DUKE ENERGY OHIO EXHIBIT_____

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc., for an Increase in Gas Rates.	)))	Case No. 12-1685-GA-AIR
In the Matter of the Application of Duke Energy Ohio, Inc., for Tariff Approval.	)))	Case No. 12-1686-GA-ATA
In the Matter of the Application of Duke Energy Ohio, Inc., for Approval of an Alternative Rate Plan for Gas Distribution Service.	))))	Case No. 12-1687-GA-ALT
In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods.	)))	Case No. 12-1688-GA-AAM

SUPPLEMENTAL DIRECT TESTIMONY OF

WILLIAM DON WATHEN JR.

ON BEHALF OF

DUKE ENERGY OHIO, INC.

__________ Management policies, practices, and organization

__________ Operating Income

__________ Rate Base

__________ Allocations

__________ Rate of Return

____X____ Tariffs

____X____ Alternative Regulation Plan

____X____ Other: Rate Case Drivers

February 25, 2013

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I. INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

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

A. I am employed by Duke Energy Business Services LLC (DEBS) as Director of Rates and Regulatory Strategy for Ohio and Kentucky. DEBS provides various administrative and other services to Duke Energy Ohio, Inc., (Duke Energy Ohio or Company) and other affiliated companies of Duke Energy Corporation (Duke Energy).

Q. ARE YOU THE SAME WILLIAM DON WATHEN JR. WHO PREVIOUSLY SUBMITTED DIRECT TESTIMONY IN THESE PROCEEDINGS?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL DIRECT TESTIMONY?

A. My Supplemental Direct Testimony will describe and support several of the Company's objections to certain findings and recommendations contained in the Report by the Staff of the Public Utilities Commission of Ohio (Staff) issued in these proceedings on January 4, 2013 (Staff Report). The Company filed its objections to the Staff Report on February 4, 2013.

II. <u>OBJECTIONS SPONSORED BY WITNESS</u>

Q. PLEASE EXPLAIN THE COMPANY'S OBJECTION NO. 1.

A. The Company's first objection to the Staff Report is that the revenue increase proposed therein understates the revenue increase to which the Company is entitled. The Company fully supported its case for an increase in revenue in its initial Application with expert testimony and supporting schedules. As will be discussed further in my Supplemental Direct Testimony and in the Supplemental Direct Testimony and Direct Testimony of other Company witnesses, Duke Energy Ohio is willing to accept a number of the adjustments proposed by the Staff; however, Staff's overall revenue requirement calculation significantly understates the costs incurred by the Company to continue providing safe and reliable natural gas service to its customers.

Many of Staff's recommended adjustments incorporate Staff-selected information that became available well <u>*after*</u> the filing of the Application in early July 2012. Staff's selectivity in this regard is inappropriate. At the time of the filing, Duke Energy Ohio's Application reflected a test year that the Public Utilities Commission of Ohio (Commission) found acceptable, and thus in compliance with Section 4909.15 of the Ohio Revised Code. The Company's test year included three months of actual data and nine months of budgeted data. In fact, the Commission issued its Entry in these proceedings on July 2, 2012, expressly approving the Company's proposed test year (calendar year 2012) and date certain (March 31, 2012). Then on August 29, 2012, the Commission issued another Entry, finding that the Application met the requirements of the

Commission's Standard Filing Requirements. Further, although I am not an attorney, budgeted data appears to be sufficient, under the plain language stated in R.C. 4909.15(C)(1): "the revenues and expenses of the utility shall be determined during a test period. The utility may propose a test period for this determination that is any twelve-month period beginning not more than six months prior to the date the application is filed and ending not more than nine months subsequent to that date." In other words, a utility must file *at least* six months of budgeted data in its test year. However, because of requirements concerning the pre-filing of notice of the application and the practical limits of preparing a case with historical data, utilities normally file applications with a test year with nine months of budgeted data. In these proceedings, the Company used actual operating income data for the period January 1, 2012, through March 31, 2012, and budgeted data for the period April 1, 2012, through December 31, 2012. For rate base valuation, the Company also used the latest date allowed (which is essentially also the latest practical date) for rate base valuation, of March 31, 2012.

Q. ARE YOU OFFERING ANY LEGAL OPINIONS AS TO HOW THE OHIO REVISED CODE OR OHIO ADMINISTRATIVE CODE APPLIES?

A. No. I am not a lawyer and, therefore, am not offering any legal opinion. I am, however, an expert in utility ratemaking. I am required, as part of my job, to interpret the rules as the apply to any application the Company makes for a rate case as my role in the Company is to oversee many of the technical aspects of our rate case development and prosecution. Therefore, my discussion about the requirements of the Ohio Revised Code and the Ohio Administrative Code reflects only my interpretation as an expert in utility ratemaking for the last twenty four years as well as through discussion with counsel.

Q. ARE THERE ANY SPECIAL RULES FOR GAS COMPANIES FILING FOR A RATE CASE AS THEY RELATE TO ADJUSTING TEST YEAR REVENUE AND EXPENSE?

A. Yes. There are a number of provisions in R.C. 4909 that apply to gas companies but not to electric companies. As it relates to adjusting the test year revenue requirement, the most relevant provisions are R.C. 4909.15(D) and 4909.191. R.C. 4909.15(D) provides instructions regarding adjustments to test year expenses that may be made by natural gas companies. R.C. 4909.191 refers to the adjustments made pursuant to R.C. 4909.15(D) and requires that, if the natural gas company proposed adjustments that were incorporated into base rates, then the utility is required to essentially update its rates to reflect the impact of any difference between the revenue and expenses that were adjusted in setting the rates and the "actual" revenue and expenses for those same items. The utility would then be required to adjust its rates, but only if the outcome of the update resulted in lower rates.

Another provision of R.C. 4909.191 applies to the use of projected data for rate base valuation but, as no party to the case, has made any proposal to use projected rate base, this is not an issue in this case.

Q. WHAT IS THE IMPLICATION OF THE SPECIAL RULES FOR NATURAL GAS COMPANIES IN LIGHT OF THE STAFF'S PROPOSED ADJUSTMENTS?

A. Again, the rules are pretty clear and, although I am not a lawyer, the plain meaning of the provisions of R.C. 4909.15 and 4909.191 is clear. The Company proposed a number of adjustments to test year expense and test year revenue. Staff modified a number of these adjustments as is described in my testimony and the testimony of other Company witnesses. However, if the provisions of R.C. 4909.191 are followed, then Staff's adjustments are redundant. By March 31, 2013, the Company is required to provide updated data for the adjustments it made to test year expenses and revenue and, if the impact of incorporating such actual expenses and revenue would result in a lower rate, then the Commission will adopt the actual data. The statute explicitly provides that the comparison of actual results to the test year amount is to the adjustments proposed by the Applicant, not those proposed by the Staff.

Q. DOES STAFF'S RECOMMENDED ADJUSTMENTS FOLLOW THE TEST YEAR PROPOSED BY THE COMPANY AND APPROVED BY THIS COMMISSION?

A. No, not consistently. Staff's recommendation replaces some but not all the Company's budgeted operating income data for April through December 2012 with *some* actual data learned well after the filing date. This is problematic on a number of fronts. First, and most importantly, and upon advice of counsel, there is no provision in the Standard Filing Requirements (O.A.C. 4901-7-01, Appendix

A) to that expressly requires or permits for such adjustments. Secondly, even if such substitution of actual data for projected data were expressly stated, Staff has inconsistently performed the substitution of data, in a manner that results in a biased outcome. More specifically, the selective substitution of data by Staff unfairly lowers the Company's overall revenue requirement. It is patently inequitable to only adjust some of the forecasted test year data to account for actual results, but not to adjust all of the forecasted data to reflect actual results. The test year concept enacted by Ohio's legislature, using a combination of forecasted data and historic data with a date certain, is a sound concept and should be followed by this Commission. Otherwise, to accomplish Staff's objectives, the governing statute, R.C. 4909.15 should be changed to require that test year revenue requirement be based on only historic test year actual expenses. It is an impossible expectation to require that expenses in a test year be based on only some known and measureable changes when the statutory requirements for filing a rate case require the use of "forecasted" data. At this time, there is no justification for the partial and selective substitutions recommended by Staff.

Q. DO YOU HAVE EXAMPLES OF THE ITEMS WHERE STAFF UPDATED FORECASTED DATA WITH ACTUAL DATA?

A. The objections to these specific issues are addressed in the testimony of other witnesses. Nevertheless, an overarching theme in the Company's objections is Staff's inconsistent and improper substitution of actual data for forecasted data. As described in its Staff Report, Staff updated the following test year operating income data with actual data, albeit with information that became available well after the Company could possibly have included it at the time of its filing. In all but one nominal instance, each of the adjustments selected by Staff served to reduce the Company's expenses and thus its overall revenue requirement, in complete isolation of any and all meaningful positive adjustments to recognize increases to the Company's expenses or revenue requirement:

- *Base revenue*: As discussed in the Supplemental Direct Testimony of James A. Riddle, Staff adjusted base revenue to reflect actual data through September 2012, using six more months of actual data than the Company could possibly have included in its test year.
- *Labor and Labor-related costs*: As discussed in the Supplemental Direct Testimony of Peggy A. Laub, Staff "annualized" the Company's test year labor expense by using actual data for a single pay period in August 2012. Notwithstanding all of the other labor and labor-related adjustments by Staff, to which the Company has objected, Staff's substitution of more contemporary actual data sets a standard that the Company cannot possibly meet given the constraints of the test year required limitations under standard filing requirements and R.C. 4909.15. At the time of the filing, the Company was able to use "actual" labor data for a full twelve-month period through April 2012 as its estimate of test year labor. The Company, therefore, complied with R.C. 4909.15 and fulfilled the objective of using the most contemporary data at the time of the filing.
- *Budget Adjustments*: As discussed in the Supplemental Direct Testimonies of Ms. Laub and Patricia W. Mullins, Staff selectively adjusted ten individual

cost items, (six total accounts), that are included in Duke Energy Ohio's test year expenses by using actual data through September 30, 2012. In doing so, Staff ignored the more than forty other accounts, not to mention the numerous sub-accounts that also make up the Company's test year expenses. Again, the Company's test year expenses in the filing were based on actual data through the latest possible date it could rely on. Staff's substitution of actual for budgeted data for the limited number of accounts, to the exclusion of all other actual results during the test period, is unreasonable and unfair in that it establishes a standard for using selective and arbitrary actual data that no utility could ever meet under the guidelines established in R.C. 4909.15.

In addition to these items, Staff also adjusted property tax expense; however, for this adjustment, Staff only adjusted property tax expense to reflect changes in the average tax rates that were learned in September 2012. Although the rate base upon which those updated property assessment rates also changed throughout the year, making it also a "known and measurable" change, Staff unfairly elected only to adjust the updated property tax rate and not the underlying property to which the rate is applied. To the extent property-related adjustments are going to be made, the adjustment methodologies must be consistently applied. Otherwise unfair and biased results will occur.

Based upon Staff's inconsistent and arbitrary adjustments, there are now multiple test periods being used by Staff to derive its recommended revenue requirement for Company.

Q. DOES STAFF SUGGEST ANY RATIONALE FOR MAKING SUCH SELECTIVE ADJUSTMENTS?

A. For the revenue adjustment reflected in the Staff Report, Staff provided no rationale, nor did it acknowledge that it made any updates for actual results. The concept of adjusting for actual expenses is not unreasonable insofar as it could make some sense to update the test year to reflect actual data. In fact, R.C. 4909.191 provides for limited adjustments to test year expenses once actual results for the full test period are known. The "reasonableness" of such adjustments, however, presumes such adjustments are fair, consistent, comprehensive, and complete. Staff's application of this concept of adjusting for actual expenses is unreasonable in that it updates only a few cost items for actual data but not all, although knowledge and measurability of ***all*** such cost items is available. If it is appropriate and allowed to update forecasted data used in the test year with actual data as it becomes available, then such adjustments must be fair, consistent, comprehensive, and complete. That is, Staff must adjust all operating income items rather than engage in selective and arbitrary adjustments intended to reduce the utility's ability to recover its costs and, consequently, undermine its ability to provide safe and reliable service.

Q. WHY DO YOU QUESTION THE APPROPRIATENESS OF SUCH ADJUSTMENTS TO THE TEST YEAR REVENUE REQUIREMENTS?

A. As I previously stated Ohio Revised Code, Section 4909.15(C)(1) provides the requirement for a utility to base its rates upon a test year that incorporates some level of actual and some level of forecasted data. The test period proposed by the

Company included three months of actual data and nine months of budgeted data and was approved by the Commission. The Company did not propose a test year comprised of more than three months of actual data and, as I suggested above, practically could not have proposed a test year with more actual data. Yet Staff is seeking to use essentially its own hybrid test year, or essentially multiple test years, with adjustments to select expense and revenue items reflecting inconsistent uses of actual information.

Furthermore, even though there are provisions in R.C. 4909.191 for updating test year results with actual data, those provisions only apply to updating the entire test year with actual results and, then, only for those adjustments proposed by the natural gas utility.

Q. ARE STAFF'S ADJUSTMENTS CONSISTENT IN THESE PROCEEDINGS?

A. No. Nor is it consistent with its prior positions. Staff has explained in a previous case that, in its opinion, the "process in a rate case is that projected data is filed and this *projected data is replaced by actual data as it becomes available*." Staff further states that the "standard filing requirements only contemplate replacement of forecasts with actual data." (Staff's Post-Hearing Brief in Case No. 07-551-EL-AIR, *et al*., page 17). Unfortunately, Staff's reference to the Commission's Standard Filing Requirements, which are contained in O.A.C. 4901-7, does not support the position that projected data in the test year must be replaced with actual data, and even the exception for natural gas companies is limited to updating only adjustments proposed by the Company and, then, only for the full year of actual results. The only reference to the notion of substituting actual data for forecasted data is Chapter II(5)(d) of the Standard Filing Requirements that refers to the projected test year data.

> "Projected test year data" - to comply with the statutory requirements regarding the test year, the utility may use estimated valuation data and up to twelve months of estimated operating income data in its application. However, <u>*if estimated valuation data and/or more than nine months of estimated operating income data is provided in the application*</u>, the utility must provide, within two months of the date of filing, actual valuation data and operating income statements which include no less than three months of actual data. The utility must also explain any material differences between the estimated and actual data. *(Emphasis added.)*

Importantly, even this provision of the Commission's rules does not apply to the filing made by Duke Energy Ohio as its test year operating income data was <u>*not*</u> based on more than nine months of estimated data and its rate base valuation is based on actual, rather than projected, data. Consequently, nothing in the Standard Filing Requirements expressly requires, supports, or compels Staff to update forecasted data in the Company's test year for actual data.

Q. ARE THERE ANY OTHER PROBLEMS WITH CONTINUALLY UPDATING THE TEST YEAR WITH ACTUAL DATA?

A. Yes. Besides the fact that the no statute or Commission rule expressly allows any such change until well after the full test period is complete,, there is also the problem with creating a moving target. The timing of filing, reviewing, and executing a rate case is a function not only of the requirements established in the Revised Code and the Ohio Administrative Code, but it is also a function of how quickly the Staff conducts its review and issues a report of its findings. A company files its case using a test period for establishing revenue requirement that necessarily includes a combination of forecasted and actual data. In recent rate cases involving other major electric and gas utilities, Staff has used actual data to make substitutions based on actual data all the way up to the end of the test period (see, for example, Staff Reports in Case Nos. 11-351-EL-AIR and 11-352-EL-AIR). In these recent cases, Staff adjustment apparently applied to all operating and maintenance expenses rather than just a select few.

In its Staff Report in these proceedings, Staff's use of actual data ranged from: 1) adjustments based upon 2011 actual expenses for one type of labor expense; 2) using original three months of actual data included in the Company's Application for many adjustments; 3) using nine months of actual data for updating (albeit incorrectly) base revenue; and 4) updating a select few expense items. Staff chose yet a different date on the calendar, a single pay period in August 2012, to (again, incorrectly) update the Company's proposed direct labor expense.

The randomness and inconsistency of Staff's use and interpretation of actual data is surprising given its own stated disdain for creating moving targets with actual data. In its Post-Hearing Brief filed in the FirstEnergy (FE) Operating Companies' most recent electric distribution rate case, Staff criticized and opposed FE's attempt to use a "date certain" other than what was provided for in the statutes and Commission's rules. In responding to FE's proposal to use valuations for certain rate base items other than the statutorily allowed date certain, Staff stated:

> "[T]he FE companies advocate using year-end or other, non-date certain values for assets. As noted, this is not permissible by statute. In addition to being good law, it is also good sense. The date certain is called that because it needs to be just that, certain. Rate base varies day in and day out. The only way it can be evaluated in a meaningful way is to take a snapshot. That is, to look at the values at a specific date. The FE companies would violate this concept and make it a date uncertain. They would apply selective adjustments when it is advantageous to do so. There is no end to this. If it is proper for the FE companies, it is proper for the intervenors. Everyone will argue valuations on whatever date helps their goals in the case. Consistency and thorough analysis will be lost in the Babel of competing values on various disjointed dates. (Staff's Post Hearing Brief in Case No. 07-551-EL-AIR, *et al*., page 4.)

This insightful reasoning has apparently been dismissed when it comes to Staff itself making adjustments to non-rate base items. Staff's observations in the FE proceeding are just as applicable to adjustments for non-rate base items as it is for rate base items. The statutes and the Commission's rules provide for a test year including the amount of actual and budgeted data that should be the basis for establishing the Company's revenue requirement. Staff should have no more right to randomly choose multiple and alternative bases for its revenue requirement calculation than the Company or any intervenor. By ignoring the test year data already filed in the case and substituting it with actual data at varying dates throughout the test year, Staff is engaging in the very action it deemed inappropriate in the FE case. Staff is inviting all intervenors to seek out the combination of actual and budgeted data that will most suit its case. The legislature obviously contemplated this when it incorporated R.C. 4909.191 which limits such adjustments to only a full year of actual data and only for adjustment to test year expenses and revenue proposed by the natural gas utility.

In this case, for example, Staff makes a number of adjustments to substitute actual data for budgeted data but, other than through Objections, the Company has little ability to challenge the Staff's sources, its assumptions, or its analyses. Staff is not required to defend its analysis until it files its own testimony shortly before the hearing.

Q. CONSIDERING THE COMPANY'S OBJECTION TO THE STAFF'S OVERALL REVENUE REQUIREMENT, HAVE YOU COMPARED THE STAFF'S PROPOSED TEST YEAR O&M EXPENSES TO ANY TREND IN THE COMPANY'S ACTUAL EXPENSES?

A. Yes. In Attachment WDW-SUPP-1, I summarized the O&M expenses for the Company's gas business for 2010 and 2011, and the O&M expenses proposed for the test year by the Company and the Staff including adjustments. A significant adjustment to the test year expense involves the Company's uncollectible expenses. To create an "apples to apples" comparison, I eliminated expenses in Account 904, Uncollectible Expenses from all columns. Also, the Company adjusted test year expenses for SmartGrid savings which the Staff corrected. Excluding any adjustment for SmartGrid and uncollectible expenses, it is clear that the Company's test year expenses are reasonable and appropriate. In fact, the Company's test year expense for 2012 is significantly lower than either of the prior two years. The table below is a summary of the total O&M (including labor) for the periods reviewed.

Period	Amount
2010	$91.1 million
2011	$93.1 million
2012	$89.2 million
Duke Energy Ohio 2012 TY	$88.2 million
Staff 2012 TY	$76.5 million

There is a striking difference between Staff's proposed test year O&M expense and the Company's actual O&M expenses for the two years prior to the test period and to the Company's actual expense for 2012, demonstrating that Staff's recommendation dramatically and significantly undervalued the Company's actual O&M expense. Included in Attachment WDW-SUPP-1 is a reconciliation of the difference between the Company's test year O&M expense.

The table above and the data in Attachment WDW-SUPP-1 clearly support the reasonableness of the Company's proposed test year O&M. At the same time, the historical trend in the Company's O&M expenses cast considerable doubt on the reasonableness of the Staff's proposed test year O&M expense.

Q. IN SUMMARY, ARE YOU SUGGESTING THAT THE COMMISSION SHOULD NOT ADJUST THE TEST YEAR DATA FOR KNOWN AND MEASURABLE CHANGES THAT OCCURRED AFTER THE COMPANY FILED ITS APPLICATION?

A. No. The Company is not suggesting that the Commission should never make such adjustments to "normalize" or "smooth out" costs or revenue items in the test year. Duke Energy Ohio recognizes the Commission has typically made adjustments based on information, *i.e.*, actual data, learned well after the date for which actual data was provided in a case. However, such adjustments must be done consistently, fairly, completely, and uniformly. Adjustments cannot be fairly made without considering *all* new information learned throughout the test year.

As an example, Staff may see that the actual amount for one expense item is ten percent lower than the amount included in the test year and make an adjustment because it believes actual history has proven the budgeted amount to be overstated. It is possible that every other expense goes *up* by one percent such that, even combined with the one significantly lower expense, the total expenses are higher or are the same as the amount originally included in the test year. If Staff just adjusts the one expense item that is conspicuously lower than the budget but fails to adjust the other items that are not as conspicuously higher, Staff will have unquestionably undermined the Company's ability to recover its cost of providing utility service, not to mention the opportunity to earn a fair rate of return.

Although the Company is willing to accept certain adjustments proposed by the Staff, especially, if those adjustments reflect a full year of actual data, the provisions of R.C. 4909.191 should only apply to adjustments proposed by the Company that are adopted by the Commission. The Company should not be required to update actual expense and revenue for the test year for those adjustments adopted by the Commission that were proposed by the Staff or any intervenor.

Q. PLEASE EXPLAIN THE COMPANY'S OBJECTION NO. 2.

A. Duke Energy Ohio objects to Staff's exclusion of materials and supplies from the Company's rate base valuation. Staff offers no assessment of the reasonableness or prudency of the amounts reported by the Company for materials and supplies as of March 31, 2012. Instead, Staff dismisses the Company's investment in materials and supplies because it inappropriately ties any investment in materials and supplies to a utility's cash working capital needs determined through a lead/lag study. Staff's adjustment to eliminate materials and supplies simply because the Company did not perform a lead/lag study is contrary to the plain language of R.C. Section 4909.15(A)(1) and its own rules, O.A.C. Rule 4901-7-01, Appendix A. In fact, there is no requirement that a lead/lag study is necessary for materials and supplies.

Q. DOES THE PLAIN LANGUAGE OF OHIO'S RATEMAKING STATUTES OR THE COMMISSION'S RULES SUPPORT A POSITION THAT INCLUSION OF MATERIALS AND SUPPLIES IS CONDITIONED UPON A UTILITY INCLUDING A LEAD/LAG STUDY FOR CASH WORKING CAPITAL?

A. Not at all. Although I am not a lawyer, I have more than twenty years extensive experience in utility ratemaking and in my capacity as Director of Rates and Regulatory Strategy for Ohio, I am familiar with the ratemaking statutes and rules in Ohio. It is very clear what the utility is allowed to include in rate base for materials and supplies, and for cash working capital. R.C. 4909.15(A)(1) provides in relevant part, as follows:.

> (1) The valuation as of the date certain of the property of the public utility used and useful or, with respect to a natural gas company, projected to be used and useful as of the date certain, in rendering the public utility service for which rates are to be fixed and determined. The valuation so determined shall be the total value as set forth in division (C)(8) of section 4909.05 of the Revised Code, and a reasonable allowance for *materials and supplies* and *cash working capital* as determined by the commission.

Contrary to Staff's prior position that there is some inexorable nexus between a Company's investment in materials and supplies, and its investment in cash working capital, the Revised Code is unambiguous – these are two different rate base items. Nothing in that statute suggests that a utility should be deprived of a return on its investment in materials and supplies if it does not perform a lead/lag study and asks for no return on *cash* working capital. The statute plainly states that the valuation of the utility's investment for rate base purposes "shall" include a "reasonable allowance" for (1) materials and supplies *and* (2) cash working capital.

If the statute was not clear enough, the Commission's own rules, and specifically O.A.C. 4901-7-01 Appendix A, further support the position that materials and supplies is a distinct rate base item from cash working capital.

> (E) Working Capital
>
> (1) Allowance for working capital (Schedule B-5)
>
> Provide a summary schedule showing the calculation of working capital included in the proposed rate base. Show each individual component and describe the methodology used to calculate each component. An allowance for cash working capital shall be supported by a recent lead-lag study. The recent lead-lag study must accurately represent conditions during the test period. A lead-lag study is defined as a procedure for determining the weighted average of the days for which investors or customers supply cash working capital to operate the utility.

(2) Miscellaneous working capital items (Schedule B-5.1)

> Provide, the test year average (thirteen months), and the date certain balances of items specified on Schedule B-5.1, if applicable, and reflected in the computation shown on Schedule B-5. Allocate the average and date certain balances to the jurisdiction using appropriate allocation factors.
>
> The information to be provided on this schedule for each item may be in a summary form, provided that the detail and calculation be included in working papers. These working papers shall be keyed to the appropriate item on the schedule and made available to the commission staff as specified in the "General Instructions," paragraphs (A)(8), and (C)(7) in Chapter II of this appendix.

Section (E)(1) unambiguously confirms that a request for a cash working capital allowance must be supported by a lead/lag study. The Company acknowledges this rule; it is not seeking *cash working capital*, and it did not develop or file a lead/lag study. It is equally clear that any determination regarding an allowance for cash working capital is independent of determinations regarding materials and supplies. There is no controlling language that requires a lead/lag study for an allowance for materials and supplies. If the Legislature intended for an allowance for materials and supplies to be conditioned upon a utility filing a lead/lag study, it would have said as much in the statute. Similarly, if the Commission interpreted the statute to create such a limitation, it could just as easily have approved language in O.A.C. 4901-7-1 to do just that. Neither the rules nor the statutes expressly exclude materials and supplies from the Company's rate base valuation, unless a lead/lag study is performed.

Q. DOES THE POSSIBILITY THAT THE CASH WORKING CAPITAL COULD BE NEGATIVE HAVE ANY BEARING ON THE AMOUNT MATERIALS AND SUPPLIES THAT SHOULD BE REFLECTED IN THE COMPANY'S RATE BASE?

A. No. Again, the Commission's rules and the Ohio Revised Code are unambiguous. A lead/lag study is only required if the Company is asking for an "allowance" for *cash working capital*. The only logical inference that can be drawn from this term is that it would be a positive number – it is equally inconceivable that a Company would "ask" for a negative allowance for a discreet rate base item, such as cash working capital. The term allowance implies that it is a positive number. In either event, a lead/lag study is only required for cash working capital and not for materials and supplies.

Q. ARE YOU AWARE OF ANY TIME STAFF HAS ALLOWED MATERIALS AND SUPPLIES IN THE VALUATION OF RATE BASE EVEN WITHOUT A LEAD/LAG STUDY?

A. Yes. Recently in Case No. 10-2929-EL-UNC, the Staff reviewed a revenue requirement calculation submitted by AEP Ohio regarding its cost to provide noncompetitive capacity service pursuant to its obligation as a Fixed Resource Requirement entity. As part of that review, Staff recommended a number of adjustments to AEP Ohio's revenue requirement calculation. Although AEP Ohio provided no lead/lag study to support its cash working capital request the Staff made no adjustment to eliminate the Company's materials and supplies balance from rate base. Staff recommended a $0 balance for cash working capital but allowed AEP Ohio to include its investment in materials and supplies in rate base. (See testimony of Ralph C. Smith on Behalf of the Staff of the Public Utilities Commission of Ohio, filed April 16, 2012, page 22).

It should be noted also that the Commission ultimately did, in its July 2, 2012 Order in that case, allow AEP Ohio to include materials and supplies in rate base despite the fact that it did not file a lead/lag study. Insofar as this case was fully litigated and not the result of any settlement, it would seem that the Commission has determined, after all, that it is *not* necessary to file a lead/lag study to include materials and supplies in the rate base valuation. The Commission's order in this case was very detailed regarding the elements of revenue requirement that it would and would not allow. Cleary, the Commission has considered the issue of whether a lead/lag study is needed in order to include materials and supplies in rate base and judged that requirement to be unnecessary.

Q. WHAT IS THE COMPANY'S RECOMMENDATION REGARDING MATERIALS AND SUPPLIES?

A. The Company recommends that the Commission ignore Staff's suggestion to exclude materials and supplies from its rate base valuation. Materials and supplies represent a known and measurable expense that the Company incurs. Furthermore, the Staff's recommendation is at odds with recent decisions made by the Commission on this very issue.

Q. PLEASE EXPLAIN THE COMPANY'S OBJECTION NO. 10.

A. Duke Energy Ohio objects to Staff's omission of expenses related to the Company's ongoing camera work. The rationale for this omission is explained the Staff Report:

> The Applicant adjusted test year operating expense to include additional AMRP camera inspection expense expected to be incurred in 2013. The Staff believes the amortization of the $5 million deferral as discussed above, provides sufficient revenue to complete and accelerate camera inspections of gas pipeline replacement work that occurred between 2001 and 2006. The Staff's adjustment removes the additional expense from the test year. The Staff's adjustment is shown on Schedule C-3.24.

Staff's rationale for excluding the item from the Company's test year revenue requirement is illogical. As Company witness Gary Hebbeler explains in his testimony, the Company has been performing this work for several years and this work is expected to continue. The ongoing costs are real and substantial, importantly, a fact not contested by the Staff.

Q. IS STAFF CORRECT THAT THE "AMORTIZATION OF THE $5 MILLION DEFERRAL PROVIDES SUFFICIENT REVENUE TO COMPLETE AND ACCELERATE CAMERA INSPECTIONS OF GAS PIPELINE REPLACEMENT WORK THAT OCCURRED BETWEEN 2001 AND 2006"?

A. Not at all. For the test year, the Company has a number of discrete expenses, such as salaries and wages, rents, and hundreds of other individual cost categories. Two of those cost items include the amortization of a Commission-approved deferral for expenses related to this camera work for periods prior to the test year. So, through the end of 2011, the Company incurred $5 million of camera work expense that it is seeking to recover in base rates. Amortized over three years, as proposed by the Company and as agreed to by the Staff, the Company's test year expense includes approximately $1.67 million just to recover the cost associated with work already performed in the past. In addition, the Company expects to spend $750,000 per year, going forward to continue this important inspection work to ensure the safety and reliability of its natural gas system.

Both of these items are "actual" expenses that will be incurred during the test year. Staff is recommending to the Company recover revenue in the amount of the amortization of prior, already performed, camera work expenses but not the expenses for the work going forward. The impact of Staff's adjustment is to knowingly ensure that the Company's test year revenue is insufficient to meet its costs. That outcome is unreasonable and unjust because it intentionally undermines the Company's ability earn a reasonable rate of return on its investment.

Staff's recommendation is based upon pure speculation about how long the amortization expense may be included in base rates and assumes it would persist long enough for the Company to also recover its costs for the ongoing camera inspection work. Neither the Company nor the Staff should make an adjustment, or dismiss an adjustment, based on expectations of costs and revenues more three years beyond the time when rates go into effect from this rate case. Staff's rationale for excluding the ongoing camera work is doing just that because it is relying on what its belief that revenue will be sufficient after three years to cover the costs of the ongoing camera work and, of course, this specious assumption means that Staff is speculating that the Company is fully recovering all other costs at this future period. Echoing sentiments expressed by the Staff itself, adjustments to test year revenue and expenses should be limited to known and measurable changes. Staff is excluding a known and measurable expense as it relates to the ongoing camera work expense because it is speculating about unknown and unknowable facts related to the amortization of prior camera work expenses. Such speculative adjustments cannot be made by any party.

Q. DO YOU HAVE ANY RECOMMENDATION REGARDING THE ONGOING CAMERA WORK EXPENSE?

A. The Commission should ignore the Staff's proposal to exclude ongoing camera work expenses as its proposal ignores known and measurable factors in favor of its speculation about future unknown and unknowable circumstances. If Staff is concerned about the potential for Company to over-recover its camera work deferral, the Company would be willing to include the amortization of this deferral in its Rider annual AMRP as long as there is no condition (*e.g.*, rate caps) in the Rider AMRP that jeopardizes the Company's ability to fully recover this deferral. In this event, base rates would include the ongoing expense and Rider AMRP would include recovery of the existing deferral.

Q. PLEASE EXPLAIN THE COMPANY'S OBJECTION NO. 16.

A. The Company objects to Staff's recommendation to reject the Company's proposed changes to its Reconnection Tariff. Staff provides a lengthy discussion of why it opposes the Company's proposal but fails to grasp the true implications of allowing the existing tariff to persist for the situation being addressed with the Company's proposal.

Q. PLEASE EXPLAIN THE SITUATION THE COMPANY IS TRYING TO ADDRESS WITH ITS PROPOSAL.

A. The Company's proposed change to the Reconnection Tariff only to limit the inappropriate transfer of cost responsibility from one group of customers to a different group of customers. The Company's proposal is not an attempt to penalize customers. Rather, it is merely an attempt to recover the Company's fixed costs to serve natural gas customers without unfairly allowing one group to subsidize another. Failing to address this issue allows a loophole to persist where some customers can game the Company's reconnection policy and deny the Company its ability to recover its costs to serve and, ultimately, transfer cost responsibility to those customers who cannot or will not take advantage of the existing loophole in the Reconnection Tariff.

Q. IF THE PROPOSED CHANGE IN THE RECONNECTION TARIFF IS NOT INTENDED TO BENEFIT THE COMPANY, WHAT IS THE PURPOSE OF THE CHANGE BEING PROPOSED?

A. It is a fundamental tenet of utility ratemaking that a utility should recover the cost of providing utility service from those who create a cost. The cost at issue in this case is the fixed cost of providing natural gas distribution service. As the Staff observed in a different section of the Staff Report, "most [gas] distribution-related costs are fixed." That notion is the very reason the Staff recommended, and the Commission approved, a significant change in rate design in the Company's most recent rate case, Case No. 07-589-GA-AIR, *et al*. This change resulted in the majority of the Company's costs to serve customers determined through a fixed monthly charge. It is important to understand that this monthly charge is based upon an annual revenue requirement.

Using the Staff's reasonable logic, and with which Duke Energy Ohio agrees, the cost of making gas service available to a customer is the same in July as it is in January whether the customer takes 1 cubic foot of natural gas through its meter or a 10,000 cubic feet through its meter – it is 'fixed' cost.

Without a reasonable obstacle to gaming the Company's tariffs, a customer who needs absolutely no gas during the summer can presently avoid paying the fixed costs for all those months when gas is not needed, simply by disconnecting service. Again, following the reasonable logic advanced by the Staff, the cost to make service available to that customer is the same for this customer as it is for another customer who, for whatever reason, does not turn off service during the summer. Regrettably, for the customers who cannot turn their service off in the summer, they will have to pick up the tab for the customer who is able to take advantage of what is effectively a loophole in the tariff.

Q. MR. WATHEN, CAN YOU PLEASE PROVIDE AN EXAMPLE TO EXPLAIN THIS TARIFF LOOPHOLE?

A. Yes. Assume there are two customers, Customer A and Customer B. Customer A uses gas only for heating and has no consumption for the months of May through September. Customer B also uses gas for heat but, in addition, has a gas water heater and a gas stove; so, this customer cannot practically "turn off" the gas service at any time during the year. Assume further that the total revenue requirement to own and operate the distribution service is $720 per year. As Staff astutely observes in its Staff Report, the cost to service both of these customers is fixed; so, following the Staff's logic, a fair distribution of the cost responsibility for the gas distribution service is $360 per year for each customer. If the rates for service are established assuming neither customer disconnects their service, simple math would suggest the Company should bill each customer $30 per month.

At some point, Customer A discovers that, if he disconnects his service during the months he has no need for gas, he can save $30 per month by avoiding the fixed bill. Since he knows he will not need gas from May through September each year, he can avoid the monthly bill for five months for a total savings of $150. He acknowledges that he will have to pay a small fee, $17 in Duke Energy Ohio's case, to reconnect his service but compared to the $150 he will avoid paying for the summer, it is a sensible thing to do. Unfortunately, the Company is now under-recovering its cost of service by $150; so, it must seek a rate increase to make up for this under-recovery.

The rate increase in this case would not even be for an overall increase in revenue. Instead, the Company essentially has to redesign its rates because instead of 24 bills (2 customers times 12 monthly bills), it will only have 19 bills (7 from Customer A and 12 from Customer B) over which to recover its cost of service. The impact of Customer A avoiding five monthly billing cycles now means that the per bill charge must be $37.89 per bill rather than the $30 per bill before the customer began avoiding the monthly bills during the summer. Admittedly, both customers will see an increase in their monthly bill but Customer A is still substantially better off while Customer B is worse off because he is paying for all of the savings being enjoyed by Customer A. And, the only reason Customer B suffers in this case is because Customer A is no longer paying his fair share of the cost of gas service. In this scenario, Customer B's bill will now be about $95 more per year so that Customer A can save $95 per year. This is a classic example of cross subsidization and it is the Company's proposal that this situation not persist.

Q. STAFF RAISED A NUMBER OF EXAMPLES WHERE IT THOUGHT THE CHANGE IN THE RECONNECTION TARIFF COULD UNFAIRLY IMPACT CERTAIN CUSTOMERS. ARE THE STAFF'S CONCERNS APPROPRIATE IN THIS MATTER?

A. No. The Company appreciates the Staff's concerns but all of the examples raised by the Staff are either not applicable to the circumstances being addressed by this tariff or, in some instances, just missing the point of the change being recommended to avoid the cross subsidization problem that currently exists.

Some examples raised by the Staff include gas service on college campuses, off-campus housing, apartments, and multi-unit dwellings. Most of the disconnection/reconnections that would come up in these scenarios are irrelevant to the issue being addressed in the Company's proposal. First, in any of the above examples where the actual customer is a non-residential customer, the issue is moot as the proposed change is only for residential customers. So, that element alone will obviate the Staff's concern with much of the service "on" a college campus or any other situation where the customer is anything but a non-residential customer. The only situation in the Staff's examples that would be at issue is where a customer is the landlord of an apartment dwelling (meaning the account is in the landlord's name) and disconnects service when a tenant leaves between May and September. If the landlord/customer maintains the account and reconnects again within a certain timeframe, then he would be subject to the terms of the new Reconnection Tariff. Staff seems to think this is unfair but, again, in light of the Staff's own assertion that gas distribution service is a fixed cost, the landlord in this case should be responsible for paying for all months that service was available to him, whether he turned the meter off or not.

In objecting to the proposed change to the Reconnection Tariff, Staff is essentially arguing against itself. If the cost of providing distribution service is fixed, as Staff and Duke Energy Ohio agrees it is, then no customer should be able to avoid their responsibility for paying such costs by 'voluntarily' disconnecting and reconnecting service. Staff's notion that customers should not have to pay their full cost of service is flatly at odds with the basic premise that costs are fixed.

Q. STAFF ALSO COMPLAINS THAT DUKE ENERGY OHIO ONLY PROVIDED TWO YEARS' WORTH OF DATA ON THIS ISSUE. IS THAT A REASONABLE BASIS FOR REJECTING THE CHANGE?

A. No. First of all, the last rates were set in May 2008 and this instant case was filed in July 2012 using actual data through March 31, 2012. So, in reality, there were only three years of data that could possibly have had any meaning. The move to mostly fixed bill for residential customers did not occur early enough in 2008 for customers to take advantage of the issue. This case was filed too early to see any evidence for 2012; so, the only summers that would have had data are 2009, 2010, and 2011. The Company had data for two of those years.

Staff argues that there is not enough data to see a trend. The only relevant trend that is needed to be known is that there are a number of customers taking advantage of this at the expense of ALL the customers who do not or who cannot turn their service off in the summer. Regardless of the trend, this subsidy between the customers gaming the Company's tariffs and those who do not must end. Any one of those customers who are unfortunate enough to be subsidizing the customers who can take advantage of this tariff situation may argue that the rates should be fair, just, and reasonable (as also suggested on page 22 of the Staff Report). The Company is only proposing to remedy that problem and eliminate this subsidy.

Q. ARE THERE ANY OTHER REASONS THE COMPANY IS PROPOSING THE CHANGE TO THE RECONNECTION TARIFF?

A. Customers typically do not ask for voluntary disconnections all at once. As the weather improves in the springtime, customers will decide when it is the right time to ask for the disconnection. So, essentially, the demand on the Company's resources is spread out somewhat. On the other hand, virtually all of these customers ask that their gas be reconnected at the first sign of cold temperatures. There are only so many trucks and crews available to the Company to safely do the work necessary for these reconnections. As the number of voluntary disconnection/reconnections grows, it becomes increasingly difficult to ensure that all customers are reconnected before gas is needed.

Eliminating the gaming potential of the existing Reconnection Tariff will ensure that the Company can satisfactorily and safely meet all of the 'normal' demand for reconnections in the winter. Left unchanged, the existing Reconnection Tariff creates a growing and unfair burden on the Company's resources.

Q. WHAT IS THE COMPANY'S RECOMMENDATION REGARDING THE PROPOSED CHANGES TO THE RECONNECTION TARIFF?

A. For all the reasons described above, the Company maintains its proposal to modify the Reconnection Tariff to ensure that the potential for one group of customers unfairly subsidizing another, and to ensure that the Company can avoid an unnecessary burden of having to reconnect so many customers at once.

III. CONCLUSION

Q. DO YOU HAVE AN OPINION REGARDING WHETHER DUKE ENERGY OHIO'S RATE REQUEST IS REASONABLE?

A. Yes.

Q. PLEASE STATE YOUR OPINION.

A. Duke Energy Ohio's rate request is fair and reasonable. The date certain in Duke Energy Ohio's last gas rate case was March 31, 2007, and the date certain for this case is March 31, 2012. Despite the five years of inflationary pressures and substantial continuing capital investment in its distribution system, Duke Energy Ohio is requesting an overall increase in rates that will result in an approximate 6.6 percent over the total gas rates that customers now pay. Through aggressive cost management practices, the Company has been able to hold its increase request to a reasonable level.

Q. WAS ATTACHMENT WDW-SUPP-1 PREPARED BY YOU OR UNDER YOUR DIRECTION?

A. Yes.

Q. DOES THIS CONCLUDE YOUR PRE-FILED SUPPLEMENTAL TESTIMONY?

A. Yes.

Duke Energy Ohio
Historical and Test Year O&M Expenses versus Staff's Test Year O&M

				2012 Rate Case (Sch. C-2)	
	2010	2011	2012	DEO Filed	Staff Report
Gas Supply Expense (excl fuel)	$3,077,404	$2,892,922	$2,643,536	$3,090,587	$3,090,587
Transmission Expense	435,887	443,405			
Distribution Expense	20,864,340	25,344,496	24,427,484	23,714,392	22,964,392
Customer Accounts Expense	34,719,665	45,052,991	26,789,149	21,295,108	16,247,545
Customer Service & Information Expense	6,897,077	9,120,633	8,794,917	8,053,632	8,053,632
Sales Expense	87,029	230,851	144,165	31	31
Administrative & General Expense	40,672,015	36,910,155	38,513,393	36,749,082	26,722,207
Total Operation and Maintenance Exp (Excl Prod)	$106,753,417	$119,995,453	$101,312,644	$92,902,832	$77,078,394
Account 904: Uncollectible Expense	$15,692,386	$26,940,511	$12,138,750	$571,810	$571,810
Eliminate Company Adjustment for SmartGrid Savings (Sch. C-3.26)				($4,110,888)	
Total O&M (Excl Account 904 & Fuel)	$91,061,031	$93,054,942	$89,173,894	$88,220,134	$76,506,584

- 2010 and 2011 data from the Company's FERC Form 2 Annual Report. 2012 Actual Data from Attachment PAL-SUPP-5.
- DEO Filed data from Schedule C-2 in the Company's Application.
- DEO Filed data from Schedule C-2 in the Staff Report.
- Difference between Staff and Company owes to the following adjustments.

Wages	Sch. C-3.4	$4,911,617
Pensions and Benefits	Sch. C-3.17	1,764,536
Medical	Sch. C-3.27	64,377
Budget Adjustment	Sch. C-3.13	4,092,313
Ongoing Camera Work	Sch. C-3.24	750,000
PUCO/OCC Assessments	Sch. C-3.15	$130,707
		$11,713,549
Total After Reconiliation (Staff Report O&M Plus Staff's Incremental Adjustments to Company Position)		$88,220,133