

FILE

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of)	
Duke Energy Ohio, Inc. for an)	Case No. 08-709-EL-AIR
Increase in Electric Distribution Rates)	
)	
In the Matter of the Application of)	
Duke Energy Ohio, Inc. for Tariff)	Case No. 08-710-EL-ATA
Approval)	
)	
In the Matter of the Application of)	
Duke Energy Ohio, Inc. for Approval)	Case No. 08-711-EL-AAM
to Change Accounting Methods)	

SUPPLEMENTAL DIRECT TESTIMONY OF

PAUL G. SMITH

ON BEHALF OF

DUKE ENERGY OHIO, INC.

_____	Management policies, practices, and organization
<u> X </u>	Operating income
_____	Rate Base
_____	Allocations
<u> X </u>	Rate of return
_____	Rates and tariffs
<u> X </u>	Other

RECEIVED-BOOKETING DIV
2009 FEB 26 AM 11:21
PUCO

260646

This is to certify that the images appearing are an accurate and complete reproduction of a case file document delivered in the regular course of business.

Technician Jm Date Processed 2/26/2009

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of)	
Duke Energy Ohio, Inc. for an)	Case No. 08-709-EL-AIR
Increase in Electric Distribution Rates)	
)	
In the Matter of the Application of)	
Duke Energy Ohio, Inc. for Tariff)	Case No. 08-710-EL-ATA
Approval)	
)	
In the Matter of the Application of)	
Duke Energy Ohio, Inc. for Approval)	Case No. 08-711-EL-AAM
to Change Accounting Methods)	

SUPPLEMENTAL DIRECT TESTIMONY OF

PAUL G. SMITH

ON BEHALF OF

DUKE ENERGY OHIO, INC.

INDEX

Supplemental direct testimony addressing the determination of various rates of return, operating income items and other requested regulatory relief.

TABLE OF CONTENTS

	<u>PAGE</u>
I. Introduction	1
II. List Of Objections	1
III. Objection No. 2 – Capital Structure	2
IV. Objection No. 9 – Merger Savings Adjustment	5
V. Objection No. 19 – Storm Damage Deferral	5
VI. Conclusion	7

I. INTRODUCTION

1 **Q. PLEASE STATE YOUR NAME.**

2 A. My name is Paul G. Smith.

3 **Q. DID YOU FILE DIRECT TESTIMONY IN THIS PROCEEDING ON**
4 **BEHALF OF DUKE ENERGY OHIO INC. ("DE-OHIO" OR**
5 **"COMPANY")?**

6 A. Yes.

7 **Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?**

8 A. I list the objections filed and introduce the DE-Ohio witnesses who will describe
9 and support each objection. Additionally, I support Objection Nos. 2, 9 and 19 in
10 DE-Ohio's Objections to Staff Report of Investigation and Summary of Major
11 Issues ("Staff Report"), filed on February 26, 2009.

II. LIST OF OBJECTIONS

12 **Q. PLEASE PROVIDE A LIST OF THE COMPANY'S OBJECTIONS AND**
13 **IDENTIFY THE SUPPLEMENTAL WITNESSES WHO WILL FURTHER**
14 **DESCRIBE AND SUPPORT THE OBJECTIONS.**

15 A. Following is a list of the Company's objections and the supplemental witnesses
16 who will further describe and support the objections:

Objection No.	Description	Witness
1	Proposed Revenue Increase	William Don Wathen
2	Capital Structure	Paul G. Smith & Roger A. Morin

3	Cost of Common Equity	Roger A. Morin
4	Working Capital	William Don Wathen
5	Regulatory Asset Amortization Expense	William Don Wathen
6	Uncollectible Expense	William Don Wathen
7	Labor Expenses	William Don Wathen
8	Pension and Benefits Expense	William Don Wathen
9	Merger Savings Adjustment	Paul G. Smith
10	EEI Expense	William Don Wathen
11	Commercial Activities Tax Expense	William Don Wathen
12	Cost of Service	Donald L. Storck
13	Residential Customer Charge	Donald L. Storck
14	Pole Attachment Rental	Donald L. Storck
15	Pole Attachment Tariff Language	Donald L. Storck
16	Economic Development Rider	James E. Ziolkowski
17	Customer- Owned Street Lighting Service	James E. Ziolkowski
18	Rider SC - Shopping Credit	James E. Ziolkowski
19	Storm Damage Deferral	Paul G. Smith

III. OBJECTION NO. 2 – CAPITAL STRUCTURE

1 Q. PLEASE EXPLAIN THE COMPANY'S OBJECTION NO. 2.

2 A. The Company objects to the Staff's use of a hypothetical capital structure
3 for determining the Company's overall rate of return on rate base. The
4 Staff's proposal departs from the Commission's traditional position for
5 establishing capital structure; it is at odds with its positions taken in other

260646

PAUL G. SMITH SUPPLEMENTAL DIRECT TESTIMONY

1 recent rate proceedings and workshops; it encourages undesired financing
2 behavior; and disregards the plain facts in this case as to the Company's
3 actual capital structure deployed to support its electric distribution
4 operations.

5 **Q. HOW HAS THE COMMISSION PREVIOUSLY ADDRESSED A**
6 **UTILITY'S CAPITAL STRUCTURE?**

7 A. In the Company's recent gas rate case, Case No. 07-589-GA-AIR, and in
8 its prior electric distribution rate case, Case No. 05-059-EL-AIR, the Staff
9 recommended the use of an adjusted DE-Ohio consolidated capital
10 structure. More recently, in the three First Energy electric distribution
11 cases (Case No. 07-551-EL-AIR et al), the Staff advocated a capital
12 structure based on the operating companies' actual capitalization. The
13 Commission's Orders in all five of these recent proceedings approved a
14 rate of return predicated on the actual capital structure.

15 The Staff also recently convened a workshop, held on June 12,
16 2007, to discuss the issue of the appropriate capital structure to use in
17 setting rates for an electric distribution utility ("EDU"). In its own report
18 on that workshop the Staff makes the following statement, "*The Staff*
19 *believes that the stand-alone EDU capital structure is the appropriate*
20 *place to begin. There may be cases where a modification to this capital*
21 *structure may be warranted for rate of return purposes. In such cases, the*
22 *reasons for a modification should be demonstrated.*". The language does
23 provide for alternatives to the stand-alone EDU capital structure; however,

1 the Staff also indicates that such alternatives must be justified. There is
2 nothing in the Staff Report to explain "the reasons for a modification" to
3 the Company's proposed stand-alone EDU capital structure. Lacking
4 Staff explanation for the departure from their recent stated preference to
5 use the stand-alone EDU capital structure, the Commission should reject
6 the Staff's recommended hypothetical capital structure and approve the
7 traditional approach as proposed by the Company.

8 **Q. DOES THE STAFF'S PROPOSAL ENCOURAGE AN UNDESIRE**
9 **FINANCING BEHAVIOR?**

10 A. Yes. By using a hypothetical capital structure in determining the
11 recommended rate of return, the Staff will encourage EDU's to maintain
12 an equity ratio that is below the hypothetical structure. Deploying an
13 actual equity ratio that is below the hypothetical structure approved in
14 rates will provide the perverse incentive whereby EDU's will earn a return
15 on equity that it does not issue.

16 **Q. DO YOU HAVE ANY REASONS FOR ADVOCATING THE USE**
17 **OF DE-OHIO'S PROPOSED STAND-ALONE CAPITAL**
18 **STRUCTURE?**

19 A. Yes. Although rejecting the traditional approach of using actual structure
20 in favor of a hypothetical structure may be appropriate when equity ratios
21 are outside of any range of reasonableness and/or cannot be deduced from
22 actual data, neither of these circumstances exists in this case. Rather, the
23 actual capital structure is both available and readily apparent. The

1 Company's proposed capital structure in this case is based on actual
2 verifiable data. Therefore, there is no justification to depart from using
3 DE-Ohio's actual capital structure.

IV. OBJECTION NO. 9 – MERGER SAVINGS ADJUSTMENT

4 **Q. PLEASE EXPLAIN THE COMPANY'S OBJECTION NO. 9.**

5 A. The Company objects to the Staff's failure to eliminate the duplicative merger
6 savings benefit that will be received by electric distribution customers. The
7 Company has satisfied its merger commitment to credit electric distribution
8 customers with 42% of projected five-year net savings. By not eliminating the
9 merger savings from the test period operating and maintenance expense
10 ("O&M"), the Staff is essentially recommending that customers receive the
11 windfall benefit of duplicative merger savings.

V. OBJECTION NO. 19 – STORM DAMAGE DEFERRAL

12 **Q. PLEASE EXPLAIN THE COMPANY'S OBJECTION NO. 19.**

13 A. On December 22, 2008, the Company filed a motion to change accounting
14 methods to defer and create a regulatory asset for storm restoration costs incurred
15 during the test year. The Commission granted this deferral request on January 14,
16 2009. Although the Staff Report recommends that Rider DR-Ike is an appropriate
17 mechanism to recover deferred storm damage costs, the Company objects to the
18 recommendation that such recovery be established in a separate procedural
19 schedule.

20 The Company believes the storm costs, which were incurred during the
21 test period, can be reviewed in detail and should be recoverable commensurate

1 with an Order in this proceeding. The Staff Report includes a detailed
2 investigation into DE-Ohio's Reliability and Service Quality. The Staff's
3 inspection and audits concluded that DE-Ohio was either in full compliance with
4 all distribution system inspection and testing requirements or was on track to be
5 fully compliant by the end of the test year.¹ The Staff Report further concluded
6 that DE-Ohio has never missed a reliability target and, in fact, commended DE-
7 Ohio for improving its System Average Interruption Frequency ("SAIFT") scores
8 since the Company's last rate case. Clearly, DE-Ohio is meeting all requirements
9 to maintain its electric delivery system so there is no question as to whether DE-
10 Ohio is providing safe, adequate and reliable service. Further Staff served DE-
11 Ohio several discovery requests related to the Hurricane Ike damage during its
12 review of the Company's Application. Accordingly, Hurricane Ike storm
13 restoration recovery through Rider DR-IKE can, and should, be considered in the
14 context of the existing case.

15 Similarly, the Staff report failed to consider the use of the Rider Ike for
16 additional storm restoration recovery. DE-Ohio experienced a winter ice storm in
17 January 2009, in which the company incurred approximately \$9 million in
18 restoration expenses. These sudden and uncontrollable weather events place
19 additional constraints on the company. DE-Ohio should have a ongoing rider
20 mechanism in place in which it can propose recovery of deferred amounts related
21 to significant weather related outages. Despite DE-Ohio's best efforts to maintain

¹ As referenced in the Staff Report on page 43, as of August 31, 2008, DE-Ohio had inspected 79% of the distribution poles scheduled for inspection in 2008. As further noted by the Staff report on page 46, as of August 31, 2008, DE-Ohio had completed 75.5% of the circuit miles scheduled for vegetation line clearing for 2008.

1 its electric delivery system and comply with all Commission rules and
2 regulations, the Company cannot defend anticipate such extreme weather
3 conditions.

VI. CONCLUSION

4 **Q. DOES THIS CONCLUDE YOUR SUPPLEMENTAL DIRECT**
5 **TESTIMONY?**

6 **A. Yes.**