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Via E-File

April 2, 2012

Public Utilities Commission of Ohio
PUCO Docketing
180 E. Broad Street, 10th Floor
Columbus, Ohio 43215

In re: Case No. 11-4920-EL-RDR and 11-4921-EL-RDR

Dear Sir/Madam:

Please find attached the COMMENTS OF THE OHIO ENERGY GROUP for filing in the above-referenced matter.

Copies have been served on all parties on the attached certificate of service. Please place this document of file.

Respectfully yours,

Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
Jody M. Kyler, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
Encl.
Cc: Certificate of Service

BEFORE THE
PUBLIC UTILITY COMMISSION OF OHIO

In The Matter Of The Application Of Columbus Southern Power Company For Approval Of A Mechanism To Recover Deferred Costs Ordered Until Ohio Revised Code 4928.144	:	**Case No. 11-4920-EL-RDR**
In The Matter Of The Application Of Ohio Power Company For Approval Of A Mechanism To Recover Deferred Costs Ordered Until Ohio Revised Code 4928.144	:	**Case No. 11-4921-EL-RDR**

COMMENTS OF THE THE OHIO ENERGY GROUP

The Ohio Energy Group ("OEG") hereby submits Comments to the Public Utilities Commission of Ohio ("Commission") in this proceeding. OEG's members who are participating in this intervention are: AK Steel Corporation, Aleris International, Inc., Amsted Rail Company, Inc., ArcelorMittal, USA, BP-Husky Refining, LLC, E.I. DuPont de Nemours & Company, Ford Motor Company, GE Aviation, Procter & Gamble Co., Linde, Inc., Praxair Inc., RG-Steel, The Timken Company and Worthington Industries. These companies purchase large amounts of electric power services from Columbus Southern Power Company and Ohio Power Company (collectively, "AEP Ohio" or "the Company").

Respectfully submitted,

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April 2, 2012

COUNSEL FOR THE OHIO ENERGY GROUP

BEFORE THE
PUBLIC UTILITY COMMISSION OF OHIO

In The Matter Of The Application Of Columbus Southern Power Company For Approval Of A Mechanism To Recover Deferred Costs Ordered Until Ohio Revised Code 4928.144	:	**Case No. 11-4920-EL-RDR**
In The Matter Of The Application Of Ohio Power Company For Approval Of A Mechanism To Recover Deferred Costs Ordered Until Ohio Revised Code 4928.144	:	**Case No. 11-4921-EL-RDR**

COMMENTS OF THE
THE OHIO ENERGY GROUP

I. The Commission Should Require AEP Ohio to Reduce the Deferred Fuel Costs by the Relevant Accumulated Deferred Income Tax Amounts When Computing the Monthly Carrying Costs During the Recovery Period.

During the deferral period, AEP Ohio failed to reduce its deferred fuel costs by the related accumulated deferred income tax ("ADIT") when computing the carrying costs on the deferred fuel costs. The Company proposes to use this same methodology prospectively.[1] Accordingly, the Company proposes no reduction for ADIT on the deferred fuel costs during the recovery period (2012 through the end of the amortization period in 2018) when computing the monthly carrying costs. The Commission should reject AEP Ohio's proposal and instead should require the Company to reduce the deferred fuel costs by the relevant ADIT during the recovery period so that the carrying costs reflect the Company's actual financing costs. The Company's proposal requires customers to pay more than the Company's actual financing costs on the deferred fuel costs by ignoring the avoided financing costs from the tax savings. In these Comments, OEG addresses only the proper calculation of the carrying charges on the deferred fuel. OEG does not propose and has never proposed that the recovery of the principal amount of the deferred fuel be reduced by ADIT.

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[1] AEP Ohio Application at 3.

The amount of ADIT, referred to as the "tax shield," is an essential component of any analysis of the economic and financial effects of regulation.[2] ADIT represents a reduction in the income taxes paid by AEP Ohio. During the deferral period, AEP Ohio deducted the fuel expenses as they were incurred for income tax purposes, but did not have any matching revenue (income) to be taxed because the Commission deferred the recovery of that revenue from AEP Ohio's customers. Accordingly, the Company received income tax savings during the deferral period. These income tax savings reduced the amount of the deferred fuel costs that had to be financed and thus, should reduce the carrying costs that must be recovered in order for the Company to be made whole. Conversely, during the recovery period, AEP Ohio will receive revenue from recovery of the deferred fuel costs, but will have no deductions against that income. Thus, only during the recovery period will the Company pay the income taxes that they did not pay during the deferral period. In essence, the federal and state governments provided interest free loans during the deferral period that will only be paid back during the recovery period.

This means that the Company did not have to finance the entire amount of the deferred fuel costs. Instead, the Company financed the amount of deferred fuel costs minus (or "net-of") the income tax savings gained during the deferral period. Consequently, the Commission should require AEP Ohio to reduce the deferred fuel costs by the relevant amount of ADIT during the recovery period when computing the carrying costs on the unamortized deferred fuel. This method correctly and accurately reflects the actual financing costs that the Company incurs on the unrecovered and unamortized deferred fuel costs until the principal amounts of the deferred fuel costs are fully recovered by the Company.

In AEP Ohio's first Electric Security Plan ("ESP") proceeding, the Commission found that the Company should use a grossed up weighted average cost of capital as the carrying charge rate for purposes of the deferred fuel costs during the deferral period.[3] The Commission expressed concern

[2] For example, the rate base for a utility regulated on a cost-basis includes net plant, but the rate base also is reduced by the ADIT effects of accelerated tax deprecation in excess of straight line tax depreciation.
[3] Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Opinion & Order at 23-24.

that the use of a a net-of-tax, rather than a gross-of-tax, basis for calculating the carrying charge on the deferred fuel costs during the recovery period is inconsistent with R.C. 4928.144. That statute provides:

> The public utilities commission by order may authorize any just and reasonable phase-in of any electric distribution utility rate or price established under sections 4928.141 to 4928.143 of the Revised Code, and inclusive of carrying charges, as the commission considers necessary to ensure rate or price stability for consumers. If the commission's order include such a phase-in, the order also shall provide for the creation of regulatory assets pursuant to generally accepted accounting principles, by authorizing the deferral of incurred costs equal to the amount not collected, plus carrying charges on that amount.

The statute requires the Commission to authorize carrying charges on the amount of costs deferred as a result of a Commission decision to phase-in rates in a manner consistent with generally accepted accounting principles ("GAAP"). The reduction of rate base in cost-based rates to subtract ADIT is a standard regulatory practice that is consistent with GAAP. The standard ratemaking practice is to include assets in rate base, such as gross plant, less liabilities, such as accumulated depreciation, less ADIT, in order to determine the net investment upon which the utility is allowed to earn a rate of return (carrying costs) and to recover in the revenue requirement. The deferred fuel balance is no different than any other regulatory asset included in rate base that is reduced by the related ADIT in accordance with standard ratemaking practice. The utility is required by GAAP to record the ADIT to reflect such income tax savings. Thus, it is entirely consistent with GAAP to reflect the regulatory asset in rate base, net of accumulated amortization, and net of the related ADIT, all of which are recorded on the utility's accounting books in accordance with GAAP. Further, since the calculation of the carrying costs on the deferred fuel is analogous to including the deferred fuel in rate base, the subtraction of the related ADIT is consistent with normal regulatory practice and is the only accurate reflection of the costs actually incurred by AEP Ohio. Accordingly, the language of R.C. 4928.144 does not bar the Commission from using a more accurate reflection of the deferred costs actually incurred by AEP Ohio to calculate carrying charges.

Though the Commission did not require AEP Ohio to reduce the deferred fuel expenses by related ADIT during the deferral period to calculate the carrying costs, the Commission should require such a reduction during the recovery period. Bifurcating regulatory treatment during an expenditure period and a recovery period is a longstanding regulatory practice and may reflect different rates of return or calculation methods. Although OEG believes that the Company's calculation of carrying costs during the deferral period was in error and inconsistent with the Commission's order, OEG seeks only to correct the calculation prospectively so that the Company does not recover more than its actual carrying costs during the recovery period.

The Company and its affiliates agreed with OEG on this issue in other proceedings. At the hearing for AEP Ohio's first ESP,[4] Company witness Assante confirmed that it was proper to subtract ADIT in the determination of cost-based rates. He not only confirmed this as a matter of principle, but also confirmed that this was the methodology in AEP's other jurisdictions where its utilities were subject to cost-based rates.[5] A fuel adjustment clause ("FAC") rate is a cost-based rate by definition because it provides current or deferred recovery on the basis of the actual FAC costs incurred. The FAC is not an arbitrary or market-based rate. Further, the carrying charge applied to the deferred FAC amounts also is cost-based. Thus, the ADIT should be subtracted from AEP Ohio's deferred fuel costs consistent with traditional cost of service principles used to develop cost-based rates.

In a recent West Virginia fuel expense proceeding, AEP witness Mitchell agreed that it is appropriate to subtract ADIT for cost-based rates. In that case, Appalachian Power Company initially failed to reduce the deferred fuel costs by the related ADIT before it applied the grossed-up weighted average cost of capital to determine the carrying charges. When confronted with this error, Mr. Mitchell conceded that it was appropriate to subtract ADIT from the deferred fuel costs when the grossed-up weighted average cost of capital was used as the carrying charge rate.[6] The deferred FAC costs at issue in this case are no different in concept than the deferred fuel costs in West Virginia.

Additionally, the point that it is appropriate to subtract ADIT from deferred fuel costs was made recently by the auditors in the Staff Report entitled *Report of the Management/Performance and Financial Audits of the FAC of the Columbus Southern Power Company and the Ohio Power Company*

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[4] Case Nos. 08-917-EL-SSO and 08-918-EL-SSO

[5] A copy of the relevant pages from the hearing transcript is attached.

[6] A copy of the relevant pages from Mr. Mitchell's written testimony is attached .

dated May 26, 2011. In that Report, the auditors explained why the Company's calculations should have reflected a subtraction of ADIT from the deferred FAC amounts and quantified the effect for the audit period. The auditors cited the Company's "understanding" of the Commission's Order in the first ESP case, but did not agree that this "understanding" was correct.[7] Therefore, the Commission should require AEP Ohio to reduce the deferred fuel costs by the relevant amount of ADIT during the recovery period

II. The Commission Should Clarify that AEP Ohio can Securitize the Deferred Fuel Expenses as Soon as Possible.

H.B. 364, recently signed into law by Governor Kasich, became effective March 22, 2012. Consequently, AEP Ohio can now initiate the process to securitize the deferred fuel expenses at issue in this proceeding pursuant to R.C. 4928.231. According to AEP Ohio witness Hawkins in the second ESP proceeding, the Companies estimate an annual potential savings of $57 million, or 75% compared to financing the deferred fuel expenses at their grossed-up weighted average cost of capital.[8] Over the seven-year recovery period, the savings from securitization would be hundreds of millions of dollars. There are significant savings that could accrue to customers from securitizing AEP Ohio's deferred fuel costs while interest rates are low. Thus, the Commission should clarify that AEP Ohio can securitize its deferred fuel expenses as soon as possible.

III. If the Commission Establishes a Blended Fuel Adjustment Clause Rate for All AEP Ohio Customers, Then the Commission Should Also Require All AEP Ohio Customers to Pay for Deferred Fuel Costs.

If the Commission intends to blend the FAC rates of Ohio Power Company and what was formerly Columbus Southern Power Company into one combined AEP Ohio FAC rate, then the Commission should likewise require all AEP Ohio customers to pay for the the deferred fuel costs at issue in this proceeding. Because the former subsidiaries have now merged, it is reasonable to treat AEP Ohio as one company and to transition into one single company rate structure. Additionally, customers of what was formerly Columbus Southern Power Company will receive a benefit from the lower FAC rate of

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[7] A copy of the relevant pages from that Report is attached.
[8] Direct Testimony of Renee Hawkins, Case Nos. 11-346-EL-SSO et al. (January 27, 2011) at 7.

Ohio Power Company, which can offset the deferred fuel costs at issue in this case. Simply put, the Commission should act consistently in its treatment of how fuel expenses will be recovered from AEP Ohio customers. OEG supports charging all AEP Ohio customers the same FAC rate and the same deferred fuel cost recovery.

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April 2, 2012

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BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

\- - -

In the Matter of the :
Application of Columbus :
Southern Power Company for:
Approval of its Electric :
Security Plan; an : Case No. 08-917-EL-SSO
Amendment to its Corporate:
Separation Plan; and the :
Sale or Transfer of :
Certain Generating Assets.:
:
In the Matter of the :
Application of Ohio Power :
Company for Approval of :
its Electric Security : Case No. 08-918-EL-SSO
Plan; and an Amendment to :
its Corporate Separation :
Plan. :

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PROCEEDINGS

before Ms. Kimberly W. Bojko and Ms. Greta See, Hearing Examiners, at the Public Utilities Commission of Ohio, 180 East Broad Street, Room 11-C, Columbus, Ohio, called at 9:00 a.m. on Thursday, November 20, 2008.

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Public Utilities Section
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purposes in the year they were incurred whether or not they are fully recovered by fuel adjustment clause revenues?

A. That's correct.

Q. And then would the deferral of the fuel expense create a deferred income tax balance until the fuel cost is recovered?

A. That's correct, yes.

Q. And would that deferred income tax balance provide AEP with temporary income tax savings?

A. It would reduce our income tax.

Q. Yes. So that would potentially be a savings for AEP.

A. It would -- yes, it would generate a lower income tax.

Q. Could then the temporary tax savings be used to help finance the unrecovered fuel balance as a net deferred tax offset to the deferred fuel balance?

A. No. No, that's not correct. I think you are getting confused with what happens when you have a traditional cost of service filing, a traditional cost of service filing, which this is not, and especially this fuel area because we are talking about generation. Generation is not cost based. In that type of a filing the deferred tax is used in the computation of the cost of capital return. And if a rate base -- you reduce the rate base by your deferred taxes and that has the effect of reflecting cost -- cost-free capital from a deferred tax in determining a cost of capital return.

This is not a cost of service filing, ESP filing. We are not determining the return based on a cost of capital rate base approach. We are determining that return based on what the company owns as adjusted for by the earnings test, the excessive earnings test. That earnings test is not based on the company's cost of capital but rather is based on the return of the companies with similar risks, the actual earned return of those companies so it's inappropriate in my opinion to offset the cost of money benefited deferred taxes in determining the carrying cost.

When you buy a car from a car company, from a car dealership, you don't compute the interest after -- after his tax deduction. You compute the tax on the balance owed. In this case what is owed us is the FAC deferrals plus the carrying cost. So it's inappropriate to do what you are suggesting.

Q. In your opinion it's inappropriate. Is it for any tax accounting purposes inappropriate?

A. For what?

Q. For any tax accounting purposes inappropriate?

A. It's inappropriate in the context of this filing. It's irrelevant and inappropriate in my opinion.

Q. And that's your opinion.

A. That would be other people's opinion as well.

Q. Thank you.

MS. WUNG: Thank you, Mr. Assante. I have no further questions.

EXAMINER SEE: Mr. Kurtz.

MR. KURTZ: Thank you, your Honor.

- - -

CROSS-EXAMINATION

By Mr. Kurtz:

Q. The accumulated deferred income tax balance would typically be a rate base also in a -- in a fully regulated environment?

A. In a cost-of-service filing, yes.

Q. And that's what would occur in the other states where AEP operates?

A. Well, we are not subject to cost of
service in every state. Texas, for example, has also gone through a restructuring, but in most of our other states we are subject to cost-of-service ratemaking, yes.

Q. Let me clarify. When I say AEP, I mean

TEM Rebuttal Exhibit No. 1

REBUTTAL TESTIMONY OF
THOMAS E. MITCHELL
ON BEHALF OF APPALACHIAN POWER COMPANY AND
WHEELING POWER COMPANY
BEFORE THE PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA IN CASE NO. 09-0177-E-GI

Q. **PLEASE STATE YOUR NAME.**

A. My name is Thomas E. Mitchell.

Q. **DID YOU PREVIOUSLY FILE DIRECT TESTIMONY IN THIS PROCEEDING?**

A. Yes.

Q. **WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

A. The purpose of my rebuttal testimony is to address the recommendations of Staff witness Oxley, Consumer Advocate Division (CAD) witness Gregg and West Virginia Energy Users Group (WVEUG) witness Baron regarding the use of a short-term debt rate to calculate carrying costs (CC) on deferred ENEC under-recovery balances associated with various phase in plans (PIP) proposed in this case. I will also discuss WVEUG witness Baron's recommendation to reduce the monthly deferral balance on which a CC is applied by the associated Accumulated Deferred Income Taxes (ADIT).

Finally, I will provide additional comments on the need for the Commission's order in this proceeding, regardless of which PIP is ordered, to provide sufficient assurances that the deferred ENEC balances will be recovered over a reasonable period of time. Such assurances are necessary so the Companies can continue to practice SFAS No. 71 regulatory accounting.

Q. **ON WHICH DEFERRED ENEC BALANCES SHOULD THE COMPANIES BE AUTHORIZED TO APPLY A CC BASED UPON THE WACC RATE?**

A. As discussed in Company witness Eads' direct testimony (Eads, page 6) and also in his rebuttal testimony, the WACC rate should be applied to all deferred ENEC balances in excess of those balances that would otherwise occur under the traditional ENEC recovery procedures.

Staff witness Oxley's proposal that a CC should be applied, if at all, only to ENEC balances as of the end of the historical review period, is inadequate. Simply stated, his proposal would not permit the Companies to recover any CC on a significant part of the deferred ENEC balances in excess of those balances that would otherwise occur under the Commission's traditional ENEC procedures.

While CAD witness Gregg's proposal appears to provide for a CC both on under-recovery balances existing on December 31, 2008 and on additional monthly under-recoveries beginning July 1, 2009, as explained by Company witness Eads' in his rebuttal testimony, the Companies have determined that CAD witness Gregg's proposal does not provide them with a CC on all deferred ENEC balances in excess of those balances that occur under the traditional procedures.

Q. **PLEASE DESCRIBE WVEUG WITNESS BARON'S PROPOSAL REGARDING ADIT.**

A. WVEUG witness Baron recommends that the monthly deferred balances on which a CC is applied should be reduced by the ADIT associated with the monthly deferred amounts (Baron, page 18). His approach is effectively a full cost of service approach as if a rate base calculation was being undertaken.

Q. IS WVEUG WITNESS BARON'S APPROACH CONSISTENT WITH THE CALCULATION USED TO DEVELOP THE COMPANIES' CONSTRUCTION SURCHARGE?

A. Yes. The Companies' construction surcharge is intended to effectively treat new construction as if it were included in rate base with an offset for any related ADIT.

Q. HAVE ENEC UNDER OR OVER-RECOVERY BALANCES HISTORICALLY BEEN INCLUDED IN RATE BASE BY THE COMMISSION?

A. No.

Q. WOULD WVEUG WITNESS BARON'S PROPOSED ADIT OFFSET BE APPROPRIATE UNDER CERTAIN CIRCUMSTANCES?

A. Yes. If the Commission determines that the adoption of a PIP is akin to using a rate base approach, it would be appropriate to adopt an ADIT offset, but only if a WACC is used. However, it would be entirely inappropriate to make an ADIT offset, if a CC rate other than the WACC rate is used. This distinction is critical as a WACC rate approach effectively simulates the rate base approach (with cost-free capital recognized). The use of only a short-term debt rate to calculate CC, with an ADIT offset, is not akin to a rate base approach because such an approach ignores long-term debt and equity costs. An ADIT offset should not be used unless a full WACC rate is also applied.

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY RELATING TO CARRYING CHARGES.

A. The use of a CC based upon a full WACC rate is necessary if any of the multi-year PIPs proposed in this case is adopted by the Commission in order to permit the Companies to recover their full actual incurred costs of financing the hundreds of millions of dollars of under-recovered balances that would result.. A related ADIT offset would only be appropriate if a full WACC rate is used. An ADIT offset would be inappropriate if a full WACC is not used to determine CC on under-recovery balances.

Q. DO YOU HAVE ANY CONCLUDING COMMENTS AS TO WHAT LANGUAGE NEEDS TO BE INCLUDED IN ANY COMMISSION ORDER ADOPTING A PIP TO SUPPORT PROBABILITY OF RECOVERY OF ANY DEFERRED ENEC BALANCES, INCLUDING RELATED CARRYING CHARGES?

A. Yes. As discussed in my direct testimony, if the Commission adopts any of the proposed PIPs, the Commission's order should state in specific language that it intends to provide for full recovery of any deferred ENEC balances, including CC, over a reasonable fixed period of time, including subsequent ENEC proceedings (subject to the Commission's normal language that costs must be prudently incurred). Inclusion of such language should enable the Companies to continue to comply with the probability of recovery requirement in SFAS No.71, and to practice regulatory deferral accounting of the deferred ENEC balances as either regulatory assets or regulatory liabilities.

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FILE

REPORT OF THE MANAGEMENT/PERFORMANCE AND FINANCIAL AUDITS OF THE FAC OF THE COLUMBUS SOUTHERN POWER COMPANY AND THE OHIO POWER COMPANY

Case No. 10-268-EL-FAC
Case No. 10-269-EL-FAC
Case No. 10-870-EL-FAC
Case No. 10-871-EL-FAC
Case No. 10-1286-EL-FAC
Case No. 10-~~1287~~ 1288-EL-FAC

May 26, 2011

Prepared for:
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The zero value AEP assigned to its non-Ohio non-solar REC inventory is questionable. A reasonable value for the REC should be assigned. The market information provided would appear to support a nominal value of $1.00 per REC, if not more. Because AEP failed to assign any valued to such REC inventory, its fuel costs for 2010 would be overstated by the amount of REC inventory value. Based on the information provided in response to LA-2010-2-97 and LA-2010-2-104, the difference between assigning a zero value and a $1.00 value to the non-Ohio, non-solar REC inventory for 2010 is approximately [redacted] for CSP and [redacted] for OPCo.

Carrying Costs on Deferred Fuel Balances

AEP Ohio's FAC rider adjusts quarterly. AEP Ohio was granted a carrying cost ratio based on its weighted average cost of capital ("WACC"). The equity portion of the WACC was grossed-up for income taxes. The gross-of-tax WACC allows the Company to recover the cost of investor-supplied financing, including (1) the cost of debt, (2) the cost of equity, and (3) income taxes related to the cost of equity. The carrying cost changes as the debt rate changes.

AEP has applied the gross-of-tax WACC-based carrying cost rate on a monthly basis to the monthly Deferred Fuel balances. AEP supplied detailed calculations of carrying costs for 2010 in response to LA-2010-43 in Excel files for CSP and OP, respectively.

As an example, for January 2010 carrying charges, the WACC is applied, separately for the debt and equity pieces, to the 12/31/2009 Deferred Fuel balance.[40]

Both CSP and Ohio Power have been in an under-recovery position.

In Commission Case Nos. 08-917 and 08-918, originally in the March 18, 2009 Opinion and Order at page 23, and subsequent on rehearing, the Commission authorized AEP Ohio to apply the gross-of-tax WACC to the under-recovered FAC balances. Larkin examined those orders and various filings from those proceedings which were provided to us by AEP Ohio and Staff. Those Commission Orders would appear to allow AEP Ohio to apply the gross-of-tax WACC to the under-recovered FAC balances without any recognition of, or offset for, the related non-investor supplied financing in the form of Accumulated Deferred Income Taxes (ADIT) that is recorded in Account 283, ADIT-Other, for the tax savings that are directly related to the under-recovered FAC balances. However, based on our review, it appears there is a mismatch concerning the authorization of a gross-of-tax WACC based on debt and equity capital, and the application of such a rate to deferred fuel under-recovery balances that were/are financed in part with non-investor supplied capital in the form of directly related credit-balance ADIT.

We did not see in the materials examined from that proceeding, in the context of the Company's carrying cost proposal, a clear presentation from AEP Ohio of the income tax deductions being taken by the Company for fuel costs that are currently deductible for income tax purposes but which are being deferred on its books for future recovery. The Company should address the income tax savings it was/is recording related to the under-recovered FAC balances, and how those provide non-investor supplied capital that is financing a portion of the Deferred Fuel balances that have been recorded in Account 1823144. The Company should specifically address the related credit-balance ADIT that is recorded in Account 283, ADIT-Other, for the tax savings-based financing that appears to be directly related to the under-recovered FAC balances.

[40] This is also referred to as the under-recovered FAC balance.

AEP Ohio is applying the gross-of-tax WACC to the under-recovered FAC balances in the following manner.

For both CSP and OP, AEP is using an ROE of 10.5% at a 50% equity ratio for a weighted cost of 5.25% per month. AEP periodically varies the cost rate for LTD. AEP computes each month a pre-tax cost of capital (based on grossing up the equity return). AEP then adjusts the monthly ROE component each month for an income tax gross up by subtracting the cost of debt from the pre-tax WACC. This results in an applied monthly pre-tax equity rate that fluctuates each month.

Larkin reviewed AEP's calculations of carrying charges for each month of 2010 provided in response to LA-2010-43. The following exhibit provides an illustration of how AEP Ohio has derived the pre-tax WACC and the monthly debt and equity carrying cost rates:

Exhibit 7-69
Illustrative Example of How AEP Ohio Derives the Pre-Tax WACC and Monthly Debt and Equity Carrying Cost Rates

	Columbus Southern		Ohio Power	
Description	Capital Ratio	Cost of Capital	Capital Ratio	Cost of Capital
Debt	50.0%	5.73%	50.0%	5.71%
Equity	50.0%	10.50%	50.0%	10.50%
Total	100.0%		100.0%	
	Weighted Average Cost of Capital	Weighted Pre-tax Cost of Capital	Weighted Average Cost of Capital	Weighted Pre-tax Cost of Capital
Debt	2.86%	2.86%	2.86%	2.86%
Equity	5.25%	8.40%	5.25%	8.40%
Total	8.11%	11.26%	8.11%	11.26%
Annual Debt Rate to be used		5.71% *		5.71% *
Annual Equity Rate to be used		5.55%		5.55%
		11.26%		11.26%
Monthly Debt Rate to be used		0.476% *		0.476% *
Monthly Equity Rate to be used		0.462%		0.462%

Per the response to LA-2010-43, carrying charge calculation Excel files
* As applied by AEP Ohio the cost of debt changes periodically

The gross-of-tax WACC based on a combination of debt and common equity financing represents the cost of investor-supplied capital. As such, it should generally be applied only to the portion of the deferred cost that has been financed by investor-supplied capital. It would generally be a mis-match, and hence inappropriate, to apply such a gross-of-tax WACC to the portion of a deferred cost balance that has actually been financed with non-investor supplied cost-free capital in the form of credit-balance ADIT that is directly related to the cost deferral.

AEP Ohio is applying the monthly debt and pre-tax equity cost rates to under-recovered fuel balances in Account 1823144 without any offset for related credit-balance ADIT it has recorded in Account 283, ADIT-Other. There would typically be credit-balance ADIT related to the fuel under-recoveries.[41] Assuming that the Company's fuel costs are deducted currently for income tax purposes, the deferral of the under-recovery for regulatory accounting would create a temporary difference and a credit-balance ADIT would be recorded. The related tax deduction would essentially provide cost-free financing for a portion of the fuel cost under-recovery. The ADIT is a source of non-investor supplied cost-free capital. Such ADIT is not being deducted from the under-recovered fuel balances in Account 1823144 in AEP Ohio's carrying cost calculations. If the ADIT balance related to the Company's FAC under-recovery balances is not considered, or deducted somewhere else, such as in rate base, ratepayers would be over-paying carrying costs by paying for carrying costs on the portion of the Deferred Fuel balance that has been financed by tax savings, i.e., on the portion not financed with investor-supplied capital. Unless the ADIT related to the under-recovered fuel balances is being recognized somewhere else in the ratemaking process, the pre-tax WACC should be getting applied to an Under-recovered fuel balances that is net of the related credit-balance ADIT, not to the gross Under-recovered balance.

The following exhibit provides an illustrative example of how AEP Ohio has applied the monthly carrying cost rates for debt and equity to the under-recovered fuel balances in Account 1823144 without any offset for related credit-balance ADIT, and an illustration of how that directly related ADIT would finance a portion of the fuel cost under-recovery, and thus reduce the carrying charges[42]:

[41] Ohio Power's 2010 FERC Form 1, at pages 276-277, line 6, for example, shows ADIT-Other (Account 283) related to Deferred Fuel of $109.2 million at January 1, 2010 and $177.1 million at December 31, 2010. Page 450.1 of OP's 2010 FERC Form 1, shows a deduction to pretax book income of $193.9 million for Deferred Fuel Costs. The credit balance ADIT in Account 283 on OP's books represents non-investor supplied cost-free capital that is financing a portion of OP's Deferred Fuel balance.

[42] For illustrative purposes, a simple calculation is presented using round numbers for under-recovered balances and a 40% combined federal and state income tax rate.

Exhibit 7-70
Illustrative Example of How AEP Ohio is Applying the Monthly Pre-Tax Carrying Cost Rates for Debt and Equity to the Under-Recovered Fuel Balances in Account 1823144 and How Reflecting an Offset for Related Credit-Balance ADIT Would Affect the Carrying Cost Calculation

	Columbus Southern		Ohio Power	
Description	Without ADIT Offset	With ADIT Offset	Without ADIT Offset	With ADIT Offset
Monthly Debt Rate to be used	0.476%	0.476%	0.476%	0.476%
Monthly Equity Rate to be used	0.462%	0.462%	0.462%	0.462%
FAC Under-Recovery [1]	$ 50,000,000	$ 50,000,000	$ 400,000,000	$ 400,000,000
Illustative ADIT Offset [2]		$ (20,000,000)		$ (160,000,000)
Amount Being Financed by Investors		$ 30,000,000		$ 240,000,000
Balance for Carrying Costs	$ 50,000,000	$ 30,000,000	$ 400,000,000	$ 240,000,000
Monthly Debt Carrying Costs	$ 238,000	$ 142,800	$ 1,904,000	$ 1,142,400
Monthly Equity Carrying Costs	$ 231,000	$ 138,600	$ 1,848,000	$ 1,108,800
Total Monthly Carrying Costs	$ 469,000	$ 281,400	$ 3,752,000	$ 2,251,200
Difference from Failing to Recognize ADIT Financing:				
Monthly	$ 187,600		$ 1,500,800	
Annual [3]	$ 2,251,200		$ 18,009,600	

Notes
[1] Simple rounded numbers used for illustrative purposes
[2] Computed for illustrative purposes at a 40% combined federal and state income tax rate
[3] For illustrative puposes, annual amount is monthly amount x 12

AEP Ohio believes its carrying cost calculations to apply the gross-of-tax WACC to the under-recovered FAC balances in Account 1823144 (without any recognition of the fact that financing for a portion of the Deferred Fuel balances has provided by income tax savings reflected in the related credit-balance ADIT, Account 283) have been fully consistent with the Company's presentation and the authorization received from the Commission in Case Nos. 08-917 and 08-918, originally in the March 18, 2009 Opinion and Order at page 23, and subsequent on rehearing.

Larkin reviewed AEP Ohio's calculations of the carrying charges on the Deferred Fuel balance and found them to be consistent with AEP Ohio's understanding of the it authorization received from the Commission in Case Nos. 08-917 and 08-918. Larkin also selectively verified the postings of the calculated carrying charge amounts for debt and equity to the deferral account for CSP and OP. No exceptions were noted.

We recommend that AEP Ohio and the other parties to the case re-examine whether the Commission-authorized gross-of-tax WACC for debt and common equity capital should be applied to what such investors are actually financing of the fuel cost under-recovery balances, which would appear to be the Deferred Fuel amounts recorded in Account 182.3 less the directly related credit-balance ADIT for Deferred Fuel recorded in Account 283.

Active Management

LA-2010-44 asked whether AEP Ohio engaged in "active management" during the review period January through December 2010, and if so, to identify, quantify and provide the accounting