BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Suburban Natural Gas Company for an Increase in Gas Distribution Rates.	)))	Case No. 18-1205-GA-AIR
In the Matter of the Application of Suburban Natural Gas Company for Tariff Approval.	))	Case No. 18-1206-GA-ATA
In the Matter of the Application of Suburban Natural Gas Company for Approval of Certain Accounting Authority.	)))	Case No. 18-1207-GA-AAM

REPLY BRIEF
BY
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

Bruce Weston (0016973)
Ohio Consumers' Counsel

Christopher Healey (0086027)
Counsel of Record
Angela O'Brien (0097579)
Assistant Consumers' Counsel

Office of the Ohio Consumers' Counsel
65 East State Street, 7th Floor
Columbus, Ohio 43215
Telephone [Healey]: (614) 466-9571
Telephone [O'Brien]: (614) 466-9531
christopher.healey@occ.ohio.gov
angela.obrien@occ.ohio.gov
(willing to accept service by e-mail)

August 16, 2019

TABLE OF CONTENTS

PAGE

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Suburban Natural Gas Company for an Increase in Gas Distribution Rates.	)))	Case No. 18-1205-GA-AIR
In the Matter of the Application of Suburban Natural Gas Company for Tariff Approval.	))	Case No. 18-1206-GA-ATA
In the Matter of the Application of Suburban Natural Gas Company for Approval of Certain Accounting Authority.	)))	Case No. 18-1207-GA-AAM

REPLY BRIEF
BY
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

This case is about giving 17,000 consumers the protection of Ohio law against having to pay for utility investment in a natural gas pipeline that is not used and useful for their utility service. It is not about the prudence of Suburban's management decisions. For Suburban's customers to be charged for the 4.9-mile Pipeline Extension,[1] that pipeline must have been used and useful on date certain (February 28, 2019). It was not.

Suburban's initial brief discusses the 4.9-mile Pipeline Extension at length, but the heart of Suburban's argument is simple. Suburban believes that its management acted prudently in deciding to build the extension, and thus, Suburban believes that customers should pay for it. The problem for Suburban is that the law says otherwise.

The law is R.C. 4909.15. And R.C. 4909.15 says that when it comes to a utility's capital investments, customers only pay for those investments if the property is used and useful in

[1] *See* OCC's Initial Brief at 3-6 (Aug. 2, 2019) for a description of the 4.9-mile Pipeline Extension.

providing service to customers as of the date certain. It does not say that the utility gets to charge customers if the utility's managers made a prudent investment decision.

And really, that is all there is to this case. Suburban wants the law to say "prudence." The law says "used and useful" instead. Suburban's decision to build the 4.9-mile Pipeline Extension was not prudent. But even if it was, it would not change the fact that on the date certain in this case, the 4.9-mile Pipeline Extension was substantially bigger than necessary to serve Suburban's current customers and therefore not useful under the law.

The extension might be useful someday if Suburban adds enough customers to justify such a significant upgrade to its distribution system. But on February 28, 2019—the date certain—it was not. The law does not allow the utility to charge current utility customers for the future needs of the utility. The Settlement reached by the PUCO Staff and Suburban includes charges to customers for the 4.9-mile Pipeline Extension. It does not meet the PUCO's three-part test for reviewing settlements and thus must be rejected or modified to exclude the extension from rate base.

I. The Settlement fails the PUCO's three-part test for evaluating settlements because it does not benefit customers or the public interest, it violates regulatory principles and practices, and it breaks the law.

The PUCO should reject Suburban's claim that the Settlement benefits customers and the public interest.[2] For many reasons, it does not—most notably because it includes charges to customers for a 4.9-mile Pipeline Extension that was not used and useful on date certain. It also violates regulatory principles and practices. Again, the 4.9-mile Pipeline Extension is the primary reason the Settlement should be rejected. It was not used and useful on date certain, so it

[2] *See generally* Suburban Initial Brief (Aug. 2, 2019).

would be unlawful to include it in rates, thereby violating the basic used and useful ratemaking principle.

A. Suburban's case for the 4.9-mile Pipeline Extension is based on a fundamental misinterpretation of utility ratemaking.

1. Suburban's proposed use of the prudent investment rule for capital investments violates R.C. 4909.15 and cannot be adopted.

Suburban's argument can be reduced to this: we made a prudent management decision to build a pipeline; therefore, customers should pay for it.[3] This is simply not the law.

The prudence standard reviews the reasonableness of a decision based on the conditions existing at the time the decision was made.[4] As the United States Supreme Court explained in *Duquesne Light Co. v. Barasch*: "Under the prudent investment rule, the utility is compensated for all prudent investments at their actual cost when made (their 'historical cost'), irrespective of whether individual investments are deemed necessary or beneficial in hindsight."[5] The used and usefulness standard, on the other hand, is an after-the-fact review of whether plant has actually become used and useful in serving customers.[6] In Ohio, operations and maintenance expenses are judged based on the prudence standard, whereas capital investments are judged based on the used and usefulness standard.[7]

---

[3] Suburban Initial Brief at 28 ("Suburban made a prudent decision to extend the DEL-MAR pipeline"), 28 ("Suburban relied upon the testimony of an experienced professional engineer ... to make prudent decisions for the safe and reliable supply of gas to customers to support its position").

[4] *See, e.g., In re Cincinnati Gas & Elec. Co.*, Case No. 01-218-GA-GCR, Finding & Order (Aug. 30, 2001) ("any decision regarding ... prudence ... should be made based on information and market conditions existing at the time the decisions were made").

[5] *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 309 (1988).

[6] R.C. 4909.15.

[7] R.C. 4909.154 (prudence for operations and maintenance costs); R.C. 4909.15 (used and usefulness for plant).

Though the court in *Duquesne Light* described the prudent investment rule, it further explained that it had long ago abandoned the prudent investment rule for capital investments.[8] Indeed, it appears that the Court recognized the problems with the prudent investment rule at least as early as 1933. In *Los Angeles Gas & Electric Corp. v. RR Commission of California*, the U.S. Supreme Court explained why it is inappropriate to charge customers simply because a capital investment was prudent: "The public have not underwritten the investment.... Even when cost is revised so as to reflect what may be deemed to have been invested prudently and in good faith, the investment may embrace property no longer used and useful for the public."[9]

Indeed, the prudent investment rule is fundamentally unfair to utility consumers. The Supreme Court of Indiana, in *Citizens Action Coalition, Inc. v. Northern Indiana Public Service Co.*,[10] explained why the prudent investment rule is an anti-market rule that turns utility customers into utility insurers. In the free market, businesses make capital investments (*e.g.*, build a factory) and use those capital investments to make products to be sold to the public.[11] The decision to make the capital investment may be prudent at the time it is made. But if the product is a failure, the company "would ordinarily be unable to recover the cost from its consumers in a competitive market," no matter how prudent the investment decision was at the time.[12] In other words, shareholders bear the risk that their capital investment eventually becomes useful in producing a good that people will buy.[13] *See also Iowa-Illinois Gas & Elec. Co. v. Iowa State Commerce Comm'n*, 347 N.W.2d 423, 429 (Iowa 1984) ("Utility investors are not insulated from

[8] *Duquesne Light*, 488 U.S. at 310.

[9] 289 U.S. 287, 306 (1933).

[10] 485 N.E.2d 610 (1985).

[11] *Id.* at 614.

[12] *Id.* at 615.

[13] *Id.*

the consequences of diseconomies resulting from a management decision that was prudent when made but which later events prove to have been mistaken.").

The prudent investment rule, as applied to utilities regulation, turns customers into insurers. If the utility prudently invests in plant, but that plant never becomes used and useful, then customers would be required to pay for plant despite never receiving any benefit from it.[14] In contrast, the used and useful standard is intended to mirror the sharing of risk that occurs in a competitive market. The utility makes a prudent decision to invest in plant. But if the plant never becomes used and useful (for whatever reason, whether under the utility's control or otherwise), customers do not pay for it. On the other hand, if the plant does become used and useful, then the utility gets to charge customers for the cost of the plant and earn a profit (rate of return) on it.

This is precisely the balance that the Ohio General Assembly struck when it enacted R.C. 4909.15. No matter how prudent a utility's decision, customers do not act as insurers for the utility's capital investments. They only pay for a utility's investment once that investment is used and useful in providing utility service to customers.

The PUCO recognized this more than 40 years ago. In *In re Application of Dayton Power & Light Co.*,[15] the PUCO analyzed R.C. 4909.15, finding that (i) "the used and useful standard of Section 4909.15 Revised Code must be applied and is controlling," and (ii) "[n]o prudent investment test is provided for in this or any other applicable statute."[16] Since then, the PUCO has consistently applied the used and useful standard and ruled that prudence alone does not justify charges to consumers for plant investments.

---

[14] *Id.*

[15] Case No. 76-823-EL-AIR, 1977 Ohio PUC LEXIS 4 (July 22, 1977).

[16] *Id.* at *15-16.

In *In re Application of Ohio Edison Co. for an Increase in Rates for Electric Service*,[17] for example, the utility complained that it made a prudent management decision to build power plants and it would thus be unfair to exclude those power plants from rate base.[18] The PUCO found that prudence of the management decision did not justify charges to consumers:

> Ohio Edison again complains that exclusion of the West Lorain units penalizes the company for a prudent management decision which was in the interest of the company's customers. ... Our response is much the same as in the case of the Mad River CTA unit. *What does all this have to do with the question of whether the units should be regarded as used and useful at date certain?*[19]

The PUCO answered that question by concluding that despite the claim of prudence, the units were not used and useful and thus permitted "no other finding than that they should be excluded from rate base."[20]

Likewise, in *In re Application of Ohio Edison Co.*,[21] the utility made an arguably prudent decision to purchase more land than it needed because it was impossible to purchase only the smaller parcel.[22] The utility asserted that because the decision was prudent, the entire piece of land should be included in rate base.[23] The PUCO found that this type of argument had been "rejected by the Commission on numerous occasions" and ruled that it was fair to deny the utility full collection of costs from consumers because part of the property was not used and useful.[24]

---

[17] Case No. 83-1130-EL-AIR, 1984 Ohio PUC LEXIS 29 (July 27, 1984).

[18] *Id.* at *14.

[19] *Id.* at *14-15 (emphasis added).

[20] *Id.* at *15.

[21] Case No. 89-1001-EL-AIR, 1990 Ohio PUC LEXIS 912 (Aug. 16, 1990).

[22] *Id.* at *16.

[23] *Id.*

[24] *Id.* at *16-17.

Numerous other courts have come to similar conclusions. The case of *Gold Canyon Sewer Co. v. Arizona Corporation Commission*[25] is particularly pertinent. There, the utility's system had a maximum capacity of 1 million gallons per day ("gpd"), and based on growth projections, the utility expanded its plant to increase capacity to 1.9 million gpd.[26] The utility admitted that it needed only 1.5 million gpd capacity currently, but increased capacity to 1.9 million gpd in one step rather than piecemeal to reduce costs.[27] The state consumer advocate argued that prudence and used and usefulness are not the same; thus, even though the decision was prudent, the plant was still not used and useful because it was overbuilt based on current needs.[28]

The commission in that case agreed that the full increase to 1.9 million gpd was not used and useful, despite the prudence of the decision.[29] That decision was affirmed on appeal.[30] *See also Md. Office of People's Counsel v. Md. Pub. Serv. Comm'n*[31] ("A public service company ordinarily is not entitled to recover costs simply because the costs were incurred prudently; instead, the Commission normally requires the company to show that the costs relate to an asset 'used and useful' in providing service."); *Utilities Comm'n v. Thornburg*[32] (utility's $570 million investment was prudent, but $180 million of it was not used and useful because it was excess and thus could not be included in rate base);

---

[25] Case No. 1 CA-CC 09-0001, 2010 Ariz. App. Unpub. LEXIS 1054 (May 20, 2010).

[26] *Id.* at *3-4.

[27] *Id.* at *10.

[28] *Id.* at *3-4, 16-17.

[29] *Id.* at *17-19.

[30] *Id.*

[31] *Md. Office of People's Counsel v. Md. PSC*, 226 Md. App. 483, 490 (Md. Ct. App. 2016).

[32] 325 N.C. 484 (N.C. 1989).

Pa. Power & Light Co. v. Pa. Pub. Util. Comm'n[33] (no dispute that decision to invest in plant was prudent, but commission properly excluded it from rate base as not used and useful because it was in excess of current needs); *Natural Gas Pipeline Co. v. FERC*[34] (affirming FERC's decision to disallow costs, even though they were prudently incurred, because they did not result in the creation of used and useful property); *Iowa-Illinois Gas & Elec. Co. v. Iowa State Commerce Comm'n*[35] (utility made a prudent decision to invest in capacity but a portion of that capacity was nonetheless excluded from rate base as not used and useful because it was excessive); *Philadelphia Elec. Co. v. Pa. PUC*[36] ("It does not follow that a unit prudently constructed must always be included in the rate base. The touchstone for determining whether or not a prudently constructed unit should be included in a utility's rate base is whether or not ... the unit will be used and useful in rendering service to the public.").

Suburban's case is a textbook case of the distinction between the prudent investment rule, which does not apply in Ohio for capital investments, and the used and useful standard, which is Ohio law that the PUCO must follow. Suburban's decision to build the 4.9-mile Pipeline Extension was not prudent.[37] But even if it were, the extension wasn't useful because, as explained in more detail in OCC's initial brief, it was vastly overbuilt when considering the needs of Suburban's customers on date certain:[38]

---

[33] 516 A.2d 426 (Comm. Ct. of Pa. 1986).

[34] 765 F.2d 1155, 1161-64 (D.C. Cir. 1985).

[35] 347 N.W.2d 423 (Iowa 1984).

[36] 433 A.2d 620, 623 (Pa. Comm. Ct. 1981).

[37] *See* section I.A.3 below.

[38] *See* OCC Initial Brief at 11-25.

- The extension is big enough to serve not only Suburban's 13,500 current southern system customers, but an additional 4,000 to 20,000.
- The extension is big enough to serve peak capacity of 842 mcfh, which is 184% of the date-certain peak capacity of 457 mcfh.
- The extension is projected to still be big enough to serve peak capacity in 2028—nine years from now.
- The extension is big enough to increase pressure at Lazelle Road to 230 psig, more than double the 100 psig pressure required for safe and reliable service.

The 4.9-mile Pipeline Extension was not useful on the date certain in this case. No matter how prudent Suburban's decision to build that pipeline may have been, and no matter how well-intentioned Suburban's management was, the law does not allow customers to pay for the pipeline extension.

2. UTI's August 31, 2018 projections are the only ones relevant to the used and useful analysis.

Suburban's engineers, UTI, prepared five sets of projections for the pressure at Lazelle Road: December 9, 2015; February 3, 2016; February 10, 2016; April 6, 2017; and August 31, 2018.[39] In its initial brief, Suburban relied on the first three of these models to support the argument that the decision to build the 4.9-mile Pipeline Extension was prudent.[40] But those earlier iterations of the model are irrelevant in determining whether the 4.9-mile Pipeline Extension was used and useful on date certain.

At best, the December 2015 and February 2016 models show that it was prudent for Suburban to consider taking *some* action at *some* point to resolve concerns about low pressure at

[39] Suburban Ex. 9 (UTI projections prepared on the dates identified).

[40] Suburban Initial Brief at 25.

Lazelle Road.[41] But again, making a business decision to invest in property, no matter how prudent, does not make that property used and useful on a date certain several years in the future.

Suburban continued to make projections after February 2016. The most recent projections were on August 31, 2018, the same day that Suburban filed its application in this case.[42] These projections show that pressure was expected to remain at safe levels through and including the date certain.[43]

The earlier projections might be relevant under the prudent investment rule, which doesn't apply to capital investments in Ohio. But for purposes of determining whether the 4.9-mile Pipeline Extension was used and useful on date certain, the most recent projections from August 2018 are the only relevant ones, and they show that the extension was unnecessary to serve customers at date certain and therefore not useful under R.C. 4909.15.

3. Even under the prudent investment rule, Suburban could not charge customers for the 4.9-mile Pipeline Extension because Suburban has not proven that its decision to build the extension was prudent.

Even if the PUCO were to follow the unlawful-if-applied-here prudent investment rule instead of the used and useful standard that R.C. 4909.15 requires, Suburban would still lose. Suburban has not shown that the investment was prudent. Based on the record here, Suburban's decision to build the 4.9-mile Pipeline Extension was imprudent for several reasons.

First, as explained in OCC's initial brief, Suburban failed to adequately consider alternatives to the 4.9-mile Pipeline Extension.[44] Had it done so, it may have found that another

[41] For all the reasons explained herein and in OCC's initial brief, the models do not show that it was prudent to build a pipeline extension 4.9 miles long in 2019.

[42] Suburban Ex. 9 (UTI Projections), page 5; Suburban Ex. 1 (Application).

[43] Suburban Ex. 9 (UTI Projections), page 5; Tr. Vol. II at 302:1-10, 332:25 – 333:18 (Grupenhof) (Suburban witness Grupenhof confirming that the 2018 EOY projections on Suburban Ex. 5, page 5, apply to the date certain).

[44] OCC Initial Brief at 27-32.

lower-cost option (like a shorter or smaller diameter pipeline extension) was feasible and therefore the prudent course of action.

Second, as Suburban admitted, a 2-mile pipeline extension would have adequately served its customers on date certain.[45] The decision to build a pipeline extension more than twice as long was imprudent.

Third, Suburban testified that without a pipeline extension, its customers were at risk for "catastrophic" outages during the winter of 2018-2019.[46] If this were true,[47] then the prudent thing would have been to ensure that a new pipeline extension was put into service in December 2018, the beginning of winter. But instead, Suburban decided to build a 4.9-mile Pipeline Extension, which increased the amount of time for Ohio Power Siting Board Approval and the time to build the pipeline.[48] As a result of the decision to build a 4.9-mile extension instead of a shorter one, the extension was not placed into service until February 22, 2019, near the end of winter.[49] Suburban made a decision that it believed put customers at risk of physical harm.[50] Putting customers at risk of physical harm is not prudent.

---

[45] Tr. Vol. II at 278:21-24 (Grupenhof); Tr. Vol. II at 289:5-20 (Grupenhof).

[46] Suburban Ex. 5 (Sonderman Testimony) at 23 (June 7, 2019); Suburban Ex. 4 (Grupenhof Testimony) at 3, 8 (June 7, 2019).

[47] The evidence does not support Suburban's conclusion that there was in fact such a risk, only that Suburban believed there was. Pressure stayed above the 100 psig level throughout the winter of 2018-2019, and the "check valve" at Lazelle Road adequately alleviated any low-pressure concerns. *See* Suburban Ex. 14 (Dead End Pressure Checks); Suburban Ex. 4 (Grupenhof Testimony) at 5 (June 7, 2019). But Suburban says it believed there was and nonetheless failed to adequately act prudently in response to that belief.

[48] Tr. Vol. II at 269:12-16 (Grupenhof) (shorter pipeline likely could have been built more quickly); Tr. Vol. II at 276:3-6 (Grupenhof) (OPSB approval could have been received more quickly for a pipeline shorter than 4.9 miles).

[49] Suburban Ex. 4 (Grupenhof Testimony) at 8 (June 7, 2019).

[50] Tr. Vol. II at 266:17 – 267:2 (Grupenhof) (risk of customer harm, including death); Tr. Vol. II at 374:23 – 375:5 (Sonderman) (claiming there was a risk of catastrophic outages in January 2019 as a result of the 4.9-mile Pipeline Extension not going into service until February 22, 2019).

B. Suburban has grossly misstated OCC's position in this case regarding Suburban's duty to build a distribution system that is the right size to serve current customers.

In its initial brief, Suburban concludes that "the broader implication of OCC's position is that a utility's property cannot be used and useful to customers unless it is precisely sized to serve the exact number of customers that the utility serves at the time the property is placed into service."[51]

Suburban in effect accuses OCC of arguing that a pipeline must be the exact size necessary to serve current customers, with no cushion, no room for error. Suburban is mistaken—this is not OCC's position at all.

Suburban had about 13,500 customers at date certain in its southern system.[52] No OCC witness took the position that the pipeline extension is only useful if it can serve precisely 13,500 customers. To the contrary, OCC took the position that a pipeline that can serve an extra 4,000 to 20,000 future customers is so clearly overbuilt as to be not useful to current customers.[53]

Suburban projected peak load at date certain of about 457 mcfh.[54] No OCC witness took the position that the pipeline extension is only useful if it can handle precisely a peak load of 457 mcfh. To the contrary, OCC took the position that a pipeline with an 842 mcfh capacity—180% of peak load—is so clearly overbuilt as to be not useful to current customers.[55]

Suburban testified that 100 psig was the minimum safe pressure at Lazelle Road.[56] No OCC witness took the position that the pipeline extension is only useful if it results in pressure of

---

[51] Suburban Initial Brief at 33.

[52] Suburban Ex. 5 (Sonderman Testimony) at 2, 20 (June 7, 2019).

[53] OCC Initial Brief at 17-19.

[54] OCC Ex. 5 (Suburban responses to Staff data requests in Power Siting case), page 4.

[55] OCC Initial Brief at 19-20.

[56] Suburban Ex. 4 (Grupenhof Testimony) at 5 (June 7, 2019).

precisely 100 psig at Lazelle Road. To the contrary, OCC took the position that a pipeline that increases pressure to 230 psig—230% of the safe pressure—is so clearly overbuilt as to be not useful to current customers.[57]

If Suburban had a built a pipeline that could serve 14,000, or some other number reasonably within the range of 13,500, then this might be a different case. If Suburban had built a pipeline that could handle a peak load of 500 mcfh, or some other number reasonably within the range of 457 mcfh, then this might be a different case. If Suburban had built a pipeline that resulted in pressure at Lazelle Road of 120 psig, or some other number reasonably within the range of 100 psig, then this might be a different case. In that different case, OCC might agree that such a pipeline is useful because OCC agrees that Suburban should not be held to a standard of building its system to the precise number of customers in its system.

But that different case does not exist and is not before the PUCO. The PUCO need not decide in this case exactly where the line is (5% cushion? 10% cushion?). Wherever the line is, Suburban went too far past it to make a colorable argument for the usefulness of the pipeline extension. This is not a close call. Suburban's 4.9-mile Pipeline Extension is so overbuilt that the PUCO should easily conclude that it is not useful under R.C. 4909.15.

C. Suburban has grossly misstated OCC's position on customer safety.

In its initial brief, Suburban claims that "OCC is suggesting that a utility like Suburban should wait until something catastrophic actually occurs to act rather than proactively ensure that catastrophe never strikes."[58] Suburban describes such a position as "nonsensical."[59] Which it is, and which is why OCC has never taken this position, and never would.

---

[57] OCC Initial Brief at 20-21.

[58] Suburban Initial Brief at 36.

[59] Suburban Initial Brief at 36.

It is a core duty of all utilities to proactively ensure that their systems are designed to provide safe and reliable service to customers. The PUCO's gas pipeline safety rules, found in Ohio Adm. Code Chapter 4901:1-16, contain detailed requirements for utilities to follow for the protection of its customers.[60] Nothing in OCC's proposals in this case in any way negatively impacts customer safety or system reliability.

In this case, OCC has accepted Suburban's position that the minimum pressure required at Lazelle Road for safe service is 100 psig.[61] Suburban's own projections show that even under the absolute worst case scenario, during the winter of 2018-2019, pressure was projected to remain above that safe level.[62] In short, without any pipeline extension, customers were safe.

Further, OCC agrees that Suburban and all other utilities should be proactive in making the investments necessary to keep customers safe. But this does not mean that utilities can invest in anything and everything they want, no matter how overbuilt and excessive, and by simply invoking "safety," customers must pay for it. OCC's position in this case properly balances the interests of the utility and consumers. The 4.9-mile Pipeline Extension is substantially more than is required for safe and reliable service to Suburban consumers and was imprudent.

Utilities should not wait for a catastrophe to occur before taking action. But when the utility does take action, the action must be consistent with Ohio law, including that any investments is useful in providing service to customers on the date certain. Suburban did not do that in this case.

---

[60] *See also* R.C. 4905.91 (requiring the PUCO to issue pipeline safety rules).

[61] Tr. Vol. I at 81:9-15 (Willis) (accepting Suburban's engineering conclusion that 100 psig is safe at Lazelle Road).

[62] OCC Ex. 5 (Suburban responses to Staff data requests in Power Siting case) at 3 (Suburban describing its engineering model as the "worst case" peak flow expected in the southern system).

D. Suburban's references to "catastrophic" consequences and "nightmare scenarios" are a scare tactic designed to distract the PUCO from the many shortcomings of Suburban's case and the Settlement.

Suburban's case for the usefulness of its 4.9-mile Pipeline Extension fails based on the unambiguous evidence in this case—the vast majority of which was provided by Suburban's engineer and Suburban itself. In an attempt to obscure the legal and factual deficiencies in its case, Suburban directs the PUCO's attention to unsubstantiated claims that without the 4.9 miles of pipeline, there could be an "extensive outage" leaving customers without service for "weeks at the coldest time of the year."[63] But there is no evidence in this record—literally none—that customers were ever at risk for anything close to a weekslong outage in Suburban's service area.

Suburban likewise mentions that an outage occurred in Rhode Island where people were forced to move into shelters to address infirmities and medical conditions.[64] Suburban refers to this as a "nightmare scenario,"[65] and it surely was for those customers impacted. But there is no evidence that the Rhode Island outages were caused by conditions even remotely similar to the cold-weather conditions that Suburban experiences here in Ohio. Indeed, there was some suggestion that the outages there occurred as a result of a valve malfunction, which would have nothing to do with low pressure resulting from high usage during cold weather.[66]

These discussions are a sideshow. Obviously, if customers lose service for weeks in the dead of winter, that would be a terrible situation. Obviously, when customers were forced to move out of their homes in Rhode Island as a result of outages, it was a terrible situation for those customers. But Suburban's customers were never at risk of these types of rare events.

---

[63] Suburban Initial Brief at 27.

[64] *Id.*

[65] *Id.*

[66] Tr. Vol. III at 588:17-20 (Willis).

E. Suburban's attempt to compare this case to cases involving excess electric generating capacity fails because they raise fundamentally different issues.

1. Electric generation reserve margins have nothing to do with proper planning of natural gas distribution systems.

In its initial brief, Suburban cites *In re Application & Complaint & Appeal of Columbus and Southern Electric Company*[67] for the proposition that "[h]indsight is always perfect and before the commission will consider denying a return on property actually used in providing service something more need be shown than that the company's foresight was not."[68] Suburban fails to explain the context in which this the PUCO made this statement, but the context is important.

In *Columbus and Southern Electric*, the PUCO was addressing arguments related to excess electric generating capacity. In that case, which was decided at a time when Ohio's electric utilities were fully regulated and owned generation, the PUCO Staff recommended a reserve margin of 20%, meaning the utility could plan its generation needs based on the expected peak load, plus an additional 20%.[69] The utility in question, however, had generation that exceeded the reserve margin by an additional 7%.[70] Staff recommended a deduction from rate base for that additional 7% of excess capacity.[71] The PUCO did not adopt the PUCO Staff's position. Instead, it ruled that electric utilities were not required to plan for their generation needs so precisely that the installed capacity of their power plants is exactly 20% more than peak load.[72]

---

[67] Case No. 77-545-EL-AIR, 1978 Ohio PUC LEXIS 3 (Mar. 31, 1978).

[68] Suburban Initial Brief at 35 (quoting *Columbus & Southern Electric*).

[69] *Columbus & Southern Electric*, 1978 Ohio PUC LEXIS 3, at *40.

[70] *Id.*

[71] *Id.*

[72] *Id.* at *40-42.

Columbus and Southern Electric is nothing at all like the current case involving Suburban, for many reasons. First, the concept of a generation reserve margin has never applied to natural gas distribution utilities, which, unlike electric utilities, have never owned power plants. Reserve margins are necessary for power plants generating electricity because electricity, unlike natural gas, cannot be stored in adequate quantities to address peaks in usage.[73]

Second, *Columbus and Southern Electric* long pre-dates the 1999 deregulation of electric utilities in Ohio.[74] Planning for a reserve margin is an electric generation issue, not a distribution issue, so it has no relevance to distribution-only utilities like Suburban (or even to Ohio's electric distribution-only utilities, which rely on PJM to plan the appropriate generation reserve margin for its multi-state region).

Third, Suburban simply did not build the 4.9-mile Pipeline Extension for reasons similar to the reasons justifying an electric generation reserve margin. An electric generation reserve margin provides a cushion to avoid outages. The utility (or more accurately in Ohio currently, PJM) estimates the peak load and then arranges for generating capacity equal to that peak load, plus some additional cushion.

Suburban projected peak load at date certain of 457 mcfh.[75] If Suburban had done a reserve-margin-type analysis, it would have designed its distribution system to handle 457 mcfh plus a reasonable cushion above that. For illustrative purposes only, if Suburban had followed

---

[73] *See, e.g. In re Regulation of the Purchased Gas Adjustment Clause*, Case No. 90-16-GA-GCR, 1991 Ohio PUC LEXIS 129, at *13 (Jan. 31, 1991) (noting that natural gas storage facilities were used to meet peak demand requirements); *Ill. Commerce Comm'n v. FERC*, 721 F.3d 764, 774 (7th Cir. 2013) (discussing losses resulting from reserve margins because excess electricity cannot be stored).

[74] Ohio Senate Bill 3, 123rd General Assembly.

[75] OCC Ex. 5 (Suburban responses to Staff data requests in Power Siting case) at 4.

the PUCO's former 20% guideline for electric generation reserve margins,[76] it would have built a system that could handle maximum capacity of about 549 mcfh.[77] That is not the calculation that Suburban made. Suburban instead looked well beyond the date certain and planned for peak capacity of 842 mcfh, enough to serve customers in 2028—nine years after the date certain.

A reserve margin takes a snapshot of generation needs and adds some percentage to that to provide a cushion in case usage is higher than expected or power plants go down. Suburban ignored the snapshot on its date certain and looked to the future in deciding how big to build its pipeline extension. Suburban's reference to electric generation reserve margin cases should be afforded no weight.

2. Even under Suburban's "reserve margin" analogy, Suburban substantially over built its distribution system.

Even if the PUCO were to accept Suburban's argument that it "cannot be expected to perfectly size" its plant based on its electric generation excess capacity analogy, it should conclude that Suburban fails that test as well.

During the 1980s and 1990s, when Ohio's electric utilities owned generation and charged customers state-regulated rates for generation, the PUCO adopted a presumption that a 20% reserve margin was reasonable.[78] Even if we accept Suburban's faulty premise that a natural gas distribution-only utility's investments in a pipeline are analogous to a fully-regulated electric utility's decision to build power plants, Suburban's 4.9-mile Pipeline Extension is still substantially overbuilt.

---

[76] *See Office of Consumers' Counsel v. PUCO*, 63 Ohio St.3d 522, 529 (1992) (noting that in the 1980s, the PUCO had adopted a rebuttable presumption that a 20% reserve margin was reasonable).

[77] 457 * 120% = 548.4 mcfh.

[78] *See Office of Consumers' Counsel v. PUCO*, 63 Ohio St.3d 522, 529 (1992).

Suburban's projected date certain peak load at Lazelle Road was 457 mcfh.[79] Suburban built a distribution system that handles peak load of 842 mcfh.[80] This is an 84% excess.[81] Suburban cannot seriously contend that because it "cannot be expected to perfectly size" its plant, it can oversize its plant by 84% and charge customers for the excess. Again, where the precise line falls is unknown (and not at issue based on the facts of this case). But the line is not anywhere close to 84% excess. Even using Suburban's reserve-margin analogy (which is deeply flawed for the reasons described above), Suburban has blown past any reasonable peak load cushion, further demonstrating that the 4.9-mile Pipeline Extension was not useful at date certain.

F. Whether the 4.9-mile Pipeline Extension is used and useful is a regulatory question, so OCC witness Willis is by far the most qualified witness on that issue.

1. Suburban's remarks about OCC witness Willis not being an engineer are irrelevant because his testimony provided his expert regulatory opinion, not an engineering opinion.

At the hearing, Suburban repeatedly emphasized the undisputed fact that OCC witness Willis is not an engineer, seeking to strike his testimony on that basis.[82] The Attorney Examiner denied all of Suburban's motions to strike and admitted Mr. Willis's expert testimony based on his many decades of experience as a regulatory expert.[83]

In its initial brief, Suburban again claims that the PUCO should favor Suburban witness Grupenhof's testimony and discount Mr. Willis's testimony because, according to Suburban, Mr.

---

[79] OCC Ex. 5 (Suburban responses to Staff data requests in Power Siting case) at 4.

[80] *Id.*

[81] 842 / 457 = 184%.

[82] Tr. Vol. I at 22:6 – 24:5; Tr. Vol. III at 544:2 – 545:22.

[83] Tr. Vol. I at 25:25 – 26:1; Tr. Vol. III at 546:15-19.

Willis's 35 years of regulatory expertise and experience in dozens of rate cases are insufficient.[84] Again, Suburban seems to misunderstand Mr. Willis's testimony.

Mr. Willis is not an engineer. He did not say one word about whether there is an engineering need for the 4.9-mile Pipeline Extension. Nor did he have to. The PUCO in this case is not answering the question: "Was there an engineering need for the 4.9-mile Pipeline Extension?" That might be the question under the prudent investment rule, but as explained above, that rule does not apply to capital investments in rate cases. The PUCO in this case is answering a related, but fundamentally different question: "Was the 4.9-mile Pipeline Extension used and useful to serve customers on February 28, 2019?"

The second question—the one actually before the Commission—is a regulatory ratemaking question. Mr. Willis is a regulatory expert, as Suburban admits.[85] Suburban witness Grupenhof, in contrast, is not a regulatory expert.[86] The Attorney Examiner ruled, more than once, that Mr. Willis was qualified as an expert in this case. The PUCO should rule that Mr. Willis is the most qualified expert. It should give substantial weight to his testimony that the 4.9-mile Pipeline Extension was not useful on date certain.

2. Suburban's attempts to discredit OCC witness Willis fail because they are based on misstatements of the record.

Suburban also tries to discredit Mr. Willis by mischaracterizing both his testimony and the record. These efforts fail.

---

[84] Suburban Initial Brief at 29.

[85] *See* Tr. Vol. I at 80:6-7 (counsel for Suburban stating, with respect to Mr. Willis: "he is the regulatory expert").

[86] *See* Tr. Vol. III at 260:16-18 (counsel for Suburban stating "Mr. Grupenhof is also not speaking to what Suburban did or did not do from a cost recovery perspective").

Suburban claims that Mr. Willis's testimony is based on an alleged "misperception of the proceeding before the Ohio Power Siting Board."[87] This is inaccurate for multiple reasons. First, Mr. Willis accurately described the Ohio Power Siting Board proceeding. In that proceeding, the PUCO Staff concluded that the proposed 4.9-mile Pipeline Extension was big enough to serve Suburban's current customers, plus 4,000 additional customers.[88] Mr. Willis cited this in support of his conclusion that the pipeline was overbuilt.[89] Suburban witness Grupenhof confirmed that Mr. Willis's interpretation was correct, stating in his testimony that the 4.9-mile Pipeline Extension was sufficient for 4,000 customers on top of Suburban's current customer count.[90] Suburban's claim that Mr. Willis somehow "misperceived" the Power Siting case is simply inaccurate.

Further, Mr. Willis based his expert opinion on far more than just the Power Siting case. He cited evidence that the extension is big enough to increase pressure at Lazelle Road to 230 psig or more, much higher than the 100 psig safe pressure.[91] He cited evidence that the extension is big enough to serve peak load of 842 mcfh, more than Suburban's projected peak load in 2028, nine years after the date certain.[92] He cited Suburban witness Grupenhof's admission that the extension is big enough to serve thousands more customers than are currently on Suburban's system.[93] The evidence demonstrates that Mr. Willis's expert opinion is based not only on his

[87] Suburban Initial Brief at 29.

[88] Suburban Ex. 6 (OPSB Staff Report).

[89] OCC Ex. 1 (Willis Initial Testimony) at 7 (Mar. 8, 2019).

[90] Suburban Ex. 4 (Grupenhof Testimony) at 8 (June 7, 2019).

[91] OCC Ex. 13 (Willis Supplemental Testimony) at 11-12 (June 21, 2019).

[92] *Id.* at 12.

[93] *Id.* at 11.

decades of regulatory experience, but on abundant evidence provided by Suburban, as well as his accurate description of Suburban's Power Siting case.

Suburban similarly tries to discredit Mr. Willis by citing his alleged "ignorance of Suburban's pipeline system."[94] According to Suburban, Mr. Willis made a false statement when he allegedly "suggested that the 20-mile 12-inch DEL-MAR pipeline, which has been in use by Suburban since 2005, was not serving customers and that those customers were only being served by the six-inch ARCO line."[95] But Mr. Willis never said this or "suggested" it. In support of this false claim against Mr. Willis's credibility, Suburban cites page 132 of the hearing transcript in this case.[96] On that page, there is no discussion whatsoever regarding the original 20-mile DEL-MAR pipeline; that page discusses the 4.9-mile Pipeline Extension.[97] So it would be impossible for Mr. Willis to have stated or "suggested" that the original 20-mile pipeline was not serving customers. The PUCO should reject Suburban's attempt to smear Mr. Willis by falsely accusing him of "ignorance" when, to the contrary, his testimony displayed a thorough understanding of Suburban's distribution system and why the 4.9-mile Pipeline Extension was not needed to serve customers at date certain.

G. The phase-in of the 4.9-mile Pipeline Extension does not benefit customers and violates regulatory principles and practices because it increases rates by charging customers for property that was not useful on date certain.

Suburban argues that by phasing in the 4.9-mile Pipeline Extension, customers benefit under the Settlement.[98] It is true that customers will pay less under the phase-in than they would

[94] Suburban Initial Brief at 31.

[95] *Id.*

[96] *Id.*

[97] *See* Tr. Vol. 1 at 132.

[98] Suburban Initial Brief at 17-19.

if the entire 4.9-mile Pipeline Extension were included in rate base immediately. But that is irrelevant. For all the reasons explained herein and in OCC's initial brief, it is unlawful to charge customers for the 4.9-mile Pipeline Extension, whether phased in or not, because it was not used and useful at date certain. The phase-in harms customers by requiring them to pay for a pipeline that is not used and useful. They should pay $0 for the extension, but instead they will pay hundreds of thousands of dollars per year.[99] That is not a benefit to customers. And it violates the regulatory principle that customers only pay for property that is used and useful at date certain.

H. The PUCO should reject Suburban's claim that the Settlement benefits customers as long as charges to consumers are not "exorbitant."

In its initial brief, Suburban states: "The ability of Suburban to meet all of its obligations to its customers without charging exorbitant rates is a significant benefited [sic] afforded to customers by this Stipulation."[100] The PUCO should reject Suburban's attempt to rewrite the law such that rates are lawful as long as they are not "exorbitant."

Under R.C. 4905.22, all rates charged to customers must be "just and reasonable." The PUCO is familiar with this standard, it having been in place for over 65 years.[101] Suburban apparently now asks the PUCO to substantially relax the standard such that rates must only meet a new lenient standard of "not exorbitant."[102] Leaving aside the fact that the Settlement would result in rates that fail even this utility-friendly test, "not exorbitant" is not the law. The PUCO must find that all rates are just and reasonable. And as OCC explained in detail herein and in its initial brief, rates under the Settlement would not be just and reasonable.

---

[99] OCC Ex. 13 (Willis Supplemental Testimony) at 6 (June 21, 2019) (including 50% of the 4.9-mile Pipeline Extension during year one of the phase-in would increase rates by at least $543,000 per year).

[100] Suburban Initial Brief at 12.

[101] *See* R.C. 4905.22 (effective date of October 1, 1953).

[102] Suburban Initial Brief at 12.

I. The tax-related provisions of the Settlement are not a benefit to customers because customers would receive those benefits anyway.

In its initial brief, Suburban touts the Settlement's treatment of the Tax Cuts and Jobs Act of 2017 (the "TCJA") as a benefit to customers.[103] Customers do deserve to receive all of the benefits of the TCJA. But their receipt of those benefits has nothing to do with the Settlement.

In the PUCO's investigation of the TCJA, the PUCO repeatedly emphasized that all tax savings must be returned to customers:

- "[T]he Commission intends that all tax impacts resulting from the TCJA will be returned to customers."[104]
- "[W]e will be guided by one central principle: all tax savings resulting from the TCJA should be returned to ratepayers."[105]
- All utility proposals will be "required to pass all tax savings on to customers."[106]
- "[W]e once again find it necessary to note that we intend all benefits resulting from the TCJA will be returned to customers. Customers should receive the savings derived from this change, as these savings were never meant to compensate the utilities or increase their respective rates of return, but merely reflect the reality that utilities are required to pay federal income taxes."[107]

As a result of this stated policy goal, the PUCO ordered all Ohio utilities to "file an application not for an increase in rates, pursuant to R.C. 4909.18, to reflect the impact of the TCJA on their current rates by January 1, 2019, unless exempted or otherwise directed in this Finding and Order."[108]

---

[103] Suburban Initial Brief at 16-17.

[104] Case No. 18-47-AU-COI, Second Entry on Rehearing ¶ 15 (Apr. 25, 2018).

[105] *Id.* ¶ 21.

[106] Case No. 18-47-AU-COI, Third Entry on Rehearing ¶ 43 (Dec. 19, 2018).

[107] Case No. 18-47-AU-COI, Finding & Order ¶ 26 (Oct. 24, 2018).

[108] Case No. 18-47-AU-COI, Finding & Order ¶ 35 (Oct. 24, 2018).

Suburban's claim that the tax issues under the Settlement are a benefit to the customers *from the Settlement* is false—customers would get those benefits anyway (including carrying costs, which the PUCO has approved in all tax cases to date,[109] and which the PUCO Staff has insisted upon in every case[110]).

If anything, the Settlement has harmed customers by delaying the return of tax funds. Under the PUCO's October 2018 Finding and Order, Suburban was required to file an application not for increase in rates by January 1, 2019—seven months ago.[111] In fact, Suburban appears to be the only Ohio utility with more than 10,000 customers that failed to do so.[112] Had Suburban complied with the PUCO's Finding and Order in the tax investigation case, customers might already have gotten the benefits of the TCJA. Instead, by waiting and including it in the Settlement, the return of those funds may have been delayed further. This is not a benefit to customers.

J. The agreement to file a rate case by October 31, 2025 is not a benefit to customers because it remains to be seen whether rates will increase or decrease as a result of that case.

The Settlement requires Suburban to file a new base rate case by October 31, 2025.[113] In its initial brief, Suburban claims that this is a benefit to customers because any new rates in that case would potentially include customer growth, "thus reducing the share of the revenue that

[109] *See, e.g., In re Ohio Power Co.'s Implementation of the Tax Cuts & Jobs Act of 2017*, Finding & Order (Oct. 3, 2018); *In re Application of Duke Energy Ohio, Inc. for Implementation of the Tax Cuts and Jobs Act of 2017*, Finding & Order (Feb. 20, 2019).

[110] Tr. Vol. IV at 754:20-23 (Lipthratt) (Staff has been consistent on requiring carrying charges in all cases).

[111] Case No. 18-47-AU-COI, Finding & Order ¶ 35 (Oct. 24, 2018) (none of the exemptions apply to Suburban).

[112] Tr. Vol. I at 201:7-18 (OCC witness Willis stating that he is not aware of a single Ohio utility with more than 10,000 customers that has failed to file an application not for increase in rates).

[113] Jt. Ex. 1 (Settlement) at 13.

each customer is responsible for."[114] The PUCO should reject Suburban's claim that the agreement to file a rate case is a benefit to customers, for several reasons.

First, because that rate case will not be filed for another six years, it remains to be seen whether and to what extent customer growth will continue. Indeed, based on Suburban's recent unsuccessful complaint filed against Columbia Gas, it appears that it might be Columbia, and not Suburban, that secures the bulk of the new customers in Delaware County.[115] Second, it remains to be seen whether rates will go up or down as a result of that new rate case. If rates go up—as they tend to do in base rate cases—customers would be harmed, not benefited. Third, Suburban could invest in new plant between now and the next rate case. If Suburban invests in new plant, that plant could potentially be included in rate base in the next case, thus further increasing rates.

There is no basis for the PUCO to conclude that a commitment to file a rate case in six years is a benefit to customers now, when that rate case could result in even higher rates.

K. The rate design in the Settlement harms customers. The PUCO should maintain Suburban's current fixed charge for small general service customers and rule that any rate increase be implemented on a volumetric (per ccf) basis.

Suburban's initial brief demonstrates its misinterpretation of OCC's position in this case regarding Suburban's rate design.[116] In its brief, Suburban suggests that OCC is proposing to "abandon" straight fixed variable ("SFV") rate design in this case.[117] Not true. While OCC would welcome a wholesale reconsideration of SFV rate design in the interests of customers

[114] Suburban Initial Brief at 19.

[115] *See In re Complaint of Suburban Natural Gas Co. v. Columbia Gas of Ohio, Inc.*, Case No. 17-2168-GA-CSS, Opinion & Order (Apr. 10, 2019) (PUCO rejecting Suburban's complaint that Columbia has an unfair competitive advantage in obtaining new customers in the region where Suburban operates).

[116] Suburban Initial Brief at 37-38.

[117] Suburban Initial Brief at 39.

throughout Ohio, OCC's position in this case is a compromise position that maintains the bulk of Suburban's SFV rate design.

Around two years ago, the PUCO approved a change in Suburban's rate design for residential customers from a relatively low $9.18 fixed customer charge plus a variable rate to a full SFV rate design with a $29.42 fixed charge and no variable rate.[118] This was intended to be a change in rate design only, not a rate increase. In the current case, OCC witness Fortney is not proposing *any change* to the $29.42 fixed charge. To the contrary, he is proposing that Suburban retain the $29.42 fixed charge and that only any rate increase be implemented through a variable rate.[119] Even under Mr. Fortney's proposal, residential customers would continue to pay a substantial majority of their distribution bill through the fixed $29.42 monthly charge. This is a reasonable compromise that maintains the PUCO's stated purpose of SFV rate design while allowing customers a small amount of additional control over their bills by lowering their usage.

L. OCC's proposed rate of return of 6.95% for Suburban is reasonable and should be adopted.

OCC witness Dr. Daniel Duann testified that a rate of return of 6.95% and a return on common equity of 9.59% are reasonable based on his analysis of the average of returns on equity authorized by state regulatory agencies for gas utilities nationwide.[120] Dr. Duann's analysis relied on S&P Global Market Intelligence reports regarding major utility rate case decisions across the United States in 2018.[121]

---

[118] *In re Application of Suburban Natural Gas Co. for Approval of an Alternative Form of Regulation to Initiate a Revenue Decoupling Mechanism*, Case No. 17-594-GA-ALT, Finding & Order (Nov. 1, 2017).

[119] OCC Ex. 11 (Fortney Testimony) at 12.

[120] OCC Ex. 14 (Duann Supplemental Testimony) at 8.

[121] *Id.*

Suburban objects to Dr. Duann's reliance on these reports because "he did not actually verify that third party analysis or confirm the returns that it considered were accurate."[122] This argument is meritless. Expert witnesses may rely on information in commercial publications and market reports they use in their occupations.[123] Dr. Duann testified that he relies on S&P Global Market Intelligence in his work as a rate of return analyst.[124] These reports are reliable without Dr. Duann personally verifying each data point. It is unreasonable to expect an expert to recreate every study, report, paper, and book, that he relies on from scratch, but that is what Suburban is suggesting here.

Suburban also complains that Dr. Duann's analysis, which relies on the S&P Global Market Intelligence, includes utilities in Wyoming, Kansas, and Florida.[125] In Suburban's view, including these states in the analysis somehow runs afoul of the standard enunciated in *Bluefield Water Works v. Public Service Commission*[126] that public utilities should be entitled to rates of return generally equal to those being made "in the same general part of the country."[127] Suburban's argument fails for at least two reasons. First, while Suburban makes reference to Wyoming, Kansas, and Florida, it ignores the fact that the report also included decisions from Indiana, Michigan, and Wisconsin, which are all in the Midwest with Ohio, and hence "in the same general part of the country." And several of the Midwest gas utilities decisions awarded lower rates of returns than the rate of return that OCC proposes for Suburban in this case.[128]

---

[122] Suburban Initial Brief at 14.

[123] Ohio Rule of Evidence 803(17).

[124] Tr. Vol. III at 641-42 (Duann).

[125] Suburban Initial Brief at 14-15.

[126] 262 U.S. 679 (1923).

[127] Suburban Initial Brief at 14.

[128] Tr. Vol. III at 679-80 (Duann).

More importantly, however, as Dr. Duann explained, in the global economy in 2019, capital costs would not be expected to differ based on local geography. So under *Bluefield*, as applied to modern times, rates of return throughout the United States are relevant.[129]

Suburban also argues that Dr. Duann did not conduct "an intensive analysis of Suburban's cost of borrowing money, or whether Suburban's ability to do so was impacted by the fact that Suburban is a small Ohio utility."[130] To the contrary, Dr. Duann directly addressed this issue and rejected it.[131] He concluded that in his expert opinion, there was no empirical or even theoretical evidence supporting Suburban's claim that small utilities are riskier than large utilities and therefore deserve a higher return on equity.[132]

The Settlement's proposed rate of return of 7.26% and return on equity of 10.25% would force Suburban's customers to unnecessarily pay an additional $277,220 during the initial three-year term of the Settlement and an additional $679,704 more over a seven-year term.[133] This is another ground for rejecting the Settlement.

M. Approving the Settlement could set a disastrous precedent for Ohio utilities regulation.

Suburban is a small utility. It may seem inconsequential, in the grand scheme of things where some Ohio utilities spend billions of dollars on capital investments to serve more than 4 million customers, that Suburban spent an extra $8.9 million, increasing rates for 17,000 customers. But consider that increase in context.

---

[129] *Id.* at 649 (Duann).

[130] Suburban Initial Brief at 13-14.

[131] OCC Ex. 14 (Duann Supplemental Testimony) at 10.

[132] *Id.* at 10-11.

[133] OCC Ex. 14 (Duann Supplemental Testimony) at 5.

The $8.9 million cost of the 4.9-mile Pipeline Extension would increase Suburban's rate base by **52%**.[134] In its most recent rate case, the PUCO found that Columbia had used and useful property as of date certain valued at just over $1 billion.[135] Now imagine if Columbia increased its rate base by 52%, six days before its date certain, as Suburban did here. That would mean that customers would pay for more than $500 million in new investments, placed into service on the eve of the date certain.

Or consider the size and scope of the 4.9-mile Pipeline Extension. In this case, Suburban's engineer projected, conservatively, that the 4.9-mile Pipeline Extension was big enough to serve Suburban's current 13,500 southern system customers, plus another 4,000.[136] Though 4,000 customers may seem like a small number, it is nearly a 30% increase to Suburban's southern system.[137] Again, imagine if bigger utilities operated this way, building distribution systems that were oversized to handle a 30% increase in their customer base. Columbia Gas has nearly 1.5 million customers in Ohio.[138] A 30% increase would mean adding 435,000 customers to Columbia's system.[139] Neither Columbia Gas, nor any other large distribution utility, should be allowed to charge customers for a distribution system that is oversized by hundreds of thousands of customers. But if the PUCO approves the Settlement here for Suburban, it might give those larger utilities license to do so.

---

[134] Joint Ex. 1 (Settlement), Schedule A-1 ($25.9 million rate base in application, including the extension). 25.9 / (25.9 – 8.9) = 52.4% increase.

[135] *In re Application of Columbia Gas of Ohio, Inc.*, Case No. 08-72-GA-AIR, Opinion & Order at 22 (Dec. 3, 2018).

[136] Suburban Ex. 4 (Grupenhof Testimony) at 8 (June 9, 2019).

[137] 4,000 / 13,500 = 29.6%.

[138] *See* Columbia Gas of Ohio Annual Report to the Public Utilities Commission of Ohio (2018), *available at* https://community.puco.ohio.gov/p/s/search-annual-reports (1,452,721 Ohio customers as of December 2018).

[139] 1,452,721 * 30% = 435,816 new customers.

The PUCO should consider not only the effect of this case on Suburban's customers but also the precedent that it would set for other Ohio utilities when evaluating the Settlement. The negative impacts of such precedent further justify rejecting the Settlement.

II. Conclusion

Suburban's best argument for charging customers for the 4.9-mile Pipeline Extension is that Suburban's management acted prudently at the time it decided to build the pipeline. Even if true—and it isn't, because Suburban did not act prudently—Ohio law unambiguously provides that prudence is not enough. Prudence alone does not make utility plant used and useful to consumers on date certain.

The 4.9-mile Pipeline Extension was not useful to Suburban's current customers on date certain. By every available metric—length, capacity, pressure, number of customers served—the extension is too big.

Suburban's current customers should not, and under the law cannot, pay for a pipeline that was designed, built, and put into service to serve thousands of future customers. The Settlement reached by the PUCO Staff and Suburban does not pass the PUCO's standard for reviewing settlements. The PUCO should reject the Settlement and order that the entire 4.9-mile Pipeline Extension be excluded from rate base.

Respectfully submitted,

Bruce Weston (0016973)
Ohio Consumers' Counsel

/s/ Christopher Healey
Christopher Healey (0086027)
Counsel of Record
Angela O'Brien (0097579)
Assistant Consumers' Counsel

Office of the Ohio Consumers' Counsel
65 East State Street, 7th Floor
Columbus, Ohio 43215
Telephone [Healey]: (614) 466-9571
Telephone [O'Brien]: (614) 466-9531
christopher.healey@occ.ohio.gov
angela.obrien@occ.ohio.gov
(willing to accept service by e-mail)

CERTIFICATE OF SERVICE

It is hereby certified that a true copy of the foregoing Reply Brief was served by electronic transmission upon the parties below this 16th day of August 2019.

/s/ Christopher Healey
Counsel of Record

SERVICE LIST

robert.eubanks@ohioattorneygenerral.gov
werner.margard@ohioattorneygeneral.gov
cmooney@opae.org
bojko@carpenterlipps.com
see@carpenterlipps.com
dressel@carpenterlipps.com

Attorney Examiners:

Sarah.parrot@puco.ohio.gov
Anna.sanyal@puco.ohio.gov

Gold Canyon Sewer Co. v. Ariz. Corp. Comm'n

Court of Appeals of Arizona, Division One, Department D

May 20, 2010, Filed

1 CA-CC 09-0001, 1 CA-CC 09-0002 (Consolidated)

Reporter
2010 Ariz. App. Unpub. LEXIS 1054 *; 2010 WL 2025198

GOLD CANYON SEWER COMPANY, an Arizona corporation, Appellant, v. ARIZONA CORPORATION COMMISSION, an agency of the State of Arizona, Appellee, and RESIDENTIAL UTILITY CONSUMER OFFICE, Intervenor/Appellee.

Prior History: [*1] ACC No. SW-02519A-06-0015.

Disposition: AFFIRMED.

Counsel: Fennemore Craig, By Norman D. James and Jay L. Shapiro, Phoenix, Attorneys for Appellant.

Arizona Corporation Commission, By Robin R. Mitchell and Ayesha Vohra, Phoenix, Attorneys for Appellee.

Residential Utility Consumer Office, By Daniel W. Pozefsky and Michelle L. Wood, Phoenix, Attorneys for Intervenor/Appellee.

Judges: JON W. THOMPSON, Judge. PATRICIA A. OROZCO, Presiding Judge, DIANE M. JOHNSEN, Judge, concurring.

Opinion by: JON W. THOMPSON

Opinion

MEMORANDUM DECISION

THOMPSON, Judge

P1 In this consolidated appeal, Gold Canyon Sewer Company ("Gold Canyon") appeals from decision numbers 70624 and 70662 of the Arizona Corporation Commission ("the Commission"). For the following reasons, we affirm.

FACTUAL AND PROCEDURAL HISTORY

P2 In January 2006, Gold Canyon filed an application with the Commission for an increase in its rates for wastewater utility service provided to customers in Pinal County. In setting rates, the Commission generally determines the original cost rate base ("OCRB") [1] and the reconstructed cost new ("RCND") [2] rate base and then takes the average of the two to determine the fair value rate base ("FVRB"). *See Litchfield Park Serv. Co. v. Ariz. Corp. Comm'n*, 178 Ariz. 431, 434-35, 874 P.2d 988, 991-92 (App. 1994). [*2] In this case, Gold Canyon did not request an RCND, so the Commission adopted the OCRB as Gold Canyon's FVRB. In addition to the FVRB, the Commission also finds the weighted average cost of capital ("WACC"). It first determines the capital structure of the company, which is the percentage of debt and the percentage of equity. It multiplies the percentage of debt with the cost of debt to find the weighted average cost of debt and multiplies the percentage of equity with the cost of equity to find the weighted average cost of equity. It then adds these two products to determine the WACC, which is used as the rate of return. The rate of return represents the income earned by a utility after operating expenses. *Turner Ranches Water & Sanitation Co. v. Ariz. Corp. Comm'n*, 195 Ariz. 574, 576 n.2, 991 P.2d 804, 806 n.2 (App. 1999). The rate of return is then applied to the rate base

---

[1] "Original cost rate base" is defined as "[a]n amount consisting of the depreciated original cost, prudently invested, of the property . . . at the end of the test year, used or useful, plus a proper allowance for [*3] working capital and including all applicable pro forma adjustments." Ariz. Admin. Code R14-2-103(A)(3)(h).

[2] "Reconstructed cost new rate base" is defined as "[a]n amount consisting of the depreciated reconstruction cost new of the property . . . at the end of the test year, used and useful, plus a proper allowance for working capital and including all applicable pro forma adjustments. Contributions and advances in aid of construction, if recorded in the accounts of the public service corporation, shall be increased to a reconstruction new basis." A.A.C. R14-2-103(A)(3)(n).

to establish rates. *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 534, 578 P.2d 612, 615 (App. 1978).

P3 Prior to filing the application for a rate increase, Gold Canyon had been expanded and upgraded from a capacity of 1 million gallons per day (mgd) to 1.9 mgd. In the test year ending October 31, 2005, Gold Canyon had an FVRB/OCRB of $15,742,719. Intervenor-appellee Residential Utility Consumer Office ("RUCO") [3] argued that the FVRB/OCRB rate base should be adjusted downward because the treatment plant upgrade resulted in excess capacity— specifically that available plant capacity that exceeded the amount necessary to serve its existing customers. While agreeing that Gold Canyon's decision to expand the plant to [*4] 1.9 mgd was prudent and appropriate based on growth projections at the time, RUCO contended that that portion of the plant that was not used and useful should not be included in the rate base for ratemaking purposes. RUCO sought a reduction of $2,789,016 of the FVRB/OCRB rate base to $13,983,602.

P4 In Decision No. 69664, the Commission rejected RUCO's proposal, finding that, if the decision to upgrade to 1.9 mgd was prudent, Gold Canyon should not be subject to the decrease. The Commission noted that the minimum expansion that Gold Canyon could have implemented was 0.5 mgd to a total capacity of 1.5 mgd and that adding the additional 0.4 mgd was more economical than incremental upgrades, with the 0.4 mgd costing less than $1,000,000. The Commission further observed that, had Gold Canyon expanded the plant in smaller increments to avoid the excess capacity disallowance, it would have needed to start planning another incremental expansion [*5] almost immediately to meet ongoing demand increases, which would have resulted in higher costs to customers and the inconvenience to customers of ongoing construction activity.

P5 The Commission adopted the recommendation of the Commission Utilities Division ("Staff") of a somewhat reduced rate base of $15,725,787. With respect to the cost of capital determination, Staff and Gold Canyon proposed a 100 percent equity capital structure based on Gold Canyon's actual capital structure. RUCO proposed a hypothetical capital structure of forty percent debt and sixty percent equity. RUCO expert William Rigsby testified that the adoption of the hypothetical capital structure was appropriate because Gold Canyon's actual capital structure resulted in a lower level of risk. Rigsby derived an estimated return on equity of 8.6 percent based on a sample group of companies with a capital structure of approximately fifty percent debt and fifty percent equity. The Commission adopted the 100 percent equity capital structure proposed by Gold Canyon and Staff. The Commission noted, "[Gold Canyon's] actual capital structure is comprised of 100 percent paid in capital. In fact, the plant in Gold Canyon's [*6] rate base is financed entirely by equity. Although RUCO's proposed hypothetical capital structure would result in lower rates to customers, that fact does not justify adoption of RUCO's recommendation."

P6 Staff recommended a cost of equity of 9.2 percent. Staff derived that number by applying two financial models to six sample water companies for an average of 10.2 percent. Staff then adjusted the number down 100 basis points to account for Gold Canyon's "financial risk being less than that of the sample companies," resulting in a proposed cost of equity of 9.2 percent.

P7 Gold Canyon sought a cost of equity of 10.5 percent using six proxy companies. RUCO advocated a cost of equity of 8.6, also based on a sample group of companies. RUCO argued that the lower rate was reasonable because of the lower risk associated with Gold Canyon's proposed 100 percent equity capital structure, which would require a lower expected return on common equity.

P8 The Commission adopted the Staff's recommendation of a cost of equity of 9.2 percent, which, because of the 100 percent equity capital structure, also represented a 9.2 percent cost of capital. The Commission found Staff's approach to be reasonable [*7] and consistent with prior Commission decisions, noting that the methodologies used by Staff had been used for many years by the Commission. The Commission's finding of a rate base of $15,725,787 and return of 9.2 percent resulted in a gross revenue increase for Gold Canyon of $1,798,999.

P9 Decision No. 69664 was adopted by a vote of three commissioners in favor and two dissenting. RUCO filed an application for rehearing. RUCO argued that the rates approved by the Commission resulted in a 72.02 percent revenue increase, which was unfair to ratepayers. RUCO asserted that the Commission's decision favored Gold Canyon's interest over the interest of ratepayers, and pointed out that Gold Canyon's former president had assured ratepayers that the improvements to the plant would not cause an increase in rates. RUCO argued that the Commission should reconsider RUCO's position that the plant had excess capacity that should be excluded from the rate base. RUCO contended that the question was whether current or future ratepayers should pay for the additional capacity, arguing that under the Commission's decision, current ratepayers would be required to pay for the additional capacity whether it

[3] RUCO is a statutorily created office "established to represent the interests of residential utility consumers in regulatory proceedings involving public service corporations before the corporation commission." Ariz. Rev. Stat. ("A.R.S.") § 40-462 (2001).

[*8] was used or not, burdening current ratepayers with the risk of future growth. RUCO also argued that its proposed hypothetical capital structure would bring Gold Canyon's capital structure in line with the industry average and would result in lower rates for ratepayers. Because Gold Canyon had a capital structure of 100 percent equity, RUCO argued, it had extremely low to no financial risk and would therefore also have a lower expected return on common equity, making adoption of the proposed hypothetical capital structure appropriate. RUCO asserted that Gold Canyon's and Staff's claim that using a hypothetical capital structure would not allow Gold Canyon an adequate level of income tax expense was disingenuous because the expense typically falls on the ratepayers.

P10 At an open meeting, the Commission discussed RUCO's application for rehearing and the scope of that rehearing. The Commission granted RUCO's application for rehearing on RUCO's proposed rate base reduction for excess capacity and its proposed hypothetical capital structure including cost of equity. The Commission accepted additional filed testimony and conducted a rehearing.

P11 The administrative law judge issued a Recommended [*9] Opinion and Order ("ROO") affirming Decision No. 69664. One commissioner offered two amendments. The first amendment would disallow $2.8 million from Gold Canyon's rate base for excess capacity, while recognizing that Gold Canyon would be able to recover a full rate of return on the entire plant once the full plant became "used and useful." The first amendment also provided for the establishment of a depreciation expense account to record the depreciation expenses on the disallowed plant. The second proposed amendment provided for the adoption of RUCO's hypothetical capital structure of forty percent debt and sixty percent equity and cost of equity capital of 8.6 percent.

P12 At the subsequent open meeting, RUCO argued that, although the excess plant capacity resulted from growth projections that exceeded the actual increase in the number of customers, ratepayers should not bear the entire risk of the erroneous growth projections. RUCO agreed that the decision to expand the plant was prudent, but asserted that prudency and "used and useful" were not synonymous and that the excess capacity was not used and useful. RUCO asserted that the average monthly sewer bill of $60.55 would decrease [*10] by $5.33 if the Commission approved proposed amendment one and would decrease $6.71 if the Commission approved proposed amendment two.

P13 With respect to excess capacity, Gold Canyon argued that its decision to expand the plant as it did was prudent. Gold Canyon noted that when it acquired the plant, it was required to renovate and expand. It noted that the Commission required that it plan five years into the future, and that the Arizona Department of Environmental Quality required that when a sewer company is at eighty percent capacity it must plan renovation and when it is at ninety percent capacity it must be building an expansion. Gold Canyon asserted it had a choice of expanding from 1 mgd to 1.5 mgd for $11 million, after which it would almost immediately have had to expand again, or it could expand to 1.9 mgd in the first instance for $11.5 million. Gold Canyon chose to expand to 1.9 mgd. Gold Canyon argued that it had a right to not only recover the capital expended but to earn a return on its investment. It asserted that prudence and "used and useful" were not different concepts, asserting that "[w]hen you tell a company to plan five years out, then everything that is planned [*11] for five years out is used and useful by definition."

P14 Staff argued that, if the Commission found excess capacity, the excess capacity would be the extra 400,000 gallons per day capacity in building the plant to handle 1.9 mgd instead of 1.5 mgd, and so the rate base should be reduced by less than $1 million, not the $2.8 million proposed by RUCO. Staff also argued that reducing the cost of equity by 100 basis points—a Hamada adjustment—achieved the same effect RUCO sought through use of a hypothetical capital structure. Staff further explained that its Hamada adjustment adjusted the return on equity as if Gold Canyon had a capital structure of sixty percent equity and forty percent debt. Staff supported the ROO as presented.

P15 The Commission adjusted the rate base disallowance for excess capacity from $2.8 million to $1 million and passed both amendments. The Commission issued Decision No. 70624, which adopted the hypothetical capital structure of forty percent debt and sixty percent equity and a cost of equity of 8.6 percent, and disallowed $1,000,000 from Gold Canyon's rate base as excess capacity. It further ordered Gold Canyon to establish a deferred depreciation expense account [*12] to record the depreciation expenses on the disallowed plant.

P16 After Gold Canyon filed its new schedule of rates, RUCO filed an objection, arguing that Gold Canyon did not account for interest synchronization in its revised rates. RUCO argued that the main benefit to ratepayers of a hypothetical capital structure was that a debt component would result in an interest expense that lowers Gold Canyon's income tax. RUCO argued that its recommendation included the effects of interest and income tax expense and asserted that the Commission clearly intended that the ratepayers receive that benefit. In response, Gold Canyon argued that the Commission had not ordered it to synchronize interest and that RUCO had admitted that use of hypothetical capital

structure did not mandate interest synchronization. The Commission scheduled and held a procedural conference to clarify the Commission's intent when it issued Decision No. 70624. Gold Canyon argued that the ordering of the paragraphs of Decision No. 70624 were unclear, pointing out as an example, that the decision did not specify whether the $1 million reduction was to come from the rate base or plant in service.

P17 The Commission issued Decision [*13] No. 70662 to clarify the language and its intent in Decision No. 70624. The decision stated in part:

> IT IS . . . ORDERED THAT Gold Canyon Sewer Company's plant in service . . . be reduced by $1.0 million . . . . Depreciation on the plant removed from plant in service shall be deferred for recovery in a future rate case and the deferral account shall also include interest calculated using the Company's rate of return authorized in Decision No. 70624.
>
> . . . .
>
> IT IS FURTHER ORDERED that the weighted cost of capital approved in this case shall be 8.54 percent . . . . Gold Canyon Sewer Company's weighted cost of debt is 3.38 percent and the Company's weighted cost of equity is 5.16 percent. The Company will use the weighted cost of debt of 3.38 percent in order to calculate Gold Canyon's test year adjusted level of income tax expense, using the interest synchronization method, to arrive at the revised level of operating revenue that will be generated by the revised rates and charges.

P18 Gold Canyon filed petitions for rehearing for Decision Nos. 70624 and 70662, which were deemed denied by operation of law. A.R.S § 40-253(A) (2001). Gold Canyon appealed from both decisions, and we consolidated [*14] the appeals. We have jurisdiction pursuant to A.R.S. § 40-254.01(A) (2001).

DISCUSSION

P19 The Arizona Constitution gives the Commission "full power" to set just and reasonable rates and requires that, in doing so, the Commission determine and use the fair value of the property of the public service corporation devoted to public use within the state. Ariz. Const. art. 15, §§ 3, 14; *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 151, 294 P.2d 378, 382 (1956); *Ariz. Corp. Comm'n v. Ariz. Water Co.*, 85 Ariz. 198, 203, 335 P.2d 412, 415 (1959); *State v. Tucson Gas, Elec. Light & Power Co.*, 15 Ariz. 294, 297-99, 138 P. 781, 782-83 (1914). In reviewing a decision by the Commission on rate-making issues, this court may vacate, set aside, reverse in part or remand the decision to the Commission if we determine upon a "clear and satisfactory" showing that the decision is "unlawful or unreasonable." A.R.S. § 40-254.01 (A). A "clear and satisfactory" showing is the same standard as a "clear and convincing" showing. *Consol. Water Utils. Ltd. v. Ariz. Corp. Comm'n*, 178 Ariz. 478, 481, 875 P.2d 137, 140 (App. 1993). We do not reweigh the evidence or substitute our judgment for that of the [*15] Commission, and may disturb the Commission's decision only if the decision "is not reasonably supported by the evidence, is arbitrary, or is otherwise unlawful." *Tonto Creek Estates Homeowners Ass'n v. Ariz. Corp. Comm'n*, 177 Ariz. 49, 58-59, 864 P.2d 1081, 1090-91 (App. 1993). The party challenging the decision bears the burden of demonstrating by clear and satisfactory proof that the decision is "arbitrary, unlawful or unsupported by substantial evidence." *Litchfield Park*, 178 Ariz. at 434, 874 P.2d at 991; A.R.S. § 40-254.01(E); *Simms*, 80 Ariz. at 154-55, 294 P.2d at 384;

P20 Gold Canyon argues that the Commission's decision reducing its plant in service account by $1 million in Decision 70662 is inconsistent with the findings of fact stated in Decision No. 70624. Gold Canyon quotes extensively from the findings in Decision No. 70624 by which the Commission reiterated its earlier conclusion that the Gold Canyon's decision to upgrade to 1.9 mgd was prudent. Gold Canyon then notes that the decision abruptly finds that it had excess capacity and that $1 million would be disallowed. Gold Canyon argues that, given the findings that its upgrade of the facility was prudent, the Commission [*16] had no factual basis to support a decrease based on excess capacity.

P21 The seeming inconsistency between the express factual findings and the Commission's conclusion is explained by the fact that the Commission reached a conclusion different from that reached by the administrative law judge who drafted the decision. The amendments adopted by the Commission that changed the conclusion did not provide express factual findings. Obviously, the better approach would have been to identify those facts on which the Commission based its decision.

P22 Findings of administrative agencies "must be sufficiently definite and certain to permit a judicial interpretation." *Hatfield v. Indus. Comm'n*, 89 Ariz. 285, 288-89, 361 P.2d 544, 547 (1961). The findings need not be in any particular form so long as a reviewing court can determine how the administrative body reached its decision. *Post v. Indus. Comm'n*, 160 Ariz. 4, 8-9, 770 P.2d 308, 312-13 (1989). The decision may be vacated if the reviewing court cannot determine that the basis for the decision is legally sound. *CAVCO Indus. v. Indus. Comm'n*, 129 Ariz. 429, 435, 631 P.2d 1087, 1093 (1981).

P23 The Commission expressly stated that it agreed with [*17] RUCO that Gold Canyon had excess capacity. RUCO had argued that, although Gold Canyon's upgrade was prudent based on the circumstances at the time, some of the plant was not being used for the benefit of the ratepayers and should not be included in the rate base. RUCO further argued that whether the upgrade was prudent was not the same question as whether the added facility had excess capacity.

P24 A utility "is entitled to a fair return on the fair value of its properties devoted to the public use, no more and no less." *Ariz. Water Co.*, 85 Ariz. at 203, 335 P.2d at 415; *see also* A.A.C. R14-2-103(A) (3) (h) (defining "[o]riginal cost rate base" as amount of depreciated original cost "used or useful"). The Commission has discretion in deciding what should or should not be included when finding fair value. *Ariz. Corp. Comm'n v. Ariz. Pub. Serv. Co.*, 113 Ariz. 368, 370-71, 555 P.2d 326, 328-29 (1976); *see also Consol. Water*, 178 Ariz. at 482-83, 875 P.2d at 141-42 (no error in Commission's excluding anticipated construction work in progress as not "used and useful," although Commission could have considered it in finding fair value).

P25 The record contains evidence that Gold Canyon has [*18] a maximum capacity of 1.9 mgd and that during the test year, it had an average flow rate of 0.708 mgd and peak flow of 1.17 mgd. This evidence alone supports the Commission's finding that a portion of the facility was not being used for the benefit of the public and could be excluded from the rate base. At the open meeting after the rehearing, RUCO argued that ratepayers should not bear the entire burden of the erroneous projections that resulted in the decision to build to 1.9 mgd instead of to 1.5 mgd, until the excess capacity became useful. Staff pointed out that Gold Canyon was required to build to 1.5 mgd, and so any reduction in rate base based on excess capacity should be limited to the cost to upgrade from 1.5 mgd to 1.9 mgd, which Decision 69664 placed at less than $1 million. The Commission adopted Staff's argument and imposed a lesser reduction than had been proposed by RUCO, demonstrating that the reduction was not arbitrary but was based on the portion of plant that was not then in service.

P26 The record and the findings demonstrate the basis of the Commission's decision sufficiently for this court's review, and the decision is supported in the record. Gold Canyon has [*19] not shown that the reduction based on the plant not yet being used was arbitrary, capricious, or unlawful.

P27 Gold Canyon also challenges the Commission's adoption of RUCO's hypothetical capital structure. The Commission had initially adopted Staff's cost of equity, which was determined using sample water utilities and then adjusted downward using the Hamada equation to account for Gold Canyon's lower investment risk arising from its 100 percent equity capital structure. In its application for rehearing, RUCO advocated using a hypothetical capital structure of forty percent debt and sixty percent equity to account for the lower risk and to bring that financial risk in line with the sample utilities. RUCO acknowledged that adjustment to the financial risk could be achieved through either the Staff's direct adjustment by the Hamada equation or by employing a fictional capital structure. However, RUCO also asserted that Staff's use of the Hamada equation was not entirely appropriate, noting that Staff applied it to both of the mathematical models that Staff had used to determine cost of equity, when the Hamada equation is properly applied to only one those models. Gold Canyon argued that [*20] the hypothetical capital structure was another way to do what the Hamada equation had done. Staff advised the Commission that it used the Hamada equation to impute a capital structure of sixty percent equity and forty percent debt. RUCO contended that the Hamada equation did not give ratepayers the benefit of an interest expense deduction that would be the case with a capital structure containing debt.

P28 Gold Canyon argues that the Commission's decision on rehearing changing its approach from using the Hamada equation to using a hypothetical capital structure is arbitrary and capricious and lacks any explanation.

P29 In its decision, the Commission explained:

> A capital structure comprised of 100 percent equity would be viewed as having little to no financial risk. The proposed capital structure adopted by the Commission will bring the Company's capital structure in line with the industry average and it will result in lower rates for the customers of the system. We therefore adopt a hypothetical capital structure of 40 percent debt and 60 percent equity.

One commissioner, who had originally voted in favor of use of the Hamada equation and who changed his vote, made a specific observation [*21] comparing the two approaches:

> I agree with RUCO that the adoption of the hypothetical capital structure is appropriate in this case in light of the company's 100 percent capital structure. The adoption of RUCO's proposed capital structure more holistically addresses the concern that the company's overly capitalized capital structure is not in the best interest of its customers.
>
> If a company has too much equity in its capital structure, it harms ratepayers in two ways. First, it raises the cost of capital because equity is generally more expensive than debt. And second, it deprives the company of favorable tax implications of having debt, which

> ultimately inures to the benefit of the ratepayers.
>
> In this case Staff proposed the Hamada adjustments and, while responding to the first concern, . . . leaves a second category of harm to the ratepayers unaddressed. In contrast RUCO's proposed capital structure addresses both concerns, the artificially high cost of capital and the loss of favorable tax treatment.

The record also shows that some of the commissioners were concerned about what would have been a seventy-two percent increase in rates and desired to lower the rates if legally possible. [*22] The Commission's concern for the ratepayers was not improper. The Commission's role is not only to set rates so a utility can earn a fair return, but also to protect the consumers from overreaching utilities. *Ariz. Corp. Comm'n v. State ex rel. Woods*, 171 Ariz. 286, 290, 830 P.2d 807, 811 (1992). The Commission has an obligation to consider the effect on ratepayers of the rates it sets and to balance the interests of the parties involved. *Ariz. Cmty. Action Ass'n v. Ariz. Corp. Comm'n*, 123 Ariz. 228, 231, 599 P.2d 184, 187 (1979) ("A reasonable rate is not one ascertained *solely from considering the bearing of the facts upon the profits of the corporation. The effect of the rate upon persons to whom services are rendered is as deep a concern in the fixing thereof as is the effect upon the stockholders or bondholders.* A reasonable rate is one which is as fair as possible to all whose interests are involved.") (quoting *Salt River Valley Canal Co. v. Nelssen*, 10 Ariz. 9, 13, 85 P. 117, 119 (1906)).

P30 Gold Canyon, like RUCO, acknowledged that employing a hypothetical capital structure and using the Hamada equation were two different approaches that addressed the lack of financial risk [*23] in Gold Canyon's 100 percent equity capital structure. Presented with two approaches, it is for the Commission and not this court to determine which is appropriate in any particular circumstance when designing rates. *See Litchfield Park*, 178 Ariz. at 435, 874 P.2d at 992 ("The Commission has discretion in determining a utility's capital structure.") (citation omitted). The Commission's ultimate decision is supported by the record; Gold Canyon has not shown that the Commission's adoption of the hypothetical capital structure was arbitrary, capricious, or unlawful.

P31 Gold Canyon argues that the Commission deviated from the generally accepted method of accounting for financial risk. Gold Canyon specifically notes that the Commission applied the Hamada equation in Black Mountain Sewer Corporation's rate case, despite that company also having a 100 percent equity capital structure and despite the same arguments by RUCO. Gold Canyon argues that the Black Mountain case involved virtually identical circumstances and that therefore the Commission's use of a hypothetical capital structure in this case was arbitrary.

P32 We find no basis for concluding that the Commission must be bound to apply [*24] in one case the methodology for ratemaking it used in a prior case, so long as its decision is supported by the record before it. Gold Canyon has offered no authority otherwise.

P33 Gold Canyon argues that the Commission improperly reconsidered the issues of cost of equity capital and operating expenses. Gold Canyon contends that, under A.R.S. § 40-253(C), the Commission may not reconsider issues not raised by a party in an application for rehearing. Gold Canyon argues that RUCO did not raise the issues of cost of equity and adjustments to income tax expense in its application for rehearing and therefore the Commission could not consider them.

P34 RUCO's application for rehearing did not articulate specific issues to be addressed at a rehearing, but discussed its position regarding excess capacity and capital structure. In discussing the problems with a 100 percent equity capital structure, RUCO discussed its proposed hypothetical capital structure and the effect on the cost of equity.

> The water utilities used in RUCO's sample are representative of the industry and, by comparison to the Company, would be considered as having a higher level of financial risk . . . because of their higher [*25] levels of debt. The additional financial risk due to debt leverage is embedded in the cost of equities derived for those companies through the DCF analysis that RUCO performed. Thus, the cost of equity derived in RUCO's DCF analysis is applicable to companies that are more leveraged and . . . riskier than a utility such as Gold Canyon, which has no debt in its capital structure. In the case of a publicly traded company, like those included in RUCO's proxy of companies, a company with Gold Canyon's level of equity would be perceived as having extremely low to no financial risk and would therefore also have a lower expected return on common equity. Because of this, a 60/40 hypothetical capital structure that produces a lower weighted cost of common equity is appropriate for Gold Canyon.
>
> . . . .
>
> The problem concerns an appropriate adjustment to the Company's cost of common equity to bring it in line with sample groups of companies that have capital structures more representative of the industry and face greater financial risk as a result of the level of debt in their capital structures.

RUCO also addressed concerns regarding income tax expense.

> The Company and Staff claim, and the Commission

> [*26] apparently believes, that a hypothetical capital structure would not allow the Company an adequate level of income tax expense because of the interest deduction associated with RUCO's recommended level of debt. This argument is disingenuous from the standpoint that the burden of paying higher levels of income tax expense for utilities with Commission-approved hypothetical capital structures containing additional equity always falls on ratepayers. The adoption of a hypothetical capital structure should be a two-way street. It is only just and reasonable that Gold Canyon ratepayers should not bear the burden of paying a higher level of income tax expense in rates simply because the Company has made the decision to adopt a 100 percent equity capital structure, which is clearly out of line with the rest of the industry.

In raising the issue of its proposed hypothetical capital structure, RUCO also raised as related matters the issues of cost of equity and income tax expense. In addition, at an open meeting to consider RUCO's application, the Commission discussed the scope of the rehearing and included cost of equity as part of the issue of capital structure. The issues were adequately raised [*27] as part of RUCO's application for rehearing.

P35 Even if the issues had not been raised, A.R.S. § 40-253(C) would not have precluded the Commission from considering them. In construing a statute, we look first to its plain language as the best indicator of the intent of the legislature. *Canon Sch. Dist. No. 50 v. W.E.S. Constr. Co.*, 177 Ariz. 526, 529, 869 P.2d 500, 503 (1994). If the language is unambiguous, we must give effect to that language. *Janson ex rel. Janson v. Christensen*, 167 Ariz. 470, 471, 808 P.2d 1222, 1223 (1991). Statutory construction is an issue of law, which we review de novo. *Schwarz v. City of Glendale*, 190 Ariz. 508, 510, 950 P.2d 167, 169 (App. 1997).

P36 Section 40-253(C) states:

> C. The application [for rehearing] shall set forth specifically the grounds on which it is based, and no person, nor the state, shall in any court urge or rely on any ground not set forth in the application.

The purpose of the statute is to give the Commission the opportunity to correct any mistakes before the matter is taken to court. *Cogent Pub. Serv., Inc. v. Ariz. Corp. Comm'n*, 142 Ariz. 52, 54, 688 P.2d 698, 700 (App. 1984).

P37 Nothing in the language of the statute suggests that [*28] it precludes the Commission from reconsidering issues not raised in the application. The Commission is not a "court," nor is it a "person" or "the state." [4] In addition, the statute also provides that "after a rehearing and a consideration of all the facts," the Commission can change an order if it "finds that the original order or decision or any part thereof is in any respect unjust or unwarranted, or should be changed." A.R.S. § 40-253(E). The Commission may consider relevant factors in a ratemaking proceeding even if not raised by the parties. *See Turner Ranches*, 195 Ariz. at 579, ¶ 23, 991 P.2d at 809. The Commission did not improperly consider the issues of cost of equity or income tax expenses.

P38 Gold Canyon also argues that the Commission made no findings to support its adoption of RUCO's 8.6 percent cost of equity and that RUCO presented no credible basis for the Commission's decision. We first note that Gold Canyon seems to assert that RUCO had a burden at the rehearing to demonstrate that the Commission's prior findings and conclusions were erroneous in order [*29] to provide a "basis to overturn the findings and conclusions" in the prior decision. Gold Canyon has cited no authority to support such a view. Rather, as noted, after rehearing, the Commission can change a prior decision if the Commission concludes it "should be changed." A.R.S. § 40-253(E).

P39 In Decision No. 70624 the Commission stated:

> We believe that RUCO's recommendation for a 8.60 percent cost of equity capital is appropriate, and will adopt it in this case. RUCO's expert witness relied on a DCF model and a CAPM analysis for calculating his cost of equity capital. We believe that adoption of RUCO's recommendations results in just and reasonable rates and charges for Gold Canyon based on the record of this proceeding. We therefore adopt a cost of equity of 8.60 percent, which also results in an overall weighted cost of capital of 8.54 percent.

The decision provided no other findings supporting its conclusion. However, because the Commission expressly adopted RUCO's recommendation, this court can determine the basis of the Commission's decision. *See Pinetop Truck & Equip. Supply v. Indus. Comm'n*, 161 Ariz. 105, 107, 776 P.2d 356, 358 (App. 1989) (adopting testimony of claimant constituted [*30] adequate findings).

P40 Rigsby, the public utilities analyst for RUCO, recommended a cost of equity of 8.6 percent and a cost of debt of 8.45 percent, which applied to RUCO's hypothetical capital structure of sixty percent equity and forty percent debt resulted in a weighted cost of debt of 3.38 percent, a weighted cost of common equity of 5.16 percent, and a weighted cost of

---

[4] A.R.S. § 40-253(A) authorizes any party "or the attorney general on behalf of the state" to apply for a rehearing.

capital of 8.54 percent. He testified that he derived the cost of equity using the discounted cash flow method ("DCF"), and used the capital asset pricing model ("CAPM") in a supporting role to provide additional information. He testified that he used the same DCF methodology as had a Staff witness in another case, whose cost of equity recommendation had been adopted by the Commission. Both methods involved analyzing data on sample proxy companies.

P41 Gold Canyon finds fault with the companies RUCO used as its proxy group and in RUCO's reliance on a single DCF model, noting that Staff had used more companies in its samples and had used two different types of DCF models and a two-part CAPM analysis to determine Gold Canyon's cost of equity. Gold Canyon asserts that the methodologies differed in other respects as [*31] well. However, the merits or flaws of the competing approaches are matters for the Commission to resolve. Gold Canyon has not demonstrated clearly and convincingly that the Commission's choice of RUCO's methodology is unlawful, arbitrary, or capricious.

P42 Gold Canyon also argues that the Commission's order adjusting income tax expense is arbitrary and capricious. The Commission ordered Gold Canyon to use the weighted cost of debt of 3.38 percent to calculate the test year adjusted level of income tax expense, using the interest synchronization method, to obtain the revised level of operating revenue. [5]

P43 The Commission's order reflects the recommendation of RUCO expert Rigsby, who recommended that the Commission adopt an "interest synchronization adjustmment, which produces an income tax deduction for interest expense that is the weighted cost of debt times the company's rate base." Rigsby explained that using Staff's methodology employing the Hamada equation

> does not produce an appropriate interest deduction that is reflective of a capital structure that contains debt. The use of debt to reduce income taxes is often referred to as a tax shield . . . . [T]he Hamada methodology does not produce a weighted cost of debt that is used to calculate an appropriate interest expense deduction to income taxes. . . . [R]atepayers are harmed from the standpoint that they will have to pay higher rates for a higher level of income tax expense that should be lower as a result of a more balanced capital structure.

Rigsby testified that he derived the cost of debt of 8.45 percent by taking the average of eight publicly traded water companies. The 3.38 percent weighted average cost of debt is the product of the cost of debt and the percentage of debt in the capital structure, which was set [*33] at forty percent in RUCO's hypothetical capital structure. Rigsby's testimony supports the Commission's decision to order the calculation of income tax expense.

P44 In addition, the adoption of a hypothetical interest expense by a utility commission is not without precedent. *See In re Citizens Utils. Co.*, 112 Idaho 1061, 739 P.2d 360 (Idaho 1987) (commission has power to adopt hypothetical interest expense based upon hypothetical capital structure); *Carnegie Natural Gas Co. v. Pa. Pub. Util. Comm'n*, 61 Pa. Commw. 436, 433 A.2d 938, 942 (Pa. Commw. Ct. 1981) (affirming commission order adopting hypothetical capital structure and hypothetical interest expense and disallowing actual income tax expense).

P45 We find that Gold Canyon has not demonstrated by clear and convincing proof that the Commission's decisions were arbitrary, capricious, or unlawful. We therefore affirm Decision No. 70624 and Decision No. 70662.

CONCLUSION

P46 We find that Decision Nos. 70624 and 70662 are supported by the record and have not been shown to be arbitrary, capricious, or unlawful. We affirm.

/s/ JON W. THOMPSON, Judge

CONCURRING:

/s/ PATRICIA A. OROZCO, Presiding Judge

/s/ DIANE M. JOHNSEN, Judge

---

[5] As explained by Gold Canyon, "[u]tilities must pay federal and state income taxes based on their taxable income. Consequently, income taxes are an expense that is part of a utility's cost of service. Increased income tax expense results in higher utility rates, unless such tax expense can be offset by deductions. In this case, [Gold Canyon's] actual capital structure does not contain any debt. [Gold Canyon], therefore, does not pay annual interest expense to any debt holder, which means that [Gold Canyon] does not have interest expense that can be used as a deduction to lower income [*32] taxes."

Summary: Brief Reply Brief by The Office of the Ohio Consumers' Counsel electronically filed by Mrs. Tracy J Greene on behalf of Christopher Healey