

**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. 15-362-GA-ALT
Ohio for Approval of an Alternative Form of)	
Regulation)	

**POST-HEARING BRIEF OF
THE EAST OHIO GAS COMPANY D/B/A DOMINION EAST OHIO**

Mark A. Whitt (Counsel of Record)
Andrew J. Campbell
Rebekah J. Glover
WHITT STURTEVANT LLP
The KeyBank Building, Suite 1590
88 East Broad Street
Columbus, Ohio 43215
Telephone: (614) 224-3946
Facsimile: (614) 224-3960
whitt@whitt-sturtevant.com
campbell@whitt-sturtevant.com
glover@whitt-sturtevant.com

ATTORNEYS FOR THE EAST OHIO
GAS COMPANY D/B/A DOMINION
EAST OHIO

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I. INTRODUCTION

When the Commission initially approved The East Ohio Gas Company d/b/a Dominion East Ohio's (DEO) Pipeline Infrastructure Replacement (PIR) Program, it did so with the expectation that DEO would complete the program within 25 years. The Commission did not give DEO a blank check to execute the program. The pace of the program is tethered to an annual cap on the level of investment that DEO may recover from customers. This cap directly impacts how long it will take to complete the program. Thus, the rate cap requires a delicate balance of competing interests: on one hand, the prompt elimination of safety hazards, and the associated rate impact on the other.

DEO filed the application because these interests have become unbalanced. The current rate-increase cap of \$1.40 will not support the level of investment needed to complete the program in 25 years. This does not reflect mismanagement or inefficiency, but the simple fact that a dollar today does not go as far as a dollar in 2007, when the original estimates of the cost of the PIR program and timeframe for completion were developed. Anyone who earns a wage knows that today's dollars do not purchase the same amount of goods and services that they did in 2007. The situation is no different for DEO. Replacing nearly 5,600 miles of bare-steel, cast-iron, and ineffectively coated pipeline—enough to stretch from Alaska to Venezuela—requires labor and materials far beyond what DEO can provide itself. DEO manages its costs well, but the firms that provide the necessary labor and materials charge more today than they did in 2007, and their costs are likely to increase further in the future. This is not merely a function of general inflation. Program-specific cost factors, such as environmental compliance, permitting, and urban replacements, have had an even more dramatic effect. As the purchasing power of a dollar continues to erode, more dollars will be needed to accomplish the same amount of work.

DEO could continue to execute the PIR program with the resources available under the existing cap, but stretching the program beyond 25 years would invite a risk measurable not in dollars, but potentially in catastrophic impacts. The pipeline targeted for replacement is prone to leak, and prone to leak at exponential rates. Over a long enough timeline, pipe that is prone to leak *will* leak. When leaking gas ignites, it can have devastating effects. The only failsafe method of eliminating the risk posed by aging, prone-to-leak pipe is to replace it.

The interests of safety and rate impacts would be put back into balance by a gradual increase in the rate cap, from its current level of \$1.40 to \$1.85 over the proposed five-year reauthorization period. The maximum cumulative impact on residential customers of the requested change will be about two dollars a month during the fifth year of the reauthorization period. This change, modest for any individual customer, will help ensure the timely replacement of DEO's vast mileage of corrosion-prone pipelines.

The only concern that might counsel against increasing investment—bill impact—is non-existent. Unlike most other costs, the cost of natural gas has dropped dramatically since 2008. Today's total bills are, on average, less than half of what they were when the PIR Program was first approved—over \$800 less per year. To be clear, the PIR Program is not a make-work exercise, only justifiable in times of low commodity costs. Far from it: the safety concerns behind the program demand that the work be done regardless of commodity costs. But with this said, the more work that can be done while commodity costs are low, the better it will be for customers.

The Commission's Staff has reviewed and confirmed that the facts support approval of DEO's application. Staff recommends approving DEO's application with one modification, to which DEO has stipulated. The Commission should approve the stipulation.

II. FACTUAL AND PROCEDURAL BACKGROUND

A. **The purpose of the PIR Program is to ensure safety, by timely replacing thousands of miles of corrosion- and leak-prone pipeline.**

When the PIR Program was first approved in 2008, DEO's pipeline system contained nearly 5,600 miles of bare-steel, cast-iron, wrought-iron, copper, and ineffectively-coated-steel pipelines, one of the largest concentrations in the country. (DEO Ex. 1.0 (Friscic Dir.) at 3.) Such lines corrode over time, until the pipe wall begins to disintegrate and natural gas escapes. When natural gas escapes and ignites, the result can be catastrophic. (*See* DEO Ex. 3.0 (Friscic Supp.) at 1; DEO Ex. 2.0 (Reed Dir.) at 8.)

To respond to this massive safety threat, DEO designed the PIR Program and the Commission authorized the PIR Cost Recovery Charge. *See* 07-829 Opin. & Order at 9–10 (Oct. 15, 2008). This charge is an automatic adjustment mechanism that enables DEO to finance the accelerated replacement of its corrosion-prone pipelines. DEO proposed completing the work over a period of 25 years, believing this time period to constitute the most reasonable balance among factors “including the pace of replacement, the manageability of the program, the availability of contractor resources, and rate impact.” (Friscic Supp. at 2.) The Commission approved the PIR Program for cost recovery for an initial term of five years, with an initial charge of \$1.12 per month and investment each subsequent year subject to a \$1.00 rate-increase cap. (*See* 08-169 Staff Report at 5.)

Before the first five years were up, however, it became clear that a substantial expansion of the program was needed, due primarily to DEO's identification of over 1,450 miles of ineffectively coated pipeline, in addition to the original 4,122 miles of bare-steel, cast-iron, wrought-iron, and copper pipe. *See* Case No. 11-2401-GA-ALT. In 2011, the Commission approved the expansion of the program to encompass these lines, along with other modifications,

and extended the PIR Program for another five years. (*See* Friscic Dir. at 3–4.) DEO had requested an annual rate-increase cap of \$2.00, but ultimately stipulated to a maximum cap of \$1.40. (*See* 11-2401 Memo. in Supp. Mot. to Modify at 12 (Mar. 31, 2011); 11-2401 Stipulation at 5 (July 15, 2011).)

B. The program approved by the Commission has been successfully executed.

DEO executed the program as promised. It built up a robust system to prioritize, design, and bid out PIR projects, and it fostered a large and able network of contractors to carry out these projects at the lowest possible market price. (*See* DEO Ex. 4.0 (Reed Supp.) at 2.) By the end of 2014, DEO had replaced nearly a thousand miles of corrosion-prone pipeline and over 103,000 curb-to-meter service lines. (*See* Reed Dir. at 3.) The program had reduced leak rates, lost-and-unaccounted-for gas, and operations-and-maintenance (O&M) expenses. (*See* Friscic Dir. at 11–13; *id.* at 25.) The Program had also been subject to audit and review by the Commission Staff and other interested parties every year. Since the Program was last reapproved in 2011, not one dollar has been disallowed nor one decision called into question for imprudence. *See* Case Nos. 11-3238-, 12-812-, 12-3125-, 13-2320-, & 14-2134-GA-RDR.

C. Cost increases are eroding the Company’s ability to maintain the pace of replacement.

Along with this success, however, the cost of the work has increased. DEO had warned of this issue from the very outset of the program. Over seven years in, the rise in costs was seriously eroding DEO’s ability to replace corroded pipeline in the accelerated timeframe approved by the Commission. The factors driving up costs were numerous and unavoidable.

Inflation took a toll on the spending power under the rate caps. Environmental compliance had become more costly. Contractor demand had increased. Working with municipalities proved more difficult than anticipated. (*See* Reed Dir. at 9–23.) All this occurred

as DEO turned from an early focus on rural projects and settled into the more-expensive urban work that will continue to make up the bulk of the program. (Reed Supp. at 4–5.) The contractors who perform the work must absorb these costs, and so as projects became more complex and costly, bid prices accordingly went up. (*Id.* at 5; Staff Report at 7–8.) The net outcome was that a program originally approved with a completion goal of 25 years was projecting to stretch to 35 years or longer. (*See* Reed Dir. at 7.)

D. Proceedings before the Commission.

Given these circumstances, DEO filed its application on March 31, 2015. DEO proposed applying all of the existing terms and conditions of the PIR Program to investments made through the end of 2016. DEO proposed that a new five-year authorization period should begin with 2017 investment. The only change proposed was to increase the annual amount of capital investment under the PIR Program. This would be accomplished by adjusting the annual rate-increase caps, presently \$1.40, as follows:

For 2017 investment:	\$1.75
For 2018 investment:	\$1.82
For 2019 investment:	\$1.83
For 2020 investment:	\$1.84
For 2021 investment:	\$1.85

(*See* DEO Ex. 5.0 (Appl.) at 6–7.) These increases would give DEO a reasonable opportunity to maintain the 25-year pace of replacement. Without these increases, DEO projects that it will take 35 years or more to complete the program. (*See* Reed Dir. at 7.)

The Office of the Ohio Consumers’ Counsel (OCC), Industrial Energy Users-Ohio (IEU) and Ohio Partners for Affordable Energy (OPAE) intervened. While a review and comment period proceeded, Staff began an extensive investigation and review of DEO’s application and its administration of the PIR Program.

E. Staff confirmed that the facts support approving DEO's application.

On August 26, 2015, Staff filed its report. It confirmed that DEO employed effective cost-management procedures, including “a robust competitive contractor bidding and selection process,” but that DEO was “indeed experienc[ing] cost increases.” (Staff Report at 7–8.)

Staff recommended one modification. Under the existing terms, DEO applies a “sharing” mechanism in which it may retain some portion of the operation and maintenance (O&M) savings realized as a result of the PIR Program. (*See* DEO Ex. 6.0 (Friscic 2d Supp.) at 2–3.) Staff recommended eliminating this mechanism, such that customers will receive as a credit to the annual revenue requirement whatever O&M expense savings DEO realizes in a given year. (*Id.*)

With this modification, Staff recommended that the Commission approve DEO's application and “that the Commission keep the 25-year time period it originally adopted for completing the PIR Program.” (Staff Report at 8.)

F. DEO ultimately accepted Staff's modification and entered a stipulation with Staff.

After DEO, OCC, and OPAE filed objections to the Staff Report, all parties engaged in negotiations in an effort to reach a unanimous stipulation to resolve the case. Ultimately, DEO and Staff agreed on a stipulation, which was filed on February 3. The stipulation reflected DEO's acceptance of all recommendations in the Staff Report, including the elimination of the O&M expense sharing mechanism, to which DEO had originally objected. OCC presented testimony against the stipulation. At the hearing on February 16, 2016, the parties unanimously agreed to waive cross-examination of the witnesses and stipulated to the admission of all testimony and exhibits. (Tr. 6–7.) Initial briefs were required by March 15, and reply briefs by March 29. (Tr. 11.)

III. ARGUMENT

The PIR Program proposed by DEO's application and modified by the stipulation complies with R.C. 4929.05, the statute governing alternative rate plans. DEO's plan is simply to continue carrying out the same program already approved *twice* by the Commission, with the modifications needed to maintain the pace already approved by the Commission. The record confirms the need for more investment: despite a cost-management system that Staff found "robust," unavoidable cost increases are sapping the purchasing power of dollars allocated to the program. Not only does the proposed plan comply with R.C. 4929.05, but the stipulation also complies with the Commission's three-part test. The Commission should approve the stipulation.

IV. COMPLIANCE WITH R.C. 4929.05

R.C. 4929.05 requires the Commission to approve an alternative rate plan if the following three conditions are met:

- (1) The natural gas company is in compliance with section 4905.35 of the Revised Code and is in substantial compliance with the policy of this state specified in section 4929.02 of the Revised Code.
- (2) The natural gas company is expected to continue to be in substantial compliance with the policy of this state specified in section 4929.02 of the Revised Code after implementation of the alternative rate plan.
- (3) The alternative rate plan is just and reasonable.

R.C. 4929.05(A)(1)–(3). All three conditions are satisfied here.

A. No party has contested whether DEO is compliant with R.C. 4905.35 and R.C. 4929.02.

The first two provisions of R.C. 4929.05(A) pertain to DEO as a company, and not to the proposed plan: the Commission must find that DEO is in compliance with R.C. 4905.35 and R.C. 4929.02 and that it will remain in compliance with R.C. 4929.02 after the alternative plan is

implemented. DEO complies with these statutes, and the fact of its compliance appears uncontested.

1. The record shows that DEO complies with the non-discrimination statute, R.C. 4905.35.

In the Alternative Rate Plan Exhibits attached to its application, DEO showed its compliance with R.C. 4905.35 by explaining:

- that it does not make or give any undue or unreasonable preference or advantage to any person;
- that it offers its regulated services or goods to all similarly situated consumers, including persons with which it is affiliated or which it controls, under comparable terms and conditions;
- that it does not offer any bundled service that includes a regulated and unregulated service; and
- that it does not condition or limit the availability of any regulated services or goods on the basis of the identity of the supplier or on the purchase of any unregulated services or goods.

(Alt. Rate Exhibits at 5-6.) No party filed comments or testimony questioning whether DEO complies with R.C. 4905.35.

2. DEO complies with state policy under R.C. 4929.02 and will continue to do so if the application is approved.

DEO also provided a detailed explanation of its compliance with state policy under R.C. 4929.02. (Alt. Rate Plan Exhibits at 6-8.) The Company offers “unbundled and ancillary service offerings that provide customers with effective and convenient choices to meet their natural gas supply needs,” and its tariff “provides numerous options for service of varying terms and conditions to meet its customers’ needs for the purchase and delivery of natural gas,” all of which satisfies R.C. 4929.02(A)(2) through (4). (*Id.* at 6–7.) Further, DEO “provides customers the opportunity to choose an alternative commodity supplier,” and “was the first Ohio natural gas utility to develop and implement a successful residential and commercial program,” (*id.*), which

both supports the emergence of competitive natural gas markets, R.C. 4929.02(A)(6), and gives customers effective choice, R.C. 4929.02(A)(3).

DEO also explained that its “current rates do not provide for subsidies to or from regulated services or goods” (Alt. Rate Plan Exhibits at 7), which is consistent with the state policy to “avoiding subsidies flowing to or from regulated natural gas services and goods.” R.C. 4929.02(A)(8).

DEO also supports choice by providing useful information to customers: “DEO’s bill inserts, public outreach initiatives, and customer service representatives provide information useful to customers in making choices about natural gas services and goods.” (Alt. Rate Plan Exhibits at 7.) This is consistent with state policy to “[e]ncourage cost-effective and efficient access to information” to promote “effective customer choice.” R.C. 4929.02(A)(5).

Moreover, DEO promotes “consumer interest in energy efficiency and energy conservation.” R.C. 4929.02(A)(12). DEO’s energy efficiency programs “provide \$6.5 million in annual funding for low-income weatherization programs resulting in more efficient use and conservation of natural gas for qualifying customers.” (Alt Rate Plan Exhibits at 7.) And in collaboration with its DSM Collaborative, DEO’s programs “provide \$3.0 million in annual funding for energy-efficiency and conservation programs for residential customers above the low-income threshold and small business customers.” (*Id.*) The Company’s conservation portfolio also includes online resources that provide energy saving tips and related information to assist customers in becoming more energy efficient in order to manage their bills. (*Id.*)

Finally, DEO explained that approval of the alternative rate plan would not cause the Company to fall out of compliance with R.C. 4929.02. The proposed plan “is a coordinated, cost-effective, and efficient systematic approach to preserving infrastructure reliability and public

safety by decreasing the instances of leakage.” (*Id.* at 8.) Rather than cause any compliance issues, “[i]mplementation of these proposals . . . will ensure continued and enhanced compliance with the policies described in Section 4929.02, Revised Code.” (*Id.*)

This evidence shows that DEO complies with state policy.

B. DEO’s proposed alternative rate plan is just and reasonable.

The final statutory condition for approval is that the “alternative rate plan is just and reasonable.” R.C. 4929.05(A)(3). The PIR Program satisfies this standard.

1. The stipulation enables DEO to continue carrying out the program as previously approved by the Commission.

DEO’s plan is very simple: continue the same plan that the Commission has already approved twice as just and reasonable.

That DEO’s plan has been approved as just and reasonable on two separate occasions shows that the present plan is also just and reasonable. *See* Case No. 08-169-GA-ALT, Order at 12, 32 (Oct. 15, 2008); Case No. 11-2401-GA-ALT, Order at 10 (Aug. 3, 2011). The only element of the plan opposed by any party (a gradual increase in the annual investment cap over the next five years) is manifestly necessary: as expected, and despite effective controls, the cost of replacing pipeline has risen substantially since the program was initially approved in 2008. Without an increase in investment, the program will likely continuously slow down.

Nothing has changed since 2008 that warrants modifying the accelerated replacement schedule. The hazards posed by corrosion-prone pipeline remain just as urgent. But while more investment is needed, the PIR Program has actually become *far more* affordable, as average total bills have declined by over \$800 since 2008, many times more than enough to offset the proposed increase. There is no reason to slow the program down at this time.

a. Natural gas presents intrinsic safety risks.

The fundamental reason for the PIR Program has been and remains public safety. “Natural gas is dangerous unless it is handled properly. It is noxious, flammable, invisible, and naturally odorless. Natural gas is potentially lethal to persons and destructive of property. [Courts] have long recognized its dangers.” *Utility Service Partners v. Pub. Util. Comm.*, 124 Ohio St.3d 284, 2009-Ohio-6764, ¶ 14. Thus, *how* natural gas is distributed implicates serious safety concerns.

At the outset of the program, DEO had more bare-steel pipe in service—over 4,000 miles—than any other gas distribution operator reporting to the U.S. Department of Transportation. Soon after, DEO confirmed that its system contained an additional 1,450 miles of ineffectively coated steel pipe. Thus, at one point, DEO’s system included approximately 5,600 miles of bare-steel, cast-iron, wrought iron, copper, and ineffectively coated lines. (Friscic Dir. at 3.)

All of these lines must be replaced. They are prone to corrosion and loss of integrity, and when that occurs, natural gas begins seeping out of the pipes and into places it does not belong—through the soil, under streets, in basements. (See Friscic Supp. at 1.) Thus far, DEO has effectively prioritized replacement to target the “worst first.” But as past incidents have made clear, “[w]hen pipelines leak and fail, the results can be catastrophic.” (Reed Dir. at 8.)

b. These safety risks demand the accelerated replacement of corrosion-prone pipelines.

The risks posed by corrosion-prone pipeline, and the massive quantity of such pipeline on DEO’s system, demands action. “The best way to cost-effectively mitigate the hazards of bare and ineffectively coated pipe is to replace [the lines].” (*Id.*) No party has proposed any other remedy, and DEO is not aware of any, than the accelerated replacement of corrosion-prone lines.

Given the cost and volume of the work, the only timely way to replace these lines is through the PIR Program.

DEO proposed and the Staff agreed that DEO should continue to target the original replacement goal of 25 years. This timeframe was proposed by DEO and approved by the Commission in 2008, and Staff recommends keeping it. “Staff is not aware of any differences or changes to the factors and information that the Commission relied on when it originally approved the PIR in the 2007 Rate Case.” (Staff Report at 7.) Of course, even with a 25-year replacement schedule, “over 99% of the original 4,122 miles of pipeline will be over 75 years old by the projected end of the program if not replaced, with much of the pipe considerably older.” (Frisic Supp. at 3.) These pipelines are already past the end of their useful lives. Particularly when commodity costs are at such low levels, there is no reason to slow the program down at this time.

c. The stipulation ensures that DEO can continue to implement the program approved by the Commission.

The application and stipulation will give DEO the opportunity to continue the pace approved by the Commission. At present, DEO is subject to an annual rate-increase cap of \$1.40. The amount of replacement work that can be financed under this limit will diminish over time. Instead of the original target goal of 25 years, DEO expects replacement would require an additional ten years, or over 35 total years. (*See* Reed Dir. at 6–7.)

That more investment is needed to keep pace is no surprise. In 2008, during the initial PIR proceeding, DEO made clear that without adjustments for increased costs, the PIR Cost Recovery Charge “will significantly undercollect the actual program costs over the 25-year life of the program, which will rise due to the increases in labor and material costs that will occur over two-and-a-half decades.” (Appl. at 5 (quoting 08-169 Murphy 3d Supp. Dir. at 3–4 (July 25, 2008)).) Again in 2011, during the modification proceeding, DEO warned that failing to adjust

the charge for inflation could “result in the program dragging on for a total of 40 years.” (*Id.* at 6 (quoting 11-2401 DEO Reply Comments at 26 (June 3, 2011)).)

What was predicted then has now come to pass. DEO observed and Staff has confirmed that mile-for-mile, it is becoming more and more expensive to replace target pipeline. (*See infra* § IV.C.) Beginning with 2017 investment, the stipulation remedies this by increasing the annual rate-increase limits from \$1.40 to \$1.75, and then by smaller increments thereafter. The maximum change in the cap, from now to the final year, will be a total of 45 cents (from \$1.40 to \$1.85). By the end of the five-year term, this increase in the annual rate-increase cap will have a cumulative impact of about two dollars a month.¹ That amount will have a minimal impact on any individual customer (particularly in a time of such low commodity prices). But in the aggregate, this sum will have a significant effect on DEO’s ability to finance replacement projects.

Because the stipulation will enable DEO to continue the program as previously approved by the Commission, and to continue aggressively eliminating a serious safety hazard on its system, the plan is “just and reasonable” under R.C. 4929.05(A)(3).

C. Staff determined, and the record confirms, that the proposed increase is necessary.

The record supports this determination. The Staff Report, corroborated by other evidence, proves that DEO is effectively managing its costs but that the factors driving up costs are unavoidable.

¹ This represents the difference between the maximum total rate increase by the fifth year of the reauthorization period if the stipulation is rejected (annual rate-increase cap of \$1.40 times 5 years = \$7.00) and if the stipulation is approved (\$1.75 + \$1.82 + \$1.83 + \$1.84 + \$1.85 = \$9.09).

1. What are PIR costs?

Before addressing the management and cause of cost increases, one must first understand the nature of the costs recovered under the PIR Program. Contractors, not DEO, perform the vast majority of PIR projects, and thus “[t]he vast majority of costs recovered through the PIR Program are contractor payments priced through competitive contractor bidding.” (Friscie Supp. at 6; *see* Reed Supp. at 1.)

Competitive bidding sets the price of PIR projects, both large and small. “Smaller projects are bid on a per-unit basis to set ‘blanket’ prices. Larger, or ‘major,’ projects are bid individually, and major projects make up a majority of contractor costs.” (Reed Supp. at 1.) If a contractor wants a job on DEO’s system, it must outbid all the other participating contractors for the right to do that job. This is the keystone of DEO’s cost-management system—active competition among “experienced and qualified contractors” is what “ensures that the price of the work is reasonable and market-driven.” (*Id.* at 2.)

So when DEO says that costs are rising, this means that the level of winning bids is rising. The salient point: regardless of what factors drive increases in cost, the ultimate price of the work is set competitively by the market. Here, the record confirms that DEO was and is effectively managing its costs, but that due to factors beyond DEO’s control, the cost of replacement work has risen.

2. The record shows that DEO’s cost-management procedures are effective.

DEO recognizes that the PIR Program is not a blank check. The Company has an obligation to manage costs effectively, and the record shows that the Company is doing just that.

a. The evidence shows that DEO's competitive-bidding process is well-designed and attended.

Staff oversees not only DEO's program but three other large infrastructure programs as well. Based on this experience, Staff observed, "One of the most significant hedges or guards against contractor inflation is a robust competitive bidding and selection process." (Staff Report at 8.) Those words describe DEO's cost-management processes.

The most critical element of the process is competitive bidding: let a large number of dedicated and experienced pipeline-construction firms determine the lowest price at which they could do the work, and then award the project to the bidder with the lowest total cost. DEO employs such a process. (*See* Reed Supp. at 1–2.) As discussed above, all PIR projects are subject to competitive bidding. (*See id.*)

No bid process is effective without bidders. DEO has worked for years to build up and maintain a large market of firms to "compete for program work." (*Id.*) Last summer, for example, "over 20 contractors were approved to participate in competitive bidding." (*Id.*) And DEO's market has not been "dominated by any one contractor"—for example, "in 2014, the largest contractor performed less than 20% of total construction projects; 6 contractors each performed at least 9% of all construction work; and 13 contractors each performed between 1% to 4% of all construction work." (*Id.*)

b. Numerous supporting procedures also ensure costs are controlled.

No less critical, the process must ensure that the lowest bid translates into the final price. The first step is clearly defined projects; contractors must know up front what they are bidding on. DEO "carefully investigates, designs, and defines each major project to help ensure that the project is accurately bid without later confusion." (*Id.* at 3.) The bid process itself must be protected, and DEO's "is subject to well-defined rules and expectations, which limit changes

between the bidding of a project and its completion.” (*Id.*) Finally, once a project is awarded, the construction process must avoid later disputes over payment. DEO accordingly applies “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.” (*Id.*)

That DEO’s competitive-bidding procedures achieve the lowest possible market price is not conjecture. “DEO has recruited major contractors from other regions of the country or other parts of Ohio to bid on PIR projects.” (*Id.*) Many of these contractors “have been unable to gain a foothold in DEO’s market because costs have been bid so low.” (*Id.*) This shows 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.” (*Id.*)

c. The Staff investigation confirmed that DEO’s cost-management processes are “robust.”

The Commission need not take DEO’s word for it. Staff investigated and corroborated these facts. It “investigated DEO’s contractor bidding and selection processes to ensure that the Company is not establishing unreasonable qualification standards on contractors or erecting any other sort of barriers that would prevent contractors from participating . . . or submitting project bids.” (Staff Report at 8.)

What did it find? “Staff did not find such barriers. In fact, Staff found that DEO has a large number of eligible contractors in its bid solicitation pool and, on average, more contractors are submitting bids on projects now than in the past.” (*Id.*) Staff concluded that “DEO has a robust competitive contractor bidding and selection process and an effective program for recruiting contractors and assisting them to become qualified to submit bids on PIR projects.” (*Id.*) DEO’s evidence, verified by Staff, clearly shows that DEO’s cost-management procedures are well designed and effective.

In sum, DEO is doing everything it reasonably can to manage costs; the unavoidable fact is that the work is becoming more costly. Staff confirmed this, too.

3. The record also shows that the increase in costs was unavoidable.

Staff found that the cost increases under the Program reflected three primary factors, in addition to general inflation: the shift in focus to urban replacements; mounting environmental regulations; and the consequent increase in contractor bid prices. (*See* Staff Report at 7–8.) The evidence corroborates the Staff Report.

a. The PIR Program has shifted in focus from rural replacements to costlier urban replacements.

Early on, DEO focused on rural replacements, but soon turned to more complex and costly urban projects. “[R]ural jobs are easier to plan, permit, and execute” and “tend to be less time-consuming, involving fewer services, an open, unpaved workspace, and fewer code or regulatory limitations.” (Reed Supp. at 4–5.) In contrast, urban projects “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.” (*Id.* at 5.) Not only is the urban environment itself fraught with challenges, but dealing with local governments can also present complications. (*See* Reed Dir. at 12–20.) Thus, “mile for mile,” urban projects demand substantially more time and expense. (Reed Supp. at 5.)

DEO cannot control the fact that target pipeline generally lies in urban areas. Staff confirmed “that replacement costs in urban areas are generally more expensive than replacements in rural areas,” having “seen similar cost increases when other Ohio gas companies switched from rural to urban replacements.” (Staff Report at 7–8.) It found that DEO had “switched from replacing pipelines in rural areas in the early years of the PIR Program to more

urban replacements in recent years.” (*Id.* at 7.) For example, in the first year, “approximately 81% of project costs and 92% of pipeline footage installed was in rural areas.” (*Id.*) “By 2014 the situation had reversed and 88% of all project footage replaced and 90% of project costs was urban” (*Id.*) And Staff verified that the “increased emphasis on urban replacement projects will continue into the proposed renewal period.” (*Id.* at 8.)

b. Environmental compliance costs have also increased.

Staff also confirmed that environmental regulations were driving up the cost of the work. The evidence demonstrates how environmental issues have affected the cost of replacement, primarily “the need to increase environmental compliance resources,” “increased implementation of Storm Water Pollution Prevention Plans,” and “increased wetland and waterway permit submittals.” (Reed Dir. at 9; *see id.* at 9–12.) Because most environmental costs are borne directly by contractors and built into bid prices, they cannot be readily quantified. (*Id.* at 12.) But the evidence suggested the extent to which these requirements had increased over the life of the PIR Program. For example, the number of Storm Water Pollution Prevention Plans “has been growing” and is expected “to continue to grow.” (*Id.* at 11.) Likewise, “DEO’s direct costs for environmental consultants (not including direct and indirect increases in project costs) has risen 169% since the beginning of the program.” (*Id.* at 10.)

Staff again verified that this was the case. According to the Staff Report, “Staff verified that DEO’s direct costs for environmental consultants has increased significantly and that it has been required to implement an increasing number of [Storm Water Pollution Prevention Plans].” (Staff Report at 8.) “[T]hese environmental costs contribute to the overall trend of increasing PIR Program costs and are largely beyond DEO’s control.” (*Id.*)

c. Staff confirmed that contractor bid prices had increased.

These costs factors ultimately played out in a verified rise in the bid prices for PIR projects. As discussed above, program costs are, by and large, payments to contractors. Staff confirmed that the dollar value of winning bids had been increasing over the life of the program. “DEO has experienced a steady increase over time in contractor costs.” (Staff Report at 8.) It observed this effect both on larger, individually bid contracts and on “smaller ‘blanket’ projects (*i.e.*, where contractors bid on a per unit basis such as number of service lines to install via directional boring, a specified amount of mainline to replace, etc.).” (*Id.*) Staff also confirmed “that the upward trend in contractor costs is likely to continue for the foreseeable future.” (*Id.*)

Thus, Staff investigated and verified that the facts set forth in DEO’s application were correct—costs were rising, resulting in an increase in the price of winning bids.

D. The evidence eliminates concern regarding total bill impact.

In sum, the plan is reasonable, and the evidence shows that an increase in investment is needed. This leaves one other question: can customers support a rate increase? The answer is undoubtedly yes.

1. The decrease in commodity costs since 2008 far outweighs the proposed increase in investment.

“[C]ommodity costs and customer bills are much lower today than they were at the time the PIR Program was first approved in 2008, and this is projected to continue at least for the next five years.” (Friscic Supp. at 4.) When the Commission first approved the PIR Program, a residential customer’s average annual bill was approximately \$1,400. As of January 2016, the average annual bill was \$586.13. (*See* Friscic Supp. at 5.) This primarily reflects the massive drop in commodity prices since 2008, and low commodity prices are expected to continue for at least the next five years. (*Id.* at 4; Friscic Dir., Ex. 1.1.)

The result is a total annual bill reduction of *over \$800 dollars* from the beginning of the program until now, even taking into account the PIR cost recovery rate currently in effect. (*See id.*) This bill reduction is many times greater than the proposed increase.

2. The modification of the O&M expense savings mechanism may also mitigate bills.

The other factor mitigating bill impact involves O&M expense savings. The plan provides a credit for certain O&M expense savings realized as a result of the PIR Program. DEO had originally proposed continuing the savings mechanism approved in Case No. 11-2401-GA-ALT. Under that approach, “a minimum credit of \$1 million is reflected as a reduction of the calculated revenue requirement; no additional credit is reflected for savings between \$1 million and \$1.5 million; and 50% of any savings in excess of \$1.5 million are reflected as a credit.” (Friscie 2d Supp. at 2.) Staff recommended eliminating this O&M-expense-savings sharing mechanism, and DEO accepted this in the stipulation. Going forward, “customers will receive as a credit the full benefit of whatever O&M expense savings DEO realizes in a given year.” (*Id.* at 3.)

With this modification, “all other things being equal and in comparison with prior practice, customers will enjoy a greater benefit from O&M expense savings whenever those savings exceed \$1 million” (*id.*), as they generally have in recent years. To be clear, DEO does not believe that there is anything unreasonable about a savings sharing mechanism *per se*. And DEO cannot guarantee that a particular amount of savings will be realized in any given year. But if past years are any guidance, this modification would tend to further mitigate the rate impact of the PIR Program.

E. The PIR Program has provided, and will continue to provide, significant benefits to customers.

As discussed, the primary benefit of the plan is to proactively ensure public safety by continuing the accelerated replacement of at-risk infrastructure. DEO would briefly note a number of other benefits also demonstrated by the record:

- *Indirect Economic Benefits.* Through 2014, the PIR Program has “generated more than \$60 million in state and local property taxes” and “many millions of dollars have been paid to contractors, resulting in hundreds of jobs, payroll-tax revenues, and other positive downstream economic impacts.” (Friscic Dir. at 10.)
- *Service-Line Responsibility.* DEO has assumed responsibility for repairing and replacing service lines at no direct incremental cost to the affected customer. (*Id.*) Through 2014, DEO replaced over 103,000 service lines. (*Id.* at 11.)
- *Leak-Rate Reduction.* The Program has “allowed DEO to eliminate 9,862 active leaks, as well as an estimated 11,812 new leaks annually that would have reasonably been expected to occur had the targeted mains lines not been replaced.” (Reed Dir. at 24.) DEO’s leak rate on PIR Program pipe has dropped by 42%, from 0.87 to 0.51 leaks per mile. (*Id.* at 25.)
- *Lost-and-Unaccounted-For Gas (UFG) Reduction.* Although not entirely attributable to the PIR Program, DEO’s lost-gas rates have declined from 2.56% in 2007–2008, to less than 1.00% in the three years from 2011–2014. (Friscic Dir. at 12.)
- *Annual Review.* The PIR Program is subject to an annual review of its investment and replacement activity under the program. (*See* Alt. Rate Exhibits at 4, 8.) Annual review helps ensure that DEO’s program is run in a prudent, cost-effective manner.

In sum, the evidence confirms that DEO’s application and stipulation are just and reasonable and fully compliant with the statutory requirements of R.C. 4929.05.

V. COMPLIANCE WITH STIPULATION CRITERA

A. The Commission’s three criteria for approving a stipulation are met in this case.

The stipulation also complies with the following three criteria used by the Commission:

(1) whether it is a product of serious bargaining among capable, knowledgeable parties; (2) whether, as a package, it benefits ratepayers and the public interest; and (3) whether the

settlement package violates any important regulatory principle or practice. *See, e.g., In re Duke Energy Ohio*, Case No. 11-4393-EL-RDR, Opin. & Order at 10 (Aug. 15, 2012).

1. The stipulation is the product of serious bargaining among capable, knowledgeable parties.

Ms. Friscic testified that the stipulation is “the result of a serious and open review process,” and that “all parties were represented by able, experienced counsel and had access to technical experts.” (Friscic 2d Supp. at 3.) The parties were given “opportunity to review settlement proposals and participate in discussions” (*id.*), and the stipulation “is the outcome of a lengthy process of investigation, discovery, discussion, and negotiation.” (*Id.*) Among other things, the stipulation reflects DEO’s acceptance of the elimination of the O&M-expense-savings sharing mechanism. As Ms. Friscic testified, the stipulation is “a comprehensive, reasonable resolution of the issues in this case by informed parties with diverse interests.” (*Id.* at 4.)

2. The stipulation, as a package, benefits ratepayers and is in the public interest.

All of the reasons and evidence showing that the application is just and reasonable under R.C. 4929.05 also show that the stipulation will benefit ratepayers and advance the public interest. The PIR Program enables the accelerated replacement of corrosion-prone pipelines and other target infrastructure, which provides customers and the public with significant benefits in terms of safety and reliability. In approving past stipulations, the Commission has already ruled that the program promotes the public interest; this stipulation continues the Program and gives DEO an opportunity to complete the program in the originally approved timeframe. Moreover, whatever rate impact customers would otherwise experience under the PIR Program is substantially mitigated by the present reduced level of natural-gas commodity prices, a level that is projected to continue for at least the next five years.

3. The stipulation does not violate any important regulatory principle or practice.

Finally, the stipulation does not violate any important regulatory principle or practice. On the contrary, as explained above, the stipulation would promote several provisions of state policy and provide other benefits as well. And the Commission will retain continuing authority to review DEO's implementation of the program.

Therefore, the Commission should find that the stipulation satisfies its three-part criteria and approve the stipulation as filed.

VI. CONCLUSION

For the foregoing reasons, DEO respectfully requests that the Commission approve the application and stipulation.

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Respectfully submitted,

/s/ Andrew J. Campbell

Mark A. Whitt (0067996)

Andrew J. Campbell (0081485)

Rebekah J. Glover (0088798)

WHITT STURTEVANT LLP

The KeyBank Building, Suite 1590

88 East Broad Street

Columbus, Ohio 43215

Telephone: (614) 224-3946

Facsimile: (614) 224-3960

whitt@whitt-sturtevant.com

campbell@whitt-sturtevant.com

glover@whitt-sturtevant.com

ATTORNEYS FOR THE EAST OHIO GAS
COMPANY D/B/A DOMINION EAST OHIO

CERTIFICATE OF SERVICE

I hereby certify that a copy of DEO's Initial Post-Hearing Brief was served by electronic mail this 15th day of March, 2016 to the following:

Jodi J. Bair
Ajay K. Kumar
Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, OH 43215-3485
jodi.bair@occ.ohio.gov
ajay.kumar@occ.ohio.gov

Frank P. Darr
Matthew R. Pritchard
McNees Wallace & Nurick LLC
21 East State Street, 17th Floor
Columbus, Ohio 43215
fdarr@mwncmh.com
mpritchard@mwncmh.com

Colleen Mooney
P.O. Box 1793
Findlay, Ohio 45839-1793
cmooney@ohiopartners.org

William L. Wright
Steven Beeler
Attorney General's Office
Public Utilities Section
180 E. Broad Street, 6th Floor
Columbus, OH 43215
william.wright@puc.state.oh.us
steven.beeler@puc.state.oh.us

/s/ Rebekah J. Glover

One of the Attorneys for The East Ohio Gas
Company d/b/a Dominion East Ohio

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The East Ohio Gas Company d/b/a Dominion East Ohio