BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Their Corporate Separation Plans.	))))	Case No. 09-464-EL-UNC

OPINION AND ORDER

The Commission finds:

Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, AEP-Ohio or the Companies) were granted authority by the Commission to legally separate each company's distribution, transmission, and generation functions in the Companies' Electric Transition Plan (ETP) cases.[1] Subsequently, the Commission approved the Companies' request to continue to operate on a functional separation basis.[2] In AEP-Ohio's electric security plan (ESP) proceeding, the Companies requested permission to modify their corporate separation plans to allow each company to retain its distribution, and its transmission assets, until the expiration of functional separation.[3] The Commission declined to rule on the request in the ESP proceeding, and instead, directed AEP-Ohio to file an application for approval of their corporate separation plans within 60 days of the effective date of the newly adopted corporate separation rules.[4]

On June 1, 2009, AEP-Ohio filed an application for approval of their corporate separation plans, in accordance with Rule 4901:1-37-05(A), Ohio Administrative Code (O.A.C.). According to the application, the Companies provide generation, transmission,

1 *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Their Electric Transition Plans and for Receipt of Transition Revenues,* Case Nos. 99-1729-EL-ETP and 99-1730-EL-ETP, Opinion and Order (September 28, 2000) and Entry on Rehearing (November 21, 2000).

2 *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of a Post-Market Development Rate Stabilization Plan,* Case No. 04-169-EL-UNC, Opinion and Order at 35 (January 26, 2005).

3 *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets,* and *In the Matter of the Application of Ohio Power Company for Approval of an Electric Security Plan; and an Amendment to its Corporate Separation Plan,* Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Opinion and Order (March 18, 2009); Entry on Rehearing (July 23, 2009); Second Entry on Rehearing (November 4, 2009) (ESP cases).

4 *In the Matter of the Adoption of Rules for Standard Service Offer, Corporate Separation, Reasonable Arrangements, and Transmission Riders for Electric Utilities Pursuant to Sections 4928.14, 4928.17, and 4905.31, Revised Code, as Amended by Amended Substitute Senate Bill No. 221,* Case No. 08-777-EL-ORD, Finding and Order (September 17, 2008), and Entry on Rehearing (February 11, 2009).

and distribution services, and the provision of such services are currently functionally separated, as approved by the Commission in previous cases.

Baker Tilly Virchow Krause, LLP (Baker Tilly or auditor) was selected as the auditor to assist the Commission with the evaluation of AEP-Ohio's corporate separation plans. As the auditor, Baker Tilly was directed to evaluate AEP-Ohio's corporate separation plans to determine if the methodologies used by affiliated companies that allocate, charge, or assign costs to the Ohio-regulated operating companies are appropriate; to ascertain whether AEP-Ohio has implemented their corporate separation plans in compliance with previous Commission orders; and to determine whether the corporate separation plans comply with Section 4928.17, Revised Code, and the rules set forth in Chapter 4901:1-37, O.A.C. Baker Tilly filed its report of investigation on March 19, 2010.

By entry issued April 7, 2010, motions to intervene in this matter filed by the Office of the Ohio Consumers' Counsel (OCC) and the Ohio Energy Group (OEG) were granted. Further, the April 7, 2010 entry directed interested persons to file comments to the auditor's report of investigation no later than April 28, 2010 and reply comments no later than May 12, 2010. AEP-Ohio and OCC each filed comments to the auditor's report. AEP-Ohio filed reply comments.

In its comments, OCC states that based on its review of AEP-Ohio's corporate separation plans, it agrees with the recommendations of Baker Tilly. OCC recommends that the Commission direct AEP-Ohio to implement each of the auditor's recommendations in their entirety within six months of the Commission's final order in this proceeding. (OCC Comments at 4-5.) AEP-Ohio's comments are discussed below.

I. AUDIT RECOMMENDATIONS, COMPANIES' REPLIES, AND COMMISSION'S DECISION:

As a part of its evaluation of AEP-Ohio's corporate separation plans, Baker Tilly reviewed various internal documents, affiliate agreements, process and control documents, financial statements and internal audit reports; interviewed company management, and conducted sample testing for accounting transactions; and reviewed the cost allocation methodology implemented by American Electric Power Service Corporation (AEPSC). AEPSC is a subsidiary of American Electric Power Company, Inc. and an affiliate of AEP-Ohio. AEPSC provides accounting, administrative, information technology, engineering, financial, legal, maintenance, and other services for American Electric Power System Corporation (AEP System) companies, including AEP-Ohio. Baker Tilly reviewed policies in place during 2009 and evaluated transactions executed June through November 2009.

Based on its evaluation, Baker Tilly concluded that AEP-Ohio implemented their corporate separation plans and the plans are in compliance with Section 4928.17, Revised Code, and the rules in Chapter 4901:1-37, O.A.C., except with regard to the following findings and recommendations:

Audit Recommendation 1:

Baker Tilly determined that not all employees completed the code of conduct training as required by AEP-Ohio's corporate separation plans. The auditor determined that AEP-Ohio had no record of completion of the code of conduct training and the required signed statement for 19 employees and one contractor. Baker Tilly recommends that AEP-Ohio strengthen the controls around the monitoring and tracking of the code of conduct training participation to enforce the code of conduct training.

AEP-Ohio admits that it could not provide verification of the code of conduct training for 19 employees, but states that training was verified for 7,859 individuals. AEP-Ohio reasons that the 19 individuals for whom training could not be verified are physical workers such as meter readers, linemen, and plant workers who, until recently, did not have ready access to a computer. The Companies note that the 19 individuals have since completed code of conduct training on-line and electronic certification of completion has been obtained. (AEP-Ohio Comments at 2.)

The Commission finds AEP-Ohio's subsequent training of the 19 individuals and the certification of their completion of the code of conduct training on-line sufficient to address the auditor's findings and recommendation. The availability of on-line code of conduct training and on-line electronic certification of completion of training will better facilitate the verification of training in the future.

Audit Recommendation 2:

Baker Tilly recommends that AEP-Ohio require employees outside Ohio that provide services to AEP-Ohio to complete Ohio corporate separation code of conduct training.

AEP-Ohio states that during the seven month period in 2009, approximately 1,500 AEPSC employees located outside of Ohio provided services to AEP-Ohio. The Companies reason that, if all employees of AEP System who might provide some service to AEP-Ohio were required to complete the Ohio code of conduct training, it would encompass approximately 13,500 AEP System employees located outside of Ohio, many of whose service to AEP-Ohio is incidental to their regular duties. AEP-Ohio contends that requiring all such AEP System employees to complete Ohio corporate separation code of conduct training would be inefficient, expensive, and burdensome. Therefore, AEP-Ohio proposes that only those out-of-state AEPSC employees in departments with substantial numbers of employees who charge time to AEP-Ohio be required to take the Ohio corporate separation code of conduct training.

The Commission agrees with AEP-Ohio that it is inefficient to require all AEP System employees outside of Ohio to complete Ohio corporate separation code of conduct training. Nonetheless, we find AEP-Ohio's proposal to require out-of-state AEP System employees in departments with "substantial numbers of employees" who charge time to AEP-Ohio, to lack reasonable definition to trigger compliance. We, therefore, require Ohio corporate separation code of conduct training to be given to all out-of-state AEP System employees in departments where more than 50 percent of the employees in the department charge time to AEP-Ohio.

Audit Recommendations 3 and 4:

The auditor found that AEP-Ohio does not maintain a listing of shared employees, shared consultants, and shared independent contractors. Therefore, Baker Tilly asserts that AEP-Ohio is not in compliance with Rule 4901:1-37-08(D)(4) and (5), O.A.C. Baker Tilly recognizes that AEP T&D Services, LLC does not have any employees; however, in lieu of its own employees, AEP T&D Services, LLC relies on employees from the operating companies and occasionally on contractors. On February 1, 2010, the Commission certified AEP Retail Energy Partners LLC as a competitive retail electric service provider. Therefore, AEP Retail Energy Partners LLC could register to provide generation service to AEP-Ohio but had not done so as of the filing of the audit report. Baker Tilly recommends that to the extent that AEP T&D Services, LLC, or any other affiliate, relies on the services of AEP-Ohio employees, other than in emergency situations, AEP-Ohio should maintain a listing of any such employees as "shared employees" in accordance with Rule 4901:1-37-08(D)(4), O.A.C. Baker Tilly also recommends that contractors and consultants that are employed by AEP-Ohio and another AEP System company be listed as a shared contractor or consultant. The auditor reasons that determining whether job duties are "incidental" can be subjective and that there are many pertinent questions that need to be answered to determine if job duties are "incidental."

AEP-Ohio interprets a "shared employee" of an affiliate to be an employee who performs a service for AEP-Ohio on more than an incidental basis and believes that the same "incidental basis" standard would apply to consultants and independent contractors. The Companies argue that the only way to avoid a subjective test for shared status is to include every employee of all AEP-Ohio affiliates and every consultant and independent contractor on the shared list, irrespective of whether or not work was actually performed for AEP-Ohio. AEP-Ohio contends that the approach advocated by Baker Tilly would result in an exhaustive list that lacked any meaningful information. AEP-Ohio proposes to retain the "incidental basis" standard and, at the end of each year, AEP-Ohio would add to the cost allocation manual a list of those additional affiliate employees, consultants and independent contractors that actually performed services for AEP-Ohio and one or more of its affiliates that year.

The Commission agrees with the auditor that, to the extent that any affiliate of AEP-Ohio relies on the services of AEP-Ohio employees, other than in emergency situations, the employee should be listed as a "shared employee" in accordance with Rule 4901:1-37-08(D)(4), O.A.C., and that contractors and consultants that are employed by AEP-Ohio and another AEP System company should also be listed. We also recognize that this approach could lead to an extensive list of shared employees, contractors, and consultants. Accordingly, the Commission finds that the approach advocated by AEP-Ohio, to retain the "incidental basis" standard and, at the end of each year, add to the cost allocation manual a list of those additional affiliate employees, consultants, and independent contractors that actually performed services for AEP-Ohio and one or more of its affiliates during the year, to be a reasonable and manageable approach.

Audit Recommendations 5 and 6:

Baker Tilly concludes that the allocation methodology, subject to the affiliate transaction agreement dated December 31, 1996, was modified without proper amendment to the agreement. For example, the auditor notes that per the affiliate transaction agreement, legal services should be allocated on a kilowatt hours (kWh) sales basis; however, the sample transaction used to test the corporate separation agreement revealed that the allocation was based on total assets. Baker Tilly recommends that changes to the allocation methodology included in affiliate transaction agreements be reviewed and approved by management of affiliate companies. Baker Tilly also notes that using total assets as an allocation factor generally favors non-regulated companies over regulated companies because regulated companies typically have more assets. Therefore, the auditor recommends that the use of total assets, as a main allocation factor for certain corporate charges, should be reviewed during a future regulatory proceeding.

According to the auditor's report, AEP-Ohio informed Baker Tilly that since the affiliate transaction agreement dated December 31, 1996, AEPSC had refined processes and established additional allocation factors to facilitate more accurate billings of costs between affiliates. In its comments, AEP-Ohio states that the affiliate transaction agreement will be updated.

The Commission finds that, consistent with Baker Tilly's recommendation, AEP-Ohio shall update its changes to the allocation methodology included in affiliate transaction agreements and shall submit those updates to the Commission's director of the utilities department or their designee. Further, AEP-Ohio is directed to update its affiliate transaction agreement within the next six months. The next audit of the Companies' cost allocation methodology shall verify compliance with this directive and review the use of total assets as a main allocation factor for corporate charges, in order to determine whether the factor unreasonably favors non-regulated affiliates over regulated affiliates.

Audit Recommendation 7:

The auditor notes that although there have been internal and external audits for other state jurisdictions, AEP-Ohio's cost allocation methodologies and the corporate separation rules have not been reviewed since 2001. Accordingly, Baker Tilly recommends that the AEPSC Audit Services Department perform more periodic internal monitoring of compliance with the Ohio corporate separation plans and the cost allocation method, including follow-up of the recommendation in this audit.

AEP-Ohio states that an internal audit of compliance with the Commission's directives in this proceeding will be conducted this year. Further, the Companies state that in 2012, and every four years thereafter, a full internal audit will be performed. AEP-Ohio states that to the extent those audits identify compliance issues, a follow-up audit of the issues will be conducted the next year to ensure that the issues have been resolved.

The Commission finds AEP-Ohio's plan to conduct an internal audit, during 2010, of the Companies' compliance with this finding and order, and to conduct a full internal audit in 2012, and every four years thereafter, to be a reasonable process to better ensure compliance with the Ohio corporate separation plans and cost allocation methodology.

Audit Recommendation 8:

Baker Tilly contends that because there is no effective control around the tracking of variable interest entities in the cost allocation manual, the cost allocation manual has not been updated to include JMG Funding LP (JMG). JMG is a variable interest entity and a subsidiary of OP. In July 2009, OP purchased all of the outstanding equity ownership of JMG. For this reason, Baker Tilly states that affiliate listing in the cost allocation manual has not been accurately maintained in compliance with Rule 4901:1-37-08(D)(1), O.A.C.

AEP-Ohio states that it will implement a biannual process to maintain the subsidiary list used in the cost allocation manual.

The Commission finds AEP-Ohio's proposal to biannually review and update the subsidiary list used for the cost allocation manual to be a reasonable process to maintain the manual.

Audit Recommendation 9:

As Baker Tilly previously noted, AEP T&D Services, LLC has no employees of its own but relies on employees from other AEP System companies. The auditor reasons that a potential issue exists where companies with no employees may not receive their fair share of corporate cost allocation, if costs are allocated based on the number of employees and notes that the number of employees is one of the top 10 allocation factors used by AEPSC. Accordingly, Baker Tilly recommends that, to the extent employees of CSP and OP also provide services to AEP T&D Services, LLC, AEP-Ohio evaluate whether it is fair and equitable to charge AEP T&D Services, LLC a certain portion of AEPSC costs currently allocated to all AEP System companies based on the number of employees. The auditor further recommends that AEP-Ohio conduct a detailed review to confirm whether the work orders allocated on the number of employees are included in the administrative and general overhead loading.

AEP-Ohio represents that this issue will be audited this year as part of the internal audit to follow-up on the Commission's order in this proceeding. We conclude that AEP-Ohio's consideration of the issue as a part of AEP-Ohio's audit is reasonable. AEP-Ohio is directed to inform the director of the utilities department, or their designee, of the results of its internal audit regarding this issue. The Commission also finds that this matter should be reviewed in the next audit of the Companies' cost allocation methodology.

II. CONCLUSION:

The Commission finds that, based on Baker Tilly's review and audit, AEP-Ohio has implemented their corporate separation plans and the plans are in compliance with Section 4928.17, Revised Code, and the rules in Chapter 4901:1-37, O.A.C., with limited exceptions delineated herein. Baker Tilly made eight specific recommendations and an additional proactive recommendation to address an issue to improve AEP-Ohio's corporate separation plans practices and policies. The Commission finds that AEP-Ohio has addressed or has plans to address the issues raised by the auditor, or has proposed an alternative which the Commission finds to be sufficient. Accordingly, based on the auditor's evaluation and the Commission's directives set forth herein, we conclude that AEP-Ohio has, in all material aspects, implemented their corporate separation plans in compliance with Section 4928.17, Revised Code, and the orders of this Commission. Further, the Companies' corporate separation plans reasonably comply with the rules set forth in Chapter 4901:1-37, O.A.C. The Commission reminds AEP-Ohio that pursuant to Rule 4901:1-37-09, O.A.C., the Companies shall not sell or transfer generation assets without prior Commission approval.

It is, therefore,

ORDERED, That AEP-Ohio comply with the directives of this order. It is, further,

ORDERED, That, upon completion of the directives set forth herein, AEP-Ohio has, in all material aspects, implemented their corporate separation plans in compliance with Section 4928.17, Revised Code, the rules set forth in Chapter 4901:1-37, O.A.C., and the orders of this Commission. It is, further,

ORDERED, That a copy of this order be served upon all persons of record in this case.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Paul A. Centolella

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