

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

**In the Matter of the OVEC Generation)
Purchase Rider Audits Required by)
4928.148 for Duke Energy Ohio, Inc.) Case No. 21-477-EL-RDR
the Dayton Power and Light Company,)
and AEP Ohio.)**

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

Pursuant to the Attorney Examiner’s April 7, 2023 Entry, Ohio Power Company (“AEP Ohio” or the “Company”) submits the following initial comments regarding the compliance audit report that London Economics International LLC (“LEI” or the “Auditor”) filed on December 17, 2022, regarding LEI’s review of costs associated with AEP Ohio’s contractual entitlement to a share of the electrical output of generating units owned by the Ohio Valley Electric Corporation (“OVEC”) for the period of January 1, 2020 through December 31, 2020. Overall, AEP Ohio notes that the Auditor found no instances of imprudence and recommends continuation of many practices and activities already being implemented by OVEC. AEP Ohio will address each recommendation below.

AEP OHIO RESPONSES TO THE AUDITOR’S RECOMMENDATIONS

Components of Fixed Cost:

The Auditor states, “The components of fixed costs were billed properly. However, one component of fixed costs, referred to as ‘Component (D)’ in the OVEC bill, is identified by the ICPA as a payment per common share (similar to a dividend). OVEC’s capital expenditures are not part of a rate base for which they are allowed a regulated rate of return, but Component D is itself a return to the owners of OVEC.” (Audit Report at 9.) While LEI acknowledges that the

Component D charges are “not a large share of the overall OVEC bill to customers,” LEI states that “the Commission may wish to examine this” because “ORC 4928.01(A)(42) requires that *“Prudently incurred costs ...must exclude any return on investment in common equity...”* (Id.)

Response:

“Component (D)” is a component and a cost of the FERC-approved Amended and Restated Inter-Company Power Agreement (ICPA); the prudence or reasonableness of the ICPA is not part of this audit. “Component (D)” refers to OVEC’s return on equity and is a fixed amount that never changes (a fixed rate times the amount of stock, that has not changed since the 1950s) and amounts to less than 1% of total demand charge or fixed costs. In the past, a dividend has been paid back to the owners, but as of this audit period this payment has not occurred since 2014. There should not be selective challenges to the individual components or the ICPA payment terms approved by the FERC and existed at the time of passage of R.C. 4928.148.

Disposition of Energy and Capacity:

The Auditor states and recommends, “OVEC energy and capacity are sold into the PJM markets; OVEC typically self-schedules its units in the PJM day-ahead market (in other words, OVEC informs PJM that a unit’s availability status is “must run”). The alternative to must-run availability status for a unit which is not on outage is to offer the unit so that it may be committed by PJM (in other words, OVEC would inform PJM that availability status is “economic”).” (Audit Report at 9-10.) Despite recognizing the prudent decision for the OVEC Operating Committee (“OC”) to give OVEC temporary permission to be committed as “must run” or “economic” from April 14, 2020 through June 30, 2020 (Audit Report at 10, 41-42, 48), “LEI’s analysis (based on monthly average PJM prices) shows that some of the time, the PJM

energy price did not cover fuel and variable costs.” (Audit Report at 10.) As such, LEI recommends that “AEP Ohio should encourage the Operating Committee to allow OVEC the option to commit available units based on must-run economics on an ongoing basis.” (Audit Report at 48.)

Response:

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

In adopting the scheduling procedures, including for offering energy into the PJM energy market, the OC reviewed other dispatch models, and considered the impact on the generating units. For instance, the OVEC generating units are designed to operate as “base load” generation and any dispatch procedure that would cause the units to cycle on and off based on scheduling and dispatch would have an adverse impact on the units, both in terms of availability and increased costs to maintain and operate the units. Indeed, LEI recognized that coal plants “are design to operate continuously” and that “[economic dispatch] can cause difficulties in managing staffing and fuel deliveries, and repeated start-up of coal plants can damage equipment.” (Audit Report at 10, 48.) The operating procedures as approved by the OC generally require that the available energy from OVEC that is allocated for bids into PJM is submitted on a “must run” basis. Further, the OC periodically reviews these procedures and considers proposals to change them from any Sponsoring Company, including review of the “must run” option for PJM bids. Indeed,

the OC made such a change in response to the unique circumstances that were presented at the beginning of the COVID-19 pandemic, which LEI found to be a prudent management decision. (Audit Report at 10, 48.)

Absent the extreme circumstances of the pandemic, a “must-run” offer produces the most value for the OVEC units due to the relationship of the units’ variable costs with the PJM energy and ancillary services revenue, especially after consideration of other factors such as cycling costs, risks, or other parameters. As a result, any commitment decision must factor in the cycling timing, risks, and costs. While PJM is solving for the most economic generation to serve its next operating day (Day Ahead Market) or in the current day (Real-Time Market), it is not evaluating economics in the long-term. OVEC, through its own processes, may identify economic usage by keeping its units online during periods when its variable cost is below market price. As is typically the case with any hedge, there are times when the underlying cost may exceed the market price for power and times when the cost is below the market price. Over the long-term, OVEC provides at-cost energy which acts as hedge during times of volatile and high natural gas prices – exactly the situation that presents itself in 2021 and 2022. For example, in 2022, the energy revenues earned from AEP Ohio’s share of OVEC exceeded the total amount billed to AEP Ohio.

Thus, OVEC’s utilization of must-run is reasonable and prudent. Nevertheless, AEP Ohio does not oppose LEI’s limited recommendation of encouraging the OC to allow economic commitment of the OVEC units. But it must be understood that AEP Ohio does not control the activities of the committee. Therefore, while AEP Ohio can make recommendations, any change in the bidding procedure requires the unanimous approval of the OC as such change would impact the availability of the OVEC generating units to all Sponsoring Companies, including two

Sponsoring Companies that do not allocate their share of OVEC's available energy for bids in the PJM energy market. As one of several members, AEP and, more specifically, AEP Ohio can only make its own recommendation to the OVEC sponsors.

Fuel and Variable Inventories and Cost:

The Auditor states, "coal inventory levels in 2020 were substantially higher than the inventory targets." (Audit Report at 10, 69.) As such, LEI makes a number of recommendations for AEP, in its role on the OC, to encourage: (1) OVEC to consider requirements contracts in the future to keep inventories from exceeding targets. (2) OVEC to procure slightly less through long-term contracts, and procure some coal through short-term contracts as needed. This will help keep inventories from exceeding targets, and (3) encourage OVEC to examine the process it uses to create coal burn outlooks, and its policy on taking deliveries of coal. (Audit Report at 69.)

Response:

While LEI did not make any specific recommendations related to coal price, the Auditor improperly calculated and compared coal prices to SNL spot markets based upon miscalculated average weighted contract prices for Clifty Creek (Figure 32) and Kyger Creek (Figure 33). Using the coal contracts provided in response to LEI-DR-02-005 and 006, the Company calculates a lower weighted contract price that is virtually identical to the weighted average costs for 2019. Naturally, spot prices continued to fall in 2020 due to an unprecedented drop in demand as a result of COVID-19 pandemic. Comparing to spot market prices, however, is a flawed comparison as it does not take long-term contracts and diverse fuel supply benefits into consideration.

While OVEC's inventory levels at Clifty Creek and Kyger Creek were above target in 2020, the days' target inventory set for Clifty Creek and Kyger Creek is based on each plant's full-load burn capability as supported by the Fuel Procurement Strategy.¹ The actual inventory calculations utilized by LEI in the Audit of the OVEC PPA Rider of AEP Ohio were based on the plants' average burn, which reflects a higher number of days inventory. Moreover, the Auditor appears to have transposed the "Actual" coal inventory levels of Clifty Creek (shown on Figure 40) with those of Kyger Creek (shown on Figure 42). (Audit Report at 66-68.) When utilizing full-load burn methodology associated with the correct respective plants, Clifty Creek inventory levels averaged 57 days in 2020 (rather than 66 days) and Kyger Creek's inventory averaged 66 days in 2020 (rather than 58 days).

The reason inventory levels were higher than targets in 2020 can be attributed to several factors outside of OVEC's control. First and foremost, the unprecedented COVID-19 pandemic resulted in nationwide economic shutdowns for months during 2020 and a slow economic rebound. This resulted in a dramatic drop in generation demand and a near disappearance of the secondary coal markets, resulting in increased inventory levels. In addition, PJM power prices were lower than anticipated in 2020 largely due to an unseasonably mild winter followed by the aforementioned pandemic-related drop in demand for generation resources, further increasing inventory levels. In fact, according to the PJM State of the Market Report - 2020, the PJM day-ahead energy prices decreased by 21.4% compared to 2019 (which had already decreased 28.3% in 2019 compared to 2018) and real-time energy prices were lower in 2020 than any year since the creation of the PJM energy market in April 1999.² Planned outage extensions or

¹ See LEI-DR-02-011_CONFIDENTIAL_Attachment_1

² https://www.monitoringanalytics.com/reports/PJM_State_of_the_Market/2020.shtml

maintenance outages can also affect the levels of the coal inventory, as the forecasted consumption does not materialize.

Additionally, existing coal contracts can have an impact on the amount of coal inventories. As recognized by LEI, contracts for coal deliveries are typically entered into months or years in advance of when the coal is actually needed for consumption. (Audit Report at 52-53.) This is a prudent decision in order to diversify coal providers, promotes innovation, reduces supply chain risk, and drives competition when there is already a lack of competition amongst coal suppliers particularly for the Kyger Creek plant. The coal contracts in place during the audit period contained certain contractual commitments that had been in place for a number of years. It is OVEC's responsibility to abide by its contractual volume obligations to retain good standing and avoid legal action. Thus, some of the coal inventory in 2020 was a result of coal delivered in prior years in response to forecasted load that did not materialize. When needed to help manage inventory levels, OVEC negotiates with its suppliers to defer tons to future periods if the supplier is willing to do so. However, these options were limited such given the unique economic circumstances that were presented in 2020. In sum, there is no basis to substantiate any problem with delivery management or coal contract prices. Nevertheless, AEP Ohio is amenable to bringing these issues to OVEC's attention to see if other contracting tactics would benefit OVEC's operation.

Capital Expenses:

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

Response:

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

OVEC Operating Committee (“OC”) Meetings:

The Auditor “recommends that AEP Ohio encourage the OVEC OC meetings to be held more frequently to receive more timely updates on each plant’s operating performance, cost of service, and profit/loss statements for market-based revenues derived from the PJM markets.” (Audit Report at 10.)

Response:

AEP Ohio cautions against overly prescriptive orders that would require OVEC to schedule additional meetings solely for that purpose at a specific time interval that limit the OC from exercising discretion and could take time away from other managerial tasks. The OC, per its Rules of Procedure, is required to meet at least annually, which was done in 2020. The agenda includes a review of operating performance, financial results, and forecasts. This

information is also provided to the Sponsors upon request. Moreover, as recognized by the Auditor, OVEC's Energy Scheduling department has an internal daily call every non-holiday weekday morning to review unit status and availability, including applicable unit derates, potential unit liabilities, outage status and expected unit return-to-service dates, etc. (Audit Report at 39.) This information is used to formulate the Day Ahead unit offers into the PJM market. Nevertheless, AEP Ohio is amenable to bringing these issues to OVEC's attention to see if additional meetings would benefit the OC's operation and managerial decision-making process.

Miscellaneous Non-Material Matters:

The Auditor appears to have calculated "AEP's Share of OVEC Generation" in Figure 13 using an allocation based upon Power Participation Ratios rather than actual OVEC invoices. As a result, LEI incorrectly calculated a weighted average loss that is higher than the correct figure based on invoices for 2020. (Audit Report at 32.)

While it did not result in any recommended changes or items for consideration, LEI finds that it was not unreasonable to have around 23% to 27% of the total O&M cost at Clifty Creek and Kyger Creek spent on labor, which "is on the lower end of industry average based on LEI's empirical knowledge." (Audit Report at 93). However, The "Total O&M Cost" set forth on Figure 56 does not appear to equate to the sum of "Total Labor O&M" and "Total Non-labor O&M" on the same figure. As a result, based upon data provided by AEP Ohio the "Share of Labor cost to Total O&M Cost" percentages should have been calculated at 28.2% and 23.4%, respectively for Clifty Creek and Kyger Creek.

CONCLUSION

Consistent with the above explanations, AEP Ohio requests that the Commission address the Auditor's recommendations as set forth in these comments. If the Commission concludes that there is any basis to support a disallowance of OVEC costs during the audit period, AEP Ohio requests an evidentiary hearing to address those matters prior to an adverse finding. The Company reserves the right to file reply comments.

Respectfully submitted,

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CERTIFICATE OF SERVICE

In accordance with Rule 4901-1-05, Ohio Administrative Code, the PUCO's e-filing system will electronically serve notice of the filing of this document upon the following parties. In addition, I hereby certify that a service copy of the foregoing was sent by, or on behalf of, the undersigned counsel to the following individuals this 8th day of May 2023, via electronic transmission.

/s/ Steven T. Nourse
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Summary: Comments Initial Comments in Response to The Audit Report.
electronically filed by Mr. Steven T. Nourse on behalf of Ohio Power Company.