FILE

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company.	)))	Case No. 09-872-EL-FAC Case No. 09-873-EL-FAC

APPLICATION FOR REHEARING AND MEMORANDUM IN SUPPORT OF INDUSTRIAL ENERGY USERS-OHIO

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Pursuant to Section 4903.10, Revised Code, and Rule 4901-1-35, Ohio Administrative Code ("OAC"), Industrial Energy Users-Ohio ("IEU-Ohio") respectfully submits this Application for Rehearing of the Opinion and Order issued by the Public Utilities Commission of Ohio ("Commission") on January 23, 2012, in the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company ("CSP") and Ohio Power Company ("OP") (collectively, "Companies"). The Commission's Opinion and Order is unlawful and unreasonable for the following reasons:

1. **The Commission's Opinion and Order is Unlawful and Unreasonable in that It Failed to Explicitly Require the Companies to Include a Carrying Cost Component in the Value Stemming From the Installment Payments and Coal Reserve the Companies Received From the Buy-Out to be Credited Against Its Deferrals.**

2. **The Commission's Opinion and Order is Unlawful and Unreasonable in that It Did Not Direct the Companies to Immediately Reduce the Phase-In Recovery Rider Rates.**

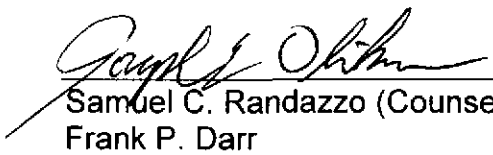
3. **The Commission's Opinion and Order is Unlawful and Unreasonable in that It Did Not Direct Commission Staff to Hire and Supervise an Independent Auditor and Set a Timeframe for the Valuation of the Coal Reserve.**

4. **The Commission's Opinion and Order is Unlawful and Unreasonable in that the Commission Failed to Direct the**

Companies to Credit Against their Deferrals the Benefits They Received Under the Contract Support Agreement.

As discussed in greater detail in the Memorandum in Support, IEU-Ohio respectfully requests that the Commission grant this Application for Rehearing and modify the Opinion and Order to remove the unlawful and unreasonable provisions.

Respectfully submitted,



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MEMORANDUM IN SUPPORT OF INDUSTRIAL ENERGY USERS-OHIO

I. INTRODUCTION

On January 23, 2012, following an audit of the Companies' fuel adjustment clause ("FAC") for 2009, the Public Utilities Commission of Ohio ("Commission") issued an Opinion and Order directing the Columbus Southern Power Company ("CSP") and Ohio Power Company ("OP") (collectively, "Companies") to credit against the deferral balance the benefits the Companies received from a settlement agreement with one of its coal suppliers. The Commission's Opinion and Order, however, did not specify the extent to which the deferral balance needs to be adjusted to account for carrying charges. Additionally, the Opinion and Order fails to acknowledge that the Companies received additional benefits not included in the amounts the Commission ordered credited against the deferrals.

The Commission should be commended for taking this important first step in addressing the financial harm that the Companies have caused to customers. But it is only the first step. As discussed in more detail below, the Commission should grant this Application for Rehearing to ensure customers do not end up paying more than their fair share of the Companies' expenses.

II. BACKGROUND

A. The Companies' Electric Security Plan

On March 18, 2009, the Commission issued an Opinion and Order approving an electric security plan ("ESP") for the Companies.[1] In *ESP I*, the Commission authorized the Companies to establish a FAC subject to annual audit and reconciliation. Also in *ESP I*, the Commission authorized the Companies to increase their rates. To mitigate the impact of the rate increases, the Commission set total annual bill limits. The Commission directed the Companies to defer expenses above the bill limits and held that recovery of these deferred expenses, including carrying costs, would begin in 2012 and would continue through 2018, as necessary. The Companies' booked deferrals accruing carrying charges at the Companies' weighted average cost of capital ("WACC"), approximately 11 percent, compounded monthly. At the time this case was briefed, OP's deferral balance had already exceeded $400 million,[2] and the deferral balance was expected to exceed $550 million[3] by the end of *ESP I*.[4]

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[1] *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case Nos. 08-917-EL-SSO, *et al.*, Opinion and Order (Mar. 18, 2009) (hereinafter "*ESP I*").

[2] IEU-Ohio Initial Brief at 5 (Sep. 23, 2010).

[3] Opinion and Order at 8.

[4] Indeed, the deferral balance exceeded $600 million at the end of *ESP I* and the Companies have already begun collecting the deferred balance through the non-bypassable phase-in recovery rider ("PIRR") established in the Companies' second ESP. The Companies were authorized to begin collection of the deferrals through the PIRR on December 14, 2011. *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, Case Nos. 11-346-EL-SSO, *et al.*, Opinion and Order at 57-59 (Dec. 14, 2011) (hereinafter "*ESP II*"); *In the Matter of the Application of Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Ohio Revised Code 4928.144*, Case No. 11-4921-EL-RDR, *et al.*, Application at Exhibit A (Sep. 21, 2011) (consolidated with *ESP II*).

Fuel expenses were a significant factor that lead to the Companies exceeding the bill limits established in *ESP I*.[5] In the audit of the FAC, however, it was apparent that the Companies had provided a one-sided and self-serving portrayal of their fuel costs. This proceeding stems from the first annual audit.

B. The Coal Contract Buy-Out

In 2007, the Companies entered into a settlement agreement ("Buy-Out") with one of its coal suppliers which relieved the supplier from performing under the terms of the contract ("Supplier Contract"). The Supplier Contract required the coal supplier to deliver coal at a price that was below the prevailing market price.[6] Had the Companies not voluntarily renegotiated the Supplier Contract, ratepayers would have received the benefits of the lower priced coal through 2012.[7] In return for agreeing to the Buy-Out, the Companies received $30 million, paid in installments,[8] and a coal reserve in West Virginia (the "Coal Reserve").[9] The Companies booked the value of the Coal Reserve at approximately $41 million.[10]

As a result of the Buy-Out, OP had to purchase coal in the market to replace the coal that would have otherwise been delivered pursuant to the Supplier Contract.[11] The

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[5] Opinion and Order at 8.

[6] *Id.* at 4-5.

[7] *Id.*

[8] Only a portion of the $30 million has been flowed back to ratepayers. Opinion and Order at 12; *see also* Tr. Vol. I at 121-123.

[9] Opinion and Order at 12.

[10] *Id.*

[11] *Id.*

replacement coal was significantly more expensive.[12] The Companies passed the cost of the more expensive coal onto customers through the FAC while retaining the benefits realized from the Buy-Out for shareholders.[13]

Energy Ventures Analysis ("EVA") performed a management performance and financial audit of the FAC for the term of January 1, 2009 to December 31, 2009. Due to the inequity of the Companies' treatment of the Buy-Out—booking the benefits for shareholders and passing the higher costs onto ratepayers—EVA recommended that the Commission consider whether the Companies should be required to credit the deferral balance for the entire value realized by the Companies as a result of the Buy-Out.[14]

A hearing was held on August 23, 2010. On January 23, 2012, the Commission issued an Opinion and Order adopting EVA's recommendation and directed the Companies to credit the deferral balance so that customers received the benefits to which they are entitled under the Buy-Out. Specifically, the Commission held:

> [T]he Commission determines that all of the realized value from the Settlement Agreement should be credited against OP's FAC under-recovery namely the portion of the $30 million 2008 lump sum payment not already credited to OP ratepayers as well as the $41 million value of the West Virginia coal reserve that AEP booked when the Settlement Agreement was executed. Additionally, because the value of the West Virginia coal reserve is not clear and because AEP had planned to begin the permitting process at the time of the audit which should enhance the value of the coal reserve, we direct AEP to hire an auditor specifically to examine the value of the West Virginia coal reserve and to make a recommendation to the Commission as to whether the increased value, if any above the $41 million already required to be credited against OP's

[12] *Id.* at 5-6.

[13] Opinion and Order at 12; *see also* Tr. Vol. I at 125, 166.

[14] Opinion and Order at 7.

> under-recovery, should accrue to OP ratepayers beyond the value of the reserve that AEPSC booked under the Settlement Agreement. The Commission will issue by subsequent entry a Request for Proposal to hire the auditor discussed above.[15]

In support of its decision, the Commission held that "to determine the real economic cost of coal during the audit period, the Commission must consider both the revenues and the benefits received by the Companies pursuant to the Settlement Agreement and not rely solely on the price paid for coal during 2009."[16]

While the Commission's Opinion and Order directed the Companies to reduce the principal of the deferred balance for the entire value realized from the Buy-Out, the Opinion and Order did not explicitly direct the Companies to reduce the deferred balance for any carrying charges that accrued on amounts that the Companies illegally booked. Despite IEU-Ohio's urging that the Commission not permit the Companies to accrue carrying charges on improperly booked deferrals,[17] the Commission did not discuss or require this necessary reduction to the deferral balance.

C. The Contract Support Agreement

In a separate contract renegotiation with a different supplier, the Companies agreed to increase the base price for coal during 2009 ("Contract Support Agreement") with the option to acquire coal at a discount off the market price for two three-year terms beginning in 2013. The Commission determined that any effect of the Contract Support

[15] *Id. at* 12. While the decision states that the Commission will hire an auditor, the order is ambiguous because the Commission later orders (at page 19) "the Companies [to] hire an auditor as discussed herein."

[16] *Id.* at 13.

[17] IEU-Ohio Initial Brief at 13.

Agreement on the Companies' fuel costs would apply outside the current audit period, and the agreement would be better examined by a future audit.[18]

But, according to the terms of the Contract Support Agreement all of the benefits the Companies received will not be realized until after the FAC mechanism approved as part of the Companies' *ESP I* expires. Further, most, if not all, of the benefits will be realized following the termination of the Companies' FAC approved in *ESP II*.[19]

III. ARGUMENT

The Commission correctly determined that the Companies have improperly passed along the costs of the Buy-Out but kept the benefits for shareholders. The Commission's Order is an important first step in reducing the economic impact of the *ESP II* and the over-inflated deferrals which are now subject to recovery through the PIRR. But merely crediting the value that the Companies received in the Buy-Out to the deferral balance will not redress the harm the Companies have caused. The deferral balance on the Companies' books has been accruing carrying charges at a full WACC rate for three years. It is unjust and unreasonable to permit the Companies to recover carrying charges on amounts that should not have been booked in the first place.

1. The Commission's Opinion and Order is Unlawful and Unreasonable in that It Failed to Explicitly Require the Companies to Include a Carrying Cost Component in the Value Stemming From the Installment Payments and Coal Reserve the Companies Received From the Buy Out to be Credited Against Its Deferrals.

The Companies entered into the Buy-Out in 2007. Any value the Companies received as a result of the Buy-Out should have been applied, immediately, as a

[18] Opinion and Order at 14.

[19] The Companies' FAC terminates on May 31, 2015. *ESP II*, Opinion and Order at 47 (Dec. 14, 2011).

reduction to fuel expenses incurred during *ESP I*—starting on January 1, 2009. While the Commission's January 23, 2012 Opinion and Order held that "all of the realized value from the [Buy Out] should be credited against OP's FAC under-recovery namely the portion of the $30 million 2008 lump sum payment not already credited to OP ratepayers as well the [value of the Coal Reserve],"[20] it did not require the Companies to apply the credit to the deferral balance on a first in first out basis. On Rehearing, the Commission must direct the Companies to adjust the deferral balance to remove the carrying charges that have accrued on amounts that were unlawfully booked.

Removing carrying charges that have accrued on improperly booked amounts is consistent with the Opinion and Order in *ESP I*[21] and analogous Commission precedent.[22] In *ESP I*, the Commission recognized the necessity for symmetrical treatment of carrying charges associated with any over-recovery or under-recovery of FAC expense.[23] Symmetrical treatment of the installment payments and value of the Coal Reserve would require their principal values to be grossed up with a carrying

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[20] Opinion and Order at 12.

[21] *ESP I*, Opinion and Order at 15 (Mar. 18, 2009).

[22] Analogous Commission precedent supports the principle that carrying charges must be applied to benefits that a utility has illegally or unreasonably withheld from customers. When electric utilities participated in emissions allowance auctions, the Commission determined that customers were entitled to the proceeds from the sale of emissions allowances. Because there was a delay between the auction and return of the proceeds to customers, the Commission required the utilities to return the proceeds with carrying charges. *In the Matter of the Regulation of the Electric Fuel Component Contained within the Rate Schedules of Toledo Edison Company and Related Matters*, Case No. 95-107-EL-EFC, Opinion and Order at 4 (Feb. 22, 1996) (hereinafter "*Toledo Edison*"); see also *In the Matter of the Regulation of the Electric Fuel Component Contained within the Rate Schedules of Toledo Edison Company and Related Matters*, Case No. 94-107-EL-EFC, Opinion and Order at 3 (Feb. 16, 2005). Indeed, the argument for reducing the deferred balance for improperly accrued carrying charges is even more compelling in this instance: IEU-Ohio does not necessarily seek carrying charges on the value that was withheld from customers due to the Buy-Out; rather, IEU-Ohio requests that the Companies not be permitted to accrue carrying charges on the amounts that were improperly booked.

[23] *ESP I*, Opinion and Order at 15.

charge component.[24] This symmetry, as well as equity, would further dictate that the carrying charges on the Coal Reserve and installment payments be calculated in the same manner as the deferral balances, which were calculated gross of tax, and compounded monthly at a full WACC rate.

Thus, to credit customers "all of the realized value" of the Buy-Out, the amount the Companies' credit against their deferrals must include both a principal component and a carrying charge component. Therefore, the Commission should grant rehearing and order the Companies to credit their deferrals with the value of the Buy-Out, including both the principal amount and the carrying charge component.

2. The Commission's Opinion and Order is Unlawful and Unreasonable in that It Did Not Direct the Companies to Immediately Reduce the Phase-In Recovery Rider Rates.

The Commission's Opinion and Order is unreasonable in that it did not direct the Companies to recalculate the Companies' PIRR rates to reflect the immediate reduction to the deferred balance that is collected through the PIRR. While the Commission directed the Companies to credit the deferral balance, the Commission did not direct the Companies to immediately adjust the PIRR rates downward to reflect the credit and removal of the associated carrying charges. By directing the Companies to immediately recalculate the PIRR, the Commission can mitigate the impact of the rate increases that were authorized in *ESP II*. On rehearing, the Commission should clarify its Opinion and Order and direct the Companies to appropriately reduce the balance of the deferrals,

[24] *ESP I*, Opinion and Order at 15 (Mar. 18, 2009). The carrying charge protection was a modification by the Commission to provide symmetrical treatment of any over- or under-recoveries of FAC costs by applying the same carrying charges to over-recovered amounts as under-recovered amounts. "With regard to interest charges assed on any over- or under-recoveries for FAC costs . . . we agree with OCC witness Medine that symmetry should exist if interest charges were assessed on any under-recoveries." *Id.*

taking into account the appropriate reduction in carrying charges, and to recalculate the rates charged through the PIRR.

3. The Commission's Opinion and Order is Unlawful and Unreasonable in that It Did Not Direct Commission Staff to Hire and Supervise an Independent Auditor and Set a Timeframe for the Valuation of the Coal Reserve.

The Commission directed the Companies to hire an auditor specifically to examine the value of the Coal Reserve and to make a recommendation to the Commission as to whether the increased value above the amount booked should accrue to OP's ratepayers.[25] The process behind the valuation of the Coal Reserve is of integral importance: it must be open, transparent, and performed by an independent auditor under the supervision of Commission Staff. Interested parties must also have due process in the proceeding that the Commission designates to handle this matter—whether it is an extension of this proceeding or a separate docket. The Opinion and Order, however, does not set forth the necessary parameters to ensure that the valuation of the Coal Reserve is determined in a fair, efficient, and timely manner.

First, the Opinion and Order is open to interpretation regarding the means by which the auditor will be selected. The body of the Opinion and Order states, "[t]he Commission will issue by subsequent entry a Request for Proposal to hire the auditor discussed above."[26] But, in the ordering paragraphs of the Opinion and Order the Commission directed "the Companies hire an auditor as discussed herein."[27] In the interest of transparency and fairness the Commission, through its Staff, should select

[25] *Id.*

[26] Opinion and Order at 12.

[27] *Id.* at 19.

and supervise the auditor. The Companies' responsibility should be limited to paying for the audit. On rehearing, the Commission should clarify the manner in which it will undertake the selection of an independent auditor to ensure the audit is conducted in a fair, transparent, and timely manner.

4. The Commission's Opinion and Order is Unlawful and Unreasonable in that the Commission Failed to Direct the Companies to Credit Against their Deferrals the Benefits They Received Under the Contract Support Agreement.

The Commission's Opinion and Order determined that the "effects" of the Contract Support Agreement would only "appear to apply outside of the current audit period" and be subject to audit in a future audit period.[28] The Contract Support Agreement contributed to increased fuel costs in 2009 (the Companies agreed to increase the base price for coal in 2009).[29] In return, the Companies received the option to purchase fuel at a discount starting in 2013 for two three-year terms.[30] The Companies' FAC approved in their first ESP terminated on December 31, 2011, and their current FAC will terminate on May 31, 2015. Since the FAC will no longer exist as of May 31, 2015, customers will not receive most of the benefits derived from the Contract Support Agreement. At best, customers will receive a portion of the benefits under the first option (the FAC will not be regulated for the last six months of the first option).[31] Moreover, the second option will be exercised at a time that the Companies do not have a FAC mechanism.

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[28] *Id.* at 14

[29] *Id.* at 9.

[30] *Id.*

[31] *ESP II*, Opinion and Order at 47 (Dec. 14, 2011); *see* Opinion and Order at 9.

Thus, the Commission's Opinion and Order incorrectly found that the "effect" of the Contract Support Agreement would apply "outside of the current audit."[32] In fact, the renegotiated agreement contributed to increased fuel costs in 2009 and there will be little benefit to customers in future years. Under the same line of reasoning that the Commission determined the value realized from the Buy-Out must flow back to ratepayers, the Commission must also ensure that customers receive the value realized from the Contract Support Agreement. On rehearing, the Commission must assign a net present value to the portion of the option that will be realized after May 31, 2015 and reduce the deferral balance for that amount along with associated carrying charges.

IV. CONCLUSION

For the reasons stated above, the Commission should grant IEU-Ohio's Application for Rehearing.

Respectfully submitted,

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[32] *Id.*

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Application for Rehearing and Memorandum In Support of Industrial Energy Users-Ohio* was served upon the following parties of record this 22th day of February, 2012, via electronic transmission, hand-delivery or first class mail, postage prepaid.

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