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**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of The :
East Ohio Gas Company dba Dominion : Case No. 09-458-GA-UNC
East Ohio to adjust its Pipeline : PIR Annual Filing for Fiscal Year
Infrastructure Replacement (PIR) Cost : 2008/2009
Recovery Charge and Related Matters :

POST-HEARING BRIEF
SUBMITTED ON BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO

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INTRODUCTION

This proceeding ultimately leads to the first PIR charge set by the Commission in the territory of the East Ohio Gas Company d/b/a Dominion East Ohio (Dominion). Because this is the first proceeding, the Commission, necessarily, will set precedent for the charge's future calculation. The parties disagree on the inputs to the charge's calculation, and, that means they also disagree on what constitutes a just and reasonable PIR charge. Staff advocates what the parties agreed upon, and the Commission approved, as well as reasonable approaches to determine inputs where the parties did not explicitly agree. Staff's proposals balance the Company's need to earn a just and reasonable return and its customers need to pay no more than a just and reasonable rate. The Company's proposals do not produce such a balance but they produce a higher rate which benefits

only the Company's shareholders. Staff's recommendations lead to a just and reasonable PIR charge and allow an opportunity to earn a just and reasonable return.

STATEMENT OF THE CASE

Dominion East Ohio (DEO) initially filed an application for approval of a Pipeline Infrastructure Replacement (PIR) program in Case No. 08-169-GA-ALT. That case was later consolidated with DEO's then pending base rate case, Case No. 07-829-GA-AIR. The Commission approved the PIR rider recovery mechanism as part of a Joint Stipulation and Recommendation that was submitted in those consolidated cases. The initial PIR rate was set at \$0.00 subject to annual reviews during each of the five year¹ term approved by the Commission for the PIR program.

This case presents the first of these annual reviews and includes a test-year of July 1, 2008 – June 20, 2009 and a date certain of June 30, 2009. DEO has proposed a PIR revenue requirement of \$16,063,471 and has requested the following PIR rates for different customer classes to recover its costs associated with accelerated repair, replacement, and maintenance of aging pipelines and related infrastructure:

¹ PIR cost recovery rates are to be established annually during the five-year period or until the effective date of new base rates established for DEO, whichever comes first. Staff Ex. 1 at 2 (Staff Comments and Recommendations in Case No. 09-458-GA-UNC).

GSS/ECTS	\$0.93 per month.
LVGSS/LVECTS	\$11.14 per month.
GGTS/TSS	\$41.88 per month.
DTS	\$0.0232 per Mcf, capped at \$1000 per month. ²

The Staff performed an investigation, somewhat truncated due to time constraints, and it made the following recommendations that are now presented for the Commission's determination:

1. The Staff agrees with the Company's request to recover the PIR annualized depreciation expense, the PIR annualized property taxes, and the amortization of post in-service carrying costs. However, for the regulatory assets associated with the incremental depreciation expense and the incremental property taxes, the Staff recommends that the regulatory assets should be amortized over the useful life of the PIR assets.³
2. The Company reduced plant additions by plant retirements in the calculation of the accumulated provision for depreciation expense amount in Schedule 5. The Staff recommends that plant additions should not be reduced because accumulated depreciation on

² Staff Ex. 1 at 4-5 (Staff Comments and Recommendations in Case No. 09-458-GA-UNC).

³ *Id.* at 7-8.

Schedule 1 already includes the provision for depreciation associated with retirements.⁴

3. The Staff recommends that DEO's total PIR Capital Additions of \$90,332,394 be reduced by a total \$3,323,208 based upon the following:
 - a) \$452,195 to remove costs associated with projects that were placed into service after the date certain of June 30, 2009.
 - b) \$2,510,364 to remove costs associated with projects that are still in construction or in the preliminary design phase; and
 - c) \$360,649 to remove costs associated with projects for curb-to-meter installations for service line extensions to new customers since the associated revenues are not reflected in the determination of the PIR rates.

The Staff further recommends that depreciation expense, property taxes, and deferred taxes on liberalized depreciation be adjusted to reflect the exclusion of the \$3,323,208.⁵

4. The Staff recommends that the incremental O&M amount of \$1,128,670 be eliminated from the revenue requirement calculation.

⁴ Staff Ex. 1 at 8 (Staff Comments and Recommendations in Case No. 09-458-GA-UNC).

⁵ *Id.* at 8-9.

The Staff believes that recovery of these types of expenses was never contemplated by the Stipulation and Recommendation ⁶

5. The Staff recommends that the O&M Baseline Savings amount of \$85,022 be increased to \$554,300 to reflect the actual savings resulting from the implementation of the PIR program that should be passed on to the customers. The Staff recommends an approach to calculating the O&M Savings that uses the Company's methodology except that only the accounts with cost savings should be included in the calculation of the net O&M savings. The remaining accounts with cost increases should be set at zero.⁷

Each of these issues will be discussed in greater detail below. As a result of its investigation and updated information provided by DEO, the Staff recommends the following PIR rider rates:

⁶ Staff Ex. 1 at 9-10 (Staff Comments and Recommendations in case No. 09-458-GA-UNC).

⁷ *Id.* at 8-12.

GSS/ECTS	\$0.72 per month. ^{8 9}
LVGSS/LVECTS	\$8.94 per month. ⁹
GGTS/TSS	\$33.65 per month. ⁹
DTS	\$0.0187 per Mcf, capped at \$1000 per month. ⁹

DISCUSSION

- A. Dominion calculated its proposed PIR charge using a one-year amortization period for of the regulatory asset associated with deferred depreciation expense and deferred property taxes. Dominion failed to demonstrate that one-year amortization period and the resulting PIR charge were just and reasonable. (Staff Recommendation No. 1).**

Dominion bears the burden of proof in this proceeding.¹⁰ That burden requires Dominion demonstrate its PIR charge and, by extension, the components of that charge's calculation are just and reasonable.¹¹ Dominion failed to demonstrate that the one-year amortization period it proposed for the regulatory asset associated with deferred depreciation and deferred property taxes was just and reasonable. Simply, these inputs to Dominion's PIR calculation are not just and reasonable.¹²

⁸ The Staff proposed a GSS/ECTS rate of \$0.73 per month in its Comments and Recommendations, which rate Staff later modified to \$0.72 per month based upon information in the record. Staff Ex. 5 at Sch. 1 (I. Soliman Prefiled Test.).

⁹ *Id.* at Attachment IS-1, Sch. 13. These rates are subject to further revision based upon additional refinements data requested by the Staff at the close of the hearing. *Id.* at 9.

¹⁰ Staff Ex. 2 at 6 (Staff Report in Case No. 08-169-GA-UNC).

¹¹ *Id.*

¹² Staff Ex. 1 at 8 (Staff Comments and Recommendations in Case No. 09-458-GA-UNC); Staff Ex. 5 at 4 (I. Soliman Prefiled Test.).

1. Dominion did not demonstrate the one-year amortization period it proposed is just and reasonable.

Dominion's argues the one-year amortization period for the regulatory asset associated with deferred depreciation expense is just and reasonable for three general reasons. First, Dominion makes several arguments centering on its claim that one-year period is just and reasonable because the regulatory asset is associated with depreciation.¹³ Second, Dominion claims that the one-year period is just and reasonable because it is timely and matches expenses with associated revenues.¹⁴ Finally, Dominion argues the one-year amortization period is just and reasonable because Staff's proposed alternative "denies DEO the opportunity to recover the true incremental cost of the program."¹⁵ Dominion makes these last two arguments also to support the one-year amortization period for deferred property taxes.¹⁶ Dominion's arguments do not satisfy their burden.

Dominion's first two arguments described above revolve around depreciation expenses as the object of the amortization. These arguments consider the wrong object of the amortization. Dominion considers depreciation expense as the object of the amortization. That is not true. A regulatory asset is the object of the amortization and not depreciation expense.¹⁷ As Mr. Soliman explained, "When the amortization [deprecia-

¹³ DEO Ex. 2 at 3 (V. Friscie Supp. Test.).

¹⁴ *Id.* at 3-4.

¹⁵ *Id.* at 5.

¹⁶ *Id.* at 4-5.

¹⁷ Staff Ex. 5 at 4-5 (I. Soliman Prefiled Test.).

tion] is recorded in the income statement, it becomes depreciation expense, and when the amortization is deferred and recorded in the balance sheet, it becomes a regulatory asset.”¹⁸ The deferral creates the asset.¹⁹ The object of the amortization is the regulatory asset.²⁰ Amortizing this regulatory asset over the life of the PIR assets “is consistent with the accounting principles of matching revenues collected through PIR rates with associated amortized cost of the PIR regulatory asset.”²¹

Additionally, amortizing the regulatory asset over the life of the PIR assets does not deprive Dominion recovery. Two factors show this. First, Dominion will recover the deferred depreciation expense and associated post-in-service-carrying-charges even if that recovery is slowed and spread over the life of the PIR assets; the only issue here involves how Dominion recovers the regulatory asset.

Second, Dominion’s PIR charge calculation includes a full year of depreciation and property tax expense.²² Dominion’s calculation includes *annualized* depreciation and property taxes in addition to the entire *deferred* depreciation and property taxes that become the regulatory asset.²³ *Annualized* depreciation and property taxes represent a full year of depreciation expense on the PIR plant assets as of the June 30, 2009 end of

¹⁸ Staff Ex. 5 at 4-5 (I. Soliman Prefiled Test.).

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.* at 5-6.

²² *Id.* at 3.

²³ *Id.* at 3.

the fiscal year.²⁴ *Annualized* depreciation and property taxes are recognized as expenses in Dominion's income statement in the same time period PIR revenues are collected from its customers.²⁵ Through annualized depreciation and property taxes, Dominion recovers a full year of depreciation and property tax expense on each piece of PIR plant in service on the last day of the fiscal year, June 30, regardless of when that piece actually went into service.²⁶ That means Dominion recovers a full year of depreciation and property tax expense on PIR plant going into service on June 30 and anytime before.²⁷ Accordingly, annualized depreciation and property taxes are calculated on the same plant over the same period as deferred depreciation and property taxes. The use of annualized depreciation and property taxes in the PIR charge is not disputed.²⁸ Simply, Dominion recovers a full year of depreciation and property tax expense through the PIR calculation. Dominion is not "denied" the opportunity to recover the costs of the program as it claims.

Accordingly, Dominion failed to demonstrate that its inclusion of one-year amortization period for the regulatory asset associated with deferred depreciation and deferred property taxes is just and reasonable.

²⁴ DEO Ex. 2 at 4-5 (V. Friscic Supp. Test.).

²⁵ Staff Ex. 5 at 3 (I. Soliman Prefiled Test.).

²⁶ *Id.*; DEO Ex. 2 at 4-5 (V. Friscic Supp. Test.).

²⁷ Staff Ex. 5 at 3 (I. Soliman Prefiled Test.); DEO Ex. 2 at 4-5 (V. Friscic Supp. Test.).

²⁸ Staff Ex. 5 at 3 (I. Soliman Prefiled Test.).

2. The over-the-asset-life amortization period Staff proposed is just and reasonable.

Amortizing the regulatory asset associated with deferred depreciation and property taxes over the useful life of the PIR assets, as Staff recommends, is just and reasonable. As previously noted, amortizing the regulatory asset associated with deferred depreciation and property taxes over the life of the PIR assets “is consistent with the accounting principles of matching revenues collected through PIR rates with associated amortized cost of the PIR regulatory asset.”²⁹ Additionally, amortizing the regulatory asset associated with deferred depreciation and property taxes over the life of the PIR assets is consistent with the treatment the Commission afforded such assets of other utilities.³⁰ Like Dominion, Columbia Gas of Ohio sought what Dominion terms “deferred depreciation expense.”³¹ Columbia “was granted that amortization over the life of the asset.”³² That means Staff’s recommendation in this case is consistent with the treatment Columbia received for a similar regulatory asset.³³ The Commission has already determined that amortizing a similar regulatory asset over the useful life of PIR assets, as Staff recommends, is consistent with a just and reasonable rate. Staff submits such treatment is just and reasonable in this case also.

²⁹ Staff Ex. 5 at 5-6 (I. Soliman Prefiled Test.).

³⁰ *Id.* at 4.

³¹ Tr. II at 15.

³² *Id.*

³³ *Id.* at 6.

Staff's proposal also provides consistent treatment for the regulatory asset. PISCC, deferred depreciation and deferred property taxes comprise the regulatory asset.³⁴ Dominion requested to amortize the regulatory asset associated with PISCC over the useful life of the PIR assets.³⁵ That treatment is not disputed. Staff's proposal achieves uniformity in the amortization of all parts of the regulatory asset.

Finally, amortizing all parts of the regulatory asset over the life of the asset spreads the cost of the PIR program better than the one-year amortization Dominion proposes. Amortizing all parts of the regulatory asset over the life of the asset "will spread the costs and benefits of the PIR program between current and future customers" and it also will "minimize the size of PIR rate increases on current and future customers."³⁶ In contrast, the one-year amortization period Dominion proposes is short, resulting in higher inputs to the PIR charge calculation and, accordingly, higher rates than the longer amortization period Staff recommends. Simply, Dominion's one-year amortization is the worse alternative for Dominion's customers. Staff suggests that also evidences Dominion's proposal is not just and reasonable.

For those reasons, Dominion failed to satisfy its burden to show that the one-year amortization period it proposed for the regulatory asset associated with deferred depreciation and deferred property taxes results in a just and reasonable rate. Staff submits that amortizing the regulatory asset over its useful life results in a just and reasonable rate.

³⁴ Staff Ex. 5 at 2 (I. Soliman Prefiled Test.).

³⁵ *Id.*

³⁶ *Id.* at 2.

B. Dominion proposed a PIR charge based on a calculation that included a return on capital additions that were not been placed in service and were not used and useful on the date certain and a return on capital additions for curb-to-meter new service installations. Dominion failed to demonstrate that including such assets in the PIR charge calculation, and the resulting PIR charge, were just and reasonable.³⁷ (Staff Recommendation No. 3).

1. Dominion failed to demonstrate that including a return on capital additions that were not placed in service and were not *used and useful* on the date certain in the calculation of the PIR charge was just and reasonable. (Staff Recommendation Nos. 3A and 3B).

Dominion bears the burden to demonstrate the PIR charge it proposes is just and reasonable.³⁸ In the application to set the PIR charge, Dominion proposed to recover a return on expenditures for capital assets that were not in service on the date certain, June 30, 2009, including some assets that were still in the design stage.³⁹ Staff commented that such expenditures should not be included in the calculation of Dominion's PIR charge because they are not associated with capital assets in-service, *used and useful*, on the date certain.⁴⁰ Accordingly, Staff submits Dominion's proposed PIR charge is fatally

³⁷ Staff Ex. 1 at 3 (Staff Comments and Recommendations in Case No. 09-458-GA-UNC). Dominion agreed with Staff Comment 2 in Staff Ex. 1 (Staff Comments and Recommendation in Case No. 09-458-GA-UNC. DEO Ex. 2 at 5 (V. Friscie Supp. Test). For that reason, Staff will not discuss Staff Comment 2 further.

³⁸ Staff Ex. 2 at 6 (Staff Report in Case No. 08-169-GA-UNC).

³⁹ Staff Ex. 1 at 8-9 (Staff Comments and Recommendations in Case No. 08-458-GA-UNC); Staff Ex. 5 at 7-8 (I. Soliman Prefiled Test).

⁴⁰ *Id.*

flawed and that Dominion must reduce the capital additions in its calculation by the amount of expenditures for assets that are not *used and useful* on the date certain.⁴¹

As the Commission is well aware, it has long used the *used and useful* criterion to limit the assets includable in the calculation of just and reasonable rates.⁴² This criterion requires an asset be in-service, *used and useful*, before Dominion may include the asset in rate calculations and before customers must pay a return on that asset through rates.⁴³ Blue Ridge Consulting Services described the effects of this requirement while highlighting the continued importance of the *used and useful* criterion in the ratemaking process, stating:

Through the rate case process, a utility is allowed the opportunity to earn a return on its investment in those assets that are deemed “used and useful” in serving the needs of the regulated utility customers. *The utility typically makes the investment in the assets, constructs the facilities and places them in service before seeking approval to include those assets in rate base and thus be allowed an opportunity to earn a return on that investment which rates are to be fixed and determined.”*⁴⁴

In this fashion, the *used and useful* criterion effectively protects Dominion’s customers from paying a return on assets before those assets provide a corresponding benefit to the customers.

⁴¹ Staff Ex. 1 at 8-9 (Staff Comments and Recommendations in Case No. 08-458-GA-UNC); Staff Ex. 5 at 7-8 (I. Soliman Prefiled Test).

⁴² Ohio Rev. Code Ann. §§4909.15 (A), 4909.18 (West 2009).

⁴³ *Id.*

⁴⁴ DEO Ex. 8 at 76 (Blue Ridge Report of its Financial Audit in Case No. 07-829-GA-AIR) (emphasis added).

Nothing in this case prevents the Commission from applying the *used and useful* criterion, and nothing in this case diminishes the importance of that criterion.

Accordingly, Staff believes the Commission should apply the *used and useful* criterion to determine just and reasonable rates in this case.⁴⁵ If the Commission applies the criterion, as Staff recommends, the assets that were not in service, *used and useful*, on the date certain should be removed from the rate calculation.⁴⁶

While applying the used and useful criterion and reducing capital investments as Staff recommends may impact Dominion's PIR charge, whatever impact occurs to Dominion will be ameliorated by post-in-service-carrying-charges.⁴⁷ As Mr. Soliman explained, "When these PIR projects [those involved in Staff's recommended adjustment] are placed in service, the company [Dominion] will start calculating post-in-service-carrying costs."⁴⁸ Mr. Soliman further explained, "The costs of these PIR projects [*when used and useful*] and the associated post-in-service carrying costs will be subject for recovery in the next year PIR filing."⁴⁹

Additionally, accommodating the *used and useful* criterion will not affect Dominion's accounting system adversely. As Mr. Soliman described, "The Company's accounting system is sophisticated and keeps records for various kinds of data for each of

⁴⁵ Staff Ex. 5 at 7-8 (I. Soliman Prefiled Test.).

⁴⁶ *Id.*

⁴⁷ *Id.* at 8.

⁴⁸ *Id.*

⁴⁹ *Id.*

the fixed asset and massed asset accounts.”⁵⁰ Because of this, “[I]t was possible for the Company to identify and provide Staff with detailed data for PIR fixed and massed assets projects during the Staff’s field investigation.”⁵¹ Simply, Dominion’s accounting system can make the adjustments necessary to identify and exclude “all PIR projects projected recorded in the fixed and massed assets that are not placed in service on the date certain.”⁵²

Dominion advocates the Commission ignore the *used and useful* criterion, and the resulting rate effect, because it claims to comply with the Federal Energy Regulatory Commission’s (FERC) System of Accounts, particularly 18 C.F.R. § 201 at Gas Plant Instructions, (11) Work Order and Property Records System Required, subpart (B).⁵³ Focusing on a provision in that guideline/rule that allows Dominion the option to clear work orders covering jobs of short duration monthly if it so chooses, Ms. Friscie explained Dominion “is recording its numerous distribution projects as ‘massed assets,’ for which projects are closed to the gas plant accounts monthly as such costs are incurred.”⁵⁴ This results in inflating the capital accounts with projects that were not *used and useful* on June 30, 2009, the date certain.⁵⁵ In a nutshell, Dominion argues that, in determining capital additions for the PIR charge calculation, the Commission should

⁵⁰ Staff Ex. 5 at 8 (I. Soliman Prefiled Test).

⁵¹ *Id.*

⁵² *Id.* at 8-9.

⁵³ DEO Ex. 2 at 6 (V. Friscie Supp. Test).

⁵⁴ *Id.*

⁵⁵ Staff Ex. 5 at 7-8 (I. Soliman Prefiled Test.).

ignore the *used and useful* criterion and, instead, defer to Dominion's choices under the FERC accounting system. Staff submits that deference is neither required nor advisable.

The FERC System of Accounts does not control rate determinations such as those involved in this case.⁵⁶ Even Ms. Friscic acknowledged as much. She acknowledged that booked amounts in Dominion's accounts may be made adjusted for rate determinations.⁵⁷ Moreover, the purpose of the FERC Uniform System of Accounts is not to control the Commission's decision in this case or any other rate matter. The purpose of the FERC Uniform System of Accounts "is to make the financial reporting of regulated energy utilities uniform and consistent."⁵⁸ Accordingly, the FERC Uniform System of Accounts does not dictate the Commission's determinations involved in this case such as the application of the *used and useful* criterion and development of a just and reasonable PIR charge.

Dominion also raised its last rate case application in connection with its argument associated with the FERC Uniform System of Accounts. Dominion claimed it did not adjust for those blanket work orders that were closed on a monthly basis in its last rate case.⁵⁹ This claim does little to support Dominion's position. First, neither Ms. Friscic nor any other witness stated that Dominion included property that was not *used and useful* in the application for a base-rate increase and no witness stated property that was not

⁵⁶ Staff Ex. 5 at 5 (I. Soliman Prefiled Test.).

⁵⁷ Tr. I at 177-178.

⁵⁸ Staff Ex. 5 at 5 (I. Soliman Prefiled Test.).

⁵⁹ Tr. II at 7.

used and useful was included in the rate base calculation. Moreover, Mr. Soliman stated that Staff was not aware that any property included in the rate base calculation was not *used and useful* and Staff remains unaware of that.⁶⁰ Of course, no evidence states that the Commission was aware that any property included in the rate base calculation was not *used and useful*. Accordingly, there is not any evidence that the Commission or its Staff ever approved the inclusion of property that was not used and useful in rates even if Dominion included it in its rate application.

Additionally, the Commission could not include property that was not used and useful in the calculation of base rates. The General Assembly did not provide the Commission with discretion to waive the *used and useful* criterion. The General Assembly authorized the Commission to compute rates with *only* property that was “used and useful in rendering the public utility service for which rates are to be fixed and determined.”⁶¹ Accordingly, the Commission can not waive the *used and useful* criterion for Dominion or any other utility. For all these reasons, whatever Dominion, or any other utility, included in rate base cannot support Dominion’s position if it was not used and useful.

For the foregoing reasons, Dominion did not meet its burden to show the PIR charge it proposed was just and reasonable.

⁶⁰ Tr. II at 71.

⁶¹ Ohio Rev. Code Ann. § 4904.15(A)(1) (West 2009).

2. Dominion failed to demonstrate that including a return on capital additions for curb-to-meter new service installations was just and reasonable. (Staff Recommendation No. 3C).

Staff believes that the PIR program was designed to allow for recovery of certain replacement of aging pipeline infrastructure.⁶² In the Supplemental Direct Testimony of Jeffery A. Murphy filed in support of Dominion's application,⁶³ the PIR program is described as excluding revenue-generating infrastructure investments, such as the new curb-to-meter installations Dominion seeks to include in the PIR.⁶⁴ Accordingly, the new service lines do not qualify for recovery through the PIR because their costs are revenue generating investments for Dominion.⁶⁵

C. Incremental Operating and Maintenance (O&M) expenses have not been recommended by the Staff nor approved by the Commission for recovery through DEO's PIR rider (Staff Recommendation No. 4).

DEO seeks recovery of \$1,128,670 in incremental O&M expenses as part of the PIR revenue requirement in this case. Staff recommends exclusion of this entire amount because:

⁶² Staff Ex. 5 at 7 (I. Soliman Prefiled Test.).

⁶³ Staff acknowledges that Dominion did not offer this testimony in the case. Nevertheless, it is descriptive of the program Dominion suggests.

⁶⁴ *Id.*

⁶⁵ *Id.*

- (a) these types of expenses have not been previously recommended for PIR recovery by the Staff nor approved for recovery by the Commission through the PIR;
- (b) of the very short time available to the Staff to analyze incremental O&M expense data. This information was not provided by DEO until it filed its PIR application, only a month before Staff's Comments were due. This allowed Staff to perform only a preliminary review; and,
- (c) including incremental O&M in the PIR revenue requirement virtually eliminates any opportunity for meaningful customer savings.

1. The documents speak for themselves. They show that the Commission Staff has never recommended PIR recovery of incremental O&M expenses and the Commission has never approved such treatment.

The issue being litigated and now before the Commission concerns what the parties agreed upon and what was approved by the Commission in consolidated Case Nos. 08-169-GA-ALT, *et al.* Is incremental O&M properly recoverable through DEO's PIR or not? Again, in this case, DEO seeks to recover approximately \$1.1 million in incremental O&M through the PIR revenue requirement in this case. In its order issued in the consolidated cases, the Commission adopted DEO's PIR as part of the Stipulation and Recommendation in that case, so it is logical, to ascertain the intent and scope of the parties' agreement, to resort to the settlement agreement itself.

The parties' Stipulation establishes a rather straightforward "pecking order:"

Unless otherwise specifically provided for in this Stipulation and Recommendation, all rates, terms, conditions, and any other items shall be treated in accordance with the Staff Reports. If any proposed rates, terms, conditions, or other items set forth in the Company's Application are not addressed in the Staff Reports, the proposed rate, term, condition, or other item shall be treated in accordance with the applicable Application filed in these consolidated proceedings.⁶⁶

Consistent with this provision, the Stipulation speaks more specifically to the PIR:

The Pipeline Infrastructure Replacement ("PIR") Application in Case No. 08-169-GA-ALT (including the proposed accounting treatment) is hereby adopted in accordance with the recommendations in the Staff Report, subject to the modifications set forth in this Stipulation and Recommendation.⁶⁷

Under the Stipulation agreed upon by the parties and *approved by the Commission*, the PIR was adopted *in accordance with the recommendations in the Staff Report*, subject to modifications set forth in other portions (at pages 8 and 9) of the Stipulation. As page eight of the Stipulation makes clear, the seven modifications, none of which is germane to the issue at hand, are the only limitations upon what the Staff recommended in the Staff Report relative to DEO's PIR. The ultimate default, if a matter is *not* addressed in the Staff Report, is the DEO application itself. So, the question becomes, did the Staff address, in the Staff Report, DEO's request to recover incremental O&M through the PIR? This obviously requires a review of the PIR Staff Report prepared and

⁶⁶ DEO Ex. 7 at 3-4 (Stipulation and Recommendation in Case No. 08-169-GA-UNC).

⁶⁷ *Id.* at 13

filed in Case No. 08-169-GA-ALT. A proper reading of this report makes three things abundantly clear:

- (1) the Staff did indeed address this question;
- (2) the Staff flatly rejected DEO's request to include incremental O&M in the PIR; and,
- (3) thus, there is no need to resort to the ultimate default – DEO's application – on this point.

What does the Staff Report actually say on this subject? At page four of the Staff Report, the Staff recites the four cost categories that DEO seeks to defer as a regulatory asset for later recovery through the PIR.⁶⁸ These include:

- (1) incremental depreciation expense;
- (2) incremental property taxes;
- (3) incremental O&M expenses; and,
- (4) a return on rate base for PIR program expenditures.⁶⁹

Did the Staff recommend all four expense categories for PIR recovery? The answer is “no” as spelled out quite clearly on page five of the Staff Report.

Staff recommends approval of the PIR Cost Recovery Charge for recovery of those costs. That recovery should include (1) incremental depreciation expense, (2) incremental property taxes, and (3) return on rate base.⁷⁰

⁶⁸ DEO has proposed additional items for PIR recovery that the Staff has not objected to. Staff Ex. 5 at 7 (I. Soliman Prefiled Test.).

⁶⁹ DEO Ex. 13 at 8 (Application in Case No. 08-169-GA-UNC).

⁷⁰ Staff Ex. 2 at 5 (Staff Report in Case No. 08-169-GA-UNC).

Noticeably absent from the list of expenses that Staff expressly recommended for PIR cost recovery is *incremental O&M*. The record is replete with testimony from Staff witness Adkins explaining, confirming, and reaffirming the Staff's exclusion of incremental O&M expenses from PIR treatment.⁷¹ On cross-examination by DEO counsel, Mr. Adkins noted:

We reviewed -- again, we believe the incremental O&M expenses should not be recovered. We believe it's outside the fence of what the Commission approved for recovery.⁷²

If this were not enough, and Staff believes it is, the Staff goes on to express, in a separate paragraph, its disapproval of DEO's request for incremental O&M expense recovery through the PIR:

Regarding the request for incremental O&M expenses, Staff recommends they not include increased corporate service company and shared service expenses allocated to DEO that are not charged to the capital project.⁷³

While DEO is likely to argue that this language applies only to the types of expenses enumerated in this paragraph, such a construction is at odds with the very words of DEO's application. The application states, in pertinent part:

Incremental O&M expenses associated with the PIR program shall be calculated based on incremental and non-duplicative costs that, but for the existence of the PIR program and assumption of ownership of service lines, would not be incurred by DEO. *Such incremental O&M includes increased*

⁷¹ See, e.g. Tr. II at 69-71, 86-87.

⁷² *Id.* at 105.

⁷³ Staff Ex. 2 at 5 (Staff Report in Case No. 08-169-GA-UNC).

*corporate service company and shared service expenses allocated to DEO that are not charged to the capital project.*⁷⁴

In other words, the Staff Report excluded incremental O&M as DEO defined the term in its application. The Staff understood this description, again as put forth by DEO, to be all-inclusive and rightly so.⁷⁵ Costs that are incremental and non-duplicative, “that, but for the existence of the PIR program would not be incurred by DEO” is a general and very broad categorization and not a specific description of the types of costs for which DEO sought PIR recovery. That description appears in the next sentence when incremental O&M costs are defined to include the very items that the Staff expressly excluded.⁷⁶

Finally, the final paragraph on page five of the Staff Report further supports the notion that the general tenor of the Staff’s discussions appearing on that page is one of limiting approval of certain items through the PIR. By stating there that Staff is recommending *one other limitation*, a reasonable construction of the preceding paragraphs on that page is that they too are intended as paragraphs of limitation or exclusion.

In sum, because the Staff Report expressly addresses and excludes recovery of incremental O&M expenses through the PIR, under terms of the 08-169-GA-ALT Stipulation and Recommendation, such expenses were not intended to be included and should now be excluded from the PIR revenue requirement in this case.

⁷⁴ DEO Ex. 13 at 9 (Application in Case No. 08-169-GA-UNC).

⁷⁵ Tr. II at 59, 63, 65-66.

⁷⁶ See also Staff Ex. 4 at 3-6 (K. Adkins Prefiled Test.).

2. Are these expenses truly incremental?

This is a difficult question to answer under the compressed time frame available to the Staff to analyze DEO's PIR recovery application. That application was filed on August 28, 2009; this was the first time⁷⁷ that PIR incremental O&M cost recovery was advanced as an issue by DEO and the first time that the Company provided any breakdown and detail as to the nature of these expenses. The Staff's Comments were due on October 2, 2009, little more than a month later. This allowed the Staff to perform only a preliminary analysis of these expenses, and the data provided by DEO as part of its application raised more questions than it answered.⁷⁸ DEO's definition of "incremental" in this context is also somewhat troubling. According to testimony presented by DEO witness Reed, this term means anything related to PIR activities.⁷⁹ From Staff's perspective, incremental expenses are also those that are incremental, or over and above the level of O&M expense recovery *already built into the new base rates* recently approved for DEO.

This is yet another basis to exclude the entirety of incremental O&M expense from the PIR revenue requirement in this case.

⁷⁷ DEO provided no detail on incremental O&M expenses in its Pre-Filing Notice filed in May of 2009 and later corrected on June 1, 2009. While DEO representatives may have had informal meetings with Staff where general concepts were discussed, the fact remains that Staff had no hard data to review and analyze until DEO filed its application on August 28, 2009.

⁷⁸ Staff Ex. 4 at 5-6 (K. Adkins Prefiled Test.).

⁷⁹ Tr. I at 37-38.

3. What cost savings?

As Staff witness Adkins testified, inclusion of additional incremental O&M expenses will eliminate any cost savings that might otherwise accrue from PIR implementation, particularly where DEO's netting approach is used to calculate the savings.⁸⁰ This, the Staff believes, would be in contravention of a very important underpinning, customer cost savings, supporting both Staff's recommendation for and the Commission's approval of DEO's PIR rider recovery mechanism.⁸¹

D. DEO's customers should enjoy savings under the PIR program. Staff's method of calculating savings maximizes benefits to customers as promised by DEO. (Staff Recommendation No. 5).

This is a very important issue to the Staff. As a regulated natural gas provider, DEO is charged with operating and maintaining a safe and reliable system. The Staff has endorsed and the Commission has approved DEO's PIR as a means to more systematically and quickly identify, replace, and improve aging infrastructure toward this end. Certainly not lost on the Staff is the importance, both to DEO and its customers, of being able to provide safe, adequate, and reliable service on an ongoing basis. A further, significant premise underlying Staff's initial recommendation to approve the PIR is the potential for significant customer savings resulting from reduced operating and maintenance expenses, better economies of scale for the Company, and less lost or unaccounted for gas as old, leaking pipe is replaced. Based upon the record in this case, Staff is con-

⁸⁰ Staff Ex. 4 at 4 (K. Adkins Prefiled Test.).

⁸¹ *Id.*

cerned that there is likely to be little, if any, customer savings generated during the five-year PIR period approved by the Commission.

1. The Promise

In fairness to DEO, there have been no promises of any specific level of savings by any particular point in time under the PIR. But that too is part of the problem. There is nothing but uncertainty in the record, and the potential for any customer savings during the five-year PIR term appears illusory as PIR-related costs continue to increase.⁸² Nor is the Staff attempting to manage and prioritize PIR projects. That is DEO's job. But savings to be passed on to customers have indeed been promised. In its application seeking PIR approval, DEO noted that:

Commission Staff has supported a similar program at Duke Energy Ohio ("Duke") in its Accelerated Mains Replacement Program ("AMRP"). In the Staff Report in Duke's pending rate case, Staff indicates that it "supports Duke's ongoing AMRP for the replacement of all cast iron and bare steel pipeline and the resulting improvement it has made to pipeline safety," and notes that "[c]ustomers have realized approximately \$8.5 million in O&M savings to date that has been credited back through Rider AMRP." [Citation omitted.] *DEO also anticipates significant benefits from a reduced incidence in leak repair expenses and, like Duke, will credit savings in avoided operations and maintenance ("O&M") costs to customers.*⁸³

In support of its PIR application, DEO presented the testimony of Tim McNutt, its then Director of Gas Operations, who echoed the above sentiments. In describing bene-

⁸²

Tr. I at 72-75.

⁸³

DEO Ex. 13 at 3 ¶ 6 (Application in Case No. 08-169-GA-UNC) (emphasis added); see also Tr. II at 120-121.

fits to customers, Mr. McNutt noted that DEO anticipates O&M savings comparable to those reported by other companies,⁸⁴ and that DEO would credit such savings to customers. These representations by DEO were important to the Staff in its original recommendation to approve the PIR and, Staff believes, to the Commission's approval as well of DEO's PIR rider recovery mechanism.⁸⁵ Despite these earlier representations, DEO witnesses have been very careful not to offer any opinion as to when, or even if, savings will result, at least in the near term.⁸⁶ Indeed, the record shows and Staff believes that cost increases seen during the test year will continue over the early years of the PIR program, making it doubtful that DEO customers will experience and enjoy any meaningful savings from implementation of the PIR during its five-year Commission-approved period.⁸⁷ DEO's roll out of the PIR program also raises questions. While representing that it expected to achieve savings "comparable" to that realized by Duke Energy and, in fact, helping to sell its PIR program to the Commission by referencing the positive Duke experience, DEO's "savings focus" continues to only be long-term. Despite acknowledging that driving down leaks is where the largest cost savings can be realized over the short term, and further acknowledging that most leaks are on distribution pipe, DEO has nonetheless chosen to move forward with larger, higher pressure pipe projects with a

⁸⁴ Staff witness Kerry Adkins pointed out that only Duke Energy Ohio had an active program in effect at that time. Tr. II at 131.

⁸⁵ Staff Ex. 4 at 9 (K. Adkins Prefiled Test.); Tr. II at 131-132.

⁸⁶ See, e.g. Tr. II at 22.

⁸⁷ Staff Ex. 4 at 10-11 (K. Adkins Prefiled Test.); Tr. I at 72.

greater “consequence of failure.”⁸⁸ Again, the Staff is not trying to micro-manage DEO’s efforts, but the Staff is rightly concerned that DEO’s initial efforts, and perhaps for the entire five-year PRI term, are principally upon projects that will only increase costs. Stated differently, any genuine focus upon customer savings in the early years seems to have faded, or, worse, to have been lost altogether.

For the record, DEO has not achieved comparable savings to that shown by Duke in its first AMRP filing. While DEO reported baseline O&M savings of \$85,022 on test-year capital investment of approximately \$90 million, Duke showed a first time savings of in excess of \$1 million on new capital investment of \$56 million.⁸⁹ While there are differences in focus between these programs,⁹⁰ Staff nonetheless harkens back to the representations contained in Mr. McNutt’s testimony and especially those contained in DEO’s PIR application that promises savings with express reference to the Duke program. Again, Staff is and remains concerned that DEO representation of continuing O&M cost increases makes it more and more likely that customers will see no cost savings under the PIR.⁹¹

Meanwhile, DEO will continue to seek recovery of steep revenue requirements on an accelerated basis through the rider. One is left to wonder whether the continuing

⁸⁸ Tr. I at 52, 62, 79, 84.

⁸⁹ Staff witness Adkins explained that it is misleading and inappropriate to point to Columbia Gas of Ohio’s zero dollar savings in the first year of its program. Tr. II at 132-133.

⁹⁰ *Id.* at 39-40, 132. Staff witness Adkins explained that, while each LDC’s replacement program must stand on its own merits, the Staff’s review and analysis will tend to be similar in all cases. *Id.* at 76-77.

⁹¹ *Id.* at 121-122.

“promise” of savings is simply DEO’s justification to seek and obtain Commission approval of extended PIR recovery beyond five years. While the overarching purpose behind DEO’s PIR remains sound, the Commission should be wary of DEO’s implementation decisions that focus upon projects that will only increase costs rather than upon leak repair activities that admittedly will reduce costs and generate savings for customers.

2. The Calculation

Staff believes that, under the PIR, customers should be at least somewhat insulated from cost increases. There appears to be no effort by DEO to make this happen, at least initially based upon how it has chosen to implement the program. Despite acknowledging that the greatest savings for customers will be realized from distribution-related projects, DEO’s focus thus far (and continuing) appears to be upon larger transmission-related projects due to what DEO terms greater “consequences of failure.”⁹² Beyond that, DEO’s netting methodology for calculating the O&M savings of \$85,022 during the test year allows cost increases in any one or more of the four O&M cost accounts to reduce or totally eliminate any O&M savings to customers.⁹³ Rather than performing an overall netting of the cost accounts as DEO has done, which again would allow an increase in costs in one category to swallow up savings in the other expense categories, Staff witness Adkins has proposed that each of the accounts be considered individually and, where test-year costs in any amount exceed the agreed-upon baseline cost, that that account simply

⁹² See, e.g. Tr. I at 52, 62, 72.

⁹³ Staff Ex. 1 at 11-12 (Staff Comments and Recommendations in Case No. 09-458-GA-UNC); Staff Ex. 4 at 7-8 (K. Adkins Prefiled Test.).

be set at zero.⁹⁴ The Staff's approach is superior because it maximizes customer savings, and in this case, results in a revised cost savings calculation of \$554,300 for the test year. This is the amount of savings that Staff advocates be passed on to customers for this review period.⁹⁵

CONCLUSION

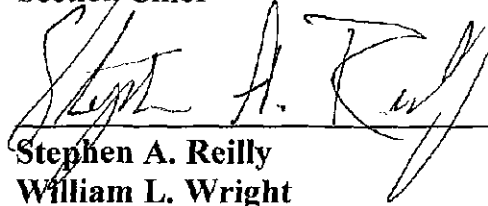
This is the important initial annual review of DEO's Pipeline Infrastructure Replacement (PIR) program to determine the level of PIR rates. Given the admittedly massive investments that DEO expects to make and ask customers to pay for in connection with the program, Staff believes that it is important that the Commission establish reasonable parameters in this case. In this brief, the Staff advocates simply that the Commission enforce what the Staff and DEO previously agreed upon and the Commission approved when it initially authorized the PIR program and adopt the Staff's approaches to determining PIR calculation inputs where the parties did not explicitly agree. Staff believes that its recommended adjustments do just that and it encourages and respectfully requests that the Commission adopt the Staff's recommendations delineated in this brief.

⁹⁴ Tr. I at 72-73; Staff Ex. 1 at 11-12 (Staff Comments and Recommendations in Case No. 09-458-GA-UNC); Staff Ex. 4 at 7-8 (K. Adkins Prefiled Test.); Tr. II at 124-125.

⁹⁵ Staff Ex. 1 at 11-12 (Staff Comments and Recommendations in Case No. 08-458-GA-UNC); Staff Ex. 4 at 7-8 (K. Adkins Prefiled Test.).

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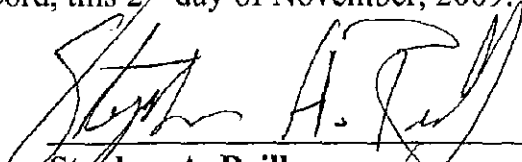
A handwritten signature in black ink, appearing to read "Stephen A. Reilly", is written over a horizontal line.

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PROOF OF SERVICE

I hereby certify that a true copy of the foregoing **Post-Hearing Brief** submitted on behalf of the Staff of the Public Utilities Commission of Ohio, was served by electronic mail, upon the following parties of record, this 2nd day of November, 2009.



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