

BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION OF)
SOURCEGAS DISTRIBUTION LLC, GOLDEN,) DOCKET NO. NG-0078
COLORADO, SEEKING AN ORDER)
AUTHORIZING IT TO PUT INTO EFFECT A)
SYSTEM SAFETY AND INTEGRITY RIDER)
TARIFF AND A SYSTEM SAFETY AND)
INTEGRITY RIDER CHARGE)

IN THE MATTER OF THE APPLICATION OF)
SOURCEGAS DISTRIBUTION LLC, GOLDEN,) DOCKET NO. NG-0079
COLORADO, SEEKING AUTHORITY TO)
REFLECT CHANGED DEPRECIATION RATES)
ON ITS NEBRASKA BOOKS OF ACCOUNT)
EFFECTIVE MAY 1, 2014, WITHOUT)
IMPACTING EXISTING RATES)

POST-HEARING BRIEF OF PUBLIC ADVOCATE

INTRODUCTION

In the two proceedings captioned above as Dockets NG-0078 and NG-0079, SourceGas has made (1) an application for the adoption for what it calls a System Safety and Integrity Rider (SSIR) tariff and charge and (2) an application seeking to reflect changed depreciation rates on its Nebraska Books of Account. Each of these items will be discussed separately in distinct parts of this brief but, as an introduction, we should recall what precipitated these filings.

It is no secret that SourceGas intended to file for a general rate case in April of this year. It was so stated in their application (E13,4:14,15). It is no secret that the Public Service Commission (PSC or Commission) was not exactly overjoyed to hear this news. Sensing this reaction from the PSC, SourceGas regrouped and proposed what it considered to be a creative solution to avoid the planned general rate case. The solution involved the filing of three dockets,

NG-0072.01 (the Infrastructure System Replacement surcharge) and these two dockets. The Public Advocate has no doubt that SourceGas has proffered this tri-part solution in good faith and in an effort to avoid a costly rate case. There is also no doubt, so far as this writer is concerned, that SourceGas considers these measures as representing a reasonable alternative to standard rate making. Unfortunately, the Public Advocate cannot agree.

I.

THE JURISDICTIONAL REVENUE DEFICIENCY AND THE LOOMING GENERAL RATE CASE

Underlying the proposals embodied in NG-0078 and NG-0079 is the assertion by SourceGas that, for a test year ending December 31, 2014, it shows a jurisdictional revenue deficiency of \$4,467,302.00 (E18,1:14,15).

Now, what should we make of that number? The fact is, not much. This jurisdictional revenue deficiency has been asserted by SourceGas but clearly has not been rigorously tested as it would be in a general rate case. Nor are the Public Advocate and its consultants in a position to do so in a proceeding such as this. What we can tell you is this: The test year utilized by SourceGas, whether we call it a future test year or not, is reliant upon projections, and not known and measurable changes, for significant portions of the adjustments made to the base year.

For instance:

- Seventy-five percent of a proposed \$25,143,302.00 increase in jurisdictional utility plant in service is comprised of the 2014 SSIR projects, a portion of 2015 proposed SSIR projects and 2014 Nebraska Direct Additions. Those categories include projects that are not constructed, not used and useful, and many of which, as has been shown, will not be constructed within the year. (E91, Table 4:19,20)

- Operating expense adjustments include forecasted hiring of 59 employees to fill new positions during the period January 1, 2014 to December 31, 2014 (E88,221:20,21). This is a substantial increase of 6.46% over the wages, benefits and payroll taxes included in the 2013 base year (E78,1:20,21). These forecasted new hires may not actually be hired. The company budgeted head count as of December 31, 2013 was 1,059 of which 1,037 positions were filled as of that date. Since the budgeted head count of December 31, 2014 is 1,143, the company needs to hire 106 employees in 2014. If these positions are not filled then the company will have lower operating expenses which will reduce the company's jurisdictional revenue deficiency (E77,25:20,21).

A single example should explain why the company's figures cannot be taken at face value: when responding to information request by the PA, the company realized that the percentages used to determine the portion of New Labor to be allocated to Nebraska was based on preliminary amounts. After the company revised the allocation percentages, wages decreased from \$765,025 to \$724,760 for a reduction of \$40,265 (E77,25:20,21). All of the company's numbers need to be properly tested and confirmed through a rigorous regulatory process, and not taken at face value.

No one is questioning the credibility or good faith of the company in asserting the revenue deficiency level that it does. However, no regulatory body in the country would accept the regulated utilities assertion at face value. As Ms. Mullinax pointed out in her Direct Testimony (E77,12-13:20,21), the "Commission granted \$4.957 million of the company's initial request of \$8.279 million or approximately 60% of the company's initial request." in Docket No. NG-0067. She went on to state, "while each general rate case is unique, companies are rarely authorized all that they request in a general rate case." Id.

To this, the Company responded, through the Rebuttal Testimony of Jerrad Hammer that, “Yes, that is almost a truism...” (E19,14:14,15). Mr. Hammer, in that same Rebuttal Testimony stated that the above-agreed upon truism is meaningless here because “The company is seeking approval of the SSIR precisely to avoid a general rate case.” (Id.) Thus, we are to evaluate the SSIR tariff without consideration of the jurisdictional revenue deficiency. Obviously, this is a little difficult to do and requires some significant mental gymnastics since it is hard to examine one of the legs of the 3-legged stool without discussing what is supposed to sit upon it.

Nevertheless in Section II, we turn first to the SSIR tariff with these questions: What is the justification for a forward looking recovery of safety and integrity costs, and is the SSIR really the better mousetrap with which to capture those costs? In Section III we address the depreciation study docket.

II.

SSIR TARIFF – NG-0078

A. LEGALITY OF SSIR TARIFF

While the Public Advocate would like to suggest to the Commission that the adoption of the proposed tariff is legally unsupportable, he will concede that such a tariff apparently could be adopted under the provisions of Neb. Rev. Stat. § 66-1808 (Reissue 2009) regarding a changed rate outside of a general rate filing. Further, the Public Advocate is aware that this Commission has, in the past, asserted its authority to consider alternate rate mechanisms for processing rate changes that do not rise to the level of a general rate filing. In Matter of Aquila, Docket NG-0031, the Commission ordered denying the application, entered on November 1, 2005:

“As a result of the plenary power conveyed by [Neb. Rev. Stat. § 66-1804], the Commission possesses great flexibility in establishing procedures to carry out its statutory obligations, one of which is the regulation of rates charged by jurisdictional utilities. In addition, Section 66-1808 sets forth procedures for

rate changes that are not general rate filings. Thus, the State Natural Gas Regulation Act provides the Commission with the jurisdiction to consider alternate mechanisms for processing rate changes that do not rise to the level of a general rate filing.”

However, the “true-up” mechanism as set forth in the proposed tariff would appear to be a form of retroactive rate making typically deemed impermissible without legislative authority. The “true-up”, in the April filing following the completion of the SSIR projects in the previous year, will establish the “SSIR True-Up Amount” that, as set forth in the proposed tariff, “shall be equal to the difference, positive or negative, between the eligible system and safety integrity costs as projected for a particular calendar year and the actual eligible system safety and integrity costs incurred by the company for that particular calendar year.” The company proposes to then either appropriately add or subtract that amount from the following year’s System Safety and Integrity Rider Charge. As noted in 73B C.J.S. Public Utilities § 137:

“Unless otherwise provided by statute, rates prescribed by a public utility regulatory commission are prospective, and cannot ordinarily be made to operate retroactively, whether it favors the utility or the ratepayers. The basic premise underlying the prohibition against retroactive rate making is that the setting of utility rates is a legislative function, even if carried out by administrative agencies; therefore, utility rates, like any other legislation, generally can have only prospective application and cannot be used to recoup losses or gains incurred under prior legal rates...

Retroactive rate making with respect to utilities is prohibited based on the general principal that customers who use the service provided by a utility should pay for its production rather than requiring future ratepayers to pay for past use, and utilities should not be allowed to recoup past losses. Furthermore, the rule against retroactive rate making protects the public by insuring that the present consumers will not be required to pay for past deficits of the company in their future payments, and it prevents the company from employing future rates as a means of insuring the investments of its stockholders, thereby removing the utility’s incentive to operate in an efficient, cost effective manner. *Id.* at page _____.”

The case of In re Central Vermont Public Service Corporation, 144 Vt. 46, 473 A.2d 1155 (1984) involved a tariff adopting an electric power adjustment clause that called for yearly reconciliation of costs and estimates and subsequent refund or surcharge during the following year. The Supreme Court of Vermont found that such a tariff was an illegal form of retroactive rate-making. As the Court stated:

“The most controversial aspect of the power adjustment clause is the mechanism referred to as the ‘true-up’. The ‘true-up’ is a reconciliation of the actual sales revenues and power and energy costs for the year ending October 31st with those that were forecast one year earlier. If the historical data reveal that Central Vermont collected rates in excess of its predicted power and energy costs, the over-collection, with interest, is refunded to customers by allowing a credit on the rates for the following year. If the historical data show that Central Vermont failed to recover all of its power and energy costs, the shortage is collected by imposing a surcharge on the following years customers Id. at 50, 473 A2d at 1157.

Further, the Court stated: The crux of this case is the Department’s contention that the CPY tariff constitutes illegal retroactive rate making. Retroactive rate making has been defined as “the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate of return with the rate actually established..... (citations omitted)

In other words, retroactive rate making is a device that enables a utility to balance its accounts for a prior period of time by making a future adjustment in its rates. In this case, the CPY allows Central Vermont annually to balance its prior years power and energy accounts through adjustments on its bills to future customers. Id. at 52, 473 A2d at 1158.

Further, the Court held: Absent such justification and absent statutory approval, we hold the CPY tariff to be an illegal form of retroactive rate making. Id. at 58, 473 A2d at 1161.”

See also Reliant Energy, Inc. v Public Utility Com’n of Texas, 153 S.W.3d 174 (2004) wherein the Court of Appeals of Texas noted that: “Utility rates are set prospectively and the Commission ‘may not set rates that allow utility to recoup past losses or refund excess utility profits to consumers.’” Id. at 198.

So here, the jurisdictional utility would calculate the “SSIR True-Up Amount” and either increase or reduce rates based upon the actual costs that it incurred, effectively adjusting the rates for future customers to cover past uncollected costs of construction. The Public Advocate suggests that the Commission should consider very strongly as to whether or not this constitutes retroactive rate making, and if so, whether such retroactive rate making can be implemented without statutory authority.

It is the position of the Public Advocate that the tariff might constitute retroactive rate-making and is contrary to good public policy.

B. THE PRACTICAL NECESSITY FOR AN SSIR, or “WHERE IS THE CRISIS?”

SourceGas offered the testimony of Mr. Charles Bayles in support of the need for an SSIR tariff. He testified regarding the industry concern that Federal regulation of pipeline system safety and integrity is currently in a state of flux. However, maintaining the safety and integrity of its facilities has always been an obligation of a public utility, as Mr. Bayles agreed during cross-examination (179:9-15). The specific wording of regulations may change from time to time, but maintaining the safety and integrity of the transmission and distribution facilities of a natural gas company has always been a requirement. As regards the idea that federal regulation is ever changing, ever increasing, and ever more pervasive there can be little argument, but that can be said, unfortunately, about every aspect of American life today. However, the initiatives identified and the information used by SourceGas to support its position are not new. The Lahood Call to Action on pipeline safety, attached to Mr. Bayles’ testimony, was issued back in February of 2011 (E27,1:14,15). This is not a new problem that just cropped up last year. SourceGas and other utilities have been operating under the TIMP Rule and DIMP Rule since 2003 and 2009 respectively and the industry knew that new regulations were in the

offing for years. Of significant concern to Mr. Bayles is the Integrity Verification Process, the so-called Mega Rule proposed by the Pipeline Hazardous Material Safety Administration (PHMSA) (E24,25:14,15). However, the IVP has yet to be adopted and implemented (22:19-25:7).

If the still-changing regulatory landscape doesn't support the SSIR tariff, has the integrity of the distribution system significantly degraded recently? No evidence has been presented to that effect. While the vintage of the pipes clearly varies, it would appear that a significant portion of the pipe, such as top of ground and bare steel pipe which is of concern to SourceGas, may be 50 or more years old (141:26-142:4). Yet the system has continued to operate over these many years.

From Mr. Bayles' Pre-Filed Testimony we know that, "as shown on page 15 of Exhibit CAB-1, the TIMP Rule and SourceGas' TIMP covers the 1,206.822 miles of SourceGas Distribution's natural gas transmission system in Nebraska. Of that mileage, only 1.288 miles of SourceGas' Distribution's natural gas pipeline system in Nebraska are located in HCAs (High Consequence Areas). (E24,9:14,15).

I ask the PSC to take judicial notice of its own records.¹ Those records show that, since passage of LB 658 (now codified as Neb. Rev. Stat. §§ 66-1865, 66-1866 and 66-1867) SourceGas did not utilize the ISR surcharge for the first three years of its existence. Thereafter,

¹ Pursuant to Rule 201(6) Judicial Notice may be taken at any stage of the proceeding. See also Gottsch v Bank of Stapleton, 235 Neb. 816, 458 N.W.2d 443 (1990) (term "proceeding" in evidentiary rule stating that judicial notice may be taken at any stage of proceeding including judicial activity which occurs after commencement of action and judicial action in appeal." "A court may judicially notice existence of its records and the records of another court, but judicial notice of fact reflected in a court's records is subject to the doctrine of collateral estoppel or res judicata." Id. at 836, 458 N.W.2d at 456.

in NG-0072 and NG-0072.1, filings were made under which an addition to rate base of \$4,853,710.00 and \$3,246,649.00 respectively were submitted with surcharges that stayed within the required jurisdictional cap. The initial Application for the 2014 SSIRs proposes 2014 construction of safety and integrity related projects in the amount of \$11,627,216.00. (E17, Table 4:14,15). The sudden escalation in capital contribution for safety projects seems unwarranted and inconsistent with the practice of the company over the past five years.

Mr. Dunkel's testimony shows that any need for higher retirements now is at least in part catch-up for low-retirements in prior years. In the largest account, Mains, SourceGas expects to retire \$1.6 million in the 2014 test year. However, that is five times as much as the average retirement of \$290,000.00 per year in the six prior years. (232:13-233:3). As Mr. Dunkel stated in his Pre-Filed Testimony, "SourceGas has actually been retiring much less than the retirements implied in the depreciation rates that are being recovered and prices charged to ratepayers." (E80,8:20,2).

By pointing this out, we are not questioning the establishment of rates in the prior rate case (NG-0067); rather, we are simply noting that, based upon the depreciation rates factored into the rates since the last rate case, ratepayers have been paying in more, considerably more, than has been going out of the depreciation reserve as a result of retirements. In total, in the last six years, over \$16 million of ratepayers supported a depreciation expense was credited into the accumulated depreciation reserve for millions, but less than \$1.8 million was debited out. When all of the accounts in the depreciation study are considered, the surplus in the accumulated depreciation reserve is over \$27 million. As highlighted by the testimony of Mr. Dunkel, perhaps more should have been done over the past span of 6-10 years to improve the safety of

the pipes and retire more, thus, utilizing the depreciation expense charged to ratepayers, rather than addressing safety and integrity as a crisis now.

What is the point of the above? Simply this. It asks the rhetorical question, where is the crisis? The top of ground pipes, the bare steel, the other issues have been around for years and years. DIMP and TIMP safety initiatives are not new and, at this point, we don't know when the new federal requirements will be adopted. It is one thing to be ahead of the curve, it is another thing to swing the bat before the ball has been pitched. Significantly, in the exhibits and testimony proffered by Mr. Bayles, the American Gas Associates notes in a June, 2012 Rate Roundup that Nebraska is already a state with an infrastructure cost recovery rate mechanism (E35,1:14,15). Why is that? Because Nebraska has already adopted the statutory Infrastructure System Cost Recovery (ISR) mechanism. Unlike Colorado, where the seminal SSIR tariff originated, Nebraska already has in place a procedure to reduce the regulatory lag. Thus, the question here is simply whether this SSIR tariff is urgently needed or better.

As regards urgency, the Public Advocate suggests that the pressing need to make a change is lacking. We already have the statutory ISR mechanism which was the reasonable legislative effort to provide a reduction in regulatory lag for safety and integrity projects. Mr. Bayles in his Pre-filed Testimony gave his opinion that, "This fundamental change in direction places greater burdens on pipeline operators such as SourceGas Distribution to implement the requirements of ever changing Federal regulations and requires that the cost of compliance be recovered on a concurrent basis as the costs are incurred." (E24,27-28:14,15). An avalanche of new Federal regulations may warrant a reduction in regulatory lag, but not concurrent recovery. Indeed, the company is not proposing concurrent recovery; rather, the SSIR as proposed to the Commission would allow, in most cases, the utility to begin recovering costs before incurring

them. The SSIR charge would be imposed upon the customer effective January 1 of the year in which projects would be commenced and presumably completed. It is obvious this is not concurrent recovery; it is prepayment. So, the question addressed in the next section is: “Is the SSIR tariff a more effective and fair way to deal with safety and integrity costs than the established ISR?”

C. THE PROPOSED SSIR TARIFF

As proposed by SourceGas, the SSIR tariff would be implemented by the jurisdictional utility filing on November 1st of each year a list of proposed safety and integrity projects meeting the project definition in the tariff. There is no formal process for approving the proposed projects, although SourceGas suggests that the projects will be discussed with the Commission and the Public Advocate. On the following January 1st, the jurisdictional utility will begin collecting the SSIR Charge from its customers. This will not be for projects that are completed, or even commenced, but rather for projects that the utility intends to complete within the next year. Then, in the following year, a “true-up” will occur in April, which SourceGas now suggests can be subject to a formal review process. After the “true-up” regarding actual costs incurred, the jurisdictional utility will make the appropriate adjustments as regards the “true-up” and also the amount that it actually collected (the Deferred SSIR Balance) and file the new SSIR charges for the following November to take effect the subsequent January. Thus, if SourceGas files a list of projects to be completed in 2015 (2015 SSIR projects) in November of this year (2014) it will begin collecting the charge on January 1, 2015, presumably complete the projects in 2015, “true-up” the costs in April of 2016, and finally begin paying back the customers for overcharges or billing for undercharges in January of 2017.

Despite all other problems that one might point out with the proposed SSIR tariff, (e.g. the lack of upfront approvals, the inclusion of certain O&M expenses², etc.), there are two fundamental defects that warrant its rejection.

First, and this is not a new complaint, the proposed tariff includes no cap on the amount of the charge that can be imposed upon the ratepayer. Unlike the statutorily authorized ISR surcharge, which limits annual increases for residential customers to \$.50 per month, (see Neb. Rev. Stat. § 66-1866(6)(a)) and has an overall cap of 10% of the jurisdictional revenue requirement (see Neb. Rev. Stat. § 66-1865), the SSIR tariff presented to the Commission contains no cap whatsoever. Thus, and despite the assurances of the company to the contrary, this charge could get out of hand very quickly. This year, with \$11 million of proposed SSIR projects, the residential customer's bill was initially proposed to increase by \$.93 per month. That is on top of the already existing statutory ISR surcharge which is now at an accumulated monthly rate of \$.84 per month. These two charges together would raise rates next year more than \$21.00 over the original base rates. ($$.93 + $.84 \times 12 \text{ months} = \21.24). Each year we can anticipate, presumably, a similar or greater increase than what are presented with the 2014 SSIR projects. The lack of a cap is a serious defect.

Second, and equally concerning, is what we found out at the hearing regarding the ability of the company to complete SSIR projects in a timely fashion and in line with anticipated "in

² The Public Advocate is still puzzled as to the inclusion of operation and maintenance costs of any type within this rider. Mr. Hammer, in his testimony, says "So if we do an O&M project, let's say, for \$50,000.00, we would recover that \$50,000.00 in one year of the rider. Then that O&M project would drop off in future riders." (E33:22-25) So, apparently, unlike the company's recovery under the rider for capital costs i.e. its revenue requirement over the course of many years, this O&M cost, as in the example \$50,000.00, is recovered in one fell swoop, in one year from the ratepayer. It would seem that this could lead to a very significant increase in the ratepayers bills in any given year.

service” dates. Table 4 attached to Exhibit 17 (the SSIR proposed rates) shows the list of estimated 2014 System Safety and Integrity Projects and their proposed “in service” dates. All of the “in service” dates as shown on Table 4 of Exhibit 17 stretch anywhere from May 2014 through November 2014 and show a total cost for the 2014 SSIR projects of \$11,627,216.00.

However, the Commission was presented at the hearing with two exhibits (91 and 92) with a revised Table 4 now showing none of the projects having an “in service” date before June of 2014, virtually all of them pushed back by anywhere from a month to 13 months, and a revised total cost of \$9,938,318.00. This is some \$1.7 million less than the initial estimated cost of these SSIR projects that was included in calculating the original revenue requirement. Perhaps this is a relatively small amount in the bigger picture as it impacts the ratepayer, but keep this fact in mind: the initial Table 4 was presented to you in April of 2014, along with the rest of the Application in this docket. We were then on the cusp of the construction season in which these projects were to be undertaken. Notwithstanding that, we see the significant slippage in completion dates. How much less can the Commission rely upon estimated costs and anticipated “in service” dates that are presented to you six or seven months before proposed projects start up? Further, if the Commission had actually approved the 2014 SSIR projects in April, when the application was first filed, we would now find included in rate base projects that were neither used nor useful in this year, nor would they qualify as construction work in progress, commenced and completed within a year. (See Neb. Rev. Stat. § 66-1817, Reissue 2009).

In sum, the Public Advocate suggests that the evidence presented to the Commission does not show that any extraordinary reasons or regulatory activism warrant the adoption of a new device for quickly recouping the cost of replacing pipes that have been in place for upwards of

50 years. Such a device should certainly not be implemented without a cap to assure that burdensome rates will not be imposed upon ratepayers. Finally, a surcharge based upon prospective construction (subject to weather, strikes, natural disasters, and all the other possibilities that make construction projects less than predicable) with a “true-up” of questionable legality is hardly a mechanism that instills confidence in its accuracy. All of the above draw into question the need for this device, the fairness of it, and the adequacy of the protection afforded by it to the ratepayer.

One final thought on the need for the SSIR tariff: If the 2014 SSIR projects are completed as projected on Exhibit 91 (this the exhibit that doesn't factor in the revised depreciation rates to the SSIR charge) then all of the 2014 projects still projected for completion in 2014 could be presented to Commission under the statutory ISR procedure in April of 2015, some six months from now. We have been completing reviews of the statutory ISR projects for the jurisdictional utilities in about three months. Thus, the actual “lag” would have been some nine months. Further, the amount proposed as a SSIR charge for residential customers pursuant to Exhibit 91 is \$.78. While I don't minimize the limitation, that is only \$.28 per month, per residential customer, that would not be recovered under the statutory ISR.

III.

SOURCEGAS SHOULD NOT BE ALLOWED TO REFLECT CHANGED DEPRECIATION RATES ON ITS NEBRASKA BOOKS OF ACCOUNT OUTSIDE OF A GENERAL RATE CASE.

A. THE ISSUE PRESENTED TO THE COMMISSION BY NG-0079.

The parties have stipulated to the depreciation rates that are appropriate for six of the largest FERC accounts comprising the assets of SourceGas as follows:

Account	Description	Present Accrual Rate	Stipulated Accrual Rate
376	Mains	3%	1.08%
380	Services	3%	3.32%
381	House Services	3%	3.44%
381.1	Meters	5%	3.72%
382	Meter Installation	3%	1.67%
383	House Regulators	3%	2.02%

The issue is simply when the new depreciation rates should be booked. The Public Advocate has proposed that new depreciation rates should not be booked outside of a general rate case. At that time, the depreciation expense charged to ratepayers and the depreciation expense recorded on the books can both be adjusted, which maintains consistency. (E81,9 (lines 10-12):21,22).

SourceGas, however, requests authorization to reflect the stipulated depreciation rates on its Nebraska Books of Account effective May 1, 2014, without impacting existing rates. An important question for the Commission is, of course, whether it is statutorily empowered to grant this application. However, in order to properly analyze the legality of granting SourceGas' request, it is necessary to understand what it actually does. What SourceGas will do, year after year, if this application is granted, would be to credit into Account 108, the Accumulated Provision for Depreciation (accumulated depreciation reserve) approximately \$1,855,061.00 less per year than it is currently crediting into that account. (E90,2:17,18)). Let's say that the next rate case will occur, as per the testimony of Mr. Jerrad Hammer, in the middle of 2017. That means, if this application is approved, there will be some three years worth or \$5.4 million less

booked into the accumulated depreciation reserve than would otherwise occur if the current depreciation rates continue to be booked. The accumulated depreciation reserve is deemed to be ratepayer money. It is deducted, as the Commission knows, from the rate base in determining what the amount of the rate base should be in establishing just and reasonable rates for the ratepayer. In a case involving telephone rates, the U.S. Supreme Court in Lindhimer v Illinois Telephone Co., 292 U.S. 151 (1934) stated:

“While property remains in the plant, the estimated depreciation rate is applied to the book cost and the resulting amounts are charged currently as expenses of operation. The same amounts are credited to the account for depreciation reserve the ‘reserve for accrued depreciation’...as the allowances for depreciation, credited to the depreciation reserve account, are charged to operating expenses, the depreciation reserve invested in the property thus represents, at a given time, the amount of the investment which has been made out of the proceeds of telephone rates, for the ostensible purpose of replacing capital consumed.”

The accumulated depreciation reserve represents an amount accumulated from the rate payers through the depreciation rate embedded in the rates approved in the last general rate case. What SourceGas proposes to do is to adjust its depreciation expense downward without adjusting the rates charged to customers. Thus, ratepayers would continue to have a 3% depreciation rate for mains embedded in customer rates while the depreciation factor that SourceGas will be crediting to the reserve is only 1.08%. This is patently unfair to the ratepayer. As Mr. Watson admitted in his testimony, all else being equal, if the stipulated depreciation rates had been employed in the last SourceGas general rate case, the customer’s rates would have been lower. (199:14-200:1).

It would seem to be beyond dispute that, if SourceGas’ expenses are going down significantly, and if this lower expense is recognized by the Commission, then there should be a correlative adjustment to rates charged to the ratepayer. The Commission expressed some

consternation that it should be presented with current data i.e. proper depreciation rates, and not implement them immediately. However, depreciation rates are not a hard, precise number. For example, if a depreciation rate is based on the assumption that investments will retire 40 years from now, that is really not a known fact. Depreciation rates are based on judgment and estimates. In fact, delaying the implementation of new depreciation rates to a subsequent general rate case is a common practice. The SourceGas witness, Mr. Watson, recently participated on behalf of Consumers Energy in a rate case in Michigan where Consumers Energy requested that the depreciation rates approved in that case be made effective with the final order in Consumers Energy's next general rate case. (E93,3:206, 207). So also, depreciation rates in a Wisconsin rate proceeding on behalf of WG Energies in 2014 showed that the new depreciation rates would be reflected in the 2015 rate case revenue requirement. (E94,1:206, 207). The depreciation change in the above two matters was an overall increase, so booking it prior to the general rate case would have recorded on the books and accumulated depreciation reserve that would have been unfair to the investors. Here, the depreciation change is an overall decrease, so booking it prior to the prior to the next general rate case would record on the books an accumulated depreciation reserve that would be unfair to the ratepayers. The Commission's consternation is understandable, but implementation and utilization of the depreciation study has to meet the matching principal that reduction in expenses, if recognized, must also reduce the rates.

Mr. Watson, the depreciation expert for SourceGas, stated in his summary that implementation of the stipulated depreciation rates now is "both reasonable and appropriate

given the facts and circumstances that they have specifically for them” (186:14-17).³ However, his testimony is based upon his “understanding....that the company has capitalized another \$57 million of capital....and that extra \$57 million worth of depreciation, the 3% is not – was not included in the base rates back in 2011, I believe, when the case was.” (188:11-24). Further, in his Pre-Filed Rebuttal Testimony, Mr. Watson states: “Mr. Dunkel only looks at one component of SourceGas distribution revenue requirement, the depreciation expense, in isolation. He does not consider that if depreciation expense is too high and operation and maintenance costs are too low in the original revenue requirements, reducing depreciation expense to the appropriate level will simply adjust the amount in recovery for each category to more appropriate levels.” (E57,2:15,15). Thereafter he says, “As stated earlier, base rates do not differentiate between depreciation expense, and other revenue requirement components. The revenue requirement is set at a point in time based on all of those components and conditions change after it is set. More than just one component, depreciation expense, needs to be considered in understanding SourceGas distribution’s request in this proceeding. “(E57,5-6:15,15)

Mr. Watson also testified at the hearing as follows:

Q: Now, for – I take it from your testimony, that the Company told you that other expenses were higher and that’s why this sort of balance is out [sic]. Is that a fair statement?

A: I have seen the testimony from other witnesses related to that. So as part of the company telling me that’s the case, if that is a true fact and circumstance, then yes.

³ Mr. Watson mentions FERC Order 618 as supporting SourceGas’ proposal herein, but a reading of that Order would lead one to a contrary conclusion. The utility therein, SCE & G, submitted a new depreciation study and wished to utilize it retroactively to January 1, 2009 and asked that the revised depreciation rates be effective June 1, 2010 for rate making purposes. FERC, if I understand the arcane order correctly, made the rates effective June 1, 2010 for all purposes.

Q: Okay. And that is significant, if that is the true fact and circumstance. And have you done any review, audit, investigation to determine the truth of those – of those statements?

A: No.

Q: So you are taking the company's word for it?

A: Yes, in the sense I am taking the testimony of the company's witnesses to be correct – true and correct. (200:1-20)

The essence of what Mr. Watson is telling you is this: despite the fact that lower depreciation rates would in fact have resulted in lower customer rates in the last rate case and the idea that the company now only wants to book the lower depreciation on one side of the equation is okay because the company has told him that the Company has made significant plant investments and because the company has told him that its other expenses are higher. So, this all balances out. With all due respect, reaching that conclusion based upon supposition after supposition is not the way to regulate a utility.

The fact is, which Mr. Watson highlights, all of these factors need to be considered together before one can make a reasonable determination as to the effect that the stipulated depreciation rates should have on rates. SourceGas is proposing by this one-factor method to only lower its jurisdictional revenue requirement, but, actually, the one factor presented to you warrants a reduction in rates as well.

Does this hurt the ratepayer? Absolutely. As Mr. Dunkel has pointed out, the SourceGas proposal would allow it to record on its books an accumulated depreciation reserve amount that is less than the accumulated depreciation that has actually been recovered from ratepayers. (E81,4-5:21,22). Because the book amount of accumulated depreciation reserve will be used to calculate depreciation rates in future depreciation studies and calculate the net rate base in future

rate cases, SourceGas will end up with excessive and improper future depreciation rates and excessive and improper future net rate base, both to the detriment of the consumer. (E81,11:21,22). SourceGas would double recover some of its investments because the rates are predicated upon a 3% depreciation rate (for mains) but they would only credit the depreciation reserve with 1.08% (for mains) and thus the consumer would continue to pay in more for the given asset than the consumer is being credited with, and so will essentially pay twice over the life of this asset. (E81,14:21,22).

B. THE LEGALITY OF APPROVING THE SOURCEGAS PROPOSAL

Having set forth the effect on ratepayers of changing depreciation rates without changing customer rates, the Public Advocate now posits three legal impediments to the approval of NG-0079: (1) It presents an adjustment to the revenue requirement that can only be effected through a general rate case; (2) it causes the rates currently in effect to be unjust and unreasonable; and (3) it constitutes single issue rate making. These will be addressed seriatim.

1.

ADJUSTMENT TO THE REVENUE REQUIREMENT.

SourceGas is proposing to reduce its jurisdictional revenue deficiency i.e. to reduce its revenue requirement, by adjusting its depreciation expenses without adjusting customer rates accordingly. The Supreme Court of Vermont, in Central Vermont Public Service Corporation, 144 Vt. 46, 43 A.2d 1155 (1984) had this to say about a proposed tariff that was designed to allow Central Vermont full recovery of its purchased power and energy costs on an annual basis:

“One of the goals of the CPY, stated by the Board in its February 17, 1983 opinion, “is to reduce the scope and frequency of major rate cases,” and there is no intention of “conducting a rate-case-as-usual-proceeding.” Presumably this means that the Board will make no in-depth study or analysis of other items of income and expense, the composition of the rate base, or even the rate of return. We recognize that rate cases are expensive and time consuming

and that the Board saw in the CPY an opportunity to reduce both time and expense. However, we reiterate the holding of In re: Green Mountain Power Corp., supra (citation omitted), that selective updating, that is, the updating of one cost factor alone, “without giving attention to whether that cost factor was itself something needing a valuation or adjustment because of transitory or abnormal factors, or without assessing other, related cost or revenue changes concurrent with it, is a “forbidden procedure”. Id. at 59, 473 A. 2d 1162.”

The Company, without doubt, will point to Neb. Rev. Stat. § 66-1804 regarding the “full power, authority and jurisdiction” of the Commission to regulate natural gas public utilities and point out that this power is to be “liberally construed.” However, the Commission itself has recognized that even this broad authority does not warrant the approval of actions that otherwise fall statutorily within the bounds of the general rate case statutes. In the Matter of Aquila, Inc. Application No. NG-0031, Aquila requested approval of a “limited cost recovery” that would result in an increase in the customer charge of approximately .50¢ per customer per month. Aquila asserted that, “its proposal is in the public interest as it will lead to greater efficiency in the rate making process; lower regulatory and litigation costs; and provide for smaller, more frequent increases to customers.” (Page 1 of Order Denying Application entered November 1, 2005 NG-0031.) However, the Commission properly rejected this proposal. The Commission recognized that “changes to rates are possible outside of a general rate filing.” However, the Commission went on to say that,

“Aquila’s proposal specifically seeks an overall increase to its revenue. As such, it fits squarely within the definition of a “general rate filing” and must be handled through the procedures set forth in Section 66-1838. Aquila’s application is, therefore, denied.” Id. at page 3.

Boiled down to its essentials, there really is no difference here. NG-0079 is not seeking a rider, a surcharge, or a special recovery. Rather, SourceGas is proposing through this accounting

procedure (which does affect ratepayers) to address its jurisdictional revenue requirement. (See testimony of Jerrad Hammer at page 47, lines 18-22.) As Neb. Rev. Stat. § 66-1802(8) states:

“General rate filing means any filing which requests changes in overall revenue requirements for a jurisdictional utility but does not include a filing for an infrastructure system replacement cost recovery charge.” (emphasis supplied.)

SourceGas may argue that they are not attempting to adjust their revenue requirement, but what else can it be? They have asserted a jurisdictional revenue deficiency and are proposing to reduce that deficiency, i.e. their revenue requirement, by \$1.8 million of reduced depreciation expense. Whether you increase the rates and recognize an increase in the revenue requirement, or decrease the expenses and recognize a decrease in the revenue requirements, it is a change in the overall revenue requirement.

Thus, the Public Advocate suggests to the Commission that utilization of the stipulated depreciation rates outside of a general rate case is unsupported and unsupportable under the State Natural Gas Regulation Act, and falls within the definition of a general rate filing.

2.

THE REQUIREMENT THAT RATES BE JUST AND REASONABLE

Neb. Rev. Stat. § 66-1825(1) states in part:

“Every rate made, demanded, or received by any natural gas public utility, shall be just and reasonable...”

The Public Advocate suggests that adoption of lower depreciation rates would, in the normal course of a rate case, result in lower rates. To adopt lower depreciation rates without lowering customer rates will cause ratepayers to pay more for depreciating assets than they are being credited with in the depreciation reserve. This causes the rates to be unjust and

unreasonable. Mr. Dunkel testified that such is the result, (E81,14:21,22) but it is not only his opinion. This has been judicially recognized. In the case of In re Green Mountain Power Corp., 162 Vt. 378, 648 A.2d 374 (1994), the Supreme Court of Vermont required the Vermont Public Service Board to reduce a utility's rate base to account for accumulated depreciation on the test year plant during the interim year between the historical test year and future adjusted test year, despite the Board's explanation that the depreciation rate base reduction, although known and measurable, would be, "offset" by potential adjusted test year plant investment by the utility.

The Court stated there:

The essential reason to apply the "known and measurable change" principle to the test year rate base is that once customers have, in effect, returned a portion of the utility's investment, they should not be required to pay for that portion a second time, once as depreciation expense and again as a return on plant value which has not been correspondingly reduced to reflect the return of the investment through depreciation expense payments. Id. at 383, 648 A.2d at 378."

See also State Utilities Commission vs. Duke Power Company, 305 N.C. 1, 287 SE.2d 786, 796 (1982) wherein the Court rejected a power company's suggestion to adjust the test period depreciation expenses without an offsetting increase to accumulated depreciation because customers would then pay twice, once for the adjustment for depreciation and then again based on an inflated rate base.

To make this adjustment, knowing that it should properly have a lowering effect on rates, and creating a higher rate base for the next rate , is simply not just and reasonable so far as the ratepayer is concerned.

3.

SINGLE ISSUE RATE MAKING (OR NOT)

In its application, SourceGas argued that its proposal does not constitute single-issue rate making because SourceGas Distribution is not proposing to change any customer rates, and there must a change in the rates to the customers for there to be “single-issue rate making” (43,6:15.15). However, when considering the future effect the change will have on the rate base in SourceGas’ next general rate case, this argument appears a bit in disingenuous. If the depreciation rates are to be adjusted, there should be a corresponding reduction in rates charged to customers. Perhaps SourceGas’ proposal is more properly labeled “single issue non-rate making.” Regardless, the Public Advocate would suggest that the arguments against single issue rate making apply just as forcefully to the application in NG-0079.

In People ex rel. Madigan v Illinois Commerce Com’n., 370 Ill. Dec. 370, 988 N.E.2d 146 (2013), the Appellate Court of Illinois noted:

“The rule against single issue rate making makes it improper to consider in isolation changes in particular portions of a utility’s revenue requirement....The rule insures that the utility’s revenue requirement is based on the utility’s aggregate costs and the demand on the utility, rather than on certain specific costs related to a component of its operation....Often a change in one item of the revenue requirement formula is offset by a corresponding change in another component of the formula....If rates are increased based solely on one factor, the rate making structure becomes distorted because there is no consideration of the changes to the other elements of the revenue formula, such as the operational savings from the improvements. Single issue rate making is prohibited because it considers changes in isolation, thereby ignoring potentially offsetting considerations and risking understatement or overstatement of the overall revenue requirement. Id. at 379, 988 N.E.2d at 155.”

In Pennsylvania Industrial Energy Coalition v. Pennsylvania Public Utility Commission, 653 A.2d 1336 (1995) the Court there noted that, “single issue rate making is similar to

retroactive rate making and, in general, is prohibited if it impacts on a matter that is normally considered in a base rate case.” Id. at 1350. See also, Commonwealth Edison Co. v. Illinois Commerce Commission, 405 Ill.App.3d 389, 937 N.E.2d 685 (2010).

The isolated changes to SourceGas’ depreciation rates and the deleterious effect on future rates are clear indications of impermissible single issue rate making and suffer from the same or similar defects: it is attempting to adjust a revenue requirement based on a single cost rather than the aggregate costs and demands of the utility and, as even Mr. Watson notes, often times a change in one item of the revenue formula is offset by a corresponding change in another component. (E57,5:15,15) Here, we have only the assertions of SourceGas as to the nature and level of the other components that should otherwise be reviewed a typical base rate case.

An important consideration for the Commission is the precedent that will be set if an application such as the one presently pending in NG-0079 is approved. If a depreciation study can be approved and implemented in isolation here, what is to prevent this or another jurisdictional utility from filing an application in which the depreciation rates are increased and requesting an appropriate increase in rates, or prevent a utility from filing any other data or study, whether it be a cost of capital study, a class of service study, or what have you, and ask that adjustments be made accordingly outside of a rate case. This proposal by SourceGas, make no mistake, would have an effect upon the ratepayer every bit as much as if the rates had been changed. The Commission should simply not grant an application such as that represented by NG-0079.

CONCLUSION

SourceGas has presented these dockets (and NG-0072.01) as an alternative to a general rate case. However, the general rate case cannot be avoided, only delayed. The testimony of Mr.

Jerrad Hammer appears to be that the best case scenario is that the PSC will have a SourceGas general rate case before it in probably 2½ years. Whatever the cost of a rate case may be, the best case scenario in approving novel proposals such as NG-0078 and NG-0079 is to save the ratepayer 2½ years of the time value of the money that would be spent in the general rate case, not the cost of the rate case itself. Even at the most generous interest rates possible, you are talking about a savings of a couple of hundred thousand dollars even if the rate case should cost \$1.3 million. SourceGas says that the other benefit is avoiding the possibility of a significant rate increase. If SourceGas is entitled to a rate increase, it should be vetted and granted, and the ratepayer should have no complaint. That is what general rate cases are all about.

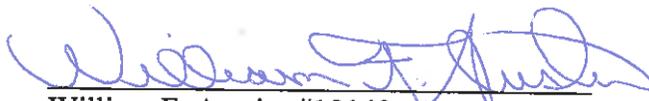
The brief sets forth the practical, procedural and legal concerns that the Public Advocate believes the Commission must address when consideration these two applications. For the above and foregoing reasons, the Public Advocate must suggest to the Commission that both of SourceGas' applications, NG-0078 and NG-0079, should be denied.

DATED this 15th day of October, 2014.

Respectfully Submitted,

PUBLIC ADVOCATE

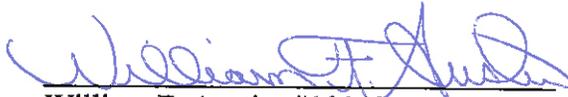
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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the above and foregoing Pos-Hearing Brief of Public Advocate was served electronically on this 15th day of October, 2014, upon the following:

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