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 for Approval of an Alternative Form of Regulation	))))	Case No. 15-0362-GA-ALT

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

I. INTRODUCTION

In accordance with the Commission's June 23, 2015 Entry, The East Ohio Gas Company d/b/a Dominion East Ohio (DEO or the Company) respectfully submits its reply to the comments filed by the Office of the Ohio Consumers' Counsel (OCC), the only entity to file comments. OCC's comments provide no reason to disapprove or modify in any way DEO's application in this case.

II. REPLY COMMENTS

A. OCC has not shown any legal basis to modify or reject DEO's application.

OCC's lead criticism is that the PIR Program will "cost . . . millions" and violate state policy that "requires that the price for natural gas service be reasonable." (OCC Comments at 2.) It argues that the request for increased investment is "an unsubstantiated and excessive amount" and should be denied. (*Id.*) OCC also argues that the historical increase in PIR costs makes the present request to further increase investment "problematic." (*Id.* at 3.)

1. That the PIR program involves a significant investment is no basis for disapproval.

OCC's comments do not show any legal problem with DEO's request. It has been known from the beginning that a system-wide infrastructure replacement program would constitute a major investment, so the mere fact that "millions" of dollars have been invested is no basis for objection. The scope of the required investment is what justifies recovery outside of base rates in the first place. OCC provides no evidence or reason to think that the program has not been well-managed, that project costs have been inflated, or that the work has not been prudently and reasonably completed. Precisely such issues are reviewed annually in cost-recovery proceedings, but the Commission has not rendered any findings of imprudence or unreasonableness in any of them.

If the program were mismanaged, inefficient, or gold-plated, this would show up in cost-recovery proceedings. The reality is that DEO has managed its program well.

2. DEO uses appropriate mechanisms to manage costs.

DEO is not insensitive to program costs. It takes very seriously the obligation to efficiently manage the PIR program, and it recognizes that costs have increased. That costs would increase over the years is not a surprise. This reflects numerous factors, including the external factors discussed in DEO's testimony (inflation, increased demand for contractors, urban complexity, increased environmental requirements). The question is not whether costs have increased, but what factors have led to the increase, and whether DEO has prudently managed them.

OCC provides not one criticism on that front. The vast majority of program costs are contractor payments, and these prices are set using a competitive-bid process. This ensures that the price of the work is reasonable and market-driven. OCC, which limits itself to generalities, gives no reason to question the efficacy of that process. On the contrary, DEO knows that the competitive-bid process achieves the lowest possible price. It knows this not only because the low bidder generally gets the work, but because DEO has repeatedly attempted to bring in major contractors from other regions of the country or parts of the State. Such contractors have been unable to gain a foothold in DEO's market because costs have been bid so low. DEO is confident that if the work could be done for less, it would be.

The reality is that pipeline work is not cheap, particularly in the densely urban portion of DEO's service territory in northeastern Ohio. If DEO could dictate the price of materials and labor, it would. But that is not the way the world works. OCC's generic criticism that the program costs too much should be rejected.

3. OCC's other general criticisms also lack merit.

OCC makes a number of other statements that are either misleading or inaccurate.

a. DEO has not underinvested in the PIR program.

For example, OCC argues that DEO "failed to spend the entire amount" authorized for 2013 and 2014, which makes the present request unreasonable. (*Id.* at 3.) This comment is misleading.

OCC cites the page of Ms. Friscic's testimony where she explained the reasons that DEO did not reach the maximum cap in 2013 and 2014, making it hard to understand why OCC did not acknowledge or address those reasons. (*See* Friscic Dir. at 5.) As DEO explained, in 2013, a late-year change in depreciation rates resulted in a 16-cent reduction, bringing that year's charge (which otherwise would have exceeded the $1.40 cap) down to $1.28. (*Id.*) The next year, 2014, DEO spent the total amount scheduled for that year, and was only unable to fully make up for 2013's eleventh-hour reduction due to extreme cold weather and the impact of bonus-tax depreciation.

OCC acknowledges none of the explanation given by DEO, much less provides any reason to hold the below-cap charges against DEO.

b. DEO supported its request for a three-percent annual increase.

OCC also asserts that DEO "asks for an inflation adjustment that is greater than the actual inflation rate Ohioans have experienced." (OCC Comments at 5.) And OCC asserts that DEO "failed to provide any support for its three percent automatic increase." (*Id.*)

OCC's comments are incorrect. First, DEO never asserted that the three-percent annual increase from 2018 to 2021 is an "inflation adjustment" intended only to account for general inflation. DEO expressly stated, "The 3% capital increase per year in 2019 through 2021 is needed in order to maintain this pace in those years, due to both inflation *and continued cost pressures*, such as those described by DEO witness Mr. Reed." (Friscic Dir. at 8 (emphasis added).) As Ms. Friscic explained, the point of the annual adjustment is not to predict inflation, but to modestly adjust the investment level to help maintain program pace. (*Id*.) Contrary to OCC's statement, the fact that general inflation *alone* accounts for two-thirds of the proposed adjustment shows that the adjustment is supportable.

Even if it turns out that cost pressures are somehow mitigated in the future, and the three-percent annual increase proves greater than the actual growth in costs, there is no harm. Either DEO will be able to do more work for the same level of investment, or the annual cost-recovery process will ensure that the lower costs are flowed back to ratepayers in the form of a lower PIR charge.

c. OCC's comments misstate the bill comparison.

OCC also takes aim at DEO's statement that now is the time to increase investment "because gas commodity rates are low." (OCC Comments at 5.) OCC responds that "[i]t is inappropriate . . . to fill the void [caused by reduced commodity costs] with additional long-term PIR charges." (*Id*. at 6.) OCC asserts that DEO "ignores the fact that although commodity rates have declined, the Utility's base rate charges and Riders have increased." (*Id*.)

OCC's comment that DEO "ignore[d]" increases in base rates and riders is incorrect, not as a matter of opinion, but of mathematics. DEO's comparison between pre-PIR-program and current bills accounted for "*total* annual cost for gas service," that is, "[b]ase rate, rider *and* gas cost charges." (Friscic Dir. at 15 (emphases added).) This is confirmed by DEO's Exhibit 1.1, which details the over-50-percent reduction from pre-program bills to current bills (*i.e.*, from $1,471.55 to $655.10 annually). That exhibit provides the change in terms of "SSO/SCO Gas Cost," "Riders," and "Monthly Charge/Base Rates." It is OCC, not DEO, that is guilty of ignoring the facts.

OCC again mathematically errs when it suggests that DEO seeks to "fill the void" caused by reduced commodity costs. (*Id*. at 6.) The proposed increase in PIR investment will come nowhere close to offsetting the reductions in commodity prices. As Ms. Friscic testified, "even if the annual cap were doubled, residential customers' bills would still be *much lower* than they were when the PIR Program was initially approved." (Friscic Dir. at 2 (emphasis added).) The "void" in average monthly billing is $68.04; the average monthly PIR charge to residential customers based on proposed investment through 2021 is projected to be roughly a quarter of that figure, or $18.43.[1]

OCC must misstate these figures, because it cannot avoid their import: the huge reductions in commodity costs make this an extremely favorable time to increase investment in the PIR program.

d. OCC's proposal to introduce contingent cut-backs should be rejected.

Finally, OCC complains that DEO "included no contingencies to cut back the expanded PIR program if natural gas commodity rates increase and negate the alleged benefit." (OCC Comments at 6.) OCC has not shown any need for such a plan, which in fact would harm the program.

Although the current and projected low prices of natural gas certainly support increased investment in the PIR program, the program was never proposed as a way to thoughtlessly spend

[1] The actual PIR charge may be lower, depending on whether and to what extent PIR investment is included in base rates in 2021.

extra money. Although OCC repeatedly minimizes the importance of safety on DEO's system, that is the central purpose of the PIR program: to replace the riskiest pipe on DEO's system in a prompt, proactive, and orderly manner. Indeed, the importance of this safety goal justified approval of the PIR program at a time when gas costs were considerably higher. The price of gas must rise far above where it stands today even to reach the level at which it stood when the program was first approved.

Making future investment contingent on natural gas prices is not only unnecessary, but would affirmatively harm the program by injecting a major element of year-to-year uncertainty. Such uncertainty would certainly reduce the efficiency of DEO's planning efforts, which for major projects generally begin between 18 and 24 months in advance of shovels hitting the ground. DEO would likely need to create alternate sets of planning and design to account for various gas-cost scenarios. Contingent investment would also require potentially major modifications to the bidding process. Most critically, this would send an extremely counterproductive signal to the contractors who make the program go. PIR work requires major investments in labor, training, and capital equipment, and contractors need assurance that the work will not suddenly dry up. OCC's proposal would send the clear message *not* to make those investments.

DEO disagrees that an increase in gas costs would justify cutting back the program. The program was approved in a time of much higher commodity prices. But it is clear that the current level of commodity prices makes the proposed increase in investment affordable.

In short, OCC fails to show that DEO's application will result in an unreasonable cost of service under R.C. 4929.02.

B. DEO's success in reducing leaks supports approving, not rejecting, the application.

OCC's second major comment actually recognizes the PIR program's "success[] in reducing leaks on the distribution system." (OCC Comments at 7.) But in OCC's view, the program's success thus far supports rejecting the application. OCC asserts that DEO has not substantiated "that there is a public safety issue that requires an acceleration of the current program." (OCC Comments at 7.) OCC's comments again suffer from several problems.

1. The recent reduction in leak rates changes none of the bases for the PIR program.

First, the success to date in reducing leaks is not a basis for rejecting the application. The leak reduction does *not* suggest that pipes are no longer corroding or that leak rates on bare-steel systems do not increase exponentially. Rather, it supports the fact that DEO's current risk-assessment system is effectively targeting prone-to-leak pipes.

DEO's past success in reducing leaks does not call into question any of the reasons for the PIR program. The need for the program is quite simple: public safety demands that pipeline integrity be maintained; bare-steel, ineffectively coated, and other target pipelines are prone to corrosion and leaks; and DEO has among the largest concentrations of such pipelines in the United States. None of that has changed since 2008, and costs (as expected) have gone up. That is why increasing PIR investment is needed. Mr. Reed's testimony explains all this, as well as a number of the safety risks that would follow from failing to increase investment in the PIR program. (*See* Reed Dir. at 5, 8, 23–27.) DEO's proposed increase in PIR investment "is necessary to give DEO a reasonable opportunity to complete the PIR Program within the 25-year time frame originally proposed in the initial 2008 PIR application. (*See* Friscic Dir. at 7.) No less than it did at the outset of the program, public safety demands the accelerated replacement of bare-steel pipelines.

2. The PIR program was not proposed as a "cost-saving" program.

OCC also argues that DEO "provided no cost benefit analysis to determine if spending millions of additional dollars per year will result in any—let alone comparable cost savings from a reduced leak rate." (OCC Comments at 7.) But OCC's premise is incorrect. The PIR program has never been proposed as being primarily a "cost saving" program. If the *sole* benefit of replacing bare-steel and other target pipe was to reduce leak-repair expenditures, then the program would not make sense.

Cost savings are an additional benefit of the program, not its reason for existence. The purpose of the PIR program is to accelerate the replacement of leak-prone pipe—pipe that poses the greatest potential threat to life, limb, and property in the event of a pipeline failure. The current success in leak reduction only supports DEO's proposal to continue and increase that investment.

3. Rider recovery remains a critical component of the PIR program.

Finally, OCC seems to suggest that "accelerated" recovery of additional PIR costs through a rider is simply unnecessary. (OCC Comments at 7.) DEO disagrees.

To begin with, the Commission has already determined that rider recovery for the PIR program is appropriate. The capital intensity of pipeline work makes accelerated recovery a critical component of the program. The availability of capital funding and recovery is what allows DEO (and its contractor base) to engage in the advance design, planning, and investment necessary to implement such a major undertaking.

Suffice to say, DEO will always do its best to ensure a safe and reliable system. Although it is true that limiting or eliminating rider recovery would not change DEO's duties, it would tend to force DEO back on its heels, reacting to leaks as they occur instead of proactively replacing the riskiest pipe before it leaks. Given the potentially catastrophic outcomes when natural gas escapes and explodes, and given the fact that DEO's system contains among the nation's largest concentrations of bare-steel pipelines, DEO cannot support a reactive approach to its system. Particularly in view of the current low price of natural gas, there is no reason not to increase investment in the program at this time.

C. OCC has not justified any change to the O&M cost saving methodology.

Finally, OCC criticizes DEO's filing for failing to "mention . . . any additional or modified O&M cost savings mechanism." (OCC Comments at 8.) OCC's only criticism of the mechanism is that "customers should reap the benefit of increased O&M cost savings that one would expect with the greater investment spending." (*Id*. at 8.)

This criticism is misguided; customers *will* reap increased savings that are achieved through increased investment. OCC's comments incorrectly suggest that O&M savings are capped. But this is not true. To the extent greater investment drives greater O&M savings, the mechanism will capture increased savings and pass them back to customers. The Commission approved this mechanism as just and reasonable in Case No. 11-2401-GA-ALT, and there is no reason to revisit it in this proceeding.

OCC also asserts that DEO has not achieved the same cost savings as realized by other utilities. (*Id*.) Such apples-to-oranges comparisons—between different utilities, managing different systems, in different cities, in different parts of the state—are of little use. Assuming for sake of argument that OCC's figures are correct, DEO has no reasonable way of knowing what drove the reductions for other companies. For example, DEO has no way of knowing whether (as OCC assumes) the companies were equally efficient during the "baseline" year, nor what other factors might have contributed to each company's reported savings. Just such concerns are what led to DEO's current savings mechanism, which guarantees a minimum level of O&M savings to customers, and provides sharing of O&M savings beyond that. A simplistic, bottom-line comparison such as OCC's is certainly easy to make—but it proves nothing.

Finally, OCC suggests that O&M cost savings should follow the same curve as leak reductions, which have declined 42 percent. (OCC Comments at 8–9.) The facts do not support OCC's comments. Despite labor and material cost increases, leak-repair expenses in 2014 were 37 percent lower than in the baseline year. This shows that leak-repair expense reductions *are* following leak reductions, with both reductions rounding to 40 percent.

There are reasons for the slight difference. Leak repair is only a subset of overall O&M expense, albeit a larger one, but there are other expenses that do not necessarily track leaks. OCC also disregards the fact that some leaks are repaired through PIR capital replacement rather than by O&M repairs, which explains why overall leak reduction can outpace the realization of leak-repair savings. How many pipelines leak in a given year, and where and when they leak, is also unpredictable. Not every leak is the same, and some repair jobs can be more costly than others. As noted, even as leaks go down, costs tend to go up.

For all these reasons, DEO would never expect a perfect correlation between PIR investment, leak reductions, and O&M savings. Even so, OCC is clearly incorrect to suggest that leak reductions have not driven O&M savings.

III. CONCLUSION

For reasons discussed above, none of OCC's comments provides any basis for rejecting or modifying DEO's application. DEO respectfully requests that the Commission approve the application as filed.

Dated: July 27, 2015

Respectfully submitted,

/s/ Andrew J. Campbell
Mark A. Whitt (0067996)
Andrew J. Campbell (0081485)
Rebekah J. Glover (0088798)
WHITT STURTEVANT LLP
The KeyBank Building, Suite 1590
88 East Broad Street
Columbus, Ohio 43215
Telephone: (614) 224-3973
Facsimile: (614) 224-3960
whitt@whitt-sturtevant.com
campbell@whitt-sturtevant.com
glover@whitt-sturtevant.com

(Counsel are willing to accept service by email)

ATTORNEYS FOR THE EAST OHIO GAS COMPANY D/B/A DOMINION EAST OHIO

CERTIFICATE OF SERVICE

I hereby certify that a copy of this Application was served by electronic mail to the following persons on this 27th day of July, 2015:

Jodi J. Bair
Joseph Serio
Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, OH 43215-3485
Jodi.Bair@occ.ohio.gov
Joseph.Serio@occ.ohio.gov

Colleen Mooney
Ohio Partners for Affordable Energy
P.O. Box 1793
Findlay, OH 45839-1793
cmooney@ohiopartners.org

Frank P. Darr
Matthew R. Pritchard
McNees Wallace & Nurick LLC
21 East State Street, 17th Floor
Columbus, Ohio 43215
fdarr@mwncmh.com
mpritchard@mwncmh.com

William Wright
Attorney General's Office
Public Utilities Section
180 E. Broad Street, 6th Floor
Columbus, Ohio 43215
william.wright@puc.state.oh.us

/s/ Rebekah J. Glover
One of the Attorneys for The East Ohio Gas Company d/b/a Dominion East Ohio