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July 11, 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 Reply 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
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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
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	:	
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
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and	:	
	:	
Columbia Industrial Intervenors	:	
	:	
Intervenors	:	
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v.	:	
	:	
Columbia Gas of Pennsylvania, Inc.	:	

REPLY BRIEF OF
COLUMBIA GAS OF PENNSYLVANIA, INC.

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I. INTRODUCTION

This Reply Brief is filed by Columbia Gas of Pennsylvania, Inc. ("Columbia" or the "Company") in response to the Main Briefs of the Office of Trial Staff ("OTS") of the Pennsylvania Public Utility Commission ("Commission"), the Office of Consumer Advocate ("OCA") and Pennsylvania Communities Organizing for Change, Inc. d/b/a ACTION United, Carol Collington and Nettie Pelton ("PCOC"). Columbia has anticipated and responded to most of the arguments presented by these parties with respect to the two issues reserved for litigation, and will endeavor to avoid repeating those responses in this Reply Brief.

II. ARGUMENT

A. BURDEN OF PROOF

OTS, OCA and PCOC all present arguments concerning Columbia's burden of proof in this case. OTS MB, pp. 5-9; OCA MB, pp. 4-7; PCOC MB, pp. 4-5. Columbia replies to two contentions made in these arguments.

The first response concerns the level of proof Columbia is required to present. OCA and PCOC, and to a lesser extent OTS, assert that Columbia bears a heightened burden of proof. OCA and PCOC argue that, in order to meet its burden of proof, Columbia has "a formidable task," and must produce evidence "precluding all reasonable inferences to the contrary." *Burleson v. Pa. P.U.C.*, 501 Pa. 433, 461 A.2d 1234 (1983) ("*Burleson*"). OCA MB, p. 5; PCOC MB, p. 4. OTS indicates Columbia has a burden to submit "substantial evidence." OTS MB, p. 6.

The parties' reliance on *Burleson* is misplaced. They are confusing standards of appellate review of Commission decisions with the evidentiary burden before the Commission, and misstating such standards.

Although the Court stated in *Burleson* that the litigant must establish that "the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary," *Id.* at 436, 461 A.2d at1236, the Court was not articulating some new evidentiary standard for Commission proceedings. Rather, the Court was simply recognizing the well-established principle that on appellate review any finding of fact necessary to support an adjudication of the Commission must be based upon "substantial evidence." *See Met-Ed Indus. Users Group v. Pennsylvania Public Utility Commission*, 960 A.2d 189, 193 n.2 (Pa. Cmwlth. 2008) (citing 2 Pa.C.S. § 704). The term "substantial evidence" does not imply a higher standard of proof, but is such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. *Borough of E. McKeesport v. Special/Temporary Civil Service Commission*, 942 A.2d 274, 281 (Pa. Cmwlth. 2008). As the Commonwealth Court recently explained, although substantial evidence must be "more than a scintilla and must do more than create a suspicion of the existence of the fact to be established," *Kyu Son Yi v. State Board of Veterinary Medicine*, 960 A.2d 864, 874 (Pa. Cmwlth. 2008) (citation omitted), the "presence of conflicting evidence in the record does not mean that substantial evidence is lacking." *Allied Mechanical and Electrical, Inc. v. Pennsylvania Prevailing Wage Appeals Board*, 923 A.2d 1220, 1228 (Pa. Cmwlth. 2007) (citation omitted).

The correct standard in assessing whether a party has met its burden of proof before the Commission is preponderance of evidence. As the Commonwealth Court has stated: "[a] litigant's burden of proof before administrative tribunals as well as before most civil proceedings is satisfied by establishing a preponderance of evidence which is substantial and legally credible." *Samuel J. Lansberry, Inc. v. Pennsylvania Public Utility Commission*, 578 A.2d 600, 602 (Pa. Cmwlth. 1990); *see also In Re: Pennsylvania Public Utility Commission v. Jackson*

Sewer Corporation, Docket Nos. R-00005997, et al., 2001 Pa. PUC LEXIS 53 at *9 (September 28, 2001). "It is well established in this Commonwealth that proof by a preponderance of the evidence is the lowest degree of proof recognized in civil judicial proceedings." *Lansberry*, at 602 (citing *Se-Ling Hosiery, Inc. v. Margulies*, 364 Pa. 45, 70 A.2d 854 (1950)). The preponderance of evidence standard requires proof by a greater weight of the evidence. *Commonwealth v. Williams*, 557 Pa. 207, 732 A.2d 1167 (1999). Consequently, as the party seeking Commission approval of the requested rate increase, Columbia bears the burden of proving by a simple greater weight of the evidence that its proposed residential rate design is just and reasonable.

Columbia's second response concerns PCOC's contention that Columbia bears the burden of proof with respect to the reasonableness and legality of its existing, Commission-approved CAP Plus. Such contention is erroneous. As explained in Columbia's Main Brief, a utility does not bear the burden of proof with respect to an issue it did not include in its rate filing. Columbia MB, pp. 5-6.

In this proceeding, Columbia proposed no changes to its CAP Plus. It is PCOC that seeks to revise the CAP Plus to reduce the required payment by CAP customers and, as a result, increase the bill shortfall paid by other customers through Columbia's Rider USP – Universal Service Program. As the proponent of a proposal to increase the expenses charged to non-CAP customers, PCOC bears the burden of proof. *See*, *Pa. P.U.C. v. Metropolitan Edison Company, et al.*, 2007 Pa. PUC LEXIS 5, *111-12 (2007).

B. THE ALJ AND THE COMMISSION SHOULD ADOPT COLUMBIA'S PROPOSED LEVELIZED DISTRIBUTION CHARGE

1. Introduction

OTS, OCA and PCOC all oppose Columbia's Levelized Distribution Charge. The arguments presented involve contentions about price signals, effects on low use and low income customers, economic theory and prior precedent. Columbia will respond to each of these contentions below.

Before responding to specific contentions, it is important to recognize the most important aspect of the Levelized Distribution Charge. It is an aspect that is unmentioned in other parties' briefs: The Levelized Distribution Charge aligns rates with the costs incurred to serve residential customers. Columbia's distribution costs to serve residential customers are fixed, and do not vary with changes in usage. Furthermore, Columbia's investment in plant to serve residential customers does not vary due to differences in usage between residential customers, because all residential customers, regardless of demand, can be served through the minimum size (two-inch) pipe installed on Columbia's system as well as the same sized meters and services. Columbia St. 12, pp. 44-46. Because the costs to serve residential customers do not vary by changes in annual usage or differences in usage between residential customers, cost of service principles dictate that these distribution costs should be recovered through a fixed charge, and not a usage-based charge. Further, a usage-based charge for residential customers only continues inappropriate intra-class subsidies. Columbia MB, pp. 9-15.

There is a second important aspect of the Levelized Distribution Charge that is not considered by other parties. The Levelized Distribution Charge will contribute to bill simplicity. By eliminating the usage-based distribution charge, residential customers can more easily focus on the commodity prices of CHOICE suppliers, and the price of Supplier of Last Resort service.

This will allow customers to shop more intelligently, by giving them a clear price signal that reflects the actual value of customer choice and of installing energy efficiency measures and appliances. See Columbia St. 2, p. 22; Columbia St. 2, p. 27.[1]

Once these overriding points are considered, the other contentions presented by parties provide no basis for rejecting the Levelized Distribution Charge.

The assertion that usage-based distribution charges provide "price signals" to conserve must be rejected because these are false price signals, which do not reflect the realities of cost of service. Reducing usage does not reduce distribution costs. Thus, under the current rate design approach, residential customers are deceived into thinking they will achieve more savings as a result of energy efficiency measures than they truly do. This deception is exposed in the next rate filing, when distribution rates must be increased to recover the same level of fixed costs over a smaller usage base. This only discourages customers from considering additional, cost-effective energy efficiency measures. There are true savings to be achieved through adoption of energy efficiency measures, and those savings come from reductions to unbundled gas supply costs. These savings will continue to provide incentives to customers to install energy efficiency measures. In addition, the Levelized Distribution Charge will align Columbia's interests with customers' interests in encouraging the installation of energy efficiency measures, thereby increasing effective conservation efforts.

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[1] In its Order No. 636, the Federal Energy Regulatory Commission observed that a SFV rate design would improve competition by suppliers: "Under SFV, gas merchants would be able to compete in a national market without regard to fixed transportation costs included in the usage charge." *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, FERC Stats. & Regs. ¶ 30,939, 30,434-435, *order on reh'g*, Order No. 636-A, FERC Stats. & Regs. ¶ 30,950, *order on reh'g*, Order No. 636-B, 61 FERC ¶ 61,272 (1992), *order on reh'g*, 62 FERC ¶ 61,007 (1993), *aff'd in part and remanded in part sub nom. United Distribution Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997). ("Order 636").

Concerns have been raised that the Levelized Distribution Charge will increase bills to low use customers. Columbia acknowledges that the change in rate design will increase some customers' bills more than others in this case; however, that is a common result of many rate designs.[2] It is noted that OCA's and OTS' proposed rate designs also increase some customers' bills more than others, but in their cases the burden falls on higher use customers. However, where, as the evidence demonstrates, low use customers are not paying their share of the fixed distribution costs of service, it is appropriate that such customers receive a greater than average increase.

OCA and PCOC also raise concerns about the potential effect of the Levelized Distribution Charge upon low income customers. Initially, it is to be noted that the effects on some low income customers should not prevent adoption of an appropriate rate design when Columbia has robust universal service programs to assist such customers. As Columbia has explained, the effect on low use customers is not a basis for improperly allocating costs. Further, Columbia disputes the argument that most low income customers are low use customers. The arguments presented by these parties are based largely on generic national or statewide data and relate to whether it is "more likely" that low income customers are high use customers or low use customers. What is undisputed is that Columbia's CAP and LIURP customers, on average, use substantially more gas than the typical Columbia residential customer. As a result, adoption of the Levelized Distribution Charge will reduce the current bill shortfall currently recovered from non-CAP customers through Columbia's Rider USP. Columbia has agreed to add customers to the CAP if low income low use customers find themselves payment-troubled as a result of

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[2] It is noted that after the Levelized Distribution Charge is adopted, residential customers will receive the same increase in their distribution rate in future rate cases.

increased bills due to the Levelized Distribution Charge. Additional CAP participants may offset the reduction to the CAP shortfall resulting from the Levelized Distribution Charge, but because Rider USP primarily recovers gas cost, it will continue to be billed based upon usage and therefore, high use customers will continue to pay a larger share of those costs.

Finally, OTS and OCA point to the results of their "direct cost studies" to support their residential rate design proposals. The fundamental flaw in these studies is that they do not reflect the reality of the cost to serve residential customers. "Direct cost studies," as historically defined by the Commission, substantially understate the fixed cost of facilities and expenses needed to provide service, because the only facilities included are meters and services. Customers cannot receive service without mains. Columbia is pursuing a substantial project to replace its aging mains, and these replacements reflect long-term, fixed costs that are available to serve all residential customers. Failure to recognize these fixed costs in customer charges under a "direct customer cost" approach is a substantial contributing factor to the intra-class subsidy of low use customers by high use customers, a disincentive to utility sponsored conservation and a disincentive to investment.

For reasons explained further below and in Columbia's Main Brief, the ALJ and Commission should adopt the residential Levelized Distribution Charge.

2. Economic Theory Does Not Change the Fact That Columbia's Costs to Serve Residential Customers are Fixed and Do Not Vary with Usage

OCA asserts that recovering distribution costs through usage-based charges is "consistent" with economic theory and competitive markets. OCA MB, pp. 29-33.

What is strikingly absent from OCA's arguments is any assertion that residential distribution costs vary based upon usage, or that there is any difference between the distribution cost to serve a low use residential customer and a high use residential customer. This is not

surprising, however, because OCA submitted no evidence to support such assertions. As conclusively demonstrated by Columbia's evidence, there is no difference in the cost to serve residential customers based upon usage. Columbia MB, pp. 9-15.

Lacking evidence of cost-based reasons for recovery of distribution cost through usage charges, OCA resorts to economic theories about "efficiency" and "fairness" to support its rate design proposal. However, these theories fail to reflect the realities of utility service.

OCA quotes its witness Mr. Watkins to contend that distribution service pricing by Columbia "should mirror those of competitive firms to the greatest extent practical." OCA MB, p. 29. Later, OCA asserts that competitive markets have usage-based pricing. OCA MB, p. 33. There are several responses.

First, competitive markets do not always rely upon usage-based pricing. Cellular telephone, cable, satellite, internet and home security services are all examples of competitive markets that charge a fixed monthly fee. Columbia St. 12, pp. 47-48. Second, competitive markets must be distinguished from regulated utilities due to the restrictions on price changes and the duty to serve imposed on utilities. Columbia cannot avoid costs by refusing service to unprofitable, low use customers, or raise its prices when demand increases, as competitive markets can. Columbia St. 112-R, pp. 17-18. Therefore, it is inaccurate to contend that a utility's pricing structure should mimic true competitive markets.

OCA further argues that "economic theory" says that efficient price signals result when prices equal long-run marginal costs and that, in the long run, costs are variable. OCA MB, pp. 29, 32. OCA's argument is wrong, for several reasons. First, the claim that long-run marginal costs are the basis for efficient pricing is incorrect. This was explained by Columbia's witness Mr. Feingold:

> Mr. Watkins is in error regarding economically efficient prices. Economic efficiency results from setting prices equal to short run marginal costs. Efficiency properties of the competitive model depend on this pricing prescription. Consider the unambiguous statement of Alfred Kahn regarding efficient pricing:
>
> > ". . ., it is short-run marginal cost to which price should at any given time – *hence always* – be equated, because it is short-run marginal that reflects the social opportunity cost of providing the additional unit that buyers are at any given time trying to decide whether to buy."[3]

Second, the evidence in this case debunks the notion that long-run costs are variable. As explained by Columbia's witness Mr. Cote, Columbia is undertaking a multi-year, multi-million dollar replacement of its mains and services infrastructure. Columbia St. 9, pp. 16-19. This replacement plant, which makes up the vast majority of Columbia's capital investment, is expected to last on average over 70 years. Columbia Supplemental Exh. 109, p. III-5. Clearly, there is nothing variable about this long-term cost, and the capital markets certainly do not view this investment as a variable cost that could be avoided.

OCA also states that competitive prices "generally" are usage-based so that those who receive more benefits pay more than those who receive fewer benefits. OCA MB, p. 30. Regardless of the accuracy of this statement with respect to non-regulated entities, OCA has failed to demonstrate at any point in this proceeding that usage defines the amount of benefits received by individual residential customers from distribution service. Again, the evidence is clear and unrebutted: there is no difference in the distribution service benefit received by residential customers based upon usage. All residential customers, whether they use 0 Mcf of gas in a month or 15 Mcf, have the same distribution service benefit and, most importantly, the same fixed distribution cost of service. The equal benefit for each residential customer is a

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[3] Columbia St. 112-R, pp. 16-17, quoting *The Economics of Regulation*, Alfred E. Kahn, The MIT Press, 1995 (Sixth Printing), Vol. 1, p. 71.

complete distribution system in place to meet all of their requirements at any time. Because the cost of that system does not vary with usage, it is proper that each customer pay the same cost for the benefit received. Columbia St. 12, p. 37.

In an attempt to equate usage with benefit, OCA refers to a century-old practice of some utilities to impose a flat fee for all service rendered, and the elimination of that practice due to unfairness. OCA MB, p. 30. This old practice is irrelevant to the issue at hand because, at the time, the cost of the product received (gas, water, electricity) was bundled with the distribution service. Since at least the year 1999 for gas utilities, following adoption of the Natural Gas Choice and Competition Act, the gas supply product has been unbundled from distribution service. That gas supply product, whether sold by Columbia or by a Natural Gas Supplier, will continue to be priced on a commodity basis following adoption of the Levelized Distribution Charge. Thus, where usage does cause a different level of cost to be incurred, customers will continue to pay based on the amount of the product. However, this has no relevance to the unrelated distribution service, which is fixed and unchanging regardless of usage.

Economic theories, and pricing by unregulated industries, cannot overcome the immutable facts regarding the provision of distribution service to residential customers. Those facts are that the distribution cost to serve is fixed, and does not vary by usage. Rate design should follow how costs are incurred. The Levelized Distribution Charge should be adopted.

3. Recovery of Fixed Distribution Costs Through Usage-Based Rates Creates False Price Signals

OCA asserts that Columbia's Levelized Distribution Charge may adversely affect a residential customer's desire to conserve. OCA MB, pp. 11-16. OCA contends that a usage-based distribution charge provides a "price signal" to encourage conservation. OTS makes a

similar contention. OTS MB, p. 25. These arguments are based on false price signals that fail to encourage effective, long-term energy efficiency measures. Columbia MB, pp. 15-18.

OCA begins its argument concerning "price signals" with a telling admission:

> The OCA agrees that recovering all of its base rate costs through a fixed monthly charge could reduce any disincentive that the Company may have to promote conservation . . . .

OCA MB, p. 11. This admission is important, as it concedes that recovery of fixed distribution costs through usage-based distribution charges for residential customers is a disincentive to Columbia to promote energy efficiency measures. As such, usage-based distribution charges fail to satisfy the requirements of Section 410(a) of the American Recovery and Reinvestment Act of 2009, Pub. L. 111-5 ("ARRA"), which directs that utility financial incentives be <u>aligned</u> with helping customers use energy more efficiently.

OCA's argument that fixed distribution charges should be recovered through usage-based rates in order to provide a price signal to conserve also is inconsistent with its contentions that customers should be provided *efficient* price signals. OCA St. 5, p. 29; OCA MB, pp. 29-32. A usage-based distribution rate cannot be efficient as a price signal because it gives a *false* signal of the true cost to serve and the true benefits from energy efficiency. This was explained by Columbia's witness Mr. Feingold:

> SFV [Straight Fixed Variable] pricing is economically efficient because first, the customer faces the full economic cost of a decision to elect gas service as a new customer. When a customer elects to connect to the delivery system, that customer knows that the full delivery cost will be paid no matter how much gas the consumer uses. Second, the marginal cost of additional commodity use is also recovered going forward. Thus, if a customer evaluates the benefits of a conservation measure designed to reduce gas consumption, the value of that change will be reflected in lower gas commodity costs. This lower gas commodity cost is not de minimis as suggested by Mr. Watkins as the gas commodity charge represents the largest portion of the annual bill for most customers.

Columbia St. 112-R, p. 20. As noted by Mr. Feingold, the accurate price signal for energy efficiency measures – gas costs – remains a strong signal. The pro forma purchased gas cost rate plus unbundled uncollectables in this case is approximately $7.91 per Mcf. This is approximately 75% of the current volumetric charge (gas commodity costs, unbundled uncollectables and usage-based distribution charges).[4] Therefore, true savings will continue to provide a strong incentive for customers to reduce energy usage. With adoption of the Levelized Distribution Charge, this continuing customer incentive to use energy efficiently will be aligned with Company incentives to encourage adoption of cost effective energy efficiency measures. Accurate, not false, price signals should be the Commission's goal.

OCA cites to the Federal Energy Regulatory Commission's ("FERC") Order No. 636 to support is contention that a SFV rate design will increase customer usage. OCA MB, p. 12. OCA overstates FERC's intentions in Order No. 636. FERC's reference to increased usage resulting from a SFV rate design was not focused upon individual customer usage, but instead on encouraging use of clean natural gas as a substitute for other fuels:

> Moreover, the Commission's adoption of SFV should maximize pipeline throughput over time by allowing gas to compete with alternate fuels on a timely basis as the prices of alternate fuels change. The Commission believes it is beyond doubt that it is in the national interest to promote the use of clean and abundant natural gas over alternate fuels such as foreign oil. SFV is the best method for doing that. As discussed above, using cost classification to design rates to influence the consumption of gas is a traditional regulatory technique of the Commission. For example, the Commission has removed costs from the commodity charge to enable pipelines to meet competition for fuel switching customers from coal. And, indeed, the Commission adopted MFV in the context of competition from oil. The Commission finds it appropriate to use that technique again in the current circumstances.

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[4] See Exhibit 103, Sch. 1, p. 1: (7.82 + 0.09) / (7.82 + 0.09 + 2.69)

Order No. 636 at 30,435. These goals of replacing foreign oil, and encouraging clean fuels, are even more important today than they were when FERC adopted Order No. 636.

OCA cites to public input testimony provided by Mr. Carryer, a representative of a trade association of manufacturers/distributors of energy efficiency products, to support its contention that usage-based distribution charges provide signals to support customer conservation efforts. OCA MB, p. 13. This testimony provides no basis to continue the false price signals provided by usage-based distribution charges.

Initially, Columbia notes that OCA is selective in its use of Mr. Carryer's testimony. OCA fails to note that Mr. Carryer acknowledged that the current usage-based distribution charge was a disincentive to encourage Columbia to support energy efficiency measures because of its effect on the utility's revenues. Tr. 76. Mr. Carryer recognized that a different approach was needed to align utility and customer interests. *Id.*

While Columbia has stressed that the Levelized Distribution Charge will remove its disincentive to promote energy efficiency, Mr. Carryer's testimony indicates more concern about the impact that Columbia's proposal would have upon his business than about Columbia's customers. He stated that his "entire business proposition" is based upon higher prices, and criticized the Levelized Distribution Charge because it will "lengthen the time it takes for customers to recovery the costs of investing in energy efficiency, making business more difficult for my company . . . ." Tr. 76. As explained below, Mr. Carryer is wrong in asserting that customers should be given distorted price signals as a way to encourage long-term investment in energy efficiency.

With respect to Mr. Carryer's concern that the Levelized Distribution Charge would reduce energy efficiency efforts, Columbia's witness Mr. Kempic explained that higher usage charges are not an effective driver of investment in energy saving equipment:

> Q. Do you agree with Mr. Carryer's statement that the LDC undermines energy efficiency?
>
> A. Absolutely not. Mr. Carryer claims that a higher fixed charge weakens the price signal sent to customers that links higher consumption to higher prices. His argument is premised on the belief that higher volumetric charges (whether they come from gas prices alone or gas prices along with volumetric distribution charges) will cause customers to invest in energy appliances. As explained on page 37 of my direct testimony, history has proven that this is not correct. Even after gas commodity rates exceeded $12.00 per Mcf during the winter of 2005/2006, Columbia's annual weather normalized residential throughput dropped only 5.2%. This drop was immediately reversed the following year by a 3.4% *increase* in annual weather normalized residential throughput, thereby resulting in only a 1.8% realized reduction in residential consumption. While accurate price signals are important for other reasons, they do not have a substantial and sustainable impact on energy efficiency improvements like those demonstrated by utility-sponsored weatherization programs.

Columbia St. 102-R, p. 19.

Mr. Kempic also responded to Mr. Carryer's concerns that the Levelized Distribution Charge would reduce energy efficiency savings:

> Artificially inflating the customer's volumetric charges by adding a volumetric distribution charge that is not reflective of how the Company incurs costs to distribute gas to residential customers is by definition an inaccurate price signal. As explained by Mr. Feingold, inaccurate pricing of the distribution cost of gas distorts savings, as any temporary savings will be offset by the need for Columbia to increase rates to recover lost margin. Thus, "savings" from energy efficiency related to distribution costs will decline, thereby extending the recovery period of investing in energy efficiency. Again, Columbia's costs to serve residential customers are fixed. They are not related to the amount of gas consumed. Columbia believes it is important to give customers clear and accurate price signals. The LDC will do that by communicating the clear and accurate message to the customer that they pay a flat charge for distribution service (which is reflective of how Columbia incurs costs to serve residential customers)

> and they pay a volumetric charge for the gas commodity (which is reflective of the cost of the gas commodity).

Columbia St. 102-R, pp. 19-20. Residential customers should not be given false signals about savings from energy efficiency equipment, by including fixed distribution costs in usage charges. This only results in consumer disappointment when the "savings" are undone in the next base rate case. Columbia St. 2, p. 35.

OCA seeks to distinguish the Levelized Distribution Charge from budget billing by noting that budget billing is trued-up, and that such true-ups provide a price signal. OCA MB, p. 14. There are several responses. First, Columbia never suggested that budget billing was identical to the Levelized Distribution Charge. Columbia referenced budget billing for the point that many residential customers are already accustomed to levelized monthly billing as a way to manage budgets, and thus would not find the Levelized Distribution Charge to be abnormal. Columbia MB, p. 14. Second, Columbia has explained that annual budget billing true-ups will be lower with the Levelized Distribution Charge than with usage-based distribution rates. Columbia St. 12, p. 47. However, Columbia did not testify that this was evidence that usage-based distribution rates provide an appropriate price signal to encourage energy efficiency. Instead, Columbia was explaining that usage-based distribution rates would contribute to higher budget billing true-ups if a customer's usage exceeds the usage reflected in the budget amount, because the customer would be paying a greater amount for fixed distribution costs through usage-based distribution rates.

OCA cites decisions by other state utility commissions that have rejected SFV rate designs. OCA MB, pp. 15-19. Columbia can cite a larger list of states that have adopted either SFV or another revenue stabilizing mechanism: See, *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 125 Ohio St.3d 57, 926 N.E.2d 261 (Oh. 2010) (Affirmed the Public Utilities

Commission of Ohio's adoption of a SFV rate design for two natural gas distribution companies), *Re Missouri Gas Energy*, 280 P.U.R.4th 107, 2010 WL 600010 (Mo. P.S.C., Order entered on February 10, 2010) (Approved the continuation of a SFV charge for residential customers, and approved the implementation of a SFV charge for small general service customers), *In re Atlanta Gas Light Co.*, WL 1034312 (Ga. P.S.C., Order entered on June 25, 1998) (Approved a SFV rate structure), *In re Chattanooga Gas Co.*, 286 P.U.R.4th 276, WL 5559687 (Tn. R.A., Order entered on November 8, 2010) (Tennessee Rate Authority approved the recovery of 70% of costs through a fixed charge). In addition, OCA has been selective in its quotation from several state utility commission decisions, giving an inaccurate impression of the position of these states with respect to progressive rate design.

For example, the OCA seeks to rely on a decision of the state commission of Washington for the proposition that use of a SFV mechanism reduces price signals for consumers to conserve. OCA MB, pp. 15-16. In the 2009 Washington Utility and Transportation Commission decision, the OCA notes that the Washington Commission allowed a 25¢ increase to an existing $6.00 customer charge rather than a recommended $10.00 customer charge. However, the OCA fails to note that the utility in the Washington case did not request a four dollar increase to its existing customer charge – this increase was proposed by the staff of the Washington Commission to replace an existing decoupling mechanism. *Washington Util. and Transp. Comm'n v. Avista Corp.*, 2009 Wash UTC LEXIS 1210, 199 (Wash. 2009) ("*Avista*"). Instead, the Washington Commission approved the utility's request to increase its customer charge by 25¢ and to continue its existing decoupling mechanism pilot program.[5] *Avista*, *178. Thus,

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[5] In 2007, the Washington Commission approved a limited decoupling mechanism for Avista, that allowed the company to recover lost margins attributable to company-sponsored conservation programs. *Re Avista, dba Avista Utilities*, 2007 WL 538824 (Wash. UTC).

contrary to the impression given by OCA, the Washington Commission is not adverse to progressive rate designs that encourage utility energy efficiency measures. *Avista*, *178.

The OCA cites to a general investigation of the Kansas Corporation Commission held in response to the Energy Independence and Security Act of 2007. OCA MB, p. 16. However, Columbia emphasizes that the order cited by OCA was a generic investigation into incentives for utilities to pursue energy efficiency programs and not a request by a utility to implement a specific decoupling proposal. In addition, the OCA selectively quotes the Kansas Commission with respect to its concern about the effect a SFV rate design may have on a customer's inclination to save energy. *General Investigation into the Commission's Consideration of the Public Utility Regulatory Policy Act's Gas Standards*, 2009 Kan. PUC LEXIS 1459, *93-94. Further review of the Kansas Commission's order indicates a greater concern with SFV by electric utilities than gas utilities:

> The Commission acknowledges that natural gas volumetric rates contain a smaller percentage of fixed costs and a higher percentage of fuel costs. Therefore, concerns about the effect on energy efficiency from separating fixed costs from volumetric charges are not as pronounced as with electric rates.
>
> * * *
>
> Natural gas utilities may, as an alternative to decoupling, propose straight fixed-variable rate structures. The Commission will entertain such proposals from natural gas utilities because of the inherent differences in rate structure between natural gas and electric utilities.

General Investigation into the Commission's Consideration of the Public Utility Regulatory Policy Act's Gas Standards, 2009 Kan. PUC LEXIS 1459, *97-98. Therefore, further analysis of this decision demonstrates that the Kansas Commission has not ruled out a SFV proposal, particularly for gas utilities, and supports decoupling of recovery of fixed costs from usage for gas companies.

The OCA also cites to decisions from the Florida and Wyoming commissions wherein these commissions considered and rejected SFV rate designs. However, upon examination it is evident that the OCA's reliance on these cases is misplaced. Initially, Columbia notes that in *Petition of Fla. Division of Chesapeake Util. Corp.*, 2005 Fla. PUC LEXIS 543, the gas utility proposed a SFV rate design for its commercial customers – not its residential customers. As addressed by Columbia witness Feingold, Columbia has proposed a Levelized Distribution Charge for its residential customers only, because, in part, the load and cost characteristics of these customers are homogeneous. Columbia St. 112-R, p. 31. However, where rate classes are more heterogeneous in nature, like commercial customers, it is more difficult to implement a SFV rate design. *Id.*

Moreover, contrary to the OCA's assertion, the Florida Public Service Commission did not reject a shift to SFV rate design in its order relative to the rate increase proposed by St. Joe Natural Gas Co., Inc. OCA MB, p. 19. Instead, in *Petition for Rate Increase by St. Joe Natural Gas Co. Inc.*, the Florida commission acknowledged the utility's argument that a local distribution company experiences very little variable cost for building and maintaining infrastructure. *Petition for Rate Increase by St. Joe Natural Gas Co. Inc.*, 2008 Fla. PUC LEXIS 448, *33. In approving increases to the monthly residential customer charges ranging between 44-82%, the Florida commission stated that:

> The rates we approve will recover a greater proportion of the base rate costs through the customer charge than current rate design as a step towards recognizing the operating characteristics of LDCs while providing some stability to customer rates and minimizing impacts on low users.

Petition for Rate Increase by St. Joe Natural Gas Co. Inc., 2008 Fla. PUC LEXIS 448, *35. Therefore, the Florida Commission did not reject a SFV variable rate design for residential customers. Indeed, the Florida commission approved sizeable increases to residential monthly

customer charges as "a step towards" recognizing the fixed costs incurred by the natural gas distribution utility.

Similarly, the OCA cites to the Wyoming Public Service Commission's decision in *Application of Source Gas Dist. LLC*, 2011 Wyo. PUC LEXIS 124 ("*Source Gas*"), as another example of a state commission "rejecting" a proposed SFV. OCA MB, p. 19. However, upon review it is apparent that the OCA has overstated the holding of this case. In *Source Gas* the utility proposed to increase its monthly customer charges in order to recover its fixed costs of doing business. *Source Gas*, *3. However, the Wyoming Commission, despite the support of the utility and the state's consumer advocate, rejected the proposed increases to the customer charges due in large part to the class cost of service study used to support the proposed increases. *Source Gas*, *74. The Wyoming commission noted that the class cost of service study presented in *Source Gas* was a "holdover from the prior case". *Id.* However, the Wyoming Commission stated that its decision, "should not be read as a categorical rejection of the theory of straight fixed variable rate design, or as a rejection of the principle that each class of customer should bear revenue responsibility in proportion to the costs each causes." *Id.* Unlike the case presented to the Wyoming Commission, Columbia's evidence in this case supports the Company's proposed Levelized Distribution Charge as most accurately reflecting the fixed nature of the Company's costs to provide residential distribution service.

Finally, Columbia will respond to one statement quoted by OCA from the case *In the Matter of UNS Gas, Inc.*, 2007 Ariz. PUC LEXIS 241. The statement that SFV sends "a signal to customers of 'the more you use, the more you save'" is, quite simply, wrong. As explained above, Columbia's residential customers will continue to pay usage-based commodity charges for gas supply. SFV rate design for fixed distribution costs will not encourage greater usage

because if customers increase their gas usage, they will still incur substantial gas supply costs and other variable charges (*i.e.*, Rider USP).

Columbia's residential Levelized Distribution Charge provides correct and efficient price signals to encourage customers to undertake energy efficiency measures, while at the same time aligning Columbia's interests with customers' interests to encourage implementation of cost-effective energy efficiency measures. OCA's contention that usage-based distribution charges provide better "price signals" for conservation are without merit and should be rejected.

4. The Current Inaccurate Residential Rate Design Should Not Be Maintained Just Because a Change Will Result in Some Customers Experiencing a Greater Than Average Percentage Increase in This Case

OCA contends that the Levelized Distribution Charge will "disproportionately affect" low use customers. OCA MB, pp. 16-19. OTS makes a similar contention. OTS MB, pp. 22-24.[6] Claims about "disproportionate" effects on customers should not prevent the Commission from correcting the inaccuracy of a rate design that does not match rates to cost incurrence.

Virtually any determination about revenue allocation among rate classes, and rate design within a rate class, is likely to have disparate effects upon different customers. In this case, Columbia's proposed Levelized Distribution Charge will require the greatest increase in payments from residential customers who currently pay the least for distribution service. The result is fully justified as the evidence establishes that the cost of distribution service is the same for each residential customer. Conversely, OCA's proposal, which recovers all of the

[6] It is noted that OTS' references to rate effects at various usage levels at pages 23 and 24 of its Brief should have been to cubic feet, not Mcf. OTS MB, pp. 23-24. Columbia has no residential customers that use 9,500 Mcf in a month.

distribution increase through increased usage rates, will require the greatest increase in payments from those residential customers who currently overpay for distribution service.[7]

Disparate rate impacts should not serve as a basis to ignore principles that rates should be designed to follow cost incurrence. For example, in *Pa. P.U.C. v. PPL Electric Utilities Corporation,* Docket No. R-2010-2161694, 2010 WL 5651177 (2010), the Commission imposed an entire rate increase on a single customer class, where the result was supported by cost of service principles. See also, *Pa. P.U.C. v. PPL Electric Utilities Corporation*, Docket No. R-00072155, 2007 Pa. PUC LEXIS 57 (2007) (Statement of Chairman Holland, dissenting in part to a settlement that allocated 87% of the increase to the residential class). In various other rate cases, the Commission has approved rate designs that apply disparate percentage increases to intra-class rate components. *Pennsylvania Public Utility Commission v. Columbia Gas of Pennsylvania, Inc.*, Docket No. R-891468, 1990 WL 489020 (Order entered on September 19, 1990) (Commission approved an increase in the customer charge of approximately 28% while only approving a 3.5% increase in the commodity charge). *Pennsylvania Public Utility Commission, et al. v. PPL Gas Utilities Corporation*, Docket No. R-00061398, 2006 Pa. PUC LEXIS 107 (Order entered November 30, 2006) (Commission approved a commodity charge increase of 25%, while only approving a customer charge increase of 15%), *Pennsylvania Public Utility Commission v. Philadelphia Gas Works*, 213 PUR 4th 280, 2001 Pa. PUC LEXIS 109 (Order entered October 4, 2001) (Commission approved increase of disparate percentages). It is impossible to correct rate design inequities without imposing greater increases on some customers as compared to other customers.

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[7] OTS' proposal also will require the greatest payment by those residential customers who currently pay the most, although customers who use less than 2 Mcf every month throughout the year also will experience above average increases.

As explained above, low use customers should receive a substantially greater percentage increase in bills because they are not – and have not been – paying their fair share of system costs. The evidence demonstrates that cost to serve is fixed and does not vary due to differences in usage among residential customers. Columbia MB, pp. 10-15. Columbia's witness reiterated this point in response to Mr. Carryer's contention that high use customers should pay a larger portion of distribution costs:

> Mr. Carryer makes a lot of statements which are simply inaccurate or misleading. For instance, he claims that the "LDC does not reflect the true cost of consumption" and "Under the LDC, a senior citizen on a fixed income who lives in a small apartment will pay the same distribution charges as a high-usage family living in an 8,000-square-foot oversized house." However, as explained in great detail in my direct testimony, and Company witness Feingold's direct and rebuttal testimonies, Columbia's true cost of providing distribution services is the same for both of these residential customers. It does not cost Columbia any more to deliver gas to the 8,000 square foot house than it does to deliver gas to a senior citizen in a small apartment. The same pipe serves both customers, Columbia incurs the same cost to read each customer's meter, Columbia incurs the same billing and collection costs for both types of customers, etc. Simply put, Columbia's costs do not increase as a residential customer's usage volume increases. Because Columbia's costs are fixed, the LDC is a far superior means of reflecting Columbia's true cost to serve customers than a volumetric rate. As Mr. Feingold explains, the correct response, if a senior citizen, as described by Mr. Carryer is a low income customer in need of assistance, is to have the customer enroll in CAP.

Columbia St. 102-R, pp. 18-19. Therefore, the Commission should adopt a rate design for residential customers that recovers these fixed distribution costs through the fixed Levelized Distribution Charge in order to correct the intra-class inequity of the current residential rate design.

OCA presents tables at pages 17-18 of its Brief to show percentage changes in residential customer bills at various usage levels. Columbia notes that these tables reflect monthly, not annual, bill impacts. Therefore, the tables do not offer an accurate portrayal of bill impacts on individual customers throughout the year. For example, many residential customers use less than

15 Ccf (1.5 Mcf) in summer months, and thus will pay substantially more on a percentage basis under the Levelized Distribution Charge in those months than under the current rate design. These customers will pay about $20 more during those months. However, those same customers may use in excess of 150 Ccf (15 Mcf) in winter months, and thus will pay less in those months under the Levelized Distribution Charge than under the current rate design. These customes will pay about $15 less during those months. These offsetting effects are demonstrated on Columbia Exhibit RAF-1. It is the nature of a Levelized Distribution Charge that monthly bills are brought closer together by levelizing the annual bill over the months.

Far more relevant than monthly bill impacts are annual bill impacts. Columbia St. 112-R, p. 29. The vast majority of Columbia's residential customers – 98.5% – are heating customers, and thus there are very few residential customers that have very low usage throughout the year. Columbia St. 102-R, p. 11. Therefore, the substantial monthly percentage differences shown on the tables on pages 17 and 18 of OCA's Brief do not present an accurate portrayal of the annual effect of the Levelized Distribution Charge upon most residential customers.

The OCA's and OTS' objections to the Levelized Distribution Charge on the basis that a small group of low usage residential customers may receive large percentage increases in their bills is not a basis to reject the cost of service principles that support the residential Levelized Distribution Charge.

5. The Levelized Distribution Charge and Low Income Customers

OCA and PCOC also object to the Levelized Distribution Charge because they believe it will result in greater than average increases to low income customers. OCA MB, pp. 19-29; PCOC MB, pp. 25-27. OCA's and PCOC's claims are speculative. Moreover, if the Levelized Distribution Charge does present ability to pay problems for some low income customers, the CAP program is available to resolve those concerns.

Initially, Columbia emphasizes that the Levelized Distribution Charge has no inherent effect upon a customer's bill based upon income. OCA's and PCOC's arguments are just an offshoot of the argument that a low use residential customer will receive a higher percentage increase to their bill from adoption of the Levelized Distribution Charge than would be experienced if the current usage-based distribution charge rate structure were retained. The contention of OCA and PCOC is that many low income customers are low use customers. It is Columbia's position that many low income customers have above average usage, and therefore are currently overpaying for distribution service.

Before identifying the flaws in OCA's and PCOC's conclusions related to low income customer usage, Columbia emphasizes that there is a solution for those low income residential customers who experience affordability problems following adoption of the Levelized Distribution Charge. No party has challenged the fact that the average CAP participant usage is substantially greater than the average usage of residential customers. Mr. Feingold has demonstrated that average annual CAP customer usage is more than 35 Mcf higher than average residential customer usage. Columbia St. 12, p. 49. As a result, the Levelized Distribution Charge will result in lower CAP current bill shortfalls, as the difference between the full bill and the discounted CAP bill will shrink. The result will be a reduction to Rider USP – Universal Service Program charges recovered from non-CAP customers. If there are additional low income, low usage customers who would become payment troubled because of increased bills under the Levelized Distribution Charge, these customers can also be placed on CAP.[8] Importantly, it is to be noted that under Columbia's proposed residential rate design, the USP

[8] One of the positions of PCOC in this case is that Columbia should increase the number of CAP participants. PCOC St. 1, p. 21.

will continue to be charged on a usage basis. Columbia St. 2, p. 22. Thus, higher use customers will continue to pay more of these costs than low use customers. As a result, if OCA and PCOC's contention that a significant number of low income customers tend to be low usage customers were to be correct, the combination of reduction in CAP costs for current CAP customers and the usage-based structure of Rider USP will offer the opportunity to expand CAP participation as a solution for increased bills to low income, low use customers.[9] Clearly, the effects on low income customers should not be used as the basis for rejecting the adoption of an appropriate rate design when CAP provides a solution.

With respect to the factual issue of whether low income customers, on average, are also low use customers, the evidence presented by OCA and PCOC is far from conclusive. Their Briefs demonstrate the speculative nature of their conclusions:

- Columbia's evidence that participants in Columbia's low income programs have higher than average usage "does not support any conclusions regarding average low-income usage." (OCA MB, p. 24)
- because national data indicates low income households are smaller homes it is "reasonable to conclude" low income customers' gas usage is lower. (OCA MB, p. 25)
- energy consumption is higher for housing unit types "more likely to be occupied" by non-low income customers. (OCA MB, p. 27)
- overall, low income households "tend to live" in smaller homes, and thus "can be expected" to use less energy. (OCA MB, p. 28)

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[9] Conversely, as explained previously, low income, high use customers will have lower bills upon adoption of the Levelized Distribution Charge.

- there is no "average low-income" customer. (PCOC MB, p. 26)

The speculative nature of OCA's conclusions about gas usage by low income customers was explained by Columbia's witness Mr. Feingold. One of the data sources relied upon by OCA's witness Colton to assert that low income customers may tend to be low use customers is the Residential Energy Consumption Survey ("RECS") from the Department of Energy. OCA St. 3, pp. 22-23. In rebuttal, Mr. Feingold demonstrated that Mr. Colton was selective in the data he used from this source:

> While Mr. Colton may attempt to persuade others to adopt his conclusion based on inferences he draws from selected federal and state data on energy expenditures, income levels, and housing stock characteristics, the fact remains that he has chosen to ignore any utility-specific data on gas consumption and income, and the resulting relationship that such data actually portrays. Importantly, one of Mr. Colton's own data sources, The Residential Energy Consumption Survey ("RECS"), proves conclusively that customers below the poverty level use more gas than all other customers. RECS data is based on actual bills for customers and . . . demonstrates that customers below the poverty level use more gas than other customers. This data demonstrates that low income customers use about 8% more gas than the average of all customers. Utility specific studies and in particular those for the Company add further evidence to support this conclusion. In my opinion, his decision not to rely upon any utility-specific data in reaching his conclusion is a fatal flaw in his approach.

Columbia St. 112-R, pp. 33-34.

In response, Mr. Colton suggested that the RECS data in the less than 100% of Poverty Level category needed to be further disaggregated because there may be distortions in the lowest income levels. OCA St. 3-S, p. 3; OCA MB, p. 26. However, the Commission's determination of residential rate design should not be based upon the effect of the Levelized Distribution Charge on households at the lowest percentage of the Federal Poverty Level, particularly where the CAP is available to assist payment-troubled customers.

Mr. Feingold further demonstrated that there are flaws in Mr. Colton's linkage of housing size to energy bills of low income customers:

> The use of size and income does not provide meaningful information since there is no basis for determining if the person pays their own heating bill. Group quarters such as group homes, dormitories, and retirement homes are all included in the data. In each case the occupant does not pay for natural gas service at all. This biases the results of any analysis of consumption by size of dwelling. Further, many low income and elderly individuals would be included in these facilities where the cost of gas is not on a residential rate at all.
>
> * * *
>
> The age of the house is an important indicator of the thermal envelope efficiency related to changes in building codes and also to the efficiency of the appliance stock. Based on data from the RECS, over 65 percent of households below 150% of the poverty level live in homes built prior to 1980 while only 57 percent of all other customers live in homes built in the same period.

Columbia St. 112-R, Appendix "A", pp. 5, 6. OCA's assertion that housing size "may" demonstrate that low income customers use less gas is speculative and should not affect the Commission's decision on the Levelized Distribution Charge.

The question of whether low income customers, on average, tend to be high use or low use customers should not drive the decision whether to adopt the Levelized Distribution Charge. There are unquestionably some low income customers who are low usage customers, just as it is certain there are low income customers who are high usage customers. Most importantly, no party has challenged the fact that Columbia's average CAP participant usage is substantially greater than the average usage of Columbia's residential customers. The Levelized Distribution Charge therefore will lower the cost of the CAP which is borne by non-CAP customers, and thereby make the CAP an even more economical program to assist customers whose bills may become unaffordable after adoption of the Levelized Distribution Charge.

The Levelized Distribution Charge should be approved.

6. Direct Customer Cost Studies as Used in the Past Substantially Understate Costs of the Facilities and Expenses Needed to Serve a Customer

OCA and OTS support their rate design proposals based upon the concept of "direct customer costs." OCA MB, pp. 36-28; OTS MB, pp. 15-16. Columbia has explained the reasons why the "direct customer cost" concept is outdated and why the Commission should recognize that appropriate rate design for residential customers should reflect that costs to serve are fixed and do not vary by usage within the residential customer class. Columbia MB, pp. 24-25.

The underlying flaw of direct customer cost studies is that they are limited to essentially metering and billing investment and associated costs. There is no consideration given to the distribution system, *i.e.*, mains, that must be in place to provide service. Without consideration of mains, low use customers are getting a near free ride on the system that is in place throughout the year to serve their needs. OSBA's witness, Mr. Knecht, cogently pointed out the flaw in the "direct cost" approach:

> It has been my experience that Mr. Kempic is correct that Commission policy supports the use of only "direct" customer costs as the cost basis for a customer charge, most particularly with respect to Residential class rate design. This policy went into effect prior to my entry into the Pennsylvania regulatory arena in the mid-1990s, and has been cited as gospel ever since. It may be time to reconsider this policy.
>
> The basic flaw in the policy is that it creates intra-class cross-subsidization. For those costs which are classified as customer-related in the COSS, every customer, large or small, will attract the same customer costs to the customer class. To the extent that the customer charge does not recover classified customer costs, smaller customers will be subsidized by larger customers.
>
> Because this policy has been in place for so long, it is no longer clear what the original basis for the policy was, or whether that basis remains relevant. It is certainly possible that an important consideration was an effort to mitigate rates for low-income residential customers, who may have been presumed to have lower usage rates. If so, this rationale is no

> longer appropriate. First, customer assistance programs for low-income residential customers have expanded dramatically over the past fifteen years, reducing the need for a crude rate design fix. Second, as Mr. Feingold's testimony demonstrates, on average, low-income residential customers actually have higher consumption rates than other residential customers. Commission policy in this respect may therefore be requiring lower-income customers to subsidize other small customers.
>
> In addition, it is not necessarily good public policy to cross-subsidize small customers. In many cases, "small" utility customers are second homes or cottages owned by the relatively well-to-do. There is little public policy need to subsidize vacation homes. In addition, the relatively small gas customers may be customers who heat with alternative fuels, including those fuels which are potentially more environmentally damaging than natural gas. It is not clear that any public policy objectives are advanced by subsidizing these customers.

OSBA St. 2, pp. 31-32.

The Commission should recognize that the residential Levelized Distribution Charge appropriately matches rates to cost incurrence, and should reject the continued use of "direct customer costs" as a limiter on customer charges.

7. OCA's Reference to Earnings Data is Misplaced

OCA refers to earnings data of Value Line companies to support its position that a Levelized Distribution Charge is not needed to maintain earnings. OCA MB, pp. 34-35. OCA's reference to this data does not support its contention.

Earnings results of Value Line companies do not demonstrate that the Levelized Distribution Charge is unnecessary to meet creditworthiness criteria of the capital markets. In fact, Mr. Moul demonstrated that all of the Value Line gas companies in his barometer group had some type of decoupling/revenue stabilization mechanisms in place. Columbia St. 10, p. 9. Columbia currently has no such mechanism in place. Therefore, it is wrong for OCA to contrast Columbia with other gas companies to conclude that Columbia has adequate, stable earnings and does not need a Levelized Distribution Charge.

OCA observes that, based upon 10 years of data, Columbia's average return has exceeded the average return of the natural gas industry generally. However, OCA ignores that the most recent five year experience shows that Columbia's achieved earnings are substantially less than the industry in general. Columbia St. 110-R, p. 46.[10] At a time when others in the industry have been implementing revenue decoupling/revenue stabilization mechanisms and Columbia has commenced accelerated replacement of infrastructure, this data is further evidence that investors will consider Columbia a greater investment risk than the barometer group companies without the Levelized Distribution Charge.

For reasons explained above and at pages 18-22 of Columbia's Main Brief, the residential Levelized Distribution Charge is responsive to expectations of capital markets and an appropriate action to encourage continued pipeline investment. These are important policy reasons that the Levelized Distribution Charge should be adopted.

8. OTS' Rate Design Proposal Does Not Address or Accomplish the Goals Behind the Levelized Distribution Charge

OTS contends that its proposal to include a 2 Mcf allowance in the customer charge "addresses and accomplishes" the goals of Columbia's proposed Levelized Distribution Charge.[11] OCA MB, pp. 19, 22. OTS' contention is incorrect.

The OTS residential rate design proposal falls far short of the purposes and goals of the Levelized Distribution Charge. First, the OTS proposal does not consider that the cost to serve residential customers does not vary with usage. As a result, OTS' proposal does not address the intra-class cross-subsidization caused by the current design.

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[10] The five year average for the industry in total is 11.9%, nearly the same as the 10 year average of 12%, whereas Columbia's five year average is 10.68%.

[11] Contrary to OTS' description of Columbia Witness Kempic's testimony, Mr. Kempic never testified that fixed monthly customer charges represent guaranteed revenue to Columbia. OTS MB, p. 20.

Second, the OTS proposal does not contribute to bill simplicity. Under OTS' proposal, customers will receive a bill that has a customer charge, a commodity charge for all gas supply and usage-based distribution charges that are calculated on 2 Mcf less than the gas supply charges. This is more confusing, not less.[12]

Third, the OTS proposal does not align Columbia's interests with customers' interests in encouraging energy efficiency. The OTS rate design continues to disincent support of energy efficiency measures by Columbia because reductions in usage will continue to decrease Columbia's distribution revenues. As explained in Columbia's Main Brief, the OTS' residential rate design makes Columbia's revenue even more sensitive to the impacts of weather and energy efficiency measures than Columbia's current rate design. Thus, the OTS proposal is contrary to the requirements of the ARRA.

Finally, the OTS proposal will not reduce bill volatility throughout the year. The 2 Mcf minimum allowance will still result in a substantial portion of distribution costs being billed on a usage basis, which means that customers' bills would continue to be much higher in winter months than they would be in summer months. Columbia St. 102-R, pp. 16-19.

As the foregoing demonstrates, the OTS rate design falls far short of the objectives of the Levelized Distribution Charge. The OTS rate design proposal should be rejected.

9. Conclusion

The residential Levelized Distribution Charge is a cost-based rate design that appropriately reflects the fixed nature of distribution costs. Adoption of the Levelized Distribution Charge will end intra-class subsidies and simplify customer bills. If any ability to pay problems result for low income, low use residential customers, they can be managed through

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[12] Further rate case presentations also will be more complicated, as the Company will need to make an additional projection of monthly bills under 2 Mcf.

enrollment in Columbia's CAP, which will be accommodated, at least in part by reductions to the bill shortfalls of high use CAP customers under the current rate design. The Levelized Distribution Charge provides correct and efficient price signals to encourage customers to undertake energy efficiency measures. Therefore, the Levelized Distribution Charge satisfies the requirements of ARRA which directs that utility financial incentives be aligned with helping customers use energy more efficiently. The Levelized Distribution Charge should be adopted.

C. PCOC'S CONTENTION THAT COLUMBIA'S CAP PLUS VIOLATES FEDERAL RULES AND SHOULD BE ELIMINATED IS UNSUPPORTED AND MUST BE REJECTED

1. Summary of the Principal Flaws of PCOC's Argument

As explained in the Main Briefs of Columbia, OCA and PCOC, PCOC contends that the Company's recently approved modifications to its CAP Plan to include a CAP Plus component are impermissible under Federal law. The Company and OCA have explained in their Main Briefs the numerous flaws in PCOC's attempts to extend Health and Human Services ("HHS") guidelines about the treatment of LIHEAP grants under PIPP programs well beyond the circumstances addressed in such guidelines, to attempt to produce an indictment of the CAP Plus approach. Columbia MB, pp. 27-37; OCA MB, pp. 42-68. Columbia will not repeat all of such explanations here but will summarize the fundamental flaws of PCOC's argument in this Reply Brief. The fundamental flaws of PCOC's contentions are as follows:

- The prior CAP did not use LIHEAP grants to reduce the CAP customers' asked to pay amounts and may have violated recently issued HHS guidance. In response, CAP Plus specifically reduces a CAP customer's asked to pay amount with LIHEAP grants and thus, does not violate such guidance.

- Contrary to PCOC's implication, DPW cannot dictate to the Commission, directly or indirectly, how to set CAP customers' asked to pay amounts because such matters are exclusively within the Commission's jurisdiction.
- CAP customers receiving LIHEAP are not treated adversely by the CAP Plus charge because all CAP customers are required to pay the CAP Plus charge irrespective of whether the customer applies for and receives LIHEAP.

PCOC's argument relies on a single thin reed - - that charging the CAP Plus amount to all CAP customers deprives CAP customers receiving LIHEAP of a portion of their LIHEAP grant.[13] There is no basis, however, for this conclusion. The HHS guidance on use of LIHEAP grants addresses a situation where the CAP asked to pay amount was not reduced by each CAP customer's LIHEAP grant. Such guidance is just not applicable to the CAP Plus approach which does further reduce the already asked to pay affordable CAP payment by the customer's LIHEAP grant. In fact, the CAP Plus is a specific change to the prior CAP Plan to address the HHS concern that LIHEAP grants were not reducing asked to pay amounts. Further, PCOC's contention that the DPW letter represents ". . . substantial evidence that DPW will definitively determine that Columbia's CAP Plus plan violates Pennsylvania's LIHEAP State Plan and federal law . . ." is erroneous and improper. PCOC MB, p. 1. The DPW letter was admitted only to advise the Commission of the letter and not for the truth of any matter asserted therein and therefore, cannot provide the basis for any factual or legal conclusion in this proceeding. Tr. 130-131.

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[13] PCOC argues that CAP Plus uses LIHEAP as a resource to make the CAP bill affordable. This contention is erroneous, as the CAP bill with CAP Plus is affordable before receipt of LIHEAP. Columbia MB, pp. 32-33; OCA MB, pp. 32-33. PCOC also argues that the CAP Plus treats the CAP LIHEAP recipient adversely in comparison to the non-CAP LIHEAP recipient. This contention also is erroneous since the CAP Plus bill remains less than the non-CAP bill both before and after LIHEAP grants. Columbia MB, pp. 34-37.

Finally, PCOC fails to properly note that it bears the burden of proving that the existing CAP Plus plan is not just and reasonable, stating incorrectly in its brief as to CAP Plus that it remains incumbent on the Company to demonstrate that its . . . "proposed rates are just and reasonable." PCOC MB, p. 5. However, CAP Plus is an existing rate and it is PCOC's burden to prove that such rate is not just and reasonable. Columbia MB, p.6; see burden of proof discussion, *supra*, pp. 1-3. Accordingly, it is PCOC that has failed to meet its burden in challenging CAP Plus.

2. PCOC Has Not Demonstrated that CAP Plus Violates Federal Law

The changes to Columbia's prior CAP Plan precipitated by HHS and DPW rulings that LIHEAP grants cannot be used to offset the CAP shortfall and instead must be used to further reduce the already affordable CAP asked to pay amounts have been explained in Columbia's Main Brief. Columbia MB, pp. 32-33. CAP Plus provides that each CAP customer receives an affordable bill and also is entitled to apply for LIHEAP and further reduce that bill with a LIHEAP grant. The CAP bill remains affordable even with the CAP Plus amount and no receipt of a LIHEAP grant. OCA St. 3-R, p. 14. Every CAP customer is eligible to apply for and receive LIHEAP. Columbia St. 117-R, p. 9. Very low income CAP customers that receive LIHEAP and apply it to their gas bill essentially pay little or no gas bill. Columbia St. 17, pp. 1-6.

Nevertheless, PCOC is not satisfied, and seeks even further reductions in payments by CAP customers at the expense of Columbia's other residential customers who pay the difference between CAP customers' payments and the full residential bill. PCOC attempts to support its contentions by extrapolating HHS guidance on use of LIHEAP grants to offset the CAP shortfall to the CAP Plus plan.

The fundamental flaw in PCOC's analysis is its failure to give adequate deference to the Commission's authority to determine the affordable CAP payment. The Commission approved the CAP Plus program by its Order of October 19, 2010 at Docket No. P-2010-2195159. Columbia MB, p. 30. All charges to CAP customers, including the CAP Plus amount, are therefore approved as in compliance with Commission requirements, including its affordability standards. PCOC, therefore, bears the burden of demonstrating that CAP Plus is unjust and unreasonable.

PCOC argues that the use of the CAP Plus amount is impermissible because it is tied to the historic level of LIHEAP grants. That contention must fail because it is an attempt to interfere with the Commission's exclusive jurisdiction to set utility rates and to determine an appropriate and affordable CAP payment. However, even if such a contention were supportable, and it is not under HHS guidance, it is an objection to the manner in which the Commission determined the CAP payment schedule and not a limitation on the Commission's authority to ultimately determine the "asked to pay" amount. In this regard, it is to be noted that the CAP Plus approach uses the historic amount of LIHEAP payments without adjustment for expected changes in available LIHEAP funding or changes in grants actually received by Columbia's CAP customers during the current program year. Therefore, the CAP Plus amount is not tied to the actual grants received by the CAP customers during the current year.

Under its statutory ratemaking authority, the Commission has plenary power to establish the appropriate CAP rate structure. If it desired, it could simply "decouple" the increase in asked to pay amounts from LIHEAP and increase CAP asked to pay amounts under Columbia's four CAP payment plans, as suggested by OCA witness Colton. OCA St. 3-R, pp. 17-18. Under this approach, PCOC's argument concerning the manner in which the CAP Plus adjustment to asked

to pay amount is determined is removed in its entirety because there is no reference or tie to LIHEAP in any way. Simply put, the Commission can design the CAP rate in any number of ways which are consistent with its statutory authority and which are consistent with the LIHEAP statute..

3. PCOC's Arguments that a Single Plus Amount for All CAP Customers Violates Federal Requirements and Makes Bills Unaffordable are Erroneous

PCOC makes interrelated arguments about charging the same Plus amount to all CAP customers.

First, PCOC argues that CAP Plus violates LIHEAP "policy" because it uses a single Plus amount of $17 without regard to household size or income. PCOC MB, p. 14. Second, PCOC argues that the single Plus amount makes unaffordable the CAP bills of customers in small households with very low incomes of 50% of the poverty level or less. PCOC MB, pp. 15-17.

PCOC's contention that the uniform Plus amount violates LIHEAP requirements is not credible and confuses the role of DPW in applying LIHEAP with the role of the Commission in determining the affordable CAP bill. CAP Plus does not prohibit DPW from making grants to the most needy customers and such grants lower the Commission-determined asked to pay affordable amounts. PCOC's argument, applied to its logical conclusion, would divest the Commission of all authority to determine an affordable bill for a CAP customer receiving LIHEAP. Such conclusion clearly overstates DPW's authority in administering LIHEAP grants.

The Commission has authority to resolve PCOC's contention that a single Plus amount of $17 per month makes bills of the very low income CAP customers unaffordable. However, PCOC here also presents a distorted view of the facts. First, PCOC notes small households with low incomes have received a large percentage increase in their CAP payment due to the Plus

amount. There are several problems with this analysis. First, percentages present a distorted picture about overall bill affordability because a $17 per month increase can be a significant percentage increase to the already very low monthly bill provided under Columbia's very favorable CAP plan for very low income customers in small household sizes. For example, a $204 annual Plus amount ($17 x 12) represents a 50% increase to an annual CAP bill that would have been only $408 without the Plus amount. The fact that the annual bill increases to $612 with CAP Plus or from $34 to $51 per month, does not demonstrate that the bill is unaffordable.

Second, OCA's witness Colton has noted that affordability is very difficult to determine for customers with very low reported income, since it is likely that such customers are meeting their daily needs through other resources. Mr. Colton also noted that DPW requires special information in this regard to satisfy its LIHEAP grant requirements that is not available to utilities. OCA MB, p. 70.

Finally, Columbia notes that any very low income customer can apply for and designate its LIHEAP grant to Columbia and that doing so would result in essentially no CAP bill for the customer. Columbia St. 117-R, pp. 1-6. As noted by Mr. Colton, very low income customers can receive LIHEAP grants up to $1,000. OCA St. 3-R, p. 14; OCA MB, p. 69.

For these reasons, PCOC has not met its burden of proving that the existing CAP Plus approved by the Commission makes CAP bills unaffordable under Commission standards.[14]

4. PCOC's Challenge to CAP Plus Should Be Rejected

PCOC has not demonstrated that CAP Plus violates federal LIHEAP rules or is inconsistent with Commission policies. CAP customers already receive an affordable bill under

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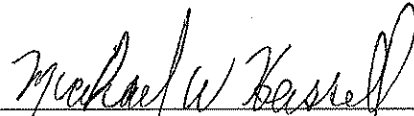
[14] It is noted that only about 38% of Columbia's CAP customers apply for LIHEAP grants and designate such grants to Columbia. PCOC St. 1, p. 14. This is the case even though essentially all CAP customers are eligible for LIHEAP and use gas as their primary heat source. Columbia St. 117-R, p. 11.

CAP Plus and can reduce that bill further by applying for and designating LIHEAP grants to Columbia. Providing even further benefits to CAP customers would be simply unfair to Columbia's other customers.

D. CONCLUSION

WHEREFORE, for all the foregoing reasons, Columbia Gas of Pennsylvania, Inc. respectfully requests that the ALJ and Commission reject the contentions of OCA, OTS, and PCOC, approve Columbia's Levelized Distribution Charge and approve CAP payment plans that appropriately balance the interests of CAP customers in affordable bills and the interests of non-CAP customers that must pay for CAP bill shortfalls.

Respectfully submitted,



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Date: July 11, 2011

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