

**FILE**

**PUBLIC VERSION**

EXHIBIT NO. \_\_\_\_\_

**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of Fuel Adjustment Clauses	)	
For Columbus Southern Power Company	)	Case No. 09-872-EL-FAC
And Ohio Power Company	)	Case No. 09-873-EL-FAC

**DIRECT TESTIMONY OF  
PHILIP J. NELSON  
ON BEHALF OF  
COLUMBUS SOUTHERN POWER COMPANY  
AND  
OHIO POWER COMPANY**

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PHILIP J. NELSON  
CASE NOS. 09-872-EL-FAC and 09-873-EL-FAC**

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1   **Q.   PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2   **A.**   My name is Philip J. Nelson. My business address is 1 Riverside Plaza, Columbus,  
3       Ohio 43215.

4   **Q.   PLEASE INDICATE BY WHOM YOU ARE EMPLOYED AND IN WHAT**  
5       **CAPACITY.**

6   **A.**   I am employed as Managing Director of Regulatory Pricing and Analysis in the  
7       Regulatory Services Department of American Electric Power Service Corporation  
8       (AEPSC), a wholly owned subsidiary of American Electric Power Company, Inc.  
9       (AEP). AEP is the parent company of Columbus Southern Power Company (CSP)  
10      and Ohio Power Company (OPCo), referred to collectively as AEP Ohio, or the  
11      Companies.

12                               **BUSINESS EXPERIENCE**

13   **Q.   PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND**  
14       **AND BUSINESS EXPERIENCE.**

15   **A.**   I graduated from West Liberty University in 1979 receiving a Bachelor of Science  
16       Degree in Business Administration, majoring in accounting. In 1979, I was employed  
17       by Wheeling Power Company, an affiliate of AEP, in the Managerial Department. At  
18       Wheeling Power, I was responsible for rate filings with the Public Service

Commission of West Virginia (PSC), for resolving customer complaints made to the PSC, as well as for preparation of the Company's operating budgets and capital forecasts. In 1996 I transferred to the AEP-West Virginia State Office in Charleston, West Virginia as a senior rate analyst. In 1997 I transferred to AEPSC as a senior rate consultant in the Energy Pricing and Regulatory Services Department, with my primary responsibility being the oversight of OPCo's and CSP's Electric Fuel Component (EFC) filings. In 1999 I transferred to the Financial Planning Section of the Corporate Planning and Budgeting Department as a Staff Financial Analyst. I held various positions in the Corporate Planning and Budgeting Department until my transfer to Regulatory Services in February, 2010.

**Q. WHAT ARE YOUR RESPONSIBILITIES AS DIRECTOR OF STRATEGY, PRICING AND ANALYSIS?**

A. My department supports regulatory filings across the AEP system in the areas of cost of service, rate design, cost recovery trackers and tariff administration. It also provides expert witness testimony on the west power pool as well as technical advice and support for west power settlements and performs financial analysis of changes to AEP's generation fleet, the east power pool and PJM issues. In addition, my department provides support and filing of generation and transmission formula rate contracts.

**Q. HAVE YOU EVER SUBMITTED TESTIMONY AS A WITNESS BEFORE A REGULATORY COMMISSION?**

A. Yes. I have testified before the Virginia State Corporation Commission and the Public Service Commission of West Virginia on behalf of Appalachian Power, before

1 the Public Service Commission of West Virginia on behalf of Wheeling Power,  
2 before the Indiana Utility Regulatory Commission on behalf of Indiana Michigan  
3 Power Company and before the Public Utilities Commission of Ohio (Commission)  
4 on behalf of CSP and OPCo.

5  
6 **PURPOSE OF TESTIMONY**

7 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

8 A. The purpose of my testimony is to address certain Management and Financial Audit  
9 Recommendations made in the Report of the Management/Performance and Financial  
10 Audits of the FAC of the Columbus Southern Power Company and the Ohio Power  
11 Company (Audit Report) filed on May 14, 2010 by Energy Ventures Analysis, Inc.  
12 (EVA or Auditor). Specifically, I address Management Audit Recommendations 1,  
13 (together with Company witnesses Rusk and Dooley) and 3, and Financial Audit  
14 Recommendations 6a, 6b, 6e, 6f, 6g and 6j. The audit recommendations are  
15 summarized on pages 1-6 through 1-9 of the May 14 Audit Report.

16  
17 **BACKGROUND OF THE ESP FAC**

18 **Q. PLEASE BRIEFLY DESCRIBE THE BACKGROUND OF THE FAC FOR**  
19 **THE COMPANIES.**

20 A. CSP and OPCo filed as part of the Electric Security Plan (ESP) (Case Nos. 08-917-  
21 EL-SSO and 08-918-EL-SSO) and SB 221 a request for a fuel clause or FAC to be  
22 effective January 1, 2009. SB 221 was signed into law by the governor May 1, 2008.  
23 The Companies filed their application for an ESP and a FAC on July 31, 2008. From

January 1, 2001 through the end of the RSP on December 31, 2008 the Companies did not have a fuel clause. Therefore, changes in fuel costs, including fuel contract changes did not have any impact on the Companies' retail rates during that period.

**MANAGEMENT AUDIT RECOMMENDATIONS 1 AND 3**

**Q. WHAT IS THE FIRST MANAGEMENT AUDIT RECOMMENDATION?**

**A.** On page 1-6 of the Audit Report, the first recommendation is set out as follows:

- 1. EVA believes that the PUCO should review whether any proceeds from the Settlement Agreement should be a credit against OPC's FAC underrecovery. This buy-out is somewhat unique as it occurred during a period in which fuel cost recovery was not regulated yet the entire value received was for tons that would have been shipped during the ESP period.**

The 2008 Settlement Agreement referenced above is described more fully by Companies witness Rusk and beginning on page 2-20 of the Audit Report.

**Q. WHAT WERE THE PROCEEDS FROM THE 2008 SETTLEMENT AGREEMENT THAT EVA RECOMMENDS THE COMMISSION SHOULD REVIEW?**

**A.** The proceeds included \$■ million in cash payments made in three equal installments and a transfer of mineral and real property interests in coal reserves estimated at \$■ million which resulted from the 2008 Settlement Agreement signed in January of that year. Companies witness Dooley describes the accounting for the proceeds.

1 **Q. DO YOU AGREE THE COMMISSION SHOULD REVIEW THE 2008**  
2 **SETTLEMENT AGREEMENT IN CONNECTION WITH THIS FAC**  
3 **PROCEEDING?**

4 A. OPCo does not object to the Commission reviewing the 2008 Settlement Agreement,  
5 for fuel costs incurred during the 2009 audit period for the FAC. In accordance with  
6 the Commission's ESP order and the prior RSP order, OPCo had no fuel clause in  
7 2008 under the RSP, but beginning in 2009 all fuel expense and credits are  
8 recognized as costs or benefits to its customers. At the time the 2008 Settlement  
9 Agreement was entered into, there was no FAC and no way to know that the FAC  
10 would be reinstated for the Companies in 2009. Also there is no guarantee that the  
11 Companies will always have an FAC in the future. Consequently, the Companies  
12 maintain that the Commission should limit its review in this proceeding to the audit  
13 period. OPCo is comfortable that the review will confirm that it made the proper  
14 entries on its books and that payments made or compensation received were treated in  
15 accordance with FAC/ESP commencement on January 1, 2009.

16 **Q. SHOULD ANY ADDITIONAL PROCEEDS FROM THE 2008 SETTLEMENT**  
17 **AGREEMENT BE CREDITED AGAINST OPCO'S FAC**  
18 **UNDERRECOVERY?**

19 A. No, for various reasons. First, it is essential to put the 2008 Settlement Agreement in  
20 the proper context of the time at which it occurred. As discussed by Companies  
21 witness Rusk, negotiations began in late 2007 at the request of the coal supplier and at  
22 the time OPCo was under the Rate Stabilization Plan (RSP). OPCo did not have an  
23 active fuel clause and SB 221 was far from being enacted. Coal prices were very

high and as stated in the Audit Report, the FOB mine price for the contract coal was \$■ per ton compared to a market price of over \$100 per ton. Any concessions and financial consequences to OPCo were incurred in the absence of a fuel clause.

**Q. DID OPCO ACCOUNT FOR THE 2008 SETTLEMENT AGREEMENT IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRACTICES (GAAP)?**

A. Yes. OPCo accounted for the 2008 Settlement Agreement in accordance with GAAP as explained by Companies witness Dooley. The proper accounting included the recordation of the Reserves to Account 121, non-utility property, which would have been the treatment regardless of whether the Company had a fuel clause or not. The proper accounting also resulted in some of the 2008 Settlement Agreement payments received by OPCo being flowed through the FAC, as Mr. Dooley explains.

**Q. DID OPCO HAVE TRANSACTIONS WHICH DISADVANTAGED IT BY NOT HAVING A FUEL CLAUSE IN 2008 UNDER THE RSP?**

Yes. For example, OPCo made payment during 2008 in the amount of \$■ million to another coal supplier, as discussed by Companies witness Rusk. This payment was expensed to account 501 and reduced OPCo's 2008 earnings. OPCo has not sought recovery of this payment since it, like the 2008 Settlement, pre-dated the FAC. Also, other fuel costs increased substantially in 2008. If OPCo had a fuel clause in place in 2008, OPCo would have been protected from the escalation in fuel costs. Accordingly, the Commission should not entertain reaching back into 2008 for a single contract and falsely presume that OPCo had a fuel clause and the ability to make fuel deferrals in 2008.



1    **Q.    HAS THE AUDITOR ASSOCIATED THE 2008 SETTLEMENT**  
2    **AGREEMENT PROCEEDS TO OPCO'S DEFERRED FUEL BALANCE?**

3    **A.**    Yes, that appears to be the case. The Auditor has associated the proceeds to the  
4    deferral balance by apparently presuming that had the original contract stayed in  
5    place the coal would have been delivered at a lower price and therefore, the 2009  
6    deferral would have been lower. This assumption is speculative. As stated in the  
7    Audit Report on page 2-20, the existing contract price was well below market. In  
8    addition, the Auditor has not suggested that OPCo acted imprudently in renegotiating  
9    the contract or that the new price of the delivered coal was in excess of the market  
10   price at the time it was negotiated. Moreover, as discussed in Companies witness  
11   Rusk's testimony, it was anticipated at the time of the ESP that existing coal contracts  
12   would have needed to be renegotiated at prices closer to the market because these  
13   contracts were not sustainable.

14   **Q.    HAS THE AUDITOR SUGGESTED THAT THE COMPANY SOUGHT TO**  
15   **TRANSFER VALUE FROM RATEPAYERS BY ENTERING INTO THE 2008**  
16   **SETTLEMENT?**

17   **A.**    No. The Auditor states on page 2-22 of the Audit report that "EVA does not mean to  
18   suggest any motivation on the part of AEPSC to transfer value from ratepayers in  
19   2009 to 2011 to an earlier date."

20   **Q.    WOULD THE FULL AMOUNT OF THE 2008 SETTLEMENT AGREEMENT**  
21   **PAYMENT AND THE RESERVES AFFECT THE RETAIL DEFERRED**  
22   **FUEL BALANCE BY THE AMOUNTS SET OUT IN THE AUDIT REPORT?**

1   **A.**   No. All the amounts that have been discussed in the Audit Report and in the  
2       Companies' testimony associated with the 2008 Settlement Agreement are total  
3       OPCo amounts. OPCo's total generation output greatly exceeds its retail sales.  
4       Therefore, had a fuel clause existed in 2008, the impact on the retail fuel deferral  
5       would have been only a portion of the total OPCo amounts that were discussed in the  
6       Audit Report.

7  
8                                   **CARDINAL UNIT 1 FGD**

9   **Q.**   **WHAT IS THE THIRD MANAGEMENT AUDIT RECOMMENDATION AND**  
10       **DO YOU HAVE ANY COMMENTS CONCERNING THE CARDINAL UNIT 1**  
11       **SCRUBBER?**

12   **A.**   The Auditor's third recommendation which appears on page 1-7 of the Audit Report  
13       is:

14               **3. EVA recommends that the next management/performance auditor**  
15               **review the Cardinal 1 scrubber situation and determine what if any**  
16               **FAC costs are due to this situation.**

17       The Cardinal 1 Scrubber issue is discussed in more detail beginning on Audit Report  
18       page 4-1. In addition, I can report the following about the status of the Cardinal Unit  
19       1 flue gas desulfurization (FGD) system. Black & Veatch (B&V) will honor the  
20       original warranty for the FGD retrofit, which will include upgrades to improve  
21       system reliability and, in the future, reduce the amount of outage time that has been  
22       necessary to clean the system. After the initial installation, when it was determined  
23       that there were operational difficulties with the FGD design, it was necessary to

1 remove Cardinal Unit 1 from service approximately every 6 weeks to clean the jet  
2 bubbling reactor (JBR) internals. After gaining more operational experience with the  
3 JBR, the interval between cleaning outages was increased to 8 weeks, and has  
4 continued to improve. While these more frequent cleaning outages will be necessary  
5 until repairs are performed in the 2011/2012 time frame, the interval between  
6 cleaning outages has increased since the design deficiencies were identified. The  
7 operation of the FGD system has effectively removed sulfur from flue gas. Because  
8 the FGD system performs well from a sulfur removal standpoint, it has not been  
9 necessary to alter the coal supply to Cardinal Unit 1 as a result of the retrofit.

10 As to the Auditor's recommendation, OPCo does not take exception with the  
11 identified Cardinal Unit 1 FGD operational issue being reviewed in the next FAC  
12 audit. However, the review of this particular issue should be limited to its effect on  
13 the FAC. The Audit should focus on whether OPCo was prudent in its actions once  
14 the problems were discovered, and whether those responses had any impact on FAC  
15 expense.

16  
17 **FINANCIAL AUDIT - RTD ISSUES**

18 **Q. ON PAGES 1-8 AND 1-9, THE AUDITOR MAKES SEVERAL**  
19 **SUGGESTIONS REGARDING ADMINISTRATION OF AND ACCOUNTING**  
20 **FOR THE COAL BARGING AGREEMENT UNDER WHICH RIVER**  
21 **TRANSPORTATION DIVISION (RTD) TRANSPORTS COAL TO SOME OF**  
22 **OPCO'S AND CSP'S POWER PLANTS. WOULD YOU PLEASE PROVIDE**  
23 **SOME BACKGROUND REGARDING THE SERVICE SUPPLIED BY RTD?**

1 A. Yes. RTD is a division of Indiana Michigan Power Company (I&M), a subsidiary  
2 company of AEP. Barge freight services are provided at cost by RTD to its affiliates  
3 under the "Barge Transportation Agreement." RTD's costs are allocated to the  
4 operating companies based on each company's utilization of the barging service.  
5 These costs are considered transportation costs and are included in the cost of coal  
6 inventory.

7 Q. **TO THE BEST OF YOUR KNOWLEDGE, IS AEPSC IN COMPLIANCE**  
8 **WITH THE REFERENCED SERVICE AGREEMENT?**

9 A. Yes, to my knowledge, AEPSC is in compliance with the referenced service  
10 agreement. During the audit, AEPSC did make corrections to an issue that surfaced  
11 during the preparation of a response to an audit question. This was promptly brought  
12 to the attention of the auditor by AEPSC and remedied as soon as possible. This  
13 matter is identified by recommendations 6c and 6d in the Audit Report.

14 Q. **PLEASE DISCUSS THE ADDITIONAL FINANCIAL AUDIT**  
15 **RECOMMENDATION RELATED TO RTD, SPECIFICALLY**  
16 **RECOMMENDATIONS 6a, 6b, 6e, 6f, 6g and 6j APPEARING ON PAGES 1-8**  
17 **AND 1-9 OF THE AUDIT REPORT.**

18 A. In item 6a the Auditor has made a general recommendation for the Companies to  
19 explain and justify the Investment Base and Cost of Capital Adder included in the  
20 determination of barge rates billed to the AEP operating companies. I will address  
21 this recommendation by responding to the more specific recommendation made by  
22 the Auditor in 6e and 6f on the same topics. The financial auditor in 6e and 6f has  
23 questioned the inclusion of balance sheet items in the 1/8 Operation and Maintenance

(O&M) cash working capital formula. The Auditor suggests that the balance sheet items are more appropriately included as 13-month averages more in line with a traditional rate base calculation. Likewise, in item 6j they have suggested that the Companies should prepare an explanation why Accumulated Deferred Income Taxes (ADIT) are not being deducted from the investment base as is typically done when computing rate base. The Companies agree with the Auditor that these items are not being treated in the traditional rate base manner. The calculation being performed by RTD is a reasonable approach and is permitted by the agreement, however, the Auditor's suggestion is acceptable to the Companies. Beginning January 1, 2011 the RTD division will amend its calculation to be more in accordance with traditional rate base treatment. The balance sheet items will be removed from the 1/8 O&M calculation. Prepayments and Materials & Supplies will be included as 13 month averages consistent with the Personal Property (Plant) calculation. Also, a 13 month ADIT balance will be calculated and the investment base ("rate base") will be adjusted accordingly. There is no need for a quarterly report in this area. The Companies will make those modifications that conform to the approved agreement and as discussed above.

In 6b the Auditor states that "RTD should be required to provide a procedure for updating the cost of capital and Return on Equity component that is commensurate with the risk of the operation." This recommendation is unnecessary. The RTD agreement provides a procedure for updating the cost of capital and Return on Equity (ROE) component that is commensurate with the risk of the operation. The ROE is adjusted on January 1 each year to the return "allowed by FERC in a

1       wholesale rate proceeding involving” I&M. In the absence of a recent FERC order  
2       the ROE becomes that established by the Indiana Utility Regulatory Commission in  
3       its most recent order. Since RTD is a division of I&M, not a separate legal entity,  
4       using I&M’s ROE as determined by the FERC or Indiana is commensurate with the  
5       risk of the operation. With respect to the Auditors’ recommendation 6g filed in this  
6       proceeding that “Other Administrative Expenses and AEP Admin Charges should be  
7       reviewed in detail in the next audit period, the Companies have no objection.

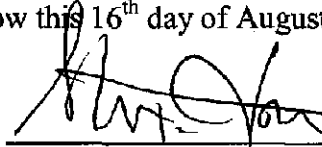
8       **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

9       **A.** Yes it does.

10  
11

## CERTIFICATE OF SERVICE

I hereby certify that a copy of the Public Version of the Direct Testimony of Philip J. Nelson on behalf of Columbus Southern Power Company and Ohio Power Company was served by U.S. Mail upon the individuals listed below this 16<sup>th</sup> day of August, 2010.



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