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OCC EXHIBIT _____

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of)	
Columbus Southern Power Company and)	
Ohio Power Company for Authority to)	Case No. 11-346-EL-SSO
Establish a Standard Service Offer)	Case No. 11-348-EL-SSO
Pursuant to 4928.143, Ohio Rev. Code)	
in the Form of an Electric Security Plan.)	
)	
In the Matter of the Application of)	
Columbus Southern Power Company and)	Case No. 11-349-EL-AAM
Ohio Power Company for Approval of)	Case No. 11-350-EL-AAM
Certain Accounting Authority.)	

**DIRECT TESTIMONY
OF
DANIEL J. DUANN, Ph.D. CRRA**

On Behalf of
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July 25, 2011

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CERTIFICATE OF SERVICE

1 **I. INTRODUCTION**

2

3 ***Q1. PLEASE STATE YOUR NAME, ADDRESS AND POSITION.***

4 ***A1.*** My name is Daniel J. Duann. My business address is 10 West Broad Street, Suite
5 1800, Columbus, Ohio, 43215-3485. I am a Senior Regulatory Analyst with the
6 Office of the Ohio Consumers' Counsel ("OCC").

7

8 ***Q2. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND***
9 ***PROFESSIONAL EXPERIENCE.***

10 ***A2.*** I received my Ph.D. degree in public policy analysis from the Wharton School,
11 University of Pennsylvania in 1984. I also have a M.S. degree in energy
12 management and policy from the University of Pennsylvania (1982) and a M.A.
13 degree in economics from the University of Kansas (1978). I completed my
14 undergraduate study in business administration at the National Taiwan University,
15 Taiwan, Republic of China in 1977. I am a Certified Rate of Return Analyst
16 conferred by the Society of Utility and Regulatory Financial Analysts in April
17 2011.

18

19 I was a Utility Examiner II in the Forecasting Section of the Ohio Division of
20 Energy ("ODOE"), Ohio Department of Development, from 1983 to 1985. From
21 1985 to 1986, I was an economist with the Center of Health Policy Research at

1 the American Medical Association in Chicago. In 1986, I joined the Illinois
2 Commerce Commission ("ICC") as a senior economist in its Policy Analysis and
3 Research Division. I was employed as a senior institute economist at the National
4 Regulatory Research Institute ("NRRI") at The Ohio State University from 1987
5 to 1995. My work at NRRI involved many areas of utility regulation and energy
6 policy. I was an independent business consultant from 1996 to 2007. A list of my
7 selected professional publications is attached as Attachment DJD-A.

8
9 I joined the OCC in January 2008 as a senior regulatory analyst. My current
10 responsibilities are to assist OCC in participating in various regulatory
11 proceedings that include rate cases, alternative regulation, cost recovery filings,
12 and service reliability by Ohio utilities. In particular, I was part of the case team
13 that analyzed the first Electric Security Plan ("ESP") filing by Columbus
14 Southern Power Company ("CSP") and Ohio Power Company ("OPC")
15 (collectively, "AEP Ohio" or "Companies") (Case Nos. 08-917-EL-SSO et al.). I
16 also conducted analysis and testified in AEP Ohio's 2009 Fuel Adjustment Clause
17 ("FAC") Audit proceeding (Case Nos. 09-872-EL-FAC and 09-873-EL-FAC).

18
19 ***Q3. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY BEFORE THE***
20 ***PUBLIC UTILITIES COMMISSION OF OHIO?***

21 ***A3.*** Yes. I submitted expert testimony before the Public Utilities Commission of Ohio
22 ("PUCO" or "Commission") in a number of cases involving electric, gas, and

1 water companies. All the cases in which I have submitted testimony are listed in
2 Attachment DJD-B.

3

4 ***Q4. HAVE YOU PREVIOUSLY TESTIFIED OR SUBMITTED TESTIMONY***
5 ***BEFORE OTHER ADMINISTRATIVE, REGULATORY, OR LEGISLATIVE***
6 ***AGENCIES?***

7 ***A4.*** Yes. I testified before the ODOE on behalf of the ODOE Staff regarding the
8 Long-Term Forecast Report of the Cleveland Electric Illuminating Company
9 (Case No. CEI-83-E) in 1984. In the same capacity, I submitted testimony on the
10 Long-Term Forecast Report of Toledo Edison Company (Case No. TEC-84-E) in
11 1985. I also testified before the ICC in 1987 on behalf of the ICC Staff regarding
12 the divestiture of three nuclear power plants by the Commonwealth Edison
13 Company and related matters (Case Nos. 87-0043, 87-0044, 87-0057, 87-0096).
14 In 1989, I testified as an expert analyst before the Senate Committee on Energy
15 and Public Utilities of the California Legislature regarding pending legislation
16 (California SB 769) that would have prohibited an electric utility from purchasing
17 electricity from a private energy producer fully or partially owned by a subsidiary
18 or affiliate of the utility.

19

20 ***Q5. WHAT DOCUMENTS HAVE YOU REVIEWED IN THE PREPARATION OF***
21 ***YOUR TESTIMONY?***

1 **A5.** I have reviewed the January 27, 2011 application (“Application”) filed by AEP
2 Ohio in this proceeding.¹ I have also reviewed related testimonies and work
3 papers filed by AEP Ohio in support of the Application, relevant discovery
4 propounded upon AEP Ohio, and AEP Ohio’s responses to such discovery. In
5 addition, I have reviewed the recent Ohio Supreme Court decision (“Remand
6 Decision”) that relates to appeals taken from AEP Ohio’s first ESP proceeding²
7 and related testimonies for the Remand case filed by AEP Ohio and other parties.
8 I have also reviewed other materials, such as recent presentations to analysts and
9 investors and regulatory filings made by American Electric Power Co. Inc. (the
10 parent company of AEP Ohio), trade publications, and general news publications
11 that are mentioned in my testimony.

12
13 **Q6. WHAT ARE YOUR QUALIFICATIONS TO ADDRESS THE ISSUES**
14 **DISCUSSED IN YOUR TESTIMONY?**

15 **A6.** I am a trained economist with over twenty years of experience in studying and
16 analyzing the regulation of electric utilities in the United States. I am familiar
17 with the issues related to the ESP filed by AEP Ohio in this Application. I have
18 participated in several cases involving AEP Ohio before the PUCO in the last
19 three years.³ Specifically, I was part of the OCC’s case team working on AEP

20

¹ PUCO Case Nos. 11-346-EL-SSO, 11-348-EL-SSO, 11-349-EL-AAM, and 11-350-EL-AAM.

² *In re Application of Columbus S. Power Co.*, Slip Opinion No. 2011-Ohio-1788.

³ They include, but are not limited to, PUCO Case Nos. 11-155-EL-RDR, 11-1337-EL-RDR, 10-163-EL-RDR, 11-1361-EL-RDR, 09-756-EL-ESS, 09-786-EL-UNC, and 10-1261-EL-UNC.

Ohio's first ESP proceeding and the 2009 Significantly Excessive Earnings Test ("SEET") proceeding.⁴ I also testified in AEP Ohio's 2009 FAC Audit case.⁵ Additionally, I filed direct testimony in the recent Remand case.⁶

II. PURPOSE OF TESTIMONY

Q7. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A7. The purpose of my testimony is to explain and support my recommendations on certain components of the proposed ESP. I recommend several modifications to the proposed ESP, which if adopted, will reduce the charges to be collected from residential customers and advance the policy of the state to ensure the availability of reasonably priced retail electric service to customers.⁷

Q8. PLEASE SUMMARIZE THE RECOMMENDATIONS IN YOUR TESTIMONY.

A8. I recommend the Commission not approve the proposed ESP in its current form because it will result in rates that are not consistent with the policy of the state to ensure reasonably priced retail electric service. Specifically, I recommend

⁴ PUCO Case Nos. 08-917-EL-SSO et al. and 10-1261-EL-UNC.

⁵ PUCO Case Nos. 09-872-EL-FAC and 09-873-EL-FAC.

⁶ PUCO Case Nos. 08-917-EL-SSO et al (Remand).

⁷ See, for example, O.R.C. 4928.02.

1 reducing or eliminating the proposed revenues AEP Ohio seeks to collect through
2 three riders: the Standard Offer Generation Service Rider ("GSR"), the
3 Environmental Investment Carrying Cost Rider ("EICCR"), and the Provider of
4 Last Resort Charge ("POLR"). I also propose modifications to the EICCR if it is
5 to be included in the ESP for the period of January 1, 2012 to May 31, 2014.

6
7 In addition, I recommend the Commission not approve the Phase-In Recovery
8 Rider ("PIRR") proposed in the ESP before AEP Ohio makes two adjustments to
9 the underlying regulatory asset ("phase-in deferral balance"). Furthermore, I
10 conclude that there is no need for new legislation, as suggested by AEP Ohio, for
11 the securitization of the phase-in deferral balance. I have been advised by counsel
12 that if a securitization is to be done, it can be done under existing statutes,
13 specifically, §4928.14.3(2)(f).

14
15 **III. RECOMMENDATION ON STANDARD OFFER GENERATION**
16 **SERVICE RIDER**

17
18 ***Q9. WHAT IS YOUR UNDERSTANDING REGARDING THE COLLECTION OF***
19 ***ENVIRONMENTAL CARRYING CHARGES UNDER AEP OHIO'S FIRST***
20 ***ESP AND THE PROPOSED ESP?***

21 ***A9.*** Under AEP Ohio's first ESP, the annual carrying charges on environmental
22 investments are collected through two different rates. The annual incremental

1 carrying charges associated with the environmental investments made during the
2 2001 through 2008 period are collected through the base generation rate. The
3 annual carrying charges on the environmental investments made after January 1,
4 2009, on the other hand, are being collected through an EICCR that is updated
5 annually.⁸

6
7 In the proposed ESP to be effective from January 2012 through May 2014, there
8 is no indication from AEP Ohio that it intends to stop collecting the
9 environmental carrying charges currently embedded in the base generation rate.
10 According to AEP Ohio witness Roush, the proposed 2012 base generation rates
11 (before the proposed increase under the ESP) were derived by deducting both the
12 FAC and the EICCR from the projected 2011 full costs.⁹ Then AEP Ohio
13 adjusted this 2012 base generation rate upward to produce AEP Ohio's target
14 revenue collection. Consequently, the 2011 full costs for both CSP and OPC do
15 include the annual carrying charges on environmental investments made by the
16 companies from 2001 through 2008. AEP Ohio will continue collecting this
17 particular type of environmental carrying charges (for environmental investments
18 made in 2001 through 2008) through the base generation rate in the proposed
19 ESP.

20

⁸ AEP Ohio sought to establish the initial EICCR for both CSP and OPC on February 28, 2010, and the Commission approved the initial EICCR on August 25, 2010. See PUCO Case No. 10-155-EL-RDR.

⁹ See Direct Testimony of David M. Roush (January 27, 2011) ("Roush Initial Testimony") at 9 and AEP Ohio's response to OCC INT-284.

1 Under the proposed ESP, the 2012 base generation rate is represented by the
2 Standard Offer Generation Rider ("GSR").¹⁰ As for the annual carrying charges
3 associated with environmental investments made after January 1, 2009, they will
4 be collected through the EICCR. AEP Ohio has proposed to continue the EICCR
5 in the second ESP largely in the same manner as that in the first ESP with some
6 modifications.¹¹

7
8 ***Q10. DO YOU BELIEVE THAT THE CARRYING CHARGES TO BE***
9 ***COLLECTED IN THE PROPOSED ESP BY AEP OHIO FOR ITS 2001***
10 ***THROUGH 2008 ENVIRONMENTAL INVESTMENTS ARE AUTHORIZED***
11 ***UNDER THE LAW?***

12 ***A10.*** No. I have been advised by counsel that there is no specific provision within R.C.
13 4928.143(B)(2) that would allow these carrying charges to be included in an
14 electric utility's ESP. It is OCC's position, confirmed by the Ohio Supreme Court
15 ("Court"),¹² that the statute permits an ESP to include only items listed in the
16 statutes, not unlisted items.

17

¹⁰ See Roush Initial Testimony, Exhibit DMR-4.

¹¹ See Direct Testimony of Philip J. Nelson (January 27, 2011) ("Nelson Initial Testimony") at 16-18.

¹² See Remand Decision at 12, Paragraph 31.

1 ***Q11. IF THE COMMISSION AGREES WITH OCC AND DETERMINES THERE***
2 ***IS NO BASIS FOR COLLECTING THE ENVIRONMENTAL CARRYING***
3 ***CHARGES, SHOULD THE GSR IN THE PROPOSED ESP BE MODIFIED?***

4 ***A11.*** Yes. I have reviewed the compliance tariffs and work papers filed by AEP Ohio
5 in the first ESP, and can confirm that these particular environmental carrying
6 charges have been collected through the base generation rates since April 2009.¹³
7 As this particular type of environmental carrying charge will remain as part of the
8 base generation rate and be collected through the GSR under the proposed ESP, I
9 recommend that the Commission order AEP Ohio to remove these particular
10 annual environmental carrying charges from the GSR.

11

12 ***Q12. PLEASE IDENTIFY THE EFFECT OF YOUR RECOMMENDATION***
13 ***REGARDING THE REDUCTION OF ENVIRONMENTAL CARRYING***
14 ***CHARGES FROM THE GSR.***

15 ***A12.*** I estimate the amount of the annual carrying charges associated with the 2001 to
16 2008 environmental investments to be about \$110 million (\$26 million in CSP's
17 rates and \$84 million in OPC's rates).¹⁴ The \$110 million annual carrying
18 charges will be part of the base generation rate (that is the GSR) in the proposed
19 ESP. If my recommendation on the 2001 to 2008 environmental carrying charges
20 were accepted, the customers of AEP Ohio would pay about \$266 million less in

¹³ Based on the Compliance work papers filed by the Companies on July 28, 2009 in PUCO Case Nos. 08-917-EL-SSO and 08-918-EL-SSO.

¹⁴ Ibid.

1 base generation revenues during the term of the proposed ESP. See Attachment
2 DJD-C.

3
4 **IV. RECOMMENDATION ON ENVIRONMENTAL INVESTMENT**
5 **CARRYING CHARGE COST RIDER**

6
7 ***Q13. WHAT IS YOUR UNDERSTANDING OF THE ENVIRONMENTAL***
8 ***INVESTMENT CARRYING CHARGE COST RIDER (EICCR) AS***
9 ***PROPOSED IN THE ESP?***

10 ***A13.*** As stated before, the annual carrying charges on the environmental investments
11 made after January 1, 2009 are being collected through an EICCR under AEP
12 Ohio's first ESP. In this proceeding, AEP Ohio intends to continue collecting an
13 EICCR through the twenty-nine-month term of the proposed ESP.¹⁵ AEP Ohio
14 proposes some modifications to the EICCR. Specifically, the Companies propose
15 to use the forecasted, instead of actual, investments in calculating the carrying
16 costs and a few other changes.¹⁶ AEP Ohio also seeks to collect certain O&M
17 costs not currently included in the EICCR, and to make the EICCR a
18 nonbypassable charge.¹⁷ The Companies propose that the EICCR be calculated to

¹⁵ See Nelson Initial Testimony at 16-18.

¹⁶ Ibid.

¹⁷ Ibid.

1 reflect one rate for both utilities, instead of the current separate rates for CSP and
2 OPC.¹⁸

3
4 As detailed in the proposed ESP, AEP Ohio will essentially have two EICCR
5 filings in 2012. In the proposed ESP, AEP Ohio would seek approval of an
6 EICCR rate that would be effective January 1, 2012 for collecting the carrying
7 charges on the average incremental environmental investments made in 2012 and
8 the expected O&M expense associated with environmental investments for 2012
9 on top of the EICCR rate set in 2011 for environmental investments made in 2009
10 and 2010.¹⁹ AEP Ohio will also make a separate filing in 2012 to recover the
11 expected carrying charges to be incurred in 2012 on the incremental
12 environmental investments made in 2011 under the EICCR approved in the first
13 ESP.²⁰

14
15 ***Q14. WHAT IS YOUR RECOMMENDATION REGARDING THE EICCR IN THE***
16 ***PROPOSED ESP?***

17 ***A14.*** I recommend that the Commission order AEP Ohio to remove the EICCR from
18 the proposed ESP. I have been advised by counsel that, to conform to the
19 Remand Decision, carrying charges associated with the environmental

¹⁸ See Direct Testimony of Andrea E. Moore (January 27, 2011) ("Moore Testimony") at 8.

¹⁹ See Nelson Initial Testimony at 17-18.

²⁰ Ibid.

1 investments may be included in an ESP only if the applicant shows that the
2 charges fit into one of the categories in R.C. 4928.143(B)(2).

3
4 ***Q15. HOW WOULD CUSTOMERS BENEFIT IF THE EICCR WERE REMOVED***
5 ***FROM THE PROPOSED ESP?***

6 ***A15.*** AEP Ohio projects it will collect about \$71 million through the EICCR in 2012
7 based on its estimated environmental investments of \$48 million in 2012 and the
8 continuation of the 2011 EICCR set in the first ESP.²¹ Thus, eliminating the
9 EICCR from the proposed ESP would save the customers at least approximately
10 \$71 million in 2012 alone. As for the projected EICCR revenues to be collected
11 in 2013 and 2014 under the proposed ESP, they cannot be determined at this time
12 because AEP Ohio has not provided its estimates of environmental investments in
13 these two years.

14
15 ***Q16. DO YOU PROPOSE ANY MODIFICATIONS TO THE EICCR IF AEP OHIO***
16 ***IS ALLOWED TO INCLUDE IT IN THE PROPOSED ESP?***

17 ***A16.*** Yes. As stated above, I recommend that the PUCO not allow the EICCR to
18 remain part of the proposed ESP. However, if the PUCO permits the EICCR to
19 remain as part of the ESP, I recommend that the Commission order AEP Ohio to
20 make several modifications to the EICCR.

²¹ See Moore Testimony, Exhibit AEM-1.

1 ***Q17. PLEASE DESCRIBE AND EXPLAIN THE MODIFICATIONS YOU***
2 ***RECOMMEND IF THE PUCO PERMITS THE EICCR TO REMAIN AS***
3 ***PART OF THE ESP.***

4 ***A17.*** First of all, I recommend that only the actual environmental investments made by
5 AEP Ohio in previous years, not projected investments in the current year, be
6 used in calculating the annual carrying charges. Under the proposed EICCR, AEP
7 Ohio can start collecting carrying charges on January 1, 2012 for the
8 environmental investments it has not yet made in 2012.²² This approach is
9 unusual and contrary to some well-established regulatory principles in public
10 utility regulation. These regulatory principles include the collection of revenue
11 after the investments were made by the utility or the collection of revenue after
12 the utility investments were deemed used and useful. AEP has not shown that
13 there is a need to justify such an unusual treatment for the carrying charges
14 associated with environmental investments.

15
16 I also recommend that the Commission reject the use of levelized cost rates in
17 calculating the annual carrying charges associated with environmental
18 investments. Instead, the annual environmental carrying charges of a particular
19 year should be calculated based on the net cumulative environmental investments,
20 after adjusting for accumulated depreciation, made after January 1, 2009 to the
21 end of the previous year. The EICCR methodology proposed by AEP Ohio does

²² See Moore Testimony at 7 and Exhibit AEM-2.

1 not explicitly recognize the gradual reduction, through accumulated depreciation,
2 of the values of its environmental investments made in previous years. Under
3 AEP Ohio's proposed EICCR, a levelized carrying cost rate is used throughout
4 the life of an environmental investment. In its Application and supporting
5 testimonies, AEP Ohio has not substantiated that the proposed levelized cost rates
6 are indeed levelized rates. For example, there is no information presented
7 regarding the total life-time cost of any environmental investment, yet it is the
8 life-time cost that is typically used in determining a levelized annual cost rate.

9
10 Further, I recommend that the EICCR be set at zero at the beginning of the
11 proposed ESP. If an EICCR is approved as a part of the proposed ESP, AEP Ohio
12 can make a filing in 2013 to establish an EICCR based on the net environmental
13 investments made after January 1, 2009 and the annual carrying charge approved
14 in this proceeding. My proposed approach for setting the annual environmental
15 carrying charge based on the "net environmental investment" is easier to
16 understand, easier to implement, and conforms to well-established regulatory
17 principles regarding public utilities.

18
19 Finally, because AEP Ohio has failed to present any evidence in this proceeding
20 supporting the proposed return on equity of 11.15%, I propose the rate for return
21 on equity proposed by AEP Ohio in calculating the EICCR be reduced to a
22 currently Commission-approved rate of 10.5% in the first ESP. AEP Ohio has not

provided any support in this Application or testimony regarding the proposed return on equity of 11.15%.²³ There is no explanation why AEP Ohio chose this specific cost rate for return on equity other than this proposed return on equity is the same one proposed by AEP Ohio in its pending distribution rate case (Case No. 11-351-EL-AIR).²⁴

V. RECOMMENDATION ON PROVIDER OF LAST RESORT CHARGE

***Q18. WHAT IS YOUR UNDERSTANDING OF THE REMAND DECISION
REGARDING AEP OHIO'S CURRENT POLR CHARGE?***

A18. It is my understanding that the Court reversed the provisions of the PUCO order in the first ESP authorizing the POLR charge.²⁵ The Court stated: "In short, the manifest weight of the evidence contradicts the commission's conclusion that the POLR charge is based on cost."²⁶ The Court indicated that there was no evidence supporting the Commission's characterization of this charge as based on cost.²⁷

The Court also provided a clear definition of "POLR" and the costs attributed to POLR in the Remand Decision. The Court stated: "This obligation to stand ready

²³ See Nelson Initial Testimony Exhibit PJN-2, and Direct Testimony of Renee V. Hawkins (January 27, 2011) ("Hawkins Testimony") at 4-5.

²⁴ See AEP Ohio's response to OCC INT-272 and OCC INT-273.

²⁵ See Remand Decision at 11, Paragraph 29.

²⁶ Ibid.

²⁷ Ibid.

1 to accept returning customers makes the utility the 'provider of last resort,' or
2 'POLR.'"²⁸ The Court further indicated that "POLR costs are those costs incurred
3 by [the utility] for risks associated with its legal obligation as the default provider,
4 or electricity provider, of last resort, for customers who shop and then return to
5 [the utility] for generation service."²⁹

6
7 The Court did allow the Commission to revisit the POLR issue. The Court stated
8 that it expressed no opinion on whether a formula-based POLR charge is *per se*
9 unreasonable or unlawful, and advised that the Commission may consider on
10 remand whether a non-cost-based POLR charge is reasonable and lawful.³⁰

11
12 ***Q19. WHY IS THE REMAND DECISION RELEVANT IN THE SETTING OF***
13 ***THE POLR CHARGE IN THE PROPOSED ESP?***

14 ***A19.*** The Remand Decision is not only relevant but critical in reviewing the proposed
15 POLR charge. Given that AEP Ohio is proposing essentially the same
16 methodology it used in the first ESP to set the POLR charge under the proposed
17 ESP, the Remand Decision provides clear and sufficient directions to the
18 Commission in addressing the POLR charge in this proceeding as well as future
19 proceedings. For example, the Commission need not consider AEP Ohio's

²⁸ See Remand Decision at 9, Paragraph 23.

²⁹ Ibid., citing *Constellation NewEnergy, Inc. v. Pub. Util. Comm.*, 104 Ohio St.3d 530, 2004-Ohio-6767, 820 N.E.2d 885, ¶ 39, fn. 5.

³⁰ See Remand Decision at 11, Paragraph 30.

1 repeated argument that its POLR charge, set through the Black-Scholes option
2 model, is cost-based. The Court made it abundantly clear that the Black-Scholes
3 option model does not measure the cost to AEP Ohio for providing the POLR
4 service.³¹

5
6 ***Q20. WHAT IS YOUR UNDERSTANDING OF THE POLR CHARGE, OR THE***
7 ***POLR CHARGE RIDER, CURRENTLY IN AEP OHIO'S TARIFFS?***

8 ***A20.*** I have reviewed the POLR-related tariffs of CSP and OPC currently in effect and
9 those in effect from April 2009 to May 2011. Specifically, I reviewed the
10 Provider of Last Resort Charge Rider, Sheet No. 69-1 for CSP, and Sheet No. 69-
11 1 for OPC filed by the Companies on May 27, 2011, and the same tariff sheets
12 filed by the Company on March 30, 2009. Based on my review, for each utility,
13 there is only one POLR Charge Rider that lists a schedule of rates for different
14 classes of customers. There are no separate rate schedules listing a POLR charge
15 embedded in the 2008 rates and a POLR charge reflecting the increase in POLR
16 as approved in the first ESP. The Commission approved one POLR charge for
17

³¹ *In re Application of Columbus S. Power Co.*, Slip Opinion No. 2011-Ohio-1788 at 9-10, Paragraphs 25 and 26.

1 CSP and one POLR charge for OPC.³² This is the same definition of POLR
2 charge I use throughout my testimony.
3

4 ***Q21. WHAT IS YOUR RECOMMENDATION REGARDING THE POLR CHARGE***
5 ***RIDER IN AEP OHIO'S PROPOSED ESP?***

6 ***A21.*** I recommend that the PUCO order AEP Ohio to remove the "entire" POLR
7 charge from the proposed ESP rates. Even though it did not explicitly state that
8 the proposed POLR charge is based on the value to the customers, AEP Ohio in
9 effect sets the POLR charge based on the value to customers for the option of
10 shopping for electricity. Allowing AEP Ohio to price a monopoly service, POLR,
11 based on the supposed value of this service to customers is contrary to the policy
12 of the state regarding electric service.³³ Rather, the POLR charge should be cost-
13 based. On this basis, which I develop later in my testimony, and the fact that AEP
14 Ohio has not provided any credible evidence regarding the actual costs of
15 providing POLR service, I recommend that the Commission find that the
16 proposed POLR charge is not justified and should not be allowed in the proposed

³² Despite this, AEP Ohio filed the revised tariffs on May 11, 2011 that erroneously kept a portion of POLR (approximately \$52 million) in rates. This portion apparently represents the POLR embedded in the 2008 rates. The tariffs filed on May 11, 2011 were later replaced the revised tariffs filed by AEP Ohio on May 27, 2011. I estimate the \$52 million (\$14,007,101 embedded in CSP's 2008 rates, and \$38,091,727 in OPC's 2008 rates) based on the compliance tariffs and work papers that were filed by AEP Ohio in PUCO Case Nos. 08-917-EL-SSO and 08-918-EL-SSO. I have been advised by counsel that the Commission entry issued on May 25, 2011 was very clear that the POLR charge collected subject to refund referred to the entire revenue collected under the POLR Charge Rider, not just a part of it. See PUCO Case Nos. 08-917-EL-SSO et al., Entry (May 25, 2011) at 4.

³³ For example, it is a state policy to ensure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service. See R.C. 4928.02(A).

1 ESP. Another OCC witness, Mack A. Thompson, in his testimony, provides
2 additional reasons to disallow the POLR charge.

3
4 ***Q22. PLEASE EXPLAIN WHY AEP OHIO'S POLR CHARGE IS NOT BASED ON***
5 ***ITS ACTUAL COSTS OF PROVIDING THE POLR SERVICE.***

6 ***A22.*** There is hardly any dispute that AEP Ohio, in the record of its first ESP
7 proceeding, in the Remand proceeding, and in its Application for the proposed
8 ESP in this proceeding, has not provided evidence regarding the actual costs
9 associated with the provision of POLR. The Court recognized this in the Remand
10 Decision and stated that:

11 Contrary to the order, this formula simply does not reveal “the cost
12 to the Companies to be the POLR and carry the risks associated
13 therewith.” The Record shows the model does not even purport to
14 estimate costs, but instead tries to quantify “the value of the
15 optionality [to shop for power] that is provided to customers under
16 Senate Bill 221.” *Value to customers* (what the model shows) and
17 *cost to AEP* (the purported basis of the order) are simply not the
18 same thing.³⁴

19

³⁴ See Remand Decision at 10, Paragraph 26 (emphasis in the original).

1 After reviewing the testimonies AEP Ohio filed in this proceeding and the
2 Remand proceeding on January 27, June 6, and July 6, 2011, I still cannot
3 find any evidence regarding the actual costs to AEP Ohio for providing
4 POLR service.

5
6 While AEP Ohio repeatedly uses the term “cost of the option” to characterize the
7 POLR charge, it is clear that the proposed POLR charge has nothing to do with
8 the actual costs of providing customers the option of switching electric service
9 providers and returning to AEP Ohio. Even AEP Ohio’s witnesses do not dispute
10 this. For example, AEP Ohio President Hamrock states that “the POLR charges
11 collect the cost of that option, not the cost of underlying generation and energy
12 needed to serve the customer.”³⁵ Another AEP Ohio witness, Ms. Thomas, says
13 that “[n]either the current or the proposed POLR charge represents the cost of
14 capacity to serve customers. As discussed previously, the POLR charge reflects
15 the cost of providing a customer with switching options, not the cost of capacity
16 and energy to serve the customer.”³⁶

17
18 In summary, through the testimonies of its several witnesses, AEP Ohio has
19 confirmed that: (1) POLR is a monopoly service that can only be provided by an
20 electric distribution utility (“EDU”), not by a competitive retail electric service

³⁵ See Direct Testimony of Joseph Hamrock (January 27, 2011) (“Hamrock Testimony”) at 28.

³⁶ See Direct Testimony of Laura J. Thomas (January 27, 2011) (“Thomas Initial Testimony”) at 19.

1 (“CRES”) provider;³⁷ (2) the current POLR charge does not represent the cost of
2 capacity and energy to serve the customer;³⁸ and (3) the Companies intend to use
3 the same basic model as used in the 2009-2011 ESP to value AEP Ohio’s POLR
4 obligation in the proposed ESP.³⁹

5
6 ***Q23. DOES AEP OHIO PROPOSE A POLR CHARGE BASED ON THE***
7 ***ALLEGED VALUE OF THE OPTION TO CUSTOMERS TO SHOP FOR***
8 ***ELECTRICITY?***

9 ***A23.*** Yes, it does. There is no dispute that the application of the Black option model is
10 intended by AEP Ohio to measure the value to customers of the option of
11 shopping for electricity. Specifically, in the Companies’ first ESP case, AEP
12 Ohio witness Baker stated that “AEP used the Black-Scholes option pricing
13 model to calculate the value of its POLR obligation.⁴⁰ He further stated that,
14 “Among its many applications, it is used extensively to provide basic
15 benchmarking pricing for equity and commodity options.”⁴¹ Consequently, the
16 POLR charge collected by AEP Ohio in the first ESP was indeed based on the

³⁷ According to AEP Ohio, only Ohio EDUs incur the POLR obligation and the CRES providers do not have the POLR obligation. In other words, only EDUs can provide POLR service. See Thomas Initial Testimony at 14 and Supplemental Direct Testimony of Laura J. Thomas (July 6, 2011) (“Thomas Supplemental Testimony”) at 3-6.

³⁸ See, for example, Hamrock Testimony at 28 and Thomas Initial Testimony at 19-20.

³⁹ See Thomas Initial Testimony at 18.

⁴⁰ PUCO Case Nos. 08-917-EL-SSO et al, Direct Testimony of J. Craig Baker (July 31, 2008) at 31.

⁴¹ Ibid. In the remand phase of that proceeding, AEP witness Thomas also confirmed that the Companies intend to continue collecting the previously-approved POLR rates for the remaining months of the first ESP. See PUCO Case Nos. 09-917-EL-SSO et. al, Thomas Remand Proceeding testimony (June 6, 2011) at 16.

1 AEP Ohio's claimed value of the shopping option, not on the actual cost of
2 providing the POLR service. However, it should be noted that the Black-Scholes
3 option model may not be an appropriate tool for measuring the value of the
4 shopping option to AEP Ohio's customers. On the contrary, there are a number of
5 significant deficiencies of the model when applied to the retail electricity
6 market.⁴²

7
8 In developing the POLR charge to be effective from January 1, 2012 through May
9 31, 2014, AEP Ohio proposes to use essentially the same methodology it used to
10 determine the POLR charge in the first ESP, with only a modification to
11 recognize the impact of the switching constraints.⁴³ A review of the Application,
12 supporting testimonies, and discovery responses in this proceeding indicates that
13 AEP Ohio still has not provided evidence supporting its position that the proposed
14 POLR charge is based on the actual costs of providing POLR service to its
15 customers.⁴⁴ Instead, as AEP Ohio did in the first ESP case, it again proposes to
16 base the POLR charge on the supposed value, as measured by the Black option
17 model, to the customer of the switching and returning option.

⁴² See the direct testimony of OCC witness Mack A. Thompson, filed concurrently with this testimony, for a more extensive discussion.

⁴³ Thomas Initial Testimony at 18.

⁴⁴ See, for example, Hamrock Testimony at 28, and Thomas Initial Testimony at 19-20.

1 ***Q24. PLEASE EXPLAIN WHY A VALUE-BASED PRICE SHOULD NOT BE***
2 ***USED IN SETTING THE POLR CHARGE FOR AEP OHIO.***

3 ***A24.*** As advised by counsel, the Remand Decision does not rule out the use of a non-
4 cost justification for setting a POLR charge. However, I find that using the Black
5 option pricing model to set the POLR charge for AEP Ohio is unreasonable and
6 should be rejected by the Commission.

7
8 In essence, this value-based pricing of POLR allows AEP Ohio, as a monopoly
9 provider of POLR, to extract from customers all the economic value to the
10 customers for having the option to shop for electricity. By allowing value-based
11 pricing, a monopoly provider can exercise its market power to set the price that
12 will maximize its profit at the expense of its customers.⁴⁵ The price set through
13 the use of a monopoly position of the supplier will be higher than both the price
14 likely to prevail in a competitive market and the cost-based price being set by a
15 regulatory agency.⁴⁶ Such negative effects on economic efficiency and equity are
16 well recognized in the field of microeconomics and industrial organization.⁴⁷ As
17 noted by a well-known public utility economist, Charles F. Phillips:

18

⁴⁵ See, for example, Jack Hirshleifer, Amihai Glazer, and David Hirshleifer, *Price Theory and Applications*, Seventh Edition (Cambridge University Press, Cambridge, 2005), Chapter 8; and Hal R. Varian, *Microeconomic Analysis* (W. W. Norton & Company, New York, 1978), Chapter 2.

⁴⁶ See, for example, Hirshleifer, Glazer, and Hirshleifer, *Price Theory and Applications*, Chapter 8.

⁴⁷ Ibid.

1 From the point of view of society, monopoly keeps output from
2 being maximized. And, in addition, the monopolist's plant is not
3 being used efficiently. Society does not get the full potential
4 advantages of economies of scale. In short, price is higher, profit
5 excessive, output smaller, and fewer resources are used under
6 conditions of pure monopoly as compared with perfect
7 competition.⁴⁸

8
9 I am not aware of any state public utility commission in the United States that has
10 set the price of a monopoly-supplied electric utility service based on the value of
11 the service to the customers who receive the service. The value-based pricing
12 methodology proposed for pricing AEP Ohio's POLR service is unreasonable and
13 contrary to public interest. It should be rejected.

14
15 ***Q25. PLEASE COMMENT ON AEP OHIO'S POSITION THAT "SINCE THE***
16 ***BENEFITS OF A POLR OBLIGATION TO THE CUSTOMERS OF A***
17 ***UTILITY REPRESENT COSTS THAT THE UTILITY BEARS, THE VALUE***
18 ***OF THE OPTIONS GIVEN TO THE CUSTOMERS EQUALS THE POLR***
19 ***COSTS TO THE UTILITY."***⁴⁹

⁴⁸ See Charles F. Phillips, Jr., *The Regulation of Public Utilities: Theory and Practice*, Second Edition, Public Utilities Reports, Inc. (1988), at 56-57.

⁴⁹ Makhija Testimony at 3, lines 5-7.

1 **A25.** I do not agree with this statement by Dr. Makhija in his testimony supporting
2 AEP Ohio's POLR methodology. I do not believe there is any plausible
3 definition of the term "cost" used in economics and finance that will make this a
4 valid statement. The value of the switching option (i.e. the economic benefits of
5 having the option to not take generation service from the utility and to come back
6 at a later date) to the customers is not the "opportunity cost" of POLR to the
7 utility. The value of the switching option to the customers is not the "carrying
8 cost" of the POLR to the utility. More importantly, the value of the switching
9 option is certainly not the "actual cost" of POLR to the utility.

10

11 In addition, none of AEP Ohio's witnesses provide any empirical evidence that
12 shows that the value to customers for the option of shopping for power is equal to
13 the actual costs to AEP Ohio in providing such an option. Dr. Makhija's assertion
14 that AEP Ohio witness Thomas's application of the Black model provides
15 empirical evidence of the POLR "liabilities" is just a repeat of AEP Ohio's
16 previous argument that has been rejected by the Court.⁵⁰ There is no additional
17 logical or empirical support for this position presented in Dr. Makhija's testimony
18 or the testimonies of any other witnesses for AEP Ohio in this proceeding. As
19 discussed earlier, the application of the Black model by AEP Ohio at best
20 represents a questionable attempt to measure a value for the option of shopping
21 for electricity to AEP Ohio's customers. The result of the Black option pricing

⁵⁰ Makhija Testimony at 9.

1 model has nothing to do with the actual cost to AEP Ohio for providing the POLR
2 service. It is one thing to say there is an unspecified, unquantified cost associated
3 with providing POLR to customers. It is another thing to proclaim that the cost to
4 the utility of providing POLR equals the value to the customers of receiving the
5 service.

6
7 ***Q26. PLEASE COMMENT ON AEP OHIO'S POSITION THAT "AN OPTION***
8 ***VALUATION MEASURES THE EXPECTED COST ON AN A PRIORI***
9 ***BASIS. WHILE THE ACTUAL, AFTER-THE-FACT COST MAY DIFFER***
10 ***FROM THE EXPECTED COST, FROM A RATEMAKING PERSPECTIVE,***
11 ***THE EXPECTED COST IS THE RELEVANT MEASURE.***⁵¹

12 ***A26.*** I do not agree with this statement by Dr. LaCasse. It is my understanding that, for
13 the past half century, the actual cost (or the after-the-fact cost) has always been
14 the primary measurement in setting the price of a monopoly service, such as
15 electric distribution service. The validity of using actual cost in setting rates for
16 monopoly service is evidenced by the common practice of determining the
17 operating expenses of a utility in a "test year" and the fixing of the rate base at a
18 "date certain" in most rate case proceedings in the United States. Indeed this is
19 the practice followed by the PUCO, as mandated by Ohio statute, for pricing non-
20 competitive electric services. There is no basis for her claim that the actual cost

⁵¹ LaCasse Testimony at 14, lines 12-14.

(or after-the-fact cost) is not a relevant measure for ratemaking purposes in the case of POLR.

Q27. HAS AEP OHIO CONDUCTED ANY “SSO AUCTIONS” REFERRED IN DR. LACASSE’S TESTIMONY?⁵²

A27. No. I am not aware that AEP Ohio, either CSP or OPC, has conducted this type of auction.

Q28. HAS AEP OHIO DEFINED AND QUANTIFIED ITS “VISIBLE COST COMPONENTS OF SSO SUPPLY” REFERENCED IN DR. LACASSE’S TESTIMONY?⁵³

A28. No. The term “visible cost component of SSO supply” for AEP Ohio was not defined by Dr. LaCasse and there were no empirical estimations provided in her testimony or by any of AEP Ohio’s witnesses.

Q29. HAS AEP OHIO DEMONSTRATED THAT THE RESULTS OF TWO STUDIES (“NORTHBRIDGE” AND “ICC STAFF”) REFERENCED IN DR. LACASSE’S TESTIMONY ARE APPLICABLE IN SETTING THE POLR CHARGE FOR AEP OHIO?

⁵² See LaCasse Testimony at 5-13.

⁵³ See LaCasse Testimony at 9.

1 **A29.** No. As discussed earlier, AEP Ohio has not provided any information regarding
2 the so-called “SSO auction price” or the “visible cost components of SSO supply”
3 in this proceeding. There is also no discussion in Dr. LaCasse’s testimony
4 regarding the wholesale market competition, the mix of generation assets, the
5 composition of retail customers or any other operational characteristics of the
6 three utilities (Philadelphia Electric Company, Commonwealth Edison, and
7 Ameren) and whether they are reasonably similar to the EDUs of AEP Ohio.
8 Accordingly, the results of the two studies cited by Dr. LaCasse are irrelevant to
9 the setting of a cost-based POLR charge for AEP Ohio.

10

11 **Q30. PLEASE SUMMARIZE YOUR RECOMMENDATION REGARDING THE**
12 **PROPOSED POLR CHARGE IN THIS PROCEEDING.**

13 **A30.** Under the current regulatory framework in Ohio, there are no alternative suppliers
14 for POLR service within the service territory of AEP Ohio. AEP Ohio’s POLR
15 charge, which was approved by the Commission as a distribution charge, should
16 be set in the same way as other distribution-related services. At the present time,
17 electric distribution service in Ohio is still being fully regulated by the PUCO and
18 the rates for distribution services are based on the actual costs incurred by the
19 utility (such as AEP Ohio) in providing the distribution service. There is no valid
20 economic and regulatory basis not to set the POLR charge based on the actual
21 cost of providing the POLR service.

1 I understand that there is also precedent for establishing POLR on a cost basis. I
2 am aware that in the another ESP case (FirstEnergy's first ESP filed on July 31,
3 2008), the Commission found that the standby charges for generation should be
4 based upon the actual, prudently-incurred costs to the electric utility of hedging
5 against the risk of customers returning to the Standard Service Offering.⁵⁴ The
6 Commission accepted the proposed rate subject to review and reconciliation on a
7 quarterly basis to ensure that it reflected the EDU's actual prudently-incurred
8 costs.⁵⁵ The Commission should, consistent with the approach taken in the
9 FirstEnergy case,⁵⁶ establish POLR based on actual, prudently incurred costs.

10
11 In summary, AEP Ohio had the opportunity to propose a POLR charge based on
12 the actual cost of providing this service when it first proposed an ESP in 2009 and
13 chose not to. AEP Ohio had the opportunity again in the remand phase to propose
14 a POLR charge that is based on actual cost. AEP Ohio has not done so. AEP
15 Ohio had the opportunity again in this proceeding to file additional testimonies to
16 provide a reasonable measurement of the actual costs of providing the POLR
17 service. The Companies chose not to do so. In the absence of any credible

⁵⁴ PUCO Case No. 08-935-EL-SSO, Opinion and Order at 28-29 (December 19, 2008).

⁵⁵ Ibid.

⁵⁶ First Energy later withdrew the ESP Application and the parties reached a stipulation that was approved by the Commission on March 25, 2009. Under the approved stipulation, there would be no minimum default service rider and standby charge in the ESP. PUCO Case No. 08-935-EL-SSO, Stipulation and Recommendation at 10 (February 19, 2011).

1 evidence that its current POLR charge is based on actual costs, AEP Ohio should
2 not be allowed to collect a POLR charge under its proposed ESP.

3
4 ***Q31. HOW WOULD CUSTOMERS BENEFIT IF THE POLR CHARGE WERE***
5 ***REMOVED FROM THE PROPOSED ESP?***

6 ***A31.*** Customers would avoid paying the POLR charge for the entire period of the
7 proposed ESP. I estimate the revenue to be collected through the POLR charge as
8 proposed by AEP Ohio is about \$123 million annually in 2012 and 2013.⁵⁷ The
9 potential savings over the entire ESP period of twenty-nine months is about \$298
10 million. See Attachment DJD-D. AEP Ohio estimates a non-bypassable uniform
11 POLR rate of \$0.00284 per kWh for all classes of customers.⁵⁸ This POLR
12 charge is only an estimate made by AEP Ohio. The Companies indicate that they
13 intend to provide the actual POLR charge after the conclusion of this proceeding
14 based on the approved methodology, ESP rates, Competitive Benchmark prices
15 and switching rules.⁵⁹

16

⁵⁷ The revenue to be collected is based on with an estimated POLR charge of \$0.00284 per kWh and estimated annual sales of 43,503,500,009 kWh (17,414,000,002 kWh from CSP and 26,029,500,000 kWh from OPC). See Roush work papers Schedule E-4.

⁵⁸ See Thomas Initial Testimony at 15 and 20.

⁵⁹ Thomas Initial Testimony at 22.

1 **VI. RECOMMENDATION ON PHASE-IN RECOVERY RIDER**

2

3 ***Q32. WHAT IS YOUR UNDERSTANDING OF THE PHASE-IN RECOVERY***
4 ***RIDER (PIRR) AS PROPOSED IN THE ESP?***

5 ***A32.*** AEP Ohio proposes to begin collecting the phase-in deferral balances in January
6 2012 through December 2018 as provided in the order of the first ESP filing. As
7 proposed in this Application, the PIRR will be a non-bypassable charge designed
8 to collect the phase-in deferral balance on a kWh basis from all customers.⁶⁰ The
9 carrying charge on any unamortized phase-in deferral balance will continue
10 during the seven-year collection period.

11

12 AEP Ohio plans to begin collecting the phase-in deferral balance from customers
13 in a separate filing when the balance can be more accurately estimated.⁶¹ AEP
14 Ohio proposes to make the PIRR filing in conjunction with the third quarter 2011
15 FAC filing.

16

17 ***Q33. WHAT IS YOUR UNDERSTANDING OF THE PHASE-IN FAC DEFERRAL***
18 ***BALANCE AND THE AMOUNT OF THAT DEFERRAL BALANCE***
19 ***PROJECTED AT THE END OF THE FIRST ESP, DECEMBER 31, 2011?***

⁶⁰ Nelson Initial Testimony at 8.

⁶¹ Id. at 9.

1 **A33.** The phase-in deferral balance is comprised of the actual fuel expenses that have
2 not been collected through the FAC rates and the carrying costs associated with
3 the shortfalls of fuel expense collection.⁶² The FAC rates during the first ESP, in
4 turn, are limited to the amount of fuel expenses that would be collected from
5 customers such that total revenues would not exceed the Commission-ordered
6 “caps” on annual revenue for CSP and OPC. According to AEP Ohio, at the end
7 of 2011, the estimated phase-in deferral balance for OPC will be about \$643
8 million. CSP is not expected to have a phase-in deferral balance.⁶³

9
10 **Q34. SHOULD THE VALUE OF THE PHASE-IN FAC DEFERRAL BALANCE**
11 **BE ADJUSTED TO ACCOUNT FOR THE REDUCTION OR ELIMINATION**
12 **OF ENVIRONMENTAL CARRYING COSTS AND THE POLR CHARGE**
13 **RESULTING FROM THE REMAND AND OTHER PENDING**
14 **PROCEEDINGS?**

15 **A34.** Yes. The value of the phase-in FAC deferral balance should be reduced based on
16 the results of the remand proceeding. There may be other proceedings pending
17 before the Commission, such as the 2009 AEP Ohio FAC Audit case, and their
18 resolution may also affect the phase-in deferral balance.

19

⁶² For a description of the method and calculation of the FAC deferral balance, see AEP Ohio's Application filed on September 30, 2009 in PUCO Case No. 09-872-EL-FAC.

⁶³ Nelson Initial Testimony at 8.

1 ***Q35. PLEASE EXPLAIN WHY THE VALUE OF THE PHASE-IN FAC***
2 ***DEFERRAL SHOULD BE ADJUSTED.***

3 ***A35.*** Under the FAC and rate caps set by the Commission in AEP Ohio's first ESP, the
4 FAC rates for CSP and OPC are essentially "residual values" between the capped
5 rates and the sum of all non-FAC rates. If the sum of all non-FAC rates (which
6 include the base generation rate, the POLR charge, and possibly other riders) were
7 reduced as a result of the remand proceeding, the allowed FAC rates (that is
8 amount of FAC expenses collected, as a residual value, from customers) would
9 increase. This type of adjustment in FAC rates was what AEP Ohio did in
10 revising OPC's allowed FAC rates on May 11, 2011 in response to the
11 Commission's May 4, 2011 order in the remand proceeding.⁶⁴ As the FAC rates
12 increase, the amount of fuel expenses being deferred, and the carrying cost
13 associated with the fuel expense deferral would decrease. Consequently, if my
14 proposed adjustments in the base generation rate and POLR were accepted by the
15 Commission, the phase-in FAC deferral balance would be reduced accordingly.

16
17 ***Q36. HOW SHOULD THE ADJUSTMENTS TO THE VALUE OF THE PHASE-IN***
18 ***FAC DEFERRAL BALANCE BE CALCULATED?***

19 ***A36.*** I propose that the Commission order AEP Ohio to re-calculate the amount of fuel
20 expenses deferred under the 2009 to 2011 rate caps, and the associated carrying
21 charges as a result of removing POLR and environmental carrying charges from

⁶⁴ See work papers for the revised tariffs provided by AEP Ohio to OCC on May 12, 2011.

1 the rates in effect since April 2009. The re-calculation is needed for determining
2 the real amount of phase-in FAC deferral. After all, should the revised ESP rates,
3 after removing environmental carrying charges and the POLR charge, were in
4 place during the period of April 2009 to May 2011, the shortfall of fuel expense
5 collection and the associated carrying costs for CSP and OPC during the first ESP
6 period would be reduced.

7
8 ***Q37. WHAT ADJUSTMENTS TO THE VALUE OF THE PHASE-IN DEFERRAL***
9 ***BALANCE DO YOU PROPOSE?***

10 ***A37.*** I propose two adjustments based on the results of the two proceedings pending
11 before the Commission. The first adjustment is a re-calculation of the amount of
12 fuel expenses deferred under the 2009 to 2011 rate caps and the associated
13 carrying charges as a result of removing POLR and environmental carrying
14 charges from the rates set in AEP Ohio's first ESP.⁶⁵ In the Remand proceeding,
15 I have provided estimates of my proposed adjustments to the phase-in FAC
16 deferral balance if the POLR charge and environmental carrying charges were
17 reduced in AEP Ohio's first ESP.⁶⁶

⁶⁵ Based on the Compliance Workpapers filed by the Companies on July 28, 2009 in PUCO case Nos. 08-917-EL-SSO and 08-918-EL-SSO, I calculated the revenue collected during the period of AEP Ohio's first ESP would be about \$330 million (\$78 million collected in CSP's rates and \$252 million in OPC's rates) in environmental carrying charges embedded in base generation rates, and about \$456 million (\$291 million collected in CSP's rates and \$165 million in OPC's rates) in POLR charges. There are additional revenues collected under the EICCR.

⁶⁶ See Direct Testimony of Daniel J. Duann at 26-28 and Attachment DJD-E in PUCO Case Nos. 08-917-EL-SSO, filed June 30, 2011. In this proceeding, I propose the revenues collected through the EICCR from 2009 through 2011 also be returned to customers by a reduction in the phase-in FAC deferral balance.

1 The second adjustment involves a regulatory liability that may be created pending
2 a decision by the Commission on AEP Ohio's 2009 FAC Audit.⁶⁷ In that
3 proceeding, OCC and other intervenors have proposed various reductions to the
4 coal procurement costs charged to customers by AEP Ohio during the 2009 to
5 2011 ESP period. The Commission has not yet issued a decision in that case.
6 Since the coal procurement cost charged to customers of AEP Ohio during the
7 January 2009 to December 2011 ESP period is directly related to the amount of
8 phase-in deferral balance to be collected, any reduction in the coal procurement
9 costs for that period would reduce the phase-in deferral balance. In the 2009 FAC
10 Audit proceeding, I have provided estimates of the various "value components"
11 that should be returned to the customers of AEP Ohio in the form of reductions to
12 the phase-in FAC deferral balance.⁶⁸

13
14 ***Q38. DOES AEP OHIO HAVE ANOTHER PROPOSAL RELATED TO THE***
15 ***PIRR?***

16 ***A38.*** Yes. Even though AEP Ohio does not propose a securitization plan for the phase-
17 in deferral balance, its witness Hawkins does contend that new legislation is
18 necessary for AEP Ohio to do a certain form of securitization for the phase-in
19 deferral balance.⁶⁹ AEP Ohio asserts that it may be in the best interest of

20

⁶⁷ PUCO Case Nos. 09-872-EL-FAC and 09-873-EL-FAC.

⁶⁸ See PUCO Case Nos. 09-872-EL-FAC et al., Confidential Direct Testimony of Daniel J. Duann (August 16, 2010) at 15-16.

⁶⁹ Hawkins Testimony at 8.

1 customers to securitize the regulatory asset representing the phase-in deferral
2 balance through a third party with an AAA credit rating.⁷⁰ However, in its
3 testimony AEP Ohio has not provided detailed information regarding the so-
4 called “needed” new legislation or the procedural and financing parameters (such
5 as the timing of a securitization and the amount of securitization) of implementing
6 a securitization plan of the phase-in deferral balance under the undefined new
7 legislation.

8

9 ***Q39. IS NEW LEGISLATION NECESSARY FOR AEP OHIO TO COMPLETE A***
10 ***SECURITIZATION OF THE PHASE-IN DEFERRAL BALANCE?***

11 ***A39.*** No. I have been advised by counsel that existing statutes, specifically O.A.C.
12 4928.14.3(B)(2)(f), already provide for a securitization based on the phase-in
13 deferral balance under the ESP. AEP Ohio had the option to propose a
14 securitization plan in the proposed ESP and choose not to do so.

15

16 **VII. CONCLUSION**

17

18 ***Q40. PLEASE SUMMARIZE YOUR RECOMMENDATION.***

19 ***A40*** I recommend the following:

⁷⁰ Id. at 5-6.

- 1 (a) The annual carrying charge of about \$110 million associated with
2 the 2001 to 2008 environmental investments be removed from the
3 GSR of the proposed ESP;
- 4 (b) The EICCR be removed completely from the proposed ESP;
5 alternatively
- 6 (c) The EICCR should be modified to be based on actual (not
7 forecasted) environmental investments, to be set at “0” at the
8 beginning of the proposed ESP, to be calculated on a basis of net
9 environmental investment, instead of the uninterrupted
10 accumulation of the annual levelized EICCR, and to be calculated
11 using a lower return on equity approved by PUCO in the first ESP;
- 12 (d) The POLR charge be removed completely from the proposed ESP;
- 13 (e) The phase-in FAC deferral balance underlying the PIRR be
14 reduced to account for the return to AEP Ohio’s customers of those
15 improper collections of environmental carrying charges and POLR
16 in the first ESP; and
- 17 (f) There is no need for new legislation regarding the securitization of
18 phase-in FAC deferral balance by AEP Ohio.

19

20 ***Q45. DOES THIS CONCLUDE YOUR TESTIMONY?***

*Direct Testimony of Daniel J. Duann, Ph.D. CRRRA
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case Nos. 11-346-EL-SSO et al.*

1 **A45.** Yes. However, I reserve the right to supplement my testimony in the event that
2 AEP, PUCO Staff or other parties submit additional testimonies or comments, or
3 if new information or data in connection with this proceeding becomes available.

ATTACHMENT DJD-A

Selected Publications of Daniel J. Duann, Ph.D. CRRRA

Journal Articles

Regulation, The Cato Review of Business & Government. "Turning up the Heat in the Natural Gas Industry." Vol. 19, 1996, (with Kenneth W. Costello).

Managerial And Decision Economics, "Designing a Preferred Bidding Procedure for Securing Electric Generating Capacity," Vol. 12, 1991.

The Journal of Energy and Development, "Direct Gas Purchases by Local Distribution Companies: Supply Reliability and Cost Implications," Vol. 14, 1989.

Public Utilities Fortnightly, "Alternative Searching and Maximum Benefit in Electric Least-Cost Planning." December 21, 1989.

Research Reports and Presentations

The National Regulatory Research Institute. *Pricing Local Distribution Services in A Competitive Market*. 1995.

Ninth NARUC Biennial Regulatory Information Conference, Ohio State University, *The Unbundling and Restructuring of Local Distribution Services in the Post-636 Gas Market*, 1994.

The National Regulatory Research Institute, *A Survey of Recent State Initiatives on EPACT and FERC Order 636*, 1994 (with Belle Chen).

The National Regulatory Research Institute, *Restructuring Local Distribution Services: Possibilities and Limitations*. 1994.

The National Regulatory Research Institute. *The FERC Restructuring Rule: Implications for Local Distribution Companies and State Public Utilities Commissions*, 1993.

The National Regulatory Research Institute, *A Synopsis of the Energy Policy Act of 1992: New Tasks for State Public Utility Commissions*, 1993.

International Symposium on Energy, Environment & Information Management. Argonne National Laboratory, *Natural Gas Vehicles: Barriers, Potentials, and Government Policies*, 1992.

The National Regulatory Research Institute, *Natural Gas Vehicles and the Role of State Public Service Commissions*, 1992 (with Youssef Hegazy).

The National Regulatory Research Institute, *Incentive Regulation for Local Gas Distribution Companies under Changing Industry Structure*, 1991 (with Mohammad Harunuzzaman, Kenneth W. Costello, and Sung-Bong Cho).

The National Regulatory Research Institute, *Discussion Papers on Competitive Bidding and Transmission Access and Pricing issues in the Context of Integrated Resource Planning*, 1990 (with Robert E. Burns, Kenneth Rose, Kevin Kelly, and Narayan Rau).

The National Regulatory Research Institute, *Gas Storage: Strategy, Regulation, and Some Competitive Implications*, 1990 (with Peter A. Nagler, Mohammad Harunuzzaman, and Govindarajan Iyyuni).

The National Regulatory Research Institute, *State Gas Transportation Policies: An Evaluation of Approaches*, 1989 (with Robert E. Burns and Peter A. Nagler).

The National Regulatory Research Institute, *Direct Gas Purchases by Gas Distribution Companies: Supply Reliability and Cost Implications*, 1989, (with Robert E. Burns and Peter A. Nagler).

The National Regulatory Research Institute, *Competitive Bidding for Electric Generating Capacity: Application and Implementation*, 1988 (with Robert E. Burns, Douglas N. Jones, and Mark Eifert).

ATTACHMENT DJD-B

Testimonies of Daniel J. Duann, Ph.D. CRRA Before the Public Utilities Commission of Ohio

- 1. Application of The Dayton Power and Light Company for Approval of Its Electric Security Plan, Case No. 08-1094-EL-SSO.**
- 2. Application of Ohio American Water Company to Increase Its Rates for Water and Sewer Service Provided to Its Entire Service Area, Case No. 09-391-WS-AIR.**
- 3. Application of Aqua Ohio, Inc. for Authority to Increase its Rates and Charges in its Masury Division, Case No. 09-560-WW-AIR.**
- 4. Application of Aqua Ohio, Inc. for Authority to increase its Rates and Charges in its Lake Erie Division, Case No. 09-1044-WW-AIR.**
- 5. In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company, Case Nos. 09-872-EL-FAC and 09-873-EL-FAC.**
- 6. 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 Asset, et al. (On Remand), Case Nos. 08-917-EL-SSO, and 08-918-EL-SSO.**
- 7. In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Approval of Tariffs to Modify and further Accelerate its Pipeline Infrastructure Replacement Program and to Recover the Associated Costs et al., Case Nos. 11-2401-GA-ALT, and 08-169-GA-ALT.**

ATTACHMENT DJD-C

Estimate of Revenues To Be Collected Under Base Generation Rate for Annual Environmental Carrying Charges

	Annual Amount As Filed In First ESP Tariffs (a)	Monthly Average (b)	Estimated Total ESP (January 2012 - May 2014) (c)
Columbus Southern Power	\$26,000,000	\$2,166,667	\$62,833,333
Ohio Power	\$84,000,001	\$7,000,000	\$203,000,002
AEP Ohio	\$110,000,001	\$9,166,667	\$265,833,336

Sources:

(a): Compliance Tariffs and Work Papers Filed on July 28, 2009, page 60 for CSP and page 71 for OPC.

(b): Annual Amount divided by 12.

(c): For January 2011 through May 2014, AEP Ohio is projected to collect a total 29 months of environmental carrying costs through the GSR.

ATTACHMENT DJD-D

Estimate of Revenues To Be Collected Under Proposed POLR Charge Rider

	Annual Amount As Filed in Proposed ESP (a)	Monthly Average (b)	Estimated Revenues (January 2012 - May 2014) (c)
Columbus Southern Power	\$49,455,760	\$4,121,313	\$119,518,087
Ohio Power	\$73,923,780	\$6,160,315	\$178,649,135
AEP Ohio	\$123,379,540	\$10,281,628	\$298,167,222

Sources:

(a) Based on information provided in Roush's work papers Schedule E-4 with an estimated POLR charge of \$0.00284 per kWh and estimated annual sales of 43,503,500 kWh (17,414,000 kWh from CSP and 26,029,500 kWh from OPC).

(b) Annual Amount divided by 12.

(c) There are twenty-nine months in the proposed ESP period.

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing *Direct Testimony of Daniel J. Duann* was served via electronic transmission to the persons listed below on this 25th day of July, 2011.



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