THE PUBLIC UTILITIES COMMISSION OF OHIO

IN THE MATTER OF THE ANNUAL APPLICATION OF DUKE ENERGY OHIO, INC. FOR AN ADJUSTMENT TO THE CAPITAL EXPENDITURE PROGRAM RIDER RATE.	CASE NO. 21-618-GA-RDR

OPINION AND ORDER

Entered in the Journal on July 27, 2022

I. SUMMARY

{¶ 1} The Commission approves Duke Energy Ohio Inc.'s application to adjust its capital expenditure program rider, consistent with the findings within this Opinion and Order.

II. PROCEDURAL HISTORY

{¶ 2} Duke Energy Ohio, Inc. (Duke or the Company) is a natural gas company as defined by R.C. 4905.03 and a public utility as defined by R.C. 4905.02, and, as such, is subject to the jurisdiction of this Commission.

{¶ 3} R.C. 4929.111 provides that a natural gas company may file an application to implement a capital expenditure program (CEP) for any infrastructure expansion, improvement, or replacement program; any program to install, upgrade, or replace information technology systems; or any program reasonably necessary to comply with any rules, regulations, or orders of the Commission or other governmental entity having jurisdiction. If the Commission finds that the CEP is consistent with the applicant's statutory obligation to furnish necessary and adequate facilities, which are also found to be just and reasonable, the Commission is tasked with approving the application and authorizing the deferral or recovery of both a regulatory asset for post in-service carrying costs (PISCC) on the portion of assets of the CEP placed in service but not reflected in rates as plant in service and a regulatory asset for the incremental depreciation directly attributable to the CEP and the property tax expense directly attributable to the CEP but not reflected in rates.

{¶ 4} In Case No. 13-2417-GA-UNC, et al., the Commission modified and approved Duke's application to implement a CEP in 2013 and succeeding years, pursuant to R.C. 4909.18 and 4929.111. The Commission also approved Duke's request for accounting authority to capitalize PISCC on program investments for assets placed in service but not yet reflected in rates; defer depreciation expense and property tax expense directly attributable to the CEP; and establish a regulatory asset to which PISCC, depreciation expense, and property tax expense are deferred for future recovery in a subsequent proceeding. Duke was authorized to accrue deferrals under the CEP until the accrued deferrals, if included in the Company's residential service rates, would cause the rates charged to residential customers to increase by more than $1.50 per month. Additionally, the Commission noted that the prudence and reasonableness of Duke's CEP-related regulatory assets and associated capital spending would be considered in any future proceedings seeking cost recovery, at which time the Company would be expected to provide detailed information regarding the expenditures for the Commission's review. *In re Duke Energy Ohio, Inc.*, Case No. 13-2417-GA-UNC, et al., Finding and Order (Oct. 1, 2014).

{¶ 5} On April 21, 2021, the Commission modified and approved a stipulation and recommendation (Stipulation) that resolved all of the issues related to Duke's application for an alternative rate plan to establish Rider CEP for recovery of its CEP deferrals and investments from January 1, 2013, through December 31, 2018. *In re Duke Energy Ohio, Inc.*, Case No. 19-791-GA-ALT (*CEP Case*), Opinion and Order (Apr. 21, 2021). The Stipulation also provides that Duke will file annual applications to update the Rider CEP rates no later than March 31 of each year and that the first such application to be filed in 2021 will cover the CEP assets placed in service and the related CEP regulatory assets as of December 31, 2020. Further, the Stipulation requires that Staff or its designee conduct a review of Duke's annual application to update the Rider CEP rates to assist our determination of the lawfulness, used and usefulness, prudence, and reasonableness of the CEP assets placed in service and the related calculation of the CEP regulatory asset included in the proposed Rider CEP revenue requirement.

{¶ 6} On April 23, 2021, Duke filed an application to adjust Rider CEP for recovery of 2019 and 2020 CEP deferrals in accordance with the Commission's Opinion and Order. *CEP Case* at ¶ 83.

{¶ 7} On May 5, 2021, the Commission issued an Entry directing Staff to issue a request for proposal (RFP) for the audit services necessary to assist the Commission with the audit of Duke's CEP for the period of January 1, 2019, through December 31, 2020. Prospective bidders were directed to submit proposals to Staff by May 17, 2021. Interested bidders were also directed to demonstrate their understanding of the project and the work required by showing a clear understanding of the tasks to be completed, the experience and qualifications of the personnel who will perform the work, and the anticipated breakdown of costs and timing.

{¶ 8} On May 26, 2021, the Ohio Consumers' Counsel (OCC) filed a motion to intervene. On July 9, 2021, Interstate Gas Supply, Inc. (IGS) filed a motion to intervene. No memoranda contra were filed. By Entry issued September 13, 2021, the attorney examiner granted the motions for intervention filed by OCC and IGS.

{¶ 9} On June 2, 2021, the Commission issued an Entry selecting Blue Ridge Consulting Services, Inc. (Blue Ridge) to conduct the audit services necessary to assist the Commission with the review of Duke's CEP for the period of January 1, 2019, through December 31, 2020. Also, the Commission directed Duke to enter into a contract with Blue Ridge by June 16, 2021, for the purpose of providing payment for its auditing services and ordered that the contract shall incorporate the terms and conditions of the RFP, the auditor's proposal, and relevant Commission entries in this case.

{¶ 10} On September 10, 2021, Staff filed a motion for extension of time to complete the draft and final audit reports. In support of its motion, Staff noted that the deadlines for Blue Ridge's draft audit report and final audit report were September 17, 2021, and September 23, 2021, respectively. According to Staff, Blue Ridge informed Staff that it would not be able to complete either report by the current deadlines. Staff requested that the

deadlines for the draft and final audit reports be extended to September 30, 2021, and October 14, 2021, respectively.

{¶ 11} By Entry issued September 13, 2021, the attorney examiner granted Staff's unopposed motion for extension of time to complete the draft and final audit reports. The attorney examiner directed Blue Ridge to provide the draft audit report by September 30, 2021, and file the final audit report by October 14, 2021.

{¶ 12} On October 14, 2021, Blue Ridge filed its audit report of Duke's Rider CEP (Audit Report).

{¶ 13} On October 22, 2021, Staff filed its review and recommendation (Staff Report) regarding Duke's Rider CEP.

{¶ 14} By Entry issued October 25, 2021, the attorney examiner established the following procedural schedule: the deadline to file motions to intervene was November 8, 2021; the deadline for any intervening party to file comments on either Duke's application or the Staff Report was November 8, 2021; and the deadline to file a statement notifying the Commission as to the existence of any unresolved issues or objections and the need for an expedited hearing process was November 22, 2021.

{¶ 15} On November 8, 2021, Blue Ridge filed a supplement to its audit report, and Staff filed a supplement to its Staff Report, adopting Blue Ridge's supplement.

{¶ 16} On the same date, IGS and OCC filed comments. On November 18, 2021, OCC filed comments in response to the above supplements.

{¶ 17} On November 19, 2021, Duke filed an unopposed motion to modify the procedural schedule and a request for expedited ruling for the purposes of engaging in further settlement with the parties.

{¶ 18} By Entry issued November 22, 2021, the attorney examiner granted Duke's motion and directed Duke to file a statement notifying the Commission as to the existence of any unresolved issues or objections and the need for an expedited hearing process by December 10, 2021.

{¶ 19} On December 10, 2021, Duke filed a statement asserting that no issues stemming from the Staff Report and intervenor comments have been resolved, and no stipulation had been reached. Duke stated that a hearing was necessary, though it did not need to be expedited.

{¶ 20} By Entry issued December 16, 2021, the attorney examiner established the following procedural schedule: the hearing would commence on February 8, 2022; the deadline for Duke to file any direct supplemental testimony was January 18, 2022; and, the deadline for the filing of direct testimony on behalf of Staff and intervenors would be January 25, 2022.

{¶ 21} On February 7, 2022, Duke filed a letter in the docket stating that all parties have agreed to waive cross-examination of the witnesses. The letter also listed exhibits from Duke, Staff, OCC, and IGS and stated that the parties are in agreement that the exhibits can be entered into the record. Further, the letter stated that, given their agreement, the parties no longer believed that the scheduled hearing was necessary. The letter also noted that the parties agreed to a briefing schedule whereby initial briefs would be due by March 10, 2022, and reply briefs due by March 31, 2022.

{¶ 22} By Entry issued February 7, 2022, the attorney examiner cancelled the February 8, 2022 hearing and admitted into the record the exhibits referenced in Duke's February 7, 2022 letter. Further, the attorney examiner established a briefing schedule. Consistent with Duke's February 7, 2022 letter, the exhibits are as follows:

Company Exhibit 1	Duke's Application filed on April 23, 2021

Company Exhibit 2	Direct Testimony of Jay Brown filed on April 23, 2022
Company Exhibit 3	Supplemental Testimony of Jay Brown filed on January 18, 2022
Staff Exhibit 1	Plant in Service and Capital Expenditure Program Audit of Duke by Blue Ridge filed on October 14, 2021
Staff Exhibit 2	Staff Report filed on October 22, 2021
Staff Exhibit 3	Supplement to Report of Plant-in-Service and Capital Expenditure Program Audit filed on November 8, 2021
Staff Exhibit 4	Supplement to Staff Report filed on November 8, 2021
OCC Exhibit 1	Direct Testimony of Daniel J. Duann, Ph.D. filed on January 25, 2022
OCC Exhibit 2	Direct Testimony of Kerry J. Adkins filed on January 25, 2022
IGS Exhibit 1	Report of Plant-in-Service and Capital Spending Prudence Audit of Duke filed on May 11, 2020, in Case No. 19-791-GA-ALT
IGS Exhibit 2	Staff Report filed May 22, 2020, in Case No. 19-791-GA-ALT

{¶ 23} On March 10, 2022, Duke, OCC, IGS, and Staff filed initial briefs. On March 31, 2022, Duke, OCC, IGS, and Staff filed reply briefs.

III. Discussion

A. Audit Report

{¶ 24} On October 14, 2021, Blue Ridge filed its Audit Report. As part of the audit, the Commission directed Blue Ridge to conduct a two-phase evaluation of the Company's CEP capital expenditures. The first part of the audit included a review of the accounting accuracy and used and useful nature of Duke's capital expenditures and corresponding depreciation reserve from January 1, 2019, through December 31, 2020. The second part of the audit included an assessment of the necessity, reasonableness, and prudence of Duke's capital expenditures and related assets, with an emphasis on the CEP expenditures and assets from January 1, 2019, through December 31, 2020. (Staff Ex. 1 at 9.)

{¶ 25} As to the first part of the audit, Blue Ridge found that, based upon the descriptions of the scope provided, the work appears to be attributed to Duke with one exception, the Kellogg Training Center, which is located in Ohio, but is used to train both Ohio and Kentucky employees. Blue Ridge notes that Ohio ratepayers pay for the cost of the training center. Consequently, Blue Ridge recommends that the facility usage be tracked and that non-jurisdictional companies be required to pay rent for the facility's use, which should be recognized as a revenue offset. Blue Ridge also found one work order included in the CEP related to propane plant sewer main, which it believes should not be included in the CEP. According to Blue Ridge, Duke agreed with this assessment. Blue Ridge also found four other work orders requiring plant-related adjustments. Blue Ridge determined that the assets were used and useful and provide benefit to the ratepayer, and the assets did not appear over built. (Staff Ex. 2 at 9-10.)

{¶ 26} As to the second portion of the audit, Blue Ridge examined the Company's processes and controls to ensure that they were sufficient so as not to adversely affect the

balances in distribution utility net plant in service. Blue Ridge also examined internal audit reports conducted on various areas of the Company's operations that could impact utility plant-in-service balances. Blue Ridge concluded that Duke's controls were adequate and not unreasonable. (Staff Ex. 1 at 11.)

{¶ 27} Blue Ridge found that capital spending had increased significantly from 2016 through 2020, though it believes the steps Duke is taking to control individual project costs is reasonable. Blue Ridge stated that, as part of its review of CEP schedule accuracy, it reviewed Duke's proposed CEP revenue requirement schedules that support its requested recovery for authority to adjust its Rider CEP included in its application. According to Blue Ridge, the approved ending balances in the *CEP Case* should reflect the beginning balances in this case; however, the balances did not match. Although Duke provided an explanation for the discrepancy, Blue Ridge states that it sees the need for improvement with respect to the reporting of beginning balances, and recommends that, in future Rider CEP applications, Duke proactively include a reconciliation schedule and disclose all proposed adjustments to prior ending balances. Further, Blue Ridge recommends that Duke should work with auditors and Staff to resolve as many computation differences as practical before the ending balances in the current Rider CEP application are filed with the Commission. Other than the recommended adjustments, Blue Ridge found nothing to indicate that the non-infrastructure replacement program capital expenses and assets for the period January 1, 2019, through December 31, 2020, were unnecessary, unreasonable, or imprudent. (Staff Ex. 1 at 11-12.)

{¶ 28} On November 8, 2021, Blue Ridge filed a supplement to the Audit Report. The supplement concerns Blue Ridge's removal of Adjustment 7—premature plant-in-service date. Blue Ridge chronicles its exchanges with Duke concerning a specific work order Blue Ridge ultimately determined in the initial Audit Report should not be included in the CEP. Blue Ridge states that, after the Audit Report was filed, Duke discovered additional information related to this work order, and Blue Ridge believes costs related to this work order should be charged to the 2020 CEP. As a result of removing Adjustment 7, Blue Ridge

determined that Duke exceeded the $9.31 residential rate cap established in 2020, and, consequently, revised another adjustment to reflect this excess. (Staff Ex. 3 at 1-3.)

B. Staff Report

{¶ 29} As noted above, the Staff Report was filed on October 22, 2021. Staff adopts the Audit Report and highlights the following Audit Report recommendations:

(1) Adjust PISCC, property tax, allowance for funds used during construction (AFUDC), and understated retirements (Adjustments 1, 2, 9, and 10);

(2) Adjust rate case depreciation offset and accumulated deferred income taxes on liberalized depreciation (Adjustments 3-5);

(3) Remove non-CEP plant and plant not in-service (Adjustments 6-7),

(4) Remove premium on land acquisition (Adjustment 8); and,

(5) Restore CEP assets removed due to rate cap (Adjustment 11).

(Staff Ex. 2 at 2-3.)

{¶ 30} Staff reviewed three measures of profitability for Ohio's local distribution companies (LDC) and the median LDC returns nationwide. After comparing those measures of profitability with Duke's profitability, Staff finds that the Company has not significantly over-earned or under-earned. (Staff Ex. 2 at 3-4.)

{¶ 31} Ultimately, Staff finds that the Company has supported its filing with adequate data and information to ensure that Rider CEP's revenue requirement and resulting rider rates are just and reasonable. Staff recommends that the Commission approve Duke's application to adjust the CEP Rider as modified by the Staff Report. (Staff Ex. 2 at 4.)

{¶ 32} On November 8, 2021, Staff filed a supplement to the Staff Report. According to Staff, it agrees with and adopts the supplemental adjustments and recommendations

provided by Blue Ridge in its November 8, 2021 supplement to the Audit Report. Staff recommends that the Commission approve Duke's application for Rider CEP as modified by the initial Staff Report and this supplement. (Staff Ex. 4 at 1.)

C. Summary of the Comments

{¶ 33} On November 8, 2021, OCC and IGS filed comments in this case concerning Rider CEP. On November 18, 2021, OCC filed comments in response to the supplement to the Audit Report. These comments align with each party's position articulated in their filed briefs, which are more fully examined below.

D. Contested Adjustments and Recommendations from the Audit Report

{¶ 34} In its initial brief, Duke states that it concurs with Adjustments 1, 2, 4, 5, and 10 found within the Audit Report and agrees with Blue Ridge's decision in its supplement to the Audit Report to withdraw Adjustment 7. Further, Duke states that it concurs with Recommendations 1 through 4, Recommendation 7, and conditionally concurs with Recommendation 6 of the Audit Report. Duke contests Adjustments 3, 6, 8, 9, 11, as well as contests Recommendation 5. (Duke Initial Br. at 5-8.)

1. ADJUSTMENT 3: DEPRECIATION OFFSET

{¶ 35} The Audit Report provided the following summary for Adjustment 3:

> "The Company modified the beginning balance of the depreciation offset. Blue Ridge recommends that the computation be restored to the one approved in Case No. 19-791-GA-ALT. While the Company's rationale would prevail in a traditional base rate case model, it does not apply under alternative ratemaking paradigms, such as in this situation. The depreciation offset is a theoretical construct that the signatory parties negotiated to balance the interests of the Company and customers. Without Staff's consent and the Commission's approval, Blue Ridge views the modified computation to be non-compliant with the Stipulation and

> Recommendation. Restoring the approved computation increases the depreciation offset and decreases rate base by $24.19 million, $28.35 million, and $31.90 million in 2018, 2019, and 2020, respectively."

(Staff Ex. 1 at 34.)

{¶ 36} Duke argues that Adjustment 3 of the Audit Report is unsupported, inappropriate, and a significant departure resulting in millions of dollars of unrecoverable costs per year for the Company. Duke warns that, if Adjustment 3 is adopted, it would be unable to recover nearly $3 million per year, each year, until Duke's next natural gas base rate case is filed and resolved (Duke Initial Br. at 18). Duke argues that Blue Ridge's finding that the Stipulation in the *CEP Case* included an agreement as to a particular depreciation offset computation is misguided and unsupported by the rest of the Stipulation. According to Duke, the Stipulation is silent as to the computation of the depreciation offset and is not the product of negotiations in the Stipulation, as Blue Ridge suggests. Duke argues that the depreciation offset was originally included in the *CEP Case* application and not negotiated and highlights that the audit report and staff report in that case opine only on the reasonableness of the methodology, with no computational method mandated to be used in subsequent applications. Further, Duke asserts that the depreciation offset was not an agreed-upon, negotiated term in the Stipulation. By way of comparison, Duke provides examples of other instances where Staff and the Company expressly agreed to formula changes within the Stipulation, such as explicit language specifying the rates charged and dates of the assets included in those charges, language detailing how to calculate the incremental revenue offset, and language stating that Rider CEP will be calculated using the most recently available annual bills issued. Duke argues that the Stipulation is devoid of any language associated with the depreciation offset and that Blue Ridge only provides conclusory statements about Duke needing to restore the depreciation calculation methodology to the one approved in the *CEP Case*. Additionally, Duke asserts that the Staff Report offers no further information or support for Blue Ridge's position. On the other hand, Duke states that Jay Brown's direct and supplemental testimony provides the only

evidence to address details of the Stipulation and the fact that the depreciation offset was not an expressly negotiated term. (Duke Initial Br. at 10-13.)

{¶ 37} Duke also asserts that Blue Ridge's use of the calculation of the depreciation offset for Columbia Gas of Ohio, Inc. (Columbia) is inapposite as it was the product of an explicit, stipulated term, unlike the present matter. In support of Adjustment 3 to Duke's proposed depreciation offset in Schedule 11 of its Application, Duke notes that Blue Ridge relied on a case brought by Columbia, Case No. 17-2202-GA-ALT (Staff Ex. 1 at 31-32). Duke argues that the Columbia case is inapposite because, in the stipulation for that case, Columbia explicitly agreed to the depreciation offset proposed by Staff in its Staff Report. *In re the Application of Columbia Gas of Ohio Inc.*, Case No. 17-2202-GA-ALT, Staff Report (Sept. 14, 2018) at 8; Stipulation and Recommendation (Oct. 25. 2018) at 4. Duke contends that, in its Schedule 11 to the Application, it did not use the same formula as Columbia and argues that the formula was not a previously agreed upon term of the Stipulation (Co. Ex. 3 at Schedule 11). Duke points to the supplemental testimony in the *CEP Case* to demonstrate that the methodology used was different than Columbia's. Duke asserts that the existence of the Columbia computation methodology does not mean Duke's computation is inappropriate or unreasonable, especially considering the Commission ultimately approved the Stipulation. (Duke Initial Br. at 13-15.)

{¶ 38} Duke also contends that it would not have agreed to the static depreciation offset formula now advanced by Blue Ridge had one been proposed in the Stipulation to the *CEP Case*. First, in its calculation of the depreciation offset, Duke states that it has excluded production and common plant from rate base in Rider CEP (Duke Initial Br. at 15; Co. Ex. 3 at 10). Duke notes that the original depreciation offset included, among other things, a line item to exclude production-related depreciation expenses from the depreciation offset, using the logic that, if production-related plant expense was not being included in the Rider CEP rate base, then it did not make sense to include it in the depreciation offset (Co. Ex. 3 at 10-11). According to Duke, Staff and the auditor in the *CEP Case* found the methodology reasonable. *CEP Case*, Audit Report (May 11, 2020) at 2-10, 2-11; Staff Report (May 22, 2020)

at 8. Duke states that during the audit in the *CEP Case*, it realized that it had inadvertently neglected to back out common-related depreciation expenses from the depreciation offset, and, as a result, Duke corrected its error in the subject case by removing common assets-related depreciation expense (Co. Ex. 3 at 11, Schedule 11). Duke asserts that it was reasonable to remove common assets-related depreciation expense since Rider CEP rate base does not include common assets, therefore, according to Duke, the depreciation offset should also not include depreciation expense for assets that are not included in the rate base (Co. Ex. 3 at 11). Considering the above, Duke argues that it would not have agreed to freeze the formula because the methodology agreed to above, if required to remain static, would result in Duke essentially double-counting depreciation expenses related to CEP assets in future filings. To calculate the depreciation offset, Duke states that it starts with the total depreciation expense reported on Duke's FERC Form 2 filings each year. According to Duke, it already backs out CEP-related depreciation expense in these annual filings and, if forced into a static formula for the depreciation offset, the same depreciation will be reported twice on the form, effectively overstating the Accumulated Provision for Depreciation on the form. Duke asserts that it always intended to modify the formula as necessary to ensure that the depreciation offset is reasonable and just. (Co. Ex. 3 at 11-12.)

{¶ 39} Secondly, Duke argues that it would not have agreed to explicit language limiting changes to the formula calculating the depreciation offset because Duke had already agreed to caps for 2019 and 2020. *CEP Case*, Opinion and Order (Apr. 21, 2021) at ¶ 41. Duke believes that the calculation of these caps already incorporated the change to back out depreciation expense related to common assets from the depreciation offset (Co. Ex. 3 at 12). Duke contends that this assertion is additionally supported by three pieces of evidence. First, Duke states that it provided an estimate of the 2019 Rider CEP calculation to the parties through a data request response in the *CEP Case*. Duke notes that the calculation shown in response to the data request in question included the exact change that Blue Ridge contends was never agreed-to. (Co. Ex. 3 at Schedule 1.) Second, Duke states that, on Schedule 11, the depreciation offset is calculated by removing common assets-related depreciation in

Line 4, and Duke used the information in the above data request in its evaluation of the caps in the Stipulation in the *CEP Case* (Co. Ex. 3 at Schedule 11). Duke asserts that, if any language in the Stipulation indicated that the calculation methodology for the depreciation offsets would be static, Duke would have understood it did not have a viable opportunity to recover those costs. Further, Duke states that, had that been the understanding, it would have been a major issue in the *CEP Case*. Third, pointing to the testimony of Duke witness Martin P. Petchul in the *CEP Case*, Duke argued that it had believed that it had negotiated the 2019 cap at a level that reflected the opportunity for Duke to recover its full costs, as long as those costs were deemed prudent and reasonable in a future audit. Duke states that the other parties have not provided evidence showing otherwise and have not addressed these points. (Duke Initial Br. at 17-18; Co. Ex. 3 at 18.)

{¶ 40} In response to Duke's arguments concerning Adjustment 3, Staff first notes that the *CEP Case* established the formula for calculating the 2012 Rate Case Depreciation Offset, an element of the Accumulated Depreciation balance in CEP rate base. *CEP Case*, Opinion and Order (Apr. 21, 2021) at ¶ 61. Staff claims that Duke modified the depreciation offset formula without disclosing or explaining its position in Mr. Brown's direct testimony, Company Exhibit 2, which was filed prior to the Audit Report being filed. According to Staff, since there was no evidence to suggest that Duke could make such a change, Blue Ridge found the modified formula to be non-compliant with the Stipulation (Staff Ex. 1 at 31). In response to Duke's argument that the Stipulation is silent as to the depreciation offset, Staff states that the argument makes no sense, asserting that the Stipulation is silent as to the depreciation offset because counterparties deemed the calculation set forth by Duke in the *CEP Case* to be reasonable. Therefore, Staff argues no disagreement existed, meaning nothing needed to be negotiated nor did the offset need to be specifically mentioned in the Stipulation. As a result, Staff recommends the Commission approve Adjustment 3. (Staff Initial Br. at 5-6.)

{¶ 41} OCC agrees with Staff's arguments. OCC asserts that a depreciation offset methodology was used in the *CEP Case*, and both Staff and Duke signed the Stipulation.

According to OCC, since there was a depreciation offset methodology process used in the *CEP Case*, there was no need to specify the mechanics of it in the Stipulation. Therefore, OCC asserts that Blue Ridge was correct that an agreement among the parties as to a particular computational methodology existed. OCC argues that Duke cannot unilaterally modify the processes and procedures in place at the time the parties entered into the Stipulation. Accordingly, the Commission should adopt Adjustment 3. (OCC Reply Br. at 10-12.)

{¶ 42} In response to Staff's arguments in its initial brief, Duke states that Staff does not cite any authority stating that an explanation of a CEP calculation via supplemental testimony or inquiry from an auditor is inappropriate or should require disallowance of costs contemplated by the calculation. As such, Duke asserts that the Commission should not assign any weight to Staff's argument that, absent inclusion in initial testimony, the explanation and support for Duke's correction of the depreciation offset calculation should be ignored. (Duke Reply Br. at 3.) Secondly, in response to Staff's argument that the Stipulation is silent as to the depreciation offset because counterparties deemed the calculation set forth by Duke in the *CEP Case* to be reasonable, ignores the fact that, through the Stipulation, Duke negotiated a cap that incorporated the corrected depreciation offset. Duke argues that, if the depreciation offset formula is changed from what was used to calculate the cap, then Duke was never given a fair opportunity to earn the cap that was negotiated in good faith in the Stipulation. Further, Duke asserts that Staff fails to address the evidence provided in the supplemental testimony of Mr. Brown in the proceeding regarding how the cap was calculated in the *CEP Case*. Additionally, Duke states that Staff failed to explain how the Stipulation is devoid of terms demonstrating that the depreciation offset was a negotiated term. Regarding the negotiated cap, Duke asserts that Mr. Brown provided the only evidence supporting an agreement concerning calculation of the depreciation offset (Co. Ex. 3 at Schedule 1). Duke believes that Schedule 1, the document used as the basis for the calculation of the 2019 cap in the Stipulation, demonstrates that Duke relied upon that calculation in its negotiation of the stipulated caps. Since all

counterparties in the *CEP Case* were provided with Schedules 1 and 11, Duke contends that if these counterparties thought it was unreasonable to exclude common assets depreciation in the depreciation offset calculation for purposes of determining the caps, it should have been argued at that time, yet no party raised an issue with this approach. Duke concludes that if Blue Ridge and Staff's position is adopted, then Duke will be unable to recover the costs associated with those caps in the amount of approximately $3 million per year, and Duke would be denied the bargain of giving up full recovery for 2020 in favor of full recovery of known costs for 2019 since full recovery for 2019 will be unavailable. (Duke Reply Br. at 4-7.)

{¶ 43} Staff argues that Duke's objection here is incorrect, because rates agreed to in the Stipulation were established using a depreciation offset ending balance as of December 31, 2018, of $225,989,904. *CEP Case*, Larkin Report (May 11, 2020) at 2-10, 2-11. Further, Staff highlights that Duke agreed, except as otherwise delineated in the Stipulation, to all other terms of the Audit Report and Staff Report. *CEP Case*, Stipulation (November 16, 2022) at ¶ 12. Consequently, Duke accepted the depreciation offset methodology used in the *CEP Case*. According to Staff, Duke reduced the beginning balance to $201,816,115 when filing this case, and Blue Ridge found the modified formula to be non-compliant with the Stipulation as a result (Staff Ex. 1 at 31; Staff Reply Br. at 1-2).

{¶ 44} We find Duke's arguments persuasive and find that Adjustment 3 should be rejected. In the *CEP Case*, we generally noted that the depreciation offset is a theoretical construct that "* * * reflects the portion of depreciation expense collected from customers through base rates, but not yet recognized as an offset to rate base." *CEP Case*, Opinion and Order at ¶ 61. The audit report and staff report[1] in the *CEP Case*, when finding Duke's methodology for calculating the depreciation offset reasonable, indicate that the offset, as

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[1] Although the *CEP Case* staff report specifically mentions only the subtraction of depreciation expense related to Rider AMRP and Rider AU from total depreciation expense, Staff also states that it fully adopts the audit report in that matter. *CEP Case*, Staff Report (May 22, 2020) at 7-8. There appears to be no indication in the *CEP Case* or the current one indicating that Staff believes subtracting production depreciation expense is unreasonable.

filed in Duke's application, was determined by subtracting (1) Rider AMRP depreciation expense, (2) Rider AU depreciation expense, and (3) production depreciation expense from the total depreciation expense listed on Duke's annual FERC Form 2 filing (Staff Ex. 1 at 31). *CEP Case*, Audit Report (May 11, 2020) at 2-10, 2-11; Staff Report (May 22, 2020) at 8. Now, Duke argues it never agreed to a static depreciation offset formula, it never would have agreed to explicit language regarding a static formula, and it intends to add a fourth category to the formula, which subtracts common assets-related depreciation expense. According to Duke, it realized during the audit of the *CEP Case* that it inadvertently neglected to back out common asset-related depreciation expense, and, consequently, did subtract that depreciation expense from the depreciation offset for 2019 prior to the conclusion of the *CEP Case* and in the current case. (Co. Ex. 3 at 11, Schedule 11.) Similar to the reason for removing production-related depreciation expense from the depreciation offset formula—if production-related plant expense is not included in Rider CEP rate base then it should not be included in the depreciation offset—we generally agree with Duke that the same reasoning should apply in a situation with common assets-related depreciation expense where common assets are not included in Rider CEP rate base; however, this reasoning alone would not overcome a Commission-approved stipulated agreement requiring an already set depreciation offset formula. For the reasons articulated below, we believe Duke sufficiently demonstrated that it reasonably believed the Stipulation did not require the depreciation offset formula to remain static and that removal of common assets-related depreciation expense from the depreciation offset is lawful and reasonable.

{¶ 45} The Audit Report states that the depreciation offset formula used in this annual audit was not compliant with the Stipulation, essentially since the depreciation offset formula changed from the *CEP Case* (Staff Ex. 1 at 31). Significantly, however, the Stipulation does not explicitly set or reference the depreciation offset, and the parties appear not to contest this point. Staff argues that the depreciation offset was not specifically mentioned in the Stipulation because Staff and the auditor found in the *CEP Case* that the depreciation offset formula originally articulated by Duke was reasonable, so there was no

need to explicitly mention the offset in the Stipulation, as they assumed it was part of the application approval. Staff also asserts that, in the Stipulation, Duke agreed to the other terms of the audit report and staff report not mentioned within the Stipulation. *CEP Case*, Stipulation at ¶ 12. Nevertheless, Duke offers two convincing reasons as to why explicit language limiting changes to the depreciation offset does not exist within the Stipulation. First, according to Duke, the specifically negotiated 2019 and 2020 caps serve as proof that the Stipulation recognizes the change in the depreciation offset formula. Second, Duke states that using a static formula would result in Duke double-counting depreciation expense related to CEP assets in future filings. Regarding the first reason, as Duke represents, it provided revised Schedules 1 and 11 to the parties in response to a data request during the *CEP Case* audit, which consisted of an estimate of the "2019 Rider CEP Calculation." Duke mentioned that it relied upon these new schedules to land on the residential rate caps during negotiations for the Stipulation. Duke effectively demonstrated that Schedule 11 removes common assets-related depreciation expense as part of the formula used to calculate the depreciation offset. Further, Schedule 1, the revenue requirement calculation, includes the depreciation offset from Schedule 11, and Line 41 on Schedule 1, which lists the estimated monthly rate impact for the residential rate, increases by $2.92 from the final rate of $3.68 per bill recommended by the auditor in the *CEP Case*. This $2.92 increase matches the final agreed-to cap in the Stipulation. *CEP Case*, Stipulation at ¶ 4 (Co. Ex. 3 at 12-13, Schedule 1, Schedule 11.) Consequently, Duke believes the negotiated rate caps recognize this change in depreciation offset formula. As Duke points out, Mr. Petchul testified in the *CEP Case* that it was reasonable to negotiate Rider CEP revenue requirement caps at a level that reflected an opportunity for Duke to recover its costs. This testimony further underscores Duke's understanding that the depreciation offset formula was not static since it assumed it would be able to recover on a signification amount of its investments in 2019. *CEP Case*, Direct Testimony of Mark Petchul (Jan. 6, 2021) at 13.

{¶ 46} Duke states that the other reason for not agreeing to a static formula is that it would result in Duke double-counting depreciation expense related to CEP assets in

future filings. Duke notes that it already backs out CEP-related depreciation expense from rate base in Schedule 1, Line 4, of its FERC Form 2 annual filings. As Duke noted, if it must include common assets-related depreciation expense in the depreciation offset formula, then the same depreciation related to CEP included in Schedule 1, Line 4, will be included in Schedule 1, Line 5, resulting in an overstatement of the Accumulated Provision for Depreciation on Line 7 of the same schedule. (Co. Ex. 3 at 11-12, Schedule 1.)

{¶ 47} Although this issue could have been avoided or at least fully addressed in the *CEP Case* if Duke had provided the correct schedules from the start, as mentioned earlier, we do find that, taking all of the arguments together, it is reasonable for Duke to have revised the depreciation offset formula in the manner provided in this case. Although the Stipulation is silent as to the depreciation offset, Duke effectively showed how the residential rate caps were tied to revised Schedules 1 and 11, which were provided to the parties in that case, at least implying that using the non-static depreciation offset was acceptable in following years. Duke also sufficiently showed how failing to use the revised formula would result in an overstatement of Accumulated Provision for Depreciation on Duke's annual FERC Form 2 filings. Notably, although Blue Ridge determined that the depreciation offset formula used by Duke was not in compliance with the Stipulation, Blue Ridge did mention that Duke's rationale for the revised depreciation offset formula would prevail in a traditional base rate case model (Staff Ex. 1 at 31). Here, considering all of the above, we also believe Duke's reasoning as to the revised depreciation offset formula should prevail in this annual audit proceeding.

2. ADJUSTMENT 6: NON-CEP PLANT: V9197 — EAST WORKS PROPANE SEWER MAIN

{¶ 48} The Audit Report provided the following summary for Adjustment 6:

> "The project was for a collapsed sewer main at East Works Propane Gas Plant. Blue Ridge found, and the Company concurs, that it

> should not have been included in the Rider CEP. The adjustment reduces gross plant by $572,944 and reverses Cost of Removal of $46,567."

(Staff Ex. 1 at 35.)

{¶ 49} Duke states that it inadvertently included the project V9197—East Works Propane Sewer Main in its filing and concurs with Blue Ridge's proposed reduction in gross plant of $572,944 (Co. Ex. 3 at 14). Duke does not agree with Blue Ridge's proposed Cost of Removal (COR) adjustment of $46,567, which Duke deems as Blue Ridge recommending removal of costs not actually in Rider CEP. According to Duke, an adjustment to remove costs that are not a part of Rider CEP would have an unreasonable result, and this adjustment is punitive and confiscatory. (Duke Initial Br. at 19-20.)

{¶ 50} Staff disagrees with Duke and recommends approval of Adjustment 6. Staff argues that, during work order testing, Duke provided the COR amount for the work order with no indication that COR was not within Rider CEP. Staff asserts that, until Duke can definitively prove that it was not reflected in Rider CEP, Staff still recommends approval of the COR adjustment. (Staff Ex. 1 at Data Request 1-39L, Attachment 2; Staff Initial Br. at 6-7.) OCC agrees with Blue Ridge and Staff's findings and believes Duke has failed to meet its burden of proof under R.C. 4929.05(B) (OCC Reply Br. at 13).

{¶ 51} In response to Staff's assertion that Duke made no indication that COR was not within the Rider CEP for this work order, Duke states that it received many data requests for information outside of Rider CEP and, at the time of the request for COR information, the audit scope was broader than just Rider CEP. Duke was not aware that the auditor would be recommending a reduction related to COR. Duke also argues that it is not clear how Staff expects Duke to prove that COR is not included in the rider, as it should be apparent from the schedules provided by Duke in the initial filing that the only costs included are plant additions and retirements. Duke asserts that, as proof, no schedule that includes COR exists in either the *CEP Case* or the subject case filings. Further, Duke asserts that, by example, Removal Work in Progress is also not included as an offset to accumulated

depreciation, as was discussed in the audit report in the *CEP Case*, which Blue Ridge reviewed as part of its scope of this audit. Duke argues that it does not make sense to remove that which is not there. (Duke Reply Br. at 7-8.)

{¶ 52} We find that Adjustment 6 should be rejected. Staff appears not to contest the rejection of this adjustment if Duke can prove that the COR amount for this work order was not within Rider CEP. Duke's response, that the schedules provided by it in the initial filing show that the only costs included are plant additions and retirements and that no schedule including COR exists within the filings in either the *CEP Case* or the subject case, is persuasive and substantially conforms with Staff's request regarding this adjustment. Accordingly, we reject Blue Ridge's Adjustment 6 regarding COR for the work order in question.

3. ADJUSTMENT 8: LAND PURCHASED ABOVE FAIR MARKET VALUE (FMV) — AW1379 BLUE ROCK STATION (LAND)

{¶ 53} The Audit Report provided the following summary for Adjustment 8:

> "The Company purchased land for $255,000 that was above the fair market value of $160,000. Blue Ridge recommends a reduction to plant of $95,000 to remove the amount above FMV."

(Staff Ex. 1 at 35.)

{¶ 54} Duke disagrees with this adjustment, stating that Blue Ridge overlooks and oversimplifies the realities of land acquisition for Duke. According to Duke, the land upon which Blue Rock Station was required to be located was not for sale at the time Duke was able to negotiate the purchase price, and Duke had to induce the owner to sell the property. Duke states that it is not unreasonable to pay a premium to acquire land that is not for sale to convince the current owner to sell it. Further, Duke asserts that it negotiated and settled the purchase price in the free market and that the price paid was necessary to acquire the land and avoid unreasonable delays through a lengthy condemnation proceeding.

Moreover, installation of this station was necessary for the continued delivery of safe and reliable natural gas service to customers. (Co. Ex. 3 at 15-16; Duke Initial Br. at 20-21.)

{¶ 55} According to Staff, Adjustment 8 provided in the Audit Report should be adopted. Despite Duke's arguments otherwise, Staff asserts that the cost of acquisition does not justify the benefit since customers will be required to pay a return on the acquisition premium in perpetuity. As a result, a condemnation proceeding would have been the better path forward even if it was less expedient and convenient. (Staff Initial Br. at 7; Staff Reply Br. at 2.)

{¶ 56} OCC concurs with Staff, noting that, if Duke is permitted to pass on cost premiums to consumers through increased rates, then it would not have an incentive to aggressively negotiate lower costs (OCC Reply Br. at 13-14).

{¶ 57} In its reply brief, Duke reiterates the arguments it made within its initial brief and mentions that the legal costs associated with a condemnation proceeding could easily make up the $95,000 difference in FMV and purchase price, and a condemnation proceeding would have resulted in a lengthy delay in moving forward with the work on the property in question. According to Duke, paying a premium to acquire this land is the reality of certain property purchases Duke must undertake for the purposes of location, project success, or safety. (Duke Reply Br. at 8-9.)

{¶ 58} We find Staff's and OCC's arguments persuasive and find that Adjustment 8 should be adopted. While Duke may at times need to pay above FMV to acquire land it needs to complete a project, considering customers may ultimately pay for the above FMV via an increase in rates, we believe it is important, as OCC argues, to incentivize Duke as much as possible to negotiate lower land acquisition prices to mitigate the potential downstream effect on ratepayers. This belief remains true even if Duke must undertake a condemnation proceeding for a particular property, an action possibly not necessary for some if any property acquisitions.

4. ADJUSTMENT 9: ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION — P7988 STA 436 SCADA INSTALL ODORIZER HEAT

{¶ 59} The Audit Report provided the following summary for Adjustment 9:

> "The Company had significant gaps in work and continued to accrue AFUDC. Blue Ridge recommends a reduction to plant of $57,000 to remove the 10 months that AFUDC was accruing while little to no work was being performed."

(Staff Ex. 1 at 35.)

{¶ 60} Duke argues that, in accruing AFUDC, it complied with its capitalization guidelines, as monthly charges continued to be charged to the project over the course of the delays, indicating that work was in fact being done. According to Duke, Blue Ridge reviewed these capitalization guidelines as part of the audit process and found the policies and procedures were adequate and not unreasonable as it relates to this point. Duke notes that Staff has no counterpoint to this finding aside from recommending Adjustment 9 be adopted. (Co. Ex. 3 at 16; Staff Ex. 1 at 39-41; Duke Initial Br. at 21-22; Duke Reply Br. at 9)

{¶ 61} Staff, on the other hand, argues that, upon review of the cost detail and supporting workpapers, Blue Ridge found only $13,000 was charged to the project for materials, inventories, and stores (i.e., no labor), and more than 80 percent of the charges were for AFUDC. (Staff Ex. 1 at 145, Appendix C: Work Papers; Staff Initial Br. at 7-8.) Staff argues that Duke's claim that work was being done is not supported by the information provided by Duke. Since no work was charged during the ten-month period in question, AFUDC should be disallowed. (Staff Reply Br. at 3.)

{¶ 62} OCC concurs with Staff's support of Blue Ridge's proposed adjustment, further noting that not upholding this adjustment could incentivize Duke to start a project and then let it sit idle for months just to collect AFUDC (OCC Reply Br. at 14).

{¶ 63} The Commission adopts Adjustment 9, which reduces plant expenses by $57,000 to remove 10 months of AFUDC that was accruing while little to no labor was being performed installing an odorizer heater in accordance with this specific work order. As stated by Blue Ridge, AFUDC should not be charged when no work is being performed. (Staff Ex. 1 at 35, 78.) While Duke states that monthly charges continued to be charged to the project over the course of the delays, which, it contends, indicates that work was being done, and states that their capitalization guidelines allow for AFUDC to be accrued when charges continue to appear for a project in this manner, we find Staff's argument persuasive that the cost detail provided by Duke for the 10-month period shows that 80 percent of the charges were for AFUDC. The other charges, $13,000, were for materials and inventories, with no labor charged during that period (Staff Ex. 1 at 145, Appendix C: Work Papers; Staff Initial Br. at 7-8.) Consequently, we find that Adjustment 9 should be adopted and AFUDC in this instance disallowed.

5. ADJUSTMENT 11: CEP ASSETS REMOVED TO STAY BELOW RESIDENTIAL RATE CAP

{¶ 64} The Audit Report provided the following summary for Adjustment 11:

> "After reflecting the impact of Adjustments #1-10, the Company is comfortably below the residential rate cap of $6.61 and $9.31 for 2019 and 2020, respectively. Accordingly, Blue Ridge recommends the full restoration of the qualified CEP investments the Company removed as shown in Table 12 above."

(Staff Ex. 1 at 35.)

{¶ 65} Duke argues that the Commission's consideration of Adjustment 11 should be tied to its treatment of Adjustments 1 through 10, particularly Adjustment 3. Duke states that, if the Commission does not set aside Adjustment 3 and other corresponding adjustments, then Duke agrees with Adjustment 11. According to Duke, if the Commission accepts Adjustment 3, it would be necessary to restore qualified CEP investments previously

removed by Duke in order that the stipulated caps would allow full recovery of the qualified CEP investments for 2019 and 2020. (Duke Initial Br. at 22; Duke Reply Br. at 22.)

{¶ 66} Staff notes that Duke reduced its balance of plant additions that would otherwise qualify for inclusion in Rider CEP to stay within the agreed upon residential rate caps. Staff further notes that no difference of opinion exists between Duke and Blue Ridge. Staff states that the final value of the plant disallowances is predicated on the Commission's decision in this matter. (Staff Ex. 1 at 35, 37; Co. Ex. 3 at 16-17; Staff Initial Br. at 8; Staff Reply Br. at 3.)

{¶ 67} As detailed in a section further below, OCC argues that Adjustment 11 should be rejected since Blue Ridge's recommended residential rate for 2020 violates the maximum rate increase from 2019 to 2020 allowed for under the Stipulation. Since the recommended 2020 rate must be reduced to meet this maximum increase threshold, Duke is no longer sitting comfortably below the rate caps for that year, meaning no qualified CEP investments should be restored.

{¶ 68} As noted by Duke and Staff above, the decision regarding Adjustment 11 depends on how the other adjustments are handled. As we have demonstrated above and will do so below, we have agreed with most adjustments and rejected only Adjustments 3 and 6. Consequently, our decision on this adjustment is conditional. We will adopt Adjustment 11 only to the extent that the stipulated caps would allow full recovery of the qualified CEP investments for 2019 and 2020. However, if our decision on Adjustment 3 and the other adjustments and recommendations in this Order results in full recovery in line with the stipulated caps, then Adjustment 11 is not necessary and should be rejected. We direct Duke to implement this directive in the appropriate manner described above after reconciling the adjustments and recommendations from this Order.

6. Recommendation 5: Estimated In-Service Dates

{¶ 69} The Audit Report provided the following summary for Recommendation 5:

> "Blue Ridge recommends that the Company establish a procedure that requires major non-blanket project changes in estimated in-service dates to be documented. Each change should be explained, and that information should be provided to Senior Management. This process should also become part of the actual to budget project variance analysis and explanations."

(Staff Ex. 1 at 36.)

{¶ 70} According to Duke, Recommendation 5, as written, would result in a significant amount of additional tracking and documentation without the realization of any benefit to customers or information that could drive decision making efficiencies for Duke. Duke asserts that tracking every in-service date change for projects is not useful to senior management and would result in an overload of information, further straining already-strained systems with more reporting and documentation requirements (Co. Ex. 3 at 17). Duke argues that the concept of "change in-service date" is not developed enough to be instructive or useful. In place of Blue Ridge's recommendation, Duke suggests that it could track projects over ten million dollars since larger projects have a more significant impact when their in-service dates shift or change. Smaller projects can be managed at lower levels (i.e., not at the senior management level) more efficiently and cost effectively. (Duke Initial Br. at 22-23.)

{¶ 71} Staff recommends adopting Recommendation 5 with the clarification that "major non-blanket projects" should be defined as non-blanket projects over $500,000. Staff argues that Duke's $10 million threshold fails to address the issues identified by Blue Ridge, namely that, when Duke is unable to explain reasons for why estimated in-service dates slip, it is not possible to determine whether the projects are being managed and completed efficiently. According to Staff, key stakeholders, including auditors and senior

management, need this information to effectively perform their monitoring function. (Staff Initial Br. at 9-10; Staff Reply Br. at 3.) OCC concurs with Staff's recommendation regarding this issue (OCC Reply Br. at 15).

{¶ 72} In response to Staff's clarification, Duke argues that the $500,000 threshold is too low and would encompass nearly every capital expenditure project. Duke then states that, in the spirit of compromise, it is willing to accept a threshold of $5 million. (Duke Reply Br. at 10-11.)

{¶ 73} The Commission notes that, generally, Duke does not object to Blue Ridge's Recommendation 5, requiring a procedure to be established to document major changes to non-blanket project in-service dates with such documentation being provided to senior management. Considering the above arguments, the only issue to be resolved regarding this adjustment appears to be the project cost threshold at which Duke must begin to engage in the analysis detailed by Blue Ridge in its recommendation. The Commission views the $10 million first proffered by Duke and then the $5 million threshold offered by Duke on reply as too high for the reasons Staff articulated. As Blue Ridge noted in the Audit Report, without more specific documentation as to why in-service dates for non-blanket projects change, an auditor is unable to determine if Duke was efficient in completing the projects (Staff Ex. 1 at 70). Being able to sufficiently track and review changes to in-service dates on capital projects on a more general scale, including providing such documentation to those at a senior management level who can determine the effectiveness of Duke's project management, appears to be needed to determine Duke's efficiency in completing these projects. At the same time, however, we agree with Duke that the $500,000 threshold suggested by Staff is too low, considering, as Duke represents, such a threshold would encompass nearly every capital expenditure project and would most likely require a significant increase in documentation and reporting. To balance the amount of additional documentation and reporting required of Duke to comply with the recommendation with the goal of tracking enough projects such that a future auditor can provide a meaningful determination as to Duke's efficiency in completing projects, we believe the non-blanket

project threshold should be $2 million. We also direct Staff, in the next CEP RFP, to instruct the auditor to review the implementation of that threshold and report on the efficacy of the $2 million threshold in achieving its purpose.

7. Recommendation 6: Stock-Based and Earnings-Related Incentive Compensation

{¶ 74} The Audit Report provided the following summary for Recommendation 6:

> "In the Stipulation in Case No. 19-791-GA-ALT, the parties agreed, and the Commission approved, that incentive pay will continue to be capitalized in accordance with Duke's existing accounting policies and procedures that follow generally accepted accounting principles. The amount of stock-based and earnings-related incentive compensation that is capitalized and included in the CEP appears to be increasing. Blue Ridge recommends that the capitalization and recovery of stock-based and earnings-related incentive compensation should be monitored to ensure the amount recovered does not significantly increase."

(Staff Ex. 1 at 36.)

{¶ 75} Duke states that it agrees with this recommendation insofar as Blue Ridge intends Staff will monitor incentives included for recovery in the CEP, by including the issue in the standard annual audit scope, as it has been included in the last two audits. However, if Blue Ridge intends that Duke should monitor these charges separate from the annual audit process, Duke believes such a process would add little to no value since it would be duplicating the annual audit process's work. (Duke Initial Br. at 24.)

{¶ 76} Staff concurs with Duke, stating that the capitalization and recovery of stock-based and earnings-related incentive compensation should be monitored as part of the annual audit scope to ensure the amount recovered does not significantly increase (Staff Initial Br. at 10-11).

{¶ 77} Duke stated in its reply brief that, based upon Staff's clarification above, Staff and Duke concur regarding Recommendation 6 (Duke Reply Br. at 1).

{¶ 78} IGS argues that Duke should not be permitted to include financial performance incentives in its 2019 and 2020 CEP revenue requirement because it has not provided any evidence to support the proposition that these costs are related to improving the quality of service, efficiency, or safety of its natural gas distribution business pursuant to R.C. 4929.111. IGS states that, as part of its review, Blue Ridge asked Duke to identify and quantify incentive compensation by "any amounts of incentive and/or stock-based compensation that relates to the Company's stock price, dividends or financial goals included in the CEP" (Staff Ex. 1 at 75). IGS notes that, based on Duke's responses, Blue Ridge found, as to the former question above, Duke increased the percentage related to earnings for the allocated incentives by approximately 10 percent since the last audit was performed in the *CEP Case*. IGS further notes that, as to the latter question above, Blue Ridge found that the earnings-based incentive compensation that Duke allocated to capital spiked in 2019 by approximately $45 million from the prior year. (Staff Ex. 1 at 75; IGS Initial Br. at 2, 5.)

{¶ 79} IGS argues that the expenses Duke seeks to recover in Rider CEP should provide measurable benefit to ratepayers by improving the quality, efficiency, or safety of its natural gas distribution. IGS states that the Commission defines financial performance incentives as including "performance awards, stock purchases, and/or other financially motivated incentives tied to the [utility's] bottom line." *In re the Application of Duke Energy Ohio, Inc.*, Case No. 16-664-EL-RDR, et al., Finding and Order (May 15, 2019) at 6, citing to the Staff Report (Sept. 11, 2018) at 2. According to IGS, financial performance incentives correlated to a utility's bottom line and used to meet shareholder interests are unrelated to a utility's obligation to furnish necessary and adequate natural gas distribution services and facilities, and, therefore, should not be recovered under R.C. 4929.111. Citing to previous Commission decisions, IGS argues that the Commission has excluded financial performance incentives from utility expenses after determining that the costs were correlated to the

utility's bottom line. According to IGS, Commission policy prohibits utilities from charging ratepayers for financial incentives because financial inducements distributed to utility employees for achieving financial goals only serve the interests of the utility's shareholders and provide no benefit to the customers who pay for those charges. IGS asserts that Duke has failed to provide any evidence demonstrating that the financial performance incentives at issue are any different than those flagged for removal in the *CEP Case* prior to the Stipulation. (IGS Initial Br. at 6-8.)

{¶ 80} In response to Duke's argument that the express language of the Stipulation allows for the continued capitalization of financial incentives and inclusion in Rider CEP, IGS contends that this argument fails for two reasons (Co. Ex. 3 at 20-21). According to IGS, the Stipulation was submitted for the purpose of resolving the *CEP Case*, with an emphasis on expenditures and related assets for the period of January 1, 2013, through December 31, 2018 (IGS Ex. 1 at 2-2). Contrarily, the subject Application was submitted for a different audit period. IGS asserts that the Stipulation cannot bind the Commission to future audits, and it should not here. Secondly, IGS argues that it was not a party to the *CEP Case* and cannot be bound by the Stipulation. Further, IGS argues that Staff expressly recommended in the *CEP Case* that Duke remove the earnings-based portion of the incentive compensation and stock-based compensation from its CEP (IGS Ex. 1 at 2-15). IGS contends that Staff's prior statements are admissions of Staff's position on this matter and should not be ignored by the Commission in this matter. Finally, IGS asserts that there is no language in the Stipulation suggesting that the financial benefit incentives are intended to be included in Duke's CEP on an ongoing basis. (IGS Initial Br. at 8-10.) IGS's reply brief largely reiterates the above arguments and notes that it agrees with OCC's arguments (IGS Reply Br. 1-6).

{¶ 81} OCC argues that the financial performance incentives included in Duke's CEP during this audit period should be removed because they are counter to the Commission's policies and would cause harm to consumers since they would receive no benefit from these charges (OCC Ex. 2 at 17). OCC notes that, in this case, Blue Ridge did not address Duke's inclusion of financial performance incentives in Rider CEP. OCC points to other cases where

an auditor recommended removing such incentives from the CEP. For example, OCC states that the auditor, Blue Ridge, in East Ohio Gas Company d/b/a Dominion Energy Ohio's most recent CEP rider case maintained that financial incentives should not be included in the CEP, that including them would reward behavior that promotes the interest of shareholders, and that excessive focus on increasing profitability and share price growth can harm customers. *In re the Annual Application of the East Ohio Gas Company d/b/a Dominion Energy Ohio*, Case No. 21-619-GA-RDR, Blue Ridge Audit Report (July 15, 2021) at 30. OCC also asserts that the auditor in the *CEP Case* specifically found that incentive compensation that is directly attributable to meeting financial performance goals, such as net income or earnings per share, is not properly recoverable from ratepayers for such reason as the following: achieving the necessary performance should be self-supporting; reaching such goals should provide the income necessary to fund the awards; and paying out for financial goals is distinguishable for incentive compensation that is measured for improving quality of service, efficiency, or safety goals. According to OCC, the auditor in the *CEP Case* also recommended that the cost of stock-based compensation programs be removed, as these goals do not improve customer service or meet other regulated utility service requirements. (IGS Ex. 1 at 9-9; OCC Ex. 2 at 16-17; OCC Initial Br. at 13-17.) Highlighting several cases, OCC asserts that the Commission has recognized that utility financial performance incentives, which benefit the utility and shareholders only, should not be collected from consumers. In its reply brief, OCC largely reiterates the above arguments and notes that it agrees with IGS's arguments (OCC Reply Br. at 5-8).

{¶ 82} In response to IGS and OCC, Duke states that the Stipulation in the *CEP Case* established the stipulated rate caps for 2019 and 2020, which have been expressly applied, and the Stipulation stated that, "[t]hese are the rates calculated in the Larkin & Associates Audit Report dated May 11, 2020 excluding adjustments to earnings-related incentives, which will continue to be capitalized, and included in Rider CEP[.]" *CEP Case*, Stipulation (Nov. 16, 2022) at 3; (Co. Ex. 3 at 19.) Duke asserts that inclusion of capitalized incentives in capital assets is consistent with Generally Accepted Accounting Principles (GAAP), Duke's

capitalization guidelines, and the Commission's approval of its natural gas base rates (Staff Ex. 1 at 36). Duke argues that no evidence exists showing Duke unreasonably included capitalized incentives in Rider CEP and points out that Staff and Blue Ridge take no issue with these incentives being included in Rider CEP. Furthermore, in response to IGS and OCC, Duke argues that their argument concerning the Stipulation in the *CEP Case* having no binding authority in this matter is paradoxical in that IGS and OCC want the Commission to enforce the stipulated and approved residential rate caps, yet they do not want the Commission to enforce the stipulated and approved financial incentive capitalization. Duke asserts that they cannot have it both ways. Further, Duke points to the Audit Report which expressly stated that its review of the financial incentives is limited due to the Stipulation, and notes that Blue Ridge recommended these incentives be monitored, not adjusted, further proof that Staff and Blue Ridge were bound by the Stipulation (Staff Ex. 1 at 36, 75). (Duke Reply Br. at 11-14.)

{¶ 83} Staff concurs with Duke that, in the *CEP Case*, the parties agreed, and the Commission approved, that incentive pay will continue to be capitalized in accordance with Duke's existing accounting policies and procedures that follow GAAP. *CEP Case*, Stipulation at 7; Opinion and Order at ¶ 69. Staff notes that the capitalization of financial performance initiatives that benefit stockholders should be addressed in the next base rate case. (Staff Reply Br. at 5.)

{¶ 84} We adopt Blue Ridge's Recommendation 6 regarding stock-based and earnings-related incentive compensation, as clarified by Duke and Staff that the capitalization and recovery of stock-based and earnings-related incentive compensation should be monitored as part of the annual audit scope to ensure the amount recovered does not significantly increase. In part, OCC and IGS take issue with including such financial performance incentives in Rider CEP since the Commission has found in prior proceedings that such incentives should not be included in capital expenditure programs. Further, OCC and IGS point to the audit report and Staff's recommendation from the *CEP Case*, both of which recommended removal of these financial performance incentive costs, as support for

removing such costs from the rider in this case. However, these arguments overlook the fact that the Stipulation in the *CEP Case*, which was entered into by Duke and Staff and adopted by the Commission, expressly states that "earnings-related incentives, * * * will continue to be capitalized, and included in Rider CEP[.]" *CEP Case*, Stipulation at ¶ 2. Further, the Stipulation states that "[t]he Stipulating Parties agree that incentive pay will continue to be capitalized in accordance with the Company's existing accounting policies and procedures that follow generally accepted accounting principles * * * ." *CEP Case*, Stipulation at ¶ 9. In that case, the Commission found that the inclusion of earnings- and stock-based incentives is not unreasonable since it is consistent with GAAP, as well as the treatment of such incentives in Duke's natural gas base rates. *CEP Case*, Opinion and Order at ¶ 69. Explicit in the Commission's order is the understanding that these financial performance incentives would continue to be capitalized in Rider CEP. Further, in this case, Blue Ridge noted in the Audit Report that it limited its review regarding financial performance incentives due to the agreement in the Stipulation, and Staff agreed with this tact (Staff Ex. 1 at 35, 75-76; Staff Ex. 2 at 3; Staff Reply Br. at 5). IGS argues that the Stipulation does not contain language stating that financial performance incentives were intended to be included in the CEP on an ongoing basis and that the incentive provisions only applied to the 2013 through 2018 audit period; however, as demonstrated above, the language of the Stipulation clearly states that these incentives will continue to be capitalized in Rider CEP after the *CEP Case* audit period. Further, we find that OCC and IGS have not provided any convincing argument regarding why the Stipulation should not be binding on this proceeding. To IGS's argument that the Stipulation cannot be binding on it because it was not part of the *CEP Case*, we disagree. The Stipulation in the *CEP Case*, which consisted of provisions that carry forward into further annual CEP audits, as well as the approval of that Stipulation, resulted from litigation between several knowledgeable parties. IGS had the opportunity to intervene in that matter, and it chose not to; therefore, IGS's argument rings hollow.

8. RECOMMENDATION 7: UNITIZATION BACKLOG

{¶ 85} The Audit Report provided the following summary for Recommendation 7:

> "Blue Ridge recommends that while the emphasis should be to unitize the over-12-month work orders[,] [t]he Company should consider what it would take to auto unitize blanket work orders to reduce the backlog."

(Staff Ex. 1 at 36.)

{¶ 86} According to Staff, Duke stated that it would consider the recommendation to help reduce the current backlog of unitization[2] (Co. Ex. 3 at 18). Staff recommends that the Commission order Duke to develop a plan or explain why auto-unitization is not viable. (Staff Initial Br. at 11.) OCC states that it agrees with Staff's recommendation. Further, OCC states that the Commission should order Duke to either timely implement an auto-unitization process for blanket work orders or timely propose a viable alternative plan to promptly work off the unitization backlog and ensure timely unitization going forward. According to OCC, either plan should include a timetable for implementation of the plan, an explanation of how the plan will address the unitization backlog and ensure timely unitization going forward, goals/milestones with anticipated dates, and description of how the plan will be evaluated. (OCC Reply Br. at 15-16.)

{¶ 87} Besides noting that it agreed with Recommendation 7, Duke did not elaborate further on this matter (Duke Initial Br. at 6; Duke Reply Br. at 1).

{¶ 88} We adopt Recommendation 7 and direct Duke to either develop a plan to implement auto-unitization of blanket work orders to reduce the backlog or provide a detailed explanation as to why auto-unitization of blanket work orders is not viable. Duke should work with Staff in developing such a plan, if viable, or provide Staff with its detailed

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[2] Unitization is the process of allocating actual costs of capital projects to the corresponding unit of property (and appropriate FERC property account) once work has been completed.

explanation as to why auto-unitization of blanket work orders is not viable. If need be, the parties can revisit this issue, as well as assess the Company's progress in reducing the backlog of work orders exceeding 12 months, during Duke's next natural gas base rate case.

E. OCC's Other Recommendations/Arguments

{¶ 89} At the outset, OCC argues that it believes the Stipulation adopted in the *CEP Case*, which was signed by Duke and Staff, has no precedential value in this proceeding. OCC asserts that the Stipulation specifically stated that it should not be cited as precedent in any future proceeding for or against any signatory party or the Commission itself and that the agreement does not necessarily reflect the position one or more of the signatory parties would have taken if the issues had been fully litigated. *CEP Case*, Stipulation at ¶ 21. As indicated by these provisions, OCC contends that the Stipulation should not be binding on this proceeding. (OCC Initial Br. at 23-24.) Duke's responses to this general argument can be found in the sections below.

1. Pre-tax Rate of Return (ROR)

{¶ 90} According to OCC, Duke is proposing to overcharge consumers for profits and for its cost of debt based on an outdated case from nine years ago. OCC notes that Duke proposed, and neither Staff nor Blue Ridge opposed, a 9.16 percent pre-tax rate of return to be charged to customers under Rider CEP. OCC asserts that the ROR is based on the same rate decided in Duke's rate case nine years ago. *In re the Application of Duke Energy Ohio, Inc.*, Case No. 12-1685-GA-AIR, et al., Opinion and Order (Nov. 13, 2013). OCC argues that this ROR will hurt consumers by increasing Rider CEP's revenue requirement to consumers by approximately $2.5 million in this proceeding, while providing no offsetting benefits (OCC Ex. 1 at 7). This windfall coupled with the fact that the ROR was decided in vastly different financial market conditions demonstrates that the ROR is unjust and unreasonable. In response to Duke arguing that this ROR should not be revised, OCC states that the *CEP Case* did not set the ROR to be used in this proceeding, it only approved the CEP program and the first-year Rider CEP charge, and Blue Ridge, in the subject case, did not endorse or

support a specific ROR, but rather just noted that the approved ROR was set in Case No. 12-1685-GA-AIR (Co. Ex. 3 at 18-19; OCC Ex. 1 at 6; Staff Ex. 1 at 33). As a result, the Commission can and should revise this rate for CEP investments based on consideration of public interest and sound regulatory principles (OCC Ex. 1 at 6). (OCC Initial Br. at 4-6.)

{¶ 91} OCC asserts that Duke's current cost of debt, 5.32 percent, is outdated and far exceeds Duke's current cost of debt, which OCC calculated as 4.03 percent. Also, OCC argues that Duke's return on equity, 9.84 percent, exceeds currently allowed profits of gas distribution companies in Ohio and nationwide, as well as a reasonable return on equity of 9.36 percent calculated by OCC. (Co. Ex. 1 at Attachment No. 1; OCC Ex. 1 at 11-16.) OCC calculated a ROR of 8.29 percent that it believes is reasonable and should be used (OCC Ex. 1 at 7, 12). By using Duke's ROR versus OCC's calculated rate, OCC asserts that Duke customers will have to pay approximately $2.5 million more for the 12-month period covering this proceeding (OCC Ex. 1 at 7, 13-14). Further, OCC warns that the Energy Information Administration has indicated that natural gas and other energy costs have rapidly risen in recent months and potentially will continue to increase over an extended period of time, so the Commission should exercise its statutory authority to set reasonable profits and debt costs for Duke's CEP program to protect customers from paying unreasonable rates. (OCC Initial Br. at 7-8.) To this point, OCC points out that Staff's financial earnings review contained within the Staff Report, which determined that Duke had not significantly over-earned or under-earned, did not limit its review to earnings contributed to the CEP like OCC believes it should have. Instead, it focused on the overall profitability of Duke and other LDCs. (Staff Ex. 2 at 4-5; OCC Ex. 1 at 15-15.) Even if Duke did not significantly over- or under-earn over the last three years, according to OCC, this does not mean that the ROR is just and reasonable, especially considering the three-year average median return on equity of 7.94 percent nationwide and the return on equity earned by Ohio LDCs shown in the Staff Report, which demonstrate that the 9.84 percent return on equity proposed by Duke is unjust and unreasonable (OCC Initial Br. at 9). OCC largely reiterated the above arguments in its reply brief (OCC Reply Br. at 3-4.)

{¶ 92} In response to OCC's arguments, Duke, citing to numerous Commission proceedings, argues that Commission precedent consistently uses the last authorized ROR to calculate the revenue requirement in various rider proceedings for natural gas utilities. Duke states that, here, the Stipulation in the *CEP Case* based its ROR on the most recent natural gas base rate case in Case No. 12-1685-GA-AIR, and Blue Ridge used this ROR for this proceeding (Staff Ex. 1 at 33). Further, Duke notes that, among other cases, the Commission upheld the practice of using the ROR from the previous rate base case in the *CEP Case* and did so in a recent Dominion CEP case, where, Duke argues, OCC presented nearly identical arguments as it does here that were rejected by the Commission. *CEP Case*, Opinion and Order (Apr. 21, 2022) at ¶¶ 66-68; *In re the Application of the East Ohio Gas Company d/b/a Dominion Energy Ohio*, Case No. 21-619-GA-RDR, Opinion and Order (Feb. 23, 2022) at ¶ 71. Duke asserts that parties devote a significant amount of time and resources litigating a new ROR, and, if a new ROR could be re-litigated in every rider proceeding, then it would be a waste of Commission resources and time, defeating a key goal of alternative regulation set forth in R.C. 4929.01(A). (Duke Reply Br. at 15-19.)

{¶ 93} In terms of the ROR suggested by OCC, Duke points out that OCC's witness supporting its position, Dr. Duann, did not perform a traditional ROR analysis, a Discounted Cash Flow, Capital Asset Pricing Model (CAPM), empirical approximation of the CAPM, Risk Premium, or any other analysis typically presented to support a return on equity. For various other reasons, Duke asserts that his proposal lacks the comprehensive expert assessment needed to determine the cost of capital in a full rate case. Duke states that the Commission found as much in the underlying *CEP Case*, noting that Dr. Duann failed to perform an analysis that was comprehensive enough to pass expert muster if undertaken in a full rate case. *CEP Case*, Opinion and Order at ¶ 68. Similarly, Duke dismisses Dr. Duann's analysis of Duke's cost of debt and return on equity as conclusory, as lacking any foundation, and as overly simplistic and selective. Regarding OCC's assertion related to a ROR that is higher than the 7.94 percent 3-year national median, Duke states that OCC fails to mention that Staff's analysis shows that Duke's actual return on

equity over the last three years is 5.98 percent, lower than the national median (Staff Ex. 2 at 4). (Duke Reply Br. at 19-21.)

{¶ 94} In terms of OCC's arguments regarding Staff's financial earnings review, Duke states that this review demonstrates that Staff and Blue Ridge did address the issue of the ROR. This review, according to Duke, shows that its earnings have been moderate and in line with both national and Ohio benchmarks, which undercuts OCC's claim that using Duke's last ROR will result in profits and debt costs not reflective of actual market conditions. Further, Blue Ridge did address the ROR. Blue Ridge determined that Duke had used the appropriate ROR authorized by the Commission in the *CEP Case* (Staff Ex. 1 at 33). Finally, Duke notes that it has agreed to file a natural gas base rate case as early as June 2022. (Duke Reply Br. at 21-23.)

{¶ 95} Staff disagrees with OCC's arguments, noting that both the auditor in the *CEP Case* and the subject case verified that the ROR was the one established in the last base rate case in Case No. 12-1685-GA-AIR and adjusted to reflect a reduction in the corporate tax rate from 35 percent to 21 percent. Staff asserts that no other approved ROR existed for the above auditors to use. Finally, Staff states that Duke agreed to file a base rate case no later than June of 2023, at which point the ROR will be updated again. (Staff Reply Br. at 4.)

{¶ 96} We note that OCC offered similar arguments regarding the ROR in the *CEP Case*, which we rejected, and again do so in this proceeding. *CEP Case*, Opinion and Order at ¶¶ 66-68, 79. It has been the Commission's longstanding practice to utilize the approved rate of return from a utility's last rate case in subsequent alternative regulation and rider proceedings. *Dominion CEP Case*, Opinion and Order (Dec. 30, 2020) at ¶ 68; *In re Columbia Gas of Ohio, Inc.*, Case No. 16-2422-GA-ALT, Opinion and Order (Jan. 31, 2018) (reauthorizing infrastructure replacement program); *In re Vectren Energy Delivery of Ohio, Inc.*, Case No. 13-1571-GA-ALT, Opinion and Order (Feb. 19, 2014) (reauthorizing distribution replacement rider); *In re The East Ohio Gas Co. d/b/a Dominion Energy Ohio*, Case No. 19-1945-GA-RDR, Finding and Order (Apr. 8, 2020) (approving automated meter

reading recovery charge); *In re The East Ohio Gas Co. d/b/a Dominion Energy Ohio*, Case No. 19-1944-GA-RDR, Finding and Order (Apr. 8, 2020) (approving pipeline infrastructure replacement charge). In the *CEP Case*, we found that the Stipulation's adherence to this existing practice is reasonable, particularly given Staff had concluded that Duke did not have excessive earnings during the 2013-2018 audit period. *CEP Case* at ¶ 66. OCC argues that the Stipulation does not specifically list the ROR and that the Commission's decision in the *CEP Case* only approved the ROR for that audit period, meaning the Commission can adjust it in this case. We find OCC's argument unavailing. The terms of the Stipulation affected more than just the 2013-2018 audit period, evidenced by setting residential rate caps for Rider CEP's ensuing years, caps which would have accounted for the subject ROR, cost of debt, and return on equity. *CEP Case*, Stipulation at ¶¶ 4-5. Moreover, we find Staff's financial earnings review reasonable, which found that Duke did not have excessive earnings during the 2019 and 2020 period under review. We also note that Duke has already filed its new natural gas base rate case in 22-507-GA-AIR, et al., during which these rates will be reexamined, and that Duke's return on equity of 9.84 percent was reaffirmed by the Commission in its last electric rate base case. *In the Application of Duke Energy Ohio, Inc.*, Case No. 17-32-EL-AIR, et al., Opinion and Order (Dec. 19, 2018) at ¶ 257. Considering all of the above, we find no reason to alter the ROR relied upon by Duke in this proceeding. However, the Commission directs Duke to file an application updating the ROR for this rider, within 30 days of an Opinion and Order resolving Duke's pending gas base rate case in 22-507-EL-AIR, et al., effective the date of the Opinion and Order.

{¶ 97} Further, we acknowledge that Duke's cost of long-term debt has likely decreased since the last natural gas base rate case in 2012 (Co. Ex. 1 at Attachment 1; OCC Ex. 1 at 11-16). However, we approved the Stipulation, on which Duke relied for implementing Rider CEP for 2019 and 2020, due to the benefits it provided as a package. We specifically noted that the adoption of OCC's lower cost of capital in that case might lead to the loss of other significant ratepayer benefits in the Stipulation. *CEP Case*, Opinion and Order at ¶ 67. Moreover, just as the cost of capital has recently decreased, it may

certainly increase at some point, which would result in an adverse impact to customer bills if we were to adopt OCC's recommended approach. And, as acknowledged in the *CEP Case*, the cost of capital is intricately tied to the utility company's capital structure and risk assessment at the time of evaluation, and it may be determined by various methods, each method with its own benefits and shortcomings. Modification of the cost of long-term debt, which is just one of several cost of capital components, would constitute "cherry picking," while ignoring any cost increases that have occurred since the prior base rate case. In addition, the continual reevaluation of the financial market to determine the appropriate rate of return components to use in each alternative rate plan or rider case would result in inefficiency and volatility. The Commission's current practice of utilizing the rate of return authorized in the prior rate case facilitates an effective and efficient use of Commission and utility resources, given that a traditional return on equity analysis, in particular, often proves quite complex and, in fact, was not undertaken by Dr. Duann in this case. We emphasize that Duke has filed its new base rate case in Case No. 22-507-GA-AIR, during which the cost of long-term debt will be revisited.

2. IMPROPER AND UNAUTHORIZED ACCELERATION OF CAPITAL REPLACEMENTS AND EXPENDITURES

{¶ 98} According to OCC, Duke's 2019 and 2020 CEP spending represents an improper and unauthorized acceleration of capital replacements and expenditures that should be capped to avoid consumers paying unjust and unreasonable rates for the CEP investments. OCC argues that alternative rate plans can only be approved under R.C. 4929.05(A)(3) if the plan is just and reasonable, and that, R.C. 4929.111(C), provides that capital expenditure programs should only be approved if the program is just and reasonable. OCC notes that it has expressed concern that the existence of the CEP has distorted Duke's decision-making, and the lack of regulatory lag associated with traditional rate cases has led Duke to significantly increase its CEP capital expenditures (OCC Ex. 2 at 4, 8-11). *CEP Case*, OCC Initial Post Hearing Br. (Feb. 24, 2021) at 25-29. According to OCC, Duke's capital expenditures have increased from the programs first year in 2013 to 2018 by

335 percent, by 547 percent from 2013 to 2019, and by 665 percent from 2013 to 2020. (OCC Ex. 2 at 9; Co. Ex. 1, Application Schedule No. 4, Line 9 + Line 12 for 2019 and 2020). OCC states that Duke was authorized to accelerate its capital spending under its Accelerated Mains Replacement Program in Case No. 01-1228-GA-AIR to address specific safety concerns surrounding corrosion and leak-prone metallic pipes; however, such safety concerns are not present here (OCC Ex. 2 at 10-11). Further, OCC asserts that the Commission has not approved accelerated infrastructure replacement under the CEP and believes the $1.00 cap on increases that goes into effect in 2021 should be applied here since 2019 and 2020 CEP investments were excessive and consisted of unapproved acceleration of investments (OCC Ex. 1 at 11). OCC also highlights that in Duke's initial CEP case, the Commission stated that "[t]he Commission has not granted cost recovery for any CEP-related items, and the prudence and reasonableness of the magnitude of Duke's CEP-related regulatory assets and associated capital spending will be considered by the Commission in any future proceedings seeking cost recovery [.]" *In re the Application of Duke Energy Ohio, Inc.*, Case No. 13-2417-GA-UNC, Finding and Order (Oct 1, 2014) at ¶ 23. Considering the above, OCC asserts that any investments and associated deferrals that will increase the CEP Rider residential charge by more than $1.00 per month should not be recoverable through Rider CEP. (OCC Initial Br. at 11-13.)

{¶ 99} Duke asserts that OCC's arguments are unavailing. Duke disputes the method by which OCC calculated the magnitude of capital investment since the start of the CEP. In addition, Duke contends that OCC cannot dispute the level of investments at issue in this proceeding since they are subject to negotiated and agreed upon caps, which are set at $1.00 for residential customers after 2020, and the level of investments did not exceed the previously established cap during 2019 and only reach that cap in late 2020. Consequently, Duke argues that OCC's concern is an improper and untimely attempt to seek rehearing of the Commission's initial decision to establish the $1.50 CEP deferral. Referring back to the *CEP Case*, Duke states that it argued, and the Commission agreed, that $1.00 residential rate caps after 2020 were reasonable since Duke's 2019 investments had already been made, and

Duke's 2020 investment plan had already been established by the time the Staff Report first proposing a revenue requirement cap was issued. Duke argues that the Stipulation did not guarantee recovery of the return on and of all investments in 2019 and 2020, and the investments were scrutinized by Blue Ridge and Staff, as well as analyzed for prudency, reasonableness, and necessity. The parties here have relied upon the precedent set forth in the *CEP Case*, argues Duke, and arguments trying to change that precedent should be dismissed. (Duke Reply Br. at 23-25.)

{¶ 100} We find OCC's argument unpersuasive. OCC argues that since the magnitude of Duke's capital investments has accelerated at an inappropriate pace since the start of the CEP, we should revise the already approved Stipulation such that the 2019 and 2020 residential rate caps are replaced with the smaller $1 per year cap on residential rate increases established for 2021 and beyond. While we have stated that the prudence and reasonableness of the magnitude of Duke's CEP-related regulatory assets and associated capital spending would be considered by the Commission in future proceedings seeking recovery, we have also addressed this very issue in the *CEP Case* and found that the Rider CEP rates offered in the Stipulation were not unjust or unreasonable. *In re the Application of Duke Energy Ohio, Inc.*, Case No. 13-2417-GA-UNC, Finding and Order (Oct 1, 2014) at 13; *CEP Case*, Opinion and Order at ¶ 81. Further, here, outside of the specified adjustments, Blue Ridge did not recommend finding that any of Duke's CEP-related expenditures or assets for the period of January 1, 2019, through December 31, 2022, were unnecessary, unreasonable, or imprudent (Staff Ex. 1 at 12). We approved the stipulated residential rate caps for 2019 and 2020 upon which Duke relied for this proceeding. Consequently, we decline to implement OCC's recommendation regarding this issue.

3. OPERATION AND MAINTENANCE (O&M) SAVINGS

{¶ 101} OCC believes that the capital investments made by Duke should result in O&M expense savings that should be passed down to customers through an offset to the Rider CEP charge to customers, similar to how these types of savings reduce other utilities'

infrastructure replacement riders (OCC Ex. 2 at 21-23). According to OCC, replacing and improving pipelines and related infrastructure under the CEP allows Duke to avoid monitoring, maintenance, and repair of aging infrastructure, which should generate O&M savings. Additionally, OCC asserts that the Compliance/Operations category involves capital investment to improve pipeline integrity, which should also generate O&M savings. (OCC Ex. 2 at 21.) OCC notes that Blue Ridge identified more than $107 million in system replacements and improvements and almost $43 million for service line replacements in 2019 and 2020. According to OCC, Duke's AMRP recognized that system improvements would generate O&M savings, and, thus, the CEP should too. (OCC Ex. 2 at 22.) OCC recommends that the Commission should direct Duke to form a collaborative group comprised of Duke, Staff, OCC, and other interested parties to identify specific expenses and related expense accounts that will be reduced as aging infrastructure is replaced and new capital investments are made; plus, the group would develop baseline spending levels for the identified categories based on spending levels built into the base rates set in Duke's last rate case. According to OCC, the revenue requirement in annual Rider CEP applications would be reduced when comparing expense reductions to the baselines resulting from the CEP capital investments. (OCC Ex. 2 at 23; OCC Initial Br. at 18-21.)

{¶ 102} Duke disagrees with OCC. According to Duke, outside of OCC's witness testimony there is no evidence to support such a claim about net O&M savings resulting from the investments made in the CEP. Duke argues that OCC's witness did not verify whether there are net operational savings and instead argues that a collaborative group should be formed to explore such savings. Duke states that, in some instances, as set forth in briefing in the *CEP Case*, O&M costs have increased due to expenditures resulting in expansion of service and new assets. Duke contends that any efficiencies that do occur will eventually be included in natural gas base rates when Duke files its next natural gas base rate case. (Duke Reply Br. at 25-26.)

{¶ 103} In the *CEP Case*, we declined to adopt a similar recommendation from OCC regarding O&M savings and find no reason to alter that decision. *CEP Case*, Opinion

and Order at ¶ 69. Here, OCC has not verified that operational savings have resulted from the CEP investments. OCC speculates that these savings exist; however, it has offered no evidence to support its argument that such savings have in fact accrued. Further, at this time, we also decline to adopt OCC's recommendation to direct certain parties to form a collaborative group in the manner suggested by OCC. Instead, we find it more appropriate for OCC, if it so desires, to pursue this issue in the natural gas base rate case that Duke has now filed in Case No. 22-507-GA-AIR, et al.

4. 2020 CEP Rider Residential Rate Cap

{¶ 104} OCC next turns to the supplemental Audit Report wherein Blue Ridge, after receiving additional information from Duke as explained above, revised its residential monthly charge to $6.23 for 2019 and $9.31 for 2020 (Staff Ex. 3 at 2-3). OCC asserts that this recommendation reflects a higher increase for 2020 than is permitted in the *CEP Case*. In that case, Duke's residential charges for these expenditures were capped at increases of $2.92 for 2019 and $2.70 for 2020. *CEP Case*, Stipulation at 4; Opinion and Order at ¶ 83. Using these figures, OCC points out that that adding $2.70, the maximum increase allowed for the 2020 charge, to the charge recommended for 2019, $6.23, results in a maximum residential charge of $8.93, not $9.31 (OCC Ex. 2 at 6-7). Consequently, the Commission should reject Blue Ridge's recommendation of a $9.31 residential charge. (OCC Reply Br. at 21-22.)

{¶ 105} In it reply brief, Staff changes its initial position and states that it agrees with OCC for the reasons mentioned by OCC. It agrees that a maximum cap of $8.93 per month for Duke's 2020 Rider CEP should be adopted to comply with the *CEP Case* (Staff Reply Br. at 4).

{¶ 106} In its reply brief, OCC also argues that Adjustment 11, which included Blue Ridge recommending full restoration of the qualified CEP investments the Company removed as shown in Table 12 of the Audit Report since Duke was sitting comfortably below the 2019 and 2020 residential rate caps, should be rejected (Staff Ex. 1 at 35). OCC essentially argues that, as demonstrated above, Duke is no longer sitting comfortably below the 2020

rate cap; therefore, Adjustment 11 should be rejected since Blue Ridge did not take into account the proper maximum increase in rates from 2019 to 2020. (OCC Reply Br. at 9-10.)

{¶ 107} Duke did not respond directly to OCC's argument regarding this issue.

{¶ 108} Considering we have rejected Adjustment 3 and have adopted some and rejected other adjustments and recommendations, we can safely conclude that the 2019 residential rate will be more than the $6.23 rate suggested by Blue Ridge and Staff; however, we cannot conclusively state the exact figure until Duke accounts for and reconciles the findings in this order. Since the 2019 residential rate will be more than $6.23, we reject OCC's argument that the maximum 2020 residential rate is $8.93 since the Stipulation allowed for an increase of no more than $2.70 from the 2019 rate to the 2020 rate (OCC Ex. 2 at 6-7; Staff Ex. 3 at 2-3). Therefore, when accounting for and reconciling the adjustments and recommendations, we direct Duke to ensure that the 2020 residential rate does not violate this stipulated maximum rate increase from 2019 to 2020. Regarding Adjustment 11, as we noted in our decision above concerning this adjustment, we conditionally approve it depending on how the Commission's decisions regarding the above adjustments and recommendations affects Duke's CEP investment recovery related to the stipulated rate caps.

F. Commission Conclusion

{¶ 109} Based on the foregoing, the Commission concludes that Duke's application should be approved, subject to the adjustments and recommendations provided in the Audit Report and findings discussed herein.

IV. FINDINGS OF FACT AND CONCLUSIONS OF LAW

{¶ 110} Duke is a natural gas company and a public utility as defined by R.C. 4905.03 and 4905.02, respectively. As such, Duke is subject to the Commission's jurisdiction.

{¶ 111} On April 23, 2021, Duke filed the Application for authority to adjust its Rider CEP charges.

{¶ 112} On October 14, 2021, Blue Ridge filed its Audit Report.

{¶ 113} On October 22, 2021, Staff filed its Review and Recommendation.

{¶ 114} On November 8, 2021, Blue Ridge filed its supplement to the Audit Report.

{¶ 115} On November 8, 2021, Staff filed its supplement to its Review and Recommendation.

{¶ 116} By Entries dated October 25, 2021, the attorney examiner issued a procedural schedule establishing a deadline for motions to intervene as well as comments.

{¶ 117} The attorney examiner granted motions to intervene filed by OCC and IGS.

{¶ 118} On November 8, 2021, OCC and IGS filed comments.

{¶ 119} On November 18, 2021, OCC filed comments regarding the supplements to the Audit Report and Staff's Review and Recommendation.

{¶ 120} By Entries dated November 18, 2021, and December 16, 2021, the attorney examiner revised the procedural schedule for the proceeding.

{¶ 121} By Entry dated February 7, 2022, the attorney examiner granted a February 7, 2022 request from Duke on behalf of Staff, OCC, IGS, and itself to establish a paper hearing process through which prefiled testimony and other specified documents would be deemed admitted. Through the approved process, a number of documents were admitted into the record.

{¶ 122} On March 10, 2022, Staff, Duke, IGS, and OCC filed initial post-hearing briefs. The same parties filed reply briefs on March 31, 2022.

{¶ 123} Based on the record, we find that Duke's Application should be adopted, subject to the adjustments and recommendations provided in the Audit Report and the findings discussed herein.

V. ORDER

{¶ 124} It is, therefore,

{¶ 125} ORDERED, That, consistent with this Opinion and Order, Duke's Application filed April 23, 2021, be approved, subject to the findings in this Order. It is, further,

{¶ 126} ORDERED, That nothing in this Opinion and Order shall be binding upon the Commission in any future proceeding or investigation involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

{¶ 127} ORDERED, That a copy of this Opinion and Order be served upon all parties of record.

COMMISSIONERS:
Approving:
Jenifer French, Chair
M. Beth Trombold
Daniel R. Conway
Dennis P. Deters

MJS/hac

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Case No(s). 21-0618-GA-RDR

Summary: Opinion & Order approving Duke Energy Ohio Inc.'s application to adjust its capital expenditure program rider, consistent with the findings within this Opinion and Order electronically filed by Ms. Mary E. Fischer on behalf of Public Utilities Commission of Ohio