

**OCC EXHIBIT NO. \_\_\_\_\_**

**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of )  
Ohio Power Company for Authority to )  
Establish a Standard Service Offer ) Case No. 16-1852-EL-SSO  
Pursuant to R.C. 4928.143, in the Form of )  
an Electric Security Plan. )

In the Matter of the Application of Ohio )  
Power Company for Approval of Certain ) Case No. 16-1853-EL-AAM  
Accounting Authority. )

**DIRECT TESTIMONY  
OF  
DAVID J. EFFRON**

**On Behalf of**  
**The Office of the Ohio Consumers' Counsel**  
*10 West Broad Street, Suite 1800*  
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**May 2, 2017**

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*Direct Testimony of David J. Effron  
On Behalf of the Office of the Ohio Consumers' Counsel  
PUCO Case No 16-1852-EL-SSO, et al.*

1    **I.       INTRODUCTION**

2

3        **A.       QUALIFICATIONS**

4

5    ***Q1.    PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.***

6    ***A1.***    My name is David J. Effron. My address is 12 Pond Path, North Hampton, New  
7        Hampshire 03862.

8

9    ***Q2.    WHAT IS YOUR PRESENT OCCUPATION?***

10   ***A2.***    I am a consultant specializing in utility regulation.

11

12   ***Q3.    PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.***

13   ***A3.***    My professional career includes over 30 years as a regulatory consultant, two years  
14        as a supervisor of capital investment analysis and controls at Gulf & Western  
15        Industries and two years at Touche Ross & Co. as a consultant and staff auditor. I  
16        am a Certified Public Accountant and I have served as an instructor in the business  
17        program at Western Connecticut State College.

18

19   ***Q4.    WHAT EXPERIENCE DO YOU HAVE IN THE AREA OF UTILITY RATE***  
20        ***SETTING PROCEEDINGS AND OTHER UTILITY MATTERS?***

21   ***A4.***    I have analyzed numerous electric, gas, telephone, and water filings in different  
22        jurisdictions. Pursuant to those analyses, I have prepared testimony, assisted

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1 attorneys in case preparation, and provided assistance during settlement negotiations  
2 with various utility companies.

3  
4 I have testified in over three hundred cases before regulatory commissions in  
5 Alabama, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Kansas,  
6 Kentucky, Maine, Maryland, Massachusetts, Missouri, Nevada, New Jersey, New  
7 York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas,  
8 Vermont, Virginia, and Washington.

9

10 ***Q5. PLEASE DESCRIBE YOUR OTHER WORK EXPERIENCE.***

11 ***A5.*** As a supervisor of capital investment analysis at Gulf & Western Industries, I was  
12 responsible for reports and analyses concerning capital spending programs,  
13 including project analysis, formulation of capital budgets, establishment of  
14 accounting procedures, monitoring capital spending, and administration of the  
15 leasing program. At Touche Ross & Co., I was an associate consultant in  
16 management services for one year, and a staff auditor for one year.

17

18 ***Q6. HAVE YOU EARNED ANY DISTINCTIONS AS A CERTIFIED PUBLIC***  
19 ***ACCOUNTANT?***

20 ***A6.*** Yes. I received the Gold Charles Waldo Haskins Memorial Award for the highest  
21 scores in the May 1974 certified public accounting examination in New York State.

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1   ***Q7. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.***

2   ***A7.*** I have a Bachelor's degree in Economics (with distinction) from Dartmouth  
3 College and a Master of Business Administration Degree from Columbia  
4 University.

5

6   **B. PURPOSE OF TESTIMONY**

7

8   ***Q8. ON WHOSE BEHALF ARE YOU TESTIFYING?***

9   ***A8.*** I am testifying on behalf of the Office of the Ohio Consumers' Counsel ("OCC").

10

11   ***Q9. WHAT IS THE PURPOSE OF YOUR TESTIMONY?***

12   ***A9.*** On November 23, 2016, The Ohio Power Company d/b/a AEP Ohio ("AEP Ohio"  
13 or "the Utility") filed an application with the Public Utilities Commission of Ohio  
14 ("PUCO") to amend its electric security plan ("ESP"). As part of this application,  
15 AEP Ohio is seeking to extend and modify its Distribution Investment Rider  
16 ("DIR"). In this testimony, I address the Utility's proposed DIR caps during the  
17 term of the ESP and the proposal to include the effect of the expiration of the  
18 theoretical reserve amortization approved in Case No. 11-351-EL-AIR in the DIR  
19 revenue requirement.

**Q10. SHOULD YOUR TESTIMONY ON THE UTILITY'S PROPOSALS  
REGARDING ITS DIR BE INTERPRETED TO MEAN THAT YOU AGREE  
THAT APPROVAL OF THE DIR EXTENSION WOULD BE APPROPRIATE?**

**A10.** No. Riders allow regulated utilities to recover designated costs from customers outside of the context of traditional base rate cases, where all elements of the cost of service are examined. As a general matter, riders entailing the automatic collection of certain utility costs are contrary to sound ratemaking policy. As such, these mechanisms tend to either reduce or eliminate incentives to control costs, or can potentially result in incentives that have the perverse effect of encouraging uneconomic choices by the utilities. In addition, to the extent that costs covered by riders result in efficiencies or offsetting cost reductions, customers may end up paying for the cost increases without seeing the benefits of the related savings.

To the extent that such riders are approved, they should be limited to costs that are large, volatile, and outside of the utility's control. Examples of such costs could be purchased gas costs for a gas distribution utility or purchased power supply costs for an electric distribution utility.

AEP Ohio has presented no evidence that the costs that it is seeking to collect through its proposed riders meet these criteria or that its financial integrity would be somehow compromised if those costs could be collected only through a traditional base rate case where the costs would be subject to closer scrutiny and appropriate incentives to control costs.

**II. DISTRIBUTION INVESTMENT RIDER**

**A. PROPOSED CAPS**

***Q11. PLEASE DESCRIBE THE UTILITY'S PROPOSED ANNUAL RATE CAPS  
ON THE DIR FOR THE TERM OF THE ESP.***

***A11.*** The Utility is proposing a revenue cap of \$136 million for the last seven months of 2018, \$312 million in 2019, \$343 million in 2020, \$373 million in 2021, \$401 million in 2022, \$427 million in 2023, and \$185 million for the first five months of 2024. These revenue caps include the effect of the effect of the expiration of the theoretical reserve amortization (as addressed later in this testimony) and reflect the Utility's proposed indexed return on equity ("ROE") mechanism. (Without the indexed ROE mechanism, the proposed caps would be \$130 million for the last seven months of 2018, \$300 million in 2019, \$329 million in 2020, \$357 million in 2021, \$384 million in 2022, \$408 million in 2023, and \$178 million for the first five months of 2024.)

***Q12. ARE THESE CAPS APPROPRIATE?***

***A12.*** No. First, as I explain below, the effect of the theoretical reserve amortization should not be included in the DIR revenue requirement. Second, the PUCO has found annual growth of three to four percent of customer base distribution charges "to be a reasonable level to allow AEP Ohio to continue to replace aging distribution infrastructure in order to maintain and improve service reliability over

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1 the term of this ESP.”<sup>1</sup> This finding was consistent with the caps permitted for the  
2 DIR in AEP Ohio’s ESP 2 case, and was reaffirmed by the PUCO in its Fourth  
3 Entry on Rehearing in Case No. 13-2385-EL-SSO.<sup>2</sup> AEP Ohio has presented no  
4 evidence that this standard is unreasonable or no longer applicable. Therefore, the  
5 DIR caps in the present case should continue to reflect annual growth of three to  
6 four percent of customer base distribution charges.

7  
8 ***Q13. WHAT DO YOU RECOMMEND?***

9 ***A13.*** If the PUCO approves continuation of the DIR, then the caps proposed by the  
10 Utility should be modified. In its Fourth Entry on Rehearing in Case No. 13-2385-  
11 EL-SSO, the PUCO established a DIR cap of \$89.6 million for January through  
12 March of 2018.<sup>3</sup> This translates into an annualized cap of \$215 million. I  
13 recommend that this cap be maintained for the remainder of 2018, which results in  
14 a cap of \$125.4 million for the months April through December of 2018.  
15 Consistent with an annual level of growth of three to four percent of base  
16 distribution charges, I recommend that the DIR caps be established at \$240 million  
17 in 2019, \$265 million in 2020, \$290 million in 2021, \$315 million in 2022, \$340  
18 million in 2023, and \$152.1 million for the first five months of 2024.

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<sup>1</sup> Case No. 13-2385, et al., Opinion and Order, February 25, 2015, at 47.

<sup>2</sup> Case No. 13-2385, et al., Fourth Entry on Rehearing, November 3, 2016, at 51.

<sup>3</sup> *Id.*



1           **B.       THEORETICAL RESERVE AMORTIZATION**

2

3    ***Q14.   PLEASE EXPLAIN WHAT THE THEORETICAL RESERVE***  
4           ***AMORTIZATION THAT THE UTILITY IS SEEKING TO INCLUDE IN THE***  
5           ***DIR REVENUE REQUIREMENT REPRESENTS.***

6    ***A14.*** In Case Nos. 11-351-EL-AIR and 11-352-EL-AIR, the Utility's book reserve for  
7           accumulated depreciation was deemed to be in excess of the theoretical reserve.  
8           As part of the Settlement in that case, the parties agreed to the amortization of the  
9           excess of the book reserve over the theoretical reserve over seven years. The  
10          amortization of the excess book depreciation reserve over seven years resulted in  
11          an annual reduction of \$38,746,032 to depreciation expense (including the  
12          amortization of the excess reserve on general plant). The amortization commenced  
13          January 1, 2012 and will be complete December 31, 2018. AEP Ohio is seeking to  
14          increase the computation of the DIR revenue requirement by \$38,746,032 to offset  
15          the increase to depreciation expense that will result from the completion of the  
16          amortization of the excess book reserve. It should be noted that what the Utility is  
17          proposing is not just an increase in the DIR cap, but an increase in the actual DIR  
18          revenue requirement that will be collected from customers.

1   ***Q15. SHOULD THE DIR REVENUE REQUIREMENT BE INCREASED TO***  
2                   ***REFLECT THE EXPIRATION OF THE AMORTIZATION OF THE EXCESS***  
3                   ***BOOK RESERVE?***

4   ***A15.*** No. The stated purpose of the DIR is “to provide capital funding, including  
5           carrying cost on incremental distribution infrastructure to support customer  
6           demand and advanced technologies.”<sup>4</sup> The amortization of the excess book  
7           reserve bears absolutely no relationship whatsoever to “incremental distribution  
8           infrastructure.” Nor does the expiration of the amortization have anything to do  
9           with costs incurred for distribution infrastructure modernization. The excess of the  
10          book reserve over the theoretical reserve in Case Nos. 11-351-EL-AIR and 11-  
11          352-EL-AIR was based on the balances of distribution and general plant as of  
12          December 31, 2009. Incremental additions to plant for distribution infrastructure  
13          modernization (or for any other purpose) subsequent to that date are totally  
14          unrelated to the excess depreciation reserve or to the amortization of the excess  
15          reserve.

16  
17          The \$38.7 million amortization of the excess depreciation reserve is certainly not  
18          immaterial, and there is no dispute that it will result in an increase in the  
19          depreciation expense recorded by the Utility when that amortization expires.  
20          However, AEP Ohio has not even asserted, much less provided any actual  
21          evidence, that it will be experiencing a revenue deficiency in its distribution  
22          operations when the amortization of the excess depreciation reserve expires. If

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<sup>4</sup> Case No. 11-346, et al., Opinion and Order, August 8, 2012, at 42.

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1 AEP Ohio believes that it will be experiencing a revenue deficiency in 2019, then  
2 the proper method to address that revenue deficiency is to file an application to  
3 increase base distribution rates, not to automatically increase the DIR revenues  
4 recovered from customers by \$38.7 million without regard to whether the Utility  
5 actually has a revenue deficiency.

6

7 ***Q16. WHAT DO YOU RECOMMEND?***

8 ***A16.*** The Utility's proposal to modify the DIR to include an additional \$38,746,032  
9 beginning January of 2019 should not be approved. The calculation of the DIR  
10 revenue requirement should not be modified to incorporate the increase in  
11 depreciation expense resulting from the expiration of the excess book depreciation  
12 reserve approved in Case Nos. 11-351-EL-AIR and 11-352-EL-AIR.

13

14 **III. CONCLUSION**

15

16 ***Q17. PLEASE SUMMARIZE YOUR TESTIMONY.***

17 ***A17.*** If the PUCO approves the continuation of the DIR, then the DIR caps should be  
18 established at no more than \$125.4 million for the months April through December  
19 of 2018, \$240 million in 2019, \$265 million in 2020, \$290 million in 2021, \$315  
20 million in 2022, \$340 million in 2023, and \$152.1 million for the first five months  
21 of 2024.

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1       The DIR should not be modified to include an additional \$38,746,032 beginning  
2       January of 2019 to accommodate the expiration of the excess book depreciation  
3       reserve approved in Case Nos. 11-351-EL-AIR and 11-352-EL-AIR.

4

5       ***Q18. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?***

6       ***A18.*** Yes. However, I reserve the right to incorporate new information that may  
7       subsequently become available.

## **CERTIFICATE OF SERVICE**

I hereby certify that a true copy of the foregoing *Direct Testimony of David J. Effron on Behalf of the Office of the Ohio Consumers' Counsel* was served via electronic transmission to the persons listed below on this 2<sup>nd</sup> day of May 2017.

/s/ William J. Michael

William J. Michael  
Assistant Consumers' Counsel

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