

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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In the Matter of the Application of)
Vectren Energy Delivery of Ohio,)
Inc. for Authority to Amend its)
Filed Tariffs to Increase the Rates)
and Charges for Gas Service and)
Related Matters.)

Case No. 07-1080-GA-AIR

In the Matter of the Application of)
Vectren Energy Delivery of Ohio, Inc.,)
for Approval of an Alternative Rate)
Plan for a Distribution Replacement)
Rider to Recover the Costs of a Program)
for the Accelerated Replacement of)
Cast Iron Mains and Bare Steel Mains)
and Service Lines, a Sales Reconciliation)
Rider to Collect Differences Between)
Actual and Approved Revenues, and)
Inclusion in Operating Expense of the)
Costs of Certain Reliability Programs.)

Case No. 07-1081-GA-ALT

In the Matter of the Application of)
Vectren Energy Delivery of Ohio, Inc. for)
Approval, Pursuant to Revised Code)
Section 4929.11, of a Tariff to Recover)
Conservation Expenses and Decoupling)
Revenues Pursuant to Automatic)
Adjustment Mechanisms and for Such)
Accounting Authority as May Be)
Required to Defer Such Expenses and)
Revenues for Future Recovery through)
Such Adjustment Mechanisms)

Case No. 05-1444-GA-UNC

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Continued Accounting Authority to Defer)
Differences between Actual Base)
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.)

Case No. 08-632-GA-AAM

**REPLY BRIEF
OF
VECTREN ENERGY DELIVERY
OF OHIO, INC.**

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October 7, 2008

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**REPLY BRIEF
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I. PROCEDURAL HISTORY AND CONTEXT

On September 26, 2008, initial post-hearing briefs were filed in these proceedings by Vectren Energy Delivery of Ohio, Inc. ("VEDO"), the Office of Consumers' Counsel/Ohio Partners for Affordable Energy ("OCC/OPAE")¹, and the Staff of the Public Utilities Commission of Ohio ("Staff" and "Commission" respectively). The Staff's and OCC/OPAE's post-hearing briefs are appropriately focused on issues associated with the design of the residential rate as a result of the Stipulation and Recommendation ("Rate Case Stipulation") which has been jointly sponsored by the parties.

OCC/OPAE's Initial Brief speaks about the interest of "...approximately 293,000 residential customers in VEDO's gas service territory." (OCC/OPAE Initial Brief at 2) and argues for a residential rate design outcome that is different from that supported by the Staff and VEDO. However, the evidence shows that from the perspective of the residential class – VEDO's 293,000 residential customers – the average distribution bill result is the same regardless of what rate design is approved by the Commission. The evidence also shows that the

¹ Hereinafter, the Initial Brief filed by OCC and OPAGE will be referred to as the "OCC/OPAE Initial Brief".

typical residential customer will pay the same annual bill for distribution service regardless of which rate design is approved by the Commission. Tr. Vol. III at 14-15. Thus, the context in which OCC/OPAE continue their campaign against a cost-based straight-fixed-variable ("SFV") residential rate design is one that requires the Commission to pick winners and losers within the residential class of customers as a precondition for accepting the outcome preferred by OCC/OPAE. This point is made clear by OCC/OPAE's Initial Brief at page 3 (emphasis added): "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." The evidence disproving this claim and others made by OCC/OPAE is addressed in more detail below.

The Staff's Post-Hearing Brief continues to express the Staff's support for an SFV rate design. VEDO's disagreement with the Staff's position is not rooted in a disagreement with what Staff says. The disagreement between VEDO and Staff is based on how the Staff proposes to implement the SFV design. As explained by Mr. Ulrey, the Staff's SFV recommendation leaves a portion of the fixed costs of residential distribution service subject to recovery, if at all, through a volumetric charge without any opportunity to recover fully shortfalls in fixed cost recovery which are anticipated as a result of the comprehensive conservation program that will be implemented upon a final order in this case. The Staff claims, without quantification, that its proposal to implement a rate design that only somewhat relies on volumetric charges is close enough to serve the

legitimate and important policy consideration of supporting cost recovery and conservation efforts. Staff Post-Hearing Brief at 15. But, as Mr. Ulrey demonstrated, Staff's recommendation would leave some \$15 million in residential fixed costs subject to recovery through a volumetric charge.² As discussed below, this is significant to VEDO. A \$15 million shortfall equates to a 50-basis-point reduction in return on equity and, therefore, leaves a significant financial disincentive to conservation efforts. As importantly, Staff's version of the SFV recommendation suggests that the General Assembly's effort to align interests of customers and utilities in favor of conservation will be compromised in cases where there is no good reason to do so and even if the dollar spend on conservation programs is increased significantly.

As indicated in VEDO's Post-Hearing Brief, there is no dispute among these parties about the policy objectives which compel the implementation of a rate mechanism that breaks the linkage between VEDO's ability to recover its fixed distribution costs and customer consumption. VEDO Post-Hearing Brief at 10. While VEDO and Staff both propose ultimate implementation of an SFV rate design³, OCC/OPAE continue to argue in favor of a reconciling decoupling rider mechanism, a likely-litigious process to administer, a below-cost customer charge, and a volumetric rate that would not likely recover the balance of the fixed-cost-revenue which parties have recommended to be recovered from

² This assumes an average monthly customer charge of \$14.00 at the stipulated revenue level, which is slightly higher than that proposed for Stage 1 rates in the Staff Report. Company Ex. 8b at 5, Staff Ex. 1 at 31.

³ The major difference between VEDO and Staff proposals relates to the time period required for transition to implementation to a full SFV rate, which will be discussed briefly below.

residential customers in accordance with the Rate Case Stipulation. VEDO Post-Hearing Brief at 10-11, Staff Post-Hearing Brief at 10, OCC/OPAE Initial Brief at 12.

OCC/OPAE observe that this is the third case in which they have advocated against the SFV rate design⁴ (OCC/OPAE Initial Brief at 10). But, the discussion about improving rate design in light of increased emphasis on the role of conservation has a life, *in the case of VEDO*, that extends well beyond the recent history associated with three recent cases.

As VEDO described in its Post-Hearing Brief, the rate design issues in this proceeding are rooted in a dialogue that began as a result of the application that VEDO filed almost three years ago in Case No. 05-1444-GA-UNC.⁵ The rate design proposal which VEDO submitted in these proceedings was submitted in compliance with the Commission's order in the Conservation Case and in furtherance of a stipulation and recommendation that was signed and supported by OPAE. The Conservation Case included a technical conference for the parties and a technical presentation for the Commissioners (Conservation Case, February 7, 2006, Entry at 1) and an extensive exchange of views regarding the

⁴ See *In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Rates, et al.*, Case No. 07-589-GA-AIR, Opinion and Order (May 28, 2008) ("Duke Rate Case"); *In the Matter of the Application of the East Ohio Gas Company d/b/a Dominion East Ohio for Authority to Increase its Rate for Gas Distribution Service, et al.*, Case No. 07-829-GA-AIR ("Dominion Rate Case").

⁵ See *In the Matter of the Application of Vectren Energy Delivery Company of Ohio, Inc., for Approval, Pursuant to Revised Code Section 4929.11, of a Tariff to Recover Conservation Expenses and Decoupling Revenues Pursuant to Automatic Adjustment Mechanisms and for Such Accounting Authority as May Be Required to Defer Such Expenses and Revenues for Future Recovery Through Such Adjustment Mechanisms*, Case No. 05-1444-GA-UNC, Supplemental Opinion and Order (June 27, 2007) ("Conservation Case").

amount of conservation funding, the role of decoupling and alternative means of accomplishing the alignment-of-interests objective that underlies decoupling. During this extended examination, the General Assembly and Congress have spoken in support of the alignment-of-interests objectives, and the General Assembly has acted to make it clearer that the Commission has the authority to adopt a “decoupling mechanism”. Amended Substitute Senate Bill 221 (effective July 31, 2008) and Energy Independence and Security Act of 2007; Title V, Subtitle D, Section 532(b)(6).

There are few, if any, rate design issues that have received more attention from the Commission or the General Assembly than the rate design issues before the Commission in these proceedings. It is wrong (and ignores years of effort) for OCC/OPAE to suggest that the transition to a fully-implemented SFV rate design in these cases would amount to a “...rush to impose the SFV rate design on VEDO’s residential customers”. OCC/OPAE Brief at 10.

Undaunted by the compelling evidence to the contrary, OCC/OPAE continue to oppose the SFV rate design claiming that it violates the principle of gradualism, discourages conservation, and harms low-income customers. Moreover, OCC/OPAE continue to advance legal and procedural arguments unsupported by Ohio law and rules and previously distinguished or rejected by the Commission. These issues are largely red herrings which serve only to distract attention from basic considerations which compel adoption of a fully-implemented SFV residential rate design.

More importantly, the arguments presented by OCC/OPAE are arguments against the rate design results that are warranted based on the cost of service evidence presented by VEDO and the Staff. But the facts in these proceedings provide no reason to deviate from the cost of service results that support full implementation of an SFV residential rate design. As parties seeking deviation from the rate design results that relate directly to the cost of service information, OCC/OPAE have the burden of demonstrating that the principle of gradualism, the goal of rational conservation and the effect of a cost-based rate on low-income customers are good reasons for the Commission to deviate from the cost-based ratemaking results. More specifically, OCC/OPAE cannot prevail on their residential rate design claims unless they can affirmatively demonstrate that a fully-implemented SFV residential rate design is unreasonable for the reasons they advance. VEDO submits that OCC/OPAE have not presented such evidence and therefore cannot prevail based on this standard.

The Commission is obliged to establish rates (and has the requisite discretion to adopt a rate design) that provide an opportunity for a utility to recover the costs of providing its service on a non-discriminatory basis. As the Commission has already recognized, and as the evidence in these proceedings clearly shows, these fundamental objectives are uniquely met by a fully-implemented SFV residential rate design.

Most of the specific matters addressed in OCC/OPAE's Initial Brief have been addressed in combination by VEDO's and Staff's Post-Hearing Briefs.

Accordingly, in this Reply Brief, VEDO will attempt to avoid redundancy where possible.

II. RATE DESIGN DISCUSSION

A. Introduction

All parties embrace the need to implement a rate design that decouples a utility's ability to recover its fixed costs from customer consumption.⁶ It is especially important here where the Parties all support a comprehensive, well-funded conservation program the purpose of which is to reduce customer consumption. As discussed in VEDO's Post-Hearing Brief and in this Reply Brief, OCC/OPAE have failed to demonstrate that a fully-implemented SFV residential rate design is an unreasonable response to this goal.

Among other defects, OCC/OPAE's discussion of the SFV rate design demonstrates some elementary misunderstandings. OCC/OPAE mischaracterize the change to an SFV rate design as a "knee-jerk over-reaction." OCC/OPAE Initial Brief at 12. As OCC/OPAE know, and as discussed briefly above, the Commission has been reviewing decoupling approaches since VEDO filed its Conservation Case in 2005. By their own admission, this is the third rate case in which the Commission has considered rate design proposals raising the same issues as herein. OCC/OPAE Initial Brief at 10. In the course of its study of this issue in VEDO's Conservation Case and the three rate cases over the last

⁶ In fact, the Commission is aware that the Staff has previously indicated that it was "not opposed to a decoupling mechanism on a stand-alone (sic) basis, with no linkage to DSM funding." Conservation Case, Supplemental Opinion and Order at 26.

three years, the Commission has not only reviewed the records of the proceedings before it (which have included scores of studies, white papers, articles, and resolutions issued by a significant number of independent organizations), but it has hosted presentations and oral argument at its meetings. The Commission has undertaken a serious, measured, in-depth consideration of the various rate design proposals before it and, in considerable detail, has enunciated the basis for its adoption of the SFV rate design. Duke Rate Case, Opinion and Order at 17-19. OCC/OPAE's suggestion that "many fundamental questions ... remain unanswered regarding the implications and impact of the SFV rate design..." (OCC/OPAE Initial Brief at 10) suggests that either they have not been paying attention, or that they wish to have the Commission ignore the substantial work that has already been devoted to this issue because they do not like the Commission's determinations.⁷

On balance, OCC/OPAE's opposition to the SFV rate design is directed at three factors: price signal (and its effect on conservation), impact on low-income customers, and gradualism. As discussed in VEDO's and Staff's Post-Hearing Briefs, the evidence in these proceedings demonstrates that the SFV rate design sends the proper price signal, benefits VEDO's low-income customers, and satisfies the principle of gradualism. Moreover, the Commission has already

⁷ Likewise, OCC/OPAE's suggestions that further study is required and alternative rate designs should be considered (OCC/OPAE Initial Brief at 27-31) suggest a lack of familiarity of the history of Commission consideration of this issue. In fact, OCC/OPAE have been parties to every case in which the Commission has considered competing proposals for decoupling riders and the SFV rate design. As indicated above, the body of information related to alternative rate designs already studied, reviewed, and considered by the Commission is significant.

addressed each of these factors⁸ and determined that a “levelized rate design,” or SFV, “is preferable to a decoupling rider.” Duke Rate Case, Opinion and Order at 18.

In spite of a growing body of evidence in multiple cases and a dispositive Commission Order, OCC/OPAE continue to argue that the SFV rate design sends the wrong price signal and discourages conservation by lengthening the payback period for energy efficiency investments. Duke Rate Case, Opinion and Order at 19; OCC/OPAE Initial Brief at 14-18. OCC/OPAE claim that an SFV rate design lengthens the payback period for energy efficiency investments. OCC/OPAE Initial Brief at 16.

B. Price Signal

OCC/OPAE begin by asserting that “high gas prices generally send a signal to consumers that encourages conservation.” They then proceed to propose a low customer charge/high volumetric rates model for distribution service that has nothing to do with gas prices and has the obvious result of misleading customers into believing that reducing their usage will reduce the fixed costs to serve them. In complaining that an SFV rate design will prolong the payback for energy efficiency investments,⁹ they ignore the fact that a rate

⁸ See *In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Gas Rates, et al.*, Case No 07-589-GA-AIR, Opinion and Order (May 28, 2008) (“Duke Rate Case”).

⁹ The fact is that OCC/OPAE do not seem to really know what motivates customers to make energy efficiency investments. First they assert as fact (absent evidence) that “customers have made conservation decisions based on the current level of volumetric billing.” OCC/OPAE Initial Brief at 18. Then they assert as fact (also absent evidence) that “each customer is different in how they approach energy efficiency investment decision-making.” *Id.* In VEDO’s Conservation Case, OCC criticized the Commission for finding that “price is the primary driver for consumers using their financial resources for energy efficiency.” Conservation Case, Entry on Rehearing at

design that recovers fixed costs based on usage levels tricks customers into faulty payback analyses which assume that fixed costs somehow can be reduced by conservation. Staff Ex. 3 at 4-5, Company Ex. 9a at 22-23. Conservation will reduce only the customer's commodity costs; an appropriate and fair rate design will reflect precisely that and permit a customer to make investment decisions on a valid economic analysis.

VEDO, Staff, and OCC witnesses agree that the distribution portion of the gas bill is minor as compared to the total bill. Company Ex. 8a at 23, Staff Ex. 3 at 4-5, and OCC Ex. 3 at 19. Mr. Puican and Mr. Overcast agree that recovering fixed costs through volumetric rates actually distorts price signals and causes poor conservation and efficiency investment decisions. Staff Ex. 3 at 4-5, Company Ex. 8a at 23. Commodity costs comprise 75 to 80 percent of the total bill. Tr. Vol. III at 68. Mr. Puican states clearly that "[c]ustomers will always achieve the full value of the gas cost savings regardless of the distribution rate," and "[a]rtificially inflating the volumetric rate beyond its cost basis skews the [efficiency investment] analysis and will cause over-investment in conservation ... which exacerbates the under-recovery of fixed costs that the utility must then recover from all other customers." Staff Ex. 3 at 3.

Again, the Commission agrees:

The Commission also believes that a levelized rate design sends better price signals to consumers. The rate for delivering gas to the home is only about 20 to 25 percent of the total bill. The largest portion of the bill, the other 75

3 (November 8, 2006). This is but one example of the kind of internally-inconsistent approach taken by OCC in furtherance of its campaign for a rate design that works against the interests of VEDO's low-income customers and sends misleading signals to all residential customers.

to 80 percent, is the biggest driver of the amount of a customer's bill. Therefore, gas usage will still have the biggest influence on the price signals received by the customer when making gas consumption decisions, and customers will still receive the benefits of any conservation efforts in which they engage. While we acknowledge that there will be a modest increase in the payback period for customer-initiated energy conservation measures with a levelized rate design, this result is counter-balanced by the fact that the difference in the payback period is a direct result of inequities within the existing rate design that cause higher use customers to pay more of their fair share of the fixed costs than low-use customers.

Duke Rate Case, Opinion and Order at 19.

C. Impact on Low-Income Customers

As indicated above, the context in which OCC/OPAE pursue their opposition to the SFV rate design suggests that the Commission must pick winners and losers within the residential class. OCC/OPAE argue that the interests of low-income customers must prevail in resolving this fight among residential customers. OCC/OPAE Initial Brief at 4 (emphasis added). If the Commission is willing to accept this invitation to pick winners and losers within the residential class of customers and, in particular, consider the rate design effects on low-income customers, the Commission must then determine how low-income customers are affected by a fully-implemented SFV residential rate design. Most importantly, ***the evidence shows that a fully-implemented SFV rate design benefits low-income customers and that the joint OCC/OPAE position will cause low-income customers to have higher bills.*** Company

Ex. 8a at 12-16. If the interests of low-income customers in particular must be considered to resolve the dispute between residential customers, this factor works decidedly in favor of a fully-implemented SFV residential rate design in VEDO's case.

The context for this residential rate design debate is, at best, unfortunate and, at worst, misguided and uninformed. It is a context in which parties representing residential customers first urge the Commission to ignore the uncontested cost of service evidence and put the interest of residential customers in conflict so that they might prevail on their rate design ideology without regard to its merit or lack thereof. From this foundation, OCC/OPAE then urge the Commission to resolve the wrongly-inspired rate design debate by increasing the subsidy paid by the low-income customers that OCC/OPAE claim that they want to protect "in particular".

While it is true that OCC sponsored testimony offering an opinion that an SFV residential rate design would negatively affect low-income residential customers (OCC Ex. 2), the evidence shows that the reasoning behind this opinion was based on bad data, data that carried a warning that it was not reliable for the use to which it was put by OCC's witness (Company Ex. 8a at 11) and that the opinion was based on a defective analytical approach disconnected from the facts and circumstances in VEDO's service area. Company Ex. 8a at 10-11, Tr. Vol. IV at 22-24. In particular, the opinion advanced by OCC/OPAE fails because of its reliance on unreliable, unverifiable, volunteered state-wide data based on an unknown sample size which may not have included any VEDO

customers. Tr. Vol. IV at 14, 22-24, Company Ex. 8a at 10-11. Additionally, the survey results relied upon by OCC/OPAE measured household gas cost, rather than usage, as compared to income. Company Ex. 8a at 10. Finally, common sense tells us that the already unreliable survey data relied upon by Mr. Colton is incapable of supporting any conclusions about natural gas usage for low-income customers. Given the availability of low-income assistance programs such as Percent of Income Payment Plan ("PIPP") and HEAP, the actual amount which these assisted customers pay for natural gas will have no direct relationship to their natural gas usage and this reality further complicates any effort to derive natural gas usage from the dollar amount which a low-income customer says, in response to a survey, he paid the utility.

VEDO conducted an analysis of the average use of VEDO's PIPP customers which shows that "these customers, on average, use more gas than the average of all residential customers." Company Ex. 8a at 17. Mr. Puican testified that usage data of PIPP customers "is the best available proxy" for all low-income customers. Staff Ex. 3 at 7, Tr. Vol. VI at 35. On rebuttal, VEDO provided an analysis of the actual usage of all VEDO's residential customers with twelve months of bills in 2007. This supplemental analysis confirmed the results reported by Mr. Puican and VEDO based on the analysis of the PIPP customer population. The supplemental analysis demonstrated that, "low income customers in VEDO's service area consume on average more natural gas annually than all but the highest income residential customers in VEDO's service area". Company Ex. 8a at 12-14. Based on these demonstrations, both Mr.

Puican and Mr. Overcast agree that VEDO's low-income customers will benefit from an SFV rate design. Staff Ex. 3 at 7, Company Ex. 8a at 12-17.

D. Gradualism

OCC/OPAE advance a vague argument that the rate proposals of VEDO and Staff violate the principle of gradualism. OCC/OPAE Initial Brief at 24-25. Yet, OCC/OPAE cite no evidence or actual rate values in support of their argument.

As discussed more generally above, the application of the principal of gradualism in the context of this narrow residential rate design context involves an academic exercise in the case of the residential class as a whole. The residential customer class will pay the same regardless of whether the results are more or less gradual.

The evidence shows that, with an SFV rate design, VEDO's average use customer will pay the same regardless of rate design, while the low use and high use customers will pay more and less, respectively. Tr. Vol. III at 14-15. Parenthetically, this is an obvious benefit to VEDO's low-income customers who, as indicated above, are typically high use customers. Assuming OCC/OPAE's gradualism claim is narrowly focused on the difference between the current customer charge and the customer charge that results from a fully-implemented SFV residential rate design, the Commission has previously rejected this claim. The Commission, in rejecting OCC's request for rehearing of the increase in VEDO's customer charge in its last rate case on the basis that it violated the principle of gradualism, found that "...the customer charge is one component of

the base rates paid by Vectren customers and the overall revenue increase to the revenue responsibility of the residential class resulting from the stipulation in these proceedings amounts to an increase of less than five percent. OCC's fourth assignment of error is denied."¹⁰ In these proceedings, the overall increase which the parties have recommended through the Rate Case Stipulation be the responsibility of residential sales customers is 4.42 percent.¹¹

E. Miscellaneous Matters

OCC/OPAE also claim that customers will not understand the concept of a fixed charge for fixed costs and that the SFV rate design may permit over-recovery by the Company of the revenue level approved in these proceedings.

1. Customer Understanding

OCC/OPAE mischaracterize their decoupling rider proposal as "transparent" and claim that customers will not understand VEDO's SFV proposal. OCC/OPAE Initial Brief at 12. Although OCC/OPAE have presented no studies or surveys of their own, they chastise VEDO for conducting no studies or analysis to support the conclusion that SFV rates

¹⁰ See *In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Authority to Amend its Filed Tariffs to Increase the Rates and Charges for Gas Service and Related Matters, et al.*, Case No. 04-571-GA-AIR, Entry on Rehearing at 5 (June 8, 2005).

¹¹ This percent increase in revenue responsibility for residential sales customers is calculated based on data found in Company Ex. 8b, Rebuttal Exhibit JLU-2 and the GCR rate for September 2008 as shown in VEDO's Monthly EGC Filing made on August 18, 2008 in Case No. 08-220-GA-GCR. This calculation does not reflect the revenue impact of any riders, which would drive the percent increase even lower.

are simpler and easier to understand than a decoupling rider.¹² *Id.* A fixed charge per month for distribution service is intuitively easier to understand than a customer charge/volumetric rate plus an annually reconciling decoupling rider charge for distribution. Tr. Vol. III at 99-100. Mr. Ulrey testified that customers do not currently know what they pay for gas distribution service and that they are confused by the customer charge/volumetric rate combination comprising the distribution rate.¹³ Tr. Vol. III at 67-68. Customers do, however, know what they pay for telephone, cable and internet services, which are billed on a fixed-charge-per-month basis. *Id.* at 68.¹⁴ The Commission agrees. In the Duke Rate Case, the Commission has already found that the SFV rate design:

... has the advantage of being easier for customers to understand. Customers will transparently see most of the costs that do not vary with usage recovered through a flat monthly fee. Customers are accustomed to fixed monthly bills for numerous other services, such as telephone, water, trash, internet, and cable services. A decoupling rider on the other hand, is much more complicated and harder to explain to customers. It is difficult for customers to understand why they have to pay more through a decoupling rider if they worked hard to reduce their usage; the appearance is

¹² VEDO has proposed a decoupling rider, the Sales Reconciliation Rider-B ("SRR-B"), to be effective only so long as is required to transition to implementation of a full SFV rate design. Company Ex. 9 at 9-10.

¹³ OCC Witness Novak's testimony suggests that residential customers do not even recognize the distribution portion of their bills. VEDO Post-Hearing Brief at 15.

¹⁴ A schedule of fixed charges for these types of services available in the Dayton, Ohio, area is attached to Mr. Ulrey's Rebuttal Testimony. Company Ex. 9b, Rebuttal Ex. JLU-3.

that the company is penalizing them for their conservation efforts.

Duke Rate Case, Opinion and Order at 18-19.

2. Revenue Recovery

Perhaps the strangest argument made by OCC/OPAE is that the SFV rate design may permit the Company to recover money to which it is not entitled. The conclusion embedded in this OCC/OPAE argument is not attached by citation to any record evidence. In any event, the argument demonstrates a significant misunderstanding of what is an exquisitely simple rate design.¹⁵

In fact, both the SFV rate design and the more complicated rate structure favored by OCC/OPAE are calculated on the basis of the revenue requirement approved in this proceeding and, assuming no adjustment for weather, produce the same amount of revenues for recovery based on the test year parameters. Tr. Vol. III at 104-105. The difference in approaches is then limited to whether that revenue requirement is recovered on a per customer basis or a combination of customer charge, volumetric charge and decoupling rider. The fact is that

¹⁵ Another example of OCC/OPAE's failure to understand how the SFV rate design works is in its suggestion that it "results in a subsidy flow from low use customers (including low income customers) to high use and high income customers," resulting in an improper subsidy. OCC/OPAE Initial Brief at 24. Because distribution costs are fixed, all subsidies are eliminated by the SFV rate design which charges each customer the same rate as every other customer.

both proposals are designed to provide the same revenue amount, an amount that has been agreed to by OCC/OPAE.¹⁶

III. STATUTORY CONSIDERATIONS

OCC/OPAE argues that Commission approval of an SFV rate design is contrary to the requirements of Sections 4929.02 and 4905.70, Revised Code.

A. Section 4929.02, Revised Code

OCC/OPAE allege that the SFV rate design cannot be approved since it “does not promote customer efforts to engage in conservation of natural gas, and instead would encourage increased usage of natural gas... .” OCC/OPAE Initial Brief at 25-26. OCC/OPAE claim that, on this basis, the SFV rate design is contrary to the policy requirements of Section 4929.02(A)(4), Revised Code, to “Encourage innovation and market access for cost-effective supply-and demand-side natural gas services and goods.” OCC/OPAE’s argument relies on their previously advanced and rejected price signal claims and reliance on but one of the elements in a longer list of state policy objectives that includes alignment of the interests of customers and utilities in favor of conservation. As discussed above, the distribution portion of the bill is not the major driver of conservation. It should be obvious that, regardless of the rate design for recovery of fixed distribution costs, increased usage of natural gas will increase a customer’s bill,

¹⁶ This assumes a decoupling mechanism consistent with VEDO’s Sales Reconciliation Rider-B. Company Ex. 9 at 9-10. OCC/OPAE’s proposed decoupling rider would subject recovery of the fixed costs of distribution to variations in weather, which increases the risks of recovery substantially. OCC/OPAE Initial Brief at 13.

thereby sending him a clear signal that decreasing his usage will decrease his bill.

As a part of its Application for and Alternative Rate Plan in these proceedings, VEDO was required by Section 4929.05, Revised Code, to demonstrate that it is in substantial compliance with and, after implementation of its alternative rate plan, it is expected to continue to be in substantial compliance with the requirements of Section 4929.02, Revised Code. VEDO submitted this uncontroverted demonstration in the form of Alt. Reg. Exhibit G to its Application and the Direct Testimony of Mr. Ulrey. Company Ex. 1, Alt. Reg. Exhibit G, Company Ex. 9 at 14-15. VEDO requests that the Commission find that it has made the required demonstration and renews its prayer in its Application that it meets the requirements of Section 4929.05, Revised Code. Company Ex.1 at 9.

B. Section 4905.70, Revised Code

Section 4905.70, Revised Code, requires the Commission to initiate programs related to conservation and energy efficiency. It says nothing about rate design for recovery of fixed costs. The Commission approved funding for low-income conservation programs and the Rate Case Stipulation recommends that the Commission approve a significant increase to conservation funding, a slate of conservation programs and an administrative process that involves a collaborative which includes OPAE and OCC and has been previously approved by the Commission. The level of conservation funding, slate of programs and administrative process have been agreed to by all parties supporting the Rate Case Stipulation including OCC and OPAE.

To the extent that OCC/OPAE's claims regarding the role of Section 4905.70, Revised Code, are an attack on the level of conservation funding, the slate of programs or the collaborative process, OCC/OPAE's claim is improper based on the terms of the Rate Case Stipulation. To the extent that OCC/OPAE's claims regarding the role of Section 4905.70, Revised Code, are designed to support their rate design position, the claims are, as a matter of law, irrelevant.

Additionally, the establishment of an SFV rate which decouples a utility's recovery of fixed costs from customer consumption frees the utility to actively support and promote conservation. In fact, a fully-implemented SFV rate design supports the goals of state policy set forth in Section 4929.02, Revised Code, and facilitates the development of programs required by Section 4905.70, Revised Code.

IV. STAFF PROPOSAL

In its brief, the Staff supports the proposal in the Staff Report for a two-stage transition toward implementation of a full SFV rate with retention of a volumetric rate component. Staff Ex. 1 at 30-31, Staff Ex. 3 at 13. However, the Staff opposes the interim SRR-B proposal, the purpose of which was to provide to VEDO "the same recovery result to VEDO that would occur from an immediate movement to a straight fixed variable rate design." Company Ex. 1, Alt. Reg. Ex. A at 12, Company Ex. 9 at 9-11. The Staff says, "...to superimpose the SRR-B on top of the Staff's proposal would eliminate one of the motivations for the move to the SFV rate design." Staff Post-Hearing Brief at 15. VEDO stated explicitly

its intent to transition to a full SFV rate in its next rate case. Company Ex. 1, Alt. Reg. Ex. A at 12, Company Ex. 9 at 6. There is no evidence suggesting that approval of the SRR-B would eliminate VEDO's motivation to achieve implementation of a full SFV rate design. In fact, it is the proposal for partial, rather than full implementation of the SFV rate design that motivates VEDO's proposal for the SRR-B in the interim. Company Ex. 9 at 9-11. Having dismissed the interim SRR-B option for transitioning to a fully-implemented SFV residential rate design, Mr. Puican proposed retention of a volumetric rate component for recovery of VEDO's fixed distribution costs claiming, without quantification or further support, that this approach creates a reasonable risk. Staff Ex. 3 at 13, Staff Post-Hearing Brief at 15. Mr. Ulrey testified that the financial impact to VEDO of the Staff's recommendation (assuming a 4.25% reduction in residential and general service usage) would result in approximately a 50-basis point reduction in VEDO's return on equity resulting from under-recovery of fixed costs. Company Ex. 9b at 6.

On examination by the Attorney Examiner, Mr. Puican testified that the rate of return reflected in the Stipulation and Recommendation filed on September 8, 2008 in these proceedings reflected a 25-basis point reduction to the return on equity made subsequent to the Staff Report for the reduced risk presented by its rate design recommendation which was contained in the Staff Report. Tr. Vol. IX, at 11-12. This downward adjustment was made notwithstanding the fact that VEDO currently has a decoupling mechanism and

without regard to the fact that this current condition is already incorporated into VEDO's cost of capital.

The cumulative effect of the reduced return on equity imbedded in the stipulated revenue requirement and that resulting from VEDO's exposure to uncertain recovery of fixed costs dependent on a volumetric rate is debilitating and works to misalign the interests of VEDO and its customers in favor of rational conservation programs. Because the decline in average use per customer is expected to continue (Company Ex. 9 at 6), a rejection of the SRR-B and retention of a volumetric component in the distribution rate design will compound under-recovery of fixed costs, and increased erosion of the return on equity will be inevitable. Company Ex. 9 at 6, Company Ex. 9b at 6.

As VEDO advocated in its Post-Hearing Brief, the policy goals of the Commission can best be met, and the adverse impacts of the OCC/OPAE and Staff proposals can be avoided, by approval of a fully-implemented SFV residential rate design in these proceedings.

V. NOTICE OF INTENT AND NEWSPAPER NOTICE REQUIREMENTS

OCC/OPAE argue that VEDO's Notice of Intent filed pursuant to Section 4909.43, Revised Code, ("Statutory PFN") is inadequate because VEDO's Stage 2 rates for residential distribution (Rate 310) and transportation service (Rate 315) in the Statutory PFN do not match those in the Application. OCC/OPAE claim defects in VEDO's newspaper notice because it did not include Stage 2

rates for residential Rates 310 and 315. OCC/OPAE Initial Brief at 4-10.¹⁷ Further, OCC/OPAE assert that the Commission must require new notices and additional hearings.

In its Initial Brief, OCC/OPAE have neither claimed nor demonstrated that VEDO's Statutory PFN, which is neither required to be filed with the Commission nor served on OCC/OPAE, lacks substantial compliance with the requirements of Section 4909.43, Revised Code. OCC/OPAE have not established their standing to raise issues related to the sufficiency of the Statutory PFN, nor have they demonstrated any harm to residential consumers resulting from the slight differences in residential Stage 2 rates in the notice and the Application. Finally, OCC/OPAE have not cited any authority that suggests that the slight differences in residential Stage 2 noticed and applied for rates either warrant or require a new notice and new hearing.

In support of their position on VEDO's newspaper notice, OCC/OPAE cite two Ohio Supreme Court decisions¹⁸ that address issues that were raised when telephone utilities seeking rate relief failed to mention proposals for new measured rate service in their newspaper notices. Yet, contrary to OCC/OPAE's argument, these two cases actually support the sufficiency of VEDO's newspaper notice. In *Committee against MRT*, the Court said:

¹⁷ OCC/OPAE claim that the slight differences in Stage 1 and 2 rates in VEDO's Statutory PFN and the omission of Stage 2 residential rates in VEDO's newspaper notices operate to deprive consumers of a constitutional right to be heard. OCC/OPAE Initial Brief at 4. The Ohio Supreme Court has found that the right to participate in rate-making proceedings is statutory, **not** constitutional. *City of Cleveland v. Public Utilities Commission of Ohio*, 67 Ohio St.2d 446, 453 (August 5, 1981).

¹⁸ *Committee against MRT, Pub. Util. Comm.*, Ohio St.2d 231 (1977) ("*Committee against MRT*"); *Ohio Association of Realtors v. Pub. Util. Comm.*, Ohio St.2d 172 (1979) ("*Ohio Assoc. of Realtors*").

While generally, the published notice required under R.C. 4909.19 need not contain every specific detail affecting rates contained in the application (indeed, such a requirement would be highly impractical and unnecessarily expensive), the court notes that the statute does require that the "substance" of the application be disclosed, i.e., that the essential nature or quality of the proposal be disclosed to those affected by the rate increases.

Committee against MRT at 233. In *Ohio Assoc. of Realtors*, the Court said:

The 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.

Ohio Assoc. of Realtors at 176.

VEDO's newspaper notice clearly states that "...VEDO proposes changes to the rate design for Rate 310 (Residential Sales Service) and Rate 315 (Residential Transportation Service) that initiate a gradual transition to a straight fixed variable rate for distribution service." SFRs, Sch. S-3, page 1; VEDO Proofs of Publication filed August 13, 2008. Additionally, the Stage 1 rates for Rate 310 and 315 contained in the newspaper notice demonstrate the first step of VEDO's proposed transition. This information discloses more than just "the essential nature or quality" of VEDO's proposal; it discloses precisely that which VEDO proposes for ultimate implementation.

The Commission approved VEDO's newspaper notice by Entry dated January 16, 2008, in which the Commission explicitly found that the notice was in compliance with the requirements of Section 4909.18(E), Revised Code. OCC did not apply for rehearing from this finding of the Commission in a timely

manner. The newspaper notice was subsequently published consistent with requirements of Section 4909.19, Revised Code.

It is also important to note that, in *Committee against MRT and Ohio Assoc. of Realtors*, the Court was addressing claims by customer groups whose participation in the Commission proceedings below was prevented by the lack of notice about which they complain. In this case, it is more than a bit disingenuous for OCC/OPAE to suggest that residential customers were, for lack of adequate notice, denied the opportunity to inquire further about VEDO's proposal or intervene in these proceedings. The record shows that OCC and OPAE filed motions to intervene in these cases on behalf of VEDO's residential customers on November 5 and November 6, 2007, respectively. The actual inquiry of residential consumers into VEDO's proposals included 570 Interrogatories (not including sub-parts), 186 Requests for Production of Documents (not including sub-parts), numerous informal information requests, and nine depositions. OCC/OPAE together filed two sets of objections to the Staff Report and five sets of expert testimony on behalf of residential customers in these proceedings. It cannot be denied that residential consumers participated fully in these proceedings.

In sum, VEDO's notices in these proceedings were in substantial compliance with applicable laws and rules. OCC's request for re-notice and additional hearings must be rejected.

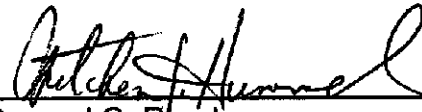
VI. CONCLUSION

The Parties to these proceedings have resolved nearly all issues as memorialized in the Rate Case Stipulation submitted to the Commission for its consideration and approval as supported by Staff Witness Puican. Staff Ex. 3a. The major issue reserved for Commission deliberation and determination is the rate design ("decoupling") mechanism which most appropriately addresses the Commission's adopted policy separating the utility's recovery of the fixed costs of delivering gas from the amount of gas customers consume. The record in these proceedings is simply a new chapter in the body of knowledge accumulated and considered by the Commission in translating its policy into a reasonable and fair rate design that accomplishes its goal. After three years of consideration in a number of proceedings, the Commission has shown a preference for implementation of an SFV rate design which apportions to each customer his fair share of the fixed costs for distribution service. Consistent with the Commission's preference, the evidence in these proceedings overwhelmingly supports the full implementation of an SFV residential rate design. The SFV rate design properly assigns responsibility for VEDO's fixed costs of providing distribution service and, as the evidence shows, eliminates the misleading price signals caused by volumetric rates which suggest that fixed costs can be reduced by less usage. The full implementation of an SFV residential rate design benefits VEDO's low-income customers and properly aligns the interests of VEDO and its customers in favor of conservation. Finally, the residential fixed charge of \$18.37 resulting from implementation of the SFV in these proceedings

is significantly less than that already approved by the Commission as Stage 1 and 2 customer charges in Duke's transition to a full SFV rate design and the full SFV residential rate recommended by Staff for Columbia. VEDO Post-Hearing Brief at 12-13.

Wherefore, VEDO respectfully requests that the Commission approve and adopt the Rate Case Stipulation as filed and in accordance with the terms set forth therein on an expedited basis, as requested in the Rate Case Stipulation. Further, VEDO requests that the Commission approve implementation of a full SFV residential rate design as discussed above and as supported by the record in these proceedings.

Respectfully submitted,



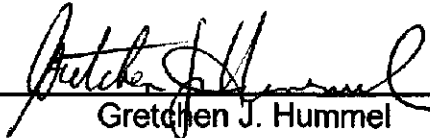
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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Reply Brief of Vectren Energy Delivery of Ohio, Inc.* was served upon the following parties of record this 7th day of October 2008, via hand-delivery or ordinary U.S. mail, postage prepaid.


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