BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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

REPLY BRIEF OF OHIO POWER COMPANY

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I. INTRODUCTION

The scope of these proceedings is limited to the 2010 and 2011 Fuel Adjustment Clause ("FAC") for Ohio Power Company ("AEP Ohio" or the "Company"). That effort was framed by the Commission through an independent audit by Energy Ventures Analysis ("Auditor")[1] and its financial and management audit recommendations contained in the 2010 and 2011 Audit Reports.[2] On brief, the intervenors continue their attempts to expand the scope of these proceedings into matters already decided by the Commission or beyond the two audit periods.

[1] Energy Ventures Analysis subcontracted a portion of the review of the Company's FAC to Larkin & Associates PLLC. Transcript (hereinafter "Tr.") at 82. References herein to the Auditor will refer to the findings and recommendations of both Energy Ventures Analysis and Larkin & Associates PLLC.

[2] Case Nos. 10-268-EL-FAC, *et al.* Report of the Management Performance and Financial Audits of the FAC of the Columbus Southern Power Company and the Ohio Power Company (May 26, 2011) ("2010 Audit Report"); Case Nos. 11-281-EL-FAC, *et al.*, Report of the Management Performance and Financial Audits of the FAC of the Columbus Southern Power Company and the Ohio Power Company (May 24, 2012) ("2011 Audit Report").

For example, Industrial Energy Users-Ohio ("IEU") devotes a significant portion of its brief to launching collateral attacks on past Commission decisions and advancing its opinions on how the Commission should manage its docket. The Office of the Ohio Consumers' Counsel's ("OCC") brief similarly reads like a late application for rehearing of past Commission decisions. OCC also seeks to have the Commission rule on issues that are not ripe for consideration in these proceedings. The Ohio Partners for Affordable Energy's ("OPAE") brief suffers from the same flaws as the other intervenors' briefs.

In its brief, the Commission Staff recognized that many of the Auditor's recommendations have been satisfied by the Company, but calls for a verification of the completed recommendations in the next audit. However, where the evidence in these cases shows that a particular recommendation has been satisfied, a subsequent verification is unnecessary. Finality of certain issues is important, and the Commission should hold over issues sparingly between audits and only when necessary. While the Commission Staff recognizes that the majority of the recommendations contained in the 2010 and 2011 Audit Reports have been completed by the Company or are undisputed, its brief does not recognize or factor in the Company's rationale and explanation from the point of view as a flexible market participant seeking to acquire resources at the lowest reasonable cost.

As discussed below and in AEP Ohio's initial brief, to the extent they have not already been implemented by the Company or rendered moot, the recommendations submitted by the Auditor, intervenors and Staff should be rejected. The Commission should refuse to entertain arguments on matters beyond the scope of these proceedings. The evidence demonstrates that the Company's actions and incurred fuel costs were prudent, reasonable and adhered to all

pertinent Commission orders. AEP Ohio respectfully requests that the Commission verify the reasonableness of the Company's actions and finalize the 2010 and 2011 audits of AEP Ohio's fuel adjustment clause.

II. ARGUMENT

A. The methodology for calculating carrying charges on the Company's fuel deferral balances, which was established by the Commission in AEP Ohio's first electric security plan proceeding and affirmed by subsequent Commission decisions, does not and should not include an adjustment for accumulated deferred income taxes.

In their initial briefs, OCC (at 9-13), IEU (at 20-22) and OPAE (at 3-6, supporting the recommendations of OCC with respect to the 2010 Audit) argue that the Commission should direct AEP Ohio to calculate carrying charges on the fuel deferrals authorized in AEP Ohio's first electric security plan proceeding (Case Nos. 08-917-EL-SSO, *et al.*, hereinafter "*ESP I*") on a net-of-tax basis – *i.e.,* with an adjustment for accumulated deferred income taxes ("ADIT"). The basis for the intervenors' position is the Auditor's recommendations on this issue[3], which, as discussed in AEP Ohio's initial brief, are inappropriate based on prior Commission decisions. The Staff, who's Auditor initially raised the point, did not include this argument in its section on remaining contested issues. The intervenors' collateral attacks on the Commission's prior decisions should be rejected and the Commission should – once again – affirm that the carrying charges on the Company's fuel cost deferral balances should be calculated without an adjustment for ADIT.

[3] *See* 2010 Audit Report at 1-10 (May 26, 2011), Financial Audit Recommendations 21 and 22; 2011 Audit Report at 1-9–1-10 (May 24, 2012), Financial Audit Recommendations 5 and 6.

The Commission has repeatedly reiterated its position on this issue in prior, more appropriate dockets and found that the carrying charges on the fuel cost deferral balances should be calculated without an adjustment for ADIT. *See ESP I,* Opinion and Order at 20-24 (Mar. 18, 2009); Case Nos. 11-4920-EL-RDR and 11-4921-EL-RDR ("*PIRR*" case), Finding and Order at 19 (Aug. 1, 2012), Entry on Rehearing at ¶ 26 (Oct. 3, 2012.) Thus, the intervenors' arguments in this regard are an improper attack on the Commission's previous rulings and should be rejected.

In its *ESP I* Opinion and Order, 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.

ESP I, Opinion and Order at 23 (Mar. 18, 2009.) The Commission discussed the matter further on page 24 of its Opinion and 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.

Id. at 24. As indicated by Company witness Nelson, the Commission affirmed this ruling in addressing a request for rehearing filed by several parties to the case. AEP Ohio Ex. 4 (Nelson Direct) at 11. The Commission's decision not to make an adjustment for ADIT became final once the Supreme Court of Ohio resolved the *ESP I* appeal, as the Commission's decision on this issue was not asserted as error on appeal. *See In re Application of Columbus S. Power*, 2011-Ohio-1788.

The Commission affirmed its decision not to adopt the recommendation for an ADIT adjustment in its August 1, 2012 Finding and Order in the *PIRR* case, finding that the ADIT issue was already considered and addressed in the *ESP I* proceedings. *See PIRR*, Finding and Order at 19, Entry on Rehearing at ¶ 26 (Oct. 3, 2012). The same rationale applies here: The ADIT issue was already considered and addressed in the *ESP I* proceedings and should not be considered in this case.

Both OCC (at 11) and IEU (at 22) argue that the Commission's prior decisions on the ADIT issue are contrary to the Commission's own precedent and regulatory principles. To support their argument, the intervenors point to the Company's Distribution Investment Rider ("DIR") as an example of the Commission ordering an adjustment for ADIT. However, unlike the PIRR, the DIR was not authorized pursuant to Section 4928.144, Revised Code ("R.C."), which requires the full collection of carrying charges on any deferrals authorized pursuant to that code section. As the Commission recognized in its *ESP I* order, if carrying charges on the fuel deferrals were calculated on a net-of-tax basis (*i.e.*, with an ADIT adjustment as suggested by the intervenors) AEP Ohio "would not recover the full carrying charges on the authorized deferrals," which "would be inconsistent with the explicit directive of Section 4928.144, Revised Code." *ESP I*, Opinion and Order at 23-24 (Mar. 18, 2009). Pointing to a rider that was not established pursuant to the phase-in statute as an example of how a rider that was should operate is not cogent.

Further, the additional precedent cited by IEU (at 22) is likewise inapplicable here. The decisions cited by IEU either address the computation of a utility's rate base generally or relate to the evidentiary showing required by a utility to sustain its burden of proof in the context of a

rate proceeding. None of the decisions address the treatment of ADIT when calculating carrying charges on deferrals authorized by R.C. 4928.144. Finally, that the Commission has addressed this issue at least twice now (in proceedings where the issue has been fully developed on the record) and has consistently reached the same conclusion belies the intervenors' arguments that the Commission's prior decisions are contrary to its own precedent and regulatory policy.

While both OCC witness Duann and IEU witness Bowser acknowledge the Commission's decisions establishing the carrying cost methodology without an adjustment for ADIT, they both seek to supplant the Commission's authority in this arena with their own opinions. *See* IEU Ex. 15 (Bowser Direct) at 5-6; OCC Ex. 1 (Duann Direct at 10-13.) As discussed above, the methodology for calculating the carrying charges associated with the Company's fuel deferral balances was established in the context of an ESP that involved a phase-in under R.C. 4928.144, as OCC witness Duann recognizes. OCC Ex. 1 at 13. Accordingly, the traditional application attempted by the intervenors here does not apply as the Commission was dealing with a statutory duty to ensure AEP Ohio recovers the full carrying charges on the authorized fuel deferrals. Ultimately, the Commission approved a package that the Company relied upon as a balanced ESP. As Company witness Nelson testified, AEP Ohio has calculated the carrying charges on the deferred fuel balances in compliance with the Commission's orders. AEP Ohio Ex. 4 at 12. The proper procedure to seek reversal of a Commission determination is to seek rehearing and then, if not successful, to file an appeal to the Supreme Court of Ohio – not to levy collateral attacks in proceedings in which the issues have not been fully developed. The focus of the audit should be on whether the Company followed the Commission's orders in calculating the FAC and has kept it books and records accordingly. The Company has done so, and its investors should have every assurance that the Commission's absolutely clear orders on

this topic are not undermined by the intervenors' collateral attacks. This case should not be used as an opportunity to reargue or re-establish the structure of the order that established the parameters of the FAC.

The Commission has repeatedly reiterated its position on the ADIT issue and the recommendation and attempts to reargue the issue in these FAC proceedings is an improper attack on the decisions of the Commission and Supreme Court of Ohio. The recommendations submitted by the Auditor and intervenors on this issue should, therefore, be rejected.

B. The methodology for calculating River Transportation Division's working capital requirement is appropriate and should not be disturbed in these proceedings.

In their initial briefs, OCC (at 6-9) and OPAE (at 2-3, supporting the recommendations of OCC with respect to the 2010 Audit) argue that the Commission should remove the costs associated with the River Transportation Division's ("RTD") cash working capital requirement from the amount to be collected from customers through the Company's FAC. It is important to recognize that the Auditor's recommendations in this regard was simply to have the Company justify the level of RTD's cash working capital requirement and not to disallow recovery of such costs, as the intervenors recommend.[4] Consistent with the Auditor's recommendations, Staff (at 5-7) merely suggests that the Commission should direct the Company to justify its costs before they are permitted to be recovered. AEP Ohio disagrees with the recommendations submitted by the Auditor, intervenors and Staff on this issue and submits that modifying the methodology for

[4] *See* 2010 Audit Report at 1-10 (May 26, 2011), Financial Audit Recommendation 19; 2011 Audit Report at 1-9 (May 24, 2012), Financial Audit Recommendation 4.

calculating RTD's cash working capital requirement should not (and indeed cannot) be undertaken in these proceedings.

As explained in the testimony of Company witness Nelson, RTD is a division of Indiana Michigan Power Company, a subsidiary company of AEP and an affiliate of AEP Ohio. Barge freight services are provided at cost by RTD to AEP's operating companies (including AEP Ohio) under the "Barge Transportation Agreement" – an agreement on file with and under the jurisdiction of the Federal Energy Regulatory Commission. AEP Ohio Ex. 4 at 8. RTD's costs are allocated to the operating companies based on each company's utilization of the barging service. *Id.* These costs are considered transportation costs and are included in the cost of coal inventory. *Id.* RTD calculates its charges to the Company in accordance with the language of the Barge Transportation Agreement and cannot modify that methodology without filing that change at FERC. *Id.* Mr. Nelson describes the agreement's prescribed allocation methodology to be 1/8 of the aggregate operation, maintenance, rental and general expense of RTD for each annual period. *Id.* Mr. Nelson also identified a recent FERC decision in Docket No. ER10-355-000 involving AEP operating companies where FERC confirmed that it was its 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.

The Auditor's and intervenors' recommendations appear benign but are actually seeking a policy shift away from the FERC-preferred methodology that is inappropriate. The Staff argument that the Company is somehow denying jurisdiction of the Commission is misplaced. The Commission relies on and passes through FERC-approved rates and schedules in many instances. The structure of this relationship in question has the benefit of following a FERC

preferred method which should provide the Commission comfort that the process has checks and balances. The recommendation seeks a lead-lag study for the sake of a lead-lag study and misses the overall point of the industry acceptance of the current methodology.

There are several problems with using a lead-lag study or other method to determine RTD's cash working capital requirement instead of using FERC's 1/8 methodology, as the Auditor recommends. Initially, as indicated by Company witness Nelson, a lead-lag study could be costly, and the focus of the Auditor should be whether the Company is implementing the costs under the existing contract not seeking to change the terms of the existing contract. AEP Ohio Ex. 4 at 8. In addition, the utility of a lead-lag study is also questionable. A lead-lag study is for a specific point in time, so while the results of a lead-lag study may provide information to be used going forward, it would have no bearing on the RTD costs at issue in these proceedings, which address 2010 and 2011. The Commission should not order a lead-lag study as a retroactive review. If the study was intended for only future use, then the lead-lag study should also be updated periodically, which may result in additional ongoing expenses associated with hiring a consultant to perform the study and perhaps result in large swings in the cash working capital component of the cost-based RTD formula. Finally, the Company would need FERC approval to depart from the 1/8 methodology because any departure from the methodology prescribed in the FERC-filed contract would violate the terms of the Barge Transportation Agreement.

In sum, it would be unreasonable and illegal to make a policy declaration in these proceedings 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 (or to January 1,

2010 as suggested by OCC) for using the approved method. The recommendation goes beyond the purpose of the audit in this case and seeks an action based on a prospective view for use in a retroactive audit. Consequently, the recommendations submitted by the Auditor and intervenors on this issue should be rejected.

C. Ordering the Company to adopt a formulaic fuel procurement procedure manual would constrain the Company's efforts to secure the necessary fuel for its customers at the lowest reasonable cost.

The Auditor made several recommendations regarding the Company's fuel procurement policies and procedures in the 2010 and 2011 Audit Reports.[5] In its brief (at 10-11), Staff states that AEP Ohio should be required to comply with the Auditor's recommendations regarding an expanded fuel procurement policy manual. However, as discussed in the Company's initial brief and in the testimony of Company witness Henry, a rigid fuel procurement procedure manual will reduce necessary flexibility in the area of fuel procurement and may ultimately result in lost opportunities and additional costs for customers.

Regarding 2010 Management Audit Recommendations 16, Company witness Henry testified that AEP Ohio has already revised its policy manual based on a similar audit recommendation in the 2009 audit report. AEP Ohio Ex. 3 (Henry Direct) at 6-7. Regarding 2010 Management Audit Recommendation 17, the Company agreed that compliance with contract terms and conditions should be required. *Id.* at 7-8. To that end, 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

[5] *See* 2010 Audit Report at 1-6 (May 26, 2011), Management Audit Recommendations 16 and 17; 2011 Audit Report at 1-5, 1-6 (May 24, 2012), Management Audit Recommendations 1 and 3.

prescribed band, with suspension and rejection limits for non-compliance with the contract terms and conditions." *Id*. Mr. Henry further 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.*; Tr. at 150-152. The important fact for the 2010 Audit recommendations 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. AEP Ohio Ex. 3 at 9.

As discussed in AEP Ohio's initial brief, 2011 Management Audit Recommendation 1 is unnecessary. Company witness Henry addressed this confidential recommendation and indicated that AEP Ohio is using a competitive process as recommend. Mr. Henry indicated that the justifications prepared for the contract in question included the results of an RFP and appropriate market indices. *Id.* at 10; Tr. at 145-146. Mr. Henry also testified that the Company would use third party assistance beyond the tools already used when necessary. AEP Ohio Ex. 3 at 10.

Regarding 2011 Management Audit Recommendation 3, the Company disagrees with the Auditor's recommendations. Mr. Henry discussed the history of this recommendation; specifically, that AEP Ohio witness Rusk's 2009 FAC testimony[6] agreed to update the Company's fuel procurement policies while indicating that a procedural manual was neither necessary nor beneficial. AEP Ohio Ex. 3 at 6. The Auditor acknowledged the changes the Company made in the revised fuel procurement policy in 2011 Management Audit

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

Recommendation 3, but proposed more specific procedural modifications, including compliance with coal specifications, business justification specifications, coal bid evaluations for coal quality, and exceptions for non-solicitations for coal. This recommendation seeks to retread the same ground already indicated as unnecessary by the Commission in the 2009 audit case.

Company witness Henry explained the value of the current approach that would be undermined by the Auditor's recommendations. He testified that the "current approach, guided by policies, results in the efficient procurement of fuel at the lowest reasonable cost." *Id.* at 6-7; Tr. at 145-150, 153-155. Mr. Henry testified that the policies provide the Company the "flexibility necessary to adapt to dynamic market and operational conditions." AEP Ohio Ex. 3 at 6-7. He stated that a rigid procedural manual removes the flexibility necessary to react to the market. *Id.* Ultimately concluding, based on past experience, that strict adherence to a single methodology would risk missing opportunities to procure coal at the lowest reasonable cost. Tr. at 149. Mr. Henry testified that AEP Ohio's customers have benefited from the Company's flexible approach, as recognized by the Auditor in 2010 Major Management Audit Finding 1 on page 1-4 of the 2010 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." AEP Ohio Ex. 3 at 7.

In advocating for a formulaic procurement manual, Staff asserts that there is a "'trust me' attitude implicit in AEP Ohio's [current] approach . . . ." Staff Brief at 11. Such a characterization is unfair and contrary to the evidence. Initially, Staff acknowledges that the Company's current strategy is "guided by policies and guidelines." *Id.* at 10. Further, even Staff must recognize that it is impossible to develop a procurement manual that addresses every conceivable circumstance that may arise. The need for sound independent business judgment in this regard can never be eliminated. Finally, the Company's fuel expenses will be audited and its fuel procurement decisions will be evaluated for prudence through the existence of the FAC – even in the absence of a rigid procurement manual. An auditor should review the actions taken by a company considering the time and circumstances faced at the time the actions occur. The recommendation to create a rigid policy manual to automate all decisions ignores the reality of the changing market and handcuffs the Company, whose actions are ultimately the subject of an audit.

The evidence shows that the recommendations to implement a more detailed procurement manual are unnecessary and that the Company's customers benefit from the current process. Consequently, the Auditor's and Staff's recommendations on this issue should be rejected, to the extent they have not already been implemented by the Company as discussed above.

D. In addition to being contrary to established regulatory policy, any recommendations related to the proceeds of the sale of the Conesville Coal Preparation Plant are beyond the scope of these proceedings as the sale did not occur until 2012.

In the 2011 Audit Report, the Auditor recommended that any proceeds from the sale of the Conesville Coal Preparation Plant ("CCPP") be applied to the FAC under recovery.[7] As discussed in AEP Ohio's initial brief, the Auditor's recommendations on this issue relate to matters outside the audit periods under review in this case as the sale of the CCPP occurred in 2012. More importantly, the recommendation is also contrary to established Ohio regulatory case law and Commission decisions. OCC supports the Auditor's recommendation, stating "AEP Ohio's customers have paid (through the FAC) the operating costs as well as closure-related costs of the CCPP. Accordingly, any proceeds received from the sale of the CCPP assets should be applied to the FAC under-collection." OCC Brief at 14. The recommendations submitted by the Auditor and OCC should be rejected.

It is well established that ratepayers do not obtain an ownership interest in utility assets as a result of paying for utility services. *See* Case No. 88-102-EL-EFC, Opinion and Order at 14-16 (Oct. 28, 1988) (finding ratepayers had no ownership interest in the utility's asset and rejecting the argument that the sale of the asset required that the gain be flowed through to ratepayers.); *See, also* Case No. 09-872-EL-FAC, *et al.,* Entry on Rehearing at 11 (Apr. 11, 2012) ("ratepayers do not earn or acquire an ownership interest in the utility's assets as a result of paying for utility services."). Even if it were appropriate to entertain the recommendations

[7] *See* 2011 Audit Report at 1-6, 1-10 (May 24, 2012), Management Audit Recommendation 5 and Financial Audit Recommendation 12.

submitted by the Auditor and OCC on this issue (which it is not) the CCPP is not even an asset used directly in providing utility services; it is not a rate based utility asset. AEP Ohio Ex. 4 at 7.

Moreover, even if it were appropriate to consider the Auditor's and OCC's recommendations, Mr. Nelson identified the incomplete analysis of the recommendation as the sale of the asset does not end the liabilities associated with the CCPP facility *Id.* To be clear, the Company is not requesting recovery for the on-going liabilities associated with the CCPP. However, in the event the Commission determines (in the context of AEP Ohio's 2012 FAC audit if at all) that it is appropriate to consider a credit to customers of any gain on the sale of CCPP, then the on-going liabilities associated with the facility need to be netted against any proceeds. The Auditor's and OCC's recommendations on this issue violate Commission precedent, seek to capture only the positive aspects of the sale without recognizing the negative on-going liabilities associated with the facility, and seek to do so for a transaction that occurred outside the audit periods under review. The recommendations, therefore, should be rejected.

While an audit of the sale transaction is beyond the scope of these proceedings, the closure of the CCPP facility occurred at the end of 2011 and was appropriately reviewed by the Auditor during its 2011 audit. Company witnesses Dooley explained that the "CCPP was fully depreciated by the end of 2011," in other words, the CCPP was closed at the end of 2011. AEP Ohio Ex. 2 (Dooley Direct) at 8. AEP Ohio's share of costs associated with the closure of the CCPP was reviewed by the Auditor and the Auditor made no recommendations or findings of imprudence. *See* 2011 Audit Report at 7-100–7-105. Accordingly, review of the closure costs associated with the CCPP should be considered complete, and Staff's recommendation that "the next auditor should be directed to review the closure and make recommendations" is unnecessary and should be rejected. Staff Brief at 12.

E. The Commission is certainly aware of the pending issues remaining from AEP Ohio's 2009 FAC audit, and IEU's instructions on how the Commission should address these issues should be ignored.

In its brief, IEU (at 23-25) discusses three issues related to the Company's 2009 FAC audit proceeding. The first relates to how the Company credited certain amounts against the FAC under-recovery.[8] As discussed in AEP Ohio's initial brief, however, the crediting of these amounts has already occurred. The Company submitted evidence on this point in the form of sworn witness testimony by Company witness Dooley who stated that the appropriate credits have been booked in accordance with Commission Orders. AEP Ohio Ex. 2 at 7. Therefore, this recommendation should be considered completed for purposes of the 2011 Audit.

The second issue relates to the 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. IEU Ex. 15 at 12. The Company too has issues associated with this case on appeal to the Supreme Court. Nonetheless, the Commission has discretion on the appropriateness of how it manages its docket. It has not issued a subsequent entry on the RFP. 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 in early 2014. Whatever the reason, IEU's recommendation in the context of these 2010 and 2011 audit proceedings is inappropriate. To the extent the outcome will impact future audits, those are issues for that future time and will be reflected accordingly.

[8] *See* 2011 Audit Report at 1-10 (May 24, 2012), Financial Audit Recommendation 7.

The third and final issue raised by IEU related to the Company's 2009 FAC audit deals with its concern that there will be unrealized benefits associated with certain coal contracts. IEU Initial Brief at 24-25. IEU witness Bowser correctly pointed out in his testimony that the Commission already indicated that the effect these agreements have on AEP Ohio's fuel costs, if any, were outside the 2009 audit period when raised and therefore were not properly considered in that audit. IEU Ex. 15 at 12-14. 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 audit case, and there are future audits to deal with the issue. IEU's recommendation is premature. The Commission should reiterate its previous holding and address the matter when it is appropriate, if the matter is in need of consideration at all.

F. IEU's double recovery claims are beyond the scope of this proceeding, improperly raised in brief and otherwise without merit.

IEU seeks to advance its premature (and otherwise misguided) theory of double recovery in these proceedings. The Attorney Examiner properly excluded evidence and cross examination relating to the double recovery issue identified in the November 13, 2013 Opinion and Order in Case No. 12-3254-EL-UNC, since these proceedings relate to 2010-2011 audit periods and the double recovery issue relates to a subsequent time period (2012 at the very earliest). Thus, none of IEU's arguments in this regard need to be considered and the excluded evidence it proffered can be ignored. Even if the proffered evidence is considered, it fails to support the factual inferences drawn by IEU. Finally, there are multiple legal barriers that also separately defeat IEU's vacuous double recovery claim, as set forth below.

1. The Attorney Examiner properly excluded evidence and prevented cross examination regarding matters outside of the 2010-2011 audit periods at issue in these proceedings.

The Attorney Examiner sustained AEP Ohio's objections and excluded evidence and precluded cross examination by IEU on matters that go well beyond the audit periods involved in this case. Tr. at 53, 55. Nonetheless, IEU proffered IEU Exhibits 7-12 in an attempt to advance its flawed double recovery theory. IEU should have filed an interlocutory appeal if it wanted to challenge the Attorney Examiner's rulings and secure a ruling from the Commission that additional evidence could be taken.[9] Because IEU failed to do so and the Attorney Examiner's rulings cannot now be reversed, the proffered evidence cannot be relied upon or otherwise considered by the Commission in deciding the merits of these cases. As IEU well knows, it would be error for the Commission to reverse the Attorney Examiner's proper ruling or rely on extra-record evidence. *Industrial Energy Users – Ohio v. Pub. Util. Comm.*, 117 Ohio St.3d 486, ¶ 30 (2008) (ruling on an issue without record support is an abuse of discretion and reversible error).

As was discussed on the record in this case, AEP Ohio has challenged and addressed the double recovery allegations as part of Case No. 12-3254-EL-UNC. Tr. at 50; IEU Brief at 6. The Commission's Opinion and Order in that case determined (at 16) that the allegations were of "AEP Ohio double recovering certain capacity revenues." Of course, the capacity revenues in that section of the decision relate to the $188.88/MW-day rate adopted in Case No. 10-2929-EL-UNC ("*Capacity Case*"), which rates did not become effective until August 2012. There is no

[9] While OAC Rule 4901-1-15(F) arguably permits IEU to challenge the evidentiary ruling in its merit brief even without having filed an interlocutory appeal, there is no basis for IEU to present and rely on evidence excluded from the record in its brief. In any case, as discussed below, IEU makes arguments that are not supported by the proffered evidence and otherwise fallacious.

possible way that such double recovery could have occurred prior to August 2012, and AEP Ohio maintains that no such double recovery occurred even after August 2012. For present purposes, however, it is sufficient for the Commission to confirm the Attorney Examiner's ruling that the double recovery allegation referenced in Case No. 12-3254-EL-UNC cannot be raised here because it bears no relationship to the 2010 and 2011 audit periods at issue in these proceedings.

In addition, there can be no consideration of IEU's double recovery allegations prior to the point in time when the decision in Case No. 12-3254-EL-UNC authorized the FAC to be unbundled into the Fixed Cost Rider ("FCR") and ordered that the energy-only auctions begin replacing portions of the FAC energy-related costs – which does not occur until April 2014. Any contrary or more expansive retrospective review would violate the prohibition against retroactive ratemaking and the filed-rate doctrine. *Keco Industries v. Cincinnati & Suburban Bell Tel. Co.*, 166 Ohio St. 254, 141 N.E.2d 465 (1957). But nothing further needs to be done in this case as the Attorney Examiner properly excluded the double recovery issue from the evidence and there is no record basis to consider or resolve the issue.

2. <u>Even if considered, the excluded exhibits proffered by IEU (which cannot be relied upon in deciding this case) do not factually support the double recovery allegations advanced by IEU.</u>

IEU relies on its proffered exhibits to assert that:

> [T]he proffered exhibits demonstrate that AEP Ohio's base generation rates in effect during 2010 and 2011 provided AEP Ohio with compensation equivalent to $355 per megawatt day. Moreover, the proffered exhibits demonstrate that AEP Ohio is fully compensated for its cost of capacity and purchased power – Lawrenceburg and OVEC demand charges – by compensation of $355 per megawatt day. Despite its 2010 and 2011 base generation rates fully

> compensating it for the Lawrenceburg and OVEC demand charges, AEP Ohio recovered the same demand charges through the FAC in 2010 and 2011. Thus, the proffered exhibits demonstrate that AEP Ohio double recovered Lawrenceburg and OVEC demand charges through the FAC.

IEU Brief at 11 (Citations omitted.) Even setting aside that the excluded evidence proffered by IEU constitutes extra-record material that cannot be relied upon by the Commission in making a decision in this case, the conclusions asserted by IEU in this regard are simply not supported by the proffered exhibits. Double recovery is a fact-intensive claim and should not be presumed from sweeping inferences or broad assumptions as IEU has done.

IEU's first point that the proposed $355/MW-day for capacity would have fully compensated AEP Ohio for the OVEC/Lawrenceburg demand charges is a "red herring," because the Commission did not grant AEP Ohio's request to recover $355/MW-day for capacity. Rather, it slashed the request to $188.88/MW-day. So it is academic and irrelevant as to whether $355 would have fully compensated the Company. The Company never said it was fully compensated by the $188/88/MW-day rate but maintained that the $355/MW-day rate would have been fully compensatory. Indeed, AEP Ohio presently is pursuing a challenge before the Supreme Court of Ohio that the $188/MW-day rate constitutes an unconstitutional taking of the Company's property. (S.Ct. Case No. 2013-521) IEU's position ignores this fundamental point.

Although AEP Ohio's original $355.72/MW-day calculation in the *Capacity Case* included capacity costs that reflected OVEC and Lawrenceburg demand charges, the Commission's final order only authorized recovery of $188.88/MW-day – far less than the cost-based request that AEP Ohio made. Of course, the $188.88/MW-day capacity charge was not in

effect during the 2010-2011 audit period involved in this proceeding. Consequently, it is manifestly evident that the authorized capacity charge of $188.88/MW-day would not enable double recovery of the OVEC/Lawrenceburg demand charges being recovered through the FAC.

The fact that certain demand charges were originally included in the test period data as part of the Company's proposed $355.72/MW-day rate simply does not support double recovery, because the final rate approved was only $188.88/MW-day. Stated differently, the Commission cannot presently support a finding that double recovery exists since the amount of OVEC/Lawrenceburg charges originally included as part of the $355.72/MW-day rate is far less than the amount by which the Commission reduced the $355.72/MW-day rate (*i.e.*, $355.72-$188.88 = $166.84/MW-day reduction). As demonstrated below, the portion of the capacity charge rate attributable to the OVEC/Lawrenceburg demand charge using the original 2010 data was less than $38/MW-day whereas the Commission reduced the Company's original cost calculation by $167/MW-day.

Specifically, the 2010 OVEC demand charge costs for the combined companies included in the proposed $356/MW-day was $37.56/MW-day, as shown in the following table.

OVEC AND LAWRENCEBURG DEMAND CHARGES INCLUDED IN THE COMPANY'S ORIGINAL 10-2929 REQUEST (2010 DATA)			
	Included In Amount in Capacity Case at	**Specific Source**	**Amount**
OVEC - OPCo	KDP-4,pg. 14, Ln. 11	FERC FORM 1 at Ln. 2, pgs. 326.3 and 327.3	$ 46,149,435
OVEC - CSP	KDP-3,pg. 14, Ln. 11	FERC FORM 1 at Ln. 2, pgs. 326.3 and 327.4	$ 13,228,114
Lawrenceburg - CSP	KDP-3,pg. 14, Ln. 12	FERC FORM 1 at Ln. 1, pgs. 326 and 327	$ 60,734,136
Total			$ 120,111,685
Divided by Peak Load	KDP-6		9,060.8
Divided by Days Per Year			365
Multiplied by Loss Factor	KDP-6		1.03412
= Rate per MW-day			$ 37.56

The $37.56/MW-day component is substantially less than the $167/MW-day reduction to the Company's original request for a $356/MW-day capacity charge. Because full removal of the OVEC/Lawrenceburg demand charges included in the original filed revenue requirement based on 2010 data would reduce the $356/MW-day by only $39/MW-day, there is no present basis for a finding of double recovery since the OVEC/Lawrenceburg demand charges were fully subsumed within the amount excluded under the *Capacity Case* decision.

Another fundamental point ignored by IEU is the obvious fact that the original development of the $188.88/MW-day charge in the *Capacity Case* was expressly adopted to apply relative to shopping capacity. *See Capacity Case*, Entry on Rehearing at 32 (Oct. 17, 2012.) ("The Commission initiated this proceeding solely to review AEP Ohio's capacity costs and determine an appropriate capacity charge for its FRR obligations.") Whereas, neither CRES providers nor their shopping customers pay the FAC at all. As with any of the demand-related costs used to support the Company's proposed capacity rate of $355/MW-day (which was not approved), there was no implication or premise that 100% of the underlying costs would be recovered through the wholesale capacity charge to CRES providers related to shopping load.

Rather, the wholesale charge would compensate AEP Ohio for the capacity service it provided to CRES – not for capacity service relating to non-shopping (SSO) load. This ignores the quantity of capacity sold under the respective rates and falsely assumes that the total is greater than the sum of the parts. Under IEU's flawed logic, the Company would always double recover all capacity costs – not just Lawrenceburg and OVEC demand charges. That is because, using IEU's flawed thinking, recovery from shopping customers fully compensates the Company for capacity costs while recovery from non-shopping customers also fully compensates the Company for capacity costs – thus causing double recovery. IEU's failure to address any allocation as between shopping and non-shopping load is another major flaw in its misguided theory of double recovery.

IEU also attempts to draw negative inferences from the Company's testimony in the *Capacity Case* that the proposed wholesale charge of $355/MW-day was comparable to the Company's existing Base Generation Rates. Specifically, IEU points out (at 13) that AEP Ohio's rebuttal testimony in the *Capacity Case* maintained that the proposed $355/MW-day capacity charge "roughly approximates and is, therefore, comparable to" the Base Generation Rates received from non-shopping SSO customers. These statements were made on rebuttal in the context of combating a claim that the proposed $355/MW-day charge was discriminatory as compared to Base Generation Rates. The Company merely pointed out that the rate levels were approximately equivalent. In other words, the two rates were quantitatively similar. IEU's sweeping leap of faith from this departure point is that all of the contents of the two rates must, therefore, be identical. That is, because the originally-proposed capacity charge of $355/MW-day reflected some level of Lawrenceburg/OVEC demand costs and because the Base Generation

Rates were roughly equivalent to a rate of $355/MW-day, the Base Generation Rates *ipso facto* must reflect Lawrenceburg/OVEC demand costs. That is another flawed syllogism of IEU.

Beyond the obvious fact that the Commission did not approve the $355/MW-day charge, the Commission also rejected the claim of discrimination and found significant distinctions between the FRR capacity service and retail SSO service. The Commission explicitly found that both the services rendered and the customers who receive the services are different. *See* Case Nos. 11-346-EL-SSO *et al.* ("*ESP II*"), First Entry on Rehearing at 33 (Jan. 30, 2013.) AEP Ohio supplies CRES providers with capacity in a wholesale transaction so that CRES providers may serve customers. It provides SSO base generation service to non-shopping, retail customers in a retail transaction that encompasses more than capacity. The two different services are rendered under different circumstances and conditions (to CRES providers for resale and to non-shopping customers as one rate component within the ESP package). In electricity markets, as in others, wholesale and retail rates are rarely the same. These service distinctions – already adopted and emphasized by the Commission in the *ESP II* decision – are even more cogent here given that the Commission simply "borrowed" the $188.88/MW-day rate from the context of wholesale capacity service relating to shopping load and applied the same number here in a quite different context for purposes of retail rate blending associated with the energy-only auctions. More importantly, the fact that two different services have a similar rate does not demonstrate that the basis for the rates are identical or that any subcomponents are the same. IEU's assertion that a similar rate for wholesale capacity and retail Base Generation Rates (which is a factually incorrect premise to begin with) means OVEC/Lawrenceburg costs are necessarily reflected in both rates is without basis. That is like concluding that a hamburger sandwich must be made of chicken since both hamburger and chicken sandwiches have a similar price! In reality, as further

discussed below, there is no basis to conclude that either the wholesale capacity price or Base Generation Rates reflect the same OVEC/Lawrenceburg costs that are recovered through the FAC (and soon to be recovered through the Fixed Cost Rider starting in April 2014).

In any case, as the Staff recognized in its brief (at 13), it is a "highly complicated" topic and Staff understands that there is only a "*possibility* that there is a double payment of capacity costs." (Emphasis original.) Of course, contrary to Staff who advocates that the next FAC auditor should further examine the issue, AEP Ohio maintains that the allegation should be dismissed and rejected because there is no factual basis to conclude that double recovery exists. Even beyond all of the foregoing lack of factual basis, there are several legal reasons to dismiss IEU's double recovery claim, as set forth below.

3. IEU's double recovery arguments are misguided and, in several respects, unlawful.

In addition to lacking a factual basis, there are also legal barriers to IEU's misguided double recovery theory.

a. Base Generation Rates are not cost-based and there is no basis for finding that any costs previously recovered through the FAC (soon to be recovered through the FCR) are being double-recovered through Base Generation Rates.

Concerns about double recovery are inherently based on cost-of-service ratemaking. But the statutory framework and the Commission's implementing decisions in AEP Ohio's prior *ESP* and *Capacity* cases demonstrate as a matter of law that there will be no double recovery through Base Generation Rates of the fixed costs already authorized for recovery by the Commission through the FAC (soon to be recovered through the FCR). A primary flaw in IEU's double recovery argument is the erroneous assumption that the FAC demand charges are reflected in the

Company's Base Generation Rates. The reality is that the Base Generation Rates are not cost-based – and that is a matter of law and a function of Commission decisions implementing the law.

The Company's Base Generation Rates result from a number of decisions that the Commission made in prior regulatory proceedings, starting in 1999, which were designed to transition the Company and its SSO generation rates to a restructured, competitive, model.[10] In none of those proceedings were Base Generation Rates established on a cost basis. Moreover, when the Commission approved each of AEP Ohio's electric security plans through its orders in the *ESP I* and *ESP II* cases, it followed the requirements of SB 221 and allowed AEP Ohio, pursuant to R.C. 4928.143(B)(2)(a), to implement, as part of its ESPs, a fuel adjustment clause that provided for the automatic recovery of, among other things, the costs of purchased power, including the cost of energy *and capacity* of those purchased power arrangements. *ESP I*, Opinion and Order at 13-17 (Mar. 18, 2009); *ESP II*, Opinion and Order at 16-17 (Aug. 8, 2012).

The FCR proposed by AEP Ohio and adopted by the Commission in Case No. 12-3254-EL-UNC does not improperly "double recover" the capacity costs of those purchased power arrangements – the FACs that have been in place throughout the terms of each of the Company's first two ESPs have properly recovered such costs separate and apart from base generation rates. *A fortiori*, because there is no basis for concluding that the Company is recovering FAC (or FCR) costs through the Base Generation rates authorized by the Commission's *ESP II* orders, there is also no basis for concluding that such costs would suddenly be recovered through the

[10] Case Nos. 99-1729 and 1730-EL-ETP (*ETP* case); 04-169-EL-UNC (*RSP* case); *ESP I*; *ESP II*.

substantially lower level of Base Generation Rates that will correspond to blending in the $188.88/MW-day rate relative to the portion of load being served through the energy-only auctions. Consequently, arguments that the FCR would enable AEP Ohio to improperly double recover fixed costs of existing purchased power arrangements currently being recovered through the Company's Base Generation Rates are meritless.

b. IEU's double recovery arguments are improper attempts to collaterally attack prior adjudicative decisions.

Even with a prospective review of the double recovery issue, however, any examination of the arguments that there will be a double recovery of FCR costs through the reduced Base Generation Rates that incorporate the $188.88/MW-day rate are simply improper attempts to collaterally attack prior decisions of the Commission. The Ohio Supreme Court has described a collateral attack as "an attempt to defeat the operation of a judgment, in a proceeding where some new right derived from or through the judgment is involved." *Ohio Pyro, Inc. v. Ohio Dep't of Commerce*, 115 Ohio St. 3d 375, 2007-Ohio-5024, 875 N.E.2d 550, ¶ 16. In addition to the doctrine of collateral attack, the related doctrines of *res judicata* and collateral estoppel are applicable to Commission proceedings and bar attempts of parties to re-litigate issues finally decided in prior proceedings. *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 16 Ohio St.3d 9, 10, 475 N.E.2d 782 (1985).[11]

[11] As the Commission knows, both the Commission and the Ohio Supreme Court have recognized that *res judicata* is not a bar to a complaint filed under R.C. 4905.26 and that that statutory provision is broad enough to permit a collateral attack on approved rates. *See, e.g.*, *Western Reserve Transit Authority v. Pub. Util. Comm.*, 39 Ohio St. 2d 16, 18-19, 313 N.E.2d 811 (1974). This proceeding, however, was not initiated under, and is not authorized by, R.C. 4905.25; thus, the narrow exception for complaint cases is inapplicable. Moreover, even where R.C. 4905.26 is implicated and permits a collateral attack through which the Commission

In the case of SSO Base Generation Rates, such pricing is not, and has not been, cost-based since before 1999. As the Commission affirmatively adjudicated in AEP Ohio's Rate Stabilization Plan case, "electric generation service (after the MDP) shall not be subject to traditional cost-of-service supervision or regulation * * *." *RSP*, Opinion and Order, 16 (Jan. 26, 2005). *See also, id.* at 18 ("[W]ith the expiration of the MDP, generation rates are subject to the market (not the Commission's traditional cost-of-service rate regulation) * * * .") Moreover, in the Company's *ESP II* case, the Commission again rejected the argument that AEP Ohio's base generation rates must be cost-based to be justified "as there is not a statutory requirement, nor * * * a Commission mandate to require that [AEP Ohio] conduct a cost of service study." *ESP II*, Opinion and Order at 42 (Dec. 14, 2011). In that case, the Commission approved AEP Ohio's proposal to freeze base generation rates, established in the Company's *ESP I* proceeding, until all rates are established through a Competitive Bidding Process ("CBP"). *ESP II*, Opinion and Order at 15 (Aug. 8, 2012). The Commission approved those now-frozen base generation rates as just and reasonable and more favorable in the aggregate than expected results of an MRO in the Company's *ESP I* case. *See ESP I*, Opinion and Order at 72 (Mar. 18, 2009). Accordingly, any contention that the Company's adjudicated and approved Base Generation Rates will – after being reduced – double recover any particular costs plainly amount to a collateral attack on the Commission's prior decisions approving those Base Generation Rates (*e.g.*, its *ESP I*, *ESP II* and *RSP* orders, which adjudicated that the FAC and Base Generation Rates are reasonable and

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determines that a utility's rate is unjust or unreasonable, any substitution of a new rate in place of the existing rate has prospective effect only. *Lucas County Comm'rs v. Pub. Util. Comm.*, 80 Ohio St. 3d 344, 347-348, 686 N.E.2d 501 (1997), *citing Keco Industries*, 166 Ohio St. 254. Thus, in addition to being an improper collateral attack barred by *res judicata*, opening up the recovery of authorized costs through the FAC to a date prior to the effective date of the FCR also is unlawful retroactive ratemaking.

found that the Base Generation Rates are not cost-based). Further, if the "logic" advocated by IEU here is upheld, the non-cost-based Base Generation Rates could be similarly characterized (improperly) as propagating double recovery for *any cost* recovered in *any other rate*. In reality, as set forth above, since before 1999, AEP Ohio's Base Generation Rates cannot be characterized as cost-based and, therefore, cannot properly be concluded as enabling the double recovery of any cost.

Separately, the question of what is the appropriate cost of capacity furnished to CRES providers during the term of the current ESP was litigated extensively and decided by the Commission in its *Capacity Case*. Of course, the demand charges to be recovered in the FCR have been recovered through the FAC for several years. Under the intervenor's misguided theory of double recovery, the $188.88/MW-day capacity charge should have been even lower to account for demand charges already being recovered through the FAC. Consequently, any argument that recovery of the capacity costs supporting the $188.88/MW-day rate double recovers any portion of the FAC costs also clearly amounts to an improper collateral attack on the *Capacity Case* decision.

For all of these reasons, the Commission should reject IEU's double recovery arguments (if the claims are considered at all). IEU's positions constitute an improper collateral attack on the *RSP*, *ESP I*, *ESP II* and *Capacity Case* decisions.

c. IEU's static comparison conflicts with the Capacity Case decision, where the Commission indicated that the Company's recovery of $188/MW-day would be based on "incurred costs" and a threshold analysis using 2012 costs confirms that the allegations of double recovery are meritless.

In its Opinion and Order in the *Capacity Case*, the Commission authorized (at 36) AEP Ohio to defer and subsequently recover "incurred capacity costs, to the extent that the total incurred capacity costs do not exceed $188.88/MW-day not recovered from CRES provider billings reflecting the adjusted RPM-based price." While the *Capacity Case* decision makes clear that AEP Ohio's total recovery for wholesale service to support shopping capacity is capped at $188.88/MW-day, it does permit a subsequent examination of incurred costs in the context of the deferral to be recovered from all retail ratepayers. If it has now become necessary to engage in such a subsequent examination in order to dispel the double recovery allegations here, it quickly becomes clear that the OVEC/Lawrenceburg demand charges recovered in the FAC are not again recovered in the $188.88/MW-day charge. Even a cursory update of the 2010 baseline costs used in the *Capacity Case* confirms what the Company has argued on rehearing and continues to argue on appeal – that the $188.88/MW-day rate is well below its actual incurred costs. Consequently, it is already clear that the $188.88/MW-day rate does not enable double recovery of the OVEC/Lawrenceburg demand charges.

An update using actual 2012 data would show that even excluding the OVEC/Lawrenceburg demand charges produces an adjusted incurred cost level of approximately $325/MW-day. If the Commission considers IEU's proffered exhibits (which it should not), it should also consider the additional data attached to this brief; if the Commission properly ignores IEU's proffered exhibits, it need not examine the additional data attached to this brief. As reflected in Exhibit A, the filed revenue requirement would go up from $355.72/MW-day to

$397.23/MW-day[12] and the energy credit goes from $147.41/MW-day in the *Capacity Case* decision to $41.88/MW-day under the same method but using actual 2012 data. As also shown in Exhibit A, if the compliance value is further adjusted to remove the 2012 OVEC and Lawrenceburg demand charges of $39/MW-day, the adjusted compliance capacity value is still approximately $325/MW-day which exceeds the $188.88/MW-day cap by approximately $136/MW-day. Hence, there is no basis to conclude that the OVEC and Lawrenceburg demand charges are being recovered through a $188.88/MW-day rate, since the updated actual calculation excluding these demand charges is substantially above the approved rate.

Finally in this regard, as AEP Ohio has explained in detail in its briefing and applications for rehearing in the *Capacity Case*, as well as its appellate briefs filed with the Ohio Supreme Court in the appeal from the Commission's decision in that case, the energy credit that the Commission adopted to determine the Company's "cost of capacity" supplied to CRES providers is opaque and riddled with errors. *See Capacity Case*, AEP Ohio App. for Rehearing at 9-56 (July 20, 2012); Ohio Supreme Court Case Nos. 2012-2098 & 2013-0228, AEP Ohio Second Merit Br. at 42-47 (Sept. 23, 2013), AEP Ohio Fourth Merit Br. at 1-9 (Nov. 12, 2013). The opaque and flawed methodology utilized to reach the price that AEP Ohio must charge CRES providers for the wholesale capacity service it supplies to them makes it infeasible to determine which costs are actually being recovered through that charge. For example, Energy Ventures Analysis used fuel costs of less than $14/MWh for AEP Ohio's largest generation plant, Gavin Station, when the 2012 data shows that actual fuel costs for Gavin was more than $23/MWh.

[12] This is significantly attributable to the reduced level of Pool capacity receipts for 2012. Of course, with the elimination of the Pool at the end of 2013, AEP Ohio's Pool capacity receipts will be eliminated entirely.

(See Exhibit B.) In fact, actual gross margins realized in 2012 were over $7/MWh below those forecasted to be realized by Energy Ventures Analysis, demonstrating that an unrealistic energy credit was used in the derivation of the $188.88/MW-day rate.

These same computations of the gross margin and energy credit have also been performed for 2013 for the period of January through September, and the results support the Company's position that the energy credit was substantially overstated. In fact, the energy credit for the entire June 2012 through September 2013 period appears to be over $100/MW-day overstated in the Staff Consultant's original forecast versus the energy credit based on actual values. Because the *Capacity Case* decision intended that the authorized charge of $188.88/MW-day was to offset costs actually incurred (and do not relate back to the original unadjusted filing data from 2010, as argued by IEU), IEU's claim that wholesale capacity charge collections from CRES providers double recovers FAC/FCR costs is baseless.

G. IEU's alternative argument that the OVEC/Lawrenceburg demand charges should either be reduced by allocation or offset by wholesale power margins should be rejected.

IEU alternatively argues (at 17-19) that the Commission should either allocate away from the retail recovery mechanism a portion of the OVEC/Lawrenceburg demand costs or offset recovery of those costs based on wholesale power (off-system) sales relating to the contracts. As with the double recovery argument, IEU's attempt to capture off-system sales ("OSS") margins is speculative and lacks any basis in the record. Like the flawed double recovery claim, IEU's proposal to reduce recovery by either allocation or offset is an unlawful collateral attack on matters fully and finally adjudicated in prior Commission cases and before the Supreme Court of Ohio. IEU's recommendation must be denied.

Regarding the lack of factual basis for these alternative recommendations, there is nothing in the record indicating the existence or level of OSS margins relating to these contracts. IEU could have sponsored a witness and advanced such a recommendation subject to cross examination but it did not. AEP Ohio witness Nelson did testify and, even though the recovery of OVEC/Lawrenceburg demand charges is beyond the scope of these proceedings, addressed these matters through cross examination. Mr. Nelson explained that, just like generation units owned by AEP Ohio, purchased power contracts can present the opportunity for OSS; if so, the subsequent cost reconstruction allocates the lowest variable production cost to internal load customers and the higher variable production cost to OSS – to the benefit of SSO customers. Tr. at 168-170, 173. But that process for variable (energy) costs "has nothing to do with fixed costs of production" which are "assigned a hundred percent to internal load customers." Tr. at 169-170. Mr. Nelson correctly pointed out that the recovery of OVEC/Lawrenceburg demand charges from SSO customers was litigated and decided in the Company's favor as part of the *ESP I* case. Tr. at 175-176.

Prior to discussing the improper collateral attack nature of IEU's position, however, AEP Ohio would like to briefly address a false claim advanced by IEU on brief that mischaracterizes the Company's position. Specifically, IEU states (at 17) that the Company has claimed in its *ESP III* application (Case Nos. 13-2385-EL-SSO *et al.*) that the margin on OVEC sales "is significant, and, together with its market-based capacity revenue, may be sufficient to cover the entire fixed cost of the OVEC units." There is no comparison between the *ESP III* proposal and IEU's present proposal – except that both are far beyond the scope of this case. IEU's supposition here is that there are substantial OSS margins associated with both the OVEC and Lawrenceburg contracts even though the Commission has found that the contracts pertain to

"commitments that AEP Ohio has made to fulfill its obligation to provide a SSO to all non-shopping customers." Case No. 12-3254-EL-UNC, Opinion and Order at 16 (Nov. 13, 2013.) This factual finding by the Commission and proper characterization of the contracts undercuts IEU's position here that a portion of the contract demand charges should be allocated away from the SSO/retail jurisdiction. By contrast, the *ESP III* proposal is to sell the entire output of capacity, energy and ancillary services under the OVEC contract to produce revenue that may offset the demand costs associated with that contract (versus dedication of OVEC capacity to serve SSO customers as is done today). In any case, IEU's attempt to present factual information and new recommendations on brief for the first time is inappropriate and should not be rewarded. IEU's extra-record proposals to either reduce recovery by allocation or offset should be treated the same as the excluded evidence proffered by IEU at the hearing – it should be ignored or rejected.

IEU's recommendation also amounts to a collateral attack on prior Commission decisions that have been upheld by the Supreme Court. The Commission has consistently refused to capture OSS margins of AEP Ohio both in the *ESP I* decision and the significantly excessive earnings test proceedings. As the Commission stated:

> We do not believe that the testimony presented offered adequate justification for modifying the Companies' proposed ESP to offset OSS margins from the FAC costs. Section 4928.143(B)(2)(a), Revised Code, specifically provides for the automatic recovery, without limitation, of prudently incurred costs for fuel, purchased power, capacity cost, and power acquired from an affiliate. As recognized by the Companies, the pertinent statutory provisions do not require that there be an offset to the allowable fuel costs for any OSS margins. Additionally, Ohio law governs the Companies' ESP application, and thus, we are not persuaded by the arguments of Kroger regarding how other jurisdictions handle OSS margins. Moreover, consistent with our discussion in Section VII of

> our opinion and order, we do not believe that OSS should be a component of the Companies' ESP, or factored into our decision in this proceeding.

ESP I, Opinion and Order at 17 (Mar. 18, 2009.) These decisions were made at the same time the Commission authorized the Company to re-institute its FAC including recovery of the OVEC/Lawrenceburg demand charges. *See ESP I*, Opinion and Order at 14-15 (proposed FAC mechanism adopted, which included 100% of OVEC and Lawrenceburg demand costs as demonstrated by Mr. Nelson's testimony in that case, Co. Ex. 7); *id.* at 52 (all costs associated with OVEC, Lawrenceburg, Darby, and Waterford recovered either through FAC or base generation rates); Entry on Rehearing at 35 (Jul. 23, 2009) (reversed base generation charge for Darby and Waterford but left FAC ruling in tact). Moreover, the Supreme Court heard and rejected a challenge on the Commission's refusal to adopt an OSS offset. *Office of Consumers' Counsel v. Pub. Util. Comm.*, 2011-Ohio-1788, Pars. 50-54 (the Court upheld the Commission's decision to exclude the OSS margin offset and noted that appellant "concedes that the law 'does not require profits from off-system sales to be included in the ESP rates' – that is, shared with customers.")

Finally, IEU attempts (at 18-19) to distinguish the *ESP I* OSS decision by saying the decision related to generation assets owned by AEP Ohio and its current recommendation relates to contracts for assets not owned by AEP Ohio. This is a weak distinction lacking substance that has no basis in the *ESP I* decision or statutory framework. The fact that the units were not directly owned by AEP Ohio simply means they were not in rate base: the Commission explicitly recognized that these generating assets "have not and are not included in rate base and, [absent the *ESP I* decision] the Companies cannot collect any expenses related thereto, even if

the facilities or contractual outputs have been used for the benefit of Ohio customers." *ESP I*, Opinion and Order at 52 (Mar. 18, 2009.) Further, as discussed above, the *ESP I* decision rejected an OSS margins offset in connection with recovery of fuel costs, including purchased power costs. Consequently, IEU's proposal is a transparent attempt to improperly circumvent the prior adjudication and rejection of this proposal – an attempt that should not be entertained.

III. CONCLUSION

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 Commission should refuse to entertain arguments on matters beyond the scope of these proceedings. Recommendations and invitations to have the Commission revisit a decision made multiple times in the past should be rejected. The scope of this proceeding is limited to auditing the actions of the Company during 2010 and 2011 in its efforts to comply with the Commission orders that established and interpreted the FAC periods. Any recommendation beyond this limited scope should be summarily rejected and the inappropriateness of any such recommendations should be made clear. For all the reasons stated in herein and in AEP Ohio's initial brief and as demonstrated by 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 21st day of January, 2014.

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Exhibit A

Exhibit A

Comparison of Original Capacity Cost as Approved Subject to Update, in Case No. 10-2929-EL-UNC, with Actual 2012 Costs
Actual Cost Update is in Compliance with Methodology Approved in the Final Order in the Case

Original 10-2929-EL-UNC Case

PJM Average 5 CP = 9060.8 MW 1.034126 Losses

	CSP	OPCo	Merged Total Revenue Req.	$/MW-day
AEP Original Filed (based on 2010 FF1 information)				
- Filed Revenue Requiremen	$477,093,822	$660,504,310	$1,137,598,132	**$355.72**
Staff Consultant Adjusted Revenue Requirement				
Staff Adj. Rev Req.	$421,753,188	$555,187,093	$976,940,281	**$305.48**
Less				
- Energy Credit (based on forecasted energy credit for the period June 2012 - May 2015) [Note 1]				($152.41)
- Ancillary Services				($6.66)
Total Staff Consultant-Proposed Energy Credit				**($159.07)**
Staff Proposed Capacity Charge				**$146.41**

COMMISSION ORDER

Started with AEP's Proposal as adjusted by Staff Consultant			$305.48
Total of Commission Final Order Adjustments			$37.47
2010 Capacity Charge Prior to Energy Credit			**$342.95**
Energy Credit (Staff Consultant Original)	($159.07)	/MW-day	
Commission Final Order Adjustment (WPCo)	$5.00	/MW-day	
Revised Energy Credit	**($154.07)**		($154.07)
Commission Order			**$188.88**

Note 1: Staff Consultant's Forecasted Energy Credit for the June 2012 - December 2012 period was $131.37/MW-day

Note 2: Does not reflect any associated adjustment to the Energy Credit.

Based on 2012 Actual Information

PJM Average 5 CP = 9184.2 MW

	OPCo Total Revenue Req.	$/MW-day
AEP 2012 Updated Revenue Requirement	$1,291,202,119	**$397.23**
2012 Update Using Staff Consultant's Adjustments		
Adjusted Revenue Req.	$1,211,535,754	**$372.72**
Less		
- Energy Credit (based on actual energy credit for the period June 2012 - Dec 2012)		($38.10)
- Ancillary Services		($3.54)
Total Staff Consultant-methodology Energy Credit		**($41.64)**
2012 Update with Staff's method		**$331.09**

2012 Update based on Final Commission Order

AEP's template with Staff updated adjustments		$372.72
Updated Commission Final Order Adjustments		$33.78
With PUCO Updated Adjustments		**$406.51**
Energy Credit (Staff Consultant Method)	($41.64)	
AEP WPCO Adjustment	($0.24)	
Revised Energy Credit	($41.88)	($41.88)
Compliance Update ($/MW-day)		**$364.63**
Remove OVEC and Lawrenceburg Demand Charges [Note 2]	($127,995,910)	**($39.38)**
Adjusted Compliance Update without OVEC and Lawrenceburg demand charges		**$325.25**

Exhibit B

Exhibit B

Comparison of Staff Consultant's Forecasted Fuel Cost to Actual Fuel Cost

Fuel Cost ($/MWh)			Staff		Actuals		Actuals - Staff	
Utility	Name	ID	2012*	2013	2012*	2013**	2012	2013
Columbus Southern Power Co	AEP Waterford Facility	55503-CTG1	30.53	32.97	22.72	26.97	($7.81)	($6.00)
Columbus Southern Power Co	AEP Waterford Facility	55503-CTG2	30.55	32.99	22.72	26.97	($7.83)	($6.02)
Columbus Southern Power Co	AEP Waterford Facility	55503-CTG3	30.54	32.98	22.72	26.97	($7.82)	($6.01)
Columbus Southern Power Co	AEP Waterford Facility	55503-ST1	30.78	32.88	22.72	26.97	($8.06)	($5.91)
Columbus Southern Power Co	Conesville	2840-3	26.20	0.00	35.20	0.00	$9.00	$0.00
Columbus Southern Power Co	Conesville	2840-4	23.92	24.57	35.20	33.46	$11.28	$8.89
Columbus Southern Power Co	Conesville	2840-5	25.77	26.64	35.20	33.46	$9.43	$6.82
Columbus Southern Power Co	Conesville	2840-6	26.67	27.44	35.20	33.46	$8.53	$6.02
Columbus Southern Power Co	Darby Electric Generating Station	55247-GT1	39.11	40.88	44.07	60.38	$4.96	$19.50
Columbus Southern Power Co	Darby Electric Generating Station	55247-GT2	39.10	40.88	44.07	60.38	$4.97	$19.50
Columbus Southern Power Co	Darby Electric Generating Station	55247-GT3	39.08	40.91	44.07	60.38	$4.99	$19.47
Columbus Southern Power Co	Darby Electric Generating Station	55247-GT4	38.91	40.79	44.07	60.38	$5.16	$19.59
Columbus Southern Power Co	Darby Electric Generating Station	55247-GT5	39.11	40.86	44.07	60.38	$4.96	$19.52
Columbus Southern Power Co	Darby Electric Generating Station	55247-GT6	38.99	40.67	44.07	60.38	$5.08	$19.71
Columbus Southern Power Co	Picway	2843-5	35.62	0.00	67.79	49.40	$32.17	$49.40
Ohio Power Co	**General James M Gavin**	**8102-1**	**13.26**	**13.64**	**23.53**	**24.47**	**$10.27**	**$10.83**
Ohio Power Co	**General James M Gavin**	**8102-2**	**13.02**	**13.39**	**23.53**	**24.47**	**$10.51**	**$11.08**
Ohio Power Co	Kammer	3947-1	26.50	26.46	38.80	39.02	$12.30	$12.56
Ohio Power Co	Kammer	3947-2	26.66	26.64	38.80	39.02	$12.14	$12.38
Ohio Power Co	Kammer	3947-3	26.71	26.67	38.80	39.02	$12.09	$12.35
Ohio Power Co	Mitchell	3948-1	23.72	24.71	29.70	31.56	$5.98	$6.85
Ohio Power Co	Mitchell	3948-2	23.67	24.67	29.70	31.56	$6.03	$6.89
Ohio Power Co	Muskingum River	2872-1	24.07	0.00	36.99	0.00	$12.92	$0.00
Ohio Power Co	Muskingum River	2872-2	24.02	0.00	36.99	0.00	$12.97	$0.00
Ohio Power Co	Muskingum River	2872-3	24.81	31.14	36.99	38.36	$12.18	$7.22
Ohio Power Co	Muskingum River	2872-4	23.31	0.00	36.99	38.36	$13.68	$38.36
Ohio Power Co	Muskingum River	2872-5	25.82	28.44	36.99	38.36	$11.17	$9.92
Ohio Power Co	Racine	6006-1	0.00	0.00	0.00	0.00	$0.00	$0.00
Ohio Power Co	Racine	6006-2	0.00	0.00	0.00	0.00	$0.00	$0.00
Ohio Power Co	Cardinal	2828-1	14.03	15.01	19.53	22.03	$5.50	$7.02
Ohio Power Co	Cardinal	2828-2	13.85	14.81	19.53	22.03	$5.68	$7.22
Ohio Power Co	Cardinal	2828-3	20.04	17.32	19.53	22.03	($0.51)	$4.71
Columbus Southern Power Co	Lawrenceburg Energy Facility	55502-100	30.12	32.51	23.63	28.57	($6.49)	($3.94)
Columbus Southern Power Co	Lawrenceburg Energy Facility	55502-1100	30.10	32.44	23.63	28.57	($6.47)	($3.87)
Columbus Southern Power Co	Lawrenceburg Energy Facility	55502-1200	30.10	32.44	23.63	28.57	($6.47)	($3.87)
Columbus Southern Power Co	Lawrenceburg Energy Facility	55502-200	30.14	32.47	23.63	28.57	($6.51)	($3.90)
Columbus Southern Power Co	Lawrenceburg Energy Facility	55502-2100	30.08	32.44	23.63	28.57	($6.45)	($3.87)
Columbus Southern Power Co	Lawrenceburg Energy Facility	55502-2200	30.07	32.45	23.63	28.57	($6.44)	($3.88)
Columbus Southern Power Co	J M Stuart	28S0-1	24.77	24.63	29.99	25.66	$5.22	$1.03
Columbus Southern Power Co	J M Stuart	2850-2	22.95	22.93	29.99	25.66	$7.04	$2.73
Columbus Southern Power Co	J M Stuart	2850-3	23.71	23.47	29.99	25.66	$6.28	$2.19
Columbus Southern Power Co	J M Stuart	2850-4	23.36	23.32	29.99	25.66	$6.63	$2.34
Columbus Southern Power Co	J M Stuart	2850-D1	0.00	48.16	---	---	---	---
Columbus Southern Power Co	J M Stuart	2850-D2	0.00	48.16	---	---	---	---
Columbus Southern Power Co	J M Stuart	2850-D3	0.00	48.16	---	---	---	---
Columbus Southern Power Co	J M Stuart	2850-D4	0.00	48.16	---	---	---	---
Columbus Southern Power Co	W H Zimmer	6019-ST1	15.95	16.52	31.21	23.17	$15.26	$6.65
Ohio Power Co	Philip Sporn	3938-2	28.07	29.75	41.28	36.39	$13.21	$6.64
Ohio Power Co	Philip Sporn	3938-4	28.03	29.70	41.28	36.39	$13.25	$6.69
Ohio Power Co	Philip Sporn	3938-5	0.00	0.00	0.00	0.00	$0.00	$0.00
Columbus Southern Power Co	Walter C Beckjord	2830-6	26.10	28.06	28.88	26.95	$2.78	($1.11)

*2012 is June through December only

**2013 Actual is January through October only.

Summary: Brief Reply Brief of Ohio Power Company electronically filed by Mr. Yazen Alami on behalf of Ohio Power Company