***OCC EXHIBIT \_\_\_\_\_\_***

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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| In the Matter of the Application ofOhio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Ohio Rev. Code, in the Form of an Electric Security Plan. | )))))) | Case No. 13-2385-EL-SSO |

|  |  |  |
| --- | --- | --- |
| In the Matter of the Application ofOhio Power Company for Approval of Certain Accounting Authority. | ))) | Case No. 13-2386-EL-AAM |

DIRECT TESTIMONY

OF

JONATHAN WALLACH

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

**MAY 6, 2014**

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**ATTACHMENTS:**

Attachment Wallach-1

Attachment Wallach-2

# Introduction

***Q1. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.***

***A1.*** I am Jonathan F. Wallach. I am Vice President of Resource Insight, Inc., 5 Water Street, Arlington, Massachusetts.

***Q2. PLEASE SUMMARIZE YOUR PROFESSIONAL EDUCATION AND EXPERIENCE.***

***A2.*** I have worked as a consultant to the electric-power industry since 1981. From 1981 to 1986, I was a research associate at Energy Systems Research Group. In 1987 and 1988, I was an independent consultant. From 1989 to 1990, I was a senior analyst at Komanoff Energy Associates. I have been in my current position at Resource Insight since September of 1990.

Over the past thirty years, I have advised and testified on behalf of clients on a wide range of economic, planning, and policy issues relating to the regulation of electric utilities, including: electric-utility restructuring; wholesale-power market design and operations; transmission pricing and policy; market-price forecasting; market valuation of generating assets and purchase contracts; power-procurement strategies; risk assessment and mitigation; integrated resource planning; mergers and acquisitions; cost allocation and rate design; and energy-efficiency program design and planning. My resume is attached as Attachment Wallach-1.

***Q3. HAVE YOU TESTIFIED PREVIOUSLY IN UTILITY REGULATORY PROCEDINGS?***

***A3.*** Yes. I have sponsored expert testimony in more than sixty state, provincial, or federal proceedings in the U.S. and Canada, including in PUCO Case Nos. 09-906-EL-SSO, 10-338-EL-SSO, and 11-346-EL-SSO. Attachment WALLACH-1 includes a detailed list of my previous testimony.

***Q4. ON WHOSE BEHALF ARE YOU TESTIFYING?***

***A4.*** I am testifying on behalf of the Office of the Ohio Consumers’ Counsel (“OCC”).

***Q5. WHAT IS THE PURPOSE OF YOUR TESTIMONY?***

***A5.*** On December 20, 2013, Ohio Power Company (“AEP Ohio” or “the Utility”) filed an application and supporting testimony seeking approval of its proposal for an electric security plan that would be in effect from June of 2015 through May of 2018 (“ESP III”). As part of the proposed ESP III, AEP Ohio proposes continuation of a number of existing distribution rate riders and implementation of several new riders. This testimony addresses AEP Ohio’s proposals for allocating to customer classes the costs to be collected through four proposed riders: (1) Distribution Investment Rider (“DIR”); (2) Enhanced Service Reliability Rider (“ESRR”); (3) Storm Damage Recovery Rider (“SDRR”); and (4) Sustained and Skilled Workforce Rider (“SSWR”).

***Q6. DOES YOUR TESTIMONY ADDRESS WHETHER AEP OHIO’S PROPOSAL TO COLLECT COSTS FROM CUSTOMERS THROUGH THESE FOUR RIDERS, RATHER THAN THROUGH BASE DISTRIBUTION RATES, IS REASONABLE OR WHETHER THE AMOUNTS TO BE COLLECTED THROUGH THESE RIDERS IS APPROPRIATE?***

***A6.*** No. Other OCC witnesses provide testimony on those issues.

# The Cost-Allocation Process

Q7. What is the role of the cost-allocation process in the setting of rates for distribution service?

***A7.*** In general, distribution rates are designed to collect a utility’s total cost of service from all customer classes in a manner that reasonably reflects the actual cost to provide distribution service to each customer class. The cost-allocation process can facilitate rate design by apportioning a utility’s total cost of service among customer classes based on “cost causation,” i.e., how the cost to provide service to each customer class contributed to the total cost of service.

Q8. Please describe the typical process for allocating a utility’s cost of service to customer classes.

***A8.*** Cost of service is typically allocated on the basis of the results of a class cost of service study (“COSS”). The COSS allocates the total cost of service to customer classes in three stages: (1) functionalization; (2) classification; and (3) allocation. First, the total cost of service is separated into either generation, transmission, or distribution categories. Second, functionalized costs are classified as either demand-related, energy-related, or customer-related depending on whether such costs vary with changes in demand, energy, or number of customers, respectively. Finally, demand-, energy-, or customer-related costs are allocated to customer classes on the basis of each class’s contribution to a utility’s total demand, energy requirements, or number of customers, respectively.

Q9. Has AEP Ohio relied on class cost of service studies to allocate distribution costs of service in the past?

***A9.*** Yes. The Utility most recently relied on cost of service studies to allocate base distribution costs in PUCO Case Nos. 11-351-EL-AIR and 11-352-EL-AIR.[[1]](#footnote-1)

# Proposed Allocation of Distribution Rider Costs

Q10. What types of costs does AEP Ohio propose to collect from customers through the DISTRIBUTION INVESTMENT RIDER, Enhanced Service Reliability Rider, Storm Damage Recovery Rider, and the Sustained and Skilled Workforce Rider?

***A10.*** According to AEP Ohio witness Andrea E. Moore, the Utility proposes to collect from customers through the DIR the revenue requirements associated with capital investments in distribution and general plant over and above those revenue requirements already collected through base distribution rates. The Utility further proposes to cap the annual amount of revenue requirements collected through the DIR.[[2]](#footnote-2)

According to AEP Ohio witness Selwyn J. Dias, the Utility proposes to collect through the ESRR the revenue requirements associated with capital investments and O&M spending for AEP Ohio’s vegetation management program. Mr. Dias also indicates that the SDRR is designed to collect all Operation and Maintenance (“O&M”) expenditures associated with major storm events above a $5 million baseline. Finally, according to Mr. Dias, the SSWR is designed to collect incremental O&M labor costs associated with the hiring of new employees.

Q11. How does AEP Ohio propose to allocate the costs collected through these four distribution rate riders?

***A11.*** The Utility proposes to allocate these costs to customer classes on the basis of each class’s contribution to total base distribution revenues.[[3]](#footnote-3) Specifically, for each of these four riders, AEP Ohio proposes to calculate the percentage ratio of costs to be collected through the rider to total base distribution revenues. This percentage ratio will then be applied uniformly to each class’s base distribution revenues to derive the share of the total rider cost to be collected from each class. By applying this percentage ratio uniformly, the Utility’s proposed approach would allocate total costs collected through each rider to customer classes in proportion to each class’s contribution to total base distribution revenues.

Q12. Is AEP Ohio’s proposal for allocating the costs collected FROM CUSTOMERS through these four riders consistent with the way such types of costs are allocated in the Utility’s most-recent cost of service study?

***A12.*** No. As AEP Ohio acknowledges, its proposal for allocating costs collected through these four riders in the ESP III is inconsistent with the approach used to allocate the same types of costs currently collected through base distribution rates.[[4]](#footnote-4) For example, the Utility proposes to allocate net plant costs associated with plant investments collected through the DIR in proportion to each customer class’s contribution to total base distribution revenues. In contrast, in AEP Ohio’s most-recent cost of service studies, net plant costs associated with plant investments collected through base distribution rates were allocated generally in proportion to each customer class’s contribution to distribution-system peak demand. In other words, AEP Ohio’s proposal would allocate costs collected through these four riders inconsistently with the way these costs would be allocated if they were instead collected through base distribution rates.

***Q13. IS THE UTILITY’S COST-ALLOCATION PROPOSAL FOR THE DISTRIBUTION INVESTMENT RIDER, ENHANCED SERVICE RELIABILITY RIDER, STORM DAMAGE RECOVERY RIDER, AND THE SUSTAINED AND SKILLED WORKFORCE RIDER REASONABLE?***

***A13.*** No. The Utility’s proposal would allocate rider costs inconsistently with the way these same costs would be allocated if they were instead collected through base distribution rates. As such, AEP Ohio’s proposal would allocate rider costs to customer classes disproportionately with each class’s responsibility for those rider costs and thus inconsistently with the cost-causation principles embodied in the Utility’s most-recent cost of service studies.

AEP Ohio has not reasonably justified allocating the costs collected through these four riders disproportionately with each class’s responsibility for such costs. Instead, the Utility supports its proposal by noting that the proposed allocation of rider costs in proportion to distribution revenues “is consistent with the *overall* cost of each customer to support the distribution function of the Company.”[[5]](#footnote-5) AEP Ohio’s logic in this regard is circular, because the *overall* allocation of base distribution costs in total is simply the sum of a number of *specific* allocations of different cost accounts, such as net plant costs or O&M expenses. Thus, for example, the allocation of net plant costs collected through DIR under the Utility’s proposal might be consistent with the overall allocation of base distribution costs in total. However, the allocation of DIR net plant costs under the Utility’s proposal would not be consistent with the allocation of net plant costs that underlies the overall allocation of base distribution costs in total.

Q14. How should the costs collected through the DISTRIBUTION INVESTMENT RIDER, Enhanced Service Reliability Rider, Storm Damage Recovery Rider, and the Sustained and Skilled Workforce Rider be allocated to customer classes?

***A14.*** As with costs collected through base distribution rates, the costs collected through these four riders should be allocated to customer classes in a manner that reflects cost causation. I therefore recommend that the net plant, O&M, or labor costs collected through the DIR, ESRR, SDRR, and SSWR be allocated to customer classes in proportion to the allocation of net plant, O&M, or labor costs in the cost of service studies filed in Case Nos. 11-351-EL-AIR and 11-352-EL-AIR. Specifically, I recommend that:

* DIR costs be allocated in proportion to the allocation of net electric plant in service.
* ESRR capital costs be allocated in proportion to the allocation of net electric plant in service.
* ESRR O&M costs be allocated in proportion to the allocation of distribution O&M expenses.[[6]](#footnote-6)
* SDRR costs be allocated in proportion to the allocation of distribution O&M expenses.
* SSWR costs be allocated in proportion to the allocation of distribution O&M labor expenses.

***Q15. HAVE YOU ESTIMATED THE ALLOCATORS THAT SHOULD BE APPLIED TO COSTS COLLECTED THROUGH THE DISTRIBUTION INVESTMENT RIDER, ENHANCED SERVICE RELIABILITY RIDER, STORM DAMAGE RECOVERY RIDER, AND THE SUSTAINED AND SKILLED WORKFORCE RIDER?***

***A15.*** Yes. In accordance with my recommended approach, I have estimated the percentage allocators associated with the allocation of net electric plant in service, distribution O&M expenses, and O&M labor costs in AEP Ohio’s most-recent cost of service studies. Each allocator represents the average cost allocation across the cost of service studies for Ohio Power Company (“OP”) and Columbus Southern Power Company (“CSP”). For example, the percentage allocator for the residential class for net electric plant in service is derived as the ratio of: (1) the sum of OP and CSP allocated residential net electric plant in service; and (2) the sum of OP and CSP total retail net electric plant in service. I provide my estimated allocators in Table 1.[[7]](#footnote-7)

**Table 1. Customer Class Allocators**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Net Plant** | **O&M** | **Labor** |
| RS | 58.52% | 55.57% | 55.71% |
| GS-1 | 3.04% | 2.65% | 2.64% |
| GS-2 | 13.44% | 14.30% | 13.81% |
| GS-3 | 21.10% | 22.86% | 23.29% |
| GS-4 | 0.40% | 0.44% | 0.41% |
| EHG/EHS/SS | 0.21% | 0.23% | 0.21% |
| Lighting | 3.28% | 3.95% | 3.93% |
| **Total Retail** | **100.00%** | **100.00%** | **100.00%** |

Q16. Have you estimated the impact of your recommended approach for allocating the costs collected through the DISTRIBUTION INVESTMENT RIDER, Enhanced Service Reliability Rider, Storm Damage Recovery Rider, and the Sustained and Skilled Workforce Rider?

***A16.*** I have estimated the impact of my recommended approach for the DIR, ESRR, and SSWR, but not the SDRR, because AEP Ohio has not forecast SDRR costs.

In Attachment Wallach-2, I show for each year of the proposed ESP III the allocation to customer class of DIR, ESRR, and SSWR costs under both AEP Ohio’s proposed approach and my recommended approach. As indicated in Attachment Wallach-2, the Utility’s proposed approach would allocate to the residential class between $8.7 million and $10.8 million more per year than would be the case under my recommended approach. In other words, over the three-year term of the proposed ESP III, AEP Ohio’s proposed approach would allocate to the residential class about $29 million more in rider costs than would be the case if rider costs were allocated in proportion to the residential class’s contribution to such costs.

In Table 2, I provide for each year of the proposed ESP III the reallocation of total costs collected through the DIR, ESRR, and SSWR that would result by substituting my recommended cost-allocation approach for AEP Ohio’s proposed approach.

**Table 2. Rider Cost Reallocation under OCC Allocation Approach**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **June, 2015 – May, 2016** | **June, 2016 – May, 2017** | **June, 2017 – May, 2018** | **Total** |
| RS | (8,745,684) | (9,620,497) | (10,774,811) | (29,140,992) |
| GS-1 | (529,785) | (582,034) | (648,642) | (1,760,461) |
| GS-2 | (2,183,224) | (2,420,232) | (2,741,146) | (7,344,602) |
| GS-3 | 9,306,807 | 10,256,546 | 11,515,031 | 31,078,384 |
| GS-4 | (222,517) | (246,193) | (278,067) | (746,776) |
| EHG/EHS/SS | 166,473 | 182,913 | 205,253 | 554,638 |
| Lighting | 2,207,929 | 2,429,497 | 2,722,382 | 7,359,809 |

Q17. Does this complete your direct testimony?

***A17.*** Yes. However, I reserve the right to incorporate new information or supplement my testimony with information that may subsequently be made available to OCC.

**CERTIFICATE OF SERVICE**

It is hereby certified that a true copy of the foregoing *Direct Testimony of Jonathan Wallach on Behalf of The Ohio Consumers’ Counsel* was served via electronic transmission this 6th day of May, 2014.

 */s/ Maureen R. Grady*

 Maureen R. Grady

 Assistant Consumers’ Counsel

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1. *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 Nos. 11-351-EL-AIR and 11-352-EL-AIR, Columbus Southern Power Company Schedule E-3.2 and Ohio Power Company Schedule E-3.2 (February 28, 2011). [↑](#footnote-ref-1)
2. See page 2 of Exhibit AEM-2 for the proposed annual caps. [↑](#footnote-ref-2)
3. For the Utility’s cost-allocation proposals for costs collected through the DIR, ESRR, SDRR, and SSWR, see AEP Ohio’s responses to OCC Int. 122, 126, 116, and 119, respectively. [↑](#footnote-ref-3)
4. See AEP Ohio’s responses to OCC Int. 117, 120, 123, 127, and 130. [↑](#footnote-ref-4)
5. AEP Ohio’s response to OCC Int. 123 with respect to net plant costs collected through the DIR. (Emphasis added.) [↑](#footnote-ref-5)
6. Distribution O&M expenses include spending for distribution plant O&M, but excludes customer account expenses, customer services and sales expenses, and administrative and general expenses. [↑](#footnote-ref-6)
7. These allocators are derived from the cost allocations provided in the cost of service spreadsheet models provided by AEP Ohio in Case Nos. 11-351-EL-AIR and 11-352-EL-AIR. Specifically, the cost allocations are provided in Tab E-3.2 in the spreadsheet files ‘2011-02-24 CSP CCOS Sched. 3.1 and 3.2 (Final).xls’ and ‘2011-02-24 OPCo CCOS Sched 3.1 and 3.2 (Final).xls.’ [↑](#footnote-ref-7)