

FILE

33

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

RECEIVED-DOCKETING DIV

2010 JUL 28 PM 4: 53

In the Matter of the Commission's
Review of Fuel Adjustment Clause
Guidelines.)

Case No. 10-479-ELUMC

PUCO

**REPLY COMMENTS
BY
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL**

**JANINE L. MIGDEN-OSTRANDER
OHIO CONSUMERS' COUNSEL**

Ann M. Hotz, Counsel of Record
Maureen R. Grady
Jody M. Kyler
Kyle L. Verrett
Assistant Consumers' Counsel

Office of the Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215
(614) 466-8574 - phone
hotz@occ.state.oh.us
grady@occ.state.oh.us
kyler@occ.state.oh.us
verrett@occ.state.oh.us

July 28, 2010

This is to certify that the images appearing are an
accurate and complete reproduction of a case file
document delivered in the regular course of business.
Technician 36 Date Processed 7/28/10

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
II. REPLY COMMENTS	2
A. The Commission Should Encourage The Auditor To Take Initiatives With Fuel Acquisition Audits And Should Encourage The Auditor To Make A Thorough And Detailed Analysis And Evaluation Of The Utilities' Fuel And Purchased Power Procurement Practices As Needed Under The Given Circumstances Of Each Case.....	2
1. General Comments	2
2. Subsection I. Introduction.....	4
3. Subsection II.A.(1) Purpose.....	6
4. Subsection II.A.(4) Scope of FAC management/performance audit.	6
5. Subsection II.A.(6) Audit procedures for fuel procurement.....	8
6. Subsection II.A.(7) Audit procedures for station visitation.....	12
7. Subsection II.A.(8) Additional language for environmental compliance	13
8. Subsection II.A.(9) Audit procedures for purchased power and sales for resale policy evaluation	13
B. The Commission Should Adapt The Guidelines To Take Into Consideration Changes In The Electric Markets But Should Encourage The Auditor To Analyze And Evaluate Current Fuel And Purchased Power Practices To The Extent Possible Based Upon Current Market Realities.....	14
C. The Commission Should Insist That Utilities Meet Their Burden Of Proof To Demonstrate That Their Purchasing Practices Are Prudent And Should Not Encourage The Auditor To Accept Purchasing Practices That Are Simply "Theoretically Prudent."	15
D. The Commission Should Adopt Only Appropriate Clarifying Language Changes Suggested By The Commentors.....	18
1. Changing "procedures" to "policies and applicable procedures" and "company" to "electric utilities."	18

2.	Changing the Term “Price” to “Cost”	18
3.	Defining “best price” and “appropriate business posture.”	20
E.	Commission Approved Standards for FAC Audits	21
F.	Financial Audit Issues.....	21
1.	Subsection II.B.(8)(b)(iii) Audit procedures for processing coal orders.....	21
2.	Subsection II.B.(2)(a) Objectives	22
3.	Subsections II.B.(5)(e) and (g) Minimum review requirements	23
4.	Subsection II.B.(6)(a) Audit procedures for fuel procurement	23
5.	Subsection II.B.(7)(b) Audit procedures for activities in the emission allowance market.....	24
6.	Subsection II.B.(8) Audit procedures for processing coal orders	25
7.	Subsections II.B.(9)(a) and (c) Audit procedures for purchased power	26
8.	Subsections II.B.(10)(a), II.B(10)(d), and II.B(10)(f) Audit procedures or reviewing the FAC rate.....	27
III.	CONCLUSION.....	28

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Commission's)	
Review of Fuel Adjustment Clause)	Case No. 10-479-EL-UNC
Guidelines.)	

**REPLY COMMENTS
BY
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL**

I. INTRODUCTION

On June 23, 2010, the Public Utilities Commission of Ohio ("PUCO" or "Commission") issued an Entry seeking comments from interested persons on the PUCO Staff's proposed fuel adjustment clause ("FAC") guidelines ("Guidelines") to be used by the auditor conducting FAC audits. On July 14, 2010 Eagle Energy , LLC ("Eagle"), The Dayton Power and Light Company ("DP&L"), Duke Energy Ohio ("Duke"), Columbus Southern Power Company and Ohio Power Company ("AEP") and the Office of the Ohio Consumers' Counsel ("OCC") filed initial comments. OCC files these Reply Comments in response to the initial comments filed by the other parties in this case.

OCC respectfully submits these Reply Comments to reiterate OCC's initial recommendations and to further clarify OCC's position regarding issues presented by the other parties. OCC's interests, as expressed in the OCC's initial comments, are to ensure that the fuel and purchased power costs that the electric utilities recover from standard service offer customers were prudently incurred.

Generally, OCC agrees with the Commission's objective that these Guidelines should not be used to limit the auditor and the Staff in reviewing the utilities' fuel and purchased power acquisition costs. Rather these Guidelines should establish a minimum

level of review that does not limit the auditor's reliance on his or her own initiative, inventiveness or thoroughness in analyzing and evaluating the utilities' fuel and purchased power activities and the related costs.

II. REPLY COMMENTS

A. The Commission Should Encourage The Auditor To Take Initiatives With Fuel Acquisition Audits And Should Encourage The Auditor To Make A Thorough And Detailed Analysis And Evaluation Of The Utilities' Fuel And Purchased Power Procurement Practices As Needed Under The Given Circumstances Of Each Case.

1. General Comments

Eagle Energy argues that FAC audits are not necessary¹ because there is sufficient competition to pressure utilities to keep fuel prices low.² Eagle Energy is mistaken and its recommendation would place Ohioans at risk for unreasonable electricity rates. Retail competition is not sufficiently robust for residential customers to keep the standard service offer fuel prices low. As of the end of March 2010, only 8.51% of the residential customers in the Duke service territory had alternative suppliers.³ As long as the utilities are able to depend upon dollar-for-dollar recovery of fuel costs through the standard service offer without significant retail price competition, the utilities will not have sufficient incentives to keep fuel acquisition costs as low as possible.

Ohio Revised Code Sections 4928.142(D)(1) and (2) and 4928.143(B)(2)(a) state that an electric utility may recover, among other things, the costs of fuel and purchased power. However, the costs must be "prudently incurred" before the Commission can

¹ Eagle Comments at 1.

² Eagle Comments at 2.

³ *Summary of Switch Rates from EDUs to CRES Providers in Terms of Sales For the Month Ending March 31, 2010*. Public Utilities Commission of Ohio Website.

authorize recovery through a FAC. Ohio Adm. Code 4901:1-35-09, sets forth the procedures for the FAC:

- (A) Each electric utility for which the commission has approved and electric security plan (ESP) which includes automatic adjustments under division (B)(2)(a) of section 4928.143 of the Revised Code shall file for such adjustment in accordance with the provisions of this rule.
- (B) The electric utility shall calculate a proposed quarterly adjustment based on projected costs and reconciliation requirements by filing an application four times per year. * * *
- (C) On an annual basis, the prudence of the costs incurred and recovered through quarterly adjustments shall be reviewed in a separate proceeding outside of the automatic recovery provision of the electric utility's ESP. The electric utility shall demonstrate that the costs were prudently incurred as required under division (B)(2)(a) of section 4928.143 of the Revised Code * * *
- (D) The commission may order that consultants be hired, with the costs billed to the electric utility, to conduct prudence and/or financial reviews of the costs incurred and recovered through the quarterly adjustments.

The audit Guidelines are necessary to assist and guide the person assigned to review the prudence of the FAC costs in the separate annual proceeding.

Eagle contends that the proposed Guidelines would needlessly add to the cost of the audit.⁴ This comment by Eagle is vague and unsupported, and would sacrifice consumers to the further risk of paying for high costs that are inappropriate so that comparatively small sums could be saved by limiting audits. Audit Guidelines are necessary to provide for a consistent examination of whether costs associated with fuel and purchased power were prudently incurred by the utility. Additionally, OCC disagrees with Eagle's assertion that the auditor may not review a significant issue because it was not specifically listed in the Guidelines. The Guidelines are intended to

⁴ Eagle Comments at 2.

guide the auditor, and will not preclude the auditor from using his/her initiative and/or inventiveness when reviewing the utility's FAC comportment.

Eagle Energy also argued that the Commission should reject the Guidelines and allow the auditors to determine the scope of the audit with no guidelines.⁵ The General Assembly directed the Commission to maintain regulatory authority over the electric utilities' standard service offers under R.C. 4928.141 through 4928.143 and it would be inappropriate for the Commission to relinquish its authority to a third-party, especially when the vast majority of residential customers depend upon the standard service offer for service.

2. Subsection I. Introduction

The Commission should not adopt AEP's recommendation to revise the Introduction. AEP argued for inclusion of additional language in this section that could be interpreted to allow the auditor to only review fuel costs that were incurred during the audit period.⁶ AEP's proposal may lead to electric utilities denying the auditor access to important fuel cost and fuel acquisition information that is outside the audit period. The Guidelines should allow for a good deal of discretion on the part of the auditor with regard to what he/she determines is appropriate for review within the context of the FAC audit.

While the auditor's focus should be on fuel procurement costs during the audit period, the auditor should be permitted to review information from previous audit periods, especially because fuel and purchased power issues and recommendations are almost always carried over from one audit period to the next. This is evident in the

⁵ Eagle Comments at 4.

⁶ AEP Comments at 3.

proposed Guidelines themselves. For example Subsection II.A.(2)(e) states that one objective of the FAC audits is to:

Identify specific areas for improvement of organizational and management practices to ensure fuel operations of the company at the lowest reasonable overall cost.

Auditors often make recommendations that fuel and purchased power activities be improved and improvement cannot be measured without information about past audit period results.⁷ Even for issues that do not carry over from one audit period to the next, auditors simply cannot obtain the proper perspective for a comprehensive management performance audit, if they do not consider fuel and purchased power activities and their related costs from prior audit periods. And sometimes the discovery of an item of concern during a current audit period leads to a need to determine for a prior audit period whether a concern should be presented to the PUCO and addressed for the prior period. For those reasons, the Commission should not revise Section I. Introduction as AEP recommends.

Rather OCC suggests that the Commission revise the Introduction as OCC suggested, in part, in its initial comments:

The FAC is the mechanism that will be used to recover prudently incurred fuel, purchased power, and other miscellaneous expenses, as articulated under the utility's standard service offer ("SSO"). An auditor shall verify compliance with the FAC conditions, terms and calculations as approved by the Commission for each utility

⁷ See, eg. *In the Matter of the Regulation of the Electric Fuel Component Contained within the Rate Schedules of Ohio Power Company and Related Matters*, Case No. 87-101-EL-EFC, Management Performance Audit Report (August 7, 1987); *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedules of Cincinnati Gas and Electric Company*, Case No. 96-103-EL-EFC, Management Performance Audit Report (March 7, 1997); *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedules of Cincinnati Gas and Electric Company*, Case No. 99-103-EL-EFC, Management Performance Report (March 12, 2000); *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedules of Monongahela Power Company and Related Matters*, Case No. 98-106-EL-EFC, Management Performance Audit Report (October 16, 1998).

under the utility's SSO. An auditor must also verify that costs are allowable under the FAC approved for the SSO.⁸

The language above would also meet Eagle's concern that the Commission did not include language that would ensure that the auditors are aware of the prudence requirement for fuel and purchased power acquisitions.⁹ For these reasons, the Commission should adopt OCC's recommended addition to the Introduction.

3. Subsection II.A.(1) Purpose

AEP's comment that the term "imagination" is overly subjective and limitless is incorrect.¹⁰ That term is consistent with the Commission's statement that the Guidelines should not be used to exclude the auditor's "initiative, imagination, or thoroughness when reviewing a company's FAC."¹¹ An auditor should use his/her imagination, creativity and ingenuity when reviewing utility and developing recommendations for that utility.

On the other hand, AEP's suggestion that an auditor should use his/her professional judgment and experience to tailor the scope of the audit to the particular aspects of the utility being audited is appropriate and helpful and should be added but not as a replacement for the term "imagination." Additionally, AEP's suggestion that the word "company" be replaced by the phrase "electric utility" in the subsection would greatly clarify the Guidelines.

4. Subsection II.A.(4) Scope of FAC management/performance audit.

AEP recommended the following language changes in subsection II.A.(4)(b):

⁸ OCC Comments at 2.

⁹ Eagle Comments at 4.

¹⁰ AEP Comments at 4.

¹¹ Entry at 1.

(b) Follow-up performance audit

The auditor shall conduct a follow-up performance audit to determine whether the recommendations developed in previous management/performance audits and adopted by the Commission ~~those determined to be reasonable in a FAC hearing~~ have been effectively implemented or addressed by the company. Other matters identified by Commission order may also be addressed.

AEP unwisely suggested that the Commission revise subsection II.A.(4)(b) to limit the scope of issues an auditor may follow-up on in the next audit.¹² The inclusion of AEP's proposed changes to the language of this guideline would needlessly limit the auditor in his/her review. If the Commission intends to encourage the auditors to rely on their own "initiative, imagination, or thoroughness when reviewing a company's FAC,"¹³ as the Commission stated in its Entry, the Commission should not adopt AEP's suggestions.

Most worrisome is AEP's insertion of the phrase "or addressed" in subsection II.A.(4)(b) after "implemented." In other words, AEP is implying that electric utilities need not implement recommendations adopted by the Commission. Rather, electric utilities need only "address" the recommendations. The term "address" is vague and electric utilities should be required to implement recommendations the Commission adopts. For those reasons, the Commission should not adopt AEP's insertion of the phrase "or addressed."

AEP explicitly states that it believes that the auditor should only pursue issues in the next audit that were recommendations specifically adopted by the Commission or

¹² AEP Comments at 6.

¹³ Entry at 1.

expressly identified by the Commission to be pursued in the next audit.¹⁴ AEP has no basis for this conclusion. Because the auditor is hired by the Commission to audit the fuel and purchased power activities, the auditor should have the flexibility necessary to conduct a thorough audit.

5. Subsection II.A.(6) Audit procedures for fuel procurement

Eagle identifies numerous items that should be explicitly identified in the Guidelines that the auditor should review.¹⁵ The Commission should incorporate some of those identified by Eagle and especially a “review of purchasing organization and items such as succession planning, decision-making, approval authorization and the organization itself.”¹⁶ While auditors have frequently reviewed such matters in past audits,¹⁷ nothing in the Guidelines makes reference to it. Additionally, the Guidelines should require review of any escalation provisions that impact costs.¹⁸ OCC recommended that a provision be added to Section II. A(6)(c)(ii) of the proposed Guidelines:

¹⁴ Id.

¹⁵ Eagle Comments at 5.

¹⁶ Eagle Comments at 5.

¹⁷ See, eg. *In the Matter of the Regulation of the Electric Fuel Component Contained within the Rate Schedules of Ohio Power Company and Related Matters*, Case No. 87-101-EL-EFC, Management Performance Audit Report (August 7, 1987); *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedules of Cincinnati Gas and Electric Company*, Case No. 96-103-EL-EFC, Management Performance Audit Report (March 7, 1997); *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedules of Cincinnati Gas and Electric Company*, Case No. 99-103-EL-EFC, Management Performance Report (March 12, 2000) ; *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedules of Monongahela Power Company and Related Matters*, Case No. 98-106-EL-EFC, Management Performance Audit Report (October 16, 1998).

¹⁸ Eagle Comments at 5.

Review any contract amendments that contain a price escalation provision and review correspondence on the amendment negotiations, including the basis for such amendments.¹⁹

Moreover, the Commission should incorporate more specific Guidelines to ensure that the auditor reviews the utility's fuel transportation policies and practices as suggested by Eagle.²⁰ OCC recommended specific language for that purpose in its initial comments:

- (xi) Examine the company's fuel transportation policies and procedures to determine if the company maintains the optimal mix of transportation resources necessary for fuel to be delivered reliably and at the most cost effective price, including an examination of demurrage costs incurred.²¹

The Commission should add an additional guideline that will ensure that the auditors will review the force majeure provisions and their impacts on fuel acquisition rates as Eagle recommends.²² OCC suggested the following revision for Section IIA.(6)(c)(iii) in its Initial Comments:

Evaluate the delivery performance of the fuel supplier for each long term fuel supply contract, including; evaluating the consequences of a supplier's failure to deliver; analyzing the consequences of a supplier's bankruptcy; reviewing a utility's policies and procedures employed to monitor and/or track the supplier's finances which could threaten performance of the contract; determining whether force majeure had been appropriately invoked; and determining whether the utility responded appropriately after being notified of a force majeure event.²³

¹⁹ OCC Comments at 5.

²⁰ Eagle Comments at 3.

²¹ OCC Comments at 8.

²² Eagle Comments at 5.

²³ OCC Comments at 5.

AEP recommends that the Commission revise language under Subsection II.A.6.(b).²⁴ The Commission should not delete the word “reliable” from the Staff’s proposed guideline:

Assess the company’s organizational ability to procure fuel and provide reliable electric service at the lowest reasonable overall cost.

Fuel procurement practices require a balance between “providing reliable electric service” with “the lowest reasonable overall cost.” Electric utilities that purchase the lowest cost fuel with no consideration for the reliability of their service they will likely be contracting for unreliable sources of fuel. Electric utilities cannot have reliable electric service without reliable sources of fuel. Auditors have frequently identified the reliability of fuel supplies as important in FAC cases so that the utilities will not be forced to purchase high cost replacement fuel or high cost purchased power if the supplier does not come through.²⁵ The auditor should be permitted to review fuel contracts for provisions, such as penalties for nonperformance, so that the suppliers will have sufficient incentive to perform even when it may not be in their best financial interest without the penalties.

AEP also suggests that the Commission should revise Subsection II.A.6(b) and II.A.(6)(c), which relate to “Audit procedures for fuel procurement.” AEP’s suggestions would further limit the auditor’s review.²⁶ Examples of AEP’s proposed revisions that would limit the auditor include: AEP’s proposal that the auditor only determine contract

²⁴ AEP Comments at 7.

²⁵ *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedule of Ohio Edison Company and Related Matters*, Case No. 89-04-EL-EFC, Opinion and Order (June 20, 1989) at 15-16; *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedule of Cincinnati Gas & Electric company and Related Matters*, 90-03-EL-EFC, Opinion and Order (June 14, 1990) at 10; *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedule of Dayton Power and Light Company and Related Matters*, 88-07-EL-EFC, Opinion and Order (August 2, 1988) at 28-29.

²⁶ *Id.*

terms with a price escalation that was triggered during the audit period; AEP's proposal that the auditor only review price escalations that were implemented; and AEP's proposal that the auditor only determine the reasonableness of spot purchases triggered by delivery deficiencies.

Because the Commission emphasized in its Entry that it did not want the Guidelines to be "used to the exclusion of the auditor's initiative, imagination, or thoroughness when reviewing a company's FAC,"²⁷ the Commission should not adopt AEP's exclusionary language within the provisions of Subsection II.A.6(b) and II.A.6(c).

The Commission should include in its Guidelines under Subsection II.A.(7) a provision requiring the auditor to analyze and evaluate plant performance, in particular, the causes of forced outages and their impact on fuel and purchased power costs as Eagle suggests.²⁸ Forced outages have frequently been the subject of fuel audits in the past.²⁹ One way of incorporating such a provision would be to incorporate it under II.A.(6)(c) as provision (ix) to state:

²⁷ Entry at 1.

²⁸ Eagle Comments at 5.

²⁹ See, *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedule of Monongahela Power Company and Related Matters*, Case No. 98-106-EL-EFC, Opinion and Order (January 21, 1999) at 16; *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedule of Cleveland Electric Illuminating Company and Related Matters*, Case No. 95-108-EL-EFC, Opinion and Order (February 22, 1996) at 15; *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedule of The Toledo Edison company and Related Matters*, 95-107-EL-EFC, Opinion and Order (February 22, 1996) at 7; *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedule of The Cincinnati Gas & Electric Company and Related Matters*, Case No. 94-103-EL-EFC, Opinion and Order (June 8, 1995) at 11.

(ix) Determine the impact on fuel and purchased power costs associated with major plant outages.

Eagle suggests that the auditor should be guided to review contracts and fuel acquisition issues that are related to renewable fuels.³⁰ Because the Commission has certified numerous utility combustion plants as renewable facilities,³¹ the Commission should also guide the auditor to review biomass contracts as the utilities begin to burn biomass in their combustion plants along with coal and natural gas.

6. Subsection II.A.(7) Audit procedures for station visitation

The Commission might find it more appropriate to require Companies to recover the costs of biomass fuel through the FAC rather than other riders in order to simplify the coordination of the management-performance review and recovery of costs related to biomass acquisition and traditional fuel acquisition. In any case, the biomass fuel acquisition should be audited for prudence in the same way traditional fuel acquisition is audited because they both result in dollar-for-dollar recovery. Neither R.C. 4928.143(B)(2)(a) nor Ohio Adm. Code 4901:1-35-09 makes a distinction between the review of traditional fuel and biomass.

Because the renewable fuel will be burned along with traditional fuels such as coal in the same plants and will be transported to the same plants, it would seem that the auditing of traditional fuels and biomass fuels together would be most convenient for everyone concerned.

³⁰ Eagle Comments at 5.

³¹ See eg. *In the Matter of the Application of Columbus Southern Power Company For Certification As an Eligible Ohio Renewable Energy Resource Generating Facility*, Case No. 09-1860-EL-REN, Finding and Order (March 31, 2010); *In the Matter of the Application of Dayton Power and Light Company for Certification as an Eligible Ohio Renewable Energy Resource Generating Facility*, Case No. 09-891-EL-REN, Finding and Order (April 6, 2010).

The Commission should facilitate the prudence review of biomass fuels through the auditor in FAC proceedings by replacing the term “coal” with the term “fuel” in Subsections II. A.(6)(d) and (e) and Subsection II.A.(7). If the utilities do not recover the costs of biomass through FAC proceedings, the Commission will be required to issue separate Guidelines for auditors in another proceeding.

7. Subsection II.A.(8) Additional language for environmental compliance

AEP’s proposed additions to Section II.A.(8) are appropriate and helpful.³² OCC also made recommendations in its Initial Comments³³ to address some of the issues that have arisen in cases in the past and also to address newer legislation.³⁴

8. Subsection II.A.(9) Audit procedures for purchased power and sales for resale policy evaluation

AEP has proposed revising Subsection II.A.(9)(b) and (c)³⁵ accordingly:

(9) Audit procedures for purchased power and sales for resale policy evaluation * * *

- (b) Review the ~~company’s procedures for assuring that economic efficiency is the determinative~~ electric utility’s policies, practice and applicable procedures or other criteria for power purchases, sales for resale, and fuel utilization.
- (c) Evaluate the ~~company’s endeavors~~ electric utility’s policies, practices and applicable procedures, when considered in light of existing contractual commitments, to purchase power or generate energy at a fuel cost significantly less than higher priced power under a contract or interconnection agreement.

³² AEP Comments at 14.

³³ OCC Comments at 14-15.

³⁴ *In the Matter of the Application of Columbus Southern Power company and Ohio Power Company for/Approval of an Additional Generation Service Rate Increase Pursuant to Their Post-Market Development Period Rate Stabilization Plan*, Case No. 07-1132-BL-UNC, Opinion and Order (January 30, 2008) at 6-8.

³⁵ AEP Comments at 15.

This suggested revision would eviscerate the auditor's ability to review purchase power and sales for resale activity to meet the Objective the Staff proposes under Subsection

II.A.(2)(b):

Ascertain the procedures utilized by the company to assure that lowest reasonable prices at the time of purchase are paid for fuel and purchased power, emission allowances and environmental reagents.

Removing the "phrase economic efficiency is determinative" from the sentence "Review the company's procedures for assuring that economic efficiency is the determinative criteria for power purchases, sales for resale, and fuel utilization," completely undermines the sentence. Moreover, the language that AEP proposes completely changes the meaning of the sentence. The Staff's proposed language appropriately addresses one of the most important objectives of the management performance audit and should be retained.

B. The Commission Should Adapt The Guidelines To Take Into Consideration Changes In The Electric Markets But Should Encourage The Auditor To Analyze And Evaluate Current Fuel And Purchased Power Practices To The Extent Possible Based Upon Current Market Realities.

A number of commentators have noted that the proposed Guidelines do not account for structural changes that have occurred as a result of the market operations and the regional transmission organizations ("RTOs").³⁶ OCC agrees that the Commission must take these structural changes into account in crafting the Guidelines. The commentators largely suggest that the Commission remove provisions from the Guidelines to take into account jurisdictional changes. Rather than carving out whole

³⁶ Initial Comments of the Dayton Power & Light Company at 1-2, 4, 6-7; Initial Comments of Eagle Energy, L.L.C. at 6; Comments of Duke Energy Ohio at 2, 8-9.

provisions, the Commission should direct the auditors to review the electric utilities' fuel and purchased power activities in light of RTO and FERC rules and regulations. And the Commission should ensure that the Commission can exercise its review of the prudence of fuel and purchased power acquisition costs of each company to the maximum extent possible.

C. The Commission Should Insist That Utilities Meet Their Burden Of Proof To Demonstrate That Their Purchasing Practices Are Prudent And Should Not Encourage The Auditor To Accept Purchasing Practices That Are Simply "Theoretically Prudent."

Duke Energy Ohio ("Duke") states that the Staff's Guidelines "place too great an emphasis on coal procurement rather than a balancing for the reasonableness of the utility's total portfolio management."³⁷ Duke suggests the Guidelines should not require the auditor to perform a detailed examination of commodities such as fuel and purchased power and emission allowance and environmental reagents independently "in a vacuum."³⁸ Duke is of the opinion that there is "a natural interplay among the commodities, and it is prudent for a utility to examine the mix of those commodities in responding to changes in market prices and determining the most prudent and lowest possible overall price for each generation asset."³⁹ As such, Duke argues that the proposed Guidelines should focus on a review of the utility's procurement procedures and management of its portfolio positions *as a whole* in producing an overall reasonable and prudent fuel adjustment clause price. (Emphasis added.)⁴⁰

³⁷ See Case No. 10-479-EL-UNC, *Initial Comments of Duke Energy Ohio* at p. 3.

³⁸ *Id.* at p. 4.

³⁹ *Id.*

⁴⁰ *Id.* at 3.

The PUCO should reject Duke's general comments because multiple auditors have been unable to audit Duke's Active Management in the past FPP audits.⁴¹ The core theory of Duke's Active Management is that "the least cost supply will be made up of an optimal mix of Generation and/or Purchased Power,"⁴² a general philosophy that is similar to the examination of the mix of commodities which Duke argues for in its comments.⁴³ Further, there has been an apparent failure to develop a reasonable process to audit Duke Energy Ohio's portfolio and to demonstrate the *economic effectiveness* of Active Management.

In Case No. 07-974-EL-UNC et al., the Liberty Consulting Group ("Liberty") conducted an audit of Duke's fuel and purchased power practices for July 2007 through December 2008. Liberty stated: "an issue in the previous audit [of Duke for July 2006 through June 2007] was that CAM [Commercial Asset Management] did not have sufficient documentation that formally set forth its procedures and Guidelines for the procurement and management of fuel and emission allowances, nor were there any procedures related to Active Management."⁴⁴ In a September 2009 Commission-approved settlement of Case No. 07-974-EL-UNC et al., Duke committed to "work with the Staff and future auditors to develop a reasonable process to audit Duke's portfolio and to demonstrate the economic effectiveness of active management."⁴⁵

⁴¹ See Case No. 07-974-EL-UNC, *Final Report Management/performance and Financial Audit*, generally.

⁴² Management/Performance Audit and Financial Audit of Duke Energy Ohio, Case No. 07-974-EL-UNC et al. (May 15, 2009) at 1-7.

⁴³ Duke Comments at 4.

⁴⁴ *Id.* at p. 1-5.

⁴⁵ Opinion and Order, (September 30, 2009) at 5.

Duke eventually produced a spreadsheet containing information on various components of Active Management, however, the spreadsheet did not contain a formal evaluation of active management, nor did it provide margins other than for coal transactions.⁴⁶ According to Liberty, the spreadsheet provided by Duke “was the only information provided that begins to give insight into the value of Active Management.” Liberty stated further: “[a]s in the previous Audit Period, Liberty continued to ask Duke Energy Ohio in order to establish the justification for this form of portfolio management. Liberty’s report of its preceding audit recommended that the Company demonstrate the economic effectiveness of Active Management. There still exists no formal internal documents that prove its effectiveness over the long term and in a range of market conditions.”⁴⁷

In regards to this commitment, in the most recent FPP audit of Duke for 2009, the May 15, 2010 audit report states that Duke had only “partially” completed this commitment, by meeting with the auditor to begin developing a process. Thus, through FPP audits of Duke for 2006, 2007, 2008, and 2009 Duke has been unable to demonstrate the economic effectiveness of its Active Management.

While Duke’s suggests that the proposed Guidelines should focus on a review of the utility’s procurement procedures and management of its portfolio positions *as a whole* in producing an overall reasonable and prudent fuel adjustment clause price, the practicality of Duke’s comments in this regard are in question because of Duke’s inability to demonstrate the economic efficiency of Active Management.

⁴⁶ *Id.* at p. II-16

⁴⁷ *Id.*

D. The Commission Should Adopt Only Appropriate Clarifying Language Changes Suggested By The Commentors.

1. Changing “procedures” to “policies and applicable procedures” and “company” to “electric utilities.”

AEP Ohio proposes to replace the word “procedures” throughout the proposed Guidelines with the phrase “policies and applicable procedures.”⁴⁸ The companies also propose using “electric utilities” instead of “company” in the Guidelines.

AEP’s proposed language change to the proposed Guidelines appears acceptable on the surface, with one caveat. To the extent that AEP attempts to eliminate review of certain of its activities by not including them in their policies, the switch from “procedures” to “policies and applicable procedures” should not be adopted. The auditor should maintain discretion over which procedures it believes will have an effect on the fuel and purchased power acquisition. To avoid any potential that AEP (or any company) intends the use of the words “policies and applicable procedures” to eliminate activities that have an effect on the price of fuel, the Commission—in the event it adopts such language—should clarify in its Order that this language shall not be interpreted to mean that an auditor is limited to reviewing activities that are included in the “policies and applicable procedures.”

2. Changing the Term “Price” to “Cost”

The Commission should not change the term “price” to “cost” in subsections II.A.(2)(b) and (c) and in subsections II.A.(4)(a)(ii) and (iii) as DP&L recommended.⁴⁹ DP&L’s suggestion that consistency with the use of “cost” in other subsections with the use of the same term in subsections II.A.(2)(b) and (c) and subsections II.A(4)(a)(ii) and

⁴⁸ *Id.*

⁴⁹ DP&L Comments at 3.

(iii) is not well taken because the circumstances addressed by subsections II.A.(2)(b) and (c) and II A(4)(a)(ii) and (iii) require the use of the term “price” rather than “cost.”

Subsection II.A.(2)(b) and (c) are intended to address the procedures the company used to ensure that it receives fuel for the “lowest reasonable prices.” The auditor should consider the actual price that the utilities pay in each individual contract and the company should be prudent in negotiating a price for each individual contract. Subsection II.A.(4)(a)(ii) and (iii) addresses the specific price that the utility paid for fuel on the spot market and the policies the Company has to ensure that they receive fuel at “reasonable prices,” which has regularly been an issue in past fuel acquisition cases.⁵⁰ The auditor should consider the specific price that the utility paid for fuel on the spot market because the auditor cannot determine the prudence of the utilities’ purchases of spot fuel without being able to compare it to the market price at the time.

Generally, it seems that the language change that DP&L proposes would limit the auditor to reviewing only certain superficial information during the audit. For example, if the auditor were only required to consider costs rather than prices, the utility could argue that it does not need to provide the auditor with the prices associated with individual contracts and that the utility would only need to provide the auditor with an overall summary of the cost of fuel. This would limit the auditor’s ability to rely on its own initiative, inventiveness, thoroughness and professional judgment in analyzing and evaluating the utilities’ fuel and purchased power procurement activities.

⁵⁰ See eg., *In the Matter of the Regulation of the Electric Fuel Component Contained with the Rate Schedules of Ohio Edison Company and Related Matters*, Case No. 88-04-EL-EFC, Opinion and Order (June 21, 1988) at 17; *In the Matter of the Regulation of the Electric Fuel Component Contained with the Rate Schedules of Ohio Power Company and Related Matters*, 95-101-EL-EFC, Opinion and Order (May 30, 1996) at 18-19; *In the Matter of the Regulation of the Electric Fuel Component Contained with the Rate Schedules of Columbus Southern Power company and Related Matters*, 95-102-EL-EFC, Opinion and Order (May 30, 1996) at 10.

3. Defining “best price” and “appropriate business posture.”

Duke recommends that the Commission clarify what the Commission intends under Subsection II.A.(6)(e)(vii), in particular the intended meaning of the words “best price” and the phrase, “appropriate business posture.” That provision states:

How the agent assures that the coal company is giving the best price and that the company is dealing with the coal company in an appropriate business posture.⁵¹

In particular, Duke requested that the Commission clarify what is meant by “best price” and what the Commission intends by “appropriate business posture.”⁵² The Commission should clarify those terms. The guideline as currently written is ambiguous because “best price” and “appropriate business posture” are ambiguous terms.

“Best price” could be clarified by a descriptive phrase such as “relative to the product being purchased and the market price at the time” or “based upon the quality, availability and limitations” of the product. The phrase “appropriate business posture” appears to go beyond (and should go beyond) Duke’s interpretation that it applies only to affiliate transactions.⁵³ Instead the phrase “appropriate business posture” seems to imply that the purchasing agent should demonstrate that it is transacting with vendors in “arms length negotiations.” The appropriate business posture could be gleaned through a variety of factors besides the competitiveness of the price received in contracts, such as the number of vendors contacted, the negotiation process and whether a formal bidding process is used, eg. In conclusion, the Commission should clarify what it intends by “appropriate business posture” and should clarify that it means more than just whether

⁵¹ Duke Comments at 6-7.

⁵² Id.

⁵³ Id at 7.

the Company followed the “appropriate code of conduct and corporate separation rules” as Duke suggests.

E. Commission Approved Standards for FAC Audits

Through its suggestion that the Commission modify Subsection II.B.(7)(e)(vi.), Duke recommends that the Commission no longer rely on its own approved procedures for physical inventory adjustment.⁵⁴ Duke’s recommendation is inappropriate. Duke perceives that because of deregulation the Commission should no longer have approved procedures for physical inventory adjustments.⁵⁵ Although the electric fuel component rules were rescinded, the Commission should adopt procedures for physical inventory adjustment as part of these guidelines. As long as utilities benefit from dollar-for-dollar recovery for fuel and purchased power, the Commission should have its own approved procedure for physical inventory adjustments. With dollar-for-dollar recovery, the utilities have no incentive to meet best fuel procurement practices, especially when those practices cost more. Accordingly, the Commission should not modify Subsection II.B.(7)(e)(vi) as Duke suggests.

F. Financial Audit Issues

1. Subsection II.B.(8)(b)(iii) Audit procedures for processing coal orders.

DP&L also recommends that the Commission preface the Staff’s proposed guideline II.B.(8)(b)(iii) with “For a company that for fuel procurement purposes, uses both approved purchased requisitions and purchase orders, . . .”⁵⁶ DP&L noted that some utilities do not engage in the two-step process implied by the guideline and does not

⁵⁴ Duke Comments at 7.

⁵⁵ Id.

⁵⁶ DP&L Comments at 6.

believe that utilities should be required to engage in such a process. The proposed guideline may indicate to the auditor that utilities are required to engage in such a process, so the preface would clarify to the auditor that utilities are not required to conduct the two step process.⁵⁷ The Commission should adopt this recommended change but the proposal would be clearer if the preface suggested by DP&L would be further revised to state:

For a utility ~~company~~ that for fuel procurement purposes, uses both approved purchased requisitions and purchase orders, . . .

2. Subsection II.B.(2)(a) Objectives

AEP has recommended the following text and deletions for Section II.B.(2)(a):

- (a) Determine that the ~~company~~ electric utility has policies and/or procedures in place and that are being followed regarding the following activities:
 - (i) Processing of fuel receipt and consumption transactions
 - (ii) Processing of energy purchase and sale transactions,
 - (iii) Processing of emission allowance purchases, swaps, and sales.
 - (iv) Accurately calculating the FAC rate, including compliance with the applicable Commission order. ~~financial audit Guidelines.~~

AEP proposed modification to the language contained in Section II.B.(2)(a). Changing “company” to “electric utility” and adding the additional language “policies and/or” to the guideline clarifies the meaning of the proposed guideline. However, AEP’s proposed modification to the language contained in Section II.B.(2)(a)(iv) unreasonably limits the scope of the financial audit. OCC believes that replacing the phrase “Commission’s financial audit Guidelines” with “applicable Commission order” is

⁵⁷ Id.

inappropriate and would serve to limit the auditor in his/her review of the FAC, a review that is important for purposes of protecting customers from unreasonable rates.

3. Subsections II.B.(5)(e) and (g) Minimum review requirements

AEP recommended the following modification to the language contained in Section II.B.(5)(e) and (g):

- (e) Recording ~~purchases~~ purchased power and sales for resale interchanges ***
- (g) Calculating the FAC rate, including an evaluation of the ~~company's~~ electric utility's compliance with applicable Commission orders, ~~the Commission's audit Guidelines~~, and their application to customer bills.

The OCC agrees with AEP Ohio's proposed modification to the language contained in Section II.B.(5)(e). Replacing the terms "purchases" with "purchased power" and "interchanges" with "sales for resale" would provide additional clarity and specificity to the Staff's proposed guideline. The OCC also agrees with AEP's substitution of "company" with the words "electric utility", in II.B.(5)(g).

However, the OCC disagrees with AEP's proposed modification to the language contained in Section II.B.(5)(g). As stated above, the OCC believes that replacing the phrase "Commission's financial audit Guidelines" with "applicable Commission order" is inappropriate and would limit the auditor's review of the FAC. Generally, proposals to limit the auditor's review are in essence proposals to limit regulatory protections for Ohioans. Such proposals should be rejected.

4. Subsection II.B.(6)(a) Audit procedures for fuel procurement

AEP made the following modification to the language contained in Sections II.B.(6)(a) and (c):

- (a) Review the ~~company's~~ electric utility's fuel procurement policies and applicable procedures ~~manual and written instructions~~ for purchasing fuel and determine whether the policies and/or procedures are being followed.
- (c) Review the quality specifications in each coal contract and determine whether the ~~company's payments~~ electric utility's policies reflect adjustments for calorific value when the weighted average calorific value of fuel received differs from that stated in the contract.

AEP's proposed modification to the language contained in Section II.B.(6)(a) is appropriate. Changing "company" to "electric utility" and adding the additional language "policies and/or" to the guideline clarifies the meaning of the proposed guideline. On the other hand, including the phrase "policies and applicable" should not be included if it is intended to limit the scope of the financial audit to only those procedures explicitly included in the utilities' policies, as OCC has commented above. The auditor should retain discretion over those procedures that it believes is relevant to the company's fuel and purchased power acquisitions.

The OCC disagrees with AEP's proposed change to the language included in Section II.B.(6)(c). The proposed guideline is seeking specific information regarding adjustments to fuel procurement contracts that could affect the cost that flow to customers through the FAC. AEP's recommended modifications would make the Guidelines less specific and change their meaning.

5. Subsection II.B.(7)(b) Audit procedures for activities in the emission allowance market

AEP recommends the following modifications to Section II.B.(7)(b):

- (b) Determine whether modifications to additions to and removal from (consumption/sales) the allowance inventory were correctly computed for a sample period.

The Commission should not adopt AEP's proposed changes to the language contained in Section II.B.(7)(b). The changes proposed by AEP limit the scope of the auditor's review.

6. Subsection II.B.(8) Audit procedures for processing coal orders

AEP recommends the following modifications to Section II.B.(8)(b)(iii), II.B.(8)(c)(iv), II.B.(8)(f), and II.B.(8)(l):

- (b) Obtain purchase orders for one month's fuel procurement during the FAC audit period and complete the following:
 - iii. ~~Compare~~ If applicable, compare the purchase orders to approved purchased requisitions.
- (c) Obtain cash vouchers for one month during the FAC period and complete the following:
 - (iv) Trace adjustments for ~~British thermal units~~ all applicable quality parameters from the laboratory to the adjustment's application to payment invoices...
- (f) ~~Obtain~~ For coal transported by barge, obtain two eash vouchers invoices each for barging the coal unloading unloaded during the FAC audit period, compare the tonnage to the unloading reports, and trace the terms and rates of the invoices eash-vouchers to the contract's purchase order/support, and to the fuel ledger. . .
- ~~(l) Summarize all discrepancies and suggestions resulting from the FAC audit and discuss them with officials of the company.~~

OCC disagrees with AEP Ohio's proposed modification to Section II.B.(8)(b)(iii) because the changes proposed by AEP would limit the scope of the auditor's review, which is not consistent with the Commission's goal to encourage the "auditor's initiative, imagination, or thoroughness when reviewing a company's FAC."⁵⁸

⁵⁸ Entry at 1.

On the other hand, AEP's proposed changes to Section II.B.(8)(c)(iv) are consistent with the Commission's goal. OCC believes the changes proposed by AEP would allow the auditor to expand the areas of investigation as it pertains to this area of the audit plan.

AEP's proposed modifications to Section II.B.(8)(f) and elimination of Section II.B.(8)(l) are as inconsistent with the Commission's goals to encourage the "auditor's initiative, imagination, or thoroughness when reviewing a company's FAC" as its proposed modifications to Section II.B.(8)(b)(iii), which address purchase orders, as discussed above. The OCC believes both the modification and proposed elimination of Section II.B.(8)(l) should be rejected as they would narrow the scope of the audit and therefore diminish the overall quality of the auditor's review and limit the regulatory protection of Ohio consumers.

7. Subsections II.B.(9)(a) and (c) Audit procedures for purchased power

AEP recommends the following modifications to Section II.B.(9)(a) and (c):

- (a) Obtain a description of the procedures followed by the system dispatcher electric utility ~~system dispatcher~~ in purchasing power and determine:
- (c) Verify a sample of purchased power transactions to related invoice, paid cash voucher, or cash receipts.

AEP Ohio's proposed modification to Section II.B.(9)(a) of the proposed audit plan does not provide as much detail and direction to the FAC auditor as does the language modification proposed by OCC in its initial comments:

II.B.(9) Audit procedures for purchased power and sales for resale.

- (a) Obtain a description of the procedures followed by the system dispatcher in purchasing power and sales for resale and determine:

The auditor should know exactly how the utility is treating revenues that arise from sales for resale because the auditor needs to ensure that the fuel and/or purchased power being used in sales for resale are not being recovered through the FAC rider.

OCC disagrees with AEP's proposed modification to the language contained in Section II.B.(9)(c). The OCC believes the AEP's suggested changes would narrow the scope of the auditor's review, meaning AEP's suggestions would limit regulatory protections for consumers. AEP's suggestions should therefore be rejected.

**8. Subsections II.B.(10)(a), II.B(10)(d), and II.B(10)(f)
Audit procedures or reviewing the FAC rate**

AEP made the following recommended modifications to the Staff's proposed Guidelines, Subsections II.B.(10)(a), II.B(10)(d), and II.B(10)(f):

- (a) ~~Obtain for~~ For the FAC audit period, obtain copies of all monthly, semiannual, and annual reports filed with the Commission. . .
- (d) ~~Determine whether the~~ electric utility's ~~company's~~ calculations of the FAC rates comply with applicable Commission orders ~~these Guidelines~~. . .
- (f) Determine the method for calculating the average of FAC cost ~~of fuel~~ consumed.

AEP's proposed language change to Section II.B.(10)(a) is appropriate because the proposed changes add clarity to the proposed guideline. As stated above, the OCC agrees with the AEP's suggested substitution of "electric utility" for "company" in Section II.B.(10)(d). The OCC believes this change provides additional clarity and specificity to the Staff's proposed guideline.

On the other hand, AEP's proposed replacement of "these Guidelines" with "applicable Commission orders" in the same guideline is not appropriate, nor is AEP's proposed rewrite of Section II.B.(10)(f). The OCC believes the proposed changes are confusing and are not appropriate for this section of the audit report.

III. CONCLUSION

In response to the comments submitted by interested parties, OCC files the above Reply Comments on behalf of Ohio consumers who need the regulatory protection of effective audits as part of the regulatory framework for determining reasonable electricity rates. Generally, some comments submitted by the utilities tended to attempt to limit the scope of the audit and the discretion of the auditor and thereby limit the regulatory protections for Ohio customers. The Commission should not incorporate such limiting changes because to do so would undermine the Commission's stated goal of encouraging "the auditor's initiative, imagination, or thoroughness when reviewing a company's FAC."⁵⁹ Additionally, the Commission should not allow utilities to maintain fuel and purchased power acquisition procedures unless the utility is able to show the auditor how it can be audited. Finally, the Commission should adopt word changes only when the changes do clarify the meaning but do not change the effect of the provision—as these provisions are intended for protecting Ohioans in their purchase of electricity.

⁵⁹ Entry at 1.

Respectfully submitted,

JANINE L. MIGDEN-OSTRANDER
OHIO CONSUMERS' COUNSEL

A handwritten signature in black ink, appearing to read "Ann M. Hotz", is written over a horizontal line.

Ann M. Hotz, Counsel of Record
Maureen R. Grady
Assistant Consumers' Counsel

Office of the Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215
(614) 466-8574 – phone
hotz@occ.state.oh.us
grady@occ.state.oh.us

CERTIFICATE OF SERVICE

I hereby certify that a copy of these *Reply Comments* was served on the persons stated below *via* regular U.S. Mail, postage prepaid, or via electronic mail this 28th day of July 2010.


Ann M. Hotz
Assistant Consumers' Counsel

SERVICE LIST

Steven T. Nourse
American Electric Power Service
Corporation
1 Riverside Plaza, 29th Floor
Columbus, OH 43215
stnourse@aep.com

Duane Luckey
Public Utilities Commission of Ohio
180 East Broad St., 6th Fl.
Columbus, OH 43215
duane.luckey@puc.state.oh.us

Randall V. Griffin
Judi L. Sobecki
The Dayton Power & Light Company
1065 Woodman Drive
Dayton, OH 45432
Randall.griffin@DPLINC.com
Judi.sobecki@DPLINC.com

Samuel C. Randazzo
Lisa G. McAlister
Joseph M. Clark
McNees Wallace & Nurick LLC
21 E. State St, 17th Floor
Columbus, OH 43215-4226
sam@mwncmh.com
lmcalister@mwncmh.com
jclark@mwncmh.com

Donald I. Marshall
Eagle Energy. LLC
4465 Bridgetown Road Suite 1
Cincinnati, OH 45211-4439

Amy B. Spiller
Elizabeth H. Watts
Rocco O. D'Ascenzo
Duke Energy Ohio
139 East Fourth St., P.O. Box 960
Cincinnati, OH 45201-0960
elizabeth.watts@duke-energy.com
Amy.Spiller@duke-energy.com
rocco.d'ascenzo@duke-energy.com