***OCC EXHIBIT* \_\_\_\_\_\_\_**

**BEFORE**

**THE PUBLIC UTILITIES COMMISSION OF OHIO**

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| --- | --- | --- |
| In the Matter of the Application ofOhio Power Company for Authority to Establish a Standard Service OfferPursuant to R.C. 4928.143, in the Form of an Electric Security Plan. | ))))) | Case No. 13-2385-EL-SSO |
| In the Matter of the Application ofOhio Power Company for Approval ofCertain Accounting Authority.  | )) | Case No. 13-2386-EL-AAM |

**DIRECT TESTIMONY**

**OF**

**DAVID J. EFFRON**

**On Behalf of the**

**Office of the Ohio Consumers' Counsel**

*10 West Broad St., Suite 1800*

*Columbus, OH 43215*

**MAY 6, 2014**

**TABLE OF CONTENTS**

 **Page**

I. INTRODUCTION 1

II. PURPOSE OF TESTIMONY 3

III. DISTRIBUTION INVESTMENT RIDER 6

IV. SUSTAINED AND SKILLED WORKFORCE RIDER 20

V. CONCLUSION 23

**SCHEDULES**

DJE-1

DJE-2

**ATTACHCMENTS**

DJE - Attachment 1

DJE - Attachment 2

DJE - Attachment 3

DJE - Attachment 4

DJE - Attachment 5

DJE - Attachment 6

DJE - Attachment 7

DJE - Attachment 8

DJE - Attachment 9

DJE - Attachment 10

DJE - Attachment 11

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# I. INTRODUCTION

***Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.***

***A1.*** My name is David J. Effron. My address is 12 Pond Path, North Hampton, New Hampshire, 03862.

***Q2. WHAT IS YOUR PRESENT OCCUPATION?***

***A2.*** I am a consultant specializing in utility regulation.

***Q3. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.***

***A3.*** My professional career includes over thirty years as a regulatory consultant, two years as a supervisor of capital investment analysis and controls at Gulf & Western Industries and two years at Touche Ross & Co. as a consultant and staff auditor. I am a Certified Public Accountant and I have served as an instructor in the business program at Western Connecticut State College.

***Q4. WHAT EXPERIENCE DO YOU HAVE IN THE AREA OF UTILITY RATE SETTING PROCEEDINGS AND OTHER UTILITY MATTERS?***

***A4.*** I have analyzed numerous electric, gas, telephone, and water filings in different jurisdictions. In regard to those analyses, I have prepared testimony, assisted attorneys in case preparation, and provided assistance during settlement negotiations with various utility companies.

 I have testified in over three hundred cases before regulatory utility commissions in Alabama, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky, Maine, Maryland, Massachusetts, Missouri, Nevada, New Jersey, New York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Virginia, and Washington.

***Q5. PLEASE DESCRIBE YOUR OTHER WORK EXPERIENCE.***

***A5*.** As a supervisor of capital investment analysis at Gulf & Western Industries, I was responsible for reports and analyses concerning capital spending programs, including project analysis, formulation of capital budgets, establishment of accounting procedures, monitoring capital spending, and administration of the leasing program. At Touche Ross & Co., I was an associate consultant in management services for one year, and a staff auditor for one year.

***Q6. HAVE YOU EARNED ANY DISTINCTIONS AS A CERTIFIED PUBLIC ACCOUNTANT?***

***A6.*** Yes. I received the Gold Charles Waldo Haskins Memorial Award for the highest scores in the May 1974 certified public accounting examination in New York State.

***Q7. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.***

***A7.*** I have a Bachelor's degree in Economics (with distinction) from Dartmouth College and a Masters of Business Administration Degree from Columbia University.

# II. PURPOSE OF TESTIMONY

***Q8. ON WHOSE BEHALF ARE YOU TESTIFYING?***

***A8.*** I am testifying on behalf of the Office of the Ohio Consumers’ Counsel (“OCC”).

***Q9. WHAT IS THE PURPOSE OF YOUR TESTIMONY?***

***A9.*** On December 20, 2013, Ohio Power Company d/b/a AEP Ohio (“AEP Ohio ” or “the Utility”) filed an application with the Public Utilities Commission of Ohio (“PUCO”) seeking approval of a new electric security plan (“the proposed ESP” or “ESP III”). As part of this application, AEP Ohio addressed provisions regarding its distribution service, including a request for authority to continue, modify, and/or expand certain distribution service riders presently in effect and to implement a new Sustained and Skilled Workforce Rider (“SSWR”). My testimony addresses the Utility’s Distribution Investment Rider (“DIR”) and its proposal to implement the SSWR.

***Q10. DOES YOUR TESTIMONY ON THE UTILITY’S PROPOSALS REGARDING ITS DISTRIBUTION RIDERS MEAN THAT YOU AGREE THAT THE NUMEROUS RIDERS PRESENTLY IN EFFECT FOR AEP OHIO SHOULD BE APPROVED BY THE PUCO?***

***A10.*** No. Riders (also referred to as “trackers,” “cost trackers,” or “reconciliation mechanisms”) allow regulated utilities to collect designated costs from customers outside of the context of traditional base rate cases, where all elements of the cost of service are examined. As a general matter, riders entailing the automatic collection of certain utility costs from customers are contrary to sound ratemaking practice. When utilities are permitted to collect costs from customers through a rider, the incentive for a utility to control costs tends to be reduced or eliminated. Even worse, a rider can potentially incentivize a utility to make uneconomic choices. To the extent that such riders are approved, they should be limited to costs that are large, volatile, and outside of the utility’s control. Examples of such costs could be purchased gas costs for a gas distribution utility or fuel and purchased power for an integrated electric utility.

AEP Ohio has presented little evidence that the costs that it is seeking to collect through its proposed riders meet these criteria (costs that are large, volatile, and outside of the utility’s control). Additionally, AEP Ohio has not shown that its financial integrity would be somehow compromised if those costs could be collected only through a traditional base rate case where the costs would be subject to closer scrutiny. A report by the National Research Regulatory Asset (“NRRI”) titled “How Should Regulators View Cost Trackers?” (September 2009) presents a succinct and balanced description of regulatory issues associated with riders, and I have attached a copy of this report to my testimony (Attachment 1).

***Q11. HOW CAN RIDERS POTENTIALLY RESULT IN UNECONOMIC INCENTIVES TO A REGULATED UTILITY?***

***A11.*** Suppose that a regulated utility was faced with a decision between either replacing a piece of equipment or contracting to maintain the equipment. From a present value perspective it might be more economic to incur the cost to maintain the equipment rather than replace it. However, if the utility has a rider where it can automatically recover the cost of plant additions but would have to “absorb” any incremental maintenance expense under its existing base rates, then there is obviously an incentive to make the replacement even though that might not be the more economic option. Further, if a utility has a rider where it can automatically recover the cost of plant additions but would have to absorb any incremental maintenance expense, then there can even be an additional incentive to modify its accounting policies to capitalize those costs that would otherwise be charged to expense.

***Q12. ARE THERE ANY OTHER POTENTIAL PROBLEMS WITH COLLECTION OF COSTS FROM CUSTOMERS THROUGH RIDERS?***

***A12.*** Yes. The collection of costs from customers through riders can lead to increases in utility rates and revenues (collected by the utility) even when a regulated utility company does not have a revenue deficiency. In this regard, it is worth noting that, based on my calculations, AEP Ohio earned a return on equity (exclusive of the effect of asset impairment charges) of 11.2% in 2011, 11.8% in 2012 and 11.4% in 2013 (Schedule DJE-1), as compared to the stipulated combined return on equity of 10.20% in Case Nos. 11-351-EL-AIR and 11-352-EL-AIR and the 10.65% return on equity requested by the Utility in the present case.

By contrast, in the absence of riders, a regulated utility would be able to implement rate increases only after a traditional rate case where all costs and the revenues under present rates were taken into consideration. If it were determined that the rates in effect were already producing an adequate return, then no rate increase would be authorized.

# III. DISTRIBUTION INVESTMENT RIDER

***Q13. PLEASE DESCRIBE THE DISTRIBUTION INVESTMENT RIDER (“DIR”) THAT CUSTOMERS PAY NOW AS PART OF THEIR ELECTRIC SERVICE.***

***A13.*** The PUCO approved the DIR (that customers presently pay) as part of the Utility’s ESP II in Case No. 11-346-EL-SSO, et al.[[1]](#footnote-1) The purpose of this DIR is to collect from customers the incremental revenue requirement associated with increases in net distribution plant since August 31, 2010 (the date certain in Case Nos. 11-351 and 11-352, the most recent base distribution rate cases at the time of the implementation of the DIR) through May 31, 2015.

***Q14. WHAT ARE THE COMPONENTS OF THE DISTRIBUTION INVESTMENT RIDER REVENUE REQUIREMENT?***

***A14.*** There are three components of the revenue requirement for the DIR. The first component is the return on the increase in net rate base, defined as the increase in gross distribution plant in service, less the increase in related accumulated depreciation and accumulated deferred income taxes. The second component is the depreciation on additions to distribution plant in service. The third component is the property taxes on the additions to distribution plant in service.

***Q15. IS AEP OHIO PROPOSING ANY CHANGES TO THE CALCULATION OF THE DISTRIBUTION INVESTMENT RIDER REVENUE REQUIREMENT?***

***A15****.* Yes. The Utility is proposing certain modifications and expansions to the present DIR formulation. First, AEP Ohio is proposing certain technical adjustments to the calculation of the DIR revenue requirement. Second, the Utility is proposing to roll the Phase 1 gridSMART assets into the distribution plant included in the DIR revenue requirement. Third, the Utility is proposing to expand the DIR to include increases in general plant. If the PUCO approves the DIR as proposed, then these changes will go into effect on June 1, 2015, when the present DIR expires.

***Q16. PLEASE DESCRIBE THE TECHNICAL ADJUSTMENTS TO THE DISTRIBUTION INVESTMENT RIDER REVENUE REQUIREMENT AS PROPOSED BY AEP OHIO.***

***A16****.* Originally, the Utility calculated a single carrying charge factor by adding together the pre-tax rate of return (cost of capital), the composite depreciation rate, and the property tax rate. The revenue requirement was then determined by applying that carrying charge rate to the increase in gross distribution plant in service, less the increase in related accumulated depreciation and accumulated deferred income taxes (“ADIT”). This formula was subsequently modified so that the carrying charge rate was applied to the net incremental plant in service and a separate credit was calculated by applying the pre-tax rate of return to the incremental ADIT. The Utility is now proposing to apply each component of the carrying charge factor separately to the relevant base for the individual factor. The base to which each factor of the carrying charge is applied is different.

 The pre-tax rate of return would be applied to the increase in gross distribution plant in service, less the increase in related accumulated depreciation and accumulated deferred income taxes, or the increase in net rate base. The composite depreciation rate would be applied to the increase in gross distribution plant in service. The property tax rate would be applied to the increase in gross distribution plant in service net of the increase in related accumulated depreciation, or the increase in net plant.

***Q17. ARE THE TECHNICAL ADJUSTMENTS BEING PROPOSED BY AEP OHIO APPROPRIATE?***

***A17.*** I agree that the rate of return should be applied to the increase in net rate base and that the composite depreciation rate should be applied to the increase in gross distribution plant in service. However, the calculation of the property tax component of the total revenue requirement should be modified.

***Q18. HOW SHOULD THE CALCULATION OF THE DISTRIBUTION INVESTMENT RIDER REVENUE REQUIREMENT IN REGARD TO PROPERTY TAXES BE MODIFIED?***

***A18.*** In response to OCC INT-14-324 (Attachment 2), the Utility stated that the property tax rate included in the total DIR carrying charge rate is based on the ratio of property taxes to net plant, rather than on the ratio of property taxes to gross plant, because property taxes are assessed on net plant. This is not exactly correct. The starting point for the property tax assessment is gross plant. After subtracting certain exclusions, “Percent Good” factors[[2]](#footnote-2) are applied to the adjusted plant in service based on the age of the plant in order to calculate the value of taxable property. The effect of applying the Percent Good factor is to recognize plant age and the deterioration of the plant value over time. However, the Percent Good factors are not based on the Utility’s book depreciation rates or on the growth in the book balance of accumulated depreciation over time. The book depreciation reserve does not enter in the determination of the value of taxable property.

In particular, the Utility is presently amortizing an excess in its book depreciation reserve at the rate of $34,910,000 per year, or $2,909,000 per month (response to OCC INT-14-321 (Attachment 4)). This amortization reduces the Utility’s book depreciation reserve accordingly. There is no corresponding recognition of the amortization of the excess depreciation reserve in the calculation of the value of taxable property for property tax purposes. In effect, by applying the property tax rate to the plant in service net of the book depreciation reserve, the Utility is calculating property tax expense on the cumulative amortization of the excess depreciation reserve. This is not what actually happens. The Utility’s method of calculating property tax expense overstates the property expense attributable to growth in distribution plant.

Instead, when calculating the base to which the property tax rate is applied, the depreciation reserve should be adjusted to eliminate the cumulative amortization of the excess depreciation reserve since December 31, 2011 (when rates in Case Nos. 11-351-EL-AIR and 11-352-EL-AIR went into effect). This will reflect the change in the base on which property taxes are calculated more accurately. It has the effect of increasing the depreciation reserve and reducing the net plant to which the property tax rate of 5.66% is applied in the calculation of the DIR revenue requirement.

***Q19. CAN YOU ILLUSTRATE THE EFFECT OF YOUR PROPOSED MODIFICATION TO THE PROPERTY TAX CALCULATION ON THE DISTRIBUTION INVESTMENT RIDER REVENUE REQUIREMENT?***

***A19.*** Yes. The DIR for September 2013 shows gross plant in service of $3,810,709,000 and accumulated depreciation of $1,411,338,000, resulting in net plant of $2,399,371,000. September 30, 2013 is 21 months after December 31, 2011. The depreciation reserve for the purpose of calculating property taxes should be increased by 21 x $2,909,000, or $61,089,000, to eliminate the cumulative amortization of the excess depreciation reserve, and the net plant to which the property tax rate of 5.66% is applied should be reduced accordingly. The DIR revenue requirement for September 2013 would be reduced by $3,458,000. The annual revenue requirement effect will increase over time by approximately $494,000 per quarter, as the cumulative amortization of the excess depreciation reserve increases (so, for example, the annual revenue requirement for the December 2013 DIR would be $3,952,000 less than it would otherwise be).

***Q20. WHY IS THE UTILITY PROPOSING TO COLLECT THE COSTS OF THE GRIDSMART PHASE I ASSETS FROM CUSTOMERS THROUGH THE DISTRIBUTION INVESTMENT RIDER?***

***A20.*** In response to OCC INT-2-019 (Attachment 5), AEP Ohio stated that as “there will be no additional assets recorded to the gridSMART Phase I plan and the audit of the final year assets will be complete, the Company is proposing to include those assets as part of the DIR.” The Utility is proposing to eliminate the gridSMART Phase I rider, transfer the collection of those costs to the DIR, and implement a new gridSMART Phase II rider.

***Q21. IS THIS ADEQUATE JUSTIFICATION FOR THE COSTS OF THE GRIDSMART PHASE I ASSETS TO BE INCORPORATED INTO THE DISTRIBUTION INVESTMENT RIDER THAT CUSTOMERS PAY?***

***A21.*** No. In Case No. 11-346-EL-SSO, the Utility also sought to include the gridSMART costs in the DIR. The PUCO emphatically rejected this request, stating that “the gridSMART projects shall be separate and apart from the DIR mechanism and projects.”[[3]](#footnote-3) In rejecting the Utility’s request, the PUCO appeared to implicitly adopt the PUCO Staff’s position that “gridSMART related cost not be recovered through the DIR, so as to better facilitate the tracking of gridSMART expenditures and savings and benefits of the gridSMART project.”[[4]](#footnote-4)

AEP Ohio has not explained why it would be better or administratively more efficient to collect the costs of the gridSMART Phase I assets from customers as part of the DIR charge rather than continuing to collect those costs as part of a continuing gridSMART rider that would cover both Phase I and Phase II. Although AEP Ohio Witness Moore’s Exhibit AEM-1 shows the gridSMART Phase I rider being eliminated and a proposed new gridSMART Phase II rider, the “new” gridSMART rider does not appear to be in substance different from a continuation of the present gridSMART rider, except that the recovery of the Phase I costs would be transferred to the DIR. Further, the Utility has not explained why the PUCO Staff’s preference for keeping the gridSMART costs separate from the DIR to better facilitate tracking of gridSMART costs and benefits is no longer relevant. Accordingly, the DIR should not be expanded to include collection of gridSMART costs. Based on the gridSMART net plant as of September 30, 2013, elimination of the costs of the gridSMART Phase I assets from the DIR plant reduces the DIR revenue requirement by approximately $3.5 million. That amount would be offset by revenues collected from customers through the gridSMART rider.

***Q22. WHY IS AEP OHIO PROPOSING TO EXPAND THE DISTRIBUTION INVESTMENT RIDER TO INCLUDE COSTS OF ADDITIONS TO GENERAL PLANT?***

***A22.*** In response to OCC INT-8-131(Attachment 6), AEP Ohio stated that the general plant additions to be included in the DIR “are capital additions that support distribution operations,” and more specifically that inclusion of general plant additions in the DIR would provide the Company with “a mechanism to recover the cost of the replacement radio system.” The replacement radio system is also addressed in the direct testimony of AEP Witness Dias and the response to Staff Data Request 8-002 (Attachment 7). As described by Mr. Dias, the new system will replace the current system, which was installed in the early 1990’s and has become obsolete. Based on the Utility’s testimony and responses to interrogatories and data requests, the collection of costs from customers related to the replacement system appears to be the main factor underlying the proposal to expand the DIR to include additions to general plant.

***Q23. SHOULD THE DISTRIBUTION INVESTMENT RIDER THAT CUSTOMERS PAY BE EXPANDED TO INCLUDE COSTS FOR ADDITIONS TO GENERAL PLANT?***

***A23.*** No. It is my understanding that riders such as the DIR have been implemented under the PUCO authority to approve electric security plans including provisions regarding distribution infrastructure and modernization incentives for the electric distribution utility. General plant, as the name implies, is plant that relates to the general operations of the utility. While it is true that general plant can support distribution operations, that plant, as the title implies, also supports other utility functions.

General plant is not distribution infrastructure and does not relate to the modernization of that infrastructure. While additions to general plant may indirectly lead to improved electric service reliability, such additions do not represent upgrades of distribution infrastructure. As explained in the testimony of Mr. Dias, the new radio system is being installed because the current system has become obsolete. It is also overloaded and subject to increasing failure rates, and it is difficult to find replacements for parts that fail or become obsolete. Based on this description, the replacement to the current radio would be necessary independent of any improvements to the Utility’s distribution infrastructure.

 While no cost/benefit analysis of the replacement of the radio system has been prepared (see response to OCC RPD-2-017 (Attachment 8)), it is clear from AEP Ohio’s description that the new system should improve efficiency and functionality, with attendant reductions to expenses. As noted in the response to Staff DR-8-002 (Attachment 7), the new system will prevent or reduce electrical outages, facilitate communications between the field crews and the office or dispatch center, provide communication infrastructure for specific distribution plant projects, and facilitate communications during outages and emergencies. Any cost savings associated with these enhanced capabilities will not flow through the DIR, but the costs of the new system will if additions to general plant are included in the DIR. Thus, inclusion of the new radio system in the DIR would treat the costs and benefits of the system asymmetrically, with AEP Ohio collecting the costs of the system from customers while retaining the benefits for shareholders.

If the PUCO authorizes the Utility to continue to collect the DIR charge from customers, then the Utility should not be permitted to expand the DIR charge by including the costs of additions to general plant. Based on the Utility’s forecast of additions to general plant in the years 2015-2018, exclusion of general plant from the DIR would result in the annual DIR revenue requirement being lower by some $11.7 million in 2018 (as compared to the DIR revenue requirement with general plant included.)

***Q24. ARE THERE CERTAIN ESTABLISHED STANDARDS FOR THE TREATMENT OF EXPENDITURES AS CAPITAL ASSETS VERSUS PERIOD EXPENSES?***

***A24.*** Yes. As a general matter, expenditures that are deemed to provide benefits of more than one year or have a service life of greater than one year will be capitalized and charged to asset accounts on the balance sheet. Expenditures that are deemed to provide benefits or have a service life of one year or less will be treated as period costs and charged to expense accounts.

 Typically, capitalized assets will be depreciated or amortized over their useful lives. For a regulated utility, to the extent that capitalized expenditures are included in plant accounts that are considered to be used and useful in providing service, those assets will be included in the utility’s rate base, and the depreciation expense will be included in operating expenses. Expenditures that are considered to be period costs will be directly included in operating expenses. For ratemaking purposes, the utility will earn a return on and a return of capitalized expenditures over their useful lives, and expenses will be included in the revenue requirement as incurred.

Often, whether a particular expenditure should be treated as a capital item or as an expense is a matter of judgment. This is particularly true with regard to expenditures that entail the replacement of assets. To avoid undue refinement and complication, all property expenditures are considered to be either retirement units or minor items of property. (See Electric Plant Instruction 10 of the FERC Uniform System of Accounts.) When a retirement unit is replaced, the cost of the replacement will be added to the appropriate plant account. When a minor item of property is replaced, the cost of the replacement will be charged to maintenance expense. Regulated utilities maintain lists of retirement units that define expenditures that are to be capitalized.

***Q25. HAS THE UTILITY MODIFIED ANY OF ITS CAPITALIZATION POLICIES IN RECENT YEARS?***

***A25.*** Yes. In response to OCC INT-2-009 (Attachment 9), AEP Ohio identified several changes in definitions of retirement units and/or minor units of property with regard to distribution plant since 2008. As can be seen in the response to OCC INT-9-152 (Attachment 10), the effect of these changes has been, on balance, to increase the amount of expenditures capitalized, as opposed to being expensed, in the years 2011, 2012, and 2013.

***Q26.* *DO ANY OF THE CHANGES IN AEP OHIO’S CAPITALIZATION POLICY (DESCRIBED IN THE RESPONSE TO OCC INT-2-009) APPEAR TO BE INAPPROPRIATE?***

***A26****.* The modified capitalization policies described in the response to OCC INT-2-009 (Attachment 9) do not appear to be improper in and of themselves. However, the timing of the changes raises a potential problem of double recovery of certain expenditures.

***Q27. PLEASE EXPLAIN HOW THE TIMING OF THE MODIFICATIONS TO AEP OHIO’S CAPITALIZATION POLICIES COULD RESULT IN A DOUBLE RECOVERY OF CERTAIN COSTS FROM CUSTOMERS.***

**A27**. The changes in capitalization policy identified in the response to OCC INT-2-009 (Attachment 9) entailed the capitalization of expenditures that had been previously charged to expense. As can be seen in the response to OCC INT-9-152 (Attachment 10), these changes affected the treatment of expenditures for manhole tops and external link boxes from September 2011 through September 2013. The test year in Case Nos. 11-351-EL-AIR and 11-352-EL-AIR, the Utility’s most recent distribution rate cases, was for twelve months ending on May 31, 2011. Thus, the effect of the changes to the capitalization policy was not reflected in the test year in those cases. Any costs covered by the changes in capitalization policy (that is, manhole top and/or external link box) would have been treated as maintenance in the twelve months ending on May 31, 2011 and included as current, annual, ongoing expenses in the determination of the Utility’s revenue requirement. The Utility is already recovering such costs in rates each year as ongoing expenses for as long as the rates established in Case Nos. 11-351-EL-AIR and 11-352-EL-AIR are in effect. By capitalizing these costs and including them in distribution plant since the resolution of the last base rate cases, the Utility is also collecting a return on and of those same expenditures in the DIR, resulting in a double recovery. Similarly, any other changes in accounting policy going forward that capitalize expenditures that had previously been charged to expense could also result in a double recovery of such expenditures from customers.

***Q28. WHAT DO YOU RECOMMEND TO ADDRESS THIS PROBLEM OF DOUBLE RECOVERY OF COSTS FROM CUSTOMERSAS A RESULT OF CHANGES IN CAPITALIZATION POLICY?***

***A28.*** First, the costs capitalized as a result of the changes in accounting policy since the end of the test year in Case Nos. 11-351-EL-AIR and 11-352-EL-AIR should be removed from the distribution plant used in the calculation of the DIR revenue requirement. The effect of eliminating these expenditures from the DIR plant has the effect of reducing the DIR revenue requirement by approximately $0.2 million annually, which is not especially material compared to the total DIR revenue requirement. However, second, and more importantly, any further changes in accounting policy that affect the capitalization of expenditures should be subject to PUCO approval. Any change in the Utility’s capitalization policies should then be synchronized with the ratemaking treatment, so that the relevant expenditures will not be capitalized at the same time that they are being collected from customers in rates as current expenses.

***Q29. PLEASE SUMMARIZE THE EFFECT OF YOUR RECOMMENDATIONS REGARDING THE PROPOSED DISTRIBUTION INVESTMENT RIDER.***

***A29.*** I have summarized the approximate revenue requirement effects of my DIR recommendations on Schedule DJE-2. The revenue requirements effects are necessarily estimates and will change over time, so they should be considered only approximations of the order of magnitude of the effect of these recommendations.

***Q30. HAVE YOU ALSO QUANTIFIED THE EFFECT OF THE RATE OF RETURN RECOMMENDATION BY DR. WOOLRIDGE?***

***A30.*** Yes. Dr. Woolridge is recommending a return on equity of 8.875%. This results in a weighted average rate of return 7.39%, which becomes 9.58% when grossed up for income taxes. Based on the September 30, 2013 DIR, Dr. Woolridge’s recommendation would reduce the DIR revenue requirement by $1,006,000.

# IV. SUSTAINED AND SKILLED WORKFORCE RIDER

***Q31. IS THE UTILITY SEEKING PUCO APPROVAL TO CHARGE CUSTOMERS THROUGH A NEW RIDER FOR OPERATION AND MAINTENANCE EXPENSES ASSOCIATED WITH NEW DISTRIBUTION EMPLOYEES ?***

***A31.*** Yes. The Utility is proposing a new Sustained and Skilled Workforce Rider (“SSWR”). As described in the testimony of Mr. Dias, the SSWR would recover the incremental operation and maintenance (“O&M”) expenses of new employees necessary to support future work requirements while reducing the reliance on contract labor to meet those work requirements.

***Q32. SHOULD THE UTILITY’S PROPOSAL TO COLLECT A Sustained and Skilled Workforce Rider CHARGE FROM CUSTOMERS BE APPROVED*?**

***A32.*** No. The costs to be collected through SSWR do not meet any of the above described criteria for costs that should be subject to recovery through a rider. First, the expenses of new employees are clearly within the control of the Utility. Second, the expense of new employee positions is not volatile or subject to unpredictable fluctuations. Third, while the forecasted expenses are not immaterial, for a utility the size of AEP Ohio, they are not expenses of a magnitude that should qualify for automatic collection from customers through a rider. As shown on Table 5 of the testimony of Mr. Dias, the Utility is forecasting costs to be collected from customers through the SSWR of $1.5 million beginning in 2015, increasing to $8.0 million in 2018.

Finally, if the costs attributed to adding new employees are permitted to be collected from customers through a rider, then this might create an incentive for the Utility to add employees rather than implement a potentially less costly alternative. As the PUCO Staff noted, in Case No. 07-1080-GA-AIR, when Vectren Energy Delivery of Ohio sought to implement alternative regulation to recover the costs of hiring new employees to address an aging workforce, these costs “should be subject to normal regulation practices for test year expenses.”[[5]](#footnote-5)

***Q33. ARE THERE ANY OTHER REASONS WHY THE NEW EMPLOYEE OPERATION AND MAINTENANCE EXPENSES SHOULD NOT BE COLLECTED FROM CUSTOMERS THROUGH A SEPARATE RIDER?***

***A33.*** Yes. The Utility has not clearly established the criteria for determining whether the new employees will actually result in incremental O&M expenses. If the addition of new employees is offset by the retirement of employees elsewhere, the addition of the new employees will not increase the total employee complement and actual labor expense. Similarly, if the addition of new employees is offset by reductions to outside contractors, the total O&M expense incurred by the Utility will not increase as a result of the employee additions. In response to OCC INT-14-327 (Attachment 11), the Utility stated that the SSWR will include incremental positions for front-line construction and construction support added after the complement baseline positions as of the date its application was filed. However, AEP Ohio has not described how any potential offsetting reductions to the cost of the new SSWR employees would be taken into account.

***Q34. WHAT DO YOU RECOMMEND REGARDING THE PROPOSED Sustained and Skilled Workforce Rider?***

***A34.*** AEP Ohio has not established that the SSWR is either necessary or appropriate, or that a rider is the proper mechanism to collect new employee costs from customers. It should not be approved.

# V. CONCLUSION

***Q35. PLEASE SUMMARIZE YOUR TESTIMONY.***

***A35.*** If the PUCO approves the continuation of the DIR, the calculation of the property tax expense should be modified to eliminate the cumulative amortization of the excess depreciation reserve from the determination of the net distribution plant balance to which the property tax rate is applied. The DIR should not be expanded to include costs from gridSMART additions or general plant additions. Any changes in accounting policy that affect the capitalization of expenditures should be subject to PUCO approval. The proposed new SSWR should not be approved.

***Q36. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?***

***A36.*** Yes. However, I reserve the right to incorporate new information that may subsequently become available.

**CERTIFICATE OF SERVICE**

It is hereby certified that a true copy of the foregoing *Direct Testimony of David J. Effron on Behalf of the Office of the Ohio Consumers’ Counsel* was served via electronic transmission this 6th day of May, 2014.

 */s/ Maureen R. Grady*

 Maureen R. Grady

 Assistant Consumers’ Counsel

**PARTIES OF RECORD**

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1. *In the Matter of Columbus Southern Power and Ohio Power Company, Inc.,* Case No. 11-346-EL-SSO, Opinion and Order at 42-47 (August 8, 2012). [↑](#footnote-ref-1)
2. See the response to OCC INT-14-325 (Attachment 3). The Percent Good factors are set percentages applied to each vintage of property in the Annual Report to the Ohio Department of Taxation, which serves as the basis of the property tax valuation. The older the vintage, the lower the Percent Good factor. The Percentage Good factors are not particular to AEP Ohio, and they are not dependent on AEP Ohio’s book depreciation reserve. [↑](#footnote-ref-2)
3. *In the Matter of Columbus Southern Power and Ohio Power Company, Inc*., Case No. 11-346-EL-SSO, Opinion and Order at 46 (August 8, 2012). [↑](#footnote-ref-3)
4. Id. at 45. [↑](#footnote-ref-4)
5. *In the Matter of Vectren Energy Delivery of Ohio, Inc*., Case Nos. 07-1080-GA-AIR and 07-1080-GA-ALT, Staff Report at 10 (June 16, 2008). [↑](#footnote-ref-5)