



## M E M O R A N D U M

Date: August 25<sup>th</sup>, 2015  
 To: Ohio Manufacturers’ Association – Energy Group  
 From: Jordan Nader & John Seryak, PE (RunnerStone, LLC)  
 RE: Phase-In Recovery Rider (PIRR)

The Phase-In Recovery Rider (PIRR) was recently increased by an average of \$0.003211, from \$0.004072 to \$0.007282 per kWh for AEP Ohio’s Ohio Power customers. The PIRR for Columbus Southern Power customers of AEP Ohio’s is unchanged at \$0. The change for Ohio Power customers occurred because AEP interpreted a remand from the Ohio Supreme Court to use the Weighted Average Cost of Capital (WACC) as being retroactive instead of prospective leading to an increase in carrying charges of approximately \$150M. The WACC is applied to deferred costs from the Fuel Adjustment Cost (FAC) from years ago. The Public Utilities Commission of Ohio (PUCO) approved AEP’s request.

OMAEG counsel argued that this is retroactive ratemaking. If the WACC is applied to carrying charges prospectively, the total cost of carrying charges increases by \$25M. This change will be in effect until the end of 2018 at which point the deferred costs from 2009-2011 should be paid off. OMAEG applied for rehearing of the PUCO order, stating that “The Commission erred by violating the prohibition against retroactive ratemaking when it authorized AEP Ohio to collect carrying charges at its weighted Average Cost of Capital through the Phase-In Recovery Rider for a past period beginning in September 2012.” The PUCO has yet to issue an entry on rehearing addressing the retroactive ratemaking concerns raised by OMAEG and other parties.

The table below presents the impact to small, medium, large, and extra-large manufacturers. The change to using WACC for the deferred costs amounts to tens-of-thousands to millions of dollars in extra cost annually for OMAEG members served by Ohio Power.

Manufacturer Size	Consumption (kWh/year)	Original Rate (\$/kWh)	New Rate (\$/kWh)	Original Rate Cost Estimate	New Rate Cost Estimate	Increased Costs from Rider Change	Original Rate Lifetime Cost	New Rate Lifetime Cost	Increased Lifetime Costs from Rider Change
Small (~\$100k/yr in electricity costs)	1,000,000	\$ 0.004222	\$ 0.007551	\$4,222	\$7,551	\$ 3,329	\$ 10,555	\$ 18,878	\$ 8,323
Medium (~\$600k/yr in electricity costs)	7,500,000	\$ 0.004076	\$ 0.007289	\$30,570	\$54,668	\$ 24,098	\$ 76,425	\$ 136,669	\$ 60,244
Large (~\$6 million/yr in electricity costs)	100,000,000	\$ 0.003994	\$ 0.007144	\$399,400	\$714,400	\$ 315,000	\$ 998,500	\$ 1,786,000	\$ 787,500
Extra Large	1,000,000,000	\$ 0.003994	\$ 0.007144	\$3,994,000	\$7,144,000	\$ 3,150,000	\$ 9,985,000	\$ 17,860,000	\$ 7,875,000



**Background**

On July 31, 2008, Columbus Southern Power Company and Ohio Power Company (collectively, “The Companies”) filed their Application to establish an Electric Security Plan (ESP) in Case(s) 08-0917-EL-SSO and 08-0918-EL-SSO as required by Senate Bill 221. During the proceedings, The Companies requested the creation of a Fuel Adjustment Clause (FAC) to recover costs associated with fuel and environmental compliance. As a component of this, The Companies proposed to defer costs associated with the FAC that would result in bill increases of more than 15 percent annually for the period of the first ESP. The Companies projected that by December 2011, Ohio Power Company and Columbus Southern Power would accrue \$554 million and \$146 million in deferrals from the FAC, respectively. The Companies proposed that all deferrals would be recovered by a non-bypassable surcharge from 2012 to 2018 with a carrying cost at the Weighted Average Cost of Capital (WACC).

A number of intervenors opposed the creation of a long term deferral mechanism for fuel costs. There were several reasons mentioned for opposition including that it would mask the true cost of ESP generation,

it would artificially suppress conservation, the carrying costs would be inclusive of equity, and it would result in customers paying interest on these deferred costs.

	2009		2010		2011	
	Max % Increase	~Avg \$/kWh	Max % Increase	~Avg \$/kWh	Max % Increase	~Avg \$/kWh
<b>Ohio Power Company</b>	8%	\$ 0.0429	7%	\$ 0.0475	8%	\$ 0.0531
<b>Columbus Southern Power Company</b>	7%	\$ 0.0547	6%	\$ 0.0607	6%	\$ 0.0631

The Ohio Consumer’s Counsel (OCC) opposed the use of WACC to calculate the carrying costs, arguing that it was unreasonable and would result in excessive payments by customers. The OCC argued that alternatively the current long-term cost of debt or the short-term actual cost of debt, excluding equity, would be more appropriate if costs were deferred. Another party argued that by not recovering the cost of fuel within the year, The Companies could record it as a “deferred tax obligation.” This would result in The Companies partially recovering the deferred fuel balance due to the reduced income tax expense.

The PUCO found that sections of the Ohio Revised Code (ORC) allowed the recovery of deferred costs with carrying costs and that they should be collected through an unavoidable surcharge. The ORC also does not limit the time allotted for a phase-in of fuel costs nor the recovery the deferrals associated with the phase-in of fuel costs. The Commission also found that a 15 percent maximum annual increase in customer bills would be “too high” and ordered that Columbus Southern Power customers would be limited to 7 percent maximum increase and Ohio Power customers would be limited to an 8 percent maximum increase in their electricity bills during 2009. In 2010, Ohio Power customers would be limited to a 7 percent increase and Columbus Southern Power customers would be limited to a 6 percent increase. And then finally in 2011, Ohio Power customers would be limited to an 8 percent increase and Columbus Southern Power customers would be limited to a 6 percent increase. The PUCO ordered that the above be enacted and upon rehearing no parties further challenged the findings.



On September 1, 2011, The Companies filed at the PUCO to create a mechanism to recover the costs deferred from the Fuel Adjustment Clause. The Companies called this their Phase-In Recovery Rider (PIRR) and requested that it be effective starting January 1<sup>st</sup>, 2012. This rider would recovery nearly \$600M in costs that The Companies had accrued in deferred fuel costs and environmental compliance. The costs were primarily accrued from Ohio Power customers. However in a stipulation filed six days later, parties agreed to collect the full cost of the deferred assets from FAC across the non-residential customer base beginning on January 1, 2012. The parties agreed that the use of the WACC carrying charges used during ESP 1 was appropriate and proper. The parties also agreed that a debt carrying charge of 5.34% was appropriate during the repayment period instead of the original WACC of 11.15%. This would save customers \$153.4 million over the course of the recovery. They also agreed that Residential customers would begin paying for this debt on January 1, 2013. Four months later, the PUCO found in the 2009 FAC Audit case that The Companies should apply proceeds from an agreement with a “coal supplier” in 2007 towards the under-recovery from Ohio Power customers. Ultimately, these proceeds were applied to accounting of the FAC deferrals; however the stipulation was rejected by the PUCO on February 23, 2012. The PUCO found that the parties involved in the stipulation had not met their “burden of demonstrating that the stipulation...benefits ratepayers and the public interest...”

The PIRR case became active again as a result of this rejection of the stipulation. OMAEG moved to intervene. The PUCO Staff concluded that The Companies’ application should be approved with four modifications:

1. Carrying charges should be calculated using long-term debt rate instead of WACC; Staff believed the long-term debt rate should be used due to the lack of collection risk and found this would save ratepayers \$130,185,906 over the use of WACC.
2. The final deferral balance in December 2011 should be reduced by the total accumulated deferred income taxes (ADIT) to prevent investors from earning a return on the deferred fuel balance that they did not finance. Staff noted that ratepayers would save an additional \$34,653,615 in carrying costs from this action.
3. The calculation of the deferred fuel balance on a going forward basis should be annually compounding instead of monthly compounding; Staff believed this to “be consistent with the PUCO’s recognition of an annual interest rate in The Companies’ rate of return allowance.” This would save Ohio Power ratepayers an additional \$23,915,797 in carrying charges. (This was supported by the OCC and Ormet).
4. The Companies should be directed to make annual filings relating to their deferred fuel balances including a “breakdown of the status of collections per rate class and by operating company and the corresponding ending deferral balance.” (This was not opposed by The Companies and was supported by the OCC).

The Companies refuted the first three recommendations on the grounds that Staff was modifying “ESP 1 Order, which is a final, non-appealable order that cannot be modified.” The OCC argued for the PIRR rider to be collected subject to refund, that there be a six year recovery period,



that a shorter recovery period should be required to reduce carrying costs that ratepayers would be subject to, and that over-collection of FAC in Columbus Southern Power territory should be returned to customers with haste and interest instead of every quarter through the FAC adjustment. IEU-Ohio argued against customers in the Columbus Southern Power rate zone being subject to PIRR due to a claim that they had no deferral balance at the end of 2011. However, AEP-Ohio claims an under-recovery of \$15 million from Columbus Southern Power ratepayers.

The PUCO found in an order dated August 1, 2012, that the application to create the PIRR was “for the most part” consistent with what was authorized in ESP 1. The PUCO disagreed with AEP-Ohio that “ESP 1 Order cannot be modified in any way by the Commission.” The PUCO argued that ESP 1 is “subject to the ongoing supervision and jurisdiction of the Commission.” Carrying costs were ordered to be calculated using the WACC until the recovery period begins and thereafter to be calculated using the long-term cost of debt rate. This was justified partially because of the decreased risk associated with recollection of the deferred costs and it was found to be consistent with “sound regulatory practice and longstanding Commission precedent.” The PUCO recognized that The Companies’ initial application had deferred costs only for Ohio Power customers but that in later filings indicated that Columbus Southern Power customers had deferred costs as well. The PUCO found that The Companies should file new tariffs recognizing this difference.

This order was appealed to the Supreme Court of Ohio and on June 2, 2015, the Court issued a decision reversing the carrying charge rate utilizing the WACC. The Court found that the PUCO had violated the ORC because it had modified the ESP 1 order after the term of ESP 1 had expired which “deprived AEP-Ohio of its right to withdraw a modified ESP as provided in the statute.” The Court remanded the case back to the PUCO to reinstate the use of WACC for calculation of the carrying costs. AEP-Ohio filed on May 23<sup>rd</sup>, 2016 to modify their PIRR tariffs in keeping with the remand from the Court. On May 24, 2016, the Ohio Energy Group (OEG) filed to suspend the PIRR tariff proposed until an investigation into the legality of the rates had been completed. OEG argued that the proposed tariffs were retroactive ratemaking. OEG suggested that The Companies should have either utilized the WACC rate going forward from the remand from the Court or from the date of their tariff filing but not from 2012. The Companies disputed this and argued that the adjustment of deferred amounts could be retroactively reconciled. OEG replied that the rates approved are legal until ordered otherwise and then all new rates shall be made prospectively. On June 29, 2016, the PUCO ordered that the arguments presented by OEG and supported by the OCC were denied and that The Companies’ rates should be placed with carrying costs calculated using WACC back to 2012 and on bills from July 2016 onward.

OMAEG, OEG, and the OCC asked that the PUCO order be revised on rehearing on July 29, 2016. As stated above, OMAEG believes that the PUCO decision was unlawful as it permitted retroactive ratemaking when it authorized The Companies to collect carrying charges at its weighted Average Cost of Capital through the Phase-In Recovery Rider for a past period. Rehearing is still pending.