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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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In the Matter of the Application of The :
East Ohio Gas Company d/b/a/ : Case No. 11-6024-GA-UNC
Dominion East Ohio to Implement a :
Capital Expenditure Program. :

In the Matter of the Application of The :
East Ohio Gas Company d/b/a/ : Case No. 11-6025-GA-AAM
Dominion East Ohio for Authority to :
Change Accounting Methods. :

COMMENTS
SUBMITTED ON BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO

Michael DeWine
Ohio Attorney General

William L. Wright
Section Chief

Stephen A. Reilly
Assistant Attorney General
Public Utilities Section
180 East Broad Street, 6th Fl.
Columbus, OH 43215
614.466.4395 (telephone)
614.644.8764 (fax)
william.wright@puc.state.oh.us
stephen.reilly@puc.state.oh.us

Date Submitted: March 12, 2012

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I. INTRODUCTION AND BACKGROUND

On December 23, 2011, the Dominion East Ohio Gas Company d/b/a Dominion East Ohio (DEO or Company) filed an Application in the above captioned cases seeking authority from the Public Utilities Commission of Ohio (Commission) to implement a capital expenditure program (CAPEX Program) and to modify its accounting procedures to provide for: (1) capitalization of post-in-service carrying costs (PISCC) on those assets of the CAPEX Program that are placed into service but not reflected in the Company's rates as plant in service; (2) deferral of depreciation expense and property taxes directly attributable to the CAPEX Program assets that are placed into service; and, (3) creation

of a regulatory asset to defer the PISCC, depreciation expense, and property tax expense for recovery in a future proceeding.¹

DEO filed its Application pursuant to sections of recently enacted Amended Substitute House Bill 95 (HB95) as codified in Chapter 49 of the Ohio Revised Code. Specifically, R.C. 4929.111(A) provides that a natural gas company may file an application with the Commission under R.C. 4909.18, 4929.05, or 4929.11 to implement a CAPEX Program for any of the following:

1. Any infrastructure expansion, infrastructure improvement, or infrastructure replacement program;
2. Any program to install, upgrade, or replace information technology systems;
3. Any program reasonably necessary to comply with any rules, regulations, or orders of the Commission or other governmental entity having jurisdiction.

R.C. 4929.111(C) provides that the Commission shall approve a natural gas company's application for a CAPEX Program if the Commission finds that the CAPEX Program is consistent with the natural gas company's obligation to furnish necessary and adequate services and facilities under R.C. 4905.22 and that the services and facilities are just and reasonable. Further, R.C. 4929.111(D) provides that, in approving an application for a CAPEX Program under Division (C), the Commission shall authorize the natural

¹ *In the Matter of the Application of The East Ohio Gas Company d/b/a/ Dominion East Ohio to Implement a Capital Expenditure Program and for Authority to Change Accounting Methods*, Case No. 11-5351-GA-UNC, *et al.* (Application at 1) (December 23, 2011) (DEO Application).

gas company to create regulatory assets for PISCC on that portion of the CAPEX Program assets that are placed into service but not reflected in base rates as plant-in-service and for incremental depreciation and property tax expense directly attributable to the CAPEX Program for recovery or deferral for future recovery in an application pursuant to R.C. 4909.18, 4905.05, or 4929.11. R.C. 4929.111(F) authorizes the natural gas company to make any accounting accruals necessary to establish the regulatory assets authorized under R.C. 4929.111(D) in addition to any allowance for funds used during construction (AFUDC). And, lastly, R.C. 4929.111(G) provides that any accrual for deferral or recovery under R.C. 4929.111(D) shall be calculated in accordance with the system of accounts established by the Commission under R.C. 4905.13.

On January 27, 2012, the Attorney Examiner assigned to these cases issued an Entry setting a procedural schedule for comments on DEO's Application as follows:

- March 5, 2012 – Deadline for filing of motions to intervene;
- March 12, 2012 – Deadline for the filing of comments on the Application by Staff and interveners; and,
- March 22, 2012 – Deadline for all parties to file reply comments.

II. DEO'S APPLICATION AND PROPOSED DEFERRALS

In its Application, DEO proposes a CAPEX Program covering the period October 1, 2011 through December 31, 2012 and totaling an estimated \$95 million.² DEO states

² *DEO Application* at Exhibit A.

that the capital spending under the CAPEX Program specifically excludes capital expenditures associated with non-jurisdictional services.³ It also breaks down the CAPEX Program expenditures into three broad categories: (1) “Infrastructure Expansion, Improvement or Replacement;” (2) “Installation, Upgrade or Replacement of Information Technology”; and (3) “Programs Reasonably Necessary to Comply with Commission Rules, Regulations and Orders.”⁴ The three categories and their estimated annual amounts are shown below in Table 1.

Table 1 – DEO’s Estimate of Annual CAPEX Program Spending by Category⁵
(\$Millions)

CAPEX Program Category	10/1 – 12/31/2011 Est.	2012 Est.
Infrastructure Expansion, Improvement or Replacement	14.0	31.0
Installation, Upgrade or Replacement of Information Technology	9.0	10.0
Programs Reasonably Necessary to Comply with Commission Rules, Regulations and Orders	11.0	20.0
Total CAPEX Program Capital Spending	34.0	61.0

³ *DEO Application* at 2.

⁴ *Id.* at 2-3.

⁵ *Id.* at Exhibit A

The Company further describes the three CAPEX Program categories as follows:

- **Infrastructure Expansion, Improvement or Replacement** – includes capital expenditures for distribution system betterments; pipeline, regulating station, or other improvements or replacements, including non-billable pipeline relocations, associated with DEO’s distribution, transmission, storage, and production/gathering systems that are not covered by DEO’s Automated Meter Reading Device (AMRD) and Pipeline Infrastructure Replacement (PIR) programs; storage well and compression station improvements or replacements; and new customer main line extensions, main-to-curb and curb-to-meter service line and meter installations.⁶
- **Installation, Upgrade or Replacement of Information Technology** – includes capital expenditures for upgrades to or replacement of computer systems utilized for accounting, billing, and utility operations, as well as communication systems which may include costs for hardware, software purchases or development, installation, and associated licenses or other costs.⁷
- **Programs Reasonably Necessary to Comply with Commission Rules, Regulations and Orders** – includes capital expenditures for required pipe-

⁶ *DEO Application* at 2.

⁷ *Id.* at 3.

line integrity, environmental compliance, metering, facilities, fleet, and other general plant associated with providing DEO's regulated services.⁸

The Company states that the CAPEX Program costs include applicable supervisory, engineering, general and administrative overheads and Allowance for Funds Used During Construction (AFUDC) and are net of any contributions, deposits, or other aid to construction.⁹ In addition, it maintains that the CAPEX Program is consistent with its obligation to furnish necessary and adequate service and facilities pursuant to R.C. 4905.22.¹⁰

III. STAFF'S REVIEW

The Staff has reviewed DEO's Application, proposed CAPEX Program, and request to create a regulatory asset to defer for future recovery PISCC, depreciation expense, and property tax expense directly attributable to the CAPEX Program investments. The purpose of the Staff's review was to determine if, in the Staff's opinion, the proposed CAPEX Program and associated deferrals meet the just and reasonable standards established in R.C. 4929.111 and generally comport with sound ratemaking principles regarding deferring costs for potential future recovery by regulated utilities. It is important to note that, in these Comments, the Staff is taking no position on the level or prudence of the capital spending proposed in the CAPEX Program. However, the Staff's

⁸ *DEO Application* at 3.

⁹ *Id.* at 4.

¹⁰ *Id.*

lack of comments or objection to the proposed CAPEX Program investments should in no way be construed as the Staff's lack of objection or support for future recovery of the investments or related deferred amounts. In fact, the Staff will investigate and recommend any necessary adjustments to the deferral when DEO applies to recover the deferred asset.

To accomplish its review, the Staff reviewed DEO's Application, issued formal information requests, requested supplemental or clarifying information, when needed, and conducted teleconferences with appropriate Company personnel.

IV. STAFF'S COMMENTS AND RECOMMENDATIONS

Based on its review, the Staff makes the following comments and recommendations to DEO's proposed CAPEX Program and regulatory asset for deferral of the PISCC depreciation, and property taxes associated with the CAPEX Program. The Staff's comments and recommendations by topic and are set forth below.

A. The deferred regulatory asset should be net of any incremental revenue.

DEO's proposed CAPEX Program investments could generate revenue that is incremental to the revenue provided by the rates that were set in its last base rate case, Case No. 07-829-GA-AIR (2007 Rate Case). However, the Company's proposal for the CAPEX Program and related deferral of PISCC and depreciation and property tax expenses does not include a provision for recognizing potential incremental revenue. The accounting and ratemaking principle known as the "matching principle" suggests that

expenses and related revenues should be recorded on a company's books in the same time period. DEO is proposing to defer on its books (i.e., carry forward) certain expenses associated with the CAPEX Program for future recovery, thus any related incremental revenue for the same time period should be recognized and brought forward as well. Therefore, the Staff would recommend that the Commission direct DEO to net out any incremental revenue from its monthly calculation of the regulatory asset that will be created to defer PISCC, depreciation expense, and property tax expense related to the CAPEX Program.

The Staff's recommendation, however, is not as simple as it sounds. DEO has multiple sources of revenue that may or may not be related to or impacted by CAPEX Program investments and identifying particular revenue sources that are impacted by the CAPEX Program and by how much is likely to be a difficult and potentially contentious process. Therefore, the Staff would recommend that the Commission direct the Company, Staff, and intervening parties to meet and attempt to agree on a formula for calculating the incremental revenue that would be subtracted from the CAPEX Program regulatory asset as it is recorded monthly. The Staff would further suggest that the Commission set a date by which the parties must file an agreed upon calculation. If the parties are unable to reach an agreement by the established date, then the Commission should set a date by which the parties should file their own proposals for calculating the potential incremental revenue with an accompanying rationale.

B. The deferred PISCC should be applied to net plant rather than gross plant.

In response to a Staff Data Request No. 2, DEO described the formula it proposes to use to calculate the PISCC that will apply to the CAPEX Program investments and be deferred via the regulatory asset created.¹¹ The proposed formula calls for applying the PISCC to gross plant additions that have not been adjusted to net out accumulated depreciation or the retirement existing plant. The data request response is unclear regarding whether or not the Company's proposed PISCC formula will net out the cost of removing existing plant.¹² The Company's proposal will result in PISCC being applied to inflated plant balances and deferral of inflated PISCC amounts and is inconsistent with past practice and Commission rulings on this topic.¹³ The Staff recommends that the Commission direct DEO to modify its proposed PISCC calculation to net out accumulated depreciation and retirement and the cost of removal of existing plant.

¹¹ DEO Response to Staff Data Request No. 2 at 1 (February 15, 2012).

¹² The PISCC formula described in the Company's response to Staff Data Request No. 2 does not include a provision to net out the cost of removal, but the response states that DEO's formula will be consistent with its practice in the Pipeline Infrastructure Replacement (PIR) Program where it does net out cost of removal.

¹³ As noted above, it is DEO's current practice to net out the cost of removal of existing plant in its PISCC calculation for its PIR Program. As to netting out retirements and accumulated depreciation, the Staff would point to the Commission's Entry in Case No. 92-555-GA-AAM, *In the Matter of the East Ohio Gas Company Application for Authority to Modify Its Accounting Procedures to Accumulate Post In-Service Carrying Charges and to Defer and Subsequently Amortize Depreciation and Other Expenses Associated with the Protection of Gas Pipelines*, Case No. 92-555-GA-AAM (Entry at 2-3) (April 30, 1992). In this Entry the Commission authorized East Ohio to create the requested deferrals with PISCC "net of retirements and deferred costs normally expensed ..." (e.g., depreciation).

C. DEO's calculation of the depreciation expense should be net of plant retirements.

In response to a Staff Data Request No. 2, DEO describes its proposed methodology for calculating the depreciation expense that will be deferred. The Company's proposed methodology, however, does not recognize the retirement of plant assets that may be replaced by CAPEX Program investments. Thus, the Company would over-recover depreciation expenses. The depreciation expenses associated with the new plant investments under the CAPEX Program will be deferred for future recovery. However, the Company fails to recognize that its current rates already include depreciation expense on the plant that is being replaced. By not netting retirements out of the calculation of the depreciation expenses to be deferred, the Company will, in effect, be recovering depreciation expenses twice. As a result, the Staff recommends that the Commission direct DEO to modify its proposed calculation of the CAPEX Program depreciation expense so as to be net of retirements and cost of removal.

D. The CAPEX program deferral should have a time limit.

All of the large natural gas companies in Ohio have infrastructure replacement riders that provide for annual recovery of investments made to replace aging infrastructure in their systems (including a return on the investments). In addition, several of the companies have riders for return of and return on annual investments to upgrade their systems through installation of automated meter reading devices. The gas companies also all have various riders to support low-income assistance programs, recovery of losses due to customer nonpayment, and cost recovery for maintaining standard service offers and sup-

porting customer choice programs. In addition, as noted above, HB95 provides for deferral of PISCC and certain expenses and potential annual recovery of non-infrastructure capital investments. These riders and deferrals are in addition to the base rates that were established in the companies' last base rate case. The rates from these cases were designed to recover the companies' capital investments and fixed and variable costs and provide a reasonable rate of return for providing gas distribution service to customers into the future. The riders and deferrals in conjunction with the base rates give rise to a concern that there could be protracted length of time between when a gas company creates CAPEX Program deferrals and ultimately seeks recovery of the deferred assets in a future rate proceeding.

Given the potential for a protracted period of time between when CAPEX Program deferrals are created and ultimately recovered, the Staff supports the Commission establishing a fixed date by which the deferrals cease and the companies must apply for recovery of deferred CAPEX assets. In its Application in these cases, DEO states that "recovery of any amounts deferred pursuant to approval of this Application will be addressed in a separate proceeding not more than one time each calendar year, commencing in calendar year 2013."¹⁴ Further, in response to Staff Data Request No. 8, the Company stated that "...it is likely that DEO will submit an application in 2013 requesting approval of either an automatic adjustment mechanism or an alternative rate plan to recover the post-in-service carrying costs, depreciation, and property tax associated with the assets placed

¹⁴

DEO Application at 5.

into service as part of DEO's capital expenditure plan, for which the authority to defer such costs to a regulatory asset has been requested in this case."¹⁵ The Staff supports a DEO application in 2013 for recovery of the deferred asset created in these cases. If, however, DEO does not seek recovery of the deferred asset in 2013, then the Staff would recommend that the deferral created in these cases cease on December 31, 2014 in order to prevent the deferral from perhaps growing to unreasonable levels.

E. DEO should be required to make annual informational filings.

The Staff also recommends that the Commission should direct the Company to make annual informational filings detailing the CAPEX Program investment deferrals recorded on its books. As noted above, there could potentially be protracted periods of time between when the regulatory asset to defer the CAPEX Program PISCC and expenses are created and when DEO makes an application to recover the deferred amount. This could result in the deferral accumulating to significant amounts that could substantially increase the rates that customers will pay when the Company ultimately seeks to recover the deferral. The Staff proposes that the annual filing should detail the monthly CAPEX capital investments and the calculation used to determine the deferred amounts to be recorded. Specifically, the Company should provide a breakdown of investments, PISCC, depreciation expense, property tax expense, and incremental revenue. This should be based on the calendar year and filed on March 15th of the succeeding

¹⁵ DEO Response to Staff DR No. 8 (March 5, 2012).

year. In addition to the calculations, a capital budget for the upcoming year should also be provided.

V. CONCLUSION

The Staff has reviewed DEO's Application in these cases for authority to create a CAPEX Program and a related regulatory asset to defer for future recovery associated PISCC and depreciation and property tax expenses. And, with adoption of the Staff's recommendations for modifying the calculation of the regulatory asset and annual informational filings detailed above, the Staff would respectfully recommend that the Commission approve DEO's Application.

Respectfully Submitted,

Michael DeWine
Ohio Attorney General

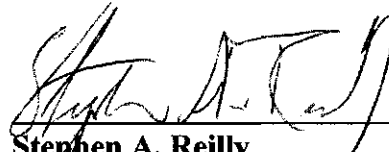
William L. Wright
Section Chief

A handwritten signature in black ink, appearing to read "Stephen A. Reilly", is written over a horizontal line.

Stephen A. Reilly
Assistant Attorney General
Public Utilities Section
180 East Broad Street, 6th Fl.
Columbus, OH 43215
614.466.4395 (telephone)
614.644.8764 (fax)
william.wright@puc.state.oh.us
stephen.reilly@puc.state.oh.us

VI. CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing **Comments** submitted on behalf of the Staff of the Public Utilities Commission of Ohio was served by electronic mail upon the following parties of record, this 12th day of March, 2012.



Stephen A. Reilly
Assistant Attorney General

PARTIES OF RECORD:

Mark A. Whitt
Carpenter, Lipps & Leland
280 Plaza, Suite 1300
280 North High Street
Columbus, OH 43215
whitt@whitt-sturtevant.com

Joseph P. Serio
Assistant Consumers' counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485
serio@occ.state.oh.us