MANAGEMENT PERFORMANCE AUDIT

OF THE

FUEL RELATED POLICIES AND PRACTICES

OF

MONONGAHELA POWER COMPANY

CASE NO. 00-106-EL-EFC

SUBMITTED BY THE STAFF

OF

THE PUBLIC UTILITIES COMMISSION OF OHIO

May 26, 2000

Commission ordered Ex. 1

MONONGAHELA POWER COMPANY

BACKGROUND

The Commission's Finding and Order in Case No. 00-106-EL-EFC, issued April 13, 2000, recognized that because of the restructuring of Ohio's electric industry, the usual audit schedule for Monongahela Power (Mon Power or company) would result in audits being conducted that would have no impact on the company's EFC rate. In light of this, and in light of the statutory requirement to conduct EFC audits at least annually while EFC statutes remain in effect, the Commission revised the usual timing and scope of the Mon Power EFC audits. Therefore, the scope of this m/p audit is limited to the review of issues as directed in the Commission's Opinion & Order in Case No. 99-106-EL-EFC, review of follow-up issues as raised by prior auditors, and review of the company's existing and proposed EFC rates.

Staff is recommending with this audit that Mon Power's proposed EFC rate of 0.965¢/kWh be approved beginning with the company's next scheduled rate change on Aug 1, 2000, and remain effective through December 31, 2000.

PRIOR AUDIT RECOMMENDATION

One recommendation from the prior EFC Management/Performance audit was adopted by the Commission as a result Mon Power's prior audit proceeding. The company's action in complying with this recommendation is discussed below:

Fuel Utilization

Staff Recommendation: Staff believed that there was an additional unquantified fuel cost associated with the operation of the new oxidation plant at the Pleasants Station, and recommended that the EFC ratepayers not subsidize this additional fuel cost if they did not receive the benefit resulting from the project.

Monongahela Follow-up Response: From discussions with company personnel, Staff found that the oxidation plant at Pleasants Station is not yet in operation. At this point, only individual components of the plant have been undergoing periodic testing. Because the fuel costs associated with this testing have not been segregated from plant generation fuel costs by the company, they are included in the three months of actual fuel costs that have been submitted as part of the proposed rate. However, the company has not included any costs associated with operation of the oxidation plant in its forecasted fuel cost data.

Staff believes that any additional fuel consumption associated with testing of components of the oxidation plant would be minimal, and would have essentially no affect on the EFC rate. Because of this, and the fact that the company has not included plant operation costs in the forecasted fuel cost data, Staff believes that the company has complied with the prior recommendation.

PRIOR AUDIT SUGGESTIONS

Several suggestions to improve fuel operations were also made to Monongahela Power during the prior EFC Management/Performance audit review. While compliance with these suggestions was not required, the company considered many of Staff's suggestions and reported to Staff the progress they have made to date. These actions are discussed below:

Fuel Procurement

Prior Staff Suggestion: Staff noted that the company was still in the process of complying with a prior recommendation regarding the Coal Evaluation Model (CEM). During the last audit period, Harrison power station personnel were evaluating the updated CEM. Once the evaluation was completed, Staff suggested that the company should continue to pursue implementation of the CEM at all company power stations.

Monongahela Follow-up Response: The company reported that Black and Veatch has completed conversion of their Coal Evaluation Model from an OS2 platform to a new Windows based version called Vista. They are currently refining the Harrison model and debugging the new Windows based version.

Clean Air Act Compliance

Prior Staff Suggestion: Staff noted in last year's report that because the potential installation of scrubbers would require a fairly significant lead-time, Mon Power's monitoring and evaluation of its Phase II compliance options should be completed regularly and on an on-going basis.

Monongahela Follow-up Response: The company has continued to monitor and evaluate Phase II compliance options on a regular and on-going basis.

Prior Staff Suggestion: Staff noted that the uncertainty of necessary future environmental compliance activities places a premium on flexibility, and with that it also heightens the significance of frequently reviewing the company's allowance management strategy.

Monongahela Follow-up Response: The evolution of environmental regulations is still being reviewed in an ongoing basis. The bank management strategy is regularly reviewed to assure applicability given those developments as well as changes in emission allowance market conditions.

Prior Staff Suggestion: Staff suggested the Company should act cautiously when securing later vintage allowances as part of its strategy of using swaps to help achieve its stated objective of maintaining a sufficient bank of allowances to defer Phase II compliance actions. Given the uncertainties surrounding future environmental regulations, it is possible that the value of future vintage allowances may be compromised.

Monongahela Follow-up Response: The Company stated in last year's Management Performance Audit Report, Allegheny's bank management strategy is to maintain a sufficient bank to defer Phase II compliance actions. Monongahela Power stated that it recognizes that trading for later vintage allowances does entail increased risk and will do so only when such swaps support the bank strategy and favorable premiums can be obtained. The company perceives that the greatest market uncertainty and risk is thought to be five to ten years out in the future. Their focus in allowance activity is on the next four to five year timeframe.

Prior Staff Suggestion: Staff noted that to the extent that Mon Power considers participating in below-the-line allowance transactions in the future, that the Commission's Allowance Guidelines should continue to delineate what constitutes reasonable below-the-line participation in the allowance market.

Monongahela Follow-up Response: Monongahela Power did not participate in any below-the-line allowance transactions during the audit period. To the extent that they consider below-the-line transactions in the future, the Company stated that the Commission's Allowance Guidelines will continue to delineate what constitutes reasonable below-the-line participation in the allowance market.

Prior Staff Suggestion: Staff believed it is reasonable to expect that, as the 1999 ozone season marked the beginning of the OTC NOx Budget Program Allegheny's evaluations and plans may have needed to be revised coincident with gaining additional experience in this program.

Monongahela Follow-up Response: Monongahela's current Phase II NOx compliance plan is based on experience with the 1999 OTC NOx Budget Program and is revised as necessary to reflect developments in environmental regulations and changes in emission allowance market conditions.

Fuel Utilization

<u>Prior Staff Suggestion</u>: Staff suggested that Mon Power give consideration to the causes for the Hatfield/Mitchell region not meeting its target (heat rate), and what actions could have been taken to address these causes.

<u>Monongahela Follow-up Response</u>: The company stated that Hatfield/Mitchell units have been operating under load regulating conditions over the past several years due to economic dispatch. The result of this is that the best efficiency point for overall Station and Region performance can not be as readily attained as in the past. Units that are regulating system load rarely operate at steady state conditions. The result of this is higher heat rates than if the units were carrying a constant load at the optimum point on the performance curve.

<u>Prior Staff Suggestion</u>: Staff suggested to Mon Power that they consider giving a higher priority to completing automation of the laboratory analysis process, so that manual transcription and entry of data that are already available electronically could be avoided.

<u>Monongahela Follow-up Response</u>: Monongahela stated that it is currently in the process of evaluating the most efficient way to electronically transfer information from the lab equipment to the fuel accounting system while maintaining the highest standards of accuracy and reliability.

System Operations

<u>Prior Staff Suggestion</u>: Staff observed that two of the follow-up recommendations from 2 year's past audit were contingent upon the furtherance of the merger with DQE. If the merger were to proceed, staff would have expected that the company would comply with the requirements from those prior follow-up recommendations and asked for an update.

<u>Monongahela Follow-up Response</u>: In October 1999, there was a non-jury trial before the Western District of Pennsylvania on the issue of whether DQE, Inc. had breached the merger agreement between Allegheny Energy, Inc. (Mon Power's parent company) and DQE, Inc. On December 3, 1999, the District Court found the Defendant, DQE, did not breach the merger agreement. The Court based it decision primarily on the finding that the Pennsylvania Public Service Commission order for West Penn Power Company on stranded costs did constitute a material adverse effect on Allegheny and the merger transaction. Accordingly, the District Court found in favor of DQE and against Allegheny on all claims and all requests for injunctive relief. On December 14, 1999, Allegheny appealed the District Court's judgment to the Third Circuit Court of Appeals and filed a Motion for Expedited Treatment of the appeal.

Prior Staff Suggestion: Staff cautioned, as other states approve and enact retail access legislation, the company must consider how to make further amendments to the power sales agreement. The amendments for West Penn's participation in the Pennsylvania restructuring program was made using 100% of West Penn's retail load because it's entire service territory is in Pennsylvania. As other states enact retail legislation, an additional complication arises in determining the appropriate excess capacity attributed to each individual operating company. The additional complication is that the other two companies operate in multiple states that may not enact retail access at the same time. So when amendments are made for Monongahela Power's participation in Ohio's retail access, concern will exist for the appropriate division of excess capacity that will be attributed to Ohio and to West Virginia. Similarly, the situation exists for Potomac Edison's operations in West Virginia and Maryland.

Monongahela Follow-Up Response: The company pointed out that most of Monongahela's jurisdictions are transitioning to customer choice at relatively the same time. Pennsylvania has fully deregulated generation and all customers have a right to choose their supplier. Maryland will move to customer choice July 1, 2000. Ohio's restructured electric industry will become effective on January 1, 2001. West Virginia has passed retail competition legislation and its effective date is anticipated for the period May through July, 2001. Virginia, the last jurisdiction in which Allegheny operates, has passed customer choice legislation and will move to customer choice in the period 2002 through 2004. Since all states are moving to full competition with frozen rates at essentially the same time, the company does not believe these are excess capacity issues.

Prior Staff Suggestion: Staff encouraged Monongahela Power to continue to actively pursue its efforts toward supporting the combination of the Midwest ISO and the Alliance RTO, and to take actions in that regard.

Monongahela Follow-Up Response: Monongahela has been very active with both the Midwest ISO and Alliance RTO as well as exploring other options with regard to RTOs. This issue and all of its activities are under heavy scrutiny in the on-going transition plan case before the Commission, Case #00-02-EL-ETP. Monongahela supports the FERC collaborative process. The company sees transmission interaction as largely a regional issue and one in which Ohio needs to work with FERC, the other states and utilities and regional players in minimizing "seams" and pancaking issues. The company believes that these efforts are perhaps more beneficial than devoting extensive resources to combining various RTO entities.

FUEL COST REVIEW

Staff reviewed and evaluated Mon Power's net includable fuel costs for the current audit period. The historical fuel cost for each month in the audit period is shown below in

Figure 1. The total average fuel cost shown during the audit period (August 1999-April 2000) was 1.0615¢kWh.

Staff also reviewed and evaluated the Company's proposed Mid-Year Adjustment Filing information that was submitted to Staff on May 12, 2000 (effective August 1, 2000-December 31, 2000), in order to determine the reasonableness of the proposed EFC rate. This review included fuel and purchased power cost information included on forms ER-15-S, ER-16-S and ER-18-S, as well as emission allowance information included on form ER-20-S. The company's proposed EFC rate is based on three months of actual data and three months of projected data. The Fuel Component being proposed is 1.042¢/kWh, the Reconciliation Adjustment (RA) is (0.008)¢/kWh and the System Loss Adjustment (SLA) being proposed is (0.069)¢/kWh. Monongahela Power is proposing an overall EFC rate of 0.965¢/kWh. This is a slight increase of 0.041¢/kWh from the current EFC rate of 0.924 ¢/kWh.

FIGURE I

Monongahela Power Company
Actual Fuel Costs (August 1999-April 2000)

Month	KWh	Fuel Cost	¢/kWh
Aug-99	923,616,179	$10,014,324	1.0843
Sept-99	838,510,286	$ 9,014,831	1.0751
Oct-99	824,532,013	$ 8,795,020	1.0667
Nov-99	814,648,289	$ 8,720,653	1.0705
Dec-99	941,819,972	$ 9,654,213	1.0251
Jan-00	997,001,878	$10,437620	1.0469
Feb-00	885,173,496	$ 9,373,764	1.0590
Mar-99	858,569,441	$ 8,408,994	0.9794
April-00	804,325,175	$ 9,313,590	1.1579
Total	7,888,196,729	$83,733,009	1.0615

AUDIT RECOMMENDATION

Staff reviewed the company's consideration of prior audit suggestions and compliance with the prior audit recommendation, the current audit period fuel costs, and the proposed EFC rate and found them to be reasonable. Staff recommends to the Commission that the proposed EFC rate of 0.965¢/kWh should be approved beginning with the company's first billing cycle of the period August, 2000, and continue through December, 2000.