BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the 2011 Through 2016 Review of the Energy Efficiency and Peak Demand Reduction Rider Contained in Tariffs of Ohio Power Company.	))))	**Case No. 17-30-EL-RDR**

INITIAL COMMENTS OF OHIO POWER COMPANY
IN RESPONSE TO APRIL 13, 2018 AUDIT REPORT

Pursuant to the Attorney Examiner's August 16, 2018 Entry, Ohio Power Company ("AEP Ohio" or the "Company") hereby files the following initial comments regarding the audit report that Larkin & Associates LLC ("Larkin") filed on April 13, 2018 regarding the operation of the Company's Energy Efficiency/Peak Demand Reduction (EE/PDR) Rider during the period 2011 through 2016.[1]

I. Response to Financial Audit Recommendations.

A. Financial Audit Recommendation One

In its first financial audit recommendation, Larkin recommends that the Company "develop additional procedures to track costs, including labor costs of employees whose costs had been included for recover in electric distribution rates, and who were transferred subsequent to the rate case test year to provide service related to the EE/PDR programs." (Audit Report at 1-77.)

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[1] The Public Utilities Commission of Ohio ("Commission") first approved the Company's EE/PDR Rider in AEP Ohio's first electric security plan (ESP) proceeding, Case Nos. 08-917-EL-SSO, *et al.* It has approved the rider's continuation in each of the Company's subsequent ESP proceedings in Case Nos. 11-346-EL-SSO, *et al.*, 13-2385-EL-SSO, *et al.*, and 16-1852-EL-SSO, *et al* . ("*ESP IV*").

The Auditor's first recommendation is not sound regulatory practice, and the Commission should not adopt it. An electric distribution utility sets its base distribution rates based on total costs for a test year. It is inappropriate to pick and choose one particular line item that is a part of a much larger cost pool and state that it should be separately tracked because there is a risk that the Company could over collect. The auditor's first recommendation disregards the Company's total costs incurred during any given year. In addition, there is a risk that the Company's costs could be higher or lower in any given year after the test year. This should be an equal risk.

If the Commission wishes to track labor, the total labor dollars should be used. But any such exercise is better handled in a base distribution case. In short, this recommendation constitutes single-issue rate making. It is irrelevant how employees' time was treated in the base rate case if you are only looking at employees' association with the EE/PDR function and not total labor in comparison with total operation and maintenance expense. In addition, the auditor did not find there was double recovery.

The labor charged to the EE/PDR rider was prudent and appropriate. As shown in the auditor's report, employees' time was charged to the rider only when working on activities as they relate to the EE/PDR programs. The standard for reviewing these costs in this audit should be prudency, not comparing employee counts or labor costs to where they were during the Company's last base rate case.

B. Financial Audit Recommendations Two, Seven, Eleven, Fifteen, and Eighteen

In its second, seventh, eleventh, fifteenth, and eighteenth financial audit recommendations, Larkin recommends that the incentive compensation and related labor fringes included in the EE/PDR programs be reduced by certain amounts which reflect the percentage of the incentive compensation payout that was tied to AEP Ohio's ROE goal. (Audit Report at 1-77, 1-78.) The auditor states that its reasoning for this recommendation is due to the portion of incentive compensation that relates to the Company achieving its financial goals should be borne by the Company's shareholders and not ratepayers. These audit recommendations all relate to total employee compensation.

The Company disagrees with any reduction to the compensation package of the EE/PDR employees. The total compensation that EE/PDR employees receive is consistent with market rates. The fact that a portion of that total compensation is related to financial goals is not a sound reason to preclude recovery of those expenses. The Company's compensation plan is a competitive compensation package and not based solely or primarily on benefitting shareholders for those measures that are tied to financial performance. This recommendation should be rejected.

Currently, the utility industry is going through a major change in employee make up and it is even more important now that the pay package remains competitive. The replacement of skilled front line employees is crucial. However, the replacement of the aging workforce for back office support is also at risk. The learning curve for certain aspects of the utility business is steep, and it is crucial that the Company remain competitive enough to attract the talent needed to provide the best level of service for our customers now as well as assuring that we have the experienced skill sets to continue to provide these benefits well into the future. Removing the ability of the Company to fully recover its reasonable and prudent compensation package further handicaps its ability to attract necessary talent.

The Commission has issued its Power Forward Initiative that discusses performance-based ratemaking. That development is another indication of how the utility world has been moving. The traditional labor, operations, etc. have evolved and the policies of this Commission should evolve as well. The current compensation package is similar to performance based ratemaking. It provides incentive for performance regardless if the goals are physical or financial. The incentive compensation better known to the Company as short term pay, is discretionary and is used to "reward the doers". It is incentive based in that those employees that are performing at levels that reach the goals of the Company are necessary to the function of the Company and as such it becomes even more critical that the pay allows for the retention and attraction of *high performing* employees.

In addition, financial incentives are not to the benefit of only the shareholders. These types of incentives ensure that each employee has cost reduction, eliminating waste whether it be in work or dollars, and spending discipline. Those traits are a clear benefit to customers. To state that goals related to the ROE should be borne by shareholders also ignores benefits the ratepayers receive from the Company reaching its ROE and financial goals. For example, in *ESP IV*, the Company agreed to reduce the cost of debt in the capital structure based on the retirement of old bonds and issuance of new bonds. The Company was able to secure the new bonds at a lower rate. The Company had just been upgraded to A2 status in June 2017. The credit rating of the Company brings benefits through lower debt values and for an extremely capital intensive utility, these are direct benefits to customers. To use the argument that the incentive related to ROE should be borne by shareholders ignores the fact that strong financial performance by the utility benefits all, not just shareholders, and is one metric viewed by credit rating agencies.

Such considerations are components of the reasonable market competitive compensation provided to AEP employees that benefits customers by enabling the Company to attract, retain, and motivate the employees needed to efficiently and effectively provide electric service to its customers. AEP frequently compares its compensation plans to other utilities and similar companies in order to maintain market competitiveness as an employer. The particular cost components are included for short term incentive compensation plans as well as long-term incentive compensation plans that allow employees at certain levels restricted stock and stock based compensation. The market based compensation includes base salary plus short term incentive for the total cash compensation. Additional compensation packages include base salary plus short term incentive for the total cash compensation and long-term incentive for the total compensation. This recommendation fosters bad public policy and is not just and reasonable ratemaking; the best interests of customers are not served by disallowing recovery of prudent utility labor costs that are needed to provide adequate, reliable service.

C. Financial Audit Recommendations Three, Four, Eight, Twelve, Sixteen, Nineteen, and Twenty-Two

In its third, fourth, eighth, twelfth, sixteenth, nineteenth, and twenty-second financial audit recommendations, Larkin recommends that stock based compensation and retirement compensation be removed from EE/PDR program costs. (Audit Report at 1-77, 1-78, 1-79.)

The Company disagrees with these recommendations for the reasons stated above with respect to incentive compensation. The Company's competitive compensation structure is reasonable, prudent, and in line with the market. Beyond the need to remain competitive to retain and attract talent, this recommendation is skewed far beyond any recommendations from the Staff report in the Company's last base distribution case, which was the basis of the Auditor's recommendations (*see* Audit Report page 1-13). However, the recommendation to remove any compensation at 100% of the value goes far beyond the scope of even the Staff report in the base distribution case and is unreasonable on its face. The Commission should reject these recommendations as there are additional benefits to customers when it comes to the level of talent employed by AEP Ohio as well as additional benefits that are realized when the Company has strong performance records as mentioned above.

D. Financial Audit Recommendations Five, Nine, Thirteen, and Twenty-Five

In its fifth, ninth, thirteenth, and twenty-fifth financial audit recommendations, Larkin recommends that certain gift card purchases should be removed from EE/PDR program costs. (Audit Report at 1-77, 1-78, 1-79.) The Company disagrees with this recommendation. As stated in the data response summarized in the audit report (at page 6-15), gift cards were used to attract customers to the Company's booth at conferences, trade shows and seminars in order to increase the knowledge and education of the energy efficiency programs. The AEP Ohio team has been tremendously successful in the number of kilowatt hour savings it has brought our customer base. The small cost of a gift card is a reasonable expense and trade off in order to expand customer education of energy efficiency programs. The draw to booths is not different than advertising on the radio or television if it peaks additional interest in the program. The cost of the gift cards has the potential to bring additional value to the entire customer base if greater awareness translates into greater participation. Overall, to use non-traditional marketing tools in order to improve education and participation at a cost of approximately $1,300 per year is a reasonable expense that would provide tremendous benefits if additional participation is gained. This is a creative way to benefit customers through incentives, not unlike the Commission's most recent nod to incentive-based rate making.

E. Financial Audit Recommendations Six, Ten, and Fourteen

In these recommendations, the Auditor recommends the removal of certain outing costs. The Company disagrees with the auditor's recommendation. These types of events and outings are meant to recognize outstanding performance and are not lavish, elaborate or unreasonable.

F. Financial Audit Recommendation Twenty-Three

The auditor recommended that the Company make an adjustment to remove labor and overheads associated with time charged to the rider for non-EE employees. (Audit Report at 1-79.) The Company discovered this inadvertent error during the audit and expressed the need for an adjustment through discovery and has adjusted the amount out of the EE/PDR rider. No further action is required.

G. Financial Audit Recommendation Twenty-Four

The Company agrees that the labor costs identified in the Auditor's financial recommendation twenty-four should be adjusted out of labor and that they are otherwise still an includable cost for recovery in the EE/PDR rider. (*See* Audit Report at 1-79.)

II. Response to Management Audit Recommendations

A. Management Audit Recommendation One

The Company does not object to management audit recommendation number one, which recommends that AEP Ohio provide ex-ante and ex-post evaluation, measurement, and verification savings in a summary table in the Portfolio Status Report for ease of reference and to promote transparency in the future. (Audit Report at 1-85.) The Company has complied with this request for future years. In 2017, AEP Ohio met with other state investor-owned utilities and completed a standardized reporting template requested by the Commission. The template has ex ante and ex post for every program in a summary table. This document, Appendix Q, is filed each year in the Company's annual portfolio status report.

B. Management Audit Recommendation Two

In its second management audit recommendation, the Auditor recommends a more thorough investigation as to why program lives change over time (e.g., a change in the measure mix that comprises the program), and the source of the data that is used to determine program life may be useful data to gather in the next independent EM&V report. (Audit Report at 1-86.)

AEP Ohio uses the Ohio Technical Reference Manual (TRM) for the inputs for Estimated Useful Life (EUL). In Case 09-0512-GE-UNC , the Commission explained:

> *In* finding that the TRM will offer a **safe harbor** with respect to the EEDR requirements of SB 221, we believe that the TRM will prove a valuable resource in determining compliance, and will fulfill the Commission's intent that the TRM should provide predictability and consistency for the benefit of the electric utilities, gas utilities, customers, and the Commission.

(Emphasis added.) Case No. 09-512-GE-UNC, Entry on Rehearing at 12 (July 31, 2013).

The Ohio TRM has established a safe harbor. It is the Company's view that this document should be updated on a regular basis to incorporate this new information. This would allow for consistent use of the most current and accurate information.

C. Management Audit Recommendation Three

The Company does not object to the Auditor's third management audit recommendation, which suggests that the PUCO investigate the impact of the federal lighting standard on all of AEP Ohio's EE/PDR programs and shared savings calculations in the next independent EM&V report. (Audit Report at 1-86.) AEP Ohio has complied with the federal lighting standards for Phase I, by using the Ohio TRM. There is substantial ambiguity for the dates of implementation of EISA Phase II. If there is found to be any changes, company recommends the Ohio TRM be the source of all updates to savings calculation information for the reasons quoted in the Company's response to management audit recommendation two.

D. Management Audit Recommendation Four

In its fourth management audit recommendation, the Auditor recommends that Staff create a consistent data reporting template that AEP Ohio can use for all EE/PDR program cost reporting to the Commission. As indicated in response to management audit recommendation one, the Company has complied with this recommendation for future years.

CONCLUSION

Consistent with the above explanation, AEP Ohio urges the Commission to reject and accept Larkin's recommendations to the extent set forth in these comments.

Respectfully submitted,

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CERTIFICATE OF SERVICE

In accordance with Rule 4901-1-05, Ohio Administrative Code, the PUCO's e-filing system will electronically serve notice of the filing of this document upon the following parties. In addition, I hereby certify that a service copy of the foregoing was sent by, or on behalf of, the undersigned counsel to the following individuals this 19th day of October, 2018, via electronic transmission.

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