BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Review of the Delivery Capital Recovery Rider Contained in the Tariffs of Ohio Edison Company, Cleveland Electric Illuminating Company, and the Toledo Edison Company.	)))))	Case No. 16-2041-EL-RDR

COMMENTS BY THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

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I. INTRODUCTION

For nearly seven years The Cleveland Electric Illuminating Company, Ohio Edison Company, and Toledo Edison Company (collectively "FirstEnergy") has been collecting money from consumers and earning a return on certain distribution plant through its Delivery Capital Recovery Rider ("DCR").[1] The DCR allows FirstEnergy to collect a return on and of investment in distribution infrastructure without having to go through a traditional rate case under R.C. 4909.18. However, OCC's review of the financial audit that was conducted of this rider has turned up some concerns regarding the $260 million dollars that FirstEnergy spent this year under this rider.[2] Additionally, the independent auditor identified issues with the Utility's project management. Specifically, the auditor stated that "[d]ue to the significant number of projects that were over budget greater than 15 percent, Blue Ridge recommends the Companies review their project planning process to ensure that the methodology allows for projects to be fully scoped

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[1] Compliance Audit of the 2016 Delivery Capital Riders of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company at 7 (May 1, 2017) *hereinafter* "Audit Report".

[2] Audit Report at 9.

prior to execution."[3] On behalf of FirstEnergy's 1.9 million customers, the Office of the Ohio Consumers' Counsel ("OCC") attempts to ensure that costs charged to those customers under the DCR Rider are reasonable and that customers do not pay for significant cost overruns.

II. COMMENTS

A. FirstEnergy customers should not have to pay for cost overruns on capital projects until and unless a determination is made that the costs associated with the overrun are prudent.

The Audit Report of the DCR indicates that FirstEnergy overspent its capital budget. This mismanagement of a capital budget could result in customers unreasonably paying millions of dollars for capital programs that are not being properly reviewed and scoped prior to execution. The 2016 audit report identified yet another eighteen capital programs (out of relatively small sample of 71 total programs) where FirstEnergy overran their capital project budget(s) by over 15 percent. The impact of these cost overruns exceeds $20.2 million dollars. The specific projects identified in the 2016 audit and the amount of money FirstEnergy spent over project budget are provided in Table 1 below.[4]

Table 1: Sample of Over-budget Capital Projects (2016 DCR Audit)[5]

Work Order Number	Capital Project Cost	Amount Over Budget	Original Capital Project Budget	Percentage Over Budget
FECO- ITF-SC-000092-SW15-1	$447,654	$447,654	$0.00	100.0%

[3] *Id.* at 19.

[4] Audit Report at 53-57.

[5] OCC determined the original budgeted amounts from the Audit Report by subtracting the Amount over budget from the Capital Project Cost.

CECO-14883452	$4,888,376	$1,386,704	$3,501,672	39.6%
CECO-14746978	$4,888,376	$1,386,704	$3,501,672	39.6%
FECO-ITS-SC-000375-1	$668,559	$267,503	$401,056	66.7%
FECO-ITS-SC-000391-1	$104,809	$104,809	$0.00	100.0%
OECO-OE-730023	$147,924	$62,144	$85,780	72.4%
CECO-CE-710001	$1,908,324	$1,161,563	$746,761	155.5%
TECO-TW-710001	$2,007,424	$1,594,374	$413,050	386.0%
OECO-OE-700362	$810,112	$544,792	$265,320	205.3%
OECO-OE-700402	$526,436	$416,670	$109,766	379.6%
FECO-ITF-SC-000065-SW16-1	$104,911	$58,911	$46,000	128.1%
OECO-PA85455260	$13,506,735	$11,629,757	$1,876,978	619.6%
TECO-PA85558090	$4,981,039	$1,271,182	$3,709,857	34.3%
TECO-PA84378970	$4,981,039	$1,271,182	$3,709,857	34.3%
TECO-15060720	$1,529,550	$903,964	$625,586	144.5%
OECO-14709852	$8,763,571	$8,212,804	$550,767	1,491.2%
OECO-14229840	$4,245,630	$3,609,992	$635,638	567.9%
TECO-13645860	$250,304	$98,541	$151,763	64.9%
	$54,760,773	$34,429,250	$20,331,523	62.9%

The auditor recommended that FirstEnergy "review their project planning process on non-IT-related projects to ensure for projects being fully scoped prior to execution."[6] The issues with FirstEnergy not fully vetting the scope of capital projects prior to

[6] Audit Report at 27.

implementation has existed for the last several years. Despite an identical recommendation being made in the 2015 DCR Audit Report, FirstEnergy's response for not implementing that recommendation is that:

> The Companies intend to conduct an internal audit of the non-IT related budget process to be initiated once a Stipulation and Recommendation has been filed in Case No. 15-1739-EL-RDR.[7]

FirstEnergy's requirement to adequately manage its capital budget program (which is being paid for by consumers) should not be dependent on a settlement in some previous case. In fact, FirstEnergy should have policies and practices in place now to ensure that the requirements and budgets for capital projects are sufficiently vetted. The lack of such policies and procedures raises serious issues regarding the prudency of the FirstEnergy capital expenditures and the reasonableness of the charges customers are paying through the DCR.

Because similar concerns for consumers were identified by the Auditor in both the 2015 Audit and 2016 Audit, recommendations provided by OCC to the PUCO regarding the 2015 DCR Audit Report are also applicable for PUCO consideration of the 2016 Audit Report. Given that FirstEnergy did not implement the review process recommended by the auditor in the 2015 Audit Report,[8] and similar issues were identified in the 2016 Audit Report, the PUCO should now establish standards to be used by independent auditors in reviewing future DCR expenditures. To be clear, the OCC's recommendation is that for any future audit, the auditor be instructed to review

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[7] Audit Report at 27.

[8] *In the Matter of the Review of the Delivery Capital Recovery Rider Contained in the Tariffs of Ohio Edison Company, Cleveland Electric Illuminating Company, and the Toledo Edison Company*, Case No. 15-1739-EL-RDR, Audit Report at 66 (April 22, 2016) *hereinafter* "2015 Audit Report".

FirstEnergy's efforts in reducing cost overruns related to project management. The additional review includes FirstEnergy being required to disclose all work orders over $1 million that have exceeded their scoped budget by 15%. This would then allow the independent auditor to accurately judge the extent to which the total DCR expenditures that customers are paying include significant cost overruns.

OCC also recommends that for projects that are 30% over the scoped budget, the PUCO should determine that such cost overruns will be presumed imprudent. This would be a rebuttable presumption that FirstEnergy could overcome by presenting evidence of prudence related to the cost overruns.[9] Such a standard would protect customers by sharing the risk of cost overruns between customers and shareholders. It would also provide an incentive for FirstEnergy to minimize costs in excess of budgeted amounts that are ultimately charged to customers under the DCR.

B. FirstEnergy customers should not have to pay for emergent projects unless the costs associated with the projects are determined to be just and reasonable.

The 2016 Audit Report identified other issues with the FirstEnergy capital budget process that also have the potential for customers to be significantly overcharged through the DCR Rider. From a sample of 71 work orders, the auditor found 13 work orders (or 18%) that were considered emergent projects. Emergent, as defined in the Merriam-Webster dictionary means "arising unexpectedly." As such, these projects do not exist in the original capital budget and have no budget amounts assigned to them. Blue Ridge recommended that the Utilities conduct a more thorough review of the state of the

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[9] *In the Matter of the Review of the Delivery Capital Recovery Rider Contained in the Tariffs of Ohio Edison Company, Cleveland Electric Illuminating Company, and the Toledo Edison Company*, Case No. 15-1739-EL-RDR, Comments filed by the Office of the Ohio Consumers' Counsel at 5 – 6 (June 23, 2017) *hereinafter* "OCC Comments on 2015 Audit."

Utility's infrastructure during the capital budget cycle to ensure these emergent projects are included as part of the approved budget.[10] The specific emergent projects identified in the 2016 audit and the amount of money FirstEnergy spent for these projects (that were not included in the budget) are provided in Table 2 below.

Table 2: Sample of Emergent Projects (2016 DCR Audit)[11]

Work Order Number	Description	Cost
CECO-14164717	CEI Plant Employee Onboarding Expenses	$1,606,349
CECO-14581787	Clark Q-1-CK-T 138 kV Breaker Replacement	$1,021,299
OECO-14619456	Class A-High Voltage	$440,155
TECO-14087593	Commercial Upgrade	$95,516
OECO-14627153	E MARKET ST REPAIR DUCT BANK	$1,255,108
CECO-14499354	Imperial 71-1P-T Transformer Replacement	$1,020,605
OECO-14292861	Sub-Replace line relaying	$1,222,930
TECO-13137497	Relocate streetlights on hi level bridge	$104,981
TECO-14853199	Rpl 4 poles in swamp area at ryan sub	$38,524
CECO-14479765	SW-Grant #3-GT-T Transformer Replacement	$2,316,564
TECO-14624000	Sylvania & Centennial Roundabout	$618,453
TECO-13792687	Talmadge Mobile Parking Expansion	$204,912
TECO-14434237	TE-Implement New Mobile Radio System	$1,557,910
Total		$11,503,306

While the auditor mentioned that the explanations provided by FirstEnergy for the emergent projects were not unreasonable, the large number of emergent projects in

[10] Audit Report at 13.

[11] Audit Report at 52-53.

relation to the sample size was significant.[12] But even the descriptions of several of the work orders raise questions regarding why they were categorized as emergent and therefore excluded from the original capital budget to begin with. For example, plant employee onboarding expenses (training and orientation) are normal on-going routine expenditures that can be reasonably estimated on an annual basis. Upgrading and relocating electric facilities requires significant time for developing requirements, engineering and planning, and program management. Implementation of new radio systems is a foreseeable expenditure and requires advance planning and program management prior to implementation. These projects should have been scoped and budgeted. The fact that many of these "so-called" emergent projects actually appear to be more suited as typical on-going capital projects raises additional concerns about FirstEnergy's capital planning process.

The Audits of the DCR demonstrate a lack of proper review and scoping of DCR projects prior to execution.[13] If the auditor's sample size of 71 work orders out of 79,564 is statistically relevant, the total number of overrun (18 projects) and emergent (13 projects) as demonstrated in these comments could result in significant charges to FirstEnergy's customers. Most concerning for consumers, is the fact that the DCR effectively shifts the financial risks for imprudent investments from FirstEnergy's shareholders onto its customers. The risk is shifted to consumers because the DCR allows FirstEnergy to collect a return on and of investment in distribution infrastructure without having to go through a traditional rate case under R.C. 4909.18. In much the same way

[12] Audit Report at 13.

[13] Audit Report at 21.

that shareholders would not tolerate inadequate project planning, the PUCO also should not tolerate inadequate project planning in the DCR. The PUCO should act to protect customers from paying for these rates that stem from FirstEnergy's inadequate project planning.

OCC recommends that for the 2016 DCR audit and any future audit, the auditor be instructed to review FirstEnergy's efforts in reducing the number of emergent projects. The additional review includes FirstEnergy being required to disclose all work orders over $500,000 that are designated emergent projects. This would then allow the independent auditor to accurately judge the extent to which the total DCR expenditures are being influenced by open-ended emergent projects that may not have been properly scoped. OCC also recommends that emergent projects that exceed $1 million in total costs be presumed imprudent. This would be a rebuttable presumption that FirstEnergy could overcome by presenting evidence of prudence related to the factors that contributed to the Utility being unable to plan for the project in the routine capital budget. Such a standard would protect customers and would also provide an incentive that FirstEnergy apparently needs to minimize costs charged to customers under the DCR.

C. Given the timing, neither of the accounting issues that OCC addressed in comments related to the 2015 DCR Audit in Case 15-1739-EL-RDR have been addressed by the PUCO.

OCC identified two issues in the 2015 Audit that should be explicitly addressed in future audits;[14] however, due to the PUCO's tight scheduling of these two comment periods, there has been no opportunity to rectify these issues. The first of these issues relates to the Utility's Asset Retirement Obligations and the second issue concerns

[14] OCC Comments on 2015 Audit at 6-7.

FirstEnergy's Accumulated Deferred Income Taxes. Because the comment periods for these two cases are within two weeks of each other,[15] the PUCO has not had the appropriate amount of time to consider the recommendations put forth by the OCC. Therefore, OCC reiterates the comments made in the 15-1739-EL-RDR case and requests the PUCO address these matters in Case No. 15-1739-EL-RDR and in the instant case.

1. FirstEnergy's accounting of Asset Retirement Obligations may have caused customers to overpay under the DCR rider.

The accrued liability for the Asset Retirement Obligations is presently included in Account 230. In Case No. 07-551-EL-AIR ("2007 Rate Case"), the Asset Retirement Obligations account (which at the time was included in Account 254) was deducted from plant in service in the determination of rate base, which was appropriate.[16] FirstEnergy did not include the change in the balance of the Asset Retirement Obligations since May 31, 2007 for the purpose of determining the DCR rate base.[17] As the Asset Retirement Obligations are directly related to the transmission and distribution ("T&D') plant that is included in the DCR rate base, the independent auditor should have determined whether the rate base reduction should have flowed through to the calculation of the DCR. If so,

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[15] *See In the Matter of the 2015 Review of the Delivery Capital Recovery Rider Contained in the Tariffs of Ohio Edison, The Cleveland Electric Illuminating Company, and the Toledo Edison Company*, Case No. 15-1739-EL-RDR, Entry (May 24, 2017) (Entry setting the Comment period in the 2015 DCR Audit).

[16] *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices and For Tariff Approvals*, Case No. 07-551-EL-AIR, Staff Report of Investigation, Schedule B-6, page 2 of 5 (Dec. 4, 2007).

[17] Attachment 1 (OCC Set 3, INT-1, Case No. 15-1739-EL-RDR).

the DCR is potentially overstated and customers have paid too much. This issue should have been addressed by the PUCO in an order on the 2016 DCR.[18]

2. FirstEnergy's accounting of Accumulated Deferred Income Taxes may have adversely affected the costs charged to consumers.

OCC identified an area of concern in the audit report regarding the consistency of the accounting practices in the DCR when compared to those approved previously by the PUCO. Accumulated Deferred Income Taxes ("ADIT") are deducted from plant in service in the determination of the net rate base used in the calculation of the DCR revenue requirement. As noted in the Audit Report, the Opinion and Order and Combined Stipulation from Case No. 10-388-EL-SSO provides that:

> The net capital additions included for recognition under Rider DCR will reflect gross plant in service not approved in the Companies' last distribution rate case less growth in accumulated depreciation reserve and accumulated deferred income taxes associated with plant in service since the Companies' last distribution rate case.[19]

The Audit review of the ADIT balance consisted of mathematical verification and source data validation. Based on these audit steps, the Audit report "concludes that the ADIT is not unreasonable."[20] The report does not explicitly address the treatment of regulatory assets and liabilities directly related to ADIT in the determination of the DCR rate base and its conformity to past precedent.

In the 2007 Rate Case, the FirstEnergy companies included "Customer Receivables for Future Income Tax" in the determination of their rate bases. The

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[18] OCC Comments on 2015 Audit at 6-7.

[19] 2015 Audit Report at 72.

[20] 2015 Audit Report at 71-73.

"Customer Receivables for Future Income Tax" was described by FirstEnergy Witness Harvey L. Wagner:

> "Customer Receivables for Future Income Tax" represent amounts due from customers for future income taxes payable by the Company that were recognized with the adoption of the liability method of accounting for deferred income taxes under Statement of Financial Accounting Standards (SFAS) 109. These costs were traditionally recovered through the ratemaking process prior to the issuance of SFAS 109 by using a "flow-through" accounting approach to identify cost recovery for income taxes. Following the implementation of SFAS 109, the same ratemaking economic effect results from fully normalizing all income tax timing differences in combination with recovery of the SFAS 109 regulatory asset. When the SFAS 109 regulatory asset (Customer Receivables for Future Income Tax) was originally established, there was an equal deferred tax liability established – net rate base was therefore unaffected. *If the SFAS 109 regulatory asset were excluded from rate base, but all accumulated deferred income taxes served to reduce rate base, net rate base would be inappropriately measured.*[21]

In other words, the "Customer Receivables for Future Income Tax," also referred to as the SFAS 109 Regulatory Asset, was a direct offset to the SFAS deferred tax liability that was booked at the time of the adoption of SFAS 109. The "Customer Receivables for Future Income Taxes" is the net balance of line items appearing in two separate accounts: Account 182.3 – Other Regulatory Assets (a debit balance that increases rate base) and Account 254 – Other Regulatory Liabilities (a credit balance that decreases rate base). The net balance of the "Customer Receivables for Future Income Tax" in those accounts was included in rate base in the 2007 Rate Case, because as Mr. Wagner explained, to do otherwise would result in an inappropriate measurement of rate base.

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[21] *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Authority to Increase Rates for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices and For Tariff Approvals*, Case No. 07-551-EL-AIR, Company Exhibit 3, Direct Testimony of Harvey L. Wagner, Pages 3-4, (emphasis added).

FirstEnergy recognizes changes in the SFAS 109 balance itself since May 31, 2007 for the purpose of determining the DCR rate base.[22] However, FirstEnergy does not take account of changes in the balance of the "Customer Receivables for Future Income Tax" (that is, the SFAS 109 regulatory asset) since May 31, 2007 for the purpose of determining the DCR rate base.[23] The "Customer Receivables for Future Income Tax" is directly related to T&D plant and to the balance of ADIT included in the determination of the DCR rate base, and it was included in rate base in the 2007 Rate Case. As was explained in the 2007 Rate Case, if this item is ignored then net rate base is not properly measured and possibly overstated. The next annual independent audit should address whether it is appropriate for FirstEnergy to disregard changes in balance of the "Customer Receivables for Future Income Tax" since May 31, 2007 for the purpose of determining the rate base used in the calculation of the DCR revenue requirement.

III. CONCLUSION

The PUCO and FirstEnergy engage in these audits on an annual basis, and hundreds of millions of dollars will be collected from customers through the DCR in the name of distribution investment. Therefore, the review of this DCR should not be perfunctory.

Customers should not be asked to provide a blank check for FirstEnergy's distribution investment. The independent auditor has highlighted issues with FirstEnergy's overspending on certain capital and emergent projects which stem from inadequate review and scoping of projects prior to execution. This is a serious issue for

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[22] Attachment 2 (OCC Set 3, INT-4, Case No. 15-1739-EL-RDR).

[23] Attachment 3 (OCC Set 3, INT-6, Case No. 15-1739-EL-RDR).

consumers who pay for the DCR. As recommended above, to protect consumers who are asked to pay the DCR, the PUCO should order a more in-depth review and adopt more stringent standards that would mitigate costs collected through the DCR.

OCC's review of FirstEnergy's DCR and the Audit Report have revealed a number of accounting discrepancies and raised a number of questions regarding FirstEnergy's project management. Consistent with the comments filed only two weeks ago, OCC recommends that the next time the PUCO issues an RFP to audit FirstEnergy's DCR, the accounting issues regarding ADIT and the Asset Retirement Obligation be specifically addressed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of these Comments was served on the persons stated below via electronic transmission, this 7th day of July, 2017.

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Case No. 15-1739-EL-RDR
Annual Compliance Audit of Delivery Capital Recovery Rider (DCR) of
Ohio Edison Company, The Cleveland Electric Illuminating Company,
and the Toledo Edison Company

RESPONSES TO REQUEST

OCC Set 3 – INT-1 Referring to the December 31, 2015 DCR Filing, Revenue Requirement Calculation, Page 2, do the changes in the Accumulated Reserve from 5/31/2007 to 11/30/2015 include the effect of the accrued Asset Removal Cost included in FERC Account 254 or Account 230? If the response is negative, please explain why not.

Response: Assuming that the question is asking if FERC Accounts 254 and 230 are included in the 11/30/2015 balances used in the Rider DCR filing, no, pursuant to Case No. 12-1230-EL-SSO, as approved by the Commission.

Case No. 15-1739-EL-RDR
Annual Compliance Audit of Delivery Capital Recovery Rider (DCR) of
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RESPONSES TO REQUEST

OCC Set 3 – INT-4 Referring to the December 31, 2015 DCR Filing, Revenue Requirement Calculation, do the changes in the ADIT balances from 5/31/2007 to 11/30/2015 take account of changes in the "FAS 109 Adjustment" included in FERC Account 190 and/or Account 283? If the response is negative, please explain why not.

Response: Consistent with the Companies' ESP III as approved by the Commission, the December 31, 2015 Rider DCR filing includes ADIT balances associated with plant in service. FAS 109 adjustments booked to Account 190 that are related to property are included in the ADIT balances included in the Rider DCR filing. FAS 109 adjustments booked to Account 190 that are not related to property are not included in the ADIT balances included in the Rider DCR filing.

Likewise, FAS 109 gross-up adjustments booked to Account 283 that are related to property are included in the ADIT balances included in the Rider DCR filing.

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RESPONSES TO REQUEST

OCC Set 3 – INT-6 Referring to the December 31, 2015 DCR Filing, Revenue Requirement Calculation, do the changes in the ADIT balances since 5/31/2007 take account of changes in the "Customer Receivable/Payable for Future Income Tax" included in FERC Account 182 net of the "Customer Receivable/Payable for Future Income Tax" included in FERC Accounts 254 and/or 283? If the response is negative, please explain why not.

Response: For the balances included in Rider DCR over the audit period in this case, no, pursuant to Case No. 12-1230-EL-SSO, as approved by the Commission.