BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc., for an Increase in Electric Distribution Rates.	)))	Case No. 17-32-EL-AIR
In the Matter of the Application of Duke Energy Ohio, Inc., for Tariff Approval.	)))	Case No. 17-33-EL-ATA
In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods.	)))	Case No. 17-34-EL-AAM

DUKE ENERGY OHIO, INC.'S OBJECTIONS TO STAFF REPORT OF INVESTIGATION AND SUMMARY OF MAJOR ISSUES

On September 26, 2017, the Rates & Analysis Department and the Service Monitoring and Enforcement Department (jointly, Staff) of the Public Utilities Commission of Ohio (Commission) filed its Staff Report (Staff Report) in the above-captioned proceedings. Pursuant to R.C. 4909.19, O.A.C. 4901:1-1-28, and the Attorney Examiner's Entry dated September 28, 2017, Duke Energy Ohio, Inc., (Duke Energy Ohio or the Company) submits the following Objections to the Staff Report (Objections) and summary of major issues in which the Company specifically identifies areas of controversy with respect to certain findings, conclusions, or recommendations contained in the Staff Report, or the failure of the report to address certain items. Duke Energy Ohio reserves the right to supplement or modify these Objections in the event that the Staff makes additional findings, conclusions, or recommendations or modifies its position with respect to any finding, conclusion, or recommendation contained in the Staff Report. The Company further reserves the right to contest issues that are newly raised between the filing of the Staff Report and the closing of the record in these proceedings.

OBJECTIONS TO THE STAFF REPORT

REVENUE REQUIREMENT

(1) **Amount of Staff's Proposed Revenue Requirement.** Duke Energy Ohio objects to the revenue decrease range of $18,357,786 to $28,932,684 recommended by the Staff. Staff's proposed revenue decrease significantly understates the magnitude of the revenue requirement to which Duke Energy Ohio is entitled and that Duke Energy Ohio supported through its Standard Filing Requirements. As more specifically described in the following objections, Staff's recommended decrease results from unreasonable, unlawful, and erroneous adjustments that would yield rates that are insufficient to provide Duke Energy Ohio just compensation or an opportunity to earn an adequate return for providing safe, necessary, adequate, and reliable electric service for its customers.

(2) **Assessment Fees for Commission and Office of the Ohio Consumers' Counsel (OCC).** Duke Energy Ohio objects to Staff's removal of the Commission and OCC assessment fees from the gross revenue conversion factor. Staff's assertion that that "there is no direct, causal relationship between the revenues collected by a company and the amount that company is assessed" is confounding inasmuch as the calculation of each utility's share of these fees is, in fact, directly and causally dependent on its revenue. If a utility subject to these fees has more revenue, it necessarily gets a larger share of the Commission and OCC maintenance fees. Regardless of how much Commission and OCC maintenance fee is reflected in the test year, the fact that these fees will increase with increased revenue is a known and measurable change and the Company's revenue should be adjusted to account for this increased expense.

RATE BASE

(3) **Materials and Supplies.** Duke Energy Ohio objects to Staff's recommendation that no allowance should be made for the Company's investment in materials and supplies, simply because Duke Energy Ohio did not file a lead/lag study. Staff's recommendation unnecessarily confuses and is contrary to the plain language of R.C. 4909.15(A), which, in pertinent part, explicitly provides for a "reasonable allowance for materials and supplies *and* cash working capital as determined by the commission." (Emphasis added.) Although the Ohio Administrative Code does require that a lead/lag study be prepared to support a request for *cash working capital*, the Company did not ask for cash working capital. Nothing in the Commission's rules or in the Ohio Revised Code conditions inclusion of materials and supplies in rate base other than that it be based on a thirteen-month average balance of that account, as the Company has done in its Application.

(4) **Plant in Service.** Duke Energy Ohio objects to Staff's recommended adjustments to Leasehold Improvements. The Fourth and Walnut (Clopay) building and Holiday Park were used and useful as of June 30, 2016 – the date certain period in this case. In fact, they were used and useful for over a year subsequent to the date certain since the Company did not vacate the Clopay building until September 2017, when the lease expired. Staff's position is contrary to the provisions for valuing utility investment as prescribed in R.C. 4909.04. Staff's position is also inconsistent inasmuch as Staff ignored plant additions after the date certain that were known and measurable at the time of the filing but did not include these in the rate case.

The Company also objects to the amount of accumulated depreciation that Staff has adjusted due to the retirement of St. Clair substation. The reserve adjustment should be the same amount as the original cost. When assets are retired, the entry is to debit FERC Account 108 and credit FERC Account 101 for the original cost of the asset.

(5) <u>Capitalization of Employee Compensation.</u> The Company objects to the Staff's recommendation that "starting at the date certain of this case of June 30, 2016 and going forward, the Company follow the bonus pay expense accounting for all capitalized bonus pay." First, Staff's recommendation is abstruse insofar as it is alluding to an unknown policy when it refers to the "bonus pay expense accounting." Second, to the extent the Staff is recommending that the Company invoke Staff's proposal with respect to a portion of its incentive pay in test-year O&M expense, the Company would oppose any changes to its capitalization policy that has already been reviewed in numerous filings that have been approved by the Commission. Third, the Company's compensation policy, including incentive pay, is no more than necessary to attract and retain its workforce and, as discussed below, the Company objects to the Staff's recommendations regarding recovery of incentive compensation, whether capitalized or expensed. Finally, Staff's recommendation to invoke any change in policy retroactively to June 30, 2016, is impracticable.

(6) <u>Interest Synchronization.</u> Although Staff made numerous adjustments to the Company's proposed rate base, it made no adjustment to reflect the change in synchronized interest. It is simply not possible, mathematically, for rate base to change without a change in interest synchronization, all else being equal. Whether simply an oversight or an error in its model, Staff erred in not adjusting interest synchronization for its changes in rate base.

(7) <u>Depreciation Study</u>. The Company objects to the Staff's recommendation to file a new depreciation study within five years as it could require the Company to incur the cost of two separate depreciation studies within six years if the Commission accepts Staff's other recommendation as to Staff's recommended timing for the filing of its next electric distribution base rate case.

OPERATING INCOME

(8) Labor Expense. Duke Energy Ohio objects to Staff's recommended adjustment to the Company's labor expense. Staff's adjustment is unreasonable, arbitrary, and contradictory. Specifically, the Company objects to Staff's objections in the following respects:

- *Unreasonable*: An adjustment was made in Staff's Adjustment C-3.4 to reduce service company labor by $119,413 for merger-related costs to achieve. The Staff's adjustment removes this expense twice because it already removed the costs to achieve from the revenue requirement in Staff's Adjustment C-3.15.
- *Arbitrary*: Staff made no finding as to the legitimacy of the Company's labor expense and, instead, simply substituted its own arbitrary methodology to estimate the Company's test year labor expense for labor provided by affiliates. Also, Staff used inconsistent methodologies between various categories of expense for its own arbitrary adjustment.
- *Contradictory*: Staff acknowledges in its Staff Report that the Company's affiliate and service company allocation processes are reasonable and appropriate.[1] In making its recommendation for labor expense, however, Staff contradicts its assessment of the affiliate allocation processes by ignoring the very product of these processes. In its filing, the Company used actual labor allocated from affiliates for the twelve-month period ending November 30, 2016. This amounted to $4,911,505, as shown on Company's WPC-3.14d. Staff arbitrarily reduced this amount to $132,712. If the affiliate and service

[1] On page 12 of the Staff Report, Staff "finds that the same allocation methods proposed by the Applicant in the present proceeding are appropriate and reasonable for the purposes of this proceeding."

company allocation processes are reasonable and appropriate, then the labor expenses allocated to Duke Energy Ohio from those processes must be reasonable and appropriate; consequently, there is no need to contrive an arbitrary analysis to estimate test year labor expense.

(9) **Bonus Pay.** First, Staff's proposed adjustment is unclear as to what is meant by "bonus pay." Second, assuming "bonus pay" to mean "incentive compensation," Staff's proposal to eliminate incentive compensation unreasonably undermines Duke Energy Ohio's ability to compete for qualified labor. The Company's compensation policy is based on providing reasonable, comprehensive, market-based competitive compensation that benefits customers by enabling the Company to attract, retain, and motivate the employees needed to efficiently and effectively provide electric service to its customers. Staff fails to provide any explanation for its recommendation to exclude this important component of the Company's overall compensation. Staff's recommendation, instead, is simply based on a reflexive opposition to certain labor incentives, ignoring the importance of providing overall compensation plans necessary for the Company to reasonably compete in the market and ensure that it attracts and retains the employees necessary to provide safe and reliable distribution service.

In addition, the Company objects to Staff's oversimplification in its calculation. The Company has different incentive plans for different classes of non-union employees. The Company opposes Staff's adjustment to incentives in general but also objects to Staff's oversimplified assumption that the incentive pay formula is the same for all non-union employees.

(10) **Labor Expense for Energy Efficiency.** As it is legally required to do pursuant to the Ohio Revised Code, the Company excluded all revenue and all expenses related to energy efficiency from base rates, as such costs are fully recovered pursuant to a separate rider, Rider

EE/PDR. Staff recommends that labor costs, and apparently only labor costs, be removed from rider recovery and, instead, be recovered in base rates. The Company objects to Staff's recommendation, first, because it is contrary to Ohio law, R.C. 4928.65(A)(1) and R.C. 4928.6611, and, second, because the existing recovery mechanism is intentionally designed to address changes in costs.

(11) **Property Taxes.** The Company objects to the Staff's omission of all property taxes assessed to Duke Energy Ohio related to materials and supplies. Despite Staff's objection to allowing investors to earn a return on materials and supplies when the utility opts not to file a lead/lag study, the property taxes assessed by the Ohio Department of Taxation and paid by Duke Energy Ohio are actual, legitimate expenses and properly recoverable from ratepayers. Staff's recommendation is also inconsistent in its past recommendations related to property taxes on materials and supplies.

(12) **Public Service Awareness Campaign.** The Company objects to Staff's recommendation to exclude a proposal in the Application to provide funding for an important public awareness campaign. Staff's recommendation to exclude this cost from the revenue requirement will deprive customers of the benefits of the program. Furthermore, the rationale for Staff's recommendation, *i.e.*, that the costs were not incurred during the test year, is at odds with other recommendations made in the Staff Report. The Company's test year revenue requirement should include an allowance to fund this important campaign proposed by the Company.

(13) **Rate Case Expense**. Staff opposes the Company's request to recover its incremental costs for prosecuting its standard service offer (SSO) case. Staff fails to offer an alternative for the Company to recover a known, measurable expense necessary for the Company to successfully offer ALL distribution customers an SSO for generation service, as is required by Ohio law. The Company should be allowed to recover prudent and reasonable expenses for this mandatory activity.

(14) Overhead Lines Expense. Staff inexplicably adjusted test year expenses in Account 583100 by simply dividing the test year amount by five and excluding all of the test year expense above that result. Staff's adjustment is not only arbitrary and opportunistic, but it contradicts the provisions of R.C. 4909.15(A)(4), which state that the Company is entitled to recover the "cost to the utility of rendering the public utility service for the test period." Staff's adjustment effectively disallows costs that were actually incurred in rendering public utility service during the test period.

(15) Miscellaneous Flow-Through Model Adjustments. In addition to the adjustments mentioned above, Duke Energy Ohio further objects to the effect of these adjustments as they impact and flow through the revenue requirement model used by the Staff. Each of the aforementioned adjustments directly impacts other expenses in the model including pensions and benefits, payroll taxes, and various income and other tax calculations. Adjustments made and corrected must be carried through the models to accurately reflect the Company's operating expenses and ultimate revenue requirement.

RIDERS

(16) Distribution Capital Investment Rider (Rider DCI). The Company objects to Staff's recommendation that Rider DCI not be expanded to include distribution-related general, intangible, and common plant. Staff's recommendation undermines the Commission's goal of encouraging electric distribution utilities "to proactively and efficiently replace and modernize infrastructure."[2] Staff's recommendation is also unfair in that the Company's proposal aligns its

[2] See Commission's Opinion and Order in Case No. 14-841-EL-SSO, August 2, 2015, page 71.

Rider DCI with a similar distribution capital investment rider for another electric distribution utility.

The Company objects to Staff's proposed caps on revenues. Although the Company is willing to consider abiding by revenue caps, the caps proposed by the Staff are unreasonable and, importantly, contradict existing Commission orders[3].

The Company also objects to the Staff failure to recommend that the Company be allowed to recover the incremental cost associated with Staff audits of Rider DCI.

Finally, the Staff's recommendation regarding a requirement for filing the next electric base distribution rate case fails to address the implications on Rider DCI if the Company makes such a filing significantly sooner than May 31, 2023.

(17) **Battery Storage.** Staff's recommendation that the Commission reject the proposed modifications to Rider DCI has the potential to undermine the deployment of battery storage equipment on the Company's grid. Although it is likely that battery storage equipment would be included in distribution FERC Accounts (Accounts 360-374), it is possible that some or all of the plant could be recorded in other accounts. Staff's recommendation to potentially disallow rider recovery of battery storage equipment simply because it is recorded in non-distribution plant accounts undermines the potential for deploying this equipment.

(18) **Storm Costs and Storm Rider.** Staff proposes a reduction in test year expense for storm costs by reducing test year expenses by $1,921,812. Staff indicates that this adjustment is based on comparing the Company's proposed storm cost to the average of the prior five years. The Company is willing to accept this adjustment conditioned upon approval of its request to continue Rider DSR; however, Staff miscalculated the normalized expense by rounding down its calculated number, resulting in an exclusion of $25,017 from test year expense. Rounding the result of a

[3] *Id.*, at pg. 72.

calculation to the nearest $100,000 is not consistent with the level of detail Staff paid to other adjustments.

The Company also objects to Staff's recommendation to refund the accumulated balance for storm costs. The provisions of the existing Rider DSR, prescribed by the Commission in that Order, state that the Company will file to implement Rider DSR when the balance of the deferral exceeds $5 million.[4] The Company is willing to implement Rider DSR beginning with the date of new rates in this case but believes it would be more appropriate to include all distribution costs related to major storms in Rider DSR.

(19) **<u>Net Metering.</u>** The Company objects to Staff's proposal to include, in base "distribution" rates, an amount to "account for costs associated with net metering."[5] The payments for excess generation to net metering customers are for energy (*i.e.*, generation) provided by the customer-owner generators. The Company accounts for such payments as a generation expense; namely, in FERC Account 555, Purchased Power. Staff provides no explanation for including the cost of payments made for generation in base "distribution" rates, regardless of whether the generation at issue is a competitive or non-competitive service.

<u>RATE OF RETURN</u>

(20) **<u>Cost of Equity.</u>** Duke Energy Ohio objects to the rate of return on common equity (ROE) used by Staff in its cost-of-capital analysis because Staff failed to recommend the high end of its proposed range. Staff calculated a range for ROE of 9.22% to 10.24%. The Company presented testimony supporting a range of 10.0% to 10.70%, with a recommended ROE of 10.4%. The Staff's and the Company's ROE recommended ranges overlap from 10.0% to 10.24% suggesting that this is a reasonable range for the ROE to be used for establishing the Company's

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[4] *Id.*, at pg. 74.
[5] Staff Report, pg. 141.

base electric distribution revenue requirement.

RATES AND TARIFFS

(21) **Cost of Service and Allocation of Rate Increase.** Staff advocates for no change in the current customer charges based on a misinterpretation of the Company's cost-of-service study. Staff mistakenly believes that the Company calculated its proposed customer charges by dividing costs allocated to "demand" in the cost of service study by the number of bills. Staff is wrong in that interpretation. Only costs allocated to "customer" (*i.e.,* fixed costs) are used to calculate the customer charge. None of the costs allocated "demand" in the cost-of-service study was incorporated into the fixed customer charge.

The Company also objects to Staff's recommendation to leave the customer charge unchanged as it moves more cost recovery into volumetric rates than under current rates, contravening a prior Commission directive.

Duke Energy Ohio also objects to Staff's proposed allocation of its proposed revenue decrease. Although the Company objects to the Staff's proposal for an overall revenue decrease, Staff's proposal does not reduce the subsidy that Staff acknowledges is currently being provided to residential customers at the expense of all other rate classes. Compounding the subsidy/excess problem, Staff proposes to spread its proposed rate decrease evenly across all rate classes based on the Staff's proposed current distribution revenue.[6] Instead of closing the gap between those rate classes being subsidized and those rate classes paying excess, Staff's proposal widens the gap.

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[6] Based on Staff's updated Table 4, filed on September 26, 2017. The far right column of the updated Table 4 incorrectly calculate different percentage decreases for each class.

MANAGEMENT AND OPERATIONS REVIEW

(22) **Purchase of Accounts Receivable Program and Rider UE-GEN**. Duke Energy Ohio objects to Staff's proposal to modify its Purchase of Accounts Receivable (PAR) program and its uncollectible rider related to generation service, Rider UE-GEN. On page 53 of the Staff Report, Staff makes a number of recommendations related to the existing arrangement for purchasing receivables from competitive retail electric service (CRES) providers, including a recommendation for the Company to conduct a "comprehensive audit" of its purchase of receivables program when it makes its next annual filing for review of Rider UE-GEN. The Staff's proposal is being made in the wrong forum and, if adopted, may deprive many affected CRES providers an opportunity for due process. Issues and concerns related to the PAR program would be more suitably addressed in the pending SSO proceeding, where CRES providers are traditionally more active.

SUMMARY OF MAJOR ISSUES

(1) Staff's recommended revenue decrease.

(2) Staff's recommendations related to Rider DCI.

(3) Staff's valuation of Duke Energy Ohio's rate base and used and useful assets for providing retail electric distribution service to customers, including common plant and materials and supplies.

(4) Staff's adjustments to the level of operating expenses allowable for ratemaking purposes, including, but not limited to, the elimination of labor and labor-related adjustments, maintenance assessments, depreciation and amortization expense, and taxes.

(5) Staff's recommended rate of return on equity to be used in determining Duke Energy Ohio's allowable rate of return on rate base.

(6) Staff's proposal to exacerbate existing subsidization of the cost of serving residential customers.

(7) Staff's proposal to shift cost recovery for energy efficiency, peak demand response, and net metering from riders to base rates.

(8) Staff's proposed rate design.

(9) Staff recommendations relating to matters that are more appropriately addressed in the pending SSO case.

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CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that a copy of the foregoing Application and the accompanying Schedules in support were served on the following parties of record by first class, U.S. mail, postage prepaid or electronic mail delivery this 26th day of October 2017.

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