

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of)
Duke Energy Ohio, Inc., for an) Case No. 12-1685-GA-AIR
Increase in Gas Rates.)

In the Matter of the Application of)
Duke Energy Ohio, Inc., for Tariff) Case No. 12-1686-GA-ATA
Approval.)

In the Matter of the Application of)
Duke Energy Ohio, Inc., for) Case No. 12-1687-GA-ALT
Approval of an Alternative Rate Plan)
for Gas Distribution Service.)

In the Matter of the Application of)
Duke Energy Ohio, Inc., for) Case No. 12-1688-GA-AAM
Approval to Change Accounting)
Methods.)

THIRD SUPPLEMENTAL TESTIMONY OF

WILLIAM DON WATHEN JR.

ON BEHALF OF

DUKE ENERGY OHIO, INC.

April 22, 2013

TABLE OF CONTENTS

	<u>PAGES</u>
I. INTRODUCTION.....	1
II. RIDER MGP	2
III. PRIOR DEFERRAL AUTHORITY.....	6
IV. CONCLUSION	12

I. INTRODUCTION

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is William Don Wathen Jr. and my business address is 139 East Fourth
3 Street, Cincinnati, Ohio 45202.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am employed by Duke Energy Business Services LLC (DEBS) as Director of
6 Rates and Regulatory Strategy for Ohio and Kentucky.

7 **Q. ARE YOU THE SAME WILLIAM DON WATHEN JR. WHO FILED
8 DIRECT AND SUPPLEMENTAL TESTIMONY IN THESE
9 PROCEEDINGS?**

10 A. Yes.

11 **Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?**

12 A. On April 2, 2013, the Company reached a Stipulation with all of the parties
13 agreeing to a number of provisions related to its overall request in this proceeding.
14 I described the Stipulation in my Second Supplemental Testimony, filed on April
15 2, 2013. Although the Stipulation settled most of the issues raised during the
16 proceeding, the Parties to the case agreed to litigate the recoverability of costs
17 incurred by Duke Energy Ohio for required environmental remediation associated
18 with the Company's operation of manufactured gas plants (MGP) that were
19 formerly used and useful in the provision of natural gas service to Duke Energy
20 Ohio's gas customers.

21 I will recommend a rider for the recovery of such costs and the
22 commensurate details associated with such a rider including cost allocation and

1 rate design. Finally, I will discuss the recoverability of such deferrals in light of
2 the Commission's prior orders.

II. RIDER MGP

3 **Q. WHY IS THE COMPANY PROPOSING TO ESTABLISH A NEW RIDER**
4 **TO RECOVER COSTS ASSOCIATED WITH REQUIRED**
5 **ENVIRONMENTAL REMEDIATION ASSOCIATED WITH ITS**
6 **FORMER MANUFACTURED GAS PLANTS?**

7 A. The Stipulation reached in this proceeding explicitly bifurcates the issues related
8 to the recovery of MGP costs. The Parties agreed to a \$0 overall increase in base
9 rates but specifically left the MGP cost recovery issue for litigation. There is an
10 expectation that there will be some amount of recovery related to MGP costs.
11 Insofar as there is no provision for recovery of such costs in the base rates that
12 were agreed to in the Stipulation, the Company is endorsing the Staff's
13 recommendation to create a new rider for recovery of allowed MGP remediation
14 costs.

15 **Q. WHAT COSTS WOULD BE INCLUDED IN RIDER MGP?**

16 A. The Company's Application in this proceeding included approximately \$65
17 million in MGP costs for recovery over a three-year amortization period. As of
18 March 31, 2012, the date certain in the case, the Company had actually spent
19 approximately \$45 million. The difference between the \$65 million in the request
20 and the \$45 million of actual spend as of March 31, 2012, represented the
21 projected spend for the balance of 2012 and carrying costs.

1 Because a rider is typically based on actual rather than projected costs, the
2 Company proposes to begin its recovery of Rider MGP costs based on actual
3 spend and associated carrying costs as of the end of the test period in this
4 proceeding.

5 The Company believes that all of the costs were prudently incurred and disputes
6 the Staff's argument that only costs incurred on plant that is "currently" used and
7 useful is recoverable from customers. Therefore, the proposed amount to initially
8 be recovered via Rider MGP is the balance at December 31, 2012.

9 **Q. DESCRIBE HOW THE COMPANY PROPOSES TO CALCULATE THE**
10 **RIDER MGP RATES.**

11 A. In order to avoid any rate shock, the Company proposes to amortize the costs over
12 a three-year period. Therefore, the initial Rider MGP will be designed in such a
13 way as to recover approximately \$20.9 million, annually (\$62.8 million divided
14 by 3 years). These figures include carrying costs.

15 The revenue requirement will be allocated between residential and non-
16 residential customers based on allocation factors agreed to in the Stipulation. The
17 allocation factors agreed to are 68.26% to RS/RFT/RSLI/RFTLI, 7.76% to GS/FT
18 Small, 21.68% to GS/FT Large, and 2.30% to IT.

19 Finally, the Company proposes to recover the allocated revenue
20 requirement on a "per bill" basis from all customers. The billing determinants to
21 be used in that calculation will be updated annually, along with the actual costs,
22 but for the initial Rider MGP, the billing determinants will be the same as those
23 agreed to in the Stipulation.

1 **Q. WHEN WILL RECOVERY OF THE RIDER MGP COSTS BEGIN?**

2 A. The Company will implement Rider MGP along with the other tariffs approved
3 by the Commission in these proceedings. Beginning March 31, 2014, and on or
4 before March 31 in each subsequent year, the Company will update Rider MGP
5 based on the unrecovered balance and related carrying costs as of the prior
6 December 31.

7 **Q. IS THE COMPANY REQUESTING TO CONTINUE DEFERRING COSTS**
8 **RELATED TO THE MGP REMEDIATION?**

9 A. Yes. The Company is requesting that the Commission continue to allow the
10 Company to defer costs associated with the required environmental remediation at
11 its former MGP sites.

12 The balance of the regulatory asset will be increased by additional deferrals and
13 carrying costs and decreased by the amount of revenue collected via Rider MGP.

14 **Q. IN HIS TESTIMONY, A WITNESS FOR THE OHIO CONSUMERS'**
15 **COUNSEL RECOMMENDED A CHANGE TO THE WAY THE**
16 **COMPANY ACCRUES CARRYING COSTS. WILL YOU EXPLAIN HIS**
17 **CONCERN?**

18 A. Yes. The Ohio Consumers' Counsel's (OCC) witness David J. Effron suggested
19 that the carrying costs be calculated on the balance of the regulatory asset less any
20 accumulated deferred taxes related to the regulatory asset.

1 **Q. DO YOU HAVE ANY COMMENTS ON MR. EFFRON'S**
2 **RECOMMENDATION?**

3 A. As a general rule, I agree that shareholders should only earn a return on their
4 actual cash investments. Deferring an actual expense, such as MGP remediation
5 expense, provides the Company an expense it can deduct for its current tax
6 expenses that, because of the Company's use of normalization accounting, will
7 not be reflected in rates until some future period. As an example, if the Company
8 spends \$1 million for MGP costs that it can defer, there will be an approximate
9 \$350,000 tax benefit in the year the deferral was taken. Because Ohio's
10 ratemaking standards follow normalization accounting, customers will not see that
11 tax benefit immediately. The upshot is that the Company's shareholders only
12 have \$650,000 of cash invested.

13 The Company is only accruing carrying costs at the most recently
14 approved debt rate; so, the benefit Mr. Efron is proposing is essentially the
15 deferred taxes on the regulatory asset times the debt rate.

16 Mr. Efron apparently did not recognize that the Company already
17 included in its rate base an offset for the ADITs associated with this regulatory
18 asset. It is the Company's understanding that the revenue requirements model
19 being sponsored by the Staff includes the impact of the ADITs associated with the
20 MGP deferral. Importantly, the inclusion of the ADIT in rate base provides an
21 even greater benefit to customers than Mr. Efron's proposal inasmuch as
22 customers are getting a benefit at the overall weighted average cost of capital
23 instead of the lower cost of debt.

1 If the Staff’s MGP-related revenue requirement calculation includes the
2 ADIT adjustment, the Commission should reject Mr. Effron’s proposal regarding
3 ADITs in the carrying cost calculation because the regulatory asset has already
4 been reduced by the ADITs. If the Staff’s MGP-related revenue requirement
5 calculation excludes the ADIT for the MGP costs, then the Company accepts Mr.
6 Effron’s proposal to only accrue carrying costs on the regulatory asset less any
7 associated ADITs.

8 **Q. WILL RIDER MGP MAKE ANY PROVISION FOR RECOVERY OF**
9 **MGP COSTS FROM SOURCES OTHER THAN RATEPAYERS?**

10 A. The Staff recommended that proceeds from any insurance policies be, at least
11 partially, credited against the total cost to recover from ratepayers. The Company
12 accepts this as a fair and reasonable proposal with the caveat that only proceeds,
13 net of costs to achieve those proceeds (e.g., litigation costs), be credited.

14 Also, to the extent the proceeds relate to any MGP costs that the
15 Commission disallowed, the Company is under no obligation to use these
16 proceeds to offset the Rider MGP revenue requirement.

III. PRIOR DEFERRAL AUTHORITY

17 **Q. HAS THE COMMISSION ADDRESSED THE ISSUE OF DEFERRING**
18 **MGP COSTS IN ANY RECENT CASES?**

19 A. Yes. In an order issued on September 24, 2008, in Case No. 08-606-GA-AAM,
20 the Commission approved a request made by Columbia Gas of Ohio, Inc.
21 (Columbia) to defer costs associated with “environmental investigation and
22 remediation costs in those situations where Columbia no longer owns the site in

1 question, or where the site is owned by Columbia but is no longer used and useful
2 in the rendition of gas service to customers.” (emphasis added).

3 Despite the fact that that property being remediated was no longer owned
4 by Columbia Gas and, consequently, could not be “currently used and useful,” the
5 Commission recognized that “these environmental hazards should be removed in
6 accordance with the applicable State and Federal standards and guidelines.” The
7 Commission further noted that Columbia Gas is the “party responsible for
8 removing the environmental and/or public health hazard.”

9 Significantly, the Commission approved the deferral authority requested
10 by Columbia Gas even though Columbia Gas and the Commission acknowledged
11 that the property at issue is no longer owned by Columbia Gas and is not currently
12 used and useful. Lastly, the Commission indicated that “recovery of the deferred
13 amounts will be addressed in Columbia’s next base rate case proceeding.”

14 **Q. IN YOUR OPINION, DID THE COMMISSION DETERMINE THAT**
15 **COSTS ASSOCIATED WITH PLANT THAT IS NO LONGER BEING**
16 **USED AND USEFUL BE DISALLOWED FOR RECOVERY?**

17 A. Absolutely not. Although I am not a lawyer, my reading of the Commission’s
18 Order in the Columbia Gas case unambiguously recognizes that the costs at issue
19 in that case related to property that was no longer even owned by Columbia Gas
20 much less currently “used and useful.” If the Commission’s standard for
21 recovering such costs was that the property had to be owned by the utility and
22 “currently used and useful,” the Commission would not have allowed the deferral
23 of costs in the Columbia Gas case.

1 Although the Commission did indicate that “recovery of the deferred
2 amounts” would be addressed in Columbia Gas’ next base rate case, no deferral at
3 all would have been authorized if the Commission’s standard for recovery was
4 that the property had to be currently owned and also used and useful. It would be
5 nonsensical for the Commission to grant the authority to defer such costs if at the
6 same time the standard for any future recovery was that such property had to be
7 currently owned and currently used and useful.

8 **Q. TO YOUR KNOWLEDGE, HAS THE COMMISSION STAFF ALSO**
9 **RECOGNIZED THIS ISSUE?**

10 A. Yes. On January 5, 2012, in the same proceeding, the Staff filed “Objections
11 Submitted on Behalf of the Staff of the Public Utilities Commission of Ohio”
12 (Staff Objections). Staff’s comments in these filed Objections are indicative of its
13 views, at least at that time, on the recoverability of MGP costs. Staff indicated
14 that it took no position regarding the ‘level or prudence of the environmental
15 remediation costs that Columbia” sought to defer and Staff reserved the right to
16 investigate and adjust any deferrals when Columbia seeks recovery of such costs.
17 Importantly, Staff goes on to acknowledge that “the intent of the Commission’s
18 original 2008 Entry was to allow creation of deferrals for environmental clean up
19 costs at sites no longer owned by Columbia or no longer in service. These costs
20 could not otherwise have been included in Columbia’s base rates due to the fact
21 that the sites are no longer used and useful in providing gas service to customers.”
22 (emphasis added).

1 At no time did the Commission or the Commission Staff declare that costs
2 associated with MGP cleanup costs are NOT recoverable because the property
3 being remediated was either no longer used and useful or no longer owned by the
4 utility. Just the opposite, the Commission and the Staff acknowledged that the
5 deferrals it authorized in the Columbia Gas case was for property no longer even
6 owned by Columbia Gas, much less currently being used and useful.

7 **Q. IF THE STANDARD FOR RECOVERY OF MGP COSTS WAS THAT**
8 **THE PROPERTY HAD TO BE CURRENTLY OWNED AND/OR**
9 **CURRENTLY USED AND USEFUL, WOULD THE COMMISSION HAVE**
10 **EVEN AUTHORIZED SUCH A DEFERRAL IN COLUMBIA'S CASE?**

11 A. It would be nonsensical for the Commission to allow deferral of costs that it
12 would knowingly disallow in the future. A deferral is granted when there is
13 assurance of recovery in the future and, typically, disallowances of any deferrals
14 occur when the Commission determines that some or all of the costs were
15 incurred imprudently. It would be contrary to standard regulatory policy for this
16 Commission or any regulator to allow for a deferral of costs knowing that the
17 circumstances for recovery of prudently incurred costs are not met.

18 **Q. WHAT IS THE STAFF'S POSITION IN THE CURRENT CASE?**

19 A. Although the Staff recognized in the Columbia Gas case that the intent of the
20 Commission's Order in that case was to address costs that could not be recovered
21 anywhere else but a base rate case, however in this case, the Staff recommends
22 that MGP remediation costs associated with plant that is no longer used and
23 useful be disallowed for recovery even if still owned by the Company.

1 **Q. IS STAFF'S RECOMMENDATION CONSISTENT WITH ITS PRIOR**
2 **POSITIONS OR WITH PRIOR COMMISSION DETERMINATIONS?**

3 A. No. As I stated above, it would appear, from the Orders in the Columbia case that
4 the Commission's intent, is to allow for recovery of such costs as there is no other
5 means of recovery. If the Commission's position was that there should be no
6 recovery of costs related to plant that is no longer owned by the utility or no
7 longer used and useful, it should not have allowed any deferral of MGP
8 remediation costs in the Columbia Gas case. Staff's statements in that case
9 clearly recognize the issues of ownership and the current use of the property, yet
10 it supported the deferral rather than opposed it insofar as it acknowledged the
11 intent of the Commission in establishing the deferral in the first place.

12 **Q. WILL YOU DESCRIBE THE CONSEQUENCES OF A COMMISSION**
13 **DECISION IN THIS PROCEEDING THAT COSTS RELATED TO THE**
14 **REMEDICATION OF FORMER MGP SITES CAN ONLY BE**
15 **RECOVERED IF THE PROPERTY AT ISSUE IS CURRENTLY OWNED**
16 **AND/OR IS CURRENTLY USED AND USEFUL?**

17 A. The consequences will be far reaching. For Duke Energy Ohio there will be a
18 significant write-off impacting earnings for 2013(assuming an order in this case is
19 received this year) and for future years as the accounting requirements to continue
20 deferring the costs at issue will no longer be supportable for a majority of these
21 costs. For accounting purposes, the creation of a regulatory asset for such
22 deferrals requires some assurance of future recovery and a finding by the
23 Commission that costs can only be recovered if they incurred for property that is

1 currently being used and useful would undermine any ability to defer such costs
2 in the future.

3 It is not possible to say for sure what the implications would be for other
4 companies but a Commission finding that MGP remediation costs related to
5 property that is currently owned and/or currently used and useful would most
6 likely impact Columbia Gas as well. Where Duke Energy Ohio at least owns the
7 property at issue, Columbia Gas does not even own the property for which it has
8 been deferring costs. If the property is not owned, it could not be currently used
9 and useful; therefore, Columbia Gas would ultimately have to write off 100% of
10 its deferral as well. Whether it continues to maintain the deferral or not, the
11 Staff's position, if adopted, means that none of the costs Columbia Gas has
12 deferred can be recovered in the future.

13 Importantly, utilities in Ohio rely on the findings in Commission orders.
14 The accountants and auditors for Duke Energy Ohio look to the Commission's
15 orders for an indication about the probability for future recovery of costs when
16 establishing deferrals. It would be contrary to precedent in previous years for the
17 Commission to issue orders regarding deferral of costs knowing that it would
18 never allow recovery of such costs. Consider the implication of the Staff's
19 recommendation in the current case on the Commission's Order in the Columbia
20 Gas case. If the Commission approved a deferral of a cost knowing all the while
21 that none of the costs at issue would ever be recoverable, the deferral authority
22 granted by the Commission is meaningless. No utility in the state could
23 reasonably rely on Commission decisions for establishing regulatory assets

1 insofar as there would be no trust in the validity of the Commission’s decision to
2 authorize such deferrals. That cannot be the case and the Commission certainly
3 could not have authorized a deferral in the Columbia Gas knowing that none of its
4 costs could be recovered.

5 Staff’s recommendation, if approved, would undermine the credibility of
6 Commission decisions authorizing such deferrals and impact the accounting
7 treatment accorded to such deferrals generally. The Commission must consider
8 the impact of such a decision if it declines to allow recovery for these MGP
9 deferrals.

IV. CONCLUSION

10 **Q. DOES THIS CONCLUDE YOUR THIRD SUPPLEMENTAL**
11 **TESTIMONY?**

12 **A. Yes.**