

THE PUBLIC UTILITIES COMMISSION OF OHIO

Case No. 12-0426-EL-SSO

Case No. 12-0427-EL-ATA

Case No. 12-0428-EL-AAM

Case No. 12-0429-EL-WVR

Case No. 12-0672-EL-RDR



BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of The Dayton Power and Light Company to Establish a Standard Service Offer in the Form of an Electric Security Plan.))))))	Case No. 12-0426-EL-SSO
In the Matter of the Application of The Dayton Power and Light Company for Approval of Revised Tariffs.))))))	Case No. 12-0427-EL-ATA
In the Matter of the Application of The Dayton Power and Light Company Approval of Certain Accounting Authority.))))))	Case No. 12-0428-EL-AAM
In the Matter of the Application of The Dayton Power and Light Company for Waiver of Certain Commission Rules.))))))	Case No. 12-0429-EL-WVR
In the Matter of the Application of The Dayton Power and Light Company to Establish Tariff Riders.))))))	Case No. 12-0672-EL-RDR

Direct Testimony of Michael P. Gorman

- 1 **Q** **PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**
- 2 **A** Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140,
- 3 Chesterfield, MO 63017.

1 **Q WHAT IS YOUR OCCUPATION?**

2 A I am a consultant in the field of public utility regulation and a Managing Principal of
3 Brubaker & Associates, Inc., energy, economic and regulatory consultants.

4 **Q PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

5 A This information is included in Appendix A to my testimony.

6 **Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

7 A I am appearing on behalf of the Federal Executive Agencies ("FEA"). FEA is a large
8 customer in Ohio, covering Wright-Patterson Air Force Base ("WPAFB") and all
9 federal agencies in the Dayton Power & Light ("DP&L" or "Company") service region.
10 WPAFB represents one of the largest electric consumers for DP&L. FEA has a real
11 and substantial interest in these proceedings as it will be directly impacted by the cost
12 of electric service to FEA and its impact on the electric bills of all federal consumers in
13 the DP&L service region.

14 **Q WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

15 A I will respond to the Company's proposal for a Service Stability Rider ("SSR"). The
16 Company claims the SSR is designed for the following:

- 17 1. Stabilize its ability to provide retail electric service,
18 2. Keep its return on equity within a 7% to 11% range during the transition
19 period, and
20 3. Maintain DP&L's financial integrity. The transition period is the completion
21 of its phase-in to Competitive Bidding Service ("CBS") by June 1, 2016.

Q DID DP&L EXPLAIN WHY IT IS SEEKING AN SSR IN THIS CASE?

A Yes. DP&L witness Philip Herrington stated that the Company is seeking an SSR similar to what was recently approved in an American Electric Power-Ohio ("AEP-Ohio") Electric Security Plan ("ESP") case. In that case, DP&L states that the Commission set a reasonable revenue target range which allowed AEP-Ohio an opportunity to earn between a 7% and 11% return on equity. The Company used this return on equity range as a method of developing an SSR revenue requirement amount (\$137.5 million) which it asserts provides it with the opportunity to earn within this return on equity range during the transitional period ending June 1, 2016 for the competitive bidding process.

Q DID MR. HERRINGTON OUTLINE STATE POLICIES WHICH DP&L BELIEVES SUPPORT ITS RECOMMENDATIONS IN THIS PROCEEDING?

A Yes. Some of them in particular I would like to emphasize because I think they are important in assessing the prudence and reasonableness of the Company's proposed SSR. Those include the following sections identified by Mr. Herrington:

Q. Section 4928.02(A) states that it is the policy of the state to:

"Ensure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service."

* * *

Q. Section 4928.02(H) states that it is the policy of the state to:

"Ensure effective competition in the provision of retail electric service by avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service or to a product or service other than retail electric service, and vice versa, including by prohibiting the recovery of any generation-related costs through distribution or transmission rates."

* * *

1 Q. Section 4928.02(N) states that it is the policy of the state to:

2 “Facilitate the state’s effectiveness in the global economy. In
3 carrying out this policy, the commission shall consider rules as
4 they apply to the costs of electric distribution infrastructure,
5 including, but not limited to, line extensions, for the purpose of
6 development in this state.”¹

7 As outlined above, sections of the state’s policy indicate that rates charged
8 should be reasonable, and non-discriminatory, and reflect efficient cost of service.
9 The rates should also support the state’s ability to compete within the global
10 economy. These objectives are important because I believe certain aspects of the
11 financial projections used to develop the SSR revenue requirement, and the SSR
12 itself, simply are deficient in meeting the state policy.

13 **Q HOW DID DP&L DEVELOP THE SSR REVENUE REQUIREMENT?**

14 A It was developed in financial projections made by DP&L witness Craig Jackson.²
15 DP&L witness Jackson as-filed projections were provided on his Second Revised
16 Exhibit CLJ-2.

17 Mr. Jackson lists the major components of his “As Filed” forecast at page 7 of
18 his Second Revised Testimony. Mr. Jackson also outlines his assumptions for
19 transitions to a competitive market under Standard Service Offer (“SSO”) and the
20 development of pro forma statements and assumed refinancing costs at pages 9
21 through 11.

22 The development of the revenue requirement for the SSR is supported in the
23 direct testimony of William Chambers. Mr. Chambers states that the SSR revenues
24 were designed to produce a return on equity for DP&L within Mr. Jackson’s forecasts
25 in a range of 7% to 11%. Mr. Chambers also then looked at the credit metrics

¹Second Revised Testimony of Philip R. Herrington at 5-7, emphasis added.

²Chambers Direct at 39, note 29.

1 produced used the information from Mr. Jackson's financial forecasts to show that
2 with the SSR revenues, DP&L's financial integrity and access to capital would be
3 preserved.

4 **Q DO THE FINANCIAL PROJECTIONS DEVELOPED BY MR. JACKSON ON HIS**
5 **Second Revised EXHIBIT CLJ-2 SUPPORT THE COMPANY'S \$137.5 MILLION**
6 **OF REVENUE REQUIREMENT TO RECOVER IT IN THE SERVICE STABILITY**
7 **RIDER?**

8 A No. The results of that forecast are summarized by Mr. Chambers on his Second
9 Revised WJC-1, page 1. As shown on that exhibit, projected for calendar year 2013
10 is an earned return on equity of 10.1%. That return on equity does not reflect the
11 estimated O&M expense savings described by Mr. Jackson on a preliminary basis,
12 and reflects a common equity ratio of 61%. These financial projections have not
13 been shown to reflect reasonable and prudent utility costs and should, therefore, not
14 be the basis of setting a non-bypassable SSR revenue requirement or charges.

15 **Q WERE MR. JACKSON'S FINANCIAL PROJECTIONS BASED ON ONLY THE**
16 **REGULATED OPERATION OF DP&L?**

17 A No. Financial projections as outlined by Mr. Chambers and his analysis of the same
18 were based on DP&L Inc. DP&L Inc. includes its utility subsidiary, DP&L, as well as
19 non-regulated subsidiaries including DP&L Energy Resources (competitive electric
20 energy service company), DP&L Energy LLC (merchant generation company).

21 Further, the details produced by Mr. Jackson and relied on by Mr. Chambers
22 do not forecast enough detail to determine whether or not earnings erosions, capital
23 improvements, or expense growth are related to regulated utility operations or

1 non-regulated operations. For these reasons, Mr. Jackson's financial forecast is
2 wholly deficient for use in determining an SSR charge which is consistent with the
3 state's mandates of reasonable and prudent regulatory costs, a prohibition against
4 increasing distribution and transmission charges to support merchant generation
5 activities, and ensuring that the regulated charges support Ohio ability to compete in
6 a global economy.

7 **Q DID MR. JACKSON ASSUME RATE CASE FILINGS TO ADJUST TRANSMISSION**
8 **AND DISTRIBUTION RATES, IF THE RATES FOR THESE FUNCTIONS WERE**
9 **DRIVING DOWN EARNINGS?**

10 A It is not clear from his filing, but I understand Mr. Jackson did not assume any rate
11 case filings to adjust distribution and transmission rates to cost of service in order
12 support the Company's ability to earn its authorized return on equity for these
13 business functions.

14 **Q SHOULD MR. JACKSON'S FORECAST BE USED TO DEVELOP AN SSR**
15 **REVENUE REQUIREMENT AND SSR CHARGE IN THIS PROCEEDING?**

16 A No. The SSR surcharge should not be approved based on the Company's evidence
17 in this case. However, if the Commission chooses to implement an SSR based on
18 this total company forecast, I will make recommendations on how to develop more
19 reasonable and fair SSR for regulated cost of service. However, even with my
20 adjustments to the Company's forecast, there are material deficiencies in the "As
21 Filed" forecasts which fail to meet the state's policies as outlined by Mr. Herrington.

1 Q ASIDE FROM YOUR CONCERN ABOUT IT NOT REFLECTING ONLY UTILITY
2 OPERATIONS, DO YOU HAVE SPECIFIC CRITICISMS OF SOME OF THE
3 ASSUMPTIONS WHICH LED TO THE FORECASTED RETURNS ON EQUITY AND
4 CREDIT METRICS INCLUDED IN THE FINANCIAL PROJECTIONS PRODUCED
5 BY MR. JACKSON?

6 A Yes. At a minimum, I propose two adjustments to Mr. Jackson's forecasts to better
7 meet the state policy objectives outlined in DP&L's testimony by DP&L witness Mr.
8 Herrington. Mr. Jackson's forecasts include excessive costs for the following
9 reasons:

10 1. He uses a DP&L projected regulatory capital structure including 60% to
11 66% common equity throughout the forecast period. A capital structure
12 this heavily weighted with common equity is not reasonable for regulatory
13 purposes. By overstating the common equity ratio, he is significantly
14 understating the earned return on equity on a reasonably balanced capital
15 structure and reasonable cost of capital used to support regulated utility
16 operations.

17 2. 
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1 Q WHY ARE THESE ADJUSTMENTS NOT ADEQUATE TO FULLY CORRECT
2 MR. JACKSON'S FORECAST TO USE TO ESTIMATE AN SSR REVENUE
3 REQUIREMENT?

4 A As noted in the state policies outlined by Mr. Herrington, the SSR based on the
5 forecasts should reflect: (a) reasonably priced retail electric service, (b) avoid anti-
6 competitive subsidies, and prohibit the recovery of generation-related costs through
7 distribution or transmission rates, and (c) facilitate the state's effectiveness in the
8 global economy. I believe several aspects of Mr. Jackson's forecasts, even with my
9 adjustments, simply do not comply with these mandates. Those include the following:

10 1. Mr. Jackson's projected revenues for retail service actually declined
11 through the forecast period, whereas its wholesale revenues increase.
12 Hence, the SSR predominantly appears to support wholesale generation-
13 related activities by the end of the forecast period, rather than retail
14 distribution and transmission services. Hence, the erosion of return on
15 equity in the latter years of his forecasts appears to be related to the
16 wholesale merchant segment. The SSR in these years appears to impose
17 transmission and distribution charges on customers to support the
18 Company's merchant generation operations.

19 2. Mr. Jackson's projections erode earnings and credit metrics through the
20 latter years reflecting significant capital improvements throughout the
21 forecast period. [REDACTED]
22 [REDACTED]
23 [REDACTED]

24 [REDACTED] Virtually all of the capital increase is attributable to growth in
25 common shareholders' equity with virtually no increase in total debt. While
26 the Company is considerably growing its balance sheet, its revenues from
27 retail operations decrease by approximately \$24 million. Further, the
28 increase in wholesale revenue and RTO capacity and other RTO revenues
29 increase significantly. This increase in capital and shift in revenue
30 generation from retail regulated operations to wholesale operations, is a
31 strong indication that the Company's earnings are increasingly driven by
32 non-regulated operations. However, Mr. Jackson did not provide
33 adequate detail to make this determination.

34 3. Mr. Jackson's projected operating expenses increased by approximately
35 [REDACTED], or [REDACTED] through the forecast period. Again, this assumption
36 largely contributes to the erosion of earnings by the end of the forecast
37 period, but it is not clear which business function is driving the increased
38 expenses.

Q HOW DID YOU MODIFY THE FORECASTS TO REFLECT A REASONABLE CAPITAL STRUCTURE TO REFLECT LOW OPERATING RISK REGULATED UTILITIES?

A The industry average capital structure for integrated electric utility companies is approximately 50% debt and 50% equity. I reached this conclusion based on the following observations:

1. *Value Line's* electric utility industry average common equity ratio is 49% for 2013 and for the projections for three to five years.
2. Mr. Chambers himself recognizes that regulated utility operations typically have capital structures of around 50% debt and 50% equity (Direct at 30-31)
3. DP&L's under-leveraged capital structure is offset by an over-leveraged capital structure at the parent company AES Corporation.

For these reasons, I recommend modifying Mr. Jackson's base forecast to reflect a capital structure for DP&L of 50% equity and 50% debt. I accomplish this by adjusting Mr. Jackson's "as filed" forecasts to reduce the common equity ratio of total capital in the forecast to produce a 50% equity weight and 50% debt weight capital structure. I included more debt to replace less common equity and then included an incremental interest expense on the incremental debt necessary to achieve this capital structure weighting. I assumed a marginal cost of debt of 5% for this new debt issue consistent with the Company's financial forecast assumptions.

Q HOW DID YOU CHANGE THE FORECASTED O&M PROJECTIONS BASED ON MR. JACKSON'S ASSESSMENT OF POTENTIAL SAVINGS OPPORTUNITY?

A [REDACTED]

[REDACTED]

[REDACTED]

1 As shown in my attached Confidential Exhibit MPG-1, I reduced the O&M
2 expenses shown on Mr. Jackson's Confidential Exhibit CLJ-2, line 17 for the period
3 2013-2017 by each year's respective cost savings opportunity amount identified
4 above by Mr. Jackson.

5 **Q WOULD THE AMOUNT OF SSR REVENUE REQUIREMENT CHANGE WITH**
6 **THESE CHANGES TO MR. JACKSON'S PROJECTIONS?**

7 A Yes. The revised forecast is shown on my Confidential Exhibit MPG-1. I reduced the
8 amount of SSR revenue from \$137.5 million as recommended by the Company down
9 to \$90 million. This reduced SSR produces a return on equity in the range of **7% to**
10 **11%** through 2014. The projected return on equity drops below 7% in 2015, however
11 it appears to be driven by changes in non-regulated rather than regulated operations.
12 Further, it is not clear whether or not the reduction in the return on equity could be
13 resolved through a filing of a rate case for transmission and distribution operations.
14 Hence, I did not propose an SSR revenue level that will maintain a return on equity in
15 the target range outside of the 2014 period. I did, however, review credit metrics over
16 the entire forecast period. This assessment supports my belief that this level of SSR
17 will achieve the earnings target through 2014, and support investment grade
18 regulated utility credit metrics through the entire forecast period.

19 **Q PLEASE DESCRIBE WHY YOU BELIEVE THAT THIS REDUCED SSR REVENUE**
20 **WILL SUPPORT DP&L'S BOND CREDIT METRICS THROUGHOUT THE**
21 **FORECAST PERIOD.**

22 A I did this by a revised estimate of DP&L's forecasted credit metrics through the
23 planning period of 2013 through 2017. These credit metrics were then compared to

1 both Standard & Poor's ("S&P") benchmarks for a utility with a financial profile rating
2 of "Aggressive" and "Significant," both with an "Excellent" business profile score. As
3 shown on Exhibit MPG-2, page 1, the Company's credit metrics were reasonably
4 consistent with S&P's benchmarks for an investment grade credit rating through the
5 forecast period. Specifically, the FFO to debt ratio stays reasonably consistent with
6 the investment grade credit metric rating for a utility with a "Significant" financial
7 profile score, although it does start to get weak in 2016 and 2017. I would note, that
8 the projections for 2017 reflect a time period where a full transition to the open market
9 has been achieved.

10 The debt to EBITDA ratio for the utility is rather weak, but for reasons outlined
11 below, is generally consistent with other utilities in the electric industry. The debt to
12 total capital ratio is generally consistent with industry averages.

13 **Q HOW DO THE PROJECTED CREDIT METRICS COMPARE TO MEDIANS FOR**
14 **S&P'S CREDIT METRICS FOR ELECTRIC UTILITY COMPANIES DURING 2011?**

15 **A** As shown on my Exhibit MPG-2, page 2, I compared these credit metric projections
16 with industry medians reported by S&P for various bond ratings. DP&L's EBITDA to
17 interest metric is generally consistent with that of an "A" to "BBB" bond rating
18 throughout the forecast period. Its FFO to debt ratio also stays within the investment
19 grade bond rating categories. Finally, the debt to EBITDA ratio stays within the
20 investment grade range through 2017.

1 Q DO YOU BELIEVE THAT IT IS APPROPRIATE TO CONSIDER THE
2 BENCHMARKS THAT WILL MAINTAIN AN INVESTMENT GRADE BOND RATING
3 FOR A BUSINESS PROFILE SCORE OF "EXCELLENT" AND A FINANCIAL RISK
4 SCORE OF "SIGNIFICANT" AND/OR "AGGRESSIVE"?

5 A Yes. These benchmarks reflect the electric utility industry rather than DP&L. DP&L's
6 current business profile and financial profile scores are "Strong" and "Aggressive,"
7 respectively. However, S&P notes that DP&L's business profile score is negatively
8 impacted by its non-regulated affiliates and its affiliation with a highly leveraged
9 parent company, AES Corp. S&P states as follows:

10 **Rationale**

11 Standard & Poor's ratings on DPL Inc. reflect the company's
12 consolidated credit profile, which includes its association with the
13 weaker credit quality of its parent, The AES Corp. (BB-/Stable/--). DPL
14 is the holding company for regulated electric utility DP&L. The ratings
15 also reflect DPL's "strong" business risk profile and its "aggressive"
16 financial risk profile, as defined in our criteria. (We rank business risk
17 from "excellent" to "vulnerable" and financial risk from "minimal" to
18 "highly leveraged.")

19 We view DPL and DP&L's business risk profiles as "strong" based on
20 the increased competition among Midwest energy retail providers and
21 the expected growth of the unregulated retail business. In addition, we
22 expect competition to increase because of lower wholesale electricity
23 prices, which will materially reduce DPL's profit margins. The
24 company's financial position has very little cushion due to the
25 increased amount of acquisition debt from parent company AES. DPL
26 recently announced that it will be taking an impairment charge of \$1.85
27 billion on the goodwill associated with the AES purchase. Although we
28 do not expect this impairment to affect cash flows, it will substantially
29 weaken net income and earnings in 2012 as well as the total-debt-to-
30 capital ratio. DPL's credit quality is heavily influenced by the
31 substantial additional acquisition-related debt and its adverse impact
32 on the company's key financial measures. Consequently, our baseline
33 forecast calls for total debt to EBITDA of about 6.5x to 7.0x and
34 adjusted FFO to total debt to be about 8% to 10%.

35 Our ratings on DPL and DP&L are higher than our rating on parent
36 AES, as structural protections (a separateness agreement, an
37 independent director, and debt limitations and covenants) provide
38 some insulation to the subsidiaries.

1 Our assessment of both entities' strong business risk profiles is based
2 on DP&L's eventual transition to generation market rates. We expect
3 increasing competition from lower wholesale electricity prices to
4 materially reduce DPL's profit margins in the next 12 to 24 months.
5 Our assessment also takes into account the expected growth of the
6 unregulated retail subsidiary, a lack of fuel diversity, and a weak
7 economy in Dayton. Those factors are partly offset, in our view, by the
8 lower-risk regulated transmission and distribution portion of the
9 business, generally low-cost generating facilities, and the completion
10 of an extensive environmental compliance program. With heightened
11 competition in Ohio, unrated affiliate DPL Energy Resources now
12 provides electricity to about 77% of DP&L's estimated 57% switched
13 load at market rates.³

14 Therefore, I recommend the use of electric industry benchmarks rather than
15 DP&L's actual to remove this merchant affiliation risk.

16 **Q WHAT IS S&P'S BUSINESS PROFILE SCORE FOR THE REGULATED ELECTRIC**
17 **UTILITIES?**

18 A S&P has assigned an "Excellent" business risk and "Aggressive" financial risk to the
19 majority of the utility regulated companies due to their low operating risk. Specifically,
20 S&P states:

21 The universe of domestic electric utilities is relatively highly rated, certainly
22 compared with the average 'BB' category for U.S. industrial companies. This is
23 a function of the large percentage of firms with excellent (nearly 90%) or
24 strong business risk profiles, which, however, is generally balanced with
25 aggressive financial risk profiles. As a consequence, almost 62% of the
26 regulated utility industry carries a 'BBB' category corporate credit rating
27 ('BBB+', 'BBB', and 'BBB-'), about 35% 'A-' and above, and just 4%
28 speculative grade ('BB+' and below).⁴

29 As such, I believe appropriate credit metrics for use in assessing the need for
30 an SSR is more consistent with electric utility industry typical business profile scores

³Standard & Poor's RatingsDirect: "Research Update: S&PCORRECT: DPL Inc., Dayton Power & Light Co. Lowered To 'BB' From 'BBB-'; Debt Ratings Also Cut; Otlk Stable," November 8, 2012 at 3, emphasis added.

⁴S&P RatingsDirect: "Industry Economic And Ratings Outlook: U.S. Regulated Utilities Expected To Continue On Stable Trajectory In 2013," January 25, 2013 at 5, emphasis added.

1 and financial profile scores, rather than DP&L's actual profile scores that are
2 negatively impacted by its affiliation with AES Corp.

3 **Q WOULD THE REVISED LEVEL OF SSR PRODUCE CREDIT METRICS THAT**
4 **WOULD SUPPORT DP&L'S CREDIT STANDING THROUGHOUT THE FORECAST**
5 **PERIOD?**

6 A Yes. My revised SSR revenue of \$90 million per year will produce returns on equity
7 in 2013 and 2014 within the range of 7% to 11%, and support investment grade credit
8 metrics throughout the forecast period.

9 **Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

10 A Yes, it does.

Qualifications of Michael P. Gorman

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140,
3 Chesterfield, MO 63017.

4 **Q PLEASE STATE YOUR OCCUPATION.**

5 A I am a consultant in the field of public utility regulation and a Managing Principal with
6 Brubaker & Associates, Inc., energy, economic and regulatory consultants.

7 **Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND WORK**
8 **EXPERIENCE.**

9 A In 1983 I received a Bachelors of Science Degree in Electrical Engineering from
10 Southern Illinois University, and in 1986, I received a Masters Degree in Business
11 Administration with a concentration in Finance from the University of Illinois at
12 Springfield. I have also completed several graduate level economics courses.

13 In August of 1983, I accepted an analyst position with the Illinois Commerce
14 Commission ("ICC"). In this position, I performed a variety of analyses for both formal
15 and informal investigations before the ICC, including: marginal cost of energy, central
16 dispatch, avoided cost of energy, annual system production costs, and working
17 capital. In October of 1986, I was promoted to the position of Senior Analyst. In this
18 position, I assumed the additional responsibilities of technical leader on projects, and
19 my areas of responsibility were expanded to include utility financial modeling and
20 financial analyses.

1 In 1987, I was promoted to Director of the Financial Analysis Department. In
2 this position, I was responsible for all financial analyses conducted by the Staff.
3 Among other things, I conducted analyses and sponsored testimony before the ICC
4 on rate of return, financial integrity, financial modeling and related issues. I also
5 supervised the development of all Staff analyses and testimony on these same
6 issues. In addition, I supervised the Staff's review and recommendations to the
7 Commission concerning utility plans to issue debt and equity securities.

8 In August of 1989, I accepted a position with Merrill-Lynch as a financial
9 consultant. After receiving all required securities licenses, I worked with individual
10 investors and small businesses in evaluating and selecting investments suitable to
11 their requirements.

12 In September of 1990, I accepted a position with Drazen-Brubaker &
13 Associates, Inc. ("DBA"). In April 1995, the firm of Brubaker & Associates, Inc. ("BAI")
14 was formed. It includes most of the former DBA principals and Staff. Since 1990, I
15 have performed various analyses and sponsored testimony on cost of capital,
16 cost/benefits of utility mergers and acquisitions, utility reorganizations, level of oper-
17 ating expenses and rate base, cost of service studies, and analyses relating to
18 industrial jobs and economic development. I also participated in a study used to
19 revise the financial policy for the municipal utility in Kansas City, Kansas.

20 At BAI, I also have extensive experience working with large energy users to
21 distribute and critically evaluate responses to requests for proposals ("RFPs") for
22 electric, steam, and gas energy supply from competitive energy suppliers. These
23 analyses include the evaluation of gas supply and delivery charges, cogeneration
24 and/or combined cycle unit feasibility studies, and the evaluation of third-party
25 asset/supply management agreements. I have participated in rate cases on rate

1 design and class cost of service for electric, natural gas, water and wastewater
2 utilities. I have also analyzed commodity pricing indices and forward pricing methods
3 for third party supply agreements, and have also conducted regional electric market
4 price forecasts.

5 In addition to our main office in St. Louis, the firm also has branch offices in
6 Phoenix, Arizona and Corpus Christi, Texas.

7 **Q HAVE YOU EVER TESTIFIED BEFORE A REGULATORY BODY?**

8 A Yes. I have sponsored testimony on cost of capital, revenue requirements, cost of
9 service and other issues before the Federal Energy Regulatory Commission and
10 numerous state regulatory commissions including: Arkansas, Arizona, California,
11 Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas,
12 Louisiana, Michigan, Missouri, Montana, New Jersey, New Mexico, New York, North
13 Carolina, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Utah, Vermont,
14 Virginia, Washington, West Virginia, Wisconsin, Wyoming, and before the provincial
15 regulatory boards in Alberta and Nova Scotia, Canada. I have also sponsored
16 testimony before the Board of Public Utilities in Kansas City, Kansas; presented rate
17 setting position reports to the regulatory board of the municipal utility in Austin, Texas,
18 and Salt River Project, Arizona, on behalf of industrial customers; and negotiated rate
19 disputes for industrial customers of the Municipal Electric Authority of Georgia in the
20 LaGrange, Georgia district.

1 **Q PLEASE DESCRIBE ANY PROFESSIONAL REGISTRATIONS OR**
2 **ORGANIZATIONS TO WHICH YOU BELONG.**

3 **A I earned the designation of Chartered Financial Analyst (“CFA”) from the CFA**
4 **Institute. The CFA charter was awarded after successfully completing three**
5 **examinations which covered the subject areas of financial accounting, economics,**
6 **fixed income and equity valuation and professional and ethical conduct. I am a**
7 **member of the CFA Institute’s Financial Analyst Society.**

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The Dayton Power and Light Company

Projected Statements of Income - Revised (\$ in millions) (2013 - 2017)

<u>Line</u>	<u>Description</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>Source</u>
1	<u>Operating Revenues</u>						
2	Retail						
3	Service Stability rider (SSR)*						
4	Wholesale						
5	RTO Capacity and Other RTO Revenues						
6	Other Revenues						
7	Total Revenues						Sum Lines 2 thru 6
8							
9	<u>Fuel and Purchased Power</u>						
10	Fuel Costs						
11	Purchased Power						
12	Total Fuel and Purchased Power						Line 10 + Line 11
13							
14	Gross Margin						Line 7 - Line 12
15							
16	<u>Operating Expenses</u>						
17	Operation and Maintenance (O&M)						
17a	O&M Adjustment						
18	Depreciation and Amortization						
19	General Taxes						
20	Total Operating Expenses						Sum Lines 17 thru 19
21							
22	Operating Income						Line 14 - Line 20
23							
24	Interest Expense						
24a	Incremental Interest Expense						
25	Other Income (Deductions)						
26							
27	Earnings Before Income Tax						Line 22 + Line 24 + Line 24a + Line 25
28							
29	Income Tax						Line 27 x 35.8%
30							
31	Net Income						Line 27 - Line 29
32							
33	Common Shareholder's Equity						Second Revised Exhibit CLJ-3
34							
35	Average Annual Return on Equity (ROE)						Line 31 / Line 33**
36	5-Year Weighted Average Return on Equity						Sum of Line 31 / Sum of Line 33
37							
38	<u>SSR Sensitivity</u>						
39	Earnings Before Income Tax, excluding SSR						Line 27 - Line 3
40							
41	Net Income, excluding Service Stability Rider						Line 39 x (1 - 35.8%)
42							
43	Common Shareholder's Equity, excluding SSR						Line 33 - (Line 31 - Line 41)
44							
45	Average Annual Return on Equity (ROE), excluding SSR						Line 41 / Line 43***
46	5-Year Weighted Average Return on Equity, excluding SSR						Sum of Line 41 / Sum of Line 43
47							
48							
49							
50							

Source:

Second Revised Exhibit CLJ-2 to CLJ-4.

Dayton Power and Light Company

Credit Metrics

<u>Line</u>	<u>Description</u>	<u>FFO³ / Debt</u> (1)	<u>Debt / EBITDA⁴</u> (2)	<u>Debt / Capital</u> (3)	<u>ROE</u> (4)
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DPL Forecast

1	2013	23%	3.0	49%	11.4%
2	2014	19%	3.6	49%	7.8%
3	2015	17%	4.0	49%	5.7%
4	2016	16%	4.5	49%	3.7%
5	2017	16%	4.5	49%	3.2%

S&P Benchmark^{*/1/2}

6	Significant	20% - 30%	3.0x - 4.0x	45% - 50%
7	Aggressive	12% - 20%	4.0x - 5.0x	50% - 60%

Sources:

Exhibit MPG-1

* Standard & Poor's, RatingsDirect, Criteria Methodology: Business Matrix Expanded; May 27, 2009.

Aggressive or Significant Excellent Business Risk Profile.

Notes:

¹ DPL has "Strong" Business and "Aggressive" Financial Risk Profiles.

² The utility industry has predominantly "Aggressive" or "Significant" Financial Risk Profiles and an "Excellent" Business Risk Profile.

³ FFO: Funds from Operations.

⁴ EBITDA: Earnings Before Interest, Taxes, Depreciation and Amortization

Dayton Power and Light Company

Credit Metrics

<u>Line</u>	<u>Year</u>	<u>EBITDA/Interest</u> (1)	<u>FFO/Debt</u> (2)	<u>Debt/EBITDA</u> (3)	<u>Debt/Capital</u> (4)
<u>DPL Forecast</u>					
1	2013	7.1x	23%	3.0x	49%
2	2014	5.9x	19%	3.6x	49%
3	2015	5.2x	17%	4.0x	49%
4	2016	4.7x	16%	4.5x	49%
5	2017	4.6x	16%	4.5x	49%
<u>S&P 2011 Industry Median</u>					
6	A+	7.8x	28%	2.8x	48%
7	A	5.8x	24%	3.9x	56%
8	A-	5.3x	23%	3.9x	52%
9	BBB+	5.0x	19%	4.0x	54%
10	BBB	4.6x	20%	3.9x	56%
11	BBB-	4.4x	16%	4.3x	56%

Source:

Standard&Poor's, RatingsDirect, CreditStats: Electric Utilities, August 30, 2012.

Note

DPL has an investment grade credit rating of "BBB-" from Standard & Poor's.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Public Redacted Direct Testimony of Michael P. Gorman and accompanying exhibits* by the Federal Executive Agencies has been served upon those persons listed below via electronic mail this 1st day of March, 2013.

/s/ *Chris Thompson*
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Summary: Testimony Public Redacted Direct Testimony of Michael P. Gorman on behalf of
Federal Executive Agencies electronically filed by MR CHRIS C THOMPSON on behalf of
FEDERAL EXECUTIVE AGENCIES ATTY