ORIGINAL

IN THE SUPREME COURT OF OHIO

12-1484

In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company.	)	Supreme Court Case No. 2012-___
	)	
	)	Appeal from the Public Utilities Commission of Ohio
	)	
	)	PUCO Case Nos. 09-872-EL-FAC and 09-873-EL-FAC

NOTICE OF APPEAL OF APPELLANT INDUSTRIAL ENERGY USERS-OHIO

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CLERK OF COURT
SUPREME COURT OF OHIO

NOTICE OF APPEAL OF APPELLANT
INDUSTRIAL ENERGY USERS-OHIO

Appellant, Industrial Energy Users-Ohio ("IEU-Ohio" or "Appellant") hereby gives notice of its appeal, pursuant to Section 4903.11 and Section 4903.13, Revised Code, and Supreme Court Rule of Practice 2.3(B), to the Supreme Court of Ohio and Appellee, Public Utilities Commission of Ohio ("Commission"), from an Entry on Rehearing dated April 11, 2012[1] (Attachment A) and an Entry on Rehearing dated July 2, 2012 (Attachment B) in Case Nos. 09-872-EL-FAC and 09-873-EL-FAC. The Entry on Rehearing dated April 11, 2012 (Attachment A) granted Ohio Power Company's Application for Rehearing of the Commission's Opinion and Order dated January 23, 2012 (Attachment C). Thus, the April 11, 2012 Entry on Rehearing modifying the January 23, 2012 Opinion and Order was the first Order adverse to Appellant. The Entry on Rehearing dated July 2, 2012 (Attachment B) denied Appellant's Application for Rehearing of the April 11, 2012 Entry on Rehearing.

Appellant was and is a party of record in Case Nos. 09-872-EL-FAC and 09-873-EL-FAC and timely filed its Application for Rehearing on Appellee's Entry on Rehearing on May 11, 2012. Appellant's Application for Rehearing was denied on July 2, 2012.

The Commission's April 11, 2012 Entry on Rehearing and July 2, 2012 Entry on Rehearing are unlawful and unreasonable for the reason set forth in the following Assignment of Error:

1. The Commission's Entry on Rehearing is Unlawful and Unreasonable

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[1] On June 8, 2012, Ohio Power Company prematurely filed a Notice of Appeal (Case No. 2012-0976) of the Commission's April 11, 2012 Entry on Rehearing. On June 15, 2012, the Commission filed a Motion to Dismiss the Notice of Appeal because IEU-Ohio's May 11, 2011 Application for Rehearing was still pending. IEU-Ohio's Notice of Appeal stems from the Commission's denial of IEU-Ohio's May 11, 2012 Application for Rehearing. The Court has yet to rule upon the Motion to Dismiss.

in that the Commission Failed to Clarify that 100 Percent of the Credit for the Settlement Agreement Must be Allocated to Ohio Retail Jurisdictional Customers.

WHEREFORE, Appellant respectfully submits that Appellee's April 11, 2012 Entry on Rehearing and July 2, 2012 Entry on Rehearing are unlawful, unjust, and unreasonable and should be reversed. The case should be remanded to the Appellee with instructions to correct the errors complained of herein.

Respectfully Submitted

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CERTIFICATE OF SERVICE

I hereby certify that a copy of this *Notice of Appeal of Appellant Industrial Energy Users-Ohio* was sent by ordinary United States mail, postage prepaid, or hand-delivered to all parties to the proceeding before the Public Utilities Commission of Ohio, listed below, and pursuant to Section 4903.13 of the Ohio Revised Code on August 30, 2012.

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CERTIFICATE OF FILING

I hereby certify that a *Notice of Appeal of Appellant Industrial Energy Users-Ohio* has been filed with the docketing division of the Public Utilities Commission of Ohio in accordance with Rules 4901-1-02-(A) and 4901-1-36 of the Ohio Administrative Code on August 30, 2012.

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ATTORNEY EXAMINER

Attachment A

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company.	)))	Case No. 09-872-EL-FAC Case No. 09-873-EL-FAC

ENTRY ON REHEARING

The Commission finds:

(1) Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, AEP-Ohio or the Companies)[1] are public utilities as defined in Section 4905.02, Revised Code, and, as such, are subject to the jurisdiction of this Commission.

(2) By opinion and order issued March 18, 2009, as clarified by the entry on rehearing issued July 23, 2009, in Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, the Commission modified and approved AEP-Ohio's application for an electric security plan (ESP) for 2009 through 2011, which included approval of a fuel adjustment clause (FAC) mechanism for CSP and OP, under which the Companies recovered prudently incurred costs associated with fuel, including consumables related to environmental compliance, purchased power costs, emission allowances, and costs associated with carbon-based taxes and other carbon-related regulations (ESP 1 order).[2] The approved FAC mechanism provided for quarterly reconciliations to actual FAC costs incurred by the Companies, which established the FAC rates for the subsequent quarter, as well as an annual audit of the accounting of the FAC costs. The Commission also authorized a phase-in of AEP-Ohio's ESP rates during the term of the ESP by deferring a portion of the annual incremental FAC costs such that the amount of the incremental FAC expense to be recovered from customers would be limited so as not to exceed specified percentage increases on a total bill basis.

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1 By entry issued March 7, 2012, the Commission approved and confirmed the merger of CSP into OP. *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals* (Merger Case), Case No. 10-2376-EL-UNC.

2 *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO; *In the Matter of the Application of Ohio Power Company for Approval of its Electric Security Plan; and an Amendment to its Corporate Separation Plan*, Case No. 08-918-EL-SSO.

(3) On May 14, 2010, Energy Ventures Analysis, Inc. (EVA) filed, in the present cases, a management/performance (m/p) and financial audit report in response to its annual audit of AEP-Ohio's FAC mechanism for 2009 (audit report).

(4) On January 27, 2011, in Case No. 11-346-EL-SSO, *et al.*, AEP-Ohio filed an application for approval of a second ESP to begin on January 1, 2012 (ESP 2 cases).[3]

(5) On September 7, 2011, a stipulation and recommendation (ESP 2 stipulation) was filed by AEP-Ohio, Staff, and other parties to resolve the issues raised in the ESP 2 cases and several other cases pending before the Commission (consolidated cases).[4] The ESP 2 stipulation provided, *inter alia*, that the current FAC mechanism was to continue through May 31, 2015.

(6) On December 14, 2011, the Commission issued an opinion and order in the consolidated cases, modifying and adopting the ESP 2 stipulation (ESP 2 order).

(7) On January 23, 2012, the Commission issued its opinion and order in the present proceedings regarding the annual audit of AEP-Ohio's FAC mechanism for 2009 (FAC order). With respect to the financial audit recommendations contained in the audit report, the Commission adopted financial audit recommendations 1 through 5, as well as 6a through 6i, with the exclusion of 6b. The Commission also adopted m/p audit recommendations 2 through 6, as contained in the audit report.

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3 *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, Case Nos. 11-346-EL-SSO and 11-348-EL-SSO; *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority*, Case Nos. 11-349-EL-AAM and 11-350-EL-AAM.

4 Merger Case, Case No. 10-2376-EL-UNC; *In the Matter of the Application of Columbus Southern Power Company to Amend its Emergency Curtailment Service Riders*, Case No. 10-343-EL-ATA; *In the Matter of the Application of Ohio Power Company to Amend its Emergency Curtailment Service Riders*, Case No. 10-344-EL-ATA; *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC; *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144, Revised Code*, Case No. 11-4920-EL-RDR; *In the Matter of the Application of Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144*, Revised Code, Case No. 11-4921-EL-RDR.

In m/p audit recommendation 1, EVA recommended that the Commission consider whether any proceeds from a settlement agreement that American Electric Power Service Corporation (AEPSC) had executed with a coal supplier in 2007 (settlement agreement) should be credited against OP's FAC under-recovery for 2009. The settlement agreement was effectively a buy-out of the contract with the coal supplier after 2008. Pursuant to the terms of the settlement agreement, OP received a lump sum payment (made in three equal payments) and coal reserve in West Virginia. In the FAC order, the Commission determined that all of the realized value from the settlement agreement should be credited against OP's FAC under-recovery for 2009. The Commission specified that the portion of the $30 million lump sum payment not already credited to the ratepayers of OP, as well as the $41 million value of the West Virginia coal reserve booked when the settlement agreement was executed, should be credited against the FAC under-recovery. Additionally, because the present value of the West Virginia coal reserve is unknown and the permitting process is expected to enhance its value, the Commission indicated that a request for proposal (RFP) would be issued by subsequent entry to hire an auditor to examine the value of the West Virginia coal reserve. The Commission noted that the auditor would be expected to make a recommendation as to whether the increased value of the West Virginia coal reserve, if any, above the $41 million already required to be credited against OP's FAC under-recovery should accrue to ratepayers.

Finally, the Commission determined that the delivery shortfall agreement and the contract support agreement would not be further examined as part of the current audit. The Commission noted, however, that these agreements may be examined in a future audit, given that their impact on AEP-Ohio's fuel costs, if any, appeared to occur in time periods outside of the current audit.

(8) Section 4903.10, Revised Code, states that any party who has entered an appearance in a Commission proceeding may apply for a rehearing with respect to any matters determined therein by filing an application within 30 days after the entry of the order upon the Commission's journal.

(9) On February 22, 2012, applications for rehearing of the FAC order were filed by AEP-Ohio, Industrial Energy Users-Ohio (IEU-Ohio), and the Ohio Consumers' Counsel (OCC).

(10) On February 23, 2012, the Commission issued an entry on rehearing in the consolidated cases, granting rehearing in part (ESP 2 entry on rehearing). Finding that the signatory parties to the ESP 2 stipulation had not met their burden of demonstrating that the stipulation, as a package, benefits ratepayers and the public interest, as required by the Commission's three-part test for the consideration of stipulations, the Commission rejected the stipulation.

(11) On March 2, 2012, in the above-captioned cases, AEP-Ohio filed a memorandum contra the applications for rehearing of the FAC order filed by IEU-Ohio and OCC. On March 5, 2012, IEU-Ohio and OCC filed memoranda contra AEP-Ohio's application for rehearing of the FAC order.

(12) By entry on rehearing issued March 21, 2012, the Commission granted the applications for rehearing of the FAC order to allow further consideration of the matters specified in the applications.

(13) The Commission has reviewed and considered all of the arguments on rehearing. Any arguments on rehearing not specifically discussed herein have been thoroughly and adequately considered by the Commission and should be denied.

Re-adjudication of the ESP 1 Order

(14) In its fourth assignment of error, AEP-Ohio contends that the FAC order unreasonably and unlawfully modifies the ESP 1 order wherein the Commission directed that annual FAC audits examine fuel procurement practices and expenses for the audit period. AEP-Ohio offers that expanding the scope of the FAC audit, as litigated and decided in the ESP 1 order, violates the principles of res judicata and collateral estoppel. According to AEP-Ohio, the FAC audit period is strictly limited to January 2009 through December 2009. Similarly, in the Companies' fifth assignment of error, AEP-Ohio claims that through the FAC order, the Commission is unreasonably and unlawfully

retroactively modifying the decision in the ESP 1 order, which established the FAC baselines to facilitate the Companies' transition from a period without a FAC mechanism to a period with a FAC mechanism. With the establishment of the FAC baseline, AEP-Ohio asserts that the FAC order in this case is a retreat from the agreement with the Companies to implement fuel deferrals to stabilize recovery. AEP-Ohio reasons that the FAC baseline is res judicata and collateral estoppel prevents the Commission from revision of its decision in these proceedings. OCC and IEU-Ohio submit that these arguments are baseless. OCC states that the purpose of Commission audits, as was the case in these proceedings, is to assist the Commission in determining the prudence and true cost of a company's fuel-related purchases so that customers pay no more than what is reasonable for electricity. IEU-Ohio offers that the FAC order properly concluded that the Companies' claim of res judicata is without merit as 2009 fuel costs were not litigated in the first ESP proceedings.

(15) For the same reasons as stated in the FAC order, we again reject both of these arguments by the Companies. The scope and extent of the audit and the audit period were not revised or expanded as a result of the FAC order. As IEU-Ohio reasoned, the focus of the dispute in these proceedings is OP's 2009 fuel costs. OP's 2009 fuel costs were not litigated in the first ESP proceedings and could not have been litigated because the 2009 fuel costs were not known at that time. The purpose of the FAC audit was to evaluate 2009 fuel and fuel-related costs and the prudency of the Companies' fuel transactions, including the true costs and accounting accuracy of the fuel transactions. AEP-Ohio's claims to the contrary are without merit. Accordingly, we deny AEP-Ohio's fourth and fifth assignments of error.

Settlement Agreement

(16) In its first assignment of error, AEP-Ohio requests that the Commission clarify that the FAC order does not include the return of any amounts allocable to wholesale and non-Ohio retail jurisdictions.

(17) IEU-Ohio initially asserts that AEP-Ohio failed to offer evidence to support its jurisdictional argument as a part of the hearing and, is, therefore, precluded from raising the subject on rehearing. IEU-Ohio argues that AEP-Ohio selectively raises the jurisdictional argument, where it advocates just the opposite in its significantly excessive earnings proceedings,[5] and does so in this case to retain the benefits of the settlement agreement for its shareholders.

(18) We disagree with IEU-Ohio that AEP-Ohio is precluded from raising the jurisdictional issue at the rehearing stage. AEP-Ohio's claim is prompted by its interpretation of the language in the FAC order. AEP-Ohio witnesses and the financial auditor recognized that fuel expenses are allocated between Ohio retail expenses, non-Ohio retail expenses, or wholesale expenses. The same is true regarding the allocation of revenues. Therefore, we find that the record includes sufficient evidence to justify presentation of the claim by AEP-Ohio. We clarify that the 2009 FAC under-recovery need only be credited for the share of the settlement agreement allocable to Ohio's retail jurisdictional customers.

(19) In its third assignment of error, AEP-Ohio reasons that the FAC order's direction that all of the realized value from the settlement agreement should be credited against OP's FAC under-recovery amounts to selective and unlawful retroactive ratemaking in violation of *Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co.* (1957), 166 Ohio St. 254, and *Lucas Cty. Commrs. v. Pub. Util Comm.* (1997), 80 Ohio St.3d 344. OCC believes that OP's arguments are faulty. In this case, OCC argues, and the Commission agrees, that the FAC order did not modify a previously established rate as part of a ratemaking proceeding, as was the case in *Keco*, or direct the issuance of a refund of unlawfully collected rates, as was the case in *Lucas Cty*.

AEP-Ohio mischaracterizes the FAC order. Further, the Commission acknowledged the Companies' arguments on retroactive ratemaking and refunds, as summarized in the

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5 See *In re AEP-Ohio*, Case No. 10-1261-EL-UNC, Order at 11-12 (January 11, 2011).

order (FAC order at 7-8). As explained in the order, the FAC adjustments ordered as a result of the settlement agreement are to align the fuel costs charged to ratepayers with the real economic cost of fuel for 2009. Nothing in OP's application for rehearing convinces the Commission that our decision should be reversed. Accordingly, OP's third assignment of error should be denied.

(20) In its sixth assignment of error, AEP-Ohio reasons that, since the auditor and the Commission did not find the settlement agreement to be imprudent, the FAC order unreasonably and unlawfully impairs the settlement agreement, which was executed by AEP-Ohio at a time when fuel costs and fuel contracts were not regulated. IEU-Ohio replies that the Companies' position is illogical as Rule 4901:1-35-03(C)(9)(a), Ohio Administrative Code, provides that a utility's FAC must include "any benefits available to the electric utility as a result of or in connection with such costs including but not limited to profits from emission allowance sales...." Thus, IEU-Ohio reasons that AEP-Ohio was required to account for the reduction in fuel costs.

(21) Despite AEP-Ohio's arguments to the contrary, it is not a condition precedent to reflecting the realized value of the Companies' fuel costs in the FAC, that the Commission find the settlement agreement imprudent. Pursuant to the requirements of division (B)(2) of Section 4928.143, Revised Code, to include the FAC mechanism as a part of the first ESP, AEP-Ohio was required to include "in the application any benefits available to the electric utility as a result of or in connection with such [FAC] costs including but not limited to profits from emission allowance sales and profits from resold coal contracts." The purpose of the FAC audit was to ensure and verify the FAC costs and expenses as well as to review the prudency of the Companies' transactions. Accordingly, we deny AEP-Ohio's sixth assignment of error.

(22) In its seventh assignment of error, AEP-Ohio argues that the FAC order selectively considers the settlement agreement, to direct a decrease in the fuel costs for 2009, but ignores the 2008 production bonus agreement also entered into when fuel contracts were not regulated. AEP-Ohio states that the 2008

production bonus agreement ensured that one of its suppliers remained in business and was able to provide the Companies' coal at below-market prices during 2008. AEP-Ohio admits that it did not seek to recover the $28.6 million dollar payment in 2009 FAC rates since it was incurred before the FAC regulatory structure was implemented. AEP-Ohio argues that this agreement is an example of why the Commission should not reach outside of the audit period to adjust AEP-Ohio's 2009 FAC under-recovered balance. Alternatively, AEP-Ohio states that the 2008 production bonus agreement fuel cost should be used to offset any "claw-back" into amounts relating to the settlement agreement. IEU-Ohio notes that AEP-Ohio overlooks the fact that the Companies received annual generation increases during the rate stabilization plan period (2005-2008),[6] which facilitated AEP-Ohio's recovery of increases in generation costs. As such, IEU-Ohio argues that customers paid their fair share of the total cost of the 2008 production bonus agreement.

(23) The Commission notes that the audit report did not recommend that the 2008 production bonus agreement be taken into consideration, in contrast to the auditor's recommendation in regards to the settlement agreement, nor recommend that the 2008 production bonus agreement be used as an offset to the benefits accrued as a result of the settlement agreement. Based on the generation rate increases built into the rate stabilization plan in effect prior to the first ESP in 2009, and the evidence of record in these proceedings, the Commission finds that the record does not support offsetting the adjustments to the deferred fuel costs for the settlement agreement, as directed in the FAC order, by the 2008 production bonus agreement. Accordingly, AEP-Ohio's seventh assignment of error is denied.

(24) In its first assignment of error, IEU-Ohio asserts that the FAC order unreasonably and unlawfully failed to require AEP-Ohio to include a carrying cost component in the value associated with the lump sum payment and West Virginia coal reserve to be credited against the FAC deferral balance. In its second

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6 See *In re AEP-Ohio*, Case No. 04-169-EL-UNC, Order at 15-19 (January 26, 2005); and *In re AEP-Ohio*, Case No. 07-1132-EL-UNC, Order at 3 (January 30, 2008).

assignment of error, OCC makes a comparable argument that the Commission erred in failing to require AEP-Ohio to credit customers for the interest accrued from 2009 until the date of the FAC order on the value of the lump sum payment and the West Virginia coal reserve. In its memorandum contra, AEP-Ohio replies that the award of interest or the reduction of carrying charges would constitute retroactive ratemaking and an unlawful modification of the ESP 1 order, and would also inequitably add to the under-recovery of actual FAC expenses for 2009.

(25) In the FAC order, the Commission determined that all of the realized value from the settlement agreement should be credited against OP's FAC under-recovery. We noted the unique circumstances of the settlement agreement and determined that, in order to assess the real economic cost of coal used during the audit period, more of the value realized as a result of entering into the settlement agreement should flow through to ratepayers by way of a credit to the FAC under-recovery. (FAC order at 12-13.) In accordance with our finding that all of the realized value from the settlement agreement should be credited to the benefit of ratepayers, we find that AEP-Ohio should flow through to its customers a carrying charge component in applying the credit to OP's FAC under-recovery. Such carrying charge component should be calculated in a manner consistent with calculation of the FAC deferrals, as approved in the ESP 1 order, including use of the approved weighted average cost of capital.[7] Thus, the Commission disagrees with OP's argument that the award of interest or the reduction of carrying charges constitutes retroactive ratemaking because a calculation that is consistent with the approved FAC deferrals is, by definition, not a modification of a previously established rate, as was the case in *Keco*. Accordingly, we find that IEU-Ohio's first assignment of error and OCC's second assignment of error should be granted.

(26) IEU-Ohio's second assignment of error is that the Commission unlawfully and unreasonably failed to direct AEP-Ohio to recalculate its phase-in recovery rider (PIRR) rates to reflect the immediate reduction of the FAC deferral balance that is

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7 ESP 1 order at 23.

collected through the rider. OCC raises a similar argument in its first assignment of error. In particular, OCC contends that the Commission unreasonably failed to specify that AEP-Ohio should immediately credit to customers the full value of the settlement agreement and also credit the increased value of the West Virginia coal reserve as soon as the valuation is completed by the auditor. OCC notes that an immediate credit to the FAC deferral balance will minimize carrying charges and reduce the amount that customers are charged through the PIRR. In response, AEP-Ohio argues that it would be unreasonable and imprudent to reduce the PIRR rates immediately. AEP-Ohio claims that, if an immediate credit is implemented and the FAC order is subsequently found to be unlawful, excessive revenue and rate volatility would result. AEP-Ohio adds that it is impossible to reduce the PIRR immediately to reflect the value of the West Virginia coal reserve, as its value is unknown and can only be accurately determined through a sale of the asset. Finally, AEP-Ohio notes that the arguments of IEU-Ohio and OCC fail to account for the fact that the PIRR as approved in the ESP 2 order has been effectively vacated by the ESP 2 entry on rehearing.

(27) Pursuant to Section 4903.15, Revised Code, Commission orders are effective immediately upon entry in the journal. Additionally, in the FAC order, the Commission specifically directed AEP-Ohio to credit the FAC under-recovery as addressed in the order, and did not grant a stay of the order (FAC order at 19). To the extent necessary to resolve any confusion on the part of the parties, the Commission now makes explicit its intention that AEP-Ohio should immediately implement the credit to reduce the FAC deferral balance in accordance with the FAC order and this entry on rehearing. We also note that AEP-Ohio's PIRR rates are the subject of separate proceedings in which the Commission will consider recovery of the deferred FAC costs and determine the proper rates, including any adjustments that may be necessary in light of the present cases.[8] With this clarification, we find that

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8 *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144, Revised Code,* Case No. 11-4920-EL-RDR; *In the Matter of the Application of Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144,* Revised Code, Case No. 11-4921-EL-RDR.

IEU-Ohio's second assignment of error and OCC's first assignment of error should be denied.

(28) In AEP-Ohio's eighth assignment of error, the Companies note that the West Virginia coal reserve is an OP asset properly accounted for as part of the settlement agreement. The valuation of the coal reserve directed in the FAC order, according to AEP-Ohio, is based on the unlawful and unreasonable premise that AEP-Ohio ratepayers have an ownership interest in the coal reserve, in contrast to Commission precedent.[9] The Companies argue that ratepayers do not acquire an ownership interest in utility assets by paying the rates for service. Accordingly, AEP-Ohio reasons there is no legal basis for the FAC order's seizure of the value of the coal reserve to reduce the 2009 fuel costs or any future fuel costs.

(29) AEP-Ohio made similar arguments in its brief and again takes the opportunity to mischaracterize the FAC order. The FAC order does not imply or recognize any ratepayer ownership interest in the coal reserve. We agree with AEP-Ohio that ratepayers do not earn or acquire an ownership interest in the utility's assets as a result of paying for utility services. An ownership interest is not necessary for the Commission to order, as it did in the FAC order, the alignment of fuel costs with the benefits of AEP-Ohio's fuel contracts. For these reasons, we again reject AEP-Ohio's claims and deny the request for rehearing.

Determination of Value of Coal Reserve

(30) In its second assignment of error, AEP-Ohio requests that the Commission clarify the methodology to be used to determine the value of the West Virginia coal reserve to include, as an alterative to the valuation by way of an appraisal, the sale of the property after a final, non-appealable decision is issued in these cases. The Companies reason that the only way to determine the proper value of the coal reserve is by sale. The Companies also request that the Commission recognize that the

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9 *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedules of the Columbus Southern Power Company and Related Matters,* Case No. 88-102-EL-EFC, Order (October 28, 1988).

value of the coal reserve could be more or less than the $41.6 million net book value. IEU-Ohio reasons that an appraisal of the value of the coal reserve, as directed in the FAC order, is the most expedient means to determine the amount by which the FAC under-recovery should be credited.

(31) We reject AEP-Ohio's request to require the sale of the coal reserve to determine its value. It was not the intent of the FAC order to permanently terminate OP's ownership of the asset but to direct that the value of the coal reserve be determined by an independent, third-party. We expect that an independent appraisal will facilitate a more expedient resolution of the issue, even assuming more litigation, as the Companies imply, than the sale of the coal reserve. Nonetheless, we clarify that the value of the coal reserve, to be determined by an independent auditor, may be more or less than the $41.6 million net book value reflected on OP's books. Accordingly, we deny AEP-Ohio's request for rehearing on this issue.

Selection of Auditor

(32) In its third assignment of error, IEU-Ohio argues that the FAC order is unreasonable and unlawful because it did not direct Staff to hire and supervise an independent auditor and set a timeframe for the valuation of the West Virginia coal reserve. Asserting that the FAC order is unclear as to how the auditor will be selected, IEU-Ohio requests that the Commission provide clarification on this point to ensure that the audit is conducted in a fair, transparent, and timely manner. OCC, likewise, asserts in its third assignment of error that the Commission erred in directing AEP-Ohio to hire the auditor. OCC argues that the Commission should clarify that it will select an independent auditor to work under the direction of Staff and that OP's shareholders will pay for the audit. In response, AEP-Ohio maintains that the Commission should reject the requests of IEU-Ohio and OCC for an independent, Commission-hired auditor. AEP-Ohio contends that the value of the West Virginia coal reserve should be determined through a sale of the asset and that OP should be permitted to direct the sale.

(33) The Commission finds that the FAC order specifically indicated that an RFP would be issued by subsequent entry for the purpose of selecting and hiring an auditor to examine the value of the West Virginia coal reserve (FAC order at 12). Upon review of the proposals received in response to the RFP, the Commission will select an appropriate individual or firm with the technical expertise to independently determine the value of the West Virginia coal reserve. We note that both the auditor/appraiser and AEP-Ohio will be expected to adhere to the terms set forth in the entry selecting the auditor/appraiser. With this clarification, we find that the third assignments of error of IEU-Ohio and OCC should be denied.

Delivery Shortfall Agreement and Contract Support Agreement

(34) In its ninth assignment of error, AEP-Ohio argues that the Commission's conclusion that the delivery shortfall agreement and the contract support agreement may be examined in a future audit is unreasonable and unlawful for the same reasons asserted regarding its third through eighth assignments of error. In their memoranda contra, IEU-Ohio and OCC assert that the Commission properly determined that the delivery shortfall agreement and the contract support agreement may be considered in a future audit.

(35) In its fourth assignment of error, IEU-Ohio contends that the Commission unreasonably and unlawfully failed to direct AEP-Ohio to credit the benefits received under the contract support agreement against the FAC under-recovery. IEU-Ohio maintains that the contract support agreement contributed to increased fuel costs in 2009 and that, in the absence of a FAC mechanism, there will be little benefit to customers in future years when AEP-Ohio exercises its option to purchase coal at a discount off the market price beginning in 2013. Similarly, OCC asserts in its fourth assignment of error that the Commission erred in failing to credit customers for the increased price of coal that AEP-Ohio agreed to pay during 2009 pursuant to the contract support agreement and in failing to account for carrying charges. In its memorandum contra, AEP-Ohio contends that any benefit that it may receive from the contract support agreement will not ripen until it exercises its option to take the discounted pricing and will, therefore,

apply to time periods outside of the current audit, if the option is even fully exercised.

(36) The Commission finds that the fourth assignments of error of IEU-Ohio and OCC, as well as AEP-Ohio's ninth assignment of error, should be denied. We find that IEU-Ohio and OCC have raised no new arguments on rehearing that would warrant reconsideration of the FAC order and that there is no merit in AEP-Ohio's arguments for the reasons discussed above with respect to its third through eighth assignments of error. To the extent that a benefit is realized from the contract support agreement, such benefit will not accrue until after AEP-Ohio elects to exercise its option in 2013, which is well beyond the time period under review in the present proceedings. Therefore, although it is premature at this point to consider the purported benefits of the contract support agreement, we note that both the contract support agreement and the delivery shortfall agreement may be examined in a future audit of AEP-Ohio's fuel costs.

Fuel Procurement Procedures

(37) AEP-Ohio, in its tenth assignment of error, argues that AEPSC should not be required to add fuel procurement procedures as it completes the process of updating its policies and procedures manual. AEP-Ohio asserts that policies, not procedures, result in the most efficient procurement of fuel at the lowest reasonable price and, for that reason, the revisions to the manual are focused on procurement policies. AEP-Ohio requests that the Commission clarify that only the fuel procurement policies be updated in the manual and that the auditor is directed to review those updated policies in the next m/p audit proceeding. IEU-Ohio responds that AEPSC should be required to update the policies and procedures manual in accordance with EVA's recommendation. According to IEU-Ohio, the Commission should reject AEP-Ohio's attempt to avoid updating the manual to include fuel procurement procedures.

(38) In the FAC order, the Commission adopted m/p audit recommendation 5, which recommended that AEPSC finalize its update of its policies and procedures manual to reflect

current business practices and that the update be completed in time for it to be reviewed in the next m/p audit (FAC order at 6, 12; Commission-ordered Ex. 1A at 1-7). Although EVA enumerated eight items including certain procedural information that it hoped the updated manual would include, EVA recommended only that the update be completed and that the revised manual be reviewed in the next m/p audit (Commission-ordered Ex. 1A at 1-7, 2-11). Thus, we clarify that, in accordance with m/p audit recommendation 5, there is no specific requirement that AEPSC's policies and procedures manual include a formal procedural section. Upon review of the updated manual in the course of the next m/p audit, the auditor may recommend that the manual be further revised to include a procedural section, as the auditor deems necessary. With this clarification, AEP-Ohio's tenth assignment of error should be denied.

It is, therefore,

ORDERED, That the applications for rehearing filed by AEP-Ohio, IEU-Ohio, and OCC be granted or denied, as discussed above. It is, further,

ORDERED, That a copy of this entry on rehearing be served upon all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

Lynn Slaby

GNS/SJP/sc

Entered in the Journal APR 11 2012

Barcy F. McNeal
Secretary

Attachment B

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company.	)))	Case No. 09-872-EL-FAC Case No. 09-873-EL-FAC

FOURTH ENTRY ON REHEARING

The Commission finds:

(1) Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, AEP-Ohio or the Companies)[1] are public utilities as defined in Section 4905.02, Revised Code, and, as such, are subject to the jurisdiction of this Commission.

(2) By opinion and order issued on March 18, 2009, as clarified by the entry on rehearing issued on July 23, 2009, in Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, the Commission modified and approved AEP-Ohio's application for an electric security plan (ESP) for 2009 through 2011, which included approval of a fuel adjustment clause (FAC) mechanism for CSP and OP, under which the Companies recovered prudently incurred costs associated with fuel, including consumables related to environmental compliance, purchased power costs, emission allowances, and costs associated with carbon-based taxes and other carbon-related regulations.[2] The approved FAC mechanism provided for quarterly reconciliations to actual FAC costs incurred by the Companies, which established the FAC rates for the subsequent quarter, as well as an annual audit of the accounting of the FAC costs. The Commission also authorized a phase-in of AEP-Ohio's ESP rates during the term of the ESP by deferring a portion of the annual

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1 By entry issued on March 7, 2012, the Commission approved and confirmed the merger of CSP into OP. *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals*, Case No. 10-2376-EL-UNC.

2 *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO; *In the Matter of the Application of Ohio Power Company for Approval of its Electric Security Plan; and an Amendment to its Corporate Separation Plan*, Case No. 08-918-EL-SSO.

incremental FAC costs such that the amount of the incremental FAC expense to be recovered from customers would be limited so as not to exceed specified percentage increases on a total bill basis.

(3) On May 14, 2010, Energy Ventures Analysis, Inc. (EVA) filed, in the present cases, a management/performance (m/p) and financial audit report in response to its annual audit of AEP-Ohio's FAC mechanism for 2009 (audit report).

(4) On January 23, 2012, the Commission issued its opinion and order regarding the annual audit of AEP-Ohio's FAC mechanism for 2009 (FAC order). With respect to the financial audit recommendations contained in the audit report, the Commission adopted financial audit recommendations 1 through 5, as well as 6a through 6i, with the exclusion of 6b. The Commission also adopted m/p audit recommendations 2 through 6, as contained in the audit report.

In m/p audit recommendation 1, EVA recommended that the Commission consider whether any proceeds from a settlement agreement that American Electric Power Service Corporation had executed with a coal supplier in 2007 (settlement agreement) should be credited against OP's FAC under-recovery for 2009. The settlement agreement was effectively a buy-out of the contract with the coal supplier after 2008. Pursuant to the terms of the settlement agreement, OP received a lump sum payment (made in three equal payments) and coal reserve in West Virginia. In the FAC order, the Commission determined that all of the realized value from the settlement agreement should be credited against OP's FAC under-recovery for 2009. The Commission specified that the portion of the $30 million lump sum payment not already credited to the ratepayers of OP, as well as the $41 million value of the West Virginia coal reserve booked when the settlement agreement was executed, should be credited against the FAC under-recovery. Additionally, because the present value of the West Virginia coal reserve is unknown and the permitting process is expected to enhance its value, the Commission indicated that a request for

proposal would be issued by subsequent entry to hire an auditor to examine the value of the West Virginia coal reserve. The Commission noted that the auditor would be expected to make a recommendation as to whether the increased value of the West Virginia coal reserve, if any, above the $41 million already required to be credited against OP's FAC under-recovery should accrue to ratepayers.

Finally, the Commission determined that the delivery shortfall agreement and the contract support agreement would not be further examined as part of the current audit. The Commission noted, however, that these agreements may be examined in a future audit, given that their impact on AEP-Ohio's fuel costs, if any, appeared to occur in time periods outside of the current audit.

(5) Section 4903.10, Revised Code, states that any party who has entered an appearance in a Commission proceeding may apply for a rehearing with respect to any matters determined therein by filing an application within 30 days after the entry of the order upon the Commission's journal.

(6) On February 22, 2012, applications for rehearing of the FAC order were filed by AEP-Ohio, Industrial Energy Users-Ohio (IEU-Ohio), and the Ohio Consumers' Counsel (OCC).

(7) On March 2, 2012, AEP-Ohio filed a memorandum contra the applications for rehearing of the FAC order filed by IEU-Ohio and OCC. On March 5, 2012, IEU-Ohio and OCC filed memoranda contra AEP-Ohio's application for rehearing of the FAC order.

(8) By entry on rehearing issued on March 21, 2012, the Commission granted the applications for rehearing of the FAC order to allow further consideration of the matters specified in the applications.

(9) On April 11, 2012, the Commission issued an entry on rehearing granting, in part, and denying, in part, the applications for rehearing filed by AEP-Ohio, IEU-Ohio, and OCC, as discussed in the entry (FAC entry on rehearing). With respect to AEP-Ohio's first assignment of error, the

Commission clarified that the 2009 FAC under-recovery need only be credited for the share of the settlement agreement allocable to Ohio's retail jurisdictional customers.

(10) On May 11, 2012, IEU-Ohio filed an application for rehearing of the FAC entry on rehearing. In its only assignment of error, IEU-Ohio asserts that the FAC entry on rehearing is unlawful and unreasonable in that the Commission limited the amount of the credit for the settlement agreement to the portion allocable to the Ohio retail jurisdiction. IEU-Ohio requests that the Commission grant rehearing on this issue or, alternatively, clarify that all of the credit is allocable to Ohio retail jurisdictional customers. IEU-Ohio contends that, because AEP-Ohio was required, pursuant to its ESP, to allocate its least cost fuel to standard service offer (SSO) customers, the entire credit from the settlement of the below-market coal contract should be allocated to SSO customers. IEU-Ohio notes that AEP-Ohio has not claimed that the coal contract was not its lowest cost fuel source. IEU-Ohio argues that the costs of the contract would have been fully allocated to the Ohio retail jurisdiction and that any benefits received as a result of a renegotiation of the contract should likewise be fully allocated to Ohio retail jurisdictional customers. IEU-Ohio adds that AEP-Ohio's jurisdictional argument is only relevant in a traditional cost-of-service ratemaking context, which is inapplicable under circumstances involving default generation service. IEU-Ohio also notes that AEP-Ohio has not shown that Ohio customers should not receive the full benefits of the settlement agreement, which were accepted by AEP-Ohio in exchange for higher fuel costs paid by such customers. IEU-Ohio adds that AEP-Ohio failed to raise its jurisdictional argument during the hearing or briefing and should thus be precluded from making the argument at this point in the proceedings. Finally, IEU-Ohio argues that AEP-Ohio's jurisdictional argument should be rejected because it is selectively advanced only when it works to the detriment of Ohio customers.

(11) On May 21, 2012, AEP-Ohio filed a memorandum contra IEU-Ohio's application for rehearing. AEP-Ohio responds that IEU-Ohio has raised no new arguments for the

Commission's consideration and that IEU-Ohio improperly seeks rehearing of an issue that has already been fully briefed and was merely clarified on rehearing. AEP-Ohio notes that IEU-Ohio raised the same arguments in its March 5, 2012, memorandum contra AEP-Ohio's application for rehearing. AEP-Ohio also asserts that the Commission properly found in the FAC entry on rehearing that the record supports AEP-Ohio's jurisdictional claim, noting that the testimony in the record is clear that the FAC involves only the retail share of AEP-Ohio's fuel costs and that the portion of the settlement agreement already passed through the FAC was based on the retail jurisdictional allocation. AEP-Ohio contends that the Commission's clarification that the 2009 FAC under-recovery need only be credited for the share of the settlement agreement allocable to Ohio's retail jurisdictional customers is required by state and federal law, prior Commission orders, and the record in these proceedings. AEP-Ohio notes that the Commission has no authority to regulate wholesale sales of electricity or the provision of retail electric service in other states. AEP-Ohio further notes that it has been consistent in recognizing the need to respect jurisdictional lines, contrary to IEU-Ohio's position. AEP-Ohio also adds that the supplier contract in question was not an available coal source from the outset of the ESP in 2009 and that AEP-Ohio fully complied with any obligation to allocate the lowest cost fuel actually available to it in 2009 to its SSO customers.

(12) By entry on rehearing issued on June 6, 2012, the Commission granted IEU-Ohio's application for rehearing to allow further consideration of the matters specified in the application.

(13) Upon review of the application for rehearing filed by IEU-Ohio on May 11, 2012, the Commission finds that the application should be denied. In the FAC entry on rehearing, the Commission clarified that the 2009 FAC under-recovery need only be credited for the share of the settlement agreement allocable to Ohio's retail jurisdictional customers. We explicitly disagreed with IEU-Ohio's argument that AEP-Ohio was precluded from raising this issue at the rehearing stage, finding that AEP-Ohio's claim was prompted by its interpretation of the FAC order and that there was

evidence in the record on this issue. We likewise find no merit in the arguments raised by IEU-Ohio in its May 11, 2012, application for rehearing and find that IEU-Ohio has raised no argument that was not already considered and rejected. In the FAC entry on rehearing, we properly clarified our intention that only the portion of the proceeds from the settlement agreement allocable to Ohio's retail jurisdictional customers must be applied to the 2009 FAC under-recovery. As in many cases before the Commission, it is necessary that certain allocations be made so that only the accounts, property, expenses, revenues, and so forth associated with rendering service to jurisdictional customers are included within the scope of the proceedings.

IEU-Ohio contends that, because AEP-Ohio was required pursuant to its ESP to allocate its least cost fuel to SSO customers, and the coal contract at issue was the Company's least cost fuel source, the Company should be required to allocate all of the settlement proceeds to SSO customers. In making its argument, IEU-Ohio points to the Commission's July 23, 2009, entry on rehearing in Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, in which the Commission stated that FAC costs were "to continue to be allocated on a least cost basis to [provider of last resort] customers and then to other types of sale customers."[3] IEU-Ohio appears to infer a meaning from this statement beyond what the Commission intended. The entry on rehearing does no more than emphasize that AEP-Ohio was expected to continue its usual fuel cost accounting procedures for allocating costs to SSO customers on a least cost basis, which, as the Company notes, is dependent on the average dispatch cost associated with a unit for a particular period of time, rather than any one particular supply contract. Accordingly, we affirm our prior findings in the FAC entry on rehearing.

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3 *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO, *et al.*, Entry on Rehearing (July 23, 2009), at 4.

It is, therefore,

ORDERED, That the application for rehearing filed by IEU-Ohio on May 11, 2012, be denied. It is, further,

ORDERED, That a copy of this fourth entry on rehearing be served upon all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

Lynn Slaby

SJP/sc

Entered in the Journal

JUL 02 2012

Barcy F. McNeal
Secretary

Attachment C

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company.	)))	Case No. 09-872-EL-FAC Case No. 09-873-EL-FAC

OPINION AND ORDER

The Public Utilities Commission of Ohio, having considered the record in these matters and the stipulation and recommendation submitted by the signatory parties, and being otherwise fully advised, hereby issues its opinion and order.

APPEARANCES:

Steven T. Nourse, One Riverside Plaza, Columbus, Ohio 43215-2373, and Daniel R. Conway, Porter, Wright, Morris & Arthur, LLP, 41 South High Street, Columbus, Ohio 43215, on behalf of Columbus Southern Power Company and Ohio Power Company.

Mike DeWine, Ohio Attorney General, by William L. Wright, Section Chief, and Werner L. Margard and Thomas W. McNamee, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio 43215, on behalf of the Staff of the Public Utilities Commission.

Janine L. Migden-Ostrander, Ohio Consumers' Counsel, by Maureen Grady, Melissa Yost, and Kyle Lynn Verrett, Assistant Consumers' Counsel, 10 West Broad Street, Suite 1800, Columbus, Ohio 43215, on behalf of the residential utility consumers of Columbus Southern Power Company and Ohio Power Company.

McNees, Wallace & Nurick, by Samuel C. Randazzo, Joseph Clark, and Joseph Oliker, Fifth Third Center, Suite 1700, 21 East State Street, Columbus, Ohio 43215, on behalf of Industrial Energy Users of Ohio.

OPINION:

I. Background

Columbus Southern Power Company (CSP) and Ohio Power Company (OP) are public utilities as defined in Section 4905.02, Revised Code, and, as such, are subject to the jurisdiction of this Commission.

On March 18, 2009, the Commission issued its Opinion and Order in CSP's and OP's (jointly, AEP-Ohio or Companies) electric security plan (ESP) cases (ESP Order).[1] By entries on rehearing issued July 23, 2009, and November 4, 2009, the Commission affirmed and clarified certain issues raised in AEP-Ohio's ESP Order. In the ESP Order, the Commission approved fuel adjustment clauses (FAC) for the Companies including an annual audit of the FAC. Further, in the ESP cases, the Commission authorized 2010 rate increases of six percent for CSP and seven percent for OP and 2011 rate increases of six percent for CSP and eight percent for OP.

Pursuant to the Commission entry issued January 7, 2010, in Case Nos. 09-872-EL-FAC and 09-873-EL-FAC (2009 FAC cases), Energy Ventures Analysis, Inc., (EVA) was selected to perform AEP-Ohio's FAC audit for 2009. In accordance with the request for proposal, EVA is performing the audits for 2010 and 2011, unless the Commission determines otherwise. Pursuant to the request for proposal, the Commission reserves the right to rescind the award of future audits.

On May 14, 2010, both redacted and unredacted versions of EVA's management/performance (m/p) and financial audit of AEP-Ohio's FAC for 2009 (audit report) were filed in these cases. By entry issued June 29, 2010, the attorney examiner granted AEP-Ohio's motion for protective treatment regarding certain information contained in the audit report for a period of 18 months, ending on December 29, 2011.

The office of the Ohio Consumers' Counsel (OCC), Industrial Energy Users-Ohio (IEU-Ohio), and Ormet Primary Aluminum Company (Ormet) were granted intervention in the 2009 FAC cases in a Commission finding and order issued on January 7, 2010.

In accordance with the attorney examiner's June 29, 2010, entry, the hearing was held in these matters on August 23 and August 24, 2010, at the offices of the Commission. At the hearing, AEP-Ohio submitted a stipulation and recommendation (Ormet stipulation) which was filed in these dockets on August 23, 2010, and signed by the Companies, Staff, OCC, IEU-Ohio, and Ormet Primary Aluminum Corporation (Jt. Ex. 1). Additionally, at the hearing, AEP-Ohio submitted the public and rebuttal testimony of four individuals (AEP-Ohio Exs. 1 and 1A through 7 and 7A) while OCC and IEU-Ohio each offered the testimony of one witness (OCC Exs. 1 and 1A; IEU-Ohio Exs. 1 and 1A). In addition, the redacted and unredacted versions of the audit report were entered into the record without objection (Bench Exs. 1A and 1B).

As stated previously, a stipulation, signed by AEP-Ohio, Staff, OCC, IEU-Ohio, and Ormet was submitted on the record, at the hearing held on August 23, 2010. Through the stipulation, the parties agree that a determination on the collection of deferrals and

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[1] *In re AEP-Ohio ESP cases*, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Opinion and Order (March 18, 2009).

carrying charges associated with an Ormet Interim Agreement is the subject of a pending case before the Commission, *In the Matter of the Application of Columbus Southern Power and the Ohio Power Company to Recover Commission-Authorized Deferrals Through each Company's Fuel Adjustment Clause*, Case No. 09-1094-EL-FAC, and that issues associated with the Ormet Interim Agreement will be addressed in that proceeding.

On November 30, 2010, a stipulation and recommendation intended to resolve all the issues in this FAC proceeding as well as in the Companies significantly excessive earnings proceeding, Case No. 10-1261-EL-UNC *In the Matter of the 2009 Annual Filing of Columbus Southern Power Company and Ohio Power Company Required by Rule 4901:1-35-10, Ohio Administrative Code*, was filed on behalf of AEP-Ohio, Staff, the Ohio Hospital Association, the Ohio Manufacturers' Association, The Kroger Company, and Ormet. On December 16, 2010, the Companies filed a notice of withdrawal from the November 30, 2010, stipulation and recommendation thus rendering the stipulation moot.

II. Summary of the Audit Report

The audit report submitted by EVA and its subcontractor Larkin and Associates PLLC (Larkin) presents the results of the m/p and financial audit for the fuel adjustment clause which is the mechanism being used to recover prudently incurred fuel, purchased power, and other miscellaneous expenses. The FAC includes: Account 501 (Fuel); Account 502 (Steam Expenses); Account 509 (Allowances); Account 518 (Nuclear Fuel Expense); Account 547 (Non-Steam Fuel); Account 555 (Purchased Power); Account 507 (Rents); Account 557 (Other Expenses); Accounts 411.8 and 411.9 (Gains and Loses from Disposition of Allowance); and Other Accounts. EVA and Larkin (jointly, auditors) conducted this audit through a combination of document review, interrogatories, site visits, and interviews. Additionally, EVA and Larkin visited the Conesville Coal Preparation Plant and the Conesville power plant. In its initial ESP application, the Companies proposed mitigating the rate impact of any FAC increases on customers by phasing in the new ESP rates by deferring a portion of the annual incremental FAC costs such that total bill increases to customers would not exceed 15 percent during each year of the ESP. The Commission's ESP order, issued on March 18, 2009, modified AEP-Ohio's proposal to mitigate the rate impact on customers by limiting the phase-in of any FAC increases on a total bill basis by seven, six, and six percent for CSP and by eight, seven, and eight percent for OP for years, 2009, 2010, and 2011, respectively. The Commission's ESP order also stated that the collection of any deferrals including carrying costs remaining at the end of the ESP shall occur from 2012 through 2018 as necessary to recover the actual fuel expense incurred plus carrying costs. (Jt. Ex. 1 at 1-2 through 1-3; ESP order at 23.)

The audit report found that AEP-Ohio's fleet is largely coal-based and coal procurement costs are by far the largest component of the FAC. The auditors noted that

since mid-2007, the coal industry has demonstrated unprecedented volatility which has resulted in utility fuel procurement personnel facing enormous challenges. Additionally, from mid-2007 until the third quarter of 2008, a global coal supply/demand imbalance increased the demand for and price of United States (U.S.) coals. In the auditors' opinion, American Electric Power Service Corporation (AEPSC) did an exceptional job during this period particularly with those suppliers that faced financial difficulties. Since the third quarter of 2008, electricity demand slowed as a result of the severe economic recession thus leading many utilities to end up with more coal under contract than needed. Thus, from mid-2007 through the end of 2008, electric utilities went from having to acquire coal under contract to having to manage a surplus of coal inventories. In the auditors' view, AEPSC also did an outstanding job managing its excess coal inventories. The auditors found this to be the case based, in part, on the treatment AEPSC afforded its suppliers, many of which were willing to defer shipments at no cost. Additionally, the auditors noted, AEPSC chose to allow stockpiles to increase rather than pay for reduced shipments which should benefit ratepayers in the long term. AEP's coal costs in 2009 were, according to the auditors, comparable to the coal procurement costs of other nearby utilities. (Jt. Ex. 1 at 1-4 through 1-5.)

The audit report further determines that, at the end of the first year of the FAC, AEP-Ohio experienced a large under-recovery. The under-recovery amounts to $37.5 million for CSP and $297.6 million for OP. The auditors note that there many components contributing to the under-recovery but that two coal contract events alone explain more than half of OP's under-recovery. The first decision attributing to the under-recovery was the decision to increase the contract price under two contracts in 2009. This surcharge under the two contracts at issue was a well-considered decision at a difficult time according to the audit report. While expensive, the auditors note that, without the surcharge, an insolvency of this coal supplier would have led to greater expense for AEP-Ohio and ultimately its ratepayers. The second contributing factor was a buy-out of a coal contract in 2007 which resulted in an increase in 2009 fuel expenses. The 2007 buy-out was structured as a Settlement Agreement arising out of contract dispute. According to the auditors, a hindsight review of such a Settlement Agreement is always difficult because its merits need to be considered at the time it was entered into. This Settlement Agreement was effectively a buy-out of the contract with this supplier after 2008. Otherwise, shipments would have continued under the contract through the ESP period. In return for agreeing to the buy-out, AEP received a settlement and a coal reserve in West Virginia. AEP booked the coal reserve as an un-regulated asset in 2008. (*Id.* at 1-5.)

The audit report further found that AEPSC's fuel procurement operation is run in a professional manner using leading industry practices in acquiring coal and transportation. To support this position, the audit report notes that AEPSC uses a portfolio strategy to purchase coal such that its market exposure at any one time is limited. Moreover, AEPSC purchases most of its coal through competitive solicitations, and AEPSC uses active

management of its coal supply to match deliveries and burn where possible. The auditors noted that AEPSC was in the process of revising its fuel procurement manual to guide its practices (*Id.*)

The audit report also addresses AEP-Ohio's coal supply and scrubber retrofit at various generating facilities as well as the reduction in the need for washed coal from the Conesville Coal Preparation Plant due to the conversion of an existing coal supply agreement from unwashed coal to washed coal. The audit report notes that AEP-Ohio has met its 2009 alternative energy obligations through compliance with reduced solar obligations, the purchase of non-solar renewable energy credits (RECs) from wind and landfill gas, purchased solar (RECs), solar installations on two AEP-Ohio service centers, and wind from two purchase power agreements (PPAs). During 2009, the Companies entered into three 20-year PPAs: two for wind and one for solar. The auditors note that the resulting power prices under all three PPAs are high compared to current power prices although competitive with current market prices for renewable power. These PPAs provide no market reopeners or early outs thereby obligating AEP-Ohio to these high rates for 20 years. The auditors note that AEPSC's strategy is to continue to examine all options including self-build options (*Id.* at 1-6.) Finally, the auditors found that the quarterly FAC filings were made in a timely manner and contained sufficient documentation to support the numbers therein. However, the back-up documentation was less well organized making the audit trail more difficult. Also, the auditors reported that AEPSC was notably well-prepared and responsive to the auditors (*Id.*)

III. Management Audit Recommendations[2]

A. Auditors' Recommendations

The audit report recommends that the Commission should review whether any proceeds from the Settlement Agreement (i.e., the 2008 lump sum payment AEP-Ohio received as well as the West Virgnia coal reserve) should be credited against OP's FAC under-recovery. The auditors note that this buy-out was unique as it occurred during a period in which fuel cost recovery was not regulated yet the entire value received was for tons of coal that would have been shipped during the ESP period. The auditors do not suggest any motivation on the part of AEPSC to transfer value from ratepayers in 2009 to 2011 to an earlier date. Clearly, it was the coal supplier who initiated the Settlement Agreement because the contract price was well below market. Nonetheless, the contract was an OP asset and the value associated with it would have flowed through to OP ratepayers through the ESP period had there not been an early termination of the contract. Further, the difference between the price of the replacement coal and the contract price is

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2 The following is a summary of the recommendations from the audit report. The Commission notes that these summaries are in no way intended to replace or supplement the text of the audit report.

one factor behind the large OP FAC under-recovery. Equity suggests that the Commission should consider whether some of the realized value should be credited against the under-recovery according to the auditors. (*Id.* at 1-6; 2-21 through 2-22.)

The audit report also recommends that coal could become the new swing fuel; therefore, AEPSC should reconsider new coal procurement strategies to avoid over-commitments in the future. Further, the audit report recommends that the next m/p auditor review the Cardinal 1 scrubber situation and determine what, if any, FAC costs are due to this situation. AEPSC should also undertake a study to determine whether there is an economic justification for continuing to operate the Conesville Coal Preparation Plant. The auditors next recommend that AEPSC should finalize the update of its policies and procedures manual to reflect current business practices and that both the policies and procedures manual and the Conesville Coal Preparation Plant study should be reviewed in the next m/p audit. Lastly, the audit report recommends that prior to entering into long-term agreements for renewables with fixed pricing, AEP-Ohio should fully evaluate self-build and biomass co-firing alternatives and should explore contract options that would provide some protection in the event that the contract pricing for power and/or RECs diverge with market prices. (*Id.* at 1-7.)

B. <u>AEP-Ohio's Position on Management Audit Recommendations</u>

AEP-Ohio witnesses generally testified that the Companies are either in agreement with or not opposed to the auditor's m/p recommendations 2 through 6 found at pages 1-7 of the audit. Regarding m/p audit recommendation 2, the reconsideration of new coal procurement strategies, AEP-Ohio witness Rusk testified that the Companies agree with the recommendation and are currently undertaking such an effort (Co. Ex. 2 at 3). AEP-Ohio witness Nelson testified regarding m/p audit recommendation 3 that the Companies are not opposed to a review of the audit period operational issues concerning the Cardinal 1 scrubber in the next fuel adjustment clause proceeding (Co. Ex. 3 at 8-9). Regarding m/p audit recommendation 4, AEP-Ohio witness Rusk explained that AEPSC has already begun an effort to study the continued use of the Conesville Preparation Plant with the goal of formulating a recommendation on this facility for the next management performance audit (Co. Ex. 2 at 4). AEP-Ohio witness Rusk also testified regarding m/p audit recommendation 5. Mr. Rusk observed that AESPC is currently updating its fuel procurement policies and should have those updates in time for the next m/p audit. However, Mr. Rusk clarified that these revisions are focused on procurement policies and not focused on procurement procedures as the Companies believe that the current approach results in the efficient procurement of fuel at the lowest reasonable cost. (*Id.* at 5.) Regarding m/p audit recommendation 6, that the Companies should fully evaluate and explore self-build and biomass co-firing alternatives before entering long-term agreements for renewables with fixed pricing, AEP-Ohio witness Simmons testified the Companies are constantly exploring the most cost effective sources of renewable generation. Witness Simmons explained that bio-mass is one renewable already under

consideration. The witness discussed two requests for proposal issued by AEPSC in 2010, one for bio-mass and one for a pre-blended bio-mass and coal mixture. Additionally, AEPSC is also considering other co-firing alternatives such as biodiesel. Finally, witness Simmons testified that the self-build option is being evaluated but is less likely without a clear cost recovery path. (Co. Ex. 4 at 4-6.) The sole m/p audit recommendation that generated substantial disagreement among the parties and was the primary focus of the hearing and post-hearing briefs involved m/p audit recommendation 1 discussed in detail below.

C. Disputed Management Audit Recommendation 1

Management audit recommendation 1 states that:

> EVA believes that the PUCO should review whether any proceeds from the Settlement Agreement should be a credit against OPCO's FAC under-recovery. This buy-out is somewhat unique as it occurred during a period in which fuel cost recovery was not regulated yet the entire value received was for tons that would have been shipped during the ESP period.

1. AEP-Ohio's Position

AEP-Ohio maintains that, contrary to the position of OCC and IEU-Ohio, it is important to note that the explicit language of m/p audit recommendation 1 is limited to deciding whether proceeds from the 2008 Settlement Agreement should be used to offset OP's under-recovery of fuel costs in 2009 (Jt. Ex. 1 at 1-6). The Companies explain that the proceeds of the 2008 Settlement Agreement include a lump sum payment (made in three equal payments) and a coal reserves asset located in West Virginia AEP-Ohio witness Dooley testified that a substantial portion of the lump sum payment was already credited, in part, against 2009 fuel costs flowed through the FAC with the other portion to be credited against 2010 fuel costs flowed through the FAC (Cos. Ex. 1 at 4). Moreover, according to AEP-Ohio, the present value of the undeveloped, unpermitted coal reserve is simply not known, but, in any event, the coal reserve is an OP asset that ratepayers have no claim upon. Additionally, the Companies note, the auditor clarified that the separate 2008 Delivery Shortfall Agreement was not a part of the equity issue raised in m/p audit recommendation 1. The auditor further clarified, according to the Companies, that EVA was not making a recommendation but merely felt that the Commission should consider the issue (Tr. I at 38). AEP-Ohio states that, while the auditor may have had good intentions in raising this equity issue, it would be inappropriate for the Commission to entertain the notion because it creates a host of legal issues and because the issue is susceptible to expansion of the issue as OCC and IEU-Ohio have done.

Contrary to the positions of IEU-Ohio and OCC, discussed below, the Companies, citing to the ESP Cases order at 20-22, assert that the Commission fully understood and

expected that the projected magnitude of the OP fuel deferrals by the end of the ESP was approximately $550 million and the Commission built this factor into the structure of the rate cap/phase-in plan as part of the modified ESP. AEP-Ohio claims that the opportunistic positions of OCC and IEU-Ohio constitute selective and unlawful retroactive ratemaking in violation of *Keco Industries, Inc., v. Cincinnati & Suburban Bell Tel. Co.* (1957), 166 Ohio St. 254 and *Lucas Cty. Commrs. v. Pub. Util. Comm.* (1997), 80 Ohio St.3d 344. Additionally, the Companies maintain that, pursuant to the determinations made in the ESP cases and the entry in this proceeding, the audit period is for 2009 and the prudence review must be limited to 2009 fuel procurement activities. These two key Commission determinations involving operation of the FAC mechanism during the ESP were fully adjudicated and decided as part of the Commission's decision in the ESP case. Thus, these determinations are res judicata and cannot be relitigated or reapplied on a retroactive basis. See *Ohio Consumers' Counsel v. Pub. Util. Comm.* (2006), 111 Ohio St.3d 300, 318; *Ohio Consumers' Counsel v. Pub. Util. Comm.* (1985), 16 Ohio St.3d 9, 10.

Moreover, the Companies assert that the FAC baseline was a hotly contested, fully litigated issue decided in the ESP cases and cannot now be modified in this case. AEP-Ohio asserts that the Commission and the parties understood in the ESP cases that adopting a lower FAC baseline created a higher non-FAC generation rate which when coupled with the rate caps adopted as part of the modified ESP resulted in large fuel deferrals recoverable in the future through a nonbypassable surcharge on all customers in order to mitigate a larger initial rate increase. These are the same fuel deferrals OCC and IEU-Ohio are challenging at the Ohio Supreme Court claims AEP-Ohio. Since these same issues have been appealed to the Ohio Supreme Court, the Companies aver that any attempt to collaterally attack the FAC in this proceeding should not be entertained. As a final matter AEP-Ohio opines that each of the 2008 agreements raised by OCC and IEU-Ohio were prudently adopted and the Commission should not disturb any continuing effects of those agreements, especially given that each agreement was entered into by OP prior to commencement of the ESP's new FAC and before the 2009 audit period.

2. <u>IEU-Ohio's Position</u>

IEU-Ohio maintains that the record reflects that the Companies received benefits or value in return for the voluntarily renegotiated contracts, that the Companies accounting failed to flow through the benefits of the voluntarily renegotiated contracts, and that, as a result, customers paid more in fuel costs in 2009 than they would have had AEP-Ohio not renegotiated certain contracts. Specifically, IEU-Ohio states that the Commission should credit to customers the full benefit of the voluntary 2008 Settlement Agreement. In this regard, IEU-Ohio recommends crediting the full lump sum cash payment resulting from the 2008 Settlement Agreement rather than only a portion of the lump sum payment as the Companies have done (IEU-Ohio Ex. 1 at 6). Additionally, IEU-Ohio argues that the Commission should direct the auditor in the next m/p audit to review and provide a current valuation of the West Virginia coal reserve to be credited against OP's FAC under-

recovery that AEP-Ohio will begin collecting in 2012. In the meantime, however, IEU-Ohio recommends that the Commission use the booked value of the West Virginia coal reserve to make an initial downward adjustment to the OP FAC under-recovery. (*Id.* at 7.) Crediting the booked value to the under-recovery now, claims IEU-Ohio, will ensure that customers do not pay carrying costs associated with the booked value while the Commission works to ensure a more accurate valuation of the West Virginia coal reserve. Additionally, claims IEU-Ohio, the booked reserve credit will not impact rates or harm OP's cash flow due to OP's FAC under-recovery deferral. IEU-Ohio also maintains that the Commission should credit against the OP FAC under-recovery the full value of the note receivable by the Companies for the remaining 2008 tonnage that was never delivered as a result of the 2008 Buyout Agreement (*Id.* at 5).

As an alternative recommendation, IEU-Ohio states that the Commission credit against OP's FAC under-recovery the difference between the coal contract price under the contract subject to the 2008 Settlement Agreement and the price per ton paid for the replacement coal multiplied by the number of replacement tons of coal purchased during 2009 (*Id.* at 8). The primary benefit of this option is one of administrative convenience claims IEU-Ohio as it does not require either a future auditor or the Commission to make a subsequent determination of the value of the West Virginia coal reserve (*Id.*). Adopting this option would moot the need to determine whether the full benefit of the lump sum 2008 Settlement Agreement should be credited to customers, the need to properly determine the value of the West Virginia coal reserve, and a determination of whether to credit customers for the proceeds of from the subsequent 2008 Buyout Agreement (*Id.* at 9).

The last adjustment recommended by IEU-Ohio involves a 2008 Contract Support Agreement. Under the 2008 Contract Support Agreement, CSP agreed to increase the base price for a certain tonnage of coal during 2009 with the option for CSP to acquire coal at a discount off the market price per ton for two three-year extensions of the agreement beginning in 2013. IEU-Ohio recommends that the Commission require CSP to refund the increased price per ton that AEP-Ohio agreed to pay for coal during 2009 as part of the 2008 Contract Support Agreement to its FAC customers and account for the total increase as a deferred expense with no carrying costs (*Id.* at 11-12). Should the Commission determine that carrying costs on the deferred expense are appropriate, IEU-Ohio argues that the carrying costs should be a debt-only rate. The deferred expense would then be amortized if and when CSP actually exercises the options for the respective three-year extensions of the 2008 Contract Support Agreement beginning in 2013. (*Id.*) Without this adjustment, IEU-Ohio claims that the present customers incurred higher costs for coal in 2009 but have no assurance that they will receive any of the future benefits. IEU-Ohio concludes by noting that its recommendations more fairly balance the benefits and costs associated with the coal supply contracts.

In response to AEP-Ohio's case-in-chief, IEU-Ohio urges the Commission to direct the Companies to provide its customers the benefits due them from the voluntary coal contract negotiations. IEU-Ohio also took issue with the Companies' claims that the relief requested by the intervenors and by Staff involves retroactive ratemaking and is prohibited under *Keco* and *Lucas Cty*. *Keco* is inapplicable, argues IEU-Ohio, as that case involved traditional regulation and did not involve issues associated with a self-reconciling automatic adjustment clause. Even if the Commission were to find some credibility in AEP-Ohio's argument, IEU-Ohio maintains that the Commission could easily remedy that situation by merely repricing the coal as outlined in the testimony of IEU-Ohio witness Hess (*Id.* at 7-8).

IEU-Ohio also urges the Commission to reject the Companies' claims that the Commission is merely limited to looking at fuel procurement activities during calendar year 2009. IEU-Ohio notes that AEP-Ohio's own witness acknowledged that in conducting the 2009 audit that it was necessary for the auditor to determine whether contracts entered into prior to the audit period had any impact on audit period costs (Tr. I at 162-163). AEP-Ohio's claims of res judicata are also suspect, IEU-Ohio avers, as neither claim preclusion nor issue preclusion, two necessary components of res judicata, apply in this instance. IEU-Ohio next takes issue with the Companies' position that the parties are attempting to illegally relitigate the FAC baseline established in the ESP case. Neither the intervenors nor Staff advanced proposals to modify the FAC baseline asserts IEU-Ohio.

IEU-Ohio next disputes the Companies' argument that the intervenors are claiming a property ownership interest in the coal reserve for ratepayers. IEU-Ohio asserts that nowhere did the intervenors or Staff claim such an ownership interest but simply that the benefits that have been deprived of OP customers be netted against the costs that OP has billed and collected from customers. Next, IEU-Ohio maintains that it is not challenging the appropriateness of the accounting based on any conflict with GAAP, but rather makes a ratemaking recommendation for the Commission's consideration. Lastly, IEU-Ohio avers that, contrary to the Companies position, IEU-Ohio did consider the production bonus payment made in 2008 and agreed that the FAC customers had paid their fair share of the costs of that contract (Tr. II at 255). For these reasons, IEU-Ohio urges the Commission to adopt its recommendations to more fairly balance the benefits and the costs associated with the coal supply contracts discussed in this proceeding.

3. OCC's Position

OCC submits that AEP-Ohio is attempting to pass on to its customers all of the Companies costs under certain fuel procurement contracts, while keeping the majority of the benefits acquired in the contracts, thereby causing its customers to pay more fuel cost than authorized by law in violation of Section 4928.143(B)(2)(a), Revised Code, and Rule 4901:1-35-03(C)(9)(a)(ii), O.A.C. For example, similar to the position taken by IEU-Ohio, OCC asserts that the Companies 2008 Settlement Agreement produced added costs for

customers while AEP-Ohio only shared a portion of the lump sum payments the Companies received as well as only a portion of the West Virginia coal reserve. Another example of AEP-Ohio passing along increased costs while keeping the majority of the benefits is the renegotiated coal procurement contract whereby AEP-Ohio agreed to pay the coal provider an increased price of coal per ton during 2009 while having the opportunity to receive a per ton discount on all tons of coal delivered from 2013-2018.

To prevent AEP-Ohio from recovering more fuel cost from its customers than the Companies should under law, OCC submits that the Commission should order that AEP-Ohio's customers receive the financial benefits from the Companies fuel procurement contracts through immediate credits to AEP-Ohio's FAC deferral balance. As previously discussed, those fuel procurement benefits that should be credited against the FAC deferral balance include the full lump sum payment and the fair value of the West Virginia coal reserve that was part of the settlement agreement as well as the fair value of the coal market price discount option for future coal delivery negotiated as part of the 2008 Contract Support Agreement. Any delay in applying these credits will unnecessarily increase the burden to the customers of OP because the carrying charges associated with OP's fuel cost deferral can exceed $10 million every three months (OCC Ex. 1 at 16).

Responding to the Companies' arguments, OCC asserts that the underlying ESP decision and the January 7, 2010, entry in this case do not limit the Commission's review of AEP-Ohio's fuel procurement contracts to only those entered into during the 2009 FAC period. Additionally, OCC argues that neither OCC nor IEU-Ohio are attempting to "claw back" revenue from a prior rate plan as argued by AEP-Ohio. Moreover, the FAC baseline is not relevant, claims OCC, to the issue of requiring AEP-Ohio to recover only its actual fuel cost nor does the FAC baseline constitute res judicata. OCC's final argument is that requiring AEP-Ohio to recover only its actual fuel cost does not constitute selective or retroactive ratemaking as argued by the Companies.

4. Staff's Position

As a general matter, Staff supports the findings and recommendations contained in the Audit Report and recommends that those recommendations be adopted by the Commission. Staff acknowledges that the Companies are entitled to recover the costs of fuel but only to recover the true cost incurred. In other words, Staff asserts that any proceeds received offsetting the cost of fuel should be credited against under-recoveries, regardless of the period in which the proceeds are recognized. Since the value of such credits cannot be determined at this time, Staff recommends that the Commission direct the auditor to evaluate the value of proceeds received by the Companies and not credited either to the FAC or to deferred under-recoveries and make recommendations in the next audit proceeding as to the value to be credited.

Responding to a number of AEP-Ohio arguments, Staff notes that arguments concerning prohibited retroactive ratemaking and imprudence are irrelevant and have not been raised by the auditor's report. AEP-Ohio's arguments concerning regulatory accounting are rejected by Staff as the Commission and not the Companies determine the appropriate accounting for regulatory purposes. Staff does agree with the Companies that Ohio ratepayers do not own the coal reserves that were part of the Settlement Agreement, however, Staff asserts that the value of the coal reserves is part of the cost of fuel and therefore should be examined by the next auditor.

D. Commission Conclusion on Management Audit Recommendations

Initially, the Commission notes that there were very few concerns raised by the parties as to the auditor's m/p recommendations 2 through 6 found at pages 1-7 of the audit. Therefore, the Commission will adopt the auditor's m/p recommendations 2 through 6 as outlined in the audit. The Commission notes that there were, however, widely contrasting positions taken by the parties concerning m/p audit recommendation 1 which recommends that the Commission should review whether any proceeds from the Settlement Agreement (i.e., the 2008 lump sum payment AEP-Ohio received as well as the West Virginia coal reserve) should be a credit against OP's FAC under-recovery.

Following a thorough review of the record and the arguments raised by the parties in this matter, the Commission determines that all of the realized value from the Settlement Agreement should be credited against OP's FAC under-recovery namely the portion of the $30 million 2008 lump sum payment not already credited to OP ratepayers as well as the $41 million value of the West Virginia coal reserve that AEP booked when the Settlement Agreement was executed. Additionally, because the value of the West Virginia coal reserve is not clear and because AEP had planned to begin the permitting process at the time of the audit which should enhance the value of the coal reserve, we direct AEP to hire an auditor specifically to examine the value of the West Virginia coal reserve and to make a recommendation to the Commission as to whether the increased value, if any above the $41 million already required to be credited against OP's under-recovery, should accrue to OP ratepayers beyond the value of the reserve that AEPSC booked under the Settlement Agreement. The Commission will issue by subsequent entry a Request for Proposal to hire the auditor discussed above.

In making the above determination the Commission notes that the record reflects that the Settlement Agreement was entered into in order to terminate a long-term coal supply agreement, entered into in 1992, because the price of coal under the agreement was significantly below market in mid-2007. This long-term agreement was replaced with a new agreement which resulted in OP ratepayers paying significantly more for coal beginning in 2009, the start of the ESP period, than would have been paid had the Settlement Agreement not been entered into. We recognize that this situation is somewhat unique given that OP's fuel costs were not regulated during the period when the buyout

occurred and the benefits booked yet the value was realized from coal that should have been delivered during the ESP period. While we do not find any motivation by AEPSC to transfer value from ratepayers during the ESP to an earlier date, nevertheless, the long-term coal agreement was an OP asset for which the value would have flowed through to OP ratepayers through the ESP period but for the extraordinary circumstances related to the early contract termination. Given these factors, we agree with Staff that, in order to determine the real economic cost of coal used during the audit period, more of the value realized by AEP for entering into the Settlement Agreement should flow through to OP ratepayers through a credit to OP's under-recovery and deferrals.

Citing to the ESP cases (Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Opinion and Order, March 18, 2009, at pages 14-15) and an earlier entry in this proceeding, AEP-Ohio argues that the Commission limited the audit period and the prudence review in this case to 2009 procurement activities and that the only relevant factor is the price the Companies paid for coal during 2009. The Commission disagrees. Contrary to the Companies argument, the Commission is not seeking to reach into another audit period in order to modify rates charged during the audit period but rather is rendering its decision in order to match the revenues and benefits incurred during the audit period. Nor has the Commission found that entering into the Settlement Agreement was imprudent. Again, the Commission is only finding that to determine the real economic cost of coal during the audit period, the Commission must consider both the revenues and the benefits received by the Companies pursuant to the Settlement Agreement and not rely solely on the price paid for coal during 2009. AEP-Ohio further claims that the parties in this case are attempting to illegally relitigate the FAC baseline established in the ESP cases. AEP-Ohio's claims are without merit as the Commission has not adjusted the baseline for the 2009 period as decided in the Companies ESP cases. Rather, the Commission, in this case, is engaging in a reconciliation and accounting which was explicitly contemplated by the ESP cases in future FAC proceedings. Otherwise, there would be no rationale for undertaking an annual audit. In this case, the Commission is making an accounting adjustment to recognize extraordinary events affecting 2009 costs such that the Companies 2009 real costs will be comparable to the proxy baseline selected in the ESP proceedings.

AEP-Ohio's arguments concerning the applicability of *Keco* and *Lucas Cty.* are likewise unavailing. According to the Companies, any attempt to credit amounts booked in 2008 during the prior rate plan would violate the longstanding prohibition against retroactive ratemaking established in *Keco*. However, *Keco* does not apply in this situation. The Commission is not considering modifying a previous rate established by a Commission order through the ratemaking process as the Court considered in *Keco*. Rather, the Commission, by ordering the Companies to credit more of the proceeds from the Settlement Agreement to OP's deferral balance, is establishing a future rate based upon the real cost of the coal used by the Companies to generate electricity during the 2009 FAC audit period. The proceeds AEP-Ohio received for entering into the Settlement Agreement

are but one of the components which impact the Companies cost to provision electricity during 2009. Likewise, *Lucas Cty.* does not apply to the present situation. In *Lucas Cty.*, the Court held that the Commission was not statutorily authorized to order a refund of, or credit for, charges previously collected by a public utility where those charges were calculated in accordance with an experimental rate program which has expired. As noted above, the Commission has not made a determination modifying the rate the Companies collected during 2009. Additionally, there is no experimental rate program involved in the current case. Thus, *Lucas Cty.* does not apply in this matter.

As to any benefits associated with the delivery shortfall agreement and the contract support agreement that OCC and IEU-Ohio assert should also be factored into the Companies FAC under-recovery, the Commission determines that any effect these agreements may have had on AEP-Ohio's fuel costs, if any, would appear to apply in time periods outside of the current audit. Therefore, while those agreements may be examined by a future audit, those agreements will not be further examined as part of the current audit.

IV. Financial Audit Recommendations

The audit report also included six financial audit recommendations. In the first recommendation, the auditors submit that the FAC workbooks should be modified to include explanations that identify and/or explain differences between includable FAC amounts recorded in the general ledger versus includable FAC amounts derived from other sources (e.g., Monthly Purchase Summary Reports). Additionally, these explanations should also apply to issues such as timing differences and/or prior period adjustments. The second recommendation is that CSP and OP should include the reconciliation of the fuel and purchased power accounts that have been designated as includable FAC costs with the monthly FAC workbooks, to facilitate a clear audit trail. The third financial audit recommendation is that the Companies overall should provide a better audit trail for tracing costs. Fourth, the auditors suggest that the Commission may want to have AEP-Ohio explain further how the four generating units designated as "must run" units by PJM are affecting the costs that are recoverable in the FAC. The fifth financial audit recommendation is that the Companies should update and/or modify its systems in order to better indicate hourly or 24-hour dispatch costs and off-system sales cost information related to forced outages.

AEP-Ohio witness Dooley testified that the Companies agree with and plan to implement the auditors recommendations regarding financial audit items 1, 2, and 3 (Co. Ex. 1 at 6). The Companies' witnesses did not specifically address financial audit recommendations 4 and 5. The Companies otherwise did acknowledge, however, that AEP-Ohio agreed with and planned to implement the financial audit recommendations as clarified in the Companies' testimony (Cos. Brief at 51).

As AEP-Ohio does not challenge financial audit recommendations 1 through 5, the Commission will adopt such recommendations made in the audit report.

The final financial audit recommendation involves the River Transportation Division (RTD) and has 10 sub-components. The audit report suggests that RTD should respond to the following prior to the next audit and that the next auditor should review the results of this additional information:

(a) RTD should be required to explain and justify the rationale of the Net Investment Base and Cost of Capital Billing Adder formula presented in EVA 4-5, Confidential Attachments 1 and 2.

(b) RTD should be required to provide a procedure for updating the cost of capital and the Return on Equity (ROE) component that is commensurate with the risk of the operation.

(c) An Over Collection by RTD indicates that RTD collected too much from the affiliated companies for barge operations in a particular year. The Over Collection should be a subtraction from the Investment Base (rather than an addition to RTD's expenses).

(d) RTD should provide documentation that it corrected its calculation of the 2008 Working Capital Requirement and the 2009 Working Capital Requirement and the resulting credits $43,314 (2008) and $45,117 (2009) to RTD's customers were recorded in its 2nd Quarter's 2010 true up and credited to the operating companies in August 2010. OP's portion of these credits is $15, 298 (2008) and $17,325 (2009).

(e) Balance Sheet items such as Prepayments, Materials and Supplies inventory and Other Current and Accrued Liabilities, if considered in developing a utility's rate base, are typically added or subtracted on a 13-month average balance basis. RTD should be required to explain why its current methodology of dividing balance sheet items (such as prepayments, materials and supplies inventory, and other current and accrued liabilities) by eight to derive the Investment Base is a reasonable and appropriate method.

(f) OP, RTD and other AEP affiliates that utilize the RTD should work together to revise the RTD formula to conform with generally accepted public utility industry rate base and ratemaking standards. OP should report quarterly concerning the progress of these efforts by including a description of progress made in its quarterly FAC filings.

(g) The details of RTD charges including, but not limited to, Other Administration Expenses and "AEP Admin Charges" such as those provided by AEP in response to LA 7-17, should be reviewed in detail in the next audit period.

(h) RTD should prepare a justification for how RTD's income tax expense and Accumulated Deferred Income Taxes are handled.

(i) RTD should explain the Accumulated Deferred Income Taxes (ADIT) amounts on its Balance Sheet and identify any amounts and components related to the use of accelerated tax depreciation.

(j) To the extent that RTD has cost-free capital in the form of ADIT related to the use of accelerated tax depreciation (which would typically be associated with credit-balance ADIT amounts), RTD should prepare an explanation why that cost-free capital should not be subtracted in deriving the Investment Base, similar to how ADIT balances would be subtracted in deriving a utility's rate base.

Regarding financial audit recommendations 6a, 6e, 6f, and 6j, the Companies state that, although the current treatment is a reasonable approach, AEP-Ohio is willing to have the RTD division amend its calculation to be in accordance with the traditional base treatment recommended by the audit report starting January 1, 2011 (Co. Ex. 3 at 11). Financial audit recommendation 6b is unnecessary, says AEP-Ohio, because there is already a procedure in place for updating the cost of capital and Return on Equity component commensurate with the risk (*Id.*). AEP-Ohio witness Nelson testified that the ROE is adjusted on January 1 each year to the return allowed by FERC. In the absence of a recent FERC order, the ROE becomes that established by the Indiana Utility Regulatory Commission in its most recent order (*Id.* at 11-12). Regarding financial audit recommendations 6c and 6d, the Companies explain that RTD has made all necessary changes to correct the Working Capital Requirement for 2008 and 2009 and will appropriately credit the applicable operating companies including OP. Documentation will be available for the next audit states AEP-Ohio (Co. Ex. 1 at 6). Similarly, the Companies have no objections to financial audit recommendations 6g, 6h, and 6i. AEP-

Ohio commits that the necessary explanations will be available for the next audit (Co. Ex. 1 at 6-7; Co. Ex. 3 at 12).

Generally, the Companies agree with and plan to implement financial audit recommendations 6a through 6i. Regarding financial audit recommendation 6b, the Companies have adequately explained and thus have complied with the auditors' recommendation. Therefore, no further action is required by the Companies on financial audit recommendation 6b. The Commission adopts as its determinations in this matter, financial audit recommendations 6a through 6i with the exclusion of recommendation 6b discussed in the preceding sentence.

V. Ormet stipulation

Rule 4901-1-30, Ohio Administrative Code, authorizes parties to Commission proceedings to enter into a stipulation. Although not binding on the Commission, the terms of such an agreement are accorded substantial weight. *Consumers' Counsel v. Pub. Util. Comm.* (1992), 64 Ohio St.3d 123, 125, *citing Akron v. Pub. Util. Comm.* (1978), 55 Ohio St.2d 155. This concept is particularly valid where the stipulation is unopposed by any party and resolves all issues presented in the proceeding in which it is offered.

The standard of review for considering the reasonableness of a stipulation has been discussed in a number of prior Commission proceedings. *Cincinnati Gas & Electric Co.*, Case No. 91-410-EL-AIR (April 14, 1994); *Western Reserve Telephone Co.*, Case No. 93-230-TP-ALT (March 30, 1994); *Ohio Edison Co.*, Case No. 91-698-EL-FOR *et al.* (December 30, 1993); *Cleveland Electric Illum. Co.*, Case No. 88-170-EL-AIR (January 30, 1989); *Restatement of Accounts and Records (Zimmer Plant)*, Case No. 84-1187-EL-UNC (November 26, 1985). The ultimate issue for our consideration is whether the agreement, which embodies considerable time and effort by the signatory parties, is reasonable and should be adopted. In considering the reasonableness of a stipulation, the Commission has used the following criteria:

(1) Is the settlement a product of serious bargaining among capable, knowledgeable parties?

(2) Does the settlement, as a package, benefit ratepayers and the public interest?

(3) Does the settlement package violate any important regulatory principle or practice?

The Ohio Supreme Court has endorsed the Commission's analysis using these criteria to resolve issues in a manner economical to ratepayers and public utilities. *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.* (1994), 68 Ohio St.3d 559, *citing*

Consumers' Counsel, supra, at 126. The court stated in that case that the Commission may place substantial weight on the terms of a stipulation, even though the stipulation does not bind the Commission (*Id.*).

We find that the Ormet stipulation entered into by the stipulating parties is reasonable and should be adopted. In making this determination, the Commission notes that the Ormet stipulation is a product of serious bargaining among capable, knowledgeable parties and is the product of an open process. Moreover, as a package, the Ormet stipulation benefits ratepayers and furthers the public interest as a more thorough examination involving the collection of deferrals and carrying charges associated with the provision of service to Ormet is already the subject of a pending case before the Commission in *In the Matter of the Application of Columbus Southern Power and the Ohio Power Company to Recover Commission-Authorized Deferrals Through each Company's Fuel Adjustment Clause*, Case No. 09-1094-EL-FAC (09-1094). Therefore, a detailed examination of the complex issues surrounding AEP-Ohio's provision of service to Ormet, the largest, most energy-intensive customer that the Companies serve in Ohio, does not have to be considered in this proceeding. Finally, the Commission finds that there is no evidence that the stipulation violates any important regulatory principle or practice and, therefore, the stipulation meets the third criterion. Accordingly, the Ormet stipulation is approved.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

(1) CSP and OP are public utilities under Section 4905.02, Revised Code, and are subject to the jurisdiction of this Commission.

(2) These cases relate to the Commission's review of CSP and OP's fuel costs during the period from January 1, 2009, through December 31, 2009.

(3) By entry issued January 7, 2010, the Commission selected EVA to perform CSP and OP's audit for the period of January 1, 2009, through December 31, 2009. On May 14, 2010, EVA filed its audit report.

(4) On January 7, 2010, IEU-Ohio, OCC, and Ormet were granted intervention in these cases.

(5) A hearing in these matters was held on August 23 and August 24, 2010.

(6) Briefs and reply were filed on September 23, 2010, and October 15, 2010, respectively.

(7) At the hearing, a stipulation was submitted acknowledging that a determination on the collection of deferrals and carrying charges associated with an Ormet Interim Agreement is the subject of a pending case before the Commission and that the issues associated with the Ormet Interim Agreement would be addressed in that proceeding. The stipulation was signed by AEP-Ohio, Staff, OCC, IEU-Ohio, and Ormet. The stipulation meets the criteria used by the Commission to evaluate stipulations, is reasonable, and should be adopted.

ORDER:

It is, therefore,

ORDERED, That the Companies credit OP's FAC under-recovery as discussed herein. It is, further,

ORDERED, That the Companies hire an auditor as discussed herein. It is, further,

ORDERED, That the stipulation entered into by AEP-Ohio, Staff, OCC, IEU-Ohio, and Ormet be adopted and approved. It is, further,

ORDERED, That AEP-Ohio take all necessary steps to carry out the terms of this opinion and order. It is, further,

ORDERED, That nothing in this opinion and order shall be binding upon the Commission in any future proceeding or investigation involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That a copy of this opinion and order be served upon each party of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

JRJ/vrm

Entered in the Journal

JAN 23 2012

Betty McCauley

Betty McCauley
Secretary