced with a decision to implement a rate design that has a negative impact on a customer's payback analysis, or a rate design that positively impacts the payback analysis. In order to adhere to the state policy in R.C. 4929.02 and R.C. 4905.70, the Commission must implement the latter rate design. In these cases, that would be the rate design that includes a smaller customer charge (\$7.00), a higher volumetric rate, and a decoupling mechanism with appropriate safeguards.

Making a radical rate design shift to a SFV rate design is especially unfair for customers who have invested to become more energy efficient as a response to actions urged by State and Federal energy efficiency policies. In this sense, an SFV rate design reduces some of the control customers have over their utility bills, because more of their bill is uncontrollable or fixed and less is controllable or dependent on their volumetric usage.

⁴⁰ Tr. Vol. VI (Puican) at 27 (Aug. 28, 2008).

⁴¹ OCC Ex. No. 3 (Novak Direct Testimony) at 21.

The reduction that would be made to the volumetric rate resulting from an increase to the customer charge under an SFV rate design could affect consumers' conservation investment decisions. Although the commodity costs do represent the largest portion of a residential customer's bill, the reality is that consumers have made conservation decisions based on the current level of volumetric billing. Based on this evidence, it is a given that the SFV rate design will reduce the benefits and will extend the payback period of energy efficiency investments. Therefore it should not be approved by the Commission.

In reality, each consumer is different in how they approach energy efficiency investment decision-making. The Commission's role is to put in place a rate design that will be most effective at removing barriers or most effective at promoting consumers' investment in energy efficiency. The only conclusion that the Commission can reach is that the SFV rate design, and the rates proposed there under extend the payback period, and are therefore unjust and unreasonable and should not be approved by the Commission in these cases.

C. The adverse impacts of the SFV rate design on low usage customers is also harmful to low-income customers.

The SFV rate design recommended by the Staff is bad news for VEDO's low-use and low income customers. OCC witness Colton testified that a SFV rate design has the effect of disproportionately increasing bills to low income customers thus increasing the natural gas burden borne by those customers⁴² Staff witness Puican concurred, stating, "The shift to a SFV rate design will result in low-usage customers seeing a higher total

⁴² OCC Ex. No. 2 (Colton direct Testimony) at 31.

bill and high-usage customers seeing a lower total bill than would occur with a continuation of the current rate design.”⁴³ Such a rate design is inherently unfair to low-usage low income customers, who because of their limited means, likely live in smaller dwellings, such as apartments, and use less natural gas than wealthy homeowners with large homes.⁴⁴ The SFV rate design is not only unfair to these customers with small incomes, it is extremely cruel in its timing; coming on the heels of several years of belt-tightening by America’s working poor, amidst a nationwide mortgage foreclosure crisis and with the country facing a looming recession. In these hard economic times, customers need tools to control the size of their overall bills. SFV wrenches one of the tools out of their hands.

1. The Company and Staff improperly assume the SFV rate design to be beneficial to non-Percentage of Income payment Plan (“PIPP”) low income customers.

Rather than seeing SFV as injurious to VEDO’s low income customers, and the Staff witness assert that an SFV rate design is beneficial. Staff witness Puican stated, “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 more likely to actually benefit from SFV.”⁴⁵ VEDO and the Staff base this argument on the erroneous assumption that VEDO’s PIPP customers, many of whom are high volume energy users, are representative of all VEDO’s low-income customers, many of whom are low volume energy users.⁴⁶

⁴³ Staff Ex. No. 3 (Puican Direct Testimony) at 6.

⁴⁴ OCC Ex. No. 2 (Colton Direct Testimony) at 12-18.

⁴⁵ Staff Ex. No. 3 (Puican Direct Testimony) at 7.

⁴⁶ Staff Ex. No. 3 (Puican Direct Testimony) at 7.

While admitting that “PIPP customer usage may not be a perfect representation of all low-income customer usage,”⁴⁷ Mr. Puican’s assertion is contradicted by the testimony and evidence submitted by OCC witness Colton. Mr. Colton testified that the average energy use of PIPP customers is higher than the average energy use of PIPP plus non-PIPP low-income customers, demonstrating that low income customers are not high energy users as assumed by the Staff.⁴⁸ Of course, low-income, non-PIPP customers are naturally motivated to conserve energy as part of their overall goal to minimize household costs.

2. PIPP customers are not an appropriate surrogate for non-PIPP low income customers.

Viewing the evidence as a whole, it is apparent that the subset of VEDO’s PIPP customers is not representative of all of VEDO’s low income customers. Nonetheless Staff accepted PIPP customers as a surrogate for all low income customers,⁴⁹ and the Company accepted that conclusion.⁵⁰ The average use for VEDO’s residential customers is 81.5 Mcf per year.⁵¹ The average use of VEDO’s PIPP customers is 110.9 Mcf per year.⁵² The Staff has improperly used PIPP as a proxy for VEDO’s low-income customer usage. Staff witness Puican stated, “Although PIPP customer usage may not be a perfect representation of all low-income customer usage, it is the best readily available proxy.”⁵³

⁴⁷ Staff Ex. No. 3 (Puican Direct Testimony) at 7.

⁴⁸ OCC Ex. No. 2 (Colton Direct Testimony) at 27.

⁴⁹ Staff Ex. No. 3 (Puican Direct Testimony) at 7.

⁵⁰ Tr. Vol. III (Ulrey) at 91 (Aug. 22, 2008).

⁵¹ Staff Ex. No. 3 (Puican Direct Testimony) at 7.

⁵² Staff Ex. No. 3 (Puican Direct Testimony) at 7.

⁵³ Staff Ex. No. 3 (Puican Direct Testimony) at 7.

This statement was made without any effort or analysis to determine if there was any better data available.⁵⁴ In so doing, Staff and VEDO have mischaracterized all of the Company's low income customers as high energy users who, they claim, are more likely to actually benefit from SFV.⁵⁵ This conclusion is not supported by the evidence presented to the Commission. Rather, it is much more likely that the vast majority of VEDO's low income customers will be economically harmed by SFV.

Mr. Colton testified that the PIPP population is an inappropriate surrogate for the entire low income population, because of the basic nature of the PIPP program which requires that a household pay a percentage of his or her income to the utility in order to maintain service.⁵⁶ Mr. Colton explained that as a result, the PIPP program excludes a substantial number of households that have lower energy bills, but are still low-income customers.⁵⁷ Mr. Colton's conclusion was based on a multi-state study that he assisted with that analyzed low income assistance programs in a number of states including Ohio.⁵⁸

OCC rebuttal witness Colton made compelling arguments that PIPP is not an appropriate proxy. Mr. Colton relied on U.S. Census Bureau data, data from the American Community Survey (2006), the U.S. Department of Energy data, Department of Labor's Consumer Expenditure Survey, and data from the Energy Information Administration to make a compelling argument that there is a strong correlation between

⁵⁴ Tr. Vol. VI (Puican) at 35 (Aug. 28, 2008).

⁵⁵ Staff Ex. No. 3 (Puican Direct Testimony) at 7.

⁵⁶ OCC Ex. No. 2 (Colton Direct Testimony) at 27.

⁵⁷ OCC Ex. No. 2 (Colton Direct Testimony) at 27.

⁵⁸ OCC Ex. No. 2 (Colton Direct Testimony) at 27.

income level and natural gas consumption.⁵⁹ This data was used to establish this correlation at the national level,⁶⁰ at the regional level (Midwest region),⁶¹ and at the state level (Ohio).⁶² Colton concluded that lower income households use less natural gas than do higher income households.⁶³

Despite Company attempts to claim that the results are not VEDO specific⁶⁴ there is no reason to believe that the same correlation does not hold true in VEDO's service territory. Mr. Colton explained that the Census Bureau data, though aggregate in nature, provides a sample size large enough to encompass PUMAs, public use micro areas, which is large enough to draw conclusions on a territory specific basis.⁶⁵

Mr. Colton specifically rebutted Staff witness Puican's testimony as follows:

First, Mr. Colton rebutted Mr. Puican's statement that "usage data indicates that low-income customers are, on average, not low-usage customers" (Puican Direct, at 7),⁶⁶

Second, Mr. Colton rebutted Mr. Puican's statement that "although PIPP customer usage may not be a perfect representation of all low-income customer usage, it is the best readily available proxy" (Puican Direct, at 7);⁶⁷ and

⁵⁹ OCC Ex. No. 2 (Colton Direct Testimony) at 10, 25.

⁶⁰ OCC Ex. No. 2 (Colton Direct Testimony) at 25, 30.

⁶¹ OCC Ex. No. 2 (Colton Direct Testimony) at 23, 25.

⁶² OCC Ex. No. 2 (Colton Direct Testimony) at 10, 25.

⁶³ OCC Ex. No. 2 (Colton Direct Testimony) at 30.

⁶⁴ Tr. Vol. V (Colton) at 22, 31 (Aug. 27, 2008).

⁶⁵ Tr. Vol V at 23 (Aug. 27, 2008).

⁶⁶ OCC Ex. No. 2 (Colton Direct Testimony) at 18.

⁶⁷ OCC Ex. No. 2 (Colton Direct Testimony) at 26-28.

Third, Mr. Colton rebutted Mr. Puican's statement that "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 more likely to actually benefit from SFV." (Puican Direct, at 7).⁶⁸

Mr. Colton testified that half of Ohio's low income natural gas customers had gas burdens below the minimum levels necessary to participate in the PIPP program.⁶⁹ As a result using PIPP customers as a surrogate for a low income customers is inaccurate. Mr. Colton demonstrated that the PIPP population is made up of the highest use, highest burden low-income customers and thus by definition is not representative of all low-income customers.⁷⁰

Mr. Colton explained that low-income, low use customers might not be eligible to participate in the PIPP program because the PIPP program is tied to a percentage of income. As a result, many low-income, low use customers might actually experience an increase in their bill if they participated in the PIPP program.⁷¹

VEDO attempted to refute the evidence presented by Mr. Colton with the rebuttal testimony of Mr. Overcast. Mr. Overcast presented his own study that claimed that the lowest income customers -- with an income of less than \$20,000 -- consumed more gas than all but the two highest income groups.⁷² However, this does not refute Mr. Colton's conclusion because Mr. Overcast's study does not segregate out PIPP customers. OCC

⁶⁸ OCC Ex. No. 2 (Colton Direct Testimony) at 30.

⁶⁹ OCC Ex. No. 2 (Colton Direct Testimony) at 28.

⁷⁰ OCC Ex. No. 2 (Colton Direct Testimony) at 29.

⁷¹ OCC Ex. No. 2 (Colton Direct Testimony) at 29.

⁷² Ex. 8A (Overcast Rebuttal Testimony) at 12.

and OPAE have not disputed that PIPP customers use greater than average usage for a number of reasons including the fact that many PIPP customers live in older, less insulated housing and because the PIPP program does not put a premium on conservation.

However, the question for the Commission remains one of how the SFV rate design will impact low use including low-income users. Moreover, Mr. Overcast's study does emphasize the fact that other than PIPP customers, the greatest users are the highest income customers. Thus to the extent that the SFV rate design results in a subsidy flow from low use customers (including low-income customers) to high use and high income customers, then the resulting subsidy is improper and does not create a just and reasonable result.

D. The Company and Staff Proposals on the Customer Charge Violate the Doctrine of Gradualism.

The PUCO has identified gradualism as one of the regulatory principles that it has incorporated as part of its decision-making process.⁷³ However, for gradualism to have any legitimacy as a regulatory principle, it must be applied with a certain level of consistency and transparency and not haphazardly. Gradualism had been relied upon in prior cases as a rationale to limit increases in customer charges.

Although Staff argued that it applied gradualism to its SFV recommendation in this case,⁷⁴ Mr. Puican acknowledged that Staff relied on no formula or over-riding principle when applying gradualism.⁷⁵ As a result, there is absolutely no transparency

⁷³ Staff Ex. No. 3 (Puican Direct Testimony) at 9.

⁷⁴ Staff Ex. No. 3 (Puican Direct Testimony) at 9.

⁷⁵ Tr. Vol. VI (Puican) at 36 (Aug. 28, 2008).

behind the Staff's proposal. Because this recommendation is such a drastic departure from over 30 years of past precedent, a more transparent explanation should have been provided on the record so that customers could have some confidence in the conclusion.

The Company also claims to have considered gradualism in their SFV approach.⁷⁶ The fact remains, however, that the "gradualism" applied by Staff and is significantly less than the type of gradualism relied on by the Staff and PUCO in the past. Such a drastic change should not be imposed on customers which may cause customer confusion, outrage, and as discussed below, the potential loss of customers and accompanying revenues.

Moreover, as previously noted, many customers have recently engaged in conservation efforts with the understanding that cost recovery would be based on a lower fixed charge and a larger volumetric component. To now flash-cut to a rate design that so dramatically changes the cost recovery formulae -- which in turn impacts the payback period for those investments -- is unreasonable and fundamentally unfair. A more gradual introduction of the SFV principles is needed in order to lessen the negative impact on customers.

E. The SFV rate design contradicts Ohio Law.

The Commission's approval of an SFV rate design would be contrary to Ohio law and policy. The SFV rate design does not promote customer efforts to engage in conservation of natural gas, and instead would encourage increased usage of natural gas

⁷⁶ Tr. Vol. III (Ulrey) at 66 (Aug. 22, 2008); Tr. Vol. VI (Overcast) at 36 (Aug. 28, 2008).

because the SFV rate design reduces costs for high use customers -- those using more than average.⁷⁷ Such a rate design is contrary to the State policy which states:

(A) It is the policy of this state to, throughout this state:

* * *

(4) Encourage innovation and market access for cost-effective supply-and demand-side natural gas services and goods;⁷⁸

For a number of reasons, approval of an SFV rate design by the Commission will also impede the development of DSM in Ohio. For example, the SFV rate design will send consumers the wrong price signal,⁷⁹ will harm consumers who have invested in energy efficiency by extending the payback period,⁸⁰ and will take away control that consumers have over their utility bills.⁸¹

The Commission has a statutory duty to initiate programs that promote conservation. R.C. 4905.70 states:

The public utilities commission shall initiate programs that will promote and encourage conservation of energy and a reduction in the growth rate of energy consumption, promote economic efficiencies, and take into account long-run incremental costs.

The SFV rate design serves the Company's limited cost recovery interests, but fails to promote conservation for the reasons discussed below. State Policy and statutory mandates direct the Commission to approve a rate design that has a positive effect on energy conservation.

⁷⁷OCC Exhibit No. 3 (Novak Direct Testimony) at 21.

⁷⁸R.C. 4929.02.

⁷⁹OCC Ex. No. 3 (Novak Direct Testimony) at 21.

⁸⁰OCC Ex. No. 3 (Novak Direct Testimony) at 21.

⁸¹OCC Ex. No. 3 (Novak Direct Testimony) at 21.

The Commission has the responsibility to approve rates that are just and reasonable.⁸² An SFV rate design would not meet the State policy of promoting energy efficiency⁸³ and would violate the legislative mandate to the Commission to initiate programs to promote and encourage conservation.⁸⁴ Therefore, an SFV rate design is harmful to consumers and if approved by the Commission would be unjust and unreasonable.

F. The impact of lost customers and lost revenues should be studied prior to approving the SFV rate design.

Since VEDO has devoted considerable resources to this attempt to impose the SFV rate design on customers, it cannot be argued that the effort is anything other than a Company business decision that carries with it certain business risks. The Company should not be immune to the risks associated with this decision.

A change to the SFV rate design will cause the fixed charge for customers to increase from the current \$7.00 to \$16.75 (winter) and \$10.00 (summer) in year one and \$22.00 (winter) and \$10.00 (summer) in year two.

The necessity of a decoupling mechanism or SFV rate design must be called into question especially since the Company accepts the premise that a certain amount of low-usage customers may leave the gas system as a result of implementing an SFV rate design. VEDO witness Ulrey acknowledged that low usage customers are not using natural gas to heat their homes.⁸⁵ Therefore, their usage may be limited to a single

⁸² R.C. 4909.18 and R.C. 4909.19.

⁸³ R.C. 4929.02(A)(4).

⁸⁴ R.C. 4905.70.

⁸⁵ Tr. Vol. III (Ulrey) at 94 (Aug. 22, 2008).

appliance (e.g. water heater, dryer, or stove) or other use (e.g. decorative light, or fire pit).⁸⁶ This usage is either discretionary or it is usage that can be switched to electricity by simply replacing appliances. There is a concern that these customers may decide to leave the system in response to the drastic increase in the fixed charges proposed in these cases, charges that a customer is obligated to pay before the first molecule of gas is consumed. Ultimately, it will be the affordability of the service that becomes the deciding factor for whether these low use customers continue to take natural gas service. All customers, including low use customers will face the following increases to their fixed charges if the Commission adopts the Company's SFV proposal: 1) a customer charge of \$16.75 per month, winter period and \$10.00 summer period (\$160.50 annually) in year one and \$22 per month, winter period and \$10.00 summer period (\$192.00 annually) in year two, and 2) and the proposed AMRP Rider beginning at \$1.00 per month in 2009, and increasing thereafter for the next five years at a \$1 per month. These are increases that could drive many of the low use customers from the system.

From a cost of service point of view, the retention of these customers for the residential class (and the system as a whole) is important. Because these low use customers are not likely space-heating load, they would tend to be high load factor customers, which is beneficial. Additionally, because of their low usage with even the present \$7.00 per month customer charge, they pay a higher rate per Mcf or usage than larger usage customers.

It would be beneficial to the residential class and the system as a whole to retain these customers on the system. Any loss in revenues from customers who leave the

⁸⁶ Tr. Vol. III (Ulrey) at 94 (Aug. 22, 2008).

system will undoubtedly become additional revenue that the Company will attempt to collect from the remaining customers. The result is higher cost for those remaining customers. The lowest use customers will feel the greatest impact from this redistribution of costs.⁸⁷ Thus it is not unreasonable to conclude that many low use customers may elect to discontinue gas service rather than to pay the increased charges. The Company noted that it has approximately 3,200 customers (3,000 residential and 200 commercial) or approximately 37,000 bills that represent low usage (less than 6 Mcf per year).⁸⁸ Mr. Ulrey noted that this usage was most assuredly not for space heating.⁸⁹ This means that approximately \$368,000⁹⁰ in revenues from these customers could be lost if they elect to leave the system.⁹¹ Moreover, other low use customers using more than 6 Mcf but less than 20-25 MCf per year could also be lost. If these customers elect to discontinue service then the facilities associated with serving those customers would no longer be considered used and useful.

G. Alternatives to SFV rate design proposed by Staff should be considered.

OCC and OPAE do not support the proposed SFV rate design and recommends the PUCO adopt a customer charge of no more than \$10.00 that VEDO initially proposed with the Rider SRR. OCC and OPAE recommends the

⁸⁷ Tr. Vol. III (Ulrey) at 64 (Aug. 22, 2008).

⁸⁸ Tr. Vol. III (Ulrey) at 94 (Aug. 22, 2008).

⁸⁹ Tr. Vol. III (Ulrey) at 94 (Aug. 22, 2008).

⁹⁰ 3000 residential customers x \$84 (current \$7.00 fixed customer charge x 12 months = \$84) = \$352,000 plus 200 commercial customers x \$120 (current \$10 fixed customer charge x 12 months = \$120) = \$16,000. \$352,000 + \$16,000 = \$368,000.

⁹¹ Tr. Vol. II (Ulrey) at 95 (Aug. 22, 2008).

following options as a means to improve the proposed SFV rate design if the PUCO is determined to override the concerns of the public (which we do not recommend that it do)⁹²:

1. Delay implementation until a better understanding of the impact of the SFV rate design on low use and low-income customers is known;
2. Limit the implementation of SFV rate design to a voluntary PILOT program⁹³ that is limited in length—12 or 24 months. An independent auditor paid for by the utility should evaluate the results of the SFV implementation on the rates of all customers—including low income and file in docketing the report setting forth its findings;
3. Require an independent auditor paid for by the utility to determine if VEDO has over-recovered its revenue requirements under the SFV and file in docketing the results of its investigation. Any over-recovery should be refunded to customers.
4. Respect the regulatory principle of gradualism and phase in the implementation of the SFV rate design, but only if the independent auditor concludes that SFV is achieving the results of saving low-use and low income customers money on their bills..⁹⁴
5. Limit Applicability -- The PUCO should limit the number of customers the SFV applies to and study its effectiveness.⁹⁵
6. Delay implementation of the SFV rate design until a full understanding of the impact from lost customers and lost revenues is understood.

⁹² VEDO is currently completing a two year pilot of a conventional decoupling rate design which has not been subjected to any analysis by the Staff or the Company.

⁹³ *Id.* (Consideration of a SFV rate design should be limited to a pilot program over a discreet period of time, and with required periodic update reports to the Commission on the actual quantifiable impact of the SFV implementation on low-use and low-income customers. The report should also determine the level of customer acceptance.).

⁹⁴ *Id.* at 20 (OCC suggests that the proposed increase be phased in over a number of years by limiting the increase in any year by a specified dollar amount, (i.e. \$1.00 to \$2.00). At the current customer charge of \$7.00 and Company/Staff's proposed charge of \$16.75 and \$10.00 (phase 1) and \$22.00 and \$10.00 (phase 2) this gradual approach would take approximately ten years if done on a dollar limited basis.).

⁹⁵ *Id.* at 19-20.

V. CONCLUSION

In this case the Company and the Staff support a radical change to rate design called straight fixed variable. This change is radical in the sense that it overturns over thirty years of rate design practice under which customer charge and volumetric rates were applied in this jurisdiction. Radical in the sense that only three out of fifty states in the U.S. have adopted a full SFV.

Under the straight fixed variable rate design the customer charge is increased to recover fixed charges while the volumetric rates are decreased. The purported rationale for SFV is that average use per customer has declined thus putting the company at greater risk of collecting its fixed costs from customers on a going forward basis. While there may be declining customer use for VEDO, it is merely one of the risks that comes with the provision of utility service. Regulation provides the opportunity to earn a reasonable rate of return, not a guarantee of earning that return.

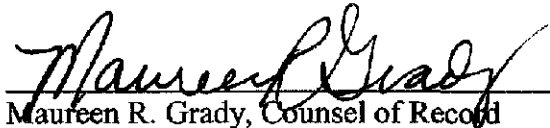
SFV need not be adopted in this proceeding. In fact, the record argues against its adoption. The SFV sends the wrong price signal to customers. SFV will have adverse impacts on low usage and low-income customers. The rate design principle of gradualism is undermined under the Company and the Staff's proposed SFV. The SFV will undermine energy conservation efforts, contradicting Ohio law which seeks to encourage such efforts.

Instead the Commission should adopt weather normalized decoupling. Such decoupling is symmetrical, providing benefits to both the company and its customers. SFV is not. Moreover, decoupling accomplishes much of the same objectives as SFV.

If the Commission is to adopt some form of SFV, which OCC and OPAE are not recommending, it should only do so once it has studied the impact of SFV on low use and low-income customers and lost customers and lost revenues. Moreover, the commission should consider structuring alternatives approaches to SFV which would include pilot programs of limited scope and duration. Additionally the Commission should consider a more gradual move to SFV if it is determined that SFV is appropriate.

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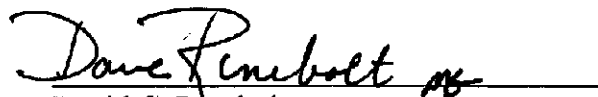
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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing *Initial Brief of the Office of the Ohio Consumers' Counsel and the Ohio Partners for Affordable Energy* was provided to the persons listed below via first class U.S. Mail, postage prepaid, this 26th day of September, 2008.


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