

**BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of The Dayton Power and Light Company for an Increase in its Electric Distribution Rates)	Case No. 15-1830-EL-AIR
)	
In the Matter of the Application of The 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
)	
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
)	
In the Matter of the Application of Dayton Power and Light Company for Approval of Revised Tariffs)	Case No. 16-0396-EL-ATA
)	
In the Matter of the Application of The Dayton Power and Light Company for Approval of Certain Accounting Authority Pursuant to Ohio Rev. Code § 4905.13)	Case No. 16-0397-EL-AAM

DIRECT TESTIMONY OF KEVIN C. HIGGINS

On Behalf of The Kroger Co.

April 11, 2018

1 economic and policy analysis, including evaluation of electric and gas utility rate
2 matters.

3 Prior to joining Energy Strategies, I held policy positions in state and local
4 government. From 1983 to 1990, I was economist, then assistant director, for the
5 Utah Energy Office, where I helped develop and implement state energy policy.
6 From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County
7 Commission, where I was responsible for development and implementation of a
8 broad spectrum of public policy at the local government level.

9 **Q. Have you ever testified before this Commission?**

10 A. Yes. Since 2004, I have testified or filed testimony in twenty-two cases
11 before this Commission, including three cases pertaining directly to DP&L.

12 Last year, I testified in the Universal Service Fund Rider proceeding, Case
13 No. 17-1377-EL-USF and filed testimony in AEP Ohio's amended ESP case,
14 Case Nos. 16-1852-EL-SSO, et al.

15 In 2016, I filed testimony in DP&L's 2016 Electric Security Plan ("ESP")
16 proceeding, Case Nos. 16-0395-EL-SSO, et al. In 2015, I filed testimony in AEP
17 Ohio's Affiliate Power Purchase Agreement proceeding, Case Nos. 14-1693-EL-
18 RDR, et al. In 2014, I filed testimony in the Ohio Edison Company, the
19 Cleveland Electric Illuminating Company, and the Toledo Edison Company's
20 (collectively, "FirstEnergy") ESP IV proceeding, Case Nos. 14-1297-EL-SSO, et
21 al. (with supplemental testimony filed in 2015); Duke Energy Ohio's ("Duke")
22 ESP III proceeding, Case Nos. 14-841-EL-SSO, et al.; the AEP Ohio ESP III
23 proceeding, Case Nos. 13-2385-EL-SSO, et al.; DP&L's storm cost recovery rider

1 proceeding, Case Nos. 12-3062-EL-RDR, et al.; and the Republic Steel
2 reasonable arrangements proceeding, Case No. 13-1913-EL-AEC.

3 In 2013, I testified in DP&L's Revised ESP proceeding, Case Nos. 12-
4 426-EL-SSO, et al., and Duke's capacity charge proceeding, Case Nos. 12-2400-
5 EL-UNC, et al. In 2012, I testified in the AEP Ohio ESP II proceeding, Case
6 Nos. 11-346-EL-SSO, et al. In 2011, I testified in the Duke Market Rate Offer
7 ("MRO") proceeding, Case No. 10-2586-EL-SSO, and Duke's ESP II proceeding,
8 Case No. 11-3549-EL-SSO, et al., and in 2010, I filed testimony in Duke's storm
9 damage cost recovery proceeding, Case No. 09-1946-EL-RDR.

10 In 2009, I testified in FirstEnergy's MRO proceeding, Case No. 09-906-
11 EL-SSO, and in Duke's distribution rate case, Case Nos. 08-709-EL-AIR, et al.

12 In 2008, I testified in AEP Ohio's ESP I proceeding, Case Nos. 08-917-
13 EL-SSO, et al.; FirstEnergy's MRO proceeding, Case No. 08-936-EL-SSO;
14 FirstEnergy's ESP proceeding, Case No. 08-935-EL-SSO; and the FirstEnergy
15 distribution rate case proceeding, Case Nos. 07-551-EL-AIR, et al.

16 In 2005, I testified in AEP Ohio's IGCC cost recovery proceeding, Case
17 No. 05-376-EL-UNC, and in 2004, I testified in the FirstEnergy Rate Stabilization
18 Plan proceeding, Case No. 03-2144-EL-ATA.

19 **Q. Have you testified before utility regulatory commissions in other states?**

20 A. Yes. I have testified in approximately 200 proceedings on the subjects of
21 utility rates and regulatory policy before state utility regulators in Alaska,
22 Arizona, Arkansas, Colorado, Georgia, Idaho, Illinois, Indiana, Kansas,
23 Kentucky, Michigan, Minnesota, Missouri, Montana, Nevada, New Mexico, New

1 York, North Carolina, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas,
2 Utah, Virginia, Washington, West Virginia, and Wyoming. I have also prepared
3 affidavits that have been filed with the Federal Energy Regulatory Commission.
4

5 **Overview and Conclusions**

6 **Q. What is the purpose of your testimony in this proceeding?**

7 A. My testimony addresses the following topics:

- 8 (1) DP&L's class cost-of-service study;
- 9 (2) The class allocation of the proposed revenue requirement in this
10 case, or "rate spread;"
- 11 (3) Rate design for the Secondary Distribution Service ("Secondary");
- 12 (4) Recent tax reform changes that impact DP&L's federal tax
13 obligations and revenue requirement; and
- 14 (5) The Distribution Investment Rider ("DIR").

15 As part of this testimony, I offer recommendations to the Commission in
16 support of a just and reasonable outcome in this proceeding.

17 **Q. Have you reviewed DP&L's Application filed in this proceeding on
18 November 30, 2015?**

19 A. Yes, I have.

20 **Q. Have you reviewed the Staff Report of Investigation ("Staff Report") dated
21 March 12, 2018?**

22 A. Yes, I have.
23

1 **Q. What are your primary conclusions and recommendations?**

2 A. I offer the following conclusions and recommendations:

3 (1) DP&L's proposal to utilize the minimum-system method in
4 classifying its distribution plant is reasonable and should be approved by the
5 Commission.

6 (2) Although a closer alignment between class cost of service and
7 revenue allocation would be preferable, the revenue allocation approach
8 recommended by Staff is within a range of reasonableness in this case. Therefore,
9 I recommend using Staff's revenue allocation as the starting point for allocating
10 the revenue requirement approved in this case. Specifically, Staff's recommended
11 revenue allocation should be used to establish each class's percentage share of the
12 total distribution revenue requirement. Those percentage shares should then be
13 applied to the final revenue requirement approved by the Commission.

14 (3) I support DP&L's proposed elimination of the distribution energy
15 charge for the Secondary Class.

16 (4) The 2017 *Act to provide for reconciliation pursuant to titles II and*
17 *V of the concurrent resolution on the budget for fiscal year 2018*, also known as
18 the Tax Cuts and Jobs Act (the "Tax Reform Act"), recently signed into law (PL
19 115-97), reduces the corporate tax rate from 35 percent to 21 percent. This
20 directly and significantly decreases the Company's federal income tax expense for
21 regulatory purposes. Although a generic docket has been initiated to address the
22 implications of the Tax Reform Act, this does not obviate the need to reflect the

1 direct impact of the Tax Reform Act on the revenue requirement determined in
2 this case.

3 5) I support Staff's recommended sunset provisions for the DIR, as well
4 as the establishment of revenue caps for this Rider. These provisions are
5 consistent with the Commission's prior treatment of similar distribution
6 investment riders. However, since the reduction in federal income tax rates will
7 reduce the grossed-up return component of the DIR, all other things being equal,
8 the use of the revenue cap growth percentages recommended by Staff should be
9 applied *after* first reducing the DP&L distribution revenue requirement to reflect
10 the reduced statutory federal income tax rate.

11

12 **Class Cost Allocation**

13 **Q. Generally speaking, what are the goals and objectives of allocating costs**
14 **among the customer classes?**

15 A. Cost allocation is undertaken to attribute to each customer class a proper
16 share of the utility's total revenue requirement in a manner that reflects the cost of
17 providing service to each class.

18 A class cost-of-service study is conducted to determine reasonable cost
19 allocations. The study typically involves the assignment of revenues, expenses,
20 and rate base to each customer class, and generally includes the following steps:

21 • Separating the utility's costs in accordance with the various functions of
22 its system (in this case, distribution service);

1 • Classifying the utility's costs with respect to the manner in which costs
2 are caused by customers (e.g., customer-related costs and demand-related
3 costs);¹ and

4 • Allocating or assigning responsibility for the cost of each utility function
5 to the various customer classes based on principles of cost causation.

6 In performing this analysis for a given utility function, various cost
7 allocation methods can be selected. The selection of a method should be guided
8 by its theoretical soundness and reasonableness as a means of assigning the
9 utility's joint and common costs to its constituent customer groups, consistent
10 with the principle of cost causation and taking into consideration the operating
11 and planning characteristics of the utility.

12 **Q. What method does DP&L use in its class cost-of-service study to determine**
13 **cost responsibilities among classes?**

14 **A.** As explained in the Direct Testimony of Bruce R. Chapman, DP&L's
15 distribution cost-of-service study is based on the Minimum-Size method which
16 recognizes a customer component as well as a demand component in overall
17 distribution costs.² Customer and demand-related costs are then allocated to
18 customer classes using various cost allocation factors. Finally, the Company
19 calculates each class's revenue responsibility that is necessary to produce a
20 recommended rate of return for each customer group.³

¹ If costs were being allocated for the generation function, then a portion of costs would also be classified as energy-related.

² Direct Testimony of Bruce R. Chapman, p. 9.

³ Id., pp. 13-14.

1 **Q. What is your assessment of DP&L’s method to classifying and allocating**
2 **distribution-related costs?**

3 A. I support the use of the Minimum-Size method by DP&L to classify and
4 allocate certain distribution costs. It is appropriate to utilize an allocation method,
5 such as the Minimum-Size method, that recognizes that certain distribution costs
6 have a significant customer-related component.

7 **Q. What is the Minimum-Size method?**

8 A. As described in the NARUC Electric Utility Cost Allocation Manual
9 (“NARUC Manual”), the Minimum-Size method seeks to determine the
10 customer-related component of certain distribution plant accounts by assuming
11 that a minimum size distribution system can be built to serve the minimum
12 loading requirements of the customer.⁴

13 The cost of such minimum system constitutes the customer related
14 component while the difference between the total cost of the utility’s installed
15 distribution facilities and the minimum system cost would constitute the demand
16 component. In this case, DP&L proposes to utilize the Minimum-Size method to
17 classify the distribution plant in Accounts 364 through 368 into demand-related
18 and customer-related components.⁵

19

⁴ NARUC Electric Utility Cost Allocation Manual, January 1992, p. 90.

⁵ Direct Testimony of Bruce R. Chapman, p. 10 (table).

1 **Q. Do you support the use of an allocation method, such as the Minimum-**
2 **System method, that recognizes that certain distribution costs have a**
3 **significant customer-related component?**

4 A. Yes. My views are consistent with the principles laid out regarding this
5 topic in the NARUC Manual. Regarding the allocation of distribution costs, the
6 NARUC Manual states: “The customer component of distribution facilities is that
7 portion of costs which varies with the number of customers. Thus, the number of
8 poles, conductors, transformers, services, and meters are directly related to the
9 number of customers on the utility’s system.”⁶

10 In my view, it is appropriate to utilize a method, such as the Minimum-
11 Size method, that recognizes that distribution facilities are installed to deliver
12 service to customer premises. As such, a significant portion of the investment
13 required to provide these facilities is directly related to the number of customers
14 and their geographic dispersion on the utility’s system.

15

16 **Revenue Allocation**

17 **Q. What general guidelines should be employed in spreading any change in**
18 **rates?**

19 A. In determining revenue allocation, or rate spread, it is important to align
20 rates with cost causation, to the greatest extent practicable. Properly aligning
21 rates with the costs caused by each customer group is essential for ensuring
22 fairness, as it minimizes cross subsidies among customers. It also sends proper
23 price signals, which improves efficiency in resource utilization.

1 At the same time, it can be appropriate to mitigate the impact of moving
 2 immediately to cost-based rates for customer groups that would experience
 3 significant rate increases from doing so by employing the ratemaking principle of
 4 gradualism. When employing this principle, it is important to adopt a long-term
 5 strategy of moving in the direction of cost causation, and to avoid practices that
 6 result in permanent cross-subsidies from other customers.

7 **Q. How is DP&L proposing to allocate its proposed revenue requirement?**

8 A. The Company is proposing to spread its proposed revenue requirement
 9 increase of \$65.8 million in the manner shown in Table KCH-1 below. DP&L
 10 indicates that its proposed revenue increases for each tariff class are predicated
 11 upon a target rate of return for each such class.

12 **Table KCH-1**
 13 **DP&L Proposed Revenue Allocation**
 14

Rate Schedule	Present Distribution Revenue	Proposed Increase		Class Share of Total Proposed Revenue
		\$	%	
Residential	142,086,900	43,716,934	30.77%	66.82%
Secondary	54,738,408	16,841,773	30.77%	25.74%
Primary	11,842,680	3,896,624	32.90%	5.66%
Primary Substation	594,268	184,119	30.98%	0.28%
High Voltage	29,160	49,571	170.00%	0.03%
Private Outdoor Lighting	2,300,582	814,869	35.42%	1.12%
Street Lighting	695,203	267,835	38.53%	0.35%
Total Distribution	212,287,201	65,771,725	30.98%	100.00%

15

16

⁶ NARUC Electric Utility Cost Allocation Manual, January 1992, p. 90.

1 **Q. At DP&L’s requested revenue requirement, what rate spread would result if**
 2 **revenues were allocated to customer classes strictly on the basis of cost?**

3 A. Table KCH-2 below shows the rate spread that would result if revenues
 4 were allocated to customer classes strictly on the basis of cost at DP&L’s
 5 requested revenue requirement. As shown in that table, all customer classes
 6 warrant significant rate increases at DP&L’s requested revenue increase.

7 **Table KCH-2**
 8 **Cost-Based Revenue Allocation at DPL’s Requested Revenue Requirement**
 9

	Present Distribution Revenue	Class Increase Based on COSS Results		Class Share of Total Electric COSS
<u>Rate Schedule</u>		<u>\$</u>	<u>%</u>	<u>%</u>
Residential	142,086,900	42,502,495	29.91%	66.38%
Secondary	54,738,408	11,538,450	21.08%	23.84%
Primary	11,842,680	10,096,700	85.26%	7.89%
Primary Substation	594,268	445,079	74.90%	0.37%
High Voltage	29,160	106,297	364.53%	0.05%
Private Outdoor Lighting	2,300,582	814,869	35.42%	1.12%
Street Lighting	695,203	267,835	38.53%	0.35%
Total Distribution	212,287,201	65,771,724	30.98%	100.00%

10

11 **Q. What is Staff’s proposal with regard to revenue allocation in this case?**

12 A. While Staff accepts the Company’s cost-of-service results as a starting
 13 point for revenue requirement allocation, Staff also recommends that most of the
 14 customer classes be moved to levelized rates of return. This represents a
 15 significant improvement in aligning class revenues with cost responsibility as
 16 compared to DP&L’s proposal. Staff’s resulting rate spread among customer
 17 groups is shown in Table KCH-3.

18

1

**Table KCH-3
Staff Recommended Revenue Allocation at DPL’s Requested Revenue Requirement**

	Present Distribution Revenue	Staff Proposed Increase		Class Share of Total Proposed Revenue
<u>Rate Schedule</u>		<u>\$</u>	<u>%</u>	<u>%</u>
Residential	142,086,900	42,502,513	29.91%	66.38%
Secondary	54,738,408	14,190,216	25.92%	24.79%
Primary	11,842,680	7,444,946	62.87%	6.94%
Primary Substation	594,268	445,080	74.90%	0.37%
High Voltage	29,160	106,266	364.42%	0.05%
Private Outdoor Lighting	2,300,582	814,869	35.42%	1.12%
Street Lighting	695,203	267,835	38.53%	0.35%
Total Distribution	212,287,201	65,771,725	30.98%	100.00%

2

3 **Q. What is your opinion regarding Staff’s proposed revenue allocation?**

4 A. As I stated above, in allocating revenue requirement among classes, it is
5 important to move toward the goal of aligning rates with cost responsibility in
6 order to achieve a fair and equitable outcome for all customers. By moving most
7 classes closer to an equalized rate of return, Staff’s proposal provides a reasonable
8 outcome in light of the cost-of-service results calculated by DP&L.

9 **Q. What is your recommendation regarding revenue allocation in this case?**

10 A. I recommend using Staff’s recommended revenue allocation as the starting
11 point for allocating the revenue requirement approved in this case. Specifically,
12 Staff’s recommended revenue allocation should be used to establish each class’s
13 percentage share of the total distribution revenue requirement. I identify these
14 shares in the last column of Table KCH-3 above. These percentage shares should
15 then be applied to the final revenue requirement approved by the Commission.

1 So, for example, under Staff's recommended rate spread at the
2 Company's requested revenue requirement, the Residential class would be
3 allocated 66.38% of the total revenue requirement. (See the last column in Table
4 KCH-3). To the extent this revenue requirement is reduced by the Commission,
5 under my proposal, the Residential class would be allocated 66.38% of the
6 reduced total revenue requirement. This apportioning would be applied to each
7 class. That is, each class would be allocated the same share of the final revenue
8 requirement as it is allocated in Staff's recommended rate spread as shown in the
9 last column of Table KCH-3.

10 **Q. What is the benefit in using your recommended approach to apportioning a**
11 **lower revenue requirement?**

12 A. A major benefit of my recommended approach is that it preserves the
13 relationships among the customer classes embedded in the rate spread starting
14 point (i.e., the rate spread initially determined to be reasonable at the utility's
15 requested revenue requirement). That is, if the rate spread starting point is
16 determined to be reasonable (in this case, Staff's rate spread proposal), then my
17 approach to calibrating the initial rate spread to a lower revenue requirement will
18 preserve the degree of reasonableness in the initial spread. Specifically, each
19 customer class will retain approximately the same percentage difference from the
20 system average percentage rate change for both the rate spread starting point (at
21 the Company's proposed revenue requirement) and the final rate spread (at a
22 lower approved revenue requirement). In retaining these relationships, the

1 movement toward cost that is incorporated into the initial rate spread is preserved
2 in the final rate spread.

3

4 **Secondary Rate Design**

5 **Q. What is DP&L's proposal regarding the Secondary rate design?**

6 A. As explained in the Direct Testimony of Nathan C. Parke, the Company
7 proposes to change the Secondary rate structure by eliminating the distribution
8 energy charge that is currently applied to the first 1,500 kWhs of the customer's
9 monthly energy usage.

10 **Q. What is your recommendation regarding DP&L's proposed changes to the**
11 **Secondary rate schedule?**

12 A. I am supportive of the Company's proposed change as it closer aligns the
13 Secondary rates with the underlying costs. It is generally well accepted that
14 distribution-related costs are classified either as customer-related or demand-
15 related – they are not energy-related. Distribution-related costs should not be
16 recovered through an energy charge in the first instance, and I recommend that the
17 Commission approve the elimination of this improper rate component.

18 **Q. Why is it important for rate design to be representative of underlying cost**
19 **causation?**

20 A. Aligning rate design with underlying cost causation improves efficiency
21 because it sends proper price signals. For example, setting demand charges below
22 the cost of demand understates the economic cost of demand-related assets, which

1 in turn distorts consumption decisions, and calls forth a greater level of
2 investment in fixed assets than is economically desirable.

3 If a utility's demand charges are below the cost of demand, the utility is
4 going to seek to recover its class revenue requirement by over-recovering its costs
5 in another area, most typically through levying an energy charge that is above unit
6 energy costs. For a given rate schedule, when demand charges are set below the
7 demand-related costs, and energy charges are set above the energy costs, those
8 customers with relatively higher load factors are required to subsidize the costs of
9 the lower-load-factor customers within the rate schedule.

10 At the same time, aligning rate design with underlying cost causation is
11 important for ensuring equity among customers, because properly aligning
12 charges with costs minimizes cross-subsidies among customers.

13

14 **Tax Reform Act**

15 **Q. Please explain how the reduction to the corporate tax rate from 35 percent to**
16 **21 percent as a result of the Tax Reform Act directly reduces DP&L's filed**
17 **cost of service.**

18 A. The reduction in the corporate tax rate reduces DP&L's federal income tax
19 expense for regulatory purposes. Since DP&L's allowed return on rate base is
20 grossed up for income tax purposes, a lower federal tax rate directly reduces the
21 revenue requirement that should be recovered from customers.

22 I understand that a generic docket has been initiated to address the
23 implications of the Tax Reform Act (Case No. 18-0047-AU-COI), and Ohio

1 utilities have been ordered to defer the revenue requirement impact of the
2 reduction to the federal corporate income tax rate effective January 1, 2018.⁷ I
3 support the Commission’s proactive approach to addressing the impacts of the
4 Tax Reform Act on Ohio utility revenue requirements through the generic docket.
5 Further, I recommend that the amount deferred by DP&L pursuant to PUCO’s
6 January 10, 2018 Entry, for the period beginning January 1, 2018 through the rate
7 effective date in this case, be expeditiously returned to customers. A temporary
8 rider may be an appropriate mechanism for this credit. Alternatively, the deferral
9 amount could be incorporated as a credit in the rates determined in this rate case
10 proceeding, as part of a larger recognition of the revenue requirement reduction
11 associated with the Tax Reform Act.

12 While the generic docket makes sense as a way of ensuring that all Ohio
13 utilities address the implications of the Tax Reform Act, including those not
14 involved in a general rate case at this time, a generic docket does not obviate the
15 need to reflect the impact of the Tax Reform Act on the revenue requirement
16 determined in this case. Rates determined in a general rate case such as this
17 should incorporate the realities of changes in statutory tax rates. Sound
18 ratemaking requires this. However, as DP&L’s case was filed prior to the
19 enactment of the Tax Reform Act, the Company’s proposed revenue requirement
20 does not include the effects of the lower tax rate. Nor, unfortunately, does the
21 revenue requirement proposed in the Staff Report. I disagree with excluding the
22 effects of the tax rate reduction in this case. In its comments provided in the
23 generic proceeding, DP&L stated that “current regulatory tax expense at the 21%

⁷ Case No. 14-47-AU-COI, Public Utilities Commission of Ohio Entry, §7.

1 tax rate within the TCJA rather than the 35% that was in effect during the test
2 period, would reduce the requested increase by about \$11 million.”⁸ At a
3 minimum, these lower costs should be passed on to customers now, in the rates
4 established in this proceeding.

5 I recommend that the Commission order DP&L to precisely quantify the
6 impact of the reduction in the federal corporate tax rate on its proposed revenue
7 requirement, and that this reduction be reflected in the revenue requirement in this
8 case.

9 **Q. Are there additional impacts from the change in the tax rate?**

10 A. Yes. In addition to the direct impact of the reduction to the corporate tax
11 rate, the Tax Reform Act decreases DP&L’s deferred tax liability resulting in a
12 significant excess Accumulated Deferred Income Tax (“ADIT”) balance that
13 should be returned to customers.

14 **Q. Please explain.**

15 A. Like most large companies, DP&L utilizes accelerated depreciation for tax
16 purposes. In the initial years of its assets’ lives, this results in greater depreciation
17 expense for tax purposes than the amount of straight-line depreciation expense
18 that is recognized on the Company’s regulatory books. The timing difference
19 between tax depreciation and book depreciation is recognized through the
20 recording of ADIT. Significantly, customers pay income taxes in rates as if
21 accelerated depreciation did not exist. In effect, a positive ADIT account balance
22 reflects the income taxes that customers prepay during the early years of an
23 asset’s life (because the tax benefits of accelerated depreciation are not flowed

⁸ Case No. 14-47-AU-COI, Comments of the Dayton Power and Light Company, p. 2

1 through directly in rates). DP&L accumulates these deferred income taxes in the
2 ADIT balance on its regulatory books in an amount equal to this anticipated
3 future tax liability. The ADIT that results from accelerated tax depreciation is
4 booked as a credit against rate base in the initial years as an asset is placed into
5 service, thereby reducing revenue requirements for customers.

6 Now that the corporate income tax rate has been reduced by 40 percent,⁹
7 DP&L's anticipated future tax liability has also decreased by a comparable
8 amount. As of January 1, 2018, when the new tax rates became effective, a
9 substantial portion of the ADIT on DP&L's books will be considered to be
10 "excess" ADIT. This excess ADIT should be returned to customers.

11 **Q. Over what period of time should the excess ADIT be returned to customers?**

12 A. The normalization requirements regarding the amortization period to be
13 used for returning excess ADIT to customers are set out in the Tax Reform Act.
14 Generally, the amortization period must correspond to the remaining lives of the
15 assets that gave rise to the ADIT balances. I recommend that the excess ADIT be
16 returned to customers as quickly as possible, consistent with the normalization
17 requirements of the Tax Reform Act. The allowed rate of amortization for ADIT
18 over the regulatory life of the assets will be gradual and should not cause financial
19 hardship for the Company.

20

⁹ $1 - (21 \div 35) = 40\%$.

1 **Q. What is your recommendation with respect to the treatment of excess ADIT**
2 **in this case?**

3 A. I recommend that the revenue requirement in this case be reduced to
4 reflect the amortization of excess ADIT; alternatively, an appropriate rider
5 mechanism for the credit should be established.

6 I recommend that the Commission order DP&L to prepare an excess
7 ADIT amortization schedule through which excess ADIT will be credited to
8 customers, preferably starting with the rate effective date in this case, in a manner
9 consistent with the normalization requirements of the Tax Reform Act. This
10 crediting should continue until the excess ADIT balance reaches zero.

11 **Q. Does the Tax Reform Act result in other impacts on ADIT besides the**
12 **creation of excess ADIT?**

13 A. Yes. As I described above, the deferred income tax expense in the test
14 year accumulates in the ADIT balance to reflect the future tax liability. If the
15 deferred income tax expense decreases as result of a reduction in corporate tax
16 rates, then the going-forward contribution to the ADIT balance will also decrease,
17 all other things being equal. Since a positive ADIT balance is credited against
18 rate base, decreasing the ADIT balance will increase rate base going forward.

19 Further, the Tax Reform Act eliminates the 50% bonus depreciation
20 deduction for public utility plant placed into service after September 27, 2017,
21 which will result in a reduction to ADIT associated with certain post-test year
22 plant additions. To the extent the elimination of bonus tax depreciation and the
23 manufacturing tax deduction are reflected in the revenue requirement in this case,

1 these adjustments should be made in tandem with adjustments to reflect the
2 reduction to income tax expense as a result of the reduced corporate tax rate and
3 the amortization of excess ADIT.

4

5 **Distribution Investment Rider**

6 **Q. What is the Distribution Investment Rider?**

7 A. The DIR was initially introduced by the Company in Case Nos. 16-0395-
8 EL-SSO, et al.,¹⁰ DP&L’s ESP III proceeding. The rider is designed to recover
9 incremental distribution capital investment. A stipulation approved by the
10 Commission in DP&L’s ESP III ultimately authorized the Company to establish a
11 placeholder rider. In its currently approved form, the DIR is a placeholder rider
12 set to zero. That is, DP&L is not permitted at this time to recover any costs
13 through the DIR.

14 **Q. Did the Commission provide any guidance regarding future cost recovery
15 under the DIR in Case Nos. 16-0395-EL-SSO, et al.?**

16 A. In approving the DIR terms of the stipulated agreement reached in Case
17 Nos. 16-0395-EL-SSO, et al., the Commission determined that all matters
18 pertaining to DIR cost recovery should be addressed in the current or future
19 distribution rate proceeding. This includes the DIR cost allocation, terms, rate
20 design and annual revenue caps.

21

¹⁰ Case Nos. 16-0395-EL-SSO, et al., October 20, 2017 Public Utilities Commission of Ohio Opinion and Order, §115.

1 **Q. What is Staff’s assessment regarding the DIR issues to be addressed in this**
2 **case?**

3 A. Staff recommends that the DIR be subject to a sunset date of October 31,
4 2023 and that the Company should be required to file a distribution rate case no
5 later than October 31, 2022. In the event the Company fails to make its required
6 rate filing, Staff recommends a DIR sunset date of November 1, 2022.
7 Furthermore, Staff recommends the imposition of revenue caps, consistent with
8 the Commission’s Order in Case Nos. 13-2385-EL-SSO, et al.¹¹

9 **Q. What is your assessment of Staff recommendations pertaining to the DIR?**

10 A. I support Staff’s recommended sunset provisions, as well as the
11 establishment of revenue caps. These provisions are consistent with the
12 Commission’s prior treatment of similar distribution investment riders. However,
13 I note that the reduction in federal income tax rates will reduce the grossed-up
14 return component of the DIR, all other things being equal. Therefore, use of the
15 revenue cap growth percentages adopted in Case Nos. 13-2385-EL-SSO, et al.,
16 should be applied *after* first reducing the DP&L distribution revenue requirement
17 to reflect the reduced statutory federal income tax rate.

18 **Q. Do you have any other comments regarding the treatment of DIR in this**
19 **case?**

20 A. With regard to the DIR rate design, I support DP&L’s approach proposed
21 in Case Nos. 16-0395-EL-SSO, et al., which is that the DIR would be designed as
22 an equal percentage rider applicable to base distribution rates. This approach is

¹¹ March 12, 2018 Staff Report of Investigation, p. 9

1 the most reasonable means for recovering incremental distribution investment
2 costs. Staff also appears to support this approach in the Staff Report.¹²

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

4 A. Yes, it does.

5
6

¹² Id.

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Summary: Deposition Direct Testimony Of Kevin C. Higgins On Behalf of The Kroger Co.
electronically filed by Mrs. Angela Whitfield on behalf of The Kroger Co.