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FILE

April 3, 2012

The Honorable Greta See
The Honorable Sarah Parrot
Attorney Examiners
Public Utilities Commission of Ohio
180 East Broad Street, 12th Floor
Columbus, Ohio 43215

RE: *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Ohio Revised Code 4928.144, et al.,* Public Utilities Commission of Ohio Case Nos. 11-4920-EL-RDR, 11-4921-EL-RDR.

Dear Examiners See and Parrot:

On April 2, 2012, Staff of the Public Utilities Commission of Ohio filed its Comments and Recommendations in the above referenced matter in compliance with the Commission's March 14, 2012 Entry. After filing its Comments and Recommendations, Staff noticed a minor typographical error in its filing. On page 4 of the original Comments and Recommendations, Staff referred to "Attachment A." This reference is incorrect. The correct reference is "*Attachments 1 and 2*". Page 5 of the Revised Comments and Recommendations correctly states "Staff has prepared *Attachments 1 and 2*."

Respectfully submitted,

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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered under Ohio Revised Code 4928.144	:	Case No. 11-4920-EL-RDR
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

REVISED COMMENTS AND RECOMMENDATIONS SUBMITTED ON BEHALF OF THE STAFF OF THE PUBLIC UTILITIES COMMISSION OF OHIO

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Date Submitted: April 3, 2012

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REVISED COMMENTS AND RECOMMENDATIONS SUBMITTED ON BEHALF OF THE STAFF OF THE PUBLIC UTILITIES COMMISSION OF OHIO[1]

I. INTRODUCTION AND BACKGROUND

On March 18, 2009, the Commission issued its Opinion and Order in which it approved the application of Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, Companies) for an electric security plan (ESP) in Case Nos. 08-917-EL-SSO and 08-918-EL-SSO (ESP 1).

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[1] Staff's Comments and Recommendations were initially filed on April 2, 2012 in compliance with the Commission's March 14, 2012 Entry. Staff now files these Revised Comments and Recommendations to correct an error on page 4 of its initial filing. On page 4 of the original Comments and Recommendations, Staff referred to "Attachment A." This reference is incorrect. The correct reference is "**Attachment 1 and 2**". Page 5 of this revised version now correctly states "Staff has prepared **Attachments 1 and 2.**"

In order to ensure rate or price stability and to mitigate the impact on customers during a difficult economic period, the Commission directed the Companies in the ESP 1 to phase-in a portion of the rate increase authorized over an established percentage for each year of the ESP. In addition, the Commission authorized the Companies to establish a regulatory asset to record and defer fuel expenses with carrying costs, at the weighted average cost of capital. The collection of any deferrals created by the phase-in that are remaining at the end of the ESP term shall occur from 2012 to 2018 via an unavoidable surcharge.

On January 27, 2011, the Companies filed an application, in Case No. 11-346-EL-SSO for authority to establish a Standard Service Offer pursuant to section 4928.143 of the Ohio Revised Code, in the form of an Electric Security Plan (ESP 2) to begin on January 1, 2012.

On September 1, 2011, in Case Nos. 11-4920-EL-RDR and 11-4921-EL-RDR, the Companies filed an application requesting approval of a mechanism to recover the fuel costs ordered to be deferred for later collection by the Commission as part of the phase-in of rate changes ordered by the Commission in the Companies' ESP cases, 08-917-EL-SSO and 08-918-EL-SSO (ESP 1).

On September 7, 2011, a Stipulation and Recommendation (ESP 2 Stipulation) was filed by the Companies, Staff, and other parties to resolve the issues raised in Case Nos. 11-346-EL-SSO, 11-4920-EL-RDR, 11-4921-EL-RDR, and several other cases pending before the Commission. The ESP 2 Stipulation included a provision regarding the establishment and terms of a phase-in recovery rider (Rider PIRR).

Pursuant to an Entry issued on September 16, 2011, a number of the Companies' pending cases were consolidated for the purpose of considering the ESP 2 Stipulation. On December 14, 2011 the Commission issued an Opinion and Order in the consolidated cases, modifying, and adopting the ESP 2 Stipulation. The PIRR provisions of the ESP 2 Stipulation were not modified in the December 14, 2011 Opinion and Order. On December 22, 2011, the Companies filed its compliance tariffs.

On February 23, 2012, the Commission issued an entry on rehearing in the consolidated cases, granting rehearing in part. Furthermore, the Commission determined, on two independent grounds, that the Stipulation submitted by the Signatory Parties does not benefit ratepayers and the public interest. Thus, the Commission rejected the ESP 2 Stipulation and the application, as modified by the ESP 2 Stipulation. The Commission directed the Companies to file, no later than February 28, 2012, new proposed tariffs to continue the provisions, terms, and conditions of their previous electric security plan (ESP 1).

On March 14, 2012, the Attorney Examiner noted that the application in the present cases was filed by the Companies less than a week prior to the filing of the ESP 2 Stipulation. In light of the Commission's rejection of the ESP 2 Stipulation, the Attorney Examiner found that the present cases should now move forward independently. The Attorney Examiner issued an Entry setting a procedural schedule for comments on the Companies' Application as follows:

April 2, 2012 – Deadline for the filing of comments on the Application by Staff and interveners; and,

April 17, 2012 – Deadline for all parties to file reply comments.

II. STAFF'S REVISED COMMENTS AND RECOMMENDATIONS

Based on its review of the Rider PIRR filing, the Staff makes the following comments and recommendations to the Companies' proposed collection of Rider PIRR. The Staff's comments and recommendations by topic are set forth below.

A. Once Rider PIRR collection commences the carrying charges should be calculated on the most recently approved Commission debt rate (5.34%) and not the 11.26 % pre-tax weighted average costs of capital (WACC) as currently proposed by the Companies.

The Companies propose to continue applying an annual WACC rate of 11.26% during the remaining seven year recovery (82 months) of the Companies' deferred fuel assets. The factor utilized is a pre-tax WACC factor which allows the Companies to recover an allowed rate of return consisting of debt and equity and the associated income tax impact on the equity return. The ESP 1 Order indicates that the Companies are entitled to WACC during the deferral period, but it does not address what happens once the collection commences. Staff agrees that the Companies are entitled to the pre tax WACC in determining the amount they are entitled to collect from ratepayers per the ESP 1 order during the deferral period. However, Staff believes that once this principal amount is determined for the calendar year ending 2011, the Companies should only be entitled to receive from ratepayers the time value of money (debt interest rate) because there is no longer any risk of collection to the Companies.

For illustration purposes, Staff has prepared Attachments 1 and 2 which compares the impact on ratepayers using various assumptions on the calculation of carrying costs. In each comparison, the December 2011principal balance of $537,263,771 was used. This balance is consistent with the amount utilized by the Companies in their February 29, 2012 filing in this case. It should be noted that at the time of these comments, the final December 2011deferred fuel balance was not fully known; therefore, Staff used the February 29, 2012 filing as the best estimate filed with the Commission.

All illustrations in Attachments 1 and 2 below are based on the February 29, 2012 filing and are reflective of OP fuel deferrals only as they have the largest impact to ratepayers. Staff would note that CSP also has a fuel deferral balance ($6,295,481 per the February 29th filing) and the same principles, policies, and recommendations proposed by Staff should be applied to the CSP deferred fuel balance if adopted by the Commission.

Attachment 1

OHIO POWER

Cost Impacts of Various Return Allowances

MONTHLY COMPOUNDING

Line No.	Description	Company As Filed 1	Difference 2	Staff Proposal 3	Difference 4	Staff Proposal Adjusted for ADIT 5	
1	Beginning balance	$ 537,263,771	$ -	$ 537,263,771	$ -	$ 537,263,771	
2	Related Income Tax Savings (ADIT)					$ (177,056,527)	1/
3	Balance financed by sources other than related income tax savings					$ 360,207,244	1/
4	Annual Rate of Return	11.26%	-5.92%	5.34%	0%	5.34%	
5	Carrying Cost	$ 235,339,409	$ (130,185,906)	$ 105,153,503	$ (34,653,615)	$ 70,499,888	1/
6	Total Cost to Customers	$ 772,603,180	$ (130,185,906)	$ 642,417,274	$ (34,653,615)	$ 607,763,659	

1/ The beginning balance in the carrying cost calculation was reduced by $177,056,527, the actual ADIT OP balance shown in FERC Form 1 for calendar year 2010. This amount should be updated using the 12/31/2011 Deferred Fuel ADIT balance once the 2011 FERC Form 1 is filed

As shown in Attachment 1, Staff proposes to use a long-term debt rate of 5.34% (Column 3) in calculating the carrying costs once collection commences on Rider PIRR. This debt rate represents the most recently approved Commission long term cost of debt. It is important to note that Column 3 is based upon the use of monthly compounding as proposed by the Companies in their February 29, 2012 filing. Using the Commission's most recently approved long-term cost of debt rate would result in collections from ratepayers over the remaining 7 year period (82 months) of $642,417,274 versus $772,603,180 should an 11.26% WACC rate be used. The change from the WACC to the debt rate saves ratepayers $130,185,906 in carrying costs. Because the Companies' risk of recovery is minimal once actual recovery begins, a lower rate (debt rate) should be used as the appropriate carrying charge. Therefore, the Staff urges the Commission to adopt the debt rate when calculating the carrying costs for Rider PIRR going forward.

B. The deferred fuel balance at the end of December 2011 should be reduced for Accumulated Deferred Income Taxes (ADIT) in the calculation of carrying costs for Rider PIRR

Staff supports an adjustment that would reduce the principal balance used in the carrying charge calculations by the amount of the ADIT because this amount is a source of funds to the Companies that would not need financing. For income tax purposes, the ADIT results from a timing difference between the occurrence of the expense and the associated revenue. If the revenue and expense occurred in the same period there would be no tax impact. However, when there is a timing difference there is an impact on the income tax computation thereby creating ADIT. Put another way, the Companies deducted fuel expense for income tax purposes as incurred, but for regulated accounting were allowed to defer those fuel costs for future recovery. The differences between the amounts of fuel costs deducted for income tax purpose and the fuel costs that have been deferred for regulatory accounting purposes have created a temporary tax timing difference that results in the deferred fuel ADIT. This ADIT is shown in account 283 under the FERC Uniform System of Accounts that the Companies follow. For Ohio Power, the ADIT related to deferred fuel at December 31, 2010, as reported on page 277 of Ohio Power's FERC Form 1, is $177,056,527. This is shown as a specific line item within the account 283 balance on the Form 1. The ADIT that is directly related to the deferred fuel balance represents net tax savings that effectively finance a portion of the deferred fuel balance. There is no carrying cost associated with the ADIT. The ADIT thus represents a cost-free source of funding for the deferred fuel balance that is provided by ratepayers and not investors. Therefore, it is the Staff's position that ADIT should have been used by the Companies as a free source of funds. This ADIT adjustment should have been reflected as a reduction to the principal deferred balance for purposes of the carrying cost calculation at the end of each year of the ESP 1 period (2009-2011).

This recommendation is consistent with the financial auditor's statement in the most recent FAC case.[2] The financial auditor brought to the Commission's attention that when applying the gross-of-tax WACC carrying charge to the deferred fuel balance there is not an off-setting adjustment to ADIT. The ADIT represents the tax savings realized by the Companies that effectively finances a portion of their deferred fuel balance. Since there was a directly related income tax savings, the Companies did not have to finance the entire deferred fuel amounts during the ESP 1 period (2009-2011). The Companies only had to finance the amount net of the directly related income tax savings, not the gross amount.

The Companies indicate that they relied on the "gross of tax" language from the ESP 1 Order and therefore have not applied the ADIT adjustment to the deferred fuel each year of ESP 1 (2009-2011). It is Staff's belief that "gross of tax" provision was applicable to the carrying cost *rate*, which then must be applied consistently to the balance that was financed by investors. Applying the "gross of tax" rate to the balance

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[2] *In re Columbus Southern Power*, Case Nos. 10-268-EL-FAC, *et al.* (Report of the Management/Performance and Financial Audits of the FAC of the Columbus Southern Power Company and the Ohio Power Company at 7-81) (May 26, 2011).

financed by investors is necessary because the equity financing cost is not tax deductible; consequently, in order for investors to collect the equity financing cost, the rate must be "grossed-up" for income taxes. The use of the "gross of tax" carrying cost rate meant the Companies would collect their full fuel expense including a gross up for the income tax expense the Companies needed to pay in order to collect the common equity portion of the carrying costs on an after-tax basis. The income tax gross up was accounted for in the gross-of-tax WACC the Companies were authorized to collect. The Companies recorded carrying costs at the "gross of tax" WACC during the deferral period as the Commission ordered. However, that "gross of tax" WACC was applied to the deferred fuel balance in total, which included (1) the portion financed by investors, and (2) the portion financed by income tax savings, upon which the Companies' investors were not reasonably entitled to a return.

It is Staff's opinion that applying a "gross of tax" WACC as the carrying cost rate, and offsetting the deferred fuel balance for the income tax savings represented by the direct related ADIT in the carrying cost calculations are not the same. The ADIT issue is a separate and distinct regulatory principle that Staff believes has been violated. The applicable regulatory concept is that investors are only entitled to earn a return on balances that they have financed. By applying the "gross of tax" WACC to the entire deferred fuel balance, investors are not only earning a return on the portion of the deferred fuel balance that they have financed, but would also earn a return on the portion of the deferred fuel balance that they have not financed, i.e., on the portion that has effectively been financed by the directly related income tax savings, which is measured by the ADIT. It is not reasonable that any rate payer would have to pay to finance amounts that the Companies' investors did not finance. The deferred fuel balance at the end of year 2009 through 2011 should have been reduced by the ADIT for purposes of calculating carrying costs. As noted by the fuel auditors[3] the reduction for the ADIT simply was not applied to the deferred fuel balance during ESP 1.

Staff's recalculation to reflect the ADIT reduction is shown in Column 5 of Attachment 1. The FERC Form 1 for 2011 was not public by April 1, 2012 and therefore the ADIT utilized by Staff was the 2010 ADIT balance in Acct 283. This was the latest information filed with the FERC. Once the December 31, 2011 ADIT balance that is directly related to the Companies' December 31, 2011 deferred fuel balance becomes available, that balance should be substituted in the calculation for the December 31, 2010 deferred fuel ADIT balance used by Staff. Using the December 31, 2010 deferred fuel ADIT balance as representative of the non-investor (tax savings related) financing of the deferred fuel balance saves rate payers an additional $34,653,615 in carrying costs. If the 2009-2010 deferred fuel balances were properly reduced by the ADIT the carrying cost savings would have been higher due to the utilization of the pre-tax WACC during deferral versus the debt rate of 5.34% being proposed by Staff once collection begins for Rider PIRR.

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3 *In re Columbus Southern Power*, Case Nos. 10-268-EL-FAC, *et al.* (Report of the Management/Performance and Financial Audits of the FAC of the Columbus Southern Power Company and the Ohio Power Company at 7-81) (May 26, 2011).

At a minimum, Staff is urging the Commission to rectify this regulatory error once collection begins for Rider PIRR by reducing the December 2011 OP principal balance of $537,263,771 and the December 2011 CSP deferred fuel balance of $6,295,481 by the latest ADIT balance known to the Companies as reflected on per the FERC Form 1.[4]

C. The Companies should be required to calculate the deferred fuel balance "going forward" using annual compounding and not monthly compounding.

For illustrative purposes, on Attachment 2 Staff has also calculated the impact of annual versus monthly compounding on both of the recommendations listed above. The use of annual compounding is consistent with the Commission's recognition of an annual interest rate in the Companies rate of return allowance. The calculations on Attachment 2 show that by using annual compounding instead of monthly compounding during the Rider PIRR collection period saves rate payers an additional $23,915,797 in carrying charges over the 7 year period. (The $23,915,797 savings utilizes the Staff's proposed debt rate of 5.34% and the 2010 FERC Form 1 ADIT reduction of $177,056,527).

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4 The deadline for filing the 2011 FERC Form No. 1 is April 18, 2012. (www.ferc.gov/docs-filing/forms/form-1/transmittal-letter.pdf) Staff's calculations have used the December 31, 2010 Deferred Fuel ADIT balance from Ohio Power's 2010 FERC Form 1 (page 277, account 283). Using the December 31, 2011 Deferred Fuel ADIT balance, once the 2011 FERC Form 1 becomes available, will better match the ADIT that directly relates to the Deferred Fuel balance with the December 31, 2011 Deferred Fuel balance.

Attachment 2

OHIO POWER

Cost Impacts of Various Return Allowances

ANNUAL COMPOUNDING

Line No.	Description	Company As Filed	Difference	Staff Proposal	Difference	Staff Proposal Adjusted for ADIT	
		1	2	3	4	5	
1	Beginning balance	$ 537,263,771	$ -	$ 537,263,771	$ -	$ 537,263,771	
2	Related Income Tax Savings (ADIT)					$ (177,056,527)	1/
3	Balance financed by sources other than related income tax savings					$ 360,207,244	1/
4	Annual Rate of Return	11.26%	-5.92%	5.34%	0%	5.34%	
5	Carrying Cost	$ 235,339,409	$ (162,768,688)	$ 72,570,721	$ (23,915,797)	$ 48,654,924	1/
6	Total Cost to Customers	$ 772,603,180	$ (162,768,688)	$ 609,834,492	$ (23,915,797)	$ 585,918,695	
7	**DIFFERENCE BETWEEN MONTHLY AND ANNUAL COMPOUNDING**						
8	Total Cost to Customers			$ (32,582,782)		$ (21,844,964)	

1/ The beginning balance in the carrying cost calculation was reduced by $177,056,527, the actual ADIT OP balance shown in FERC Form 1 for calendar year 2010. This amount should be updated using the 12/31/2011 Deferred Fuel ADIT balance once the 2011 FERC Form 1 is filed.

D. The Companies should be required to make annual informational filings regarding the collection balance of the PIRR.

The Staff also recommends that the Commission direct the Companies to make annual informational filings detailing the deferred fuel recorded on their books during the 7 year recovery period. Specifically, the Companies should provide a breakdown of where collections stand per rate class and by operating company and the corresponding ending deferral balance. This should be based on the calendar year and filed on March 15th of the succeeding year.

III. CONCLUSION

The Staff has reviewed the Companies' Application in these cases for authority to create a PIRR rider to collect a related regulatory asset for fuel expenses. And, with adoption of the Staff's recommendations for modifying the calculation of the regulatory asset and annual informational filings detailed above, the Staff would respectfully recommend that the Commission approve the Companies Application.

Respectfully Submitted,

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IV. CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing **Revised Comments** submitted on behalf of the Staff of the Public Utilities Commission of Ohio was served by electronic mail upon the following parties of record, this 3rd day of April, 2012.

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