

BEFORE THE

PUBLIC UTILITIES COMMISSION OF OHIO

THE DAYTON POWER AND LIGHT COMPANY

CASE NO. 12-3062-EL-RDR

CASE NO. 12-3266-EL-AAM

STORM DAMAGE RECOVERY REQUEST

DIRECT TESTIMONY

OF MICHAEL E. BARRETT

- ☐ **MANAGEMENT POLICIES, PRACTICES, AND ORGANIZATION**
- ☐ **OPERATING INCOME**
- ☐ **RATE BASE**
- ☐ **ALLOCATIONS**
- ☐ **RATE OF RETURN**
- ☐ **RATES AND TARIFFS**
- ☒ **OTHER**

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ON BEHALF OF
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I. INTRODUCTION

Q. Please state your name, current position, and business address.

A. My name is Michael E. Barrett. I am a principal in the firm of MBarrett Consulting, LLC. My business address is 911 Symphony Beach Lane, Apollo Beach, FL 33572.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of The Dayton Power & Light Company ("DP&L").

Q. What is your educational and professional background?

A. I am the principal and founder of MBarrett Consulting, LLC ("MBarrett"), which specializes in providing financial advisory services to the power & utility industry. Prior to MBarrett, I was a partner with Ernst & Young LLP ("EY"), one of the Big Four accounting firms for fifteen years. At EY, I was their National Director – Utilities from 1998 until 2006, when I became the Southeast Area Power & Utilities Sector Leader. Prior to EY, I was at Coopers & Lybrand ("C&L") for seventeen years, progressing from supervisor to partner in 1988, and serving as their national utility industry leader for business assurance services. At both EY and C&L, I specialized in providing audit and financial consulting services to electric, gas, water and wastewater companies. Prior to C&L I was a field auditor for the Federal Energy Regulatory Commission ("FERC").

I graduated from the University of Scranton in 1976 with a Bachelor of Science in Accounting. I am a certified public accountant in Florida, Pennsylvania and Georgia.

1 I have practiced public utility accounting for over 32 years in addition to my 4 years
2 with FERC. My experience includes performing financial audits of electric and gas
3 utilities, rural electric cooperatives, and energy marketers and traders. During the
4 course of my career, I have worked with clients on a number of complex accounting
5 and ratemaking transactions that involved the application of Statement of Financial
6 Accounting Standard No. 71, Accounting for the Effects of Certain Types of
7 Regulation (currently Accounting Standards Codification ("ASC") 980, Regulated
8 Operations. I have testified as an expert witness in regulatory proceedings and
9 arbitrations over 40 times. I also co-authored a biennial report "Survey of FERC
10 Compliance Audit Findings" published by the Corporate Accounting Committee. My
11 curriculum vita is attached at Attachment 1.

12 **II. PURPOSE OF TESTIMONY**

13 **Q. What is the purpose of your testimony?**

14 A. The purpose of my testimony is to provide my opinion on certain issues raised by the
15 Staff of the Public Utilities Commission of Ohio ("Commission") associated with its
16 review of DP&L storm-related restoration costs.

17 **Q. Have you read the Comments Filed on Behalf of the Staff?**

18 A. Yes I have.

19 **Q. Do you agree with Staff's comments in this matter?**

20 A. No.

1 **Q. Can you summarize why you disagree with Staff?**

2 A. Yes. I disagree with Staff's recommendation that DP&L be denied recovery of certain
3 storm costs that the Commission has previously authorized DP&L to defer as a
4 regulatory asset. Many third parties, such as investors, lenders, auditors, and rating
5 agencies, have relied on the Commission's orders and the historical precedents that
6 have been set by the Commission, and it would be unreasonable to deny recovery of
7 the storm expenses in light of that reliance. Further, Staff's justification for its
8 recommendation – an ad hoc financial analysis used to apply retroactive ratemaking to
9 the last twelve years of DP&L's financial results – is unprecedented.

10 **III. ANALYSIS OF ISSUES**

11 **Q. Can you describe the costs at issue?**

12 A. Yes. In 2008, DP&L incurred substantial Operation and Maintenance ("O&M") costs
13 to respond to Hurricane Ike. The Commission authorized DP&L to defer those costs
14 and other 2008 storm costs, less a three-year average of storm costs, as a regulatory
15 asset in 2009.

16 **Q. What is the basis for using regulatory accounting in the company's financial**
17 **statements?**

18 A. Generally Accepted Accounting Principles in the United States (GAAP) includes
19 guidance that allows for regulatory accounting. That is the recognition of regulatory
20 assets and liabilities based on actions of the rate setter whereby these incurred costs

are included in rates in different time periods from when they would normally be recorded under GAAP. It is included in the guidance under ASC 980, Regulated Operations. This guideline includes the old Statement of Financial Accounting Standard No 71, Accounting for Effects of Certain Types of Regulation, and other related guidance. The purpose of the guidance is to reflect in the financial statements the economic effects of cost-based rate regulation of utilities.

Q. Can you summarize the guidance?

A. Yes. ASC 980.05-5 states that:

“Regulators sometimes include costs in allowable costs in a period other than the period in which the costs would be charged to expense by an unregulated entity. For the regulated entity, that procedure can do any of the following:

a. Create assets (future cash inflows that will result from the rate-making process)

b. Reduce assets (reductions of future cash inflows that will result from the rate-making process)

c. Create liabilities (future cash outflows that will result from the rate-making process).”

This guideline is the support for a company to defer as an asset an already incurred cost and to include it as an expense in future years as rates are collected that include

that cost. It is also the guidance that would require the recognition of a liability today for revenues that are being provided to cover a future cost.

Q. Is there guidance on when to rely on accounting deferral orders from the Commissions?

A. Yes, such guidance is provided in ASC 980.05-8. It states:

“Unless an accounting order indicates the way a cost will be handled for rate-making purposes, it causes no economic effects that would justify deviation from the GAAP applicable to business entities in general. The mere issuance of an accounting order not tied to rate treatment does not change an entity's economic resources or obligations. In other words, the economic effect of regulatory decisions—not the mere existence of regulation—is the pervasive factor that determines the application of GAAP.”

This guidance establishes that the Company may record a deferral based on a deferral order only if there is the expected economic effect of rate recovery. The current Commission practice of issuing accounting deferral orders and permitting subsequent rate treatment consistent with the deferral order meets these requirements. If the Commission were to adopt Staff's recommendations, this relationship will be broken for future Commission deferral orders. Or said differently, management and auditors will not be able to rely on expectations of future rate recovery from a deferral order and will have to wait for a final rate order to determine the proper accounting.

1 **Q. Do third parties rely on the fact that Commission Orders authorize a utility to**
2 **record expenses as regulatory assets on a utility's financial records?**

3 A. Yes. As discussed above, a Commission Order authorizing a utility to record an
4 expense as a regulatory asset indicates to investors and lenders that the amounts will
5 probably be recovered in a future period. Those parties thus make decisions to invest
6 in a utility or to lend money to a utility based upon the Commission's Order.

7 **Q. Can you describe the Staff's recommendations regarding whether DP&L should**
8 **be permitted to recover its deferred expenses associated with Hurricane Ike and**
9 **other 2008 storms?**

10 A. Yes. In comments (pp. 4-6) that the Staff filed in this matter on June 17, 2013, Staff
11 recommended that the Commission deny DP&L's request to recover the regulatory
12 asset on DP&L's books associated with Hurricane Ike and other 2008 storms because
13 the Staff believed that DP&L's historic O&M expenditures have been too low and that
14 DP&L's historic earnings have been too high.

15 **Q. What would be the impact of Staff's recommendation if it was adopted?**

16 A. If the Staff's recommendation was adopted by the Commission, then DP&L will be
17 forced to record as additional expense in the current period the amounts that have been
18 deferred (or included as an asset) on DP&L's balance sheet since 2008, pursuant to the
19 Commission's deferral Order.

1 **Q. Would recording those amounts as an expense in the current period have a**
2 **negative impact on DP&L?**

3 A. Yes, doing so would have a very significant negative impact. Specifically, recording
4 the deferred amounts as an expense now will have a significant negative impact on
5 DP&L's current expenses, which would significantly reduce its earnings. That
6 reduction will have a negative impact on DP&L's debt-to-equity ratio during a time of
7 significant restructuring of the Company, which could impact its ability to attract
8 capital and to fund needed capital projects.

9 **Q. Are there other impacts that the Commission should consider?**

10 A. Yes. If the Commission were to deny recovery of that regulatory asset, that Order
11 could have long-term consequences for DP&L and the other utilities in Ohio:

- 12 • First, investors and lenders could begin to view utility regulation in Ohio as
13 undergoing significant negative change because of the Commission's policy
14 change away from permitting recovery of prudently incurred costs that have
15 received a deferral order;
- 16 • Second, the Commission's use of retroactive ratemaking to justify the
17 disallowance of the storm costs represents a significant change in Commission
18 policy.

19 Both of those items would likely increase the cost of capital for Ohio utilities
20 because of the perceived added risk for utilities in the state; and

- 1 • Finally, the companies and their auditors who rely on the deferral order and the
- 2 related precedent of recovery in rates may be forced to wait for the actual rate
- 3 order before the deferrals could be recognized for financial reporting purposes.

4 **Q. Can you explain why investors and lenders may begin to view Ohio utility**
5 **regulation less favorably?**

6 A. Yes. Investors prefer to reduce or eliminate risk and uncertainty. The Commission's
7 current practice of issuing timely deferral orders and then permitting recovery of the
8 deferred amounts provides certainty. Investors and lenders know that once a deferral
9 order is issued, the only remaining uncertainty is whether the company has included
10 only reasonable, prudent costs in the deferral. If the Commission adopts Staff's
11 recommendations, that would mark a significant change in policy around the
12 Commission's deferral orders. That change, along with the use of retroactive
13 ratemaking in the justification, increases the uncertainty to the investors and lenders.

14 **Q. Can you give an example?**

15 A. Yes. DP&L's 2008 storms costs provide a good example of how this policy change
16 would affect investors and lenders. The costs were incurred in 2008 and DP&L
17 received a deferral order in 2009. Based on past Commission practices, the investors
18 and lenders had a reasonable expectation that those costs would be recovered. The
19 only uncertainties for the investors and lenders were when that recovery would occur
20 and whether the deferred costs were reasonable and prudent.

1 However, the Staff recommendation would indicate that this assumption was incorrect
2 on the part of the investors and lenders. Now in 2013, the Staff has recommended that
3 the Commission no longer follow its past practices of allowing recovery of costs that
4 were reasonable and prudently incurred and for which the Commission had previously
5 issued a deferral order. Such an action would create additional risks and uncertainties
6 that investors and lenders would have to evaluate, which would likely lead to different
7 decisions than those made in the past. This added risk will lead to increased costs of
8 capital for DP&L and potentially for other utilities in the state.

9 **Q. You indicate above that Staff's recommendation to disallow these storm costs**
10 **constitutes retroactive ratemaking. Can you explain?**

11 A. Yes. The Staff's justification for disallowing the storm costs is based on an ad hoc
12 analysis of the financial results of DP&L over the past twelve years. Staff annualizes
13 distribution O&M expenses over the twelve years and compares each year to the
14 amount allowed in the last test year. Based upon its analysis, Staff asserts that DP&L
15 did not incur distribution O&M expenses in each year equal to what was allowed in
16 the 1991 test year that was later used in the 1999 Electric Transition Plan ("ETP")
17 case. Staff then summed the differences and compared them to the total storm costs
18 incurred; Staff asserts that the difference shows that DP&L's distribution O&M
19 expense reductions outweighed storm O&M costs.

20 With this analysis, Staff is in essence re-doing the rates that were agreed to in the 1999
21 ETP case based on the 1991 test year. The Commission issued an order that the rates

1 in 1999 were just and reasonable. Now, the Staff would conclude that they were not
2 just and reasonable and should have been lower. Then, the Staff recommends that
3 DP&L's reduced distribution O&M spending be used to offset the reasonably incurred
4 storm costs that the Commission had approved for deferral. That is retroactive
5 ratemaking with the Staff depending only on the fact that distribution O&M expenses
6 were not incurred at the same level as they were included in the 1991 test year.

7 **Q. If the Commission were to consider DP&L's historic O&M expenses, are there**
8 **other items that the Commission should consider?**

9 A. Yes. The Staff's analysis focuses on one element of costs: distribution O&M
10 expenses. It fails to consider all the other elements of costs that are included in
11 determining utility rates. Staff's analysis fails to consider DP&L's investments in
12 capital assets, with the related depreciation and return requirements, that played a
13 substantial role in achieving the distribution O&M expense reductions. If the
14 Commission considers the level of technological and business transformation that has
15 occurred since 1991 in DP&L distribution operations, Staff's focus on just the one
16 element, distribution O&M expenses, is seriously flawed. Expecting the 2011 and
17 1991 distribution O&M expenses to be comparable as the Staff is doing would be the
18 same as expecting the old rotary dial phones to do the same thing in the same way as
19 today's smartphones.

1 **Q. Can you explain your earlier conclusion that companies and their auditors will**
2 **have to wait for the final rate order to determine if a regulatory asset can be**
3 **recorded?**

4 A. Yes. A regulatory asset is recorded when the recovery of incurred costs is probable of
5 future recovery in rates. Currently, for those companies under the Commission's
6 jurisdiction, there is a high probability of recovery on certain types of costs like storm
7 restoration costs. This is because the Commission has established the precedent of
8 providing deferral accounting orders and then allowing recovery of those reasonably
9 and prudently incurred costs in rates. If the Commission were to adopt Staff
10 recommendations, those precedents would no longer exist and the deferrals would not
11 be recorded until a final rate order authorizing recovery of the costs in rates was
12 issued. So in the case of the 2008 storm costs, they would have been expensed in 2008
13 and would not be deferred until the Commission authorized the recovery of those
14 costs. That result would create significant fluctuations in company earnings.

15 **IV. CONCLUSION**

16 **Q. Can you summarize your testimony?**

17 A. Yes. I believe that Staff's recommendation that the Commission disallow the recovery
18 of storm costs that have already received a deferral order is not appropriate. Staff's use
19 of an ad hoc analysis of historical distribution O&M expenses and failure to consider
20 all the other cost elements included in base rates to support its recommendation is

1 seriously erroneous. Staff's use of retroactive ratemaking would be a significant
2 departure in policy and may cause significant concern among investors and lenders.

3 Finally, the Commission should follow its historical precedent of allowing the
4 recovery of reasonable and prudently incurred costs once a deferral accounting order
5 is issued, because failing to do so would indicate to investors and lenders that they
6 cannot rely upon such orders. The timely recording of deferred costs may no longer
7 occur and companies may be forced to wait until a final rate order allowing cost
8 recovery is issued to record the deferral.

9 **Q. Does this conclude your direct testimony?**

10 **A.** Yes, it does.

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing Direct Testimony of Michael E. Barrett
has been served via electronic mail upon the following counsel of record, this 14th day of
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