

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the 2016 Review of the)
Distribution Investment Rider Contained)
in the Tariff of Ohio Power Company.) Case No. 17-0038-EL-RDR

In the Matter of the 2017 Review of the)
Distribution Investment Rider Contained)
in the Tariff of Ohio Power Company.) Case No. 18-0230-EL-RDR

**REPLY COMMENTS
BY
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL**

I. INTRODUCTION:

The billion dollars that Ohio Power Company (“AEP Ohio”) has already spent to upgrade its electricity infrastructure is not providing the promised reliability benefits for customers. If customers are not going to see reliability benefits for the amounts they are being charged, then it is time for AEP Ohio to stop charging customers for it.

In these cases, an independent auditor audited what AEP Ohio charged customers through its Distribution Investment Rider (“DIR”) for expenses it allegedly incurred in years 2016 and 2017. These expenses were meant to upgrade AEP Ohio’s electric distribution infrastructure. The DIR allows AEP Ohio to charge customers much sooner for the investments it makes in its infrastructure for electric distribution service as compared to capital expenditures collected in a base distribution rate case. And AEP Ohio earns a return on the money it spends to upgrade its electric distribution infrastructure.

The DIR is supposed to support investments in distribution infrastructure modernization to improve reliability of AEP Ohio's electric distribution system for customers. But as the Office of the Consumers' Counsel ("OCC") showed in its initial comments, despite the boundless spending by AEP Ohio since the DIR was initiated, the reliability that customers are receiving from AEP Ohio has not gotten better.¹ In fact, the average duration of customer outages in 2017 (after spending over a billion dollars and charging customers through the DIR) were over three minutes longer than in 2011 before the DIR was implemented.²

The Public Utilities Commission of Ohio ("PUCO") should protect consumers by requiring that AEP's Ohio's spending and commensurate charging of customers under the DIR is focused on programs that quantifiably reduce the number of outages and the duration of those outages for consumers. In addition, the PUCO should adopt certain recommendations by the auditors, Blue Ridge Consulting ("Blue Ridge"), discussed in these Reply Comments. The recommendations help protect customers from paying unjust and unreasonable charges to AEP Ohio through the DIR.

II. COMMENTS

- A. The PUCO should order AEP Ohio to cease collecting incentive pay compensation from customers through the DIR and to immediately credit to customers at least the \$1.7 million the auditor estimated was inappropriately collected from customers.**

In its audit of a limited sample of AEP Ohio work orders, Blue Ridge identified \$138,511 in incentive pay compensation from 2016 that should not have been collected

¹ OCC Comments (October 26, 2018) at 3-4.

² *Id.* at 4.

from customers through the DIR.³ Through extrapolation, Blue Ridge determined that for 2016 alone, the amount of inappropriately collected incentive pay compensation costs were over \$353,000. Blue Ridge calculated that, since the DIR was initiated, AEP Ohio has inappropriately charged customers approximately \$1.7 million in inappropriate incentive pay compensation.⁴

AEP Ohio disagreed with the audit, arguing that the charges are part of its actual cost of labor.⁵ AEP Ohio further claimed that incentive pay was necessary to attract, retain, and motivate employees needed to efficiently and effectively provide electric service to customers.⁶ And AEP Ohio also asserted that incentive pay compensation should be collected through the DIR because it was included in the rates from the settlement in the last distribution rate case (Case No. 11-351-EL-AIR).

In the initial comments, both OCC⁷ and the PUCO Staff⁸ agreed with Blue Ridge's recommendation that incentive pay compensation should not be collected through the DIR. AEP Ohio's claim that incentive pay compensation should be collected through the DIR because of the settlement in the last distribution rate case (Case No. 11-351-EL-AIR) is meritless.⁹ First, the settlement in that case was a "black box" settlement. The actual components of the rates from that case are not identified in the stipulation.

³ Case No. 17-38-EL-RDR, Audit Report (August 10, 2017) at 8.

⁴ *Id.*

⁵ AEP Ohio Initial Comments at 2.

⁶ *Id.*

⁷ OCC Comments at 5.

⁸ Staff Initial Comments at 8.

⁹ AEP Ohio Initial Comments at 2

Second, the stipulation in that case clearly states that it shall not be cited as precedent against any signatory party in a future case.¹⁰ The stipulation further states that the acceptance of any provision in the settlement shall not be used in any forum to imply that a signatory party agrees with any specific provision of the settlement.¹¹ And the stipulation acknowledges that the settlement reflects an overall compromise involving a balance of competing provisions and does not necessarily reflect the position a signatory party might take on any individual issue.¹² AEP Ohio's position is contradicted by terms of the settlement and violates the stipulation in Case No. 11-351-EL-AIR.

Third, any settlement in the last distribution rate case is irrelevant to DIR rates because the PUCO authorized the DIR in a later case. The Opinion and Order that approved the settlement in the last distribution rate case (Case No. 11-351-EL-AIR) was on December 14, 2011. The Opinion and Order approving the DIR was part of AEP Ohio's Electric Security Plan case (Case No. 11-346-EL-SSO) and was issued on August 8, 2012. There is no mention of incentive pay compensation being authorized in this opinion and order.

Fourth, it would be fundamentally unfair for consumers to be charged for incentive pay compensation given that the DIR has not improved reliability. Companies reward employees when they meet certain targets for profitability. One way to reach these targets is through getting additional revenue from customers through increased rates or additional rider charges. Customers should not pay for incentive payments that are

¹⁰ Case No. 11-352-EL-AIR, Stipulation and Recommendation (November 23, 2011) at 14.

¹¹ *Id.*

¹² *Id.* at 14-15.

based on achieving financial goals because the primary benefit of such incentives inures to shareholders.¹³

The PUCO should order AEP Ohio to adjust the next quarterly filing of the DIR by the \$1.7 million estimated by Blue Ridge. Because the \$1.7 million is an estimate of the charges inappropriately collected from customers, Blue Ridge should audit the actual amount of incentive pay compensation that has been included in the DIR since its inception and identify the total amount should be excluded from that the DIR.

B. The PUCO should order AEP Ohio to perform an analysis of its capital spares policy to determine if more cost-effective options are available to procure spares.

Based on its limited review of DIR work orders, Blue Ridge identified \$1,860,202 in capital spares (i.e., spare equipment) that could have potentially been procured in a more cost-effective manner.¹⁴ Because transformers (and some other capital equipment) are capitalized upon purchase, there is an incentive to purchase large quantities or very expensive equipment for which AEP Ohio would earn a return on the investment which could then be included in rates or rider charges. In addition, spares that AEP Ohio has purchased are not necessarily used and useful and should be ineligible for collection from customers. Because Blue Ridge examined only a small sample of work orders from 2016, the total dollar amount that AEP Ohio has included in the DIR since inception for spares could be substantial.

¹³ See, e.g., *Ohio American Water Company*, Case No. 09-391-WS-AIR, Entry on Rehearing (June 23, 2010), ¶17; *Ohio Edison Company*, Case No. 07-551-EL-AIR et al, Opinion and Order (January 21, 2009) at 17.

¹⁴ Case No. 17-38-EL-RDR, Blue Ridge Audit Report at 48.

In the initial comments OCC agreed with Blue Ridge's recommendation that AEP Ohio should be required to perform an analysis to determine the most cost-effective option to procure capital spares.¹⁵ The PUCO Staff also agreed with this recommendation.¹⁶ In disagreeing with Blue Ridge, AEP Ohio argued that renting spares such as station transformers can be more expensive than purchasing a spare as the permanent replacement for a failed transformer.¹⁷

The PUCO should require AEP Ohio to perform an analysis of its capital spares policy to determine if more cost-effective options are available to procure spares. Blue Ridge should conduct a comprehensive examination of AEP Ohio's capital spares policy (including the reasonableness and the total amount included in the DIR since its inception) in the next annual audit review. Blue Ridge should make recommendations concerning changes in AEP Ohio's capital spares policy to ensure that spares are procured in a cost-effective manner and are reasonable for inclusion in the DIR.

C. The PUCO should adopt the Blue Ridge recommendations that involve better project controls on DIR spending and documentation, including project justifications and savings.

Blue Ridge reviewed a sample of work orders from 2016 to determine if there was sufficient documentation and justification to support performing the project and collecting the costs through the DIR.¹⁸ Out of a sample of 47 work orders, Blue Ridge found that nine were over budget by more than 15% of the original budget.¹⁹ Blue Ridge

¹⁵ OCC Comments at 6.

¹⁶ PUCO Staff Initial Comments at 8.

¹⁷ AEP Ohio Initial Comments at 5.

¹⁸ Case No. 17-38-EL-RDR, Blue Ridge Audit Report at 11-12

¹⁹ *Id.*

also found that not all the work orders included documentation of other alternatives that were considered prior to choosing a particular solution.²⁰

Blue Ridge recommended that AEP Ohio document operational and/or economic alternatives as part of the documentation supporting the procurement of items included in the DIR.²¹ Finally, Blue Ridge identified at least one work order where the project was over budget due to an incomplete work plan when the project was initiated. Blue Ridge recommended that work plans and requirements be complete before projects begin.²²

AEP Ohio disputed Blue Ridge's recommendations. AEP Ohio argued that adequate information exists for business decisions.²³ However, the PUCO specifically requires an independent audit of the DIR on an annual basis for specific purposes, including verifying accounting accuracy and prudence.²⁴ Blue Ridge's responsibility in evaluating the prudence of costs that AEP Ohio is passing along to customers necessarily includes reviewing the sufficiency of documentation and budgetary controls, and ensuring that requirements are sufficiently defined before customer money is spent.

To protect consumers from paying more than reasonable and prudently incurred costs under the DIR, the PUCO should order AEP Ohio to implement Blue Ridge's recommendations for any costs it intends to collect from customers through the DIR. In the next audit, Blue Ridge should evaluate the improvements that are made in AEP Ohio's procurement practices to safeguard that improved budgetary controls are in place.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ AEP Ohio Initial Comments at 6-8.

²⁴ Case No. 11-346-EL-SSO, Opinion and Order (August 8, 2012) at 47.

D. The PUCO should require AEP Ohio to verify to the satisfaction of the auditor that inappropriate vegetation management expenses are not included in the DIR for collection from customers.

Blue Ridge recommended that AEP Ohio provide a better definition of which vegetation management practice costs should be expensed as operations and maintenance (“O&M”) and which costs should be capitalized.²⁵ AEP Ohio collects vegetation management costs from customers through base rates as well as the Enhanced Service Reliability Rider and the DIR.²⁶ The Blue Ridge audit is required to ensure there is no double-collection of costs between the DIR and other AEP Ohio mechanisms that charge customers for distribution-related expenses.²⁷ Both OCC²⁸ and the PUCO Staff²⁹ agreed with Blue Ridge’s recommendations.

It was is unfortunate for consumer protection that Blue Ridge was unable to verify that the DIR was only collecting appropriate vegetation management costs from customers. Based on Blue Ridge’s interpretation of Federal Energy Regulatory Commission (“FERC”) guidelines, AEP Ohio is capitalizing vegetation management costs that should be expensed as O&M.³⁰

AEP Ohio claims that it is in compliance with the FERC rules.³¹ However, AEP Ohio makes the distinction between which costs are capitalized and which costs are

²⁵ Case No. 18-230-EL-RDR, Blue Ridge Audit Report (August 23, 2018) at 34.

²⁶ OCC Comments at 7.

²⁷ *Id.*

²⁸ *Id.*

²⁹ PUCO Staff Comments at 8.

³⁰ Case No. 18-230-EL-RDR, Blue Ridge Audit Report at 34.

³¹ AEP Ohio Initial Comments at 9.

expensed based on the diameter of the tree that is to be removed.³² After the initial clearing, removing trees that exceed 18 inches in diameter are capitalized and clearing of trees that are under 18 inches are expensed.³³ This policy may be inappropriate given that AEP Ohio has financial incentives to remove vegetation that exceeds 18 inches. This policy also makes it very difficult if not impossible for the auditor to verify that vegetation management costs are being appropriately recorded in the DIR as required by the PUCO.

The PUCO should require AEP Ohio to adapt its vegetation management policies in a manner that enables the auditor to be able to verify that only appropriate costs are being collected from customers through the DIR. To make sure that customers do not pay multiple times for the same vegetation management projects, the PUCO should not allow AEP Ohio to include vegetation management costs in the DIR.

III. CONCLUSION

To protect consumers, the PUCO should adopt the auditor's recommendations discussed in OCC's original comments and in these reply comments. In addition, the PUCO should require that AEP Ohio remove pay incentives for meeting financial goals, and require the next audit evaluate whether AEP Ohio has implemented improved budgetary controls. Consumers should be charged only for reasonable and prudent expenditures through the DIR.

³² *Id.*

³³ *Id.*

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Reply Comments was served on the persons stated below via electronic mail this 16th day of November 2018.

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