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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to § 4928.143, Ohio Rev. Code, in the Form of an Electric Security Plan.	:	Case Nos. 11-346-EL-SSO 11-348-EL-SSO
In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority.	:	Case Nos. 11-349-EL-AAM 11-350-EL-AAM

PREFILED TESTIMONY
OF
RICHARD E. RETTERER

ON BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO
UTILITIES DEPARTMENT
ACCOUNTING & ELECTRICITY DIVISION

STAFF EX. ___

August 4, 2011

1. Q. Please state your name and business address.

A. My name is Richard E. Retterer, 180 East Broad Street, Columbus, Ohio, 43215-3793.

2. Q. By whom are you employed and in what capacity?

A. I am a Utility Specialist 2 in the Accounting & Electricity Division of the Utilities Department for the Public Utilities Commission of Ohio.

3. Q. Briefly state your educational background, experience and qualifications.

A. I graduated from The Ohio State University with a Bachelor of Science Degree in Business Administration. After graduation, I was employed by the Columbia Gas System where I held several job positions with increasing responsibilities in the Regulatory Department. During that time, I had contact with commissions in the states of Kentucky, Maryland, Ohio, Pennsylvania, West Virginia, and with the Federal Energy Regulatory Commission. I have presented testimony before the Pennsylvania and West Virginia Public Service Commissions. I also worked as a consultant to gas utilities and presented testimony on behalf of Apollo Gas Company, Carnegie Natural Gas Company, Claysville Natural Gas Company, Cook Forest Gas Company and Equitable Gas Company. During this time my duties also included the management of Cook Forest Gas Company.

I attended the American Gas Association's Advanced Rate Seminar conducted by the University of Maryland and the Fundamentals of Finance & Accounting for the Non-Financial Executive presented by the Wharton School of Business from the University of Pennsylvania.

4. Q. What is the purpose of your testimony?

A. I am responsible for the "carrying cost" calculation on all the riders.

5. Q. Please list the riders you plan to discuss.

A. The Companies' list of current riders includes: a Fuel Adjustment Clause (FAC), Provider of Last Resort (POLR), an Environmental Investment Carrying Cost Rider (EICCR), a Transmission Cost Recovery Rider (TCRR), an Economic Development Rider (EDR), an Energy Efficiency and Peak Demand Response Rider (EE/PDR), a gridSMART® Rider, and an Enhanced Service Reliability Rider (ESRR).

New riders proposed in this ESP include: a Generation Resource Rider (GRR), an Alternative Energy Rider (AER), a Standard Offer Generation Service Rider (GSR), Market Transition Rider (MTR), a Distribution Investment Rider (DIR), a Generation NERC Compliance Cost Recovery Rider (NERCR), a Phase-In Recovery Rider (PIRR), a Facilities Closure Cost Recovery Rider (FCCR), a Green Power Portfolio Rider (GPPR), a

Carbon Capture and Sequestration Rider (CCSR), and a Rate Security Rider (RSR).

6. Q. Are the "carrying cost" calculations the same on all the riders?

A. No, after reviewing the above riders and the testimony of the Companies' witnesses, it became apparent that "carrying cost" calculations are being used for two purposes. First, carrying cost factors were used to calculate revenue requirements the Companies would be entitled to collect if the expenditures were included in a base rate case. This is more commonly referred to formula rate-making. The factor used in this methodology can include several components. In the last ESP filing for these Companies, the components were a weighted average cost of capital (WACC), depreciation rates, an adjustment for Federal Income Taxes, and a combined component based Property taxes and Administrative and General Expense.

7. Q. Do you have any proposed changes on the rate making type of "carrying cost?"

A. Yes I do. I am recommending the depreciation factor as developed by the Companies be based on Commission-approved depreciation factors. Currently the factor utilized includes the depreciation rate adjusted to reflect the revenue impact of a declining rate base. It is my opinion the impact of the declining rate should be set out separately and shown as an adjustment to the return allowance. There would be no change to the revenue requirement, only presented in a different manner. I also propose the elimination of the A&G component from the calculation. These are not incremental costs and allowing them to be recovered as part of riders could result in double recovery. The amount subject to double recovery increases if the Companies are allowed to include another component to recover O&M expenses as proposed by the Companies.

8. Q. To which riders do your changes noted above apply?

A. The gridSmart® Rider, Enhanced Service Reliability Rider (ESRR), Generation Resource Rider (GRR), Standard Offer Generation Service Rider (GSR), Generation NERC Compliance Cost Recovery Rider (NERCR), Alternative Energy Rider (AER), and Environmental Investment Carrying Cost Rider (EICRR).

9. Q. Are you proposing any other changes to these riders?

A. Yes, the gridSMART® Rider was approved for the years 2009, 2010 and 2011. Columbus Southern Power is proposing to extend the rider for the second phase. If this is approved, I recommend that the rider be based on the plant in service and not on the expenditures of the Company. This allows Staff a better opportunity to audit and verify amounts on the books and records of the Company.

Staff also notes that the carrying cost calculations in the EICCR Rider were based on month's balances that included the prior month's carrying costs. The carrying costs have both a debt and equity components and, by including the equity component in the next month's calculation balance, the Companies are compounding equity returns. It is Staff's opinion that this compounding of equity return should be eliminated because it allows the Companies to earn a return on investment greater than would be allowed in a base rate case.

The Companies also filed Supplemental Direct Testimony summarizing the Turning Point Solar Project (TSP) and the proposed accounting on July 1, 2011. Staff has reviewed the Supplemental filing and the proposed carrying cost calculations. It appears the Companies are using a carrying cost factor to calculate the revenue requirement to be recovered and a carrying cost rate applied to the over/under recovery of the calculated revenue requirement. Final determination of the carrying costs should be subject to further review if and when Turning Point is approved for recovery in the GRR.

10. Q. What is the other application of "carrying costs"?

A. These calculations were used to determine the cost of financing expenditures. This compensates Companies for the time lag between the incurrence of the expense and the recovery of the expenditure. These calculations were based on either the cost of debt or the weighted cost of capital (WACC). In some cases the equity portion of the WACC is adjusted to reflect the income tax effect.

11. Q. Will you identify the "carrying cost" riders?

A. Yes, however different riders have different factors.

TRANSMISSION COST RECOVERY RIDER (TCRR) – The carrying cost factor used in this rider is the latest Commission-approved debt rate. The latest Commission-approved long-term interest rate recognizes an allowance for the time value of money, and since it is trued up there is no risk component. There is no change proposed for this rider and Staff agrees.

ECONOMIC DEVELOPMENT RIDER (EDR) - The carrying cost used in this rider is the latest Commission-approved weighted average cost of long-term debt. There is no change proposed for this rider and Staff agrees.

DISTRIBUTION INVESTMENT RIDER (DIR) – The Companies are proposing to apply a WACC adjusted to reflect income taxes impact on the equity return (pre-tax WACC) plus a component for O&M expenses to investment. Staff witness Doris McCarter discusses the O&M component. Since the expenditures in this rider are plant-related, Staff supports the use of the pre-tax WACC for calculating revenue requirement. However, carrying costs during the recovery period should be based on the latest Commission-approved long-term debt rate to recognize the time lapse the Companies incur before they receive full recovery of the approved amount.

PHASE-IN RECOVERY RIDER (PIRR) – The carrying costs on these deferred assets are calculated by applying a pre tax return to the deferred costs. I agree with this methodology and the adjustment discussed by Staff Witness Tammy Turkenton, who is supporting the elimination of the Accumulated Deferred Income Taxes (ADIT) from the carrying cost calculations because it is a source for financing. Accumulated deferred income taxes result from the Companies reflecting actual expenses on the Companies' income tax calculation when they are incurred and not when they are recovered. The higher expenses reflected on the tax return reduce the Companies' tax liability on their books, but this will be reversed when the Companies collect the revenues. The reduced tax liability generated by this timing difference reduces the need for additional financing. To pass the benefit on to the ratepayer, the Companies should apply the tax savings as an offset to the deferred balance before applying the carrying cost factor. Staff Witness Tammy Turkenton's testimony also recommends applying the latest Commission-approved long-term debt rate to calculate carrying cost during the recovery period, and I support the same in this rider. Applying the latest Commission-approved long-term debt rate over the recovery period compensates the Companies for the time difference between the incurrence of the expense and the recovery. Excluding the equity return during the recovery period recognizes that the Companies are no longer at risk for recovery.

FACILITIES CLOSURE COST RECOVERY (FCCR) – Staff Witness Jodi Bair's testimony does not support recovery of these costs; however, if the Commission approves this rider, Staff recommends the following modifications to the Companies' calculations. The Companies are proposing to apply a factor consisting of two components. These factors will be applied to the net book value of the assets as they are retired and eliminated from the Companies' books. The first component is a WACC, adjusted to reflect income taxes impact on the equity return (pre-tax WACC). Staff supports using the pre-tax WACC to determine the revenue amount the Companies are allowed to recover. The second component used in the calculation recovers O&M expenses. Staff proposes to eliminate the O&M component from the calculation unless it is incremental cost. However, once the amount to be recovered is determined, Staff recommends that the Companies use the latest Commission-approved long-term debt rate to calculate carrying costs during the recovery period. Staff's proposal to not include an equity component is based on the Companies having no recovery risk once the recovery amounts have been determined.

CARBON CAPTURE AND SEQUESTRATION RIDER (CCSR) - The Companies are proposing to apply a pre tax WACC plus a component for O&M expenses to develop a factor that applied to the investments. Since the expenditures in this rider are plant-related, Staff supports the use of the pre-tax WACC to calculate their revenue requirement. However Staff does not support the inclusion of an O&M component in the "carrying cost" factor, because it allows the Companies to collect these costs in both the base rates and in this rider. Once the revenue requirement is established, the time over which the revenue is collected value should be based on the latest Commission-approved long-term cost of debt rate.

FUEL ADJUSTMENT CLAUSE (FAC) – There are no carrying cost calculations associated with this rider.

PROVIDER OF LAST RESORT (POLR) – There are no carrying cost calculations associated with this rider.

ENERGY EFFICIENCY AND PEAK DEMAND RESPONSE (EE/PDR) - There are no carrying cost calculations associated with this rider.

MARKET TRANSITION RIDER (MTR) – There are no carrying cost calculations associated with this rider.

GREEN POWER PORTFOLIO RIDER (GPPR) – The Companies are not proposing a carrying cost on these revenues since they flow through the AER and the filings are made quarterly.

RATE SECURITY RIDER (RSR) - There are no carrying cost calculations in this rider.

12. Q. Does that conclude your testimony?

A. Yes it does.

PROOF OF SERVICE

I hereby certify that a true copy of the foregoing **Prefiled Testimony of Richard E. Retterer,** submitted on behalf of the Staff of the Public Utilities Commission of Ohio, was served by regular U.S. mail, postage prepaid, or hand-delivered, upon the following Parties of Record, this 4th day of August, 2011.

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