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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Application of the East Ohio Gas Company d/b/a Dominion East Ohio to Adjust its Pipeline Infrastructure Replacement Program Cost Recovery Charge and Related Matters.	))))))	**Case No. 09-458-GA-RDR**

APPLICATION FOR REHEARING OF THE EAST OHIO GAS COMPANY D/B/A DOMINION EAST OHIO

Pursuant to R.C. 4903.10 and Ohio Administrative Code Rule 4901-1-35, The East Ohio Gas Company d/b/a Dominion East Ohio ("DEO"), hereby files its Application for Rehearing of the Opinion and Order issued in the above-captioned case on December 16, 2009 (the "Order"). As demonstrated in the attached Memorandum in Support, the Order in this case is unreasonable and unlawful for the following reasons:

1 The Order is unreasonable and unlawful because the Order revises the terms of the Stipulation and Recommendation that the Commission previously adopted in its October 15, 2008 Order in Case No. 07-829-GA-AIR *et al.* (the "Rate Order") to impose additional liabilities on DEO for transactions and undertakings that DEO has already completed in reliance upon the Rate Order.

2 Even as to Pipeline Infrastructure Replacement ("PIR") costs and expenses that DEO has not yet incurred, the Order is unreasonable and unlawful because the Order deviates from the Rate Order, and the Commission has failed to provide sufficient reasons for deviating from that Rate Order.

3 The Order is unjust and unreasonable because it amended the calculation of Operating and Maintenance savings based on a finding that "immediate customer savings were articulated as a goal of the PIR program..." (Order at 11), a finding that is against the manifest weight of the evidence.

4 The Order is unreasonable and unlawful in holding that DEO failed to meet its burden of proving that its proposed incremental O&M costs were actually incremental, when DEO submitted specific schedules and expert testimony identifying particular O&M costs and showing that they were in fact incremental.

For these reasons, the Commission should grant this Application for Rehearing and modify the Order as set forth in DEO's Application in this case.

Respectfully submitted,

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MEMORANDUM IN SUPPORT OF APPLICATION FOR REHEARING OF THE EAST OHIO GAS COMPANY D/B/A DOMINION EAST OHIO

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I. INTRODUCTION

The Commission's December 16, 2009 Opinion and Order (the "Order") in this case amended the Commission's October 15, 2008 order in Case No. 07-829-GA-AIR *et al.* (the "Rate Order"). In so doing, the Commission's Order here is unlawful and unreasonable.

In the Rate Order, the Commission approved and adopted a Stipulation and Recommendation signed by a host of parties, ***including each of the three parties to the instant proceeding***: The East Ohio Gas Company d/b/a Dominion East Ohio ("DEO"), the Staff[1] and the Office of the Ohio Consumers' Counsel ("OCC"). That Stipulation expressly addressed each of the five issues concerning DEO's PIR cost recovery that were disputed in this case.[2] The Order, however, effectively rewrites—to DEO's detriment—the deal reflected in that Stipulation as to each of the disputed issues.

The Order is particularly troubling because the Stipulation represented a negotiated resolution of a variety of issues arising in five related cases. The parties' ability to compromise on the various issues in the context of a global settlement was an important underpinning of the negotiation process. By rewriting only the PIR Cost Recovery portion of that carefully negotiated arrangement, the Order deprives DEO of the benefits which it had obtained, and which the Commission had previously approved in the Rate Order.

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[1] Pursuant to O.A.C. 4901-1-10(C), Staff is a party for the purpose of signing a Stipulation.

[2] The Rate Order approved the Stipulation. Rate Order at 32. The Stipulation contains some, but not all of the terms and conditions of the settlement among the parties. DEO Ex. 7 at 3-4, 8, 13. Where the Stipulation is silent regarding an issue the applicable Staff Report is the controlling document. *Id.* Where the Stipulation and applicable Staff Report are both silent DEO's PIR Application is the controlling document. Throughout this Application for Rehearing, DEO will cite to the document containing the specific controlling language as to each issue, but will refer to the Commission's approval of the Stipulation through the Rate Order. The Stipulation is cited as "DEO Ex. 7 at ---," the PIR Staff Report is cited as "Staff Ex. 2 at ---," the rate case Staff Report is cited as "Staff Ex. 3 at ---," and DEO's PIR Application is cited as "DEO Ex. 13 at ---."

In adopting this approach, the Commission's Order is unlawful and unreasonable for four reasons. First, an agency cannot rewrite its previous orders to change retroactively the consequences of actions that a party has already undertaken in reliance on that earlier order. *See, e.g., Columbus Southern Power Company v. Pub. Util. Comm'n*, 67 Ohio St. 3d 535, 541 (1993). Second, even as to not-yet-incurred costs, settled principles of administrative law prevent the Commission from deviating from its previous orders unless and until it provides sufficient reasons for doing so. *Office of Consumers' Counsel v. Pub. Util. Comm'n*, 10 Ohio St. 3d 49, 50-51 (1984).[3]

The Order violates both of these settled principles. As to the first, in reliance on the Rate Order (and the Stipulation approved in that Order), DEO has already incurred ***over $90 million in PIR program capital investments***, an amount that is equal to more than 8% of its entire investment in net plant included in rate base. Staff Post-Hearing Brief at 4; DEO Ex. 5 at Ex. A, Sch. 1. DEO documented each dollar of these expenditures, and there is no meaningful dispute that DEO has in fact made those capital investments. Accordingly, DEO should recover expenses associated with those investments. *Id.* The Order, however, resolves the five issues disputed in this case in a way that substantially rewrites the Stipulation, thereby retroactively denying or delaying DEO's recovery for these already-incurred investments and related

[3] "Generally speaking, an agency may be prevented from applying a new policy for one of two reasons (in addition to the standard constraints that apply to any agency decision). First, ***a departure from prior policy cannot stand when the agency fails to explain the reason for the change.*** *See Greater Boston Television Corp. v. FCC*, 143 U.S. App. D.C. 383, 444 F.2d 841, 852 (D.C. Cir. 1970), cert. denied, 403 U.S. 923, 91 S. Ct. 2229, 29 L. Ed. 2d 701 (1971). Second, under certain circumstances ***an agency may be prevented from applying a new policy retroactively to parties who detrimentally relied on the previous policy.*** *See RKO General v. FCC*, 216 U.S. App. D.C. 57, 670 F.2d 215, 223 (D.C. Cir. 1981), cert. denied, 456 U.S. 927, 72 L. Ed. 2d 442, 102 S. Ct. 1974 (1982)." *New England Telephone and Telegraph Company v. Fed. Comm. Comm'n*, 826 F.2d 1101 (1987) (D.C. Cir.) (emphasis added).

expenses. This attempt to change the cost-recovery rules mid-stream renders the Order *per se* unlawful as applied to DEO's already-incurred costs.[4]

As to not-yet-incurred costs, the Order violates the second settled administrative law principle. The Commission has failed to provide any reasons explaining its deviation from the PIR Cost Recovery arrangement that it adopted and approved in the Rate Order. Indeed, as to most of the disputed issues, the Commission does not even acknowledge that it is rewriting the deal. Instead, the Commission either ignores the Stipulation's plain language or asserts that it is merely "interpreting" that language. The Commission's "interpretation," however, flies directly in the face of the language that DEO and the other parties negotiated, ***and that the Commission approved***. As a matter of law, the Commission cannot use creative "interpretation" to undo its previous order.

Third, the Order is also unreasonable and unlawful in its finding with regard to O&M savings for another reason. The Order based its determination on the O&M cost savings calculation issue on its finding that there had been a commitment to immediate savings. The record, however, unequivocally showed that DEO had made no such promise, a fact that Staff admitted. The finding was thus against the manifest weight of the evidence, and the Order was unlawful in relying on it.

Further, the Order is unreasonable and unlawful in holding that DEO failed to meet its burden of proving that its incremental O&M costs that DEO proposed to recover through the PIR Cost Recovery Charge were, in fact, incremental. DEO submitted specific schedules and expert

[4] DEO's PIR program investments and expenses made in reliance of the Commission's Rate Order will impact the PIR Cost Recovery Charge for many years. Even if the Commission amends how the PIR Cost Recovery Charge will be calculated with regard to not-yet-incurred costs, it must permit DEO to continue to recover on the investments and expenses DEO has already made in reliance of the Commission's Rate Order in the manner already approved in the Rate Order.

testimony identifying those costs and showing that they were "incremental" (*i.e.*, that the costs would not have been incurred but for the PIR program). Staff failed to produce any meaningful evidence to the contrary; indeed, it did not even audit DEO's O&M costs. In light of the undisputed record evidence, as a matter of law, DEO has met its burden of demonstrating its incremental O&M expenses, and the Commission was wrong to conclude otherwise.

Accordingly, DEO respectfully requests that the Commission grant this Application for Rehearing and modify the Order to reflect the terms set forth in DEO's Application in this case.

II. ARGUMENT

A. The Commission Cannot Amend Its Previous Orders To Deny Recovery Of Costs Undertaken In Good-Faith Reliance On That Previous Order.

Fundamental notions of due process prevent an administrative agency from changing the consequences of transactions undertaken in good-faith reliance on a previous agency order. Yet, that is exactly the result that the Order seeks to impose here. The Order denies or delays DEO's cost recovery for parts of ***over $90 million*** in investments and expenses that DEO has already incurred in reliance on the language contained in the Stipulation.

1. Basic principles of administrative law prevent the Commission from seeking to change retroactively the consequences of actions already undertaken in good faith reliance on a previous Commission order.

Under Ohio law, a utility is entitled to rely upon Commission rate orders. When a utility undertakes actions in reliance on such orders, the Commission cannot change the consequences of those already-completed acts. For example, in *Columbus Southern Power Company v. Pub. Util. Comm'n*, 67 Ohio St. 3d 535, 541 (1993), the Commission had ordered a phase-in of new rates. During the phase-in period, the Company was under-collecting its approved revenue requirement (*i.e.*, receiving an artificially low rate). *Id.* The Commission's order provided that the Company could create a regulatory asset in which to aggregate this under-recovery, and then

recover on that regulatory asset on a deferred basis. *Id.* On appeal, the Court determined that the Commission's order providing for a rate phase-in was unlawful. *Id.* A customer then claimed that the company should not be able to recover on the regulatory asset that the Commission approved as part of its unlawful phase-in order. *Id.* The Court rejected that argument, holding that the Company must be allowed to collect on the deferred regulatory asset that had arisen from the Company's good faith reliance on the earlier Commission order. *Id.*; *see also East Ohio Gas Company v. Limbach*, 26 Ohio St. 3d 63, 69 (1986) (Wright, J., dissenting) (noting that settled principles preclude the Commission from changing the rate consequences associated with already-completed transactions undertaken in reliance on Commission orders).[5]

The Commission itself has likewise followed the principle that it may not impose additional liability on a utility based on the utility's adherence to a prior order. *See In the Matter of the Regulation of the Electric Fuel Component Contained with the Rate Schedules of The Cleveland Electric Illuminating Company and Related Matters*, Case No. 83-38-EL-EFC (Opinion and Order at [*35-*37]) (February 28, 1984) (the "*EFC Case*"). In that case, the utility, acting in reliance on a Commission order, was over-collecting its system loss adjustment over a prolonged period. *Id.* The Commission determined that it could correct the over-recovery, ***but only with regard to a limited period***:

> [W[e are to some extent limited as to how far back we can go in remedying the problem discussed herein. As we stated in *The Cincinnati Gas & Electric Company* [*In the Matter of the*

[5] Other courts have likewise recognized this principle. In *RKO General, Inc. v. Fed. Comm. Comm'n*, 670 F.2d 215, 223 (1981) (D.C. Cir.), for example, the FCC refused to renew an applicant's broadcasting license based on certain conduct. The applicant argued that it had relied upon a prior FCC ruling involving the same applicant in which the FCC had permitted identical conduct. The Court remanded to the FCC for reconsideration, noting its particular concern about the FCC's reversal of a previously-established policy without any justification, and decrying the FCC's attempt to impose detrimental consequences for activities that the applicant had already undertaken in good-faith reliance on the agency's order. *Id.* Or, as the D.C. Circuit succinctly put it in a later case, "an agency may be prevented from applying a new policy retroactively to parties who detrimentally relied on the previous policy." *New England Telephone and Telegraph Co.*, 826 F.2d at 1101, 1110 (1987) (*citing RKO*).

> *Regulation of the Electric Fuel Component contained within the Rate Schedules of The Cincinnati Gas & Electric Company and Related Matters*, Case No. 82-163-EL-EFC (Subfile A) (Opinion and Order) (June 29, 1983)]..., we normally limit the scope of the EFC to the base period under consideration. In *The Cincinnati Gas & Electric Company* case we did go outside of the base period. For the same reason, we do so again here. **For reasons of law, fairness, and finality, however, we believe we are constrained to go no further in this case than the audit period. The Supreme Court of Ohio in *Ohio Edison Company v. Pub. Util. Comm.*, 56 Ohio St. 2d 419 (1978), indicated that if the actions of a public utility are in compliance with an order of the Commission, the fact, if it be a fact, that the Commission's order itself is in violation of statutory law does not permit a conclusion that the acts of the utility in obedience to the order of the Commission are "unlawful".** While not on all fours with the facts of the current case, this decision does serve to indicate, if only by analogy, that the Commission cannot tread too far into the murky past to correct its own errors. **Nor will fundamental fairness allow us to require a Company, adhering to a rule as written, to refund monies collected because a year or more later we correct an oversight in our rules.** Last, but still important, administrative law would be in chaos if decisions never achieved finality.

Id. (emphasis added). In short, the Commission cannot change rules mid-stream and then apply those new rules to already-incurred costs undertaken in reliance on the old rule.

2. The Order modifies the Rate Order (which adopted the Stipulation), and, in doing so, denies DEO recovery of, and a return on, a portion of its $90 million in investments and expenses.

The Commission's Order here violates the very principles of "fundamental fairness" the Commission identified in the *EFC Case*. Over a year ago, in Case No. 07-829-GA-AIR *et al.*, the Commission adopted the Rate Order in which it approved a Stipulation that addressed the PIR Cost Recovery Charge. Based on the Rate Order, DEO elected to make a substantial PIR investment and to assume the management responsibilities and costs associated with the PIR program. DEO's financial commitment to the PIR program is significant. DEO has already made more than $89 million of net capital investments and has documented over $5 million of

operating and maintenance expenses associated with the investments made during the first year of the PIR program. DEO Ex. 5 at Ex. A, Sch. 1. These include, for example: (1) $89,396,488.56 in net capital additions; (2) $935,905.59 for accumulated depreciation expense; (3) $2,285,301.40 for annualized depreciation on assets; (4) $33,268.18 for annualized amortization of PISCC; (5) $359,185.66 for accumulated property tax expense; (6) $1,261,777.87 for annualized property tax expense on assets; and (7) $1,128,669.73 for incremental O&M expense. DEO Ex. 5 at Ex. A, Sch. 1. No party disputes the amount of DEO's investment and expense in the PIR program.[6]

After having made substantial investments in the PIR program, DEO filed this case seeking to set the PIR Cost Recovery Charge under the terms of the Stipulation adopted in the Rate Order. The Commission's Order here, however, rewrites the deal reached in the Stipulation and approved in that Rate Order. The Order's resolution of each of the five disputed issues modifies the Commission-approved deal in a way that permanently denies DEO recovery of some already-incurred costs and delays DEO's recovery of other such costs. This attempt to change retroactively the rate consequences of already-incurred costs is unreasonable and unlawful.

(a) The Order changes the Stipulation to deny DEO cost recovery of incremental O&M expenses.

The Order seeks to change the Commission-approved Stipulation with regard to incremental O&M expenses. In DEO's PIR Application, DEO expressly sought recovery of incremental O&M expenses. The Application stated:

> Incremental O&M expenses associated with the PIR program shall be calculated based on incremental and non-duplicative costs that,

[6] Over the expected 25-year life of the PIR program, DEO will invest more than $2.6 billion. Staff Ex. 2 at 3.

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

DEO Ex. 13 at 9.

The PIR Staff Report (which the Stipulation makes a controlling document on issues, such as this one, on which the Stipulation is silent)[7] did not disagree with the PIR Application as to this aspect of cost recovery, recommending only that certain narrowly-identified categories of such expenses be excepted:

> Regarding the request [in the PIR Application] 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. Staff will also withhold any recommendation regarding the inclusion of any O&M expenses allocated with relocating inside meters until such time as a meter relocation plan is submitted.

Staff Ex. 2 at 5. The narrow exceptions were the only dispute that Staff identified as to cost recovery of incremental O&M expenses. Consistent with this language, DEO sought recovery in this case for incremental O&M expenses (other than corporate service company and shared service expenses) that it had incurred. Specifically, DEO sought recovery of $1,128,699.63 for incurred incremental O&M expenses. DEO Ex. 5 at Ex. A, Sch. 15.

Contrary to the language from these controlling documents, however, the Order now denies recovery for these already-incurred incremental O&M expenses. In doing so, the Order does not address the Rate Order, the PIR Staff Report, or the above-cited language from DEO's PIR Application. The Commission's Order offers no explanation for why it is permissible to deny retroactively DEO recovery of $1,128,669.63 of already-incurred incremental O&M

[7] DEO Ex. 7 at 3-4, 8, 13.

expenses. *Id.* The Commission simply stated that it agreed with Staff that it did not intend to allow recovery of incremental O&M expense. Order at 9. The Commission did not explain how DEO could have known of such alleged "intent" which appears nowhere in the Rate Order. Moreover, the Commission denies recovery of these costs despite expressly acknowledging that DEO actually may have incurred "truly incremental costs" other than the corporate service company and shared service expenses that the Stipulation excluded. *Id.*

Simply put, the Commission changed its mind about whether DEO should be able to recover incremental O&M expenses through the PIR Cost Recovery Charge. Because DEO reasonably relied upon the Commission's Rate Order in deciding to move forward with the PIR program and incurring incremental O&M expenses, however, it is unlawful for the Commission to now deny DEO recovery of the $1,128,669.63 of already-incurred expense.

(b) The Order changes the Stipulation's approach to O&M savings, forcing DEO to report "savings" that do not exist.

As to the second disputed issue, the Order expressly acknowledges that it is retroactively changing how O&M savings are calculated. In fact, the Order retroactively changes that calculation in two ways. First, as the Order concedes, the Order changes the number of categories that are included in calculating the savings. Second, the Order changes the way in which savings are aggregated. In so doing, the Order requires DEO to report "savings" that DEO does not, in fact, achieve.

The Order acknowledges that "there were only three categories included, in the Stipulation in the DEO Distribution Rate Case, for comparison to determine O&M savings: leak detection, leak repair, and corrosion monitoring." Order at 11. It is undisputed that DEO did not achieve cost savings in the three categories that the Stipulation specified. DEO Ex. 7 at Ex. A, Sch. 16. Indeed, the record shows that the costs in these three categories actually ***increased***

during the first year of the program. Thus, under the Stipulation's plain language, DEO had no reportable O&M cost savings.

In order for customers to be able to recognize some savings, DEO voluntarily included a fourth category, corrosion remediation, in its savings calculation. Because DEO realized significant savings in this category, including this category resulted in DEO reporting net savings across the four categories of $85,022.02.

In the Order, the Commission adopted DEO's inclusion of the fourth category. According to the Order, "corrosion remediation is a necessary component of corrosion monitoring. Therefore, we agree that it is essential that the category of corrosion remediation be included in our review of baseline savings." Order at 11.

Having taken DEO up on its offer, however, the Commission then proves that no good deed goes unpunished. In addition to adding a new category of O&M expenses, the Order changes the way in which the aggregate O&M savings are calculated. Under the new methodology, instead of DEO reflecting $85,022.02 in aggregate savings in its PIR Cost Recovery Charge, DEO is forced to pass along $554,300.64 of "savings," ***far more than DEO has in fact saved***.

That this new methodology represents a change is evident from the plain language of the Stipulation. The portion of the Stipulation addressing O&M savings expressly stated that O&M savings shall equal "[a]ny savings relative to a baseline level of O&M expenses associated with" three specified expense categories. DEO Ex. 7 at 10. The use of the phrase "***a*** baseline level of O&M expenses" clearly means that, to determine savings, there will be a ***single*** baseline, *i.e.*, one that represents the aggregate of the three specified categories. Nowhere does the Stipulation even suggest that DEO is required to establish a separate baseline for each expense category.

The Order's methodology, by contrast, requires DEO to establish four separate baselines (one for each expense category), to compute four separate O&M expense savings (again, one for each category), and to disregard any category in which DEO actually experienced an increase in costs. Order at 10-11. As a result, while the Rate Order contemplated that DEO would pass along savings that it actually achieved, the Order requires DEO to report as "net savings" amounts far in excess of its actual savings.

For example, if DEO's costs increased by $750,000 in each of two of the listed categories, but decreased by $1 million in each of the other two, DEO would actually experience a net savings of $500,000 (*i.e.*, $1.5 million in cost increases and $2 million in cost decreases). Under the methodology specified in the Stipulation and originally approved in the Rate Order, DEO would adjust the PIR Cost Recovery Charge to pass along those savings. Under the Order's methodology, by contrast, DEO would be forced to ignore the $1.5 million cost increase, and pass along $2 million dollars as "savings," even though DEO did not actually save that amount.

The Commission approved the Rate Order (thereby approving the methodology specified in the Stipulation), in part based upon evidence that, while the PIR program would yield savings, the magnitude and timing of the savings was unknown. *In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Authority to Increase Rates for its Gas Distribution Service*, Case No. 07-829-GA-AIR *et al*, Tr. II at 89, 107 (August 22, 2008). In fact, DEO's witnesses testified ***and Staff admitted*** that "there have been no promises of any specific level of savings by any particular point in time under the PIR." Staff's Post-Hearing Brief at 26. The calculation methodology was designed to allow DEO to identify its net savings as they arose, and pass those savings on to its customers. DEO Ex. 7 at 10.

It is not at all surprising that some of DEO's pipeline maintenance related costs will continue to increase in the program's early years. *In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Authority to Increase Rates for its Gas Distribution Service*, Case No. 07-829-GA-AIR *et al*, Tr. II at 82, 106 (August 22, 2008). One of the reasons that DEO is undertaking the PIR program, after all, is to replace untreated and ineffectively treated pipelines—pipelines that are experiencing corrosion. Staff Ex. 2 at 1-2. In the first year of what will be a 25-year replacement effort, DEO has replaced about 4% of those pipes. Tr. II at 18. The remaining 96%, of course, continue to corrode. This, in turn, leads to higher detection, repair and monitoring costs. *In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Authority to Increase Rates for its Gas Distribution Service*, Case No. 07-829-GA-AIR *et al*, Tr. II at 82, 106 (August 22, 2008).

The Order's new methodology for calculating "savings" represents a fundamental change to the calculation of O&M savings. The Commission was not free to make that change; DEO relied on the Commission's previously-approved understanding of such savings in making its PIR investment decisions over the past year. DEO considered the projected return on investment in deciding whether, and at what level, to participate in the PIR program. DEO Ex. 13 at 4-5, 10. The new savings calculation methodology, though, in forcing DEO to report "savings" that do not exist, directly reduces the return that DEO will achieve on its PIR investment (as compared to the original savings methodology, which required DEO to report only actual cost savings).

Independent of whether the Commission could impose this idiosyncratic view of "savings" on DEO for future expenses (and, as shown below, the Commission cannot, *see infra* at 23-25), and independent of whether there is any record support for the Commission's finding on this issue (and, as shown below, there is not, *see infra* at 32-35), it is simply unlawful for the

Commission to modify the calculation rules with regard to transactions already completed. Accordingly, the Order cannot require DEO to include $554,300.64 in O&M savings in its PIR Cost Recovery Charge.

(c) In direct contradiction of the Stipulation's plain language, the Order unlawfully seeks to prevent DEO's recovery of costs it already incurred for installation of new curb-to-meter service lines.

DEO sought to recover a return on and expenses associated with investments of $390,686.00 related to the installation of new curb-to-meter service lines. Order at 8. The Order denies DEO that recovery through the PIR Cost Recovery Charge. *Id.*

The Order basically concedes that the Commission is changing the deal regarding new curb-to-meter service lines. The Order states that "the Commission finds it necessary to clarify our determination regarding the costs incurred as a result of DEO's assumption of ownership for the curb-to-meter service lines." Order at 7. That "clarification," however, is a retroactive amendment to the Stipulation that the Commission approved in the Rate Order.

Indeed, the Commission's decision to "clarify" its Rate Order is directly analogous to an improper subsequent attempt to "clarify" an order in *Ohio Edison Company v. Pub. Util. Comm'n*, 56 Ohio St. 2d 419 (1978). In *Ohio Edison*, the Commission issued an order that permitted the company's new tariffs to "become effective with the first billing for electric service after the date of this entry." *Ohio Edison Company v. Pub. Util. Comm'n*, 56 Ohio St. 2d 419 (1978). An industrial customer filed a complaint, arguing that the order was improper because the company's next billing included a service period prior to the Commission's order. *Id.* The Commission found in favor of the industrial customer. *Id.* In doing so, it "clarified" that its previous order had meant that Ohio Edison could charge the new tariffs only for services provided ***after*** the Order's effective date, and stated that interpreting the order to allow

imposition of the higher tariffs on services provided before the order's effective date would violate Ohio statutes. *Id.* at 420. The Court reversed. The Court reasoned that the company was entitled to rely on the language of the Commission's order, regardless of whether the order violated the applicable statutes. *Id.* at 425.

Here, the Commission likewise seeks to "clarify" an order that DEO relied upon to invest capital and incur costs in new curb-to-meter installations. That "clarification" deprives DEO of timely recovery of costs associated with $390,686.00 of capital additions for new curb-to-meter installations. For the same reasons that the Court denied the clarification in *Ohio Edison*, the proposed "clarification" here is also unlawful.

Notably, this case is even more egregious than *Ohio Edison* because the language at issue here does not need "clarification." The PIR Staff Report (which controls because the Stipulation itself is silent on the issue) twice unambiguously provides for recovery of new curb-to-meter service installation costs:

> ***Staff believes the PIR Cost Recovery Charge should recover the following costs***:...costs associated with ***assuming ownership of curb-to-meter service lines including new installations***, and the repair or replacement of existing service lines including risers, to the extent recommended in the customer service lines section of the report.

Staff Ex. 2 at 4-5 (emphasis added). Later, the PIR Staff Report stated:

> Staff therefore supports DEO's proposal to assume the responsibility for the installation of ***all customer service lines***.... The costs associated with this activity should be recovered as part of the Infrastructure Replacement Program.

Id. at 3 (emphasis added). It is unlawful for the Commission to amend the Stipulation retroactively to deny DEO cost recovery for costs DEO already incurred in reliance on the Rate Order in undertaking new curb-to-meter installations.

(d) The Commission's Order changes the way in which blanket work order projects are treated, delaying DEO's recovery associated with such capital additions.

Pursuant to the Stipulation, DEO sought to recover through the PIR Cost Recovery Charge a return on its investment of $4,440,734.00 in plant additions closed by June 30, 2009 through the blanket work order process and associated expenses. Order at 5. The Order denies DEO that recovery through the PIR Cost Recovery Charge. *Id.* The Order did so by modifying the previously-approved method of identifying used and useful plant additions eligible for recovery through the PIR Cost Recovery Charge. Under the modified approach, DEO cannot include in its PIR investments certain projects of short duration closed to plant through June 30, 2009, using the blanket work order process, meaning that some portion of DEO's PIR Cost Recovery Charge revenue requirement will be excluded from recovery every year.

The Stipulation adopted DEO's proposed accounting treatment for purposes of calculating the PIR Cost Recovery Charge. DEO Ex. 7 at 13. Indeed, the Stipulation expressly states that the PIR "Application in Case No. 08-169-GA-ALT (***including the proposed accounting treatment***) is hereby adopted...." *Id.* (emphasis added).

The "proposed accounting treatment"—*i.e.*, the accounting treatment that the Stipulation adopts pursuant to its plain language—incorporates the Federal Energy Regulatory Commission ("FERC") system of accounts and associated accounting guidance. Tr. I at 156-157; OCC Ex. 4 at 620.[8] It is undisputed that the FERC system of accounts uses the work order process to account for projects and specifies that work orders covering jobs of short duration may be closed monthly. OCC Ex. 4 at 620. Thus, the Rate Order, through the adoption of the Stipulation,

[8] The Commission also requires DEO to use the FERC system of accounts. O.A.C. 4901:1-13-13.

approves use of the blanket work order process to account for the costs on projects of short duration that should be included in calculating the PIR Cost Recovery Charge.

The Staff Report in the base rate case further confirms this fact. (The Stipulation made the "Staff Reports" controlling on any issue on which the Stipulation is silent. It is undisputed that this reference to "Staff Reports" includes the Staff Report in the base rate case (the "rate case Staff Report") in addition to the PIR Staff Report. *See* DEO Ex. 7 at 3-4; Tr. II at 56-57; *see also* Staff Reply Brief at 6-7.) The rate case Staff Report adopted a report from Blue Ridge Consultants that reviewed DEO's plant additions. Staff Ex. 3 at 3-4. In that report, Blue Ridge Consultants specifically audited DEO's use of blanket work orders. DEO Ex. 8 at 83; *see* Rate Order at 29. In particular, the Blue Ridge Report recognized that DEO accounted for a significant portion of plant additions "through the blanket work order process." DEO Ex. 8 at 83. Blue Ridge recognized that blanket work orders include "activities which are recurring, ***usually of short duration***, and do not exceed certain dollar expenditure limitations. Customer installations, meters, and ***distribution main replacements are typical of the types of plant additions in which blanket work orders are used.***" *Id.* (emphasis added). With full knowledge that DEO used the blanket work order process, Blue Ridge found that "plant additions since the last rate case are reasonable and ***appropriately used and useful*** in operation." *Id.* at 92 (emphasis added). In effect, Staff's own auditor determined that plant balances that included blanket work order project costs are properly included as date certain rate base for ratemaking purposes. Staff made no adjustments to distribution rate base in the rate case as a result of the audit. Staff Ex. 3 at 3-4, 55; DEO Ex. 8 at 92.

Given the express language in the Blue Ridge Report, Staff was certainly on notice that DEO used the blanket work order process to account for distribution main replacement plant

additions— the very plant additions at issue in the PIR program—when Staff issued its rate case Staff Report and the PIR Staff Report.[9] Indeed, highlighting this fact, the rate case Staff Report expressly stated that "[a]s a result of Blue Ridge's investigation and the Staff review of the application, the Staff recommends certain adjustments be made to Applicant's date certain plant investment for ratemaking purposes." Staff Ex. 3 at 4. Yet, despite Staff's knowledge that DEO accounted for distribution main plant additions through blanket work orders, none of Staff's recommended adjustments related to DEO's distribution plant additions.[10] Staff Ex. 3 at 55.

The Commission adopted the Stipulation after considering all of the evidence, including the rate case Staff Report and the PIR Staff Report. *See* Rate Order at 1, 4, 29-30. The Commission adopted the Stipulation with notice that DEO accounted for distribution main plant additions through the blanket work order process. *Id.* Thus, the Rate Order approved the blanket work order process—an accounting treatment that Blue Ridge itself refers to as a "commonly used process"[11]—for identifying costs appropriately included in rate base. [12]

DEO relied on that accounting treatment in its first year expenditures under the PIR program in two ways. First, had DEO known that the Commission was going to change the rules regarding the permissible accounting practices, DEO could have accounted for its projects of short duration differently than it did. The Commission's retroactive change to the rules,

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[9] The Blue Ridge Report and rate case Staff Report were issued on May 23, 2008. The PIR Staff Report was issued on June 12, 2008.

[10] The rate case Staff Report Schedule B-2 shows the applicant's distribution plant as $1,330,545,152 and Staff's recommended distribution plant as $1,330,545,150.

[11] *In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Gas Rates*, Case No. 07-589-GA-AIR (Blue Ridge Report at 86) (December 20, 2007).

[12] Staff argued in its Reply Brief that Staff could not have agreed that projects of short duration closed monthly are used and useful because such an agreement would be unlawful. Staff Reply Brief at 7. Staff does not cite any authority defining "used and useful." Nevertheless, Staff signed the Stipulation and the Commission approved the Stipulation. The Staff's argument is akin to the very argument that the Court rejected in *Columbus Southern Power Company v. Pub. Util. Comm'n*, 67 Ohio St. 3d 535, 541 (1993).

however, deprives DEO of the opportunity it would have had to obtain recovery under the accounting treatment that the Order now implements. Second, DEO's decision to invest in PIR projects, and its selection of PIR projects, may have been different under a different accounting methodology. DEO makes investment decisions based on its expected return. Forcing DEO to adopt a more burdensome, and more expensive, accounting methodology may have led DEO to different investment decisions.

Having approved the blanket work order process in the Rate Order, the Order cannot now change the rules for determining rate base for purposes of the PIR Cost Recovery Charge in a way that delays DEO's recovery of costs incurred in reliance on the previous Rate Order. The Order is unlawful in seeking to do so.

(e) The Order changes the amortization period for incremental depreciation and property tax expense to deny DEO recovery of those expenses for the life of assets, potentially up to fifty-years.

The Order modifies the Rate Order's treatment of amortization of incremental depreciation and property tax expense to require DEO to amortize those expenses over the life of the asset, rather than one year. Order at 5. DEO relied upon the Stipulation in making investment decisions that resulted in $935,905.59 of incremental depreciation expense and $359,186.66 of incremental property tax expenses. DEO made these investments and incurred these expenses with the understanding that it would be able to recover the expenses through a regulatory asset amortized over one year. DEO Ex. 5 at Ex. A, Sch. 1. The Commission cannot now change that as to these already-incurred expenses.

As noted above, the Stipulation provided for use of DEO's accounting treatment. DEO Ex. 7 at 13. The accounting treatment includes the determination of an amortization period for incremental depreciation and property tax expense. DEO's accounting treatment provides for a

one-year amortization period. *See* DEO Ex. 1 at 7, 11,12; DEO Ex. 13 at 4, 11; Tr. II at 11-12, 20.

Moreover, DEO's PIR Application (which controls on issues on which the Stipulation and Staff Reports are silent) conclusively establishes that the recovery of all expenses, including incremental depreciation and property tax expense, should occur over a one-year period. DEO Ex. 13 at 4. Footnote 1 of the PIR Application explained that the PIR Cost Recovery Charge was (and is) designed to replace the need for annual rate cases. *Id.* Annual rate cases—which the PIR Cost Recovery Charge replaces—would have resulted in a one-year amortization period for incremental depreciation and property tax expenses. R.C. 4909.15. Nor is there any doubt that, in agreeing to the Stipulation, Staff understood that there would be a one-year amortization period for incremental depreciation and amortization expense. In fact, the PIR Staff Report cites the precise portion of DEO's PIR Application that states that the PIR Cost Recovery Charge was to act in lieu of annual rate cases. Staff Ex. 2 at 5.

Paragraph 19 of the PIR Application further confirms the parties' intent to permit DEO to recover its PIR program expenses within a year after it incurs such expenses. DEO Ex. 13 at 11. Paragraph 19 expressly stated that DEO will calculate the PIR Cost Recovery Charge based upon the prior year's costs. *Id.* Such costs include incremental depreciation and property tax expense. And, of course, a one-year amortization period better conforms to basic principles of cost causation; it better matches recovery of the incremental depreciation and property tax expenses to the period in which these expenses were incurred. DEO Ex. 2 at 3.

Without discussing any of the language identified above, the Commission's Order changes the amortization period from one year to the life of the asset, approximately fifty years. Because DEO reasonably relied on the Rate Order—and specifically, the provisions of the Rate

Order, Stipulation and related documents regarding the nature of the expenses that DEO would be allowed to recover through the PIR Cost Recovery Charge—in making its PIR investment decisions over the past year, the Order, which seeks to change the rate consequences of those already-completed transactions, is unlawful.

B. The Order Is Unlawful Because It Deviates From The Rate Order And Because The Commission Did Not Explain The Reasons For That Deviation.

1. The Commission must state its reasons before it may amend previously-entered orders or its own past practice.

The Order is also unlawful with regard to each of the five disputed issues for another reason. Ohio law provides that the Commission may not deviate from a previously-entered order unless the Commission provides reasons explaining that deviation:

> When the commission has made a lawful order, it is bound by certain institutional constraints ***to justify that change before such order may be changed or modified.*** We have previously articulated this concern in *Cleveland Elec. Illuminating Co.*, supra, at 431[42 Ohio St. 2d 403 (1975)], as follows:
>
> Although the Commission should be willing to change its position when the need therefor is clear and it is shown that prior decisions are in error, ***it should also respect its own precedents in its decisions to assure the predictability which is essential in all areas of the law, including administrative law.*** *See also, State, ex rel. Auto. Machine Co., v.. Brown* (1929), 121 Ohio St. 73, 75; *Indus. Comm. v.. Brown* (1915), 92 Ohio St. 309, 311.

Office of Consumers' Counsel v. Pub. Util. Comm'n, 10 Ohio St. 3d 49, 50-51 (1984) (emphasis added).

Here, however, the Order's treatment of the five disputed issues deviates both from the Rate Order, the Stipulation (and supporting record) and the Commission's established precedent. Yet, the Order offers no reasons to support these deviations from precedent and past practice. Indeed, the Commission barely acknowledges that the deviations exist. Throughout the Order,

the Commission simply agrees with Staff. Not once does the Order analyze the Stipulation (or, where the Stipulation does not address an issue specifically, the Staff Reports and the PIR Application) or explain why the Order deviates from the Stipulation's terms.[13] Not once does the Commission analyze the alleged precedent that it relies upon. Not once does the Commission analyze the record to see if it supports Staff's allegations. Neither the Stipulation, Commission precedent, nor the record evidence support the Order. Accordingly, the Order is unlawful.

2. Without explanation, the Order modifies the Rate Order.

As to each of the five disputed issues, the resolution specified in the Order represents a marked deviation from the PIR Cost Recovery mechanism specified in the Rate Order (and the Stipulation adopted therein).

(a) The Order offers no reasons for deviating from the Rate Order and Commission precedent to deny DEO recovery of incremental O&M expenses.

DEO properly sought incremental O&M cost recovery pursuant to the Stipulation approved in the Commission's Rate Order. Without reference to the Stipulation, though, the Order states that "the Commission agrees with Staff that it was not our intent to allow recovery of incremental O&M as an expense." Order at 9. This is the only reason that the Commission offers for denying DEO recovery of $1,128,669.73 for incremental O&M expenses.

Yet, regardless of what the Commission may say after the fact about its "intent," as described above (*see supra* at 8-9), the Stipulation plainly permits DEO to recover its incremental O&M expenses with the exception of certain specifically identified O&M subcategories. *See* DEO Ex. 7 at 9-10; Staff Ex. 2 at 5; DEO Ex. 13 at 11; DEO Ex. 5 at Ex. A,

[13] The Order does not attempt to explain how it is consistent with the Stipulation either.

Sch. 15. The "intent" to which the Order refers appears nowhere in the language of the Stipulation.

Nor can the Commission justify the deviation from the Stipulation based on Staff's argument, set forth at page 8 of the Order, that Staff did not include incremental O&M in the list of items specifically identified for recovery at pages 4 and 5 of the PIR Staff Report. At the hearing, Staff expressly conceded that the list—which mentions only incremental depreciation, incremental property tax and a return on rate base (Staff. Ex. 2 at 5)—was not, and was not intended to be, all inclusive. Tr. II at 103-104. The list did not include, for example, annualized depreciation, annualized property tax expense or post in service carrying charges. Yet, the Commission approved recovery of each of these items.

The Commission also fails to explain its deviation from its own precedent in other cases permitting gas utilities to recover O&M expenses incurred through a main replacement program, such as DEO's PIR program. Tr. II at 83-85; DEO Ex. 10 at Stipulation Ex. 1 at 4, Sch. 22 Revised; DEO Ex. 9 at Stipulation Att. 2 Sch. AMRP-1. The Commission has approved recovery of incremental O&M for such programs, including an increased recovery of over $1 million for Duke Energy Ohio, Inc. ("Duke") and $26,589 for Columbia of Ohio, Inc. ("Columbia") in the initial adjustment of its AMRP charge. *Id.* The Commission offered no reason for treating DEO differently from other gas utilities by denying DEO recovery of incremental O&M expenses. The Order's failure to explain these deviations, both from the Rate Order and past precedent, renders the Order unlawful as to such expenses.

(b) The Order states no reason for deviating from the Rate Order and Commission precedent in determining that DEO should calculate O&M savings on a category-by-category basis.

As described above (*see supra* at 10-13), the Rate Order contemplated that DEO would calculate its O&M cost savings by comparing the aggregate sum of its O&M expenses across three categories in a given year to the aggregate sum of those expenses in the baseline year. DEO Ex. 7 at 10. The Order changed that methodology in two ways. First, it added a fourth category. Second, it changed the calculation to require DEO to use four baselines, one for each category.

The Commission's Order fails to state any good reason to amend its Rate Order in this manner. The Order appears to rely on the testimony of Staff witness Adkins who recommended a category-by-category calculation of O&M savings. *Id.* at 10. But, in recommending that approach, Mr. Adkins never once referred to the Stipulation. Nor did he offer any analysis of whether or why it would be prudent to change the calculation methodology that the Stipulation adopted. Rather, Mr. Adkins gave only one reason for Staff's newly-proposed category-by-category calculation of O&M savings: "Staff's proposed methodology protects customers from cost increases, which could eliminate any savings, and is more consistent with the premises of the PIR program, which was intended to result in savings." *Id.*

Mr. Adkins' testimony simply ignores the fact that the methodology specified in the Stipulation, supplemented by DEO's addition of the new cost category, ***did in fact result in immediate savings of $85,022.22.*** *Id.* at 11. The Order offers no reason why $85,022.22 is an insufficient level of savings, nor why savings of that amount warranted rewriting the deal reflected in the Commission-approved Stipulation. The Order's failure to do so is particularly surprising in light of the fact that Staff concedes: "there have been no promises of any specific

level of savings by any particular point in time under the PIR." Staff's Post-Hearing Brief at 26.[14] Staff's statement is confirmed by the record evidence in the rate case relied upon by the Commission to approve the Stipulation. *In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Authority to Increase Rates for its Gas Distribution Service*, Case No. 07-829-GA-AIR *et al*, Tr. II at 89, 107 (August 22, 2008). The record evidence there demonstrated that DEO promised neither the amount, nor the timing, of any savings. *Id.* All were aware of that when Staff and OCC signed the Stipulation, and when the Commission approved it.

The Commission has also not explained why it departed from its precedent to treat DEO differently from other gas utilities. It is uncontroverted that Duke and Columbia calculate O&M savings by aggregating expenses compared to a baseline year in the same manner that DEO calculated O&M savings. Tr. II at 83-85; DEO Ex. 10 at Stipulation Ex. 1 at 4, Sch. 22 Revised; DEO Ex. 9 at Stipulation Att. 2 Sch. AMRP-1. And, as the record demonstrates, Duke and Columbia had negative O&M savings in their main replacement filings. DEO Ex. 9 at Stipulation Att. 2 Sch. AMRP-1; *In the Matter of the Annual Application of Columbia Gas of Ohio, Inc. for an Adjustment to Rider IRP and to Rider DSM Rates*, Case No. 09-0006-GA-UNC (Application at Sch. 9B) (June 2, 2009).

DEO agrees that a benefit of the PIR program is the ability to pass O&M savings ***that DEO actually achieves*** through to customers. The record shows that DEO offered to pass

[14] That DEO did not achieve more O&M savings may be explained by at least two reasons. First, because DEO's distribution system consists of a substantial amount of uncoated or ineffectively coated pipes, the number of leaks in the remaining pipe increase faster than the decrease in leaks in replaced pipe. In the first year, only 4% of the pipe was replaced, meaning the remaining 96% deteriorated further. Tr. II at 18. As more pipe is replaced the number of leaks will decrease and savings will increase. Second, DEO prioritized the replacement of transmission pipe to assure continued system reliability. A failure of transmission pipe will affect many more customers than a failure of distribution pipe. Tr. I at 62.

through the $85,022.22 of O&M savings it actually realized, as the Stipulation contemplated. The Commission has failed to offer adequate reasons for deviating from that methodology now.

(c) The Order provides no reasons for deviating from the Rate Order by denying DEO recovery on the capital investment associated with new curb-to-meter installations.

The Rate Order allowed DEO to recover the cost of and a return on its investments for new curb-to-meter service installations. Staff Ex. 2 at 3, 4-5. The PIR Staff Report, adopted by the Commission through the Stipulation, included an entire section discussing whether DEO should assume ownership of curb-to-meter service lines. Staff Ex. 2 at 2-3. The PIR Staff Report twice stated that DEO should recover the costs associated with the installation of new curb-to-meter installations. *Id.* at 3, 4-5. Yet, in the Order, the Commission now denies recovery of those investments and the return on those investments. Order at 7-8.

In making this change from the Rate Order, the Commission does not even refer to the controlling language from the Stipulation. Instead, it cites only testimony from Staff witness Ibrahim Soliman. Mr. Soliman testified that "new service lines do not qualify for recovery because their costs are revenue-generating investments for DEO and should not be recovered from customers through the PIR rates." *Id.* at 7. Mr. Soliman also noted that "a DEO witness testified that DEO would not seek to include the costs associated with the revenue generating mainline extensions or other revenue-generating infrastructure investments in the amounts to be recovered by Rider PIR." *Id.*

Mr. Soliman's testimony fails to justify the deviation from the Rate Order. New curb-to-meter service lines do not generate any more revenue than a service line installed for an existing customer. Moreover, to the extent that those new installations are "revenue generating," that was equally true at the time the parties agreed to, and the Commission approved, the Stipulation.

Yet, the Stipulation called for recovery of the expenses associated with new additions. Thus, this is hardly a new fact justifying a deviation from the earlier order. Indeed, if anything, revenue generation concerns cut ***against*** this change. The evidence in the rate case demonstrated that demand in DEO's service territory is shrinking—meaning that revenues are falling, not increasing. Rate Order at 18. The rate case evidence was corroborated in this proceeding where the evidence showed that DEO has seen a decline of 35,000 residential customers. Tr. I at 162-163. Staff did not introduce evidence to the contrary in this case. In short, neither the record nor the Order gives any reason to depart from the Rate Order.

Nor does Mr. Soliman's reference to testimony from "a DEO witness" change this result. The testimony Mr. Soliman is referring to is testimony from Jeffrey Murphy. That testimony, however, did not even address the subject of curb-to-meter service line installations; it is improper to imply otherwise. Staff Ex. 5 at Attachment IS-2. In Mr. Murphy's fourth supplemental testimony supporting the Stipulation—which is directed toward such installations—he described that those installations benefit ratepayers because the PIR program will "promote the continued safe and reliable operation of its pipeline system, with DEO taking over ownership and responsibility ***for newly installed***, replaced and repaired curb-to-meter service lines." *In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Authority to Increase Rates for its Gas Distribution Service*, Case No. 07-829-GA-AIR *et al*, Fourth Supplemental Direct Testimony of Jeffery A. Murphy at 4-5 (August 25, 2008) (emphasis added). Indeed, the Commission approved DEO's recovery of its investment in new curb-to-meter installations (and a return on such investments), in part, based upon Mr. Murphy's testimony supporting the Stipulation. Rate Order at 12. It is unlawful for the Commission to

now modify that result without explaining why it is doing so, particularly where the record does not support the Commission's holding.

(d) The Order offers no reasons for deviating from the Rate Order and Commission precedent to deny DEO cost recovery on projects accounted for under the blanket work order process that were *not* complete by June 30, 2009.

As noted above (*see supra* at 15-19), the Rate Order permitted DEO to recover its investment in capital additions closed monthly through the blanket work order process and a return on such investments. DEO Ex. 7 at 13. The Rate Order also approved DEO's rate base in the rate case pursuant to R.C. 4909.15 and made a finding of fact that the property was used and useful. Rate Order at 30. The rate base included plant closed monthly through blanket work orders. Staff Ex. 3 at 3-4, 55; DEO Ex. 8 at 83. The Commission expressly acknowledged the filing of the Blue Ridge report (Rate Order. at 4, 29), that report audited and approved DEO's use of blanket work orders. Despite the Commission's earlier approval of the blanket work order process in the Rate Order, however, the Order now rejects the blanket work order process without explaining the reason for this change.

The Commission's Order held that DEO's costs associated with investments in plant additions not completed by June 30, 2009 could not be included in the rate base for calculating the PIR Cost Recovery Charge until the period ending June 30, 2010. Order at 6. The sole basis the Commission cites is testimony from Staff witness Soliman that the plant additions at issue were not complete as of June 30, 2009, and that they thus could not qualify as used and useful. *Id.*

Neither Mr. Soliman nor the Commission have offered any reasoning to support this definition of used and useful. DEO has long-used the FERC-approved systems of accounts to establish used and useful property. The Commission has consistently accepted that practice,

including in the base rate case here. There is no reason—and the Commission has offered none—that the same standard should not be used in determining which assets are used and useful for purposes of the PIR Cost Recovery Charge.

In addition to its failure to address the standard for determining what is used and useful, the Commission failed to address its own precedent. The record shows that Duke and Columbia, like DEO, use blanket work orders to close projects of short duration. On cross examination, Staff witness Soliman testified that Columbia uses blanket work orders to process plant additions and closes its work orders on a 30-day cycle. Tr. II; DEO Ex. 18 at 82. Just as in the DEO rate case, the Staff Report in Columbia's rate case accepted the Blue Ridge findings and made no adjustments to distribution plant additions or retirements. DEO Ex. 17 at 3, 50; Tr. II at 181. Duke also uses blanket work orders closed monthly to process projects of short duration. *In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Gas Rates*, Case No. 07-589-GA-AIR (Blue Ridge Report at 86) (December 20, 2007). Yet, in Duke's rate case, Staff made no changes to distribution rate base. *In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Gas Rates*, Case No. 07-589-GA-AIR (Staff Report at 4, 57) (December 20, 2007). In light of this precedent, the Commission must justify the deviation from its normal practices that the Order seeks to foist upon DEO here. It has failed to do so.

The Commission's failure to justify this change is not surprising. The use of blanket work orders to account for the costs of those projects that should be included in rate base simply makes sense. Blanket work orders apply only to projects of short duration. OCC Ex. 4 at 620. There are thousands of such projects annually in a program as massive as PIR. *In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Authority to Increase Rates for its Gas Distribution Service*, Case No. 07-829-GA-AIR *et al*, Tr. II at 86

(August 22, 2008). It would be unduly and unnecessarily burdensome, and accordingly quite expensive, to track such projects on an individual basis, as utilities do for large plant additions. Blanket work orders are easy for Staff to audit. There is little risk that projects will be placed in rate base long before they are completed because of the nature of the projects themselves—smaller projects of short duration. Absent a better explanation as to why blanket work orders no longer can be used to determine plant additions that are used and useful, the Commission's Order is unlawful.

(e) The Order states no reasons for deviating from the Rate Order and Commission precedent in requiring DEO to amortize incremental depreciation and property tax over the lives of the PIR assets, approximately fifty years.

The Stipulation approved and adopted in the Rate Order provided for a one-year amortization period for incremental depreciation and property tax expenses. *See supra* at 19-20. Without examining the Stipulation, past precedent or the record, the Commission agreed with Staff and ordered DEO instead to amortize incremental depreciation and property tax expense over the lives of the PIR assets, approximately 50 years. Order at 5. The Order appears to justify this amortization period as consistent with the Commission's past precedent, *see id.* at 5, but, in fact, there is no precedent that supports the amortization period that the Order imposed here.

With regard to main replacement programs, there is no precedent at all. Duke has not asked to recover incremental depreciation and property tax. And the Columbia settlement is not "precedent;" it was based on a negotiated agreement voluntarily entered by the utility. DEO Ex. 9 at 2.

With regard to other regulatory assets, the Commission has never required such an extended period for amortization as it does here. In Duke's Standard Service Offer case, the

Commission approved a three-year amortization period for $50,000,000 in O&M expenses at the Beckjord generating plant. *In the Matter of the Application of Duke Energy Ohio, Inc., for Approval of an Electric Security Plan*, Case No. 08-920-EL-SSO et al, (Opinion and Order at *29) (December 17, 2008). In the acquisition of Monongahela Power by Columbus Southern Power Company ("CSP"), the Commission permitted CSP to amortize over five-years, not over the lives of the acquired assets, a $10,000,000 surcharge related to the acquisition. *In the Matter of the Transfer of Monongahela Power Company's Certified Territory in Ohio to the Columbus Southern Power Company*, Case No. 05-765-EL-UNC (Entry on Rehearing at *4-*6) (December 31, 2005). Similarly, the Commission approved a two-year amortization for study adjustments associated with depreciation accrual rates and depreciation reserves for Wabash Mutual Telephone Company. *In the Matter of the Application of Wabash Mutual Telephone Company to Change its Depreciation Accrual Rates and to Adjust its Plant in Service and Depreciation Reserve*, Case No. 05-1318-TP-AAM (Entry at *2-*3) (November 9, 2005). The two-year amortization period was not tied to the lives of the depreciable assets. In an identical case involving Columbus Grove Telephone Company the Commission approved a five-year amortization period. *In the Matter of the Application of Columbus Grove Telephone Company to Change its Depreciation Accrual Rates and to Adjust its Depreciation Reserve*, Case No. 05-1288-TP-AAM (Entry at *2-*3) (November 9, 2005).

In fact, in *In the Matter of the Application of Columbus Southern Power Company for Authority to Amend its Filed Tariffs to Increase the Rates and Charges for Electric Service*, 91-418-EL-AIR (Opinion and Order) (May 12, 1992), Columbus Southern Power applied to amortize deferred tax reserves over the lives of the assets. Mr. Soliman testified that the amortization period should be four years because the new rates would be in effect for four years.

Id. at *161-162. Ultimately the Commission approved Staff's recommended four-year amortization period and rejected the company's request to amortize the deferred tax reserves over the lives of the assets. *Id.*

In short, DEO has been unable to identify a single case (other than the voluntary settlement in Columbia) in which the Commission has ordered a fifty-year amortization period. Accordingly, there is simply no basis for Mr. Soliman's assertion that the amortization period he recommends for incremental depreciation and property tax expense in this case is consistent with Commission precedent.[15]

Further, the change from the one-year period in the Stipulation to the life of asset period in the Order cannot be justified on the facts. The record shows that depreciation itself is ***already*** an amortization over the life of the asset. Staff Ex. 5 at 4-6. It makes no sense to amortize an already-amortized amount. Nor can such an approach be squared with basic cost-causation principles. The recovery for the depreciation expense should be closely correlated to the period in which the expense was incurred. The method approved in the Stipulation achieved that result, but the method in the Order does not. DEO Ex. 2 at 3.

The Commission's Order largely ignores the record, fails to examine its own precedent, does not analyze the Stipulation and provides little or no rationale for changing the policies and procedures it adopted in the Rate Case. The Commission's Order is thus unlawful and unreasonable.

[15] Moreover, in a related case relying on the same Stipulation that is at issue in this proceeding, Staff agreed to, and the Commission approved, a one-year amortization for incremental depreciation expense. DEO Ex. 19 at Stipulation Attachment 1. It is true that annualized depreciation was treated differently in the Automated Meter Reading case than Staff and DEO agreed to in this case. But incremental depreciation, the same depreciation at issue in this proceeding, was amortized over one-year, not the lives of the AMR assets.

C. The Commission's Determination On The O&M Savings Issue Is Against The Manifest Weight Of The Evidence.

A Commission determination must fall if it is "manifestly against the weight of the evidence," or is "so clearly unsupported by the record as to show misapprehension, mistake or willful disregard of duty." *Monongahela Power Co. v. Pub. Util. Comm'n*, 104 Ohio St. 3d 571, 577-578 (2004) (citing *AT&T Communications of Ohio, Inc. v. Pub. Util. Comm'n*, 88 Ohio St. 3d 549, 555, (2000), citing *MCI Telecommunications Corp. v. Pub. Util. Comm'n*, 38 Ohio St. 3d 266, 268 (1988)). Here, the Commission's determination on the O&M savings issue fails under this test.

The sole basis that the Commission cites in support of the O&M savings calculation methodology it adopted is essentially the Commission's contention that "immediate customer savings were articulated as a goal of the PIR program." The undisputed testimony from both Staff and DEO, however, roundly rejects the Commission's contention that "more immediate" means "in the first year." In fact, ***the Staff expressly admits that DEO did not promise savings within any particular time period***: "there have been no promises of any specific level of savings by any particular point in time under the PIR." Staff's Post-Hearing Brief at 26. Indeed, DEO personnel repeatedly confirmed that, while the company was certain that there would be savings over the life of the program (and beyond), it would be impossible to state with certainty when those savings would occur. According to DEO witness Vicki Friscic:

> Q. Do you recall Dominion ever indicating the cost savings from the program accruing over any particular period within that 25-year time frame?
>
> A. No. In either our application or testimony in the rate case proceeding we did not discuss any anticipated savings or timing of such savings. We did discuss that we anticipate there will be savings, but not the period in which we should expect to see those savings occur.

> Q. And is it reasonable to expect that large savings would immediately occur as a result of the program?
>
> A. No. In this first year of the program East Ohio has replaced or retired only about 3-1/2 percent of the pipeline that's in scope for the project or the program and so it doesn't make sense yet that we would have significant savings. We expect that to occur as the program goes forward.

Tr. II at 17-18. Another DEO witness confirmed this same point. DEO witness Tim McNutt testified: "We think that that's going to be a significant cost savings in the scope of the program and we've identified that in the testimony. But we aren't sure exactly what that's going to entail when we get into all the details of the projects for the program." *In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Authority to Increase Rates for its Gas Distribution Service*, Case No. 07-829-GA-AIR *et al*, Tr. II at 89 (August 22, 2008). He put it even more succinctly later during cross-examination: "***[W]e aren't sure exactly what we're going to save until we actually get into the project level and actually start replacing specific areas ... where we have leaks.***" *Id.* at 105 (emphasis added)

The only support that the Commission provides in its Order is one sentence from the PIR Staff Report that the Commission cites out of context. The cited language states that "Staff agrees with DEO that this reduction in O&M expenses be used to reduce the fiscal year-end regulatory asset in order to provide customers a more immediate benefit of the cost reductions achieved as a result of the PIR program." Staff Ex. 2 at 5. But, "more immediate" in that sentence simply refers to the savings being passed through to customers more quickly than they would be under the alternative treatment, where DEO would pass the savings through as part of its next base rate case. By instead incorporating the savings into the PIR Cost Recovery Charge calculation, the customers will receive the savings as they are experienced. Thus, recovery through that charge is "more immediate," just as the PIR Staff Report said. But, as the DEO

witnesses testified, and Staff agreed, "more immediate" does not mean that savings would be realized within any particular time frame.

Accordingly, the Commission's finding that the PIR program's goal was to provide savings in the first year is contrary to the manifest weight of the evidence. As that finding is the sole basis supporting the Commission's determination regarding the O&M savings methodology, that determination cannot stand.

D. DEO Met Its Burden Of Proof Regarding The Level Of Incremental O&M Expense It May Recover Through The PIR Cost Recovery Charge.

Without reference to the record, or any standard, the Commission held that "DEO did not meet its burden of proof to establish that its proposed incremental O&M costs were actually incremental to DEO's base rates...." Order at 9. The Commission's lack of justification or reasoning for its casual dismissal of DEO's record evidence—evidence that Staff did not even bother to audit—is patently unreasonable. The record demonstrates that DEO did in fact meet its burden of proof as to incremental O&M costs. The Commission was wrong to conclude otherwise.

The applicant's only burden in a rate proceeding is to produce sufficient evidence to permit the regulatory body to make an informed judgment on the issue presented. *Mt. Vernon Telephone Corp. v. Pub. Util. Comm'n*, 163 Ohio St. 381, 390-391 (1955). Here, DEO easily met that burden on the question of incremental O&M expenses. DEO witness Vicki Friscic presented schedules clearly and concisely demonstrating the amount of incremental O&M expense. DEO Ex. 2; DEO Ex. 5 at Ex. A, Sch. 15. DEO witness Mike Reed unequivocally testified that the costs were incremental, not duplicative. *See, e.g.*, DEO Ex. 3 at 2-3. ("Simply put, if it weren't for the PIR program, the incremental O&M expenses included in the Application would not have been incurred.")

Staff, on the other hand, admitted that it did not even examine DEO's O&M expenses, despite the fact that Staff clearly had the opportunity to do so. Staff Ex. 4 at 5; Tr. II at 71.[16] At the hearing, Staff produced no evidence showing that the costs were not incremental. Under such circumstances DEO met its burden of proof, and it is unreasonable and unlawful for the Commission to hold otherwise.

III. CONCLUSION

The Commission's Order fails to examine the Stipulation or other controlling documents that the Commission approved in its Rate Order regarding any of the contested issues before it. Given DEO's reliance upon the Rate Order and the Stipulation that Order approved, the Commission's Order here is unlawful in retroactively amending the PIR Cost Recovery Charge to deprive DEO of an opportunity to recover previously-incurred costs associated with the PIR program or to deny DEO timely recovery of and on its already-made PIR investments. Even as to not-yet-incurred costs, the Order fails to state sufficient reasons to explain the changes that the Order imposes on the Commission's previously-entered order, and is thus unlawful. Moreover, the sole finding underlying the Commission's determination on the O&M savings issues is against the manifest weight of the evidence. Finally, the Commission erred in concluding that DEO failed to meet its burden of proof to establish the amount of incremental O&M expenses. DEO placed sufficient evidence in the record for the Commission to form a judgment, and Staff failed to perform any audit of that evidence. Under these circumstances, DEO respectfully requests that the Commission reverse its Order and approve the PIR Cost Recovery Charge requested by DEO in its application.

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[16] Staff knew no later than November 14, 2008, the types of O&M expenses that DEO sought to recover. DEO Ex. 14 at 31. Yet, Staff made no effort to collect additional information with regard to those costs at that time. When Staff finally sought information, DEO supplied it promptly. Tr. II at 142.

January 15, 2010

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was sent by electronic mail and hand-delivery to the following party on this 15th day of January, 2010.

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