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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Investigation into the Development of the Significantly Excessive Earnings Test Pursuant to S.B. 221 for Electric Utilities	))))	Case No. 09-786-EL-UNC

INITIAL COMMENTS OF THE DAYTON POWER AND LIGHT COMPANY

I. INTRODUCTION

By entry dated September 23, 2009, the Commission directed that a workshop be conducted on the development of the significantly excessive earnings test (SEET) and that the Commission Staff file a report and recommendations for the SEET. The workshop was held October 5, 2009, and the Staff filed its recommendations on November 18, 2009. DP&L hereby respectfully submits its comments to the Staff's recommendations pursuant to entry dated November 19, 2009, which invited comments from interested parties.

As an initial matter, there are two fundamental principles set forth in the express language of the statute which are of critical importance, and which should anchor the discussion when considering each of Staff's recommendations. First, the SEET applies to adjustments made as a result of an electric security plan ("ESP") proceeding only. Second, the test is a significantly excessive earnings test.

Revised Code §4928.143(F) provides specifically:

> With regard to the provisions that are included in an electric security plan under this section, the commission shall consider, following the end of each annual period of the plan, if any such adjustments resulted in excessive earnings as measured by whether the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments

> for capital structure as may be appropriate. Consideration also shall be given to the capital requirements of future committed investments in this state. (Emphasis added).

Under the clear language of the statute, only the impact of incremental adjustments to rates made in the context of an ESP proceeding are subject to scrutiny under the SEET provisions of the Revised Code. The focus of what is actually subject to the SEET as enacted by the General Assembly is narrow, and the Commission must not broaden it in application. Further, in order for prospective adjustments to be made, the earnings must be found to be <u>significantly</u> in excess. Simply earning more than an allowed return on equity is not "significantly" excessive earnings. Inherent in the use of the modifier "significantly," is the notion that subjecting an entity to prospective rate adjustments should be an extraordinary measure occurring only in the rarest of circumstances.

Keeping these overarching principles in mind, DP&L respectfully submits specific comments to each of Staff's recommendations below.

II. <u>SPECIFIC COMMENTS</u>

1. Should off-system sales be included in the significantly excessive earnings test (SEET) calculation?

Staff recommends that off-system sales be included in the SEET calculation. DP&L respectfully disagrees. Off-system sales such as wholesale generation sales into PJM or MISO, or wholesale transmission, distribution, and/or generation sales to municipal power systems or rural electric co-ops have never been included in retail rates over which the Public Utilities Commission of Ohio (PUCO) has jurisdiction. Since the purpose of conducting the Significantly Excessive Earnings Test (SEET) is to determine if the ESP adjustments under the PUCO's jurisdiction result in excessive earnings for the regulated utility, it would be inappropriate to include non-jurisdictional revenues. Thus, the costs and revenues associated with off-system sales should be excluded from earnings in the SEET calculation conducted by the Commission.

If Staff proposal is accepted, and off-system sales are included in the SEET, this would have the effect of discouraging utilities to make off-system sales placing ratepayer interest and shareholder interest at odds.

2. Should the Commission determine SEET on a single entity basis or company-wide basis?

DP&L has no comment on this topic given it is a single entity utility.

3. What adjustments should be included in the SEET calculation?

As discussed above, adjustments should be made to remove off-system sales from the SEET calculation since those sales are not subject to PUCO jurisdiction. Other adjustments may include significant non-recurring adjustments that are related to regulated operations, such as out-of-period tax adjustments, adjustments for economic conditions or potential significant loss of load.

Consistent with ORC §4928.143 the cost of capital may be adjusted to consider "the capital requirements of future committed investments in this state," which DP&L believes would be treated as an increase to the common equity portion of the capital structure.

Also consistent with the ORC §4928.143, the revenues, expenses and earnings of any affiliate or parent company shall not be considered, directly or indirectly, in the SEET calculation.

4. What is the precise accounting definition of "earned return on common equity" that should be used?

DP&L agrees with Staff that "earned return on common equity" should mean net income divided by average common equity. However, DP&L suggests two changes: 1) net income less preferred dividends should be the starting point from which adjustments may be made, and 2) average common equity should be calculated using 13 monthly balances rather than the average of 12 calendar month balances. Including December of the previous year reflects the capital structure that was in place for the full calendar year.

5. What is the definition of "significantly in excess of the return on common equity"?

Significantly Excessive Earnings should be determined if a Company is earning more than two standard deviations beyond the average of the comparable companies. Based on the information provided by FE Witness Vilbert, two standard deviations would result in 2.3% of companies in the sample having earnings that fall outside of the range of reasonableness, and thus would truly be deemed "significantly" excessive.

Staff's suggestion of a 1.28 standard deviations beyond the mean suggests that 10% of the sample companies will fall outside the reasonable range, and thus be deemed to have significantly excessive earnings. DP&L respectfully disagrees, as this test is by definition a "significantly" excessive earnings test and thus should not apply to 10% of the companies each year.

Staff suggests that in tough economic times perhaps 200 basis points above the mean should replace the 1.28 standard deviation calculation. While DP&L agrees that the concept of tough economic times may result in a peer return of equity that is unreasonably low, DP&L believes that the appropriate backstop measure should be the utility's regulated return on equity established in its most recent rate setting proceeding before the PUCO, plus thirty percent. Again, the Significantly Excessive Earnings Test is by definition identifying "significantly" excessive earnings, not just excessive earnings. 200 basis points above the mean may still be below a utility's regulated return on equity. DP&L believes it is not reasonable for a utility to be deemed to have significantly excessive earnings if it is not earning well over its regulated return on equity.

6. How should companies "that face comparable business and financial risk" be determined?

DP&L agrees that the comparable group should vary on a case-by-case basis to reflect different company structures, business profiles and economic conditions.

7. How are "significantly excessive earnings" to be determined? (Located in the third sentence of Section 4928.143(F), Revised Code.)

See response to Question #8 below.

8. What does "in the aggregate" mean in relation to the adjustments resulting in significantly excess earnings?

Pursuant to ORC §4928.143 (E) and (F), and the intent of SB 221, as discussed in the legislature's Final Analysis of SB 221, the SEET only applies to the adjustments made by the ESP. As such, the components of the utility's standard offer that was approved by the Commission prior to the ESP, are not subject to the SEET. Per the Final Analysis on page 22, "the PUCO must determine if any price adjustments granted under the plan resulted in excessive earnings for the utility." And further only if "the adjustments, in the aggregate, did result in significantly excessive earnings, it must require the utility to return to consumers the amount of the excess by prospective adjustments," subject to the utilities right to terminate the ESP and file an MRO immediately.

The legislative analysis clearly provides that the SEET applies only to the ESP created adjustments to the standard service offer. Therefore, the phrase "in the aggregate" means that the adjustments to the standard offer should be looked at together, and not by each individual component.

9. How should the earnings of a comparable company be adjusted to compensate for the financial risk difference associated with the difference in capital structures?

Comparable companies may be adjusted on a case-by-case basis to take into account different capital structures consistent with ORC §4928.143 (E) and (F).

10. What mechanism should be employed to refund to customers the amount of the excess earnings?

ORC §4928.143 (E) and (F) mandate that any returns of excess earnings to customers must be made "by prospective adjustments." DP&L agrees with Staff's proposal that these prospective adjustments should be decided on a case-by-case basis. However, DP&L emphasizes that the statute does not characterize the adjustments as "refunds" and believes that any prospective adjustments from SEET represent prospective changes in charges associated with providing future electric services.

11. How should write-offs and deferrals be reflected in the return on equity calculation for SEET?

See response to Question #3 above.

III. CONCLUSION

DP&L appreciates the opportunity to provide comments with respect to the Staff's recommendations. For the reasons more fully explained above, DP&L respectfully requests that the Commission adopt DP&L's proposals in its development of the significantly excessive earnings test.

Respectfully submitted,

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Enclosed please find the signed participation agreement.

Please contact me if you have any questions or require any additional information.

Regards,

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