OCC EXHIBIT NO. ______

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. 17-0032-EL-AIR
In the Matter of the application of Duke Energy Ohio, Inc., for Tariff Approval.	))	Case No. 17-0033-EL-ATA
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods.	))	Case No. 17-0034-EL-AAM
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Modify Rider PSR.	)))	Case No. 17-0872-EL-RDR
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Amend Rider PSR.	)))	Case No. 17-0873-EL-ATA
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods.	)))	Case No. 17-0874-EL-AAM
In the Matter of the Application of Duke Energy Ohio, Inc. for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan, Accounting Modifications and Tariffs for Generation Service.	)))))))	Case No. 17-1263-EL-SSO
In the Matter of the Application of Duke Energy Ohio, Inc. for Authority to Amend Its Certified Supplier Tariff, P.U.C.O. No. 20.	))))	Case No. 17-1264-EL-ATA
In the Matter of the Application of Duke Energy Ohio, Inc. for Authority to Defer Vegetation Management Costs.	)))	Case No. 17-1265-EL-AAM

In the Matter of the Application of Duke Energy Ohio, Inc. to Establish Minimum Reliability Performance Standards Pursuant to Chapter 4901:1-10, Ohio Administrative Code.	)))))	Case No. 16-1602-EL-ESS

DIRECT TESTIMONY
OF
DAVID J. EFFRON

IN OPPOSITION TO THE JOINT STIPULATION AND RECOMMENDATION

On Behalf of
The Office of the Ohio Consumers' Counsel
65 East State Street, 7th Floor
Columbus, Ohio 43215-4213

June 25, 2018

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SCHEDULES

I. INTRODUCTION

A. QUALIFICATIONS

Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A1. My name is David J. Effron. My address is 12 Pond Path, North Hampton, New Hampshire 03862.

Q2. WHAT IS YOUR PRESENT OCCUPATION?

A2. I am a consultant specializing in utility regulation.

Q3. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.

A3. My professional career includes over 30 years as a regulatory consultant, two years as a supervisor of capital investment analysis and controls at Gulf & Western Industries and two years at Touche Ross & Co. as a consultant and staff auditor. I am a Certified Public Accountant and I have served as an instructor in the business program at Western Connecticut State College.

Q4. WHAT EXPERIENCE DO YOU HAVE IN THE AREA OF UTILITY RATE SETTING PROCEEDINGS AND OTHER UTILITY MATTERS?

A4. I have analyzed numerous electric, gas, telephone, and water filings in different jurisdictions. Pursuant to those analyses, I have prepared testimony, assisted attorneys in case preparation, and provided assistance during settlement negotiations with various utility companies.

I have testified in over 300 cases before regulatory commissions in Alabama, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky, Maine, Maryland, Massachusetts, Missouri, Nevada, New Jersey, New York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Virginia, and Washington.

Q5. ***PLEASE DESCRIBE YOUR OTHER WORK EXPERIENCE.***

A5. As a supervisor of capital investment analysis at Gulf & Western Industries, I was responsible for reports and analyses concerning capital spending programs, including project analysis, formulation of capital budgets, establishment of accounting procedures, monitoring capital spending, and administration of the leasing program. At Touche Ross & Co., I was an associate consultant in management services for one year, and a staff auditor for one year.

Q6. ***HAVE YOU EARNED ANY DISTINCTIONS AS A CERTIFIED PUBLIC ACCOUNTANT?***

A6. Yes. I received the Gold Charles Waldo Haskins Memorial Award for the highest scores in the May 1974 certified public accounting examination in New York State.

Q7. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A7. I have a Bachelor's degree in Economics (with distinction) from Dartmouth College and a Master of Business Administration Degree from Columbia University.

B. PURPOSE OF TESTIMONY

Q8. ON WHOSE BEHALF ARE YOU TESTIFYING?

A8. I am testifying on behalf of the Office of the Ohio Consumers' Counsel ("OCC").

Q9. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A9. On April 13, 2018, Duke Energy Ohio, Inc. ("Duke," "DEO" or "the Utility") filed a Stipulation and Recommendation ("the Settlement") with the Public Utilities Commission of Ohio ("PUCO"), which was signed and/or supported by certain parties to this case. Included in the Settlement is a provision implementing new base distribution rates effective June 1, 2018, or upon issuance by the Commission approving the Settlement, should that occur after June 1, 2018.[1] The purpose of this testimony is to address the development of the revenue requirement used to support the new base distribution rates, as it relates to the criteria used by the PUCO to evaluate settlements.

[1] Stipulation and Recommendation, Page 8.

Q10. PLEASE DESCRIBE YOUR UNDERSTANDING OF THE CRITERIA USED BY THE PUCO TO EVALUATE STIPULATIONS AND SETTLEMENTS.

A10. I understand that the PUCO uses the following criteria to evaluate the reasonableness of proposed stipulations/settlements:

1. Is the proposed stipulation a product of serious bargaining among capable, knowledgeable parties?
2. Does the proposed stipulation, as a package, benefit customers and the public interest?
3. Does the proposed stipulation violate any important regulatory principle or practice?

In addition to these three criteria, the PUCO also routinely considers whether the parties to a settlement represent diverse interests.

Q11. IS THE DEVELOPMENT OF THE REVENUE REQUIREMENT USED IN THE DETERMINATION OF THE NEW BASE DISTRIBUTION RATES SPECIFIED IN THE SETTLEMENT CONSISTENT WITH ALL OF THESE CRITERIA?

A11. No. Based on my review, the new base distribution rates under the Settlement would violate what I consider to be an important regulatory principle – namely that rates charged for the provision of regulated utility services should be based on a revenue requirement consistent with the costs of providing such services.

II. BASE DISTRIBUTION RATE REVENUE REQUIREMENT

Q12. DOES THE SETTLEMENT SPECIFY THE REVENUE REQUIREMENT FOR DISTRIBUTION SERVICE TO DUKE'S CUSTOMERS?

A12. Yes. Attachment D of the Settlement shows a revenue requirement of $467,776,000 for distribution service.

Q13. DOES THE REVENUE REQUIREMENT SPECIFIED IN ATTACHMENT D OF THE SETTLEMENT PROPERLY REFLECT THE UTILITY COST OF SERVICE THAT WILL BE INCURRED WHEN THE SETTLEMENT RATES GO INTO EFFECT?

A13. No. Based on the Gross Revenue Conversion Factor used to calculate the Revenue Deficiency (Excess), the $467,776,000 revenue requirement includes a federal income tax expense that is calculated using a federal income tax rate of 35%. The Tax Cuts and Jobs Act of 2017 ("TCJA") was signed into law in December 2017. Among other changes affecting the determination of federal taxable income subsequent to January 1, 2018, the TCJA reduces the corporate income tax rate to 21%. This change has a significant effect on the determination of federal income taxes and will impact the Utility's income tax obligation when the Settlement rates go into effect. The federal income tax is a substantial component of the total revenue requirement. As the Settlement revenue requirement of $467,776,000 includes federal income tax expense calculated at a rate of 35%, it is significantly overstated.

Q14. HAVE YOU CALCULATED THE EFFECT USING THE CURRENT 21% FEDERAL INCOME TAX RATE TO CALCULATE THE FEDERAL INCOME TAX EXPENSE INCLUDED IN THE UTILITY'S REVENUE REQUIREMENT?

A14. Yes. On my Schedule DJE-1, Page 2, I have calculated that, with a federal income tax rate of 35%, the Settlement revenue requirement includes federal income tax expense of $39,276,000, which takes account of current income tax expense and normalized deferred income tax expense. I have employed what is sometimes referred to as the "return" method to calculate the federal income tax expense included in the Settlement revenue requirement. I have relied on the net income requirement included in the Required Operating Income on Attachment D to the Settlement and the income tax calculation on Schedule C-4 of the Staff Report to make my calculations of the federal income tax expense included in the Settlement revenue requirement.

If the present federal income tax rate of 21% is used to calculate the federal income tax expense, the expense included in the Settlement revenue requirement is reduced by $15,710,000 to $23,566,000 (Schedule DJE-1, Page 1). That reduction to the federal income tax expense results in a reduction of $20,183,000 to the Utility's revenue requirement, from $467,776,000 to $447,593,000. If the revenue requirement used to calculate the Utility's new rates is not modified accordingly, the Utility's base distribution rates will not be based on its cost of providing service.

Q15. DOESN'T THE SETTLEMENT SPECIFICALLY ADDRESS THE TREATMENT OF THE TCJA?

A15. Paragraph 20 of the Settlement acknowledges that TCJA has reduced the federal income tax rate and that the Utility will realize net savings as a result of the TCJA. To address these net savings "The Signatory Parties agree that Rider DCI shall be calculated using the lower federal tax rates established under the TCJA as reflected in the pre-tax return to be used in the Rider DCI [Distribution Capital Investment] calculation described in Paragraph 4(a) of Stipulation Part III.E."[2] The Settlement recognizes that it does not fully reflect the savings to be realized by the Utility "because certain matters, such as the refund of jurisdictional excess ADITs [accumulated deferred income taxes], remain unresolved"[3] and further states that "It is the intent of the Signatory Parties to resolve all remaining issues concerning the impact of the TCJA, through Case No. 18-047-AU-COI, (the COI), a successor proceeding or some other proceeding."[4]

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[2] Stipulation and Recommendation, Page 25

[3] *Id.*

[4] *Id.*

Q16. DOES MODIFYING THE RATE OF RETURN USED IN THE DCI TO RECOGNIZE THE LOWER FEDERAL INCOME TAX RATE RECOGNIZE ALL THE BENEFITS OF THE TCJA OTHER THAN THE REFUND OF EXCESS ADITS?

A16. No. First, Rider DCI addresses eligible distribution plant, but not other elements of the distribution rate base. As of the date certain in Case No. 17-0032-EL-AIR, the distribution rate base was approximately $250 million greater than "Distribution Rate Base for Rider DCI" as of that date. Rider DCI does not address the reduced revenue requirement on the distribution rate base not covered by Rider DCI. The benefits of the lower tax rate associated with the return on distribution rate base other than net distribution plant are not reflected in Rider DCI.

Second, the Rider DCI includes specified caps on annual revenue increases. To the extent that these caps are reached, customers will not realize benefits in the form of lower rates attributable to the TCJA, because the capped Rider DCI revenues would then be the same as if there had been no reduction to the federal income tax rate.

Q17. DOES THE INTENT OF THE SIGNATORY PARTIES TO RESOLVE ALL REMAINING ISSUES CONCERNING THE IMPACT OF THE TCJA THROUGH THE COI OR SOME OTHER PROCEEDING MEAN THAT THE TCJA IS IRRELEVANT TO THE DETERMINATION OF THE BASE DISTRIBUTION REVENUE REQUIREMENT IN THE PRESENT CASE?

A17. No. The COI is certainly a useful forum to address matters such as the treatment of tax savings from January 1, 2018 until the time that permanent distribution rates can be reduced prospectively to reflect the income tax savings from the TCJA, the refund of excess deferred taxes, and other matters. However, we *know* that the income tax rate reduction in the TCJA reduces the base rate revenue requirement. As far as I can determine, there is no dispute among the parties to any of these cases that the full effect of the TCJA tax savings must be passed on to customers. Given that we know that the TCJA will result in tax savings and that we can calculate the effect of reduction to the income tax rate on the Utility's revenue requirement, I cannot think of any sound reason why this effect of the TCJA should be excluded from the determination of the revenue requirement used to establish permanent base distribution rates in Case No. 17-0032-EL-AIR.

The exclusion of the income tax savings due to the TCJA rate reduction from the determination of base distribution rates charged to Duke's customers violates the regulatory principle that rates for regulated utility services should be based on costs. Therefore, the PUCO should not approve the Settlement.

Q18. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A18. Yes.

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing *Direct Testimony of David J. Effron on Behalf of the Office of the Ohio Consumers' Counsel* was served via electronic transmission to the persons listed below on this 25th day of June 2018.

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

SERVICE LIST

Case No. 17-0872-EL-RDR et al.	
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Case No. 17-0032-EL-AIR et al.	
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mjsettineri@vorys.com glpetrucci@vorys.com talexander@calfee.com jlang@calfee.com slesser@calfee.com talexander@calfee.com mkeaney@calfee.com **Case No. 17-1263-EL-SSO et al.** Steven.beeler@ohioattorneygeneral.gov fdarr@mwncmh.com mpritchard@mwncmh.com mkurtz@BKLlawfirm.com jkylercohn@BKLlawfirm.com cmooney@ohiopartners.org Bojko@carpenterlipps.com dressel@carpenterlipps.com slesser@calfee.com jlang@calfee.com talexander@calfee.com mkeaney@calfee.com eakhbari@bricker.com nhewell@bricker.com paul@carpenterlipps.com whitt@whitt-sturtevant.com campbell@whitt-sturtevant.com glover@whitt-sturtevant.com rsahli@columbus.rr.com tony.mendoza@sierraclub.org **Case No. 16-1602-EL-ESS** Thomas.lindgren@ohioattorneygeneral.gov Elizabeth.watts@duke-energy.com	Bojko@carpenterlipps.com dressel@carpenterlipps.com mnugent@igsenergy.com swilliams@nrdc.org daltman@environlaw.com jnewman@environlaw.com jweber@environlaw.com rdove@attorneydove.com Jeanne.kingery@duke-energy.com Elizabeth.watts@duke-energy.com Rocco.dascenzo@duke-energy.com chris.michael@icemiller.com Mike.Mizell@icemiller.com Kay.pashos@icemiller.com Camal.Robinson@duke-energy.com charris@spilmanlaw.com dwilliamson@spilmanlaw.com lbrandfass@spilmanlaw.com mfleisher@elpc.org tdougherty@theOEC.org mleppla@theOEC.org joliker@igsenergy.com mnugent@igsenergy.com dborchers@bricker.com dparram@bricker.com mjsettineri@vorys.com glpetrucci@vorys.com mdortch@kravitzllc.com sean.mcglone@ohiohospitals.org

DUKE ENERGY OHIO, INC.
CASE NO. 17-0032-EL-AIR
EFFECT OF TCJA TAX RATE CHANGE
($000)

FIT @35% Under Proposed Rates, Excl. ARAM & ITC	(A)	39,276
Federal Income Tax Expense @ 21%	(B)	23,566
Reduction to Federal Income Tax Expense		(15,710)
Revised Revenue Conversion Factor	(C)	1.2847
Reduction to Revenue Requirement		(20,183)
Revenue Requirement per Settlement	(D)	467,776
Adjusted Revenue Requirement		447,593

Sources:
(A) Schedule DJE-1, Page 2
(B) FIT @35% Under Proposed Rates, Excl. ARAM & ITC * 21/35
(C) Schedule DJE-1, Page 3
(D) Stipulation and Recommendation, Attachment D

DUKE ENERGY OHIO, INC.
CASE NO. 17-0032-EL-AIR
FIT IN SETTLEMENT REVENUE REQUIREMENT
($000)

Rate Base	(A)		1,302,465
Equity Component	(B)		5.00%
Net Income Requirement			65,123
Permanent Differences	(C)		7,084
Deferred Tax Differences	(D)		472
ARAM, ITC	(C)		(615)
Taxable Income Base			72,064
Taxable Income	(E)	64.639%	111,488
State & Municipal Income Taxes	(E)	0.5556%	619
Federal Taxable Income			110,868
Federal Income Tax Expense		35%	38,804
Deferred Tax Difference	(D)		472
ARAM Adjustment and ITC	(C)		(615)
Net Federal Income Tax Expense			38,661
FIT @35% Under Proposed Rates, Excl. ARAM & ITC			39,276

Sources:

(A) Stipulation and Recommendation, Attachment D

(B)	Overall Rate of Return	7.54%	Stipulation and Recommendation
	Debt Component	2.54%	Staff Report, Schedule D-1
	Equity Component	5.00%	
(C)	Staff Report, Schedule C-4	(438+177)	
(D)	Staff Report, Schedule C-4		

			C-4 Actual	Difference
	Tax vs. Book Depreciation	69,042		
	Other Timing Differences	45,457		
	Total	114,499		
	Combined State & Local Tax Rate	0.5556%		
	Calculated Deferred Tax Expense	636	636	0
	Timing Differences less S&L Def Tax	113,863		
	FIT Rate	35%		
	Calculated Deferred FIT	39,852	40,324	472
(E)	Schedule DJE-1, Page 3			

DUKE ENERGY OHIO, INC.
CASE NO. 17-0032-EL-AIR
FACTORS

Operating Revenues			100.000%
Less:			
Uncollectible Accounts Expenses	0.5569%		
City of Cincinnati Franchise Tax	0.1000%		
Commercial Activities Tax	0.2600%		0.917%
Income before Income Tax			99.08310%
State Income Tax	0.0618%		0.06123%
Municipal Income Tax	0.4938%		0.48927%
Income before Federal Income Tax			98.53260%
Federal Income Tax		21%	20.69185%
Operating Income Percentage			77.84075%
Gross Revenue Conversion Factor			1.2846742

<u>Prior to Federal Tax Rate Change</u>

Combined State & Local Tax Rate	0.5556%
Federal Income Tax Rate	35%
Combined Rate	35.361%
Complement	64.639%

Source: Staff Report Schedule A-2