

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Fuel Adjustment)
Clause of Columbus Southern Power) Case No. 10-268-EL-FAC
Company and Ohio Power Company and) Case No. 10-269-EL-FAC
Related Matters for 2010.)

In the Matter of the Fuel Adjustment)
Clauses for Columbus Southern Power) Case No. 11-281-EL-FAC
Company and Ohio Power Company and)
Related Matters.)

(PUBLIC VERSION)

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

**On Behalf of
The Office of the Ohio Consumers' Counsel**
*10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485*

November 8, 2013

TABLE OF CONTENTS

	Page
I. INTRODUCTION	1
II. PURPOSE AND SUMMARY OF TESTIMONY	4
III. PROPOSED FAC ADJUSTMENTS AND RECOMMENDATIONS.....	5
IV. CONCLUSION.....	23

LIST OF ATTACHMENTS

Attachment DJD-1

Attachment DJD-2

1 **I. INTRODUCTION**

2

3 ***Q1. PLEASE STATE YOUR NAME, BUSINESS 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 Principal Regulatory Analyst with
6 the 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. I also have a M.S. degree in energy management and
12 policy from the University of Pennsylvania and a M.A. degree in economics from
13 the University of Kansas. I completed my undergraduate study in business
14 administration at the National Taiwan University, Taiwan, Republic of China. I
15 was conferred by the Society of Utility and Regulatory Financial Analysts as a
16 Certified Rate of Return Analyst in April 2011.

17

18 I was a Utility Examiner II in the Forecasting Section of the Ohio Division of
19 Energy, Ohio Department of Development, from 1983 to 1985. From 1985 to
20 1986, I was an Economist with the Center of Health Policy Research at the
21 American Medical Association in Chicago. In late 1986, I joined the Illinois
22 Commerce Commission as a Senior Economist in its Policy Analysis and
23 Research Division. I was employed as a Senior Institute Economist at the

PUBLIC VERSION
Direct Testimony of Daniel J. Duann, Ph.D.
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 10-268-EL-FAC et al.

1 National Regulatory Research Institute (“NRRI”) at The Ohio State University
2 from 1987 to 1995. My work at NRRI involved many areas of utility regulation
3 and energy policy. I was an independent business consultant from 1996 to 2007.

4
5 I joined OCC in January 2008 as a Senior Regulatory Analyst. I was promoted to
6 my current position in November 2011. My responsibilities are to assist OCC by
7 participating in various regulatory proceedings before the Public Utilities
8 Commission of Ohio (“PUCO” or “Commission”). These proceedings include
9 rate cases, alternative regulation, fuel cost recovery, service reliability, and other
10 types of filings by Ohio’s electric, gas, and water companies.

11
12 ***Q3. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY OR TESTIFIED***
13 ***BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO?***

14 ***A3.*** Yes. I have submitted expert testimony on behalf of OCC before the PUCO in a
15 number of cases involving electric, gas, and water companies. A list of these
16 cases is included in Attachment DJD-1.

17
18 ***Q4. HAVE YOU PREVIOUSLY TESTIFIED BEFORE OTHER ENTITIES IN***
19 ***REGARD TO PUBLIC UTILITY REGULATION?***

20 ***A4.*** Yes. I have testified before the Ohio Division of Energy, the Illinois Commerce
21 Commission, and the Senate Committee on Energy and Public Utilities of the
22 California Legislature.

1 **Q5. WHAT ARE YOUR QUALIFICATIONS IN REGARD TO YOUR**

2 **TESTIMONY IN THIS PROCEEDING?**

3 **A5.** I am a trained economist with over twenty-five years of experience in studying
4 and analyzing the regulation of public utilities in the United States. A list of my
5 selected professional publications is included in Attachment DJD-2. I have
6 directly participated in many public utility proceedings in Ohio and Illinois. I am
7 familiar with the many issues related to fuel adjustment clauses (“FAC”) and fuel
8 cost deferrals for regulated electric utilities in Ohio. I have testified in regard to
9 the FAC and related issues regarding Columbus Southern Power Company
10 (“CSP”) and Ohio Power Company (“OP”) (collectively, “AEP Ohio”¹) in several
11 recent proceedings before the PUCO,² including AEP Ohio’s 2009 FAC
12 Management/Performance and Financial Audits.³

¹ Effective at the end of 2011, Columbus Southern Power Company and Ohio Power Company merged, with Ohio Power becoming the successor in interest to Columbus Southern Power. See *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals*, Case No. 10-2376- EL-UNC, Entry (March 7, 2012) at 11. In this testimony, “CSP” and “OP” will be used to refer to the separate operating companies that existed before the merger, and “AEP Ohio” will be used to refer to the two operating companies collectively.

² These proceedings include *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 4928.143, Ohio Rev. Code in the Form of an Electric Security Plan (ESP)*, Case Nos. 11-346-EL-SSO, et al. (July 25, 2011); *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Merge and Related Approval (ESP Stipulation)*, Case Nos. 10-2376-EL-UNC, et al. (September 27, 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 4928.143, Ohio Rev. Code in the Form of an Electric Security Plan (Modified ESP)*, Case Nos. 11-346-EL-SSO, et al. (May 4, 2012).

³ *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 (August 16, 2010).

1 **II. PURPOSE AND SUMMARY OF TESTIMONY**

2

3 ***Q6. WHAT IS THE PURPOSE OF YOUR TESTIMONY?***

4 **A6.** The purpose of my testimony is to support and explain OCC's position regarding
5 the Audit Findings and Audit Recommendations contained in the 2010 FAC
6 Audit Report⁴ and the 2011 FAC Audit Report⁵ for AEP Ohio.

7

8 ***Q7. DO YOU AGREE WITH THE FINDINGS AND RECOMMENDATIONS IN***
9 ***THE 2010 AUDIT REPORT AND THE 2011 AUDIT REPORT?***

10 **A7.** Yes. I have reviewed the two Audit Reports. Based on my expertise as a
11 regulatory economist and prior experience with the fuel adjustment clauses and
12 related matters, it is my opinion that the findings and recommendations in the
13 Audit Reports are well-supported and reasonable, and should be adopted by the
14 Commission, with some modifications.

⁴ See *Report of the Management/Performance and Financial Audits of the FAC of the Columbus Southern Power Company and the Ohio Power Company*, Case Nos. 10-268-EL-FAC et al. (May 26, 2011) ("2010 FAC Audit Report").

⁵ See *Report of the Management/Performance and Financial Audits of the FAC of the Columbus Southern Power Company and the Ohio Power Company*, Case No. 11-281-EL-FAC (May 24, 2012) ("2011 FAC Audit Report").

III. PROPOSED FAC ADJUSTMENTS AND RECOMMENDATIONS

Q8. WHILE SUPPORTING THE AUDITORS' RECOMMENDATIONS AND FINDINGS, DO YOU HAVE ADDITIONAL CONCERNS OR ADJUSTMENTS REGARDING CERTAIN ISSUES IDENTIFIED IN THE AUDIT REPORTS?

A8. Yes. I have concerns regarding several inflated and unjustified cost items for fuel transportation, carrying costs for deferred fuel expenses, fuel procurement and disposition of assets identified in the Audit Reports. I also recommend specific adjustments to the FAC to address my concerns.

Q9. PLEASE BRIEFLY EXPLAIN YOUR ADDITIONAL CONCERNS.

A9. In the two Audit Reports, there are extensive analyses and explanations why certain cost items are inflated and unjustified. The two Audit Reports also discuss certain remedies the PUCO should consider in order to remove those inflated and unjustified costs from the 2010 and 2011 FAC costs and from the fuel cost deferral carrying charges collected from AEP Ohio's customers. Nevertheless, in several instances, the Auditors do not explicitly propose specific regulatory remedies or calculate the amounts of FAC adjustments associated with these inflated and unjustified cost items. I will discuss these regulatory remedies and proposed adjustments in the following testimony.

1 ***Q10. PLEASE BRIEFLY EXPLAIN YOUR PROPOSED ADJUSTMENTS TO THE***
2 ***2010 AND 2011 FAC COSTS.***

3 ***A10.*** The PUCO should order several adjustments to the 2010 and 2011 annual FAC
4 costs to protect AEP Ohio's customers from paying inflated and unjustified fuel
5 costs for electric services. Specifically, these proposed adjustments are related to
6 the Financial Audit Recommendations No. 19, No. 21, and No. 22 included in the
7 2010 FAC Audit Report, and the Financial Audit Recommendations No. 4, No. 5,
8 and No. 6 and Management Audit Recommendation No. 5 included in the 2011
9 FAC Audit Report.⁶

10
11 ***Q11. WHAT ARE YOUR PROPOSED FAC ADJUSTMENTS RELATED TO***
12 ***FINANCIAL AUDIT RECOMMENDATION NO. 19 OF THE 2010 AUDIT***
13 ***REPORT?***

14 ***A11.*** I recommend that [REDACTED] be removed from OP's 2010 FAC costs. This
15 adjustment is based, in part, on the Auditors' recommendation that:

16 "AEP should be required to analyze the receipt of revenue and the
17 payment of cash expenses for RTD captive operations, similar to a
18 lead-lag study, and to present such information to support its
19 assumption that RTD has a significant Cash Working Capital
20 requirement. If adequate supporting information is not provided to
21 substantiate that RTD has a significant Cash Working Capital

⁶ It should be noted that the audit reports referenced in my testimony are the confidential version of the 2010 and 2011 FAC Audit Reports.

1 requirement and the amount of that requirement using lead-lag
2 study analysis of cash receipts and cash payments, the RTD
3 Capital component of the RTD investment base should be removed
4 from the cost charged by RTD to OPCo from January 1, 2011
5 forward.”⁷

6
7 This recommendation by the Auditors is related to the cost of coal transportation
8 charged to OP by the AEP River Transportation Division (“RTD”). The RTD is
9 owned by Indiana and Michigan Power Company (“IMPC”), an affiliated
10 company of AEP Ohio, and is responsible for shipping coal by barge to OP and
11 other AEP operating companies.⁸ The primary purpose of the RTD is “to move
12 coal for the operating companies of the AEP system at the most reasonable
13 price.”⁹ The prices of RTD transportation services are not set by the Federal
14 Energy Regulatory Commission (“FERC”) or by any state regulatory agencies.
15 The RTD transportation services are priced based on the costs of providing these
16 services as specified in the May 1986 Barge Transportation Agreement.¹⁰ These
17 costs include a return (initially set at 9.21% per annum) on the net investment in
18 the RTD by IMPC.¹¹ RTD’s Net Investment Base consists primarily of a

⁷ See 2010 Audit Report at 1-10.

⁸ See 2010 Audit Report at 7-99 to 7-109.

⁹ See 2010 Audit Report at 7-100.

¹⁰ See 2010 Audit Report at 7-99 to 7-109.

¹¹ Id.

1 Working Capital Requirement and Real Property and Personal Property taxes.¹²

2 The Working Capital Requirement, in turn, equals 0.125 (i.e., 1/8) of the amount
3 of annual Net Expenses.¹³ The Auditors were critical of this approach used by
4 RTD and they recommend that AEP Ohio be required to support its assumption
5 that RTD has a significant Cash Working Capital requirement.¹⁴

6
7 The proposed exclusion of Working Capital Requirement by RTD, as a result of
8 the absence of any supporting information similar to a lead-lag study, is
9 reasonable and consistent with current regulatory practices in Ohio. For example,
10 in the most recent AEP Ohio rate case, the PUCO Staff did not recommend a
11 working capital allowance (which would put the working capital allowance at \$0)
12 because AEP Ohio did not prepare a lead-lag study for the rate case.¹⁵

13
14 In this proceeding, I am not aware of any additional information or documentation
15 that AEP Ohio has provided up to now to substantiate RTD's significant Cash
16 Working Capital requirement. In addition, I believe this specific recommendation
17 (the removal of costs associated with RTD's Cash Working Capital requirement
18 that has not been substantiated) should be applicable to the 2010 FAC period,

¹² See 2010 Audit Report at 7-105. Consequently, a very significant portion (approximately [REDACTED]) of the capital cost charged by RTD is related to the RTD Working Capital requirement.

¹³ See *id.*

¹⁴ See 2010 Audit Report at 7-107 to 7-109.

¹⁵ See *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company, Individually and, if Their Proposed Merger is Approved, as a Merged Company (collectively, AEP Ohio) for an Increase in Electric Distribution Rates*, PUCO Case No. 11-351-EL-AIR, et al., Staff Report of Investigation (September 15, 2011) at 7 and Schedule B-5.

1 rather than from January 1, 2011 forward. In the 2010 Audit Report, the Auditors
2 estimated the 2010 annual charges collected from OP associated with the RTD
3 Working Capital Requirement was [REDACTED].¹⁶ However, in the 2011 Audit
4 Report, this 2010 annual charge related to the RTD Working Capital Requirement
5 was reduced to [REDACTED] to reflect a lower share of OP's revenue allocation
6 among RTD's customers.¹⁷ Accordingly, this updated amount [REDACTED] should
7 be removed from OP's 2010 FAC costs.

8
9 ***Q12. WHAT ARE YOUR PROPOSED FAC ADJUSTMENTS RELATED TO***
10 ***FINANCIAL AUDIT RECOMMENDATION NO. 21 AND NO. 22 OF THE***
11 ***2010 AUDIT REPORT?***

12 ***A12.*** I propose a reduction of \$16.1 million to OP's 2010 FAC costs to account for the
13 actual annual financing cost of deferred fuel expenses incurred by OP in 2010.

14 This adjustment is, based in part, on the Auditors' recommendation that:

15 "AEP Ohio and the other parties to the case should re-examine
16 whether the Commission-authorized gross-of-tax WACC for debt
17 and common equity capital should be applied to what such
18 investors are actually financing of the fuel cost under-recovery
19 balances, which would appear to be the Deferred Fuel amounts
20 recorded in Account 1823144 less the directly related credit-

¹⁶ See 2010 Audit Report at 7-107.

¹⁷ The 2010 amount of [REDACTED] was based on an approximate OP portion of [REDACTED]. The approximate OP portion was reduced to [REDACTED] in the 2011 Audit Report, and the estimated annual revenue requirement charged to OP for RTD's Working Capital Requirement was reduced to [REDACTED]. See 2011 Audit Report at 7-121.

1 balance ADIT-Other for Deferred Fuel recorded in Account

2 283.”¹⁸

3
4 The Auditors also recommend that:

5 “The Company should address the income tax savings it was/is

6 recording related to the under-recovered FAC balances, and how

7 those provide non-investor supplied capital that is financing a

8 portion of the Deferred Fuel balances that have been recorded in

9 Account 1823144. The Company should specifically address the

10 related credit-balance ADIT that is recorded in Account 283,

11 ADIT-Other, for tax savings-based financing that appear to be

12 directly related to the under-recovered FAC balances.”¹⁹

13
14 The Auditors contend that the ADIT (Accumulated Deferred Income Taxes

15 balance²⁰) balance related to deferred fuel costs is a source of non-investor

16 supplied cost-free capital that has been used to finance part of the FAC deferral

17 balance (or Under-Recovered Fuel Balances).²¹ Furthermore, the Auditors state

18 that:

¹⁸ See 2010 Audit Report at 1-10.

¹⁹ Id.

²⁰ The ADIT balance is recorded in FERC Account 283 and reported as a line item in the Comparative Balance Sheet in FERC Form 1.

²¹ See 2010 Audit Report at 7-83.

1 “If the ADIT balance related to the Company’s FAC under-
2 recovery balances is not considered, or deducted somewhere else,
3 such as in rate base, ratepayers would be over-paying carrying
4 costs by paying for carrying costs on the portion of the Deferred
5 Fuel balance that has been financed by tax savings, i.e. on the
6 portion not financed with investor-supplied capital. Unless the
7 ADIT related to the under-recovered fuel balances is being
8 recognized somewhere else in the ratemaking process, the pre-tax
9 WACC should be getting applied to an Under-recovered fuel
10 balances that is net of the related credit-balance ADIT, not to the
11 gross Under-recovered balance.”²²

12
13 The PUCO Staff, in a related proceeding, also recommended that an ADIT
14 balance should have been reflected as a reduction to the principal of deferred fuel
15 balance for purposes of calculating the carrying cost calculation at the end of each
16 year of the Electric Security Plan (“ESP”) period of 2009 through 2011.²³ I agree
17 with both the Auditors and the PUCO Staff on this important and long-standing
18 regulatory principle of utility investors receiving compensation only on the funds
19 they provided through utility rates. It is clear to me that, because OP did not use

²² Ibid.

²³ See *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Section 4928.144, Ohio Revised Code*, Case No. 11-4920-EL-EDR et al., Finding and Order (August 1, 2012) at 9.

PUBLIC VERSION
Direct Testimony of Daniel J. Duann, Ph.D.
On Behalf of the Office of the Ohio Consumers' Counsel
PUCO Case No. 10-268-EL-FAC et al.

1 its own fund to finance a portion of the FAC deferral balance, OP should not be
2 reimbursed (in the form of carrying cost) for the financing costs it did not incur.

3
4 For the 2010 audit period, the Auditors did not calculate the amount of reduction
5 in the FAC deferral balance carrying cost if the ADIT balance for deferred fuel
6 under-collection was used to offset part of the FAC deferral balance for carrying
7 cost purposes. Instead, the Auditors only provided an illustrative example of the
8 reduction in carrying cost as a result of the ADIT offset.²⁴ I have reviewed the
9 information contained in the separate FERC Form 1 filed by OP and CSP for
10 2010. I calculated the 2010 average monthly balance of ADIT for deferred fuel
11 expenses to be \$143.1 million (\$143,130,019.50) for OP based on the average of
12 its beginning and ending ADIT balances.²⁵ In 2010, CSP did not have an ADIT
13 balance associated with fuel cost deferral and no adjustment for this purpose was
14 necessary.²⁶ Based on OP's average annual Weighted Average Cost of Capital
15 ("WACC") of 11.26%,²⁷ I calculated that approximately \$16.1 million
16 (\$16,116,440) in the 2010 carrying cost of the FAC deferral balance should not be

²⁴ See 2010 Audit Report at 7-84.

²⁵ See Ohio Power's FERC Form 1, at 276-277, line 6. For ADIT – Deferred Fuel, the 2010 balance at the beginning of the year was \$109,203,512, and the year-end balance \$177,056,527. I calculated the average of these two balances ($\$143,130,019.5 = (\$109,203,512 + \$177,056,527) / 2$) and used it as the average monthly balance.

²⁶ See Columbus Southern Power's FERC Form 1 at 276-277.

²⁷ AEP Ohio has applied the WACC-based carrying cost rate on a monthly basis to the monthly Deferred Fuel balance. The 11.26% WACC used here is based a debt-equity ratio of 50% each, a debt cost of 5.71%, and cost of equity (return on equity) of 10.50%. This is considered to be representative of the carrying cost rate used by OP for FAC purposes. See 2010 Audit Report at 7-81 to 7-83.

1 charged to OP's customers.²⁸ Therefore, the PUCO should reduce OP's 2010
2 FAC costs by \$16.1 million to account for the reduction in the annual financing
3 cost of deferred fuel expenses.

4
5 ***Q13. HAS THE COMMISSION ALREADY ADDRESSED THE ISSUE OF***
6 ***CALCULATING CARRYING COSTS TO ACCOUNT FOR ADIT BALANCE***
7 ***RELATED TO FUEL COST DEFERRAL?***

8 ***A13.*** Yes. I am aware that the Commission has addressed the issues related to the
9 carrying costs of fuel cost deferrals in the past. Specifically, the Commission, in a
10 related proceeding, found that the carrying charge on a fuel cost deferral balance
11 should be calculated without an adjustment for ADIT in order to ensure that AEP
12 Ohio collects its actual fuel expenses from customers, as required by Section
13 4928.144, Revised Code.²⁹

14
15 ***Q14. WHY SHOULD THE COMMISSION ADOPT THE AUDITORS'***
16 ***RECOMMENDATIONS AND YOUR PROPOSED ADJUSTMENT RELATED***
17 ***TO THE OFFSET OF ADIT BALANCE IN CALCULATING CARRYING***
18 ***COST?***

19 ***A14.*** I am not an attorney and I am not making any legal conclusions regarding prior
20 Commission decisions in this instance. Nevertheless, based on my experience

²⁸ \$16,116,440.2 = \$143,130,019 * 11.26%.

²⁹ See *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Section 4928.144, Ohio Revised Code*, Case No. 11-4920-EL-RDR et al., Finding and Order (August 1, 2012) at 19.

1 and expertise as a regulatory economist, I conclude that (1) the calculation of
2 carrying charge without an adjustment of ADIT balance will allow AEP Ohio to
3 collect more than its actual carrying costs for fuel cost deferral from its customers,
4 and (2) the Commission can and should adopt the proposed regulatory remedy
5 (that is, offsetting the FAC deferral balance by the ADIT balance when
6 calculating the carrying cost of FAC deferral) in this proceeding.

7
8 This proposed regulatory remedy is consistent with long-standing regulatory
9 principles and practices in Ohio. For example, in a typical cost-based rate setting,
10 the amount of customer deposits, customer advances for construction, and
11 **accumulated deferred taxes** are considered funding sources that are not supplied
12 by investors. These funds typically are not included in the rate base and the utility
13 and its shareholders do not earn a return on these funds. This regulatory principle
14 is well established and recognized by many utilities. It appears to me that AEP
15 Ohio did not dispute the validity of this regulatory principle in the past.

16 Specifically, as a result of the 2009 FAC Audit proceeding, AEP Ohio modified
17 the RTD investment base calculation and “has calculated a 13-month average
18 Accumulated Deferred Income Tax (ADIT) balance and applied that in deriving
19 the RTD investment base.”³⁰ Even though in this instance the ADIT adjustment
20 was made for determining the rate base (i.e., investment base), the ADIT

³⁰ See 2010 Audit Report at 7-106.

1 adjustment should be equally applicable regarding the determination of the FAC
2 deferral balance for carrying cost calculation.

3
4 It is my understanding, and confirmed by counsel, that the prior Commission
5 ruling regarding the FAC deferral and carrying costs is based on the requirements
6 of R.C. 4928.144. Under that statute, if the Commission orders a phase-in of rates
7 as part of an ESP, the Commission must also authorize the deferral of incurred
8 costs equal to the amount not collected, plus carrying charges on that amount.³¹

9 In other words, if an FAC deferral is ordered in an ESP with a phase-in, the
10 electric utility should be allowed to collect all deferred fuel expenses (subject to
11 the determination that they were prudent) and associated cost of financing these
12 deferred expenses. The proposed regulatory remedy is consistent with this
13 statutory requirement. Specifically, it is my understanding that the proposed
14 regulatory remedy (that is, offsetting the FAC deferral balance by the ADIT
15 balance when calculating the carrying cost of FAC deferral) does not reduce the
16 principal amount of under-collected 2010 fuel costs. The actual deferred fuel
17 costs incurred will still be collected from customers. In addition, the proposed
18 regulatory remedy does not reduce the WACC used in calculating the carrying
19 cost. The only effect of the proposed regulatory remedy is to have an accurate
20 calculation of the actual 2010 carrying charges **incurred** by AEP Ohio associated
21 with the full amount of the under-collected FAC balances. Such a calculation can

³¹ See *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Section 4928.144, Ohio Revised Code*, Case No. 11-4920-EL-RDR et al., Fifth Entry on Rehearing (October 3, 2012) at 8.

1 only be done by recognizing in the carrying charge calculation the tax savings that
2 accrued to AEP Ohio as a result of the ADIT directly related to the under-
3 collected fuel balances. Under the proposed regulatory remedy, AEP Ohio has
4 and will continue to collect all the prudently incurred fuel costs and the actually
5 incurred financing costs from customers.

6
7 ***Q15. WHAT ARE THE FACTORS THAT THE COMMISSION SHOULD***
8 ***CONSIDER IN DECIDING WHETHER TO INCLUDE THE ADIT OFFSET***
9 ***IN THE CALCULATION OF THE CARRYING COST?***

10 ***A15.*** There are several factors that should be considered by the Commission in
11 deciding this ADIT issue in this proceeding. They are:

- 12 (1) The issue of including the ADIT offset in calculating the
13 carrying cost of fuel deferral balance is pending before the
14 Supreme Court of Ohio;³²
- 15 (2) The prior Commission decision does not specifically
16 prohibit the offset of the ADIT balance in calculating the
17 carrying costs associated with deferred fuel costs, and the
18 Commission has noted that the deferral balance is subject
19 to adjustment as a result of the annual FAC proceedings;³³

³² See Ohio Supreme Court Case No. 12-2008, Notice of Appeal of Appellant Industrial Energy Users-Ohio (November 30, 2012) at 1-2.

³³ See *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Section 4928.144, Ohio Revised Code*, Case No. 11-4920-EL-RDR et al., Finding and Order (August 1, 2012) at 19-20.

1 (3) AEP Ohio's customers have paid and will continue to pay a
2 significant amount of carrying cost for FAC deferral
3 balances from 2009 through 2018.³⁴ The proposed
4 regulatory remedy will provide needed relief for AEP
5 Ohio's many customers who are now paying the highest
6 electric rates in Ohio.³⁵

7
8 In summary, it is fair and reasonable that in a cost-based regulatory mechanism
9 such as the FAC, customers should not be required to pay AEP Ohio a return on
10 investment on funds that were not provided by investors. AEP Ohio may collect
11 from its customers the prudently incurred fuel costs and actually incurred carrying
12 costs, but no more. Therefore, the Commission should reduce OP's 2010 FAC
13 costs by \$16.1 million to account for the reduction in the actual annual financing
14 cost of deferred fuel expenses.

³⁴ For example, in another case, I estimated that OP's fuel cost deferral balance at the end of March 2010 was \$358 million and the carrying charges associated with this amount of fuel cost deferral balance could exceed \$10 million every three months. See PUCO Case No. 09-872-EL-FAC et al., Direct Testimony of Daniel J. Duann (August 16, 2010) at 16. In addition, AEP Ohio estimated that the monthly carrying charges to be billed to customers in the OP Rate Zone in 2013 and 2014 would be approximately \$1.7 million to \$2.4 million based on the Deferred Fuel Balance of \$592.8 million on September 1, 2012. See PUCO Case No. 11-4920-EL-RDR et al., Compliance Tariffs filing (August 8, 2012), Exhibit A.

³⁵ See Ohio Utility Rates Survey (October 15, 2013). For a typical residential customer of CSP using 750 KWH, the monthly bill is \$116.34, or 13.45% higher than the state average of \$102.55. For a typical residential customer of OP, the monthly bill is \$106.89, or 4.23% higher than the state average.

1 ***Q16. WHAT IS YOUR PROPOSED FAC ADJUSTMENT RELATED TO***
2 ***FINANCIAL AUDIT RECOMMENDATION NO. 4 OF THE 2011 AUDIT***
3 ***REPORT?***

4 ***A16.*** The Auditors' recommendation in 2011 is similar to the Financial
5 Recommendation No. 19 of the 2010 Audit Report.³⁶ The Auditors estimated that
6 the 2011 annual charges collected from OP associated with the RTD Working
7 Capital Requirement was [REDACTED].³⁷ I recommend this amount be removed from
8 OP's 2011 FAC costs.

³⁶ See 2011 Audit Report at 1-9. Specifically, the recommendation reads: "AEP should be required to analyze the receipt of revenue and the payment of cash expenses for RTD captive operations, similar to a lead-lag study, and to present such information to support its assumption that RTD has a significant Cash Working Capital requirement. If adequate supporting information is not provided to substantiate that RTD has a significant Cash Working Capital requirement and the amount of that requirement using lead-lag study analysis of cash receipts and cash payments, the RTD Capital component of the RTD investment base should be removed from the cost charged by RTD to OPCo from January 1, 2011 forward."

³⁷ See 2011 Audit Report at 7-121.

**Q17. WHAT ARE YOUR PROPOSED FAC ADJUSTMENTS RELATED TO
FINANCIAL AUDIT RECOMMENDATION NO. 5 AND NO. 6 OF THE 2011
AUDIT REPORT?**

A17. The Auditors' recommendations in the 2011 Audit Report are similar to Financial Recommendation No. 21 and No. 22 of the 2010 Audit Report.³⁸ In the 2011 Audit Report, the Auditors did calculate the 2011 carrying cost overstatement from not using the ADIT balance related to deferred fuel to offset the FAC deferral balance in calculating the annual carrying costs. The Auditors estimated the 2011 carrying cost on FAC deferral balance was overstated by approximately [REDACTED] for AEP Ohio.³⁹ As a result of the merger between Columbus Southern Company and Ohio Power Company, there was no separate 2011 FERC Form 1 filed for CSP and OP. I propose to allocate this combined amount of [REDACTED] between the CSP Rate Zone and the OP Rate Zone based on their shares of the estimated FAC deferral balances at the end of June 2011 (4.72% for CSP and 95.28% for OP).⁴⁰ Accordingly, I recommend [REDACTED] be

³⁸ See 2011 Audit Report at 1-9. Specifically, the two recommendations read: "AEP Ohio and other parties to the case should re-examine whether the commission-authorized gross-of-tax WACC for debt and common equity capital should be applied to what such investors are actually financing of the fuel cost under-recovery balances, which would appear to be the Deferred Fuel Amounts recorded in Account 1823144 less the directly related credit-balance ADIT-Other for Deferred Fuel recorded in Account 283" and "The Company should address the income tax savings it was/is recording related to the under-recovered FAC balances, and how those provide non-investor supplied capital that is financing a portion of the Deferred Fuel balances that have been recorded in Account 1823144. The company should specifically address the related credit-balance ADIT that is recorded in Account 283, ADIT-Other, for tax savings-based financing that appear to be directly related to the under-recovered FAC balances."

³⁹ See 2011 Audit Report at 7-98 to 7-99.

⁴⁰ See 2011 Audit Report Exhibit 7-42 and Exhibit 7-43. On June 30, 2011, the actual FAC deferral balances were \$28,169,051 for CSP and \$568,063,327 for OP. The total FAC deferral balance was \$596,232,378, and CSP's share was 4.72% and OP's share was 95.28%. This was the last time the FAC deferral balances were separately reported by AEP Ohio in the quarterly FAC filings.

1 removed from CSP's 2011 FAC cost and [REDACTED] be removed from OP's
2 2011 FAC cost.

3
4 ***Q18. PLEASE EXPLAIN YOUR OPINION IN REGARD TO MANAGEMENT***

5 ***AUDIT RECOMMENDATION NO. 5 OF THE 2011 AUDIT REPORT.***

6 ***A18.*** I fully support this recommendation by the Auditors. The Auditors recommend
7 that:

8 "EVA recommends that any proceeds received from the sale of CCPP
9 assets be applied to the FAC under-recovery."⁴¹

10
11 This recommendation is related to the closing of the Conesville Coal Preparation
12 Plant ("CCPP"). The Auditors had recommended in the 2009 FAC Audit Report
13 that American Electric Power Service Corporation ("AEPSC") should undertake a
14 study to determine whether there is an economic justification for continuing to
15 operate the CCPP.⁴² AEPSC concluded in April 2011 that it was not economic to
16 continue operating CCPP beyond the first quarter of 2012.⁴³ The Auditors also
17 indicated the coal procurement costs (on a dollar per MMBtu basis) increased in
18 2011 and the largest increase was experienced at Conesville due to the decision to
19 close the CCPP and the costs associated with the shortened asset life.⁴⁴

⁴¹ See 2011 Audit Report at 1-6.

⁴² See 2011 Audit Report at 7-100.

⁴³ Id.

⁴⁴ See 2011 Audit Report at 1-3.

1 It is my opinion that, since AEP Ohio's customers have paid (through the FAC)
2 the operating costs as well as closure-related costs of the CCPP, any proceeds
3 received from the sale of CCPP assets should be applied to the FAC under-
4 collection. This treatment is consistent with the Commission's decision regarding
5 AEP Ohio's 2009 FAC Audit.⁴⁵ In that proceeding, the Commission decided that
6 only the actual costs of any coal procurement contract should be collected from
7 customers. The benefits (such as a payment by a coal producer to AEP Ohio) of a
8 coal contract should be used to offset the costs of a coal contract for calculating
9 the FAC costs. Specifically, the Commission found that, "Given these factors, we
10 agree with Staff that, in order to determine the real economic cost of coal used
11 during the audit period, more of the value realized by AEP for entering into the
12 Settlement Agreement should flow through to OP ratepayers through a credit to
13 OP's under-recovery and deferrals."⁴⁶ More importantly, the Commission
14 directed that the yet-determined value of a coal reserve (received by AEP Ohio as
15 a result of the Settlement Agreement) above the value already required to be
16 credited against FAC deferral, accrue to AEP Ohio's customers.⁴⁷

17
18 This regulatory principle of matching benefits with costs of a specific contract
19 should also be applicable to the utility's decision to close the CCPP. The many
20 costs associated with the closing of the CCPP are collected through the FAC from

⁴⁵ *In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company*, Case Nos. 09-872-EL-FAC et al., Opinion and Order (January 23, 2012).

⁴⁶ *Id.* at 13.

⁴⁷ *Id.* at 12.

1 customers.⁴⁸ Then customers are entitled to all the proceeds from any sale of the
2 CCPP assets. In addition, the process and terms of the sale or disposition of the
3 CCPP should be reviewed in the next audit to ensure that AEP Ohio's customers
4 receive the full and fair value of the CCPP and that the proceeds are properly
5 credited to customers through the FAC.

6
7 ***Q19. PLEASE EXPLAIN THE ADJUSTMENT OF RATES PAID BY***
8 ***CUSTOMERS AS A RESULT OF THE PROPOSED ADJUSTMENTS TO***
9 ***THE 2010 AND 2011 FAC COSTS OF COLUMBUS SOUTHERN POWER***
10 ***AND OHIO POWER.***

11 ***A19.*** As a result of the fuel cost deferral ordered in AEP Ohio's first ESP in 2009, only
12 a portion of the 2010 and 2011 FAC costs and associated carrying costs for CSP
13 and OP have been collected through the FAC charges in effect in 2010 and 2011.
14 The remaining balance of the FAC costs incurred in 2010 and 2011, and their
15 associated carrying costs, are currently being collected through the Phase-In
16 Recovery Rider ("PIRR") through 2018.⁴⁹ Those FAC deferral balances and
17 carrying costs incurred in 2010 and 2011 are not being collected from customers
18 under the current FAC (which does not have a fuel cost deferral provision)
19 established in the second ESP approved in 2012. Consequently, all proposed
20 adjustments in my testimony, if adopted by the Commission, should be applied as

⁴⁸ See 2011 Audit Report at 7-100 to 7-105. The estimated closure related costs in 2011 is [REDACTED].

⁴⁹ See PUCO Case No. 11-4920-EL-RDR et al., Compliance Tariffs filing (August 8, 2012), Exhibit A. On September 1, 2012, the estimated FAC deferral balances were \$7,668,632 for CSP and \$592,761,577 for OP.

1 credits to offset part of the Deferred Fuel Balance to be collected through the
2 PIRR. The monthly PIRR to be collected from AEP Ohio's customers will be
3 reduced accordingly.

4
5 In summary, solely based on the adjustments proposed here and not including
6 other potential adjustments (such as the yet-determined proceeds of the sale of
7 CCPP) identified in the Audit Reports, the total FAC cost adjustment for CSP is
8 approximately [REDACTED] for the 2011 audit period.⁵⁰ The total FAC
9 adjustments for OP are approximately [REDACTED] for the 2010 audit period⁵¹
10 and [REDACTED] for the 2011 audit period.⁵²

11
12 **IV. CONCLUSION**

13
14 ***Q20. DOES THIS CONCLUDE YOUR TESTIMONY?***

15 ***A20.*** Yes. However, I reserve the right to supplement my testimony in the event that
16 AEP Ohio, the Auditors, the PUCO Staff or other parties submit additional
17 testimonies, or if new information or data in connection with this proceeding
18 becomes available.

⁵⁰ The [REDACTED] adjustment is for the reduction in carrying costs associated with the ADIT offset in 2011. In 2010, there is no proposed adjustment here for CSP.

⁵¹ The [REDACTED] is the sum of the proposed reductions associated with RTD Working Capital Requirement [REDACTED] and the ADIT Offset [REDACTED]

⁵² The [REDACTED] is the sum of the proposed reductions associated with RTD Working Capital Requirement [REDACTED] and the ADIT Offset [REDACTED]

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing *Direct Testimony of Daniel J. Duann (Public Version)* was served via electronic transmission to the persons listed below on this 8th day of November 2013.

/s/ Terry L. Etter

Terry L. Etter
Assistant Consumers' Counsel

SERVICE LIST

Thomas McNamee
Steven Beeler
Assistant Attorneys General
Public Utilities Section
180 East Broad Street, 6th Floor
Columbus, Ohio 43215
Thomas.mcnamee@puc.state.oh.us
Steven.beeler@puc.state.oh.us

Samuel C. Randazzo
Frank P. Darr
Joseph E. Olikier
McNees Wallace & Nurick LLC
21 East State Street, 17th Floor
Columbus, Ohio 43215
sam@mwncmh.com
fdarr@mwncmh.com
joliker@mwncmh.com

Philip B. Sineneng
Thompson Hine LLP
Duke Energy Commercial Asset
Management Inc.
41 S. High Street, Suite 1700
Columbus, OH 43215
Tel: (614) 469-3200
Fax: (614) 469-3361
Philip.Sineneng@ThompsonHine.com

Stephen T. Nourse
Matthew J. Satterwhite
Yazen Alami
American Electric Power Company
1 Riverside Plaza 29th Floor
Columbus, OH 43215
stnourse@aep.com
mjsatterwhite@aep.com
yalami@aep.com

Amy B. Spiller
Rocco O. D'Ascenzo
Jeanne W. Kingery
Duke Energy Ohio Inc.
139 East Fourth Street 1303-Main
P.O. Box 961
Cincinnati, OH 45201-0960
amy.spiller@duke-energy.com
Rocco.DAscenzo@duke-energy.com
Jeanne.kingery@duke-energy.com

Attorney Examiners:

Sarah.parrot@puc.state.oh.us
Greta.see@puc.state.oh.us

Daniel J. Duann, Ph.D.
List of Testimonies Filed Before the PUCO

1. *Application of the Dayton Power and Light Company for Approval of Its Electric Security Plan*, Case No. 08-1094-EL-SSO (January 26, 2009).
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 (January 4, 2010).
3. *Application of Aqua Ohio, Inc. for Authority to Increase its Rates and Charges in its Masury Division*, Case No. 09-560-WW-AIR (February 22, 2010).
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 (June 21, 2010).
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 (August 16, 2010).
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 (Remand)*, Case Nos. 08-917-EL-SSO et al (June 30, 2011).
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 (July 15, 2011).
8. *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 4928.143, Ohio Rev. Code in the Form of an Electric Security Plan (ESP)*, Case Nos. 11-346-EL-SSO, et al (July 25, 2011).
9. *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Merge and Related Approval (ESP Stipulation)*, Case Nos. 10-2376-EL-UNC, et al (September 27, 2011).
10. *In the Matter of the 2010 Annual Filing of Columbus Southern Power Company and Ohio Power Company Required by Rule 4901:1-35-10, Ohio Administrative Code*, Case Nos. 11-4571-EL-UNC and 11-4572-EL-UNC (October 12, 2011).

11. *In the Matter of the Application of Ohio American Water Company to Increase Its Rates for Water and Sewer Service Provided to Its Entire Service Area*, Case No. 11-4161-WS-AIR (March 1, 2012).
12. *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 4928.143, Ohio Rev. Code in the Form of an Electric Security Plan (Modified ESP)*, Case Nos. 11-346-EL-SSO, et al (May 4, 2012).
13. *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company For Authority to Establish a Standard Service Offer Pursuant to R.C. § 4928.143 in the Form Of an Electric Security Plan*, Case No. 12-1230-EL-SSO (May 21, 2012).
14. *In the Matter of the Application of Duke Energy Ohio Inc. for an Increase in Electric Distribution Rates*, Case No. 12-1682-EL-AIR et al. (February 19, 2013).
15. *In the Matter of the Application of Duke Energy Ohio Inc. for an Increase in Gas Distribution Rates*, Case No. 12-1685-GA-AIR et al. (February 25, 2013).
16. *In the Matter of the Application of Dayton Power & Light Company For Authority to Establish a Standard Service Offer in the Form Of an Electric Security Plan Pursuant to R.C. § 4928.143*, Case No. 12-426-EL-SSO et al. (March 1, 2013).

Daniel J. Duann, Ph.D.
List of Professional Publications

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).

This foregoing document was electronically filed with the Public Utilities

Commission of Ohio Docketing Information System on

11/8/2013 4:02:11 PM

in

Case No(s). 10-0268-EL-FAC, 10-0269-EL-FAC, 11-0281-EL-FAC

Summary: Testimony Direct Testimony of Daniel J. Duann, Ph.D (Public Version) by the Office of the Ohio Consumers' Counsel electronically filed by Ms. Deb J. Bingham on behalf of Etter, Terry L.