

**IN THE SUPREME COURT OF OHIO**  
**On Appeal from the Public Utilities Commission of Ohio**

Ohio Partners for Affordable Energy,	)	Case No. 08-1837
	)	
Appellant,	)	
	)	Appeal from the Public
	)	Utilities Commission of Ohio
v.	)	
	)	
The Public Utilities Commission of Ohio,	)	Public Utilities
	)	Commission of Ohio
Appellee.	)	Case Nos. 07-589-GA-AIR,
	)	07-590-GA-ALT,
	)	07-591-GA-AAM

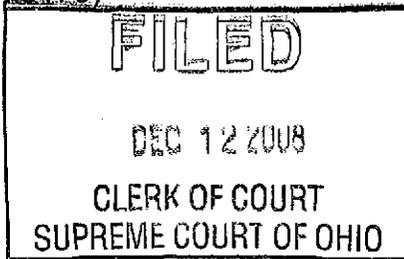
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**MERIT BRIEF OF APPELLANT,  
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## I. INTRODUCTION

Ohio Partners for Affordable Energy ("OPAE") is a non-profit Ohio corporation with the stated purpose of advocating for affordable energy policies for low- and moderate-income Ohioans. OPAE includes as members non-profit organizations located in the areas served by Duke Energy Ohio, Inc. ("Duke"), a public utility engaged in the distribution and sale of natural gas to approximately 424,000 customers in Adams, Brown, Butler, Clermont, Clinton, Hamilton, Highland, Montgomery, and Warren counties, Ohio. OPAE members advocate on behalf of Duke's low- and moderate-income customers and manage bill payment assistance programs to ensure customer access to natural gas distribution and gas service from Duke. OPAE members also provide weatherization and energy efficiency services to those same customers. Finally, OPAE's nonprofit members are also ratepayers of Duke.

On behalf of low- and moderate-income customers and the nonprofit agencies that provide these customers with bill payment assistance and energy efficiency services, OPAE was an intervener at the Public Utilities Commission of Ohio ("PUCO") in these cases, which concern applications made by Duke to increase the rates charged for its natural gas distribution service. The PUCO approved a stipulation and recommendation that resolved all the issues in these cases, except for one, the residential rate design, which is the issue that OPAE has appealed to the Court in this case. The PUCO-approved residential rate design is unlawful and unreasonable; therefore, the Court should reverse the PUCO's orders and remand this case to the PUCO for correction of errors as discussed herein.

## II. STATEMENT OF FACTS

On July 18, 2007, Duke Energy Ohio, Inc. ("Duke") filed applications at the Public Utilities Commission of Ohio ("PUCO") to increase its rates for natural gas distribution service and to institute an alternative rate plan. On February 26, 2008, the parties to these cases filed a joint stipulation and recommendation resolving all issues in the cases except for the residential rate design. OPAE Supplement to Merit Brief ("Supp.") 010. With respect to the unresolved issue of the residential rate design, Duke, the Office of the Ohio Consumers' Counsel ("OCC"), and the Staff of the PUCO ("Staff") presented witnesses at an evidentiary hearing convened on March 5 and 6, 2008.

When an application to increase rates is filed, the PUCO determines the revenue requirement for a utility. In addition to the revenue requirement, the responsibility of each customer class to contribute to the revenue requirement is also determined. Upon determination of the revenues that each customer class will contribute to the revenue requirement, the rates for each customer class are designed. The rate design is the method by which the utility's required revenue from each customer class is collected.

At the time Duke's application was filed, Duke's residential customer charge was \$6 per month and its residential usage (or volumetric) charges were \$.18591 per ccf. The combination of these two charges is designed to allow the utility to collect its PUCO-approved revenue requirement. In its application, Duke had proposed to recover its revenue requirement from the residential class through a \$15 customer charge in addition to volumetric charges. Duke also proposed a sales

decoupling rider to address an alleged problem of revenue erosion caused by declining average sales per customer. OPAE Appendix to Merit Brief ("App.") 015, 026. The PUCO's Staff rejected the sales decoupling rider but chose to address Duke's concerns about declining sales per customer and revenue erosion by proposing a radical new residential rate design, which is called the Straight Fixed Variable ("SFV") rate design.

Under the SFV residential rate design, Duke's previous \$6 per month residential customer charge would be increased to \$20.25 in the first year and \$25.33 thereafter, while volumetric charges based on customer usage were correspondingly reduced. *Id.* Duke accepted the Staff's recommendation for the SFV rate design. In the stipulation and recommendation, OPAE and OCC opposed the SFV rate design and reserved the issue for litigation. *Supp.* 010.

The PUCO issued its Opinion and Order on May 28, 2008. In its Opinion and Order, the PUCO acknowledged that the residential rate design recommendation made by Duke and the Staff marked a "sea change." *App.* 015, 026. The PUCO acknowledged that "traditionally" natural gas distribution rates in Ohio have been set to collect a relatively small proportion of the revenue requirement from the fixed customer charge with the bulk of the revenue requirement collected through charges based on customer usage. *Id.* The PUCO found, however, that sustained price increases had caused customers to increase their efforts to conserve gas and that sales per customer were declining. *Id.*

The PUCO also found that the ability of a utility to recover its revenue requirement depends on sales so that a negative trend in sales may have a

corresponding negative effect on the utility's ongoing financial stability and (ironically) its incentive to encourage energy efficiency and conservation. App. 015, 031. In order to remedy the perceived problem that customers were using less gas in order to pay less, the PUCO determined that customers would pay more to use less gas. The PUCO acknowledged that the SFV rate design would impact low-usage customers more than other customers. App. 015, 032.

A dissenting opinion offered by Commissioner Paul A. Centolella suggested a more gradual transition to a SFV rate design to minimize near-term bill increases for low-use customers and to recognize the investments that many of these consumers have made to reduce their gas usage. Commissioner Centolella's dissent points out that a more gradual approach would also avoid the appearance that the PUCO is rewarding high-use by lowering the gas bills of high-use customers and penalizing low use by raising the gas bills of low-use customers. App. 015. It is not just a perception that the rate design lowers the gas bills of high-use customers and produces a corresponding increase in the bills of low-use customers; it is a fact.

OPAE filed an application for rehearing on June 27, 2008 from the PUCO's Opinion and Order. App. 60. OPAE alleged first that the radical SFV residential rate design violates long-standing, important regulatory principles and PUCO precedent. Given that the SFV residential rate design ignores regulatory principles and precedents, it also fails to produce just and reasonable rates in violation of Ohio law set forth at R.C. §§4905.22 and 4909.18. App. 049, 054.

Second, the SFV residential rate design discounts the value of and discourages customer conservation efforts. Under the SFV rate design, customers

who conserve pay more regardless of their conservation efforts, while customers with excessive usage pay less. The payback period for energy efficiency investments also increases. Therefore, the SFV rate design violates the policy of the state of Ohio to encourage conservation. The policy of the state is set forth in Ohio law at R.C. §4929.02(A)(4). App. 058.

Third, the adoption of the SFV rate design is not supported by the evidence of record. The evidence did not demonstrate that natural gas sales to residential customers were consistently declining. Thus, the SFV rate design addresses an alleged problem whose very existence is not supported by the evidentiary record. Moreover, the evidence did not demonstrate that the SFV rate design would alleviate any of the concerns the PUCO expressed in adopting it. Therefore, in adopting the SFV rate design, the PUCO violated R.C. §4903.09, which requires the PUCO to make specific findings of fact and written opinions that are supported by record evidence. App. 048. The record did not justify adoption of a radical residential rate design.

The PUCO issued its Entry on Rehearing on July 23, 2008. App. 008. In the Entry on Rehearing, OP&E's Application for Rehearing was denied with respect to all issues raised in this appeal. Thus, OP&E timely filed this appeal with the Court on September 19, 2008. App. 001.

The PUCO's May 28, 2008 Opinion and Order and July 23, 2008 Entry on Rehearing are unlawful and unreasonable, and the PUCO erred as a matter of law. The PUCO's adoption of the radical SFV residential rate design violates regulatory principles and PUCO precedent and therefore Ohio statutory requirements for the

establishment of just and reasonable utility rates (R.C. §§4905.22 and 4909.18).

App. 049, 054. The SVF rate design also violates the statutory requirement for the

promotion of energy efficiency and conservation (R.C. §4929.02). App. 058. The

PUCO's adoption of the SFV rate design also violates the statutory requirement that

the PUCO orders be based on record evidence (R.C. §4903.09). App. 048.

The SFV rate design should not be approved. The Court should remand this case to the PUCO with instructions that require the PUCO to adopt a residential rate design based on regulatory principles, PUCO precedent, Ohio statutes, and the evidence of record.

### III. ARGUMENT

Proposition of Law No. 1:

The Public Utilities Commission of Ohio acts unreasonably and unlawfully when it authorizes a radical residential rate design that violates regulatory principles and PUCO precedent and does not produce just and reasonable rates as required by Ohio law set forth at R.C. §§4905.22 and 4909.18.

R.C. §§4905.22 and 4909.18 require that utility rates established by the PUCO be just and reasonable. App. 049, 054. Just and reasonable utility rates are set according to long-standing regulatory principles that govern public utility ratemaking. The PUCO has, prior to the order issued in this case, followed traditional regulatory principles in designing rates and setting the level of the customer charge.

Among those regulatory principles is gradualism (or stability) in rate design. While revenue stability from year to year for the utility is a regulatory principle of rate design, stability of the rates themselves, with a minimum of unexpected changes seriously adverse to existing customers, is also a principle. Bonbright, James C., *Principles of Public Utilities Rates*, App. 088, 095. Gradualism requires that abrupt changes in rate design be avoided in order that one group of customers does not bear the burden of radical changes to its responsibility to provide for the utility's revenue requirement. Abrupt changes to the amount of the fixed customer charge, which customers pay regardless of usage, are inconsistent with the regulatory principle of gradualism.

The PUCO itself had always adhered to the regulatory principle of gradualism when designing residential rates and setting the residential customer charge. With regard to residential rate design and the customer charge, the PUCO has made the following observation:

We believe that it is appropriate in this case to keep the customer charge at its current level in order to minimize rate shock that would otherwise be experienced by residential customers. Our decision is consistent with past cases where we have identified the principles of gradualism and rate continuity as important factors to be considered in setting rates.

*In the Matter of the Application of The Cincinnati Gas & Electric Company for an Increase in Its Rates for Gas Service, Case No. 95-656-GA-AIR, Opinion and Order (December 12, 1996). App. 078, 080.* In the instant case, however, the PUCO maximizes rate shock to low- and average-use customers by issuing orders entirely inconsistent with past cases where the principles of gradualism and rate continuity were important factors in setting rates.

In prior PUCO cases, following the relevant precedent and regulatory principles, customer charges have been set relatively low, usually in the \$5 to \$6 range, and volumetric charges have been set correspondingly high. OCC Ex. 17; Supp. 042. In fact, a traditional rate design, following regulatory principles and precedent, would seek the lowest possible customer charge and correspondingly high volumetric charges. In addition, when designing new rates, increases in the customer charge have been modest – in the \$1 to \$2 range at most. OCC Ex. 18 at WG-2; Supp. 062.

Clearly, the residential customer charge increase in this case is far beyond what the PUCO has previously sanctioned. The SFV rate design approved by the PUCO produces a 320% increase in the customer charge from the current \$6 to \$25.33. Such a huge increase clearly does not satisfy the regulatory principle of gradualism, which, even the PUCO acknowledges, has been the regulatory principle governing rate design for at least thirty years.

When Duke filed this rate increase application, the residential rate design was a fixed customer charge of \$6.00 per month and \$0.18591 per ccf for all ccf used. Given average annual usage of 800 ccf, the average customer would have paid \$72 in customer charges (\$6 times 12) and \$149 in volumetric charges (.18591 times 800) for a total of about \$220 annually. The new residential rates adopted in this case, as of June 2009, are a fixed customer charge per residential customer of \$25.33 and \$0.040828 per ccf for the first 400 ccf. The average customer using 800 ccf annually would pay \$304 in customer charges annually (\$25.33 times 12) and \$32.66 in volumetric charges for the year for a total of \$336.66. Given that the increase in the revenue requirement from the residential class resulting from this case is only about 26%, the increase from \$220 to \$336.66 is extreme. The 54% increase for the average-use customer more than doubles the increase in the revenue requirement responsibility of the residential class.

The PUCO may claim that it mitigated the massive increase in the customer charge with a stepping stone approach. The SFV rate approved by the PUCO started at \$15 per month for the short period of June through September, 2008, then increased to \$20.25 through the following June 2009, after which it rises to \$25.33.

The three steps to the \$25.33 customer charge do not mitigate the problem. In reality, the three step increases violate the principle of gradualism at each step. The increase from the current \$6 to \$15 is a 150% increase. The subsequent increase to \$20.25 is roughly a 233% increase. The final step to \$25.33 is approximately a 320% increase when compared to the \$6 current service charge. The huge impact of this radical rate design on low- and average-use customers is not mitigated by the three-step phase-in approved by the PUCO.

Another important regulatory principle in ratemaking is fairness of the specific rates in the apportionment of total cost of service among different consumers. Bonbright, App. 088, 095. The SFV rate design is inconsistent with the cost-of-service study accepted by the PUCO, which underlies the rates established in this case. The cost-of-service study is the method by which costs are allocated among the customer classes in order to determine each class's responsibility for the utility's revenue requirement. The PUCO-approved cost-of-service study is based on peak and average usage. If costs to serve residential customers were fixed, then peak usage would not even be considered in a cost-of-service study. The cost-of-service study, however, does not disregard peak usage because, clearly, customers using more than the system average are contributing excessively to peak usage.

Through the cost-of-service study accepted by the PUCO in this case, these large users in the residential class are causing the allocation of additional costs to the entire residential class. The SFV rate design insulates these large-use residential customers from responsibility for their excessive use. Under the SFV rate design, small users subsidize large users, who are the very customers responsible

for higher cost allocations to the residential class in the cost-of-service study. Thus, the SFV rate design violates the fundamental regulatory principles of fairness and cost causation. *Id.*

Moreover, low-use customers will bear a disproportionate increase in their bills even if they maintain their current usage. A customer using less than the average usage annually, say 600 ccf, would have paid \$72 in fixed customer charges plus \$112 in volumetric charges for a total \$184 under the prior rate design. The same low-use customer using 600 ccf for the year that the new rate design is in effect would pay \$304 in customer charges (\$25.33 times 12) and \$24.50 in volumetric charges for a total of \$328.50 for the year, a 78.5% increase.

On the other hand, a person using much more than the average, say 2,500 ccf annually, would have paid \$72 for the fixed customer charges annually plus \$465 in volumetric charges for a total \$537 annually under the prior rates. This high-use customer under the new rate design, however, pays \$304 in customer charges annually but only \$102.07 in volumetric charges for a total \$406.07, or a reduction of 24%. The high-use customer pays much less under the new rate design (even given the 26% increase in the residential revenue requirement approved in this rate increase application) while the low-use and average customer pay a great deal more.

Thus, the SFV shifts costs from high-usage, high-income customers to low-usage, low-income customers. This is unfair because those who make greater use of the distribution system should bear a greater share of its costs. An estimated 65% of Duke's customers will have higher bills and be worse off under the SFV rate

design than if the customer charge had remained at \$6 and the volumetric charges were increased to accommodate the revenue increase authorized in this case.

OCC Ex. 5, Direct Testimony of Wilson Gonzalez at 17; Supp. 01.

An additional regulatory principle in ratemaking is to discourage wasteful use of service. Bonbright, App. 088, 095. This principle is increasingly important given the recent price increases for natural gas and the future decline of recoverable reserves. The SFV rate design, as noted above, subsidizes large users by rewarding them for excessive usage. Rather than encouraging those with big, inefficient homes to make the necessary investments to reduce the use of natural gas, the SFV sends customers the price signal to use more. Encouraging wasteful use is a violation of regulatory principles and Ohio law. R.C. §4929.02(A)(4). App. 058. Meanwhile for those who control their usage, live in a small residence, and invest in energy efficiency and conservation, the SFV means that the bill increases are highest.

Another regulatory principle is acceptability of the rate design to the public. Bonbright, App. 088, 095. The PUCO's Staff acknowledged that it failed to investigate customer views on the SFV versus traditional rate design. Tr. I at 210, 244 (Cross Examination of Staff Witness Puican), Supp. 035. The Staff also acknowledged that it had not reviewed the impact of the SFV rate design in any of the other three states that have adopted it. *Id.*

In spite of the Staff's failure to investigate the public's ability to accept the radical new rate design, the evidence of record demonstrates that the new rate design is clearly not acceptable to the public. Attendees at the public hearings

based their comments on the notice approved by the PUCO and published by Duke. The notice referred only to an increase in the customer charge from \$6 to \$15, not the \$25.33 ultimately approved. Nonetheless, the comments of customers were universally opposed to the 150% increase in the customer charge from \$6 to \$15. Had customers been noticed of the higher 320% increase to \$25.33 approved by the PUCO, the opposition of low- and moderate use customers, who, based on relevant data, have low and moderate incomes and depend on natural gas to heat their homes, would certainly have been even greater. This SFV rate design is unacceptable to residential customers.

Another important regulatory principle in ratemaking is a balancing of interests between utilities and their customers. *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L. Ed. 333 (1944). Under the regulatory compact, the utility is responsible for making the required investments necessary to provide essential utility service to customers. In return, customers are required to compensate the utility, through rates, for the cost of providing utility service. State public utilities commissions regulate the utilities to achieve the provision of adequate service at reasonable prices. As a part of this responsibility, state regulators oversee the design of rates, which collect the revenues to pay the approved expenditures. R.C. §4909.15. App. 050. The rates and the rate design provide the utility with an adequate opportunity to earn the authorized revenue requirement, balanced with the need of customers for rates that are just and reasonable.

Under the SFV rate design, Duke is guaranteed a far larger share of the revenue requirement than a utility traditionally receives. The guaranteed recovery from such a large fixed charge per residential customer regardless of customer usage is unprecedented in PUCO ratemaking and violates the regulatory principle requiring a balancing of interests between the utility and customers. There is no balance between the utility and customers when the utility is virtually guaranteed recovery of nearly its entire revenue requirement while customers are subject to huge fixed charges regardless of their usage and far in excess of any prior customer charges approved by the PUCO.

The PUCO failed to follow established regulatory principles, its own precedent, and ultimately Ohio law. The SFV rate design does not represent a gradual change in the residential rate structure; thus, the established regulatory principle of gradualism has been violated by the adoption of the SFV rate design. Other regulatory principles violated by the adoption of the SFV rate design are the principles of cost causation, the discouragement of wasteful use of service, the acceptability of the rate design to the public, and the balancing of interests between the utility and its customers.

The PUCO's failure to adhere to these important regulatory principles violates PUCO precedent. The Court has ruled that the PUCO should respect its own precedents. It is essential that the PUCO respect its previous decisions and not depart from them without a clear need. In *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* (1975), 42 Ohio St.2d 403, 431, this Court stated:

Although the Commission should be willing to change its position when the need therefore is clear and it is shown that prior decisions are in error, it should also respect its own precedents in its decisions to assure the predictability which is essential in all areas of the law, including administrative law.

*Consumers' Counsel v. Pub. Util. Comm.* (1984) 10 Ohio St.3d 49.

The PUCO made no statement that its precedents favoring gradualism and the other regulatory principles were in error. In allowing the violation of the regulatory principles discussed above, the PUCO showed no respect for its own precedent and did nothing to assure the predictability that is essential in all areas of law, including administrative law. The PUCO may argue that simply because something has been done the same way for thirty years is not a valid reason to shy away from change. The response is that the regulatory principles cited above deserve the strong support they have received in numerous cases over the past thirty years. The PUCO should not violate important regulatory principles and precedent with such radical changes to rate design in the absence of strong legal, policy and evidentiary support. No such support for the SVF rate design exists.

Thus, the SFV rate design also does not comport with Ohio law. The SFV rate design does not result in just and reasonable rates, violating Ohio law at R.C. §§4905.22 and 4909.18. App. 049, 054. The PUCO derives its authority to design distribution rates from R.C. §4909.18 and §4909.19. App. 054, 056. The PUCO is a creature of statute and lacks authority to deviate from the statutory requirements related to ratemaking. *Canton Storage and Transfer Co. v. Pub. Util. Comm.* (1995), 72 Ohio St.3d 1. The PUCO is not free to ignore the statutory requirements that rates be just and reasonable. The Court should

reverse the PUCO's orders unlawfully ignoring the statutory requirements for just and reasonable rates.

Proposition of Law No. 2:

The Public Utilities Commission Ohio acts unreasonably and unlawfully when it violates the policy of the State of Ohio set forth at R.C. §4929.02 by approving a residential rate design that discounts the value of and creates a disincentive for customer conservation efforts.

The PUCO's Opinion and Order and Entry on Rehearing unreasonably and unlawfully approve a residential rate design that discounts the value of and creates a disincentive for customer conservation efforts. The policy of the State of Ohio set forth at R.C. §4929.02 recognizes the need to control demand for increasingly scarce natural resources such as natural gas. R.C. §4929.02(A)(4) declares that it is the policy of the State of Ohio to "[e]ncourage innovation and market access for cost-effective supply- and demand-side natural gas services and goods." App. 058. The PUCO is required to follow this state policy. R.C. §4929.02(B) states, "The public utilities commission **shall** follow the policy specified in this section...." [emphasis added]. *Id.*

The SFV rate design approved by the PUCO violates the policy of the State of Ohio. The SFV fails to encourage demand-side natural gas services in several ways. First, under traditional rate design using a low fixed customer charge and relatively high volumetric charges, the more natural gas a customer uses, the more he or she pays. This is the traditional price signal, which encourages conservation and energy efficiency in compliance with the policy of the State of Ohio. The SFV

high fixed customer charge eliminates the price signal sent to customers as usage increases. Under the SFV rate design, the customer actually pays more the less gas she uses.

The SVF rate design's extreme disincentive to conservation is apparent. As discussed above, a customer using less than the average usage annually, say 600 ccf, would have paid \$72 in customer charges (\$6 times 12) plus \$112 in volumetric charges for a total \$184 under the prior rate design. That same customer with the same usage will pay \$304 in customer charges (\$25.33 times 12) and \$24.50 in volumetric charges for a total of \$328.50 for the year under the SFV. The average usage customer using 800 ccf in one year goes from \$220 under the prior rate design to \$336.66 under the SVF rate design. The payback from an energy-efficiency investment is reduced by a minimum of \$232 per year because the customer cannot reduce the fixed charge.

On the other hand, a person using much more than the average, say 2,500 ccf annually, would have paid \$72 for the monthly service charge of \$6 plus \$465 in volumetric charges for a total \$537 annually under the prior rates. This high-use customer under the SFV rate design, however, pays \$304 in customer charges and only \$102.07 in volumetric charges for a total \$406.07 under the SFV. The high-use customer pays much less under the SFV rate design (even given the 26% increase in the residential revenue requirement approved in this rate increase) while the low-use and average-use customer pay a great deal more.

Thus, for Duke's larger-use customers, there will be a significant decrease overall because of the decreased volumetric charges. This certainly is not sending

a price signal to the high-use customer to conserve. Likewise, for the small-use customer, a greatly increased customer charge and reduced usage charges will not be sending a price signal to conserve either. OCC Ex. 17 at 19 (Rebuttal Testimony of OCC Witness Yankel), Supp. 042.

The SVF sends the wrong price signal to all residential customers and reduces the incentive to use natural gas more efficiently. Consumers should be rewarded with lower bills when their consumption decreases, and penalized with higher bills when consumption increases. The SFV rate design does the opposite. Clearly the PUCO has unlawfully disregarded the state policy to encourage conservation. R.C. §4929.02; App. 058.

Customers who work hard to conserve either by closing off parts of their home, choosing to live in a small home or apartment, or investing in energy efficiency are penalized by the SFV rate design, with the smallest users harmed the most. Every reduction in consumption increases the customer charge on a per ccf basis. The more one saves, the higher the cost per ccf. When a customer makes efforts to address her demand for natural gas, the SFV rate design frustrates those efforts and actually forces the customer to pay more for less gas used. At the same time, customers who use more, pay less. The SFV rate design not only fails to promote conservation, it actually discourages conservation.

The SFV rate design also discounts the value of energy efficiency investments. Investments in comprehensive energy improvements will certainly suffer as a result of the SVF rate design. This is because each ccf saved from energy efficiency investments is worth less under the SVF rate design. OCC Ex. 17.

Supp. 042. Obviously, if less of the bill is dependent on usage, the value of the energy efficiency investment will be decreased.

The SFV rate design also extends the payback period for energy efficiency investments. Cost effectiveness for energy efficiency investments is generally determined over the life of the efficiency measure, which is assumed to be twenty years for an energy-efficient furnace and insulation. Financing requires payback over the life of the measure, or twenty years. If the higher customer charge extends the payback period to over twenty years, the investment cannot be financed under current standards that require a twenty-year payback period. If a customer relies on an audit to determine what investments are cost effective, the savings from the investment will be reduced because the high fixed customer charge discounts the value of the investments. This means that fewer investments in energy efficiency will be made because the payback period is too long.

Weatherization programs such as the Home Weatherization Assistance Program ("HWAP") implemented by the Ohio Department of Development have resulted in energy savings in the Duke service territory. OCC Exhibit 18 (Rebuttal Testimony of Wilson Gonzalez), Supp. 047, 054. HWAP works to reduce the energy usage of low-income households relative to the average Duke customer. HWAP participants reduced their gas consumption on average 25% from their pre-weatherization consumption. OCC Ex. 16; Supp. 019. The value of those savings would be reduced under the SVF rate design, where the usage sensitive part of the bill is less than under a traditional rate design.

In short, the high fixed customer charge is precisely the opposite rate design to encourage investments in demand-side and energy efficiency goods and services as required by Ohio law. R.C. §4929.02(A)(4). Thus, the SFV rate design should be rejected as contrary to state policy because it discourages innovation and market access for demand-side natural gas services. R.C. §4929.02(A)(4). App. 058.

The PUCO is a creature of statute and lacks authority to deviate from the statutory requirements of R.C. §4929.02. *Canton Storage and Transfer Co. v. Pub. Util. Comm.* (1995), 72 Ohio St.3d 1. The PUCO is not free to ignore the statutory requirement that encourages demand-side natural gas initiatives. The Court should reverse the PUCO's orders unlawfully ignoring the statutory requirement set forth in the policy of the state of Ohio at R.C. §4929.02. App. 058.

### Proposition of Law No. 3

The PUCO acts unreasonably and unlawfully when it approves an untested, radical residential rate design that is not supported by the evidence of record.

R.C. §4909.19 places the burden of proof on the applicant to prove the need for an increase in rates and, in this case, the need for a radical redesign of the residential rate structure. R.C. §4909.19 establishes the procedures that must be followed in rate cases, requiring that "the burden of proof to show that the increased rates or charges are just and reasonable shall on the public utility." App. 056. The evidence fails to satisfy that burden with regard to the residential rate design. As the

Court has noted, a verdict based on conjecture, guess, random judgment or supposition cannot be upheld. *Landon v. Lee Motors, Inc.*, 118 N.E. 2d 147, 161 Ohio St. 82 (1954).

Duke failed to meet its burden of proof in several distinct areas. The first is the lack of evidence supporting the conclusion that reductions in customer usage were the primary reason for Duke's failure to recover its revenue requirement. The PUCO and Duke claimed that reductions in customer usage justified the radical new rate design.

In fact, the evidence shows that only 15% of Duke's revenue deficiency in this rate case was attributable to declining customer usage. Opinion and Order at 17. App. 015. Thus, declining customer usage was not shown to be the primary reason for the rate increase. In fact, declines in usage have been modest, and such declines have had a negligible impact on revenues, a decline on average of only 3% per year.

Moreover, the PUCO ignored the fact that residential usage actually increased in three of the past five years over the level of use in the test year in the *previous* rate case, meaning that Duke over-recovered its revenue requirements during those years. Tr. I at 75, Supp. 026; OCC Exhibit 12, Supp. 017. There have been only intermittent reductions in throughput. The reductions, based on the record, are negligible at best, and there is no clear trend over the past five years. The evidentiary record is also devoid of any evidence that throughput will continue to decline in the period that the rates set in this case will be in effect.

What little revenue erosion Duke has experienced due to declining sales per customer would be more than offset by future increases in the number of residential customers. The record shows that, while sales per customer have not consistently declined, the number of residential customers has consistently increased. There is no evidentiary support for adopting a radical rate design that assumes reductions in customer usage and revenue shortfalls resulting from such reductions.

In addition, the proper remedy for Duke, in the event of reduced customer usage and revenue shortfall, is to do exactly what Duke has done every six years for the last two decades – file a rate case to increase rates. The proper regulatory remedy for a revenue shortfall, if such shortfall exists, is an application for an increase in rates, not the institution of a radical, unreasonable, and unlawful residential rate design.

The PUCO also claimed ironically that “a negative trend in sales has a corresponding negative effect on the utility’s ongoing financial stability, [and] its ability to attract new capital to invest in its network.” Opinion and Order at 17. App. 015. The record did not demonstrate that Duke’s financial stability was in any way threatened, merely that Duke’s earnings had dropped below its authorized rate of return. Moreover, the PUCO has allowed Duke a rider called the Accelerated Main Replacement Rider (“AMRP”) that mitigates any difficulty Duke may have in attracting new capital. Under Rider AMRP, new capital is supplied by customers annually. With the Rider AMRP and regular rate cases incorporating new plant into rate base, there is no concern about the ability of Duke to obtain adequate capital.

In short, there is no evidentiary basis to justify the SFV rate design as a response to Duke's need for capital because there is no evidence of a lack of capital.

The Staff acknowledged that it had not reviewed or analyzed the impact of the SFV rate design in the three other utility service territories where it has been adopted. Tr. I at 240; 244, Supp. 035. As a result there is no evidence to show that an SFV rate design has produced financial stability for utilities, nor improved their access to capital. Therefore, even if Duke needed additional access to capital, there is no evidence that the SFV rate design would address that need.

Duke also failed to meet its burden to prove that the SFV rate design complies with state policy. Ohio law requires the encouragement of energy efficiency and conservation. R.C. §4929.02(A)(4). App. 058. The PUCO lamely attempted to justify the SFV rate design in terms of the state policy by claiming that a negative trend in sales has a negative impact when it comes to incentivizing a utility to encourage energy efficiency and conservation. The record does not support the PUCO's justification for two reasons. First, the record shows that Duke has funded energy efficiency and conservation programs for many years. The stipulation in this case increases funding for low-income weatherization by 50%. Supp. 010. Duke agreed to the stipulation before the SFV rate design was adopted.

Duke has also filed cases to authorize electric and gas riders to fund conservation. *In the Matter of the Application for the Recovery of Costs, Lost Margin, and Performance Incentive Associated with the Implementation of Natural Gas Demand Side Management Programs by The Cincinnati Gas & Electric Company*, Case No. 95-656-GA-AIR, Finding and Order, July 11, 2007. App. 078.

The cost of these programs is included in the revenue requirement and Duke earns a return on those funds. Thus, the SFV rate design is not needed to serve as additional incentive to promote energy conservation. Adherence to Ohio law and state policy is enough incentive for any utility, as it should be for the PUCO.

There is no evidence to support the movement to the SFV rate design. While reducing work demands on Duke and the Staff of the PUCO resulting from frequent rate cases is apparently driving the move to the SFV, even this justification has no basis in fact. The continuation of Rider AMRP and the related infrastructure improvement program guarantees regular rate cases to incorporate the new plant into rate base. The SFV rate design does not eliminate the demand on Staff to perform its regulatory functions.

Thus, Duke failed to prove that the new SFV rate design is just and reasonable as required by Ohio law. R.C. §§4905.22, 4909.18, App. 0049, 054. The law requires the applicant to meet the burden of proving the new rate design is consistent with Ohio law and policy – Duke has not done so. R.C. §4909.19, App. 056. The law also requires the PUCO to base its findings and orders on the evidence of record. R.C. §4903.09. App. 048. The PUCO has not done so. The evidentiary record does not support adoption of the SFV rate design.

#### **IV. Conclusion**

The Supreme Court is required to reverse, vacate or modify final orders of the Public Utilities Commission where the PUCO's order is unreasonable or unlawful. *Consumers' Counsel v. Pub. Util. Comm.*, (1979) 58 Ohio St.2d 108, 110. The Court should reverse and vacate the unlawful and unreasonable PUCO decision in this case to deny ratepayers the benefit of just and reasonable rates and the policy of the state of Ohio to promote demand-side initiatives.

The SFV rate design, which amounts to a huge increase in the fixed monthly customer charge, does not result in just and reasonable rates as required by R.C. §§4905.22 and 4909.18. App. 048, 054. While the SFV rate design virtually guarantees Duke recovery of a large percentage of the revenue requirement, it achieves this goal unfairly on the backs of residential customers with low and average usage who cause less cost to the system than high-usage residential customers. For most customers, the SFV rate design means higher bills than they would have expected under a rate design that adheres to regulatory principles and PUCO precedent. The SFV rate design also transfers wealth from low-use and low-income customers to high-use customers who are predominantly high-income customers. App. 015, 028.

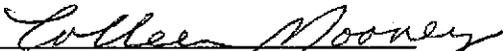
The SFV rate design also sends an anti-conservation price signal to consumers, penalizes low-use customers and customers who have invested in energy efficiency, extends the payback period for such investments, and takes away the ability of customers to control their energy bills by altering their usage. State

policy is to encourage demand-side investments. R.C. §4929.02. App. 058. The PUCO has chosen instead to discourage them in contravention of the state's policy.

The lack of evidence supporting the SFV rate design demonstrates that it is a solution in search of a problem. The record evidence does not support adoption of the SFV. R.C. §4909.18 requires that "the burden of proof to show that proposals in the application are just and reasonable shall be upon the public utility." App. 054. Duke has failed to meet its burden of proof. The PUCO has failed to issue orders that are based on the evidence of record. R.C. §4903.09. App. 048.

The PUCO's May 28, 2008 Opinion and Order and July 23, 2008 Entry on Rehearing are unlawful, unjust and unreasonable and should be reversed. The case should be remanded to the PUCO with instructions to establish a residential rate design that comports with regulatory principles, PUCO precedent, and Ohio law as set forth at R.C. §§4903.09, 4905.22, 4909.18, 4909.19, and 4929.02(A)(4).

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**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing Merit Brief of Appellant, Ohio Partners for Affordable Energy, was served upon all parties to this proceeding by hand delivery or regular U. S. Mail this 12th day of December 2008.

  
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