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September 22, 2014

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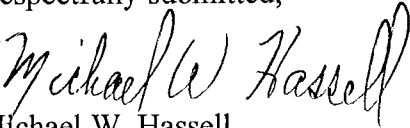
Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor North
P.O. Box 3265
Harrisburg, PA 17105-3265

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

Dear Secretary Chiavetta:

Enclosed please find the Reply Exceptions of Columbia Gas of Pennsylvania, Inc. in the above-referenced proceeding. Copies will be provided as indicated on the Certificate of Service.

Respectfully submitted,


Michael W. Hassell

MWH/skr
Enclosure

cc: Honorable Mark A. Hoyer
Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been served upon the following persons, in the manner indicated, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

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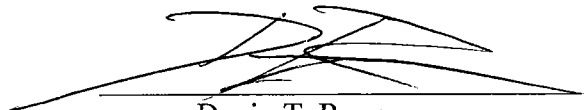
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Date: September 22, 2014



Devin T. Ryan

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

REPLY EXCEPTIONS OF COLUMBIA GAS OF PENNSYLVANIA, INC.

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I. INTRODUCTION

Columbia Gas of Pennsylvania, Inc. ("Columbia") hereby files these Replies to the Exceptions of the Office of Consumer Advocate ("OCA") to the Recommended Decision ("RD") of the Honorable Mark A. Hoyer (the "ALJ") issued on August 22, 2014.

OCA's Exceptions to the well-reasoned RD are fundamentally flawed. Underlying the Exceptions is OCA's continued premise that Columbia's Pilot Rider NAS will fail. Based upon this unproven premise, OCA proposes several revisions that will force existing customers to subsidize the uneconomic portions of new customers' line extensions. (RD at 54-55, 59-60). OCA fails to acknowledge that the goal of this four-year pilot program is to test whether the program will be successful in extending natural gas service to unserved and underserved areas of Columbia's service territory without shifting new service extension costs to existing customers. (RD at 50; Columbia RB p. 12). The RD correctly found that such cost shifting is inequitable and that there is no basis to change the fundamental calculations used for Pilot Rider NAS to shift costs to existing customers. (RD at 55, 59).

Furthermore, OCA's proposals are contrary to ratemaking principles, such as cost causation. (RD at 54). OCA admits that its proposals shift costs to existing customers. (OCA Exceptions p. 9). Noting the substantial savings to be achieved by switching natural gas service, OCA wants to force existing customers to subsidize uneconomic line extensions so that new customers will receive those savings without paying for the uneconomic portion of the line extension. (Columbia RB pp. 5-6). Such subsidization by existing customers, who have already paid for the backbone plant, is contrary to cost causation principles. (RD at 54)

OCA also suggests changes to Columbia's economic model for Pilot Rider NAS, yet wholly fails to demonstrate any flaws in Columbia's economic model. (OCA Exceptions pp. 10-15). OCA proposes to exclude service lines, meters, and regulating equipment from the economic model, thereby shifting the cost recovery of those new facilities to existing customers. (OCA Exceptions p. 13). OCA's basis for this cost shifting is that such facilities are unrelated to extending mains. (OCA Exceptions p. 13). However, the goal of Pilot Rider NAS is to extend service, not just mains; a distinction which OCA continues to ignore. (RD at 50; Columbia RB p. 12). Service lines, meters, and regulating equipment are necessary costs incurred to extend and provide that service. (RD at 60). Therefore, the costs of service lines, meters, and regulating equipment are properly reflected in the economic model.

For these reasons and others explained in more detail in Columbia's Main and Reply Briefs, and summarized below, the Pennsylvania Public Utility Commission ("Commission") should deny the Exceptions of the Office of Consumer Advocate.

II. ARGUMENT

A. RESPONSE TO OCA EXCEPTION 1 – THE RECOMMENDED DECISION CORRECTLY REJECTED OCA'S PROPOSAL TO USE THE COST OF DEBT IN THE PILOT RIDER NAS ECONOMIC MODEL

OCA's first Exception challenges the ALJ's recommendation to reject OCA's proposal to replace the equity return in Columbia's economic model with the cost of debt for Pilot Rider NAS projects. (OCA Exceptions p. 10; RD at 59). OCA's Exception should be denied.

OCA concedes that using the cost of debt will reduce the amount new customers will have to pay for a line extension. (OCA Exceptions p. 10). Consequently, costs will

be shifted to existing customers, which is unreasonable. (Columbia RB p. 9). While Columbia strives for Pilot Rider NAS to be successful, transforming it into a program that forces existing customers to pay for new customers' line extensions is unfair and unacceptable. (Columbia MB p. 11). Thus, as explained previously, the effectiveness of the Pilot Rider NAS program should be tested without shifting costs.

OCA attempts to support its position by asserting that such cost shifting is not a subsidy. (OCA Exceptions p. 10). However, OCA's proposal falls squarely within the definition of "subsidy" provided by I&E – "[t]he dictionary defines subsidize as 'to help someone pay for the costs of something.'" (Columbia RB p. 5). OCA also tries to assert that no subsidy will exist because using the cost of debt accurately assesses the costs and benefits of main extensions. (OCA Exceptions pp. 10-11). This argument is contradicted by the testimony of OCA's own witness. OCA's witness admitted that the traditional economic model used by Columbia to determine customer contributions is "appropriate" and "an industry standard." (Columbia RB p. 9). OCA's witness also stated that "the Company's use of a DCF model 'generally provides a sound basis for evaluating feasibility of individual project.'" (OCA MB p. 10). This evidence, along with the absence of any evidence that Columbia's model fails to accurately determine the cost to extend service to new customers, conclusively supports the RD's rejection of OCA's proposal.

Additionally, OCA's Exceptions fail to address that Pilot Rider NAS line extensions are capital investments. (RD at 58-59). As the ALJ correctly found, "[t]o ensure that the Company obtains a proper return on its investment, the model should continue to use the cost of equity." (RD at 59). Columbia explained that it has a capital structure consisting of both debt and equity. (Columbia RB p. 11). Therefore, it would

be improper to assume that all of the Company's main extensions are financed with debt. (Columbia RB p. 11). If debt were the exclusive way of financing facility extensions, Columbia's capital structure would be outside the norm and result in ever increasing debt cost rates.

Finally, OCA asserts that the cost of debt should be used instead of the equity return because Pennsylvania water utilities use the cost of debt in their bona fide main extension rules. (OCA Exceptions p. 11). However, the OCA's continued reference to the bona fide main extension rules of Pennsylvania water utilities is without merit.

OCA points to 52 Pa. Code § 65.21, which requires water utilities to use their weighted long-term debt cost rate when evaluating whether a line extension for a bona fide service applicant is economic or not. (OCA Exceptions p. 11). OCA also notes that Chapter 65 was amended by the Commission in *Re Line Extensions*, Docket No. L-930089, 173 Pa. PUC 188, 1996 Pa. PUC LEXIS 162 (Order Entered Oct. 7, 1996). (OCA Exceptions p. 11). To support its position, OCA selects a portion of the Commission's order where the Commission "suggest[ed]" that the water regulations serve as guidance for other utilities' economic models and line extension policies. *Re Line Extensions*, 1996 Pa. PUC LEXIS at *11; (OCA Exceptions p. 12). However, in that order, the Commission was explicit that "the new proposal [was] limited to water utilities" and that it was "no longer proposing that the line extension regulation apply across the board" to the other Pennsylvania utilities. *Re Line Extensions*, 1996 Pa. PUC LEXIS at *10; (Columbia RB p. 10). OCA also fails to realize that in the order, the Commission stated that it would "not hesitate to institute a similar rulemaking in the future . . . if the kinds of problems . . . in the water industry begin to occur regularly in electric, telephone and gas line extension cases." *Id.* at *10-11; (Columbia RB p. 10). However, the

Commission's order was issued in 1996, and regulations for natural gas utilities have not changed to mandate the use of cost of debt instead of the equity return since that time. (Columbia RB p. 10). Moreover, OCA offered no evidence that any other utilities in Pennsylvania, other than water utilities, use the cost of debt instead of the weighted cost of capital.

Further, it is unfair to compare water service to natural gas service. (Columbia RB p. 11). First, water is a basic human need. (Columbia RB p. 11). The Commission removed the language, "safe, adequate and competitively priced alternative" from the water utility regulation because it was unnecessary. *Id.* at *17 n.5. No safe, adequate and competitively priced alternative exists for water. (Columbia RB p. 11). In contrast, people have alternatives to natural gas service, as recognized by the Commission in *Re Line Extensions* and by OCA's own witness. *Id.* at *9-10; (OCA Statement No. 1, pp. 7-9). Therefore, OCA's comparison of water service to natural gas service is improper.

For these reasons, the RD properly rejected OCA's proposal to utilize the cost of debt instead of the equity return in Columbia's economic model for Pilot Rider NAS projects. Thus, OCA Exception 1 should be denied.

B. RESPONSE TO OCA EXCEPTION 2 – THE RECOMMENDED DECISION CORRECTLY REJECTED OCA'S PROPOSAL TO REMOVE THE COSTS OF SERVICE LINES, METERS, AND REGULATING EQUIPMENT FROM THE PILOT RIDER NAS ECONOMIC MODEL

In the RD, the ALJ properly rejected OCA's proposal to remove the costs of service lines, meters, and regulating equipment from Columbia's economic model for Pilot Rider NAS projects. (RD at 59-60). OCA contends, in its Exceptions, that the costs of service lines, meters, and regulating equipment should be removed from the

economic model because these costs do “not promote the purpose of Rider NAS, which is to extend mains.” (OCA Exceptions p. 13). Such contention is without merit.

As discussed previously, the purpose of Pilot Rider NAS is to provide another option to pay the upfront cost to extend service. (RD at 50; Columbia RB p. 12). There is no logic behind including service lines, meters, and regulating equipment in the traditional upfront contribution, but then excluding those costs from Pilot Rider NAS because they are not “mains.” (Columbia RB p. 12).

Furthermore, OCA’s witness even admitted that meters and regulating equipment are necessary to extend and provide service to a new customer. (RD at 60). As the ALJ found, “[a]n accurate economic model for line extensions properly reflects all of the costs to extend and provide service to new customers.” (RD at 60). Since “[s]ervice lines, meters, and regulating equipment are necessary to extend and provide service to a new customer,” Columbia’s economic model for Pilot Rider NAS should continue to reflect those costs. (RD at 60).

In addition, the ALJ correctly found that removing these costs from the economic model shifts costs to existing customers. (RD at 60). As noted in the RD, “[t]he OCA’s proposal would shift, on a dollar for dollar basis, the cost of service lines, meter, and regulating equipment from Pilot Rider NAS applications to existing customers. Such proposed shift is without limitation of any degree.”¹ (RD at 60). Existing customers should not be required to bear the costs of these investments, which are incurred exclusively to extend service to new customers. (Columbia RB p. 12). Further, as

¹ As Columbia’s witness explained, OCA’s proposal could require existing customers to pay the cost of a 1,000-foot service line to serve a new customer. (Columbia MB p. 22).

explained previously, the effectiveness of the Pilot Rider NAS program should be tested without shifting these costs to existing customers.

OCA attempts to discount the cost shifting by stating that the amount shifted to existing customers is minor. (OCA Exceptions p. 15). However, the RD recognized that Pilot Rider NAS is a pilot program that can set a precedent for a future expansion of Pilot Rider NAS or similar programs adopted by other natural gas distribution companies (“NGDCs”). (RD at 55). For instance, commercial and industrial customers are not able to participate in Pilot Rider NAS. (Columbia MB p. 16). However, a future program could include such customers. (Columbia MB p. 16). Any future expansion of Pilot Rider NAS with potentially greater capital investments would further increase a subsidy. (Columbia MB p. 16). The potential for future expansion, and the resulting increase in subsidies, further confirms the importance of testing whether Pilot Rider NAS will expand service availability without subsidy by existing customers. Therefore, service lines, meters, and regulating equipment should continue to be reflected in Columbia’s economic model for Pilot Rider NAS.

The ALJ also correctly concluded that Columbia’s economic model comports with the Commission’s regulations. (RD at 60-62). OCA’s Exceptions maintain that the model does not comply with 52 Pa. Code § 59.17 and submit that the ALJ’s interpretation of the regulation is incorrect. (OCA Exceptions p. 14). 52 Pa. Code § 59.17(a) provides that, “Except as provided in § 59.31 . . . a public utility shall provide and install at its own expense and shall continue to own, maintain and operate equipment necessary for the regulation and measurement of gas furnished to its customers.” The ALJ found that Columbia’s inclusion of meters and regulating equipment in its economic model comports with Section 59.17(a). (RD at 61). The

intent of that regulation is to prevent customers from installing and owning meters, not to prohibit utilities from considering costs of meters and regulating equipment in their economic models. (RD at 61). Furthermore, removing the costs of service lines, meters, and regulating equipment from the economic model would cause the equation to become unbalanced, thereby forcing Columbia to engage in uneconomic expansions. (RD at 61-62). Lastly, “Columbia’s customer charge, which covers these costs, is sufficient on its own to justify a meter and average service line without a customer contribution.”² (RD at 62). Therefore, the Company’s economic model covers these costs without charging the customer. (RD at 62). Thus, Columbia’s economic model comports with the Commission’s regulations and should continue to reflect the costs of service lines, meters, and regulating equipment.

For these reasons, the RD properly rejected OCA’s proposal to remove the costs of service lines, meters, and regulating equipment from Columbia’s economic model for Pilot Rider NAS projects. As a result, OCA Exception 2 should be denied.

C. RESPONSE TO OCA EXCEPTION 3 – THE RECOMMENDED DECISION CORRECTLY REJECTED OCA’S PROPOSED 3% INTEREST RATE FOR CALCULATING THE PILOT RIDER NAS SURCHARGE

The RD rejected OCA’s proposed 3% interest rate used in calculating the Pilot Rider NAS surcharge. (RD at 54). OCA has excepted to this finding. (OCA Exceptions pp. 15-18). OCA’s Exception should be denied.

² For instance, the Company’s current customer charge is \$16.75 and produces an NPV over 40 years of \$2,018. (Columbia MB p. 24). In 2013, the average cost of a residential service line was \$1,689. (Columbia MB p. 24). Using OCA’s example that a residential meter and regulating equipment cost \$200, the total cost of an average residential service line, meter, and regulating equipment is \$1,889. (Columbia MB p. 24). As a result, the NPV over 40 years of the customer charge (\$2,018) exceeds the cost of the service line, meter, and regulating equipment (\$1,889). (Columbia MB p. 24). Therefore, the Company’s customer charge alone justifies the investment in the service line, meter, and regulating equipment. (Columbia MB p. 24). Thus, Columbia’s DCF model covers those costs without charging the customer and complies with 52 Pa. Code § 59.17(a). (Columbia MB p. 24).

Initially, it is important to understand the purpose of the interest rate charged during the term of the Pilot Rider NAS surcharge. Under Pilot Rider NAS, the uneconomic cost of an extension will be recovered over a term of 20 years. (Columbia MB p. 5). The uneconomic investment will be included in Columbia's rate base. (Columbia MB p. 7). The principal portion of the Pilot Rider NAS charge will be accounted for as a contribution in aid of construction as received, ultimately offsetting the uneconomic investment included in rate base. (Columbia MB p. 7). However, because the plant initially will be included in rate base, the capital cost (weighted cost of debt and equity) will be charged to existing customers. (Columbia MB p. 7). To offset this increased capital cost associated with the uneconomic investment, Columbia will charge an interest rate equal to its weighted cost of capital (currently about 7.91%) in calculating the Pilot Rider NAS charge. (Columbia MB pp. 7, 13). The interest recovery will be credited as revenues in base rate proceedings, thereby avoiding a subsidy of Pilot Rider NAS by existing customers. (Columbia MB p. 7).

OCA proposes that the interest rate should be reduced to 3% to make the Pilot Rider NAS program more attractive to potential applicants. (OCA Exceptions pp. 16-17). OCA contends that lowering the interest rate to 3% will not result in subsidization by existing customers. (OCA Exceptions p. 17).

However, as the ALJ recognized, Columbia set the interest rate used in the surcharge calculation at its weighted average cost of capital to sufficiently compensate existing customers for the carrying costs of the line extensions. (RD at 54). Lowering the interest rate to 3% will not sufficiently compensate existing customers. (RD at 54). Therefore, cost shifting will result, which is inequitable and contrary to cost causation principles. (RD at 54). Moreover, as discussed previously, Pilot Rider NAS is a pilot

program whose effectiveness should be tested without shifting costs to existing customers. It should also be noted that since the interest payments are credited to the cost of service for all of Columbia's customers, the Company does not stand to benefit from a higher interest rate used in calculating the Pilot Rider NAS surcharge. Columbia simply set the interest rate at its weighted average cost of capital to prevent shifting costs to existing customers, which OCA wants to undo. (RD at 54; OCA Exceptions pp. 15-18).

OCA asserts that its proposed 3% interest rate is more in line with home equity loan interest rates. (OCA Exceptions p. 16). However, the RD properly found that comparing a Pilot Rider NAS surcharge, which is unsecured, to a home equity loan is inappropriate. (RD at 55). OCA wants Pilot Rider NAS applicants to receive a home equity loan interest rate without having collateral, a credit check, or an appraisal, all of which a bank would perform before giving out a home equity loan. (RD at 55; Columbia RB p. 8). Moreover, Columbia is not a bank, and Pilot Rider NAS is not a loan. (RD at 55). Therefore, OCA's comparison of the interest rate used in the Pilot Rider NAS surcharge calculation to home equity loan interest rates is improper.

In actuality, the relevant criterion is not bank interest rates; it is the ratemaking return. (Columbia RB pp. 8-9). Pilot Rider NAS customers will pay the same return that they will pay in utility rates on utility investment. (Columbia RB p. 9). The interest is then provided as a credit in rate cases to compensate existing customers for the uneconomic share of the investment. (Columbia RB p. 9). Therefore, setting the interest rate at the weighted average cost of capital is appropriate and not excessive because it equals the return customers would have paid in rates for an economic plant investment. (Columbia RB p. 9).

Columbia emphasized that nothing in Pilot Rider NAS prevents applicants from using a home equity loan, or any other line of credit or source of funds, to pay for the upfront deposit. (Columbia RB p. 8). Columbia does not deny that some customers pay for uneconomic portions of line extensions with home equity loans, and future applicants may continue to do so. (RD at 55; Columbia RB p. 8). However, contrary to the assertions of OCA, Pilot Rider NAS is not focused just on applicants who cannot obtain a home equity loan to pay for the upfront deposit. (Columbia RB p. 8; OCA Exceptions p. 17).³ Rather, the purpose of the pilot is to provide another option to assist all potential applicants in expanding service to unserved and underserved areas of Columbia's service territory. (Columbia RB p. 8).

In a further effort to justify its proposal to shift recovery of uneconomic costs of extensions to existing customers, OCA asserts that applicants will be able to reflect no more than \$4,184 in capital investment through Pilot Rider NAS. (OCA Exceptions p. 16). However, this does not provide a full picture of the operations of Pilot Rider NAS. A customer with projected annual usage of 100 dekatherms ("Dth") would provide revenues to support approximately \$6,200 in an economic extension. (Columbia RB p. 4). Therefore, the combination of new customer revenues and Columbia's proposed Pilot Rider NAS could enable a \$10,400 extension. (Columbia RB p. 4).

In addition, OCA fails to recognize that its \$4,184 figure is limited to a single applicant paying the maximum \$35.00 monthly surcharge over a period of 20 years. (Columbia RB p. 4). If multiple applicants request to participate in the Pilot Rider NAS program to pay for the uneconomic portion of a line extension, the amount grows

³ Even if the focus of Pilot Rider NAS were on customers who do not have access to a home equity loan, this would not justify the use of an understated interest rate that would shift costs to existing customers.

linearly because the deposit amount is split among all of those applicants. (Columbia RB p. 4). For example, if five homeowners agree to use Pilot Rider NAS to pay for a line extension at the maximum \$35.00 monthly surcharge over 20 years, the maximum investment in the service extension, including the portion justified by new revenues, would increase by a factor of five, to potentially over \$50,000. (Columbia RB p. 4). Therefore, OCA's Exceptions grossly understate the amount of projects that will be able to participate in Pilot Rider NAS.

Finally, to support shifting costs to existing customers, OCA contends that the ALJ failed to recognize that some of Columbia's new customer projects produced a positive net present value ("NPV") over costs. (OCA Exceptions p. 17). However, the ALJ explicitly found that this argument had no merit. (RD at 56). First, "[n]o Pilot Rider NAS project will produce a positive NPV." (RD at 56). Moreover, there is no guarantee that future projects will produce a positive NPV. (RD at 56). Further, existing customers have paid for much of the existing backbone plant, and Pilot Rider NAS projects will not contribute toward that existing backbone plant. (RD at 56). Consequently, "any positive income effective from other main extension projects helps spread the cost of remaining recovery among a broader customer base." (RD at 56).

For these reasons, the RD correctly rejected OCA's proposed 3% interest rate to be used in the Pilot Rider NAS surcharge calculation. Thus, OCA Exception 3 should be denied.

D. RESPONSE TO OCA EXCEPTION 4 – THE RECOMMENDED DECISION CORRECTLY REJECTED OCA’S PROPOSAL TO PROHIBIT PILOT RIDER NAS IN AREAS ALREADY SERVED BY OTHER NGDCS

OCA’s final Exception to the RD objects to the rejection of OCA’s proposal to prohibit Pilot Rider NAS in areas already served by mains of other NGDCs. (OCA Exceptions p. 18; RD at 74). OCA’s Exception should be denied.

The crux of OCA’s position is that it opposes gas on gas competition and seeks to use this proceeding to decide the issue of duplicative facilities. (OCA Exceptions p. 18). However, the Commission already is considering the issue in the “Gas-on-Gas” competition case at Docket Nos. P-2011-2277868 and I-2012-2320323. (OCA Exceptions p. 18; Columbia MB p. 29; Columbia RB p. 17). That issue should not be prejudged in this case. (Columbia RB p. 17). Therefore, the RD correctly rejected OCA’s proposal and found that this proceeding is not the appropriate place to consider the issue of duplicative facilities.

There are additional reasons supporting the RD’s conclusion. OCA recommended that Pilot Rider NAS should not be allowed “in areas where mains of another natural gas company are already available for the applicants to take service.” (Columbia MB p. 29). In an attempt to clarify its proposal, OCA stated that “‘already available’ means that there is a main belonging to another NGDC in the ground which can be connected to the home being considered for Rider NAS.” (OCA MB p. 28). However, OCA has failed to define with enough specificity what is meant by “available.” (Columbia MB p. 29; Columbia RB p. 17). For instance, OCA’s restriction fails to provide how far off another NGDC’s distribution main the customer must reside to be ineligible for Pilot Rider NAS. (Columbia RB p. 17). Furthermore, if an applicant

requested a line extension from Columbia today, Columbia cannot reject the request based upon whether another gas utility's mains are in the area. (Columbia MB p. 29). Similarly, the availability of Pilot Rider NAS to be used in the event of such a request should not be limited.

For these reasons, the RD properly rejected OCA's proposal to prohibit Pilot Rider NAS in areas already served by other NGDCs. Thus, OCA Exception 4 should be denied.

III. CONCLUSION

For the foregoing reasons, the Pennsylvania Public Utility Commission should deny the Office of Consumer Advocate's Exceptions.

Respectfully submitted,



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