BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio to Implement a Capital Expenditures Program.	))))	Case No. 11-6024-GA-UNC
In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Authority to Change Accounting Methods.	))))	Case No. 11-6025-GA-AAM

REPLY COMMENTS OF THE EAST OHIO GAS COMPANY D/B/A DOMINION EAST OHIO

I. INTRODUCTION

In accordance with the procedural entry of January 27, 2012, The East Ohio Gas Company d/b/a Dominion East Ohio ("DEO") now files its reply comments, first to Staff, then to the Office of the Ohio Consumers' Counsel ("OCC"). As made clear in these comments, both Staff and OCC seek to undermine the accounting treatment expressly provided in R.C. 4929.111. As such, their proposed conditions and limitations on deferrals and subsequent recovery of DEO's proposed capital expenditure ("CAPEX") program—if accepted by the Commission—would be unlawful and unreasonable.

II. REPLY TO STAFF COMMENTS

A. Incremental Revenue Associated with CAPEX Program Assets Must Be Properly Determined and Approved by the Commission in this Proceeding.

In its first comment, Staff states that DEO's "deferred regulatory asset should be net of any incremental revenue." (Staff Comments 7.) DEO is not opposed to this recommendation in principle, but (as Staff also recognizes) the key is correctly matching incremental revenue to the proposed capital expenditures.

DEO agrees that its last rate case provides the correct baseline to identify what revenue is incremental. But it disagrees that this issue needs to be settled at a later date or in a separate proceeding. Because the determination of incremental revenues will impact the amount of deferrals that DEO may be permitted to recognize on its books upon Commission approval in this case, DEO proposes that the methodology for determining incremental revenues should be approved by the Commission in this proceeding. Past experience shows that kicking the can down the road for resolution after an order has been issued is a poor idea and leads to disagreements that could have been avoided by resolving the issue up front. A possible methodology has been proposed in Case No. 11-5351-GA-UNC, regarding the capital expenditure program of Columbia Gas of Ohio. It makes sense that both proceedings before the Commission would include determination of an appropriate methodology in a reasonably consistent manner.

In determining incremental revenues associated with the CAPEX Program, there must be a direct and clear link between the calculation of the incremental revenues and the revenue-generating portion of the CAPEX Program. DEO's revenue streams are derived from a wide variety of sources and are affected by many factors that have no link to the CAPEX Program. The only portion of the CAPEX Program that may produce revenues are the new customer facilities located in the "Infrastructure Expansion, Improvement or Replacement" category. Accordingly, DEO proposes that comparing the number of bills relative to the test year in DEO's last rate case provides a reasonable basis for calculating incremental revenues. Most of the factors that affect customer usage—such as weather and economic activity—bear no relation to the CAPEX Program. Thus, calculating incremental revenues based on a volume comparison will not accurately reflect the amount attributable to the CAPEX Program.

The change in the number of customer bills should be multiplied by the portion of the monthly customer charge directly attributable to CAPEX Program costs. Under straight fixed variable ("SFV") rates, the monthly customer charge recovers both capital-related costs (i.e., property tax, depreciation and return on rate base) as well as operating expenses. Since capital expenditure programs under R.C. 4929.111 do not involve deferrals of non-capital costs, those costs must be removed from the portion of the monthly customer charge used to calculate incremental revenues attributable to the CAPEX Program. In order to determine the portion of the monthly service charge that should be treated as incremental revenue, the class cost of service study underlying DEO's existing rates can be used to separate the CAPEX Program portion (i.e., depreciation, property tax, and the return on rate base attributable to a post-in-service carrying costs ("PISCC") accrual) from the remainder of the rate. Only this portion should be used to determine incremental revenues. To do otherwise would violate the "matching principle" that Staff cites in its comments.

B. Monthly Deferred Post-In-Service Carrying Costs Should Not Be Calculated on Plant Balances Net of Retirements or Accumulated Depreciation.

In Staff Comment B, Staff recommends that the PISCC calculation should be based on plant balances net of accumulated depreciation, retirements, and the cost of removal of existing plant. (Staff Comments 9.) OCC makes a similar comment. (OCC Comments 8.) DEO proposes to calculate PISCC based on accumulated gross plant balances less costs of removal, consistent with the calculations of PISCC in its Pipeline Infrastructure Replacement ("PIR") Program and Automated Meter Reading ("AMR") Program. DEO, however, does not agree that PISCC should be calculated net of retirements and accumulated depreciation.

First, this approach is foreclosed by law. If the Commission approves an application, R.C. 4929.111(D) requires it to authorize deferral or recovery of both PISCC *and* depreciation:

> (D) In approving an application under division (C) of this section, the commission *shall* authorize the natural gas company to defer or recover in an application that the natural gas company may file under section 4909.18, 4929.05, or 4929.11 of the Revised Code, *both* of the following:
>
> (1) A regulatory asset for the post-in-service carrying costs on that portion of the assets of the capital expenditure program that are placed in service but not reflected in rates as plant in service;
>
> (2) A regulatory asset for the incremental depreciation directly attributable to the capital expenditure program and the property tax expense directly attributable to the capital expenditure program.

(Emphases added.) Far from suggesting that DEO's PISCC should be offset by depreciation, the statute requires recovery of both. Staff's recommendation is inconsistent with R.C. 4929.111 and on that basis alone should be rejected.

Staff also suggests that applying PISCC to gross plant balances is inconsistent with past practices and Commission rulings on this topic. Staff cites in support a single case from roughly twenty years ago, but more recent Commission rulings have gone the other way: the PISCC calculations approved in DEO's AMR and PIR cost-recovery filings do not reduce the plant balance by retirements or accumulated depreciation. *See* Case No. 11-3238-GA-RDR, Replacement Sched. 6 (Sept. 15, 2011) (PISCC calculation in PIR case; no reduction for retirements or accumulated depreciation); Case No. 10-2853-GA-RDR, Application, Ex. A Sched. 4 (Nov. 30, 2010) (PISCC calculation AMR case; no reduction for retirements or accumulated depreciation). The same goes for Columbia Gas of Ohio. *See* Case No. 10-2353-GA-RDR, Jt. Stip., Att. 2, Sch. AMRP-1.

Since the Commission has now approved cost-recovery adjustments reflecting DEO's proposed PISCC accrual methodology in multiple applications affecting multiple companies, the Commission has plainly adopted a different approach than that contained in Case No. 92-555-GA-AAM. Contrary to Staff's suggestion, the four-page entry in that case was not a path-

marking decision. But even if it were, R.C. 4929.111 has been enacted since then, speaks directly to this issue, and must be heeded.

Finally, this recommendation fails to account for the nature of the underlying expense. PISCC is permitted at DEO's cost of long-term debt. R.C. 4929.111(G)(2). As that provision suggests, PISCC represents the cost of financing DEO's capital expenditures until the resulting assets are included in rate base. True, once placed in service, newly purchased assets begin to depreciate, and older assets are retired. But that does not diminish the significant cost to DEO of new capital investments. Although Staff claims that PISCC will be applied to "inflated" plant balances, that is not the case. The cost of capital depends on DEO's outlay of capital—that is, gross plant additions—and depreciation and retirements do not reduce that cost.

DEO should be allowed to recognize PISCC on its new capital investments under the CAPEX Program, net of costs of removal, that are not incorporated into rate base.

C. Depreciation Expense Deferrals Should Be Calculated Net of Retirements.

DEO does not disagree with Staff Comment C. It may be, however, that there is some misunderstanding of DEO's discovery responses regarding estimated deferrals for the CAPEX Program and the planned methodology for calculating PISCC, depreciation, and property taxes. Staff Data Request No. 1 requested an estimate of the deferrals the company will make for each of the budget categories included on Exhibit A of DEO's application, and Staff Data Request No. 2 requested DEO to show its "methods and/or formulas for calculating and recording each entry for deferral."

In response to both requests, DEO provided a file with schedules set up in a manner similar to the filing schedules submitted for its annual PIR and AMR cost-recovery filings. The language of DEO's response to Staff Data Request No. 2 specifically states, "The calculations of PISCC, depreciation and property tax are consistent with those used in the filings under DEO's

PIR and AMR programs." Confusion may have occurred, however, because while DEO did provide the requested calculations, those calculations were based on gross plant values assuming "the assets placed in service are equal to the planned CAPEX Plan expenditures" and did not include projections of the associated retirements and costs of removal because such projections were not available.

In order to provide clarity regarding DEO's discovery responses, DEO specifically states that consistent with the PIR program calculations:

a) PISCC will be calculated based on the long-term debt rate of 6.5% applied to the prior month's ending balance of accumulated gross capital additions net of cost of removal;

b) Depreciation will be calculated based on applicable asset category depreciation rates applied to each month's ending balance of accumulated gross capital additions net of cost of removal;

c) Property taxes will be calculated using an appropriate effective tax rate applied to accumulated gross capital additions net of cost of removal and retirements.

If required, DEO will also net retirements against the accumulated plant balances on which depreciation deferrals under the CAPEX Program are calculated, as recommended by Staff. In accordance with R.C. 4929.111, deferrals will commence when the associated assets are placed in service and will cease when such assets are reflected in base rates.

D. The Duration of CAPEX Program Deferrals Is Established by R.C. 4929.111.

In Staff Comment D, Staff asserts that the "program deferral should have a time limit," to be established by the Commission as a fixed date. (Staff Comments 10–11.) OCC makes a similar comment. (*See* OCC Comments 11.) DEO is willing to agree to a filing schedule to resolve this issue. But it does not concede that this is required by law; in fact, R.C. 4929.111 speaks to this issue in two places, and it rules out the absolute time limits recommended by Staff and OCC.

First, the statute directly addresses *when* deferrals must cease. "Any accruals for deferral or recovery under division (D) of this section . . . shall cease when rates reflecting the cost of those assets are effective." R.C. 4929.111(H). The statute uses mandatory language ("shall") to require that deferrals cease upon the occurrence of a particular event ("when rates reflecting the cost of those assets are effective"), not after a given period of time or by a certain date. This specific, mandatory provision rules out the absolute expiration date that Staff and OCC recommend. "[T]he express inclusion of one thing implies the exclusion of the other." *Myers v. Toledo*, 110 Ohio St.3d 218, 2006 Ohio 4353, 852 N.E.2d 1176, ¶ 24. Staff's recommendation in this area undermines one of the key benefits of House Bill No. 95, which gave rise to R.C. 4929.111, in that it would require more frequent rate adjustments rather than fewer. The General Assembly could have imposed an absolute expiration period or date on deferrals, or it could have left it up to the Commission to establish such a date. But it did neither, and that legislative choice should be respected.

Second, division (E) of the statute imposes a *maximum* frequency of filing for cost recovery—no more than once per year—but it imposes no *minimum* frequency. *See id.* (company "shall not request recovery of . . . costs . . . more than one time each calendar year"). The legislature plainly considered the frequency at which recovery filings may be made, yet did not see fit to impose a minimum. As before, this legislative choice must be respected.

These provisions together rule out Staff and OCC's recommendation that deferrals expire on a specific date. Nevertheless, DEO is not opposed to seeking recovery of the deferrals under the CAPEX Program on an agreed-upon schedule, thereby ceasing continuation of deferrals for the associated assets, provided (1) that recovery includes the full pre-tax return on rate base associated with the CAPEX Plan assets and (2) that approval of the cost recovery mechanism is

not required to be sought in conjunction with a full rate case. (DEO addresses the latter issue below in its response to OCC Comments, *infra* III.A.3).)

Staff's recommendation comes after it cites a list of various riders approved for gas companies and expresses concern about the length of time between CAPEX deferrals and their recovery because those riders help companies stay out of rate cases. While a requirement for more frequent rate cases might enhance job security for the legions of people involved in the ratemaking process, it would do nothing to increase customer satisfaction with utility service. Needless to say, DEO has yet to hear customers clamoring for even more rate cases and rider adjustments. Perhaps Staff, like OCC, is concerned about the magnitude of the cumulative deferrals and their potential impact on customer rates once recovery is addressed in a future proceeding. If so, that concern is largely mitigated by the fact that, in cases such as those involving DEO's PIR and AMR programs, those deferred expenses are amortized over the life of the assets, not over the course of a single year. Furthermore, if a company were to file a rate case to recover those regulatory assets, the rate of return on the investments reverts to a full rate of return including equity rather than the debt-only PISCC permitted under R.C. 4929.111. Thus, not only would Staff's recommendation require more frequent rate adjustments, it would lead to even higher rates at the time of those adjustments. Thus, Staff's recommendation for prompt recovery of the deferrals sought in this application is as unreasonable as it is unlawful.

E. More Time Should Be Allowed for the Annual Informational Filings.

In its final comment, Staff states that DEO should make "annual informational filings detailing the CAPEX Program investment deferrals recorded on its books." (Staff Comments 12–13.) DEO is willing to make such filings. It would request, however, that the filing date be April 30, not March 15, to avoid a bottleneck with the annual PIR and AMR filings. This

additional time window would eliminate the practical difficulties arising from making three filings at the same time, but would not deprive Staff of timely information.

Staff also states that "a capital budget for the upcoming year should also be provided." (*Id*. at 13.) DEO intends to file this budget in the fourth quarter of the *preceding* year in conjunction with future CAPEX filings submitted pursuant to R.C. 4929.111.

III. REPLY TO OCC COMMENTS

A. Response to OCC General Comments.

1. DEO Did Not File Its Application as an "Alternative Regulation" Case.

In the first page of its comments, OCC states that DEO's application "was filed as an Alternative Regulation case." That is not true. DEO filed its application "[p]ursuant to R.C. 4909.18" as an application "not for an increase in rates." (Appl. 2.) R.C. 4929.05 permits "alternative rate plans," and it is one of the statutory filing options under R.C. 4929.111(D). It is unclear what exactly OCC means by "Alternative Regulation case," but DEO neither filed under R.C. 4929.05 nor characterized its application the way OCC does. To the degree OCC's comments suggest the contrary, they misstate the facts and should be disregarded.

2. OCC Provides No Reason to Reject DEO's Application.

One of OCC's comments is that DEO's application should simply be rejected. But it provides no good reason why.

OCC's problem at bottom is that DEO has not provided a detailed and itemized accounting of capital expenses. The statute, in fact, speaks to this issue, and it does not support OCC. Two provisions of the statute show that the detailed, itemized accounting sought by OCC is not what the law requires. First, DEO must "specify the total cost," R.C. 4929.111(B), and show that the "program"—not each and every proposed expenditure—is just and reasonable, R.C. 4929.111(C). DEO made these showings, and the detailed, predictive itemization sought by

OCC is not a condition of granting DEO deferral authority. The General Assembly certainly could have required detailed program descriptions down to the cent, but it did not, and that legislative choice must be respected.

And contrary to OCC's arguments, DEO has specified the total cost of the program (*see* Appl. Ex. A), and demonstrated that its program would support the provision of just and reasonable service, (Appl. 2–5). OCC alleges only one instance in which detail is lacking: expenditures relating to information technology. But DEO provided more than enough detail at this stage of the proceeding. The General Assembly specifically and broadly authorized deferral and recovery of expenses related to "*[a]ny* program to install, upgrade, or replace information technology systems." R.C. 4929.111(A)(2) (emphasis added). DEO explained that its program included "capital expenditures for upgrades to or replacements of computer systems utilized for accounting, billing, and utility operations, as well as communication systems." (Appl. 3.) All of these expenses pertain directly to serving customers and will allow DEO to continue to provide service at the level required by law. DEO provided more than enough detail to satisfy the requirements of R.C. 4929.111.

OCC's complaints about any lack of detail—besides failing to show any violation of law—are beside the point. Now is not the time to review DEO's actual expenditures, because they have not been made. Contrary to OCC's apparent misunderstanding, DEO's application does not seek cost recovery, but deferral authority. (Appl. 4.) This, of course, is permitted under R.C. 4929.111(D). *See id*. (applications may "defer *or* recover" costs related to capital expenditures) (emphasis added). And DEO proposed in its application that "[r]ecovery . . . will be addressed in a separate proceeding." (Appl. 5.) That means customers will not pay a single

cent related to any program expenditures until the Commission examines them in a future proceeding.

Staff recognized this point, and stated that it would "investigate and recommend any necessary adjustments to the deferral when DEO applies to recover the deferred asset." (Staff Comments 7.) OCC also seems to recognize this at points. (*See, e.g.*, OCC Comments 3 ("final determination as to the used and useful nature of the CAPEX capital spending will not be made until some future rate case").) Nevertheless, it does not recognize that this fact precludes its concerns. Were DEO seeking to come out of this proceeding with $95 million in cost recovery, OCC might have a point. But DEO is not, and OCC does not.

Finally, even if any information were missing from DEO's application, the solution would be to supplement, not reject, the application. As already discussed, however, OCC has not shown this to be the case. The Commission should disregard these comments.

3. DEO's Later Cost-Recovery Options Are Not Limited to Rate Cases under R.C. 4909.18.

Several of OCC's comments suggest that the only way DEO may recoup deferred expenses is through "a rate case." (OCC Comments 3, 5, 7.) If OCC is using the phrase "rate case" simply as shorthand for a cost-recovery proceeding permitted by R.C. 4929.111, then there is no problem. But if OCC means to limit DEO to a proceeding to increase rates under R.C. 4909.18, then OCC is wrong.

When the time comes to seek cost recovery, DEO has options besides R.C. 4909.18. The statute expressly states that "the natural gas company may file under section 4909.18, 4929.05, or 4929.11" to recover program costs. R.C. 4929.111(D). The statute places the choice of recovery mechanism with the company. And two of the options—alternative rate regulation or an automatic adjustment mechanism—are not rate-increase proceedings under R.C. 4909.18.

Indeed, requiring a full rate case would defeat the basic purpose of R.C. 4929.111. As described by Jeffrey A. Murphy is his testimony on House Bill 95 before the Senate Energy and Public Utilities Committee on May 11, 2011, "One of the most obvious benefits [of House Bill 95] is fewer rate cases." Mr. Murphy also points out that House Bill 95 would allow gas companies to seek approval for an alternative rate plan without going through an entire rate case. Eliminating the ability to recover deferred CAPEX costs outside of a full rate case would not only violate the law, but it would reduce gas companies' incentive to invest more in Ohio.

B. Incremental Revenue Issues Are Addressed in the Reply to Staff.

Regarding OCC Comment A, DEO addressed issues regarding incremental revenue that may arise from capital expenditures in its response to Staff's comment, and that discussion pertains here, too.

C. DEO Should Not Be Held to a Strict Retirement Program.

Regarding OCC Comment B, DEO agrees with the position set forth in OCC's heading, namely, that "Post-In-Service Carrying Charges . . . Should be Applied to Gross Plant Balances." (OCC Comments 8.) Based on the comments submitted after that heading, DEO suspects that OCC intended to include the word "not" somewhere in that heading. To the extent OCC holds the opposite of its heading—that PISCC should *not* apply to gross plant balances—DEO disagrees for the reasons stated in response to Staff Comment B.

OCC also recommends that DEO "should be required to adhere to a strict retirement program." (OCC Comments 9.) OCC does not spell out what this means, which is grounds alone for disregarding the comment, as it deprives DEO of a fair opportunity to respond. In any event, plant should be retired in the normal course of business, as warranted by actual conditions and service needs, and not whenever necessary to achieve the accounting results that OCC may desire.

D. DEO's Application Made Clear that CAPEX, PIR, and AMR Costs Would Be Kept Separate.

In Comment C, OCC suggests that "there is no indication" that certain plant items "are not included in both" DEO's CAPEX Program and either the PIR or the AMR program. (OCC Comments 9.) That is not true. DEO specifically stated in its application that it sought authority to defer only those expenditures "not covered by DEO's Automated Meter Reading and Pipeline Infrastructure Replacement programs." (Appl. 2.) DEO already has mechanisms in place to ensure that expenditures are kept in the proper baskets.

That being the case, OCC's concerns regarding double recovery have been fully addressed in the application.

E. OCC's Comment Regarding Blanket Work Orders Is Nothing More than Groundless Speculation.

OCC's Comment D amounts to the following: DEO uses blanket work orders; therefore, DEO might ("[t]he potential exists") miscategorize certain expenses. (OCC Comments 10.) Then it asks the Commission to "exclude these items"—that is, items potentially miscategorized in the future—from the application. (*Id*.)

DEO agrees that it should properly categorize expenditures; it has ample procedures and experienced personnel in place to ensure that it does so; and whether it has done so will surely be a topic explored in the later cost-recovery proceeding. (On this score, it bears noting that the auditor who reviewed DEO's blanket-work-order process in DEO's last rate case did not raise any concerns of the nature described by OCC. *See* Case No. 07-829-GA-AIR, Blue Ridge Consulting Rep. 83–84 (May 23, 2008).) OCC's comment amounts to mere speculation and identifies no problem with the application. It is impossible to do what OCC asks and exclude items miscategorized in the future. This comment should be disregarded.

F. R.C. 4929.111 Speaks for Itself, and OCC's Paraphrase Is Unnecessary.

In Comment E, OCC argues that deferrals should not begin until certain requirements are satisfied—it is essentially paraphrasing the statute without actually addressing DEO's application. (OCC Comments 10.) First, what standards must be satisfied is addressed by R.C. 4929.111, and OCC cannot add to or subtract from those requirements. OCC does not actually complain in this comment that anything in DEO's application violates the law, but simply paraphrases the statute in the abstract. DEO fails to see the point of that exercise; the law speaks for itself.

And regardless, this is yet another matter that cannot be addressed until later. DEO cannot make any of the requested deferrals until it receives authority from the Commission. Whether DEO implements that authority properly can be determined after the fact, most likely in the cost-recovery proceeding.

G. R.C. 4929.111 Does Not Impose a Time Limit on Deferrals.

In OCC's final comment (F), it states that deferrals "must have some time limit," and suggests they should "cease when the costs are reflected in rates or by December 31, 2016." (OCC Comments 11 (capitalization omitted).) OCC is wrong for the reasons stated in DEO's reply to Staff Comment D.

IV. CONCLUSION

In conclusion, DEO respectfully requests that the Commission grant DEO's application in accordance with DEO's comments and disregard those comments of OCC and Staff that would undermine the accounting treatment required by R.C. 4929.111.

Dated: March 22, 2012

Respectfully submitted,

/s/ Andrew J. Campbell

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CERTIFICATE OF SERVICE

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This foregoing document was electronically filed with the Public Utilities

Commission of Ohio Docketing Information System on

3/22/2012 4:11:14 PM

in

Case No(s). 11-6024-GA-UNC, 11-6025-GA-AAM

Summary: Reply Comments of The East Ohio Gas Company d/b/a Dominion East Ohio electronically filed by Ms. Melissa L. Thompson on behalf of Andrew J. Campbell