

FILE**FAX**

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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

In the Matter of the Application of)
Vectren Energy Delivery of Ohio, for)
Approval of an Alternative Rate Plan) Case No. 07-1081-GA-ALT
For a Distribution Replacement Rider)
To Recover the Costs of a Program for)
The Replacement of Cast Iron Mains)
And Service Lines, a Sale Reconciliation)
Rider to Collect Differences between)
Actual and Approved Revenues, and)
Inclusion on Operating Expenses of the)
Cost of Certain System Reliability)
Programs.)

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

In the Matter of the Application of)
Vectren Energy Delivery of Ohio, Inc. for)
Continued Accounting Authority to Defer)
Differences between Actual Base) Case No. 08-632-GA AAM
Revenues and Commission-Approved)
Base Revenues Previously Granted in)
Case No. 05-1444-GA-UNC and)
Request to Consolidate with Case No.)
07-1080-GA-AIR.)

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**REPLY BRIEF OF
OHIO PARTNERS FOR AFFORDABLE ENERGY**

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October 7, 2008

**Counsel for Ohio Partners
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REPLY BRIEF OF OHIO PARTNERS FOR AFFORDABLE ENERGY

INTRODUCTION

The Straight-Fixed Variable Rate (SFV) has been the subject of much discussion and verbiage over the last several months. The reasons for this discussion are clear. Local distribution companies (LDCs) are concerned about significant fluctuations in sales on their systems caused by price volatility, climatic changes that have reduced the number of Heating Degree Days (HDD) in recent years, and the increased market penetration of high efficiency natural gas appliances. The latter has long been considered the primary cause of a nominal one percent reduction in throughput since the mid-1990s. The climate trends follow roughly the same timeframe. Price volatility reared its ugly head for the first time in the 1980s and again in December, 2000 when prices skyrocketed to \$15/Mcf. After an initial burst, prices quickly fell back, declining and stabilizing the following year. But the pattern was destined to return with greater ferocity and has done so. Prices adjusted downward by 40% in August, 2008 after significant increases beginning in April, 2008. The prices have caused customers to conserve by reducing the temperature in their homes and businesses – nothing like a nice sweater – and investing in energy

efficiency. Consumption is more elastic than most experts believed; the price signal works.

LDCs have developed and advanced a number of policy initiatives to counter the increasing risk of recovering their revenue requirement caused by high commodity prices and the other factors noted above. For many companies, this only recently became an issue because they had been over-earning for a variety of reasons, though their rates had been set in the early 1990s. Vectren Energy Delivery of Ohio, Inc. ("VEDO") is not one of those companies. The Company came in for a rate case in 2004, four years after acquiring the natural gas business of the Dayton Power & Light Company. The resulting rate increase was modest and the Company agreed to invest ratepayer funds in low-income weatherization, which has a long track record of benefiting all customers by improving payment behavior, reducing arrearages and assistance program costs, and providing a host of social benefits.

But back to the policy initiatives. The American Gas Association and the Natural Resources Defense Council ("NRDC"), an environmental organization, joined forces to promote decoupling of revenues from sales. NRDC was motivated by its desire to promote energy efficiency by making the LDC indifferent to sales. The gas utilities wanted the guarantee of revenue recovery – translation profits – and a significant reduction in risk, which pays dividends all its own.

Other policy initiatives followed. VEDO's Initial Brief points to two of them. The first, the Energy Independence and Security Act of 2007, includes a provision imploring "state regulatory authorities to consider separating recovery of natural gas utility fixed costs from customer volumes". (Think about it' language isn't hard to get in federal legislation.) The second is contained in Ohio's own Am. Sub. SB 221 ("SB 221"), an erstwhile electric regulation bill. VEDO points to the provisions of a late addition to the legislation, the incorporation of a natural gas bill, which specifically authorizes the establishment of revenue decoupling mechanisms for gas utilities. Given that decoupling was already authorized by Ohio's alternative regulation statute, R.C. 4929.01, et.seq., this was not such a big deal, but another provision of the legislation is. The bill made a significant change in the regulatory compact, redefining monopoly regulation, which is designed to mimic the competitive market by providing a utility with the *opportunity* to earn its revenue requirement through rates to a rate mechanism that "provides recovery of the fixed costs of service and a fair and reasonable rate of return." R.C. 4929.02(B). Under Ohio law, utilities now have an entitlement – recovery of the revenue requirement, including their profit.

What is the offsetting benefit to customers? SB 221 is not explicit though it calls for existing conservation benefits to be continued. This is reasonable given that utilities regularly use the lofty goal of promoting

conservation as a fig leaf for risk reduction and guaranteed revenue recovery. Again, VEDO has been more supportive of efficiency than many parties in the regulatory arena. Nonetheless, Ohio law still requires rates be just and reasonable and this means achieving a balance between customer and company interests.

In this case that outcome has been achieved to a great extent. The parties have agreed to a revenue requirement, cost-of-service, and infrastructure replacement program that will benefit the Company and consumers. VEDO has methodically increased its commitment to energy efficiency for the past four years and the expansion of programs requested in its Application was embraced by the signatories to the settlement.

The last issue is the rate design and it is contentious. The two sides are dug in, though in some of the cases the LDCs were more mercenary than committed to the cause of SFV. As noted at the start, this issue has generated much debate. OPAE will now attempt to restate its case more effectively than it has in past proceedings, hoping against hope that its arguments can provide the information that result in the other camp changing its collective mind.

LOW-USE CUSTOMERS AND THE SFV

It is undisputed that VEDO customers participating in the Percentage Income Payment Plan ("PIPP") use more than the break-even point in the SFV. It is also arguable that customers receiving benefits under the Home

Energy Assistance Program ("HEAP") use something close to the break-even point. However, PIPP customers account for less than one-half of HEAP clients. But only roughly thirty five percent of low-income customers avail themselves of HEAP. There are many reasons for this, but the most significant is that these customers manage to pay their bills without assistance. Given the high gas prices, the only reasonable conclusion is that these customers use relatively small amounts of natural gas.

The testimony of OCC Witness Colton provides the statistical framework for analyzing the rate impacts. The conclusion is that consumption generally tracks income. As a result, lower income customers are more likely to pay more per Mcf for natural gas under an SFV. This translates into a shift of responsibility for the revenue requirement of the residential class from larger consumers, who are likely further up the income scale, to small consumers, who likely have lower incomes. If one grants that distribution costs are fixed, a point OPAE does not concede, arguing cost causation makes some sense. However, cost causation alone has never determined rate design nor class allocations. Recent gas rate cases have, according to the applications and staff, reduced the subsidy provided to the residential class. Why was there a subsidy? Because public policy and considerations of equity justified it. We live in a harder world now, when cost causation is apparently the rule rather than merely one of a number of regulatory principles. And the public

policy imperative to reduce natural gas consumption by encouraging conservation and efficiency is for some reason no longer an imperative.

THE PRICE SIGNAL

The impact of price elasticity on natural gas usage has been underestimated by the experts. Large, sustained increases in natural gas prices have resulted in conservation and hastened investment in efficiency leading to reductions in sales. This is consistent with customer reaction to increases in energy prices generally.

The proponents of SFV argue that it sends an appropriate price signal. The message the SFV actually sends is that no matter what you do to save, you are paying the distribution charge. The SFV is antithetical to the basic concept of a price signal. You cannot cut consumption and escape the SFV; the rate design does not so much send the proper price signal than it eliminates a price signal to conserve because, at least for the percentage of one's bill that is made up of the distribution charge, conservation no longer matters. The return on investments in efficiency is extended, making some investments on the margin no longer cost-effective. For low-use customers the impact is greater. Since low-use customers already have a limited opportunity for cost-effective investments, increases in fixed charges have a larger impact as their rates are increasingly decoupled from use. The interaction of the infrastructure replacement rider, a fixed charge that increases annually, with the SFV

lowers the potential payback on efficiency investments significantly. It is true that the likely increases in natural gas prices will counteract to some extent the higher fixed charges and provide a price signal to conserve but the discount of those investments caused by the higher fixed charges will not go away. As an organization that represents community agencies that are tasked with providing cost-effective energy efficiency services based on technically sound audits and advanced diagnostics, the simple fact is that an increased number of low-use households will not be served because they cannot be served cost-effectively with the increased fixed charge.

How many customers is this? What is the real impact of high fixed charges on efficiency investments? Frankly at this point we do not know. There has been no empirical analysis of the impact of the SFV on conservation in the three LDCs nationally that have implemented the rate design for more than a month. There is none on this record. So we are making policy based on suppositions and predictions, not on data. All OPAE can offer is the anecdotal knowledge of those who weatherize thousands of homes every year and serve families that cannot afford their bills: our agencies see those who use more gas than average or have low incomes and thus cannot afford their bills. We generally do not provide low users with bill assistance and we do not weatherize their houses

unless they are very poor. Natural gas use does track income, and we serve the outliers.

ALTERNATIVES TO THE SFV

The Commission authorized VEDO to conduct a pilot program to test decoupling in 2005. The approach to be tested used an annual deferral process that accounted for revenue not recovered because of reductions in use through an authorized deferral, and a subsequent collection of the revenue shortfall through a volumetric reconciliation rider.¹ Customers who reduce use would offset the rider to some extent, so conservation and efficiency would still receive a positive price signal, though slightly less than under traditional volumetric rates. Reconcilable riders are used in a variety of situations in today's regulatory regime, usually requiring an initial litigation at the first rider adjustment followed by minimal litigation in future adjustment proceedings. This conventional decoupling approach also has the advantage of returning excess revenue recovery to customers in the event usage increased.

The pilot has never been evaluated. Recovery of the deferral from the pilot is a part of the stipulation in this case; it was not litigated. All Evidence indicates the pilot was a modest success. VEDO deferred the uncollected revenue and will collect it in the future. The Company is made

¹ The VEDO rider includes a weather normalization feature. This is an unnecessary component of a decoupling rider which is focused on a revenue requirement.

whole. Customers going forward will be able to moderate the effect of the rider through conservation or efficiency so long as the rider exists. On its face, the pilot decoupling program has achieved the goal of ensuring VEDO recovery of its revenue requirement. The other impacts have not and apparently will not be assessed.

CONCLUSION

The issue of whether or not an LDC should earn its revenue requirement is moot. Ohio law requires it. Customers are now confronted with two options for ensuring a gas utility receives the revenue it is entitled to: conventional decoupling or SFV.

Under an SFV, low use customers will pay a larger bill than they would under a decoupling approach that uses a volumetric rider to collect the revenue shortfall. Under an SFV, no customer will receive a refund via a negative rider if the utility over recovers. The discount to the cost recovery from efficiency investments will be around ten percent. This will tend to affect those that receive services from programs that are evaluated for cost-effectiveness. The average customer that opts for a high efficiency furnace after his or her heat exchanger cracks probably won't notice. The world won't end because of SFV and conservation and efficiency investment will not cease. An out of control wholesale market will see to that. But low use customers, who likely have lower incomes, will see rate increases and higher income customers who use more gas will

see lower rates per Mcf. This is a fact. And no customers will see a credit if the utility happens to over-recover. For these reasons, the Commission should not endorse the SFV rate design.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "David C. Rinebolt", written over a horizontal line.

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**On Behalf of Ohio Partners for
Affordable Energy**

CERTIFICATE OF SERVICE

I hereby certify that a copy of the *Reply Brief of Ohio Partners for Affordable Energy* was served by regular U.S. Mail, postage prepaid, upon the parties of record identified below on this 7th day of October, 2008.


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