BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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. 16-2041-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 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 May 1, 2017 ("2016 Audit Report") prepared by Blue Ridge Consulting Services, Inc. ("Blue Ridge").

The comments of the Office of Consumers' Counsel ("OCC") are largely repetitive of its comments on the Rider DCR audit report in Case No. 15-1739-EL-RDR ("2015 Audit Report"), and reflect a fundamental lack of understanding of effective capital budgeting management. Its recommendations for arbitrary thresholds of imprudence are 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. To the extent not explicitly addressed

herein with respect to OCC's previous assertions, the Companies hereby incorporate by reference their Reply Comments submitted on the 2015 Audit Report.

COMMENTS

OCC begins its comments herein repeating the same misrepresentations and misunderstandings opening its Comments on the 2015 Audit Report, thereby suggesting a continuing fundamental misunderstanding of the mechanics of Rider DCR. These assertions are just as wrong now as they were then.[1] OCC's comments regarding the Companies' capital budget and spending processes, like its comments on the 2015 Audit Report, are misguided and inappropriately ignore the nature and reality of the electric distribution utility budgeting and planning function.

For example, OCC clearly misapprehends the role of individual work orders within the overall budget process. Indeed, OCC refers to "yet another eighteen capital *programs* (out of relatively small sample of 71 total *programs*)"[2] (emphasis added) when, in fact, these were not "*programs*" at all—they were individual work orders that may or may not have rolled up into a "program." As will be explained below, it is neither unusual nor unreasonable for individual projects to come in over- or under-budget, and the Commission should reject OCC's recommendation to wield arbitrary and unfounded imprudence presumptions in future audits.

I. CAPITAL BUDGET/SPEND PROCESSES

A. OCC's comments regarding mismanagement of the Companies' capital budget

[1] Companies' Reply Comments, 2015 Audit Report at 2. OCC also misinterprets the 2016 Audit Report and incorrectly concludes that the Companies spent $260 million under Rider DCR during the audit period. OCC Comments at 1.
[2] OCC Comments at 2.

are unsupported by the record.

OCC alleges "[T]he 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."[3] Nothing could be further from the truth. First, the fact that OCC omits any citation to the Audit Report for these assertions is no surprise—because there is no such language in the Report. Instead, OCC once again appears to assume that any given work order that exceeds the budgeted amount is a management failure. Further, OCC repeats its erroneous statistical projections based on random sampling as it stated in Comments on the 2015 Rider DCR Audit, despite the Auditor's clear indication that it uses professional judgment in the sample selection.[4]

OCC opines that the auditor recommended the Companies "review their project planning process on non-IT-related projects to ensure for projects being fully scoped prior to execution."[5] OCC goes on to characterize this recommendation as a conclusion that the Companies are not "fully vetting the scope of capital projects prior to implementation". As before, OCC goes on to claim that this "issue has existed for the last several years" and then further states that "adequate management of the Companies' capital budget program should not be dependent on a settlement in some previous case". The Companies addressed the fallacy of these assertions in their Reply Comments on the 2015 Audit Report and reiterate their rebuttal here.[6]

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[3] Id.
[4] 2016 Audit Report at 23.
[5] OCC Comments at 3. OCC misquotes the report, which actually reads "review their project planning process on non-IT-related projects to ensure <u>that the methodology allows</u> for projects <u>to be</u> fully scoped prior to execution." (emphasis added).
[6] Companies' Reply Comments, 2015 Audit Report, at 2-4.

OCC then goes even further to assert a "lack of such policies and procedures to ensure that the requirements and budgets for capital budgets are sufficiently vetted."[7] This is a progressively gross exaggeration. An examination of the process to ensure the methodology allows for projects to be fully scoped is a far cry from concluding that the Companies have not been doing so, and is even farther from having any "lack of policies and procedures." In fact, the Auditor reached exactly the opposite conclusion from its in-depth review of the Companies' processes and controls:

> Blue Ridge was able to obtain an understanding of the Companies' processes and controls that affect each of the categories within Rider DCR. Furthermore, we were satisfied with actions taken with regard to internal audits and the process and control of the prior Rider DCR recommendations. Blue Ridge concluded that the Companies' controls were adequate and not unreasonable.[8]

The Auditor obtained its understanding by reviewing "policies, procedures, and process flow diagrams associated with the various processes that affect the categories that feed into the Rider DCR calculations."[9] The Auditor expressly stated that it reviewed the Companies' processes and controls "to ensure that they were sufficient so as not to adversely affect the costs in Rider DCR" and "concluded that FirstEnergy exhibits reasonable management practices associated with the investment funded by Rider DCR."[10]

Unlike OCC's one-dimensional focus on whether and by how much the cost of individual work orders may exceed the original budget, the Auditor ensures that the underlying policies, procedures and controls are adequate and not unreasonable.[11] And in every instance of further

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[7] Id. at 3-4.
[8] Audit Report at 9.
[9] Id. at 30.
[10] Id.
[11] As noted on page 22 of the Audit Report, the Commission approved standard of review in the Rider DCR audit is to confirm that the amounts sought for recovery are not unreasonable based

inquiry as to the cause of any given work order budget variance, the Auditor found the Companies' explanation to be not unreasonable. Indeed, the Auditor examines budget *variance*, including incidences of both over- and under-budget projects, to form its conclusions about the underlying processes and the overall result. Therefore, OCC's allegations of the Companies' mismanagement of their capital budget planning process should be rejected.

B. OCC's evaluation of perceived emergent projects are misguided and any conclusions drawn should be rejected.

OCC further opines that "customers should not have to pay for emergent projects unless the costs associated with the projects are determined to be just and reasonable."[12] This recommendation is unworkable for several reasons, not least of which is OCC's highly subjective definition of the term that does not capture what the Companies mean when considering projects "emergent." "Arising unexpectedly" is just one meaning that certainly applies to some emergent work, though it is inappropriate and short-sighted to overlook the underlying nature of the work, such as customer requests that arise after the budget is prepared and approved, or sudden equipment failure. OCC is simply wrong to assume that the Companies neither anticipate nor plan for emergent projects, and that not being included in original *project* budgets means there are no processes or controls in place for them. Instead, the Companies use experience and judgment to establish budgeted amounts, though not always for the individual project work orders.

As a first case in point, the OCC opines that "upgrading and relocating electric facilities

on the facts and circumstances known at the time such expenditures were committed.

[12] OCC Comments at 5.

requires significant time for developing requirements, engineering and planning, and program management."[13] And yet, it is precisely the significant length of time which can cause municipal and government projects in particular to be unable to identify with precision the scope and timing of a relocation project at the time of annual budget finalization. For these types of situations, the Companies use their professional judgment and experience to establish general budget categories. These general or "placeholder" budget categories do not directly incur any actual charges, but rather, are drawn down as individual projects are established and incur actual charges. While activity within a specific project or work order may not have been directly budgeted and may appear to the casual observer to be an "emergent project with a cost overrun," in reality the Companies fully anticipated that there would be costs associated with such an emergent project, and on an overall basis, properly scoped and executed the project. OCC's claims to the contrary are misinformed and should be disregarded.

As a second alleged example, OCC argues that employee onboarding expenses are "normal on-going routine expenditures that can be reasonably estimated".[14] This claim neglects to recognize the methodology that the Companies utilized to budget this work. The costs for this project referenced by OCC <u>were</u> budgeted, though they were budgeted in a different category than the project where the actual costs ultimately were incurred. As such, this was not an unanticipated, unchecked, or uncontrolled expenditure and it should not be characterized as warranting a new audit control ordered by the Commission.

In contrast, the lone recommendation in the area of budgeting for emergent projects in the 2016 Audit Report is for the Companies to consider how they review the conditions of

[13] Id. at 7.
[14] OCC Comments at 7.

infrastructure during the budget cycle to ensure, wherever possible, those projects are budgeted.[15] While the Companies believe they currently adequately do so given that the nature and operation of electrical equipment entails unexpected failure, the Companies have already agreed to implement the Auditor's recommendation[16] because it could result in an improvement in the budgeting process. Indeed, the Companies have consistently proved open to suggestions for improvement in project management processes, in contrast to OCC's misguided and draconian focus on individual work order outcomes.

OCC's assessment of perceived "emergent projects" represents a narrow, misinformed view of the Companies' budgeting process and should be disregarded.

C. OCC's comments and recommendations to establish imprudence thresholds for the purposes of Rider DCR should be rejected.

OCC reiterates its recommendations on the 2015 Audit Report regarding perceived "cost overruns" and introduces two new similar recommendations for "emergent projects" in the 2016 Audit Report: (1) the Companies provide the Auditor with all projects over $500,000 that are designated emergent projects; and (2) the Commission establish a threshold and determine that every emergent project that exceeds $1 million in total costs be presumed imprudent requiring evidence from the Companies proving prudence. While the context of these two recommendations is slightly different than those raised by OCC in the 2015 Audit Report, the overall substance is the same. OCC offers no additional support for why such arbitrary and unfounded thresholds should be established, so the Companies' Reply Comments in the 2015

[15] 2016 Audit Report at 19.
[16] Companies' Comments at 2-3.

Audit Report related to similar recommendations are also applicable here.[17]

The Companies urge the Commission to reject OCC's recommendations to drastically alter the quarterly filing and annual compliance audit process approved in three successive ESP cases by carving out specific projects and withholding them from recovery until after a Commission order determining that associated costs are just and reasonable.

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

Similar to its comments in the 2015 Audit Report, OCC again 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.[18] As stated in the Companies' Reply Comments on the 2015 Audit Report, these allegations are improper as part of the Rider DCR audit process and are simply not true.[19] There is no need for the Companies to restate those comments here except to reiterate that the Commission established revenue caps which are an incentive not to mismanage or overspend capital budgets as OCC alleges is happening.

II. ACCOUNTING ISSUES

Similar to its comments filed on the 2015 Audit Report, 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. As explained in the Companies' Reply Comments in on the 2015

[17] Companies' Reply Comments, 2015 Audit Report, at 6-8.
[18] OCC Comments at 7.
[19] Companies' Reply Comments, 2015 Audit Report, at 4-5.

Audit Report, these "accounting issues" identified by OCC are clearly outside of the scope of the Commission approved Rider DCR calculation. 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.[20]

With respect to Asset Retirement Obligations, OCC has mashed two different accounts together and draws the wrong conclusions about both. With respect to Customer Receivables for Future Tax Obligations, OCC fails to understand that the associated activity is largely not at all related to incremental changes in plant balances. In addition to being outside the scope of Rider DCR, OCC's recommendations are based on incorrect assumptions and 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. OCC's recommendations to modify the Rider DCR mechanism to remove costs associated with specific projects from recovery through quarterly filings and instead wait until a Commission order determines them to be just and reasonable is contrary to the Commission's order in Case No. 12-1230-EL-SSO. Further, OCC's recommendations 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 prior Commission orders. For all of the reasons stated above and in their Reply Comments on the 2015 Audit Report, the Companies recommend the Commission issue an Order adopting the recommendations contained in the Audit

[20] Companies' Reply Comments, 2015 Audit Report, at 8-12.

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, ESP III, and ESP IV.

Respectfully submitted,

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CERTIFICATE OF SERVICE

On August 7, 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:

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Summary: Reply Reply Comments of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company electronically filed by Mr. Robert M. Endris on behalf of Endris, Robert Mr.