

BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

THE DAYTON POWER AND LIGHT COMPANY

CASE NO. 15-1830-EL-AIR
CASE NO. 15-1831-EL-AAM
CASE NO. 15-1832-EL-ATA

SUPPLEMENTAL DIRECT TESTIMONY OF
EDWARD J. KUNZ

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

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Edward J. Kunz. I work for the AES U.S. Services, LLC ("AES Services"). I have duties and responsibilities with Indianapolis Power and Light Company ("IPL") and The Dayton Power and Light Company ("DP&L" or "Company") via an affiliate agreement with AES Services.

Q. Did you previously file testimony in this case?

A. Yes.

Q. What is the purpose of this testimony?

A. The purpose of this testimony is to support the December 31, 2015 Mercer certified actuarial report and to support and explain DP&L Objection No. 13, regarding Staff's recommendation that DP&L's net prepaid pension asset be excluded from rate base.

Q. What Schedules and Workpaper are you supporting?

A. I support the Pension and OPEB expense amounts included in Schedule C-3.13, supported by Workpaper C-3.13, both of which are sponsored by Company Witness Forestal. The amounts contained therein have been updated for the December 31, 2015 Mercer certified actuarial report and actual charges for test year months. The adjusted test year amount annualizes the expenses that result from the December 31, 2015 Mercer certified actuarial report. These amounts were adopted in the March 13, 2018 Staff Report in this case, and result in a decrease in jurisdictional O&M expense of \$1,832,760 for pension and \$113,148 for OPEB expense.

II. NET PREPAID PENSION ASSET

Q. Please explain DP&L Objection No. 13 to the Staff Report regarding the Staff's disallowance of DP&L's Net Prepaid Asset.

A. The Staff Report recommends a disallowance of the \$40.9 million Prepaid Pension Asset. DP&L objects to this disallowance because the prepaid pension asset is an actual asset on the books that reflects a benefit to DP&L employees as well as DP&L's customers. DP&L also objects to the disallowance because it is inconsistent with prior Staff Reports and Commission precedent.

Q. What is the definition of Net Prepaid Pension Asset?

A. The Net Prepaid Pension Asset is the cumulative amount of actual cash pension contributions to the pension trust fund made by DP&L beyond the cumulative amount of pension cost that has been accrued to expense for DP&L. The Net Prepaid Pension Asset represents an asset supplied by investors, requiring a return.

Q. Does having a Net Prepaid Pension Asset, determined under GAAP, reduce the net pension and other postretirement cost (expense)?

A. Yes, each year the net annual pension cost and other postretirement cost is reduced by the expected return on assets. Thus, since the Company has made contributions into the pension trust in excess of what has been expensed over time, the net result is a decrease in the net pension and other postretirement cost (expense).

Q. Why would the Net Prepaid Pension Asset appear in a company's financial statements?

1 A. When a company's contribution to the pension trust exceeds the net pension cost for a
2 given year, an asset (prepaid pension cost) is recognized. In the case of other
3 postretirement benefits (OPEBS), an accrued liability exists showing that the net OPEB
4 expense exceeds the amounts contributed towards funding of this benefit. For DP&L,
5 both of these amounts are included in the regulatory asset for unrecognized pension and
6 OPEB costs in DP&L's financial statements. The financial statement footnotes reflect
7 the components of these amounts.

8 **Q. Why has DP&L made contributions to the pension trust that exceed the amounts**
9 **that have been expensed?**

10 A. The additional contributions to the pension trust provide current and future benefits to
11 DP&L's employees and customers. The net prepaid pension asset reduces the annual
12 pension expense calculated under ASC 715 by earning a return which directly offsets
13 future ongoing pension costs. Through this rate case, those savings are transferred to
14 DP&L customers. Had DP&L not made additional contributions to the pension trust,
15 pension expense included in this rate case would have been higher, resulting in an
16 increased cost to customers. The quantifiable annual net benefit to customers of having a
17 net prepaid pension asset is approximately \$1 million.

18 In addition, funding the pension plan makes it more secure, benefitting customers. A
19 strong pension plan is important to attracting and retaining a good work force, allowing
20 DP&L to continue to provide customers cost-effective and reliable electric service.

21 **Q. Is the \$40.9 million net prepaid pension asset an asset of DP&L?**

1 A. Yes. Assets represent probable future economic benefits to the enterprise. They are
2 created in transactions where value is exchanged. This is an established core accounting
3 concept from the theoretical underpinnings of GAAP as expressed in FASB Statement of
4 financial Accounting Concepts No. 6, Elements of Financial Statements ("CON 6") and
5 throughout the accounting literature. As an example, Statement of Financial Accounting
6 Standards No. 71, Accounting for the Effects of Certain Types of Regulation ("FAS 71")
7 at Paragraph 58 provides a similar description of the criteria for an asset but in a
8 regulatory context. As explained further above and below, the net prepaid asset meets
9 this criteria.

10 **Q. Does the Net Prepaid Pension Asset represent investor-supplied funding requiring a**
11 **return?**

12 A. Yes, the Net Prepaid Pension Asset recorded on the books of DP&L in accordance with
13 GAAP represents investors supplied investment and should be entitled to a return. The
14 time value or opportunity cost associated with the Net Prepaid Pension Asset is an actual
15 cost that was prudently and beneficially incurred but will not be recognized in the
16 ratemaking process unless the Net Prepaid Pension Asset is included in rate base.

17 **Q. The Staff Report (p. 12) says "Staff also removed Net Prepaid Pension Asset**
18 **because it is uncertain if the funds collected for a pension asset in rate base would**
19 **actually be contributed toward the pension fund." Do you agree?**

20 A. No. Including the Net Prepaid Pension Asset in rate base is consistent with the long
21 established practice of including similar utility investments in rate base, such as
22 investments in materials and supplies and regulatory assets. The time value or
23 opportunity cost associated with the Net Prepaid Pension Asset is an actual cost that was

1 prudently and beneficially incurred but will not be recognized in the ratemaking process
2 unless the Net Prepaid Pension Asset is included in rate base. The assets in the pension
3 trust (the Net Prepaid Pension Asset) cannot be withdrawn from the pension trust. There
4 is not, nor should there be, any requirement that returns on any investment, including
5 plant in service, be immediately and solely directed toward a similar investment. These
6 returns reflect the cost of investing in these assets in the first place. In this respect, the
7 net prepaid pension asset is no different than the other investments included in rate base.
8 It is an investor-supplied investment, the benefits of which flow directly to DP&L's
9 customers, that has a true cost of capital that must be recovered through a return on that
10 asset. The Net Prepaid Pension Asset represents employer contributions (that have
11 already been contributed into the pension trust) in excess of the net periodic benefit cost
12 that has been previously expensed in the Company's financial statements.

13 **Q. What are the economic benefits to be expected from the Net Prepaid Pension Asset?**

14 A. Eventually, the prepaid pension asset will be used to pay pension benefits, benefits
15 already earned by DP&L employees. In the meantime, the prepaid pension asset will
16 earn returns for the pension plan, reducing every year the net annual pension cost charged
17 to DP&L and ultimately the amount reflected in the ratemaking process. In addition,
18 DP&L's employees are protected by funding the benefits that they have already earned.
19 Second, DP&L's perceived financial strength has been increased by reducing unfunded
20 obligations.

21 **Q. Has Staff previously recommended that a prepaid pension asset be included in rate**
22 **base?**

1 A. Yes. The Staff filed a Staff Report in Case No. 11-352-AIR on September 15, 2011 that
2 recommended on pages 7-8 that a prepaid pension asset be included in rate base. The
3 Staff stated:

4 "The Staff increased rate base to recognize a prepaid pension asset.
5 The Applicant recorded a prepaid asset in the amount of
6 \$68,487,856 for additional pension cash contributions as of the
7 date certain, August 31, 2010. The additional contributions
8 represent cash investments above the amount of the pension cost
9 included in the cost of service or the income statement. The
10 additional contributions benefit customers by reducing future
11 pension costs through increased earnings. In accordance with
12 generally accepted accounting principles under FASB No. 87
13 Employers' Accounting for Pensions, the cumulative difference
14 between the pension cost and pension cash contributions is to be
15 recorded on the balance sheet as an asset or liability. A prepaid
16 asset is recorded if pension contributions are greater than the
17 pension cost. A liability is recorded if pension contributions are
18 less than the pension cost.

19 The prepaid pension asset is entirely supported by cash
20 contributions in excess of pension cost. None of the additional
21 pension contributions serve to prefund the pension obligation in
22 advance. The Staff agrees with the Applicant's adjustment.
23 Including in rate base the additional cash contributions, that will be
24 expensed in the future, allows for ratemaking recognition of the
25 cost of funds for the prepaid contributions."

26 The facts that the Staff cited in its recommendation are also true for DP&L.

27 **Q. Has the Commission previously held that prepaid pension assets should be included**
28 **in rate base?**

29 A. Yes, the Commission has done so on at least two occasions. In the Matter of the
30 Application of The Ohio Edison Company, The Cleveland Electric Illuminating
31 Company and The Toledo Edison Company for Authority to Increase Rates for
32 Distribution Service, Modify Certain Accounting Practices and for Tariff Approvals,
33 Case No. 07-551-EL-AIR, et al., Opinion and Order (January 21, 2009) p. 16; In the

1 Matter of the Commission Review of Capacity Charges of Ohio Power Company and
2 Columbus Southern Power, Case No. 10-2929-EL-UNC, Opinion and Order (July 2,
3 2012) p. 34.

4 **Q: Have other regulatory commissions addressed whether a prepaid pension asset**
5 **should be included in rate base?**

6 A: Yes. In Docket ER 08-129-000, page 8, the Federal Energy Regulatory Commission
7 concluded that a prepaid pension asset should be included in rate base:

8 “[P]repaid pensions arise when the income earned on pension funds accumulated
9 in an external trust exceeds the net periodic pension cost, i.e., the current year’s
10 pension income exceeds the current year’s pension expense. By law, a utility
11 cannot withdraw such income, although it is required (under Generally Accepted
12 Accounting Principles) to reflect the income as a reduction to its pension
13 expense.... At the same time, the utility records a corresponding amount of
14 prepaid pensions. If that reduction in pension expense is used in determining a
15 utility’s rates, there will be a corresponding reduction in the amounts collected
16 from ratepayers. Because a utility cannot withdraw the pension income, it will be
17 out-of-pocket for the amount of pension income that has reduced rates, i.e., it
18 must reduce its pension expense by the amount of income, even though it is not
19 allowed to receive such income from the pension trust. Thus, when a utility’s
20 rates have been reduced by pension income, but the utility has not received such
21 income from the external trust, it will have to finance such amount, and is entitled
22 to include the pension income in rate base.”

23 **III. CONCLUSION**

24 **Q. What are your conclusions with respect to the appropriate ratemaking treatment of**
25 **DP&L’s net prepaid pension asset?**

26 A. The prepaid pension asset is an investor-supplied asset of DP&L. The prepaid pension
27 asset provides benefits to DP&L’s employees and customers currently and for years into
28 the future. The net prepaid pension asset reduces the annual pension expense calculated
29 under ASC 715 and customers receive the benefit of this reduced expense, which is a

1 component of operating expenses. The quantifiable annual net benefit to customers of
2 having a net prepaid pension asset is approximately \$1 million. In addition, funding the
3 pension plan makes DP&L's pension plan more secure, benefitting customers because a
4 strong pension plan is important to attracting and retaining a good work force so that
5 DP&L can continue to provide customers cost-effective and reliable electric service.
6 Funding pension benefits is a responsible and integral part of providing service.
7 Therefore, the prepaid pension asset should be included in rate base and earn the
8 authorized rate of return.

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

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

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing Supplemental Direct Testimony of Edward J.

Kunz has been served via electronic mail upon the following counsel of record, this 11th day of

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This foregoing document was electronically filed with the Public Utilities

Commission of Ohio Docketing Information System on

4/11/2018 3:38:41 PM

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Case No(s). 15-1830-EL-AIR, 15-1831-EL-AAM, 15-1832-EL-ATA

Summary: Testimony Supplemental Direct Testimony of Edward J. Kunz electronically filed by Mr. Jeffrey S Sharkey on behalf of The Dayton Power and Light Company