

Before the
Public Utilities Commission of Ohio

In the Matter of the Review of the Smart Grid)
Modernization Initiative Contained in the)
Tariffs of Ohio Edison Company, The) Case No. 12-0406-EL-RDR
Cleveland Electric Illuminating Company,)
and The Toledo Edison Company.)

COMMENTS
SUBMITTED ON BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO

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Introduction

The Commission approved FirstEnergy's (FE's) Rider AMI as the mechanism for recovering costs related to the deployment of smart grid and advanced metering infrastructure in Case No. 07-551-EL-AIR.¹ As part of the stipulation approved by the Commission in Case No. 08-935-EL-SSO, FE committed to developing a proposal to pursue federal funds for smart grid investment. The signatory parties agreed that recovery would be through a non-bypassable rider.² The Commission approved certain terms and conditions for Rider AMI in Case No. 09-820-EL-ATA et. al.³ Final guidance regarding cost recovery and related matters was provided by the Commission in Case No 10-388-EL-SSO.⁴

FE was awarded funding by the U.S. Department of Energy (DOE) to conduct a pilot program, which included certain consumer behavior and distribution automation projects in Ohio. The Commission authorized FE to collect smart grid costs incurred as part of its pilot program over a ten year period through Rider AMI with quarterly adjustments. O&M expenses were deemed to be incremental to costs reflected in base rates for purposes of the pilot program. The Commission directed that FE shall not complete any part of the Ohio deployment for which DOE does not match funding in an equal amount.⁵

¹ Opinion and Order, January 21, 2009, at 44 – 45.

² Second Opinion and Order, March 25, 2009 at 13.

³ Finding and Order, June 30, 2010, at 9 – 11.

⁴ Finding and Order, August 25, 2010, at 13 – 14.

⁵ Case No. 10-388-EL-SSO, August 25, 2010 Opinion and Order at p. 14.

Rider AMI works differently from other utility companies' Smart Grid riders. It is a ten year rider. All costs incurred will need to be recovered in that time frame. The rider is billed monthly on a fixed customer charge basis. The rate, or charge, is adjusted quarterly. As investments are made and costs incurred, those values are incrementally included in rates. The approach for incrementing the rate is to divide the costs incurred in the last quarter divided by the number of months remaining in the ten year recovery period at the time those costs are incorporated into the rate. Thus, the costs incurred prior to rates going into effect are divided by 120 months, the costs incurred in the first quarter of the rates being in effect are divided by 117 months and added to the existing rate, and so forth.

These comments provide the results of Staff's first annual financial audit of FE's smart grid pilot program investments and expenses. The only items contained in these comments are those that address issues and exceptions identified by Staff in FE's filing in this case. If a topic is not addressed in these comments, Staff takes no issue with regard to that topic. Staff reserves the right to identify topics in subsequent audits, which may not be addressed in these comments; however, Staff will not apply objections or exceptions to future filings retroactively to this filing.

Financial Audit

Staff's general approach to the financial audit was to request a detailed list of all capitalized charges and expenses, as they were incurred relating to advanced meters, communications

equipment, distribution automation, volt / var controls, and power quality, to group those charges by cost category, and then to select samples based on relative dollar value. Staff then requested documentation supporting the samples it selected. After reviewing this documentation, Staff requested additional documentation as needed until it was either satisfied that the costs were substantiated or concluded that an adjustment was warranted. Because the rates are applied quarterly, the Commission should specify that any adjustments should be applied concurrent with the next quarterly filing after the Commission issues an Order.

Because this audit extended in time significantly beyond the original filing, staff issued a final data request asking the Company to supplement any or all prior interrogatories in order to assure the issues identified herein are still valid. Several issues staff identified from early discovery requests had been mitigated during the course of the audit. Since those issues were corrected or mitigated, they are not included in these comments. This helped to eliminate rate adjustments that would subsequently have had to be reversed, saving all parties time and expense.

Physical Audit

Staff conducted a physical audit for deployed distribution automation equipment. Because of resource constraints, Staff identified a subset of deployed equipment for physical inspection and verification of installation.

After identifying the locations of all major equipment purchased in 2011 for the Substation Automation and Distribution Automation program, Staff physically verified 38 of the 88 line reclosers constructed in 2011, 55 of the 101 line capacitors constructed in 2011, and 27 of 61 substation equipment line-items. The circuits containing line reclosers and line capacitors associated with the following substations were also verified: Kepler, Lark, Leo, Millgate, Nelson, Newport, Norway, Pinegrove, Quartz, Oxford, Nash, and Pawnee. Finally, substations verified for automation included Oxford, Nelson, Norway, Millgate, Ruth, and Quartz.

Fiber Optic Cable Installation - Affiliate Transactions

Execution of Contractual Obligations

FirstEnergy contracted with an affiliate company, First Telecom Services (FTS), to install two segments of fiber optic cable for data communications to support its Smart Grid Modernization Initiative in Ohio. FE required 12 pairs of fiber for the purpose of supporting its Grid Modernization Initiative in Ohio. However, 24 pairs of fiber were installed. First Telecom Services has retained ownership of the cable itself, meaning the sheath and 12 of the 24 pairs of fiber,⁶ while FE owns the other 12 pairs of fiber.

According to the Agreement of Sale of (then) FirstEnergy Telecom to First Communications executed in March 2008, (now) First Telecom Services is obligated to remit to FE, 5% of gross revenues for any commercial telecommunications traffic that may use any or all of FTS' 12 fiber

⁶ Response to Staff Data Request 13, question 6 as supplemented by Response to Staff Data Request 15, question 4.

pairs.⁷ During the course of this audit FE developed mechanisms to assure that; 1) FTS would identify to FE revenues from fiber pairs owned by FTS by specifically itemizing them on monthly invoices, and 2) FE would credit such revenues to ratepayers through Rider AMI.⁸

Those are laudable developments, which go a long way to alleviating staff concerns. FE indicates that it will ensure that gross revenues are properly accounted for, by means of periodic audits of FTS' books, which would be conducted by FE. Staff recommends the Commission require the audit reports be filed with, or made known to the Commission for purposes of documentation and review. The Commission should specify that the audit reports contain sufficient detail and transparency that staff can aver the line items on FTS' monthly invoices accurately reflect the remittance of 5% of gross revenues.

As a corollary matter, no methodology has been specified for quantifying the gross revenues or for calculating the 5% of gross revenues attributable to FTS' strands in the fiber line segments at issue in this case. Is it 5% of gross revenues received for any commercial traffic running through either of FTS' capacity in either of the fiber segments regardless of the origin or destination of such traffic? Or is it a proration of the traffic based upon the length of the fiber segments compared to the length of fiber from the origin and destination of the traffic? Staff

⁷ Response to Staff Data Request 25, Question 1. "The Agreement of Sale of FE Telecom [by FirstEnergy] to First Communications in March 2008 specified that any First Telecom owned fiber cable installed on FirstEnergy infrastructure (underlying electric distribution poles) would require the payment by First Telecom to the FirstEnergy owner of the infrastructure 5% of any revenue that First Telecom receives for the use of that fiber if the fiber is installed outside of the communication space." See also Confidential Response to Staff Data Request 18 as specified on page 2 of P.O. #45369311 dated 5/11/2011 between FirstEnergy and First Telecom Services.

⁸ Supplemental Response to Staff Data Request 25 dated 1/9/2013.

recommends the Commission require the Company specify how the gross revenues associated with the fiber cable segments at issue in this case will be determined.

The questions of how to attribute revenues from FTS commercial transactions, and the amount of revenues that should be remitted to FE and credited back to ratepayers, are tied to facts beyond the scope of this audit. The audit in this case is limited to the Leroy and Mayfield segments, which were installed as part of the Company's Grid Modernization Initiative. The gross revenues and rate mechanisms for crediting the 5% amounts could be impacted if other fiber segments have been constructed under the same arrangement, i.e., whereby FTS retains ownership of some portion of the data transfer capability.

This begs the question of how many, and which fiber optic cable segments, other than the segments for which cost recovery is at issue in this case, may have been installed by FTS under the same or similar joint build arrangements. The Company has represented that it will use Rider AMI as the rate mechanism for crediting FTS revenues back to ratepayers. If other fiber optic cable segments exist, rate mechanisms other than Rider AMI may be appropriate for crediting revenues back to ratepayers. Staff believes it would be useful for the Commission to require the Company to disclose whether other fiber has been installed under similar joint build arrangements, and if so, where it is, how much there is, whether commercial traffic has generated revenue for FTS, and how many revenues have been generated.

For purposes of crediting revenues from the Leroy and Mayfield segments, and for now, Rider AMI is fine. However, Rider AMI has a life of 10 years, some of which time has elapsed. The life of the fiber segments is likely to exceed the life of Rider AMI, and revenues from FTS may

likely succeed Rider AMI. Staff recommends the Commission require the Company to specify the rate mechanism that will be used after Rider AMI is no longer in existence.

Ownership and Cost Sharing

Staff's concern lies in the realm of whether, and by how much, FE's affiliate, FTS, has been inappropriately advantaged by the ownership arrangements for the cable segments at issue in this case. Ratepayers should not subsidize FTS' ownership of fiber optic cable. Staff's recommended remedy goes to the appropriate level of cost recovery from ratepayers. Since each entity, FE and FTS, owns half of the data transfer capacity, each entity should be responsible for half the cost.

The Facts

The contractual arrangements for procuring, installing, and connecting the two fiber optic cable segments are fixed cost purchase orders. The contract price for the Leroy segment was \$482,000, and the price for the Mayfield segment was \$423,000 for a total of \$905,000. Staff requested information about the degree to which FTS contributed to the capital cost of the two projects to install fiber optic cable. The company has represented that FTS' contributions to the capital costs may be valued as follows;⁹

1. FE estimated a dollar value attributable to FTS eliminating its normal 15 percent markup on cost estimates for materials, make ready, permitting, internal labor and contractor labor,

⁹ The actual dollar value numbers are competitively sensitive information. See Response to Staff's supplemental data request, January 9, 2013.

2. FE estimated a dollar value attributable to FTS eliminating its internal labor charges from the fixed price proposal.

The Company also represents that FTS contributes value in two other ways;

3. by means of the terms and conditions that require FTS to remit 5% of gross revenues from commercial traffic (discussed above), and
4. FTS bears full cost for all maintenance (preventive, corrective/repairs, predictive, etc.) performed during the life of the asset for all cable installed under Fixed Price Contracts.

The Company estimates a dollar value of maintenance of both fiber segments based upon average costs experienced in past years.

The Company admits that the actual maintenance costs may vary from year to year.

The Company has entered into an agreement with the U.S. Department of Energy (USDOE) under its Smart Grid Investment Grant program, which allows for a 50% match of qualifying expenditures. The Company sought and received reimbursement in the amount of \$452,500 for half the cost of the fixed price contracts.

Argument and Recommendations

Staff's reasoning is simple. Half the cost of purchasing and installing the fiber optic cable should be eligible for recovery subject to netting contributions by USDOE. At issue is whether, and which of, the four value contributions from FTS in contribution to capital and/or operating costs of the fiber segments, should be considered in determining the value of the fiber segments.

None of the 4 value claims is known or measurable, therefore none of the Company's claims that its affiliate, FTS, provided contributions, is valid. Only two components have been demonstrated by the Company to relate to specific contractual terms – the 5% of gross revenues remittance, and the value of FTS' obligation to maintain the cable as long as the cable remains in service. Neither is a cost that has been incurred, and neither is known or knowable for certain at this time. Staff has therefore not included either of these values as part of the equation to determine the number of dollars eligible for recovery from ratepayers.

The Company has not demonstrated that the contributions by FTS of foregoing its normal 15% markup on its estimates for labor and materials and for not charging for internal labor result from any formal agreement, term or condition. Under a fixed price contract it is impossible for Staff to verify the value of these contributions. They are not known and measurable. Staff concludes that those value contributions are not appropriately includable in valuing the capital cost of the fiber segments.

The analysis is therefore straightforward. The known and measurable cost of purchasing and installing the cable is \$905,000 in fixed price contracts. Staff recommends the Commission decide that FE may be eligible to recover from ratepayers, only half that amount, \$452,500. The other half of the fixed price contract costs should not be recovered from ratepayers, because FTS owns half the assets. The Staff therefore recommends a disallowance of \$452,500 in capital costs.

FE has received matching funds from the United States Department of Energy in the amount of \$452,500 (half the cost of the fixed price contracts with FES). Staff recommends the Commission approve only the residual value of the fiber installations after netting out the

USDOE match. The residual capital costs for which ratepayers should be responsible is therefore \$0.

The rate for Rider AMI is adjusted quarterly. The mechanics of calculating (or, more properly, recalculating) the rate are such that a separate accounting track, looking back to the time when the first invoices were paid to FES and recorded on FE's books, and carried forward through the rate calculations until the rate expires, will need to be created. The purpose of that is to recalculate what the rates should have been, and to recognize the rate difference going forward. Along the way, various depreciation and tax measures will have been applied, which may not be standard for each and every quarter. The Commission should therefore require the Company to file an accounting of the adjustment in its next Rider AMI filing, or subsequent to that filing as a supplemental filing.

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing **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 19th day of February, 2013.

/s/ Thomas G. Lindgren

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Summary: Comments electronically filed by Mrs. Tonnetta Y Scott on behalf of PUCO