

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of The East)	
Ohio Gas Company d/b/a Dominion East)	Case No. 15-0362-GA-ALT
Ohio for Approval of an Alternative Form of)	
Regulation)	

**SUPPLEMENTAL DIRECT TESTIMONY OF MICHAEL C. REED
ON BEHALF OF
THE EAST OHIO GAS COMPANY D/B/A DOMINION EAST OHIO**

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1 **I. INTRODUCTION**

2 **Q1. Please introduce yourself.**

3 A. My name is Michael C. Reed. I am employed by The East Ohio Gas Company d/b/a
4 Dominion East Ohio (DEO) as General Manager, Pipeline Operations. My business
5 address is 1201 East 55th Street, Cleveland, Ohio 44103-1028.

6 **Q2. Are you the same Michael Reed who submitted direct testimony in this proceeding**
7 **on March 31, 2015?**

8 A. Yes, although as noted my title and business address have changed since then.

9 **Q3. What is the purpose of your supplemental testimony?**

10 A. My testimony will respond to certain objections to the Staff Report submitted by the
11 Office of the Ohio Consumers' Counsel (OCC). In particular, I will explain DEO's
12 strategies to manage program costs, as well as recent trends that tend to increase overall
13 project costs.

14 **II. COST-MANAGEMENT PRACTICES**

15 **Q4. OCC has questioned DEO's management of costs. (OCC Objections at 11.) Do you**
16 **believe that DEO reasonably manages its costs?**

17 A. Yes, and this was verified in the Staff Report. It is important to bear in mind two points:
18 one, that the vast majority of program costs are contractor payments; and two, that the
19 prices for contractor work are set using a competitive-bid process. Smaller projects are
20 bid on a per-unit basis to set "blanket" prices. Larger, or "major," projects are bid
21 individually, and major projects make up a majority of contractor costs. Every major
22 project is unique, reflecting a specific combination of cost factors, including the kind,
23 amount, and complexity of the infrastructure to be replaced; the location and terrain; the
24 presence of man-made and natural obstacles and other kinds of interference; and local

1 codes and regulations. The use of a bid process, in which experienced and qualified
2 contractors bid for the right to perform these projects, ensures that the price of the work is
3 reasonable and market-driven. DEO believes that the competitive-bid process achieves
4 the lowest possible price.

5 **Q5. Did Staff review DEO's cost-management processes?**

6 A. Yes. According to the Staff Report, DEO employs "a robust competitive contractor
7 bidding and selection process and an effective program for recruiting contractors and
8 assisting them to become qualified to submit bids on PIR projects." (Staff Report at 8.)
9 The Staff found that "DEO has a large number of eligible contractors in its bid
10 solicitation pool and, on average, more contractors are submitting bids on projects now
11 than in the past." (*Id.*)

12 **Q6. Do you agree with these statements?**

13 A. Yes. These statements correctly describe DEO's processes and experience, and they
14 confirm that DEO's approach to bidding projects constitutes a reasonable means of
15 managing costs.

16 **Q7. In addition to utilizing a competitive-bidding process, what other steps has DEO**
17 **taken to keep project costs down?**

18 A. DEO continually works to develop and increase a large network of contractors to
19 compete for program work. For example, in July 2015, over 20 contractors were
20 approved to participate in competitive bidding. And DEO's market is not dominated by
21 any one contractor. For example, in 2014, the largest contractor performed less than 20%
22 of total construction projects; 6 contractors each performed at least 9% of all construction
23 work; and 13 contractors each performed between 1% to 4% of all construction work.

DEO also takes steps to ensure that the bid price generally matches the final price. The bid process is subject to well-defined rules and expectations, which limit changes between the bidding of a project and its completion. DEO also carefully investigates, designs, and defines each major project to help ensure that the project is accurately bid without later confusion. DEO applies a set of clearly defined, written rights and obligations for each project, which includes assigning numerous risks upfront and establishing clear “rules of the road” for any changes. A construction-guidance document for each project also provides detailed information about construction procedures and helps define expectations for contractors to avoid problems later. These and other processes and procedures, in conjunction with the competitive bidding process, all help ensure that costs are kept under control.

Q8. Are there any other facts that lead you to believe that DEO is generally achieving the lowest possible market prices for replacement projects?

A. Yes. As noted, DEO continually works to increase the number of contractors participating in the program. Along those lines, DEO has recruited major contractors from other regions of the country or other parts of Ohio to bid on PIR projects. In many cases, these contractors have been unable to gain a foothold in DEO’s market because costs have been bid so low. This fact demonstrates that DEO is achieving the lowest possible price for project work. If existing contractors were bidding noncompetitive prices, outside contractors would have no problem taking the work.

III. FACTORS DRIVING COST INCREASES

Q9. OCC asserts that that DEO “does not have a firm handle on what is driving the significant increase in unit costs.” (OCC Objections at 13.) Do you agree?

A. No. OCC quotes a DEO discovery response in making this statement, but it does not fairly characterize that response. The response explained that the reason certain costs are

1 “impractical to track” is that they are “experienced primarily through contractor bid
2 prices, and as such are not itemized.” (*See id.* (quoting DEO response to Staff DR No.
3 2).) As explained above, the vast majority of program costs are payments to contractors,
4 and many of the cost drivers (environmental compliance, municipal regulations, etc.) are
5 experienced and borne by contractors. Thus, many of these costs are not itemized on
6 DEO’s books, but “baked into” the bid prices on individual PIR projects. Given the
7 volume of PIR work, individual cost elements cannot be easily broken out and precisely
8 quantified. That is what DEO’s discovery response explained, not that it does not
9 understand the factors driving up costs. On the contrary, DEO verified these cost factors
10 to the satisfaction of Staff.

11 **Q10. The Staff Report agreed with DEO that cost increases are attributable to four**
12 **different “cost drivers”: the switch from rural to urban work; environmental**
13 **compliance; inflation; and increased contractor costs. Based on your knowledge of**
14 **the PIR Program, do you agree with the Staff Report’s conclusion?**

15 A. Yes. I have already explained the increase in environmental-compliance costs in my
16 direct testimony, which Staff verified, and DEO witness Vicki Friscic addresses
17 inflationary impacts. I will further elaborate here on the two other drivers: the switch in
18 focus from rural to urban work, and the increase in contractor costs.

19 **Q11. Explain the shift in focus from rural to urban pipeline replacement projects.**

20 A. Early in the PIR Program, there was a significant focus on rural projects, which
21 constituted the large majority of major project work, with only a small percentage of
22 costs spent on urban projects. Compared to urban work, rural jobs are easier to plan,
23 permit, and execute. But given the amount of work to be done in DEO’s highly urban,
24 northeastern Ohio service territory, it was always known that the rural focus would be

temporary. And at present, that focus has reversed, with urban projects now constituting the large majority of work and rural projects only making up a small portion.

Q12. What impact does this shift have on overall costs?

A. As noted, rural projects are much less costly than urban projects. Rural projects tend to be less time-consuming, involving fewer services, an open, unpaved workspace, and fewer code or regulatory limitations. In contrast, urban projects tend to involve a more crowded environment, a larger number of services, more difficult terrain, reliance on additional traffic control operations, man-made obstacles (such as paved surfaces and other underground facilities), and greater permitting or code restrictions. As a result of all of these factors, urban projects mile for mile tend to require substantially more time and resources to complete than rural projects. Because of these factors, and because a majority of projects now involve urban pipeline replacement, overall project costs have substantially increased in recent years.

Q13. Does DEO expect this trend to continue?

A. Yes. Certainly for the next five years, DEO expects that pipeline-replacement work for major projects—larger, planned jobs which constitute the majority of work under the Program—will continue to be more concentrated in urban areas. Based on DEO's review of projects currently underway or in development, urban footage will continue to substantially exceed rural footage.

Q14. The Staff Report also stated that contractor costs have increased. What factors have led to an increase in contractor costs?

A. As already discussed, the challenges of urban replacement projects make the work much more costly to perform. Contractors will generally reflect these increased costs in their bid prices. Environmental requirements also drive up the cost of work. Beyond this, other

1 components of replacement projects have increased: labor costs have gone up, as have the
2 cost of various components necessary for replacement work, such as concrete, plastics,
3 pipefittings, and the pipe itself.

4 **Q15. Does DEO expect the trend of these increased costs to continue?**

5 A. Yes. Based on information available to it at this time, DEO anticipates that the trend of
6 increasing contractor costs will continue over the proposed reauthorization period of the
7 program. DEO contacted its four largest contractors, all of whom reported an expectation
8 that current trends would continue. Contractors specifically cited contractual increases in
9 labor rates, and expected increases in material costs, due to increased demand and
10 reported reductions in supply sources.

11 **Q16. OCC states that “the costs of achieving [the 25-year goal] have increased,” which**
12 **supports reconsidering the goal. (OCC Objections at 3.) Do you agree that**
13 **increasing costs justify slowing down the pace of replacement?**

14 A. No. In addition to the concerns expressed by DEO witness Vicki Friscic, I am also
15 concerned that slowing down the pace of the program could increase the perception of
16 risk on the part of contractors, and discourage them from further expanding their
17 businesses. If this occurred, it could result in unwanted price impacts or other slowdowns.

18 **Q17. OCC also states that the “pipe construction market is likely to see a reversal in**
19 **recent trend of cost increases.” (OCC Objections at 8.) Do you agree with OCC that**
20 **there is likely to be a reversal in recent cost increases?**

21 A. As noted, DEO’s contractors reported that they expected continued increases, and the
22 cost trend at present is upward. But even if OCC is correct, as explained in DEO witness
23 Vicki Friscic’s testimony, cost decreases would be beneficial, so I do not see this as being
24 cause for concern.

1 **IV. CONCLUSION**

2 **Q18. Does this conclude your testimony?**

3 A. Yes. DEO reserves, however, the right to provide rebuttal testimony upon considering
4 any additional testimony provided by other parties to this case.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Supplemental Testimony was served
by electronic mail this 21st day of January, 2016, to the following:

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Summary: Text Supplemental Direct Testimony of Michael C. Reed electronically filed by Ms. Rebekah J. Glover on behalf of The East Ohio Gas Company d/b/a Dominion East Ohio