ORIGINAL

In The
Supreme Court of Ohio

The Ohio Energy Group, Industrial Energy Users-Ohio,	:	Case No. 11-751
Appellants,	:	On appeal from the Public Utilities Commission of Ohio, Case No. 10-1261-EL-UNC, *In the Matter of the Annual 2009 Filing of Columbus Southern Power Company and Ohio Power Company Required by Rule 4901:2-35-10, Ohio Administrative Code.*
and	:	
Columbus Southern Power Company,	:	
Cross-Appellant,	:	
v.	:	
The Public Utilities Commission of Ohio,	:	
Appellee.	:	

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MERIT BRIEF
SUBMITTED ON BEHALF OF APPELLEE, THE PUBLIC UTILITIES COMMISSION OF OHIO

David F. Boehm (0021881)
Michael L. Kurtz (0033350)
Counsel of Record
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, OH 45202
513.421.2255 (telephone)
513.421.2764 (fax)
dboehm@bkllawfirm.com
mkurtz@bkllawfirm.cmo

Counsel for Appellant,
The Ohio Energy Group

Michael DeWine (0009181)
Ohio Attorney General

William L. Wright (0018010)
Section Chief

Thomas W. McNamee (0017352)
Counsel of Record
Assistant Attorney General
Public Utilities Section
180 East Broad Street, 6th Fl
Columbus, OH 43215-3793
614.466.4397 (telephone)
614.644.8764 (fax)
william.wright@puc.state.oh.us
thomas.mcnamee@puc.state.oh.us

Counsel for Appellee,
The Public Utilities Commission of Ohio

Samuel C. Randazzo (0016386)
Counsel of Record
Frank P. Darr (0025469)
Joseph E. Oliker (0086088)
McNees Wallace & Nurick
21 East State Street, 18th Floor
Columbus, OH 43215
614.469.8000 (telephone)
614.469.4653 (fax)
sam@mwncmh.com
fdarr@mwncmh.com
joliker@mwncmh.com

Counsel for Appellant,
Industrial Energy Users-Ohio

Steven T. Nourse (0046705)
Counsel of Record
American Electric Power Corporation
1 Riverside Plaza, 29th Floor
Columbus, OH 43215-2373
614.716.1608 (telephone)
614.716.2950 (fax)
stnourse@aep.com

Kathleen M. Trafford (0021753)
Daniel R. Conway (0023058)
Porter, Wright, Morris & Arthur
41 South High Street
Columbus, OH 43215
614.227.1915 (telephone)
614.227.1000 (fax)
ktrafford@porterwright.com
dconway@porterwright.com

Counsel for Cross-Appellant,
Columbus Southern Power Company

Janine L. Migden-Ostrander (0002310)
Consumers' Counsel
Maureen R. Grady (0020847)
Counsel of Record
Melissa R. Yost (0070914)
Kyle L. Verrett (0084199)
Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, OH 43215-3485
614.466.9567 (telephone)
614.466.9475 (fax)
grady@occ.state.oh.us
yost@occ.state.oh.us
verrett@occ.state.oh.us

Counsel for Intervening Appellant,
Office of the Ohio Consumers' Counsel

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In The
Supreme Court of Ohio

The Ohio Energy Group, **Industrial Energy Users-Ohio,** Appellants, and **Columbus Southern Power Company,** Cross-Appellant, v. **The Public Utilities Commission of Ohio,** Appellee.	: : : : : : : : : : : : : : : : :	Case No. 11-751 On appeal from the Public Utilities Commission of Ohio, Case No. 10-1261-EL-UNC, *In the Matter of the Annual 2009 Filing of Columbus Southern Power Company and Ohio Power Company Required by Rule 4901:2-35-10, Ohio Administrative Code.*

MERIT BRIEF
SUBMITTED ON BEHALF OF APPELLEE,
THE PUBLIC UTILITIES COMMISSION OF OHIO

INTRODUCTION

The standard service offer of all electric utilities in Ohio is set through Electric Security Plans (ESPs). These plans are complicated and can last for years. To assure the public that these plans are not setting prices that are too high, the General Assembly requires the Public Utilities Commission (Commission) to perform a "significantly excessive earnings test" (SEET) each year. This analysis assures that a utility's plan does not result in earnings significantly higher than those of similar companies. The statute creates a straight-forward, three-step process for accomplishing this. The Commission implemented that process, determined that the Columbus Southern Power Company (CSP) had significantly excessive earnings, and ordered customers to be credited with over $42,000,000. The public has been protected in just the way that the General Assembly intended.

The three appellants herein present two alternative scenarios for a SEET[1] that might have been. They describe, and show the consequences of, SEET structures that the General Assembly might have created. Whether these alternatives would have been wise or foolish is of no moment because they are not the SEET actually created by the General Assembly. The Appellants objections to the Commission orders should be directed to the General Assembly. The Commission properly implemented the law as it is and its orders should be affirmed.

STATEMENT OF THE FACTS AND CASE

Three years ago the General Assembly passed, and the Governor signed, S.B. 221. This was a legislative effort to further the goal of restructuring the nature of electric regulation in Ohio begun in 1999. S.B. 221 established two mechanisms under which the standard service (that is to say the default service provided to those customers who do not take their electricity supply from a competitive supplier) could be established. One mechanism would have the rate for this standard service set through a competitive bid-

1 Appellants have chosen not to pursue some arguments presented in the notices of appeal. As a result, this brief addresses only those arguments made in Appellants' briefs.

ding process and was termed a market rate offer (MRO). Ohio Rev. Code Ann. § 4928.142 (West 2011), App. at 13-16.[2] The other mechanism, termed an electric security plan (ESP), set rates through a negotiated process and allowed other issues, new plant construction, distribution service, economic development and energy efficiency among others, to be addressed. Ohio Rev. Code Ann. § 4928.143 (West 2011), App. at 17-21. All electric distribution utilities (EDU's) had to file an application under one or the other of these sections. Both of American Electric Power Company's (AEP's) affiliated utilities in Ohio, OP and CSP submitted applications seeking approval of ESPs. These plans were approved by the Commission in March of 2009.

The ESP's created under S.B. 221 are subject to two different *ex post facto* reviews. If a plan extends for more than three years, the ESP must be reviewed in the fourth year, and every four years thereafter, to assure that the statutory criterion under which the ESP was originally approved still holds. Ohio Rev. Code Ann. § 4928.143(E) (West 2011), App. at 20. It is the other review that is involved in this case. Every year the ESP must be reviewed to determine if the adjustments to rates that were made 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..." Ohio Rev. Code

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2 References to appellee's attached appendix are denoted "App. at ____;" references to the appendix of appellant Ohio Energy Group are denoted "OEG App. at ___;" references to the appendix of appellant Industrial Energy Users-Ohio are denoted "IEU App. at ___;" references to the supplement of Industrial Energy Users-Ohio are denoted "IEU Supp. at ___."

Ann. § 4928.143(F) (West 2011), App. at 21. In an effort to smooth the implementation of this novel provision the Commission has issued rules and held a proceeding to provide guidance to EDUs and ratepayers. Ohio Admin. Code § 4901:1-35 (West 2011), App. at 23-40; *In the Matter of the Investigation in the Development of the Significantly Excessive Earnings Test Pursuant to S.B. 221 for Electric Distribution Utilities*, PUCO Case No. 09-786-EL-UNC (Finding and Order) (June 30, 2010), App. at 41-73.

AEP filed an application for approval of ESPs for its CSP and OP affiliates on September 1, 2010. Hearing was held and the testimony of six witnesses was taken on direct examination. Two witnesses took the stand a second time in rebuttal. *In the Matter of the Annual 2009 Filing of Columbus Southern Power Company and Ohio Power Company Required by Rule 4901:2-35-10, Ohio Administrative Code*, Case No. 10-1261-EL-UNC (hereinafter *In re AEP*) (Opinion and Order at 3) (January 11, 2011), OEG App. at 11, IEU App. at 36. Appellant Industrial Energy Users did not present a witness on either direct or rebuttal. Applying the statute as written, the Commission found that OP did not have significantly excessive earnings but that CSP did. The Commission reduced the significantly excessive earnings of CSP to eliminate the effect of the only non-ESP effect supported by the record, off system sales, as required by statute. It directed the net amount to be credited to the benefit of customers first by the elimination of deferrals carried by CSP and then by direct bill credits.

Applications for rehearing were submitted by OEG, OCC, IEU, and AEP. Rehearing was denied by entry on March 9, 2011 and these appeals ensued.

ARGUMENT

Proposition of Law No. I:

> **When the Public Utilities Commission determines: (1) "excessive returns" by the difference between the earned return of the electric distribution utility and companies comparable to it; (2) "significantly excessive returns" as those exceeding a band ("safe harbor") above the earned returns of the comparable group determined with reference to myriad factors; and (3) adjusts the level of any significantly excessive returns to eliminate the effects of matters unrelated to the electric security plan, the Public Utilities Commission has complied with the requirements of R.C. 4928.143(F).**

In its revamp of electric industry regulation, the General Assembly established an annual review to assure that utility earnings under electric security plans (ESPs) would not be "significantly excessive." The statutory requirement, *in toto*, is:

> (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.

Ohio Rev. Code Ann. § 4928.143(F) (West 2011), App. at 21. Although the section is long, its requirements are rather simple. The Commission must do three things. First it needs to determine what level of earnings is "excessive". Second it must decide how high the excessive earnings must be to be considered "significantly excessive". Finally the Commission must eliminate from the significantly excessive earnings the portion that the electric distribution utility (EDU), which bears the burden of proof, has shown not to be tied to the ESP that is being reviewed. The end result of these steps is the amount of significantly excessive earnings arising from the ESP which must be returned to ratepayers. The statute is clearly discretionary and, as this Court has noted, "{d]iscretionary decisions receive deferential review." *In re Application of Columbus S. Power Co.,* Slip Opinion No. 2011-Ohio-4129, quoting *Consumers' Counsel v. Pub. Util. Comm'n*, 117 Ohio St. 3d 289, 2008-Ohio-860, 883 N.E.2d 1025, ¶ 10 (2008).

The Commission applied the statutory test reasonably as will be shown in the following sections.

A. Defining "Excessive"

The statute requires that excessive earnings be ". . . 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. . . ." Ohio Rev. Code Ann. § 4928.143(F) (West 2011), App. at 21. To accomplish this task two things are needed. The Commission must determine the earned return on common equity of the EDU in question and it must find the earned return on of a comparable group of companies. To the extent that the EDU's earnings are above the range of those of the comparable group, the returns are "excessive" within the meaning of the statute.

The earned return for the comparable group is, perhaps surprisingly, not controversial. The evidence in the case produced estimates that only ranged between approximately 9.6 and 11%. *In In re AEP* (Opinion and Order at 22) (January 11, 2011), OEG App. at 30, IEU App. at 55. Given the nature of the subject matter, this is a significant agreement. The Commission considered the various arguments presented in determining that those of the EDU and the Commission's own Staff were persuasive and found, as a factual matter, that 11% was the earned return for the comparable group.

Calculating the earned return for the EDU should not be a controversial matter either, but it is the crux of appellant IEU's argument in this case. AEP presented a perfectly sensible calculation of the earned returns achieved by OP (10.81%) and CSP (20.84%). *Id.* at 21-22, OEG App. at 29-30, IEU App. at 54-55. All parties to the case, except IEU, agreed with the calculation. *Id.* at 22, OEG App. at 30, IEU App. at 55. As OP's earnings were below those of the comparable group, its returns were not "excessive" and, therefore, could not be "significantly excessive" within the meaning of that statute. The examination needed only proceed for CSP. This analysis will be discussed in the next subheading.

Appellant IEU simply takes a different view of the calculation. Its view is not based in law. IEU believes that it is necessary for the earned return to be based not on the EDU's actual earnings; but rather only on the portion of earnings derived from jurisdictional activities, in the parlance of utility regulation, the earnings should have been "jurisdictionalized."[3] While this might have been an interesting way for the General Assembly to have defined this test, it did not do so. In fact it did quite the opposite. The statute seeks to measure the ". . . earned return on common equity of the electric distribution utility. . . ." Ohio Rev. Code Ann. § 4928.143(F) (West 2011), App. at 21. "Electric Distribution Utility" is a defined term. Specifically it is "...an *electric utility* that supplies at least retail electric distribution service." Ohio Rev. Code Ann. § 4928.01(A)(6) (West 2011), App. at 7 (emphasis added). Thus it is clear that an EDU can supply more than just distribution service. No limitation on other lines of business is given. The definition of electric utility shows that the EDU can supply both competitive and non-competitive services, specifically an electric utility is 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." Ohio Rev. Code

3 Interestingly while IEU argues that the Commission did not remove enough from CSP's earnings, Ohio Energy Group and the Consumers Counsel argue just the opposite, that the Commission removed too much.

Ann. § 4928.01(A)(11) (West 2011), App. at 8. An electric light company is defined, without any limitation at all, specifically as:

> (A) Any person, firm, copartnership, voluntary association, joint-stock association, company, or corporation, wherever organized or incorporated, is:
>
> * * *
>
> (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.

Ohio Rev. Code Ann. § 4905.03(A)(3) (West 2011), App. at 1. There is nothing in these definitions that limits an EDU to functioning in only its role as an EDU. They can and do act in other lines of business. The definitions recognize this; and when the General Assembly required a comparison between the "electric distribution utility" and comparable companies it meant "electric distribution utilities" as they are, no matter what lines of business that might entail.

The statutory comparison itself recognizes this. If the General Assembly had meant the analysis to be done based on solely regulated activities, the comparable group would have been regulated entities. The comparison then would have been regulated to regulated. The General Assembly did not do this; rather, it indicated that the comparable companies were to be ". . . publicly traded companies, *including utilities*, that face comparable business and financial risk . . . ." Ohio Rev. Code Ann. § 4928.143(F) (West 2011), App. at 21 (emphasis added). The statutory comparison is to companies with more than just state-regulated utility operations because the General Assembly recognized that the EDU's to be examined under the SEET test themselves have more than just state-regulated utility operations. The General Assembly required apples to apples, while Appellant IEU wants apples to oranges.

The Commission explained the situation quite clearly in its order saying:

> 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.

In re AEP (Opinion and Order at 13) (January 11, 2011), OEG App. at 21, IEU App. at 46.

Fundamentally, Appellant IEU wants to add a phrase to the statute. It wants to change the phrase ". . . the earned return on common equity of the electric distribution utility. . . ." as it appears in the statute, to "the earned return on common equity of the electric distribution utility from only its state-regulated activities." As has been shown previously, that is not what the statute provides. It is improper to read words into a statute to interpret it. *State v. Hughes*, 86 Ohio St. 3d 424, 427, 715 N.E. 2d 540 (1999). This is precisely what IEU asks this Court to do and the argument should be rejected.

The Commission did the first step of the statutory comparison correctly. It compared the actual returns of the OP and CSP to the actual returns of a group of publicly traded companies with comparable risk. Appellant IEU wants something different. It wants a comparison between the actual returns achieved by the comparable group and some sub-set of the returns actually achieved by the two utilities. The Commission was correct.

The return on equity of the comparable group was 11 percent. Ohio Power's return on equity was less than 11 percent and therefore the company did not have excessive earnings. Columbus Southern Power Company had return on equity higher than 11 percent and, therefore, had excessive earnings within the meaning of the statute. The Commission should be affirmed.

B. Defining "Significantly Excessive"

The second step of the SEET analysis is to determine how large excessive earnings must be to become "significantly excessive". In an earlier case, the Commission established a guideline (sometimes called a "safe harbor") of 200 basis points (2 percent) above the mean of the comparable group. *In re AEP* (Opinion and Order at 22) (January 11, 2011), OEG App. at 30, IEU App. at 55. In the case below, the Commission reconsidered this guideline. It was presented with arguments that the guideline should be either 200-400 basis points (OEG and OCC), or two standard deviations above the comparable group (AEP), or 50 percent of the comparable group mean (PUCO Staff). The Commission determined that it should alter its previous approach. It determined that a percentage-based method was most appropriate as it creates symmetry between the need to create a check on rates that result in excessive earnings and the obligation to ensure that a company can continue to operate successfully, maintaining financial integrity, attracting capital, and compensating investors for risks borne. *Id.* at 25, OEG App. at 33, IEU App. at 58.

The Staff presented a percentage-based method and was recognized as a reasonable starting point for this determination. It is reasonable to consider that "significance" is symmetric. This is to say that the distance above the average that is considered "significantly excessive" should be the same as the distance below the mean that is considered "significantly deficient." Staff's recommendation works in exactly this way. The Staff's recommendation, a 50 percent adder, when *subtracted* from the mean of the comparable group, yields a result of 5.5 percent, approximately the same as CSP's embedded cost of debt. *Id.* It would be undeniable that *a return on equity* at or below the *cost of debt* would be significantly deficient. Because that provides a measure of how far below the mean of the comparable group is significantly low, moving that far above the mean is a test of what is significantly excessive. Thus the percentage adjustment suggested by the Staff of the Commission was a reasonable starting point for setting the safe harbor.

Having determined that the 50 percent adder was a reasonable starting point for the safe harbor determination, the Commission turned to company-specific factors. This is necessary because the simple comparison between earnings does not fully capture the factors which impact whether earnings are significantly excessive. To this end, the Commission looked to a large number of factors including:

- business risks faced by CSP;
- capital outlay requirements;
- service reliability improvements;
- the most recent authorized rate of return for CSP (12.46 percent);
- CSP's commitments to innovation in the GridSmart program;
- CSP's commitments to furthering the state's energy policy by far exceeding requirements in energy efficiency and peak demand response; and
- CSP's capital commitment to development of an Ohio solar facility.

In re AEP (Opinion and Order at 25-27) (January 11, 2011), OEG App. at 33-35, IEU App. at 58-60. These factors, in the aggregate, warrant an adjustment of the 50 percent adder to 60 percent. Thus, for CSP, return on equity above 17.6 percent would fall into the category of "excessive earnings." *Id.* These determinations are not controversial.

C. Eliminating Non-ESP Earnings.

Having determined the level of excessive earnings, the final step of the test is to remove the effects of those items that are not related to the provisions of the ESP under review. An ESP is structured by adjustments to the prior rates and the statute requires "[w]ith regard to the provisions that are included in an electric security plan. . . , the commission shall consider . . . if any such adjustments resulted in excessive earnings . . . ." Ohio Rev. Code Ann. § 4928.143(F) (West 2011), App. at 21. In this way, those significantly excessive earnings which arise from the ESP under review are identified.

Although a variety of adjustments were suggested by CSP, the Commission was persuaded that only one adjustment was necessary, off system sales (OSS). The appropriateness of this adjustment is almost self-evident. CSP sells electricity at wholesale to other utilities, co-operatives, and municipalities. OSS are subject to regulation by the Federal Energy Regulatory Commission. They have nothing whatever to do with the ESP under review. Whatever profit is derived from OSS is entirely independent of the ESP. The rates which existed before the current ESP had nothing to do with OSS (they could not, it is a matter of federal jurisdiction) and no adjustment within the plan had anything to do with OSS (again they could not as it is a matter of federal jurisdiction). CSP met its burden of proof to establish the appropriateness of removing the effect of these sales from the SEET calculation.

Appellants raise several lines of objection to the Commission decision. Appellants OEG and OCC argue that OSS must be included because the statute, in their incorrect view, requires a comparison of all earnings of the EDU to all earnings of the comparable group. Appellant IEU argues that the statute requires the comparison be made between only some sub-set of the EDU's earnings and all the earnings of the comparable group. Further it argues that the OSS adjustment (along with many more) should have been done but the Commission did the calculation incorrectly. These arguments will be addressed below.

Appellants OEG and OCC simply misunderstand what the Commission did and what the law requires.[4] They believe that the statute requires all of the EDU's earnings to be compared with all of the earnings of the comparable group. That is exactly what the Commission did. This very comparison is the first step of the analysis. That is how "excessive earnings" are determined. *In re AEP* (Opinion and Order at 21-22) (January 11, 2011), OEG App. at 29-30, IEU App. at 54-55. It was based on just this comparison of "all to all" by which OP was determined not to have excessive earnings and, therefore, not to warrant further examination. *In re AEP* (Opinion and Order at 22) (January 11, 2011), OEG App. at 30, IEU App. at 55. Appellants OEG and OCC are factually mis-taken.

Appellant IEU argues that the EDU's earned return on common equity should have been jurisdictionalized. That is to say the earned return on equity should be calcu-lated based on only a part of the EDU's business activity. As has been discussed, the statute requires nothing of the sort. The statute provides that the comparison is to be made by determining whether the ". . . earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was

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4 Appellants OEG and OCC spend much time discussing *Bluefield Water Works v. West Virginia*, 262 U.S. 679 (1923). The case has no relevance. *Bluefield* lays out the test under which utilities are constitutionally protected from confiscation by rates that are set too low. No such issue is presented in the case at bar. *Bluefield* in essence sets a floor below which utilities rates cannot be set, while the SEET establishes a ceiling above which a portion of utility earnings cannot go. There is no relationship between the two.

earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk . . . ." Ohio Rev. Code Ann. § 4928.143(F) (West 2011), App. at 21. The statute could not be plainer. The Commission must consider the earned return on equity of the EDU. That's what the statute says. The EDU's earnings are what they are. Its equity is what it is. The earned return on equity is simply the ratio between them and that is what the Commission determined for both OP and CSP. *In re AEP* (Opinion and Order at 22-23) (January 11, 2011), OEG App. at 30-31, IEU App. at 55-56. Adjustment comes into play at the third step of the analysis. Appellant IEU is legally incorrect.

Appellants OEG and OCC compound their error by assuming that the statute stops at that point. It does not. As discussed above, the Commission must continue the statutory analysis, as it did, to determine a "significantly excessive" level and then the removal of non-ESP related earnings. The statute requires it. Ohio Rev. Code Ann. § 4928.143(F) (West 2011), App. at 21. Quite specifically there is no possible relationship between the elements of the ESP and off system sales. This is why OEG and OCC make no such showing, none can exist. AEP met its burden of proof and showed that OSS are related to federally regulated transactions and not the ESP and therefore should be excluded. *In re AEP* (Opinion and Order at 27) (January 11, 2011), OEG App. at 35, IEU Ohio App. at 60.

Appellants OEG and OCC argue that OSS should be included because, they claim, ratepayers have funded the plants used or that, in some undefined way, sales to ratepayers allow the OSS to occur. This is nonsense. With the exception of construction work in progress (CWIP), utility construction is funded either by shareholders or debt holders of the company. Putting aside CWIP, there is simply no mechanism by which ratepayers *could* fund construction.

CWIP has two statutory sources, R.C. 4909.15(A)(1) and 4928.143(B)(2)(b). The second of these has never been used. Columbus and Southern Ohio Electric Company (the predecessor of CSP prior to the merger with AEP) did obtain R.C. 4909.15(A)(1) CWIP for construction of a plant in 1978, 33 years ago. *See*, *Consumers' Counsel v. Pub. Util. Comm'n*, 58 Ohio St. 2d 108, 388 N.E.2d 1370 (1979). The statute, however, requires that whatever amount ratepayers have provided by way of CWIP must be returned to them before the plant may be included in the rate base. Ohio Rev. Code Ann. § 4909.15(A)(1) (West 2011), App. at 3-4. Ratepayers have not funded CSP's plants. The notion that sales to ratepayers facilitate off system sales seems the exact opposite of the real situation. Every sale to a ratepayer uses generating plant that is then *not available* to make an off system sale. OEG and OCC's arguments are wrong.

Appellant IEU takes a different tack. It argues that the Commission did not remove enough when it made its OSS adjustment. Appellant IEU argues, but does not prove, that an adjustment for transmission plant should have been made. There is no basis for this. The Commission did make a significant adjustment. It removed the value of the plant used to support the off system sales. *In re AEP* (Opinion and Order at 28-30) (January 11, 2011), OEG App. at 36-38, IEU App. at 61-63. This adjustment was based on the testimony of Staff witness Cahaan. *Id.* This is apparently not enough for IEU but adjustments must be based on evidence and there is no evidence that the adjustment, proposed on brief by Appellant IEU, is needed. None of the witnesses testifying felt the need to make such an adjustment. Indeed, the very portion of the transcript (cross-examination of Staff witness Cahaan) cited by Appellant IEU shows that the witness did not believe the adjustment was feasible. Tr. Vol. III at 475, IEU Supp. at 203. Even if, contrary to the record evidence, the adjustment were feasible, nothing indicates the size of the effect the adjustment would have. The Commission is not free to speculate in these ways. The Commission must act based on facts not speculation. It did so here. No further adjustment was shown to be needed and so none was done.

In keeping with its "the Commission did not remove enough" theme, Appellant IEU argues that the effect of non-jurisdictional activities must be removed from the calculation. This is an odd argument for Appellant IEU to make. Removing earnings from the SEET analysis would appear to be advantageous for CSP as it would reduce the level of earnings and thereby reduce the level of earnings that could be determined to be "significantly excessive." This is certainly the view the Commission took as it ruled, in response to an effort by AEP to reserve the ability to perform additional jurisdictionalization, that:

> . . . [T]o 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 re AEP (Opinion and Order at 13) (January 11, 2011), OEG App. at 21, IEU App. at 46. Appellant IEU's argument, if accepted, would be beneficial to AEP. The burden of proof to show that significantly excessive earnings did not occur lies with OP and CSP. With regard to additional jurisdictionalization, the companies failed to meet that burden of proof. IEU cannot resurrect AEP's argument now.

The Court has repeatedly declared that it "will not reverse an order of the Commission absent a showing of prejudice by the party seeking reversal." *Myers v. Pub. Util. Comm'n*, 64 Ohio St. 3d 299, 302, 595 N.E. 2d 873, 876 (1992). *See also Holladay Corp. v. Pub. Util. Comm'n*, 61 Ohio St. 2d 335, 402 N.E. 2d 1175, syllabus (1980); *Akron v. Pub. Util. Comm'n*, 55 Ohio St. 2d 155, 161, 378 N.E. 2d 480, 484 (1978); *Ohio Edison Co. v. Pub. Util. Comm'n*, 173 Ohio St. 478, 496, 184 N.E. 2d 70, 83 (1962). As regards these two IEU arguments, it has shown no prejudice; rather, it has merely speculated. Speculation is not sufficient.

D. Conclusion

In sum, the Commission implemented the statute correctly. Three steps were required. Three steps were performed. The Commission determined, first, the level of excessive earnings; second, the level of significantly excessive earnings; and third, identified those earnings shown not to be associated with the ESP and eliminated them. Appellants would impose different, non-statutory tests based in part on speculation. The Commission properly rejected these arguments and should be affirmed.

Proposition of Law No. II:

> **Where the charges collected by a public utility are based upon rates which have been established by an order of the Public Utilities Commission of Ohio, the fact that such order is subsequently found to be unreasonable or unlawful on appeal to the Supreme Court of Ohio, in the absence of a statute providing therefor, affords no right of action for restitution of the increase in charges collected during the pendency of the appeal. *Keco Industries Inc. v. Cincinnati and Suburban Bell Tel. Co.*, 166 Ohio St. 254, 141 N.E.2d 465 (syllabus 2) (1957).**

Long ago this Court recognized that only the Public Utilities Commission may establish rates and the rates it establishes are valid until replaced by the Public Utilities Commission. *Keco Industries Inc. v. Cincinnati and Suburban Bell Tel. Co.*, 166 Ohio St. 254, 141 N.E.2d 465 (syllabus 2) (1957). Appellants OEG and OCC argue that this Court should create an exception to this long standing rule. This Court should decline.

In *Keco*, this Court reasoned: "We have determined further that the General Assembly provided that there is no automatic stay of any order, but that it is necessary for any person aggrieved thereby to take affirmative action, and if he does so he is required to post bond." *Keco Industries Inc. v. Cincinnati and Suburban Bell Tel. Co.*, 166 Ohio St. 254, 258, 141 N.E.2d 465, 468 (1957). Appellants wish this Court to allow them to side-step this statutory structure. No stay was sought. As this Court has reasoned:

> In *Keco*, the court was confronted with a situation where a consumer was suing for restitution of amounts collected under a commission approved tariff which was later determined to be unreasonable and unlawful. There, we held, at page 257, 141 N.E.2d 465, that an action for restitution would

> not lie, since a "utility must collect the rates set by the commission."

River Gas Co. v. Pub. Util. Comm'n, 69 Ohio St. 2d 509, 513, 433 N.E.2d 568, 571 (1982). The situation before this Court is no different. Appellants OEG and OCC simply want restitution of amounts they believe were overpaid and they want to avoid the step of obtaining a stay. The *Keco* rule is a good one and would apply in this situation. The arguments of Appellants OEG and OCC should be rejected.

CONCLUSION

The General Assembly requires the Commission to review ESPs each year to determine if the adjustments made in the plan result in significantly excessive earnings when measured against a group of companies facing comparable risk. To do this, the Commission must do three things. First it needs to determine what level of earnings is "excessive". Second it must decide how high the excessive earnings must be to be considered "significantly excessive". Finally the Commission must eliminate from the significantly excessive earnings the portion that the EDU, which bears the burden of proof, has shown *not* to be tied to the ESP that is being reviewed. The Commission has done each of these steps reasonably and its order should be affirmed.

Respectfully submitted,

Michael DeWine (0009181)
Ohio Attorney General

William L. Wright (0018010)
Section Chief

Thomas W. McNamee (0017352)
Counsel of Record
Assistant Attorney General
Public Utilities Section
180 East Broad Street, 6th Fl
Columbus, OH 43215-3793
614.466.4397 (telephone)
614.644.8764 (fax)
william.wright@puc.state.oh.us
thomas.mcnamee@puc.state.oh.us

Counsel for Appellee,
The Public Utilities Commission of Ohio

PROOF OF SERVICE

I hereby certify that a true copy of the foregoing **Merit Brief,** submitted on behalf of appellee, the Public Utilities Commission of Ohio, was served by regular U.S. mail, postage prepaid, or hand-delivered, upon the following parties of record, this 26th day of September, 2011.

Thomas W. McNamee
Assistant Attorney General

Parties of Record:

David F. Boehm
Michael L. Kurtz
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, OH 45202

Samuel C. Randazzo
Frank P. Darr
Joseph E. Oliker
McNees Wallace & Nurick
21 East State Street, 18th Floor
Columbus, OH 43215

Janine L. Migden-Ostrander
Consumers' Counsel
Maureen R. Grady
Melissa R. Yost (0070914)
Kyle L. Verrett (0084199)
Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, OH 43215-3485

Steven T. Nourse
American Electric Power Corporation
1 Riverside Plaza, 29th Floor
Columbus, OH 43215-2373

Kathleen M. Trafford
Daniel R. Conway
Porter, Wright, Morris & Arthur
41 South High Street
Columbus, OH 43215

APPENDIX

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§ 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.

§ 4909.15. *[Effective Until 9/9/2011]* Fixation of reasonable rate

(A) The public utilities commission, when fixing and determining just and reasonable rates, fares, tolls, rentals, and charges, shall determine:

(1) The valuation as of the date certain of the property of the public utility used and useful in rendering the public utility service for which rates are to be fixed and determined. The valuation so determined shall be the total value as set forth in division (J) of section 4909.05 of the Revised Code, and a reasonable allowance for materials and supplies and cash working capital, as determined by the commission. The commission, in its discretion, may include in the valuation a reasonable allowance for construction work in progress but, in no event, may such an allowance be made by the commission until it has determined that the particular construction project is at least seventy-five per cent complete. In determining the percentage completion of a particular construction project, the commission shall consider, among other relevant criteria, the per cent of time elapsed in construction; the per cent of construction funds, excluding allowance for funds used during construction, expended, or obligated to such construction funds budgeted where all such funds are adjusted to reflect current purchasing power; and any physical inspection performed by or on behalf of any party, including the commission's staff. A reasonable allowance for construction work in progress shall not exceed ten per cent of the total valuation as stated in this division, not including such allowance for construction work in progress. Where the commission permits an allowance for construction work in progress, the dollar value of the project or portion thereof included in the valuation as construction work in progress shall not be included in the valuation as plant in service until such time as the total revenue effect of the construction work in progress allowance is offset by the

total revenue effect of the plant in service exclusion. Carrying charges calculated in a manner similar to allowance for funds used during construction shall accrue on that portion of the project in service but not reflected in rates as plant in service, and such accrued carrying charges shall be included in the valuation of the property at the conclusion of the offset period for purposes of division (J) of section 4909.05 of the Revised Code. From and after April 10, 1985, no allowance for construction work in progress as it relates to a particular construction project shall be reflected in rates for a period exceeding forty-eight consecutive months commencing on the date the initial rates reflecting such allowance become effective, except as otherwise provided in this division. The applicable maximum period in rates for an allowance for construction work in progress as it relates to a particular construction project shall be tolled if, and to the extent, a delay in the in-service date of the project is caused by the action or inaction of any federal, state, county, or municipal agency having jurisdiction, where such action or inaction relates to a change in a rule, standard, or approval of such agency, and where such action or inaction is not the result of the failure of the utility to reasonably endeavor to comply with any rule, standard, or approval prior to such change. In the event that such period expires before the project goes into service, the commission shall exclude, from the date of expiration, the allowance for the project as construction work in progress from rates, except that the commission may extend the expiration date up to twelve months for good cause shown. In the event that a utility has permanently canceled, abandoned, or terminated construction of a project for which it was previously permitted a construction work in progress allowance, the commission immediately shall exclude the allowance for the project from the valuation. In the event that a construction work in progress project previously included in the valuation is removed from the valuation pursuant to this division, any revenues collected by the utility from its customers after April 10, 1985, that resulted from such prior inclusion shall be offset against future revenues over the same period of time as the project was included in the valuation as construction work in progress. The total revenue effect of such offset shall not exceed the total revenues previously collected. In no event shall the total revenue effect of any offset or offsets provided under division (A)(1) of this section exceed the total revenue effect of any construction work in progress allowance.

(2) A fair and reasonable rate of return to the utility on the valuation as determined in division (A)(1) of this section;

(3) The dollar annual return to which the utility is entitled by applying the fair and reasonable rate of return as determined under division (A)(2) of this section to the valuation of the utility determined under division (A)(1) of this section;

(4) The cost to the utility of rendering the public utility service for the test period less the total of any interest on cash or credit refunds paid, pursuant to section 4909.42 of the Revised Code, by the utility during the test period.

(a) Federal, state, and local taxes imposed on or measured by net income may, in the discretion of the commission, be computed by the normalization method of accounting, provided the utility maintains accounting reserves that reflect differences between taxes actually payable and taxes on a normalized basis, provided that no determination as to the treatment in the rate-making process of such taxes shall be made that will result in loss of any tax depreciation or other tax benefit to which the utility would otherwise be entitled, and further provided that such tax benefit as redounds to the utility as a result of such a computation may not be retained by the company, used to fund any dividend or distribution, or utilized for any purpose other than the defrayal of the operating expenses of the utility and the defrayal of the expenses of the utility in connection with construction work.

(b) The amount of any tax credits granted to an electric light company under section 5727.391 of the Revised Code for Ohio coal burned prior to January 1, 2000, shall not be retained by the company, used to fund any dividend or distribution, or utilized for any purposes other than the defrayal of the allowable operating expenses of the company and the defrayal of the allowable expenses of the company in connection with the installation, acquisition, construction, or use of a compliance facility. The amount of the tax credits granted to an electric light company under that section for Ohio coal burned prior to January 1, 2000, shall be returned to its customers within three years after initially claiming the credit through an offset to the company's rates or fuel component, as determined by the commission, as set forth in schedules filed by the company under section 4905.30 of the Revised Code. As used in division (A)(4)(c) of this section, "compliance facility" has the same meaning as in section 5727.391 of the Revised Code.

(B) The commission shall compute the gross annual revenues to which the utility is entitled by adding the dollar amount of return under division (A)(3) of this section to the cost of rendering the public utility service for the test period under division (A)(4) of this section.

(C) The test period, unless otherwise ordered by the commission, shall be the twelve-month period beginning six months prior to the date the application is filed and ending six months subsequent to that date. In no event shall the test period end more than nine months subsequent to the date the application is filed. The revenues and expenses of the utility shall be determined during the test period. The date certain shall be not later than the date of filing.

(D) When the commission is of the opinion, after hearing and after making the determinations under divisions (A) and (B) of this section, that any rate, fare, charge, toll, rental, schedule, classification, or service, or any joint rate, fare, charge, toll, rental, schedule, classification, or service rendered, charged, demanded, exacted, or proposed to be rendered, charged, demanded, or exacted, is, or will be, unjust, unreasonable, unjustly discriminatory, unjustly preferential, or in violation of law, that the service is, or will be, inadequate, or that the maximum rates, charges, tolls, or rentals chargeable by any such public utility are insufficient to yield reasonable compensation for the service rendered, and are unjust and unreasonable, the commission shall:

(1) With due regard among other things to the value of all property of the public utility actually used and useful for the convenience of the public as determined under division (A)(1) of this section, excluding from such value the value of any franchise or right to own, operate, or enjoy the same in excess of the amount, exclusive of any tax or annual charge, actually paid to any political subdivision of the state or county, as the consideration for the grant of such franchise or right, and excluding any value added to such property by reason of a monopoly or merger, with due regard in determining the dollar annual return under division (A)(3) of this section to the necessity of making reservation out of the income for surplus, depreciation, and contingencies, and;

(2) With due regard to all such other matters as are proper, according to the facts in each case,

(a) Including a fair and reasonable rate of return determined by the commission with reference to a cost of debt equal to the actual embedded cost of debt of such public utility,

(b) But not including the portion of any periodic rental or use payments representing that cost of property that is included in the valuation report under divisions (F) and (G) of section 4909.05 of the Revised Code, fix and determine the just and reasonable rate, fare, charge, toll, rental, or service to be rendered, charged, demanded, exacted, or collected for the performance or rendition of the service that will provide the public utility the allowable gross annual revenues under division (B) of this section, and order such just and reasonable rate, fare, charge, toll, rental, or service to be substituted for the existing one. After such determination and order no change in the rate, fare, toll, charge, rental, schedule, classification, or service shall be made, rendered, charged, demanded, exacted, or changed by such public utility without the order of the commission, and any other rate, fare, toll, charge, rental, classification, or service is prohibited.

(E) Upon application of any person or any public utility, and after notice to the parties in interest and opportunity to be heard as provided in Chapters 4901., 4903., 4905., 4907., 4909., 4921., and 4923. of the Revised Code for other hearings, has been given, the commission may rescind, alter, or amend an order fixing any rate, fare, toll, charge, rental, classification, or service, or any other order made by the commission. Certified copies of such orders shall be served and take effect as provided for original orders.

§ 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.

(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.

§ 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.

§ 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.

4901:1-35-01 Definitions.

(A) "Application" means an application for standard service offer pursuant to this chapter.

(B) "Commission" means the public utilities commission of Ohio.

(C) "Competitive bidding process" means a bidding process established pursuant to section 4928.142 of the Revised Code.

(D) "Dynamic retail pricing" means a retail rate design which includes prices that can change based on changes in wholesale electricity prices, power system conditions, or the marginal cost of providing electric service.

(E) "Electric utility" shall have the meaning set forth in division (A)(11) of section 4928.01 of the Revised Code.

(F) "Electric security plan" means an electric utility plan for the supply and pricing of electric generation service including other related matters pursuant to section 4928.143 of the Revised Code.

(G) "First application for a market rate offer" means the application filed under section 4928.142 of the Revised Code by an electric utility that has not previously implemented an approved market-rate offer.

(H) "Market development period" shall have the meaning set forth in division (A)(17) of section 4928.01 of the Revised Code.

(I) "Market-rate offer" means an electric utility plan for the supply and pricing of electric generation service pursuant to section 4928.142 of the Revised Code.

(J) "Person" shall have the meaning set forth in division (A)(24) of section 4928.01 of the Revised Code.

(K) "Rate plan" means an electric utility's standard service offer approved by the commission prior to January 1, 2009, that established rates for electric service at the expiration of an electric utility's market development period.

(L) "Standard service offer" means an electric utility offer to provide consumers, on a comparable and nondiscriminatory basis within its certified territory, all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service.

(M) "Staff" means the staff of the commission or its authorized representatives.

(N) "Time differentiated pricing" means a retail rate design which includes differing prices based upon the time that electricity is used in order to reflect differences in expected costs or wholesale electricity prices in different time periods.

4901:1-35-02 Purpose and scope.

(A) Pursuant to division (A) of section 4928.141 of the Revised Code, beginning January 1, 2009, each electric utility in this state shall provide consumers, on a comparable and nondiscriminatory basis within its certified territory, a standard service offer (SSO) of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service. Pursuant to this chapter, an electric utility shall file an application for commission approval of an SSO. Such application shall be in the form of an electric security plan or market rate offer pursuant to sections 4928.142 and 4928.143 of the Revised Code. The purpose of this chapter is to establish rules for the form and process under which an electric utility shall file an application for an SSO and the commission's review of that application.

(B) The commission may, upon an application or a motion filed by a party, waive any requirement of this chapter, other than a requirement mandated by statute, for good cause shown.

4901:1-35-03 Filing and contents of applications.

Each electric utility in this state filing an application for a standard service offer (SSO) in the form of an electric security plan (ESP), a market-rate offer (MRO), or both, shall comply with the requirements set forth in this rule.

(A) SSO applications shall be case captioned as (XX-XXX-EL-SSO). Twenty copies plus an original of the application shall be filed. The application must include a complete set of direct testimony of the electric utility personnel or other expert witnesses. This testimony shall be in question and answer format and shall be in support of the electric utility's proposed application. This testimony shall fully support all schedules and significant issues identified by the electric utility.

(B) An SSO application that contains a proposal for an MRO shall comply with the requirements set forth below.

(1) The following electric utility requirements are to be demonstrated in a separate section of the standard service offer SSO application proposing a market-rate offer MRO:

(a) The electric utility shall establish one of the following: that it, or its transmission affiliate, belongs to at least one regional transmission organization (RTO) that has been approved by the federal energy regulatory commission; or, if the electric utility or its transmission affiliate does not belong to an RTO, then the electric utility shall demonstrate that alternative conditions exist with regard to the transmission system, which include non-pancaked rates, open access by generation suppliers, and full interconnection with the distribution grid.

(b) The electric utility shall establish one of the following: its RTO retains an independent market-monitor function and has the ability to identify any potential for a market participant or the electric utility to exercise market power in any energy, capacity, and/or ancillary service markets by virtue of access to the RTO and the market participant's data and personnel and has the ability to effectively mitigate the conduct of the market participants so as to prevent or preclude the exercise of such market power by any market participant or the electric utility; or the electric utility shall demonstrate that an equivalent function exists which can monitor, identify, and mitigate conduct associated with the exercise of such market power.

(c) The electric utility shall demonstrate that an independent and reliable source of electricity pricing information for any energy product or service necessary for a winning bidder to fulfill the contractual obligations resulting from the competitive bidding process (CBP) is publicly available. The information may be offered through a pay subscription service, but the pay subscription service shall be available under standard pricing, terms, and conditions to any person requesting a subscription. The published information shall be representative of prices and changes in prices in the electric utility's electricity market, and shall identify pricing of on-peak and off-peak energy products that represent contracts for delivery, encompassing a time frame beginning at least two years from the date of the publication. The published information shall be updated on at least a monthly basis.

(2) Prior to establishing an MRO under division (A) of section 4928.142 of the Revised Code, an electric utility shall file a plan for a CBP with the commission. The electric utility shall provide justification of its proposed CBP plan, considering alternative possible methods of procurement. Each CBP plan that is to be used to establish an MRO shall include the following:

(a) A complete description of the CBP plan and testimony explaining and supporting each aspect of the CBP plan. The description shall include a discussion of any relationship between the wholesale procurement process and the retail rate design that may be proposed in the CBP plan. The description shall include a discussion of alternative methods of procurement that were considered and the rationale for selection of the CBP plan being presented. The description shall also include an explanation of every proposed non-avoidable charge, if any, and why the charge is proposed to be non-avoidable.

(b) Pro forma financial projections of the effect of the CBP plan's implementation, including implementation of division (D) of section 4928.142 of the Revised Code, upon generation, transmission, and distribution of the electric utility, for the duration of the CBP plan.

(c) Projected generation, transmission, and distribution rate impacts by customer class and rate schedules for the duration of the CBP plan. The electric utility shall clearly indicate how projected bid clearing prices used for this purpose were derived.

(d) Detailed descriptions of how the CBP plan ensures an open, fair, and transparent competitive solicitation that is consistent with and advances the policy of this state as delineated in divisions (A) to (N) of section 4928.02 of the Revised Code.

(e) Detailed descriptions of the customer load(s) to be served by the winning bidder(s), and any known factors that may affect such customer loads. The descriptions shall include, but not be limited to, load subdivisions defined for bidding purposes, load and rate class descriptions, customer load profiles that include historical hourly load data for each load and rate class for at least the two most recent years, applicable tariffs, historical shopping data, and plans for meeting targets pertaining to load reductions, energy efficiency, renewable energy, advanced energy, and advanced energy technologies. If customers will be served pursuant to time-differentiated or dynamic pricing, the descriptions shall include a summary of available data regarding the price elasticity of the load. Any fixed load provides to be served by winning bidder(s) shall be described.

(f) Detailed descriptions of the generation and related services that are to be provided by the winning bidder(s). The descriptions shall include, at a minimum, capacity, energy, transmission, ancillary and resource adequacy services, and the term during which generation and related services are to be provided. The descriptions shall clearly indicate which services are to be provided by the winning bidder(s) and which services are to be provided by the electric utility.

(g) Draft copies of all forms, contracts, or agreements that must be executed during or upon completion of the CBP.

(h) A clear description of the proposed methodology by which all bids would be evaluated, in sufficient detail so that bidders and other observers can ascertain the evaluated result of any bids or potential bids.

(i) The CBP plan shall include a discussion of time-differentiated pricing, dynamic retail pricing, and other alternative retail rate options that were considered in the development of the CBP plan. A clear description of the rate structure ultimately chosen by the electric utility, the electric utility's rationale for selection of the chosen rate structure, and the methodology by which the electric utility proposes to convert the winning bid(s) to retail rates of the electric utility shall be included in the CBP plan.

(j) The first application for a market rate offer by an electric utility that, as of July 31, 2008, directly owned, in whole or in part, operating electric generation facilities that had been used and useful in this state shall include a description of the electric utility's proposed blending of the CBP rates for the first five years of the market rate offer pursuant to division (D) of section 4928.142 of the Revised Code. The proposed blending shall show the generation service price(s) that will be blended with the CBP determined rates, and any descriptions, formulas, and/or tables necessary to show how the blending will be accomplished. The proposed blending shall show all adjustments, to be made on a quarterly basis, included in the generation service price(s) that the electric utility proposes for changes in costs of fuel, purchased power, portfolio requirements, and environmental compliance incurred during the blending period. The electric utility shall provide its best current estimate of anticipated adjustment amounts for the duration of the blending period, and compare the projected adjusted generation service prices under the CBP plan to the projected adjusted generation service prices under its proposed electric security plan.

(k) The electric utility's application to establish a CBP shall include such information as necessary to demonstrate whether or not, as of July 31, 2008, the electric utility directly owned, in whole or in part, operating electric generation facilities that had been used and useful in the state of Ohio.

(l) The CBP plan shall provide for funding of a consultant that may be selected by the commission to assess and report to the commission on the design of the solicitation, the oversight of the bidding process, the clarity of the product definition, the fairness, openness, and transparency of the solicitation and bidding process, the market factors that could affect the solicitation, and other relevant criteria as directed by the commission. Recovery of the cost of such consultant(s) may be included by the electric utility in its CBP plan.

(m) The CBP plan shall include a discussion of generation service procurement options that were considered in development of the CBP plan, including but not limited to, portfolio approaches, staggered procurement, forward procurement, electric utility participation in day-ahead and/or real-time balancing markets, and spot market purchases and sales. The CBP plan shall also include the rationale for selection of any or all of the procurement options.

(n) The electric utility shall show, as a part of its CBP plan, any relationship between the CBP plan and the electric utility's plans to comply with alternative energy portfolio requirements of section 4928.64 of the Revised Code, and energy efficiency requirements and peak demand reduction requirements of section 4928.66 of the Revised Code. The initial filing of a CBP plan shall include a detailed account of how the plan is consistent with and advances the policy of this state as delineated in divisions (A) to (N) of section 4928.02 of the Revised Code. Following the initial filing, subsequent filings shall include a discussion of how the state policy continues to be advanced by the plan.

(o) An explanation of known and anticipated obstacles that may create difficulties or barriers for the adoption of the proposed bidding process.

(3) The electric utility shall provide a description of its corporate separation plan, adopted pursuant to section 4928.17 of the Revised Code, including but not limited to, the current status of the corporate separation plan, a detailed list of all waivers previously issued by the commission to the electric utility regarding its corporate separation plan, and a timeline of any anticipated revisions or amendments to its current corporate separation plan on file with the commission pursuant to Chapter 4901:1-37 of the Administrative Code.

(4) A description of how the electric utility proposes to address governmental aggregation programs and implementation of divisions (I) and (K) of section 4928.20 of the Revised Code.

(C) An SSO application that contains a proposal for an ESP shall comply with the requirements set forth below.

(1) A complete description of the ESP and testimony explaining and supporting each aspect of the ESP.

(2) Pro forma financial projections of the effect of the ESP's implementation upon the electric utility for the duration of the ESP, together with testimony and work papers sufficient to provide an understanding of the assumptions made and methodologies used in deriving the pro forma projections.

(3) Projected rate impacts by customer class/rate schedules for the duration of the ESP, including post-ESP impacts of deferrals, if any.

(4) The electric utility shall provide a description of its corporate separation plan, adopted pursuant to section 4928.17 of the Revised Code, including, but not limited to, the current status of the corporate separation plan, a detailed list of all waivers previously issued by the commission to the electric utility regarding its corporate separation plan, and a timeline of any anticipated revisions or amendments to its current corporate separation plan on file with the commission pursuant to Chapter 4901:1-37 of the Administrative Code.

(5) Division (A)(3) of section 4928.31 of the Revised Code required each electric utility to file an operational support plan as a part of its electric transition plan. Each electric utility shall provide a statement as to whether its operational support plan has been implemented and whether there are any outstanding problems with the implementation.

(6) A description of how the electric utility proposes to address governmental aggregation programs and implementation of divisions (I), (J), and (K) of section 4928.20 of the Revised Code.

(7) A description of the effect on large-scale governmental aggregation of any unavoidable generation charge proposed to be established in the ESP.

(8) The initial filing for an ESP shall include a detailed account of how the ESP is consistent with and advances the policy of this state as delineated in divisions (A) to (N) of section 4928.02 of the Revised Code. Following the initial filing, subsequent filings shall include how the state policy is advanced by the ESP.

(9) Specific information

Division (B)(2) of section 4928.143 of the Revised Code authorizes the provision or inclusion in an ESP of a number of features or mechanisms. To the extent that an electric utility includes any of these features in its ESP, it shall file the corresponding information in its application.

(a) Division (B)(2)(a) of section 4928.143 of the Revised Code authorizes an electric utility to include provisions for the automatic recovery of fuel, purchased power, and certain other specified costs. An application including such provisions shall include, at a minimum, the information described below:

(i) The type of cost the electric utility is seeking recovery for under division (B)(2) of section 4928.143 of the Revised Code including a summary and detailed description of such cost. The description shall include the plant(s) that the cost pertains to as well as a narrative pertaining to the electric utility's procurement policies and procedures regarding such cost.

(ii) The electric utility shall include in the application any benefits available to the electric utility as a result of or in connection with such costs including but not limited to profits from emission allowance sales and profits from resold coal contracts.

(iii) The specific means by which these costs will be recovered by the electric utility. In this specification, the electric utility must clearly distinguish whether these costs are to be recovered from all distribution customers or only from the customers taking service under the ESP.

(iv) A complete set of work papers supporting the cost must be filed with the application. Work papers must include, but are not limited to, all pertinent documents prepared by the electric utility for the application and a narrative and other support of assumptions made in completing the work papers.

(b) Divisions (B)(2)(b) and (B)(2)(c) of section 4928.143 of the Revised Code, authorize an electric utility to include unavoidable surcharges for construction, generation, or environmental expenditures for electric generation facilities owned or operated by the electric utility. Any plan which seeks to impose surcharge under these provisions shall include the following sections, as appropriate:

(i) The application must include a description of the projected costs of the proposed facility. The need for the proposed facility must have already been reviewed and determined by the commission through an integrated resource planning process filed pursuant to rule 4901:5-5-05 of the Administrative Code.

(ii) The application must also include a proposed process, subject to modification and approval by the commission, for the competitive bidding of the construction of the facility unless the commission has previously approved a process for competitive bidding, which would be applicable to that specific facility.

(iii) An application which provides for the recovery of a reasonable allowance for construction work in progress shall include a detailed description of the actual costs as of a date certain for which the applicant seeks recovery, a detailed description of the impact upon rates of the proposed surcharge, and a demonstration that such a construction work in progress allowance is consistent with the applicable limitations of division (A) of section 4909.15 of the Revised Code.

(iv) An application which provides recovery of a surcharge for an electric generation facility shall include a detailed description of the actual costs, as of a date certain, for which the applicant seeks recovery and a detailed description of the impact upon rates of the proposed surcharge.

(v) An application which provides for recovery of a surcharge for an electric generation facility shall include the proposed terms for the capacity, energy, and associated rates for the life of the facility.

(c) Division (B)(2)(d) of section 4928.143 of the Revised Code authorizes an electric utility to include terms, conditions, or charges related to retail shopping by customers. Any application which includes such terms, conditions or charges, shall include, at a minimum, the following information:

(i) A listing of all components of the ESP which would have the effect of preventing, limiting, inhibiting, or promoting customer shopping for retail electric generation service. Such components would include, but are not limited to, terms and conditions relating to shopping or to returning to the standard service offer and any unavoidable charges. For each such component, an explanation of the component and a descriptive rationale and, to the extent possible, a quantitative justification shall be provided.

(ii) A description and quantification or estimation of any charges, other than those associated with generation expansion or environmental investment under divisions (B)(2)(b) and (B)(2)(c) of section 4928.143 of the Revised Code, which will be deferred for future recovery, together with the carrying costs, amortization periods, and avoidability of such charges.

(iii) A listing, description, and quantitative justification of any unavoidable charges for standby, back-up, or supplemental power.

(d) Division (B)(2)(e) of section 4928.143 of the Revised Code authorizes an electric utility to include provisions for automatic increases or decreases in any component of the standard service offer price. Pursuant to this authority, if the ESP proposes automatic increases or decreases to be implemented during the life of the plan for any component of the standard service offer, other than those covered by division (B)(2)(a) of section 4928.143 of the Revised Code, the electric utility must provide in its application a description of the component, the proposed means for changing the component, and the proposed means for verifying the reasonableness of the change.

(e) Division (B)(2)(f) of section 4928.143 of the Revised Code authorizes an electric utility to include provisions for the securitization of authorized phase-in recovery of the standard service offer price. If a phase-in deferred asset is proposed to be securitized, the electric utility shall provide, at the time of an application for securitization, a description of the securitization instrument and an accounting of that securitization, including the deferred cash flow due to the phase-in, carrying charges, and the incremental cost of the securitization. The electric utility will also describe any efforts to minimize the incremental cost of the securitization. The electric utility shall provide all documentation associated with securitization, including but not limited to, a summary sheet of terms and conditions. The electric utility shall also provide a comparison of costs associated with securitization with the costs associated with other forms of financing to demonstrate that securitization is the least cost strategy.

(f) Division (B)(2)(g) of section 4928.143 of the Revised Code authorizes an electric utility to include provisions relating to transmission and other specified related services. Moreover, division (A)(2) of section 4928.05 of the Revised Code states that, notwithstanding Chapters 4905. and 4909. of the Revised Code, commission authority under this chapter shall include the authority to provide for the recovery, through a reconcilable rider on an electric distribution utility's distribution rates, of all transmission and transmission-related costs (net of transmission related revenues), including ancillary and net congestion costs, imposed on or charged to the utility by the federal energy regulatory commission or a regional transmission organization, independent transmission operator, or similar organization approved by the federal energy regulatory commission.

Any utility which seeks to create or modify its transmission cost recovery rider in its ESP shall file the rider in accordance with the requirements delineated in Chapter 4901:1-36 of the Administrative Code.

(g) Division (B)(2)(h) of section 4928.143 of the Revised Code authorizes an electric utility to include provisions for alternative regulation mechanisms or programs, including infrastructure and modernization incentives, relating to distribution service as part of an ESP. While a number of mechanisms may be combined within a plan, for each specific mechanism or program, the electric utility shall provide a detailed description, with supporting data and information, to allow appropriate evaluation of each proposal, including how the proposal addresses any cost savings to the electric utility, avoids duplicative cost recovery, and aligns electric utility and consumer interests. In general, and to the extent applicable, the electric utility shall also include, for each separate mechanism or program, quantification of the estimated impact on rates over the term of any proposed modernization plan. Any application for an infrastructure modernization plan shall include the following specific requirements:

(i) A description of the infrastructure modernization plan, including but not limited to, the electric utility's existing infrastructure, its existing asset management system and related capabilities, the type of technology and reason chosen, the portion of service territory affected, the percentage of customers directly impacted (non-rate impact), and the implementation schedule by geographic location and/or type of activity. A description of any communication infrastructure included in the infrastructure modernization plan and any metering, distribution automation, or other applications that may be supported by this communication infrastructure also shall be included.

(ii) A description of the benefits of the infrastructure modernization plan (in total and by activity or type), including but not limited to the following as they may apply to the plan: the impacts on current reliability, the number of circuits impacted, the number of customers impacted, the timing of impacts, whether the impact is on the frequency or duration of outages, whether the infrastructure modernization plan addresses primary outage causes, what problems are addressed by the infrastructure modernization plan, the resulting dollar savings and additional costs, the activities affected and related accounts, the timing of savings, other customer benefits, and societal benefits. Through metrics and milestones, the infrastructure modernization plan shall include a description of how the performance and outcomes of the plan will be measured.

(iii) A detailed description of the costs of the infrastructure modernization plan, including a breakdown of capital costs and operating and maintenance expenses net of any related savings, the revenue requirement, including recovery of stranded investment related to replacement of un-depreciated plant with new technology, the impact on customer bills, service disruptions associated with plan implementation, and description of (and dollar value of) equipment being made obsolescent by the plan and reason for early plant retirement. The infrastructure modernization plan shall also include a description of efforts made to mitigate such stranded investment.

(iv) A detailed description of any proposed cost recovery mechanism, including the components of any regulatory asset created by the infrastructure modernization plan, the reporting structure and schedule, and the proposed process for approval of cost recovery and increase in rates.

(v) A detailed explanation of how the infrastructure modernization plan aligns customer and electric utility reliability and power quality expectations by customer class.

(h) Division (B)(2)(i) of section 4928.143 of the Revised Code authorizes an electric utility to include provisions for economic development, job retention, and energy efficiency programs. Pursuant to this section, the electric utility shall provide a complete description of the proposal, together with cost-benefit analysis or other quantitative justification, and quantification of the program's projected impact on rates.

(10) Additional required information

Divisions (E) and (F) of section 4928.143 of the Revised Code provide for tests of the ESP with respect to significantly excessive earnings. Division (E) of section 4928.143 of the Revised Code is applicable only if an ESP has a term exceeding three years, and would require an earnings determination to be made in the fourth year. Division (F) of section 4928.143 of the Revised Code applies to any ESP and examines earnings after each year. In each case, the burden of proof for demonstrating that the return on equity is not significantly excessive is borne by the electric utility.

(a) 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.

(b) For demonstration under division (E) of section 4928.143 of the Revised Code, the electric utility shall also provide, in addition to the requirements under division (F) of section 4928.143 of the Revised Code, calculations of its projected return on equity for each remaining year of the ESP. The electric utility shall support these calculations by providing projected balance sheet and income statement information for the remainder of the ESP, together with testimony and work papers detailing the methodologies, adjustments, and assumptions used in making these projections.

(D) The first application for an SSO filed after the effective date of section 4928.141 of the Revised Code by each electric utility shall include an ESP and shall be filed at least one hundred fifty days before the electric utility proposes to have such SSO in effect. The first application may also include a proposal for an MRO. First applications that are filed with the commission prior to the initial effective date of this rule and that are determined by the commission to be not in substantive compliance with this rule shall be amended or refiled at the direction of the commission. The commission shall endeavor to make a determination on an amended or refiled ESP application, which substantively conforms to the requirements of this rule, within one hundred fifty days of the filing of the amended or refiled application.

(E) Subsequent applications for an SSO may include an ESP and/or MRO; however, an ESP may not be proposed once the electric utility has implemented an MRO approved by the commission.

(F) The SSO application shall include a section demonstrating that its current corporate separation plan is in compliance with section 4928.17 of the Revised Code, Chapter 4901:1-37 of the Administrative Code, and consistent with the policy of the state as delineated in divisions (A) to (N) of section 4928.02 of the Revised Code. If any waivers of the corporate separation plan have been granted and are to be continued, the applicant shall justify the continued need for those waivers.

(G) A complete set of work papers must be filed with the application. Work papers must include, but are not limited to, all pertinent documents prepared by the electric utility for the application and a narrative or other support of assumptions made in the work papers. Work papers shall be marked, organized, and indexed according to schedules to which they relate. Data contained in the work papers should be footnoted so as to identify the source document used.

(H) All schedules, tariff sheets, and work papers prepared by, or at the direction of, the electric utility for the application and included in the application must be available in spreadsheet, word processing, or an electronic non-image-based format, with formulas intact, compatible with personal computers. The electronic form does not have to be filed with the application but must be made available within two business days to staff and any intervening party that requests it.

4901:1-35-04 Service of application.

(A) Concurrent with the filing of a standard service offer (SSO) application and the filing of any waiver requests, the electric utility shall provide notice of filings to each party in its most recent SSO proceeding or, if this is its first SSO filing after the effective date of section 4928.141 of the Revised Code, then its last rate plan proceeding. At a minimum, that notice shall state that a copy of the application and all waiver requests are available through the electric utility's and commission's web sites, available at the electric utility's main office, available at the commission's offices, and any other sites at which the electric utility will maintain a copy of the application and all waiver requests.

(B) The electric utility shall also submit with its SSO application a proposed notice for newspaper publication that fully discloses the substance of the application, including projected rate impacts, and that prominently states that any person may request to become a party to the proceeding.

(C) The electric utility shall provide electronic copies of the application upon request, without cost, and transmit the application within five business days, or make a hard copy available for review at the electric utility's business office. Upon request, electronic copies shall be provided in spreadsheet, word processing, or an electronic non-image-based format, with formulas intact, compatible with personal computers.

4901:1-35-05 Technical conference.

Upon filing of a standard service offer application, the commission, legal director, deputy legal director, or attorney examiner shall schedule a technical conference. The purpose of the technical conference is to allow interested persons an opportunity to better understand the electric utility's application. The electric utility will have the necessary personnel in attendance at this conference so as to explain, among other things, the structure of the filing, the work papers, the data sources, and the manner in which methodologies were devised. The conference will be held at the commission offices, unless the commission, legal director, deputy legal director, or attorney examiner determines otherwise.

4901:1-35-06 Hearings.

(A) After the filing of a standard service offer application that conforms to the commission's rules, the commission shall set the matter for hearing and shall cause notice of the hearing to be published one time in a newspaper of general circulation in each county in the electric utility's certified territory. At such hearing, the burden of proof to show that the proposals in the application are just and reasonable and are consistent with the policy of the state as delineated in divisions (A) to (N) of section 4928.02 of the Revised Code shall be upon the electric utility.

(B) Interested persons wishing to participate in the hearing shall file a motion to intervene no later than forty-five days after the issuance of the entry scheduling the hearing, unless ordered otherwise by the commission, legal director, deputy legal director, or attorney examiner. This rule does not prohibit the filing of a motion to intervene and conducting discovery prior to the issuance of an entry scheduling a hearing.

4901:1-35-07 Discoverable agreements.

Upon submission of an appropriate discovery request during a proceeding establishing a standard service offer, an electric utility shall make available to the requesting party every contract or agreement that is between the electric utility or any of its affiliates and a party to the proceeding, consumer, electric service company, or political subdivision and that is relevant to the proceeding, subject to such protection for proprietary or confidential information as is determined appropriate by the commission.

4901:1-35-08 Competitive bidding process requirements and use of independent third party.

(A) An electric utility proposing a market-rate offer in its standard service offer application, pursuant to section 4928.142 of the Revised Code, shall propose a plan for a competitive bidding process (CBP). The CBP plan shall comply with the requirements set forth in paragraph (B) of rule 4901:1-35-03 of the Administrative Code. The electric utility shall use an independent third party to design an open, fair, and transparent competitive solicitation; to administer the bidding process; and to oversee the entire procedure to assure that the CBP complies with the CBP plan. The independent third party shall be accountable to the commission for all design, process, and oversight decisions. The independent third party shall incorporate into the solicitation such measures as the commission may prescribe, and shall incorporate into the bidding process any direction the commission may provide. Any modifications or additions to the approved CBP plan requested by the independent third party shall be submitted to the commission for review prior to implementation.

(B) Within twenty-four hours after the completion of the bidding process, the independent third party shall submit a report to the commission summarizing the results of the CBP. The report shall include, but not be limited to, the following items:

(1) A description of the conduct of the bidding process, including a discussion of any aspects of the process that the independent third party believes may have adversely affected the outcome.

(2) The level(s) of oversubscription for each product.

(3) The number of bidders for each product.

(4) The percentage of each product that was bid upon by persons other than the electric utility.

(5) The independent third party's evaluation of the submitted bids, including the bidders' generation source and financial capabilities to perform.

(6) The independent third party's final recommendation of the least cost winning bidder(s).

(7) A listing of the retail rates that would result from the least cost winning bids, along with any descriptions, formulas, and/or tables necessary to demonstrate how the conversion from winning bid(s) to retail rates was accomplished under the conversion process approved by the commission in the electric utility's CBP plan.

(C) The electric utility shall provide access to staff and any consultant hired by the commission to assist in review of the CBP of any and all data, information, and communications pertaining to the bidding process, on a real time basis, regardless of the confidential nature of such data and information.

(D) The commission shall make the final selection of the least-cost winning bidder(s) of the CBP. The commission may rely upon the information provided in the independent third party's report in making its selection of the least-cost winning bidder(s) of the CBP.

4901:1-35-09 Electric security plan fuel and purchased power adjustments.

(A) Each electric utility for which the commission has approved an electric security plan (ESP) which includes automatic adjustments under division (B)(2)(a) of section 4928.143 of the Revised Code shall file for such adjustments in accordance with the provisions of this rule.

(B) The electric utility shall calculate a proposed quarterly adjustment based on projected costs and reconciliation requirements by filing an application four times per year. The staff shall review the quarterly filing for completeness and computational accuracy. If staff raises no issues prior to the date the quarterly adjustment is to become effective, the rates shall become effective on that date. Although rates are to be adjusted and provided on a quarterly basis, the cost information shall be summarized monthly.

(C) On an annual basis, the prudence of the costs incurred and recovered through quarterly adjustments shall be reviewed in a separate proceeding outside of the automatic recovery provision of the electric utility's ESP. The electric utility shall demonstrate that the costs were prudently incurred as required under division (B)(2)(a) of section 4928.143 of the Revised Code and, if a significant change in costs has incurred, include an analysis comparing the electric utility's resource and/or environmental compliance strategy with supply and demand-side alternatives. The process and timeframes for that separate proceeding shall be set by order of the commission, the legal director, deputy legal director, or attorney examiner.

(D) The commission may order that consultants be hired, with the costs billed to the electric utility, to conduct prudence and/or financial reviews of the costs incurred and recovered through the quarterly adjustments.

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.

4901:1-35-11 Competitive bidding process ongoing review and reporting requirements.

(A) The initial market rate offer (MRO), and subsequent offers, implemented by each electric utility that, as of July 31, 2008, directly owned, in whole or in part, operating electric generation facilities that had been used and useful in this state, shall include a blended price for electric generation services for the first five years of the MRO, or some other period determined by the commission under section 4928.142 of the Revised Code.

(B) Once a competitive bidding process (CBP) plan subject to a price blending period is approved by the commission pursuant to section 4928.142 of the Revised Code, the electric utility shall file its proposed adjustments to the standard service offer (SSO) portion of the blended rates of its CBP in a filing to the commission on a quarterly basis (quarterly filing) for the duration of the price blending period of the CBP plan, on specific dates to be determined by the commission.

(1) The quarterly filing shall include a separate listing of each cost or cost component including costs for fuel, purchased power, alternative portfolio requirements, and environmental compliance, in comparison with the costs or cost components included in the most recent SSO and the previously existing level of each cost. Any offsetting benefits, as defined in division (D) of section 4928.142 of the Revised Code, obtained directly or as a result of expenditures in the specified cost areas shall be listed separately and be used to reduce the cost levels requested for recovery. Rates are to be adjusted on a quarterly basis. Such adjustments may include, or be made pursuant to, the application of incentive factors or formulas that the commission determined to be reasonable in its approval of the CBP plan. The cost information shall consist of monthly data submitted on a quarterly basis.

(2) The quarterly filing shall include any descriptions, formulas, and/or tables necessary to show how the adjusted cost levels are translated into blended CBP rates.

(3) The electric utility shall provide projections, in its quarterly filing, of any impacts that the proposed adjustments will have on its return on common equity.

(4) The staff shall review the quarterly filing for completeness, computational accuracy, and consistency with prior commission determinations regarding the adjustments. If the staff raises no issues prior to the date the quarterly adjustment is to become effective, the rates shall become effective on that date.

(5) On an annual basis, or other basis as determined by the commission, the prudence of the costs incurred and recovered through quarterly adjustments to the electric utility's SSO portion of the blended rates shall be reviewed. The commission shall determine the frequency of the review and shall establish a schedule for the review process. The commission may order that consultants be hired, with the cost to be billed to the company, to conduct prudence and/or financial reviews of the costs incurred and recovered through the quarterly adjustments. The cost to the electric utility of the commission's use of such consultants may be included by the electric utility in its quarterly rate adjustment filing.

(C) If the CBP plan is approved by the commission subject to a price blending period, approximately one year after filing the CBP plan, and annually thereafter for the duration of the price blending period of the CBP plan, on dates to be determined by the commission, the electric utility shall file an annual report on its CBP.

(1) The annual report shall provide a general statement about the operation of the CBP to date. The annual status report shall also provide a summary of generation service obtained via the CBP during the period under review, and impacts of the cost of the CBP service and the resulting blended rates on the electric utility's customers.

(2) The annual report shall describe any defaults and/or other difficulties encountered in obtaining generation service from winning bidder(s) of the CBP, and describe in detail actions taken by the electric utility to remedy such situations.

(3) The annual report shall describe the condition and significant developments of the wholesale electric generation and transmission market during the year covered by the report, and any developments in those markets anticipated and/or known for the following year.

(4) The annual report shall describe the financial condition of the electric utility, its current and projected return on common equity, and the return on common equity of publicly traded companies that face comparable business and financial risk. The electric utility shall show that its earnings under the price blending period will not be significantly excessive as compared with similarly situated companies. Information submitted by the electric utility to demonstrate its projected earnings shall include, but not be limited to, balance sheet information, income statement information, and capital budget requirements for future investments in Ohio. This information should be provided separately for generation, transmission, and distribution for the electric utility and its affiliates. Additionally, the electric utility shall provide testimony and analysis demonstrating the return on equity earned by publicly traded companies that face comparable business and financial risks as the electric utility.

(5) If in an emergency situation the electric utility claims that its financial integrity is threatened by the operation of the CBP price blending period, it shall demonstrate its claim through information and data filed in its annual report. The electric utility has the burden of proof in any such claim of threatened financial integrity.

(6) The electric utility shall discuss, in its annual report, upcoming solicitations to be conducted pursuant to its approved CBP plan. Any deviations or modifications of the approved CBP plan being requested by the electric utility shall be described in detail, with specific rationale provided for every such deviation or modification requested.

(7) The annual report shall describe the blended phase-in rates projected to be charged to its customers under the continuation of the CBP plan, as modified pursuant to paragraph (C)(6) of this rule. The rate projections shall show the existing and projected generation service price(s) blended with the CBP determined rates and projected CBP determined rates, and any descriptions, formulas, and/or tables necessary to show how the blending is accomplished. The projected blended phase-in rates shall be compared in the annual report to the existing blended phase-in rates.

(8) The annual report shall describe the operation to date of any time-differentiated and dynamic rate designs implemented under the CBP, the approaches used to communicate price and usage information to consumers, and observed price elasticity.

(9) The annual report shall include a status report of the market conditions relevant to the continued operation of the electric utility's MRO, including but not limited to information about the existence of published source(s) of electric market pricing information, whether the electric utility or its affiliate still belongs to an regional transmission organization (RTO), and whether the RTO's market monitoring function has mitigation authority over the transactions resulting from the CBP.

(10) The commission, legal director, deputy legal director, or attorney examiner shall determine the level of review required for any information, plans, or requests set forth in the annual report, and set any necessary schedules through an entry.

(D) If the CBP plan is approved by the commission without the requirement of a price blending period, or after the expiration of any such required price blending period, on an annual basis, on dates to be determined by the commission, the electric utility shall file an annual report with the commission.

(1) The annual report shall provide a general statement about the operation of the CBP to date. The annual report shall also provide a summary of generation service obtained via the CBP during the period under review, and impacts of the cost of the CBP on the electric utility's customers' rates.

(2) The annual report shall describe any defaults or other difficulties encountered in obtaining generation service from winning bidder(s) of the CBP, and describe in detail actions taken by the electric utility to remedy such situations.

(3) The annual report shall describe the condition and significant developments of the wholesale electric generation and transmission market during the year covered by the report, and any developments in those markets anticipated or known for the following year.

(4) The electric utility shall discuss, in its annual report, upcoming solicitations to be conducted pursuant to its approved CBP plan. Any deviations or modifications of the approved CBP plan being requested by the electric utility shall be described in detail, with specific rationale provided for every such deviation or modification requested.

(5) The annual report shall describe the operation to date of any time-differentiated and dynamic rate designs implemented under the CBP, the approaches used to communicate price and usage information to consumers, and observed price elasticity.

(6) The commission, legal director, deputy legal director, or attorney examiner shall determine the level of review required for any information, plans, or requests set forth in the annual report, and set any necessary schedules through an entry.

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

FINDING AND ORDER

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The Commission finds:

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 an 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 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] To carry out the Commission's directives, the Commission directed Staff to conduct a workshop to allow interested stakeholders to present concerns and to discuss and clarify issues raised by Staff. The workshop was held on October 5, 2009. Further, the Commission directed Staff to develop and file recommendations for the significantly excessive earnings test (SEET) subsequent to the workshop. Staff filed its recommendations on November 18, 2009.

By entry issued November 19, 2009, interested persons that wished to file comments were directed to do so by December 14, 2009, and to file reply comments by January 4, 2010. On December 23, 2009, a motion was filed for a five-day extension of the time to file reply comments with a request for an expedited ruling. The request for an extension of time to file reply comments was granted until January 11, 2010.

Initial comments were filed by the following interested persons: Ohio Consumers Counsel (OCC), Ohio Manufacturers' Association, Ohio Hospital Association and Ohio Energy Group (OEG) (jointly, Customer Parties); Duke Energy Ohio, Inc. (Duke); Ohio Edison Company, The Cleveland Electric Illuminating Company, and Toledo Edison Company (jointly, FirstEnergy); Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, AEP-Ohio); Citizen Power, Inc. (Citizen); and Dayton Power & Light Company (DP&L). On January 11, 2010, Citizen filed a request to withdraw its initial comments in this matter and to recognize its support for the initial

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).

comments filed by Customer Parties. The Commission finds Citizen's request to withdraw its initial comments reasonable and the request is hereby granted. Reply comments were filed by Customer Parties (including, Citizen), Duke, FirstEnergy, AEP-Ohio, DP&L, and Ohio Partners for Affordable Energy (OPAE).

On April 1, 2010, a question and answer session was held before the Commission for interested stakeholders who filed comments or reply comments in this case. Prior to the session, 11 questions were posted to the Commission's web site for the commenters' consideration.

1. What is the legal basis for employing an earnings cap on total earnings that does not consider adjustments?

2. How should the Commission define and quantify "adjustments" that could be subject to return if the Commission found significantly excessive earnings?

3. Are adjustments which "will cause" earnings significantly in excess pursuant to Section 4928.142(D)(4), Revised Code, the same as those which "will result" in earnings significantly in excess pursuant to Sections 4928.143(E) and (F), Revised Code?

4. Does a return become "excess" as a result of "adjustments" (e.g., fuel) or as a result of the establishment of a standard service offer?

5. How should the Commission define what is significant? Is there a difference in its meaning in the various statutory sections in which it appears (Sections 4928.142(D)(4), 4928.143(E), 4928.143(F), Revised Code)?

6. What is the best way to establish the threshold for significantly excessive earnings?

7. Taking into account factors such as differences in capital requirements and business risks, should significantly excessive earnings thresholds be established on a state-wide or company-specific basis?

8. How should the Commission identify and consider "the capital requirements of future committed investments in this state"?

9. What is the mechanism that an electric utility might employ to select its proposed peer group?

10. How should the Commission treat deferrals to ensure that expenses and revenues are appropriately matched in each year and to facilitate comparisons with the reported earnings of other firms?

11. Are there any ways to apply the SEET or other steps the Commission can or should take to recognize efficient operations or discourage electric utilities from incurring inefficient or wasteful expenses to "manage" their reported earnings based on the expected results of their earnings test?

All of the commenters, and the Staff, participated in the question and answer session before the Commission.[2]

LAW:

Section 4928.142(D)(4), Revised Code, provides, in relevant part:

> 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

2 In addition to participating in the question and answer session, Customer Parties filed its responses to the questions on April 1, 2010.

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.

Section 4928.143(E) and (F), Revised Code, provide, in relevant part:

(E) If an electric security plan ... exceeds three years from the effective date of the plan ... 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 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.

<u>DISCUSSION:</u>

<u>Staff Recommendation 1: Should off-system sales be included in the SEET calculation?</u>

Staff proposes that off-system sales (OSS) should be included in the net earnings used to calculate return on equity for the SEET. Staff reasons that OSS are routine operating items and not one-time write-offs or non-recurring items and inclusion of ongoing revenue and expense items for OSS would have a representative effect on the financials. Therefore, Staff concludes that stated financial results, without adjustment for OSS, are appropriate for calculation of the return on equity.

Customer Parties and OPAE concur with Staff's position and add that the return on common equity earned by each of the electric utilities that owns generation could include profits from OSS pursuant to Section 4928.143(F), Revised Code. To eliminate OSS from the SEET calculation, Customer Parties and OPAE argue, would distort the comparison between the electric utility and the comparable group of companies. Further, Customer Parties and OPAE contend that excluding OSS ignores the fact that the cost of the power plant used to make OSS is included in the electric utility's capitalization. Customer Parties offer that including OSS in the SEET calculation results in an unbiased comparison of earnings and promotes fairness by sharing the profits from OSS between customers and the electric utility. Customer Parties assert that the Commission has previously ordered that proceeds from OSS be shared between customers and the electric utility.[3] (Customer Parties Initial at 19; Customer Parties Reply at 4-6; OPAE Reply at 2.) Lastly, Customer Parties support offsetting the electric utility's ESP costs by profits from OSS. Customer Parties argue that sharing OSS profits between customers and the electric utility recognizes that the generation facility was constructed for the benefit of, and ultimately paid for by, jurisdictional customers. (Customer Parties Initial at 19; Customer Parties Reply at 4-6.)

In response, AEP-Ohio argues, among other things, that customers pay rates for retail service and not for the assets that produce those services. AEP-Ohio states that the proposal to share OSS margins is irrelevant and meritless in this proceeding. AEP-Ohio reasons that there is no statutory basis for incorporating a sharing of OSS margins into the SEET application based on Sections 4928.142(D)(4), 4928.143(E) or 4928.143(F), Revised Code, and that the Commission already rejected such arguments in AEP-Ohio's ESP cases. The only authorized adjustments to the SEET are from the company's ESP; to do otherwise, AEP-Ohio argues, would have the effect of disallowing cost recovery already authorized by the Commission. (AEP-Ohio Reply at 3-4.)

DP&L and AEP-Ohio argue that the focus of SB 221 is retail sales and OSS has not previously been included in retail rates under the Commission's jurisdiction. DP&L and AEP-Ohio also note that the purpose of conducting the SEET is to determine if the electric utility's ESP has resulted in excessive earnings for the electric utility and, therefore, it is inappropriate to include non-jurisdictional revenues. The costs and revenues associated with OSS, according to DP&L and AEP-Ohio, should be excluded from earnings in the SEET calculation. DP&L notes that acceptance of Staff's proposal would discourage electric utilities from making OSS, thus placing the interests of ratepayers and shareholders at odds. AEP-Ohio adds that excluding OSS from the SEET calculation also respects the Federal Energy Regulatory Commission's (FERC) jurisdiction and complies with well-settled federal constitutional law. Further, 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 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

3 See, for example, *In the Matter of the Application of the Cleveland Electric Illuminating Company for an Increase in Rates*, Case No. 84-188-EL-AIR, Opinion and Order at 61-65 (March 7, 1985).

Clause and 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*). (DP&L Initial at 2-3; DP&L Reply at 3; AEP-Ohio Initial 2-3.)

In response to the arguments of AEP-Ohio and DP&L, Customer Parties assert that the commenting electric utilities' position is inconsistent with the energy efficiency mandates of SB 221 and explain that customers pay the costs of energy efficiency programs and the power conserved as a result of these programs becomes available for sale in the OSS market. Customer Parties argue that if OSS margins are included in the SEET, OSS can serve as a form of off-set to the energy efficiency costs. However, according to Customer Parties, under AEP-Ohio's position, consumers would pay the full energy efficiency costs while AEP-Ohio would benefit from higher OSS profits made possible by energy efficiency programs. (Customer Parties Reply at 7.)

As to AEP-Ohio's legal argument, that including the OSS profits in the SEET violates the federal law, Customer Parties proclaim that none of the cases cited by AEP-Ohio support that claim. Customer Parties state that the cases cited stand for the proposition that when an electric utility prudently incurs FERC-approved costs, the state may not deny collection of such costs in retail rates. None of the cases deal with the retail ratemaking treatment of OSS margins derived from power plants included in retail rates. (Customer Parties Reply at 7.)

Upon further consideration of the issues raised by the electric industry and Customer Parties regarding OSS, the Commission concludes that this issue is more appropriately addressed in the context of each individual electric utility's SEET proceedings. In order to fully understand the impact of the treatment of OSS on an electric utility's earnings, the Commission directs the electric utility to include in its filing the identification of any OSS and the effect of excluding OSS from and including OSS in the SEET calculation.

<u>Staff Recommendation 2: Should the Commission determine SEET on a single entity basis or company-wide basis?</u>

Staff believes the General Assembly's intent is clearly expressed in the language of Section 4928.143(F), Revised Code, and division (C)(2)(b) of this section, to indicate that the SEET should be calculated for the electric utility as a single entity.

Duke offers that Staff's recommendation fails to take into account the difference in accounting issues where the electric utility wholly owns a subsidiary utility, like Duke owns Duke Energy Kentucky, Inc. (Duke-KY), as opposed to the situation where two electric utilities are owned by a parent holding company. Accordingly, Duke's financial books and records reflect its investment and costs associated with Duke-KY. In addition, Duke indicates that the situation is further complicated since it is a combination utility, offering both electric and gas distribution services. While Duke acknowledges that there may be justification for omitting affiliates and the parent holding company from the SEET calculation for some electric utilities, Duke advocates that a different treatment should apply to electric utilities with wholly owned subsidiaries and combination utilities. Duke contends that separating Duke from Duke-KY and segregating its gas and electric businesses are difficult and the process to do so could easily lead to protracted disputes. Furthermore, Duke argues that if the Staff recommendation is adopted and is interpreted to include the wholly owned subsidiaries of a utility and combination utility operations, an additional process may be required to resolve accounting issues that would arise with regard to the allocation of capitalization between a utility and its wholly owned subsidiaries. (Duke Initial at 2-5.)

Customer Parties respond that Duke has previously been required to file with the Commission electric-only financial information to support its ESP application and electric rate cases. Customer Parties state that in each instance Duke has separated, calculated, and filed all the financial and regulatory information allocated to Duke's electric distribution system to comply with the filing requirements. Accordingly, Customer Parties contend that there is no undue burden imposed on Duke associated with preparing the information on rate base, operating expenses, operating income, return on equity, and rate of return solely for Duke's electric services and there is no reason that the same or similar type of information cannot be made available for the application of SEET. (Customer Parties Reply at 10-11.)

Duke contends that, while it may be relatively straightforward to determine net income on a single entity basis, it is more difficult than Customer Parties represent to extract the equity that supports the subsidiary from the equity of the electric utility. For this reason, Duke reiterates that to follow Staff's narrow interpretation of the statute and exclude all earnings from affiliates, as well as subsidiaries, the Commission should determine the common equity balance attributable to the single entity, the electric utility, on a case-by-case basis in order to review the underlying equity structure of the subsidiaries, and interest and dividend income of the electric utility. (Duke Reply at 2-3.)

AEP-Ohio argues that there are compelling reasons for performing the SEET on CSP and OP on a combined basis, as CSP and OP are vertically integrated electric utilities (generation, transmission, and distribution) and are operated as a single entity, with a single management structure. AEP-Ohio reasons that combining CSP and OP for purposes of performing the SEET helps to promote efficient investment and operating practices, encourages the companies to seek and achieve economies of scale, and is consistent with the Commission's analysis of AEP-Ohio's SSO in their respective ESP. Conversely, AEP-Ohio states that performing the SEET analysis on CSP and OP as separate entities assumes that investment and operations and maintenance (O&M)

spending are determined on a stand-alone basis and could result in the punishment of one of the affiliated electric utilities for management's focus on maximizing efficient investment and O&M spending on a combined-company basis. (AEP-Ohio Initial at 3-4.)

AEP-Ohio maintains that, while CSP and OP maintain different rate structures, those differences do not preclude performing the SEET's earned return on equity calculation on a combined-company basis, as any differences could be taken into account, in the event significantly excessive earnings are determined to have occurred on a combined-company basis, as part of the remedy the Commission adopts for returning such earnings to customers. (AEP-Ohio Initial at 4-5.)

Furthermore, AEP-Ohio reasons that the restriction in Section 4928.143(F), Revised Code, against considering the revenues, expenses, or earnings of "any affiliate or parent company" in the significantly excessive earnings determination, need not preclude the Commission from applying the SEET on a combined-company basis. According to AEP-Ohio, the reference to "affiliates" in Section 4928.143(F), Revised Code, only relates to entities that are not electric utilities, such as competitive retail electric service providers or generation-only and transmission-only companies. If one electric utility's return on equity is considered to be significantly excessive, the statute does not preclude the Commission from considering the combined return on equity of the affiliated electric utility. If that combined return is not significantly excessive that fact can and should be a factor for the Commission to consider and should reduce or eliminate the refund that might otherwise be imposed by the Commission. Lastly, AEP-Ohio argues that if the Commission determines that the statute precludes calculating return on equity on a company-wide basis, the Commission still should consider the policy concerns stated as part of any SEET refund. (AEP-Ohio Initial at 4-5.)

Customer Parties oppose calculating the SEET on a combined basis and assert that the arguments of AEP-Ohio are unsubstantiated and irrelevant to the application of the SEET. The approved rate of return, capital structure, cost of debt, and tariffs of CSP and OP are established separately by the Commission. Further, Customer Parties offer that the application of the SEET on a single-entity basis neither prevents nor precludes CSP and OP from improving operational efficiency or investments or benefiting from various economies of scale. (Customer Parties Reply at 9-10.)

The Commission finds the language in Section 4928.143(F), Revised Code, to be dispositive of whether the SEET is to be calculated for a single-entity or on a company-wide basis. The last sentence of Section 4928.143(F), Revised Code, clearly states that: "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." We believe that the intent of the language quoted above is to avoid penalizing or rewarding the electric utility for the business operations of its affiliate or parent company. Accepting the arguments of AEP-Ohio to perform the SEET calculation on CSP and OP jointly is not only contrary to the plain language of the statute but would neutralize the earnings of one affiliate, and its customers, over the other. While AEP-Ohio may find it cost-effective for investment and operation and maintenance purposes to make decisions for CSP and OP on a combined-company basis, AEP-Ohio's management decisions do not override the requirements of the statute. As for Duke, with its wholly-owned subsidiaries, we find that the intent of the legislation is to extract, to the extent reasonably feasible and prudently justified, the expenses, earnings, and equity of any affiliate from the SEET calculation. Similarly, where Duke can separate and justify the revenue and expenses associated with its gas distribution service operations from its electric services, we find it appropriate to do so for calculation of the SEET. While making such adjustments may complicate the Duke SEET evaluation, it maintains what the Commission believes to be the intent of the legislation and protects the interest of Duke's electric customers.

Staff Recommendations 3 and 11: What adjustments should be included in the SEET calculation? How should write-offs and deferrals be reflected in the return on equity calculation for SEET?

Staff recommends that stated financial results, without adjustment, should be used for calculation of the SEET and extraordinary items should be excluded. Staff reasons that such definition provides a reasonable, representative, and consistent measure of return on equity. Extraordinary items could overwhelm normal levels of earnings and would not be pertinent to the SEET unless directly tied to an ESP or MRO. Where applicable, adjustments should also be made to remove items associated with non-Ohio service areas. Staff believes that the adjustments created by the implementation of an ESP or MRO are what should be determined on a company-specific basis, only if financial results, as stated, are deemed to be excessive. If excessive earnings, after exclusion of the total adjustments from the earned return, are brought below the threshold deemed to be excessive, then the amount of the excess shall be refunded to the electric utility's customers. If the return with the adjustments excluded is still excessive, then the adjustments cannot be at fault for excessive earnings, and no amount need be returned to the consumers.

Further, Staff recommends that if extraordinary items are created as an adjustment in the ESP or MRO, they should be included for purposes of the SEET in earnings and as adjustments. Extraordinary items that are not created as an adjustment in the ESP or MRO should not be included for purposes of the SEET, either in earnings or as an adjustment. Staff also advocates that OSS should be included as an adjustment in the SEET calculation only when OSS is also included as an adjustment to an electric utility's MRO or ESP. If OSS are not included as an adjustment to the MRO or ESP, then they should not be included as an adjustment in the SEET calculation. OSS are to be included in the earnings, in any case.

Customer Parties concur with the Staff Recommendation concerning the treatment of extraordinary items and OSS, but add that any SEET refund should be excluded from the SEET calculation in the year the refunds are reported on the income statement. (Customer Parties Initial at 15.) No commenters responded to this concern.

Customer Parties recognize that Staff proposes a two-pronged test for determining whether an electric utility's earnings are significantly excessive and subject to refund. Customer Parties assert, however, that the second prong of Staff's test is based on a fundamental misinterpretation of the law. Customer Parties agree that if the ESP rate increases are removed from earnings, and the return on equity is below the SEET threshold, the excess earnings should be subject to refund to the electric utility's customers and no further analysis is necessary. However, Customer Parties assert that the second prong of the analysis, as proposed by Staff, would not result in any refund to customers where the ESP rate increases are excluded from the earnings and the return on equity remains above the established SEET threshold. Customer Parties reason that even if the excess earnings are not a result of the ESP, the ESP contributed to the electric utility's excessive earnings and, therefore, the entirety of the ESP adjustments or rate increase should be returned to customers. Staff's interpretation of the statute, according to Customer Parties, nullifies the very reason for the statute. (Customer Parties Initial at 16-17; Tr. at 7-11.)

As to the adjustments to be included in the SEET calculation, FirstEnergy requests that for the purpose of calculating SEET, net income applicable to common shareholders be adjusted to exclude extraordinary or nonrecurring items which are otherwise non-representative of an electric utility's operations, and any specific adjustments defined in an electric utility's ESP then in effect. The denominator shall be the average monthly common equity balance during the measurement period, adjusted to exclude the related effects of any items excluded from net income. The resulting adjusted return on common equity becomes the reference point, as described in more detail in the company's comments regarding the definition of "significantly in excess of the return on common equity" at Recommendation 5. (FirstEnergy Initial at 2-3.) Customer Parties argue that excluding extraordinary items "which are otherwise non-representative of a utility's operations," as FirstEnergy proposes, would result in mini rate case proceedings and is unworkable. (Customer Parties Reply at 13.)

Duke notes that the Commission approved the stipulation filed in its ESP, which specifically provides that the return on common equity is to be computed using FERC Form 1 financial statements from the prior year, including OSS, subject to certain listed adjustments.[4] Duke mentions that its ESP Stipulation does not indicate that adjustments

4 *In the Matter of the Application of Duke Energy Ohio Inc. for Approval of an Electric Security Plan*, Case No. 08-920-EL-SSO, Opinion and Order (December 17, 2008) (Duke ESP case).

would be made to remove items associated with non-Ohio service areas. Accordingly, Duke objects to the notion that any such change would be made pursuant to this proceeding. (Duke Initial at 5; Duke Reply at 4.) Similarly, FirstEnergy argues that its approved ESP Stipulation includes an express provision excluding deferrals related to deferred carrying charges in the SEET application.[5] Accordingly, FirstEnergy argues that this provision of the approved Stipulation should not be abrogated by this proceeding. (FirstEnergy Reply at 3.) While Duke argues that FirstEnergy's proposal to exclude extraordinary items, nonrecurring items and items that are not representative of an electric utility's operations only from the income statement is inappropriate, Duke supports the proposal as long as the impacts of such adjustments are accounted for in the SEET calculation. (FirstEnergy Initial at 2-3; Duke Reply at 4.)

DP&L avers that, in addition to excluding OSS, other adjustments to the SEET should include significant non-recurring adjustments that are related to regulated operations, such as out-of-period tax adjustments, adjustments for economic conditions, or potential significant loss of load. (DP&L Initial at 3.)

AEP-Ohio states that it agrees with Staff's recommendations regarding the treatment of extraordinary items, but holds that, when correctly interpreted, Staff's proposed treatment of extraordinary items necessitates an adjustment in the calculation of earnings for OSS since OSS are FERC-jurisdictional and associated with non-Ohio service areas. Furthermore, AEP-Ohio clarified its position that if the electric utility is found to have exceeded the significantly excessive earnings threshold, that only those components of the ESP that produce earnings for the electric utility are subject to refund (Tr. 24-25; AEP-Ohio Initial at 5-6.)

Customer Parties urge the Commission to strictly compare an electric utility's earnings to the determined SEET threshold, a one-step process, and if the electric utility's earnings exceed the threshold, adjust the electric utility's earnings accordingly. Customer Parties' proposal essentially establishes a cap on the electric utility's return on equity rather than ensures that the ESP adjustments do not result in significantly excessive earnings as Section 4928.143(E), Revised Code, requires.

Based on the clear, unambiguous language of the statute, the Commission is directed to analyze whether the ESP is the cause of the electric utility's significantly excessive earnings. The Commission finds the "one-step process" to be more appropriate than the two-pronged analysis advocated by Staff. In the context of the SEET analysis, it is unreasonable to presume that even if the electric utility was very profitable prior to the ESP, the adjustments in the ESP would not be adding to excess earnings. We also believe that the two-step analysis could encourage gaming by the electric utilities. The clear,

5 *FirstEnergy ESP cases*, Stipulation (February 19, 2009), paragraph B.6 at 17.

unambiguous language of the statute limits the amount of any refund to customers to the adjustments in the current ESP. More specifically, an adjustment for purposes of Section 4928.143(F), Revised Code, includes any change in rates when compared to the rates in the electric utility's preceding rate plan. Therefore, in any given year, the earnings, which if significantly excessive, subject to being returned is the difference between those earned under the rate in place in that year and what would have been earned if the utility's preceding rate plan had been in place in that year. For example, in the year 2010, the comparison for most electric utilities would be to the rates from the preceding rate plan for 2008. Thus, the Commission reasons that in 2010, we would not be permitted to "claw back" into 2009 profits if the 2009 profits were not significantly excessive. We find FirstEnergy's arguments to be persuasive. FirstEnergy reasoned that in the first sentence of Section 4928.143(F), Revised Code, the phrase "any such adjustments" should be read as referring to the first part of the sentence and the phrase, "the provisions that are included in an electric security plan under this section" (Tr. 20-22). We note that Customer Parties seem to agree with FirstEnergy's interpretation (Tr. 16-17, 18-19). Finally, we also agree, as Customer Parties emphasize, that any adjustment to the earnings of an electric utility, as a result of a refund, should be excluded from the SEET calculation in the year the adjustment is made to avoid distorting the electric utility's income. In order to facilitate the valuation of the ESP adjustments, the electric utilities are directed to include in their SEET filings the difference in earnings between the ESP and what would have occurred had the preceding rate plan been in place.

As to Staff Recommendation 11, regarding how write-offs and deferrals should be reflected in the return on equity calculation for SEET, Customer Parties advocate that any deferral of fuel costs or other items should be reflected in the return on equity calculation for SEET in the year when the retail sales occur, not in later years when the deferred revenues are received. Customer Parties argue that such would be consistent with Staff's recommendation that stated financial results should be used for calculation of the SEET. Customer Parties suggest that in any year where there is a deferral and a SEET finding of excess profits, that the excess profits could first be used to pay down the deferrals before any refund is awarded to customers. (Customer Parties Initial at 15-16; Tr. 34-35.)

AEP-Ohio disagrees, maintaining that a SEET obligation to return significantly excessive earnings due to ESP adjustments should not be premised on deferrals since the electric utility has not yet received the cash that would have to be returned. Further, AEP-Ohio argued that Section 4928.143(F), Revised Code, should not be applied in a manner that underminds the probability of the electric utility's future recovery of deferrals that were previously authorized by the Commission and jeopardizes the utility's ability to create the deferral to phase-in rate increases and moderate customer rate impacts and contends that Section 4928.144, Revised Code, supports its interpretation. (AEP-Ohio Reply at 4-5; Tr. 26-33, 36-37.)

OPAE argues that the focus of the SEET is to protect consumers and it is not necessary to put deferrals, booked pursuant to generally accepted accounting principles, at issue to achieve the goal of the SEET. OPAE believes the electric utility's revenues, in total, should be considered in the SEET analysis. (Tr. at 33-34.)

Duke explained that there are two types of deferrals. One type is deferred revenue with an underlying expense, like the FAC expense in AEP-Ohio's case. Duke argues that it would be unfair to require the electric utility to recognize the revenue or incur expense until it is received. The second type of deferral, according to Duke, is a deferred rate increase which may not have an underlying expense and is different in concept than the first type of deferral. (Tr. 35-36.)

The Commission recognizes that the issues surrounding the treatment of deferrals are extremely complex. The Commission notes that granting a company the ability to defer expenses does not equate to the unequivocal right to collect the deferral. However, deferrals are a regulatory tool used by the Commission to avoid rate shock to customers and as such can be a public benefit. The Commission is also mindful that from a financial reporting perspective that the recovery of deferrals by an electric utility needs to be fairly known so that it may be treated appropriately for accounting purposes. The Commission understands that to cast an unacceptable level of doubt on the recovery of a deferral, particularly a large deferral, will severely dampen the electric utility's willingness to agree to deferrals. Because many factors need to be considered in order to weigh the appropriateness of the treatment of any given deferral, the Commission finds that the treatment of deferrals, for purposes of the SEET, should be determined on a case-by-case basis. To facilitate the Commission's consideration of an electric utility's deferrals, in their SEET filings, the electric utility should identify any deferrals and the effects of excluding and including the deferrals in the SEET calculation. Furthermore, similar information should also be provided for extraordinary items.

In regards to Staff's recommendation 11, the Commission further finds that where an electric utility's ESP or MRO has been resolved by stipulation, which includes a method for the treatment of write-offs and deferrals in calculating the SEET, the Commission is not modifying the stipulation with this proceeding, to the extent that the issue is adequately addressed in the stipulation and the order approving the stipulation. Accordingly, the approved standard service offer stipulations of Duke and FirstEnergy shall stand as approved by the Commission to the extent the treatment of deferrals and write-offs in the SEET calculation were addressed.

As discussed further, in regard to Recommendation 10, the Commission will determine how any significantly excessive earnings are returned to customers based on the circumstances of the company-specific case.

Staff Recommendation 4: What is the precise accounting definition of "earned return on common equity" that should be used?

Staff proposes, and Customer Parties concur, that earned return should be the net income for the year divided by the average common equity over all months of the year with extraordinary items excluded. (Customer Parties Initial at 21.) Staff reasons that this definition is consistent with the use of stated financials with minimal adjustments. DP&L agrees that "earned return on common equity" should mean net income divided by average common equity. However, DP&L recommends that preferred dividends be excluded from net income and that average common equity be calculated using 13 monthly balances rather than the average of 12 calendar month balances. DP&L reasons that including December of the previous year reflects the capital structure that was in place for the full calendar year. (DP&L Initial at 4.)

For clarity, AEP-Ohio requests that, in the equation proposed by Staff, the numerator, net income, be defined as profit after deduction of all expenses, including taxes, minority interest, and preferred dividends, paid or accumulated, and excluding any non-recurring, special, and extraordinary items, and the denominator is average book equity as determined by averaging beginning of the year equity and end of the year equity. Further, AEP-Ohio argues that the earned return on common equity should not include deferred fuel adjustment clause (FAC) expenses. More specifically, AEP-Ohio explains that an electric utility should not be made to refund deferred amounts it has not yet collected. Instead, during the deferral period of AEP-Ohio's 10-year phase-in (2009-2011) all deferrals of FAC expenses would be excluded from the SEET and, during the recovery period of the phase-in (2012-2018), FAC expenses associated with the amounts previously deferred would be excluded from the SEET. (AEP-Ohio Initial at 7-8.)

Like DP&L and AEP-Ohio, FirstEnergy concurs that the methodology selected should capture an average of common equity over all months of the year as opposed to use of an unrepresentative, single point measure of equity. FirstEnergy also recommends that the exclusion of extraordinary or nonrecurring items, or those which are otherwise non-representative of the electric utility's operations, in order to maintain comparability with the sample of companies against which the electric utility's earnings are being considered. (FirstEnergy Initial at 3.)

Customers Parties object to AEP-Ohio's recommendation, specifically, that earned return on common equity exclude FAC revenues and, generally, that FAC revenues and expenses be excluded from the SEET calculation during the ESP period of 2009-2011 and also the recovery period of 2012-2018. Customers Parties argue such treatment would forever deny consumers a proper accounting. Customer Parties recommend that any deferral of fuel costs or other items should be reflected in the return on equity calculation for SEET in the year when the retail sales occur, not in later years when the deferred revenues are received. Deferrals, according to Customer Parties, could be included in earnings and any excess profits should first be used to pay back the deferral before there are any cash refunds. However, Customer Parties express concern about pre-determining that deferrals should be collected from customers. (Customer Parties Reply at 14-15.)

Duke asserts that, while there appears to be some agreement between Staff and commenters that earned return on common equity is equal to net income available for common equity divided by some average of common equity balance, it may be necessary to carve out additional equity, in addition to adjusting the equity balance for any net income adjustments. (Duke Reply at 4-5.)

We find that Staff's proposal, with some commenter clarifications, is appropriate for the purpose of determining whether an electric utility has had significantly excessive earnings. Accordingly, for the SEET calculation, the earned return will equal the electric utility's profits after deduction of all expenses, including taxes, minority interest, and preferred dividends, paid or accumulated, and excluding any non-recurring, special, and extraordinary items. The average book equity used to calculate the SEET will be the book equity for the 12-month period. The Commission is not convinced that using the 13 monthly common equity book balances, as proposed by DP&L, is likely to lead to a significantly different result than the 12-month average. Furthermore, as the Commission declines, at this time, to make a generic finding with respect to the treatment of deferrals, the Commission directs the electric utilities to file their earnings with the inclusion of deferrals and also without the inclusion of deferrals.

Staff Recommendation 5: What is the definition of "significantly in excess of the return on common equity"?

Staff recommends that a return on common equity of the greater of 200 basis points above the mean or in excess of 1.28 (expressed as basis points) times the standard deviation above the mean of a comparable group of companies should be defined as significantly in excess. Assuming a normal distribution, this would establish a level of return below which 90 percent of the sample of comparables would fall. This methodology was used by Michael J. Vilbert in direct testimony filed in FirstEnergy's SSO cases and Staff believes the resultant level of return defined as significantly in excess to have been reasonable.[6] Two hundred basis points above the mean would act as a backstop when earnings are low.

Customer Parties' primary concern is the definition of "significantly in excess of the return on common equity" as Customer Parties believe it is the foundation of the consumer protection aspect of SB 221. Customer Parties contend that through the SEET,

6 *FirstEnergy ESP case*, Application, Ex. 8 at Appendix B-3 (July 31, 2008).

the legislature determined that Ohio electric consumers cannot be required to fund significantly excessive utility profits.

Customer Parties note that Staff's recommendation on this issue is a complete departure from Staff's position in the AEP-Ohio and FirstEnergy ESP cases, as demonstrated by the direct testimony of Staff witness Cahaan in the AEP-Ohio ESP case.[7] Customer Parties argue that the use of a statistical standard deviation approach requires an assumption that the return on equity for the comparable companies are normally distributed, and no evidence presented in the AEP-Ohio or FirstEnergy ESP proceedings supports such an assumption. AEP-Ohio retorts that this assumption exists with any statistics-based methodology and there is no basis for concluding that the returns on equity of a yet to be determined comparable group will not be normally distributed. Thus, AEP-Ohio argues that Customer Parties' criticism is without merit. (AEP-Ohio Reply at 8-9.)

Next, using AEP-Ohio witness Makhija's comparable group for 2007 as an example, Customer Parties argue that the proposed method may result in unreasonable SEET return on equity thresholds, in this case 55.5 percent.[8] Customer Parties maintain that this is not some inherent flaw in the SEET, as the test is very similar to the "comparable earnings" standard used by public utilities across the United States for years; the U. S. Supreme Court upheld the constitutionality of this standard in *Bluefield Water Works v. West Virginia*, 262 U.S. 679, 692 (1923) (*Bluefield*); and *F.P.C. v. Hope Natural Gas*, 320 U.S. 591, 603 (1944) (*Hope*). Further, Customer Parties note that, in comparison to the potential result of Dr. Makhija's methodology, for the first nine months of 2009 in 22 cases the average electric utility's return on equity authorized by state commissions was 10.43 percent, with the highest return on equity being 11.39 percent in 22 cases for the year 1996.[9] Customer Parties prefer the use of the threshold of 200-400 basis points above the mean return of the sample group instead of the recommendation now advocated by Staff. This approach was supported by OEG witness King in AEP-Ohio's ESP proceedings.[10] Mr. King proffered that the SEET threshold be set at a simple 200 basis points above the mean return of the comparable companies group. Customer Parties state that a 200 basis point premium is equal to the return on equity adder used by FERC to incentivize utilities to make especially risky transmission investments and provides an ample return on equity premium. Finally, Customer Parties reason that as long as the Commission retains ultimate authority regarding the return on equity premium to be added to the comparable

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7 *AEP-Ohio ESP cases*, Direct Testimony of Staff witness Cahaan (November 7, 2008).

8 The greater of: a) 13.91 percent plus 200 basis points which equals 15.91 percent; or b) 13.91 percent plus (32.51 multiplied by 1.28) which equals 55.5 percent. See *AEP-Ohio ESP cases*, Direct Testimony of AEP-Ohio witness Makhija (July 31, 2008).

9 Regulatory Research Associates, Regulatory Focus, October 2, 2009.

10 *AEP-Ohio ESP cases*, Direct Testimony of OEG witness King (November 3, 2008).

group return on equity, then a reasonable balancing of customer and shareholder interests can be maintained under any economic conditions. (Customer Parties Initial at 3-11.)

AEP-Ohio states that the use of a statistical approach for determining the SEET threshold is appropriate. Further, AEP-Ohio argues that Customer Parties have mischaracterized Dr. Makhija's testimony filed in AEP-Ohio's ESP proceeding. AEP-Ohio explains that, with a 95 percent confidence level, using 2007 data, results in a comparable group with a mean return on equity of 13.9 percent, an adder of 13 percent, and a significantly excessive earnings threshold of 26.9 percent. AEP-Ohio further states that using Dr. Makhija's method with a 90 percent confidence level or a 1.28 standard deviation variance reduces the adder to 8.3 percent, and when added to the mean return on equity of 13.9 percent yields a return on equity threshold of 22.1 percent for 2007, not an increase of 28 percent to 55.5 percent, as Customer Parties claims. (AEP-Ohio Reply at 8.)

In response to the criticism of Customer Parties, FirstEnergy notes that, while Customer Parties lament the use of a statistical criterion, Dr. Woolridge's approach, which Customer Parties supported in the FirstEnergy ESP proceeding, proposed the use of a statistical based criterion as the mechanism by which to define "significantly excessive earnings."[11] FirstEnergy, AEP-Ohio, and Duke further challenge Customer Parties' recitation of *Bluefield* and *Hope* as irrelevant to the issue of whether an electric utility has significantly excessive earnings during a given period in comparison to other businesses with similar business and financial risk. Duke argues that the Bluefield and Hope cases apply to FERC's setting of rates. Further, Duke also asserts that the Commission is not governed by federal law or case precedent and that those principles are inapplicable to Commission practice. FirstEnergy notes three specific differences in the analysis at hand as opposed to the rate of return on equity at issue in *Bluefield* or *Hope*. First, FirstEnergy argues, and AEP-Ohio agrees, that the determination of what rate of return should be allowed in a rate case is a forward-looking exercise which attempts to capture the return that will be required by an investor to make a future investment. In contrast, the SEET determination is a retrospective look at the financial results achieved in a prior fiscal period. Second, the commenting electric utilities agree that ascertaining an appropriate allowed rate of return focuses on market-based measures while the SEET relies on a comparison of accounting or book-based measures. Third, FirstEnergy opines that in setting an allowed rate of return, there is an inherent expectation that an electric utility may at times earn slightly more or less than the precise return on equity allowed; however, over time and on average, the electric utility will earn its allowed return. FirstEnergy and AEP-Ohio argue that the SEET mechanism presents the prospect that the electric utility may be required to return to customers that portion of earnings which is deemed to be "significantly excessive" and that requirement is not balanced out by any offsetting mechanism applicable in a period of particularly low earnings. Thus, FirstEnergy

11 FirstEnergy ESP case, Tr. V at 30 (October 22, 2008); FirstEnergy Reply Brief at 90.

concludes that determining the proper rate of return and the SEET application are fundamentally different. (FirstEnergy Reply at 4-5; AEP-Ohio Reply at 6-11; Duke Reply at 7.)

AEP-Ohio responds that Customer Parties' proposal to use a 200 basis points premium to the return on equity is a misguided comparison to the adder used by FERC to incent utilities to invest in new transmission line projects. AEP-Ohio reasons that the adder used by FERC is not, by definition, set at a significantly excessive level, but is based on a traditional just and reasonable standard. Further, AEP-Ohio surmises that the use of the FERC adder overlooks the SEET statutory requirement to establish the threshold for excessive earnings based on matching the business and financial risks of an electric utility to a group of comparable companies or change with economic conditions and the performance of comparable firms. (AEP-Ohio Reply at 10.)

Duke disagrees with the Staff proposal. In Duke's ESP case, Duke witness Rose recommended using a 95 percent confidence level or 1.64 standard deviations above the mean.[12] Mr. Rose advocated using a comparable group that is weighted by traditionally regulated utilities and fully non-regulated industries. Duke believes this is the threshold that defines the level of earnings that is "significantly excessive." Duke surmises the legislature included the adjective "significantly" in order to avoid capturing situations in which earnings are just somewhat higher than average. Without a threshold at the 95 percent confidence level, it is difficult to conclude that earnings are significantly excessive. In response to Customer Parties' support of 200 basis points above the mean approach, DP&L presents that two standard deviations is a more appropriate threshold for SEET and would result in only those companies that truly have "significantly excessive earnings." (Duke Initial at 6; DP&L Initial at 4; DP&L Reply at 2.)

Also, Duke argues that Staff's recommendation, which it attributes to FirstEnergy's witness Vilbert, disregards a significant qualification made by Dr. Vilbert that his recommended confidence level would increase from 1.28 standard deviations if a comparable group of companies is limited to regulated electric utilities for purposes of calculating the SEET.[13] For this reason, Duke contends that the Commission should recognize the impact of the composition of the comparable group in the determination of the confidence level. Duke interprets Section 4928.142(D)(4), Revised Code, to require electric utilities and other publicly traded companies to be part of the comparison group, with a commensurate standard deviation above the mean. (Duke Initial at 6; Duke Reply at 6-7.)

12 Duke ESP case, Direct Testimony of Duke witness Rose (July 31, 2008).

13 FirstEnergy ESP case, Direct Testimony of Vilbert (July 31, 2008).

DP&L's comments focus on the word "significantly" and suggest that the Commission find significantly excessive earnings if an electric utility earns more than 2.00 standard deviations beyond the average of the comparable companies. DP&L notes that Vilbert's testimony represents that two standard deviations would result in 2.3 percent of the companies in the sample having earnings beyond the range of reasonableness and, therefore, deemed "significantly excessive earnings." In light of Dr. Vilbert's representation, Staff's recommendation of 1.28 standard deviations would result in 10 percent of the comparable companies' earnings beyond the range of reasonableness and their earnings excessive. DP&L argues that the test is for "significantly excessive earnings" and, thus, should not apply to 10 percent of the comparable companies each year. (DP&L Initial at 4.) Instead, DP&L also supports that two standard deviations is the more appropriate threshold for SEET and would result in a finding of only those companies that truly have "significantly excessive earnings." (DP&L Reply at 2.)

AEP-Ohio primarily agrees with the Staff recommendation but suggests that the multiplier for the standard deviation-based adder should be 2.00, rather than 1.28 as the Staff proposes. The 2.00 standard deviation level, which corresponds to a 95 percent confidence level, is a more commonly used measure of what is significantly above (or below) the mean than is a 1.28 standard deviation level (corresponding to a 90 percent confidence level).[14] (AEP-Ohio Initial at 8-9.) As discussed in detail in its initial comments, Customer Parties admonish AEP-Ohio's proposal for a 2.00 standard deviation adder, which by Customer Parties' calculations would yield a 78.9 percent return on equity, as unreasonable on its face and another example of why the statistical method is unreasonable and should be rejected. (Customer Parties Reply at 18.)

FirstEnergy explains that the Staff recommended methodology reflects the most conservative acceptable statistical confidence level of 90 percent. Further, FirstEnergy notes that this method and confidence level, assuming the sample group would include companies from industries other than the electric utility industry, reduces the prospect of a "false positive" result where the SEET would incorrectly identify the electric utility's earnings as significantly excessive, and mitigates the likelihood of imposing an asymmetric risk upon the electric utilities with regard to the electric utility's ability to actually earn the return allowed by the Commission.[15] However, FirstEnergy points out that if the sample of comparable companies is more restrictive it would be appropriate to use a higher confidence level of 95 percent or 97.5 percent. The higher confidence level is appropriate, as FirstEnergy reasons, since there is less variance in distribution of returns within more restricted samples and, therefore, the danger of the test resulting in false positives is increased and may yield an incorrect implication of significantly excessive

14 AEP-Ohio ESP cases, Direct and Rebuttal Testimony of AEP-Ohio witness Makhija (July 31, 2008 and December 8, 2008).

15 FirstEnergy ESP case, Companies' Exhibit 8, Direct Testimony of FirstEnergy witness Vilbert at 14-20 (July 31, 2008).

earnings.[16] Moreover, FirstEnergy emphasizes that beyond the mechanical application of a mathematical test, Section 4928.143(F), Revised Code, requires the Commission to consider the capital requirements of future committed investments in Ohio. (FirstEnergy Initial at 4-5.)

With respect to the appropriate "backstop" level, FirstEnergy and AEP-Ohio concur in Staff's recommendation to adopt, and the rationale for implementing, 200 basis points as a minimum increment above the mean return for the comparable companies as a "backstop." (FirstEnergy Initial at 5; AEP-Ohio Initial at 9.)

Duke believes that Staff's proposal to use 200 basis points rather than the 1.28 standard deviation is appropriate in difficult economic times (Duke Initial at 6). DP&L recommends that the electric utility's regulated return on equity established in its most recent rate proceeding plus 30 percent, be used as the appropriate backstop for determining significantly excessive earnings (DP&L Initial at 4-5).

Customer Parties state that DP&L's recommendation is not based on the company's testimony in its ESP or any other case and is, thus, without foundation. Further, Customer Parties request clarification of whether the 30 percent is an adjustment made as a percentage of the established return on equity as opposed to an adjustment of 30 percentage points over the established return on equity, and notes that the established rate of return on common equity for most of Ohio's electric utilities was established in rate proceedings ten to 15 years ago and have little relevance to the current cost of capital and economic conditions. Accordingly, Customer Parties oppose DP&L's backstop recommendation. (Customer Parties Reply at 17.)

Because the comments received in response to Recommendation 5 intertwine with the comments received in response to Recommendation 7, the Commission's finding with respect to Recommendation 5 will be provided in the discussion of its findings in response to Recommendation 7 so that interested stakeholders have a cohesive synopsis of the methodology establishing the SEET threshold.

<u>Staff Recommendations 6 and 9: How should companies "that face comparable business and financial risk" be determined? How should the earnings of a comparable company be adjusted to compensate for the financial risk difference associated with the difference in capital structures?</u>

In regard to the method for comparable group sample selection, Staff suggests that since different companies are structured differently and economic conditions will vary over time, the comparable group samples should vary case-to-case. While leverage can be

16 Id. at 16.

used as a factor in the group selection, Staff believes that not doing so and adjusting the resulting returns for the comparable group companies is preferable, as this enables a larger sample to be used. A larger sample enables greater validity for the results. Staff would leave this choice to the discretion of the Applicant companies as doing so would be consistent with the case-by-case group selection policy and because the leverage consideration is of secondary significance.

DP&L agrees with Staff that the comparable companies should vary on a case-by-case basis to reflect different company structures, business profiles, and economic conditions and that the earnings of the comparable companies may be adjusted on a case-by-case basis to account for different capital structures consistent with paragraphs (E) and (F) of Section 4928.143, Revised Code. (DP&L Initial at 5-6.)

AEP-Ohio generally concurs with Staff's recommendation and observations and, in particular, the recommendation that the choice for selecting the comparable group would be at the discretion of the electric utility (AEP-Ohio Initial at 10).

FirstEnergy suggests that the method for selecting comparable companies be uniformly applied to all Ohio electric utilities pursuant to the process set out in the FirstEnergy ESP cases. A uniform selection method, according to FirstEnergy, reduces potential uncertainty in the application of the SEET from year to year and from electric utility to electric utility but allows, if the specific circumstances presented justify, a departure from application of the uniform methodology on a limited basis. (FirstEnergy Initial 5-6.) FirstEnergy advocates the comparable companies selection process presented by FirstEnergy witness Vilbert in the FirstEnergy ESP case.[17]

FirstEnergy also supports, as advocated by FirstEnergy in its ESP proceeding and most recent distribution rate case, the Staff recommendation regarding the financial risk of comparable companies and notes such approach facilitates a larger sample of comparable companies to be used, which improves the validity of the results. (FirstEnergy Initial 6.)

Customer Parties and OPAE note that Staff originally advocated that a single methodology for selection of comparable companies be used for all electric utilities.[18] Customer Parties and OPAE contend that selection of the comparable group is critical for

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17 FirstEnergy ESP case, Direct Testimony of Vilbert at 10-14 (July 31, 2008). Dr. Vilbert's methodology may be summarized as follows: (1) determine that the companies have business risk similar to that of the electric utility selecting : (a) companies that operate in industries that rely on a network of assets to provide services to a customer mix that includes residential, commercial and industrial customers; and (b) the companies have high capital intensity; (2) adjust for differences in capital structure by adjusting the measure of return on capital; and (3) eliminate companies that: (a) have a credit rating below investment grade; (b) foreign companies; and (c) the necessary information to compute the asset turnover measure is not available.

18 AEP-Ohio ESP cases, Direct Testimony of Staff witness Cahaan (November 7, 2008).

two reasons. First, selection of the comparable group determines the mean (average) rate of return on equity and, second because the comparable group also determines the variability of earnings from which the statistical standard deviation is derived. Customer Parties argue that the recommended method will result in unreasonable return on equity thresholds. (Customer Parties Initial at 4, 12; OPAE Reply at 4-5; Tr. 40-41.)

Customer Parties insist that a common methodology for the selection of a comparable group of companies is essential to the SEET. If, as proposed by Staff, this issue is decided on a case-by-case basis, Customer Parties argue that this aspect of the SEET calculation will essentially be a mini rate case. Customer Parties propose the methodology offered by OCC witness Woolridge in the electric utility ESP cases be implemented for all electric utility SEET proceedings. (Customer Parties Initial at 13; Tr. 41.)[19]

AEP-Ohio asserts that Customer Parties' comparable group selection process is flawed to the extent that the process limits comparable firms to only those with the characteristics of other electric utilities, contrary to the language of Section 4928.143(F), Revised Code, and fails to consider the business and risk characteristics of the electric utility. Thus, AEP-Ohio points out that Customer Parties' proposed selection process results in the same list of comparable firms for each Ohio electric utility and, therefore, assumes that the risk of FirstEnergy's electric utilities, which are insulated from generation and transmission risks, is equivalent to the risk faced by AEP-Ohio, even though AEP-Ohio is not insulated from generation and transmission risks. Accordingly, AEP-Ohio continues to support a case-by-case approach to applying the SEET methodology to each electric utility, including the determination of the comparable group. (AEP-Ohio Reply 12-13.)

In regards to how the earnings of comparable companies should be adjusted for the financial risk difference associated with the difference in capital structure, Customer Parties assert there is consensus among three of the experts who offered testimony in the

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19 AEP-Ohio ESP cases, Direct Testimony of OCC witness Woolridge (October 31, 2008). Woolridge's methodology may be summarized as follows: (1) Identify a proxy group of electric utilities that must have: (a) an investment grade bond rating; (b) total revenue less than $10 billion; (c) percent of regulated electric revenue of at least 75%; and (d) a three-year history of paying cash dividends. (2) Identify a list of business and financial risk measures to insure that the comparable private sector companies are similar to the proxy group of electric utilities. These business and financial risk measures are: (a) stock price beta (a measure of stock price volatility); (b) asset turnover ratio (measures capital intensity); (c) common equity ratio (shareholder equity as percent of total capitalization); and (d) no foreign companies. (3) Determine the business and financial risk measures identified above (beta, asset turnover ratio, and common equity ratio) for the proxy group of electric utilities. (4) Use the beta, asset turnover ratio, and common equity ratios for the proxy group of electric utilities to screen the thousands of companies in the Value Line database. The result was 64 comparable companies, 44 of which were electric utilities. (5) Calculate the mean (average) ROE for the 64 company comparable group. (6) Finally, adjust the mean (average) ROE for the 64 company comparable group for the actual capital structure of the Ohio electric utility being examined.

ESP cases—Dr. Woolridge, Dr. Vilbert and Mr. King. The process involves computing the pre-tax return on capital for the comparable companies, and then making adjustments to reflect the difference in the benchmark return on equity based on the capital structure of the Ohio electric utility relative to the average of the comparable public companies. Dr. Woolridge's three-step process to make this adjustment includes:

(1) Compute the average pre-tax return on total capital for the comparable group of public companies, using the average return on equity, debt/equity percentages, income tax rates, and long-term debt cost rates;

(2) Compute the pre-tax return on equity for the Ohio electric utility using: (a) the average pre-tax return on total capital for the comparable companies; and (b) the individual debt/equity percentages, income tax rates, and long-term debt cost rates of the Ohio electric utility; and

(3) Compute the after-tax benchmark return on equity for the Ohio electric utility using its income tax rates.

Customer Parties assert that, using 2007 data, Dr. Woolridge's methodology results in a comparable group with a mean return on equity of 11.37 percent and a relatively stable standard deviation of 4.2. By contrast, Dr. Makhija's 2007 comparable group had a mean return on equity of 13.91 percent and a standard deviation of 32.51. The OCC and FirstEnergy witnesses both determined a similar mean return on equity (11.37 percent versus 13.91 percent). Customer Parties recognize that the standard deviation of the OCC's and AEP-Ohio's comparable group was widely different, 4.52 versus 32.51, which demonstrates why statistical standard deviation approach to SEET cannot be relied upon for protecting customers under the statutory standard. (Customer Parties Initial at 13-14.)

Customer Parties acknowledge that SB 221 explicitly states that the capital structure of the electric utility should be considered and accounted for in assessing the SEET. However, Customer Parties are concerned that the Staff recommendation makes consideration of the capital structure a secondary consideration and also that it should not be determined on a case-by-case basis. Further, as stated previously, Customer Parties object to each electric utility selecting the comparable group of companies pursuant to Dr. Vilbert's method since the statute requires that leverage (i.e., ratio of common equity) consideration be given primary and explicit consideration in the group selection process. Customer Parties assert that FirstEnergy's proposal ignores the leverage consideration in the sample group selection and instead adjusts the resulting return. (Customer Parties Reply at 19-20.)

Lastly, while Customer Parties and FirstEnergy both support a uniform statewide method for determining comparable companies, Customer Parties argue that the method proposed by FirstEnergy is flawed, unreasonable, and arbitrary and includes no risk measures. Customer Parties claim that if the Commission believes that the distribution-only FirstEnergy utilities are less risky than generation-owning utilities, then that factor can be accounted for with a lower basis point premium above the benchmark return. (Customer Parties Reply at 19-20.)

FirstEnergy challenges Customer Parties' representation that Dr. Woolridge, Dr. Vilbert and Mr. King "provide much the same methodology" for making the adjustment to account for financial risk. FirstEnergy states that there is considerable difference between the mechanism proposed by Dr. Vilbert and that offered by Dr. Woolridge and Mr. King, as Staff witness Cahaan recognized.[20] The uniform methodology for selection of the comparable companies as advocated by Dr. Woolridge is amiss with shortcomings and deficiencies, as FirstEnergy allegedly demonstrated in its briefs in its ESP case. DP&L asserts that a common methodology fails to recognize that each of the Ohio electric utilities have different financial and business risks. Further, FirstEnergy, AEP-Ohio, Duke, and DP&L note that Customer Parties' criticism overlooks the fact that under Section 4928.143(F), Revised Code, the electric utility bears the burden of proof on the SEET determination and that it is the Commission that will determine if the burden has been sustained. FirstEnergy reasons it is procedurally customary for the party with the burden of proof to present its case and prove its methodology with the active participation of interested persons. Further, AEP-Ohio points out that the electric utility cannot dictate the comparable group of companies as the statute sets forth the basis for evaluating the group of comparable companies. (FirstEnergy Reply at 8-10; AEP-Ohio Reply at 6-7; Duke Reply at 7-8; DP&L Reply at 2-3.)

At this time, the Commission declines to predetermine which companies shall be included in the "comparable group" in determining the SEET. Because each electric utility is unique, and conditions are constantly changing, the Commission does not believe it to be prudent to establish a comparable group process now which may be subject to change. All parties acknowledge that, at a minimum, there may need to be "tweaks" to a comparable group, among the companies and over time, if the group were predetermined now. The Commission also notes that it is the electric utility that will bear the burden of proof of demonstrating that its preferred comparable group is appropriate. As with other cases wherein earnings are considered, it is the Commission that will make the final decision as to the appropriate mix of companies comprising the "comparable group." Therefore, the Commission will decide the comparable group on a case-by-case basis each year. Doing so, fosters the goal of ensuring that the comparable group reflects current general market conditions and that of the individual electric utility.

20 FirstEnergy ESP case, Tr. Vol. IX at 119 (October 28, 2008).

Staff Recommendation 7: How are "significantly excessive earnings" to be determined, as that phrase is used in the third sentence of Section 4928.143(F), Revised Code?[21]

Staff recommends that significantly excessive earnings be 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, with such adjustments for capital structure as may be appropriate. Staff endorses the concept that a return on common equity in excess of 1.28 times the standard deviation above the mean of a comparable group of companies should be defined as earnings significantly in excess, except in a low earnings environment when 200 basis points could be substituted.

AEP-Ohio agrees with the Staff's recommended approach; however, as discussed above in Recommendations 5, 6, and 9, regarding the definition of "significantly in excess of the return on common equity," and comparable companies, AEP-Ohio proposes that 2.00 standard deviations, rather than 1.28 standard deviations, should be used as the adder to determine the threshold for significantly excessive earnings. DP&L agrees with AEP-Ohio's claims and recommendation on this issue. (AEP-Ohio Initial at 10; DP&L Reply at 3.)

Customer Parties disagree with Staff's recommendation on this matter, arguing instead that a 200 basis point premium above the mean return of the comparable group is appropriate and should also recognize upcoming major capital expenditures of the electric utility, subject to certain conditions precedent. (Customer Parties Initial at 2, 8-9, 22; Tr. 37-39.) AEP-Ohio asserts that Customer Parties' proposal is misguided, as the company states in its comments in regard to Recommendations 3 and 9, above. (AEP-Ohio Reply 14.)

FirstEnergy reiterates its comments made with regard to Recommendation 5, the definition of "significantly in excess of the return on common equity." (FirstEnergy Initial at 4-6.) At the question and answer session, FirstEnergy interpreted Section 4928.143(F), Revised Code, to provide the Commission with some discretion to be used on a case-by-case basis to adjust the earnings of the electric utility in comparison to the comparable group (Tr. 39-40).

Having fully considered all the comments regarding establishing the threshold and in consideration of the discretion afforded the Commission in SB 221, the Commission

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21 The third sentence of Section 4928.143(F), Revised Code, states:
"The burden of proof for demonstrating that significantly excessive earnings did not occur shall be on the electric distribution utility."

concludes that "significantly excessive earnings" should be determined based on the reasonable judgment of the Commission on a case-by-case basis.

The Commission notes that within Ohio's electric utilities, there is significant variation, including, for example, whether the electric utility provides transmission, generation, and distribution service or only distribution service. For this reason, the 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 practices; and the extent to which the electric utility has advanced state policy. We therefore, direct the electric utilities to include this information in their SEET filings.

While a number of commenters request a bright line statistical analysis test for the evaluation of earnings, and the Commission agrees that statistical analysis can be one of many useful tools, utilizing 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 more from the utilities to meet the burden of proof that excess earnings did not occur. The Commission may use a standard deviation test as one tool by which to determine whether an electric utility had significantly excessive earnings.

However, the Commission is willing to recognize a "safe harbor" of 200 basis points above the mean of the comparable group. To that end, any electric utility earning less than 200 basis points above the mean of the comparable group will be found not to have significantly excessive earnings.

Staff Recommendation 8: What does "in the aggregate" mean in relation to the adjustments resulting in significantly excessive earnings?

Staff interprets "in the aggregate" in relation to the adjustments resulting in significantly excess earnings to mean that the total of all the adjustments created by the implementation of an ESP is to be assessed for its impact in determining whether the electric utility achieved a return on common equity significantly in excess of the earnings of comparable companies.

Customer Parties cite the language in Section 4928.143(F), Revised Code, in support of their arguments that: (1) an electric utility's SEET refund exposure is limited to the aggregate amount of the ESP rate adjustment the electric utility receives, and excludes any excess earnings which resulted from something other than the ESP; and (2) the cumulative level of the ESP rate adjustment is subject to refund (Customer Parties Initial at 18). FirstEnergy, AEP-Ohio, and Duke argue that the Customer Parties' concept that "in the aggregate" is also "cumulative" is unsupported and inconsistent with the statutory directive of applying the SEET annually based on the language in Section 4928.143(F), Revised Code, and modifies the General Assembly's design for SEET (FirstEnergy Reply at 10; AEP-Ohio Reply at 1-2; Duke Reply at 8). Further, AEP-Ohio argues that the inherent flaw in Customer Parties' argument is that the earnings from the first year of an ESP would be subject to refund in every year of the term of the ESP, but adjustments made in the first year are not considered in subsequent years. The initial adjustment, AEP-Ohio rationalizes, becomes a part of the base rate level for the next year. Therefore, AEP-Ohio emphasizes that the proposal could result in returning to consumers 2009 earnings in 2011, or later, depending on the term of the ESP. (AEP-Ohio Reply at 14.)

AEP-Ohio concurs with the Staff recommendation (AEP-Ohio Initial at 11). Duke asserts that the Staff's proposal is unclear and requests clarification (Duke Initial at 6-7). DP&L contends that pursuant to Section 4928.143(E) and (F), Revised Code, and the intent of SB 221, the SEET only applies to the adjustments made by the ESP. DP&L believes that the components of an electric utility's standard service offer, approved by the Commission prior to the ESP, are not subject to the SEET, as supported by the company's interpretation of the legislation's Final Analysis. DP&L points out that the legislature's Final Analysis of SB 221 specifically states: "the PUCO must determine if any price adjustments granted under the plan resulted in excessive earnings for the utility" and only if "the adjustments, in the aggregate, did result in significantly excessive earnings, it must require the utility to return to consumers the amount of the excess by prospective adjustments," subject to the electric utility's right to terminate the ESP and file an MRO immediately. DP&L asserts that the legislative analysis clearly provides that the SEET applies only to ESP-created adjustments to the standard service offer and, therefore, reasons that the phrase "in the aggregate" means that the adjustments to the standard offer should be looked at together, and not by each individual component. (DP&L Initial at 5-6.)

The Commission finds that "in the aggregate" refers to the total of any adjustments resulting from the ESP as advocated by Staff. In addition, we do not equate the phrase "in the aggregate" to mean "cumulative" as Customer Parties argue. The Commission reasons that to make the adjustments resulting in significantly excessive earnings cumulative would, as AEP-Ohio argues, make the electric utility's earnings from the first year of an ESP subject to refund in every year of the term of the ESP without consideration of the adjustments made in the first year being considered in subsequent years. Furthermore, as previously explained in response to Recommendations 3 and 11, the Commission finds that the amount of adjustments eligible for refund will be the value of the adjustments in the current year under review compared to the revenues which would have been collected had the rates from the electric utility's previous rate plan still been in place. For these reasons, we adopt the recommendation of the Staff as to the meaning of "in the aggregate."

Staff Recommendation 10: What mechanism should be employed to return to customers the amount of excess earnings?

Staff recommends that the Commission determine in each electric utility's annual SEET proceeding the mechanism by which any excess earnings may be returned to customers. This would allow the Commission the discretion, based on any unique situation or time sensitive circumstance, to return the money to customers as the Commission believes appropriate. The Commission would also have the latitude to return the money in varying time periods and/or as reductions to other electric utility-imposed charges as the Commission deems appropriate.

Customer Parties generally concur with the Staff recommendation, but only to the extent that "other EDU imposed charges" means charges affecting customer rates and, thus, a reduction of such charges results in a reduction in customer rates. Customer Parties contend that after a finding of significantly excessive earnings, the parties should endeavor to stipulate to the mechanism to return the excess earnings to customers and, if a stipulation cannot be achieved, the parties should be provided an opportunity to present their respective position to the Commission. Customer Parties contend that SEET refunds may raise a number of issues better addressed as a part of the circumstances of any given case.[22] Finally, Customer Parties express some concern with the recommendation regarding the Commission's discretion to refund over varying time periods. Customer Parties argue that customers should get any excess earnings refund as promptly as possible without delay. (Customer Parties Initial at 23.)

AEP-Ohio, DP&L, and FirstEnergy agree with Staff's recommendation that the prospective adjustments should be determined on a case-by-case basis. DP&L, however, emphasizes that Section 4928.143(E) and (F), Revised Code, does not characterize the

22 Customer Parties state, for example, that a SEET proceeding may raise the following issues: (1) Should a SEET refund be bypassable or non-bypassable credit; (2) Over what period of time should the refund be made; (3) Should there be interest on the unamortized SEET refund balance and, if so, at what level; (4) Should a customer on discounted economic development contract (reasonable arrangement or unique arrangement) receive an additional discount through a SEET refund; and (5) Should any SEET refund first be used to pay off monies owed by customers to the electric utility in the form of deferrals.

adjustments as "refunds" and, therefore, proffers that any prospective adjustments from the SEET represent prospective changes in charges associated with providing future electric services. AEP-Ohio contends that the case-by-case determination should be addressed by the parties after a Commission determination of significantly excessive earnings. This two-step process would enable parties to a proceeding to consider the appropriate mechanism in the context of the amount of the significantly excessive earnings. (DP&L Initial at 6; AEP-Ohio Initial at 11; AEP-Ohio Reply at 14-15; FirstEnergy Initial at 7.)

As each of the commenters recognizes, if an electric utility is found to have significantly excessive earnings, such a determination has the potential to raise several issues, which are better addressed on a case-by-case basis. For that reason, the Commission may offer the parties to a SEET proceeding a reasonable, limited period of time to propose how any excess earnings should be returned to customers, including any buy-down of deferrals.

ORDER:

It is, therefore,

ORDERED, That pursuant to the decisions of the Commission as set forth herein, each electric utility's earnings be evaluated in accordance with this Order. It is further,

ORDERED, That Citizen's request to withdraw its initial comments and adopt the position of Customer Parties in its initial and reply comments be granted. It is, further,

ORDERED, That each electric utility file its proposed SEET application, in accordance with the Commission's directives, by July 15, 2010. It is, further, ORDERED, That a copy of this entry be served upon all commenters, electric distribution companies and electric service companies operating in Ohio, and all other interested persons of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Paul A. Centolella

Valerie A. Lemmie

Steven D. Lesser

Cheryl L. Roberto

GNS/ vrm

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Reneé J. Jenkins
Secretary