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January 8, 2014

Ms. Sarah Parrot  
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Columbus, OH 43215

RE: *In the Matter of the Fuel Adjustment Clause of Columbus Southern Power Company and Ohio Power Company and Related Matters for 2010 and 2011*, Case Nos. 10-268-EL-FAC, 10-269-EL-FAC, and 11-281-EL-FAC.

Examiner Parrot:

Initial briefs in these cases were due January 7, 2014. Due to a major water main break in downtown Columbus, the Commission offices at 180 East Broad Street were closed on January 7, 2014. As a result, Staff was unable to enter the building to file its initial brief on that date. Please accept for filing Staff's initial brief today.

Please feel free to contact me if you have any additional questions.

Sincerely,

*Thomas W. McNamee*

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**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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

In the Matter of the Fuel Adjustment :  
Clause of the Columbus Southern Power : Case No. 11-281-EL-FAC  
Company and Ohio Power Company :  
And Related Matters for 2011. :

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**INITIAL BRIEF  
SUBMITTED ON BEHALF OF THE STAFF OF  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

---

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Date Submitted: January 8, 2014

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██████████ to improve the quality of the results as third parties may be more aware of

..... If the FAC continues, EVA recommends that the strategy be provided to the next management/ performance auditor for review. ....

9. EVA recommends that AEPSC be directed to develop a strategy for addressing the [REDACTED] and that the strategy should consider a full range of options. If the situation has not been resolved in 2012 and the FAC continues, EVA recommends that the strategy be available for review by the next management/ performance auditor..... 12
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**INITIAL BRIEF  
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---

**I. INTRODUCTION**

Although AEP Ohio's fuel adjustment clause (FAC) is drawing to a close in the relatively near future, it is important to continue to monitor AEP Ohio's performance so long as standard service customers take service under it. Staff's recommendations herein are made with a view toward continuing this monitoring function. The two controversial recommendations are of this sort – directing the company to provide a justification of a barging contract provision and to direct the auditor to examine whether there is a double counting of capacity costs. In both instances the point of the recommendation is to develop an understanding of a component of the FAC. The information is simply necessary to adequately assess the FAC rate.

## II. ARGUMENT

### A. Completed Recommendations

#### 1. **AEP Ohio's claims that it has completed certain audit recommendations should be independently verified in the next audit period.**

In its direct testimony filed in this case AEP Ohio has stated that the following audit recommendations have been completed:

- [AEP Ohio] should review and update the “Instructions” tab in its monthly FAC support Excel files at least annually.<sup>1</sup>
- [AEP Ohio] should identify and separate the renewable energy credits (RECs) value from the energy and capacity value of its renewable energy purchases.<sup>2</sup>
- AEP Ohio should show in detail how REC costs incurred by CSP [Columbus Southern Power] and OPCo [Ohio Power] in 2011 have been separately identified and excluded from the 12/31/2011 FAC deferral for each company, CSP and OPCo.<sup>3</sup>
- AEP Ohio should be assigning appropriate values to its renewables inventory, including its non-Ohio, non-solar REC inventory.<sup>4</sup>

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<sup>1</sup> Staff Exs. 1 and 1A (Report if the Management/Performance and Financial Audits of the FAC of the Columbus Southern Power Company and the Ohio Power Company at 1-9) (May 26, 2011) (Financial Audit Recommendation 15).

<sup>2</sup> Staff Exs. 1 and 1A at 1-9 (Financial Audit Recommendation 16); Staff Exs. 2 and 2A (Report if the Management/Performance and Financial Audits of the FAC of the Columbus Southern Power Company and the Ohio Power Company) (May 24, 2012) (Financial Audit Recommendation 1).

<sup>3</sup> Staff Exs. 1 and 1A at 1-9 (Financial Audit Recommendation 17); Staff Exs. 2 and 2A at 1-9 (Financial Audit Recommendation 1).

<sup>4</sup> Staff Exs. 1 and 1A at 1-10 (Financial Audit Recommendation 18); Staff Exs. 2 and 2A at 1-9 (Financial Audit Recommendation 3).

- AEP Ohio and the other parties to the case should re-examine whether the Commission authorized gross-of-tax WACC [weighted average cost of capital] 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 [accumulated deferred income tax]-Other for Deferred Fuel recorded in Account 283.<sup>5</sup>
- [AEP Ohio] 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 the tax savings-based financing that appears to be directly related to the under-recovered FAC balances.<sup>6</sup>
- On January 23, 2012 the Commission issued an Opinion and Order in Case Nos. 09-872-EL-FAC and 09-873-EL-FAC, and on April 11, 2012 issued an Entry on Rehearing in those dockets which provided clarification of AEP Ohio's obligations as they affect crediting OPCo's FAC under-recovery. AEP Ohio's crediting of those clarified amounts against OPCo's FAC under-recovery should be reviewed in the next audit.<sup>7</sup>
- The \$ [REDACTED] difference between the December estimate and actual for Account [REDACTED] as it relates to Lawrenceburg be removed from the 2011 FAC.<sup>8</sup>
- AEP Ohio determine and assign a salvage value to the CCPP [Conesville Coal Preparation Plant] for the purposes of the depreciation calculations.<sup>9</sup>

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<sup>5</sup> Staff Exs. 1 and 1A at 1-10 (Financial Audit Recommendation No. 21); Staff Exs. 2 and 2A at 1-9 (Financial Audit Recommendation No. 5).

<sup>6</sup> Staff Exs. 1 and 1A at 1-10 Financial Audit Recommendation No. 22); Staff Exs. 2 and 2A at 1-9 through 1-10 (Financial Audit Recommendation No. 6).

<sup>7</sup> Staff Exs. 2 and 2A at 1-10 (Financial Audit Recommendation No. 7).

<sup>8</sup> *Id.* at 1-10 (Financial Audit Recommendation No. 10).

<sup>9</sup> *Id.* at 1-10 (Financial Audit Recommendation No. 11).



- [T]he PUCO direct AEPSC [American Electric Power Service Company] to provide all requested documents to the auditor related to the wind purchases and not agree to provide CSP and OPCo recovery of any wind contract cost until they have been reviewed.<sup>10</sup>
- AEPSC work to minimize the costs associated with the closure of the CCPP. EVA recommends that AEPSC provide its plan for accounting for the closure costs to the auditor for review in the next audit cycle.<sup>11</sup>
- AEPSC in its next CSP and OPCo Compliance Status Reports correct the allocation of the 2010 solar obligations so that it is clear that should any future force majeure situations occur the accounting procedures are clear.<sup>12</sup>
- AEP Ohio should be required to explain fully the derivation of, and the purpose for, the "[REDACTED]," including what those costs are for and why these items are reasonable costs to be included in the FAC.<sup>13</sup>
- AEP Ohio needs to develop and implement a strategy to reduce the inventory at [REDACTED]. AEP Ohio should consider shifting some of the [REDACTED] coal supplies to other AEP Ohio plants, consignment of [REDACTED] coal to affiliate power plants, and/or the sale of some excess volumes to third parties.<sup>14</sup>

Each of the above management/financial recommendations must be verified in the next audit. While AEP Ohio asserts that it has since completed these recommendations, independent verification is still required.

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<sup>10</sup> Staff Exs. 1 and 1A at 1-6 (Management Audit Recommendation No. 19).

<sup>11</sup> *Id.* at 1-6 (Management Audit Recommendation No. 18).

<sup>12</sup> *Id.* at 1-6 (Management Audit Recommendation No. 20).

<sup>13</sup> Staff Exs. 2 and 2A at 1-10 (Financial Audit Recommendation No. 8).

<sup>14</sup> Staff Exs. 1 and 1A at 1-6 (Management Audit Recommendation No. 13).

## **B. Disputed Recommendations**

In its direct testimony filed in this case AEP Ohio contests a number of recommendations from the audit reports. Each disputed recommendation is addressed below.

- 1. AEP Ohio should be required to analyze the receipt of revenue and the payment of cash expenses for River Transportation Division (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 Working Capital component of the RTD investment base should be removed from the cost charged by RTD to OPCo from January 1, 2011 forward.<sup>15</sup>**

The auditors were not able to find a justification for the working capital requirement included in the charges made by the RTD for barging services. It is axiomatic that charges should be justified, that is the point of having the audit in the first place. Rather than providing this justification, it is anticipated that AEP Ohio will argue that this Commission is pre-empted and cannot examine the matter at all. This claim presents an interesting legal question which warrants some discussion.

When the contract between RTD and OPCo was written, the Public Utilities Holding Company Act (PUHCA) was still in force. Under PUHCA, once the Securities

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<sup>15</sup> Staff Exs. 1 and 1A at 1-10 (Financial Audit Recommendation No. 19); Staff Exs. 2 and 2A at 1-9 (Financial Audit Recommendation No. 4).

and Exchange Commission (SEC), the entity charged to implement PUHCA, had approved an affiliate agreement, other governmental entities, including, oddly, the Federal Energy Regulatory Commission (FERC), could not second guess charges made under that affiliate agreement. Were the PUHCA still in force it is clear that AEP Ohio would be correct and this Commission would not be able to examine the RTD contract. PUHCA has now been repealed. With this repeal, some of the functions formerly done by the SEC are now done by the FERC and some are not done at all.

It appears that the pre-emptive effect of the former PUHCA has been eliminated. The section of the act repealing the PUHCA concerning affiliate transactions, 42 U.S.C. 16455, provides:

**Affiliate transactions**

**(a) Commission authority unaffected**

Nothing in this part shall limit the authority of the Commission under the Federal Power Act (16 U.S.C. 791a et seq.) to require that jurisdictional rates are just and reasonable, including the ability to deny or approve the pass through of costs, the prevention of cross-subsidization, and the issuance of such rules and regulations as are necessary or appropriate for the protection of utility consumers.

**(b) Recovery of costs**

Nothing in this part shall preclude the Commission or a State commission from exercising its jurisdiction under otherwise applicable law to determine whether a public-utility company, public utility, or natural gas company may recover in rates any costs of an activity performed by an associate company, or any costs of goods or services acquired by such public-utility company from an associate company.<sup>16</sup>

Lest there be some doubt, in 42 U.S.C. 16457, Congress went on to provide:

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<sup>16</sup>

42 U.S.C. 16455.

### **Effect on other regulations**

Nothing in this part precludes the Commission or a State commission from exercising its jurisdiction under otherwise applicable law to protect utility customers.<sup>17</sup>

While there is a mechanism under which the FERC could become involved in this sort of contract in 42 U.S.C. 16462(b), that section could only come into play if the contract was submitted to the FERC by either the holding company or a state Commission and neither of these has happened.<sup>18</sup> Even if the contract had been submitted to the FERC under that section, 42 U.S.C. 16462(c) provides:

#### **(c) Effect on Federal and State law**

Nothing in this section shall affect the authority of the Commission or a State commission under other applicable law.<sup>19</sup>

It appears quite clear that the Congress intended that states should be able to carry out their function of protecting their citizens. That is what is recommended here. The company should be directed to justify its costs before customers should be required to pay them.

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<sup>17</sup> 42 U.S.C. 16457.

<sup>18</sup> This provision would be meaningless if the Congress had meant to continue the pre-emptive effect that the old PUHCA had.

<sup>19</sup> 42 U.S.C. 16462(c).

2. **AEP should address why an ROE [return on equity] that has been set in a FERC order or by a state commission (such as Indiana) for a utility would be appropriate for RTD, when RTD is functioning as a fully cost reimbursed operation with annual true-ups and with not competition serving captive affiliated clients, and, consequently, the level of risk to RTD and the related return required by investors would seem to be lower than for other utility operations.**<sup>20</sup>

This issue has been resolved by the Opinion and Order in 09-872-EL-FAC and 09-873-EL-FAC.<sup>21</sup>

3. **EVA [Energy Ventures Analysis] recommends that if the FAC does not continue that the next management/ performance audit determine if there should be any credit to the underrecovery due to [REDACTED].**<sup>22</sup>

This recommendation is no longer relevant as the FAC has continued.

4. **EVA recommends that any payments made to [REDACTED] through the remaining term of the FAC not be recoverable through the FAC.**<sup>23</sup>

While it is useful to identify potential issues at an early date, no recovery of any of these sorts of payments is sought in this case. The issue should be revisited when and,

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<sup>20</sup> Staff Exs. 1 and 1A at 1-10 (Financial Audit Recommendation No. 20)

<sup>21</sup> *In the Matter of the Fuel Adjustment Clauses of the Columbus Southern Power Company and Ohio Power Company*, Case Nos. 09-872-EL-FAC, *et al.* (Opinion and Order at 16-20) (Jan. 23, 2012).

<sup>22</sup> Staff Exs. 2 and 2A at 1-6 (Management Recommendation No. 2).

<sup>23</sup> *Id.* at 1-6 (Management Audit Recommendation No. 4).

given the relatively short period during which the FAC will remain in effect, if recovery of such payments is sought.

- 5. EVA recommends that AEPSC should revise its approach to coal contracting for AEP Ohio in order to reduce the likelihood of being over-contracted. The strategy should be available for review in the next audit cycle.<sup>24</sup>**

While it does not appear that AEP Ohio has revised any documentation, it does appear that coal inventories are approaching target levels.<sup>25</sup> These inventory levels should be examined and verified again by the next auditor.

- 6. EVA recommends that AEPSC improve its approach to determining the market values by which it makes procurement decisions. The revised approach should be available for review in the next audit cycle.<sup>26</sup>**

It appears that the company is using RFPs more frequently.<sup>27</sup> The sufficiency of these efforts should be reviewed by the next auditor.

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<sup>24</sup> Staff Exs. 1 and 1A at 1-6 (Management Audit Recommendation No. 14).

<sup>25</sup> Staff Exs. 2 and 2A at 1-10 (Financial Audit Recommendation No. 8).

<sup>26</sup> Staff Exs. 1 and 1A at 1-6 (Management Audit Recommendation No. 15).

<sup>27</sup> AEP Exs. 3 and 3A (Henry) at 4.

7. **EVA recommends that AEPSC expand upon its policies and procedures in its revised policy manual so that they provide true guidance and a yardstick against which to measure performance.<sup>28</sup> EVA recommends that the fuel procurement manual be revised to contain more specificity. Based upon AEPSC's 2011 performance, EVA specifically recommends that AEPSC develop policies with respect to the following: a. Procedures for addressing the [REDACTED]**
- b. The basic items that should be included in all [REDACTED] including firm indications of market price, market indexes that are representative of the products being purchased, and full disclosure to management as to the value of the transaction relative to market, c. The quality that should be used to evaluate coal bids from the [REDACTED] and d. The exceptions when AEPSC is not required to solicit bids for procurements. If the FAC continues, EVA recommends that the revisions be done in time for review by the next management/performance auditor.<sup>29</sup> EVA recommends that AEPSC insist upon compliance with coal quality specifications in its coal supply agreements. AEPSC should document these efforts for review in the next audit cycle.<sup>30</sup>**

The audit reports indicate continuing problems with the quality of the coal that AEP receives.<sup>31</sup> Staff finds AEP Ohio's refusal to develop a fuel procurement procedures manual to be beyond perplexing. While AEP Ohio witness Henry (at pages 6-7) indicates the company is guided by policies and guidelines, Staff believes it is imperative

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<sup>28</sup> Staff Exs. 1 and 1A at 1-6 (Management Audit Recommendation No. 16).

<sup>29</sup> Staff Exs. 2 and 2A at 1-6 (Management Audit Recommendation No. 3).

<sup>30</sup> Staff Exs. 1 and 1A at 1-6 (Management Audit Recommendation No. 17).

<sup>31</sup> Staff Exs. 2 and 2A at 3-15, 3-16, 3-19, 3-20, 3-22, 3-23, 3-24, 3-26, 3-30, 3-32, 3-37, 3-38, and 3-39.

that a more detailed procurement manual be instituted to guide fuel purchasing decisions. The “trust me” attitude implicit in AEP Ohio’s approach is beneficial for neither the ratepayers nor the company. AEP Ohio should be required to comply with EVA’s audit recommendations in this regard.

8. **EVA recommends that prior to any future negotiations with [REDACTED], AEPSC develop a coal procurement strategy that allows it to conduct a competitive solicitation [REDACTED] and that the results of that solicitation, if favorable, be used in the negotiation. EVA further recommends that any future justification memorandum contain the results of the solicitation combined with a fulsome disclosure and analysis of comparable indexes. Finally, as necessary, AEPSC should reach out to third parties to assist it in the development and implementation of [REDACTED] to improve the quality of the results as third parties may be more aware of [REDACTED]. If the FAC continues, EVA recommends that the strategy be provided to the next management/ performance auditor for review.<sup>32</sup>**

This recommendation is a more specific version of the concern in item 7 above. It highlights the need for a comprehensive procurement manual that results in a transparent, documented decision-making process. AEP Ohio should be directed to comply with Management Audit Recommendation No. 1.

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<sup>32</sup>

Staff Exs. 2 and 2A at 1-5 (Management Audit Recommendation No. 1).



9. **EVA recommends that AEPSC be directed to develop a strategy for addressing the [REDACTED] and that the strategy should consider a full range of options. If the situation has not been resolved in 2012 and the FAC continues, EVA recommends that the strategy be available for review by the next management/performance auditor.**<sup>33</sup>

Negotiations with [REDACTED] are ongoing. The next auditor should review AEP Ohio's activities in this negotiation.

10. **EVA recommends that any proceeds received from the [REDACTED] be applied to the FAC under-recovery.**<sup>34</sup>

The closure of the facility did not occur during the audit period. It is therefore premature to discuss the matter at this time. The next auditor should be directed to review the closure and make recommendations.

### **C. Capacity Issue**

During the course of the hearing it became apparent that there may be a double counting of a portion of capacity costs. The record reflects that the costs associated with two of the company's plants were used by the Commission in calculating the capacity charge that AEP Ohio is permitted to impose.<sup>35</sup> It also appears that these same two plants

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<sup>33</sup> Staff Exs. 2 and 2A at 1-6 (Management Audit Recommendation No. 6).

<sup>34</sup> *Id.* at 1-10 (Financial Audit Recommendation No. 12) and 1-6 (Management Audit Recommendation No. 5).

<sup>35</sup> Tr. I at 50.

were the source of purchased power, the cost of which flows through the FAC.<sup>36</sup> The purchased power cost includes capacity cost.<sup>37</sup> This situation creates a *possibility* that there is a double payment of capacity costs. As this Commission is all too aware however, the topic of capacity cost is highly complicated and the question requires close examination to reach a full understanding. The current auditor did not examine the question as it was not within its charge. The Commission should direct the next auditor to examine the collection of capacity charges to determine if there is a double collection and, if there is, to recommend a resolution.

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<sup>36</sup> Tr. II at 126.

<sup>37</sup> Tr. III at 160.

### III. CONCLUSION

The Staff requests that the Commission adopt the recommendations indicated above to assure an adequate review of the FAC mechanism.

Respectfully Submitted,

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## PROOF OF SERVICE

I hereby certify that a true copy of the foregoing **Initial Brief** 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 8th day of January, 2014.

/s/ Thomas W. McNamee

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Summary: Brief Initial Brief submitted by Assistant Attorney General Thomas McNamee.  
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