ORIGINAL

IN THE SUPREME COURT OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company For Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	: Case No. 2011-0751 : : Appeal from the Public Utilities : Commission of Ohio : : Public Utilities : Commission of Ohio : Case No. 10-1261-EL-UNC

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BRIEF OF INDUSTRIAL ENERGY USERS-OHIO

On March 18, 2009, the Public Utilities Commission of Ohio (Commission) issued an order modifying and approving electric security plans ("ESP") for Columbus Southern Power Company ("CSP") and Ohio Power Company ("OP") (collectively, "Companies" or "AEP-Ohio"). Pursuant to the modified and approved ESPs, OP and CSP significantly increased their standard service offer ("SSO") rates and charges as their customers were attempting to address the challenges of the Great Recession. As the Court subsequently held in *In re Application of Columbus Southern Power Co.*,[1] the rate increases were unlawful in several respects, and as the evidence in the proceeding below demonstrated, it was clear at the time when the Commission authorized the unlawful and significant increases that the increases would yield very high profits (expressed as a return on common equity) to at least CSP.[2]

The Commission's authority to approve SSO rates in the form of an ESP is contained in Section 4929.143, Revised Code. Once an ESP is approved, Section 4928.143(F), Revised Code, requires the Commission (1) to annually conduct a review of an ESP to determine if the ESP provided the electric distribution utility ("EDU") with a "significantly excessive" earned return on common equity; and, (2) to prospectively return the excess to customers if the EDU is unable to prove that the ESP did not yield a significantly excessive earned return on common equity,. In other words, the General Assembly requires the Commission to test the results of an ESP and to affirmatively rebalance the economic relationship between an EDU and its customers if an ESP yields significantly excessive profits.

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[1] *In re Application of Columbus Southern Power Co.*, 128 Ohio St.3d 512 (2011).

[2] Tr. Vol. II at 386 (IEU-Ohio Supp. at 179).

This appeal stems from the proceedings initiated by the Commission to determine if each EDU's 2009 return on common equity from the ESP was significantly excessive. In some measure, the General Assembly gave the Commission the opportunity to put right some portion of the wrong that occurred when the Commission authorized ESPs for OP and CSP. The Commission, however, let the full scope of this opportunity pass because it failed to hold each EDU accountable based on the measurement standard contained in Section 4928.143(F), Revised Code. Instead of focusing on each EDU's earned return from the ESP as required by the General Assembly, the Commission allowed OP and CSP to test their 2009 financial performance based on the total company earned return on common equity from all (retail, wholesale, affiliated, regulated and non-regulated) lines of business. Because the Commission failed to evaluate the EDUs and their ESPs based on the earned return on equity standard set forth in Section 4928.143(F), Revised Code, the resulting order is unlawful and unreasonable.

Because the Commission's order is unlawful and unreasonable, the Industrial Energy Users-Ohio ("IEU-Ohio") brings this appeal and urges the Court to reverse the Commission's order and issue a remand order directing the Commission to conduct the review for each EDU that is required by Section 4928.143(F), Revised Code, based upon the required earned return on equity measurement standard.

BACKGROUND AND STATEMENT OF FACTS

In 1999, the General Assembly began the process of introducing competition in the provision of retail electric service in Ohio with the adoption of Senate Bill 3. As the Court has noted elsewhere, "[f]aced with a lack of competition, rising electricity prices, and unpalatable market-based rates, the commission and utilities responded with various rate plans not expressly contemplated by statute."[3] Following a warning by the Court that legislative intervention might be required, the General Assembly adopted SB 221.[4]

In setting the price of the SSO, SB 221 created two options.[5] The first, the market rate offer ("MRO"), established a price for default service by starting with an existing regulated price and blending in over several years the results of competitively bid and purchased power.[6] The alternative, an ESP, required the EDU to provide provisions relating to the supply and pricing of electric generation service and permitted the EDU to seek other provisions to address recovery of fuel and purchased power costs, recovery of new construction costs, and other matters.[7]

SB 221 also provided two checks on the revenues that an EDU could recover under an ESP. First, the Commission had to determine that the ESP was "more favorable in the aggregate as compared to the expected results that would otherwise apply" under an MRO before the Commission could approve an application for an ESP.[8] Second, the Commission was directed to determine annually if an approved ESP produced an earned return on common equity of the EDU that was significantly in excess of the return on common equity by other publicly traded companies, including utilities, that face comparable business and financial risk.[9] To the extent

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[3] *In re Application of Columbus Southern Power Co.*, 128 Ohio St.3d 512, 513 (2011).

[4] 2008 Am. Sub. S.B. No. 221.

[5] Section 4928.141, Revised Code (IEU-Ohio Appx. at 175). The SSO is the default rate for customers who take retail generation service from the EDU or who return to the EDU after taking service from a competitor.

[6] Section 4928.142, Revised Code (IEU-Ohio Appx. at 176-178).

[7] Section 4928.143(B), Revised Code (IEU-Ohio Appx. at 179-182).

[8] Section 4928.143(C), Revised Code (IEU-Ohio Appx. at 180-181).

[9] Section 4928.143(F), Revised Code (IEU-Ohio Appx. at 182).

that an EDU was found to have significantly excessive earnings, the Commission was directed to order the significantly excessive earnings returned to customers.[10] This annual earnings review has become known as the Significantly Excessive Earnings Test or SEET.

On March 18, 2009, the Commission approved ESPs for CSP and OP.[11] The evidence in the ESP proceeding provided a strong indication that the Commission's authorization of significant rate increases (for some things that the Court has since ruled were unlawfully authorized[12]) was going to produce significantly excessive earnings for CSP. As recounted in the proceeding below, the ESP evidence demonstrated that CSP was earning a very high return on equity prior to the very significant rate increases that the Commission authorized in the *2009 ESP Case*. As one witness testified, it was very predictable that CSP would be earning even higher returns on equity once the Commission approved the ESP.[13]

On September 1, 2010, CSP and OP filed their Application for the first excessive earnings review for the 2009 calendar year. Appellant Industrial Energy Users-Ohio ("IEU-Ohio") filed and was granted intervention in the case. Several other parties also intervened, and AEP-Ohio, a group of intervenors identified in the Opinion and Order as the Customer Parties[14]

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[10] *Id.*

[11] *In the Matter of the Application of Columbus Southern Power Co. for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917 *et al.*, Opinion and Order (Mar. 18, 2009), *aff'd in part, rev'd in part, and remanded, In re Application of Columbus Southern Power Co.*, 128 Ohio St.3d 512 (2011) ("*2009 ESP Case*").

[12] *In re Application of Columbus Southern Power Co.*, 128 Ohio St.3d 512 (2011).

[13] Tr. Vol. II at 386 (IEU-Ohio Supp. at 179).

[14] *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section*

and the Commission's Staff presented testimony. After a four-day hearing in which IEU-Ohio repeatedly raised its concern about the failure of CSP and OP to provide the Commission with the information necessary to perform the SEET properly, the Commission issued its Opinion and Order on January 11, 2011.[15] IEU-Ohio filed a timely Application for Rehearing, again identifying for the Commission the failure of the Companies to present a case that complied with the statutory requirements and identifying the failure of the Commission to implement the SEET properly.[16] The Commission denied the Application, and IEU-Ohio filed a timely Notice of Appeal.[17]

Simply stated, Section 4928.143(F), Revised Code, directs the Commission to determine whether return on common equity for the EDU that resulted from the ESP was significantly excessive.[18] The first part of the SEET determination is a calculation of the return on average common equity of the EDU for adjustments of provisions resulting from the ESP. An EDU is

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4928.143(F), Revised Code, and Rule 4901:1-35-10, Administrative Code, Opinion and Order (Jan. 11, 2011) at 3 (IEU-Ohio Appx. at 36) (hereinafter "Opinion and Order") (ICN 56). The Customer Parties were the Ohio Consumers' Counsel, Ohio Manufacturers' Association, the Ohio Hospital Association, the Ohio Energy Group, and Appalachian Peace and Justice Network.

[15] IEU-Ohio Appx. at 34.

[16] IEU-Ohio Appx. at 7.

[17] IEU-Ohio Appx. at 1.

[18] The statutory language is complex: "With regard to the provisions that are included in an electric security plan . . . following the end of [the first] annual period of the plan, if any such adjustments [of the ESP] resulted in excessive earnings as measured by whether the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate." Section 4928.143(F), Revised Code (IEU-Ohio Appx. at 182).

defined by statute to be an electric utility that may be engaged in multiple lines of business including the provision of service under an SSO such as an ESP.[19] Return on common equity is a ratio of earnings divided by shareholders' common equity.[20] Only after the proper return on common equity was calculated could the Commission determine if the return was significantly excessive.

The prefiled and oral testimony by the Companies and various intervenors foretold the problems that would emerge in the Commission's Opinion and Order. The Companies presented three witnesses: Thomas Mitchell, Joseph Hamrock, and Dr. Anil Makhija. The Companies sought to demonstrate that they did not have excessive earnings by providing a statistical test that would have resulted in no finding of significantly excessive earnings unless a total company income exceeded twenty-two percent, an approach which the Commission found "unrealistic and indefensible."[21]

More importantly for purposes of this appeal, however, the Companies presented a calculation of earnings based upon the FERC Form 1[22] filings of the Companies, but made no

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[19] Section 4928.01(A)(6), Revised Code (IEU-Ohio Appx. at 169) (EDU means an electric utility that supplies at least retail electric distribution service); Section 4928.01(A)(11), Revised Code (IEU-Ohio Appx. at 169) (electric utility means an electric light company that is engaged on a for-profit basis in the business of supplying a noncompetitive retail electric service in this state or in the business of supplying both a noncompetitive and competitive retail electric service in this state); Section 4928.141(A), Revised Code (IEU-Ohio Appx. at 175) (requirement that an EDU supply a standard service offer in the form of either an MRO or an ESP).

[20] The ratio developed by the Companies and used by the various other parties providing testimony was calculated using net income from the FERC Form 1. Companies Ex. 1 at 117-118 (CSP 2009 FERC Form 1) (IEU-Ohio Supp. at 3-4); see Companies Ex. 4, Ex. TEM-1 (IEU-Ohio Supp. at 14-16).

[21] Opinion and Order at 24 (IEU-Ohio Appx. at 57).

[22] The FERC Form 1 is a filing required by federal law that summarizes the total company balance sheet and total company income statement.

demonstration that they were attempting to identify earnings specifically of the EDUs. For example, AEP-Ohio's earned return calculation witness, Mr. Mitchell, did not develop his calculations or opinions based on the understanding that "electric distribution utility" and "electric utility" are defined terms under Ohio law. Prior to the hearing, Mr. Mitchell did not ask if these terms have specific meaning in Ohio.[23] During the hearing and after sponsoring his prepared testimony, he apparently became aware that these terms were defined by Ohio law.[24]

Whether it was because he did not understand the basics of the statutory structure for the SEET or otherwise, the math behind his earned return on equity numbers for 2009 was driven by total company numbers. Working from the FERC Form 1 filings of CSP and OP for all lines of retail and wholesale business, he used $271.5 million and $305.8 million, respectively, to calculate the earned return on common equity for 2009.[25] These 2009 earned return on equity numbers were the total company earned returns for CSP and OP. As he explained, his calculation of the earned return on common equity for 2009 included income from wholesale transactions involving affiliates of OP and CSP and subject to FERC's jurisdiction.[26] In other words, Mr. Mitchell's earned return on common equity calculation produced a 2009 earned return on equity for all lines of CSP and OP business, not the earned return for each EDU as a result of the ESP.[27]

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[23] Tr. Vol. I at 36 (IEU-Ohio Supp. at 131).

[24] Tr. Vol. I at 36-39 (IEU-Ohio Supp. at 131-134).

[25] Companies Exhibit 4, Exhibit TEM-1 (IEU-Ohio Supp. at 14-16).

[26] Tr. Vol. I at 43 (IEU-Ohio Supp. at 137).

[27] Tr. Vol. I at 37-38 (IEU-Ohio Supp. at 132-133).

AEP-Ohio's "cleanup" witness, Mr. Hamrock, confirmed that CSP and OP were engaged in multiple lines of business including nonutility business. He also confirmed that the net income and earned return calculations contained in AEP-Ohio's testimony included income from non-EDU and FERC-jurisdictional activities, including the various pool agreements that allocate costs and revenue among other operating companies affiliated with OP and CSP.[28] Of course, Section 4928.143(F), Revised Code, states "[i]n making its determination of significantly excessive earnings under this division, the commission shall not consider, directly or indirectly, the revenue, expenses or earnings of any affiliate or parent company." In his testimony, Mr. Hamrock also conceded that the total company earned return on equity calculations for OP and CSP include non-jurisdictional activities and gains or losses affecting CSP's and OP's 2009 net income. As he explained, "there are … non-jurisdictional activities and gains or losses that impact CSP's and OPCo's earnings" but that "the Companies did not attempt to fully jurisdictionalize the 2009 earnings."[29]

Like Mr. Mitchell, AEP-Ohio's consultant, Dr. Makhija, provided analysis that was conducted without knowledge that "electric distribution utility" has a specific statutory definition and that this definition must be respected for purposes of the SEET.[30] During cross-examination, he acknowledged that the term "electric distribution utility" is "suggestive of distribution activities" and that the earned return calculations required by the SEET are to be focused on the

[28] Tr. Vol. I at 134, 136-137, 141-152 (IEU-Ohio Supp. at 150, 152-153, 157-168).

[29] Companies Exhibit 6 at 7 (IEU-Ohio Supp. at 22).

[30] Tr. Vol. I at 100-101 (IEU-Ohio Supp. at 143-144).

EDU,[31] but Dr. Makhija was not responsible for calculating the EDU earned return on common equity.[32]

As previously discussed, Mr. Mitchell was responsible for OP's and CSP's earned return on equity calculations and, as documented above, OP's and CSP's earned return on equity calculations were not based on the EDU earnings from the Commission-approved rate plans. Since Mr. Mitchell and Mr. Hamrock used total company numbers to lay a foundation for Dr. Makhija's testimony, Dr. Makhija's opinions also were based on a misapplication of the SEET by the Companies' other witnesses.

Testimony by the Customer Parties followed a similar pattern. The Customer Parties presented two witnesses: Lane Kollen and Professor J. Randall Woolridge. The direct case presented by the Customer Parties was structured so that Mr. Kollen's opinions and recommendations relied significantly on the opinions of Professor Woolridge.[33] Professor Woolridge, however, did not look at OP's earned return on common equity; he limited his analysis to CSP.[34] He did not know that "electric distribution utility" and "electric utility" are defined terms in Ohio.[35] He testified that if there are statutory definitions for these terms, then he did not take them into account for purposes of his SEET analysis.[36]

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[31] Tr. Vol. I at 101-102 (IEU-Ohio Supp. at 144-145).

[32] Tr. Vol. I at 103-104 (IEU-Ohio Supp. at 146-147).

[33] Tr. Vol. II at 385 (IEU-Ohio Supp. at 178).

[34] Tr. Vol. II at 319 (IEU-Ohio Supp. at 172).

[35] Tr. Vol. II at 320 (IEU-Ohio Supp. at 173).

[36] Tr. Vol. II at 320-321 (IEU-Ohio Supp. at 173-174).

Mr. Kollen did not address the SEET as applied to OP, and he did not take issue with Mr. Mitchell's calculation of CSP's earned return[37] even though (as explained above) Mr. Mitchell did not present information on the earned return for each EDU. Like Mr. Mitchell, Dr. Makhija, and Professor Woolridge, Mr. Kollen was, when he offered his testimony, unaware that "electric distribution utility" is a defined term in Ohio.[38] By focusing on the total company numbers for CSP, Mr. Kollen adopted OP's and CSP's erroneous approach to calculating the earned return on equity for purposes of applying the SEET.[39] During cross-examination, Mr. Kollen, like Mr. Hamrock, acknowledged that CSP was engaged in various lines of business (involving generation, transmission and distribution functions) and that he did not know the extent to which each line of business was responsible for the significantly excessive earnings in 2009.[40]

The Commission Staff presented testimony by Richard Cahaan. Like Professor Woolridge, and Mr. Kollen, Mr. Cahaan offered no testimony on the SEET as applied to OP.[41] Like Mr. Mitchell, Dr. Makhija, Professor Woolridge and Mr. Kollen, Mr. Cahaan did not approach his assignment with an understanding that "electric distribution utility" is a defined term in Ohio.[42] Like the other witnesses for the Companies and the Customer Parties, Mr. Cahaan also relied on total company earned return on equity numbers rather than the return

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37 Joint Intervenors Exhibit 2 at 18 (IEU-Ohio Supp. at113).

38 Tr. Vol. II at 387 (IEU-Ohio Supp. at 180).

39 Tr. Vol. II at 387 (IEU-Ohio Supp. at 180).

40 Joint Intervenors Exhibit 2 at 27 (IEU-Ohio Supp. at 118); Tr. Vol. II at 400 (IEU-Ohio Supp. at 189).

41 Tr. Vol. III at 445 (IEU-Ohio Supp. at 194).

42 Tr. Vol. III at 444 (IEU-Ohio Supp. at 193).

earned by each EDU from the ESP during 2009. On cross-examination, he explained his approach:

Q. Now, the numbers that appear at line 11, the net income number –

A. Which page are we on?

Q. Page 19. I'm sorry.

A. Yes, I see it.

Q. The 271.5 million,[43] that would be a total Columbus & Southern Company number?

A. Yes, it would.

Q. Yeah. And when I say "total," as you understand it it's referring to all the various lines of business that Columbus & Southern is in? That would include wholesale, retail, and other.

A. Oh, definitely.[44]

Thus, there was no evidence before the Commission in the proceeding below that identified the return on common equity earned by each EDU as a result of the ESP. Absent such evidence, it is impossible for the Commission to apply the SEET as required by Section 4928.143(F), Revised Code.

Some parties did propose selective adjustments to the total company earned returns and common equity balances. To reduce the total company earned returns on equity and manage the SEET risks, for example, the Companies proposed to remove revenues associated with off-system sales ("OSS"). OSS are some of the wholesale transactions in which a utility makes a sale of power for resale to a third party; these wholesale transactions, like other lines of business within the total company numbers, take place outside the scope of the ESP and the

[43] The $271.5 million net income in Mr. Cahaan's testimony is the same total company net income number identified in Mr. Mitchell's testimony.

[44] Tr. Vol. III at 474-75 (IEU-Ohio Supp. at 202-203).

Commission's jurisdiction.[45] The Commission agreed with the Companies' selective removal of the OSS revenues for the purpose of applying the SEET, but also made its own selective adjustment to the total company common equity balances.[46] Based on the testimony of the Staff's witness, Richard Cahaan, the Commission also reduced the total company common equity balances which he attributed to the investment in generation assets he associated with OSS.[47]

Beyond the reliance on total company numbers in all other respects, Mr. Cahaan's selective adjustment to the total company common equity balances was incomplete, arbitrary and unreasonable. As Mr. Cahaan explained in response to cross-examination, his adjustment to the total company equity balances was based on an incorrect assumption that only generation assets are involved in wholesale transactions.[48] As the Companies acknowledge, it is not possible to sell generation supply without also using transmission assets to deliver the generation supply.[49] For every generation transaction, there is a transmission transaction. Thus, the Staff's adjustment to the total company common equity balances neglected a necessary step if one wanted to properly identify the adjustment that must be made to the total common equity

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[45] *2009 ESP Case*, Opinion and Order at 17 (IEU-Ohio Appx. at 106).

[46] Opinion and Order at 27, 29-30 (IEU-Ohio Appx. at 60, 62-63) (ICN 56).

[47] Opinion and Order at 28 & 30 (IEU-Ohio Appx. at 61 & 63) (ICN 56). Mr. Cahaan calculated the percentage of rate base listed on the FERC Form 1 that is applicable to generation. He then calculated the percentage of revenue of OSS to total sales and used that to allocate the percentage of generation plant that was used for OSS. Once he determined that percentage, he reduced the average total common equity of CSP by that percentage. *Id.* at 28 (IEU-Ohio Appx. at 61) (ICN 56).

[48] Tr. Vol. III at 475 (IEU-Ohio Supp. at 203).

[49] Tr. Vol. I at 147 (IEU-Ohio Supp. at 163).

balances (the denominator in an earned return on equity calculation) as a result of eliminating the effects of OSS revenue from the numerator. Because all of the OSS revenue was removed from the numerator, but only a portion of the OSS-related total company common equity balance was removed from the denominator, the earned return on common equity was by definition understated. That is, by failing to properly adjust the denominator by making it smaller to reflect the removal of transmission plant used for OSS, the earned return calculation produced a smaller earned return on equity than if the denominator had properly been adjusted to remove the common equity balance attributable to transmission assets (along with generation assets) used for OSS.[50] (This result would be true for both companies if the same approach had been applied to OP's earned return calculation as it was to CSP's earnings.)

Regardless of the erroneous math associated with the OSS-related adjustments to the numerator and denominator of the earned return calculation, the OSS-related adjustment is the only adjustment to total company data that was even attempted. Even if the OSS-related

[50] A simple example may be helpful. To calculate the adjustment to common equity Mr. Cahaan recommended, one multiplies the percentage of total plant by the ratio of OSS to total income, and then multiplies the resulting percentage by the average total equity. The result is then subtracted from average total equity to give the amount of average total equity attributable to sales other than OSS. If one assumes that total annual income is \$20 and retail income is \$15, in a simple example, OSS sales are \$5. Thus, OSS represents 25% of total income. If one further assumes that the portion of generation plant to produce sales is 50% of total plant and an additional 10% is transmission plant with total average common equity of \$100, then Mr. Cahaan's approach produces the following adjustment to common equity: .5 x .25 x \$100 = \$12.50. Average total equity attributable to retail income is \$100 - \$16.50 = \$87.50. If transmission plant is taken into consideration, however, the adjustment to common equity is calculated as follows: .6 x .25 x \$100 = \$15. Average total equity then is \$100 - \$15 = \$85. Return on average common equity is approximately 17.1%. The first incomplete calculation overstates the common equity by \$2.50 (\$87.50 - \$85). Return on average common equity is approximately 17.6%. Because the earnings per share (net income divided by average total common equity) is inversely related to the size of the denominator, Mr. Cahaan's failure to include the transmission adjustment effectively, and always, will understate earnings.

adjustment had been mathematically correct (and it was not), the adjustment does not, in any event, result in an identification of the EDU earned return on equity arising from the ESP.

Throughout the hearing, IEU-Ohio repeatedly brought the concerns raised in this appeal to the attention of the Commission.[51] Despite the legal problems evident in the earned return math relied upon by the Companies and other parties, including the Commission's Staff, the Commission rejected IEU-Ohio's motion to dismiss and arguments on brief supporting the motion, finding that it could rely upon total company data in lieu of the EDU earned return on equity data that is required by the SEET. The Commission stated:

> Rather, we find that it is acceptable to make appropriate adjustments to FERC Form 1 data in order to develop an earned ROE for SEET. In making this determination, we note that, under applicable provisions of Section 4928.01, Revised Code, and under Section 4905.03, Revised Code, an electric utility is not limited to a subset of a firm's activities that may be regulated under an ESP. Additionally, the definition of an electric light company explicitly covers firms engaged in both activities subject to rate regulation by this Commission and activities such as transmission that are, in large part, subject to federal jurisdiction. Thus, while adjustments to FERC Form 1 data may be appropriate to isolate the effects on ROE of the adjustments in the ESP under review, the SEET, in the first instance, may be measured based upon the return of common equity of the electric utility viewed as a company without a complete jurisdictional cost and revenue allocation study.[52]

Thus, the Commission rejected the need to identify the specific ESP-related earned return on common equity arising from the ESP of CSP and OP and instead adopted selective, arbitrary and unreasonable adjustments to the total company data.

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[51] Tr. Vol. 1 at 18-25 (IEU-Ohio Supp. at 207-214); Tr. Vol. IV at 746-47 (IEU-Ohio Supp. at 215-216).

[52] Opinion and Order at 13 (IEU-Ohio Appx. at 46) (ICN 56).

Despite a legally defective reliance on total company data, the failure to remove revenue, expenses and earnings associated with affiliate or parent company transactions, and a failure to identify the EDU's earned return on common equity arising from the ESP, the Commission concluded that OP carried its burden of proof regarding the SEET. Nowhere in the Commission's decision did the Commission identify the return on common equity that OP earned as an EDU from the ESP during 2009.[53] In the case of CSP, however, the Commission found (as Mr. Kollen had previously predicted in the ESP proceeding[54]) that the 2009 earned return on common equity was 20.84%.[55] Because the 2009 earned return on common equity for CSP substantially exceeded the "safe harbor" adopted by the Commission, the Commission proceeded to analyze whether the 2009 earned return was significantly excessive. With the selective, unreasonable and unbalanced adjustments to the numerator and denominator as a result of the OSS-related line of business only, the Commission found that CSP's 2009 earned return on common equity was 19.73%,[56] and determined that a return greater than 17.6% percent was significantly excessive.[57] Then, the Commission ordered CSP to return to customers $42.683 million.[58] Nowhere in the Commission's decision did the Commission identify the 2009 return on equity earned by CSP under the ESP as an EDU.

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[53] *Id.* at 22 (IEU-Ohio Appx. at 55) (ICN 56).

[54] Tr. Vol. II at 386 (IEU-Ohio Supp. at 179).

[55] *Id.* at 22 (IEU-Ohio Appx. at 55) (ICN 56).

[56] *Id.* at 30 (IEU-Ohio Appx. at 63) (ICN 56).

[57] *Id.* at 27 (IEU-Ohio Appx. at 60) (ICN 56).

[58] *Id.* at 35 (IEU-Ohio Appx. at 68) (ICN 56).

Much of the focus of the evidence in the Commission proceedings was on CSP because of CSP's very rich 2009 earned return numbers. In contrast, the Commission's obligation to apply the mandated SEET to OP was for the most part brushed aside based on a casual review of total company numbers and a customer-unfriendly reading of Section 4928.143(F), Revised Code. More careful consideration of OP's ESP-related earned return, however, was warranted. For example, on cross-examination, Mr. Cahaan described the structure of AEP and how CSP and OP fit within AEP's holding company structure. He testified that AEP owns all the common equity of CSP and OP; CSP and OP pay common stock dividends to their parent corporation (AEP); and excessive earnings yield a greater facility to pay such dividends. He observed that OP's dividend pattern is not that of an independent company and that the same dividend pattern has the effect of depressing OP's earned return on common equity.[59]

The evidence also demonstrated that there are strong reasons to believe that the required examination of the EDU returns on common equity arising from the ESPs would show that the retail jurisdictional lines of business generated an earned return on common equity numbers well above the total company earned return on common equity. The evidence showed that even though the costs of providing generating and transmission service are shared throughout the AEP-East system, the retail rates in Ohio tend to be the highest among all the AEP-East operating companies which include OP and CSP.[60] Likewise, the record also included information for each of the AEP-East operating companies' total-company earned returns on common equity for 2009 as well as estimated returns for 2010 and 2011; the Ohio-based

[59] Tr. Vol. III at 451-52 (IEU-Ohio Supp. at 198-199).

[60] IEU-Ohio Exhibit 3 from a presentation that AEP made on June 23, 2010 showed residential rate comparisons for the AEP-East operating companies for 2009. IEU-Ohio Ex. 3 at 8 (IEU-Ohio Supp. at 82).

companies, CSP and OP, provided generally higher returns on equity.[61] As Mr. Kollen explained, higher returns on common equity generally indicate higher electric rates.[62]

AEP presentations such as the one designated as IEU-Ohio Exhibit 3 also contained information on the relative levels of "gross margin"[63] that various AEP business units achieved in 2009.[64] The gross margin data showed that the "Ohio Companies" (CSP and OP) provided a gross margin of $57.6 per megawatt hour ("MWh") in 2009 and were expected to provide $63.6 per MWh in 2010. The actual per MWh 2009 gross margin from the Ohio-based companies was 51% higher than the per MWh gross margin from the balance of the AEP-East operating companies. The next highest gross margin number anywhere within AEP was $38 per MWh from the balance of the AEP-East Companies. In 2009, OP and CSP accounted for about 41% of combined Ohio companies and AEP-East companies GWh sales but over 51% of the comparable gross margin revenue.

In summary, the record in this case demonstrated four important points. First, the evidence the Commission used to apply the SEET was based on total company rather than ESP-specific and EDU-specific data. The Commission did not determine the EDU-earned return on common equity arising from the ESP. Second, and contrary to the requirements of Section 4928.143(F), Revised Code, the evidence which the Commission used to apply the SEET

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[61] IEU-Ohio Exhibit 2 at 36, 38, 40, and 46 (IEU-Ohio Supp. at 59, 61, 63, and 69). AEP-East includes CSP, OP, Appalachian Power Co., Wheeling Power Co., Kentucky Power Co., and Indiana Michigan Power Co. *Id.*

[62] Tr. Vol. II at 392-393 (IEU-Ohio Supp. at 182-183).

[63] "Gross margin" is revenue less related direct cost of fuel including consumption of chemicals and emission allowances and purchased power. Tr. Vol. II at 395 (IEU-Ohio Supp. at 185).

[64] IEU-Ohio Exhibit 3 at 10 (IEU-Ohio Supp. at 84).

included revenue, expenses and earnings associated with transactions involving the parent or affiliated companies. Third, the modifications made to CSP earnings for OSS, even when further modified by the Commission Staff's witness, did not and could not properly adjust the calculation. Fourth, the evidence regarding the relative profitability of the Ohio retail operations indicated that the total company return on common equity numbers relied upon by the Commission are helping OP and CSP hide the actual profitability of their Ohio retail business *via* the ESPs and thereby depriving Ohio consumers of the protection which the General Assembly provided through the SEET. Taken together with the statutory requirements discussed below, these points demonstrate that the Commission's application of the SEET to OP and CSP for 2009 was unlawful and unreasonable.

STANDARD OF REVIEW

In this proceeding, the Court has "complete and independent power of review of all questions of law."[65] With regard to the Commission's determinations of issues of fact, the Court "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."[66] However, as the Court recently noted in a case addressing the CSP and OP ESP that generated the earned returns under review in this case, "[r]uling on an issue without record support is an abuse of discretion and reversible

[65] *Ohio Edison Co. v. Pub. Util Comm'n,* 78 Ohio St.3d 466, 469 (1977).

[66] *Cincinnati Gas & Elec. Co. v. Pub. Util. Comm'n,* 96 Ohio St.3d 53, 58 (1999).

error."[67] Moreover, the Commission "must explain its rationale, respond to contrary positions, and support its decision with appropriate evidence."[68]

ARGUMENTS

PROPOSITION OF LAW NO. I:

> **The Opinion and Order was unlawful and unreasonable because the Commission failed to follow the legal standard required by Section 4928.143(F), Revised Code, to apply the significantly excessive earnings test.**

PROPOSITION OF LAW NO. II:[69]

> **The Opinion and Order was unlawful and unreasonable because the Commission found that the significantly excessive earnings test may be measured based upon the total company return on common equity rather than the electric distribution utility's earned return on common equity from the Electric Security Plan.**

Section 4928.143(F), Revised Code, provides the legal basis for the SEET. That division states:

> With regard to the provisions that are included in an electric security plan under this section, the commission shall consider, following the end of each annual period of the plan, if any such adjustments resulted in excessive earnings as measured by whether the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate. Consideration also shall be given to the capital requirements of future committed investments in this state. The burden of proof for demonstrating that significantly excessive earnings did not occur shall be on the electric distribution utility. If

[67] *In re Application of Columbus Southern Power Co.*, 128 Ohio St.3d 512, 519 (2011).

[68] *Id.*

[69] Because Proposition of Law I and II present related issues and are supported by the same legal argument, they are presented together.

> the commission finds that such adjustments, in the aggregate, did result in significantly excessive earnings, it shall require the electric distribution utility to return to consumers the amount of the excess by prospective adjustments; provided that, upon making such prospective adjustments, the electric distribution utility shall have the right to terminate the plan and immediately file an application pursuant to section 4928.142 of the Revised Code. Upon termination of a plan under this division, rates shall be set on the same basis as specified in division (C)(2)(b) of this section, and the commission shall permit the continued deferral and phase-in of any amounts that occurred prior to that termination and the recovery of those amounts as contemplated under that electric security plan. In making its determination of significantly excessive earnings under this division, the commission shall not consider, directly or indirectly, the revenue, expenses, or earnings of any affiliate or parent company.

Section 4928.143(F), Revised Code, requires an EDU to demonstrate that it did not have significantly excessive earnings during the ESP year under review. The EDUs failed to satisfy this burden because they failed to identify each EDU's earned return on equity arising from the ESP. Indeed, there is no evidence in the record before the Commission that identifies each EDU's 2009 earned return on equity arising from the ESP. Because OP and CSP failed to meet this burden, IEU-Ohio moved to dismiss, without prejudice, the SEET filings made by each EDU.[70] The Commission denied IEU-Ohio's motion to dismiss and the legal error committed by the Commission in denying such motion is the main source of the issues raised by this appeal.

As provided in Section 4928.143(F), Revised Code, the SEET is confined to the earned returns of the EDU as a result of the ESP by three specific references. First, the review of earned return on common equity is limited to "the provisions that are included in an electric security plan under this section."[71] Second, this limit to a review of the ESP earned return on equity is

[70] Tr. Vol. 1 at 18-25 (IEU-Ohio Supp. at 207-214); Tr. Vol. IV at 746-47 (IEU-Ohio Supp. at 215-216.).

[71] Section 4928.143(F), Revised Code (IEU-Ohio Appx. at 182).

reemphasized later in the division in that it directs the Commission to determine if "any such adjustments [from the ESP] resulted in excessive earnings."[72] Finally, in a third reference to the ESP, the division directs that the Commission shall order a return of any excess to customers if the Commission "finds that such adjustments, in the aggregate, ...result in significantly excessive earnings."[73]

Additionally, the earned return that the Commission must identify and evaluate for purposes of the SEET is that of the EDU. [74] Under Section 4928.143(F), Revised Code, the Commission is directed to consider if the EDU earned significantly excessive returns. If the EDU earns significantly excessive earnings, the Commission is directed to order the EDU to return the excess to customers. Finally, it is the EDU that has the right to terminate the ESP if it wishes to after being ordered to return significantly excessive earnings. Thus, every reference to the entity that is being reviewed is to an EDU.

If there were any doubt about the General Assembly's intention to focus the Commission's review on the earned return on common equity of the EDU as it relates to the ESP, the definition of the SEET draws a distinction between the service provided by the ESP and the recognition in the definition of an EDU that it may be engaged in other lines of business;[75] only the former are under review in the SEET. Further, the last sentence of Section 4928.143(F),

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[72] Section 4928.143(F), Revised Code (IEU-Ohio Appx. at 182).

[73] *Id.*

[74] Section 4928.01, Revised Code, defines "electric distribution utility" as an "electric utility" that supplies retail electric distribution service and defines an "electric utility" as an "electric light company"; the entity that has an Ohio certified territory and also provides retail service in Ohio (IEU-Ohio Appx. at 169).

[75] As noted previously, an EDU is defined as an electric utility which may be engaged in both competitive and noncompetitive lines of business. See note 17 *supra*.

Revised Code, states, "In making its determination of significantly excessive earnings under this division, the commission shall not consider, directly or indirectly, the revenue, expenses, or earnings of any affiliate or parent company."

Two conclusions can be drawn from the language of Section 4928.143(F), Revised Code. First, the application of the SEET is focused on the earned return on common equity from the ESP. Second, the review is focused on the EDU's earned return on equity. These conclusions are the purposeful result of the General Assembly's effort to manage the risk of an ESP that is significantly and excessively unbalanced in favor of an EDU relative to its retail customers. More bluntly stated, there is no way for a SEET to protect consumers against the excesses of an ESP unless it is focused on the EDU's earned return on equity from the ESP. A SEET of the type applied by the Commission—a SEET that uses the composite and consolidated total company earned return for all lines of regulated and unregulated businesses that reside within OP and CSP—is a SEET that permits an EDU to hide its Ohio-ESP earned return on equity under a total company barrel. Unfortunately, the Commission's application of the SEET for 2009 for both OP and CSP ignored the requirements of Section 4928.143(F), Revised Code, and thereby evaded the consumer protections established by the General Assembly.

There is no argument at this stage of the proceedings that the Commission did not limit its review to the EDU's earned return on equity from the ESP. For both Companies, the Commission began with FERC Form 1 total company data. In the case of OP, however, the Commission's application of the SEET involved unadjusted total company data, and based on this irrelevant and unlawful total company data, the Commission unlawfully concluded that OP passed the SEET.[76] In the case of CSP, however, the Commission applied an adjustment for

[76] *Id.*

OSS in a selective and unbalanced way unfavorable to customers.[77] As explained earlier, the selective adjustments to CSP's 2009 earned return on equity were unbalanced and unreasonable because they did not fully account for the change in the equity balance necessary to recognize that transmission assets (in addition to generation assets) are part of every OSS. (The OSS-related adjustments to CSP's earned return on common equity for 2009 even understated the adjusted total company earned return.[78]) Even under the Companies' misapplied SEET, CSP had a return on equity exceeding 20 percent and almost 20 percent after the incomplete adjustment for OSS.[79]

In an effort to focus the Commission on the correct application of the SEET to OP and CSP, IEU-Ohio moved to dismiss the Companies' SEET filings because they failed to show the 2009 EDU earned return on common equity from the ESP through the jurisdictionalization of net income (the numerator) and the common equity balance (the denominator). But that motion was rejected on a supposed statutory ground. According to the Commission, "[n]owhere in Section 4928.143(F), Revised Code, is a comprehensive jurisdictional allocation study required in order to determine an earned ROE appropriate for use in the SEET."[80] In fact, however, the statute states that the SEET applies to the provisions included in an ESP and based on whether the EDU had significantly excessive earnings as measured by the EDU's earned return on common equity. Thus, as a matter of law, the EDU in the first instance and the Commission thereafter are

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[77] Opinion and Order at 22 (IEU-Ohio Appx. at 55) (ICN 56).

[78] See text accompanying notes 38-42 *supra*.

[79] *Id.* at 22 & 35 (IEU-Ohio Appx. at 55 & 68) (ICN 56).

[80] *Id.* at 13 (IEU-Ohio Appx. at 46).

required to identify the EDU's earned return from the ESP (through a jurisdictionalized or other analysis that disaggregates the EDU's ESP earned return from the composite total company earned return arising from all lines of business). The statute thus requires the Commission to perform a SEET that is EDU and ESP driven.

The Commission apparently recognized that its initial statement that it was not required to have the Companies perform a cost of service analysis would be a problem, because it then proceeded, in the next sentence, to justify an allocation process, stating: "Nor do we find that a comprehensive jurisdictional allocation study is the only manner in which to determine an earned ROE for SEET."[81] At this point, however, the Commission lost its way, both accepting and rejecting the need to identify the effects of the ESP on the EDU's income and equity:

> [W]e find that it is acceptable to make appropriate adjustments to FERC Form 1 data in order to develop an earned ROE for SEET. In making this determination, we note that, under applicable provisions of Section 4928.01, Revised Code, and under Section 4905.03, Revised Code, an electric utility is not limited to a subset of a firm's activities that may be regulated under an ESP. Additionally, the definition of an electric light company explicitly covers firms engaged in both activities subject to rate regulation by this Commission and activities such as transmission that are, in large part, subject to federal jurisdiction. *Thus, while adjustments to FERC Form 1 data may be appropriate to isolate the effects on ROE of the adjustments in the ESP under review, the SEET, in the first instance, may be measured based upon the return of common equity of the electric utility viewed as a company without a complete jurisdictional cost and revenue allocation study.*[82]

In the last sentence quoted above, the Commission confirmed that it was implementing a SEET based on total company data rather than the EDU's earned return on common equity from the ESP. The SEET implemented by the Commission thus conflicts with the requirements of the

[81] *Id.*

[82] *Id.* (emphasis added).

statute, which limits the review to whether "provisions that are included in an electric security plan… resulted in excessive earnings…."[83]

The manner in which the Commission attempted to rationalize its failure to focus on the EDU's earned return from the ESP also demonstrated the Commission's failure to comply with the statutory SEET requirements. The Commission pointed to the fact that the EDU may also be an electric utility engaged in activities other than the provision of default service under an ESP.[84] The fact that an electric utility may engage in other activities, however, pointed to the need to separate these non-EDU lines of business from the EDU business and to focus on the EDU's earned return on common equity from the ESP, as set out in Section 4928.143(F), Revised Code.

By the command of Section 4928.143(F), Revised Code, the Commission has no authority to measure significantly excessive earnings based on total company earnings. The SEET must be applied based on the earned return on common equity achieved by an EDU as a result of an ESP. The Commission did not so apply the SEET. Therefore, the Commission's Opinion and Order is unlawful and must be reversed.

PROPOSITION OF LAW NO. III:

> **If reliance on total company data was lawful and appropriate for purposes of commencing the significantly excessive earnings test analysis, the Opinion and Order was unlawful and unreasonable because the Commission failed to adjust net income and common equity to account fully for the removal of off system sales and other non-jurisdictional effects from the calculation of excessive earnings.**

The Commission's failure to require the Companies to file proper applications for the SEET led to an attempt to "correct the numbers" which itself became patently unreasonable. As

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[83] Section 4928.143(F), Revised Code (first sentence) (IEU-Ohio Appx. at 182).

[84] Opinion and Order at 13 (IEU-Ohio Appx. at 46) (ICN 56).

applied by the Commission, the fixes were a one-sided, selective and unreasonable adjustment to the total company numbers.

The earned return on equity values the Commission used to implement the SEET were based on an incomplete modification of CSP's FERC Form 1 information.[85] CSP's total company net income was reduced by the "net margins" which CSP attributed to OSS.[86] Mr. Mitchell was responsible for the computation performed to remove OSS net margins from CSP's net income (the numerator in the percentage earned return calculation) for 2009, but he was directed to make this adjustment by Mr. Hamrock.[87] In his testimony, Mr. Hamrock claimed that the adjustment to CSP's total company net income to remove "net margins" attributed to OSS was required because the "[o]ff-system-sales margins, which result from wholesale, not retail, transactions, are not the result of a rate adjustment included in CSP's or OPCo's ESP. They result from wholesale transactions approved by the Federal Energy Regulatory Commission (FERC)."[88] Mr. Hamrock also acknowledged, however, that "there are other non-jurisdictional activities and gains or losses that impact CSP's and OPCo's earnings" but that "the Companies did not attempt to fully jurisdictionalize the 2009 earnings... ."[89] The Companies' testimony, therefore, acknowledged that the adjustment to CSP's total company earnings or net income for

[85] The Commission used the total company calculation for OP to conclude that it did not have significantly excessive earnings and did not address any adjustments. *Id.* at 22 (IEU-Ohio Appx. at 55) (ICN 56).

[86] Companies Exhibit 4 at 5 (IEU-Ohio Supp. at 11) (ICN 3).

[87] Companies Exhibit 4 at 3 (IEU-Ohio Supp. at 9) (ICN 3); Companies Exhibit 6 at 6-7 (ICN 2) (IEU-Ohio Supp. at 21-22); Tr. Vol. I at 35-36 (IEU-Ohio Supp. at 130-131).

[88] Companies Exhibit 6 at 6-7 (IEU-Ohio Supp. at 21-22) (ICN 2).

[89] *Id.* at 7 (IEU-Ohio Supp. at 22) (ICN 2).

2009 to remove net margins from OSS was a selective application of AEP-Ohio's theory regarding the relationship between SEET and jurisdictional transactions and that a comprehensive application of this theory was not attempted by AEP-Ohio. (As noted previously, only total company data was submitted by OP for purposes of satisfying its SEET burden.)

The Commission Staff started with CSP's selectively adjusted total company data (the data adjusted to remove net margins from CSP's total company net income number). Mr. Cahaan identified one effect (at least directionally) of CSP's selective application of CSP's theory regarding the relationship between SEET and jurisdictional rate plan transactions. As Mr. Cahaan testified, the theory relied upon by CSP to adjust the numerator (net income available for common shareholders) would require, if adopted, an adjustment to the denominator (the dollar value of common shareholder equity).[90] In making his adjustment, however, he assumed that there was no transmission investment associated with making OSS, an assumption that has no support in the record or anywhere else.[91] While Mr. Cahaan's testimony demonstrated the one-sided and misleading effect of CSP's selective application of its theory, his quantification of the effect of this theory on the denominator (the dollar value of common shareholder equity) relied upon an factually incorrect assumption that disadvantaged customers.

The Commission both recognized the problem and ignored it in its Opinion and Order. In the Opinion and Order, the Commission determined that "while adjustments to FERC Form 1 data may be appropriate to isolate the effects on ROE of the adjustments in the ESP under review, the SEET, in the first instance, may be measured based upon the return of common equity of the electric utility viewed as a company without a complete jurisdictional cost and

[90] Staff Exhibit 1 at 19-21 (IEU-Ohio Supp. at 124-126) (ICN 22).

[91] Tr. Vol. III at 477 (IEU-Ohio Supp. at 205); Tr. Vol. I at 137 (IEU-Ohio Supp. at 153).

revenue allocation study."[92] After seemingly acknowledging that adjustments could be made, however, the Commission limited its adjustments to those regarding OSS proposed by Mr. Cahaan, even though Mr. Cahaan himself noted that he had not included an adjustment to equity to transmission plant used for OSS. The Commission made no other adjustments to total company income other than the adjustment for OSS despite being aware that the Companies were engaged in other lines of business that operated outside the ESP.[93] Moreover, the failure to decrease equity for transmission plant serving OSS lowered the calculated percentage earnings and was biased in favor of the EDU.[94]

Two conclusions can be drawn from the Commission's decision regarding the attempt to adjust total company income and common equity. First, the Commission did not make the adjustments that would remove from total company income all the effects of the wholesale and non-ESP retail activities of the EDU, in this instance CSP, that it did review. Second, to the extent it did act regarding OSS, the action it took biased the result in favor of the utility; and by definition, its adjustment would always be biased in favor of the utility. Thus, if the Commission is correct that it may make adjustments to the total electric utility data contained in the FERC Form 1 in a way that satisfies the SEET, in this instance the Commission simply ignored its duty to act on the record before it.

The importance of getting the SEET right goes beyond the legal requirements. As noted above, the Companies have secured substantial benefits from Ohio customers. Judged by the

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[92] Opinion and Order at 13 (IEU-Ohio Appx. at 46) (ICN 56).

[93] *Id.* at 27-31 (IEU-Ohio Appx. at 60-64) (ICN 56).

[94] IEU-Ohio attempted to have the Commission address this issue through its Application for Rehearing (ICN 61). The Commission, however, found that a new issue was not presented and denied rehearing. Entry on Rehearing at 4 (IEU-Ohio Appx. at 75) (ICN 69).

several standard measures, Ohio customers are paying higher rates than other customers of non-Ohio affiliates, CSP and OP are generating better returns for their stockholder-parent than other affiliates, and CSP and OP retail rates are providing a larger contribution to gross margins than other affiliates.[95] Thus, the use of total company data (and in the case of CSP, improperly adjusted total company data) has helped OP and CSP hide the actual profitability of their Ohio retail business *via* the ESPs and thereby deprived Ohio consumers of the protection which the General Assembly provided through the SEET.

This Court has made clear that the Commission may not ignore the record in making its findings. Noting the lack of any evidence that the Companies incurred a cost to justify a provider of last resort charge, the Court in its review of the CSP and OP 2009 ESP cases determined that the Commission's finding that the charge was cost-based was contradicted by the manifest weight of the evidence.[96] The Court specifically noted that the Commission's failure to support its findings with record evidence was an abuse of discretion and reversible error.[97] Similarly, in this case, the record demonstrates that the Commission ignored Section 4928.143(F), Revised Code, and its own determination that adjustments to the FERC Form 1 data were necessary to isolate the effects of the ESP on the return on equity of the EDU. Moreover, the step the Commission did take to adjust the data was factually wrong, biased in favor of the EDU, and by its nature will always be biased in that way. Given this fundamental and prejudicial approach adopted by the Commission, its Opinion and Order is manifestly

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[95] See *supra* text accompanying notes 57-60.

[96] *In re Application of Columbus Southern Power Co.*, 128 Ohio St.3d 512, 518 (2011).

[97] *Id.* at 519.

against the weight of the evidence and so clearly unsupported as to show misapprehension, mistake, or willful disregard of duty.[98]

CONCLUSION

To date, the promise of SB 221 has not been realized in its application to CSP and OP. Initially, the Commission approved an ESP for CSP and OP that was unlawful, as this Court has found.[99] Thus, the Companies were permitted to collect revenues that were not authorized by Section 4928.143, Revised Code. Under SB 221, the Commission is also charged with assuring that the Companies do not earn significantly excessive earned returns on common equity from the Commission-authorized ESP. Given the already substantial returns the Companies were earning prior to the adoption of the ESP, it was not surprising that the first SEET proceeding revealed real problems with the Commission-ordered ESP. In the application of the SEET, however, the Commission failed to take the necessary steps to isolate, for each of the EDUs, the returns associated with the operation of the ESPs as required by Section 4928.143(F), Revised Code. This failure has helped OP and CSP hide the actual profitability of their Ohio retail business *via* the ESPs and thereby deprived Ohio consumers of the protection which the General Assembly provided through the SEET. As judged by the statutory requirements and the practical outcomes, the Commission's Opinion and Order should be reversed and the Commission should be directed to require the Companies to file the necessary information so that the Companies' customers are better assured that the law as enacted is enforced. Further, the Court should direct the Commission to review the 2009 earned returns on common equity of CSP and OP in compliance with the applicable law.

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[98] *Cincinnati Gas & Elec. Co. v. Pub. Util. Comm'n,* 96 Ohio St.3d 53, 58 (1999).

[99] *In re Application of Columbus Southern Power Co.*, 128 Ohio St.3d 512 (2011).

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Brief of Appellant, Industrial Energy Users-Ohio,* was served upon the parties of record this 8th day of August 2011 *via* electronic transmission, hand-delivery, or ordinary U.S. mail, postage prepaid.

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IN THE SUPREME COURT OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company For Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	: Case No. 2011-0751 : : Appeal from the Public Utilities : Commission of Ohio : : Public Utilities : Commission of Ohio : Case No. 10-1261-EL-UNC

APPENDIX OF
APPELLANT INDUSTRIAL ENERGY USERS-OHIO

{C34692: }

58

IN THE SUPREME COURT OF OHIO

FILE

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company For Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	: Case No. 2011-0751 : : Appeal from the Public Utilities : Commission of Ohio : : Public Utilities : Commission of Ohio : Case No. 10-1261-EL-UNC

NOTICE OF APPEAL OF APPELLANT INDUSTRIAL ENERGY USERS-OHIO

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{C33746: }

NOTICE OF APPEAL OF APPELLANT
INDUSTRIAL ENERGY USERS-OHIO

Appellant, Industrial Energy Users-Ohio ("IEU-Ohio" or "Appellant") hereby gives its notice of appeal, pursuant to Section 4903.11 and Section 4903.13, Revised Code, and Supreme Court Rule of Practice 2.3(B), to the Supreme Court of Ohio and Appellee from the Opinion and Order of January 11, 2011 (Attachment A) and Entry on Rehearing of March 9, 2011 (Attachment B) of the Public Utilities Commission of Ohio ("Commission" or "PUCO") in Case No. 10-1261-EL-UNC.

Appellant was and is a party of record in Case No. 10-1261-EL-UNC and timely filed its Application for Rehearing on Appellee's Opinion and Order on February 10, 2011. Appellant's Application for Rehearing was denied by the Commission's Entry on Rehearing on March 9, 2011.

The Commission's Opinion and Order and Entry on Rehearing are unlawful and unreasonable for the reasons set out in the following Assignments of Error:

A. The Opinion and Order was unlawful and unreasonable because the Commission failed to follow the legal standard required by Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C., to apply the significantly excessive earnings test ("SEET").

B. The Opinion and Order was unlawful and unreasonable because the Commission found that the SEET may be measured based upon the total company return on common equity rather than the electric distribution utility's ("EDU") earned return on common equity from the Electric Security Plan ("ESP").

C. If reliance on total company data was lawful and appropriate for purposes of commencing the SEET analysis, the Opinion and Order was unlawful and unreasonable because the Commission failed to adjust net income and common equity to account fully for the removal of off system sales and other non-jurisdictional effects from the calculation of excessive earnings.

D. The Opinion and Order was unlawful and unreasonable because the Commission failed to remove the operating expenses for Waterford and Darby generating stations from the calculation of the SEET when the Commission previously ordered that the expenses be removed from the ESP.

E. The Opinion and Order as implemented through the January 27, 2011 Finding and Order was unlawful and unreasonable because the Commission did not allow reasonable arrangement customers, particularly those that were paying rates under the Standard Service Offer ("SSO") in 2009, to participate in the SEET credit in violation of Sections 4928.143(F) and 4903.09, Revised Code.

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

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of this *Notice of Appeal of Appellant Industrial Energy Users-Ohio* was sent by ordinary United States mail, postage prepaid, or hand-delivered to all parties to the proceeding before the Public Utilities Commission of Ohio, listed below, and pursuant to Section 4903.13 of the Ohio Revised Code on May 6, 2011.

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CERTIFICATE OF FILING

I hereby certify that a *Notice of Appeal of Appellant Industrial Energy Users-Ohio* has been filed with the docketing division of the Public Utilities Commission of Ohio in accordance with Rules 4901-1-02-(A) and 4901-1-36 of the Ohio Administrative Code on May 6, 2011.

Frank P. Darr
Counsel for Appellant
Industrial Energy Users-Ohio

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FILE

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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the 2009 Annual Filing of Columbus Southern Power Company and Ohio Power Company Required by Rule 4901:1-35-10, Ohio Administrative Code)	Case No. 10-1261-EL-UNC

APPLICATION FOR REHEARING AND MEMORANDUM IN SUPPORT OF INDUSTRIAL ENERGY USERS-OHIO

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February 10, 2011

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THE PUBLIC UTILITIES COMMISSION OF OHIO

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APPLICATION FOR REHEARING OF INDUSTRIAL ENERGY USERS-OHIO

Pursuant to Section 4903.01, Revised Code, and Rule 4901-1-35, Ohio Administrative Code ("O.A.C."), Industrial Energy Users-Ohio ("IEU-Ohio") respectfully submits this Application for Rehearing from the Opinion and Order issued by the Public Utilities Commission of Ohio ("Commission") on January 11, 2011 ("Opinion and Order" or "January 11 Opinion and Order") on the determination whether Columbus Southern Power Company ("CSP") or Ohio Power Company ("OP") (collectively the "Companies" or "AEP-Ohio") earned significantly excessive earnings during the first year of their respective Electric Security Plans ("ESP") under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C. As explained more fully in the attached Memorandum in Support, the Commission's January 11 Opinion and Order is unreasonable and unlawful for the following reasons:

A. The Opinion and Order was unlawful and unreasonable because the Commission failed to order CSP or OP to refile its testimony and supporting materials to address properly the requirements of Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C.

B. The Opinion and Order was unlawful and unreasonable because the Commission failed to follow the legal standard required by Section

4928.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C., to apply the significantly excessive earnings test ("SEET").

C. The Opinion and Order was unlawful and unreasonable because the Commission found that the SEET may be measured based upon the total company return on common equity rather than the electric distribution utility's ("EDU") earned return on common equity from the ESP.

D. If reliance on total company data was lawful and appropriate for purposes of commencing the SEET analysis, the Opinion and Order was unlawful and unreasonable because the Commission failed to adjust net income and common equity to account fully for the removal of off system sales and other non-jurisdictional effects from the calculation of excessive earnings.

E. The Opinion and Order was unlawful and unreasonable because the Commission failed to use the appropriate annual period to conduct the SEET as required by Section 4928.143(F), Revised Code.

F. The Opinion and Order was unlawful and unreasonable because the Commission failed to remove the operating expenses for Waterford and Darby generating stations from the calculation of the SEET when the Commission previously ordered that the expenses be removed from the ESP.

G. The Opinion and Order was unlawful and unreasonable because the Commission failed to comply with the policy of the State to ensure the availability to consumers of reasonably priced retail electric service and encourage the competitiveness of the State's economy.

H. The Opinion and Order as implemented through the January 27, 2011 Finding and Order was unlawful and unreasonable because the Commission did not allow reasonable arrangement customers, particularly those that were paying rates under the Standard Service Offer ("SSO") in 2009, to participate in the SEET credit in violation of Sections 4928.143(F) and 4903.09, Revised Code.

For these reasons, discussed in greater detail below, IEU-Ohio requests that the Commission grant this Application for Rehearing, order OP and CSP to make the necessary filings in compliance with the statutory and regulatory requirements, and conduct further hearings consistent with requirements of Section 4927.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C.

Respectfully submitted,

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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the 2009 Annual Filing of Columbus Southern Power Company and Ohio Power Company Required by Rule 4901:1-35-10, Ohio Administrative Code)	Case No. 10-1261-EL-UNC

MEMORANDUM IN SUPPORT OF INDUSTRIAL ENERGY USERS-OHIO

I. BACKGROUND AND ARGUMENT

On January 11, 2011, the Commission issued its Opinion and Order in these matters, finding that CSP had earned significantly excessive earnings. Because the results were based on a flawed filing that affected both the remainder of the hearing and the Commission's Opinion and Order when viewed in light of Section 4928.143(F), Revised Code, IEU-Ohio urged (both before testimony began and at the conclusion of the hearing) the Commission to order CSP and OP to refile the appropriate information and to refrain from acting until that was done. Certainly, IEU-Ohio's motion was not made in the belief that one or the other company was not significantly over-earning, but rather in the expectation that proper information would result in a more accurate and lawful result. Once again, IEU-Ohio urges the Commission to take the opportunity to require the Companies to comply with the statutory requirements so that a proper evaluation can take place.

For the following reasons, IEU-Ohio requests that the Commission order rehearing in this matter.

A. **The Opinion and Order was unlawful and unreasonable because the Commission failed to order CSP or OP to refile its testimony and supporting materials to address properly the requirements of Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C.**

B. **The Opinion and Order was unlawful and unreasonable because the Commission failed to follow the legal standard required by Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C., to apply the significantly excess earnings test ("SEET").**

C. **The Opinion and Order was unlawful and unreasonable because the Commission found that the SEET may be measured based upon the total company return on common equity rather than the electric distribution utility's ("EDU") earned return on common equity from the ESP.**

D. **If reliance on total company data was lawful and appropriate for purposes of commencing the SEET analysis, the Opinion and Order was unlawful and unreasonable because the Commission failed to adjust net income and common equity to account fully for the removal of off system sales and other non-jurisdictional effects from the calculation of excessive earnings.**

The starting point for defining the scope of the Commission's authority is the applicable statute. Section 4928.143(F), Revised Code, provides (emphasis added):

> **With regard to the provisions that are included in an electric security plan** under this section, the commission **shall** consider, following **the end of each annual period of the plan**, if any such adjustments resulted in excessive earnings as measured by whether the **earned return on common equity of the electric distribution utility** is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate. Consideration also shall be given to the capital requirements of future committed investments in this state. The burden of proof for demonstrating that significantly excessive earnings did not occur shall be on the **electric distribution utility**. If the commission finds that such adjustments, in the aggregate, did result in significantly excessive earnings, it shall require the **electric distribution utility** to return to consumers the amount of the excess by prospective adjustments; provided that, upon making such prospective adjustments, the electric distribution utility shall have the right to terminate the plan and immediately file an application pursuant to section 4928.142 of the Revised Code. Upon termination of a plan under this division, rates shall

be set on the same basis as specified in division (C)(2)(b) of this section, and the commission shall permit the continued deferral and phase-in of any amounts that occurred prior to that termination and the recovery of those amounts as contemplated under that electric security plan. In making its determination of significantly excessive earnings under this division, **the commission shall not consider, directly or indirectly, the revenue, expenses, or earnings of any affiliate or parent company.**

As demonstrated during the hearing and found in the Opinion and Order, neither OP nor CSP met its burden to show that it did not experience significantly excessive earnings as a result of its individual ESP in the first annual period. By law, the Commission should find that OP and CSP experienced significantly excessive earnings because, as a threshold matter, neither OP nor CSP offered any evidence to show that the EDU earned a return on equity arising from its particular ESP during the required annual period.[1] Short of holding both Companies over-earned, however, the Commission should reconsider its decision to go forward on the deeply flawed record. While IEU-Ohio is eager to have the Commission remove the significantly excessive economic burden that was imposed on customers when the Commission approved the OP and CSP ESPs, the Commission, nonetheless, must comply with Section 4928.143(F), Revised Code, before doing so.

At the heart of the problem is the failure of the Commission to limit its review to the ESP earnings of the EDU. Section 4928.143(F), Revised Code, contains words that are defined by Ohio law and, as stated in Section 4928.01, Revised Code, these definitions control for purposes of construing and applying the SEET. Section 4928.143(F), Revised Code, explicitly directs the Commission to review the earnings of the EDU operating under the ESP. In turn, Section 4928.01, Revised Code, defines

[1] As the statute does not provide a remedy for a failure to meet the prima facie burden, the logical solution is to require the company to refile its case in compliance with the statute.

"electric distribution utility" as an "electric utility" that supplies retail electric distribution service and defines an "electric utility" as an "electric light company"; an electric light company has an Ohio certified territory and also provides retail service in Ohio.

The definitions in Section 4928.01, Revised Code, apply to Section 4928.143(F), Revised Code, and these definitions control the scope of the SEET. Based on these definitions and the plain meaning of Section 4928.143(F), Revised Code, the SEET must be applied to measure the earned equity return on the EDU's retail service which is the service that is subject to the Commission's jurisdiction.[2] This is the only service that can be covered by a rate plan that the Commission is empowered to approve under Section 4928.143, Revised Code. Therefore, the SEET mandated by Section 4928.143(F), Revised Code, requires the Commission to design and apply the SEET to identify the EDU's earned return on equity as that earned return is measured from the retail service rate plan approved by the Commission under Section 4928.143, Revised Code. Section 4928.143(F), Revised Code, further states that the Commission may not consider, "directly or indirectly, the revenue, expenses, or earnings of any affiliate or parent company."

Nothing in Section 4928.143(F), Revised Code, suggests that the Commission has authority to measure significantly excessive earnings based on total company

[2] Utility applications for rate increases have historically been filed with explicit reference to the service that is subject to the Commission's jurisdiction. *In the Matter of the Application of The Toledo Edison Company for Authority to Amend and Increase Certain of its Rates and Charges for Electric Service*, Case Nos. 95-299-EL-AIR, *et al.*, Opinion and Order (April 11, 1996). Section 4928.39, Revised Code, required the Commission to jurisdictionalize any transition cost allowance that the Commission authorized EDUs to collect in conjunction with Ohio's approach to restructuring its electric laws and regulations. *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 Their Transition Plans and for Authorization to Collect Transition Revenues*, Case Nos. 99-1212-EL-ETP, *et al.*, Opinion and Order at 31-36), (July 19, 2000). The notion that the Commission must apply the SEET so as to respect this fundamental legal principle is hardly new. But whether new or old, this principle must also be respected because it is an explicit requirement of Section 4928.143(F), Revised Code.

earnings. On the contrary, Ohio law directs that the SEET must exclude any consideration of net income and the earned return on equity attributable to non-retail transactions such as those subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC").[3] The SEET must be applied based on the earnings achieved by an EDU as a result of an ESP.

The testimony (prefiled and oral) and exhibits sponsored by all the witnesses in this proceeding demonstrate that none of the witnesses based his calculations and opinions on parameters required by Section 4928.143(F), Revised Code. The problem is not limited to the analysis that focused on CSP.

For example, AEP-Ohio's Mr. Mitchell did not develop his calculations or opinions based on the understanding that "electric distribution utility" and "electric utility" are defined terms under Ohio law. Prior to the hearing, Mr. Mitchell did not ask if these terms have specific meaning in Ohio. Tr. Vol. I at 36. During the hearing and after sponsoring his prepared testimony, he apparently became aware that these terms are defined by Ohio law. Tr. Vol. I at 36-39.

Mr. Mitchell's testimony and attached exhibits show that the math behind his earned return on equity numbers for 2009 is driven by total company numbers. For CSP and OP, he used $271.5 million and $305.8 million, respectively, as the earned return on common equity for 2009.[4] These 2009 earned return on equity numbers are the total company earned returns for OP and CSP. In other words, Mr. Mitchell's calculation of earned return on common equity is for all lines of CSP and OP business,

[3] As noted in IEU-Ohio's reply brief, the companies conceded that the calculations had to be adjusted for non-jurisdictional effects. IEU-Ohio Reply Brief at 6.

[4] Companies' Exhibit 4, Exhibit TEM-1.

not just the equity return earned by each EDU as a result of the retail rate plan. Tr. Vol. I at 37-38. As he explained, his calculation of the earned return on common equity for 2009 includes income from wholesale transactions involving affiliates of OP and CSP and subject to FERC's jurisdiction. Tr. Vol. I at 43.

AEP-Ohio's Mr. Hamrock confirmed that CSP and OP are engaged in multiple lines of business including nonutility business. He also confirmed that the net income and earned return calculations contained in AEP-Ohio's testimony included income from FERC-jurisdictional activities, including the various pool agreements that allocate costs and revenue among other operating companies affiliated with OP and CSP. Tr. Vol. I at 134, 136-137, 141-152. In his testimony, Mr. Hamrock conceded that AEP-Ohio's total company earned return on equity calculations for OP and CSP include non-jurisdictional activities and gains or losses affecting CSP's and OP's earnings. He testified that "there are ... non-jurisdictional activities and gains or losses that impact CSP's and OPCo's earnings" but that " the Companies did not attempt to fully jurisdictionalize the 2009 earnings ...." Companies' Exhibit 6 at 7.

Like Mr. Mitchell and Mr. Hamrock, Dr. Makhija's analysis was conducted without knowledge that "electric utility" has a specific statutory definition for purposes of the SEET. Tr. Vol. I at 100-101. During cross-examination, he acknowledged that the term "electric distribution utility" is "suggestive of distribution activities" and that the earned return calculations required by the SEET are to be focused on the EDU. Tr. Vol. I at 102. Although Dr. Makhija was not responsible for calculating the EDU earned returns on common equity, Tr. Vol. I at 103-104, the calculations he used were based on total company data, rendering Dr. Makhija's opinions irrelevant.

Professor Woolridge did not look at OP's earnings; he limited his analysis to CSP. Tr. Vol. II at 319. He did not know that "electric distribution utility" and "electric utility" are defined terms in Ohio. Tr. Vol. II at 320. He testified that if there are statutory definitions for these terms, he did not take them into account. Tr. Vol. II at 320-321.

The direct case presented by the Joint Intervenors[5] was structured so that Mr. Kollen's opinions and recommendations relied significantly on the opinions of Professor Woolridge. Tr. Vol. II at 385. Mr. Kollen did not address the SEET as applied to OP and he did not take issue with Mr. Mitchell's calculation of CSP's earned return[6] even though Mr. Mitchell relied on total company numbers.

Like the other witnesses, Mr. Kollen was, when he offered his testimony, unaware that "electric utility" is a defined term in Ohio. Tr. Vol. II at 387. By focusing on the total company numbers for CSP, Mr. Kollen adopted OP's and CSP's erroneous approach to calculating the earned return on equity component of the SEET. Tr. Vol. II at 387. During cross-examination, Mr. Kollen acknowledged that CSP has various lines of business (involving generation, transmission and distribution functions) and that he did not know the extent to which each line of business was responsible for the significantly excessive earnings in 2009. Joint Intervenors' Exhibit 2 at 27; Tr. Vol. II at 400.

Like Professor Woolridge and Mr. Kollen, Mr. Cahaan offered no testimony on the SEET as applied to OP. Tr. Vol. III at 445. As with the other witnesses, Mr. Cahaan

[5] The Office of the Ohio Consumers' Counsel ("OCC"), the Ohio Manufacturers' Association ("OMA"), the Ohio Hospital Association ("OHA"), Appalachian Peace and Justice Network ("APJN") and the Ohio Energy Group ("OEG") are the "Joint Intervenors." Joint Intervenors' Exhibit 2 at 2.

[6] Joint Intervenors' Exhibit 2 at 18.

did not approach his assignment with an understanding that "electric utility" is a defined term in Ohio. Tr. Vol. III at 444. Mr. Cahaan also relied on total company numbers. The $271.5 million net income in Mr. Cahaan's testimony is the same total company net income number ($271.5 million) identified in Mr. Mitchell's testimony. Tr. Vol. III at 474-475.

As might be expected, the erroneous SEET analysis relied upon by the various witnesses flowed into the Commission's decision. In its Opinion and Order, the Commission stated:

> [W]e reject IEU-Ohio's contention that the Companies' application cannot proceed as AEP-Ohio did not perform a comprehensive jurisdictional allocation study. Nowhere in Section 4928.143(F), Revised Code, is a comprehensive jurisdictional allocation study required in order to determine an earned ROE appropriate for use in the SEET. Nor do we find that a comprehensive jurisdictional allocation study is the only manner in which to determine an earned ROE for SEET. Rather, we find that it is acceptable to make appropriate adjustments to FERC Form 1 data in order to develop an earned ROE for SEET. In making this determination, we note that, under applicable provisions of Section 4928.01, Revised Code, and under Section 4905.03, Revised Code, an electric utility is not limited to a subset of a firm's activities that may be regulated under an ESP. Additionally, the definition of an electric light company explicitly covers firms engaged in both activities subject to rate regulation by this Commission and activities such as transmission that are, in large part, subject to federal jurisdiction. Thus, while adjustments to FERC Form 1 data may be appropriate to isolate the effects on ROE of the adjustments in the ESP under review, **the SEET, in the first instance, may be measured based upon the return of common equity of the electric utility viewed as a company without a complete jurisdictional cost and revenue allocation study.**

January 11, 2011 Opinion and Order at 13 (emphasis added). The Commission then accepted only a single adjustment for off system sales despite the testimony that other non-ESP services, revenue, and income were in the SEET analysis that each witness relied upon. January 11, 2011 Opinion and Order at 27-31. The Commission did not require OP or CSP to provide it with the correct data on which to make the required determinations, and it did not make the full range of adjustments.

The apparent premise of the Commission's Opinion and Order is that an "electric utility is not limited to a subset of a firm's activities that may be regulated under an ESP." January 11, 2011 Opinion and Order at 13. While that statement may be true "in the first instance" and as a place to start the SEET analysis, it does not answer and is inconsistent with the further requirement that the Commission should remove non-jurisdictional off-system sales ("OSS") and make other adjustments suggested by the Commission's next finding. *Id.* Moreover, the Commission's statement has little or nothing to do with the test provided by Section 4928.143(F), Revised Code, which specifically provides that the review is limited to "to the provisions that are included in an electric security plan under this section."

It follows then that the Commission's failure to require the companies to file testimony and exhibits consistent with the statutory requirements caused the SEET analysis to end prematurely, before the statutory SEET analysis could possibly be performed. In light of this uncontested reality, the solution was dutifully straight-forward: the Commission should have required that the Companies not only refile, but do so in a way that would allow the required SEET analysis to be performed. Thus, it was error to go forward on the data provided, and it was error for the Commission to not impose on the Companies an obligation to show the earned return on common equity arising from the ESP.

As discussed above, the Commission endorsed in its Opinion and Order AEP-Ohio's failure "to fully jurisdictionalize" the total company earnings. Companies' Exhibit

6 at 7. But even if the Commission ignores the fact that the SEET requires reliance upon the EDU's ESP and retail jurisdictional numbers, the total company analysis provided by AEP-Ohio and utilized by the Commission is based on one-sided, selective and misleading adjustments to the total company numbers.

For example and with regard to the math performed by AEP-Ohio in the case (and only in the case) of CSP, AEP-Ohio reduced CSP's total company net income by the "net margins" which AEP-Ohio attributed to OSS. Companies' Exhibit 4 at 5. Mr. Mitchell was responsible for the computation performed to remove OSS net margins from CSP's total company dollar return on equity (the numerator in the percentage earned return calculation) for 2009 but he was directed to make this adjustment by Mr. Hamrock. Companies' Exhibit 4 at 3; Companies' Exhibit 6 at 6-7; Tr. Vol. I at 35.

In his testimony, Mr. Hamrock claimed that the adjustment to CSP's total company net income to remove "net margins" which AEP-Ohio attributed to "OSS" was required because the "[o]ff-system-sales margins, which result from wholesale, not retail, transactions, are not the result of a rate adjustment included in CSP's or OPCo's ESP. They result from wholesale transactions approved by the Federal Energy Regulatory Commission (FERC)." Companies' Exhibit 6 at 6-7. Mr. Hamrock also acknowledged, however, that "there are other non-jurisdictional activities and gains or losses that impact CSP's and OPCo's earnings" but that "the Companies did not attempt to fully jurisdictionalize the 2009 earnings." Companies' Exhibit 6 at 7. AEP-Ohio's testimony, therefore, acknowledged that its adjustment to CSP's total company earnings or net income for 2009 to remove net margins from OSS was a selective application of AEP-Ohio's theory regarding the relationship between SEET and jurisdictional transactions and that a comprehensive application of this theory was not attempted by AEP-Ohio.

Mr. Cahaan's testimony identified one effect (at least directionally) of AEP-Ohio's selective application of AEP-Ohio's theory regarding the relationship between SEET and jurisdictional rate plan transactions. As Mr. Cahaan testified, the theory relied upon by AEP-Ohio to adjust the numerator (net income available for common shareholders) would require, if adopted, an adjustment to the denominator (the dollar value of common shareholder equity). Staff Exhibit 1 at 19-21. While Mr. Cahaan's testimony demonstrated the one-sided and misleading effect of AEP-Ohio's selective application of its theory, his quantification of the effect of this theory on the denominator (the dollar value of common shareholder equity) relied upon assumptions that did not account fully for the removal of the off-system sales. For example, he assumed that there was no further adjustment necessary for transmission investment associated with making OSS, an assumption that has no support in the record or anywhere else. Tr. Vol. III at 477; Tr. Vol. I at 137.

Beyond failing to hold that OP and CSP failed to meet their burden to come forward with evidence showing no significantly excessive earnings as measured by the SEET, the Commission compounded the problem when it assessed the ESP by using inappropriate data. For this reason as well, rehearing should be granted.

E. The Opinion and Order was unlawful and unreasonable because the Commission failed to use the appropriate annual period to conduct the SEET as required by Section 4928.143(F), Revised Code.

Section 4928.143(F), Revised Code, requires that the SEET be applied following the end of each "annual period **of the plan**." The start date of the first ESP annual period for OP and CSP was April 1, 2009. Mr. Mitchell testified that the revenue collection opportunity enabled by the retail rate plan did not commence until April 1, 2009. Tr. Vol. I at 44-46. As the Commission knows from its own public records, the first effective date of the rates and charges collected by CSP and OP pursuant to the retail rate plan approved by the Commission is also April 1, 2009. The annual period thus commenced on April 1, 2009 and ended on March 31, 2010.

In the January 11 Opinion and Order, the Commission apparently concluded that using the retroactive start date of January 1, 2009 was appropriate.[7] Once again, however, the issue is compliance with the statute. The ESP did not and cannot be construed to have commenced any earlier than the first billing cycle. The Commission's attempt to avoid a revenue gap by annualizing the recovery to January 1, 2009 in the ESP Order did not change that fact. Thus, the annual period of the SEET analysis should have been for the period of April 1, 2009 through March 31, 2010. Any other result fails to capture the period required by Section 4928.143, Revised Code, and is unlawful and unreasonable.

F. **The Opinion and Order was unlawful and unreasonable because the Commission failed to remove the operating expenses for Waterford and Darby generating stations from the calculation of the SEET when the Commission previously ordered that the expenses be removed from the ESP.**

Over the objection of IEU-Ohio, the Commission refused to remove from the SEET calculation expenses associated with the Waterford Energy Center and the Darby Generating Station. There apparently is no argument that the Companies for purposes of this filing included the expenses. Despite the Commission's prior decision to remove

[7] Opinion and Order at 13 ("The Commission has already fully addressed the start date of AEP-Ohio's ESP." [Citations to various ESP orders omitted.]).

expenses for the two facilities from expenses recoverable under the ESP, the Commission's January 11 Opinion and Order indicated that removing the $51 million expense in calculating the SEET would be unreasonable. January 11 Opinion and Order at 13-14. Although two adjustments must be made to avoid overstating expenses and understating the earned return on equity, neither was done.

In *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets,* Case Nos. 08-917-EL-SSO, *et al.,* Opinion and Order at 51-52 (March 18, 2009) (hereinafter refered to as the "*AEP-Ohio ESP Case*"), the Commission initially authorized CSP to increase revenues for the jurisdictional portion of expenses associated with Waterford Energy Center and the Darby Electric Generating Station. On rehearing, however, the Commission reversed this determination because AEP-Ohio had not presented evidence showing that the revenue produced by its rates was insufficient to cover such expenses and directed "AEP-Ohio to modify its ESP and remove the annual recovery of $51 million of expenses including associated carrying charges related to these generation facilities." *AEP-Ohio ESP Case,* Entry on Rehearing at 35-36 (July 23, 2009). CSP subsequently perfected an appeal to the Ohio Supreme Court and alleged that the "Commission unlawfully and unreasonably denied CSP the authority to recover, as part of its Electric Security Plan, costs associated with its ownership of the Waterford Energy Center and the Darby Electric Generating Station". *Columbus Southern Power Company v. Public Utilities Commission of Ohio,* Ohio Supreme Court Case No. 09-2298, Notice of Appeal of Columbus Southern Power Company at 3 (December 22, 2009).

Despite the prior Commission order excluding recovery, the net income and earned return computations performed by the parties who used the Companies' numbers included expenses associated with the Waterford Energy Center and the Darby Electric Generating Station as if they are properly recoverable under the CSP ESP. They were included in CSP's 2009 per book net income number. Tr. Vol. I at 139-140. As explained above, AEP-Ohio, Joint Intervenors, and the Commission's Staff copied AEP-Ohio's net income number into their analyses and thereby picked up AEP-Ohio's inclusion of the expenses associated with the Waterford Energy Center and the Darby Electric Generating Station in their otherwise defective recomendations regarding the SEET. To exclude such expenses, it would be necessary to make two adjustments. The first necessary change is an adjustment to CSP's 2009 per book net income number. Tr. Vol. I at 141. The second necessary adjustment would be one to the common equity balance of CSP, for the same reasons suggested by Mr. Cahaan noted above. Thus, the income statement (expenses, revenue and net income) and balance sheet (common equity) effects attributable to the Waterford Energy Center and the Darby Electric Generating Station must be removed to apply the SEET to the ESP plan that is currently in effect. [8] The failure of the Commission to take these steps, therefore, requires the Commission to grant this Application for Rehearing.

G. The Opinion and Order was unlawful and unreasonable because the Commission failed to comply with the policy of the State to ensure the availability to consumers of reasonably priced retail electric service and encourage the competitiveness of the State's economy.

Beyond the issues raised above, however, the Commission's decision failed to advance public policy requirements that the Commission is required to follow. In

[8] Similar adjustments are required for the Lawrenceburg Generating Station. Tr. Vol. I at 141-142.

particular, the goals of stable and reasonably priced retail rates and global competitiveness suffer as a result of this decision.

Under current law, the Commission is directed to "[e]nsure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service." Section 4928.02(A), Revised Code. While it was readily apparent even under CSP's presentation at hearing that CSP's earned return was significantly excessive, there was a fundamental breakdown in the process which as noted above likely resulted in an understatement of the amounts by which at least CSP exceeded the threshold. Quantification of the error has been made impossible by the failure to specify properly the SEET analysis. When there are obvious mistakes that deflate the signficantly excessive earnings and these mistakes can be addressed by requiring the proper accounting and allocation, then State policy to ensure reasonably priced service requires that effort be made. See *Elyria Foundry Co. v. Public Util. Comm'n of Ohio*, 114 Ohio St. 3d 305, 2007-Ohio-4164, 871 N.E.2d 1176 (2007).

Further, Section 4928.02, Revised Code, requires the Commission, among other things, to administer Chapter 4928 in ways that facilitate Ohio's competitiveness. Businesses in Ohio compete with businesses in Indiana, Michigan, Kentucky and West Virginia. As demonstrated in IEU-Ohio's Brief at 15–22, AEP-Ohio retail customers appear according to AEP financial information to be carrying more than their fair share of the profitability achieved by the AEP-East companies. In this case, the Commission is obligated to take action because this undue burden on Ohio customers affects their ability to, among other things, compete in the global economy.

> We are tasked, under Chapter 4928 of the Revised Code, with approving generation charges that are market-based and consistent with the State

policy set forth in this Chapter. Although, in some instances, costs or changes in costs may serve as proxies for reasonable market valuations or changes in such valuations, this is not the same as establishing prices based on costs. Similarly, a market-based SSO price is not the same as a deregulated price. SSOs remain subject to Commission jurisdiction under Chapter 4928 of the Revised Code. And, SSOs must be consistent with State policy under Section 4928.02, Revised Code. *Elyria Foundry Co. v. Pub. Util. Comm.* (2007), 114 Ohio St. 3d 305. Thus, while an SSO price need not reflect the sum of specific cost components, the result must produce reasonably priced retail electric service, avoid anticompetitive subsidies flowing from noncompetitive to competitive services, be consistent with protecting consumers from market deficiencies and market power, and meet other statutory requirements.[9]

Running the SEET to identify the revenues, costs, net income available for common shareholders, and the portion of OP's and CSP's equity capital directly assignable or allocable to the retail service provided by each EDU pursuant to the retail rate plan (making sure the SEET is applied to the retail jurisdiction subject to the Commission's jurisdiction) is required by law. Based on the evidence in this record, applying the SEET as written by the General Assembly may also help to identify and eliminate a significantly excessive burden that now rests on the backs of the retail customers of AEP-Ohio in ways that will permit the Commission to discharge its duties under Section 4928.02, Revised Code.

H. The Opinion and Order as implemented through the January 27, 2011 Finding and Order was unlawful and unreasonable because the Commission did not allow reasonable arrangement customers, particularly those that were paying rates under the Standard Service Offer ("SSO") in 2009, to participate in the SEET credit in violation of Sections 4928.143(F) and 4903.09, Revised Code.

In its Finding and Order entered January 27, 2011, the Commission directed that the tariffs should be adjusted so as to exclude the application of any credit to

[9] *In the Matter of the Consolidated Duke Energy Ohio, Inc. Rate Stabilization Plan Remand and Rider Adjustment Cases*, Case Nos. 03-93-EL-ATA, *et al.*, Order on Remand at 36-37 (October 24, 2007).

reasonable arangement customers who receive service under a discount rate supported by delta revenue recovery. Finding and Order at 1 (January 27, 2011). The only explanation provided by the Commission was a conclusion that customers currently receiving service under a discount rate supported by delta revenue recovery were not entitled to both the discount rate and a SEET discount. *Id.* For several reasons, the Opinion and Order as implemented by the January 27, 2011 Finding and Order was unlawful and unreasonable.

As a statutory matter, there is no basis for the Commission to exclude the special contract customers from participating in the prospective adjustment. Section 4928.143(F), Revised Code, provides that the Commission shall require the EDU to return to consumers the amount of the excess by prospective adjustments. The provision does not segregate special arrangement customers from the recovery; it states that "consumers" shall be permitted to recover.[10] This conclusion is even clearer when applied to those consumers that were taking service under the SSO in 2009 and subsequently moved to a reasonable arrangement, as noted below.

Second, neither the Commission's Opinion and Order nor the Finding and Order points to anything in the record that would support the revision of the tariff to exclude reasonable arrangements consumers who were previously served under the general tariff. In fact, the record evidence suggested the opposite result in the case of customers that had been taking service in 2009 under an SSO. OCC's witness Lane Kollen offered that all consumers that were receiving service under the SSO should be eligible. Tr. Vol. III at 396. Nonetheless, the Commission, in apparent violation of

[10] Section 4905.31, Revised Code, similarly recognizes that the contracting parties to a reasonable arrangement may be a customer, consumer, or employee.

Section 4903.09, Revised Code, failed to tie together anything to support the conclusion that these current special arrangement customers should be denied the benefit of the SEET determination based on the subsequent arrangement.

Finally, the Commission's January 27, 2011 Finding and Order unreasonably denies recovery of the adjustment for a customer who may have been on a tariff rate during 2009 and then moved from that rate. As suggested by Mr. Kollen's conclusion, a customer that was paying the standard rates in 2009 that are later found to be producing significantly excessive returns is no better off in 2011 for prior improper charges regardless of what rate the customer may later have paid. Customers that paid rates in 2009 subsequently judged to produce significantly excessive refunds should benefit, at least proportionately, from the determination of excessive earnings, as suggested by Mr. Kollen.

On these grounds, the January 11 Opinion and Order as implemented by the January 27, 2011 Finding and Order was unlawful and unreasonable.

II. CONCLUSION

For the reasons stated above, IEU-Ohio urges that the Commission grant rehearing of its January 11 Opinion and Order in this matter. The Companies' failure to present a *prima facie* case began a process that resulted in numerous errors, the effect of which renders the Opinion and Order unreasonable and unlawful for the reasons stated above.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Application for Rehearing and Memorandum in Support of Industrial Energy Users-Ohio* was served upon the parties of record this 10th day of February 2011 *via* electronic transmission, hand-delivery, or ordinary U.S. mail, postage prepaid.

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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 Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	)))) Case No. 10-1261-EL-UNC))))

OPINION AND ORDER

The Commission, considering the application, the evidence of record, the applicable law, and being otherwise fully advised, hereby issues its Opinion and Order.

APPEARANCES:

Steven T. Nourse, American Electric Power Service Corporation, One Riverside Plaza, Columbus, Ohio 43215, and Porter, Wright, Morris & Arthur, by Daniel R. Conway, 41 South High Street, Columbus, Ohio 43215, on behalf of Columbus Southern Power Company and Ohio Power Company.

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

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BACKGROUND:

I. Significantly Excessive Earnings Test Background

On May 1, 2008, the governor signed into law Amended Substitute Senate Bill No. 221 (SB 221), amending various statutes in Title 49 of the Ohio Revised Code. Among the statutory amendments were changes to Section 4928.14, Revised Code, to establish a standard service offer (SSO). Pursuant to the amended language of Section 4928.14, Revised Code, electric utilities are required to provide consumers with a SSO, consisting of either a market-rate offer (MRO) or an electric security plan (ESP). Sections 4928.142(D)(4), 4928.143(E), and 4928.143(F), Revised Code, direct the Commission to evaluate the earnings of each electric utility's approved ESP or MRO to determine whether the plan or offer produces significantly excessive earnings for the electric utility.

After considering the arguments raised in the ESP and/or MRO proceedings of the electric utilities, the Commission concluded that initially the methodology for determining whether an electric utility has significantly excessive earnings as a result of an approved ESP or MRO should be examined within the framework of a workshop.[1] The Commission directed Staff to conduct a workshop to allow interested stakeholders to present concerns and to discuss and clarify issues raised by Staff. Accordingly, Case No. 09-786-EL-UNC, *In the Matter of the Investigation into the Development of the Significantly Excessive Earnings Test Pursuant to Amended Substitute Senate Bill 221 for Electric Utilities* (09-786) was opened. The workshop was held on October 5, 2009. Staff filed its recommendations in 09-786 on November 18, 2009.

In 09-786, by Finding and Order issued on June 30, 2010, as amended and clarified in accordance with the entry on rehearing issued August 25, 2010, the Commission

1 *In re Ohio Edison Company, The Cleveland Electric Illuminating Company, and the Toledo Edison Company*, Case No. 08-935-EL-SSO, Opinion and Order at 64 (December 19, 2008) (FirstEnergy ESP case); and *In re Columbus Southern Power Company and Ohio Power Company*, Case No. 08-917-EL-SSO, et al., Opinion and Order at 68 (March 18, 2009) (AEP-Ohio ESP cases).

provided guidance on the interpretation and application of Sections 4928.142(D)(4), 4928.143(E), and 4928.143(F), Revised Code.

On April 16, 2010, in 09-786 and in Case No. 10-517-EL-WVR, Columbus Southern Power Company (CSP) and Ohio Power Company(OP) (jointly AEP-Ohio or Companies) filed an application for a limited waiver of Rule 4901:1-35-10, Ohio Administrative Code (O.A.C.), to the extent that the rule requires the electric utility to file their SEET information by May 15, 2010.[2] By entry issued May 5, 2010, the Commission granted AEP-Ohio's request for an extension and directed AEP-Ohio to make its SEET filing by July 15, 2010. The due date for Companies to file their SEET information was further extended to September 1, 2010, pursuant to entry issued July 14, 2010, in 09-786.

On September 1, 2010, AEP-Ohio filed an application in Case No. 10-1261-EL-UNC, for the administration of the SEET, as required by Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C. By entry issued September 21, 2010, as amended on October 8, 2010, a procedural schedule was established for this proceeding. Pursuant to the procedural schedule, motions to intervene were due by October 8, 2010.

Motions to intervene were filed by, and intervention granted to, the following entities: the Office of the Ohio Consumers' Counsel (OCC), Industrial Energy Users-Ohio (IEU-Ohio), Ohio Partners for Affordable Energy (OPAE), Ohio Energy Group (OEG), Appalachian Peace and Justice Network (APJN), Ohio Manufacturers Association (OMA) and Ohio Hospital Association (OHA).

The hearing commenced, as scheduled, on October 25, 2010, and concluded on November 1, 2010, including rebuttal testimony offered by AEP-Ohio. At the hearing, AEP-Ohio presented the direct testimony of three witnesses: Thomas E. Mitchell (Cos. Ex. 4), Dr. Anil K. Makhija (Cos. Ex. 5), Joseph Hamrock (Cos. Ex. 6) and on rebuttal presented the testimony of Dr. Makhija (Cos. Ex.7) and Mr. Hamrock (Cos. Ex. 8). OCC, OMA, OHA, APJN and OEG (jointly Customer Parties) presented the testimony of Dr. J. Randall Woolridge (Joint Inv. Exs. 1 and 1-A) and Lane Kollen (Joint Inv. Ex. 2). The Staff offered the testimony of Richard Cahaan (Staff Ex. 1). Initial briefs and reply briefs were filed by AEP-Ohio, Staff, Customer Parties,[3] IEU-Ohio, and OPAE.

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2 By May 15 of each year, the electric utility shall make a separate filing with the commission demonstrating whether or not any rate adjustments authorized by the commission as part of the electric utility's electric security plan resulted in significantly excessive earnings during the review period as measured by division (F) of Section 4928.143, Revised Code. The process and timeframes for that proceeding shall be set by order of the commission, the legal director, or attorney examiner. The electric utility's filing shall include the information set forth in paragraph (C) of Rule 4901:1-35-03, O.A.C., as it relates to excessive earnings.

3 The reply brief filed by Customer Parties did not include OMA or OHA as a party to the brief. Only OCC, APJN, and OEG are listed as parties to the reply brief.

On November 30, 2010, AEP-Ohio, Staff, OHA, OMA, The Kroger Company (Kroger), and Ormet Primary Aluminum Corporation (Ormet) filed a Joint Stipulation and Recommendation (Stipulation) in this case and in Case Nos. 09-872-EL-FAC and 09-873-EL-FAC, *In the Matter of the Review of the Fuel Adjustment Clauses of Columbus Southern Power Company and Ohio Power Company*, (Fuel Adjustment Clause (FAC) or FAC cases).[4] The Stipulation included a proposed procedural schedule for the consideration of the Stipulation. Further, as part of the Stipulation, AEP-Ohio agreed to withdraw its opposition to Kroger's request to intervene and, pursuant to the entry issued December 1, 2010, Kroger was granted limited intervention to participate in the SEET case. On December 16, 2010, AEP-Ohio filed a notice of withdrawal of the Stipulation. The Companies' withdrawal, as any party to a Stipulation may, dissolves, terminates and voids the Stipulation. Nonetheless, in its notice of withdrawal, AEP-Ohio unilaterally and voluntarily agreed to fulfill its obligations in the Stipulation to: (1) contribute $1 million of shareholder funds for OMA to be used to assist its members with programs and initiatives designed to bring energy-related benefits to Ohio manufacturers; (2) contribute $1 million of shareholder funds for OHA to be used to assist its members with programs and initiatives designed to bring energy-related benefits to hospitals as those institutions continue to serve their communities; and (3) promote the accelerated deployment and use of new energy efficiency technologies by contributing $100,000 of shareholder funds towards Kroger's energy efficiency projects that may not otherwise be eligible for recovery under a reasonable arrangement or pass the total resource cost test as defined in Rule 4901:1-39-01, O.A.C. AEP-Ohio stated that there would be no deadline or time limitation to deploy Kroger's projects and that the contribution would not expire, but may be used by Kroger on acceptable energy efficiency projects until the contribution amount is exhausted. Kroger is required to commit its energy usage reductions resulting from energy efficiency projects funded by AEP-Ohio's $100,000 contribution to AEP-Ohio so that AEP-Ohio may meet its energy efficiency requirements under Section 4928.66, Revised Code. Further, in the notice of withdrawal, CSP agreed, as part of its upcoming ESP filing to propose and work with the Staff to develop a Phase II pilot program for AEP-Ohio's gridSMART program beyond the current footprint of Phase I, which will include dynamic pricing options.

APPLICABLE LAW:

Section 4928.143(F), Revised Code, provides, in relevant part:

4 On May 14, 2010, in Case Nos. 09-872-EL-FAC and 09-873-EL-FAC, AEP-Ohio filed its 2009 report of the management/performance and financial audits of its FAC (FAC cases). Motions to intervene in the FAC cases were timely filed by, and intervention granted to the following entities: OCC, IEU-Ohio, and Ormet. The hearing in the FAC cases commenced, as scheduled, on August 23, 2010, and concluded on August 24, 2010. Briefs and reply briefs were filed on September 23, 2010, and October 15, 2010, respectively.

(F) With regard to the provisions that are included in an electric security plan under this section, the commission shall consider, following the end of each annual period of the plan, if any such adjustments resulted in excessive earnings as measured by whether the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate. Consideration also shall be given to the capital requirements of future committed investments in this state. The burden of proof for demonstrating that significantly excessive earnings did not occur shall be on the electric distribution utility. If the commission finds that such adjustments, in the aggregate, did result in significantly excessive earnings, it shall require the electric distribution utility to return to consumers the amount of the excess by prospective adjustments; provided that, upon making such prospective adjustments, the electric distribution utility shall have the right to terminate the plan and immediately file an application pursuant to section 4928.142 of the Revised Code. Upon termination of a plan under this division, rates shall be set on the same basis as specified in division (C)(2)(b) of this section, and phase-in of any amounts that occurred prior to that termination and the recovery of those amounts as contemplated under that electric security plan. In making its determination of significantly excessive earnings under this division, the commission shall not consider, directly or indirectly, the revenue, expenses, or earnings of any affiliate or parent company.

Further, Rule 4901:1-35-03(C)(10)(a), O.A.C., as effective May 7, 2009, provides:

For the annual review pursuant to division (F) of section 4928.143 of the Revised Code, the electric utility shall provide testimony and analysis demonstrating the return on equity that was earned during the year and the returns on equity earned during the same period by publicly traded companies that face comparable business and financial risks as the electric utility. In addition, the electric utility shall provide the following information:

(i) The federal energy regulatory commission form 1 (FERC form 1) in its entirety for the annual period under review. The electric utility may seek protection of any confidential or proprietary data if necessary. If the FERC form 1 is not available, the electric utility shall provide balance sheet and income statement information of at least the level of detail as required by FERC form 1.

(ii) The latest securities and exchange commission form 10-K in its entirety. The electric utility may seek protection of any confidential or proprietary data if necessary.

(iii) Capital budget requirements for future committed investments in Ohio for each annual period remaining in the ESP.

I. PROCEDURAL ISSUES:

A. AEP-Ohio's void-for-vagueness constitutionality argument

Section 4928.143(F), Revised Code, is void and unenforceable, AEP-Ohio claims, because it is impermissibly vague and fails to provide CSP and OP with fair notice, or the Commission with meaningful standards, as to what is meant by "significantly excessive earnings." According to AEP-Ohio, the void-for-vagueness doctrine has two primary goals. The first is to ensure "fair notice" to those subject to the law and the second is to provide standards to guide those charged with enforcing the law. Citing to *Columbia Natural Resources, Inc. v. Tatum*, 58 F.3d 1101, 1105 (6th Cir. 1995), AEP-Ohio asserts that the Supreme Court has provided greater specificity related to the two primary goals. The Companies acknowledge that the vagueness doctrine arises most often in the context of criminal laws that implicate First Amendment values. However, the Companies argue that laws that impose criminal penalties or sanctions or that reach a substantial level of constitutionally protected conduct must satisfy a "higher level of definiteness." *Belle Maer Harbor v. Charter Township of Harrison*, 170 F.3d 553, 557 (6th Cir. 1999). The Ohio Supreme Court applied this heightened standard of scrutiny, claims AEP-Ohio, in *Norwood v. Horney*, 110 Ohio St.3d 353, 2006-Ohio-379; a case involving a municipal ordinance that allowed a taking of property by eminent domain even though the statute carried no penalties or sanctions.

Similar to the *Norwood* case cited above, AEP-Ohio claims that Section 4928.143(F), Revised Code, results in a taking of private property rights as the Companies are being required to forfeit earnings lawfully gained through the efficient use of their own property so that those earnings can be redistributed to its customers, even though the customers indisputably paid a just and reasonable rate for the service they received. According to the Companies, Section 4928.143(F), Revised Code, fails to give any definitive notice or guidance as to what is meant by "significantly excessive earnings." For example, AEP-Ohio states that there are no definitions, standards or guidance in the statute providing the electric utility fair notice of the risk of forfeiture or giving the Commission adequate standards to appropriately judge the result as is evident by the parties' starkly conflicting positions in this case. Further, AEP-Ohio asserts, the parties have no common understanding of what level of earnings should be deemed "significantly excessive," whether off-system sales should be included in the net earnings used to calculate the return on equity, how write-offs and deferrals should be treated, how to identify companies that face "comparable business and financial risk" or what is meant by the reference to "adjustments in the aggregate."

According to AEP-Ohio, the vagueness of Section 4928.143(F), Revised Code, is further compounded because the statute applies in a retrospective manner, requiring an electric utility to forfeit earnings from a prior year; because it is the electric utility's burden to prove its earnings in the prior year were not significantly excessive; and because the statute penalizes an electric utility for excess earnings in the prior year but does not insulate the electric utility from prior year earnings that fall significantly below what was earned in the same period by companies with comparable business and financial risk. Given the asymmetric consequences leveled by a determination of significantly excessive earnings, and the burden on the electric utility to prove that its earnings were not significantly excessive, the General Assembly, AEP-Ohio argues, failed to meet its heightened constitutional duty in this instance to assure that an electric utility had fair notice in advance of how its earnings would be measured and to assure that the Commission had clear direction on how the test was to be administered.

AEP-Ohio also argues that the Commission had the opportunity to cure, or at least ameliorate, the effects of the statute's vagueness but that the Commission failed to do so. The Companies claim that it pointed out the uncertainty associated with the SEET in its ESP case, and the Commission initially recognized the importance of giving AEP-Ohio the requested clarification at least with respect to OSS and deferrals. However, the Companies aver, the Commission inexplicably reversed itself even as to those two issues on rehearing.[5] Additionally, the workshop proceeding in 09-786, which was intended to bring clarity to the statute, did not conclude until August 25, 2010, and even then several critical uncertainties remained. AEP-Ohio concludes that, because the SEET offers virtually no guidance as to its proper application and because the Commission failed to cure the uncertainties involved, Section 4928.143(F), Revised Code, is unconstitutionally vague and the Commission's only recourse now to ameliorate the consequences of the statute's constitutional infirmity is to adopt the position advanced by the Companies' witnesses which assures that AEP-Ohio will not be wrongfully deprived of its property.

On reply, Customer Parties (members include OCC, APJN, and OEG) and OPAE argue that constitutional issues are not within the jurisdiction of the Commission and the void-for-vagueness doctrine is inapplicable to Section 4928.143(F), Revised Code.

5 AEP-Ohio ESP, Entry on Rehearing at 45-49 (July 23, 2009).

Referring to *East Ohio Gas Co. v. Pub. Util. Comm.* (1940), 137 Ohio St. 225, 238-239, 28 N.E.2d 599, Customer Parties claim that the Ohio Supreme Court has long held that it is the duty of the Commission to assume the constitutionality of a statute and further that the "constitutionality of statutes is a question for the courts and not for a board or commission." Similarly, in *Consumers' Counsel v. Pub. Util. Comm.* (1994), 70 Ohio St.3d 244, 247, 638 N.E.2d 550, the Ohio Supreme Court stated that "an administrative agency such as the commission may not pass upon the constitutionality of a statute." Citing to *Monongahela Power Co. v. Schriber* (S.D. Ohio 2004), 322 F. Supp.2d 902, 911, Customer Parties assert that the Commission has also acknowledged its lack of authority to determine constitutional issues. In short, therefore, Customer Parties and OPAE submit that the Commission must presume the constitutionality of Section 4928.143(F), Revised Code, and any challenges to the constitutionality of that statute must be decided by the Ohio Supreme Court on appeal.

In arguing that the Companies void-for-vagueness argument is misplaced, improperly applied, and inapplicable to Section 4928.143(F), Revised Code, Customer Parties assert that, as acknowledged by AEP-Ohio, the vagueness doctrine is rarely ever applicable to statutes other than criminal laws. Moreover, Customer Parties argue, the case law that the Companies rely on and discuss in great length on brief is simply not relevant to the Commission's consideration of the SEET as established by Section 4928.143(F), Revised Code. In fact, it is significant, Customer Parties note, that AEP-Ohio failed to cite any public utility cases where a statute had been challenged on vagueness grounds. This is easily explained, according to Customer Parties, because the vagueness doctrine is a constitutional law concept that was created to protect individuals from statutes that are too vague for the average citizen to understand in the criminal realm. *Connally v. General Construction Co.* (1926), 269 U.S. 385. Customer Parties submit that there is little question that the vagueness doctrine was not intended to apply to a statute like Section 4928.143(F), Revised Code and that it was never intended to protect utilities from returning significantly excessive earnings to ratepayers.

Customer Parties also disagree with AEP-Ohio's position that the statute is so vague that it provides no standard at all. To support this contention, Customer Parties point out that AEP-Ohio's witnesses garnered sufficient guidance from the statute to draft prefiled testimony and discussed, at great length in detail over 60-plus pages of its initial brief, the meaning and application of the SEET. Moreover, Customer Parties note, the SEET standard is arguably more detailed than the "just and reasonable" standard used in most jurisdictions, including Ohio, for distribution rate cases.

Citing to *Alliance v. Carbone* (2009), 181 Ohio App.3d 500, 2009-Ohio1197, Customer Parties assert that the courts have held that a statute is not void merely because it could have been worded more precisely. Rather, the critical question is whether the statute affords a reasonable person of ordinary intelligence fair notice and sufficient definition and guidance to enable the individual to conform his or her conduct to the law. In this case, Customer Parties aver, the meaning of Section 4928.143(F), Revised Code, is not under debate but rather which expert witness' methodology the Commission will adopt to determine whether CSP's earnings were significantly excessive in 2009.

Customer Parties also reject AEP-Ohio's complaint that the Commission failed to cure the vagueness of the SEET when it had the opportunity to do so. Customer Parties point out that the Commission did provide further guidance and clarity regarding the application of Section 4928.143(F), Revised Code, through the SEET order and entry on rehearing in 09-786 and the SEET workshop.[6] To support this position, Customer Parties assert that Ohio's other electric utilities had no difficulty understanding the SEET or the proper application of Section 4928.143(F), Revised Code. In summary, Customer Parties submit that the Companies' vagueness doctrine argument should be rejected as the Commission cannot decide constitutional issues and must presume the constitutionality of Section 4928.143(F), Revised Code, and that, in any event, the doctrine of vagueness is inapplicable to the SEET provision set forth in Section 4928.143(F), Revised Code.

After reviewing the arguments and case law of record, the Commission determines that it is the province of the courts, and not the Commission, to judge the constitutionality of Section 4928.143(F), Revised Code. Thus, the appropriate venue for AEP-Ohio to raise its constitutional challenges to the SEET is at the Ohio Supreme Court. Without addressing the constitutional threshold issue propounded by AEP-Ohio, the Commission determines, for the reasons that follow, that there is ample legislative direction to reasonably apply the statute in this case.

Initially, we note that, pursuant to *Connally*, supra, the typical due process claim of vagueness seeks to bar enforcement of "a statute which either forbids or requires the doing of an act." Section 4928.143(F), Revised Code, is not such a statute. This statute does not forbid or require the doing of an act but merely directs that prospective adjustments to rates be made in a future period if there is a finding that past rate adjustments resulted in significantly excessive earnings. Nor is AEP-Ohio penalized for its earnings under this statute. The fact that there would be a SEET review was known to the Companies when the rate plans were proposed.

The Commission also determines that Section 4928.143(F), Revised Code, is part of a comprehensive regulatory framework for setting rates under the provisions of S.B. 221. S.B. 221 created an approach to establishing ESP rates with significant regulatory flexibility including flexibility in what the utility may propose, a scope that may include distribution as well as generation charges and the option for the utility to withdraw any rate plan

6 09-786, Finding and Order (June 30, 2010); Entry on Rehearing (August 25, 2010).

modified by the Commission. The SEET examination included in S.B. 221 provides a check to this flexible approach.

Contrary to AEP-Ohio's argument, Section 4928.143(F), Revised Code, provides a clear benchmark for identifying "excessive earnings." For example, the statute defines earnings as excessive "as measured by whether the earned return on common equity of the electric utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk." Additionally, the statute directs the Commission to make "such adjustments for capital structure as may be appropriate." Further, the Commission is to consider "the capital requirements of future committed investments in this state." Finally, the Commission is directed to "not consider, directly or indirectly, the revenue, expenses, or earnings of any affiliate or parent company." These concepts are not new or novel and have been traditionally applied in the regulatory ratemaking process. *Federal Power Commission v. Hope Natural Gas Co.* (1944), 320 U.S. 591.

Moreover, the fact that there may be disagreement about how to define and apply this benchmark is not new. Parties frequently present the Commission with different views about a utility's return on common equity. The Commission has extensive experience adjudicating this issue. Utility regulation is not so mechanical that it can be performed without any expert judgment. The General Assembly has directed the Commission to utilize its experience and technical expertise in deciding a broad range of ratemaking issues. We do not find this issue to be fundamentally different from those which the Commission regularly decides under Ohio's statutory provisions for utility regulation. For these reasons, we find that Section 4928.143(F), Revised Code, provides sufficiently definitive guidance to the Commission to conduct the SEET.

B. IEU-Ohio's motion to dismiss

On the opening day of hearing before AEP-Ohio called its first witness, IEU-Ohio made an oral motion to dismiss the Companies' application in this matter. In support of its motion, IEU-Ohio claims that CSP and OP failed to come forward with evidence that satisfies the Companies' burden of proving that the Companies did not have significantly excessive earnings for calendar year 2009. IEU-Ohio renewed its motion to dismiss AEP-Ohio's application at the close of the evidentiary record. Both motions to dismiss were denied by the bench. (Tr. at 18-26, 746- 747.)

Pursuant to Rule 4901-1-15(F), O.A.C., IEU-Ohio challenged, on brief, the hearing examiner's rulings on the motions to dismiss. In support, IEU-Ohio submits that the Commission does not have subject matter jurisdiction to adopt an earnings test other than the earnings test outlined in Section 4928.143, Revised Code, or apply the required earnings test other than as mandated by Section 4928.143, Revised Code. IEU-Ohio argues that AEP-Ohio's application includes more than retail services in its earned return on equity (ROE), includes revenues for a period less than one year, includes nonretail transactions such as those subject to Federal Energy Regulatory Commission (FERC) jurisdiction and considers revenue, expenses and earnings of any affiliate or parent company.

Citing to the testimony of record, IEU-Ohio submits that AEP-Ohio witness Mitchell utilized earned ROE numbers for 2009 that were driven by total company numbers from all lines of business and not just the equity earned as a result of the ESP.[7] AEP-Ohio witness Hamrock confirmed that CSP and OP engage in multiple lines of business including nonutility business and that the calculations in AEP-Ohio's testimony includes income from FERC-jurisdictional activities.[8] Further, IEU-Ohio claims that all other witnesses in this proceeding relied upon AEP-Ohio's non-jurisdictionalized total company numbers as the starting point for developing their recommendations. Thus, IEU-Ohio argues, under the provisions of Section 4928.143, Revised Code, the Commission can proceed no further in its analysis of AEP-Ohio's SEET.

IEU-Ohio next submits that, even if the evidence presented by AEP-Ohio and the other parties conformed to the requirements of Section 4928.143, Revised Code, the Commission would not be able to rely on such evidence without correcting the math to eliminate other problems with the numbers used by the parties to present their recommendations. For example, pointing to the AEP-Ohio ESP order, IEU-Ohio submits that AEP-Ohio was instructed to remove the annual recovery of $51 million of expenses, including associated carrying charges, related to the Waterford Energy Center and the Darby Electric Generating Station.[9] However, pointing to the testimony of AEP-Ohio witness Hamrock, the expenses associated with the Waterford Energy Center and the Darby Electric Generating Station are included in the per book net income for CSP for 2009. IEU-Ohio claims that, in order to properly measure CSP's electric utility earned return from the ESP, the income statement (expenses, revenue and net income) and balance sheet (common equity) effects attributable to the Waterford Energy Center and the Darby Electric Generating Station must be removed in order to apply the SEET to the ESP currently in effect. (Tr. at 139-141.)

Even if the Commission ignores the fact that SEET requires reliance upon the electric utility and retail jurisdictional numbers, IEU-Ohio argues, the total company analysis provided by AEP-Ohio is based on one-sided, selective and misleading adjustments to the total company numbers. For example, AEP-Ohio removed off-system sales (OSS) net margins from CSP's total company dollar return on equity for 2009 because

7 Cos. Ex. 4 at 4-5; Tr. I at 37-39.

8 Cos. Ex. 6 at 6; Tr. I at 134, 136-137, 141-152.

9 AEP-Ohio ESP cases, Order at 51-52 (March 18, 2009); Entry on Rehearing at 35-36 (July 23, 2009); and Second Entry on Rehearing at 2-4 (November 4, 2009).

OSS margins result from wholesale transactions subject to FERC jurisdiction and not retail transactions. AEP-Ohio admits, however, that there are other nonjurisdictional activities that the Companies did not attempt to fully jurisdictionalize for 2009 earnings purposes although the Companies claim the right to do so, if necessary. The importance of AEP-Ohio's selective application between SEET and jurisdictional rate plan transactions was discussed by Staff witness Cahaan. Mr. Cahaan testified that if the OSS were excluded from the net income (numerator) then there should have been an adjustment made to the common stock equity (denominator). Failure to make such an adjustment tends to lower the overall return on equity. (Cos. Ex. 4 at 5; Cos. Ex. 6 at 6-7; Tr. at 36; Staff Ex. 1 at 19-20.)

AEP-Ohio submits that IEU-Ohio's motion to dismiss based upon IEU-Ohio's reading of Section 4928.143, Revised Code, as well as IEU-Ohio's criticisms of the Companies exclusions and deferrals for purposes of performing ROE calculations is without merit. Regarding IEU-Ohio's contention that the first annual period for the calculation of SEET began on April 1, 2009, and ended on March 31, 2010, AEP-Ohio claims that this position is contrary to determinations made by the Commission in the Companies' ESP proceedings. The Companies state that the Commission specifically found that AEP-Ohio's ESP was authorized effective January 1, 2009.[10] The Commission later confirmed the January 1, 2009, start date of the Companies' ESP in a March 30, 2009, entry *nunc pro tunc* and in an entry on rehearing issued on July 23, 2010. Therefore, AEP-Ohio argues, the first annual period of the Companies' ESP is calendar year 2009, and IEU-Ohio's contention otherwise is incorrect.

IEU-Ohio's argument that Section 4928.143(F), Revised Code, requires a jurisdictionalized earnings allocation study, based on ESP rate plan-approved services, is also incorrect, AEP-Ohio argues. The statute does not specifically require, claims AEP-Ohio, that the Commission perform a comprehensive jurisdictional allocation study in order to determine an earned ROE appropriate for use in the SEET. Rather, the Companies submit, FERC Form 1 data provides a reasonable starting point from which appropriate adjustments can be made in order to develop an earned ROE.

Next, AEP-Ohio disputes IEU-Ohio's contention that the Companies' filing contains faulty data insofar as the net income reflects inclusion of the expenses associated with CSP's Waterford and Darby generating stations. Adopting IEU-Ohio's logic, AEP-Ohio claims, would mean that every item of expense not related to an ESP rate adjustment would be adjusted out of expenses resulting in an artificial inflation of earnings for purposes of applying the SEET. Such a position is inappropriate, the Companies claim, because such an approach reflects a traditional ratemaking analysis pursuant to Section 4909.15, Revised Code, rather than favorably comparing the ESP to the expected results of

10 AEP-Ohio ESP cases, Order at 64 (March 18, 2009).

a MRO as intended by the General Assembly. AEP-Ohio urges the Commission to reject IEU-Ohio's position for purposes of developing the SEET analysis in this proceeding.

Lastly, AEP-Ohio's arguments responding to intervenors concerns regarding the exclusion of OSS, deferrals, and the failure to fully account for other nonjurisdictional activities are addressed under specific topic areas and not further addressed in this section of the Commission's decision.

IEU-Ohio's motion to dismiss is denied. The Commission has already fully addressed the start date of AEP-Ohio's ESP.[11] Likewise, we reject IEU-Ohio's contention that the Companies' application cannot proceed as AEP-Ohio did not perform a comprehensive jurisdictional allocation study. Nowhere in Section 4928.143(F), Revised Code, is a comprehensive jurisdictional allocation study required in order to determine an earned ROE appropriate for use in the SEET. Nor do we find that a comprehensive jurisdictional allocation study is the only manner in which to determine an earned ROE for SEET. Rather, we find that it is acceptable to make appropriate adjustments to FERC Form 1 data in order to develop an earned ROE for SEET. In making this determination, we note that, under applicable provisions of Section 4928.01, Revised Code, and under Section 4905.03, Revised Code, an electric utility is not limited to a subset of a firm's activities that may be regulated under an ESP. Additionally, the definition of an electric light company explicitly covers firms engaged in both activities subject to rate regulation by this Commission and activities such as transmission that are, in large part, subject to federal jurisdiction. Thus, while adjustments to FERC Form 1 data may be appropriate to isolate the effects on ROE of the adjustments in the ESP under review, the SEET, in the first instance, may be measured based upon the return of common equity of the electric utility viewed as a company without a complete jurisidictional cost and revenue allocation study.

Regarding IEU-Ohio's argument that the Companies' filing contains faulty data insofar as the net income reflects inclusion of expenses associated with CSP's Waterford and Darby generating stations, this argument is also rejected. In the Companies' ESP proceedings, the Commission had authorized CSP to increase revenues by $51 million to recover jurisdictional expenses associated with the Waterford and Darby facilities.[12] The Waterford and Darby facilities had never before been included in rate base. In response to IEU-Ohio's application for rehearing, the Commission agreed with IEU-Ohio that the Companies had not demonstrated that their current revenue was inadequate to cover the costs associated with the generating facilities. Therefore, the Commission directed AEP-Ohio to modify its ESP and remove the annual recovery of $51 million of expenses,

11 AEP-Ohio ESP, Order at 64 (March 18, 2009); Entry *Nunc Pro Tunc* (March 30, 2009); Entry on Rehearing at 41-45 (July 23, 2009).

12 AEP-Ohio ESP, Order at 51-52 (March 18, 2009).

including associated carrying charges related to these generation facilities.[13] Today, AEP-Ohio is in the same position regarding the Waterford and Darby facilities as it was before issuance of the ESP Order and, therefore, excluding an additional $51 million would be unreasonable.

II. APPLICATION OF SEET ANALYSIS:

A. Comparable Group of Companies, ROE of Comparable Companies and SEET Threshold

1. AEP-Ohio

One of the steps in the process to determine whether an electric utility has significantly excessive earnings is to compare the earned return on common equity of the electric utility to the earned return on common equity of a group of publicly traded companies, including utilities that face comparable business and financial risk. AEP-Ohio, Customer Parties and Staff advocate different methods to select the comparable group of publicly traded companies to develop the ROE to which AEP-Ohio's ROEs will ultimately be compared.

AEP-Ohio presented the testimony of Dr. Anil Makhija, professor of finance at The Ohio State University (Cos. Ex. 5). The process advocated by Dr. Makhija may be summarized as stated below. AEP-Ohio's proposed process evaluates all publicly traded U.S. firms to develop its comparable group of companies. To evaluate business risk, AEP-Ohio used unlevered betas and to evaluate financial risk, it used the book equity ratio. By using data from Value Line,[14] AEP-Ohio applies the standard decile portfolio technique to divide the companies into five different business risk groups and five different financial risk groups (listing each unlevered beta or book equity ratio lowest to highest). AEP-Ohio defines business risk as evolving from the day-to-day operations of CSP and OP, including the uncertainty associated with revenue stream, operating and maintenance expenses, regulatory risks, and fluctuations in weather and demand. AEP-Ohio equates financial risk with the debt obligation of CSP and OP. AEP-Ohio then selects the companies in the cell which includes AEP Corporation (AEP) as the comparable group companies. To account for the fact that the business and financial risks of CSP and OP may differ from AEP, this aspect of the process is repeated for CSP and OP and taken into consideration in determining whether CSP's or OP's ROEs are excessive. (Cos. Ex. 5 at 5-6, 13-18, 24-27.)

AEP-Ohio accounts for the risk faced by common equity holders by using the Capital Asset Pricing Model (CAPM), and then attempts to verify its findings by repeating

[13] AEP-Ohio ESP cases, Order at 51-52 (March 18, 2009); Entry on Rehearing at 35-36 (July 23, 2009); and Second Entry on Rehearing at 2-4 (November 4, 2009).

[14] *Value Line Standard Edition* as of June 1, 2010.

the analysis using capital intensity and the ratio of revenues to total assets as screens. AEP-Ohio argues that CAPM, which is used to measure total market-related risks, is "by far the most widely used model for taking risk into account." AEP-Ohio uses Value Line betas for AEP, as compared to the betas of CSP and OP, to confirm the conservative nature of AEP-Ohio's proposed method. To account for any difference in the capital structure of CSP or OP, as compared to the capital structure of the companies in the comparable group companies, the electric utility examines the unlevered beta and the debt/equity ratio of the publicly traded comparable companies as a part of determining their ROE. (Cos. Ex. 5 at 18-25.)

AEP-Ohio again advocates, as it proposed in its ESP proceeding and in 09-786, that an electric utility's earnings not be considered significantly excessive if the annual earnings are less than two standard deviations above the mean ROE of the comparable group of companies. The Companies explain that approximately two standard deviations (which is equivalent to a 1.96 standard deviation adder for SEET purposes) is equivalent to the traditional 95 percent confidence level, and the 95 percent confidence level provides for a reasonably acceptable risk of false positives. Further, this process for selection of the comparable group of companies is preferable, according to AEP-Ohio, because it is objective, as it relies on market-based measures of risk, best targets comparable companies, delivers a reliably large sample of comparable companies and can be replicated in future proceedings. Further, AEP-Ohio confirms its proposed method by repeating the analysis using other business and financial risk measures and a larger population of companies to form the comparable group of companies. (Cos. Ex. 5 at 5-6, 13.)

AEP-Ohio concludes that the mean ROE for the comparable group of companies for 2009 is 11.04 percent with a standard deviation of 5.85 percent. Multiplying the standard deviation of the comparable group of companies by 1.96 (corresponding to a 95 percent confidence level) yields an adder of 11.47 percent. Thus, AEP-Ohio's SEET analysis yields a threshold ROE, the point at which earnings should be considered significantly excessive for 2009, of 22.51 percent (11.04 +11.47) for CSP and OP. (Cos. Ex. 5 at 39, 45.)

Opposition to AEP-Ohio's proposed SEET analysis

Customer Parties and Staff argue that there are a number of errors with the method advocated by AEP-Ohio. First, Customer Parties claim that AEP-Ohio's approach for determining the comparable group companies identifies comparable utility and publicly traded companies based on the business and financial risk profile of AEP and not CSP (or OP) in contradiction of the language in Section 4928.143(F), Revised Code, which directs the Commission not to consider the revenues, expenses, or earnings of the electric utility's affiliates or its parent company. Second, Customer Parties contend that AEP-Ohio's process establishes an ROE threshold for SEET based on a 95 percent confidence interval and, as such, only 2.5 percent of companies would ever be determined to have significantly excessive earnings. Customer Parties argue that using such a high confidence interval results in an excessively high ROE SEET threshold. Third, Customer Parties argue that AEP-Ohio's method does not directly adjust the ROE for the capital structure and cost of debt of CSP to appropriately account for the differences in financial risk between CSP and the comparable companies. Ultimately, Customer Parties contend that AEP-Ohio's proposed SEET analysis does not provide a direct ROE SEET for CSP. (Joint Inv. Ex. 1 at 24-26.)

Staff notes a number of advantages and some disadvantages with AEP-Ohio's SEET process. Staff supports AEP-Ohio's proposed SEET process to the extent that it yields a reliably large sample and is objective as a result of its reliance on market-based measures. However, Staff asserts that AEP-Ohio's process very significantly reduces any aspect of judgment as to the appropriateness of any company included in the comparable group of companies. Staff also argues that AEP-Ohio's implementation of the CAPM does not allow for the consideration of the type of business risk and, thus, creates a group of comparable companies with diverse business risk which produces a large variance. Staff argues that AEP-Ohio's use of CAPM to evaluate business risk is misplaced. Staff interprets Section 4928.143(F), Revised Code, to focus on the company's business risk as opposed to the investor's diversifiable business risk. Staff also dislikes AEP-Ohio's reliance on unlevered betas as a part of the SEET process. Staff reasons that unlevered beta measures are not stable. Finally, Staff rejects a statistical definition of "significantly" for three reasons. In this case, it is Staff's opinion that the Companies' proposal for statistical significance is egregiously excessive and counter-intuitive to the requirements of SB 221. According to Staff, a statistical definition of "significant" does not provide a useful or satisfactory interpretation of the legislative language, common sense or the ordinary meaning of the words as used in the English language. Staff believes that there is no reason to implement a scientific process for statistical inference when direct observation to reach a conclusion is feasible. Although Staff recognizes that direct observation to surmise a result could put the electric utility in the position of trying to prove a negative, Staff believes it is in essence a method to avoid false negatives like the Companies' proposed method is designed to avoid false positives. (Staff Ex. 1 at 3-9, 12-16.)

2. <u>Customer Parties</u>

Customer Parties advocate a seven-step process by which to determine the SEET threshold ROE which may be summarized as follows: (1) identify a proxy group of electric utility companies (electric proxy group); (2) identify a list of business and financial risk measures for the electric proxy group; (3) establish the ranges for the business and financial risk indicators for the companies in the electric proxy group; (4) screen the *Value Line* database to identify a group of comparable public companies, including electric utilities, whose business and financial risk indicators fall within the ranges of the electric proxy group; (5) compute the benchmark ROE for the group of comparable public companies, including electric utilities; (6) adjust the benchmark ROE for the capital structures of CSP; and (7) add a ROE premium to establish the SEET threshold ROE. (Joint Inv. Ex. 1 at 8.)

Customer Parties first created an electric proxy group by reviewing utilities in the *AUS Utility Reports* based on four criteria. The electric proxy group includes 15 electric utilities with: (1) at least 75 percent of revenue from regulated electric; (2) an investment grade bond rating; (3) total revenue of less than $10 billion; and (4) a three-year history of paying cash dividends (2007–2010) with no dividend reductions.[15] Customer Parties reason that this aspect of its proposed SEET analysis is appropriate, as it is common to use this screening process in estimating the cost of capital in public utility rate cases and because the process results in a group of businesses with similar business and financial characteristics to the utility at issue, in this case CSP. After excluding foreign companies, Customer Parties use three business and financial risk indicators, beta, asset turnover and common equity ratios, from the electric proxy group to establish ranges for beta, asset turnover and common equity to develop the comparable group of companies as required in Section 4928.143(F), Revised Code. (Joint Inv. Ex. 1 at 9-15.)

Step 4 of the process advocated by Customer Parties is to screen the *Value Line Investment Analyzer 2010* to develop the comparable group companies with business and financial risk indicators within the range of the electric utility proxy group. Forty-five companies compose Customer Parties' comparable group of companies with 15 electric utilities, 28 gas and electric utilities and only two nonutility companies. Under Customer Parties' proposed SEET, the next step is to determine the median ROE for the comparable group companies, in this case, 9.55 percent for 2009. Customer Parties argue that it is appropriate to use the median ROE, as opposed to the mean ROE, to avoid the impact of outliers in the distribution of the ROEs, as the presence of outliers can greatly inflate the standard deviation of the comparable group companies and ultimately inflate the SEET threshold ROE. (Joint Inv. Ex. 1 at 15-21; JRW-2; JRW-3; Cos. Br. at 32.)

Next, Customer Parties adjust the benchmark ROE of the comparable group companies for the capital structure of CSP to account for the differences in financial risk between the comparable group of companies and CSP. Under Customer Parties' proposed SEET analysis, the benchmark ROE for CSP is 9.58 percent and the benchmark ROE for the comparable group of companies is 9.55 percent. Customer Parties recommend a 200 to 400 basis point premium adder to the benchmark ROE of the comparable group of companies ROE to establish the threshold ROE for significantly excessive earnings for the year 2009. Customer Parties emphasize that the 200-400 basis points premium should not be considered an unchanging precedent but is based on the ROE adder used by the FERC for transmission investments that are not routine and riskier than the usual investments made

15 Joint Inv. Ex. 1 at 10, Table 1.

by transmission companies. The rationale is that the basis points premium is an administrative standard based on informed judgment for additional risk. In comparison, Customer Parties offer that setting the SEET threshold 200 basis points over the returns of the comparable group of companies is an appropriate proxy for the significantly excessive earnings threshold for AEP-Ohio and, in its opinion, is consistent with the Commission's adoption of the 200 basis points "safe harbor" provision as set forth in 09-786. Under this analysis, Customer Parties argue that the threshold ROE for CSP is 11.58 percent to 13.58 percent. OPAE supports the SEET analysis advocated by Customer Parties (Joint Inv. Ex. 1 at 7-8, 17-23; OPAE Br. at 6-7.)

Opposition to Customer Parties' proposed SEET analysis

AEP-Ohio argues that Customer Parties' proposed SEET analysis does not meet the objective required by the statute that the comparable group of companies match the business and financial risk of CSP and OP. AEP-Ohio also asserts that Customer Parties' method presupposes what kind of companies ought to be a match for CSP or OP by use of the electric proxy group, limits the sample of companies available and rules out publicly traded companies that may have been a better match to the electric utility. AEP-Ohio also reasons that Customer Parties' process does not produce a reliably large sample of comparable companies. AEP-Ohio suggests that Customer Parties implicitly recognize the relatively small sample size by modifying the results to eliminate outliers and by using the median rather than the mean based on a misinterpretation of Section 4928.143(F), Revised Code. AEP-Ohio reasons that the median is inadequate for purposes of the SEET analysis because it does not respond to the variation in the ROEs among the comparable group of companies. AEP-Ohio advocates that the mean and standard deviation better capture the information regarding the ROEs of the comparable group of companies and the distribution of their ROEs. AEP-Ohio notes that the mean ROE of the electric proxy group is 9.74 percent. The Companies contend that Customer Parties' proposed SEET analysis process includes the FERC adder based on an arbitrary calculation that has no connection to the comparable group of companies to whose mean or median the ROE is applied. AEP-Ohio asserts that the Customer Parties' approach lacks objectivity. Further, AEP-Ohio argues that Customer Parties' method produces the same result for all electric utilities in Ohio as well as others across the country and includes only two non-utility companies out of the 45 that form the Customer Parties' group of comparable companies. (Cos. Ex. 7 at 1-5, 7-9.)

AEP-Ohio contends that Customer Parties' use of the beta range produced by the electric proxy group is inappropriate to compare to the year-end value for CSP. Because CSP's beta is higher, since it is a smaller company, Customer Parties' analysis necessarily puts CSP's beta outside of the range of the electric proxy group beta, causing a misguided comparable group of companies to be composed. According to AEP-Ohio, Customer Parties' method implements a screen for business risk too late in the process and utilizes inappropriate screens. AEP-Ohio contends that Customer Parties' proposal mixes business and financial risks where SB 221 requires the consideration of both business and financial risks in the formation of the comparable group of companies. (Cos. Ex. 7 at 5-6.)

Further, AEP-Ohio asserts that Customer Parties failed to correctly adjust the data for the comparable group of companies for the capital structure of CSP. The Companies contend that Customer Parties should have considered short-term debt as well as long-term debt, preferred and common equity. (Cos. Ex. 7 at 6-7.)

Finally, AEP-Ohio argues that Customer Parties' adder is arbitrary and produces an unreasonably high number of companies that would fail the SEET. With the 200 basis points adder, and using Customer Parties' benchmark ROE of 9.58 percent, and a threshold ROE minimum of 11.58 percent, AEP-Ohio concludes that almost one in every four companies in Customer Parties' comparable group of companies would have significantly excessive earnings. Further, AEP-Ohio reasons that, pursuant to Customer Parties' SEET analysis, if applied symmetrically, to a mean below 7.58 percent and above 11.58 percent, nearly half the comparable group companies would have earnings that were significantly excessive or deficient under Customer Parties' proposed 200 points adder. AEP-Ohio argues that such results demonstrate excessive failure rates in the application of the SEET with dire consequences for attracting capital to Ohio's utilities. (Cos. Ex. 7 at 10-11; Joint Int. Ex. 1 at Ex. JRW-4.)

3. Staff

Staff presented the testimony of Richard Cahaan, consultant to the Capital Recovery and Financial Analysis Division of the Utilities Department. Staff's SEET analysis proposal is based on a three-step process: (1) determine the ROE for the group of companies with comparable business and financial risks; (2) establish a threshold ROE that is significantly in excess of the ROE for the comparable group of companies; and (3) calculate AEP-Ohio's ROE for use in the SEET. (Staff Ex. 1 at 1-2.)

After evaluating the SEET analyses offered by AEP-Ohio and by Customer Parties in this proceeding, as well as the model advocated by Dr. Vilbert in the FirstEnergy Companies SEET case,[16] Staff posits that, while each approach is considerably different, the results are not so different. Staff characterizes AEP-Ohio's model as theoretical, abstract and academic and Customer Parties' model as more traditional. Staff claims that the Customer Parties' comparable group of companies includes an anomaly company or isolated outlier with one portion of its business that is characteristically quite different

16 *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Administration of the Significantly Excessive Earnings Test Under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code,* Case No. 10-1265-EL-UNC.

from utility generation and distribution assets. Staff reasons that it is not unusual to eliminate the highest and lowest observations in a sample to calculate the mean and, if the high and low outliers were omitted from the Customer Parties' process, the mean would be 10.06 percent. In light of such a comparison, Staff reasons that Customer Parties' 9.58 percent ROE for the comparable group of companies is low. However, the witness acknowledges that, if the median ROE is used, Staff's proposed adjustment to eliminate the outliers would have no affect on the ROE of the comparable group of companies. (Staff Ex. 1 at 3-9, 12; Tr. III at 518).

In the application of SEET, the Staff declares that it is appropriate to recognize a range of reasonableness as opposed to the accounting accuracy usually associated with public utility regulation. Consistent with that reasoning, Staff notes that the ROE as presented in two exchange funds, namely *iShares Dow Jones U.S. Utilities Sector Index Fund* and *Utilities Select Sector SPDR Fund*, have a weighted average ROE of 11.15 percent and 11.39 percent, respectively. Staff offers that these independently determined ROEs confirm the reasonableness of the ROE offered by the parties to this case. Considering the SEET analyses offered and Staff's expressed advantages and disadvantages of each parties' proposal, Staff witness Cahaan believes that the mean ROE for the group of comparable companies is reasonably within the 10 percent to 11 percent range with a bit more evidence on the higher side of the range. (Staff Ex. 1 at 3, 11-13.)

Operating under the theory that "significantly excessive" is a concept of fairness, Staff advocates that, rather than a 200-400 basis points adder to the mean of the comparable group companies' ROE, the threshold ROE be expressed as a percentage of the comparable group companies' benchmark ROE. The benefits of using a percentage of the comparable group companies' benchmark ROE incorporates an adjustment that works and is reasonable in deflationary and inflationary economic conditions. Staff advocates a 50 percent adder to the comparable group of companies' ROE to establish the SEET threshold. Staff explains that, in this case for 2009, the 50 percent adder is in the reasonable range by comparing it to CSP's current embedded cost of debt. Staff argues that if the result of subtracting the adder from the comparable ROE yields a result that is near CSP's cost of debt, the adder is reasonable. Staff, therefore, recommends a SEET threshold for CSP of 16.05 percent before the company's earnings may be considered significantly excessive. (Staff Ex. 1 at 13-17).

Finally, for efficiency of the annual SEET analysis, Staff proposes that, in future SEET cases, the Commission direct Staff to offer a benchmark ROE based on an index or combination of indices announced in advance and that parties to the case put forward analysis for adjustments or modifications to the indexed benchmarks (Staff Ex. 1 at 12).

Opposition to Staff's analysis

AEP-Ohio argues that Staff's proposed 50 percent adder is roughly equivalent to less than one standard deviation and is too low when the frequency with which a company will be considered to have significantly excessive earnings is considered. According to AEP-Ohio, the 50 percent adder would cause more than one out of every three companies to be found to have significantly excessive earnings. Further, AEP-Ohio notes that under Staff's proposal, where the comparable group of companies are right-skewed and fat-tailed, an even greater portion of companies would be beyond the threshold ROE. (Cos. Ex. 5 at 39-40; Cos. Br. at 40-41.)

4. Commission decision on comparable companies and comparable companies' ROE

Contrary to Customer Parties' claims, AEP-Ohio took into account the business and financial risks of the electric utility in determining its comparable group of companies and adjusted for the capital structure of the electric utility. AEP-Ohio's determination of the comparable group of companies was initially determined by publicly traded companies that share similar business and financial risks, and the use of the beta of AEP-Ohio, as opposed to the beta of CSP or OP, does not negate the validity of the comparable group of companies selected under AEP-Ohio's analysis. The Commission is concerned that Customer Parties' determination of the comparable group of companies was developed from an electric only proxy group which predetermines, to some extent, the characteristics of the comparable group without any direct relationship to the electric utility, and, most significantly, produces the same comparable group of companies for all Ohio's electric utilities.

Given the divergent methods with which each party computed the comparable companies' ROE, including Staff's use of two independent indices to confirm the reasonableness of the resulting ROEs, the evidence indicates the comparable benchmark ROE is in the general range of between 10 percent and 11 percent. Thus, this is the range within which the mean of the comparable companies should be established. However, we believe that the reasons cited by Staff and AEP-Ohio warrant establishing the benchmark at the top of the range, 11 percent, rather than the 10.7 percent recommended by the Staff.

B. AEP-Ohio 2009 Earned ROEs

AEP-Ohio witness Thomas E. Mitchell presented testimony that supported the Companies' calculation of CSP's and OP's earned ROE for the 2009 SEET, proposed deductions to the Companies' ROEs and quantified the revenue producing provisions of the Companies' ESP. AEP-Ohio calculates each electric utility's ROE by using the net earnings available to common equity shareholders compared to the beginning and ending average equity for the year ended December 31, 2009, as dictated by the Commission in 09-786. AEP-Ohio witness Mitchell testified that there were no minority interest, non-recurring, special or extraordinary items for CSP or OP for the year 2009. Thus, without any further adjustments, AEP-Ohio determined an ROE for OP of 10.81 percent and for CSP of 20.84 percent for 2009. AEP-Ohio acknowledges that included in the earnings of CSP and OP are nonjurisdictional earnings (excluding as it proposes off-system sales) that it did not attempt to fully jurisdictionalize for purposes of the 2009 SEET analysis; however, AEP-Ohio asserts to reserve the right to further jurisdictionalize its earnings if necessary. (Cos. Ex. 4 at 3-5, Ex. TEM-1 at 1; Cos. Ex. 6 at 7.)

Based on the Companies' determination of the mean ROE of the comparable group of companies of 11.04 percent, the Companies concluded that OP was within the safe harbor provision of 200 basis points above the mean of the comparable group of companies and, thus, did not have significantly excessive earnings for 2009 (Cos. Ex. 4 at 3-5; Cos. Ex. 6 at 7-9).

Customer Parties and Staff accepted the Companies' calculation of CSP's ROE of 20.84 percent for 2009 and OP's ROE of 10.81 percent for 2009, excluding any adjustments (Joint Inv. Ex. 2 at 18; Staff Ex 1 at 18).[17]

1. Commission decision on SEET Threshold

First, to the extent that AEP-Ohio failed to further jurisdictionalize its 2009 earnings for the SEET proceeding, AEP-Ohio has waived its right to do so subsequent to the issuance of this Order. The parties to this proceeding should not be required to revise their position or the Commission reconsider its Order because AEP-Ohio elected not to further jurisdictionalize its earnings before the application was filed.

In 09-786, the Commission concluded that, for purposes of the SEET analysis, any electric utility earnings found to be less than 200 basis points above the mean of the comparable group of companies would not be significantly excessive earnings.[18] In this case, depending on the comparable group of companies selected and the range of the comparable companies' ROEs, the ROE spans from 9.58 percent, as proposed by Customer Parties, to 11.04 percent, as proposed by AEP-Ohio. The Commission observes that under any parties' proposed SEET analysis presented in this proceeding, OP's earned ROE is less than 200 basis points above the mean of the comparable group of companies. Thus, we find that OP did not have significantly excessive earnings for 2009 pursuant to Section

17 Customer Parties nonetheless note that it computes CSP's ROE for 2009 as slightly more, 20.86 percent, and that SNL Financial database computes CSP's ROE at 20.82 percent. Customer Parties concede that the difference is immaterial. (Joint Inv. Ex. 2 at 18.)

18 09-786, Order at 29 (June 30, 2010).

4928.143(F), Revised Code, or pursuant to the Commission's directives in 09-786 and we will not further analyze the earnings of OP as a part of this 2009 SEET proceeding.

Further, we find the Companies' straight-forward calculation of CSP's and OP's earned ROE for 2009 to be reasonable, consistent with the requirements of Section 4928.143(F), Revised Code, and the directives of the Commission as set forth in 09-786.[19] We address the related arguments of IEU-Ohio regarding the jurisdictionalization of CSP's and OP's revenues above in the procedural section of this order and, therefore, see no reason to restate our findings on the issue again here.

To recap the position of the parties, AEP-Ohio advances a 2009 SEET threshold for CSP of 22.51 percent. At the other end of the spectrum is Customer Parties, who argue that, under its proposed SEET analysis, the threshold ROE for CSP is in the range of 11.58 percent to 13.58 percent. Staff advocates a 50 percent adder to the ROE of the comparable group of companies which when added to its recommended benchmark ROE of 10.70 yields, in this case, a SEET threshold of 16.05 percent for CSP.

In regards to the determination of the SEET threshold, in 09-786, a number of commenters requested a "bright line statistical analysis test for the evaluation of earnings." While the Commission agreed that "statistical analysis can be one of many useful tools," we declined to adopt such a test. We concluded, instead, that "significantly excess earnings should be determined based on the reasonable judgment of the Commission on a case-by-case basis." Our Order noted the significant variation among Ohio electric utilities and went on to identify specific factors which the Commission would consider in its case-by-case analysis.

> [T]he Commission will give due consideration to certain factors, including, but not limited to, the electric utility's most recently authorized return on equity, the electric utility's risk, including the following: whether the electric utility owns generation; whether the ESP includes a fuel and purchased power adjustment or other similar adjustments; the rate design and the extent to which the electric utility remains subject to weather and economic risk; capital commitments and future capital requirements; indicators of management performance and benchmarks to other utilities; and innovation and industry leadership with respect to meeting industry challenges to maintain and improve the competitiveness of Ohio's economy, including research and development expenditures, investments in advanced technology, and innovative

19 09-786, Entry on Rehearing at 6 (August 25, 2010).

> practices; and the extent to which the electric utility has advanced state policy.

In the current case, AEP-Ohio again proposes a bright line SEET threshold based exclusively on a statistical analysis of comparable companies, with some regard for the Commission's directives. The Companies' recommendation is unreasonable and inconsistent with the statute. As we clearly stated in 09-786:

> [U]tilizing only a statistical method for establishing the SEET threshold is insufficient by itself to meet the electric utility's burden of proof pursuant to Section 4928.143(F), Revised Code. Section 4928.143(F), Revised Code, places on the utility "the burden of proof for demonstrating that significantly excessive earnings did not occur." Passing a statistical test does not, in and of itself, demonstrate that excessive earnings did not occur.

The statute requires us to measure excessive earnings by whether "the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity" earned by comparable companies. Section 4928.143(F), Revised Code. Whether any differential between the ROE of the electric utility and that of the comparable companies is significant necessarily depends on factors related to the individual electric utility under review. While a statistical analysis of the variation in returns among companies facing comparable business and financial risks can provide useful information, as indicated in our decision in 09-786, we will not rely exclusively on a statistical approach or set a generic bright line threshold based only on variations in the returns of the comparable companies.

We find that not only does AEP-Ohio's proposed SEET analysis rely exclusively on a bright line statistical test for its SEET threshold, it relies on the statistical analysis to the point of producing an unrealistic and indefensible result. If the Commission were to accept AEP-Ohio's SEET analysis to determine the threshold ROE for CSP at 22.51 percent, the Commission would be forced to accept an electric utility ROE of less than 22.51 percent as not significantly excessive. Without additional comparisons to justify its SEET threshold for CSP as reasonable, we conclude that AEP-Ohio improperly relied on a statistical test for its SEET threshold. In light of the Commission's rejection of Customer Parties' development of the comparable group of companies, we also reject their SEET threshold range of 11.58 to 13.58 percent. Not only do we reject Customer Parties' SEET threshold range in this case, we do not believe that their use of a 200-400 basis points adder to the benchmark ROE of the comparable group of companies is optimally related to the purpose of the SEET. We find the conceptual construct of Staff's proposal to use a percentage of the average of the comparable companies to be more appropriately related to the purpose of the SEET.

Although the purpose of the SEET is to be a statutory check on rates that result in excessive earnings, we find that one of the impacts of the SEET creates symmetry with our obligation to ensure that a company may operate successfully, maintain financial integrity, attract capital and compensate its investors for the risk assumed. Among the parties' positions we find that Staff's basic methodology best gives effect to the statutory design to create such symmetry. Specifically, the Commission is persuaded by the fact that Staff's proposed adder's impact, if subtracted from the comparable ROE benchmark yields a result that is similar to the company's cost of debt. Given the Commission's adoption of an 11 percent ROE, the impact of a 50 percent downward adjustment to the comparable ROE results in an earnings of 5.5 percent, which is similar to CSP's embedded cost of debt. Therefore, 50 percent is a reasonable guide for establishing an adder.

Additionally, when there is a differential by which the return for a specific electric utility exceeds the safe harbor threshold established in 09-786, the Commission must attribute any such amount to and allocate it between earnings that are significantly excessive as a result of adjustments in the utility's ESP, or to earnings that are not significantly excessive because they reflect utility specific factors, are reasonable given the utility's actual performance or are attributable to factors unrelated to the ESP.

Turning first to utility specific factors related to investment requirements, risk, and investor expectations, the Commission must recognize that a comparison to other firms will not fully capture company specific factors which influence whether a return is significantly excessive. On a going forward basis, the Commission expects to refine the quantitative analysis associated with these factors through future SEET proceedings.

In its SEET application, as set forth in the Order in 09-786, Mr. Hamrock discusses at length in his testimony the various factors which the Commission indicated it would take into consideration in the establishment of the level of significantly excessive earnings. Mr. Hamrock discussed the capital commitments made by CSP for both 2010 and 2011, as well as the various business and financial risks faced by CSP. The witness also explained several ways in which CSP has demonstrated positive management performance in several areas. He discussed the improved service reliability experienced by CSP customers from 2003 to 2009 and the various technological innovations CSP has initiated, such as gridSMART, to its leadership in energy efficiency and peak demand response programs. CSP continues to make extensive capital investments in the state of Ohio. Customer Parties raised a concern that CSP was not making a firm commitment to its 2010 budget. The Commission notes that, on cross-examination, it was demonstrated that CSP is indeed committed to spending the projected capital budget for 2010.

In terms of the various business and financial risks discussed by Mr. Hamrock in his testimony, the Commission concurs that CSP is facing various business and financial risks. Despite the use of riders, some bypassable and other nonbypassable riders, the fact remains that initial capital outlays must be made to fund many of the activities enumerated by CSP. In addition to initial capital outlays that CSP must make in order to fund its obligations under its ESP and its provision of service in general, there are other risks, not clearly associated with a rider, of which the Commission must remain mindful. For example, the Commission concurs with CSP that electric utilities are not assured recovery of their generation assets due to the change in the regulatory environment; the prospect of future industry restructuring and carbon regulation is unknown; and market prices for generation-related services are volatile. Lastly, the Commission gives consideration to the challenge of fulfilling the various mandates of SB 221, within the context of a rapidly changing electric market.

The Commission also takes into consideration the fact that CSP's service reliability, both in terms of the number of outages experienced by its customers and the length of those outages, has improved. CSP's actual frequency of outages (SAIFI) went from 1.91 in 2003 to 1.31 in 2009. During the same period, CSP's number and duration of outages (CAIDI) went from 148.6 to 122.6.

Additionally, the Commission notes that CSP's most recently authorized ROE was 12.46 and, while dated, it may still be influencing earned returns and should be acknowledged and considered. We also believe, in light of the current economic situation across the state, it is unreasonable to overlook economic volatility in the SEET analysis.

The Commission also believes consideration should be given to CSP's commitment to innovation. In particular, the Commission believes that consideration should be given to CSP's gridSMART program. CSP's gridSMART program is a holistic approach to the deployment of gridSMART and, as such, as noted by Mr. Hamrock, received the highest rating among all demonstration grant applications to the U. S. Department of Energy. Further CSP has agreed to initiate a Phase 2 gridSMART program.[20]

Lastly, the Commission must also include in its consideration CSP's efforts to advance Ohio's energy policy and future committed capital investments. CSP far exceeded the established benchmark requirements both in the area of energy efficiency and peak demand response. CSP continues its innovation efforts and dedication to Ohio's energy policy by its commitment to provide $20 million in funding to a solar project in Cumberland, Ohio. Not only will this project advance the state's energy policy, but it will also bring much needed economic development activity to Ohio. Various parties noted that this commitment was contingent on several other factors and questioned the appropriateness of giving any consideration to this investment. The Commission remains confident that this project will move forward and the funds will be expended for this project in the near future. Nevertheless, should this project not move forward in 2012,

20 See AEP-Ohio Notice of Withdrawal of the Stipulation filed December 16, 2010.

such that the funds are expended in 2012, the Commission requires the $20 million to be spent in 2012 on a similar project.

Giving due consideration to the aforementioned factors, and keeping in mind the nature of the SEET, the Commission believes that Staff's 50 percent baseline adder should be adjusted upward. Thus, the appropriate percentage to be added to the mean of the comparable group companies is 60 percent which in this case yields a SEET threshold of 17.6 percent.

C. Adjustments to CSP's 2009 Earnings

1. Off-system sales

(a) AEP-Ohio's SEET application excludes OSS

AEP-Ohio submits that its ROEs should be reduced for OSS margins (after federal and state income taxes). Based on AEP-Ohio's interpretation of Section 4928.143(F), Revised Code, only those earnings resulting from adjustments included in AEP-Ohio's ESP are part of the SEET analysis process. AEP-Ohio reasons that OSS margins are based on wholesale transactions, approved by FERC, and excluding OSS margins from SEET complies with well-settled federal constitutional law. AEP-Ohio argues that under federal constitutional law, the State is preempted from interfering with the Companies' ability to realize revenue rightfully received from wholesale power sales pursuant to contracts or rates approved by FERC. *Pacific Gas & Electric v. Energy Resources Comm.*, 461 U.S. 190 (1983) (*Energy Resources Comm.*); *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) (*Nantahala*); *Mississippi Power & Light v. Mississippi*, 487 U.S. 354 (1988) (*MP&L*); *Pacific Gas & Electric Co. v. Lynch*, 216 F. Supp. 2d 1016 (N.D. Cal. 2002) (*Lynch*). AEP-Ohio extends that reasoning to conclude that, just as the state may not trap FERC-approved wholesale power costs, it may not, in effect capture or siphon off the revenue the Companies receive from FERC-approved wholesale sales for the purpose of reducing the retail rates paid by Ohio customers. Any such order by the Commission, according to AEP-Ohio, would conflict with the Federal Power Act and Congress' power under the Supremacy Clause. AEP-Ohio further alleges that this type of economic protectionism would also violate the federal Commerce Clause. *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982) (*NEPC*). Thus, AEP-Ohio declares that it would be unlawful for the Companies' OSS earnings to be included in the computation of any significantly excessive earnings. To that end, AEP-Ohio proposes that, to avoid any jurisdictional conflict, OSS margins be excluded from AEP-Ohio's earnings to comply with Section 4928.143(F), Revised Code. Consistent with this reasoning, AEP-Ohio reduces it earnings attributable to common stock after taxes and adjusts its ROE for CSP from 20.84 percent to 18.31 percent. (Cos. Ex. 4 at 5-6, Ex. TEM-1; Cos. Ex. 6 at 6-7.)

(b) Staff's positions as to OSS

Staff takes no position on the inclusion or exclusion of OSS from the SEET analysis. However, Staff argues that the Companies' calculation to exclude OSS from CSP's earned ROE is incorrect. According to Staff, to appropriately exclude OSS margins from CSP's earned ROE there must be an adjustment to the equity base of the ROE. Staff adjusts the denominator, common stock equity, to account for that part of the equity which finances the generation plant which facilitates OSS. To make the adjustment, Staff first calculates the amount of equity that supports production plant, which is 51.5 percent of CSP's total equity. The next step is to allocate that portion of equity to OSS by using the ratio of sales for resale revenues to total sales revenues, which equals 13.9 percent. Staff's calculation results in $93.4 million of the total average equity of $1,302.6 million being allocated to OSS, leaving the remaining average equity balance at $1,209.2 million. As adjusted by Staff, CSP's ROE after excluding OSS, acknowledging the corresponding equity effect, produces an earned ROE of 19.73 percent as opposed to the 18.31 percent offered by CSP. (Staff Ex. 1 at 19-21, Ex. 3.)

Customer Parties oppose any adjustment to CSP's earned ROE of 20.84 percent. Nonetheless, if the Commission elects to exclude OSS margins from CSP's earned ROE, Customer Parties admit that the Staff's proposed revision to the calculation is an appropriate starting point although it understates the company's earned return. (Joint Inv. Br. at 29-31.)

AEP-Ohio explains that, despite Staff's claims that the Companies' calculation to exclude OSS from CSP's earned ROE needs to be refined, according to AEP-Ohio, the calculation is consistent with the Commission's directive as to the calculation of equity in 09-786 (Cos. Ex. 4 at 4-5; Tr. at 78).[21]

(c) Customer Parties' position on OSS

Customer Parties, as supported by OPAE, vehemently oppose any adjustment to CSP's earned ROE of 20.84 percent including OSS. Customer Parties reason that OSS are sales by the utility to individuals or entities that are not Ohio retail customers. OSS are possible, Customer Parties explain, by generation plant that otherwise produces power for Ohio retail electric customers; generation facilities built for the benefit of and funded by Ohio customers. Customer Parties are adamant that CSP's jurisdictional customers have funded a return on as well as a return of the generation assets used for OSS transactions. Thus, Customer Parties and OPAE reason that it is only equitable to include OSS earnings in CSP's SEET calculation. (Joint Inv. Ex. 2 at 22-24; OPAE Br. at 4-7.)

21 09-786, Order at 18 (June 30, 2010); Entry on Rehearing at 6 (August 25, 2010).

Customer Parties offer that in 2009, CSP's earnings from OSS were $32,977 million, in comparison to CSP's total earnings of $271,504 million, 12.1 percent of CSP's total earnings. If, as AEP-Ohio requests, earnings from OSS are excluded from the SEET analysis, Customer Parties argue that the Commission would be comparing 87.9 percent of CSP's earnings to 100 percent of the earnings of the comparable group of companies, biasing the SEET analysis in favor of AEP-Ohio. Customer Parties plead that such a comparison is in conflict with the language of Section 4928.143(F), Revised Code, and will render the SEET analysis meaningless and asymmetrical. Further, Customer Parties contend that OSS are an inherent component of the company's earnings, as prescribed by generally accepted accounting principles, as such earnings are reported to the Securities and Exchange Commission (SEC) and FERC. Customer Parties declare that modifying such reported earnings would be inconsistent with federal law as well as FERC and SEC accounting standards. (Joint Inv. Ex. 2 at 21-24; Cos. Ex. 4 at Ex. TEM-1.)

Moreover, Customer Parties note that Ohio customers are paying CSP for its energy efficiency programs instituted pursuant to Section 4928.64, Revised Code, which facilitate OSS. On that basis, Customer Parties believe it is unreasonable to exclude OSS margins from the SEET analysis. Incorporating OSS margins in the SEET analysis serves as a form of off-set to the energy efficiency costs incurred by CSP's customers and promotes the policy of the state, under Section 4928.02(A), Revised Code, to ensure the availability of reasonably priced retail electric service to Ohio's consumers. (Joint Int. Ex. 2 at 23-24; Tr. 253-254.)

In regard to the FERC jurisdictional claims made by AEP-Ohio, Customer Parties retort that there is no valid federal preemption prohibiting consideration of OSS earnings in retail ratemaking. Customer Parties assert that several other state commissions have done so. (Joint Inv. Ex. 2 at 24.)

(d) <u>Commission decision on OSS margins</u>

Initially, the issue of OSS margins in the SEET analysis was considered by the Commission in AEP-Ohio's ESP proceedings. Numerous interested stakeholders also participated in 09-786 and offered their position on the issue of OSS in that proceeding. While the Commission offered guidance on numerous aspects of the issues raised as to the application of the SEET, in regards to OSS, the Commission determined that the issue was more appropriately addressed in the individual SEET proceedings. As the Commission had hoped, in this case the Companies and Customer Parties have expanded and clarified their positions and have provided context to the effects of each position presented as part of this SEET analysis.

We are required to consider not only whether the electric utility had significantly excessive earnings but also whether its earnings are the result of adjustments in its ESP. Where it can be shown that the electric utility received a return on its OSS, which if included in the calculation could unduly increase its ROE for purposes of SEET comparisons, OSS margins and the related equity in generation facilities should be excluded from the SEET calculation. Thus, without reaching the federal and constitutional law arguments, we will exclude OSS and the portion of generation that supports OSS from the SEET analysis.

With the exclusion of OSS margins from the SEET analysis, we find it necessary to correct, as Staff recommends and Customer Parties at least accept as conceptually correct, to account for the equity effect of the exclusion. Therefore, we reduce CSP's earnings to exclude OSS and similarly adjust the calculation to account for that portion of the generation facilities that supports OSS. Accordingly, the Commission recalculates CSP's ROE, excluding OSS and incorporating the equity effect of excluding OSS, to be 19.73 percent.

2. Deferrals

(a) AEP-Ohio

In AEP-Ohio's SEET application, the Companies exclude what it refers to as "significant" deferrals- deferred fuel adjustment clause revenues (including the interest on carrying costs and the equity carrying costs component on the deferred fuel) and deferred economic development rider (EDR) revenues from CSP's ROE for SEET purposes, thereby reducing CSP's ROE from 18.31 percent (with OSS excluded) to 15.99 percent (excluding both OSS and deferrals) for 2009. AEP-Ohio calculates CSP's deferrals to total $47.2 million. AEP-Ohio argues that this exclusion is critical for the Companies to preserve the probability of recovery of the deferred fuel cost as it is a necessary basis for the utility to record and maintain the regulatory asset on its balance sheet and for the Commission to direct the phase-in of rate increases as permitted pursuant to Section 4928.144, Revised Code. The Companies also argue it is inappropriate for the Commission to consider refunding earnings through the SEET analysis that the Companies have not actually collected from customers. (Cos. Ex. 6 at 13-15; Cos. Ex. 4 at 12-16, Ex. TEM-6.)

(b) Other parties' position regarding deferrals

(1) Customer Parties

Customer Parties view FAC and EDR deferred revenues as deferred rate increases pursuant to the ESP which contribute to the earnings approved by the Commission and subject to refund to customers. Customer Parties argue that deferred expenses only affect earnings in the year of the deferral and there is no effect on earnings in future years. In future years, revenues and expenses are matched with no effect on earnings. Customer Parties recommend that any excess earnings first be used to eliminate or reduce the regulatory asset created by the deferral on the electric utility's books as of the date the refund is effective. (Joint Inv. Ex. 2 at 6-7, 15-16, 25-26.)

(2) Staff

Like OSS, Staff takes no position on the inclusion or exclusion of deferrals from the SEET analysis. However, like the adjustment for OSS, Staff argues that the Companies' calculation to exclude deferrals from CSP's earned ROE is incorrect and requires an adjustment to the denominator to account for the equity effect of the exclusion from revenue. As adjusted by Staff, CSP's ROE to exclude deferrals, acknowledging the corresponding equity effect, produces an earned ROE of 18.74 percent as opposed to the 18.52 percent (deferrals only excluded) offered by CSP. (Staff Ex. 1 at 19-21, Ex. 3.)

(c) Commission decision on deferrals

Unlike OSS or extraordinary or non-recurring items, deferrals should not be excluded from the electric utility's ROE as requested by AEP-Ohio. Consistent with generally accepted accounting principles, deferred expenses and the associated regulatory liability are reflected on the electric utility's books when the expense is incurred. Subsequently, with the receipt of deferred revenues, there is an equal amortization of the deferred expenses on the electric utility's books, such that there is no effect on earnings in future years. Accordingly, we are not persuaded by the arguments of AEP-Ohio to adjust CSP's 2009 earnings to account for certain significant deferred revenue.

D. Capital requirements for future committed Ohio investments

In support of its future committed investments, AEP-Ohio offered its actual construction expenditures for 2007 through 2009 and capital budget forecast for 2010 and 2011 categorized by new generation, environmental, other generation, transmission, distribution, gridSMART and corporate/other. For the ESP period, AEP-Ohio offers a plan to invest $1.67 billion in Ohio. More specifically, AEP-Ohio had total construction expenditures for the year 2009 for CSP of $280,108 million, and for 2010 and 2011 projected construction expenditures of $256,100 million, and $186,969 million, respectively. Over and above the future committed investments set forth in the Companies' construction expenditures and budget projections, AEP-Ohio notes a commitment to make a capital investment associated with the company's compliance with its alternative energy portfolio requirements pursuant to Section 4928.64, Revised Code. CSP has made a commitment to invest $20 million to support the development of a large solar farm near Cumberland, Ohio, and entered into a 20-year purchase agreement for all of the facility's power. CSP also plans to expand its gridSMART project to its entire service territory. (Cos. Ex. 6 at 16-18, Ex. JH-1; Cos. Ex. 8 at 7; Cos. Br. at 67-72; Tr. 289-290, 687-690.)

1. Opposition to the committed future investment claims

Customer Parties opine that consideration of future committed investments is a factor to be considered in association with the development of comparable companies, the establishment of the threshold ROE and any adjustment to the threshold. To that end, Customer Parties note that its development of the comparable group of companies includes consideration of the fixed asset turnover ratio as part of the business and financial risk measures. IEU-Ohio and Customer Parties also note that, using CSP's 2009 construction expenditures as a baseline of $280.108 million, CSP's budgeted projections are declining through 2011. The intervenors argue that the Commission should only consider future committed investments during the ESP period that are funded by the electric utility itself and which are beyond the utility's normal rate of funding. Further, Customer Parties challenge AEP-Ohio's commitment to construct the projects on which the budget projections are developed. In light of the tenuous nature of the committed future investments, and the fact that CSP's future capital commitments are declining during the ESP period, Customer Parties implore the Commission that, although it is required to give consideration to the electric utility's future committed capital investments in Ohio, in this instance, it is not appropriate to take future investments into consideration. OPAE joins Customer Parties in its conclusion that there should not be an upward adjustment in the SEET or a reduction in any refund due customers for future committed investments. (Joint Inv. Ex. 1 at 13; Joint Inv. Ex. 2 at 29-30; Joint Inv. Br. at 47-56; OPAE Reply Br. at 9; IEU-Ohio Br. at 22-24.)

In its response, AEP-Ohio notices that Staff did not acknowledge the evidence offered concerning the Companies' committed capital investments and states that the other parties to the proceeding mischaracterize the approximately $1.7 billion investments as merely "business as usual." AEP-Ohio argues that Section 4928.143(F), Revised Code, clearly allows the consideration of the utility's future committed investments without limitations as to ESP period and no language in the statute requires that the investment be unreimbursed shareholder-funded contributions. AEP-Ohio is of the opinion that the statute does not require the future investment to be extraordinary in comparison to an historical baseline of investments. The Companies rely on the language in Rule 4901:1-35-03(C)(10)(a)(iii), O.A.C., in support of the notion that the capital budget forecasts are indicative of the electric utility's "capital requirements for future committed investments." AEP-Ohio contends it would be arbitrary and capricious to only consider the electric utility's incremental future capital investments that increase annually year-after-year. AEP-Ohio reiterates that while all of the projects in the forecasted budget have not completed the management review process, approximately 90 percent of the projects listed for 2010 and 70-80 percent of the projects listed for 2011 have received the necessary management approvals. (Cos. Reply Br. at 28-35.)

Commission Decision

As required by the statute and as discussed above, the Commission considered the electric utility's future committed capital investments when rendering its decision on the SEET.

2. Other adjustments to CSP's 2009 Earnings

(a) AEP-Ohio

As part of its SEET application, AEP-Ohio presented a narrative of information regarding the Companies' risk and performance. AEP-Ohio notes that as an Ohio electric utility that owns generation, it faces numerous risks including risks associated with: the lack of guaranteed recovery for generation assets; customer shopping; the term of the Companies' approved ESP and the unanticipated shutdown of generation stations; environmental regulation; and market-price impact for generation-related services. Further, the Companies contend that they face risks associated with the variability and uncertainty of its retail revenue stream and weather.

As for the Companies management performance and industry benchmarks, AEP-Ohio notes that since 2005, CSP and OP have consistently performed very well on customer satisfaction surveys. Further, AEP-Ohio notes that its SAIFI and CAIDI have improved since 2003 through 2009. The Companies state that they are leaders in the industry regarding advances in electric generation and transmission technologies. CSP and OP invest in Ohio and maintain a significant tax base throughout the state with a total economic impact that exceeds $2 billion per year. CSP states that its gridSMART project received the highest rating among all such applications presented to the U.S. Department of Energy (US DOE). AEP-Ohio asserts the Companies regularly participate in various industry efforts to strengthen interoperability standards and cyber security. AEP-Ohio is working in collaboration with US DOE to advance carbon capture and sequestration technologies. AEP-Ohio also claims that its energy efficiency and demand reduction programs have the potential to save Ohio consumers $630 million and reduce power plant emissions. Finally, AEP-Ohio emphasizes that CSP achieved 202 percent and OP achieved 171 percent of their respective energy efficiency benchmarks for 2009. (Cos. Ex. 6 at 19-24, Ex. JH-2.)

(b) Other parties' position

Customer Parties reason that any consideration of the additional factors offered as directed in 09-786 do not negate any significantly excessive earnings by CSP in 2009 and any consideration of such factors as to CSP and OP, jointly, or AEP-Ohio, are prohibited pursuant to the language of the statute. Indeed, Customer Parties assert that the return on equity in CSP's last general rate case was 12.46 percent,[22] the most recent ROE in CSP's rider cases of 10.50 percent,[23] and the company's 2009 actual ROE of 20.84 percent is a strong indicator of significantly excessive earnings. Further, Customer Parties argue that evidence presented by AEP-Ohio on the business and financial risks faced by CSP does not justify any additional further consideration than what the Companies have reflected in their comparable group of companies. Customer Parties and OPAE offer that only a small portion of CSP's customers are actually shopping and, according to their calculations, CSP has been sufficiently compensated for the shopping risk by the provider of last resort (POLR) charge. (Joint Inv. Ex. 2 at 30; Joint Inv. Reply Br. at 40-43; OPAE Br. at 6.)

In addition, Customer Parties argue there are other factors that reduce or neutralize the risks alleged by AEP-Ohio. Customer Parties note that CSP's ESP includes a FAC that protects CSP and OP against rising fuel costs. Customer Parties also note that CSP's ROE of 20.84 percent was the highest reported by Ohio's electric utilities; the highest among the company's affiliates in the AEP East power pool; and the highest ROE among all investor-owned regulated electric utilities in the United States. Customer Parties submit that these factors likewise must be considered by the Commission in making its decision as to CSP's 2009 earnings. (Joint Inv. Ex. 2 at 18-20; Joint Inv. Reply Br. at 44-48.)

Commission decision on additional factors

As discussed previously in our discussion of the SEET threshold, the Commission has considered these arguments in its establishment of the threshold.

Commission's Conclusions Regarding AEP-Ohio's 2009 SEET

In consideration of the Commission's conclusion as discussed above regarding the application of the SEET to OP for 2009, the Commission finds that under any parties' proposed SEET analysis presented in this proceeding, OP's earned ROE is less than 200 basis points above the mean of the comparable group of companies. Thus, the

22 Tr. at 214-216.

23 *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company to Establish Environmental Investment Carrying Cost Riders*, Case No. 10-155-EL-RDR, Finding & Order (August 25, 2010); and *In the Matter of the Application of Columbus Southern Power Company to Update its gridSMART Rider*, Case No. 10-164-EL-RDR, Finding & Order (August 11, 2010).

Commission concludes that OP did not have significantly excessive earnings for 2009 pursuant to Section 4928.143(F), Revised Code, and the Commission's directives in 09-786. Next, in regard to CSP, consistent with the findings discussed above, the Commission finds:

	Percent	$ in millions
CSP's earned ROE for 2009	20.84	271.504
Exclusion of OSS with equity effect	19.73	
Threshold ROE for 2009 SEET	17.6	
Difference (19.73 – 17.6) x $ 20.039[24]	2.13	42.683
CSP's 2009 Significantly Excessive Earnings Subject to Return		42.683

The Commission directs CSP to apply the significantly excessive earnings, as determined in this Opinion and Order, first to any deferrals in the FAC account on CSP's books as of the date of this order, with any remaining balance to be credited to CSP's customers on a per kilowatt hour basis beginning with the first billing cycle in February 2011 and coinciding with the end of the current ESP period. Additionally, the Commission finds that any balance credited to CSP's customers will not be deducted from the Company's earnings for purposes of the 2011 SEET review.

In the Companies' ESP case, the Commission approved an increase in rates for 2011 of six percent of total bill. With the Commission's determination of significantly excessive earnings for CSP in 2009, the Commission directs CSP, consistent with this Opinion and Order, to adjust its tariff rates, accordingly.

Finally, in regards to Staff' recommendation to offer a benchmark ROE based on an index or combination of indices as the starting point for the annual SEET, the Commission will continue to consider the proposal and address any amendment to the SEET process by entry to be issued in the near future.

24 Joint Int. Ex. 2 at 17.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

(1) CSP and OP are public utilities as defined in Section 4905.02, Revised Code, and, as such, the companies are subject to the jurisdiction of this Commission.

(2) On September 1, 2010, CSP and OP filed an application for administration of the SEET in accordance with Section 4928.143(F), Revised Code.

(3) Intervention in this case was granted to OCC, IEU-Ohio, OPAE, OEG, APJN, OMA, OHA and The Kroger Company.

(4) The hearing in this case commenced on October 25, 2010, and concluded on November 1, 2010. Three witnesses testified on behalf of AEP-Ohio, two witnesses testified on behalf of Customer Parties, and one witnesses testified on behalf of the Commission Staff.

(5) Initial briefs were filed on November 19, 2010 and/or reply briefs were on filed on November 30, 2010, by AEP-Ohio, Staff, Customer Parties,[25] IEU-Ohio and OPAE.

(6) AEP-Ohio waived its right to further jurisdictionalize its earnings in this SEET proceeding.

(7) OP did not have significantly excessive earnings for 2009 pursuant to Section 4928.143(F), Revised Code, and the Commission's safe harbor provision.

(8) CSP had significantly excessive earnings for 2009 pursuant to Section 4928.143(F), Revised Code.

ORDER:

It is, therefore,

ORDERED, That IEU-Ohio's motion to dismiss AEP-Ohio's SEET application is denied. It is, further,

ORDERED, That CSP apply the significantly excessive earnings, as determined in this Opinion and Order, first to any deferrals in the FAC account on CSP's books as of the date

25 The reply brief filed by Customer Parties did not include OMA or OHA as a party to the brief. Only OCC, APJN and OEG are listed as parties to the reply brief.

of this Order, with any remaining balance to be credited to CSP's customer bills beginning with the first billing cycle in February 2011. The bill credit shall be on a kilowatt hour basis and coincide with the end of the current ESP period. It is, further,

ORDERED, That AEP-Ohio comply with its commitments as set forth in its notice of withdrawal of the Stipulation. It is, further,

ORDERED, That a copy of this Opinion and Order be served upon all parties and other interested person of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Steven D. Lesser, Chairman

Paul A. Centolella

Valerie A. Lemmie

Cheryl L. Roberto Concurring

Cheryl L. Roberto

GNS/JRJ/vrm

Entered in the Journal

JAN 11 2011

Reneé J. Jenkins

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	))))))))	Case No. 10-1261-EL-UNC

CONCURRING OPINION OF COMMISSIONER CHERYL L. ROBERTO

I generally concur with my colleagues as to the matters discussed within the majority opinion and with the conclusion that CSP enjoyed significantly excessive earnings which must be returned to consumers.

However, I would have preferred that my colleagues and I could have considered another alternative to the timing and methodology for the consideration of Off Systems Sales (OSS). Recognizing that we may only consider excessive earnings resulting from "adjustments" granted in an electric security plan, we account for this by excluding the OSS from the return on equity (ROE) reported by CSP on its FERC Form No. 1, thereby reducing the reported ROE of 20.84 percent to 19.73 percent for purposes of the SEET analysis. I am concerned that this method may skew the SEET analysis by an improper weighting of OSS while also failing to account for any other earnings that were not the result of "adjustments." A better practice may have been first to determine what earnings are significantly excessive by calculating all earnings over the SEET threshold (i.e., earnings that increased the ROE from 17.6 percent to 20.84 percent). Recognizing that some of these earnings were due to "adjustments" but the remaining were due to any number of factors, including but not limited to OSS, one could allocate the earnings between adjustment-related and nonadjustment-related earnings. The most straight-forward method to accomplish this would be to calculate a simple ratio of total revenue resulting from adjustments (collected and deferred) to total earnings. It is that ratio applied to the calculated significantly excessive earnings that would reasonably identify what proportion of those earnings resulted from adjustments. However, because the record does not contain total earnings resulting from adjustments both collected and deferred, this calculation is not possible.

Therefore, I concur with the majority.

Cheryl L. Roberto

Cheryl L. Roberto

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	))))))	Case No. 10-1261-EL-UNC

ENTRY ON REHEARING

The Commission finds:

(1) On July 31, 2008, Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, AEP-Ohio or the Companies) filed an application for a standard service offer (SSO) pursuant to Section 4928.141, Revised Code. The application was for an electric security plan (ESP) in accordance with Section 4928.143, Revised Code.

(2) On March 18, 2009, the Commission issued its opinion and order (ESP Order) modifying and approving AEP-Ohio's ESP.[1] By entries on rehearing issued July 23, 2009 (First ESP EOR), and November 4, 2009 (Second ESP EOR), the Commission affirmed and clarified certain issues raised in AEP-Ohio's ESP Order.

(3) On September 1, 2010, AEP-Ohio filed the instant application for the administration of the significantly excessive earnings test (SEET), as required by Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code (O.A.C.). By entry issued September 21, 2010, as amended on October 8, 2010, a procedural schedule was established for this proceeding.

(4) Motions to intervene were timely filed by, and intervention granted to, the following entities: the Office of the Ohio Consumers' Counsel (OCC), Ohio Energy Group (OEG), Appalachian Peace and Justice Network (APJN), Ohio Manufacturers' Association (OMA), Ohio Hospital Association (OHA), Ohio Partners for Affordable Energy (OPAE), and

1 *In re AEP-Ohio*, Case Nos. 09-917-EL-SSO and 09-918-EL-SSO.

Industrial Energy Users-Ohio (IEU-Ohio). Pursuant to the entry issued December 1, 2010, The Kroger Company (Kroger) was granted limited intervention to participate in the SEET case.

(5) On January 11, 2011, the Commission issued its Opinion and Order (SEET Order), pursuant to the requirements of Section 4928.143(F), Revised Code, and the Commission's directives in *In the Matter of the Investigation into the Development of the Significantly Excessive Earnings Test Pursuant to Amended Substitute Senate Bill 221 for Electric Utilities*, Case No. 09-786-EL-UNC (09-786). In the SEET Order, the Commission found that under any party's proposed SEET analysis presented in this proceeding, OP's earned return on equity (ROE) is less than 200 basis points above the mean of the comparable group of companies. Thus, the Commission concluded that OP did not have significantly excessive earnings for 2009 pursuant to Section 4928.143(F), Revised Code, and the Commission's directives in 09-786.

As to CSP, the Commission ultimately concluded that, based on an earned ROE of 20.84 percent for 2009, CSP had significantly excessive earnings of $42.683 million. Accordingly, the Commission directed CSP to apply the significantly excessive earnings, first to any deferrals in the fuel adjustment clause (FAC) account on CSP's books as of the date of the SEET Order, with any remaining balance to be credited to CSP's customers on a per kilowatt hour (kWh) basis beginning with the first billing cycle in February 2011 and coinciding with the end of the current ESP period. The Commission also concluded that any balance credited to CSP's customers would not be deducted from CSP's earnings for purposes of the 2011 SEET review.

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

(7) On February 10, 2011, applications for rehearing were filed by Customer Parties,[2] CSP, IEU-Ohio and OPAE. Memoranda

2 Originally, Customer Parties included OMA and OHA. However, neither the reply brief nor the application for rehearing filed by Customer Parties included OMA or OHA as parties to the pleadings. Only OCC, APJN, and OEG are listed as parties to the reply brief and application for rehearing.

contra the various applications for rehearing were filed by CSP, IEU-Ohio, Customer Parties, and OPAE. In their applications for rehearing, the parties raise a number of assignments of error, alleging that the SEET Order is unjust, unreasonable, and/or unlawful.

(8) On January 21, 2011, CSP filed tariffs to implement the directives in the SEET Order. CSP proposed that any over or under reconciliation be addressed in the subsequent FAC audit and determined that based on its calculations, all CSP customers, including reasonable arrangement customers, will receive a credit of $.001256 per kWh. By entry issued January 27, 2011, the Commission approved the proposed SEET tariff, with clarification that reasonable arrangement customers who receive service under a discount rate supported by delta revenue recovery are not entitled to both the discount rate and a SEET credit. Therefore, the Commission directed CSP to revise the SEET credit calculation to omit such reasonable arrangement customers and file revised tariffs.

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

<u>Constitutionality and Application of Section 4928.143(F), Revised Code</u>

(10) CSP argues that the Commission erred by concluding that Section 4928.143(F), Revised Code, provides ample direction to reasonably apply the statute in this case. CSP presents three arguments in support of this assignment of error. First, CSP notes that the Commission erred by concluding that Section 4928.143(F), Revised Code, is not void for vagueness. Next, CSP claims that the Commission erred by determining that there is ample legislative direction to reasonably apply Section 4928.143(F), Revised Code, in this case. Last, CSP asserts that the Commission erred in finding that the SEET issue is not fundamentally different from concepts the Commission regularly decides under Ohio's statutory provisions for utility regulation. (CSP App. at 4-6.)

(11) The Commission fully addressed the arguments CSP raises in its first assignment of error at pages 9-10 of the SEET Order. As CSP has raised no new argument not already considered and addressed by the Commission, we find that CSP's first assignment of error should be denied.

(12) IEU-Ohio raised eight arguments in support of its position that the SEET Order was unjust and unreasonable.[3] IEU-Ohio argues that it was unreasonable for the Commission to have failed to order CSP and OP to refile their testimony and supporting materials to properly address the requirements of Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C. IEU-Ohio next submits that the Commission erred by failing to properly apply the SEET as outlined in Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C. Next, IEU-Ohio argues that the Commission erred by determining that the SEET may be measured by the total company return on common equity rather than the electric distribution utility's (EDU) earned return on common equity from the ESP. Even if reliance on total company data was lawful, IEU-Ohio asserts that the Commission failed to adjust appropriately net income and common equity to account fully for the removal of off-system sales (OSS) and other non-jurisdictional effects from the calculation of excessive earnings. (IEU-Ohio App. at 5-14.)

(13) The Commission fully addressed at pages 13-14 of the SEET Order the first four arguments raised by IEU-Ohio in its application for rehearing. As IEU-Ohio has raised no new argument not already considered and addressed by the Commission, we find that IEU-Ohio's first four arguments of error should be denied.

(14) IEU-Ohio next argues that the Commission erred by failing to use the appropriate annual period to conduct the SEET as required by Section 4928.143(F), Revised Code. IEU-Ohio submits that the start date of the ESP was April 1, 2009, and thus, the annual period should have ended on March 31, 2010, but that the Commission once again relied on the noncompliant position that the ESP was retroactive to January 1, 2009. (IEU-Ohio App. at 14-15.)

3 IEU-Ohio's first four assignments of error were grouped together for discussion in its application for rehearing and will be treated similarly in this entry on rehearing.

(15) As noted in the SEET Order at page 13, the Commission has on several prior occasions addressed the start date of AEP-Ohio's ESP. *See* AEP-Ohio ESP Order at 64; Entry Nunc Pro Tunc (March 30, 2009); and First ESP EOR at 41-45. As the Commission has already fully addressed this issue and because IEU-Ohio has raised no new argument not already fully considered and addressed by the Commission, we deny IEU-Ohio's assignment of error on this matter.

(16) IEU-Ohio further argues that the SEET Order was unlawful and unreasonable because the Commission failed to comply with the policy of the state as outlined in Section 4928.02, Revised Code, to ensure the availability to consumers of reasonably priced electric service and encourage the competitiveness of Ohio's economy (IEU-Ohio App. at 17-19).

(17) IEU-Ohio's concern with the Commission's order on this issue appears to be one of degree as the Commission sided with IEU-Ohio and with the intervenors on the argument that CSP benefitted from significantly excessive earning during 2009. In other words, IEU-Ohio's argument appears to be predicated on the position that the Commission's order did not go far enough in ordering customer refunds. IEU-Ohio's assignment of error is predicated on the position that there may be an understatement of the amounts by which CSP exceeded the significantly excessive threshold and that Ohio's competitiveness is being harmed because AEP-Ohio retail customers may be carrying more than their fair share of the profitability achieved by the parent, American Electric Power Company, Inc. The Commission fully explained, in the SEET Order, the rationale for rendering the determination that CSP benefitted from significantly excessive earnings during 2009 and the appropriate level of refunds to be returned to customers pursuant to Section 4928.143(F), Revised Code. Aside from the issues addressed in the SEET Order, IEU-Ohio has not demonstrated the presence of any other significant factors that has caused Ohio customers to carry more than their fair share of the parent company's profitability. IEU-Ohio's assignment of error on this matter is, therefore, denied.

Comparable Group of Companies, Return on Equity of Comparable Companies and SEET Threshold

(18) OPAE argues the SEET Order is unreasonable and unlawful under the requirements of Section 4928.143(F), Revised Code, in its rejection of Customer Parties' methodology and composition of the comparable group of companies, the comparable companies' benchmark ROE of 9.58 percent, and the establishment of the SEET threshold range of 11.58 percent to 13.58 percent based on a 200-400 basis points adder over the comparable companies' ROE. OPAE also argues that the SEET Order is unreasonable and unlawful for failing to make, in OPAE's opinion, the statutory refund required based on the arguments of Customer Parties. (OPAE App. at 3-8, 14-16.)

(19) Similarly, CSP also argues that the SEET Order is unlawful and unreasonable in its failure to adopt AEP-Ohio's method for establishing the benchmark ROE, determination of significantly excessive earnings at approximately two standard deviations above the benchmark ROE, and adoption of the 2009 SEET threshold of 22.51 percent (CSP App. at 7-9). Customer Parties and OPAE support the Commission's rejection of CSP's proposed method for establishing and adopting the SEET threshold (Customer Parties Memo at 2-4; OPAE Memo at 4-5). IEU-Ohio, however, maintains that CSP and OP failed to file a SEET application which complied with the statutory requirement to demonstrate that the electric utilities did not have significantly excessive earnings. (IEU-Ohio Memo at 5-6.)

(20) The Commission thoroughly considered and discussed in the SEET Order each party's process to determine the comparable group of companies, the comparable companies' benchmark ROE, and the SEET threshold to determine the significantly excessive earnings subject to refund. The SEET Order also presented the Commission's rationale and justification for its decision on each component of the SEET analysis. Neither OPAE nor CSP presents any new arguments that the Commission did not already consider. Accordingly, OPAE's and CSP's requests for rehearing, on the basis that the Commission did not adopt their respective positions, are denied.

(21) OPAE contends that the SEET Order is unreasonable and unlawful to the extent that it adopts Staff's proposed 50 percent

adder to the benchmark ROE and considered "utility specific factors related to investment requirements, risk and investor expectations" to adjust the adder applied to the mean ROE of the comparable group of companies. OPAE insists that the Commission should have only considered CSP's capital requirements for future committed investments in Ohio to occur during the current ESP period, through December 2011, which are not funded by riders paid by ratepayers. OPAE argues that CSP's capital investment budget for 2009 was below its actual construction expenditures in 2007 and 2008. For these reasons, OPAE concludes that the Commission should not have accorded any consideration to the solar project, the gridSMART project, future environmental investments, or for any shopping risk. (OPAE App. at 8-12.)

(22) As the Commission indicated in the order and entry on rehearing in 09-786 and as thoroughly discussed in the SEET Order at pages 23-27, the Commission must recognize, in applying the SEET, the variation among Ohio's electric utilities and our obligation to ensure that the electric utility is allowed to operate successfully, to maintain its financial integrity, attract capital, and to compensate its investors. OPAE has not raised any new arguments for the Commission's consideration. As such, the Commission affirms its decision in the SEET Order and denies OPAE's request for rehearing on this matter.

<u>Adjustments to CSP's 2009 Earnings</u>

(23) OPAE and Customer Parties request that the Commission reconsider the exclusion of OSS margins from CSP's earnings for the SEET. OPAE and Customer Parties assert that OSS are an inherent component of CSP's earnings and further argue that excluding OSS from CSP's earnings skews the comparison to the earnings of the comparable group of companies in violation of the language in Section 4928.143(F), Revised Code. (OPAE App. at 13; Customer Parties App. at 6-7.)

(24) These are the same arguments presented to the Commission on brief by Customer Parties and OPAE regarding OSS in the SEET calculation and considered in the Commission's decision. OPAE and Customer Parties have not presented any new arguments for the Commission's consideration. As such, the requests for rehearing regarding the exclusion of OSS from the SEET calculation are denied.

(25) Further, Customer Parties and OPAE argue that the Commission's adoption of the Staff's adjustment to account for the impact of excluding OSS from the SEET calculation is incomplete as no evidence was presented to correctly quantify the necessary adjustment. Customer Parties and OPAE claim that the adjustment in the SEET Order understates the significantly excessive earnings subject to refund and argue that, because there is a lack of record evidence to correctly quantify the exclusion of OSS, CSP failed to meet its burden of proof in accordance with Section 4928.143(C)(1), Revised Code. Therefore, Customer Parties and OPAE contend that the Commission must include OSS in CSP's earnings for purposes of the SEET. (OPAE App. at 13-14; Customer Parties App. at 3-5.)

(26) The arguments presented by Customer Parties and OPAE on rehearing do not persuade the Commission that OSS should be included in the electric utility's earnings for purposes of the SEET. We also note that, in their brief, Customer Parties acknowledged, at least conceptually, Staff's adjustment as a starting point for excluding OSS. The Commission affirms its decision to exclude CSP's OSS from the SEET analysis for the reasons stated in the SEET Order. Further, while it is always our intent to correctly calculate any adjustment, in this instance we used the best information available in the record to account for the equity effect in the numerator and the denominator. Thus, we affirm the SEET Order and deny Customer Parties' and OPAE's requests for rehearing on this matter.

(27) IEU-Ohio also finds error in the Commission failing to remove the operating expenses of the Waterford and Darby generating stations from the calculation of the SEET when the Commission previously ordered that the expenses be removed from the ESP (IEU-Ohio App. at 15-17).

(28) The Commission fully addressed this issue at pages 13 and 14 of the SEET Order. Having raised no new argument for the Commission's consideration, IEU-Ohio's assignment of error on this issue is denied.

(29) CSP contends that the SEET Order is unlawful and unreasonable to the extent the Commission included non-cash earnings, deferrals of FAC revenues, and economic development rider revenues in the calculation of the company's

earnings. CSP reiterates its position that including deferrals in the company's earnings jeopardizes the electric utility's ability to create deferrals and the Commission's ability to phase-in rate increases in contrast to the policy expressed in Section 4928.144, Revised Code. CSP argues that if an electric utility is determined to have significantly excessive earnings and has deferrals, the electric utility should not have to refund amounts not yet received nor refund amounts that are merely a recovery of costs which do not contribute to earnings. CSP advocates that, in the year the deferral is collected, when cash is received from customers, if the electric utility has significantly excessive earnings in that year, an adjustment be made to exclude the amortized deferral expenses to recognize recovered revenues in the earnings subject to refund. (CSP App. at 10-11.)

(30) Consistent with the Commission's conclusion in the SEET Order, Customer Parties, OPAE, and IEU-Ohio ask the Commission to deny CSP's request for rehearing on this issue. IEU-Ohio explains that CSP's process would shift earnings to later periods and, by definition, understates income. Customer Parties offer that deferrals fall within the definition of "rate adjustments" as adopted in 09-786 and, because deferrals are included in the ROE reported for financial accounting purposes, it is appropriate to include deferrals in CSP's earnings for the SEET analysis. (OPAE Memo at 5; IEU-Ohio Memo at 6; Customer Parties Memo at 4-7.)

(31) The Commission thoroughly considered AEP-Ohio's position and presented the Commission's justification for including deferrals in the SEET analysis at pages 30-31 of the SEET Order. CSP has not presented any new arguments for the Commission's consideration on rehearing. Accordingly, CSP's request for rehearing on this issue is denied.

(32) CSP also argues that the SEET Order is unreasonable and unsupported by the record to the extent that the Commission required CSP to expend $20 million by the end of 2012 on the Turning Point solar project in Cumberland, Ohio, or other similar project. CSP states that, although it is fully committed to the solar project, there are outstanding details, including federal loan guarantees and state and local tax incentives, which must be finalized for the project to go forward. The company argues that the regulatory requirement to spend $20 million by the end of 2012 is detrimental to CSP's ability to

negotiate the best terms for its investment and, therefore, is not in the public interest, which is not ameliorated by the option to invest in another similar project. CSP requests the flexibility necessary to make the best decision as to how the Turning Point project or similar project is structured and implemented. CSP expects that sufficient progress will be made in the upcoming months to allow the company to propose a firm schedule for the solar project or similar project, during the course of its next ESP proceeding.[4] In the alternative, CSP asks that the Commission require the company to submit a status report on the Turning Point project or other similar project in 2012 so that the Commission can consider and determine whether sufficient progress is being made. (CSP App. at 11-13.)

(33) As part of the Commission's application of the SEET, the Commission gave consideration to CSP's future committed capital expenditure in the Turning Point solar project. Given the Commission's consideration of CSP's expenditure in a solar project in the development of the 2009 SEET threshold, it is reasonable for the Commission to require that the expenditure occur by a date certain. However, we agree that CSP should propose, during the course of its next ESP proceeding, a firm schedule setting forth its expenditure in the Turning Point solar project or other similar project. Accordingly, we deny CSP's request for rehearing.

Application of the SEET Credit

(34) IEU-Ohio offers that the SEET Order, as implemented by the January 27, 2011 entry, addressing the applicable tariffs, is unreasonable and unlawful to the extent that reasonable arrangement customers paying rates under the SSO do not receive the SEET credit in violation of Sections 4928.143(F) and 4903.09, Revised Code (IEU-Ohio App. at 19-21).

(35) Special arrangement customers receive a discount off of the otherwise applicable tariff rate and the difference between the tariff rate and the discounted rate is recoverable from the electric utility's remaining customers. As such, special

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

arrangement customers did not fully contribute to CSP's 2009 significantly excessive earnings as determined in the SEET Order and should not be entitled to the SEET credit. Accordingly, the Commission denies IEU-Ohio's request for rehearing on this issue.

Other Issues

(36) Customer Parties argue that the SEET Order is unreasonable and inconsistent with paragraphs (A) and (L) of Section 4928.02, Revised Code, as the Order failed to require CSP to honor the $1 million commitment to the Partnership with Ohio, as set forth in the Stipulation filed November 30, 2010. Given the slow economic recovery in the state, Customer Parties admonish the Commission for not requiring CSP to honor the $1 million commitment to the Partnership with Ohio. (Customer Parties App. at 7-10.)

(37) Customer Parties note, but then ignore the fact, that CSP withdrew from the Stipulation but "unilaterally and voluntarily agreed" to fulfill certain obligations under the Stipulation which did not include the negotiated commitment to the Partnership with Ohio. The SEET Order merely recognized CSP's voluntary agreement to fulfill certain obligations with shareholder funds pursuant to its notice of withdrawal of the Stipulation. Since the Stipulation was withdrawn, the Commission finds it inappropriate to hold any party to a select provision of the Stipulation unless the party elects to do so voluntarily. Accordingly, Customer Parties' request for rehearing to enforce the Partnership with Ohio provision of the withdrawn Stipulation is denied.

It is, therefore,

ORDERED, That the applications for rehearing be denied. It is, further, ORDERED, That a copy of this entry on rehearing be served upon all parties and other interested persons of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Valerie A. Lemmie

Steven D. Lesser

Cheryl L. Roberto

GNS/JRJ/vrm

Entered in the Journal

MAR 0 9 2011

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	)	Case No. 10-1261-EL-UNC

<u>CONCURRING AND DISSENTING OPINION</u>
<u>OF COMMISSIONER CHERYL L. ROBERTO</u>

I concur with my colleagues in each aspect of the majority opinion, excepting the demarcation as to which "consumers" are due SEET credit.

We previously found, and affirm here on rehearing, that CSP, as a result of provisions (or "adjustments")[1] included in its most recent electric security plan, enjoyed significantly excessive earnings of $42.683 million. Pursuant to Section 4928.143(F), Revised Code, having made such a finding, the Commission "shall require the electric distribution utility to return to consumers the amount of the excess by prospective adjustment...." It falls to the Commission to identify which consumers are due SEET credit.

CSP's electric security plan included provisions (adjustments) relating to the supply and pricing of generation service, as well as provisions relating to CSP's distribution service. Any or all of these provisions could have been the source of the significantly excessive earnings. In the absence of a record otherwise, we must assume that all such provisions did contribute to the significantly excessive earnings and, as such, any consumer class[2] that contributed revenue pursuant to one of these provisions is due SEET credit. Thus, on the facts before us, a SEET credit would be due to any consumer on CSP's distribution system.

On a more complete record, I believe it would have been possible and appropriate for the Commission to determine that the significantly excessive earnings were principally due to provisions relating to supply and pricing of generation service. On these

1 Section 4928.143, Revised Code, uses "provisions" and "adjustments" interchangeably.

2 Because Section 4928.143, Revised Code, directs that significantly excessive earnings must be returned to consumers "by prospective adjustment," I believe we must reject any of the arguments on rehearing that suggest an individual consumer's status or magnitude of usage during the previous year is relevant to whether the consumer receives a SEET credit. The "return" of significantly excessive earnings is prospective not retrospective. Thus, the "return" is to a consumer class prospectively. Those current members of the recipient class will be the consumers receiving the SEET credit.

hypothetical facts, the consumers due a SEET credit would be those consumers purchasing power pursuant to the standard service offer only. On these circumstances, it would have been appropriate to exclude from receipt of the SEET credit any consumer who does not purchase power from CSP via the standard service offer, e.g. consumers on reasonable arrangements or consumers who shop competitive suppliers for their energy.

In the case before us, however, we have made no finding that the significantly excessive earnings were due principally to provisions relating to supply and pricing of generation. Yet the majority excludes CSP distribution service consumers who purchase power via a reasonable arrangement from receipt of the SEET credit. The majority, however, does not exclude CSP distribution consumers who shop for their energy. In ruling thus, the majority has stated that "reasonable arrangement customers who receive service under a discount rate supported by delta revenue recovery are not entitled to both the discount rate and a SEET credit." I can find no statutory support for this distinction, therefore I dissent from this portion of the Entry on Rehearing.

Cheryl L. Roberto

Cheryl L. Roberto

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	))))))))	Case No. 10-1261-EL-UNC

FINDING AND ORDER

The Commission finds:

(1) By Opinion and Order issued January 11, 2011 (SEET Order), the Commission concluded that pursuant to Section 4928.143(F), Revised Code, Columbus Southern Power Company (CSP) had significantly excessive earnings of $42.683 million for 2009. The Commission directed CSP to apply the significantly excessive earnings first to any deferred fuel adjustment clause (FAC) costs on CSP's books as of the date of the SEET Order, with any remaining balance to be credited to CSP's customers on a per kilowatt (kWh) hour basis beginning with the first billing cycle in February 2011 and coinciding with the end of the current ESP period.

(2) On January 21, 2011, CSP filed tariffs to implement the directives in the SEET Order. The proposed tariffs are to be effective with the first billing cycle of February 2011 and expire with the last billing cycle of December 2011. CSP proposes that any over or under reconciliation be addressed in the subsequent FAC audit. Based on CSP's calculations, all CSP customers, including special contract customers, will receive a credit of $.001256 per kWh.

(3) Upon further consideration of the application of the credit to all customer bills, the Commission clarifies that reasonable arrangement customers who receive service under a discount rate supported by delta revenue recovery are not entitled to both the discount rate and a SEET credit. Accordingly, CSP is directed to revise the SEET credit calculation to omit such reasonable arrangement customers and file revised tariffs.

(4) CSP is directed to immediately file revised tariffs consistent with this Order to be effective with the first billing cycle of February 2011 and expire with the last billing cycle of December 2011. In light of the short timeframe remaining before these tariffs must go into effect, the Commission finds that the revised tariffs shall be approved to be effective as of the date of filing, contingent upon final review by Staff.

It is, therefore,

ORDERED, That CSP's January 21, 2011, tariff filing, as modified by this finding and order, should be approved as set forth in findings (3) and (4). It is, further,

ORDERED, That CSP be authorized to immediately file, in final form four complete copies of tariffs consistent with this finding and order. CSP shall file one copy in this case docket and one copy in the company's TRF docket (or may make such filing electronically, as directed in Case No. 06-900-AU-WVR). The remaining two copies shall be designated for distribution to Staff. It is, further,

ORDERED, That the effective date of the new tariffs shall not be a date earlier than the date on which the revised tariffs are filed and the date this finding and order is issued for bills rendered with the first billing cycle of February 2011. It is, further,

ORDERED, That nothing in this finding and order shall be binding upon this Commission in any subsequent investigation or proceeding involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further, ORDERED, That a copy of this Finding and Order be served upon all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Steven D. Lesser, Chairman

- Concur in Result

Paul A. Centolella

Valerie A. Lemmie

Cheryl L. Roberto

GNS/ vrm

Entered in the Journal

JAN 27 2011 JAN 27 2011

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	))))))))	Case No. 10-1261-EL-UNC

CONCURRING OPINION OF COMMISSIONER PAUL A. CENTOLELLA

I concur in the result of the Commission's Finding and Order in that it produces an impact for consumers that largely approximates that which I believe to be appropriate. While I find the Order's impact to be reasonable, for customers who are served under the Commission-approved special arrangements addressed in the Finding and Order, I would have preferred to make the prospective adjustments required under Section 4928.143(F), Ohio Revised Code, by reducing the costs, incentives, and foregone revenues recoverable through the Company's unavoidable Economic Development Rider.

Paul A. Centolella, Commissioner

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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

OPINION AND ORDER

The Commission, considering the above-entitled applications and the record in these proceedings, hereby issues its opinion and order in this matter.

APPEARANCES:

Marvin I. Resnik and Steven T. Nourse, American Electric Power Service Corporation, One Riverside Plaza, Columbus, Ohio 43215, and Porter, Wright, Morris & Arthur, by Daniel R. Conway, 41 South High Street, Columbus, Ohio 43215, on behalf of Columbus Southern Power Company and Ohio Power Company.

Richard Cordray, Attorney General of the State of Ohio, by Duane W. Luckey, Section Chief, and Warner L. Margard, John H. Jones, and Thomas G. Lindgren, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio 43215, on behalf of the Staff of the Public Utilities Commission of Ohio.

Janine L. Migden-Ostrander, the Office of the Ohio Consumers' Counsel, by Maureen R. Grady, Terry L. Etter, Jacqueline Lake Roberts, Michael E. Idzkowski and Richard C. Reese, Assistant Consumers' Counsel, 10 West Broad Street, Columbus, Ohio 43215-3485, on behalf of the residential utility consumers of Columbus Southern 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.

Chester, Wilcox & 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.

McNees, Wallace & Nurick, LLC, by Samuel C. Randazzo, Lisa G. McAlister, and Joseph M. Clark, 21 East State Street, 17th Floor, Columbus, Ohio 43215-4228, on behalf of Industrial Energy Users-Ohio.

David C. Rinebolt and Colleen L. Mooney, 231 West Lima Street, P.O. Box 1793, Findlay, Ohio 45839-1793, on behalf of Ohio Partners for Affordable Energy.

Bell & Royer Co., LPA, by Barth E. Royer, 33 South Grant Avenue, Columbus, Ohio 43215-3927, on behalf of Ohio Environmental Council and Dominion Retail, Inc.

Vorys, Sater, Seymour & Pease, LLP, by M. Howard Petricoff, Mike Settineri and Betsy L. Elder, 52 East Gay Street, Columbus, Ohio 43216-1008, and Bobby Singh, Integrys Energy, 300 West Wilson Bridge Road, Worthington, Ohio 43085, on behalf of Integrys Energy.

Vorys, Sater, Seymour & Pease, LLP, by M. Howard Petricoff, Mike Settineri and Betsy L. Elder, 52 East Gay Street, Columbus, Ohio 43216-1008, and Cynthia A. Fonner, Constellation Energy Group, Inc., 550 West Washington Boulevard, Suite 3000, Chicago, Illinois 60661, on behalf of Constellation NewEnergy, Inc., and Constellation Energy Commodities Group, Inc.

Vorys, Sater, Seymour & Pease, LLP, by M. Howard Petricoff, Mike Settineri and Betsy L. Elder, 52 East Gay Street, Columbus, Ohio 43216-1008, on behalf of EnerNoc, Inc. and Consumer Powerline, Inc.

Schottenstein, Zox & Dunn Co., LPA, by Gregory H. Dunn, Christopher L. Miller, and Andre T. Porter, 250 West Street, Columbus, Ohio 43215, on behalf of the Association of Independent Colleges and Universities of Ohio.

Bricker & Eckler, Thomas J. O'Brien, 100 South Third Street, Columbus, Ohio, and Richard L. Sites, 155 East Broad Street, 15th Floor, Columbus, Ohio 43215-3620, on behalf of Ohio Hospital Association.

Bell & Royer Co., LPA, by Langdon D. Bell, 33 South Grant Avenue, Columbus, Ohio 43215-3927, and Kevin Schmidt, 33 North High Street, Columbus, Ohio 43215-3005, on behalf of Ohio Manufacturers' Association.

Vorys, Sater, Seymour & Pease, LLP, by M. Howard Petricoff and Stephen M. Howard, 52 East Gay Street, Columbus, Ohio 43216-1008, on behalf of Direct Energy Services, LLC.

McDermott, Will & Emery, LLP, by Grace C. Wung, 600 Thirteenth Street, N.W., Washington, D.C. 20005, on behalf of Wal-Mart Stores East, LP, and Sam's East, Inc., LP, Macy's, Inc., and BJ's Wholesale Club, Inc.

Vorys, Sater, Seymour & Pease, LLP, by M. Howard Petricoff and Stephen M. Howard, 52 East Gay Street, Columbus, Ohio 43216-1008, on behalf of Ohio Association of School Business Officials, Ohio School Boards Association, and Buckeye Association of School Administrators.

Michael R. Smalz and Joseph E. Maskovyak, Ohio State Legal Services Association, 555 Buttles Avenue, Columbus, Ohio 43215, on behalf of Appalachian People's Action Coalition.

OPINION:

I. HISTORY OF PROCEEDINGS

On July 31, 2008, Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, AEP-Ohio or the Companies) filed an application for a standard service offer (SSO) pursuant to Section 4928.141, Revised Code. The application is for an electric security plan (ESP) in accordance with Section 4928.143, Revised Code.

By entries issued August 5, 2008, and September 5, 2008, the procedural schedule in this matter was established, including the scheduling of a technical conference and the evidentiary hearing. A technical conference was held regarding AEP-Ohio's application on August 19, 2008. A prehearing conference was held on November 10, 2008, and the evidentiary hearing commenced on November 17, 2008, and concluded on December 10, 2008. The Commission also scheduled five local public hearings throughout the Companies' service area.

The following parties were granted intervention by entries dated September 19, 2008, and October 29, 2008: Ohio Energy Group (OEG); the Office of the Ohio Consumers' Counsel (OCC); Kroger Company (Kroger); Ohio Environmental Council (OEC); Industrial Energy Users-Ohio (IEU); Ohio Partners for Affordable Energy (OPAE); Appalachian People's Action Coalition (APAC); Ohio Hospital Association (OHA); Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc. (Constellation); Dominion Retail, Inc. (Dominion); Natural Resources Defense Council (NRDC); Sierra Club - Ohio Chapter (Sierra); National Energy Marketers Association (NEMA); Integrys Energy Service, Inc. (Integrys); Direct Energy Services, LLC (Direct Energy); Ohio Manufacturers' Association (OMA); Ohio Farm Bureau Federation (OFBF); American Wind Energy Association, Wind on Wires, and Ohio Advance Energy (Wind Energy); Ohio Association of School Business Officials, Ohio School Boards Association, and Buckeye Association of School Administrators (collectively, Schools); Ormet Primary Aluminum Corporation (Ormet); Consumer Powerline; Morgan Stanley Capital Group Inc.; Wal-Mart Stores East, LP and Sam's East, Inc., Macy's, Inc., and BJ's Wholesale Club, Inc. (collectively, Commercial Group); EnerNoc, Inc.; and the Association of Independent Colleges and Universities of Ohio.

At the hearing, AEP-Ohio offered the testimony of 11 witnesses in support of the Companies' application, 22 witnesses testified on behalf of various intervenors, and 10 witnesses testified on behalf of Staff. At the local public hearings held in this matter, 124 witnesses testified. Briefs were filed on December 30, 2008, and reply briefs were filed on January 14, 2009.

A. Summary of the Local Public Hearings

Five local public hearings were held in order to allow CSP's and OP's customers the opportunity to express their opinions regarding the issues in this proceeding. The hearings were held in the evenings in Marietta, Canton, Lima, and Columbus. Additionally, an afternoon hearing was held in Columbus. At those hearings, public testimony was heard from 21 customers in Marietta, 21 customers in Canton, 17 customers in Lima, 25 customers at the afternoon hearing in Columbus and 40 customers at the evening hearing in Columbus. In addition to the public testimony, numerous letters were filed in the docket by customers stating concern about the applications.

The principal concern expressed by customers, both at the public hearings and in letters, was over the increases in customer rates that would result from the approval of the ESP applications. Witnesses stated that any increase in rates would negatively impact low-income customers, the elderly, and those on fixed incomes. Customers cited the recent downturn in the economy as the primary source of their apprehension. It was noted by many at the hearings that customers are also facing increases in other utility charges, gasoline, food, and medical expenses and that the proposed increases would cause undue hardship. On the other hand, some witnesses at the public hearings and in the letters filed in the docket acknowledged AEP-Ohio as a good corporate partner in their respective communities.

B. Procedural Matters

1. Motion to Strike

On January 7, 2009, AEP-Ohio filed a motion to strike a section of the brief jointly filed by OCC and Sierra (collectively, OCEA). More specifically, AEP-Ohio filed to strike the sentence starting on line 2 of page 63 ["In fact,"] through the first two lines of page 64, including footnotes 244 to 248. AEP-Ohio argues that the above-cited portion of OCEA's brief, regarding the deferral of fuel expenses and the carrying charges and the tax effect thereof, relies upon testimony offered by OCC witness Effron in the FirstEnergy Distribution Case.[1] AEP-Ohio notes that Mr. Effron was not a witness in this ESP proceeding and, therefore, was not available for the Companies, or any other party, to cross-examine. Accordingly, the Companies argue that consideration of Mr. Effron's testimony in this matter would be a denial of the Companies' due process rights, and request that the specified portion of OCEA's brief be stricken. On January 14, 2009, OCC filed a memorandum contra the motion to strike. OCC agreed to withdraw the second and third sentences on page 63, the quoted testimony of Mr. Effron on page 63, and footnotes 244 to 248 on pages 63 and 64. However, OCC contends that AEP-Ohio's

1 *In re Ohio Edison Company, The Cleveland Electric Illuminating Company, and Toledo Edison Company*, Case No. 07-551-EL-AIR, et al. (FirstEnergy Distribution Case).

motion is overly broad and the remaining portion of the brief that AEP-Ohio seeks to strike is appropriate legal argument regarding deferrals on a net-of-tax basis and, therefore, should remain. AEP-Ohio filed a reply on January 16, 2009. AEP-Ohio first notes that because the memorandum contra was filed by OCC only and Sierra did not respond to the motion, it is not clear whether Sierra is also willing to withdraw the portions of the brief listed in the memorandum contra. AEP-Ohio also argues that the remaining portion of this particular argument in OCEA's brief should be stricken with the removal of the footnotes. With this removal, AEP-Ohio then argues that there is no longer any support in the brief for such arguments. By letter docketed January 22, 2009, Sierra confirmed that it joins OCC in OCC's withdrawal of the limited portions of the OCEA brief as stated by OCC in its January 14, 2009, reply.

The Commission grants, in part, and denies, in part, AEP-Ohio's motion to strike OCEA's brief. The Commission agrees with AEP-Ohio and OCC that the use of Mr. Effron's testimony filed in the FirstEnergy Distribution Case in this proceeding was inappropriate and, therefore, we accept OCC's and Sierra's withdrawal of that portion of their brief. As for the remaining portion of OCEA's brief that AEP-Ohio has requested to be stricken, we agree with OCC that the language that discusses the calculation of deferred fuel expenses on a net-of-tax basis could be construed to be legal argument on brief, which rationalized why the issue should be decided in OCEA's favor. Moreover, we can surmise that if OCEA had recognized its error in the drafting stage of the brief, that OCEA would have drafted similar legal arguments without referencing Mr. Effron's testimony. Accordingly, we will only strike the portions of OCEA's brief that OCC and Sierra have agreed to withdraw.

2. Motion for AEP-Ohio to Cease and Desist

On February 25, 2009, Integrys filed a motion with the Commission requesting that the Commission direct AEP-Ohio to cease and desist the Companies' refusal to process SSO retail customer applications to enroll in the Interruptible Load for Reliability (ILR) Program of PJM Interconnection, LLC (PJM). Integrys also filed a request for an expedited ruling; however, Integrys represented that counsel for AEP-Ohio objected to the expedited ruling request. Integrys is a registered curtailment service provider with PJM and as such receives notices from PJM and coordinates with retail customers to curtail load. Integrys argues that retail customer participation in PJM demand response programs was raised in the Companies' ESP application and has not yet been decided by the Commission. For this reason, Integrys contends that AEP-Ohio lacks the authority to refuse to process the ILR applications and the denial of the application violates the Companies' tariffs. Two other curtailment service providers in the AEP-Ohio service territory, Constellation and KOREnergy, Ltd., filed memoranda in support of Integrys' motion.[2]

On March 2, 2009, AEP-Ohio filed a memorandum contra the motion to cease and desist. AEP-Ohio affirms the arguments made in this proceeding to prohibit retail customers from participating in PJM's demand response programs. Further, AEP-Ohio argues, among other things, that despite the claims of Integrys andConstellation, AEP-Ohio is providing, in a timely manner, the load data required for customer enrollment in the PJM ILR program, informs the customer that AEP-Ohio is not consenting to the customer's participation in the program, and discloses that the matter is currently pending before the Commission.

On March 9, 2009, Integrys and Constellation filed a withdrawal of the motion to direct AEP-Ohio to cease and desist. The movants state that despite AEP-Ohio's assertions that the applicants were not eligible to participate in PJM's demand response programs, PJM rejected AEP-Ohio's opposition to the ILR applications and processed the ILR applications. Integrys and Constellation further state that, except for two pending applications, all their customers in the AEP-Ohio service territory have been certified for participation in the PJM programs.

As the parties acknowledge, this matter was presented for the Commission's consideration as part of the ESP application. The Commission, therefore, specifically addresses and discusses the issues raised concerning SSO retail customer participation in PJM demand response programs at Section VI.C of this opinion and order. Accordingly, we grant Integrys' and Constellation's request to withdraw their motion to cease and desist.

II. DISCUSSION

A. Applicable Law

Chapter 4928 of the Revised Code provides an integrated system of regulation in which specific provisions were designed to advance state policies of ensuring access to adequate, reliable, and reasonably priced electric service in the context of significant economic and environmental challenges. In reviewing AEP-Ohio's application, the Commission is cognizant of the challenges facing Ohioans and the electric industry and will be guided by the policies of the state as established by the General Assembly in Section 4928.02, Revised Code, which was amended by Senate Bill 221 (SB 221).

Section 4928.02, Revised Code, states that it is the policy of the state, inter alia, to:

2 KOREnergy, Ltd., has not filed to intervene in this proceeding and, therefore, its memoranda in support will not be considered.

(1) Ensure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service.

(2) Ensure the availability of unbundled and comparable retail electric service.

(3) Ensure diversity of electric supplies and suppliers.

(4) Encourage innovation and market access for cost-effective supply- and demand-side retail electric service including, but not limited to, demand-side management (DSM), time-differentiated pricing, and implementation of advanced metering infrastructure (AMI).

(5) Encourage cost-effective and efficient access to information regarding the operation of the transmission and distribution systems in order to promote both effective customer choice and the development of performance standards and targets for service quality.

(6) Ensure effective retail competition by avoiding anticompetitive subsidies.

(7) Ensure retail consumers protection against unreasonable sales practices, market deficiencies, and market power.

(8) Provide a means of giving incentives to technologies that can adapt to potential environmental mandates.

(9) Encourage implementation of distributed generation across customer classes by reviewing and updating rules governing issues such as interconnection, standby charges, and net metering.

(10) Protect at-risk populations including, but not limited to, when considering the implementation of any new advanced energy or renewable energy resource.

In addition, SB 221 amended Section 4928.14, Revised Code, which now provides that on January 1, 2009, electric utilities must provide consumers with an SSO, consisting of either a market rate offer (MRO) or an ESP. The SSO is to serve as the electric utility's default SSO. The law provides that electric utilities may apply simultaneously for both an

MRO and an ESP; however, at a minimum, the first SSO application must include an application for an ESP. Section 4928.141, Revised Code, specifically provides that an SSO shall exclude any previously authorized allowances for transition costs, with such exclusion being effective on and after the date that the allowance is scheduled to end under the electric utility's rate plan. In the event an SSO is not authorized by January 1, 2009, Section 4928.141, Revised Code, provides that the current rate plan of an electric utility shall continue until an SSO is authorized under either Section 4928.142 or 4928.143, Revised Code.

AEP-Ohio's application in this proceeding proposes an ESP, pursuant to Section 4928.143, Revised Code. Paragraph (B) of Section 4928.141, Revised Code, requires the Commission to hold a hearing on an application filed under Section 4928.143, Revised Code, to send notice of the hearing to the electric utility, and to publish notice in a newspaper of general circulation in each county in the electric utility's certified territory.

Section 4928.143, Revised Code, sets out the requirements for an ESP. Under paragraph (B) of Section 4928.143, Revised Code, an ESP must include provisions relating to the supply and pricing of generation service. The plan, according to paragraph (B)(2) of Section 4928.143, Revised Code, may also provide for the automatic recovery of certain costs, a reasonable allowance for certain construction work in progress (CWIP), an unavoidable surcharge for the cost of certain new generation facilities, conditions or charges relating to customer shopping, automatic increases or decreases, provisions to allow securitization of any phase-in of the SSO price, provisions relating to transmission-related costs, provisions related to distribution service, and provisions regarding economic development.

The statute provides that the Commission is required to approve, or modify and approve the ESP, if the ESP, including its pricing and all other terms and conditions, including deferrals and future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142, Revised Code. In addition, the Commission must reject an ESP that contains a surcharge for CWIP or for new generation facilities if the benefits derived for any purpose for which the surcharge is established are not reserved or made available to those that bear the surcharge.

The Commission may, under Section 4928.144, Revised Code, order any just and reasonable phase-in of any rate or price established under Section 4928.141, 4928.142, or 4928.143, Revised Code, including carrying charges. If the Commission does provide for a phase-in, it must also provide for the creation of regulatory assets by authorizing the deferral of incurred costs equal to the amount not collected, plus carrying charges on that amount, and shall authorize the deferral's collection through an unavoidable surcharge.

By finding and order issued September 17, 2008, in Case No. 08-777-EL-ORD (SSO Rules Case), the Commission adopted new rules concerning SSO, corporate separation, and reasonable arrangements for electric utilities pursuant to Sections 4928.06, 4928.14, 4928.17, and 4905.31, Revised Code. The rules adopted in the SSO Rules Case were subsequently amended by the entry on rehearing issued February 11, 2009.

B. State Policy – Section 4928.02, Revised Code

AEP-Ohio submits that, contrary to the views of the intervenors, Section 4928.02, Revised Code, does not impose additional requirements on an ESP and the ESP should not be modified or rejected because it does not satisfy all of the policies of the state. According to the Companies, "[t]he public interest is served if the ESP is more favorable in the aggregate than the expected results of an MRO" (Cos. Br. at 15).

OHA asserts that the Commission "must view the 'more favorable in the aggregate' standard through the lens of the overriding 'public interest,'" and that the public interest cannot be served if the result is not reasonable (OHA Br. at 10). OPAE/APAC seems to state that the ESP must be more favorable in the aggregate and comply with the state policy, but also recognizes that state policies are to be used to guide the Commission in its approval of an ESP (OPAE/APAC Br. at 3). OEG agrees that the policy objectives are required to be met prior to the approval of an ESP (OEG Br. at 1). The Commercial Group submits that costs must be properly allocated to ensure that the policies of the state are met, to improve price signals, and to ensure effective retail competition (Commercial Group Br. at 5).

In its reply brief, AEP-Ohio maintains that its proposed ESP is consistent with the policy of the state as delineated in Sections 4928.02(A) through (N), Revised Code, and is "worthy of approval, without modification" (Cos. Reply Br. a 7). According to the Companies, the ESP advances the general policy objectives of the policy of the state (Id. at 6-7). Furthermore, the Companies argue that the concerns raised by some intervenors regarding the impact of AEP-Ohio's ESP on the difficult economic conditions would have the Commission ignore the statutory standard for approving an ESP and, instead, establish rates based on the current economic conditions (Cos. Reply Br. at 7). While the Companies believe that aspects of the proposed ESP address these concerns (e.g., fuel deferrals), they argue that their SSO must be established in accordance with applicable ESP statutory provisions (Id.).

As explained above, and previously in our opinion and order issued in the FirstEnergy ESP proceeding,[3] the Commission believes that the state policy codified by the General Assembly in Chapter 4928, Revised Code, sets forth important objectives,

3 *In re Ohio Edison Company, The Cleveland Electric Illuminating Company, and the Toledo Edison Company*, Case No. 08-935-EL-SSO, Opinion and Order at 12 (December 19, 2008) (FirstEnergy ESP Case).

which the Commission must keep in mind when considering all cases filed pursuant to that chapter of the code. As noted in the FirstEnergy ESP case, in determining whether the ESP meets the requirements of Section 4928.143, Revised Code, we take into consideration the policy provisions of Section 4928.02, Revised Code, and we use these policies as a guide in our implementation of Section 4928.143, Revised Code. Accordingly, we agree with AEP-Ohio and will use these policies as a guide in our decision-making in this case, just as we did in the FirstEnergy ESP Case (Cos. Reply Br. at 6).[4] The Commission has reviewed the ESP proposal presented by AEP-Ohio, as well as the issues raised by the various intervenors, and we believe that, with the modifications set forth herein, we have appropriately reached a conclusion advancing the public's interest.

C. Application Overview

In their application, the Companies are requesting authority to establish an SSO in the form of an ESP pursuant to the provisions of Sections 4928.141 and 4928.143, Revised Code. The proposed ESP is to be effective for a three-year period commencing January 1, 2009. According to the Companies, pursuant to the proposed ESP, the overall, estimated increases in total customer rates, including generation, transmission, and distribution, would be an average of 13.41 percent for CSP and 13 percent for OP in 2009, and 15 percent in 2010 and 2011 for both CSP and OP (Cos. Ex. 1, Exhibit DMR-1). The Companies also propose a 15 percent cap per year on the total allowable increases for each customer rate schedule should the actual costs be higher than expected, excluding transmission costs and costs associated with new government mandates (Cos. App. at 6).

III. GENERATION

A. Fuel Adjustment Clause (FAC)

The Companies contend that Section 4928.143(B)(2)(a), Revised Code, authorizes the implementation of a FAC mechanism to recover prudently incurred costs associated with fuel, including consumables related to environmental compliance, purchased power costs, emission allowances, and costs associated with carbon-based taxes and other carbon-related regulations (Cos. Ex. 7 at 4-7).

4 Some intervenors recognize that the state policy objective must be used as a guide to implement the ESP provision (IEU Br. at 19; OPAE/APAC Br. at 3).

1. FAC Costs

The Companies proposed to include in the FAC mechanism types of costs recovered through the electric fuel component (EFC) previously used in Ohio[5] (Cos. Ex. 7 at 3-4). In addition to those types of costs, the Companies stated that Section 4928.143(B)(2)(a), Revised Code, provides for a broader cost-based adjustment mechanism that authorizes the inclusion of all prudently incurred fuel, purchased power, and environmental components (Id. at 4). Companies' witness Nelson itemized and described the accounts that the Companies proposed to include in their FAC mechanism (Id. at 5-7).

Staff, OCC, and Sierra support the FAC mechanism that will be updated and reconciled quarterly (Staff. Ex. 8 at 3-4; OCEA Br. at 47-48, 67-68; OCC Ex. 11 at 4-5, 31-40). Specifically, Staff witness Strom testified that the costs proposed to be recovered through the FAC mechanism are appropriate and recovery of those costs through a FAC mechanism is logical (Staff Ex. 8 at 3). OCC and Sierra also agree that Section 4928.143(B)(2)(a), Revised Code, authorizes the enactment of a FAC mechanism to automatically recover certain prudently incurred costs (OCEA Br. at 47), and OCC does not seem to oppose the list of categories of accounts proposed to be included in the FAC by Companies witness Nelson (OCC Ex. 11 at 18-20). Additionally, Staff recommended that annual reviews of the prudency and appropriateness of the accounting of FAC costs be conducted (Staff Ex. 8 at 3-4), and OCC recommended that an interest charge be paid to customers on any over-recovered fuel costs in a quarterly period until the subsequent reconciliation occurs, similar to the carrying charge for any under-recovery that she believed the Companies were proposing to collect[6] (OCC Ex. 11 at 4). Kroger and IEU, however, seem to state that a FAC mechanism cannot be established until a cost-of-service or earnings test is completed (Kroger Br. at 9-10; IEU Br. at 12-15). IEU also questioned the appropriate term of the proposed FAC mechanism (IEU Br. at 13; Tr. Vol. IX at 143-146).

The Commission believes that the establishment of a FAC mechanism as part of an ESP is authorized pursuant to Section 4928.143(B)(2)(a), Revised Code, to recover prudently incurred costs associated with fuel, including consumables related to environmental compliance, purchased power costs, emission allowances, and costs associated with carbon-based taxes and other carbon-related regulations. Given that the FAC mechanism is authorized pursuant to the ESP provision of SB 221, we will limit our authorization, at this time, to the term of the ESP.

5 See Sections 4905.01(G), 4905.66 through 4905.69, and 4909.159, Revised Code (repealed January 1, 2001); Chapter 4901:1-11, Ohio Administrative Code (O.A.C.) (rescinded November 27, 2003).

6 In AEP's Brief, the Companies clarified that they did not propose to collect a carrying charge on any FAC under-recovery in one quarterly period until a reconciliation in the subsequent period occurred. The only carrying charge that they proposed was on the FAC deferrals that would not be collected until 2012-2018 (Cos. Br. at 27).

With regard to interest charges assessed on any over- or under-recoveries for FAC costs within the quarterly period until the subsequent reconciliation occurs, we agree with OCC witness Medine that symmetry should exist if interest charges were assessed on any under-recoveries (Tr. Vol. VI at 210). However, we do not conclude that any interest charges on either over- or under-recoveries are necessary as a deterrent to the creation of over- or under-recoveries as OCC witness Medine suggests (Id. at 210-211). As proposed by the Companies and supported by others, the FAC mechanism includes a quarterly reconciliation to actual FAC costs incurred, which will establish the new charge for the subsequent quarter. These quarterly adjustments combined with the annual review proposed by Staff to review the appropriateness of the accounting of the FAC costs and the prudency of decisions made are sufficient to control the over- or under-recoveries that may occur within a particular quarter. Therefore, we find that the FAC mechanism with quarterly adjustments as proposed by the Companies, as well as an annual prudency and accounting review recommended by Staff, is reasonable and should be approved and implemented as set forth herein.

(a) Market Purchases

As part of the FAC costs, the Companies proposed to purchase incremental power on a "slice of the system basis" equal to 5 percent of each company's load in 2009, 10 percent in 2010, and 15 percent in 2011 (Cos. Ex. 2-A at 21). The Companies argue that while these purchases will be included in the FAC mechanism, as the appropriate recovery mechanism for these costs, the purchases are permitted as a discretionary component of an ESP filing authorized by Section 4928.143(B)(2), Revised Code, which states: "The plan may provide for or include, without limitation, any of the following:" (emphasis added) (Cos. Br. at 37). To support its proposal, AEP-Ohio states that the purchases reflect the continued transition to market rates and represent an appropriate recognition of the Companies' incorporation of the loads of Ormet Primary Aluminum Company (Ormet) and the certified territory formerly served by Monongahela Power Company (MonPower) (Cos. Ex. 2-A at 21-22). The Companies further assert that, during the ESP, they should be able to continue to recover a market-based generation price for serving these loads, as was previously authorized by the Commission during the RSP period.

Staff supported market purchases sufficient to meet the additional load responsibilities that the Companies assumed for the addition of the former MonPower customers and Ormet to the Companies' system, which equals approximately 7.5 percent of the Companies' total loads (Staff Ex. 10 at 5). However, based on the size of the additional load assumed by the Companies, Staff only recommended that the incremental power purchases equal, on average, 5 percent of each company's load in 2009, 7.5 percent in 2010, and 10 percent in 2011 (Id.).

The Companies responded to Staff's reduction in the amount of market purchases by adding that the Companies also intended to utilize their proposed levels of market purchases to encourage economic development (Cos. Ex. 2-E at 7).

Various parties oppose the inclusion of incremental "slice of the system" power purchases in AEP-Ohio's ESP. OEG witness Kollen testified that the Commission should reject this provision of AEP-Ohio's ESP because the Companies have not demonstrated a need for the excess generation purchased on the market to meet its existing load, and such "purchases are not prudent because they will uneconomically displace lower cost Company owned generation and cost-based purchased power that is available to meet their loads" (OEG Ex. 3 at 3, 9-10). IEU witness Bowser agrees that this portion of the ESP should be rejected (IEU Ex. 10 at 9). Kroger witness Higgins also concurs, stating: "The only apparent purpose of these slice-of-system purchases is to serve as a device for increasing prices charged to customers" (Kroger Ex. 1 at 9). OCEA concurs with the testimony offered by these intervenor witnesses (OCEA Br. at 53-55). Intervenors also question this provision in light of the AEP Interconnection Agreement (OEG Ex. 3 at 10-14; OCEA Br. at 54-55).

Given that AEP-Ohio has explicitly stated that the purchased power is not a prerequisite for adequately serving the additional load requirements assumed by AEP-Ohio when adding Ormet and the MonPower customers to its system (Cos. Ex. 2-B at 7), the Commission finds that Staff's rationale for the support of the proposal, as well as the recommendation for a reduction in the amount of purchased power proposed to equal the additional load, fails. We struggle, along with the other parties, to find a rational basis to approve such a proposal in the absence of need. The Commission notes that while we appreciate AEP-Ohio's willingness and cooperation with regard to the inclusion of Ormet and MonPower customers into its system, we believe that the Companies have been able to prepare and plan for the additions to its system under the current regulatory scheme and have been compensated during the transitional period. As for the reliance on the market purchases to promote economic development, the Commission believes that this goal can be more appropriately achieved through other means as outlined in this opinion and order, the Commission's recently adopted rules, and SB 221. Accordingly, we find that AEP-Ohio's ESP shall be modified to exclude this provision.

(b) Off-System Sales (OSS)

Kroger and OEG contend that FAC costs must be offset by a credit for OSS margins, stating that other jurisdictions governing other operating companies of AEP Corporation require such an OSS offset to revenue requirements (Kroger Br. at 11-12; Kroger Ex. 1 at 3, 9, 10; OEG Br. at 10; OEG Ex. 3 at 14-15, 16-17). Kroger argues that it is incongruent to allow a rate increase based on certain costs without examining AEP-Ohio's net costs to determine that AEP-Ohio's costs have actually increased (Kroger Br. at 11-12). OEG notes that the Companies' profits for 2007 from off-system sales were $146.7 million for OP and $124.1 million for CSP (OEG Ex. 3 at 14). OEG reasons that because the cost of the power plants used to generate off-system sales are included in rates, all revenue from the power plants should be a rate credit (OEG Br. 10). OCEA raises similar arguments to those of OEG and Kroger in its brief (OCEA Br. at 57-59). More specifically, OCEA argues that the Companies' proposal to eliminate off-system sales expenses from Ohio ratepayers is not equivalent to providing customers the benefit of off-system sales margins. OCEA notes that, in other cases, the Commission has required electric utilities to share the benefits of off-system sales revenue with jurisdictional customers (OCEA Br. at 58-59).

Staff did not take a position in regard to the intervenors' arguments to offset FAC costs by the OSS margin. Staff, however, concluded that the costs sought to be recovered through the FAC are appropriate (Staff Ex. 10 at 4; Staff Ex. 8 at 3; Staff Br. at 2).

The Companies argue that an OSS offset to FAC charges is not required by Section 4928.143(B)(2)(a), Revised Code, or any other provision in SB 221 (Cos. Ex. 2-E at 8-9; Cos. Reply Br. at 12). The Companies also state that the regulatory or statutory regimes in other states have no bearing on Ohio or Ohio's statutory requirements (Id.). As to the other arguments raised by OEG and OCEA, the Companies argue that the intervenors' arguments ignore the fact that the Companies' ESP reduces the FAC and environmental carrying cost expenses for AEP-Ohio customers based on the calculation of the pool capacity payments in the FAC and use of the pool allocation factor (Cos. Ex. 7, Exhibits PJN-1, PJN-2, PJN-6 and PJN-8).

Upon a review of the record in this case, the Commission is not persuaded by the intervenors' arguments. We do not believe that the testimony presented offered adequate justification for modifying the Companies' proposed ESP to offset OSS margins from the FAC costs. Section 4928.143(B)(2)(a), Revised Code, specifically provides for the automatic recovery, without limitation, of prudently incurred costs for fuel, purchased power, capacity cost, and power acquired from an affiliate. As recognized by the Companies, the pertinent statutory provisions do not require that there be an offset to the allowable fuel costs for any OSS margins. Additionally, Ohio law governs the Companies' ESP application, and thus, we are not persuaded by the arguments of Kroger regarding how other jurisdictions handle OSS margins. Moreover, consistent with our discussion in Section VII of our opinion and order, we do not believe that OSS should be a component of the Companies' ESP, or factored into our decision in this proceeding. Intervenors cannot have it both ways: they cannot request that OSS margins be credited against the fuel costs (i.e., offset the expenses); and, at the same time, ask us to count the OSS margins as earnings for purposes of the significantly excessive earnings test (SEET) calculation.

(c) Alternate Energy Portfolio Standards (including Renewable Energy Credit program)

Section 4928.64, Revised Code, establishes alternative energy portfolio standards which consist of requirements for both renewable energy and advanced energy resources. Section 4928.64(B)(2), Revised Code, introduces specific annual benchmarks for renewable energy resources and solar energy resources beginning in 2009.

The Companies' ESP application included, as a part of the FAC costs, cost recovery for renewable energy purchases and renewable energy credits (RECs) with purchased power reflected in Account 555 and RECs reflected in Account 557 (Cos. Ex. 7 at 6-7, 14). The Companies stated that they plan to purchase almost all of the RECs required for 2009. The Companies further state that they will enter into renewable energy purchase agreements (REPAs) to meet compliance requirements for the remainder of the ESP period, for which they have already conducted a request for proposal (Cos. Ex. 9 at 10-11). The Companies also recognized that recovery of such costs to comply with Section 4928.64(E), Revised Code, is, as stated in the statute,avoidable. Therefore, the Companies explained that they intend to include all of the renewable energy costs within the FAC mechanism and not as part of any FAC deferral. The Companies, however, recognized that their request for proposal and procurement practices for renewable energy will be subject to a prudency review and the renewable purchases subject to a financial audit (Cos. Br. at 96-98).

Staff and OPAE/APAC express concern with the Companies' plan to include renewable energy purchases and RECs as a component of the FAC mechanism (Staff Ex. 4 at 6-7; Staff Br. at 4-5; OPAE/APAC Br. at 11).

The Commission notes that the renewable energy purchases and RECs requirements are based on Section 4928.64(E), Revised Code, and any recovery of such costs is, as the statute provides, bypassable. With the Companies' recognition that such costs must be accounted for separately from fuel costs, and is not to be deferred, the Commission finds that Staff's and OPAE/APAC's issue is adequately addressed. Accordingly, with that clarification, the Commission finds that this aspect of the Companies' ESP application is reasonable and should be adopted.

2. FAC Baseline

The Companies proposed establishing a baseline FAC rate by identifying the FAC components of the current SSO. The Companies started with the EFC rates that were unbundled as part of the electric transition plan (ETP) proceedings (those in effect as of October 5, 1999) (step #1), and then added calendar year 1999 amounts for the additional fuel, purchased power, and environmental accounts that are included in the requested

FAC mechanism for this proceeding (1999 data from FERC Form 1 and other financial records were used as the base period for the additional components that were not in the frozen EFC rates) (step #2) (Cos. Ex. 7 at 8). The Companies then adjusted the 1999 frozen EFC rates (step #1) and the 1999-level rates developed for the additional components (step #2) for subsequent rate changes (step #3) to get the base FAC component that is equal to the fuel-related costs presently embedded in the Companies' most recent SSO (i.e., the RSP) (Id.). The subsequent rate changes that occurred during the RSP period and reflected in step #3 of the Companies' calculation included annual increases of 7 percent for OP and 3 percent for CSP, an increase in CSP's generation rates for 2007 by approximately 4.43 percent through the Power Acquisition Rider, and a reduction in OP's base period FAC rate by the amount of the Gavin Cap and mine investment shutdown cost recovery component that was in OP's 1999 EFC rate given that the Regulatory Asset Charge (RAC) established in the ETP case expired (Id. at 9).

Staff argued that the actual costs should be used in determining the FAC baseline and, therefore, recommended using 2007 actual data, escalated by 3 percent for CSP and 7 percent for OP, as a reasonable proxy for 2008 (Staff Ex. 10 at 3-4). Staff explained that utilizing actual 2007 costs and updating them to 2008 is appropriate given that the resulting amounts should be the costs that the Companies are currently recovering for fuel-related costs (Id.). Additionally, Staff notes that this proposal produces a result that is very close to the result produced by utilizing the Companies' methodology (Staff Br. at 3).

OCC recommended the use of 2008 actual fuel costs to establish the FAC baseline, which will be reconciled to actual costs in the future FAC proceeding (OCC Ex. 10 at 11-14). OCC's witness testified that her concern is that if the FAC baseline is established too low, the base portion of the generation rates (the non-FAC portion) will be established too high (OCC Ex. 10 at 13). In its Brief, OPAE/APAC opposed the Companies' use of 1999 rates as the baseline and seems to support OCC's recommendation to use 2008 fuel costs (OPAE/APAC Br. at 11-12). The Companies' responded by explaining that they did not use 1999 rates as the baseline, rather the 1999 level was just the starting point to calculating the baseline (Cos. Reply Br. at 21). The Companies also stated that a variable baseline was not appropriate as it would result in a variable non-FAC generation rate as well since the non-FAC component of the current generation SSO was determined to be the residual after subtracting out the FAC component (Id.).

As noted by OCC's witness, the 2008 actual fuel costs were not known at the time of the hearing (OCC Ex. 10 at 14). Thus, the Companies and Staff proposed methodologies to obtain a proxy for 2008 fuel costs. While both had a different starting point to the calculation of the 2008 proxy, we agree that in the absence of known actual costs, a proxy is appropriate to establish a baseline. Therefore, based on the evidence presented, we agree with Staff's resulting value as the appropriate FAC baseline.

3. FAC Deferrals

The Companies proposed to mitigate the rate impact on customers of any FAC increases by phasing in their new ESP rates by deferring a portion of the annual incremental FAC costs during the ESP (Cos. App. at 4-5; Cos. Ex. 3 at 11; Cos. Ex. 1 at 13-15). The amount of the incremental FAC expense that would be recovered from customers would be limited so that total bill increases would not be more than 15 percent for each of the three years of the ESP (Id.). The 15 percent target for FAC does not include cost increases associated with the transmission cost recovery rider (TCRR) or with any new government mandates (the Companies' could apply to the Commission for recovery of costs incurred in conjunction with compliance of new government mandates, including any Commission rules imposed after the filing of the AEP-Ohio application (Cos. App. at 6)). The Companies proposed to periodically reconcile the FAC to actual costs, subject to the maximum phase-in rates (Cos. Ex. 1 at 14-15). Under the Companies' proposal, any incremental FAC expense that exceeds the maximum rate levels will be deferred. The Companies project the deferrals under the proposed ESP to be $146 million by December 31, 2011 for CSP and $554 million by December 31, 2011 for OP (Cos. Ex. 6, Exhibit LVA-1). If the projected FAC expense in a given period is less than the maximum phase-in FAC rates, the Companies proposed to give the Commission the option of charging the customer the actual FAC expense amount or increasing the FAC rates up to the maximum levels in order to reduce any existing deferred FAC expense balance (Id.). Any deferred FAC expense remaining at the end of 2011 would be recovered, with a carrying cost at the Weighted Average Cost of Capital (WACC), as an unavoidable surcharge from 2012 to 2018 (Id.).

As noted previously, Staff, OCC, and Sierra support the FAC mechanism that will be updated and reconciled quarterly (Staff. Ex. 8 at 3-4; OCC Ex. at 11 at 4-5, 31-40; OCEA Br. at 47-48, 67-68). Staff, OCC, and Sierra, however, oppose the creation of any long-term deferrals for fuel costs (Staff Ex. 10 at 5; OCEA Br. at 62). Similarly, the Commercial Group recommended that "customers pay the full cost of fuel during the ESP" (Commercial Group Ex. 1 at 9). Constellation argued that the deferral proposal should be rejected because it masks the true cost of the ESP generation, deferrals have the effect of artificially suppressing conservation, the carrying costs proposed by the Companies would be set at the Companies' cost of capital, which would include equity, and customers do not want to pay interest on any deferred amounts (instead, customers would rather pay when the costs are incurred so as to not pay the interest) (Constellation Br. at 8-9). The Schools also questioned the need for the phase-in of rates, as well as the avoidability of the surcharge that would be created to collect the deferred fuel costs, with carrying charges, from 2012 to 2018 (Schools Br. at 3).

If the Commission, however, authorizes such deferrals to levelize rates during the ESP period, Staff, OCC, and Sierra believe that the deferrals should be short-term deferrals that do not extend beyond the ESP period (Staff Ex. 10 at 5; OCEA Br. at 62). IEU also supports the use of a phase-in to stabilize rates, but does not believe that Section 4928.144, Revised Code, allows the deferrals to extend beyond the ESP term (IEU Br. at 27-29).

Furthermore, OCC opposed the Companies' use of WACC, stating that such an approach is not reasonable and results in excessive payments by customers (OCC Ex. 10 at 34). Through testimony, OCC asserts that the carrying charges on deferrals should be based on the current long-term cost of debt (OCC Ex. 10 at 34-35; Tr. Vol. VI at 157-158). However, in its joint brief, OCC seems to have modified its position and is now arguing that the carrying charges should be calculated to reflect the short-term actual cost of debt, excluding equity (OCEA Br. at 62). In reliance on OCC's testimony, Constellation submits that it is appropriate to use the long-term cost of debt (Constellation Br. at 8). The Commercial Group also opposed the use of WACC; instead, Commercial Group witness Gorman recommended that the Companies finance the FAC phase-in deferrals entirely with short-term debt given that the accruals are a temporary investment and not long-term capital (Commercial Group Ex. 1 at 9-11).

Additionally, the Commercial Group and OCC argued that the deferred fuel expenses should be calculated to reflect the net of applicable deferred income taxes (Commercial Group Ex. 1 at 9-10; OCEA Br. at 63). Commercial Group witness Gorman testified that if a company does not recover the fuel expense in the year that it was incurred, the company will reduce its current tax expense and record a deferred tax obligation. The deferred tax obligation would then represent a temporary recovery of the fuel expense via a reduction to the current income tax expense (Commercial Group Ex. 1 at 10). Commercial Group witness Gorman then goes on to recognize that the income tax will ultimately have to be paid after the incremental fuel cost is recovered from customers, but states that, while deferred, the company will partially recover its deferred fuel balance through the reduced income tax expense (Id.). To bolster their argument that deferred fuel expenses should be calculated on a net-of-tax basis, OCC and Sierra relied, in their brief, on a witness' testimony in an unrelated proceeding, which has been subsequently withdrawn as explained above. Neither OCC nor Sierra offered any record evidence to support its position.

AEP-Ohio, on the other hand, argued that the calculation of carrying charges for the deferrals should not be done on a net-of-tax basis. AEP-Ohio witness Assante testified that limiting the application of the carrying cost rate to a net-of-tax balance of FAC deferrals improperly utilizes a traditional cost-of-service ratemaking approach in a generation pricing proceeding (Tr. Vol. IV at 158-160). Additionally, while the Companies proposed the phase-in proposal to help mitigate increases and believe that their proposal is reasonable, in light of the opposition received from several parties, the Companies stated that they would accept a modification to their ESP that eliminated such deferrals (Cos. Reply Br. at 41-42).

To ensure rate or price stability for consumers, Section 4928.144, Revised Code, authorizes the Commission to order any just and reasonable phase-in of any electric utility rate or price established pursuant to 4928.143, Revised Code, with carrying charges, through the creation of regulatory assets. Section 4928.144, Revised Code, also mandates that any deferrals associated with the phase-in authorized by the Commission shall be collected through an unavoidable surcharge. Section 4928.144, Revised Code, does not, however, limit the time period of the phase-in or the recovery of the deferrals created by the phase-in through the unavoidable surcharge.

Contrary to OCC and others,[7] we believe that a phase-in of the increases is necessary to ensure rate or price stability and to mitigate the impact on customers during this difficult economic period, even with the modifications to the ESP that we have made herein. To this end, the Commission appreciates the Companies' recognition that over 15 percent rate increases on customers' bills would cause a severe hardship on customers. Nonetheless, given the current economic climate, we believe that the 15 percent cap proposed by the Companies is too high.[8] Therefore, we exercise our authority pursuant to Section 4928.144, Revised Code, and find that the Companies should phase-in any authorized increases so as not to exceed, on a total bill basis, an increase of 7percent for CSP and 8percent for OP for 2009, an increase of 6percent for CSP and 7percent for OP for 2010, and an increase of 6percent for CSP and 8percent for OP for 2011 are more appropriate levels.

Based on the application, as modified herein, the resulting increases amount to approximate overall average generation rates of 5.47 cents/kWh and 4.29 cents/kWh for CSP and OP, respectively in 2009; 6.07 cents/kWh and 4.75 cents/kWh for CSP and OP, respectively, in 2010; and 6.31 cents/kWh and 5.31 cents/kWh for CSP and OP, respectively, in 2011.

Any amount over the allowable total bill increase percentage levels will be deferred pursuant to Section 4928.144, Revised Code, with carrying costs. If the FAC expense in a given period is less than the maximum phase-in FAC rate established herein, the Companies shall begin amortization of the prior deferred FAC balance and increase the FAC rates up to the maximum levels allowed to reduce any existing deferred FAC expense balance, including carrying costs. As required by Section 4928.144, Revised Code, any deferred FAC expense balance remaining at the end of 2011 shall be recovered

7 See, e.g., OCC Reply Br. at 45-46; Constellation Br. at 6-9.

8 Numerous letters filed in the docket by various customers confirm our belief.

via an unavoidable surcharge. We believe that this approach balances our objectives of limiting the total bill increases that customers will be charged in any one year with minimizing the deferrals and carrying charges collected from customers.

Based on the record in this proceeding, we do not find the intervenors' arguments concerning the calculation of the carrying charges persuasive. Instead, for purposes of a phase-in approach in which the Companies are expected to carry the fuel expenses incurred for electric service already provided to the customers,[9] we find that the Companies have met their burden of demonstrating that the carrying cost rate calculated based on the WACC is reasonable as proposed by the Companies. As explained previously, Section 4928.144, Revised Code, provides the Commission with discretion regarding the creation and duration of the phase-in of a rate or price established pursuant to Sections 4928.141 through 4928.143, Revised Code. The Commission is not convinced by arguments that limit the collection of the deferrals to the term of the ESP. Limiting the phase-in to the term of the ESP may not ensure rate or price stability for consumers within that three-year period and may create excessive increases, which may defeat the purpose for establishing a phase-in. The limitation of any deferrals to the ESP term may also negate the cap established by the Commission herein to provide stability to consumers. Therefore, we find that the collection of any deferrals, with carrying costs, created by the phase-in that are remaining at the end of the ESP term shall occur from 2012 to 2018 as necessary to recover the actual fuel expenses incurred plus carrying costs.

Regarding OCC's, Sierra's, and the Commercial Group's recommendations that the tax deductibility of the debt rate be reflected in the carrying charges on a net-of-tax basis,[10] we have recently explained that this recommendation accounts for the deductibility of the debt rate, but does not account for the fact that the revenues collected are taxable.[11] If we were to adopt the net-of-tax recommendation, the Companies would not recover the full carrying charges on the authorized deferrals. We believe that this outcome would be inconsistent with the explicit directive of Section 4928.144, Revised

9 We agree with the Companies that this decision is consistent with our decision in the recent TCRR and accounting cases with regard to the calculation based on the long-term cost of debt. See *In re Columbus Southern Power Company and Ohio Power Company*, Case No. 08-1202-EL-UNC, Finding and Order (December 17, 2008) and *In re Columbus Southern Power Company and Ohio Power Company*, Case No. 08-1301-EL-UNC, Finding and Order (December 19, 2008). However, we believe that, with regard to the equity component, these cases are distinguishable from the current ESP proceeding, where we are establishing the standard service offer and requiring the Companies to defer the collection of incurred generation costs associated with fuel over a longer period. We also believe that this decision is reasonable in light of our reduction to the Companies' proposed FAC deferral cap, which may have the effect of requiring the Companies to defer a higher percentage of FAC costs than what was otherwise proposed.

10 OCEA Br. at 63-64; Commercial Group Ex. 1 at 9-10.

11 *In re Ohio Edison Co., The Cleveland Electric Illuminating Co., Toledo Edison Co.*, Case No. 07-551-El-AIR, et al., Opinion and Order at 10 (January 21, 2009).

Code: "If the commission's order includes such a phase-in, the order also shall provide for the creation of regulatory assets pursuant to generally accepted accounting principles, by authorizing the deferral of incurred costs equal to the amount not collected, plus carrying charges on that amount." Therefore, we find that the carrying charges on the FAC deferrals should be calculated on a gross-of-tax rather than a net-of-tax basis in order to ensure that the Companies recover their actual fuel expenses. Accordingly, we modify the deferral provision of the Companies' ESP to lower the overall amount that may be charged to customers in any one year.

B. Incremental Carrying Cost for 2001-2008 Environmental Investment and the Carrying Cost Rate

A component of the non-FAC generation increase is the incremental, ongoing carrying costs associated with environmental investments made during 2001-2008. The Companies propose to include, as a part of their ESP, costs directly related to energy produced or purchased. While the Companies are not proposing to include the recovery of capital carrying costs on environmental capital investments in the FAC, the Companies are requesting recovery of carrying charges for the incremental amount of the environmental investments made at their generating facilities from 2001 to 2008. The Companies' annual capital carrying costs for the incremental 2001-2008 environmental investments not currently reflected in rates equals $84 million for OP and $26 million for CSP. The Companies' ESP includes capital carrying costs for 2001 through 2008 net of cumulative environmental capital expenditures for each company multiplied by the carrying cost rate.

Each company's capital expenditures in the ESP are determined by the expenditures made since the start of the market development period as offset by the estimate included in the Companies' rate stabilization plan (RSP) case, Case No. 04-169-EL-UNC, and the environmental expenditures included in the Companies' adjustments received in the RSP 4 Percent Cases[12] (Cos. Ex. 7 at 15-17, Exhibits PJN-8, PJN-12). The Companies calculated the carrying cost rate based on levelized investment and depreciation over the 25-year life of the environmental investment. CSP and OP utilized a capital structure of 50 percent common equity and 50 percent debt to calculate the carrying charges, asserting that such is consistent with the capital structure as of March 31, 2008, and consistent with the expected capital structure during the ESP period. Short-term debt and the Gavin Lease were excluded from OP's capital structure. AEP-Ohio asserts that such was the process in the RSP 4 Percent Cases. AEP-Ohio also argues that, for ratemaking purposes, the Gavin Lease is considered an operating lease as opposed to a component of rate base. Further, the Companies reason that the WACC incorporated a 10.5 percent ROE as used by the Commission in the proceeding to transfer

12 *In re Columbus Southern Power Company and Ohio Power Company,* Case Nos. 07-1132-EL-UNC, 07-1191-EL-UNC, and 07-1278-EL-UNC (RSP 4 Percent Cases).

MonPower's certified territory to CSP (MonPower Transfer Case)[13] (Cos. Ex. 7 at 16-17, 19, Exhibit PJN-8, Exhibits PJN-10 - PJN-13; Cos. Ex. 7-B at 7).

Staff testified that the Companies should be allowed to recover carrying costs associated with capitalized investments to comply with environmental requirements made between 2001-2008 that are not currently reflected in rates (Staff Ex. 6 at 2, 4-5). Staff confirmed that AEP-Ohio's estimated revenue increases for incremental carrying costs associated with additional environmental investments in the amounts of $26 million for CSP and $84 million for OP are not currently reflected in rates (Id.).

OCEA and OEG oppose the Companies' request for recovery of environmental carrying charges on investments made prior to January 1, 2009. OEG contends that the rates in the RSP Case included recovery for environmental capital improvements made through December 31, 2008, as reflected in the RSP 4 Percent Cases. Further, OCEA and OEG argue that SB 221 only permits the recovery of carrying costs associated with environmental expenditures that are prudently incurred and that occur on or after January 1, 2009, pursuant to Section 4928.143(B)(2)(b), Revised Code (OCEA Ex. 10 at 32; OEG Ex. 3 at 21). Thus, OCEA reasons that approval of such expenditures necessitates an after-the-fact review, which cannot be considered in this proceeding. OEG, however, is not opposed to the Companies' increases due to environmental capital additions made after January 1, 2009, in the ESP in accordance with Section 4928.143(B)(2)(b), Revised Code (OEG Ex. 3 at 20). OEG and Kroger argue that the Companies' assertion that existing rates do not reflect environmental carrying costs ignores the Companies' non-environmental investment and the effects of accumulated depreciation and, therefore, according to OEG and Kroger, fails to demonstrate any net under-recovery of generation costs in total by the Companies (OEG Ex. 3 at 21; Kroger Ex. 1 at 10-11). OCEA and APAC/OPAE agree that the Companies have failed to demonstrate that they lack the earnings to make the environmental investments (OCEA Ex. 10 at 32; APAC/OPAE Br. at 5-6).

Further, OCEA asserts that there are several reasons that the Companies' attempt to recover environmental carrying cost during the ESP is unlawful. OCEA contends that it is retroactive ratemaking[14] and Senate Bill 3, which was the governing law from 2001 to 2005, included rate caps pursuant to Section 4928.34(A)(6), Revised Code, and the RSP, applicable to 2006 through 2008, included limitations on the rate increases. Therefore, the Companies can not collect now for costs incurred during those periods. Further, OCEA

13 *In the Matter of the Transfer of Monongahela Power Company's Certified Territory in Ohio to the Columbus Southern Power Company*, Case No. 05-765-EL-UNC.

14 *Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co.* (1957), 166 Ohio St. 25.

states that allowing for recovery of such environmental carrying costs would also violate the Stipulation and the Commission's order in the ETP case.[15]

OCEA argues that, should the Commission allow AEP-Ohio to recover carrying costs on environmental investments, the Companies' carrying charges should be based on actual investments made, not actual and forecasted environmental expenditures, and the carrying costs should be adjusted. More specifically, OCEA recommends that because the Companies failed to provide any support or explanation of the calculation of the property taxes or general and administrative components of the carrying cost calculation, the Commission should not grant recovery of these aspects of the Companies' request. Additionally, OCEA and IEU argue that the proposed carrying cost rates do not reflect actual financing for environmental investments, which could impact the calculation of the carrying cost rates (IEU Br. at 21-22, citing IEU Ex. 7 at 132-133; Tr. Vol. XI at 111-113; OCEA Br. at 71-72). The carrying cost rates, according to IEU and OCEA, should be revised to reflect actual financing, including the use of pollution control bonds that have been secured by the Companies (Id.). To support their argument, IEU and OCEA rely on Staff witness Cahaan who testified at the hearing that "if specific financing mechanisms can be identified that would be appropriate and applicable to the assets being financed, I see no reason why those shouldn't be specifically used"[16] (IEU Br. at 21-22; OCEA Br. at 72-73). However, Staff witness Cahaan also stated that "[A]t the time when we looked at the carrying cost calculations it seemed reasonable, given the cost of debt and cost of equity of the company,"[17] which is consistent with his prefiled testimony that said: "I have examined the carrying costs rates provided to Mr. Soliman and found them to be reasonable" (Staff Ex. 10 at 7).

OCEA also recommends that the carrying costs for deferrals of environmental costs be revised to reflect actual short-term cost of debt, as opposed to WACC as proposed by the Companies, and that the calculated carrying charges should not be based on the original cost of the environmental investment but at cost minus depreciation. Thus, OCEA argues that the Companies are seeking a return on and a return of their investment as would be the case under traditional ratemaking, but overstating the depreciation component. OCEA also advocates that the carrying cost rates, 13.98 percent for OP and 14.94 percent for CSP, are too high in light of the economic environment at this time (OCEA Br. at 73-74). Finally, OCEA urges the Commission to offset the Companies' request for carrying charges by the Section 199 provision of the Internal Revenue Code (Section 199). Section 199 allows the Companies to take a tax deduction for "qualified production activities income" equal to 6 percent in 2009 and 9 percent in 2010 and

15 *In the Matter of the Application 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).

16 Tr. Vol. XII at 237.

17 Id.

thereafter. IEU, OEG, and OCEA request that the Commission adjust the carrying costs for the Section 199 deduction as the Commission has found appropriate in the Companies' 07-63 Case[18] and in the FirstEnergy ESP Case. OCEA argues that while Section 4928.143(B)(2)(a), Revised Code, allows the Companies to automatically recover the cost of federally mandated carbon or energy taxes, which will be passed on to customers, customers should be afforded the benefits of the Section 199 tax deduction (OCEA Br. at 74-75; IEU Br. at 21; IEU Ex. 10 at 6; OEG Ex. 3 at 23).

The Companies emphasize that their request for carrying costs is for the incremental carrying charges on the 2001-2008 investments that the Companies will incur post-January 1, 2009. AEP-Ohio explained that the carrying costs themselves are the costs that the Companies will incur after January 1, 2009, and, therefore, the Companies reason that the "without limitation" language in Section 4928.143(B)(2), Revised Code, supports their request (Tr. Vol. XIV at 93, 114). AEP-Ohio stresses that Section 4928.143(B)(2), Revised Code, is the basis for the carrying cost request as opposed to paragraph (B)(2)(a) of Section 4928.143, Revised Code, as OCEA and OEG claim and, therefore, the arguments as to retroactive ratemaking are misplaced (Cos. Reply Br. at 29-30). Further, the Companies insist that Section 4928.143(B)(2)(b), Revised Code, supports their request, as the carrying charges are necessary to recover the ongoing cost of investments in environmental facilities and equipment that are essential to keep the generation units operating. The Companies assert that the operating costs of their generation units remain well below the cost of securing the power on the market (Cos. Ex. 7-B at 7).

As to the claims that the carrying costs are overstated, the Companies claim that the levelized depreciation approach used by the Companies is better for customers than traditional ratemaking given the relative newness of the environmental investments (Tr. Vol. V at 55-56; Tr. Vol. VII at 22-23). The Companies also argue that the Companies' investments in environmental compliance equipment during 2001-2008 were not factored into the rates unbundled in 2000 and capped under the ETP case as alleged. The rate increase approved, as part of the RSP, and the RSP 4 Percent Cases did not, according to the Companies, provide recovery of the carrying costs to be incurred during the ESP period (Cos. Ex. 7, Exhibits PJN-8 - PJN-9 and PJN-12). The Companies reply that the intervenors' request to adjust carrying charges for the Section 199 deduction is flawed. AEP-Ohio states that the Section 199 deduction is not a reduction to the statutory tax rate used in the WACC, a fact which AEP-Ohio asserts has been recognized by FERC and the Financial Accounting Standards Board. The Companies further note that IEU witness Bowser indeed confirmed that Section 199 does not reduce the statutory tax rate (Tr. Vol. XI at 271-273). The Companies also argue, and IEU witness Bowser agreed, that the Section 199 tax deduction is applicable to AEP Corporation as a whole and not to each operating subsidiary. The Companies note, therefore, that any deduction available to

18 *In re Columbus Southern Power Company and Ohio Power Company*, Case No. 07-63-EL-UNC, Opinion and Order (October 3, 2007) (07-63 Case).

AEP-Ohio is reduced if one of the other AEP Corporation operating affiliates is not eligible for the Section 199 deduction (Cos. Br. 36; Tr. Vol. XI at 266-267). Accordingly, the Companies state that AEP-Ohio has not been able to take the full deduction (Tr. Vol. XIV at 115-117). Further, the Companies argue that the intervenors have misinterpreted the Commission's decision in the FirstEnergy ESP Case to imply that the Commission made an adjustment to account for the Section 199 deduction. For these reasons, the Companies request that the Commission reconsider adjusting carrying charges for the potential Section 199 deduction.

Upon review of the record, we agree with Staff that AEP-Ohio should be allowed to recover the incremental capital carrying costs that will be incurred after January 1, 2009, on past environmental investments (2001-2008) that are not presently reflected in the Companies' existing rates, as contemplated in AEP-Ohio's RSP Case. Further, the Commission finds that this decision regarding the recovery of continuing carrying costs on environmental investments, based on the WACC, is consistent with our decision in the 07-63 Case and the RSP 4 Percent Cases. Additionally, we agree with Staff that the levelized carrying cost rates proposed by AEP-Ohio are reasonable and, therefore, should be approved. We further find, as we concluded in the FirstEnergy ESP Case, that adequate modifications to the Companies' ESP application have been made in this order to account for the possibility of any applicable Section 199 tax deductions.

C. Annual Non-FAC Increases

The Companies proposed to increase the non-FAC portion of their generation rates by 3 percent for CSP and 7 percent for OP for each year of the ESP to provide a recovery mechanism for increasing costs related to matters such as carrying costs associated with new environmental investments made during the ESP period, increases in the general costs of providing generation service, and unanticipated, non-mandated generation-related cost increases. Specifically, as part of this automatic increase, the Companies intend to recover the carrying costs associated with anticipated environmental investments that will be necessary during the ESP period (2009-2011) (Cos. Br. at 27; Cos. Reply Br. at 46-49). The Companies argued that the annual increases are not cost-based and are avoidable for those customers who shop. The Companies also proposed two exceptions to the fixed, annual increases, one for generation plant closures and the other for OP's lease associated with the scrubber at the Gavin Plant, which would require additional Commission approval during the ESP. After establishing the FAC component of the current generation SSO to get a FAC baseline, the Companies determined that the remainder of the current generation SSO would be the non-FAC base component.

The intervenors oppose automatic annual increases in the non-FAC component of the generation rate, and argue that any generation increases should be cost-based (IEU Br.

at 24; OPAE/APAC Br. at 6; OEG Br. at 12; OCEA Br. 29-31). OEG contends that since the Companies have not provided any support for the automatic annual increases, which could result in total rate increases over the three-year period of $87 million for CSP and $262 million for OP, the annual increases should be disallowed (OEG Ex. 3 at 18-19); Similarly, Kroger argues that AEP-Ohio did not appropriately account for costs associated with the non-FAC component of the proposed generation rates (Kroger Br. at 14).

Staff opposes CSP's and OP's recommended annual, non-FAC increases of 3 and 7 percent, respectively (Staff Ex. 10 at 4). Instead, Staff stated that it believes a more appropriate escalation of the non-FAC generation component would be half of the proposed amounts; therefore, recommending annual increases of 1.5 percent for CSP and 3.5 percent for OP (Id.). Staff witness Cahaan rationalized the proposed reduction by stating that "an average of 5% for the two companies may have been a reasonable expectation of cost increases at the time that the ESP was contemplated, but not now. With the recent financial crises, we are entering a recessionary, and possibly a deflationary, period and any expectations of price increases need to be revised downward" (Id.). Furthermore, while recognizing that the ultimate balancing of interests lies with the Commission, Staff witness Cahaan testified that Staff's recommended reduction in the proposed increases was a reasonable balance between the Companies' obligation and costs to serve customers and the current economic conditions (Tr. Vol. XII at 211). The Companies rejected Staff's rationalization for the reduction in their proposed non-FAC increases (Cos. Reply Br. at 49). IEU also rejected Staff's rationalization for the reduction, arguing that no automatic increases are warranted (IEU Br. at 24).

Stating that it is in the public interest for the Companies to continue investing in environmental equipment and to be in compliance with current and future environmental requirements, Staff witness Soliman also recommended that AEP-Ohio be permitted to recover carrying costs for anticipated environmental investments made during the ESP period (Staff Ex. 6 at 5). Staff recommended that this recovery occur through a future proceeding upon the request of the Companies for recovery of additional carrying costs associated with actual environmental investment after the investments have been made (Staff Br. at 6-7). Specifically, Staff suggested that the Commission require the Companies to file an application in 2010 for recovery of 2009 actual environmental investment cost and annually thereafter for each succeeding year to reflect actual expenditures (Tr. Vol. XII at 132; Staff Ex. 10 at 7). OCEA seems to agree with Staff's recommendation (OCEA Br. at 71).

The Companies further respond that Section 4928.143, Revised Code, does not require that the SSO price be cost-based and, instead, Section 4928.143(B)(2)(e), Revised Code, authorizes electric utilities to include in their ESP provisions for automatic increases in any component of the SSO price (Cos. Reply Br. at 48-49).

The Commission finds Staff's approach with regard to the recovery of the carrying costs for anticipated environmental investments made during the ESP to be reasonable, and, therefore, we direct the Companies to request, through an annual filing, recovery of additional carrying costs after the investments have been made.

We also agree with Staff that the economic conditions must be balanced against the Companies' provision of electric service under an ESP. In balancing these two interests, as well as considering all components of the ESP, we believe that it is appropriate to modify this provision of the Companies' ESP and remove the inclusion of any automatic non-FAC increases. As recognized by several intervenors, the record is void of sufficient support to rationalize automatic, annual generation increases that are not cost-based, but that are significant, equaling approximately $87 million for CSP and $262 million for OP (see, i.e., OCEA Br. at 29-30, citing Tr. Vol. XIV at 208-209). We also believe the modification is warranted in light of the fact that we have removed one of the Companies' significant costs factored into establishing the proposed automatic increases. Accordingly, we find that the ESP should be modified to eliminate any automatic increases in the non-FAC portion of the Companies' generation rates.

IV. DISTRIBUTION

A. Annual Distribution Increases

To support initiatives to improve the Companies' distribution system and service to customers, the Companies proposed the following two plans, which will result in annual distribution rate increases of 7 percent for CSP and 6.5 percent for OP:

1. Enhanced Service Reliability Plan (ESRP)

The Companies proposed to implement a new, three-year ESRP pursuant to 4928.143(B)(2)(h), Revised Code,[19] which includes an enhanced vegetation initiative, an enhanced underground cable initiative, a distribution automation initiative, and an enhanced overhead inspection and mitigation initiative (Cos. Ex. 11 at 3). While noting that they are providing adequate and reliable electric service, the Companies justify the need for the ESRP by stating that customers' service reliability expectations are increasing, and in order to maintain and enhance reliability, the ESRP is required (Id. at 3, 8, 10-14). AEP-Ohio further states that the three-year ESRP, consisting of the four reliability

19 On page 72 of its brief, the Companies rely on Section 4928.154(B)(2)(h), Revised Code, to support their request to receive cost recovery for the incremental costs of the incremental ESRP activities. We are assuming that the reference was a typographical error and that the Companies intended to cite to Section 4928.143(B)(2)(h), Revised Code (see Cos. Reply Br. at 50-51).

programs, is designed to modernize and improve the Companies' distribution infrastructure (Id.).

(a) Enhanced vegetation initiative

The Companies state that the purpose of this new initiative is to improve the customer's overall service experience by reducing and/or eliminating momentary interruptions and/or sustained outages caused by vegetation. The Companies proposed to accomplish this goal by balancing its performance-based approach to reflect a greater consideration of cycle-based factors (Id. at 26-28). The Companies state that under their proposed vegetation initiative, they will employ additional resources (approximately double the current number of tree crews in Ohio), employ greater emphasis on cycle-based planning and scheduling, increase the level of vegetation management work performed so that all distribution rights-of-way can be inspected and maintained, and utilize improved technologies to collect tree inventory data to optimize planning and scheduling by predicting problem areas before outages occur (Id. at 28-29).

(b) Enhanced underground cable initiative

The Companies state that the purpose of this initiative is to reduce momentary interruptions and sustained outages due to failures of aging underground cable. The Companies' plan to target underground cables manufactured prior to 1992 to replace and/or restore the integrity of the cable insulation (Id. at 31).

(c) Distribution automation (DA) initiative

The Companies explain that DA is a critical component of their proposed gridSMART distribution initiative that is described below. DA is an advanced technology that improves service reliability by minimizing, quickly identifying and isolating faulted distribution line sections, and remotely restoring service interruptions (Id. at 34-35).

(d) Enhanced overhead inspection and mitigation initiative

The Companies state that the purpose of this initiative is to improve the customer's overall service experience by reducing equipment-related momentary interruptions and sustained outages. The Companies intend to accomplish this goal through a comprehensive overhead inspection process that will proactively identify equipment that is prone to fail (Id. at 18). The Companies also state that the new program will go beyond the current inspection program required by the electric service and safety (ESSS) rules, which is a basic visual assessment of the general condition of the distribution facilities, by conducting a comprehensive inspection of the equipment on each structure via walking the circuit lines and physically climbing or using a bucket truck to inspect (Id. at 19). In conjunction with this program, AEP-Ohio proposes to focus on five targeted overhead asset initiatives, including cutout replacement, arrester replacement, recloser replacement, 34.5 kV protection, and fault indicator (Id. at 20-22).

Generally, numerous intervenors and Staff opposed the distribution initiatives and cost recovery of such initiatives through this proceeding. Many parties advocated for deferral of these distribution initiatives, and the ESRP as a whole, for consideration in a future distribution base rate case (Staff Br. at 7; Staff Ex. 1 at 6-7; OPAE/APAC at 19; IEU Br. at 25-26; Kroger Br. at 18; OHA Br. at 17; OMA Br. at 6). Further, OCEA argued that the Companies have not demonstrated that the ESRP is incremental to what the Companies are required to do and spend under the current ESSS rules and current distribution rates (OCEA Br. at 44; OCC Ex. 13 at 8-11). While supporting several aspects of the Companies' ESRP programs, Staff witness Roberts also questioned the incremental nature of the proposed ESRP programs (Staff Ex. 2 at 4-6, 13, 17, 18; Tr. Vol. VIII at 70-77).

The Commission agrees, in part, with Staff and the intervenors. The Commission recognizes that Section 4928.143(B)(2)(h), Revised Code, authorizes the Companies to include in its ESP provisions regarding single-issue ratemaking for distribution infrastructure and modernization incentives. However, while SB 221 may have allowed Companies to include such provisions in its ESP, the intent could not have been to provide a 'blank check' to electric utilities. In deciding whether to approve an ESP that contains provisions for distribution infrastructure and modernization incentives, Section 4928.143(B)(2)(h), Revised Code, specifically requires the Commission to examine the reliability of the electric utility's distribution system and ensure that customers' and the electric utilities' expectations are aligned, and to ensure that the electric utility is emphasizing and dedicating sufficient resources to the reliability of its distribution system. Given AEP-Ohio's proposed ESRP, the only way to examine the full distribution system, the reliability of such system, and customers' expectations, as well as whether the programs proposed by AEP-Ohio are "enhanced" initiatives (truly incremental), is through a distribution rate case where all components of distribution rates are subject to review. Therefore, at this time, the Commission denies the Companies' request to implement, as well as recover costs associated therewith, the enhanced underground cable initiative, the distribution automation initiative, and the enhanced overhead inspection and mitigation initiative. With regard to these issues, we concur with OHA: "The record in this case reflects the fact that the distribution prong of AEP's electric service deserves further Commission scrutiny – but not in the context of this accelerated ESP proceeding" (OHA Br. at 17).

Nonetheless, the Commission finds that AEP-Ohio has demonstrated in the record of this proceeding that it faces increased costs for vegetation management and that a specific need exists for the implementation of the enhanced vegetation initiative, as proposed as part of the three-year ESRP, to support an incremental level of reliability activities in order to maintain and improve service levels. The Companies' current approach to its vegetation management program is mostly reactive (Staff Ex. 2 at 10). While we recognize the difficulties that recent events have caused, we believe that it is important to have a balanced approach that not only reacts to certain incidents and problems, but that also proactively limits or reduces the impact of weather events or incidents. In addition to reacting to problems that occur, it is imperative that AEP-Ohio implements a cycle-based approach to maintain the overall system. To this end, the Companies have demonstrated in the record that increased spending earmarked for specific vegetation initiatives can reduce tree-caused outages, resulting in better reliability (Cos. Ex. 11 at 27-31). OCC witness Cleaver also recognized a problem with the current vegetation management program, and supported the adoption of a new, hybrid approach that incorporates a cycle-based tree-trimming program with a performance-based program (OCC Ex. 13 at 30, 35). Staff witness Roberts further supported the move to a new, four-year cycle-based approach and recommended that the enhanced vegetation initiative include the following: end-to-end circuit rights-of-way inspections and maintenance; mid-point circuit inspections to review vegetation clearance from conductors, equipment, and facilities; greater clearance of all overhang above three-phase primary lines and single-phase lines; removal of danger trees located outside of rights-of-ways where property owner's permission can be secured, and using technology to collect tree inventory data to optimize planning and scheduling (Staff Ex. 2 at 13).

The Commission is satisfied that the Companies have demonstrated in the record that the costs associated with the proposed vegetation initiative, included as part of the proposed three-year ESRP, are incremental to the current Distribution Vegetation Management Program and the costs embedded in distribution rates (Cos. Ex. 11 at 26-31). Specifically, the Companies proposed to employ additional resources in Ohio, place a greater emphasis on cycle-based planning and scheduling, and increase the level of vegetation management work performed (Id. at 28-29). Although OCC's witness questions the incremental nature of the costs proposed to be included in the enhanced vegetation initiative, OCC offered no evidence that the proposed initiative is already included in the current vegetation management program, and thus, is not incremental (OCC Ex. 13 at 30-36). Rather, OCC seems to quibble with the definition of "enhanced." OCC witness Cleaver stated: "I recommend that the Commission rule that the Company's proposed Vegetation Management Programs, while an improvement over its current performance based program, is *not an enhancement* but *rather a reflection of additional* tree trimming needed as a result of their prior program" (Id. at 35 (emphasis added)). Furthermore, we believe that the record clearly reflects customers' expectations as to tree-caused outages, service interruptions, and reliability of customers' service.[20] We also believe that, presently, those customer expectations are not aligned with the Companies' expectations. However, as required by Section 4928.143(B)(2)(h), Revised Code, we believe that the Companies' proposal for a new vegetation initiative more closely aligns

20 A common theme from the customers throughout the local public hearings was that outages due to vegetation have been problematic.

the customers' expectations with the Companies' expectations as it relates to tree-caused outages, importance of reliability, and the increasing frustration surrounding momentary outages with the emergence of new technology.

Accordingly, in balancing the customers' expectations and needs with the issues raised by several intervenors, the Commission finds that the enhanced vegetation initiative proposed by the Companies, with Staff's additional recommendations, is a reasonable program that will advance the state policy. To this end, the Commission approves the establishment of an ESRP rider as the appropriate mechanism pursuant to Section 4928.143(B)(2)(h), Revised Code, to recover such costs. The ESRP rider initially will include only the incremental costs associated with the Companies' proposed enhanced vegetation initiative (Cos. Ex. 11 at 31, Chart 7) as set forth herein. Consistent with prior decisions,[21] the Commission also believes that, pursuant to the sound policy goals of Section 4928.02, Revised Code, a distribution rider established pursuant to Section 4928.143(B)(2)(h), Revised Code, should be based upon the electric utility's prudently incurred costs. Therefore, the ESRP rider will be subject to Commission review and reconciliation on an annual basis.

As for the recovery of any costs associated with the Companies' remaining initiatives (i.e., enhanced underground cable initiative, distribution automation initiative, and enhanced overhead inspection and mitigation initiative), the ESRP rider will not include costs for any of these programs until such time as the Commission has reviewed the programs, and associated costs, in conjunction with the current distribution system in the context of a distribution rate case as explained above. If the Commission, in a subsequent proceeding, determines that the programs regarding the remaining initiatives should be implemented, and thus, the associated costs should be recovered, those costs may, at that time, be included in the ESRP rider for future recovery, subject to reconciliation as discussed above.

2. GridSMART

The Companies propose, as part of their ESP, to initiate Phase 1 of gridSMART, a three-year pilot, in northeast central Ohio. GridSMART will include three main components, AMI, DA, and Home Area Network (HAN). The AMI system features include smart meters, two-way communications networks, and the information technology systems to support system interaction. AEP-Ohio contends that AMI will use internal communications systems to convey real-time energy usage and load information to both the customer and the company. According to the Companies, AMI will provide the capability to monitor equipment and convey information about certain malfunctions and operating conditions. DA will provide real-time control and monitoring of select

21 *In re Ohio Edison Co., The Cleveland Electric Illuminating Co., Toledo Edison Co.*, Case No. 08-935-EL-SSO, Opinion and Order at 41 (December 19, 2008).

electrical components with the distribution system, including capacitor banks, voltage regulators, reclosers, and automated line switches. HAN will be installed in the customer's home or business and will provide the customer with information to allow the customer to conserve energy. HAN includes providing residential and business customers who have central air conditioning with a programmable communicating thermostat (PCT) and a load control switch (LCS), which is installed ahead of a major electrical appliance and will turn the appliance on and off or cycle the appliance on and off. AEP-Ohio reasons that central air conditioners are typically the largest piece of electrical equipment in the home and will yield the most significant demand response benefit (Tr. Vol. III at 304). LCS will provide customers who have a direct load control or interruptible tariff the ability to receive commands from the meter and the option to respond and signal the appropriate action to the meter for confirmation. The Companies propose a phased-in implementation of Phase 1 gridSMART to approximately 110,000 meters and 70 distribution circuits in an approximately 100 square mile area within CSP's service territory (Cos. Ex. 4 at 9, 12-13; Tr. Vol. III at 303-304). The Companies further propose to extend the installation of DA to 20 circuits in areas beyond the gridSMART Phase 1 program. The Companies propose a phased-in approach to fully implement gridSMART throughout their service area over the next 7 to 10 years, if granted appropriate regulatory treatment. The Companies estimate the net cost of gridSMART Phase 1 to be approximately $109 million (including the projected net savings of $2.7 million) over the three-year period (Cos. Ex. 4 at 15-16, KLS-1). The rate design for gridSMART includes the projected cost of the program over the life of the equipment. The Companies have requested recovery during the ESP of only the costs to be incurred during the three-year term of the ESP (Cos. Ex. 1 at DMR-4). Thus, AEP-Ohio asserts that it is inappropriate to consider the long-term operational cost savings when the long-term costs of gridSMART have not been included in the ESP for recovery.

Although Staff generally supports the Companies' implementation of gridSMART, particularly the AMI and DA components, Staff raises a few concerns with this aspect of the Companies' ESP application. Staff is concerned that the overhead costs for meter purchasing is overstated and recommends that the overhead costs be reviewed before approval to ensure that the costs are not duplicative of the overhead meter purchasing costs currently recovered in the Companies' rates (Staff Ex. 3 at 3). Staff argues that there is no reason for the Companies to restrict the PCTs to customers with air conditioning only, and recommends that the device be offered to any customer that desires to own this type of thermostat to control air conditioning or other electrical appliances (Staff Br. at 12). Staff and OCC also argue that customers who have invested in advanced technological equipment for gridSMART will not benefit from dynamic pricing and time differentiated rates if the Companies do not simultaneously file tariffs for such services (Staff Ex. 3 at 5; OCEA Br. at 82). Staff recommends that the Companies offer some form of a critical peak pricing rebate for residential customers, and some form of hedged price for commercial customers for a fixed amount of the customers' demand (Staff Ex. 3 at 5).

Further, Staff argues that the Companies' gridSMART proposal does not contain sufficient information regarding any risk-sharing between the ratepayers and shareholders, operational savings, or a cost/benefit analysis, and states that AEP-Ohio did not quantify any customer or societal benefits of the proposed gridSMART initiative (Staff Br. at 12-13). Staff notes that according to the Companies, DA will not be implemented until 2011, the third year of the ESP, and that the ESP proposes to install DA beyond the Phase I gridSMART area (Tr. Vol. III at 246). Staff opposes DA outside of the Phase I area because the Companies' cannot estimate the expected reliability improvements associated with the installation of DA. Staff also argues that DA costs should be recovered through a DA rider. The cost of gridSMART, per AEP-Ohio's proposal, is to be recovered by adjusting distribution rates. Staff is opposed to increasing distribution rates in this proceeding (Staff Ex. 5 at 6). Instead, Staff recommends that a rider be established and set at zero. The Staff argues that a rider has several benefits over the proposed increase to distribution rates, including separate accounting for gridSMART costs, an opportunity to approve and update the plan annually, assurance that expenditures are made before cost recovery occurs, and an opportunity to audit expenditures prior to recovery. Finally, Staff also advocates that the Companies share the financial risk of gridSMART between ratepayers and shareholders, as there is a benefit to the Companies. Additionally, Staff questions whether gridSMART will meet minimum reliability standards. Lastly, Staff asserts that AEP-Ohio should conduct a study that quantifies both customer and societal benefits of its gridSMART plan (Staff Br. at 14).

OCC, Sierra, and OPAE/APAC argue that the Companies' ESP fails to demonstrate that its gridSMART program is cost-effective as required by Sections 4928.02(D) and 4928.64(E), Revised Code, and state that AEP-Ohio's assumption that the societal and customer benefits are self-evident is misplaced (OCEA Br. at 77-80; OPAE/APAC Br. at 17-18). OCC, Sierra, and OPAE/APAC note that there are a number of factors about the program that the Companies have not determined or evaluated, which are essential to the Commission's consideration of the plan. OCC, Sierra, and OPAE/APAC state that the Companies have failed to include any full gridSMART implementation plan or costs, the anticipated life cycle of various components of gridSMART, a methodology for evaluating performance of gridSMART Phase I, an estimate of a customer's bill savings, or the positive impact to the environment or job creation (OCEA Br. at 79-80; OPAE\APAC Br. at 17-18). Further, OCC's witness states that the ESP fails to acknowledge that full system implementation is required before many of the benefits of gridSMART can actually be realized (OCC Ex. 12 at 6). OCC recommends that Phase I have its own set of performance measures, a more detailed project plan, including budget, resource allocation, and life cycle operating cost projections for the full 7-10 year implementation period of gridSMART and beyond, and performance measures for the Commission's approval (OCC Ex. 12 at 18).

AEP-Ohio regards the Staff's proposal to offer PCTs to any customer as overly generous, particularly given that Staff is recommending that the rider be set initially at zero (Cos. Br. at 68-69). AEP-Ohio also submits that it has committed to offering new service tariffs associated with Phase I of gridSMART once the technology is installed and the billing functionalities available (Cos. Ex. 1 at 6; Tr. Vol. III at 304-305; Cos. Br. at 68-69). Further, regarding Staff's policy of risk-sharing, the Companies contend that the assertion that the gridSMART investment benefits CSP just as much as it does customers is not true and, given that the operational savings do not equal or exceed the cost of the program, is without any basis presented in the record. Thus, AEP-Ohio argues that discounting the net cost to be recovered by CSP is unfair and inappropriate (Cos. Reply Br. at 63-64). The Companies are unclear how the Staff expects to determine whether gridSMART meets the minimum reliability standards and contend that this issue was first raised in the Staff's brief. Nonetheless, the Companies argue that imposing reliability standards as to gridSMART Phase 1 is inappropriate, primarily because strict accountability for achieving the expected reliability impacts does not take into account the many dynamic factors that impact service reliability index performance. Moreover, accurate measurement and verification of the discrete impact of gridSMART deployment on a particular reliability index would be difficult. The Companies also explain that the expected reliability impacts provided to the Staff were based on good faith estimates of the full implementation of gridSMART Phase 1 as proposed by the Companies. Thus, the Companies would prefer the establishment of deployment project milestones as opposed to specific reliability impact standards.

Although the Companies maintain that their percentage of distribution increase is reasonable and an appropriate part of the ESP package, in recognition of Staff's preference for a distribution rider and to address various parties' concerns regarding the accuracy of AEP-Ohio's cost estimates for gridSMART Phase I, the Companies would agree to a gridSMART Phase I rider set at the 2009 revenue requirement subject to annual true-up and reconciliation based on CSP's prudently incurred net costs (Cos. Reply Br. at 70; Cos. Ex. 1, Exhibit DMR-4).

The Commission believes it is important that steps be taken by the electric utilities to explore and implement technologies, such as AMI, that will potentially provide long-term benefits to customers and the electric utility. GridSMART Phase I will provide CSP with beneficial information as to implementation, equipment preferences, customer expectations, and customer education requirements. A properly designed AMI system and DA can decrease the scope and duration of electric outages. More reliable service is clearly beneficial to CSP's customers. The Commission strongly supports the implementation of AMI and DA, with HAN, as we believe these advanced technologies are the foundation for AEP-Ohio providing its customers the ability to better manage their energy usage and reduce their energy costs. Thus, we encourage CSP to be more expedient in its efforts to implement these components of gridSMART. While we agree that additional information is necessary to implement a successful Phase I program, we do not believe that all information is required before the Commission can conclude that the program is beneficial to ratepayers and should be implemented. Therefore, we will approve the development of a gridSMART rider, as we agree with the Staff that a rider has several benefits over the proposed annual increase to distribution rates, including separate accounting for gridSMART, an opportunity to approve and update the plan each year, assurance that expenditures are made before cost recovery occurs, and an opportunity to audit expenditures prior to recovery. The Commission notes that recent federal legislation makes matching funds available to smart grid projects. Accordingly, the Companies' gridSMART proposal contained in its proposed ESP to recover $109 million over the term of ESP, should be revised to $54.5 million, which is half of the Companies' requested amount. Additionally, we direct CSP to make the necessary filing for federal matching funds under the American Recovery and Reinvestment Act of 2009 for the balance of the projected costs of gridSMART Phase I. The gridSMART rider shall be initially established at $33.6 million for the 2009 projected expenses subject to annual true-up and reconciliation based on the company's prudently incurred costs.

With the creation of the ESRP rider and the gridSMART rider, the Commission finds that annual distribution rate increases in the amounts of 7 percent for CSP and 6.5 percent for OP to recover the costs for the ESRP and gridSMART programs are unnecessary and should be rejected. Accordingly, the Commission finds that AEP-Ohio's proposed ESP should be modified to include the ESRP rider and the gridSMART rider, as approved herein, and to eliminate the annual distribution rate increases.

B. Riders

1. Provider of Last Resort (POLR) Rider

The Companies proposed to include in their ESP a distribution non-bypassable POLR rider (Cos. App. at 6-8). The POLR charge was proposed to collect a POLR revenue requirement of $108.2 million for CSP and $60.9 million for OP (Cos. Ex. 2-A at 34; Cos. Ex. 1, Exhibit DMR-5). The Companies stated that they have a statutory obligation to be the POLR,[22] and thus, the proposed POLR charge is based on a quantitative analysis of the cost to the Companies to provide to customers the optionality associated with POLR service (Cos. Ex. 2-A at 25-26). AEP-Ohio argued that this charge covers the cost of allowing a customer to remain with the Companies, or to switch to a Competitive Retail Electric Service (CRES) provider and then return to the Companies' SSO after shopping (Id.). To further support the proposed increase, the Companies added that their current POLR charge is significantly below other Ohio electric utilities' POLR charges (Cos. Ex. 2 at 8). The Companies utilized the Black-Scholes Model to calculate their cost of fulfilling

22 See Section 4928.141(A) and 4928.14, Revised Code.

the POLR obligation, comparing the customers' rights to "a series of options on power" (Cos. Br. at 43; Cos. Ex. 2-A at 31). AEP-Ohio listed the five quantitative inputs used in the Black-Scholes Model: 1) the market price of the underlying asset; 2) the strike price; 3) the time frame that the option covers; 4) the risk free interest rate; and 5) the volatility of the underlying asset (Id.). The Companies assert that the resulting POLR charge is conservatively low (Cos. Br. at 44).

The numerous intervenors and Staff opposed the level of POLR charge proposed by the Companies, as well as the use of the Black-Scholes Model to calculate the POLR charge (OPAE/APAC Br. at 14-17; OCC Ex. 11 at 8-14). Specifically, OCC and others questioned the use of the LIBOR rate as the input for the risk-free interest rate (Tr. Vol. X at 165-182, 188-189; Tr. Vol. XI at 166-182). Staff questioned the risk that the POLR charge was intended to compensate the Companies for, explaining that there are only two risks involved: one risk is the risk of customers returning to the SSO and the other risk is that the customers leave and take service from a CRES provider (migration risk) (Staff Ex. 10 at 6). Staff witness Cahaan testified that the risk associated with customers returning to the SSO could be avoided by requiring the customer to return at a market price, instead of the SSO rate, which would either be paid directly by the returning customer or any incremental cost of the purchased power could be flown through the FAC (Id.). Staff witness Cahaan admitted that if customers are permitted to return at the SSO rate, without paying the market price or without compensating the Companies for any incremental costs of the additional purchased power that they would be required to purchase, then the Companies would be at risk (Tr. Vol. XIII at 36-37). Thus, Staff witness Cahaan concluded that, if the risk of returning is addressed, then the migration risk is the only risk that should be compensated through a POLR charge (Id. at 7).

The Companies responded that their risk is not alleviated by customers agreeing to return at market price, arguing that future circumstances or policy considerations may require them to relieve customers of their promises to pay market price when circumstances change (Cos. Ex. 2-A at 27-30). AEP-Ohio's witness expressed skepticism as to a future Commission upholding such promises (Id). AEP-Ohio also opposed recovering any costs for market purchases incurred for returning customers through the FAC as an improper subsidization of those customers who chose to shop, and then return to the electric utility, by non-shopping customers (Cos. Ex. 2-E at 14-16). Furthermore, the Companies claim that their risk of being the POLR exists, regardless of historic or current shopping levels (Id.). Nonetheless, AEP witness Baker testified that, even adopting Staff witness Cahaan's theory that the Companies are only at risk for migration (the right of customers to leave the SSO), migration risk equals approximately 90 percent of the Companies' POLR costs pursuant to the Black-Scholes model (Tr. Vol. XIV at 204-205; Cos. Ex. 2-E at 15-16).

As the POLR, the Commission believes that the Companies do have some risks associated with customers switching to CRES providers and returning to the electric utility's SSO rate at the conclusion of CRES contracts or during times of rising prices. However, we agree with the intervenors and Staff that the POLR charge as proposed by the Companies is too high, but we do not agree that there is no risk or a very minimal risk as suggested by some. As noted by several intervenors and Staff, the risk of returning customers may be mitigated, not eliminated, by requiring customers that switch to an alternative supplier (either through a governmental aggregation or individual CRES providers) to agree to return to market price, and pay market price, if they return to the electric utility after taking service from a CRES provider, for the remaining period of the ESP term or until the customer switches to another alternative supplier. In exchange for this commitment, those customers shall avoid paying the POLR charge. We believe that this outcome is consistent with the requirement in Section 4928.20(J), Revised Code, which allows governmental aggregations to elect not to pay standby service charges, in exchange for agreeing to pay market price for power if they return to the electric utility. Therefore, based on the record before us, we conclude that the Companies' proposed ESP should be modified such that the POLR rider will be based on the cost to the Companies to be the POLR and carry the risks associated therewith, including the migration risk. The Commission accepts the Companies' witness' quantification of that risk to equal 90 percent of the estimated POLR costs,[23] and thus, finds that the POLR rider shall be established to collect a POLR revenue requirement of $97.4 million for CSP and $54.8 million for OP. Additionally, the POLR rider shall be avoidable for those customers who shop and agree to return at a market price and pay the market price of power incurred by the Companies to serve the returning customers. Accordingly, the Commission finds that the POLR rider, which is avoidable, should be approved as modified herein.

2. Regulatory Asset Rider

The Companies proposed to begin the recovery of a variety of regulatory assets that were authorized in various Commission proceedings regarding the Companies' electric transition plan (ETP), rate stabilization plan (RSP), line extension program, green pricing power program, and the transfer of the MonPower's service territory to CSP. In their application, the Companies proposed to begin the amortization of these regulatory assets in 2011 and complete the amortization over an eight-year period. The projected balances at the end of 2010 to amortize are $120.5 million for CSP and $80.3 million for OP. AEP-Ohio asserts that these projected balances, or the value on June 30, 2008, were not challenged by any party. To recover these regulatory assets, the Companies created a RAC rider to be collected from customers in 2011 through 2018. The rider revenues will be reconciled on an annual basis for any over- or under-recoveries.

23 See Cos. Ex. 1, Exhibit DMR-5.

Staff proposed that the eight-year amortization period proposal be deferred until the Companies' next distribution rate case where all components of distribution rates are subject to review (Staff Ex. 1 at 4). AEP-Ohio responded that SB 221 authorizes single-issue ratemaking related to distribution service, which is what it is proposing. AEP-Ohio also notes that the only opposition to the Companies' proposal is with regard to the collection of the historic regulatory assets, which was by Staff (Cos. Reply Br. at 94). The Companies submit that Staff's preference to deal with this issue in a distribution rate case is irrelevant and inconsistent with the statute.

The Commission finds that the Companies have not demonstrated that the creation of the RAC rider in its proposed ESP, as a single-issue ratemaking item for distribution infrastructure and modernization incentives, fulfills the requirements of SB 221 or advances the state policy. Therefore, the Commission finds that the RAC rider should not be approved in this proceeding. We note, however, that we agree with Staff that the consideration of the requested amortization of regulatory assets is more appropriate within the context of a distribution rate case where all distribution related costs and issues can be examined collectively. Accordingly, the Commission finds that AEP-Ohio's proposed ESP should be modified to eliminate the RAC rider.

3. Energy Efficiency, Peak Demand Reduction, Demand Response, and Interruptible Capabilities

(a) Energy Efficiency and Peak Demand Reduction

Section 4928.66, Revised Code, requires the electric utilities to implement energy efficiency programs that will achieve energy savings and peak demand programs designed to reduce the electric utility's peak demand. Specifically, an electric utility must achieve energy savings in 2009, 2010, and 2011 of .3 percent, .5 percent, and .7 percent, respectively, of the normalized annual kWh sales of the electric utility during the preceding three calendar years. This savings continues to rise until the cumulative savings reach 22 percent by 2025. Peak demand must be reduced by one percent in 2009 and by .75 percent annually until 2018.

CSP and OP include, as part of their ESP, an unavoidable Energy Efficiency and Peak Demand Reduction Cost Recovery Rider (EE/PDR rider). The estimated annual DSM program cost (including both EE and PDR) is to be trued-up annually to actual cost and compared to the amortization of the actual deferral on an annual basis via the EE/PDR rider (Cos. Ex. 6 at 47-48).

(b) Baselines and Benchmarks

In the ESP, the Companies have established the baselines for meeting the benchmarks for statutory compliance by weather normalizing retail sales, excluding economic development load, accounting for the load of former MonPower service territory and the Ormet/Hannibal Real Estate load, accounting for future load growth due to the Companies' economic development efforts, and accounting for increased load associated with the funds for economic development purposes pursuant to the order in Case No. 04-169-EL-ORD (RSP Order)[24] (Cos. Ex. 8 at 4; Cos. Ex. 2A at 46-51). The Companies contend that its process is consistent with Sections 4928.64(B) and 4928.66(A)(2)(a), Revised Code. The Companies request that the methodology be adopted in this proceeding so as to provide the Companies clear guidance with statutory compliance mandates. Further, the Companies reserve their right to request additional adjustments due to regulatory, economic, or technological reasons beyond the reasonable control of the Companies.

As to the calculation of the Companies' baseline, Staff asserts that the former MonPower load was acquired prior to the three-year period (2006 to 2008) and is not truly economic development. Therefore, Staff contends that the MonPower load is not a reasonable adjustment to the baseline. Staff suggests that the Companies' savings and peak demand reductions for 2009 be as set forth by Staff witness Scheck (Staff Ex. 3 at 6-8, Ex. GCS-1 and Ex. GCS-2). Staff recommends that CSP and OP make a case-by-case filing with the Commission to receive credit for the energy savings and peak demand reduction efforts of the electric utility's mercantile customers. Staff argues that because programs like PJM's demand response programs are not committed for integration into the electric utilities' energy efficiency and peak reduction programs, such credits should not count towards AEP-Ohio's annual benchmarks and retail customers who have such agreements should not receive an exemption from AEP-Ohio's energy efficiency cost recovery mechanism (Staff Br. at 17-19; Staff Ex. 3 at 6-11).

Kroger recommends an opt-out provision of the rider for non-residential customers that are above a threshold aggregate load (10 MW at a single site or aggregated at multiple sites) within the AEP-Ohio service territories. Kroger proposes that, at the time of the opt-out request, the customer would be required to self-certify or attest to AEP-Ohio that for each facility, or aggregated facilities, the customer has conducted an energy audit or analysis within the past three years and has implemented or plans to implement the cost-effective measures identified in the audit or analysis. Kroger argues that the unavoidable rider penalizes customers who have implemented cost efficient DSM measures. Kroger contends that this is consistent with the intent of Section 4928.66(A)(2)(c), Revised Code (Kroger Ex. 1 at 13-14).

IEU notes that the Commission has previously rejected a proposal similar to Kroger's opt-out proposal with a demand threshold for mercantile customers in Duke's

24 *In re Columbus Southern Power Company and Ohio Power Company*, Case No. 04-169-EL-ORD, Opinion and Order (January 26, 2005) (RSP Order).

ESP case.[25] IEU urges the Commission, consistent with Section 4928.66, Revised Code, and its determination in the Duke ESP case, to reject Kroger's request (IEU Reply Br. at 22).

The Commission concludes that the acquisition of the former MonPower load should not be excluded from baseline. The MonPower load was not a load that CSP served and would have lost, but for some action by CSP. Therefore, we find that the Companies' exclusion of the MonPower load in the energy efficiency baseline is inappropriate. The Commission does not believe that all economic development should automatically result in an exclusion from baseline. On the other hand, we agree with the Companies' adjustment to the baseline for the Ormet load. We note that the Companies and Staff agree that the impact of customer-sited specific DSM resources will be included in the Companies' compliance benchmarks and adjusted for any existing resources that had historic implication during the years 2006-2008. The Commission also recognizes that Staff and the Companies agree that the appropriate approach would be for the Companies to make case-by-case filings with the Commission to receive credit for contributions by mercantile customers.

In regards to Kroger's recommendation, for an opt-out process for certain commercial or industrial customers, the Commission finds Kroger's proposal, as advocated by Kroger witness Higgins, too speculative. It is best that the Commission determine the inclusion or exemption of a mercantile customer's DSM on a case-by-case basis. We note that Section 4928.66(A)(2)(c), Revised Code, provides, in pertinent part, the following:

> Any mechanism designed to recover the cost of energy efficiency and peak demand reduction programs under divisions (A)(1)(a) and (b) of this section may exempt mercantile customers that commit their demand-response or other customer-sited capabilities, whether existing or new, for integration into the electric distribution utility's demand-response, energy efficiency, or peak demand reduction programs, if the commission determines that that exemption reasonably encourages such customer to commit those capabilities to those programs.

This provision of the statute permits the Commission to approve a rider that exempts mercantile customers who commit their capabilities to the electric utility. However, the statute does not dictate a minimum consumption level. For these reasons, the Commission rejects Kroger's proposal.

25 *In re Duke Energy Ohio, Inc.*, Case No. 08-920-EL-SSO, et al., Opinion and Order (December 17, 2008) (Duke ESP Order).

(c) Energy Efficiency and Peak Demand Reduction Programs

The Companies propose ten energy efficiency and peak demand reduction programs that will be refined and supplemented at the completion of the Market Potential Study through the creation of a working collaborative group of stakeholders.

As part of the Companies' energy efficiency and peak demand reduction plan, the Companies propose to spend $178 million on the following programs: (1) Residential Standard Offer Program, Small Commercial and Industrial Standard Offer Program, Commercial and Industrial Standard Offer Program; (2) Targeted Energy Efficient Weatherization Program; (3) Low Income Weatherization Program; (4) Residential and Small Commercial Compact Fluorescent Lighting Program; (5) Commercial and Industrial Lighting Program; (6) State and Municipal Light Emitting Diode Program; (7) Energy Star® New Homes Program; (8) Energy Star® Home Appliance Program; (9) Renewable Energy Technology Program; (10) Industrial Process Partners Program (Cos. Ex. 4 at 20-22). OEG supports the Companies EE/PDR rider as a reasonable proposal (OEG Ex. 2 at 13). OPAE generally supports the Companies proposed programs as reasonable for low-income and moderate income customers. However, OPAE requests that the Companies be required to empower the collaborative to design appropriate programs, provide funding for existing programs that can rapidly provide energy efficiency and demand response reductions, and to retain a third-party administrator to manage program implementation (OPAE Ex. 1 at 16-17; OPAE/APAC Br. at 21-22).

Staff also generally approves of the Companies' demand-side management and energy efficiency programs. However, Staff notes that certain of AEP-Ohio's programs are expensive and should be required to comply with the Total Resources Cost Test (Staff Br. at 17-19; Staff Ex. 3 at 6-11).

OCC makes five specific recommendations (OCC Ex. 5 at 9). First, OCC contends that the Companies DSM programs for low-income residential customers are adequate but should be available to all residential customers in Ohio. Second, OCC recommends that AEP-Ohio work with Columbia Gas of Ohio, Inc., to develop a one-stop home performance program in year two of the ESP. Third, OCC recommends that programs for consumers above 175 percent of the federal poverty level should be competitively bid and customers charged for services according to a sliding fee scale based on income. Fourth, like Staff, OCC contends that all programs should be evaluated for cost-effectiveness pursuant to the Total Resource Cost Test. Finally, OCC expresses concern regarding the administrative costs of the programs, in comparison to energy efficiency programs offered by other Ohio utilities and recommends that the administrative cost of the DSM program (administrative, educational, and marketing expenses) be determined by the collaborative, and limited to 25 percent of the program costs to ensure that the majority of the program dollars reach the customers (Id.).

The Commission directs, as the Companies submit in their ESP, that the collaborative process be used to contain administrative cost of the EE/PDR programs and to ensure, with the possible exception of low-income weatherization programs, that all programs comply with the Total Resource Cost Test. We do not agree with OPAE/APAC that a third-party administrator is necessary to act as a liaison between the Companies and the collaborative. Thus, the Companies should proceed with the proposed EE/PDR programs proposed in its ESP as justified by the market project study and as refined by the collaborative.

(d) Interruptible Capacity

The Companies count their interruptible service towards their peak demand reduction requirements in accordance with Section 4928.66(A)(2)(b), Revised Code. More specifically, the Companies propose to increase the limit of OP's Interruptible Power-Discretionary Schedule (Schedule IRP-D) to 450 Megawatts (MW) from the current limit of 256 MW and to modify CSP's Emergency Curtailable Service (ECS) and Price Curtailable Service (PCS) to make the services more attractive to customers. The Companies request that the Commission recognize the Companies' ability to curtail customer usage as part of the peak demand reductions (Cos. Ex. 1 at 5-6).

Staff advocates that any credits awarded for the annual peak demand reduction targets for the Companies' interruptible programs should only apply when actual reductions occur (Staff Ex. 3 at 11). OCEA argues that interruptible load should not be counted toward AEP-Ohio's peak demand reduction as it is contrary to the intent of SB 221 to improve grid reliability and would be based on load under the control of the customer rather than AEP-Ohio. Further, OCEA argues that the Companies would reap an inequitable benefit from interruptible load (possibly in the form of off-system sales) that is not reduced at peak which would allow the Companies to sell the load or avoid buying additional power. OCEA contends that any such benefit is not passed on to customers (OCEA Br. at 102-103; Tr. Vol. IX at 68-69).

The Companies argue that capacity associated with interruptible customers should be counted toward compliance with the requirements of Section 4928.66, Revised Code, as the ability to interrupt is a significant demand reduction resource to AEP-Ohio. Further, the Companies state that interruptions have a real impact on customers and the Companies do not want to interrupt service when there is no system or market requirement to do so (Cos. Ex. 1 at 6). The Companies note that Section 4928.66(A)(1)(b), Revised Code, requires the electric utility to implement programs "designed to achieve" a specified peak demand reduction level as opposed to "achieve" a specified level of energy savings as required by Section 4928.66(A)(1)(a), Revised Code. Staff witness Scheck admits that the plain meaning of "designed to achieve" and "achieve" are different (Tr. Vol. VIII at 208). The Companies argue that the different language in the statutory requirements is intended to recognize the differences between energy efficiency programs and peak demand reduction programs. As such, the Companies contend that Staff's position is not supported by the language of the statute and it does not overcome the policy rationale presented by the Companies. The Companies also note that, in the context of integrated resource planning, interruptible capabilities are counted as capacity and evaluated in the need to plan for new power facilities. Finally, the Companies note that the Commission defines native load as internal load minus interruptible load.[26] For these reasons, the Companies contend that their interruptible capacity should be counted toward their compliance with the peak demand reduction benchmarks (Cos. Br. 114-115; Cos. Reply Br. at 90-93).

Further, the Companies claim that interruptible customers receive a benefit in the form of a reduced rate for taking interruptible service irrespective of whether their service is actually curtailed. AEP-Ohio notes that it includes such interruptible service as a part of its supply portfolio, unlike the PJM demand response programs, which is based on PJM's zonal load. Therefore, AEP-Ohio asserts there is no disparate treatment between counting interruptible capabilities as part of peak demand reduction compliance requirements and prohibiting retail participation in wholesale PJM demand reduction programs (Cos. Reply Br. at 90-91). Further, as to OCEA's claims regarding interruptible customer load, the Companies argue that the assertions are without merit or basis in the statute. The Companies argue that counting interruptible load fits squarely within the stated intent of the statute that programs be "designed to achieve" peak demand reduction and facilitates the ability to avoid the construction of new power plants. As to the customer's control of interruptible load argument, the Companies note that the customer has a choice to "buy through" to obtain replacement power at market prices to avoid curtailment and in such situations the Companies' supply portfolio is not affected. Regarding OCEA's assertion that the Companies might benefit from the associated interruption, AEP-Ohio acknowledges that off-system sales are indirectly possible, as are other circumstances, based on the market price. Nonetheless, AEP-Ohio argues that such does not alter the fact that AEP-Ohio's retail supply obligation is reduced and the supply portfolio is not accessed to serve the retail customer. Accordingly, AEP-Ohio asserts that interruptible tariff capabilities should count toward the Companies' peak demand reduction compliance requirements.

The Commission agrees with the Staff and OCEA that interruptible load should not be counted in the Companies' determination of its EE/PDR compliance requirements unless and until the load is actually interrupted. As the Companies recognize, it is imperative, with regard to the PJM demand response programs, that the Companies have

26 See proposed Rule 4901:5-5-01(Q), O.A.C., *In the Matter of the Adoption of Rules for Alternative and Renewable Energy Technologies and Resources, and Emission Control Reporting Requirements, and Amendment of Chapters 4901:5-1, 4901:5-3, 4901:5-5, and 4901:5-7 of the Ohio Administrative Code, Pursuant to Chapter 4928, Revised Code, to Implement Senate Bill No. 221*, Case No. 08-888-EL-ORD (Green Rules).

some control or commitment from the customer to be included as a part of AEP-Ohio's Section 4928.66, Revised Code, compliance requirements.

Further, the Commission emphasizes that we expect that applications filed pursuant to Section 4928.66(A)(2)(b), Revised Code, to be initiated by the electric utility only when the circumstances are justified. At the time of such filing by an electric utility, the Commission will determine whether the electric utility's continued compliance is possible under the circumstances.

4. Economic Development Cost Recovery Rider and the Partnership with Ohio Fund

The Companies' ESP application includes an unavoidable Economic Development Rider as a mechanism to recover costs, incentives and foregone revenue associated with new or expanding Commission-approved special arrangements for economic development and job retention. The Companies propose quarterly filings to establish rates based on a percentage of base distribution revenue subject to a true-up of any under- or over-collection in subsequent quarterly filings. In addition, the Companies propose the development of a "Partnership with Ohio" fund from shareholders. The fund would consist of a $75 million commitment, $25 million per year of the ESP, from shareholders. The Companies' goal is for approximately half of the fund to be used to provide assistance to low-income customers, including energy efficiency programs for such customers, and the balance to be used to attract and retain business development within the AEP-Ohio service area (Cos. Ex. 1 at 12; Cos. Ex. 3 at 15-16; Cos. Ex. 6 at 49; Tr. Vol. III at 115-119).

OCC proposes that the Commission continue its policy of dividing the recovery of forgone revenue subsidies equally from AEP-Ohio's shareholders and customers or require shareholders to pay a larger percentage. Further, OCC expresses some concern that the rider may be used in an anti-competitive manner as it is not likely that incentives and/or discounts will be offered to shopping customers. To address OCC's anticompetitive concerns, OCC proposes that the Commission make the economic development rider avoidable or establish the charge as a percentage of the customer's entire bill rather than a percentage of distribution charges. OCC also recommends that all parties participate in the initial and annual review of the economic development contracts and that, at the annual review, if the customer has not fulfilled its obligation, the arrangement be cancelled, the subsidy paid back, and the Companies directed to credit the rider for the discounts (OCC Ex. 14 at 4-8; OCEA Br. at 104-106).

The Companies contend that Section 4905.31, Revised Code, as amended by SB 221, explicitly provides for the recovery of foregone revenues for entering into reasonable arrangements for economic development and, thus, OCC's recommendation to continue the Commission's previous policy is misplaced. Further, the Companies note that the

Commission's approval of any special arrangement will include a public interest determination. Thus, the Companies argue that OCC's recommendation for all parties to initially and annually review economic development arrangements is unnecessary, bureaucratic and burdensome, and should be rejected. The Companies contend that economic development and full recovery of the foregone revenue for economic development is consistent with SB 221 and a significant feature of the Companies' ESP, which should not be modified by the Commission (Cos. Br. at 132).

The Commission finds that OCC's concerns are unfounded and unnecessary at this stage. The Commission is vested with the authority to review and determine whether or not economic development arrangements are in the public interest. OCC's request is denied.

OPAE and APAC argue that the Companies have not provided any assurances that the $75 million will be spent from the Partnership with Ohio fund if the Commission modifies the ESP and fails to state how much of the fund will be spent on low-income, at-risk populations (OPAE/APAC Br. at 19-20). The Companies submit that, if the ESP is modified, they can then evaluate the modified ESP in its entirety to determine whether this fund proposal contained in the ESP requires elimination or modification (Tr. Vol. III at 137-138; Tr. Vol. X at 232-233).

While the Partnership with Ohio fund is a key component of the economic development proposal, in light of the modifications made to the ESP pursuant to this opinion and order, we find that the Companies' shareholders should fund the Partnership with Ohio fund, at a minimum of $15 million, over the three-year ESP period, with all of the funds going to low-income, at–risk customer programs. Accordingly, we direct AEP-Ohio to consult with Staff to administer the program established herein.

C. Line Extensions

In its ESP, AEP-Ohio proposes to modify certain existing line extension policies and charges included in its schedules (Cos. Ex. 10 at 5-14). Specifically, the Companies requested a modification to their definition of line extension and system improvements, a continuation of the up-front payment concept established in Case No. 01-2708-EL-COI,[27] an increase in the up-front residential line extension charges, implementation of a uniform, up-front line extension charge for all nonresidential projects, the elimination of the end use customer's monthly surcharge, and the elimination of the alternative construction option (Id. at 3-4, 6-7, 10-12).

27 *In the Matter of the Commission's Investigation into the Policies and Procedures of Ohio Power Company, Columbus Southern Power Company, The Cleveland Electric Illuminating Company, Ohio Edison Company, The Toledo Edison Company and Monongahela Power Company Regarding the Installation of New Line Extensions,* Case No. 01-2708-EL-COI, et al., Opinion and Order (November 7, 2002).

Staff testified that distribution-related issues and costs, such as those related to line extensions, be examined in the context of a distribution rate case (Staff Ex. 13 at 4). IEU concurred with Staff's position (IEU Br. at 25). OCC also agreed and added that AEP-Ohio should be required to demonstrate in that rate proceeding that its costs related to line extensions have substantially increased, thereby justifying AEP-Ohio's proposed increase to the up-front residential line extension charges (OCEA Br. at 87).

Per SB 221, the Commission is required to adopt uniform, statewide line extension rules for nonresidential customers within six months of the effective date of the law. The Commission adopted such rules for nonresidential and residential customers on November 5, 2008.[28] Applications for rehearing were filed, which the Commission is still considering. Accordingly, the new line extension rules are not yet effective.

The Commission finds that AEP-Ohio has not demonstrated that its proposal to continue, in its ESP, its existing line extension policies regarding up-front payments, with modifications, is consistent with SB 221 or advances the policy of the state. Therefore, in light of the SB 221 mandate that the Commission adopt statewide line extension rules that will apply to AEP-Ohio, we do not believe that it makes sense to adopt a unique policy for AEP-Ohio at this time. As such, the Companies' ESP should be modified to eliminate the provision regarding line extensions, which would have the effect of also eliminating the alternative construction option as requested by the Companies. AEP-Ohio is, however, directed to account for all line extension expenditures, excluding premium services, in plant in service until the new line extension rules become effective, where the recovery of such will be reviewed in the context of a distribution rate case. The Companies may continue to charge customers for premium services pursuant to their existing practices.

V. TRANSMISSION

In its ESP, the Companies requested to retain the current TCRR, except the marginal loss fuel credit will now be reflected in the FAC instead of the TCRR. We concur with the Companies' request. We find the Companies' request to be consistent with our determination in the Companies' recent TCRR Case,[29] and thus, approve the TCRR rider as proposed by the Companies. Additionally, as contemplated by our prior order in the TCRR Case, any overrecovery of transmission loss-related costs, which has

28 See *In the Matter of the Commission's Review of Chapters 4901:1-9, 4901:1-10, 4901:1-21, 4901:1-22, 4901:1-23, 4901:1-24, and 4901:1-25 of the Ohio Administrative Code,* Case No. 06-653-EL-ORD, Finding and Order (November 5, 2008), Entry on Rehearing (December 17, 2008) (06-653 Case).

29 *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company to Adjust Each Company's Transmission Cost Recovery Rider,* Case No. 08-1202-EL-UNC, Finding and Order (December 17, 2008) (TCRR Case).

occurred due to the timing of our approval of the Companies' ESP and proposed FAC, shall be reconciled in the over/underrecovery process in the Companies' next TCRR rider update filing.

VI. OTHER ISSUES

A. Corporate Separation

1. Functional Separation

In its ESP application, AEP-Ohio requested to remain functionally separated for the term of the ESP, as was previously authorized by the Commission in the Companies' rate stabilization plan proceeding,[30] pursuant to Section 4928.17(C), Revised Code (Cos. App. at 14; Cos. Br. at 86). The Companies also requested to modify their corporate separation plan to allow each company to retain its distribution and, for now, transmission assets and that, upon the expiration of functional separation, the Companies would sell or transfer their generation assets to an affiliate (Id.).

Staff testified that the Companies' generating assets have not been structurally separated from the operating companies (Staff Ex. 7 at 2-3). Staff also recommended that, in accordance with the recently adopted corporate separation rules issued by the Commission in the SSO Rules Case,[31] the Companies should file for approval of their corporate separations plan within 60 days after the rules become effective. Furthermore, Staff proposes that the Companies' corporate separation plan should be audited by an independent auditor within the first year of approval of the ESP, the audit should be funded by the Companies, but managed by Staff, and the audit should cover compliance with the Commission's rules on corporate separation (Staff Ex. 7 at 3-4). No party opposed AEP-Ohio's request to remain functionally separate.

Accordingly, the Commission finds that, while the ESP may move forward for approval, as noted by Staff, in accordance with our recently adopted rules in the SSO Rules Case, the Companies must file for approval of their corporate separation plan within 60 days after the rules become effective.

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30 *In re Columbus Southern Power Company and Ohio Power Company*, Case No. 04-169-EL-UNC, Opinion and Order at 35 (January 26, 2005).

31 *In the Matter of the Adoption of Rules for Standard Service Offer, Corporate Separation, Reasonable Arrangements, and Transmission Riders for Electric Utilities Pursuant to Sections 4928.14, 4928.17, and 4905.31, Revised Code, as amended by Amended Substitute Senate Bill No. 221*, Case No. 08-777-EL-ORD, Finding and Order (September 17, 2008), and Entry on Rehearing (February 11, 2009) (SSO Rules Case).

2. Transfer of Generating Assets

The Companies request authorization for CSP to sell or transfer two recently acquired generating facilities (Waterford Energy Center and the Darby Electric Generating Station) that have not been included in rate base for ratemaking purposes and the costs of operating and maintaining the plants are not built into the current rates) (Cos. Ex. 2-A at 42; Cos. Ex. 2-E at 20). CSP purchased the Waterford Energy Center, a natural gas combined cycle power plant, on September 28, 2005, which has a generating capacity of 821 MW (Cos. App. at 14). On April 25, 2007, CSP purchased the Darby Electric Generating Station, a natural gas simple cycle generating facility, with a generating capacity of 480 MW and a summer capacity of approximately 450 MW (Id.). Although AEP-Ohio is requesting authority to transfer these generating assets pursuant to Section 4928.17(E), Revised Code, CSP has no immediate plans to sell or transfer the generating facilities. If AEP-Ohio obtains authorization to sell these generating assets through this proceeding, AEP-Ohio will notify the Commission prior to any such transaction (Id. at 15).

Through its application, the Companies also notify the Commission of their contractual entitlements/arrangements to the output from the Ohio Valley Electric Corporation generating facilities and the Lawrenceburg Generation Station that the Companies intend to sell or transfer in the future, but argue that any sale or transfer of those entitlements do not require Commission authorization because the entitlements do not represent generating assets wholly or partly owned by the Companies pursuant to Section 4928.17(E), Revised Code (Id.).

The Companies argue that, if the Commission does not grant authorization to transfer these plants or entitlements, then any expense related to the plants or entitlements not recovered in the FAC should be recovered in the non-FAC portion of the generation rate (Cos. Br. at 89; Cos. Ex. 2-E at 20-21). AEP-Ohio states that this rate recovery would include approximately $50 million of carrying costs and expenses related to the Waterford Energy Center and the Darby Electric Generating Station annually, and $70 million annually for the contract entitlements (Id.).

Staff witness Buckley testified that, while Staff does not necessarily disagree with the proposal to transfer the Waterford Energy Center and the Darby Electric Generating Station facilities, Staff believes that the transfers could have a potential financial and policy impact at the time of the transfer (Staff Ex. 7 at 3). Thus, Staff recommended that the Companies file a separation application, in accordance with the Commission's SSO rules, at the time that the transfer will occur (Id.). Several other parties agree that, in the absence of a current plan to sell or transfer, the Commission should not approve a future sale or transfer. Rather, the parties argue that the Companies should seek approval, pursuant to Section 4928.17(E), Revised Code, at the time of the actual sale or transfer (OCEA Br. at 100; IEU Br. at 26-27; OEG Br. at 16).

The Commission agrees with Staff and the intervenors that the request to transfer the Waterford Energy Center and the Darby Electric Generating Station facilities, as well as any contractual entitlements/arrangements to the output of certain facilities, is premature. AEP-Ohio should file a separate application, in accordance with the Commission's rules, at the time that it wishes to sell or transfer these generation facilities. The Commission, however, recognizes that these generating assets have not and are not included in rate base and, thus, the Companies cannot collect any expenses related thereto, even if the facilities or contractual outputs have been used for the benefit of Ohio customers. If the Commission is going to require that the electric utilities retain these generating assets, then the Commission should also allow the Companies to recover Ohio customers' jurisdictional share of any costs associated with maintaining and operating such facilities. Accordingly, we find that while the Companies still own the generating facilities, they should be allowed to obtain recovery for the Ohio customers' jurisdictional share of any costs associated therewith. Thus, we believe that any expense related to these generating facilities and contract entitlements that are not recovered in the FAC shall be recoverable in the non-FAC portion of the generation rate as proposed by the Companies. The Commission, therefore, directs AEP-Ohio to modify its ESP consistent with our determination herein.

B. Possible Early Plant Closures

The Companies include as a part of their application in these cases a request for authority to establish a regulatory asset to defer any unanticipated net cost associated with the early closure of a generating unit or units. The Companies assert that, during the ESP period, generating units may experience failures or safety issues that would prevent the Companies from continuing to cost-effectively operate the generation unit prior to the end of the depreciation accrual (unanticipated shut down) (Cos. App. at 18-19; Cos. Ex. 2-A at 51-52). The Companies request authority to include net early closure cost in Account 182.3, Other Regulatory Assets. In the event of an unanticipated shut down, the Companies state they will timely file a request with the Commission for recovery of such prudent early closure costs via a non-bypassable rider over a relatively short period of time. The Companies are requesting that the rider include carrying cost at the WACC rate (Cos. App. at 18-19; Cos. Ex 6 at 25-26). The Companies also request authority to come before the Commission to determine the appropriate treatment for accelerated depreciation and other net early closure costs in the event that the Companies find it necessary to close a generation plant earlier that otherwise expected (earlier than anticipated shut down) (Cos. Ex. 6 at 28).

OCEA posits that the Companies' request for accounting treatment for early plant closure is wrong and should be rejected. OCEA reasons that the plant was included in rate base under traditional ratemaking regulation to give the Companies the opportunity to earn a return on the investment and the Companies accepted the risk that the plant might not be fully depreciated when it was removed from service. OCEA asserts it is not appropriate to guarantee the Companies recovery of their investment. If the Commission determines to allow the Companies to establish the requested accounting treatment, OCEA asks that the Commission adopt the Staff's "offset" recommendation (OCEA Br. at 102).

Staff argues that the value of the generation fleet was determined in the Companies' ETP cases,[32] wherein, pursuant to the stipulation, AEP-Ohio agreed not to impose any lost generation cost on switching customers during the market development period. Staff notes that, although the economic value of the generation plants was never specifically addressed by the Commission, it is reasonable to assume that the net value of the Companies' fleet was not stranded. Accordingly, Staff opposes the Companies' requests to impose on customers the cost or risk of uneconomic plants without accounting for the offset of the positive economic value of the rest of the Companies' generation plants (Staff Ex. 1 at 8).

Based on the record in this proceeding, the Commission is not convinced that it is appropriate to approve the Companies' request for recovery of net cost associated with an unanticipated shut down. Despite the arguments of the Companies to the contrary, we are persuaded by the arguments of the Staff that there may be offsetting positive value associated with the Companies generation fleet. Accordingly, while we will grant the Companies the authority to establish the accounting mechanism to separate net early closure cost, the Companies must file an application before the Commission for recovery of such costs. Accordingly, this aspect of the Companies' ESP application is denied. As to the Companies' request for authority to file with the Commission to determine the appropriate treatment associated with an earlier-than-anticipated shut down, the Commission finds this aspect of the application to be reasonable and, accordingly, the request should be granted.

C. PJM Demand Response Programs

Through the ESP, the Companies propose to revise certain tariff provisions to prohibit customers receiving SSO from participating in the demand response programs offered by PJM, either directly or indirectly through a third-party. Under the PJM programs retail customers can receive payment for being available to curtail even if the

32 *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 at 15-18 (September 28, 2000).

customer's service is not actually curtailed. AEP-Ohio argues that allowing its retail customers receiving SSO to also participate in PJM demand response programs is a no-win situation for AEP-Ohio and its other customers and inconsistent with the requirements of SB 221. The Companies contend that PJM demand response programs are intended to ensure the proper price signal to wholesale customers, not to address retail rate issues (Cos. Ex. 1 at 5-7). AEP-Ohio argues that retail customers should participate through AEP-Ohio-sponsored and Commission-approved programs. The Companies contend that FERC has granted state commissions, or- more precisely, the "relevant electric retail regulatory authority," the authority to preclude retail customer participation in wholesale demand response programs. *Wholesale Competition in Regions with Organized Electric Markets* (Docket Nos. RM07-19-000 and AD07-7-000), 125 FERC ¶ 61,071 at 18 CFR Part 35 (October 17, 2008) (Final Rule) (Cos. Br. at 119)

AEP-Ohio notes that it has consistently challenged retail customers' ability to participate in such programs and argued that the terms and conditions of its tariff prohibited such and, therefore, demand response retail participants should not be surprised by the Companies' position in this proceeding (Tr. Vol. IX at 212). AEP-Ohio argues that Ohio businesses participating in PJM's demand response programs have not invested their own capital or assets, taken any financial risk, or added any value to the services for which they are being compensated through PJM. The Companies assert, as stated by Staff witness Scheck, that the PJM demand response programs cost AEP-Ohio's other customers as the load of such PJM program participants continues to count toward the Companies' Fixed Resource Requirements (FRR) option and such cost is reflected in AEP-Ohio's retail rates (Tr. Vol. VIII at 165-166). Further, the PJM program participant/customer's ability to interrupt is of no use to AEP-Ohio, as the Companies claim that PJM's curtailment request is based on PJM's zonal load and not AEP-Ohio's peak load (Cos. Br. at 122-123).

The Companies reason that SB 221 includes a process whereby mercantile customer-sited resources can be committed to the utility to comply with the peak demand reduction benchmarks as set forth in Section 4928.66(A)(2)(d), Revised Code. Further, AEP-Ohio argues that it is unclear how the interruptible capacity of a customer participating in PJM's demand response program can count toward the Companies' benchmarks without being under the control of the Companies and "designed to achieve" peak demand reductions as required by the statue. As such, the Companies argue that, if participation in the PJM demand response program is allowed, PJM will be in direct competition with the electric distribution companies' efforts to comply with energy efficiency and peak demand reduction benchmarks and thus, render the mercantile customer commitment provisions largely ineffective. For these reasons, AEP-Ohio states that it should incorporate participation in PJM's demand response programs through AEP-Ohio and AEP-Ohio would then be in a position to pass some of the economic benefits associated with participation in PJM programs on to retail customers through complementary retail tariff programs and to pursue mercantile customer-sited arrangements to achieve benchmark compliance, thus allowing the Companies to avoid duplicate supply costs (Cos. Br. at 124-126).

This aspect of the Companies' ESP proposal is opposed by Integrys, OMA, Commercial Group, OEG, and IEU. Most of the intervenors contend that AEP-Ohio, in essence, considers retail customer participation in PJM programs the reselling of power provided to them by AEP-Ohio. Integrys makes the most comprehensive arguments opposing AEP-Ohio's request for approval to prohibit customer participation in the PJM demand response programs. Integrys argues that 18 C.F.R. 35.28(g) only permits this Commission to prohibit a retail customer's participation in demand response programs at the wholesale level through law or regulation. Section 18 C.F.R. 35.28(g) states:

> Each Commission-approved independent system operator and regional transmission organization must permit a qualified aggregator of retail customers to bid demand response on behalf of retail customers directly into the Commission-approved independent system operator's or regional transmission organization's organized markets, *unless the laws and regulations of the relevant electric retail regulatory authority expressly do not permit a retail customer to participate*. [Emphasis added.]

Thus, Integrys reasons that a ban on participation in wholesale demand response programs through AEP-Ohio's tariff is not equivalent to an act of the General Assembly or rule of the Commission. Accordingly, Integrys reasons that any attempt by the Commission to prohibit participation in this proceeding is beyond the authority granted by FERC and will be preempted. Further, Integrys and Constellation argue that AEP-Ohio has failed to state under what authority the Commission could bar customer participation in PJM's demand response and reliability programs. Constellation and Integrys posit that it is not in the public interest for the Commission to approve the prohibition from participation in such programs (Constellation Br. at 20-23; Constellation Ex. 2 at 18; Integrys Ex. 2 at 15; Integrys Br. at 2).

Even if the Commission concludes that it has the authority to grant AEP-Ohio's request to revise the tariff as requested, Integrys asserts that the Companies have not met their burden to justify prohibiting participation in PJM demand response programs. Integrys asserts that the request is not properly a part of the ESP applications and should have been part of an application not for an increase in rates pursuant to Section 4909.18, Revised Code. Nonetheless, Integrys concludes that under Section 4928.143 or Section 4909.18, Revised Code, the burden of proof is on the electric utility company to show that its proposal is just and reasonable.

The Companies, according to Integrys and the Commercial Group, have failed to present any demonstration that the Companies' programs are more beneficial to customers than the PJM programs. On the other hand, Integrys asserts that the PJM programs are more favorable to customers than the programs offered by AEP-Ohio as to notification, the number of curtailments per year, the hours of curtailments, payments and payment options, and penalties for non-compliance (Integrys Ex. 2 at 10-12; Commercial Group Br. at 9). In addition, certain interveners note, and the Companies agree, that PJM has not curtailed any customers since AEP-Ohio joined PJM (Tr. Vol. IX at 48). Furthermore, the intervenors contend that participation in the demand response programs provides improved grid reliability and improved efficiency of the market due to competition (Integrys Ex. 2 at 8).

Integrys also notes that the Ohio customers receive significant financial benefits from load serving entities beyond Ohio (Tr. Vol. IX at 52-52, 118). Integrys argues that AEP-Ohio wishes to ban customer participation in wholesale demand response programs to facilitate the increase in OSS of capacity to the benefit of the Companies' shareholders. Integrys reasons that because AEP-Ohio can count load enrolled in its interruptible service offerings as a part of the PJM ILR demand response program, the Companies will receive credit against its FRR commitment. The Companies, according to Integrys, hope that additional load will come from the customers currently participating in PJM's demand response programs in Ohio (Tr. Vol. IX at 53-58; Integrys Br. at 20-22). Integrys proposes, as an alternative to prohibiting customer participation in wholesale demand response programs, that the Commission count participation in the programs towards AEP-Ohio's peak demand reduction goals in accordance with the requirements of Section 4928.66, Revised Code. Integrys argues that the load can be certified, as it is today with the PJM demand response programs, or the electric services company could be required to register the committed load with the Commission.

Furthermore, Integrys reasons that the Commission can not retroactively interfere with existing contracts between customers and the customer's electric service provider in relation to the commitment contracts with PJM. With that in mind and if the Commission decides to grant AEP-Ohio's request to prohibit participation in wholesale demand response programs, Integrys requests that customers currently committed to participate in PJM programs for the 2008-2009 planning period and the 2009-2010 planning period be permitted to honor their commitments (Integrys Br. at 27-28).

Integrys argues that the Companies' claim that taking SSO and participating in a wholesale demand response program is a resale of power and a violation of the terms and conditions of their tariffs is misplaced. Integrys opines that there is no actual resale of energy, but, instead, there is a reduction in the customer's consumption of energy upon a call from the regional transmission operator (in this case, PJM). The customer is not purchasing energy from AEP-Ohio, so any energy purchased by AEP-Ohio can be transferred to another purchaser. Thus, Integrys asserts that AEP-Ohio's argument regarding participation in a wholesale demand response program is fiction and not based on FERC's interpretation of participation in such programs. Finally, Integrys contends that AEP-Ohio's proposal is a violation of Section 4928.40(D), Revised Code, as such prohibits electric utilities from prohibiting the resale of electric generation service.

The Commercial Group asserts, that because AEP-Ohio has not performed any studies or analyses, the Companies' assertion that wholesale demands response programs must be different from a demand response program offered by AEP-Ohio is unsupported by the record (Tr. Vol. IX at 47). The Commercial Group requests that the Companies be directed to design energy efficiency and demand response programs that incorporate all available programs (Commercial Group at Br. 9).

OEG argues that, to the extent there are real benefits to the Companies as well as to their retail customers in the form of improved grid reliability, AEP-Ohio should be required to offer PJM demand response programs to its large industrial customers by way of a tariff rider or through a third-party supplier (OEG Ex. 2 at 13). IEU adds that the Companies currently use the capabilities of their interruptible customers to assist the Companies in satisfying their generation capacity requirements to PJM. According to IEU, SB 221 gives mercantile customers the option of whether or not to dedicate their customer-sited capabilities to the Companies for integration into the Companies' portfolio (IEU Ex. 1 at 12).

Constellation argues that AEP-Ohio's proposal violates Section 4928.20, Revised Code, and the clear intent of SB 221. Further, Constellation argues that approving AEP-Ohio's request to prohibit Ohio businesses from conservation programs during this period of economic hardship is ill-advised, especially considering that other businesses with which Ohio businesses' must compete are able to participate in the PJM programs. As such, consistent with the Commission's decision in Duke's ESP case (Case No. 08-920-EL-SSO, et al.), Constellation encourages the Commission to reject AEP-Ohio's request to prohibit SSO customers from participating in PJM demand response programs and give Ohio's business customers all available opportunities to reduce demand, conserve energy, and invest in conservation equipment (Constellation Br. at 23). OMA supports the claims of Constellation (OMA Br. at 10).

First, we will address the claims regarding the Commission's authority, or as claimed by Integrys, the lack of authority, for the Commission to determine whether or not Ohio's retail customers are permitted to participate in wholesale demand response programs. The Commission finds that the General Assembly has vested the Commission with broad authority to address the rate, charges, and service issues of Ohio's public utilities as evidenced in Title 49 of the Revised Code. Accordingly, we consider this Commission the entity to which FERC was referring in the Final Rule when it referred to the "relevant electric retail regulatory authority." We are not convinced by Integrys' arguments that a specific act of the General Assembly is necessary to grant the Commission the authority to determine whether or not Ohio's retail customers are permitted to participate in the RTO's demand response programs.

Next, the Commission acknowledges that the PJM programs offer benefits to program participants. We are, however, concerned that the record indicates that PJM demand response programs cost AEP-Ohio's other customers as the load of AEP-Ohio's FRR and the cost of meeting that requirement is reflected in AEP-Ohio's retail rates. Finally, we are not convinced, as AEP-Ohio argues that a customer's participation in demand response programs is the resale of energy provided by AEP-Ohio. For these reasons, we find that we do not have sufficient information to consider both the potential benefits to program participants and the costs to Ohio ratepayers to determine whether this provision of the ESP will produce a significant net benefit to AEP-Ohio consumers. The Commission, therefore, concludes that this issue must be deferred and addressed in a separate proceeding, which will be established pursuant to a subsequent entry. Although we are not making a determination at this time as to the appropriateness of such a provision, we direct AEP to modify its ESP to eliminate the provision that prohibits participation in PJM demand response programs.

D. Integrated Gasification Combined Cycle (IGCC)

In Case No. 05-376-EL-UNC, the Commission concluded that it was vested with the authority to establish a mechanism for recovery of the costs related to the design, construction, and operation of an IGCC generating plant where that plant fulfills AEP-Ohio's POLR obligation and, therefore, approved the Phase I cost recovery mechanism included in the Companies' application.[33] Applications for rehearing of the Commission's IGCC Order were timely filed and by entry on rehearing issued June 28, 2006, the Commission denied each of the applications for rehearing (IGCC Rehearing Entry). Further, the IGCC Rehearing Entry conditioned the Commission's approval of the application, stating that: (a) all Phase I costs would be subject to subsequent audit(s) to determine whether such expenditures were reasonable and prudently incurred to construct the proposed IGCC facility; and (b) if the proposed IGCC facility was not constructed and in operation within five years after the date of the entry on rehearing, all Phase I charges collected must be refunded to Ohio ratepayers with interest.

In this ESP proceeding, AEP-Ohio witness Baker testified that, although the Companies have not abandoned their interest in constructing and operating an IGCC facility in Meigs County, Ohio, certain provisions of SB 221 are a barrier to construction and operation of an IGCC facility. As AEP-Ohio interprets SB 221, the Companies may be

33 *In re Columbus Southern Power Company and Ohio Power Company*, Case No. 05-376-EL-UNC, Opinion and Order (April 10, 2006) (IGCC Order).

required to remain in an ESP to assure an opportunity for cost recovery for an IGCC facility; the construction work in process (CWIP) provision which requires the facility to be at least 75 percent complete before it can be included in rate base; the limit on CWIP as a percentage of total rate base which the witness contends causes particular uncertainties since the concept of a generation rate base has no applicability under SB 221; and the effect of "mirror CWIP" (Cos. Ex. 2-A at 52-56). The Companies assert that not only are these barriers to the construction of an IGCC facility but also to any base load generation facility in Ohio. Nonetheless, the Companies state that they are encouraged by the fact that SB 221 recognizes the need for advanced energy resources and clean coal technology, such as an IGCC. Finally, the Companies' witness notes that, since the time the Companies proposed the IGCC facility, CSP has acquired additional generating capacity. According to Company witness Baker, the Companies hope to work with the Governor's administration, the General Assembly, and other interested parties to enact legislation that will make an IGCC facility in Meigs County a reality (Cos. Ex. 2-A at 55-56).

OCEA opines that SB 221 did not eliminate the existing requirement that electric utilities must satisfy to earn a return on CWIP and, since the Companies do not ask for the Commission to make any determination in this proceeding or at any definite time in the future as to the IGCC facility, the Commission should take no action on this issue (OCEA Br. at 98-99).

The Commission notes that the Ohio Supreme Court remanded, in part, the Commission's IGCC Order, for further proceedings and, accordingly, the matter is currently pending before the Commission. Further, as OCEA asserts, there does not appear to be any request from the Companies as to the IGCC facility in this proceeding. Accordingly, we find it inappropriate to rule, at this time, on any matter regarding the Meigs County IGCC facility in this proceeding. We will address the matter as part of the pending IGCC proceeding.

E. Alternate Feed Service

As part of the ESP, the Companies propose a new alternate feed service (AFS) schedule. For customers who desire a higher level of reliability, a second distribution feed, in addition to the customer's basic service, will be offered. Existing AEP-Ohio customers that are currently paying for AFS will continue to receive the service at the same cost under the proposed tariff. Existing customers who have AFS and are not paying for the service will continue to receive such service until AEP-Ohio upgrades or otherwise makes a new investment in the facilities that provide AFS to that customer. At such time, the customer will have 6 months to decide to discontinue AFS, take partial AFS, or continue AFS and pay for the service in accordance with the effective tariff schedule (Cos. Ex. 1 at 8). While OHA supports the implementation of an AFS schedule offering with clearly defined terms and conditions, OHA takes issue with two aspects of the AFS proposal. OHA witness Solganick testified that it is his understanding that the customer will have six months after the customer is notified by the company to make a decision (OHA Ex. 4 at 15). However, OHA witness Solganick advocated that six months was insufficient because critical-use customers, like hospitals, require more lead time to evaluate their electric supply infrastructure and needs (Id.). As such, he argued that 24 months would be more appropriate for planning purposes (Id.). Moreover, OHA argued that, because this issue involves the overall management and cost of operating AEP-Ohio's distribution system, the Commission should defer consideration of the proposed AFS until AEP-Ohio's next distribution rate case where there will be a more deliberate treatment of the issue as opposed to this 150-day proceeding (OHA Br. at 23). OHA believes that a distribution rate proceeding would better ensure that the underlying rate structure for AFS is correct, similar to the argument for deferring decision on other distribution rate issues presented in this ESP proceeding (Id.). Staff and IEU also agree that the issue should be addressed in a distribution rate case (Staff Ex. 1 at 4; IEU Ex. 10 at 11). However, IEU further recommends that the Commission deny the Companies' request because it is not based on prudently incurred costs (IEU Br. at 25-26).

The Companies retort that, while they may have some flexibility as to the notice provided customers, such notice is limited by the Companies' planning horizon for distribution facilities and the lead time required to complete construction of upgraded AFS facilities (Cos. Reply Br. at 122). The Companies reason that, while more than 6 months may be feasible, anything more than 12 months would not be prudent and, in certain rare circumstances, would not facilitate the construction of complex facilities (Id.). Nonetheless, the Companies stated that they will commit to 12 months notice to existing AFS customers for the need to make an election of service (Id.). However, the Companies vehemently opposed deferring approval of their proposed AFS schedule to some future proceeding, stating that the proposed AFS tariff codifies existing practices currently being addressed on a customer-by-customer contract addendum basis (Id.). Further, the Companies argue that IEU has not presented any basis to support the implication that the AFS schedule will recover imprudently incurred costs (Id. at 123). Thus, AEP-Ohio contends there is no good reason to delay implementation of the AFS schedule with the understanding that the Companies will provide up to 12 months notice to existing customers (Id. at 122-123).

As previously noted in this order in regards to other distribution rate issues, the Commission believes that the establishment of various distribution riders and rates, including the proposed new AFS schedule, is best reviewed in a distribution rate case where all components of distribution rates are subject to review.

F. Net Energy Metering Service

The Companies' ESP application includes several tariff revisions. More specifically, the Companies propose toeliminate the one percent limitation on the total rated generation capacity for customer-generators on the Companies' Net Energy

Metering Service (NEMS) and add a new Net Energy Metering Service for Hospitals (NEMS-H). The Companies note that, at the time the ESP application was filed, they had filed a proposed tariff modification to the NEMS and Minimum Requirements for Distribution System Interconnection and Standby Service in Case No. 05-1500-EL-COI.[34] The Companies state that upon approval of the modifications filed in 05-1500, the approved modifications will be incorporated into the tariffs filed in the ESP case (Cos. Ex. 1 at 8-9).

OHA identifies two issues with the Companies' proposed NEMS-H schedule. First, OHA asserts the conditions of service are unduly restrictive to the extent that NEMS-H requires the hospital customer-generator's facility must be owned and operated by the customer and located on the customer-generator's premises. OHA asserts that this requirement prevents hospitals from benefiting from economies of scale by utilizing the expertise of distributed generation or cogeneration companies, centralized operation and maintenance of such facilities, and shared expertise and expenses. Further, OHA asserts that the requirement that the facility be located on the hospital's premises is a barrier because space limitations and legal and/or financing requirements may suggest that a generation facility be located on property not owned by the hospital. OHA argues that the Companies do not cite any regulatory, operational, financial, or other reason why the ownership requirement is necessary. Therefore, OHA requests that the Commission delete this condition of service and require only that the hospital contract for service and comply with the Companies' interconnection requirements (OHA Ex. 4 at 8-10).

AEP-Ohio responds that the requirement that the generation facility be on-site and owned and operated by the customer is a provision of the currently effective NEMS schedule. Further, the Companies argue that economies of scale may be accomplished with multiple hospitals contracting with a third-party to operate and maintain the generation facilities of each hospital. Further, AEP-Ohio argues that there is no support for the claim that efficiencies can not be had if the hospital, rather than a third-party developer, is the ultimate owner of such facilities (Cos. Br. at 128). As to OHA's opposition to the requirement that the hospital own and operate the generation facility on its premises, AEP-Ohio contends that such is required based on the language in the definitions of a customer-generator, net metering system, and self-generator at Section 4928.02(A)(29) to (32), Revised Code (Cos. Reply Br. at 124-125).

Second, OHA argues that the payment for net deliveries of energy should include credits for transmission costs that are avoided and energy losses on the subtransmission and distribution systems that are avoided or reduced. Further, OHA requests that such payments for net deliveries should be made monthly without a requirement for the

34 *In the Matter of the Application of the Commission's Review to Provisions of the Federal Energy Policy Act of 2005 Regarding Net Metering, Smart Metering, Demand Response, Cogeneration, and Power Production*, Case No. 05-1500-EL-COI (05-1500).

customer-generator to request any net payment. The Companies propose to make such payment annually upon the customer's request (OHA Ex. 4 at 11-12). The Companies assert that OHA assumes that the customer-generator's activities will reduce transmission, subtransmission, and distribution line losses and there is no support for OHA's contention. Further, AEP-Ohio argues that annual payment is in compliance with Rule 4901:1-10-28(E)(3), Ohio Administrative Code (O.A.C.) (Cos. Reply Br. at 124). OHA witness Solganick conceded that the annual payment requirement is in compliance with the Commission's rule (Tr. Vol. X at 118-119).

Staff submits that the Companies' proposed NEMS-H tariff is premature given that requirements for hospital net metering are currently pending rehearing before the Commission in the 06-653 Case. Thus, Staff proposes, and OHA supports, that the Companies withdraw their proposed NEMS-H and refile the tariff once the new requirements are effective or with the Companies' next base rate proceeding, whichever occurs first (Staff Ex. 5 at 9; OHA Reply Br. at 9). AEP-Ohio argues that the status of the 06-653 Case should not postpone the implementation of one of the objectives of SB 221 and notes that, if the final requirements adopted in the 06-653 Case impact the Companies' NEMS-H, the adopted requirements can be incorporated into the NEMS-H schedule at that time.

As the Commission is in the process of determining the net energy meter service requirements pursuant to SB 221 in the 06-653 Case, the Commission finds AEP-Ohio's revisions to its net energy metering service schedules premature. Therefore, the Commission finds, as proposed by Staff and supported by OHA, the Companies should refile their net metering tariffs to be consistent with the requirements adopted by the Commission in the 06-653 Case or with the Companies' next base rate proceeding.

G. Green Pricing and Renewable Energy Credit Purchase Programs

OCEA proposes that the Commission order AEP-Ohio to continue, with the input of the DSM collaborative, the Companies' Green Pricing Program and to require the Companies to develop a separate residential and small commercial net-metering customer renewable energy credit (REC) purchase program. OCC witness Gonzalez recommended a market-based pricing for RECs. On brief, OCEA proposes an Ohio mandatory market-based rate for in-state solar electric application and a different rate for in-state wind and other renewable resources. OCEA asserts that the programs will assist customers with the cost of owning and using renewable energy and assist the Companies in meeting the renewable energy requirements (OCC Ex. 5 at 10-11; Tr. Vol. IV at 232-234; OCEA Br. at 97-98).

The Companies argue that, pursuant to the stipulation agreement approved by the Commission in Case No. 06-1153-EL-UNC,[35] the Green Pricing Program expired December 31, 2008. Further, the Companies note that the Commission approved the expiration of the Green Pricing Program by the Finding and Order issued in Case No. 08-1302-EL-ATA.[36] However, the Companies state that they intend to offer a new green tariff option during the ESP term (Cos. Ex. 3 at 13). Accordingly, the Companies request that the Commission OCEA's request to detail or adopt a new green tariff option at this time. In regards to OCEA's REC proposal, the Companies assert that the prescriptive pricing recommendation presented on brief is at odds with the testimony of OCC's witness. Further, the Companies note that OCC's witness acknowledged the administrative and cost-effective issues associated with the proposal. Thus, the Companies note that, as OCC's witness acknowledged, the proposal requires further study before being implemented.

While the Commission believes there is merit to green pricing and REC programs and, therefore, encourages the Companies to evaluate the feasibility and benefits to implementing such programs as soon as practicable , we decline to order the Companies to initiate such programs as part of this ESP proceeding, as it is not necessary that these optional requests be pursued by the Companies at this time. Accordingly, we find that it is unnecessary to modify AEP-Ohio's ESP to include any green pricing and REC programs, and we decline to do such modification at this time.

H. Gavin Scrubber Lease

The Companies note that in the Gavin Scrubber Case,[37] the Commission authorized OP to enter into a lease agreement with JMG Funding, L.P. (JMG) for a scrubber/solid waste disposal facilities (scrubber) at the Gavin Power Plant. Under the terms of the lease agreement, the agreement may not be cancelled for the initial 15-year term. After the initial 15-year period, under the Gavin lease agreement, OP has the option to renew or extend the lease for an additional 19 years. OP entered into the lease on January 25, 1995. Therefore, the initial lease period ends in 2010, and at that time, OP will have the option of renewing the Gavin scrubber lease for an additional 19 years, until 2029. On April 4, 2008, OP filed an application for authority to assume the obligations of JMG and restructure the financing for certain JMG obligations in the OP and JMG case.[38] In the OP and JMG case, the Commission approved OP's request subject to two conditions: OP must seek Commission approval to exercise the option to purchase the

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35 *In re Columbus Southern Power Company and Ohio Power Company*, Case No. 06-1153-EL-UNC (May 2, 2007).

36 *In re Columbus Southern Power Company and Ohio Power Company*, Case No. 08-1302-EL-ATA (December 19, 2008).

37 *In re Ohio Power Company*, Case No. 93-793-EL-AIS, Opinion and Order (December 9, 1993).

38 *In re Ohio Power Company*, Case No. 08-498-EL-AIS, Finding and Order (June 4, 2008).

Gavin scrubbers or terminate the lease agreement; and OP must provide the Commission with details of how the company intends to incorporate the project into its ESP (Cos. Ex. 2-A at 56-58).

As part of the Companies' ESP application, OP requests authority to return to the Commission to recover any increased costs associated with the Gavin lease (Cos. Ex. 2-A at 56-58). The Companies state that a decision on the Gavin scrubber lease has not been made because the market value of the scrubbers and the analysis to determine the least cost option is not available at this time.

The Commission recognizes that additional information is necessary for the Companies to evaluate the options of the Gavin lease agreement and, to that end, we believe that AEP-Ohio should be permitted to file an application to request recognition of the Gavin lease at the time that it makes its decision as to purchasing or terminating the lease. Once the Companies have made their election, they should conduct a cost-benefit analysis and file it with the Commission prior to seeking recovery of any incremental costs associated with the Gavin scrubber lease.

I. Section V.E (Interim Plan)

The Companies assert that this provision is part of the total ESP package and should be adopted. The Companies requested that the Commission authorize a rider to collect the difference between the ESP approved rates and the rates under the Companies' current SSO for the length of time between the end of the December 2008 billing month and the effective date of the new ESP rates.

We find Section I.E of the proposed ESP to be moot with this opinion and order. The Commission issued finding and orders on December 19, 2008, and February 25, 2009, interpreting the statutory provision in Section 4928.14(C)(1), Revised Code, and approving rates for an interim period until such time as the Commission issues its order on AEP's proposed ESP.[39] Those rates have been in effect with the first billing cycle in January 2009. Consistent with Section 4928.141, Revised Code, which requires an electric utility to provide consumers, beginning on January 1, 2009, a SSO established in accordance with Section 4928.142 or 4928.143, Revised Code, and given that AEP-Ohio's proposed ESP term begins on January 1, 2009, and continues through December 31, 2011, we are authorizing the approval of AEP's ESP, as modified herein, effective January 1, 2009. However, any revenues collected from customers during the interim period must be recognized and offset by the new rates and charges approved by this opinion and order.

39 *In re Columbus Southern Power Company and Ohio Power Company*, Case No. 08-1302-EL-ATA, Finding and Order at 2-3 (December 19, 2008) and Finding and Order at 2 (February 25, 2009).

VII. SIGNIFICANTLY EXCESSIVE EARNINGS TEST (SEET)

Section 4928.143(F), Revised Code, requires that, at the end of each year of the ESP, the Commission shall consider if any adjustments provided for in the ESP:

> ...resulted in excessive earnings as measured by whether the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate.

AEP-Ohio's proposed ESP SEET process may be summarized as follows: The book measure of earnings for CSP and OP is determined by calculating net income divided by beginning book equity. The Companies then propose that the ROE for CSP and OP should be blended as the book equity amounts for AEP-Ohio is more meaningful since CSP and OP are supported by AEP Corporation. To develop a comparable risk peer group, including public utilities, with similar business and financial risk, AEP-Ohio's process includes evaluating all publicly traded U.S. firms. By using data from both Value Line and Compustat, AEP-Ohio applies the standard decile portfolio technique, to divide the firms into 10 different business risk groups and 10 different financial risk groups (lowest to highest). AEP-Ohio would then select the cell which includes AEP Corporation. To account for the fact that the business and financial risks of CSP and OP may differ from AEP Corporation, this aspect of the process is repeated for CSP and OP and taken into consideration in determining whether CSP's or OP's ROEs are excessive. The ESP evaluates business risk by using unlevered Capital Asset Pricing Model betas (or asset betas) and the financial risk by evaluating the book equity ratio. The Companies assert that the book equity ratio is more stable from year to year and, therefore, is considered by fixed-income investors and credit rating agencies. The ESP utilized two standard deviations (which is equivalent to the traditional 95 percent confidence level) about the mean ROEs of the comparable risk peer group and the utility peer group to determine the starting point for which CSP's or OP's ROE may be considered excessive (Cos. Ex. 5 at 13-42). Finally, AEP-Ohio advocates that the earnings for each year the SEET is applied should be adjusted to exclude the margins associated with OSS and accounting earnings for fuel adjustment clause deferrals for which the Companies will not have collected revenues (Cos. Ex. 2-A at 37-38; Cos. Ex. 6 at 16-17; Cos. Ex. 2 at 39-40).

OCC, OEG, and the Commercial Group each take issue with the development of the comparable firms and the threshold of significantly excessive earnings. Kroger and OCEA argue that the Companies' statistical process for determining when CSP and OP have earned significantly excessive earnings improperly shifts the burden of proof set forth in the statute from the company to other parties.

OCC witness Woolridge developed a proxy group of electric utilities to establish the business and financial risk indicators, then uses Value Line to develop a data base of companies with business and financial risk indicators within the range of the electric utility proxy group. Woolridge suggests computing the benchmark ROE for the comparable companies and adjusting the benchmark ROE for the capital structure of Ohio's electric utility companies and adjusting the benchmark by the FERC 150 basis points ROE adder to determine significantly excessive earnings (OCC Ex. 2 at 5-6, 20). AEP-Ohio argues that OCC's process is contrary to the language and spirit of Section 4928.143(F), Revised Code, as the statute requires the comparable firms include non-utility firms. The SEET proposed by OCC witness Woolridge results in the same comparable list of firms for each Ohio electric utility evaluated (Cos. Ex. 5-A at 5-6).

OEG proposes a method to establish the comparable group of firms by utilizing the entire list of publicly traded electric utilities in Value Line's Datafile,[40] and one group of non-utility firms. The comparable non-utility group is composed of Companies' with gross plant to revenue between 1.2 and 5.0, gross plant in excess of $1 billion and companies for which Value Line has a beta (OEG Ex. 4 at 4-6). OEG then calculates the difference in the average beta of electric utility group and the non-utility group and adjust it by the average historical risk premium for the period 1926 to 2008, which equals 7.0 percent to determine the adjustment to account for the reduced risk associated with utilities. Thus, for example, for the year 2007 OEG determined that the average non-utility earned return of 14.14 percent yields a risk-adjusted return of 12.82 percent. OEG then applies an adjustment to recognize the financial risk differences of AEP-Ohio to the utility and non-utility comparison groups. Finally, to determine the level at which earnings are "significantly excessive," OEG suggests an adder of the 200 basis points to encourage investments (OEG Ex. 4 at 7-9). OEG argues that the use of statistical confidence ranges as proposed by AEP-Ohio would severely limit any finding of excessive earnings as a two-tailed 95 percent confidence interval would mean that only 2.5 percent of all observations of all the sample company groups would be deemed to have excessive earnings. Further, OEG argues that as a statistical analysis the AEP-Ohio-proposed method eliminates most, if not all, of the Commission's flexibility to adjust to economic circumstances and determine whether the utility company's earnings are significantly excessive (OEG Ex. 4 at 9-10).

AEP-Ohio contends that OEG's SEET method fails to comply with the statutory requirements for the SEET, fails to control for financial risk of the comparable sample groups, fails to account for business risk and will, like the process proposed by OCC,

40 OEG would eliminate one company with a significant negative return on equity for 2007.

produce the same comparable non-utility and utility group for each of the Ohio electric utilities (Cos. Ex. 5-A at 8-9).

The Commercial Group asserts that AEP-Ohio's proposed SEET methodology will produce volatile earned return on equity thresholds and, therefore, does not meet the primary objective of an ESP which is to stabilize rates and support the economic development of the state. Further, AEP-Ohio's SEET method, according to the Commercial Group, fails to compose a comparable proxy group with business risk similar to CSP and OP, including unregulated nuclear subsidiaries and deregulated generation subsidiaries. Thus, Commercial Group recommends a comparable group consist of publicly traded regulated utility companies as determined by the Edison Electric Institute (EEI). Commercial Group witness Gorman notes that using EEI's designated group of regulated entities and Value Lines earned return on common equity shows that the regulated companies had an average return on equity of approximately 9 percent for the period 2005 through 2008. Witness Gorman contends that over the period 2005 through 2008 and projected over the next 3 to 5 years, approximately 85 percent of the earned return on equity observations for the designated regulated electric utility companies will be at 12.5 percent return on equity or less. Therefore, Commercial Group recommends that the SEET test be based on the Commission-approved return on equity plus a spread of 200 basis points. Commercial Group witness Gorman reasons that the average risk, extreme risk and beta spread over AEP-Ohio's proxy group suggest that a 2 percent/200 basis points is a conservative determination of the excessive earnings threshold (Commercial Group Ex. 1 at 3, 12-17).

AEP-Ohio argues that the Commercial Group's proposed SEET fails to develop a comparable group as required by the SEET and ignores the fact that the rate of return is a forward-looking analysis and the SEET is retrospective. Thus, AEP-Ohio concludes that this method does not address the measurement of financial and business risk (Cos. Ex. 5-A at 9-10).

OCC opposes the exclusion of accounting earnings for fuel adjustment clause deferrals and the deduction of revenues associated withOSS, as OSS are not one-time write-offs or non-recurring items (OCC Ex. 2 at 21). OCC contends that revenues associated with the deferrals are reported during the same period with the Companies fuel-related expenses and to eliminate the deferrals, as AEP-Ohio proposes, would reduce the revenues for the period without deducting for the underlying expense (OCC Reply Br. 69-70). Similarly, Kroger proposes that AEP-Ohio credit the fuel adjustment clause for the margin generated by OSS and notes that AEP Corporation's West Virginia and Virginia electric distribution subsidiaries currently do so despite AEP-Ohio's assertion that such is in violation of federal law (Kroger Ex. 1 at 9).

Staff advocates a single SEET methodology for all electric distribution utilities as to the selection of comparable firms and, further, proposes a workshop or technical conference to develop the process to determine the "comparable group earnings" for the SEET. Staff witness Cahaan reasons that the SEET proposed by AEP-Ohio as a technical, statistical analysis, if incorrectly formulated shifts the burden of proof from the company to the other parties. Staff also contends that the Companies' SEET proposal is based upon a definition of significance which would create internal inconsistencies if applied to the statute. Further, Staff believes the "zone of reasonable" earnings can be framed by a return on equity with an adder in the range of 200 to 400 basis points. Further, Staff recognizes that if, as AEP-Ohio suggests, revenues from OSS are excluded from SEET, other adjustments would be required. Staff believes it would be unreasonable to predetermine those other adjustments as this time. Thus, Staff proposes that this proceeding determine the method of establishing the comparable group and specify the basis points that will be used to determine "significantly excessive earnings." Staff claims that under its proposed process, at the end of the year, the ROE of the comparable group could be compared to the electric utility's 10-K or FERC-1 and, if the electric utility's ROE is less than that of the sum of the comparable group's ROE plus the adder, it will be presumed that the electric utility's earnings were not significantly excessive. Further, Staff asserts that any party that wishes to challenge the presumption would be required to demonstrate otherwise. If, however, the electric utility's earned ROE is greater than the average of the comparable group plus the adder, the electric utility would be required to demonstrate that its earnings are not significantly excessive (Staff Ex. 10 at 8, 16, 19, 21-24, 26-27; Staff Br. at 27).

OCEA, OMA, and the Commercial Group recommend that the comparable firm process for the SEET be determined, as Staff proposes, as part of a workshop (OCEA Br. at 110; OMA Br. at 13; Commercial Group Br. at 9).

The Commission believes that the determination of the appropriate methodology for the SEET is extremely important. As evidenced by the extensive testimony in this case concerning the test, there are many different views concerning what is intended by the statute and what methodology should be utilized. However, as pointed out by several parties, whatever the ultimate determination of what the methodology should be for the test, the test itself will not be actually applied until 2010 and, as proposed by the Companies, will not commence until August 2010, after Compustat information is made publicly available (Cos. Ex. 5 at 11-12). Therefore, consistent with our opinion and order issued in the FirstEnergy ESP Case,[41] the Commission agrees with Staff that it would be wise to examine the methodology for the excessive earnings test set forth in the statute within the framework of a workshop. This is consistent with the Commission's finding that the goal of the workshop will be for Staff to develop a common methodology for the

41 *In re Ohio Edison Company, The Cleveland Electric Illuminating Company, and the Toledo Edison Company,* Case No. 08-935-EL-SSO, Opinion and Order (December 19, 2008).

excessive earnings test that should be adopted for all of the electric utilities and then for Staff to report back to the Commission on its findings. Despite AEP-Ohio's assertions that FirstEnergy's ESP is no longer applicable since the FirstEnergy companies rejected the modified ESP, the Commission finds that a common methodology for significantly excessive earnings continues to be appropriate given that other ESP applications are currently pending and, even under AEP-Ohio's ESP application, the SEET information is not available until the July of the following year. Accordingly, the Commission finds that Staff should convene a workshop consistent with this determination. However, notwithstanding the Commission's conclusion that a workshop process is the method by which the SEET will be developed, we recognize that AEP-Ohio must evaluate and determine whether to accept the ESP as modified herein or reject the modified ESP and, therefore, require clarification of our decision as to OSS and deferrals (Cos. Reply Br. at 134). We find that a determination of the Companies' earnings as "significantly excessive" in accordance with Section 4928.143(F), Revised Code, necessarily excludes OSS and deferrals, as well as the related expenses associated with the deferrals, consistent with our decision regarding an offset to fuel costs for any OSS margins in Section III.A.1.b of this order. The Commission believes that deferrals should not have an impact on the SEET until the revenues associated with deferrals are received. Further, although we conclude that it is appropriate to exclude off-system sales from the SEET calculation, we do not wish to discourage the efficient use of OP's generation facilities and, to the extent that the Companies' earnings result from wholesale sources, they should not be considered in the SEET calculation.

VIII. MRO V. ESP

The Companies argue that "[t]he public interest is served if the ESP is more favorable in the aggregate than the expected results of an MRO" (Cos. Br. at 15). The Companies' further argue that the state policy set forth in Section 4928.02(A), Revised Code, is satisfied if the price for electric service, as part of the ESP as a whole, is more favorable than the expected results of an MRO (Id.). The Companies aver that not only is the SSO proposed under the ESP more attractive than the SSO resulting froman MRO, other non-SSO factors exist adding to the favorability of the ESP over the MRO (Cos. Ex. 2-A at 4, 8; Cos. Ex. 3 at 14-19). Specifically, AEP calculated the market price competitive benchmark for the expected cost of electricity supply for retail electric generation SSO customers in the Companies' service territories for the next three years as $88.15 per MWH for CSP and $85.32 per MWH for OP for full requirements service (Cos. Ex. 2-A at 5). These competitive benchmark prices were calculated by AEP using market data from the first five days of each of the first three quarters of 2008, and averaging the data (Id. at 15).

AEP-Ohio witness Baker then compared the ESP-based SSO with the MRO-based SSO, analyzing the following components: market prices for 2009 through 2011; the phase-in of the MRO over a period of time pursuant to Section 4928.142, Revised Code, at 10 percent, 20 percent, and 30 percent; the full requirements pricing components of the states of Delaware and Maryland; PJM costs; incremental environmental costs, POLR costs, and other non-market portions of an MRO-based SSO (Cos. Ex. 2-A at 3-17). AEP-Ohio witness Baker also considered non-SSO costs in the comparison, such as the distribution-related costs of $150 million for CSP and $133 million for OP (Id. at 16-17). AEP-Ohio concluded that the cost of the ESP is $1.2 billion and the cost of the MRO is $1.5 billion for CSP, while the cost of the ESP is $1.4 billion and the cost of the MRO is $1.7 billion for OP (Cos. Ex. 2-B, Revised Exhibit JCB-2). Therefore, AEP-Ohio states that the ESP for the Companies in the aggregate and for each individual company is clearly more favorable for customers, and would result in a net benefit to the customers under the ESP as compared to the MRO of $ 292 million for CSP and $262 million for OP (Id.; Cos. Br. at 135).

The Companies state that, in addition to the generation component, the ESP has other elements that, when taken in the aggregate, make the ESP considerably more favorable to customers than an MRO alternative (Cos. Ex. 2-A at 17-18). AEP-Ohio explains that the benefits in the ESP that are not available in an MRO, include: a shareholder-funded commitment focused on economic development and low-income customer assistance programs; price certainty and stability for generation service for a specified three-year period; and gridSMART and enhanced distribution reliability initiatives (Cos. Ex. 2-A at 17-18; Cos. Ex. 3 at 16-18; Cos. Br. at 135-137).

The Companies contend that once the Commission determines that the ESP is more favorable in the aggregate, then the Commission is required to approve the ESP. If the Commission determines that the ESP is not more favorable in the aggregate, then the Commission may modify the ESP to make it more favorable or it may disapprove the ESP application.

Staff states that, as a general principle, Staff believes that the Companies' proposed ESP is more favorable than what would be expected under an MRO (Staff Br. at 2). However, Staff explains that modifications to the proposed ESP are necessary to make the ESP reasonable (Id.). With Staff's proposed adjustments to the ESP rates, Staff witness Hess testified that the Companies' proposed ESP "results in very reasonable rates" (Staff Ex. 1 at 10). Furthermore, Staff witness Hess demonstrated, utilizing Staff witness Johnson's estimated market rates, that the ESP is more favorable in the aggregate as compared to the expected results of an MRO (Staff Ex. 1-A, Revised Exhibit JEH-1; Staff Br. at 26).

Several intervenors are critical of various components of AEP-Ohio's proposed ESP and thus conclude that the ESP, as proposed, is not more favorable in the aggregate and should be rejected or substantially modified, or that AEP-Ohio has failed to meet its burden of proof under the statute that the proposed ESP, in the aggregate, is more favorable than an MRO (OPAE Br. at 3, 22-23; OMA Br. at 3; Kroger Br. at 4; OHA Br. at 11; Commercial Group Br. at 2-3; OEG Br. at 2-3; Constellation Br. at 16-18). More specifically, OHA contends that the Commission must take into account all terms and conditions of the proposed ESP, not just pricing (OHA Br. at 8-9). OHA further explains that the Commission must weigh the totality of the circumstances presented in the proposed ESP with the totality of the expected results of an MRO (Id. at 9). OHA also states that the proposed ESP fails to mitigate the harmful effects of new regulatory assets, proposed deferrals, and rate increases on hospitals and, therefore, the ESP does not provide benefits that make it more favorable than a simple MRO (Id. at 11). IEU asserts that both the Companies' and Staff's comparison of the ESP to an MRO are flawed because the comparisons fail to reflect the projected costs of deferrals, assume the maximum blending percentages allowed under 4928.142, Revised Code, and fail to demonstrate the incremental effects of the maximum blending percentages on the FAC costs (IEU Br. at 33, citing Cos. Ex. 2-A, Staff Ex. 1, Exhibit JEH-1, Tr. Vol. XI at 78-82, and Tr. Vol. XIII at 87-88).

OCEA disputes the Companies' comparison of the ESP to the MRO, stating that the Companies have overstated the competitive benchmark prices (OCC Ex. 10 at 15; OCEA Br. at 19-24). Based on data from the fourth quarter 2008, and taking in consideration adjustments for load shaping and distribution losses, OCC calculates that the updated competitive benchmark prices should be $73.94 for CSP and $71.07 for OP (OCC Ex. 10 at 15-24). OCEA also questioned other underlying components of AEP witness Baker's comparison of the MRO to the ESP regarding the proposed ESP, as well as the exclusion of certain costs in the MRO calculation (Id. at 37-40). Nonetheless, OCEA ultimately concludes that AEP's ESP, if appropriately modified, is more favorable than an MRO (OCEA Br. at 19-24; OCC Ex. 10 at 39). Constellation also submits that the forward market prices for energy have fallen significantly since the Companies' filed their application and submitted their supporting testimony (Constellation Ex. 2 at 16).

Contrary to the position taken by Constellation and OCEA,[42] AEP-Ohio contends that the market price analysis supplied in support of the ESP does not need to be updated in order for the Commission to determine whether the ESP is more favorable that the expected result of the MRO. Furthermore, AEP-Ohio responds that the appropriate method is to look over a longer period of time, and not just focus on the recent decline in forward market prices. (Cos. Reply Br. at 130-131).

Contrary to arguments raised by various intervenors, AEP-Ohio avers that the legal standard to approve the ESP is not whether the Commission can make the ESP even more favorable, whether the rates are just and reasonable, whether the costs are prudently

42 Constellation Br. at 17; OCEA Br. at 19-24.

incurred, whether the plan provisions are cost-based, or whether each provision of the plan is more favorable than an MRO (Cos. Reply Br. at 1-6). The Companies contend that the Commission only has authority to modify a proposed ESP if the Commission determines that the ESP is not more favorable than the expected results of an MRO (Id. at 4). As some intervenors have recognized,[43] the Commission does not agree that our authority to make modifications is limited to an after-the-fact determination of whether the proposed ESP is more favorable in the aggregate. Rather, the Commission finds that our statutory authority includes the authority to make modifications supported by the evidence in the record in this case. 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.

Accordingly, upon consideration of the application in this case and the provisions of Section 4928.143(C)(1), Revised Code, the Commission finds that the ESP, including its pricing and all other terms and conditions, including deferrals and future recovery of deferrals, as modified by this order, is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142, Revised Code.

IX. CONCLUSION

The Commission believes that it is essential that the plan we approve be one that provides rate stability for the Companies, provides future revenue certainty for the Companies, and affords rate predictability for the customers. Upon consideration of the application in this case and the provisions of Section 4928.143(C)(1), Revised Code, the Commission finds that the ESP, including its pricing and all other terms and conditions, including deferrals and future recovery of deferrals, as modified by this order, is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142, Revised Code. Therefore, the Commission finds that the proposed three-year ESP should be approved with the modifications set forth in this order. To the extent that intervenors have proposed modifications to the Companies' ESP that have not been addressed by this opinion and order, the Commission concludes that the requests for such modifications are denied.

Furthermore, the Commission finds that the Companies' should file revised tariffs consistent with this order, to be effective with bills rendered January 1, 2009. In light of the timing of the effective date of the tariffs, the Commission finds that the revised tariffs shall be approved upon filing, effective January 1, 2009, as set forth herein, and contingent upon final review by the Commission.

43 OEG Br. at 3.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

(1) CSP and OP are public utilities as defined in Section 4905.02, Revised Code, and, as such, the companies are subject to the jurisdiction of this Commission.

(2) On July 31, 2008, CSP and OP filed applications for an SSO in accordance with Section 4928.141, Revised Code.

(3) On August 19, 2008, a technical conference was held regarding AEP-Ohio's applications and on November 10, 2008, a prehearing conference was held in these matters.

(4) On September 19, 2008, and October 29, 2008, intervention was granted to: OEG; OCC; Kroger; OEC; IEU-Ohio; OPAE; APAC; OHA; Constellation; Dominion; NRDC; Sierra; NEMA; Integrys; Direct Energy; OMA; OFBF; Wind Energy; OASBO/OSBA/BASA; Ormet; Consumer Powerline; Morgan Stanley Capital Group Inc.; Commercial Group; EnerNoc, Inc.; and AICUO.

(5) The hearing in these proceedings commenced on November 17, 2008, and concluded on December 10, 2008. Eleven witnesses testified on behalf of AEP-Ohio, 22 witnesses testified on behalf of various intervenors, and 10 witnesses testified on behalf of the Commission Staff.

(6) Five local hearings were held in these matters at which a total of 124 witnesses testified.

(7) Briefs and reply briefs were filed on December 30, 2008, and January 14, 2009, respectively.

(8) AEP-Ohio's applications were filed pursuant to Section 4928.143, Revised Code, which authorizes the electric utilities to file an ESP as their SSO.

(9) The proposed ESP, as modified by this opinion and order, including its pricing and all other terms and conditions, including deferrals and future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142, Revised Code.

ORDER:

It is, therefore,

ORDERED, That the Companies' application for approval of an ESP, pursuant to Sections 4928.141 and 4928.143, Revised Code, be modified and approved, to the extent set forth herein. It is, further,

ORDERED, That the Companies file their revised tariffs consistent with this opinion and order and that the revised tariffs be approved effective January 1, 2009, on a bills-rendered basis, contingent upon final review and approval by the Commission. It is further,

ORDERED, That each company is authorized to file in final form four complete, printed copies of its tariffs consistent with this opinion and order, and to cancel and withdraw its superseded tariffs. The Companies shall file one copy in this case docket and one copy in each Company's TRF docket (or may make such filing electronically, as directed in Case No. 06-900-AU-WVR). The remaining two copies shall be designated for distribution to Staff. It is, further,

ORDERED, That the Companies notify all affected customers of the changes to the tariff via bill message or bill insert within 45 days of the effective date of the tariffs. A copy of this customer notice shall be submitted to the Commission's Service Monitoring and Enforcement Department, Reliability and Service Analysis Division at least 10 days prior to its distribution to customers. It is, further, ORDERED, That a copy of this opinion and order be served on 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

KWB/GNS:vrm/ct

Entered in the Journal
MAR 1 8 2009

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

CONCURRING OPINION OF CHAIRMAN ALAN R. SCHRIBER

AND COMMISSIONER PAUL A. CENTOLELLA

We agree with the Commission's decision and write this concurring opinion to express additional rationales supporting the Commission's decision in two areas.

gridSMART Rider

The Order sets the initial amount to be recovered through the gridSMART rider based on the availability of federal matching funds for smart grid demonstrations and deployments under the American Recovery and Reinvestment Act of 2009. AEP-Ohio should promptly take the necessary steps to apply for available federal funding. Additionally, AEP-Ohio should work with staff and the collaborative established under the Order to refine its Phase 1 plan and initiate deployments in a timely and reasonable manner.

The foundation of a smart grid is an open-architecture communications system which, first, provides a common platform for implementing distribution automation, advanced metering, time-differentiated and dynamic pricing, home area networks, and other applications and, second, integrates these applications with existing systems to improve reliability, reduce costs, and enable consumers to better control their electric bills.

These capabilities can provide significant consumer and societal benefits. In the near term, participating consumers will have new capabilities for managing their energy usage to take advantage of lower power costs and reduce their electric bills. AEP-Ohio will be able to provide consumers feedback regarding their electric usage patterns and improved customer service. And, the combination of distribution automation and advanced metering should enable AEP-Ohio to rapidly locate damaged and degraded distribution equipment, reduce outages, and minimize the duration of any service interruptions. We expect that consumers will experience a material improvement in service and reliability.

SB 221 made it state policy to encourage time-differentiated pricing, implementation of advanced metering infrastructure, development of performance standards and targets for service quality for all consumers, and implementation of distributed generation. Section 4928.02 of the Revised Code. The Commission's Order advances these policies.

AEP-Ohio and its customers are likely to face significant challenges over the next decade from rising costs, requirements for improved reliability, and environmental constraints. Our Order will enable AEP-Ohio to take a first step in developing a modern grid capable of providing affordable, reliable, and environmentally sustainable electric service into the future.

PJM Demand Response Program

First, we wish to emphasize that the Commission supports demand response initiatives.

Second, it is essential that consumers benefit from demand response in terms of a reduction in the capacity for which AEP-Ohio customers are responsible. We encourage AEP-Ohio to work with PJM, the Commission, and interested stakeholders to ensure that predictable consumer demand response is recognized as a reduction in capacity that it must carry under PJM market rules.

Finally, consumers should have the opportunity to see and respond to changes in the cost of the power that they use. While an ESP may set the overall level of prices, consumers should have additional opportunities to benefit by reducing consumption when wholesale power prices are high. We would encourage the companies to work with staff to develop additional dynamic pricing options for commercial and industrial SSO customers who have the interval metering needed to support such rates. Such options should enable eligible consumers to directly manage risk and optimize their energy usage.

Alan R. Schriber

Paul A. Centolella

4905.03 Public utility company definitions.

As used in this chapter:

(A) Any person, firm, copartnership, voluntary association, joint-stock association, company, or corporation, wherever organized or incorporated, is:

(1)

A telephone company, when engaged in the business of transmitting telephonic messages to, from, through, or in this state ;

(2) A motor transportation company, when engaged in the business of carrying and transporting persons or property or the business of providing or furnishing such transportation service, for hire, in or by motor-propelled vehicles of any kind, including trailers, for the public in general, over any public street, road, or highway in this state, except as provided in section 4921.02 of the Revised Code;

(3) An electric light company, when engaged in the business of supplying electricity for light, heat, or power purposes to consumers within this state, including supplying electric transmission service for electricity delivered to consumers in this state, but excluding a regional transmission organization approved by the federal energy regulatory commission;

(4) A gas company, when engaged in the business of supplying artificial gas for lighting, power, or heating purposes to consumers within this state or when engaged in the business of supplying artificial gas to gas companies or to natural gas companies within this state, but a producer engaged in supplying to one or more gas or natural gas companies, only such artificial gas as is manufactured by that producer as a by-product of some other process in which the producer is primarily engaged within this state is not thereby a gas company. All rates, rentals, tolls, schedules, charges of any kind, or agreements between any gas company and any other gas company or any natural gas company providing for the supplying of artificial gas and for compensation for the same are subject to the jurisdiction of the public utilities commission.

(5) A natural gas company, when engaged in the business of supplying natural gas for lighting, power, or heating purposes to consumers within this state. Notwithstanding the above, neither the delivery nor sale of Ohio-produced natural gas by a producer or gatherer under a public utilities commission-ordered exemption, adopted before, as to producers, or after, as to producers or gatherers, January 1, 1996, or the delivery or sale of Ohio-produced natural gas by a producer or gatherer of Ohio-produced natural gas, either to a lessor under an oil and gas lease of the land on which the producer's drilling unit is located, or the grantor incident to a right-of-way or easement to the producer or gatherer, shall cause the producer or gatherer to be a natural gas company for the purposes of this section.

All rates, rentals, tolls, schedules, charges of any kind, or agreements between a natural gas company and other natural gas companies or gas companies providing for the supply of natural gas and for compensation for the same are subject to the jurisdiction of the public utilities commission. The commission, upon application made to it, may relieve any producer or gatherer of natural gas, defined in this section as a gas company or a natural gas company, of compliance with the obligations imposed by this chapter and Chapters 4901., 4903., 4907., 4909., 4921., and 4923. of the Revised Code, so long as the producer or gatherer is not affiliated with or under the control of a gas company or a natural gas company engaged in the transportation or distribution of natural gas, or so long as the producer or gatherer does not engage in the distribution of natural gas to consumers.

Nothing in division (A)(5) of this section limits the authority of the commission to enforce sections 4905.90 to 4905.96 of the Revised Code.

(6) A pipe-line company, when engaged in the business of transporting natural gas, oil, or coal or its derivatives through pipes or tubing, either wholly or partly within this state;

(7) A water-works company, when engaged in the business of supplying water through pipes or tubing, or in a similar manner, to consumers within this state;

(8) A heating or cooling company, when engaged in the business of supplying water, steam, or air through pipes or tubing to consumers within this state for heating or cooling purposes;

(9) A messenger company, when engaged in the business of supplying messengers for any purpose;

(10) A street railway company, when engaged in the business of operating as a common carrier, a railway, wholly or partly within this state, with one or more tracks upon, along, above, or below any public road, street, alleyway, or ground, within any municipal corporation, operated by any motive power other than steam and not a part of an interurban railroad, whether the railway is termed street, inclined-plane, elevated, or underground railway;

(11) A suburban railroad company, when engaged in the business of operating as a common carrier, whether wholly or partially within this state, a part of a street railway constructed or extended beyond the limits of a municipal corporation, and not a part of an interurban railroad;

(12) An interurban railroad company, when engaged in the business of operating a railroad, wholly or partially within this state, with one or more tracks from one municipal corporation or point in this state to another municipal corporation or point in this state, whether constructed upon the public highways or upon private rights-of-way, outside of municipal corporations, using electricity or other motive power than steam power for the transportation of passengers, packages, express matter, United States mail, baggage, and freight. Such an interurban railroad company is included in the term "railroad" as used in section 4907.02 of the Revised Code.

(13) A sewage disposal system company, when engaged in the business of sewage disposal services through pipes or tubing, and treatment works, or in a similar manner, within this state.

(B) "Motor-propelled vehicle" means any automobile, automobile truck, motor bus, or any other self-propelled vehicle not operated or driven upon fixed rails or tracks.

Amended by 128th General Assembly File No. 43, SB 162, § 1, eff. 9/13/2010.

Effective Date: 01-01-2001

4928.01 Competitive retail electric service definitions.

(A) As used in this chapter:

(1) "Ancillary service" means any function necessary to the provision of electric transmission or distribution service to a retail customer and includes, but is not limited to, scheduling, system control, and dispatch services; reactive supply from generation resources and voltage control service; reactive supply from transmission resources service; regulation service; frequency response service; energy imbalance service; operating reserve-spinning reserve service; operating reserve-supplemental reserve service; load following; back-up supply service; real-power loss replacement service; dynamic scheduling; system black start capability; and network stability service.

(2) "Billing and collection agent" means a fully independent agent, not affiliated with or otherwise controlled by an electric utility, electric services company, electric cooperative, or governmental aggregator subject to certification under section 4928.08 of the Revised Code, to the extent that the agent is under contract with such utility, company, cooperative, or aggregator solely to provide billing and collection for retail electric service on behalf of the utility company, cooperative, or aggregator.

(3) "Certified territory" means the certified territory established for an electric supplier under sections 4933.81 to 4933.90 of the Revised Code.

(4) "Competitive retail electric service" means a component of retail electric service that is competitive as provided under division (B) of this section.

(5) "Electric cooperative" means a not-for-profit electric light company that both is or has been financed in whole or in part under the "Rural Electrification Act of 1936," 49 Stat. 1363, 7 U.S.C. 901, and owns or operates facilities in this state to generate, transmit, or distribute electricity, or a not-for-profit successor of such company.

(6) "Electric distribution utility" means an electric utility that supplies at least retail electric distribution service.

(7) "Electric light company" has the same meaning as in section 4905.03 of the Revised Code and includes an electric services company, but excludes any self-generator to the extent that it consumes electricity it so produces, sells that electricity for resale, or obtains electricity from a generating facility it hosts on its premises.

(8) "Electric load center" has the same meaning as in section 4933.81 of the Revised Code.

(9) "Electric services company" means an electric light company that is engaged on a for-profit or not-for-profit basis in the business of supplying or arranging for the supply of only a competitive retail electric service in this state. "Electric services company" includes a power marketer, power broker, aggregator, or independent power producer but excludes an electric cooperative, municipal electric utility, governmental aggregator, or billing and collection agent.

(10) "Electric supplier" has the same meaning as in section 4933.81 of the Revised Code.

(11) "Electric utility" means an electric light company that has a certified territory and is engaged on a for-profit basis either in the business of supplying a noncompetitive retail electric service in this state or in the businesses of supplying both a noncompetitive and a competitive retail electric service in this state. "Electric utility" excludes a municipal electric utility or a billing and collection agent.

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(12) "Firm electric service" means electric service other than nonfirm electric service.

(13) "Governmental aggregator" means a legislative authority of a municipal corporation, a board of township trustees, or a board of county commissioners acting as an aggregator for the provision of a competitive retail electric service under authority conferred under section 4928.20 of the Revised Code.

(14) A person acts "knowingly," regardless of the person's purpose, when the person is aware that the person's conduct will probably cause a certain result or will probably be of a certain nature. A person has knowledge of circumstances when the person is aware that such circumstances probably exist.

(15) "Level of funding for low-income customer energy efficiency programs provided through electric utility rates" means the level of funds specifically included in an electric utility's rates on October 5, 1999, pursuant to an order of the public utilities commission issued under Chapter 4905. or 4909. of the Revised Code and in effect on October 4, 1999, for the purpose of improving the energy efficiency of housing for the utility's low-income customers. The term excludes the level of any such funds committed to a specific nonprofit organization or organizations pursuant to a stipulation or contract.

(16) "Low-income customer assistance programs" means the percentage of income payment plan program, the home energy assistance program, the home weatherization assistance program, and the targeted energy efficiency and weatherization program.

(17) "Market development period" for an electric utility means the period of time beginning on the starting date of competitive retail electric service and ending on the applicable date for that utility as specified in section 4928.40 of the Revised Code, irrespective of whether the utility applies to receive transition revenues under this chapter.

(18) "Market power" means the ability to impose on customers a sustained price for a product or service above the price that would prevail in a competitive market.

(19) "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.

(20) "Municipal electric utility" means a municipal corporation that owns or operates facilities to generate, transmit, or distribute electricity.

(21) "Noncompetitive retail electric service" means a component of retail electric service that is noncompetitive as provided under division (B) of this section.

(22) "Nonfirm electric service" means electric service provided pursuant to a schedule filed under section 4905.30 of the Revised Code or pursuant to an arrangement under section 4905.31 of the Revised Code, which schedule or arrangement includes conditions that may require the customer to curtail or interrupt electric usage during nonemergency circumstances upon notification by an electric utility.

(23) "Percentage of income payment plan arrears" means funds eligible for collection through the percentage of income payment plan rider, but uncollected as of July 1, 2000.

(24) "Person" has the same meaning as in section 1.59 of the Revised Code.

(25) "Advanced energy project" means any technologies, products, activities, or management practices or strategies that facilitate the generation or use of electricity or energy and that reduce or support the reduction of energy consumption or support the production of clean, renewable energy for industrial, distribution, commercial, institutional, governmental, research, not-for-profit, or residential energy users, including, but not limited to, advanced energy resources and renewable energy resources. "Advanced energy project" also includes any project described in division (A), (B), or (C) of section 4928.621 of the Revised Code.

(26) "Regulatory assets" means the unamortized net regulatory assets that are capitalized or deferred on the regulatory books of the electric utility, pursuant to an order or practice of the public utilities commission or pursuant to generally accepted accounting principles as a result of a prior commission rate-making decision, and that would otherwise have been charged to expense as incurred or would not have been capitalized or otherwise deferred for future regulatory consideration absent commission action. "Regulatory assets" includes, but is not limited to, all deferred demand-side management costs; all deferred percentage of income payment plan arrears; post-in-service capitalized charges and assets recognized in connection with statement of financial accounting standards no. 109 (receivables from customers for income taxes); future nuclear decommissioning costs and fuel disposal costs as those costs have been determined by the commission in the electric utility's most recent rate or accounting application proceeding addressing such costs; the undepreciated costs of safety and radiation control equipment on nuclear generating plants owned or leased by an electric utility; and fuel costs currently deferred pursuant to the terms of one or more settlement agreements approved by the commission.

(27) "Retail electric service" means any service involved in supplying or arranging for the supply of electricity to ultimate consumers in this state, from the point of generation to the point of consumption. For the purposes of this chapter, retail electric service includes one or more of the following "service components" : generation service, aggregation service, power marketing service, power brokerage service, transmission service, distribution service, ancillary service, metering service, and billing and collection service.

(28) "Starting date of competitive retail electric service" means January 1, 2001.

(29) "Customer-generator" means a user of a net metering system.

(30) "Net metering" means measuring the difference in an applicable billing period between the electricity supplied by an electric service provider and the electricity generated by a customer-generator that is fed back to the electric service provider.

(31) "Net metering system" means a facility for the production of electrical energy that does all of the following:

(a) Uses as its fuel either solar, wind, biomass, landfill gas, or hydropower, or uses a microturbine or a fuel cell;

(b) Is located on a customer-generator's premises;

(c) Operates in parallel with the electric utility's transmission and distribution facilities;

(d) Is intended primarily to offset part or all of the customer-generator's requirements for electricity.

(32) "Self-generator" means an entity in this state that owns or hosts on its premises an electric generation facility that produces electricity primarily for the owner's consumption and that may provide any such excess electricity to another entity, whether the facility is installed or operated by the owner or by an agent under a contract.

(33) "Rate plan" means the standard service offer in effect on the effective date of the amendment of this section by S.B. 221 of the 127th general assembly, July 31, 2008.

(34) "Advanced energy resource" means any of the following:

(a) Any method or any modification or replacement of any property, process, device, structure, or equipment that increases the generation output of an electric generating facility to the extent such efficiency is achieved without additional carbon dioxide emissions by that facility;

(b) Any distributed generation system consisting of customer cogeneration of electricity and thermal output simultaneously;

(c) Clean coal technology that includes a carbon-based product that is chemically altered before combustion to demonstrate a reduction, as expressed as ash, in emissions of nitrous oxide, mercury, arsenic, chlorine, sulfur dioxide, or sulfur trioxide in accordance with the American society of testing and materials standard D1757A or a reduction of metal oxide emissions in accordance with standard D5142 of that society, or clean coal technology that includes the design capability to control or prevent the emission of carbon dioxide, which design capability the commission shall adopt by rule and shall be based on economically feasible best available technology or, in the absence of a determined best available technology, shall be of the highest level of economically feasible design capability for which there exists generally accepted scientific opinion;

(d) Advanced nuclear energy technology consisting of generation III technology as defined by the nuclear regulatory commission; other, later technology; or significant improvements to existing facilities;

(e) Any fuel cell used in the generation of electricity, including, but not limited to, a proton exchange membrane fuel cell, phosphoric acid fuel cell, molten carbonate fuel cell, or solid oxide fuel cell;

(f) Advanced solid waste or construction and demolition debris conversion technology, including, but not limited to, advanced stoker technology, and advanced fluidized bed gasification technology, that results in measurable greenhouse gas emissions reductions as calculated pursuant to the United States environmental protection agency's waste reduction model (WARM).

(g) Demand-side management and any energy efficiency improvement.

(35) "Renewable energy resource" means solar photovoltaic or solar thermal energy, wind energy, power produced by a hydroelectric facility, geothermal energy, fuel derived from solid wastes, as defined in section 3734.01 of the Revised Code, through fractionation, biological decomposition, or other process that does not principally involve combustion, biomass energy, biologically derived methane gas, or energy derived from nontreated by-products of the pulping process or wood manufacturing process, including bark, wood chips, sawdust, and lignin in spent pulping liquors. "Renewable energy resource" includes, but is not limited to, any fuel cell used in the generation of electricity, including, but not limited to, a proton exchange membrane fuel cell, phosphoric acid fuel cell, molten carbonate fuel cell, or solid oxide fuel cell; wind turbine located in the state's territorial

waters of Lake Erie; methane gas emitted from an abandoned coal mine; storage facility that will promote the better utilization of a renewable energy resource that primarily generates off peak; or distributed generation system used by a customer to generate electricity from any such energy. As used in division (A)(35) of this section, "hydroelectric facility" means a hydroelectric generating facility that is located at a dam on a river, or on any water discharged to a river, that is within or bordering this state or within or bordering an adjoining state and meets all of the following standards:

(a) The facility provides for river flows that are not detrimental for fish, wildlife, and water quality, including seasonal flow fluctuations as defined by the applicable licensing agency for the facility.

(b) The facility demonstrates that it complies with the water quality standards of this state, which compliance may consist of certification under Section 401 of the "Clean Water Act of 1977," 91 Stat. 1598, 1599, 33 U.S.C. 1341, and demonstrates that it has not contributed to a finding by this state that the river has impaired water quality under Section 303(d) of the "Clean Water Act of 1977," 114 Stat. 870, 33 U.S.C. 1313.

(c) The facility complies with mandatory prescriptions regarding fish passage as required by the federal energy regulatory commission license issued for the project, regarding fish protection for riverine, anadromous, and catadromous fish.

(d) The facility complies with the recommendations of the Ohio environmental protection agency and with the terms of its federal energy regulatory commission license regarding watershed protection, mitigation, or enhancement, to the extent of each agency's respective jurisdiction over the facility.

(e) The facility complies with provisions of the "Endangered Species Act of 1973," 87 Stat. 884, 16 U.S.C. 1531 to 1544, as amended.

(f) The facility does not harm cultural resources of the area. This can be shown through compliance with the terms of its federal energy regulatory commission license or, if the facility is not regulated by that commission, through development of a plan approved by the Ohio historic preservation office, to the extent it has jurisdiction over the facility.

(g) The facility complies with the terms of its federal energy regulatory commission license or exemption that are related to recreational access, accommodation, and facilities or, if the facility is not regulated by that commission, the facility complies with similar requirements as are recommended by resource agencies, to the extent they have jurisdiction over the facility; and the facility provides access to water to the public without fee or charge.

(h) The facility is not recommended for removal by any federal agency or agency of any state, to the extent the particular agency has jurisdiction over the facility.

(B) For the purposes of this chapter, a retail electric service component shall be deemed a competitive retail electric service if the service component is competitive pursuant to a declaration by a provision of the Revised Code or pursuant to an order of the public utilities commission authorized under division (A) of section 4928.04 of the Revised Code. Otherwise, the service component shall be deemed a noncompetitive retail electric service.

Amended by 128th General Assembly File No. 47, SB 181, § 1, eff. 9/13/2010.

Amended by 128th General Assembly File No. 48, SB 232, § 1, eff. 6/17/2010.

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Amended by 128th General Assembly File No. 9, HB 1, § 101.01, eff. 10/16/2009.

Effective Date: 10-05-1999; 01-04-2007; 2008 SB221 07-31-2008

4928.141 Distribution utility to provide standard service offer.

(A) Beginning January 1, 2009, an electric distribution utility shall provide consumers, on a comparable and nondiscriminatory basis within its certified territory, a 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. To that end, the electric distribution utility shall apply to the public utilities commission to establish the standard service offer in accordance with section 4928.142 or 4928.143 of the Revised Code and, at its discretion, may apply simultaneously under both sections, except that the utility's first standard service offer application at minimum shall include a filing under section 4928.143 of the Revised Code. Only a standard service offer authorized in accordance with section 4928.142 or 4928.143 of the Revised Code, shall serve as the utility's standard service offer for the purpose of compliance with this section; and that standard service offer shall serve as the utility's default standard service offer for the purpose of section 4928.14 of the Revised Code. Notwithstanding the foregoing provision, the rate plan of an electric distribution utility shall continue for the purpose of the utility's compliance with this division until a standard service offer is first authorized under section 4928.142 or 4928.143 of the Revised Code, and, as applicable, pursuant to division (D) of section 4928.143 of the Revised Code, any rate plan that extends beyond December 31, 2008, shall continue to be in effect for the subject electric distribution utility for the duration of the plan's term. A standard service offer under section 4928.142 or 4928.143 of the Revised Code shall exclude any previously authorized allowances for transition costs, with such exclusion being effective on and after the date that the allowance is scheduled to end under the utility's rate plan.

(B) The commission shall set the time for hearing of a filing under section 4928.142 or 4928.143 of the Revised Code, send written notice of the hearing to the electric distribution utility, and publish notice in a newspaper of general circulation in each county in the utility's certified territory. The commission shall adopt rules regarding filings under those sections.

Effective Date: 2008 SB221 07-31-2008

4928.142 Standard generation service offer price - competitive bidding.

(A) For the purpose of complying with section 4928.141 of the Revised Code and subject to division (D) of this section and, as applicable, subject to the rate plan requirement of division (A) of section 4928.141 of the Revised Code, an electric distribution utility may establish a standard service offer price for retail electric generation service that is delivered to the utility under a market-rate offer.

(1) The market-rate offer shall be determined through a competitive bidding process that provides for all of the following:

(a) Open, fair, and transparent competitive solicitation;

(b) Clear product definition;

(c) Standardized bid evaluation criteria;

(d) Oversight by an independent third party that shall design the solicitation, administer the bidding, and ensure that the criteria specified in division (A)(1)(a) to (c) of this section are met;

(e) Evaluation of the submitted bids prior to the selection of the least-cost bid winner or winners. No generation supplier shall be prohibited from participating in the bidding process.

(2) The public utilities commission shall modify rules, or adopt new rules as necessary, concerning the conduct of the competitive bidding process and the qualifications of bidders, which rules shall foster supplier participation in the bidding process and shall be consistent with the requirements of division (A)(1) of this section.

(B) Prior to initiating a competitive bidding process for a market-rate offer under division (A) of this section, the electric distribution utility shall file an application with the commission. An electric distribution utility may file its application with the commission prior to the effective date of the commission rules required under division (A)(2) of this section, and, as the commission determines necessary, the utility shall immediately conform its filing to the rules upon their taking effect. An application under this division shall detail the electric distribution utility's proposed compliance with the requirements of division (A)(1) of this section and with commission rules under division (A)(2) of this section and demonstrate that all of the following requirements are met:

(1) The electric distribution utility or its transmission service affiliate belongs to at least one regional transmission organization that has been approved by the federal energy regulatory commission; or there otherwise is comparable and nondiscriminatory access to the electric transmission grid.

(2) Any such regional transmission organization has a market-monitor function and the ability to take actions to identify and mitigate market power or the electric distribution utility's market conduct; or a similar market monitoring function exists with commensurate ability to identify and monitor market conditions and mitigate conduct associated with the exercise of market power.

(3) A published source of information is available publicly or through subscription that identifies pricing information for traded electricity on- and off-peak energy products that are contracts for delivery beginning at least two years from the date of the publication and is updated on a regular basis. The commission shall initiate a proceeding and, within ninety days after the application's filing date, shall

determine by order whether the electric distribution utility and its market-rate offer meet all of the foregoing requirements. If the finding is positive, the electric distribution utility may initiate its competitive bidding process. If the finding is negative as to one or more requirements, the commission in the order shall direct the electric distribution utility regarding how any deficiency may be remedied in a timely manner to the commission's satisfaction; otherwise, the electric distribution utility shall withdraw the application. However, if such remedy is made and the subsequent finding is positive and also if the electric distribution utility made a simultaneous filing under this section and section 4928.143 of the Revised Code, the utility shall not initiate its competitive bid until at least one hundred fifty days after the filing date of those applications.

(C) Upon the completion of the competitive bidding process authorized by divisions (A) and (B) of this section, including for the purpose of division (D) of this section, the commission shall select the least-cost bid winner or winners of that process, and such selected bid or bids, as prescribed as retail rates by the commission, shall be the electric distribution utility's standard service offer unless the commission, by order issued before the third calendar day following the conclusion of the competitive bidding process for the market rate offer, determines that one or more of the following criteria were not met:

(1) Each portion of the bidding process was oversubscribed, such that the amount of supply bid upon was greater than the amount of the load bid out.

(2) There were four or more bidders.

(3) At least twenty-five per cent of the load is bid upon by one or more persons other than the electric distribution utility. All costs incurred by the electric distribution utility as a result of or related to the competitive bidding process or to procuring generation service to provide the standard service offer, including the costs of energy and capacity and the costs of all other products and services procured as a result of the competitive bidding process, shall be timely recovered through the standard service offer price, and, for that purpose, the commission shall approve a reconciliation mechanism, other recovery mechanism, or a combination of such mechanisms for the utility.

(D) The first application filed under this section by an electric distribution utility that, as of July 31, 2008, directly owns, in whole or in part, operating electric generating facilities that had been used and useful in this state shall require that a portion of that utility's standard service offer load for the first five years of the market rate offer be competitively bid under division (A) of this section as follows: ten per cent of the load in year one, not more than twenty per cent in year two, thirty per cent in year three, forty per cent in year four, and fifty per cent in year five. Consistent with those percentages, the commission shall determine the actual percentages for each year of years one through five. The standard service offer price for retail electric generation service under this first application shall be a proportionate blend of the bid price and the generation service price for the remaining standard service offer load, which latter price shall be equal to the electric distribution utility's most recent standard service offer price, adjusted upward or downward as the commission determines reasonable, relative to the jurisdictional portion of any known and measurable changes from the level of any one or more of the following costs as reflected in that most recent standard service offer price:

(1) The electric distribution utility's prudently incurred cost of fuel used to produce electricity;

(2) Its prudently incurred purchased power costs;

(3) Its prudently incurred costs of satisfying the supply and demand portfolio requirements of this state, including, but not limited to, renewable energy resource and energy efficiency requirements;

(4) Its costs prudently incurred to comply with environmental laws and regulations, with consideration of the derating of any facility associated with those costs. In making any adjustment to the most recent standard service offer price on the basis of costs described in division (D) of this section, the commission shall include the benefits that may become available to the electric distribution utility as a result of or in connection with the costs included in the adjustment, including, but not limited to, the utility's receipt of emissions credits or its receipt of tax benefits or of other benefits, and, accordingly, the commission may impose such conditions on the adjustment to ensure that any such benefits are properly aligned with the associated cost responsibility. The commission shall also determine how such adjustments will affect the electric distribution utility's return on common equity that may be achieved by those adjustments. The commission shall not apply its consideration of the return on common equity to reduce any adjustments authorized under this division unless the adjustments will cause the electric distribution utility to earn a return on common equity that is significantly in excess of the return on common equity that is earned by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate. The burden of proof for demonstrating that significantly excessive earnings will not occur shall be on the electric distribution utility. Additionally, the commission may adjust the electric distribution utility's most recent standard service offer price by such just and reasonable amount that the commission determines necessary to address any emergency that threatens the utility's financial integrity or to ensure that the resulting revenue available to the utility for providing the standard service offer is not so inadequate as to result, directly or indirectly, in a taking of property without compensation pursuant to Section 19 of Article I, Ohio Constitution. The electric distribution utility has the burden of demonstrating that any adjustment to its most recent standard service offer price is proper in accordance with this division.

(E) Beginning in the second year of a blended price under division (D) of this section and notwithstanding any other requirement of this section, the commission may alter prospectively the proportions specified in that division to mitigate any effect of an abrupt or significant change in the electric distribution utility's standard service offer price that would otherwise result in general or with respect to any rate group or rate schedule but for such alteration. Any such alteration shall be made not more often than annually, and the commission shall not, by altering those proportions and in any event, including because of the length of time, as authorized under division (C) of this section, taken to approve the market rate offer, cause the duration of the blending period to exceed ten years as counted from the effective date of the approved market rate offer. Additionally, any such alteration shall be limited to an alteration affecting the prospective proportions used during the blending period and shall not affect any blending proportion previously approved and applied by the commission under this division.

(F) An electric distribution utility that has received commission approval of its first application under division (C) of this section shall not, nor ever shall be authorized or required by the commission to, file an application under section 4928.143 of the Revised Code.

Effective Date: 2008 SB221 07-31-2008; 2008 HB562 09-22-2008

4928.143 Application for approval of electric security plan - testing.

(A) For the purpose of complying with section 4928.141 of the Revised Code, an electric distribution utility may file an application for public utilities commission approval of an electric security plan as prescribed under division (B) of this section. The utility may file that application prior to the effective date of any rules the commission may adopt for the purpose of this section, and, as the commission determines necessary, the utility immediately shall conform its filing to those rules upon their taking effect.

(B) Notwithstanding any other provision of Title XLIX of the Revised Code to the contrary except division (D) of this section, divisions (I), (J), and (K) of section 4928.20, division (E) of section 4928.64, and section 4928.69 of the Revised Code:

(1) An electric security plan shall include provisions relating to the supply and pricing of electric generation service. In addition, if the proposed electric security plan has a term longer than three years, it may include provisions in the plan to permit the commission to test the plan pursuant to division (E) of this section and any transitional conditions that should be adopted by the commission if the commission terminates the plan as authorized under that division.

(2) The plan may provide for or include, without limitation, any of the following:

(a) Automatic recovery of any of the following costs of the electric distribution utility, provided the cost is prudently incurred: the cost of fuel used to generate the electricity supplied under the offer; the cost of purchased power supplied under the offer, including the cost of energy and capacity, and including purchased power acquired from an affiliate; the cost of emission allowances; and the cost of federally mandated carbon or energy taxes;

(b) A reasonable allowance for construction work in progress for any of the electric distribution utility's cost of constructing an electric generating facility or for an environmental expenditure for any electric generating facility of the electric distribution utility, provided the cost is incurred or the expenditure occurs on or after January 1, 2009. Any such allowance shall be subject to the construction work in progress allowance limitations of division (A) of section 4909.15 of the Revised Code, except that the commission may authorize such an allowance upon the incurrence of the cost or occurrence of the expenditure. No such allowance for generating facility construction shall be authorized, however, unless the commission first determines in the proceeding that there is need for the facility based on resource planning projections submitted by the electric distribution utility. Further, no such allowance shall be authorized unless the facility's construction was sourced through a competitive bid process, regarding which process the commission may adopt rules. An allowance approved under division (B)(2)(b) of this section shall be established as a nonbypassable surcharge for the life of the facility.

(c) The establishment of a nonbypassable surcharge for the life of an electric generating facility that is owned or operated by the electric distribution utility, was sourced through a competitive bid process subject to any such rules as the commission adopts under division (B)(2)(b) of this section, and is newly used and useful on or after January 1, 2009, which surcharge shall cover all costs of the utility specified in the application, excluding costs recovered through a surcharge under division (B)(2)(b) of this section. However, no surcharge shall be authorized unless the commission first determines in the proceeding that there is need for the facility based on resource planning projections submitted by the electric distribution utility. Additionally, if a surcharge is authorized for a facility pursuant to plan approval under division (C) of this section and as a condition of the continuation of the surcharge, the electric distribution utility shall dedicate to Ohio consumers the capacity and energy and the rate associated with the cost of that facility. Before the commission authorizes any surcharge pursuant to this division, it may consider, as applicable, the effects of any decommissioning, deratings, and retirements.

(d) Terms, conditions, or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service, default service, carrying costs, amortization periods, and accounting or deferrals, including future recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service;

(e) Automatic increases or decreases in any component of the standard service offer price;

(f) Provisions for the electric distribution utility to securitize any phase-in, inclusive of carrying charges, of the utility's standard service offer price, which phase-in is authorized in accordance with section 4928.144 of the Revised Code; and provisions for the recovery of the utility's cost of securitization.

(g) Provisions relating to transmission, ancillary, congestion, or any related service required for the standard service offer, including provisions for the recovery of any cost of such service that the electric distribution utility incurs on or after that date pursuant to the standard service offer;

(h) Provisions regarding the utility's distribution service, including, without limitation and notwithstanding any provision of Title XLIX of the Revised Code to the contrary, provisions regarding single issue ratemaking, a revenue decoupling mechanism or any other incentive ratemaking, and provisions regarding distribution infrastructure and modernization incentives for the electric distribution utility. The latter may include a long-term energy delivery infrastructure modernization plan for that utility or any plan providing for the utility's recovery of costs, including lost revenue, shared savings, and avoided costs, and a just and reasonable rate of return on such infrastructure modernization. As part of its determination as to whether to allow in an electric distribution utility's electric security plan inclusion of any provision described in division (B)(2)(h) of this section, the commission shall examine the reliability of the electric distribution utility's distribution system and ensure that customers' and the electric distribution utility's expectations are aligned and that the electric distribution utility is placing sufficient emphasis on and dedicating sufficient resources to the reliability of its distribution system.

(i) Provisions under which the electric distribution utility may implement economic development, job retention, and energy efficiency programs, which provisions may allocate program costs across all classes of customers of the utility and those of electric distribution utilities in the same holding company system.

(C)(1) The burden of proof in the proceeding shall be on the electric distribution utility. The commission shall issue an order under this division for an initial application under this section not later than one hundred fifty days after the application's filing date and, for any subsequent application by the utility under this section, not later than two hundred seventy-five days after the application's filing date. Subject to division (D) of this section, the commission by order shall approve or modify and approve an application filed under division (A) of this section if it finds that the electric security plan so approved, including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under section 4928.142 of the Revised Code. Additionally, if the commission so approves an application that contains a surcharge under division (B)(2)(b) or (c) of this section, the commission shall ensure that the benefits derived for any purpose for which the surcharge is established are reserved and made available to those that bear the surcharge. Otherwise, the commission by order shall disapprove the application.

(2)(a) If the commission modifies and approves an application under division (C)(1) of this section, the electric distribution utility may withdraw the application, thereby terminating it, and may file a new standard service offer under this section or a standard service offer under section 4928.142 of the Revised Code.

(b) If the utility terminates an application pursuant to division (C)(2)(a) of this section or if the commission disapproves an application under division (C)(1) of this section, the commission shall issue such order as is necessary to continue the provisions, terms, and conditions of the utility's most recent standard service offer, along with any expected increases or decreases in fuel costs from those contained in that offer, until a subsequent offer is authorized pursuant to this section or section 4928.142 of the Revised Code, respectively.

(D) Regarding the rate plan requirement of division (A) of section 4928.141 of the Revised Code, if an electric distribution utility that has a rate plan that extends beyond December 31, 2008, files an application under this section for the purpose of its compliance with division (A) of section 4928.141 of the Revised Code, that rate plan and its terms and conditions are hereby incorporated into its proposed electric security plan and shall continue in effect until the date scheduled under the rate plan for its expiration, and that portion of the electric security plan shall not be subject to commission approval or disapproval under division (C) of this section, and the earnings test provided for in division (F) of this section shall not apply until after the expiration of the rate plan. However, that utility may include in its electric security plan under this section, and the commission may approve, modify and approve, or disapprove subject to division (C) of this section, provisions for the incremental recovery or the deferral of any costs that are not being recovered under the rate plan and that the utility incurs during that continuation period to comply with section 4928.141, division (B) of section 4928.64, or division (A) of section 4928.66 of the Revised Code.

(E) If an electric security plan approved under division (C) of this section, except one withdrawn by the utility as authorized under that division, has a term, exclusive of phase-ins or deferrals, that exceeds three years from the effective date of the plan, the commission shall test the plan in the fourth year, and if applicable, every fourth year thereafter, to determine whether the plan, including its then-existing pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, continues to be more favorable in the aggregate and during the remaining term of the plan as compared to the expected results that would otherwise apply under section 4928.142 of the Revised Code. The commission shall also determine the prospective effect of the electric security plan to determine if that effect is substantially likely to provide the electric distribution utility with a return on common equity that is significantly in excess of the return on common equity that is likely to be earned by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate. The burden of proof for demonstrating that significantly excessive earnings will not occur shall be on the electric distribution utility. If the test results are in the negative or the commission finds that continuation of the electric security plan will result in a return on equity that is significantly in excess of the return on common equity that is likely to be earned by publicly traded companies, including utilities, that will face comparable business and financial risk, with such adjustments for capital structure as may be appropriate, during the balance of the plan, the commission may terminate the electric security plan, but not until it shall have provided interested parties with notice and an opportunity to be heard. The commission may impose such conditions on the plan's termination as it considers reasonable and necessary to accommodate the transition from an approved plan to the more advantageous alternative. In the event of an electric security plan's termination pursuant to this division, the commission shall permit the continued deferral and phase-in of any amounts that occurred prior to that termination and the recovery of those amounts as contemplated under that electric security plan.

(F) With regard to the provisions that are included in an electric security plan under this section, the commission shall consider, following the end of each annual period of the plan, if any such adjustments resulted in excessive earnings as measured by whether the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate. Consideration also shall be given to the capital requirements of future committed investments in this state. The burden of proof for demonstrating that significantly excessive earnings did not occur shall be on the electric distribution utility. If the commission finds that such adjustments, in the aggregate, did result in significantly excessive earnings, it shall require the electric distribution utility to return to consumers the amount of the excess by prospective adjustments; provided that, upon making such prospective adjustments, the electric distribution utility shall have the right to terminate the plan and immediately file an application pursuant to section 4928.142 of the Revised Code. Upon termination of a plan under this division, rates shall be set on the same basis as specified in division (C)(2)(b) of this section, and the commission shall permit the continued deferral and phase-in of any amounts that occurred prior to that termination and the recovery of those amounts as contemplated under that electric security plan. In making its determination of significantly excessive earnings under this division, the commission shall not consider, directly or indirectly, the revenue, expenses, or earnings of any affiliate or parent company.

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4901:1-35-10 Annual review of electric security plan.

By May fifteenth of each year, the electric utility shall make a separate filing with the commission demonstrating whether or not any rate adjustments authorized by the commission as part of the electric utility's electric security plan resulted in significantly excessive earnings during the review period as measured by division (F) of section 4928.143 of the Revised Code. The process and timeframes for that proceeding shall be set by order of the commission, the legal director, or attorney examiner. The electric utility's filing shall include the information set forth in paragraph (C) of rule 4901:1-35-03 of the Administrative Code as it relates to excessive earnings.

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