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Docketing Division
Public Utilities Commission of Ohio
180 East Broad Street
Columbus OH 43215

RE: *In the Matter of the Application of Duke Energy Ohio, Inc. for Authority to Change
Accounting Methods, Case No. 17-2118-GA-AAM*

Dear Docketing Division:

Enclosed please find the Staff's Review and Recommendation regarding the authority to change accounting methods application made by Duke Energy Ohio, Inc., Case No. 17-2118-GA-AAM.

Tamara S. Turkenton
Chief, Regulatory Services Division
Public Utilities Commission of Ohio

David Lipthratt
Chief, Research and Policy Division
Public Utilities Commission of Ohio

Enclosure
Cc: Parties of Record

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Duke Energy Ohio, Inc.
Case No. 17-2118-GA-AAM

BACKGROUND:

On October 12, 2017, in Case No. 17-2118-GA-AAM, Duke Energy Ohio, Inc. (Duke or Company) filed an application (Application) seeking authority to establish a regulatory asset in order to defer expenses (plus carrying costs) related to construction of a retaining wall being constructed by the City of Cincinnati that may serve to protect a section of Duke's gas facilities from potential damage.¹ Duke's Application states that a portion of the Company's service area has recently experienced an active landslide that is endangering a 20-inch natural gas pipeline in proximity to the slide area. The Company asserts this pipeline is "a vital and integral part of the Company's natural gas distribution system..." and that its ability to furnish "necessary and adequate services and facilities" (as required by R.C. 4905.22) for customers served by the affected pipeline is placed at extreme risk.²

The City of Cincinnati also has infrastructure that is being affected by the landslide. The City has commenced construction of a retaining wall to arrest the slide in order to protect its underground water and sewer facilities. The City has requested that Duke contribute to the retaining wall's construction costs on the theory that Duke's gas facilities will also be protected.³ Duke states that the Company agreed to pay \$3.0 million to the City to help defray construction costs associated with building the retaining wall. The Company maintains that construction of the retaining wall is a prudent response to protect its critical pipeline and that its contribution to the construction costs is an unanticipated expense in response to an issue that is outside of its control and is not included in its current rates.⁴ The Company asserts that the Commission should deem it desirable that it take steps to proactively avoid potential damage to its pipeline as a result of continued ground movement, and, therefore, the Commission should grant its deferral request.⁵

In two recent cases, the Commission expressly delineated the criteria that should be applied to evaluate utility deferral applications and cited numerous cases where such criteria has been applied for deferral applications.⁶ In Case No. 15-1741-GA-AAM, the Commission stated that it will consider the following criteria when evaluating deferral requests⁷:

¹ *In the Matter of the Application of Duke Energy Ohio, Inc. for Authority to Change Accounting Methods*, Case No. 17-2118-GA-AAM (Application at 2-5) (October 12, 2017) (Application).

² Application, at 2-6.

³ Application, at 3.

⁴ Application, at 4-5.

⁵ Application, at 5.

⁶ *In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Approval to Change Accounting Methods Associated with Its Distribution Accelerated Risk Reduction Program*, Case No. 15-1741-GA-AAM (November 3, 2016), at 5-6. And, *In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods Associated with Its Integrity Management Program*, Case No. 16-387-GA-AAM (January 4, 2017), at 5.

⁷ When applying the above criteria, the Commission may at its discretion also consider a deferral to incent a utility towards a public goal.

1. Whether the utility's current rates or revenues are sufficient to cover the costs associated with the requested deferral?
2. Whether the costs are material?
3. Whether the reason for requesting the deferral is outside the utility's control?
4. Whether the expenses are atypical and infrequent?
5. Whether the financial integrity of the utility be significantly and adversely affected, if the deferral is not granted?

SUMMARY OF DUKE'S APPLICATION:

In the Application, Duke states that one of its 20-inch natural gas pipelines is located in an area that had been subject to ground movement of approximately one-tenth of an inch per year over the past 15 years. However, the Company says that, beginning in mid-2016, the affected area experienced accelerated movement, including showing nine inches of lateral movement over a 30-day period in the summer of 2017.⁸ The Company maintains that testing by a contractor retained by the City of Cincinnati demonstrated that the 20-inch pipeline would be at "extreme risk" and that an urgent need to slow the movement was necessary.⁹ The Company also claims that relocation of the pipeline out of the potential landslide area is not an option due to the time and complexities surrounding such an undertaking (such as engineering, permitting, construction, etc.) in proximity to the impending winter heating season.¹⁰ Duke further indicates that the land movement also affects water and sewer lines owned by the city of Cincinnati and that the Cincinnati Department of Transportation and Engineering commissioned a study to identify possible solutions. According to Duke, the study suggested that construction of retaining wall above the landslide area was the most viable option for the protection of the buried infrastructure.¹¹

In addressing the Commission's deferral criteria, the Company only presented the following considerations:

- The need to construct the wall is outside the Company's control;
- Its contribution to the wall's construction costs is an irregular and unanticipated expense that is not included in its base rates; and,
- The Commission should deem it desirable that the Company take proactive steps to avoid potential damage¹²

The Company failed to address the full list of criteria that must be met in order to qualify for a deferral of incurred expenses.

STAFF'S REVIEW AND RECOMMENDATIONS:

The Company claims that construction of the retaining wall is urgent and requires action before the winter heating season and that its contribution for construction of the wall is a prudent and

⁸ Application, at 3.

⁹ Application, at 2.

¹⁰ Application, at 2-3.

¹¹ Application, at 3.

¹² Application, at 4-5.

reasonable expense towards maintaining a safe and reliable system.¹³ Staff does not oppose the Company contributing to the City of Cincinnati's retaining wall, or the timing, the only issue is whether such an expense is sufficiently extraordinary as to fall outside the normal funding method. With that in mind, the following is an analysis that applies the Commission's recommended criteria for evaluating deferral applications to the question of should the retaining wall be funded as a normal business expense or deferred so that customers pay for the retaining wall in future rates.

1. Are the utility's current rates or revenues sufficient to cover the costs associated with the requested deferral?

The Company's Application does not address whether or not revenue generated by its current rates are sufficient or insufficient to cover the expenses it is seeking to defer for the retaining wall. In its Opinion and Order in Case No. 15-1741-GA-AAM, the Commission states a utility must make a "demonstration" that it meets the deferral criteria. In this case, Duke makes no demonstration at all regarding this criterion. In Staff's opinion, this criterion is critical because it is fundamentally unfair to ask customers to pay for an expense when the rates that customers already pay provides the utility with sufficient revenue to meet its expenses. Duke's claim that the expense for constructing the retaining wall was unanticipated and not included in current rates is a red herring. It is fully known and expected that in between base rate cases expenses built into a utility's base rates are based on representative test year expenses that will change over time. Some expenses will go up and others will go down. Some expenses included in the test year will disappear in subsequent years, while new expenses may be incurred. What is germane is whether or not a utility can cover its expenses (including new expenses) with the revenue generated from its current rates. In this case, Duke provides no evidence that its current rates provide insufficient revenue to cover the \$3.0 million expense towards construction of the retaining wall. Therefore, the Company's deferral request should be denied.

2. Are the costs material?

Duke's Application does not address materiality of the requested deferral amount. In Staff's opinion, the \$3.0 million deferral request is not material. The \$3.0 million request is less than one percent of the \$328,139,916 Total Operating Expenses¹⁴ that are built into the Company current base rates.¹⁵ Duke's deferral request is not material and should be denied.

3. Are the reasons for requesting the deferral outside the utility's control?

While a sudden unexpected landslide is beyond the Company's control, the Company's Application fails to demonstrate that it participated in or independently monitored and evaluated the situation. The Company does not appear to have conducted an independent assessment of the damage, project planning, and the construction timing for the retaining

¹³ Application, at 5.

¹⁴ Case No. 12-1685-GA-AIR, Staff Schedule C-1.

¹⁵ $3,000,000/328,139,916 = 0.0091$ or 0.91%

wall. Similarly, the Company provided nothing in the record indicating that its pipeline is at imminent risk of damage from more landslides in the area. The Company did provide a copy of the City of Cincinnati's consultant's report with Staff at an October 12, 2017 meeting, but that report only alludes to potential risk to Duke's pipeline. It offers no details as to the probability or immediacy of the risk to Duke's pipeline. The only actual damage that it shows is to the railroad tracks and the City of Cincinnati's facilities. Neither the consultant's report nor Duke's Application provide any specifics regarding the Company's pipeline.

4. *Are the expenses atypical and infrequent?*

This criterion speaks to the nature of the new expenses. If they are unanticipated and infrequent, and they meet the other criteria, then deferral may be warranted. If, however, the new expenses could have and should have been anticipated or they will become the new norm, then a rate case would be the proper remedy for such expenses rather than a deferral. In this case, Duke is correct that the expense leading to the deferral request is atypical and it is likely infrequent, but there is no guarantee that the retaining wall will be fully effective and that Duke will not come back to the Commission seeking additional deferrals if it is not.

5. *Will the financial integrity of the utility be significantly and adversely affected, if the deferral is not granted?*

This criterion addresses instances when a utility's current rates do not provide sufficient revenue to cover a large and material unanticipated expense. Despite these circumstances, a utility commission still may not elect to grant a deferral request if the event leading to the request is short term and/or is something that the utility can recover from quickly. In this case, Duke's Application provides no evidence that, if its deferral request is not granted, its financial integrity will be significantly adversely impacted. In fact, the Application does not speak to the criterion at all. In Staff's opinion, given the very small size of the deferral request relative to the expenses built into its base rates, Duke's financial position will not be affected if the Commission denies its deferral request. Therefore, Duke's Application should be denied.

For all of the reasons stated above, in Staff's opinion Duke has failed to meet its burden of proof to demonstrate that it needs or should be granted authority to defer expenses associated with its contribution towards construction of the retaining wall. Therefore, Staff recommends that the Commission deny Duke's Application in this case.