***OCC EXHIBIT NO. \_\_\_\_\_\_***

**before**

**the PUBLIC UTILITIES COMMISSION OF OHIO**

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| --- | --- | --- |
| In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc., for Approval of an Alternative Rate Plan. | )  )  ) | Case No. 18-0049-GA-ALT |
| In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc., for Approval of an Increase in Gas Rates.  In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc., for Approval of an Alternative Rate Plan. | )  )  )  )  )  ) | Case No. 18-0298-GA-AIR  Case No. 18-0299-GA-ALT |

**SUPPLEMENTAL DIRECT TESTIMONY**

**OF**

**RAPLH C. SMITH**

**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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# INTRODUCTION

q1. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS.

1. Ralph C. Smith. I am a Senior Regulatory Consultant at Larkin & Associates, PLLC, 15728 Farmington Road, Livonia, Michigan 48154.

q2. ARE YOU THE SAME RALPH C. SMITH WHO SUBMITTED DIRECT TESTIMONY ON BEHALF OF THE OFFICE OF THE OHIO CONSUMERS’ COUNSEL (“OCC”) IN THIS MATTER?

1. Yes, I am.

Q3 WHAT IS THE PURPOSE OF YOUR TESTIMONY?

1. The purpose of my testimony is to make recommendations to the Public Utilities Commission of Ohio (“PUCO”) regarding the Stipulation and Recommendation (“Settlement”) filed by Vectren Energy Delivery of Ohio, Inc. (“Vectren,” “VEDO,” or “Utility”), the PUCO Staff and others in this case on January 4, 2019. I recommend that the PUCO disapprove or modify the Settlement, with the result of a lower base rate revenue increase for customers to pay.

Q4. PLEASE SUMMARIZE YOUR OPINIONS REGARDING THE SETTLEMENT.

1. I recommend that the PUCO not approve the Settlement as filed. The proposed Settlement, as a package, does not benefit customers and is not in the public interest. Additionally, the package violates important regulatory principles and practices.

# CRITERIA FOR REVIEW

Q5. WHAT ARE THE PUCO’S STANDARDS OF REVIEW FOR EVALUATING PROPOSED SETTLEMENTS?

1. The PUCO uses three criteria for evaluating the reasonableness of a proposed settlement:
2. Is the settlement a product of serious bargaining among capable, knowledgeable parties?
3. Does the settlement, as a package, benefit customers and the public interest?
4. Does the settlement package violate any important regulatory principle or practice?

The PUCO also routinely considers whether the parties represent a diversity of interests.

# EVALUATION OF THE PROPOSED SETTLEMENT

Q6. WHO ARE THE SIGNATORY PARTIES TO THE SETTLEMENT?

1. The Signatory Parties are the PUCO Staff and Vectren, the City of Dayton, Ohio ("Dayton"), the Federal Executive Agencies ("FEA"), and Interstate Gas Supply, Inc. ("Interstate") (collectively, the “Signatory Parties”).

Q7. IN YOUR OPINION, DOES THE SETTLEMENT, AS A PACKAGE, BENEFIT VEDO’S CUSTOMERS AND THE PUBLIC INTEREST?

1. No.

Q8. WHY DOES THE SETTLEMENT NOT BENEFIT VEDO’S CUSTOMERS AND THE PUBLIC INTEREST?

1. If adopted, the Settlement will result in VEDO charging customers rates for gas distribution service that are unjust and unreasonable.

Q9. What amounts of revenue increase was requested by vedo and recommended by staff in staff's orgiinally filed comments?

1. In its filing dated February 21, 2018, VEDO requested a revenue increase to be charged to consumers of $34.02 million. VEDO proposed a return of 7.97%, which incorporated a Utility-requested return on equity (ROE) of 10.75%.

In its report dated October 1, 2018 ("Staff Report"), the PUCO Staff recommended two-revenue requirement ranges for VEDO. Staff recommended a "lower bound" revenue increase of $12.09 million. In addition, Staff also recommended an "upper bound" revenue increase of $16.19 million, using a recommended rate of return of 7.49%.

Q10. HOW HAS THE PUCO STAFF’S POSITION IN THE SETTLEMENT CHANGED FROM ITS POSITION IN FILED COMMENTS?

1. The Settlement provides that VEDO shall be granted a net base rate increase of $22.73 million. This is $11.3 million below VEDO's originally filed request. However, the Settlement base rate increase is $6.54 million or 40.4% above the $16.19 million Staff "upper bound" noted above. It is $10.64 million or 88% above the $12.09 million Staff "lower bound" noted above. The public interest is harmed by having a base rate revenue increase that exceeds the Staff Report upper bound which is already too high.

The Settlement produces a base rate increase that is too high by failing to reflect all of these proper recommendations from the PUCO Staff report.

Q11. does the Settlement violate the public interest in additional ways?

1. Yes. As described in my Direct Testimony, and as shown on Exhibit RCS-2, Schedule A, filed with my Direct Testimony, at a 7.82% ROE, I calculated a base rate revenue increase of $1.08 million and a revenue increase of $5.09 million at an 8.82% ROE. The Settlement provides for a base rate revenue increase of $22.73 million, which is unjust and unreasonable because it is too high to be in the public interest.

Q12. DOES THE SETTLEMENT VIOLATE ANY IMPORTANT REGULATORY PRINCIPLES?

1. Yes. The Settlement fails to establish an amortization period for the Utility's unprotected excess accumulated deferred income taxes ("EADIT") of five years or to reflect the impact of that amortization as a reduction to the Utility's base rate revenue requirement. Failure to establish an amortization period for the Utility's unprotected EADIT or to reflect that impact in determining Utility's base rate revenue requirement is not in the public interest because it results in a base rate revenue requirement that is too high. It also violates important regulatory principles by failing to use information that is known and measurable. Additionally, providing for rate treatment in a rider for an amortization that, once established will be occurring on a straight-line basis and will not fluctuate from year to year, violates an important regulatory principle of failing to recognize expense savings impacts in base rates for items that are known and measurable and which are not expected to fluctuate between Utility base rate cases. The Settlement should be modified to use an amortization period for the Utility's unprotected EADIT of five years and to reduce the base rate revenue requirement accordingly. The five-year amortization period for unprotected EADIT is representative of the Utility's rate case filing cycle.

Q13. How was the utility's eadit created?

1. As described in my Direct Testimony, the Tax Cuts and Jobs Act of 2017 ("TCJA") reduced the federal corporate income tax rate to 21% from 35 %. This reduction in the federal income tax rate has resulted in VECO having Excess Accumulated Deferred Income Taxes ("EADIT").

Q14. What are the utility's amounts of eadit?

1. VEDO's EADIT can be appropriately classified into "protected" (subject to Internal Revenue Code and TCJA normalization requirements, which prescribes using the Average Rate Assumption Model ("ARAM")) and "unprotected" (i.e., not subject to Internal Revenue Code or TCJA normalization requirements and thus subject to an amortization period or application to be determined by the PUCO). VEDO has identified protected EADIT of $57.465 million and unprotected EADIT of $20.080 million for total EADIT of $77.545 million.[[1]](#footnote-1)

Q15. What is provided for in the settlement concerning the utility's eadit?

***A15.*** The Settlement at page 12, paragraph 9, provides that the EADIT would be flowed back to customers through a Tax Savings Credit Rider ("TSCF").

***Q16****.* ***IS PART OF THAT TREATMENT APPROPRIATE AND CONSISTENT WITH IMPORTANT REGULATORY PRINCIPLES?***

***A16.*** Yes. The use of a TSCF to flow back the protected portion of the EADIT, which is based on the application of the ARAM, is appropriate because those amounts will fluctuate from year to year.

Q17. Should the unprotected eadit amortization be recognized in the utilty's current base rate proceeding, rather than in a rider?

***A17.*** Yes. The unprotected EADIT amortization should be on a straight-line basis, over a period of five years, and the amortization of the unprotected EADIT should be recognized in this rate case to reduce the revenue requirement. A rider is not needed for the amortization of unprotected EADIT because once the amortization period is set, the amounts of annual amortization will not fluctuate.

Q18. does the Settlement establish the amortization period for unprotected eadit?

***A18.*** No. Paragraph 9 of the Settlement provides that the annual amortization of "non-normalized" EADIT shall be addressed in a different proceeding, Case No. 19-0029-GA-ATA.

***Q19.*** ***IS FAILURE TO ESTABLISH AN AMORTIZATION PERIOD FOR UNPROTECTED EADIT IN THE CURRENT VEDO BASE RATE CASE IN THE PUBLIC INTEREST OR CONSISTENT WITH IMPORTANT REGULATORY PRINCIPLES?***

***A19.*** No, it is not. It would be in the public interest and consistent with regulatory principles to establish the amortization period for VEDO's unprotected EADIT in the current base rate proceeding and to reflect the impact of such amortization in establishing base rates for gas distribution service. That is because unprotected EADIT amounts are known and measurable now and should be passed back to consumers as part of the resolution of this case.

Q20. What amortization period should be used for vedo's unprotected eadit?

***A20.*** The amortization period for VEDO's unprotected EADIT is subject to the discretion of the PUCO. VEDO had proposed to amortize the unprotected EADIT over 30 years. Staff recommended that the unprotected EADIT be amortized over a period no greater than ten years. I continue to recommend that the unprotected EADIT be amortized on a straight-line basis over five years and flowed through the Utility's test year revenue requirement as a credit to income tax expense. I note that five years is also the Utility's proposed cycle for amortizing rate case expense[[2]](#footnote-2) and can thus be viewed as being consistent with the Utility's base rate case filing cycle. This approach benefits consumers and is in the public interest by returning the unprotected EADIT sooner than under Staff's and the utility's proposal. Reflecting known and measurable amounts of an amortization that, once established, would not fluctuate between rate cases, in determining a Utility's base rate revenue requirement is also consistent with important regulatory principles, whereas the failure to do so is not.

Q21. Should the amortization of the utility's unprotected eadit be reflected in determining the revenue requirement in this base rate case?

***A21.*** Yes. A special ratemaking tracking mechanism, such as the TSCR, is not needed for the unprotected EADIT amortization, which should be done on a straight-line basis over the recommended period of five years, corresponding with the Utility's rate case filing cycle. Failing to address and incorporate the amortization of unprotected EADIT in the current rate case would not be in the public interest. As noted above, because the amortization of the unprotected EADIT would be on a straight-line basis, the amortization amount would not vary from year to year. The amortization of unprotected EADIT can be reasonably determined in the context of the current Utility rate case, and thus should be reflected in the determination of the test year revenue requirement, not deferred into a different proceeding.

***Q22***. ***WHAT IMPACT ON INCOME TAX EXPENSE DOES AMORTIZATION OF THE UNPROTECTED EADIT HAVE?***

***A22.*** As shown on Exhibit RCS-2, Schedule C-1, which was filed with my Direct Testimony, amortizing the Utility's unprotected EADIT of $20.080 million over five years, and flowed through base rates results in a credit to income tax expense of $4.016 million. That income tax impact amount is grossed-up to determine the impact on the Utility's revenue requirement. Multiplying the $4.016 million income tax amount by the 1.2658228 revenue conversion factor indicates a reduction to the revenue requirement provided for in the Settlement of $5.083 million.

Q23. is the Settlement also contrary to the public interst AND RATEMAKING PRINCIPLES by ommitting the impact of an occ-proposed adjustment FOR INVESTOR RELATIONS EXPENSE?

***A23.*** Yes. Investor Relations is a term that describes the division of the Utility that is devoted to responding to inquiries from shareholders and investors (or others) who may be interested in a Utility’s stock price or financial stability. In VEDO’s case, investor relations are a means by which the Utility's shareholders can receive and review information about the Utility for things such as capital spending and VEDO's ability to access debt and/or equity markets to finance such capital spending. As such, a significant portion of VEDO's investor relations expenses are for the benefit of the Utility's shareholders. Services provided by investor relations benefit shareholders and consumers and should be adjusted. The allowance for Investor Relations Expense should be 50% to provide for an equal sharing of such costs, and therefore provides an appropriate balance between the benefits attained by both shareholders and customers. As shown on Exhibit RCS-2, Schedule C-2, filed with my Direct Testimony, exclude 50% of the Utility's investor relations expense from the test year reduces VEDO's requested O&M expense by $96,143. For this reason, in addition to those identified earlier, the Settlement does not benefit customers and is not in the public interest. Consequently, it should not be approved by the PUCO.

Q24. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY IN OPPOSITION TO THE SETTLEMENT?

***A24.*** Yes, it does. However, I reserve the right to incorporate new information that may subsequently become available through outstanding discovery or otherwise. Additionally, I reserve the right to supplement my testimony if other parties submit new or corrected information in connection with this proceeding.

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing *Supplemental Direct Testimony of Ralph C. Smith 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

**SERVICE LIST**

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| --- | --- |
| [werner.margard@ohioattorneygeneral.gov](mailto:werner.margard@ohioattorneygeneral.gov)  [mjsettineri@vorys.com](mailto:mjsettineri@vorys.com)  [glpetrucci@vorys.com](mailto:glpetrucci@vorys.com)  [joliker@igsenergy.com](mailto:joliker@igsenergy.com)  [mnugent@igsenergy.com](mailto:mnugent@igsenergy.com)  [slesser@calfee.com](mailto:slesser@calfee.com)  [mkeaney@calfee.com](mailto:mkeaney@calfee.com)  [talexander@calfee.com](mailto:talexander@calfee.com)  [tony­\_long@hna.honda.com](mailto:tony_long@hna.honda.com)  [mfleisher@elpc.org](mailto:mfleisher@elpc.org)  [cmooney@ohiopartners.org](mailto:cmooney@ohiopartners.org)  Attorney Examiner:  [Gregory.price@puc.state.oh.us](mailto:Gregory.price@puc.state.oh.us)  [patricia.schabo@puc.state.oh.us](mailto:patricia.schabo@puc.state.oh.us) | [campbell@whitt-sturtevant.com](mailto:campbell@whitt-sturtevant.com)  [whitt@whitt-sturtevant.com](mailto:whitt@whitt-sturtevant.com)  [rust@whitt-sturtevant.com](mailto:rust@whitt-sturtevant.com)  [kennedy@whitt-sturtevant.com](mailto:kennedy@whitt-sturtevant.com)  [fdarr@mcneeslaw.com](mailto:fdarr@mcneeslaw.com)  [mpritchard@mcneeslaw.com](mailto:mpritchard@mcneeslaw.com)  [jstephenson@vectren.com](mailto:jstephenson@vectren.com)  [Thomas.jernigan.3@us.af.mil](mailto:Thomas.jernigan.3@us.af.mil)  [Andrew.unsicker@us.af.mil](mailto:Andrew.unsicker@us.af.mil) |

1. These amounts are identified in VEDO's response to INT-4-117. [↑](#footnote-ref-1)
2. See page 15 (lines 21-24) of the Direct Testimony of Utility witness J. Cas Swiz. [↑](#footnote-ref-2)