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(14)

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. to Implement a Capital Expenditure Program.	:	Case No. 12-530-GA-UNC
In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Authority to Change Accounting Methods.	:	Case No. 12-531-GA-AAM

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

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INTRODUCTION AND BACKGROUND

On February 3, 2012, Vectren Energy Delivery of Ohio, Inc. (VEDO or Company) filed an Application in the above captioned cases seeking authority from the Public Utilities Commission of Ohio (Commission) to implement a capital expenditure program (CAPEX Program) and to modify its accounting procedures to provide for: (1) capital-ization of post-in-service carrying costs (PISCC) on those assets of the CAPEX Program that are placed into service but not reflected in the Company's rates as plant in service; (2) deferral of depreciation expense and property taxes directly attributable to the CAPEX Program assets that are placed into service; and (3) creation of a regulatory asset to defer the PISCC, depreciation expense, and property tax expense for recovery in a future proceeding.[1]

VEDO filed its Application pursuant to sections of recently enacted Amended Substitute House Bill 95 (HB95) as codified in Chapter 49 of the Ohio Revised Code. Specifically, R.C. 4929.111(A) provides that a natural gas company may file an application with the Commission under R.C. 4909.18, 4929.05, or 4929.11 to implement a CAPEX Program for any of the following:

> 1. Any infrastructure expansion, infrastructure improvement, or infrastructure replacement program;
>
> 2. Any program to install, upgrade, or replace information technology systems;
>
> 3. Any program reasonably necessary to comply with any rules, regulations, or orders of the Commission or other governmental entity having jurisdiction.

R.C. 4929.111(C) provides that the Commission shall approve a natural gas company's application for a CAPEX Program if the Commission finds that the CAPEX Program is consistent with the natural gas company's obligation to furnish necessary and adequate services and facilities under R.C. 4905.22 and that the services and facilities are just and reasonable. Further, R.C. 4929.111(D) provides that, in approving an application for a CAPEX Program under Division (C), the Commission shall authorize the natural gas company to create regulatory assets for PISCC on that portion of the CAPEX Pro-

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1 *In the Matter of the Application of Vectren Energy Delivery of Ohio to Implement a Capital Expenditure Program and for Authority to Change Accounting Methods*, Case No. 12-530-GA-UNC, *et al.* (Application at 1) (February 3, 2012) (*VEDO Application*).

gram assets that are placed into service but not reflected in base rates as plant-in-service and for incremental depreciation and property tax expense directly attributable to the CAPEX Program for recovery or deferral for future recovery in an application pursuant to R.C. 4909.18, 4905.05, or 4929.11. R.C. 4929.111(F) authorizes the natural gas company to make any accounting accruals necessary to establish the regulatory assets authorized under R.C. 4929.111(D) in addition to any allowance for funds used during construction (AFUDC). And, lastly, R.C. 4929.111(G) provides that any accrual for deferral or recovery under R.C. 4929.111(D) shall be calculated in accordance with the system of accounts established by the Commission under R.C. 4905.13.

On March 5, 2012, the Attorney Examiner assigned to these cases issued an Entry setting a procedural schedule for comments on VEDO's Application as follows:

- April 9, 2012 – Deadline for filing of motions to intervene;
- April 16, 2012 – Deadline for the filing of comments on the Application by Staff and interveners; and,
- April 27, 2012 – Deadline for all parties to file reply comments.

VEDO'S APPLICATION AND PROPOSED DEFERRALS

In its Application, VEDO proposes a CAPEX Program covering the period October 1, 2011 through December 31, 2012 and totaling an estimated $24.9 million.[2] VEDO states that the capital spending under the CAPEX Program specifically excludes

2 *VEDO Application* at Exhibit A.

capital expenditures associated with non-jurisdictional services or its Distribution Replacement Rider.[3] It also breaks down the CAPEX Program expenditures into three broad categories: (1) "Infrastructure Expansion"; (2) "Infrastructure Improvement and Replacement"; and (3) "Programs Reasonably Necessary to Comply with Commission Rules, Regulations or Orders."[4] The three categories and their estimated annual amounts are shown below in Table 1.

Table 1 – VEDO's Estimate of Annual CAPEX Program Spending by Category[5] ($Millions)

CAPEX Program Category	10/1 – 12/31/2011 Est.	2012 Est.
Infrastructure Expansion	0.6	5.7
Infrastructure Improvement and Replacement	4.5	11.0
Programs Reasonably Necessary to Comply with Commission Rules, Regulations or Orders	0.4	2.7
Total CAPEX Program Capital Spending	5.5	19.4

The Company further describes the three CAPEX Program categories as follows:

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3 *VEDO Application* at 2.

4 *Id.* at 2-3.

5 *Id.* at Exhibit A

- **Infrastructure Expansion, Improvement or Replacement** – includes capital expenditures for main line extensions to serve new customers, main-to-meter service line installations, meter installations, and compressed natural gas stations.[6]
- **Infrastructure Improvement and Replacement** – includes capital expenditures for distribution system betterments that are not covered by VEDO's Distribution Replacement Rider including pipeline, service line, regulating station, and integrity management improvements or replacements and non-billable pipeline relocations associated with the Company's distribution and transmission systems.[7]
- **Programs Reasonably Necessary to Comply with Commission Rules, Regulations or Orders** – includes capital expenditures for investments in buildings, fleet, tools and equipment, and metering and instrumentation.[8]

The Company states that the CAPEX Program is consistent with its obligation to furnish necessary and adequate service and facilities pursuant to R.C. 4905.22.[9]

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6 *VEDO Application* at 2.

7 *Id.* at 2-3.

8 *Id.* at 3.

9 *Id.*

STAFF'S REVIEW

The Staff has reviewed VEDO's Application, proposed CAPEX Program, and request to create a regulatory asset to defer for future recovery PISCC, depreciation expense, and property tax expense directly attributable to the CAPEX Program investments. The purpose of the Staff's review was to determine if, in the Staff's opinion, the proposed CAPEX Program and associated deferrals meet the just and reasonable standards established in R.C. 4929.111 and generally comport with sound ratemaking principals regarding deferring costs for potential future recovery by regulated utilities. It is important to note that, in these Comments, the Staff is taking no position on the level or prudence of the capital spending proposed in VEDO's CAPEX Program. However, the Staff's lack of comments or objection to the proposed CAPEX Program investments should in no way be construed as the Staff's lack of objection or support for future recovery of the investments or related deferred amounts. In fact, the Staff will investigate and recommend any necessary adjustments to the deferral when VEDO applies to recover the deferred asset.

To accomplish its review, the Staff reviewed VEDO's Application, issued formal information requests, requested supplemental or clarifying information, when needed, and conducted teleconferences with appropriate Company personnel.

STAFF'S COMMENTS AND RECOMMENDATIONS

Based on its review, the Staff makes the following comments and recommendations to VEDO's proposed CAPEX Program and regulatory asset for deferral of the PISCC depreciation, and property taxes associated with the CAPEX Program. The Staff's comments and recommendations by topic are set forth below.

A. The deferred regulatory asset should be net of any incremental revenue.

VEDO's proposed CAPEX Program investments could generate revenue that is incremental to the revenue provided by the rates that were set in its last base rate case, Case No. 07-1080-GA-AIR (2007 Rate Case). However, the Company's proposal for the CAPEX Program and related deferral of PISCC and depreciation and property tax expenses does not include a provision for recognizing potential incremental revenue. The accounting and ratemaking principle known as the "matching principle" suggests that expenses and related revenues should be recorded on a company's books in the same time period. VEDO is proposing to defer on its books (*i.e.*, carry forward) certain expenses associated with the CAPEX Program for future recovery, thus any related incremental revenue for the same time period should be recognized and brought forward as well. The Staff recommends that the Commission direct VEDO to net out any incremental revenue from its monthly calculation of the regulatory asset that will be created to defer PISCC, depreciation expense, and property tax expense related to the CAPEX Program.

B. The deferred PISCC should be applied to net plant rather than gross plant.

In response to a Staff Data Request No. 2, VEDO described the formula it proposes to use to calculate the PISCC that will apply to the CAPEX Program investments and be deferred via the regulatory asset created.[10] The proposed formula calls for applying the PISCC to gross plant additions that have not been adjusted to net out accumulated depreciation or the retirement or cost of removal of existing plant. The Company's proposal will result in PISCC being applied to inflated plant balances and deferral of inflated PISCC amounts and is inconsistent with past practice and Commission rulings on this topic.[11] The Staff recommends that the Commission direct VEDO to modify its proposed PISCC calculation to net out accumulated depreciation and retirement and the cost of removal of existing plant.

C. VEDO's calculation of the depreciation expense is properly formulated to be net of plant retirements.

In response to a Staff Data Request No. 2, VEDO describes its proposed methodology for calculating the depreciation expense that will be deferred. Unlike proposals by other natural gas companies in CAPEX program applications, VEDO's pro-

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10 VEDO Response to Staff Data Request No. 2 at 1 (March 2, 2012).

11 See *In the Matter of the East Ohio Gas Company Application for Authority to Modify Its Accounting Procedures to Accumulate Post In-Service Carrying Charges and to Defer and Subsequently Amortize Depreciation and Other Expenses Associated with the Protection of Gas Pipelines*, Case No. 92-555-GA-AAM (Entry at 2-3) (April 30, 1992). In this Entry the Commission authorized East Ohio to create the requested deferrals with PISCC "net of retirements and deferred costs normally expensed …" (*e.g.*, depreciation).

posed depreciation expense calculation properly subtracts the plant retirements from each month's gross plant additions prior to applying the applicable depreciation rate. Other natural gas companies have argued that the depreciation expense should be calculated on gross plant rather than plant that is net of plant retirements. However, VEDO's approach is correct and the depreciation expense calculation should be net of retirements.

D. The CAPEX program deferral should have a time limit.

With the Company's Distribution Replacement Rider and other riders in place at the same time as the base rates set in its last base rate case that were designed to recover its fixed and variable costs for providing natural gas service, there is a potential for a protracted period of time between when VEDO creates CAPEX Program deferrals and when it ultimately seeks recovery of the deferred assets in a future rate proceeding. The Staff is concerned that over a protracted period of time the deferrals created under the CAPEX Program could grow to unreasonable levels that could cause rate shock for customers when VEDO seeks recovery of the deferred assets at some point in the future. Therefore, the Staff recommends that the Commission set a deadline by which VEDO must apply for recovery of the deferred assets under one of the recovery methods established by R.C. 4909.18, 4905.05, or 4929.11 or the deferral authority would cease. The Staff further recommends that the deadline for Vectren to apply for recovery of the deferred assets should be December 31, 2014.

E. VEDO should be required to make annual informational filings.

The Staff also recommends that the Commission should direct the Company to make annual informational filings detailing the CAPEX Program investment deferrals recorded on its books. As noted above, there could potentially be protracted periods of time between when the regulatory asset to defer the CAPEX Program PISCC and expenses are created and when VEDO makes an application to recover the deferred amount. This could result in the deferral accumulating to significant amounts that could substantially increase the rates that customers will pay when the Company ultimately seeks to recover the deferral. The Staff proposes that the annual filing should detail the monthly CAPEX capital investments and the calculation used to determine the deferred amounts to be recorded. Specifically, the Company should provide a breakdown of investments, PISCC, depreciation expense, property tax expense, and incremental revenue for each "Expenditure Program Category" listed on Exhibit A of the Company's application in this case. Further, the breakdown should be based on the calendar year and filed on March 15th of the succeeding year. In addition to the calculations, a capital budget for the upcoming year should also be provided.

CONCLUSION

The Staff has reviewed VEDO's Application in these cases for authority to create a CAPEX Program and a related regulatory asset to defer for future recovery associated PISCC and depreciation and property tax expenses. And, with adoption of the Staff's recommendations for modifying the calculation of the regulatory asset and annual informational filings detailed above, the Staff respectfully recommends that the Commission approve VEDO's Application.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing **Comments** submitted on behalf of the Staff of the Public Utilities Commission of Ohio was served by electronic mail upon the following parties of record, this 16th day of April, 2012.

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