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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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In the Matter of the Application of The : CASE NO. 05-276-EL-AIR
Dayton Power and Light Company for the :
Creation of a Rate Stabilization Surcharge : Hearing Examiner: Gregory A. Price
Rider and Distribution Rate Increase :

**APPLICANT THE DAYTON POWER AND LIGHT COMPANY'S
OBJECTIONS TO THE STAFF'S REPORT OF INVESTIGATION**

Pursuant to Ohio Admin. Code § 4901-1-28(B), Applicant The Dayton Power and Light Company ("DP&L") submits its objections to the Staff's Report of Investigation in this matter.

This proceeding arises from a Stipulation and Recommendation ("RSP Stipulation") from DP&L's Rate Stabilization Plan proceeding (Case No. 02-2779-EL-ATA). That RSP Stipulation was approved by the Commission on September 2, 2003, and permits DP&L to implement a Rate Stabilization Surcharge ("RSS"), under the following terms:

"At no time during the RSP shall the RSS charge be greater than eleven (11) percent of the tariffed generation charges in effect on January 1, 2004. The RSS will allow DP&L the opportunity to recover verifiable increases in costs over a base period of twelve (12) months ending May 31, 2003 from only the following events:

1. production costs per kWh directly related to the generation of electricity from plants owned by DP&L and its affiliates resulting from fuel price increases, or actions taken in compliance with environmental and tax laws, regulations or court or administrative orders; and
2. costs per kWh directly related to physical security and cyber-security costs associated with the generation of electricity from plants owned by DP&L and its affiliates imposed by final rule, regulation or administrative or court order."

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RSP Stipulation, ¶ IX.E. The RSS cap of 11% of the tariffed generation charges in effect on January 1, 2004 permits DP&L to implement a rate increase of \$76,250,127 based on test year sales (provided that DP&L can justify this increase with verifiable increases in costs over the base period). DP&L Summary Schedule A-1.

On April 14, 2005, DP&L filed an application to implement the RSS, and on June 6, 2005, DP&L filed a two-month update to that application. That two-month update showed that DP&L had incurred allowable increases in expenses in the amount of \$117,369,200. DP&L Summary Schedule A-1. Since DP&L had incurred increased expenses in excess of \$76,250,127, DP&L's two-month update showed that DP&L was entitled to implement the full 11% rate increase.

On August 26, 2005, the Commission's Staff issued its Staff's Report of Investigation. In that Report, the Staff concluded that DP&L had incurred allowable increases in expenses of \$98,319,648. Staff Summary Schedule A-1. Since that figure exceeds \$76,250,127, the Staff's Report also shows that DP&L is entitled to implement the full 11% rate increase throughout the Rate Stabilization Period.

DP&L agrees with the Staff's ultimate conclusion that DP&L is entitled to implement the full 11% rate increase. DP&L, however, objects to several of the Staff's calculations and recommendations that resulted in lowering the calculation of DP&L's total cost increases from \$117,669,200 (DP&L's figure) to \$98,319,648 (Staff's figure). In light of the Staff's ultimate conclusion that DP&L is entitled to implement the full 11% increase, DP&L has not filed objections in every instance in which it disagrees with the Staff's calculations and recommendations. DP&L's decision not to object to some Staff calculations or recommendations

does not necessarily indicate agreement with those recommendations, but instead, establishes only that DP&L does not intend to pursue those issues at this time. DP&L further reserves the right to object to post-Staff Report changes or new matters raised by the Staff, and to support those objections by testimony and at hearing.

I. OPERATING INCOME

1. DP&L objects to the Staff's recommendation (Staff Report, p. 6) that DP&L not be permitted to recover increased expenses that DP&L incurred due to the failure of the coal conveyor at Stuart Station. Mechanical failures and other disruptions are to be expected and are an ordinary part of operating a utility business, and expenses associated with such failures and disruptions should not be excluded from DP&L's recovery of its expenses.

2. To the extent that DP&L is not entitled to recover expenses associated with the failure of the coal conveyor at Stuart Station, DP&L objects to the Staff's deduction (Staff Report, p. 6) of \$1,644,580 from DP&L's allowable expenses in the test year. The total expenses incurred at Stuart Station to address the failure were \$1,644,580; DP&L is a part owner of Stuart Station and incurred only 35% of that cost, so that if any deduction should be made, only 35% of \$1,644,580 should be deducted from DP&L's allowable expenses.

3. DP&L objects to the Staff's recommendation (Staff Report, p. 7) that DP&L not be permitted to recover increased fuel and emission allowance expenses associated with power purchased from non-affiliated entities. DP&L purchases power only when doing so is the least-cost method of supplying power, and DP&L should not be penalized (through a disallowance of increased fuel and emission allowance costs included in purchased power) for acting efficiently.

4. DP&L objects to the Staff's recommendation (Staff Report, p. 8) that DP&L's SCR run costs be calculated at average cost of production rather than average purchased power costs. The SCR units use electricity to operate, the value of which is readily apparent: it is the value of that lost generation in the market.

5. DP&L objects to the Staff's recommendation (Staff Report, pp. 8-9) that DP&L not recover its rate case expenses. Rate case expenses are ordinarily recoverable in a rate case such as this one. The RSP Stipulation provided that DP&L had to recover the expenses in this case "by application by the Company to the Commission under R.C. 4909.18 to update the RSS rider"; since this case is a § 4909.18 application, it is appropriate to recover rate case expense. In addition, DP&L's rate case expenses in this matter are associated with increased fuel, environmental, tax and security expenses, because the reason that DP&L filed this case was to recover increased expenses in those categories.

II. RATE BASE

6. DP&L objects to the Staff's recommendation (Staff Report, p. 12) that DP&L's cash working capital be calculated through the use of the Staff's lead/lag study from Case No. 91-414-EL-AIR, as opposed to using the formula approach. The formula approach is a reliable method for calculating working capital that has long been used and is still used throughout the country. Conditions have changed since the 1991 rate case, making use of the old lead/lag study less reliable than the formula approach. In addition, the expense of a full lead/lag study is not warranted in this limited-issue proceeding.

7. To the extent that a lead/lag study is to be used, DP&L objects to the Staff's decision (Staff Schedules Base and Test B-4.2) not to include revenue lags in its lead/lag

analysis. The purpose of a lead/lag study is to compare the value (in dollars) of the fact that a utility pays its expenses after they are incurred (an "expense lag") to the value (in dollars) of the fact that a utility is paid by its customers after the utility performs services (a "revenue lag"). A lead/lag study is incomplete if revenue lags are not included because it fails to account for cash working capital associated with delays in receiving payment from a utility's customers.

8. To the extent that there is a negative total allowance for working capital for the base period, DP&L objects to the Staff's decision (Staff Schedule Base B-4) to convert that negative allowance to zero. Staff's decision to convert the negative allowance in the base period to zero has the effect of artificially increasing DP&L's base period costs, which artificially reduces the difference in costs between the base period and the test period.

9. DP&L objects to the Staff's recommendation (Staff Report, p. 12) that expenses DP&L incurred associated with the failure of the coal conveyor at Stuart Station not be included in coal inventory balances for November 2004. Equipment malfunctions, breakdowns, and other disruptions are an ordinary part of operating a utility business, and costs associated with those events should not be excluded from DP&L's inventory balances.

10. To the extent that expenses associated with the failure of the coal conveyor are to be excluded from DP&L's coal inventory balances, DP&L objects to the Staff's decision (Staff Report, p. 12) to reduce DP&L's inventory balance for November 2004 by \$1,644,580. The total costs incurred due to the failure of the coal conveyor were \$1,644,580; DP&L is a part owner of Stuart Station and incurred only 35% of that cost, so if costs are to be excluded from DP&L's coal inventory balances, only 35% of \$1,644,580 would be deducted from DP&L's inventory balance.

III. RATE OF RETURN

11. DP&L objects to the Staff's recommendation (Staff Report, pp. 23-24), based on principles of "efficient capital budgeting," that the Commission use the capital structure for DP&L's parent company DPL Inc instead of DP&L's capital structure to calculate DP&L's rate of return. Standard regulatory practice is to use the utility's capital structure, because the cost of capital is a function of the use to which the capital is put.

12. DP&L objects to the Staff's recommendation (Staff Report, pp. 24-25) that the Commission use historical values to calculate the market risk premium used to derive the CAPM cost of common equity. Best practice in CAPM calculations call for forward-looking market risk premium because particularly in a market typified both by unusually low interest rates and equity risk premia that are high by historical standards, backward-looking market risk premia are unlikely to be a good gauge to current costs of equity.

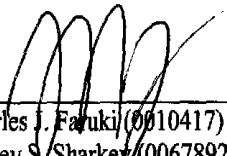
13. DP&L objects to the Staff's recommendation (Staff Report, p. 26) that the Commission adjust the cost of equity for selling and issuance costs by only a factor of 1.00145. DP&L agrees with the need for such an adjustment, but objects to the form in which Staff made it, as it has a substantial downward effect on Staff's recommendation vis-à-vis its proper effect. The literature on the proper application of the selling and issuance adjustment supports the adjustment to the total capitalization of the company in question, not just to the "paid-in" portion of capitalization.

14. To the extent that the Commission uses DPL Inc.'s capital structure to calculate DP&L's rate of return, DP&L objects to the Staff's Recommendation (Staff Report, Rate of Return Table 1) to use \$22,850,800 as the preferred stock amount for DPL, Inc. Per

Staff Report Rate of Return Table 4, the Carrying Value for DP&L's preferred stock is \$21,346,414.

15. DP&L objects to the Staff's recommendation on DP&L's DCF and CAPM return on equity and subsequent rate of return. If Staff had made a proper adjustment to their DCF results for selling and issuance costs, Staff would have produced a DCF cost of equity estimate of 10.34 percent. Also, if Staff had used a forward-looking CAPM cost of equity and DP&L's comparable group, Staff would have produced a CAPM cost of equity estimate of 10.86 percent. Finally, if Staff had used DP&L's capital structure and costs of capital, Staff would have produced a rate of return of 8.78 percent.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I certify that a copy of the foregoing Applicant The Dayton Power and Light Company's Objections to the Staff's Report of Investigation has been served via regular U.S. mail, postage prepaid, upon the following counsel of record, this 26th day of September, 2005:

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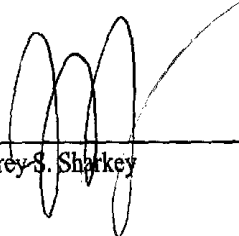
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