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DEO EXHIBIT 1.0

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Approval of Tariffs to Recover Certain Costs Associated with a Pipeline Infrastructure Replacement Program Through an Automatic Adjustment Clause, And for Certain Accounting Treatment.	)))))))	Case No. 08-169-GA-ALT

DIRECT TESTIMONY OF JEFFREY A. MURPHY ON BEHALF OF THE EAST OHIO GAS COMPANY d/b/a DOMINION EAST OHIO IN SUPPORT OF MOTION TO MODIFY ORDER APPROVING ALTERNATIVE RATE PLAN

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I. INTRODUCTION

Q1. Please introduce yourself.

A1. My name is Jeffrey A. Murphy. I am employed by The East Ohio Gas Company d/b/a Dominion East Ohio ("DEO" or "Company") as its Managing Director, Commercial Operations. My business address is 1201 E. 55th Street, Cleveland, Ohio 44103.

Q2. Please summarize your education and work experience.

A2. I graduated from The University of Akron in 1980 with a Bachelor of Arts in Economics and in 1981 with a Master of Arts in Economics with a concentration in Quantitative Methods. In 1988, I graduated from Baldwin Wallace College with an Executive Masters of Business Administration with a focus on Systems Management. I joined the Babcock & Wilcox Company in 1981 and held various positions involving econometric forecasting, cost analysis and pricing. In 1986, I joined The East Ohio Gas Company (now DEO) and have since held a variety of positions in the planning, rates, financial analysis, gas supply, transportation services and customer service areas. I have also served as a part time faculty member of the University of Akron in the Department of Economics.

Q3. What are your responsibilities as Managing Director, Commercial Operations?

A3. My principal duties include oversight of DEO's customer service, transportation services, and gas supply acquisition areas. DEO's customer service area includes the call center, meter reading, billing and credit departments as well as the personnel that perform work at the customer's premises in response to odor complaints, malfunctioning equipment and other customer initiated work requests. In the transportation services portion of my duties, I am responsible for the administration of the Energy Choice and traditional transportation programs and for DEO's gas pooling and storage service offerings. I also oversee the company's gas supply function where I work closely with our Gas Supply Group based in Richmond, Virginia.

Q4. What is the purpose of your testimony?

A4. My testimony addresses DEO's request for the Commission to modify certain portions of the October 15, 2008 Opinion and Order in this proceeding ("2008 Order"). In its 2008 Order, the Commission approved, among other things, the alternative rate plan that established DEO's Pipeline Infrastructure Replacement Program ("PIR Program").

II. OVERVIEW

Q5. Please summarize the PIR Program, as approved in the 2008 Order.

A5. In very broad terms, the PIR Program involves the replacement of over 4,100 miles of DEO's bare steel, cast iron, wrought iron and copper pipelines as well as older vintage field coated pipelines where the coating is no longer effective in preventing corrosion. The program also includes the relocation of some inside meters outside the premises, often in conjunction with a plan to operate the system serving that area at a regulated pressure. In its 2008 Application, the Company also requested recovery of "the revenue requirement associated with ongoing pipeline infrastructure expenditures for other transmission and distribution pipeline replacements and relocations, system improvements and directly related capital expenditures for main-to-curb connections, service lines, regulating stations, transmission and distribution integrity, and environmental compliance." (Paragraph 8 in the Application filed on February 22, 2008, in Case No. 08-169-GA-ALT et al.) The PIR Program also entailed DEO assuming both ownership and responsibility for the replacement of curb-to-meter service lines that previously had been the property and responsibility of customers.

Q6. Is DEO requesting changes to the existing PIR Program?

A6. Yes. DEO is proposing to approximately double the current annual spending in the PIR Program. The provisions of the currently authorized program and cost recovery mechanism will not support such a significant increase. The major changes that DEO is proposing in conjunction with a further accelerated program are:

- Five-year reauthorization of the program effective with Commission approval of DEO's motion to modify the alternative rate plan approved in the 2008 Order;
- Clarification of the program scope to address governmental relocation projects and meter relocations;
- Changes in the PIR Cost Recovery Charge fiscal period and filing schedule;
- Adjustment of the $1 annual increase limit in the PIR Cost Recovery Charge to accommodate an approximate doubling of annual expenditures;
- Replacement of the current PISCC rate with DEO's authorized pre-tax return on rate base for PIR assets placed into service before being reflected in the PIR Cost Recovery Charge;
- Approval of a reconciliation adjustment to ensure full recovery of the approved revenue requirement through the PIR Cost Recovery Charge; and
- Other changes as needed to facilitate the regulatory review process and ensure sufficient Commission oversight of the expanded program

Q7. Why is DEO proposing to further accelerate its PIR Program?

A7. DEO is proposing to accelerate the PIR Program for several reasons:

- After the start of the program, DEO conducted a review to quantify the miles of potentially ineffectively coated pipeline that may need to be replaced in addition to over 4,100 miles of bare steel, cast iron, wrought iron and copper pipeline identified in its initial application. That analysis revealed over 1,450 miles of ineffectively coated pipeline installed before 1955 that need replacement. The additional in-scope mileage of the ineffectively coated pipe would add at least a decade to the 25 years initially envisioned for completion of the program even with moderate increases in program spending. Given the vintages involved, much of the ineffectively coated pipeline could approach, if not exceed, 100 years of age at the time of replacement.
- Like many others, DEO has paid close attention to the tragic incidents in San Bruno, California and in Philadelphia and Allentown, Pennsylvania. Those incidents highlight the potentially catastrophic nature of pipeline failures, particularly those involving lines operating at higher pressures. At the same time, Commission Staff and the Ohio Consumers' Counsel ("OCC") have pressed DEO to place its highest priority on pipeline replacements that will reduce current leak repair expense levels, so that savings can be passed back to customers. If cost savings were the focal point of the PIR Program – which DEO respectfully submits they should not be – then replacements of in-scope high-pressure distribution pipelines would have to occur later in the program, because the leak rates of those facilities are much lower than those experienced by low pressure distribution pipelines. DEO believes that delaying the replacement of in-scope high pressure distribution pipelines to focus on those that might generate more cost savings is not advisable. Accelerating the program will permit the Company to replace the higher pressure distribution pipelines more

quickly, while also progressing towards the low pressure pipeline projects that can provide greater long-term savings in operating and maintenance expenses.

- As Company Witness Eric Hall explains in more detail, DEO experienced the failure of an ineffectively coated pipeline in the Youngstown area that also raised the Company's concerns about higher pressure distribution pipelines. Because that section of pipeline had not exhibited high leak rates, it was not ranked highly in the replacement prioritization process. Nonetheless, this pipeline failed even while operating well below its maximum allowable operating pressure. When viewed in the context of other incidents as well as the magnitude of DEO's in-scope high pressure distribution pipeline system, the event demonstrates the benefit to be gained by accelerating the replacement of those lines.
- Although the Company anticipates that the PIR Program produce will produce leak repair savings over time, our primary purpose for this program has always been clear: DEO must substantially increase the rate of infrastructure replacement in order to maintain system reliability and better ensure public safety. At the time the Company filed its initial PIR Program Application, DEO determined, and Staff and no other parties disagreed, that 25 years was a reasonable time frame in which to complete the program. The increase in scope from potentially ineffectively coated pipeline alone is sufficient reason to make changes that enable the Company to increase program investments, to avoid adding ten years or more to the program. The recent spate of pipeline incidents also highlights the need to move aggressively in replacing older infrastructure, including the curb-to-meter service lines that can pose safety issues as well.

Q8. How does DEO's replacement of curb-to-meter service lines affect customers beyond improving the safety and reliability of their gas service?

A8. DEO's assumption of responsibility for service lines through PIR has proved to be a substantial economic benefit to our customers. As stated previously, such replacements were once the customer's responsibility, meaning that customers independently paid for repair or replacement if a service line was found to be leaking. Claims submitted shortly after DEO assumed responsibility for those replacements in late 2008, had an average cost of over $1,450. Because DEO now replaces those service lines under the PIR Program, customers do not face such expenses on an up-front, individual basis.

Without the PIR Program, replacing service lines would collectively cost customers millions of dollars every year. In 2009, DEO replaced approximately 10,800 service lines that were found to be leaking, in addition to those replaced as part of PIR mainline projects. Using that $1,450 average cost figure, our customers would have paid nearly $16 million out of pocket had those replacements not been funded through the PIR Program, which spreads those costs over the depreciable life of the asset. That avoided, immediate cost is much higher than the ***entire*** first year PIR Program revenue requirement of $12.5 million.

As the Company moves further into replacing low pressure distribution mains, PIR capital expenditures will become more heavily weighted toward service line replacements. Service line replacements comprised 20.5% of the first year PIR capital spending and 31.1% of the second year, meaning that nearly a third of the total spending in the program would have been paid directly by customers – up front, and not spread over time – if they were still responsible for those replacements.

Q9. Are there also broader economic benefits of the PIR Program?

A9. Yes. The two most significant benefits are associated with property and payroll tax generation and the significant job creation that will be enhanced by an accelerated PIR Program. With an effective property tax rate of approximately 2% of gross plant, an increase of $100 million per year in spending will generate significant cumulative property tax revenues. Incremental spending of that magnitude would generate another $2 million in year 1, $4 million in year 2, $6 million in year 3 and so forth. It is also important to note that over 10% of DEO's PIR revenue requirement is comprised of property tax expense, meaning that over 10¢ on each dollar of PIR Cost Recovery Charges paid by our customers is returned right back to their communities.

A more significant economic benefit of an accelerated program comes from the job creation that will take place. In 2008, DEO engaged Kleinhenz & Associates to examine the regional economic impact of the Company's proposed PIR Program, including effects the program might have on job creation, personal income and overall economic activity. That study concluded that the program could be expected to create or support over 3,000 jobs at its peak, increase personal income by over $3 billion, and drive over $7.5 billion of output after the economic spin-off activity is taken into account. More important for our customers, Kleinhenz & Associates projected that the northeast Ohio region would account for approximately 75% of all of the benefits that accrue to the State of Ohio. Accelerating that level of economic activity at this particular time is especially important given the "jobless recovery" from the recent recession. John E. Kleinhenz is sponsoring testimony that includes as an exhibit the study completed in July 2008.

Q10. What has changed since the Commission approved the PIR Program?

A10. There are various findings upon which the 2008 Order was based that have been clarified, changed or are no longer valid, the most important of which are:

- The clarification of the scope involving potentially ineffectively coated pipelines;
- The clarification of the scope involving the relocation of inside meters;
- Changes in other regulatory jurisdictions affecting DEO's ability to attract incremental capital from its corporate parent;
- The pipeline safety climate in the aftermath of pipeline failures across the country;
- The severe economic downturn and the unquestionable need for job creation and property tax revenues in DEO's service territory and the state of Ohio;
- The substantial decrease in natural gas prices much below the levels that gave rise to limitations on PIR Cost Recovery Charge annual increases; and
- The beneficial and substantial impact of bonus tax depreciation on the revenue requirement associated with a given level of investment.

Q11. How has the program scope changed since the Commission first approved the PIR Program?

A11. Since the PIR Program began, DEO has quantified the exposure created by potentially ineffectively coated pipeline within its system. That clarification added 1,454 miles of in-scope pipelines to the originally estimated 4,122 miles, or a 35% increase. In addition, Commission Staff has clarified its expectations regarding cost recovery for the relocation of inside meters. Staff has indicated that such costs can be capitalized and recovered through the PIR Cost Recovery Charge, if done in conjunction with a mainline replacement where the company plans to operate the system at a regulated pressure.

Those two clarifications alone mean that what was designed as a 25-year replacement will now take over 35 years, unless spending increases substantially above current levels.

Q12. Please describe the evolution of DEO's ability to attract incremental capital from its corporate parent.

A12. Like any other company, DEO competes for capital with the other operating companies of its corporate parent. In order to fulfill its fiduciary duty to shareholders, Dominion must evaluate alternative uses of capital to obtain an appropriate return on its investment. As a result, additional PIR program expenditures must compete with other opportunities offering attractive regulated returns. In recent presentations to investors, Dominion has indicated that it plans to spend over $10 billion of growth-related capital expenditures over the next five years across its Generation, Dominion Virginia Power and Energy business units, the last of which includes DEO. Those plans include capital expenditures in jurisdictions with base returns on equity ("ROE") that significantly exceed DEO's currently authorized 10.38% and provide premiums of 100 basis points (1.00%) in many cases. Those investments include electric transmission and regulated generation facility expansion projects that generate ROEs of well over 12%.

Dominion senior management has indicated a willingness to expand DEO's PIR-related capital spending by an additional $100 million per year, if DEO can obtain sufficiently competitive returns for all of its PIR-related investments. That commitment marks a very important consideration for DEO's ability to fund an accelerated program.

Q13. Can you broadly describe the other factors which demonstrate that certain findings upon which the 2008 Order was based which are no longer valid?

A13. Yes, as explained further by Company Witness Eric Hall, recent pipeline failures involving fatalities have dramatically increased the focus on older vintage pipeline systems and the potentially catastrophic consequences of such failures. A joint statement issued on February 14, 2011, by the National Association of Regulatory Utility Commissioners President Tony Clark of North Dakota and Gas Chair Timothy Alan Simon of California regarding a meeting with Department of Transportation Secretary Ray LaHood declared:

> On behalf of the nation's State public utility commissioners, we thank Secretary LaHood for meeting with us today. State regulators fully understand the importance of assuring the safety of our nation's pipeline system. We take these responsibilities seriously and personally. We truly appreciate the Secretary offering an invitation to us to speak about these issues on a bigger scale. The nation must be assured that its gas pipeline system is safe and reliable, and that responsibility falls on all of us. We welcome Secretary LaHood's call for action and we look forward to working with him, Pipeline and Hazardous Materials Safety Administrator Cynthia Quarterman, and whomever else the Secretary includes.

Such actions and statements make clear that the environment has changed dramatically since the Commission first approved the PIR Program.

The severe economic downturn that saw its biggest decline in economic activity occur in the year immediately following the 2008 Order hardly needs further explanation. The number of foreclosed homes, increased unemployment, intensified governmental budget pressures and overall decline in economic activity severely affected Ohio. The expanded economic activity supported by an accelerated PIR Program is much more critical than could possibly have been foreseen at the time the program was initially approved. In his testimony, Dr. Kleinhenz addresses the increased economic activity that will be supported by such an acceleration.

As explained further in the direct testimony of Company Witness Vicki H. Friscic, customer bills have shown a marked decline since 2008 when the PIR Program was first approved, mostly due to lower natural gas commodity prices and, more recently, a lower PIPP Rider and Retail Price Adjustment established in the March 2011 Standard Service Offer ("SSO") and Standard Choice Offer ("SCO") auctions, both of which will be implemented in April. Updating DEO's March 2011 rates for those changes shows that customers are paying nearly $40 per month, or almost 35%, less than the amount they paid when final rates were established in DEO's last rate case, consolidated with the PIR Program in Case No. 08-169-GA-ALT. To the extent that the Commission had concerns about bill increases resulting from the PIR Program, those concerns have since been addressed in a way that no one foresaw at the time.

The Commission recognized these developments explicitly in its December 21, 2010 Supplemental Finding and Order in Case No. 10-200-GA-ATA involving the extension of DEO's low-use, low-income pilot program ("Low-Use Low-Income Pilot Order"). In that ruling, the Commission rejected the OCC and OPAE argument that declining commodity prices should not be considered in the Commission's decision about whether that program should continue. As the Commission stated:

> Instead, the Commission now has an opportunity to evaluate the low-use, low-income pilot program to determine whether it should be continued. In evaluating the future of the low-use, low-income program, the Commission is aware the original goal of the low-use, low-income pilot program was to mitigate the impact of the imposition of the SVF [sic] rate design on low-use, low-income customers. The supplemental report filed by Staff demonstrates that declining commodity prices served to mitigate much of the feared rate shock and continued to do so as the full SVF [sic]

> rate went into effect in October 2010. Accordingly, we find that DEO's [sic] should be allowed to discontinue its low-use, low-income pilot program. (Low-Use Low-Income Pilot Order at page 5.)

The same decline in natural gas prices which convinced the Commission that its findings in the Low-Use, Low-Income Pilot Order were no longer valid likewise supports a conclusion that its findings that limit the pace of investments in the 2008 Order are no longer valid.

As explained further by Ms. Friscic, the bonus tax depreciation which continues through 2012 for eligible investments means that a given level of capital spending results in a much lower revenue requirement. DEO's customers will receive nearly $46 million of such benefits over the next five years alone given the Company's proposed acceleration, an amount that handily exceeds the nearly $40 million recoverable from the first two years of PIR Program revenue requirements combined.

Q14. Are the changes proposed by DEO in the public interest?

A14. Absolutely. If we begin with the proposition that substantially all in-scope facilities have to be replaced eventually, the modification of the 2008 Order to accommodate an accelerated program is clearly in the public interest. Acceleration of the program supports increased system reliability and pipeline safety, in light of advances in the replacement of in-scope high pressure distribution pipelines. DEO's greater investments will increase property and payroll tax receipts, and support substantial job creation by promoting regional economic activity. Doing so now is made all the more compelling by recent and projected low levels of natural gas prices and sizeable decreases in the PIPP Rider and the Retail Price Adjustment approved in DEO's March 2011 SSO and SCO auctions. The PIPP Rider and Retail Price Adjustment reductions that take effect in April alone will save the average residential customer about $10 per month. That effectively "buys" four and possibly five years' worth of PIR Cost Recovery Charges, meaning that customers may not see a net increase from March 2011 in the non-gas portion of their bill for most of the reauthorization period sought by DEO.

III. PROGRAM SCOPE

Q15. By what order of magnitude does DEO intend to accelerate the PIR Program?

A15. DEO will approximately double the current annual spending level for its PIR Program. In order to provide sufficient time for the design and bidding of the expanded construction and to coordinate the resulting activity with the affected communities, DEO will ramp up its spending level over the course of approximately 12 months. If DEO were to receive approval with enough time remaining in the prime construction season, it could spend as much as $50 million above the currently planned level in calendar year 2011 and $100 million or more above the currently planned level each year in calendar years 2012 and beyond.

Q16. What reauthorization period is the Company requesting?

A16. DEO is requesting reauthorization for the program for a period of five years from the date that the Commission issues its final order in this proceeding.

Q17. Why does DEO want to extend the program authorization period for another five years?

A17. The Commission approved the current program for an initial five-year period or until the effective date of new base rates, whichever comes first. That authorization would expire on October 15, 2013, if DEO does not file a base rate case resulting in new rates before that time. That timing would permit only one full year of accelerated spending and not enable DEO to properly plan and staff for a near doubling of its program. Likewise, contractors would not commit the resources and hire the additional personnel for such a short-term commitment. A five-year reauthorization will provide the certainty needed for DEO and its contractors to expand their capacity and employ the personnel needed to implement the accelerated program in a prudent and cost-effective manner.

Q18. How does DEO propose to modify the program scope?

A18. DEO is proposing two changes to the program scope, effective July 1, 2011. First, DEO proposes to exclude the cost of a non-billable relocation project, if the amount of plastic pipe on that project is more than 25% of the total pipeline replaced. Second, DEO will include in PIR Program scope only those meter relocations directly associated with a mainline replacement project where DEO plans to operate the pipeline at a regulated pressure; as a result, no separate approval process will be required.

IV. <u>RETURN ON PIR INVESTMENTS</u>

Q19. Please explain the current return on investment that DEO receives in its PIR Program.

A19. The current return approach varies, based on four distinct points in time for each project:

1. Construction Start Date – the point in time that the company begins to spend money on a particular pipeline replacement project;
2. In-Service Date – the point in time that the new pipeline is placed into service;
3. Date Certain – the date used to value DEO's cumulative investment for a proposed adjustment to the PIR Cost Recovery Charge; and
4. Rate Implementation Date – the point in time that the Company begins to bill customers an updated PIR Cost Recovery Charge.

We also distinguish projects that have a relatively short-term construction period from those with longer construction periods. If a project has relatively short construction period, i.e., typically less than two months, there is no recognition of the financing costs incurred during construction. For longer term projects, the Company accrues an allowance for funds used during construction ("AFUDC") to reflect financing costs. Those costs are accumulated and added to the cost of the project on the Company's books and amortized over the depreciable life of the asset. The rate used to calculate AFUDC is updated quarterly to reflect changes in capital structure and includes a cost of equity at the authorized return level as well as the actual cost of the Company's long-term and short-term debt during the quarter.

Under the current PIR Cost Recovery Charge, the Company recovers post in-service carrying costs ("PISCC") on investments from the In-Service Date to the Rate Implementation Date. PISCC equates to the 6.50% cost of long-term debt embedded in the Commission-authorized return in DEO's last rate case. It is only when an adjusted PIR Cost Recovery Charge including those investments is first billed to customers that DEO begins to receive the full Commission-approved level of debt and equity return on rate base ("RORB"). The amount of the return provided at that time reflects the cumulative PIR Program "rate base" as of the Date Certain reflected in the rate approved by the Commission.

The table below summarizes the financing costs recovered for longer-term projects during the periods described above:

Period	Return Provided	Capital Cost Included	Most Recent Pre-Tax Rate
Construction Start Date to In-Service Date	AFUDC	Equity, Long-Term Debt, Short-Term Debt	9.22%
In-Service Date to Rate Implementation Date	PISCC	Long-Term Debt	6.50%
Post Rate Implementation Date	RORB	Equity, Long-Term Debt	11.36%

Q20. Does the existing approach to recognition accurately reflect the cost of funds used to finance PIR Program expenditures?

A20. No. The AFUDC and RORB returns reasonably reflect the cost of funds used to finance the PIR Program because they both include an equity component. However, the PISCC rate, which is based solely on the cost of long-term debt, does not adequately reflect financing costs because it does not include the cost of equity. Although DEO's PIR Program application requested a RORB return as of the In-Service Date, the Company accepted the PISCC return as one consideration in the settlement of the case.

Q21. How long does the PISCC rate apply to investments made in the PIR Program?

A21. PISCC is applied from the In-Service Date to the Rate Implementation Date. If rates are approved by the Commission consistent with the timing of the most recent update to DEO's PIR Cost Recovery Charge, that period could be a little as five months or as long as 17 months. On average, the rate applies for 11 months, or nearly a year.

Q22. Why is that level of PISCC compensation inadequate for investments made under the accelerated PIR Program?

A22. PISCC does not fully recover the cost of funds because it fails to consider the role of equity in support of capital expenditures. With DEO now on the verge of committing nearly twice as much annual spending, it is time to recognize the cost of the debt <u>and</u> equity used to finance the program. It makes no sense to begin recording a cost of funds with equity via AFUDC during construction, reduce it for nearly a year on average to a debt-only PISCC rate once the asset is actually placed into service, and then wait for up to 17 months before being permitted to recognize a full pre-tax RORB that once again includes an equity component. That disparity, while challenging enough under the current program, becomes unbearable with an annual program expenditure that is nearly twice as large. To put that in perspective, the $230 to $250 million that DEO plans to spend <u>each year</u> under its accelerated program is roughly 22% of DEO's entire net plant of $1.067 billion included in the rate base from its last rate case. A commitment to that level of capital spending – and the job creation and other benefits that go along with it – should not be penalized by a return that is so obviously deficient, especially since it is applied to nearly a year's worth of investment on average (i.e., the average of 11 months between the In-Service Date and the Rate Implementation Date).

Q23. How does DEO propose to change the return it receives on investments between the In-Service Date and the Rate Implementation Date?

A23. DEO proposes to replace the current debt-only PISCC rate with a pre-tax return on rate base that reflects the embedded cost of long-term debt and a cost of equity using the 10.38% rate included in its existing, Commission-authorized RORB. This change will properly recognize the cost of the debt and equity previously authorized by the Commission and eliminate the disparity present in the current return structure.

Q24. Does Dominion's capital allocation process support that proposed change?

A24. Yes, it does. Without a change, DEO operates at a distinct disadvantage in competing for capital funds within Dominion. For example, Dominion investments in FERC-regulated electric transmission facilities are subject to formula rate treatment in which the rates that are put into effect reflect forward looking costs – including a return on rate base that includes an equity component. Likewise, Dominion Virginia Power investments in certain state-regulated generation obtain a full return, including equity, throughout the life of the project. In both of those examples, the company is able to earn a premium on top of its authorized return. By contrast, DEO labors for nearly a year at a sub-par return, with no equity component, before generating an RORB that is still below those of other regulated Dominion investments. Dominion senior management acknowledges the importance of DEO's plan to accelerate PIR Program spending. However, it has made it clear that increased PIR Program investments – investments that will nearly equal DEO's total net plant reflected in current rates every four years – must receive a return that is more commensurate with those of other operating companies competing within Dominion for the same capital funding.

Q25. Why is it appropriate for DEO to adopt a pre-tax return on rate base for investments from the In-Service Date to the Rate Implementation Date, when other LDCs with similar programs still operate with a debt-only PISCC rate?

A25. DEO is not suggesting that it be the only LDC afforded that type of treatment. In fact, DEO believes it would be appropriate to provide such an opportunity to other LDCs that significantly increase their spending in such programs. The policy template for such an approach can be found in the federal Energy Policy Act of 2005. That Act directed FERC to develop incentive-based rate treatment for electric transmission investments to bolster investment in the nation's transmission infrastructure, promote electric power reliability and lower costs for consumers by reducing transmission congestion. A new section of the Federal Power Act, section 219, implemented that directive through incentive-based rate treatments such as premium rates of return on equity for new investment, use of hypothetical capital structures and full recovery of prudently incurred construction work in progress and pre-operations costs, among other measures. The rule also provided expedited procedures for the approval of incentives to provide utilities greater regulatory certainty and facilitate the financing of projects. The situation facing Ohio's energy infrastructure is strikingly similar to this interstate example. Providing a return that is more commensurate with an LDC's real cost of capital throughout the entire investment and recovery cycle will promote increased investment in the replacement of aging infrastructure. Note that DEO is <u>not</u> requesting a premium ROE nor a return on projected investments. We are merely requesting a compensatory equity return on actual expenditures to recognize the following factors:

- DEO's need to compete for discretional capital funding with other Dominion operating companies that are providing superior regulated returns,
- DEO's willingness to nearly double the rate of its mainline replacement capital spending,
- An annual capital spending commitment equal to approximately 22% of the net plant reflected in existing base rates,

- The need to properly recognize the equity portion of the cost of capital throughout the entire investment and recovery cycle, and
- The opportunity to promote increased investments in the replacement of aging pipeline infrastructure and enhance job creation and the economic climate within the Company's service territory and the State of Ohio.

Q26. Does this conclude your direct testimony?

A26. Yes.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Direct Testimony of Jeffrey H. Murphy was served by U.S. Mail to the following on this 31st day of March, 2011:

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