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November 8, 2013

Honorable Examiner Sarah Parrot
Administrative Law Judge
Public Utilities Commission of Ohio
180 East Broad Street, 11th Floor
Columbus, Ohio 43215

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Re:
In the Matter of the Fuel Adjustment)
Clause of Columbus Southern Power)
Company and Ohio Power Company)
And Related Matters for 2010)

Case No. 10-268-EL-FAC
Case No. 10-269-EL-FAC

In the Matter of the Fuel Adjustment)
Clause of Columbus Southern Power)
Company and Ohio Power Company)
And Related Matters for 2011)

Case No. 11-281-EL-FAC

Examiner Parrot:

In accordance with the Attorney Examiners September 19, 2013 Entry please find attached the pre-filed direct testimony of Ohio Power Company witnesses Timothy M. Dooley, James D. Henry (Public-Redacted) and Philip J. Nelson. Mr. Henry's testimony includes confidential information from the Audit Report and has been redacted.

Cordially,

//s// Matthew J. Satterwhite

Matthew J. Satterwhite
Senior Counsel

cc: Parties of Record

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the attached Testimony of Ohio Power Company was served via electronic mail upon the below-listed counsel this 8th day of November, 2013.

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EXHIBIT NO. _____

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Fuel Adjustment)	
Clause of Columbus Southern Power)	Case No. 10-268-EL-FAC
Company and Ohio Power Company)	Case No. 10-269-EL-FAC
And Related Matters for 2010)	

In the Matter of the Fuel Adjustment)	
Clause of Columbus Southern Power)	Case No. 11-281-EL-FAC
Company and Ohio Power Company)	
And Related Matters for 2011)	

PRE-FILED DIRECT TESTIMONY OF
TIMOTHY M. DOOLEY
ON BEHALF OF
OHIO POWER COMPANY

Filed: November 8, 2013

1 INDEX TO PRE-FILED DIRECT TESTIMONY OF
2 TIMOTHY DOOLEY
3 CASE NOS. 10-268-EL-FAC, 10-269-EL-FAC, AND 11-281-EL-FAC
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6 SUBJECT

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**BEFORE THE PUBLIC UTILITY COMMISSION OF OHIO
PRE-FILED DIRECT TESTIMONY OF
TIMOTHY M. DOOLEY
ON BEHALF OF OHIO POWER COMPANY
IN CASE NOS. 10-268-EL-FAC, 10-269-EL-FAC, AND 11-281-EL-FAC**

INTRODUCTION

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

2 **A.** My name is Timothy M. Dooley. I am employed by the American Electric Power
3 Service Corporation (AEPSC), a subsidiary of American Electric Power Company, Inc.
4 (AEP), in the Utility Energy & Commercial Accounting group as Director of Energy
5 Accounting. My business address is 155 West Nationwide Boulevard, Suite 500,
6 Columbus, Ohio 43215.

7 **Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**
8 **PROFESSIONAL AFFILIATIONS.**

9 **A.** I graduated from Cleveland State University in 1985 receiving a Bachelor of Business
10 Administration in Accounting. I am a Certified Public Accountant in the State of Ohio,
11 and I am a member of the American Institute of Certified Public Accountants.

12 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND.**

13 **A.** In 1985 I joined AEPSC as an internal auditor and through 1997 held various
14 financial/operational and IT internal audit positions, including the professional
15 designation of Certified Internal Auditor (now inactive). In 1998 I transferred to
16 Accounting Policy & Research where I held staff accounting positions through 2001. In
17 2002 I became a Manager in Utility Energy & Commercial Accounting. I assumed my
18 current position, Director of Energy Accounting, in March 2007.

1 **Q. WHAT ARE YOUR PRINCIPAL AREAS OF RESPONSIBILITY AS DIRECTOR**
2 **OF ENERGY ACCOUNTING FOR AEPSC?**

3 **A.** I am responsible for the accounting and reporting of fuel, consumables, and emission
4 allowances for the generation business units of AEP's eastern and western operating
5 companies, which includes respective transactions for power plants owned and operated
6 by Ohio Power Company (OPCo) and Cardinal Operating Company.

7 **Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY AND/OR TESTIFIED**
8 **BEFORE ANY REGULATORY AGENCIES?**

9 **A.** Yes, I have testified before the Public Utility Commission of Ohio on behalf of OPCo
10 and Columbus Southern Power Company (CSP) and before the Indiana Utility
11 Regulatory Commission on behalf of Indiana Michigan Power Company.

12
13 **PURPOSE OF TESTIMONY**

14 **Q. WHAT IS THE PURPOSE OF YOUR PRE-FILED DIRECT TESTIMONY?**

15 **A.** I am providing pre-filed direct testimony in response to specific portions of the Financial
16 Audit Recommendations in the Report of the Management/Performance and Financial
17 Audits of the Fuel Adjustment Clause ("FAC") of the Columbus Southern Power
18 Company and the Ohio Power Company ("Audit Report") as filed May 26, 2011 ("2010
19 Audit) and May 24, 2012 ("2011 Audit"). The Audit Reports were prepared by Energy
20 Ventures Analysis, Inc. ("EVA") and its subcontractor, Larkin & Associates PLLC
21 ("Larkin") (referred in combination as "Auditor"), under the authority of the Public
22 Utilities Commission of Ohio (the "Commission", also referenced by the Auditor as
23 "PUCO") for its annual FAC audits.

1 **Q. SPECIFICALLY, TO WHICH OF THE RECOMMENDATIONS DO YOU**
2 **RESPOND ON BEHALF OF AEP OHIO?**

3 **A.** I am responding to Financial Audit Recommendations 15 through 18 and Management
4 Audit Recommendations 18 and 20 of the May 26, 2011 Audit Report, and Financial
5 Audit Recommendations 1 through 3, 7, 10, and 11 of the May 24, 2012 Audit Report. I
6 have demonstrated in this testimony that AEP Ohio has been fully responsive and to
7 establish that all of these recommendations should be considered complete, with the
8 exception of one recommendation I consider to be unnecessary. In addition, I introduce,
9 but defer, Financial Audit Recommendation numbers 8 and 9 to AEP Ohio Witness
10 Henry.

11
12 **AUDIT RECOMMENDATIONS**

13 **Q. PLEASE ADDRESS 2010 FINANCIAL AUDIT RECOMMENDATION NUMBER**
14 **15.**

15 **A.** In Financial Audit Recommendation number 15 on page 1-9 of the 2010 Audit Report,
16 the Auditor states that: "AEP should review and update the "Instructions" tab in its
17 monthly FAC support Excel files at least annually". As requested, the monthly FAC
18 support Excel files have been updated. This recommendation can be considered
19 complete.

20 **Q. PLEASE ADDRESS 2010 FINANCIAL AUDIT RECOMMENDATION NUMBER**
21 **16.**

22 **A.** As described on page 1-9 of the 2010 Audit Report, Financial Audit Recommendation
23 number 16 states that: "AEP should identify and separate the renewable energy credits

(RECS) value from the energy and capacity value of its renewable energy purchases”. In docket 11-346-EL-SSO, the PUCO approved, through an order dated August 8, 2012, the implementation of an Alternative Energy Rider (AER). In October 2012, AEP Ohio achieved this separation of costs as dictated and approved in that PUCO order. Please refer to the testimony of AEP Ohio Witness Philip J. Nelson in the above referenced case for details pertaining to the AER calculation.

Q. DID THE AUDITOR MAKE A SIMILAR RECOMMENDATION IN THE 2011 AUDIT?

A. Yes, the exact wording from this 2010 audit recommendation is used in Financial Audit Recommendation 1 from the 2011 Audit.

Q. DOES AEP OHIO HAVE A DIFFERENT POSITION WITH RESPECT TO THE 2011 RECOMMENDATION?

A. No. AEP Ohio has achieved the desired separation of energy and capacity through the use of the AER beginning in October 2012. This recommendation from 2010 and 2011 can be considered complete.

Q. PLEASE ADDRESS 2010 FINANCIAL AUDIT RECOMMENDATION NUMBER 17.

A. Financial Audit Recommendation number 17 of the 2010 Audit Report states that: “AEP should show in detail how REC costs incurred by CSP and OPCo in 2010 have been separately identified and excluded from the 12/31/2010 FAC deferral for each company, CSP and OPCo”. AEP Ohio had been showing the REC expense detail by CSP and OPCo and has been more clearly presented it in the support schedules for the quarterly FAC filings.

1 **Q. DID THE AUDITOR MAKE A SIMILAR RECOMMENDATION IN THE 2011**
2 **AUDIT?**

3 **A.** Yes, the exact wording from this 2010 audit recommendation is used in Financial Audit
4 Recommendation 2 from the 2011 Audit.

5 **Q. DOES AEP OHIO HAVE A DIFFERENT POSITION WITH RESPECT TO THE**
6 **2011 RECOMMENDATION?**

7 **A.** No. AEP Ohio has been showing the requested detail of REC costs by CSP and OPCo.
8 This recommendation from 2010 and 2011 can be considered complete.

9 **Q. PLEASE ADDRESS 2010 FINANCIAL AUDIT RECOMMENDATION NUMBER**
10 **18.**

11 **A.** As described on page 1-9 of the 2010 Audit Report, Financial Audit Recommendation
12 number 18 states that: "AEP should be assigning appropriate values to its Renewables
13 inventory, including its non-Ohio, non-solar REC inventory." AEP Ohio achieved this
14 assignment of REC values with the use of the AER beginning in October 2012.

15 **Q. DID THE AUDITOR MAKE A SIMILAR RECOMMENDATION IN THE 2011**
16 **AUDIT?**

17 **A.** Yes, the exact wording from this 2010 audit recommendation is used in Financial Audit
18 Recommendation 3 from the 2011 Audit.

19 **Q. DOES AEP OHIO HAVE A DIFFERENT POSITION WITH RESPECT TO THE**
20 **2011 RECOMMENDATION?**

21 **A.** No. AEP Ohio has achieved the requested assignment of REC values through the use of
22 the AER beginning in October 2012. This recommendation from 2010 and 2011 can be
23 considered complete.

1 **Q. PLEASE ADDRESS 2010 MANAGEMENT AUDIT RECOMMENDATION**
2 **NUMBER 18.**

3 **A.** In Management Audit Recommendation number 18 on page 1-6 of the 2010 Audit, the
4 Auditor states “EVA recommends that AEPSC work to minimize the costs associated
5 with the closure of the Conesville Coal Preparation Plant. EVA recommends that
6 AEPSC provide its plan for accounting for the closure costs to the auditor for review in
7 the next audit cycle.” As this Management Audit Recommendation is based on financial
8 treatment, I will address this recommendation. However, should any operational
9 questions arise, they should be addressed to AEP Ohio Witness Henry. During the 2011
10 Audit, accounting provided the Auditor with the closure costs and addressed any follow-
11 up questions that were raised by the Auditor with regard to the accounting treatment of
12 closure costs. Following the Auditor’s review of the information provided, the Auditor
13 did not introduce any findings or recommendations in the 2011 Audit (which was
14 performed during 2012). This suggests that there were no concerns for the cost
15 associated with the closure of the Conesville Coal Preparation Plant (CCPP) or the
16 accounting treatment of such costs. Consequently, this recommendation can be
17 considered completed.

18 **Q. PLEASE ADDRESS 2010 MANAGEMENT AUDIT RECOMMENDATION**
19 **NUMBER 20.**

20 **A.** In Management Audit Recommendation number 20 on page 1-6 of the 2010 Audit, the
21 Auditor states “EVA recommends that AEPSC in its next CSP and OPCO Compliance
22 Status Reports correct the allocation of the 2010 solar obligations so that it is clear that
23 should any future force majeure situations occur the accounting procedures are clear.”

1 Although AEP Ohio does not anticipate future force majeure issues, AEP Ohio has
2 updated the report as requested. Consequently, this recommendation can be considered
3 completed.

4 **Q. PLEASE ADDRESS 2011 FINANCIAL AUDIT RECOMMENDATION NUMBER**
5 **7.**

6 **A.** In Financial Audit Recommendation number 7 on page 1-10 of the 2011 Audit, the
7 Auditor states "On January 23, 2012 the Commission issued an Opinion and Order in
8 Case Nos. 09-872-EL-FAC and 09-873-EL-FAC, and on April 11, 2012 issued an Entry
9 on Rehearing in those dockets which provided clarification of AEP Ohio's obligations as
10 they affect crediting OPCO's FAC under-recovery. AEP Ohio's crediting of those
11 clarified amounts against OPCO's FAC under-recovery should be reviewed in the next
12 audit." Respective credits have been booked in accordance with Commission Orders and
13 will be available for review by the Auditor. Consequently, this recommendation can be
14 considered completed in the context of the 2011 Audit.

15 **Q. PLEASE ADDRESS 2011 FINANCIAL AUDIT RECOMMENDATION**
16 **NUMBERS 8 and 9.**

17 **A.** Financial Audit Recommendation numbers 8 and 9 are based on operational aspects that
18 lead to financial treatment; they will be addressed by AEP Ohio Witness Henry's Pre-
19 Filed Direct Testimony. Should financial treatment questions arise during the
20 proceeding, I will be pleased to respond.

21 **Q. PLEASE ADDRESS 2011 FINANCIAL AUDIT RECOMMENDATION NUMBER**
22 **10.**

1 **A.** In Financial Audit Recommendation number 10 on page 1-10 of the 2011 Audit, the
2 Auditor states “Larkin recommends that the \$9,579 difference between the December
3 estimate and actual for Account No. 5550046 as it relates to Lawrenceburg be removed
4 from the 2011 FAC.” AEP Ohio has properly accounted for the Lawrenceburg
5 transaction with any difference simply due to timing. Any difference was appropriately
6 captured in January, 2012. Consequently, this recommendation is unnecessary.

7 **Q. PLEASE ADDRESS 2011 FINANCIAL AUDIT RECOMMENDATION NUMBER**
8 **11.**

9 **A.** In Financial Audit Recommendation number 11 on page 1-10 of the 2011 Audit, the
10 Auditor states “Larkin recommends that AEP Ohio determine and assign a salvage value
11 to the CCPP for the purposes of the depreciation calculations.” CCPP was fully
12 depreciated by the end of 2011. In accordance with Generally Accepted Accounting
13 Principles (“GAAP”), the salvage value was considered and determined to be zero for
14 purpose of depreciation calculations.

15 **Q. PLEASE SUMMARIZE THE AUDIT RECOMMENDATIONS THAT HAVE**
16 **BEEN ADDRESSED IN THIS TESTIMONY.**

17 **A.** I have responded to Financial Audit Recommendations 15 through 18 and Management
18 Audit Recommendations 18 and 20 of the May 26, 2011 Audit Report, and Financial
19 Audit Recommendations 1 through 3, 7, 10, and 11 of the May 24, 2012 Audit Report. I
20 have demonstrated in this testimony that AEP Ohio has been fully responsive and to
21 establish that all of these recommendations should be considered complete, with the
22 exception of one recommendation I consider to be unnecessary.

23 **Q. DOES THIS CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?**

1 A. Yes.

EXHIBIT NO. _____

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Fuel Adjustment)	
Clause of Columbus Southern Power)	Case No. 10-268-EL-FAC
Company and Ohio Power Company)	Case No. 10-269-EL-FAC
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In the Matter of the Fuel Adjustment)	
Clause of Columbus Southern Power)	Case No. 11-281-EL-FAC
Company and Ohio Power Company)	
And Related Matters for 2011)	

PUBLIC REDACTED

PRE-FILED DIRECT TESTIMONY OF
JAMES D. HENRY
ON BEHALF OF
OHIO POWER COMPANY

Filed: November 8, 2013

1 INDEX TO PRE-FILED DIRECT TESTIMONY OF
2 JAMES D. HENRY
3 CASE NOS. 10-268-EL-FAC, 10-269-EL-FAC, AND 11-281-EL-FAC
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**BEFORE THE PUBLIC UTILITY COMMISSION OF OHIO
PRE-FILED DIRECT TESTIMONY OF
JAMES D. HENRY
ON BEHALF OF OHIO POWER COMPANY
IN CASE NOS. 10-268-EL-FAC, 10-269-EL-FAC, AND 11-281-EL-FAC**

INTRODUCTION

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

2 **A.** My name is James D. Henry. I am employed by the American Electric Power Service
3 Corporation ("AEPSC"), a subsidiary of American Electric Power Company, Inc.
4 ("AEP"), in the Fuel, Emissions & Logistics Group ("FEL") as Vice President of Coal
5 Procurement and Transportation. My business address is 155 West Nationwide
6 Boulevard, Suite 500, Columbus, Ohio 43215.

7 **Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**
8 **PROFESSIONAL AFFILIATIONS.**

9 **A.** I graduated from The Ohio State University in 1987 receiving a Bachelor of Science
10 Degree in Mining Engineering. I am a Member in the Society for Mining, Metallurgy,
11 and Exploration. I have also participated in various management training and
12 development programs.

13 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND.**

14 **A.** I was employed by Ohio Power Company beginning in 1985 as an Engineering Co-op
15 with Central Ohio Coal Company, and upon completing my degree in 1987 was hired on
16 a permanent basis. In 1995, I transferred to the Fuel Supply Department of AEPSC as an
17 analyst. In 1999, I transferred to what is currently known as the Fuel, Emissions &
18 Logistics Group where I held various positions from 1999 through 2003 when I was

1 named Director, Fuel Procurement. In 2004, I was promoted to the position of Vice
2 President of Eastern Fuel Procurement where I was responsible for the procurement of
3 coal, natural gas, and fuel oil for AEP's eastern fleet as well as the inventory
4 management of those locations. I subsequently transitioned to the role of Vice President
5 of Operations and Mining in 2010. In this role, I was responsible for the Dolet Hills,
6 Oxbow, and Pirkey mining-related activities as well as the operations of Cook Coal
7 Terminal, Metropolis Rail Car Facility, Alliance Rail Car Facility, Conesville Coal
8 Preparation Plant, and the Central Coal Lab. I accepted my current position in 2012.

9 **Q. WHAT ARE YOUR PRINCIPAL AREAS OF RESPONSIBILITY AS VICE**
10 **PRESIDENT OF COAL PROCUREMENT AND TRANSPORTATION?**

11 **A.** I am responsible for the procurement of coal for all of AEP's operating companies,
12 including AEP Ohio, OVEC-IKEC, and Cardinal Operating Company as well as
13 inventory management for these entities. I am also responsible for the transportation of
14 coal and other bulk commodities; logistics; railcar leasing; and marketing of available
15 capacity at Cook Coal Terminal.

16 **Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY AND/OR TESTFIED**
17 **BEFORE ANY REGULATORY AGENCIES?**

18 **A.** Yes. I have provided testimony before the Kentucky Public Service Commission on
19 behalf of the Kentucky Power Company, before the Virginia State Corporation
20 Commission and the Public Service Commission of West Virginia on behalf of
21 Appalachian Power Company, and before the Indiana Utility Regulatory Commission
22 and the Michigan Public Service Commission on behalf of Indiana Michigan Power
23 Company.

1 **PURPOSE OF TESTIMONY**

2 **Q. WHAT IS THE PURPOSE OF YOUR PRE-FILED DIRECT TESTIMONY?**

3 **A.** I am providing pre-filed direct testimony in response to specific portions of the
4 Management Audit Recommendations in the Report of the Management/Performance
5 and Financial Audits of the Fuel Adjustment Clause ("FAC") of the Columbus Southern
6 Power Company and the Ohio Power Company ("Audit Report") as filed May 26, 2011
7 ("2010 Audit") and May 24, 2012 ("2011 Audit"). The Audit Reports were prepared by
8 Energy Ventures Analysis, Inc. ("EVA") and its subcontractor, Larkin & Associates
9 PLLC ("Larkin") (referred in combination as "Auditor"), under the authority of the
10 Public Utilities Commission of Ohio (the "Commission", also referenced by the Auditor
11 as "PUCO") for its annual FAC audits.

12 **Q. SPECIFICALLY, TO WHICH OF THE RECOMMENDATIONS DO YOU**
13 **RESPOND ON BEHALF OF AEP OHIO?**

14 **A.** I am responding to 2010 Management Audit Recommendations 13 through 17, and 2011
15 Management Audit Recommendations 1 through 4 and 6, and the operational aspects of
16 2011 Financial Audit Recommendations 8 and 9.

17
18 **2010 MANAGEMENT AUDIT RECOMMENDATIONS**

19 **Q. PLEASE ADDRESS 2010 MANAGEMENT AUDIT RECOMMENDATION**
20 **NUMBER 13.**

21 **A.** In 2010 Management Audit Recommendation number 13 on page 1-6 of the Audit
22 Report, the Auditor states that: "AEP Ohio needs to develop and implement a strategy to
23 reduce the inventory at [REDACTED]. AEP Ohio should consider shifting some of the [REDACTED]"

1 coal supplies to other AEP Ohio plants, consignment of [REDACTED] coal to affiliate power
2 plants, and/or the sale of some excess volumes to third parties”.

3 This recommendation is no longer relevant as the strategy and practices
4 implemented by AEPSC, on behalf of AEP Ohio, already contributed to a sufficient
5 reduction in inventory. Statements made by the Auditor elsewhere in the 2010 Audit
6 Report suggest awareness, if not an acceptance, of the circumstances surrounding excess
7 coal inventory. On page 3-4 of the 2010 Audit Report, the Auditor states that “EVA was
8 sympathetic to the inflated inventory levels given the large decline in coal burn due to the
9 global financial crisis” and “AEP Ohio continued to struggle with its inventory levels and
10 achieved some success at all plants except [REDACTED]”. The strategy implemented, which
11 ultimately resulted in the reduction of coal inventory at [REDACTED], was not that unlike the
12 strategy that AEPSC employed at other AEP Ohio plants.

13 **Q. PLEASE ADDRESS 2010 MANAGEMENT AUDIT RECOMMENDATION**
14 **NUMBER 14.**

15 **A.** As described on page 1-6 of the 2010 Audit Report, Management Audit
16 Recommendation number 14 states that: “AEPSC should revise its approach to coal
17 contracting for AEP Ohio in order to reduce the likelihood of being over-contracted.
18 This strategy should be available for review in the next audit cycle.” AEP Ohio agrees
19 with EVA’s recommendation to revise its approach to coal contracting, but does not
20 agree with the underlying premise that the cause of “over-contracted” positions was
21 simply due to AEPSC’s approach to coal contracting. AEP Ohio still believes that a
22 layered approach to coal commitments whereby coal is purchased intermittently and with
23 overlapping contract terms is a very prudent way to minimize market exposure.

1 Regardless, adjustments were made and have contributed to a reduction at AEP Ohio
2 plants to near target levels.

3 **Q. WHAT ARE THE ADJUSTMENTS IN THE APPROACH TO CONTRACTING**
4 **THAT HAVE LED TO THE INVENTORY REDUCTION?**

5 **A.** AEPSC enters into contracts based on the generation and consumption information
6 available at the time of contract execution. This has not changed. However, AEPSC has
7 increased its tolerance for open positions at the beginning and during the year. The result
8 is a potential decrease in the amount of coal purchased under longer term contracts along
9 with the decreased risk of being over supplied. Following the Auditor's recommendation
10 may introduce additional market exposure, but, going forward, it also provides for
11 increased flexibility in meeting the demands of each plant.

12 **Q. PLEASE ADDRESS 2010 MANAGEMENT AUDIT RECOMMENDATION**
13 **NUMBER 15.**

14 **A.** Management Audit Recommendation number 15 on page 1-6 of the 2010 Audit Report
15 states that: "AEPSC improve its approach to determining the market values by which it
16 makes procurement decisions. The revised approach should be available for review in
17 the next audit cycle." AEPSC already uses a varied approach to determine market
18 conditions, including, but not limited to, Request for Proposals (RFPs), monitoring
19 published pricing data and discussions with suppliers. At times, a variety of indicators
20 are reviewed to assess the market and to decide how the proposed purchase compares to
21 market.

1 **Q. PLEASE ADDRESS THE REPEATING MANAGEMENT AUDIT**
2 **RECOMMENDATIONS: NUMBER 16 FROM THE 2010 AUDIT AND NUMBER**
3 **3 FROM THE 2011 AUDIT.**

4 **A.** As described on page 1-6 of the 2010 Audit Report, Management Audit
5 Recommendation number 16 states that: “AEPSC expand upon its policies and
6 procedures in its revised policy manual so that they provide true guidance and a yardstick
7 against which to measure performance.” Based on a similar audit recommendation in the
8 2009 Audit, AEPSC did revise its policy manual. While the Auditor recognizes that
9 changes were made in the revised FEL Procurement Policy, in Management Audit
10 Recommendation number 3 from the 2011 Audit on page 1-6, the Auditor proposes more
11 specific procedural modifications, including compliance with coal specifications,
12 business justification specifications, coal bid evaluations for coal quality, and exceptions
13 for non-solicitations for coal. However, as stated in AEP Ohio Witness Rusk’s 2009
14 FAC testimony¹, AEPSC agreed to update its fuel procurement policies while indicating
15 that a procedural manual was neither necessary nor beneficial.

16 **Q. PLEASE EXPLAIN WHY A PROCEDURAL MANUAL IS NOT BENEFICIAL**
17 **TO AEP OHIO’S CUSTOMERS.**

18 **A.** The current approach, guided by policies, results in the efficient procurement of fuel at
19 the lowest reasonable cost. AEPSC’s experienced fuel procurement personnel are
20 centrally located and managed, and are guided by FEL’s fuel procurement policies to
21 achieve the lowest reasonable fuel costs for ratepayers. These policies provide guidance
22 for AEPSC’s fuel procurement activities and include the flexibility necessary to adapt to
23 dynamic market and operational conditions. A rigid procedural manual, as opposed to

¹ Direct testimony of AEP Ohio Witness Rusk, page 5, Case No.09-872-EL-FAC and Case No. 09-873.

1 guidelines, removes the flexibility necessary to react to the market. This approach
2 focused only on a singular methodology risks missing opportunities to procure coal at the
3 lowest reasonable cost.

4 AEP Ohio's customers have benefited from AEPSC's present flexible approach,
5 such as described in audit finding 1, on page 1-4 of the Audit Report, where the Auditor
6 states: "Overall, AEP Ohio's fuel costs declined in 2010, primarily as result of the
7 expiration of the contract premium AEP Ohio had paid to its largest supplier in 2009.
8 The ability to terminate the premium is an affirmation of the success of the AEP Ohio's
9 strategy vis-à-vis bolstering this critical supplier during a difficult market period in
10 exchange for continued contract performance." It is the flexibility in the fuel procurement
11 policy, which allowed for the financial support of this supplier and maintained the future
12 benefit of the supply agreement.

13 **Q. PLEASE ADDRESS 2010 MANAGEMENT AUDIT RECOMMENDATION**
14 **NUMBER 17.**

15 **A.** The Auditor recommends, in Management Audit Recommendation number 17 on page 1-
16 6 of the Audit Report that: "AEPSC insist upon compliance with coal quality
17 specifications in its coal supply agreements. AEP should document these efforts for
18 review in the next audit cycle." AEP Ohio agrees that compliance with the contract terms
19 and conditions should be required. Perhaps there is some misunderstanding on how coal
20 contracts, industry wide, are structured, and have been structured for years. The coal
21 contracts for AEP Ohio's plants account for this concern by including financial
22 adjustments for deviations in coal quality within a prescribed band, with suspension and
23 rejection limits for non-compliance with the contract terms and conditions. AEPSC, on

1 behalf of AEP Ohio, administers the contracts per the terms and conditions of each coal
2 supply agreement.

3 **Q. HOW ARE CONTRACTED PRICE-ADJUSTED COAL QUALITY**
4 **SPECIFICATIONS MANAGED?**

5 **A.** Each coal supply agreement contains quality specifications, including “Contracted”,
6 Rejection, and Suspension, from which quality-based price adjustments are determined.
7 In other words, AEP Ohio’s coal supply contracts provide a range of acceptable coal
8 qualities with financial credits or deductions to compensate for variances above or below
9 the “contracted” levels. Such financial quality adjustments are typically assessed on
10 positive or negative variances on calorific heat content, measured in Btu/lb., and sulfur
11 dioxide content, usually measured in terms of sulfur dioxide per million Btu, and in
12 excess values of ash, measured in terms of percent of ash.

13 **Q. ARE THERE LIMITS AS TO HOW FAR SUPPLIERS MAY VARY FROM THE**
14 **CONTRACTED COAL SPECIFICATIONS?**

15 **A.** Yes, while variances are acceptable from the contracted coal specifications, with the
16 associated financial adjustments for such variances, the contracts provide specific
17 rejection and suspension limits.

18 **Q. PLEASE EXPLAIN HOW THE SUSPENSION CLAUSES, REJECTION**
19 **CLAUSES, AND FINANCIAL PENALTIES/PREMIUMS ARE ADMINISTERED.**

20 **A.** The intent of the suspension specification is to provide the AEP Ohio the right to suspend
21 future shipments should the supplier not comply with the suspension and/or rejection
22 provisions as defined by the coal supply agreement. Rejection specifications function in
23 a similar way. Typically, suspension limits must be violated as defined in each contract

1 to result in any action. A violation of the rejection limits, on the other hand, can result in
2 an immediate outright rejection of a shipment. Upon violation, specific provisions of the
3 coal supply agreement must be met for the supplier to resume deliveries in the case of a
4 suspension, or in the case of a shipment rejection, the coal is merely not delivered to the
5 AEP Ohio's facility and remains the property of the supplier.

6 **Q. DID AEPSC ADMINISTER THE CONTRACTS APPROPRIATELY IN REGARD**
7 **TO SUPPLIER COMPLIANCE WITH PRICE-ADJUSTED COAL QUALITY**
8 **SPECIFICATIONS?**

9 **A.** Yes, AEPSC administered the contracts appropriately in regard to compliance with the
10 price-adjusted quality specifications of the contracts. As stated above, suspension and
11 rejection specifications and clauses are typically included within the coal supply
12 agreements for half-monthly or monthly quality averages of deliveries, as well as on a
13 shipment basis, with shipment being specifically defined within each coal supply
14 agreement. AEPSC consistently applied the financial penalty/premium provisions of the
15 agreements. AEP Ohio will continue to monitor the coal shipments received to ensure
16 they are within the acceptable band with the corresponding financial adjustments, with
17 the use rejection and/or suspension where necessary in accordance with contractual terms
18 and conditions.

19
20 **2011 MANAGEMENT AUDIT RECOMMENDATIONS**

21 **Q. PLEASE ADDRESS 2011 MANAGEMENT AUDIT RECOMMENDATION**
22 **NUMBER 1.**

1 A. In Management Audit Recommendation number 1 starting on page 1-5 of the 2011 Audit
2 Report, the Auditor states that: “prior to any future negotiations with [REDACTED]
3 [REDACTED], AEPSC develop a coal procurement strategy that allows it to conduct a
4 competitive solicitation [REDACTED] and that the results of that solicitation, if
5 favorable, be used in the negotiation. EVA further recommends that any future
6 justification memorandum contain the results of the solicitation combined with a fulsome
7 disclosure and analysis of comparable indexes. Finally, as necessary, AEPSC should
8 reach out to third parties to assist it in the development and implementation of [REDACTED]
9 [REDACTED]g [REDACTED] to improve the quality of the results as third parties may be more aware
10 of [REDACTED]. If the FAC
11 continues, EVA recommends that the strategy be provided to the next
12 management/performance auditor for review”.

13 AEPSC agrees that using a competitive process [REDACTED]
14 [REDACTED] could, at times, be beneficial, but does introduce some risks. [REDACTED]
15 [REDACTED]
16 [REDACTED]. Justifications prepared for [REDACTED] contract have included
17 the results of the RFP as well as the appropriate market indexes. Should AEPSC find that
18 the assistance of a third party is necessary, efforts will be made to engage such resources.

19 **Q. WHAT RISKS ARE ASSOCIATED WITH [REDACTED]**

20 [REDACTED]?

21 A. The [REDACTED] is at risk when an [REDACTED]
22 [REDACTED]. If AEPSC begins the practice of [REDACTED]
23 [REDACTED] suppliers may, and have in the past, [REDACTED]

1 [REDACTED]. This could have a detrimental effect on [REDACTED]
2 [REDACTED]. To mitigate such risk, at least in part, [REDACTED]
3 [REDACTED]. This has enabled AEPSC [REDACTED]
4 [REDACTED]. This
5 would have been difficult in [REDACTED], but AEP's [REDACTED]
6 [REDACTED].

7 **Q. PLEASE ADDRESS 2011 MANAGEMENT AUDIT RECOMMENDATION**
8 **NUMBER 2.**

9 **A.** In Management Audit Recommendation number 2 on page 1-6 of the 2011 Audit Report,
10 the Auditor states that: "if the FAC does not continue that the next management/
11 performance audit determine if there should be any credit to the under-recovery due to
12 [REDACTED]". This
13 Recommendation is not applicable as the FAC is expected to be continued through 2014
14 with subsequent reconciliations in 2015.

15 **Q. PLEASE ADDRESS 2011 MANAGEMENT AUDIT RECOMMENDATION**
16 **NUMBER 4.**

17 **A.** In Management Audit Recommendation number 4 on page 1-6 of the 2011 Audit Report,
18 the Auditor states that: "[REDACTED]
19 [REDACTED] through the remaining term of the FAC not be recoverable through the
20 FAC". This Recommendation is not applicable as [REDACTED] should be
21 reviewed in the audit period in which it occurs. AEP Ohio does not agree with the
22 Auditor's recommendation to prospectively disallow fuel contract expenses from the
23 FAC, which cannot and have not been considered by the Commission in the context of

1 the conditions and alternatives that will exist during such future time period. This matter
2 is not ripe for a Commission decision.

3 **Q. PLEASE ADDRESS 2011 MANAGEMENT AUDIT RECOMMENDATION**
4 **NUMBER 6.**

5 **A.** In Management Audit Recommendation number 6 on page 1-6 of the 2011 Audit Report,
6 the Auditor suggests that: "AEPSC be directed to develop a strategy for addressing the
7 [REDACTED] and that the strategy should consider a full range of options.
8 If the situation has not been resolved in 2012 and the FAC continues, EVA recommends
9 that the strategy be available for review by the next management/performance auditor".
10 AEPSC agrees that a full range of options should and are always considered and those
11 practices are available for review. I need to point out that AEPSC is [REDACTED]
12 [REDACTED] and do not want to divulge information at the hearing or in this
13 proceeding that would have a detrimental impact on these discussions and, ultimately, the
14 fuel costs charged to customers.

15 **Q. PLEASE ADDRESS 2011 FINANCIAL AUDIT RECOMMENDATION NUMBER**
16 **8.**

17 **A.** Financial Audit Recommendation number 8 on page 1-10 of the 2011 Audit has
18 operational aspects leading to the financial treatment in the Audit. I can address this
19 recommendation from an operational standpoint, but defer to AEP Ohio Witness Timothy
20 Dooley for any financial elements. In this recommendation the Auditor states "AEP Ohio
21 should be required to explain fully the derivation of, and the purpose for, [REDACTED]
22 [REDACTED] including what those costs are for and why these items are reasonable costs to be
23 included in the FAC." The auditor was provided with the agreement that articulates the

1 necessary information. Consequently, I believe that this recommendation can be
2 considered completed.

3 **Q. PLEASE ADDRESS 2011 FINANCIAL AUDIT RECOMMENDATION 9.**

4 **A.** The Auditor recommends, in 2011 Financial Audit Recommendation number 9 on page
5 1-10 of the Audit Report that: "AEP Ohio may want to question the costs billed to CSP
6 [REDACTED] for the reasons explained in the [REDACTED]
7 [REDACTED]." I reviewed the Auditor's recommendation from the [REDACTED]
8 [REDACTED] that described [REDACTED], as a result of a
9 forced outage on its [REDACTED], to deliver coal intended for
10 the [REDACTED] and then [REDACTED]
11 [REDACTED] to insure adequate coal supply. AEP Ohio appreciates the Auditor bringing this
12 matter to our attention and the conditions will continue to be monitored.

13 **Q. DOES THIS CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?**

14 **A.** Yes.

EXHIBIT NO. _____

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Fuel Adjustment)	
Clause of Columbus Southern Power)	Case No. 10-268-EL-FAC
Company and Ohio Power Company)	Case No. 10-269-EL-FAC
And Related Matters for 2010)	
 In the Matter of the Fuel Adjustment)	
Clause of Columbus Southern Power)	Case No. 11-281-EL-FAC
Company and Ohio Power Company)	
And Related Matters for 2011)	

PRE-FILED DIRECT TESTIMONY OF
PHILIP J. NELSON
ON BEHALF OF
OHIO POWER COMPANY

Filed: November 8, 2013

INDEX TO PRE-FILED DIRECT TESTIMONY OF
PHILIP J. NELSON
CASE NOs. 10-268-EL-FAC, 10-269-EL-FAC, 11-281-EL-FAC

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**BEFORE THE PUBLIC UTILITY COMMISSION OF OHIO
PRE-FILED DIRECT TESTIMONY OF
PHILIP J. NELSON
ON BEHALF OF
OHIO POWER COMPANY
IN CASE NOS. 10-268-EL-FAC, 10-269-EL-FAC, 11-281-EL-FAC**

INTRODUCTION

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").

10 **BUSINESS EXPERIENCE**

11 **Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND**
12 **AND BUSINESS EXPERIENCE.**

13 A. I graduated from West Liberty University in 1979 receiving a Bachelor of Science
14 Degree in Business Administration, majoring in accounting. In 1979, I was employed
15 by Wheeling Power Company, an affiliate of AEP, in the Managerial Department. At
16 Wheeling Power, I was responsible for rate filings with the Public Service
17 Commission of West Virginia ("PSC"), for resolving customer complaints made to

1 the PSC, as well as for preparation of the Company's operating budgets and capital
2 forecasts. In 1996, I transferred to the AEP-West Virginia State Office in Charleston,
3 West Virginia as a senior rate analyst. In 1997, I transferred to AEPSC as a senior
4 rate consultant in the Energy Pricing and Regulatory Services Department, with my
5 primary responsibility being the oversight of Ohio Power Company's ("OPCo") and
6 Columbus Southern Power's ("CSP") Electric Fuel Component ("EFC") filings. In
7 1999, I transferred to the Financial Planning Section of the Corporate Planning and
8 Budgeting Department where I helped prepare AEP financial forecasts. I held
9 various positions in the Corporate Planning and Budgeting Department until my
10 transfer to Regulatory Services in February, 2010.

11 **Q. WHAT ARE YOUR RESPONSIBILITIES AS MANAGING DIRECTOR OF**
12 **REGULATORY PRICING AND ANALYSIS?**

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

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

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

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

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 2010 and 2011 Report of the
10 Management/Performance and Financial Audits of the FAC of the Columbus
11 Southern Power Company and the Ohio Power Company (Audit Report) filed on May
12 26, 2011 and May 24, 2012 respectively, by Energy Ventures Analysis, Inc. (EVA or
13 Auditor). Specifically, from the 2010 audit I address Management Audit
14 Recommendation 19, and Financial Audit Recommendations 19, 20, 21, and 22.
15 These audit recommendations are summarized on pages 1-6 through 1-10 of the May
16 26, 2011 audit report (“2010 Audit”). From the May 24, 2012 audit report (“2011
17 Audit”) I address Management Audit Recommendation 5 and Financial Audit
18 Recommendations 4, 5, 6, and 12. These audit recommendations are summarized on
19 pages 1-5 through 1-10 of the 2011 Audit Report.

- 1 The following table provides audit recommendations and the company witnesses
2 addressing each recommendation.

2010 Management Audit Recommendation Number	Company Witness
13-17	James Henry
18	Timothy Dooley
19	Philip Nelson
20	Timothy Dooley

2010 Financial Audit Recommendation Number	Company Witness
15-18	Timothy Dooley
19-22	Philip Nelson

2011 Management Audit Recommendation Number	Company Witness
1-4	James Henry
5	Philip Nelson
6	James Henry

2011 Financial Audit Recommendation Number	Company Witness
1-3	Timothy Dooley
4-6	Philip Nelson
7	Timothy Dooley
8-9	James Henry
10-11	Timothy Dooley
12	Philip Nelson

BACKGROUND OF THE ESP FAC

Q. PLEASE BRIEFLY DESCRIBE THE BACKGROUND OF THE FAC FOR THE COMPANIES.

A. CSP and OPCo filed as part of the Electric Security Plan (ESP) (Case Nos. 08-917-EL-SSO and 08-918-EL-SSO) and SB 221 a request for a fuel clause or FAC to be effective January 1, 2009. SB 221 was signed into law by the Governor of Ohio on May 1, 2008. 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. The reintroduced FAC has been subject to audit with the first audit report for calendar year 2009 filed with the Commission on May 14, 2010.¹ The second and third audits of the reintroduced FAC for the calendar year 2010 and 2011 resulted in the audit reports filed on May 26, 2011 and May 24, 2012 respectively, that are the subject of this direct testimony.²

¹ Public Utilities Commission of Ohio, *In the Matter of Fuel Adjustment Clauses for Columbus Southern Power Company And Ohio Power Company*, Case Nos. 09-872-EL-FAC and 09-873-EL-FAC.

² Public Utilities Commission of Ohio, *In the Matter of Fuel Adjustment Clauses for Columbus Southern Power Company And Ohio Power Company*, Case Nos. 10-268-EL-FAC, 10-269-EL-FAC, 10-870-EL-FAC, 10-871-EL-FAC, 10-1286-EL-FAC, and 10-1287-EL-FAC and Public Utilities Commission of Ohio, *In the Matter of Fuel Adjustment Clauses for Columbus Southern Power and Ohio Power Company*, Case No. 11-281-EL-FAC.

1 **MANAGEMENT AUDIT RECOMMENDATIONS**

2 **Q. PLEASE DESCRIBE MANAGEMENT AUDIT RECOMMENDATION 19**
3 **FROM THE 2010 AUDIT.**

4 **A.** On page 1-6 of the Audit Report, Management Audit Recommendation 19 states:
5 “EVA recommends that the PUCO direct AEPSC to provide all requested documents
6 to the Auditor related to the wind purchases and not agree to provide CSP and OPCO
7 recovery of any wind contract costs until they have been reviewed.”

8 **Q. HAS THIS ISSUE BEEN RESOLVED?**

9 **A.** Yes, the Company provided the Timber Road contract to the Staff (which was the
10 contract that was not provided at the time of the audit) in the course of the ESP II
11 proceeding and this Commission has approved the cost recovery.

12 **FINANCIAL AUDIT RECOMMENDATIONS**

13 **Q. PLEASE DESCRIBE MANAGEMENT AUDIT RECOMMENDATION 5 AND**
14 **FINANCIAL AUDIT RECOMMENTDATION 12 FROM THE 2011 AUDIT.**

15 **A.** The 2011 Audit Report on page 1-6 states as management audit recommendation 5
16 “EVA recommends that any proceeds received from the sale of CCPP assets be
17 applied to the FAC under-recovery.” Further on page 1-10 financial audit
18 recommendation 12 concurs with “Larkin recommends that should AEP Ohio sell the
19 CCPP, the proceeds from the sale should be credited against the December 31, 2011
20 under-recovered FAC balance.”

21 **Q. DOES THE COMPANY AGREE WITH THESE RECOMMENDATIONS?**

22 **A.** No. First this issue should not be a subject for these audit periods since the sale
23 occurred in a subsequent audit period. However, it is my understanding that

1 regulatory case law has established that customers are paying for a service and do not
2 have any claim on the assets owned by the utility. Furthermore this particular asset is
3 not an asset even used directly in utility service, that is, it is not or never was a rate
4 based utility asset. Also, the sale of the CCPP facility does not wrap up or extinguish
5 all the costs associated with the operation of the facility. The Company is not asking
6 for recovery for these on-going liabilities. However, in the event the Commission
7 determines that it is appropriate to consider a credit to customers of any gain on the
8 sale of CCPP, then these on-going liabilities need to be netted against the proceeds.

9 **Q. ON PAGE 1-10 IN THE 2010 AUDIT REPORT, THE AUDITOR MAKES**
10 **TWO RECOMMENDATIONS REGARDING THE RIVER**
11 **TRANSPORTATION DIVISION (RTD). WOULD YOU PLEASE PROVIDE**
12 **SOME BACKGROUND REGARDING THE SERVICE SUPPLIED BY RTD?**

13 **A.** Yes. RTD is a division of Indiana Michigan Power Company (I&M), a subsidiary
14 company of AEP. Barge freight services are provided at cost by RTD to its affiliates
15 under the "Barge Transportation Agreement." RTD's costs are allocated to the
16 operating companies based on each company's utilization of the barging service.
17 These costs are considered transportation costs and are included in the cost of coal
18 inventory. The contract is under FERC jurisdiction.

19 **Q. PLEASE ADDRESS FINANCIAL AUDIT RECOMMENDATION NUMBER**
20 **19 OF THE 2010 REPORT AND RECOMMENDATION 4 OF THE 2011**
21 **REPORT.**

22 **A.** The recommendation states that: "AEP should be required to analyze the receipt of
23 revenue and the payment of cash expenses for RTD captive operations, similar to a

1 lead-lag study, and to present such information to support its assumption that RTD
2 has a significant Cash Working Capital requirement. If adequate supporting
3 information is not provided to substantiate that RTD has a significant Cash Working
4 Capital requirement and the amount of that requirement using lead-lag study analysis
5 of cash receipts and cash payments, the RTD Working Capital component of the RTD
6 investment base should be removed from the cost charged by RTD to OPCo from
7 January 1, 2011 forward.”

8 **Q. DOES AEP OHIO AGREE WITH THIS RECOMMENDATION?**

9 A. No. Primarily because it is outside the scope of this audit since using a lead-lag study
10 or other method in place of the cash working capital component described in the RTD
11 contract would be a violation of that contract. The contract describes the method to
12 be 1/8 of the aggregate operation, maintenance, rental and general expense of RTD
13 for each annual period. RTD is calculating its charges to OPCo and other AEP
14 operating companies in accordance with this language of the agreement and cannot
15 choose to use some other method without filing that change with FERC. Also, the
16 expense in hiring a consultant to perform a lead –lag could be significant and, in my
17 opinion, is not warranted.

18 **Q. HAS FERC PROVIDED ANY RECENT GUIDANCE ON THE 1/8 CASH**
19 **WORKING CAPITAL METHOD FOR USE IN FORMULA RATES?**

20 A. Yes. In an opinion issued January 28, 2010 in Docket No. ER10-355-000 involving
21 the AEP operating companies’ transmission formula rates, the FERC confirmed, upon
22 challenge by certain intervenors, that it was their policy to use the 1/8 method for
23 determining the cash working capital method, i.e. the same method as used by RTD.

1 **Q. WHAT WAS FINANCIAL AUDIT RECOMMENDATION NUMBER 20**
2 **FROM THE 2010 AUDIT?**

3 A. Financial Audit Recommendation 20 addresses the Return on Equity (ROE) of RTD.
4 It specifically states: “AEP should address why an ROE that has been set in a FERC
5 order or by a state commission (such as Indiana) for a utility would be appropriate for
6 RTD, when RTD is functioning as a fully cost reimbursed operation with annual true-
7 ups and with not competition serving captive affiliated clients, and, consequently, the
8 level of risk to RTD and the related return required by investors would seem to be
9 lower than for other utility operations.”

10 **Q. HAS THIS ISSUE HAS BEEN RESOLVED?**

11 A. Yes. This recommendation was made prior to the receipt of the Commission’s order
12 in the 2009 FAC case, in which a similar concern about the method for determining
13 RTD’s ROE was raised. The Commission in its order³ stated that the Companies
14 adequately explained that they had a procedure for updating the cost of capital and the
15 ROE component that is commensurate with the risk of the RTD’s operation. As
16 explained in the Company’s testimony and relied upon by the Commission, the ROE
17 is adjusted on January 1 each year to the return allowed by FERC in a wholesale rate
18 proceeding involving I&M. In the absence of a recent FERC order the ROE becomes
19 that established by the Indiana Utility Regulatory Commission in its most recent
20 order. Since RTD is a division of I&M, not a separate legal entity, using I&M’s ROE
21 as determined by the FERC or Indiana is commensurate with the risk of the operation.
22 Since the Auditor did not repeat this recommendation in the 2011 audit, it appears the

³ Opinion and Order dated January 23, 2012 in Case No. 09-0872-EL-FAC and 09-873-EL-FAC, *In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company*, page 17.

1 Auditor recognized that the issue has been addressed and that there was no need to
2 raise it once again in the 2011 Audit Report.

3 **Q. WHAT WAS FINANCIAL AUDIT RECOMMENDATION NUMBER 21**
4 **FROM THE 2010 AUDIT?**

5 **A.** On page 1-10, the Auditor recommends: “AEP Ohio and the other parties to the case
6 should re-examine whether the Commission-authorized gross-of-tax WACC for debt
7 and common equity capital should be applied to what such investors are actually
8 financing of the fuel cost under-recovery balances, which would appear to be the
9 Deferred Fuel amounts recorded in Account 1823144 less the directly related credit-
10 balance ADIT-Other for Deferred Fuel recorded in Account 283.”

11 **Q. PLEASE DISCUSS FINANCIAL AUDIT RECOMMENDATION NUMBER 22**
12 **FROM 2010, WHICH IS ASSOCIATED WITH THE ABOVE**
13 **RECOMMENDATION.**

14 **A.** Financial audit recommendation 22 states: “The Company should address the income
15 tax savings it was/is recording related to the under-recovered fuel balances, and how
16 those provide non-investor supplied capital that is financing a portion of the Deferred
17 Fuel balances that have been recorded in Account 1823144. The Company should
18 specifically address the related credit-balance ADIT that is recorded in Account 283,
19 ADIT-Other, for the tax savings-based financing that appears directly related to the
20 under-recovered FAC balances.”

1 **Q. DID THE AUDITOR MAKE SIMILAR RECOMMENDATIONS IN THE 2011**
2 **AUDIT?**

3 A. Yes, in Financial Audit Recommendations 5 and 6 on pages 1-9 and 1-10 of the 2011
4 Audit, the auditor makes the same recommendations.

5 **Q. HAVE THESE ISSUES BEEN RESOLVED BY THIS COMMISSION?**

6 A. Yes, the Commission ruled on these issues in Case Nos. 08-917-EL-SSO and 08-918-
7 EL-SSO⁴, where on page 23 of the order, the Commission writes: “Regarding the
8 OCC’s, Sierra’s, and the Commercial Group’s recommendation that the tax
9 deductibility of the debt rate be reflected in the carrying charges on a net-of-tax basis,
10 we have recently explained that this recommendation accounts for the deductibility of
11 the debt rate, but does not account for the fact that the revenues collected are taxable.
12 If we were to adopt the net-of-tax recommendation, the Companies would not recover
13 the full carrying charges on the authorized deferrals.” Further, on page 24, the order
14 continues with: “Therefore, we find that the carrying charges on the FAC deferrals
15 should be calculated on a gross-of-tax rather than a net-of-tax basis in order to ensure
16 that the Companies recover their actual fuel expenses.” The Commission affirmed
17 this ruling in addressing a request for rehearing filed by several parties to the case.

⁴ Opinion and Order from PUCO Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, pages 20 through 24

1 **Q. IS THERE ANY REASON TO FURTHER ADDRESS THE WACC**
2 **APPLICATION TO DEFERRED FUEL BALANCES OR THE ASSOICIATED**
3 **ADIT?**

4 A. No, there is no reason to further address this issue. AEP Ohio has calculated the
5 deferred fuel balances in compliance with the Commission final orders in the ESP
6 cases.

7 **Q. DOES THIS CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?**

8 A. Yes it does.

This foregoing document was electronically filed with the Public Utilities

Commission of Ohio Docketing Information System on

11/11/2013 10:08:54 AM

in

Case No(s). 10-0268-EL-FAC, 10-0269-EL-FAC, 11-0281-EL-FAC

Summary: Testimony -pre-filed direct testimony of Timothy M. Dooley, James D. Henry, (Public-Redacted) and Philip J. Nelson. electronically filed by Mr. Matthew J Satterwhite on behalf of Ohio Power Company