

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of Vectren)
Energy Delivery of Ohio, Inc. for Approval) Case No. 18-0049-GA-ALT
of an Alternative Rate Plan.)

In the Matter of the Application of Vectren)
Energy Delivery of Ohio, Inc. for Approval) Case No. 18-0298-GA-AIR
of an Increase in Gas Rate)

In the Matter of the Application of Vectren)
Energy Delivery Ohio, Inc. for Approval of) Case No. 18-0299-GA-ALT
an Alternative Rate Plan.)

**SUPPLEMENTAL DIRECT TESTIMONY
OF
JEFFREY P. HECKER**

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*

January 28, 2019

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On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 18-0298-GA-AIR, et al.*

1 **I. INTRODUCTION**

2

3 ***Q1. PLEASE STATE YOUR NAME, ADDRESS AND POSITION.***

4 ***A1.*** My name is Jeffrey P. Hecker. I am a Senior Regulatory Analyst with the Office
5 of the Ohio Consumers' Counsel ("OCC"). My business address is 65 East State
6 Street, 7th Floor, Columbus, Ohio 43215.

7

8 ***Q2. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND***
9 ***PROFESSIONAL EXPERIENCE.***

10 ***A2.*** I earned a Bachelor of Science Degree in Business with a major in Accounting
11 from Miami University in Oxford, Ohio, in May 1980.

12

13 After graduation, I worked as an accountant/analyst at The Dayton Power and
14 Light Company. From December 2004 until November 2017, I was a Utility
15 Specialist I and II with the Public Utilities Commission of Ohio ("PUCO") where
16 my responsibilities included auditing utility financing cases (such as Applications
17 to Issue Stocks/Securities) as well as base rate and rider cases.

18

19 I joined the OCC in January 2018 as a Senior Regulatory Analyst. My primary
20 responsibility at OCC is to assist in various regulatory proceedings before the
21 PUCO. These proceedings include rate cases, rider cases, cost of capital,
22 alternative regulation, and other types of cases filed by Ohio's regulated utilities.

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1 ***Q3. DID YOU FILE DIRECT TESTIMONY IN THIS PROCEEDING?***

2 ***A3.*** Yes. I submitted direct testimony on November 7, 2018. I will refer to that
3 testimony as “Hecker Direct Testimony.”¹
4

5 **II. PURPOSE**
6

7 ***Q4. WHAT IS THE PURPOSE OF THIS TESTIMONY?***

8 ***A4.*** The purpose of this testimony is to explain and support my recommendation that
9 the PUCO should protect consumers from the unjust and unreasonable rates that
10 result from the Stipulation and Recommendation (“Settlement”) filed on January
11 4, 2019, by Vectren Energy Delivery of Ohio (“Vectren” or “Utility”), regarding
12 the proposed rate of return on rate base that was referenced on Page 3 of the
13 Settlement. The Settlement states that “the revenue requirement reflects 7.48% as
14 a reasonable rate of return (“ROR”) on rate base.”² I believe this proposed rate of
15 return is unjust and unreasonable and the PUCO should reject the Settlement
16 because it violates the PUCO’s three-prong standard for reviewing settlements.
17 As I explained in my Direct Testimony, a range of 6.47% to 6.98% is a reasonable
18 ROR for Vectren in this proceeding.

¹ *In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Approval of an Increase in Gas Rates*, Case No. 18-298-GA-AIR, et al, Direct Testimony of Jeffrey P. Hecker (November 7, 2018).

² *In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Approval of an Increase in Gas Rates*, Case No. 18-298-GA-AIR, et al, Stipulation and Recommendation (January 4, 2019).

III. DISCUSSION OF THE THREE-PRONG TEST

***Q5. WHAT IS YOUR UNDERSTANDING OF THE THREE-PRONG TEST THAT
THE PUCO COMMONLY USES IN EVALUATING A PROPOSED
SETTLEMENT?***

A5. If a proposed settlement is to be considered, I understand that the PUCO typically analyzes a proposed settlement under a three-prong test. Specifically, the PUCO will consider the following criteria:

- (1) Is the proposed settlement a product of serious bargaining among capable, knowledgeable parties representing diverse interests?
- (2) Does the proposed settlement, as a package, benefit customers and the public interest?
- (3) Does the proposed settlement, as a package, violate any important regulatory principle or practice?

In this testimony, I will focus on the second and third prongs of the three-prong test.

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1 ***Q6. WHY DOES THE SETTLEMENT FAIL THE SECOND PRONG OF***
2 ***BENEFITTING CUSTOMERS AND BEING IN THE PUBLIC INTEREST?***

3 ***A6.*** The proposed settlement fails the second prong because the rate of return is
4 unreasonably high. Consequently, it does not benefit customers or the public
5 interest. If the proposed rate of return is too high, the resulting revenue
6 requirement to be collected from Vectren's customers would be unnecessarily
7 high and customers will be paying more for Vectren's gas service than is just and
8 reasonable.

9
10 As explained in the Hecker Direct Testimony, Staff and OCC calculated the rate
11 of return by using the capital structure (expressed as percentages of long-term
12 debt and common equity), the long-term debt rate, and the return on equity
13 ("ROE"). OCC's calculation of the ROR used the same capital structure and cost
14 of debt that were used by the Staff. The difference in the rate of return proposed
15 by the Staff and OCC lies in the different ROEs used by the Staff and OCC.

16
17 The PUCO Staff typically calculates the ROE by averaging the results from the
18 two common methods of estimating the ROE - the Capital Asset Pricing Method
19 ("CAPM") and the Discounted Cash Flow ("DCF") method.³ To calculate the
20 ROE, I accepted Staff's calculation of the DCF method as reasonable; however,

³ *In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Approval of an Increase in Gas Rates*, Case No. 18-298-GA-AIR, et al, Staff Report (October 1, 2018).

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1 my calculation of ROE using the CAPM method was different. In some past rate
2 cases (including the recently-completed Dayton Power and Light Company rate
3 case (PUCO Case No. 15-1830-EL-AIR et al.)) and other cases in which a ROR
4 was established, Staff and OCC used the same method of calculating the ROE,
5 which was based on a historical average of the daily 10-year and 30-year treasury
6 yields for a “risk-free” rate. However, for this case, Staff calculated the risk-free
7 rate by using a *forecast* of the 10-year Treasury Notes *and adding 50 basis points*
8 to produce a risk-free rate of 4.66%.⁴ This method is not supported by current
9 financial market conditions. Also, by averaging the 10-year and 30-year
10 treasuries, there is no reason to add an artificial adder to account for the historical
11 difference.

12
13 In its ROE calculation, Staff also factored in an unnecessary issuance cost of
14 3.5% (resulting in an adjustment factor of 1.01407). As also explained in the
15 Hecker Direct Testimony, this led to Staff’s ROE calculation of a range of 8.80%
16 to 9.81% and an overall ROR of 6.97% to 7.49%. OCC’s risk-free rate using a
17 one-year historical average of the two treasuries was 2.954%, which led to a
18 calculation of a ROE of 7.82% to 8.82% and an overall ROR of 6.47% to 6.98%.

⁴ *In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Approval of an Increase in Gas Rates*, Case No. 18-298-GA-AIR, et al, Staff Report (October 1, 2018).

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Q7. WHAT KIND OF EFFECT WOULD THIS UNREASONABLE RATE OF RETURN RECOMMENDED IN THE SETTLEMENT HAVE ON THE REVENUE REQUIREMENT TO BE COLLECTED FROM VECTREN'S CUSTOMERS?

A7. If the ROR is set at the stipulated rate of 7.48% in the proposed Settlement, this could cost residential customers approximately \$2.7 million to \$5.4 million more in base distribution revenue than if the PUCO determines that the ROR should be in OCC's recommended range of 6.47% to 6.98%. See table below:

| | OCC Low | OCC High | Settlement |
|--|----------------|-----------------|-------------------|
| Rate of Return | 6.47% | 6.98% | 7.48% |
| Rate Base | 622,297,988 | 622,297,988 | 622,297,988 |
| Return | 40,262,680 | 43,436,400 | 46,547,890 |
| Gross Revenue Conversion Factor | 1.2658228 | 1.2658228 | 1.2658228 |
| Grossed Up for federal income tax | 50,965,418 | 54,982,785 | 58,921,380 |
| Residential % | 68.06% | 68.06% | 68.06% |
| Residential RR | 34,687,064 | 37,421,283 | 40,101,891 |
| Difference between Settlement and OCC's recommended range. | 5,414,828 | 2,680,608 | |

It should be noted that this stipulated ROR of 7.48% and its associated ROE will be used in several riders that include a return on investment or rate base such as the Distribution Replacement Rider (DRR) and the Capital Expenditure Program

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1 (CEP) Rider. The use of an unreasonable and overstated ROR or ROE would also
2 unreasonably increase the rates, and the revenues, to be collected from VEDO's
3 customers for these riders. Because the ROR in the Settlement is too high,
4 producing an unreasonably high revenue requirement, the proposed agreement
5 harms customers and is not in the public interest.

6

7 ***Q8. HOW DOES THE PROPOSED SETTLEMENT VIOLATE ANY***
8 ***IMPORTANT REGULATORY PRINCIPLE OR PRACTICE?***

9 ***A8.*** State regulatory policy says that customers should not pay any more than is
10 reasonable for the Utility to cover expenses and earn a reasonable profit. If the
11 PUCO were to allow the ROR proposed in the Settlement be used in calculating
12 the base distribution revenue requirement and related riders, customers would be
13 paying more than reasonable rates for electric services.

14

15 Also, as explained in the Hecker Direct Testimony, in many past rate cases,
16 including the most recent rate cases, the PUCO authorized RORs that were
17 calculated based on current risk and financial market conditions and not based on
18 a future forecast or on projection of what might happen.

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1 **IV. CONCLUSION**

2

3 ***Q9. WHAT IS YOUR FINAL RECOMMENDATION?***

4 ***A9.*** As discussed in the Hecker Direct Testimony, customers shouldn't be expected to
5 pay any more than is just and reasonable to support the Utility's operations and
6 allow the Utility the opportunity to earn a reasonable profit. A more appropriate
7 rate of return, which I recommend being no greater than 6.98%, would
8 accomplish this regulatory directive. At the same time, the rate of return used in
9 any riders with a return on capital investments (or rate base) should be adjusted
10 accordingly. For example, the pre-tax ROR used in the CEP should be no higher
11 than 8.18% (vs. 8.81% proposed in Page 9 of the Settlement). Similarly, the pre-
12 tax ROR used in DRR cases should also be no higher than 8.18%.

13

14 ***Q10. DOES THIS CONCLUDE YOUR TESTIMONY?***

15 ***A10.*** Yes. However, I reserve the right to supplement my testimony if additional
16 testimony is filed, or if new information or data in connection with this
17 proceeding becomes available.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Supplemental Direct Testimony of Jeffrey P. Hecker on behalf of the Office of the Ohio Consumers' Counsel* has been served upon those persons listed below via electronic service this 28th day of January 2019.

/s/ William J. Michael

William J. Michael
Counsel of Record

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Summary: Testimony Supplemental Direct Testimony of Jeffrey P. Hecker in Opposition to the Joint Stipulation and Recommendation electronically filed by Ms. Jamie Williams on behalf of Michael, William Mr.