

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

**REPLY BRIEF
OF THE
BUREAU OF INVESTIGATION & ENFORCEMENT**

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I. INTRODUCTION

On July 16, 2014, Columbia Gas of Pennsylvania, Inc. (Columbia or Company), the Bureau of Investigation and Enforcement (I&E), the Office of Consumer Advocate (OCA), and the Office of Small Business Advocate (OSBA) filed main briefs in accordance with the ALJ's hearing and briefing schedule addressing Columbia's proposed Rider New Area Service (Rider NAS or Rider) as proposed by Columbia in Supplement No. 210 to Tariff-Gas – PA. P.U.C. No. 9. I&E herein files its reply brief responding primarily, but not exclusively, to the brief of the OCA.

As I&E submitted in its main brief, as proposed by the Company Rider NAS is intended to be a financial alternative to the Company's existing main extension tariff that requires an up-front payment by a new prospective customer for the portion of a main extension that is found by the Company's approved tariff analysis to constitute an uneconomic investment. Rider NAS was not proposed or intended, either by the Company originally in the 2012 base rate case at Docket No. R-2012-2321748 or in the subsequent parties' collaborative, to constitute an entirely different economic analysis for main extensions than what is already in the Company's existing tariff. It should not be approved as such here.

II. DESCRIPTION OF THE COMPANY'S RIDER NAS PROPOSAL

For a full description of Rider NAS, I&E relies on the description provided in its main brief. I&E believes it important to address, however, a statement in OSBA's main

brief that small business customers will not benefit from Rider NAS and therefore ought not absorb costs or risks associated with the program.¹

First, as OSBA acknowledges, as designed by the Company Rider NAS is open to residential housing developers.² Residential housing *developers* are *not* residential customers, and certainly can comprise small businesses, including not just the developers, but all the contractors – large or small – involved in the build-out of a new development. In this manner, small businesses benefit from the availability of Rider NAS because the ability to offer the availability of gas service promotes their business development. Further, simply because plant is added as a result of the connection of a new residential customer does not mean that that plant is not available to any other customers, including small business customers that may find the new availability of gas service as an economic alternative. Finally, to the extent that Rider NAS enables new customers help to grow the availability of a potentially lower cost fuel alternative in an area, these new customers may have available more money to spend on the local economy, also benefitting small businesses in the area.

Although OSBA neither contests the limitation of this alternative financing option to residential customers³ nor challenges Columbia's cost allocation procedures as a result of this pilot program,⁴ I&E disputes OSBA's assertion that small business customers do not benefit from the program and the concomitant apparent implication that a separate cost allocation may be appropriate. OSBA's assessment of the benefits of Rider NAS is

¹ OSBA Main Brief, p. 5.

² OSBA Main Brief, p. 4.

³ OSBA Main Brief, p. 5.

⁴ OSBA Main Brief, p. 6.

too narrow, and its concerns about protecting small business customers from costs or risks of the program too broad. Any suggestion that a separate allocation for this mains investment pilot is appropriate should be ignored.

III. SUMMARY OF ARGUMENT

Columbia's Rider NAS pilot program was not designed or introduced to change or provide a wholly different economic model from the Company's current line extension tariff. It simply allows potential new customers to secure gas service for a modest monthly charge over a twenty-year period rather than be required to pay the entire cash contribution up-front.

OCA's recommended changes to the surcharge interest rate and economic model far exceed the parties' expectations of Rider NAS based upon the tariff's introduction in the 2012 base rate case. Further, they place the Company and its prospective customers seeking line extensions in the ironically tenuous position of giving and receiving inconsistent economic analyses and results that favor the long-term paying customers based solely on whether the uneconomic portion is paid up-front in total or over time in installments. OCA's proposals should be rejected and the Rider approved as filed. If the OCA seeks to make an industry change to parameters to more closely resemble the Commission's regulation on main extensions for the water industry, it should be done on an industry basis and not to Columbia exclusively.

IV. OCA'S POSITION

A. SETTING THE INTEREST RATE AT 3%

In describing its position, OCA contends that the interest rate for financing the line extension project should be modified in order to make the alternative financing option more attractive. OCA continues to compare the financial attraction of a home equity loan as a reason to offer Rider NAS prospective customers a 3% interest rate.⁵ As I&E contended in its main brief, however, a comparison to a home equity loan is inappropriate for several reasons.⁶ Certainly if a prospective Columbia customer qualifies for a low rate home equity loan, it would be in his or her interest to pursue that financial opportunity. For customers without such options, however, including those with little or no home equity of other form of collateral, the Company's proposal to offer an alternative to what can be an up-front payment of possibly a few thousand dollars in exchange for a \$35/month surcharge certainly presents an attractive option. Rider NAS, as an unsecured offering from a utility charged with providing utility service, not lending service, to all ratepayers. It simply is not intended to replace other commercial lending opportunities and should not be evaluated on the basis of that comparison.

OCA also continues to emphasize that the benefits of growing Columbia's customer base even if at the expense of growing existing customers' contributions to these new customers' extensions is a well-justified trade-off since the increased subsidy from existing customers is small and not really a subsidy.⁷ As I&E stated, OCA's narrow

⁵ OCA Main Brief, p. 14.

⁶ I&E Main Brief, pp. 5-7.

⁷ OCA Main Brief, p. 11.

focus on the interest rate fails to fully recognize the benefit of Rider NAS to customers for whom an alternative to a large up-front deposit is best. Under that scenario, and given the rates for unsecured personal loans, an 8% interest rate is attractive.⁸ Moreover, the size of the increased subsidy under this pilot is less relevant than OCA's position that Rider NAS be compared to commercially available loans rather than considered simply as an alternative to a large, up-front payment.

As I&E witness Boyd stated, while new costs to existing customers may be low under the pilot, the cumulative effects of NAS, should it be continued beyond the initial four-year term or increased in value, could become a substantial burden to existing customers.⁹ Further, OCA's contention that completed extensions will have a net value that will offset these enlarged subsidization effects over time¹⁰ is not realistic. As I&E witness Boyd noted, Columbia's existing economic test currently utilizes a 40-year analysis of anticipated revenue to determine what portion of a project is economic. In reviewing economic tests identified by other NGDCs as well as the State of New York Public Service Commission's Policy Statement regarding gas service expansion, five to seven year recovery periods were more common periods used in economic analyses.¹¹

Because Columbia uses a 40-year recovery period, rather than the more common shorter period of time, for the bulk of the extension life existing customers will be providing the revenue necessary to provide recovery of and recovery on the line extension's economic investment. The new customer is undoubtedly not providing

⁸ I&E Main Brief, p. 6; I&E St. No. 1-R, p. 16.

⁹ I&E Main Brief, pp. 7-10; I&E St. No. 1-R, p. 19, I&E St. No. 1-RE, p. 10.

¹⁰ OCA Main Brief, p. 12-13.

¹¹ I&E St. No. 1-R, p. 9.

enough revenue in the first year or years to fund the return on investment. Until the revenue requirement for the remaining undepreciated economic piece is less than that new customer's annual revenue to the Company, all customers are funding that investment. Under OCA's proposal, however, where a larger piece of the project would be deemed economic yet still earn the Commission authorized ROR in rate base, the existing customers could subsidize the extension for the entire life of the investment.¹²

Moreover, while OCA may consider an increased subsidy of \$0.19 per customer per year to be immaterial, this is just in a single year of the Pilot. As previously stated, cumulatively these effects can be substantial. Even more troubling is the prospect that were the Commission to allow this change to the long-standing method of financing service extensions, other companies could seek to establish similar line extension financing models that may have a material effect on existing customers.¹³

OCA's other point to minimize the extra-subsidy effect that OCA's proposed interest payment causes, namely that I&E's calculation does not reflect the certainty that Columbia's distribution rates will also increase over time, ignores the reasons for those future rate increases. Future customer rate increases cannot be applied directly to the cost of the uneconomic NAS extensions. Rates increase in direct response to increasing operating costs or changes in the Commission authorized rate of return. Where rates increase due to rising expenses, the additional revenue granted is for the purpose of meeting those expenses and does not represent additional money available for the line

¹² I&E St. No. 1-R, pp. 9-10.

¹³ I&E St. No. 1-RJ, p. 12.

extension economic analysis. Similarly where rates increase due to rising debt and equity costs in response to market conditions, this projected increase in equity and debt costs would need to be built into the economic model along with the projected revenue increases. It would not be equitable to use an economic analysis reflecting increased revenues resulting from increased debt and equity rates without embedding corresponding debt and equity rate increases in the model.¹⁴ Thus, no matter how reviewed or how small measured under a pilot, OCA's increased subsidy must be rejected as it results in unjust and unreasonable rates for Columbia's existing ratepayers.

B. ECONOMIC MODEL

1. Cost of Debt as Surrogate for Equity Return

As previously described, Columbia's Rider NAS program is not designed to change Columbia's existing line extension process.¹⁵ Yet, in addition to recommending an unreasonably low interest rate, OCA also recommends changing the Company's current economic model by removing the cost of equity from the calculation of future cash flows within its DCF calculation and substituting it with the Company's cost of debt, which would reduce the overall calculation of the uneconomic portion of the investment.¹⁶ As support, OCA points to one out of state utility as well as Pennsylvania's in-state line extension regulation for water companies. Without any further relation to Pennsylvania or other Pennsylvania utility operations, the former, I&E submits, is wholly irrelevant. The latter I&E might agree carried some instructional insight but for the fact

¹⁴ I&E St. No. 1-RJ, pp. 13-14.

¹⁵ I&E Main Brief, p. 10; Columbia St. No. 1-R, p. 12.

¹⁶ OCA Main Brief, p. 16-19.

that the Commission has already specifically considered and rejected application of the water line extension regulation to other industries, specifically including the regulated natural gas distribution industry. As such, I&E submits that OCA's support for changing Columbia's capital cost rate in its economic model is inapposite.

To support its proposed removal of the cost of equity from any consideration in the Company's capital cost portion of the DCF analysis, OCA relies heavily on the Commission's regulation for water line extensions, which uses the cost of debt in economic models. As OCA notes, the line extension regulation for water companies was revised by the Commission in 1996. While the OCA recognizes that this regulation applies to the water industry in Pennsylvania only, OCA fails to acknowledge that the Commission considered – and rejected – applying this same capital cost alteration to other Pennsylvania regulated utilities, including gas. OCA's unilateral effort to amend this regulation for Columbia, therefore, is wholly unsupported not only because it understates the cost of capital to the detriment of existing ratepayers, but also because it was specifically considered and rejected by the Commission when the water regulation was revised.

Regulations for line extensions for each of the electric, gas, and water industries in Pennsylvania have independent authority and direction in the Commission's regulations. Line extensions for the electric industry are addressed in 52 Pa. Code §57.19; gas line extensions are addressed in 52 Pa. Code §59.27; water line extensions are addressed in 52 Pa. Code §65.21. Each is different, with the water line extension regulation expressly mandating a formula to measure the utility's investment. More pertinent than each

industry's specific regulation, however, is the fact that the Commission specifically refused to impose the same standard on other industries as it had on water.

The Commission's *1996 Water Line Extension Order*,¹⁷ relied on by the OCA, was initiated in 1993 as a Commission rulemaking to provide a public forum to address issues related to utility extensions. In the order, the Commission expressly notes that "the claim of an individual seeking the line extension must be balanced against the right of the public utility to remain financially viable and *the right of existing customers to avoid subsidizing uneconomic line extensions for new customers.*"¹⁸ While initially considered as perhaps an industry-wide resolution, the Commission noted that electric and telephone did not experience the same levels of uncertainty and litigation as had water and gas, and further that gas was increasingly an industry for which alternative fuels and electricity were readily available as alternatives, making natural gas "largely a matter of customer choice."¹⁹ And while the Commission did state that the water regulation could serve as guidance for other industries, it expressly found that the proposed line extension regulation no longer was necessary "across the board" but instead would be limited to "target the real problem area," namely the water industry.²⁰

Moreover, in defining the new "debt costs" term in Section 65.1 of the water regulation, the Commission specifically noted that "[d]ue to the infrequency of base rate cases for some companies, we have decided to use a company's current debt cost data"

¹⁷ *Re Line Extensions*, Docket No. L-930089, 1996 Pa. PUC Lexis 162 (Order entered October 7, 1996) (*1996 Water Line Extension Order*).

¹⁸ *1996 Water Line Extension Order*, at *8 (emphasis added).

¹⁹ *Id.*, at *10.

²⁰ *Id.*

and that “[t]he cost of preferred stock, however, has been specifically excluded since it is a relatively minor component of any utility’s cost of service and would needlessly complicate the economic standard for a line extension.”²¹ Having filed four base rate cases in the past six years, it hardly holds true today that Columbia’s base rate cases are infrequent, nor has OCA attempted to limit Columbia’s capital cost rate to the cost of debt because preferred stock is either a minor component or needlessly complicates the Company’s economic model. Rather, OCA relies on an order and regulation that both, by their express terms, do not apply to the gas industry and does so for reasons that do not warrant exclusion of the equity cost rate as was decided in 1996 for the water industry.

When approving the parties’ settlement of Columbia’s 2012 base rate case, Commissioner Cawley addressed the proposed resolution of Rider NAS as follows:

The parties also committed to pursuing further discussions on a means of removing barriers to new service extensions by entering into an informal collaborative with Columbia to attempt to develop a program to extend service to new areas. As a result, Columbia may file a tariff in the near future for our review that represents a new and creative method that *balances the needs and concerns of existing and prospective customers.*²²

OCA’s reliance on the *1996 Water Line Extension Order* is misplaced. OCA’s proposed changes to Columbia’s economic model’s use of the capital cost rate fails to balance the needs and concerns of existing customers and should be rejected.

2. Costs of Service Lines, Meters, and Regulating Equipment

I&E relies upon its discussion of OCA’s proposal to exclude the capital costs of service lines, meters, and regulating equipment from the DCF model when evaluating

²¹ *Id.*; at * 15.

²² *Pennsylvania Public Utility Commission v. Columbia Gas of Pennsylvania, Inc.*, Docket No. R-2012-2321748, Statement of Commissioner Cawley at 2 (emphasis added).

NAS projects as presented in I&E's main brief. I&E continues to maintain that not only does this proposal result in Columbia having two different economic models and evaluations depending on whether a new prospective customer chooses the Company's traditional line extension analysis or its Rider NAS but also this proposal continues to exacerbate the subsidy required from existing customers. It should be rejected.

C. ADDITIONAL REPORTING REQUIREMENTS

I&E relies upon its discussion in its main brief with respect to additional reporting requirements.

D. TREATMENT OF RESIDENTIAL DEVELOPERS

I&E took no position on this issue.

E. OTHER PROPOSED MODIFICATIONS

I&E took no position on this issue.

V. OSBA'S POSITION

A. REVIEW OF TAX DEPRECIATION BENEFITS IN CUSTOMER CONTRIBUTION CALCULATION

I&E took no position on this issue.

B. INCOME TAX COSTS IN RIDER NAS CHARGE CALCULATION

I&E took no position on this issue.

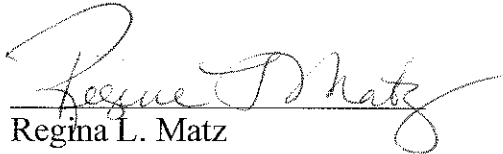
C. RECORDING CUSTOMER CONTRIBUTIONS WHETHER PAYMENTS ARE MADE OR NOT

I&E took no position on this issue.

VI. CONCLUSION

For the reasons stated herein as well as in I&E's main brief, I&E recommends that the Administrative Law Judge dismiss the proposed modifications to the Company's proposed Rider NAS submitted by the OCA as addressed by I&E and, except for the additional reporting requirements, approve the Rider as filed in Supplement No. 210 to Tariff-Gas – PA. P.U.C. No. 9.

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Pa PUC. No. 9 of Columbia Gas of : Docket No. R-2014-2407345
Pennsylvania, Inc. :

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Reply Brief** dated July 23, 2014,
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