

COMMONWEALTH OF PENNSYLVANIA



OFFICE OF CONSUMER ADVOCATE

555 Walnut Street, 5th Floor, Forum Place  
Harrisburg, Pennsylvania 17101-1923  
(717) 783-5048  
800-684-6560

FAX (717) 783-7152  
consumer@paoca.org

July 1, 2014

Honorable Mark A. Hoyer  
Pennsylvania Public Utility Commission  
Office of Administrative Law Judge  
Suite 220, Piatt Place  
301 Fifth Avenue  
Pittsburgh, PA 15222

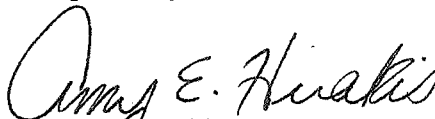
RE: Supplement No. 210 to Tariff Gas Pa.  
P.U.C. No. 9 of Columbia Gas of  
Pennsylvania, Inc.  
Docket No. R-2014-2407345

Dear Judge Hoyer:

Enclosed please find the Office of Consumer Advocate's Surrebuttal Testimony of Glenn A. Watkins 1-SR, in the above-referenced proceeding.

Copies have been served as indicated on the enclosed Certificate of Service.

Respectfully Submitted,

  
Amy E. Hidakis  
Assistant Consumer Advocate  
PA Attorney I.D. # 310094

Enclosures

cc: Rosemary Chiavetta, Secretary (Certificate of Service)  
Certificate of Service

\*184560

CERTIFICATE OF SERVICE

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

I hereby certify that I have this day served a true copy of the foregoing document, the Office of Consumer Advocate's Surrebuttal Testimony of Glenn A. Watkins 1-SR, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 1st day of July 2014.

SERVICE BY E-MAIL & INTER-OFFICE MAIL

Regina L. Matz, Esq.  
Allison C. Kaster, Esq.  
Bureau of Investigation & Enforcement  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street  
Harrisburg, PA 17120

SERVICE BY E-MAIL & FIRST CLASS MAIL, POSTAGE PREPAID

Charis Mincavage, Esq.  
Elizabeth P. Trinkle, Esq.  
McNees Wallace & Nurick LLC  
100 Pine Street  
P.O. Box 1166  
Harrisburg, PA 17108-1166

Theodore J. Gallagher, Esq.  
Columbia Gas of Pennsylvania  
121 Champion Way, Suite 100  
Canonsburg, PA 15317

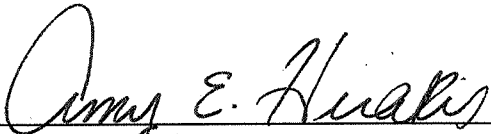
Daniel G. Asmus, Esq.  
Office of Small Business Advocate  
Commerce Building, Suite 1102  
300 North Second Street  
Harrisburg, PA 17101

Michael W. Hassell, Esq.  
Devin T. Ryan, Esq.  
Post & Schell, PC.  
17 North Second Street, 12<sup>th</sup> Fl.  
Harrisburg, PA 17101-1601

Andrew S. Tubbs, Esq.  
NiSource  
800 N. Third St., Suite 402  
Harrisburg, PA 17102

Mr. Robert D. Knecht  
Industrial Economics Inc.  
2067 Massachusetts Ave.  
Cambridge, MA 02140

Joseph Vullo, Esq.  
Burke Vullo Reilly Roberts  
1460 Wyoming Avenue  
Forty Fort, PA 18704



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Candis A. Tunilo  
Assistant Consumer Advocate  
PA Attorney I.D. # 89891  
E-Mail: [CTunilo@paoca.org](mailto:CTunilo@paoca.org)

Amy E. Hirakis  
Assistant Consumer Advocate  
PA Attorney I.D. # 310094  
E-Mail: [AHirakis@paoca.org](mailto:AHirakis@paoca.org)

Counsel for  
Office of Consumer Advocate  
555 Walnut Street 5th Floor, Forum Place  
Harrisburg, PA 17101-1923  
Phone: (717) 783-5048  
Fax: (717) 783-7152  
\*180544

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
v.	:	Docket No. R-2014-2407345
Columbia Gas of Pennsylvania, Inc.	:	

SURREBUTTAL TESTIMONY

OF

GLENN A. WATKINS

ON BEHALF OF THE

PENNSYLVANIA OFFICE OF CONSUMER ADVOCATE

JULY 1, 2014

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Glenn A. Watkins. My business address is 9030 Stony Point  
3 Parkway, Suite 580, Richmond, VA 23235.

4  
5 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS**  
6 **PROCEEDING?**

7 A. Yes. I pre-filed direct testimony on June 10, 2014, which is identified as OCA  
8 Statement No. 1 as well as rebuttal testimony on June 24, 2014, which is identified as  
9 OCA Statement No. 1-R.

10

11 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

12 A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimonies  
13 of Columbia witness Erich Evans, I&E witness Lisa Boyd and OSBA witness Robert  
14 Knecht.

15

16 **Q. PLEASE SUMMARIZE THE FUNDAMENTAL ASPECTS OF COLUMBIA'S**  
17 **CURRENT PRACTICES RELATING TO THE EXPANSION OF MAINS TO**  
18 **SERVE NEW CUSTOMERS.**

19 A. Under current practices, prospective new customers are evaluated based on a  
20 traditional Discounted Cash Flow ("DCF") technique in which the present value of future  
21 revenues (cash inflows) are measured against the present value of future capital  
22 expenditures and income taxes (cash outflows).<sup>1</sup> Under Columbia's approach, each new  
23 customer's expected annual usage (Dth) is multiplied by the current distribution rate plus  
24 the revenue generated from fixed customer charges. It is important to understand that  
25 under the Company's modeling technique, rates are assumed to remain at the current  
26 level for 40 years. Similarly, all costs required to extend a main and connect a new  
27 customer are included within this evaluation. These costs include the cost of extending a  
28 main as well as the cost of installing a service line and meter. The annual net cash flows  
29 are then discounted at the Company's current total cost of capital (approximately 8%) to  
30 determine if the project produces an internal rate of return ("IRR") greater than or less

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<sup>1</sup> There are also a minimal amount of incremental expenses considered.

1 than the total cost of capital. If the project will produce an IRR greater than the cost of  
2 capital, no upfront deposit is required from the prospective customer. However, if the  
3 IRR is less than the Company's cost of capital, the customer will be required to make an  
4 upfront deposit equal to the present value of the net cash flow shortfall.

5 Under the Company's NAS rider proposal, new customers would be allowed to  
6 finance all or a portion of their required deposit for a term of 20 years at an interest rate  
7 equal to the Company's cost of capital (approximately 8%) up to a maximum amount of  
8 approximately \$4,200.<sup>2</sup> For reasons discussed in my direct testimony, it is my opinion  
9 that the Company's NAS rider, as proposed, will have limited success and will not result  
10 in a material increase in the availability of natural gas to unserved areas within  
11 Columbia's service area. As a result, I recommend three major modifications to the  
12 Company's proposed NAS rider.

13 First, I recommend that the cost of installing service lines and meters be excluded  
14 from the DCF model. Second, I recommend that the discount rate used within the DCF  
15 model be set at the Company's cost of debt instead of the overall cost of capital. Third, I  
16 recommend that the interest rate used for financing be established at 3.00% as opposed to  
17 the Company's authorized total cost of capital (approximately 8%).  
18

19 **Q. PLEASE SUMMARIZE THE AREAS OF AGREEMENT AND DISAGREEMENT**  
20 **BETWEEN YOU, COLUMBIA WITNESS EVANS, I&E WITNESS BOYD AND**  
21 **OSBA WITNESS KNECHT.**

22 A. There are few material disagreements regarding the technical aspects of my  
23 recommended modifications to Columbia's NAS rider. Rather, our disagreements relate  
24 to regulatory policy. All witnesses agree that from a technical perspective, Columbia will  
25 incur service line and metering capital costs whenever a new customer is added to the  
26 system.<sup>3</sup> In addition, all witnesses appear to agree that the use of the Company's  
27 authorized total cost of capital within the DCF model will ensure that all incremental

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<sup>2</sup> Under Columbia's proposal, the maximum monthly payment is \$35.00. This maximum monthly payment amount of \$35.00 financed at 8% equals about \$4,200. Any deposit requirement above approximately \$4,200 must be met with an upfront cash contribution.

<sup>3</sup> As discussed in my direct testimony, Columbia's service line investment requirements vary between the Eastern and Western portions of the Company's service area.

1 capital costs are recovered over the life of the project plus a full level of profitability to  
2 Columbia. Furthermore, all witnesses agree that the financing of upfront deposits will  
3 result in some timing difference of contributions to traditional revenue requirements.<sup>4</sup>  
4 Therefore, all witnesses agree that the exclusion of service line and metering costs as well  
5 as the use of a discount rate lower than the Company's total cost of capital will result in  
6 existing ratepayers bearing some costs that would not be incurred under Columbia's  
7 approach, at least in the early years of each new customer's use of natural gas. However,  
8 it appears that no witness disagrees with my assessment that these costs stemming from  
9 my recommended modifications to the NAS rider will be immaterial to existing  
10 ratepayers.

11 The witnesses in this case disagree, however, as to whether my modifications to  
12 Columbia's proposed NAS rider are in the public interest and will benefit Pennsylvanians  
13 overall. Whereas my recommended modifications to the NAS rider will have an  
14 immaterial upward impact on distribution rates, the other witnesses in this case advocate  
15 a policy of absolutely no potential upward impact on distribution rates regardless of the  
16 benefits that will be achieved by making natural gas more available to residential energy  
17 consumers. As indicated in my direct testimony, each new residential customer that  
18 converts to natural gas from an alternative heating energy source can expect to save in the  
19 neighborhood of \$1,000 to \$1,300 per year. Furthermore, initiating a program that truly  
20 encourages the expansion of Columbia's distribution mains to currently unserved areas  
21 will have direct and indirect benefits to residences and small businesses within  
22 Columbia's service territory. These expansions will make the future expansions of other  
23 mains more feasible allowing more energy consumers to realize the benefits of natural  
24 gas and provide more disposable income available to be spent within the community. At  
25 the same time, the benefits that will accrue under my proposed modifications to  
26 Columbia's proposed NAS rider will far outweigh the minimal costs that are incurred  
27 under my proposal.

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<sup>4</sup> This is the result of principal payments being booked and applied to CIAC over the life of the financing term.

1 **Q. IS THERE ANY TECHNICAL ASPECT OF THE COMPANY'S MODELING**  
2 **PROCEDURE THAT WARRANTS FURTHER DISCUSSION WHEN**  
3 **CONSIDERING THE IMPACT OF YOUR PROPOSAL?**

4 A. Yes. As indicated earlier, the Company's modeling procedures assume that  
5 current rates will remain in effect for 40 years. This assumption is certainly not realistic  
6 given Columbia's recent propensity to increase rates every year or two. As such, as  
7 Columbia's distribution rates increase over time, the revenue contributions from new  
8 customers will increase over the 40 year modeling life. These certain increases in rates,  
9 and hence, additional contributions to revenue by new customers, are not reflected in the  
10 Company's model, nor are they mentioned or evaluated by the other witnesses concerned  
11 about the potential for cost shifting.

12  
13 **Q. DOES THE EXPANSION OF MAINS TO SERVE NEW CUSTOMERS RESULT**  
14 **IN A REDUCTION OF EXISTING RATEPAYERS' RATES IN SOME**  
15 **INSTANCES?**

16 A. Yes. As discussed in my direct testimony, about half of the potential projects  
17 evaluated result in an IRR greater than the Company's cost of capital. These new  
18 customers contribute more than the incremental costs of serving that customer, such that  
19 the average cost to existing ratepayers declines.

20  
21 **Q. CAN YOU QUANTIFY THE SPECIFIC DOLLAR IMPACT THAT YOUR**  
22 **RECOMMENDED MODIFICATIONS TO COLUMBIA'S PROPOSED NAS**  
23 **RIDER WILL HAVE ON EXISTING CUSTOMERS' DISTRIBUTION RATES?**

24 A. No. This is because the exact amount of costs that will be borne by existing  
25 ratepayers will depend on the level and type of expansions that occur. However, as  
26 discussed in my direct testimony, under a worst case scenario in which every new mains  
27 extension resulted in zero revenue from customers (i.e., mains are extended but no  
28 customers are added with no resulting revenue), the additional cost impact on existing  
29 residential customers would be approximately \$0.38 per customer per year.<sup>5</sup>

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<sup>5</sup> \$0.38 reflects the Company's proposed cap of \$1,000,000 capital spending per year such that under my proposed cap of \$2,000,000 per year, this impact would be about \$0.76 per customer per year.

1 In her rebuttal testimony, Ms. Boyd provides a scenario of the cost impact on  
2 existing ratepayers under the assumption that all mains extension projects result in the  
3 maximum amount financed. Under this assumption, Ms. Boyd calculates a total cost to  
4 existing ratepayers of \$74,418 per year. Under this scenario, this \$74,418 would result in  
5 an increase to existing residential customers' rates of about \$0.19 per customer per year.  
6 It should be noted that Ms. Boyd's scenario overstates the additional costs to ratepayers  
7 in that her scenario assumes every mains extension project will result in the maximum  
8 amount of financing available. In reality, many, if not most, mains expansion projects  
9 that will go forward will result in a significantly lower contribution. Ms. Boyd's scenario  
10 also does not consider those mains expansion projects that have a positive present value  
11 which will reduce the cost to existing customers. Ms. Boyd's scenario also does not  
12 reflect the certainty that Columbia's distribution rates will increase over time.

13  
14 **Q. UNDER YOUR RECOMMENDED MODIFICATIONS TO THE COMPANY'S**  
15 **NAS RIDER PROGRAM, IS THERE A LIKELIHOOD THAT ANY TRULY**  
16 **UNECONOMIC OR UNREALISTIC MAINS EXTENSIONS WILL OCCUR?**

17 A. No. This is because potential new customers will still be evaluated based on their  
18 expected revenues against the expected costs of each new mains extension. For projects in  
19 which either expected revenues will be grossly deficient or capital expenditures are  
20 exceptionally high, the required deposit will be so large as to dissuade such expansions.

21  
22 **Q. WITNESSES EVANS, BOYD AND KNECHT CLAIM THAT YOUR PROPOSED**  
23 **MODIFICATIONS TO THE NAS RIDER WILL RESULT IN A NEW**  
24 **CUSTOMER SUBSIDY FROM EXISTING CUSTOMERS. DO YOU AGREE**  
25 **WITH THIS ASSERTION?**

26 A. No. While I agree that my proposed modifications to the Company's NAS rider  
27 could have an immaterial increased impact in existing customers' distribution rates in the  
28 near term, it cannot be said that existing customers will be "subsidizing" these new mains  
29 expansions. This is because a subsidy only exists when a ratepayer is charged more than  
30 his/her stand alone cost of providing natural gas service. Indeed, all customers receive  
31 substantial benefits by being part of Columbia's distribution system. Therefore, while

1 customers are clearly better off by being part of a system that averages Columbia's total  
2 cost, it cannot be said that they would be asked to subsidize other customers who join the  
3 system and share in the averaging of the Company's total cost.  
4

5 **Q. FROM A PRACTICAL STANDPOINT, CAN YOU ILLUSTRATE WHY THE**  
6 **VARIOUS WITNESSES' USE OF THE TERM "SUBSIDY" IS INCORRECT?**

7 A. Yes. It is well known that residential rates reflect the averaging of all of  
8 Columbia's costs of providing service. If one were to dissect utility systems for each and  
9 every customer, one would likely find that the incremental cost to serve each customer  
10 varies considerably, yet all ratepayers pay the same distribution rates. For example,  
11 Pennsylvania's electric distribution companies serve virtually every residence in the State  
12 -- urban, suburban, and rural. While it is very likely that the incremental cost to serve  
13 rural residential customers is greater than that to serve suburban and urban customers, all  
14 residential rates are the same throughout each utility's service area and are designed  
15 based on the averaging of all costs. With respect to Columbia specifically, those  
16 residential customers in the Western portion of the Company's service area must repair  
17 and replace their own service lines located on their property. Yet, those service lines in  
18 the Eastern portion of the Company's service area are replaced and maintained by  
19 Columbia. All else constant, even though the cost to provide distribution service in  
20 Columbia's Western area is less than the Eastern area, residential customers pay the same  
21 distribution rates throughout the Company's service area. However, under current  
22 ratemaking practices, no "subsidy" is alleged.  
23

24 **Q. COMPANY WITNESS EVANS INDICATES THAT YOUR MODIFICATIONS**  
25 **TO THE NAS RIDER TO USE A LOWER INTEREST RATE COMBINED WITH**  
26 **THE USE OF THE COMPANY'S COST OF DEBT IN PLACE OF ITS COST OF**  
27 **CAPITAL WITHIN THE DCF MODEL WILL RESULT IN A REGULATORY**  
28 **LAG TO THE COMPANY. DO YOU HAVE COMMENTS REGARDING THIS**  
29 **ASSERTION?**

30 A. Yes. First, it should be remembered that Columbia is afforded the opportunity to  
31 utilize fully forecasted future test years within the ratemaking process. As such, its fully

1 forecasted future test years will reflect a reasonable level of future mains extensions.  
2 Second, to the extent there is some regulatory lag resulting from a mains expansion, this  
3 occurs with virtually every actual capital project undertaken between rate cases.  
4

5 **Q. DO YOU HAVE ANY CONCLUDING COMMENTS REGARDING THE**  
6 **REBUTTAL TESTIMONIES OF THE VARIOUS WITNESSES IN THIS CASE?**

7 A. Yes. As is well known, the expansion of natural gas infrastructure in  
8 Pennsylvania has been significantly limited for the last several decades. As such, many  
9 energy consumers in Pennsylvania do not have natural gas available but would realize  
10 significant savings if they used natural gas for their heating requirements. In my opinion,  
11 Columbia's proposal to offer financing of deposit requirements is a step in the right  
12 direction. However, as proposed by the Company, the NAS rider will result in few mains  
13 expansions due to the methods in which deposit requirements are determined as well as  
14 the Company's proposed high interest rate for financing such deposits. In recommending  
15 my proposed modifications to the NAS rider, I have evaluated the benefits and costs to  
16 potential new customers, existing ratepayers, and Pennsylvania overall. I have concluded  
17 that the minimal amount of additional cost that will be borne by existing customers is far  
18 outweighed by the benefits that will be realized by energy users within Columbia's  
19 service area as well as Pennsylvania as a whole.  
20

21 **Q. DOES THIS COMPLETE YOUR SURREBUTTAL TESTIMONY?**

22 A. Yes.

23 185691