



COMMONWEALTH OF PENNSYLVANIA

July 16, 2014

**E-FILED**

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Pa. Public Utility Commission  
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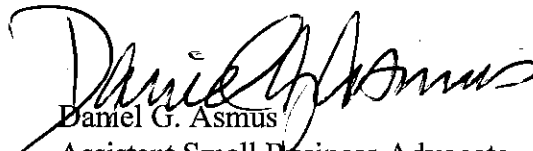
**Re: Supplement No. 210 to Tariff Gas - Pa PUC. No. 9 of Columbia Gas of Pennsylvania, Inc.  
Docket No. R-2014-2407345**

Dear Secretary Chiavetta:

Enclosed for filing is the original of the Main Brief, on behalf of the Office of Small Business Advocate in the above-docketed proceeding. As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case.

If you have any questions, please contact me.

Sincerely,

  
Daniel G. Asmus  
Assistant Small Business Advocate  
Attorney ID #83789

Enclosures

cc: Parties of Record

Robert D. Knecht

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**SUPPLEMENT NO. 210 TO TARIFF GAS** :  
**PA. P.U.C. NO. 9 OF COLUMBIA GAS OF** : **DOCKET NO. R-2014-2407345**  
**PENNSYLVANIA, INC.** :

**CERTIFICATE OF SERVICE**

I certify that I am serving two copies of the Main Brief, on behalf of the Office of Small Business Advocate, by e-mail, e-file and first-class mail (unless otherwise noted) upon the persons addressed below:

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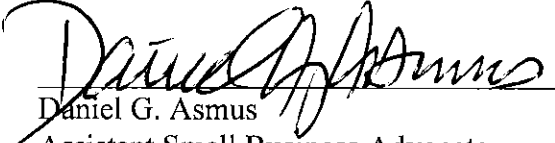
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PA. P.U.C. NO. 9 OF COLUMBIA GAS OF : DOCKET NO. R-2014-2407345  
PENNSYLVANIA, INC. :**

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**MAIN BRIEF ON BEHALF OF THE  
OFFICE OF SMALL BUSINESS ADVOCATE**

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**Dated: July 16, 2014**

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## **I. INTRODUCTION**

Columbia Gas of Pennsylvania, Inc. (“Columbia” or “Company”) filed Supplement No. 210 to Tariff Gas-Pa. P.U.C. No. 9 (“Supplement No. 210”), with the Pennsylvania Public Utility Commission (“Commission”) on February 26, 2014. The proposed Pilot Rider New Area Service (“Pilot Rider NAS”), if approved by the Commission, would provide the Company with an alternative approach for residential customers and developers to pay the upfront deposit charged by Columbia to extend its facilities to provide natural gas service.

The Office of Small Business Advocate (“OSBA”) filed a Complaint, Notice of Intervention and Public Statement on March 19, 2014. Other statutory parties to this proceeding include the Office of Consumer Advocate (“OCA”) and the Commission’s Bureau of Investigation and Enforcement (“I&E”). Additionally, the Columbia Industrial Intervenors (“CII”) filed an intervention in this proceeding.

Administrative Law Judge (“ALJ”) Mark A. Hoyer was assigned to this proceeding and presided over an Initial Prehearing Conference on May 9, 2014, where the Intervention of CII was granted and a procedural schedule was established.

The parties attempted to negotiate a settlement, but despite such efforts, no settlement has been reached. On July 9, 2014, an evidentiary hearing was held, where two of the witnesses were cross-examined, and where the remaining testimony of the various parties’ witnesses was admitted into the record by stipulation of the parties.

The OSBA submits this Main Brief in accordance with the procedural schedule approved by ALJ Hoyer in a Prehearing Order issued on May 23, 2014.

## **II. DESCRIPTION OF THE COMPANY'S RIDER NAS PROPOSAL**

In the Company's current tariff, when a new customer desires service, Columbia conducts an economic evaluation that compares the incremental cost of attaching that customer with the distribution revenues the new customer will provide. If the present value of the distribution revenues is insufficient to cover the incremental investment costs, the Company requires an upfront contribution from the new customer. This contribution is designed to protect existing customers from being economically harmed by the new customer. However, in the Rider NAS filing, the Company deems that this upfront cash contribution requirement may discourage customers from switching to natural gas, and so offers Rider NAS as an alternative approach for achieving the same ends.

The essence of Rider NAS is that the Company will replace the upfront contribution with a series of fixed monthly payments spread over a 20-year period, much like a home mortgage. Like a home mortgage, the payments must reflect both principal and interest costs. As conceived by the Company, the "interest" payments will reflect the Company's weighted average cost of capital, including both debt and equity costs.

Certain restrictions apply to Rider NAS as proposed, namely that it is available only to residential customers (including residential housing developers), the maximum Rider NAS payment is \$35 per month, and the overall funding for the pilot program is limited to \$1.0 million.

The Rider NAS payment requirements will continue for 20 years after the investment is made, and will be associated with a particular residence. Thus, if a residence changes owners, the Rider NAS charge for that residence will apply to the new owner. If additional customers

convert to gas and use the Rider NAS investments, they will also pay the Rider NAS charge. Any such additional payments will serve to shorten the 20-year recovery period for all customers using those assets.

As a matter of regulatory accounting, the Company proposes to include the assets subject to Rider NAS in rate base, and to draw down the gross book value of those assets using the “principal” component of the Rider NAS payments as they are actually made. Plant assets in rate base will apparently be subject to normal depreciation procedures. From a rate setting perspective, the Rider NAS assets will be included in rate base, allocated to all rate classes in base rates proceedings, and (presumably) offset by Rider NAS revenues.

The OSBA is not contesting the Company’s decision to exclude small business customers from eligibility in this program. The Company provided its rationale for excluding small business customers from the program in its response to OSBA-I-1.<sup>1</sup> Regarding that response, the OSBA respectfully disagrees with the Company that small business owners have a lower cost of capital than a large regulated natural gas distribution utility. However, given the nature of Rider NAS as a pilot program, the Company’s constraints on the overall size of the program, the economics of the program, and the complexities involved in offering this option to non-residential customers, the OSBA agrees with the Company that it is premature to extend this program to non-residential customers at this time.

Therefore, the OSBA’s focus in this proceeding has been to ensure that small business customers are not absorbing costs or risks associated with the program, as they will not benefit from it.

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<sup>1</sup> Referenced interrogatory responses are attached to OSBA Statement No. 1, Direct Testimony of Robert D. Knecht, as Exhibit IEC-2.

### **III. SUMMARY OF ARGUMENT**

The OSBA agrees with I&E that this is not the appropriate forum for a major review of Commission policy on customer contributions. While there may be merit in such a review, the OSBA believes that the issue is important enough to warrant a generic proceeding. The OSBA does not object to continuing to subsidize new customers through the depreciation tax benefits in Columbia's DCF calculation until such time as the Commission undertakes a full evaluation of the policy. Nevertheless, the OSBA recognizes that the existing mechanism is favorable to new customers in that respect, as the Commission explicitly intended.

The OSBA objects to OCA's proposal to overhaul the methodology and substantially increase subsidies for new customers at the expense of existing customers, in a proceeding designed merely to create an alternative to the existing method. The OSBA is also concerned that increasing subsidies will result in higher costs being assigned to small business customers, under normal cost allocation procedures.

Columbia itself has failed to make the NAS payments equivalent to the upfront contribution, by excluding the income tax costs related to the return on equity from its NAS calculation. In effect, if Rider NAS is approved, existing customers will be paying the taxes for the return on equity portion of the ratebase for these new customers.

Finally, the Company is unwilling to absorb any risk of non-payment of NAS charges, but is perfectly happy to assign that risk to existing ratepayers. This is obviously inequitable.

#### **IV. OCA'S POSITION**

##### **A. Setting the Interest Rate at 3%**

OCA witness Glenn A. Watkins proposes to calculate the Rider NAS charges using a 3.0 percent "interest" rate, which is well below both the rate proposed by Columbia and the pre-tax weighted average cost of capital that the Company will include in its base rate revenue requirements. This will cause a shortfall between the charged cost of capital in Rider NAS and the Company's claimed cost of capital on the total investments, a shortfall which will be passed on to existing ratepayers, including small business customers. Additionally, at a 3.0 percent interest rate, Mr. Watkins' proposed financing terms for Rider NAS are relatively attractive, compared to home equity or credit card interest rates.<sup>2</sup>

The OSBA believes that Mr. Watkins' proposals would be likely to have a negative impact on small business customers. Under normal base rate cost allocation and rate design procedures, the new investment would be allocated to all rate classes. Because the Pilot NAS investment is not justified by rates, it is implicitly of higher cost per unit of demand (or per customer) than the existing rate base. Under the normal arithmetic of cost allocation studies, this higher cost will be shared among all rate classes. Moreover, the greater the cost of the expansion, the larger is the amount shared with other classes. Thus, relative to the Company's proposal, Mr. Watkins' proposals will likely serve to increase the burden on small business customers. Therefore, the OSBA prefers the Company's proposal.

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<sup>2</sup> In comparing the interest rate charged by Columbia under Rider NAS with home mortgage or home equity loans, it is important to recognize that Rider NAS is not secured by the property, and is in fact not even secured by the threat of cutting off service. As such, Columbia would face higher lending risk than a bank, and the customer would face much lower risks associated with non-payment.

## **B. Economic Model**

### **1. Cost of Debt as Surrogate for Equity Return**

Mr. Watkins proposals for Rider NAS investments serve to shift costs from new customers to existing customers: First, Mr. Watkins proposes that the Company lower the pre-tax cost of equity capital used in its net present value (“NPV”) assessment model from the allowed equity return to the cost of long-term debt.<sup>3</sup> This change will reduce the net investment amount that is the basis for the Rider NAS charges. However, as Columbia is unlikely to voluntarily lower its claimed cost of capital for these new investments, this change will reduce the implicit contribution made by Rider NAS customers, creating an additional shortfall from new customers that is implicitly passed to existing customers. Therefore, existing customers, including small business customers, will be subsidizing the Rider NAS customers.

### **2. Cost of Service Lines, Meters, Regulating Equipment**

Under Mr. Watkin’s proposal, the Rider NAS customer would avoid the investment costs for a service line, meter and regulator, for which the non-Rider NAS customer generally must pay.<sup>4</sup> This obviously makes the Rider NAS program more attractive to new customers than the existing tariff model. The OSBA is concerned that rather than achieving the worthy goal of economically expanding gas service to new customers, Mr. Watkins’ proposal would essentially be a first-come first-served subsidy for Residential system expansions, paid for, in part, by small business customers.

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<sup>3</sup> As Mr. Knecht explained in his Direct Testimony, the Company uses a NPV (or discounted cash flow (“DCF”)) model to compare the present value of expected rate revenues from a new customer with the capital cost associated with attaching a new customer. OSBA Statement No. 1 at 3-5.

<sup>4</sup> OSBA Statement No. 2, Rebuttal Testimony of Robert D. Knecht at 3.

### C. Additional Reporting Requirements

Mr. Watkins' includes in his recommendations a listing of the information requirements from the Company that would go a long way toward allowing a segregation of the costs and revenues of the Rider NAS proposal in a base rates proceeding (cost allocation and rate design analyses) to ensure that small business and other non-Residential customers are not burdened by the subsidies provided to new Residential customers under Rider NAS. Mr. Watkins' list may need to be clarified to include class-specific information, for those expansion projects which involve both Residential and non-Residential customers.

Further, Mr. Watkins argues that inter-class effects of the Company's proposal should be addressed in the context of a base rates case. The Company has offered a proposal that appears to increase subsidies to new residential customers, and Mr. Watkins offers a proposal that will result in larger subsidies to new customers. While it is theoretically possible that the issues related to inter-class cross-subsidization can be addressed in a base rates proceeding, they can only be so addressed if the Company (a) is capable of tracking the information needed, and (b) is either willing or required to track the information needed to do so.

The OSBA's witness, Mr. Knecht, proposed a list of tracking requirements, based upon Mr. Watkins model, which included:

- a) Investment per project by rate class, including the economic model results and surcharge calculation details;
- b) Total distance and cost of NAS project mains and service lines installed, by pipe diameter;
- c) Number of customers originally and subsequently connected, by rate class;
- d) Annual load by rate class, segregated between customers initially and subsequently connected;
- e) Base rate and Rider NAS revenues received by NAS project by rate class, with Rider NAS revenues segregated between "principal" and "interest;"

- f) Number of customers along NAS extensions who have not yet connected, by rate class, and, to the extent available, an explanation for non-conversion;
- g) Direct program expenses;
- h) Data on collections, including efforts for unpaid surcharge amounts; and,
- i) Number of applicants turned down for insufficient credit.<sup>5</sup>

The Company appears to be uninterested in separately accounting for Rider NAS investments. In effect, then, Mr. Watkins asks small business customers to agree to a program that will increase their rates unless the Company and the Commission agree to depart from normal ratemaking practices at some uncertain future time.

Without some reasonable assurance from the Commission and the Company that reasonable protection against cross-subsidies will be afforded non-residential customers, the OSBA can do nothing but oppose Mr. Watkins proposal in the current proceeding. While the magnitude of cross-subsidies may not be large, the potential exists for the approval of such a programs to be used as a model for other NGDCs across the Commonwealth which may be contemplating a NAS program such as the one proposed here.

#### **D. Treatment of Residential Developers**

The OSBA has not taken a position with respect to the OCA's proposed treatment of residential developers

#### **E. Other Proposed Modifications**

The OSBA takes no position on the other modifications suggested by the OCA.

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<sup>5</sup> OSBA Statement No. 3, Surrebuttal Testimony of Robert D. Knecht at 6-7.

**V. OSBA’S POSITION**

**A. Review of Tax Depreciation Benefits in Customer Contribution Calculation**

This is not the appropriate venue for evaluating substantive changes to the Company’s economic evaluation. Economic models related to customer contributions involve a variety of debatable assumptions, some of which may be relatively favorable to protecting existing customers and some of which may be favorable to new customers. As noted in OSBA witness Robert D. Knecht’s Direct Testimony, Columbia’s established procedures for making this calculation are biased in favor of new customers, and it is the OSBA’s position that the Company’s method may merit additional review at the appropriate time.

**B. Income Tax Costs in Rider NAS Charge Calculation**

The Commission’s decision at Docket No. I-880083 approved the method used by the Company (as one of the allowable options), with the explicit recognition that this method would shift tax costs to existing ratepayers.<sup>6</sup> In so doing, the Commission cited the benefits of economic development as an advantage of this method.

Therefore, the OSBA will not advocate for a modification to the established practices at this time as long as reasonable protections are established to prevent small business customers from bearing the costs for a program in which they are not eligible to participate.

In its NPV analyses (provided in response to OSBA-I-2), the Company does not include the direct tax effect of CIAC in assessing the costs related to system expansion. The Company’s NPV model excludes the direct tax cost of the CIAC, but includes the depreciation tax shields.

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<sup>6</sup> The Commission also approved an alternative method in which taxable customer contributions are grossed up for income taxes, and recognized that this method provided better protections to existing ratepayers.

Company witness Mr. Evans argues that the Commission determined that utilities “should include in rate base the resulting deferred tax debit from paying the tax on the CIAC and that the debit is removed from rate base as the gas utility receives the tax depreciation on plant constructed with the CIAC.” However, in the NPV analysis provided in response to OSBA-I-2, the Company does not reflect the costs to ratepayers for the ratebase associated with this deferred tax debit.

The OSBA concludes, therefore, that the Company’s NPV model understates the tax costs (or overstates the tax benefits) associated with the CIAC, thereby understating the economic cost of the system expansion.

The OSBA also concludes that the “interest” rate used by the Company in calculating the Rider NAS charge fails to recognize that the Company incurs income taxes related to equity. The Company’s economic evaluation explicitly includes the income tax costs associated with the new customer, including both regular and deferred tax impacts. These costs (correctly) serve to increase the magnitude of the required contribution. In contrast, the Company includes no such tax effects in deriving the “interest” rate for Rider NAS. The Company’s economic model and its “interest” calculation are simply not consistent.

Finally, with regard to the complexities associated with deferred taxes, the OSBA notes that neither Columbia nor the Commission saw a need to include any such complexities in its DSIC calculations, which simply gross up the equity returns for income taxes.<sup>7</sup> The OSBA proposal is consistent with that approach.

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<sup>7</sup> See Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution System Improvement Charge, Docket No. P-2012-2338282, January 2, 2013.

### **C. Recording Customer Contributions whether Payments are Made or Not**

The Company proposes to write down the gross book value of the Rider NAS investment only if Rider NAS payments are actually made.<sup>8</sup> If the contributions are not made, the Rider NAS investment will remain in gross plant. It is the understanding of the OSBA that this non-payment implies that net book value associated with the Rider NAS investment will be higher than if the Rider NAS payments were made. In effect, non-Rider NAS customers will be absorbing higher costs if Rider NAS payments are not made than if they are made.

This is particularly problematic for two reasons. First, the Company has relatively little leverage to collect Rider NAS charges, since it will not shut off service for non-payment of Rider NAS charges. This means that un-collectibles costs are likely to be higher than normal.<sup>9</sup> Second, the relatively high implied financing costs for the Rider NAS program (particularly if income tax costs are fully reflected) implies that the customers most interested in using the Rider NAS option are more likely to have capital constraints of their own, and are therefore less likely to pay their bills.

In order to eliminate this bias, the OSBA recommends that the Company write down gross book value associated with Rider NAS charges whether or not payments are made, in order to eliminate the impact of non-payments on non-Rider NAS ratepayers. In light of this recommendation, the Company may wish to include an un-collectibles component in the Rider NAS charge, in order to offset the incremental un-collectibles costs that it is likely to incur.

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<sup>8</sup> OSBA-I-5(d).

<sup>9</sup> OSBA-I-5(b).

## VI. CONCLUSION

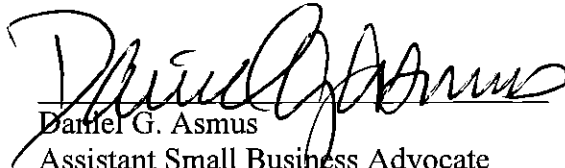
This is not the appropriate forum for a major review of Commission policy on customer contributions. The issue is important enough to warrant a generic proceeding of its own. The OSBA does not object to continuing to subsidize new customers through the depreciation tax benefits in Columbia's DCF calculation until such time as the Commission undertakes a full evaluation of the policy.

The OSBA objects to OCA's proposal to overhaul the methodology and substantially increase subsidies for new customers at the expense of existing customers, in a proceeding designed merely to create an alternative to the existing method. The OSBA is also concerned that increasing subsidies will result in higher costs being assigned to small business customers, under normal cost allocation procedures.

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Finally, the Company is unwilling to absorb any risk of non-payment of NAS charges, but is perfectly happy to assign that risk to existing ratepayers. This is obviously inequitable.

Respectfully submitted,

  
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