BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Review of the Power Purchase Agreement Rider of Ohio Power Company for 2018.	)))	**Case No. 18-1004-EL-RDR**
In the Matter of the Review of the Power Purchase Agreement Rider of Ohio Power Company for 2019.	)))	**Case No. 18-1759-EL-RDR**

INITIAL COMMENTS OF OHIO POWER COMPANY
IN RESPONSE TO THE AUDIT REPORT

Pursuant to the Attorney Examiner's December 7, 2020 Entry, Ohio Power Company ("AEP Ohio" or the "Company") submits the following initial comments regarding the compliance audit report that London Economics International LLC ("LEI" or the "Auditor") filed on September 16, 2020, regarding LEI's review of costs associated with AEP Ohio's contractual entitlement to a share of the electrical output of generating units owned by the Ohio Valley Electric Corporation (OVEC) for the period of January 1, 2018 through December 31, 2019. Overall, AEP Ohio notes that the Auditor found no instances of imprudence and recommends continuation of many practices and activities already being implemented by OVEC. AEP Ohio will address each recommendation below.

AEP OHIO RESPONSES TO THE AUDITOR'S RECOMMENDATIONS

<u>The True Up Process for the PPA Rider:</u>

The Auditor states, "The true up process between forecasted PPA charges and actual PPA charges involves a 6-month lag. Good accounting practice usually involves timely recording and charging for transactions. LEI recommends the lag be reduced from two billing cycles (six months) to one billing cycle (three months) because actual charges and energy consumption are available within that time frame. However, all true ups were accurate, despite the lag and despite some errors (which impacted forecast costs but not actual costs) in one of the rider statements." (Audit Report at 9.)

Response:

This recommendation is now moot, given that the PPA rider ended on December 31, 2019, when the General Assembly adopted the Legacy Generation Rider (LGR) under R.C. 4928.148 to collect the net costs associated with the OVEC units. *In the Matter of Establishing the Nonbypassable Recovery Mechanism for Net Legacy Generation Resource Costs Pursuant to R.C. 4928.148*, Case No. 19-1808-EL-UNC, Entry (Nov. 21, 2019).

Components of Fixed Cost:

The Auditor states, "The components of fixed costs were billed properly for the most part, based on reconciliation of the OVEC bill and the PPA Rider, though the reconciliation shows relatively small discrepancies. However, one component of fixed costs, referred to as "Component (D)" in the OVEC bill, is identified by the ICPA as a payment per common share. It is a relatively minor part of the monthly bill to the ICPA participants, though it represents a substantial share of the net profits earned by OVEC. OVEC's capital expenditures are not part of a rate base for which they are allowed a regulated rate of return." (Audit Report at 9.)

Response:

"Component (D)" is a component and a cost of the FERC-approved Amended and Restated Inter-Company Power Agreement (ICPA); the prudence or reasonableness of the ICPA is not part of this audit. "Component (D)" refers to OVEC's return on equity and is a fixed amount that never changes (a fixed rate times the amount of stock, that has not changed since the

1950s) and amounts to less than 1% of total demand charge or fixed costs. Further, taking into account OVEC's 2019 year-end total capitalization balance of $1,226,862,432, "Component (D)" results in a mere 2.22% return. In the past, a dividend has been paid back to the owners, but this payment has not occurred since 2014, well outside the scope of the audit review period.

Neither the Auditor nor the intervenors can selectively challenge individual components or the ICPA payment terms approved by the FERC. Regardless, the Company would also note that the capital charges that flow through the ICPA are more favorable than a capital carrying charge that would be rendered by a regulated public utility. In any case, while the Auditor's idle characterization of Component D as a substantial share of the net profits earned by OVEC could be misunderstood, it is ultimately inconsequential and irrelevant to resolution of this audit.

Disposition of Energy and Capacity:

The Auditor states and recommends, "OVEC energy and capacity are sold into the PJM markets; energy is offered as self-scheduled. At a high level, this would be prudent under the ICPA arrangement, as any revenue is helpful to offset costs. However, LEI's analysis showed that some of the time, the PJM energy price did not cover fuel and variable cost, though LEI's analysis did not fully evaluate a re-dispatching of the OVEC units. Markets can change, so LEI recommends that OVEC re-consider its "must-run" offer strategy (offering energy irrespective of the day ahead market price, discussed in more detail in Section 5) and utilize near-term (one week to one month) demand and price forecasts to formulate offers. During some periods of time, a must-run strategy can be optimal, but at other times it may not." (Audit Report at 9 and 10.)

Response:

The procedure for the dispatch of OVEC's generating units is determined under formal procedures established by the OVEC Operating Committee (OC), which is a committee formed under the terms of the ICPA to establish procedures for, among other things, the scheduling of the OVEC generating units. Each of the counterparties to the ICPA (Sponsoring Companies) is represented on the OC through a single representative for each group of affiliated Sponsoring Companies (*e.g.*, one representative for all of the AEP subsidiaries that are Sponsoring Companies).

In adopting the current scheduling procedures, including for offering energy into the PJM energy market, the OC reviewed other dispatch models, and considered the impact on the generating units. For instance, the OVEC generating units are designed to operate as "base load" generation and any dispatch procedure that would cause the units to cycle on and off based on scheduling and dispatch would have an adverse impact on the units, both in terms of availability and increased costs to maintain and operate the units. The current operating procedures as approved by the OC generally require that the available energy from OVEC that is allocated for bids into PJM is submitted on a "must run" basis. Further, the OC periodically reviews these procedures and considers proposals to change them from any Sponsoring Company, including review of the "must run" option for PJM bids. Any change in this bidding procedure would require the unanimous approval of the OC as such change would impact the availability of the OVEC generating units to all Sponsoring Companies, including two Sponsoring Companies that do not allocate their share of OVEC's available energy for bids in the PJM energy market. As one of several members, AEP Ohio does not control the activities of the committee and can only make its own recommendation to the OVEC sponsors. The result sought by this audit recommendation is not under the exclusive control of AEP Ohio.

Currently, a Must-Run offer produces the most value for the OVEC units due to the relationship of the units' variable costs with the PJM energy and ancillary services revenue, especially after consideration of other factors such as cycling costs, risks, or other parameters. As a result, any commitment decision must factor in the cycling timing, risks, and costs. While PJM is solving for the most economic generation to serve its next operating day (Day Ahead Market) or in the current day (Real-Time Market), it is not evaluating economics in the long-term. OVEC, through its own processes, may identify economic usage by keeping its units online during periods when its variable cost is below market price. For example, it is often more economic to run the unit during periods where it is "out of the money" so that the unit is capable of operations during periods when it is deep "in the money" to maximize potential revenues. Further, over the long-term, OVEC provides at-cost energy which acts as hedge during times of volatile and high natural gas prices.

The Commission approved the PPA Rider, in part, because it provides a financial hedge for customers. As is typically the case with any hedge, there are times when the underlying cost may exceed the market price for power and times when the cost is below the market price. For example, going into the winter of 2021-22 and facing higher gas prices, the OVEC hedge is currently expected to produce a credit for customers during this period. Regardless, OVEC's utilization of must-run is reasonable and prudent.

Fuel and Variable Cost Expense:

The Auditor states, "Coal inventories were much higher than target levels in 2019. This may indicate a problem with management of contract deliveries versus projected coal burns. However, it was trigged by an event which occurred in one month (April) in 2019 and may be an anomaly, as discussed in Section 6." (Audit Report at 10.)

Response:

OVEC's inventory levels at Clifty Creek and Kyger Creek were above target in 2019. However, the days' target inventory set for Clifty Creek (35 days) and Kyger Creek (35-40 days) is based on each plant's full-load burn capability as supported by the Fuel Procurement Strategy.[1] The actual inventory calculations utilized by LEI in the Audit of the OVEC PPA Rider of AEP Ohio were based on the plants' average burn, which reflects a higher number of days inventory. When utilizing full-load burn methodology, Clifty Creek inventory levels averaged 43 days in 2019, rather than 70 days and Kyger Creek's inventory averaged 48 days in 2019, not 80 days.

The reason inventory levels were higher than targets in 2019 can be attributed to several factors outside of OVEC's control. First, PJM power prices were lower than anticipated in 2019, reducing generation demand and increasing inventory levels. In fact, according to the PJM State of the Market Report - 2019, the PJM day-ahead energy prices decreased 28.3% compared to 2018 and real-time energy prices were lower in 2019 than any year since the creation of the PJM energy market in April 1999.[2] Planned outage extensions or maintenance outages can also affect the levels of the coal inventory, as the forecasted consumption does not materialize. Additionally, contracts for coal deliveries are typically entered into months or years in advance of when the coal is actually needed for consumption. It is OVEC's responsibility to abide by its contractual volume obligations to retain good standing and avoid legal action. When needed to help manage inventory levels, OVEC negotiates with its suppliers to defer tons to future periods if the supplier is willing to do so. In sum, there is no basis to substantiate any problem with delivery management.

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[1] See the Company's response to LEI 1.2.1

[2] https://www.monitoringanalytics.com/reports/PJM_State_of_the_Market/2019.shtml

Capital Expenses:

The Auditor states, "The process of planning and executing individual capital projects appears to be well-managed. However, it appears there is no cap on annual capital expenses. This could lead to over-investment in the plants, as the Commission does not review and/or approve the OVEC capital expenditures as they relate to the AEP Ohio PPA Rider filings (though the Commission does review construction through the power siting process)." (Audit Report at 10.)

Response:

OVEC makes decisions on the prudent and reasonable capital investment in regards to the maintenance of Kyger and Clifty Creek Plants and as such, investment is reviewed by executive management and the OVEC Board of Directors, which includes the Chief Operating Officer of AEP Ohio. AEP Ohio does not seek pre-approval for the capital investments because that is not practical in terms of the operation and maintenance of a power plant and it is not contemplated in the ICPA. Neither AEP, nor OVEC, receive a return on equity on capital investments and OVEC equity layer is less than 3%. Capital investments are just one of a number of non-fuel costs that are treated equally with other costs such as Operation and Maintenance expense that is billed to AEP Ohio as part of the ICPA. An arbitrary cap would not make sense and is contrary to the prudent and reasonable standard that is applied when making such investments.

Power Plant Performance:

The Auditor states, "The plants performed well, with some small exceptions. Plant maintenance costs during outages were budgeted reasonably at Clifty Creek, but the budgeting for Kyger Creek needs to be improved." Please see the Confidential Audit Report at page 10 for LEI's recommendation.

Response:

Based on AEP Ohio's experience and understanding, OVEC conducts projects to minimize forced outages, and reasonably budgets for its generating units. This is highlighted by the fact that OVEC units significantly outperformed the industry average with an average Equivalent Forced Outage Rate (EFOR) of approximately 6% in 2019, compared to the industry average of approximately 13% as referenced in the report. OVEC's budgets are annual estimates where spend is allocated based on scheduled activity and emergent need throughout the year. Kyger Creek's Total Budget, as referenced in Figure 58 (Audit Report at 105), was under budget for all three years reviewed. The variances in unplanned outage cost versus budget was due to completing work intended for planned outages during maintenance outages. This action reduced the future scope of the planned outages and improved reliability.

With respect to Audit recommendation listed on Page 10, OVEC evaluates all capital projects based on risk and economic benefit. For example, if a unit operates at lower operating hours, then an investment (such as included in LEI's recommendation) may not be economically justified at a given point in time. However, it is currently a capital improvement budget item for future years and is reevaluated annually with current reliability and operational data used to determine efficient timing of replacement.

Accounting Errors:

The Auditor states, "There had been some errors discovered in the previous audit, some of which were corrected by AEP Ohio for the current audit and others which were not. These errors and the follow-up are discussed in detail in Section 4. The errors did not have a material impact on customers or on AEP Ohio. LEI recommends ongoing monitoring and checking of AEP Ohio's Riders and related data for accuracy, such as were performed during the current audit." (Audit Report at 10.)

Response:

The error noted by LEI was based on the forecasted kilowatt hours used to determine the rate were not changed from the previous filing. The rider is trued up to actuals and the error noted changes the rate applied to that particular period which would impact the over/under recovery of that quarter; but the over/under balance reflects only the actual costs and actual recovery, ensuring that customers were only charged for the actual costs to be collected through the rider. The error would have created a timing difference, but the overall charges to customers would be correct – which is a normal part of the rider reconciliation process.

As noted above the General Assembly adopted the LGR to collect the net costs associated with the OVEC units. As part of the process established for the LGR going forward, the Ohio electric distribution utilities will be working directly with the Staff to determine the rates and will help ensure that such errors are not reflected in future filings relating to OVEC cost recovery. Thus, this audit recommendation has no ongoing applicability.

OVEC Operating Committee ("OC") Meetings:

The Auditor States, "The previous auditor noted that OVEC OC meetings should be held more frequently to deal with updates on each plant's operating performance, cost of serve or profit/loss statements for market-based revenues derived from the PJM markets in a more timely manner. AEP Ohio's response for the current audit indicated that they felt the current meeting schedule was adequate and do not plan to make any changes. LEI recommends more frequent meetings to discuss energy offer strategies. This could help prevent plants running when energy prices are too low to cover variable costs." (Audit Report at 10.)

Response:

As stated in the Company's comments in the previous audit review period in Case Number 18-1003-EL-RDR, AEP Ohio submits that the form of this recommendation constitutes improper micro-managing and invades upon OVEC's management discretion and function. Recommending that OVEC continue to work to develop performance improvement strategies is one thing; but recommending more frequent separate meetings be scheduled solely for that purpose at a specific time interval and requiring that certain things be chronicled in meeting minutes reflects an unnecessary and arbitrary level of detail and improperly invades the Company's management and discretion. As such, the Commission should not adopt the recommendation as written. With respect to the underlying substantive issue relating to this recommendation, the Company states as follows. The OVEC Operating Committee, per its Rules of Procedure, is required to meet at least annually. The agenda includes a review of operating performance, financial results, and forecasts. This information is also provided to the Sponsors upon request.

In further response to LEI's recommendation of more frequent meetings to discuss energy offer strategies, OVEC's Energy Scheduling department has an internal daily call every non-holiday weekday morning to review unit status and availability, including applicable unit derates, potential unit liabilities, outage status and expected unit return-to-service dates, etc. This information is used to formulate the Day Ahead unit offers into the PJM market. The Company submits that no additional action is required.

Study of Potential Ancillary Services:

The previous auditor noted that AEP Ohio should provide PUCO with a study assessing the potential participation in the ancillary services market if the plants are technically able to do so. AEP Ohio indicated that such a study is under way and will be completed by the end of 2020; the study was not available for review at the time of the audit." (Audit Report at 10 and 11.)

Response:

The Company submits that the report is not completed at this time, but is ongoing and anticipated to be complete in the first quarter of 2022 and can be addressed in a future audit.

Sliding Pressure Control:

The previous audit recommended that OVEC consider a sliding pressure control strategy to be utilized during low load periods. AEP Ohio agreed to address this with OVEC and the sponsoring parties to evaluate whether this recommendation would be appropriate; it is currently under evaluation.

Response:

OVEC's initial evaluation has determined that there is a limited potential that the Clifty and Kyger units could operate on sliding pressure. All of the units are subcritical units and the units have motor driven boiler feed pumps (BFPs), which materially reduce any potential benefit relative to units with turbine driven BFPs like many supercritical units. In addition, load response rate would be expected to slow down with sliding pressure and would cause economic consequences from the units being less responsive, which would cause an offset to any marginal heat rate gains, particularly if OVEC opts to enter into the ancillary services market.

OVEC does intend to continue to evaluate opportunities to utilize sliding pressure at low loads; however, given the initial evaluation, there is anticipation that any possible benefit from sliding pressure operation may be negated by economic impacts from slower response rates.

Performance Engineer:

The Auditor states, “The previous audit recommended that OVEC add a Performance Engineer position to the Clifty Creek and Kyger Creek organization. AEP Ohio noted in response to a data request in the current audit that this was implemented through the engineering staff in the Technical department at Kyger Creek, and the Operation department at Clifty Creek, and did not believe that any additional action was necessary.” (Audit Report at 11.)

Response:

This recommendation is already being implemented through the engineering staff within the Technical department at Kyger Creek and the Operation department at Clifty Creek, and the Company submits that no additional action is required.

Jet Bubbling Reactor (“JBR”) Scrubber:

The Auditor states, “The previous audit noted that the JBR-46 scrubber was a major availability detractor and recommended that OVEC develop a predictive maintenance program. AEP Ohio noted in response to a data request in the current audit that this was already in place and they believe that no additional action was required.” (Audit Report at 11.)

Response:

This process was implemented at the plant during the previous audit review period, and the Company submits that no additional action is required.

CONCLUSION

Consistent with the above explanations, AEP Ohio requests that the Commission address the Auditor's recommendations as set forth in these comments.

Respectfully submitted,

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CERTIFICATE OF SERVICE

In accordance with Rule 4901-1-05, Ohio Administrative Code, the PUCO's e-filing system will electronically serve notice of the filing of this document upon the following parties. In addition, I hereby certify that a service copy of the foregoing was sent by, or on behalf of, the undersigned counsel to the following individuals this 12th day of November, 2021, via electronic transmission.

/s/ Steven T. Nourse
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