

**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	)	

**PUBLIC VERSION (REDACTED)  
INITIAL POST-HEARING BRIEF ON BEHALF OF  
OHIO POWER COMPANY**

**Filed Wednesday January 8, 2014**

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## **Introduction**

Ohio Power Company (“Company” or “AEP Ohio”), files this initial post hearing brief as agreed to at the conclusion of the evidentiary hearing in these proceedings. These proceedings are focused on the audit of the fuel adjustment clauses for the 2010 and 2011 calendar years.

The Public Utilities Commission of Ohio (“Commission”) established a fuel adjustment clause for Columbus Southern Power Company and Ohio Power Company (now merged as Ohio Power Company or AEP Ohio) in Commission Case Nos. 09-917/918-EL-SSO (“ESP 1”). The FAC was approved in the March 18, 2009 Opinion and Order and affirmed in the July 23, 2009 Entry on Rehearing.

The fuel audits ordered by the Commission are comprised of an annual audit to review the appropriateness of the accounting of the FAC costs and the prudence of decisions made. To assist it in auditing the Company’s FAC, an outside auditor is enlisted to assist the Commission Staff in the annual audits. In both the 2010 and 2011 audit the Commission appointed Energy Ventures Analysis, Inc. (“Auditor”) as that outside auditor set to assist the Commission staff in its review.

A hearing was held on November 18, 2013 where the Auditors appeared to present their report and witnesses for the Industrial Energy Users-Ohio (“IEU”), Office of the Ohio Consumers’ Counsel (“OCC”) and the Company appeared to provide sworn testimony in response to the issues related to the audit. Due to failed attempts of the parties to settle matters in the two audits, the evidentiary hearings were delayed into 2013. The delay in an evidentiary hearing for 2010 meant that some of those issues appeared again in the 2011 audit. Despite the delay of the proceedings for both audits into 2013, the scope remains the same, a review of the FAC for each of the respective years based on the structure of the FAC determined in the ESP 1

proceeding in 2009. At the hearing the Company provided evidence addressing the Auditor's concerns or explained the misunderstanding of the Auditor in the recommendations made. Ultimately, the issues in these proceeding are focused on the audit reports and those issues are adequately addressed by Company testimony. The Commission should find the costs and actions under review prudent during the two audit periods in the two proceedings under review.

## **2010 AUDIT REPORT**

The 2010 Audit Report consisted of 8 management audit (see Audit Report at 1-6) and 8 financial audit recommendations (see 2010 Audit Report at 1-9 – 1-10).

### **2010 Management Audit Recommendations**

**2010-M-13: EVA recommends that AEP Ohio needs to develop and implement a strategy to reduce the inventory at [REDACTED] AEP Ohio should consider shifting some of the [REDACTED] coal supplies to other AEP Ohio plants, consignment of [REDACTED] coal to affiliate power plants, and/or the sale of some excess volumes to third parties.**

Recommendation 2010-M-13 is already satisfied. AEP Ohio witness James Henry testified that the Company's "...strategy and practices implemented by AEPSC, on behalf of AEP Ohio, already contributed to a sufficient reduction in inventory." (Henry Direct at 4.) Mr. Henry indicated (as agreed by the Auditor) that there were increased levels of inventory due to the economic downturn. (Id.) But that the Company's strategy, used at other plants too, ultimately resulted in the reduction of inventory at the plant in question in the report. The evidence shows the recommendation has been addressed.

**2010-M-14: EVA recommends that AEPSC should revise its approach to coal contracting for AEP Ohio in order to reduce the likelihood of being over-contracted. The strategy should be available for review in the next audit cycle.**

Recommendation 2010-M-14 is already satisfied. AEP Ohio witness James Henry testified that the Company "agrees with EVA's recommendation to revise its approach to coal contracting, but does not agree with the underlying premise that the cause of "over-contracted"

positions was simply due to AEPSC's approach to coal contracting." (Id. at 4-5.) As indicated in the testimony of AEP Ohio witness James Henry, the Company "increased its tolerance for open positions at the beginning and during the year. The result is a potential decrease in the amount of coal purchased under longer term contracts along with the decreased risk of being over supplied." Mr. Henry testified that adopting this recommendation may introduce additional market exposure, but that it also provided for increased flexibility in meeting the demands of each plant. The evidence shows the recommendation has been addressed.

**2010-M-15: EVA recommends that AEPSC improve its approach to determining the market values by which it makes procurement decisions. The revised approach should be available for review in the next audit cycle.**

Recommendation 2010-M-15 is already satisfied by the current actions of the Company. As indicated in the testimony of Company witness James Henry, the Company, "already uses a varied approach to determine market conditions, including, but not limited to, Request for Proposals (RFPs), monitoring published pricing data and discussions with suppliers." (Id. at 5.) Mr. Henry went on to testify that "[a]t times, a variety of indicators are reviewed to assess the market and to decide how the proposed purchase compares to market." (Id.) The evidence shows the recommendation has been addressed.

**2010-M-16: EVA recommends that AEPSC expand upon its policies and procedures in its revised policy manual so that they provide true guidance and a yardstick against which to measure performance.**

For the sake of the 2010 audit, the recommendation was satisfied. Specifically, Company witness Henry testified that AEP Ohio did revise its policy manual based on a similar audit recommendation in the 2009 audit. However, this issue represents a point of disagreement

between the Auditor and the Company. The Auditor reviewed those changes in the 2011 audit and had further recommendations the Company will address in the 2011 section of this post-hearing brief. For purposes of the 2010 Audit this recommendation was satisfied. The evidence shows the recommendation has been addressed.

**2010-M-17: EVA recommends that AEPSC insist upon compliance with coal quality specifications in its coal supply agreements. AEPSC should document these efforts for review in the next audit cycle.**

In the testimony of Company witness Henry, the Company agreed that compliance with the contract terms and conditions should be required. (Id. at 7.) The concern raised by the Company is that the Auditor may not understand the terms of those contracts because, upon review the contracted specifications that are standard in the industry, the coal quality specifications are being followed in accordance with the contracted terms and conditions. (Id.) Mr. Henry testified that contracts are structured, and have been structured for years, to account for a concern in specifications “by including financial adjustments for deviations in coal quality within a prescribed band, with suspension and rejection limits for non-compliance with the contract terms and conditions.” (Id.) he testified that there is a range of acceptable coal qualities with financial adjustments on the price depending on the variance, with suspension an available tool if the variance is outside the acceptable band. (Id. at 8.) Ultimately, the important fact for the 2010 audit is the testimony of Mr. Henry that states that the Company administered the contracts appropriately in regard to coal compliance with the long-standing price-adjusted band used by the Company. (Id. at 9.) The evidence shows the recommendation is not necessary.

**2010-M-18: EVA recommends that AEPSC work to minimize the costs associated with the closure of the Conesville Coal Preparation Plant. EVA recommends that AEPSC provide its plan for accounting for the closure costs to the auditor for review in the next audit cycle.**

This recommendation sought to minimize closure costs associated with an action set to take place at a later time; actions that were later reviewed by the Auditor and not called into question. Specifically, Company witness Timothy Dooley testified that the closure costs were provided to the Auditor in the 2011 Audit where the Company answered all the Auditor's questions on the facility closure as indicated in the 2010 recommendation. (Dooley Direct at 6.) Mr. Dooley pointed out that no recommendations concerning this point were raised in the 2011 Audit when those costs were ultimately reviewed. The plant is now closed. The evidence shows the recommendation has been addressed.

**2010-M-19: EVA recommends that the PUCO direct AEPSC to provide all requested documents to the auditor related to the wind purchases and not agree to provide CSP and OPCo recovery of any wind contract cost until they have been reviewed.**

Recommendation 2010-M-19 is already satisfied. As indicated in the testimony of Company witness Philip J. Nelson, the Company already provided the Timber Road contract to the Staff in the course of the 11-346-EL-SSO et al. ("*ESP II*") proceedings where the Commission approved its cost recovery. (Direct of Philip J. Nelson at 6.) The evidence shows the recommendation has been addressed.

**2010-M-20: EVA recommends that AEPSC in its next CSP and OPCO Compliance Status Reports correct the allocation of the 2010 solar obligations so that it is clear that should any future force majeure situations occur the accounting procedures are clear.**

Recommendation 2010-M-20 is already satisfied. Company witness Dooley testified that he does not expect any future *force majeure* issues. However, he also testified that the



recommendation was adopted and the Company updated the report as recommended. The evidence shows the recommendation has been addressed.

### **2010 Financial Audit Recommendations**

**2010-F-15: AEP should review and update the “Instructions” tab in its monthly FAC support Excel files at least annually.**

Recommendation 2010-F-15 is already satisfied. Company witness Dooley testified that the monthly excel files were updated as requested. (Id. at 3.) The evidence shows the recommendation has been addressed.

**2010-F-16: AEP should identify and separate the renewable energy credits (RECs) value from the energy and capacity value of its renewable energy purchases.**

Recommendation 2010-F-16 is already satisfied.<sup>1</sup> As indicated in the testimony of Company witness Dooley, the Commission approved the Alternative Energy Rider (AER) in the *ESP II* docket. (Dooley Direct at 3.) This rider allows the Company to achieve the desired separation of costs. (Id.) The evidence shows the recommendation has been addressed.

**2010-F-17: 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**

Recommendation 2010-F-17 is already satisfied.<sup>2</sup> Company witness Dooley testified that the Company had been showing the REC expense detail by CSP and OPCo and more clearly presents it in support schedules for the quarterly FAC filings. (Id. at 4.) The evidence shows the recommendation has been addressed.

**2010-F-18: AEP should be assigning appropriate values to its Renewables inventory, including its non-Ohio, non-solar REC inventory**

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<sup>1</sup> The same recommendation appears in the 2011 Audit Report under 2011-F-1.

<sup>2</sup> The same recommendation appears in the 2011 Audit Report under 2011-F-2.

Recommendation 2010-F-18 is already satisfied.<sup>3</sup> Company witness Dooley testified that the Company has achieved the requested assignment of REC values through the use of the AER beginning in October 2012. (Id. at 5.) The evidence shows the recommendation has been addressed.

**2010-F-19: AEP should be required to analyze the receipt of revenue and the payment of cash expenses for RTD captive operations, similar to a lead-lag study, and to present such information to support its assumption that RTD has a significant Cash Working Capital requirement. If adequate supporting information is not provided to substantiate that RTD has a significant Cash Working Capital requirement and the amount of that requirement using lead-lag study analysis of cash receipts and cash payments, the RTD Working Capital component of the RTD investment base should be removed from the cost charged by RTD to OPCO from January 1, 2011 forward.**

AEP Ohio does not agree with this recommendation.<sup>4</sup> OCC attempts to quantify the impact of this recommendation and proposes an adjustment. (Duann Direct at 6-7.) As indicated in the testimony of Company witness Nelson, preparing a lead lag study may be expensive and using the results of a lead-lag study to bill the parties to the contract would be in violation of the existing contract. (Direct Testimony of Philip J. Nelson at 8.) Mr. Nelson summarizes the contract and pointed out that it requires the method to be 1/8 of the aggregate operation, maintenance, rental and general expense of RTD for each annual period. (Id. at 8.) RTD calculates its charges to OPCo and other AEP operating companies in accordance with this language of the agreement and cannot modify that methodology without filing that change at FERC. (Id.) Mr. Nelson also pointed out a recent FERC decision in Docket No. ER10-355-000 involving AEP operating companies, where FERC confirmed that it was their policy to use the 1/8 method for determining cash working capital, the same method used by the RTD for years but questioned by the Auditor in this case. It would be unreasonable and illegal to make a

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<sup>3</sup> The same recommendation appears in the 2011 Audit Report under 2011-F-3

<sup>4</sup> This same recommendation appears in the 2011 Audit as 2011-F-4.

policy declaration that the Company ignore the method approved by FERC for a contract under its jurisdiction and then to penalize the Company retroactively to January 1, 2011 for using the approved method. The evidence shows the recommendation is not appropriate.

**2010-F-20: AEP should address why an ROE that has been set in a FERC order or by a state commission (such as Indiana) for a utility would be appropriate for RTD, when RTD is functioning as a fully cost reimbursed operation with annual true-ups and with not competition serving captive affiliated clients, and, consequently, the level of risk to RTD and the related return required by investors would seem to be lower than for other utility operations.**

Recommendation 2010-F-20 is not necessary. Company witness Nelson testified that the Auditor made this recommendation prior to the Commission making a determination on a similar issue from the 2009 audit that addressed this concern. As testified to by Mr. Nelson, the Commission determined that the Company “adequately explained that they had a procedure for updating the cost of capital and the ROE component that is commensurate with the risk of the RTD’s operation.” (Nelson at 9.<sup>5</sup>) Mr. Nelson explained the rationale provided the Commission at hearing leading to the 2009 FAC Order. (Id.) He also pointed out that the Auditor did not repeat this recommendation in the 2011 audit. (Id. at 9-10). The evidence and 2009 FAC Order shows the recommendation has previously been rejected by this Commission and is not necessary.

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<sup>5</sup> Citing *In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company*, in Case Nos. 09-872-EL-FAC and 09-873-EL-FAC, January 23, 2012 Opinion and Order at 17. (2009 FAC Order)

**2010-F-21: AEP Ohio and the other parties to the case should 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 1823144 less the directly related credit-balance ADIT-Other for Deferred Fuel recorded in Account 283.**

Recommendation 2010-F-21 is not necessary based on Commission holdings.<sup>6</sup> As indicated by Company witness Nelson, the Commission already addressed the issue of how AEP Ohio calculated the deferred fuel balances in compliance with the Commission's final orders in the ESP cases. (Nelson at 12.) This recommendation and the next few appear to seek to reopen prior decisions by the Commission and attempt a new approach as opposed to an audit of whether the Company complied with the orders of this Commission. Such an approach in a financial audit is inappropriate. The Commission speaks through its orders and the Company complied with the orders issued by the Commission. It is not the role of the Auditor to second guess the decisions previously made and seek to undo the actions taken, it is the role of the Auditor to determine if the actions taken by the Company follow the orders issued by the Commission.

The Commission has spoken and determined that the carrying charge should be applied at the WACC rate as proposed by the Company without an ADIT offset. In its March 18, 2009 *ESP I* decision the Commission considered this very issue and determined that the Company's method was reasonable as proposed.

Based on the record in this proceeding, we do not find the intervenors' arguments concerning the calculation of the carrying charges persuasive. Instead, for

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<sup>6</sup> The same recommendation appears in the 2011 Audit Report under 2011-F-5 and will be addressed in this section of the brief. The argument also contains elements of 2010-F-22 which should be incorporated into this response as appropriate to avoid repeating the same points in both sections.

purposes of a phase-in approach in which the Companies are expected to carry the fuel expenses incurred for electric service already provided to the customers, we find that the Companies have met their burden of demonstrating that the carrying cost rate calculated based on the WACC is reasonable as proposed by the Companies.

(*ESP I*, Opinion and Order at 23 note omitted.) The Commission reiterated the approval of the carrying charge as presented by the Company later in a December 14, 2011 Opinion and Order in the *ESP II* proceeding where the Commission stated:

The Companies offer that the carrying charge rate on deferred fuel expense was argued extensively by the parties to the ESP 1 case, and the Commission ultimately decided that the WACC, as proposed by the Companies, was reasonable. The Commission agrees with the Signatory Parties that the carrying charge on the deferred fuel expenses was established in the ESP 1 proceeding.

(*ESP II*, Opinion and Order at 58.) In sum, the carrying charge issues were fully litigated in the *ESP I* case and the Commission adjudicated that the WACC was a reasonable carrying cost rate as applied by the Company without any offset. The recommendation would result in re-litigation of the issue previously-decided by the Commission and is therefore, not appropriate.

**2010-F-22: 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.**

Recommendation 2010-F-22 is not necessary and seeks to improperly use a financial audit meant to verify application of past Commission orders to second guess prior decisions by the Commission.<sup>7</sup> As indicated by Company witness Nelson, the Commission already addressed the issue concerning the application of accumulated deferred income taxes (ADIT) in the *ESP I*

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<sup>7</sup> The same recommendation appears in the 2011 Audit Report under 2011-F-6 and will be addressed in this section of the brief.

proceeding. (Nelson Direct at 11.) In the *ESP I* March 18, 2009 Opinion and Order at pages 20-24, the Commission writes:

Regarding the OCC's, Sierra's, and the Commercial Group's recommendation that the tax deductibility of the debt rate be reflected in the carrying charges on a net-of-tax basis, we have recently explained that this recommendation accounts for the deductibility of the debt rate, but does not account for the fact that the revenues collected are taxable. If we were to adopt the net-of-tax recommendation, the Companies would not recover the full carrying charges on the authorized deferrals.

The Commission discussed the matter further, on page 24 of the Order stating,

Therefore, we find that the carrying charges on the FAC deferrals should be calculated on a gross-of-tax rather than a net-of-tax basis in order to ensure that the Companies recover their actual fuel expenses.

As indicated by Company witness Nelson, the Commission affirmed this ruling in addressing a request for rehearing filed by several parties to the case. (Id. at 11.) The proper procedure for an auditor working for the Commission is to perform its audit in recognition of these past decisions and not offer recommendations to second guess decisions previously made.

In further support of the point, the Commission also correctly pointed out in its August 1, 2012 Finding and Order in Case Nos. 11-4920-EL-RDR and 11-4921-EL-RDR ("*PIRR Order*"), that the ADIT issue was already considered and addressed in the *ESP I* proceeding. *PIRR Order* at 19; *PIRR Entry on Rehearing* (Oct. 3, 2012) at ¶ 26. The Commission again declined to adopt the recommendation to offset for ADIT as it was already considered and addressed in the *ESP I Order*. The Commission pointed out that the topic was decided in the *ESP I Order* and was not properly before this Court in the *PIRR* proceeding. The same rationale applies here in the financial audit of the FAC to ensure the actions complied with the Commission orders that repeatedly held no offset for ADIT.

IEU also improperly seeks to raise this issue in this proceeding. (Bowser Direct at 3-4.) However, the proper procedure to seek reversal of a Commission determination is to seek rehearing and then if not successful file an appeal to the Supreme Court of Ohio. IEU did not challenge the ADIT finding by the Commission in rehearing or on appeal in the *ESP I* proceeding. The Commission's decision not to make an adjustment for ADIT became final once the Supreme Court of Ohio resolved the appeal of the *ESP I Order* because the Commission's decision not to make this adjustment was not asserted as error in the appeal of the *ESP I Order*. See *In re Application of Columbus S. Power*, 2011-Ohio-1788. This matter was raised, considered, and part of the order appealed to the Supreme Court of Ohio. IEU, thus, is barred from raising this untimely argument again at this time. IEU's approach in this case is to have the Commission apply its previously denied argument to the PIRR balance as a means of appearing to offer something new. (Id.) However, as discussed above the Commission also denied this argument in the PIRR Order, a matter currently on appeal to the Supreme Court of Ohio in case number 2012-2008. Such a strategy to raise this argument yet again is improper and should be denied by the Commission.

OCC also seeks to improperly reopen this issue in this proceeding in its testimony filed by Dr. Duann. (Duann Direct at 9-19.) Dr. Duann recognizes in his testimony that the Commission has addressed this exact issue and found that the carrying charge on a fuel cost deferral balance should be calculated without an adjustment for ADIT. (Id. at 13.) Dr. Duann then states he is not an attorney and gives further testimony on what he would do with the balance. Fortunately for the industry the Commission is bound by legal principles and has already denied previous attempts to reargue the exact point that Dr. Duann again provides the Commission. OCC's attempt to repackage this argument suffers from the same fatal flaws

addressed above with IEU relating to the fact that the matter is settled and final. The subsequent actions cited by OCC merely show the Commission's following of the law and verification of its initial decision. The carrying charge associated with the deferral balance was set up in the context of an ESP that involved a phase-in under Section 4928.144, Revised Code. The traditional application attempted by Dr. Duann does not necessarily apply as the Commission was dealing with a statutory duty to apply the carrying charge and balance the overall ESP plan in comparison to a market rate offer. Ultimately, the Commission approved a package that the Company relied upon as a balanced ESP. Attempts to chip away at that overall balance through after the fact attempts at rehearing in audit proceedings should be denied. OCC's arguments should be denied.

Any attempt by any party to this proceeding to raise the matter in the context of these audit cases is an improper application for rehearing of an issue adjudicated in the ESP proceeding and governed by the decisions made in that proceeding. The Auditor's (and IEU's) recommendation to revisit this issue in this case is unreasonable and unlawful and beyond the scope of a financial audit. The Commission has repeatedly reiterated its position on this issue in prior more appropriate dockets and the recommendation and attempts to reargue this argument in these FAC proceedings is an improper attack on the Commission and Supreme Court of Ohio. The recommendation and arguments should be denied.



## 2011 AUDIT REPORT

The 2010 Audit Report consisted of 6 management audit (see Audit Report at 1-5 – 1-6) and 12 financial audit recommendations (see Audit Report at 1-9 – 1-10).

### 2011 Management Audit Recommendations

**2011-M-1: EVA recommends that prior to any future negotiations with [REDACTED], AEPSC develop a coal procurement strategy that allows it to conduct a competitive solicitation [REDACTED] and that the results of that solicitation, if favorable, be used in the negotiation. EVA further recommends that any future justification memorandum contain the results of the solicitation combined with a fulsome disclosure and analysis of comparable indexes. Finally, as necessary, AEPSC should reach out to third parties to assist it in the development and implementation of a repricing strategy to improve the quality of the results as third parties may be more aware of re-opener negotiation strategies and relevant non-AEP transactions. If the FAC continues, EVA recommends that the strategy be provided to the next management/performance auditor for review.**

Recommendation 2011-M-1 is not necessary. Company witness Henry addressed this confidential recommendation and indicated that AEP Ohio is using a competitive process. Mr. Henry indicated that the justifications prepared for the contract in question included the results of an RFP and appropriate market indices. (Henry at 10.) Mr. Henry also testified that the Company would use third party assistance beyond the tools already used when necessary. Mr. Henry warned against some of the recommendation offered by the Auditor explaining confidentially that such a practice could harm efforts by [REDACTED] [REDACTED] (Id. at 10-11.) Mr. Henry explained how practices of the service corporation helped alleviate that concern. (Id.) The evidence shows the recommendation is not necessary.

**2011-M-2: EVA recommends that if the FAC does not continue that the next management/performance audit determine if there should be any credit to the under-recovery due to the**

Recommendation 2011-M-2 is not necessary. The Commission already ordered the audit for the 2012-2013-period. Thus the premise underlying the recommendation, that the FAC would not be continued, did not occur. Therefore, this recommendation is no longer applicable.

**2011-M-3: EVA recommends that the fuel procurement manual be revised to contain more specificity. Based upon AEPSC's 2011 performance, EVA specifically recommends that AEPSC develop policies with respect to the following:**

- a. Procedures for addressing the**
  - b. The basic items that should be included in all including firm indications of market price, market indexes that are representative of the products being purchased, and full disclosure to management as to the value of the transaction relative to market.**
  - c. The quality that should be used to evaluate coal bids from the**
  - d. The exceptions when AEPSC is not required to solicit bids for procurements.**
- If the FAC continues, EVA recommends that the revisions be done in time for review by the next management/performance auditor.**

The Company disagrees with the Auditor's 2011-M-3 recommendation. Mr. Henry pointed out the history on this recommendation, specifically that AEP Ohio Witness Rusk's 2009 FAC testimony<sup>8</sup> agreed to update the Company's fuel procurement policies while indicating that a procedural manual was neither necessary nor beneficial. (Id. at 6.) The Auditor recognized the changes the Company made in the revised FEL Procurement Policy, in this Management Audit Recommendation, but proposed more specific procedural modifications, including compliance with coal specifications, business justification specifications, coal bid evaluations for coal

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<sup>8</sup> Direct testimony of AEP Ohio Witness Rusk, page 5, Case No.09-872-EL-FAC and Case No. 09-873.

quality, and exceptions for non-solicitations for coal. This recommendation seeks to retread the same ground already indicated as unnecessary by this Commission in the 2009 FAC proceeding.

Company witness Henry explained the value of the current approach that would be undermined by the Auditor's recommendation. He testified that the "current approach, guided by policies, results in the efficient procurement of fuel at the lowest reasonable cost." (Id. at 6.) Mr. Henry testified that the policies provide the Company the "flexibility necessary to adapt to dynamic market and operational conditions." (Id. at 6-7.) He stated that a rigid procedural manual removes the flexibility necessary to react to the market. (Id. at 7.) Ultimately concluding that strict adherence to a single methodology would risk missing opportunities to procure coal at the lowest reasonable cost. (Id.) Mr. Henry cited an example of deviating from the norm that would likely not be in a procedure yet a fact that was praised by the Auditor. Specifically, he testified that AEP Ohio's customers have benefited from the Company's flexible approach, such as described in audit finding 1, on page 1-4 of the Audit Report. There the Auditor states:

Overall, AEP Ohio's fuel costs declined in 2010, primarily as result of the expiration of the contract premium AEP Ohio had paid to its largest supplier in 2009. The ability to terminate the premium is an affirmation of the success of the AEP Ohio's strategy vis-à-vis bolstering this critical supplier during a difficult market period in exchange for continued contract performance.

Mr. Henry stated that it was "the flexibility in the fuel procurement policy, which allowed for the financial support of this supplier and maintained the future benefit of the supply agreement." (Id. at 7.) The evidence shows the recommendation is not necessary and customers' benefit from the current process.

**2011-M-4: EVA recommends that any payments made to [REDACTED] through the remaining term of the FAC not be recoverable through the FAC**

The Company disagrees with the Auditor's 2011-M-4 recommendation. As discussed by Company witness Henry, this recommendation seeks to predetermine issues open for determination in future FAC proceedings. (Henry at 11.) As Mr. Henry points out, the fuel contract expenses from a future FAC should be considered in the context of the conditions and alternatives that will exist during that time period. (Id.) Perhaps the Auditor made this recommendation in line with other recommendations concerned that there may not be a future FAC period for review. The Company does not agree with the premise that if the FAC is ending that there should be cherry picking of future benefits, but certainly the concern that the FAC was not continuing into the ESP II period is no longer valid and rendered this recommendation moot for the 2011 FAC proceeding. This recommendation is not appropriate and should not be adopted.

**2011-M-5: EVA recommends that any proceeds received from the [REDACTED] be applied to the FAC under-recovery.**

The Company disagrees with the Auditor's 2011-M-5 recommendation. This recommendation covers the same issue as financial recommendation 12 (2011-F-12) and will be addressed together in that section of this brief.

**2011-M-6: EVA recommends that AEPSC be directed to develop a strategy for addressing the [REDACTED] and that the strategy should consider a full range of options. If the situation has not been resolved in 2012 and the FAC continues, EVA recommends that the strategy be available for review by the next management/performance auditor**

Recommendation 2011-M-6 is also not necessary. Mr. Henry agreed that a full range of options should and are always considered and those practices are available for review. (Henry

Direct at 12.) Mr. Henry did respectfully decline to discuss the specifics of its review of those options in the docket due to the nature of the proceedings and the intervenors involved. (Id.) But Mr. Henry represented that the Company is considering options and can share its actions with future auditors. The evidence shows that this recommendation is not necessary beyond the actions already taken.

### **2011 Financial Audit Recommendations**

#### **2011-F-1: AEP should identify and separate the renewable energy credits (RECs) value from the energy and capacity value of its renewable energy purchases.**

Recommendation 2011-F-1 is identical to 2010-F-16 and can be considered complete.<sup>9</sup> Company witness Dooley identified these two recommendations as addressing the same issue. (Dooley Direct at 4.) Mr. Dooley pointed out that the Company has achieved the separation through use of the AER and that the recommendation has been addressed. (Id.)

#### **2011-F-2: AEP should show in detail how REC costs incurred by CSP and OPCO in 2011 have been separately identified and excluded from the 12/31/2011 FAC deferral for each company, CSP and OPCO**

Recommendation 2011-F-2 is identical to 2010-F-17 and can be considered complete.<sup>10</sup> Company witness Dooley identified these two recommendations as addressing the same issue. (Dooley Direct at 4.) Company witness Dooley testified that the Company had been showing the REC expense detail by CSP and OPCo and more clearly presents it in support schedules for the quarterly FAC filings. (Id. at 4.) The evidence shows the recommendation has been addressed.

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<sup>9</sup> See response to 2010-F-16 above.

<sup>10</sup> See response to 2010-F-17 above.

**2011-F-3: AEP should be assigning appropriate values to its Renewables inventory, including its non-Ohio, non-solar REC inventory**

Recommendation 2011-F-3 is identical to 2010-F-18 and can be considered complete.<sup>11</sup>

Company witness Dooley identified these two recommendations as addressing the same issue. (Dooley Direct at 5.) Company witness Dooley testified that the Company AEP Ohio has achieved the requested assignment of REC values through the use of the AER beginning in October 2012. (Id. at 5.) The evidence shows the recommendation has been addressed.

**2011-F-4: AEP should be required to analyze the receipt of revenue and the payment of cash expenses for RTD captive operations, similar to a lead-lag study, and to present such information to support its assumption that RTD has a significant Cash Working Capital requirement. If adequate supporting information is not provided to substantiate that RTD has a significant Cash Working Capital requirement and the amount of that requirement using lead-lag study analysis of cash receipts and cash payments, the RTD Working Capital component of the RTD investment base should be removed from the cost charged by RTD to OPCO from January 1, 2011 forward.**

The Company disagrees with Recommendation 2011-F-4, which is an identical issue to 2010-F-19.<sup>12</sup> The evidence shows that the recommendation is not appropriate.

**2011-F-5: AEP Ohio and the other parties to the case should 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 1823144 less the directly related credit-balance ADIT-Other for Deferred Fuel recorded in Account 283.**

The Company disagrees with Recommendation 2011-F-5, which is an identical issue to 2010-F-21, and is contrary to Commission orders.<sup>13</sup> The evidence shows that the recommendation is not appropriate.

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<sup>11</sup> See response to 2010-F-18 above.

<sup>12</sup> See response to 2010-F-19 above.

<sup>13</sup> See response to 2010-F-21 above.

**2011-F-6: 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.**

The Company disagrees with Recommendation 2011-F-6, which is an identical issue to 2010-F-22, and is contrary to Commission orders.<sup>14</sup> The recommendation and arguments should be denied.

**2011-F-7: On January 23, 2012 the Commission issued an Opinion and Order in Case Nos. 09-872-EL-FAC and 09-873-EL-FAC, and on April 11, 2012 issued an Entry on Rehearing in those dockets which provided clarification of AEP Ohio's obligations as they affect crediting OPCO's FAC under-recovery. AEP Ohio's crediting of those clarified amounts against OPCO's FAC under-recovery should be reviewed in the next audit.**

Recommendation 2011-F-7 is not necessary. As supported by the testimony of Company witness Dooley, the appropriate credits have been booked in accordance with Commission Orders and will be available for review by the Auditor. (Dooley Direct at 7.) It should be pointed out that the scope of each FAC audit is defined and should not be disturbed. But to the extent any issue is eligible for consideration in future audit periods they can be considered. Therefore this recommendation should be considered completed.

**2011-F-8: AEP Ohio should be required to explain fully the derivation of, and the purpose for, the [REDACTED] including what those costs are for and why these items are reasonable costs to be included in the FAC**

Recommendation 2011-F-8 is not necessary. This recommendation appeared to seek more of an operational explanation versus a financial audit issue. The Company provided the testimony of Company witness James Henry. Mr. Henry indicated that the Auditor was subsequently provided with the agreement that articulated the necessary information. (Henry

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<sup>14</sup> See response to 2010-F-22 above.

Direct at 12-13.) The Company made Mr. Dooley available at hearing and indicated in Mr. Henry's testimony that any further financial questions could be addressed to him, but no questions were asked on this subject at hearing. It appears that the recommendation is therefore addressed and complete.

**2011-F-9: AEP Ohio may want to question the costs billed to CSP [REDACTED] for the reasons explained in the [REDACTED]**

Recommendation 2011-F-9 is complete and further action is not necessary at this time. Mr. Henry indicated in testimony that he reviewed the Auditor's recommendation from another utility's proceeding and the situation will be monitored for purposes of AEP Ohio. (Id. at 13.) The Auditor did not make any findings in the context of the AEP Ohio audit that found the same circumstances. The recommendation to review the finding is complete.

**2011-F-10: Larkin recommends that the [REDACTED] difference between the December estimate and actual for Account [REDACTED] as it relates to Lawrenceburg be removed from the 2011 FAC.**

Recommendation 2011-F-10 is not appropriate. Company witness Dooley testified that AEP Ohio already properly accounted for the Lawrenceburg transaction with any difference, simply due to timing, appropriately captured in January, 2012. (Id. at 8.) In recognition of these facts established in the record, there is no need for the recommendation.

**2011-F-11: Larkin recommends that AEP Ohio determine and assign a salvage value to the CCPP for the purposes of the depreciation calculations.**

Recommendation 2011-F-11 has been addressed. As discussed in the testimony of Company witness Dooley, the CCPP was fully depreciated by the end of 2011 (Dooley Direct at 8.) Mr. Dooley testified that the salvage value was considered and determined to be zero for



purpose of depreciation calculations in accordance with Generally Accepted Accounting Principles (“GAAP”). (Id.) In recognition of these facts established in the record the recommendation is inappropriate.

**2011-F-12: Larkin recommends that should AEP Ohio sell the CCPP, the proceeds from the sale should be credited against the December 31, 2011 under-recovered FAC balance.**

The Company disagrees with the Auditor’s 2011-F-12 recommendation. This recommendation is tied closely to the fifth management recommendation made in the 2011 audit this response serves to address both recommendations. OCC also addressed the 2011-M-5 recommendation in its testimony arguing improperly that since customers have paid through the FAC the operating and closing costs of the CCPP that any proceeds received from the sale should be applied to the FAC. (Duann Direct at 21-23.)

First and foremost, the recommendation and OCC’s argument conflicts with the Commission’s established holding that customers pay for service and do not have any claim on the assets owned by the utility. Ratepayers do not obtain an interest in utility assets as a result of paying a utility for service. *See* Case No. 88-102-EL-EFC, Opinion and Order (Oct. 28, 1988) at 14-16; Case No. 09-872-EL-FAC, Entry on Rehearing (Apr. 11, 2012) at 11. As noted by Company witness Nelson, this particular asset is not an asset even used directly in utility service; it is not a rate based utility asset. (Id. at 7.)

Secondly, as pointed out by Company witness Nelson, even if the issue were appropriately considered (which it is not), the issue is premature as the sale occurred in a later audit period. (Nelson at 6.) The recommendation is untimely. Mr. Nelson also pointed out the incomplete analysis of the recommendation as the sale of the asset does not end the liabilities associated with the CCPP facility (Id. at 7.) The Company did not ask for recovery for these on-going liabilities, However. in the event the Commission determines that it is appropriate to

consider a credit to customers of any gain on the sale of CCPP, then these on-going liabilities need to be netted against the proceeds. Applying the sale of this asset violates Commission precedent, is done so in a manner that only seeks to capture the positive aspects without recognizing the negative liabilities still assigned to that asset, and seeks to do so for a transaction from another audit period. This recommendation and the OCC argument are not appropriate in a multitude of manners and should not be adopted.

**IEU's Remaining Arguments:**

IEU offered two arguments beyond the ADIT issue addressed above, both arguments involving matters outside of the audits under review. IEU sought Commission action on a prior FAC case and also Commission treatment of issues that reach into future FAC periods. (Bowser Direct at 4.)

The first argument dealt with a request for issuance of a RFP related to the 2009 FAC case. As IEU witness Bowser points out there are issues related to the 2009 FAC on appeal to the Supreme Court of Ohio. (Id. at 12.) The Company too has issues associated with this case on appeal to the Supreme Court. The Commission has discretion on the appropriateness of how it manages its dockets. It has not issued a subsequent entry on the RFP for reasons known only to the Commission. Perhaps the Commission is not confident that the current market supports a beneficial opportunity for sale or perhaps the Commission is awaiting clarification by the Court on the myriad of issues in a case set for oral argument early in 2014. Whatever the reason, the recommendation in the context of the 2010 and 2011 audit is not appropriate. To the extent the outcome will impact future FAC's, those are issues for that future time and will be reflected accordingly.

The second argument raised by IEU deals with its concern that there will be unrealized benefits associated with coal contracts. (Bowser at 12-14.) Mr. Bowser correctly pointed out in his testimony that the Commission already indicated that any effect these agreements have on AEP Ohio fuel costs, if any, were outside the 2009 audit period when raised and therefore were not properly considered in that audit. (Id.) That Commission finding applies equally to the present proceedings. There is no need or justification to create a regulatory liability just because issues MAY have an impact in future years. The impact is unknown, as indicated by the Commission in the 2009 case, and there are future FAC audits to deal with the issue. There is simply no need to adopt IEU's request. The Commission should reiterate its previous holding in the 2009 audit and deal with the matter when it is appropriate if the matter is in need of consideration at all at that time.

### **OCC's Arguments**

OCC concurs with the Audit Report and provides its own quantification of certain points raised by the Auditor. The OCC arguments were considered in the context of the auditor recommendations above.

### **Conclusion**

Overall the adoption of Company practices and the passage of time have addressed a number of the Auditor's recommendations. The FAC is continuing into the future and some of the concerns for future periods can and will be addressed in the appropriate years for audit. The Company has modified some practices, where appropriate, as recommended by the Auditor and will continue to secure FAC related components at the most reasonable cost for customers.

The arguments raised by the Intervenors and some of the audit recommendations stray from the limited scope of the 2010 and 2011 audit purpose of this case. Recommendations and

invitations to have the Commission revisit decision made multiple times in the past should be rejected. The scope of this proceeding is very focused on auditing the actions of the Company in its efforts to comply with the Commission's issued orders that established the FAC. Anything beyond that scope should be summarily rejected and made clear the inappropriateness of the argument for clarity of the record.

For all the reasons stated in this brief and all the evidence in support offered by AEP Ohio in the evidentiary hearing, the Company respectfully request that the Commission verify the reasonableness of the Company's actions and finalize the 2010 and 2011 audits of the fuel adjustment clause.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing was served via electronic mail upon the below-listed counsel this 8<sup>th</sup> day of January, 2014.

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