BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Dayton Power and Light Company for an Increase in Electric Distribution Rates	)))	Case No. 15-1830-EL-AIR
In the Matter of the Application of Dayton Power and Light Company for Accounting Authority	)))	Case No. 15-1831-EL-AAM
In the Matter of the Application of Dayton Power and Light Company for Approval of Revised Tariffs	)))	Case No. 15-1832-EL-ATA

OBJECTIONS TO THE STAFF REPORT OF INVESTIGATION AND SUMMARY OF MAJOR ISSUES OF INDUSTRIAL ENERGY USERS-OHIO

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Under R.C. 4909.19, Rule 4901-1-28(B), Ohio Administrative Code ("OAC"), and the Attorney Examiner's Entry dated March 14, 2018, Industrial Energy Users-Ohio ("IEU-Ohio") hereby files its Objections to the Staff Report of Investigation ("Staff Report") and Summary of Major Issues in the above-captioned matters. The Staff Report was filed with the Public Utilities Commission of Ohio ("Commission") on March 12, 2018. It provides the findings of the Commission Staff ("Staff") regarding the application for authority to increase rates for distribution service filed by Dayton Power and Light Company ("DP&L) on November 30, 2015. In submitting the Objections listed below, IEU-Ohio specifically reserves the right to contest, through presentation of documentary evidence, testimony, or cross examination, issues on which Staff's position changes, or which are newly raised, between the issuance of the Staff Report and the closing of the record.

I. OBJECTIONS TO THE STAFF REPORT

Revenue Requirement

1. The Staff Report's recommendation of a revenue increase of $23,230,037 to $28,111,474, as set out on Schedule A-1, violates Ohio law and proper ratemaking practices because the increase is too large to yield just and reasonable rates in accordance with Ohio law and proper ratemaking practices as demonstrated by the additional objections stated below.

As provided by R.C. 4909.15, the Commission is to compute the gross annual revenue to which the utility is entitled by adding the dollar amount of the return on rate base to the cost of rendering utility service. To determine the increase in gross annual revenue, the Staff Report estimates the revenue deficiency. As set out in Schedule A-1 of the Staff Report, the revenue deficiency is equal to the recommended revenue increase. As detailed in the objections concerning taxes and the rate of return that follow, the estimate of the revenue deficiency does not comply with Ohio law and proper ratemaking practices. Accordingly, the revenue increase set out in Schedule A-1 should be decreased to account for the effects of the other adjustments required by Ohio law and proper ratemaking practices.

Operating Income

2. The Staff Report's recommendation of a revenue increase based on the application of a federal corporate income tax rate of 35%, as shown on

Schedule C-1 and C-4 and related schedules, violates Ohio law and proper ratemaking practices.

As provided by R.C. 4909.15, the Commission is to compute the gross annual revenue to which the utility is entitled by adding the dollar amount of the return on rate base to the cost of rendering utility service. In computing the gross annual revenue, the Commission adjusts net operating income before income taxes with an estimate of state and federal income taxes to produce net operating income. Staff Report, Schedule C-1. After making various adjustments to operating income, the Staff Report estimates federal income taxes on Schedule C-4. Staff Report at 17.

The Staff Report incorporates a federal corporate income tax rate of 35% to calculate federal corporate income tax expense even though the federal corporate income tax rate was reduced as of January 1, 2018 to 21%. As a matter of Ohio law and Commission practice, the federal corporate income tax rate of 21% is the proper rate because it is known and measurable and reflects the rate that DP&L will be paying during the period the new rates will be in effect. *In the Matter of the Application of The Cleveland Electric Illuminating Company for Authority to Amend and Increase Certain of its Filed Schedules Fixing Rates and Charges for Electric Service*, 1987 Ohio PUC Lexis 28 at *197 (Dec. 16, 1987). As a result of the application of the incorrect federal corporate income tax rate, the revenue increase set out in Schedule A-1 should be decreased, all other things being equal.

__Gross Revenue Conversion Factor__

3. The Staff Report's recommendation of a Gross Revenue Conversion Factor of 1.549772, as shown on Schedule A-1 and Schedule A-2, violates Ohio law and proper ratemaking practices.

As provided by R.C. 4909.15, the Commission is to compute the gross annual revenue to which the utility is entitled by adding the dollar amount of the return on rate base to the cost of rendering utility service. In determining the revenue deficiency and increase, the Commission applies a gross revenue conversion factor that recognizes that the amount of the revenue increase must be adjusted to account for the application of taxes to the increase in revenue. Staff Report, Schedule A-1 and A-2.

The Staff Report incorporates a federal corporate income tax rate of 35% to calculate the Gross Revenue Conversion Factor. *Id.*, Schedule A-2. As of January 1, 2018, the federal corporate income tax rate was reduced to 21%. As a matter of Ohio law and Commission practice, the federal corporate income tax rate of 21% is the proper amount because it is known and measurable and reflects the rate that DP&L will be paying during the period the new rates will be in effect. *In the Matter of the Application of The Cleveland Electric Illuminating Company for Authority to Amend and Increase Certain of its Filed Schedules Fixing Rates and Charges for Electric Service*, 1987 Ohio PUC Lexis 28 at *197 (Dec. 16, 1987).

As a result of the application of an incorrect gross revenue conversion factor that includes an unlawful and unreasonable federal corporate income tax rate, the revenue increase set out in Schedule A-1 should be decreased, all other things being equal.

Return on Investment

4. The Staff Report's recommendation to use a hypothetical cost of debt of 5.29%, as shown on Schedule D-1 and explained at page 18, violates Ohio law and proper ratemaking practices.

As provided by R.C. 4909.15, the Commission is to compute the gross annual revenue to which the utility is entitled by adding the dollar amount of the return on rate base to the cost of rendering utility service. In determining a fair and reasonable rate of return, the Commission is to reference the cost of debt "equal to the actual embedded cost of debt of such public utility." *Id.*

The actual embedded cost of debt of DP&L when the Application was filed was 2.72%. Schedules D-1 and D-3 of the Application and Testimony of Jeffrey K. McKay. As shown by the annual report DP&L filed with the Securities and Exchange Commission, the weighted cost of debt for 2017 did not exceed 3.76%. Although the actual embedded cost of debt for 2017 did not exceed 3.76%, the Staff recommends a hypothetical cost of debt of 5.29%. Staff Report at 18.

Use of a hypothetical cost of debt violates the requirement of R.C. 4909.15 and constitutes an improper ratemaking practice. R.C. 4909.15(E)(2); *In the Matter of the Application of The Cincinnati Gas & Elec. Co. for Authority to Increase its Rates for Electric Service to all Jurisdictional Customers*, 1984 Ohio PUC LEXIS 9 at *25-*26 (Nov. 20, 1984). Actual cost of debt was no less than 2.72% and no greater than 3.76%, not 5.29% as adopted in the Staff Report. As a result of this error, the revenue increase set out in Schedule A-1 should be decreased, all other things being equal.

<u>Return on Investment Adjusted for Management Practices</u>

5. The Staff Report's recommendation of a cost of common equity of 9.59% to 10.61%, as shown on Schedules D-1 and D-1.1 and explained on page 19, violates Ohio law and proper ratemaking practices. Due to management performance problems including failure of accounting supervision and failure to maintain a reasonable debt-equity structure, the Staff Report should have recommended that the return on equity be set at the low end of the recommended range of the cost of equity that is determined to be reasonable.

As provided by R.C. 4909.15, the Commission is to compute the gross annual revenue to which the utility is entitled by adding the dollar amount of the return on rate base to the cost of rendering utility service. In determining a fair and reasonable rate of return, the Commission may elect a rate of return at the low end of the range of reasonable rates of return so as to alter behavior that the Commission believes should be improved. *General Telephone Co. of Ohio*, 68 P.U.R. 4th 212 (Pub. Utils. Comm'n of Ohio 1985); *In the Matter of the Application of Ohio Gas Company for an Increase in Gas Distribution Rates*, Case Nos. 17-1139-GA-AIR, *et al*., Staff Report at 13 (Nov. 22, 2017).

The Staff Report provides evidence of poor management controls that should be improved. As a result of the Staff's investigation of the Application, the Staff and its outside auditor recommend disallowances from the requested rate base due to the inability of DP&L to document representations of the valuation of property that was used and useful in the provision of utility service. Staff Report, Schedule B-1 and supporting schedules; Audit of Plant in Service for Dayton Power and Light's Application to Increase Rates (Sept. 28, 2017). Additionally, DP&L has operated in such a way that it is significantly over-leveraged. Due to poor management controls, the Commission should reduce the return on equity so as to alter behavior of DP&L management that the Commission believes could be improved. Accordingly, the Commission should set the return on equity at the low end of range of a reasonable cost of equity, and the revenue increase set out in Schedule A-1 should be decreased, all other things being equal.

II. STATEMENT OF MAJOR ISSUES

1. Based on the objections of IEU-Ohio to the recommendations of the Staff Report that uses a federal corporate income tax rate of 35% rather than 21% to calculate net operating income, that uses a federal corporate income tax rate of 35% rather than 21% in the calculation of the gross revenue conversion factor, that includes the use of a hypothetical debt cost to set the return on investment, and that demonstrates management performance that should be incented to improve, should the base distribution revenue be reduced so that the resulting rates are just and reasonable as required by R.C. 4909.15?

2. Based on the objection of IEU-Ohio that the Staff Report unreasonably and unlawfully uses a federal corporate income tax rate of 35% rather than 21% to calculate net operating income, should the distribution revenue increase be decreased?

3. Based on the objection of IEU-Ohio that the Staff Report unreasonably and unlawfully included a 35% federal corporate income tax rate to set the gross revenue conversion factor, should the distribution revenue increase be decreased?

4. Based on the objection of IEU-Ohio that the Staff Report improperly used a hypothetical cost of debt to calculate the return on investment, should the distribution revenue increase be decreased?

5. Based on the management performance that resulted in several rate base-related disallowances identified by the Staff Report and the over-leveraged balance sheet of DP&L, should the Commission adopt the low end of the range of return on equity so as to alter behavior of DP&L management that the Commission believes could be improved?

Respectfully submitted,

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CERTIFICATE OF SERVICE

In accordance with Rule 4901-1-05, Ohio Administrative Code, the PUCO's e-filing system will electronically serve notice of the filing of this document upon the following parties. In addition, I hereby certify that a service copy of the foregoing *Objections to the Staff Report of Investigation and Summary of Major Issues of Industrial Energy Users-Ohio* was sent by, or on behalf of, the undersigned counsel for Industrial Energy Users-Ohio, to the following parties of record this 11th day of April 2018, *via* electronic transmission.

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