Columbia Exhibit No.______

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the matter of:	)	
	)	
APPLICATION OF COLUMBIA GAS OF KENTUCKY, INC. FOR AN ADJUSTMENT OF RATES	)	Case No. 2016-00162
	)	
	)	

PREPARED REBUTTAL TESTIMONY OF
CHAD E. NOTESTONE
ON BEHALF OF COLUMBIA GAS OF KENTUCKY, INC.

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October 21, 2016

PREPARED REBUTTAL TESTIMONY OF CHAD E. NOTESTONE

Q: Please state your name and business address.

A: My name is Chad E. Notestone and my business address is 290 West Nationwide Blvd., Columbus, Ohio, 43215.

Q: Did you file Direct Prepared Testimony in this proceeding?

A: Yes, I did.

Q: What is the purpose of your Rebuttal Testimony in this proceeding?

A: My rebuttal testimony addresses allocated cost of service recommendations and conclusions made by Mr. Higgins on behalf of the Kentucky Industrial Utility Consumers, Inc. Specifically, I disagree with Mr. Higgins' conclusions that 1) the Demand/Commodity study is an invalid study because it does not include a customer component of mains; 2) a system load factor weighting should be used in Columbia's Demand/Commodity study; and 3) the Flex Provision and Special Rate customers should be removed from the DS/IS class in the allocation studies and placed in their own class.

Additionally, I will respond to Mr. Kollen's testimony on behalf of the Attorney General's office in regard to his cash working capital recommendation.

Q: Do you agree with Mr. Higgins' statement[1] that the Demand/Commodity methodology is invalid because it does not recognize a customer component of mains and unreasonably shifts costs to higher load factor customers.

A: No. Columbia's Demand/Commodity studies use a valid and reasonable method of cost allocation that when considered with the Customer/Demand method, creates a range of reasonableness that has been accepted by commissions in jurisdictions in which it operates since the 1980s. The underlying assumption for cost allocation purposes is that Columbia assigns distribution mains costs due to two functions. One part is a function of system usage, whereas the other part is a function of system capacity. Columbia presents the Demand/Commodity study on the basis that it represents a generally accepted methodology of cost allocation that produces results that are at the opposing end of the range of reasonableness when compared to the results produced by the Customer/Demand

[1] Direct testimony of KIUC witness Kevin C. Higgins (p. 7).

study. The Demand/Commodity study tends to favor low load factor customers (i.e. residential class) rather than the results produced by the Customer/Demand study which tend to favor higher load factor customers (i.e. industrial class). However, Columbia's cost allocation philosophy is that there is no one correct cost allocation method, but rather a range of reasonable alternatives, which include the Demand/Commodity study methodology. Given this situation, Columbia supports the use of its Average study which does recognize a customer component of mains cost by giving equal weight to both mains allocation factors in the Customer/Demand and Demand/Commodity studies.

Q: How do you address Mr. Higgins' recommendation that the throughput component in the Demand/Commodity study should be weighted based on Columbia's system load factor and that Columbia's 50% weighting as proposed is arbitrary?

A: Columbia believes Mr. Higgins' alterations to the throughput and demand weightings in the Demand/Commodity (aka Peak and Average) study are based on a misinterpretation of the distinction between an Average and Excess demand allocation methodology and Columbia's Peak and Average study. Mr. Higgins references a load factor weighting as described in the NARUC manual as justification for the change. However, the load factor weighting recommended by NARUC only applies in the context of using the Average and Excess demand method for the allocation of demand costs to the various customer classes. On the other hand, Columbia's Demand/Commodity study first classifies 50% of mains costs as demand related and then utilizes a Coincident Demand (aka peak responsibility) method in the allocation of demand costs to the various customer classes. Simply put, it appears that Mr. Higgins has mistaken Columbia's Demand/Commodity study methodology in this case with the Average and Excess demand allocation. The approach he describes actually is a method of allocating demand costs to customer classes and not an accepted method used to classify costs as being either commodity or demand related. The Average and Excess method also called "used and unused capacity" recognizes both the average use of capacity and responsibility for peak capacity required to meet the maximum system loads. The Average and Excess demand method as described in the NARUC[2] manual is stated below:

> Total demand costs are multiplied by the system's load factor to arrive at the capacity costs attributed to average use and are apportioned to the various customer

[2] National Association of Regulatory Utility Commissioners Gas Distribution Rate Design Manual (June 1989).

> classes on an annual volumetric basis. The remaining capacity costs (i.e. excess capacity) are considered to have been incurred to meet the individual peak demands of the various classes of service and are allocated on the basis of the coincident peak of each class. (NARUC p. 27)

As described above, the purpose of the Average and Excess demand method is to allocate total demand costs among the various rate classes and clearly is not intended to be used as a means to classify total distribution mains costs as being either demand or commodity related. Therefore, Columbia recommends that the Commission reject the use of a load factor weighting in the Demand/Commodity study because the use of the Average and Excess demand method as proposed by Mr. Higgins is completely different than the methodology described by NARUC.

Furthermore, Mr. Higgins' throughput load factor weighting approach in the Demand/Commodity study is contrary to the accepted methodology most commonly used based on Columbia's experience. Columbia's Demand/Commodity study traditionally uses 50% demand and 50% commodity as the basis for assigning cost. The underlying assumption when performing a Demand/Commodity study is that the cost of Columbia's investment in distribution mains is assigned equally by two factors. One factor is that distribution mains are built and exist to deliver gas to customers 365 days a year (i.e. average usage) and not just during peak periods. The other factor is that customers require service availability during the coldest days of the year, and, therefore, the system must be sized appropriately and have enough capacity to provide for peak day requirements. Therefore, the 50/50 weighting is not arbitrary as Mr. Higgins states[3], but rather it assumes that utilization of distribution mains and, therefore, the cost incurrence is driven equally by demand and throughput. As such, in Columbia's Demand/Commodity study, one cost assignment factor does not outweigh the other.

Q: Does Columbia agree with Mr. Higgins' recommendation that Columbia should separate the Flex Provision and Special Rate customers from the DS/IS customer class in the cost allocation studies?

A: No. Columbia disagrees with this recommendation because it is contrary to an underlying principle that is used in performing an allocated cost of service study, which is to group customers to rate classes based on similar cost characteristics. For cost allocation study purposes, Columbia groups its customers into different rate classes to establish groups of customers that share cost characteristics. Consideration is

[3] Direct testimony of Kevin C. Higgins, p. 8.

given based on similar service requirements such as usage levels and load characteristics. The purpose of this approach is to recognize that on average, similar levels of investment and operating expenses are required to serve each customer within the designated group. Grouping customers this way allows for a practical way to allocate Columbia's common system costs to the various customer rate classes from a cost causation perspective. Alternatively, Mr. Higgins' approach advocates the segregation and grouping of customers primarily based on the level of revenue each customer is contributing to the class without due consideration of the costs required to serve these customers.

It is important to note that class rates of return produced from any rate class are an average considering that, in reality, each customer within the rate class can either contribute higher or lower levels of revenue when compared to the average level of investment for the group as a whole. Columbia refers to this issue as intra-class cost subsidization, which occurs to a degree within any rate class.

Mr. Higgins states that having the Flex/Special Contract customers in the DS/IS class "adversely distorts the perceived performance of the customers in the DS class that are paying standard rates[4]." However,

[4] Direct testimony of KIUC witness Kevin C. Higgins p. 4.

using this reasoning, it would follow that Columbia should also remove any other DS/IS customer who contributes a level of revenue that would produce less than the average return for the DS/IS group on the basis that it adversely distorts the perceived performance of the other customers in the DS/IS class who are contributing to average or above average returns. Subsequently, the DS/IS class average returns would change when any customer or group of customers are removed from the class. Columbia would continually create separate rate classes to no end because intra-class cost subsidization would not be completely eliminated. Therefore, Columbia recommends that the Flex and Special Contract customers remain embedded with the DS/IS class as a whole because a fundamental principle used in the studies is to group customers based on similar costs and not revenue characteristics.

Q: Do you agree with Mr. Kollen's recommendation that Columbia's cash working capital requirement should be $0 based on his blanket assertion that a "properly performed" cash working capital study would result in negative working cash working capital?

A: Absolutely not. Mr. Kollen provides no evidence or justification for what he deems a "properly performed" study nor did he attempt to prepare one for Columbia Gas of Kentucky, Inc. In response to a data request[5], Columbia provided six lead/lag studies performed on behalf of three other NiSource companies in other jurisdictions over the last four years. Only two[6] of the six studies had a negative cash working capital requirement. In response to a Commission Staff data request[7], Mr. Kollen states that "once errors in some of the studies were corrected, every one of the studies prepared by NiSource indicates negative cash working capital." However, Mr. Kollen does not identify what these "errors" were and does not provide any "corrected" studies for the record. Therefore, Columbia does not understand how Mr. Kollen can recommend a $0 cash working capital requirement given that he did not perform a study for Columbia Gas of Kentucky, Inc. and does not provide any evidence that his "corrections" to the lead/lag studies accepted by commissions in other jurisdictions would produce a negative cash working capital requirement for Columbia Gas of Kentucky, Inc.

Q: Does this complete your Prepared Rebuttal Testimony?

A: Yes, it does.

[5] Columbia response to AG Data Request 1-6.

[6] Only Columbia Gas of Maryland, Inc. has a negative cash working capital requirement.

[7] Attorney General's response to Commission Staff's First Data Request 1-6