

OCC EXHIBIT NO. _____

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of)
the Dayton Power and Light Company for) Case No. 16-0395-EL-SSO
Approval of its Electric Security Plan.)

In the Matter of the Application of the)
Dayton Power and Light Company for) Case No. 16-0396-EL-ATA
Approval of Revised Tariffs.)

In the Matter of the Application of the)
Dayton Power and Light Company for) Case No. 16-0397-EL-AAM
Approval of Certain Accounting Authority)
Pursuant to Ohio Rev. Code § 4905.13.)

**PUBLIC VERSION
SUPPLEMENTAL TESTIMONY
OF
DAVID C. PARCELL**

**IN OPPOSITION TO THE
STIPULATION AND RECOMMENDATION**

**On Behalf of
The Office of the Ohio Consumers' Counsel**
*10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485*

March 29, 2017

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*Supplemental Testimony of David C. Parcell – Public Version
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 16-395-EL-SSO, et al.*

1 **I. INTRODUCTION**

2

3 ***Q1. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS***
4 ***ADDRESS.***

5 ***A1.*** My name is David C. Parcell. I am Principal and Senior Economist of Technical
6 Associates, Inc. My business address is Suite 130, 1503 Santa Rosa Rd.,
7 Richmond, Virginia 23229.

8

9 ***Q2. PLEASE BRIEFLY DESCRIBE YOUR BACKGROUND AND EXPERIENCE.***

10 ***A2.*** I hold B.A. (1969) and M.A. (1970) degrees in economics from Virginia
11 Polytechnic Institute and State University (Virginia Tech) and a M.B.A. (1985)
12 from Virginia Commonwealth University. I have been a consulting economist
13 with Technical Associates since 1970. The majority of my consulting experience
14 has involved the provision of cost of capital testimony in public utility ratemaking
15 proceedings. I have previously testified in about 550 utility proceedings before
16 over 50 regulatory agencies in the United States and Canada, including the Public
17 Utilities Commission of Ohio ("PUCO"). Attachment DCP-1 provides a more
18 complete description of my education and relevant business experience.

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1 ***Q3. WHAT IS THE PURPOSE OF YOUR TESTIMONY?***

2 ***A3.*** My testimony addresses certain issues, related to the costs of capital (for both debt
3 and equity) and the financial integrity for The Dayton Power & Light Co.
4 (“DP&L” or “Utility”), that are included or implied as parts of the Amended
5 Stipulation and Recommendation (“Settlement”) filed on March 13, 2017
6 regarding the DP&L’s 2016 Electric Security Plan (“ESP”). I am only addressing
7 these costs of capital (for both debt and equity) and the financial integrity
8 components of the ESP and am not commenting on other components of the ESP
9 and/or Settlement. In addition, because DP&L is a subsidiary of DPL, Inc.
10 (“DPL”), which in turn is owned by AES Corp. (“AES”), and the financial
11 integrity components of the ESP flow primarily from DPL’s huge debt load
12 incurred in connection with its merger with AES, I also considered these entities
13 in my analyses.

14

15 I also explain why the approval of the proposed Settlement, with its resulting
16 costs of debt and equity, is not in the public interest, does not benefit customers,
17 and violates important regulatory principles. As such it fails to meet the PUCO's
18 settlement standard.

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1 ***Q4. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING***
2 ***PRIOR TO FILING OF THE SETTLEMENT BY DP&L ON JANUARY 30,***
3 ***2017 AND THE AMENDED SETTLEMENT ON MARCH 13, 2017?***

4 ***A4.*** Yes, I did. I filed, on behalf of the Office of the Ohio Consumers' Counsel
5 ("OCC") Direct Testimony dated November 21, 2016 ("Direct Testimony").
6

7 ***Q5. WHAT WAS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS***
8 ***PROCEEDING?***

9 ***A5.*** My Direct Testimony addressed the respective costs of long-term debt and
10 common equity of DP&L, relative to its ESP¹ filing including the original
11 application filed by DP&L on February 22, 2016, and the amended application
12 and related testimonies filed on October 11 and October 31, 2016. In that
13 testimony, I performed independent studies and made recommendations of the
14 current cost of debt and cost of common equity for DP&L.

¹ *In the Matter of the Application of The Dayton Power and Light Company for Approval of its Electric Security Plan*, Case No. 16-0395-EL-SSO, et al. (February 22, 2016) and subsequent filings on October 11, 2016 and October 31, 2016.

1 **II. THE PROPOSED SETTLEMENT WITH ITS ASSOCIATED COST OF**
2 **CAPITAL COMPONENTS AND RIDER DMR SHOULD BE REJECTED**

3
4 **Q6. WHAT ARE THE CRITERIA THE COMMISSION HAS USED IN**
5 **APPROVING A SETTLEMENT?**

6 **A6.** The PUCO commonly uses the following standard in adopting and approving
7 proposed settlements: “In considering the reasonableness of a Stipulation, the
8 PUCO uses the following criteria:

- 9 1. Is the settlement a product of serious bargaining among
10 capable, knowledgeable parties?
11 2. Does the settlement package violate any important
12 regulatory principle or practice?
13 3. Does the settlement, as a package, benefit ratepayers and
14 the public interest?”²

15 I note that the testimony of DP&L witness Sharon R. Schroder also cites
16 these criteria.³

² Case No. 12-1230-EL-SSO, *In the Matter of Ohio Edison Company, The Cleveland Electric Illuminating Company and the Toledo Edison Company for Authority to Provide a Standard Service Offer Pursuant to Section 4928.143*, Revised Code in the Form of an Electric Security Plan, June 18, 2012, Opinion and Order, at p. 24.

³ Direct Testimony of Sharon R. Schroder in support of the Amended Stipulation and Recommendation, Public Utilities Commission of Ohio, Case Nos. 16-0395-EL-SSO, et. al., page 4, lines 5-8.

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1 ***Q7. WILL THE PROPOSED SETTLEMENT WITH ASSOCIATED COSTS OF***
2 ***CAPITAL COMPONENTS AND RIDER DMR BENEFIT THE CUSTOMERS***
3 ***AND BE IN THE PUBLIC INTEREST?***

4 ***A7.*** No. The adoption of a cost of debt of 5.29 percent and a cost of common equity
5 of 10.5 percent for DP&L's ESP is not in the public interest and does not benefit
6 DP&L's customers. A reasonable cost of debt should be no higher than DP&L's
7 embedded cost of debt, which is estimated to 4.4%, and a cost of common equity
8 should be no higher than 9.25 percent. If DP&L's proposed costs of capital are
9 adopted, the customers of DP&L will be paying more than a just and reasonable
10 rate for electricity service.

11
12 As for Rider DMR, it is clear that the current financial condition of DPL is largely
13 the result of its merger with AES in 2011. The customers of DP&L are not
14 responsible for the current financial condition of DPL and they should not be
15 asked to pay for any subsidy (in the form of a Rider DMR) to improve the
16 financial condition (consequently the credit rating) of DPL. AES, as the parent
17 company of DPL, has the financial resources available and should bear more
18 responsibility for improving the credit rating of DPL.

19

20 ***Q8. DOES THE PROPOSED SETTLEMENT WITH ASSOCIATED COSTS OF***
21 ***CAPITAL VIOLATE IMPORTANT REGULATORY PRINCIPLES?***

22 ***A8.*** Yes. The proposed Settlement, with its associated costs of capital, if approved,
23 does violate important regulatory principles. Specifically, as discussed in greater

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1 detail in my Direct Testimony, the proposed cost of debt of 5.29 percent and cost
2 of common equity of 10.5 percent are not based on DP&L's actual costs, the
3 current economic and financial market conditions, and the return recently
4 approved for utilities with similar business and financial risks. Consequently, the
5 costs of debt and common equity as proposed by DP&L and implied by the
6 Settlement are not consistent with commonly-applied regulatory principles. They
7 should not be adopted and the PUCO should not approve the Settlement.

8
9 **III. RECOMMENDATIONS AND SUMMARY**

10
11 ***Q9. PLEASE SUMMARIZE YOUR ANALYSES AND CONCLUSIONS AS***
12 ***CONTAINED IN YOUR DIRECT TESTIMONY.***

13 ***A9.*** In my Direct Testimony, I recommended use of a cost of debt of 4.4 percent and a
14 cost of common equity of 9.25 percent for DP&L. First, I examined the
15 embedded cost rate of debt of DP&L. In this proceeding, DP&L proposes to use
16 a 5.29 percent cost of long-term debt.⁴ This 5.29 percent cost of debt proposed by
17 DP&L assumes that 30-year mortgage bonds were sold in August of 2016 at a
18 cost of 6.60 percent.⁵ In actuality, DP&L "sold \$445 million of six-year debt"⁶ at

⁴ See PUCO Case Nos. 16-0395-EL-SSO, et al., Direct Testimony of DP&L Witness Craig L. Jackson at 23 (October 11, 2016).

⁵ Direct Testimony of Jackson at 23-27 (October 11, 2016).

⁶ On August 24, 2016, DP&L entered into a six-year credit agreement to finance \$445 million of First Mortgage Bonds that were scheduled to mature on September 15, 2016.

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a cost of about 4.41 percent.⁷ I note that DP&L has subsequently acknowledged that, as of February 2017, the cost of the new bonds is 4.03 percent.⁸ I recommend that DP&L's actual cost of debt be used for any ESP purposes. As of this time DP&L has not provided the actual cost of long-term debt, notwithstanding OCC's requests for this information.⁹

Second, I estimated the cost of common equity, or the return on common equity ("ROE"), of DP&L. I employed three recognized methodologies to estimate DP&L's return on equity, each of which I applied to two proxy groups of utilities. These three methodologies and my findings are:

Methodology	ROE Range
Discounted Cash Flow ("DCF")	8.6%-9.0% (8.8% mid-point)
Capital Asset Pricing Model ("CAPM")	5.9-6.5% (6.2% mid-point)
Comparable Earnings ("CE")	9.0%-10.0% (9.5% mid-point)

Based upon these findings, I concluded that DP&L's return on equity is within a range of 9.0 percent to 9.5 percent, which is based upon the upper end of the range of the results for the DCF model and the mid-point up the range of results for the CE model.¹⁰ Instead of the 10.5 percent return on equity requested in DP&L's distribution rate case (PUCO Case Nos. 15-1830-EL-AIR, et al.) and

⁷ The calculation of 4.41% is shown in Section VI. of my Direct Testimony. In addition, DP&L continues to refuse to provide its actual cost of long-term debt, as evidence by its response to OCC Request INT-505.

⁸ Response to IEU 13th Set INT 13-11 (this discovery response was originally marked as Confidential; however, DP&L has agreed to treat this rate as Non-Confidential). Attachment DCP-2.

⁹ See Schedules DCP-5 and DCP-6 of my Direct Testimony.

¹⁰ As I indicate in my Direct Testimony, my return on equity recommendation does not directly incorporate my CAPM results, which I believe to be somewhat low at this time relative to the DCF and CE results.

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1 adopted in this proceeding by DP&L Witness Malinak,¹¹ I recommend a 9.25
2 percent return on equity for DP&L.

3
4 ***Q10. WERE THE COST OF DEBT AND COST OF COMMON EQUITY***
5 ***EXPLICITLY SPECIFIED IN THE PROPOSED SETTLEMENT?***

6 ***A10.*** No, they were not. To my knowledge, the cost of debt is not specified in either
7 the Settlement or the two DP&L testimonies in support of the Settlement.¹² The
8 cost of equity, to my knowledge, is not specified in the Settlement but is noted in
9 DP&L Witness Malinak's testimony in support of the Settlement.¹³

10
11 ***Q11. WHAT IS YOUR UNDERSTANDING OF THE COST OF DEBT AND COST***
12 ***OF COMMON EQUITY APPLICABLE TO THE ESP?***

13 ***A11.*** Page 37 (paragraph XI.2.) of the Settlement states:

14 "Except as modified by this Stipulation, DP&L's Application in
15 these matters is approved."

16 It is therefore my understanding that the proposed Settlement will result in a cost
17 of debt of 5.29 percent and a cost of equity of 10.50 percent for the ESP if the
18 PUCO approves the Settlement without specifically modifying the cost of debt
19 and cost of common equity.

¹¹ See PUCO Case Nos. 16-0395-EL-SSO, et al., Direct Testimony of R. Jeffrey Malinak at 21 (October 31, 2016), and Direct Testimony of R. Jeffrey Malinak in Support of Amended Stipulation and Recommendation, page 26, lines 10-21.

¹² Direct Testimonies of Sharon R. Schroder and R. Jeffrey Malinak in support of Amended Stipulation and Recommendation.

¹³ Direct Testimony of R. Jeffrey Malinak in Support of Amended Stipulation and Recommendation, Public Utilities Commission of Ohio, Case Nos. 16-0395-EL-SSO, et. al., page 26, lines 10-21.

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1 ***Q12. DO YOU SUPPORT THE USE OF THESE COST RATES FOR DP&L'S***
2 ***ESP?***

3 ***A12.*** No, I do not. As I indicated in my Direct Testimony, both the 5.29 percent cost of
4 debt and 10.50 percent cost of common equity are not reasonable cost rates for
5 DP&L at this time. The adoption of these cost rates is not based on sound
6 regulatory principles and practices, because they both reflect costs higher than
7 actual cost incurred by DP&L or expected returns set for electric utilities with
8 similar business and financial risks, and will not result in reasonable rates for
9 DP&L's customers.

10

11 ***IV. RESPONSES TO TESTIMONY OF DP&L WITNESS R. JEFFREY***
12 ***MALINAK***

13

14 ***Q13. HAVE YOU REVIEWED THE TESTIMONY OF DP&L WITNESS R.***
15 ***JEFFREY MALINAK IN SUPPORT OF THE AMENDED SETTLEMENT?***

16 ***A13.*** Yes, I have.

1 **Q14. MR. MALINAK INDICATES HIS BELIEF, ON PAGE 26 OF HIS**
2 **TESTIMONY, THAT A 10.5 PERCENT RETURN ON EQUITY IS**
3 **“REASONABLE” TO USE IN DP&L’S ESP WHEN OPERATING UNDER**
4 **THE SETTLEMENT. DO YOU AGREE WITH THIS?**

5 **A14.** No, I do not. First, a 10.5 percent return on equity exceeds virtually all of the
6 authorized returns on equity for electric utilities in 2015 and 2016.¹⁴ In fact, of
7 the 26 “non-rider” cases in 2015 where a return on equity was indicated, none
8 were as high as 10.5 percent.¹⁵ In 2016, only two of 35 cases were as high as 10.5
9 percent.¹⁶ Consequently, it is apparent that DP&L’s proposed 10.5 percent return
10 on equity, if approved by the PUCO, would burden DP&L’s customers with what
11 is virtually the highest recently-awarded return on equity for any electric utility in
12 the United States.

13
14 Second, DP&L has or has proposed an array of regulatory mechanisms, as
15 discussed later in my testimony, available to it that tend to reduce the business
16 and financial risks to DP&L, and is requesting more as part of the ESP. Not only
17 does DP&L Witness Malinak ignore the positive impact of these risk-reducing
18 regulatory mechanisms, but he proposes the adoption of what is a well above-
19 average return on equity to be used in conjunction with these mechanisms. There
20 is no justification to mix the beneficial impacts of those mechanisms with what

¹⁴ Regulatory Research Associates, “Regulatory Focus” January 14, 2016 and January 18, 2017.

¹⁵ Regulatory Research Associates, “Regulatory Focus” January 14, 2016, pages 5-6.

¹⁶ Regulatory Research Associates, “Regulatory Focus” January 18, 2017, pages 8-9.

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1 would be virtually the highest nearly-authorized return on equity for any electric
2 utility in the United States.

3
4 ***Q15. WHAT HAVE BEEN THE AVERAGE AUTHORIZED RETURNS ON***
5 ***EQUITY FOR ELECTRIC UTILITIES IN RECENT YEARS?***

6 ***A15.*** The average authorized returns on equity in the U.S. for electric and natural gas
7 utilities¹⁷ in recent years have been:

<u>Year</u>	<u>Electric¹⁸</u>	<u>Natural Gas</u>
2012	10.01%	9.94%
2013	9.94%	9.68%
2014	9.76%	9.78%
2015	9.58%	9.60%
2016	9.60%	9.50%

8
9 These are well below the 10.5 percent return on equity cited by Mr. Malinak and
10 requested by DP&L.

11
12 ***Q16. DO YOU HAVE RESPONSES TO ANY OTHER ASPECTS OF MR.***
13 ***MALINAK'S TESTIMONY?***

14 ***A16.*** Yes, I do. There are several aspects of Mr. Malinak's testimony that I disagree
15 and wish to comment.

¹⁷ Regulatory Research Associates, "Regulatory Focus" January 18, 2017, pages 1 and 4.

¹⁸ Excludes "limited issue rider cases."

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1 ***Q17. MR. MALINAK NOTES, ON PAGES 4 AND 6, THAT PART OF THE***
2 ***SETTLEMENT IS THAT DPL WILL NOT PAY DIVIDENDS TO AES***
3 ***DURING THE ESP PERIOD. DO YOU HAVE ANY RESPONSES TO THIS?***

4 ***A17.*** Yes, I do. While I understand the intent of this provision, I find that it provides
5 no meaningful protection to DP&L's customers. I note that DP&L and its
6 customers have been paying a substantial amount of dividends to DPL from 2011
7 to 2016. Even though DP&L will not be paying dividends to AES, DP&L and its
8 customers will still be paying substantial amounts of dividends to DPL over the
9 next few years and in the foreseeable future, and essentially funding the service of
10 DPL's debt, which is largely issued to finance AES's acquisition of DP&L. Even
11 Mr. Malinak acknowledges, on page 30:

12 "Timely and full service of this (i.e., DPL) debt will depend
13 heavily on the cash flow from DP&L, DPL's primary subsidiary
14 and source of operating profits."
15

16 In this regard, I note that DP&L has paid the following dividends to DPL
17 since the merger:

Year	Dividends (millions) ¹⁹
2011	\$220
2012	\$145
2013	\$190
2014	\$159
2015	\$50
2016	\$70

18

¹⁹ DPL/DP&L Form 10-K, various years.

1 ***Q18. MR. MALINAK STATES, ON PAGES 21-22, THAT MAINTAINING***
2 ***AN INVESTMENT GRADE CREDIT RATING IS A REASONABLE***
3 ***COMPONENT OF FINANCIAL INTEGRITY FOR DPL AND DP&L.***
4 ***DO YOU HAVE ANY RESPONSE TO THIS?***

5 ***A18.*** I do have a response to this. DP&L, the electric distribution company that
6 provides service to Ohio customers, currently does have an investment grade
7 credit rating and there is no indication that DP&L cannot maintain its financial
8 integrity. It is DPL that does not have an investment grade credit rating. It is also
9 useful, as discussed later in my testimony, to recognize that there are a broad
10 range of options available to AES (the parent company) to improve or to maintain
11 an investment grade credit rating of DPL and DP&L (which already has an
12 investment grade credit rating). It would be unfair and unreasonable to ask the
13 customers of DP&L to pay, for example, through the proposed Rider DMR, solely
14 for the purpose of improving or maintaining DPL's credit rating.

15
16 ***Q19. WHAT ARE THE PRESENT DEBT RATINGS OF DP&L AND DPL?***

17 ***A19.*** These are shown on the DP&L/DPL Form 10-K for December 31, 2016 (page
18 68). The respective debt ratings are:

	<u>DPL</u>	<u>DP&L</u>
Moody's	Ba3	Baa2
Fitch	BB/ BB-	BBB
S&P	BB	BBB-

19
20 It is apparent that at the present time all of DP&L's debt ratings are triple B (i.e.,
21 investment grade), while all of DPL's debt ratings are less than investment grade.

1 **Q20. MR. MALINAK ALSO NOTES, ON PAGE 22, THAT “DP&L IS ONE OF**
2 **JUST THREE FIRMS WITH THE LOWEST INVESTMENT GRADE**
3 **RATING (“BAA3”).” DO YOU HAVE ANY COMMENT ON THIS?**

4 **A20.** I do. As I noted in my Direct Testimony, DP&L and DPL had single A ratings
5 prior to the 2011 AES merger. As was noted by the rating agencies, and cited in
6 my Direct Testimony, DP&L’s and DPL’s ratings were downgraded due to the
7 merger or the acquisition of DP&L and DPL by AES.

8
9 In fact, Standard & Poor’s made the following comments about the merger of
10 DP&L into AES on pages 2 and 3 of a November 22, 2011 Ratings Direct titled
11 “DPL Inc., Subsidiary Dayton Power & Light Downgraded To ‘BBB-‘From ‘A.’”
12 Rating Action.

13
14 On Nov. 22, 2011, Standard & Poor’s Ratings Services lowered its corporate
15 credit ratings on DPL Inc. and principal subsidiary Dayton Power & Light Co.
16 (DP&L) to ‘BBB-‘from ‘A-.’ We also removed all ratings on DPL and DP&L
17 from CreditWatch with negative implications, where they were placed on April
18 20, 2011. The outlook is stable.

19 **The lower ratings are attributable to the soon to be completed**
20 **acquisition of DPL by lower rated AES and the substantial**
21 **amount of additional acquisition-related debt leverage at DPL.**
22 **Moreover, we believe that the combination with an entity that**
23 **has significantly weaker business risk and financial risk**
24 **profiles, and the ample leverage employed in this transaction,**

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1 **demonstrates a lack of commitment to credit quality by DPL's**
2 **management.**
3 **[Emphasis added]**
4

5 Moreover, this situation (the substantial amount of additional acquisition-
6 related debt leverage) continues, as Moody's noted on page 1 of an
7 October 13, 2015 Credit Opinion:

8 **"The ratings of DP&L and DPL remain constrained by the**
9 **group's significant financial leverage including the material**
10 **amount of DPL holding company debt.** This is largely related to
11 the indebtedness used to help fund DP&L's acquisition by AES in
12 November 2011 that was assumed by DPL at the closing of the
13 transaction."
14 **[Emphasis added]**
15

16 More recently, Moody's stated on page 1 of an August 11, 2016 Credit Opinion:

17 "DP&L's Baa3 rating is constrained by the material amount of
18 holding company debt of around \$1.2 billion or 61.5% of the
19 consolidated debt that is outstanding at its parent company DPL,
20 Inc. (DPL; Ba3 senior unsecured rating negative). This considers
21 the fact that the PUCO did not impose any dividend restrictions on
22 DP&L which historically was DPL's main source of cash flows.
23 This limits the utility's financial flexibility which constrains its
24 rating and drives the notching differential between the Ba3 senior
25 unsecured ratings of DPL and DP&L's Baa3 Issue rating.

26
27 This demonstrates that DP&L's ratings remain negatively impacted by the
28 DPL debt that was largely incurred to finance the merger of DPL (and
29 DP&L) by AES in 2011.

1 **Q21. MR. MALINAK STATES, ON PAGE 22, THAT THE “MOST COMMON**
2 **RATING FOR THESE FIRMS (I.E., INTEGRATED UTILITY COMPANIES)**
3 **IS A3.” WHAT WERE THE RATINGS OF DP&L PRIOR TO THE 2011**
4 **MERGER WITH AES?**

5 **A21.** As noted in my Direct Testimony, DP&L’s pre-merger ratings were A- by S&P
6 and A3 by Moody’s. These are the same ratings that Mr. Malinak now describes
7 as “most common.”

8
9 **Q22. MR. MALINAK STATES, ON PAGE 29, THAT “IF DPL EXPERIENCES**
10 **FINANCIAL STRESS, IT WOULD HAVE A NEGATIVE IMPACT ON**
11 **DP&L.” DO YOU HAVE ANY RESPONSE TO THIS?**

12 **A22.** I do have a response. The question at hand is not whether DPL’s financial stress
13 will affect DP&L. The real question is what caused the financial stress at DPL
14 and how to resolve or reduce the financial stress on DPL. As Mr. Malinak notes
15 (page 29) less than four percent of DPL’s total revenue comes from subsidiaries
16 other than DP&L. Yet, as noted by Mr. Malinak on page 30, DPL has some \$1.9
17 billion of debt at year-end 2016, while DP&L has less than \$0.8 billion debt.
18 Thus, DPL has over \$1 billion in debt not attributed to DP&L. As noted
19 elsewhere, this debt is associated with AES’s acquisition of DPL/DP&L, as
20 described by Moody’s and Standard & Poor’s. Again, DP&L (through
21 unwarranted charges to its customers) is being unfair and unreasonably asked to
22 pay for the debt of DPL – the debt used to finance its purchase by AES.

1 **Q23. IN YOUR DIRECT TESTIMONY, YOU COMMENTED ON THE RISK-**
2 **REDUCING NATURE OF VARIOUS REGULATORY MECHANISMS.**
3 **WHAT ARE THE EXAMPLES OF THESE REGULATORY MECHANISMS**
4 **INCLUDED IN THE SETTLEMENT AND DP&L'S ESP APPLICATION?**

5 **A23.** I did explain, in my Direct Testimony, how certain regulatory mechanisms are
6 recognized as risk-reducing to public utilities. I also noted that the credit rating
7 agencies have recognized the risk-reducing nature of these regulatory
8 mechanisms.

9
10 Mr. Malinak cites, on page 5 of his testimony, the following regulatory
11 mechanisms that are “characteristics” of the Settlement:

- 12 • Distribution Modernization Rider (“DMR”)
13 • Ohio Valley Electric Cooperative facilities (“Reconciliation
14 Rider”)

15
16 In addition, DP&L Witness Schroder cites, on pages 11-12 the following
17 regulatory mechanisms in her testimony:

- 18 • Distribution Infrastructure Rider
19 • Smart Grid Rider (“SCR”), and
20 • Economic Development Rider

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1 Except for the DMR, I do not have an opinion on whether these proposed
2 regulatory mechanisms should be adopted.²⁰ It is evident that DP&L may
3 continue to have an extensive and growing suite of favorable regulatory
4 mechanisms. The possible adoption of these risk-reduction regulatory
5 mechanisms is another reason why the requested 10.5 percent return on equity
6 should not be approved as a part of the ESP.

7
8 **V. FINANCIAL STATUS OF AES AND ITS IMPACT ON THE TERMS AND**
9 **CONDITIONS OF DP&L'S ESP**

10
11 ***Q24. ARE DP&L AND DPL SUBSIDIARIES OF AES?***

12 ***A24.*** Yes, they are. AES is mainly a multi-national energy generation company with
13 both regulated and unregulated operations. It owns two major electric distribution
14 utilities in the United States – DP&L/DPL and Indianapolis Power & Light.

15
16 ***Q25. IS AES A FINANCIALLY STRONG COMPANY AT THE CURRENT TIME?***

17 ***A25.*** Yes, it is. For example, AES has raised its common stock dividend each year
18 since 2012, having not paid dividends prior to that time.

19

²⁰ I cite the DMR in this Supplemental Testimony due to the relatively large size of the customer contribution required as part of this mechanism. In addition, the DMR is specifically designed to collect revenue “to pay debt obligations of DPL and DP&L” as cited on page 152 of DPL/DP&L 2016 form 10-K.

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1 ***Q26. HAS AES MADE INVESTOR PRESENTATIONS THAT REFLECT THIS***
2 ***COMPANY'S PERCEPTIONS OF ITS FINANCIAL STRENGTHS AND***
3 ***PROSPECTS?***

4 ***A26.*** Yes, it has. A recent investor presentation, as listed on the Company website, is a
5 December 2016 presentation at Barclays Beaver Creek Utilities Conference.²¹

6
7 AES describes itself as “De-Risking and De-Levering,”²² as reflected in positive
8 developments (in terms of revised “Outlooks” by Fitch and Moody’s and an
9 “upgrade” from S&P).

10
11 AES cites “Strong and Growing Free Cash Flow Supports Attractive Dividend
12 Growth.”²³ This reflects the growth in dividends since 2012 (from \$0.04 in 2012
13 to \$0.44 in 2016), as well as an expectation of ten percent annual growth in 2017-
14 2018.

²¹ Barclays Beaver Creek Utilities Conference, The AES Corporation (December 2016), *available at* http://s2.q4cdn.com/825052743/files/doc_presentations/2016/dec/12-12-16-Barclays-Beaver-Creek-Utilities-Conference_FINAL.pdf.

²² Id. at 15.

²³ Id. at 20.

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1 In fact, a number of AES's investor presentations over the past year show close to
2 a billion dollars of free cash flow for 2016 and subsequent years.²⁴

3 AES also cites the debt of DP&L and DPL.²⁵ This reflects total "non-recourse
4 debt" of DP&L of \$785.9 million and for DPL of \$1,177.6 million. As noted
5 previously, DP&L accounts for about 96 percent of DPL's operations, yet only
6 accounts for less than 40 percent of DPL's debt (i.e., DP&L debt as percent of
7 combined DP&L and DPL debt). This \$1,177.6 million of DPL debt is supported
8 by DP&L and its customers, largely to finance the AES acquisition.

9
10 ***Q27. BASED ON YOUR REVIEW OF AES'S FINANCIAL STATUS, SHOULD***
11 ***AES DO MORE TO REDUCE THE DEBT LEVEL OF DPL AND IMPROVE***
12 ***THE CREDIT RATING OF DPL?***

13 ***A27.*** Yes. As I noted previously, AES's acquisition of DP&L and DPL was largely
14 financed by debt at the DPL entity. This significant additional leverage was

²⁴ 51st Annual EEI Financial Conference Presentation at 4 (November 7-8, 2016), *available at* [http://s2.q4cdn.com/825052743/files/doc_presentations/2016/Nov/11-07-51st-Annual-EEI-Financial-Conference-Original-\(appendix-MW-revised\).pdf](http://s2.q4cdn.com/825052743/files/doc_presentations/2016/Nov/11-07-51st-Annual-EEI-Financial-Conference-Original-(appendix-MW-revised).pdf); Third Quarter 2016 Financial Review at 4 (November 4, 2016), *available at* <http://www.aes.com/investors/presentations-and-webcasts/event-details/2016/Q3-2016-AES-Corporation-Earnings-Conference-Call/default.aspx>; Presentation of Tom O'Flynn, Executive Vice President and CFO, Wolfe Research Power and Gas Leaders Conference at 12 (September 2016), *available at* <http://www.aes.com/investors/presentations-and-webcasts/event-details/2016/2016-Wolfe-Research-Power--Gas-Leaders-Conference/default.aspx>; Second Quarter 2016 Financial Review at 4 (August 5, 2016), *available at* http://s2.q4cdn.com/825052743/files/doc_presentations/2016/08-05-16-Second-Quarter-2016-Financial-Review_FINAL.pdf; Presentation of Tom O'Flynn, EVP and CFO, JP Morgan Energy Equity Conference at 19 (June 27, 2016), *available at* http://s2.q4cdn.com/825052743/files/doc_presentations/2016/06-26-16-JPM-Energy-Conference_FINAL.pdf; Presentation of Andrés Gluski, President and CEO, Bernstein Strategic Decisions Conference (June 3, 2016), *available at* http://s2.q4cdn.com/825052743/files/doc_presentations/2016/06-26-16-JPM-Energy-Conference_FINAL.pdf; First Quarter 2016 Financial Review at 4 (May 9, 2016), *available at* http://s2.q4cdn.com/825052743/files/doc_presentations/2016/AES-050916-First-Quarter-2016-Financial-Review-FINAL.pdf.

²⁵ Barclays Beaver Creek Utilities Conference Presentation at 26 (December 2016).

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1 largely responsible for DP&L and DPL having their respective security ratings
2 reduced from low A to low triple B. DP&L's customers have subsequently been
3 paying dividends to DPL to support these debt levels. In essence, DP&L's
4 customers have been paying for the debt service used to finance the 2011
5 acquisition.

6 ***Q28. THE PROPOSED SETTLEMENT INDICATES THAT DP&L "WILL***
7 ***COMMIT TO COMMENCE A SALE PROCESS TO SELL TO A THIRD***
8 ***PARTY ITS OWNERSHIP" IN CERTAIN COAL GENERATION ASSETS TO***
9 ***MAKE DISCRETIONARY DEBT REPAYMENTS AT DP&L AND DPL, INC.***
10 ***THIS IS ALSO CITED BY MR. MALINAK ON PAGE 27. DOES THIS***
11 ***PROPOSED SETTLEMENT COMPONENT PROVIDE THE ADDITIONAL***
12 ***SUPPORT FROM AES THAT YOU ARE RECOMMENDING?***

13 ***A28.*** No, it does not. I note, first, that this states that DP&L "will commit to
14 commence a sale process," which is not a true commitment. It is also not certain
15 how much DP&L and/or DPL will receive from any sale of its coal generation
16 assets. I note that DP&L witness Malinak does not include a potential change in
17 the status of generation assets as part of his financial analysis.²⁶
18 Finally, even though I am not a rate base witness, it seems apparent that DP&L's
19 customers have been providing a return on and a return of these assets throughout
20 their service lives by the inclusion of these plants in DP&L's rate base. As such,

²⁶ Direct Testimony of R. Jeffrey Malinak on the Amended Stipulation and Recommendation at 31.

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1 it does not appear that this (the potential sale of generation assets) represents any
2 contribution from AES.

3 ***Q29. WHAT ADDITIONAL ACTIONS CAN AES TAKE TO REDUCE THE DEBT***
4 ***LEVEL OF DPL AND IMPROVE THE CREDIT RATING OF DPL INC.?***

5 ***A29.*** AES, for example, could apply a significant amount of its “debt reduction” to the
6 retirement of DPL’s current debt, which is nearly about \$1,177.6 million.

7
8 ***Q30. DOES AES HAVE THE ABILITY TO TAKE THESE ACTIONS TO***
9 ***REDUCE THE DEBT LEVEL AND IMPROVE THE CREDIT RATING***
10 ***OF DPL?***

11 ***A30.*** Yes, it does. The above review of AES’s financial circumstances indicates that
12 AES currently has the ability to provide more support to finance its acquisition of
13 DPL than it has in the past. AES, not the captive customers of DP&L should be
14 on the hook for funding actions to reduce the debt level and improve the credit
15 rating of DPL.

1 **Q31. THE PROPOSED SETTLEMENT INDICATES THAT DPL WILL NOT**
2 **MAKE ANY “CONTRACTUALLY-REQUIRED TAX-SHARING PAYMENTS**
3 **TO AES. THIS IS ALSO CITED IN THE TESTIMONIES OF MR. MALINAK**
4 **(PAGE 27) AND MS. SCHRODER (PAGE 10). DOES THIS PORTION OF**
5 **THE PROPOSED SETTLEMENT PROVIDE THE ADDITIONAL SUPPORT**
6 **FROM AES THAT YOU ARE RECOMMENDING?**

7 **A31.** No, it does not. Whereas it appears that one intent of this arrangement is to
8 “infuse” equity into DPL, it must be recognized that DPL currently has a very
9 significant level of negative common equity. As of December 31, 2016, DPL’s
10 common equity was a negative \$587.6 million.²⁷ It appears that the anticipated
11 annual effect of this agreement is about [REDACTED]²⁸, meaning that it would take
12 some [REDACTED] years to get DPL’s equity back to a positive amount through this
13 so-called equity infusion alone. In addition, there does not appear to be any direct
14 link or benefit to DP&L and its customers resulting from this tax-sharing payment
15 agreement.

16 I note that I am not testifying on income tax matters in this proceeding.

17

18 **Q32. DOES THIS CONCLUDE YOUR TESTIMONY?**

19 **A32.** Yes, it does, but I incorporate my November 2016 Direct Testimony by reference
20 for reasons discussed herein. In addition, I reserve the right to update my
21 testimony as outstanding discovery or other new information become available.

²⁷ DPL/DP&L December 31, 2016 Form 10-K page 83).

²⁸ Response to Kroger INT-04-002 (Highly confidential). Attachment DCP-3

CERTIFICATE OF SERVICE

It is hereby certified that a true copy of the foregoing *Supplemental Testimony of David C. Parcell on Behalf of the Ohio Consumers' Counsel* was served via electronic transmission this 29th day of March 2017.

/s/ William J. Michael

William J. Michael
Assistant Consumers' Counsel

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BACKGROUND AND EXPERIENCE PROFILE
DAVID C. PARCELL, MBA, CRR
PRESIDENT/SENIOR ECONOMIST

EDUCATION

1985	M.B.A., Virginia Commonwealth University
1970	M.A., Economics, Virginia Polytechnic Institute and State University, (Virginia Tech)
1969	B.A., Economics, Virginia Polytechnic Institute and State University, (Virginia Tech)

POSITIONS

2007-Present	President, Technical Associates, Inc.
1995-2007	Executive Vice President and Senior Economist, Technical Associates, Inc.
1993-1995	Vice President and Senior Economist, C. W. Amos of Virginia
1972-1993	Vice President and Senior Economist, Technical Associates, Inc.
1969-1972	Research Economist, Technical Associates, Inc.
1968-1969	Research Associate, Department of Economics, Virginia Polytechnic Institute and State University

ACADEMIC HONORS

Omicron Delta Epsilon - Honor Society in Economics
Beta Gamma Sigma - National Scholastic Honor Society of Business Administration
Alpha Iota Delta - National Decision Sciences Honorary Society
Phi Kappa Phi - Scholastic Honor Society

PROFESSIONAL DESIGNATIONS

Certified Rate of Return Analyst - Founding Member

RELEVANT EXPERIENCE

Financial Economics -- Advised and assisted many Virginia banks and savings and loan associations on organizational and regulatory matters. Testified approximately 25 times before the Virginia State Corporation Commission and the Regional Administrator of National Banks on matters related to branching and organization for banks, savings and loan associations, and consumer finance companies. Advised financial institutions on interest rate structure and loan maturity. Testified before Virginia State Corporation Commission on maximum rates for consumer finance companies.

Testified before several committees and subcommittees of Virginia General Assembly on numerous banking matters.

Clients have included First National Bank of Rocky Mount, Patrick Henry National Bank, Peoples Bank of Danville, Blue Ridge Bank, Bank of Essex, and Signet Bank.

Published articles in law reviews and other periodicals on structure and regulation of banking/financial services industry.

Utility Economics -- Performed numerous financial studies of regulated public utilities. Testified in over 545 cases before some fifty state and federal regulatory agencies.

Prepared numerous rate of return studies incorporating cost of equity determination based on DCF, CAPM, comparable earnings and other models. Developed procedures for identifying differential risk characteristics by nuclear construction and other factors.

Conducted studies with respect to cost of service and indexing for determining utility rates, the development of annual review procedures for regulatory control of utilities, fuel and power plant cost recovery adjustment clauses, power supply agreements among affiliates, utility franchise fees, and use of short-term debt in capital structure.

Presented expert testimony before federal regulatory agencies Federal Energy Regulatory Commission, Federal Power Commission, and National Energy Board (Canada), state regulatory agencies in Alabama, Alaska, Arizona, Arkansas, California, Connecticut, Delaware, District of Columbia, Florida, Georgia, Hawaii, Illinois, Indiana, Kansas, Kentucky, Maine, Maryland, Mississippi, Missouri, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, Ohio, Oklahoma, Ontario (Canada), Pennsylvania, South Carolina, Texas, Utah, Vermont, Virginia, West Virginia, Washington, Wisconsin, U. S. Virgin Islands and Yukon Territory (Canada).

Published articles in law reviews and other periodicals on the theory and purpose of regulation and other regulatory subjects.

Clients served include state regulatory agencies in Alaska, Arizona, Delaware, Georgia, Massachusetts, Mississippi, Missouri, New Hampshire, New Mexico, North Carolina, Ontario (Canada), South Carolina, Washington, Vermont and Virginia; consumer advocates and attorneys general in Alabama, Arizona, District of Columbia, Florida, Georgia, Hawaii, Illinois, Indiana, Kansas, Kentucky, Maryland, Nevada, New Jersey, New Mexico, Ohio, Oklahoma, Pennsylvania, South Carolina, Texas, Utah, Vermont, Virginia, and West Virginia; federal agencies including Defense Communications Agency, the Department of Energy, Department of the Navy, and General Services Administration; and various organizations such as Bath Iron Works, Illinois Citizens' Utility Board, Illinois Governor's Office of Consumer Services, Illinois Small Business Utility Advocate, Wisconsin's Environmental Decade, Wisconsin's Citizens Utility Board, and Old Dominion Electric Cooperative.

Insurance Economics -- Conducted analyses of the relationship between the investment income earned by insurance companies on their portfolios and the premiums charged for insurance. Analyzed impact of diversification on financial strength of Blue Cross/Blue Shield Plans in Virginia.

Conducted studies of profitability and cost of capital for property/casualty insurance industry. Evaluated risk of and required return on surplus for various lines of insurance business.

Presented expert testimony before Virginia State Corporation Commission concerning cost of capital and expected gains from investment portfolio. Testified before insurance bureaus of Maine, Massachusetts, New Jersey, New Mexico, North Carolina, Rhode Island, South Carolina and Vermont concerning cost of equity for insurance companies.

Prepared cost of capital and investment income return analyses for numerous insurance companies concerning several lines of insurance business. Analyses used by Virginia Bureau of Insurance for purposes of setting rates.

Special Studies -- Conducted analyses which evaluated the financial and economic implications of legislative and administrative changes. Subject matter of analyses include returnable bottles, retail beer sales, wine sales regulations, taxi-cab taxation, and bank regulation. Testified before several Virginia General Assembly subcommittees.

Testified before Virginia ABC Commission concerning economic impact of mixed beverage license.

Clients include Virginia Beer Wholesalers, Wine Institute, Virginia Retail Merchants Association, and Virginia Taxicab Association.

Franchise, Merger & Anti-Trust Economics -- Conducted studies on competitive impact on market structures due to joint ventures, mergers, franchising and other business restructuring. Analyzed the costs and benefits to parties involved in mergers. Testified in federal courts and before banking and other regulatory bodies concerning the structure and performance of markets, as well as on the impact of restrictive practices.

Clients served include Dominion Bankshares, asphalt contractors, and law firms.

Transportation Economics -- Conducted cost of capital studies to assess profitability of oil pipelines, trucks, taxicabs and railroads. Analyses have been presented before the Federal Energy Regulatory Commission and Alaska Pipeline Commission in rate proceedings. Served as a consultant to the Rail Services Planning Office on the reorganization of rail services in the U.S.

Economic Loss Analyses -- Testified in federal courts, state courts, and other adjudicative forums regarding the economic loss sustained through personal and business injury whether due to bodily harm, discrimination, non-performance, or anticompetitive practices. Testified on economic loss

to a commercial bank resulting from publication of adverse information concerning solvency. Testimony has been presented on behalf of private individuals and business firms.

MEMBERSHIPS

American Economic Association
Virginia Association of Economists
Richmond Society of Financial Analysts
Financial Analysts Federation
Society of Utility and Regulatory Financial Analysts
 Board of Directors 1992-2000
 Secretary/Treasurer 1994-1998
 President 1998-2000

RESEARCH ACTIVITY

Books and Major Research Reports

"Stock Price As An Indicator of Performance," Master of Arts Thesis, Virginia Tech, 1970

"Revision of the Property and Casualty Insurance Ratemaking Process Under Prior Approval in the Commonwealth of Virginia," prepared for the Bureau of Insurance of the Virginia State Corporation Commission, with Charles Schotta and Michael J. Ileo, 1971

"An analysis of the Virginia Consumer Finance Industry to Determine the Need for Restructuring the Rate and Size Ceilings on Small Loans in Virginia and the Process by which They are Governed," prepared for the Virginia Consumer Finance Association, with Michael J. Ileo, 1973

State Banks and the State Corporation Commission: A Historical Review, Technical Associates, Inc., 1974

"A Study of the Implications of the Sale of Wine by the Virginia Department of Alcoholic Beverage Control", prepared for the Virginia Wine Wholesalers Association, Virginia Retail Merchants Association, Virginia Food Dealers Association, Virginia Association of Chain Drugstores, Southland Corporation, and the Wine Institute, 1983.

"Performance and Diversification of the Blue Cross/Blue Shield Plans in Virginia: An Operational Review", prepared for the Bureau of Insurance of the Virginia State Corporation Commission, with Michael J. Ileo and Alexander F. Skirpan, 1988.

The Cost of Capital - A Practitioners' Guide, Society of Utility and Regulatory Financial Analysts, 2010 (previous editions in 1991, 1992, 1993, 1994, 1995 and 1997).

Papers Presented and Articles Published

"The Differential Effect of Bank Structure on the Transmission of Open Market Operations," Western Economic Association Meeting, with Charles Schotta, 1971

"The Economic Objectives of Regulation: The Trend in Virginia," (with Michael J. Ileo), William and Mary Law Review, Vol. 14, No. 2, 1973

"Evolution of the Virginia Banking Structure, 1962-1974: The Effects of the Buck-Holland Bill", (with Michael J. Ileo), William and Mary Law Review, Vol. 16, No. 3, 1975

"Banking Structure and Statewide Branching: The Potential for Virginia", William and Mary Law Review, Vol. 18, No. 1, 1976

"Bank Expansion and Electronic Banking: Virginia Banking Structure Changes Past, Present, and Future," William and Mary Business Review, Vol. 1, No. 2, 1976

"Electronic Banking - Wave of the Future?" (with James R. Marchand), Journal of Management and Business Consulting, Vol. 1, No. 1, 1976

"The Pricing of Electricity" (with James R. Marchand), Journal of Management and Business Consulting, Vol. 1, No. 2, 1976

"The Public Interest - Bank and Savings and Loan Expansion in Virginia" (with Richard D. Rogers), University of Richmond Law Review, Vol. 11, No. 3, 1977

"When Is It In the 'Public Interest' to Authorize a New Bank?", University of Richmond Law Review, Vol. 13, No. 3, 1979

"Banking Deregulation and Its Implications on the Virginia Banking Structure," William and Mary Business Review, Vol. 5, No. 1, 1983

"The Impact of Reciprocal Interstate Banking Statutes on The Performance of Virginia Bank Stocks", with William B. Harrison, Virginia Social Science Journal, Vol. 23, 1988

"The Financial Performance of New Banks in Virginia", Virginia Social Science Journal, Vol. 24, 1989

"Identifying and Managing Community Bank Performance After Deregulation", with William B. Harrison, Journal of Managerial Issues, Vol. II, No. 2, Summer 1990

"The Flotation Cost Adjustment To Utility Cost of Common Equity - Theory, Measurement and Implementation," presented at Twenty-Fifth Financial Forum, National

Society of Rate of Return Analysts, Philadelphia, Pennsylvania, April 28, 1993.

Biography of Myon Edison Bristow, Dictionary of Virginia Biography, Volume 2, 2001

Due to Confidential Attachments:

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