

**BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of Duke)	
Energy Ohio for Authority to Establish a)	Case No. 14-841-EL-SSO
Standard Service Offer Pursuant to)	
Section 4928.143, Revised Code, in the)	
Form of an Electric Security Plan,)	
Accounting Modifications and Tariffs for)	
Generation Service.)	

In the Matter of the Application of Duke)	
Energy Ohio for Authority to Amend its)	Case No. 14-842-EL-ATA
Certified Supplier Tariff, P.U.C.O. No. 20.)	

DIRECT TESTIMONY OF KEVIN C. HIGGINS

On Behalf of The Kroger Co.

September 26, 2014

1 **DIRECT TESTIMONY OF KEVIN C. HIGGINS**

2

3 **Introduction**

4 **Q. Please state your name and business address.**

5 A. Kevin C. Higgins, 215 South State Street, Suite 200, Salt Lake City, Utah,
6 84111.

7 **Q. By whom are you employed and in what capacity?**

8 A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies
9 is a private consulting firm specializing in economic and policy analysis
10 applicable to energy production, transportation, and consumption.

11 **Q. On whose behalf are you testifying in this proceeding?**

12 A. My testimony is being sponsored by The Kroger Co. ("Kroger"). Kroger
13 is one of the largest grocers in the United States. Kroger has over 100 accounts
14 served by Duke Energy Ohio ("Duke" or "the Company") that collectively
15 consume over 250 million kWh per year. Kroger takes most of its service under
16 the DS, DP, and TS rate schedules. Kroger is a shopping customer in Duke's
17 service territory.

18 **Q. Please describe your professional experience and qualifications.**

19 A. My academic background is in economics, and I have completed all
20 coursework and field examinations toward a Ph.D. in Economics at the University
21 of Utah. In addition, I have served on the adjunct faculties of both the University
22 of Utah and Westminster College, where I taught undergraduate and graduate
23 courses in economics from 1981 to 1995. I joined Energy Strategies in 1995,

1 where I assist private and public sector clients in the areas of energy-related
2 economic and policy analysis, including evaluation of electric and gas utility rate
3 matters.

4 Prior to joining Energy Strategies, I held policy positions in state and local
5 government. From 1983 to 1990, I was economist, then assistant director, for the
6 Utah Energy Office, where I helped develop and implement state energy policy.
7 From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County
8 Commission, where I was responsible for development and implementation of a
9 broad spectrum of public policy at the local government level.

10 **Q. Have you ever testified before this Commission?**

11 A. Yes. Earlier this year, I filed testimony in the AEP Ohio Electric Security
12 Plan ("ESP") 3 proceeding, Case No. 13-2385-EL-SSO, et al.; Dayton Power &
13 Light's ("DP&L") storm cost recovery rider proceeding, Case No. 12-3062-EL-
14 RDR, et al. and the Republic Steel reasonable arrangements proceeding, Case No.
15 13-1913-EL-AEC. In 2013, I testified in DP&L's Revised ESP proceeding, Case
16 No. 12-426-EL-SSO, et al. and in Duke's capacity charge proceeding, Case No.
17 12-2400-EL-UNC, et al. In 2012, I testified in the AEP Ohio ESP 2 proceeding,
18 Case No. 11-346-EL-SSO, et al. In 2011, I testified in the Duke Market Rate
19 Offer ("MRO") proceeding, Case No. 10-2586-EL-SSO, and Duke's ESP
20 proceeding, Case No. 11-3549-EL-SSO, and in 2010, I filed testimony in Duke's
21 storm damage cost recovery proceeding, Case No. 09-1946-EL-RDR.

22 In 2009, I testified in FirstEnergy's MRO proceeding, Case No. 09-906-
23 EL-SSO, and in Duke's distribution rate case, Case No. 08-709-EL-AIR, et al.

1 In 2008, I testified in AEP Ohio's ESP 1 proceeding, Case No. 08-917-
2 EL-SSO, et al.; FirstEnergy's MRO proceeding, Case No. 08-936-EL-SSO;
3 FirstEnergy's ESP proceeding, Case No. 08-935-EL-SSO; and the FirstEnergy
4 distribution rate case proceeding, Case No. 07-551-EL-AIR, et al.

5 In 2005, I testified in AEP Ohio's IGCC cost recovery proceeding, Case
6 No. 05-376-EL-UNC, and in 2004, I testified in the FirstEnergy Rate Stabilization
7 Plan proceeding, Case No. 03-2144-EL-ATA.

8 **Q. Have you testified before utility regulatory commissions in other states?**

9 A. Yes. I have testified in approximately 185 proceedings on the subjects of
10 utility rates and regulatory policy before state utility regulators in Alaska,
11 Arizona, Arkansas, Colorado, Georgia, Idaho, Illinois, Indiana, Kansas,
12 Kentucky, Michigan, Minnesota, Missouri, Montana, Nevada, New Mexico, New
13 York, North Carolina, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas,
14 Utah, Virginia, Washington, West Virginia, and Wyoming. I have also prepared
15 affidavits that have been filed with the Federal Energy Regulatory Commission.

16
17 **Overview and Conclusions**

18 **Q. What is the purpose of your testimony in this proceeding?**

19 A. My testimony addresses the following aspects of Duke's ESP proposal
20 filed May 29, 2014:

21 (1) Duke's proposal for a new, non-bypassable Price Stabilization Rider
22 ("PSR"); and

1 (2) Duke's proposal to increase distribution cost recovery through a new
2 Distribution Capital Investment rider ("Rider DCI").

3 Relative to the wide scope of the issues addressed in Duke's filing, my
4 recommendations are concentrated on a limited number of issues. Absence of
5 comment on my part regarding a particular aspect of Duke's filing does not
6 signify support (or opposition) toward the Company's filing with respect to the
7 non-discussed issue.

8 **Q. What are your primary conclusions and recommendations?**

9 A. (1) The Commission should reject Duke's PSR proposal. The PSR would
10 make all customers, including shopping customers, responsible for the
11 Company's legacy generation costs long after the period for transition cost
12 recovery had ended. Notwithstanding my primary recommendation, if some form
13 of a non-bypassable PSR is approved, I recommend an allocation and rate design
14 approach which reflects the fixed cost component of the PSR.

15 (2) The Commission should reject the mechanics of Duke's proposed
16 approach to class allocation and rate design for its proposed Rider DCI. If Rider
17 DCI is approved by the Commission, I recommend that it be redesigned as an
18 equal percentage rider applicable to base distribution rates for all rate schedules
19 served at distribution voltage, consistent with the design of AEP Ohio's
20 Distribution Investment Rider. Moreover, the revenue recovery for Rider DCI
21 should not be based on *projected* additions to rate base, but on *actual* plant
22 additions. This approach is also consistent with AEP Ohio's Distribution
23 Investment Rider.

1

2 **Price Stabilization Rider**

3 **Q. What is Duke proposing with respect to a Price Stabilization Rider (“PSR”)?**

4 A. As discussed in the Direct Testimony of William Don Wathen Jr., Duke is
5 proposing a non-bypassable PSR that would recover the fixed and variable cost of
6 the Company’s entitlement to Ohio Valley Electric Corporation (“OVEC”) power
7 after crediting the revenues from the sale of its OVEC entitlement into the PJM
8 market. The Company proposes to calculate the PSR quarterly based on the
9 difference between the expected revenue and expected cost, and charge or credit
10 all customers using a per-kWh rate, adjusted for delivery voltage.

11 According to Mr. Wathen’s testimony, Duke has a nine percent share of
12 OVEC’s two coal-fired generating plants, with a combined nameplate capacity of
13 nearly 2,400 megawatts.¹ Mr. Wathen’s testimony asserts that Duke is not
14 required to transfer its equity interest to an affiliate because OVEC’s generation
15 assets are not directly owned by the Company. Duke is proposing the PSR in
16 response to its expected continuation of the OVEC entitlement.

17 **Q. What is your assessment of the PSR proposal?**

18 A. The PSR appears to be a form of recovering transition revenues, making
19 shopping and non-shopping customers responsible for Duke’s legacy generation
20 costs long after the period for transition cost recovery has ended. In fact, Duke is
21 proposing that the PSR continue for as long as it receives energy and capacity
22 from OVEC.² Duke’s contractual commitment to OVEC extends through June,

¹ OVEC’s two plants are Clifty Creek in Jefferson, IN, and Kyger Creek in Gallia, OH.

² Direct Testimony of James P. Henning, p. 11, Ins. 1-5.

1 2040³, nearly thirty years after the December 31, 2010 deadline for transition cost
2 recovery.

3 I am not aware of any provisions in Am. Sub. S.B. 3, which began the
4 restructuring of the Ohio retail electric market over thirteen years ago, that
5 provide for a new round of transition cost recovery for legacy generation costs.
6 Indeed, Ohio Revised Code § 4928.40, which was enacted as part of that
7 legislation, appears to expressly limit recovery of transition revenues to no later
8 than December 31, 2010.

9 The proposed PSR forces all customers, including shopping customers, to
10 insure against the Company's potential exposure to cost increases or declining
11 market prices related to the Company's continued ownership of its legacy OVEC
12 entitlement. Although Duke's PSR proposal places emphasis on the potential
13 customer benefits of the OVEC sharing arrangement, these benefits are not
14 expected to materialize in the near-term.

15 **Q. Is the PSR expected to result in a net cost benefit to customers over the**
16 **duration of the proposed ESP term?**

17 A. No. Duke projects that annual OVEC costs will exceed revenue over the
18 2015 through 2018 period, resulting in a net charge to customers under the
19 Company's PSR proposal.⁴ Beginning in 2019, Duke projects that revenue from
20 the sale of its OVEC entitlement will exceed costs, resulting in a credit to
21 customers. Thus, the claimed customer benefits of the PSR are not expected to be

³Direct Testimony of William Don Wathen, Jr., p. 11, lns. 4-5.

⁴ See Duke's discovery responses, Attachment OEG-DR-01-001 Highly Confidential and OCC-INT-16-413, Attachment B Highly Confidential. Based on OCC-INT-16-413, Attachment B Highly Confidential, the difference between OVEC revenue and costs fluctuates on a monthly basis. However, on an annual basis, cash flows are negative (net PSR charge to customers) on an annual basis for 2015-2018.

1 realized until after the proposed ESP term. However, the projected benefits are
2 dependent on market price assumptions several years into the future, which may
3 or may not prove to be accurate.

4 **Q. Other than market prices, what other factors could affect the impact of the**
5 **PSR on customers?**

6 A. In the section of Duke Energy Corporation's 2013 Form 10-K which
7 discusses OVEC, it states, "As discussed in Note 5, proposed environmental
8 rulemaking could increase the costs of OVEC, which would be passed through to
9 Duke Energy Ohio."⁵ The Environmental section of the referenced Note 5 to the
10 Consolidated Financial Statements outlines pending and finalized EPA
11 regulations, including Clean Water Act 316(b), Coal Combustion Residuals, and
12 Mercury and Air Toxics Standards.

13 Despite Duke's assertion that the PSR will have, "the effect of adding
14 stability and certainty with regard to the overall price of retail electric service,"⁶
15 and its claims that Duke's OVEC costs are "relatively stable,"⁷ Duke's proposal
16 appears in fact to expose customers to these potentially substantial risks in its
17 Form 10-K.

18 **Q. What is your recommendation to the Commission on this matter?**

19 A. For the reasons cited above, I recommend that Duke's PSR proposal be
20 rejected by the Commission. Notwithstanding this recommendation, if the
21 Commission approves some form of the PSR, the rider should be modified to

⁵ Duke Energy Corporation, 2013 Form 10-K, p. 175.

⁶ Direct Testimony of William Don Wathen Jr., p. 14, lns. 7-8.

⁷ Ibid, lns. 9-13.

1 make it a bypassable rider, not payable by those customers who choose to obtain
2 generation service from a CRES provider.

3 **Q. In the event some form of a non-bypassable PSR is approved by the**
4 **Commission, do you have a recommendation regarding the allocation and**
5 **design of the rider?**

6 A. Yes. If some form of a non-bypassable PSR is approved, I recommend
7 that its allocation and design should reflect the fixed cost component of the PSR.
8 As the PSR represents the difference between the *demand* and energy OVEC
9 costs allocated to Duke, and the revenue from wholesale *capacity* and energy
10 sales of Duke's OVEC entitlement, the PSR is not strictly energy-related. Thus,
11 Duke's recommendation to allocate and design the entirety of the PSR on the
12 basis of energy does not reflect cost causation.

13 One option would be to calculate the difference between the demand-
14 related OVEC costs allocated to Duke and the revenue from the sale of Duke's
15 OVEC capacity entitlement. This charge or credit would be allocated to customer
16 classes on the basis of demand, and designed as per-kW rate for demand-billed
17 customers. Concomitantly, the difference between energy-related OVEC costs
18 allocated to Duke and the revenue from the sale of Duke's energy entitlement
19 would be allocated to customer classes on the basis of energy, and designed as a
20 per-kWh rate.

21 In the alternative, the net difference between the total OVEC costs
22 allocated to Duke, and the total revenues generated from the sale of Duke's
23 entitlement could be apportioned into demand-related and energy-related

1 components, based on the demand and energy proportions of OVEC costs
2 allocated to Duke. The demand and energy-classified portions of the PSR would
3 be allocated and designed based on their respective classifications.
4

5 **Distribution Capital Investment Rider ("Rider DCI")**

6 **Q. What has Duke proposed with respect to Rider DCI?**

7 A. As explained in the Direct Testimony of Peggy A. Laub, Duke is
8 proposing a new rider, Rider DCI, to recover a return on incremental capital
9 investment and the associated depreciation and property tax expense for
10 distribution related reliability investment. All capital investments recorded in
11 FERC distribution plant accounts 360 through 374 will be included in this rider,
12 as well as distribution-allocated portions of general and intangible plant
13 accounts.⁸

14 The Rider DCI revenue requirement would be determined quarterly, by
15 calculating the revenue requirement associated with projected rate base at the end
16 of the next quarter, and subtracting the revenue requirement for rate base
17 recovered in base rates.

18 **Q. How would the proposed Rider DCI be allocated to customer classes?**

19 A. According to Ms. Laub's Direct Testimony, "the incremental revenue
20 requirement will be allocated based on the same allocation as used in Schedule E
21 in the Company's then most recently approved distribution base rate case."⁹

⁸ General Plant FERC Accounts 389 through 398 and Intangible Plant Account 303 are proposed to be included in Rider DCI.

⁹ Direct Testimony of Peggy A. Laub, p. 6, Ins. 5-7.

1 Ms. Laub's narrative description seems to suggest that each class will be
2 allocated a share of incremental Rider DCI costs proportionate to their share of
3 revenues as determined in the last distribution rate case. On the surface, this
4 concept appears reasonable. However, the illustrative example in Ms. Laub's
5 Attachment PAL-1, page 1, demonstrates that this is not the case. While Rates
6 DP and DP-RTP were allocated 6.1% of base distribution revenues, this class is
7 allocated 11.3% of incremental Rider DCI costs in Attachment PAL-1.¹⁰
8 Conversely, Rates DS and DS-RTP were allocated 29.4% of base distribution
9 revenues, but were allocated only 22.8% of Rider DCI costs. The resultant Rider
10 DCI charges in Duke's example are \$0.42 per-kW for Rate DP and \$0.21 per-kW
11 for Rate DS.

12 **Q. Why has this cost allocation distortion occurred?**

13 A. Attachment PAL-1, page 1, employs an elaborate series of calculations
14 using billing determinants for the base period and for the current twelve-month
15 period (YE 12/31/13 in this example), which appears to result in a shifting level
16 of revenue shortfall for Rates DP and DS. This series of calculations essentially
17 *redistributes* cost responsibility among the classes, rather than reflecting the
18 spread of base distribution revenue determined in the last distribution rate case.
19 In particular, if the billing determinants of a rate schedule decrease, then the
20 customers in that class are assigned a greater responsibility to "make up" the
21 revenue deficiency. So, for example, if a rate schedule loses load due to
22 migration of customers to other rate schedules or business relocation, the

¹⁰ See Column (b) of Attachment PAL-1, page 1 for the percent of base distribution revenue allocated to each class in Case No. 12-1682-EL-AIR. See Column (i) for the incremental Rider DCI revenue requirement allocated to each class.

1 remaining customers in the rate schedule are arbitrarily punished through an
2 upward rate adjustment. In effect, Duke's notion of allocating each class's share
3 of Rider DCI costs based on the same allocation as used in Schedule E in the
4 Company's most recently approved distribution base rate case is literally to lock
5 in each class's share of costs irrespective of what happens to the relative sizes of
6 each class's load. This approach makes no sense whatsoever. If a rate case were
7 conducted, then each class's share of costs would be *reallocated* based on the size
8 of its loads. If Duke wishes to avoid distribution rate cases and enjoy the benefits
9 from Rider DCI, then the Company needs to allocate cost responsibility for the
10 rider in a more reasonable and thoughtful manner. Duke has taken what should
11 be a straightforward allocation exercise and produced a convoluted mechanism
12 that yields arbitrary results.

13 **Q. What is your recommendation to the Commission regarding the allocation**
14 **and design of Rider DCI?**

15 A. If Rider DCI is approved by the Commission, I recommend that it be
16 designed as an equal percentage rider applicable to base distribution rates,
17 consistent with the design of AEP Ohio's Distribution Investment Rider.
18 This approach effectively and efficiently allocates the incremental Rider DCI
19 costs in proportion to each customer's base distribution rates and accurately
20 reflects the spread of base distribution revenues as determined in the last rate case,
21 which is Duke's stated intent. In contrast, the mechanics of the Company's
22 illustration of Rider DCI allocation are unnecessarily complex and produce
23 unreasonable and unjust results.

1 **Q. Do you have any other comments on the mechanics of Rider DCI?**

2 A. Yes. The revenue recovery for Rider DCI should not be based on
3 *projected* additions to rate base as proposed by Duke, but on *actual* plant
4 additions. An approach based on actual plant additions is consistent with AEP
5 Ohio's Distribution Investment Rider, which is based on data from Ohio Power
6 Company's FERC Form 3-Q, and is subject to annual audits. Such a mechanism
7 provides for very timely recovery of a utility's capital investments and avoids
8 regulatory lag. Duke's proposal to subject customers to a rider based on
9 *prospective* distribution investments is not necessary to avoid regulatory lag and
10 is unreasonably aggressive.

11 **Q. Does this conclude your direct testimony?**

12 A. Yes, it does.

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