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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Authority to Amend its Filed Tariffs to Increase the Rates and Charges for Gas 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
In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for 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
SUBMITTED ON BEHALF OF THE STAFF OF THE PUBLIC UTILITIES COMMISSION OF OHIO

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TABLE OF CONTENTS

Page

INTRODUCTION

The amount of the rate increase in this proceeding was agreed upon. The parties also agreed as to how that increase would be distributed among customer classes. The only real issue in this case is how the Company should recover those rates from residential customers.

The customers of Vectren Energy Delivery of Ohio (Vectren) were put on notice at the very beginning of this case that the Company wanted to recover more of its fixed costs through the customer charge. The notice made the shift to a straight-fixed-variable rate design abundantly clear. The Office of the Ohio Consumers' Counsel (OCC) criticism of the sufficiency of that notice is improper and disingenuous. Customer's had more than adequate opportunity to be heard regarding the proposed change in rate design, and residential customers were active participants in both the evidentiary and the public hearings in this case. The record demonstrates that straight-fixed-variable (SFV) designed rates are reasonable, understandable, and send the proper price signal to customers. The record also demonstrates that straight-fixed-variable rate design benefits low-income customers, encourages conservation by both consumers and the utility, and provides better information and results in more informed consumer decisions. The Commission has already described the straight-fixed-variable rate design method as a more appropriate reflection of cost causation. The time has come to extend those benefits to Vectren's customers.

ARGUMENT

I. Customers were provided adequate *notice* of the SFV rate design proposal.

OCC argues that notice to Vectren's customers of the SFV rate design proposal was legally defective. To the contrary, Vectren's customers were provided legally sufficient notice that the Company's proposed rates were designed to increase the proportion of fixed costs recovered in the customer charge while they decreased fixed costs recovery through volumetric rates. This was the substance of the application in terms of the proposed change in residential rate design. The Stage 1 and Stage 2 residential rate design proposals were revenue neutral; the revenue recovered from residential customers was the same in each stage. The notice specifically mentioned this proposed rate design change for residential customers. It was clear that the Company proposed to recover more fixed costs through the fixed rate and less through the volumetric rate. The Commission approved this notice by Entry dated January 16, 2008. OCC failed to apply for rehearing of that Entry.

A. R.C. 4909.43(B) is a pre-filing notification to municipalities, not to the utility's customers as a whole.

OCC represents the residential customers of Vectren and every other regulated utility in Ohio. OCC does not and cannot represent the interests of municipalities. As Vectren points out in its brief the focus of R.C. 4909.43(B) is on the need for home rule municipalities to have information regarding the utilities that operate in these cities. These cities can exercise home rule authority over utility rates. This pre-filing notice is not required to be filed with the Commission or printed in newspapers of general circula-

tion in the utility's service territory, as is the notice required by R.C. 4909.18 and 4909.19.

OCC has no standing to raise the interests of municipalities. Even assuming OCC could make this argument, it fails to show that the notice lacked substantial compliance with the statute and that the alleged defect caused harm to OCC or its constituency.[1] As the Company points out, the difference between the rates noticed to the municipalities and those in the application was miniscule, less than 25 cents a year for a customer using 1000 mcf annually.[2] This constitutes neither a substantial deviation from the notice requirement, nor harm to the municipalities or any of the Company's customers.

B. The notices published pursuant to R.C. 4909.18 and 4909.19 contained the substance and prayer of the residential rate design proposed by Vectren.

The Commission approved the proposed newspaper notice by entry of January 16, 2008. The notice included the residential rate design proposed by the Company. Vectren's notice disclosed the change in focus of residential rate design from recovery of fixed costs through a minimal fixed customer charge and higher volumetric rates to one of recovery of the majority of fixed costs through a fixed rate accompanied by a lower volumetric rate. This is the change noticed. The shift in Stage 2 to a greater fixed charge does not impact the level of revenue recovered in that stage; the revenue proposed for

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1 *Senior Citizens Coalition v. Pub. Util. Comm'n*, 40 Ohio St. 3d 329, 533 N.E.2d 353 (1988); *Cincinnati v. Pub. Util. Comm'n*, 63 Ohio St. 3d 366, 588 N.E.2d 1175 (1992); *Myers v. Pub. Util. Comm'n*, 64 Ohio St. 3d 299, 595 N.E.2d 873 (1992); *Holladay Corp. v. Pub. Util. Comm'n*, 61 Ohio St. 2d 335, 402 N.E.2d 1175 (1980).

2 Co. Brief at 220-21.

recovery for Stage 1 and Stage 2 was identical. The rate design shift to recovery of fixed costs primarily through a fixed charge is demonstrated in the notice of Stage 1 rates. That Stage 2 rates were not specifically included in the notice does not change the fact that customers were properly notified of the proposed change in fixed cost recovery. OCC signed a stipulation as to the amount of the rate increase and how that increase is distributed among the customer classes. OCC cannot now dispute rates to which it agreed.

OCC cites *Committee against MRT v. Pub. Util. Comm'n*, 52 Ohio St.2d 231, 371 N.E.2d 547 (1977) as authority for its argument that Vectren's notice is deficient. In fact the Court's opinion supports the sufficiency of the published notice. The Court opined that:

> 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. Although there is no specific test or formula this court can apply in reviewing challenges made by subscribers with respect to the sufficiency of the notice provided by a utility, it is clear, given the purposes of the publication requirement under R.C. 4909.19, that a highly innovative material change in the method of charging customers should be included in the notice.[3]

The rate increase proposed by Vectren was contained in the published notice, as was the "material change in the method of charging customers" embodied in the pro-

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[3] *Committee Against MRT v. Pub. Util. Comm'n*, 52 Ohio St. 2d 231, 371 N.E.2d 547 (1977).

posed shift to greater fixed cost recovery in a higher fixed charge.[4] There was no difference in the revenues recovered in Stage 1 that was contained in the notice, and those recovered through Stage 2 rates. The difference between the noticed Stage 1 rates and those contained in Stage 2 is one of degree, not of method. Both Stages recover a greater proportion of fixed costs through a higher fixed charge, and both recover the same level of revenue for the Company.

This is unlike the situation in *Committee against MRT*, where the notice published by Cincinnati Bell failed to mention the proposed change to usage based rates.[5] Here, Vectren published notice that contained the significant change from a low customer charge and higher volumetric rates to a more level, but higher fixed charge, and lower volumetric rates. Vectren customers opposed to this type of rate design were notified of the change proposed, and displayed significant interest in these proceedings because of the shift to greater recovery of fixed costs through a fixed charge. Vectren customers filed numerous letters in this docket evincing knowledge of the SFV proposal, and participated vigorously regarding this topic in the local hearings held by the Commission. Vectren's notice insured that their customer's had an opportunity to be heard regarding the proposed change in rate design.[6] As a result the Commission should find that the notice was legally sufficient.

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4 *Committee Against MRT v. Pub. Util. Comm'n*, 52 Ohio St. 2d 231, 371 N.E.2d 547 (1977).

5 *Committee Against MRT, supra*, 52 Ohio St. 2d at 234, 371 N.E.2d at 549.

6 *Id.*

Further, as it is also apparent from OCC's extensive participation in this case, Vectren's notice provided OCC with notice of the "reasonable substance of the proposal so that consumers [could] determine whether to inquire further as to the proposal or intervene in the rate case."[7] OCC, the statutory representative of Vectren's consumers, intervened in this case, agreed to a lower rate increase than requested in the application, and strenuously litigated the proposed change to residential rate design, the shift to SFV. The notice given in this case harmed neither OCC, nor its constituents.

II. The record demonstrates that straight-fixed-variable designed rates are reasonable, understandable, and send the proper price signal to customers.

A. SFV designed rates are reasonable.

1. SFV rates follow cost causation principals.

Even OCC, or at least its witness, Mr. Colton, agrees that a basic ratemaking principal "is that rates should reflect costs" and "to the extent practicable, one set of customers should not be charged for costs that a different set of customers cause a utility to incur."[8] Some have claimed that the straight-fixed-variable rate design results in low usage customers subsidizing high usage customers. That claim is not true. As the Commission appreciates, SFV rate design is a change from the current rate design and, "as with any change, there will be some customers who will be better off and some customers

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7 *Ohio Ass'n of Realtors v. Pub. Util. Comm'n*, 60 Ohio St. 2d 172, 176, 398 N.E.2d 784, 786 (1979).

8 OCC Ex. 2 at 21-22.

who will be worse off, as compared to the existing rate design."[9] Some will not be affected by a switch to the straight-fixed-variable rate design.[10] These results do not mean a subsidy has been created.

Rather than creating a subsidy, the straight-fixed-variable rate *reduces* a subsidy that exists under current rates. The current rate design recovers most of the company's fixed distribution costs through a rate that varies with usage, and it recovers only a small part of the costs through a fixed rate. Accordingly, the current rate design distributes more of the fixed costs to higher users of natural gas. The straight-fixed-variable rate design more evenly distributes fixed costs by increasing the portion of those costs recovered through a fixed rate component, thereby, matching fixed and variable cost recovery more closely with the costs actually incurred.[11] Since some low usage customers have not paid the entirety of their fixed costs under the current rate design, they may pay more. The converse is true for higher usage customers. In the *Duke* case the Commission explained:

> The levelized rate design [the straight-fixed-variable] will impact low usage customers more, since they have not been paying the entirety of their fixed costs under the existing rate design. Higher use customers who have been overpaying their fixed costs will actually experience a rate reduction. Average users will see only the impact of the increase ... [due to the rate increase rather than the change in rate design]; they

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9 *In re Duke Energy Ohio,* Case No. 07-589-GA-AIR (Opinion and Order at 19) (May 28, 2008).

10 *Id.*

11 Staff Ex. 3 (S. Puican Prefiled Dir. Test.) at 4-5.

> will see no additional impact as a result of the Commission choosing the levelized rate design.[12]

As the Commission described, this effect is not a *subsidy*. It is a reduction in one that results from a more appropriate reflection of cost causation and proper rate design.

2. SFV designed rates do not disproportionately impact low income customers.

The rate effects of the straight-fixed-variable rate design are not impacted by the income of individual rate payers. Higher use customers who have been overpaying their fixed costs, including those with low-income, will experience a rate reduction. Conversely, lower use customers who have not been paying all their fixed costs, including those with low-income, will experience an increase. Average use customers who have been paying their fixed costs, including those with low-income, will not see an effect from a change in rate design.[13]

The record shows that many low-income customers will be benefited. The average annual usage of PIPP customers, historically, has been over the break-even level. As Staff Witness Puican testified:

> If one compares the average annual usage of Vectren's PIPP customers with the usage of non-PIPP residential customers. The data shows that, for the 12 months ending September 2007, PIPP customers' average usage was 110.9 Mcf and non-PIPP residential customers' average usage was 81.5 Mcf Although PIPP customer usage may not be a perfect representation of all low-income customer usage, it is the best readily available proxy. The usage data indicates that low-

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12 *In re Duke Energy Ohio,* Case No. 07-589-GA-AIR (Opinion and Order at 19) (May 28, 2008).

13 *Id.*

> income customers are, on average, not low-usage customers. Because high-usage customers will benefit from the SFV rate design, and low-income customers are more likely to be high-usage customers, it is reasonable to conclude that low-income customers are actually more likely to benefit from SFV.[14]

Contrary to OCC witness Colton, Company witness Overcast further corroborated that low income customers on Vectren's system are in fact among the Company's higher usage customers.[15] Mr. Overcast found that "[b]ased on the analysis of actual billing information for VEDO's residential customer[s] and available Census block group data for VEDO's service area,...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."[16] OCC's witness based his conclusions on national and state-wide data, not Vectren-specific data. Staff and the Company found that low income customers will actually benefit from the change to SFV rate design based upon analysis of Vectren-specific data. Accordingly, the record demonstrates that many customers with low-income have been overpaying their fixed costs and they will benefit from a change to the straight-fixed-variable rate.

B. SFV designed rates give the appropriate price signal to Vectren's customers.

OCC alleges that the straight-fixed-variable rate design discourages conservation. Based on this claim, OCC also incorrectly concludes that straight-fixed-variable designed

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14 Staff Ex. 3 (S. Puican Prefiled Dir. Test.) at 6-7.

15 Co. Ex. 8a at 11.

16 *Id.* at 14.

rates violate Revised Code provisions promoting conservation, R.C. 4929.02(A)(4). The claims are not true. The straight-fixed-variable rate design encourages appropriate conservation by consumers.

As Mr. Puican explained, "customers make conservation decisions based on their total bill."[17] The largest and volatile component of that bill is the cost of natural gas.[18] The gas cost rate is many times greater than the distribution rate.[19] For example, Mr. Puican noted:

> Vectren used a gas cost rate of $9,686 per Mcf in its application and regardless of which rate design is ultimately approved in this proceeding, the variable component of base rates will be relatively small in comparison to the cost of the gas itself. Customers will always achieve the full value of the gas cost savings regardless of the distribution rate. I believe most customers make conservation decisions based on their total bill rather than by an explicit cost/benefit analysis based solely on the variable portion of rates, particularly given the volatility of the gas cost component."[20]

OCC ignores that the cost of natural gas is the largest factor, by far, in conservation decisions.

The savings in the cost of natural gas drive the size of bills and, accordingly, conservation decisions. The rate design does not affect the cost of gas and, for that reason, it will not have a significant affect on conservation decisions.

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17 Staff Ex. 3 (S. Puican Prefiled Dir. Test.) at 3.

18 *Id.*

19 *Id.*

20 *Id.* at 3-4.

A change in consumer's total bill due to a change in distribution rate design should not have a chilling effect on conservation decisions. The largest component of those bills, natural gas cost, is volatile.[21] For example, those costs increased every month from January, 2008 through July, 2008.[22] In one month the increase was $1.78 per Mcf., and that was 6 times greater than a $00.28 increase from the prior month.[23] The entire period experienced a $5.04 increase, approximately a 69% increase.[24] Such fluctuations led Mr. Puican to conclude, "Given these types of extreme fluctuations, I believe customers recognize the imprecision of any payback analysis and will incorporate that uncertainty into their energy efficiency investment decisions."[25] Accordingly, the change to a straight-fixed-variable rate structure cannot be expected to adversely affect consumer conservation investment decisions.

Rather than impede investment decisions, the straight-fixed-variable rate design will benefit them because it sends better price signals. Including fixed costs in a variable rate distorts price signals.[26] Since the straight-fixed-variable rate design aligns fixed costs with fixed rate components and variable costs with variable rate components better

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21 Staff Ex. 3 (S. Puican Prefiled Dir. Test.) at 4.

22 *Id.*

23 *Id.*

24 *Id.*

25 *Id.*

26 *Id.*

than the current rate structure, it provides better price signals for consumers' investment decisions.[27] Mr. Puican explained:

> The variable rate component of rates should reflect a utility's true avoided costs, *i.e.* the costs that a utility does not incur with a unit reduction in sales. The SFV [straight-fixed-variable] rate design satisfies this condition by more closely matching fixed and variable cost recovery to those actual costs incurred. Artificially inflating the volumetric rate beyond its cost basis skews the analysis and will cause an over-investment in conservation.[28]

The straight-fixed-variable rate design provides better information and results in more informed consumer decisions. That is a benefit, not a detriment, to consumers and conservation.

In that fashion also, the straight-fixed-variable rate design eliminates a disincentive for Vectren to promote energy efficiency. Mr. Puican explained that any gas distribution utility has a disincentive to promote energy efficiency when its must recover its fixed costs through volumetric rates.[29] He stated:

> To artificially require the Company to recover its fixed costs through the volumetric rate creates a disincentive for the Company to promote energy efficiency. Staff is proposing a rate design [straight-fixed-variable] that eliminates this disincentive. The relatively small potential disincentive for customers to conserve due to the volumetric rate is more than offset by the removal of the Company's disincentive to actively promote and fund energy-efficiency.[30]

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27 Staff Ex. 3 (S. Puican Prefiled Dir. Test.) at 4.

28 *Id.*

29 *Id.*

30 *Id.*

Even if some small potential disincentive was associated with the straight-fixed-variable rate design, it is more than offset by the removal of the company's disincentive to promote and fund energy-efficiency.[31]

For these reasons, the straight-fixed-variable rate design encourages conservation, contrary to OCC's assertions. Accordingly, it is in accord with state policy and it consistent with any provision of the Revised Code encouraging conservation.

C. The straight-fixed-variable rate design proposal incorporates the rate design principle of gradualism.

Some have suggested the Commission proceed more slowly in adopting a straight-fixed-variable rate design. They have suggested studies and other time-consuming activities.

Staff believes such proposals are not necessary. The straight-fixed-variable rate design more appropriately aligns fixed costs with fixed rate components, and better reflects the fixed costs customers should incur and the utility should recover. Additionally, this rate design does not affect recovery of the principle cost that drives a consumer's bill, the commodity cost. Accordingly, Staff does not believe a slower approach is warranted.

Moreover, the straight-fixed-variable proposal incorporates the principle of gradualism as discussed in Staff's merit brief. The proposal leaves a portion of the fixed

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[31] Staff Ex. 3 (S. Puican Prefiled Dir. Test.) at 4.

costs in the variable rate component and it phases-in the transfer of fixed costs from the variable to the fixed rate component over two years.

CONCLUSION

The Stipulation and Recommendation resolves all issues in the case but one. Staff recognizes that that one issue, the shift to a straight-fixed-variable rate design, is a significant change. But Staff submits that customers were adequately informed of the proposed change, and had ample opportunity to be heard on the issue. Staff further submits that reason and the record support the change to an SFV rate design.

Respectfully submitted,

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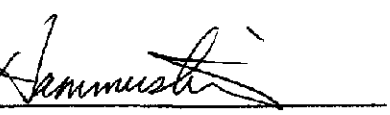

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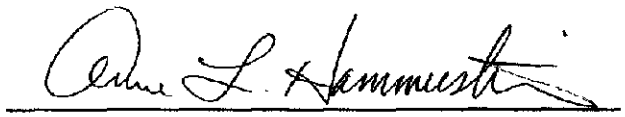
PROOF OF SERVICE

I hereby certify that a true copy of the foregoing Reply Brief submitted on behalf of the Staff of the Public Utilities Commission of Ohio, was served by regular U.S. mail, postage prepaid, hand-delivered, and/or delivered via electronic mail, upon the following parties of record, this 7th day of October, 2008.



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