

**FILE**

**BEFORE THE  
PUBLIC UTILITIES COMMISSION OF OHIO**

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**In the Matter of the Application of )  
Ohio Power Company for Approval of )  
the Shutdown of Unit 5 of the Philip ) Case No. 10-1454-EL-RDR  
Sporn Generating Station and to )  
Establish a Plant Shutdown Rider )**

**REPLY COMMENTS OF OHIO POWER COMPANY**

**Background**

Ohio Power Company (OPCo) filed an application on October 1, 2010 for approval of the shutdown of Unit 5 of the Philip Sporn Generating Station (Sporn 5) and the establishment of a rider to recover closure costs. In particular, OPCo's application sought approval to establish a new non-bypassable distribution rider, outside the rate caps to recover these early closure costs. Specifically, the early closure cost requested for recovery through the rider would include both incurred closure costs as of December 2010 ("incurred costs") as well as future closure costs to be incurred after December 2010 ("future costs"). The incurred costs include (1) the unamortized plant balance remaining on OPCo's books (estimated at \$56.1 million as of December 31, 2010); and (2) the materials and supplies on hand that are unique to Sporn 5 that cannot be used at other AEP plants (approximately \$2.6 million). The future costs include: (1) any legally required asset retirement obligations, including asbestos removal, the fly ash pond closure and the disposal of transformer-rectifier set fluids; and (2) any net salvage to be incurred (received) related to the Sporn 5 assets including the unique materials and supplies. In order to accurately account for the future Sporn 5 costs to be incurred, OPCo proposed that the Commission grant accounting authority to record the future costs in a

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regulatory asset/liability account to be included in the proposed non-bypassable rider when incurred. In this regard, OPCo also requested that a weighted average cost of capital carrying charge on those future cost deferrals be recovered through the proposed rider. To the extent that the Commission determines that it would be appropriate to mitigate the rate impact of the proposed rider, OPCo alternatively requested in its application that the Commission amortize recovery of the closure costs over a 36-month period beginning in the first billing cycle of January 2011 (rather than being recovered entirely in 2011), with carrying charges being included over such an extended recovery period. Only one commenter, Wal-Mart, addressed this alternative request by stating (at 4) that the Commission should adopt the offer to mitigate the rate impact by amortizing recovery over a 36-month period.

In addition to seeking Commission approval for the shutdown, as discussed in paragraph 13 of the application, OPCo was also obligated to give at least 90 days advance notice to PJM Interconnection, LLC (PJM) of the planned closure of Sporn 5 and such notice was given to PJM concurrent with the filing of the application. On March 30, 2011, OPCo filed an update regarding the other regulatory-related approvals. Specifically, on October 29, 2010, PJM informed OPCo that from PJM's perspective, Sporn 5 "may be deactivated at any time," since PJM did not identify any reliability violations resulting from the proposed shutdown. Similarly, on February 1, 2011, Monitoring Analytics, LLC - the "Market Monitoring Unit" (MMU) in PJM's Open Access Transmission Tariff (PJM OATT) - notified OPCo that it "cannot identify a market power issue" with respect to the proposed shutdown of Sporn 5, after reciting the MMU's obligation under Section IV of Attachment M to the PJM OATT to analyze the

effects of a proposed deactivation with regard to any potential market power issues.

Thus, the only remaining regulatory approval for the proposed shutdown of Sporn 5 is for the Commission to rule on the application filed by OPCo in this case. Regarding OPCo's request for approval to shutdown Sporn 5 (to the extent needed under R.C. 4905.20 and 4905.21), no party in comments contested this request or suggested that OPCo not be permitted to close the unit.

### **Summary of AEP Ohio's Argument**

S.B. 221 permits recovery of early closure costs and the Commission's ESP Order granted OPCo the ability to request closure costs for a generating plant that closed earlier than anticipated during the term of the ESP. The ESP statute supports the Commission's ability to allow recovery of plant closure costs. More importantly, the ESP Order already explicitly permitted OPCo to request recovery of early plant closure costs during the ESP term, which was a lawful determination that in any case cannot presently be challenged. As an important, threshold factual matter, Staff is wrong in claiming that OPCo had already recovered its investment in Sporn 5. S.B. 3's prior allowance for recovery of stranded generation investment is not applicable here and, consequently, its expiration does not preclude OPCo's request. Traditional cost-based regulation principles also support the recovery of early closure costs, as do the additional policy considerations explained below. OPCo is not opposed to OCC's suggestion that this case be consolidated with the pending ESP Cases for purposes of hearing and decision – subject certain specific concerns set forth below being addressed by the Commission.

## Argument

### **I. S.B. 221 permits recovery of early closure costs and the Commission's ESP Order granted OPCo the ability to request closure costs for a generating plant that closed earlier than anticipated during the term of the ESP.**

Several parties argue that the ESP statute and S.B. 221 generally do not allow OPCo to recover early closure costs. For example, OCC claims (at 3) that “[n]o where in that section are the closing costs of plants that existed before S.B. 3 included.” IEU states (at 6) that “nothing in Section 4928.143, Revised Code, provides a basis for recovering closure costs.” Similarly, Staff argues (at 3) that S.B. 221 “makes no provision for recovery of generating unit closure costs.” Staff goes on to reference R.C. 4928.143(B)(2)(c)’s allowance for non-bypassable recovery of costs associated with building a generating unit as “the only provision under current law which would permit the sort of charge sought by OPCo” but concludes that it is inapplicable. This narrow view of the ESP statute and S.B. 221 is unsupported and inconsistent with the Commission’s application of the statute.

#### **A. The ESP statute supports the Commission’s ability to allow recovery of plant closure costs**

Some parties argue that generation has been deregulated in Ohio. For example, OPAE argues (at 4) that “generation resources are deregulated” and the owners are no longer required to dedicate the output of those plants to customers. OPAE concludes (at 4) that S.B. 3 allows OPCo to utilize its generation facilities *in any manner it sees fit*” and that Sporn 5 “belongs to OPCo and it makes all decisions related to that asset.” OPAE’s characterizations are out of touch with regulatory reality. OPCo cannot transfer or sell generating assets such as Sporn 5, without Commission approval under R.C. 4928.17.

The retail rates for electricity sales supported by Sporn 5 are regulated and OPCo is not permitted to immediately collect market prices for the retail electricity sales supported by Sporn 5 under S.B. 221; an MRO plan requires a multi-year rate blending period prior to being permitted to charge market rates. OPCo is not even permitted to unilaterally shut down the plant without regulatory approval, per R.C. 4905.20 and 4905.21. Thus, it is more accurate to recognize that S.B. 3's prior regime of a purely market-based SSO was abandoned in favor of S.B. 221's hybrid form of re-regulation, including rate adjustments within the ESP statute that are cost-based and more akin to single-issue ratemaking using traditional regulatory principles. To that extent, traditional ratemaking principles concerning recovery of plant closure costs also inform the debate in this case about what is fair and reasonable about OPCo's request.

Contrary to comments that portray S.B. 221 as continuing S.B. 3's deregulation of generation service, there can be no question that Am. Sub. S.B. No. 221, 2007 Ohio SB 221, effective July 31, 2008 (S.B. 221) constitutes a hybrid form of *regulation*. S.B. 221 modified the method for setting standard service offer (SSO) rates for electric service. The Commission's decision-making process in ESP proceedings is markedly different than in its traditional ratemaking process under R.C. Chapter 4909. The valuation of property under R.C. 4909.05 is not required in an ESP proceeding; nor is there a Staff Report of Investigation prepared in an ESP as it is for compliance with R.C. 4909.19. An ESP proceeding has no date certain or test year, as would be required in traditional ratemaking under R.C. 4909.15 (B). A "fair and reasonable rate of return," which the Commission "shall determine" in traditional ratemaking, is mentioned in R.C. 4928.143, but only in conjunction with an ESP provision regarding the EDU's distribution

infrastructure modernization plan. An ESP does not involve the Commission's determination of the overall cost to the utility of rendering service, or the gross annual revenue to which the EDU is entitled by following the formula set out in R.C. 4909.15 - dollar amount of return on investment to which the utility is entitled plus the cost of rendering service.

Instead of the well-established ratemaking formula in R.C. 4909.15, the General Assembly provided that the contents of an ESP are left to the EDU to propose and the Commission to approve, modify or disapprove. The contents of an ESP are addressed in R.C. 4928.143, the ESP statute, which indicates that an ESP may include any combination of the rate adjustments listed in the statute. Those rate adjustments specify recovery of certain categories of costs, whether or not those adjustments are cost-based. The inclusion of cost-based rate adjustments, however, does not permit converting the ESP ratemaking process into a traditional overall cost-of-service analysis. Rather, the General Assembly directed the Commission to make but one determination regarding a proposed ESP. R.C. 4928.143 (C) directs that the Commission:

by order shall approve or modify and approve the application [for an ESP] if it finds that the electric security plan so approved, including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under section 4928.142 of the Revised Code.... Otherwise, the commission by order shall disapprove the application. (emphasis added).

That's it. No rate base, no date certain, no test year, no test year cost of service and no formula for the Commission to follow. The simple stated required determination for the Commission to make is whether the ESP is better than the results expected under an MRO.

As an additional matter, commenters are wrong in claiming S.B. 221 does not address plant retirement at all. In division (B)(2)(c), the General Assembly provided that “[b]efore the commission authorizes any surcharge pursuant to this division, it may consider, as applicable, the effects of any decommissioning, deratings, and retirements.” And it makes sense that the General Assembly authorized the Commission to address decommissioning, deratings and retirements” as an integral part of attempting to encourage construction of new generating capacity in Ohio. In order to effectively address construction of new capacity in a comprehensive manner as envisioned by the General Assembly, AEP Ohio submits that the Commission needs to also address the entire investment cycle, including planning, development, construction, environmental compliance, operation *and retirement of existing plants*. Otherwise, capacity will not be built in Ohio. Separately, division (B)(2)(d) of the ESP statute also allows recovery of “carrying costs” and authorizes “deferrals, including future recovery of such deferrals” – all of which support granting the relief requested by OPCo in this case. The legality of this component of the approved ESP (or any other component), however, cannot be re-litigated in this case.

**B. The ESP Order explicitly permitted OPCo to request recovery of early plant closure costs during the ESP term, which was a lawful determination that in any case cannot presently be challenged**

In OPCo's Electric Security Plan (ESP) proceeding (Case No. 08-918-EL-SSO) it requested authority to come before the Commission during the ESP term to determine the appropriate treatment for accelerated depreciation and other net early closure costs should it become necessary to close a generation plant earlier than otherwise expected. (ESP Application at 19.) In OPCo's ESP case, the Commission found this aspect of the

application "*to be reasonable and, accordingly the request should be granted.*" (ESP Opinion and Order, March 18, 2009, p. 53, emphasis added). Thus, contrary to the commenters that claim OPCo is legally precluded from seeking recovery of the Sporn 5 closure costs, OPCo's approved ESP includes the ability to request recovery of such costs during the 2009-2011 term.

No party challenged the Commission's decision in this regard and it is a final and non-appealable order on this point. While the Commission retains discretion to grant or deny the request (as further discussed below), no party can reasonably claim that the Commission lacks the legal ability to implement this ESP provision explicitly adopted in the ESP decision and never challenged by any party. On page 53 of the Opinion and Order in the ESP cases, the Commission affirmatively and unequivocally granted OPCo's request to provide for the ability to seek earlier-than-anticipated closure costs during the ESP period. The Commission fully understood OPCo's proposal and, while it denied the request related to unanticipated closure, explicitly granted OPCo's request regarding earlier-than-anticipated closures during the ESP term.

Some of the commenters in this proceeding correctly recognize that the Commission granted this ability to request closure cost recovery during the ESP term. (OCC Comments at 2; OMA Energy Group Comments at 2.) Other parties recognize that the ESP Order permitted OPCo to file an application for early closure costs but then inexplicably claim that S.B. 221 precludes recovery of such costs. (IEU Comments at 3, 5-7.) Such untimely collateral attacks should not be permitted, let alone entertained. Staff completely ignores this authorization in the ESP Order – perhaps because the Commission partially rejected the Staff's position on that issue in the ESP case. In any

event, neither the parties presently complaining about the opportunity for OPCo to recover early closure costs granted by the Commission (including Staff), nor any other parties, can challenge the ESP order at this point. None of the parties presently arguing against OPCo's legal ability to request recovery of early closure costs ever challenged the ESP Order permitting OPCo to file such a request – either on rehearing or appeal – and the order is now final and non-appealable.

OCC submitted late supplemental comments instanter (on April 20, 2011) and relies upon the Supreme Court's opinion released on April 20, 2011 in Case No. 2009-2022 as authority for the proposition that OPCo's closure costs for Sporn 5 should not be permitted. The Court's decision cannot be retroactively applied to modify aspects of the ESP that were not challenged on rehearing and appeal, as OCC suggests. Regarding the Court's holding regarding the interpretation of division (B)(2) of the ESP statute relied upon by OCC, the scope of the remand proceeding under the opinion (assuming that the decision becomes final and a mandate is issued consistent with the opinion) is that the Commission is to determine whether any of the listed categories of (B)(2) authorize recovery of environmental carrying charges challenged by OCC in its Proposition of Law No. (See Par. 35 of opinion.)

Neither OCC nor the Commission can use that limited reversal and remand to open up other aspects of the approved ESP. All of the other components of the ESP became final when the rehearing process was completed and no appeals were filed (and all of the issues that were raised on appeal will also become final, except for the two narrow questions reversed and remanded in the opinion, at such time as the Court's mandate is issued). OPCo's application in this case does not present the question of

whether the ESP should be modified but only whether the early closure costs of Sporn 5 should be permitted pursuant to a currently-approved provision of the ESP (granted by the Commission on page 53 of the Opinion and Order). While the Commission has discretion to permit or deny that requested recovery, the legality of this component (or any other existing component) of the ESP cannot be re-litigated in this case.

The ESP Order is not only final and non-appealable but also represents a “package deal” applicable for the full ESP term that cannot be amended after-the-fact by piecemeal modifications. In this regard, OCC’s argument (at page 5, note 11) is an improper attempt to adjust the balance achieved by the package deal adopted in the Commission’s ESP order. OCC’s attachment 1 (OPCo discovery response) does not prove anything since it merely shows the percent of the unit’s annual generation produced for off-system sales. There is no comparison to the test year level of OSS margins reflected in base rates, per the decision in OPCo’s last general rate case. Moreover, the OSS margins retained by OPCo during the ESP were permitted over OCC’s objections and were part of the ESP package deal that cannot now be re-litigated. As referenced above, another part of the existing ESP package approved by the Commission was OPCo’s ability to request recovery of early plant closure costs.

In sum, OPCo’s ability to seek early closure costs was part of the ESP plan and cannot now be deleted from the plan, which is what the opposing comments seek to do as a practical matter. Rather, the Company’s application is a legally appropriate and permissible request that is properly before the Commission. On the contrary, it is the parties’ arguments collaterally attacking the ESP Order that are legally precluded from doing so. Thus, OPCo’s request should be debated on its merits instead of falsely

portrayed as being legally precluded. As discussed above, the ESP Order clearly established OPCo's ability to seek recovery during the ESP term and that order was not challenged and is now final and non-appealable. Parties that seek to undercut OPCo's legal ability to request early closure cost recovery at this point are precluded from doing so. In any case, their legal arguments are without merit. This case presents an important set of policy questions and should not center on the Commission's clear legal ability to grant cost recovery.

**II. As an important, threshold factual matter, Staff is wrong in claiming that OPCo had already recovered its investment in Sporn 5**

Staff alone makes the claim (at 4) that Sporn 5 should have been fully depreciated in 2010, based on the depreciation rates established more than 15 years ago in the Company's last general rate case (Case No. 94-996-EL-AIR). It strains credibility to suggest that such stale depreciation rates would be used to override the current accounting books of the Company. As detailed below, Staff's position is wrong in concluding that OPCo's investment in Sporn 5 is fully recovered, as it relies on outdated information and does not conform to established regulatory accounting and ratemaking principles regarding updating depreciation rates when circumstances change. Since at least a portion of closure costs may have been reflected in the previously-authorized rates, some partial adjustment to recovery of future closure costs may be appropriate. However, the Company is still entitled to recovery of the net book value. As further discussed below, the remaining net book value of Sporn 5 is driven by capital plant additions that occurred since the time of the 1994 rate case.

In addition to recovery of the net book value, OPCo also requested (paragraph 9 of the application) recovery of incurred costs of approximately \$2.6 million of materials & supplies on hand that are unique to Sporn 5. Finally, OPCo requested unknown future closure costs, being legally required asset retirement obligations, asbestos removal, the fly ash pond closure and the disposal of transformer-rectifier set fluids. OPCo maintains that the removal/closure costs reflected in depreciation rates established in the 1994 rate case substantially under-estimated the actual closure/removal costs that apply to Sporn 5 today, given the dramatic intervening increase in environmental regulations that apply to coal-burning power plants.

As set forth in paragraph 9 of the Company's application, the net book value of Sporn 5 was \$56.1 million at the time the application was filed. Specifically, the \$56.1 million net book value as of December 2010 consists of approximately \$222 million of gross plant less approximately \$166 million in accumulated depreciation. For the reasons stated in the application and in these reply comments, OPCo believes recovery of the net book value is reasonable and lawful.

Staff's position that OPCo should have already recovered its investment in Sporn 5 based on the depreciation rates adopted in the 1994 rate case ignores the substantial capital additions that have been made in the intervening 17 years. Significantly, approximately \$70 million of the existing gross plant for Sporn 5 relates to surviving additions made in the period of 1994 through 2010. (See Attachment A for details on capital additions.) Simply relying on the depreciation rates established in the 1994 rate case and concluding that OPCo should have recovered its investment by now ignores the \$70 million capital investment that OPCo has made to keep Sporn 5 running and in

compliance with ever-expanding environmental regulations. Ignoring the \$70 million does not make it go away – if it is not recovered and Sporn 5 is shutdown, OPCo will take a write-off of the net book value.

The theoretical depreciation reserve, as is obvious from its name, only represents an estimate and as the NARUC “Public Utility Depreciation Practices” (excerpt attached as Exhibit B) recognizes (at 189) that “only after plant has lived its entire useful life will the true depreciation parameters become known.” Thus, NARUC’s depreciation practices manual recommends (at 187) that “the utility and regulators should strive to ensure that the unrecovered dollars are reasonable in relationship to the property’s remaining life.” When changed factors result in a material reserve imbalance, NARUC’s depreciation practices manual indicates “one should make immediate depreciation accrual adjustments.”

These established principles show that depreciation rates are not established “once and for all” or deemed to still enable investment recovery when circumstances change. These principles directly undercut Staff’s position that the depreciation rates established in the 1994 rate case should be definitively presumed to have resulted in recovery of OPCo’s investment in Sporn 5 by 2010. The Commission should not rely on Staff’s faulty position and ignore the \$70 million investment in additions that kept Sporn 5 running and available for Ohio customers for the past 17 years.

**III. S.B. 3’s prior allowance for recovery of stranded generation investment is not applicable here and does not preclude OPCo’s request**

Some of the parties claim that OPCo’s request is really an untimely request for recovery of stranded investment under R.C. 4928.41. (IEU Comments at 8-10; OCC

Comments at 3-7; Staff Comments at 1-2; OEG Comments at 3; OPAE Comments at 2.) While parties characterize OPCo's request as seeking untimely recovery of stranded generation investment, that is incorrect. OPCo never claimed that Sporn 5 was a stranded generation investment under S.B. 3 and understands that the window of opportunity for pursuing stranded generation investment under R.C. 4928.40 has closed. However, the requested recovery of net book value of the plant and closure costs is qualitatively not the same as stranded generation investment. In addition, intervening factual and legal developments do support Commission approval of the requested cost recovery.

Another factual development is that, had OPCo been permitted to transition to market rates by 2006 as originally envisioned when SB 3 was passed, it could have absorbed such early closure costs through the then-prevailing market prices as part of transitioning to fully market-based generation pricing. But OPCo was not permitted to charge market prices for generation and charged its customers FAC rates that have not recovered costs due to the phase-in deferral plan. Thus, in addition to being specifically contemplated under the Commission's order in OPCo's ESP case, OPCo submits that it is reasonable under the current circumstances for OPCo to recover early closure costs.

As a related matter, the law has changed as described above. Specifically, the General Assembly has since rescinded the purely market-based pricing regime of S.B. 3 (the rescinded pricing regime is what gave rise to the transition period and temporary opportunity to recover generation investments that were stranded at that time). As discussed above, the replacement regime of hybrid regulation known as S.B. 221 enables the Commission to authorize the recovery of early plant closure costs. Because the facts and law have substantially changed, the Parties' arguments regarding recovery of

stranded investment costs under S.B. 3 are neither relevant nor dispositive of OPCo's requested relief.

**IV. Traditional cost-based regulation principles also support the recovery of early closure costs**

IEU and OCC both wrongly claim that OPCo's request would have been improper under traditional rate regulation as reflected in R.C. Chapter 4909. (IEU Comments at 7-8; OCC Comments at 8.) Ironically, both IEU and OCC recognize elsewhere in their comments that OPCo was permitted to recover closure costs in its last general base rate case, Case No. 94-996-EL-AIR. (IEU Comments at 7; OCC Comments at 2.) OCC also recognizes that the Commission has permitted recovery of closure costs, though characterizing it (at 7) as being "rarely permitted." On the other hand, OMA Energy Group acknowledges (at 3) that such costs "may be appropriate under traditional cost-based regulation" but adds that generation rates are no longer subject to traditional regulation.

Staff and others unjustifiably rely upon cases that are inapposite, since they involve plant cancellations. (Staff Comments at 5; OCC Comments at 8; OMA Energy Group Comments at 4; IEU Comments, at 8.) These comments attempt to rely upon the Ohio Supreme Court's decision in *Consumers' Counsel v. Pub. Util. Comm'n*, 67 Ohio St.2d 153 (1981) for the proposition that the Commission may not approve the Companies' request to recover early closure costs. In that case, the utility sought recovery of its investment in a "failed" nuclear generating plant that was never completed and never went into service and, thus, was never "used and useful." In contrast, OPCo's application in this case involves a request for recovery of early closure costs for a

generating unit that is, and has been since it first went into service, "used and useful." Thus, the Court's decision in *Consumers' Counsel*, supra, is simply not applicable to OPCo's proposal in this case.

Similarly, Staff's citation to the Commission's Opinion and Order, at 14, in Case No. 07-551-EL-AIR (January 21, 2009) as authority for the proposition that the application should be denied is misguided for the same reason. That was a distribution service rate case and the retired generation plants did not support the distribution service being priced in that case. In any case, while traditional ratemaking principles may guide the Commission's policy decision in this case, those principles (as reflected in case law) are not binding and ultimately need not be followed here.

It is a routine matter of utility accounting and ratemaking that plant in service is retired and replaced, though the magnitude of a power plant example is larger. But every day in utility operation, poles and other plant in service are replaced and retired. A retired pole or transformer will also have a removal cost and may have environmental disposal costs as well. There is no great fanfare or policy debate when such plant is retired. The FERC Uniform System of Accounts (FERC Electric Plant Instructions, Item 10 "Additions and Retirements of Electric Plant" at paragraph F) provides:

The book cost less net salvage of depreciable electric plant retired shall be charged in its entirety to account 108. Accumulated Provision for Depreciation of Electric Plant in Service (Account 110, Accumulated Provision for Depreciation and Amortization of Electric Utility Plant, in the case of Nonmajor utilities).

Thus, when an asset is retired, both electric plant in service [Account 101] and accumulated depreciation [Account 108] are reduced by the original cost of the asset. Any net related salvage would either increase or decrease accumulated depreciation.

Therefore, any remaining net book value of the asset remains in accumulated depreciation.

In order to properly recover any net book value (including additions) on retired property, the net book value of the retired asset (included in accumulated depreciation, Account 108) will be included in the next depreciation study in the next rate case and recovered in future rates. OPCo's argument in paragraph 10 of its application was correct in stating that:

Sporn 5 has served OPCo's ratepayers during the life of the asset. It would not be reasonable to expect shareholders to absorb early closure costs when Sporn 5 has benefited ratepayers for its entire productive life. The requested early closure cost represents dollars invested during a regulatory regime in which OPCo was permitted to recover all prudently incurred costs including plant closure costs.

The Commission should follow these established regulatory accounting and ratemaking principles and authorize non-bypassable recovery of the Sporn 5 early closure costs.

#### **V. Additional policy considerations support granting OPCo's request**

Since the passage of S.B. 221, CEOs of Ohio's investor-owned utilities have consistently indicated publicly that, they could see no path to investment in new generating assets under Ohio's current framework. A comprehensive framework for the recovery of current and future generating assets can mitigate the distinct risk that Ohio could become an importer of electric power. Such framework includes certainty in the recovery of early plant retirement and closure costs in order to enable the utilities to make sustainable business decisions. In order to establish a viable framework for investment recovery opportunity must address the entire plant lifecycle, including retirement.

As utilities face major decisions regarding whether to retire, retrofit, or replace existing assets, the regulatory framework adopted by this Commission will largely define

the environment for those decisions. If Ohio wants to avoid becoming like California who is a power importer that has been exposed to the risks and volatility of market prices, AEP Ohio submits that the Commission needs to address the entire investment cycle, including planning, development, construction, environmental compliance, operation *and retirement of existing plants.*

Notwithstanding the Staff's comments advocating rejection of the Company's proposal, the Commission itself has recently acknowledged the likely impact on ratepayers of proposed environmental regulations. For example, in response to the USEPA's proposed air transport rules, the Commission itself argued as follows:

*The proposed rule, in concert with anticipated rules, will accelerate the retirement of coal fired electric generating plants. The cost of premature retirements will have a direct impact on rates, not only as a result of necessary amortization and other closure costs, but also due to the fact that the lower-cost, locally available power will be removed from the market, making the marginal unit a higher-priced energy source, and driving the need for additional generating capacity. Compounding this concern is the consideration that many of the electric distribution utilities that may be negatively impacted, as discussed above, serve as the Provider of Last Resort (POLR) to our native load customers. The current and foreseeable economic environments indicate that Ohio's ratepayers will be hard-pressed to absorb "rate shock" due to the overly aggressive implementation schedule advanced in the proposed rule.*

(USEPA Docket ID No. EPA-HQ-OAR-2009-0491, October 1, 2010 PUCO Comments at 6, emphasis added.) Similarly, when commenting on USEPA's proposed coal combustion residuals rule, the Commission again voiced concerns about the direct rate impact expected from accelerated retirements that would be caused by the proposed regulation:

*The proposed rule, in concert with other anticipated rules, has a real, very serious probability to accelerate the retirement of coal fired electric generating plants. The cost of premature retirements will have a direct impact on rates, not only as a result of necessary amortization and other*

*closure costs*, but also due to the fact that the lower-cost, locally available power will be removed from the market, making the marginal unit a higher-priced energy source, and driving the need for additional generating capacity. *Compounding this concern is the consideration that many of the electric distribution utilities that may be negatively impacted, serve as the Provider of Last Resort (POLR) to our native load customers.* The current and foreseeable economic environments indicate that Ohio's ratepayers will be hard-pressed to absorb "rate shock" due to the implementation schedule advanced in the proposed rule under RCRA subtitle C.

(USEPA Docket ID No. EPA-HQ-RCRA-2009-0640, November 18, 2010 PUCO

Comments at 6-7, emphasis added.)

The Commission's explicit representations to the Federal government about accelerated retirements having an unavoidable and direct impact on rates were made with the understanding that all of Ohio's electric distribution utilities are operating under an Electric Security Plan. Moreover, these prescient observations were also made well after the "stranded generation investment" recovery opportunity in R.C. 4928.40 expired. More to the point, the Commission's observations in the second rulemaking were made several weeks after OPCo's application in this proceeding was filed and pending. Not only does this Commission position undercut the Staff's staunch position against the legality of early plant closure cost recovery, but it directly supports OPCo's policy arguments in favor of the requested cost recovery. Whether Sporn 5 is being closed based on either set of proposed regulations referenced above is immaterial – the Commission's representation to the USEPA that ratepayers would pay for early plant retirements is the salient point. Surely, the Commission cannot now claim that such a result is unlawful or unreasonable.

**VI. OPCo is not opposed to OCC's suggestion that this case be consolidated with the pending ESP Cases for purposes of hearing and decision**

OCC suggests (at 8-10) that the Commission should consolidate this case with the pending ESP Cases. While OCC's consolidation suggestion references the IEU's request for consolidation as a supporting basis, OPCo notes that IEU's request for consolidation was much broader and included several other proceedings. OPCo opposed IEU's request to consolidate all of the referenced cases as being unsubstantiated and overbroad because a substantial commonality of issues did not exist across all of the cases. Further, unlike the lack of overlapping parties in all of the cases referenced in IEU's motion, virtually all of the parties in this case are also intervenors in the ESP cases. Moreover, to the extent the Commission would like to further explore the underlying factual issues being debated in this case (*e.g.*, the accounting issues) and would find a hearing beneficial in deciding the case, consolidation would be an efficient use of resources.

Thus, upon considering OCC's consolidation suggestion, OPCo is not opposed to consolidation of this case with the pending ESP Cases – subject to the following concerns being addressed. As a procedural matter, the discovery cutoff date in the ESP Cases should remain the same and apply to the Sporn 5 issues. Parties have already done a significant amount of discovery in this case and the discovery cutoff needs to remain June 16 so that the Company can adequately complete its preparation for the evidentiary hearing. Another procedural matter is that, if the issues in this case are to be consolidated with the ESP cases, then written testimony should be submitted and a testimony schedule should be established. If this option is selected by the Commission, the Company should

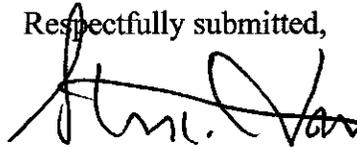
be permitted to file testimony by May 15 and the parties existing testimony deadline of June 13 should remain the same (as would the Staff's June 27 testimony deadline).

On a more substantive level, OPCo's main concern in consolidating this case with the ESP Cases is the associated delay in getting a decision regarding Sporn 5. Consequently, if this case is to be consolidated within the ESP Cases and further delay a comprehensive decision in this case, OPCo requests that the Commission rule on the uncontested request to shutdown Sporn 5 and grant the temporary accounting relief, as detailed in paragraph 14 of its application, that is needed to avoid an immediate write-off pending the final outcome of the case.

### **CONCLUSION**

For the forgoing reasons, the Commission should grant the relief requested in OPCo's application. If the Commission prefers to consolidate this case with the pending ESP Cases, it should address the concerns outlined above – most notably the issuance of an order permitting closure of the plant and permitting the establishment of regulatory assets pending the final outcome.

Respectfully submitted,



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# **Exhibit A**

**Ohio Power Company**  
**Sporn Unit 5**  
**Post 1993 - Surviving Dollars at December 2010**

<u>Vintage</u>	<u>31100</u>	<u>31200</u>	<u>31400</u>	<u>31500</u>	<u>31600</u>	<u>35300</u>	<u>Total</u>
1994	\$44,640.10	\$3,971,614.89	\$3,508,439.42	\$913,140.28	\$54,741.85	\$121,651.68	\$8,614,228.22
1995	\$606,220.12	\$688,267.85	\$356,197.06	\$233,366.02	\$31,566.45	\$0.00	\$1,915,617.50
1996	\$874,969.38	\$1,483,477.53	\$1,111,292.54	\$375,830.68	\$9,551.09	\$0.00	\$2,855,121.22
1997	\$671,490.28	\$9,248,532.36	\$722,883.78	\$791,262.21	\$223,009.89	\$0.00	\$11,657,178.52
1998	\$26,324.27	\$4,349,219.25	\$544,541.63	\$527,188.45	\$10,934.24	\$255,456.20	\$5,713,664.04
1999	\$48,580.30	\$2,223,152.79	\$163,447.71	\$542,200.56	\$2,218.78	\$0.00	\$2,979,600.14
2000	\$11,621.92	\$2,777,702.25	\$41,684.02	\$3,079.58	\$3,029.77	\$100,800.82	\$2,937,918.36
2001	\$0.00	\$2,878,989.46	\$392,736.94	\$0.00	\$0.00	\$0.00	\$3,271,726.40
2002	\$0.00	\$17,808,067.03	\$0.00	\$0.00	\$39,996.10	\$0.00	\$17,848,063.13
2003	\$218,088.71	\$397,314.39	\$2,935,540.62	\$153,057.50	\$67,739.79	\$0.00	\$3,771,741.01
2004	\$455,039.87	\$1,508,582.13	\$0.00	\$0.00	\$0.00	\$0.00	\$1,963,622.00
2005	\$0.00	\$1,169,497.72	\$0.00	\$157,469.41	\$27,125.72	\$0.00	\$1,354,092.85
2006	\$325,582.66	\$2,116,246.56	\$1,743,571.98	\$0.00	\$0.00	\$0.00	\$4,185,401.20
2007	\$0.00	\$0.00	\$0.00	\$0.00	\$89,604.76	\$0.00	\$89,604.76
2008	\$0.00	\$14,146.82	\$0.00	\$0.00	\$41,934.96	\$281,628.21	\$337,709.99
2009	\$4,859.82	\$147,582.86	\$28,545.82	\$78,470.51	\$0.00	\$0.00	\$259,459.01
2010	<u>\$0.00</u>	<u>\$371,422.52</u>	<u>\$54,588.64</u>	<u>\$60,463.67</u>	<u>\$19,631.00</u>	<u>\$0.00</u>	<u>\$506,105.83</u>
	<b>\$3,318,517.43</b>	<b>\$51,185,016.41</b>	<b>\$10,634,870.16</b>	<b>\$3,867,028.87</b>	<b>\$652,684.40</b>	<b>\$794,836.91</b>	<b>\$70,260,854.18</b>

**Note: Account 35300 represents amounts applicable to the Generator Step Up Transformer at Sporn Unit 5.**

# **Exhibit B**

Public Utility  
Depreciation Practices

August 1996



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## CHAPTER XIII

### THEORETICAL RESERVE STUDIES

#### Introduction

As discussed in Chapter IV, the sole purpose of depreciation accounting is to rateably allocate the capital costs of the property over its average service life through current charges to utility expenses. In depreciation accounting, depreciation expense is calculated either monthly or annually, charged (debited) to the current expense, and credited to the depreciation reserve (accumulated provision for depreciation account). Most commissions require that the depreciation reserve be charged (debited) at retirement with the book cost of plant and credited with any actual net salvage received. Some commissions, however, require that salvage and cost of removal be recovered through current income and expense accounts, respectively, allowing only the book (original or gross) cost of the plant to be accounted for through depreciation charges.

It is intended that the depreciation reserve at the end of an accounting period be that part of the book cost of the plant in service which has been charged to depreciation expense. If depreciation rates have been accurately estimated, the depreciation reserve will reflect the investment in service capacity, utility, or service life of the surviving plant which has been used up in operations. Therefore, the unconsumed usefulness of the plant is its book cost less the depreciation reserve.

In many regulatory customer rate-setting procedures, the depreciation reserve is a deduction from rate base. Therefore, it is desirable that the depreciation reserve be as accurate as possible. Financial reporting standards also demand accuracy.

The depreciation reserve is a balance sheet account, shown as a reduction to the property, plant, and equipment balance and is not a cash reserve. Depreciation accounting is not intended for the purpose of funding plant replacement. The cash flows resulting from the recovery of the capital invested in plant are not required to be retained in the utility accounts or assets. Utility directors have the responsibility and freedom to use these funds in accordance with their best judgement.

#### Theoretical Reserve In General

It is important that utility management and regulators monitor the consumed service capacity of plant and its complement—unconsumed service value. Because the dollars representing the unconsumed service value, calculated by subtracting the theoretical reserve from the book cost, must be recovered from operations over the property's average remaining life, the utility and the regulators should strive to ensure that the unrecovered dollars are reasonable in relationship to the property's remaining life.

One way to estimate this theoretical consumed service capacity of plant or the adequacy of the depreciation reserve is to perform theoretical reserve studies, often called reserve

When a depreciation reserve imbalance exists, one should investigate why past depreciation rates, average service lives, salvage, or cost of removal amounts differ from current estimates. Care should be taken to analyze these effects before correcting for the reserve imbalances. Instances will occur where subsequent experience shows the original estimates no longer to be appropriate. It should be noted that only after plant has lived its entire useful life will the true depreciation parameters become known. Recognizing the nature of depreciation and its requirement for future estimations, no adjustment in annual depreciation accruals to reflect a reserve requirement, based on current rates, should be made unless there is a clear indication that the theoretical reserve is materially different from the book reserve.

Whereas the judgement of materiality is subjective, if further analysis confirms a material imbalance, one should make immediate depreciation accrual adjustments. The use of an annual amortization over a short period of time or the setting of depreciation rates using the remaining life technique are two of the most common options for eliminating the imbalance. The size of the plant account, the reserve ratio, the account remaining life, the technology of the plant in the account, and the account reserve imbalance in relationship to the account annual accrual all have a bearing on the chosen course of action.

### Calculating a Theoretical Depreciation Reserve

There are two accepted methods for calculating a theoretical depreciation reserve, the prospective method and the retrospective method.

For any given class of depreciable plant, the theoretical reserve plus the estimated future depreciation accruals equals the service value of the plant (i.e., book cost less estimated net salvage). Under the prospective method, the future depreciation accruals are first estimated. Under the retrospective method, the aggregate of past net accruals (annual depreciation accruals less salvage and cost of removal) is determined.

Future depreciation accruals represent the estimated aggregate of annual depreciation charges during the average remaining life of the plant. Future depreciation accruals are based on the best available data as to past and future conditions affecting the average service lives and net salvage percentages of plant. Past accruals are calculated based upon depreciation rates deemed reasonable for the future but applied to the annual average historical plant balances.

Reasonable estimates of plant service lives, net salvage percentages, and resulting depreciation rates incorporating future conditions are used to estimate the theoretical depreciation reserve.

#### Prospective Method

As previously expressed, the theoretical reserve, as of the study date, is equal to the plant balance minus future accruals (the depreciation rate times the average annual plant balance times the expected remaining life in years) and minus estimated net salvage value expected at the end of the plant's average life. Expressed as a percent of book cost of plant, the theoretical reserve ratio using the prospective method is:

requirement studies. The results of analyses from theoretical reserve studies answer many questions about the consumption pattern of plant. However, theoretical reserve studies should not be used to modify the life and net salvage parameters for calculating future depreciation rates. If a theoretical reserve study reflects an inadequate reserve, and the service lives are reduced solely on this basis, a new theoretical reserve study based on the new service lives would indicate not a "corrected" reserve but instead a greater deficiency, calling for even higher depreciation rates. This would not be a correct application of the results of a theoretical reserve study.

Theoretical reserve studies also have been conducted for the purpose of allocating an existing reserve among operating units or accounts. Such allocation is done when either the reserve has not been accumulated in sufficient detail or cannot be determined from utility records.

In recent years, theoretical reserve studies have been used to estimate the theoretically correct book depreciation reserve based upon past and/or future service life and net salvage considerations. Changes in technology and challenges from competition place a greater emphasis on theoretical reserve studies. Periodic comparisons of the theoretical reserves to the actual book reserves and the booking, as depreciation expense, of any reserve imbalance decrease the risk that the original cost of plant will not be recovered during its service life.

The booked consumed service capacity of plant is also expressed by the reserve ratio, which is the book depreciation reserve divided by the book plant balance. A higher ratio indicates a higher consumption of service capacity or life.

For example, the reserve and the reserve ratio, for a single unit, continually increase with each accounting period until the unit is retired. The reserve ratio for a single vintage with a large number of units, however, does not steadily increase. The ratio increases, with some fluctuations caused by the retirement dispersion, until the vintage's age equals its average service life, after which the ratio decreases with the later period retirements until the vintage's units are all retired.

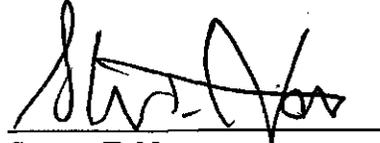
The reserve ratio for an account containing several vintages also does not steadily increase. It may be affected by vintages with differing survivor curve characteristics caused by improvements which lengthen the property's service life. Other factors affecting reserve ratios are inflation and the pattern of growth in vintage installations.

#### Treatment of Reserve Imbalances

A reserve imbalance exists when the theoretical reserve is either greater or less than the actual reserve. If changes are made to the estimated service life and net salvage, creating a reserve imbalance, a decision must be made as to whether and how to correct the reserve imbalance. Should the imbalance be amortized (debited or credited) to the current depreciation expense over a short period of time; or should a remaining life depreciation rate be used to spread the imbalance over the future remaining life of the plant; or should future depreciation rates be adjusted to reflect the current estimated service life of the plant leaving the decision to adjust the reserve for the future? Further analysis will provide additional information to assist in making these decisions.

**PROOF OF SERVICE**

I certify that Ohio Power Company's Reply Comments were served by First-Class U.S. Mail upon counsel for all parties of record identified below this 22<sup>nd</sup> day of April, 2010.



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