

COMMONWEALTH OF PENNSYLVANIA



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October 27, 2008

James J. McNulty
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

RE: Pennsylvania Public Utility Commission
v.
Equitable Gas Company
Docket No. R-2008-2029325, et al

Independent Oil and Gas Association of
Pennsylvania
v.
Equitable Gas Company
Docket No. C-20066800

Secretary McNulty:

Enclosed for filing are an original and three (3) copies of the Statement in Support of Settlement on behalf of the Office of Consumer Advocate, in the above-referenced proceeding.

Copies have been served on the parties as indicated on the enclosed Certificate of Service.

Respectfully Submitted,

A handwritten signature in cursive script, appearing to read "Candis A. Tunilo".

Candis A. Tunilo
Assistant Consumer Advocate
PA Attorney I.D. # 89891

Enclosures

cc: Honorable John H. Corbett, Jr.
Certificate of Service
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2008-2029325
	:	
Equitable Gas Company, a Division of	:	
Equitable Resources, Inc.	:	
	:	
Formal Complaint of the Independent Oil and	:	
Gas Association of PA	:	
	:	
v.	:	Docket No. C-20066800
	:	CONSOLIDATED BY ORDER
Equitable Gas Company	:	ENTERED: JULY 18, 2008

STATEMENT OF THE
OFFICE OF CONSUMER ADVOCATE
IN SUPPORT OF SETTLEMENT

The Office of Consumer Advocate (OCA), one of the signatory parties to the proposed Settlement of Base Rate Case (Settlement), finds the terms and conditions of the Settlement to be in the public interest for the following reasons:

I. INTRODUCTION

On June 30, 2008, Equitable Gas Company (Equitable or Company) filed Supplement No. 60 to Tariff Gas - Pa. P.U.C. No. 22 at Docket No. R-2008-2029325 (Tariff) with the Pennsylvania Public Utility Commission (Commission) and proposed that the Tariff become effective on August 29, 2008. The Company proposed to increase rates to produce additional annual operating revenues of \$51.9 million, or 10%, over total present revenues. The proposed increase represented a 37% increase in distribution-only revenue.

On July 16, 2008, the Independent Oil and Gas Association of Pennsylvania (IOGA) filed a Petition to Intervene. Thereafter, on August 1, 2008, the OCA filed a Formal Complaint, and Hess Corporation (Hess) filed a Petition to Intervene on that same date. On August 5, 2008, the Office of Small Business Advocate (OSBA) filed a Formal Complaint. On August 19, 2008, the Office of Trial Staff (OTS) filed a Notice of Appearance.

By Order entered August 21, 2008, the Commission suspended the Company's proposed Tariff pending investigation. The proceeding was assigned to the Office of Administrative Law Judge and, further, to Administrative Law Judge John H. Corbett, Jr. (ALJ Corbett) for investigation and scheduling of hearings to determine whether Equitable's proposed base rate increase was just and reasonable and otherwise in compliance with the standards set forth in the Public Utility Code.

ALJ Corbett held a prehearing conference on September 4, 2008, wherein a procedural schedule was established, and the parties agreed to certain modifications to the discovery rules on a going-forward basis. Public input hearings were held at the Allegheny County Courthouse on October 14, 2008, at 2:00 p.m. and 7:00 p.m., where seven people testified in opposition to the proposed increase in rates.

As part of its investigation and analysis of the filings, the OCA served fifteen sets of discovery on Equitable. On October 8, 2008, the OCA submitted the direct testimony of Lafayette K. Morgan, Jr. (OCA Statement No. 1), David C. Parcell (OCA Statement No. 2), Glenn A. Watkins (OCA Statement No. 3), and Roger D. Colton (OCA Statement No. 4). On October 14, 2008, the OCA submitted the corrected direct testimony of Lafayette K. Morgan, Jr. (OCA Statement No. 1 (Corrected)) and Roger D. Colton (OCA Statement No. 4 (Corrected)). The OCA submitted the rebuttal testimony of Glenn A. Watkins (OCA Statement No. 3R) on October 31, 2008. On November 14, 2008, the OCA submitted the surrebuttal testimony of

Lafayette K. Morgan, Jr. (OCA Statement No. 1S), David C. Parcell (OCA Statement No. 2S), Glenn A. Watkins (OCA Statement No. 3S), and Roger D. Colton (OCA Statement No. 4S). On November 18, 2008, the OCA submitted the Revised Schedules to the surrebuttal testimony of Lafayette K. Morgan, Jr. The Company, OTS and OSBA agreed to stipulate to the admission of the foregoing OCA Statements into the record, and the Statements were admitted into the record without objection on November 19, 2008.

Pursuant to the Commission's policy of encouraging settlements that are in the public interest, the Company, OCA, OTS, OSBA, Hess and IOGA (Joint Petitioners) met on numerous occasions to discuss the possibility of reaching a settlement. For the reasons set forth below, the OCA submits that the Settlement is in the public interest.

The following represent the terms of the Settlement that directly address the OCA's concerns raised in this case. The OCA expects that the other signatory parties will address those areas of the Settlement that apply to their issues. As with all settlements, the terms and conditions represent compromise by all parties on individual issues. The OCA submits that the Settlement must be taken as a whole. When reviewed on this basis, the OCA respectfully submits that the Settlement fairly resolves the issues in the case and is in the public interest.

II. DISTRIBUTION REVENUE REQUIREMENT

Based on OCA witness Morgan's adjustments to the Company's projected rate base and O&M expenses for the future test year ending December 31, 2008, and OCA witness Parcell's recommended cost of equity and overall rate of return, the OCA recommended that Equitable receive \$29.4 million in additional revenue. See OCA Statement No. 1 (Corrected) at 3. After conducting additional discovery and reviewing Equitable's rebuttal testimony, OCA witness Morgan made additional adjustments and in his surrebuttal testimony, recommended that the Company receive \$31.4 million in additional distribution revenues. OCA Statement No. 1S at 1.

Mr. Morgan also calculated the impact of adjustments recommended by OCA witness Watkins concerning negotiated rate discounts and OCA witness Colton regarding the universal service charge rider (Rider D). These issues will be separately discussed below in Sections III and IV, respectively.

The Joint Petitioners reached a settlement regarding the Company's revenue requirement and agreed to \$38.35 million in additional revenues. The Settlement provides:

A. Revenue Increase/Rates/Rate Design

1. Equitable may file a tariff supplement on one day's notice that produces additional annual base rate operating revenue of \$38,350,000 in a "black box" settlement of issues related to Supplement No. 60 and the additional annual operating revenue of \$51.9 million proposed thereby. Joint Petitioners do not object to the settlement tariff supplement becoming effective prior to March 30, 2009, the end of the present suspension period for Supplement No. 60.

...

B. Stay Out/Gas Competition Investigation/Logs

1. Equitable agrees that it will not file a general base rate case prior to April 1, 2010; provided, however, that the foregoing provision shall not prevent Equitable from filing a tariff or tariff supplement proposing a general increase in base rates in compliance with Commission orders or in response to fundamental changes in regulatory policies or federal or state tax policies affecting Equitable's rates.

Settlement at 7.

The proposed Settlement provides for an overall distribution base rate increase of \$38.35 million, approximately \$13.55 million less than the rate increase amount of \$51.9 million originally requested by Equitable.¹ This rate increase reflects an increase in overall revenues of approximately 7.4% as compared to the Company's original request of a 10% increase in overall revenues. Equitable has agreed to refrain from filing for another base rate increase before April 1, 2010. This proposed stay-out provision should prevent another rate increase before January

¹ The Settlement also recognizes a flowback of approximately \$360,000 of pooling fees. See Appendix A attached to the Joint Stipulation.

2011, assuming the Company files as soon as the stay-out provision expires and assuming the next case is fully litigated. Thus, Equitable's ratepayers will be assured some level of rate stability by the Settlement.

The revenue requirement provided for in the Settlement is within the range of reasonable outcomes of this proceeding. Equitable has not had a base rate increase since 1997, approximately 11 years. The Settlement mitigates the impact of this request and provides for an extended period of rate stability.

III. NEGOTIATED RATE DISCOUNTS

In his direct testimony, OCA witness Watkins testified that Equitable's claims for revenue shortfall of approximately \$22.79 million based on negotiated rates had not been adequately justified. The \$22.79 million was associated with discounts that are provided to customers that have competitive alternatives. Mr. Watkins also recommended that the Company's claim be disallowed unless and until the Company provided justification that the discounts provided are just and reasonable. See OCA Statement No. 3 at 25-35. Mr. Watkins also recommended that the NRG Energy discount for gas retainage not be recovered through a surcharge (Rider C) but instead should be recovered through base rates. Id. at 36.

As Mr. Watkins points out in his direct testimony, in western Pennsylvania, the use of negotiated rate discounts associated with gas-on-gas competition has evolved. OCA Statement No. 3 at 26-27. The benefits are available to only selected customers based purely on geographic location in a utility's service area, and the practice holds the utility's remaining ratepayers captive. Id. Specifically, Mr. Watkins states:

It is my understanding that the practice of negotiated rates has been prevalent in western Pennsylvania as a result of what is known as "gas on gas" competition. This gas on gas competition exists primarily because of the way natural gas distribution systems evolved in the Pittsburgh area prior to regulation. This gas on gas competition results from the geographic location of specific

customers such that certain natural gas customers are located in close proximity to either interstate pipelines or other natural gas LDC's. It should be noted that customers who are not located in reasonably close proximity to alternative natural gas facilities, are not eligible for gas on gas negotiated rate discounts as a practical manner. Furthermore, these geographic proximity reasons for discounted rates apply to all classes of customers in varying degrees throughout western Pennsylvania.

With regard to rate discounts associated with gas on gas competition among LDC's, I do not think it in the public interest to continue such a practice. This is true because the benefits that generally accrue due to competitive market forces are only available to selected customers purely based on geographic location within a utility's service area. Furthermore, gas on gas competition among natural gas LDC's is a zero sum game with captive ratepayers being the losers.

While it is true that revenue generated from discounted rate customers contributes to the recovery of gas utilities fixed costs and thereby result in lower rates than if no revenue was achieved from discounted rate customers, the downward spiral in negotiated rates due to LDC versus LDC competition is a zero sum game as far as societal resources are concerned. As an example, captive customer rates served by Utility A are higher than they otherwise would be due to Utility B attempting to gain business from certain Utility A customers. Similarly, captive customers served by Utility B are higher than they otherwise would be due to Utility A attempting to gain the business of selected customers from Utility B.

OCA Statement No. 3 at 26-27. Additionally, Mr. Watkins testified as to the importance of the need for rigorous analysis and review of negotiated rates when captive customers are asked to pay the cost of these discounts. See OCA Statement 3 at 29-30.

While acknowledging in his surrebuttal testimony that it is likely that much, if not most, of Equitable's negotiated rates could be justifiable given the current practice of allowing competition between intrastate local distribution companies (LDCs), the cost to other ratepayers from this practice and the need to fully justify each and every discount raises serious concerns. See OCA Statement No. 3S at 4. Among other things, Mr. Watkins recommended that the Commission open a generic investigation into the costs and benefits of LDC gas-on-gas

competition in Western Pennsylvania to ratepayers, utility shareholders and the Commonwealth at large. Id.

The Settlement in this matter provides:

A. Revenue Increase/Rates/Rate Design

...

4. All negotiated delivery service agreements are accepted as just and reasonable.

5. The NRG retainage discount will be recovered through Equitable's purchased gas cost filing.

...

B. Stay Out/Gas Competition Investigation/Logs

...

2. Equitable agrees to join with the OCA in petitioning the Commission to open a generic investigation concerning gas-on-gas competition in western Pennsylvania.

3. Equitable will agree to maintain a highly confidential log of negotiated delivery service agreements available for review by the Office of Trial Staff, the Office of Consumer Advocate and the Office of Small Business Advocate. The log will contain the following information related to negotiated agreements:

- Customer number, effective date of the agreement, the reason(s) for offering a negotiated delivery agreement, supporting work papers relied upon to substantiate the negotiated agreement, and an analysis which evaluates the contribution to overall fixed costs provided by each customer.

Settlement at 7, 8.

The Settlement provides that Equitable will join with the OCA in petitioning the Commission to initiate an investigation into gas-on-gas competition in Western Pennsylvania and that Equitable will maintain detailed logs regarding its negotiated delivery service agreements, including an analysis of each discount that will aid in determining whether the discount was cost justified. These provisions specifically meet those recommendations raised by OCA witness Watkins in his testimony. Equitable's ratepayers will benefit by having the Commission determine the extent, if any, negotiated delivery contracts aid ratepayers as a whole, and if there is no benefit found, having the Commission address this issue. Additionally, the log

agreed to be kept by Equitable will result in better record keeping and analysis. This log and the detailed analysis will be available in all future cases in determining the reasonableness of negotiated rate discounts. The NRG retainage discount will now be considered annually like Equitable's other retainage discounts, which the OCA submits is reasonable.

IV. RIDER D

In its filing, Equitable estimated the costs of its Customer Assistance Program (CAP) for purposes of establishing the rate that will be charged to residential customers to recover those costs. OCA witness Colton, however, estimated that the Company may have overstated its universal service costs by about \$5.9 million due to improper calculation of the number of monthly bills issued to its CAP customers, inclusion of administrative costs that should be in base rates and failure to account for cost offsets. See OCA Statement No. 4 (Corrected) at 6-20. After conducting additional discovery and reviewing Equitable's rebuttal testimony, which adopted some of OCA's recommendations, including providing CAP credits upon rendering a customer's bill, OCA witness Colton updated his adjustments and recommended a downward adjustment to the Company's universal service cost recovery of approximately \$5.7 million for the first year.

With regard to CAP costs, the Settlement in this matter states:

C. Universal Service and Energy Conservation Program
Rider D

1. Effective with bills rendered no later than February 1, 2009 Equitable will provide CAP credits when bills are issued upon the completion of CIS programming modifications.

2. Equitable's Rider D tariff will be established initially at \$1.30/Mcf on the effective date of rates in this case, which recognizes a cost recovery of \$25,483,797. The Company will be permitted to recover the following costs through a reconcilable Rider D surcharge: CAP credits, CAP arrearage forgiveness, LIURP.

3. CAP administrative expenses will be collected in base rates.

4. Universal Service cost offsets: Equitable will recognize universal service cost offsets when the base level of CAP shortfall (\$23,836,467) and CAP arrearages (\$780,397) set in this proceeding, which is \$24,616,864 in the aggregate, and CAP participation of 20,335 CAP customers are both exceeded. The CAP offset will be determined using 12% of the average CAP credit attributable to CAP customers in excess of 20,335. These offsets will be applied if necessary as a credit to Rider D on a quarterly adjustment basis. Reconciliation will be reflected in the October quarterly filing following the close of the annual reconciliation period of September through August. The adjustment/reconciliation procedure will be similar to Section 1307(f) and the purchase gas cost rate procedure where there are quarterly adjustments and annual reconciliations.

Settlement at 8.

In the Settlement, the Company agreed to adjust the estimate of projected CAP program costs that are used to calculate the surcharge to customers. Although the surcharge will be reconciled annually, using a refined estimate of costs should help to minimize over- or under-collections from the residential customers.

Further, the Company agreed to reflect cost offsets in its universal service cost recovery mechanism associated with increased participation to avoid any double recovery of costs included in base rates. Specifically, when the CAP program exceeds 20,335 participants and \$24,616,864 in CAP credits and arrearages, the Company will apply a credit to the surcharge for each new customer. The credit is based on a credit factor of 12% (Base Credit) of the average CAP credit and is initially estimated to be approximately \$172 for each customer over 20,335. See Settlement at Appendix C. The OCA submits that the 12% credit factor will more accurately account for the working capital offset and capture the fact that cost offsets and savings should be matched with cost recovery as the CAP program grows.

The OCA submits that these provisions will provide benefits to CAP customers by allowing the program to grow and to residential non-CAP customers by recognizing the savings and offsets generated by the program.

V. RATE STRUCTURE

A. Rate Allocation

The Settlement provides that Equitable can increase base rates by amounts designed to produce a \$38.35 million increase in annual operating revenues, in lieu of the increase of \$51.9 million originally proposed by the Company. This results in an increase in total operating revenues of approximately 7.4% as opposed to the 10% increase originally requested by the Company. Under the revenue allocation agreed to by the Joint Petitioners, the Equitable residential class would experience an increase of \$32.68 million, or 7.5%. On a distribution-only basis, the Settlement provides a 30.2% increase for the residential class, compared to the Company's filed proposal of 37%. Under the proposed Settlement, the average total monthly bill for an Equitable residential customer using 7.3 Mcf per month would rise from \$138.33 to \$149.26 per month or by 7.2%. This is in lieu of the 10.0% increase, or \$152.17 monthly bill, that was originally proposed in the filing.

Based on the OCA's analysis of the Company's filing and discovery responses received, the revenue allocation under the proposed Settlement represents a result that would be within the range of likely outcomes in the event of full litigation of the case. The allocation is appropriate and when accompanied by other important conditions contained in the proposed Settlement, yields a result that is just and reasonable.

B. Residential Rate Design

In its filing the Company proposed increasing the residential customer charge from \$11.65 to \$20.00. See Equitable Statement No. 1 at 20. In his direct testimony, OCA witness

Watkins recommended that the residential customer charge be increased to \$12.50 rather than the increase to \$20.00 proposed by the Company. See OCA Statement No. 3 at 25.

Under the Settlement, Equitable's monthly residential customer charge would increase from \$11.65 to \$13.25, or 13.7%, rather than increase to \$20.00 as originally proposed by the Company. The commodity charges will be increased to recover the remaining revenue increase from the residential class.

The OCA submits that eliminating most of the customer charge increase will significantly benefit residential customers. By providing a customer charge \$6.75 lower than the Company's proposed charge and recovering the remaining revenue through the commodity charges, the commodity charges can provide necessary signals to customers regarding conservation.

The OCA submits that the residential rate design established through the settlement is reasonable and consistent with sound ratemaking principles. Combined with a \$13.55 million lesser revenue increase, these rate design changes result in rates that are below the rates originally proposed by the Company and within the range of the likely outcomes in the event of full litigation of the case.

VI. CONCLUSION

For the foregoing reasons, the Office of Consumer Advocate submits that the terms and conditions of the Settlement are in the public interest and therefore, should be approved.

Respectfully submitted,



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Date: December 19, 2008

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CERTIFICATE OF SERVICE

Pennsylvania Public Utility Commission,	:	
	:	
v.	:	Docket No. R-2008-2029325, et al
	:	
Equitable Gas Company	:	
	:	
Independent Oil and Gas Association of	:	
Pennsylvania	:	
v.	:	C-20066800
Equitable Gas Company	:	

I hereby certify that I have this day served a true copy of the foregoing documents, the Statement in Support of Settlement on behalf of the Office of Consumer Advocate, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 19th day of December 2008.

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