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**

INITIAL BRIEF OF THE FEDERAL EXECUTIVE AGENCIES
PUBLIC REDACTED VERSION

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I. INTRODUCTION

On December 12, 2012, Dayton Power & Light ("DP&L" or "Company") filed its revised Electric Security Plan ("ESP"). In this ESP, DP&L offered a plan for its proposed Standard Service Offer ("SSO") rates which consist of a blend of DP&L's current ESP rates and rates resulting from a Competitive Bidding Plan ("CBP") for generation supply service. The blending phase-in will be accomplished over the period January 2013 through June 2016. The Company's proposed blending plan is summarized as follows:

TABLE 1

DP&L's Proposed Blending Plan

Period	ESP%	CBP%
January '13 – May '14	90%	10%
June '14 – May '15	60%	40%
June '15 – May '16	30%	70%
Beginning June '16	0%	100%

Source: Revised ESP, page 2.

As part of its ESP, DP&L also recommended various new rate mechanisms during this blending process. Those rate mechanisms include:[1]

1. A base generation rate,
2. A Service Stability Rider ("SSR"),
3. A Transmission Cost Recovery Rider ("TCRR"),
4. A Reliability Pricing Model ("RPM") rider,
5. An Alternative Energy Rider ("AER"),
6. A competitive bidding rate,
7. A Competitive Bidding True-Up ("CBT"), and
8. A Reconciliation Rider.

As part of its blending plan, the Company also acknowledged certain state policies it believes should be observed in developing its ESP blending plan. Those state policies are summarized as:

[1]Revised ESP Rate Blending Plan, at 7-14.

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."

* * *

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."

* * *

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

> "Facilitate the state's effectiveness in the global economy. In carrying out this policy, the commission shall consider rules as they apply to the costs of electric distribution infrastructure, including, but not limited to, line extensions, for the purpose of development in this state."[2]

The Federal Executive Agencies ("FEA") do not take issue with DP&L's proposal to follow these state policies to design a balanced ESP blending plan. Unfortunately, many aspects of DP&L's proposed rate adjustment mechanisms and procedures are not consistent with these state policies. Hence, certain rate adjustments proposed by DP&L, should be rejected or modified.

II. SERVICE STABILITY RIDER

DP&L proposed a Service Stability Rider ("SSR") that was allegedly designed to maintain the financial integrity of DP&L during the blending period. DP&L witness Philip Herrington stated the Company is seeking an SSR similar to what was recently

[2]Second Revised Testimony of Philip R. Herrington at 5-7, emphasis added, as quoted in Direct Testimony of Michael P. Gorman at 3-4.

approved by American Electric Power Company ("AEP-Ohio") in its ESP case.[3] DP&L asserted that the Public Utilities Commission of Ohio ("Commission") set a standard revenue target which allowed AEP-Ohio an opportunity to earn between a 7% and 11% return on equity. Based on that interpretation of AEP-Ohio's ESP, DP&L proposed an SSR that would make a revenue requirement adjustment over its projected phase-in plan term of $137.5 million annually which DP&L asserts is necessary to keep its earned return on equity within this tolerance band and maintain adequate credit metrics and financial integrity.

DP&L's own recognition of the state policies include that an ESP should impose only reasonable prices on retail electric customers, the charges should avoid anti-competitive subsidies, and the charges should prohibit recovery of any generation-related costs through distribution and transmission rates. DP&L's proposed SSR fails all of these policies. DP&L's SSR is not based on a competent assessment of the Company's regulated cost of service, and therefore, it is not appropriate to impose the SSR charge as proposed on retail customers. Furthermore, Section 4928.02(H), Revised Code, states the general policy prohibiting anticompetitive subsidies. In AEP-Ohio's *Sporn* proceeding, the Commission held that under Section 4928.02(H), Revised Code, AEP-Ohio was not entitled to a rider it sought to recover the costs it alleged resulted from the closure of the Sporn 5 generating unit.[4] The Commission concluded that such a rider would effectively subsidize AEP-Ohio's generation, in violation of Section 4928.02(H), Revised Code.[5]

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[3] *Id.* at 3.
[4] *Sporn Decision*, Opinion and Order at 19 (Jan. 11, 2012).
[5] *Id.*

A. DP&L's SSR is Not a Reasonable ESP Price

The proposed SSR is not a reasonable retail cost of service rate. The SSR revenue level is supported by a projection of financial metrics for DP&L over the period 2013 through 2016. DP&L witness Mr. Jackson sponsored these financial projections. Mr. Jackson's financial projections do not meet this standard for the following reasons.

First, Mr. Jackson's projections do not reflect only DP&L's regulated cost of service. Rather, his projections reflect the operations of DP&L's entire company – both regulated and non-regulated operations.[6] Importantly, the earnings erosion in Mr. Jackson's financial projections is primarily driven by reduced margin in DP&L's non-regulated merchant generation operations. Hence, the SSR revenue is needed to support DP&L non-regulated operations. Regulated operations are not eroding earnings, and if they do, DP&L can file for a change in rates when a rate change is needed to correct an earnings deficiency.

Second, Mr. Jackson's financial projections reflect a capital structure with an excessive amount of common equity. This excess common equity ratio is not a reasonable regulated cost of service. The excess common equity ratio erodes DP&L's projected return on equity. Mr. Jackson's capital structure projections included common equity as high as 66% of total capital.[7] This capital structure is excessive for regulated purposes because it does not reflect the low operating risk of electric utility companies. Therefore, Mr. Jackson's cost projections do not reflect a reasonable cost of service for DP&L.

Mr. Jackson's projections also fail to recognize O&M expense reductions the Company is currently investigating. Hence, the Company does not know with certainty

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[6]Confidential Direct Testimony of Michael P. Gorman at 5.
[7]*Id.* at 7.

what its earnings will be over the forecast period and, therefore, its projection of an SSR revenue requirement is not known and measurable. As a result, the projected earnings erosion is not reliable, and the SSR cost is not reasonable. There appears to be reasonable probability that O&M expense reductions being studied by DP&L can be realized. The Company witnesses acknowledge that in an impairment test of DP&L's generating assets, the Company assumed that the O&M expense reductions not included in its SSR financial projections were reflected in the financial projections underlying the Company's decision not to record an impairment charge of its generating assets.[8] This impairment charge decision was disclosed to investors. Therefore, it is reasonable to believe that the Company had good cause to assume that those O&M expense reductions could be realized. Otherwise, the Company may not have been forthright with its disclosures with investors.

For these reasons, the Company's failure to recognize any O&M expense adjustment renders Mr. Jackson's financial forecast unreliable, and the cause of an earnings erosion during the blending period to not be known and measurable. As a result, the SSR charge does not result in reasonable ESP prices.

B. DP&L's SSR Will Recover Generation Cost in Distribution ESP Rates

Mr. Jackson's financial projections largely reflect earnings erosion caused by the Company's non-regulated business operations. As a result, the SSR will recover generation-related earnings erosions in distribution prices. This is inconsistent with allowable state policies.

Mr. Jackson's financial projections and the erosion of earnings are quite evident from an outline of Mr. Jackson's financial projections. This includes the following:

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[8] Tr. Vol. I at 231.

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

2. Mr. Jackson's projections erode earnings and credit metrics through the latter years reflecting significant capital improvements throughout the forecast period. [redacted] Virtually all of the capital increase is attributable to growth in common shareholders' equity with virtually no increase in total debt. While the Company is considerably growing its balance sheet, its revenues from retail operations decrease by approximately $24 million. Hence, the financial projections are driven by non-regulated investments. The increase in wholesale revenue and RTO capacity and other RTO revenues increase significantly in Mr. Jackson's projections. This increase in capital and shift in revenue generation from retail regulated operations to wholesale operations, is a strong indication that the Company's earnings are increasingly driven by non-regulated operations.

3. Mr. Jackson's projected operating expenses increased by approximately [redacted], or [redacted] through the forecast period. Again, this assumption largely contributes to the erosion of earnings by the end of the forecast period, but it is not clear which business function is driving the increased expenses.[9]

C. The Proposed SSR is Anti-Competitive

By charging an SSR that supports DP&L's merchant generation function, it provides DP&L a competitive advantage to sell its generation output to retail customers relative to alternative third-party suppliers. In effect, DP&L will recover part of its generation cost from retail customers irrespective of whether or not customers buy generation from DP&L or a third-party supplier. As such, the proposed SSR is anti-competitive because it supports the financial integrity of DP&L's merchant

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[9] Confidential Direct Testimony of Michael P. Gorman at 8.

generation fleet, makes it a stronger competitor against alternative generation suppliers, and provides financial support for DP&L whereas third-party suppliers do not receive such generous treatment. As such, DP&L's proposed SSR should be rejected as anti-competitive and inconsistent with state ESP policies.

D. If Approved, the SSR Should be Significantly Modified

While the FEA does not support implementing the SSR as proposed by DP&L, if the Commission chooses to implement the SSR, several adjustments must be made to Mr. Jackson's financial forecasts. Those adjustments were outlined by FEA as follows:

A capital structure of 50% debt and 50% equity is reasonable for the following reasons:

> 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.[10]

DP&L's projected O&M expense reductions currently under study should be reflected in DP&L's financial forecast. Since the probability of O&M expense reductions was likely enough to be used in an impairment study which was disclosed to the investment public, the likelihood of being able to achieve the reductions should also be considered in SSR financial projections of DP&L's financial integrity. To the extent DP&L's financial integrity suffers because these expense reductions cannot be realized

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[10]Confidential Direct Testimony of Michael P. Gorman at 9.

later, DP&L can share that information with the Commission at a later time and request an adjustment to the SSR rate.

Based on these parameters, Mr. Gorman estimated in his testimony an alternative SSR revenue of no more than $90 million. Based on a $90 million SSR, DP&L's earnings will stay within the range of 7% of 11% through 2016, but earnings will erode thereafter.[11] However, Mr. Gorman observed that the earnings erosion for later periods may be cured through regulatory filings, or higher than expected market prices for generation output. Therefore, these later years' earnings erosions can be cured, and are too uncertain at this time to be used to set a revenue requirement in this case. Mr. Gorman also observed that with this $90 million SSR, DP&L's credit metrics will maintain an investment grade bond rating throughout the forecast period. Hence, if the main objective of an SSR is to maintain DP&L's financial integrity, an SSR of $90 million fully meets that objective.

Mr. Gorman also demonstrated that his revised financial projections would maintain a return on equity target of 7% to 11% for the first two years of the forecast, but would maintain credit metrics adequate to support DP&L's investment grade bond rating throughout the forecast period. Mr. Gorman made this comparison by comparing the forecasted financial metrics to Standard & Poor's ("S&P") benchmarks for a utility company with an "Excellent" business profile score. These credit risk operating and financial profiles generally reflect the typical electric utility company where its risk assessments are not degraded by its affiliation with a high-risk parent company, as is the case for DP&L. Therefore, these credit metrics reasonably represent strong credit standing for regulated operations which are adequate for determining an SSR revenue entitlement if the Commission chooses to implement one in this case. However, DP&L's

[11] *Id.* at 8.

actual credit metrics business and financial risk profiles should not be used in this assessment because its risk assessments are highly impacted by its higher-risk parent company.

III. RECONCILIATION RIDER

DP&L is proposing a reconciliation rider that would be applicable to the following bypassable riders.[12]

- Fuel rider,
- RPM rider,
- TCRR-B rider,
- AER rider, and
- CPT rider.

The Company claims that this reconciliation rider is appropriate if its costs exceed 10% of the base recovery of the amounts recovered in these riders. DP&L witness Seger-Lawson states that the costs are designed to recover the following:

1. Competitive bidding process ("CBP") costs,
2. Costs the Company incurs to implement certain competitive retail enhancements,
3. Any deferred cost balance that exceeds 10% of base recovery rates associated with any of the affected riders.[13]

Company witness Seger-Lawson argues that the bypassable riders can expose the utility to costs associated with providing service to customers which no longer take SSO supply from the utility if they switch to Competitive Retail Electric Service ("CRES") supply. She argues that the customers that remain on SSO service with the Company should not be required to bear the brunt of costs associated with customers that

[12]Revised ESP Rate Blending Plan, at 7-14.
[13]Testimony of Emily W. Rabb at 8, as adopted by Ms. Donna Seger-Lawson.

switched to alternative suppliers. She therefore recommends reconciling these costs and spreading them over all customers – whether they were on SSO supply with DP&L in the reconciliation period or not. She concludes that this process will stabilize the rate for all customers and provide benefits to both SSO customers and customers that switched suppliers.[14]

A. The Reconciliation Rider Should be Rejected

DP&L's proposed Reconciliation Rider should be rejected or modified because it does not reconcile costs incurred by DP&L to be paid for by the customers for which the costs were actually incurred. Rather, DP&L proposes to reconcile costs for bundled customers from all customers irrespective of how they procured generation supply service, whether it be from DP&L or an alternative supplier. This is simply not a reasonable price-setting mechanism and fails to meet the state's policy of setting ESP prices which are just and reasonable.

The Commission should modify the Reconciliation Rider to only apply to customers that were taking SSO service during the period the unrecovered costs were incurred. Customers that were not taking SSO service during the cost period should not be obligated to pay a portion of the unrecovered costs.

Further, the Company's proposal to reconcile 10% cost tolerance is simply arbitrary.

As put forth in the testimony of FEA witness Brian Collins, FEA recommended the following with respect to the Reconciliation Rider:

1. The Company's proposed recovery of deferred costs exceeding 10% of base recovery for the bypassable FUEL Rider, RPM Rider, TCRR-B Rider, AER Rider, and CBT Rider via its proposed Reconciliation Rider be rejected.

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[14] *Id.* at 10.

2. All costs assigned to the above bypassable riders should remain with each respective rider and be recovered via each rider's respective charges from customers taking SSO service from DP&L and those customers who have not provided timely notification of switching to a CRES provider.

3. Customers who currently take electric supply service from a CRES provider and continue to do so during DP&L's ESP period would continue to avoid all charges under the above bypassable riders.

4. Customers that provide proper notification to the Company prior to each annual auction that they intend to leave SSO service would avoid all future charges under the bypassable riders.

5. Customers that leave SSO service without sufficient notification to the Company prior to each annual auction, customers that provided notification but failed to contract with a CRES provider prior to the flow of power on June 1 of each year, and customers that leave SSO service after the annual auction, would continue to pay the bypassable riders for one year or portion thereof until the next auction.

6. Customers that return to SSO service would pay the bypassable rider charges until the time they leave SSO service with proper notification prior to the annual auction.[15]

The only costs that should be recovered through the reconciliation riders are costs associated with the auction option. These costs fall within items 1 and 2 proposed by Ms. Seger-Lawson at page 8 of her testimony list and recovered in the Reconciliation Rider.

FEA also proposes that customers timely notify DP&L prior to each annual auction during the ESP period of their intention to switch from DP&L SSO supply service to supply service with a CRES provider. This will help DP&L manage its procurement costs as customers switch to a CRES provider. By giving the Company enough time to remove the load intending to switch to CRES supply from the amount of load to be bid and procured in the auction, the Company can avoid the cost of procuring power in the auction for those customers. Since the Company will conduct auctions in 2013, 2014,

[15]Direct Testimony of Brian C. Collins at 2-3.

2015, 2016, and 2017, each auction provides an opportunity to adjust its SSO load for customers that have notified DP&L of their intent to switch.

Customers that timely notify DP&L of their intent to switch would avoid the bypassable rider charges. However, if such a customer does not in fact contract with a CRES provider prior to power flowing on June 1, that customer would continue to pay the bypassable riders.[16]

By providing timely notification, a balance is achieved regarding the need for the Company to recover its costs incurred for procuring power on behalf of its SSO load, and the desire of customers to avoid the costs of power supply that they did not cause DP&L to incur, especially those customers who were on CRES supply at the time of the auction and who remain off SSO service during the ESP period.[17]

This proposal is consistent with other jurisdictions that manage costs of switching from regulated service to deregulated service. For example, Ameren Illinois requires that customers eligible for its Rider HSS (Hourly Supply Service) notify it by April 15 in order to avoid the costs of capacity contracts that are secured to serve Rider HSS load during the capacity obligation period of June through September. Lack of notice to Ameren Illinois by eligible customers taking service under Rider HSS on April 15 is considered under the tariff a confirmation that the customer intends to remain on Rider HSS service through the entire summer capacity obligation period that begins June 1. Customers that cease to take supply from Ameren Illinois without prior notice or that notified Ameren Illinois of their intent to switch to service from Ameren Illinois but

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[16] *Id.* at 9
[17] *Id.*

subsequently elected alternative service would be assessed capacity charges for the June through September capacity obligation period.[18]

As recommended by Mr. Collins, the exact date for the notification deadline will be determined in conjunction with the Company's input. However, the date should be sufficient to allow for DP&L to remove all noticed load that intends to switch to CRES supply from the auction and avoid flowing power for these customers on June 1 of each year.

Though customers that provide timely notification of a switch to CRES supply would avoid all future bypassable rider charges, these customers still should be responsible for any prior year under-collections of rider charges. Similarly, they should also receive credit for any prior year overcharges.[19]

With respect to DP&L's ability to track SSO costs that need to be reconciled after SSO customers switch to a CRES, DP&L knows which customers have switched to CRES supply. DP&L's existing billing system should be sufficient to allow it to track these costs and collect them from the customers who caused DP&L to incur them.

Lastly, the Commission should reject DP&L's proposal to bifurcate the TCRR into bypassable and non-bypassable components because it violates Rule 4901:1-36-04(B), O.A.C., which requires that transmission costs be fully avoidable by shopping customers. Although this rule may be waived for good cause, DP&L has failed to demonstrate that good cause exists for the waiver.[20] DP&L's Application and pre-filed direct testimony of DP&L witness Seger-Lawson indicated DP&L was seeking a waiver of Rule 4901:1-36-04(B), O.A.C., however, neither the Application, nor Ms. Seger-Lawson's direct testimony offered any analysis to demonstrate that good cause existed

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[18] *Id.* at 10.
[19] *Id.* at 11.
[20] Rule 4901:1-36-02(B), O.A.C.

for the waiver.[21] Thus, good cause for the waiver does not exist. Without good cause or the application to explain the reason for the waiver, the Commission should reject this proposal.

IV. CONCLUSION

For the reasons stated herein, FEA urges the Commission to reject DP&L's unreasonable and potentially unlawful ESP proposals.

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[21] *See* DP&L's Revised Application at 16 (Oct. 5, 2012) (DP&L did not move to admit the Application into the record); DP&L Ex. 9 at 5.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Public Redacted Version Initial Brief for the Federal Executive Agencies has been served upon those persons listed below via electronic mail this 20th day of May, 2013.

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