**BEFORE**
**THE PUBLIC UTILITIES COMMISSION OF OHIO**

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| In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Gas Rates | ) ) | Case No. 12-1685-GA-AIR |
| In the Matter of the Application of Duke Energy Ohio, Inc. for Tariff Approval | ) ) | Case No. 12-1686-GA-ATA |
| In the Matter of the Application of Duke Energy Ohio, Inc. for Approval of an Alternative Rate Plan for Gas Distribution Service | ) ) ) | Case No.12-1687-GA-ALT |
| In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods | ) ) ) | Case No.12-1688-GA-AAM |

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# REPLY BRIEF OF THE GREATER CINCINNATI HEALTH COUNCIL AND CINCINNATI BELL TELEPHONE COMPANY

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On June 6, 2012, Initial Briefs were filed by the Greater Cincinnati Health Council and Cincinnati Bell ("GCHC/CBT"), Duke Energy Ohio ("Duke"), the Staff of the Public Utilities Commission of Ohio ("Staff"), the Ohio Consumers' Counsel and Ohio Partners for Affordable Energy ("OCC/OPAE"), and The Kroger Company ("Kroger"). In addition, Columbia Gas of Ohio, Inc. ("Columbia Gas") filed a motion for leave to file an amicus brief. The Greater Cincinnati Health Council ("GCHC") and Cincinnati Bell Telephone Company ("CBT") will briefly respond to a few points made by Duke and Columbia Gas. Otherwise, GCHC and CBT generally agree with the positions advocated by Staff, OCC/OPAE and Kroger and will not respond to those briefs.

## I. Duke Has Not Shown Its MGP Expenses Were Incurred For the Provision of Gas Distribution Service During the Test Year.

Duke takes the position that it is entitled to the recovery of all amounts that it has spent for investigation and remedial work on the two MGP sites in question under the ratemaking formula established by Revised Code § 4909.15 because the expenses are a part of its "cost of doing business."[1] But the statute does not permit rates to recover the "cost of doing business" – what it authorizes is recovery of the cost of *providing utility service* during the test year.

As GCHC/CBT pointed out in their Initial Brief, the MGP expenses incurred by Duke are not the result of its provision of utility service during the test year but, rather, are the result of having provided MGP service in the distant past. Duke acknowledges that MGP production ceased at the West End site in 1928 and at the East End site in 1963. It would have environmental liability for those sites regardless of whether it was currently in the natural gas distribution business by virtue of past ownership and operation of the sites. Duke's liability has nothing to do whatsoever with the fact that is currently in the natural gas distribution business. Staff justified allowing approximately $6 million in MGP expenses because they happened to have been spent around property that is used and useful for natural gas service. However, that is a mere coincidence that current gas distribution facilities happened to be located on a portion of the property that was remediated. The contamination was not caused by those existing facilities, nor was the remediation work done because of those facilities. Thus, the causal and temporal connection required by R.C. § 4909.15(A)(4) between the reason for the expenses and the service to which they relate is missing. The MGP expenses are not recoverable under the ratemaking formula.

[1] Duke Brief at 4-5.

With respect to the West End site, Duke seeks recovery for cleanup of property that is being used for electrical service. There were no current gas distribution facilities in the areas of the West End site that have been remediated,[2] which primarily houses electrical equipment such as transmission towers and substations.[3] To allow recovery of those electric expenses in a gas distribution case would be an unlawful cross-subsidy. It is ironic that Duke would advocate such a cross-subsidy, when it has been so adamant in its generation capacity case[4] that only jurisdictional services may be considered in establishing rates.[5] As Mr. Wathen testified in the capacity case: "The Company's provision of natural gas service has, for decades, been functionally separate from its electric business."[6] "[Duke] is required under the Commission rules to segregate, as part of its filing, the rate base and expenses associated with the service at issue. Consequently, when the Commission reviews the application for such an increase in base rates, the Commission is only considering the costs of providing the service at issue."[7]

## II. Decisions From Other Jurisdictions Are Not Determinative Under Ohio Law.

Duke cites several cases from other jurisdictions where state utility commissions allowed gas utilities to recover MGP remediation costs. However, none of those cases was decided in Ohio and none of them was based upon the Ohio ratemaking statute that requires that the expenses be attributable to gas service provided during the test period to be recoverable in gas rates. Duke has not provided any specific statutory language relied upon by other state

[2] Tr. 448-49, 453-54, 458.
[3] Tr. 419-27.
[4] Case No. 12-2400-EL-AIR.
[5] *See* Rebuttal Testimony of William Don Wathen, Jr. at pp.5-9 (filed May 13, 2013) ("common sense, simple fairness, and traditional ratemaking principles confirm that it is improper to commingle the activities of jurisdictional and nonjurisdictional entities and services.") (p. 5). Property used for electric service is non-jurisdictional. And, Duke's pre-1911 predecessor company that contaminated the MGP sites was a non-jurisdictional entity.
[6] *Id.,* p. 6.
[7] *Id.,* p. 8.

commissions to authorize recovery of MGP expenses in those jurisdictions. It should not be assumed that those jurisdictions would have authorized recovery of MGP expenses if they had to apply the Ohio statute.

Furthermore, if decisions from other states are to be considered, Duke has totally ignored the fact that the neighboring state of Indiana has rejected the recovery of MGP remediation costs for past contamination. The Indiana Utility Regulatory Commission rejected an application by Indiana Gas to recovery MGP remediation costs it spent at numerous sites in Indiana.[8] Indiana Gas incurred these costs because it owned the land, not because it was a public utility.[9] The IURC found that environmental regulations regarding hazardous waste were not utility-specific, but pertain to owners of land upon which the wastes are found and previous owners in the chain of title.[10] Since the cleanup activities did not result in the provision of current service, Indiana Gas could not assign the liability to ratepayers.[11] Even though the IURC largely sided with the utility on the issue of whether remediation expenses were prudent, it still found the costs non-recoverable from ratepayers because "these costs do not create the provision of gas service to current customers."[12] This is essentially the same legal standard as R.C. § 4909.15(A)(4).

The Indiana Court of Appeals affirmed the IURC's denial of MGP cost recovery.[13] The court agreed that for operating expenses to be recovered through rates, the expenses must have a connection to the service rendered, but the cleanup costs associated with the MGP sites had no

[8] *Petition of Indiana Gas Company, Inc., et al.,* Cause No. 39353 (May 3, 1995) ("*Indiana Gas*").
[9] *Indiana Gas at 45.*
[10] *Id.* at 51.
[11] *Id.* at 46.
[12] *Id.* at 51.
[13] *Indiana Gas Co., Inc. v. Office of Utility Consumer Counsel*, 1997 Ind. App. LEXIS 12, 675 N.E.2d 739 (1997).

connection to service rendered to current customers.[14] The court rejected Indiana Gas' argument that some of the properties it cleaned up are still being used by the company for other purposes. The court found that, unlike taxes and like expenses, environmental costs were incurred because of the past use of the property and the connection was too tenuous to meet the standard established in *NIPSCO*.[15]

The *NIPSCO* precedent has a parallel in Ohio. In *Office of Consumers' Counsel v. Public Utilities Commission*,[16] the Supreme Court rejected the Commission's treatment of a utility's investment in cancelled nuclear plants. Those costs were inconsistent with the ratemaking formula in R.C. § 4909.15 because they did not relate to the provision of service in the test year. A group of utilities had invested in nuclear plants based upon growth forecasts indicating the need for more capacity. It was agreed that the utilities acted prudently at the time. However, circumstances changed and the plants were later deemed unnecessary and were cancelled during the pendency of a rate case. The Commission had decided to permit the utility to amortize the past costs of the plants and to recover the amortized amounts in current rates, which it characterized as a "current" cost caused by the cancellation, which it also deemed prudent. Furthermore, the overwhelming authority from other jurisdictions supported the Commission's allowance of these kinds of costs. However, the Ohio Supreme Court correctly noted that no other jurisdiction had considered the propriety of cost recovery under *Ohio* law. The Court found that R.C. § 4909.15(A)(4) demanded more than just prudence in incurring expenses; the statute contemplated "the normal, recurring expenses incurred by utilities in the course of

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[14] 675 N.E.2d at 743-44.
[15] *Citizens Action Coalition v. Northern Indiana Public Service Company*, 485 N.E.2d 610 (Ind. 1985), *cert. denied*, 476 U.S. 1137, 90 L.Ed.2d 687, 106 S.Ct. 2239 (1986) ("*NIPSCO*"). *NIPSCO* had rejected the recovery of the unamortized sunk costs of a canceled nuclear power plant that had never been placed in service.
[16] 67 Ohio St.2d 153, 423 N.E.2d 820 (1981).

rendering service to the public for the test period."[17] The extraordinary losses incurred by cancelling the nuclear plants could not be transformed into a current operating expense by Commission fiat.

*Office of Consumers' Counsel* is instructive in this case for several reasons. First, it demonstrates that what regulators do in other states is largely irrelevant in Ohio as the Commission must act under the Ohio statutes, which were not under consideration in those other jurisdictions. The Commission must apply R.C. § 4909.15(A)(4) here, not some other state's statutes. Second, it illustrates the principal that, to be recoverable as expenses, costs must relate to the current provision of service, not to past activities. Thus, expenses to clean up facilities that have been closed for over fifty years have no bearing on the current provision of gas service. And, third, it shows that the prudence of an expense (while necessary to recovery) is not determinative of whether it is recoverable as an expense of providing utility service. Therefore, it is irrelevant whether the MGP facilities were operated prudently at the time they operated or whether Duke's environmental remediation activities and costs were prudent[18] – if the expenses do not relate to the current provision of service, they are not recoverable in rates.

### III. Duke Criticism of the Staff's "Used and Useful" Analysis is Unfounded.

Duke criticizes the Staff's position that only expenses related to property that is "used and useful" for gas service should be recovered. In doing so, Duke either misunderstands or mischaracterizes the basis for Staff's position. Columbia Gas makes a similar "used and useful" argument as Duke.[19] Duke appears to believe that Staff is making a determination of what property ought to be in the rate base for which Duke may seek capital recovery. Certainly,

[17] 67 Ohio St.2d at 164.
[18] GCHC/CBT do not concede that Duke's MGP expenses were prudently incurred, but leaves those issues for others to discuss.
[19] Columbia Gas Amicus Brief, pp. 4-5.

property must be used and useful in order to be included in the rate base and for the utility to earn a return on that property, but that is not what Staff is saying in its analysis. Staff is saying that, for an expense to be an expense of providing utility service, it has to be related to gas plant that is currently used and useful. This is nothing more than an analysis of what expenses are recoverable under R.C. § 4909.15(A)(4) as expenses of providing utility service during the test year. Staff's approval of approximately $6 million in MGP expense was based on its judgment that only that amount of expense was attributable to property that was "used and useful" during the test year, so only that amount could have related to the provision of current service.

Duke sidesteps the Staff's analysis by claiming that the Commission has already determined that the MGP expenses are necessary costs of business in the deferral order. However, the Commission did *not* determine that the MGP expenses were necessary for the provision of *utility* service. No matter what line of business Duke was in, environmental cleanup expenses would be a necessary cost of doing business if past activities caused contamination. But that does not make those expenses attributable to providing utility service or recoverable from ratepayers. The Staff's "used and useful" analysis is much more relevant to determining what expenses relate to the current provision of utility service than Duke's "cost of doing business" argument.

Duke and Columbia Gas' reliance on a Minnesota case[20] that allowed recovery because property was used and useful at the time it was contaminated is contrary to Ohio law. Ohio law does not allow the recovery of expenses attributable to the provision of utility service in *past* years. Revised Code § 4909.15(A)(4) requires that the expenses relate to utility service provided in the test year. Duke's MGP expenses fail that test because they related to utility

[20] *In the Matter of the Request of Interstate Power Company*, 1996 Minn. PUC LEXIS 27 (Minn. PUC 1996).

service provided more than 50 years ago or to non-utility service provided over 100 years ago, not current utility service. And, another Minnesota case[21] relied upon by Duke Gas as allowing recovery of MGP expenses to clean a site currently used as a parking and storage facility is directly countered by the *Indiana Gas* decision. The IURC noted the Minnesota decision, but still disallowed expenses attributable to an MGP site currently used for a parking lot and other uses.[22] The current use of the property was unrelated to the past pollution of the property when it was an MGP facility, so the remediation cost was a risk of land ownership that should be borne by shareholders, not ratepayers. Other types of businesses face environmental liability from past activities as well, but do not have the luxury of passing those costs onto ratepayers as Duke is attempting to do.

## IV. The Deferral Order Does Not Foreclose the Commission From Determining That the MGP Expenses Are Unrecoverable On Any Basis.

Duke contends that it should be allowed to recover MGP expenses because the Commission approved their deferral in Case No. 09-712-GA-AAM. But that argument is reverse logic and would be the tail wagging the dog. Duke argues that under accounting rules, it may only create a regulatory asset when it is reasonably certain that it will be able to recover the deferred costs from ratepayers. As Duke correctly notes, FAS 71 only allows it to create a regulatory asset for accounting and financial reporting purposes if *the utility* concludes that future recovery is probable, which is a matter of judgment. But that accounting judgment is for Duke to make, given the nature of the Commission's deferral order and all other facts and circumstances. The Commission's Deferral Order made it quite clear that the recoverability of MGP expenses was not being decided, a position that Duke understood and agreed with at the time. In opposing rehearing of the deferral order, Duke argued that nothing had been decided

[21] *In re Peoples Natural Gas Co.*, 144 PUR4th 333 (Minn. PUC June 11, 1993).
[22] *Indiana Gas*, at p. 45.

and that the parties would have a full opportunity to oppose recovery of the deferred costs in the proceeding in which Duke sought rate recovery.[23]

In approving the request, the Commission expressly stated that it was "not determining what, *if any*, of these costs may be appropriate for recovery in Duke's distribution rates."[24] The Commission expressly stated that nothing in the deferral order would be binding upon it in any subsequent investigation or proceeding involving the justness or reasonableness of any rate, charge, rule or regulation.[25] In response to requests for rehearing, the Commission confirmed that it had decided nothing with respect to the recoverability of any deferred MGP expenses.[26] Duke could not rationally have construed that order as eliminating all non-prudence issues, as all issues were expressly preserved.[27]

Nothing in the Deferral Order gave Duke certainty that *any* of the MGP costs could be recovered through rates. While Duke was free to make its own judgment whether it believed recovery was likely, that judgment is not binding on the Commission in any manner, shape or form. The Commission's determination in this case of whether Duke should be allowed to recover the deferred costs should not be influenced by the accounting judgment that Duke made to book a regulatory asset but, rather, on the applicable facts and law.

The Indiana Commission faced the same issue in *Indiana Gas* and reminded that company that its authorization of deferral accounting did not pre-judge the recoverability of the

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[23] Entry on Rehearing, Case No. 09-712-GA-AAM, p. 5, ¶ 10 ("Duke responds that any discussion of potential recovery of the costs is premature. Duke points out that, in its order, the Commission did not address the manner in which recovery should be had, *if at all*.") (emphasis added).
[24] Nov. 12, 2009 Finding and Order, Case No. 09-712-GA-AAM, ¶ 7 (Kroger Exh. 3) (emphasis added).
[25] *Id.*, p. 4.
[26] Jan. 7, 2010 Entry on Rehearing, ¶¶ 3, 4, 7, 9, 10, 11 (Kroger Exh. 4).
[27] The Commission could not have justified taking action without a hearing (Deferral Order, ¶ 7), if any issues properly the subject of a hearing had been decided.

environmental costs at issue.[28] It stated that, in the event recovery is denied, the deferral accounting becomes meaningless for ratemaking purposes. The Commission should find the same – it quite clearly stated in the deferral order that those costs, *if any*, that could be recovered through gas rates would be determined in a separate (this) proceeding. The Commission should not be influenced by Duke's erroneous interpretation of the deferral order. Duke asserts that, once there has been a deferral order, the only issue is the prudence of the expenses. However, no authority is cited for this proposition and it runs directly counter to the Commission's deferral order, which placed no limitation on the grounds for which expenses might be disallowed. A deferral order is not a meaningless exercise, as it is a necessary step before a utility may seek cost recovery for expenses incurred outside the test year. But a deferral order but does nothing to determine recoverability.[29]

Columbia Gas devotes much of its brief to an argument that the Commission should find that deferred MGP expenses were incurred in the test period. However, that issue is not germane to the real issues in this case. While the effect of a deferral order is do exactly that – to defer expenses for potential recovery in a later period – that does not make the expenses properly recoverable from ratepayers. Revised Code § 4909.15(A)(4), still requires that the expenses be for the provision of gas service during the test year. The MGP expenses were not incurred for the provision of current service (either at the time the expenses were incurred or during the test year), but for the remediation of environmental consequences attributable to MGP service provided at least fifty years ago. It makes no difference that the expenses were incurred recently (or are at least deemed to have been incurred in the test year); the service to which they pertain was not. Hence, they are not proper expenses to be included in Duke's gas rates.

[28] *Indiana Gas* at 38.
[29] *Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St.3d 305, 308 (2007).

## V. Conclusion

Environmental remediation costs are only be recoverable to the extent that they are necessary expenses to Duke's current gas distribution service. Costs Duke would have had to incur even if it was not in the gas utility business are not recoverable from ratepayers. Duke's MGP cleanup activities do not relate to the provision of current service, so the liability for these costs should not be assigned to current ratepayers.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served upon the parties of record listed below this 20th day of June, 2013 by electronic mail service.

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Summary: Reply Brief electronically filed by Mr. Douglas E. Hart on behalf of Greater Cincinnati Health Council and Cincinnati Bell Telephone Company LLC