

**BEFORE**

**THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of Duke	)	
Energy Ohio, Inc., for Approval of an	)	Case No. 19-0791-GA-ALT
Alternative Form of Regulation.	)	

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

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On May 22, 2020, the Utilities and Service Monitoring and Enforcement Department (Staff) of the Public Utilities Commission of Ohio (Commission) filed its Staff Report of Investigation (Staff Report) in the above-captioned proceeding. Pursuant to R.C. 4909.19, O.A.C. 4901-1-28, and the Attorney Examiner's Entry dated May 27, 2020, 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 Staff 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**

### **(1) Removal of Fitness Room Costs.**

Duke Energy Ohio objects to the recommended removal of the costs associated with construction and outfitting of a fitness room in the Company's Eastern Gas Operations Center (Fitness Room).

The Staff Report "fully adopts" the Audit Report filed by Larkin & Associates PLLC (Larkin) in this proceeding on May 11, 2020 (Audit Report), including the recommendation therein that the costs for the Fitness Room be removed from CEP costs.<sup>1</sup> Staff provides absolutely no explanation of a rationale for excluding such costs. Larkin, in its Audit Report simply states that, "[i]n our view, the costs associated with the employee fitness center are not an appropriate use of ratepayer funds." Again, Larkin provides no rationale for its "belief."

Contrary to Larkin's suggestion and Staff's recommendation, maintaining employee fitness and health, whether through health insurance or preventive health measures such as yearly physicals, vaccinations, programs to encourage healthy behaviors, or convenient fitness equipment, is an entirely appropriate use of ratepayer dollars. Costs related to employee health care are regularly included in rates approved by the Commission. For example, neither Staff nor any other party in any of the Company's natural gas base rate cases for at least the last three decades<sup>2</sup> recommended disallowance of costs incurred by the Company to reduce overall healthcare costs. Similarly, the Company is not aware of the Commission disallowing recovery of costs for health maintenance for any other Ohio utility subject to its jurisdiction.

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<sup>1</sup> Staff Report, p. 7; Audit Report, p. 9-13.

<sup>2</sup> *In the Matter of the Application of The Cincinnati Gas & Electric Company for an Increase in Gas Rates in Its Service Area*, Case No. 92-1463-GA-AIR, *et al.*, *In the Matter of the Application of The Cincinnati Gas & Electric Company for an Increase in Its Rates for Gas Service to Jurisdictional Customers*, Case No. 95-656-GA-AIR, *et al.*; *In the Matter of the Application of The Cincinnati Gas & Electric Company For an Increase in its Gas Rates in its Service Territory*, Case No. 01-1228-GA-AIR, *et al.*; *In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Gas Rates*, Case No. 07-589-GA-AIR, *et al.*; *In the Matter of the Application of Duke Energy Ohio, Inc., for an Increase in its Natural Gas Distribution Rates*, Case No. 12-1685-GA-AIR, *et al.*

Maintaining a healthy workforce has unquestionable benefits to both the Company and its customers. Besides the obvious benefit of simply having healthier employees, such programs serve to lower overall healthcare costs that are included in base rates, as well as lowering absenteeism and employee turnover and improving teamwork. The idea of discouraging utilities to invest in facilities that both encourage healthy behaviors by employees and lower overall healthcare costs that are ultimately recovered from customers is contrary to conventional ratemaking theory. Generally, regulators encourage utilities to invest in those assets that reduce overall costs. In effect, Staff is recommending that the Commission should actually discourage such investment. The Staff's proposal to disallow recovery of investment related to the Fitness Room and the exercise equipment located therein should be rejected, as these investments should be recoverable in rates, including the appropriate allocated costs through the CEP rider.

**(2) Exclusion of Certain Compensation Expenses.**

Duke Energy Ohio objects to Staff's recommendation to remove the earnings-based portion of incentive compensation and stock-based compensation, as suggested in the Audit Report.<sup>3</sup>

Just as with the Fitness Room issue, Staff provided no explanation of its recommendation; it simply adopted the Audit Report and called "attention" to Larkin's recommendation that these items be removed from recovery.

Larkin did provide its rationale for each proposed exclusion, but the explanations are unsound. With regard to incentive compensation that is tied to the Company's financial performance, Larkin posits that there are three reasons behind its decision:

- If financial goals are set properly, achieving the necessary performance should be self-supporting.
- The payouts for achieving financial goals can be distinguished from incentives based on improvements to quality of service, efficiency, or safety.

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<sup>3</sup> Staff Report, p. 7.

- The incentive to improve financial performance is not necessarily consistent with ratepayers' interests.<sup>4</sup>

With regard to stock-based compensation, Larkin argues:

- The cost of this compensation is incurred to improve the Company's financial performance for the benefit of shareholders, not to improve customer service or meet other service requirements.
- Objectives of maximizing shareholder value and minimizing costs to ratepayers are generally opposed to each other.
- Dividend are considered in the determination of the required return on common equity and stock performance is a component of shareholder return.<sup>5</sup>

All of these purported justifications can and will be proved incorrect. They should not serve as support for an exclusion by the Commission.

To the Company's knowledge, there is no prior instance where the Commission has excluded capitalized incentive pay from a natural gas distribution utility's capital recovery rider. All four major gas utilities in Ohio have filed for approval of CEP riders and external audits have been conducted in all of these cases. All of the gas distribution utilities have incentive programs tied to earnings<sup>6</sup> and, following Generally Accepted Accounting Principles (GAAP), each one would include a portion of incentives when it capitalizes labor to construction projects.

For instance, Columbia Gas of Ohio, Inc.,<sup>7</sup> (CGO) filed for its CEP Rider and has since updated its CEP Rider in annual filings. There was no recommendation from the Staff, the external auditor, or any intervenor filing objections suggesting that capitalized incentives should be removed from any of CGO's CEP investment. As recently as June 17, 2020, months after Staff made a recommendation to exclude capitalized incentives from Duke Energy Ohio's CEP Rider,

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<sup>4</sup> Audit Report, p. 9-9.

<sup>5</sup> Audit Report, p. 9-9.

<sup>6</sup> This is evident from a review of the Staff Reports in Cases No. 07-829-GA-AIR, 08-72-GA-AIR, and 18-298-GA-AIR (the most recent rate case for each of the other large natural gas utilities in Ohio), where Staff adjusted each utility's incentive pay to remove incentive pay related to earnings.

<sup>7</sup> *In the Matter of the Application of Columbia Gas of Ohio, Inc. for Approval of an Alternative Form of Regulation*, Case No. 17-2202-GA-ALT.

an external audit was filed in CGO's most recent update of its CEP Rider, without any mention of capitalized incentives.<sup>8</sup>

The East Ohio Gas Company d/b/a Dominion Energy Ohio (DEO) also has a pending application to implement a CEP Rider. Again, there has been no recommendation from Staff, the Auditor, or any intervenors filing objections in that case that capitalized incentives should be excluded from the CEP investment for recovery.

Finally, Vectren Energy Delivery of Ohio, Inc., (VEDO) also has a pending application to implement its initial Rider CEP.<sup>9</sup> In the Audit Report, filed on June 17, 2020, also months after the issue surfaced in Duke Energy Ohio's CEP rider, VEDO's Auditor made no recommendation related to incentive pay.

The four largest natural gas distribution utilities all have had riders to recover capital-related costs for many years. Such riders have been recovering amounts associated with accelerated main replacement programs, advanced metering, or other capital-related costs, yet the Company is unaware of any prior instance where Staff, an external auditor, or any intervenor recommended disallowance of capitalized incentive pay. Similarly, the Company is not aware of Staff or any intervenor recommending that capitalized incentive pay be removed from rate base in any prior base rate proceeding for any of the large gas distribution utilities. As recently as VEDO's base rate case, Case No. 18-298-GA-AIR, *et al.*, Staff only recommended disallowance of incentive pay related to earnings goals from operating and maintenance expense; Staff made no finding or recommendation whatsoever to exclude capitalized incentives, of any kind, from rate base.

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<sup>8</sup> *In the Matter of the Annual Application of Columbia Gas of Ohio, Inc. for an Adjustment to the CEP Rider Rate*, Case No. 20-49-GA-RDR, Audit Report (June 17, 2020).

<sup>9</sup> *In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Authority to Adjust its Capital Expenditure Program Rider Charges*, Case No. 20-99-GA-RDR.

There is no precedent for excluding capitalized incentives from rate base in base rate proceedings or in rider proceedings in any prior case for a major natural gas distribution utility. That Staff makes such a recommendation only in Duke Energy Ohio's CEP Rider proceeding but not in any other proceeding involving a gas utility, including cases contemporaneously pending before the Commission, is startling and is unfairly singling out Duke Energy Ohio. As consistency is one of the important hallmarks of utility regulation, it is difficult for the Company to comprehend why the Staff has consistently allowed capitalization of incentives but does not do so here.

Importantly, Duke Energy Ohio, like all of the major utilities in Ohio, provides compensation packages designed to recruit and retain the talent needed to provide safe, reliable, and efficient utility service. That compensation is what attracts and retains talented employees. While the combination of base pay, incentive pay, and fringe benefits may differ from utility to utility, it is the sum of all of these forms of compensation that a prospective employee weighs when deciding to accept a job or whether a current employee remains with the utility. In all cases, prospective and current employees look to the market to determine whether they are being fairly compensated. Dismissing the value of complete compensation packages by disallowing recovery of certain components of this compensation unfairly undermines a utility's ability to fully recover its actual cost to serve customers. Offering competitive compensation to employees, in whatever form, is a reasonable and legitimate cost of service that should be recoverable.

Regarding stock-based compensation, there is a continuing misconception about the nexus between shareholder interests and the cost of this form of compensation. Compensation provided in the form of stock vests over time so that an employee must remain with the Company for a period of time in order to receive the actual benefit. If the employee leaves before the awarded

stock has fully vested, the employee forfeits this benefit. Consequently, stock-based compensation is almost exclusively intended to retain top level employees. The operating and maintenance expense associated with such compensation and the amount capitalized to plant is independent of the Company's earnings in a given year and is independent of the value of the stock. Once granted, the employee may see the value of his or her stock-based compensation appreciate or depreciate, over time, but the expense recorded on Duke Energy Ohio's books for the stock awards is a fixed percentage of employee's salary. Therefore, the Auditor is simply wrong in asserting that the cost of this compensation is related to the Company's financial performance for the benefit of shareholders. Stock-based compensation is a fixed amount, independent of financial performance, and is offered as an incentive to retain employees.

The earnings-based portion of incentive compensation and stock-based compensation should not be removed from the rate base included in the CEP rider.

**(3) Addition of Caps on Spending.**

Duke Energy Ohio objects to the imposition of caps on CEP rider adjustments, as well as the corresponding cap on CEP deferral authority as of calendar year 2019.

Staff has proposed that annual CEP Rider filings be set with fixed caps, starting the first year the rider is adjusted and continuing until the filing of the next natural gas base rate case. The recommendation is for the fixed cap to be set at no more than \$1.00 per year for residential customers.<sup>10</sup> In connection with that recommendation, Staff also proposes that the Company's deferral authority be capped, starting with calendar year 2019.

This proposal is not supported by Ohio law. Nothing in R.C. 4929.05 suggests that the Commission has the authority to impose a cap on a company's ability to take advantage of the alternative rate plan provisions enacted by the General Assembly. Indeed, the language of the

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<sup>10</sup> Staff Report, p. 8-9.

section states that the Commission “shall authorize” implementation of the plan, if the three enumerated conditions are met. It does not allow for partial authority. This problem is analogous to similar caps that the Commission attempted to impose on FirstEnergy’s recovery of certain costs. Finding no statutory authority for the Commission imposition of caps, the Ohio Supreme Court noted that the Commission has no ability to act beyond its statutory power and, therefore, reversed and remanded the case for approval without the cap on cost recovery.<sup>11</sup>

The proposal to cap deferrals and recovery starting in calendar year 2019 is also unjust and unreasonable, considering that 2019 expenditures and deferrals have already occurred. Indeed, although only half over, the expenses and deferrals for 2020 have either already occurred or are long since planned and underway. It is unreasonable to expect the Company to cap its work for those years. Thus, if the Commission were to impose caps, even though not allowed for under the applicable law, it should not start such caps until at least 2021.

It is also unreasonable, given the Commission’s interest in improving customers’ access to natural gas supply, to expect the Company to invest further in delivery infrastructure without the ability to obtain timely recovery of the investments.

Finally, in the event Staff or the Commission believes that imposition of these caps will put Duke Energy Ohio into a comparable position as other natural gas distribution utilities (LDCs) with CEP riders, that also is incorrect. All three of the other large LDCs have other riders available, through which they can obtain timely recovery of certain capital expenditures. Duke Energy Ohio, on the other hand, does not have additional riders through which to recover prudently incurred expenditures. Therefore, a larger portion of the Company’s costs qualify for recovery through the CEP program. The situations are not comparable. Staff’s recommendation would limit Duke Energy Ohio’s recovery of capital-related revenue requirements, while the other three

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<sup>11</sup> *In re Ohio Edison Co.*, 2019-Ohio-4196, 158 Ohio St.3d 27.



major LDCs will have caps more than double that amount, as they are recovering other capital-related costs in addition to the CEP Rider. Creating a “comparable” cap for Duke Energy Ohio would require adding up the caps for all other riders of the “comparable” group; otherwise, Staff is suggesting that the Commission compare an apple to an orange.

Because the recoverability of costs under R.C. 4929.05 is explicitly clear, the Commission should affirm that, to the extent imposing a cap limits the cash recovery of investments found reasonable and prudent under the Company’s CEP, full recovery is still allowed even if deferred for a future proceeding. Indeed, Staff is proposing “the annual CEP Rider should include a reconciliation and true-up mechanism for actual costs from the prior year.” To the extent caps are imposed on the CEP rider, actual costs from the prior year in excess of said caps would be included in this reconciliation and true-up mechanism.

## **SUMMARY OF MAJOR ISSUES**

- (1) The capital costs associated with the Fitness Room should be recovered through the CEP rider.
- (2) The earnings-based incentive compensation and stock-based compensation should be recovered through the CEP rider.
- (3) The caps on annual adjustments of the CEP rider and corresponding caps on deferral authority should be eliminated.

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## **CERTIFICATE OF SERVICE**

I, the undersigned, hereby certify that a copy of the foregoing Objections to Staff Report and Summary of Major Issues was served on the following parties of record by first class, U.S. mail, postage prepaid or electronic mail delivery this 22<sup>nd</sup> day of June, 2020.

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**Case No(s). 19-0791-GA-ALT**

Summary: Objection Objections of Duke Energy Ohio, Inc. to the Staff Report of Investigation and Summary of Major Issues electronically filed by Dianne Kuhnell on behalf of Rocco D'Ascenzo and Kingery, Jeanne W. and Duke Energy Ohio, Inc.