BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc., for an Increase in Electric Distribution Rates.	)))	Case No. 12-1682-EL-AIR
In the Matter of the Application of Duke Energy Ohio, Inc., for Tariff Approval.	)))	Case No. 12-1683-EL-ATA
In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods.	)))	Case No. 12-1684-EL-AAM

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

On January 4, 2013, the Utilities and Service Monitoring and Enforcement Departments (Staff) of the Public Utilities Commission of Ohio (Commission) filed its Staff Report of Investigation (Staff Report) in the above-captioned proceedings. Pursuant to R.C. 4909.19 and O.A.C. 4901-1-28, and the Attorney Examiner's entries dated January 10, 2013 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 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, conclusions, or recommendations 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.

<u>OBJECTIONS TO STAFF REPORT</u>

<u>REVENUE REQUIREMENT</u>

(1) **<u>Amount of Staff's Proposed Revenue Increase.</u>** Duke Energy Ohio objects to the revenue increase range of $37,168,986 to $46,166,385 recommended by Staff. Staff's proposed revenue increase significantly understates the magnitude of the increase to which Duke Energy Ohio is entitled and that Duke Energy Ohio supported through its Standard Filing Requirements. As more specifically described in the objections below, Staff's recommended revenue requirement range is based upon unreasonable, unlawful, and erroneous adjustments that yield rates that are insufficient to provide Duke Energy Ohio just compensation and an opportunity to earn an adequate return for providing safe, necessary, adequate and reliable electric distribution service for its customers.

<u>RATE BASE</u>

(2) **<u>Materials and Supplies.</u>** Duke Energy Ohio objects to Staff's recommendation that no allowance should be made for materials and supplies in rate base simply because Duke Energy Ohio did not file a lead/lag study. Staff's recommendation unnecessarily confuses and is contrary to the plain language of R.C. 4909.15(A), which in pertinent part, explicitly provides for a "reasonable allowance for materials and supplies *and* cash working capital as determined by the commission." (Emphasis added.)

Although the Ohio Administrative Code does require that a lead/lag study be prepared to support a request for *cash working capital*, nothing in the Commission's rules or in the Ohio Revised Code conditions inclusion of materials and supplies in rate base other than that it be based on a thirteen-month average balance of that account, as the Company has done in its Application.

(3) **<u>Plant in Service - Envision Center.</u>** Duke Energy Ohio objects to the Staff's recommendation to exclude the entire date certain investment related to the Duke Energy Envision Center. The only reasoning provided by the Staff for excluding this item was that it was a 'shared facility' and because the Company 'could not demonstrate how many customers were Ohio ratepayers.'[1] The Company's records do show that Ohio customers, industry professionals and the Commission itself have attended demonstrations at the Envision Center on multiple occasions, including during 2012. The fact that the Company does not record the service provider, residency, or other details for each participant should not be prohibitive in terms of recovering this cost.

<u>OPERATING INCOME</u>

(4) **<u>Base Revenue Adjustment.</u>** Duke Energy Ohio objects to the Staff's adjustment to the test year revenue based on an average consumption per customer methodology. Staff does not provide any meaningful justification for its adjustment. Duke Energy Ohio submitted an estimate of sales based upon three months of actual and nine months of forecasted data in accordance with R.C. 4909.15(C)(1). Duke Energy Ohio's estimates as provided in the Application were reasonable and should be the basis for revenues during the test period.

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[1] Staff Report at 5.

Staff also erred in calculating an annual average customer consumption level in that its calculation only considered actual data from the first nine months of the test year. Staff's analysis is flawed and biased in that it ignores the fact that customer usage varies each month. Staff's unreasonable assumption that the average consumption for nine months is representative of the average consumption for the remaining three months serves to unreasonably overstate the Company's test year base revenue.

(5) **<u>Depreciation Expense.</u>** Duke Energy Ohio objects to Staff's recommendation to amortize the depreciation of the Company's old meters over 7.25 years, rather than accelerate the depreciation as requested by the Company in these proceedings. Staff's adjustments are erroneous in two respects. First, Staff's adjustment includes equipment dollars not related to the legacy residential meters replaced as part of the grid modernization initiative. Second, even with respect to just the meters, amortizing these meters over a 7.25 year period, fails to recognize that all of those meters will be replaced and/or retired by 2015.

(6) **<u>Gross Revenue Conversion Factor.</u>** Duke Energy Ohio objects to Staff's calculation of the Gross Revenue Conversion Factor because, without providing any basis, Staff failed to include the Commission and the Office of the Ohio Consumers' Counsel (OCC) maintenance fees when calculating the Gross Revenue Conversion Factor.

(7) **<u>Property Taxes.</u>** Duke Energy Ohio objects to Staff's recommended adjustment to property taxes in that Staff failed to include any provision for property taxes on real property.

(8) **Labor Expense.** Duke Energy Ohio objects to Staff's recommended adjustment to the Company's labor expense. Staff's adjustment is unreasonable, arbitrary, illogical and fraught with error. Specifically, the Company objects to Staff's objections in the following respects:

- *Methodology*: Staff made no finding as to the legitimacy of the Company's labor expense and, instead, simply substituted its own new and arbitrary methodology to estimate the Company's test year labor expense.
- *Inconsistency*: Staff used inconsistent methodologies between various categories of expense for its own arbitrary adjustment.
- *Outside the Test Year*: Staff used actual data for 2011 to estimate a portion of labor expense without any adjustment to project labor expense for 2012, which, ignores the fact that 2012, not 2011, is the test year in the case.
- *Oversimplification*: Staff uses a snapshot of labor costs by selecting one pay period during the year to draw conclusions about the Company's labor expense for the entire year. This methodology is incapable of accurately capturing the changes in how shared employees allocate their time, which changes from week to week throughout the year.
- *Discriminatory*: Staff's methodology for calculating labor expense appropriately recognizes the fact that labor expense for Duke Energy Ohio should be reduced for labor performed by Duke Energy Ohio employees for affiliates. However, Staff unfairly ignores any labor expense allocated to Duke Energy Ohio from employees of its non-service company affiliates.

- *Contradictory*: Staff acknowledges in its Staff Report that the Company's affiliate and service company allocation processes are reasonable and appropriate. In making its recommendation for labor expense, however, Staff is contradicting its assessment of the affiliate and service company allocation processes by ignoring the very product of these processes. If the affiliate and service company allocation processes are reasonable and appropriate, then the labor expenses allocated to Duke Energy Ohio from those processes must be reasonable and appropriate; consequently, there is no need contrive an arbitrary analysis to estimate test year labor expense.

(9) Interest Synchronization. Duke Energy Ohio objects to the Staff's failure to account for a change in interest synchronization. Staff's rate base differed from the Company's proposed rate base but Staff made no recommendation to change the weighted-average cost of debt. The interest synchronization calculation applies the weighted-average cost of debt to rate base; therefore, if rate base changes and the debt rate does not, then the interest synchronization adjustment must change. Although it may be a clerical error, the interest synchronization adjustment in the Staff Report cannot be correct.

(10) Test Year Budget Adjustment. Duke Energy Ohio objects to Staff's recommended budget adjustments. Staff's proposed adjustment is arbitrary, unreasonable, and violates long-standing prohibitions on single-issue ratemaking. Staff opportunistically chose to adjust only five of the more than seventy individual accounts that make up the Company's operation and maintenance (O&M) expense by adjusting the test year to include actual data for the first nine months and a thirteen-month average of historical actual data for the last three months. Not surprisingly, the adjustments to the five accounts proposed by Staff served to significantly lower O&M expense and, consequently, unreasonably lowered the Company's revenue requirement.

Staff's adjustment is selective and results-driven by intentionally and deliberately not proposing a consistent adjustment for all accounts. Applying the Staff's methodology to all O&M accounts (as opposed to only portions of five accounts) reveals that there are increases to O&M expenses in other accounts that offset the decreases in the five O&M accounts that the Staff opportunistically selected to adjust. It violates traditional regulatory principles, not to mention any reasonable concept of fairness, to only address those adjustments that reduce revenue requirement, intentionally ignoring those adjustments that actually increase the revenue requirement under the same methodology. Staff must apply its logic consistently and either adjust all O&M accounts and sub-accounts to reflect updated actual 2012 expenses or, preferably, rely upon the reasonable data submitted as part of the Company's test year. Staff cannot arbitrarily select only a few of those accounts that serve to reduce the Company's expense and wholly ignore those that offset the reduction or add to expense.

Staff's proposed adjustments are inconsistent insofar as Staff uses different methodologies to arrive at its adjustments to the various accounts it chose to address.

(11) **Vegetation Management.** Duke Energy Ohio objects to Staff's exclusion of the Company's proposed incremental expenses for vegetation management, thereby reducing the Company's operational expense and thus the Company's revenue requirement in these proceedings. Staff provided no justification or explanation for this arbitrary adjustment. It is inconsistent for the Commission, on one hand, to require utilities to maintain comprehensive vegetation management programs and meet reliability target indices and, on the other, to allow Staff to arbitrarily eliminate reasonable funding requests for these programs.

(12) **Street Light Audit.** Duke Energy Ohio objects to the Staff's exclusion of the Company's proposed streetlight audit program. Staff did not offer any explanation to support its adjustment to eliminate this program and thus it is unreasonable and arbitrary and only serves to improperly and without justification reduce the Company's revenue requirement as supported in the case.

(13) **Maintenance Fees.** Duke Energy Ohio objects to the Staff's recommended adjustment to lower the amount of assessments for the maintenance fees charged by the Commission and the OCC. Staff's adjustment has a clerical error in that the formula excludes fees paid by Duke Energy Ohio to the Division of Forecasting.

(14) **Miscellaneous Flow-Through Model Adjustments.** In addition to the adjustments mentioned above, Duke Energy Ohio further objects to the effect of these adjustments as they impact and flow through the revenue requirement model used by the Staff. Each of the aforementioned adjustments directly impacts other expenses in the model including pensions and benefits, payroll taxes, income, and various income other tax calculations. Adjustments made and corrected must be carried through the models to accurately reflect the Company's operating expenses and ultimate revenue requirement.

DEFERRAL REQUEST

(15) **Storm Cost Deferral.** Staff failed to address Duke Energy Ohio's tracker proposal as part of the Company's base rate application. Specifically, the Staff failed to address the Company's proposal to establish a regulatory asset account to defer storm costs over a base amount to be established in the test year revenue requirement in these proceedings. The Company's proposal in these proceedings is similar to those already approved by the Commission and supported by the Commission Staff.

RATE OF RETURN

(16) **Cost of Equity.** Duke Energy Ohio objects to the cost of equity used by Staff in its cost of capital analysis because Staff failed to apply generally accepted methods for accurately estimating the cost of equity. Staff's recommended range of 8.82% to 9.84% with an overall rate of return of 7.19% to 7.73% is confiscatory and contrary to the *Hope* and *Bluefield Water* jurisprudence.[2] Staff's analysis contains numerous errors that result in an unreasonable and understated rate of return, including, but not limited to:

- Staff's Discounted Cash Flow analysis lacks statistical reliability as it relies on a very small sample of five companies and an understated flotation cost allowance.
- Staff's CAPM results are flawed and understate an appropriate Return on Equity (ROE) for Duke Energy Ohio because Staff: (1) employed an improper Risk-Free Rate; (2) used an incorrect market risk premium adjustment; (3) understated the flotation cost adjustment; and (4) failed to use an empirical CAPM adjustment.

COST OF SERVICE

(17) **Cost of Service.** Duke Energy Ohio objects to the Staff's apparent recommendation to move customers 66% towards full cost of service rates but at the

[2] *Federal Power Commission v. Hope Natural Gas Company,* 320 U.S. 591 (1944); and *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia,* 262 U.S. 679 (1923).

same time proposing revenues by class that are actually similar to the Company's proposed revenues developed using a 15% movement towards a cost of service.

<u>RATES AND TARIFFS</u>

(18) <u>Facilities Relocation Tariff (Rider FRT).</u> Duke Energy Ohio objects to the Staff's recommendation to eliminate the proposed Rider FRT. Staff lists several reasons why it believes the Rider should not be approved in these proceedings. Staff's concerns in this regard are misplaced, raise issues that are beyond the jurisdictional capabilities of the Commission to consider and, in some cases, are simply false. As such the Staff's justification in recommending a denial of approval for Rider FRT is unfounded.

SUMMARY OF MAJOR ISSUES

(1) The fair amount of revenue increase to which Duke Energy Ohio is entitled.

(2) The appropriate value of Duke Energy Ohio's rate base and used and useful assets for providing electric distribution service to customers, including common plant and materials and supplies.

(3) The appropriate level of operating expenses allowable for ratemaking purposes, including, but not limited to, the elimination of vegetation management, streetlight inspections, labor and labor related adjustments, maintenance assessments, depreciation and amortization expense, taxes, etc.

(4) The proper return on equity to be used in determining Duke Energy Ohio's allowable rate of return.

(5) The appropriate mechanism for dealing with excess storm costs.

(6) The appropriate rate design.

(7) The appropriate distribution of revenue increases among customer classes.

(8) The approval of several tariffs and tariff changes proposed by the Company.

(9) Cost responsibility for governmentally mandated transportation projects.

Respectfully Submitted

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and accurate copy of the foregoing document was served this 4th day of February 2013, by U.S. mail, postage prepaid, or by electronic mail upon the persons listed below.

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