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

OHIO POWER COMPANY'S MERIT BRIEF

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I. OVERVIEW

The Ohio Valley Electric Company ("OVEC") was originally formed on October 1, 1952, in response to a request from the United States Atomic Energy Commission to supply electric power and energy to meet the needs of a uranium enrichment plant built in Pike County, Ohio.[1] To serve the needs of the uranium enrichment plant, OVEC built two coal-fired generation plants – (1) the Kyger Creek Plant in Cheshire, Ohio, with a generating capacity of 1,086 megawatts (MW) consisting of five turbo-generators and (2) the Clifty Creek Plant in Madison, Indiana, with a generating capacity of 1,304 MW consisting of six turbo turbo-generators. And the Sponsoring Companies all executed the Inter-Company Power Agreement ("ICPA"), which sets forth the terms and conditions governing the rights of the sponsoring companies to receive available power from the generation stations and the obligations of the sponsoring companies to pay for the available power.

Under the ICPA, the Sponsoring Companies collectively are entitled to take from OVEC and OVEC is obligated to supply to the Sponsoring Companies any and all available power and available energy in accordance with the power-participation ratio. Ohio Power Company ("AEP Ohio") has 19.93% of the output of OVEC. Section 4 of the ICPA describes the members' entitlement to available power and energy supply from OVEC. Section 5 of the ICPA describes charges to the Sponsoring Companies. Specifically, Section 5.02 sets forth how the energy

[1] For ease in reading this summary, all citations have been removed from this section of the brief; but each and every statement made in the introduction is based on the record and is properly supported by citations in the body of the brief below.

charge will be calculated, while Section 5.03 sets forth how the capacity charge will be calculated.

In the *ESP III* case, the Commission found that the Purchased Power Agreement ("PPA") Rider as a mechanism would increase rate stability for all customers because it was designed to rise and fall in a manner that was counter to the market. On rehearing, the Commission approved AEP Ohio's modified (OVEC-only) PPA Rider proposal. The PPA Rider reflects the net charge or credit from AEP Ohio's share of the cost for OVEC units less market revenues received for liquidating the output into the market. Upon review of the orders, the PPA Rider decision cannot be reasonably interpreted as requiring PPA Rider credits in the early years or as guaranteeing that the overall projection of a modest net credit over the entire subsequent 8-year period meant that every year had to be a credit. Based entirely on the fact that the PPA Rider turned out to produce a charge, however, the intervenors now improperly ask the Commission to relitigate the same matters previously decided in the PPA Rider cases (affirmed by the Supreme Court of Ohio) and exclude all of the charges as being imprudent. Such hindsight arguments are not properly raised in an audit proceeding.

Consistent with the Commission's RFP in this case and contrary to most of the intervenor arguments that rely on hindsight, the scope of this audit should focus on the Company's actions in implementing the ICPA during the audit period (2018-2019), based on a prudence standard that reviews facts and circumstance known at the time. As the Auditor, Dr. Fagan, testified at hearing, the London Economic International, LLC ("LEI") Audit Report did not make any findings of imprudence. Instead, LEI concluded that the processes, procedures, and oversight were mostly adequate and consistent with good utility practice. Dr. Fagan explained that finding areas for improvement did not mean that the actions that needed improvement were imprudent. Rather, she testified, LEI was simply offering "advice" and "recommendations" based on the audit. As discussed below in detail, the three main areas of recommendations relate to the capital project investment process, fuel recommendations and must-run commitment status.

Nevertheless, the intervenors broadly argue that the entirety of the PPA Rider charges during the audit period should be disallowed primarily because the OVEC costs turned out to be above-market prices overall during the audit period. The Commission's approval of the OVEC-only PPA Rider is *res judicata,* and intervenors are barred by collateral estoppel from relitigating that prior approval in this audit proceeding. The *post facto* data relied upon by intervenors also violates the prudence standard. These intervenor arguments rely on data and information after the audit period and clearly show that intervenors are making improper "Monday morning quarterback" prudence arguments.

As a related matter, intervenor arguments that AEP Ohio was supposed to "manage" the financial hedge during the audit period are misguided and the claim that the Company used the PPA Rider as a "blank check" is without basis and conflicts with the PPA Rider decisions. In reality, the PPA Rider operates as a financial hedge that is counter-cyclical to market prices – without regard to whether the OVEC costs are below market prices or above market prices at a given point in time. This intrinsic hedge concept is rooted in the Commission's orders and is a function of the mechanics of the rider. It does not require or contemplate (or authorize) active management of the hedge impacts by the Company.

Lacking any proper legal or substantive issues to raise in this audit, intervenors pervasively attempt to smear the Auditor's reputation and independence. OCC witness Haugh claims that emails between Staff and the Auditor show a "pro-utility influence" by Staff that "undermined the independence of the Auditor" and concluded that the emails "raise concerns about regulatory capture." And OCC's counsel spent several hours of cross-examination trying to address the draft audit report and generally questioning the Auditor's independence – advancing the perverse notion that the Auditor's only shining moment was when it initially drafted the "best interests" sentence it ultimately decided to remove prior to finalizing the report.

But if the Auditor had decided to actually retain the draft "best interests" statement in the final report (which it did not), it would have exceeded the scope of the Audit and improperly encouraged re-litigation of the PPA Rider decision. As Staff witness Windle properly observed, the purpose of this Audit "was not to reconsider the past PUCO findings and orders within Case No. 14-1693-EL-SSO, or the impact of the HB 6 legislation" and "questions as to whether there should be a Rider or the cost benefit metrics of the OVEC plants were litigated and resolved in Case No. 14-1693-EL-SSO and are outside of the scope of this audit." Because the inclusion of the ICPA in the PPA Rider during the audit period was already decided, it would be inappropriate as OCC suggests to force the Auditor to make such an adverse "best interests" finding in this case. Simply stated, it is irrelevant and beyond the scope of this case whether either he Auditor or OCC agree with the Commission's prior decision to approve the ICPA for inclusion in the PPA Rider.

OCC's illusory claim that the "regulatory capture" of the Auditor has occurred fares no better. The record is clear that AEP Ohio had zero influence on the Auditor's decision to delete the sentence. Dr. Fagan testified, in connection with AEP Ohio Ex. 29 showing an email she had sent concerning the draft report, that she had already decided to delete the sentence in question when she sent a communication that first informed AEP Ohio of the language and before she received any feedback from AEP Ohio. Staff witness Windle also confirmed his understanding, based on overseeing the audit and reviewing all the correspondence, that there was no substantive change recommended to the Auditor by the Company regarding the draft Audit Report.

Finally in this regard, there is nothing unusual or inappropriate about the Auditor sharing its draft before finalizing and docketing the report. As a general matter, the Auditor indicated that, in her experience, draft reports are shared with certain stakeholders "almost always." And Staff witness Windle confirmed that such draft report sharing occurred in all four of the OVEC-related audits he has been involved with for Staff. Indeed, Mr. Haugh even acknowledged that a utility such as AEP Ohio that submits confidential information in the audit has an interest in confidentiality, and he opined that such parties "should have the ability to verify that confidential information is not released in the Audit Report." In order to exercise that right, Mr. Haugh agreed that it is reasonable that the utility review a draft of the Audit Report.

Several parties take issue with OVEC's use of a must-run commitment strategy in the PJM energy markets during the audit period. These criticisms, however, are misguided. The auditor thoroughly examined OVEC's must-run commitment strategy, and though she recommended that OVEC "carefully consider when and whether the must-run strategy is optimal," the Auditor did <u>not</u> find the use of the must-run strategy during the audit period imprudent, and the Auditor did <u>not</u> recommend any disallowance. Indeed, OVEC's use of a must-run commitment strategy during the audit period was reasonable, and the parties' criticisms of the must-run strategy should be rejected.

Unlike the Auditor, intervenors fail to recognize that AEP Ohio could not unilaterally change OVEC's must-run strategy during the audit period. By contrast, the Auditor thoroughly examined OVEC's use of the must-run commitment strategy during the audit period, and the Auditor did <u>not</u> find this strategy imprudent and did <u>not</u> recommend any disallowance. Rather, the Auditor recommended that OVEC carefully consider when and whether the must-run offer strategy is optimal, as it appears that in some months, it may result in negative energy earnings for the plants. Weekly demand and price outlooks can be utilized, for example, to determine whether and how to offer generation during a given block of time, considering start-up costs and other factors. As AEP Ohio witness Stegall testified, AEP Ohio agrees with this recommendation.

Parties argue that the Auditor should have conducted a redispatch analysis of the OVEC units to determine what net revenues OVEC would have realized if it had committed its units as economic instead of must-run during the audit period. This redispatch proposal should be rejected because it is at odds with the prudence standard, is unnecessary, was not carried out by any party, and would be prohibitively complex and difficult to undertake. More importantly, the kind of after-the-fact, 20/20 hindsight embodied by the proposed redispatch analysis is also inappropriate because it at odds with the prudence standard.

Regardless, if one were to redispatch the OVEC units based on an economic commitment – cycling the units off and on based on daily energy prices – one would have to offset any additional net revenues by the likelihood and cost of failed start-ups, additional maintenance costs, and potentially even plant damage resulting from running the units in a way they were not designed to run. But the bottom line is that no party to this proceeding has even attempted to provide a way of calculating these costs, so the record lacks any basis for using such an analysis. Several intervening parties also suggest as an alternative that OVEC should have undertaken "seasonal operation" during the audit period, only running its units during the summer and winter months when energy prices are allegedly higher. For reasons that are further explained below, however, that proposal is utterly unworkable and would cause considerable harm to AEP Ohio's customers.

In sum, the Auditor reviewed the must-run commitment status and did not find any basis to conclude the practice was imprudent – and intervenors failed to demonstrate the practice was imprudent. So the Auditor's recommendation to further study the practice is the only reasonable outcome based on the record.

Finally, intervenors' other arguments including challenges to fuel contracts and inventory issues lack merit. And the general arguments that attempt to block all charges properly billed under the ICPA are also misguided. The Auditor's review of these issues and lack of any basis for findings of imprudence supports the Company's position that the intervenors' claims lack a basis in the record and should be rejected.

II. BACKGROUND MATTERS

A. OVEC and the ICPA.

OVEC was originally formed by various investor-owned utilities ("Sponsoring Companies") on October 15, 1952 in response to a request from the United States Atomic Energy Commission ("USAEC"), a predecessor to the United States Department of Energy ("USDOE"), to supply electric power and energy to meet the needs of a uranium enrichment plant built by the USAEC in Pike County, Ohio. (AEP Ohio Ex. 7 at 3; Staff Ex. at 12.); *see also*

Case No. 18-1004-EL-RDR, et al., Entry ("*RFP Entry*") at Request for Proposal No. RA20-PPA-1 ("*RFP*") § I (January 15, 2020). OVEC, USAEC, and the Sponsoring Companies entered into power agreements to ensure the availability of power to the uranium enrichment plant. *RFP* at § I. To serve the needs of the uranium enrichment plant, OVEC built two coal-fired generation plants – (1) the Kyger Creek Plant in Cheshire, Ohio, with a generating capacity of 1,086 megawatts ("MW") consisting of five turbo-generators and (2) the Clifty Creek Plant in Madison, Indiana with a generating capacity of 1,304 MW consisting of six turbo-generators. (AEP Ohio Ex. 7 at 3; Staff Ex. at 12.) But on April 30, 2003, the USDOE cancelled the agreement with OVEC to serve the uranium enrichment plant. *RFP* at § I.

The Sponsoring Companies each own capital stock issued by OVEC. And the Sponsoring Companies all executed the Inter-Company Power Agreement ("ICPA") which sets forth the terms and conditions governing the rights of the Sponsoring Companies to receive available power from the generation stations and the obligations of the sponsoring companies to pay for the available power that is not utilized by the USAEC/USDOE. (AEP Ohio Ex. 7 at 30); *RFP* at § I. Ohio Power combined with Columbus Southern Power Company in 2011 and now AEP Ohio has 19.93% of the power-participation ratio. (Tr. III at 765, 917); *RFP* at § I.

Under the ICPA filed with FERC, "the Sponsoring Companies collectively shall be entitled to take from [OVEC] and [OVEC] shall be obligated to supply to the Sponsoring Companies any and all available power and available energy" in accordance with the power-participation ratio. (AEP Ohio Ex. 7 at 35.) Section 4 of the ICPA describes the members' entitlement to available power and energy supply from OVEC. (Id. at 35-36.) Section 5 of the ICPA describes charges to the Sponsoring Companies. (Id. at 36-40.) Specifically, Section 5.02

sets forth how the energy charge will be calculated, while Section 5.03 sets forth how the capacity charge will be calculated. (Id. at 36-40.)

Section 9.05 of the ICPA establishes an Operating Committee consisting one member of OVEC and one member from each Sponsoring Company and its affiliates. (Id. at 46; AEP Ohio Ex. 1 at 4.) During the audit period this equated to a total of nine members – one non-voting OVEC member and eight from the parent companies of the Sponsoring Parties. (Id.). Therefore, AEP had a single member on behalf of the three AEP affiliates (AEP Ohio, Appalachian, and Indiana Michigan), (*see also* Tr. III at 765, 914-915) that represents only 12.5% of the voting authority of the Operating Committee.

Pursuant to Section 9.05 of the ICPA, the Operating Committee establishes "scheduling, operating, testing and maintenance procedures of [OVEC]." (AEP Ohio Ex. 7 at 46). This includes establishing procedures for: (1) scheduling delivery of available energy, (2) power and energy accounting, (3) scheduling firm and non-firm transmission service, and (4) minimum generation output. (Id.) The Operating Committee also has adopted Operating Procedures, which articulate decisions on unit commitment practices (Section E), minimum generation output (Section F), and energy scheduling (Section E). (AEP Ohio Ex. 1 at 4; NRDC Ex. 3 at JIF-6 – CONFIDENTIAL pp. 425-439.) But any adoption or modification of any procedure by the Operating Committee must approved by at least two-thirds of the members of the Operating Committee. (AEP Ohio Ex. 1 at 4; AEP Ohio Ex. 7 at 46.)

On March 23, 2011, OVEC filed its most recent Amended and Restated ICPA with the Federal Energy Regulatory Commission ("FERC"). (AEP Ohio Ex. 1 at 4; *see generally*, AEP Ohio Ex. 7.) When a utility files a new rate schedule or tariff (such as the ICPA) with FERC, it becomes the FERC-jurisdictional filed rate unless FERC affirmatively rejects the rate schedule or tariff in accordance with the Federal Power Act, 16 U.S.C. § 824d(c)-(e). Because the ICPA was filed and accepted without objection, protests, or adverse comments, pursuant to FERC rules, it constitutes the FERC-jurisdictional filed rate under 16 U.S.C. § 824d.

B. The ESP III and PPA Rider Decisions Approved the OVEC-Only PPA Rider Construct as a Financial Hedge and Rate Stability Mechanism.

As part of AEP Ohio's *ESP III*, the Commission properly approved a placeholder PPA Rider under R.C. 4928.143. *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. 13-2385-EL-SSO, *et al*. ("*ESP III*"), Opinion and Order (Feb. 25, 2015). Mechanically, the PPA Rider will produce a credit to customers when largely fixed and stable purchased power costs (at the time the costs are incurred) are below market prices. Conversely, if such purchased power costs are above market prices, the PPA Rider will produce a charge. In other words, the PPA Rider reflects the net charge or credit from AEP Ohio's share of the unit output less market revenues received for liquidating the output into the market. The Commission properly found that the PPA Rider will have the effect of stabilizing or providing certainty regarding retail electric service in accordance with division (B)(2)(d) of the Electric Security Plan statute, R.C. 4928.143(B)(2)(d).

In the *ESP III* case, the Commission found that the PPA Rider as a mechanism would increase rate stability for all customers because it was designed to rise and fall in a manner that was counter to the market. *Id*. at 21. But at the time of the *ESP III* proceeding, the Commission found that there was insufficient evidence for the Commission to substantively approve the Company's request to include a specific purchased power agreement in the rider based upon the record before it. *Id.* at 23-25. Noting that a properly conceived PPA Rider proposal could provide significant customer benefits, the Commission authorized AEP Ohio to establish a placeholder PPA Rider, at an initial rate of zero, for the term of *ESP III*, and required the Company to justify any future request for cost recovery through the rider. *Id.* at 25.

On May 15, 2015, following the issuance of the Commission's *ESP III* Order, AEP Ohio amended its initial PPA Rider application and sought approval to include the net impacts of both an affiliate PPA and the Company's OVEC contractual entitlement in the placeholder PPA Rider. *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.* ("*PPA Rider*"), Opinion and Order at 6 (Mar. 31, 2016) ("*PPA Rider Order*"). On April 27, 2016, the FERC issued an order that required FERC review of the affiliate PPA included in AEP Ohio's PPA Rider proposal, which caused the affiliate PPA to be withdrawn. *Electric Power Supply Association v. AEP Generation Resources, Inc.*, 155 FERC ¶ 61,102 (2016) ("FERC Order"); *see also PPA Rider,* Second Entry on Rehearing at 27-28 (Nov. 3, 2016) ("*PPA Rider Second Entry on Rehearing*"). In light of the FERC Order, AEP Ohio proposed on rehearing to honor the Stipulation in its entirety but forego the affiliate PPA's inclusion in the PPA Rider. *PPA Rider Second Entry on Rehearing* at ¶ 57. Thus, the Company proposed that the Commission affirm its approval of the Stipulation with a pared-down PPA Rider that included only the Company's OVEC contractual entitlement. *Id.*

The Commission approved AEP Ohio's modified (OVEC-only) PPA Rider proposal on November 3, 2016. *Id.* at ¶¶ 57-65.

In the initial order, the Commission had already found, based upon the record evidence presented in the case, that the OVEC-only PPA Rider was projected to produce a net credit to customers of approximately $110 million over its term – through the end of 2024. *PPA Rider Order* at 38, fn.2. Yet, the Commission fully expected charges in the first few years of the PPA Rider (through 2019). As a general matter, the Opinion and Order acknowledged that "the projections presented in these cases are simply predictions of future market prices and costs; thus, even the most reliable projections may be proven wrong in the future, particularly over an eight-year timeframe." *Id.* at 81. As a related matter, Commissioner Trombold also observed in her concurring opinion that financial forecasts based on future market prices are inherently challenging:

> One of the challenges of utility regulation is that it is based on forecasts, and forecasts are just that: a prediction about an uncertain future. We all know there have been changes in the market in recent years caused by the weather, the economy, technological innovations, and environmental considerations that have resulted in market prices no one predicted despite our best attempts to forecast them.

PPA Rider Order, Trombold concurring opinion at 2. Obviously, the Commission did not rely on the rate impact projections as a guarantee that they would come true, but rather as the best indication at the time and based on the evidence in the record of what would happen.

More to the point of expected charges under the PPA Rider, then-Commissioner Haque acknowledged the anticipated charges based on the projections at the time:

> I think that, based upon the projections and the evidence in the record, there is general consensus that the PPA riders will result in a charge to consumers for at least the first 2-3 years of the riders. Because the Commission feels somewhat

> certain of this, we have attempted to build in certain consumer protections to ensure that bills do not increase beyond a certain limit.

PPA Rider Order, Haque concurring opinion at 4. At the time of the decision, the Commission did not anticipate PPA Rider credits in the first 2-3 years (*i.e.*, 2017-2019). And as referenced in then-Commissioner Haque's opinion, the original Opinion and Order approved a 5% annual rate cap for the first two years of the PPA Rider – knowing full well that charges were likely during the first two years. *PPA Rider Order* at 81. *See also PPA Rider Second Entry on Rehearing* at ¶ 100.

The Commission's original decision also approved the OVEC-only PPA Rider to permit retail charges to flow through to customers. *PPA Rider Order* at 82 ("our approval of the PPA rider is limited to an authorization of an amount to pay at retail"). Thus, the decision cannot be reasonably interpreted as requiring PPA Rider credits in the early years or as a guarantee that the overall projection of a modest net credit over the entire subsequent 8-year period meant that every year had to be a credit. In this context, then-Commissioner Haque also made his now-famous "blank check" statement in his concurring opinion in the PPA Rider cases:

> This should not be perceived as a blank check, and consumers should not be treated like a trust account. It's not right. At the same time, consumers, you have the *potential* to benefit from this if market prices increase, I know that experts opposing PPAs are saying *now* that there is no way that this will happen. Please read my commentary on wholesale markets below, and understand that *the energy industry is very dynamic with many, many moving parts that have the potential to impact these markets and make them unpredictable*.

PPA Rider Order, Haque concurring opinion at 5 (emphasis added).

In light of today's world events that are driving up energy prices and producing market prices (even SSO auction results in Ohio) that exceed OVEC's more stable, cost-based pricing, then-Commissioner Haque's statement about unpredictable future events in his concurring opinion in the PPA Rider cases seems prophetic. But his description of the potential for credits, again, clearly does not mean a guarantee of credits in any given year – especially when he stated directly in the same section of his opinion that he expected charges for at least the first 2-3 years. Another indication that the Commission expected charges in the early years is the credit commitment that would only apply in years 5-8 of the PPA Rider.

As the Commission noted, AEP Ohio will fund credits to ratepayers "over the last four years of the PPA term, if the actual revenues under the PPA rider are at a level that would otherwise impose a charge or provide a credit that is less than the amount of the credit commitment." *PPA Rider Order* at 84. Subsequently, R.C. 4928.148 was enacted and became effective in 2019 and provided that "any mechanism authorized by the public utilities commission prior to the effective date of this section for retail recovery of prudently incurred costs related to [OVEC] shall be replaced by a nonbypassable rate mechanism established by the commission for recovery of those costs through December 31, 2030." R.C. 4928.148. Consequently, the PPA Rider mechanism was replaced by the Legacy Generation Resource Rider and all aspects of the PPA Rider were superseded going forward as of January 1, 2020 – including the PPA Rider credits that might have otherwise been triggered starting in 2021. The salient point is that the original design of the PPA Rider with charges in the early years and potential credits in the latter years – which again confirms that charges were fully expected for the 2018-2019 audit period being addressed in this case.

The Commission indicated that it was approving population of the PPA Rider "as a financial hedging mechanism" and made specific findings about how it would benefit customers:

> The PPA rider will supplement the benefits derived from the staggering and laddering of the SSO auctions and protect retail customers from price volatility in

> the market. The record reflects that the PPA rider will provide added rate stability during periods of extreme weather, when the rider can be expected to offset severe price spikes. The different scenarios reflected in AEP Ohio's projection of the PPA rider's impact demonstrate the effect of variation in load due to severe weather or economic factors, including the asymmetric impact that such factors have on electric prices, where increases in load tend to increase prices more so than load reductions decrease prices. If load increases due to weather or economic conditions, shopping and SSO customers will be exposed to the resulting higher wholesale prices, which the PPA rider will partially offset.

PPA Rider Order at 83. The Commission went on to reaffirm its prior finding in *ESP III* that the PPA Rider was "an essential component of AEP Ohio's ESP" adopted under R.C. 4928.143(B)(2)(d), the ESP statute, that "provides the benefit of a more balanced hedge than relying exclusively on the market." *Id*.

The Stipulation provided that annual audits would be conducted to confirm that the costs and revenues flowing through the PPA Rider were prudently incurred. *PPA Rider Order* at 25. The Commission indicated that the purpose of the prudence audits was "to ensure that *actions taken by AEP Ohio* when selling the output from generation units included in the PPA rider into the PJM market were not unreasonable." *Id*. at 87 (emphasis added). Per the Stipulation language adopted by the Commission, "[a]ny determination that the costs and revenues included in the PPA Rider are unreasonable shall be made in light of the facts and circumstances known at the time such costs were committed and market revenues were received." *Id*. at 25. On rehearing, the Commission reiterated that the main issue in the prudence audits would be whether "the Company's actions were in the best interests of retail ratepayers." *PPA Rider Second Entry on Rehearing* at ¶ 178.

Aside from the Stipulation's enhancements to the PPA proposal, the Commission found that the Stipulation "also includes numerous commitments by AEP Ohio to offer proposals in future proceedings that are intended to promote economic development and retail competition, facilitate energy efficiency measures, reduce carbon emissions, expand the development of renewable resources, and pursue grid modernization in the state." *PPA Rider Order* at 84. Thus, the Commission also found, based on the record evidence, that the Stipulation package would provide "numerous benefits for customers that are in the public interest and consistent with the policy of the state, as set forth in R.C. 4928.02." *Id.* at 82. The sole reservation the Commission adopted on rehearing when accepting the OVEC-only PPA Rider was that "the Commission reserves the right to reevaluate the PPA rider, when AEP Ohio divests or transfers its share of the OVEC asset to an affiliate or any other third party. AEP Ohio should provide notice to the Commission in advance of the divestiture or transfer of the OVEC entitlement." *PPA Rider Second Entry on Rehearing* at ¶ 58.

In its Second Entry on Rehearing, the Commission reiterated the benefits associated with the new Stipulation package that retained the other benefits even though the affiliate PPA was being dropped when the OVEC-only PPA Rider was adopted:

> Given this change in circumstances, we find that AEP Ohio's proposal to move forward with the implementation of the other provisions of the stipulation, which conceptually is not opposed by any of the signatory parties to the stipulation, is reasonable and should be approved. In the PPA Order, the Commission found, based on the record evidence, that the stipulation will provide numerous benefits for customers that are in the public interest and consistent with the policy of the state, as set forth in R.C. 4928.02. In addition to the rate stability and financial hedging benefits provided by the PPA rider, the Commission addressed the fuel supply diversity and economic development benefits of the stipulation, as well as AEP Ohio's many commitments in the stipulation to offer proposals in future proceedings that are intended to promote economic development and retail competition, facilitate energy efficiency measures, reduce carbon emissions,

> expand the development of renewable resources, and pursue grid modernization in the state.

PPA Rider Second Entry on Rehearing at ¶ 57 (internal citations omitted). *See also id.* at ¶¶ 62-63, 141, 145, 149, 152 (numerous other provisions of Stipulation developing renewable energy, advancing grid modernization, and promoting retail competition will continue to provide substantial benefits even though affiliate PPA dropped).

On rehearing, OCC and OMAEG broadly challenged the PPA Rider including the OVEC component and the forward projection of PPA Rider impacts. As discussed below, the parties further pursued their grievances to the Supreme Court of Ohio in attempting to challenge the PPA Rider decisions of the Commission. In any case, after thorough consideration, the Commission rejected all of OCC's and OMAEG's rehearing arguments in its Second Entry on Rehearing. *Id*. at ¶ 17.

For example, OCC's witness had projected a $1.9 billion charge under the original version of the PPA Rider. *PPA Rider Order* at 79. In its sixth ground for rehearing, OCC argued that this projection by its witness was the best record evidence of the PPA Rider's future impact. *PPA Rider Second Entry on Rehearing* at ¶¶ 66-71. In the Second Entry on Rehearing, the Commission explained in detail why the OCC testimony was flawed and was being rejected in favor of the Company's projections. *Id*. at ¶¶ 84-86.

The OCC also argued that the PPA Rider rate impact mechanism (5% cap) is unreasonable and sought to curtail the Company's full recovery of costs – which OCC expected to exceed the rate cap. *Id*. at ¶ 94. The Commission disagreed and found that the cap during the first two years was "appropriate, and the parties have offered no reason for concluding that our judgment regarding the level or duration of the rate impact mechanism was unreasonable." *Id*. at

¶ 100. OCC also argued that the PPA Rider constitutes unlawful transition revenues and was not otherwise authorized under the ESP statute, but the Commission rejected all of OCC's arguments in this regard. *Id*. at ¶¶ 205-216, 251-253.

OMAEG for its part, argued, for example, that the Commission erred in concluding that the PPA Rider will function as a financial hedge and provide rate stability. *Id*. at ¶ 110. The Commission disagreed, reiterating its findings in this regard as follows:

> Emphasizing that rate stability is an essential component of an ESP that may be established under R.C. 4928.143(B)(2)(d), the Commission found, in the PPA Order, that the PPA rider will protect retail customers from price volatility in the market. Based on the record in these proceedings, we noted that the PPA rider will provide added rate stability during periods of extreme weather, when the rider is expected to offset severe price spikes, as confirmed by AEP Ohio's different scenarios showing the asymmetric impact that harsh weather and economic factors have on electric prices, where increases in load tend to increase prices more so than load reductions decrease prices. We recognized that, if load increases due to weather or economic conditions, shopping and SSO customers will be exposed to the resulting higher wholesale prices, which the PPA rider will partially offset. The Commission concluded that the PPA rider, as a cost-based hedging mechanism, provides the benefit of a more balanced approach than relying exclusively on the market.

Id. at ¶ 57. OMAEG made numerous other arguments to challenge the OVEC-only PPA Rider but the Commission rejected each one after fully considering each point.

C. The Supreme Court of Ohio Upheld the Commission's Approval of the OVEC-Only PPA Rider as a Financial Hedge and Expressly Recognized that the Rider May Result in Credits or Charges.

OCC and OMAEG appealed the Commission's rulings in the *ESP III* and the *PPA Rider* proceedings raising multiple arguments. In separate decisions issued on the same day, the Supreme Court of Ohio rejected each one of OCC's and OMAEG's arguments and affirmed the Commission's rulings in the *ESP III* and the *PPA Rider* proceedings in all respects. *See In re*

Application of Ohio Power Co., 155 Ohio St. 3d 320, 2018-Ohio-4697 ("*ESP III Appeal*"); *In re Application of Ohio Power Co.*, 155 Ohio St. 3d 326, 2018-Ohio-4698 ("*PPA Rider Appeal*").

In the *ESP III Appeal*, the Court determined that "OCC and OMAEG have not shown any harm or prejudice to ratepayers caused by the commission's approval of the PPA Rider in the ESP Order." *ESP III Appeal*, 2018-Ohio-4697, ¶ 18. Among other things, the Court rejected OCC's claim that it was "prevented from effectively challenging the PPA Rider in the ESP case" because OCC's claim "ignores that the commission *did* consider the impact of the PPA Rider when it conducted the statutory [MRO versus ESP] test under R.C. 4928.143(C)(1) in the PPA Rider case." *Id.* ¶ 12 (emphasis added). The Court also rejected OMAEG's assertion that it was harmed by the Commission's alleged delays in ruling on rehearing applications, finding that "OMAEG makes no argument that the delay at the commission was unreasonable or unjustified." *Id.* ¶ 17. As to OCC's and OMAEG's other arguments of harm from the PPA Rider, the Court referred to its opinion in the *PPA Rider Appeal*. *See id.* ¶ 14 ("Because OCC and OMAEG are able to assert claims of actual harm or prejudice in the PPA Rider appeal, see Supreme Court case No. 2017-0752, however, there is no reason for us determine here whether there is merit to this argument.").

In the *PPA Rider Appeal*, the Court considered numerous arguments from OCC and OMAEG against the OVEC-only PPA Rider and rejected each one. Reviewing the factual record, the Court explained that the "intended purpose of the rider was to provide a financial hedge against fluctuating prices in the wholesale power market in order to stabilize retail-customer rates." *PPA Rider Appeal*, 2018-Ohio-4698, ¶ 3. The Court expressly recognized that the "PPA Rider works as *either a charge or a credit* to Ohio Power's retail customers, depending on how OVEC's costs compare to the market rate." *Id.* ¶ 4 (emphasis added). The Court rejected each of OCC's and OMAEG's criticisms of the Commission's analysis of these facts, finding that the "evidence relied on by the commission is sufficient to sustain its decision" and that "the mere fact that evidence before the commission points both ways does not justify reversal." *Id.* ¶ 45.

OCC and OMAEG raised several statutory challenges to the PPA Rider, and the Court rejected each one. The Court affirmed the Commission's conclusion that the PPA Rider was a statutorily authorized "limitation on customer shopping" under R.C. 4928.143(B)(2)(d). *Id.* ¶¶ 28-32. In reaching that conclusion, the Court rejected OCC's claims that the statute is limited to "physical" limitations and endorsed the Commission's understanding that the statute allows "financial" limitations on shopping. *Id.* ¶ 29. The Court also rejected OCC's claim that the Commission improperly applied the MRO versus ESP test in R.C. 4928.143(C)(1), finding that the Commission properly considered not only "pricing" but also "all other terms and conditions" of the Stipulation including "nonquantifiable factors." *See id.* ¶¶ 33-38. And the Court rejected OCC's and OMAEG's claim that the PPA Rider constitutes unlawful "transition revenue" under R.C. 4928.38 and R.C. 4928.141(A), holding that the "'notwithstanding' clause" in R.C. 4928.143(B) "allow[s] an ESP to include items that R.C. Title 49 would otherwise prohibit." *Id.* ¶ 19.

The Court then rejected each of OMAEG's criticisms of the Commission's application of the three-part test for stipulations. *Id.* ¶¶ 40-50. The Court dismissed OMAEG's allegations of customer harm as "entirely speculative." *Id.* ¶ 46. As to OMAEG's criticism of the Commission's determination that the PPA Rider was a "financial hedge," the Court found that

"OMAEG once again ignores that the commission cited evidence to support this finding." *Id.* ¶ 47. And the Court found that "OMAEG's claim that the commission violated state electric policy when it approved the PPA Rider raises questions of fact, not law, and OMAEG's arguments lack factual evidence in support." *Id.* ¶ 50.

Lastly, the Court upheld the Commission's approval of the "OVEC-only PPA Rider" on rehearing against OMAEG's claim that the "OVEC-only" rider was unsupported by the record. OMAEG, the Court found, "overlooks" the fact that "the projected benefit" of the OVEC-only PPA Rider "was based on several data factors." *Id.* ¶ 57. The Court concluded that OMAEG "has not demonstrated that the commission's findings are against the manifest weight of the evidence or clearly unsupported by the record." *Id.* In reaching these conclusions, the Court reiterated that "the PPA Rider was designed to act as a financial hedge against market volatility, particularly during extreme weather conditions," and the Court upheld the approval of the OVEC-only PPA Rider because "the OVEC-only PPA Rider retained value as a financial hedge." *Id.* ¶ 59.

III. CONSISTENT WITH THE COMMISSION'S RFP, THE SCOPE OF REVIEW IN THIS CASE SHOULD FOCUS ON COMPANY ACTIONS IN IMPLEMENTING THE ICPA DURING THE AUDIT PERIOD BASED ON A PRUDENCE STANDARD THAT REVIEWS FACTS AND CIRCUMSTANCES KNOWN AT THE TIME

The Commission's RFP Entry set forth the audit period as January 1, 2018 through December 31, 2019. *RFP Entry* at 1 (Jan. 15, 2020). The *RFP Entry* provided that Staff and the Commission were to "select and solely direct the work of the auditor" and "review and approve payment invoices submitted by the auditor." *Id.* ¶ 10. The *RFP Entry* provided that the Auditor "will execute its duties pursuant to the Commission's statutory authority to investigate and acquire records, contracts, reports, and other documentation" under various provisions in the Revised Code including R.C. 4901.16. *Id.* ¶ 12.

The RFP also reinforced that Staff would oversee the project, be informed of correspondence between the Auditor and the Company, and be given advance notice of interviews and meetings. *RFP* at § II.C. Indeed, the RFP also specified some level of detail about how the Auditor should keep Staff in the loop during the investigation:

> At the midpoint of the audit activities, the auditor selected will provide a progress report to Staff. This report will briefly describe progress made on required audit activities, as well as initial/tentative findings and conclusions on issues investigated to date. Unless otherwise requested by the PUCO Staff, this interim report may be made verbally.

Id. The RFP went on to provide for draft audit report should be send to Staff at least 10 days prior to the due date. *Id.* at § II.D. The RFP indicated that proposals should be sent to Rodney Windle, who was the Staff member that oversaw the audit and provided testimony in this case. *Id*. at § VIII.C.

The RFP for the audit of Ohio Power's PPA Rider for 2018 and 2019 included a "Scope of Investigation" section, which listed six categories for the auditor to review:

- Disposition of Energy and Capacity: This category required the auditor to review the prudency of OVEC's "unit scheduling," "bidding behavior and/or participation" in PJM's energy, capacity, ancillary services, and other markets; and [whether] accounting procedures accurately and properly allocate revenues to ratepayers * * * ." *Id.* at § III.A.1.

- Fuel and Variable Cost Expenses: This category required the auditor to review whether "all of OVEC's fuel (i.e., coal) and variable operations and maintenance (O&M) related expenses were prudently incurred and properly allocated to AEP Ohio"; and "a comparison between incurred fuel costs and market prices to evaluate the reasonableness of fuel expenses during the audit period." *Id.* at § III.A.2.

- Capital Expenses: This category required the auditor to review whether "any fixed costs incurred by OVEC are properly allocated to AEP Ohio, including depreciation, debt service, and plant maintenance expenses"; whether "only prudently incurred costs are included for recovery"; and whether "any and all costs that have been deemed to be ineligible for recovery by the Commission have been appropriately excluded." *Id.* at § III.A.3.

- Environmental Compliance: This category required the auditor to consider "(1) compliance with existing environmental regulations, and (2) preparation for compliance with any proposed or newly enacted environmental regulations[,]" and "at least the following environmental compliance related issues: "the impact that compliance activities had on OVEC's fuel procurement strategy, as well as the type and cost of fuel that was actually purchased;" "overall emission allowance management strategy, including any emission allowance transactions in which OVEC participated;" and "methods used to analyze compliance options and develop overall mitigation strategies." *Id.* at § III.A.4.

- Power Plant Performance: This category required the auditor to review "significant plant outages or other degradations observed in the operating availability, equivalent availability, or capacity factors of OVEC's generating plants and their impact on ratepayers"; and "an on-site investigation of at least one of OVEC's generating stations" with attention to, at a minimum, "fuel handling and quality control (i.e., weighing, sampling, scale calibrations, etc.), inventory surveying methodologies and results, performance monitoring (i.e., heat rate), and maintenance." *Id.* at § III.A.5.

- Utility Industry Perspective: This category required the auditor to "discuss[ ] the current dynamics of the PJM wholesale markets in which OVEC operates, and the impact that changing market dynamics have on OVEC's operations and practices." *Id.* at § III.A.6.

On March 11, 2020, the Commission selected LEI to conduct the audit. Entry ¶ 1 (Mar. 11, 2020). Dr. Marie Fagan, Chief Economist at LEI, was the project manager for the audit, "the main point of contact with the PUCO Staff and the Company, * * * and lead author of the [audit] report." (Tr. I at 35-36.) Dr. Fagan testified that she understood that the RFP's "Scope of Investigation" section identified the tasks that LEI was to perform as part of its audit. (*See* Tr. II at 540-541.) Considerations relating to the PUCO's approval of the PPA Rider itself, on the other hand, were outside the scope of the audit as Dr. Fagan understood it, including topics like the inclusion of the ICPA in the PPA Rider (*see* Tr. II at 550); whether it was in AEP Ohio's customers' best interests to pay above-market charges under the PPA Rider (*see* Tr. I at 86, 91, 94); whether it was prudent for AEP Ohio to flow above-market costs to retail ratepayers (*see* Tr. I at 96, 99, 100); and whether the PPA Rider functioned as a financial hedge (*see* Tr. I at 166).

LEI conducted its audit primarily by issuing formal data requests to AEP Ohio, which it did between May and August 2020. (Staff Ex. 1 at 8.) LEI also relied on "publicly available data from OVEC annual reports, and other sources of public data[,]" including "industry data from * * * the Energy Information Administration." (Id.) In addition, LEI "conducted a single 'virtual site visit' to audit the presence and use of environmental control equipment in the plants." (Id.) LEI did not visit the plants in person due to COVID-19. (Id.)

The Commission's RFP further provided that the purpose of the audit as ordered in the PPA Rider cases was "to establish the prudency of all costs and sales flowing through the PPA rider and to demonstrate that the Company's actions were in the best interest of retail ratepayers." *RFP* at § II.A. In the *PPA Rider Order*, the Commission provided that "[a]ny determination that the costs and revenues included in the PPA Rider are unreasonable shall be made in light of the facts and circumstances known at the time such costs were committed and market revenues were received." *PPA Rider Order* at 25.

This standard for prudence is consistent with Commission precedent and Supreme Court of Ohio precedent on the subject. Just a few months ago, the Supreme Court of Ohio addressed this topic as part of its decision in *In re Application of Suburban Natural Gas Co*. ("*Suburban*"), Slip Opinion No. 2021-Ohio-3224 (September 21, 2021). The Court held that the prudence test examines whether an expenditure "was prudent when it was made." *Suburban*, 2021-Ohio-3224 at ¶ 32. The Court went on to explain that the prudence test "places the risk of a failed investment on the customers, who must pay so long as that investment was prudently made." *Id*.

Thus, a proper examination under the prudence test considers *only* those facts and circumstances known at the time the decision was made.

The Auditor, Dr. Fagan, agreed that the prudence of a decision must be determined based upon information known to the decision-maker at the time of the decision. (Tr. II at 551.) OCC witnesses Haugh and Glick agreed during cross-examination that a utility decision to invest is one that is judged based on facts known at the time the decision was made. (Tr. IV at 1075; Tr. V at 1425.) OCC witness Haugh also agreed that a decision that was prudent based on the facts at the time later turns out to be a failed decision does not render the decision imprudent. (Tr. V at 1425.) The Auditor further explained that prudence does not presume that there is a single correct answer because there is a "spectrum of prudent behavior." (Tr. II at 552-553.) This is because reasonable people can have reasonable differences of opinion without those different opinions arising to the level of imprudence. (Tr. I at 68.) As discussed further below, however, intervenors do not follow the key prudence concept of reviewing a decision based on information known at the time of the decision and, instead, seek to second-guess decisions based on subsequent information.

IV. SUMMARY OF THE AUDIT REPORT

A. The Audit Report and LEI's Errata.

LEI filed the report of its Audit of the OVEC Power Purchase Agreement Rider of Ohio Power Company ("Audit Report") on September 16, 2020. (*See* Staff Ex. 1.) On December 29, 2021, Commission Staff filed a "Notice of Filing Errata Sheet for the Audit Report." (*See* OCC Ex. 2.) Dr. Fagan developed the three errata in that document in December 2021 (Tr. I at 120;

Tr. II at 405), and neither Commission Staff nor AEP suggested any of the errata (Tr. II. at 406.) LEI's errata changes to the Audit Report were limited to the following:

- On page 20, in Section 3.1.2 (PJM capacity prices), Staff deleted the entire paragraph beginning "The sum of average day ahead energy price * * * ."
- On page 23, Staff deleted the first sentence in Section 3.5 (Levelized cost of new entry in PJM).
- On pages 73-74, Staff said that "LEI incorrectly calculated the monthly average days of coal inventory for the Clifty Creek and Kyger Creek plants" because it based its calculations on average burn in each month, rather than full load.

(OCC Ex. 2.)

For the first errata, Dr. Fagan explained that the capacity clearing price in 2018 was not calculated correctly. (Tr. I at 121.) Dr. Fagan explained that capacity market prices are expressed in megawatt-days and that she was "not happy" with the fact that LEI had expressed them in megawatt-hours. (Id. at 123.) For the second errata, Dr. Fagan explained again that she was "not that happy" with the fact that LEI measured capacity in terms of megawatt-hours. (Id. at 128.) And at hearing, Dr. Fagan proposed extending the errata through the colon in the second sentence of Section 3.5. (Id. at 129.)

B. LEI Offered Recommendations, but No Findings of Imprudence.

After one-hundred-eighteen data requests, an in-depth discussion with AEP Ohio and OVEC personnel related to a virtual site visit, and completing a one-hundred-eighteen page audit report, at no point did the Auditor making any findings of imprudence on behalf of AEP Ohio or OVEC. To the contrary, the Auditor repeatedly testified that LEI's Audit Report "didn't make any findings of imprudence." (Tr. I at 95, 184, 214, 216; Tr. II at 296.) Instead, LEI concluded that "the processes, procedures, and oversight were mostly adequate and consistent with good utility practice * * * ." (Staff Ex. 1 at 9.) Dr. Fagan explained that the audit report used the phrase "*mostly* adequate" (emphasis added) because LEI had recommendations for improvement. (Tr. II at 439.) Dr. Fagan further explained that finding areas for improvement did not mean that the actions that needed improvement were imprudent. (Tr. I at 95, 184, 214, 216.) Rather, she testified, LEI was simply offering "advice" and "recommendations" based on the audit. (Tr. II at 551.) The Auditor went so far to make express findings that AEP Ohio and OVEC acted prudently or "not imprudently." For instance, the Auditor found that AEP Ohio's capacity "offer price was prudent" (Staff Ex. .1 at 50; Tr. II at 394-396.) The Auditor made similar findings on other aspects as discussed below.

1. Capital investment review.

One of the areas in which LEI offered recommendations related to OVEC's capital expenses. LEI concluded that "[t]he process of planning and executing individual capital projects appears to be well-managed." (Staff Ex. 1 at 10.) LEI outlined OVEC's "six-step process" for reviewing and approving proposed capital projects over $100,000 and concluded that OVEC's process "provides a good foundation for capital project planning and implementing." (Id. at 90-91.) However, LEI recommended that OVEC "specify more clearly the personnel in charge of each step" and "establish standardized criteria (such as net present value, payback period, and/or comparison to alternatives), for evaluating and approving the proposed capital projects at each step." (Id. at 91.)

LEI also commented that the lack of a "cap on annual capital expenses * * * could lead to over-investment in the plants" (Staff Ex. 1 at 10) and, for that reason, suggested that "the Commission consider implementing such a cap." (Id. at 91.) At hearing, however, Dr. Fagan agreed that AEP Ohio is not solely in control of capital expenditures at OVEC. (Tr. II at 593.) Moreover, LEI found that "OVEC's capital projects in 2018 and 2019 * * * were generally completed within or close to the budget, and that the total actual costs did not exceed the total budgeted cost in these two years * * * ." (Staff Ex. 1 at 92.) In fact, after selecting and examining "four projects that had relatively high costs or that had actual costs exceeding planned costs," LEI concluded that "these projects were planned and completed on a prudent and reasonable basis. These projects were necessary for economic or safety purposes, went through cost-benefit analysis (with an average payback timeline of around 4 years), and were compared to alternatives in terms of practicality and cost." (Id. at 93.) On cross-examination, the Auditor reaffirmed that capital investments made in OVEC during the audit period were "not found to be imprudent" (Tr. II at 591.)

2. Fuel recommendations.

Another area in which LEI offered recommendations related to fuel and variable cost expenses. With regard to coal procurement, LEI concluded that "[c]oal contract terms seem reasonable in terms of compliance with the coal procurement target strategy. Coal transaction in long- and short-term allowed for some volume flexibility. LEI feels the overall coal contracts reflected market awareness and prudency." (Staff Ex. 1 at 70.) The Auditor also found that coal purchase decisions made a result of the RFPs reviewed by the Auditor "demonstrate that the Company acted prudently in procuring the commodity or service." (Staff Ex. 1 at 59.) Given these positive conclusions, LEI's recommendations for improving OVEC's coal procurement were minor. LEI suggested that "OVEC re-examine the process" by which it forecasts coal burn and conduct such forecasts "more frequently to reduce the discrepancies between the actual and estimated coal burns in the following periods." (Id. at 71.) LEI also suggested that OVEC attempt to negotiate "more competitive prices" for "good quality" coal for Clifty Creek. (Id.) And LEI suggested that OVEC audits its own coal procurement annually. (Id.)

With regard to coal inventory management, LEI found that "[c]oal inventories were much higher than target levels in 2019" and hypothesized that those high coal inventories "may indicate a problem with management of contract deliveries versus projected coal burns." (Staff Ex. 1 at 10.) LEI acknowledged, however, that the higher-than-target coal levels were "trigg[er]ed by an event which occurred in one month (April) in 2019 and may be an anomaly * * * ." (Id. at 10.) In the end, LEI simply recommended that OVEC "improve its inventory management processes." (Id. at 75.)

3. Must-run recommendations.

LEI also offered recommendations related to OVEC's disposition of energy and capacity. Again, LEI's findings were generally positive. LEI reported that "the OVEC energy management group organization and staffing are adequate, and * * * procedures are thorough and well documented. OVEC has multiple channels to actively participate in the PJM market developments and is well informed of the PJM market. OVEC's offer prices in the RPM are low enough to ensure those offers clear the PJM RPM auction; the OVEC units subsequently receive the pay-as-cleared CP price, which is typically higher than their offer price." (Staff Ex. 1 at 53.)

LEI noted that OVEC's "energy is offered as self-scheduled" and commented that "some of the time, the PJM energy price did not cover fuel and variable cost * * * ." (Id. at 9.) In particular, LEI examined seven months in 2018-2019 that "represented different weather conditions, * * * different times of the year and * * * different requirements on the system, prices, et cetera." (Tr. II at 581.) For three of those months, Dr. Fagan testified, the OVEC units were "a lot in the money" (id. at 327-328), meaning that "the energy market earnings [we]re greater than their energy charge." (Id. at 377.) For the other four months, however, LEI concluded that "PJM prices were slightly lower than OVEC energy charges" on a monthly average basis. (Staff Ex. 1 at 52.) Based on this analysis, LEI recommended that OVEC "re-consider its 'must-run' offer strategy * * * and utilize near-term (one week to one month) demand and price forecasts to formulate offers." (Staff Ex. 1 at 9.)

Dr. Fagan made clear at hearing, however, that LEI did not definitively recommend that OVEC "offer the plants in a different manner[,]" because the results of LEI's analysis comparing OVEC energy charges and PJM day-ahead prices "weren't unequivocal * * * ." (Tr. II at 329.) Dr. Fagan also testified that LEI did not find that OVEC's "must-run" strategy was imprudent even during times when PJM energy prices did not cover fuel and variable costs. (Tr. I at 266.) Indeed, LEI acknowledged that a must-run strategy may not always be optimal (*see* Staff Ex. 1 at 9) and that whether OVEC decides to continue running in a must-run commitment status "depends on energy prices and their costs and their evaluation of risk. There [are] a lot of factors." (Tr. II at 577.) Accordingly, LEI suggested only that "OVEC carefully consider when and whether the must-run offer strategy is optimal * * * ." (Staff Ex. at 53; *see also* Tr. II at 371.)

V. RESPONSE TO INTERVENOR POSITIONS

A. The Commission's Approval of the OVEC-Only PPA Rider is *Res Judicata* and Intervenors are Barred by Bilateral Estoppel from Relitigating that Prior approval in this Audit Proceeding; and the *Post Facto* Data Relied Upon by Intervenors Also Violates the Prudence Standard.

As discussed above, the Commission approved AEP Ohio's modified (OVEC-only) PPA Rider proposal over the objections of intervenors for the period covering the entire audit period. *PPA Rider Second Entry on Rehearing* at ¶¶ 57-64. Moreover, the prior decision was challenged before the Supreme Court of Ohio and upheld as lawful and reasonable. The Supreme Court of Ohio has held under similar circumstances that intervenors are barred by collateral estoppel from relitigating matters of *res judicata*. *In re Application of Ohio Power Co.*, 144 Ohio St. 3d 1, 11 (2015). *See also O'Nesti v. DeBartolo,* 113 Ohio St.3d 59, 2007-Ohio-1102, 862 N.E.2d 803, at ¶ 7, citing *Fort Frye Teachers Assn., OEA/NEA v. State Emp. Relations Bd.*, 81 Ohio St.3d 392, 395, 692 N.E.2d 140 (1998); *See also Consumers' Counsel v. Pub. Util. Comm*., 16 Ohio St.3d at 10, 475 N.E.2d 782 (applying collateral estoppel to bar litigation of an issue in a second commission proceeding). Any attempt by the Commission to reverse its prior decision would also violate AEP Ohio's statutory right to consent to the terms of its ESP under R.C. 4928.143(C)(2)(a). *Id*. at 6-7. While intervenors claim not to challenge the PPA Rider decision here, their positions belie that claim.

For example, most of OCC witness Haugh's testimony and recommendations either constitutes an improper and relatively undisguised collateral attack on the PPA Rider decision or attempts to apply an improper prudence standard based on information and developments after the Commission's PPA Rider decision, after the Company's actions, and after the audit period. In this regard, Mr. Haugh summarized his three primary arguments – setting aside the "must-run" issues (which will be separately addressed below): (1) the PPA Rider charges during the audit period should be disallowed "because the actual OVEC costs have been much higher than original projections and it is clear now that the PPA Rider will not be a net credit over the lifetime of the rider," (2) the Commission should "disallow all PPA Rider costs based on the auditor's finding that OVEC's costs are above the Levelized Cost of New Entry and therefore the plants' are not viable,'" and (3) the Commission should "restore to the audit report the original language that 'keeping the plans running does not seem to be in the best interests of retail ratepayers.'" (OCC Ex. 21 at 6.) All three of these claims are doubly flawed because they are: (1) premised on untimely challenges to the PPA Rider decision, and (2) are based on after-the-fact data that is not relevant to a proper prudence review.

Regarding Mr. Haugh's first basis for disallowance (OVEC costs turned out to be higher than original projected), he admitted on cross-examination that OCC recommends disallowing every dollar of OVEC costs billed to AEP Ohio that was above market prices during the audit period. (Tr. V at 1448-1450.) Because the output of OVEC is liquidated and the resulting revenue based on market prices is credited to the PPA Rider, the "above market" disallowance theory is simply another way of saying all OVEC costs should be disallowed. Mr. Haugh agreed during cross-examination that OCC's position is based on two related arguments: (1) actual costs of the PPA Rider after the fact have been higher than the original projections, and (2) it is now clear after the fact that the PPA Rider will not be a credit over the lifetime of the rider. (Tr. V at 1425-1426; OCC Ex. 21 at 6.) Both of those points are based on after-the-fact data and both second guess the original decision to approve the ICPA for inclusion in the PPA Rider during the audit period by revisiting the decision based on after-the-fact data.

The only way to know this is after-the-fact data and Mr. Haugh candidly admitted that his observation in testimony about the actual costs having been higher was "backwards from the end of the audit period" and admitted that it became clear as of "December 31, 2019" at the end of the audit period. (Tr. V at 1428-1429.) This kind of analysis is accurately referred to as hindsight review, which is improper under the prudence standard. And Mr. Haugh acknowledged that he did not do any independent quantitative analysis in support of his testimony in this case without reliance on the Auditor or another witness (id. at 1419) – so his testimony cannot really be relied upon to support any quantitative assertions. In any case, it is plain and obvious that the "above market" argument violates the appropriate standard for prudence reviews and otherwise constitutes an improper collateral attack on the PPA Rider decision's findings in support of the Company's original projections. OCC witness Glick's analysis supports the "above market" quantitative analysis and she also recommends total disallowance under the same flawed theory. (*See* OCC Ex. 14 at 7, 17-35.)

There is no way to reasonably conclude that PPA Rider charges occurring during the audit period violated or conflicted with the Commission decision to adopt the OVEC-only PPA Rider. On the contrary, as discussed above, the Commission anticipated charges for the first 2-3 years of the PPA Rider (*i.e.*, through 2019). *PPA Rider Order*, Haque concurring opinion at 4. Consistent with that assumption, the Commission imposed a rate cap for the first two years based on that assumption. *PPA Rider Order* at 81. And of course, the Commission did not condition using the ICPA during the audit period on there being a credit. Thus, the Commission must reject OCC's categorical position based purely on hindsight that all above-market costs should be disallowed as imprudent.

Similarly, Mr. Haugh's positions that the PPA Rider charges should be disallowed because a competitive procurement process was not used to incorporate the ICPA into the PPA Rider (OCC Ex. 21 at 12-13) and because OVEC costs were above the Levelized Cost of Entry

("LCOE") for 2018 and 2019 (*id*. at 32-33) are flawed – since both seek to second-guess or relitigate the decision to include the ICPA in the PPA Rider during the audit period based on data only known after the audit period. Moreover, Mr. Haugh's reliance on the Auditor's LCOE finding is misplaced because the Auditor issued an errata to delete that finding as inaccurate. (Staff Ex.2; Tr. I at 129-130.) In the same vein, OCC witness Haugh admitted OCC's position that the OVEC-only PPA Rider did not reasonably serve as a financial hedge during the audit period was an after-the-fact observation.[2] (Tr. V at 1446.)

Finally, Mr. Haugh's recommendation for the Commission to force the Auditor to make a finding based on a statement in the draft Audit Report that was abandoned by the Auditor is misguided on several levels. (OCC Ex. 21 at 6, 20-24.) Setting aside the unfounded attacks on the Auditor's credibility and independence as well as the related allegations of undue influence on the Auditor by AEP Ohio (these items are discussed separately below), OCC's reliance on the "best interests" comment is inappropriate simply because it was not in the final Audit Report and was not the Auditor's final opinion. (Tr. II at 495-497, 526-527.) For example, Dr. Fagan also indicated that costs are not always the driver for customer's best interest and other things such as reliability can be very important. (Id. at 384-386, 605.) In any case, it makes no sense to force the Auditor to support a finding based on a fleeting observation that it abandoned for good reasons. And it is not OCC's place to force other parties to adopt OCC's views or put words into an Audit Report that are not there. Fundamentally, the Commission must make findings based

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[2] The financial hedge arguments are further addressed elsewhere in this brief. *See* Argument Section V.B, *infra*.

on the record evidence and the draft Audit Report was not admitted as evidence and did not contain the "best interests" language sought to be included by OCC.

OMAEG witness Seryak also launches improper collateral attacks on the Commission's prior decision in the *PPA Rider Cases*, by recommending total disallowance of the PPA Rider charges during the audit period because the underlying costs "are not part of a market cost of market revenue stream" and by recommending total disallowance of PPA Rider charges during the audit period because the rider "is neither functioning as a financial hedge nor a rate stabilization charge." (OMAEG Ex. 1 at 3-4, 13-14, 21-22.) In support of his recommendation for total exclusion of PPA Rider charges, Mr. Seryak argues that the PPA Rider "resulted in charges during the audit period" and he harkens back to the original ruling in *ESP III* denying the OVEC-only PPA Rider – choosing to ignore the intervening final order approving the OVEC-only PPA Rider. (Id. at 14.) This approach is also an improper collateral attack on the Commission's decision to approve the OVEC-only PPA Rider.

These intervenor arguments rely on data and information after the audit period and clearly show that intervenors are making improper "Monday morning quarterback" prudence arguments. More to the point, the intervenor recommendations for total disallowance of all OVEC costs during the audit period clearly represent improper collateral attacks on the Commission's decision in the PPA Rider cases and directly undermine the entire purpose and effect of the Commission's decision to approve the ICPA for inclusion in the PPA Rider during the audit period – especially given the hindsight nature of the arguments.

Intervenor arguments for a total refund here are like saying they want all of the premiums refunded after a property insurance policy period ends because they now know that their houses did not burn down. Although it is rare and unlikely for an individual's home to burn down, it is a real risk that should be insured against. Does that mean that a customer's home insurance policies paid over a number of years have been wasted expenditures? More to the point, should a refund occur when both parties agreed to implement the insurance policy from the outset? Of course not! The insurance policy and the coverage to pay losses associated with such potential circumstances brings stability and peace of mind (and is required by a lender if there is a mortgage on the property) – even though nobody expects their house to burn down at the time they purchase an insurance policy. All of these intervenor arguments should be categorically denied.

B. Intervenor Arguments that AEP Ohio was Supposed to "Manage" the Financial Hedge During the Audit Period are Misguided and the Claim that the Company used the PPA Rider as a "Blank Check" is Without Basis.

OCC witness Glick asserts that AEP Ohio did not conduct a competitive bidding process when selecting OVEC to serve as a price hedge and that other resources could have been used at a lower price. (OCC Ex. 14 at 34-35.) On cross-examination, Ms. Glick clarified that she was referring to the time before the OVEC-only PPA Rider was approved and the subsequent period after that. (Tr. IV at 1048-1049, 1051-1052.) OCC witness Haugh also complained that the Company has not conducted a competitive bidding process under the PPA Rider and asserted that the OVEC-only PPA Rider did not reasonably serve as an economic hedge during the audit period. (OCC Ex. 21 at 12, 19.) Mr. Haugh admitted that his assertion that the PPA Rider did not reasonably serve as a financial hedge during the audit period was an after-the-fact observation. (Tr. V at 1446.) Similarly, OMAEG witness Seryak argued that the Commission could disallow all net charges if "all of those costs were related to an imprudent decision," but the only such purportedly all-encompassing decision he identifies is that he "do[es] not believe that AEP Ohio implemented Rider PPA as a financial hedge or rate stabilization charge." (Tr. IV at 1325-26.) These intervenor claims conflict with the *PPA Rider* decision and are otherwise misguided.

The PPA Rider operates as a financial hedge that is counter-cyclical to market prices – without regard to whether the OVEC costs are below market prices or above market prices at a given point in time. This intrinsic concept is rooted in the Commission's orders and is a function of the mechanics of the rider. It does not require or contemplate (or authorize) active management of the hedge by the Company. The Auditor, Dr. Fagan, concluded that the issue of whether the PPA Rider was functioning as a financial hedge was out of scope for this audit and the Auditor did not review whether the Company was monitoring the performance of the PPA Rider as a hedge. (Tr. I at 166.)

The Commission indicated that it was approving population of the PPA Rider "as a financial hedging mechanism" and made specific findings about how it would benefit customers:

> The PPA rider will supplement the benefits derived from the staggering and laddering of the SSO auctions and protect retail customers from price volatility in the market. The record reflects that the PPA rider will provide added rate stability during periods of extreme weather, when the rider can be expected to offset severe price spikes. The different scenarios reflected in AEP Ohio's projection of the PPA rider's impact demonstrate the effect of variation in load due to severe weather or economic factors, including the asymmetric impact that such factors have on electric prices, where increases in load tend to increase prices more so than load reductions decrease prices. If load increases due to weather or economic conditions, shopping and SSO customers will be exposed to the resulting higher wholesale prices, which the PPA rider will partially offset.

PPA Rider Order at p. 83. The Commission went on to reaffirm its prior finding in *ESP III* that the PPA Rider was "an essential component of AEP Ohio's ESP" adopted under R.C.

4928.143(B)(2)(d), the ESP statute, that "provides the benefit of a more balanced hedge than relying exclusively on the market." *Id*.

On rehearing, the Commission made this point particularly clear when it observed that the rider's design ensures that the rider will act in a countercyclical manner to market prices and found that "[t]he PPA rider *mechanism* will *prevent* customers' total reliance on the market." *PPA Rider Entry on Rehearing* at ¶¶ 216, 220 (emphasis added). By its structure, if market prices are up, the PPA Rider becomes a credit; when market prices are down, the rider becomes a charge. Either way, the rider acts to stabilize volatile market prices. And as the Commission found, the PPA Rider "prevents" customers from totally relying on market prices – which is exactly what the revisionist intervenors now argue is required.

In reviewing these conclusions on appeal, the Supreme Court of Ohio also recognized that "the PPA Rider was designed to act as a financial hedge against market volatility, particularly during extreme weather conditions," and the Court upheld the approval of the OVEC-only PPA Rider because "the OVEC-only PPA Rider retained value as a financial hedge." *PPA Rider Appeal* ¶ 59. The Court further explained that the "intended purpose of the rider was to provide a financial hedge against fluctuating prices in the wholesale power market in order to stabilize retail-customer rates." *Id.* at ¶ 3. None of the findings of the Commission or the Court are contingent on OVEC costs creating a below-market credit, as intervenors' theory assumes. Rather, it was always envisioned as a passive hedge that was set up and operated automatically in response to market prices.

Moreover, unlike the premise of OCC witness Glick's and OMAEG witness Seryak's position, there was no requirement for competitive bidding to include OVEC because that was the whole purpose of the PPA Rider cases and was already decided by the Commission in that case. There is no basis to actively manage the hedge and no reason to procure an alternative source of power since the PPA Rider was a financial mechanism and is not used to serve load. AEP Ohio had no unilateral authority under the *PPA Rider* decision to manage the hedge as intervenors now conveniently assert.

As a related matter, OCC witness Haugh says that because the PPA Rider has produced charges and not credits, calling it a hedge is "window dressing" and "AEP Ohio is treating the PPA Rider as a blank check." (OCC Ex. 21 at 26.) Of course, the phrase "blank check" was not coined by OCC witness Haugh in this context but was quoted from then-Commissioner Haque's concurring opinion in the PPA Rider cases. Mr. Haugh testified that he agrees with the section of then-Commissioner Haque's concurring opinion in which the "blank check" statement was made and intended to cite the statement for its true purpose and in its proper context. (Tr. V at 1430, 1432-1433.)

But as Mr. Haugh admitted, then-Commissioner Haque explicitly stated in the section leading up to the "blank check" admonition that "there is general consensus that the PPA riders will result in a charge to consumers for at least the first two to three years of the riders. Because the Commission feels somewhat certain of this, we have attempted to build in certain consumer protections to ensure that bills do not increase beyond a certain limit." (Tr. V at 1432); *PPA Rider Order*, Haque Concurring Opinion at 4. Mr. Haugh thus reluctantly acknowledged that then-Commissioner Haque made the “blank check” statement in the context of fully expecting charges under the PPA Rider for the first 2-3 years. (Tr. V at 1433.)

Mr. Haugh also acknowledged that, just like then-Commissioner Haque did at the time off the PPA Rider decision, OCC also projected a charge for at least the first few years. (Tr. V at 1445-1446.) Of course, the Commission also established a rate cap for the first two years of the PPA Rider since charges were expected to flow through the rider during that period. (Tr. V at 1456.)

In sum, the fact that the PPA Rider produced charges during the first few years does not mean that AEP Ohio mismanaged the rider or that the Company is using the rider as a “blank check”; it just means that market prices were low relative to the OVEC costs.

C. There is no Basis to Conclude that the Auditor Lacked Independence or was Subject to Undue Influence Favoring AEP Ohio.

OCC witness Haugh claims that emails between Staff and the Auditor show a “pro-utility influence” by Staff that “undermined the independence of the Auditor” and concluded that the emails “raise concerns about regulatory capture.” (OCC Ex. 21 at 23-24.) And OCC’s counsel spent several hours of cross-examination trying to address the draft audit report and generally questioning the Auditor’s independence – advancing the perverse notion that the Auditor’s only shining moment was when it initially drafted the “best interests” sentence it decided to remove. Mr. Haugh also claimed that the PUCO process “would have remained secret but for OCC’s public records request.” (OCC Ex. 21 at 23.) All these claims lack merit and amount to speculative rhetoric by OCC. Dr. Fagan testified that independence in this context means that the Auditor is ultimately responsible for the contents of the Audit Report – regardless of what recommendations the Auditor may receive from stakeholders – and she took full ownership of the contents of the final Audit Report. (Tr. I at 58, 60; Tr. II at 506.)

The sentence "However, LEI's analysis shows that the OVEC contract overall is not in the best interest of AEP Ohio ratepayers" was removed from the draft Audit Report. (Tr. II at 505.) Dr. Fagan decided to remove the sentence because it was "too broad a statement." but was a "refer[ence] to the sentence afterward[,]" which stated that "the OVEC plants cost customers more than the cost of energy and capacity that could be bought on the PJM wholesale markets." (Id. at 510, 514-515.) Dr. Fagan explained that "[LEI's] analysis showed that the plants cost the customers more than the cost of energy and capacity that could be bought on the PJM wholesale markets. That's what the analysis showed. And that's the piece that I preserved for the final report." (Id. at 511.)

Dr. Fagan testified, in connection with AEP Ohio Ex. 29 showing an email she had sent concerning the draft report, that she had already decided to delete the sentence in question when she sent a communication that first informed AEP Ohio of the language and before she received any feedback from AEP Ohio. (Id. at 638, 644; AEP Ohio Ex. 29.) Staff witness Windle also confirmed his understanding based on overseeing the audit and reviewing all the correspondence that there was no substantive change recommended to the Auditor by the Company regarding the draft Audit Report. (Tr. VII at 1883.) Thus, the record is clear that AEP Ohio had zero influence on the Auditor's decision to delete the sentence.

Moreover, had the Auditor decided to actually retain the draft "best interests" statement in the final report, it would have exceeded the scope of the Audit and improperly encouraged re-litigation of the PPA Rider decision. As Staff witness Windle properly observed, the purpose of this Audit "was not to reconsider the past PUCO findings and orders within Case No. 14-1693-EL-SSO, or the impact of the HB 6 legislation" and his understanding "is that questions as to whether there should be a Rider or the cost benefit metrics of the OVEC plants were litigated and resolved in Case No. 14-1693-EL-SSO and are outside of the scope of this audit." (Staff Ex. 3 at 5, 7.) Because re-examining the inclusion of the ICPA in the PPA Rider during the audit period was already decided and would have exceeded the scope of this audit, it would be inappropriate to force the Auditor to make such an adverse "best interests" finding in this case. Simply stated, it is irrelevant whether either OCC or the Auditor agree with the Commission's prior decision to approve the ICPA for inclusion in the PPA Rider. So allowing any party to testify on that subject – let alone forcing a party to testify – is wholly inappropriate.

Regarding Mr. Haugh's unfounded allegation of a secret process, the RFP was publicly issued and clearly provided that Staff would oversee the project, be informed of correspondence between the Auditor and the Company, and be given advance notice of interviews and meetings. *RFP* at § II.C. Indeed, the RFP also specified some level of detail about how the Auditor should keep Staff in the loop during the investigation and went on to provide for draft audit report should be send to Staff at least 10 days prior to the due date. *Id*. at § V.C. & D. Indeed, OCC witness Haugh already understood that the Auditor was obligated to provide the draft report to Staff. (Tr. V at 1394-1395.) And Mr. Haugh admitted that neither the Auditor nor the Staff had any obligation to share the draft Audit Report with OCC. (Tr. V at 1393-1394, 1398-1399, 1402.) Finally, with respect to Mr. Haugh's unsupported allegations of a secret process, he acknowledged that AEP Ohio produced the draft audit report and over a thousand pages of correspondence in response to an OCC discovery request that encompassed those materials and similar material that was released by the Commission in response to a public records request. (Tr. V at 1450-1452.) Thus, OCC witness Haugh's statements concerning "a secret process" are completely inaccurate.

Further, there is nothing unusual or inappropriate about the Auditor sharing its draft before finalizing and docketing the report. As a general matter, the Auditor indicated that, in her experience, draft reports are "almost always" shared with certain stakeholders. (Tr. I at 58.) And Staff witness Windle confirmed that such draft report sharing occurred in all four of the OVEC-related audits he has been involved with for Staff. (Tr. VII at 1884-1885.) Indeed, OCC witness Haugh even acknowledged that a utility such as AEP Ohio in this case that submits confidential information in the audit has an interest in confidentiality and he opined that such parties "should have the ability to verify that confidential information is not released in the Audit Report." (Tr. V at 1396-1398.) In order to exercise that right, Mr. Haugh agreed that it is reasonable that the utility review a draft of the Audit Report. (Id. at 1399.)

The OCC's illusory "regulatory capture" allegation by OCC fares no better. As explained during cross-examination, Mr. Haugh's use of the phrase "regulatory capture" is a concern where the decision-maker become overly interested in the Companies they regulate. (Id. at 1403.) Mr. Haugh ultimately admitted he "didn't delve very deeply into" the regulatory capture concern other than reading the emails. (Id. at 1403.) And OCC witness Haugh confirmed that he has never spoken with the Auditor and has no personal knowledge as to why certain statements were made or removed from the Audit Report. (Id. at 1385-1386.) On a more substantive level, Mr. Haugh acknowledged that an agreement or favorable position by one stakeholder is not evidence of undue influence by the other party. (Id. at 1453.) Indeed, Mr.

Haugh acknowledged that OCC and AEP Ohio have reached several important settlements in recent years that resolved a large number of cases. (Id. at 1453-1454.)

Consequently, there was no undue influence on the Auditor by AEP Ohio, and OCC's rhetorical concerns about the Auditor are misguided and lack any basis in reality.

D. OVEC's Must-Run Commitment Strategy for the PJM Energy Market During the Audit Period was Reasonable.

Several parties take issue with OVEC's use of a must-run commitment strategy in the PJM energy markets during the audit period. (*See* NRDC Ex. 3 at 15; OCC Ex. 14 at 52; OCC Ex. 21 at 27.) These criticisms, however, are misguided. The Auditor thoroughly examined OVEC's must-run commitment strategy, and though she recommended that OVEC "carefully consider when and whether the must-run strategy is optimal," the Auditor did <u>not</u> find the use of the must-run strategy during the audit period imprudent, and the Auditor did <u>not</u> recommend any disallowance. (*See* Tr. II at 568-69) (Auditor agrees that she "did not conclude that must-run was an imprudent action during the audit period"). Indeed, OVEC's use of a must-run commitment strategy during the audit period was reasonable, and the parties' criticisms of the must-run strategy should be rejected.

1. Background: commitment vs. dispatch.

Understanding OVEC's must-run commitment strategy requires some background on the PJM energy markets. As AEP Ohio witness Stegall explained, the PJM energy markets involve two separate concepts, *commitment* and *dispatch*. (AEP Ohio Ex. 1 at 8.) As part of its participation in the PJM energy market, OVEC is required to designate a *commitment* status for each of its units every day. (Id.) There are four commitment statuses: Not Available, Emergency, Must-Run, and Economic. (Id.) *Not available* means that a unit is in an outage and incapable of delivering energy. (Id.) *Emergency* means that a unit is available to deliver energy only in an emergency. *Must-run* (which is also called *self-commitment* or *self-scheduling*) means that the unit "must-run" at least at its economic minimum level of output, though the PJM dispatch model may call on the unit to deliver energy above its economic minimum. (Id.) *Economic* means that the PJM dispatch model may choose the unit to operate at a certain level of output, or it may choose not to run the unit at all, and the unit must shut down. (Id.)

Dispatch, by contrast, is the process by which the PJM dispatch model chooses whether a unit will run, and how much energy it will deliver, within the confines established by the unit's commitment status. (Id.) As noted above, a unit with a must-run commitment status will be dispatched at a level between its economic minimum and economic maximum, depending on various factors including the unit's cost. A unit with an economic commitment status may not be called to run at all, or it may be called on to run and dispatched at a certain level of output – again, depending on various factors including cost. (Id.)

2. OVEC's must-run commitment strategy during the audit period was reasonable.

During the audit period, the OVEC Operating Procedures, established by the OVEC Operating Committee, required OVEC to commit all in-service units except Clifty Creek 6 as must-run. (AEP Ohio Ex. 1 at 9.)[3] This must-run commitment strategy was entirely reasonable given OVEC's design and operating characteristics.

Clifty Creek and Kyger Creek, OVEC's two generating facilities, were built in the mid-1950s to provide baseload generation. (Id. at 10.) This means that they were designed to start up

[3] During the Ozone Season, Clifty Creek 6 was committed as economic based on its NOx emissions profile. (AEP Ohio Ex. 1 at 9.)

and stay on for a long time. (Id.) As wet-bottom coal-fired generators, the OVEC units are not capable of instantaneous startup and shutdown and were not designed to be cycled on and off frequently. (Id.) OVEC's must-run commitment ensured that the OVEC units would operate as designed – i.e., as base load units – because it required the PJM dispatch model to keep the units on at their economic minimum and not cycle the units on and off. (Id.)

If, instead, the OVEC units had been committed as economic during the audit period, the units could have been dispatched by PJM in a manner at odds with the units' design, leading to increased costs and potentially causing damage. (Id.) The units could have failed to start due to thermal cycling or other cycling issues, causing potential damage, additional maintenance expense, and the loss of market revenues. (Id.)

Ensuring that the OVEC units continued to run as designed – *i.e.*, as base load units – was an appropriate long-term economic strategy. PJM's energy markets are limited because they do not consider any factors beyond the *next day*. (Id.) There are many aspects of running baseload generators, however, that require a planning horizon far beyond a single day. For instance, to receive a more favorable price for coal, OVEC has entered into long-term coal contracts with regularly scheduled deliveries. If OVEC units were to cycle on-and-off instead of operating as baseload generators, coal deliveries could pile up, causing an unsafe overabundance of coal. (Id.) In addition, baseload generators such as the OVEC units have mandatory environmental testing and PJM-mandated testing that require them to be online and performing. (Id.) The OVEC units' long-term planning horizon means that it may be more economical in the long run to keep these units on even if they lose money in the short run. For example, as AEP Ohio witness Stegall explained, "it may be cheaper to keep OVEC units online during a weekend even though prices are generally lower and OVEC may appear to be selling at a loss, because the expense to restart units Monday morning is greater than the loss that would be realized by keeping the units on." (Id.)

The economic benefits of must-run commitment – *i.e.*, of running the OVEC units as base load generators, as they were designed – were realized during the audit period. AEP Ohio witness Stegall calculated that AEP Ohio's customers received a net benefit of $32 million from OVEC's participation in the PJM energy markets using a must-run commitment strategy during the audit period. (Id. at 11.) This $32 million benefit, moreover, does not include all the costs that the OVEC units *avoided* by running as designed. As explained above, if the OVEC units had been committed as economic, they could have been cycled on-and-off far more frequently than designed, potentially causing the plants to fail when called on by PJM, causing parts to wear out more quickly, and even causing damage to plant equipment. None of these potential cycling costs were incurred during the audit period. In sum, the must-run commitment strategy resulted in $32 million of net benefits to customers while avoiding significant lost revenue and maintenance costs that would have been incurred if the plants had been run contrary to their design. That was a reasonable strategy.

3. AEP Ohio could not unilaterally change OVEC's must-run strategy during the audit period.

OVEC's must-run commitment strategy during the audit period was reasonable, as explained immediately above. But even if AEP Ohio had wanted to change the must-run commitment strategy during the audit period, it could not have done so unilaterally.

The Commission has made clear that the question in an audit proceeding such as this is whether "*the Company's* actions were in the best interest of retail ratepayers." *PPA Rider*

Second Entry on Rehearing at ¶¶ 70-71 (emphasis added). The Commission further clarified that the purpose of the audit is to "review the accuracy and appropriateness of the rider's accounting and the prudency of *AEP Ohio's decisions*." *PPA Rider Order* at 90 (emphasis added). Here, this standard requires focusing on what AEP Ohio could – and could not – have done about OVEC's must-run commitment strategy during the audit period.

As noted above, OVEC's must-run commitment strategy during the audit period was dictated by the OVEC Operating Procedures. The OVEC Operating Procedures were set by the OVEC Operating Committee. The OVEC Operating Committee, in turn, was established by the FERC-jurisdictional ICPA. Under the ICPA, each OVEC "Sponsoring Company" is entitled to appoint one member to the Operating Committee, except that Sponsoring Companies that are affiliates are entitled to only one member. (*See* AEP Ohio Ex. 7, at 46.) This means that AEP Ohio and its affiliates Appalachian Power Company and Indiana Michigan Power Company together share one member on the Operating Committee. Furthermore, the decisions of the Operating Committee, "including the adoption or modification of any procedure of the Operating Committee," require "the affirmative vote of at least two-thirds of the members of the Operating Committee." (Id.; *see also* AEP Ohio Ex. 1 at 4-5.) Therefore, to change the must-run commitment provision of the Operating Procedures, and thereby allow OVEC to offer its units with an economic commitment during the audit period, would have required at least a two-thirds vote of the OVEC Sponsoring Companies. AEP Ohio could not have accomplished this alone.

4. The auditor's recommendations concerning the must-run strategy are reasonable.

As noted above, the Auditor thoroughly examined OVEC's use of the must-run commitment strategy during the audit period, and the Auditor did <u>not</u> find this strategy imprudent and did <u>not</u> recommend any disallowance. (*See* Tr. II at 568-69.) Rather, the Auditor recommended as follows:

> LEI recommends that OVEC carefully consider when and whether the must-run offer strategy is optimal, as it appears that in some months, it may result in negative energy earnings for the plants. Weekly demand and price outlooks can be utilized, for example, to determine whether and how to offer generation during a given block of time, considering start-up costs and other factors.

(Staff Ex. 1 at 53.) As AEP Ohio witness Stegall testified, AEP Ohio agrees with this recommendation. (AEP Ohio Ex. 1 at 12.)

As described above, the must-run commitment strategy set forth in the OVEC Operating Procedures can only be changed by a two-thirds vote of the Operating Committee members. The Operating Committee regularly examines and discusses OVEC's operating status, including the must-run strategy. As AEP Ohio witness Stegall explained, the Operating Committee "would change to an economic commitment status if there [were] a substantial change in the market and there was a sustained period of low prices or other circumstances develop that warrant consideration of an Economic commitment." (AEP Ohio Ex. 1 at 12.) Indeed, when asked on cross-examination whether the OVEC Operating Committee had ever permitted OVEC to offer the units with an economic commitment, Mr. Stegall stated that the Operating Committee had done so during the pandemic in 2020. (Tr. III at 883-84, 959-960.)

Although AEP Ohio cannot unilaterally change the OVEC Operating Procedures to permit economic commitment, the Auditor found that AEP Ohio was "well represented in OVEC Operating Committee's meetings with active engagement." (Staff Ex. 1 at 46.) AEP Ohio will continue to actively participate in the Operating Committee's ongoing evaluation of the must-run commitment strategy and will encourage the Operating Committee to undertake the "careful[] consider[ation]" of the must-run strategy that the Auditor recommends. (Staff Ex. 1 at 53.)

5. A hypothetical, retroactive redispatch analysis of the OVEC units' participation in the PJM energy markets is unworkable and unwise.

Kroger and OMAEG have argued that the Auditor should have conducted a redispatch analysis of the OVEC units to determine what net revenues OVEC would have realized if it had committed its units as economic instead of must-run during the audit period. (Joint Comments of Kroger Co. & OMAEG at 4.) Other parties have suggested that the Commission disallow costs based on OVEC's use of a must-run commitment during the audit period. (*See* NRDC Ex. 3 at 21; OCC Ex. 21 at 27.) These proposals should be rejected because they are at odds with the prudence standard, are unnecessary, and would involve prohibitively complex and difficult backward-looking calculations that no parties have properly made.

As an initial matter, the kind of after-the-fact, 20/20 hindsight embodied by the proposed redispatch analysis and disallowances are at odds with the prudence standard. As explained above, the prudence test examines whether an expenditure "was prudent when it was made." *Suburban*, 2021-Ohio-3224, ¶ 32. The prudence test "places the risk of a failed investment on the customers, who must pay so long as that investment was prudently made." *Id.* Thus, a proper examination under the prudence test should consider *only* those facts and circumstances known at the time the decision was made.

Here, the proposed redispatch analysis and disallowances are improper under the prudence standard because they do not focus on what OVEC knew at the time it made unit commitments. That is, they do not look at whether a must-run commitment was reasonable given forward-looking energy forecasts and other market forecasts available at the time. Instead, a redispatch analysis second-guesses OVEC's energy market commitments based on what market prices actually turned out to be. That is unfair, and contrary to the prudence standard, because OVEC's Operating Committee and management never knew what future market prices would be. Rather, during the audit period, they had to do the best they could based on projections of future market prices, as well as projections of potential OVEC costs.

Just as importantly, a redispatch analysis would provide a misleading picture because it would not consider the cost of cycling outside design parameters. As described above, the OVEC Operating Committee's must-run strategy is intended to reflect the design and operating characteristics of the OVEC wet-bottom coal units, which were built to be run for long periods as base load generators and not cycled on-and-off. If one were to redispatch the OVEC units based on an economic commitment – cycling the units off-and-on based on daily energy prices – one would have to offset any additional net revenues by the likelihood and cost of failed start-ups, additional maintenance costs, and potentially even plant damage resulting from running the units in a way they were not designed to run. No party to this proceeding has even attempted to provide a way of calculating these costs. Indeed, the costs from constant cycling would be extremely difficult to predict, both in terms of the likelihood of the cost being incurred and in terms of the amount. As AEP Ohio witness Stegall explained:

> Such an analysis would also have to take into account operational characteristics like the OVEC units' minimum down time, their startup time, their startup cost,

> and the added risk and cost associated with cycling a baseload unit. It would also need to take into account days when units were running in order to satisfy mandatory environmental or RTO testing. An analysis that took into account all of that information would be prohibitively difficult, expensive, and time-consuming without any guarantee of being able to accurately evaluate the decisions made at the time.

(AEP Ohio Ex. 1 at 15.)

Moreover, there is additional information that would be critical to conducting an after-the-fact redispatch analysis that neither AEP Ohio nor any other party could ever obtain. For one thing, OVEC is responsible for operating the OVEC units and submitting all required information to PJM, including daily energy market price curves. OVEC keeps this information strictly confidential and does not provide it to Sponsoring Companies. (AEP Ohio Ex. 1 at 15; *see also* Staff Ex. 1 at 44) ("ICPA participants, including AEP Ohio, do not have access to and cannot view hourly [OVEC unit] offer history. They only can view their respective ownership share of market awards. This ensures that competing OVEC owners are kept at arm's length."). For another thing, no one in PJM has full access to the PJM economic dispatch model, and therefore any redispatch analysis "would have no way to determine the effect of reduced generation on regional reliability or transmission congestion." (AEP Ohio Ex. 1 at 15.)

6. Seasonal operation is equally unworkable and unwise.

OCC suggests that OVEC should have undertaken "seasonal operation" during the audit period, only running its units during the summer and winter months when energy prices are allegedly higher. (*See* OCC Ex. 14 at 60.) This proposal is utterly unworkable and would cause considerable harm to AEP Ohio's customers.

Most importantly, because AEP Ohio and other Sponsoring Companies sell their share of OVEC capacity into the PJM capacity market, the OVEC units are prohibited from shutting down in spring and fall for economic reasons. (AEP Ohio Ex. 1 at 15; *see also* Tr. II at 602) (the Auditor agrees that a PJM capacity resource cannot operate seasonally). Instead, the OVEC units must be offered into the PJM energy markets, and they must be available to perform on PJM capacity performance periods. (AEP Ohio Ex. 1 at 15-16.) Capacity performance events can happen at any time, including during the months when OCC believes OVEC should have shut down per seasonal operation. During the audit period, for instance, a capacity performance event occurred during the fall, i.e., on October 2, 2019. (Id. at 16.) AEP Ohio earned $40.2 million in capacity revenues during the audit period from selling its share of OVEC in the PJM capacity market. (Id.) Had OVEC operated seasonally, AEP Ohio would have lost these capacity revenues to the detriment of its customers.

Furthermore, in addition to foregoing capacity revenues, there is no demonstration that OVEC would have saved any costs by operating seasonally. For instance, OCC witness Glick admitted that she did not evaluate the economics of moving the OVEC plants to seasonal operation. (Tr. IV at 1068.) Likewise, the Auditor did not evaluate seasonal operation as part of the audit. (Tr. I at 259.) Moreover, although OCC witness Glick baldly claimed that there were "studies" that showed "savings" from switching coal-fired plants to seasonal operation, she admitted she did not cite any of those studies in her testimony. (Tr. IV at 1072-1073.)

E. There are No Allegations that AEP Ohio or OVEC Acted out of Compliance with the ICPA.

The PPA Rider was approved to allow charges or credits related to "net credits or costs of AEP Ohio's contractual entitlement to a share of the electrical output of generating units owned by OVEC." *PPA Rider Order* at 24. Neither the Auditor nor any party in this proceeding has asserted that AEP Ohio or OVEC failed to act in accordance with the ICPA. Indeed, the intervening Parties spend a great deal of their testimony and efforts questioning the initial decision(s) approving the PPA Rider to include the ICPA. (*See supra* Section I).

It is also uncontested that OVEC billed AEP Ohio for the Company's share of energy and capacity costs in accordance with the ICPA. Section 5.02 of the ICPA sets forth how the energy charges will be assessed to sponsoring companies. (AEP Ohio Exhibit 7 at 188-189.) Specifically, energy charges are a monthly charge that include the total costs assigned to FERC Accounts 501, 506.5 and 509. Furthermore, Section 5.03 of the ICPA establishes a prescriptive categorization of how demand charges calculated and assessed to Sponsoring Companies. The demand charges are assessed monthly and contains six components – Components A through F. There are no allegations nor evidence that OVEC failed to bill and assign costs in accordance with the ICPA. To the contrary, the Auditor found that the fixed costs were "billed properly." (Staff Ex. 1 at 30.)

The ICPA and its accompanying documents establishes that "AEP Ohio is responsible for offering its share of OVEC capacity into the PJM Base Residual Auction and successive Incremental Auctions." (AEP Ohio Ex. 1 at 5.) No party has submitted testimony questioning or otherwise asserting that AEP Ohio failed to meet its obligation or otherwise imprudently bid into the PJM capacity markets. Indeed, the Auditor found that AEP Ohio offered OVEC as a capacity resource as part of the PJM Base Residual Auction, at a price the Auditor found to be prudent. (Staff Ex. 1 at 50.)

While there was much testimony and commenting about the prudency of OVEC decisions regarding participation in the energy markets, no parties have alleged or otherwise established that OVEC or AEP Ohio failed to abide by the terms of the ICPA or Operating

Procedures adopted by the Operating Committee. PJM operates two energy markets – the Day-Ahead market and the Real-Time market. (AEP Ohio Ex. 1 at 7.) Section 9.05 of the ICPA delegates certain operating decisions, such as designating the unit commitment status, to the Operating Committee. (AEP Ohio Ex. 7 at 196.) Each day, the OVEC units must designate themselves one of the four commitment designations – (1) must-run, (2) economic, (3) emergency, or (4) not available. (AEP Ohio Ex. 1 at 8). The Operating Committee designated ten of the eleven OVEC units as "must-run." (NRDC Exhibit 3 at JIF-6 p. 432.) It is uncontested that OVEC followed the Operating Committee designation during the audit period. It is also uncontested that OVEC followed he daily operating procedures

F. OVEC Contractual Coal Prices and Inventory were Reasonable and Prudent.

The Auditor found that the OVEC "coal contract terms seem reasonable" and "reflected market awareness and prudency." (Staff Ex. 1 at 70.) Citing to the coal prices for Clifty Creek, however, the Auditor recommended that OVEC "negotiate with the coal suppliers to ensure the delivery of coal with good quality but at more competitive prices." (Id. at 71.) Oddly, OMAEG witness Seryak cites identical language from the Auditor's October 21, 2020 audit of Duke's Price Stabilization Rider but goes on to question "why LEI did not include a similar finding in its audit report in this case regrading AEP Ohio's Rider PPA." (OMAEG Ex. 1 at 15, citing Case No. 20-167-EL-RDR, Rider PSR Audit Report at 64, 71.) Nevertheless, in making this recommendation, the Auditor's analysis indicated that the coal purchase prices for Clifty Creek were higher than the spot prices from SNL, primarily due to the coal purchased pursuant to the a certain fuel contract. (Staff Ex. 1 at 63.) But the SNL spot prices used for comparison do not account for the costs of delivery or transportation. (Tr. II at 584.) All of the OVEC coal contracts in effect at the time of the audit period include delivery to certain locations on the Ohio River, Monongahela River, and Green River, and some even include delivery at the plants themselves. (*See* AEP Ohio Ex. 13A.)

Despite misunderstanding the LEI Audit Report at issue in this case, OMAEG Witness Seryak embarks upon his own analysis of what he deems to be excessive coal prices. Seemingly, without conducting any sort of market price analysis, OMAEG Witness Seryak calculates that OVEC paid $24,316,087 in "above-market" coal purchased from Resource Fuels, $4,846,196 of which was assigned to AEP Ohio per its PPR. (OMAEG Ex.1 at 16.) Accordingly, Witness Seryak recommends disallowance of this amount that he deems imprudent. (Id. at 15.) But OMAEG Witness Seryak's analysis is a red herring without adequate support.

OMAEG Witness Seryak bases his analysis exclusively on comparing the Resource Fuels, LLC ("Resource Fuels") coal to that provided by Alliance Coal, LLC ("Alliance"). (Id. at 14-16.) Despite possessing all of the coal contacts for the audit period, Mr. Seryak relies exclusively upon EIA data. (Id. at 14-16.) In doing so, OMAEG Witness Seryak paints an overly simplistic picture in an attempt to establish OVEC overpaid Resource for "essentially the same coal." (Id. at 15.) Contrary to witness Seryak's assertions, not all of the coal from Resource Fuels and Alliance are mined from the same location nor delivered to the same location. (*See generally* AEP Ohio Ex. 13A.)

Putting factual misstatements aside, Mr. Seryak's analysis is still one of apples and oranges. The Resource Fuels contract is long-term contract that was executed in January 2012. (Id. at 199.) OVEC executed numerous contracts with Alliance for delivery over the audit period, none of which appear to have been relied upon by OMAEG Witness Seryak. The Alliance contracts vary in length, price, and delivery location; all of were executed many years later for significantly shorter lengths than the Resource Fuels contract. (Id. at 174.) A long-term product contracted in 2012 is very different from the multiple short-term products executed throughout 2017 and 2019. Certainly, no one would expect to pay the same for a thirty-year mortgage on a house purchased in 2012 compared to a ten-year mortgage on the same house in 2018 by claiming "it is the essentially the same house." The same logic applies to contracting for coal based upon different lengths at remarkably different time periods.

In addition to pricing, the Auditor also analyzed the coal inventory levels at OVEC, has a process and cross-functional team to determine fuel inventory targets. (Staff Ex. 1 at 73.) The Auditor also recognized the many factors that impact setting inventory targets – shipment distance, lock risks, river conditions, load dispatch, maintenance and other outages, and coal year equipment. (Id. at 72.) The Auditor initially found that "coal inventory levels in 2018 were "more or less in line with targets" but were substantially higher than inventory targets in 2019. (Id. at 75.) Subsequently, however, the Staff filed an Errata to the Audit Report at the Auditor's request. (OCC Ex. 2; Tr. II at 406-413.) In that Errata, the Auditor admits to "incorrectly calculating the monthly average days of coal inventory for the Clifty Creek and Kyger Creek plants" on pages 73-74 of the Audit Report. (OCC Ex. 2.) The inventory on hand should have been calculated based on full load, instead of average coal burn," but the Auditor did not offer updated calculations. (Id.) Therefore, the Auditor's coal inventory analyses on pages 73-74 are not accurate. (Tr. II at 409.)

Quoting the Audit Report, NRDC Witness Fisher also takes issue with the coal inventory levels "significantly exceed[ing]" OVEC's recommended inventory. (OMAEG Ex. 3 at 29, citing Staff Ex. 1 at 74.) In fact, Dr. Fisher relied exclusively upon Auditor analysis of coal inventory. (Tr. IV at 1198.) But those are precisely the pages that the Auditor disclaimed as part of the Errata. Moreover, Dr. Fisher acknowledged that OVEC acquired its coal through laddered bilateral contracts. (Tr. IV at 1187-1189.) Many of those contracts were sourced through requests for proposal, which Dr. Fisher did not contest. (Staff Ex. 1 at 59; Tr. IV at 1188.) And some of those contracts, were long-term contracts that predated the PPA Rider and certainly predated the audit period of January 1, 2018 through December 31, 2019. Thus, there is no evidence to support the notion that AEP Ohio or OVEC acted imprudently in sourcing fuel for the OVEC units during the audit period.

VI. CONCLUSION

For the reasons provided above, AEP Ohio respectfully requests that the Commission adopt each of the Company's positions, as outlined above, as its decision in these proceedings.

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 *Ohio Power Company's Merit Brief* was sent by, or on behalf of, the undersigned counsel to the following parties of record this 18th day of March, 2022, via e-mail.

/s/ Steven T. Nourse
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