

FILE

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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In the Matter of the Application of The)
East Ohio Gas Company d/b/a)
Dominion East Ohio for Approval to)
Modify and Further Accelerate its) Case No. 11-2401-GA-ALT
Pipeline Infrastructure Replacement)
Program and to Recover the)
Associated Costs.)

COMMENTS
SUBMITTED ON BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO

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INTRODUCTION

On March 31, 2011, The East Ohio Gas Company d/b/a/ Dominion East Ohio (“DEO” or “Company”) filed a Motion pursuant to R.C. 4929.08(A) in the above captioned case requesting authority to modify its Pipeline Infrastructure Replacement (“PIR”) Program and associated PIR Cost Recovery Charge. DEO requests that the Commission modify its October 15, 2008 Opinion and Order authorizing DEO’s PIR Program (the “2008 Order”)¹ to permit the Company to further accelerate the removal and replacement of bare steel, cast iron, wrought iron, copper, (“BS/CI”) and

¹ DEO’s most recent base rate proceeding, Case No. 07-829-GA-AIR *et al.*

ineffectively coated pipelines² in its system. Specifically, DEO is requesting that the Commission modify the 2008 Order to authorize it to:

- Adjust the current \$1.00 annual cap on increases to the PIR Cost Recovery Charge to accommodate a proposed approximate doubling of annual PIR expenditures;
- Replace the capitalized interest or “post in-service carrying cost” (“PISCC”) component of the annual PIR Cost Recovery Charge with the Company’s authorized pre-tax rate of return on rate base (“ROR”) for PIR assets placed into service before being reflected in the PIR cost Recovery Charge;
- Make changes to the PIR Cost Recovery Charge fiscal period and filing schedule;
- Clarify the PIR Program scope regarding pipeline relocations and inside meter relocations;
- Include a reconciliation adjustment designed to ensure that DEO recovers the approved PIR Cost Recovery revenue requirement;
- Reauthorize the PIR Program for a five-year period from the date of Commission approval of the Motion; and
- Make other changes to facilitate regulatory review of the modified PIR Program, including retention of an independent financial auditor to review annual PIR Cost Recovery Charge applications and biennial depreciation studies of PIR investments.

On April 11, 2011, the Attorney Examiner assigned to this case by the Commission issued an Entry that, among other things, established May 25, 2011 as the deadline for filing comments on DEO’s Motion. The remainder of this document presents the Staff of the Public Utilities Commission of Ohio (“Staff”) comments on DEO’s Motion, including a summary of the Staff’s investigation and the Staff’s findings and recommendations by topic.

²

The Staff maintains that ineffectively coated pipelines are in the scope of the current PIR Program only if the pipelines have been tested and shown to be leaking or corroded. Replacement of ineffectively coated pipelines not shown to be corroded or leaking was never intended or authorized to supplant replacement of BS/CI mains.

BACKGROUND

With the 2008 Order, the Commission adopted a Stipulation and Recommendation (“2008 Stipulation”) filed by the parties to the case establishing DEO’s PIR Program for cost recovery for accelerated replacement of approximately 4,122 miles of BS/CI pipelines and, to a limited extent, certain other pipeline projects³ over a 25 year period. In its original PIR Application, the Company estimated that without accelerated replacement it would have taken 89 years at its then existing replacement rate to complete replacement of all of the in-scope pipelines. The approved 2008 Stipulation also provided that DEO would assume ownership and ongoing responsibility for all customer-owned service lines when such lines were separated from service due to replacement of associated mainlines or to repair leaks where a pressure test is required prior to returning the line to service. In addition, the 2008 Stipulation established an initial authorization period for the PIR Program for five years or until the effective date of new base rates resulting from a base rate application (whichever came first). It also set limits on annual increases to the PIR Cost Recovery Charge and provided for an application and review process for annual PIR Cost Recovery Charge applications. The initial PIR Cost

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DEO suggests that the original PIR scope includes pipeline relocations, system improvements, regulating stations, integrity management programs, and environmental compliance programs. The Staff does not agree that these additional items were included on an unlimited and unrestricted basis. The Staff maintains that these items were classified as “ongoing system improvements” in the Staff Report in Case No. 08-169-GA-UNC which was adopted by the parties in the 2008 Stipulation. In the 08-169-GA-UNC Staff Report, the Staff makes it clear that the PIR Program is (as the name implies) primarily a replacement program and that costs for ongoing system improvements, pipeline relocations, environmental compliance, regulating stations, transmission and distribution integrity management, etc. can only be included in the PIR Cost Recovery Charge if there is room under the applicable cap in a given year. Such “ongoing system improvements” were never authorized to supplant BS/CI pipeline replacement. If there isn’t room under the cap for such projects, then the Company is to recover its costs through its normal capital recovery program.

Recovery Charge was set at \$1.12 per customer per month for the Small General Service Class ("GSS") of customers and subsequent annual increases were capped at \$1.00 per year. The annual application and review process called for the DEO to file a pre-filing notice by May 31 each year containing nine months of actual and three months of estimated data for recovery of Program costs incurred in a fiscal year period July 1 to June 30 of the subsequent year followed by an application containing updated annual cost data by August 31 and rates resulting from the approved application going into effect on November 1.

To date, DEO has filed two PIR Cost Recovery Charge applications covering the period July 1, 2008 through June 30, 2010. The Company reports that during this time period it replaced approximately 33 miles of high pressure transmission pipeline, 11 miles of high pressure distribution pipeline, 233 miles of lower pressure distribution pipeline, and approximately 24,600 steel service lines.⁴ In addition, the Company reports that through June 2010 it has completed replacement of approximately 6.7% of the pipeline included in the original PIR Program scope at an authorized capital expenditure totaling approximately \$175 million.⁵

BURDEN OF PROOF

Ohio Revised Code Section 4929.08(A)(1) provides that the Commission may modify an approved alternative rate plan as long as two conditions are satisfied: "(1) The commission determines that the findings upon which the order was based are no longer

⁴ Direct Testimony of Timothy C. McNutt, Case No. 11-2401-GA-ALT, March 31, 2011 at

7.

⁵

IBID.

valid and that the abrogation or modification is in the public interest; and (2) The abrogation or modification is not made more than eight years after the effective date of the order, unless the affected natural gas company consents.” DEO’s Motion in the instant case requesting the Commission to modify the 2008 Order authorizing its alternative rate plan (the PIR Program) is being made less than three years after the Order was issued, therefore the second condition is met. As to the first condition, the Staff believes that DEO bears the burden to show that the Commission findings regarding the PIR Program adopted via an alternative rate plan are no longer valid and that the proposed modifications are in the public interest.

SUMMARY OF THE STAFF’S INVESTIGATION

The Staff reviewed DEO’s Motion and supporting testimony, issued formal information requests, attended Company presentations, conducted several interviews with Company personnel, and researched past cases and relevant Commission precedent to reach the findings and recommendations presented in these comments. The Staff’s findings and recommendations by topic area are set forth below.

STAFF’S COMMENTS AND RECOMMENDATIONS BY TOPIC RAISED IN THE MOTION

Modifications to the PIR Program Scope:

Ineffectively Coated Pipeline

DEO states that it has identified approximately 1,450 miles of steel distribution piping that it classifies as “ineffectively coated”. This piping is in addition to the

approximately 4,122 miles of bare steel, cast iron, wrought iron, and copper mainlines identified for replacement in the Commission's October 15, 2008 Opinion and Order (in Case No. 08-169-GA-ALT) approving DEO's current PIR program. DEO has requested that the 1,450 miles of ineffectively coated pipeline be added to the scope of its PIR program.

The Pipeline Safety Regulation 49 C.F.R. 192.457 defines ineffectively coated piping as follows: "... a pipeline does not have an effective external coating if its cathodic protection current requirements are substantially the same as if it were bare. The operator shall make tests to determine the cathodic protection current requirements." DEO has chosen to use a current requirement standard of 0.1 milliamps per square foot in order to determine whether or not a steel pipeline is ineffectively coated.⁶ Staff believes that this standard is reasonable.

Pipeline safety regulations did not require steel pipelines to have any external coating or provide standards for the proper application of external protective coating until August 1, 1971. DEO states that a methodology of hand applying a tar-like substance to steel piping in the field as an external coating was used on pipelines in their system prior to 1955, and that approximately 1,450 miles of such piping has been identified. A total of 94 segments of pre-1955 coated pipeline (4.3 miles) have been tested using their 0.1 milliamps per square foot current standard and DEO has determined that all of this piping is ineffectively coated²⁷. Based on testing results and DEO's knowledge of the field

⁶ Case No. 08.169-GA-ALT "Direct Testimony of Timothy C. McNutt on behalf of DEO.

⁷ Case No. 11-2401-GA-ALT "Response to Data Request PUCO Set 2 – Chace."

coating techniques in use prior to 1955, DEO believes that all externally coated steel pipeline installed prior to 1955 should be assumed to be ineffectively coated. Staff has determined that this assumption is reasonable and that pre-1955 coated steel piping should be considered for replacement as if it were bare steel without the further need to test each individual pipeline segment to determine the effectiveness of the external coating.

Staff still believes that it is appropriate to replace all of the remaining pipe included in the current PIR program (cast-iron, bare steel, wrought iron, and copper) as well as the pre-1955 ineffectively coated pipe over the same 25 year period (23 years remaining) identified in the current PIR program (Staff refers to these two sets of pipe as target pipe). In a related subject, Staff maintains its position that a one-time approval of a 23-year program is not appropriate but rather recommends that the Commission grant approval for an additional 5-year term beginning on the date of the Commission's order in this case.

In addition to recommending the expansion of the existing PIR program, Staff believes it is necessary to limit the scope of the DEO's current PIR program to align it with other accelerated main replacement programs implemented by other large local distribution companies as detailed below.

Pipeline Relocations

In its Motion, DEO proposes to exclude from the PIR Rider the entire cost of a pipeline relocation project if plastic pipe comprises more than 25 percent of total footage

being replaced by the project. Conversely, the proposal implies that the entire cost of the project would be recovered through the PIR Rider if 25 percent or less of the total footage being replaced were plastic. It is Staff's position that relocations should qualify for PIR Rider recovery only if the relocation is ordered by a government body with appropriate jurisdiction and to the extent that the relocation involves the replacement of target pipe as identified above. Accordingly, Staff recommends that the cost of main relocation projects involving plastic pipe should be prorated so that non-plastic footage replaced as a percent of total footage replaced would dictate the percentage of total project cost to be recovered through the PIR Rider.

System Improvements

DEO proposes to continue recovering the cost of system improvements through its PIR Rider.⁸ Staff recommends excluding from PIR Rider recovery the cost of any system improvements (e.g., over-sizing and looping of pipe) unless they involve the replacement of target pipe as identified above.

Regulating Stations

DEO proposes continued PIR Rider recovery for the cost of replacing, modifying, or removing regulating stations.⁹ Staff supports such recovery only to the extent that such regulator station replacement, modification, and removal was undertaken to address gas-pressure increases resulting from the replacement of target pipe identified above.

⁸ See footnote 3 discussing the Staff's position on limits to the scope of current PIR Program.

⁹ See footnote 3 discussing the Staff's position on limits to the scope of current PIR Program.

Integrity Management and Environmental Compliance Programs

In its motion, DEO proposes to continue recovering through the PIR Rider the cost of integrity management and environmental compliance programs.¹⁰ Although Staff expects DEO to comply with integrity management requirements, Staff considers such compliance a part of normal maintenance activities, which are outside the scope of the PIR program. If, in the course of implementing these integrity management and environmental compliance programs, DEO identifies target pipe as identified above and prioritizes the need for its replacement, Staff recommends that only such replacement cost (and not the foregoing maintenance activities) should be recovered through the PIR Rider.

Meter Relocations

Also in its Motion, DEO proposes to recover through the PIR Rider the cost of moving inside meters outside when DEO plans to operate the pipeline at regulated pressure. Staff recommends PIR Rider recovery for such meter move-outs only when they are performed in conjunction with the replacement of target pipe as identified above and where DEO plans to operate the replacement mains and associated service lines at regulated pressure within two years following such replacement.

Service Lines

DEO's current PIR Rider recovers the cost of three categories of service line replacements: (1) main-to curb service lines associated with PIR Program main

¹⁰ See footnote 3 discussing the Staff's position on limits to the scope of current PIR Program.

replacement project; (2) curb-to-meter service lines previously owned by the customer; and (3) main-to-curb service lines not associated with a main replacement. Although the costs of the first two categories are recovered through the facility replacement riders of Ohio's other large gas utilities, the third category is not. Since the third category has traditionally been the utility's responsibility, Staff considers it part of normal operations, the cost of which should be recovered through normal cost recovery mechanisms. Staff therefore recommends that the cost of replacing main-to-curb service lines not associated with replacement of target pipe (as identified above) be excluded from recovery through DEO's PIR Rider.

Further Acceleration of the PIR Program Pace

Increase the Program Pace for Completion in Less than 20 Years

DEO maintains that doubling the annual cap on the PIR Cost Recovery Charge, while maintaining all original assumptions, would enable it to further accelerate the pace of pipeline replacement and complete the PIR Program in less than 20 years.¹¹ The Company maintains that further acceleration of the Program is advisable because of high-profile pipeline failures and explosions in other jurisdictions and the failure of a larger diameter coated steel distribution pipeline on its system. The Staff does not believe accelerating the pace of the PIR Program is warranted at this time. The Company has not provided any new evidence or data suggesting that the pipelines on its system are deteriorating or leaking at higher rates than was previously anticipated by the 2008 Black & Veatch Report or Company testimony accompanying the original PIR Program

¹¹ DEO response to Staff Data Request No. 6, May 21, 2011.

Application to support accelerating the PIR Program pace to complete the Program earlier than the 23 years remaining in the original timeline.

In addition, the Company has not spent or even proposed spending up to its allowable cap in the current PIR Program. In its first year, DEO could have spent up to \$1.12 per GSS/ECTS customer per month (hereafter referred to simply as “per month”). However, it only proposed spending \$0.93 per month (19 cents per month under the cap). It was actually authorized to receive \$0.72 per month. The following year’s cap was \$1.72 per month (second year cap of \$1.00 plus the \$0.72 authorized in year one), but DEO only proposed spending \$1.63 per month (10 cents under the available cap). It was actually authorized to receive \$1.58 per month.

Adjustments to PIR Program Annual Caps and Application Process

Proposed Doubling of Annual PIR Cost Recovery Charge Cap

In order to expand the scope of the PIR Program to include the additional 1,454 miles of ineffectively coated pipe, accommodate the other changes to the Program scope advocated in its Motion, and support the accelerated pace of replacement of the expanded Program, DEO recommends that the Commission authorize it to double the current annual cap from \$1.00/customer/month for the GSS/ECTS customer class to \$2.00/customer/month for recovery of investments through 2012. The Company then recommends that the August 2012 report evaluating the PIR Program ordered by the Commission’s 2008 Order include a study to determine if the \$2.00 cap is sufficient or should be raised for the remainder of the five-year reauthorization period. This means that annual increases to the revised cap could be higher but would not be less than \$2.00

per year during the five-year reauthorization period. The Company is also proposing that it be permitted to carry over any unused portion of the cap in a given year to future program years and that the cap should include an annual inflation adjustment.

As explained above, the Staff supports adding the proposed 1,454 miles of pre-1955 potentially ineffectively coated pipe to the PIR Program scope without costly tests to verify that the pipe is indeed ineffectively coated. However, also as noted above, the Company has not provided any new evidence or data suggesting that the pipelines on its system are deteriorating or leaking at a greater rate than was previously anticipated when the original 25-year replacement period (23 years remaining) was established with adoption of the original PIR Program.

In order to accommodate the expanded scope while not authorizing further acceleration the Program pace, the Staff recommends that the Commission authorize DEO to increase the annual cap on the PIR Cost Recovery Charge from the current \$1.00 per GSS/ECTS customer per month to \$1.35 per GSS/ECTS customer per month. DEO states in its Motion and accompanying testimony that adding the ineffectively coated pipeline causes an approximate 35% increase to the PIR Program scope. Given this increase, the Staff recommends that a 35% increase to the PIR Program annual cap should be sufficient to enable the Company to complete the modified PIR Program replacement within the remaining 23 years left in the original Program timeline.

Cap Carry-Over and Inflation Adjustment

DEO is recommending that it be permitted to carry-over any unused portion under the annual PIR Cost Recovery Charge cap left over from one program year to the next program year. In other words, if the annual cap was set at the Staff recommended \$1.35 but in a given year DEO's actual costs eligible for recovery resulted in a \$1.25 increase to the PIR Cost Recovery Charge, then DEO would carry-over the \$0.10 to the next year and the cap would be \$1.45 per GSS/ECTS customer per month.

The Staff believes that a carry-over is not necessary or advisable. Neither DEO nor any other natural gas company with an accelerated pipeline replacement programs has a Commission authorized cap carry-over. Despite lacking a carry-over, however, the companies have implemented their programs at or ahead of their original schedules. In addition, a large cap carry-over could cause rate shock for customers. If the Company under-spent the cap by a significant amount, then the next year's increase to the PIR Cost Recovery Charge could be quite large, thus eliminating the meaning of the words "annual cap" and likely causing customer confusion and aggravation. The Staff recommends that the Commission not approve DEO's request for a cap carry-over.

DEO also recommends including an inflation adjustment in its annual PIR Cost Recovery Charge, although it does not specify how this inflation adjustment would work in light of a "cap" being in place. The Staff does not believe that an inflation adjustment is warranted. The effects of inflation (e.g., increased contractor costs, added materials and supplies costs, etc.) will be seen in increased Program costs that will be passed on to

ratepayers. No additional adjustment is needed. The Commission should reject the Company's proposal.

Changes to Calendar Year Recovery Period and Application Dates

The Company requests authority to change the time period of costs included in its annual PIR application filings. Currently, costs subject to recovery in each year's PIR application are incurred in a fiscal year period of July 1 to June 30 of the following year. DEO proposes changing to a calendar period for costs in order to align its PIR investments with its capital budget planning year and annual construction cycle. In order to transition to the calendar year cost recovery period, the Company is also proposing to change its PIR Application date.

Presently, DEO files a pre-filing notice containing nine months of actual and three months of estimated cost data for the July 1 through December 31 period of one year and January 1 through June 30 of the following year on May 31. It then files an application on August 31 containing an update with a full year of cost data and the new rates are set to take effect on November 1. Under its proposed application process, DEO would file a pre-filing notice containing nine months of actual and three months of estimated cost data for the previous calendar year on November 30 each year and an application that updates the cost data for a full year of actual data on February 28 of the following year and rates would go into effect on May 1. To transition to the new calendar year cost period and application timing, DEO recommends that it file its next PIR Application in accordance with its existing authorization – a May 31, 2011 pre-filing notice with actual and

estimated data for recovery of costs incurred between July 1, 2010 and June 30, 2011, an August 31, 2011 application with twelve months of actual data, and the revised PIR rate set to take effect on November 1, 2011. DEO then proposes that it would file another PIR application in February 2012 covering a six month period for costs incurred between July 1, 2011 and December 31, 2011. Thereafter, DEO would file in accordance with its proposed process timeline.

The Staff does not object to DEO's proposal to change from a fiscal year to a calendar year recovery period or to changing the PIR application dates as identified above.

Proposed Changes to Rate of Return on PIR Investments and Revenue Recovery

Pre-Tax Rate of Return Instead of Post In-Service Carrying Costs –

Currently when DEO begins a PIR construction project, it accrues Allowance for Funds Used During Construction (AFUDC) on that project expenditure amount. This accrual continues during construction until the project is placed into service. The AFUDC rate contains lower cost short-term debt, long-term debt and equity components. DEO's most recent AFUDC accrual rate is 9.22%. The AFUDC rate represents the interest cost of funds that are procured for advancing construction and is treated for regulatory purposes as a valid construction cost. However, AFUDC ceases after the project is placed into service and the AFUDC accruals are then amortized over the life of the project.

In the Staff Report in Case No. 08-169-GA-ALT, the Staff recommended that DEO be allowed to accrue Post-in-Service Carrying Charges (PISCC) on construction projects after the project is placed into service until the time that rates are placed into

effect representing any particular construction project. The Commission's Order in that case allowed for the PISCC rate to be used. The PISCC rate for DEO is based upon the cost of long-term debt of 6.5% as established in DEO's most recent base rate proceeding.

In the current Motion, the Company proposes to continue to accrue an AFUDC based rate on construction until the project is placed into service. At the in-service date, DEO then proposes that the project begin to earn a full pre-tax rate of return (11.36%) rather than the lower PISCC rate of 6.5% that is applied currently. The full rate of return contains long-term debt and equity components, but no short-term debt component. Short-term debt rates are currently at near historic lows. Historically, the Commission has allowed utilities to earn the full pre-tax rate of return on new construction only after a Commission order authorizes rates to be placed into effect.

The rate impact of allowing DEO to earn a full rate base return on construction between the in-service date and the placing of rates into effect is in excess of \$5 million per year to customers at the accelerated levels of PIR construction that DEO is proposing. Granting DEO's request would be a radical change to current practice and is counter to the recovery that any other natural gas company has requested or been authorized to recover in their pipeline replacement programs. However, with its proposal, DEO is asking the Commission to set aside several long-standing precedents and rate-making principles and would grant the Company recovery for a revenue deficiency that has not been shown to exist. The Company's pursuit of an immediate and ongoing equity return through the request for a full pre-tax rate of return from when a project is placed into service until it is placed into rates is essentially a request for post in-service AFUDC

(except that the rate of return is even more generous to the Company since the current AFUDC rate is 9.22% while the pre-tax rate of return is 11.36%). The Commission's long-standing approach to AFUDC and post-in-service AFUDC has been guided by the Commission adopted Federal Energy Regulatory Commission's ("FERC") Uniform System of Accounts for Natural Gas Utilities¹² (USOA). The USOA prescribes the treatment of utility plant assets when they are placed into service. USOA Gas Plant Instructions Number 3(17)(b) states in relevant part that: "When a part only of a plant or project is placed in operation or is completed and ready for service but the construction work as a whole is incomplete, that part of the cost of the property placed in operation, or ready for service, shall be treated as "Gas Utility Plant" and allowance for funds used during construction thereon as a charge to construction shall cease."¹³ (Emphasis supplied.) The USOA's prescribed treatment for AFUDC (which includes the equity component that DEO is seeking to recover) once a plant asset is placed into service is clear, AFUDC shall cease.

Another long-standing regulatory utility principle that DEO would have the Commission ignore is the fact that in between base rate cases in a normal rate-making setting a utility does not receive any compensation for plant assets that are placed into operation until the asset is included in the utility's plant-in-service and the utility's entire plant-in-service is valued at the date certain of the utility's next base rate case. The utility is compensated for this "regulatory lag" by the fact that the rates set at that time

¹² 18 CFR Part 201 "Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provisions of the Natural Gas Act" Gas Plant Instructions 3.17.

¹³ IBID.

were based in part on the net book value (original cost minus accrued depreciation) of its plant-in-service. The net book value of the plant-in-service declines due to depreciation accruals, but, in between rate cases, the utility's rates (which provide for a rate of return that includes an equity return) and resulting revenues are not reset to reflect the declining value of the plant-in-service. Utility ratemaking theory, suggests that the lag in utility recovery for assets placed into service between rate cases offsets or balances the lag in recognition of the depreciation of in-service assets used to fix current rates. If this relationship becomes unbalanced, then the utility can file a new base rate case. With its request to receive a full pre-tax rate of return as soon as projects are placed into operation, DEO is asking the Commission to ignore that the net book value of the plant-in-service included in its last rate case is declining but its rates are not being reset. This point is particularly cogent considering that the Company's capital investments in plant assets that are not related to the PIR and Automated Meter Reading Device (AMRD) Programs (which are recovered through annual filings) has declined by 13% compared to its five-year historical average¹⁴. In other words, DEO is asking for additional revenue recovery in exchange for expanding and further accelerating the PIR Program, but it has not shown that the regulatory lag caused by the new investment would cause it a revenue deficiency.

¹⁴ DEO response to Staff Data Request No.1, April 11, 2011

PIR Reconciliation Adjustment

DEO proposes that a reconciliation adjustment mechanism be established for PIR filings that would approve both a rate and revenue requirement such that any over or under-recovery of the revenue requirement be reconciled in the next PIR case. In effect, if the number of customer bills or customer consumption volumes vary from that used to calculate the revenue requirement in a PIR proceeding, DEO will be guaranteed recovery of the difference in revenue requirement in the succeeding PIR case.

Staff believes that companies regulated by the Commission should have an opportunity to earn their authorized return. Staff does not believe that companies should be guaranteed a return on authorized investments. The risk of over or under-recovery of the approved revenue requirement has always existed in base rate regulation. With its request, the Company asks for guaranteed revenue. However, granting the request essentially eliminates any risk for recovery that the Company may face. Ordinarily, this would argue for a decrease to the authorized rate of return. Yet, as discussed in the return section above, DEO is seeking even greater returns than it is currently authorized to receive. The Staff does not recommend a reconciliation adjustment (and thus guaranteed rate recovery) be established in this case.

Prioritization of Pipeline Replacement Projects and O&M Savings

Pipeline Replacement Prioritization

DEO prioritizes gas pipelines for replacement using a computer program called Optimain. Optimain is a risk ranking assessment tool that analyses pipeline data, attributes, and other characteristics to calculate relative risk scores for segments of pipe

within the system. The Optimain tool uses the following factors to determine each pipeline segment's priority or risk score: history of leaks, outages, and heat tape installations; pipeline attributes (material, vintage, size, pressure, coating type); building data (density, proximity risk, class); feasibility of repair; ground cover type (i.e. concrete or asphalt) ; survey interval; and leak source. Projects (composed of single or multiple pipeline segments) with a higher total risk score than other projects generally reflect the need to be replaced sooner and are typically scheduled for replacement before projects with lower risk scores.

Staff supports DEO's prioritization methodology and recommends that DEO continue using the Optimain program to prioritize potential pipeline replacement projects.

O&M Savings vs. Safety

In its Motion and accompanying testimony, DEO suggests that the Staff and Office of the Ohio Consumers Counsel's (OCC) efforts to ensure that the Company provide operation and maintenance (O&M) savings in the PIR Program has distorted its decision making and caused it to replace leaking lower pressure pipelines instead of higher pressure pipelines that are not leaking but carry a greater safety significance in order to show O&M savings. The Staff rejects this suggestion and believes that DEO is attempting to confuse the Commission by establishing a false choice between safety and O&M savings. The Commission has already decided "immediate customer savings were articulated as a goal of the PIR program."¹⁵ And, DEO's current PIR Program does not

¹⁵ *In re The East Ohio Gas Company d/b/a Dominion East Ohio*, Case No. 09-458-GA-RDR (Opinion and Order at 11) (December 16, 2009).

result in a pipeline system that is unsafe and Staff does not believe DEO has claimed its system is not safe.

As discussed earlier, DEO has not shown its system is unsafe and DEO has not shown the safety of its system is more in question now than when the Commission approved the PIR program less than 3 years ago. The condition of DEO's system was considered at that time and DEO has not presented anything suggesting the material it presented then is inaccurate now. As noted earlier, the Company has not provided any new evidence or data suggesting that the pipelines on its system are deteriorating or leaking at an increased rate than was previously anticipated in the 2008 Black and Veatch Report or DEO's testimony accompanying the original PIR Program Application. The facts surrounding DEO's pipeline system are as DEO described when it applied for approval of its PIR Program.

Like safety, DEO has not provided anything new regarding savings. DEO claimed its ratepayers would benefit through savings resulting from its PIR program. DEO's Application in the original PIR case stated:

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." See A Report by the Staff of the Public Utilities Commission of Ohio (December 20, 2007), Case No, 07-589-Ga-AIR, at p. 39. DEO also anticipates significant benefits from a reduced

incidence in leak repair expenses and, like Duke, will credit savings in avoided operation and maintenance (“O&M”) costs to customers.¹⁶

Similarly, a Company witness in that Case provided testimony that:

DEO also anticipates O&M savings comparable to those reported by the other companies from reduced incidence in leak repair expense, and DEO will credit such savings to customers. The use of plastic mains will result in lower operating expenses, because these lines do not require cathodic protection nor corrosion-related leak repairs.¹⁷ (Emphasis supplied.)

DEO’s current arguments that insistence of Staff and OCC that DEO deliver on its claims is causing it to prioritize replacement of pipelines that will deliver O&M savings over safety-related pipelines as well as its claim in the 09-458-GA-RDR case that it never promised O&M savings early in the original PIR Program are simply not credible.

DEO knew the amount of higher pressure pipeline that was in its system at the time it was offering to deliver O&M savings and it knew the replacement priority this pipe. Similarly, DEO’s attempt to recast its savings offer by arguing that O&M savings were not anticipated early in the original PIR Program is an attempt at obfuscation. The quote from DEO’s original PIR Application excerpted above regarding DEO’s anticipation of significant benefits (like Duke achieved) includes a time metric that was known to DEO at the time it was making its offer of O&M savings from the PIR Program. It was well known at the time that Duke achieved a cumulative \$8.5 million in O&M savings over the first five years of its AMRP program. There would have been no reason for DEO to cite to the Duke time metric for O&M savings while discussing the

¹⁶ DEO Application in Case No. 08-169-GA-UNC, p. 3.

¹⁷ Direct Testimony of Timothy C. McNutt, Case No. 07-829-GA-AIR, *et al.* p. 14.

anticipated benefits of its own replacement program unless it intended to provide comparable results.

As DEO is aware, its O&M savings results have lagged well behind the results produced by the other natural gas companies. Accordingly, the Commission should reject DEO's false choice between safety and O&M savings.

Other Modifications Recommended by DEO

Retention of an Independent Auditor

DEO proposes that the Commission retain an independent third-party financial auditor to support the Staff's review of future PIR Cost Recovery Charge applications.

The Company maintains that the independent auditor would allow the Staff to more efficiently review the Company's applications and would provide the Commission another layer of oversight. The Company suggests that the costs of the independent auditor would be rolled into the PIR Cost Recovery Charge.

The Staff recommends that the Commission reject the suggestion to retain an independent auditor. An independent auditor is not necessary and would add an unnecessary expense that would be passed onto customers.

Biennial Depreciation Studies

DEO recommends that it utilize its independent depreciation consultant to perform biennial assessment of the PIR-related plant every two years to determine whether the in-scope plant service lives have increased, thus warranting a reduction in the depreciation expense. If an assessment identifies differences between the actual and theoretical depreciation reserves for accounts due to longer service lives, then the Company will

reduce the depreciation expense by amortizing the difference over a ten-year period. The costs of the biennial assessments would be rolled into the PIR Cost Recovery Charge.

The Staff recommends that the Commission reject DEO's proposal for biennial depreciation assessments of its PIR-related assets. The benefit of such frequent assessments may outweighed by the costs. Additionally, the Staff does not support amortization of reserve imbalances in only one or a few accounts. When looking at amortizing reserve imbalance, it is the Staff's policy to look at all of a company's accounts because some accounts could be over-accrued while others could be under-accrued. Similarly, the Commission has not historically approved amortization for individual plant accounts unless the variance is due to an extraordinary retirement or a dying account.¹⁸

¹⁸ See Case No. 91-418-EL-AIR, *et al.*

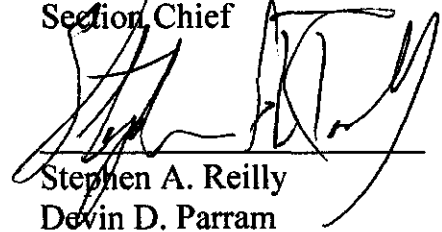
RECOMMENDATIONS TO THE COMMISSION

The Staff recommends that the Commission adopt all of the Staff recommendations contained herein and approve DEO's Motion as modified.

Respectfully submitted,

Michael DeWine
Ohio Attorney General

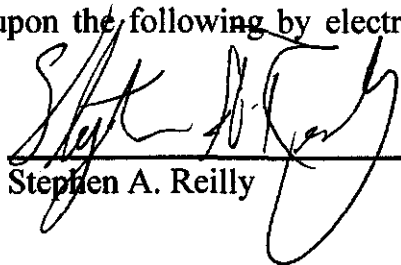
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CERTIFICATE OF SERVICE

I certify a copy of the foregoing was served upon the following by electronic mail on May 25, 2011.



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