**BEFORE**
**THE PUBLIC UTILITIES COMMISSION OF OHIO**

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| **In the Matter of the Delivery Capital Recovery Rider Contained in the Tariffs of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company** | : | **Case No. 15-1739-EL-RDR** |

# REPLY COMMENTS OF OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND THE TOLEDO EDISON COMPANY

## INTRODUCTION

Pursuant to the Attorney Examiner's Entry on May 24, 2017, Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company ("Companies") hereby submit reply comments to the Office of Consumers' Counsel ("OCC") on the Compliance Audit of the Delivery Capital Recovery ("DCR") Riders ("Rider DCR") of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company submitted on April 22, 2016 ("Audit Report") prepared by Blue Ridge Consulting Services, Inc. ("Blue Ridge").

As will be explained further below, the comments of OCC are unfounded, misguided, and out-of-scope. Its recommendation for an arbitrary threshold of imprudence is unwarranted. And its recommendation to investigate expanding the Rider DCR mechanism to include new accounts never approved by the Commission is simply beyond the scope of the Commission's Entry soliciting comments on the Audit Report, as well as beyond the Commission approved Rider DCR mechanism itself.

## COMMENTS

In the opening sentence on page one OCC claims that the Companies have been collecting money under Rider DCR for "nearly seven years."[1] This is demonstrably false: Rider DCR has only been in effect since January 1, 2012, as clearly identified in the document OCC cites. Thus, at the time OCC's Comments were filed, Rider DCR had been in effect for 5 years, and the Audit Report at issue in these comments addressed revenue requirements collected in the *fourth* year since inception.

## I. CAPITAL BUDGET/SPEND PROCESSES

### A. OCC's comments regarding audit recommendations on project planning are misguided and unwarranted.

OCC misconstrues the recommendations in the *2013* Audit Report by asserting that the audit report "acknowledged" that FirstEnergy was not fully vetting the scope of IT projects before implementation.[2] This is simply not true. As the 2015 Audit Report makes clear, in the *2014* Audit Report Blue Ridge recommended the Companies should "review their IT project planning to ensure that the methodology allows for projects to be fully scoped prior to execution."[3] Not only did OCC reference the wrong year of the original recommendation, it also mischaracterized the Auditor's findings, which never included concerns of "overspending" at all; but, rather, recommended digging deeper into the budgeting process for IT projects. OCC glosses over the fact that the stipulation with Staff[4] resulted in the Companies not merely reviewing IT project planning methodology, but instead conducting an internal audit pursuant to

[1] OCC Comments at 1.
[2] OCC Comments at 1-2.
[3] Audit Report, p. 27, Case No. 15-1739-EL-RDR
[4] Stipulation dated May 18, 2015 in Case No. 14-1929-EL-RDR.

Staff's input on the audit scope.

OCC continues its mischaracterizations by opining that the Companies did not implement the results of this internal audit until after the period under review for the Audit Report in this proceeding. However, the Stipulation with Staff[5] called for the Companies to conduct the internal audit before December 31, 2015. Instead of the OCC's implied delay, the Companies timely completed the terms of the Stipulation, which as noted above went beyond the Audit Report recommendations. In the 2015 Audit Report, Blue Ridge acknowledged that the Companies did conduct the IT audit, and the changes recommended from the internal audit were completed as of March 31, 2016 and no additional work was required.[6] It's a success story of both the Companies and the audit process, not a failure. OCC's insinuation of unchecked overspending on IT projects stems from a misinterpretation of the 2014 Rider DCR Audit Report and is unfounded.

Turning to the recommendations in the 2015 Rider DCR Audit Report, OCC then complains that ten months after the Auditor's recommendation to review the non-IT project budgeting process, that the Companies had "only begun to have internal discussions" regarding this recommendation even though the Companies had no obligation to do more than review.[7] Internal discussions would, of course, be compliant with the recommendation to review. At this time, the Companies are under no obligation to initiate an internal audit. OCC conveniently ignores that the 2016 Rider DCR Audit Report identifies that the Companies had agreed to and were (and are) prepared to conduct an internal audit of the non-IT project budgeting process upon execution of a Stipulation.[8] This approach is consistent with past practice. OCC thus fails

[5] Id.
[6] Audit Report, p. 28, Case No. 15-1739-EL-RDR.
[7] OCC Comments at 2.
[8] 2016 Rider DCR Audit Report, Case No. 16-2041-EL-RDR, p. 19 (May 1, 2017).

to acknowledge all relevant circumstances pertaining to the audit recommendation for the Companies to review their non-IT project planning process and their comments are correspondingly misguided.

### B. Rider DCR does not shift the financial risk of the Companies' investments from shareholders to ratepayers.

OCC further claims that Rider DCR has effectively shifted the financial risk of imprudent investments from shareholders to ratepayers simply because cost recovery associated with incremental investments is not obtained through a traditional rate case.[9] As an initial matter, these allegations are improper as part of the Rider DCR audit process as the appropriate forum to address such matters would be the Companies' ESP proceedings where the Commission approved Rider DCR. Nonetheless, OCC's claims are not true for a number of reasons. In the first place, OCC neglects to acknowledge the Commission-approved standard for the Rider DCR audits. That is, the Companies still have the burden of proof to demonstrate in the annual Rider DCR audits that the amounts sought for recovery under Rider DCR are not unreasonable based on the facts and circumstances known at the time the investments were made.[10] The Commission's orders approving Rider DCR in successive ESP proceedings have not shifted that burden.

Second, Rider DCR does not create an unlimited incentive for "overspending" as suggested by OCC, since Rider DCR is subject to Commission approved revenue caps.

Third, the focus of the Rider DCR annual audits is the Companies' incremental investment over the prior year. This narrow scope allows for far more scrutiny of individual

[9] OCC Comments at 4.
[10] 2015 Rider DCR Audit Report, p. 23.

work orders and the underlying project planning, budgeting, and change order processes, compared to a traditional rate case where all of the elements of revenue requirements must be examined.

Further, each year the Auditor has built upon its experience conducting previous audits,[11] and the resulting evolution of its investigations results in recommendations that are far more precise in depth and scope than otherwise would occur. These recommendations cover not just the outcomes, but the underlying processes that drive the outcomes. The scrutiny and granular review experienced by the Companies' annual Rider DCR audits clearly contradicts the OCC's concern that the Companies no longer bear any financial risk associated with incremental investments.

Fourth, OCC's logic is skewed: arguing that the current budgeting and project planning processes would be unacceptable to investors because of specific project cost variances suggests that investors care more about individual project minutiae than overall management effectiveness. However, it is the Companies' processes for managing overall spending that most directly impacts investors. These processes are reviewed in each year's Rider DCR audit and have been incrementally improved by implementing the Auditor's recommendations. Despite OCC's allegations of perceived imprudence, the Auditor has consistently found that the Companies' processes and cost variance explanations are not unreasonable, which suggests a good thing being made better. Notably, OCC makes no mention of the fact that the Companies' 2015 overall capital spend came in *under* budget.[12] For all of these reasons, Rider DCR clearly does not shift the financial risk from shareholders to customers.

**C. OCC's comments and recommendations regarding work order testing are misguided and should be disregarded.**

[11] "Blue Ridge Advantage", pp. 6-7, Blue Ridge Consulting Services Inc – Request for Proposal No. RA15-CA-2.
[12] BRC Set 1 – INT-009.

As an initial matter, OCC is mistaken in its assessment of the sample of work orders selected for further examination in the audit. The Audit Report unmistakably indicates the sample selection includes professional judgment,[13] which is the antithesis of random sampling. Therefore, no statistical conclusions about the population can be drawn from analysis of the selected sample. OCC's vague, ominous prediction of an "astonishing" overspend is simply empty conjecture and presents an asymmetric view. It is telling that the OCC has no corresponding conclusion regarding work orders coming in under budget. As discussed above, the annual Rider DCR revenue caps approved by the Commission also serve as a control by protecting customers from any perceived overspending.

Next, OCC suggests something is drastically wrong because the Companies have not previously tallied the number of work orders that exceeded original budget by 15%.[14] The Companies' processes are reviewed each year by the Rider DCR auditor and are discussed at length in the audit reports. The Companies would never rely on such a tally to prove its investments have been prudent, and note that the Companies have a track record of consistently exceeding their reliability standards.[15]

In concluding its recommendations on the capital budgeting process, OCC again inappropriately assumes that every work order with actual costs exceeding the original budgeted amount represents a "cost overrun", and that customers are being overcharged. OCC then recommends that the Companies: 1) provide the Auditor with all projects over $1 million that exceed the budget by more than 15%; and 2) the Commission establish a threshold and determine that every project exceeding its original budget amount by 30% be presumed

[13] Audit Report at p. 14.
[14] OCC Comments at 5.
[15] Case No. 14-1297-EL-SSO, Direct Testimony of Eileen M. Mikkelsen, pp. 9-11.

imprudent requiring evidence from the Companies proving prudence. These recommendations are both unnecessary and unwise.

With respect to the first recommendation, the Companies already provide the entire universe of work orders with activity during the prior year to the auditor in an electronic spreadsheet. Further, Staff already directs the Auditor's efforts pursuant to Commission order — there is no need for the Commission to begin cherry-picking pre-determined subsets of the information for examination by the auditor. Indeed, the Auditor routinely examines work orders wherein the actual costs vary from the budgeted costs by 15%, which is where OCC got the data for the table in its comments. Accordingly, OCC's first recommendation to establish in advance specific criteria for the auditor's' examination should be rejected as such matters should continue to be left to the discretion of the Staff and the auditor.

With respect to OCC's second recommendation, OCC cites no rule, statute or case where such a threshold presumption has ever been established by the Commission. OCC's 30% threshold is an arbitrary and capricious standard that is unwarranted when the Auditor has never concluded that *any* given work order project was imprudent, let alone simply because actual costs exceeded the budgeted costs by a certain amount. Instead, the Auditor has always found the Companies' explanations of such outcomes to be not unreasonable. Indeed, the Rider DCR Audits have properly applied the relevant standard: whether the amounts sought for recovery are not unreasonable given the facts and circumstances known at the time the investment decision was made.[16] This is the same standard that has applied since the inception of Rider DCR. This standard was authorized by the Commission in the Companies' prior ESP cases - there is no good reason to change it now and any attempts to do so in the review of an Audit Report would

[16] 2015 Rider DCR Audit Report, p. 23.

be improper.

Finally, it is notable that the OCC has had in its possession the full range of information provided to the Auditor, including 100% of the work order data as noted above, for several months longer than did the Auditor prior to the filing of the Audit Report. OCC also had the additional benefit of the Auditor's very detailed 124-page report as well as its own incremental discovery. Yet with all of this time and information available to it, OCC does not identify even one dollar of imprudent investment nor any given work order to challenge. OCC's recommendations are nothing more than an attempt to create a new, higher standard of review in order to paint broadly a wide swath of imprudence for the Companies to rebut. OCC's recommendations are improper and should be rejected.

## II. ACCOUNTING ISSUES

OCC raises two accounting issues that it believes "may" have led to overcharging of customers and recommends that the next Rider DCR auditor should address whether it is appropriate for these two items to be excluded from Rider DCR. While OCC casts these issues as revelatory, it cites only to historical cases, the Audit Report, and its discovery questions about the Audit Report. These issues were easily discernible in any of the Companies' three ESP proceedings approving Rider DCR. In its Order first approving Rider DCR in Case No. 10-388-EL-SSO, the Commission prescribed the precise make-up of the determinants for Rider DCR: plant in service; accumulated reserve for depreciation; and ADIT associated with plant in service since the last base distribution rate case. The "accounting issues" identified by OCC are clearly outside of the scope of the Commission approved Rider DCR calculation. To allow for the next Rider DCR auditor to address whether these "accounting issue" balances should be included in Rider DCR would incorrectly suggest that there is a possibility that they should be included in Rider DCR. As discussed further below, these balances are not and have never been included in the Commission approved calculation of Rider DCR, and were never intended to be included in Rider DCR. To do so now would contradict the stipulations approved by the PUCO in prior ESP cases. Moreover, the proper forum to challenge whether to expand the accounts to be included in Rider DCR is an ESP proceeding where the Commission approves the mechanism. OCC's recommendations should be rejected.

### A. OCC is incorrect when it asserts that the Companies' treatment in Rider DCR of Asset Retirement Obligations is inconsistent with the 2007 base rate case.

OCC believes it "may" have discovered an accounting issue with respect to Asset Retirement Obligations.[17] However, the OCC simply misunderstands and confuses the nature of the two FERC accounts it has identified: Account 230 (Asset Retirement Obligations) and Account 254 (Asset Removal Costs). These are separate and distinct accounts that OCC has mashed together. OCC alleges incorrectly that the Account 230 Asset Retirement Obligations balance was included in rate base in the 2007 base distribution rate case in Account 254. A line item within Account 254 reflecting "Asset Removal Costs" was included in rate base in the last base distribution rate case, and the vast majority of those costs continues to be updated and reflected in Rider DCR through the incremental depreciation reserve for plant in service. Accumulated reserve for depreciation for plant in service is expressly included in Rider DCR pursuant to the Commission's order in ESP II. There is no discrepancy in the ongoing accounting treatment of Account 254, Asset Removal Costs, and customers are not being

[17] OCC Comments at 7.

adversely affected in the Rider DCR revenue requirements.

The Account 230 Asset Retirement Obligations liability balance, on the other hand, was not included as a rate base item in the last base distribution rate case and is neither plant in service, accumulated reserve for depreciation, nor ADIT associated with plant in service. Therefore, Account 230, Asset Retirement Obligations, is properly excluded from ongoing Rider DCR revenue requirements. There is no discrepancy in the ongoing Rider DCR accounting treatment of Account 230, Asset Retirement Obligations, and customers are not being adversely affected.

Given the OCC's accounting mishmash, it is unclear ultimately whether OCC's comments are intended to refer to Account 230, Asset Retirement Obligations, which were not part of rate base in the last base distribution rate case and are not currently reflected in Rider DCR, or instead Account 254, Asset Removal Costs, which were included in the last base distribution rate case and are largely reflected incrementally in Rider DCR in accumulated reserve for depreciation as appropriate. In the case of either account, there simply is no discrepancy in accounting that would necessitate further investigation in the Rider DCR audit. As explained above, the remaining balances in these accounts are appropriately excluded from Rider DCR because they are clearly outside of the scope as authorized by the Commission. Thus, there is no need for the next Rider DCR auditor to address whether these items should be included in Rider DCR, and OCC's recommendation should be rejected.

**B. OCC is incorrect that the Companies' treatment in Rider DCR of the regulatory assets and liabilities associated with Customer Receivables For Future Income Tax is inappropriate.**

OCC again claims that the Companies "may" have adversely affected the costs charged to customers under Rider DCR, this time by failing to reflect incremental changes in the "Customer Receivables for Future Income Taxes."[18] OCC alleges that the Auditor's "mathematical verification of source information" is not a sufficient basis for its conclusion because 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."[19] This criticism is off base for several reasons.

First, it is entirely appropriate that the Auditor did not explore whether and how regulatory assets and regulatory liabilities accounts are reflected in the Rider DCR revenue requirements because the Commission did not approve for them to be so included.[20] Rider DCR explicitly includes only plant in service, accumulated reserve for depreciation, and ADIT associated with plant in service. By listing specifically what is included, the Commission has excluded other rate base items such as regulatory assets and liabilities, so the "Customer Receivables for Future Income Taxes" are clearly outside of the scope of Rider DCR.

Second, OCC mischaracterizes the relationship between Rider DCR and "Customer Receivables for Future Income Taxes" by asserting that the latter is "directly related to Transmission and Distribution plant and to the balance of ADIT included in the determination of the Rider DCR "rate base."[21] This just is not true. These regulatory assets and liabilities at the time of last base distribution rate case consisted almost entirely of balances created at the time of the change in accounting treatment from SFAS 109 (which pre-dated the 2007 base distribution rate case). While it was necessary to include those balances to synchronize with the ADIT

[18] OCC Comments at 7.
[19] OCC Comments at 8-9.
[20] The Auditor also did 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 Case Nos. 11-5428-EL-RDR, 12-2855-EL-RDR, 13-2100-EL-RDR, and 14-1929-EL-RDR.
[21] OCC Comments at 9.

balance for purposes of the base distribution rate case as explained in the Testimony of Company Witness Wagner that is cited by the OCC, that synchronization does not apply here. These regulatory assets and regulatory liabilities are not related to incremental plant in service since the Companies' last base distribution rate case, other than for a portion primarily related to AFUDC. In other words, any changes in the remaining balances of these accounts occur completely independent of the level of incremental investments made by the Companies since the last base distribution rate case.

OCC correctly points out that Rider DCR has included changes in ADIT balances related to SFAS 109. This is appropriate because this activity is directly related to incremental plant in service since the Companies' last base distribution rate case,[22] which is in direct contrast to the regulatory asset and regulatory liability balances discussed above. The bottom line is that these balances: a) are not within any of the categories approved by the Commission for inclusion in Rider DCR and b) nearly all are not related to incremental plant investment. Thus, there is no need for the next Rider DCR auditor to address whether these items should be included in Rider DCR, and OCC's recommendation should be rejected.

## CONCLUSION

OCC's recommendations do not identify necessary or useful changes to the audit standard of review of the Companies' Rider DCR annual Compliance Audits. Further, OCC's recommendation for the Auditor to explore the inclusion of additional accounts in Rider DCR beyond those expressly approved by the Commission in the Companies' respective ESPs should be rejected as an unfounded collateral attack on the Commission's orders. The Companies

[22] See Companies' response to OCC Set 3-INT-4, included in OCC's comments

recommend the Commission issue an Order adopting the recommendations contained in the Audit Report as described in the Companies' initial Comments, and find that Blue Ridge satisfactorily performed the scope of audit services outlined in the RFP, consistent with the Commission's Orders in ESP II and ESP III.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

On July 24, 2017, the foregoing document was filed on the Public Utilities Commission of Ohio's Docketing Information System. The PUCO's e-filing system will electronically serve notice of the filing of this document and the undersigned has served electronic copies to the following parties:

*/s/ Robert M. Endris*
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