ORIGINAL

IN THE SUPREME COURT OF OHIO

Columbus Southern Power Company	)	Supreme Court Case No. 2010-0723
	)	
Appellant,	)	Appeal from the
	)	Public Utilities Commission of Ohio
v.	)	
	)	PUCO Case No. 09-516-EL-AEC
The Public Utilities Commission of Ohio	)	
	)	
Appellee.	)	

MERIT BRIEF OF INTERVENING APPELLEE INDUSTRIAL ENERGY USERS-OHIO

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INTRODUCTION

Columbus Southern Power Company ("CSP" or "Appellant"), would have this Court render R.C. 4905.31, as amended by Amended Substitute Senate Bill 221 ("SB 221") senseless by ruling that the General Assembly intended to give Ohio electric distribution utilities ("EDUs") an absolute veto power over the Public Utilities Commission of Ohio ("Commission" or "PUCO") when it approves a mercantile customer-proposed reasonable arrangement pursuant to R.C. 4905.31. Further, CSP asserts that it is authorized as a matter of law to recover both 100 percent of any delta revenue that results from a reasonable arrangement and 100 percent of its charges for being the provider of last resort ("POLR") or default electric service provider for a customer taking service pursuant to a Commission-approved reasonable arrangement whereby the customer agrees not to shop for electric generation service. CSP is simply wrong on all three assertions as a matter of law and reasonableness. For the reasons discussed below, the Court should affirm the decision of the Commission.

STATEMENT OF FACTS

A. Ohio's Electricity Restructuring Law and AEP-Ohio's POLR Charge

In 1999, Ohio enacted an electric restructuring law, Amended Substitute Senate Bill 3 ("SB 3"), that was designed and enacted on the assumption that the wholesale market would be sufficiently robust and mature to provide a reliable supply and a transparent source of reasonable prices after a market development period. However, as the end of the market development period approached, it became evident that the benefits of competition anticipated at the time that SB 3 was enacted were not coming to fruition.[1] As a result of the collective realization that

[1] *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of a Post-Market Development Period Rate Stabilization Plan,*

competition had not arrived as planned, the Commission requested that Ohio's EDUs file plans to establish the default, or SSO, rates that reasonably approximated future market conditions, were reasonable in magnitude, would spur competition, and protect customers from the risks and dangers associated with price volatility and a nascent competitive market.

As part of its rate stabilization plan ("RSP"), CSP and Ohio Power Company ("OP") (collectively, American Electric Power-Ohio or "AEP-Ohio") proposed to defer the costs of several items during the RSP that they argued were new, significant costs that could not be capitalized and were not built into AEP-Ohio's then-current rates.[2] AEP-Ohio estimated the total amounts of these proposed deferrals over the three-year RSP to be over $241 million. While the Commission denied AEP-Ohio's request to defer RTO administrative charges and CWIP for

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PUCO Case No. 04-169-EL-UNC, Opinion and Order at 27 (January 26, 2005) (*hereinafter* "AEP-Ohio's RSP Case") (IEU-Ohio Appendix at 27).

[2] The costs that AEP-Ohio proposed to defer included:

(a) Regional transmission organization ("RTO") administrative charges (adjusted for net congestion costs) from the time of integration into PJM Interconnection, LLC through 2005, plus a carrying charge (based on the weighted average cost of capital).

(b) The 2004 and 2005 equity carrying charges on expenditures begun in 2002 through 2005 for expenditures located in Account 107, construction work in process ("CWIP").

(c) The full carrying charges (based on the weighted average cost of capital) on expenditures begun in 2002 through 2005 for all functions in Accounts 101 (electric plant in service) and 106 (completed construction not classified), except line extension expenditures, which are already subject to carrying cost deferrals.

(d) Consumer education, customer choice implementation, and transition plan filings through 2005, plus a carrying charge.

(e) Consumer education, customer choice implementation, and transition plan filing costs incurred after 2003, and all RSP filing costs, plus a carrying charge.

Id. at 23-24 (IEU-Ohio Appendix at 23-24).

recovery after the RSP, it directed AEP-Ohio to recover those same amounts through a non-bypassable POLR rider applicable to all distribution customers.[3] The Commission's justification for allowing AEP-Ohio to institute a new charge on all customers was that the RTO charges had been instrumental in enabling AEP-Ohio to efficiently fulfill its POLR responsibilities and other EDUs were permitted to recover POLR costs during the RSPs. Thus, a POLR charge for AEP-Ohio customers was born out of AEP-Ohio's desire to defer the above-mentioned costs.

As this Court recognized in its decisions responding to appeals from the RSPs authorized by the Commission, the mismatch between expectations about the development of a competitive electric market that existed when SB 3 was enacted and the actual results thereafter had reached a level appropriate for the attention of the Ohio General Assembly.[4] Thereafter, the General Assembly enacted SB 221, which Governor Strickland signed on May 1, 2008, becoming effective on July 31, 2008.[5]

Upon SB 221 becoming effective, AEP-Ohio filed its electric security plan ("ESP") case on July 31, 2008.[6] While SB 221 was enacted between the approval of AEP-Ohio's RSP and the

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[3] *Id.* at 27 (IEU-Ohio Appendix at 27).

[4] *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 114 Ohio St.3d 340, 2007-Ohio-4276 at ¶41.

[5] Rather than leaving the Commission with only the market-based approach that was the focus of the version of R.C. 4928.14 created by SB 3, SB 221 created two avenues by which the Commission was authorized to establish pricing for the SSO: 1) SB 221 preserved SB 3's market-based approach (now called the "market rate offer" or "MRO") in R.C. 4928.142; and, 2) SB 221 added R.C. 4928.143 to give the Commission authority, subject to specific statutory criteria, to deviate from the market-based approach in response to an EDU application seeking approval of an ESP.

[6] *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,* PUCO Case Nos. 08-917-EL-SSO, *et al.*, Columbus Southern Power Company's and Ohio Power Company's Application (July 31, 2008) (*hereinafter* "AEP-Ohio ESP Case").

time when AEP-Ohio filed its ESP Application, nothing else changed. OP and CSP, as Ohio EDUs, had the obligation to provide default generation service prior to the enactment of SB 221, and they would have carried the same legal obligation even had they gone to market-generation supply pricing under SB 3, and they continue to have the obligation post-SB 221 enactment.[7]

Nonetheless, in its ESP case, which is now before this Court on appeal, AEP-Ohio requested to recover a distribution non-bypassable POLR rider, asking for $169.1 million **annually** to cover its alleged POLR risk.[8] This time around, AEP-Ohio characterized its POLR risk as a put (the risk of customers leaving AEP-Ohio's SSO) and a call (the risk of customers returning to AEP-Ohio's SSO), comparing customers' rights to leave AEP-Ohio and return to the SSO price to a series of options on power. CSP Merit Brief at 20-22.[9]

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[7] Former R.C. 4928.14(A) read "After its market development period, each electric distribution utility shall provide consumers, on a comparable and nondiscriminatory basis within its certified territory, a market-based standard service offer of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service." Nearly identical language now resides in R.C. 4928.141. (Appellant's Appendix at 10).

[8] *AEP-Ohio ESP Case,* Opinion and Order at 38 (March 18, 2009) (Appellant's Appendix at 131).

[9] *See AEP-Ohio ESP Case*, Opinion and Order at 39 (March 18, 2009) (Appellant's Appendix at 132). For a discussion on the unreasonableness and unlawfulness of AEP-Ohio's POLR charge, *see Industrial Energy Users-Ohio v. Pub. Util. Comm. of Ohio,* Ohio Supreme Court Case No. 2009-2022, Merit Brief of Appellant Industrial Energy Users-Ohio at 16-30 (January 25, 2010). It is worth noting here, however, that AEP-Ohio asserted that its proposed ESP was better for customers in the aggregate than the alternative MRO option, thereby effectively acknowledging that its ESP proposal carried little risk that customers would go shopping for generation service. Also, the only service that consumers can shop for is generation service so that so-called POLR risk is really a generation supply risk rather than any risk related to the distribution function. AEP-Ohio's requested distribution revenue allowance was <u>not cost-based</u>, but rather relied on a model called the Black-Scholes model to <u>hypothetically</u> select a <u>market price</u> to value AEP-Ohio's alleged risk. Importantly, the hypothetical costs arrived at through the Black-Scholes model and approved by the Commission do not vary regardless of whether 5% or 95% of customers shop and return to AEP-Ohio for generation service. And, AEP-Ohio made it clear

Over the objections of intervenors, the Commission found that AEP-Ohio does have some POLR risk. The Commission then gave AEP-Ohio a revenue allowance of approximately $152.2 million annually using the hypothetical market price and the workings of the blackbox known as the Black-Scholes model.[10] The Commission's Opinion and Order on AEP-Ohio's ESP states, based on the Commission's belief that AEP-Ohio has some risks associated with customers switching to competitive retail electric supply ("CRES") providers and returning to the EDU's SSO rate, that this risk is equivalent to 90% of AEP-Ohio's hypothetical quantification of such alleged risk.[11] The POLR revenue allowance authorized by the Commission in AEP-Ohio's ESP case is <u>180%</u> greater than the annual POLR revenue allowance that AEP-Ohio collected under its RSP. AEP-Ohio's ability to lawfully collect the POLR revenue the Commission authorized in AEP-Ohio's ESP case is being challenged by IEU-Ohio contemporaneously in a separate appeal. Specifically, it is IEU-Ohio's position that AEP-Ohio is not lawfully entitled to an 180% increase in POLR revenue and nothing in this case should be construed as a modification of that position.[12]

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that even if the Commission granted its requested POLR-related revenue allowance, it was <u>not going to actually purchase</u> insurance to manage the alleged risk.

[10] *AEP-Ohio ESP Case,* Opinion and Order at 40 (March 18, 2009) (Appellant's Appendix at 133). The Black-Scholes Model is the same econometric model that "experts" used to gain support for the creation and broad use of the mortgaged back securities that are largely responsible for the largest retreat of our National economy since the Great Depression.

[11] *Id.* All intervenor Applications for Rehearing related to the POLR revenue authorization were summarily denied by the Commission in its Entry on Rehearing. Appeals on AEP-Ohio's ESP case were filed by IEU-Ohio and the Office of the Ohio Consumers' Counsel ("OCC").

[12] *Industrial Energy Users-Ohio v. Pub. Util. Comm. of Ohio,* Ohio Supreme Court Case No. 2009-2022, Merit Brief of Appellant Industrial Energy Users-Ohio at 16-30 (January 25, 2010).

B. Eramet's Reasonable Arrangement

Given the steep rate increases effectuated by the Commission's approval of AEP-Ohio's RSP and ESP proposals, customers are seeking alternatives to alleviate some of the impact on their businesses and are turning to a modified statutory provision regarding reasonable arrangements. A reasonable arrangement is essentially a customized service arrangement for a mercantile customer or group of mercantile customers[13] that, with the approval of the Commission, allows the EDU to deviate from the requirements of the otherwise applicable standard tariff provided by the EDU. With the enactment of SB 221, R.C. 4905.31 was modified to give customers, as opposed to only EDUs, the opportunity to also propose a reasonable arrangement with an EDU for approval by the Commission. R.C. 4905.31 permits the prices, terms and conditions of the EDU's service to be enabled through a "reasonable arrangement" provided that the arrangement is filed with and approved by the Commission.

Eramet Marietta, Inc. ("Eramet") is a CSP customer who unilaterally proposed a reasonable arrangement pursuant to R.C. 4905.31.[14] Eramet eventually entered into a Joint Stipulation and Recommendation ("Joint Stipulation") (i.e. a settlement) with Commission Staff ("Staff") under which Eramet would take service pursuant to a reasonable arrangement with

[13] "Mercantile customer" means a commercial or industrial customer if the electricity consumed is for nonresidential use and the customer consumes more than seven hundred thousand kilowatt hours per year or is part of a national account involving multiple facilities in one or more states. R.C. 4928.01(A)(19) (Appellant's Appendix at 4).

[14] *In the Matter of the Application for Establishment of a Reasonable Arrangement Between Eramet Marietta, Inc. and Columbus Southern Power Company,* PUCO Case No. 09-516-EL-AEC, Opinion and Order (October 15, 2009) (*hereinafter* "Eramet Case") (Appellant's Appendix at 31).

CSP. The full Commission approved the Joint Stipulation inasmuch as it was reasonable and met the Commission's criteria for the approval of settlements.[15]

The approved reasonable arrangement provides Eramet, under defined circumstances, generation service priced at a different rate than would otherwise apply under CSP's applicable tariffs. As part of its Joint Stipulation, Eramet committed to making capital expenditures of at least $40 million in its Marietta facility by the end of 2014 (with a potential investment of up to $100 million overall in the Marietta facility) as well as promised to maintain a minimum average employment level of 200 people during the 10-year term of its reasonable arrangement.[16]

The difference between what Eramet would pay under the otherwise applicable SSO tariff and what Eramet pays under the reasonable arrangement is commonly referred to as delta revenue.[17] R.C. 4905.31(E) states, in pertinent part, that reasonable arrangements "may include a device to recover costs incurred in conjunction with any economic development and job retention program of the utility within its certified territory, including recovery of revenue foregone as a result of any such program...." The same section also states that every reasonable arrangement "shall be under the supervision and regulation of the commission, and is subject to change, alteration, or modification by the commission."

Under the Commission-approved reasonable arrangement, other CSP customers pay CSP for the delta revenue. In the approved reasonable arrangement, the Commission required CSP to credit any POLR charges associated with service to Eramet to CSP's economic development rider (the delta revenue recovery mechanism) in order to reduce the recovery of delta revenue

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[15] *Id.* at 10-12 (Appellant's Appendix at 40-42).

[16] *Id.* at 3-4 (Appellant's Appendix at 34-35).

[17] *See* Rule 4901:1-38-01, Ohio Administrative Code, (Eramet's Appendix at 1).

from other ratepayers inasmuch as the Commission determined that CSP does not have any risk that Eramet will shop for generation supply and then return to CSP as the default service provider.[18]

The Commission's decisions regarding its authority to modify and approve a reasonable arrangement are grounded in Ohio law and are reasonable. CSP has failed to demonstrate otherwise.[19] Accordingly, the Court should affirm the Commission's decision.

STANDARD OF REVIEW

R.C. 4903.13 states that "[a] final order made by the public utilities commission shall be reversed, vacated, or modified by the supreme court on appeal, if, upon consideration of the record, such court is of the opinion that such order was unlawful or unreasonable." With regard to the Commission's determinations regarding questions of fact, the Court has held that it "will not reverse or modify a [commission] decision as to questions of fact where the record contains sufficient probative evidence to show that the determination is not manifestly against the weight of the evidence and is not so clearly unsupported by the record as to show misapprehension, mistake, or willful disregard of duty."[20] The appellant "bears the burden of demonstrating that

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[18] *Eramet Case*, Opinion and Order at 7-9 (October 15, 2009) (Appellant's Appendix at 37-39).

[19] CSP makes the same arguments in its appeal of the instant case as it did in its appeal of the Commission's approval of a reasonable arrangement for Ormet Primary Aluminum Corporation ("Ormet"). *Columbus Southern Power Company and Ohio Power Company v. Pub. Util. Comm.*, Ohio Supreme Court Case No. 2009-2060; *In the Matter of the Application of Ormet Primary Aluminum Corporation for Approval of a Unique Arrangement with Ohio Power Company and Columbus Southern Power Company*, PUCO Case No. 09-119-EL-AEC (*hereinafter* "Ormet Case"). The Commission's precedent in the Ormet Case, as followed in the Eramet Case, is directly applicable here and is cited within this brief as further evidence of the lawfulness and reasonableness of the Commission's decision in the Eramet Case.

[20] *The Cincinnati Gas & Elec. Co. v. Pub. Util. Comm.*, 86 Ohio St.3d 53, 58, 711 N.E.2d 670 (1999).

the commission's decision is against the manifest weight of the evidence or is clearly unsupported by the record."[21]

As to matters of law, the Court has "complete and independent power of review of all questions of law" in appeals from the Commission.[22]

Additionally, as approved by this Court, the Commission reviews stipulations using a three-part test. The ultimate issue for the Commission's determination is whether the agreement is reasonable and should be adopted. In considering the reasonableness of a stipulation, the Commission uses 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?; and (3) Does the settlement package violate any important regulatory principle or practice? The Court has endorsed the Commission's criteria as a means to resolve issues in a manner economical to ratepayers and public utilities.[23]

CSP notes in its Merit Brief that it is not going to address the Commission's legal criteria under which it approved the Joint Stipulation in this case inasmuch as the Joint Stipulation did not deal with the issues in this appeal. CSP Merit Brief at 11, FN 9. As a threshold matter the Court should uphold the Commission's decision because CSP has not addressed the standard for approving settlements (as endorsed by this Court) that the Commission determined the Joint Stipulation met.[24] CSP cannot ignore the test applied by the Commission to approve the Joint

[21] *Constellation NewEnergy v. Pub. Util. Comm.*, 104 Ohio St.3d 530, 2004-Ohio-6767 at ¶50.

[22] *Ohio Edison Co. v. Pub. Util. Comm.*, 78 Ohio St.3d 466, 469, 678 N.E.2d 922 (1977).

[23] *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.*, 68 Ohio St. 3d 547 (1997), quoting *Consumers' Counsel v. Pub. Util. Comm.*, 64 Ohio St. 3d 123 (1992).

[24] *Eramet Case*, Opinion and Order at 11-12 (October 15, 2009) (Appellant's Appendix at 41-42). IEU-Ohio also notes that CSP did not bring an Assignment of Error in its Application for

Stipulation simply because its unpersuasive arguments do not provide a basis for overturning the Commission's decision under the settlement evaluation criteria. IEU-Ohio submits that the Commission does not need to reach CSP's substantive arguments inasmuch as it entirely fails to attempt to demonstrate the Commission's Opinion and Order and Entry on Rehearing are unlawful under the Commission's settlement evaluation criteria.

Should the Court find that it will take up CSP's arguments despite this fatal flaw, IEU-Ohio asserts that the Commission's Opinion and Order and Entry on Rehearing are also lawful and reasonable for the reasons described below and should be upheld.

ARGUMENT

As a preliminary matter, in order to avoid duplicating efforts, IEU-Ohio notes that it has coordinated efforts with Eramet, who is also a member of IEU-Ohio. As a result, IEU-Ohio joins the arguments made by Eramet in its Propositions of Law I and II (A) and hereby incorporates the arguments by reference.

PROPOSITION OF LAW I:

The Commission's decision to require CSP to credit its POLR revenue against the delta revenue resulting from the reasonable arrangement is reasonable and lawful.

The Commission held that, because CSP will be Eramet's exclusive service provider for the term of the reasonable arrangement, there is no risk that Eramet will shop for a competitive supplier during the term of CSP's ESP and return to CSP's SSO, and therefore CSP will incur no costs for providing POLR service that can be recovered under R.C. 4905.31.[25] Accordingly, the

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Rehearing or an allegation of error in its Notice of Appeal that asserts the Commission's decision violates its settlement evaluation criteria.

[25] *Eramet Case,* Opinion and Order at 8-9 (October 15, 2009) (Appellant's Appendix at 38-39).

Commission directed CSP to credit the full amount of the POLR component of the tariff rate that would otherwise apply to Eramet to the economic development rider that recovers the delta revenue.[26]

CSP argues that the Commission's decision conflicts with its decision in CSP's ESP case that made the POLR charge non-bypassable for SSO customers and Ohio's policy set forth in R.C. 4928.02. CSP Merit Brief at 19-20. Setting aside for the sake of argument the fact that IEU-Ohio believes that the Commission's decision authorizing AEP-Ohio to recover 180% more POLR revenue than previously authorized is unlawful, CSP's argument regarding its entitlement to POLR revenue in this case is flawed and incorrect.

A. The Commission's decisions do not contradict the terms of CSP's approved ESP.

First, CSP incorrectly assumes that there is "foregone revenue" at issue. Specifically, because the Commission determined that there is no risk that Eramet will shop for a competitive supplier during CSP's current Commission-approved ESP, CSP has not and will not incur any costs for providing POLR service during its ESP that can be recovered under R.C. 4905.31.[27]

Notwithstanding the fact that there are no "costs incurred" or "foregone revenue" that can be recovered under R.C. 4905.31, CSP is also incorrect that the Commission's decision conflicts with its ESP decision. Specifically, CSP argues that the Commission's decision to require CSP to credit POLR revenues against the delta revenue resulting from Eramet's reasonable arrangement conflicts with the Commission's decision in CSP's ESP case that customers taking

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[26] *Id.* at 9 (Appellant's Appendix at 39).

[27] *Eramet Case*, Opinion and Order at 7 (October 15, 2009) (Appellant's Appendix at 37); *Eramet Case*, Entry on Rehearing at 3 (March 24, 2010) (Appellant's Appendix at 54).

SSO service could not avoid paying the POLR charge by agreeing not to shop. CSP Merit Brief at 22-25.

The Commission succinctly and completely addressed this issue and identified that there is no conflict inasmuch as its ESP decision applied to customers taking service under CSP's SSO and Eramet is not taking CSP's SSO service. Thus, the Commission again specifically distinguished its ruling regarding POLR charges for customers taking service pursuant to Commission-approved reasonable arrangements in the Eramet case. Specifically, the Commission stated:

> Further, as we noted in *Ormet*, the Commission finds that CSP's reliance upon our orders approving its ESP to be misplaced. Under the reasonable arrangement, Eramet will not be receiving service under CSP's SSO, but rather, Eramet will be receiving service under a reasonable arrangement. Although CSP posits that this is a distinction without a difference, the Commission has opined that the service under a reasonable arrangement is authorized by Section 4905.31, Revised Code, whereas service under the SSO is authorized by Section 4928.141, Revised Code. Thus by its very nature, service under a unique arrangement provides for service under different prices, terms, and conditions than service under the SSO. (Ormet, Entry on Rehearing at 11). For the reasons discussed above, we find that providing service to Eramet does not present the same POLR risk as providing service to customers on the SSO. Accordingly, CSP must credit any POLR charges paid by Eramet to its economic development rider.[28]

CSP fails to refute (because it cannot) this important and pivotal distinction. The Court should affirm the Commission's decision.

Finally, and again notwithstanding the fact that there is no "revenue foregone" and that Eramet is not an SSO customer, CSP argues that CSP's ESP, as a package, is more favorable, in the aggregate, than the expected results of an MRO and by modifying the POLR piece of the package, the Commission undermines the balance of interests reached in the ESP case. CSP Merit Brief at 26. CSP's argument is erroneous at best for several reasons.

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[28] *Eramet Case*, Opinion and Order at 9 (October 15, 2009) (Appellant's Appendix at 39).

First, as the Commission noted in the Ormet Case and as applicable here, its decision that CSP's ESP was more favorable in the aggregate than the expected results that would otherwise apply under the MRO option "does not imply that the electric utility's ESP is the only basis for setting rates. The rates established by a reasonable arrangement under Section 4905.31, Revised Code, will frequently differ from the rates established under an ESP."[29]

Second, CSP has not accepted the ESP. In fact, CSP has appealed a portion of its ESP to the Court itself.[30] It is beyond reason for CSP to argue that the overall package and balancing of interests reached in the ESP cases is undermined by a POLR offset to recovery of revenues when CSP has not yet accepted the ESP and is itself challenging the "balance."

Third, in the AEP-Ohio ESP Case, AEP-Ohio argued that "[t]he public interest is served if the ESP is more favorable in the aggregate than the expected results of an MRO."[31] AEP-Ohio calculated that the ESP is more favorable than an MRO by approximately $292 million for CSP and $262 million for OP.[32] Similarly, the Commission concluded, "Based upon our opinion and order and using Staff witness Hess' methodology of the quantification of the ESP v. MRO comparison, as modified herein, we believe that the cost of the ESP is $673 million for CSP and $747 million for OP, and the cost of the MRO is $1.3 billion for CSP and $1.6 billion for OP."[33] Clearly no level of offset to the POLR charges in this case would reach the level of tipping the

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[29] *Ormet Case*, Entry on Rehearing at 11-12 (September 15, 2009) (IEU-Ohio Appendix at 51-52).

[30] *Columbus Southern Power Company v. Pub. Util. Comm. of Ohio,* Ohio Supreme Court Case No. 09-2298, Notice of Appeal of Columbus Southern Power Company (December 22, 2009).

[31] *AEP-Ohio ESP Case,* Opinion and Order at 69 (March 18, 2009) (Appellant's Appendix at 162).

[32] *Id.* at 72 (Appellant's Appendix at 165).

[33] *Id.*

scale towards an MRO being more favorable than CSP's unaccepted ESP. In fact, even if the entire POLR revenue requirement for CSP of $97.4 million was wiped out, according to CSP's own calculations, the ESP would still be more favorable in the aggregate than an MRO.

For these reasons, CSP's argument that the Commission's decision in this case conflicts with the Commission's decision on its ESP is irrelevant and incorrect. The Court should affirm the Commission's decision.

B. Preventing CSP customers from paying for non-existent risk associated with the Eramet and Ormet reasonable arrangements does not violate Ohio's state energy policy or contradict the public interest.

CSP next argues that, because the reasonable arrangement includes an exclusive supplier clause, the Commission's decision violates the policy of the State to ensure diversity of electricity supplies and suppliers, to recognize the continuing emergence of competitive electricity markets through the development and implementation of flexible regulatory treatment, and to ensure effective competition in the provision of retail electric service. CSP Merit Brief at 33. Additionally, CSP asserts that exclusive supplier provisions contradict "the public interest, as expressed in Ohio's policy adopted in SB 3 and SB 221" and it recommends that the Court consider exclusive supplier provisions "void against public policy and unenforceable." CSP Merit Brief at 35-36.

First, as the Commission pointed out in the Ormet Case, R.C. 4905.31 specifically states that nothing in Chapter 4928, Revised Code, "including the policy provisions of Section 4928.02, Revised Code, should be construed as prohibiting a reasonable arrangement for the supply of retail electric service."[34] The Commission also noted in the Ormet Case, and as applies

[34] *Ormet Case*, Entry on Rehearing at 13 (September 15, 2009), (IEU-Ohio Appendix at 53). *See also*, *Ormet Case*, Opinion and Order at 13-14 (July 15, 2009) (IEU-Ohio Appendix at 72-73).

equally in the Eramet Case, that this is "not an instance in which the electric utility is seeking to become a customer's exclusive electric supplier as a condition of a unique arrangement. Rather, it is Ormet who is committing to CSP to be its exclusive electric supplier. In a competitive retail market, a consumer has the right to choose to enter into a long-term forward contract for generation service."[35] In its Entry on Rehearing in the Eramet Case, the Commission observed that, one of the policies of the state, as set forth in Section 4928.02(A), Revised Code, is to "ensure the availability to consumers of adequate, reliable, safe, efficient, non-discriminatory, and reasonably priced retail electric service."[36] In this instance, Eramet has chosen to take service from CSP pursuant to the reasonable arrangement in order to secure reliable electric service at a reasonable, predictable price.[37]

Additionally, the Commission found that the concept of customer choice functions as a "legitimate interest" that outweighs the public policy considerations upon which CSP focuses.[38] And, the authorities cited by CSP, specifically a section from Williston on Contracts and *Taylor Building Corp. of America v. Benfield,* 117 Ohio St.3d 352 (2008) (hereinafter "*Taylor*"), do not stand for the assertions presented by CSP. Specifically, *Taylor* does not stand for the proposition that contracts must be declared unconscionable and void where the contract purports to violate important public policies. In fact, in *Taylor,* the Court found that the contract language in question (an arbitration clause), supported the public policy in favor of arbitration and, thus, was

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[35] *Ormet Case,* Entry on Rehearing at 13 (September 15, 2009) (IEU-Ohio Appendix at 53).

[36] *Eramet Case,* Entry on Rehearing at 4 (March 24, 2010) (Appellant's Appendix at 55).

[37] *Id.*

[38] *Id. See* CSP Merit Brief at 35, *citing* 8 Williston on Contracts (4th Ed. 1998) 43, Section 18:7.

not unconscionable despite other questionable aspects of the clause.[39] Additionally, the portion of Williston referenced does not address a situation in which there are conflicting public policies and statutory authority specifically enabling the contract, such as the case here. CSP's reliance on Williston and *Taylor* are misplaced.

The Court should reject CSP's argument that an exclusive supplier provision in a reasonable arrangement violates Ohio law and public policy and affirm the Commission's decision.

CONCLUSION

The Commission has correctly applied the law and its discretion to modify and approve reasonable arrangements proposed by mercantile customers and Eramet specifically. Therefore, the Commission's orders challenged by CSP on appeal should be affirmed in all respects.

Respectfully Submitted,

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[39] *Taylor,* 117 Ohio St.3d at 357, 368.

CERTIFICATE OF SERVICE

I hereby certify that a copy of this *Merit Brief of Intervening Appellee Industrial Energy Users-Ohio* was sent by ordinary U.S. mail, postage prepaid, to the parties listed below this 26th day of August 2010.

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IN THE SUPREME COURT OF OHIO

Columbus Southern Power Company	)	Supreme Court Case No. 2010-0723
	)	
Appellant,	)	Appeal from the
	)	Public Utilities Commission of Ohio
v.	)	
	)	PUCO Case No. 09-516-EL-AEC
The Public Utilities Commission of Ohio	)	
	)	
Appellee.	)	

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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of a Post-Market Development Period Rate Stabilization Plan.	))))	Case No. 04-169-EL-UNC

OPINION AND ORDER

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OPINION AND ORDER

The Commission, having considered the evidence, the arguments of the parties, and the applicable law, hereby issues its opinion and order in this proceeding.

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OPINION

I. Background

In June 1999, the Ohio General Assembly passed legislation (Amended Substitute Senate Bill No. 3 of the 123rd General Assembly, referred to as SB3) requiring the restructuring of the Ohio electric utility industry and providing for competition for the generation component of electric service. That legislation was signed by the governor in July 1999. Pursuant to SB3, the Commission received and reviewed proposed plans by Columbus Southern Power Company and Ohio Power Company (collectively AEP) to transition from the then-existing regulatory framework to the restructured SB3 framework. *In the Matter of the Applications of Columbus Southern Power Company and Ohio Power Company for Approval of Their Electric Transition Plans and for Receipt of Transition Revenues*, Case Nos. 99-1729-EL-ETP and 99-1730-EL-ETP, Opinion and Order (September 28, 2000) and Entry on Rehearing (November 21, 2000).

Ohio electric choice (a short-hand term for the competitive electric generation component in Ohio) began on January 1, 2001. Under Section 4928.40, Revised Code, a period of time was established to allow a competitive electric market to develop for the generation component of electric service (market development period, MDP). The default expiration date of the MDPs was December 31, 2005, unless otherwise determined by the Commission in conformance with certain statutory criteria. Since electric choice began, three competitive retail electric service providers have been certified to serve customers in AEP's service territories, with only one actually serving customers (nonresidential) (Tr. I, 34, 127). There has been at most 3.4 percent shopping in Columbus Southern's service territory and zero percent shopping in Ohio Power's territory (Tr. II, 175; OCC Ex. 8; GMEC Ex. 5, at first set discovery requests 25 and 26 and third set discovery requests 1 and 2). AEP's MDP is currently scheduled to expire on December 31, 2005.

In September 2003, the Commission (while addressing a proposed stipulated plan for the competitive market in The Dayton Power and Light Company service territory) encouraged all other electric distribution utilities (EDUs) in the state to consider continuation of their MDPs, a plan for rate stabilization, and/or a market-based standard service offer as a means for allowing time for their competitive electric markets to grow. *In the Matter of the Continuation of the Rate Freeze and Extension of the Market Development Period for The Dayton Power and Light Company*, Case No. 02-2779-EL-ATA, Opinion and Order at 29 (September 2, 2003). Then later that month, the Commission elaborated further that such proposals should balance three objectives: rate certainty, financial stability for the EDU, and further competitive market development. *In the Matter of the Application of FirstEnergy Corp. on Behalf of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Approval of Tariff Adjustments*, Case No. 03-1461-EL-UNC, Entry at 4-5 (September 23, 2003).

On February 9, 2004, AEP filed an application with the Commission for approval of a rate stabilization plan (RSP) to follow its competitive electric MDP. AEP proposes a plan to substitute for a post-MDP, market-based standard service offer and to eliminate a competitive bidding process from 2006 through 2008.

Twenty-five entities filed motions to intervene in this proceeding. Those requests were all granted and the intervenors are:

Appalachian People's Action Coalition (APAC)[1]	Buckeye Power Inc.
Calpine Corporation	City of Dublin
City of Upper Arlington	Constellation NewEnergy Inc.[2]
Constellation Power Source Inc.	Green Mountain Energy Company (Green Mountain or GMEC)
Industrial Energy Users-Ohio (IEU-Ohio)	The Kroger Company
Lima/Allen Council on Community Affairs	MidAmerican Energy Company
National Energy Marketers Association (NEMA)	Ohio Consumers' Counsel (OCC)
Ohio Energy Group (OEG)[3]	Ohio Hospital Association
Ohio Manufacturers' Association	Ohio Partners for Affordable Energy (OPAE)
Ohio Rural Electric Cooperatives Inc.	PJM Interconnection L.L.C. (PJM)
PSEG Energy Resources and Trade LLC (PSEG)	Strategic Energy LLC
Wheeling-Pittsburgh Steel Corporation	WPS Energy Services Inc.
WSOS Community Action	

By entry dated March 11, 2004, the Commission established a procedural schedule for this proceeding. A technical conference was held on March 24, 2004. Objections to the application were filed on April 8, 2004. By entry dated April 27, 2004, the examiner slightly modified that procedural schedule, changing deadlines for prefiling expert testimony, discovery cut-off, the local hearing dates (to be held in Canton and Columbus), and the evidentiary hearing date. In May 2004, the parties prefiled their expert testimony under the revised schedule.

Pursuant to the revised schedule, the local, public hearing in Canton, Ohio, was conducted on May 19, 2004. However, the examiner discovered after that hearing that the Commission had not properly sent any of the publication notices to the newspapers in AEP's service territory. Therefore, the examiner scheduled another local hearing in Canton, Ohio, for July 7, 2004, and rescheduled the local hearing in Columbus for July 1, 2004.

On May 24, 2004, OCC filed a motion to dismiss the application on various legal grounds. On May 25, 2004, AEP filed a motion to extend the time to respond to OCC's motion. IEU-Ohio supported an extension of the time to respond to OCC's motion. By

1 Appalachian People's Action Coalition, Lima/Allen Council on Community Affairs, Ohio Partners for Affordable Energy, and WSOS Community Action are collectively referenced in this decision as the low-income advocates or LIA.

2 Constellation NewEnergy Inc., MidAmerican Energy Company, Strategic Energy LLC, and WPS Energy Services Inc. are collectively referenced in this decision as the Ohio Marketers Group or OMG.

3 OEG is composed of AK Steel Corporation, BP Products North America Inc., The Procter and Gamble Co., Ford Motor Company, and International Steel Group Inc.

entry dated June 1, 2004, the examiner granted the request to defer a ruling on OCC's motion to dismiss, stating that all parties shall have the opportunity to argue the legality of AEP's proposal in post-hearing briefs.

The evidentiary hearing began on June 8, 2004, and continued to June 14, 2004. AEP presented the testimony of five witnesses. The staff and OCC each presented the testimony of two witnesses. APAC, Lima/Allen Council on Community Affairs, and WSOS Community Action jointly sponsored the testimony of one witness and OEG presented the testimony of one witness. At the July 1 and 7, 2004 local hearings, three people provided testimony in opposition to AEP's proposed RSP. The parties filed post-hearing briefs on July 13 and 30, 2004.

II. The Law

Section 4928.14, Revised Code, states in pertinent part:

(A) After its market development period, an electric distribution utility in this state shall provide consumers, on a comparable and nondiscriminatory basis within its certified service territory, a market-based standard service offer of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service....

(B) After that market development period, each electric distribution utility also shall offer customers within its certified territory an option to purchase competitive retail electric service the price of which is determined through a competitive bidding process....At the election of the electric distribution utility, and approval of the commission, the competitive bidding option under this division may be used as the market-based standard offer required in division (A) of this section. The commission may determine at any time that a competitive bidding process is not required, if other means to accomplish generally the same option for customers is readily available in the market and a reasonable means for customer participation is developed.

Also relevant, the Commission approved a request filed by AEP to temporarily waive the need for it to propose a market-based standard service offer and/or competitive bidding process (CBP). *In the Matter of the Request for a Temporary Waiver by Columbus Southern Power Company and Ohio Power Company from the Requirements of Chapter 4901:1-35, Ohio Administrative Code*, Case No. 04-888-EL-UNC, Entry (June 23, 2004). The Commission agreed that AEP need not make such proposal(s) until 30 days after the final order is issued in this proceeding.

III. Certain Elements of the Approved Electric Transition Plan

In moving to electric choice in Ohio, the Commission had to address a number of financial and regulatory concerns so that each of the electric utilities could transition into utilities providing monopoly distribution service, while competing to provide the generation component. In the course of making that transition, the bundled rates and services of the electric utilities had to be separated, or unbundled, into generation, distribution and transmission components in the electric transition plan (ETP) proceedings.

Most of the parties to the AEP ETP proceedings agreed upon a resolution of the issues. The Commission reviewed that proposed resolution and approved it, with some minor modifications and with a reservation of a ruling upon the independent transmission plan. For purposes of better understanding the proposed RSP, several relevant components of the ETP are:

(1) All distribution rates effective December 31, 2005 will be frozen through 2007 for Ohio Power and 2008 for Columbus Southern. However, during that period, distribution rates can adjust to reflect costs of complying with certain changes (e.g., environmental, tax and regulatory changes) and for relief from storm damage or emergencies.

(2) Columbus Southern and Ohio Power agreed to absorb the first $20 million of actual consumer education, customer choice implementation and transition plan filing costs, but the remainder of such were permitted to be deferred, plus a carrying charge, as regulatory assets for recovery in future distribution rates (via a rider).

(3) Regulatory asset recovery was approved for the companies' MDP and for the subsequent three years for Columbus Southern and the subsequent two years for Ohio Power. Recorded regulatory assets at the beginning of the MDP, which exceeded specific regulatory asset dollar amounts in the stipulation, were amortized during the MDP and recovered through existing frozen and unbundled rates.

(4) Columbus Southern made available to the first 25 percent of the switching residential customers a shopping incentive. Any unused portion of that incentive as of December 31, 2005, will be credited to Columbus Southern's regulatory transition cost recovery.

(5) AEP reduced by five percent its generation component (including the regulatory transition costs). AEP agreed to not seek to reduce that five percent reduction for residential customers during the MDP. The first 20 percent of Ohio Power residential customer load as of December 31, 2005, that switches will not be charged the regulatory transition charge in 2006 and 2007.

(6) AEP shall transfer, by no later than December 15, 2001, operational control of its transmission facilities to a Federal Energy Regulatory Commission (FERC) approved regional transmission organization (RTO). AEP established a fund (up to $10 million) for costs associated with transmission charges imposed by PJM and/or the Midwest

Independent System Operator (MISO) on generation originating in the service territories of PJM or MISO as such costs may be incurred.

IV. Elements of the Proposed Rate Stabilization Plan

AEP proposes a plan from 2006 through 2008 to substitute for a post-MDP market-based standard service offer and to eliminate a competitive bidding process (Tr. I, 27). The RSP states that all provisions of the approved ETP that are not changed by the RSP will not be changed. The RSP proposal can be quickly summarized as follows:

(1) Keeps distribution rates in effect on December 31, 2005, frozen through 2008, except for changes allowed by 12 categories.

(2) Continues to defer pre-2006 consumer education, customer choice implementation and transition plan filing expenses beyond $20 million. Defer post-2005 consumer education, customer choice implementation and transition plan filing expenses and all RSP filing costs. All will be recovered as distribution regulatory assets, along with carrying charges, after the RSP.

(3) Allows deferral and recovery in RSP distribution rates of: (a) RTO administrative charges from the date of integration in PJM through 2005, along with a carrying cost; (b) full carrying charges for construction expenses in Accounts 101 (electric plant in service) and 106 (completed construction not classified) from 2002 through 2005; and (c) 2004 and 2005 equity carrying charges for expenditures from 2002 through 2005 in Account 107 (construction work in progress).

(4) Increases generation rates for all customer classes by three percent for Columbus Southern and seven percent for Ohio Power each year of the plan. Also, generation rates can be adjusted in the event that any of five situations arise, but the sum of the generation increases shall not be greater than seven percent for Columbus Southern and 11 percent for Ohio Power in any one of the years. As an alternative to the increases for residential customers, AEP offers that the Commission can terminate the five percent residential generation rate discount on June 30, 2004 (which will, instead, increase generation rates for residential customers by 1.6 percent for Columbus Southern and 5.7 percent for Ohio Power each year of the plan). These generation rate increases are avoidable for customers who choose another competitive generation supplier.

(5) Allows adjustments of transmission components for changes in costs directly or indirectly imposed on the companies during the RSP.

(6) Recovers amortized generation-related transition regulatory assets under the ETP rates.

(7) Makes the Columbus Southern 2.5 mills per kilowatt-hour (kWh) shopping incentive available during the RSP to the first 25 percent of the Columbus Southern residential load. Any unused portion will not be credited to the regulatory asset charge, but will become income to Columbus Southern. Still for 2006 and 2007, the first 20 percent of Ohio Power residential load that switches will not be charged the regulatory asset charge.

(8) Includes other terms addressing post-RSP Commission action, functional separation, an allowance for AEP to participate in the CBPs of other companies, and minimum stay requirements for all categories of customers.

AEP provided estimated revenue amounts expected from the fixed generation rate increases and the new deferrals to be recovered during the RSP (AEP Ex. 3, at 10):

Company	2006	2007	2008	Total
Columbus Southern	$48 million	$74 million	$100 million	$222 million
Ohio Power	$112 million	176 million	$247 million	$535 million

If the potential four percent generation increase were also added to the calculation, AEP acknowledges that the total estimated revenue amount combined for both companies becomes $1.17 billion (Tr. II, 78).

V. OCC's Motion to Dismiss

As noted earlier, OCC filed, on May 24, 2004, a motion to dismiss the application in this proceeding on two grounds, namely that the application will violate several statutes and it illegally proposes to repudiate the ETP stipulation. In the context of describing the various components of the RSP, we will also explain and address the legal and policy arguments raised by the parties, including the specific arguments made by OCC.

VI. Positions of the Intervening Parties and Commission Discussion

Of the parties who have expressed a position in this proceeding, nearly all agree that a competitive market has not adequately developed in AEP's service territories (AEP Ex. 1, at 4; AEP Ex. 2, at 24; Tr. I, 201; Staff Ex. 2, at 3; Tr. IV, 151; OEG Ex. 2, at 5; Tr. III, 208; GMEC Initial Br. 2, 5; IEU-Ohio Initial Br. 8-10; LIA Reply Br. 2, 9). Moreover, many also believe that some action needs to be taken by the Commission to avoid a "flash-cut" in 2006 to a freely competitive electric generation market (OEG Ex. 2, at 5; Tr. III, 208; 7/7/04 Tr. 6-7, 9; IEU-Ohio Reply Br. 7). Some of these parties openly fear that, without some Commission action, generation rates will escalate and fluctuate dramatically, which could hurt consumers, hurt the development of a competitive market, and harm the market participants (AEP Ex. 1, at 4; Staff Ex. 2, at 7; Staff Initial Br. 1, 12). The disagreement here is over the specific approach that the Commission should take to spur competition in AEP's service territories, while balancing the interests of the different market participants. As already noted, the Commission has determined that the objectives of an RSP are to develop a plan providing for: rate certainty, financial stability for the EDU, and further competitive market development.

A. Market-Based Standard Service Offer and Competitive Bidding Process

AEP has not conducted any studies or surveyed the market to determine the impact of its RSP upon shopping or participation by competitive suppliers (Tr. II, 177; GMEC Ex. 2). However, AEP believes that the proposed rate increases will create some opportunity for increased shopping (Tr. II, 178). Staff also agreed (Tr. IV, 23, 243-244). Moreover in AEP's view, its RSP will cover AEP's need to spend approximately $1.3 billion on environmental controls after 2005 and address AEP's environmental expenditures of roughly $1.0 billion between 2002 and 2004 (AEP Ex. 3, at 8, 11; Tr. I, 234-235). Additionally, AEP states that the RSP addresses transmission expenses, customer switching and future uncertainty (AEP Initial Br. 11). It is for those reasons that AEP believes its RSP is a reasonable proposal and good substitute for a market-based standard service offer and CBP.

AEP's RSP contains no CBP; instead, AEP seeks to substitute its RSP for a CBP. AEP takes the position that a CBP is not practical and not worth the effort (Tr. I, 96-97, 104-105). As noted earlier, the Commission has waived, temporarily, the current requirement for the filing of a CBP while the proposed RSP is under consideration. AEP believes that its proposed increased generation rates are reasonable substitutes for market-based rates. In AEP's view, if the market exceeds those rates, customers will benefit by having a fixed rate and, if the market rates fall below the increase levels, customers can avoid them by switching to another supplier (AEP Initial Br. 23, 65-66). Staff concurs that the generation rates constitute a reasonable proxy of market-based rates because of prices in the current wholesale market, prices in AEP's area, and shopping levels (Tr. IV, 20-21, 26-27, 244; Staff Initial Br. 4, 6). Moreover, staff believes that a next step (RSP) that provides generation rate stability and gradual, predictable increases is the best approach (Staff Reply Br. 3).

OEG and IEU-Ohio agree with the Commission's stated objectives and the concept of an RSP. However, neither agrees with AEP's RSP. Instead, they each advocate that their own proposed rate plan be adopted by the Commission (OEG Ex. 2, at 7-9; OEG Initial Br. 15-18; IEU-Ohio Initial Br. 6, 14, 37-40). OEG's rate plan basically provides: (a) no new transmission and distribution deferrals beyond that authorized in the ETP decision; (b) no transmission and distribution increases except for costs to comply with environmental (distribution-related), tax and regulatory laws or regulations, relief from storm damage expenses, or an emergency; (c) transmission and distribution rate increases after 2005 only upon a fully evaluated rate case; and (d) fixed generation rate increases after 2005 through a monthly rider designed to recover incremental environmental and governmentally mandated costs that have passed an earnings test (OEG Ex. 2, at 7-9; OEG Initial Br. 15-18). OEG's plan also addresses allowed components of rate base, components of operating expenses and rate of return (OEG Initial Br. 23-26).[4] OEG considers its plan to appropriately balance several things: (a) new environmental and

[4] Green Mountain disagrees with OEG's proposed RSP because the increases are cost-based, not market-based (GMEC Reply Br. 6).

generation-related costs are balanced with timely recovery, while the rates increase to reasonable levels based upon earned returns; (b) allows gradual and steady monthly rate increases when needed for financial stability; (c) ensures market development through moderate generation rate increases; and (d) ensures that earned returns do not increase through piecemeal, single-issue, distribution rate increases (*Id.* at 18; OEG Reply Br. 23-24).

IEU-Ohio recommends various modifications to AEP's RSP that focus upon the price certainty and financial stability objectives identified by the Commission (IEU-Ohio Initial Br. 38-40). In particular, IEU-Ohio recommends that: (a) AEP establish its standard service offer prices as the current generation charge[5] of each rate schedule; (b) AEP continue to collect transition costs; and (c) AEP be permitted to seek adjustment of the current generation charges (either as confiscatory or as requiring increases due to increased jurisdictional costs from fuel prices, environmental actions, tax laws, or judicial/administrative orders).[6] In the alternative, IEU-Ohio urges the Commission to consider extending and lowering the current fixed rates, as was found to be acceptable in Virginia (IEU-Ohio Reply Br. 11). AEP responds to both OEG's and IEU-Ohio's proposed plans, stating among other things that those parties simply want to keep AEP's low rates for another period of time and their plans do not take into account all three Commission goals (AEP Reply Br. 14, 25-26).

OCC argues that AEP's proposed RSP does not meet the requirements of Sections 4928.02 or 4928.14, Revised Code, because the RSP is not a market-based standard service offer and/or a CBP (OCC Motion to Dismiss 3-4, 11; OCC Initial Br. 35-36; OCC Reply Br. 22). Thus, in OCC's view, the Commission has no authority to approve the RSP. Similarly, OCC argues that the generation rate component of the RSP is improper because it contains no CBP, as required by Section 4928.14(B), Revised Code (OCC Initial Br. 35). Also, OCC contends that, since the RSP addresses service during the MDP that conflicts with the approved ETP, it violates Section 4928.33(C), Revised Code (OCC Motion to Dismiss 12). OMG, NEMA, PSEG, Green Mountain, and LIA concur with these criticisms (OMG/NEMA Initial Br. 2-6, 15; OMG/NEMA Reply Br. 3-5; PSEG Br. 3-4, 8-9; GMEC Initial Br. 6; GMEC Reply Br. 4; LIA Initial Br. 9-11). In their view, the RSP cannot be an acceptable substitute because it is not based on market prices. OCC, OMG and NEMA acknowledge that the RSP was proposed as an alternative to the market-based standard service offer, but argue that, legally, an alternative cannot be substituted because the statute does not allow for such (OCC Initial Br. 38; OMG/NEMA Initial Br. 5-6; OMG/NEMA Reply Br. 4-5). LIA and Green Mountain state that, instead of illegally seeking RSP proposals, the Commission should have followed the path set forth in Section 4928.06, Revised Code, and provided an evaluation to the legislature (LIA Initial Br. 12-14; LIA Reply Br. 8; GMEC Reply Br. 6). OCC recommends that a CBP be filed as soon as

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5 In IEU-Ohio's proposal, it references the "little g" instead of current generation charges. When AEP's rates were unbundled prior to the start of electric choice, the amounts that were categorized as generation-related (or the "big G") were the amounts not distribution-related, transmission-related, other unbundled amounts, and tax valuation adjustments. Section 4928.34(A)(4). Revised Code. For AEP, the "little g" is the difference between the "big G" and the amounts allotted for the regulatory transition charge. The "little g" is what is reflected in AEP's charges as the current generation charges.

6 Green Mountain also disagrees with IEU-Ohio's proposed RSP because the MDP rates are not market-based rates (GMEC Reply Br. 5).

possible and recommends a particular format (OCC Ex. 10, at 10, Attach. A; OCC Reply Br. 24-25).

PSEG and OEG argue that the Commission's goals for a RSP are not fulfilled by AEP's proposal. Specifically, PSEG states that rate certainty is not assured because of the many exceptions that are contained in the RSP for possible future events (PSEG Br. 6). OEG states that rate stability is not included in the RSP because the $1.17 billion potential increase cannot constitute stability (OEG Initial Br. 5). Next, they both contend that the RSP really just provides financial stability to AEP and PSEG believes it will benefit AEP's competitive activities, rather than financial stability of its regulated functions (PSEG Br. 7; OEG Initial Br. 5). Moreover, PSEG claims that the RSP will do nothing to foster development of the competitive electric market (PSGE Br. 8). OCC quantifies the impact on the residential class for some of the costs over the three years as $266 million if the additional generation increase is not included and $410 million if it is included (OCC Ex. 5, at 3-4, Schedule FRP-1). OCC recommends that the entire RSP be rejected (OCC Initial Br. 64)

If the RSP is not rejected for failure to use market-based rates, OMG, NEMA and PSEG recommend that the Commission require a competitive bid to test the market (as it did with the FirstEnergy EDUs) and establish a basis for that market's prices (OMG/NEMA Reply Br. 6-8, 11; PSEG Br. 9).[7] Moreover, OMG and NEMA point out that, pursuant to Section 4928.14(B), Revised Code, AEP must either provide for a competitively bid generation service or demonstrate that such would be duplicative to available services. They argue that AEP cannot make such a demonstration and, therefore, a CBP must be scheduled like the Commission has done with other EDUs (OMG/NEMA Reply Br. 8-9). If the Commission decides to require a CBP, Green Mountain advocates a retail CBP (bidding for customers) as done in Pennsylvania, instead of a wholesale CBP (bidding to provide generation) (GMEC Reply Br. 10-12). IEU-Ohio took the opposite position, stating that providing customers with a CBP in the current state of the market would elevate form over substance (IEU-Ohio Initial Br. 40). Instead, IEU-Ohio believes the Commission should ask the legislature to delay the CBP option until the Commission concludes that the market is sufficiently mature to warrant the time and resources needed for CBPs (*Id.*).

Commission Discussion

At the outset, we will note that AEP proposed an RSP because we requested it. All parties to this proceeding are aware of the direction that this Commission has taken and the concerns it has with the post-MDP competitive electric environment. In fact, many of

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7 The Commission ordered a CBP for the FirstEnergy EDUs in *In the Matter of the Applications of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Authority to Continue and Modify Certain Regulatory Accounting Practices and Procedures, for Tariff Approvals and to Establish Rates and Other Charges Including Regulatory Transition Charges Following the Market Development Period*, Case No. 03-2144-EL-ATA (June 9, 2004). On December 8, 2004, the CBP took place (an auction). The Commission concluded, on December 9, 2004, that the CBP auction price should be rejected because the previously approved RSP price is more favorable for consumers than the clearing price of the auction, which represented the best available market-based price to cover FirstEnergy's retail load. *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Approval of a Competitive Bid Process to Bid Out Their Retail Electric Load*, Case No. 04-1371-EL-ATA, Finding and Order.

the parties in this proceeding have participated in several other proceedings involving the MDPs and post-MDP activities for other EDUs. Many of the parties readily acknowledge that a competitive electric generation market has not developed thus far in AEP's service territories and will not adequately develop by the time AEP's MDP expires in December 2005. With so few participants, so very little shopping having taken place in Columbus Southern's territory and no shopping at all having taken place in Ohio Power's territory, we do not want to simply allow market forces to be unfettered. We believe, in AEP's territory, a controlled transition is not only appropriate, but very much needed. We also believe that many, if not all parties, agree with this fundamental starting point.

The difference of opinion occurs with the manner in which to handle the near term. OCC, OMG, NEMA and LIA argue that Section 4928.14, Revised Code, provides the only mechanisms available to the Commission (adoption of a market-based standard service offer and a service developed through a CBP) and the proposed RSP is neither. Even with those two mechanisms identified in Section 4928.14, Revised Code, the parties disagree what should be done. However, AEP, staff, OEG and IEU-Ohio believe greater flexibility is available, namely, the Commission can adopt an RSP. We agree. AEP takes the position that a CBP is not practical and not worth the effort. Staff and IEU-Ohio agreed. We also agree and, as is within our authority, we conclude that a CBP is not warranted for AEP at the conclusion of its MDP. The record reflects that, in the past several years, only three competitive suppliers have been certified to provide competitive electric service in AEP's territory and only one is actually serving customers (Tr. I, 34, 127). Plus, there has been at most 3.4 percent shopping in Columbus Southern's service territory and zero percent shopping in Ohio Power's territory (Tr. II, 175; OCC Ex. 8; GMEC Ex. 5, at first set discovery requests 25 and 26 and third set discovery requests 1 and 2). This level of inactivity leads us to seriously doubt the efficacy of initiating a competitive bid. Instead, we conclude that an RSP (and in particular the one we adopt today) will accomplish, generally, the same as a CBP for customers and provide a reasonable means for customers to participate in that competitive environment as it continues to develop. As further explained in this decision, we agree to increase generation rates (which are avoidable to customers who choose another competitive generation supplier). These components of the RSP, along with continuation of the unaffected provisions of the ETP, we believe will prompt the competitive market and continue to provide customers a reasonable means for customer participation. Therefore, we conclude that, at this time, a CBP is not required for AEP between 2006 and 2008.

Many parties argue that AEP's proposed RSP is not a market-based standard service offer because it is not based upon the market. OMA and NEMA have argued that the RSP is not based upon a willing buyer and a willing seller. AEP proposes its RSP as a substitute for a market-based standard service offer (Plan at 3). Staff presented evidence that the RSP is a reasonable proxy of market-based rates based upon its evaluation (Tr. IV, 20-21, 26-27, 244). OCC's witness acknowledged that the Commission has the discretion to determine an appropriate proxy for a market-based standard service offer, given that both the retail electric choice market and the wholesale market have not sufficiently developed (Tr. III, 147). For the period involved (2006 through 2008), we conclude that the generation rates that we approve in this RSP today will constitute an appropriate market-based standard service offer, as required by Section 4928.14(A), Revised Code. We will evaluate any subsequent, additional generation rate adjustments (which are limited to only the enumerated categories). Additionally, we conclude that the RSP that we approve today complies with the requirements of Section 4928.14, Revised Code. None of the arguments raised to the contrary convinces us otherwise. Finally, we note that there is greater flexibility under Section 4928.14, Revised Code, than what some parties have advocated in this proceeding. The Ohio Supreme Court recently recognized, in *Constellation NewEnergy, Inc. v. Pub. Util. Comm.*, ____ Ohio St.3d ___, 2004-Ohio-6767 (December 17, 2004), that an RSP could satisfy Section 4928.14, Revised Code.

Next, we conclude that our decision today will fulfill our previously identified RSP goals. Throughout this decision, as we address the various components of the proposed RSP, we specifically explain how and why we believe that various approved components are acceptable, including how they meet or fulfill our intended goals.

B. Generation Rates and Charges (Provisions Two and Three of the RSP)

1. Three and Seven Percent Increases

AEP proposes in the RSP that, for all customer classes, the generation rates will increase each year (2006, 2007, and 2008) by three percent for Columbus Southern and by seven percent for Ohio Power. These increases will generate $151 million for Columbus Southern and $376 million for Ohio Power (AEP Ex. 3, at 10). AEP contends that the three and seven percent generation rate increases are reasonable to address the Commission's three objectives of a RSP. These generation rate increases are based upon the companies' judgment (AEP Ex. 2, at 12). Given that AEP has low generation rates currently, AEP contends that fixed increases will spur market competition and be preferable to customers, rather than imposition of full market-based rates (*Id.* at 13). AEP further notes that the generation rate increases complement the companies' substantial investments to comply with environmental requirements. AEP noted that it plans to spend $1.3 billion beyond normal capital expenditures after 2005 on generation-related environmental controls (AEP Ex. 2, at 14; AEP Ex. 3, at 11). Next, AEP points to other EDU generation rates and contends that its increased rates would still be below the current lowest average residential generation rates of those EDUs (AEP Ex. 5, at 13; Tr. III, 31).[8] When that comparison is made, AEP argues that its proposed generation rate increases are reasonable (AEP Ex. 5, 13; AEP Initial Br. 24, 67-68).

Staff supports the fixed generation rate increases as reasonable in magnitude and because they are completely avoidable if a competitor can beat the price and customers shop (Staff Ex. 2, at 8; Tr. IV, 152, 154-155, 163-164, 248-249; Staff Reply Br. 4). Staff evaluated this portion of the plan in the context of the current market, the expectation that generation rates will rise and the magnitude of the proposed numbers for company financial integrity (Tr. IV 156, 158; Staff Ex. 2, at 8). Moreover, staff noted that AEP's rates are low compared to the Ohio market and keeping them frozen would impede supplier entry in the territory (Tr. IV, 248).

8 Staff notes that AEP is distinguishable from other EDUs in Ohio because it has lower cost generation supplies and has an infrastructure to allow it to move power within a seven-state region (Staff Initial Br. 4). Staff suggests that AEP's proposal here should be evaluated separately from the other RSPs (*Id.*).

OEG, Green Mountain, LIA, OCC, and IEU-Ohio disagree with the proposed fixed, generation rate increases. OEG and IEU-Ohio object to the three and seven percent generation rate increases on the ground that they will generate excessive earnings, while AEP has been already receiving very healthy returns (OEG Ex. 2, at 14-16; OEG Reply Br. 4, 6; IEU-Ohio Initial Br. 7). OEG contends that the fixed generation increases will engender 3.6 times more revenues than the companies' projected costs for the environmental expenditures identified (OEG Ex. 2, at 15). OEG and OCC are also skeptical that customers will really avoid the increased generation rates on the ground that the market is defective now and even AEP anticipates that it will remain defective for a period of time (OEG Reply Br. 22-23; OCC Reply Br. 20). Thus, in OEG's and OCC's view, customers will only have an option to shop in a defective market or take generation service from AEP at increasing rates (*Id.*). Moreover, OCC highlights that the identified projected costs for the environmental expenditures are not costs just for these companies; rather, they will be allocated throughout the entire AEP system, but AEP did not account for such allocation (Tr. I, 79; OCC Ex. 10, at 8; OCC Initial Br. 28). AEP and staff respond that, after the MDP, generation service is no longer subject to cost-based regulation and, thus, AEP's generation rates and charges need not be cost-based (AEP Initial Br. 31; Staff Initial Br. 4; Tr. IV, 154, 158, 165-166, 245). OEG counters by noting that AEP justified many aspects of the proposed RSP by relying solely on the cost of service for those items (e.g., additional generation-related expenses to be recovered through generation rate increases and deferrals) (OEG Reply Br. 17-18).

Green Mountain argues that the RSP's rates are below market (GMEC Initital Br. 8). Green Mountain further argues that AEP should be required to prove the cost basis of its generation rates (and distribution and transmission rates) since AEP has justified its RSP by pointing to various costs/expenses and Section 4905.33(B), Revised Code, prohibits service for less than actual cost for purposes of destroying competition (*Id.* at 18).

IEU-Ohio contends that justification for the fixed generation rate increases is weak because it is not clear that AEP will spend all estimated amounts on environmental compliance, the estimated expenditures only modestly affect production costs during the RSP period, and those expenditures will be allocated among the various operating companies as production costs (Tr. I, 58-60; IEU-Ohio Initial Br. 5-6). IEU-Ohio points out that the proposed fixed generation rate increases will allow AEP to collect $527 million more than current generation rates allow, in addition to the $702 million in transition costs allowed under the ETP decision (IEU-Ohio Initial Br. 3). IEU-Ohio points out that this RSP asks the Commission to approve generation rate increases on the basis that the current generation rates are below market, while in 1999, AEP claimed that the generation component was at above-market prices and, therefore, asked for regulatory transition costs (IEU-Ohio Initial Br. 17-18, 22; IEU-Ohio Reply Br. 7).

IEU-Ohio acknowledges that electric generation service (after the MDP) shall not be subject to traditional cost-of-service supervision or regulation, but it also believes that the Commission has a duty to ensure that the standard service offer prices are just and reasonable (IEU-Ohio Initial Br. 25-29; IEU-Ohio Reply Br. 3-5). In IEU-Ohio's view, the RSP's proposed generation rates are too high and not reasonable, particularly since AEP's financial condition has been very favorable over the last few years. Next, IEU-Ohio contends that these rate increases will simply fund investments and growth on earnings and are not necessary for financial stability (IEU-Ohio Initial Br. 30-31). IEU-Ohio also noted that, in Virginia, price caps have been extended and Ohio should realize that raising retail prices in Ohio (while other states extend rate caps) will not benefit Ohio as it strives to compete in the global economy (IEU-Ohio Reply Br. 8).

OCC argues that this portion of the RSP violates Section 4928.38, Revised Code, because it seeks recovery of additional generation-related costs not authorized in the ETP at the time when AEP is supposed to be on its own with respect to recovery of generation-related costs (OCC Motion to Dismiss 5). OCC further argues that these fixed generation rate increases are not cost-based or justified because a complete picture of current costs has not been made (some prior costs may no longer exist, while some new costs and benefits have developed) (Tr. I, 173-174, 222; OCC Initial Br. 28-31; OCC Reply Br. 16, 17). OCC supports OEG's estimated rates of return and argues that they demonstrate that the fixed generation rate increases alone will cause extremely high returns for AEP that should not be permitted (OCC Initial Br. 32, 39; OCC Reply Br. 16-17). In other words, OCC states that AEP should not be earning higher returns on equity than they could possibly be allowed in a regulatory environment when a developed competitive market is absent (*Id.* at 39).

LIA also disagrees with the generation rate increases in the RSP (LIA Initial Br. 16). On legal grounds, LIA argues that, since the RSP involves an increase in rates, AEP has violated Sections 4909.17 and 4909.19, Revised Code, by not following rate increase procedures (*Id.* at 9). Moreover, LIA contends that AEP's actions/inactions regarding RTO membership have caused a competitive market to not develop and, therefore, AEP does not have "clean hands" and should not be rewarded with excessive increases in rates (LIA Reply Br. 2). From a public policy perspective, LIA contends that the companies already have high profit margins and do not need rate increases, and yet do not propose any programs to mitigate the impact of the RSP on low-income customers (LIA Initial Br. 16, 20, 31; LIA Reply Br. 3-4, 6). LIA notes that AEP is the only Ohio utility to ever terminate funding for low-income energy efficiency programs (APAC Ex. 1, at 7; Tr. IV, 182; LIA Initial Br. 32). LIA further contends that the RSP will exacerbate the already high amounts of percentage of income payment plan (PIPP) arrearages for AEP customers (*Id.* at 26). If the Commission proceeds with an RSP, LIA and OCC argue the Commission must consider the impact of the RSP on the low-income consumers and vulnerable populations in order to promote rate stability and certainty (*Id.* at 20, 34; OCC Initial Br. 62). Specifically, LIA urges: (a) the Commission to allow PIPP customer pools to participate in CBPs during the RSP; (b) AEP to negotiate with the Ohio Department of Development, Commission staff, and low-income intervenors to develop "an approach to arrearages that reinforces good payment behavior by PIPP program participants and reduces the PIPP debt to a manageable level that can conceivably be repaid"; and (c) the Commission require funding by AEP of $1.5 million per year for a low-income energy efficiency program in AEP's service territory (APAC Ex. 1, at 8, 12; Tr. IV, 197, 201; LIA Initial Br. 29, 32; LIA Reply Br. 7-8). OCC supports these three recommendations (OCC Initial Br. 62).

Commission Discussion

Certainly, to some extent, the generation rate increases will provide additional funds to the companies and assist in their financial stability. As noted, AEP will be incurring large generation-related expenses above normal capital expenditure levels during the RSP period. However, we also believe that the RSP package as a whole supports our goals of helping to develop the competitive market and providing some rate stability. We reach this conclusion because we believe that the generation rate increases are a reasonable approximation of the future market conditions. With the RSP's structured, periodic generation rate increases, customers will not be subjected to significant swings in generation rates in an emerging competitive market for AEP. We believe this provision is not only very important to spurring a competitive market, but also to protecting customers from the risks and dangers associated with price volatility and a nascent competitive market.

We also accept our staff's conclusion that the percentage increases are reasonable in magnitude. Many of the parties object to this provision because they contend that AEP is already earning too much. However, these parties seem to forget that, with the expiration of the MDP, generation rates are subject to the market (not the Commission's traditional cost-of-service rate regulation) and that the plan was an option that AEP voluntarily proposed. Section 4928.05(A)(1), Revised Code. We make this observation to point out that, under the statutory scheme, company earnings levels would not come into play for establishing generation rates - market tolerances would otherwise dictate, just as AEP argued (AEP Reply Br. 26-27). We are strongly committed to encouraging the competitive market in AEP's service territories as it is the policy of this state, per Section 4928.02, Revised Code. Given that commitment, we do not feel that the earnings levels evidence or cost-based analyses and arguments presented by OEG, OCC, IEU-Ohio or LIA justify rejection of this provision. We believe that this provision will establish generation rates that are appropriate for the RSP period, spur the competitive market, and also protect customers from dramatic or volatile generation rate price changes. We do not agree that this provision violates any of the cited statutes.

While we have found the proposed generation rate increases to be reasonable, both in concept and in number, it is also appropriate to point out that these increases will be avoidable during the rate stabilization period. Customers who choose another competitive generation supplier can avoid AEP's increased generation rates (because those customers will pay, instead, the rates of their chosen supplier). We believe this is an important point to note.

We do realize that rate increases can be difficult for some customers to handle, as LIA has argued. We are not ignoring these concerns. In fact, we believe that the structured nature of the generation rate increases will be more helpful to the low-income customers in AEP's territory than would otherwise likely occur without the RSP. Ideally, we agree that rate increases are not preferred, but we are weighing and balancing several competing interests and we believe that the proposed generation rate increases will result in the most balanced and reasonable generation rates for all customers in AEP's service territories during the three years following the MDP. For these additional reasons, we accept this provision. Despite that conclusion, we agree that low-income customers, in particular, can be disproportionately affected by the RSP. To alleviate that concern, we conclude that low-income customers should receive some additional assistance. Therefore, we have provided for additional funding of low-income and economic development programs during the RSP period as set forth in Section VI.G of this decision.

2. Elimination of Five Percent Residential Discount

For all residential customers, AEP proposes an additional generation rate increase each year of 1.6 percent for Columbus Southern and 5.7 percent for Ohio Power, if the five percent generation discount terminates on June 30, 2004. This would end the five percent residential rate reduction 18 months earlier than what was agreed upon in the ETP stipulation (Tr. I, 28). If elimination of the five percent discount to residential customers is included, AEP calculates that the generation rate increases will be 8.5 percent for Columbus Southern residential customer and 13.2 percent for Ohio Power residential customers in 2006 (AEP Ex. 2, at 11). This would amount to roughly a $6 million increase for residential rates (Tr. I, 29). AEP supports this proposal by noting that Section 4928.40(C), Revised Code, allows the Commission to terminate the discount if it is "unduly discouraging market entry by [...] alternative suppliers." Despite the proposed June 30, 2004 date having passed, AEP has noted that the alternative is still viable, but the later termination of the discount (still prior to the end of the MDP) will result in reduced fixed increases for residential customers (AEP Initial Br. at footnote 11). AEP, staff and Green Mountain believe that the current generation rates, along with the existing temporary discount, unduly discourages market entry because of the small price differential between AEP's generation rates and others' generation supplies (AEP Ex. 2, at 12; Tr. IV, 23; GMEC Br. at 16-17). Staff and Green Mountain urge the Commission to eliminate the temporary discount (Staff Ex. 2, at 9; GMEC Initial Br. 17).

OCC opposes elimination of the five percent discount on the ground that the ETP stipulation requires the companies to retain the discount for residential customers through the MDP (OCC Initial Br. 32; OCC Reply Br. 17).[9] The ETP stipulation states that the companies will "not seek to reduce the [five percent] reduction in the generation component rate reduction for residential customers during the market development period" (OCC Ex. 1, at 6). OCC also contends that AEP has not demonstrated that the discount is unduly discouraging market entry, as required by Section 4928.40(C), Revised Code (OCC Ex. 10, at 5; OCC Reply Br. 18). In fact, AEP could not say that elimination of the discount would result in suppliers entering the residential market (AEP Ex. 2, at 12; Tr. I, 137-138). AEP contends that its RSP does not ask to remove the five percent discount during the MDP; it only noted that it was an option that the Commission could consider in the context of the RSP's proposed generation rate increases (AEP Initial Br. 27-28, 68, 78).

IEU-Ohio states that the Commission should consider elimination of AEP's five percent residential discount in a "stand-alone" proceeding that is "focused on the

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9 OCC argues that the Commission lacks authority to approve any portion of the RSP that impacts any term in the ETP decision (OCC Motion to Dismiss 2; OCC Initial Br. 2-3). Staff disagrees with that argument because the Commission retains ongoing jurisdiction over its orders, including the authority to change or modify its earlier decisions as it deems necessary in the best interests of the utility and customers (Staff Initial Br. at footnote 1).

residential customer sector and the full range of conditions that are affecting market entry by alternate suppliers" (IEU-Ohio Initial Br. 41).

Commission Discussion

OCC correctly cites the ETP stipulation. We also believe that AEP's argument that its RSP does not ask to remove the five percent discount is an attempt at "hair-splitting". AEP's RSP proposed eliminating the five percent discount and it previously agreed that it would not make such a request during the MDP.

Notwithstanding the language in the ETP stipulation and our acceptance of that stipulation, we have the ability to evaluate the impact of the five percent residential discount under Section 4928.40(C), Revised Code. Section 4928.40(C), Revised Code, gives the Commission the flexibility to eliminate the five percent residential discount if it unduly discourages market entry in AEP's service territories. We believe that an early ending to the discount is not warranted and, rather, it is appropriate that the five percent residential discount in both companies' territories, end effective December 31, 2005. We further note that ending the five percent residential discount on December 31, 2005, is in keeping with SB3 (including Section 4928.40, Revised Code) and is consistent with the timing required of the residential discounts of four other EDUs. *Ohio Edison*, Case No. 03-2144-EL-ATA, *supra* at 24-25 and *In the Matter of the Application of The Cincinnati Gas & Electric Company to Modify its Nonresidential Generation Rates to Provide for Market-Based Standard Service Offer Pricing and to Establish an Alternative Competitive-Bid Service Rate Option Subsequent to the Market Development Period*, Case No. 03-93-EL-ATA, Opinion and Order at 36-37 (September 29, 2004).

3. Additional Generation Rate Increases

AEP's RSP allows generation rates to further increase, after a Commission hearing, for: (a) increased expenditures incurred through an affiliate pooling arrangement for complying with changes in laws/rules/regulations related to environmental requirements, security, taxes, and new generation-related regulatory requirements imposed by statute/rule/ regulation/administrative order/court order; or (b) customer load switches that materially jeopardize either company's ability to recover the anticipated generation revenues. Total generation rate increases cannot be greater than seven percent for Columbus Southern and 11 percent for Ohio Power in any given year (if the five percent residential discount is not eliminated).[10] The additional generation adjustments are effectively capped at four percent. The RSP proposes a 90-day time frame, after which the proposed increase will become effective on an interim basis until the Commission's final order is implemented.

AEP points out that this aspect of the RSP only gives the company the flexibility to ask for additional, limited generation rate increases in the event of changes in the two enumerated categories; it does not pre-approve or guarantee rate increases (AEP Ex. 2, 16-

[10] If the five percent residential discount would have been eliminated as of June 30, 2004, any additional generation rate increases would be at most four percent above the residential customers' fixed annual increase, which would be at most 5.6 percent for Columbus Southern residential customers and 9.7 percent for Ohio Power residential customers (AEP Ex. 2, at 18).

17; AEP Initial Br. 35). AEP characterizes this provision as a means to manage the risk it faces relative to the fixed generation rate increases (AEP Reply Br. 28). At this point in time, AEP does not expect to ask for additional rate increases (Tr. I, 198). Also, AEP mentions that any additional increases that might be authorized by the Commission could be avoided for customers who choose another competitive supplier (AEP Initial Br. 35).

Staff, Green Mountain and IEU-Ohio do not fully support or fully object to this provision. They believe that any request for additional generation rate increases should be evaluated by looking at the company's overall financial health (not just the events that triggered the proposed further increase) and not be limited to four percent (Staff Ex. 2, at 9-10; GMEC Reply Br. 12-13; IEU-Ohio Initial Br. 42; Tr. IV, 33, 153, 231, 245). Staff recognizes that the proposed additional generation increases would be sought for many of the same reasons that AEP had based its proposed three and seven percent increases and, thus, believes automatic additional increases should only be considered after looking at the whole company (Tr. IV, 153, 245-247). AEP responded by stating that a look at the overall financial health of the company is contrary to Section 4928.05(A)(1), Revised Code, because generation pricing will not be subject to cost-of-service ratemaking principles (AEP Initial Br. 38). Additionally, AEP predicts that holding generation rates down because of a strong "wires business" is likely to result in rate shock in 2009, which is what the Commission is trying to avoid today (*Id.*; Tr. I, 247).

OCC argues that the proposed four percent additional increase does not result from changes in market prices and, thus, is not market-based (OCC Ex. 10, at 9). Like staff, OCC characterizes this provision as improper single-issue ratemaking and also criticizes the ambiguity of the phrase "materially jeopardizes either or both companies' ability to recover the increased revenues" (*Id.*).

OEG worries that this portion of the RSP could permit recovery twice for the same expenses; essentially that the same costs used to justify the fixed increases arguably could justify the proposed additional increases (OEG Ex. 2, at 16-17). Plus, because the companies will continue to have very high earnings, OEG believes that the additional generation rate increases are not needed to maintain financial stability (OEG Initial Br. 8). AEP notes that this criticism is really a concern over the Commission's ability to judge any proposed additional generate rate increase and not a sufficient basis for rejecting this portion of the RSP (AEP Initial Br. 39).

Commission Discussion

We find this portion of the RSP to be acceptable. We agree with AEP that this portion of the RSP will allow AEP to seek additional generation rate increases; it does not pre-approve them (although it does limit any approved amount). We understand staff's and IEU-Ohio's preference that subsequent generation rate increases be viewed in the context of the company's overall financial health, but that position ignores the requirements of Section 4928.05(A)(1), Revised Code. Thus, we find this portion of the RSP to appropriately temper potentially large generation rate increases (by limiting the dollar amounts), while also recognizing AEP's interest in financial stability. This provision is a compromise position that takes into consideration the competing interests. We understand the criticism raised with the phrase "materially jeopardizes either or both companies' ability to recover the increased revenues." In the event that further increases are requested by AEP, we will evaluate this. Similarly, we understand OEG's concern that AEP could request further generation-related rate increases for items that it is already recovering. But, as AEP states, the concern does not justify rejecting the provision; it is really a question of whether the proposed further increase is properly evaluated. For these reasons, none of the comments raised in this proceeding convinces us that this portion of the RSP should be rejected.

C. Distribution Rates and Charges (Provision One of the RSP)

Under the RSP, AEP distribution rates and charges in effect on December 31, 2005, would remain in effect through 2008 (except for the universal service fund rider, energy efficiency fund rider, and certain cost-based charges such as right-of-way charges). These "frozen" distribution charges could be also adjusted in the event of an emergency, changes in transmission/distribution allocations under the FERC's seven-factor test, or if the companies experience increased distribution-related expenses due to: (a) changes in laws/rules/regulations related to environmental requirements; (b) security; (c) taxes; (d) O&M due to new requirements imposed by federal or state legislative or regulatory bodies after March 31, 2004; and (e) major storm damage service restoration. Furthermore, the "frozen" distribution rates will be adjusted, if the Commission approves, to recover certain deferred RTO administrative costs (deferred in 2004 and 2005) plus carrying costs and certain deferred carrying costs on certain environmental expenditures since 2002, plus carrying costs.

AEP points out that the RSP only freezes distribution rates for an additional one-year period for Ohio Power, because the ETP froze them previously (AEP Ex. 2, at 5). AEP acknowledges that, in addition to what is contained within the ETP, the RSP would add some additional categories for which the "frozen" distribution rates would/could be adjusted (*Id.*; Tr. I, 31-32). AEP contends that, at least with the proposed adjustments for security expenses and the specified O&M expenses, they are justified because of the unforeseen security issues that previously developed and the likelihood that O&M expenditures will be needed since the ETP was approved (AEP Ex. 2, at 6).

Staff, IEU-Ohio and OEG state that a distribution rate case should be conducted, instead of freezing distribution charges from 2006 to 2008 (Staff Ex. 2, at 7-8; Tr. IV, 230; IEU-Ohio Initial Br. 42; OEG Ex. 2, at 22-23). They reach this conclusion because these distribution rates were established in 1991 and 1994 rate cases (Staff Ex. 2, at 8). More specifically, OEG believes that AEP's returns on common equity have been very high over the last several years and the proposed RSP will only perpetuate them (OEG Ex. 2, at 11-14). AEP took issue with OEG's rate of return calculations, alleging a number of errors (AEP Initial Br. 31-35).

OCC also opposes this provision. OCC contends that the additional exceptions to the distribution rate freeze (security and O&M expenses) are unwarranted (OCC Ex. 10, at 6). In OCC's view, AEP accepted the risk that increasesd expenses for these two items would occur when it signed the ETP stipulation and AEP should not now be permitted to illegally attempt to modify the ETP or violate Sections 4909.18 and 4909.19, Revised Code

(OCC Ex. 10, at 6-7; OCC Motion to Dismiss at 9).[11] Moreover, OCC contends that these exceptions to the distribution rate freeze constitute single-issue ratemaking, which is not appropriate public policy because the exceptions do not recognize other cost-related changes (OCC Ex. 10, at 6-7; Tr. III, 187-188). In response, AEP states that OCC's position conflicts with its position that the Commission set a post-MDP generation rate at something other than market levels (AEP Initial Br. 14).

LIA disagrees with the distribution rate provision in the RSP because it will also allow rate increases (LIA Initial Br. 16).

Commission Discussion

We find that Provision One of the RSP is acceptable. The additional exceptions to the distribution rate freeze are, in the context of considering the RSP as a package, reasonable. We understand OCC's contention that the additional exceptions to the rate freeze can be considered single-issue ratemaking, but we also must point out that OCC previously agreed to other exceptions to the distribution rate freeze, which can also be considered single-issue ratemaking. The next question then is whether the additional exceptions are justified. We do accept AEP's contention that, in 1999 and 2000, security expenses and the specified O&M expenses were not fully foreseeable. In this respect, we believe that allowing for these additional exceptions to the distribution rate freeze during the RSP is acceptable. We view the extension of the distribution rate freeze as a positive aspect of the RSP, which meets our goal of fostering a competitive market and still balancing rate stability with financial certainty for AEP.

We appreciate the position taken by staff, IEU-Ohio and OEG about the need for a distribution rate case. They have correctly noted that a rate proceeding has not taken place for either company for a period of time. AEP believes that, after the RSP, it would be appropriate for the Commission to initiate rate proceedings (Tr. I, 102). AEP explained that a rate proceeding at this point would frustrate the Commission's goals of rate stability and financial stability over the next few years (*Id.*). We agree that embarking on a rate proceeding at this point could run counter to our ultimate goals. Therefore, we do not accept that position.

D. Deferral Requests (Provisions One, Five and Six of the RSP)

The companies propose to defer the costs of several items during the RSP (AEP Ex. 2, at 8-9; AEP Ex. 4, at 4-6, 10-12). These items are:

(a) RTO administrative charges (adjusted for net congestion costs) from the time of integration into PJM[12] through 2005, plus a carrying charge (based on the weighted average cost of capital).

(b) The 2004 and 2005 equity carrying charges on expenditures begun in 2002 through 2005 for expenditures located in Account 107, construction work in process (CWIP).

11 OCC contends that, after the MDP, EDU distribution rates can only be adjusted through properly filed applications under Chapter 4909, Revised Code (OCC Motion to Dismiss 10).

12 AEP integrated into PJM on October 1, 2004.

(c) The full carrying charges (based on the weighted average cost of capital) on expenditures begun in 2002 through 2005 for all functions in Accounts 101 (electric plant in service) and 106 (completed construction not classified), except line extension expenditures, which are already subject to carrying cost deferrals.

(d) Consumer education, customer choice implementation, and transition plan filings through 2005, plus a carrying charge.

(e) Consumer education, customer choice implementation, and transition plan filing costs incurred after 2005, and all RSP filing costs, plus a carrying charge.

Most of the expenditures in the second and third categories are associated with environmental control equipment (nitrogen oxide burners, flue gas desulphurization, and selective catalytic reduction) for generation facilities (Tr. II, 14-18; OCC Ex. 3). AEP estimated the total amounts of these proposed deferrals over the RSP as follows (AEP Ex. 4, at 3, 6-7; AEP Ex. 3, at 4-5, 7; AEP Ex. 2, at 8):

Proposed Deferral	Columbus Southern	Ohio Power
RTO Admin. Costs[13]	$11.9 million	$15.6 million
RTO Admin. Costs Carrying Costs	2.5 million	3.2 million[14]
CWIP Carrying Costs	1.0 million	9.0 million
In-Service Plant Carrying Costs	13.0 million	50.0 million
Addl. Carrying Costs for CWIP and		
In-Service Plant	2.0 million	9.0 million[15]
Pre-2006 Education, Choice		
Impl. and Transition Plan		
Filing Costs[16]	40.6 million	45.5 million
Post-2005 Education, Choice		
Impl., Transition Plan Filing		
and all RSP Filing Costs[17]	18.2 million	19.7 million
Total	$89.2 million	$152 million

13 These estimates do not include an adjustment for congestion costs, as those are unknown (AEP Ex. 3, at 3; AEP Ex. 2, at 8).

14 AEP's estimate of the RTO administrative costs totaled $14.4 million for Columbus Southern and $18.8 million for Ohio Power, while the revenues to be produced by this aspect of the RSP are estimated to be $48 million for Columbus Southern and $60 million for Ohio Power (AEP Ex. 3, at 7, 10). However, we note that AEP's brief reflects instead that the anticipated revenues to be produced by this aspect of the RSP will be $16.8 million for Columbus Southern and $20.7 million for Ohio Power (AEP Initial Br. Attachment A at 3 and Attachment B at 3).

15 AEP's estimates of the carrying costs of the CWIP and in-service plant totaled $16 million for Columbus Southern and $68 million for Ohio Power, while the revenues to be produced by this aspect of the RSP are estimated to be $23 million for Columbus Southern and $99 million for Ohio Power (AEP Ex. 3, at 7, 10).

16 These estimates were made by AEP in May 2000 (OCC Ex. 1, at 4). They do not include carrying charges. No updated estimates were presented as evidence in this proceeding.

17 The companies did not estimate RSP filing costs (AEP Ex. 3, at 5).

In AEP's view, these are new, significant costs that cannot be capitalized and were not built into current rates (AEP Ex. 4, at 7). It should be noted, however, that AEP would amortize these new deferrals over the three-year RSP and begin recovering those amounts as regulatory assets through distribution charges in 2006, except for the consumer education, customer choice implementation, transition plan filing costs incurred, and all RSP filing costs, plus a carrying charge (AEP Ex. 2, at 21; AEP Ex. 4, at 4).

1. Regional Transmission Organization Administrative Costs

Staff calculated an average of the RTO deferral rider to be .27 mills/kWh for both companies and found it to be a reasonable level for what it considers to be a new service (Tr. IV, 63-64, 67-68, 112, 253). OMG and NEMA do not fully object to this proposed deferral, but contend that recovery of it during the RSP will cause some shopping customers to be charged twice for those same costs (OMG/NEMA Initial Br. 9-11). OCC also agrees with this criticism, but still otherwise objects to the deferral, as detailed further below (OCC Initial Br. 8-9; OCC Reply Br. 8). More specifically, OMG and NEMA explain that any shopping customer will pay the pre-2006 RTO administrative charges to his/her generation supplier as part of the cost of receiving that generation supply and, then, also pay AEP when it assesses the deferral during the RSP. OMG and NEMA state that an easy solution is to require that AEP customers who shop after October 1, 2004, get a credit for PJM administrative charges until the end of the MDP, but impose the deferrals upon them during the RSP (OMG/NEMA Initial Br. 11-12). Green Mountain agrees (GMEC Reply Br. 9). AEP responds to this suggestion, stating that it is impossible to segregate how much each customer's bill will recover the deferral and, thus, the suggestion is not possible (AEP Reply Br. 19-20).

OCC objects to the RTO administrative cost deferral for several other reasons. OCC first contends that this proposed deferral should be rejected because it violates the intent of the distribution service rate cap (set forth in Section 4928.34(A)(6), Revised Code); it is simply an attempt to recover costs that were to be recovered by the capped distribution rates (OCC Ex. 10, at 7; OCC Initial Br. 5-6, 9; OCC Reply Br. 2-3; OCC Motion to Dismiss 7). OCC also considers this provision to violate the part of the ETP decision which freezes distribution rates beyond the MDP. OCC points out that a utility can recover transmission costs through an increase to the transmission component, which will correspondingly decrease the distribution component during the MDP (OCC Initial Br. at 6). AEP even acknowledged this possibility (Tr. I, 171). Second, OCC argues that AEP is proposing single-issue ratemaking contrary to Chapter 4909, Revised Code (OCC Initial Br. 7; OCC Reply Br. 12-13). OCC does not believe that the Commission should consider this single ($33.2 million) charge in isolation of overall transmission rates.

OCC next contends that the proposed deferral of the RTO administrative charges would improperly allow AEP to recover transmission-related expenses through nonbypassable distribution rates (OCC Reply Br. 7-8). AEP acknowledges that the RTO administrative charges are transmission-rated (AEP Ex. 2, at 7; AEP Ex. 4, at 16; Tr. I, 240). However, AEP contends that these costs benefit all customers (switching and non-switching customers) because all customers benefit with AEP's participation in an RTO. AEP explains that the only means to allocate cost recovery among all customers in a competitively neutral fashion is a nonbypassable distribution charge (AEP Ex. 2, at 7; AEP Ex. 4, at 18). AEP also explained that, without the requested authority or FERC authority, the RTO administrative charges would not be recovered (Tr. I, 237). Moreover, AEP stated that, while the RTO administrative costs could be recovered via a change in state transmission charges (and thereby reduce distribution rates), AEP would effectively not be able to recover those transmission expenses (Tr. I, 238). Finally, in OCC's view, it "strains credibility that the companies did not know there would be RTO administrative costs when they agreed to join an RTO in the ETP stipulation" (OCC Initial Br. 10). OCC also does not consider the RTO administrative costs to be a new service, as staff indicated, or rate stabilization charges. OCC believes these are MDP-incurred transmission charges proposed to be recovered through a distribution rider after the MDP (*Id.*).

LIA argues that a deferral of the pre-2006 RTO administrative costs is tantamount to an increase in the MDP-capped distribution rates (LIA Initial Br. 4, 6). LIA states that Section 4928.38, Revised Code, prohibits the creation of new deferrals associated with distribution service construction, and Section 4928.34(A)(6), Revised Code, and the ETP decision are also violated (*Id.* at 5, 7). In LIA's view, this deferral constitutes a "back door" attempt to raise distribution rates, regardless of when the deferral is collected (*Id.* at 6).

OEG contends that the RTO administrative cost deferral proposes to adjust frozen distribution rate under circumstances not permitted by the ETP decision (OEG Initial Br. 13). OEG also believes that the effect of the deferral request is to avoid a rebalancing of transmission and distribution rate levels, which is required by Section 4928.34(A)(1), Revised Code, to remain at the MDP levels (*Id.*). Next, OEG takes issue with the dollar amounts in this proposed deferral for two reasons. OEG points out that AEP does not plan to recognize, in the amount of RTO administrative deferrals, the benefit that AEP will receive from making additional off-system sales as a member of PJM (Tr. I, 173). Further, OEG highlights that these administrative costs will include costs related to the companies' efforts to participate in the MISO (Tr. I, 248; OEG Initial Br. 14).

IEU-Ohio states that these RTO administrative costs were considered when transition costs were developed in the ETP proceeding and the companies' current financial condition does not justify creation of new regulatory assets (IEU-Ohio Initial Br. at 44). For this reason, IEU-Ohio contends that the proposed deferral should be denied. IEU-Ohio also noted that, in July 2004, an AEP affiliate in Virginia agreed to forego recovery of RTO administrative costs, certain congestion costs, and ancillary service cost increases, except through a base rate case (IEU-Ohio Reply Br. 7-8, Attachment). That affiliate also agreed to not seek to defer such Virginia-specific costs. Furthermore, that affiliate agreed to not seek to recover development and implementation costs that were then being deferred, other than through a base rate case. IEU-Ohio makes the point that other treatment of RTO administrative costs has been agreeable to an AEP company.

Commission Discussion

The RTO administrative charges involved in this proposed deferral will be charges incurred from October 2004 through 2005. We do not believe that this proposed deferral is a rate increase. Accord, *Consumers' Counsel v. Pub. Util. Comm.* (1983), 6 Ohio St.3d 377. Recovery of the deferred RTO administrative charges would be based upon accruals during AEP's MDP. As a result, we will not approve the proposed deferral of 2004 and 2005 RTO administrative charges.

The Commission recognizes that AEP's expenditures for RTO membership during the MDP have been and will continue to be instrumental in enabling AEP to efficiently fulfill its provider of last resort (POLR) responsibilities during the rate stabilization period. AEP is required to provide that function after the MDP. Section 4928.14(A) and (B), Revised Code. The Commission has also recognized in other cases that the POLR responsibility of the EDU is one for which the EDU incurs necessary costs and which warrants compensation during rate stabilization periods. See, *Dayton, supra* at 28, and *Ohio Edison*, Case No. 03-2144-EL-ATA, *supra* at 23-24. The Supreme Court of Ohio recently upheld an earlier Commission conclusion that the existence of POLR costs makes it reasonable to apply a charge to customers during a RSP period. *Constellation, supra*. Our staff also made this argument in this proceeding (but in relation to the CWIP and in-service plant deferrals). We believe the proposed RTO administrative charge amounts for collection during the rate stabilization period constitute reasonable and not excessive compensation to AEP for part of the cost of fulfilling its POLR responsibilities and, accordingly, approve the collection of these amounts as part of a POLR charge. This POLR charge will be established as part of a separate unavoidable rider that is applicable to all distribution customers.

We reach this conclusion based upon the specific circumstances before us in this proceeding. Nothing in this decision is intended to be precedent-setting or to be construed as ruling upon the other RTO charge-related deferral requests that we have recently received from other EDUs. See, *In the Matter of the Application of The Dayton Power and Light Company for Authority to Modify its Accounting Procedures*, Case No. 04-1645-EL-AAM, and *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company to Modify their Accounting Procedures*, Case No. 04-1931-EL-AAM.

2. Carrying Costs of Construction Work in Progress and In-Service Plant Expenditures

Staff supports the CWIP and in-service plant deferrals as well (Staff Ex. 2, at 11). Staff considers such deferrals to be equivalent to POLR charges (Tr. IV, 108-109, 147, 148, 171). Staff reaches this conclusion because the RSP is providing an option to switch and avoid charges for AEP customers and creating a risk for AEP that customers will switch, for which it is reasonable, in staff's view, for AEP to collect POLR charges (Tr. IV, 149-150). AEP concurs that these costs function as POLR costs (AEP Initial Br. 47, 79; AEP Reply Br. 16). Moreover, staff noted that, when compared to similar charges proposed by other EDUs, staff felt that AEP's proposed levels were reasonable (*Id.*). Staff calculated the amounts per kWh to be .38 mills for Columbus Southern and 1.16 mills for Ohio Power, for an average of .84 mills (Tr. IV, 108-109). Staff also stated that allowing AEP to recover a part of what it would be able to obtain under traditional regulatory process when competition has not really arrived is reasonable (Staff Ex. 2, at 11). Staff further acknowledges that, if these costs are allowed as rate stabilization charges, it is fair for the charges to be bypassable (that is to say, a customer who chooses another supplier and is not returning would not be subject to the charge while purchasing another's generation) (Tr. IV, 254-255).

OCC objects to this portion of the RSP for a host of reasons. OCC argues that, if these generation-related deferrals are permitted for recovery after the MDP, then the rate freeze is meaningless (OCC Initial Br. at 14, 51; OCC Reply Br. 2-3). OCC believes that, after the MDP, new distribution deferrals are not permitted under Ohio law because distribution rates are subject to rate regulation under Chapter 4909, Revised Code (OCC Initial Br. 14-15, 52). Additionally, OCC contends that AEP assumed the risk of these expenditures when it agreed to freeze distribution rates in the ETP proceeding (*Id.* at 15, 17-19). OCC points to OEG's evidence that AEP does not need the deferrals to provide financial stability. OCC also claims that distribution rates should not be increased to recover generation costs, per the ETP decision and Sections 4928.15, 4928.17(A), 4928.34(A)(6) and 4928.38, Revised Code (*Id.* at 15-16; OCC Motion to Dismiss 8; OCC Reply Br. 10-11). Like the RTO administrative costs, OCC contends that the Commission should not approve these single-issue ratemaking deferrals without looking at the full picture and because shopping customers will then pay a portion of AEP's generation costs even though they will be taking generation service from a competitor (OCC Initial Br. 15, 22; OCC Reply Br. 12-13).

OEG and OCC argue that these deferrals constitute retroactive ratemaking (a rate increase during the MDP) because the deferral relates to amounts in existence prior to the date of the decision in this case (OEG Ex. 2, at 18-19; OCC Initial Br. 17-19). Also, OEG and LIA contend that these two deferrals take away one of the primary incentives of implementing electric choice in Ohio (a cap on distribution rates during the MDP) contrary to Section 4928.34(A)(6), Revised Code (OEG Initial Br. 9-11; LIA Initial Br. 4). Further, OEG, LIA and OCC believe these deferrals violate the ETP decision because they are generation-related expenses used to adjust distribution rates during the period allowed by the ETP decision for frozen distribution rates (LIA Initial Br. 5, 7; OEG Initial Br. 12-13; OCC Initial Br. 16). AEP disagrees, noting that the Commission has allowed deferrals for periods that precede the date of a decision (AEP Initial Br. 46). Also, AEP argues that accounting deferrals are not rate increases and, thus, cannot constitute retroactive ratemaking (*Id.*; AEP Initial Br. 70; AEP Reply Br. 17).

OEG also argues that these deferrals do not recover distribution-related costs and should not be deferred for recovery in distribution charges (OEG Ex. 2, at 20-22). AEP agrees that these deferrals are not recovering distribution costs and, thus, argues that the distribution rate freeze cannot preclude them (AEP Initial Br. 47). In AEP's and staff's view, recovery of these deferrals will function as POLR charges, not distribution service charges (*Id.*; AEP Reply Br. 16; Tr. IV, 108, 147).

Green Mountain has a different point of view. It argues that generation-related increases should not be as limited as set forth in the RSP (GMEC Initial Br. 15-16). Instead, Green Mountain contends that any generation-related costs that AEP seeks to recover should be included in generation rates. However, if the Commission accepts another recovery mechanism (such as the proposed deferrals), then the established recovery mechanism should be bypassable (*Id.*; GMEC Reply Br. 9).

IEU-Ohio states that these CWIP and in-service plant expenditures were considered when transition costs were developed in the ETP proceeding and the companies' current financial condition does not justify creation of new regulatory assets (IEU-Ohio Initial Br. at 44). For this reason, IEU-Ohio contends that these proposed deferrals should be denied.

Commission Discussion

Similar to our reasoning for the RTO administrative charges, we do not believe that this proposed deferral is a rate increase. However, recovery of the deferred CWIP and in-service plant carrying charges would be based upon accruals during AEP's MDP. The Commission recognizes that AEP's expenditures for CWIP and in-service plant during the MDP have been and will continue to be instrumental in enabling AEP to efficiently fulfill its POLR responsibilities during the rate stabilization period, which warrants compensation during rate stabilization period. Section 4928.14(A) and (B), Revised Code, requires AEP to provide that function after the MDP. We believe these carrying charge amounts proposed for collection during the rate stabilization period constitute a reasonable and not excessive compensation to AEP for part of the cost of fulfilling its POLR responsibilities and, accordingly, approve the collection of these amounts as part of a POLR charge. As noted earlier, this POLR charge will be established as part of a separate unavoidable rider that is applicable to all distribution customers.

3. Consumer Education, Customer Choice Implementation, Transition Plan Filing Costs, and all Rate Stabilization Plan Filing Costs

Staff supports this deferral provision (Staff Ex. 2, at 10). IEU-Ohio does not believe that the Commission needs to address most of this deferral because it was already addressed in the ETP decision (IEU-Ohio Initial Br. 43). Also, IEU-Ohio does not believe that the Commission should authorize increases for isolated categories of costs, even if expected (*Id.* at 44). OCC argues that, aside from the agreement in the ETP decision to allow some of these deferrals, the Commission should reject additional deferrals in this case (OCC Initial Br. at 52). OCC reaches this conclusion because new distribution deferrals and rate riders for single issues have no basis in Ohio law; the Commission can only adjust regulated distribution rates through a properly filed rate case.

Commission Discussion

We already allowed deferral for most of the costs in this category (in the ETP proceeding). This RSP provision would further defer those costs and also allow deferral of the RSP filing costs. In the context of considering the RSP package and our stated RSP goals, we are willing to accept this provision of AEP's plan.

E. Transmission Rates and Charges (Provision Four of the RSP)

This part of the proposed RSP states the AEP may adjust state transmission charges (attributable to the applicable company, affiliated company or RTO open access transmission tariff [OATT]) to reflect FERC-approved rates and charges during the RSP, whether imposed directly on the companies or through an approved RTO. These include RTO administrative changes imposed, amortization of RTO start-up costs, and/or surcharges for recovery of lost transmission revenues. Such rate changes would be effective 30 days after filing, unless delayed by the Commission (but no longer than a period of 60 days).

AEP characterizes this portion of the RSP as an affirmation of the companies' existing right to make a filing for recovery of FERC-approved costs (AEP Initial Br. 40, 60). AEP believes the proposed expedited review process of such applications is warranted because the Commission should look at new transmission charges and should allow the pass-through of FERC-approved transmission charges (Tr. I, 242-243). Furthermore, AEP believes these costs will be significant, new costs, which are not currently in rates (AEP Ex. 3, at 4; AEP Initial Br. 40). A preliminary estimate of at least some of the anticipated costs in this area is \$10.4 million per year for Columbus Southern and \$13.1 million per year Ohio Power (AEP Ex. 3, at 4).

Staff expressly supports this provision of the RSP (Staff Ex. 2, at 10). IEU-Ohio recommends that this provision be rejected because transmission costs were taken into consideration when the ETP decision was issued and there are indications that AEP's integration into PJM will create additional transmission revenues. Thus, IEU-Ohio believes that there is no need for this provision (IEU-Ohio Initial Br. 43). Similarly, OEG and OCC argue that this provision will allow AEP to be reimbursed for RTO expenses, but it does not take into account certain savings that will simultaneously be realized, e.g., off-system sales (OEG Reply Br. 19; OCC Reply Br. 13-14). OEG contends that the corresponding savings should be recognized so that the provision is truly a "pass through" (*Id.*). Also, OCC contends that there should be no authorization for additional transmission charges that have not been authorized by FERC or that AEP selects apart from charges in the PJM RTO OATT (OCC Initial Br. 46).

Commission Discussion

We find that this provision of AEP's RSP is reasonable, except as discussed below. In concept, any FERC-approved transmission rates and charges during the RSP should be passed through. We will look at them and ensure that "pass through" is appropriate. Despite IEU-Ohio's, OEG's and OCC's comments, we believe this aspect of Provision Four is appropriate. We do, however, have concerns with the Commission review process set forth in Provision Four. If viewed in isolation, we would not necessarily believe that the 30-day/60-day automatic process was problematic. However, we and our staff will be receiving similar types of applications from more than just AEP. For that reason, we believe that the time period proposed is not as workable as it should be. Therefore, we conclude that the applications to adjust state transmission charges (attributable to the applicable company, affiliate company or RTO OATT) to reflect FERC-approved rates and charges during the RSP (whether imposed directly on the companies or through an approved RTO) shall be automatically approved on the 61st day after filing, unless the Commission rejects, modifies or suspends the filing. We believe this approval process fairly and adequately balances: (1) the desire for a definitive conclusion from the Commission in a prompt manner, (2) the ability of other interested persons to participate, and (3) the concerns for adequate amounts of time to review the anticipated applications in the context of other Commission work.

F. Current Regulatory Asset Recovery (Provision Five of the RSP)

The RSP proposes that AEP continue to recover amortized generation-related transition regulatory assets under the approved ETP. Staff accepts this provision, describing this term as simply continuing practices established in the ETP decision (Staff Ex. 2, at 10). OCC supports this portion of the RSP because it continues one part of the ETP decision. However, OCC does argue that, if the Commission will not require AEP to keep the rest of the ETP bargain, the Commission should revisit this and other aspects of the ETP decision (OCC Ex. 10, at 4; OCC Initial Br. 47). To this argument, AEP contends that an examination of the regulatory assets recovery should not be a consequence of filing the RSP as requested (AEP Reply Br. 42). OCC notes that the bulk of the transition regulatory assets for Ohio Power (associated with mining operations) may no longer represent a liability to Ohio Power (Tr. II, 27, 36). IEU-Ohio is not opposed to this provision, if the Commission accepts its proposed RSP (IEU-Ohio Reply Br. 10, Footnote 11).

<u>Commission Discussion</u>

We also agree with Provision Five and find it appropriate to allow AEP to continue to recover amortized generation-related transition regulatory assets under the approved ETP. We note that no direct opposition to this portion of the RSP was raised by any of the parties.

G. Shopping Incentives and Credits (Provision Seven of the RSP)

AEP proposes in the RSP that Ohio Power will still not charge the regulatory asset charge rider, from January 1, 2006 to December 31, 2007, to the first 20 percent of the Ohio Power residential customer load that switches, as was agreed in the ETP stipulation.[18] Columbus Southern will, through the MDP and 2008, make available to the first 25 percent of the residential class load an incentive of 2.5 mills/kWh that the qualifying customers will receive as a credit. Any unused amount of the incentive money at December 31, 2005, will not be credited to regulatory asset charge recovery. Thus, as proposed under the RSP, Columbus Southern will receive as income any unused shopping incentive balance and not offset the incentive balance against the transition regulatory asset.

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[18] Although both the ETP stipulation and the RSP state that there will be no shopping incentive for Ohio Power customers, the provision to not charge certain shopping Ohio Power customers the regulatory asset charge rider was included in the RSP's Provision Seven under the heading "Shopping Incentives". Nothing in our decision should be construed as converting that term into a shopping incentive or characterizing it otherwise. We have simply chosen to discuss the entirety of Provision Seven at one time.

Columbus Southern's unused shopping incentive through January 2004 was roughly $12.9 million (Tr. II, 108; OCC Ex. 4). The RSP extends the Columbus Southern shopping incentive through 2008. As a trade off, AEP also proposes to alter the manner in which the unused portion of Columbus Southern's shopping incentive is handled (AEP Ex. 2, at 23-24; AEP Ex. 4, at 5; Tr. I, 33). To be clear, AEP's proposal to extend this shopping incentive is tied to the new proposed treatment of its unused balance (AEP Reply Br. 32). AEP argues that the extended shopping incentive, along with increased generation rates, should result in more shopping (AEP Initial Br. 48).

Staff believes that the unused Columbus Southern shopping incentive should be treated as a regulatory liability and flowed back to customers (Staff Ex. 2, at 12). IEU-Ohio concurs (IEU-Ohio Initial Br. 45). AEP believes that this position does not adequately acknowledge that the companies are proposing to extend the shopping incentive (AEP Initial Br. 49).

OCC believes Provision Seven of the plan violates the ETP decision by altering the treatment of the unused Columbus Southern shopping incentive (OCC Ex. 10, at 8; OCC Initial Br. 53). AEP points out that the effect of OCC's position is that no shopping incentive would be available to Columbus Southern residential customers during the RSP (AEP Initial Br. 49).

Green Mountain contends that the RSP's shopping incentive will be inadequate to spur shopping. AEP calculated that the average residential price to compare for the generation component (under the RSP and its shopping incentive terms) will be as follows (GMEC Ex. 5, at fourth set discovery request 1):

Company	2006	2007	2008
Columbus Southern			
With Three Percent Increase	4.26	4.38	4.51
With Termin. of Resid. Discount	4.20	4.27	4.33
Ohio Power			
With Seven Percent Increase	3.73	3.98	3.94
With Termin. of Resid. Discount	3.69	3.89	3.79

In Green Mountain's view, the residential incentive values may be at their highest during the RSP, but they will still not spur shopping (GMEC Initial Br. 10; GMEC Reply Br. 8). In addition to greater shopping incentives, Green Mountain also advocates for shopping credits (avoidable charges) set at market prices (GMEC Initial Br. 11). Green Mountain further advocates that the $10 switching fees be waived, market support generation be provided, a voluntary enrollment process be instituted, new partial payment priority changes be made, and reasonable/nondiscriminatory credit arrangements be created (*Id.* at 10-15, 19-20). AEP states in response to these additional requests that there is no evidence to support them and they should be rejected (AEP Reply Br. 40-14).

Commission Discussion

First, we accept again the term of this provision related to Ohio Power's residential customers who shop in 2006 and 2007. We continue to believe that this term will be beneficial to Ohio Power customers in the near future. No arguments were raised against this part of Provision Seven, except those raised by Green Mountain (in relation to the amount and impact), which we address further below.

The first criticism raised about Provision Seven of the RSP is that AEP proposes to not credit the unused Columbus Southern shopping incentive to regulatory asset charge recovery (and instead extends the incentive through 2008, with any remaining amounts becoming income to Columbus Southern). AEP correctly notes that, if the Commission does not accept this aspect of Provision Seven, there will be no shopping incentive for Columbus Southern's residential customers. Shopping credits and incentives were established to promote customer switching and effective competition. Sections 4928.37 and 4928.40, Revised Code. Accord, *Constellation, supra*. Shopping credits and incentives are not mandated by statute after the MDP. Certainly, however, the idea of having a Columbus Southern shopping incentive during the RSP is attractive, particularly since we are trying to spur further development of the competitive market in AEP's service territories. However, we must weigh that against AEP's clear statements that its proposed extension of the Columbus Southern shopping incentive is contingent upon any remaining amounts at the end of the RSP becoming income to Columbus Southern.

We do not agree that the unused amount of the Columbus Southern shopping incentive at the end of the RSP should become income to that company on the basis that it is a fair trade-off to offering to extend that incentive during the period, as AEP has argued. Under the ETP, Columbus Southern was not going to receive income if that shopping incentive was not completely used during the MDP. Instead, AEP previously agreed to flow those dollars back to customers (by making a reduction to the remaining regulatory asset amounts equivalent to the amount of the unused shopping incentive). Moreover, we do not believe that Columbus Southern should earn income when customers have not shopped sufficiently to utilize the same shopping incentive over an extended period. Furthermore, as explained below, we do not believe that the RSP must include a shopping incentive for Columbus Southern customers either. Therefore, the proposed Columbus Southern shopping incentive portion of Provision Seven of the RSP is rejected.

As previously noted, the ETP decision requires that the unused balance of the Columbus Southern shopping incentive at the end of the MDP be credited back to Columbus Southern customers (via an adjustment to the level of regulatory asset recovery). We agree that customers should benefit in the event that Columbus Southern customers do not shop sufficiently by the end of this year (which is the end of the MDP). We believe that most parties, if not all, would agree that sufficient shopping is very unlikely to occur by the end of the MDP and, thus, an unused dollar amount will exist. However, we conclude a redirected application of the unused shopping incentive monies is more appropriate, while yet still in line with the goal of benefiting customers. LIA and OCC have asked in this proceeding for specific dollars targeted to low-income customer issues because that segment of the customer base may be disproportionately affected by the RSP. As we noted in section VI.B.1 of this decision, we believe that it is appropriate to assist the AEP low-income customers. Therefore, we conclude that $14 million should be should be allotted by AEP for the benefit of the Columbus Southern and Ohio Power low-income customers, as well as for economic development during the RSP period. We will require AEP to work with our Service Monitoring and Enforcement Department staff to develop the details for the use of those sums. Our staff will consult with the Ohio Department of Development in relation to the use of that money in AEP's service territories.

Green Mountain has alleged that the shopping incentives (as identified for Columbus Southern customers above and a zero incentive for Ohio Power customers) will not be sufficient to spur shopping in either company's territory. As we have already noted, shopping incentives are not mandated after the MDP. In any event, the shopping incentives are only one manner of further developing the competitive market and we believe that, in the full context of the proposed RSP, our decision to require monetary assistance for low-income and economic development issues is an appropriate conclusion. With regard to Green Mountain's argument related to partial payment priority, the Commission is not willing to alter its established payment priority scheme just because AEP is seeking to establish a RSP. Green Mountain has also asked for several other specific alterations (establish other credits via avoidable charges, waiver of the $10 switching fees, provision of market support generation and institution of a voluntary enrollment process). We do not believe that these items are needed at this point. Accordingly, we will not adopt them.

H. Other Items (Provisions Eight through Eleven of the RSP)

1. Additional Future Proceedings

AEP recommends (in Provision Eight) that the Commission conduct a proceeding to determine the "manner in which electric generation service should be provided to the companies' customers" after the RSP and report the results to the legislature by December 31, 2005. AEP explains that this provision is intended to avoid facing the same situations at the end of the RSP as we face today (AEP Ex. 2, at 24-25). Staff and IEU-Ohio agree (Staff Ex. 2, at 13; IEU-Ohio Initial Br. 45). OMG and NEMA also appear to agree. Specifically, OMG and NEMA state that, if the Commission approves a RSP for AEP, it should establish a re-opener during 2007 in order to make adjustments to assist market development and to plan for the end of the rate stabilization period (to meet the statutory goals of market-base rates) (OMG/NEMA Initial Br. 12). OCC disagrees that the Commission should complete a report by 2005, arguing that any report completed by that date will not likely provide any valuable information for the post-RSP period (OCC Initial Br. 55-56).

<u>Commission Discussion</u>

This provision of the RSP is acceptable as a recommendation on steps the Commission should consider by the end of the RSP period. The Commission has a mandate to consider all possible options for implementation at the end of the rate stabilization period.

2. Functional Versus Structural Separation

In Provision Nine, the companies would continue functional separation (one corporate entity with separate groups to handle each function). AEP explained that it has not yet received authorization from the Securities and Exchange Commission to structurally separate, although AEP has made that request (AEP Ex. 2, at 25-26). At this point, AEP "does not contemplate structurally separating" the generation assets (*Id.*) because restructuring has slowed down. Staff concurs with this provision, particularly since structural separation could limit or preclude options in the future (Staff Ex. 2, at 13; Tr. IV, 250). IEU-Ohio does not oppose this provision (IEU-Ohio Initial Br. 45).

OCC, OMG, NEMA and Green Mountain state that AEP must structurally separate per Section 4928.17, Revised Code (OCC Initial Br. 56; OMG/NEMA Initial Br. 13-14; GMEC Initial Br. 21). PSEG states that it makes little sense for the Commission to approve the RSP based upon risks/volatility of the competitive market and not protect customers by requiring AEP to implement corporate separation (PSEG Br. 7-8). Green Mountain argues that to continue functional separation seeks something that AEP never lawfully had (because the ETP approved only structural separation) (GMEC Initial Br. 21). Green Mountain states that the Commission should not permit AEP to continue functional separation if the RSP is not implemented (*Id.*).

<u>Commission Discussion</u>

We are willing to accept this term of the RSP for several reasons. First and foremost, AEP has been unable to structurally separate, as it had planned, because it does not have the necessary federal authority to do so. We simply cannot force structural separation when other agencies also must give their approval and that approval has not been forthcoming. Second, we would be remiss if we did not recognize that many expectations surrounding a competitive electric market in Ohio and around the country have changed from 2000, which is when we approved AEP's plan in its ETP proceeding to structurally separate its generation functions from the remainder of its functions. Third, Sections 4928.17(C) and (D), Revised Code, allow the Commission to modify a previously approved corporate separation plan. OCC, OMG and NEMA seem to have overlooked that aspect of the corporate separation statute. More specifically, we conclude that good cause has been shown to allow AEP to operate on a functional separation basis for the RSP period and such functional separation can still provide compliance with the state's policies associated with competitive retail electric service, as enumerated in Section 4928.02, Revised Code.

3. Participation in Other CBPs

Provision 10 of the RSP allows the companies to submit bids in other EDU's CBPs. AEP argues that Section 4928.14(B), Revised Code, compels the Commission to grant this provision of the RSP and the Commission has acknowledged such previously (AEP Initial Br. 52). Staff agrees with this provision and IEU-Ohio believes current law already allows AEP to participate in the CBPs of other EDUs (Staff Ex. 2, 13; IEU-Ohio Initial Br. 46).

Green Mountain contends that AEP should not be permitted to participate in other CBPs until it has structurally separated (GMEC Initial Br. 21-22).

Commission Discussion

AEP correctly notes that we have refused to limit participation in CBPs to non-EDU affiliate participants because of the language in Section 4928.14(B), Revised Code. *In the Matter of the Commission's Promulgation of Rules for the Conduct of a Competitive Bidding Process for Electric Distribution Utilities Pursuant to Section 4928.14, Revised Code*, Case No. 01-2164-EL-ORD, Finding and Order at 9 (December 17, 2003). We find this provision of the RSP to be reasonable. Nothing that Green Mountain has argued on this provision convinces us that this aspect of the RSP should not be approved.

4. Minimum Stay Requirements

Also, the RSP addresses in Provision 11 the topic of minimum stay. It provides that, during the RSP, residential and small commercial customers that return to the standard service must remain through April 15 of the following year, if the customer took generation service from the company between May 16 and September 15. During the RSP, a 12-month minimum stay would be required for large commercial and industrial customers that return under the standard service tariff.

This RSP provision corresponds with AEP's current minimum stay tariff provisions, but those tariff provisions have not been in effect due to a Commission moratorium.[19] AEP believes that minimum stay requirements are needed to avoid seasonal impacts of switching when AEP's prices are essentially annual average rates (AEP Ex. 5, at 5). Staff finds AEP's approach to be reasonable, but also recommends that the alternative mentioned in those tariffs be more fully detailed (Staff Ex. 2, at 14).

OMG and NEMA argue that, before the minimum stay provisions are triggered, the Commission should require that shopping customers be able to return to the standard service offer three times (OMA/NEMA Initial Br. 15). They note that AEP agreed to such a term in its ETP and, since no real shopping has taken place, it makes sense to require this term during the RSP (*Id.*). AEP points out that the Commission did not accept this part of the ETP settlement and nothing was presented in this proceeding to warrant its acceptance now (AEP Reply Br. 39).

IEU-Ohio contends that this topic should be addressed by the Commission on a generic basis, not in this RSP proceeding (IEU-Ohio Initial Br. 46). OCC contends that AEP has not demonstrated a need for the minimum stay or any harm from the moratorium (any alleged harm will only occur if customers actually shop and then return to AEP) and, therefore, the moratorium should remain in place (OCC Initial Br.60).

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19 The Commission issued a moratorium on any minimum stay requirements for residential and small commercial customers on March 21, 2002, in *In the Matter of the Establishment of Electronic Data Exchange Standards and Uniform Business Practices for the Electric Utility Industry*, Case No. 00-813-EL-EDI. That moratorium has continued indefinitely. While another proposal is pending before the Commission on the matter, we have not issued a definitive ruling on the matter.

Commission Discussion

We are willing to accept this provision of the RSP. We realize that we still have not addressed the pending minimum stay proposal (which differs from AEP's minimum stay requirements) in the generic proceeding. For the short three-year period of the RSP, we are willing to allow AEP to implement these minimum stay requirements. It will allow us the opportunity to evaluate participation, gaming of enrollments, and the impact of our originally approved minimum stay requirements. We consider this approval to essentially test the debate that has been raised with us for quite a period of time.

VII. Conclusion

Based upon the foregoing, we conclude that the proposed RSP should be adopted (with the exception of the RSP's proposed elimination of the five percent residential discount in Provision Two, the proposed deferral of RTO administrative charges, the proposed deferral of CWIP and in-service plant carrying charges, the proposed review period associated with FERC-approved transmission rate changes, and the proposed treatment of the Columbus Southern shopping incentive) for the reasons set forth herein. We also conclude that OCC's motion to dismiss the application should be denied. Additionally, we conclude that, AEP shall allot $14 million for low-income customers and economic development, and work with our Service Monitoring and Enforcement Department staff to work out the details for those dollars. AEP is, furthermore, allowed to establish a POLR charge.

As we have already mentioned, we believe certain changes are warranted as the MDP ends for AEP. This decision will move AEP to market-based rates for the 2006-2008 period in an appropriate and balanced fashion and conforms with the state's electric policy (Section 4928.02, Revised Code) and this Commission's stated goals. Circumstances are not the same as when we issued our ETP decision and we recognize that fact and have reached conclusions today that we believe are most appropriate for the 2006-2008 period. To the extent any arguments were raised in this proceeding and they are not expressly addressed in this decision, they have been rejected.

As noted earlier in this Order, AEP will be held forth as the POLR to consumers who either fail to choose an alternative supplier or who choose to return to AEP's system after taking service from another energy company. Consistent with Ohio law, the POLR designation places expectations upon EDUs; the companies must have sufficient capacity to meet unanticipated demand. Additionally, the Commission is among many state agencies that have been charged by the Governor to enhance the business climate in Ohio as it competes on a regional, national, and global basis for economic development projects. One of the Commission's roles in this endeavor has been to focus on reliable energy. We believe that, consistent with Section 4928.02, Revised Code, Ohio consumers are entitled to a future secure in the knowledge that electricity will be available at competitive prices. We also feel strongly that electric generators of the future should be both environment-friendly and capable of taking advantage of Ohio's vast fuel resources. With the recognition that new technologies must be forthcoming to replace the utilities' aging generation fleet, we urge AEP to move forward with a plan to construct an integrated gasification combined-cycle (IGCC) facility in Ohio. AEP should engage the Ohio Power

Siting Board in pursuit of such a plant. We are encouraged by emerging information that suggests that the IGCC technology will be economically attractive. It is worth noting that the Commission is exploring regulatory mechanisms by which utilities, given their POLR responsibilities, might recover the costs of these new facilities.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

(1) On February 9, 2004, AEP filed an application with the Commission for approval of a rate stabilization plan for the period 2006 through 2008.

(2) Twenty-five entities filed motions to intervene in this proceeding. All those requests were granted.

(3) A technical conference was held on March 24, 2004. Objections to the application were filed on April 8, 2004.

(4) A local, public hearing in Canton, Ohio, was conducted on May 19, 2004. However, the Commission had not properly sent any of the publication notices to the newspapers in AEP's service territory. Therefore, the examiner scheduled another local hearing in Canton, Ohio, for July 7, 2004 and rescheduled the local hearing in Columbus, Ohio, for July 1, 2004. At the July 1 and 7, 2004 local hearings, three people provided testimony.

(5) On May 24, 2004, OCC filed a motion to dismiss the application on various legal grounds. By entry dated June 1, 2004, the examiner deferred a ruling on OCC's motion to dismiss, stating that all parties shall have the opportunity to argue the legality of AEP's proposal in post-hearing briefs.

(6) The evidentiary hearing began on June 8, 2004, and continued through June 14, 2004. AEP presented the testimony of five witnesses. The staff and OCC each presented the testimony of two witnesses. APAC, Lima/Allen Council on Community Affairs, and WSOS Community Action jointly sponsored the testimony of one witness and OEG presented the testimony of one witness.

(7) The parties filed post-hearing briefs on July 13 and 30, 2004.

(8) AEP's MDP will end on December 31, 2005.

(9) AEP's proposed elimination of the five percent residential discount in provision two is precluded by the ETP decision.

(10) OCC's motion to dismiss the application should be denied.

(11) We adopt all provisions of the proposed RSP with the exception of the:

(a) RSP's proposed elimination of the five percent residential discount in Provision Two,
(b) Proposed deferral of RTO administrative charges in Provisions One and Six,
(c) Proposed deferral of CWIP and in-service plant carrying charges in Provisions One and Six,
(d) Proposed review period associated with FERC-approved transmission rate changes in Provision Four, and
(e) Proposed treatment of the Columbus Southern shopping incentive in Provision Seven.

(12) Our adopted provisions of the proposed RSP, our decision to require AEP to allot $14 million for low-income customers and economic development, our decisions to require AEP to work with our Service Monitoring and Enforcement Department staff to work out the details for those dollars, and our decision to allow AEP to establish a POLR charge, taken together, appropriately balance three objectives: (a) rate certainty, (b) financial stability for AEP, and (c) the further development of the competitive electric market. Moreover, the combination of the approved components of the RSP, along with the additional conditions of our decision and continuation of the unaffected provisions of the ETP, will prompt the competitive market and continue to provide customers a reasonable means for customer participation in the electric competitive market.

ORDER

It is, therefore,

ORDERED, That OCC's motion to dismiss this application is denied. It is, further,

ORDERED, That AEP's application is approved, subject to the modifications set forth in this decision. It is, further,

ORDERED, That AEP work with our Service Monitoring and Enforcement staff to work out the details for the allotted low-income and economic development dollars. It is, further, ORDERED, That a copy of this opinion and order be served upon all 28 parties to this proceeding and any interested persons of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Ronda Hartman Fergus

Judith A. Jones

Donald L. Mason

Clarence D. Rogers, Jr.

GLP;geb

Entered in the Journal

JAN 2 6 2005

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ormet Primary Aluminum Corporation for Approval of a Unique Arrangement with Ohio Power Company and Columbus Southern Power Company.	)	Case No. 09-119-EL-AEC

ENTRY ON REHEARING

The Commission finds:

(1) On February 17, 2009, Ormet Primary Aluminum Corporation (Ormet) filed an application to establish a unique arrangement with the Ohio Power Company and Columbus Southern Power Company (AEP-Ohio) for electric service to its aluminum-producing facility located in Hannibal, Ohio. Ormet is requesting that the Commission establish a unique arrangement for electric service with AEP-Ohio that links the price of electricity for its facility with the price of aluminum as reported on the London Metal Exchange. Ormet filed an amended application on April 10, 2009, to reflect the possible curtailment of the equivalent of at least two of its six potlines.

(2) On July 15, 2009, the Commission issued its Opinion and Order, approving the amended application as modified by the Commission.

(3) Section 4903.10, Revised Code, states that any party to a Commission proceeding may apply for rehearing with respect to any matters determined by the Commission within 30 days of the entry of the order upon the Commission's journal.

(4) On August 14, 2009, Industrial Energy Users-Ohio (IEU-Ohio) filed an application for rehearing, alleging that the Opinion and Order was unreasonable and unlawful on the following grounds:

(a) The Commission should grant rehearing to clarify the rate that will apply to Ormet during 2009.

(b) The Commission's failure to include a provision to terminate the reasonable arrangement automatically if Ormet fails to maintain operations is unreasonable.

(c) The Commission's failure to require Ormet to maintain deposit and advance payment provisions is unreasonable.

(5) Moreover, the Ohio Consumers Counsel and the Ohio Energy Group (OCC and OEG) filed an application for rehearing on August 14, 2009, alleging that the Opinion and Order was unreasonable and unlawful on the following grounds:

(a) The Commission erred in failing to specify and ensure how AEP-Ohio will apply the credit for the full amount of provider of last resort (POLR) charges that will reduce what customers will have to pay for Ormet's unique arrangement.

(b) The Commission erred by failing to specify that AEP-Ohio and Ormet shall not be permitted to reduce the delta revenue credit, for example by negotiating a discount for the POLR charge, that is intended by the Commission to reduce what customers will have to pay for Ormet's unique arrangement.

(6) Further, on August 14, 2009, AEP-Ohio filed an application for rehearing, alleging that the Opinion and Order was unreasonable and unlawful on the following grounds:

(a) The Commission's conclusion that, during the ten-year term of this unique arrangement, there is no risk Ormet will be permitted to shop for competitive generation and then return to AEP-Ohio is unreasonable and conflicts with the Commission's orders in AEP-Ohio's electric security plan cases, *In re Columbus Southern Power Co. and Ohio Power Co.*, Case No. 08-917-EL-SSO, et al.

(b) Even assuming there is no risk Ormet will be permitted to shop for competitive generation and then return to AEP-Ohio, requiring that POLR charges paid by Ormet must be credited by AEP-

Ohio to its economic development rider is unlawful. Section 4905.31(E), Revised Code, does not permit the Commission to offset the amount of revenue forgone by alleged or real expense reductions. Further, the Commission's authority under Chapters 4901., 4903., 4905., 4907., 4909., 4921., 4923., 4927., 4928., and 4929., Revised Code, is not available to the Commission to prohibit AEP-Ohio from recovering all revenues forgone as a result of the unique arrangement.

(c) The Opinion and Order commits a customer to refrain from acquiring its generation service from a competitive retail electric service provider in violation of the clearly stated public policy of this State. Contract provisions that are contrary to the public interest are unenforceable.

(d) The Commission ordered AEP-Ohio and Ormet to execute and file a power agreement conforming to the Commission's Opinion and Order even though AEP-Ohio did not agree with all the terms of the modified reasonable arrangement. There is no "reasonable arrangement with" AEP-Ohio under Section 4905.31, Revised Code.

(e) Eliminating the existing requirement for AEP-Ohio to retain a deposit from Ormet and no longer requiring Ormet to make payments in advance to AEP-Ohio is unreasonable in light of the increased possibility of Ormet terminating production, either indefinitely or permanently, along with the related inability to make timely payments for electric services or Ormet's decision not to make such payments.

(7) On August 24, 2009, IEU-Ohio, and Ormet each filed memoranda contra AEP-Ohio's application for rehearing. OCC and OEG also filed a joint memorandum contra AEP-Ohio's application for rehearing on August 24, 2009. Further, on August 24, 2009, AEP-Ohio filed a memorandum contra the application for rehearing filed by OCC and OEG.

(8) In its first assignment of error, IEU-Ohio requests that the Commission clarify the rate for electric service which Ormet will pay in 2009. IEU-Ohio notes that, after the Commission issued its Opinion and Order in this proceeding, Ormet issued a notice of layoff and closure pursuant to the Federal Worker Adjustment and Retraining Notification Act (WARN). IEU-Ohio also cites to a recent press release issued by Ormet regarding a decision in its arbitration proceeding with its alumina supplier. IEU-Ohio claims that, because the 2009 rates approved by the Commission in the Opinion and Order were expressly contingent upon Ormet maintaining at least 900 employees at its Hannibal facility, these developments require the Commission to clarify the rates that Ormet should pay in 2009.

In its memorandum contra, Ormet claims that it issued its initial WARN notices in order to preserve all of its available options in light of the arbitration decision and the Commission's Opinion and Order in this proceeding. Further, Ormet represents that it has issued a supplemental WARN notice stating its intention to shutdown two of its six potlines and reduce its workforce by 100 employees and that it has issued a subsequent press release regarding its intention to operate four of its six potlines through the balance of 2009. With respect to its 2009 rate under the unique arrangement, Ormet argues that, if it is not able to maintain an employment level of 900 employees, it will not be entitled to the 2009 rate set forth in the Opinion and Order; and AEP-Ohio will charge Ormet the default rate set forth in the power agreement, which is an average of $38.00 per MWh for 2009 until such time as Ormet resumes employment of 900 employees.

As a preliminary matter, the Commission notes that none of the WARN notices and press releases cited by both IEU-Ohio and Ormet have been admitted into the evidentiary record in this proceeding. Further, no witnesses have testified regarding the nature or the implications of the WARN notices. Therefore, the WARN notices and press releases will not be considered by the Commission in this Entry on Rehearing. The Opinion and Order provided that, if Ormet maintained an employment level of 900 employees for calendar year 2009, AEP-Ohio would bill Ormet, for the balance of 2009, at a rate which averages $38.00 per MWh for the periods when Ormet was in full production (i.e., six potlines), $35.00 per MWh for the periods when Ormet curtailed production to 4.6 potlines, and $34.00 per MWh for the periods when Ormet curtailed production to 4 potlines. Further, the Commission ordered Ormet to provide AEP-Ohio and Staff with monthly reports detailing its employment levels. The Commission agrees with Ormet that, to the extent that Ormet fails to maintain the required employment level in 2009, AEP-Ohio should charge Ormet $38.00 per MWh, which is the default rate in the power agreement, irrespective of Ormet's production levels. Moreover, the Commission will clarify that the termination provision contained in Section 2.03 of the proposed power agreement shall not apply for 2009 billing periods (Ormet Ex. 8, Attachment A at 9). Although the Commission does not believe that any further clarification is necessary, we will direct Staff to review Ormet's monthly billing records for 2009 and the submitted monthly employment reports to ensure that Ormet was billed in accordance with the unique arrangement. Rehearing on this assignment of error should be denied.

(9) In its second assignment of error, IEU-Ohio claims that the Commission's failure to include a provision to terminate the reasonable arrangement automatically if Ormet fails to maintain operations is unreasonable. IEU-Ohio notes that, because the unique arrangement is for a ten-year period, once AEP-Ohio and Ormet file an executed power agreement, it is possible that Ormet may cease operations and, at some point in the future, resume operations and attempt to claim it is entitled to receive electric service pursuant to the contract for the balance of the term. Therefore, IEU-Ohio contends that the termination provisions of the unique arrangement, as modified by the Commission in the Opinion and Order, do not sufficiently protect ratepayers from undue risks.

Rehearing on this assignment of error should be denied. The Commission finds that the provisions of the unique arrangement, as modified by the Commission, adequately protect ratepayers in the event that Ormet ceases operations. The power agreement introduced into the record of this proceeding provides that the power agreement shall terminate 24 months after any shutdown, unless Ormet begins ramping up production (Ormet Ex. 8, Attachment A at 10). Further, in the Opinion and Order, the Commission modified the unique arrangement such that Ormet is required to maintain an employment level of 650 full-time employees. In the event that Ormet does not maintain this employment level, the maximum rate discount, or floor, would be reduced by $10 million for every 50 employees below 650 full-time employees that were employed for the previous month. This modification ensures that the maximum rate discount funded by ratepayers is directly linked to continued employment at the Hannibal facility. Therefore, we find that the provisions of the power agreement, as modified, provide sufficient protection to ratepayers from any risk of curtailment of production or shutdown of the Hannibal facility by Ormet.

(10) In its third assignment of error, IEU-Oho contends that the Commission's failure to require Ormet to maintain deposit and advance payment provisions is unreasonable. Likewise, in its fifth assignment of error, AEP-Ohio claims that the Commission's failure to maintain the existing requirements for a deposit and advance payments from Ormet is unreasonable.

IEU-Ohio argues that ratepayer exposure to the risk of default by Ormet has increased due to the issuance of the WARN notice, discussed above, by Ormet. Similarly, AEP-Ohio argues that it may be unreasonable to release Ormet from the requirement that it provide a deposit and advance payments due to Ormet's recent issuance of the WARN notice.

Ormet claims that the absence of deposit and advance payment provisions actually benefits ratepayers. Ormet notes that the annual calculation of the rate that Ormet can afford to pay is currently based upon the assumption that the cash deposit currently held by AEP-Ohio will be returned to Ormet, thereby increasing its cash flow (Tr. I at 19-21, 22-23). However, Ormet contends that, if it is required to keep a deposit with AEP-Ohio and to continue paying in advance for power, then its cash flow will be reduced and the magnitude of the discount required by Ormet to continue in operation would increase.

The Commission finds that IEU-Ohio and AEP-Ohio have not raised any new arguments, based upon evidence in the record in this proceeding, in support of their assignments of error. IEU-Ohio's argument relies solely on the issuance by Ormet of the WARN notice, an event which the Commission has already determined was not part of the evidentiary record in this proceeding and will not be considered on rehearing. The evidence in the record in this case demonstrates that payment provisions contained in the power agreement, as proposed by Ormet, reflect the same terms available to customers receiving service under AEP-Ohio's standard service offer (Tr. I at 124, 227). Moreover, the record demonstrates that such terms are necessary for Ormet to continue operations under the unique arrangement (Ormet Ex. 6 at 7, Ormet Ex. 11A at 3, 4). Rehearing on this assignment of error is denied.

(11) In support of its first assignment of error, AEP-Ohio argues that there is a risk that, during the ten-year term of the unique arrangement, Ormet will be permitted to shop for competitive generation and then return to AEP-Ohio. AEP-Ohio argues that the Commission's authority over the unique arrangement is continuous and that, as circumstances change, the Commission can order a modification of the unique arrangement. AEP-Ohio specifically notes that the Commission modified the proposed unique arrangement to provide provisions related to employment levels and the requirement that any accumulated deferrals be reduced through payment of above-tariff rates no later than April 2012. Further, AEP-Ohio notes that Ormet has not just shopped for competitive generation in the past but has also sought and been granted permission to switch to another electric supplier's certified territory. *See Ormet Primary Aluminum Corporation et al., v. South Central Power Co. and Columbus Southern Power Co.,* Case No. 05-1057-EL-CSS. Therefore, based upon the Commission's continuing jurisdiction over the special arrangement and upon its experience with this customer, AEP-Ohio argues that the Commission should reverse its conclusion that there is no risk of Ormet shopping and then returning to POLR service.

In their joint memorandum contra AEP-Ohio's application for rehearing, OCC and OEG argue that the Commission's conclusion that there is no risk of Ormet shopping and returning to AEP-Ohio during the ten-year term of the unique arrangement was reasonable and consistent with the Commission's order in AEP-Ohio's ESP case. OCC and OEG claim that the record established that Ormet made the decision that it would not shop and that the Opinion and Order simply ratifies Ormet's decision to make AEP-Ohio its exclusive electric supplier for the next ten years. Further, OCC and OEG dispute AEP-Ohio's assertion that the Commission's ability to modify the arrangement at any time provides an opportunity for Ormet to shop for a different supplier.

The Commission finds that rehearing on this assignment of error should be granted in order to clarify that the relevant period when Ormet cannot shop is the duration of AEP-Ohio's current approved electric security plan (ESP). It is not necessary to reach the question of whether Ormet can shop beyond the duration of the current ESP because no determination has been made whether future standard services offers will include a comparable POLR charge. Under the terms of the unique arrangement as approved by the Commission, AEP-Ohio will be the exclusive supplier to Ormet for ten years, commencing January 1, 2009 (Tr. I at 37-38; Tr. IV at 484). Accordingly, in the Opinion and Order the Commission determined that AEP-Ohio would not be subject to POLR risk (i.e., the risk that Ormet may shop and subsequently seek to return to AEP-Ohio's standard service offer) and, therefore, that AEP-Ohio should not be compensated for bearing this risk. Although AEP-Ohio argues that there is a risk of Ormet shopping and then returning to AEP-Ohio's standard service offer because the unique arrangement remains under the Commission continuing jurisdiction, the Commission notes that any modification to the unique arrangement would take place only after notice and an opportunity for hearing for any party affected by such modification, including AEP-Ohio.

Moreover, the unique arrangement provides that the Commission may modify the unique arrangement only after January 1, 2016, unless the cumulative net discount under the unique arrangement exceeds 50 percent of the amount that Ormet would have been required to pay under AEP-Ohio's applicable tariff rates (Ormet Ex. 8, Attachment A at 9). Although the Commission modified the unique arrangement to provide an additional independent termination provision, this termination provision, by its terms, cannot be effective before April 1, 2012. However, AEP's electric security plan, and its authority to assess POLR charges to its standard service offer customers, expires on December 31, 2011. Therefore, under the terms of the unique arraignment as modified by the Commission, there is no risk that Ormet will shop and return to

AEP-Ohio's standard service offer during its current electric security plan.

With respect to AEP-Ohio's argument there is a risk of Ormet shopping based upon AEP-Ohio's experience with this customer, specifically the repeated transfer of Ormet's Hannibal facilities pursuant to Section 4933.83, Revised Code, the Commission notes that both the initial transfer and the return of Ormet's Hannibal facilities were approved with AEP-Ohio's consent and that AEP-Ohio was fully compensated for the return of Ormet to its service territory. *Ormet Primary Aluminum Corporation*, Case No. 05-1057-EL-CSS, Supplemental Opinion and Order (November 8, 2006) at 2, 4, 5-6, 8, 10. This experience, therefore, has no bearing upon whether there is any risk of Ormet shopping for a competitive retail electric supplier.

(12) In support of its second assignment of error, AEP-Ohio argues that the Commission lacks authority to preclude AEP-Ohio from recovering all revenue foregone as a result of the unique arrangement and that the failure to permit AEP-Ohio to recover all revenue foregone conflicts with AEP-Ohio's approved electric security plan. AEP-Ohio contends that the plain language of Section 4905.31, Revised Code, provides the Commission with no statutory authority to offset the recovery of the revenue foregone by any expense the Commission believes will not be incurred by the electric utility due to the unique arrangement. AEP-Ohio claims that any such reduction in the recovery of revenue foregone would not be "advantageous" to both parties to the contract, as required by Section 4905.31, Revised Code. AEP-Ohio claims that, in other contexts, the General Assembly provided explicit offset authority to the Commission and that the absence of such explicit authority is particularly telling in light of the presence of explicit offset authority in other provisions amended by Am. Sub. Bill 221. AEP-Ohio also contends that the Opinion and Order is contrary to the Commission's order approving AEP-Ohio's ESP. AEP alleges that the Commission determined in the ESP proceeding that all customers would pay the POLR charge for the entire time they are served under AEP-Ohio's standard service offer and that customers would avoid POLR charges during the period they are actually served by a CRES provider if they agreed to return at a market price. Further, AEP-Ohio contends that the Commission cannot distinguish its decision in

the ESP proceeding from this case because the same POLR risk that formed the basis for the POLR charge adopted in the ESP proceeding is present with Ormet.

OCC and OEG argue that Section 4905.31, Revised Code, does not preclude the Commission from requiring that the POLR charge for Ormet be credited to the economic development rider. OCC and OEG contend that Section 4905.31, Revised Code, allows for reasonable arrangements which are either "practicable" or "advantageous" to the "parties interested." Thus, according to OCC and OEG, the reasonable arrangement can be either practicable *or* advantageous; but it need not be both. Further, OCC and OEG argue that the plain meaning of the term "parties interested" goes beyond just the parties to the contract and includes other ratepayers, who have a distinct interest in how the agreement will affect the rates they must pay. Finally, OCC and OEG claim that the POLR provisions of AEP-Ohio's ESP do not apply to Ormet, which is not receiving service under AEP-Ohio's standard service offer.

The Commission finds that rehearing on this assignment of error should be denied. Contrary to AEP-Ohio's analysis, the plain language of Section 4905.31, Revised Code, does not require the Commission to approve the full recovery of all delta revenue resulting from the unique arrangement. Section 4905.31, Revised Code, states that a unique arrangement "*may include* a device to recover *costs incurred* in conjunction with any economic development and job retention program . . . including recovery of revenue foregone." The Commission finds that the use by the General Assembly of "may" in this context authorizes, but does not require, the recovery of delta revenues. If the General Assembly had intended to require the recovery of delta revenues, the General Assembly would have used "shall" or "must" rather than "may." Moreover, Section 4905.31, Revised Code, states that "[e]very . . . reasonable arrangement shall be under the supervision and regulation of the commission, and is subject to change, alteration, or modification by the commission." This provision provides the Commission with broad statutory authority to change, alter, or modify proposed unique arrangements and includes no exception to that authority with respect to the recovery of delta revenues. Thus, the Commission finds that, according to the plain language of the statute, the recovery of delta revenues is a matter for the Commission's discretion.

In addition, Section 4905.31, Revised Code, provides for the recovery of "costs incurred." In this Entry on Rehearing, the Commission has determined that there is no risk that Ormet will shop for a competitive supplier during AEP-Ohio's current approved ESP. Therefore, if there is no risk of Ormet shopping and returning to standard offer service during its ESP, AEP-Ohio will incur no costs for providing POLR service which can be recovered under Section 4905.31, Revised Code. Accordingly, the Commission determined in the Opinion and Order that AEP-Ohio should credit any POLR charges paid by Ormet to its economic development rider in order to reduce the recovery of delta revenues from other ratepayers.

Finally, the Commission finds that AEP-Ohio's reliance upon our orders approving its ESP to be misplaced. Under the unique arrangement, Ormet will *not* be receiving service under AEP-Ohio's standard service offer; instead, Ormet will be receiving service under a unique arrangement. Although AEP-Ohio posits that this is a distinction without a difference, the Commission notes that service under a unique arrangement is authorized by a different statute, Section 4905.31, Revised Code, than service under a standard service offer, Section 4928.141, Revised Code. By its very nature, service under a unique arrangement provides for service under different prices, terms, and conditions than service under a standard service offer. In fact, in this proceeding, AEP-Ohio, enumerating several factors that it believes distinguishes Ormet from customers who are on the standard service offer, has argued that Ormet should not receive standard service offer terms for security deposits and advance payments. The Commission agrees that Ormet is different from customers on the standard service offer, and one of those differences is that Ormet has committed to AEP-Ohio to be its exclusive supplier (Tr. I at 37-38; Tr. IV at 484). Therefore, since there is no risk that Ormet will shop during AEP-Ohio's ESP, Ormet does not present the same POLR risk as customers on the standard service offer as claimed by AEP-Ohio. Moreover, the Commission's decision that AEP-Ohio's ESP was more favorable in the aggregate than the expected results that would otherwise apply under Section 4928.142, Revised Code, does not imply that the electric utility's ESP is the only basis for setting rates. The rates established by a reasonable arrangement under Section 4905.31, Revised Code, will frequently differ from the rates established under an ESP.

(13) In its third assignment of error, AEP-Ohio argues that the Opinion and Order commits a customer to refrain from acquiring its generation service from a competitive retail electric service provider in violation of the clearly stated public policy of this state, as codified in Section 4928.02, Revised Code. Specifically, AEP-Ohio claims that the statute sets forth the state's policy to ensure diversity of electric supplies and suppliers, to recognize the continuing emergence of competitive electric markets through the development and implementation of flexible regulatory treatment, and to ensure effective competition in the provision of retail electric service. AEP-Ohio claims that it is clear from these policy pronouncements that a contract by which a customer states a commitment not to pursue competitive options for 10 years stifles the development of a competitive retail electric market. Therefore, AEP-Ohio concludes that the Commission should not approve this provision.

OCC and OEG argue that allowing a customer to choose AEP-Ohio as an exclusive provider does not violate any public policy of the state but, rather, furthers the policy of the state in facilitating reasonable rates and customer choice. OCC and OEG claim that competition is not the end-all purpose of Am. Sub. Senate Bill 221; rather, Am. Sub. Senate Bill 221 is intended to ensure "reasonably priced electric retail service" by providing customers with tools and opportunities to achieve such reasonably priced rates. OCC and OEG also claim that customer choice means that a customer, who agrees to contract provisions, including a long-term exclusive supplier provision, should not be second-guessed by AEP-Ohio.

The Commission finds that rehearing on this assignment of error should be denied. AEP-Ohio does not cite to any evidence in the record of this proceeding to support its claim that the exclusive supplier provision of the proposed unique arrangement violates state policy as codified in Section 4928.02, Revised Code. There is no testimony in the record that the exclusive supplier provision will adversely impact the diversity of electric suppliers and supplies. There is no evidence that the proposed unique arrangement fails to recognize the continuing emergence of competitive markets or adversely impacts the development and implementation of flexible regulatory treatment. There is no testimony cited by AEP-Ohio regarding the impact of the exclusive supplier provision upon competition in the provision of retail electric service. The exclusive supplier provision may, or may not, adversely affect competition in this state, but there is no evidence in the record to support that *determination.*

In the absence of evidence to support its assignment of error, AEP-Ohio argues that, as a matter of law, the unique arrangement violates Section 4928.02, Revised Code. However, Section 4905.31, Revised Code, states, in relevant part:

> Chapters 4901., 4903., 4905., 4907., 4909., 4921., 4923., 4927., 4928., and 4929. of the Revised Code do not prohibit a public utility from filing a schedule or establishing or entering into any reasonable arrangement with another public utility or with one or more of its customers, consumers, or employees, and *do not prohibit a mercantile customer of an electric distribution utility* as those terms are defined in section 4928.01 of the Revised Code or a group of those customers *from establishing a reasonable arrangement* with that utility . . . [emphasis added].

Therefore, nothing in Chapter 4928, Revised Code, including the policy provisions of Section 4928.02, Revised Code, should be construed as prohibiting a reasonable arrangement for the supply of retail electric service. Accordingly, the Commission cannot find, as a matter of law, that the proposed unique arrangement, which includes an exclusive supplier provision violates Section 4928.02, Revised Code.

Further, AEP-Ohio's concern is misplaced in this case. This is not an instance in which the electric utility is seeking to become a customer's exclusive electric supplier as a condition of a unique arrangement. Rather, it is Ormet who is committing to AEP-Ohio to be its exclusive electric supplier. In a competitive retail market, a consumer has the right to choose to enter into a long-term forward contract for generation service.

(14) With respect to its fourth assignment of error, AEP-Ohio argues that a reasonable arrangement proposed by an electric utility's mercantile customer cannot be approved by the Commission under Section 4905.31, Revised Code, unless the electric utility agrees to be bound by the proposed reasonable arrangement. Although AEP-Ohio acknowledges that the term "arrangement" in the statute is ambiguous, AEP-Ohio claims that a fair and reasonable interpretation of the term, is "mutual agreement or understanding." Further, AEP-Ohio contends that the context of the statute confirms that "arrangement" should be interpreted as "mutual agreement" because the statute envisions that a reasonable arrangement submitted to the Commission is an arrangement already in existence which becomes lawful and immediately enforceable upon approval by the Commission.

In addition, AEP-Ohio contends that the amendment to Section 4905.31, Revised Code, contained in Am. Sub. Senate Bill 221, which allows mercantile customers to submit a reasonable arrangement to the Commission for approval, merely clarified that an electric utility may offer a general arrangement to all of its customers or to customers in a specific class and allow the individual customers to decide whether to actually "enter into" the offered arrangement. Moreover, AEP-Ohio posits that the amendment recognizes that a mercantile customer has the option of establishing a reasonable arrangement not only with its electric utility but also with some other public utility electric light company. AEP-Ohio claims that this language suggests mutual agreement because it would be strange for the Commission to force a CRES provider or an electric utility serving another territory to enter into an arrangement. Moreover, AEP-Ohio argues that the mercantile customer may apply for a proposed reasonable arrangement because the mercantile customer has a key role to play in persuading the Commission that the reasonable arrangement furthers its intended purpose.

Ormet responds that the Commission has already rejected the arguments raised by AEP-Ohio. Ormet notes that, in adopting the rules governing reasonable arrangements, the Commission specifically rejected a claim that a reasonable arrangement required the electric utility's agreement, holding that:

> FirstEnergy argues that the Commission should make it clear that such applications require the electric utility's consent before they can be approved by the Commission. We believe FirstEnergy's position is not consistent with Section 4905.31, Revised Code, as modified by [Am. Sub. Senate Bill 221]. This section provides that a mercantile customer may apply to the Commission to establish a reasonable arrangement with an electric utility. *Although such arrangement requires Commission approval, there is no requirement that the electric utility must consent to the arrangement before the Commission approves it.*
>
> *In the Matter of the Adoption of Rules for Reasonable Arrangements,* Case No. 08-777-EL-ORD, Entry on Rehearing (February 11, 2009) at 21 [emphasis added].

OCC and OEG also contend that the Commission may order AEP-Ohio and Ormet to enter into a reasonable arrangement without mutual agreement by the electric utility. OEG and OCC claim that AEP-Ohio's assumption that "establishing" a reasonable arrangement and "entering into a reasonable arrangement" mean the same thing violates the rule of statutory interpretation that the entire statute is intended to be effective. *See* Section 1.47(B), Revised Code. Instead, OCC and OEG argue that "establishing" a reasonable arrangement and "entering into a reasonable arrangement" are listed separately under Section 4905.31, Revised Code, and constitute two separate acts. Thus, OCC and OEG posit that "establishing a reasonable arrangement" can be completed through a filed design or plan *without mutual agreement* while "entering into a reasonable arrangement" specifically means to reach an agreement and cannot be completed without mutual consent. Moreover, OCC and OEG argue that AEP-Ohio's interpretation of "establishing a reasonable arrangement" within the context of Section 4905.31, Revised Code, is faulty. OCC and OEG claim that, in assuming that the arrangement becomes immediately enforceable upon approval, AEP-Ohio neglects to recognize the last paragraph of the statute, which states that "[e]very such . . . reasonable arrangement shall be under the supervision and regulation of the commission, and is subject to change, alteration, or modification by the commission." OCC and OEG contend that this provision means that the "establishment of a reasonable arrangement" is not final until the Commission finds that the arrangement is reasonable and in the public interest.

Finally, OCC and OEG allege that AEP-Ohio's interpretation of Section 4905.31, Revised Code, fails to recognize that a major reason that the General Assembly amended Section 4905.31, Revised Code, was to encourage economic development contracts. OCC and OEG claim that the General Assembly wanted to ensure that mercantile customers have the opportunity to propose reasonable arrangements to the Commission even if the electric utility was unwilling to "enter into an agreement" with the mercantile customer. OCC and OEG argue that, irrespective of whether an arrangement is filed by the utility or a mercantile customer, an arrangement should be approved only if it is "reasonable," which OCC and OEG define as an arrangement which does not impose economic burdens on the customers paying any subsidies.

IEU-Ohio argues that AEP-Ohio seeks an absolute veto over authority delegated to the Commission by Section 4905.31, Revised Code, to enable a reasonable arrangement that is filed by a mercantile customer or group of such customers. IEU-Ohio claims that Am. Sub. Senate Bill 221 did not modify the requirement that the Commission review and approve any reasonable arrangement before it becomes lawful and effective; however, Am. Sub. Senate Bill 221 did explicitly expand the persons eligible to submit a reasonable arrangement for the Commission's consideration and approval. Moreover, IEU-Ohio notes that, despite expanding the scope of persons eligible to submit a proposed reasonable arrangement to the Commission, the General Assembly did not modify the requirement that, upon Commission approval of a reasonable arrangement, the electric utility is required to conform its schedule of rates, tolls, and charges to the arrangement. IEU-Ohio also notes that there is no new language requiring the agreement of the electric utility with the Commission-approved reasonable arrangement even though, in Am. Sub. Senate Bill 221, the General Assembly did provide such a provision where the Commission modifies a proposed ESP.

According to IEU-Ohio, the clear and plain language in Section 4905.31, Revised Code, states that: (1) an electric utility, a mercantile customer, or group of mercantile customers may submit a proposed reasonable arrangement to the Commission for the Commission's consideration and approval; (2) the proposed reasonable arrangement may become lawful and effective only upon Commission approval; and (3) the electric utility must then conform its rates to the Commission-approved reasonable arrangement.

The Commission notes that, although AEP-Ohio argues that a reasonable arrangement proposed by an electric utility's mercantile customer cannot be approved by the Commission unless the electric utility agrees to be bound by the proposed reasonable arrangement, the record in this case demonstrates that AEP-Ohio did not engage in negotiations with Ormet in order to reach such an agreement (Tr. I at 13, 15, 17). Thus, AEP-Ohio appears to believe that it can effectively veto reasonable arrangements simply by declining to negotiate with mercantile customers. However, AEP-Ohio ignores the language of Section 4905.31, Revised Code, as amended by Am. Sub. Senate Bill 221, which provides that a mercantile customer may submit an application for a reasonable arrangement to the Commission. Prior to the enactment of Am. Sub. Senate Bill 221, a reasonable arrangement required the electric utility's agreement because only the electric utility was authorized to file an application for a reasonable arrangement. In Am. Sub. Senate Bill 221, the General Assembly expressly authorized mercantile customers to file applications with the Commission for reasonable arrangements. If the General Assembly had intended on retaining the requirement that an electric utility agree to a proposed reasonable arrangement, there would have been no need for the General Assembly to amend Section 4905.31, Revised Code, to authorize the filing of an application by a mercantile customer.

Moreover, AEP-Ohio does not address the plain language of Section 4905.31, Revised Code, which provides that the proposed reasonable arrangement is subject to "change, alteration, or modification" by the Commission but does not provide for the opportunity for the electric utility to reject such modifications. If the General Assembly had intended to provide the electric utility with the opportunity to reject modifications by the Commission, the General Assembly would have expressly provided that opportunity as it did in a similar situation in Section 4928.143(C)(2)(a), Revised Code. Instead, the General Assembly enacted a statutory framework under which an electric utility or mercantile customer (or a group of mercantile customers) may file an application with the Commission for a proposed reasonable arrangement. The Commission may approve or change, alter, or modify the proposed reasonable arrangement. After the Commission has approved, or modified and approved, a reasonable arrangement, the electric utility must conform its rates to the reasonable arrangement. There is no provision in this statutory framework for an electric utility to reject the modifications ordered by the Commission. Accordingly, the Commission finds that rehearing on this assignment of error should be denied.

(15) In support of their two assignments of error, OCC and OEG contend that the Opinion and Order failed to address the mechanics of how POLR credits would be applied to AEP-Ohio's economic development rider. Specifically, OCC and OEG request that the Commission clarify the Opinion and Order to preclude AEP-Ohio and Ormet from negotiating a discount to the POLR charge as part of Ormet's discounted rate.

AEP-Ohio argues that OCC and OEG erroneously assume that the percentage discount to which Ormet might be entitled applies to all rate components except the POLR rider. AEP-Ohio, on the other hand, contends that all components of the tariff, including all riders, should be discounted by the percentage amount of the discount.

The Commission finds that rehearing should be granted in order to clarify the manner in which POLR charges paid by Ormet should be credited to the economic development rider. AEP-Ohio argues that the amount of the credit should be discounted by the same percentage of the maximum rate discount provided to Ormet. This interpretation is not consistent with the Opinion and Order in this case. The rate discount provided to Ormet has no impact whatsoever on the amount of the credit to be applied to the economic development rider. Instead, AEP-Ohio should credit the full amount of the POLR component of the tariff rate which would otherwise apply, on a per MWh basis.

It is, therefore,

ORDERED, That the application for rehearing filed by IEU-Ohio be denied and that the applications for rehearing filed by OCC and OEG and AEP-Ohio be granted, in part, and denied, in part. 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

Alan R. Schriber, Chairman

Paul A. Centolella

Ronda Hartman Fergus

Valerie A. Lemmie

Cheryl L. Roberto

GAP:ct

Entered in the Journal

SEP 15 2009

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ormet Primary Aluminum Corporation for Approval of a Unique Arrangement with Ohio Power Company and Columbus Southern Power Company.	)))))	Case No. 09-119-EL-AEC

OPINION AND ORDER

The Commission, considering the above-entitled application, hereby issues its opinion and order in this matter.

APPEARANCES:

Sonnenschein Nath & Rosenthal LLP, by Clifton A. Vince, Douglas G. Bonner, Daniel D. Barnowski, and Emma F. Hand, 1301 K Street NW, Suite 600 East Tower, Washington, D.C. 20005, on behalf of Ormet Primary Aluminum Corporation.

Richard Cordray, Ohio Attorney General, by Duane W. Luckey, Section Chief, and Thomas Lindgren and Thomas McNamee, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio 43215, on behalf of the staff of the Public Utilities Commission of Ohio.

Marvin I. Resnik and Steven T. Nourse, American Electric Power Service Corporation, 1 Riverside Plaza, 29th Floor, Columbus, Ohio 43215, on behalf of Columbus Southern Power Company and Ohio Power Company.

Janine L. Migden-Ostrander, Ohio Consumers' Counsel, by Gregory J. Poulos, and Maureen R. Grady, Assistant Consumers' Counsel, Office of Consumers' Counsel, 10 West Broad Street, Columbus, Ohio 43215, on behalf of the residential consumers of Columbus Southern Power Company and Ohio Power Company.

Boehm, Kurtz & Lowry, by David F. Boehm and Michael L. Kurtz, 36 East Seventh Street, Suite 1510, Cincinnati, Ohio 45202, on behalf of Ohio Energy Group.

McNees, Wallace & Nurick, LLC, by Samuel C. Randazzo, Lisa G. McAlister and Joseph M. Clark, 21 East State Street, Columbus, Ohio 43215, on behalf of Industrial Energy Users-Ohio.

Chester, Willcox & Saxbe, LLP, by John W. Bentine, Mark S. Yurick, and Matthew S. White, 65 East State Street, Suite 1000, Columbus, Ohio 43215-4213, on behalf of The Kroger Company.

OPINION:

I. History of the Proceeding

On February 17, 2009, Ormet Primary Aluminum Corporation (Ormet) filed an application pursuant to Section 4905.31, Revised Code, to establish a unique arrangement with the Ohio Power Company and Columbus Southern Power Company (AEP-Ohio) for electric service to its aluminum-producing facility located in Hannibal, Ohio. In its application, Ormet requests that the Commission establish a unique arrangement for electric service with AEP-Ohio that links the price of electricity for its facility for calendar years 2010 through 2018 with the price of aluminum as reported on the London Metal Exchange (LME). Ormet filed an amended application on April 10, 2009, to reflect the possible curtailment of the equivalent of at least two of its six potlines.

On March 9, 2009, Industrial Energy Users-Ohio (IEU-Ohio) filed comments regarding Ormet's application. Further on April 28, 2009, Ohio Energy Group (OEG) and Kroger Company (Kroger) each filed comments regarding Ormet's amended application.

Motions to intervene were filed by AEP-Ohio, IEU-Ohio, OEG, Kroger, and the Ohio Consumers' Counsel (OCC). Those motions were granted by the attorney examiner.

Based upon the comments, the attorney examiner set this matter for hearing. The hearing in this matter commenced on April 30, 2009, and concluded on June 17, 2009. At the hearing, Ormet presented four witnesses, OCC presented three witnesses, and Staff presented one witness. Briefs were filed on July 1, 2009, by Ormet, AEP-Ohio, OCC and OEG, IEU-Ohio, Kroger, and Staff.

II. Discussion and Conclusions

In support of the unique arrangement, Ormet argues that the benefits to the region of keeping Ormet in operation will more than offset the delta revenue paid by other ratepayers. Ormet claims that the undisputed expert testimony in the record of this proceeding demonstrates that, at full operations, Ormet provides $195 million of benefits to the regional economy (Ormet Ex. 5 at 1).

Ormet also contends that the proposed unique arrangement furthers the policy of the State of Ohio as codified in Section 4928.02, Revised Code. Ormet claims that the unique arrangement is designed to meet the specific needs of Ormet with respect to the price, terms, conditions, and quality options of electric service as specified by Section 4928.02(B), Revised Code. Further, Ormet claims that the unique arrangement will help Ohio compete in the global economy pursuant to Section 4928.02(N), Revised Code. Ormet contends that it competes in a global market and needs affordable energy in order to compete.

Ormet further contends that it has provided the information needed by the Commission to approve the unique arrangement. Ormet notes that it has provided an affidavit from its chief executive officer verifying the information provided in the application and that it has also provided verifiable data in support of the application.

OCC and OEG claim that Ormet's economic analysis of its impact on the region is flawed because it fails to factor in the negative economic impact on the rest of the state from raising electric rates to pay for the delta revenues (Tr. I at 263, 265). OCC and OEG assert that there will be a clear negative economic impact to requiring all other AEP-Ohio ratepayers to pay increased rates to pay for the delta revenues under the proposed unique arrangement.

IEU-Ohio notes that the Commission may approve a proposed unique arrangement if it is shown to be just and reasonable and that it furthers the policy of this state. However, IEU-Ohio argues that Ormet's application should not be approved. IEU-Ohio claims that there are no clear or reliable indications of how the proposed unique arrangement will produce sufficient beneficial outcomes to make the transfer of revenue responsibility just and reasonable. IEU-Ohio alleges that there are many unanswered questions regarding the proposed unique arrangement, including questions related to the future price of aluminum, the treatment of delta revenue, pending litigation between Ormet and its alumina supplier, Ormet's ability to negotiate a new tolling contract, the sale of significant assets currently owned by Ormet, and the minimum cash requirement associated with labor costs for 2010 and beyond.

The Commission finds that Ormet's application for a unique arrangement should be approved subject to a number of modifications set forth below. The evidence in the record of this proceeding demonstrates that Ormet provides significant economic benefits to the region. Specifically, the evidence demonstrates that Ormet provides $195 million in total employee compensation and benefits to the regional economy (Ormet Ex. 5 at 1). The evidence also indicates that Ormet is a key employer for the region (Ormet Ex. 5 at 3-4) and that Ormet's operations are responsible, indirectly, for the creation of an additional 2,400 jobs in the region (Tr. 1 at 262-263). Further, the record shows that Ormet's operations generate over $6.7 million in tax revenue each year (Tr. 1 at 271). Finally, although OCC and OEG, as well as Staff, claim that the increased rates paid by ratepayers will have a negative economic effect on the state's economy, no party presented evidence in the record which quantified this negative effect (TR. 1 at 264-265).

The Commission notes that, although the proposed unique arrangement covers the period between January 1, 2009 and December 31, 2018, the specific terms and conditions of the unique arrangement are distinctly different for calendar year 2009 than for the remaining years of the unique arrangement. Therefore, the Commission will address the terms related to calendar year 2009 separately.

A. Terms of the Unique Arrangement for Calendar Year 2009

Under the terms of the amended application, for the balance of calendar year 2009, Ormet will pay AEP-Ohio the lesser of the applicable AEP-Ohio tariff rate or $38.00 per MWh. If Ormet reduced its production by the equivalent of at least two potlines, Ormet's rate would be reduced to the lesser of the applicable AEP-Ohio tariff rate or $34.00 per MWh. Ormet requests that the rate for 2009 going forward be set at a level that, taking into account the rate that Ormet has been paying to date, would result in an average rate of $38.00 per MWh for the portion of the year that Ormet was above the four potline operating level and an average rate of $34.00 per MWh for the portion of the year that Ormet was operating at four potlines or less.

OCC and OEG argue that, while Ormet's proposed unique arrangement for 2009 is reasonable in most respects, the provisions calling for retroactive recovery of discounted rates should be rejected. OCC and OEG note that the proposed unique arrangement requests the Commission make the unique arrangement retroactive to January 1, 2009. OCC and OEG allege that this would result in Ormet receiving discounted rates for electricity that were different from the rates which were approved and in effect at the time the service was delivered. OCC and OEG argue that this would constitute retroactive ratemaking which is prohibited. *Lucas County v. Public Util. Comm.* (1997), 80 Ohio St.3d 344, 348-349. Further, OCC and OEG contend that Ormet should be required to pay AEP-Ohio's economic development rider. OCC and OEG note that this rider is unavoidable and that Ormet should pay this rider just like all other customers.

Finally, OCC and OEG claim that the proposed unique arrangement for 2009 is unreasonable and unlawful because it provides compensation to AEP-Ohio for its POLR responsibilities when Ormet cannot shop under the contract. OCC and OEG claim that, because AEP-Ohio will not incur any risk that Ormet would leave and come back to system and seek service when the market makes it more economical, AEP-Ohio should not assess a POLR charge on Ormet, and ratepayers should not pay any discount which compensates AEP-Ohio for a non-existent POLR risk for this consumer.

AEP-Ohio argues that the Commission should not reopen its prior approval of the temporary amendment to the 2007-2008 contract between Ormet and AEP-Ohio. This temporary amendment was approved by the Commission effective January 1, 2009. AEP contends that, if the Commission approves the proposed unique arrangement, the unique arrangement should be effective on a prospective basis only because an earlier effective date would violate the terms of the temporary amendment.

Staff notes that Ormet's rate for 2009, the first year of the agreement, would be fixed at either $38 per MWh or $34 per MWh, depending on the number of potlines in operation (OCC Ex. 3 at 6-7). Although Staff had previously recommended that the Commission bifurcate this proceeding and address calendar year 2009 separately, Staff recommends Commission approval of the terms for the first year of the unique arrangement.

The Commission finds that the terms of the unique arrangement for 2009 should be approved subject to the following modifications. With respect to price, the Commission orders AEP-Ohio to bill Ormet, for the balance of 2009, at a rate which, for all of calendar year 2009, averages $38.00 per MWh for the periods when Ormet was in full operation (i.e., six potlines), $35.00 per MWh for the periods when Ormet curtailed production to 4.6 potlines, and $34.00 per MWh for the periods when Ormet curtailed production to 4 potlines. This rate will ensure that Ormet will receive the benefits of the rates proposed for calendar year 2009 in its amended application without bifurcating the proceeding as originally proposed by Staff. Further, this rate is contingent upon Ormet maintaining employment levels at 900 employees for calendar year 2009 pursuant to Ormet's representations in the record of this proceeding (Ormet Ex. 11A at 5-6; Tr. III at 425).

However, with respect to the delta revenue for 2009, the Commission believes further proceedings are necessary regarding the recovery of delta revenues by AEP-Ohio for calendar year 2009. Therefore, the Commission authorizes AEP-Ohio to defer the delta revenues created by the unique arrangement for the remainder of calendar year 2009, and the Commission directs AEP-Ohio to file an application to recover the appropriate amounts of the deferrals authorized by the Commission in Case No. 08-1338-EL-AAM and the delta revenues for calendar year 2009.

The approved unique arrangement shall be effective for services rendered following the filing in this docket of an executed power agreement which conforms to the modifications ordered by the Commission in this Opinion and Order. Although the power agreement shall be effective for services rendered after the filing of an executed power agreement, the Commission retains the right, upon review of the executed power agreement, to order further revisions to the power agreement in order to ensure that the power agreement conforms to the modifications of the proposed unique arrangement ordered by the Commission in this Opinion and Order.

B. Terms of the Unique Arrangement for Calendar Years 2010 through 2018

For calendar years 2010 through 2018, the rate Ormet will pay under the proposed unique arrangement will be determined based upon schedules filed each year with the Commission. Each schedule would include an "indexed rate" and a "target price." The indexed rate would be the rate that Ormet could pay to produce the minimum cash flow necessary to sustain operations and pay its required legacy costs depending upon the LME price of aluminum. The target price will be the projected average price of aluminum for the calendar year as reported on the LME at which Ormet would be able to pay the AEP-Ohio tariff rate and still maintain the minimum cash flow necessary to maintain its operations and pay its required legacy costs. Under the proposed unique arrangement, the Commission may require an independent third-party review of each year's schedule at Ormet's expense.

When the LME price of aluminum is less than or equal to the target price, Ormet will pay the indexed rate. When the LME price of aluminum is greater than the target price, but not more than $300 per tonne above the target price, Ormet will pay 102 percent of the AEP-Ohio tariff rate. When the LME price is greater than $300 per tonne than the target price, Ormet will pay 105 percent of the AEP-Ohio tariff rate. At the end of each year, there will be a true-up to reconcile the projected LME prices for the year with the actual LME prices.

With respect to the terms of the unique arrangement for calendar years 2010 through 2018, intervenors in this proceeding and Staff have raised a number of specific arguments related to: (1) the proposed discount and delta revenue recovery; (2) potential delta revenue credits; (3) POLR charges; (4) deposit and advance payment requirements; and (5) the need for future review of the proposed unique arrangement. Although the Commission will approve the proposed unique arrangement, the Commission will order a number of modifications to the unique arrangement in order to address the issues raised by intervenors and Staff.

1) Proposed Discount and Delta Revenue Recovery

IEU-Ohio argues that the unique arrangement, if approved, would impose an excessive burden on other customers of AEP-Ohio. IEU-Ohio claims that, under the pricing formula contained in the proposed unique arrangement and assuming an AEP-Ohio tariff rate of $44.24 per MWh, Ormet would need to sell aluminum at $2,843 per tonne to avoid creating delta revenues; however, if Ormet sold aluminum in 2010 at $1,602 per tonne, which was the LME forward price as of April 29, 2009, delta revenues would amount to $283 million (OEG Ex. 1; OEG Ex. 6).

Likewise, OCC and OEG claim that the proposed unique arrangement is unreasonable because it fails to limit the delta revenues that ratepayers could be asked to pay. OCC and OEG note that any LME price less than $2,200 per tonne will result in Ormet being paid, in the form of a credit on its bill, to use electricity (Tr. I at 153; Tr. II at 297). As of May 1, 2009, the LME futures price for July 2010 was $1,602 per tonne (Tr. I at 150-155). OCC and OEG claim that, if the futures price for July 2010 accurately reflects the actual LME price for July 2010, Ormet will be paid $77.1 million to use power in 2010 (Tr. I at 153). OCC and OEG contend that there is no basis in law for the proposed unique arrangement and that Ormet has failed to provide any credible legal justification for requiring ratepayers to pay cash to a company beyond discounting rates to zero dollars. Therefore, OCC and OEG conclude that the proposed unique arrangement would not be reasonable without an appropriate floor for the rate Ormet will pay.

OCC and OEG note that, although the total impact of wages on the states of Ohio, West Virginia and Pennsylvania, if Ormet were to close, would be $195 million per year (Ormet Ex. 8 at 4), half of the employees and retirees identified in the amended application reside in Pennsylvania and West Virginia (Ormet Ex. 5 at 5), and a substantial amount of the tax revenues received from Ormet goes to West Virginia (Ormet Ex. 5 at 11-12). Thus, OCC and OEG conclude that Ormet's economic study should be discounted by 42 percent before it can be considered a relevant study on the Ohio economic impact of a potential closing by Ormet. OCC and OEG note that Staff recommended in the hearing that the amount of the rate discount be limited to $54 million per year and that the discount be phased out over the term of the contract (Staff Ex 2 at 3). However, OCC and OEG maintain that the limit should not exceed $32 million, the amount of wages of the Ohio workers at the Ormet plant.

Kroger argues that, when considering a proposed unique arrangement, the Commission must balance all costs of the proposed arrangement with the benefits of assuming those costs. Further, Kroger contends that, in order to avoid exposing ratepayers to unreasonable and unlimited risk, any unique arrangement approved by the Commission in this proceeding should include reasonable protections for AEP-Ohio ratepayers. Kroger believes that the reasonable protections should include a definitive limit on the cost that ratepayers are required to pay, by either limiting the discount Ormet receives to a certain percentage below AEP-Ohio's tariff rates or placing a dollar limit on the amount of delta revenues AEP-Ohio may recover annually from the unique arrangement.

AEP-Ohio believes that the amount of any discount to be provided to Ormet is a matter for the Commission's judgment. However, AEP-Ohio claims that, under Section 4905.31(E), Revised Code, AEP-Ohio must be provided full recovery of all delta revenues under the unique arrangement because the statute specifies that all costs of an economic development program or job retention program are recoverable by an electric utility, including all "revenue forgone."

Ormet claims that the potential harm predicted by the intervenors in this proceeding is speculative and based upon an unlikely worst case scenario. Ormet contends that the delta revenue calculations by OCC and OEG are based upon the erroneous assumption that current LME forward prices are reliable predictors of future LME prices and that future LME prices are likely to stay below $1,941 per tonne (OCC Ex. 3 at 11-12). However, Ormet contends that a more reliable projection predicts that aluminum prices will be near $2,000 per tonne by the end of 2009 (Ormet Ex. 9 at 1; Tr. I at 173-174). Ormet also claims that there are several additional factors that will lower its costs, and the need for rate discounts, over time; these factors include deleveraging through the proceeds raised by asset sales and internally-generated cash (Ormet Ex. 7 at 2), and reductions in Ormet's pension contributions beginning in 2013 (Tr. III at 434-436).

Staff argues that any unique arrangement approved by the Commission should contain a floor and a ceiling. The Staff believes that a price floor, below which a customer's payments cannot go, reflects the need to maintain the customer's incentive to operate efficiently and effectively. Staff maintains that a maximum reduction of 25 percent from the tariff rate is the appropriate balance, keeping the customer focused on efficiency but providing temporary assistance as well (Staff Ex. 2). This floor would result in a maximum rate discount of $54 million.

In addition, Staff argues that there should be a ceiling on the amount of delta revenue to be recovered from other ratepayers. Staff notes that the benefits of unique arrangements to other ratepayers are limited and that the ability of other ratepayers to pay for delta revenues is likewise limited. Staff believes that the primary benefit of the unique arrangement is the potential preservation of jobs in Ohio; thus, Staff argues that the cap on annual delta revenue recovery should be set initially at $54 million, which is the amount of Ormet's payroll. In addition, Staff recommends that the amount of any discount be reduced by 11 percent of the initial discount each year during the term of the unique arrangement.

Ormet argues that the $54 million cap proposed by Staff is insufficient. Although Ormet believes that the aluminum market will rebound, Ormet claims that this market is highly volatile and that any cap must address this volatility (Ormet Ex. 6 at 6-7). Ormet maintains that the $54 million cap proposed by Staff is inadequate given the volatility of the aluminum market. Ormet claims that, if the discount in any given year is not sufficient to keep Ormet in business, then the entire contract will fail and Ormet will likely need to curtail production at its Hannibal facility.

Moreover, Ormet contends that Staff's proposed cap is unreasonable and speculative. Ormet believes that Staff's proposed cap fails to consider what Ormet needs to operate or to balance the costs of discounts against Ormet's benefits to this state. Ormet also claims that Staff has provided no support for its position that a maximum reduction of 25 percent from the tariff rate is appropriate. Further, Ormet contends that Staff has not demonstrated that its proposed $54 million cap would enable Ormet to remain in business for the years 2010 through 2019.

The Commission agrees with Staff's position that, generally, unique arrangements must contain a floor, a minimum amount that the party seeking a unique arrangement should be required to pay, and a ceiling, a maximum amount of delta revenue which the ratepayers should be expected to pay. Ormet represents that it does not oppose the application of a cap or floor to its contract (Ormet Brief at 21).

With respect to a floor, Ormet proposes a number of different methods for establishing a floor, with a range of $93 million to $114 million as the maximum discount from tariff rates. This range includes the variable costs of production of the electricity consumed by Ormet, which testimony indicates would be approximately $90 million (Tr. I at 235; Staff Ex. 2A, Tr. IV. at 478-479, 491-492). On the other hand, Staff has proposed a floor in which Ormet would receive a maximum discount from tariff rates of $54 million. OCC and OEG propose a floor of $32 million, based upon the total wages paid to Ormet's employees who reside in this state.

Based upon the record in this case, the Commission finds that Ormet's rate should be determined as proposed in the unique arrangement, but with a floor, or maximum discount from tariff rates. Although the Commission does not agree with Staff's recommendation on the amount of the floor, this floor should be implemented in the manner proposed by Staff at the hearing (Staff Ex. 2). Moreover, the Commission is not persuaded by the arguments presented by OCC and OEG that the Commission should consider only the Ohio portions of the regional economy. All of the jobs which would be retained under the proposed unique arrangement are located in this state irrespective of where the employees reside. Further, neither OCC nor OEG presented any economic analysis regarding how much of the indirect benefits of Ormet's continuing to remain in operation advantage the residents of this state as opposed to other states.

Therefore, the Commission will modify the proposed unique arrangement to set the maximum rate discount at $60 million for calendar years 2010 and 2011. The Commission has based the floor upon the variable costs of production of the electricity consumed by Ormet at full capacity, which the testimony at hearing indicates would be approximately $90 million. However, testimony in the record also indicates that, at the time of the hearing, Ormet was in the process of curtailing production to 4 potlines (Tr. 1 at 70-71). This curtailment of operations should reduce Ormet's demand for electricity by approximately one-third; therefore, the Commission has reduced the estimate of the variable costs of production of the electricity of $90 million by one-third to $60 million. The Commission finds that this is an appropriate floor or maximum discount for Ormet. This floor will be subject to two adjustments: a flexible phase down and a reduction in the discount due to reductions in employment, both of which will be discussed below.

With respect to the ceiling, or the maximum amount ratepayers should be expected to pay in any given year, the Commission agrees with Staff and the intervenors that the ability of ratepayers to fund the recovery of delta revenues is not unlimited. Ormet contends that the Staff has not offered proof for its recommendation of what ratepayers can afford to pay. However, Ormet, not Staff nor the intervenors, has the burden of proof in this proceeding, and it is Ormet that has failed to present evidence contravening the Staff's expert testimony, which was based upon substantial experience in relevant utility matters in this state (Staff Ex. 1 at 1; Tr. II at 336-338; Tr. IV at 505). Therefore, the Commission will adopt Staff's recommendation of $54 million as the maximum amount of delta revenue which ratepayers should be expected to pay in a given year.

However, this will result in a potential differential of up to $6 million per year between the $60 million maximum discount from tariff rates for Ormet and the $54 million maximum in delta revenues which ratepayers can be expected to pay. AEP-Ohio will be authorized to defer this differential, with carrying costs equal to AEP-Ohio's long term cost of debt, during the term of the unique arrangement. During this time, all delta revenue credits attributable to above-tariff payments by Ormet, to be calculated as discussed below, will be first applied to reduce or eliminate the deferral and carrying charges before being applied to AEP-Ohio's economic development rider. At the end of the term of the unique arrangement, AEP-Ohio will be permitted to recover any remaining deferred amounts, including carrying charges, through its economic development rider.

With respect to the adjustments to the floor, or maximum rate discount, the Commission agrees with Staff's recommendation that the unique arrangement be modified to phase down the discount over time. Ormet represents that there are several additional factors that will lower its costs, and in turn the need for rate discounts, over time; these factors include deleveraging through the proceeds raised by asset sales and internally-generated cash (Ormet Ex. 7 at 2) and reductions in Ormet's pension contributions beginning in 2013 (Tr. III at 434-436, 457-458). Therefore, although the $60 million floor will be in effect for calendar years 2010 and 2011, the Commission finds that, for calendar year 2012, the floor should be reduced to $54 million; for calendar years 2013 through 2018, the remaining six years of the contract, the floor should be reduced each year by $10 million, until it phases out completely for calendar year 2018.

The Commission also acknowledges that the aluminum market is subject to a great deal of volatility and that the unique arrangement should address that volatility.

Therefore, for calendar year 2013 through 2018, Ormet may elect to use, in the current year, any unused portion of the floor from a previous year (or years). Ormet shall apply this election by providing written notice to AEP-Ohio and by filing such notice in this docket. For example, if, due to LME prices in 2014, Ormet only uses a discount of $28.75 million, leaving $6 million of the 2014 discount unused, Ormet may elect to increase the floor in calendar year 2015 (or 2016 through 2018) by the $6 million unused discount. In no event will an adjusted floor be permitted to exceed $54 million in any year between 2013 and 2018. This should assist Ormet in weathering any short-term swings in the LME market while ensuring that the floor, or maximum rate discount, phases out over the duration of the unique arrangement.

Second, the Commission notes that the primary purpose of the unique arrangement is to retain jobs rather than to boost worldwide aluminum production or to enrich Ormet's investors. Any rate discounts provided to Ormet must be directly related to Ormet maintaining certain levels of employment. The record in this case demonstrates Ormet cannot continue to employ 900 employees beyond 2009 with curtailed production (Tr. III at 425). Therefore, under the unique arrangement, Ormet will be required to maintain an employment level of full-time employees of 650. Ormet will be required to provide a monthly report to Staff and AEP-Ohio detailing its employment levels. The floor will be reduced each month by $10 million for every 50 employees below 650 full-time employees that were employed by Ormet for the previous month. This reduction will be in addition to any planned phase down of the floor discussed above.

2) Potential Delta Revenue Credits

Kroger argues that the unique arrangement must provide for a greater share in the benefits for AEP-Ohio ratepayers in the event that aluminum prices rise above the target price. Kroger claims that ratepayers are being asked to bear the risk of declining aluminum prices and, therefore, should receive a reasonable return in the event that aluminum prices rebound. Kroger does not believe that a potential five percent gain is sufficient to compensate ratepayers for these risks.

OCC and OEG also allege that, under the proposed unique arrangement, AEP-Ohio's ratepayers bear great risks related to the price of aluminum while receiving little benefit if the price of aluminum rises. OCC and OEG cite to the testimony of OCC witness Ibrahim that the proposed unique arrangement lacks symmetry regarding the risks and benefits born by AEP-Ohio's customers (OCC Ex. 3 at 14-15). OCC and OEG claim that, if aluminum prices double from the price when Dr. Ibrahim filed his testimony, the possible benefit to AEP-Ohio's ratepayers would only be $3.6 million to $8.9 million (OCC Ex. 3 at 15). On the other hand, if the futures price for July 2010 accurately reflects the actual LME price for July 2010, Ormet will be paid $77.1 million to use power in 2010 and ratepayers would be responsible for delta revenues of $281.1 million. OCC and OEG contend that this asymmetry is extremely disadvantageous to AEP-Ohio's ratepayers because these ratepayers will bear huge risks for delta revenues while the benefits are extremely unlikely and minimal compared to the risks. Consequently, OCC and OEG recommend that a reasonable symmetry would require Ormet to pay a rate that exceeds the tariff rate by $0.049 per MWh times 50 percent for each $1 per tonne when the actual LME price exceeds the target price. AEP-Ohio would receive delta revenue credits for the amount that Ormet pays in excess of tariff rates with a maximum delta revenue credit cap of $16.35 million per year.

Ormet contends that the proposed unique arrangement is designed to assure that Ormet is not unreasonably benefitted at the expense of AEP-Ohio's ratepayers. Ormet notes that the unique arrangement is designed to impose the minimum burden on ratepayers by providing for the minimum cash flow necessary to keep its Hannibal facility in operation and pay its required legacy costs; the unique proposed arrangement does not guarantee that Ormet will earn a profit or a particular rate of return. Further, Ormet notes that it has voluntarily offered to pay above-tariff rates when the LME price of aluminum is greater than the target price.

The Commission finds that the unique arrangement, as filed, contains insufficient potential benefits to ratepayers in relation to the risks which Ormet proposes the ratepayers bear. Further, the Commission notes that the record indicates that Ormet will be able to substantially reduce its pension fund obligations beginning in the future (Tr. III at 434-436). However, the Commission finds that this can be addressed by increasing the amounts that Ormet will pay when LME prices exceed the LME target price. Therefore, beginning in 2012, if the LME price is greater than the LME target price, but not more than $300 above the LME target price, Ormet will pay 104 percent of the AEP-Ohio tariff rate rather than 102 percent of the AEP-Ohio tariff rate. Assuming full operations at Ormet's facility, this will increase the Ormet's potential contribution to delta revenue credits to approximately $8.74 million per year from $4.37 million. Further, if the LME price is greater than $300 above the LME target price, Ormet will pay 108 percent of the AEP-Ohio tariff rate rather than 105 percent of the AEP-Ohio tariff rate. This will increase Ormet's potential contribution to delta revenue credits to approximately $17.48 million per year from $10.91 million.

The Commission finds that any amounts paid by Ormet in excess of AEP-Ohio's tariff rates should be considered as delta revenue credits. AEP-Ohio is directed to apply the delta revenue credits first to any deferred amounts, including carrying charges, of delta revenues. Any remaining delta revenue credits should be applied to AEP-Ohio's economic development rider.

3) POLR Charges

OCC and OEG claim that the proposed unique arrangement is unreasonable and unlawful because it compensates AEP-Ohio for POLR charges when Ormet cannot shop under the unique arrangement. Under terms of the proposed unique arrangement, AEP-Ohio would be the exclusive supplier to Ormet's Hannibal facility (Ormet Ex. 8, Attachment A at 8-9; Tr. I at 37; Tr. IV at 484). OCC and OEG reason that, since there is no risk that Ormet will shop generation service while the contract is in effect, there is no risk to AEP-Ohio that it will be called to serve as Ormet's provider-of-last-resort; therefore, a POLR charge should not be assessed upon Ormet, and the other ratepayers should not pay delta revenues for POLR charges.

Kroger also contends that POLR charges should be excluded from the amount of delta revenues recovered by AEP-Ohio. Kroger reasons that, because Ormet will be contractually obligated to receive electricity from AEP-Ohio under the proposed unique arrangement, there is no risk to AEP-Ohio that Ormet will purchase electricity from an alternative electric service supplier. Kroger claims that, under the proposed unique arrangement, AEP-Ohio would still receive compensation for being the POLR supplier without incurring POLR costs. Further, Kroger believes that AEP-Ohio should be required to share the cost of any discount to Ormet since AEP-Ohio benefits financially from continued Ormet operations.

AEP-Ohio argues that the POLR charges authorized in its electric security plan should not be reduced. AEP-Ohio notes that the policy of the State is to promote competitive generation markets and customer choice. Section 4928.02, Revised Code. AEP-Ohio believes that any Commission order keeping Ormet's load out of the competitive markets for ten years would conflict with that policy. Further, AEP-Ohio contends that the Commission has already determined, in its electric security plan proceeding, that a customer should not be able to give up its statutory right to obtain service from a competitive supplier in exchange for avoiding the POLR charge. Instead, the only opportunity for a customer to avoid the POLR charge is to switch to a competitive supplier and agree to pay market rates for generation upon any return to the electric utility. *In re Columbus Sothern Power Co. and Ohio Power Co.*, Case No. 08-917-EL-SSO et al., Opinion and Order (March 18, 2009) at 40.

The Commission finds that, under the terms of the unique arrangement, AEP-Ohio will be the exclusive supplier to Ormet (Tr. I at 37-38; Tr. IV at 484). Therefore, there is no risk that Ormet will shop for competitive generation and then return to AEP-Ohio's POLR service. If AEP-Ohio were to retain these charges, AEP-Ohio would be compensated for a service it would not be providing. Moreover, our decision in the AEP-Ohio electric security plan is inapplicable to this case because that holding addressed customers receiving service under AEP-Ohio's standard service offer rather than a customer receiving service under a unique arrangement specifically approved by the Commission. Therefore, the Commission finds that the unique arrangement should be modified such that any POLR charges paid by Ormet are used to reduce the AEP-Ohio's ratepayers' obligations under the unique arrangement. During the term of the unique arrangement, AEP-Ohio shall credit any POLR charges paid by Ormet to its economic development rider in order to reduce the impact of the unique arrangement on other ratepayers' bills.

4) Deposit and Advance Payment Provisions

IEU-Ohio observes that the proposed unique arrangement would shift all risk of a potential default by Ormet to AEP-Ohio's customers by relieving Ormet of its current obligation to provide a security deposit as long as AEP-Ohio is permitted to treat any defaulted amounts as delta revenue to be recovered from its customers (Ormet Ex. 8, Attachment A at 14). IEU-Ohio argues that there is no real offset to the costs as a result of shifting the default risks to the other ratepayers and that this is part of the excessive burden placed upon AEP-Ohio's ratepayers under the proposed unique arrangement.

Ormet claims that all it is seeking with respect to deposit and advance payment terms is a return to standard tariff terms (Tr. I at 124, 227). Ormet believes that these terms will benefit AEP-Ohio's other ratepayers. Ormet notes that the calculation of the rate that Ormet can afford to pay is based on the assumption that the cash deposit currently held by AEP-Ohio will be returned to Ormet, thereby increasing its cash flow. If this deposit is not returned, it will result in increasing the magnitude of the discount required and in increasing the delta revenues to be collected from ratepayers. Thus, Ormet claims that, if the deposit is returned, the certainty of lower delta revenues would offset any potential risk of default.

AEP-Oho argues that the provisions in the proposed unique arrangement regarding waiver of deposit and advanced payment should not be modified. AEP avers that any modification would jeopardize the ability of AEP-Ohio to recover any unpaid amounts.

The Commission finds that the provisions related to deposit and advance payments should not be modified. The record clearly demonstrates that these provisions are an essential element of the proposed unique arrangement (Ormet Ex. 11A at 3, 4). Further, the record also demonstrates that Ormet has curtailed its operations, which will result in less ratepayer exposure to the risk of default by Ormet.

5) Future Review of the Proposed Unique Arrangement

In addition, IEU-Ohio claims that the proposed unique arrangement would prohibit the Commission and other stakeholders from seeking to modify the unique arrangement, except in very limited circumstances, while allowing Ormet to request modifications that would further benefit Ormet. Likewise, OCC and OEG claim that the proposed unique arrangement would unlawfully limit the Commission's jurisdiction to review and modify the agreement. Kroger also states that the Commission must have the ability to periodically review and, if necessary, modify the unique arrangement. Further, Kroger claims that ten years is an unreasonable amount of time to expose ratepayers to the risk and cost of a unique arrangement; thus there must be a reasonable time limit on the unique arrangement. Staff agrees that there should be some limit upon the length of the unique agreement. Thus, Staff believes that there should be periodic reviews of whether the unique agreements should continue.

The Commission believes that the provisions contained in the proposed unique arrangement for future review will be adequate to safeguard ratepayers from undue risks if supplemented by an additional, independent provision. The Commission notes that Ormet has repeatedly, throughout this proceeding, represented to the Commission its belief that, in the long-term, LME prices will recover sufficiently for Ormet to profitably operate. Ormet has disparaged the use of futures prices by OCC and OEG to predict future LME prices and has argued instead that the Commission should rely instead upon an analyst report which predicts a future rise in LME prices (Ormet Ex. 9 at 14).

Therefore, the Commission will modify the unique arrangement to provide an additional, independent, termination provision in the event that long-term LME prices do not recover as Ormet predicts. The Commission, above, has determined that, for calendar years 2010 and 2011, AEP should be permitted to defer for future recovery the differential between the floor, or maximum discount, of $60 million and the ceiling of $54 million. The Commission will modify the proposed unique arrangement to allow the Commission to terminate, by order, the unique arrangement if Ormet does not begin to reduce the amount of the accumulated deferrals, and carrying charges, through the payment of above-tariff rates, pursuant to the terms of the unique arrangement, by April 1, 2012. The Commission specifically notes that the crediting of POLR charges by AEP in the form of delta revenue credits shall not constitute the payment of above-tariff rates by Ormet for purposes of this termination provision. Unless otherwise ordered by the Commission, such termination shall be effective immediately upon issuance of a Commission order terminating the unique arrangement.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

(1) On February 17, 2009, Ormet filed an application pursuant to Section 4905.31, Revised Code, to establish a unique arrangement with AEP-Ohio for electric service to its aluminum-producing facility located in Hannibal, Ohio.

(2) Ormet filed an amended application on April 10, 2009.

(3) Comments regarding Ormet's application and amended application were filed by IEU-Ohio, OEG, and Kroger.

(4) Based upon the comments, the attorney examiner set this matter for hearing before the Commission.

(5) The hearing in this matter commenced on April 30, 2009, and concluded on June 17, 2009.

(6) The amended application is reasonable and should be approved as modified by the Commission.

ORDER:

It is, therefore,

ORDERED, That the amended application for a unique arrangement filed by Ormet be approved as modified by the Commission. It is, further,

ORDERED, That Ormet and AEP-Ohio file an executed power agreement in this docket that conforms to the modifications ordered by the Commission. It is, further,

ORDERED, That the approved unique arrangement shall be effective for services rendered following the filing in this docket of an executed power agreement. It is, further,

ORDERED, That AEP-Ohio be authorized to defer delta revenues for the remainder of calendar year 2009 and for calendar years 2010 and 2011, to the extent set forth in this Opinion and Order. It is, further, ORDERED, That a copy of this Opinion and Order be served upon all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Paul A. Centolella

Ronda Hartman Fergus

Valerie A. Lemmie

Cheryl L. Roberto

GAP:ct

Entered in the Journal
JUL 15 2009

Reneé J. Jenkins
Secretary