BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Power Company for an Increase in Electric Distribution Rates	)))	Case No. 20-0585-EL-AIR
In the Matter of the Application of Ohio Power Company for Tariff Approval	)))	Case No. 20-0586-EL-ATA
In the Matter of the Application of Ohio Power Company for Approval to Change Accounting Methods	)))	Case No. 20-0587-EL-AAM

DIRECT TESTIMONY OF FRANK LACEY ON BEHALF OF
INTERSTATE GAS SUPPLY, INC. AND
DIRECT ENERGY BUSINESS, LLC & DIRECT ENERGY SERVICES, LLC

Filed: April 20, 2021

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Frank Lacey. I am the President of Electric Advisors Consulting, LLC. My business address is 3 Traylor Drive, West Chester, PA 19382.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of Interstate Gas Supply, Inc. ("IGS") and Direct Energy Business, LLC & Direct Energy Services, LLC ("Direct Energy") (collectively, the "Supplier Companies"). The Supplier Companies provide competitive retail electric service ("CRES") to residential and commercial & industrial ("C&I") customers in Ohio, including in the Ohio Power Company ("AEP" or the "Company") service territory. In addition to providing energy and innovative retail energy products, the Supplier Companies offer additional advanced energy management services including demand management, energy efficiency, home warranty, renewable energy, and distributed energy resources.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. I provide policy- and market-related consulting services to advanced energy management companies and end-use customers. I have worked in the electric power industry for approximately 28 years, beginning immediately after earning my graduate degree. I have worked on major industry restructuring issues including generation asset divestiture, with a specialization in environmental asset valuation; stranded cost valuations; transmission restructuring including the development of

Independent System Operators ("ISOs") and Regional Transmission Organization ("RTOs") and other independent transmission entities; the development of retail energy markets; and the development of demand response markets. Early in my career, I was employed as a consultant to industry participants, first by Putnam, Hayes & Bartlett, Inc. and then by Arthur Andersen Business Consulting. Within the industry, I have worked for Strategic Energy, a retail electricity supplier, Direct Energy, a retail energy supplier that acquired Strategic Energy in 2008, and most recently, Comverge, Inc. and CPower, two demand response companies that shared a common owner and provided services to residential and to C&I customers, respectively. I founded Electric Advisors Consulting LLC in 2015. I earned a Bachelor of Science degree in Transportation and Logistics from the University of Maryland and a Master of Science in Industrial Administration with concentrations in finance and environmental management from the Tepper School of Business at Carnegie Mellon University. My resume is provided as Exhibit FPL-1.

Q. HAVE YOU EVER TESTIFIED BEFORE THE PUBLIC UTILITY COMMISSION OF OHIO OR ANY OTHER UTILITY REGULATORY AGENCY?

A. Yes. I have testified before the Public Utility Commission of Ohio ("Commission" or "PUCO"). I have also testified numerous times before other state regulatory agencies, legislatures, and twice as a technical conference witness at the Federal Energy Regulatory Commission ("FERC"). I have also filed expert reports in judicial proceedings in the Superior Court of New Jersey in Bergen County and in the Supreme Court of the State of New York in New York County. In addition to

Ohio, I have provided expert testimony before the utility commissions in New York, Pennsylvania, Maryland, New Jersey, Massachusetts, Illinois, Delaware, Rhode Island, Virginia, Utah and California. I have made presentations to the Commissions in Pennsylvania, Maryland, Delaware and Texas. I have presented legislative testimony in New York, Connecticut, Maryland, Pennsylvania, Delaware, Michigan, California and Texas. I have also spoken at numerous trade shows, conferences and other industry and corporate events as an expert on electricity market issues. A detailed listing of my prior testimony is contained in Exhibit FPL-2.

Q. HAVE YOU PREVIOUSLY STUDIED UTILITY DEFAULT SERVICE RATES AND COST ALLOCATION IN COMPETITIVE MARKETS?

A. Yes. In January 2019, my article "Default Service Pricing Has Been Wrong All Along – Allows Utilities to Maintain Dominance in Markets" was published in Public Utilities Fortnightly.[1] This article is attached as Exhibit FPL-3. The second article, "Default Service Pricing – The Flaw and the Fix: Current pricing practices allow utilities to maintain market dominance in deregulated markets" was more academic in nature and was published in the Electricity Journal in April 2019.[2] That article, attached as Exhibit FPL-4, described more thoroughly the problem of the discriminatory pricing, addressed some of the market results from the

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[1] Frank Lacey, "Default Service Pricing Has Been Wrong All Along – Allows Utilities to Maintain Dominance in Markets," Public Utilities Fortnightly, January 2019, Pages 40-44 (Exhibit FPL-3).
[2] Frank Lacey, "Default Service Pricing – The Flaw and the Fix: Current pricing practices allow utilities to maintain market dominance in deregulated markets," The Electricity Journal, Volume 32, Issue 3, 2019, Pages 4-10 (Exhibit FPL-4).

discriminatory pricing and presented a solution that was modeled based on a fully-allocated implementation of a model similar to the Retail Reconciliation Rider model in place in Ohio. Much of the research and analyses from those two articles informs the testimony I offer in this proceeding.

Q. WHY IS THE ALLOCATION OF DEFAULT SERVICE COSTS IMPORTANT TO THE SUPPLIER COMPANIES?

The Supplier Companies operate competitive retail electric and gas supply businesses in Ohio. Their electric offerings compete directly with AEP's Standard Service Offer ("SSO").[3] The SSO is available to customers who do not purchase their electricity from competitive suppliers in the market. The Supplier Companies' interest in this proceeding is to ensure that AEP complied with the terms of the Stipulation in their ESP IV proceeding which obligated them to provide certain analyses to the Commission in this rate proceeding.[4] Accordingly, the Supplier Companies' interest is to see that the rates for the SSO reflect the full cost of providing that service so that customers are able to make more accurate comparisons when shopping for electricity supply. When the costs of providing the SSO, which are currently embedded in distribution rates, are properly recovered through the SSO rate, distribution customers will no longer be subsidizing the SSO.

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[3] When I refer to the SSO in my testimony, I am referring to generation service provided to customers that do not choose a competitive retail electric service provider.

[4] *See In 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,* Case Nos. 16-1852-EL-SSO, et al. ("ESP IV"), Joint Stipulation and Recommendation (Aug. 25, 2017) ("ESP IV Stipulation") at 31-32.

The elimination of this subsidy will improve the retail market, thereby giving customers more competitive supply options.

II. SUMMARY AND CONCLUSIONS

Q. HAVE YOU READ AEP'S RATE CASE FILING AND SUPPORTING TESTIMONY AND THE TESTIMONY FILED BY AEP AND OTHERS IN SUPPORT OF THE STIPULATION?

A. I have.

Q. COULD YOU PLEASE SUMMARIZE THE FILINGS AND YOUR CONCLUSIONS?

Yes. AEP filed what would be classified as a traditional utility rate case, seeking an increase in base distribution rates for its electric distribution business. Base distribution rates are non-competitive service costs; therefore, they are recovered from all customers.

In AEP's Expanded PPA Case, AEP agreed to propose the bypassable Retail Reconciliation Rider[5] in its next ESP proceeding in order to recognize the costs associated with providing competitive retail electric generation service that are not collected through SSO rates.[6] The total collected from the Retail Reconciliation Rider would then be refunded to all distribution customers through a nonbypassable

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[5] The Retail Reconciliation Rider was initially named the Competitive Incentive Rider ("CIR") but was later renamed by the Commission in ESP IV. For clarity, I will just refer to it as the Retail Reconciliation Rider.

[6] *In the Matter of the Application Seeking Approval of Ohio Power Company's Proposal to Enter into an Affiliate Power Purchase Agreement for Inclusion in the Power Purchase Agreement Rider*, Case Nos. 14-1693-EL-RDR, et al. ("Expanded PPA Case"), Joint Stipulation and Recommendation (Dec. 14, 2015) at 12-13.

rider established in ESP IV.[7] Additionally, AEP Ohio agreed to "provide an analysis as part of its next distribution rate case to show all of the actual costs required to provide SSO generation service that are included in the Company's cost of service study," and propose that these costs be allocated to the default service in that rate case.[8]

Subsequently, in AEP's ESP IV, AEP signed a stipulation ("ESP IV Stipulation") that established the Retail Reconciliation Rider and the SSO Credit Rider mechanisms and their respective rates. Recognizing that shopping customers were overpaying for SSO services they did not receive, under the ESP IV Stipulation, those rates would continue until AEP's next distribution rate case.[9] At that time, AEP would fulfill its commitment in the Expanded PPA Case to propose the recovery of the actual costs required to provide the SSO from only default service customers.[10]

The Commission approved the establishment of the Retail Reconciliation Rider and the SSO Credit Rider but unfortunately declined to adopt the rates established in the ESP IV Stipulation.[11] Instead, the Commission stated the riders would serve as placeholders until a thorough analysis of AEP's distribution costs was conducted in

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[7] *Id.* at 12.
[8] *Id.* at 12-13.
[9] ESP IV Stipulation at 31-32.
[10] *Id.*
[11] ESP IV Order at ¶ 213-214.

the next distribution rate case.[12] Specifically, the Commission stated that "[a]dditional analysis is needed to determine whether and how AEP Ohio's Customer Accounts Expense, Customer Service and Information Expense, Administrative and General Expense, and Taxes Other than Income Taxes should be reallocated through the [Retail Reconciliation Rider] and SSOCR."[13] Due to this delay, shopping customers have been subsidizing the SSO for many years because of an improper assignment and allocation of the costs of the SSO.

Thus, in this rate proceeding, AEP was required to complete a thorough analysis of its distribution rates, including the actual costs associated with the SSO. However, based on my review of the testimony supporting the Application, the Staff Report issued in this proceeding, and the stipulations in the ESP IV proceeding and this proceeding,[14] AEP's analysis in its Application was by no means "thorough." It simply concluded that aside from uncollectible generation expenses and the PUCO and Ohio Consumers' Counsel ("OCC") assessments, there were negligible "qualitative costs" that are used in the delivery of the SSO, and proposed that they should be ignored.[15] AEP witness Roush testified that "the Company reviewed certain functions, such as its call center, accounting operations and billing system that are clearly necessary to support both shopping and non-shopping customers."[16]

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[12] *Id.* at ¶ 214.
[13] *Id.*
[14] Joint Stipulation and Recommendation ("AEP Rate Stipulation") (Mar. 12, 2021).
[15] Direct Testimony of David M. Roush ("Roush Testimony") (June 15, 2020) at 11-12, Ex. DMR-2.
[16] *Id.* at 12.

However, in his "thorough analysis" of these shared costs to serve customers, other than the PUCO and OCC assessments, he allocated a grand total of zero dollars to the SSO.[17] This analysis is anything but "thorough" as it omits from SSO all of the most basic elements of running a business, such as rent, personnel, computers, systems, accounting and finance, and billing.

Mr. Roush also deducted from his total allocation to the SSO, "choice-related costs" which he says should be "assigned strictly to shopping customers."[18] This is an incorrect analysis as the choice-related costs benefit all customers, not just those who choose an alternative supplier. As discussed in more detail below, these are not competitive costs. The costs relate to service that only AEP can provide and they benefit all customers. As such, they should be classified as regulated distribution service costs.

I find that Staff's recommendation to dismiss AEP's analysis and related riders because AEP did not examine "all cost causation factors" to be wholly inappropriate. The resolution found in the Stipulation that the "Retail Reconciliation Rider and SSO Credit Rider will remain at zero based on the Staff Report's recommendation" is equally indefensible and is extremely detrimental to the competitiveness of the Ohio electricity markets. It will further cement AEP's

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[17] *Id.* at Ex. DMR-2.
[18] *Id.* at 12.

unearned competitive advantage in this market and will distort consumers' ability to evaluate electricity and other generation service offerings.

Finally, with respect to the logic, advanced by AEP and adopted by Staff, that "SSO is a default service, available to all customers and required by electric distribution companies to provide" is a red herring argument for not allocating costs to the SSO business.[19] By that logic, one could argue that AEP should not allocate costs to residential distribution because they are obligated to provide the service. Of course, that makes no economic sense at all. Similarly, it makes no economic sense to simply not allocate costs of operating the SSO business to that business.

As directed, this rate proceeding was supposed to include a "thorough analysis" of SSO-related costs and an allocation of those costs to the SSO. I take no position on the overall revenue requirement submitted by AEP in this proceeding as modified by the AEP Rate Stipulation. However, I find that AEP's analysis of the SSO-related costs is inadequate, is far from "thorough" and drastically understates the true cost of operating the SSO business. By failing to perform this analysis correctly, AEP inappropriately includes these costs in its distribution rates, which renders the distribution rates unjust and unreasonable.

I conclude based on my review of the filing that if the rates proposed by AEP are adopted as presented, AEP would be allocating too many costs to its distribution

[19] Amended Staff Review and Recommendation in the Matter of the Application of Ohio Power Company for an Increase in Electric Distribution Rates ("Staff Report") (Nov. 25, 2020) at 31.

business and failing to allocate costs appropriately to the SSO business, rendering both SSO and distribution rates unjust and unreasonable. Under such a rate design, AEP would be over-collecting its distribution costs from all customers including from customers who have chosen a competitive supplier, and under-collecting costs from SSO customers related to serving them. Without an accurate SSO rate, shopping customers are subsidizing the SSO and consumers are deprived of an opportunity to meaningfully compare offers in the competitive market with the SSO rate charged by AEP. This result is harmful to customers, to CRES suppliers and to the long-term success of Ohio's competitive energy policy and environmental goal, which will be met most efficiently if the competitive landscape is not biased in the utilities' favor. I have developed a financial model based on those presented by AEP to support its rate request that shows that an appropriate allocation of costs to the SSO would yield the following impacts on the Retail Reconciliation Rider and the SSO Credit Rider. Table FL-1 summarizes the results of my analysis:

Table FL-1

Appropriate SSO Cost Allocation

		Impacts
Allocation Pool	$	190,244,486
Retail Reconciliation Rider Allocation	$	64,377,767
Retail Reconciliation Rider Charge ($/kWh)	$	0.0057
SSO Credit ($/kWh)	$	0.0015

My findings and analysis are supported by National Association of Regulatory Utility Commissioners ("NARUC") cost allocation guidelines, by several noted economists, by general business practices and by AEP's own cost allocation manual.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. My understanding is that the Commission will review the Stipulation to determine whether it meets a test adopted by the Commission that addresses three questions: (1) Is the settlement the product of serious bargaining among capable, knowledgeable parties? (2) Does the settlement, as a package, benefit ratepayers and the public interest? (3) Does the settlement package violate any important regulatory principle or practice? I will not address the first of these three questions. My testimony will show quite clearly, however, that the proposed settlement, as a package, does not benefit ratepayers and is not in the public interest. I will show that the proposed settlement violates several very important ratemaking standards, principles and practices and it violates other regulatory standards.

Additionally, IGS and Direct have filed objections to the Staff Report. My testimony provides evidence supporting Objections to the Staff Report filed by IGS and Direct Energy, respectively.[20] My conclusions rest on a showing that AEP has not followed long-standing traditional rate-making procedures in determining the costs that should be allocated to the Retail Reconciliation Rider. In reaching my conclusions, I conducted an independent analysis of AEP's proposed costs and

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[20] Specifically, this testimony addresses IGS Objections A through D and all of the Direct Objections.

based on that analysis, make recommendations about the amount of costs that should be allocated to SSO. My recommended cost allocations are consistent with NARUC principles of cost allocation; with sound utility ratemaking practices; with AEP's own cost allocation principles; and with general cost accounting principles.

My testimony will detail how AEP's flawed analysis can be corrected within the current SSO framework. If implemented as designed, the Retail Reconciliation Rider will neither increase nor decrease the base distribution revenues that AEP will receive. Total costs to customers in aggregate will not change. Additionally, a correct implementation of the Rider will facilitate the type of robust competition envisioned for Ohio.

My testimony will show that AEP has failed to allocate costs to the SSO that are incurred to provide that service. By proposing a Retail Reconciliation Rate of just \$0.0003120 (312/10,000ths of a cent) per kWh, AEP has omitted major cost categories and significantly understated other cost allocations. For example, AEP has not allocated administrative and general expenses to the SSO, including costs of information technology ("IT") and human resources ("HR") and other costs that are clearly necessary to operate the SSO business.

Moreover, Staff's recommendation to dismiss AEP's analysis and related riders because AEP did not examine "all cost causation factors" is wholly inappropriate. I agree with the Staff that AEP did not examine all costs causation factors; in fact AEP ignored most of them. However, that failure should not be used to ignore or excuse the obligation of AEP to conduct a thorough analysis of its costs to serve the SSO and to properly set the Retail Reconciliation Rider and the SSO Credit Rider previously agreed to.

Further, I will address several concerns with the "shadow billing" proposal in the proposed settlement. The shadow billing proposal, ironically, is being proffered at the same time as some stakeholders oppose an appropriate allocation of costs to SSO. While there are many reasons to reject a shadow billing construct, most notably, the result of any shadow billing calculations will be biased on day one because the framework is designed to compare the cost of several different fully allocated and market-based products to a singular product that is heavily subsidized and that benefits from several regulatory protections.

Finally, I will address the failure to determine whether AEP is proposing to collect any direct or indirect costs associated with customer sited renewable energy resources through distribution rates, in violation of R.C. 4928.47.

Q. HOW DO THE SUPPLIER COMPANIES PROPOSE TO CORRECT THIS SUBSIDY PROBLEM?

A. The Supplier Companies ask the Commission to populate the Retail Reconciliation Rider and the SSO Credit Rider in order to fully and equitably allocate the costs that are proposed to be recovered through distribution rates that are clearly used to provide the SSO.

I calculate a full allocation of costs to SSO service to be $64,377,767 as compared to AEP's allocation of only $3,500,765.[21] This allocation to SSO does not increase costs. It only moves costs from distribution to SSO. While this allocation will increase the cost for SSO service, the distribution rate will be reduced simultaneously. As shown in Table FL-1, above, if implemented as recommended today, the SSO cost will increase by $0.0057 per kWh via a charge on the Retail Reconciliation Rider. The distribution rate would be $0.0015 per kWh lower as a result of the SSO Credit. All else being equal, AEPs net revenues will remain unchanged as all revenues collected are credited back to customers. An appropriate allocation, which removes costs that are currently embedded in distribution rates and recovers them instead from bypassable SSO rates, will result in rates for both distribution service and the SSO that are just and reasonable. Deploying the allocation through the Retail Reconciliation Rider and the SSO Credit Rider mechanisms will ensure that AEP is fully – and not over – collecting its distribution costs while under-collecting its SSO-related costs. More importantly, it will result in SSO prices that more accurately reflect the cost of providing that service.

Q. IS IT IMPORTANT TO HAVE SSO PRICES THAT MORE ACCURATELY REFLECT THE COST OF PROVIDING SSO?

A. Yes. The SSO is electricity service provided to customers that do not choose an alternative electricity supplier. As the default, or "do nothing" product, SSO has

[21] Roush Testimony at Ex. DMR-2.

been positioned as the baseline product against which all competitive offers should be compared. Therefore, it becomes more important for the SSO price to be accurate and reflective of its true costs.[22] The problems associated with the failure to price the SSO properly are further exacerbated by the Shadow Billing proposal in the proposed settlement. Notwithstanding the drive to compare competitive offers to the SSO price, all utility products should be charged at cost, including a full allocation of costs. With a proper allocation of costs to the SSO, customers will be able to make much more informed choices about their energy consumption and about competitive energy options.

The cost to provide SSO should not be subsidized by distribution rates. By proposing a rate for the SSO that is reflective of the true cost to offer and provide that service to customers, the Supplier Companies seek to remove these SSO subsidies from the distribution rates. Properly allocating costs to SSO will also empower customers with more accurate pricing information, enabling them to make better informed competitive energy market choices. When SSO pricing reflects the costs to provide this service, competitors are able to offer competitive prices. By contrast, the current allocation of costs to the SSO and the allocation of

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[22] I do not endorse the concept of the SSO being any type of pricing comparison or baseline against which competitive supply products should be compared. The SSO is procured for discreet periods of time, at discreet dates and as it is priced today, reflects what is essentially a pass-through of wholesale market prices, with no appropriate allocations of costs necessary to provide the service. Suppliers' products have different attributes, different benefits, different terms and are procured and offered on dates that are different from the SSO. Any comparison of the costs of such products are immaterial unless the comparison adjusts for all of those differences and others.

costs proposed by Mr. Roush in this proceeding will result in SSO pricing that harms the competitive market, harms customers and results in an over-consumption of energy. The recommendation by Staff to ignore this issue altogether is inconsistent with the policy directives of the state and inconsistent with the obligations outlined in AEP's ESP IV Stipulation. Accordingly, the proposed settlement should be modified to include an appropriate allocation of costs to SSO, and the Shadow Billing Component of the proposed settlement should be rejected.

III. <u>FUNDAMENTAL MARKET FLAWS</u>

Q. WHY IS COST ALLOCATION IMPORTANT?

A. An appropriate allocation of costs to different business lines, in any business, is important so that management can understand the true cost to produce and deliver a product and then make decisions about the product like proper pricing. In a market where costs are regulated and are generally to be provided "at cost," allocation takes on a new level of importance because of the possibility of a regulated business subsidizing another business unit. NARUC has recognized that "utilities have a natural business incentive to shift costs from non-regulated competitive operations to regulated monopoly operations…"[23] and has issued cost allocation guidance (discussed below) to prevent such subsidization.

Q. WHAT HAPPENS IF COST ALLOCATION IS NOT DONE CORRECTLY?

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[23] NARUC, "Guidelines for Cost Allocations and Affiliate Transactions," ("NARUC Guidelines") Section D at 3; available at https://pubs.naruc.org/pub.cfm?id=539BF2CD-2354-D714-51C4-0D70A5A95C65 (FPL-Exhibit 13).

A. It leads to market flaws – not just in energy markets, but in any market. For example, if a company failed to allocate costs properly to one of its business lines, it could potentially cause severe financial harm to the business or possibly lead the business into bankruptcy. A simple example is a company that manufactures pens and pencils. If all of the overhead is allocated to one of those products (pens, for example), the pencils will be priced below-market and the company will be able to sell as many as they could manufacture. The pens, on the other hand, will be too expensive and the company will sell few, if any pens. However, it will need to sell pens to recover its overhead costs. This business will bankrupt itself because it will never collect its overhead costs. In the case before this Commission, AEP's SSO costs are too low and distribution costs are too high. The only reason the utility can sustain itself even though there is a misallocation of costs is because it has a monopoly on the part of its business that is priced too high.

Q. DOES AN IMPROPER ALLOCATION OF COSTS TO SSO HARM CONSUMERS?

A. Yes. It harms consumers who choose competitive electricity options and those who are taking the SSO.

Q. COULD YOU PLEASE EXPLAIN THIS IN MORE DETAIL?

Yes. Under the current Ohio retail energy market structure, utility costs are recovered through the rates of two distinct services – distribution and generation.[24]

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[24] Under Ohio law, transmission costs are set by federal orders and are passed through a specific rider. For simplicity, I am looking at only distribution and generation costs.

AEP has 1,503,881 distribution customers and 928,901 generation service (SSO) customers.[25] As rates stand today and as designed in the proposed settlement, 928,901 customers will be receiving generation service without understanding of the true cost to serve that product. Without an appropriate allocation of costs between the two retail products, the generation product (the SSO) will be priced below the market value for that product. This harms consumers who have chosen an electricity supplier because they are subsidizing, through distribution rates, the provision of the SSO to customers who do not migrate to competitive options. It also harms consumers on the SSO because it prevents them from being able to make a fair comparison to alternatives that may in fact offer real value to these customers, and it obscures the appropriate price signal, potentially resulting in over-consumption. This flawed allocation approach also creates a market where a utility can hold a significant anti-competitive pricing advantage on the services that are supposed to be "competitive." As recognized by NARUC, a "natural business incentive" exists to shift costs from the competitive customers to the captive customers.[26] This incentive, which harms customers and the markets, is the exact incentive that NARUC was trying to prevent when it wrote its Guidelines for Cost Allocations and Affiliate Transactions. The Commission should ensure that utilities do not give undue preference in favor of utility products and/or engage in

[25] *See* AEP Response to IGS-INT-03-012, Att. 1 (Exhibit FPL-9).
[26] NARUC Guidelines at Section D.

practices that could result in noncompetitive SSO rates. It is essential that steps be taken in this proceeding to rectify AEP's cost allocations.

Q. DOES THIS PRICING DISORDER CAUSE ANY OTHER PROBLEMS?

A. Yes. Artificially low SSO prices are anti-competitive because they make it more difficult for suppliers in the market to compete for retail customers since they need to charge prices that reflect all of the costs of supplying electricity while AEP provides a heavily subsidized SSO product.

Q. IS A FULL ALLOCATION OF SSO COSTS TO THE RETAIL RECONCILIATION RIDER AN EFFECTIVE MARKET OUTCOME?

Yes. It is the policy of the state of Ohio to "[e]nsure effective competition in the provision of retail electric service by avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service or to a product or service other than retail electric service, and vice versa, including by prohibiting the recovery of any generation-related costs through distribution or transmission rates."[27] The SSO is a competitive offering from the utility. The current pricing structure for the SSO results in anticompetitive subsidies flowing from distribution to generation service, resulting in below-market energy prices for SSO customers. A full allocation of SSO costs to the Retail Reconciliation Rider would remove or mitigate the many market problems I have identified.

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[27] R.C. 4928.02(H).

IV. COST ALLOCATION PRINCIPLES

Q. HOW SHOULD AEP ALLOCATE COSTS TO THE RETAIL RECONCILIATION RIDER?

After the General Assembly restructured the electricity market, utilities were required to unbundle competitive services from non-competitive services. After the inception of the competitive market in Ohio, it is inappropriate for the Commission to apply its traditional regulatory authority to provide nonbypassable compensation to utilities for the provision of competitive services such as the SSO. To ensure that AEP does not recover competitive service costs through base rates, AEP should allocate the appropriate amount of costs to its SSO using a fully-allocated cost approach. If a resource is used in the provision of supplying the SSO, the cost of that resource should be allocated, in some manner, to that product. Several sources posit that a full allocation of costs to SSO products is appropriate. Most notably, guidance from NARUC and AEP suggests that all utility products should be priced using fully allocated cost principles.[28] General utility rate-making, including the distribution rates being sought in this proceeding, are fundamentally premised on an appropriate allocation of costs to certain products and services. Finally, general sound business, management and pricing practices require a full and appropriate allocation of costs to all products and services. For

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[28] *See* NARUC Guidelines at Section D; "American Electric Power, Cost Allocation Manual as of December 31, 2019;" available at https://www.aep.com/assets/docs/requiredpostings/TariffFilings/AEPOpCos-2020ATRR/13CostAllocationManual-12-31-19.pdf (FPL Exhibit 6).

purposes of this proceeding, properly allocating the costs to the SSO is the only way to facilitate a more appropriate market price for the SSO.

A. NARUC STANDARDS FOR COST ALLOCATION

Q. HAS NARUC OPINED ON COST ALLOCATION?

A. NARUC has issued a manual and guidelines on cost allocation at least twice. In 1992, NARUC published its "Electric Utility Cost Allocation Manual" ("NARUC CAM"), which is an almost 200-page tome on cost allocation in utility rate making.[29] NARUC also published "Guidelines for Cost Allocation and Affiliate Transactions" ("Guidelines" or "NARUC Guidelines").[30]

The NARUC CAM states:

> "While opinions vary on the appropriate methodologies to be used to perform cost studies, <u>few analysts seriously question the standard that service should be provided at cost</u>. Non-cost concepts and principles often modify the cost of service standard, but it remains the primary criterion for the reasonableness of rates. The cost principle applies not only to the overall level of rates, but to <u>the rates set for individual services</u>, classes of customers, <u>and segments of the utility's business</u>. Cost studies are therefore used by regulators for the following purposes:
>
> - To attribute costs to different categories of customers based on <u>how those customers cause costs to be incurred</u>.
> - To determine how costs will be recovered from customers within each customer class.
> - To calculate costs of individual types of service based on the costs each service requires the utility to expend.

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[29] NARUC, "Electric Utility Cost Allocation Manual" (1992) ("NARUC CAM"); available at https://pubs.naruc.org/pub.cfm?id=53A20BE2-2354-D714-5109-3999CB7043CE (Exhibit FPL-14).

[30] *See* NARUC Guidelines.

- To determine the revenue requirement for the monopoly services offered by a utility operating in both monopoly and competitive markets.
- To separate costs between different regulatory jurisdictions."[31]

These observations are especially prescient given the date of the NARUC CAM – January 1992. At that point in time NARUC was envisioning an allocation of costs of monopoly services offered by a utility operating in both monopoly and competitive markets. Notably, the NARUC CAM expressly identifies "segments of the utility's business."[32] In other words, it is appropriate to allocate costs to each business segment, even if it is not a separate business unit with profits and/or losses attached to it.

Q. DO NARUC'S GUIDELINES ALSO APPLY TO ALLOCATION OF COSTS TO SSO?

A. Yes. Even though the NARUC CAM likely did not envision SSO services as they are being provided today, the allocation principles hold true from an accounting perspective and from a regulatory rate making perspective and should be applied to SSO rate making.[33]

According to NARUC, the principles should be applied "whenever products or services are provided between a regulated utility and its non-regulated affiliate or division."[34] Under its first identified principle, direct costs "should be collected

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[31] NARUC CAM at 12 (emphasis added).
[32] *Id.*
[33] Lacey, Electricity Journal, Page 7.
[34] NARUC Guidelines at Section B.

and classified on a direct basis for each asset, service or product provided."[35] The set of direct costs that should be charged to the standard service offer include, but is not limited to, the cost of credit, the cost of wholesale market departments used to source the SSO, the costs of procurement, bad debt, the cost of communicating SSO issues to customers, and the cost of any other regulatory requirements imposed on SSO providers.

NARUC's second principle addresses indirect costs, which are costs for resources that are used for multiple products, services or other. This principle states that "[t]he general method for charging indirect costs should be on a <u>fully allocated cost basis</u>."[36] The resources deployed to provide the standard service offer are vast and include executives' salaries and benefits, rents and other office space expenses, regulatory cost, billing and customer care costs and others. To meet NARUC's "fully allocated cost basis" principle, the costs for all resources that are utilized in the provision of the standard service offer must be included in bucket of costs allocated to the Retail Reconciliation Rider component.

The principles of cost allocation should apply to all utility products and services. The NARUC CAM states exactly that fact: "The cost principle applies not only to the overall level of rates, but to the rates set for individual services, classes of customers, and segments of the utility's business."[37] More importantly, the

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[35] *Id*. at Section B.1.
[36] *Id.* at Section B.2 (emphasis added).
[37] NARUC CAM at 12.

Guidelines state: "The allocation methods should apply to the regulated entity's affiliates in order to prevent subsidization from, and ensure equitable cost sharing among the regulated entity and its affiliates, and vice versa."[38] These principles are directly applicable to pricing SSO.

Q. IS AEP'S STANDARD SERVICE OFFER BUSINESS AN "AFFILIATE" OF AEP?

A. Technically, they are not affiliate organizations, but should be treated as affiliates under the Commission's rules. Specifically, Ohio Adm.Code 4901:1-37-01(A) states "[t]he affiliate standards shall also apply to any internal merchant function of the electric utility whereby the electric utility provides a competitive service." The SSO is a competitive service, so it must be treated as if provided by an affiliate of AEP. I have incorporated the NARUC Guidelines into this testimony because AEP's SSO business acts like and must be treated like an affiliate in the market.

The NARUC manual and guidelines provide guidance as to the proper assignment and allocation of the costs between the "affiliates." NARUC very specifically states that the objective of its Guidelines is to "lessen the possibility of subsidization in order to protect monopoly ratepayers and to help establish and preserve competition in the electric generation and the electric and gas supply markets."[39] In fact, to ensure the competitiveness of markets, NARUC states that generally, "the price for services, products and the use of assets provided by a regulated entity to its non-

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[38] NARUC Guidelines at Section B.4 (emphasis added).
[39] *Id.* (emphasis added).

regulated affiliates should be at the higher of fully allocated costs or prevailing market prices."[40] As noted above, Ohio defines fully allocated costs as the sum of direct costs plus an appropriate share of indirect costs. This is exactly the approach taken in the analysis presented in this testimony.

B. AEP'S COST ALLOCATION STANDARDS

Q. HAVE YOU READ AEP'S COST ALLOCATION MANUAL?

A. I have reviewed a document entitled "American Electric Power, Cost Allocation Manual as of December 31, 2019" ("AEP-CAM").[41] The document lists "Corporate Accounting" as the author.

Q. DOES THE AEP CAM REFERENCE ALLOCATIONS TO STANDARD SERVICE OFFER?

A. It does not specifically reference allocations to the SSO. I reference it, however, because it clearly shows that AEP knows and understands that it has an obligation to allocate costs to its businesses in an appropriate manner. For example, the very first sentence of its corporate allocation overview states "AEP's internal guidelines applicable to cost allocations are designed to result in a fair and equitable allocation of costs."[42] It continues, "Unless otherwise exempted, the AEP

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[40] *Id*. at Section D.1.
[41] "American Electric Power, Cost Allocation Manual as of December 31, 2019;" available at https://www.aep.com/assets/docs/requiredpostings/TariffFilings/AEPOpCos-2020ATRR/13CostAllocationManual-12-31-19.pdf.
[42] *Id.* at Section 02-02-01.

companies allocate costs between regulated and non-regulated operations, on a fully distributed cost basis."[43] Perhaps most importantly, the AEP-CAM states:

> "AEP's cost accounting and cost allocation policies and procedures shall not result in any cost subsidies among or between regulated and non-regulated operations. Unless otherwise exempted, all affiliate transactions for services or products will be conducted at fully allocated cost. For the transfer of capital assets, fully allocated cost shall equal the net book value of the capital asset.
>
> "The term 'affiliate transactions' refers to all transactions between the utility and any separate affiliate company, both regulated and non-regulated, including all transactions between a utility's regulated operations (above-the-line) and non-regulated operations (below-the-line)."[44]

I have included relevant pages of AEP's Cost Allocation Manual as Exhibit FPL-6.

This discussion in the AEP-CAM of transactions that are "below-the-line" with respect to the utility's regulated operations is descriptive of the SSO business. Clearly, the SSO business is not part of AEP's regulated distribution operations. The AEP-CAM shows clearly that on paper, AEP understands the importance of not subsidizing a business that is competing in the markets. That purpose is the fundamental reason for allocating costs appropriately to the standard service offer.

Q. DOES AEP APPLY ITS OWN COST ALLOCATION PHILOSOPHY TO THE COSTS OF PROVIDING THE SSO?

A. No. It does not.

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[43] *Id.* at Section 02-02-02.
[44] *Id.*

Q. HAS AEP REASONABLY ALLOCATED COSTS TO THE SSO?

No. Mr. Roush stated that "the Company has prepared a quantitative and qualitative analysis of its costs related to the provision of SSO service that are included in its distribution cost of service and the costs related to shopping service that are included in the distribution cost of service."[45] In that analysis, the only costs AEP included were uncollectible SSO generation expenses and portions of the PUCO and OCC assessments. Notably, he identifies these costs as costs "to be <u>assigned</u>" to non-shopping customers.[46] That language is not accidental. The costs identified in that analysis are all "direct costs". These costs should be <u>assigned</u> to SSO. However, neither Mr. Roush nor any other individual within AEP presented any analysis of shared costs or indirect costs required to operate the SSO business. In other words, AEP's analysis of <u>indirect costs</u> yielded an allocation of exactly zero dollars of indirect costs to SSO. It is simply not possible to run the SSO business if the only resources available to it were an allowance for uncollectible costs and money to pay for the PUCO and OCC assessments.

Q. IS IT POSSIBLE THAT AEP'S SSO BUSINESS DOES NOT INCUR THESE COSTS, PROVIDING IT WITH A COST ADVANTAGE OVER SUPPLIERS?

A. No. The elements included in an appropriate allocation are costs that any business would incur. AEP has chosen not to allocate a reasonable share of those indirect

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[45] Roush Testimony at 11.
[46] *Id.* at 12.

costs to the SSO. Their cost advantage is one of accounting tactics only and the Commission should not allow AEP to continue the practice of hiding SSO costs in distribution rates.

Q. DOES AEP HAVE AN INCENTIVE TO UNDER-ALLOCATE COSTS TO THE STANDARD SERVICE OFFER?

A. Yes. As identified in the Guidelines, NARUC observed that utilities have a "natural business incentive" to include costs of competitive service in regulated rates. AEP has a strong "natural business incentive" to shift costs to the distribution company in order to keep the standard service offer rates below cost and maintain their customer base.

This incentive is not new or unique to electricity providers. It was observed and written about in the 1980s when the telecommunications industry was being deregulated. Timothy Brennan, an anti-trust lawyer for the U.S. Department of Justice and later a professor of economics at George Washington University, wrote about a hypothetical "hot dog monopolist" who could put his competitors in the sausage business out of business by hiding costs of sausage in the regulated hot dog business.[47] He wrote:

> Suppose the monopolist enters the sausage business, which is assumed not regulated. The competitive price of sausages in the market is 45¢. Assume that the expense for the pork used to make sausages can be assigned to the hot dog business. In other words, the hot dog regulator cannot tell whether the firm's purchase of pork went into the making of hot dogs or into the making of sausages.

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[47] Brennan, Timothy, "Why regulated firms should be kept out of unregulated markets: understanding the divestiture in *United States v. AT&T,*" *The Antitrust Bulletin,* Fall 1987.

> The hot dog manufacturer has the incentive to allocate pork used to make sausages to the hot dog side of the business, up to 25¢ per hot dog. At that point, the regulated price of hot dogs rises to $1. Profits are taken through selling sausages at 45¢, while the apparent costs are lower due to the shifting of pork costs to the production of hot dogs.[48]

The Brennan example is analogous to the AEP practice of cross-subsidization of the SSO. It is using regulated distribution rates, including rates paid by shopping customers, to subsidize the provision of the SSO. Mr. Brennan concludes that the impact of such cross-subsidizations leads to sub-optimal outcomes:

> This may result in an increase in its share of the competitive market over what it would have been had the costs not been misallocated. At the margin, this may result in the displacement of more efficient capacity of unaffiliated firms by less efficient capacity of the regulated firm. In the extreme, more efficient suppliers of the competitive product may be excluded altogether. This ability arises not from the regulated firm's efficiencies, but because its costs may be borne by customers of its regulated product through cost misallocation.[49]

We do not know what the total impact of this SSO cross-subsidy has been to date. However, we know that over the past several years, AEP has repeatedly attempted to participate in various generation functions. Additionally, AEP has publicly expressed its intent to expand the scope of its future distribution investments and advanced legislation in Ohio that would allow AEP to pursue behind the meter technologies.[50]

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[48] *Id.* at 759-760.
[49] *Id.* at 760.
[50] American Electric Power, "Leading the Way Forward," 54th EEI Financial Conference, November 10-12, 2019 (Exhibit FLP-15) at 37, 40.

As long as the subsidy continues, it will limit competition, potentially leaving the door open for regulated energy services. For example, a firm who might have had a new innovative renewable product could have been kept out of the market. The best demand management practices could have been sidelined. Companies with newer, better ideas could have been dissuaded from entering the market. We know, however, that going forward, the same patterns will emerge. CRES providers will be limited in the products and services that they will be willing to provide. Potential market entrants will be less likely to enter. We do know that the subsidy provides the appearance of a lower SSO cost to consumers. That has allowed AEP to keep a large market share of the residential generation customers. Ultimately, this subsidy harms consumers as they are not getting a lower price – they are paying for SSO in distribution rates. It limits competitive options. Left uncorrected, consumers will continue to over-pay for distribution services and in return, they will receive fewer energy options.

C. GENERAL UTILITY PRICING PRINCIPLES

Q. ARE YOU FAMILIAR WITH THE BONBRIGHT PRINCIPLES?

I am. They are typical principals cited in many rate proceedings. James Bonbright was a finance professor at Columbia University and published in 1961 the "Principles of Public Utility Rates", which is to this day, considered by most, to be the seminal writing on public utility rates.

Q. COULD YOU PLEASE SUMMARIZE SOME OF THOSE PRINCIPLES?

A. Yes. They are the typical principles cited in most rate proceedings or discussions about regulated rate making. Dr. Bonbright advocated one principle that is very applicable to this proceeding. Dr. Bonbright articulated a principle that a competitive price should be the norm of regulation. He stated specifically that:

> "Regulation, it is said, is to be a substitute for competition. Hence, its objective should be to compel a regulated enterprise, despite its possession of complete or partial monopoly, to charge rates approximating those which it would charge if free from regulation but subject to the market forces of competition. In short, regulation should be not only a substitute for competition, but a closely imitative substitute."[51]

This concept is directly applicable to this proceeding, and AEP fails to meet this principle.

Q. PLEASE EXPLAIN.

Neither AEP's proposed distribution rates nor its SSO rates are designed as if they are subject to the market forces of competition. Instead, its rates appear to be designed to capture the "natural business incentive" of concern in NARUC's Guidelines, by subsidizing the competitive product with services from the regulated entity, with a captive customer base and a guaranteed collection of rates. AEP's SSO rates are priced at a level that is under-market and the corresponding

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[51] Bonbright, James C. "Competitive Price as a Norm of Rate Regulation." *Principles of Public Utility Rates*, Columbia University Press, 1961, pp. 93–93.

distribution rates, which are not competitive, are priced above where they should be.

D. SOUND BUSINESS ACCOUNTING AND PRICING PRACTICES

Q. IS IT COMMON BUSINESS PRACTICE TO ALLOCATE COSTS TO DIFFERENT BUSINESS UNITS AND SEGMENTS?

A. It is common and prudent business practice to allocate an appropriate amount of costs to any business or business unit so that management can better understand the practical implications of running that line of business. According to the Corporate Finance Institute, "Cost allocation is an important process for a business because if costs are misallocated, the business might make wrong decisions to overprice/underprice a product or invest unnecessary resources in non-profitable products."[52]

Allocation of costs to different businesses or business units is not a novel concept in utility ratemaking. Utilities, including AEP in this rate proceeding, allocate indirect costs to varying business units and cost centers on a regular basis. In fact, this rate case is premised almost entirely on allocating indirect costs to certain customers and customer classes. AEP witness Buck testifies that "The cost allocation methodology used in the CCOSS assigns costs among the customer classes in a fair and equitable manner based on principles of cost causation."[53]

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[52] Corporate Finance Institute, "Cost Structure: The different types of expenses incurred by a business" available at https://corporatefinanceinstitute.com/resources/knowledge/finance/cost-structure/.

[53] Buck Testimony at 2-3.

My testimony does not take issue with allocations to any customer classes. However, AEP falls short in the next step of the required allocations, allocating no indirect costs incurred by the SSO business to that service. The failure to allocate an appropriate level of costs to the SSO will continue to result in anti-competitive pricing structure for SSO, and rates for distribution customers that are not just and reasonable. I have identified the set of costs that are incurred in the provision of SSO and have calculated the costs that should be allocated to the Retail Reconciliation Rider.

V. <u>THE APPROPRIATE ALLOCATION</u>

Q. COULD YOU PLEASE EXPLAIN BRIEFLY THE DIFFERENCE BETWEEN ASSIGNING AND ALLOCATING COSTS AND HOW THEY RELATE TO THE COSTS AT ISSUE IN THIS PROCEEDING?

Yes. Costs can generally be divided into two categories – direct and indirect. Direct costs are assigned. Indirect costs are allocated. Direct costs should be "assigned" to the business unit that incurs the cost. For example, in the provision of the SSO, uncollectible generation expense is a direct cost. The uncollectible generation expense should be <u>assigned</u> to the SSO. A simple test to determine if a cost is a direct cost is to evaluate whether it would go away if the product or service goes away. In my example, if AEP no longer provided the SSO, there would be no uncollectible generation expense for that service. Therefore, the uncollectible expense for generation is a direct cost that should be assigned to the SSO business. Likewise, a portion of the PUCO and OCC assessments that AEP pays are directly assignable to the SSO, because AEP's assessment is determined by its total intrastate revenue (a portion of which is generation revenue).

Indirect costs, by contrast, are those costs that are incurred for more than one purpose. A very obvious example of an indirect cost incurred in the provision of standard service offer is the billing system and all of the employees and other expenses related to billing. These resources are certainly utilized in the provision of the SSO every time AEP bills a customer for SSO service. If the SSO went away, AEP would still be utilizing the billing system for its distribution business. Therefore, the billing system and its costs are shared or indirect costs that must be <u>allocated</u> to the businesses for which it provides services.

Q. DO OHIO PUBLIC UTILITY REGULATIONS ACKNOWLEDGE THE DIFFERENCE BETWEEN DIRECT AND INDIRECT COSTS?

They do. Ohio public utility regulations state, "Fully allocated costs are the sum of direct costs plus an appropriate share of indirect costs."[54]

Q. WHAT IMPACT WILL THE ALLOCATION YOU ESPOUSE HAVE ON STANDARD SERVICE OFFER RATES?

A. If the Retail Reconciliation Rider and the SSO Credit Rider are implemented correctly, the total cost to all customers will not increase. SSO customers will see a slight increase in the SSO rate. They will also receive a credit through the SSO Credit Rider. Shopping customers (who are already paying charges to their CRES provider for similar categories of costs that are also incurred by AEP Ohio in

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[54] Ohio Administrative Code §4901:1-37-01(G).

providing the SSO) will not see an increase with the Retail Reconciliation Rider and will see a slight decrease in distribution rates though the SSO Credit Rider. As described below, I have identified an allocation pool of costs shared by both businesses of $190 million. After allocating that pool of resources to SSO, I calculate that the total allocation to the Retail Reconciliation Rider should be about $64.4 million.

Q. HOW WAS THIS AMOUNT CALCULATED?

A. I reviewed AEP's rate study included in AEP's rate analysis is Schedule E-3.1, sponsored by AEP witness Douglas Buck.[55] Mr. Buck testified that this Schedule "includes only the customer component of the CCOSS."[56] Because Mr. Buck attempted to remove all of the non-customer costs in this Schedule, I used this as the starting point of my analysis. Using this as my starting point, I investigated the costs that still remained and investigated by way of reading the FERC Uniform System of Accounts for each entry to ascertain whether any of the costs remaining in his analysis were related in any way to the provision of the SSO. I made a few modifications to his analysis, removing costs that I could only conclude were directly assignable to the distribution business.

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[55] Mr. Buck's testimony was subsequently adopted by Mr. Roush.
[56] Direct Testimony of Douglas Buck ("Buck Testimony") (June 15, 2020) at 3.

Q. COULD YOU PLEASE EXPLAIN HOW OR WHY THE COSTS YOU IDENTIFIED ARE USED IN THE PROVISION OF THE STANDARD SERVICE OFFER?

These categories of costs have been specifically identified based on the descriptions of the accounts in FERC Uniform System of Accounts[57] or because of AEP's own description of cost elements within the pools, as follows:

- Customer Accounts expenses are captured in FERC Accounts 901-905 and are intended to cover expenses related to operations of the customer care center, including supervision, collections and account management, postage, bank fees and other expenses related to customer care. Many of these costs are driven, at least in part, by the provision of SSO.
- Customer Service & Information includes costs that are captured in FERC Accounts 906 – 910 and are intended to capture miscellaneous customer items such as efficient use of equipment, customer education, printing, postage, and other miscellaneous expenses.
- A&G costs are captured in FERC Accounts 920 – 931 and capture costs for administrative salaries, office supplies, consulting costs, accountants and auditors, insurance, pensions and benefits, regulatory commission expenses and office rents.
- Depreciation & Amortization costs are captured in FERC Account 403. Only a small percentage of AEP's annual depreciation expense has been allocated to SSO and that allocation included depreciation on items such as general plant.

Q. COULD YOU DESCRIBE THE ADJUSTMENTS YOU MADE TO THE SCHEDULE SPONSORED BY MR. BUCK?

A. Yes. I made several adjustments to his assumptions in the Rate Base section of his spreadsheet. Mr. Buck included costs from Accounts 369, 370, 371, 372, and

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[57] *See* FERC Uniform System of Accounts, 18 C.F.R. Part 101, viewed at https://www.ecfr.gov/cgi-bin/text-idx?c=ecfr&SID=054f2bfd518f9926aac4b73489f11c67&rgn=div5&view=text&node=18:1.0.1.3.34&idno=18

373 to his "customer" costs. I removed all of the costs from Accounts which appeared to be distribution materials related to street lighting accounts. I made the corresponding adjustments for the distribution O&M expense categories that he included. I also eliminated just over $40 million in expenses related to the DSM programs and a few others.

Q. DID YOU ADD ANY EXPENSES TO MR. BUCK'S ASSESSMENT OF "CUSTOMER COSTS"?

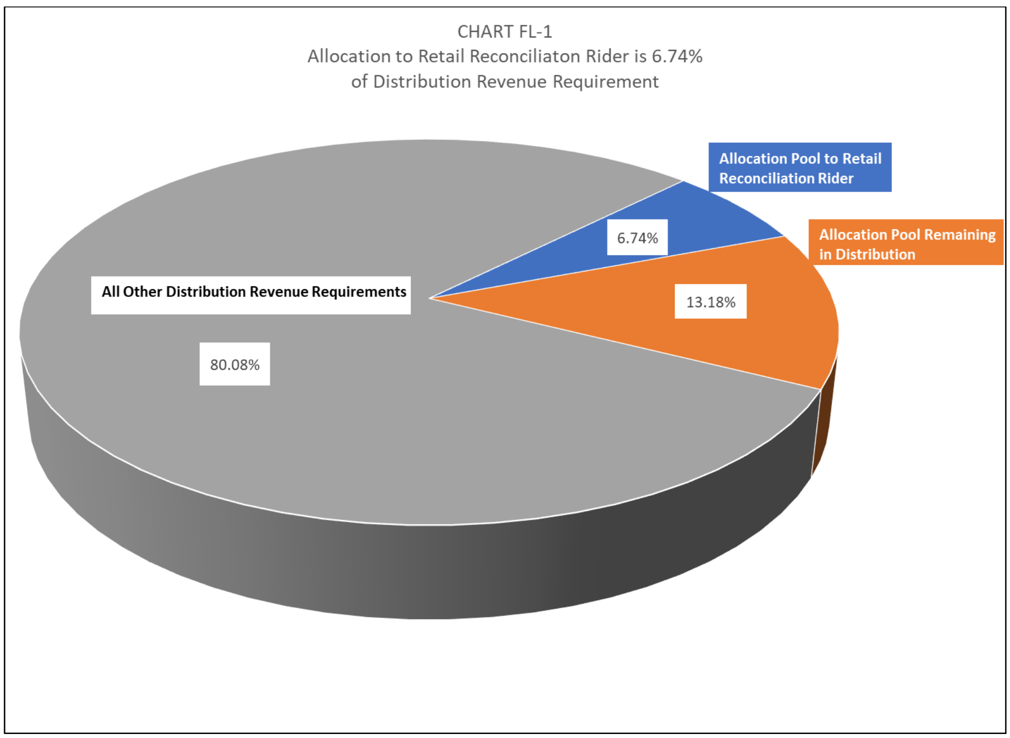
A. I did not.

Q. COULD YOU PLEASE DESCRIBE THE RESULTS OF YOUR ANALYSIS?

A. Yes. In my base case, the pool of resources that needs to be considered when allocating costs to the SSO is $190 million. An appropriate allocation, based on a combination of revenue-based or customer-based allocators, of a portion of the $190 million shared cost pool yields a total charge of $64.3 million to the Retail Reconciliation Rider (versus the $3.5 million allocation identified by Mr. Roush). After those funds are collected from SSO customers by AEP, it would then be refunded to all of its distribution customers through the SSO Credit Rider, resulting in no net increase in costs to customers and no net increase in revenue to AEP. At today's electricity shopping rates, this equates to a $0.0057 per kWh charge, offset by a $0.0015 per kWh credit.

The spreadsheet supporting these numbers is presented as Appendix 1 to this testimony.

AEP's revenue requirement proposed in the settlement is $955 million and includes a total rate base of $3 billion. As shown in Chart FL-1, the total allocation pool is only about 20% of the distribution revenue requirement. I am proposing that a mere 6.74 percent of the revenue requirement be moved to the Retail Reconciliation Rider.



Q. WHAT IS THE SIGNIFICANCE OF A 5.7 MILL INCREASE PER KWH IN THE PRICE FOR SSO?

A. I recognize that 5.7 mills (57/100th of one cent) per kWh may seem like a slight difference in price, and it is when talking about most products. However, in relative terms, it indicates that AEP's SSO rate, which is currently 5.03 cents per kWh for the residential customer class, is understated by about 11 percent.[58] A similar disparity on a gallon of gas would have the competitive market supply gas at $3.00 per gallon, but the "incumbent monopoly" providing a gallon of gas at $2.69 per gallon. That kind of price differential is fundamentally misleading to consumers when they are looking at prices being offered by suppliers and deprives them of the information that is needed to compare prices and services on a fair and accurate basis. This is significant so that customers receive adequate and accurate information enabling them to make informed choices regarding the purchase of any electric services. As consumers shop for generation supply, they are constantly reminded of the price. Specifically, AEP publishes a price to compare on its electricity invoices. When the SSO rate is inaccurate by 11 percent, consumers are being misled and cannot meaningfully compare it to offers in the market. In short, AEP's SSO customers are not being provided adequate information that is needed to enable them to make informed choices regarding the purchase of electricity. I have attached a sample AEP invoice, found on the AEP website, as Exhibit FPL-5. Additionally, the shadow billing component of the proposed settlement will aggregate all supplier sales and compare the prices (wrongly) to the SSO price. This will provide the Staff and OCC inaccurate

[58] The SSO rate, or the "Price to Compare," is the sum of the following charges found in AEP's Standard Service Offer Tariff: Generation Energy Rider (Tariff Sheet 467); Generation Capacity Rider (468); Auction Cost Reconciliation Rider (469); and Alternative Energy Rider (492).

comparisons and could potentially lead to policy decisions that are not in the best interest of Ohio energy consumers.

Q. WHAT HAPPENS IF AND WHEN MORE CUSTOMERS MIGRATE TO COMPETITIVE SUPPLY?

The pool of costs from which the SSO allocation is made will always stay the same (until base rates change). However, the allocation percentages to SSO will be lower if customers migrate to competitive supply because many of the allocators are based on the revenue split between the SSO and distribution businesses and that ratio will change periodically.

The Retail Reconciliation Rider and the SSO Credit Rider were designed to work in tandem so that regardless of the number of customers shopping, or the SSO rates, an appropriate amount of costs will be allocated to SSO. In the scenario where only one customer remains on SSO, the allocation pool remains the same, but the allocation to SSO would be only $120 for the year. Table FL-2 shows that this equates to 1 cent per kWh[59].

[59] It is likely that this 1 cent per kWh is overstated, because at the point when only one customer remains on SSO, it is likely that the SSO model will have changed significantly and that some of the costs borne by AEP today to serve SOS will be greatly reduced or eliminated.

Table FL-2			
One Customer Remains on SSO			
[a]	Customer Annual kWh		12,000
[b]	SSO Price/kWh		0.05030
[c]	**Total SSO Revenue**	[a]*[b]	**$ 603.60**
[d]	Distribution Revenue		955,100,928
[e]	Allocation to SSO	[c]/[d]	0.000063%
[f]	Allocation Pool		190,244,486
[g]	Allocation to SSO	[e]*[f]	120.23
[h]	Customer Impact		
[i]	Customer Allocation		120.23
[j]	Cost/kWh	[i]/[a]	$ 0.0100

The Retail Reconciliation Rider and the offsetting SSO Credit Rider can be adjusted as frequently as desired. As long as the adjustments come with customer true-ups to account for mid-month meter readings and other technical details, customers will always be paying and AEP will always be collecting its full revenue requirement and nothing more.

VI. <u>CHOICE PROGRAM COSTS</u>

Q. IN THE ESP IV ORDER, THE COMMISSION DETERMINED THAT AEP SHOULD ALSO ANALYZE ITS ACTUAL COSTS ASSOCIATED WITH THE CHOICE PROGRAM IN ITS NEXT RATE CASE. SHOULD THAT EXERCISE BE CONSIDERED IN THE ALLOCATION OF COSTS TO THE SSO?

A. No. The two issues are not related. Mr. Roush netted AEP's "certain choice-related costs" associated out of the cost pool that it suggests should be assigned to the SSO business. The explicit costs included in this category are not described by Mr. Roush, other than in his "analysis" which labels these costs as "Provider Support Costs" and an amortization of "Choice-specific IT costs." Netting these costs from the allocation pool is incorrect from a business perspective and also from a policy perspective. It is suggested by Mr. Roush only to minimize the appearance of the cost of SSO, further harming customers and the competitive market.

Q. CAN YOU PLEASE EXPLAIN WHY THAT IS INCORRECT?

Yes. From the policy perspective, in the ESP IV Order, the Commission stated "[f]ollowing a thorough analysis of AEP Ohio's distribution rates in the rate case, the Commission will determine whether it is necessary to reallocate costs between shopping and non-shopping customers, in order to ensure that the Company's rates are fair and reasonable for all customers."[60] Apparently, Mr. Roush assumed that meant he should net out choice costs from the costs allocated to the SSO. It does not mean that at all. As the market is designed today, operating the choice program is a function of distribution service, i.e. a monopoly service provided to customers by AEP. For example, AEP remains responsible for collecting and disseminating customer usage and billing information to suppliers. Only the AEP can rescind or facilitate a customer switch. AEP recovers the costs for these functions in its base distribution rates. Operating the SSO business, on the other hand, is separate and distinct from distribution, as borne out in this rate proceeding. Energy revenues from SSO are not a part of the distribution business. From a business perspective, it might be an interesting exercise to understand what operating the choice program costs AEP. In fact, if I was running the utility, I would want to know the cost

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[60] ESP IV Order at ¶ 215.

structure of the choice program as the choice program is an important policy element that is being implemented by the utility, but understanding the costs does not mean that that they should be allocated to any particular group of customers.

From a policy perspective, it makes no sense at all to net those costs out of the costs of providing the SSO. The choice program falls into one of three categories. It is either part of AEP's distribution business; it is part of AEP's SSO business; or it is something separate and distinct from those two businesses. After identifying its classification, the Commission's challenge is then to figure out how to fund that program. Its options are to charge all customers, charge choice customers, or charge just SSO customers. Drawing on standard rate making principles, the clear answer is to charge all customers for the costs of the choice program, for all customers benefit from the choice program.

The choice program benefits all customers – not just those who choose an alternative supplier. The simple fact that choice exists helps moderate SSO prices. The threat of customer migration to a CRES provider forces wholesale electricity suppliers to bid more competitively. Additionally, the choice program provides all customers with an option (which is value) to move to a better service. The option allows customers to move back and forth between suppliers and/or the SSO and purchase the energy products and services that best fit their needs and desires. A simple example of a choice customer who moves back to SSO reveals the flawed logic of assessing the costs of operating the market to shopping customers. This customer exercises a choice to move back to SSO (perhaps to avoid being assessed with the charges of the choice program), and still has a choice to move back to a supplier (and will do so if prices fall enough to offset the burden of the choice program payment). But by Mr. Roush's logic, all the while on SSO, the customer would not have to pay for the choice program.

Finally, Mr. Roush's testimony also reveals clearly the flawed logic. Over half of the costs he suggested are choice program costs are fixed costs (and perhaps all are fixed). He included $638,000 in depreciation expense (fixed) and $565,000 in labor expense (which is probably fixed) in his analysis of choice program costs. In the instance with only one choice customer, that customer would have to pay $1.2 million annually for the right to be served by someone other than AEP. Of course, that scenario is highly unlikely in the near-term, but proves the fallacy of the logic of applying those costs to choice customers only.

The analysis from the business perspective is also clear. In a cost allocation exercise, the goal is to align costs to operate a business with that business. So, if the choice costs are related to operating the SSO business, they should be allocated to that business, not netted out of the allocation. If they are not related to the SSO business, they should be ignored for the purposes of the allocation. In no scenario does it make sense to reduce the allocation of costs to SSO because costs are incurred to run the choice program.

Q. DO SUPPLIERS CURRENTLY PAY FOR MANY OF AEP'S CHOICE PROGRAM COSTS?

A. They do, through a variety of fees imposed on them by AEP.

Q. DID THE STAFF REPORT ADDRESS THE MYRIAD OF FEES THAT AEP ASSESSES TO RETAIL CHOICE SUPPLIERS?

A. It did not.

Q. WHAT FEES DOES AEP ASSESS AGAINST CRES PROVIDERS?

A. It charges a Switching Fees, an Interval Data Fee, and Supplier Registration Fee, among others.

Q. HOW MUCH HAS AEP COLLECTED FROM CRES PROVIDERS FOR THESE FEES?

A. The following fees have been collected from CRES Providers between 2014 and 2020:[61]

Switching Fees	$3,464,445
Interval Data Fees	$98,070
Supplier Registration Fees	$15,400
Registration Renewal Fees	$26,800
Pre-Enrollment Customer List Fees	$6,750
Enroll From Your Wallet Fees	$25,000
Supplier Consolidated Billing Pilot Program Development Fees	$1,000,000
Total Fees	**$4,636,465**

Q. WHAT GIVES AEP THE AUTHORITY TO ASSESS THESE FEES?

AEP's Supplier Tariff allows AEP to assess these fees. For example, Section 32.8(b) of the AEP Open Access Distribution ("OAD") Tariff says that in order to

[61] AEP Response to Direct-INT-01-001, Att. 1 (Exhibit FPL-10).

register with AEP, a CRES provider must provide "A completed copy of the Company's CRES Provider Registration Application for the State of Ohio, along with a non-refundable $100.00 registration fee payable to the Company."[62] That requirement is followed by a requirement to submit "A $100.00 annual registration fee payable to the Company which shall be due October 31 of the first calendar year following the year of the initial registration and each calendar year thereafter."[63] CRES providers should not have to pay a recurring registration fee to the utility. This is nothing more than a tax on the CRES providers. A CRES provider imposes no incremental costs on the utility because it remains in operation from year to year.

The OAD Tariff also allows AEP to charge $5.00 every time a customer switches its supplier unless it is through no fault of their own. The tariff states "A charge of $5.00 will be assessed to the CRES Provider for each transaction in which a customer authorizes a change in one or more CSPs."[64] As described above, implementation of the choice program is run by the distribution utility. It is a service that benefits all customers. The processing of a customer switch transaction should impose no cost on the utility other than the costs that are already captured in distribution rates to pay for the choice program. This fee penalizes customers (or their suppliers) who choose to exercise the right to choose an electric supplier

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[62] Ohio Power Company Terms and Conditions of Open Access Distribution Service, Section 32.8 (b), 6th Revised Sheet No. 103-31D, Effective May 3, 2019.
[63] *Id*. at Section 32.8 (c).
[64] *Id*. at Section 27, 6th Revised Sheet No. 103-23D, Effective May 3, 2019.

granted by the legislature. AEP has provided no justification to continue this assessment on choice customers. Additionally, AEP does not assess this fee to customers returning to SSO. Assessing customers when switching to a supplier, but not when switching to SSO is blatantly discriminatory and this practice should be terminated by the Commission in this proceeding.

Finally, the OAD Tariff allows AEP to charge CRES providers for a customer's historic interval usage data, stating, "Requests from the CRES Provider to the Company for customer load data will be submitted to the Company and provided back to the CRES Provider using standard electronic format at no charge. Requests for manually prepared interval load data reports will be provided at a charge of $50 to the CRES Provider."[65] For several reasons, this is an outdated policy and should be rejected by the Commission. Most notably, AEP should not be in a situation where it must manually process a supplier's request for a customer's historic interval usage data. Modern day computer systems should allow this process to be done in an automated fashion and with no delay. In fact, AEP should not even have to get into the middle of the data review effort. More important, however, is that this is a financial impediment on the delivery of advanced energy products and services.

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[65] *Id*. at Section 32.22 (m), 6th Revised Sheet No. 103-53D, Effective May 3, 2019.

These fees run counter to the development of a robust competitive energy market. AEP collects its costs for running the choice market, including data management costs in its distribution rates. AEP has made no attempt to show that choice costs including data management are not already included in base rates, nor has it attempted to show that these services impose incremental costs on the utility that would somehow warrant the charges. As a result, at a minimum, AEP is shifting distribution costs to shopping customers and CRES businesses. It is also possible that AEP is over-recovering for services provided to run the choice market. These charges impose a burden on the choice market, which only exacerbates the inequity of the lack of allocation of costs to SSO that is discussed throughout this testimony. AEP is subsidizing its own service with distribution rates and over-collecting from CRES providers as they attempt to serve customers.

VII. THE RETAIL RECONCILIATION RIDER AND THE SSO CREDIT RIDER MECHANISMS

Q. ARE YOU FAMILIAR WITH THE RETAIL RECONCILIATION RIDER AND THE SSO CREDIT RIDER MECHANISMS THAT ARE APPLIED TO SSO RATES IN OHIO?

A. I am.

Q. COULD THE RETAIL RECONCILIATION RIDER AND THE SSO CREDIT RIDER BE UTILIZED TO IMPLEMENT AN APPROPRIATE COST ALLOCATION MECHANISM THAT WOULD KEEP BOTH AEP AND THE CUSTOMERS WHOLE FINANCIALLY?

Yes. They are designed to operate in tandem to accomplish that goal exactly.

Q. COULD YOU EXPLAIN HOW THE RETAIL RECONCILIATION RIDER AND THE SSO CREDIT RIDER MECHANISMS COMBINE TO ENSURE THAT AEP IS MADE WHOLE FINANCIALLY?

A. Yes. The Retail Reconciliation Rider should include two types of costs related to SSO service. The first is the direct costs associated with providing SSO that might not be recovered in other riders. These costs are costs that would simply go away if AEP did not offer the SSO. The direct costs of providing the SSO should not be included in distribution rates because they are not in any way related to distribution service.

The other category of costs is indirect costs, or shared costs, of resources used to serve both the distribution business and the SSO. A portion of the indirect costs is allocated to the Retail Reconciliation Rider. However, in making this allocation, these costs are not removed from distribution rates. As AEP collects SSO revenues from customers, including the Retail Reconciliation Rider, it is temporarily "over-collecting". However, it then credits these collections to all distribution customers through the SSO Credit Rider. Without the crediting mechanism, AEP would over-collect every month. These mechanisms are already adopted in Ohio and if implemented properly, will deliver a more accurate and fairer rate for energy to customers and ensure AEP is made whole as customers migrate back and forth from the SSO.

Q. WHAT HAPPENS IF THE RETAIL RECONCILIATION RIDER IS TOO LOW?

A. Without an appropriately priced Retail Reconciliation Rider, SSO service would have an unfair pricing advantage over retail suppliers and Ohio's competitive retail market will be biased toward AEP's SSO service. This will continue to be the scenario if the Commission adopts either Mr. Roush's testimony on this issue; accepts Staff's recommendation; or accepts the provision in the proposed settlement to set the riders at zero.

A. SCOPE OF THE RETAIL RECONCILIATION RIDER

Q. HAS AEP OR THE STAFF REPORT APPLIED AN APPROPRIATE SCOPE OF COSTS TO ITS PROPOSED RETAIL RECONCILIATION RIDER?

No, they have not. AEP has materially understated the amount of costs that it incurs in the provision of SSO. In its Application, AEP includes only direct costs for uncollectibles and the PUCO and OCC assessments. It did not include any other direct costs or any indirect costs, including staffing, billing, IT, rent, computers, or any other shared expenses. Even worse, the Staff Report failed to evaluate or propose to allocate any costs to the SSO.

Q. WHAT IS THE MAGNITUDE OF COSTS THAT AEP PROPOSED FOR THE RETAIL RECONCILIATION RIDER?

A. AEP has proposed that approximately $3.5 million be assigned to the Retail Reconciliation Rider for all customer classes.

Q. WHAT IS THE SIZE OF AEP'S SSO BUSINESS?

A. According to AEP's response to IGS-INT-05-001, AEP's SSO business is expected to account for approximately $550 million in revenue. As recently as 2018, it accounted for $962 million in revenue (AEP Response to IGS-INT-03-025). I have attached these Interrogatory responses as Exhibits FPL-7 and FPL-8 respectively.

Q. IS IT REASONABLE TO BELIEVE THAT A BUSINESS WITH REVENUES BETWEEN $500 MILLION AND $1 BILLION COULD OPERATE WITH ONLY THE COSTS THAT AEP ASSIGNED TO IT?

No. By way of simple example, with its proposed cost structure, the SSO business could not even issue bills to its customers. AEP would not have anyone to pay the winning bidders of the SSO, would go into supplier default in a matter of days and would be in bankruptcy shortly thereafter. AEP did not include any IT expenses, any expenses for computer equipment, communications, rent or insurance or any expenses for executive time. It did not even include any costs for personnel to count and account for the revenues it received.

Q. WILL THE FULL ALLOCATION OF UTILITY COSTS TO THE RETAIL RECONCILIATION RIDER ENSURE THE INTEGRITY AND FULL FUNCTIONALITY OF THE COMPETITIVE ENERGY MARKETS?

A. This allocation reflects a significant step toward a fully robust competitive market. There are several other market issues currently before this Commission in other proceedings, all intended to improve the competitiveness of the market. Those aside, the long-term integrity and full functionality of the market is dependent on a full and fair allocation of utility costs to the standard service offer. It will provide many benefits to the market including an energy price that is reflective of the true cost to provide that energy, and one that will allow customers to more meaningfully compare competitive offerings. Perhaps most importantly, it will eliminate the subsidy that is currently occurring when competitive market customers are paying for SSO customers' services from the utility, spurring more competition in the market and bringing more value-added services to the market.

VII. SHADOW BILLING

Q. HAVE YOU REVIEWED THE SHADOW BILLING PROVISIONS IN THE PROPOSED SETTLEMENT?

A. I have.

Q. WILL THE SHADOW BILLING PROCESS LEAD TO GOOD POLICY OUTCOMES?

A. No. It can only lead to bad policy outcomes.

Q. CAN YOU PLEASE EXPLAIN WHY THAT IS?

A. Yes. The Shadow Billing form, presented as Attachment D to the proposed settlement, seeks to calculate Cumulative Savings by customers who are taking competitive supply service. This concept is flawed from the outset for many reasons. First, the SSO is nothing more than a default service. It is one of many products available to customers, but it is in no sense a "better" product or a "benchmark" product. There is no justification to use the SSO as any type of baseline to which compare other products. This type of comparison has the impact of elevating the status of the SSO to something it is not. It is important to note that the policy of the state is one of customer choice. State policies do not provide any preference to the SSO. The proposed settlement conflicts with those policies and calls for further analysis to be displayed on AEP's customer invoices that will show additional computations that "reflect potential consumer savings or losses as compared to the Company's SSO." Further, one of the recipients of the Shadow Billing data will be the OCC, which will receive an annual analysis and whenever they request it. The OCC does not hold the position of Market Monitor. Market monitoring data is to be sent to the Commission or Commission Staff as required. The OCC has not justified its need to see such data.

Finally, even if such a comparison had any validity to it whatsoever, the concept and the form fall drastically short of what would be required to calculate such savings. But even before the calculation begins, the product to which all other products will be compared (the SSO rate), is undervalued, as demonstrated by this testimony. I have shown unequivocally that no indirect costs of operating the SSO business are allocated to that business. Stakeholders enabling the subsidy, notably AEP, are also endorsing the concept of the price comparison.

Customer savings cannot be measured in a vacuum. It is a very dynamic calculation. The calculation must consider other attributes, like renewable energy, efficiency products or other value-added services. For example, product ABC from a competitive supplier might include an energy efficiency measure and cut the customer's usage by 10%. Table FL-3 outlines three hypothetical products that a supplier might offer that are, on a unit basis, more expensive than SSO, but that provide the customer monthly energy cost savings.

Table FL-3

Potential Competitive Supply Customers

	SSO	Supplier (5% Premium)	Supplier (10% Premium)	Supplier (Solar)
Usage (kWh)	1,000	900	900	500
Rate	0.050	0.05	0.06	0.06
Total bill	$ 50.00	$ 47.25	$ 49.50	$ 30.00
Bill Difference	-	$ 2.75	$ 0.50	$ 20.00
Percent Difference	-	5.50%	1.00%	40.00%

The Shadow Billing calculation will show these products to be “non-savings” for the customer. This simple example shows why the Shadow Billing feature will almost certainly yield bad results and if any policy actions are taken as a result of those results, they will almost certainly be bad policy decisions.

The Shadow Billing feature can only perform elementary mathematics in a static environment. However, the market is dynamic and in order for the Commission to get an accurate valuation of the retail electricity practices, a customer-by-customer analysis would need to occur and each customer will need to be queried individually. For all of the foregoing reasons, the Shadow Billing concept should be rejected by the Commission.

VIII. CUSTOMER SITED RENEWABLE ENERGY RESOURCES

Q. DO YOU HAVE ANY OTHER CONCERNS REGARDING THE PROPOSED RATES?

A. Yes. Subject to Commission approval, an electric distribution utility (“EDU”) may enter into an agreement with mercantile customers for the purpose of constructing customer sited renewable energy resources.[66] Ohio law requires that the collection of any direct or indirect costs associated with these projects must solely be collected from participating customers and the EDU.[67] The law states that “[a]t no point shall the commission authorize the utility to collect, nor shall the utility ever collect, any

[66] R.C. 4928.47(A).
[67] R.C. 4928.47(B).

of those costs from any customer other than the mercantile customer or group of mercantile customers."[68]

Q. WOULD APPROVAL OF THESE RATES POTENTIALLY AUTHORIZE THE COLLECTION OF THESE COSTS FROM ALL CUSTOMERS IN VIOLATION OF OHIO LAW?

A. Yes. IGS raised these concerns in Objection E to the Staff Report. For example, AEP solicited some of its customers via letter regarding its ability to provide them with a supply of renewable energy. AEP admitted that it did not separately identify the costs associated with the development of the letter.[69] AEP also admitted that the salaries of the individuals that created the letter and the costs associated with printing and disseminating the letter would be costs typically included in the test year.[70]

Additionally, AEP admits it has been engaging its customers about providing them renewable energy, but claims "[a]ny costs associated with such conversations are incidental to the utility's customer service function and do not constitute project costs."[71] It is concerning that AEP appears to be ignoring the law's explicit prohibition on collecting *any* costs, including indirect, from non-participating customers. The failure to track and strip the cost of customer solicitations from distribution rates is

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[68] *Id.*
[69] IGS-INT-04-009(a) (Exhibit FPL-11).
[70] *Id.* at (b) & (d).
[71] AEP Response to IGS-INT-06-004 (Exhibit FPL-12).

just another example of AEP subsidizing its generation business through non-competitive distribution rates contrary to Ohio law.

Q. DID THE STAFF REPORT EXAMINE THESE COSTS?

A. No. There is no evidence in the Staff Report that a review was completed to ensure the Commission would not be authorizing the collection of these costs through distribution rates. This furthers the possibility that the Commission could be authorizing the collection of costs associated with renewable resources through distribution rates, in violation of R.C. 4928.47(B).

IX. SUMMARY

Q. COULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?

Yes. Per the terms of the ESP IV Stipulation, AEP was obligated to conduct a "thorough analysis" of its distribution costs in this current rate proceeding. The goal was to provide the Commission with the data to identify costs that are supporting SSO but are collected through distribution rates. AEP's analysis simply concluded that aside from uncollectible generation expenses and the PUCO and OCC assessments, there were negligible "qualitative costs" that are used in the delivery of the SSO and proposed that those costs should be ignored. As a result of this "thorough analysis" of these costs, AEP concluded, in error, that a grand total of zero of what was described as "qualitative" costs should be allocated to the SSO. Staff went further, saying that the AEP analysis was incomplete and should therefore be rejected altogether. As a result, in the proposed settlement, no costs are allocated to the Retail Reconciliation Rider.

AEP suggested that choice related costs should be assigned strictly to shopping customers. This is another egregious error. Choice-related costs benefit all customers, not just those who choose an alternative supplier and should be assessed as monopoly charges in distribution rates.

The argument advanced by AEP and adopted by Staff, that SSO is a default service, available to all customers and required by electric distribution companies to provide is a red herring argument for not allocating costs to the business. The purpose of an allocation exercise is to share costs between business units if more than one business unit consumes the costs. Allocation is not an exercise of assigning costs to “required” business operations; it is an exercise of placing appropriate costs with all business operation.

AEP’s analysis of the SSO-related costs is inadequate, is far from “thorough” and drastically understates the true cost of operating the SSO business. By failing to perform this analysis correctly, AEP inappropriately includes costs related to the provision of SSO in its distribution rates.

Based on my review of the proposed settlement, AEP will be allocating too many costs to its distribution business and failing to allocate costs appropriately to the SSO business, rendering both SSO and distribution rates unjust and unreasonable if the proposed settlement is approved. Under such a rate structure, AEP will be over-collecting its distribution costs, most notably from customers who have chosen a competitive supplier, and under-collecting costs related to serve SSO customers from that entire class of customers. Without an accurate SSO rate, shopping customers are subsidizing the SSO and consumers are deprived of an opportunity to meaningfully compare offers in the competitive market with the SSO rate charged by AEP. This result is harmful to customers, to CRES suppliers and to the long-term success of Ohio's competitive energy policy and environmental goals.

An appropriate allocation of costs will move approximately $64.4 million from distribution rates to the Retail Reconciliation Rider. SSO customers will pay the Rider rate and all distribution customers will receive a credit equal to the $64.4 million in collections. On net, customers and AEP will be held harmless by this allocation exercise.

My findings and analysis on the allocation issues are supported by the NARUC cost allocation guidelines, by several noted economists, by general business accounting practices and by AEP's own cost allocation manual.

Additionally, implementation of the Shadow Billing practices outlined in the proposed settlement will yield inaccurate estimations of customer savings and will potentially yield ill-advised policy decisions at a future date. As such, the Shadow Billing practices should be rejected by the Commission.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.