BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Review of the	)	
Distribution Investment Rider Contained	)	**Case No. 15-066-EL-RDR**
In the Tariffs of Ohio Power Company	)	

AEP OHIO REPLY COMMENTS

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Table of Contents

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In adopting the modified Electric Security Plan (ESP) for Ohio Power Company ("AEP Ohio" or the "Company") in Case Nos. 11-346-EL-SSO *et al.*, the Commission approved, among the other components of the ESP, a Distribution Investment Rider (DIR). The DIR allows for the recovery of capital costs for distribution infrastructure investments in order to facilitate improved service reliability. The Commission required that the DIR be reviewed annually for accounting accuracy and prudency. (ESP Order at 46-47.) In this docket, the Commission undertook the third annual review and appointed Baker Tilly, Inc. ("Baker Tilly" or "Auditor") to conduct the audit. On August 6, 2015, the Auditor filed its Audit Report. AEP Ohio hereby submits reply comments addressing the comments of The Office of the Ohio Consumers' Counsel (OCC).

I. The audit included a prudency review.

OCC compares the auditor to previous auditors and argues that the Auditor failed to fulfill the audit duties and in particular that field inspections were necessary.[1] OCC's comments ignore the instructions provided the auditor for this audit. Baker Tilly fulfilled the General Project Requirements of the audit listed in Section A of the Request For Proposal (RFP) in this case. These requirements did not include field inspections. Baker

[1] OCC Comments at 2-4.

Tilly's proposal in response to the RFP included a description of the work to be performed including a work plan, as required by section J of the RFP. The Commission selected Baker Tilly to conduct the audit based on the work plan submitted. Therefore the audit is consistent with the Commission's approval and fulfills the prudency analysis requirement.

II. This is an audit case dealing with the application of the DIR mechanism and not a venue to argue how the DIR mechanism should be designed – that has already been ruled upon.

The OCC's recommendations for adjustments to the balance of the DIR audit are an untimely attempt to re-litigate the mechanics of the DIR.[2] It is inappropriate and untimely for OCC to suggest a change to the DIR calculation once the methodology has already been approved in the ESP II as well as the base distribution case. The Company provided the mechanism for the DIR in exhibit WAA-5 of the ESP Case No. 11-346-EL-SSO. The Company provided the same layout which was used to calculate the $62 Million credit that runs through the DIR in Attachment R of the Base Distribution Stipulation (Case No. 11-351-EL-AIR). The Commission took no exception to either of these calculations in any of its orders. It is inappropriate for OCC to seek that in this proceeding.

The purpose of the DIR audit is to review the filing for accounting accuracy and prudency not a re-litigation of the mechanism and the underlying rate case and Commission proceedings that define the elements within that mechanism. In this case the Auditor found that the Company acted in a prudent manner as it relates to the DIR. That

[2] OCC Comments at 4-9.

is the scope of the review. Absent a lack of prudency, the OCC comments are moot and run afoul of the audit procedures before the Commission.

Despite OCC's attempts to reopen the mechanics underlying the DIR, the mechanism already approved includes a carrying charge rate for a return component, depreciation as well as property taxes. The DIR was approved to collect a return on and of the additional capital spend as it compares to the capital spend as of date certain. The Commission did not order an auditor reviewing the implementation of the rider to consider changing any of these elements. The DIR does not contemplate updating the carrying charge rate for any given line item, updating expenses based on actuals, nor does the DIR contemplate adjustments for O&M expenses. The Company originally requested a carrying charge component for O&M be included in the DIR, which the final Commission-approved DIR excluded. The DIR mechanism is not intended to be a property tax, depreciation or O&M tracker.

A. Tax modifications

The first argument made by the OCC in an attempt to re-litigate the DIR related to tax modifications from an IRS regulation that provided guidance regarding deduction and capitalization of expenditure related to tangible property.[3] However, there is no suggestion of imprudence by the Auditor and no grounds to suggest that the Company has acted imprudently in regards to this change.

Internal Revenue Service Revenue Procedure 2011-43 provides a "safe harbor" election for determining the retirement unit of property for tax purposes. If adopted, this "safe harbor" election will enable certain expenditures being capitalized for financial purposes to qualify for a current tax deduction as a repair expense. The Revenue

[3] OCC Comments at 4-5.

Procedure has several requirements as to how the tax repair deduction amount is determined, some of which were transitional in nature. In order to implement the "safe harbor" method a company must be able to classify its work order activity in conformity with the requirements listed in the Revenue Procedure.

To provide background on the nature of the issues involved in the IRS procedure, there are two main hurdles for the Company to overcome related to the classification of substation work order expenditures and the test for the replacement of poles and conductor. For poles and conductor, the Revenue Procedure allowed a current tax repair deduction for replacements so long as 10% or less of the poles or conductor on the specific circuit was replaced on any given work order. The computation is to be made on a circuit specific basis. Section 5.03 (h) (3) of Revenue Procedure 2011-43 did provide a transition rule for computing the repair amounts for pole and conductor replacements. It allowed a company to use the average circuit size within a county during a transition period. Once the transition period ended, the circuit specific information would be required for continued compliance with the Revenue Procedure. For substation property, the Revenue Procedure had different criteria for determining what was eligible for deduction.

The Company's accounting systems at the time the Revenue Procedure was issued did not support the level of detail needed to perform the computations required by the Revenue Procedure for an ongoing implementation of the change in accounting method. In 2015 the Company completed an update of its main electric plant accounting software. This upgrade will support the computations needed by the Revenue Procedure. The Company is currently in the process of upgrading the "feeder" systems to capture the information needed by the main plant accounting software to make the computations. Once these upgrades/modifications are implemented the Company will be in a position to implement the "safe harbor" method described in Revenue Procedure 2011-43. Having an accounting system in place to ensure post-implementation compliance is necessary in order to meet the ongoing substantiation requirements of the Revenue Procedure.

A second factor that the report did not mention was the availability of bonus depreciation for the years in question. The availability of bonus depreciation at either 50% or 100% acts as an offset to the benefit of claiming the tax repairs under Revenue Procedure 2011-43 and lessens the favorable impact of the repair deduction. The Auditor did not find nor is there any basis for finding any actions in this area are imprudent. OCC's comments should not be adopted by the Commission.

B. Property Tax

The OCC's second attempt to re-litigate the DIR relates to recovery of property taxes in the audit year.[4] The property tax rate was fully litigated and approved by the Commission in Case No. 11-346-EL-SSO et al. However, OCC seeks a true up of the property tax level previously established. The DIR, as approved by the Commission does not call for a true up of actual costs in the calculation. Yet OCC includes a suggested reduction in the DIR revenue requirement based on the inaccurate calculation of property taxes included in the Company's base distribution case. OCC's suggestion is improper. The last rate case stipulation included a black box settlement, making it impossible to assign specific expenses from that case as asserted by OCC. For instance, the values that the OCC starts with in its inaccurate calculation of property taxes are from Schedule 2.1

[4] OCC Comments at 6-9.

as filed by the Company. However, due to the black box agreement it is inappropriate to assign expenses. The total value for AEP Ohio is based on the stipulated agreement which is lower than the as filed schedules. The fact is that there are many line items that make up the taxes other than income section and it is impossible to say which specific tax was adjusted to get to the final stipulated amount.

The OCC also misapplies the Commission order on double recovery. The quoted Commission language from the ESP II order refers to the DIR work plan.[5] The purpose of the DIR work plan is to outline planned Company expenditures in various component programs, for example animal mitigation. The specific language in the ESP II order is a mandate to ensure that Company DIR expenditures within the DIR component programs do not include expenditures for programs recovered through other recovery mechanisms. The other mechanisms that recover distribution plant are the gridSMART and Enhanced Service Reliability Riders. The DIR work plan shows that DIR spending is for separate programs not recovered through other riders.

C. Accounting Capitalization Policy Change

OCC's third attempt to re-litigate the DIR is to incorrectly assert that AEP Ohio improperly applied accounting updates.[6] The Auditor found no such improper application. The Company periodically reviews capitalization policies and also looks for any Financial Accounting Standards Board (FASB) changes in order to reflect any needed policy changes. The change attacked by OCC was a company-wide change to more accurately reflect the work performed by employees and done in a prudent manner. OCC makes an assumption that AEP Ohio is already recovering certain employee time in

[5] OCC Comments at 8.
[6] Id. at 9.

base rates.[7] But the OCC's comments on the accounting change are misleading because employee time for job site safety meetings have always been charged to capital. The change only included an allocation of employee time for non-job site safety meetings.

The Company made an appropriate change to more accurately reflect accounting policy that the Auditor did not find was imprudent. Even the OCC admits that that the change in the Company's policy does not appear to be improper.[8] Yet OCC seeks a change in the DIR due to the Company's prudent change in policy. In the ESP III order in Case No. 13-2385-EL-SSO, the Commission ordered the Company to "highlight and quantify" any accounting policy changes as they relate to its capitalization policy (ESP III, Opinion and Order, February 25, 2015, at 44-47). It is appropriate for the Staff to have this information in order to review the policy changes for accuracy and prudence as the Auditor reviews the Company's controls and policies. The scope of those changes should be limited to accuracy and prudency because the DIR is not an O&M tracker.

OCC's argument is also without merit as the DIR mechanism was not approved to reflect such changes. The Company filed testimony in Case No. 11-346-EL-SSO et al. that showed that the level of O&M increases with additional capital investment. However, the approved DIR mechanism did not include a separate carrying charge component for O&M. As such, the DIR mechanism looks at the change in net plant and allows the Company a return on and of prudent capital expenditures. The final approval of the DIR did not include a mechanism to adjust O&M and as such does not provide for recovery of O&M associated with plant additions regardless if the plant additions increase or decrease O&M. OCC mistakes the DIR as an opportunity to pick and choose

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[7] Id. at 9-10.
[8] Id. at 9.

items from the rate case to track and make changes. This practice runs afoul of the regulatory compact and the limited scope of specific riders versus the overall application of Commission orders implementing rates. OCC should respect the parameters of the Commission defined audit. The Commission holds parties to the scope of the audit and to the issues raised by the auditor (See, *In the Matter of the Five Year Review of Natural Gas Company Uncollectible Riders*, 08-1229-GA-COI, Entry on Rehearing December 14, 2011, the Commission determined comments raised exceeded the scope of the items raised by the auditor in the audit and declined their adoption; see also, *Re Columbus Southern Power*, 10-268-EL-FAC, May 14, 2014 Opinion and Order, the Commission determined that IEU's arguments on recovery exceeded the scope of the audit and therefore was not relevant).

The Commission should recognize that a base distribution case is set on a test year at a certain period of time. There is a risk of utility total expenses in future periods being higher than those included in the test year, but there is also a risk that the total expenses in any given year will be lower than the test year. This risk occurs naturally in years between utility rate cases. In some years the total expense could be higher than test year and in some years the total expense could be lower than test year. If the Commission orders an adjustment based on a small fraction of labor it is adding additional risk to the utility as the balance of this risk is now weighted towards always assuming the expenses are higher as there is no mechanism for the utility to collect more O&M in years between base rate cases. As such, the Commission should ignore the OCC's recommendation.

Also, it is inappropriate to pick and choose one small portion of the Company's costs, in this case a small fraction of labor, and draw the conclusion that the Company is somehow over collecting. OCC has pulled a 2014 policy change that impacts 2014 dollars yet only theorized that these labor costs in the test year of the base distribution case would have been higher and are now lower so the Company is over recovering. OCC gave no regard to the actual dollars spent for labor in 2014 let alone Company O&M expenses in total. In order to determine whether or not there was double recovery, the total costs for labor in 2014 would need to be compared to the cost of labor during the Company's base distribution case as there is no other way to state or imply an over recovery. If the Commission is swayed by OCC's argument in this case, then prepare for abandonment of the regulatory compact and a future of constantly trueing up to the test year for individual line item expenses of base distribution costs, which, if treated fairly, should allow the Company to collect additional dollars for any costs that are in fact higher than the costs in the test year of the case. It would appear that OCC is seeking a formula rate approach. The Company is not advocating that this is an appropriate process for cost of service or utility ratemaking in these comments given that the DIR did not allow for this type of adjustment. The Company raises the point because it is clear that OCC is attempting to pick and choose certain line items based on an argument that these costs are higher now than before yet ignoring all other line items adding an additional risk to the Company.

III. OCC's recommendations in connection with the reliability are misguided and should be rejected.

A. Improper Use of Reliability Indices in Table 2

OCC improperly uses the reliability indices to support an argument that is without merit.[9] The data presented to the Commission, for the annual CAIDI and SAIFI values used by the OCC for 2010 through 2012 are fictional.[10] OCC knows this as a signatory party to the combining of the standards in 2014 for SAIFI and CAIDI. The Commission approved the first combination of the rate zones into a single set of reliability indices on March 19, 2014 in docket 12-1945-EL-ESS. Yet, OCC improperly combines reliability data for the Columbus Southern Power (CSP) and Ohio Power (OP) Companies to provide a comparison to current standards. OCC's combination of the standards ignores the fact that the two entities were distinct EDUs prior to merger. As such, AEP Ohio had separate reliability standards for the two companies during these years.

Adding any reliability number together, even if weighted by customer, will give an inaccurate value, as OCC has done. The Commission should not base its review of the Company's DIR reliability impact on the inaccurate and misleading calculations constructed by the OCC. The Commission should reject the entire portion of section C of the OCC's comments because that analysis based on a false premise.

The Commission should instead base its determination on the consistent and accurate methodology utilized by Staff in its reliability analysis in the Company's annual DIR audit cases. Staff's review considers actual historical expenditures, based on the books and records of the Company, rather than the incorrect historical data favored by the OCC.

B. The Company Complied With Commission Order and Guidance

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[9] OCC Comments at 10-12.
[10] OCC includes SAIDI in its presentation which is a number not even required as a standard by the Commission. OCC apparently used its flawed extrapolation of the CAIDI and SAIFI numbers to determine a flawed SAIDI number.

The OCC argument in part D of its comments contains language directly from the Commission order approving the 2014 DIR work plan, yet manages to misinterpret a straight-forward phrase.[11] The Commission ordered that the plan should "quantify the expected reliability improvements" of DIR expenditures. The quantification of expected reliability improvements occurs directly in Tables 4 and 5 of the Staff comments. As OCC admits, the Company uses a consistent methodology to quantify expected reliability impacts. The Company's quantification calculation uses the assets replaced as part of the DIR programs to determine the number of avoided outages. The Company provides this quantification data to Staff for use in Staff's annual analysis of the DIR, and this method does exactly what the Commission ordered.

C. The Company Cannot Control All Outages

The OCC includes Table 3 in its comments in an attempt to prove that annual fluctuations in outage events mean that the Company is not delivering the system improvements.[12] As the actual owner and operator of the distribution system, the Company recognizes three flaws with this analysis. First, it includes the effects of factors not under the Company's control. Non-major storms contribute to system asset failures, which cause outages (data excludes outages due to major storms). The Company lacks the expertise to control the weather. In addition, the Company is unable to control several causes of outages listed in OCC's Table 3. The table below summarizes some of these categories:

Cause	2013	2014	Difference
Fire / Police	90	113	23

[11] Id. at 12-16.
[12] Id. at 13.

Underground / Construction / Dig-Ins	219	246	27
Unknown / Unknown by Weather	2,997	3,540	543
Vehicle Accident / Auto Damage	1,007	1,022	15
Total			608

For example, the Fire/Police category represents outages requested by Fire and Police departments in the course of carrying out their duties. Likewise, the other categories shown in the above table are outside the Company's control. Therefore the Company addresses the causes of outages it can attempt to control, namely the component DIR programs listed in the work plan. The methodology employed by Staff to measure DIR reliability impact considers expenditures and avoided outages. These factors are within the Company's control and are appropriate metrics with which to judge the Company's DIR performance.

Second, the outage category Scheduled/Planned Outage should be excluded from the analysis. This category represents outages intentionally taken by the Company for the specific purpose of system upgrades. So an increase of 643 Scheduled/Planned outages is reflective of the increased level of system improvement work being undertaken by the Company. Company expenditures under the DIR work plan increased in 2014, as reflected in the Company's filings and Staff's comments. In order to safely do the work associated with the expenditures, the Company had to de-energize portions of the grid. The increase in the number of Scheduled/Planned Outages is proof that the DIR program is working as the Commission intended.

Finally, the proactive replacement of failing and aging distribution assets is intended to improve total system reliability for many years. All distributions assets will fail if allowed to remain on the system for a long enough time. The Company's DIR work plan programs involve replacing assets to reduce the total future outages. A one-year increase of outages related to a specific cause does not mean the DIR has failed. DIR system improvements accrue throughout many years, with natural fluctuations in reliability expected. By reviewing Company DIR work on the basis of expenditures and avoided outages, the Commission can accurately determine that the Company is maintaining and improving reliability.

D. System Improvement Benefits Accrue Through Time

OCC notes that the quantification of avoided/reduced outages due to 2014 DIR work (42,766 total) is greater than the number of outages reported in either 2013 or 2014.[13] However, OCC demonstrates its misunderstanding of distribution system improvement by failing to include any analysis of this fact. When the Company replaces a distribution asset, the new asset placed in service improves system reliability by helping to avoid an outage caused by the replaced asset's failure. The reliability impact does not exist for only one calendar year; rather it extends into the future. Due to the nature of distribution system improvements, this is the appropriate way to report avoided outages, using the consistent methodology employed in its annual DIR audits. The Staff understands the nature of system improvements, which is why it requests and utilizes the aforementioned Company data. The Commission should accept the expertise of its Staff contained within the Staff's reliability analysis on this issue. The Commission should reject the OCC arguments, which mischaracterize the Commission's guidance and demonstrate a lack of knowledge about how distribution system improvement works.

[13] OCC Comments at 16.

E. An Evidentiary Hearing is not needed.

The OCC believes that a hearing is necessary to analyze and evaluate the 2014 DIR Rider. Ohio Power believes that a hearing is not required since the plan has been approved, the Company provided Staff with improvements results, and an independent auditor reviewed the spending under the plan. OCC's statements that a hearing would force the Company to quantify service reliability improvements are a blatant disregard of the Commission's previous orders in at least three cases disagreeing with OCC's position that narrowly focuses on reliability projects, and also Staff's comments which demonstrate that the Company complied with the Commission's order to show reliability improvements and reference those improvements in their comments.

OCC likely seeks hearing to continue its attempt to undermine the Commission's approval of the DIR at every opportunity. OCC has consistently been opposed to the DIR in every aspect. Even OCC witness Effron in the Company's most recent ESP proceeding criticized the Commission for its approval of trackers like the DIR. OCC witness Effron testified that he believed that riders are contrary to sound regulatory policy and the fact that the Commission had approved them in the prior ESPs was just an indication that the Commission could have done better in the past. (*In the the Matter of the Application of Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to R.C. 4928.143, in the Form of an Electric Security Plan*, PUCO Case No. 13-2385-EL-SSO, Tr. XII at 2740.) The OCC seeks a hearing in this case not to consider the accounting or compliance with the Commission Order approving the DIR plan. OCC seeks hearing as a collateral attack on the ESP Order approving the DIR at the outset and to offer arguments already offered in practically every docket that even mentions the DIR.

This case has no need for an evidentiary hearing. The independent auditor validated the Company's actions implementing the Commission Order. The Commission Staff filed a letter supporting the actions of the Company and its compliance with Commission Orders relating to reliability. There are simply no issues, beyond OCC's stout opposition to the existence of the DIR, that are ripe for a hearing and none should be ordered. Asking for a hearing to demonstrate the same reliability information which was already shared with Staff or to discuss the attributes of the 2014 DIR Plan itself would be an unnecessary use of both the Commission's time and the Company's time.

IV. CONCLUSION

Consistent with the above explanation, AEP Ohio urges the Commission to reject the OCC's recommendations to untimely re-litigate the merits of the DIR.

Respectfully submitted,

/s/ Steven T. Nourse

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