

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

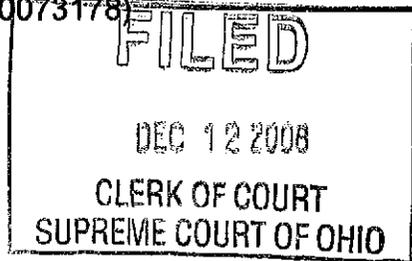
Ohio Partners for Affordable Energy,	)	Case No. 08-1837
	)	
Appellant,	)	
	)	Appeal from the Public
	)	Utilities Commission of Ohio
v.	)	
	)	
	)	
The Public Utilities Commission of Ohio,	)	Public Utilities
	)	Commission of Ohio
Appellee.	)	Case Nos. 07-589-GA-AIR,
	)	07-590-GA-ALT,
	)	07-591-GA-AAM

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**APPENDIX TO MERIT BRIEF OF APPELLANT,  
OHIO PARTNERS FOR AFFORDABLE ENERGY**

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

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

NOTICE OF APPEAL  
OF APPELLANT,  
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**Notice of Appeal of Appellant, Ohio Partners for Affordable Energy**

Appellant, Ohio Partners for Affordable Energy, pursuant to R.C. §§4903.11 and 4903.13 and S. Ct. Prac. R. II(3)(B), hereby gives notice to the Supreme Court of Ohio and to the Public Utilities Commission of Ohio ("Appellee" or "PUCO") of this appeal to the Supreme Court of Ohio from Appellee's Opinion and Order entered in its Journal on May 28, 2008 (attached) and its Entry on Rehearing entered in its Journal on July 23, 2008 (also attached) in the above-captioned cases, PUCO Case Nos. 07-589-GA-AIR, 07-590-GA-ALT and 07-591-GA-AAM.

Appellant, Ohio Partners for Affordable Energy, is an Ohio corporation engaged in advocating for affordable energy policies for low and moderate income Ohioans. Appellant, on behalf of low-income customers and the nonprofit agencies that provide these customers with bill payment assistance and energy efficiency services, was a party of record in the above-captioned PUCO cases.

On June 27, 2008, Appellant timely filed an Application for Rehearing from the May 28, 2008 Opinion and Order pursuant to R.C. §4903.10. Appellant's Application for Rehearing was denied with respect to the issues raised in this appeal by an Entry on Rehearing entered in the Appellee's Journal on July 23, 2008.

Appellant complains and alleges that Appellee's May 28, 2008 Opinion and Order and July 23, 2008 Entry on Rehearing are unlawful, unjust and

unreasonable, and the Appellee erred as a matter of law, in the following respects that were raised in Appellant's Application for Rehearing:

1. The PUCO's Opinion and Order and Entry on Rehearing unreasonably and unlawfully authorize an unprecedented, radical residential rate design that violates the regulatory principles of gradualism and rate continuity and does not produce just and reasonable rates, which violates Ohio law set forth at R.C. §§4905.22 and 4909.18.
2. 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, which violates the policy of the State of Ohio set forth at R.C. §4929.02.
3. The PUCO's Opinion and Order and Entry on Rehearing unreasonably and unlawfully approve an untested, radical residential rate design that is not supported by the evidence and is against the weight of the evidence.

**Wherefore**, Appellant respectfully submits that the Appellee'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 Appellee with instructions to correct the errors complained of herein.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing Notice of Appeal of Ohio Partners for Affordable Energy was served upon the Chairman of the Public Utilities Commission of Ohio by leaving a copy at the office of the Chairman in Columbus and upon all parties to the proceeding pursuant to R.C. §4903.13 by hand delivery or regular U. S. Mail this 19<sup>th</sup> day of September 2008.

  
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**CERTIFICATE OF FILING**

I certify that this Notice of Appeal has been filed with the docketing division of the Public Utilities Commission of Ohio in accordance with sections 4901-1-02(A) and 4901-1-36 of the Ohio Administrative Code.

  
Colleen L. Mooney  
Counsel for Appellant  
Ohio Partners for Affordable Energy

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Rates. ) Case No. 07-589-GA-AIR

In the Matter of the Application of Duke Energy Ohio, Inc. for Approval of an Alternative Rate Plan for Gas Distribution Service. ) Case No. 07-590-GA-ALT

In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods. ) Case No. 07-591-GA-AAM

ENTRY ON REHEARING

The Commission finds:

- (1) On July 18, 2007, Duke Energy of Ohio, Inc. (Duke) filed applications to increase its gas distribution rates, for authority to implement an alternative rate plan for its gas distribution services, and for approval to change accounting methods. On February 28, 2008, the parties filed a Joint Stipulation and Recommendation (Stipulation) resolving all the issues raised in the application except the issue of residential rate design. By Opinion and Order issued May 28, 2008, the Commission approved the Stipulation and, based on the record presented, adopted a "levelized" residential rate design to decouple Duke's revenue recovery from the amount of gas actually consumed.
- (2) Section 4903.10, Revised Code, states that any party who has entered an appearance in a Commission proceeding may apply for rehearing with respect to any matters determined in that proceeding, by filing an application within 30 days after the entry of the order upon the journal of the Commission.
- (3) On June 27, 2008, the Office of the Ohio Consumers' Counsel (OCC) and Ohio Partners for Affordable Energy (OPAE) filed applications for rehearing. Both applications assert that the May 28, 2008 Order is unreasonable, unlawful and/or an abuse of the Commission's discretion on the following grounds:

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- (a) The Commission erred by approving a rate design that unreasonably violates prior Commission precedent and policy, and does not produce just and reasonable rates in violation of Sections 4905.22 and 4909.18, Revised Code.
- (b) The Commission erred by approving a rate design that discourages customer conservation efforts in violation of Sections 4929.05 and 4905.70, Revised Code.
- (c) The Commission erred when it failed to comply with the requirements of Section 4903.09, Revised Code, and provide specific findings of fact and written opinions that were supported by record evidence.

In addition to the foregoing common three arguments, OCC adds a fourth ground for rehearing: that the Commission erred by approving a rate design which increases the monthly residential customer charge without providing consumers adequate notice of the new rate design pursuant to Sections 4909.18, 4909.19 and 4909.43, Revised Code.

- (4) On July 7, 2008, Duke filed a memorandum in opposition to the applications for rehearing.
- (5) Before addressing these arguments, we would note that the opinion contains a clerical error which we now correct, *nunc pro tunc*. In the summary of the stipulation on page 6, the Opinion incorrectly states that Duke's revenue increase of \$18,217,566 is based on an 8.15 percent rate of return. The stipulated revenue increase was based upon a rate of return of 8.45 percent.
- (6) With respect to the applications for rehearing, we first observe that neither OCC nor OPAE raises any issues which were not fully considered and rejected in the Opinion at pages 12-15 and 17-20. As noted therein, the only unstipulated issue left to the Commission in this proceeding is the adoption of a new residential gas distribution rate design which would reduce or eliminate the link between natural gas sales volumes and the utility's revenue requirement in order to more closely match costs and revenues such that customers pay their fair share of distribution costs, to reduce or eliminate any disincentive for

the utility to promote conservation programs, and to afford the utility a reasonable opportunity to recover fixed costs. Our choice was between the two approaches deemed most appropriate to accomplish this decoupling: (1) a modified "straight fixed-variable (SFV)" or "levelized" rate design, which recovers most fixed costs in a flat monthly fee; or (2) a decoupling rider, which maintains a lower customer charge and allows the company to offset lower sales through an annually adjusted rider. For the reasons set forth in the record and our Opinion, we believe the levelized rate design best balances the interests of customers and the utility.

- (7) The first ground for rehearing listed by both OCC and OP&E is that our adoption of a levelized rate design violates prior Commission precedent, as well as the regulatory principles of gradualism and rate continuity, thereby producing unjust and unreasonable rates in violation of Sections 4905.22 and 4909.18, Revised Code. In examining these claims, we first observe that this Commission is not bound by any statutory requirement relating to the regulatory principle of gradualism, which is only one of many important regulatory principles. However, consistent with the principle of gradualism, the Commission noted at page 19 of our Opinion that the new levelized rate design best corrects the traditional rate design inequities while mitigating the impact of the new rates on residential customers by maintaining a volumetric component to the rates, by phasing in the increase over a two-year period, and by not reflecting the full extent of Duke's fixed costs in the proposed fixed charge. We also noted that the Pilot Low Income Program, aimed at helping low-income, low-use customers pay their bills, was crucial to our decision. Furthermore, OCC and OP&E continue to compare the new flat monthly fee with the customer charge under the previous distribution rate structure. Such comparisons are misleading and distort the impact on customers, since any analysis of the impact of the new levelized rate structure should consider the total customer distribution charges, including the current Rider AMRP and the volumetric charge. We note that, in association with the adoption of the levelized rate design, the volumetric charge reflected on the bills of residential customers will be reduced as the customer charge is phased-in to reflect the elimination of the majority of the company's fixed costs from the volumetric charge. Moreover, as noted in our Opinion, at page 18, the new rate

design also achieves the important regulatory principle of matching costs and revenues to ensure that customers pay their fair share of distribution costs. Accordingly, the Commission finds that OCC's and OPAE's requests for rehearing on such basis should be denied.

- (8) With respect to the second common ground for rehearing, both OCC and OPAE assert that the Commission erred by approving a rate design that discourages customer conservation efforts in violation of Sections 4929.05 and 4905.70, Revised Code. This argument was fully considered and rejected in the Opinion at pages 14-15 and 18-19. There is no dispute that both the modified straight fixed-variable rate design and the decoupling rider reduce or eliminate any disincentive for utility sponsored or promoted conservation programs. There is also no dispute that, under both of the rate designs, a customer who makes conservation efforts to reduce gas consumption will equally enjoy the full benefit of those efforts for the commodity portion of their gas bill which typically represents 75 to 80 percent of their total gas bill. While under the levelized rate design, a lower-use customer who conserves may not reduce his distribution charges as much as such charges would otherwise be reduced under the decoupling rider method, it is also true that all potential customer savings are not guaranteed under the decoupling rider method due to the attendant uncertainty caused by periodic reviews and adjustments necessary with the decoupling rider. Moreover, any greater reduction in distribution charges achieved through a decoupling rider would have the effect of preserving the inequities within the existing rate design that have caused higher use customers to subsidize the fixed costs of lower use customers. As discussed in the Commission's opinion at page 19, the Commission opted to more closely match costs and revenues such that customers pay their fair share of distribution costs. Finally, this argument for rehearing disregards the fact that a fundamental reason for our adoption of the new rate design is to foster conservation efforts in accordance with Sections 4929.02 and 4905.70, Revised Code. The only question at issue in these proceedings is whether a levelized rate design or a decoupling rider better achieves all competing public policy goals. As discussed at length in our opinion, we believe the levelized rate design is the better choice. This ground for rehearing is denied.

- (9) The third common assignment of error is that the Commission erred when it failed to comply with the requirements of Section 4903.09, Revised Code, by failing to provide specific findings of fact and written opinions that were supported by record evidence. We find this assertion to be without merit. The evidence of record and arguments of the parties were fully considered as reflected in the Opinion at pages 12-15 and 17-20, in accordance with Section 4903.09, Revised Code. The undisputed evidence of record is that the new levelized rates will more closely match fixed costs with fixed revenues, thereby ensuring that residential distribution customers pay their fair share of the costs incurred to serve them. Our adoption of this new rate design was conditioned upon this consideration and upon other important factors, including the gradual phase-in of these new rates and the company's new low-income assistance plan.
- (10) OCC also identifies a fourth basis for rehearing in arguing that our approval of the new levelized rate design violates Sections 4909.18, 4909.19 and 4909.43, Revised Code, by increasing the monthly residential customer charge without providing consumers adequate notice.

We find this argument to be without merit. Sections 4909.18, 4909.19, and 4909.43, Revised Code, direct the utility to notify customers, mayors and legislative authorities in the company's service area of the application and the rates proposed therein. Duke served upon mayors and legislative authorities and published in newspapers throughout its affected service area notices that met the requirements of Section 4909.18, 4909.19, and 4909.43, Revised Code, as approved by the Commission. The notice specifically set forth the rates and percentage increase, by rate schedule, proposed by Duke in the application, including a reference to and explanation of the proposed sales decoupling rider.

OCC relies on *Committee Against MRT v. Pub. Util. Comm.* (1977), 52 Ohio St.2d 231, to argue that the notice failed to inform customers of the levelized rate design adopted by the Commission. In the *Committee Against MRT* case, Cincinnati Bell Telephone Company (CBT) filed an application with the Commission requesting approval to introduce a new rate plan for basic local exchange service throughout its service area.

The notice submitted by CBT did not include a description of measured rate service but did include a general reference to the exhibits filed in the case. The exhibits filed in the case and referenced in the notice included an explanation of the proposed measured rate service. In *Committee Against MRT*, the Commission approved and CBT issued the proposed notice. Subsequently, the Commission approved a stipulation filed by the parties to the case, recommending that the Commission authorize CBT to provide non-optional measured rate service on an experimental basis in one exchange. The court held that the notice issued by CBT failed to sufficiently describe the company's proposal to implement measured rate service. The court reasoned that the notice failed to disclose the essential nature or quality of the proposal; that is, to implement usage-based rates. The Commission finds this case to be distinguishable from *Committee Against MRT*. In *Committee Against MRT*, the court found that the notice failed to disclose the essential nature of the rates proposed by CBT. The notice in this case clearly disclosed the nature of the rates, including the implementation of a decoupling mechanism, as such was proposed by Duke. Although the Commission did not adopt the decoupling mechanism proposed by Duke, the notice was sufficient to inform customers of such proposal and to allow customers to register an objection to a decoupling mechanism and the increase in rates. In addition, the notice stated that "[r]ecommendations which differ from the filed application ... may be adopted by the Commission." Accordingly, OCC's request for rehearing on this basis is denied.

- (11) Finally, the Commission observes that, in addition to electronically filing its application for rehearing, OCC also uploaded an electronic video file of the webcast of the April 23, 2008, Commission meeting, where these matters were discussed at length by the Commissioners. While Commission webcasts may be instructional on the views of the individual members, it is well settled that the Commission speaks through its published opinions and orders, as provided by Section 4903.09, Revised Code. *Murray v. Ohio Bell Tel. Co.*, 54 Ohio Op. 82, 117 N.E.2d 495 (1954). We note that OCC has argued exactly this point in a prior Commission proceeding. In *Cincinnati Bell Telephone Company*, Case No. 04-720-TP-ALT, et al., OCC cited Supreme Court of Ohio decisions for the proposition that commissions, such as this one, only speak

through their published orders (See, OCC's August 9, 2004, reply memorandum at 3, in Case No. 04-720-TP-ALT, et al.). Moreover, the minutes of the Commission meetings are not considered to be a part of the record in the cases discussed. Accordingly, the Commission will, on its own motion, strike this file from the record in these proceedings.

It is, therefore,

ORDERED, That the applications for rehearing filed by OCC and OP&E on June 27, 2008, are denied. It is, further,

ORDERED, That the video file of the April 23, 2008, Commission webcast, which was electronically filed by OCC with its application for rehearing, is hereby stricken from the record in these proceedings. It is, further,

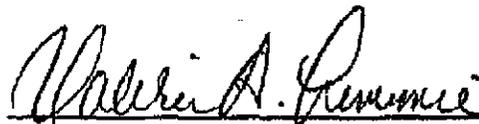
ORDERED, That a copy of this order be served upon all interested persons of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

  
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Alan R. Schriber, Chairman

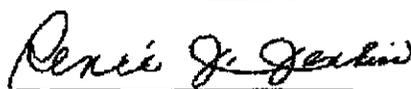
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Secretary

## BEFORE

## THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Rates.	)	Case No. 07-589-GA-AIR
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In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods.	)	Case No. 07-591-GA-AAM

OPINION AND ORDER

The Commission, considering the applications, testimony, the applicable law, proposed Stipulation, and other evidence of record, and being otherwise fully advised, hereby issues its opinion and order.

APPEARANCES:

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## OPINION:

### I. PROCEDURAL BACKGROUND

Duke Energy Ohio, Inc. (Duke, company) is 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. As a public utility and a natural gas company within the definition of Sections 4905.02 and 4905.03(A)(6), Revised Code, Duke is subject to the jurisdiction of this Commission in accordance with Sections 4905.04, 4905.05 and 4905.06, Revised Code.

On June 18, 2007, Duke filed notice of its intent to file an application to increase its rates. The Commission issued an entry on July 11, 2007, establishing a test period of January 1, 2007 through December 31, 2007 for the proposed rate increase and a date certain of March 31, 2007, as well as granting certain waivers requested by Duke.

Duke filed the application in Case No. 07-589-GA-AIR, seeking to increase its gas rates on July 18, 2007. Duke also filed separate applications for approval of an alternative rate plan (Case No. 07-590-GA-ALT) and for approval to change accounting methods (Case No. 07-591-GA-AAM). As originally filed, Duke's rate increase application sought approval for a 5.71 percent annual rate increase, an additional \$34 million, over current total adjusted operating revenues. As part of the alternative rate plan application, Duke proposes to: (a) extend the term of the Accelerated Main Replacement Program (AMRP) and the associated rider (Rider AMRP) through the year 2019, (b) establish a process to recover its future investment in Duke's Utility of the Future initiative through a new rider

(Rider AU), and (c) create a new sales decoupling rider (Rider SD) to remove any disincentive for energy conservation initiatives. In the accounting application, Duke seeks approval to defer certain costs to be recovered later as a part of the AMRP expenditures and to capitalize the cost incurred for certain property relocations and replacements.

By entry issued September 5, 2007, the Commission found that Duke's application in Case No. 07-589-GA-AIR complied with the requirements of Section 4909.18, Revised Code, and Rule 4901:1-19-05, Ohio Administrative Code (O.A.C.) and accepted the application for filing as of July 18, 2007. The entry also granted Duke's waiver requests as to certain standard filing requirements and directed Duke to publish notice of the application in newspapers of general circulation in the company's service territory. Duke filed proof of such publication on February 25, 2007. To provide interested parties with an opportunity to make inquiries about the Duke applications, a technical conference was hosted by the Commission's staff on August 20, 2007.

Motions to intervene in these cases were granted to the Ohio Energy Group (OEG), the Kroger Company (Kroger), Interstate Gas Supply, Inc. (Interstate), the city of Cincinnati, the office of the Ohio Consumers' Counsel (OCC), People Working Cooperatively, Inc. (PWC), Integrys Energy Services, Inc. (Integrys), Direct Energy Services, LLC (Direct), Stand Energy Corporation (Stand), and the Ohio Partners for Affordable Energy (OPAE).

Investigations of Duke's applications were conducted and reports filed by the Commission staff and Blue Ridge Consulting Services, Inc. (Blue Ridge), an independent auditing firm. Both the report filed by staff (Staff Report, Staff Ex. 1) and financial audit report filed by Blue Ridge (financial audit report, Staff Ex. 4) were filed on December 20, 2007. Objections to the Staff Report and/or financial audit report were filed by PWC, OEG, Duke, OPAE, OCC, and, jointly, by Integrys and Direct. Motions to strike certain objections were filed by Duke and OCC. Memoranda contra the motions to strike objections were filed by Duke, Interstate, OPAE, and, jointly, by Integrys and Direct.

On January 25, 2008, a prehearing conference was held, as required by Section 4909.19, Revised Code. In accordance with Section 4903.083, Revised Code, local public hearings were held on February 25, 2008, in Cincinnati, Ohio, and on March 11, 2008, in Mason, Ohio.

A total of 27 witnesses testified at the two local hearings in Cincinnati, while four people took the stand at the Mason hearing. Two witnesses testified in favor of the rate increase, particularly as to the accelerated main replacement (AMRP) and riser replacement programs. Another witness testified that, although he was not opposed to the rate increase if Duke required additional money to maintain the gas lines, he was opposed to the extent that the increase is incorporated into the monthly customer charge as

opposed to the volumetric charge. The witness claimed that applying the increase in such a manner discourages energy efficiency and adversely affects residential customers with small homes (Cincinnati Public Hearing I, p. 20-21). The remaining witnesses at the local public hearings were opposed to the increase, asserting that their utility bills are already expensive, particularly for individuals on fixed incomes and for low income individuals and families; while others argued that increasing the customer charge, as proposed, would discourage conservation.

The evidentiary hearing was called on February 26, 2008, and continued, to allow the parties additional time to negotiate a settlement of the issues in these proceedings. On February 28, 2008, the parties filed a Joint Stipulation and Recommendation (Stipulation, Joint Ex. 1) resolving all the issues except the adoption of a new residential rate design. The evidentiary hearing was reconvened on March 5 and March 6, 2008. Duke and staff filed the testimony of Paul G. Smith (Duke Ex. 29) and of J. Edward Hess (Staff Ex. 2), in support of the Stipulation. With respect to the unresolved issue of residential rate design, Duke presented witnesses James A. Riddle (Duke Exs. 10 and 25), Paul G. Smith (Duke Exs. 11 and 19), Donald L. Stork (Duke Exs. 13, 20, and 22), and James E. Ziokowski (Duke Ex. 16); OCC called Wilson Gonzalez (OCC Exs. 5 and 18) and Anthony J. Yankel (OCC Ex. 6 and 17); and Staff presented the testimony of Stephen E. Puican (Staff Ex. 3).

Initial briefs, in support of their respective positions, were filed by Duke, OP&E, OCC, and staff on March 17, 2008. Reply briefs were filed on March 24, 2008.

A. Duke's Motion for Protective Order

On February 21, 2008, Duke filed a motion for protective order for information attached to the direct testimony of Matthew G. Smith (Duke Ex. 27) and marked as Attachment MGS-1. Duke contends that Attachment MGS-1 contains proprietary pricing information from vendors for equipment necessary for Duke's Utility of the Future program. The company states that the information for which Duke seeks confidential treatment is not known outside of Duke and its vendors. Furthermore, Duke states that, within the company, such information is only disseminated to employees who have a legitimate business need to know and act upon such information. Accordingly, Duke considers the information to be proprietary, confidential, and trade secret, as defined in Section 1333.61, Revised Code, and requests that the information be treated as confidential in accordance with the provisions of Sections 1333.61 and 4901.16, Revised Code. No party opposed Duke's request for protective treatment of Attachment MGS-1.

The Commission recognizes that Ohio's public records law is intended to be liberally construed to ensure that governmental records are open and made available to the public, subject to only a few very limited and narrow exceptions. *State ex rel. Williams*

*v. Cleveland* (1992), 64 Ohio St.3d 544, 549. However, one of the exceptions is for trade secrets. Section 1333.61(D), Revised Code, defines trade secret as:

[I]nformation, including the whole or any portion or phase of any scientific or technical information, design, process, procedure, formula, pattern, compilation, program, device, method, technique, or improvement, or any business information or plans, financial information, or listing of names, addresses, or telephone numbers, that satisfies both of the following:

- (1) It derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use.
- (2) It is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

The Commission finds that Attachment MGS-1 is financial information that derives independent economic value from not being generally known to or readily ascertainable by proper means by others who can obtain economic value from its use and that it is subject to reasonable efforts to maintain its secrecy. Therefore, we find that it contains trade secret information, as defined under Section 1333.61(D), Revised Code, and, therefore, that it should be granted protective treatment. In accordance with Rule 4901-1-24, O.A.C., Duke's request for a protective order is granted and the information filed under seal, as Attachment MGS-1, shall be afforded protective treatment for 18 months from the date this order is issued. Any request to extend protective treatment shall be made in accordance with Rule 4901-1-24(F), O.A.C.

**B. Duke's Motion for Waiver and Leave to File Depositions**

On February 25, 2008, Duke filed a motion for waiver of a Commission filing requirement and leave to file depositions *instanter*. Duke states that depositions were conducted on February 21, 2008. On Friday, February 22, 2008, Duke filed notice that it would be filing the deposition transcripts of five witnesses and commenced electronic transmission of the depositions. However, Duke states that it subsequently learned that only one of the five depositions was received by the Commission's Docketing Division before the end of the business day on February 22, 2008. Accordingly, the remaining four depositions were electronically transmitted on Monday, February 25, 2008. Duke requests that the Commission waive the requirement of Rule 4901-1-21(N), O.A.C., that depositions be filed with the Commission at least three days prior to the commencement of the

hearing. In this instance, the Commission finds Duke's request to waive the requirement that deposition transcripts be filed at least three days prior to the commencement of the hearing to be reasonable. Accordingly, the request for waiver should be granted.

## II. SUMMARY OF THE EVIDENCE

### A. Summary of the Proposed Stipulation

The only issue not resolved by the Stipulation is the proposed residential rate design which was litigated and is expressly reserved for our determination. A new design is recommended by the Commission's staff and Duke, but opposed by OCC and OP&E. The city of Cincinnati, PWC, and the commercial and industrial intervenors take no position with respect to this issue (Jt. Ex. 1 at 5). Pursuant to the Stipulation, the parties agree, among other things, that:

- (1) Duke will receive a revenue increase of \$18,217,566, which represents a percentage increase of 3.05 percent and is based on a 8.15 percent rate of return. Duke will not be required to file the 60-day update filing of actual financial data for the test year (Jt. Ex. 1, at 5 and Stipulation Ex. 1).
- (2) Duke's revenue distribution, billing determinants, and rates to be adopted are shown on Exhibit 2 of the Stipulation, and assume the adoption of the new residential rate design. The rates also reflect the shift of \$6,000,000 to the residential class, phased-in over two years, based upon the agreed revenue requirement and Duke's updated cost of service study (*Id.* at 5; Stipulation Ex. 2).<sup>1</sup>
- (3) Duke will amortize deferred rate case expenses requested for recovery in its filing in these cases as recommended in the Staff Report (*Id.* at 6).
- (4) Duke will implement new depreciation rates that reflect the mid-point between Duke's proposed depreciation rates and the rates proposed in the Staff Report, as shown on Stipulation Exhibit 5 (*Id.*).
- (5) The allocation of common plant related to the provision of gas distribution service will be based on an updated allocation

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<sup>1</sup> OCC and OP&E object to the characterization of this cost reallocation as a "subsidy/excess" used in the Stipulation (*Id.* at 5, footnote 6).

factor of 18.29 percent that excludes the generation plant assets contributed to Duke by Duke Energy North America, LLC (*Id.*).

- (6) Duke will file actual data to support a Rider AMRP adjustment for the last nine months of 2007. The Rider AMRP revenue requirement will be modified to include deferred curb-to-meter expense and riser expense, net of maintenance savings, for calendar year 2007. Such net deferred expense shall be capitalized with carrying charges at an annual rate of 5.87 percent, representing the company's long-term debt rate, and recovered through Rider AMRP, beginning in this filing. Duke may elect to recover this expense in any annual Rider AMRP filings, provided that the recovery does not exceed the Rider AMRP cumulative residential rate caps. If this deferred expense causes Duke to exceed the Rider AMRP cumulative rate cap in any year, Duke may recover that portion of the deferred expense that exceeds the rate cap in a subsequent year as long as the recovery does not exceed the cumulative rate cap. The new Rider AMRP residential rates are limited on a cumulative basis as shown on Stipulation Exhibit 4, at 3, and recoverable pursuant to the Rider AMRP revenue allocation described in paragraph 9 of the Stipulation. Duke may implement these rates, effective with the beginning of the first billing cycle following issuance of the Commission's order, adjusted as necessary to permit the company full recovery of the revenue increase through May 1, 2009, subject to refund, upon Commission approval (*Id.* at 6-7).
- (7) Following the implementation of new Rider AMRP rates, Duke will file a pre-filing notice and application annually to implement subsequent adjustments to Rider AMRP, beginning in November 2008.<sup>2</sup> The annual filing will support the adjustment to Duke's revenue requirement for any increase to Rider AMRP. Duke shall continue to make its Rider AMRP annual filing until the effective date of the Commission's order in Duke's next base rate case (*Id.* at 8-9).

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<sup>2</sup> Although the Stipulation directs Duke to make its annual filings in Case No. 07-589-GA-AIR, each annual review should be filed in a new case to accommodate the operational efficiencies of the Commission's Docketing Information System. These annual review cases will be linked to the instant proceedings, and Duke should serve all parties to these proceedings with each pre-filing notice and annual AMRP application.

- (8) Duke's revenue requirement calculation and Rider AMRP application filed with the Commission shall include the post-March 31, 2007 (date certain) original cost and accumulated reserve for depreciation of property associated with the AMRP program that is used and useful on December 31 of the prior year in the rendition of service as such property is associated with the AMRP and riser replacement programs, including capital expenditures for new plant (including but not limited to new mains, services and risers), adjustments for the retirement of existing assets, calculated Post-In-Service Carrying Charges ("PISCC") on net plant additions and related deferred taxes until included in rates for collection in Rider AMRP, a proper annual depreciation expense, and any sums of money or property that Duke may receive to defray the cost of property associated with the AMRP capital expenditures. The return assigned to the recovery of all such net capital expenditures shall be at a pre-tax weighted average cost of capital of 11.7 percent (*Id.* at 9-11).<sup>3</sup>
- (9) Duke will substantially complete the AMRP by the end of 2019 and will complete the riser replacement program by the end of 2012. Duke will file an application with the Commission for approval to extend the AMRP program if not substantially completed by the end of 2019 (*Id.* at 12).
- (10) Duke shall maintain its alternative regulation commitments until the effective date of the Commission's order in the company's next base rate case, except that the incremental \$1,000,000 in funding for weatherization shall be funded through base rates.<sup>4</sup> If, for any reason, Duke does not expend the \$3,000,000 gas weatherization funding amount in any year, the amount not expended will be carried over to the following year and added to the annual \$3,000,000 funding to be available for distribution to weatherization projects during that year. If a weatherization service provider does not meet its contract requirements, including its failure to meet deadlines, following consultation with the Duke Energy Community Partnership (Collaborative), Duke will reprogram the remaining funding to

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<sup>3</sup> This rate of return is based on a 10.4 percent return on equity.

<sup>4</sup> OCC agrees with Duke's incremental \$1 million weatherization funding; however, OCC does not agree that this out-of-test period expenditure should be collected through base rates, and asserts that this amount should instead be collected through a rider.

a different project and/or assign it to another weatherization service provider so that the funding dollars can be spent expeditiously and productively (*Id.* at 12-14).<sup>5</sup>

- (11) The residential rate caps on Stipulation Exhibit 4 apply to Rider AMRP. Duke may establish deferrals for the expenses of the riser replacement program if these expenses cause Duke to exceed the cumulative rate cap, including a carrying cost of 5.87 percent. The rate caps shall be cumulative rather than annual caps such that if the rate increase is below the annual cap in a given year, the unused portion of the cap may be carried forward to future years but can never exceed the cumulative cap. If the deferred curb-to-meter expense or the deferred riser replacement program expense causes Duke to exceed the cumulative rate cap in any year, then Duke may recover that portion of the deferred expense that exceeds the cumulative rate cap in a subsequent year as long as the recovery does not exceed the cumulative rate cap (*Id.* at 17).
- (12) The parties agree that Duke shall take over ownership of the curb-to-meter service, including the riser, whenever a new service line or riser is installed or whenever an existing curb-to-meter service or riser is replaced. Duke shall file its tariffs in these cases such that Duke will be responsible for the cost of initial installation, repair, replacement and maintenance of all curb-to-meter services, including risers, except that consumers shall pay the initial installation costs related to the portion of service lines in excess of 250 feet. In 2008, Duke will begin capitalizing rather than expensing the costs currently described as "Customer Owned Service Line Expense." For this purpose, Duke will submit proposed tariff changes to Staff for review and approval, with a copy to parties, prior to filing the revised sheets with the Commission. Such capitalized costs shall be recoverable through Rider AMRP (*Id.* at 12-14).<sup>6</sup>
- (13) Duke will file, within 60 days of the Commission's final order in this proceeding, a deployment plan for the company's Utility of the Future Program for 2008-2009 (*Id.* at 15-16).

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<sup>5</sup> The members of the Collaborative include Duke personnel and representatives of the OCC, Staff, the Hamilton County Cincinnati Community Action Agency, City of Cincinnati, and PWC.

<sup>6</sup> Neither Direct, Interstate, nor Integrys endorse this provision of the stipulation.

- (14) Duke's base rates do not include any amount for gas storage carrying costs. On a going forward basis, Duke will recover its actual gas storage carrying costs through its gas cost recovery rider (Rider GCR), without reduction to rate base, as shown on Stipulation Exhibit 1. Carrying charges associated with the actual monthly balances of Current Gas in Storage shall be accrued at a 10 percent annual rate as shown on Stipulation Exhibit 3. Further, the parties agree that the Commission should: (a) approve the methodology for the calculation of the storage carrying costs for inclusion in the GCR rate, as demonstrated in Stipulation Exhibit 3; (b) find that such an adjustment to Duke's rates is not an increase in base rates; and (c) approve recovery of such costs in Duke's next GCR filing following the Commission's order in this proceeding (*Id.* at 16-17).
- (15) Duke shall conduct an internal audit of its method and process for allocating service company charges to Duke by no later than 2009, and shall provide the audit report to Staff and the OCC (*Id.* at 18).
- (16) Duke shall continue to use the "Participants Test" as one of the methods for evaluating its Demand Side Management/Energy Efficiency programs as appropriate; however, Duke shall continue to use other cost/benefit tests as the Collaborative deems appropriate (*Id.* at 19).
- (17) Duke will implement a pilot program available to the first 5,000 eligible customers. The intent of the pilot program will be to provide incentives for low-income customers to conserve and to avoid penalizing low-income customers who wish to stay off of programs such as the Percentage of Income Payment Plan (PIPP). Eligible customers shall be non-PIPP low usage customers verified at or below 175 percent of the poverty level. Duke will design a tariff that adjusts the fixed monthly charge for eligible customers as shown on Stipulation Exhibit 2. These rates may be adjusted if the Commission does not approve the fixed customer charge as shown in Stipulation Exhibit 2. Duke will develop the details for this program in consultation with Staff and the parties. Duke shall evaluate the program after the first winter heating season to determine, following consultation with staff and the parties, whether the program should be

continued to all eligible low-income customers, including considerations of program demand and cost (*Id.* at 20).

- (18) Duke will convene a working group or collaborative process, open to interested stakeholders, within 60 days after approval of the Stipulation, to explore implementing an auction to supply the standard service offer. Duke will report to the Commission within one year after approval of this Stipulation, the findings of the working group or collaborative including the facts and arguments which support and or oppose implementation of an auction process. The working group or collaborative process shall also review whether the present allocation of 80 percent of the net revenues from Duke's asset management agreement should continue to flow to GCR customers only, or should be changed to flow to GCR customers and choice customers (*Id.* at 21-22).
- (19) Duke shall revise its GCR tariff to implement a sharing mechanism for sharing of net revenues from off-system transactions.<sup>7</sup> Such sharing mechanism shall be effective if Duke does not have an asset management agreement transferring management responsibility for its gas commodity, storage and transportation contracts to a third party, and shall provide for sharing of the net revenues from off-system transactions to be allocated 80 percent to GCR and choice customers and 20 percent to Duke shareholders. The revenue sharing percentage proposed by implementation of the sharing mechanism in this Stipulation is expressly limited to gas-related sales transactions, and shall not have precedential value in establishing the sharing percentages for similar electric sales transactions by Duke. This sharing mechanism, but not the 80 percent/20 percent revenue allocation, shall be subject to review in future GCR cases (*Id.* at 21-22).<sup>8</sup>
- (20) Duke shall meet with Staff and other interested parties to discuss eliminating customer deposits for PIPP customers and shall eliminate such deposits if Staff agrees (*Id.* at 18).

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<sup>7</sup> Off-system transactions are defined to include but are not limited to Off-System Sales Transactions, Capacity Release Transactions, Park Transactions, Loan Transactions, Exchange Transactions, and any other similar, but yet unnamed transactions.

<sup>8</sup> This paragraph does not change the allocation contained in the current sharing mechanism for revenues received under Duke's asset management agreement.

- (21) Duke shall review and fully consider the merits of adopting any new payment plans submitted by any party and, if Duke elects not to implement such new payment plan, Duke shall respond to the stakeholder in writing to state the reason for its decision (*Id.* at 18).
- (22) Duke shall review its use of payday lenders as authorized payment stations and will use its best efforts to eliminate the use of payday lenders as authorized payment stations if other suitable locations for the payment stations are available in the same geographic area. Duke shall provide a list of all payday lenders utilized as authorized payment stations to Staff and other interested parties annually. The annual payday lenders list is to be provided initially on May 1, 2008, and on May 1, each year thereafter (*Id.* at 18-19).
- (23) Duke shall communicate with its customers to educate them about the difference between authorized and non-authorized payment stations. Duke shall work with members of the Collaborative to develop the educational materials and communication strategy (*Id.* at 19).

B. Summary of the Residential Rate Design Issue

This case marks a sea change in the recommendation of the Commission's Staff with respect to the method of determining a gas utility's residential distribution rate design. Traditionally, natural gas distribution rates in Ohio have been set by allocating a relatively small proportion of the fixed costs to the "customer" charge, with the remaining fixed costs recovered through a volumetric component. However, volatile and sustained increases in the price of natural gas, along with heightened interest in energy conservation, have called into question long-held ratemaking practices for gas companies. In this proceeding, Staff and Duke advocate the adoption of a modified Straight Fixed Variable (SFV) residential rate design that allocates most fixed costs of delivering gas to a monthly flat fee with the remaining fixed costs recovered through a variable or volumetric component. Under this proposed new "levelized" rate design, Duke's current \$6.00 residential customer charge would be eliminated. Instead, residential customers would pay a flat monthly fee of around \$20 to \$25, but with a corresponding lower usage component to recover the remaining fixed distribution costs (Staff Ex. 1, at 30-33, 46-48; Stipulation Ex. 2; Duke Ex. 29 at 6; Tr. I at 87-88, 147-148, 159).

In its initial filings, Duke's proposed residential rate design included a \$15.00 customer charge with a sales decoupling rider to address an alleged revenue erosion problem caused by declining average use per customer. The Staff Report noted this

historical trend, but rejected a sales decoupling rider mechanism in favor of a phased-in SFV rate design. Staff's position was subsequently joined by Duke and the new design was used for calculations in the Stipulation exhibits, but adoption of the proposed rate design was expressly reserved for consideration by the Commission (Staff Ex. 1, at 30-33, 46-49; Jt. Ex. 1, at 1, 5, 19-20).

The levelized rate design is opposed by OCC and OPAE, both of whom advocate keeping the current low residential customer charge and high volumetric rates. In the alternative, they argue that, if a decoupling mechanism is to be adopted, the appropriate design is a decoupling rider rather than the flat rates recommended by Duke and Staff. The other parties to these proceedings either have no interest in residential rate design or chose not to take a position on this issue.

OCC and OPAE first cite the projected overall growth in Duke's residential gas revenues for 2008-2012 in contending that Duke has no revenue erosion problem because any revenue loss from declining sales on a per-customer basis will be more than offset by future increases in Duke's residential customer base (OCC Br. at 53; OCC Ex. 6, at 5-6; OCC Ex. 12). OCC and OPAE then argue that, in the event the Commission determines there is a revenue erosion problem, the Commission should adopt a sales decoupling rider to unlink revenue recovery from sales, similar to that stipulated to by Vectren Energy Delivery of Ohio ("Vectren"). *See, In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Approval, Pursuant to Section 4929.11, Revised Code, of a Tariff to Recover Conservation Expenses and Decoupling Revenues Pursuant to Automatic Adjustment Mechanisms and for Such Accounting Authority as May be Required to Defer Such Expenses and Revenues for Future Recovery through Such Adjustment Mechanisms, Case No. 05-1444-GA-UNC, Supplemental Opinion and Order (June 27, 2007).*

Staff maintains that the evidence of record clearly indicates that Duke's revenue erosion problem is real and that the levelized rate design is the better way to balance the utility's desire for recovery of its authorized return with promotion of energy efficiency as a customer and societal benefit through control of energy bills. Staff notes that nearly six million dollars of the total \$34.1 million revenue deficiency identified by Duke in this case is attributable to declining customer usage and cites the decline in per-customer, residential natural gas consumption, which has been accelerating since the marked price increases in the winter of 2000/2001. Staff asserts that, as long as the bulk of a utility's distribution costs are recovered through the volumetric component of base rates, this decline in per-customer usage threatens the utility's recovery of its fixed costs of providing service. Staff contends that the levelized rate design best addresses this issue while simultaneously removing the disincentives to utility-sponsored energy efficiency programs that exist with the traditional rate design (Duke Ex. 11, at 3-6, 11; Staff Ex. 3, at 3-5; Tr. I at 214-216; Staff Br. at 6-7).

Staff points out that the proposed new levelized rate design is a form of decoupling that breaks strict linkage between utility earnings and customer consumption by recognizing that virtually all the costs of gas distribution service are fixed, and the cost to serve a residential customer is largely the same, regardless of the specific customer's usage. Duke and Staff contend that it is neither fair nor accurate to characterize this fixed component as a customer charge because, under Duke's current rate design, the customer charge is set at an artificially low level that only minimally compensates the company for its fixed costs of providing gas service (Duke Ex. 29, at 6; Tr. I at 159; Staff Br. at 6-8; ).

Staff and Duke argue that, since the costs of providing gas distribution service are almost exclusively fixed, the proposed rate design will more closely match costs and revenues, thereby giving customers more accurate and timely pricing signals. They also contend that spreading the recovery of fixed costs more evenly over the entire year will help to reduce winter heating bills. Staff and Duke allege that customer incentives to conserve energy will remain strong because 75 to 80 percent of each customer's total bill is the cost of the gas itself (Staff Ex. 3, at 3-5; Tr. I at 159, 214-216; Tr. II at 91-93).

Finally, Staff and Duke suggest that a strict matching of fixed rates with fixed costs would result in a \$30.00 fixed residential distribution charge. However, because the proposed rate design is a significant departure from current rates, the Stipulation proposes to phase-in the new design over two years, using a lower fixed charge of \$20.25 in year one, and \$25.33 in year two. In addition, the remaining variable base rate component contains two usage tiers in an effort to minimize impacts on low-use residential customers, since average and larger usage residential customers will either benefit or be unaffected by the levelized rate design proposal (Jt. Ex. 1, at Ex. 2; Tr. I at 55, 87-88, 147-148).

OCC and OPAB counter that the stipulated rate design proposal amounts to a huge jump in the fixed monthly customer charge and violates a 30-year rate-making principle of gradualism. Moreover, they allege, it would violate the state policy to promote energy efficiency under Section 4929.02, Revised Code, because the proposed rate design sends an anti-conservation price signal to consumers, penalizes customers who have invested in energy efficiency by extending the payback period, and takes away the consumers' ability to control their energy bills. In addition, they assert that the levelized rate design is regressive towards low-use customers, and transfers wealth from low-income customers to high-use customers who are predominantly high-income customers (OCC Br. at 17-35, 46-55, 75-76).

Staff and Duke contend that under the proposed new rate design, high-use customers will benefit relative to low-use customers, and cite an analysis of PIPP customers to support the proposition that most low-income customers will actually benefit from this change. According to Duke witness Paul G. Smith, the PIPP customer data indicated that the average PIPP customer consumes approximately 1,000 ccf per year, or

approximately 25 percent more than the average non-PIPP customer and, therefore, levelized rates will actually reduce the annual cost for the average PIPP customer, and the cost of the PIPP program (Duke Ex. 29, at 11-12). Duke and Staff argue that if PIPP customer usage is representative of all of Duke's low-income customers, then most of Duke's low-income ratepayers will actually benefit from this policy change. In addition, they note any adverse impact of the levelized rate design will be mitigated by the new low-income/low-use pilot program included in the Stipulation. This program provides a credit to offset the higher fixed monthly charge for the first 5,000 non-PIPP, low-use customers verified at or below 175 percent of the federal poverty level. (Duke Br. at 17-35, 46-55, 75-76).

OCC and OPAE insist that the levelized rates will harm low-income customers and that the PIPP customer data is not indicative of other Duke low-income customers, but offered no data to support this contention (OCC Br. at 46-53; OPAE Br. at 4, 8).

### III. DISCUSSION AND CONCLUSION

#### A. Consideration of the Stipulation

Rule 4901-1-30, O.A.C., authorizes parties to Commission proceedings to enter into a stipulation. Although not binding on the Commission, the terms of such an agreement are accorded substantial weight. See *Consumers' Counsel v. Pub. Util. Comm.*, 64 Ohio St.3d 123, at 125 (1992), citing *Akron v. Pub. Util. Comm.*, 55 Ohio St.2d 155 (1978). This concept is particularly valid where the stipulation is unopposed by any party and resolves all or most of the issues presented in the proceeding in which it is offered.

In considering the reasonableness of a stipulation, the Commission has used the following criteria:

- (a) Is the settlement a product of serious bargaining among capable, knowledgeable parties?
- (b) Does the settlement, as a package, benefit ratepayers and the public interest?
- (c) Does the settlement package violate any important regulatory principle or practice?

The Ohio Supreme Court has endorsed the Commission's analysis using these criteria to resolve issues in a manner economical to ratepayers and public utilities. *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.*, 68 Ohio St.3d 559 (1994) (citing *Consumers' Counsel, supra*, at 126). The court stated in that case that the Commission may

place substantial weight on the terms of a stipulation, even though the stipulation does not bind the Commission (*Id.*).

The Commission finds that the Stipulation filed in these cases appears to be the product of serious bargaining among capable, knowledgeable parties. The signatory parties represent a wide diversity of interests including the utility, residential consumers, low-income residential consumers, commercial and industrial consumers, and Staff. Further, we note that the signatory parties routinely participate in complex Commission proceedings and that counsel for the signatory parties have extensive experience practicing before the Commission in utility matters.

The Stipulation also meets the second criterion. As a package, the Stipulation advances the public interest by resolving all issues raised, except as to residential revenue design, thereby avoiding extensive litigation. While the Stipulation includes a general rate increase of approximately three percent across all customer classes, that increase will allow the company an opportunity to recover its expenses. As for the new AMRP, which now includes riser replacement and company ownership of certain customer service lines, the Stipulation continues the mechanism established for the parties and the Commission to evaluate the reasonableness of the expenses incurred on a consistent, regular basis during the program until another base rate application is filed by Duke. We conclude that the continuance of the main replacement program, the initiation of the riser replacement program and Duke's ownership of customer service lines advances the public interest and safety. As with the previous program, the new AMRP and riser replacement program does not sanction cost recovery of any or all yet-to-be-incurred costs and does institute caps on future recovery. The Stipulation also continues the process under which each year's AMRP and riser replacement expenses can be evaluated for the next AMRP rider, while also addressing questions related to over-recovery and treatment of cost savings. We note that the accounting provisions adopted to facilitate the new AMRP program and the riser replacement program cease at the completion of each program. The Commission further notes that the Stipulation provides for the continuation of the weatherization program and a pilot program for low income customers.

Regarding company ownership of certain customer service lines, Duke should, upon the request of the customer, work with the customer as to location, relocation, and manner of installation of the service line, to the extent feasible under the gas pipeline safety regulations, Duke's tariff, and Duke's procedures.

Finally, the Stipulation meets the third criterion because it does not violate any important regulatory principle or practice. Indeed, the Stipulation provides a resolution for Duke to economically continue the AMRP and to initiate the riser replacement program facilitating gas system safety and reliability improvements.

On March 14, 2008, Duke moved for waiver of the requirement to file an update of the partially forecasted income statement and any variances for the test year, pursuant to Rule 4901-7-01, Appendix A, Chapter II(A)(5)(d), O.A.C. Duke notes that, as part of the Stipulation, the parties negotiated a revenue increase and further agreed to recommend that Duke be allowed to forgo the requirement of filing actual financial data for the test year (Jt. Ex. 1, at 5, footnote 5).

The Commission finds that the Stipulation filed in these matters is in the public interest and represents a reasonable disposition of all but one of the issues raised in these proceedings. We will, therefore, adopt the Stipulation in its entirety and grant Duke's motion for a waiver of the requirement to file an updated income statement in accordance with Rule 4901-7-01, Appendix A, Chapter II(A)(5)(d), O.A.C.

**B. Consideration of the Residential Rate Design**

The Commission first notes that there is no disagreement in this case that Duke's residential rates need to go up in order to cover Duke's prudently incurred costs to provide service. There is also no dispute in this case as to the amount of the increase in revenues needed to allow Duke to earn a fair rate of return on its investment. In addition to an overall increase in revenue of 3.1 percent, the settlement before us provides for the assignment of \$6 million in costs from commercial and industrial customers to the residential class. This reallocation reduces a pre-existing subsidy of residential customers by commercial and industrial customers. Thus, the parties have already agreed that residential customers, as a class, will pay an increase of 11.9 percent during the first year and 14.1 percent in the second year for the distribution portion of each residential customer's bill.

The only issue left to the Commission is the design of the rates Duke should bill residential customers to collect the revenues agreed to in the settlement. We agree with Staff that the time has come to re-think traditional natural gas rate design. Conditions in the natural gas industry have changed markedly in the past several years. The natural gas market is now characterized by volatile and sustained price increases, causing customers to increase their efforts to conserve gas. The evidence of record clearly documents the declining sales-per-customer trend over the decades. In fact, more than 15 percent of Duke's revenue deficiency in this rate case is attributable to declining customer usage, a trend which is not just continuing, but is also accelerating (Duke Ex. 11, at 3-6, 11; Staff Ex. 3, at 3-5; Tr. I at 214-216; Staff Br. at 7). Under traditional rate design, the ability of a company to recover its fixed costs of providing service hinges in large part on its actual sales, even though the company's costs remain fairly constant regardless of how much gas is sold. Thus, a negative trend in sales has a corresponding negative effect on the utility's ongoing financial stability, its ability to attract new capital to invest in its network, and its incentive to encourage energy efficiency and conservation.

The Commission, therefore, concludes that a rate design which separates or "decouples" a gas company's recovery of its cost of delivering the gas from the amount of gas customers actually consume is necessary to align the new market realities with important regulatory objectives. We believe it is in the interest of all customers that Duke has adequate and stable revenues to pay for the costs of its operations and capital and to ensure the continued provision of safe and reliable service. We further believe that there is a societal benefit to removing from rate design the current built-in incentive to increase gas sales. A rate design that prevents a company from embracing energy conservation efforts is not in the public interest. Duke's commitment to provide \$3 million for weatherization projects under the Stipulation is critical to our decision in this case (Jt. Ex. 1, at 12-14). Indeed, the Commission notes that a commitment to conservation initiatives will be an important factor in any future decision to adopt a decoupling mechanism. The Commission encourages Duke to review and further enhance its weatherization and conservation program offerings. As one part of this review, Duke should adopt the objective to make cost-effective weatherization and conservation programs available to all low-income consumers and to ramp up such programs as rapidly as reasonably practicable.

Having determined that a new decoupling rate design is appropriate, we must decide the better choice of two methods: a levelized rate design, which recovers most fixed costs up front in a flat monthly fee, or a decoupling rider, which maintains a lower customer charge and allows the company to offset lower sales through an adjustable rider.

On balance, the Commission finds the levelized rate design advocated by Duke and Staff to be preferable to a decoupling rider. Both methods would address revenue and earnings stability issues in that the fixed costs of delivering gas to the home will be recovered regardless of consumption. Each would also remove any disincentive by the company to promote conservation and energy efficiency. The levelized rate design, however, has the added benefit of producing more stable customer bills throughout all seasons because fixed costs will be recovered evenly throughout the year. In contrast, with a decoupling rider, as favored by OCC, customers would still pay a higher portion of their fixed costs during the heating season when their bills are already the highest, and the rates would be less predictable since they could be adjusted each year to make up for lower-than-expected sales.

A levelized rate design also has the advantage of being easier for customers to understand. Customers will transparently see most of the costs that do not vary with usage recovered through a flat monthly fee. Customers are accustomed to fixed monthly bills for numerous other services, such as telephone, water, trash, internet, and cable services. A decoupling rider, on the other hand, is much more complicated and harder to explain to customers. It is difficult for customers to understand why they have to pay

more through a decoupling rider if they worked hard to reduce their usage; the appearance is that the company is penalizing them for their conservation efforts.

The Commission also believes that a levelized rate design sends better price signals to consumers. The rate for delivering the gas to the home is only about 20 to 25 percent of the total bill. The largest portion of the bill, the other 75 to 80 percent, is for the gas that the customer uses. This commodity portion, the cost of the actual gas used, is the biggest driver of the amount of a customer's bill. Therefore, gas usage will still have the biggest influence on the price signals received by the customer when making gas consumption decisions, and customers will still receive the benefits of any conservation efforts in which they engage. While we acknowledge that there will be a modest increase in the payback period for customer-initiated energy conservation measures with a levelized rate design, this result is counterbalanced by the fact that the difference in the payback period is a direct result of inequities within the existing rate design that cause higher use customers to pay more of their fair share of the fixed costs than low-use customers.

The levelized rate design also promotes the regulatory objective of providing a more equitable cost allocation among customers regardless of usage. It fairly apportions the fixed costs of service, which do not change with usage, among all customers, so that everyone pays his or her fair share. Customers who use more energy for reasons beyond their control, such as abnormal weather, large number of persons sharing a household, or older housing stock, will no longer have to pay their own fair share plus someone else's fair share of the costs.

We recognize that, with this change to rate design, as with any change, there will be some customers who will be better off and some customers who will be worse off, as compared with the existing rate design. The levelized rate design will impact low usage customers more, since they have not been paying the entirety of their fixed costs under the existing rate design. Higher use customers who have been overpaying their fixed costs will actually experience a rate reduction. Average users will see only the impact of the increase agreed to by the parties; they will see no additional impact as a result of the Commission choosing the levelized rate design.

The Commission is sensitive to the impact of any rate increase on customers, especially during these tough economic times. We believe that the new levelized rate design best corrects the traditional design inequities while mitigating the impact of the new rates on residential customers by maintaining a volumetric component to the rates, by phasing in the increase over a two-year period, and by not reflecting the full extent of Duke's fixed costs in the proposed fixed charge. Still, we are concerned with the impact on low-income, low-use customers. Thus, crucial to our decision to adopt Duke and Staff's proposed rate design is the Pilot Low Income Program aimed at helping low-income, low-use customers pay their bills. This new program will provide a four-dollar, monthly

discount to cushion much of the impact on qualifying customers. To ensure that this discount is available to as many customers as possible, we direct that Duke expand this pilot program to include up to 10,000 customers, instead of the 5,000 customers specified in the Stipulation. Pursuant to the terms of the stipulation, Duke, in consultation with staff and the parties, shall establish eligibility qualifications for this program by first determining and setting the maximum low usage volume projected to result in the inclusion of 10,000 low-income customers who have previously been defined by the stipulation to be those at or below 175 percent of the poverty level. The Commission expects that Duke will promote this program such that to the fullest extent practicable the program is fully enrolled with 10,000 customers. Following the end of the pilot program, the Commission will evaluate the program for its effectiveness in addressing our concerns relative to the impact on low-use, low-income customers.

We are also concerned about the immediate impact of implementing the levelized rate design during the summer months when overall consumption is lowest. For the average customer, the new rate design will result in lower bills in the winter, but higher bills in the summer. Our concern is that the fixed charge increase may not be anticipated by customers who have budgeted for the traditional lower fixed charge during the low usage summer months. To mitigate this impact, we are directing that, from the initial bills resulting from this order through bills covering the period ending September 30, 2008, the fixed charge be set at \$15.00, consistent with Duke's original proposal. The corresponding volumetric rate for those months should also be adjusted to compensate for any revenue shortfall that this adjustment in the fixed charge will cause. Thereafter, rates will be as proposed in the Stipulation. We believe this additional phase-in of the new residential rate structure will give customers a further opportunity to adapt to this change, including the benefits of the budget billing option.

C. Rate Determinants:

1. Rate Base

The value of Duke's property used and useful in the rendition of natural gas services as of the December 31, 2007, is not less than \$649,964,874, as stipulated by the parties (Jt. Ex. 1, at Schedule A-1).

The Commission finds the rate base of \$649,964,874, as provided in the Stipulation, to be reasonable and proper based on the evidence presented in these matters. Accordingly, the Commission adopts the valuation of \$649,964,874 as the rate base for purposes of this proceeding.

2. Operating Income:

In accordance with the proposed Stipulation, the parties agree that Duke's operating revenue is \$597,573,805 and that the net operating income is \$43,274,872 for the 12 months ended December 31, 2007 (Jt. Ex. 1, at Schedule A-1). The Commission finds the operating revenue and net operating income, as provided in the Stipulation, to be reasonable and proper based on the evidence presented in these matters. The Commission will, therefore, adopt these figures for purposes of these proceedings.

3. Rate of Return and Authorized Increase:

As stipulated by the signatory parties, under its present rates, Duke's net operating income is \$43,274,872. Applying this amount to the rate base of \$649,964,874 results in a rate of return of 6.66 percent. Such a rate of return is insufficient to provide Duke with reasonable compensation for the gas service it renders to customers. Accordingly, the signatory parties have agreed that Duke should be authorized to increase its revenues by \$18,217,566, an increase of approximately 3.05 percent above current annual revenues. This would result in an overall rate of return of 8.45 percent, which the Commission finds to be reasonable.

4. Rates and Tariffs:

Duke is directed to file a proposed customer notice. Duke is further authorized to cancel and withdraw its present tariffs governing service to customers affected by these applications and to file tariffs consistent in all respects with the discussion and findings set forth herein for the Commission's consideration. The approved tariffs will be effective for all services rendered after the effective date of the tariffs.

FINDINGS OF FACT:

- (1) On June 18, 2007, Duke filed notice of its intent to file an application to increase its rates. In that notice, the company also requested a test year beginning January 1, 2007, and ending December 31, 2007, with a date certain of March 31, 2007.
- (2) By entry issued July 11, 2007, the Commission approved Duke's request to establish the test period of January 1, 2007, through December 31, 2007, for the rate increase proposal and a date certain of March 31, 2007.
- (3) Duke filed its rate increase application on July 18, 2007. On July 18, 2007, Duke also separately filed requests for approval

of an alternative rate plan, docketed at Case No. 07-590-GA-ALT, and for approval of changes in accounting methods, docketed at Case No. 07-591-GA-AAM.

- (4) By entry dated September 5, 2007, the Commission found that Duke's rate increase and alternative rate plan applications complied with the requirements of Section 4909.18, Revised Code, and Rule 4901:1-19-05, O.A.C.
- (5) The Commission accepted Duke's rate increase application for filing as of July 18, 2007.
- (6) OEG, Kroger, Interstate, the city of Cincinnati, OCC, PWC, Integrys, Direct, Stand and OP&E each requested, and was granted, intervention in these proceedings.
- (7) Objections to the staff report were filed by Duke, PWC, OEG, OP&E, OCC, and, jointly, by Integrys and Direct.
- (8) Duke published notice of its applications and the hearings and filed the required proofs of publication on February 11, February 25, and March 12, 2008.
- (9) The staff of the Commission and the financial auditor filed their respective reports of investigation on December 20, 2007.
- (10) On January 25, 2008 a prehearing conference was held, as required by Section 4909.19, Revised Code.
- (11) Two local public hearings were held in Cincinnati, Ohio, on February 25, 2008, and another local public hearing was held in Mason, Ohio, on March 11, 2008, in accordance with Section 4903.083, Revised Code. At the Cincinnati hearings a total of 27 witnesses gave testimony and four witnesses gave testimony at the Mason hearing.
- (12) On February 28, 2008, a Stipulation was filed by all the parties to this proceeding resolving all the issues presented in these matters, except rate design.
- (13) The evidentiary hearing commenced as scheduled on February 26, 2008, was continued until February 28, 2008, and reconvened on March 5, 2008. At the evidentiary hearing, Duke and staff each presented one witness in support of the

Stipulation. In regard to the one litigated issue, rate design, Duke presented four witnesses, OCC presented two witnesses and staff presented one witness.

- (14) The Stipulation is the product of serious bargaining between knowledgeable parties, benefits ratepayers, advances the public interest, and does not violate any important regulatory principles or practices.
- (15) The value of all of the company's jurisdictional property used and useful for the rendition of natural gas service to customers affected by this application, determined in accordance with Section 4909.15, Revised Code, is not less than \$649,964,874.
- (16) Under its existing rates, Duke's net operating revenue is \$43,274,872, under its existing rates. This net annual revenue of \$43,274,872, when applied to a rate base of \$649,964,874, results in a rate of return of 6.66 percent.
- (17) A rate of return of 6.66 percent is insufficient to provide Duke reasonable compensation for the service it provides.
- (18) A rate of return of 8.45 percent is fair and reasonable, under the circumstances presented in these cases, and is sufficient to provide the company just compensation and return on the value of its property used and useful in furnishing natural gas service to its customers.
- (19) A rate of return of 8.45 percent applied to the rate base of \$649,964,874 will result in allowable net operating income of \$54,922,032.
- (20) The allowable gross annual revenue to which the company is entitled for purposes of this proceeding is \$615,791,371.

#### CONCLUSIONS OF LAW:

- (1) Duke's application for a rate increase was filed pursuant to, and this Commission has jurisdiction of the application pursuant to, the provisions of Sections 4909.17, 4909.18, and 4909.19, Revised Code. The application complies with the requirements of these statutes.

- (2) Staff and Blue Ridge conducted investigations of the application, filed their respective reports, and served copies of the Staff Report on interested persons in accordance with the requirements of Section 4909.19, Revised Code.
- (3) The hearings, and notice thereof, complied with the requirements of Sections 4909.19 and 4903.083, Revised Code.
- (4) The Stipulation is the product of serious bargaining between knowledgeable parties, benefits ratepayers, advances the public interest, and does not violate any important regulatory principles or practices. The Stipulation submitted by the parties is reasonable and shall be adopted in its entirety.
- (5) Duke's existing rates and charges for gas service are insufficient to provide Duke with adequate net annual compensation and return on its property used and useful in the provision of natural gas service.
- (6) A rate of return of 8.45 percent is fair and reasonable under the circumstances of this case and is sufficient to provide Duke just compensation and return on its property used and useful in the provision of gas service to its customers.
- (7) Duke should be authorized to cancel and withdraw its present tariffs governing service to customers affected by these applications and to file tariffs consistent in all respects with the discussion and findings set forth herein.
- (8) The levelized rate design, as modified herein, is a reasonable resolution to address Duke's declining sales volumes per customer, allow Duke the opportunity to collect the revenue requirement established in this rate case proceeding and encourage Duke's participation in customer energy conservation programs.

ORDER:

It is, therefore,

ORDERED, That Duke's request for a protective order in regards to Attachment MGS-1 is granted for 18 months from the date this order is issued. It is, further,

ORDERED, That Duke's request for leave to file depositions less than three days prior to the commencement of the evidentiary hearing is granted. It is, further,

ORDERED, That the Stipulation filed on February 28, 2008 is approved in its entirety. It is, further,

ORDERED, That Duke's request for a waiver of the requirement to file an updated income statement, pursuant to Rule 4901-7-01, Appendix A, Chapter II(A)(5)(d), O.A.C., is granted. It is, further,

ORDERED, That Duke implement the levelized rate design for its residential customers as discussed in this order. It is, further,

ORDERED, That Duke's applications to increase its rates and charges for gas service, to implement an alternative rate plan and to modify accounting methods are granted to the extent provided in this opinion and order. It is, further,

ORDERED, That Duke is authorized to cancel and withdraw its present tariffs governing gas service to customers affected by these applications and to file new tariffs consistent with the discussion and findings as set forth in this order. Upon receipt of four complete copies of tariffs conforming to this opinion and order, the Commission will review and consider approval of the proposed tariffs by entry. It is, further,

ORDERED, That a copy of this order be served upon all interested persons of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber - CONCURRING OPINION  
Alan R. Schriber, Chairman

Paul A. Centolella - CONCURRING OPINION  
Paul A. Centolella

Ronda Hartman Fergus  
Ronda Hartman Fergus

Valerie A. Lemmie  
Valerie A. Lemmie

Cheryl L. Roberto  
Cheryl L. Roberto

RMB/GNS/vrm

Entered in the Journal  
MAY 28 2008

Renee J. Jenkins

Renee J. Jenkins  
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke )  
Energy Ohio, Inc. for an Increase in Rates. ) Case No. 07-589-GA-AIR

In the Matter of the Application of Duke )  
Energy Ohio, Inc. for Approval of an ) Case No. 07-590-GA-ALT  
Alternative Rate Plan for Gas Distribution )  
Service. )

In the Matter of the Application of Duke )  
Energy Ohio, Inc. for Approval to Change ) Case No. 07-591-GA-AAM  
Accounting Methods. )

CONCURRING OPINION OF  
CHAIRMAN ALAN R. SCHRIBER

The straight fixed variable (SFV) option proposed by the PUCO Staff and adopted here today appropriately speaks to two significant issues. One is the potential impact on low income customers and the other is the desired effect that the Order shall have upon conservation.

The latter consideration is paramount. As we acknowledge that there are serious energy issues, we strive to promote and adopt advanced and renewable energy sources. While these are necessary and important pursuits, I believe that conservation is the most important measure of all. Nothing is less costly or more effective than simply reducing consumption. As time goes by, I trust that we will expend many resources adopting conservation measures on "both sides of the meter".

What we are attempting to do today is to provide appropriate incentives, through a rational pricing scheme, to encourage a reduction in the consumption of natural gas. By "rational", I mean a balanced approach that penalizes neither those whom have already squeezed the last cubic foot of natural gas from their budget, nor those whom might be inclined to "over-conserve".

The proposed SFV option achieves the optimum balance because it segregates fixed costs from those costs that are within the control of the consumer. In contrast, the current pricing scheme assigns all costs- fixed and variable - to the level of usage. The inherent danger with the current system is that consumers might be led to believe that the more they cut back, the more they save. This is true to a point. The point happens to be that of diminishing returns; over conservation takes place when the fixed costs of providing the

service are no longer covered with revenue. This inevitably leads to a rate case and higher rates. In other words, if usage-sensitive rates are assigned to fixed costs, and if usage falls below a certain point, then fixed costs do not get covered. It is then time for a rate case: what has the consumer saved?

If the solution is appropriate price signals, then prices must be associated with the volume of gas alone. In contrast, under the current pricing scheme, the gas company has no incentive to encourage conservation because those same usage sensitive rates might flow through to fixed costs as consumption grows, much to the utility's advantage. Under the SFV, the fixed costs are covered and the company makes no money on the gas commodity. Therefore, the company might actually promote conservation more aggressively.

One alternative to the old conventional method is a decoupling rider mechanism. In this case, Homeowner A who has already squeezed the last cubic foot of un-needed gas from his home via conservation oriented expenditures is discriminated against. This results from the make-whole provision that accrues to the utility when Homeowner B begins to pare down consumption. In other words, as B's meter begins to spin slower, so too do the company's revenues. Homeowner A will be compelled to make up some share of the shortfall, notwithstanding the fact that Homeowner A can cut back consumption no further.

Finally, those who argue that inadequate price signals are the biggest issue need only look at the impact of budget billing. What signal is being sent when the bill each month is the same regardless of consumption? Yet, is anyone recommending the elimination of budget billing?

The other issue in play is that of the income effect of the SFV methodology. One can conclude that consumers of greater amounts of gas will see their bills fall while those at the low end will see theirs rise. This does not mean that the burden will fall disproportionately on low-income consumers. There is record testimony that suggests that low-income consumers, i.e., PIPP customers consume more on average per year than others. Clearly, PIPP customers are protected. Furthermore, while one can play freely with percentages, the nominal dollar increases due to the rate restructuring is quite small. As a precaution, however, the Commission is modifying the stipulation to provide a four dollar credit to ten thousand non-PIPP customers as opposed to five thousand provided for in the stipulation.

All told, it is important that we arrive at a decision as expeditiously as possible. I believe that over the years the lesson to be learned is that we can never know with one hundred percent certainty all of the facts and all of the possible outcomes. This is precisely why the law has provided this Commission with the ability to react to adverse outcomes should they arise. This is the ultimate consumer protection.



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Alan R. Schriber, Chairman

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke )  
Energy Ohio, Inc. for an Increase in Rates. ) Case No. 07-589-GA-AIR

In the Matter of the Application of Duke )  
Energy Ohio, Inc. for Approval of an ) Case No. 07-590-GA-ALT  
Alternative Rate Plan for Gas Distribution )  
Service. )

In the Matter of the Application of Duke )  
Energy Ohio, Inc. for Approval to Change ) Case No. 07-591-GA-AAM  
Accounting Methods. )

OPINION OF COMMISSIONER PAUL A. CENTOLELLA  
CONCURRING IN PART AND DISSENTING IN PART

The majority concludes that the current residential rate design has a negative impact on the ability of Duke Energy Ohio (hereafter "Duke", "the Company", or "the utility") to maintain financial stability, attract new capital, and on its incentive to encourage energy efficiency and conservation. And, the majority determines that it is necessary to decouple the utility's recovery of fixed costs from its volumetric sales. I concur with the majority in these conclusions and on issues other than residential rate design. I dissent from the majority regarding how to transition toward a residential rate design which decouples the recovery of fixed costs from volumetric rates.

Having determined that a new decoupling rate design is appropriate, the Commission must decide two questions. First, we must decide the better choice between two decoupling methods: a straight fixed variable (SFV) rate design, which recovers fixed costs in a flat monthly customer charge, or a decoupling adjustment, which allows the company to recover the same fixed cost revenue requirement with a lower customer charge by adjusting subsequent year rates to true up revenues received from volumetric charges. Second, in the event the Commission finds the SFV rate design preferable, the Commission should consider how to transition to a rate design which is significantly different from the rate structures that have formed the basis of consumer expectations.

Over the long-term, moving in the direction of a SFV rate design is preferable to keeping a modest customer charge and relying entirely on a decoupling adjustment. Both methods will address revenue and earnings stability issues in that the fixed costs of delivering gas to the home will be recovered irrespective of consumption. When fully implemented, each will remove any disincentive by the Company to promote conservation

and energy efficiency. And, both methods can be implemented in a straight forward manner and, if appropriately designed, easily explained to consumers as a deliberate or more gradual transition toward recovering fixed costs through a customer charge. However, as the ultimate objective, significant movement toward a fixed variable rate design is consistent with developing a more efficient rate structure. Efficient rate design seeks to align price elastic rate elements more closely to marginal costs, while recovering a larger portion of any residual revenue requirements through comparatively price inelastic charges. Experience shows that there is a significant price response to increases in volumetric charges, as evidenced by the recent steep reductions in average per customer consumption as gas costs increased. Given that customer charges are paid to provide access to gas service, it is reasonable to expect comparatively less price response with respect to increases in the customer charge. Over the long-term, this supports significant movement toward a SFV rate design in which a larger portion of the company's fixed cost revenue requirements is recovered through the customer charge.

Additionally, the SFV rate design will reduce the month-to-month variation in customer bills as fixed costs will be recovered evenly throughout the year, making it easier for customers to deal with high winter heating bills. While decoupling adjustments are not difficult to implement, a SFV rate design, when fully implemented, will remove the need for any additional administrative proceedings to review decoupling adjustments.

Consumers have made investment decisions based on expectations regarding natural gas pricing and fairness compels us to move at a measured pace when making fundamental changes in rate design. For this reason, the Commission should carefully consider the appropriate transition path.

On the question of how to transition to a fixed charge rate design, Duke and the Staff have proposed a modified SFV rate design in which the customer charge would be set at \$20.25 per bill in year one and \$25.33 per bill in year two. Fully implementing a SFV rate design would require a customer charge in excess of \$30 per residential consumer bill. Duke and the Staff also proposed and the Commission has expanded a "Pilot Low Income Program" that would provide some low income consumers a discount to cushion the impact of the change in rate design.

In my view, the pace of the transition in this case is more rapid than should be selected given the consumer expectations created by long-standing rate design practices and the recovery of fixed costs should be fully decoupled from sales volumes during the transition.

The pace of the transition proposed in the stipulation could send the wrong message to consumers with respect to energy conservation. Consumers who have made efficiency investments and reduced their consumption could see a significant increase in

the regulated portion of their bills, while their neighbors who have implemented no energy efficiency measures and are high use customers will see the regulated portion of their gas bills decline by similar amounts. Given rising gas commodity costs, increasing dependence on foreign sources of gas supply, and the likely adoption of limits on greenhouse gas emissions from the burning of fossil fuels, encouraging the adoption of cost effective energy efficiency measures should be among our highest priorities. A more gradual transition to a SFV rate design would minimize near term bill increases for low use consumers recognizing the investments that many of these consumers have made to reduce their gas usage, allow consumers to capture a greater portion of the expected benefits of such investments, and avoid the appearance that the Commission is rewarding high use by lowering the gas bills of high use customers.

Second, during the period covered by this Order, the modified SFV approach will not fully decouple recovery of the Company's fixed costs from sales volumes. A modest three percent reduction in sales during the first year would represent a loss to Duke of the opportunity to recover more than a million dollars of its fixed costs.

To address these concerns, I would reach the following result.

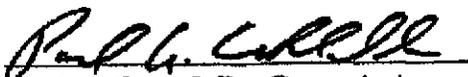
First, the recommendation of the Staff and Company should be modified to reduce the year one customer charge for all residential consumers to \$16.25 per residential bill and establish the base level of the year two customer charge for all residential consumers at \$21.33.

Second, consistent with the majority opinion, the Company should review and further enhance its weatherization and conservation program offerings. As one part of this review, Duke should adopt the objective of making cost-effective weatherization and conservation programs available to all low income consumers and to ramp up programs to facilitate implementation of all such measures as rapidly as reasonably practicable. Low income consumers often face difficult choices between paying their energy bills and meeting other essential needs, yet may be among the last to be able to take advantage of cost-effective energy efficiency investments. Consumers who struggle to make ends meet often find it difficult to pay for the initial cost of efficiency measures. And, many low income consumers live in rental housing with landlords who have little incentive to install efficiency measures that would reduce their tenants' utility bills.

Third, in conjunction with filing a proposal for approval of significantly expanded energy efficiency programs and recovery of the costs of such programs, I would invite the Company to propose an interim decoupling adjustment. This adjustment should be structured to adjust the second and subsequent year base customer charge of \$21.33 for the difference, on a per customer bill basis, between the portion of the Company's fixed cost

residential revenue requirement that is allocated to volumetric rates and the revenues recovered for such fixed costs through volumetric rates at weather normalized sales levels.

To meet the energy challenges of the 21<sup>st</sup> Century, Ohio will need to greatly improve the efficiency with which we use all forms of energy including natural gas. Efficient price signals will be an important, but not sufficient, element in this transformation. Our increasing knowledge of behavioral economics and experience with utility energy efficiency programs has shown that utility efficiency programs can produce significant net economic benefits. The Commission needs to encourage the cost-effective expansion of such programs. And, we should not wait through the completion of a multi-year transition to a SFV rate design before doing so in full measure.



Paul A. Centolella, Commissioner

## **4903.09 Written opinions filed by commission in all contested cases.**

In all contested cases heard by the public utilities commission, a complete record of all of the proceedings shall be made, including a transcript of all testimony and of all exhibits, and the commission shall file, with the records of such cases, findings of fact and written opinions setting forth the reasons prompting the decisions arrived at, based upon said findings of fact.

Effective Date: 10-26-1953

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11/24/2008

## **4905.22 Service and facilities required - unreasonable charge prohibited.**

Every public utility shall furnish necessary and adequate service and facilities, and every public utility shall furnish and provide with respect to its business such instrumentalities and facilities, as are adequate and in all respects just and reasonable. All charges made or demanded for any service rendered, or to be rendered, shall be just, reasonable, and not more than the charges allowed by law or by order of the public utilities commission, and no unjust or unreasonable charge shall be made or demanded for, or in connection with, any service, or in excess of that allowed by law or by order of the commission.

Effective Date: 10-01-1953

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## **4909.15 Fixation of reasonable rate.**

(A) The public utilities commission, when fixing and determining just and reasonable rates, fares, tolls, rentals, and charges, shall determine:

(1) The valuation as of the date certain of the property of the public utility used and useful in rendering the public utility service for which rates are to be fixed and determined. The valuation so determined shall be the total value as set forth in division (J) of section 4909.05 of the Revised Code, and a reasonable allowance for materials and supplies and cash working capital, as determined by the commission.

The commission, in its discretion, may include in the valuation a reasonable allowance for construction work in progress but, in no event, may such an allowance be made by the commission until it has determined that the particular construction project is at least seventy-five per cent complete.

In determining the percentage completion of a particular construction project, the commission shall consider, among other relevant criteria, the per cent of time elapsed in construction; the per cent of construction funds, excluding allowance for funds used during construction, expended, or obligated to such construction funds budgeted where all such funds are adjusted to reflect current purchasing power; and any physical inspection performed by or on behalf of any party, including the commission's staff.

A reasonable allowance for construction work in progress shall not exceed ten per cent of the total valuation as stated in this division, not including such allowance for construction work in progress.

Where the commission permits an allowance for construction work in progress, the dollar value of the project or portion thereof included in the valuation as construction work in progress shall not be included in the valuation as plant in service until such time as the total revenue effect of the construction work in progress allowance is offset by the total revenue effect of the plant in service exclusion. Carrying charges calculated in a manner similar to allowance for funds used during construction shall accrue on that portion of the project in service but not reflected in rates as plant in service, and such accrued carrying charges shall be included in the valuation of the property at the conclusion of the offset period for purposes of division (J) of section 4909.05 of the Revised Code.

From and after April 10, 1985, no allowance for construction work in progress as it relates to a particular construction project shall be reflected in rates for a period exceeding forty-eight consecutive months commencing on the date the initial rates reflecting such allowance become effective, except as otherwise provided in this division.

The applicable maximum period in rates for an allowance for construction work in progress as it relates to a particular construction project shall be tolled if, and to the extent, a delay in the in-service date of the project is caused by the action or inaction of any federal, state, county, or municipal agency having jurisdiction, where such action or inaction relates to a change in a rule, standard, or approval of such agency, and where such action or inaction is not the result of the failure of the utility to reasonably endeavor to comply with any rule, standard, or approval prior to such change.

In the event that such period expires before the project goes into service, the commission shall

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exclude, from the date of expiration, the allowance for the project as construction work in progress from rates, except that the commission may extend the expiration date up to twelve months for good cause shown.

In the event that a utility has permanently canceled, abandoned, or terminated construction of a project for which it was previously permitted a construction work in progress allowance, the commission immediately shall exclude the allowance for the project from the valuation.

In the event that a construction work in progress project previously included in the valuation is removed from the valuation pursuant to this division, any revenues collected by the utility from its customers after April 10, 1985, that resulted from such prior inclusion shall be offset against future revenues over the same period of time as the project was included in the valuation as construction work in progress. The total revenue effect of such offset shall not exceed the total revenues previously collected.

In no event shall the total revenue effect of any offset or offsets provided under division (A)(1) of this section exceed the total revenue effect of any construction work in progress allowance.

(2) A fair and reasonable rate of return to the utility on the valuation as determined in division (A)(1) of this section;

(3) The dollar annual return to which the utility is entitled by applying the fair and reasonable rate of return as determined under division (A)(2) of this section to the valuation of the utility determined under division (A)(1) of this section;

(4) The cost to the utility of rendering the public utility service for the test period less the total of any interest on cash or credit refunds paid, pursuant to section 4909.42 of the Revised Code, by the utility during the test period.

(a) Federal, state, and local taxes imposed on or measured by net income may, in the discretion of the commission, be computed by the normalization method of accounting, provided the utility maintains accounting reserves that reflect differences between taxes actually payable and taxes on a normalized basis, provided that no determination as to the treatment in the rate-making process of such taxes shall be made that will result in loss of any tax depreciation or other tax benefit to which the utility would otherwise be entitled, and further provided that such tax benefit as redounds to the utility as a result of such a computation may not be retained by the company, used to fund any dividend or distribution, or utilized for any purpose other than the defrayal of the operating expenses of the utility and the defrayal of the expenses of the utility in connection with construction work.

(b) The amount of any tax credits granted to an electric light company under section 5727.391 of the Revised Code for Ohio coal burned prior to January 1, 2000, shall not be retained by the company, used to fund any dividend or distribution, or utilized for any purposes other than the defrayal of the allowable operating expenses of the company and the defrayal of the allowable expenses of the company in connection with the installation, acquisition, construction, or use of a compliance facility. The amount of the tax credits granted to an electric light company under that section for Ohio coal burned prior to January 1, 2000, shall be returned to its customers within three years after initially claiming the credit through an offset to the company's rates or fuel component, as determined by the

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commission, as set forth in schedules filed by the company under section 4905.30 of the Revised Code. As used in division (A)(4)(c) of this section, "compliance facility" has the same meaning as in section 5727.391 of the Revised Code.

(B) The commission shall compute the gross annual revenues to which the utility is entitled by adding the dollar amount of return under division (A)(3) of this section to the cost of rendering the public utility service for the test period under division (A)(4) of this section.

(C) The test period, unless otherwise ordered by the commission, shall be the twelve-month period beginning six months prior to the date the application is filed and ending six months subsequent to that date. In no event shall the test period end more than nine months subsequent to the date the application is filed. The revenues and expenses of the utility shall be determined during the test period. The date certain shall be not later than the date of filing.

(D) When the commission is of the opinion, after hearing and after making the determinations under divisions (A) and (B) of this section, that any rate, fare, charge, toll, rental, schedule, classification, or service, or any joint rate, fare, charge, toll, rental, schedule, classification, or service rendered, charged, demanded, exacted, or proposed to be rendered, charged, demanded, or exacted, is, or will be, unjust, unreasonable, unjustly discriminatory, unjustly preferential, or in violation of law, that the service is, or will be, inadequate, or that the maximum rates, charges, tolls, or rentals chargeable by any such public utility are insufficient to yield reasonable compensation for the service rendered, and are unjust and unreasonable, the commission shall:

(1) With due regard among other things to the value of all property of the public utility actually used and useful for the convenience of the public as determined under division (A)(1) of this section, excluding from such value the value of any franchise or right to own, operate, or enjoy the same in excess of the amount, exclusive of any tax or annual charge, actually paid to any political subdivision of the state or county, as the consideration for the grant of such franchise or right, and excluding any value added to such property by reason of a monopoly or merger, with due regard in determining the dollar annual return under division (A)(3) of this section to the necessity of making reservation out of the income for surplus, depreciation, and contingencies, and;

(2) With due regard to all such other matters as are proper, according to the facts in each case,

(a) Including a fair and reasonable rate of return determined by the commission with reference to a cost of debt equal to the actual embedded cost of debt of such public utility,

(b) But not including the portion of any periodic rental or use payments representing that cost of property that is included in the valuation report under divisions (F) and (G) of section 4909.05 of the Revised Code, fix and determine the just and reasonable rate, fare, charge, toll, rental, or service to be rendered, charged, demanded, exacted, or collected for the performance or rendition of the service that will provide the public utility the allowable gross annual revenues under division (B) of this section, and order such just and reasonable rate, fare, charge, toll, rental, or service to be substituted for the existing one. After such determination and order no change in the rate, fare, toll, charge, rental, schedule, classification, or service shall be made, rendered, charged, demanded, exacted, or changed by such public utility without the order of the commission, and any other rate, fare, toll, charge, rental, classification, or service is prohibited.

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(E) Upon application of any person or any public utility, and after notice to the parties in interest and opportunity to be heard as provided in Chapters 4901., 4903., 4905., 4907., 4909., 4921., and 4923. of the Revised Code for other hearings, has been given, the commission may rescind, alter, or amend an order fixing any rate, fare, toll, charge, rental, classification, or service, or any other order made by the commission. Certified copies of such orders shall be served and take effect as provided for original orders.

Effective Date: 11-24-1999

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11/24/2008

## **4909.18 Application to establish or change rate.**

Any public utility desiring to establish any rate, joint rate, toll, classification, charge, or rental, or to modify, amend, change, increase, or reduce any existing rate, joint rate, toll, classification, charge, or rental, or any regulation or practice affecting the same, shall file a written application with the public utilities commission. Except for actions under section 4909.16 of the Revised Code, no public utility may issue the notice of intent to file an application pursuant to division (B) of section 4909.43 of the Revised Code to increase any existing rate, joint rate, toll, classification, charge, or rental, until a final order under this section has been issued by the commission on any pending prior application to increase the same rate, joint rate, toll, classification, charge, or rental or until two hundred seventy-five days after filing such application, whichever is sooner. Such application shall be verified by the president or a vice-president and the secretary or treasurer of the applicant. Such application shall contain a schedule of the existing rate, joint rate, toll, classification, charge, or rental, or regulation or practice affecting the same, a schedule of the modification amendment, change, increase, or reduction sought to be established, and a statement of the facts and grounds upon which such application is based. If such application proposes a new service or the use of new equipment, or proposes the establishment or amendment of a regulation, the application shall fully describe the new service or equipment, or the regulation proposed to be established or amended, and shall explain how the proposed service or equipment differs from services or equipment presently offered or in use, or how the regulation proposed to be established or amended differs from regulations presently in effect. The application shall provide such additional information as the commission may require in its discretion. If the commission determines that such application is not for an increase in any rate, joint rate, toll, classification, charge, or rental, the commission may permit the filing of the schedule proposed in the application and fix the time when such schedule shall take effect. If it appears to the commission that the proposals in the application may be unjust or unreasonable, the commission shall set the matter for hearing and shall give notice of such hearing by sending written notice of the date set for the hearing to the public utility and publishing notice of the hearing one time in a newspaper of general circulation in each county in the service area affected by the application. At such hearing, the burden of proof to show that the proposals in the application are just and reasonable shall be upon the public utility. After such hearing, the commission shall, where practicable, issue an appropriate order within six months from the date the application was filed.

If the commission determines that said application is for an increase in any rate, joint rate, toll, classification, charge, or rental there shall also, unless otherwise ordered by the commission, be filed with the application in duplicate the following exhibits:

(A) A report of its property used and useful in rendering the service referred to in such application, as provided in section 4909.05 of the Revised Code;

(B) A complete operating statement of its last fiscal year, showing in detail all its receipts, revenues, and incomes from all sources, all of its operating costs and other expenditures, and any analysis such public utility deems applicable to the matter referred to in said application;

(C) A statement of the income and expense anticipated under the application filed;

(D) A statement of financial condition summarizing assets, liabilities, and net worth;

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(E) A proposed notice for newspaper publication fully disclosing the substance of the application. The notice shall prominently state that any person, firm, corporation, or association may file, pursuant to section 4909.19 of the Revised Code, an objection to such increase which may allege that such application contains proposals that are unjust and discriminatory or unreasonable. The notice shall further include the average percentage increase in rate that a representative industrial, commercial, and residential customer will bear should the increase be granted in full;

(F) Such other information as the commission may require in its discretion.

Effective Date: 01-11-1983

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## **4909.19 Publication - investigation.**

Upon the filing of any application for increase provided for by section 4909.18 of the Revised Code the public utility shall forthwith publish the substance and prayer of such application, in a form approved by the public utilities commission, once a week for three consecutive weeks in a newspaper published and in general circulation throughout the territory in which such public utility operates and affected by the matters referred to in said application, and the commission shall at once cause an investigation to be made of the facts set forth in said application and the exhibits attached thereto, and of the matters connected therewith. Within a reasonable time as determined by the commission after the filing of such application, a written report shall be made and filed with the commission, a copy of which shall be sent by certified mail to the applicant, the mayor of any municipal corporation affected by the application, and to such other persons as the commission deems interested. If no objection to such report is made by any party interested within thirty days after such filing and the mailing of copies thereof, the commission shall fix a date within ten days for the final hearing upon said application, giving notice thereof to all parties interested. At such hearing the commission shall consider the matters set forth in said application and make such order respecting the prayer thereof as to it seems just and reasonable.

If objections are filed with the commission, the commission shall cause a pre-hearing conference to be held between all parties, intervenors, and the commission staff in all cases involving more than one hundred thousand customers.

If objections are filed with the commission within thirty days after the filing of such report, the application shall be promptly set down for hearing of testimony before the commission or be forthwith referred to an attorney examiner designated by the commission to take all the testimony with respect to the application and objections which may be offered by any interested party. The commission shall also fix the time and place to take testimony giving ten days' written notice of such time and place to all parties. The taking of testimony shall commence on the date fixed in said notice and shall continue from day to day until completed. The attorney examiner may, upon good cause shown, grant continuances for not more than three days, excluding Saturdays, Sundays, and holidays. The commission may grant continuances for a longer period than three days upon its order for good cause shown. At any hearing involving rates or charges sought to be increased, the burden of proof to show that the increased rates or charges are just and reasonable shall be on the public utility.

When the taking of testimony is completed, a full and complete record of such testimony noting all objections made and exceptions taken by any party or counsel, shall be made, signed by the attorney examiner, and filed with the commission. Prior to the formal consideration of the application by the commission and the rendition of any order respecting the prayer of the application, a quorum of the commission shall consider the recommended opinion and order of the attorney examiner, in an open, formal, public proceeding in which an overview and explanation is presented orally. Thereafter, the commission shall make such order respecting the prayer of such application as seems just and reasonable to it.

In all proceedings before the commission in which the taking of testimony is required, except when heard by the commission, attorney examiners shall be assigned by the commission to take such testimony and fix the time and place therefor, and such testimony shall be taken in the manner prescribed in this section. All testimony shall be under oath or affirmation and taken down and

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transcribed by a reporter and made a part of the record in the case. The commission may hear the testimony or any part thereof in any case without having the same referred to an attorney examiner and may take additional testimony. Testimony shall be taken and a record made in accordance with such general rules as the commission prescribes and subject to such special instructions in any proceedings as it, by order, directs.

Effective Date: 01-11-1983

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## **4929.02 Policy of state as to natural gas services and goods.**

(A) It is the policy of this state to, throughout this state:

- (1) Promote the availability to consumers of adequate, reliable, and reasonably priced natural gas services and goods;
- (2) Promote the availability of unbundled and comparable natural gas services and goods that provide wholesale and retail consumers with the supplier, price, terms, conditions, and quality options they elect to meet their respective needs;
- (3) Promote diversity of natural gas supplies and suppliers, by giving consumers effective choices over the selection of those supplies and suppliers;
- (4) Encourage innovation and market access for cost-effective supply- and demand-side natural gas services and goods;
- (5) Encourage cost-effective and efficient access to information regarding the operation of the distribution systems of natural gas companies in order to promote effective customer choice of natural gas services and goods;
- (6) Recognize the continuing emergence of competitive natural gas markets through the development and implementation of flexible regulatory treatment;
- (7) Promote an expeditious transition to the provision of natural gas services and goods in a manner that achieves effective competition and transactions between willing buyers and willing sellers to reduce or eliminate the need for regulation of natural gas services and goods under Chapters 4905. and 4909. of the Revised Code;
- (8) Promote effective competition in the provision of natural gas services and goods by avoiding subsidies flowing to or from regulated natural gas services and goods;
- (9) Ensure that the risks and rewards of a natural gas company's offering of nonjurisdictional and exempt services and goods do not affect the rates, prices, terms, or conditions of nonexempt, regulated services and goods of a natural gas company and do not affect the financial capability of a natural gas company to comply with the policy of this state specified in this section;
- (10) Facilitate the state's competitiveness in the global economy;
- (11) Facilitate additional choices for the supply of natural gas for residential consumers, including aggregation;
- (12) Promote an alignment of natural gas company interests with consumer interest in energy efficiency and energy conservation.

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(B) The public utilities commission and the office of the consumers' counsel shall follow the policy specified in this section in exercising their respective authorities relative to sections 4929.03 to 4929.30 of the Revised Code.

(C) Nothing in Chapter 4929. of the Revised Code shall be construed to alter the public utilities commission's construction or application of division (A)(6) of section 4905.03 of the Revised Code.

Effective Date: 06-26-2001; 2008 SB221 07-31-2008

**FILE**

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**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of Duke )  
Energy Ohio, Inc. for an Increase in Gas ) Case No. 07-589-GA-AIR  
Rates. )

In the Matter of the Application of Duke )  
Energy Ohio, Inc. for Approval of an ) Case No. 07-590-GA-ALT  
Alternative Rate Plan for its Gas )  
Distribution Service. )

In the Matter of the Application of Duke )  
Energy Ohio, Inc. for Approval to ) Case No. 07-591-GA-AAM  
Change Accounting Methods. )

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**APPLICATION FOR REHEARING OF  
OHIO PARTNERS FOR AFFORDABLE ENERGY  
AND  
MEMORANDUM IN SUPPORT**

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June 27, 2008

**Counsel for Ohio Partners for  
Affordable Energy**

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**BEFORE  
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In the Matter of the Application of Duke )  
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Change Accounting Methods. )

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**APPLICATION FOR REHEARING OF  
OHIO PARTNERS FOR AFFORDABLE ENERGY**

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Pursuant to R.C. §4903.10 and Ohio Adm. Code 4901-1-35, Ohio Partners for Affordable Energy ("OPAE") hereby applies to the Public Utilities Commission of Ohio ("Commission") for rehearing of the Commission's May 28, 2008 Opinion and Order in the above-captioned case. The Commission's May 28, 2008 Opinion and Order is unreasonable and unlawful in the following respects:

- A. The Commission acted unreasonably and unlawfully when it authorized an unprecedented, radical rate design that violates the regulatory principles of gradualism and rate continuity, and does not produce just and reasonable rates in violation of R.C. §§ 4905.22 and 4909.18.
- B. The Commission acted unreasonably and unlawfully when it approved a residential rate design that discounts the value of

and creates a disincentive for customer conservation efforts in violation of state policy, R.C. § 4929.02.

- C. The Commission acted unreasonably and unlawfully when it approved an untested residential rate design not supported the weight of the evidence.

The arguments supporting OP&E's Application for Rehearing are set forth in the attached Memorandum in Support pursuant to Ohio Adm. Code 4901-1-35(A).

Respectfully submitted,



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**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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Distribution Service. )

In the Matter of the Application of Duke )  
Energy Ohio, Inc. for Approval to ) Case No. 07-591-GA-AAM  
Change Accounting Methods. )

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**MEMORANDUM IN SUPPORT**

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**I. Introduction**

The Opinion and Order issued in this case approves a radical departure from rate design conventions. Adoption of the modified straight-fixed variable rate design ("SFV") will raise bills for well over half of Duke Energy Ohio's ("Duke" or "the Company") residential customers. The SFV fails to balance the interests of customers with those of the utility. Instead the SFV is a one-way street; it virtually guarantees the Company will recover the revenue requirement while raising bills excessively for over half of Duke's residential customers and subsidizing residential customers who use large amounts of natural gas.

Ohio Partners for Affordable Energy ("OPAE") respectfully requests that the Commission reverse its ruling approving a fundamental change in utility rate

design, which forsakes the regulatory principle of gradualism to the detriment of energy efficiency and just and reasonable rates.

## **II. Argument**

- A. The Commission acted unreasonably and unlawfully when it authorized an unprecedented, radical rate design that violates the regulatory principles of gradualism and rate continuity, and does not produce just and reasonable rates in violation of R.C. §§ 4905.22 and 4909.18.**

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." R.C. §§ 4905.22 and 4909.18 require that rates be just and reasonable. The concept of 'just and reasonable' is a two edged sword; the rates and the rate design must provide the utility with an adequate opportunity to earn the authorized revenue requirement, balanced with the need of customers for rates that are fair, do not discriminate, and discourage wasteful use of service.<sup>1</sup> Long-standing regulatory principles also dictate gradualism and continuity in rate design in order that one group of customers does not bear the burden of radical changes to their responsibility to provide for the utility's revenue requirement.

The SFV rate approved by the Commission starts at \$15 per month for the period of June through September, 2008, then increases to \$20.25 through the following May, after which it rises to \$25.33. The Commission concludes that creating this stepping stone to a 322 percent increase over one year in the customer charge satisfies the regulatory principles of gradualism and rate

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<sup>1</sup> Bonbright, James C. *Principles of Public Utility Rates*, [http://www.terry.uga.edu/bonbright/pdfs/principles\\_of\\_public\\_utility\\_rates.pdf](http://www.terry.uga.edu/bonbright/pdfs/principles_of_public_utility_rates.pdf)

continuity. Even with this approach, the Commission fails to follow precedent.<sup>2</sup>

More like the tip of a hat or a wink and a nod.

With regard to rate design, the Commission 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." Opinion and Order, *In the Matter of the Application of The Cincinnati Gas & Electric Company for an Increase in Its Rates for Gas Service to All*, Case No. 95-656-GA-AIR, December 12, 1996 at 29.

The three step increases violate the principle of gradualism and rate continuity at each step. The increase to \$15 is a 150% increase. The subsequent increase to \$20.25 is roughly a 233% increase. The final step is approximately a 320% increase when compared to current rates. In prior cases, following the relevant precedents, customer charge increases have been modest – in the \$1 to \$2 range. Clearly, the customer charge increases in this case are far beyond what this Commission has previously sanctioned.<sup>3</sup>

The proposed rate is also inconsistent with the cost of service study accepted by the Commission which underlies the rates established in this case. The cost of service study is based on a peak and average method. The average

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<sup>2</sup> Staff argues that "[s]imply because something has been done the same way for 30 years is not a valid reason to shy away from needed change." *Post-Hearing Brief Submitted on Behalf of the Staff of the Public Utilities Commission of Ohio* at 11 ("Staff Post-Hearing Brief"). There have been numerous cases over the 30 years supporting the principles of gradualism and rate continuity. Legal precedent should not be ignored.

<sup>3</sup> OCC Exhibit 18 at WG-2

usage component is arguably consistent with a high fixed charge. However, the peak component is based on volume of use. These combined approaches are used to allocate cost responsibility to residential customers.

If costs to serve residential customers are truly fixed, as the Staff and the Company relentlessly contends, then consideration of peak usage would not be appropriate for cost allocation purposes. However, peak usage is considered and customers using more than the system average are contributing excessively to peak usage. As a result, these larger users are causing the allocation of additional costs to the residential class. The SFV, however, insulates these customers from responsibility for their profligate use. While the Company and the Staff have argued that under a volumetric rate large users subsidize small users, with SFV the pendulum actually swings the other way; small users now subsidize large users, the very customers responsible for higher cost allocations to the residential class. By comparison, if one accepts the Company and Staff argument, the so-called subsidies provided by large users to small users are not subsidies, they are based on cost causation. Yet large residential users cause greater system costs to be allocated to the residential class. The SFV exacerbates this situation because large users are now insulated from having to pay for the costs they cause. This violates the fundamental regulatory principles of fairness and cost causation.

The new rate design is clearly not acceptable to the public. Staff acknowledges that it failed to investigate customer views on the SFV versus

traditional rate design. Tr. I at 188; Tr. I at 210. In fact, the Staff acknowledges that it has not reviewed the impact of the rate design in any of the five utility service territories where it has been adopted. Attendees at the public hearings based their comments on the notice approved by the Commission and published by the Company. The notice mentioned only 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.<sup>4</sup> Had customers been noticed of the higher increase approved by the Commission, the howls from the little people who depend on natural gas to heat their homes would have been much louder. This rate design is unacceptable to residential customers.

The proposed rates are clearly not stable. The break-even point – the point where the SFV is equal to a conventional rate design – is somewhere above 10 Mcf usage per year. The average Duke customer uses 8 Mcf. As a result, the majority will pay a higher total bill because of the excessive increase in the customer charge.<sup>5</sup> For those who control their usage, live in a small residence, or invest in conservation, the bill increases are highest. The only stability provided by this rate design is in utility earnings.

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<sup>4</sup> February 25, 2008, 4:00 p.m. Local Public Hearing Tr. at 11, 14, 37, 39, 42, 48, 55, 62; February 25, 2008, 6:30 p.m. Local Public Hearing Tr. at 17, 20; March 11, 2008, Local Public Hearing Tr. at 16.

<sup>5</sup> There appears to be no data in the record indicating the actual number of customers who fall under the break even point and exactly what that point is, as the data provided by two Company witnesses is not in agreement. Tr. I at 243 - 244.

An additional regulatory principle is to discourage wasteful use of service. This is increasingly important given the massive price increases for natural gas and future declines in recoverable reserves. The SFV, 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 the price signal to use more. Encouraging use is a violation of regulatory principles.

The concept of a regulatory compact has been fundamental from the outset of public utilities regulation. Under the regulatory compact, the monopoly franchise holder is responsible for making the required investments necessary to provide essential utility service to customers at just and reasonable prices.<sup>6</sup> In return, the customers are required to compensate the utilities, through rates, for the cost of providing utility service. Government entities, particularly state public utilities commissions, regulate the utilities to achieve what the free market cannot: the provision of adequate service at reasonable prices.<sup>7</sup> As a part of this responsibility, state regulators are responsible for reviewing the prudence of expenditures and overseeing the design of rates which collect the revenues to pay the approved expenditures.<sup>8</sup>

The principles which underpin the regulatory compact require a balancing of the interests of customers and the utility. *Federal Power Commission v. Hope*

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<sup>6</sup> Bonbright, James C., *Principles of Public Utility Rates*, New York: Public University Press (1961), Supplement at 51.

<sup>7</sup> R.C. §4909.15.

<sup>8</sup> *Id.*

*Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L. Ed. 333 (1944). Under the SFV, the utility is guaranteed 80% of the revenue requirement. Residential customers are sent a price signal encouraging greater use. Increased residential consumption will cause additional system costs to be foisted on residential customers as a class leading to even higher rates in the future. The SFV rates are far from stable when compared to current rates; the increase is not gradual nor provides continuity; and, the rate design violates the principles of cost causation. One can only conclude that SFV rates are not just and reasonable under the requirements of Ohio law.

- B. The Commission acted unreasonably and unlawfully when it approved a residential rate design that discounts the value of and discourages customer conservation efforts in violation of state policy, R.C. § 4929.02.

State policy 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 state policy to "[e]ncourage innovation and market access for cost-effective supply- and demand-side natural gas services and goods." The PUCO is required to follow this policy. "The public utilities commission *shall* follow the policy specified in this section...." [Emphasis added.] R.C. § 4929.02(B). The SFV approved by the Commission is contrary to state policy.

The SFV fails to encourage demand-side natural gas services in several ways. First, it eliminates the price signal sent to customers as usage increases. Under traditional rates using a low customer charge, the more a customer uses, generally the more he or she pays. This is a traditional 'price signal.'

The Company and Staff argue that an extremely high fixed charge sends the right price signal since the costs of serving each customer are fixed. As noted above, the level of cost allocated to a customer class is dependent on the usage by that class. A rate design that fails to send a price signal to reign in use by a certain customer class will result in higher cost allocations to that class in the future. Proper price signals, those that discourage use, benefit the class as a whole as well as individual users.

Customers who work hard to conserve either through 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 weight of the customer charge on a per Mcf basis. The more one saves, the higher the cost per Mcf.

The SFV rate design discounts the effect of energy efficiency investments and extends the payback for these investments. Each Mcf saved is worth less because of the increased customer charge. While the effect can be negligible for minor investments which cost little and result in modest savings, investments in comprehensive energy improvements will suffer. For example, if a customer invests \$5000 for insulation, air sealing and a new furnace, reducing natural gas usage by 30%, the payback – the time it takes to recover the cost of the

investment – is 17.5 years.<sup>9</sup> The higher customer charge extends that payback to 22.2 years.<sup>10</sup>

Taken from a different perspective, if a customer relies on an audit to determine what is cost effective, the savings will be reduced by 15-20% because the fixed customer charge discounts the investments. This means that fewer investments will be made because the payback period is too long.<sup>11</sup> 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. 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.

C. The Commission acted unreasonably and unlawfully when it approved an untested, radical residential rate design not supported by the weight of the evidence.

R.C. §4909.19 places the burden of proof on the applicant to establish the need for an increase in rates and, in this case, a radical redesign of the rate structure. Even though the Company's effort is aided and abetted by the Staff, the evidence fails to satisfy that burden. As the Supreme Court has noted, a

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<sup>9</sup> The example assumes a total cost of \$10/Mcf. A low customer charge is assumed to be 5% of the bill, while a high customer charge equals 20% of the bill. Given the lack of hard data in the record, this is an estimate based on the information that is on the record.

<sup>10</sup> Cost effectiveness is generally determined over the life of the measure which is assumed to be 20 years for a furnace and insulation. Financing requires payback over the life of the measure. Thus, the package cannot be financed under current standards if an SFV rate design as adopted in this case is used. This will also affect the outcome of cost-effectiveness tests traditionally applied to demand side management ("DSM") programs, making them appear less cost-effective. See OCC Exhibit 16, Ohio Home Weatherization Assistance Impact Evaluation (July 8, 2006).

<sup>11</sup> *Id.*

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 fails to meet its burden of proof in three distinct areas. The first is Duke's argument that reduction in customer use is the primary reason for its failure to earn an adequate rate of return, so that a radical new rate design is justified. The Opinion and Order notes that just over "15 percent of Duke's revenue deficiency in this rate case is attributable to declining customer usage...." [Citations omitted.] Opinion and Order at 17. Declining customer usage is not the primary reason for the rate increase; rather, modest declines in use have had a negligible impact on revenues, a decline on average of 3% per year. Moreover, what the Commission ignores is that residential use increased in 3 of the past 5 years over the level of use in the test year in the *previous* rate case. Tr. 1 at 75; OCC Exhibit 12. The record is devoid of any evidence that throughput will continue to decline. There is thus no evidentiary support for putting in place a rate design that assumes reductions in customer usage and revenue shortfalls resulting from such reductions. The proper remedy for the Company, in the event of future reduced customer usage and revenue shortfall, is to do exactly what it has done every six years for the last two decades – file a rate case to increase rates in order to recover the revenue requirement.

The Opinion and Order goes even farther, again without any basis in the record. The Commission alleges 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." The record does not demonstrate that the Company's financial stability is threatened, merely that earnings had dropped below its authorized rate of return. The Rider AMRP mitigates any difficulty in attracting new capital; it is supplied by customers annually. If Duke was subject to lawful regulatory restraints on a recovery on CWIP this might be an issue, but with the Rider AMRP and regular rate cases incorporating the new plant into rate base, there is little concern about the ability of the Company to obtain adequate capital. Moreover, the Company argued in its merger docket that the merger enhanced its ability to access low-cost capital. The modest revenue increase provided in this case is hardly going to sway the capital markets regardless of the residential rate design. In short, there is no evidentiary basis to justify the SFV rate design as the solution to the Company's need for additional capital, if any such need exists.

The SFV rate design is a solution in search of a problem. There is no evidence other than the opinion of proponents that there are problems caused by a conventional rate design and *intermittent reductions* in throughput. The recent reductions, based on the record, are negligible at best and there is no clear trend over the past five years. There is no evidence of a lack of capital.

Second, the Company fails to meet its burden of proving that the new rate design is just and reasonable as required by Ohio law. As noted above, the rate design violates a number of important regulatory principles. There is a dearth of evidence that the SFV provides customers with any advantages. Staff

acknowledges it has not reviewed or analyzed the impact of SFV in other utility service territories where it has been adopted. Tr. I at 240; 244. As a result there is no empirical evidence to show that an SFV has produced financial stability for utilities, nor improved their access to capital.

Admittedly, an SFV does virtually guarantee 80 percent recovery of 80 percent of the revenue requirement. It achieves this goal unfairly on the backs of residential customers with low usage who cause the least cost to the system. And what does it offer customers? Nothing. For most customers, it means higher bills than they would expect under a conventional rate design and a disincentive to conserve. The price signal sent by the SFV is you pay and get service or you don't pay and you don't get service. Try using less and you will still pay more. That is not a price signal; it is an ultimatum.

Finally, the Company fails to meet its burden to prove that the SFV rate design complies with state policy. The Commission notes that a negative trend in sales has a negative impact when it comes to incentivizing a utility to encourage energy efficiency and conservation. The Commission is wrong for two reasons. First, the record does not support that conclusion. Duke has funded energy efficiency and conservation programs for many years. The Stipulation in this case increases funding for low-income weatherization by 50 percent, regardless of the rate design ultimately approved. The Company filed a stand-alone case several years ago to authorize electric and gas riders to fund

conservation.<sup>12</sup> The cost of these programs is included in the revenue requirement and the Company earns a return on those funds. No additional incentive is necessary, given Duke's track record of supporting these programs. Second, Ohio law requires the encouragement of energy efficiency and conservation. Adherence to Ohio law and state policy is enough incentive for any utility, as it should be for the Commission.

What is clear is that a high fixed charge discounts the savings from efficiency investments, punishes those with small residences, and undercuts the personal virtue of conservation. State policy is to encourage demand-side investments. The Commission has chosen to discourage them instead, in contravention of the state's policy.

Where the record conflicts with the vision of the Company and Staff, the Commission ignores it. Had the two proponents for the radical rate design bothered, they could have presented evidence to support the movement to a rate design that violates Ohio law and precedent, but they did not do so. Reducing work demands on Duke and the Staff to engage in rate cases is apparently driving the outcome but that does not eliminate the need to provide an evidentiary basis for radical change.<sup>13</sup> However, the law requires the applicant to meet the burden of proving the new rate design is consistent with Ohio law and policy – it has not done so.

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<sup>12</sup> The only opposition to non-low income DSM spending by gas utilities in the past has come from the Staff for the reasons noted in the Staff Report. Staff Report at 51.

<sup>13</sup> The continuation of Rider AMRP and the related infrastructure improvement program guarantees regular rate cases to incorporate the new plants into rate base. An SFV will not prevent future rate cases.

### III. Conclusion

As OPAE has noted, the SFV is a solution in search of a problem. The SFV violates at least thirty years of ratemaking precedent. It violates Ohio statutory law, most of the basic principles of ratemaking and is counter to the state's policy. 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." R.C. §4929.04(C) requires that when proposing an alternative regulation plan, "[t]he applicant shall have the burden of proof under this section." Duke has failed to meet the burden of proof even with assistance from the Staff. The Opinion and Order is contrary to Ohio law and should be reversed.

Wherefore, OPAE respectfully requests that this application for rehearing be granted for the reasons set forth herein.

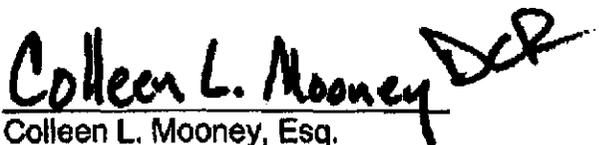
Respectfully submitted,



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## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Application for Rehearing* was served by electronic means upon the parties of record identified below on this 27<sup>th</sup> day of June, 2008.

  
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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application for )  
Recovery of Costs, Lost Margin, and )  
Performance Incentive Associated with the ) Case No. 06-91-EL-UNC  
Implementation of Electric Residential )  
Demand Side Management Programs by )  
The Cincinnati Gas & Electric Company. )

In the Matter of the Application for )  
Recovery of Costs, Lost Margin, and )  
Performance Incentive Associated with the ) Case No. 06-92-EL-UNC  
Implementation of Electric Non-Residential )  
Demand Side Management Programs by )  
The Cincinnati Gas & Electric Company. )

In the Matter of the Application for )  
Recovery of Costs, Lost Margin, and )  
Performance Incentive Associated with the ) Case No. 06-93-GA-UNC  
Implementation of Natural Gas Demand )  
Side Management Programs by The )  
Cincinnati Gas & Electric Company. )

FINDING AND ORDER

The Commission finds:

- (1) On January 24, 2006, as amended on August 16, 2006, Duke Energy Ohio, formerly The Cincinnati Gas & Electric Company (Duke) filed applications in the above-captioned cases to implement a set of electric and natural gas demand side management (DSM) programs for residential, commercial, and industrial consumers, as well as a research DSM program. Duke intends to recover the costs of the DSM programs through DSM cost recovery riders applicable to residential electric and gas sales and non-residential electric sales.
- (2) Under the applications, Duke proposes ten residential DSM programs, two commercial/industrial DSM programs, and one research DSM program. There are four residential DSM programs that provide home energy analysis to help consumers determine cost effective steps to save energy and two residential

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DSM programs that provide market incentives to promote the use of high efficiency heating and air conditioning equipment. In addition, there are three residential DSM programs designed to reduce demand by providing educational information, market incentives, energy use audits, and by promoting old appliance turn in. Finally, there is a pre-paid residential billing service program to allow consumers to control their bills. There are two commercial/industrial DSM programs which encourage commercial and industrial customers to install high efficiency equipment in new construction and to retrofit and replace failed equipment and one DSM program that encourages energy savings through school and demonstration projects. Finally, one DSM research program is also included.

- (3) In its applications, Duke noted that the DSM programs were developed with the consensus of the Duke Energy Community Partnership (DECP), the Office of Ohio Consumers' Counsel (OCC), and the Cincinnati Public Schools.<sup>1</sup> In addition, Duke indicated that it is applying for recovery of costs, lost margins, and shared savings associated with the proposed set of residential and non-residential DSM programs. Duke requested approval to implement the proposed set of programs through 2010 and seeks funding of the DSM programs and compensation for economic loss of reduced consumption by the establishment of a set of electric and natural gas riders for residential, commercial, and industrial classes of customers.<sup>2</sup>
- (4) By entry of January 10, 2007, motions to intervene filed by The Kroger Co. (Kroger), The Ohio Energy Group (OEG), Industrial Energy Uses-Ohio (IEU), OCC, and Ohio Partners for Affordable Energy (OPAЕ) were granted. The January 10, 2007 entry also directed the Commission staff to file a report of investigation of the applications and requested comments in response to the staff report from any interested person. In order to ensure that notice of Duke's DSM applications was provided to those entities thought to be most interested, the Commission served a copy of the entry on all parties to Duke's applications

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<sup>1</sup> The collaborative members of DECP are Working in Neighborhoods, People Working Cooperatively, Home Ownership Center of Greater Cincinnati, Adams/Brown counties Economic Opportunities, Inc. Communities United for Action, Cincinnati/Hamilton County Community Action Agency, staff of the Commission, staff of the OCC, Cincinnati Public Schools, and the Ohio Department of Development.

<sup>2</sup> Qualifying industrial consumers (less than 500 kW) are permitted to "opt-out" of participation in and payment for the DSM programs.

to establish its rate stabilization plan, *In the Matter of the Application of The Cincinnati Gas & Electric Company to Modify its Nonresidential Generation Rates to Provide for Market-Based Standard Service Offer Pricing and to Establish an Alternative Competitive-Bid Service Rate Option Subsequent to the Market Development Period*, Case No. 03-93-EL-ATA.

- (5) On January 12, 2007, staff filed its report of investigation on the applications. In its report, staff noted that most electric customers of Duke have not observed the need to implement energy efficiency measures and that it is estimated that Duke will be short of needed sources of generation over the next ten years. Staff indicated that DSM programs will help in reducing Duke's dependency on purchasing power to meet its standard service obligations. In part, staff recommended approval of several of the DSM programs identified by Duke and recommended approval of the method by which Duke is seeking to recover its DSM costs. Comments and reply comments were filed by Duke, OCC, IEU, and OPAE.
- (6) On June 14, 2007, a stipulation was filed in these proceedings. The stipulation, which was signed by Duke, Commission staff, OEG, OCC, and Kroger, resolves all of the outstanding issues raised by commenters. In part, the stipulation provides the following:
- (a) Duke shall recover lost revenues and shared savings, subject to refund, based upon future impact studies performed by Duke and submitted to staff for evaluation for three residential programs—Home Energy House Call, Energy Efficiency Website, and Ohio Energy Project.
  - (b) Independent program evaluation costs will be capped at five percent of each program's expenditures. The program evaluations shall be performed at the direction of the DECP Board in consultation with staff.
  - (c) After completion of a program evaluation that demonstrates that the evaluated program is not cost-effective, any remaining monies allocated to such program shall be referred back to the DECP Board for the evaluation and implementation of other cost-effective

DSM programs or the expansion of existing cost-effective programs.

- (d) Shared savings shall not be collected by Duke for each program until such program has achieved at least 65 percent of its targeted savings. Duke shall receive graduated shared savings as set forth in Duke's application and such recovery shall be capped at 10 percent of the shared savings for any program if Duke meets 100 percent of the targeted goal.
- (e) Duke may continue the cost-effective electric DSM programs set forth in the application for a five-year period from the effective date of the Commission's order in these cases. Thereafter, Duke must seek Commission approval to continue the programs.
- (f) Duke's natural gas DSM programs shall be limited to a three-year pilot program to test the effectiveness of providing rebates to encourage customers to purchase more efficient natural gas furnaces. Duke will implement the Smart Saver-Energy Star Products-Gas Furnace, and the Smart Saver-Energy Star Products-Gas Furnace with electronically commutated motors programs (Gas Furnace Programs) as such pilot programs. Duke may recover the costs of these programs and the associated lost revenues through the electric DSM rider. Duke shall not be permitted to recover any shared savings during the three-year pilot program. These programs shall be available only to customers with both gas and electric service provided by Duke. Prior to the end of the pilot phase of these two programs, Duke shall conduct a market analysis to determine whether these programs have been effective in increasing the saturation of these furnaces in Duke's certified territory. Based upon that market analysis, DECP, in consultation with staff, shall determine whether or not to continue the furnace program beyond the three-year pilot phase. With Commission approval, Duke may extend the pilot programs for up to an additional two-year period to coincide with the other programs set forth in the stipulation.

- (g) Duke may file its reevaluation reports six months later than the dates specified in the amended applications.
  - (h) Non-residential consumers may opt-out of participation in, and payment of Rider DSM, as set forth in the amended applications.
- (7) On June 15, 2007, Duke filed a letter indicating that IEU and OPAE will not oppose the stipulation. Duke also indicated that it is ready to implement the programs set forth in the stipulation beginning July 1, 2007. On June 19, 2007, OPAE filed a statement that it will neither support nor oppose the stipulation.
- (8) On June 28, 2007, a hearing was held on Duke's DSM applications. At the hearing, the staff noted that a stipulation had been filed in these cases. No members of the public attended the hearing.
- (9) Historically, prior to retail electric choice, Duke, along with other electric distribution utilities, developed and implemented a large number of DSM programs. These DSM programs were designed to increase energy efficiency as well as help reduce the electrical demand of consumers. Most of these programs were phased out in the 1990's for a variety of reasons, including the presumption that not all customers would benefit from avoided electric generation resulting from such DSM programs. Since the enactment of legislation involving the deregulation of electric generation, energy efficiency has occurred in the electric marketplace, but it has been rather limited and most customers have not observed the need to implement energy efficiency measures. In addition, demand for electric generation and natural gas continues to grow and puts increased pressure on electric and gas utilities to find new sources of electric generation and natural gas. The Commission believes that the DSM programs proposed by Duke will result in system-wide benefits to all customers and, at the same time, will help reduce Duke's dependency on purchasing power and natural gas to meet its service obligations. In addition, the Commission finds that the DSM programs proposed by Duke, which are primarily energy efficiency conservation programs, may also result in some reductions in load during the on-peak periods. Therefore,

the Commission finds that the stipulation in these cases should be approved. Accordingly, Duke is directed to file tariffs in final form, consistent with this finding and order and which incorporate the provisions of the stipulation. Because the programs we are approving will result in savings to Duke's participating customers, and because Duke was prepared to begin these programs effective July 1, 2007, we find that the DSM programs should be approved for July 2007. The new tariffs shall apply on a bills rendered basis beginning with the first billing cycle in July 2007.

It is, therefore,

ORDERED, That the applications of Duke in Case Nos. 06-91-EL-UNC, 06-92-EL-UNC, 06-93-GA-UNC be approved. It is, further,

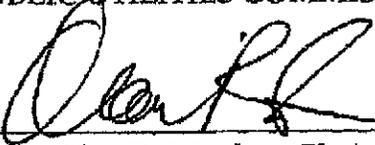
ORDERED, That Duke is authorized to file in final form four complete copies of the tariff consistent with this finding and order. Duke shall file one copy on its TRF docket (or may make such filing electronically as directed in Case No. 06-900-AU-WVR) and one copy in this case docket. The remaining two copies shall be designated for distribution to the Rates and Tariffs, Energy and Water Division of the Commission's Utilities Department. It is, further,

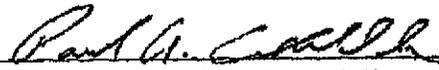
ORDERED, That the new tariffs shall apply on a bills rendered basis beginning with the first billing cycle in July 2007. It is, further,

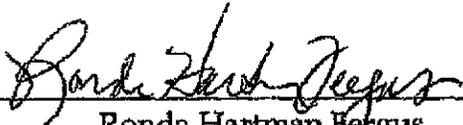
ORDERED, That Duke shall notify all affected customers via a bill message or via a bill insert within 30 days of the effective date of the tariffs. A copy of the customer notice shall be submitted to the Commission's Service Monitoring and Enforcement Department, Reliability and Service Analysis Division, at least 10 days prior to its distribution to customers. It is, further,

ORDERED, That a copy of this finding and order be served upon all parties of record in Case Nos. 06-91-EL-UNC, 06-92-EL-UNC, 06-93-GA-UNC, and 03-93-EL-ATA.

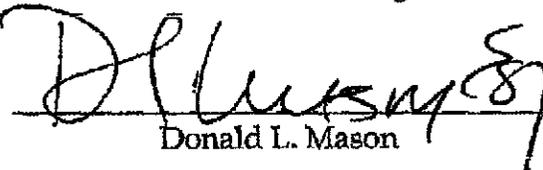
THE PUBLIC UTILITIES COMMISSION OF OHIO

  
Alan R. Schriber, Chairman

  
Paul A. Centolella

  
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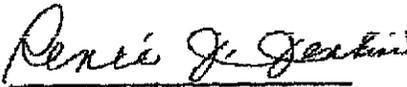
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Renee J. Jenkins  
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of The )  
Cincinnati Gas & Electric Company for an )  
Increase in Its Rates for Gas Service to All ) Case No. 95-656-GA-AIR  
Jurisdictional Customers. )

OPINION AND ORDER

The Commission, coming now to consider the application of The Cincinnati Gas & Electric Company to increase rates and charges pursuant to Section 4909.18, Revised Code, the Staff Report of Investigation, the exhibits and testimony introduced into evidence, having appointed its attorney examiner to conduct the public evidentiary hearings and to certify the record directly to the Commission, and being fully advised of the facts and issues, hereby issues its opinion and order.

APPEARANCES:

James B. Gainer and G. James Van Heyde, Cinergy Corporation, and Jeffrey A. Gollomp, on behalf of The Cincinnati Gas & Electric Company, 139 East Fourth Street, Cincinnati, Ohio 45202.

Betty D. Montgomery, Attorney General of the State of Ohio, by Duane W. Luckey, Section Chief, Anne L. Hammerstein, Gerald Rocco, and Paul A. Colbert, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio 43215-3793, on behalf of the staff of the Public Utilities Commission of Ohio.

Robert S. Tongren, Consumers' Counsel, by Werner L. Margard, III, Evelyn Robinson-McGriff, and Thomas O'Brien, Assistant Consumers' Counsel, 77 South High Street, Columbus, Ohio 43266-0550, on behalf of the residential customers of The Cincinnati Gas & Electric Company.

Bell, Royer & Sanders Co., L.P.A., by Langdon D. Bell, 33 South Grant Avenue, Columbus, Ohio 43215, on behalf of Avon Products Company, Bayer Corporation, Cincinnati Milacron Company, Ford Motor Company, The Greater Cincinnati Hospital Council, W.R. Grace Company, Henkel Corporation, Hillshire Farm & Kahn's, Morton International, The Procter & Gamble Company, Senco Products, Inc., Sun Chemical Corporation, and Occidental Chemical Corporation (collectively Cincinnati Energy Consumers).

Chester, Willcox & Saxbe, by John W. Bentine, 17 South High Street, Suite 900, Columbus, Ohio 43215, on behalf of the Ohio Council of Retail Merchants.

Fay D. Dupuis, City Solicitor, and Richard Ganulin, Assistant City Solicitor, 801 Plum Street, Cincinnati, Ohio 45202, on behalf of the city of Cincinnati.

upstream pipeline contracts (IMG Brief at 20-21). The company is unwilling to let any of these contracts expire until there is a solid contract with marketers to replace the capacity and the marketers are unwilling to enter into such contracts until there is an open and viable program in place. The marketers recommend, therefore, that the Commission reject the FT and RFT tariffs and require the company to file (by no later than the 1997-1998 heating season) a revised and commercially viable RFT tariff. The independent marketers also request that the company be ordered to submit a revised FT tariff, that includes open sourcing, within 60 days from the issuance of the order.

As the gas industry enters an era of increasing competitiveness, it is imperative that LDCs begin to provide customers, both large and small, with opportunities to take advantage of gas supply choices. We commend CG&E for bringing forth a proposal that would begin to provide smaller customers, including residential customers, with the opportunity to take part in the competitive arena. However, we are concerned with the limitations contained in the company's proposal that appear to hinder the availability of realistic competition in the CG&E service area. These factors include the lack of opportunity for marketers to find cost cutting alternatives to the source management currently offered under the FT tariff.

We believe that open sourcing is an important factor to consider in developing a viable firm transportation program for small customers. We direct CG&E to file, within 90 days of the issuance of this order, modified FT and RFT tariffs that include development of open sourcing options for marketers. The applications attached to this filing should include a proposed solution of how the company intends to address issues raised by the marketers such as how to make these transportation programs commercially viable, how to deal with potentially stranded costs (if any), and whether a pooling assessment is necessary or justified. The company should include marketers, and other interested parties, in discussions related to the development of the revised tariff proposal.

#### Residential Customer Charge

CG&E's current customer charge for residential (RS) customers is \$5.50 per month. In this case, the company proposed to increase the customer charge to \$10.00. The staff initially recommended that the customer charge be increased to \$7.00 per month (Staff Ex. 1, at 45). Staff witness Crossin reduced the staff's recommendation to \$5.50 through his testimony and subsequent cost of service model runs. The staff indicated that its recommendation was not based on an attempt to identify dollar for dollar recovery of actual costs but was a reasonable estimate of the costs incurred in providing service (Staff Ex. 18, at 8; Attach. A, Table 5). On brief, the company argued that the staff's original recommendation (\$7.00) should be adopted (Co. Reply Brief at 16-17).

We agree with the staff's revised recommendation that the residential customer charge should be maintained at its current level of \$5.50 per month. We heard a great deal of testimony at the local hearings regarding the detrimental impact that an increase

in the customer charge would have on low income customers (*See, Cincinnati Tr.*, 29-30, 54, 61, 93). 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.<sup>13</sup>

## MANAGEMENT AND OPERATIONS REVIEW

### Affiliate Transactions

As part of the 1994 agreement between Cinergy Services, Inc. (CSI) and CG&E, CSI renders a monthly statement which reflects billing information for costs charged for that month. Company witness Winger stated that CSI costs are billed to CG&E as part of the monthly closing process and entries are recorded in the company's general ledgers to reflect receivables and payables. Mr. Winger indicated that management reports are kept that provide supporting documentation for the charges in order to satisfy the terms of the service agreement between CSI and CG&E (Co. Ex. 11, at 1-2).

Staff witness Buckley testified that the staff interpreted the 1994 agreement to require that an itemized bill be sent by CSI prior to payment for services being made. CG&E claims that requiring that a bill be sent creates an unnecessary administrative burden. The staff believes, however, that having a bill from CSI would enable CG&E the opportunity to question charges from CSI to ensure that CG&E is not paying for services that are unjustified (Staff Ex. 8, at 2-3).

We disagree with the staff that physically rendering a bill would provide ratepayers with any additional protection from unwarranted costs. The company indicated that itemized entries are recorded to reflect charges and payments and that supporting documentation is provided in support of CSI's charges. There is no evidence that the staff found any of the charges made by CSI to be improper or that CG&E does not have the ability to question charges made by CSI under the terms of the agreement. We agree with the company that requiring CSI to physically render a copy of a monthly bill would constitute a redundant exercise that would not further the goal of insuring that charges are properly assessed.

### Benefit Verification System

Staff witness Buckley also indicated that the staff was concerned that CSI's goals, as a non-regulated subsidiary of Cinergy, could conflict with the Commission's goals to

<sup>13</sup> We also believe it is appropriate to maintain the customer charge for each customer class at current levels due to our concern with the cost of service information presented in this case. This does not mean, however, that the Commission is satisfied that all of the customer charges are at appropriate levels, especially those applied to transportation service. The Commission is very interested in addressing these issues in the next rate case.

## Principles of Public Utility Rates by James C. Bonbright

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# Principles of Public Utility Rates

by JAMES C. BONBRIGHT



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PART THREE

The Rate Structure

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## XVI

### CRITERIA OF A SOUND RATE STRUCTURE

Despite its recognized importance as a basis of rate control, the determination of revenue requirements under a fair-return standard, which was the subject of the preceding chapters, by no means exhausts the issues of a rate case. For even if this standard were accepted as the master rule of rate making, overriding all conflicting rules such as that against unjust discrimination—an exalted status which, though sometimes claimed for it, it does not enjoy in fact—there would still remain the question what specific rates will yield a fair return, together with the further question what rates and rate relationships should be chosen when a company's earning power is so high that any one of a variety of tariffs could be made to yield adequate over-all revenues.<sup>1</sup>

<sup>1</sup>As noted in Chap. IX, the Interstate Commerce Commission has given far more attention to rate relationships than to rate levels. But the contrary emphasis has characterized the utility rate cases before the state public service commissions. As to the specific rates, the major concern of these commissions has been to protect the interests of the residential customers. In the words of Russell E. Caywood, "The thought is that the larger customer can protect himself, whereas the small customer requires the help of a third party." *Electric Utility Rate Economics* (New York, 1956), p. 4. But in recent years particularly, very large industrial customers have intervened actively in rate cases, not just with respect to the relative height of their rates, but also with respect to the form: e.g., in the Commonwealth Edison Company Rate Case of 1957-1958 before the Illinois Commerce Commission (Case No. 44391), 24 PUR 3d 209.

Public utility counsel have sometimes argued that once a company's total revenue entitlements have been determined by a commission, the choice of a pattern of rates that will yield the allowed revenues should be left to the discretion of the management, which will then be in an impartial position to make a fair apportionment of burdens among its different classes of customers. This is only a half-truth argument: among other reasons, because a utility company is concerned not just to secure rates that will presently yield the approved "fair rate of return," but to develop a pattern of rates that will promote growth of earnings and that will protect these earnings against business depressions. The better the utility management, the greater is this long-run concern.

A much more plausible reason for caution on the part of a commission in over-

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We turn now to principles of rate making designed to throw light on these two other questions, but particularly on the latter. By what basic standards, for example, shall regulation pass judgment on a system of electric-utility rates which allows liberal discounts for incremental blocks of energy; or which levies higher charges, per kilowatt-hour, on residential consumers than on industrial customers; or which concedes lower rates for off-peak consumption than for consumption at peak-time hours or seasons? With the telephone utilities, does public policy justify the practice of the industry in setting higher rates for service in larger communities than for comparable service in small communities even when these differentials are not based on differences in cost of service? And what are the merits of the contentions, advanced by some economists but enjoying no popular support, that rush-hour fares for local-transit service or commuter railroad service should be higher than fares at nonrush periods? These are mere random samples of the many practical issues falling under the subject of rate structure.

But rate-structure problems are far more complex than problems of a fair return even though the latter are by no means elementary; and they are even less amenable to solution by reference to definite principles or rules of rate making. In part, the complexity is due to the mass of technical detail, including the technology of metering, involved in the design and administration of workable rate schedules for different types of utility enterprises. In part it is due

riding the rate-pattern policies of a utility company is the one suggested many years ago by Dr. G. P. Watkins, in expressing regret that few American commissions had contributed substantially to the development of principles of electric-rate design. "This situation," he wrote, "is perhaps partly due to doubt as to the possession of adequate powers, but more fundamentally to the diffidence of commissioners when confronted with a subject so complex, both theoretically and practically, as that of electric rates." *Electrical Rates* (New York, 1921), p. 37. The commissions that have given the most attention to rate-structure principles are the stronger commissions, such as those of California, New York, and Wisconsin, which have the aid of relatively large expert staffs.

A strong case can be made for the contention that, as far as feasible, fundamental problems of rate-structure revision should be handled in special proceedings, since they need far more time for satisfactory solution than can properly be given to them in what the Interstate Commerce Commission calls the "revenue cases." Referring to this situation in railroad rate cases, Professor Merrill J. Roberts writes: "The general rate case as presently construed is a veritable farce. Its broad sweep virtually precludes even the most rudimentary consideration of the intimate demand and cost relationships that should govern pricing in specific markets." "Maximum Freight Rate Regulation and Railroad Earnings Control," 35 *Land Economics* 125-138 at 136 (1959). See also footnote 11 of Chap. XVIII.

to the inability of the rate maker to predict the effect of changes in rates on demand for the services and hence on costs of supply—due, in short, to ignorance of demand functions and cost functions. But in part—and this is the most serious theoretical difficulty—it is due to the necessity, faced alike by public utility managements and by regulating agencies, of taking into account numerous conflicting standards of fairness and functional efficiency in the choice of a rate structure. The nature of some of these conflicts will be revealed as the discussion proceeds. But, by way of illustration, we may note the conflict between the desirable attribute of simplicity and the otherwise desirable attribute of close conformity to the principle of service at cost. Here, as with other clashes among various desiderata of rate-making policy, the wise choice must be that of wise compromise; and in reaching this compromise, the practical rate expert would look in vain to any general theory of public utility rates, at least in its present stage of development, for a scientific method of reaching the optimum solution.<sup>2</sup>

In view of this complexity of subject matter, the present study will not undertake descriptions of the typical rate structures of the different types of public utilities; and the reader unfamiliar with these structures is therefore referred to the treatises for background material, in the absence of which the following discussion of general principles may seem hopelessly abstract.<sup>3</sup> Even in its treatment

<sup>2</sup> Certain approaches toward a rational solution may be possible. Note, e.g., one economist's attempt to compare the additional costs of time-of-day metering as a device for differential electric rate making based on on-peak versus off-peak use with the possible resulting savings in plant generating capacity. Ralph Kirby Davidson, *Price Discrimination in Selling Gas and Electricity* (Baltimore, 1955), pp. 182-195. But other "intangible" costs of time-of-day metering are not readily assessed. In its investigation of the nationalized electric supply industry, a British inquiry commission concluded that, acting under statutory mandate to simplify rate structures, the Electricity Boards had deviated too far from the principle of rate differentials based on service at cost. *Report of the Committee of Inquiry into the Electricity Supply Industry*, Jan., 1956, Cmd. 9672, pp. 104-105. Needless to say, however, the Committee supplied no formula by which to draw the line between too much and too little simplicity.

<sup>3</sup> In addition to the treatment of rate structures in the general textbooks on public utility and transportation economics, see Caywood's book already cited in footnote 1; J. M. Bryant and R. R. Herrmann, *Elements of Utility Rate Determination* (New York, 1940); L. R. Nash, *Public Utility Rate Structures* (New York, 1939). For a significant critical monograph on modern utility rate structures in the United States, see Ralph Kirby Davidson's study already cited in footnote 2. On many technical issues, no American treatise on electric utility rates can equal that by the distinguished British rate engineer, D. J. Bolton, *Electrical Engineering Economics*, Vol. II: *Costs and Tariffs in Electricity Supply*, 2d ed. (London, 1951).

of principles, these chapters are mere essays on the nature of the more controversial, largely unresolved, problems rather than attempts at systematic development. All of them have one theme in common: the thesis that the most formidable obstacles to further progress in the theory of public utility rates are those raised by conflicting goals of rate-making policy.

#### CRITERIA OF A DESIRABLE RATE STRUCTURE

Throughout this study we have stressed the point that, while the ultimate purpose of rate theory is that of suggesting feasible *measures* of reasonable rates and rate relationships, an intelligent choice of these measures depends primarily on the accepted *objectives* of rate-making policy and secondarily on the need to minimize undesirable side effects of rates otherwise best designed to attain these objectives. No rational discussion, for example, of the relative merits of "cost of service" and "value of service" as measures of proper rates or rate relationships is possible without reference to the question what desirable results the rate maker hopes to secure, and what undesirable results he hopes to minimize, by a choice between or mixture of the two standards of measurement. Not only this: the very *meaning* to be attached to ambiguous, proposed measures such as those of "cost" or "value"—an ambiguity not completely removed by the addition of familiar adjuncts, such as "out-of-pocket" costs, or "marginal costs," or "average costs"—must be determined in the light of the purposes to be served by the public utility rates as instruments of economic policy. This is a commonplace; but it is a commonplace which, so far from being taken for granted, needs repeated emphasis.

What then, are the good attributes to be sought and the bad attributes to be avoided or minimized in the development of a sound rate structure? Many different answers have been suggested in the technical literature and in the reported opinions by courts and commissions; and a number of writers have summarized their answers in the form of a list of desirable attributes of a rate structure, comparable to the "canons of taxation" found in the treatises on public finance. The list that follows is fairly typical, although I have derived it from a variety of sources instead of relying on any

one presentation. The sequence of the eight items is not meant to suggest any order of relative importance.

1. The related, "practical" attributes of simplicity, understandability, public acceptability, and feasibility of application.
2. Freedom from controversies as to proper interpretation.
3. Effectiveness in yielding total revenue requirements under the fair-return standard.
4. Revenue stability from year to year. ✓
5. Stability of the rates themselves, with a minimum of unexpected changes seriously adverse to existing customers. (Compare "The best tax is an old tax.")
6. Fairness of the specific rates in the apportionment of total costs of service among the different consumers.
7. Avoidance of "undue discrimination" in rate relationships.
8. Efficiency of the rate classes and rate blocks in discouraging wasteful use of service while promoting all justified types and amounts of use:
  - (a) in the control of the total amounts of service supplied by the company:
  - (b) in the control of the relative uses of alternative types of service (on-peak versus off-peak electricity, Pullman travel versus coach travel, single-party telephone service versus service from a multi-party line, etc.).

Lists of this nature are useful in reminding the rate maker of considerations that might otherwise escape his attention, and also useful in suggesting one important reason why problems of practical rate design do not readily yield to "scientific" principles of optimum pricing. But they are unqualified to serve as a base on which to build these principles because of their ambiguities (how, for example, does one define "undue discrimination"?), their overlapping character, and their failure to offer any rules of priority in the event of a conflict. For such a base, we must start with a simpler and more fundamental classification of rate-making objectives.

#### THREE PRIMARY CRITERIA

General principles of public utility rates and rate differentials are necessarily based on simplified assumptions both as to the objectives of rate-making policy and as to the factual circumstances un-

der which these objectives are sought to be attained. Attempts to make these stated principles subserve all special objectives and cover all specific conditions would be hopeless. Writers on the theory of rates are therefore at liberty to base their analyses on the acceptance of those objectives which are of wide application and the attainment of which may be aided by whatever tests or measures of sound rate structure the analyses suggest.

Among these objectives, three may be called primary, not only because of their widespread acceptance but also because most of the more detailed criteria are ancillary thereto. They are (a) the revenue-requirement or financial-need objective, which takes the form of a fair-return standard with respect to private utility companies; (b) the fair-cost-apportionment objective, which invokes the principle that the burden of meeting total revenue requirements must be distributed *fairly* among the beneficiaries of the service; and (c) the optimum-use or consumer-rationing objective, under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is economically justified in view of the relationships between costs incurred and benefits received.<sup>4</sup>

In actual rate cases, these three criteria of reasonable rates and rate relationships, and particularly the last two, are by no means always sharply distinguished. But the distinction may be illustrated by the imagined example of a request, submitted to a regulating commission by a group of consumers, that an electric company be ordered forthwith to abandon its present, somewhat elaborate, schedule of class rates, block rates, and two-part or three-part

<sup>4</sup>These three criteria correspond to three of the four "primary functions" of utility rates set forth in Chap. III. The function ignored for present purposes, that of encouraging managerial efficiency, is omitted because of its more direct bearing on the desirable criteria for a fair over-all rate of return. See pp. 262 ff., *supra*. Professor John Maurice Clark had in mind essentially the same three criteria in writing: "The chief purposes of a rate system should be to earn a reasonable total return, to develop the utmost use of facilities so long as every service pays at least its differential cost, and to distribute residual costs fairly according to the responsibility of different users for the amount of these costs." *Studies in the Economics of Overhead Costs* (Chicago, 1923), p. 322. Professor Donald H. Wallace added a fourth possible objective: that of benefiting specific classes of customers, such as customers of substandard income or a submerged industry. Temporary National Economic Committee, Investigation of Concentration of Economic Power, 76th Congress, 3d Session, Monograph No. 32: *Economic Standards of Government Price Control* (Washington, D.C., 1941), pp. 475-478. This fourth objective comes under the heading of "social" principles of rate making as I have used the term in Chap. VII.

tariffs in favor of a uniform kilowatt-hour rate for all customers throughout its franchise territory. Almost certainly this proposal would be held subject to the threefold objection: (a) that no uniform rate, however high, could be made to yield a fair return on the company's invested capital; (b) that, even if it could do so, rate uniformity despite lack of cost uniformity in the supply of different types of service would impose *unfair* burdens on the consumers of the less costly services; and (c) that, quite aside from its unfairness, the uniform rate would result in a serious underutilization of plant capacity because it would cut down the demand for services (especially, for off-peak services) that could be supplied at increment costs materially below average unit costs, while stimulating a wasteful demand for services that can be supplied only at increment costs higher than the average.

Some modern writers who confine their attention to what they call the "economic" principles of public utility rates have ignored the second of these three standards of rate making in their development of these principles, on the ground that fairness questions are beyond the competence of professional economists.<sup>5</sup> Instead, they have centered attention on the third standard, often with special reference to its application under the constraint of a revenue-requirement standard. But a refusal to recognize fairness issues as relevant to the design of a sound rate structure would so far divorce theory from practice that these issues will not be completely ignored in the discussion that follows.

In the remainder of the present chapter as well as in all of the following chapters except Chapter XX ("The Philosophy of Marginal-Cost Pricing"), principles of rate structure will be discussed under the assumption that they are designed primarily to subserve the three above-noted objectives of rate-making policy. But in order to avoid extreme complexities, we shall make three further simplifying assumptions, all of which are implicit in much of the literature on public utility rates.

In the first place, we shall impute an unqualified priority to the "fair-return" standard of reasonable rate levels despite the fact, noted in Chapter IX, that no such priority is accorded either by legal doctrine or by rate-making practice. That is to say, we shall assume that the rates of any given utility enterprise, taken as a

<sup>5</sup>See Chaps. II and VIII.

whole, must be designed as far as possible to cover costs as a whole including (or plus) a fair return on capital investment.

In the second place, we shall assume the availability of a wide range of alternative rate structures, any one of which could be made to yield the allowed fair return on whatever capital investment is required in order to supply the demand for service. This assumption, which implies that the utility enterprise in question enjoys a substantial degree of monopoly power, permits us to center attention on a choice among rate structures, any one of which would be equally fair to investors and equally effective in maintaining corporate credit.

And in the third place, except for incidental references, we shall rule out all of those so-called "social" principles of rate making, discussed in Chapter VII, which may justify the sale of some utility services at less than even marginal or out-of-pocket costs.

#### *IMPORTANCE AND LIMITATIONS OF THE PRINCIPLE OF COST OF SERVICE*

Without doubt the most widely accepted measure of reasonable public utility rates and rate relationships is cost of service. In the literature, this measure is generally given a dominant position even by writers who insist upon, or reluctantly concede, the necessity for deviations from cost in the direction of value-of-service principles or of various "social" objectives of rate making. In actual practice there is usually an obvious, marked degree of correlation between the relative charges for different amounts and types of service and the relative costs of rendition. To be sure, local transit rates, with their customary flat fares regardless of distance and (even more important) regardless of time of travel come close to providing an outright exception. But intercity railroad rates, despite their many familiar departures from cost principles<sup>8</sup> and despite their notorious failure to accord well with any other sane principles of rate making, bear important partial correlations with

<sup>8</sup> Referring to railroad rates, the Interstate Commerce Commission said: "Costs alone do not determine the maximum limits of rates. Neither do they control the contours of rate scales or fix the relations between rates or between rate scales. Other factors along with costs must be considered and given due weight in these aspects of rate making." 262 I.C.C. 693, quoted by Justice Douglas in *New York v. United States*, 331 U.S. 284, 328 (1947).

relative costs. Thus, by and large, Pullman fares are much higher than coach fares; charges for the shipment of ten tons of any given class of freight are much higher than charges for the shipment of one ton; and freight rates from New York City to points in California are far higher than freight rates from New York City to Albany. Electric utility rates deviate from a cost standard much less than railroad rates. But it is a testimony to the prestige of this standard that, whenever actual or proposed electric tariffs are criticized for their asserted unfairness, the criticism usually takes the form of the contention that the rate relationships fail to conform to cost relationships. When this complaint is made before a public service commission, the defenders of the rates are likely to feel in a much stronger position if they can meet it on its own ground, without having to rely on value-of-service arguments in support of preferential rates to favored classes of customers.

The basic reasons in support of a cost-of-service standard of public utility rates and rate relationships have already been discussed at length in the early chapters of this book, particularly in Chapter IV. Here we may recall that the defense rests both on considerations of fairness as among the different customers and on considerations of optimum utilization or "consumer rationing." As to the issue of fairness, a cost-price standard probably enjoys more widespread acceptance than any other standard except for the even more popular tendency to identify whatever is fair with whatever is in one's self-interest. As to the issue of optimum utilization, this same standard (or, at least, a standard of the same name) comports with the "consumer sovereignty" principle, under which public utility consumers should be encouraged to take whatever types of service, in whatever amounts, they wish to take as long as they are made to indemnify the utility enterprise for the costs of rendition.

#### NECESSARY DEVIATIONS FROM A COST-OF-SERVICE STANDARD

In view of what has just been said, one might suppose that "the theory" of public utility rate structures or rate differentials would call for the acceptance of no basic principle of reasonable or non-discriminatory rates other than a mere extension of the very principle already accepted in the determination of entire rate levels, namely, the principle of service at cost. Just as, under the fair-return standard, rates as a whole should cover costs as a whole, so

Respectfully submitted,



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**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing Appendix to 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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