

Appendix K

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :
 :
 v. : Docket No. R-2010-2201702
 :
 Peoples Natural Gas Company LLC :
 :

STATEMENT OF THE OFFICE OF CONSUMER ADVOCATE
IN SUPPORT OF
JOINT PETITION FOR SETTLEMENT OF RATE INVESTIGATION

The Office of Consumer Advocate (OCA), one of the signatories to the Joint Petition for Settlement of Rate Investigation (Settlement), finds the terms and conditions of the proposed Settlement to be in the public interest for the reasons discussed below. The Settlement satisfactorily addresses the issues raised in the OCA analysis of the Peoples Natural Gas Company L.L.C. (Peoples) base rate filing, Public Input Hearing testimony, and Peoples' discovery responses to Parties' interrogatories. The Settlement terms do not reach all recommendations the OCA proposed in litigation. Nevertheless, likely results are the best lens through which a party to litigation may evaluate settlement terms; the terms and rates proposed here are within the range of expected litigation results. The Pennsylvania Public Utility Commission should therefore find that the proposed Settlement is in the public interest and should approve it without modification.

I. INTRODUCTION

The OCA notes that the Background section at pages 1 through 4 of the Settlement is

accurate. As to public input testimony and customer communications regarding the rate case, the OCA would note that the most common consumer concern was affordability.

The OCA will detail below how the Settlement terms and conditions satisfy the issues raised in the OCA Formal Complaint, in the testimony of its expert witnesses, and of individual consumers in this proceeding. While the Settlement is in the nature of a “black box” with few identified adjustments, the overall revenue number agreed to by the Parties shows that the Settlement, as a whole, is a reasonable resolution of the individual issues raised by the OCA. The OCA will not discuss every Settlement term; the OCA looks to each Party to discuss how the Settlement resolves the issues raised by that Party. To the extent the OCA does not address a settlement term, the OCA does not oppose the term for the purpose of resolving this proceeding. By the resolution of these issues, and the issues raised by the other Parties, approval of the Settlement is in the public interest.

II. RESOLUTION OF OCA ISSUES

A. Revenues

The OCA Formal Complaint and Public Statement, testimony, and advocacy focused on how Peoples’ proposed rates did not appear to be just and reasonable. The proposed Settlement resolves these issues. The Settlement provides for an approximate 24.9% reduction in Peoples’ \$70,527,620 rate increase request to \$53,000,000. Settlement at ¶ 21. The Settlement increase represents a 16.2% revenue increase designed to produce total annual revenue not to exceed \$381,115,000 and is in lieu of the 21.4% increase originally proposed.

The initial overall revenue increase recommended by the OCA was approximately \$33,176,602 in lieu of Peoples’ \$70,218,751 initial claim. OCA St. No. 1 at 4. In its surrebuttal

testimony, the OCA revised its recommended increase to \$47,663,816 based on various information provided by Peoples and as a result of the as-yet unapproved settlement in Peoples' concurrent Rager Mountain Application at Docket No. A-2010-2203699. OCA St. No. 1S at 10. Thus, the proposed increase is approximately 10.2% larger than the OCA recommendation. The proposed Settlement revenue increase of \$53 million is reasonable given likely litigation outcomes on the OCA's recommended adjustments at this revenue level.

B. Residential Rates

The settlement rates, before applicable ratepayer credits, will increase the bill for an average Peoples' residential customer using 90 Mcf per year from \$73.09 per month to \$85.02 per month, or \$11.93 (16.3%), compared to the \$17.86 per month (approximately 25%) increase originally proposed by Peoples. The Company's residential customer charge will increase from \$11.00 to \$13.75, before applicable ratepayer credits, compared to the \$16.00 customer charge originally proposed in Peoples' filing. However, a ratepayer credit resulting from the recent acquisition of Peoples will be implemented when new rates become effective which will reduce the average residential bill from \$85.02 per month to \$82.62 and will reduce the monthly customer charge from \$13.75 to \$12.25. Taking into account the ratepayer credits, the increase to the average residential customer will be 13%.

This Settlement revenue increase and resulting rate increase represent amounts within the range of likely litigation outcomes. As such, this aspect of the Settlement represents a reasonable resolution of the revenue adjustments recommended by the OCA. The resolution of these issues, and the issues raised by the other Parties, supports Commission approval of the Settlement as being in the public interest.

C. Rate Design

OCA Statement No. 3, the direct testimony of OCA witness Jerome Mierzwa, recommended that the Commission reject Peoples' proposed \$16 residential customer charge, a \$5 increase, and retain Peoples current residential customer charge of \$11. OCA St. No. 3 at 29-32. Settlement paragraph 37 provides that the residential customer charge will increase from \$11 to \$13.75. In addition, the Settlement accounts for the rate credit trust established at Docket No. A-2008-2063737, the SteelRiver Infrastructure Fund North America acquisition of Peoples from Dominion. The effect of applying that credit to the Settlement customer charge is to reduce the \$13.75 charge to \$12.25, a reduction of \$1.50, for as long as the trust contains funds (approximately three years). The trust will also provide a volumetric discount of approximately \$0.13 per Mcf for the same approximate period. Settlement at ¶ 37. This resolves the OCA rate design issues to its satisfaction, is consistent with expected litigation outcomes, and should be approved by the Commission as being in the public interest.

D. Specific Accounting Adjustments

The OCA performed extensive discovery and analysis on Peoples' revenue requirement claims. OCA Statement Number 1, the direct testimony of Thomas Catlin, contains an array of proposed adjustments. A summary of all these may be found at OCA St. No. 1, Schedule TSC-3. These range from simple expense adjustments to the appropriate regulatory treatment of complex federal tax claims. While the overall Settlement revenue increase inherently addresses most of the OCA accounting adjustments, the Settlement specifically addresses several accounting issues.

Settlement paragraphs 23 and 24 respectively establish amortization and depreciation

periods for contested claims. Paragraph 23 establishes a three-year amortization period for a single large claim paid in 2010 thus permitting a reasonable normalization of injuries and damages expenses. OCA St. No. 1 at 22. Paragraph 24 provides for a five-year depreciation period for capitalized desktop software licenses. This is consistent with the OCA recommendation regarding this expense at OCA St. No. 1 at 18.

Settlement paragraphs 33 and 34 address Post Retirement Benefits. Paragraph 33 memorializes that Peoples will continue to recover FAS 112 Post-retirement Benefit costs on a pay-as-go basis in accord with Docket No. R-00943252. Paragraph 34 addresses the unfunded balance of Peoples Accumulated Postretirement Benefits Obligation authorized for recovery as a regulatory asset at Docket No. R-00953318. In its accounting testimony, the OCA recommended that the Commission exclude the amortization from Peoples' expense claim because Peoples included the amortization both as a regulatory asset and as a claim within its total funding deficiency. That is, the OCA testimony provides that Peoples made the error of requesting a double-recovery of the amount. OCA St. No. 1 at 14. Paragraph 34 of the Settlement, through the proposed Settlement rates, addresses this issue to the satisfaction of the OCA.

E. Competitive Discounts

At pages 32 through 35 of OCA St. No. 3, the OCA provided testimony supporting an approximate \$2.6 million downward adjustment to Peoples' residential class cost allocation. The adjustment represents costs placed on the residential class by Peoples' discounting service to competitively situated customers, i.e., large customers located where a choice between or among more than one natural gas distribution company is present. The OCA recommended that these costs not be imposed on the residential customer class and be paid by those customer classes

generating the discount, because in a strict economic sense, these competitive discounts represent a cost to serve large customers -- not residential customers. Settlement paragraphs 35 through 40 and their associated appendices provide for class revenue requirements and allocations which, in part, provide for the resolution of the cost responsibility issues raised by the Parties.

Peoples has also agreed to join with the Parties to request a generic investigation or rulemaking to address the issues presented by this type of gas-on-gas competition and its ensuing rate discounting practices. The Settlement rates, settlement revenue allocations, and future actions by Peoples resolve this issue to the satisfaction of the OCA. Settlement at ¶¶ 35-40.

G. Distribution System Improvement Charge

At pages 28 through 32 of OCA St. No. 1, the OCA provided testimony showing that Peoples' proposed Distribution System Improvement Charge (DSIC) was improper under established ratemaking principles, and in any event, contained incorrect calculations. In addition, there are no legislative or regulatory mechanisms in place to permit Peoples to institute such a surcharge. Regardless, Peoples filing and testimony here proposed to tariff a DSIC charge. Peoples reasoned that if a legislative or regulatory mechanism were approved, it would stand ready to implement the surcharge.

The Settlement resolves these issues to the satisfaction of the OCA. Paragraphs 30 through 31 of the Settlement provide for the withdrawal of Peoples DSIC proposal, without prejudice, clarifies the contents any such proposal should contain, if legislative authority is subsequently granted for such a mechanism, and preserves the rights of the Parties to challenge any Peoples' DSIC proposal. This resolves the OCA issue to its satisfaction and is consistent with expected litigation outcomes, and is in accord with the public interest.

H. Pennsylvania Producer Enhancement Services

Peoples' Pennsylvania Producer Enhancement Services Program (PES) is a program designed to make more locally-produced Pennsylvania gas available for distribution to Peoples' customers. Local gas producers pay Peoples a per-unit Mcf fee to compensate Peoples for its investment in bringing their local gas to market. This amounts to revenue of approximately \$6 million. Peoples proposed to share these revenues 50/50 with ratepayers net of costs, resulting in a proposed revenue credit of \$3 million in this proceeding. OCA St. No. 3 at 39. In its Direct testimony, the OCA recommended that the Commission reduce Peoples' cost of service claim by an additional \$3 million, effectively returning all PES revenues to ratepayers. The OCA recommended this adjustment because of its position that Peoples should take a consistent approach to revenues; i.e., it should not fully shift revenue shortfalls onto consumers at the same time it claims revenue surpluses for itself. OCA St. No. 3 at 40. Settlement paragraph 25 resolves this issue.

Settlement paragraph 24 provides that Peoples will invest \$3 million of the approximate \$6 million in PES revenue discussed above to reduce lost and unaccounted for gas. Settlement paragraph 25 provides for the timing of that investment. Peoples will use the remaining \$3 million as a cost of service offset to achieve the \$53 million Settlement revenue increase. This is a reasonable resolution to this issue -- it provides value to ratepayers through reduced lost and unaccounted for gas expense and it reduces Peoples' over-all cost of service. This condition supports approval of the Settlement as being in the public interest.

I. Purchase of Receivables

At pages 45-46 of OCA Statement Number 3, the OCA provided testimony critical of two aspects of Peoples' proposed purchase of receivables (POR) program. OCA witness Mierzwa testified that Peoples was unclear on which receivables were eligible for inclusion in its POR, and did not include restrictions on security deposits imposed on residential customers or other credit limits that may be used by natural gas suppliers. Mr. Mierzwa also provided suggested language to correct these issues. In OCA Statement Number 5-R, the rebuttal testimony of Barbara Alexander, Ms. Alexander agreed with Mr. Mierzwa regarding Peoples and addressed POR issues raised by Parties other than Peoples. OCA St. No. 5-R. These included the unbundling of bad debt charges, the inclusion of late fees in the calculation of the bad debt percentage, and conditions that should attach to any "all in/all out" proposal.

Settlement paragraphs 42 through 44 resolve these issues to the satisfaction of the OCA. These paragraphs define what should and should not be included in receivables purchased by Peoples, places limit on how deposits and credit are handled when customers request service from a competitive gas supplier, provides for customer notice that termination can result from non-payment of a Peoples or competitive supplier basic bill, requires confirmation of revised terms and conditions should alternative suppliers opt to participate in Peoples' POR program, provides for on-request reporting, and provides that any revenue shortfall from POR expenses or costs will not be recovered from sales customers. These provisions resolve the OCA issues to its satisfaction, are consistent with expected litigation outcomes, and should be approved by the Commission as being in the public interest.

J. Universal Service/Low Income Assistance

OCA Statement Number 4, the direct testimony of Roger D. Colton, raised a number of

issues regarding Peoples' proposed universal services and low income assistance programs. Mr. Colton addressed whether Peoples reasonably responded to the Pennsylvania Department of Public Welfare's (DPW) new policy regarding the posting of LIHEAP benefits to the accounts of Customer Assistance Program ("CAP") participants, whether the recovery of universal service program costs through Peoples' proposed reconcilable surcharge ("Rider F") is reasonable, whether Peoples had proposed reasonable modifications to its CAP program; whether Peoples' proposed cost-recovery for its universal service programs other than CAP is reasonable; and whether Peoples proposal to include new components in its universal service program is reasonable.

The following provisions from Settlement paragraphs 45 through 48 resolve these issues to the satisfaction of the OCA. In summary, the pertinent Settlement terms included in those paragraphs provide that:

- CAP customers eligible for the Low Income Home Energy Assistance Program (LIHEAP) have an obligation to apply for LIHEAP, but will not be terminated from Peoples' CAP program for failure to do so. Settlement ¶ 45(a).
- Peoples will investigate improvements to its CAP income verification process. Settlement ¶ 45 (b)
- In response to DPW mandates, Peoples will seek approval of a CAP Plus Program in its June 1, 2011 Universal Service and Energy Conservation Plan filing, and will establish the calculation of the CAP Plus amount as outlined in the Settlement. Settlement ¶ 45(e).
- Peoples will modify its CAP Plus calculations, billing system, and tariffs should DPW remove its current directives on posting LIHEAP grants to CAP "asked-to-pay" amounts. Settlement ¶ 45(f).
- Defines the CAP participation levels in Rider F at \$4,681,170 as of June 30, 2011. Settlement ¶ 46.
- Rider F CAP credits will be limited to actual CAP credits and arrearage forgiveness earned. Settlement ¶ 47(a).

- Rider F CAP participation projections will reflect the projected average net change in the number of CAP participants for the quarter. Settlement ¶ 47(b)
- Defines the “CAP credit amount.” Settlement ¶ 47(c).
- Establishes a reasonable offset to CAP credits and arrearage forgiveness amounts to eliminate the double-recovery of uncollectable expense. Settlement ¶ 47(d).
- Provides that the incremental costs of a specialized universal service call group will not be recoverable under Rider F. Settlement ¶ 47(e).
- Establishes that Peoples will use historical payment statistics concerning earned credits and arrearage forgiveness to project amounts recoverable under Rider F. Settlement ¶ 47(f).
- Supports Peoples’ proposed Emergency Furnace and Service Repair Program and Community Weatherization Program and permits the recovery of the costs of these programs under Rider F. Settlement ¶ 48.

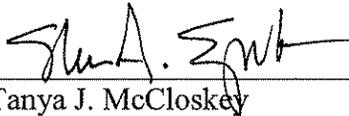
These terms and conditions resolve the issues developed by the OCA in its Statement Number 4 to the satisfaction of the OCA. These terms and conditions are likewise consistent with expected litigation outcomes, and should be approved by the Commission as being in the public interest.

III. CONCLUSION

The terms and conditions of the proposed Settlement represent a fair and reasonable resolution of the issues and claims developed by the OCA in this proceeding. If approved, the proposed Settlement would produce revenues within a range of anticipated litigation outcomes. Finally, the Commission and all Parties would benefit by the reduction in rate case expense and the conservation of resources made possible by adoption of the Settlement in lieu of full litigation.

WHEREFORE, for the foregoing reasons, the Office of Consumer Advocate submits that the Commission approval of the proposed Settlement is in public interest.

Respectfully Submitted,



Tanya J. McCloskey
Senior Assistant Consumer Advocate
PA Attorney I.D. # 50044

Shaun A. Sparks
Assistant Consumer Advocate
PA Attorney I.D. # 87372

James A. Mullins
Assistant Consumer Advocate
PA Attorney I.D. # 77066

Counsel for:
Irwin A. Popowsky
Consumer Advocate

Office of Consumer Advocate
555 Walnut Street
5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152
Dated: April 7, 2011
140695