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June 27, 2011

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor North
P.O. Box 3265
Harrisburg, PA 17105-3265

RE: Pennsylvania Public Utility Commission, Office of Consumer Advocate, Office of Small Business Advocate, Columbia Industrial Intervenors, The Pennsylvania State University, Pennsylvania Communities Organizing for Change d/b/a ACTION United, Nettie Pelton and Carol Collington, James Landis, Marie Weaver, Margaret Sentz, Albert Jochen, Patsy Orlando, Maureen A. Doerr-Roman, and Shipley Energy Company, Dominion Retail, Inc., Interstate Gas Supply, Inc., v. Columbia Gas of Pennsylvania, Inc. - Docket Nos. R-2010-2215623, C-2011-2224941, C-2011-2224985, C-2011-2227004, C-2011-2230067, C-2011-2232186, C-2011-2224944, C-2011-2225050, C-2011-2225828, C-2011-2225878, C-2011-2227222, C-2011-2231015

Pennsylvania Public Utility Commission, Office of Small Business Advocate, Office of Consumer Advocate, v. Columbia Gas of Pennsylvania, Inc. - Docket Nos. R-2010-2201974, C-2010-2208133 and C-2010-2208503 (Consolidated)

Dear Secretary Chiavetta:

Enclosed, for filing, is the Main Brief of Columbia Gas of Pennsylvania, Inc. in the above-referenced proceedings.

Copies have been provided to the persons as indicated on the certificate of service.

Respectfully Submitted,

Michael W. Hassell

MWH/jl
Enclosures

cc: Honorable Katrina L. Dunderdale
Certificate of Service
David Huff
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CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing have been served upon the following persons, in the manner indicated, in accordance with the requirements of § 1.54 (relating to service by a participant).

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	Docket Nos. R-2010-2215623
Office of Consumer Advocate	:	C-2011-2224941
Office of Small Business Advocate	:	C-2011-2224985
Columbia Industrial Intervenors	:	C-2011-2227004
The Pennsylvania State University	:	C-2011-2230067
Pennsylvania Communities Organizing for	:	C-2011-2232186
Change d/b/a ACTION United, Nettie	:	
Pelton and Carol Collington	:	
James Landis	:	C-2011-2224944
Marie Weaver	:	C-2011-2225050
Margaret Sentz	:	C-2011-2225828
Albert Jochen	:	C-2011-2225878
Patsy Orlando	:	C-2011-2227222
Maureen A. Doerr-Roman	:	C-2011-2231015
	:	
and	:	
	:	
Shipley Energy Company	:	
Dominion Retail, Inc.	:	
Interstate Gas Supply, Inc.	:	
	:	
Intervenors	:	
	:	
v.	:	
	:	
Columbia Gas of Pennsylvania, Inc.	:	

Pennsylvania Public Utility Commission	:	Docket Nos. R-2010-2201974
Office of Small Business Advocate	:	C-2010-2208133
Office of Consumer Advocate	:	C-2010-2208503
	:	
v.	:	
	:	
Columbia Gas of Pennsylvania, Inc.	:	

MAIN BRIEF OF COLUMBIA GAS OF PENNSYLVANIA, INC.

TO ADMINISTRATIVE LAW JUDGE KATRINA L. DUNDERDALE:

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Date: June 27, 2011

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I. INTRODUCTION

Columbia Gas of Pennsylvania, Inc. ("Columbia" or the "Company") is a "public utility" and "natural gas distribution company" ("NGDC") as those terms are defined in Sections 102 and 2202 of the Public Utility Code, 66 Pa.C.S. §§ 102 and 2202. Columbia provides natural gas sales, transportation, and/or supplier of last resort services to approximately 414,000 retail customers in portions of 26 counties of Pennsylvania.

In this proceeding, Columbia requests Pennsylvania Public Utility Commission ("Commission") approval of a base rate increase, with an anticipated effective date on or before October 18, 2011.

As set forth in a Joint Petition for Partial Settlement to be filed in this proceeding, and in the various statements in support thereof, the parties have achieved settlement on all issues in this case, with just two exceptions. The two issues reserved for resolution by Administrative Law Judge Katrina A. Dunderdale (the "ALJ") and the Commission concern the residential rate design and Columbia's continued use of CAP Plus. Joint Petitioners have agreed to a base rate increase, an allocation of that increase to the rate classes and the rate design for non-residential rate classes to recover the allocated portions of the rate increase to such classes. Other issues raised by the Company's filing and by intervening parties also have been resolved. Columbia will address in this Brief the two issues reserved for litigation. Columbia's explanation of the Partial Settlement is contained in Columbia's detailed Statement in Support of the Joint Petition for Partial Settlement.

A. STATEMENT OF THE CASE

On January 14, 2011, Columbia filed the above-captioned 2011 Base Rate Filing, together with Supplement No. 163 to its Tariff Gas – Pa. P.U.C. No. 9 ("Supplement No. 163"), responses to Commission filing requirements and standard data requests, and supporting direct

testimony and exhibits. In the 2011 Base Rate Filing, Columbia proposed new tariff rules and regulations and proposed increased rates designed to produce an overall revenue increase of approximately $37.8 million annually based upon the *pro forma* level of operations for the twelve months ended September 30, 2011.

Supplement No. 156 to Tariff Gas – Pa. P.U.C. No. 9 ("Supplement No. 156" or "BTU factor proceeding"), which proposed a BTU adjustment factor to Mcf billing, was filed with the Commission on September 29, 2010 at Docket No. R-2010-2201974, and was suspended to May 27, 2011 by Commission Order dated November 19, 2010 at R-2010-2201974. On January 20, 2011, Columbia filed a Motion to Consolidate Supplement No. 156 with the base rate filing. Further, Columbia agreed to voluntarily extend the effective date for Supplement No. 156 to coincide with the Company's base rate filing.

On January 24, 2011, Administrative Law Judge Katrina L. Dunderdale issued an order consolidating the BTU factor proceeding with the 2011 Base Rate Filing.

Complaints were filed by the Office of Small Business Advocate ("OSBA"), the Office of Consumer Advocate ("OCA"), Columbia Industrial Intervenors ("CII"), the Pennsylvania State University ("PSU"), and Pennsylvania Communities Organizing for Change d/b/a ACTION United, Nettie Pelton and Carol Collington ("PCOC"). A Petition to Intervene was filed by Dominion Retail, Inc., Shipley Energy Company and Interstate Gas Supply (collectively "NGS Intervenors"). In addition, several customers filed formal complaints.

On February 14, 2011, the Company filed with the Commission Supplement No. 164 to Tariff Gas Pa. P.U.C. No. 9 ("Supplement No. 164"). Supplement No. 164, issued February 14, 2011 with an effective date of March 15, 2011, suspended the proposed rates contained in Tariff

Supplement No. 163 until March 18, 2011, to permit further time for the Commission to adopt its Investigation Order.

On March 14, 2011, Columbia served Supplemental Direct Testimony and related exhibits of Mark R. Kempic, John J. Spanos, Marianne L. Schuster, Danny G. Cote and John M. O'Brien related to revisions to Future Test Year Plant Additions and income taxes.

In an Order entered March 17, 2011, the Commission initiated an investigation of Columbia's proposed general rate increase. Supplement No. 163 was suspended by operation of law pursuant to Section 1308(d) of the Public Utility Code, 66 Pa.C.S. § 1308(d), for up to seven months or until October 18, 2011, unless permitted by Commission Order to become effective at an earlier date. In its Investigation Order, the Commission also identified several areas of concern to be investigated and addressed by the parties in this proceeding.

On March 18, 2011, Columbia filed with the Commission Supplement No. 165 to Tariff Gas Pa. P.U.C. No. 9 ("Supplement No. 165"). Supplement No. 165, issued March 18, 2011 with an effective date of March 18, 2011, suspended the proposed rates contained in Tariff Supplement No. 163 until October 18, 2011.

An initial Prehearing Conference was held on March 23, 2011. At the prehearing conference, the ALJ established the litigation schedule. The ALJ also set forth discovery rules, which included shorter response times than those provided in the Commission's regulations. See 52 Pa. Code §§ 5.341 *et seq.*

On March 24, 2011, the ALJ issued a Prehearing Order that confirmed the litigation schedule established at the Prehearing Conference.

On April 18, 2011, the ALJ issued an Order Scheduling Public Input Hearings in Columbia's service territory. Pursuant to this Order, one public input hearing was held on May

16, 2011 at 1:00 p.m. in Pittsburgh, Pennsylvania, and one public input hearing was held on May 16, 2011 at 6:00 p.m. in Beaver Falls, Pennsylvania.

In accordance with the litigation schedules, various parties filed direct, rebuttal, surrebuttal and rejoinder testimony.

On May 25, 2011, PCOC filed an Application for Issuance of a Subpoena to the Department of Public Welfare ("DPW").

On June 2, 2011, Columbia filed an unopposed Motion for Protective Order. On June 3, 2011, ALJ Dunderdale issued a Protective Order for this consolidated proceeding.

By letter dated June 3, 2011, DPW responded to PCOC's Application for Issuance of a Subpoena.

On June 6, 2011, Columbia and OCA filed letter responses to the PCOC Application for Issuance of a Subpoena. In addition, PCOC filed a notice of withdrawal of its Application for Issuance of a Subpoena.

The Joint Petitioners held numerous settlement discussions over the course of this proceeding. As a result of those discussions and the efforts of the Joint Petitioners to examine the issues in the proceeding, a settlement in principle of all but two issues was achieved by the Joint Petitioners, thereby negating the need for the scheduled evidentiary hearings on most issues. The Parties subsequently agreed to waive cross-examination on the two issues that remain in dispute. Therefore, the Joint Petitioners requested that the ALJ hold a hearing to allow for the introduction and admission into evidence of Columbia's filing, testimony and exhibits, testimony and exhibits filed by the other parties during the course of the proceeding, and to rule on admission of DPW's letter response to PCOC's subpoena. The hearing was held before the ALJ on June 10, 2011.

The Main Brief on the two reserved issues for litigation is being filed in accordance with the procedural schedule adopted by the ALJ.

B. LEGAL STANDARDS AND BURDEN OF PROOF

Under the Public Utility Code, rates charged by public utilities must be just and reasonable and cannot result in unreasonable rate discrimination. 66 Pa.C.S. §§ 1301 and 1304.

A public utility seeking a general rate increase has the burden of proof to establish the justness and reasonableness of every element of the rate increase request. 66 Pa.C.S. § 315(a); *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, Docket No. R-00038805, 236 PUR 4th 218, 2004 Pa. PUC LEXIS 39 (August 5, 2004). However, a public utility, in proving that its proposed rates are just and reasonable, does not have the burden to affirmatively defend claims made in its filing that no other party has questioned. As the Commonwealth Court has explained:

> While it is axiomatic that a utility has the burden of proving the justness and reasonableness of its proposed rates, it cannot be called upon to account for every action absent prior notice that such action is to be challenged.

Allegheny Center Assocs. v. Pa. P.U.C., 570 A.2d 149, 153 (Pa. Cmwlth. 1990).

Although the ultimate burden of proof does not shift from the utility seeking a rate increase, a party proposing an adjustment to a ratemaking claim of a utility bears the burden of presenting some evidence or analysis tending to demonstrate the reasonableness of the adjustment. *See, e.g., Pa. P.U.C. v. PECO*, Docket No. R-891364, *et al.*, 1990 Pa. PUC LEXIS 155 (May 16, 1990); *Pa. P.U.C. v. Breezewood Telephone Company*, Docket No. R-901666, 1991 Pa. PUC LEXIS 45 (January 31, 1991). In addition, tariff provisions previously approved by the Commission are deemed just and reasonable and, therefore, a party challenging a previously-approved tariff provision bears the burden to demonstrate that the Commission's prior approval is no longer justified. *See, e.g., Pa. P.U.C. v. Philadelphia Gas Works*, Docket

Nos. R-00061931, *et al.*, 2007 Pa. PUC LEXIS 45 at *165-68 (September 28, 2007) (adopting the ALJ's discussion on burden of proof).

Further, a party that raises an issue that is not included in a public utility's general rate case filing bears the burden of proof. For example, in *Pa. P.U.C. v. Metropolitan Edison Company, et al.*, Docket Nos. R-00061366, *et al.*, 2007 Pa. PUC LEXIS 5 (January 11, 2007), a party offered proposals to have the companies incur expenses not included in their filings. The ALJ held that, as the proponent of a Commission order with respect to its proposals, the party bears the burden of proof as to proposals that are not included in the companies' filings. The Commission agreed and adopted the ALJ's conclusion that Section 315(a) of the Public Utility Code cannot reasonably be read to place the burden of proof on the utility with respect to an issue the utility did not include in its general rate case filing and which, frequently, the utility would oppose. *Id.* at *111-12.

II. COLUMBIA'S PROPOSAL TO IMPLEMENT A LEVELIZED DISTRIBUTION CHARGE SHOULD BE APPROVED

A. INTRODUCTION

1. Description of Levelized Distribution Charge

The primary issue reserved for litigation in this proceeding concerns the design of residential base rates. Columbia has proposed to recover all of its residential distribution costs through a Levelized Distribution Charge.[1]

The design of the residential Levelized Distribution Charge is simple. It is a form of Straight Fixed Variable ("SFV") rate design. All residential customers will be charged a fixed

[1] The term "distribution costs" is intended to include all components of distribution revenue requirement, including return on plant, depreciation, operating & maintenance expenses and taxes. Columbia St. 12, p. 41.

monthly distribution charge to recover all distribution costs.[2] The usage-based distribution rate would be eliminated. Gas costs would continue to be charged on the basis of commodity usage, as would the unbundled uncollectibles cost that relates to gas cost charges. Columbia St. 12, p. 35. In addition, Columbia's Rider USP – Universal Service Plan would continue to be charged on a usage basis. Columbia St. 2, p. 22.

As filed, the Levelized Distribution Charge was proposed to be $36.88 per residential customer per month. The charge would be approximately $33 per residential customer per month under the revenue allocation for residential customers established by the Settlement.[3]

2. Summary of Reasons for Adopting the Levelized Distribution Charge

Columbia recognizes that the Levelized Distribution Charge represents a substantial departure from the customer charge/usage charge rate structure that Pennsylvania gas utilities traditionally have used for residential rate design. However, the Company respectfully submits that adherence to "tradition" is outweighed by a number of sound reasons favoring a new approach for residential rate design. A summary of these reasons is provided here, and will be followed by greater detail in the next section of this Brief.

The chief reason favoring the Commission's adoption of the Levelized Distribution Charge for residential customers is that it most accurately reflects how costs are incurred. Simply stated, Columbia's distribution costs to serve residential customers do not vary with

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[2] Low income customers served under Columbia's Rate CAP – Customer Assistance Program ("CAP") would continue to be billed based upon their CAP payment, and will not be affected by the Levelized Distribution Charge. Columbia St. 12, p. 50. However, as explained later in this Brief, the current bill shortfall recovered under Rider USP – Universal Service Plan will be reduced under the Levelized Distribution Charge because CAP customers overall use more gas than the average residential customers. Columbia St. 12, p. 49.

[3] As noted above, the Levelized Distribution Charge recovers components of the distribution revenue requirement of residential customers through the fixed monthly charge. The reduction from the as-filed to the as-settled revenues to be recovered from residential customers accounts for the reduction to the Levelized Distribution Charge that would be recovered under the Settlement. It is noted that, pursuant to paragraphs 36 and 54 of the Settlement, $1 million of the $12.7 million increase allocated to the residential customer class is for increased LIURP funding, which will be recovered through an increase in charges under Rider USP.

customer usage. A rate design should follow costs. Accordingly, Columbia should recover the same level of distribution costs from all residential customers regardless of their levels of consumption. Usage-based recovery of fixed costs improperly causes the lower use customer to be subsidized by the higher than average use customer.

A second reason why the Commission should adopt the Levelized Distribution Charge is to remove the utility's disincentive to encourage energy efficiency measures. This, in turn, will remove the loss of volumes due to customer efficiency improvements as a driver of rate cases. Residential customers should not be lulled into the false belief that reducing usage lowers a utility's costs of distributing gas to them. Reduced usage, where costs are fixed, only results in a need for frequent future rate cases. As a result, usage-based distribution charges discourage Columbia from aggressively assisting customers to adopt cost-effective energy efficiency measures.

A third compelling reason for the Commission to adopt Columbia's proposed Levelized Distribution Charge for residential customers is the need for Columbia to raise capital at cost-effective rates. As the Commission is aware, Columbia has both immediate and ongoing needs to raise substantial capital for its Cast Iron and Bare Steel ("CIBS") pipe replacement program. Utilities across the country have extensive infrastructure replacement needs, and will be competing with Columbia for capital. Many other states have adopted accelerated cost recovery mechanisms and mechanisms that decouple fixed cost recovery from volumetric charges. Investors will favor utilities with progressive rate designs over those that have substantial revenue volatility due to usage-based rate designs.

For these reasons, the Commission should be forward-thinking in the area of residential rate design. The Commission clearly has authority to establish a rate design that matches cost

recovery to cost incurrence. The Commission should exercise that authority to adopt a new design of residential rates, particularly where, as described in detail below, the Levelized Distribution Charge will encourage utility/customer partnership to improve energy efficiency and will provide important signals to capital markets to encourage investment in Pennsylvania's infrastructure. Such action would reaffirm the Commission's position as a leader in utility regulation, as has been demonstrated by its actions in establishing a Distribution System Improvement Charge and in promoting Customer Choice. The Commission should follow these progressive efforts by adopting Columbia's proposed residential Levelized Distribution Charge.

B. ARGUMENT

1. The Levelized Distribution Charge Properly Aligns Rates with Costs Incurred to Serve Residential Customers

Columbia's Levelized Distribution Charge for residential customers should be adopted because it is consistent with the principle that rate design and cost recovery should be aligned with cost causation. As the Pennsylvania Commonwealth Court recognized in *Lloyd v. Pennsylvania Public Utility Commission*,[4] the polestar of ratemaking is the "cost of providing service."

The evidence in this proceeding overwhelmingly supports Columbia's position that its distribution costs to serve residential customers are not affected by gas consumed by residential customers. Columbia witness Kempic's testimony explained that, with a slight exception for gas odorant, none of the Company's distribution-related costs increase as customers consume more gas. Columbia St. 2, p. 21. Furthermore, as Columbia explained, its delivery service costs do not vary materially from month to month, further demonstrating that usage variances do not

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[4] *Lloyd v. Pennsylvania Public Utility Commission*, 904 A.2d 1010, 1020 (2006), appeal denied, 591 Pa. 676, 917 A.2d 1104 (2007).

drive distribution costs. Columbia St. 112-R, p. 27. These simple facts of cost causation are alone sufficient to conclude that usage-based distribution rates for residential customers fail to comport with principles of designing rates to match the manner in which costs are incurred.

Mr. Kempic's common-sense recognition that costs do not vary with usage is supported by Columbia's cost of service/rate design expert Mr. Russell Feingold. Mr. Feingold has over 35 years of experience in utility regulation, and has testified in support of revenue stabilization mechanisms in a number of jurisdictions. Columbia St. 12, pp. 2-3. As Mr. Feingold explained, a gas utility designs and installs a distribution system to meet customers' design day requirements. Columbia St. 2, p. 39. These distribution facilities include the city gate, mains, regulators, services and meters. Columbia St. 2, p. 39. Once installed, the costs are fixed and do not vary with the amount of gas consumed. Columbia St. 2, p. 39.

Mr. Feingold further explained that the system investment required to serve residential customers does not vary between residential customers by customer usage, because the design day requirements of residential customers can be satisfied by the minimum size pipe installed on Columbia's system. Specifically, Mr. Feingold analyzed the ability of a two-inch main to serve residential customers. Using the Company's average customer density, standard operating pressures and applying pipeline flow formulas, Mr. Feingold determined that a two-inch pipe would be capable of serving a customer with a design day requirement of 18.4 Mcf, which would translate into a customer with annual requirements of over 1,300 Mcf, at a 20 percent load factor.[5] Columbia St. 12, pp. 44-46. Thus, the smallest sized main that Columbia installs is

[5] Average residential consumption continues to drop. As of the end of the historic test year, the average Columbia residential heating customer used 82.96 Mcf annually. Columbia Exhibit 10, Schedule 2.

effectively able to serve any residential customer. This further supports Columbia's position that residential customer usage does not affect Columbia's cost to serve.

It is important to emphasize that Columbia is proposing the Levelized Distribution Charge only for residential customers because, as the foregoing demonstrates, the class is relatively homogenous – individual customer size has no effect on the cost to serve. The Levelized Distribution Charge is not being proposed for commercial and industrial classes. That is because there is less homogeneity of demand. Because commercial and industrial customer demands can vary substantially, this can affect distribution costs to serve due to variability in investments in the meters and mains. Columbia St. 112-R, p. 22; Columbia St. 12, pp. 44-45. It may be appropriate to consider demand-based or other innovative rate structures for commercial and industrial classes in the future,[6] but Columbia did not undertake any examination of rate design changes for these classes in this case.

In addition to the reasons explained above, the Company's residential Levelized Distribution Charge also is supported by economic theory. This was described by Mr. Feingold:

> To understand the dynamic of fixed cost pricing for utility service one must begin with the concept of economies of scale. Utilities exhibit significant economies of scale. This means that pricing at marginal cost would not result in the utility recovering all of its costs. As a result, economists have long recognized that regulated utilities must follow a different pricing paradigm. The theory of Ramsey pricing was developed to address the recovery of fixed costs when prices are set at marginal cost for utilities with scale economies. Under Ramsey pricing, the recovery of fixed costs above the level that marginal cost pricing would recover must result from increasing the least elastic infra-marginal price. In this case, the customer charge is the least elastic infra-marginal price. Indeed, economic theory directly supports SFV rate design to promote efficiency. Since fixed costs do not impact marginal costs, the separate recovery of fixed cost is wholly consistent with economic theory.

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[6] See OSBA St. 2, p. 29.

Columbia St. 112-R, pp. 19-20.

There are other benefits to the residential Levelized Distribution Charge. By aligning rates with the cost to serve, rate cases will be simplified as issues such as weather normalization and sales forecasting are eliminated for the residential class. Columbia St. 12, p. 47. The residential Levelized Distribution Charge also eliminates existing intra-class cross subsidies that result from charging distribution costs on a usage basis, where the evidence shows there is no difference in the cost to serve. Columbia St. 12, p. 47; Columbia St. 112-R, pp. 27-28.

Finally, the residential Levelized Distribution Charge achieves bill simplicity and promotes understandability of the true cost to serve. These points were explained both graphically and textually by Columbia's witness Mr. Kempic:[7]

> Q. How does the current rate structure recover the company's cost of providing gas distribution service?
>
> A. Columbia recovers its costs and derives its revenue from both the fixed monthly customer charge (the yellow horizontal pipe) and the volumetric distribution charge (the gas meters). The volumetric commodity charge recovers the cost of the gas itself (the gas flames) and Columbia does not earn a profit on the commodity component. This rate structure has been in place for quite a long time, but it is still misunderstood by customers, as evidenced by the purchased gas cost complaints received in base rate cases and the base rate issues raised by customer complainants in purchased gas cost proceedings.
>
> Q. Why do you believe it confuses customers?
>
> A. This volumetric distribution charge rate structure is confusing because it bears no relationship to the manner in which a utility incurs costs to provide customers with gas distribution service. The volumetric distribution charge suggests to customer that the utility's costs to provide distribution service increase as the customer uses more gas, but that is simply not true. With the exception of the cost for gas odorant which increases as consumes use more gas, none of the Company's distribution-related costs

[7] Copies of the two graphics are attached to this Brief as Appendix A.

increase as customers consume more gas. While this has always been the case, the inappropriate volumetric distribution charge has mislead customers over the years so that customers now believe a gas utility's costs increase as the customers use more gas.

Q. Do you believe most customers care about how a gas utility recovers its costs?

A. Customers may not care about how a utility recovers its costs, but customers want bills that are easy to understand and they want to be treated fairly. As shown in the image above, the bill presently contains three primary charges, one of which (the volumetric distribution charge) is unnecessary and as previously stated, bears no relationship to the manner in which the Company incurs its costs. Moving to a structure in which virtually all of the utility's costs are recovered through a flat monthly fee will simplify the bill by splitting it into two primary components: One to recover the company's costs of distribution service and the other to recover the cost of the gas consumed. . . . With a fixed monthly charge for distribution service, customers will be given a correct price signal regarding the company's cost of providing distribution service and customers will clearly see how much the gas commodity costs them each month. As illustrated by the image below, customers will be given a simpler bill, which will contain accurate price signals regarding both the cost of distribution service and the cost of the gas commodity itself.

Columbia St. 2, pp. 20-23.

It is to be noted that a change from usage-based to flat rate billing of distribution costs to residential customers should not be viewed as confusing. Residential customers already are accustomed to paying for many basic consumer services on a fixed monthly basis. These include:

- Local and long distance telephone service
- Cellular telephone service
- Cable and satellite service
- Internet access
- Home security
- Trash removal
- Automobile leases

Columbia St. 12, pp. 47-48.

It is also noteworthy that many customers already are accustomed to levelized monthly billing for utility services, since Columbia is required to offer budget billing under the Commission's regulations. 52 Pa. Code § 56.12(7). The Commission and the OCA encourage customers to consider budget billing as a way to level out monthly charges. Columbia St. 2, pp. 35-36. Thus, adopting a fixed charge for residential distribution services should not be considered as outside the norm.[8]

In direct testimony, OCA witness Watkins asserted that many businesses in competitive industries have significant fixed costs, but still charge on a usage basis. However, as Columbia's witness Mr. Feingold explained, these examples from non-regulated industries should not be relied upon as a guide for appropriate rate design for a regulated utility like Columbia:

> First, none of these businesses have an obligation to serve. They are free to enter and exit the business at a moment's notice. Second, these businesses directly control the volume of production and may adjust that production consistent with market conditions so as to insure recovery of fixed costs. Third, these businesses may adjust the price in response to market conditions so that during times of high demand the earned return increases and falls during times of low demand. In contrast, a utility has limited upside potential and must file a rate case and wait to adjust revenues upward when demand falls or costs increase. And even when costs fall, the utility often is subject to regulatory review of earnings and the potential for lower rates. Fourth, these businesses are free to choose whether to serve a customer or not provide service. Fifth, these businesses have the right to dictate payment terms. Thus, a propane supplier might require payment at the time of delivery rather than bill the customer after the service is rendered. In summary, each of these differences causes pricing strategies to differ by type of service. Consider the airline industry and its pricing. Prices vary significantly from one passenger to the next even on the same flight and for the same class of service. Utilities may not price discriminate in this way. Further, airlines may adjust to demand by cancelling flights, changing aircraft type and limiting access to service by overbooking. None of these options would be permitted for a utility

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[8] In direct testimony, OCA witness Watkins noted that water utilities once billed on a fixed monthly fee basis, but moved away from this design to charge based on consumption. OCA St. 5, p. 30. Water utility billing is not an appropriate comparison. Unlike gas utilities, water utilities have not unbundled their charge for the product sold. As explained previously, Columbia will continue to charge its customers a commodity rate for the gas consumed.

> trying to manage its costs and revenues. Finally, volumetric pricing based on marginal cost produces a full return of and on investment under competitive equilibrium conditions, but would not do so for a regulated utility because of scale economics.

Columbia St. 112-R, pp. 18-19.

As demonstrated above, the residential Levelized Distribution Charge most appropriately matches rates to cost incurrence, and should be adopted.

2. The Residential Levelized Distribution Charge Provides Proper Price Signals and Removes Disincentives to Utility-Driven Conservation

Various parties argue that the Levelized Distribution Charge may discourage customer conservation. OCA St. 5, pp. 32-33; OTS St. 3, p. 48. However, as Columbia explained, current usage-based pricing of fixed distribution costs gives false price signals to customers and discourages a "win-win" approach to implementation of cost-effective energy efficiency improvements.

When fixed costs are recovered on a usage basis, a customer's perceived conservation "savings" are distorted because the customer receives a bill reduction when there is no matching reduction to Columbia's distribution costs.[9] As a result, a regulated entity like Columbia will underrecover its costs, contributing to the need to file for a rate increase. Columbia St. 2, p. 35. This results in a cycle of potentially inefficient conservation activities, rate cases, and customer disillusionment, as Columbia's witnesses Feingold and Kempic explained:

> Under volumetric rates, customers who invest in conservation see their expected benefits eroded by subsequent rate cases, where dollars are added to the commodity rates to offset the loss of fixed cost recovery

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[9] Under the current usage-based distribution charge rate design and the gas cost commodity rates in effect during the historic test year, a customer saving one Mcf would see a savings of $10.5051 (i.e. $2.6891from avoided usage-based distribution charges and $7.8160 from avoided gas costs). Under the Company's proposed Levelized Distribution Charges, the customer will realize a savings of $7.8160 when he reduces consumption by one Mcf. Exhibit RAF-1. The customer will continue to have strong a financial incentive to implement energy efficiency measures and that financial incentive will accurately reflect the actual savings the customer and the utility will experience from the energy efficiency gain.

> resulting from reduced gas usage. This may encourage other customers to adopt conservation, but discourage additional conservation from early adopters. However, the cycle will continue as new investment in conservation is again eroded by subsequent rate cases. The net result is lower expected returns from conservation investment by customers. There is no efficiency result from volumetric rates. It is SFV rates that assure economic efficiency by sending optimal price signals to customers.

Columbia St. 112-R, pp. 20-21

> Including recovery of fixed costs in volumetric distribution rates gives a false price signal to encourage conservation and ultimately is counterproductive to both the Company and customers. This approach leads to an ongoing cycle of future rate cases as fixed costs go unrecovered due to conservation. This leads to customer confusion and complaints, when, in future rate cases, the Company informs customers that one of the causes of the rate filing is reduced revenues from reduced customer consumption. Customers may conclude that conservation efforts serve no purpose if their efforts just lead to further rate increases.

Columbia St. 2, p. 35. As the foregoing demonstrate, efficient price signals, which measure a customer's true gas commodity cost savings, will produce the most cost-effective energy efficiency improvements.

Columbia also demonstrated that price signals alone are not a successful approach to achieving permanent energy efficiency improvements. Columbia tracked residential weather-normalized throughput over the past decade. That data indicated that while higher gas prices encouraged reduced consumption, customer usage increased when gas prices moderated. Columbia St. 2, pp. 37-38. This indicates that customers are likely responding to price signals by using temporary measures, such as turning down thermostats, instead of investing in permanent energy-saving measures. As explained below, the Levelized Distribution Charge presents a better way forward, in which both the utility and the customer can cooperate in achieving real sustained energy efficiency improvements by involving Columbia in permanent conservation efforts by removing the current disincentive to Columbia to reduce customer usage.

The American Recovery and Reinvestment Act of 2009, Pub L. 111-5 ("ARRA"), Section 410(a) recognizes that advancing energy efficiency requires an alignment of utility and customer interests:

> The applicable State regulatory authority will seek to implement . . . a general policy that ensures that utility financial incentives are aligned with helping their customers use energy more efficiently . . .

However, the present method of recovering a substantial portion of residential distribution costs through usage-based rates places Columbia in a dilemma. Columbia is discouraged from helping customers use energy more efficiently when it only leads to underrecovery of distribution costs and the need for further rate relief. Customers are disadvantaged, as they do not have an eager utility partner in weatherization and energy efficiency efforts and they incur the expense of rate cases driven in part by cost underrecovery caused by recovery of distribution costs through usage-based rates.

The effectiveness of utility involvement in energy efficiency gains should not be understated. As Mr. Kempic explained, a coordinated utility/customer effort can be much more effective than individual customers acting alone:

> Comparing the annual average decline in total normalized residential consumption of 1.2% a year to the average annual reduction in consumption of 25% that Columbia achieves through its LIURP shows that involving the utility in energy efficiency efforts yields far better results than relying on price signals. As the local gas distribution company, we have a unique ability and opportunity to communicate with our customers through an established relationship, customer intake infrastructure and large scale customer program management. Simply put, if substantial and sustained energy efficiency improvements are the goal, price signals fail to compare with the results obtained by involving the Company in the process. The way to encourage the Company to become more involved in the process is to make it indifferent to the amount of gas customers consume. Columbia's proposed Levelized Distribution Charge will do just that.

Columbia St. 2, p. 38.

The residential Levelized Distribution Charge provides efficient price signals and will encourage utility/customer cooperation to achieve cost-effective weatherization and energy efficiency savings. This is a further reason for the Commission to adopt the residential Levelized Distribution Charge.

3. The Residential Levelized Distribution Charge is Responsive to the Expectations of Capital Markets

As the Commission is aware, beginning in 2007, Columbia began to accelerate its replacement rate of CIBS pipe. Over the past four years, Columbia has replaced nearly 300 miles of CIBS pipe. Columbia St. 9, p. 18. However, Columbia has approximately 1,900 miles of CIBS pipe in its distribution system that still need to be replaced. Columbia St. 9, p. 3. This replacement represents a substantial and ongoing need for capital – over $80 million just in 2011. Columbia St. 1, p. 5; Columbia St. 9-Supp., p. 2. Columbia is not alone in the need for substantial investment capital for infrastructure replacements. According to a recent Commission-published report, Pennsylvania has 3,600 miles of cast iron and 9,000 miles of unprotected steel pipes. The Commission report estimates the replacement costs of these pipes to be $13 billion over a 20 year period. Pennsylvania Public Utility Commission, *Pennsylvania National Gas Trends and Developments*, p. 6 (February 2011). Moreover, the U. S. Department of Transportation, Office of Pipeline Safety issued a preliminary report, wherein it noted that "it has been estimated that [infrastructure replacement] costs could exceed billions of dollars nationwide."[10] The significant need and expense associated with infrastructure replacement is

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[10] U.S. Department of Transportation, Pipeline and Hazardous Material Safety Administration, Office of Pipeline Safety, *The State of the National Pipeline Infrastructure, Preliminary Report*, p. 12, http://opsweb.phmsa.dot.gov/pipelineforum/docs/Long%20Version%20Preliminary%20Report%20on%20Infrastructure%20040711draftwDecadeCauseCharts.pdf (last accessed June 27, 2011).

evidenced by a number of recent state public utility commission decisions approving infrastructure replacement programs for other NGDCs across the country.[11]

In this environment, where Columbia is competing with others for capital, utility creditworthiness is a heightened concern.[12] As Mr. Richard Cortright, Managing Director in the Utilities & Infrastructure Practice of Standard & Poor's Ratings Services explained at the Commission's Technical Conference concerning the ARRA:

> [W]e as a rating agency will be closely focused on the various recovery mechanisms that regulators establish to enable utilities to recover their costs – in particular those costs over which they have little control – on a timely basis.
>
> * * *
>
> To the extent that a commission has established recovery mechanisms such as the various trackers discussed on this slide, as well as decoupling mechanisms, we would view a commission as being supportive of and attentive to the creditworthiness of a utility.

Columbia St. 2, p. 17, *quoting* transcripts of ARRA Technical Conference, Commission Docket No. I-2009-2099811 (November 19, 2009), Tr. 99-100. Decoupling is positive from a credit rating agency perspective as it enables utilities to project cash flows more accurately and reduces earnings volatility. Columbia St. 2, p. 25.

Credit rating agencies' assessments of creditworthiness are important as a guide to debt and equity investors in determining risk of a company, and thus affect the cost of capital to be

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[11] *Atlanta Gas Light Company's 2009-2012 Integrated System Reinforcement Program and Georgia Strategic Infrastructure Development and Enhancement Program*, 2009 WL 3184986, (Order entered October 6, 2009) (Total cost of the pipeline replacement plan for the years 2009 to 2012 estimated at $175.7 Million), *Order Instituting Rulemaking on the Commission's Own Motion to Adopt new Safety and Reliability Regulations for Natural Gas Transmission and Distribution Pipelines and Related Ratemaking Mechanisms*, Rulemaking 11-02-019 (Order Issued June 16, 2011) (California Commission considers rate treatment of "important but costly safety improvements", PG&E gathering and MAOP validation process estimated to exceed $100 million dollars prior to any infrastructure upgrades), North Shore Gas Company and The Peoples Gas Light and Coke Company v. Illinois Commerce Commission, 2010 WL 2375848 (June 2, 2010) (Commission approved a $45.28 million annual rider to recover costs for a program that would replace ductile iron/cast iron mains over a 50 year period).

[12] Columbia St. 10, Appendix B, p. 1.

demanded for an investment. Columbia St. 2, pp. 16-17; Columbia St. 10, p. 13. As explained subsequently, many other states have adopted decoupling/revenue stabilization mechanisms for their utilities. As a result, investors will demand substantial premiums to invest in a utility like Columbia, which currently recovers most of its residential customer revenues through usage-based charges, as compared to investing in a utility with an approved decoupling/revenue stabilization mechanism.[13] Columbia St. 2, p. 8.

An increasing number of states are adopting decoupling mechanisms. As of October, 2010, decoupling (including flat monthly fee rate design) has been approved for service to 27 million gas utility customers in 20 states, with decoupling proposals pending in three more states. Columbia St. 2, p. 13. In addition, other types of accelerated revenue recovery mechanisms have been adopted for gas companies in six other states. Columbia St. 2, p. 15.

For example, all seven gas distribution companies used in Company witness Paul Moul's barometer group have decoupling/revenue stabilization mechanisms in effect. Columbia St. 10, p. 9. Four of the companies have some form of decoupling, and four have some form of accelerated recovery for infrastructure investment. All have some type of weather normalization mechanism in use. Columbia St. 2, p. 16.[14] Other examples are detailed in Columbia's testimony. See Columbia St. 2, pp. 9-13; Columbia St. 112-R, pp. 24-26.

The reasoning offered by these other state commissions is instructive, and adopts the explanations previously presented in this Brief. For example, the Missouri Public Service

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[13] Currently, Columbia recovers about 67% of its total residential non-gas charges through usage-based rates. See Exh. 103, Schedule 1.

[14] Columbia notes that the settled revenue requirement in this case will not be affected by the determination of residential rate design. Settlement, ¶ 42 Nevertheless, it would be Columbia's position, if this case had been fully litigated, that the cost of equity of the barometer group already reflects the Levelized Distribution Charge, because the barometer group data already accounts for any positive credit benefits from decoupling/revenue stabilization. Columbia St. 10, p. 9.

Commission ("MPSC") approved a SFV rate design for Missouri Gas Energy ("MGE"). In its Order, the MPSC wrote:

- "Straight Fixed Variable rate design best reflects the actual costs customers impose upon MGE's system."
- "SFV Rate Design Reduces Spikes in Winter Bills and Moderates Bill Fluctuations Throughout the Year."
- "SFV Rates Represent Economically Efficient Pricing."
- "SFV Rate Design Simplifies Customers' Bills."
- "SFV Rate Design Stabilizes MGE's Revenues."
- "State Energy Policy Strongly Favors Revenue Decoupling Rate Design."

Columbia St. 112-R, pp. 24-25 (footnotes omitted); *quoting* Missouri Public Service Commission, Case No. GR-20090355, Report and Order pp. 41-48.

In approving SFV for Columbia's sister company, Columbia Gas of Ohio, Inc., the Public Utilities Commission of Ohio has stated:

> We find that the SFV rate design is preferable . . . because it benefits customers by producing more stable bills throughout the year, it is easier for customers to understand, better price signals are sent to consumers, and it provides a more equitable cost allocation among customers regardless of usage. It is in the interest of all customers that Columbia has adequate and stable revenues to pay for the costs of its operations and capital to ensure the continued provision of safe and reliable service. Under current circumstances, the SFV rate design will best provide that stability. There is also a societal benefit to engage Columbia to promote conservation. This is best accomplished by removing from rate design the current built-in incentive that Columbia has to increase revenues through increased gas sales. The SFV rate design, which decouples recovery of fixed costs from sales of gas, clearly eliminates any disincentive that Columbia has to promote conservation.

Columbia St. 112-R, pp. 23-26 (footnote omitted) *quoting* Public Utilities Commission of Ohio, Case No. 08-72-GA-AIR, Opinion and Order at pp. 19-20.

Investors are looking for reduced revenue volatility and more timely recovery of investments, and their decisions will be influenced by the rate recovery mechanisms adopted by state utility commissions. The Commission should recognize these needs of the capital markets, and the long-term effects on the cost to serve resulting from its decision on the residential Levelized Distribution Charge. The Levelized Distribution Charge should be adopted.

4. The Levelized Distribution Charge and Low Income Customers

In its direct testimony, Columbia presented data on the average usage of residential customers participating in its various energy assistance programs. This data demonstrated that the average annual usage of Columbia's energy assistance program participants exceeded the average annual usage of a typical Columbia residential customer. Columbia St. 12, p. 49. Because the Levelized Distribution Charge will, as its name indicates, levelize the distribution charge for all residential customers, customers with above-average usage would experience a lower bill under the Levelized Distribution Charge than under a customer charge/usage-based distribution charge rate structure. Columbia St. 12, p. 51. Other data submitted by Columbia reinforces that lower income residential customers on Columbia's system, on average, tend to have higher usage than the overall residential customer average. Columbia St. 12, pp. 50-51.

In response, OCA submitted testimony of Mr. Roger Colton. Mr. Colton presented selective data from certain national and statewide sources to question the conclusion that the average usage of low income customers is above the level of a typical Columbia customer. OCA St. 3. Despite the array of data he offers, the most Mr. Colton can conclude is that it "is more likely to be accurate" that low income households have lower natural gas usage than average. OCA St. 3-S, p. 5. This is despite his acknowledgment that low income households may have less efficient homes, and thus use more energy on a square foot basis, and the undisputed evidence that the average use of Columbia's CAP and LIURP customers is above the average

usage of all Columbia residential customers. OCA St. 3, p. 23.[15] Columbia disputed Mr. Colton's conclusions. Columbia St. 112-R, pp. 32-37; Columbia St. 112-R, Appendix A.

The question of whether low income customers on Columbia's system have above or below average usage should not be the basis for determining whether to adopt the Levelized Distribution Charge. The Levelized Distribution Charge is a cost-based rate that eliminates intra-class rate subsidies, and it is on this basis that the rate design should be approved. The affordability of the rate to a specific residential customer, or a subset of customers defined by income and usage in combination, should not factor into the decision of proper rate design.[16] If there are low income customers who find their bill unaffordable under the Levelized Distribution Charge, the proper approach is to address these customers through Columbia's energy assistance programs, and the Company can extend outreach efforts to these customers if the Levelized Distribution Charge is approved. Columbia St. 112-R, p. 33.

The Levelized Distribution Charge should be adopted for the reasons explained above, and approval should not hinge on its affect upon a subset of low income, low use customers.

5. The OCA and OTS Residential Rate Design Proposals Should Be Rejected

a. Summary of Other Parties' Residential Rate Design Proposals

The OCA's residential rate design proposal in this case is to continue in effect Columbia's current $12.25 per month customer charge, and recover all of the distribution

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[15] Indeed, the Levelized Distribution Charge will lower the bill for customers with above average usage and will lower the discounts for CAP customers on percentage income plans thereby lowering amounts charged to non CAP customers to support the CAP program.

[16] Columbia does note that its unrebutted evidence demonstrates that current CAP customer usage is above average. Columbia St. 12, p. 49. As a result, under current volumetric rates, these customer are overcharged for delivery service, which produces a greater CAP shortfall that is charged to all other residential customers through the USP Rider. Columbia St. 112-R, p. 33.

revenue increase assigned to the residential class in this case through an increased usage-based distribution charge. OCA St. 5, p. 34.

The OTS' residential rate design is a variant of the OCA proposal. OTS begins with a claimed calculated customer charge of $13 per month and would include the distribution cost of a 2 Mcf usage allowance in a "minimum" charge. At the filed for increase in this case, OTS calculated this minimum charge to be $19.90/month. OTS St. 3, p. 51.

b. Both OCA's and OTS' Customer Charge Proposals Rely Upon Erroneous Concepts of Cost Incurrence

The primary error inherent in both the OCA's and the OTS' customer charge proposals is that they are based upon incorrect concepts of cost incurrence.

As explained at pages 9 to 15 of this Brief, proper cost causation principles recognize that the distribution costs to serve residential customers are fixed, and equivalent for all residential customers. As fixed, equal costs, the costs should be recovered equally from all residential customers through a Levelized Distribution Charge, and not through usage-based rates.

The fundamental flaw in the OTS and OCA rate designs is that both rely upon the outdated concept of "direct customer costs" in setting customer charges.

The "direct customer cost" concept substantially limits the definition of customer costs to essentially meters and services investment, and certain "directly" associated expenses, such as meter reading and collections. OTS Exh. 3, Sch. 20-22; OCA Sch. GAW-6. The effect is to shift recovery of millions of dollars in fixed costs into usage charges.

Columbia acknowledges that the concept of setting customer charges on "direct customer costs" has been used in Pennsylvania for a number of years. However, for all of the reasons explained previously in this Brief, the Commission should reject the concept of "direct customer costs" for limiting customer charges, and should recognize that appropriate rate design based on

cost causation principles weighs in favor of recovering all fixed costs through fixed rates for residential customers as proposed by the Levelized Distribution Charge.[17]

c. OCA's Residential Rate Design Proposal

As explained previously, OCA's residential rate design proposal would hold Columbia's current residential customer charge at $12.25 per month, and recover all of the increase in this case through usage charges. This approach increases the percentage of revenues recovered through usage charges because the amount of residential revenue recovered through the fixed charge would remain the same even though residential revenues are increasing as a result of this case. Therefore, OCA's proposal would make Columbia's recovery of fixed distribution costs even more sensitive to usage variances. This would result in a further increase to revenue volatility, directly contrary to the creditworthiness criteria that the capital markets consider to be important. Columbia St. 2, p. 25. This result also would further discourage Columbia from meaningful efforts to encourage energy efficiency, in contradiction to the goals and policies of the ARRA. Columbia St. 2, p. 27.

OCA's proposal offers no progressive thinking on rate design, and would represent a backward step from the forward-thinking rate design concepts adopted in at least 20 other states to date. OCA's proposal should be rejected.

d. The OTS Rate Design Proposal is an Inadequate Effort to Increase Fixed Cost Recovery

As explained previously, OTS' proposed "minimum charge" would somewhat increase the fixed charge to residential customers, but would be achieved by including and pricing a 2

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[17] Columbia notes that if customer charges were set based on all customer costs, rather than "direct customer costs," residential customer charges should still be increased to a range of $26.50/mo. to $29/mo., according to Columbia's two cost of service studies. Columbia Exh. 111, Sch. 2, p. 10; Columbia Exh. 111, Sch. 3, p. 10. This still would not recover all fixed costs through a fixed monthly charge.

Mcf per month distribution charge usage allowance in the minimum charge. Customers would pay the increased customer charge and receive the first 2 Mcf of consumption without paying a usage-based distribution charge. As explained next, the OTS proposal, while apparently well-intentioned, does not match rates to costs, resulting in inadequate fixed cost recovery.

Columbia appreciates OTS' attempt to find a way to move toward increased fixed cost recovery through fixed charges. Unfortunately, the reality is that Columbia will continue to experience substantial revenue volatility under this proposal. This is because only a small percentage of the Company's residential usage is billed below 2 Mcf in a month. OTS Exh. 3, Sch. 26. Further, the first 2 Mcf of monthly usage is not affected by energy efficiency measures or temperature. Columbia St. 102-R, p. 12.[18] As a result, the residential usage that is affected by conservation and weather would remain subject to loss under the OTS' proposed usage-based distribution rate. Columbia witness Kempic demonstrated this in rebuttal testimony, where he explained that reduced usage from conservation would result in an increased percentage loss in revenues under the OTS proposal than under Columbia's current rate design. Columbia St. 102-R, p. 17. Thus, the OTS proposal, like the OCA proposal, does not address the problem of revenue instability caused by energy efficiency improvements and weather, and does not encourage utility participation in weatherization and energy efficiency improvement efforts. The proposal also is not cost-based, as it fails to recognize that Columbia's costs do not change with usage. The OTS proposal should be rejected.

C. CONCLUSION

The Commission has a demonstrated record as a leader in utility regulation. The Commission now has the opportunity to continue to show its leadership in the industry by

[18] It can be expected that most of this usage is billed in the summer months of July – September. See, e.g., OTS Exh. 3, Sch. 11, Column D.

adopting a residential rate design proposal that is cost-based, comports with the principles of ARRA, and would signal to capital markets that Pennsylvania utilities are creditworthy entities for investment. The Commission should adopt Columbia's residential Levelized Distribution Charge.

III. PCOC'S CHALLENGE TO COLUMBIA'S CAP PLUS PLAN

A. INTRODUCTION

Columbia provides reduced rates/discounts to low income residential customers pursuant to a Customer Assistance Program ("CAP"). Columbia Exh. 14, Sch. 2, pp. 143-147. In general, the CAP provides for reduced residential rates to customers with incomes at, or below, 150% of the federal poverty level. Discounts are based upon levels of income and household size. Columbia's CAP was established many years ago pursuant to the Commission's CAP Policy Statement, 52 Pa. Code § 69.261 et. seq. ("CAP Policy Statement"), and is reviewed every three years by the Commission through the Universal Service and Energy Conservation Plan ("USECP") filing required by 52 Pa. Code § 62.4(a)(1).

The issues raised by PCOC in this proceeding concern certain adjustments made by Columbia to its CAP, and approved by Commission Order of August 18, 2010 at Docket No. R-2009-2149262, which established CAP Plus. As explained below, CAP Plus was a reaction to a 2009 directive issued by the Pennsylvania Department of Public Welfare ("DPW"), with regard to use of Low Income Home Energy Assistance Program ("LIHEAP") grants to low income customers funded by the federal government and administered by DPW. PCOC contends in this proceeding that Columbia's Commission-approved CAP Plus violates LIHEAP requirements.

For many years, Columbia's CAP customers were provided an affordable bill, based upon Commission guidelines in the CAP Policy Statement. Columbia St. 117-R, p. 9. This is typically done by requiring customers to pay a percentage of their income toward their monthly

gas bill. This approach is often referred to as a Percentage of Income Payment Plan ("PIPP").[19] The remainder of the residential bill not paid by the CAP customer, commonly referred to as the "CAP shortfall" or "CAP credit," is the discount provided to the CAP customer. The CAP credit is recovered from non-CAP customers through the Company's universal service rider, Rider USP. Columbia St. 117-R, pp. 8-9. For CAP customers who pay their discounted bills, CAP features forgiveness of their pre-program arrearages, which is recovered from non-CAP customers through Rider USP. CAP customers are required to apply for LIHEAP grants, which are paid directly to Columbia as the "Vendor" under the LIHEAP program. Because CAP customers were already being provided an affordable bill under the PIPP, Columbia's prior CAP used the LIHEAP grants received for all CAP customers to reduce the amount of discounts that were recovered from non-CAP customers by applying the grants against the CAP customer shortfall. Columbia St. 117-R, p. 7.

In the summer of 2009, DPW proposed changes in the way federal LIHEAP grants are applied to the accounts of CAP customers. Specifically, DPW directed distribution companies to apply the LIHEAP cash grants to the customer's monthly asked to pay amount, rather than the CAP credit. The DPW directive is formalized in Pennsylvania's 2010 LIHEAP State Plan. In response to DPW's directive, the Commission temporarily suspended the provision of its regulation which provides that "the LIHEAP grant should be applied to reduce the amount of CAP credits" 52 Pa. Code § 69.265(9)(iii). *Customer Assistance Program Policy Statement Suspension and Revision*, Docket No. M-00920345 (Order entered April 9, 2010).

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[19] Some customers pay a percentage of what a residential customer would pay under the budget payment plan, but this formula also is based upon income and ability to pay. Columbia St. 117-RJ, p. 3.

In response to DPW's directive that LIHEAP cash grants be applied to the customer's monthly asked to pay amount, OCA proposed, in Columbia's 2010 base rate proceeding at R-2009-2149262, that Columbia adjust its CAP to provide for the following:

1. Direct reduction of each CAP customer's CAP charge or asked to pay amount for the LIHEAP grant received by Columbia for the customer; and
2. An increase to all CAP customers' CAP charges to avoid the increase in discounts that would be created by the loss of LIHEAP grants as an offset to amounts charged to non-CAP customers under Rider USP.

2010 Rate Case, Docket No. 2010-2149262 (Recommended Decision, dated July 10, 2010, p. 20).

Columbia agreed to OCA's CAP Plus proposal in the 2010 rate case settlement, which provides as follows:

> Columbia will adopt a CAP-plus program consistent with the CAP-plus program recommended by OCA witness Colton's testimony (OCA Statement No. 4). The Company will work with the interested parties to develop and design interim changes to the CAP payments in time to request any required waiver of its approved universal service plan from the Commission prior to the start of the 2010-2011 LIHEAP season. If a consensus cannot be developed, Columbia will file its proposal with the Commission by October 1, 2010.

2010 Rate Case, Docket No. 2010-2149262 (Joint Petition for Settlement filed June 25, 2010), ¶ 21(f)(3).

On July 21, 2010, a LIHEAP Information Memorandum ("LIHEAP IM") was issued by the Office of Community Services of the US Department of Health and Human Services ("HHS"). The LIHEAP IM states as follows:

> HHS has determined that the process of subtracting the LIHEAP benefit from the client's energy bill and to then calculate the PIPP discount and/or

> the client's payment amount appears to be using LIHEAP as a resource and creates an inequity or adverse treatment for LIHEAP clients participating in the PIPP. Such use of LIHEAP funds appears to be out of compliance with Sections 2605(b)(7) of the LIHEAP statute, which in part states: ". . . no household receiving assistance under this title will be treated adversely because of such assistance under applicable provisions of State law or public regulatory requirements . . ." and Section 2605(f) which states ". . . home energy assistance payments or allowances provided directly to, or indirectly for the benefit of, an eligible household under this title shall not be considered income or resources of such household (or any member thereof) for any purpose under any Federal or State law . . ."

LIHEAP-IM-2010-2013 (Exhibit PCOC-PAB-6).

Pursuant to the 2010 Columbia Rate Case Settlement, on August 25, 2010, Columbia filed a petition to amend its USECP to include CAP Plus. The Commission approved Columbia's proposed CAP Plus by Order entered October 19, 2010 at Docket No. P-2010-2195759, and served the Order on DPW. DPW did not file any objection to the Order with Columbia or the Commission. To the contrary, DPW officials informally advised Columbia that the CAP Plus plan was permissible. Columbia St. 117-R, p. 9-10.

PCOC now challenges the legality of the CAP Plus plan. PCOC contends that Columbia's additional charge to all CAP customers (approximately $17 per month) that was implemented under the approved CAP Plus violates LIHEAP requirements. It is noteworthy that PCOC pursues this challenge even though CAP customers already receive an affordable bill without consideration of LIHEAP grants and therefore, any CAP customer that also applies for and receives a LIHEAP grant and applies it to their gas service would be paying a net gas bill amount that is well below Commission standards of affordability. In fact, CAP charges with the CAP Plus amount meet Commission affordability standards even if the customer does not receive a LIHEAP grant. Columbia St. 117-R, pp. 10-12.

As explained in this brief, PCOC overstates the conclusions of the LIHEAP IM and understates the Commission's scope of authority in balancing the interests of low income customers in receiving affordable bills with the interests of other residential customers in paying reasonable charges to support the CAP. The CAP Plus program achieves the appropriate balance and should either be confirmed or adjusted through other approaches without increasing the burden on non-CAP customers.

B. ARGUMENT

1. PCOC's Position that CAP Plus Violates HHS Requirements is Unsupported

PCOC argues that CAP Plus violates HHS requirements. As Columbia understands PCOC's argument, it is based on the following propositions.

- Use of LIHEAP grants "as a resource" to make the CAP customer charges affordable violates HHS requirements and the LIHEAP statute;
- The CAP Plus plan violates federal law because it denies CAP customers a "portion" of the full LIHEAP grant; and
- The CAP Plus amount is impermissible because it is not charged to all CAP and non-CAP customers.

PCOC St. 1, pp. 6-20.

PCOC supports these assertions by its testimony concerning its view as to HHS legal requirements and a letter[20] from DPW containing statements that Columbia's CAP Plus may violate federal law, although the letter notes that DPW has not reviewed Columbia's CAP Plus program.

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[20] The letter was admitted into evidence solely to identify that it exists and not for the truth of the matters asserted therein or the correctness of tentative legal conclusions contained in the letter (Tr. 130-131). Indeed, in its letter the DPW states that it has not reviewed Columbia's CAP Plus model.

For the reasons explained in the following sections of the brief, PCOC's claims are unsupported and overstate the scope of the HHS' guidance.

2. CAP Plus Does Not Use LIHEAP as a Resource to Make CAP Charges Affordable

Any assertion that the CAP Plus plan uses LIHEAP grants to reach affordability levels is factually unsupported and erroneous. While prior CAP plans accumulated all LIHEAP grants for CAP customers and used such funds as an offset to discounts recovered from non-CAP customers, the Commission's approval of Columbia's CAP Plus specifically removed such provision of Columbia's CAP program and was a specific response to cure the resource issue raised by DPW and the LIHEAP IM. Columbia St. 117-R, p.8-9. In particular, under CAP Plus the LIHEAP grant is applied to further reduce the already affordable CAP bill of each grantee. As a result, the LIHEAP payments permit CAP customers to further reduce the customer's already affordable CAP bill by receipt of LIHEAP. For example, the record in this proceeding demonstrates that both of PCOC's named complainants have affordable bills under CAP Plus and would have essentially no gas bill if they applied for and received a LIHEAP grant and assigned it to gas service. Columbia St. 117-RJ, pp. 1-6. Therefore, CAP Plus is a substantial change to the prior CAP where LIHEAP payments did not reduce the CAP asked to pay amount. This is clearly the focus of the LIHEAP IM.

PCOC may attempt to argue that the CAP Plus amount effectively uses LIHEAP funds as a resource. However, such an argument is incorrect for two reasons. First, the CAP Plus amount is charged to all CAP customers.[21] Second, PCOC has failed to demonstrate that the CAP Plus

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[21] DPW recently challenged Philadelphia Gas Works ("PGW") proposed changes to its version of CAP wherein it proposed to charge the "plus" amount to just those customers that receive LIHEAP. *Petition of Philadelphia Gas Works To Modify its Universal Service and Energy Conservation Plans with respect to the Customer Responsibility Program*, P-2010-2178610. DPW asserted that PGW's proposal would have adversely impacted PGW's LIHEAP

program, as approved by the Commission, results in payments that are not affordable. The Commission's approval of CAP Plus confirms that customer payment requirements comply with the CAP Policy Statement. PCOC has failed to meet its burden of showing that the CAP Plus existing rate does not comply with Commission policies and regulations.[22]

3. CAP Plus Does Not Deny the CAP Customer a Portion of its LIHEAP Grant

PCOC and the DPW letter appear to argue that the effect of the CAP Plus is to deny a LIHEAP grantee a portion of the customers' LIHEAP grant by charging the CAP Plus amount. The DPW letter states as follows:

> There is no basis in IM 2010-13 to believe that HHS's prohibition on subtracting a LIHEAP benefit amount from the client's energy bill when determining CAP payment amounts (or PIPP discounts) is limited to the situation where the utility company subtracts the actual LIHEAP benefit the participant receives. While it is impermissible to subtract the whole LIHEAP benefit, it is also impermissible to subtract any part of that benefit, however estimated. It is unclear how Columbia Gas's model meets this requirement. Federal LIHEAP funds are not intended to benefit or subsidize non-LIHEAP recipients or the energy vendor. Instead, LIHEAP must benefit the individual LIHEAP recipient.

First, these arguments are simply speculation as to HHS policy/statutory interpretation because the LIHEAP IM does not evaluate a CAP Plus program. Second, the Commission has exclusive jurisdiction to set CAP payment levels and balance affordability standards with burdens on customers and PCOC admits this legal conclusion in its testimony. PCOC St. 1-SR,

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customers solely due their receipt of LIHEAP grants. However, Columbia CPA never considered charging the "plus" amount to just LIHEAP customers as it would have violated DPW policy. Columbia St. 117-R, p. 9.

[22] It is PCOC's burden to prove that the CAP Plus rate is unjustified and unreasonable and PCOC has failed to do so. (Where a party proposes an adjustment to a ratemaking claim of a utility, the proposing party bears the burden of presenting some evidence or analysis tending to demonstrate the reasonableness of the adjustment. *See, e.g., Pa.P.U.C. v. PECO*, Docket No. R-891364, *et al.*, 1990 Pa. PUC LEXIS 155 (May 16, 1990); *Pa.P.U.C. v. Breezewood Telephone Company*, Docket No. R-901666, 1991 Pa. PUC LEXIS 45 (January 31, 1991). In addition, tariff provisions previously approved by the Commission are deemed just and reasonable and, therefore, a party challenging a previously-approved tariff provision bears the burden to demonstrate that the Commission's prior approval is no longer justified. *See, e.g., Pa.P.U.C. v. Philadelphia Gas Works*, Docket Nos. R-00061931, *et al.*, 2007 Pa. PUC LEXIS 45 at *165-68 (September 28, 2007) (adopting the ALJ's discussion on burden of proof)).

pp. 11-13. Whether the Commission decides to increase CAP payments by $17 per month or a greater or lesser amount or not at all, is not a basis for a conclusion that the CAP Plus amount violates federal law.

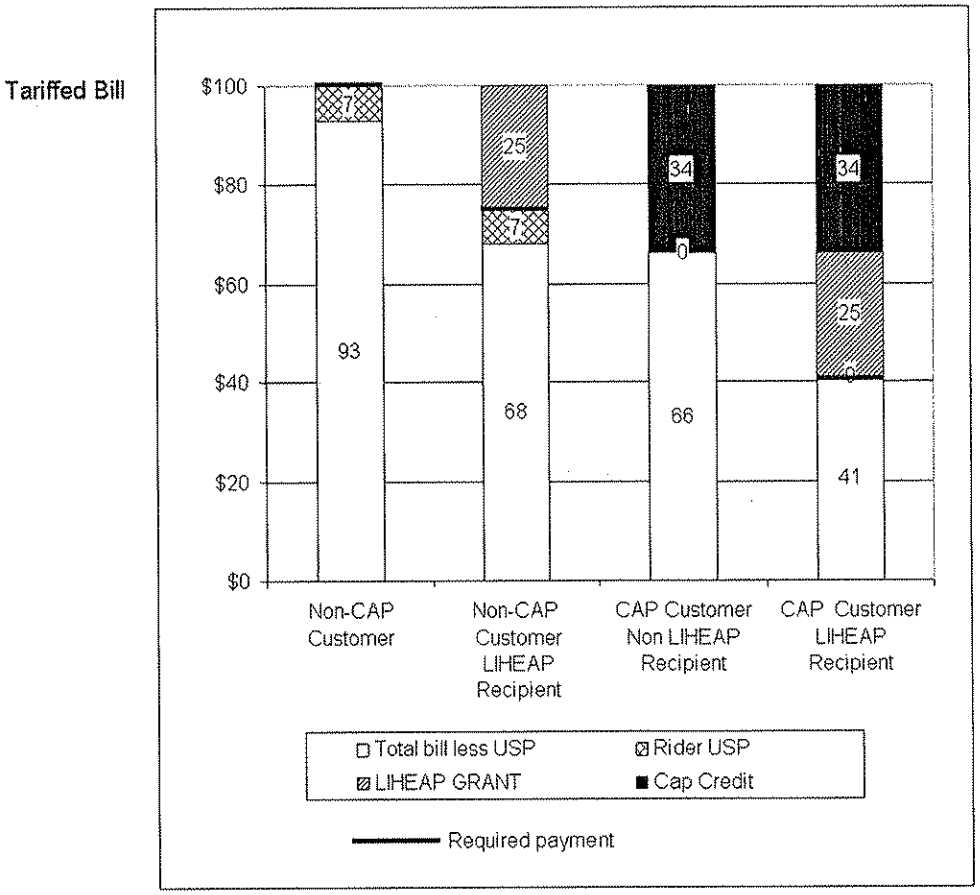
4. DPW's and PCOC's Arguments that Charging the CAP Plus Amount Only to CAP Customers Violates LIHEAP Requirements is Unsupported

DPW argues the CAP Plus is improper because the Plus amount is not charged to all customers. The DPW letter states as follows:

> To the extent Columbia Gas's "CAP-Plus" model adds a "plus" amount to the bills of CAP participants to reflect the fact that these customers will either receive a LIHEAP Cash Grant or will be eligible to receive a LIHEAP Cash Grant, but does not add an amount for all of its customers, the "CAP-Plus" model likely violates Pennsylvania's LIHEAP State Plan and federal law, because it treats LIHEAP Cash Grant recipients "adversely" within the meaning of applicable federal law and regulations. Pursuant to that guidance, if Columbia Gas subtracts a LIHEAP benefit from the CAP participant's energy bill that results in adverse treatment of the LIHEAP recipient and the improper deeming of LIHEAP funds as resources available to the LIHEAP recipient, then it likely violates federal law. Such a model is mathematically equivalent to the exact thing the HHS guidance identifies as a violation of the federal LIHEAP statute because of the manner in which it uses LIHEAP benefits in calculating the PIPP discount and the customer's payment amount.

The PCOC and DPW argument is a broad and speculative extension of the LIHEAP IM, which concerns receipt of the LIHEAP grant by the grantee as a further reduction of his/her PIPP bill. Equally important, it is hard to see how any argument can be made that LIHEAP Cash Grant recipients are being treated adversely by CAP Plus. In this regard, a CAP LIHEAP Cash Grant recipient is already receiving a reduced gas bill even with the CAP Plus amount and also receiving the full benefit of the LIHEAP Cash Grant. Columbia St. 117-R, p. 10. The non-CAP residential customer must pay the full residential rate plus Rider USP charges. Id. The Rider USP was approximately 96¢/Mcf at the time of the rate filing, and all CAP customers are currently exempt from Rider USP. Clearly, CAP LIHEAP recipients are not treated adversely by

not charging non-CAP customers the CAP Plus amount when the full level of CAP discounts and waiver of the Rider USP charge for CAP customers is considered. Columbia St. 117-R, p. 10. This fact is illustrated in the chart below:



Specifically, the chart illustrates that Columbia's existing CAP Plus methodology does not adversely impact CAP LIHEAP recipients relative to other customers when all rate components are considered. The chart illustrates how much each of the following customers pay of a typical average low income non-CAP residential $100 monthly customer bill for

Columbia:[23] (1) Non-CAP customer; (2) Non-CAP Customer-LIHEAP Recipient, (3) CAP Customer Non-LIHEAP Recipient and (4) CAP Customer LIHEAP Recipient.

- Non-CAP customer: The chart illustrates that the non-CAP customer pays the full $100 monthly bill – $93.00 in full tariffed rate charges plus $7.00 per month via Rider USP.[24]

- Non-CAP Customer – LIHEAP Recipient: The chart illustrates that the customer receives a minimum monthly LIHEAP grant of $25.00.[25] Therefore, the customer will pay a total of $75.00 in monthly charges, $68 in full tariffed rates plus $7.00 in Rider USP charges

- CAP Customer – Non-LIHEAP Recipient: As noted above, CAP customers do not pay Rider USP charges. Therefore, the CAP customer's $100 monthly bill consists of $49.00 in average CAP payment[26] plus the $17 of CAP Plus payment for a total of $68.00. This results in the customer receiving an average discount (i.e. CAP credit) and avoidance of Rider USP charges totaling $34.00.

- CAP Customer – LIHEAP Recipient: The CAP Customer – LIHEAP recipient receives an average discount (i.e. CAP credit) and avoidance of Rider USP charges totaling $34.00, that is the same as the CAP non-LIHEAP recipient. However, based

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[23] See Columbia Exh. DAD-1RJ, Question 2, Column 3, ($1,217.61/12).

[24] As reflected in Columbia Exhibit DAD-1RJ, in response to Question 2, Rider USP charges make up approximately 7.0% of a non-CAP customer's monthly bill regardless of whether the customer is low-income or not - Rider USP/Annual Bill * 100 = 7.3%.. ($77.34/ 1053.44 * 100 = 7.3%). Column D of Exhibit DAD-1RJ, p. 2

[25] Assumes that the customer receives the minimum LIHEAP grant of $300. Columbia St. 117-RJ, p. 4. ($300/12 = $25/month in LIHEAP grants.

[26] Columbia St. 117-R, 16.

upon participation in LIHEAP, the customer also receives $25.00 per month via a minimum LIHEAP grant of $300. This results in the customer paying a net average amount of $41 per month, the lowest payment of any customer group.

As evidenced by this chart, contrary to the unsupported assertions of PCOC and DPW, the use of CAP Plus does not adversely impact CAP customers that receive LIHEAP grants. In fact, the CAP LIHEAP recipient pays equal to or less than any other group both before and after consideration of the LIHEAP grant.

PCOC also argues that CAP customers that receive LIHEAP grants obtain less benefit from their grant than non-CAP LIHEAP recipients. PCOC St. 1-SR, p. 15. This argument is both illogical and unsupported. First, as noted above, the argument is based upon consideration of only the CAP Plus amount and ignores all the benefits of the CAP program for the CAP customer. Second, PCOC has failed to make any presentation to support that there are a significant number of non-CAP LIHEAP recipients. Third, if any CAP LIHEAP recipients believe that they are disadvantaged by participating in CAP, they could withdraw from the CAP. Of course, that would be foolish because it would cause the customer's bill to increase since CAP charges, including the CAP Plus amount, are always less than the full residential bill.

PCOC's arguments require parsing of claims about alleged offsets to LIHEAP benefits without consideration of the full level of benefits of the CAP program. Further, PCOC attempts to bootstrap HHS's determination about the prior CAP program's treatment of LIHEAP benefits, which has been resolved by CAP Plus, into another alleged violation of HHS requirements. The Commission should not accept such arguments as a basis to reject the CAP Plus approach.

5. The Commission Should Consider Other Options to CAP Plus in Light of the DPW Letter

Columbia does not believe that PCOC's arguments and the tentative conclusions about CAP Plus in the DPW letter are reasonable. However, resolution of whether the CAP Plus program approach violates HHS requirements is not a matter that can be resolved by a decision of the Commission. Columbia is concerned that DPW will proceed with its statement that Columbia could be denied vendor status if the Commission continues the CAP Plus program. This would result in customers receiving LIHEAP payments directly, instead of Columbia receiving payments for application to customers' accounts, with the possible result that CAP customers will use the funds for purposes other than their utility service to the detriment of CAP customers. This could result in increased customer terminations, which the CAP seeks to avoid. Columbia St. 117-R, p. 8.

If the issue cannot be resolved with DPW, Columbia suggests that the Commission consider options other than CAP Plus to balance the levels of CAP customer payments and the level of support provided by non-CAP residential customers. The Commission should consider options that do not relate directly to LIHEAP. Several alternatives are set forth in OCA St. 3-R, pp. 18-19, and include no longer exempting CAP customers from the Rider USP charge and/or increasing required CAP payments, and revising, if necessary, the range of affordability under the CAP Policy Statement. Even PCOC admits that such matters are within the sole discretion of the Commission, but PCOC dismisses them because OCA did not endorse a specific alternative. PCOC St. 1-SR, pp. 11-13. Clearly the Commission can do so and terminate this controversy by exercise of its authority to revise CAP payment amounts without reference to LIHEAP grants.

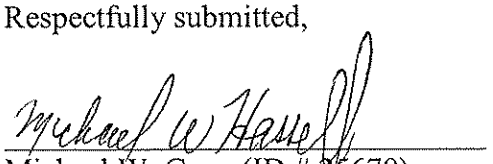
C. THE SETTLEMENT

As noted above, the parties to this proceeding have achieved a comprehensive partial Settlement, which resolves all but the two issues addressed above in this Brief. The Settlement terms are self-explanatory. In addition, parties have attached to the Settlement Statements in Support that explain why the Settlement terms are reasonable and in the public interest. The Settlement should be adopted without modification.

D. CONCLUSION

WHEREFORE, for all the foregoing reasons, Columbia Gas of Pennsylvania, Inc. respectfully requests that the ALJ and Commission: 1) adopt the Joint Petition for Partial Settlement without modification; 2) approve Columbia's proposed residential Levelized Distribution Charge; and 3) either dismiss PCOC's challenges to CAP Plus or, alternatively, revise CAP payment amounts without reference to LIHEAP grants.

Respectfully submitted,



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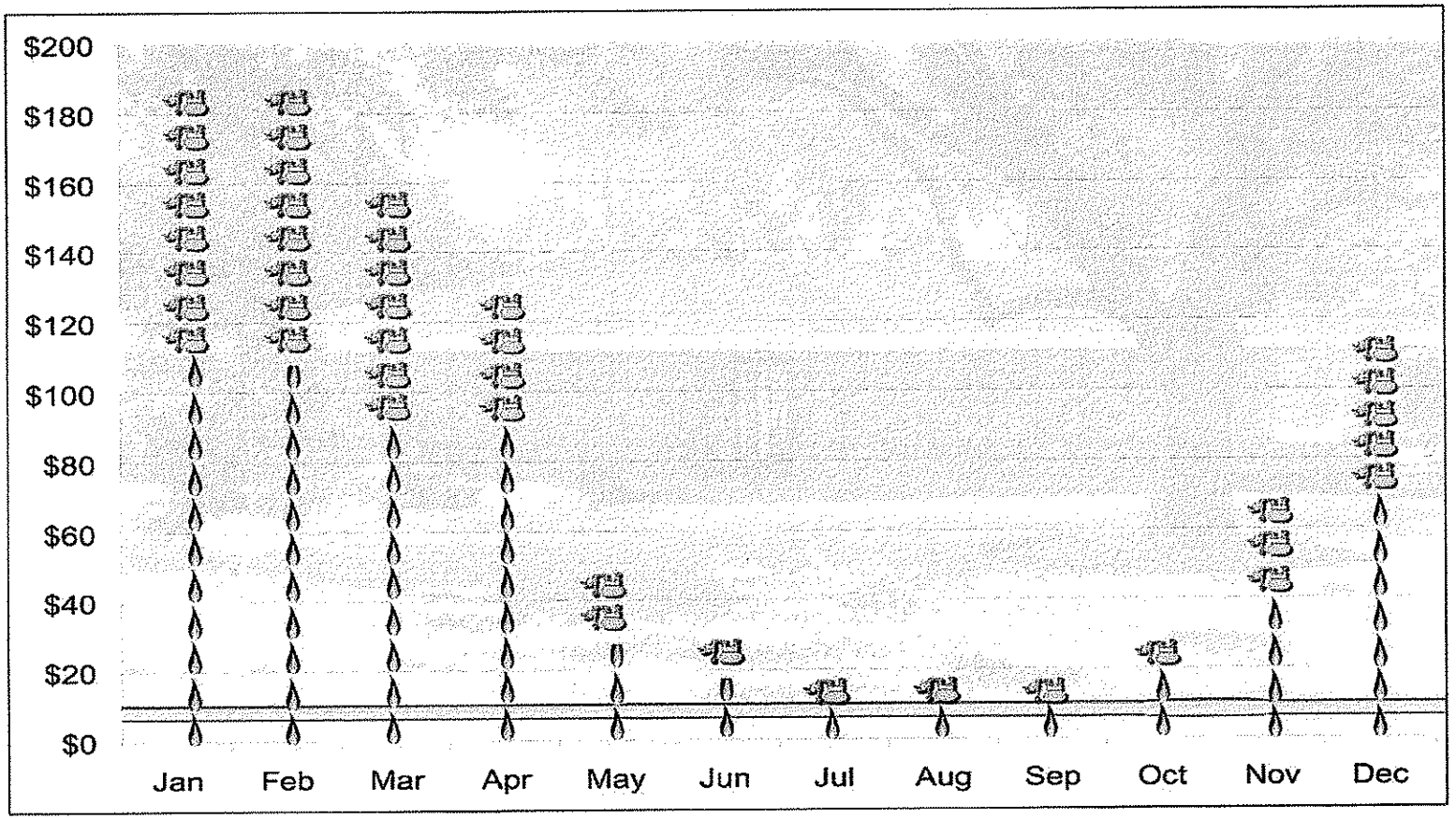
Date: June 27, 2011

Attorneys for Columbia Gas of Pennsylvania, Inc.

Appendix "A"

Columbia Gas of Pennsylvania, Inc.
Current Price Signals Confuse and Don't Reflect the Real Drivers of Costs



Today, volumetric distribution charges are used to recover 60% of Columbia's fixed costs making the Company dependent on cold weather and customer usage to recover its fixed costs. Each gas meter represents approximately $10.00 in volumetric distribution charges.

The current fixed customer charge recovers only 40% of Columbia's fixed costs of providing service.

Each gas flame represents $10.00 in gas commodity costs.

Columbia Gas of Pennsylvania, Inc.
Honest Price Signals Will Simplify and Encourage Energy Efficiency