BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Northeast Ohio Natural Gas Corp. for an Increase in Gas Distribution Rates	))))	Case No. 18-1720-GA-AIR
In the Matter of the Application of Northeast Ohio Natural Gas Corp. for Tariff Approval	)))	Case No. 18-1721-GA-ATA
In the Matter of the Application of Northeast Ohio Natural Gas Corp. for Approval of Alternative Regulation	)))	Case No. 18-1722-GA-ALT

OBJECTIONS TO THE STAFF REPORT BY NORTHEAST OHIO NATURAL GAS CORP.

I. INTRODUCTION

Pursuant to R.C. 4909.19(C) and Ohio Admin.Code 4901-1-28, Northeast Ohio Natural Gas Corp. ("NEO") hereby submits the following objections to the Staff Report as filed on June 25, 2019 ("Staff Report"). NEO's lack of objection to any adjustment or treatment recommended in the Staff Report should not be construed as indicating NEO's support for such adjustment or treatment. Any dollar amounts specified within any objections are preliminary, presented for informational purposes only, and based on currently available information; NEO reserves the right to update such dollar amounts, including insofar as they may be dependent on how other issues or objections are resolved.

II. REVENUE REQUIREMENT

A. Staff should not move customers from the GS to SGS classes.

Staff recommends that customers currently taking service in the General Service ("GS") rate class who consume less than 200 Mcf in the test year be reclassified to the Small General Service ("SGS") class to help mitigate the bill impacts to the lower use GS customers. NEO objects to Staff's proposal because it fails to provide the necessary continuity in the pricing structures impacting customers in the next rate case. Instead of reclassifying these customers as SGS customers, NEO proposes that two GS subclasses be created. The first would be GS-1, which would include all customers currently taking service under the GS rate who had an annual usage of more than 200 Mcf during the test period. The second subclass, GS-2, would include those customers currently taking service under the GS rate with an annual usage less than 200 Mcf during the test period and mitigate their increase by charging a lower customer charge than the GS-1. This reduction in revenue would need to be recovered through a higher volumetric charge across all GS volumes.

B. If Staff's proposal to shift GS to SGS classes is accepted, then NEO needs to recover a revenue shortfall.

Staff's recommended revenue requirement and rates presented in the Staff Report do not reflect Staff's reclassification of customers. If the Commission orders the reclassification consistent with Staff's recommendation, the revenue shortfall will need to be recovered from either one or both classes. Under Staff's proposal, NEO believes the shortfall should be allocated to the SGS class because those costs ought to follow the customers being reassigned to their new class, and those costs should be recovered based on volumetric rates.

C. Staff should have authorized the creation of Rider IRP.

The Infrastructure Replacement Program ("Rider IRP"), as proposed by NEO, is designed to recover the costs to replace/upgrade bare steel and plastic mains and services, as well as the replacement of certain risers prone to failure and regulators, regulating stations, and advanced meters in certain locations. Staff recommends that the Commission deny NEO's request to approve Rider IRP because Staff was not satisfied it was necessary, just, or reasonable. However, Staff failed to provide any explanation or justification for its recommendation. Staff should have authorized the creation of Rider IRP because Rider IRP, as proposed by NEO, is similar to other Commission-approved infrastructure development riders that provided cost recovery for the same type of investments and services as those covered by Rider IRP and encourages efficient and responsible replacement of aging infrastructure.

D. Staff's recommended depreciation rates are calculated incorrectly.

Staff determined the depreciation rates used for its annual depreciation expense and for its theoretical reserve calculation using three peer group companies (i.e., Dominion Energy Ohio ("Dominion"), Ohio Gas Company ("Ohio Gas"), and Suburban Natural Gas Company ("Suburban")). However, Staff's workpapers show that it used production information from only one utility (i.e., Dominion), while all the remaining depreciation rates proposed by Staff were created using data solely from two utilities (i.e., Ohio Gas and Suburban). Making matters worse, Staff did not use Suburban's Commission-approved rate, only rates proposed by Staff in Suburban's pending rate case. Nevertheless, using a sample of only two peer companies means that any atypical estimates for either company are given significant, disproportionate weight in determining NEO's estimates. As an example, Staff's proposals assign fifty percent weighting to unusual estimates of zero percent net salvage for Ohio Gas. Additionally, Staff has not recommended Iowa survivor curve types for its service life estimates. Instead, Staff appears to base its calculations on the incorrect assumption that all assets in an account will have a life equal to the average service life. Finally, Staff should have incorporated NEO-specific information into its recommended depreciation parameters. Without such information, Staff's recommended depreciation rates are inappropriate and fundamentally flawed.

E. Staff's theoretical reserve was calculated incorrectly.

Staff's theoretical reserve imbalance is $6,993,858, which amounts to approximately 9% of NEO's investment base. However, Staff's proposal was calculated incorrectly for numerous reasons outlined below.

1. Staff used an incorrect vintage for some of NEO's assets.

Staff failed to make certain adjustments necessary to ensure a reasonable theoretical reserve calculation. When performing a depreciation study, it is important to review the data in detail to ensure that it is reflective of both the experience of the assets and the outlook for a company's property. In some instances, the data needs to be adjusted in order to assure that it is appropriate to be used in depreciation calculations. Although Staff made some adjustments to NEO's data, Staff failed to make other adjustments that are necessary to ensure a reasonable theoretical reserve calculation.

NEO's asset base includes assets that have been acquired from other companies over the years. Specifically, a portion of NEO's system was acquired from Columbia Gas of Ohio Inc. ("Columbia"). While many of these assets are decades old, they are reflected on NEO's books (and in Staff's calculations) as vintage 2008, the year they were purchased. Staff has used this vintage as the vintage year for these assets in the theoretical reserve calculations. As a result, Staff's calculations understate the age of certain NEO assets and thus, overstate the remaining life of those assets, meaning that Staff calculates a theoretical reserve for these assets that is far too low.

2. Staff used incorrect depreciation rates.

As discussed above in Section II(D), the depreciation rates used by Staff in its theoretical reserve calculation are inappropriate and fundamentally flawed.

3. Staff's gas production account estimates are based only on Dominion and are inaccurate.

As mentioned above in Section II(D), the depreciation rates used by Staff in developing its theoretical reserve amount rely on information from only three peer companies. Of those three, only Dominion provided production account data. Staff should have used production account data from multiple utilities, not just one, to ensure a statistically valid and reasonable sample size.

4. Staff's theoretical reserve should have been calculated after accounting for Staff's depreciation categorization adjustments.

While Staff proposes certain adjustments to NEO's plant in service balances, Staff does not incorporate these adjustments into its theoretical reserve calculations. Failing to include these adjustments understates the theoretical reserve. As a result, this and the foregoing issues undermine and cast serious doubt on the accuracy of the theoretical reserve and theoretical reserve imbalance that Staff calculates.

5. If any theoretical reserve adjustment is made, it should be instituted over a period greater than ten years.

Staff proposes to amortize its calculated theoretical reserve imbalance over ten years. Correcting for the issues raised above related to vintage years and Staff's depreciation categorization adjustments would likely result in a theoretical reserve imbalance below Staff's historical threshold for which adjustments have not been warranted for other utilities. If an adjustment is deemed necessary, Staff's proposed ten-year period is too short given the considerable uncertainty surrounding Staff's theoretical reserve imbalance. Instead, a more reasonable time period would be to use the remaining life of the Company's assets which is consistent with the approach used in the vast majority of depreciation studies. Using Staff's proposals, the overall average remaining life for NEO's assets would be just under twenty-five years. The remaining life is the most common period of time used to adjust for any theoretical reserve imbalances and is more reasonable and appropriate to use under the circumstances.

III. RATE BASE

A. Certain assets from the purchase of Orwell and Brainard should be added back to plant in service balances and accumulated depreciation balances.

Assets totaling $443,310 related to the opening balances from the purchase of the original Orwell and Brainard systems were able to be physically inspected during Staff's audit. Maps of these systems were not available at the time of the physical inspections. Subsequently, NEO has produced maps that show original main lines, service lines, customer counts, and regulator stations. As such, $443,310 should be added back to the plant in service balances and $350,172 should be added back to the reserve for accumulated depreciation balances.

B. NEO vehicle (Orwell asset #7060021) should be added back to the plant in service balances and accumulated depreciation balances.

An NEO vehicle (i.e., Orwell asset #7060021) was unable to be physically inspected during Staff's audit as it was undergoing repairs in a repair shop during the time of the inspection. The vehicle is now fully operational and able to be inspected. As such, $31,307 should be added back to the plant in service balances and $26,611 should be added back to the reserve for accumulated depreciation balances.

C. NEO flame pack (Spelman asset 7008006) should be added back to the plant in service balances and accumulated depreciation balances.

An NEO flame pack (i.e., Spelman asset 7008006) was unable to be physically inspected during Staff's audit as it was at the factory being recalibrated during the time of the inspection. The flame pack is now fully operational and able to be inspected. As such, $4,695 should be added back to the plant in service balances and $4,695 should be added back to the reserve for accumulated depreciation balances.

D. Two vehicles (Orwell asset #7060004 and Spelman asset #7060000) that were sold after the date certain of September 30, 2018, were improperly removed by Staff and should be reinstated.

Staff made adjustments to remove Orwell asset #7060004 and Spelman asset #7060000, both of which are vehicles that were sold after the date certain and prior to the physical inspection date. NEO used an actual date certain rather than a projected date certain for this rate application; therefore, all assets used and useful as of the date certain should be included in rate base. Importantly, no capital additions subsequent to the date certain are included in rate base, including CWIP balances as of the date certain that have since cleared to plant. The vehicles' costs of $36,250 and $35,578 should be added back to the plant in service balances, and Staff's related adjustments to accumulated depreciation of $36,250 and $35,578 should be added back to the reserve for accumulated depreciation balances.

E. Staff's reclassification of accumulated depreciation balances from Account 391 to Accounts 303, 391.1, and 397 does not net to zero.

Staff made adjustments to reclassify balances from Account 391 to Accounts 303, 391.1, and 397. Staff removed $1,665,165 from Account 391, yet only added a total of $1,519,441 to the other three accounts. The $145,724 difference understates the reserve for accumulated depreciation balance and should be added back.

F. Staff's adjustments to Schedule B-3 do not match the total of the adjustments from Schedule B-3.1.

Staff's adjustments in Schedule B-3 for Accounts 379, 382, and 387, which total $232,344, are not included in the supporting documentation in Schedule B-3.1. Schedule B-3.1 appears to be correct because there is no corresponding adjustment on the asset side for these accounts. Furthermore, the adjustment would cause all three accounts to have a higher reserve for accumulated depreciation balance than their asset balance. The adjustments totaling $232,344 included in Schedule B-3 appear to be in error and should be removed from the reserve for accumulated depreciation balance.

G. Staff's adjustment to accumulated depreciation for Orwell asset #7030100 appears to be mathematically incorrect and should be corrected to achieve the desired result.

Staff's adjustment to accumulated depreciation for Orwell asset #7030100 was included in both Account 391 and Account 391.1. Furthermore, the adjustment proposed by Staff adds to the accumulated reserve balance rather than subtracts from it. Since the adjustment is the result of disallowing an item not able to be observed during physical inspection, both the asset and associated accumulated depreciation should be removed from rate base. Correcting the adjustment to simply remove the amounts from the reserve balance causes a $6,662 decrease to Staff's proposed adjustment.

H. NEO's adjustments to operating and maintenance expense, income taxes, and rate base cause a corresponding adjustment to the working capital component of rate base.

NEO's adjustments to Schedule C-2 for operating and maintenance expenses, other taxes, and income taxes, combined with the adjustments to rate base, require a corresponding adjustment to increase the working capital allowance component of rate base by $128,060.

IV. OPERATING INCOME

A. Staff's calculation of annual depreciation expense is flawed.

First, as discussed in Section II(D) above, Staff's recommended depreciation rates are flawed and result in an inappropriate $480,463 decrease in annual depreciation expense.

Second, Staff's proposed ten-year amortization results in a reduction to depreciation expense of $699,386 per year. As discussed above in Section II(D)(5), based on the uncertainty in Staff's calculations, it is likely that no amortization will be deemed necessary; however, if it is found to be necessary, the appropriate amortization period is 25 years or longer.

B. Staff improperly adjusted labor expenses.

NEO objects to Staff's use of NEO's actual employee levels in April 2019 as doing so was inconsistent with other adjustments recommended by Staff. In calculating adjustments to test year revenues, Staff used customer counts through June 2019. However, when calculating labor expenses, Staff used a completely different period (i.e., actual employee levels as of April 2019). In addition, Staff used the average hourly pay rate for each employee during the test period. As such, Staff's recommended adjustment to test year payroll, benefits, and payroll tax expenses is improper. Staff should have used the same period as the one they used when calculating test year revenues, i.e., June 2019, and should have used the most current rate of pay for each employee instead of the average to be consistent with Staff's other adjustments.

C. Staff's adjustment to Hearthstone Services expenses is based on incorrect information.

NEO supplied an incorrect date in responding to Staff DR #45, which appears to be information upon which Staff relied when removing NEO's adjustment as being out of period. NEO's normalization adjustment was based on the amendment to the original contract which changed the billing rates effective August 16, 2018, through August 15, 2019. NEO adjusted test year expense to include 1.5 months at the original contract rates and 10.5 months at the amended (current) contract rates. Therefore, NEO's adjustment should be reinstated. Applying NEO's allocation from the four-factor formula increases the adjustment to Schedule C-3.9 shared services expense from Staff's $2,031 to $50,073.

D. Staff's property tax adjustment must be updated.

NEO's adjustments to plant in service necessitate an increase in property tax expense from Staff's adjusted amount by $8,715.

E. Staff's income tax adjustment must be updated.

NEO's adjustments to operating income and rate base necessitate a decrease in income tax expense from Staff's adjusted amount by $341,583.

V. RATE OF RETURN

A. Staff used an inappropriate ROE methodology by focusing on historic returns.

Staff's proposed return on equity ("ROE") of 9.5% to 10.5% is based on a comparison of a group of alleged peer companies. Staff based its ROE recommendation on historical ROEs earned by a group of public utilities over a three-year period. However, ROEs for rate making purposes should be based on the future expectations of a market investor, not calculated historical returns. Staff calculated an arbitrary three-year average of historical ROEs for their comparable group. A calculated return from three years ago is not an indicator of a current, forward-looking return requirement for NEO. Staff should have used the Capital Asset Pricing Model or Discounted Cash Flow models – accepted models for determining a reasonable future return – by using betas from comparable companies.

B. Staff used an incorrect peer group.

Staff used an incorrect peer group when determining ROE. For example, Staff's peer group included unregulated midstream entities and failed to include regulated gas utilities more analogous to NEO. The flaws in Staff's peer group are obvious. Four of the companies in Staff's peer group have returns on equity below NEO's cost of debt. As such, comparison to these companies is inappropriate; thus, they should not be included in the peer group. Instead, Staff should have used a corrected peer group, which excludes companies with unusual financial issues, to conduct its calculations.

C. Staff failed to make necessary adjustments to the historic ROEs it used.

Staff applied no analysis to its ROE indications, over and above a simple averaging calculation. While using historical data for purposes of determining a future rate is problematic by itself, Staff could have performed an analysis regarding why the average ROEs of certain comparable companies were so low. Had Staff analyzed the companies' historical results, they would have seen that several companies had financial reporting impairments (not reflected in regulatory accounting) and other non-recurring events that biased the ROEs of those companies downward and resulted in Staff recommending a lower ROE.

D. Staff should have made an adjustment for the risks associated with small companies.

As has been found by Staff in the past, small companies face greater risk than larger companies. As a result, investors in smaller companies require higher returns. Staff erred by failing to make any adjustment to account for this reality, as it has in prior rate cases involving small utilities.

E. If historic ROEs are to be used, then the median of the peer group should be used instead of the average.

Staff's use of an average provides significant weight to outlier results. As discussed above, there are significant concerns with outliers in the Staff-selected peer group. Using the median instead of the average ensures that outliers will not adversely impact Staff's calculations to the same degree as using an average would.

VI. TARIFFS

A. Staff used incorrect administrative code section citations as part of its recommendation to replace references to "Ohio law" in certain tariffs.

Staff recommends that references to "Ohio law" in a number of tariff provisions should be replaced with specific administrative code sections. While NEO does not object to replacing "Ohio law" with specific administrative code sections in general, NEO has identified at least two specific code sections proposed by Staff that are inaccurate. First, Staff recommends that reference to "Ohio law" in Original Sheet No. 17, Section IV, No. 12, 2nd paragraph, should be replaced with O.A.C. 4901:1-18-03, which provides reasons for disconnecting residential service. The correct and applicable code section is O.A.C. 4901:1-18-06, which governs disconnection procedures. Second, Staff recommends that reference to "Ohio law" in Original Sheet No. 21, Section V, No. 20, 2nd sentence, should be replaced with O.A.C. 4901:1-18-04, which governs delinquent bills.

Again, Staff is mistaken. O.A.C. 4901:1-18-05, which governs extended payment plans and responsibilities, is the correct and applicable code section for this particular tariff provision.

Notwithstanding the foregoing, NEO reserves the right to supplement or modify these objections if Staff makes additional findings, conclusions, or recommendations with respect to the Staff Report. NEO further reserves the right to respond to objections or other issues raised by other parties in the above-captioned proceedings.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that the foregoing Objections to the Staff Report by Northeast Ohio Natural Gas Corp. was filed electronically through the Docketing Information System of the Public Utilities Commission of Ohio on this 25th day of July, 2019. The PUCO's e-filing system will electronically serve notice of the filing of this document on counsel for all parties.

/s/ *Mark T. Keaney*
One of the Attorneys for Northeast Ohio Natural Gas Corp.