



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE
REFER TO OUR FILE

September 22, 2014

Via E-Filing

Secretary Rosemary Chiavetta
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

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 please find the Bureau of Investigation and Enforcement's (I&E)
Reply Exceptions in the above-captioned proceeding.

Copies are being served on all active parties of record. If you have any questions,
please contact me at (717) 783-7998.

Sincerely,

Allison C. Kaster
Prosecutor
Bureau of Investigation and Enforcement
PA Attorney I.D. No 93176

ACK/sea
Enclosures

cc: Certificate of Service
Hon. Mark A. Hoyer

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

Docket No. R-2014-2407345

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

Johnnie E. Simms
Chief Prosecutor
PA Attorney I.D. #33911

Richard A. Kanaskie
Deputy Chief Prosecutor
PA Attorney I.D. #80409

Allison C. Kaster
Prosecutor
PA Attorney ID #93176

Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

Dated: September 22, 2014

TABLE OF CONTENTS

| | | |
|------|---|----|
| I. | INTRODUCTION | 1 |
| II. | REPLY EXCEPTIONS..... | 1 |
| A. | Economic Model..... | 1 |
| 1. | <u>Reply to OCA Exception No. 1: The ALJ Properly Recommended That OCA’s Proposal to Use the Cost of Debt as a Surrogate for Return on Equity be Rejected</u> | 1 |
| 2. | <u>Reply to OCA Exception No. 2: The ALJ Properly Recommended that the Cost of Service Lines, Meters and Regulating Equipment be Included in the Rider NAS Economic Model</u> | 5 |
| B. | <u>Reply to OCA Exception No. 3: The ALJ Properly Rejected OCA’s Proposal to Reduce the Interest Rate to 3% and Correctly Recommended that the Interest Rate be Set at the Company’s Weighted Average Cost of Capital</u> | 7 |
| III. | CONCLUSION..... | 12 |

TABLE OF CITATIONS

Cases

1996 Water Line Extension Order, Re Line Extensions,
Docket No. L-930089, 1996 Pa. PUC Lexis 162
(Order entered October 7, 1996).....4

Regulations

52 Pa. Code §57.194
52 Pa. Code §59.176
52 Pa. Code §59.274
52 Pa. Code §65.214

I. INTRODUCTION

On August 22, 2014, Administrative Law Judge Mark A. Hoyer (ALJ) issued a Recommended Decision (R.D.) approving Columbia Gas of Pennsylvania, Inc.'s (Columbia or Company) proposed Pilot Rider New Area Service (Rider NAS), which is a four-year pilot program designed to provide an alternative to financing line extensions for customers located in unserved and underserved areas who may be unable to secure access to natural gas service due to the up-front customer deposit required to extend such service. The ALJ declined to adopt the Office of Consumer Advocate's (OCA) proposed modifications to the Rider NAS surcharge interest rate and Columbia's economic model. The OCA filed exceptions to the R.D. on September 11, 2014. The Bureau of Investigation and Enforcement (I&E) has presented the evidence and law in support of the ALJ's recommendation to reject OCA's proposed modifications to the Company's Rider NAS pilot program and respectfully requests that the Commission adopt the R.D. without modification.

II. REPLY EXCEPTIONS

A. Economic Model

Columbia's Rider NAS pilot program was not designed 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. Accordingly, the ALJ correctly rejected OCA's proposed modifications to the equity cost rate and removal of service lines, meters, and regulating equipment costs from

the economic evaluation as those modifications constitute wholesale changes to the Company's current economic model that would result in the Company having two different economic evaluations for Rider NAS and non-Rider NAS line extensions and would improperly shift costs from Rider NAS customers to existing customers. R.D. at 57-58.

1. Reply to OCA Exception No. 1: The ALJ Properly Recommended That OCA's Proposal to Use the Cost of Debt as a Surrogate for Return on Equity be Rejected.

Columbia uses a Discounted Cash Flow (DCF) model to evaluate the expected revenues and costs of line extension projects. If the full cost of the extension is not justified by the projected revenues, customers must pay for the uneconomic portion in the form of an up-front deposit. No party disputes that the DCF model is appropriate; however, OCA proposes to modify the DCF for Rider NAS projects by using the Company's cost of debt as a surrogate for the Commission's approved return on equity in the model. The driving force behind OCA's recommendation is to make the Rider NAS more attractive to potential new customers and ensure the success of the Rider NAS program. OCA Exceptions at 7. However, the ALJ correctly determined that it has not been established that creating a separate economic model for Rider NAS customers, especially one that inappropriately shifts costs, is necessary to achieve the goals of the Rider NAS pilot program. R.D. at 59.

OCA's proposal to reduce the return on equity utilized in the Company's economic analysis to the cost of debt will significantly change the outcome for the uneconomic and economic pieces of an extension and shifts some of the uneconomic

portion that the new Rider NAS customer is required to pay to the economic portion that is recovered in rate base from existing customers. OCA explains that substituting the cost of debt for the cost of equity would reduce the amount that Rider NAS customers would have to pay and recognizes that the portion not paid by Rider NAS customers would be recovered from Columbia's existing customers; however, OCA contends that this cost shifting is not a subsidy as it appropriately reflects the cost and benefits of main extensions. OCA Exceptions at 8-11. Columbia and I&E disagree because line extensions are capital investments, and the return on those investments should be reflected in the DCF by using the Company's weighted cost of capital. Not including the full cost of capital to serve a customer in the economic analysis will reduce or eliminate the recommended deposit for NAS customers and will unfairly shift those costs to existing customers. The ALJ properly determined that OCA's modifications to the DCF will understate the capital cost of main extension projects by replacing the cost of debt with the cost of equity and improperly shift those unrecovered capital costs from the new Rider NAS customer to existing customers. R.D. at 59.

Moreover, OCA's proposed modification to the economic evaluation only applies to Rider NAS customers; therefore, customers who chose to pay their deposit upfront will have the line extension evaluated on the Company's cost of capital but customers participating in the pilot Rider NAS will have the economic evaluation conducted with the cost of debt. OCA has failed to explain how it will be in the public interest to have two different economic evaluations for line extensions that could result in two very different deposit amounts based simply on the potential new customer's choice for

payment. In short, OCA has failed to demonstrate why Rider NAS projects should have an economic evaluation that is substantially more favorable than non-Rider NAS projects.

In support of its equity modification, OCA relies heavily on the Commission's regulation for water line extensions, which uses the cost of debt in economic models. OCA Exceptions at 11-12. These arguments have been fully addressed in I&E's reply brief. I&E Reply Brief at 7-10. However, it must be explained that OCA's reliance on the *1996 Water Line Extension Order, Re Line Extensions*, Docket No. L-930089, 1996 Pa. PUC Lexis 162 (Order entered October 7, 1996) (*1996 Water Line Extension Order*) is misplaced because it fails to acknowledge that the Commission considered – and rejected – applying this modification to other industries, including those utilities providing natural gas service. The OCA selectively highlights that the Commission initially considered the water regulations as providing guidance for line extensions in other utility industries, but fails to recognize that the Commission declined to apply those regulations industry wide. In the *1996 Water Line Extension Order*, the Commission expressly found that the proposed water line extension regulations were not necessary industry wide but instead would be limited to “target the real problem area,” namely the water industry. As such, line extensions regulations for the electric (52 Pa. Code §57.19), gas (52 Pa. Code §59.27), and water (52 Pa. Code §65.21) industries are different and have independent authority in the Commission's regulations.

OCA's discussion of line extensions in the water industry is simply not instructive or proper to apply to the gas industry. The Commission has already refused to impose the water line extension standards industry wide, and ALJ Hoyer correctly determined

that this Rider NAS proceeding “is not the appropriate forum for a major review of Commission policy on customer contributions.” R.D. at 58. Accordingly, the ALJ appropriately rejected OCA’s effort to amend Columbia’s line extension economic model.

2. Reply to OCA Exception No. 2: The ALJ Properly Recommended that the Cost of Service Lines, Meters and Regulating Equipment be Included in the Rider NAS Economic Model.

The ALJ appropriately rejected OCA’s recommendation to remove the cost of service lines, meters and regulating equipment from the economic model. Again, OCA’s proposal will require the Company to evaluate Rider NAS projects differently from all other extension projects and will shift costs from new Rider NAS customers to existing customers.

The ALJ found that an accurate economic model for line extensions must reflect all costs required to extend and provide service to new customers. R.D. at 60. Service lines, meters, and regulating equipment are part of the project costs to extend natural gas service and, as such, belong in the analysis to determine the economic and uneconomic share. Section 1501 of the Public Utility Code does not require utilities to extend service to all customers in their service territory, but only requires such extensions under reasonable conditions subject to the regulations and orders of the Commission. R.D. at 61. Commission regulations require gas utilities to include a rule in its tariff setting forth the conditions under which facilities will be extended and Columbia’s Tariff Rule 8 complies with this regulatory mandate and requires residential applicants to provide a cash deposit equal to difference between the minimum capital investment required to

serve the applicant and the amount of capital the Company can justify investing in the project. The economic analysis for Rider NAS projects will not be complete if the cost of service lines, meters, and regulator equipment are excluded from the evaluation and the OCA's recommendation will significantly understate the investment required from the Rider NAS customer.

OCA contends that these costs do not belong in the economic model as they do not promote the purpose of Rider NAS, which is to extend mains. OCA Exceptions at 13.

This position is too narrow. The purpose of the Rider NAS is to extend service to new customers, not simply extend mains. Columbia R.B. at 12. OCA witness Watkins

recognized that meter and regulating equipment are necessary to extend and provide service to a new customer. R.D. at 60. Accordingly, the ALJ correctly concluded that an

accurate economic model must reflect all costs required to extend and provide service to new customers, and determined that service lines, meters and regulating equipment are

necessary to achieve this goal. R.D. at 60.

To support its position that such facilities should not be included in the economic model, OCA relies upon 52 Pa. Code § 59.17, which states that regulation and

measurement equipment shall be installed at the Company's own expense. OCA Exceptions at 14-15. Although meter costs are the Company's responsibility, they are

still a cost component of line extension projects that should be considered in the economic evaluation. To do otherwise would severely understate the cost of the

extension. OCA's reliance on this regulation is misplaced as it is designed to prevent customers from installing and owning their own meters; however, it does not prohibit the

inclusion of these costs in the line extension economic analysis. R.D. at 61. How meters are accounted for in rate base is an accounting matter, but there is no doubt that they are costs the Company will incur to expand its infrastructure and should be properly included in the economic evaluation. Columbia illustrated this absurdity of OCA's recommendation to remove service lines, meters and regulating equipment by explaining that, under OCA's proposal, if a potential Rider NAS customer requires a 1,000 foot service line those costs would be excluded from the DCF model and would be shifted to existing customers. R.D. at 60. By doing so, the Rider NAS customer would receive a windfall because those costs would be entirely paid by existing customers. If these costs are not included in the economic model, they will be shifted entirely to existing customers. Accordingly, the ALJ appropriately found that the economic analysis for Rider NAS projects will not be complete if the cost of service lines, meters, and regulator equipment are excluded from the evaluation.

B. Reply to OCA Exception No. 3: The ALJ Properly Rejected OCA's Proposal to Reduce the Interest Rate to 3% and Correctly Recommended that the Interest Rate be Set at the Company's Weighted Average Cost of Capital.

The monthly Rider NAS surcharge is designed to recover the investment required for the Company to extend its facilities from Rider NAS customers. Both the Company and I&E believe it is appropriate to use Columbia's weighted average cost of capital in its most recent base rate proceeding to determine the Rider NAS surcharge. If no return on equity was specified in the most recent rate case, the Company proposes to use the Commission's published Distribution System Improvement Charge (DSIC) equity return for gas utilities as a proxy. Utilizing the weighted average cost of capital reflects the

actual cost of the funds utilized by the Company in making the line extensions; therefore, the ALJ correctly determined that the surcharge interest rate be set at the return customers would have paid in rates for an economic plant investment. R.D. at 57.

OCA maintains that an interest rate equal to the Commission authorized rate of return at approximately 8% is not competitive, and cites to home equity loans in the range of 3.5% to 4.5% to support its recommended Rider NAS interest rate of 3%. OCA Exceptions at 15. The reason for this recommendation is OCA's concern that the participation and success of the Rider NAS program will be limited given that most homeowners are savvy enough to recognize the high interest rate proposed by Columbia. OCA Exceptions at 15-16. While OCA recognizes that Columbia is not a financial institution, it nevertheless contends that its financing rate should be comparable to the rates offered by a financial institution in order to promote main extensions and the goals for the program. OCA Exceptions at 16.

The ALJ discussed the flaws in this argument. Namely, that it is inappropriate to compare Rider NAS to a secured bank loan because Columbia is not a bank and Rider NAS is not a loan. R.D. at 55. While OCA wants the Rider NAS interest rate to mimic a secured loan, OCA ignores the fact that Rider NAS will not have any of the traditional requirements of a home equity loan such as a credit check, collateral, or a home appraisal. Given that they are very different instruments, the ALJ correctly concluded that it is inappropriate to compare an unsecured Rider NAS surcharge to a home equity loan. R.D. at 55. OCA disagrees with the ALJ's recommendation and asserts that Columbia "should not be able to use an 8% interest rate simply because it is not a bank." OCA Exceptions

at 16. I&E disagrees and maintains that this is precisely why the Company should not be forced to lower its surcharge interest rate from the weighted cost of capital to an arbitrary 3%. Rider NAS is an unsecured offering from a utility charged with providing utility service, not lending service, and should not be required to match home equity interest rates.

OCA's concerns about the interest rate are focused on the fact that the Rider NAS program will not be attractive to applicants. However, it must be remembered that Rider NAS is not intended to replace other commercial lending opportunities and should not be evaluated on the basis of that comparison. In short, Rider NAS simply provides another option and is not offered to compete with or replace the use of a home equity loan or any other financing tool available to the customer. For customers with little or no home equity or 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 may present an attractive option. Additionally, OCA's position ignores the fact that financing a gas line extension with a home equity loan may not necessarily reflect the best approach for all customers. The Rider NAS surcharge is paid by the person taking service from that meter; therefore, customers will not be responsible for the principal balance if they do not stay in the home for the twenty-year financing period. Unlike a home equity or personal loan, the flexibility to walk away from the extension balance under Rider NAS if the home is sold may be an attractive feature given the mobile nature of society today. Therefore, OCA's narrow focus on the interest rate fails to fully recognize the benefit of Rider NAS, which is that it provides an option to

pay the up-front deposit for those customers who may not have another option or who, for whatever reason, may not like the options available to them.

Reducing the interest rate to OCA's recommended 3% is especially troublesome because it will cause Columbia's existing customers to subsidize the new Rider NAS customers by requiring them to provide significantly more funding of the revenue requirement for the rate-based uneconomic portion of Rider NAS projects. Columbia included the interest portion of the NAS payment to reimburse existing customers for the carrying costs of NAS investments costs that are included in rate base. Reducing the interest percentage as OCA recommends requires existing customers to provide significantly more funding of the revenue requirement for the rate-based uneconomic portion of NAS projects. As such, the ALJ appropriately found that "[i]t would be unreasonable, contrary to cost-causation principles, and unnecessarily burdensome to make existing customers subsidize line extensions to new customers." R.D. at 54.

OCA disagrees with the ALJ's finding that reducing the surcharge interest rate would result in existing ratepayers subsidizing Rider NAS main extension projects. OCA

Exceptions at 17. OCA contends:

The ALJ failed to recognized that some of Columbia's new customer projects result in an economic model analysis that produces a positive present value of revenues over costs—in other words, from a mathematical standpoint, half of the new main extension projects that go forward result in a negative CIAC requirement, but since there are no CIAC credits or refunds, these benefits reduce existing ratepayer rates."

OCA Exceptions at 17.

Moreover, OCA disputes the fact that a subsidy will exist because there will be less than a \$0.38 per year difference for existing customers between the Company and OCA's proposals, which does not account for the fact that approximately half of the main extension projects have a positive net present value. OCA Exceptions at 9. Therefore, while OCA recognizes that some minimal cost shifting may occur, it continues to maintain that this does not create a subsidy for new NAS customers.

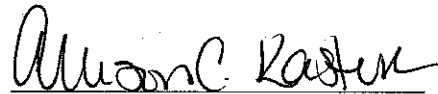
The ALJ rejected these arguments. The ALJ correctly concluded that there are no assurances that future main extension projects will have a positive net present value. Moreover, the ALJ was unpersuaded by the fact that main extensions *occasionally* produce a positive net present value and determined that this was not a basis to intentionally establish main extension rules that shift costs to existing customers. R.D. at 56. The ALJ was similarly unpersuaded by OCA's representation of a small increase to existing customer rates. While new costs to existing customers may be low under this pilot program, the cumulative effects of Rider NAS, should it be continued beyond the initial four-year term or increase in value, could become a substantial burden to existing customers. The ALJ was concerned that "using an insufficiently compensatory interest rate is used to justify an expanded program in the future, the magnitude of the subsidy per existing customer could grow exponentially" and was also concerned that such a program could be used as precedent for other NGDCs that might adopt a similar line extension program. R.D. at 55.

For these reasons, the ALJ appropriately rejected OCA's proposed 3% surcharge interest rate and recommended that the interest rate be set at the Company's weighted average cost of capital.

III. CONCLUSION

For the reasons stated herein, the Bureau of Investigation & Enforcement respectfully requests that the Commission deny the OCA exceptions to the Recommended Decision.

Respectfully submitted,



Allison C. Kaster

Prosecutor

PA Attorney I.D. No. 93176

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. :

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Reply Exceptions** dated
September 22, 2014, in the manner and upon the persons listed below, in accordance with
the requirements of 52 Pa. Code § 1.54 (relating to service by a party):

Via Electronic and First Class Mail

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

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

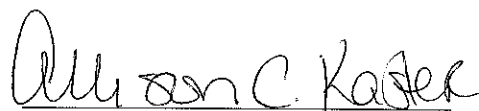
Candis A. Tunilo, Esquire
Amy E. Hirakis, Esquire
Office of Consumer Advocate
555 Walnut Street
5th Floor Forum Place
Harrisburg, PA 17101-1923

Michael W. Hassell, Esquire
Devin T. Ryan, Esquire
Post & Schell, PC
17 North Second Street – 12th Floor
Harrisburg, PA 17101

Via Electronic Mail

Nancy Krajovic
nkrajovic@nisource.com

Andrew S. Tubbs, Esquire
astubbs@nisource.com



Allison C. Kaster
Prosecutor
Bureau of Investigation and Enforcement
PA Attorney I.D. No. 93176