ORIGINAL

IN THE SUPREME COURT OF OHIO

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

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INTRODUCTION

In its Initial Brief, the Industrial Energy Users-Ohio ("IEU-Ohio") explained the statutory and practical failures of the decision applying the Significantly Excessive Earnings Test ("SEET") by the Public Utilities Commission of Ohio ("Commission") to the earned return on common equity of Columbus Southern Power Company and Ohio Power Company (individually "CSP" and "OP," respectively, and collectively "Companies" or "AEP-Ohio"). In response, both CSP and the Commission have failed to address the fundamental problem in the Commission's decision: The Commission did not dismiss the applications of OP and CSP that did not comply with the requirements of Section 4928.143(F), Revised Code, and then used the flawed applications to apply the SEET. The resulting Opinion and Order thus failed to address properly the adjustments in rates effected by CSP's and OP's first Electric Security Plan ("ESP"), a plan that the Court previously determined contained provisions generating millions of dollars of revenue for OP and CSP that were not legally supported,[1] and implicitly endorsed the obvious manner in which the rates paid by Ohio retail electric consumers of CSP and OP have enhanced unfairly the returns of OP's and CSP's corporate parent, American Electric Power ("AEP"). Because the Commission has failed to properly apply the SEET to OP's and CSP's ESP, it will once again be this Court's duty to direct the Commission to comply with the requirements of Amended Substitute Senate Bill 221 ("SB 221").

SUMMARY OF IEU-OHIO'S REPLY ARGUMENTS

As noted in the Initial Brief of IEU-Ohio, Section 4928.143(F), Revised Code, sets out the terms of the SEET. That section directs the Commission to apply the SEET "to those

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

provisions that are included in an electric security plan under [Section 4928.143(F)]."[2] It further provides that "the commission shall consider, following the end of each annual period of the plan, if any such adjustments resulted in excessive earnings ... ." The statute directs the Commission to assess the effects of the ESP on the electric distribution utility's ("EDU") earned return on common equity. To do so, the Commission must isolate the effects of the ESP from other activities of the EDU. As all parties to this appeal agree that the EDUs, CSP and OP, were engaged in a scope of business activities beyond those associated with the provision of retail electric service under the ESP, it must follow that looking at the total earnings of the EDUs without "jurisdictionalizing" for the ESP did not conform to the requirements of Section 4928.143(F), Revised Code.

As discussed separately below, the Commission and CSP take different paths to argue that the Commission properly applied the SEET to CSP and OP. On the one hand, the Commission concludes that isolating the return on common equity with regard to the provisions that are included in an ESP was not necessary by either ignoring the requirement of Section 4928.143(F), Revised Code, to look at the adjustments in the ESP in applying the SEET or suggesting that the adjustments are made in a third step. On the other hand, CSP argues that the Commission was not required to make adjustments to the total company earned return on common equity. Neither the Commission's suggestion that the Court ignore the terms of the statute nor CSP's argument that the statute does not require a SEET based return on equity achieved under an ESP is lawful or reasonable.

Additionally, CSP in its cross-appeal urges the Commission to find that Section 4928.143(F), Revised Code, is unconstitutionally vague and thus violates its right to due process.

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[2] Section 4928.143(F), Revised Code.

Although CSP asserts that it is entitled to heightened scrutiny, under either the correctly stated standard of review or a heightened level of scrutiny, Section 4928.143(F), Revised Code, satisfies the requirements of Due Process.

PROPOSITION OF LAW NO. I[3]

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

PROPOSITION OF LAW NO. II

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

PROPOSITION OF LAW NO. III

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

A. The Commission Ignores the Operative Terms of Section 4928.143(F), Revised Code.

The Commission's argument begins by asserting that Section 4928.143(F), Revised Code, establishes a three step process. According to the Commission, the first step is to determine the earned return on common equity of the EDU. The second is to determine the amount of return that is significantly excessive. The third is to remove from the significantly

[3] The following discussion relates to the original three propositions of law argued in IEU-Ohio's First Brief. A fourth proposition of law, below, addresses the CSP's cross-appeal.

excessive earnings the portions shown not to be tied to the ESP for the EDU under review.[4] As described in the Commission's Brief, however, the first step fails to follow the requirements of the statute, and in practice, the Commission failed to apply the third step to make the adjustments required by the statute. Moreover, the Commission argues it must be "persuaded" to make an adjustment in the third step, a position that is contrary to the express requirements of Section 4928.143(F), Revised Code.[5] Because of the fundamental problems with the Commission's approach, the resulting Opinion and Order is illegal and unreasonable.

The Commission asserts that the starting point is to look at the EDU's earned return on common equity without reference to the provisions that are included in an ESP and without acknowledging that EDU is a defined term under Ohio law.[6] Ignoring the definition of an EDU sets the Commission on the path that led to the fundamental error in its Opinion and Order.

An EDU is defined as an electric utility that supplies at least retail electric distribution service.[7] An electric utility is defined as an electric light company that is engaged on a for-profit basis in the business of supplying a noncompetitive retail electric service or in the businesses of supplying both noncompetitive and competitive retail electric service in Ohio.[8] Thus, an EDU

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[4] Merit Brief Submitted on Behalf of Appellee, the Public Utilities Commission of Ohio at 7 (Sept. 26, 2011) ("Commission Brief").

[5] IEU-Ohio provided the Commission with evidence indicating that the profit from CSP and OP per MWH was higher than other business units of AEP and was much higher than anything associated with off system sales activities. Thus, even assuming the Commission's position that a burden to persuade the Commission to make adjustments rested with a party other than the Companies is lawful, the Commission *was* provided with the persuasive evidence that adjustments were necessary. Brief of Appellant, Industrial Energy Users of Ohio at 25-30 (Aug. 8, 2011) ("IEU-Ohio Brief").

[6] *Id.* at 7.

[7] Section 4928.01(A)(6), Revised Code.

[8] Section 4928.01(A)(11), Revised Code.

may be engaged in services that are regulated on a more traditional basis and services governed by the terms of an ESP and subject to the SEET.[9] As electric light companies, therefore, CSP and OP were engaged in multiple lines of business, and the total company income and equity included more than ESP-related income and equity.

Rather than requiring the Companies to isolate the EDUs' ESP-related income, however, the Commission accepted the total company income as stated in the FERC Form 1 provided in the Companies' Applications and then divided it by the value of total company common equity as measured by the average of the beginning and ending of year value.[10] Thus, the Commission, in applying the first step of its three step process, did not make any attempt to isolate earned returns from the EDU's ESP-related activities from total earned returns of CSP or OP as determined from the FERC Form 1.

In response to IEU-Ohio's argument that Section 4928.143(F), Revised Code, requires the Commission to perform the SEET on the ESP-related earned return on common equity, the Commission states that the General Assembly defined the test to apply to the "earned return on common equity of the electric distribution utility," citing that same section.[11] The Commission then points to the definition of EDU to suggest that an EDU can engage in multiple regulated and non-regulated activities.[12] Thus, the Commission concludes that the reference to an EDU in the

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[9] Section 4928.05, Revised Code.

[10] ~~For a summary of the evidence and Opinion and Order on the calculation of the earned return~~ on common equity, *see* IEU-Ohio Brief at 6-11.

[11] Commission Brief at 8.

[12] *Id.*, citing Section 4928.01(A)(6), Revised Code.

portion of Section 4928.143(F), Revised Code, means that the review must extend to all company activities, "no matter what lines of business those activities might entail."[13]

There are two problems with the Commission's argument. First, it ignores the statutory definition of the SEET contained in Section 4928.143(F), Revised Code: by law, the Commission must consider "with regard to the provisions that are included in an electric security plan" "if any such adjustments resulted in excess earnings."[14]

Second, the fact that the EDU can engage in both ESP-related and unrelated business activities explains why the portions left out of the Commission's definition of the first step of the SEET cannot be ignored. As previously noted, the definition of an EDU recognizes that the EDU is also engaged in both activities other than providing the Standard Service Offer under an ESP. An EDU is defined as an electric utility which itself is an electric light company that serves customers in a certified territory.[15] The EDU may be providing both competitive and noncompetitive services because it is also an electric utility and an electric light company.[16] If the General Assembly had intended to measure significantly excessive earnings in light of total company earnings including the earnings from lines of business not conducted under or through an ESP, then no qualifications to the ESP-related earned return on common equity would have

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[13] *Id.* at 9.

[14] Section 4928.143(F), Revised Code.

[15] The Revised Code contains overlapping definitions, as discussed *supra*. Section 4928.01(A)(6), Revised Code, defines an EDU as an electric utility; Section 4928.01(A)(11), Revised Code, defines an electric utility as an electric light company; Section 4928.01(A)(7), Section 4905.03((A)(4) and 4933.81 *et seq.*, Revised Code, provide for the continuation of certified territories in which the EDU is required to provide standard offer service. An EDU is required to provide a standard service offer in the form of an ESP or a market rate offer to consumers within its certified territory. Section 4928.141, Revised Code.

[16] Section 4928.01(A)(11), Revised Code.

been necessary. Yet, the review of earned return on common equity specified by statute is plainly limited "to the provisions that are included in an electric security plan." In contrast to the Commission's suggestion that "Appellant IEU wants to add a phrase to the statute,"[17] the Commission has ignored the express terms of Section 4928.143(F), Revised Code.

The Commission offers one other explanation for adopting a total company approach in its "first step" of the SEET. The Commission argues that the total company earned returns are the proper basis because the publicly traded companies used to determine the comparable level of earned return on common equity in the SEET include both utility and non-utility companies of comparable risk.[18] As the Commission explains, "If the General Assembly had meant the analysis to be done based on solely regulated activities, the comparable group would have been regulated entities."[19] This policy argument fails in two regards. First, the statutory language requires that the comparison group used to determine whether the EDU fails the SEET be made up of "publicly traded companies, including utilities, that face comparable business and financial risk."[20] The law instructs the Commission to evaluate the EDU's earned return from the ESP compared to the earned return of businesses having comparable business and financial risk. The comparison is of risk; lines of business are not relevant. Second, a policy argument such as that offered by the Commission cannot be used to ignore the express terms of the statute. Regardless

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[17] Commission Brief at 10.

[18] Commission Brief at 9-10. The Commission repeats this argument in justifying its third step in the review process. *Id.* at 15-16. The same response discussed here applies to the Commission's arguments regarding the relevance of the non-utility companies being in the comparable group made at pages 15-16 of the Commission's Brief.

[19] *Id.* at 9.

[20] Section 4928.143(F), Revised Code.

of what the comparison group is, there is no room in the statutory language to redefine the earned returns of the EDU beyond those resulting from the ESP.[21]

Having improperly defined the first step in its process of applying the SEET, the Commission states that the third step in its application of the SEET nonetheless properly implemented the SEET by making the necessary adjustments to remove non-ESP earnings.[22] Although the Commission may have intended to provide a "fix" to properly adjust the total company earned return on common equity, the Commission's decision did not accomplish that result.

The Commission argues that the third step in the SEET is designed to remove from the significantly excessive earnings the portions shown not to be tied to the ESP.[23] Although this argument suggests that the Commission would use this "step" to correct the problems created by the first "step," the Commission apparently has to be "persuaded" that non-ESP-related income and the related common equity investment have to be removed from its calculations.[24] In CSP's case,[25] it could be "persuaded" to remove only off-system sales ("OSS") revenues in making

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[21] The Court held in *In re Application of Columbus Southern Power Company*, 128 Ohio St. 3d at 520, that the Commission is required to comply with the express terms of Section 4928.143(B), Revised Code, and cannot create its own undefined terms of an ESP. Similarly, the Commission is not permitted to redefine the SEET to accommodate an approach that is not provided by the express statutory terms.

[22] Commission Brief at 13-19.

[23] *Id.* at 13-14.

[24] *Id.* at 14.

[25] Because the Commission determined under the "total company earnings" approach that OP had not exceeded a threshold requiring further review, the Commission did not inquire whether OP had satisfied the SEET as applied to the ESP-related return on common equity. Thus, OP's earnings were never tested correctly.

adjustments for non-ESP earned returns on common equity.[26] In removing OSS, however, the Commission failed to implement the adjustment properly. Both the need to persuade the Commission to make changes in the total company earned return on common equity and the Commission's implementation of that OSS adjustment highlight the fundamental failure of the Commission to comply with the statutory requirements of Section 4928.143(F), Revised Code.

First, the Commission's argument that it must be persuaded to make adjustments for non-ESP related earned returns turns the statutory burden of proof for the SEET on its head. "The burden of proof for demonstrating that significantly excessive earnings did not occur shall be on the electric distribution utility."[27] In its Brief, however, the Commission takes the position that it must be persuaded to remove from the total company numbers anything that is non-ESP related, effectively ending its review after step one if it chooses. In effect, then, the Commission is requiring the non-EDU parties to demonstrate that the EDU's total company earned return on equity is significantly excessive by "persuading" the Commission to change the numerator (adjusted total company net income) and the denominator (adjusted common equity balance to reflect adjusted numerator) for amounts that were not properly or lawfully includable either in the numerator or the denominator in the first place. Having improperly defined the first "step," the Commission thus compounds the problem by shifting the statutory burden of proof in the third step, a shift that becomes necessary only because the Commission committed the initial

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[26] *Id.*

[27] Section 4928.143(F), Revised Code.

misstep of failing to properly limit the review to the earned return on common equity due to the adjustments included in the ESP.[28]

Second, the Commission in applying its third step demonstrated that it acted unreasonably by not completing the process to remove the full OSS effects from the total 2009 earned returns on common equity of only CSP. As highlighted in its brief, the Commission observes that it was required to make a SEET-related adjustment for OSS since the earned return for OSS was generated by a line of business not conducted under the ESP for CSP.[29] Having, in effect, acknowledged that it did not start its SEET duties with the proper ESP reference, it then asserts that the subsequent failure to completely remove the effects of the known and necessary adjustment to the EDUs common equity balance for transmission-related plant was the fault of IEU-Ohio because "there was no evidence that the adjustment, proposed on brief by Appellant IEU, is needed"[30] or "feasible."[31]

The Commission's assertion that there was no evidence in the record to support the adjustment for transmission is factually incorrect. A witness for CSP and OP acknowledged that it would be impossible to sell generation supply without also using transmission assets to deliver the generation supply.[32] The Staff witness, Mr. Cahaan, provided the ratios to adjust the

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[28] This shift of the burden of proof uniquely benefits the EDU as it has the information necessary to demonstrate whether various adjustments should be made. The asymmetry of information provides strong policy support for requiring a proper jurisdictional study as part of the application, as suggested by IEU-Ohio.

[29] Commission Brief at 14.

[30] *Id.* at 18-19.

[31] *Id.* at 19.

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

common equity balance for the generation plant related to OSS,[33] but acknowledged that he had not adjusted the earned return on common equity denominator for transmission plant related to OSS.[34] Thus, the record not only provided a basis for making the balance of the OSS adjustment (the same ratio used by Mr. Cahaan), but compelled the adjustment once the Commission acknowledged that an adjustment for OSS should be made.

The second argument that it was not feasible to make the adjustment is also unsupported. Mr. Cahaan testified that he assumed that OSS profits may be net of transmission costs, but he had not determined that to be true.[35] Mr. Cahaan, thus, did not say that he had not done the calculation because it was not feasible; he had simply and wrongly assumed that there was not a need to go further than he ventured.

Finally, the Commission appears to be suggesting that IEU-Ohio was requesting adjustments that would likely result in understating what CSP's and OP's ESP-related earned return on common equity was for 2009,[36] but this argument does not find support in what the Commission did in its Opinion and Order. It is apparent that the Commission's third step in its defective application of the SEET resulted in an understatement of the earned return on common equity when the Commission failed to properly reduce the denominator, the common equity

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[33] Opinion and Order at 28, 30 (IEU-Ohio Appx at 61 & 63) (ICN 56). *See* IEU-Ohio Brief at 12 n.12.

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

[35] Tr. Vol. III at 476-77 (IEU-Ohio Supp. at 204-05).

[36] Commission Brief at 18. As there is no page reference to IEU-Ohio's Brief, it is impossible to determine what the Commission is referencing. IEU-Ohio has noted previously that it has not determined the effect of proper jurisdictionalization, but in regard to OSS the Commission's flawed analysis will always favor the EDU over the customer because the Commission's mathematical approach overstates the denominator of the ratio of net income to common equity.

balance, in proportion to the transmission-related plant associated with OSS. Moreover, the Commission's error would always mathematically result in an understatement of the effect of removing OSS by improperly overstating the denominator (average common equity outstanding during the SEET period) in the calculation of earned return on common equity. Given this EDU friendly and arbitrary bias, the Commission cannot be found to have acted lawfully and reasonably.[37]

In summary, the Commission has failed to demonstrate that its three step process properly implements the requirements of Section 4928.143(F), Revised Code. The first step fails to properly adjust the scope of the review to the EDU's ESP-related earned return on common equity and thus was both unlawful and unreasonable in regard to both CSP and OP. The "fix" found in the third step does not comply with the statutory requirements because it apparently shifts the statutory burden of proof and, as implemented in this case, resulted in an unlawful and unreasonable determination of CSP's earned return on common equity by failing to account fully for the removal of OSS. Nothing in the Commission's Brief suggests otherwise.

B. CSP Misreads Express Terms of the Statute

Echoing many of the Commission's arguments regarding the application of the SEET, CSP[38] in its second proposition of law[39] argues that "[t]he statute does not require the Commission to isolate a return on common equity for only that portion of the utility's earnings

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[37] IEU-Ohio Brief at 25-30.

[38] IEU-Ohio appealed the Commission's decision to use total company information for both CSP and OP. If the Court reverses and remands the Commission's Opinion and Order, that decision would apply to the review of both CSP and OP. Only CSP, however, intervened as an appellee/cross-appellant.

[39] IEU-Ohio is addressing only the second and third propositions of law presented by CSP in this section of its brief. CSP's first proposition of law is responsive to the arguments presented by other appellants.

that are derived solely from adjustments in the utility's electric service plan."[40] In reaching this result, CSP argues that a jurisdictional allocation study is not statutorily required[41] and that CSP filed the materials the Commission rules required,[42] offers an *in personam* attack based on IEU-Ohio's lack of participation in a Commission investigation which offers no basis for explaining how the Commission is properly applying the statute, and finally suggests that the statute does not require a review of an ESP-specific earned return on common equity.[43] According to CSP, "[t]he statute does not state or imply that the SEET calculation should include a determination of the earned return on equity for some other entity created to reflect only that portion of the EDU's business governed by the ESP."[44]

In support of its argument that the statute does not require an ESP-specific review, CSP first argues that an EDU can be involved in several other lines of business. Because an EDU can be involved in other lines of business, CSP concludes that "had the General Assembly intended to limit the SEET analysis to a return on equity for some truncated or completely remodeled version of an EDU, it surely would have used apt wording to express that intent."[45] CSP then

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[40] Merit Brief of Appellee/Cross-Appellant Columbus Southern Power Company at 9 (Sept. 26, 2011) ("CSP Brief").

[41] IEU-Ohio recommended that a proper cost of service study be performed so as to accommodate the terms of Section 4928.143(F), Revised Code. That approach or another is not specified by the statute, but the statute makes clear that some process to divide ESP-related earned returns from non-ESP related ESP earned returns is necessary.

[42] Had the Commission applied the statute correctly, OP and CSP would have been directed to revise their filings. Absent the proper filings, the Commission should have granted the motion to dismiss without prejudice that IEU-Ohio made at the start of the hearing.

[43] CSP Brief at 6-11.

[44] *Id.* at 11.

[45] CSP Brief at 12.

adds that the statute does not require further adjustments from "a fully functioning EDU into a ESP-only [*sic*] parody of itself."[46] CSP also asserts a second argument that IEU-Ohio failed to demonstrate any effect from the Commission's failure to execute on the terms of the statute.[47]

The first argument that an ESP-specific review is not required is not supported by the statutory language, as discussed above. The argument ignores the express terms of the statute. Regardless of what the Commission or CSP may suggest, the statute is specific about what the Commission is required to do.

The second argument that there was no effect of the Commission's failure to properly impose the terms of the statute ignores at least two important demonstrations in the record of this case. As noted above, the Commission, in its attempt to "fix" its miscalculation in the "third step" of the SEET as applied to CSP, failed to properly adjust the common equity divisor in the calculation of the earned return on common equity by removing common equity associated for a known adjustment, transmission plant associated with OSS. As a result, the calculation of the earned return on common equity was and would always be understated in favor of CSP and any other EDU that is reviewed under this misapplication of the SEET.[48] Additionally, the record before the Commission and this Court is filled with evidence that AEP is leaning on the Ohio EDUs, CSP and OP, to the detriment of Ohio consumers. No other conclusion can be drawn from AEP's shareholder materials.[49] Despite CSP's suggestion otherwise,[50] the failure of the

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[46] *Id.*

[47] *Id.* at 12-13.

[48] IEU-Ohio Brief at 12-13 and n.50.

[49] *Id.* at 16-18.

[50] CSP Brief at 13.

Commission to fully jurisdictionalize OP's and CSP's ESP-related earned return on common equity resulted in both a known and uniformly adverse "fix" and ignored substantial evidence that Ohio consumers are carrying, through the ESP rates and charges of CSP and OP, an unfair share of AEP's overall profitability.

Finally, CSP argues in its third proposition of law[51] that Section 4928.143(F), Revised Code, does not permit the Commission to "claw back" an EDU's earnings because its earnings are higher than the earnings of other utilities, a statement that is irrelevant to the issues presented by Section 4928.143(F), Revised Code, or by this appeal.

Initially, CSP does not accurately describe the operation of Section 4928.143(F), Revised Code. Section 4928.143(F), Revised Code, does not require the Commission to order nominally high earnings returned to consumers. Rather, the section provides that "[i]f 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."[52] Thus, the third proposition of law offered by CSP provides no legal basis on which the Court may act.

Second, the argument that the Commission cannot claw back an EDU's earnings is not relevant to the determination of the EDU's earned return on common equity. The issue raised in this appeal is the proper application of the SEET. Thus, CSP's argument concerning whether the Commission can "claw back" simply does not address the issue presented by IEU-Ohio's appeal.

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[51] *Id.* at 13.

[52] Section 4928.143(F), Revised Code.

Instead, CSP uses the "claw-back" argument as a basis for criticizing other parties for noting that CSP and OP are providing AEP with disproportionately high returns compared with those of the non-Ohio affiliates.[53] As part of its response, CSP offers the testimony of its president and the Commission findings that CSP and OP face special risks due to the Ohio regulatory structure, presumably as a justification for those admittedly higher earnings contributions.[54] The suggestion that the EDU is somehow at special risk due to an adverse SEET review, however, is much ado about nothing because CSP's argument fails to account for the substantial statutory protections built into the SEET and other statutes. If the EDU is ordered to adjust its ESP rates due to an adverse SEET review, the EDU may also elect to terminate the plan, file an application for a market rate offer ("MRO") under Section 4928.142, Revised Code, and continue to recover any amounts that had been previously ordered deferred and subject to any phase-in order.[55] Moreover, as discussed below, CSP is protected constitutionally from Commission action that would operate as a taking. Finally, even if there were some asymmetric risk associated with the SEET (a claim that is far from demonstrated), the Commission and this Court cannot rewrite the statute and ignore the direction of the General Assembly. Thus, CSP's third proposition of law does not offer any basis for justifying the Commission's decision to improperly and illegally apply the SEET on a total company basis.

PROPOSITION OF LAW OF LAW NO. IV

The Terms of Section 4928.143(F), Revised Code, Though General, Are Not Unconstitutionally Vague

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[53] CSP Brief at 13-14.

[54] *Id.* at 14.

[55] Section 4928.143(F), Revised Code.

While defending the Commission's application of the SEET as an appellee, CSP, as a cross-appellant, invokes this Court's authority to review constitutional questions to assert that Section 4928.143(F), Revised Code, is void because it is impermissibly vague. CSP argues that the section does not provide fair notice or meaningful standards as to what is meant by significantly excessive earnings.[56] CSP, however, has failed to demonstrate that the statute should be ruled unconstitutional.

Due process requires that the state provide "meaningful standards in its laws. A law must give fair notice to the citizenry of the conduct proscribed and the penalty to be affixed if the law is breached. ... Implicitly, the law must also convey an understandable standard capable of enforcement in the courts ... ."[57] Statutes by their very nature contain some imprecision. Thus, this Court has noted that a determination whether a statute is impermissibly imprecise "must be made in light of the facts presented in the given case and the nature of the enactment challenged."[58]

Generally, economic regulation is reviewed under a lower level of scrutiny than criminal laws or laws interfering with constitutionally protected interests. The lower level of scrutiny applied to economic regulation is based on several reasons.

> The degree of vagueness that the Constitution tolerates—as well as the relative importance of fair notice and fair enforcement—depends in part on the nature of the enactment. Thus, economic regulation is subject to a less strict vagueness test because its subject matter is often more narrow, and because businesses, which face economic demands to plan behavior carefully, can be

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[56] CSP Merit Brief at 15-23.

[57] *Norwood v. Horney*, 110 Ohio St.3d 353, 378-79 (2006).

[58] *Id.* at 379.

> expected to consult relevant legislation in advance of action. Indeed the regulated enterprise may have the ability to clarify the meaning of the regulation by its own inquiry, or by resort to an administrative process.[59]

Thus, the nature of the regulation, including the process used for creating the rule being challenged as vague, is relevant to the level of scrutiny applied to the determination whether Section 4928.143(F), Revised Code, violates the Due Process Clause.

In this instance, the level of review applicable to Section 4928.143(F), Revised Code, is relatively low when compared to that applied when a property interest or other core constitutional value is threatened. First, the statute is economic regulation applicable to an already heavily regulated sector of the economy, EDUs. The statute itself applies to a narrow area of concern within the regulation of an EDU, specifically the treatment of significantly excess earnings of an EDU operating under an ESP. Finally, the EDU is well positioned to manage the application of the statute to its business, and CSP and OP spent an enormous of amount of effort trying to direct the operation of the statute.[60] At this stage, CSP cannot fairly claim that it is entitled to an elevated standard of review of its claim that the statute is void for vagueness under the traditional rules applicable to economic regulation.

Nothing presented by CSP supports its claim that it is entitled to a higher level of review of the statute. Although the differences in the levels of scrutiny have not been completely spelled out, "regulations that are directed to economic matters and impose only civil penalties are

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[59] *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 498 (1982).

[60] CSP Brief at 2-3.

subject to a 'less strict vagueness test,' but if the enactment 'threatens to inhibit the exercise of constitutionally protected rights,' a more stringent vagueness test is to be applied."[61]

CSP does not suggest that a SEET triggers criminal liability, and Section 4928.143(F), Revised Code, does not raise that concern. It does not contain a criminal penalty or raise the possibility of one; thus the attachment of criminal liability is not a basis for a higher level of scrutiny.

CSP instead argues that it has some sort of protected property interest in earnings that result from the Commission-authorized rates. In support of its argument that a property interest is implicated, CSP states that "[t]he statute requires an EDU to disgorge or forfeit earnings it lawfully gained through the efficient use of its own property so that those earnings can be re-distributed to its customers, even though the customers indisputably paid a just and reasonable price for the service they received."[62] Apparently, CSP is claiming that once a set of ESP rates is authorized, CSP is entitled to whatever customers are required to pay, regardless of the effect on CSP's earned return on common equity. CSP's Brief, however, does not provide any citation to support the proposition that CSP has a property right in the earned return it achieves as a result of a Commission-approved ESP.

The lack of citation is not surprising since it would be a novel extension of the confiscation argument in utility regulation. At issue in utility rate cases raising the issue of confiscation is whether the regulator has set rates too low, not too high. "All that is protected against, in a constitutional sense, is that the rates fixed by the Commission be higher than a

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[61] *Norwood v. Horney,* 110 Ohio St.3d at 379.

[62] CSP Brief at 18.

confiscatory level."[63] Indeed, this Court has found a Commission order denying both a return on and a return of property not found used and useful did not result in a taking.[64]

CSP, in contrast, offers that it is entitled to retain the benefits of a rate that results in significantly excessive earnings apparently because the rates that produced the significantly excessive earnings initially satisfied the statutory test that the ESP was better than the alternative under Section 4928.142, Revised Code.[65] This argument, however, ignores the fact that the same statute that provides for the ESP also requires the plan to be reviewed annually to determine whether the plan results in significantly excessive earnings for the EDU and directs, as part of the ESP structure, that significantly excessive returns be returned to customers by prospective adjustments.[66] Moreover, CSP was well aware that the approval of its ESP came with possibility that significantly excessive earnings would have to be prospectively returned to consumers.[67] In fact, CSP and OP made substantial efforts in the original ESP case to define the SEET test and understood that their earnings were subject to review and possible prospective revision to

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[63] *Federal Power Commission v. Texaco*, 417 U.S. 380, 391-92 (1974). See *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989) (reaffirming the confiscation test based on the impact of the rates rather than protecting some particular level of return on investment).

[64] See, e.g., *Dayton Power & Light Co. v. Public Utilities Commission of Ohio*, 4 Ohio St.3d 91 (1983); *Ohio Consumers' Counsel v. Public Utilities Commission of Ohio*, 58 Ohio St.2d 449 (1979).

[65] CSP Brief at 18.

[66] Section 4928.143(F), Revised Code.

[67] One of the risks OP and CSP offered as a basis to raise the threshold for determination of significantly excessive earnings was the earnings test itself. AEP-Ohio Ex. 6, attached as Ex. JH-2 (IEU-Ohio Third Brief Supp. at 6). The Commission's decision suggests that the Commission relied on AEP-Ohio Ex. 6 to increase the threshold used to determine significantly excessive earnings, but does not have a direct citation to the exhibit. Opinion and Order at 26-27 (IEU-Ohio Appx. at 59-60).

remove significantly excessive earnings as a result of the order authorizing the ESP.[68] Furthermore, CSP and OP reported to the Securities and Exchange Commission that their earnings were subject to review and adjustment due to Section 4928.143(F), Revised Code.[69] Thus, there is no basis to conclude that there is some sort of property interest in the current rates or the resulting earnings that requires the Court to use a higher level of scrutiny in assessing Section 4928.143(F), Revised Code.

Moreover, CSP has failed to suggest that the Commission's application of the SEET has or would result in investors not securing a return on investment commensurate with the level of risk associated with similar enterprises. As part of a review of whether a Commission order resulting in a taking of property, a Court would assess whether the order denied a return commensurate with returns on investments in other enterprises having corresponding risk.[70] The SEET, however, explicitly addresses this factor in its determination of what is to be considered significantly excessive. The SEET requires a comparison of the earned returns on common equity of the EDU to the return on common equity over the same period by publicly traded companies that face comparable business and financial risk, and the Commission may order the EDU to return only the amount found to be significantly excessive as compared to the returns on

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[68] *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan: an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets,* Case Nos. 08-917-EL-SSO, *et al.,* Opinion and Order at 65-69 (IEU-Ohio Appx. at 154-158).

[69] Company Ex. 3, American Electric Power Company, Form 10-K for Year Ended December 31, 2009 at 26 ("If the PUCO and/or the Supreme Court of Ohio reverses all or part of the rate recovery, if deferred fuel costs are not fully recovered for other reasons, or if the PUCO determines CSPCo's or OPCo's earnings are significantly excessive, it could reduce further net income and cash flows and harm our financial condition.") (IEU-Ohio Third Brief Supp. at 4).

[70] *Barasch*, 488 U.S. at 314, following *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

common equity of the those companies of similar risk.[71] By definition, then, Section 4928.143(F), Revised Code, recognizes that an EDU's returns commensurate with the returns on investments in other enterprises having corresponding risks are not excessive. An order directing a prospective adjustment would affect only those returns "significantly in excess"[72] of the comparable returns.[73] The SEET, thus, does not interfere with any constitutionally protected investor expectations.

Despite the lack of a constitutional claim to excess earnings, CSP attempts to bolster its case for the application of a higher level of scrutiny by referencing the *Norwood* decision and *Carter v. Welles-Bowen Realty Inc.*,[74] These opinions, however, are not applicable. In the *Norwood* case, the Court applied a higher level of review because the challenged statute operated to allow condemnation of property. The district court in the *Welles-Bowen* case found that a heightened level of scrutiny applied because a violation of a Department of Housing and Urban Development interpretative statement could result in criminal sanctions. Since there is no property interest in significantly excessive earnings or the threat of criminal sanction in the application of the SEET, CSP's reliance on each of these cases is misplaced.

Once it is established that the statute does not reach constitutionally protected conduct, "[t]o succeed … the complainant must demonstrate that the law is impermissibly vague in all of

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[71] Section 4928.143(F), Revised Code.

[72] *Id.*

[73] As previously noted, the possibility that there could be a prospective adjustment for significantly excessive earnings was known, well-understood, and reported to third parties such as the SEC by CSP.

[74] 719 F. Supp. 2d 846 (N.D. Ohio 2010).

its applications."[75] In this instance, CSP has not demonstrated, or for that matter even attempted to demonstrate, that Section 4928.143(F), Revised Code, is vague in all of its applications. CSP, itself, provided the evidence that it was earning returns in excess of 20%, even on the inappropriate basis of total company earned return on common equity. The Commission concluded that any attempt to justify this level of earned return, as offered by CSP's and OP's rejected "bright-line statistical test," would render results that were "unrealistic and indefensible."[76] Further, the Commission in the ESP decision authorizing the rates that produced the earned return reviewed in the SEET proceeding provided the basic structure of the review process, including the anticipated treatment of OSS, and opened an additional proceeding to allow OP and CSP to assist the Commission in forming the criteria for the application of the SEET.[77] Taken together, the extremely high level of returns, CSP's sophistication and access to the regulatory apparatus, and its extensive and successful effort to frame key issues such as the treatment of OSS before the SEET was applied preclude a finding that Section 4928.143(F), Revised Code, is unconstitutionally vague. The general terms of Section 4928.143(F), Revised Code, provide both sufficient direction and notice of their requirements so as to avoid arbitrary application, especially in light of the substantial ability of the EDU to monitor and direct the application of the statute to its activities.

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[75] *Flipside*, 456 U.S. at 497.

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

[77] *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan, an Amendment to its Corporate Separation Plan; and the Sale or transfer of Certain Generating Assets*, Case Nos. 08-917-EL-SSO, *et al.*, Opinion and Order at 68-69 (Mar. 18, 2009) (IEU-Ohio Appx. at 157-58).

Even if a heightened level of scrutiny applied to the review of Section 4928.143(F), Revised Code, CSP has failed to present an argument that warrants a finding that the section is unconstitutionally vague. Initially, CSP suggests that the differing interpretations of the statute and the Commission's decision to address the application of the statute on a case-by-case basis are evidence of vagueness.[78] Differing arguments about statutory construction, however, do not rise to constructional dimensions unless there is a showing that the statute provides insufficient direction to provide fair notice and to avoid arbitrary application. CSP attempts to meet this standard by arguing that the SEET does not place the EDU on notice as to the action or conduct that can be taken to avoid forfeiture.[79] Yet, it is clear that CSP could manage not only the regulatory process but also its rates and expenses to define its income and capitalization so as to produce a return on common equity that would not cross a threshold of being significantly excessive. If nothing else, CSP could have sought to reduce its rates (and thereby also manage the risk that its customers might switch to competitive suppliers). Instead, it billed and collected the ESP rates that produced a total company earned returns on common equity in excess of 20% before removing some of the effects of OSS. Surely, CSP was not surprised that the Commission would direct prospective adjustments under these circumstances.[80]

"[T]o succeed on a claim of unconstitutional vagueness ..., the complaining party must do more than show that the statute 'requires a person to conform his conduct to an imprecise but

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[78] CSP Brief at 22.

[79] *Id.*

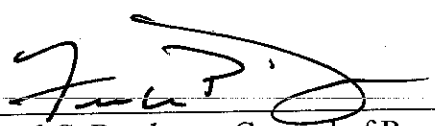
[80] Opinion and Order at 35 (IEU-Ohio Appx. at 68).

comprehensible normative standard.' ... Instead the complaining party must prove that 'no standard of conduct is specified at all.'"[81] CSP has failed to carry that heavy burden.

CONCLUSION

Although Section 4928.143(F), Revised Code, is not void for vagueness, that conclusion does not change the fact that the Commission illegally and unreasonably applied the statute in this case. The SEET set out in Section 4928.143(F), Revised Code, required CSP and OP to demonstrate that they were not generating significantly excessive earnings from ESP-related business. When the Commission permitted the case to proceed on the basis of total company earned returns on common equity and then failed to fully and properly measure the EDUs' earned return from the ESP, it failed to execute its statutory duty. This failure has helped OP and CSP hide the actual profitability of their Ohio retail business and thereby deprive Ohio consumers of the protection the General Assembly sought to provide through the SEET. As judged by the statutory requirements and the practical outcomes, the Commission's Opinion and Order should be reversed and the Commission should be directed to require the Companies to file the necessary information so that CSP's and OP's customers are better assured that the law as enacted is enforced. Further, the Court should direct the Commission to review the 2009 earned returns on common equity of CSP and OP in compliance with the applicable law.

Respectfully submitted,



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[81] *Columbia Natural Resources, Inc. v. Tatum*, 58 F.3d 1101, 1108 (6th Cir. 1995).

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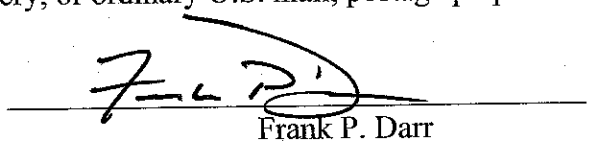
CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Reply Brief of Appellant and Cross-Appellee, Industrial Energy Users-Ohio,* was served upon the parties of record this 15th day of November 2011 *via* electronic transmission, hand-delivery, or ordinary U.S. mail, postage prepaid.



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