OCC EXHIBIT NO. ______

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of The Dayton Power and Light Company for Approval of Its Electric Security Plan.	)	Case No. 16-395-EL-SSO
In the Matter of the Application of The Dayton Power and Light Company for Approval of Revised Tariffs.	)	Case No. 16-396-EL-ATA
In the Matter of the Application of The Dayton Power and Light Company for Approval of Certain Accounting Authority Pursuant to Ohio Rev. Code § 4905.13.	)	Case No. 16-397-EL-AAM

SUPPLEMENTAL DIRECT TESTIMONY
OF
MATTHEW I. KAHAL

On Behalf of
The Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485

March 29, 2017

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I. INTRODUCTION

Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A1. My name is Matthew I. Kahal. I am employed as an independent consultant retained by the Office of the Ohio Consumers' Counsel ("OCC") to address certain issues in this docket. My business address is 1108 Pheasant Crossing, Charlottesville, VA 22901.

Q2. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS CASE?

A2. Yes. On November 21, 2016, the OCC submitted direct testimony that I prepared addressing various matters, including the statutory test for the Electric Security Plan ("ESP") versus the alternative of a Market Rate Offer ("MRO"). That testimony includes a statement of my qualifications and listing of my past testimony.

Q3. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL DIRECT TESTIMONY?

A3. On March 13, 2017, the Dayton Power and Light Company ("DP&L" or "the Utility") filed a proposed Amended Stipulation and Recommendation ("Settlement"), supported (or not opposed) by certain parties to resolve all issues in this case. On March 22, 2017, DP&L submitted the Testimony of Sharon R. Schroder and R. Jeffrey Malinak in support of the proposed Settlement. In addition, some of the non-utility signatory parties submitted testimony supporting the proposed Settlement. This includes: The Direct Testimony of Matthew White for Interstate Gas Supply, Inc. ("IGS") and the Retail Energy Supply Association ("RESA"), the Direct Testimony of Cherish Chronmiller for Edgemont Neighborhood Coalition ("Coalition") and the Ohio Partners for Affordable Energy ("OPAE"), and the testimony of PUCO Staff Witnesses Jacob Nicodemus and Patrick Donlan. It is referred to as "Amended" because it changes and replaces a settlement document filed in this docket on January 30, 2017. My testimony at this time refers only to this amended Settlement filed on March 13, 2017.

I have been asked by the OCC to evaluate the merits of the proposed Settlement and whether it should be approved as filed. Because this proposed Settlement incorporates some of the key features of the October 2016 Amended Application, my November 21, 2016 Direct Testimony remains relevant, and I incorporate it by reference.

Q4. BEFORE TURNING TO THE PROPOSED SETTLEMENT, PLEASE SUMMARIZE YOUR FINDINGS AND RECOMMENDATIONS IN YOUR DIRECT TESTIMONY.

A4. My earlier Direct Testimony evaluates DP&L's assertions that the filed ESP proposal, in the aggregate, is superior to an MRO considering both quantitative and qualitative grounds. This includes the Utility's assertion that its proposed $1.015 billion Distribution Modernization Rider ("DMR") to be collected by

DP&L from customers is essential to protect the Utility's financial integrity and therefore is reasonable. My testimony also specifically discusses certain other key aspects of the filed ESP including the Distribution Investment Rider ("DIR"), which is discussed in more detail by other OCC witnesses, the Clean Energy Rider ("CER"), the Reconciliation Rider, and the proposed seven-year length of the ESP and riders.

As explained in my previous testimony, I found that the proposed ESP does not pass the statutory ESP versus MRO test, primarily due to the very costly and unnecessary $1.015 billion DMR. While I concur that DP&L's credit quality is both impaired and endangered by the excessive debt leverage of DP&L's direct corporate parent, DPL, Inc., the proposed DMR is excessively burdensome to utility customers, constitutes affiliate abuse and appears to be (at least in part) an improper "transition charge." Moreover, the DPL, Inc. "excessive leverage" problem is best addressed by the ultimate parent AES Corporation ("AES"). This problem fundamentally is AES's corporate responsibility to solve as the owner of DPL, Inc. Further, it is also particularity appropriate to assign this responsibility to AES because AES largely caused this excessive debt problem by its massive debt financing of its 2011 acquisition of DPL, Inc. and DP&L. For these reasons, I recommend in that testimony the rejection of the filed ESP and particularly the very expensive DMR.

My previous testimony further recommended rejection of the DIR, the Reconciliation Rider, and the CER. In the event the Public Utilities Commission of Ohio (the "PUCO") decides to approve the ESP, I recommend the ESP be limited to three years and that the DMR be subject to the normal Significantly Excessive Earnings Test ("SEET").

Q5. IS YOUR NOVEMBER 2016 DIRECT TESTIMONY RELEVANT TO THE PROPOSED SETTLEMENT?

A5. Yes, very much so. Nearly all of my Direct Testimony is applicable to the proposed Settlement now before the PUCO. The one exception is that the proposed Settlement withdraws the CER (a rider that was intended to collect from customers the costs associated with future coal plant environmental compliance requirements). It also appears to modify the Reconciliation Rider by moving the request for a deferral for 2015 and 2016 for the Ohio Valley Electric Corporation ("OVEC") over market costs from the ESP to another docket. The proposed Settlement includes several provisions (with modifications) that are set forth in the October 2016-filed ESP and addressed in my earlier Direct Testimony: The DMR, the SEET exemption, the DIR, and the Reconciliation Rider.

It is for this reason that I incorporate by reference my Direct Testimony. This enables me to largely avoid submitting, to the extent practicable, repetitive testimony.[1]

Q6. PLEASE PROVIDE A SUMMARY OF THE SALIENT CHANGES IN THE PROPOSED SETTLEMENT AS COMPARED TO THE FILED ESP.

A6. As noted above, the centerpiece of the October-2016 filed ESP is DP&L's proposal to charge consumers $145 million per year for seven years, or $1.015 billion over the course of the ESP, to generate additional pre-tax earnings. The proposed Settlement retains this onerous ESP feature but at the level of $105 million per year for three years -- $315 million. In addition, the Utility would have the option of seeking PUCO authorization for a two-year extension on the DMR or a total of $525 million.[2] However, because the proposed Settlement does not specifically approve this potential two-year extension, i.e., it is only a right to request PUCO authorization at a future time, my testimony refers to this as being a three-year charge totaling $325 million. Under the proposed Settlement there are several "strings attached" to the annual $105 million revenue collection from customers: (a) DP&L has an obligation to pursue investments for grid enhancement/modernization (subject to PUCO approval); (b) the funds are not to be used for DPL, Inc. dividend payments to AES during this time period; and (c)

[1] Portions of my Direct Testimony that are particularly pertinent to the PUCO's evaluation of this proposed Settlement would include all of Section III (pages 19 – 40), Section IV D (pages 49 – 52), Section IV F and IV G (pages 56 – 60) and my two schedules on ring fencing and AES's financial presentation.

[2] See Settlement, paragraph 2 (a).

DPL, Inc. during this period is excused from making tax-sharing payments to AES (and no tax liability booked). In addition, DP&L agrees to divest its coal plants and initiate a sale process for certain coal assets with sale proceeds to be used for debt reduction.

With the exception of the CER, the proposed Settlement retains the riders proposed in the October 2016-filed ESP. The proposed Settlement is rather lengthy and contains numerous specialized provisions, subsidies, discounts, and even direct payments specifically targeted to the signatory (or non-opposing) parties. Some of these provisions are potentially quite large and far-reaching. This includes a commitment to make a Smart Grid Plan filing and various measures to provide asserted retail market enhancements.

Q7. WITNESS SCHRODER STATES THAT THE PROPOSED SETTLEMENT IS BENEFICIAL.[3] DO YOU AGREE?

A7. No, I do not. Her testimony at page 9 asserts six customer benefits associated with the proposed Settlement, while ignoring the cost burden that the proposed Settlement imposes on utility customers. As my testimony explains, the costs include a massive rate burden and providing DP&L (and by extension AES shareholders) with an egregiously high-level of profitability that would not be mitigated by the SEET. The stated purpose of the proposed Settlement is to

[3] Schroder Testimony, at 9.

protect DP&L's financial integrity (by subsidizing the unregulated operations of DPL, Inc.), thereby allowing DP&L to maintain safe and reliable service and to facilitate investing in grid modernization. But this same goal can be accomplished equally well simply by AES meeting its corporate responsibility to financially support DPL, Inc., along with implementing the DP&L "ring fencing" measures described in my Direct Testimony. The DMR, which would unreasonably burden utility customers, is not needed.

Section II of my Supplemental Direct Testimony explains why the other public interest benefits claimed by Witness Schroder are either incorrect or overstated. Please note that the alleged benefits associated with retail market enhancements are addressed by OCC Witness Haugh.

Q8. HAS THE COMMISSION ESTABLISHED STANDARDS OF REVIEW FOR EVALUATING PROPOSED SETTLEMENTS?

A8. Yes, it has. The PUCO approved a settlement in the FirstEnergy ESP III case in which it articulated the criteria for evaluating the reasonableness of a proposed settlement. The PUCO stated:

> In considering the reasonableness of a Stipulation, the Commission has used the following criteria:
>
> 1. Is the settlement a product of serious bargaining among capable, knowledgeable parties?

2. Does the settlement package violate any important regulatory principle or practice?
3. Does the settlement, as a package, benefit ratepayers and the public interest?[4]

My Supplemental Direct Testimony applies all three of the PUCO criteria to the proposed Settlement, and in doing so, I respond to Witness Schroder's supporting testimony. I explain that the proposed Settlement fails to pass the PUCO's three-pronged test.

And, of course, DP&L's proposal for fulfilling its obligation to provide Standard Service Offer ("SSO") service, as reflected in the proposed Settlement, must pass the ESP versus MRO test.

Q9. DOES THE PROPOSED SETTLEMENT PASS THE STATUTORY ESP VERSUS MRO TEST?

A9. No, it does not. The DMR will improperly and unnecessarily charge utility customers $315 million, and there likely are tens of millions of dollars of additional (but difficult to quantify) collections from customers (e.g., the Reconciliation Rider and economic development subsidies) that are not justified.

[4] Case No. 12-1230-EL-SSO, *In the Matter of Ohio Edison Company, The Cleveland Electric Illuminating Company and the Toledo Edison Company for Authority to Provide a Standard Service Offer Pursuant to Section 4928.143*, Revised Code in the Form of an Electric Security Plan, June 18, 2012, Opinion and Order, at p. 24.

These charges to customers, particularly for DMR, represent little more than a transfer of wealth from DP&L utility customers to AES shareholders unrelated to the cost (i.e., revenue requirements) of providing utility local distribution service. These massive unnecessary charges to customers could be avoided under an MRO. Consequently, the proposed Settlement clearly fails to pass the ESP versus MRO test on a quantitative basis. It also fails to provide "qualitative benefits" that plausibly would offset this massive quantitative penalty.

Q10. BASED ON YOUR REVIEW OF THE PROPOSED SETTLEMENT, WHAT IS YOUR RECOMMENDATION?

A10. I find that the proposed Settlement, on balance, would harm the general body of DP&L utility customers and is not in the public interest. While some intervening signatory parties would enjoy material subsidies (paid for by the general body of customers) or other provisions in the proposed Settlement (i.e., retail market enhancements), these limited provisions cannot justify the transfer of wealth from customers to AES, which would be collected through DMR charges. These customer-funded subsidies are improper, and I recommend that the PUCO reject the proposed Settlement. Moreover, if the proposed Settlement is approved, the DMR should be subject to the annual SEET and be subject to refund in the event it is later rejected on rehearing or by a court decision.

Q11. HOW IS THE REMAINDER OF YOUR TESTIMONY ORGANIZED?

A11. In Section II, I apply each of the PUCO's three settlement approval criterion to the proposed Settlement and explain why it falls short. My main focus is on the new DMR proposal, which is clearly the centerpiece of the proposed Settlement. Section III responds to Witness Malinak's contention that the proposed Settlement passes the ESP versus MRO statutory test. This discussion is brief, as I have already covered this same subject in my Direct Testimony filed in November 2016. Section IV summarizes my main findings and recommendations.

Q12. BEFORE TURNING TO THE PUCO'S EVALUATION CRITERIA, HAVE YOU EVALUATED THE CUSTOMER RATE AND DP&L PROFIT IMPACTS OF THE PROPOSED SETTLEMENT?

A12. Yes. I have largely limited my quantitative analysis to the proposed DMR even though there are other provisions (e.g., the Reconciliation Rider) that could adversely impact customers and enhance DP&L profits.[5] I note that Witness Schroder seems to claim only modest ratepayer impacts, and Witness Malinak argues that the proposed Settlement would not unduly increase DP&L profits above reasonable profit levels. My testimony shows why these claims are not plausible.

[5] I have chosen to focus my quantitative analysis on the DMR because it represents the lion's share of the adverse customer rate impact and enhancement to the DP&L/AES profits. There are other riders provided in the proposed Settlement that would further adversely impact customers but they are either much smaller or cannot be reliably quantified at this time.

I calculate that DMR alone would cost a residential customer using 1,000 kWh per month about $9 per month (or about $108 per year). The Reconciliation Rider, economic development subsidies, and other provisions would add further to this adverse cost impact. According to Witness Schroder's rate impact information, the proposed Reconciliation Rider, the Regulatory Compliance Rider, and the Economic Development Rider would add about another $3 per month to this 1,000 kWh per month residential customer bill, or a total of $12 per month (about $144 per year).[6]

At the same time, DMR would produce significantly excessive profits for DP&L (and by extension for AES shareholders) and includes no SEET mitigation and protections for customers. Correcting Witness Malinak's financial projections, I find that DMR would produce a "total DP&L company" return on equity ("ROE") of about 20 percent over the three-year life of the DMR — compared to the proposed "fair" ROE of 10.5 percent, which is advocated by DP&L's own base rate case witness, Dr. Morin.[7] I also calculate the implied ROE on DP&L's distribution utility service using the Utility's proposed rate base from the pending base rate case. That implied ROE is about 30 percent, with that outlandishly high profit declining only gradually over time.

[6] See Schroder testimony, Exhibit A, page 1.

[7] See Malinak testimony at page 26 for a reference to the Morin rate case ROE recommendation.

II. II. ....APPLYING THE PROPOSED SETTLEMENT EVALUATION CRITERIA

A. PUCO CRITERION (1)

Q13. PLEASE STATE YOUR UNDERSTANDING OF CRITERION (1).

A13. This first criterion requires the settlement to be the product of serious bargaining among capable, knowledgeable parties. The PUCO has in the past looked at the diversity of interests as evidence of serious bargaining. Witness Schroder asserts at pages 4-8 of her testimony that this indeed is the case with this proposed Settlement. Her testimony also states that the proposed Settlement is the result of an extensive "arm's length" negotiation process among the parties, all of whom are represented by experienced counsel. Among the more than two dozen parties to this case, ten (non-utility) parties are supporting signatories while four others express non-opposition rather than support. Her testimony also claims that the supporting parties reflect a diverse set of interests representing a municipality, a hospital association, an industrial customer group, a large commercial customer, retail electric suppliers, and the PUCO Staff ("Staff"). An industrial customer and an industrial customer group are among the four non-opposition parties.

Based on this negotiation process and the diverse nature of signatory parties, Witness Schroder concludes that the PUCO's first criterion for approval is met.

Q14. WHAT IS YOUR ASSESSMENT OF THE ADEQUACY OF THE NEGOTIATION PROCESS AND CAPABILITIES OF THE SIGNATORY PARTIES?

A14. As I did not participate in the negotiation process, I cannot comment on how that process was conducted or the capabilities of the signatory parties. I take no position on Witness Schroder's factual assertions regarding those aspects.

My concern, however, for this proposed Settlement is the narrow and limited support among the many parties identified in this case. Only about half the non-utility parties are supporting, and notably the OCC, which represents the interests of DP&L residential customers (nearly half the load and most of the customers) opposes. Moreover, it appears that many of the supporting (or even non-opposing parties) appear to be motivated by what appears to be a focus on specific (and in some cases very narrow) provisions rather than the proposed Settlement as a whole. As I mentioned earlier, the centerpiece of this proposed Settlement is the approximately $315 million transfer of wealth from DP&L customers to the Utility (and ultimately AES shareholders), through the DMR. Other than a relatively brief discussion by Staff Witness Donlon, I am unable to find any explicit support among the non-Utility signatory parties for the DMR, the potential alternatives to the DMR or why it should be set to collect $315 million.

It is also my understanding that the PUCO has expressed concern about the approval of settlements in which there is perceived to be unequal bargaining power between utility and non-utility settling parties. That may be the case here, which is further reason not to approve this proposed Settlement.

Q15. WHY DO YOU FIND THE SUPPORT AMONG THE PARTIES TO BE LIMITED?

A15. There are only ten supporting parties from the approximately 30 parties listed by Witness Schroder. This means that the vast majority of parties are not supporting the proposed Stipulation. By and large, it appears that the supporting parties (other than Staff) are focused mostly on "niche" or specific individual provisions providing cash or cash equivalents to the signatory party such as low-income contributions for the community organizations, retail market enhancements for RESA and IGS, the location of corporate offices for the City of Dayton, etc. In fact, footnote (1) on page 5 of the proposed Settlement contains an important caveat stating that three of the signatory parties (IGS, RESA, and the Ohio Manufacturing Association Energy Group) do <u>not</u> explicitly support the DMR or the DIR, only the proposed Settlement as a package. This is an extremely important caveat given that the DMR is the centerpiece of this proposed Settlement.

I urge the PUCO to consider the fact that DP&L failed to procure signatory support from most of the parties to this case. Even more important, the party charged with protecting the interests of DP&L's residential customers, i.e., the OCC, is opposed to the proposed Settlement.

Q16. SHOULD THE PUCO BE PERSUADED BY THE NON-UTILITY SUPPORTING TESTIMONY?

A16. No, to the contrary, that testimony reveals how narrow the support is for the proposed Settlement among the non-utility parties. Other than Staff, only two such witnesses representing four parties submitted supporting testimony with that testimony focusing narrowly on provisions for low-income support and retail market enhancement. While that testimony forcefully advocates for those specific individual provisions, their testimony does not attempt to persuasively explain why the proposed Settlement, taken as a whole, is in the public interest and should be approved. Neither of these two witnesses is specifically willing to advocate for the $315 million of DMR customer payments and why such payments are needed or are in the public interest. While Staff Witness Donlon does support the DMR, his testimony does not explain why $315 million is a reasonable amount to collect from ratepayers and why this is preferable to alternative remedies to the very real financial integrity problem created by AES.

To some extent, I find the manner in which the proposed Settlement is structured, as explained later in this answer, to be disturbing, and this should be a reason for its rejection by the PUCO. Certain provisions, such as the proposed retail competition enhancements, are designed to be general in nature, i.e., impacting (positively or negatively) broad groups of customers and/or market suppliers—not just a benefit for an individual supporting party. Consequently, those provisions can be fairly judged on their public interest merits.

There are other provisions, however, clearly intended to purchase the signatures of individual parties in exchange for DP&L securing its own investor benefits. Section IV provides rate discounts that are only available to a few signatory parties. Section X of the proposed Settlement is entitled "Individual Signatory Parties," which extends from page 27 to page 36. This section defines the cash and/or cash equivalents that DP&L provides in exchange for signatures on the proposed Settlement. Similar rewards or benefits are not made available to the opposing or non-signatory parties, including most residential customers, but these opposing parties nonetheless will be required to pay for the Section X concessions. One can agree or disagree whether these provisions, on balance, are beneficial or are appropriately included in the proposed Settlement. But such payouts (in some cases improperly characterized as shareholder contributions) hardly constitute a reason for PUCO approval of the proposed Settlement under Criterion (1).

B. PUCO CRITERION (2)

Q17. WHAT IS YOUR UNDERSTANDING OF THE SECOND CRITERION?

A17. This second criterion considers whether a settlement package violates any important regulatory principle or practice. This criterion is briefly addressed by Witness Schroder at page 19. Her testimony merely asserts that this criterion is satisfied because it is consistent with the provision of safe and reliable utility service at reasonable cost. Her Exhibit A calculates customer bill impacts from the proposed Settlement finding them to be minimal, including a slight decrease for residential customers consuming 1,000 kWh per month.

Q18. DO YOU AGREE WITH THIS BILL IMPACT CALCULATION?

A18. No. For purposes of evaluating this proposed Settlement, I believe this is misleading. While Witness Schroder's testimony does not describe the calculation details, it appears that the reason for this surprisingly modest impact is due to cost reduction offsets that are not directly the result of the proposed Settlement. While it is difficult to determine this from the Appendix A tables, the claimed modest net rate impact may be the result of the expiration of the ESP I Rate Stability Charge ("RSC"). Further, the calculation seems to include reductions in the market-based cost of the SSO. But these two offsets or sources of customer cost savings are exogenous and not a result of the proposed Settlement. Rather, these same cost savings would also be realized under an MRO, as the Utility has conceded that the SSO pricing would be essentially identical under an MRO and the proposed ESP.

Q19. HAVE YOU SEPARATELY CALCULATED THE EXPECTED CUSTOMER RATE IMPACT?

A19. I have calculated the rate impact for the DMR component, (i.e., about $105 million per year) on DP&L's residential customers. There are various other rate riders included in the proposed Settlement that could further add to customer rates, but they are difficult or impossible to reliably quantify at this time. I calculate that DMR alone (absent the offsets) would add about $9 per month for the 1,000 kWh per month customer, or $108 per year. Witness Schroder on page 1 of Exhibit A estimates a rate impact of about $3 per month for this customer from other riders, including the Reconciliation Rider, the Regulatory Compliance Rider, and the Economic Development Rider, resulting in a total monthly bill impact of about $12 (or $144 per year) from the proposed Settlement.

In my November 2016 Direct Testimony, I estimated that the $145 million DMR would result in roughly a 40 percent increase in utility distribution rates. This means that the somewhat scaled down $105 million DMR under the proposed Settlement (by itself) would be roughly a 30 percent increase in distribution rates. Please note that the proposed Settlement DMR rate increase of $105 million is in addition to the pending base rate increase request of about $65 million— resulting in a total annual rate increase of nearly $170 million if that base rate request is approved as requested.

Q20. WITNESS SCHRODER ALSO ASSERTS THE PROPOSED SETTLEMENT PROVIDES FOR SAFE AND RELIABLE ELECTRIC DELIVERY SERVICE. DO YOU AGREE?

A20. I agree that the proposed Settlement is likely to allow DP&L to provide safe and reliable service. However, the essential point is that the proposed Settlement is extremely expensive for customers, and would not constitute reasonably priced retail electric service, a policy of the State under Ohio law.[8] More importantly, I do not believe that the excessive charges to customers are required to provide safe and reliable service. Nor are the excessive charges to customers required for grid modernization. These are two of Witness Schroder's six categories of proposed Settlement benefits.

To begin with, Witness Schroder has not identified service reliability issues that require a DMR. Indeed, Staff Witness Jacob J. Nicodemus finds no such reliability deficiency for DP&L.[9] As explained in considerable detail in my Direct Testimony and more briefly in this testimony, DP&L's credit quality needs required to effectively access capital markets on reasonable terms can be adequately addressed through a combination of ring fencing DP&L from its corporate affiliates, generation divestiture/asset sales, and AES cash contributions to deleverage DPL, Inc.

Q21. DOES THE PROPOSED SETTLEMENT CONFLICT WITH ACCEPTED REGULATORY PRINCIPLES AND PRACTICES?

A21. Yes, it does. The most important violation of accepted regulatory principle is the approval of extraordinary earnings for DP&L/DPL, Inc. unrelated to its market cost of capital or the utility's cost of providing service to customers. This is precisely what the DMR provisions of the proposed Settlement would do. Those

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[8] R.C. 4928.02(A).

[9] Testimony of Witness Nicodemus, at 5.

riders would collect about $315 million from customers as pre-tax earnings (not for cost of service recovery purposes) over and above the pending base rate case requested 10.5 percent "fair" rate of return on equity. This $315 million represents excess or monopoly profits from captive customers that serve no legitimate public interest purpose.

Q22. HAVE YOU ESTIMATED THE DP&L ROE WITH THE DMR?

A22. Yes. I start with Witness Malinak's projected DP&L ROEs shown on Exhibit RJM-7 which, as one would expect, are far above the rate case proposed annual 10.5 percent ROE through 2019 (i.e., the life of the DMR absent future extension). In fact, for 2017 to 2019, his ROE estimates are close to mine. While these ROEs are extraordinarily high, they are still biased downward due to Witness Malinak's modeling assumptions. This bias appears to be the case because his projections incorporate projected DP&L cost increases (expenses and new capital investment), but it fails to include new revenue that DP&L would undoubtedly receive over time from future distribution increases that DP&L undoubtedly would request and receive to recover those incremental costs. The omitted revenue increases would appear to include expected added revenue from the DIR, base rate cases (beyond the current pending case), and grid modernization charges. I discussed this same downward bias problem in my Direct Testimony in connection with Witness Malinak's October 2016 financial projections.

To address this "missing revenue" problem, I assumed that DP&L would earn a ROE of 10.5 percent on its book equity (i.e., the book equity projected by Witness Malinak on his Exhibit RJM-18B). I then add $67.2 million per year as the after-tax amount of DMR revenue (using a 36 percent composite income tax rate). This produces a DP&L total Company-projected earned rate of return on equity that averages about 20 percent during those three years—roughly double the requested cost of equity/ return on equity recommended by the Utility's rate case Witness Morin.

I have also calculated the ROE on DP&L's proposed distribution rate base ($684 million) from its pending rate case filing. Assuming the rate case provides the requested 10.5 percent ROE, using a 50 percent equity ratio (also as proposed by DP&L) and $67.2 million additional after-tax earnings from DMR, the resulting ROE on the Utility's distribution investment becomes about 30 percent—or nearly three times Dr. Morin's proposed "fair" ROE of 10.5 percent.[10]

Q23. DOES REQUIRING CUSTOMERS TO FUND THESE 20 TO 30 PERCENT UTILITY PROFITS VIOLATE REGULATORY PRINCIPLES?

A23. Absolutely. Witness Malinak appears to believe that such ROEs are proper because he asserts that the primary purpose of setting utility rates and the

[10] Calculated as: (($684m x 50% x 10.5%) + $67.2 m) / (50% x $684) = 30%.

authorized ROE is to ensure financial integrity regardless of the reason why financial integrity is threatened.

> Importantly, in order for the company to maintain its credit and to be able to attract capital, the expected ROE should be sufficient to assure confidence in the company's financial integrity. This requirement is why the PUCO considers ROE in its rate cases, and why I rely on ROE as a measure of financial integrity in my prior testimony before the Commission.[11]

While I fully agree that the authorized ROE normally should meet the capital attraction/financial integrity standard, Witness Malinak's statement of regulatory principle is woefully lacking. Regulatory commissions set cost of service rates and fair ROEs not just to meet financial integrity needs, but also to ensure consumers are not over charged. While the utility is a monopoly, the fundamental role of regulation is to restrain the utility from charging customers' rates that would systematically provide unwarranted monopoly profits. Such excessive monopoly profits are not needed to satisfy the capital attraction standard. In this case, setting rates to provide ROEs in excess of 20 percent and as high as 30 percent clearly would violate this core purpose and principle of regulation. It would allow DP&L to exploit with impunity its status as a delivery service

[11] Malinak Testimony, at 26.

monopoly of an essential product. Witness Malinak seems willing to overlook this violation of a core regulatory principle embedded in the proposed Settlement.

Q24. ARE THERE OTHER VIOLATIONS OF REGULATORY PRINCIPLES THAT MERIT REJECTION OF THE PROPOSED SETTLEMENT?

A24. Yes, there are. I will mention them only briefly here because I have discussed these issues at some length in my Direct Testimony:

- The DMR collected from utility customers is intended to fund and solve the "excess leverage" problem of the non-utility DPL, Inc. It is not needed for a stand-alone DP&L, as even Witness Malinak demonstrates. It represents a customer-provided subsidy collected from regulated customers (through a non-bypassable charge) to fund activities of the unregulated parent.
- The DPL, Inc. "excess leverage" problem is unrelated to utility delivery service. It is a combination of (a) excess leverage imposed on DPL, Inc. by AES as part of the 2011 merger; and (b) weak earnings performance from the DP&L/DPL, Inc. unregulated generation.
- As I explained in my Direct Testimony, the DMR is an improper transition charge as it is, at least partly, motivated by weak unregulated generation earnings. This problem also applies to the OVEC-related Reconciliation Rider.

- The inconsistencies of DIR with accepted regulatory principles have been discussed at length in the testimony of OCC Witness Williams.
- While this issue is quantitatively small compared to the DMR, I believe the PUCO should be troubled by aspects of Sections IV and X of the proposed Settlement. In those sections, DP&L agrees to provide financial inducements, payments, discounts, and subsidies to the signatory parties in exchange for their support of (or non-opposition to) the proposed Settlement. In some cases, these are specific customers rather than classes or groups of customers, and they are to be provided to a small handful of signatory large customers. Even more egregious, Paragraph V.1.(c) provides direct annual payments to a few signatory customers (or interveners), which Witness Schroder euphemistically refers to as "offsetting" (presumably offsetting the DMR).[12] I believe the use of such financial inducements explicitly provided to individual parties to "purchase" their support of a Settlement and/or to insulate them from the DMR, when doing so is at the expense of non-supporting parties or customers, is a very troubling violation of regulatory principle. That is, this feature of the proposed Settlement provides discriminatory rate or subsidy

[12] Schroder testimony, at 13.

treatment in favor of individual named customers merely due to their support of the Utility's objective, in this case the proposed Settlement

Q25. AREN'T SOME OF THE FINANCIAL INDUCEMENTS IN SECTION X TO BE PAID FOR BY SHAREHOLDERS?

A25. Witness Malinak claims that the proposed Settlement would provide a minimum of $11.5 million of shareholder contributions.[13] Normally, I would consider such contributions to be an unambiguous benefit for customers. I certainly have no objection in principle to reasonable and affordable contributions for low-income customer assistance, energy efficiency, and beneficial economic development. However, in this case this $11.5 million of shareholder "contributions" (or more properly $9 million) must be juxtaposed with the roughly $315 million (or possibly $525 million) collection of DMR charges from customers.

To put it differently, DP&L in the proposed Settlement extracts $315 million of excess (pre-tax) profits from its utility customers through DMR and in return provides $9 million of purported "shareholder contributions." Therefore, the net amount paid for by customers is $306 million for financial integrity purposes. In short, DP&L claims it necessary to increase the DMR utility customer charges from $315 million to "pay for" the $9 shareholder "contribution." This is

[13] Malinak Testimony, at 71 and Exhibit RJM-20. This appears to be the five-year figure, with the amount assuming a three-year DMR being about $9 million. I employ this latter figure as does Staff Witness Donlon (see his testimony, page 5).

analogous to a store raising the price of an item by 10 percent, and then offering the item on sale for a 10 percent discount. The entire notion that the proposed Settlement generously provides a shareholder contribution is a sham and a fiction. That is, the proposed Settlement simply sets the DMR at a level to recover the supposed $9 million of shareholder contributions.

The PUCO should not be misled by this sleight of hand.

C. PUCO CRITERION (3)

Q26. PLEASE EXPLAIN CRITERION (3).

A26. Criterion (3) concerns whether the proposed Settlement provides, on balance, public interest benefits for utility customers. As a matter of common sense, in this case, the net public interest/customer impact benefits of the proposed Settlement should be compared with the relevant alternative—an MRO with no DMR. Another possible alternative would be for the PUCO to approve an ESP in some form but exclude the DMR and the "offsetting" payments in kind to the signatory parties.

Q27. WHAT PUBLIC INTEREST BENEFITS ARE ASSERTED BY DP&L WITNESSES FOR THIS PROPOSED SETTLEMENT?

A27. The asserted public interest benefits are discussed in pages 9-19 of Witness Schroder's testimony and throughout Witness Malinak's testimony. Above all, these witnesses assert that the proposed Settlement benefits customers by deleveraging DPL, Inc. and thereby protecting the credit quality of DP&L. This is to be achieved by collecting approximately $315 million from customers through DMR along with substantial collections under other riders. They assert that this DMR is needed to ensure safe and reliable distribution service and grid modernization. Note that Witness Malinak finds that DP&L has no problem with its credit quality problem if viewed on a stand-alone basis. Its credit quality/financial integrity issue is due strictly to its affiliation with DPL, Inc.

Witness Schroder then proceeds to assert four additional categories of the proposed Settlement benefits: (1) a competitively bid SSO; (2) the promotion of economic development; (3) retail competition enhancement; and (4) low-income funding.[14]

Q28. PLEASE ADDRESS THE FIRST BENEFIT ASSERTION REGARDING THE DMR.

A28. DP&L's case is that DMR absolutely is required to preserve its financial integrity to attract needed investments in transmission/distribution and later in grid modernization. This is based on the financial projections of DP&L/DPL, Inc. submitted by Witness Malinak (although, as noted above, there is no stand-alone DP&L credit metric problem).

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[14] Schroder Testimony, at 9.

One problem is that these financial projections are not reliable, nor are they consistent with the proposed Settlement itself. It is worth noting that this same Witness Malinak testified in October 2016 that DP&L required $1.015 million from a DMR to protect its financial integrity, as compared to $315 million in March 2017 (or $525 million if one assumes the two-year extension as he does). The question remains unanswered by DP&L: What has transpired during the last five months for DPL, Inc.'s cash need to fall by more than $500 million? To my knowledge, nothing has occurred in the last several months to cause such a drastic change in DP&L's (or DPL, Inc.'s) alleged financial integrity cash injection need. This simply points out that the Utility's claims of cash requirements—that must be funded by utility customers—have proven to be overstated.

I question the reasonableness of Witness Malinak's financial projections. While his testimony fails to document his modeling assumptions (other than noting that they go back to October 2016), it appears that he assumes only minimal growth in regulated distribution and transmission customer revenue after 2017, even though the financial projections incorporate hundreds of millions of dollars of new capital investment along with normal expense escalation. This leads to an unrealistic understatement of DP&L earnings and cash flow. In addition, the proposed Settlement calls for DP&L to divest and ultimately sell its unregulated coal-fired generation assets, with sales proceeds to be used for debt reduction. As best I can tell, neither the divestiture nor the sales proceeds have been reflected in the "with

DMR" financial projections.[15] Correcting these erroneous and biased assumptions likely would reduce the asserted need for the DMR.

As explained in my Direct Testimony, DMR should not be viewed as providing a public interest benefit because the DP&L financial integrity could be better protected, without the use of customer-funded subsidies, by using a combination of ring fencing and equity contributions from AES. This could take the form of asset divestiture/sales, dividend payment reductions by AES (including AES simply slowing its anticipated rapid increases in dividend payout), and AES applying its substantial surplus cash flow to DPL, Inc. debt reduction. AES certainly has the financial capability to replace the approximately $67.2 million per year of (after-tax) DMR customer payments with cash equity transfers to DPL, Inc. Moreover, it is AES's corporate responsibility to do so, not that of its captive customers. AES has every incentive to do so absent the DMR. In fact, approval of the DMR reduces AES's incentive to undertake the appropriate steps to support DPL, Inc./DP&L.

If AES would take these reasonable and responsible actions, then DP&L's financial integrity and access to capital on favorable terms would be preserved without the need for the burdensome DMR. This could be further ensured by

[15] In fact, the generation divestiture/sale also should be reflected in the "without" DMR case as well as this would be likely to occur absent the proposed Settlement or an ESP.

implementing ring fencing for DP&L to further assure investors of bankruptcy protection.

Q29. WHY IS SOLVING THIS PROBLEM AES'S RESPONSIBILITY?

A29. As a general matter, AES accepted this responsibility when it acquired DPL, Inc. and DP&L in the 2011 merger. As I explained in some detail in my Direct Testimony, AES chose to finance this acquisition with massive amounts of debt, including imposing $1.3 billion of that debt on DPL, Inc. While it is true that since that time the DPL, Inc. merger debt has been reduced to approximately $0.8 billion, this debt level remains grossly excessive and is the lion's share of the DPL, Inc. issued debt. Moreover, funds used to reduce DPL, Inc. debt are fungible. That is, the funds used to reduce DPL, Inc. merger–related debt from $1.3 billion to approximately $0.8 billion could have been used instead to reduce other debt at DP&L and DPL, Inc. (e.g., debt supporting generation assets).

In addition, and as documented on page 27 of my Direct Testimony, AES committed to the PUCO in Case No. 11-3002-EL-MER (November 22, 2011)[16] that it would not charge customers for costs associated with merger closing and/or any acquisition premium. It seeks to do exactly that in this proposed Settlement through the inclusion of the DMR. AES is simply attempting to transfer the business risk and its imprudent financial decisions associated with DP&L

[16] The merger financing arrangement is documented in DP&L's response to IGS-INT-4-1, Attachment MIK-1. For convenience, I attached that response to my testimony.

acquisition to its captive monopoly utility customers. This transfer of risk does not benefit customers, is unfair, and is not in the public interest.

Q30. ***WITNESS SCHRODER FURTHER CLAIMS THAT THE PROPOSED SETTLEMENT BENEFITS CUSTOMERS BY AES'S AGREEMENT NOT TO COLLECT DIVIDENDS OR TAX SHARING PAYMENTS DURING THE TERM OF THE DMR. IS THIS IN FACT A SETTLEMENT BENEFIT?***

A30. No, it is not. While these are certainly appropriate measures for AES to take, from a customer standpoint this is not a benefit, nor is it a substantial "sacrifice" of any kind by AES. Referring to the above discussion, it is AES's responsibility and obligation to ameliorate the excessive leveraged problem at DPL, Inc., not that of utility customers who played no part in creating the financial distress. Tax sharing and dividend suspensions (or the financial equivalent) under these circumstances would be a normal part of prudent corporate financial management. According to DP&L Witness Jackson's October 2016 testimony on behalf of DP&L, this is current and ongoing practice. These corporate cash management practices, therefore, would almost certainly continue with no settlement and an MRO outcome. Witness Schroder therefore cannot claim this to be a customer benefit.

It is also important to understand that the tax and dividend suspension (which is the status quo) is not a major shareholder sacrifice. Neither action reduces the AES consolidated corporate earnings by one dollar, nor does it have any effect on

AES's corporate income tax obligation. These are simply intra-corporate actions needed to properly manage cash flows among corporate affiliates. In fact, these suspensions are entirely consistent with AES's corporate goal of reducing its overall debt leverage. It also should be mentioned that the DPL, Inc. tax sharing suspension does not provide a rate benefit for DP&L customers. Income taxes will be included in the DP&L regulated revenue requirements and therefore customer rates in the conventional manner using statutory income tax rates.

Q31. DO YOU AGREE WITH WITNESS SCHRODER THAT THE PROPOSED SETTLEMENT PROVIDES AN ECONOMIC DEVELOPMENT BENEFIT?

A31. No, I do not. I explain why the DMR would harm the Dayton area economy by reducing customer disposable income and causing business cost increases on pages 22-23 of my Direct Testimony. While that discussion was in the context of a $1.015 million DMR, the Stipulation DMR cost burden of $315 million (or $525 million if an extension is approved) remains quite substantial and therefore detrimental to local economic activity and development.

While Section IV of the proposed Settlement does provide for "economic development incentives," these are provided only to a small group of privileged customers, likely in exchange for their support for or non-opposition to the proposed Settlement. There is no showing by Witness Schroder whatsoever that this provision has anything to do with economic development or that this will induce expansion or maintaining of employment or operations at those sites.

These discounts or cash payouts are based on proposed Settlement support, not economic need or merit.

Not only is it false to claim an economic development benefit, but to the contrary, the proposed Settlement and its unwarranted captive customer-funded subsidies would actually provide an economic activity headwind for the Dayton area.

Q32. IS WITNESS SCHRODER CORRECT IN ASSERTING THAT THE INCLUSION OF A COMPETITIVE BIDDING PROCESS ("CBP") FOR SSO IS A BENEFIT OF THE PROPOSED SETTLEMENT?

A32. No. Witness Malinak already has conceded that the ESP and an MRO would use the same CBP and therefore the same SSO cost in his October 2016 testimony, and he repeats that acknowledgment in his March 2017 testimony.[17] Staff Witness Donlon makes a similar observation.[18] In other words, DP&L has taken the position that it would use the same CBP under an ESP versus an MRO. There is no SSO rate benefit from the proposed Settlement.

Witness Schroder further discusses as an alleged public interest benefit the competitive market enhancements in Section IX of the proposed Settlement.[19] These alleged benefits are refuted by OCC Witness Haugh.

[17] See Malinak October 31, 2016 Testimony, at 60; March 22, 2017 Testimony, at 11.

[18] Donlon testimony, at 5.

[19] Schroder Testimony, at 15-16.

Q33. WITNESS SCHRODER ARGUES THAT THE OVEC-RELATED RECONCILIATION CHARGE IS A STIPULATION BENEFIT. DO YOU AGREE?

A33. No, I do not agree. Her testimony at pages 13 - 14 references the proposed Settlement provisions that allows DP&L to collect from customers the over market costs of the OVEC contract, which Witness Malinak acknowledges will total tens of millions of dollars over the ESP term. This is a customer burden, not a benefit. Witness Malinak attempts to justify this burden by claiming it is needed to prop up DP&L profits (and by extension those of AES) and the DPL, Inc. cash flow. I disagree that such charges are needed, for the reasons provided earlier, and I certainly would not characterize payments of tens of millions of dollars by captive customers when they receive nothing tangible in return as being a public interest benefit.

Similarly, Witness Schroder asserts at page 14 that the OVEC charges will serve as a "hedge" on customer bills, although she provides no support for that assertion. Even if it does have a hedge attribute, all it does is help (slightly) to stabilize customer bills at a higher level because it is a net charge in every year. This is a hedge (an essentially guaranteed loss) that no one would want. I also observe that none of the settling parties seem to want this hedge benefit, which is why it has been 100 percent shoved off onto the SSO customers.

Q34. DOES WITNESS SCHRODER PROVIDE A RATIONALE FOR THE OVEC CHARGE INCLUDED IN THE PROPOSED SETTLEMENT?

A34. Yes. She explains that the OVEC contract is a legacy power supply resource that has been providing generation service to DP&L customers for decades. Moreover, she states that DP&L has not been able to divest this contract despite good faith attempts to do so.

While I understand her argument, and agree that the OVEC contract has been a legacy power supply resource serving DP&L customers, I must take issue with the imposition on customers of the Reconciliation Rider. This charges customers for the out-of-market costs of a resource that will not be used either for utility service or to provide power supply for DP&L customers. It therefore is a transition charge. Its real purpose (as explained by Witness Malinak) is to address the DP&L financial integrity (although the funds actually will go to DPL, Inc.). However, the proposed Settlement already addresses DP&L's financial integrity through the DMR by providing $315 million for three-years (and potentially $525 million for five-years) of additional funds over and above the utility cost of service. The Reconciliation Rider would be loaded on top of the massive DMR, unnecessarily burdening customers. Finally, this Rider would blunt the Utility's incentive to divest the contract.

Q35. DO YOU HAVE ANY OTHER CONCERNS WITH THIS RIDER?

A35. Yes. Proposed Settlement Paragraph VI(a)(ii) allocates 100 percent of the OVEC net cost to SSO customers. This allocation obviously is a matter of indifference to DP&L, and the rationale is not even discussed by DP&L witnesses. This allocation clearly is improper because the OVEC costs have nothing to do with the provision of SSO. It cannot be supported by "cost causation" or any other generally accepted regulatory principle of cost allocation. The OVEC charges are, in essence, stranded costs, and I am not aware of any instance where a regulatory body has deemed it appropriate to assign 100 percent of stranded costs to one distinct group or class of utility customers or just to default service customers.

There are additional practical or common sense concerns regarding this anomalous cost allocation. It essentially assigns all costs to one narrow set of customers (as indicated, unrelated to cost causation or cost responsibility), in this case those who take SSO. For example, assume that all OVEC charges could be fully collected by a charge to all distribution customers of 0.1 cents per kWh, and further assume that SSO is 25 percent of total DP&L kWh sales. Hence, this direct assignment would require a charge to SSO customers of 0.4 cents per kWh – a 400 percent increase over a more conventional allocation. All other customers pay zero. This is clearly unreasonable and unfair. It effectively targets residential and small commercial customers because these are the customers more likely to be taking SSO service. Further, no one has any idea what the SSO load will be over the six-year term of the ESP. For example, suppose the SSO load falls in half over the next six years (due to migration to competition or municipal aggregation). In my example, the already onerous 0.4 cents charge for SSO customers now goes to 0.8 cents as compared to a more reasonable 0.1 cent if assigned to all distribution customers. Such an outcome is unfair and unacceptable.

Q36. DOES ANY WITNESS EXPLICITLY SUPPORT THIS ALLOCATION?

A36. Yes, it is supported briefly by IGS/RESA Witness White at pages 11–12 of his testimony. He argues that assigning 100 percent of the OVEC charges to the SSO load "preserves the right of shopping customers to select their choice of competitive generation supply". He further states that this "avoids an anti-competitive subsidy" to DP&L. To Witness White's credit, his testimony does not seem to advocate for the Reconciliation Rider or OVEC out-of-market cost recovery from utility customers, and he clearly is right that this Rider provides DP&L with a subsidy.

The remainder of his brief testimony on this anomalous allocation is clearly wrong. The OVEC charge could simply be allocated to all distribution customers (using some conventional allocation factors), and this would be an entirely competitively neutral outcome. That is, it would have no distorting (i.e., a neutral) effect on shopping decisions for generation supply and would not be an impediment to a customer's decision regarding the selection of a supplier. The allocation of above-market PPA costs as charges to all customers is an issue that has been frequently presented to the PUCO and has been acknowledged to be competitively neutral (even if the subsidy charge itself is not competitively neutral because it will distort wholesale generation markets).

The competitively bid SSO rate generally is the rate use by customers to compare to alternative competitor solicitations and prices. The OVEC charge rendered to SSO customers only will artificially inflate SSO costs to consumers thereby allowing competitive suppliers additional revenue margins to compete head to head with the SSO. Consequently, this unfair cost allocation will result in not only unwarranted SSO price increases but also higher charges from competitors. This policy is not in the public interest.

Witness White and his testimony sponsors, of course, have a business interest in assigning all OVEC costs to SSO customers. Ratemaking that makes SSO less attractive and more onerous of a service from a pricing standpoint would benefit retail suppliers. While I understand this business incentive, doing so in this manner is just not fair, reasonable, or in the public interest. It discriminates against SSO customers. I therefore urge the PUCO to reject this allocation provision, and if it approves the Reconciliation Rider, assign the costs to all distribution customers in some equitable manner. This modification to the proposed Settlement will in no way harm its central purposes or DP&L's financial integrity.

Q37. WITNESS SCHRODER'S FINAL ENUMERATED BENEFIT PERTAINS TO LOW-INCOME FUNDING. IS THIS A SETTLEMENT BENEFIT?

A37. Unfortunately, it would appear not to be. It is true that Section X, Paragraphs 3 and 6 do provide some low-income assistance funding, but the amount averages only about $1 million per year. In return for this otherwise welcome assistance, low-income customers (however defined) must pay for their assigned shares of the $315 million (and possibly $525 million) DMR, along with other substantial charges including the Reconciliation Rider (assigned entirely to SSO customers), DIR, and other costly obligations created by the proposed Settlement. While this may be hard to reliably quantify, given the overwhelming cost of the proposed Settlement, it seems highly unlikely that, taken as a whole, it could possibly benefit low-income customers. This proposed Settlement, on balance, is likely to make low-income customers much worse off, not better off.

III. III...THE ESP VERSUS MRO TEST

Q38. PLEASE SUMMARIZE WITNESS MALINAK'S ESP VERSUS MRO STATUTORY TEST.

A38. Consistent with his October 2016 testimony, Witness Malinak identifies three main elements for the statutory test: (a) quantifiable customer rate impacts of the ESP versus MRO ("Aggregate Price Test"); (b) other quantifiable impacts; and (c) qualitative attributes of the ESP. The qualitative criterion could include impacts on service quality or reliability.

Witness Malinak begins by recognizing that the ESP (embedded in the proposed Settlement) will collect $525 million from the DMR plus tens of millions of additional charges from the Reconciliation Rider. The only quantified benefit or savings would be the $9 million to $11.5 million of shareholder contributions for low-income, energy efficiency, and other identified purposes.

His study uses three scenarios for the DMR/Reconciliation Rider. However, the second and third scenarios appear to be conceptually very similar, so for purposes of exposition, I treat them as if they are one single scenario, hence a total of two scenarios.[20] Under the first scenario, there is an MRO (no Settlement or ESP), but DP&L simply requests identical dollars for DMR/Reconciliation Rider in a distribution base case or some other docket. He then assumes, without any support whatsoever, that in a hypothesized future rate case, the PUCO would grant DMR/Reconciliation Rider revenues that are identical to those specified in the proposed Settlement. In other words, the proposed Settlement ESP and MRO produce identical quantitative results for these two riders.[21]

Under the second scenario, Witness Malinak assumes that DMR and Reconciliation Rider charges would not be approved under an MRO. Under this second scenario, the ESP would then be far more costly than an MRO.[22]

[20] Malinak Testimony, at 9 – 10.

[21] Id., at 9.

[22] Id., at 10.

His analysis also considers SSO pricing, but he assumes this is a neutral item in the quantitative test because the ESP and MRO will use the same CBP. He states, "Consequently, the generation rates will be the same under both the MRO and Amended Stipulation."[23]

Q39. WHAT IS WITNESS MALINAK'S FINDING FOR THE QUANTITATIVE TEST?

A39. He finds no difference between the proposed Settlement ESP and MRO under the first scenario because he surmises that DP&L can obtain identical revenues in a distribution base rate case or other docket. Under the second scenario, the MRO would produce much lower rates because the DMR/Reconciliation Charge riders are excluded from rates with no base rate case offset.[24]

Q40. HAS HE EVALUATED OTHER QUANTITATIVE IMPACTS?

A40. Yes. Witness Malinak contends that the proposed Settlement ESP provides "at least" $11.5 million (for five years or $9 million for three years) of quantified benefits for customers as shareholder contributions, benefits that would not be present under an MRO.[25] That is, there would be no such shareholder contributions under an MRO.

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[23] Id., at 11.

[24] Id., at 12 - 13.

[25] Id., at 17.

Q41. HOW DOES WITNESS MALINAK CONSIDER THE QUALITATIVE ATTRIBUTES?

A41. Witness Malinak mentions a number of qualitative factors, but he emphasizes the assertion that the DMR/Reconciliation Rider revenue stream (absent under the MRO second scenario) is essential if DP&L is to maintain its financial integrity and therefore the ability to provide safe and adequate electric service and to pursue beneficial grid modernization. In other words, absent the proposed Settlement ESP, he asserts that customers would suffer from service quality degradation. He asserts that the subjective harm from deteriorating service quality would exceed in value the more than the $525 million cost of the rider.[26] He does concede that this conclusion is merely a subjective opinion or value judgment on his part, not based on any objective evidence.

His discussion identifies certain other qualitative benefits from the proposed Settlement ESP not available under an MRO. This would include the AES dividend and tax suspension mentioned earlier, renewable resource development, retaining corporate offices in Dayton, and grid modernization commitments.[27]

[26] Id., at 18.

[27] Id., at 18 – 19.

Q42. WHAT DOES HE CONCLUDE REGARDING THE OUTCOME OF THE TEST?

A42. He finds that under both of his MRO scenarios the proposed Settlement ESP is more favorable in the aggregate. Under the first scenario, the MRO and ESP would provide the same DMR/Reconciliation Rider revenue, and both would protect DP&L's credit quality. However, the ESP provides to customers the $11.5 million of shareholder contributions, along with various other asserted qualitative benefits absent from the MRO. Under the second scenario, the proposed Settlement ESP is far more expensive for customers than an MRO, but in his judgment the service quality benefit from the ESP is greater in value than the ESP's higher quantified cost.

Q43. DO YOU AGREE WITH MR. MALINAK'S ANALYSIS?

A43. No. I address both of Mr. Malinak's MRO scenarios. In the first scenario, DP&L certainly would and could request the more than $525 million of new revenue (in the form of additional earnings, not cost recovery) in a base rate case or other docket. But this specific revenue stream is merely a negotiated set of figures from a settlement. There is no basis for assuming this specific revenue and excess profit stream would be approved by the PUCO in a base rate (or other) case, particularly when there is no cost (and a dubious financial integrity) support for it. The combination of the significantly excessive ROEs these riders would produce, the lack of credible analytical support, and the fact that DP&L's financial integrity could be protected at much lower customer cost through ring fencing and

AES supportive actions discussed in my testimony mean that the DMR/Reconciliation Rider revenue request likely would be rejected or significantly pared back by the PUCO with no adverse financial integrity impact for DP&L. Thus, rates under the MRO would be substantially lower, with no offsetting impairment to service quality, reliability, or impediment to grid modernization investments. Any needed investments could be recovered in a conventional base rate case or other docket (such as a specific grid modernization docket).

The MRO is also superior under Witness Malinak's second scenario. He concedes in that scenario that the MRO would produce lower rates but believes (subjectively) that this price disadvantage for the ESP is fully offset by better service quality and other favorable Settlement attributes. I disagree because there is no reason why service quality should be impaired under an MRO. Again, this is because DP&L's credit ratings and financial integrity can be fully protected by the measures previously mentioned—ring fencing, AES equity and cash contributions, asset sales, and so forth.

In conclusion, the proposed Settlement ESP fails the quantitative portion of the statutory test by more than $525 million even with including the $11.5 million "shareholder contributions" as a benefit. The proposed Settlement will not provide improved service quality or reliability for electric distribution service, nor is it required for pursuing an effective and cost/beneficial grid modernization.

Q44. ASIDE FROM CLAIMS CONCERNING SERVICE QUALITY, HOW DO YOU RESPOND TO WITNESS MALINAK'S OTHER CLAIMS OF QUALITATIVE ATTRIBUTES?

A44. The other claimed qualitative benefits from the proposed Settlement ESP are discussed and listed at pages 15 -18 of his testimony. The list includes maintaining the Utility's corporate offices in Dayton, promotion of renewable resources, grid modernization, low-income support, alleged economic development payments, and the AES dividend/tax payment suspensions.

He asserts that these qualitative benefits of the proposed Settlement ESP would be lost under an MRO. I have already discussed these issues at some length in Section II. C. of my testimony, but I will summarize for purposes of this test.

The DPL, Inc. tax payment suspensions to AES almost certainly would continue under an MRO, as long as needed, absent the proposed Stipulation ESP because it is in AES's interest to do so. This is merely a continuation of current and past practice. Also, as explained earlier, while the tax payment suspension is a benefit to DPL, Inc., it does not in any way reduce the utility revenue requirements or charges that DP&L customers must pay. Similarly, the dividend suspension also would be likely to continue, as required, due to DPL, Inc.'s inability to pay dividends.

Witness Malinak asserts that the proposed Settlement also benefits customers by converting the DPL, Inc. tax obligation to equity. This measure, while being on balance a positive, really does not cost AES anything and to some limited degree benefits AES. It does not cost the consolidated AES anything in terms of its earnings, its tax payments, or its balance sheet. It is really the same thing as AES infusing equity into its own subsidiary to shore up its finances, which it is likely to do absent a lucrative DMR. While Witness Malinak attaches a significant dollar value to this accounting write up (and the tax payment suspension), it would amount to only a small fraction of the $1.3 billion of debt that AES imposed on DPL, Inc. in connection with the merger. Moreover, Witness Malinak's dollar estimate is highly uncertain of this new equity, and it could fall dramatically if the federal statutory income tax rate is reduced as proposed. Finally, this equity contribution from eliminating the tax liability balance is a non-cash accounting write up. While appropriate, it has little to do with credit ratings that are based primarily on a utility's operations and cash flow. I am not opposed to any of these measures. In fact, I regard them as positive and appropriate. But they simply do not go far enough, and AES should do far more to support DPL, Inc./DP&L, given AES's past actions. The proposed Settlement has the effect of excusing and even rewarding AES for financing the DP&L/DPL acquisition with excess leverage.

DP&L Witnesses Schroder and Malinak make claims that the proposed Settlement supports employment and economic activity in the Dayton area, including maintaining corporate offices in Dayton. But there is no evidence presented that those offices would leave Dayton under an MRO. More generally, I have demonstrated that, overall, the proposed Settlement ESP would produce an economic headwind for the Dayton area by reducing disposable income, increasing customer rates, and increasing the cost of doing business in DP&L's service area.

Finally, contrary to Witness Malinak, an MRO would not be a barrier for DP&L proceeding over time with PUCO-approved and cost-beneficial grid modernization measures. This is because DP&L's financial integrity and credit quality can be adequately protected without the onerous DMR and OVEC charges to customers. Cost recovery for such investments can and should take place in a standard base rate case.

Q45. IS IT YOUR CONTENTION THAT THERE ARE NO QUALITATIVE BENEFITS IN THE PROPOSED SETTLEMENT?

A45. No, I am not asserting that to be the case. I realize that what constitutes a qualitative benefit is subjective, and reasonable people (or stakeholders) have different interests and can differ in their assessments. I merely find that most of the qualitative benefits claimed by Witness Malinak are also available (if worth having) under an MRO. Other claimed qualitative benefits are of questionable merit. However, even if one can identify some qualitative benefits from the proposed Settlement that would not be available under an MRO, those benefits would have to be worth more than $315 million DMR (plus Reconciliation Rider payments) in order for the proposed Settlement ESP to pass the statutory test. This is just not the case.

I find that, based on my review of the proposed Settlement and DP&L supporting testimony, the ESP embedded in that proposed Settlement fails the statutory test and therefore should be rejected. An MRO would avoid a large and unneeded rate burden, designed to improperly enrich AES shareholders, and would better serve DP&L utility customers than the expensive proposed Settlement ESP.

IV. IV. .... SUMMARY OF RECOMMENDATIONS

Q46. BEFORE TURNING TO A SUMMARY OF YOUR RECOMMENDATIONS, WHAT ARE YOUR MAIN FINDINGS?

A46. To emphasize again, the centerpiece of the proposed Settlement is the more than $315 million rate burden imposed on DP&L customers via the DMR plus an additional tens of millions of dollars from the Reconciliation Rider. While the credit quality problem that the DMR is intended to address is real, that problem is best solved by AES meeting its responsibility to properly capitalize DPL, Inc., along with the implementation of ring fencing for DP&L. The proposed Settlement elevates the interests of AES shareholders over those of DP&L's captive customers. This is particularly unfair because this credit quality problem was largely created by AES's management's merger financing decisions, not by customers. The DMR would perversely reward AES shareholders for AES's dubious excess leverage decisions by substantially increasing its corporate profits.

Based on my review of the proposed Settlement, I find that it fails the PUCO's two basic tests required for approval. First, it fails the statutory ESP versus MRO test, as discussed in Section III of my testimony. Second, as discussed in Section II of my testimony, it fails the PUCO's three-prong test for approval of a settlement, in this case a settlement that has rather narrow and limited support by the parties. No signatory party has been willing to explicitly advocate for the very expensive DMR.

I therefore recommend rejection of the proposed Settlement.

Q47. IN THE EVENT THAT THE COMMISSION IS INCLINED TO APPROVE AN ESP OR SETTLEMENT IN SOME FORM, DO YOU HAVE ANY RECOMMENDATIONS FOR MODIFICATION?

A47. Yes, I have several suggestions for protecting customers and providing for greater fairness in the proposed Settlement. First and foremost, the enormous magnitude of the DMR revenue collection should be eliminated, or if not eliminated entirely, materially reduced. The burden for "fixing" DPL, Inc.'s poor credit quality should not be imposed principally or entirely on customers. AES's management, which created the problem and in 2011 committed not to charge customers for merger closing costs or the acquisition premium (the cause of the current excess leverage problem), must accept at least a substantial portion of the responsibility for its imprudent financial decisions. The proposed dividend and tax suspensions and the equity accounting write up, would cost AES nothing in terms of earnings and are not sufficient and fail to provide what is needed.

In addition, I recommend the following:

- Limit the ESP to three years, as discussed in my Direct Testimony.
- Subject the DMR to the SEET, also as recommended in my Direct Testimony.
- Reject the improper provision that allocates 100 percent of the OVEC over market costs to SSO customers instead of to all distribution customers, in the event the Reconciliation Rider is approved at all (which I do not support).
- Eliminate the unjustified rate discounts, direct payments, or subsidies in Section IV of the proposed Settlement as they appear to be provided only as a *quid pro quo* to a very small group of signatory customers with no *bona fide* economic development purpose.
- Adopt the modification recommendations of other OCC witnesses.

Q48. YOU RECOMMEND THAT IF THE PUCO APPROVES THIS SETTLEMENT WITH A DMR, THE DMR SHOULD BE ON A SUBJECT TO REFUND BASIS IN THE EVENT THAT THE DMR IS SUBSEQUENTLY DISALLOWED BY THE PUCO OR A COURT DECISION. HAS THE PUCO PREVIOUSLY ADDRESSED THIS ISSUE?

A48. Yes, it has, in last year's decision on a DMR for the FirstEnergy Ohio utilities.[28] In that ruling, the PUCO stated that "[m]aking Rider DMR subject to refund would be counterproductive and impose additional risks on the Company." I interpret that finding to mean that, in the case of FirstEnergy, implementing Rider DMR subject to refund potentially might work at cross purposes with achieving improved credit metrics as well as increasing perceived investment risk.

Q49. PLEASE RESPOND TO THE PUCO'S CONCERN REGARDING THIS ISSUE FOR DP&L.

A49. I am raising this issue in order to recognize the possibility of a future finding by the PUCO or a court that the DMR is either improper or unlawful and therefore should not be collected from DP&L utility customers. Undoubtedly, DP&L would prefer that such collections not be subject to refund and therefore retained for shareholders even in the event of this possible disallowance. The Utility would, as the PUCO suggested for FirstEnergy, perceive this as a risk. DP&L probably would also argue that a refund, in the event of a disallowance, would

[28] Fifth Entry on Rehearing, October 12, 2016, Case No. 14-1297-EL-SSO, at page 97.

interfere with its deleveraging efforts and therefore undermine the intended strengthening of its credit ratings.

I disagree with these arguments in the case of DP&L. For example, assume a PUCO or court disallowance one year after implementation. DP&L would have collected $105 million, which it could keep absent a subject to refund provision (about $67 million in AES corporate earnings). The overriding concern is one of inequity between shareholders and utility customers. As a matter of equity, DP&L and AES in this hypothetical simply were never entitled to that revenue and earnings that they enjoyed that first year, as affirmed in a court or by the PUCO. Therefore, absent a subject to refund provision, inevitably, utility customers experience very substantial irreparable harm. There is no remedy to the loss of $105 million. The subject to refund provision is required as a matter of basic equity.

Second, while I concur that a subject to refund provision involves more risk for the utility than no such provision, this is not unusual. Based on my regulatory experience, implementing rate increases (or delaying proposed rate decreases) subject to refund is a tool routinely used by regulators. There are many instances when a utility implements a rate increase on a subject to refund basis as a means of mitigating regulatory lag and/or because a given utility investment is subject to a protracted prudence investigation. The subject to refund provision is routine used at the Federal Energy Regulatory Commission ("FERC") for both proposed rate increases and decreases, and it is a "risk" with which utilities are quite familiar. FERC regulation has not been singled out as being particularly risky due to its use of such a mechanism. In addition, while I recognize the PUCO's point that subject to refund involves more risk than insulating the utility from a potential refund, DP&L is being well compensated for that risk under the proposed Settlement. As I previously explained, it is expected that the DMR will provide DP&L with an ROE of about 20 percent on a total Company basis and as much as 30 percent if measured using the rate case distribution rate base. Given these very lucrative ROEs, it is entirely reasonable to ask DP&L to bear the refund risk in the event that the PUCO or a court later finds the DMR collections from customers to be improper.

Finally, in the case of DP&L, the argument of a potential refund harming financial integrity really does not apply, or at best is unpersuasive. This is because AES' parent has the ultimate responsibility for ensuring the financial integrity (and therefore the capability to make needed distribution investments) for the utility that it owns. It accepted this responsibility when it acquired DP&L in 2011. In the above example, with a subsequent disallowance of the DMR earnings ($67 million), AES clearly has the capability of replacing the refunded earnings. This amount is only a very small percentage of the AES equity and annual cash flow.

In summary, I believe that fairness considerations overwhelmingly support the inclusion of a subject to refund provision in the event of a future DMR rejection in order to prevent irreparable harm to customers. Excluding such a provision does not provide a fair balancing of interests.

Q50. ARE THERE ANY OTHER PROVISIONS THAT SHOULD BE CONSIDERED REGARDING DMR IN THE EVENT THAT THE DMR IS APPROVED BY THE PUCO?

A50. Yes. The DMR in the proposed Settlement would provide DP&L and AES about $67 million of additional after-tax income for each year that it is in place. I already have discussed the ROE implications of this for DP&L. This after-tax earnings amount is based on the current statutory corporate income tax rates in effect at this time. However, there is at this time considerable interest in substantially lowering the federal income tax rate – from 35 percent at present to possibly as low as 15 percent – with such change occurring within the next year. If this were to occur, this could result in the DMR being far more valuable to shareholders than the presently contemplated $67 million per year. I urge the PUCO to take note of this possibility and to provide for an adjustment in the DMR on a going forward basis. If a reduction in the federal income tax rate does occur, the DMR annual collection amount should be reduced so that utility customers receive the benefit, as they should, for the income tax rate savings. Unless such a provision is included, AES shareholders would enjoy a DMR windfall potentially of tens of millions of dollars at customers' expense to which they are not entitled. This provision should operate prospectively only.

Q51. YOU ALSO ADVOCATED A THREE-YEAR ESP TERM LIMIT IN YOUR DIRECT TESTIMONY. IS THERE FURTHER REASON TO DO SO AT THIS TIME?

A51. Yes. My reading of the proposed Settlement is that it explicitly would grant at this time a three-year DMR. DP&L would have the right to come before the PUCO in the future and request a two-year extension (although the exact procedures for doing so are not spelled out). Given this three-year term is approved in the proposed Settlement for the DMR, which is the centerpiece of the proposed Settlement, I believe that it makes sense for the entire ESP to be limited to three years

Q52. DOES THIS CONCLUDE YOUR SUPPLEMENTAL DIRECT TESTIMONY?

A52. Yes, it does, but I incorporate my November 2016 Direct Testimony by reference for reasons discussed herein. In addition, I reserve the right to update my testimony as outstanding discovery or other new information become available.

CERTIFICATE OF SERVICE

It is hereby certified that a true copy of the foregoing *Supplemental Direct Testimony of Matthew I. Kahal on Behalf of the Ohio Consumers' Counsel* was served via electronic transmission this 29th day of March 2017.

/s/ *William J. Michael*
William J. Michael
Assistant Consumers' Counsel

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OBJECTIONS AND RESPONSES TO INTERROGATORIES

INT-4-1. In response to IGS INT-2-1 (which requested an identification of all debt obligations entered into by DPL Inc. as a consequence of the acquisition of DPL Inc. by AES Corp. ("AES")), "DP&L states that the $1.25 billion of DPL Inc. debt at the end of 2015 was initially incurred between 2000-2011 to finance capital expenditures and a portion is related to AES' acquisition of the Company ($1.25 billion was assumed in 2011, of which —$520 million has been since repaid)." Regarding this response:

a. Identify whether AES entered into a debt obligation in the amount of $1.25 billion (through its subsidiary Dolphin Subsidiary II, Inc. ("Dolphin Sub.")) to finance the acquisition of DPL Inc.
b. Identify whether DPL Inc. assumed the obligation to repay the $1.25 billion debt obligation entered into by Dolphin Sub. following AES' acquisition of DPL Inc.
c. All else being equal, is it true that the AES acquisition of DPL Inc. increased the debt obligation of DPL Inc. by $1.25 billion. If this is not true, explain your answer.

RESPONSE: General Objections Nos. 1 (relevance), 2 (unduly burdensome), 4 (proprietary), 5 (inspection of business records), 6 (calls for narrative answer), 9 (vague or undefined), 10 (possession of DP&L's unregulated affiliate), 11 (calls for a legal conclusion), 13 (mischaracterization). Subject to all general objections, DP&L states:

a. Please see IGS 2nd Set RPD-2-1 Attachment 26, DP&L-SSO 0007603 - DP&L-SSO 0007605 (AES 8-K filed 10-5-11), which states that "On October 3, 2011, Dolphin Subsidiary II, Inc. (the "Company"), a newly formed, wholly owned special purpose indirect subsidiary of The AES Corporation ("AES"), entered into an indenture (the "Indenture") with Wells Fargo Bank, N.A. (the "Trustee") as part of its issuance of $450 million aggregate principal amount of 6.50% senior notes due 2016 (the "2016 Notes") and $800 million aggregate principal amount of 7.25% senior notes due 2021 (the "2021 Notes" and together with the 2016 Notes, the "notes") to finance the pending AES acquisition (the "Acquisition") of DPL Inc. ("DPL")." That same document also stated that "The proceeds from issuance of the notes were deposited into an escrow account pledged for the benefit of the Trustee pending the consummation of the Acquisition."

b. Please see IGS 2nd Set RPD-2-1 Attachment 24, DP&L-SSO 0007289 - DP&L-SSO 0007509 (DPL 10-K YE 2011) Debt footnote #7 pg. 100, which states that "In connection with the closing of the Merger (see Note 2), DPL assumed $1.25 billion of debt that Dolphin Subsidiary II, Inc., a subsidiary of AES, issued on October 3, 2011 to finance a portion of the merger." Footnote #2 from the same document states, "On November 28, 2011, AES completed its acquisition of DPL. AES paid cash consideration of approximately $3,483.6 million. The allocation of the purchase price was based on the estimated fair value of assets acquired and liabilities assumed. In addition, Dolphin Subsidiary II, Inc. (a wholly-owned subsidiary of AES) issued $1,250.0 million of debt, which, as a result of the merger of DPL and Dolphin Subsidiary II, Inc. was assumed by DPL."

c. Please see IGS 4th Set INT-4-1 Attachment 1, DP&L-SSO 0007720 - DP&L-SSO 0007725 (DPL 8-K filed 11-28-11)) which states: "On November 28, 2011 (the "Merger Date"), DPL Inc. ("DPL") completed its merger (the "Merger") with Dolphin Sub, Inc. ("Merger Sub"), a wholly owned subsidiary of The AES Corporation ("AES"), pursuant to that certain Agreement and Plan of Merger, dated as of April 19, 2011, by and among AES, Merger Sub and DPL (the "Merger Agreement"). As a result, each issued and outstanding share of the common stock, par value $.01 per share, of DPL (the "DPL

Common Stock") (other than shares owned directly or indirectly by AES or Merger Sub or held by DPL or its subsidiaries, which were cancelled as a result of the Merger), including grants of restricted common stock, was automatically cancelled and, other than shares of DPL Common Stock held by shareholders who have validly exercised their appraisal rights under Ohio law, converted into the right to receive $30 in cash (the "Per Share Merger Consideration"), without interest. DPL is the surviving corporation in the Merger and, as a result of the Merger, is a wholly owned subsidiary of AES." That same document also states "Effective on the Merger Date, DPL assumed all obligations with respect to the $450 million aggregate principal amount of 6.50% senior notes due 2016 (the "2016 Notes") and $800 million aggregate principal amount of 7.25% senior notes due 2021 (the "2021 Notes" and together with the 2016 Notes, the "Notes") previously issued by Dolphin Subsidiary II, Inc. ("Dolphin II"), a wholly-owned special purpose indirect subsidiary of AES. The Notes were issued in a private offering on October 3, 2011 and the proceeds from the offering were deposited into an escrow account pending the consummation of the Merger. In connection with the consummation of the Merger, the funds were released from the escrow account to fund the consummation, and Dolphin II was merged with and into DPL, with DPL continuing as the surviving company. As a result, DPL assumed all obligations under the Notes and the Notes are no longer subject to the special mandatory redemption provision relating to the consummation of the Merger contained in the indenture (the "Indenture") relating to the Notes."

Witness Responsible: Craig L. Jackson