ORIGINAL

# IN THE SUPREME COURT OF OHIO

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| In the Matter of the Application of Columbus Southern Power Company for Approval of its Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets | : Case No. 2012-0187<br>:<br>: Appeal from the Public Utilities<br>: Commission of Ohio<br>:<br>: Public Utilities Commission of Ohio Case<br>: Nos. 08-917-EL-SSO and 08-918-EL-SSO |
| In the Matter of the Application of Ohio Power Company for Approval of its Electric Security Plan; and an Amendment to its Corporate Separation Plan | :<br>:<br>:<br>: |

## APPENDIX OF
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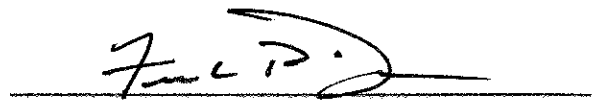
## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Appendix of Appellant Industrial Energy Users-Ohio,* was served upon the parties of record this 10th day of April 2012 *via* electronic transmission, hand-delivery, or ordinary U.S. mail, postage prepaid.



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# IN THE SUPREME COURT OF OHIO

12-0187

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| In the Matter of the Application of Columbus Southern Power Company for Approval of its Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets | : Case No. 2012-____ |
| | : Appeal from the Public Utilities Commission of Ohio |
| | : Public Utilities Commission of Ohio Case Nos. 08-917-EL-SSO and 08-918-EL-SSO |
| In the Matter of the Application of Ohio Power Company for Approval of its Electric Security Plan; and an Amendment to its Corporate Separation Plan | |

## NOTICE OF APPEAL OF APPELLANT INDUSTRIAL ENERGY USERS-OHIO


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**NOTICE OF APPEAL OF APPELLANT**
**INDUSTRIAL ENERGY USERS-OHIO**

Appellant, Industrial Energy Users-Ohio ("IEU-Ohio" or "Appellant") hereby gives its notice of appeal, pursuant to Section 4903.11 and Section 4903.13, Revised Code, and Supreme Court Rule of Practice 2.3(B), to the Supreme Court of Ohio and Appellee from the Order on Remand of October 3, 2011 (Attachment A) and Entry on Rehearing of December 14, 2011 (Attachment B) of the Public Utilities Commission of Ohio ("Commission" or "PUCO") in Case Nos. 08-917 EL-SSO and 08-918-EL-SSO.

Appellant was and is a party of record in Case Nos. 08-917-EL-SSO and 08-918-EL-SSO and timely filed its Application for Rehearing on Appellee's Order on Remand on November 2, 2011. Appellant's Application for Rehearing was denied by the Commission's Entry on Rehearing on December 14, 2011.

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

1. The Commission's finding that the Companies may collect revenues for the carrying costs of 2001-2008 incremental environmental investments ("pre-2009 Component") pursuant to Section 4928.143(B)(2)(d), Revised Code, is unlawful and unreasonable because Columbus Southern Power Company ("CSP") and Ohio Power Company ("OP") (collectively "Companies or AEP-Ohio") failed to demonstrate that granting such collection would have the effect of providing certainty regarding retail electric service.

2. The Commission's finding that the Companies may collect revenues for the pre-2009 Component pursuant to Section 4928.143(B)(2)(d), Revised Code, is unlawful and unreasonable because the Companies failed to demonstrate that their other revenues did not provide adequate compensation.

3. The Commission's authorization of the pre-2009 Component pursuant to Section 4928.143(B)(1), Revised Code, was unlawful and unreasonable in that it is based on a statutory provision that was not advanced by any party to the proceeding and was beyond the scope of the Supreme Court's

remand directing the Commission to determine if a provision of Section 4928.143(B)(2), Revised Code, supports collection of these revenues.

4. The Commission unlawfully and unreasonably permitted collection of the pre-2009 Component during a period in which there was no legal authority to permit collection of those revenues.

5. The Commission's Order on Remand is unlawful and unreasonable because it failed to order the adjustment of phase-in deferral balances of OP caused by the ESP rate caps on the theory that the proposed adjustment "would be tantamount to retroactive ratemaking."

6. The Commission's Order on Remand is unlawful and unreasonable because it failed to order the adjustment of the phase-in deferral balances of OP based on a finding not supported in the record that the "past rates ... have already been collected from customers."

7. The Commission's Order on Remand is unlawful and unreasonable in that it extended the prohibition of retroactive ratemaking to prevent the adjustment of phase-in deferral balances that had not been collected from customers and which were subject to further adjustment by the Commission's order establishing the basis for those deferral balances.

8. The Commission's Order on Remand is unlawful and unreasonable in that it failed to address the flow-through effects of Supreme Court's finding that the Commission's original Opinion and Order on deferral balances, recovery of delta revenues, and the earnings of the Companies.

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

Respectfully submitted,

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I hereby certify that a copy of this *Notice of Appeal of Appellant Industrial Energy Users-Ohio* was sent by ordinary United States mail, postage prepaid or hand-delivered to all parties to the proceeding before the Public Utilities Commission of Ohio, listed below, and pursuant to Section 4903.13 of the Ohio Revised Code on February 1, 2012.

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I hereby certify that a *Notice of Appeal of Appellant Industrial Energy Users-Ohio* has been filed with the docketing division of the Public Utilities Commission of Ohio in accordance with Rules 4901-1-02-(A) and 4901-1-36 of the Ohio Administrative Code on February 1, 2012.

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{C36610: }

ATTACHMENT A

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

ORDER ON REMAND

The Commission, coming now to consider the evidence presented in these proceedings, pursuant to the Supreme Court of Ohio's remand in *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, the transcripts of the hearing, and briefs of the parties, hereby issues its order on remand.

APPEARANCES:

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OPINION:

I. HISTORY OF THE PROCEEDINGS

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

By entries issued August 5, 2008, and September 5, 2008, the procedural schedule in these matters was established. A technical conference was held regarding AEP-Ohio's application on August 19, 2008, and a prehearing conference occurred on November 10, 2008. The evidentiary hearing commenced on November 17, 2008, and concluded on

December 10, 2008. The Commission also held five local public hearings throughout the Companies' service area.

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

On March 18, 2009, the Commission issued its opinion and order regarding AEP-Ohio's application (ESP Order). By entries on rehearing issued July 23, 2009 (First ESP EOR) and November 4, 2009, the Commission affirmed and clarified certain issues raised in the ESP Order. As ultimately modified and adopted by the Commission, AEP-Ohio's ESP directed, among other things, that AEP-Ohio be permitted to recover the incremental capital carrying costs that would be incurred after January 1, 2009, on past environmental investments (2001-2008) and approved a provider of last resort (POLR) charge for the ESP period.[1]

The Commission's decision was appealed to the Supreme Court of Ohio. On April 19, 2011, the Court affirmed the ESP Order in numerous respects, but remanded the proceedings to the Commission with regard to two portions of the Commission's decision. The Court determined that Section 4928.143(B)(2), Revised Code, does not authorize the Commission to allow recovery of items not enumerated in the section. The Court remanded the cases to the Commission for further proceedings in which the Commission may determine whether any of the listed categories set forth in Section 4928.143(B)(2), Revised Code, authorize recovery of environmental investment carrying charges.[2] Regarding the POLR charge, the Court concluded that the Commission's decision that the POLR charge is cost-based was against the manifest weight of the evidence, an abuse of the Commission's discretion, and reversible error. The Court noted two methods by which the Commission may consider the POLR charge on remand, specifically, as either a non-cost-based POLR charge or by way of evidence of AEP-Ohio's actual POLR costs.[3]

By entry issued May 4, 2011, the Commission directed AEP-Ohio to file proposed tariffs removing the POLR and environmental carrying charges from its rates by May 11, 2011. The entry also directed AEP-Ohio, if it intended to seek recovery of the POLR or environmental carrying charges, pursuant to the Court's remand, to make the appropriate filing with the Commission. On May 11, 2011, the Companies filed proposed tariffs, under protest, and corrections on May 13, 2011. AEP-Ohio also filed motions requesting that the

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1 AEP-Ohio ESP Order at 24-28, 38-40; First ESP EOR at 10-13, 24-27.

2 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 520.

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

Commission either establish a procedural schedule for the remand proceedings and reject or hold in abeyance the proposed tariffs eliminating the POLR and environmental carrying charges, or collect the existing tariff rates subject to refund pending the Commission's decision on remand. By responses filed May 16, 2011, the Ohio Energy Group (OEG), Ohio Manufacturers' Association (OMA), and Ohio Hospital Association (OHA) endorsed the collection of the existing rates, subject to refund. In various filings, other parties, namely, the Office of the Ohio Consumers' Counsel (OCC), Ohio Partners for Affordable Energy (OPAE), and Industrial Energy Users-Ohio (IEU-Ohio) opposed AEP-Ohio's motions.

On May 20, 2011, AEP-Ohio filed what it referred to as an initial merit filing on remand. In the filing, the Companies state that there is sufficient evidence in the record for the Commission to find that the environmental carrying costs are recoverable under one of the provisions in Section 4928.143(B)(2)(a) through (h), Revised Code, without further proceedings. While AEP-Ohio argued for the Commission to determine the level of POLR charges due the Companies based on the existing record and made various arguments in support thereof, AEP-Ohio also recognized that the Commission may schedule hearings and admit additional evidence regarding the Companies' POLR obligation.

By entry issued May 25, 2011, the Commission directed AEP-Ohio to file revised tariffs by May 27, 2011, making the POLR and environmental carrying charges subject to refund, as of the first billing cycle of June 2011, until the Commission specifically orders otherwise on remand. The Commission specified that, if it ultimately determines in the remand proceedings that any POLR or environmental carrying charges are to be refunded to customers, interest may be imposed on the amounts collected. The Commission concluded that making the current tariff rates subject to refund, pending the outcome of the remand proceedings, is the most reasonable means to facilitate a just process for customers and the Companies, and to avoid rate volatility for some customers. In the May 25, 2011, entry, the Commission also established a procedural schedule to afford AEP-Ohio and the intervenors an opportunity to present testimony and to offer additional evidence in regard to the POLR and environmental carrying charges remanded to the Commission. The parties were specifically directed to address the amount of POLR charges at issue and the rate of interest charges applicable, if any. On May 27, 2011, AEP-Ohio filed revised tariffs in accordance with the May 25, 2011, entry.

Following issuance of the May 25, 2011, entry, FirstEnergy Solutions Corp. (FES), Appalachian Peace and Justice Network (APJN), and Exelon Generation Company, LLC (Exelon) filed motions to intervene in these proceedings. By entry issued June 16, 2011, the attorney examiner denied the motions, finding that they were filed nearly three years past the established intervention deadline and that the movants had not demonstrated

extraordinary circumstances justifying late intervention. On June 29, 2011, the Commission affirmed the attorney examiner's ruling and denied the interlocutory appeals of FES, APJN, and Exelon.

Pursuant to the procedural schedule established in the May 25, 2011, entry, as modified by entries of June 23, 2011, and June 30, 2011, a prehearing conference was held on July 8, 2011. The hearing commenced on July 15, 2011, and continued on July 19, 2011, through July 21, 2011. The hearing concluded with rebuttal testimony on July 28, 2011.

At the hearing, AEP-Ohio presented the testimony of Dr. Anil Makhija (Cos. Remand Ex. 1), Dr. Chantale LaCasse (Cos. Remand Ex. 3), and Laura J. Thomas (Cos. Remand Ex. 4), regarding the Companies' POLR obligation, and the testimony of Philip J. Nelson (Cos. Remand Ex. 2), regarding the environmental investment carrying charges incurred during the ESP for investments made from 2001-2008.[4] The Companies also offered the rebuttal testimony of Dr. Chantale LaCasse (Cos. Remand Ex. 5), Thomas E. Mitchell (Cos. Remand Ex. 7), and Laura J. Thomas (Cos. Remand Ex. 8).

Six witnesses testified for various intervenors: on behalf of OCC, Mack A. Thompson (OCC Remand Ex. 1) and Dr. Daniel J. Duann (OCC Remand Ex. 2); on behalf of IEU-Ohio, Dr. Jonathan A. Lesser (IEU-Ohio Remand Ex. 1), Kevin M. Murray (IEU-Ohio Remand Ex. 2), and Joseph G. Bowser (IEU-Ohio Remand Ex. 3); and on behalf of Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc. (jointly, Constellation), David I. Fein (Constellation Remand Ex. 1). Staff presented the testimony of Timothy W. Benedict (Staff Remand Ex. 1).

At the conclusion of the hearing on July 28, 2011, IEU-Ohio, joined by OCC, moved to dismiss these cases, asserting that AEP-Ohio failed to sustain its burden of proof. The attorney examiner deferred ruling on the motion to dismiss.

Initial briefs were filed on August 5, 2011, by AEP-Ohio, Staff, IEU-Ohio, and Constellation. Joint briefs were filed by OCC and OPAE, as well as OMA and OHA. Additionally, FES filed a motion for leave to file an *amicus curiae* brief attached to its motion. On August 10, 2011, AEP-Ohio filed a memorandum contra FES' motion. FES filed a reply on August 15, 2011.

On August 10, 2011, OCC and OPAE filed a motion to strike a portion of AEP-Ohio's initial brief. IEU-Ohio filed a similar motion on August 11, 2011. AEP-Ohio filed a memorandum contra the motions to strike on August 16, 2011. OCC, OPAE, and IEU-Ohio filed a joint reply on August 18, 2011.

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4 References to exhibits or transcripts from the remand proceedings will specifically be designated as such in this order. All other references refer to evidence from the original record compiled in 2008.

Reply briefs were filed on August 12, 2011, by AEP-Ohio, IEU-Ohio, and Constellation. Joint reply briefs were filed by OCC and OPAE, as well as OMA and OHA. On August 17, 2011, OCC, OPAE, and IEU-Ohio filed a joint motion to strike portions of AEP-Ohio's reply brief. AEP-Ohio filed a memorandum contra the motion to strike on August 24, 2011. OCC, OPAE, and IEU-Ohio filed a joint reply on August 29, 2011.

## II. PROCEDURAL ISSUES

### A. IEU-Ohio's Motion to Dismiss

As noted above, IEU-Ohio moved to dismiss these cases at the conclusion of the hearing on July 28, 2011, and OCC joined the motion. With respect to AEP-Ohio's POLR charges, IEU-Ohio contends that the Companies asserted during the remand proceedings that their POLR costs are based on the value to customers of the option to switch to an alternative supplier, which IEU-Ohio believes is the same argument that was previously rejected by the Supreme Court of Ohio. Regarding environmental carrying charges, IEU-Ohio argues that the Companies have failed to identify any category within Section 4928.143(B)(2), Revised Code, that supports their recovery of such costs. IEU-Ohio concludes that the Companies have failed to meet their burden of proof. (Remand Tr. V at 894-895.)

AEP-Ohio responds with respect to the POLR charges that the Court's decision does not dictate a particular outcome in these cases or prevent the Commission from reaching the same result as in the original proceedings. The Companies argue that the evidence should be considered by the Commission. On the subject of environmental carrying charges, AEP-Ohio maintains that it has identified multiple bases in the statute that support recovery of its costs. (Remand Tr. V at 895-897.)

The Commission finds that AEP-Ohio has presented sufficient evidence, as addressed in detail below, such that we may decide these matters on the record. Accordingly, IEU-Ohio's motion to dismiss should be denied.

### B. FES' Motion to File *Amicus Curiae* Brief

On August 5, 2011, FES filed a motion for leave to file an *amicus curiae* brief in these proceedings. FES notes that its brief addresses AEP-Ohio's POLR charges. According to FES, it has extensive experience on the subject of POLR risk, given that it has assumed such risk in competitive auctions as a competitive retail electric service (CRES) provider. FES believes that its experience may be beneficial to the Commission. FES notes that it was denied intervention in these proceedings and that, in other cases, the Commission has permitted *amicus* filings by entities denied intervention or even where intervention was

not sought. FES asserts that its brief will not delay the proceedings or expand on the issues, as FES does not seek to introduce new evidence. FES points out that the Commission's decision will have a significant impact on CRES providers operating in AEP-Ohio's service territory and that the Commission should have as much information as possible in making its decision.

In its memorandum contra, AEP-Ohio responds that FES was properly denied intervention in these cases and that its participation at this point adds no value to the record. The Companies further note that FES has identified no legal basis authorizing FES to file an *amicus curiae* brief. AEP-Ohio disputes FES' claim that it does not intend to seek new evidence, pointing out that FES attached a non-record exhibit to its brief. The Companies maintain that FES has no unique POLR experience to share with the Commission and that the perspective of CRES suppliers has already been provided by Constellation, which is a party to these proceedings. AEP-Ohio notes that the Commission has not solicited FES' *amicus* filing, as it has from other entities in prior cases, and that FES' true concerns are those of a competitor of the Companies and not an aide to the Commission.

The Commission finds no basis under the present circumstances to justify permitting FES to file an *amicus curiae* brief. As discussed above, FES' late motion for intervention was denied. In the entry of June 29, 2011, we noted that FES was granted intervention in AEP-Ohio's pending ESP case, Case No. 11-346-EL-SSO, *et al.*, and that our decision was not intended to prevent FES from presenting its arguments with respect to AEP-Ohio's POLR charges or from otherwise fully participating in those proceedings, regardless of the outcome of the present cases. Additionally, as AEP-Ohio notes, the perspective of CRES providers is already represented in these proceedings by Constellation, which has provided expert testimony, as well as filed initial and reply briefs. Finally, we find that FES' *amicus curiae* brief raises no issue that has not also been raised by Constellation or the other parties. For these reasons, FES' motion for leave to file an *amicus curiae* brief should be denied.

C. Motions to Strike of OCC, OPAE, and IEU-Ohio

1. Testimony

a. Rebuttal Testimony of Dr. LaCasse

During the remand hearing, OCC, joined by IEU-Ohio, OPAE, Constellation, and OHA, moved to strike a portion of the rebuttal testimony of Companies witness LaCasse. The motion to strike was denied by the attorney examiner. (Remand Tr. V at 637-643, 653.) In their initial brief, OCC and OPAE renew the motion to strike, request that the Commission find that the attorney examiner's ruling was erroneous, and ask that the

rebuttal testimony and related testimony on cross-examination be disregarded. Regarding the specific portion of the rebuttal testimony in question, which pertains to Monte Carlo model results offered in support of the Companies' option model results (Cos. Remand Ex. 5 at 7-11), OCC and OPAE argue that proper rebuttal testimony does not include subjects that could have been presented during the party's direct case. OCC and OPAE note that AEP-Ohio indicated in its initial merit filing of May 20, 2011, that it intended to support the reasonableness of its POLR charges based on additional modeling, which could include the results of a Monte Carlo model. OCC and OPAE assert that the late arrival of a study is insufficient justification for its presentation in rebuttal testimony and that the late admission into the record of the Monte Carlo results was highly prejudicial. AEP-Ohio responds that Dr. LaCasse offered proper rebuttal testimony and that, because OCC failed to take an interlocutory appeal of the attorney examiner's ruling, it may not now be attacked on brief.

Initially, the Commission notes that OCC and OPAE may raise the propriety of the attorney examiner's ruling for the Commission's consideration pursuant to Rule 4901-1-15(F), Ohio Administrative Code (O.A.C.). We find, however, that the attorney examiner properly denied the motion. The rebuttal testimony of Dr. LaCasse regarding the results of the Monte Carlo model was specifically provided in response to the direct testimony of IEU-Ohio witness Lesser, stating that "options must be valued using empirical models, such as [M]onte-[C]arlo models" if the strike price is correlated with the price of the underlying asset and that "one cannot use either the Black-Scholes or Black models to do so" (IEU-Ohio Remand Ex. 1 at 22; Cos. Remand Ex. 5 at 7). As Dr. LaCasse's rebuttal testimony was specifically offered in response to Dr. Lesser's testimony, it could not have been offered as part of the Companies' direct case, given that the Companies' direct testimony was filed before the intervenors'. Further, OCC and OPAE have offered no support for their contention that the Monte Carlo results were presented in rebuttal testimony because they were late. Neither have OCC and OPAE demonstrated how the admission of the testimony into the record caused them prejudice. Both parties were afforded the opportunity to cross-examine Dr. LaCasse regarding the Monte Carlo results.

b. Direct Testimony of Mr. Nelson

OCC also moved during the remand hearing to strike a portion of the direct testimony of Companies witness Nelson. This motion was also denied by the attorney examiner. (Remand Tr. I at 69-70, 78.) OCC and OPAE, in their initial brief, ask that the Commission reverse the ruling. In the relevant portion of the testimony, Mr. Nelson identified three statutory bases in support of the Companies' recovery of environmental carrying costs (Cos. Remand Ex. 2 at 4). OCC and OPAE move to strike this testimony on the grounds that Mr. Nelson is not qualified to offer a legal opinion.

*The Commission finds that this motion to strike was also properly denied.* Mr. Nelson explained that his testimony was offered based on the advice of counsel (Cos. Remand Ex. 2 at 4) and that he was not testifying as an expert in legal matters (Remand Tr. I at 78). Mr. Nelson's testimony was thus not offered as a legal opinion.

2. Initial Brief

On August 10, 2011, OCC and OPAE filed a motion to strike a portion of AEP-Ohio's initial brief referring to the POLR charges of other electric distribution utilities (EDUs) in Ohio. IEU-Ohio filed a similar motion on August 11, 2011. OCC, OPAE, and IEU-Ohio argue that the POLR charges of the other EDUs were not introduced or admitted into evidence and that the Companies' attempt to rely on non-record information should be rejected. They further assert that the Commission must base its decision on the record before it, as required by Section 4903.09, Revised Code. OCC, OPAE, and IEU-Ohio add that they have concerns about the relevancy, comparability, and accuracy of the charges listed for the other EDUs, which they would have raised if the information had been introduced during the hearing.

AEP-Ohio responds that the information that OCC, OPAE, and IEU-Ohio seek to strike was taken directly from tariffs that have been approved by the Commission and that the Commission has the authority to recognize its own decisions and approved tariffs, which have the effect of a statute. The Companies argue that the Commission has previously taken administrative notice of tariff provisions for comparison purposes and may do so here, if necessary. They note that the information was provided to assist the Commission in applying its prior decisions to the present cases. AEP-Ohio contends that the circumstances surrounding approval of the other EDUs' POLR charges are known by the Commission and may be weighed accordingly.

OCC, OPAE, and IEU-Ohio reply that it is inappropriate to take administrative notice of the information after the record is closed, as it denies them the opportunity to explain and rebut the information through cross-examination, contrary to Ohio Supreme Court and Commission precedent. They add that the Companies have offered no reason for having waited until the briefing stage to present the information.

The Commission agrees with OCC, OPAE, and IEU-Ohio that they should have been afforded the opportunity to challenge the information in question during the hearing and that it would be improper to take administrative notice of the information at this stage in the proceedings. AEP-Ohio admits that the table in its brief was included in its initial merit filing of May 20, 2011, but offers no explanation as to why it was not presented during its direct case. Additionally, the Commission questions whether the information presented in the table may properly be used for the purpose of comparison. As the intervenors note, the rates and charges of the other EDUs shown in the table do not appear

to relate solely to their POLR obligation and, in any event, were determined in the context of Commission-approved stipulations. Accordingly, the motions to strike should be granted, such that the first paragraph on page 30 of AEP-Ohio's initial brief, including the table, should be stricken.

3. Reply Brief

On August 17, 2011, OCC, OPAE, and IEU-Ohio filed a motion to strike two portions of AEP-Ohio's reply brief. The first portion is a sentence pertaining to the POLR charges of the other EDUs. The second portion pertains to statements made by OCC witness Medine regarding the Black-Scholes model in a Commission-ordered audit report in the Companies' fuel adjustment clause (FAC) proceedings, Case No. 10-268-EL-FAC, *et al.* With respect to both portions, OCC, OPAE, and IEU-Ohio argue that the Companies' attempts to rely on non-record information should be rejected for the same reasons advanced in their motions to strike a portion of AEP-Ohio's initial brief, as discussed above.

Likewise, AEP-Ohio raises the same arguments asserted in its response to the motions to strike a portion of its initial brief. Regarding the statements of OCC witness Medine on the subject of the Black-Scholes model, the Companies argue that whether to take administrative notice is a case by case determination and that, under the circumstances, it is appropriate for the Commission to do so in order to be able to compare Ms. Medine's testimony in these cases, as addressed by OCC and OPAE in their initial brief, with her statements in the audit report in the FAC proceedings.

The Commission finds that the motion to strike should be granted for the same reasons addressed above. We find that it is improper to take administrative notice of the information in question, which was not presented until the reply brief was filed and thus foreclosed the intervenors from challenging the information. Therefore, the motion to strike should be granted, such that both portions of AEP-Ohio's reply brief, as identified by OCC, OPAE, and IEU-Ohio, should be stricken.

## III. DISCUSSION

### A. Incremental Carrying Cost for 2001-2008 Environmental Investment

#### 1. Supreme Court's Directive

In the ESP Order, the Commission authorized AEP-Ohio "to recover the incremental capital carrying costs that will be incurred after January 1, 2009, on past environmental investments (2001-2008) that are not presently reflected in the Companies'

existing rates."[5] The Commission interpreted Section 4928.143(B)(2), Revised Code, to permit AEP-Ohio to include, in the ESP, environmental investment carrying costs incurred during the ESP term. The Commission found that "[t]he carrying costs on the environmental investments fall within the ESP period and, therefore, may be included in the ESP pursuant to the broad language of Section 4928.143(B)(2), Revised Code, permitting recovery for unenumerated expenses."[6] The Commission authorized the Companies to collect a revenue requirement of $26 million for CSP and $84 million for OP. On appeal, the Supreme Court of Ohio determined that Section 4928.143(B)(2), Revised Code, does not authorize the Commission to allow recovery of items not enumerated in the section. The Court remanded the cases to the Commission for further proceedings in which the Commission may determine whether any of the listed categories set forth in Section 4928.143(B)(2), Revised Code, authorize recovery of environmental investment carrying charges.[7]

2. Applicable Law

Section 4928.143(B)(1), Revised Code, provides that an ESP "shall include provisions relating to the supply and pricing of electric generation service." Additionally, Section 4928.143(B)(2), Revised Code, enumerates specific categories of items that an ESP may include.

3. Arguments

In their application, the Companies requested increases to their base, non-FAC generation rates for recovery of carrying costs for environmental investments made during 2001-2008 that were not currently reflected in their SSO rates, or an annual amount of $26 million for CSP and $84 million for OP. The Commission approved the Companies' request.

AEP-Ohio asserts that the narrow legal issue remanded to the Commission may be readily addressed by substantiating its recovery of carrying costs on 2001-2008 environmental investments by way of any one of multiple provisions within Section 4928.143(B)(2), Revised Code. First, the Companies state that Section 4928.143(B)(2)(d), Revised Code, authorizes the Commission to establish terms relating to carrying costs, as would have the effect of stabilizing rates. In their brief, the Companies note that the effect of perpetuating the useful lives of existing generation assets through prudent environmental investments is to stabilize rates, particularly when compared to the cost of investing in new generation. As another statutory basis, AEP-Ohio points to Section

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5 ESP Order at 28.

6 First ESP EOR at 12.

7 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 520.

4928.143(B)(2)(e), Revised Code, which authorizes automatic increases in any component of the SSO price. The Companies claim that, because compliance with environmental regulations is compulsory when operating a generating station, it is appropriate to allow automatic pass-through of prudently incurred carrying costs on environmental investments. Finally, AEP-Ohio identifies Section 4928.143(B)(2)(b), Revised Code, as another legal basis for its recovery of such costs, noting that the provision allows cost recovery for an environmental expenditure for an electric generating facility of an EDU, provided the cost is incurred or the expenditure occurs on or after January 1, 2009. The Companies explain that, although the environmental investments were made prior to that date, the carrying costs on those investments were incurred in 2009 and beyond.

Staff agrees with AEP-Ohio that Section 4928.143(B)(2)(d), Revised Codes, allows for recovery of the Companies' environmental investment carrying costs, given that "carrying costs" are specifically enumerated in that provision.

IEU-Ohio argues that AEP-Ohio has failed to demonstrate that the carrying charges on 2001-2008 environmental investments are lawful. Initially, IEU-Ohio notes that the Companies have not claimed that the revenues from their other rates and charges are inadequate to compensate the Companies for their environmental investment carrying costs. IEU-Ohio further argues that AEP-Ohio failed to offer any evidence in support of its claim for recovery and instead merely referred to certain provisions in the statute, without demonstrating that it satisfies the criteria of any of those provisions. With regard to those provisions, IEU-Ohio asserts that Section 4928.143(B)(2)(b), Revised Code, pertains only to recovery of expenses related to construction work in progress occurring on or after January 1, 2009, and is not applicable to AEP-Ohio's carrying costs. Regarding Section 4928.143(B)(2)(d), Revised Code, IEU-Ohio contends that Companies witness Nelson failed to demonstrate how the carrying charges stabilize or provide certainty regarding retail electric service. Finally, with respect to Section 4928.143(B)(2)(e), Revised Code, IEU-Ohio notes that the carrying charges do not constitute an automatic increase or decrease.

OCC and OPAE contend that the carrying costs were not incurred on or after January 1, 2009, because they pertain to environmental investments that occurred from 2001-2008, and that the carrying costs, therefore, may not be recovered pursuant to Section 4928.143(B)(2)(b), Revised Code. With respect to Section 4928.143(B)(2)(d), Revised Code, OCC and OPAE argue that there is no evidence that carrying charges on older environmental investments benefit customers in terms of stability or certainty regarding retail electric service. Finally, OCC and OPAE assert that Section 4928.143(B)(2)(e), Revised Code, is inapplicable, as the carrying charges are a distinct component of the SSO, rather than an adjustment mechanism for a component.

4. Conclusion

The Supreme Court of Ohio directed that "[o]n remand, the [C]ommission may determine whether any of the listed categories of (B)(2) authorize recovery of environmental carrying charges."[8] AEP-Ohio submits that three of the categories listed in Section 4928.143(B)(2), Revised Code, including Section 4928.143(B)(2)(d), Revised Code, authorize recovery of its environmental investment carrying charges.

Section 4928.143(B)(2)(d), Revised Code, provides that an ESP may include "[t]erms, conditions, or charges relating to...carrying costs, amortization periods, and accounting or deferrals, including recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service." Section 4928.01(A)(27), Revised Code, defines "retail electric service" as "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" and specifically includes "generation service."

The Commission agrees with AEP-Ohio and Staff that Section 4928.143(B)(2)(d), Revised Code, authorizes the Companies' recovery of incremental capital carrying costs that are incurred after January 1, 2009, on past environmental investments (2001-2008) that were not previously reflected in the Companies' existing rates prior to the ESP Order. Section 4928.143(B)(2)(d), Revised Code, specifically authorizes recovery of carrying costs. There is no dispute among the parties on this point.

As an initial matter, IEU-Ohio asserts that the Companies have failed to show that their rates, excluding the environmental investment carrying charges, do not provide adequate compensation. IEU-Ohio, however, offers no support for its position that AEP-Ohio is required to make such a showing or pass an earnings test as a condition of recovery of its incremental environmental investment carrying costs.

OCC, OPAE, and IEU-Ohio argue that the Companies failed to demonstrate how their carrying costs stabilize or provide certainty regarding retail electric service. OCC and OPAE further add that the determination regarding the stabilizing effect must be made from the perspective of the customer and that the Companies have not shown that their customers benefit from the carrying charges on past environmental investments. We disagree with the arguments raised by OCC, OPAE, and IEU-Ohio. During the initial hearing, Companies witness Nelson testified:

> The capital carrying cost is the annual cost associated with the investment of a dollar of capital asset investment. Capital expenditures are typically long lived assets that are recovered over the life of the asset. Investors require

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8 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 520.

> both a return on and of their capital expenditures....The carrying cost rate includes the cost of money (weighted average cost of capital), a depreciation component, an income tax component, property and other taxes component and an administrative and general component.

(Cos. Ex. 7 at 15-16.) He further testified:

> These environmental investments are necessary to keep the Companies' low-cost coal-fired generating units running. The customers will benefit because the operating costs of these units remain well below the cost of securing the power on the market. The Companies are passing the lower-cost power through the FAC.

(Cos. Ex. 7B at 6.)

We find that the environmental investment carrying charges have the effect of providing certainty to both the Companies and their customers regarding retail electric service, specifically generation service. With respect to AEP-Ohio, inclusion of the carrying charges in the ESP compensates the Companies for their investment in their generating plant. Companies witness Nelson explained that the Companies' investors expect to earn a return on their capital investments and that the carrying cost rate includes the cost of money, among other components. AEP-Ohio's recovery of the carrying costs works to ensure that the investors earn a return on their investment.

However, customers benefit as well. As Mr. Nelson pointed out, the carrying charges recover the ongoing costs of environmental investments that were necessary to continue operation of the Companies' generation units and extend the useful lives of those facilities. Customers benefit from the lower cost power that they receive as a result. The alternative to the investments in the Companies' generation assets would be increased use of purchased power to serve the Companies' SSO load. The record reflects that this cost of the environmental investments was below the market rate for purchased power at the time the Commission considered the ESP. Thus, we agree with Staff that "[t]he [C]ompanies' compliance with the current and future environmental requirements is in the public interest, and they should continue investing in environmental equipment" (Staff Ex. 6 at 5). As AEP-Ohio's environmental investment carrying charges have the effect of providing certainty regarding retail electric service, Section 4928.143(B)(2)(d), Revised Code, authorizes their inclusion in the ESP.

With respect to the argument raised by OCC and OPAE that, because the carrying costs pertain to environmental investments that occurred from 2001-2008, the carrying costs may not be recovered pursuant to Section 4928.143(B)(2)(b), Revised Code, the

Commission notes that Section 4928.143(B)(2)(b), Revised Code, applies only to nonbypassable surcharges. Since the carrying costs at issue are recovered through rates which are bypassable, the limitation to environmental expenditures incurred on or after January 1, 2009, contained in Section 4928.143(B)(2)(b), Revised Code, is inapplicable in this case.

The Commission further notes that our decision in this case is consistent with the broad authority granted to the Commission by Section 4928.143(B)(1), Revised Code, which authorizes ESPs to include "provisions relating to the supply and pricing of electric generation service." The carrying charges are a specific component of the Companies' standard service offer generation rates and are directly related to environmental investments made at generating facilities which are used to serve standard service offer customers.

The Commission concludes that AEP-Ohio should be authorized to continue its recovery of incremental capital carrying costs that are incurred after January 1, 2009, on past environmental investments (2001-2008) that were not previously reflected in the Companies' existing rates prior to the ESP Order. The Companies should file revised tariffs, consistent with this order on remand, reflecting that the environmental investment carrying charges are no longer subject to refund. The effective date of the new tariffs should be the date of this order, or the date upon which four complete, printed copies of the final tariffs are filed with the Commission, whichever date is later.

B. POLR Rider

1. Supreme Court's Directive

In the ESP Order, the Commission found that "the Companies do have some risks associated with customers switching to CRES providers and returning to the electric utility's SSO rate at the conclusion of CRES contracts or during times of rising price."[9] The Commission concluded that "the Companies' proposed ESP should be modified such that the POLR rider will be based on the cost to the Companies to be the POLR and carry the risks associated therewith, including the migration risk." The Commission approved recovery of 90 percent of the estimated POLR costs presented by the Companies, or the approximate portion representing the migration risk, and authorized the Companies to collect a revenue requirement of $97.4 million for CSP and $54.8 million for OP. The Commission also specified that "the POLR rider shall be avoidable for those customers who shop and agree to return at a market price and pay the market price of power incurred by the Companies to serve the returning customers."

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9 ESP Order at 40.

On appeal, the Supreme Court of Ohio concluded that the Commission's decision that the POLR charge is cost-based, which determination was based on the results of "a mathematical formula" known as the Black-Scholes model, was against the manifest weight of the evidence, an abuse of the Commission's discretion, and reversible error.[10] Additionally, the Court stated:

> To be clear, we express no opinion on whether a formula-based POLR charge is per se unreasonable or unlawful, and the [C]ommission may consider on remand whether a non-cost-based POLR charge is reasonable and lawful. Alternatively, the [C]ommission may consider whether it is appropriate to allow [AEP-Ohio] to present evidence of its actual POLR costs. However the [C]ommission chooses to proceed, it should explain its rationale, respond to contrary positions, and support its decision with appropriate evidence.

2. Applicable Law

An EDU's POLR obligation is derived from several statutory provisions in Chapter 4928, Revised Code. Section 4928.141(A), Revised Code, provides, in part:

> Beginning January 1, 2009, an electric distribution utility shall provide consumers, on a comparable and nondiscriminatory basis within its certified territory, a standard service offer of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service.

Additionally, Section 4928.14, Revised Code, provides, in part:

> The failure of a supplier to provide retail electric generation service to customers within the certified territory of an electric distribution utility shall result in the supplier's customers, after reasonable notice, defaulting to the utility's standard service offer under sections 4928.141, 4928.142, and 4928.143 of the Revised Code until the customer chooses an alternative supplier.

In its decision in these cases, the Supreme Court of Ohio described the EDU's POLR obligation as the "obligation to stand ready to accept returning customers."[11]

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10 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518-519.

11 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 517.

3. Issues

On appeal, the Supreme Court of Ohio found "no evidence suggesting that [AEP-Ohio's] POLR charge is related to any costs it will incur."[12] Regarding the Black-Scholes model used by the Companies to determine their POLR costs, the Court stated that "[v]alue to customers (what the model shows) and cost to [AEP-Ohio] (the purported basis of the order) are simply not the same thing" and "we fail to see how the amount a customer would be willing to pay for the right to shop necessarily establishes [AEP-Ohio's] costs to bear the attendant risks."

AEP-Ohio claims that the evidentiary record on remand fully supports the Companies' existing POLR charges and addresses the Court's concerns as to how the charges are cost-based. The Companies urge the Commission to approve again their existing POLR charges. Numerous intervenors, including OCC, OPAE, IEU-Ohio, Constellation, OMA, and OHA, argue that the Companies have failed to sustain their burden of proof and should, therefore, refund to customers the POLR charges collected since the first billing cycle of June 2011 and cease any further collection of such charges.

a. Legal Basis for POLR Charge

i. Arguments

AEP-Ohio notes that all EDUs have a mandatory, continuing obligation to stand as the POLR in their respective service territories and that the Supreme Court of Ohio has recognized that EDUs are entitled to be compensated for discharging their POLR obligations.[13] Additionally, the Companies state that, pursuant to Section 4928.143(B)(1), Revised Code, an ESP is required to include provisions related to the supply and pricing of electric generation service. They also note that, pursuant to Section 4928.143(B)(2)(d), Revised Code, an ESP may include charges relating to bypassability, standby service, and default service, as would have the effect of stabilizing or providing certainty regarding retail electric service. AEP-Ohio contends that recoverable costs may include lost revenues due to its POLR obligation, pointing out that Section 4928.143(B)(2)(h), Revised Code, expressly authorizes recovery of lost revenues related to distribution infrastructure and modernization incentives. The Companies assert that this provision confirms that the components of an ESP may be based on lost revenues.

The Companies further state that, although the record demonstrates that the POLR charges are cost-based, the charges would nevertheless be lawful even if they could not be justified on a cost basis, as they have the effect of providing stability and certainty

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12 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518.

13 *Constellation NewEnergy, Inc. v. Pub. Util. Comm.* (2004), 104 Ohio St.3d 530.

regarding the price that customers will pay for retail electric service, consistent with Section 4928.143(B)(2)(d), Revised Code. Finally, AEP-Ohio argues that, because POLR costs are recovered by the other EDUs or through the competitive bid prices of SSO suppliers, it would be unfair and unlawful to deny the Companies the same right to recover such costs.

IEU-Ohio asserts that the Companies have not demonstrated any legal basis for their POLR charges. Noting that the POLR charges were proposed as a distribution rider, IEU-Ohio contends that the charges do not qualify under Section 4928.143(B)(2)(h), Revised Code, which authorizes only certain types of distribution charges. IEU-Ohio further notes that the Companies have identified no legal authority that would justify the POLR charges as a generation rider.

ii. Conclusion

As an initial matter, the Commission clarifies that AEP-Ohio's POLR rider should properly be classified as a generation service rider. Although the POLR obligation is an exclusive obligation of the EDUs, it pertains to the provision of generation service.[14] The Commission agrees with the Companies that Section 4928.143(B)(1), Revised Code, provides a statutory basis for their recovery of POLR costs, which relate to the pricing of electric generation service. Additionally, Section 4928.143(B)(2)(d), Revised Code, provides that an ESP may include "[t]erms, conditions, or charges relating to...standby, back-up, or supplemental power service, [and] default service...as would have the effect of stabilizing or providing certainty regarding retail electric service." As AEP-Ohio must stand ready to provide SSO service to returning customers, and customers have the option to return at any time, we find that the charges associated with the Companies' POLR obligation, which are charges related to standby and default service, provide certainty for both the Companies and their customers regarding retail electric service.

b. POLR Cost

i. Arguments

According to AEP-Ohio, the record establishes that the Companies incur substantial costs associated with providing customers with the optionality to switch away from, and to return to, the SSO generation rates that the Companies have committed to make available for the duration of the ESP term (POLR optionality) (Cos. Remand Ex. 1 at 3-5; Cos. Remand Ex. 3 at 5-7; Cos. Remand Ex. 4 at 3). AEP-Ohio describes the POLR optionality as enabling customers to take service from the Companies at SSO rates until

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14 *Ohio Consumers' Counsel v. Pub. Util. Comm.* (2007), 114 Ohio St.3d 340, 344-346.

market prices decline below the SSO rates such that it becomes advantageous to switch to a CRES provider. The POLR optionality also allows customers who have switched to a CRES provider to return to the Companies at SSO rates if market prices rise above the SSO rates or the CRES provider defaults in providing service.

Companies witness LaCasse described the costs associated with the POLR optionality in terms of shopping-related risks:

> If market prices fall sufficiently so that SSO customers shop, a portion of the generation output that the EDU expected would serve SSO customers instead would be sold at prices below the ESP price, leading to a shortfall in revenue. If instead market prices rise sufficiently so that customers taking service from CRES providers return to SSO, the EDU would divert a portion of the generation output that could have been sold at those higher market prices to serve SSO customers, or the EDU would purchase from the market at those higher market prices to serve SSO customers, leading to additional unexpected cost.

(Cos. Remand Ex. 3 at 7.) In further support of AEP-Ohio's claim that it incurs POLR costs as a result of shopping-related risks, Dr. LaCasse provided examples of analyses of SSO auction results that quantified the risks, including shopping-related risks, associated with providing wholesale supplies for customers that take SSO-type service (Cos. Remand Ex. 3 at 18-20).

Companies witness Makhija used a hypothetical situation to describe the effect of the POLR obligation as a diminution in equity value, by comparing Utility A, which has the same POLR obligation as the Companies, with Utility B, which does not:

> The earnings of Utility A will have greater variability because its customers are likely to depart when the market price falls below its SSO price, and to return when the market price goes above the SSO price. This makes Utility A riskier and its equity requires a higher required rate of return compared to Utility B. That is, shareholders for Utility A have a higher risk premium (and, hence, a higher cost of equity capital) as a result of the optionality it is required to provide to its customers. Cash flows for Utility A should be discounted at the higher cost of capital, which amounts to a diminution of shareholders equity for Utility A.

(Cos. Remand Ex. 1 at 5.)

Dr. Makhija further testified that the cost to AEP-Ohio, as the provider of the POLR optionality, is "no more or less than the value of the options received by the customers" (Cos. Remand Ex. 1 at 4). Additionally, Dr. LaCasse testified that the value of the option (*i.e.*, the expected value of the difference between the ESP price and the market price at which customers choose to shop) is also the amount by which realized revenue for AEP-Ohio can be expected to be below the ESP revenue that AEP-Ohio would have received absent the customer shopping. She explained that the Companies experience an actual, quantifiable loss in that they are left to make an alternate sale at the lower market price, leading to a loss in revenue. (Cos. Remand Ex. 3 at 5; Cos. Remand Ex. 5 at 6.) Similarly, according to Dr. Makhija, AEP-Ohio incurs a cost, due to its POLR obligation, in the form of a lost opportunity, as measured by the difference between the SSO price and the market price (Remand Tr. I at 49).

Companies witness Thomas explained that AEP-Ohio estimates, by way of an option model, the value of the POLR optionality given to customers to determine the cost imposed on the Companies from their POLR obligation. Ms. Thomas adopted the results from the unconstrained option model proposed originally by Companies witness Baker, which were modified and used by the Commission as the basis for the existing POLR charges. Ms. Thomas also reported the results of the Companies' constrained option model, which refines the original unconstrained option model by incorporating switching constraints, to confirm that the results from the unconstrained option model are reasonable and should be retained. (Cos. Remand Ex. 4 at 12-16.) Additionally, on rebuttal, Dr. LaCasse offered the results of a Monte Carlo model as support for the magnitude of the POLR costs calculated by the Companies' constrained option model (Cos. Remand Ex. 5 at 10).

The Companies contend that their POLR costs are not based on a subjective determination of the amount that a customer would be willing to pay for the right to shop, as discussed in the Supreme Court's decision,[15] but rather are based on forward-looking, market-based measurements that objectively quantify their costs using an option model, which also quantifies the value of the POLR optionality to customers. Because the POLR obligation is undertaken by AEP-Ohio at the outset of the ESP term, the Companies argue that their POLR risk should be modeled at that point (Cos. Remand Ex. 3 at 12-13; Cos. Remand Ex. 8 at 2-4).

AEP-Ohio concludes that its testimony sufficiently explains the rationale for using an option model to estimate its POLR costs, as well as how the value of the POLR optionality to its customers relates to the cost to the Companies of providing the POLR optionality. The Companies submit that that their modeled cost of providing the POLR

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15 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518.

optionality, as supported by the record, confirms the reasonableness of their existing POLR charges.

Numerous parties, including Staff, OCC, OPAE, IEU-Ohio, Constellation, OMA, and OHA, respond that AEP-Ohio has identified no out-of-pocket costs associated with its POLR obligation. They note that none of the Companies' witnesses performed an out-of-pocket cost calculation or even found such costs relevant (Remand Tr. I at 17-18; Remand Tr. II at 152-153, 244-245; OCC Remand Ex. 1 at 36-37). OCC, OPAE, Constellation, OMA, and OHA contend that, by failing to present any evidence showing that their POLR charges are indeed based on cost, the Companies have effectively chosen a non-cost-based approach, despite their insistence to the contrary.

OCC and OPAE assert that Chapter 4928, Revised Code, contains no guarantee that AEP-Ohio will be made whole for generation sales lost to CRES providers and that lost revenues may not be recovered through a POLR charge. OCC and OPAE argue that POLR costs should be limited to verifiable, out-of-pocket costs for incremental energy and capacity that are incurred to serve returning customers (OCC Remand Ex. 1 at 12). They state that the POLR obligation is a non-competitive, distribution-related service that should be priced based on actual, prudently incurred costs, according to traditional cost-of-service principles under Chapters 4905 and 4909, Revised Code (OCC Remand Ex. 2 at 21-22). OCC and OPAE also note that allowing the Companies to recover lost off-system sales opportunities would be contrary to the ESP Order,[16] as well as the Commission's recent order reviewing the Companies' annual earnings,[17] in which the Commission found that off-system sales were irrelevant.

IEU-Ohio witness Murray testified that AEP-Ohio may have a negative financial risk if the cost of serving a returning customer is greater than the fixed cost of serving that customer that is already embedded in the SSO rate (IEU-Ohio Remand Ex. 2 at 7). IEU-Ohio argues, however, that the Companies failed to offer any evidence that their current SSO rates do not already compensate the Companies for the fixed costs associated with their POLR obligation. According to IEU-Ohio, the Companies cannot likely make such a showing because the fixed costs of capacity were known when the Companies sought their current SSO rates (OCC Remand Ex. 1 at 13-14; Remand Tr. II at 223-223). Additionally, IEU-Ohio disputes the Companies' claim that the value of the option equals the POLR cost to the Companies. IEU-Ohio witness Lesser testified that it is a false assumption that value to a customer is exactly equal to the cost to AEP-Ohio (IEU-Ohio Remand Ex. 1 at

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16 ESP Order at 17.

17 *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code*, Case No. 10-1261-EL-UNC, Opinion and Order (January 11, 2011), at 30.

12-15). IEU-Ohio contends that only if lost revenues are costs can the argument be made that there may be some equality between value and cost, and lost revenues are not recoverable as part of the Companies' POLR obligation.

Constellation also argues that lost opportunity costs are not properly included in a POLR charge, given that AEP-Ohio is not entitled to revenue from a set amount of sales. Constellation witness Fein testified that other EDUs in Ohio and other jurisdictions do not recover lost opportunity costs (Constellation Remand Ex. 1 at 11-13). Further, Constellation points out that AEP-Ohio has conducted no study to show that the purported benefit to customers is equal to the cost to the Companies.

ii. Conclusion

In the ESP Order, the Commission stated that it "believes that the Companies do have some risks associated with customers switching to CRES providers and returning to the electric utility's SSO rate at the conclusion of CRES contracts or during times of rising prices."[18] We continue to believe that the Companies have such risks and that the costs associated with such risks may be recovered through a POLR charge. The Commission is concerned, however, that AEP-Ohio has not properly valued its POLR costs or adhered to the clear directive from the Supreme Court of Ohio. The Court afforded two avenues for consideration of AEP-Ohio's POLR charges on remand, stating that "the [C]ommission may consider on remand whether a non-cost-based POLR charge is reasonable and lawful. Alternatively, the [C]ommission may consider whether it is appropriate to allow [AEP-Ohio] to present evidence of its actual POLR costs."[19]

AEP-Ohio has advocated its belief throughout the remand proceedings that its POLR charges are indeed based on cost, leaving the Commission to pursue the latter of the two approaches sanctioned by the Court (*i.e.*, consideration of whether the Companies have presented evidence of their actual POLR costs).[20] Upon review of the record, it is clear that the Companies have not presented any evidence of their actual, out-of-pocket POLR costs (Remand Tr. I at 17-18, 37-38; Remand Tr. II at 152-153, 237-238, 244-247; OCC

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18 ESP Order at 40.

19 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

20 Although AEP-Ohio has asserted throughout these remand proceedings that its POLR charges are cost-based, AEP-Ohio suggests, for the first time in a single section of its brief, that the charges can be justified alternatively on a non-cost basis. The Companies contend that non-cost-based POLR charges are lawful pursuant to Section 4928.143(B)(2)(d), Revised Code. However, the Companies offered no evidence to demonstrate that their POLR charges, if considered non-cost-based, are reasonable, as required by the Court. The Companies' reference on brief to their exposure to market risk is not by itself sufficient to justify the proposed POLR charge as a non-cost based charge. *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519. The Companies' belated argument that their POLR charges can be justified alternatively on a non-cost basis will, therefore, not be addressed further in this order.

Remand Ex. 1 at 36-37; OCC Remand Ex. 2 at 22; IEU-Ohio Remand Ex. 1 at 34; IEU-Ohio Remand Ex. 2 at 4-5; Constellation Remand Ex. 1 at 14). Rather, the Companies' claimed POLR costs are derived from an *ex ante* valuation of the benefit that customers are afforded by their option to shop for an alternative supplier (Cos. Remand Ex. 3 at 12-13; Cos. Remand Ex. 8 at 2-4). In simple terms, AEP-Ohio equates the value of the option with the benefit to the customer, which, in turn, the Companies equate with their costs (Cos. Remand Ex. 1 at 4; Cos. Remand Ex. 3 at 12; Remand Tr. I at 38; Remand Tr. II at 242, 260; Remand Tr. V at 706-707). Describing their costs in terms of lost revenues or a diminution of shareholder equity (Cos. Remand Ex. 1 at 5; Cos. Remand Ex. 3 at 5; Cos. Remand Ex. 5 at 6), the Companies contend that they have now sufficiently demonstrated that the value of the POLR optionality to their customers is precisely equal to the cost to the Companies of providing the POLR optionality.

The Companies' theory, however, has been directly refuted by OCC witness Thompson and IEU-Ohio witness Lesser (OCC Remand Ex. 1 at 37; IEU-Ohio Remand Ex. 1 at 12-15) and questioned by other intervenors and Staff. Further, no empirical evidence was offered by the Companies in support of their theory. Although Companies witness Makhija testified that the Companies' POLR costs would be reflected as a diminution of equity, neither Dr. Makhija nor any other witness provided the Companies' books or any other evidence in support of Dr. Makhija's theory (Remand Tr. I at 20, 45-46). Similarly, Companies witness LaCasse, as well as Dr. Makhija, spoke of the Companies' costs in terms of lost revenues, but provided no evidence of any revenues that the Companies actually lost (Remand Tr. II at 221). Instead, AEP-Ohio put forth the very same modeled or "formula-based" costs that were rejected by the Court. The Companies apparently equate modeled costs, which by definition provide a simulation or representation, with actual costs. We do not agree with the Companies on this point. Although actual costs may encompass more than just out-of-pocket costs, they must reflect some definite and concrete component that is able to be quantified and verified through the Companies' books, records, receipts, or other tangible documentation.

The Companies insist that an *ex post* determination of their POLR costs would be a "speculative re-enactment" and that their POLR risk should be assessed at the outset of the ESP term, which is when the risk is incurred (Cos. Remand Ex. 3 at 12-13; Cos. Remand Ex. 8 at 2-4). Under the present circumstances, where these proceedings were remanded to the Commission in the third and final year of the ESP, the Commission believes that it would have been reasonable for AEP-Ohio to undertake an *ex post* analysis of its POLR costs. Such an analysis would have enabled the Commission to compare the projected results of the Companies' option model with their actual costs incurred to date, a comparison that would have been highly useful in ensuring that customers are not paying unwarranted POLR charges. In the absence of such a comparison, AEP-Ohio has neglected to alleviate the Court's concern that "[a]t the very least, all this evidence raises

doubts about the proposition that [AEP-Ohio] would justifiably expend $500 million to bear the POLR risk."[21] Upon review of the record on remand, the Commission shares this concern. We conclude that AEP-Ohio has failed to present evidence of its actual POLR costs and has not justified recovery of POLR charges at the level reflected in its existing rates.

c. Option Valuation Methodology

i. Arguments

Throughout these proceedings, AEP-Ohio has contended that modeling is a reasonable economic tool for the Commission to use as a basis for determining POLR costs. In their application, the Companies quantified their POLR costs by calculating the value of the POLR optionality using the Black-Scholes model, which is an economic model used to value stock and other spot options (Cos. Remand Ex. 4 at 12; IEU-Ohio Remand Ex. 1 at 5-6, 7). The inputs to the model consisted of the Companies' proposed first-year ESP price as the strike price; the then current competitive benchmark price as the market price; the three-year ESP term as the term of the option; the London Interbank Offered Rate (LIBOR) as the risk-free interest rate; and a measure of annual average volatility, based on historical data, as the volatility.[22] As originally proposed, the Companies' option model did not incorporate the shopping rules contained in their tariffs and is thus now referred to as the unconstrained option model. Since 2008, the Companies have developed a constrained option model, which incorporates the shopping rules, utilizes ESP prices that change over the ESP term, and reflects the fact that customers essentially receive a series of options to buy SSO generation service at the ESP price during the ESP term. The constrained option model is based on the Black model, which is used to value options on futures contracts. (Cos. Remand Ex. 3 at 16-17; Cos. Remand Ex. 4 at 12, 13; IEU-Ohio Remand Ex. 1 at 10.)

Companies witness Thomas used the constrained option model, including updated inputs to incorporate the SSO rates approved by the Commission and the decreased market prices occurring between the time of the Companies' application and the ESP Order, to determine the Companies' POLR costs during the ESP term. AEP-Ohio asserts that the results of the constrained option model are comparable to the conservative results of the unconstrained option model. (Cos. Remand Ex. 4 at 15-16.)

Companies witness LaCasse reviewed both models and found that option valuation as a methodology for determining costs associated with shopping-related risks is

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21 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

22 ESP Order at 38-39.

conceptually valid. She further found that certain aspects of the unconstrained option model tended to either understate or overstate the Companies' POLR charges. She explained that, in the constrained option model, only the factors tending to overstate the POLR charges were corrected for the most part. Dr. LaCasse concluded that the results of the constrained option model are apparently conservative estimates of the Companies' POLR costs. (Cos. Remand Ex. 3 at 18.) On rebuttal, Dr. LaCasse presented the results of a Monte Carlo model, using the same basic inputs used in the constrained option model, as an alternative to option valuation. She concluded that the results of the Monte Carlo model support the reasonableness of the results derived from the constrained option model. Although the results from the Monte Carlo model are approximately 80 percent of the constrained model results, Dr. LaCasse explained that the decision-making process of the customer that the Monte Carlo model assumes tends to understate the Companies' POLR costs as compared to the constrained option model, which considers the possible future customer movements that may occur. (Cos. Remand Ex. 5 at 7-11.)

According to the Companies, the results of the constrained option model and the Monte Carlo model support the reasonableness of the results of the unconstrained option model, which, in turn, should be used as the basis for approval of their existing POLR charges. AEP-Ohio also notes that the Commission has already approved its application of the unconstrained option model to measure its POLR costs. The Companies assert that this aspect of the ESP Order was not challenged by any party on rehearing or appeal and is thus a final order of the Commission.

The intervenors and Staff identify numerous problems with AEP-Ohio's option valuation methodology. For their part, OCC and OPAE argue that the Companies' option model assumes that every customer will switch for a penny differential in generation price and ignores numerous non-price and other price considerations, such as transaction costs, that determine customer switching (OCC Remand Ex. 1 at 20; Remand Tr. I at 27-29; Remand Tr. II at 167; Remand Tr. V at 859), which overstates the results. OCC and OPAE further contend that AEP-Ohio made significant errors in its volatility and date assumptions, which, if corrected, would reduce the POLR charges by at least 80 percent and possibly to zero (OCC Remand Ex. 1 at 28-36). Because the model predicts lost revenues (Remand Tr. II at 143-144), OCC and OPAE argue that it does not measure true POLR costs, being the costs to provide incremental energy and capacity to returning customers beyond what is already collected in SSO rates (OCC Remand Ex. 1 at 21-22). They further assert that the model fails to reflect the value of the POLR optionality to customers, because it wrongly assumes that the SSO price is fixed and does not account for the variable nature of the FAC and other riders (OCC Remand Ex. 1 at 22). OCC and OPAE point out that the model overstates lost revenues in that it does not account for restrictions on the Companies with respect to off-system energy and capacity sales (OCC Remand Ex. 1 at 25-27). Finally, they argue that AEP-Ohio is already fully compensated

for its POLR obligation because its incremental energy and capacity costs are recovered through the FAC (OCC Remand Ex. 1 at 12-14).

IEU-Ohio contends that the Companies' implementation of the option model is flawed because it measures, if anything, lost revenues rather than costs (Cos. Remand Ex. 3 at 12); overstates the lost revenues because it fails to account for capacity payments from CRES providers (IEU-Ohio Remand Ex. 2 at 15-19); and fails to satisfy the necessary assumptions on which the Black-Scholes model is based (IEU-Ohio Remand Ex. 1 at 18-25). Specifically, IEU-Ohio notes that the Black-Scholes model assumes that markets are perfect with no transaction costs; customers are perfectly rational and will act on any price advantage, even a difference of one cent; price volatility is constant; the strike price is constant; returns are lognormally distributed; and the option can be exercised only on its expiration date. IEU-Ohio argues that none of these assumptions holds true in the context within which the Companies have used the model and concludes that the Black-Scholes model simply was not designed to estimate the cost of the risk assumed by the seller of an option. (IEU-Ohio Remand Ex. 1 at 18-25.)

OMA and OHA argue that AEP-Ohio's use of what is effectively a non-cost-based option model is fundamentally inappropriate, unreasonable, and unlawful because it ignores the Companies' actual, small shopping numbers (Cos. Remand Ex. 4 at Ex. LJT-2); it is not used for the purpose to which it was put (Remand Tr. II at 286-287); and, even assuming that it truly measures the value of shopping to customers, the measurement of value by way of a mathematical formula is not a proper basis for establishing charges in utility regulation.

Constellation contends that the Commission should reject the Companies' unconstrained option model as it is based on the unsupported premise that the value of a customer's option to shop equals the POLR cost to the Companies. Additionally, Constellation argues that neither the Black-Scholes model nor the Black model has been shown to be a generally accepted method for determining POLR costs and, regardless, the inputs used by the Companies are inappropriate. Constellation notes that these models were designed to value stock options, not customer options related to competitive retail electric generation, and that AEP-Ohio knows of no other utility or state regulatory agency that uses them to establish POLR charges (IEU-Ohio Remand Ex. 1 at 7-10; Remand Tr. II at 286-287). Constellation further points out that AEP-Ohio admits that there are numerous non-cost factors that were not modeled even though these factors affect the value of the option to shop (Cos. Remand Ex. 8 at 6; Remand Tr. V at 837-838).

Staff notes that it has general concerns with the model used by the Companies. In addition, with respect to the inputs used by the Companies, Staff asserts that the interest rate, market price volatility, and option term inputs are likely to result in an overstated

option value and, therefore, recommends that adjustments be made to these inputs such that the Companies' POLR charges would be lower, if the Commission initially determines that use of the model is reasonable (Staff Remand Ex. 1 at 2-4). Constellation agrees with Staff that the volatility input should be reduced by 20 percent as an adjustment to the capacity component of the market price (Staff Remand Ex. 1 at 3). IEU-Ohio also contends that the volatility input is overstated (IEU-Ohio Remand Ex. 1 at 26-30).

Numerous parties, including IEU-Ohio, OMA, OHA, and Constellation, dispute AEP-Ohio's claim that it would be inappropriate to compare modeled results with actual shopping levels during the ESP term. They note that AEP-Ohio has made no attempt, by way of a study or any other means, to compare modeled and actual results (Remand Tr. II at 221). OMA, OHA, and Constellation argue that the Companies should have used these remand proceedings as an opportunity to compare projected and actual results, but instead elected to present a second time the results of the same option model that was criticized by the Court. OMA and OHA further note that it is thus unreasonable to use the results of the constrained option model to corroborate the results of the unconstrained option model. OCC, OPAE, and IEU-Ohio add that the constrained option model suffers from most of the same problems as the unconstrained option model and that it makes no sense to compare the results of two flawed models. OMA, OHA, and Constellation question the testimony of Companies witness LaCasse in support of the Companies' option model, given that she had not used the Black-Scholes model prior to these proceedings nor had she used an option model to price shopping-related risks (Remand Tr. II at 149-150). Constellation concludes that AEP-Ohio has failed to verify empirically the model's use in this context and that the Companies' witnesses are not qualified to determine appropriate inputs.

IEU-Ohio agrees that the results of the Companies' model are unverified, given that the constrained option model suffers from the same flaws as the unconstrained option model. Additionally, IEU-Ohio contends that the analyses of SSO auction results cited by Companies witness LaCasse incorporated much more than POLR risk (Cos. Remand Ex. 3 at 18-20), making a true comparison with the Companies' POLR charges difficult. With respect to the Monte Carlo model used by Dr. LaCasse, IEU-Ohio argues that, like the Black-Scholes model, the Monte Carlo model fails to measure the cost to stand ready to serve returning customers (Cos. Remand Ex. 5 at 9). IEU-Ohio further notes that the Monte Carlo model was not verified against the actual customer switching that occurred and that the Companies failed to demonstrate that the model was verified or tested in any way (Remand Tr. V at 694-698, 699-700).

ii. Conclusion

In the ESP Order, the Commission modified and approved AEP-Ohio's quantification of its POLR costs based on the Black-Scholes or unconstrained option model.[23] As an initial matter, the Companies point out that the Commission has already approved their use of the unconstrained option model as a means to determine their POLR costs. However, the issue of the Commission's approval of the Companies' POLR charges was appealed to the Supreme Court of Ohio, which then specifically questioned the Companies' use of the Black-Scholes model to determine their POLR costs. Finding an absence of record support, the Court reversed the provisions of the ESP Order that authorized the POLR charges,[24] which would include those pertaining to the Black-Scholes or unconstrained option model. Therefore, we find it appropriate to review on remand the Companies' use of the unconstrained option model to measure their POLR costs.

Upon review of the record, and in light of the Court's decision, the Commission finds that the unconstrained option model fails to provide a reasonable measure of the Companies' POLR costs. The Court found that AEP-Ohio's unconstrained option model does not reveal the Companies' POLR costs, but rather purports to measure the value of the POLR optionality provided to customers.[25] The Court specifically determined that value to customers and cost to AEP-Ohio are not the same thing.[26] The Companies have nevertheless asserted that very same argument on remand, contending that the Court did not understand that the model objectively measures the value of the POLR optionality, rather than subjectively determines how much a customer would be willing to pay for the right to shop. Regardless, we agree with the Court that the model simply does not measure POLR costs.

As discussed above, AEP-Ohio maintains that the value of the option or benefit to the customer is equal to its costs (Cos. Remand Ex. 1 at 4; Cos. Remand Ex. 3 at 12; Remand Tr. I at 38; Remand Tr. II at 242, 260; Remand Tr. V at 706-707). Having already been rejected by the Court, this argument that the option value is exactly the same as the cost to the Companies was further discredited by the intervenors during the remand proceedings (OCC Remand Ex. 1 at 37; IEU-Ohio Remand Ex. 1 at 12-15). As we agree with the Court and intervenors that the value to customers does not equal the Companies' costs, we find that the unconstrained option model, which measures the value of the POLR optionality to customers (Cos. Remand Ex. 3 at 12; Cos. Remand Ex. 4 at 10; Remand Tr. I at 38), cannot also measure the Companies' costs. Additionally, even assuming that the

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23 ESP Order at 38-40; First EOR at 26.

24 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

25 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518.

26 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518.

results of the model do truly calculate the Companies' POLR costs, we are concerned that several of the inputs, particularly the interest rate, market price volatility, and option term, may result in an overstated option value, as noted by Staff and others (Staff Remand Ex. 1 at 2-4; OCC Remand Ex. 1 at 28-30; IEU-Ohio Remand Ex. 1 at 26-30).

The Commission further adds that, although modeling may be appropriate in certain contexts (*e.g.*, rate of return analysis), we question its use to predict costs that are readily measurable and verifiable through more reliable means. As the record reflects, POLR costs may be determined in numerous ways, such as hedging, competitive bidding, or an after-the-fact calculation of any incremental energy and capacity costs incurred to serve returning customers (Remand Tr. I at 44-45, 56; Cos. Remand Ex. 3 at 8-9, 11; Remand Tr. II at 144-145; IEU-Ohio Remand Ex. 1 at 31-34; IEU-Ohio Remand Ex. 2 at 8-9; Remand Tr. IV at 577-579). The Companies have pursued none of these options and instead have elected to present again the results of their unconstrained option model, as purportedly backed by the results of the constrained option model and the Monte Carlo analysis performed by Companies witness LaCasse. Given our finding that the unconstrained option model fails to measure AEP-Ohio's POLR costs and our reluctance to apply modeling in this context, we are not persuaded that the results of the constrained option model or the Monte Carlo model support the reasonableness of the results of the unconstrained option model.

As previously discussed, the Commission shares the concern of the intervenors that AEP-Ohio has made no attempt to compare the results of its unconstrained option model with its actual costs incurred over the ESP term to date based on actual shopping levels (Cos. Remand Ex. 8 at 2-4; Remand Tr. II at 221). The Court specifically addressed the lack of shopping in the Companies' service territories as a reason to "call into question the accuracy of [AEP-Ohio's] POLR theory."[27] Although shopping levels appear to have increased somewhat throughout the ESP term, at least for CSP (Cos. Remand Ex. 4 at 8-9, Ex. LJT-2; Remand Tr. II at 299-300; IEU-Ohio Remand Ex. 6 at 31), the level of shopping is still sufficiently small enough to cast "doubts about the proposition that [AEP-Ohio] would justifiably expend $500 million to bear the POLR risk."[28] In any event, AEP-Ohio has not offered any evidence that its modeled costs bear any relation to any actual costs incurred due to shopping.

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

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

d. POLR Risk

i. Arguments

In the ESP Order, two types of POLR risks were addressed, namely the risk associated with customers switching to a CRES provider (migration risk) and the risk related to customers returning to the EDU's SSO rates from service with a CRES provider (return risk).[29] The Commission found that the return risk may be mitigated "by requiring customers that switch to an alternative supplier (either through a governmental aggregation or individual CRES providers) to agree to return to market price, and pay market price, if they return to the electric utility after taking service from a CRES provider, for the remaining period of the ESP term or until the customer switches to another alternative supplier." The Commission determined that such customers would thereby avoid the POLR charge. Regarding the migration risk, the Commission accepted the quantification of Companies witness Baker that such risk comprises 90 percent of the Companies' estimated POLR costs and modified the Companies' proposed POLR revenue requirements on that basis. On remand, Companies witness Thomas testified that she had not determined what the Companies' POLR costs would be, if the portion attributable to migration risk were removed (Remand Tr. V at 884).

AEP-Ohio notes that the Commission's determination regarding migration risk was not at issue on appeal and thus is not properly before the Commission at this time. AEP-Ohio asserts that the issue before the Commission is the appropriate level for the Companies' POLR charges and not whether there should be a POLR charge or whether such charge should compensate for migration risk. AEP-Ohio claims that nothing in the Supreme Court's decision redefined the POLR obligation to exclude migration risk.

AEP-Ohio further contends that its migration risk is different than the competitive risk of customer mobility shared by all providers. Due to its statutory POLR obligation, AEP-Ohio contends that its migration risk is unique in that customers may switch to a CRES provider when the market price falls below the SSO rate, leaving the Companies to sell electricity that they were required to have available to satisfy their SSO obligation at the reduced market price rather than the SSO rate.

AEP-Ohio also notes that the migration risk exists due to the fact that customers can switch; it is not based on whether they in fact exercise their right to switch. Regardless, AEP-Ohio contends that shopping levels have increased substantially for the Companies during the term of the ESP, which the Companies cite as additional evidence that they incur substantial risk (Cos. Remand Ex. 4 at 8-9).

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[29] ESP Order at 38-40.

Many of the intervenors and Staff argue that migration risk is a business risk that is not unique to AEP-Ohio and that compensating the Companies for this risk disadvantages other market participants to the detriment of the competitive market and retail choice. Staff, OCC, OPAE, IEU-Ohio, and Constellation point out that the Court has referred to the POLR obligation as the "obligation to stand ready to accept returning customers"[30] and, therefore, they argue that migration risk is not part of the Companies' POLR obligation. Staff agrees with IEU-Ohio witness Lesser that migration risk exists for all suppliers operating in a competitive market (IEU-Ohio Remand Ex. 1 at 13). According to Staff, only the return risk is unique to the POLR obligation and thus comprises the POLR risk. Noting that migration risk constitutes 90 percent of the Companies' estimated POLR costs as originally proposed in their application, Staff contends that the Companies' option model significantly overstates their POLR costs.

Constellation notes that the risk that AEP-Ohio will not be able to sell generation at a price that is at or above the SSO price due to customer migration is a competitive generation risk and is not related to the non-competitive POLR obligation. Constellation argues that only approximately 10 percent of the value of shopping may legally be attributed to POLR risk and that the remaining 90 percent is attributable to migration risk and lost opportunity costs, which is not legally supported and constitutes an anticompetitive subsidy.

OCC, OPAE, and IEU-Ohio add that recognizing migration risk as part of the Companies' POLR costs would run afoul of Section 4928.38, Revised Code, as it would allow them to recover, after the market development period, revenues that would not be available due to competition, which would effectively be transition revenues. IEU-Ohio witness Lesser notes that the time for recovering losses due to competition has past (IEU-Ohio Remand Ex. 1 at 12-13; Remand Tr. III at 337).

ii. Conclusion

As discussed above, the Court reversed the provisions of the ESP Order that authorized the Companies' POLR charges,[31] which would include the portion of the ESP Order that addresses migration risk, which was the basis for the charges. Therefore, the Commission finds, as an initial matter, that it is appropriate to consider the issue of migration risk on remand. Having reviewed the arguments of the parties, as well as the Court's precedent regarding the POLR obligation, we find that migration risk is more properly regarded as a business risk faced by all retail suppliers as a result of competition

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30 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 517.

31 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

rather than a risk resulting from an EDU's POLR obligation. We find the arguments of the intervenors and Staff on this issue to be persuasive, recognizing that migration risk exists for any supplier, whether CRES provider or EDU, that operates in the competitive generation market. Thus, compensation for migration risk by means of an EDU's POLR charge would provide an advantage over its CRES competitors. Although the Companies may suffer lost revenues as a result of customer switching, the same is true for all suppliers competing in the market. The risk of lost revenues due to customer migration is simply not a risk derived from an EDU's POLR obligation. (OCC Remand Ex. 1 at 8-12; IEU-Ohio Remand Ex. 1 at 12-13.) We agree that the return risk, however, is unique to EDUs, which must be ready to serve customers returning to SSO service from another supplier, pursuant to their statutory obligation.

Our conclusion that migration risk, although a real risk, is not a risk directly resulting from AEP-Ohio's POLR obligation is consistent with the Court's precedent. The Court defines POLR costs as "those costs incurred by [the EDU] for risks associated with its legal obligation as the default provider, or electricity provider, of last resort, for customers who shop and then return to [the EDU] for generation service."[32] Recently, the Court reaffirmed that "POLR charges compensate utilities for standing ready to serve 'customers who shop and then return,'"[33] and, in these very cases, described the POLR obligation as the "obligation to stand ready to accept returning customers."[34] These cases confirm that migration risk alone is not uniquely associated with the POLR obligation. Rather, it is the customer's subsequent return that imposes the POLR risk and attendant costs.

e. Bypassability of POLR Charge

i. Arguments

In the ESP Order, the Commission stated:

> As noted by several intervenors and Staff, the risk of returning customers may be mitigated, not eliminated, by requiring customers that switch to an alternative supplier (either through a governmental aggregation or individual CRES providers) to agree to return to market price, and pay market price, if they return to the electric utility after taking service from a CRES provider, for the remaining period of the ESP term or until the

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32 *Constellation NewEnergy, Inc. v. Pub. Util. Comm.* (2004), 104 Ohio St.3d 530, 539 n.5.

33 *In re Application of Ormet Primary Aluminum Corp.* (2011), 129 Ohio St.3d 9, 11, *quoting Constellation NewEnergy, Inc. v. Pub. Util. Comm.* (2004), 104 Ohio St.3d 530, 539 n.5.

34 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 517.

customer switches to another alternative supplier. In exchange for this commitment, those customers shall avoid paying the POLR charge.[35]

Constellation contends that the Companies' POLR charges are contrary to the ESP Order in that they are essentially nonbypassable. Constellation asserts that AEP-Ohio has led shopping customers to believe that, by waiving the POLR charge, they must indefinitely pay market rates upon return to the Companies, rather than until the end of the ESP term (Remand Tr. II at 296). Constellation points out that Companies witness Thomas characterizes the POLR charge as nonbypassable; admits that customers are only given information regarding waiver of the charge upon request; and testified that 98 percent of customers have elected not to waive the charge (Cos. Remand Ex. 4 at 5, 7-8; Remand Tr. II at 247-248). If AEP-Ohio is permitted to continue to collect POLR costs, Constellation argues that the Companies should inform their shopping customers that they may elect to waive POLR charges and still obtain SSO rates if they return to the Companies after the initial ESP term has ended. AEP-Ohio responds that the existing POLR charge is bypassable at the customer's option and that Constellation has not shown that AEP-Ohio is inappropriately implementing the ESP Order with respect to the customer's right to waive the POLR charge.

ii. Conclusion

In light of our decision in this order on remand, that the POLR charges are not supported by the record, Constellation's arguments on this issue are moot, as customers will return to the Companies' service at the standard service offer rate for the remainder of the term of this ESP.

4. Overall Conclusion on POLR Rider

In sum, the Commission concludes that AEP-Ohio has not provided any evidence of its actual POLR costs, the unconstrained option model does not measure POLR costs, and migration risk is not properly part of a POLR charge. In accordance with the Court's decision, we thus find that AEP-Ohio's increased POLR charges authorized as a part of the ESP Order are insufficiently supported by the record on remand. Accordingly, the Commission finds that AEP-Ohio should back out the amount of the POLR charges authorized in the ESP Order and file revised tariffs, consistent with this order on remand. The effective date of the new tariffs should be the date of this order, or the date upon which four complete, printed copies of the final tariffs are filed with the Commission, whichever date is later.

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35 ESP Order at 40.

The Commission further directs the Companies to refund the amount of the POLR charges which have been collected subject to refund since the first billing cycle in June 2011, to customers by applying that amount, as determined in this order, first to any deferrals in the FAC accounts on the Companies' books as of the date of this order, with any remaining balance to be credited to customers on a per kilowatt hour basis beginning with the first billing cycle in November 2011 and coinciding with the end of the current ESP period.

The Commission's May 25, 2011, entry stated that "if the Commission ultimately determines in the remand proceeding that any environmental or POLR charges are to be refunded to AEP-Ohio customers, interest may be imposed on the amounts collected." The Commission further stated that the "parties may address ... the rate of interest charges applicable, if any." During the remand proceedings, AEP-Ohio testified that the minimum interest rate of three percent applied to customer deposits, as set forth in Rule 4901:1-17-05, O.A.C., would be appropriate (Cos. Remand Ex. 2 at 5).

OCC and OPAE contend that the interest rate should be 10.93 percent, which is equivalent to the interest rate used to calculate AEP-Ohio's carrying costs on the FAC deferral balance (OCC Remand Ex. 2 at 29-30). OCC and OPAE note that even the Companies' tariffs provide for an interest rate on customer deposits of five percent or more (Remand Tr. I at 86-87). They argue that Rule 4901:1-14-05, O.A.C., is more comparable to the present circumstances than the rule cited by the Companies. Rule 4901:1-14-05, O.A.C., provides for an interest rate of 10 percent on adjustments to a gas utility's gas cost recovery rate that are ordered by the Commission following a hearing.

Where the Commission authorizes the creation of a regulatory asset including carrying charges, such charges are typically based on the utility's cost of long-term debt. We find that this practice is equally applicable in the converse situation presented here. Therefore, the amount of the POLR charges to be refunded to customers by the Companies should include interest at the rate equal to the Companies' long-term cost of debt commencing with the June 2011 billing cycle until all the charges subject to refund are returned.

C. Flow-Through Effects of Remand

The ESP Order authorized a phase-in of the Companies' ESP rates during the term of the ESP by deferring a portion of the annual incremental FAC costs such that the amount of the incremental FAC expense to be recovered from customers would be limited so as not to exceed certain percentage increases on a total bill basis.[36]

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36 ESP Order at 20-24.

OCC, OPAE, and IEU-Ohio argue that AEP-Ohio should adjust the FAC deferral balance associated with the phase-in to address, on a prospective basis, the unjustified POLR and environmental carrying charges collected from April 2009 through May 2011 (*i.e.*, from the beginning of the ESP term through the point at which the charges became subject to refund). They argue that the amount of deferred FAC expenses to be collected from customers from 2012 through 2018 should be recalculated consistent with the outcome of the remand proceedings (OCC Remand Ex. 1 at 6, 38; OCC Remand Ex. 2 at 5-6, 23-28; IEU-Ohio Remand Ex. 3 at 9-11). Citing Ohio Supreme Court precedent,[37] OCC and OPAE assert that there is no violation of the prohibition against retroactive ratemaking addressed by the Court in *Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co.* (1957), 166 Ohio St. 254, where there is a mechanism built into rates that allows for prospective rate adjustments. IEU-Ohio maintains that the amount of the phase-in must be just and reasonable, pursuant to Section 4928.144, Revised Code. IEU-Ohio also contends that there are other areas in which the Commission should address the effects of the remand, such as AEP-Ohio's recovery of delta and Universal Service Fund revenues; the significantly excessive earnings test of Section 4928.143(F), Revised Code; and the Companies' pending ESP application in Case No. 11-346-EL-SSO, *et al.*

AEP-Ohio responds that attempts to expand the narrow scope of the remand proceedings should be rejected. The Companies contend that the scope of the remand proceedings is governed by the Court's remand instructions and that the Commission may not consider issues, such as flow-through effects, that were not remanded by the Court. Relying on the Court's decision in these cases and others,[38] AEP-Ohio further argues that the position of OCC, OPAE, and IEU-Ohio on flow-through effects is contrary to the prohibition against retroactive ratemaking and refunds. The Companies assert that OCC, OPAE, and IEU-Ohio seek to adjust previously approved rates on a retroactive basis by providing a future credit to customers and that the Commission lacks the authority to order such a credit. AEP-Ohio maintains that the exclusive remedy for a purportedly unlawful rate increase is to seek a stay and post a bond pursuant to Section 4903.16, Revised Code, and notes that no intervenor elected to pursue this option. According to the Companies, an adjustment to the calculation of FAC costs, which were incurred and deferred during the ESP term, so as to deny recovery of revenue that the Commission previously authorized to be collected from 2012 through 2018 would constitute retroactive ratemaking; violate Section 4928.144, Revised Code; and be contrary to the ESP Order.

The Commission finds that the proposed adjustment to the FAC deferral balance, as recommended by OCC, OPAE, and IEU-Ohio, would be tantamount to unlawful

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[37] *Lucas County Com'rs v. Pub. Util. Comm.* (1997), 80 Ohio St.3d 344, 348-349; *Columbus S. Power Co. v. Pub. Util. Comm.* (1993), 67 Ohio St.3d 535, 541.

[38] *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 516-517; *Lucas County Com'rs v. Pub. Util. Comm.* (1997), 80 Ohio St.3d 344, 348-349.

retroactive ratemaking. In the ESP Order, we authorized AEP-Ohio to defer any FAC amount over the allowable total bill increase percentage levels pursuant to Section 4928.144, Revised Code, and directed that any deferred FAC expense balance remaining at the end of 2011 is to be recovered via an unavoidable surcharge from 2012 to 2018.[39] The Commission agrees with AEP-Ohio that an adjustment to the FAC deferral balance, which we previously authorized to be collected as a means to recover the Companies' actual fuel expenses incurred plus carrying costs, would be contrary to the Court's prohibition against retroactive ratemaking and refunds.[40] Although OCC, OPAE, and IEU-Ohio characterize their proposed adjustment as a prospective offset to amounts deferred for future collection, they essentially ask the Commission to provide customers with a refund to account for the Companies' past POLR and environmental carrying charges, which were collected from April 2009 through May 2011. Consistent with the Court's precedent, we cannot order a prospective adjustment to account for past rates that have already been collected from customers and subsequently found to be unjustified. The Commission likewise disagrees with IEU-Ohio's contention that there are other areas in which we should similarly address the purported flow-through effects of the Court's remand.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

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

(2) On July 31, 2008, AEP-Ohio filed an application for an SSO in accordance with Section 4928.141, Revised Code. AEP-Ohio's application was filed pursuant to Section 4928.143, Revised Code, which authorizes the electric utilities to file an ESP as their SSO.

(3) On March 18, 2009, the Commission issued its opinion and order regarding AEP-Ohio's ESP application. Following entries on rehearing, the Commission's decision was appealed to the Supreme Court of Ohio.

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39 ESP Order at 22-23.

40 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 516 (stating that "the law does not allow refunds in appeals from [C]ommission orders"); *Ohio Consumers' Counsel v. Pub. Util. Comm.* (2009), 121 Ohio St.3d 362, 367 (noting that "any refund order would be contrary to our precedent declining to engage in retroactive ratemaking"); *Lucas County Com'rs v. Pub. Util. Comm.* (1997), 80 Ohio St.3d 344, 348 (determining that "utility ratemaking by the Public Utilities Commission is prospective only").

(4) On April 19, 2011, the Court issued an opinion in *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, remanding these cases back to the Commission on two grounds.

(5) A hearing on remand commenced on July 15, 2011, and concluded on July 28, 2011, for the purpose of gathering such additional evidence as might be necessary to comply with the Court's remand order. Five witnesses testified on behalf of AEP-Ohio, six witnesses testified on behalf of various intervenors, and one witness testified on behalf of Staff.

(6) Briefs and reply briefs were filed on August 5, 2011, and August 12, 2011, respectively.

(7) Sections 4928.143(B)(1), and 4928.143(B)(2)(d), Revised Code, authorize the Companies' recovery of incremental capital carrying costs that are incurred after January 1, 2009, on past environmental investments (2001-2008) that were not previously reflected in the Companies' existing rates prior to the ESP.

(8) On remand, the Ohio Supreme Court directed the Commission to consider evidence of a cost-based POLR charge or to determine whether a non-cost based POLR charge is reasonable and lawful.

(9) AEP-Ohio did not demonstrate that its POLR charges requested in the ESP are cost-based nor demonstrate that its non-cost based POLR charges requested in the ESP were reasonable and lawful.

(10) AEP-Ohio's POLR charges, as approved in the ESP Order, are not supported by the record on remand.

(11) AEP-Ohio is directed to refund the POLR charges collected subject to refund since the first billing cycle in June 2011 by first applying that amount to any deferrals in the FAC accounts on each Companies' books as of the date of this order, with any remaining balance to be credited to customers on a per kilowatt hour basis beginning with the first billing cycle in November 2011 and coinciding with the end of the current ESP period.

(12) The proposed ESP, as modified by this order on remand, including its pricing and all other terms and conditions, including deferrals and future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142, Revised Code.

ORDER:

It is, therefore,

ORDERED, That IEU-Ohio's motion to dismiss these cases be denied. It is, further,

ORDERED, That FES' motion for leave to file an *amicus curiae* brief be denied. It is, further,

ORDERED, That the motions of OCC and OPAE to strike certain testimony be denied. It is, further,

ORDERED, That the motions of OCC, OPAE, and IEU-Ohio to strike certain portions of AEP-Ohio's initial and reply briefs be granted to the extent set forth herein. It is, further,

ORDERED, That the Companies' ESP, pursuant to Sections 4928.141 and 4928.143, Revised Code, be modified to the extent set forth herein. It is, further,

ORDERED, That the Companies be authorized to file, in final form, four complete copies of their tariffs, consistent with this order on remand. Each utility shall file one copy in its TRF docket (or may make such filing electronically as directed in Case No. 06-900-AU-WVR) and one copy in these case dockets. The remaining two copies shall be designated for distribution to the Rates and Tariffs, Energy and Water Division, of the Commission's Utilities Department. It is, further,

ORDERED, That the effective date of the new tariffs shall be a date not earlier than the date of this order on remand, or the date upon which four complete, printed copies of the final tariffs are filed with the Commission, whichever date is later. It is, further,

ORDERED, That the Companies notify all affected customers of the changes to the tariffs via bill message or bill insert within 30 days of the effective date of the tariffs. A copy of the customer notice shall be submitted to the Commission's Service Monitoring and Enforcement Department, Reliability and Service Analysis Division, at least 10 days prior to its distribution to customers. It is, further,

ORDERED, That the Companies refund, with interest, the amount of the POLR charges, which has been collected subject to refund since the first billing cycle in June 2011, to customers by applying that amount, as determined in this order, first to any deferrals in the FAC accounts on the Companies' books as of the date of this order, with any remaining balance to be credited to customers on a per kilowatt hour basis beginning with the first billing cycle in November 2011 and coinciding with the end of the current ESP period. It is, further,

ORDERED, That nothing in this order on remand shall be binding upon this Commission in any future proceeding or investigation involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That a copy of this order on remand be served upon all persons of record in these cases.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto *see concurring*

SJP/GNS/sc

Entered in the Journal

OCT 03 2011

Betty McCauley

Betty McCauley
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

CONCURRING OPINION OF COMMISSIONER CHERYL L. ROBERTO

I concur in today's decision and write separately only to amplify the analysis upon which I relied to reach these findings of fact and conclusions of law. As I wrote in my concurrence of the Commission Entry on Rehearing in this matter on July 23, 2009 and as I continue to believe today, we are mandated to approve or modify and approve an electric security plan (ESP) when we find that the plan or modified plan, including its pricing and all other terms and conditions, including any deferrals and future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142 of the Revised Code. Section 4928.142(C)(1), Revised Code.

While an ESP may include components described in Section 4928.143(B)(2), Revised Code, nothing in S.B. 221 requires that it be built on a component by component basis. As I observed in my prior concurrence, given that the ESP is not cost-based, focusing on any component in which a cost increase is expected or demonstrated obscures the failure to conduct the corollary examination of components of the base rate in which savings have occurred or in which revenue has increased. Thus, it is not only not useful to use a cost-based component by component basis to evaluate an ESP it is misleading as we are practically limited in our examination of an ESP to the aggregate impact. The Ohio Supreme Court in its remand to us has not suggested that this Commission is required to use a cost-based analysis, merely that if we do we must have a record to support it. To the contrary, the Court has invited the Commission to consider "whether a non-cost-based POLR charge is reasonable and lawful." *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518-519.

Having rejected a cost-based analysis in my concurrence to our original order, I specifically declined to find that Section 4928.13(B)(2)(b), Revised Code, contemplates recovery for pre-January 1, 2009 environmental expenditures or that carrying costs for

environmental expenditures should be accrued at the weighted average cost of capital when there has been no finding that the debt has been prudently incurred taking into account the availability of pollution control funds. I also declined to find as to the provider of last resort cost that the Black Scholes model was appropriate tool to determine a cost-based POLR charge or that an increased risk of migration exists which requires an incremental increase in POLR, as a POLR component was already included within the Companies' existing base rates. Nonetheless, I believed and continue to believe that the test of reasonableness and lawfulness for an ESP is whether in the aggregate the ESP is more favorable than the results otherwise to be expected pursuant to Section 4928.142, Revised Code. Whether characterized as environmental expenditures or a POLR requirement, AEP sought to increase its authorized revenue. This increase in revenue which when combined with revenue from existing rates would result in a particular price for retail electric service. It is this price together with all the terms and conditions of the modified ESP that we must judge to be more favorable in the aggregate than the results otherwise to be expected in order for the modified ESP to be approved.

The Court remanded this matter to the Commission because it found that the Commission majority relied upon a cost-basis for POLR that was unsupported by the record and upon a too expansive reading of Section 4928.143(B)(2), Revised Code. Upon remand, AEP had the opportunity to provide argument and demonstrate within the record that the revenue requirement that it sought was reasonable and lawful. We have found that AEP successfully demonstrated that the environmental costs could be appropriately supported pursuant to divisions (B)(1) and (B)(2)(d) of Section 4928.143, Revised Code. AEP continued to advocate that its POLR charge was cost-based as supported by the Black Scholes model. I concur that it had not on the previous record nor has it on the remand record established the POLR charge to be cost-based. AEP, however, made no argument and offered no record support that, as the Supreme Court invited the Commission to consider, the POLR charges were non-cost-based yet nonetheless reasonable and lawful. As I indicated in my original concurring opinion, I believe that it may have been possible to demonstrate this successfully but having no record or argument before me to support it, I concur with my colleagues that the POLR charge can not be supported.

Cheryl L. Roberto

Cheryl L. Roberto, Commissioner

/dah

Entered in the Journal
OCT 03 2011

Betty McCauley

Betty McCauley
Secretary

ATTACHMENT B

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

ENTRY ON REHEARING

The Commission finds:

(1) On March 18, 2009, the Commission issued its opinion and order in Columbus Southern Power Company's and Ohio Power Company's (OP) (jointly, AEP-Ohio or the Companies) electric security plan (ESP 1) cases (ESP 1 Order).[1] By entries on rehearing issued July 23, 2009, (First ESP 1 EOR) and November 4, 2009, the Commission affirmed and clarified certain issues raised in AEP-Ohio's ESP 1 Order. As ultimately modified and adopted by the Commission, AEP-Ohio's ESP 1 directed, among other things, that AEP-Ohio be permitted to recover the incremental capital carrying costs that would be incurred after January 1, 2009, on past environmental investments (2001-2008) and approved a provider of last resort (POLR) charge for the term of ESP 1.[2]

(2) The Commission's decision in AEP-Ohio's ESP 1 cases was appealed to the Ohio Supreme Court. The Ohio Supreme Court determined that Section 4928.143(B)(2), Revised Code, does not authorize the Commission to allow recovery of items not enumerated in the section. The Court remanded the case to the Commission for further proceedings in which "the Commission may determine whether any of the listed

1 *In re AEP-Ohio ESP cases*, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Opinion and Order (March 18, 2009).

2 ESP 1 Order at 24-28, 38-40; First ESP 1 EOR at 10-13, 24-27.

categories set forth in Section 4928.143(B)(2), Revised Code, authorize recovery of environmental carrying charges."[3] In regards to the POLR charges, the Court concluded that the Commission's decision that the POLR charge is cost-based was against the manifest weight of the evidence, an abuse of the Commission's discretion, and reversible error. While the Court specifically stated that "we express no opinion on whether a formula-based POLR charge is per se unreasonable or unlawful," the Court noted two other methods by which the Commission may establish the POLR charge: a non-cost-based POLR charge or evidence of AEP-Ohio's actual POLR costs.

(3) By entry issued May 25, 2011, the Commission directed AEP-Ohio to file tariff pages that reflect that the POLR riders and environmental carrying charges included in rates are being collected subject to refund until the Commission specifically orders otherwise on remand. Additionally, the Commission adopted a procedural schedule for the remand proceedings in order to afford AEP-Ohio and intervenors the opportunity to present testimony and additional evidence in regard to the POLR and environmental carrying charges remanded to the Commission.

(4) On October 3, 2011, the Commission issued its order on remand (Remand Order). The Commission concluded that, in accordance with the provisions of Section 4928.143(B)(2)(d), Revised Code, the Companies should be authorized to continue to recover the incremental capital carrying costs incurred after January 1, 2009, on environmental investments made from 2001-2008. As to the POLR charges, the Commission ruled that AEP-Ohio had not provided any evidence of its actual POLR costs, found that its unconstrained option model did not measure its POLR costs, and, therefore, directed AEP-Ohio to deduct the amount of the POLR charges reflected in the Companies' rates and file revised tariffs consistent with the Remand Order.

(5) On October 6, 2011, AEP-Ohio filed two sets of tariffs in response to the Remand Order. AEP-Ohio advocated that the first set of tariffs, which reflected a reduction of the POLR charges to the level in effect prior to the implementation of the

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3 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512.

ESP 1 Order, were appropriate. The POLR charges reflected in this version were as established in Case No. 04-169-EL-UNC, *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of a Post-Market Development Period Rate Stabilization Plan* (RSP Case). In the alternative, in the event that the Commission intended that the POLR charges be eliminated in their entirety, AEP-Ohio offered a second set of tariffs, reflecting the elimination of all POLR charges, without conceding its right to request rehearing on the issue.

(6) By finding and order issued October 26, 2011, the Commission found, without prejudging any issue that may be raised on rehearing in these matters, that the second set of tariffs eliminating all POLR charges from the Companies' rates should be approved to be effective with the first billing cycle of November 2011, subject to Commission review and subsequent adjustment, if appropriate (Tariff Approval Order).

(7) Section 4903.10, Revised Code, states that any party who has entered an appearance in a Commission proceeding may apply for a rehearing with respect to any matters determined therein by filing an application within 30 days after the entry of the order upon the Commission's journal.

(8) On November 2, 2011, applications for rehearing of the Remand Order were filed by AEP-Ohio, Industrial Energy Users-Ohio (IEU-Ohio), and jointly by the Ohio Consumers' Counsel (OCC) and Ohio Partners for Affordable Energy (OPAE) (jointly, OCC/OPAE). On November 10, 2011, AEP-Ohio filed a memorandum contra the applications for rehearing of IEU-Ohio and OCC/OPAE. On November 14, 2011, IEU-Ohio and OCC/OPAE filed memoranda contra AEP-Ohio's application for rehearing. In their applications for rehearing, the parties raise a number of assignments of error, alleging that the Remand Order is unreasonable and unlawful. In addition to its arguments pertaining to the Remand Order, AEP-Ohio raises further arguments and seeks rehearing with respect to the Tariff Approval Order.

(9) By entry on rehearing issued November 22, 2011, the Commission granted the applications for rehearing to allow

further consideration of the matters specified in the applications.

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

Incremental Carrying Cost for 2001-2008 Environmental Investment

(11) IEU-Ohio raises four arguments in support of its position that the Remand Order was unjust and unreasonable with respect to the subject of the carrying costs on 2001-2008 environmental investments. In its first assignment of error, IEU-Ohio asserts that the Commission's finding that AEP-Ohio may recover environmental investment carrying costs pursuant to Section 4928.143(B)(2)(d), Revised Code, is unlawful and unreasonable because the Companies failed to demonstrate that granting such recovery would have the effect of providing certainty regarding retail electric service. IEU-Ohio argues that AEP-Ohio provided no evidence on remand that the environmental carrying charges in question are "necessary to provide certainty in the provision of retail electric service" and that the evidence relied upon by the Commission fails to demonstrate how the requirements of Section 4928.143(B)(2)(d), Revised Code, are satisfied such that the charges are "necessary to make retail electric service probable." Finally, IEU-Ohio avers that the Commission's determination that customers benefit from the lower cost power received as a result of the environmental investments is inconsistent with the manner in which electric service is dispatched by PJM Interconnection, LLC, (PJM) based on the least cost set of offer prices. (IEU-Ohio App. at 5-8.)

(12) As an initial matter, AEP-Ohio responds that IEU-Ohio has raised no new arguments for the Commission's consideration. Further, AEP-Ohio argues that IEU-Ohio's reading of the statute is unnatural, pointing out that a charge may have the effect of stabilizing or providing certainty regarding retail electric service, without being necessary to make the service certain or probable. The Companies also dispute IEU-Ohio's contention that there is no support in the record for the Commission's finding that the environmental carrying charges

have the effect of providing certainty to both the Companies and their customers. AEP-Ohio further notes that the Companies pass the benefit of lower cost power to customers through the fuel adjustment clause (FAC) and that the manner in which PJM dispatches resources does not negate this established practice. (Cos. Memo Contra at 11-13.)

(13) The Commission thoroughly reviewed the record established in both the initial and remand proceedings and found evidence in the record offered by AEP-Ohio (Cos. Ex. 7 at 15-16; Cos. Ex. 7B at 6), which supports a finding that the Companies' environmental investment carrying charges have the effect of providing certainty to both the Companies and their customers regarding retail electric service.[4] This evidence is part of the record; it makes no difference that it was offered by AEP-Ohio during the initial, rather than the remand, proceedings. Additionally, we explained in the Remand Order how the Companies' testimony satisfies the requirements of Section 4928.143(B)(2)(d), Revised Code (Remand Order at 13-14). Further, we find no merit in IEU-Ohio's argument that the environmental carrying charges must be necessary to make retail electric service "probable." Section 4928.143(B)(2)(d), Revised Code, requires only that the carrying charges "have the effect of stabilizing or providing certainty regarding retail electric service." Finally, we find no relevance in IEU-Ohio's argument regarding the dispatch of power by PJM, as AEP-Ohio, in actual practice, generally uses its own generating units to serve its customers and passes the benefit of the lower cost power to its customers through the FAC (Tr. XI at 58, 60; Cos. Ex. 7B at 6). Moreover, the presence of lower cost units in the PJM market will tend to lower current and future PJM energy market prices and contribute to stabilizing prices for the benefit of the Companies' customers. Therefore, IEU-Ohio's first assignment of error should be rejected.

(14) IEU-Ohio next asserts that the Commission's finding that AEP-Ohio may recover the carrying costs on 2001-2008 environmental investments pursuant to Section 4928.143(B)(2)(d), Revised Code, is unlawful and unreasonable because the Companies failed to demonstrate that their other

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4 References to exhibits or transcripts from the remand proceedings will specifically be designated as such in this order. All other references refer to evidence from the original record compiled in 2008.

revenues do not provide adequate compensation. IEU-Ohio argues that, in not requiring AEP-Ohio to make such a showing, the Commission has violated, without explanation, its own policy regarding the legal basis for authorizing rate increases under Section 4928.143(B)(2), Revised Code. As evidence of this alleged Commission policy, IEU-Ohio points to the Commission's determination in the ESP 1 Order that AEP-Ohio's enhanced service reliability plan (ESRP) rider should be based on the Companies' prudently incurred costs subject to Commission review in the context of a distribution rate case. (IEU-Ohio App. at 8-9.)

(15) AEP-Ohio responds that the ESRP rider was proposed and approved pursuant to a different statutory provision, specifically, Section 4928.143(B)(2)(h), Revised Code. The Companies assert that the Commission's determination that Section 4928.143(B)(2)(h), Revised Code, requires a cost basis for approval of the recovery of distribution-related infrastructure improvements does not call into question the Commission's determination that Section 4928.143(B)(2)(d), Revised Code, contains no similar requirement. (Cos. Memo Contra at 13-14.)

(16) Upon consideration of IEU-Ohio's second assignment of error, the Commission finds that IEU-Ohio has raised no new argument on rehearing that would warrant reconsideration of the Remand Order. IEU-Ohio cites no authority that would require AEP-Ohio to address adequacy of revenue, and we find no such requirement or Commission policy with respect to Section 4928.143(B)(2)(d), Revised Code. Further, the environmental investment carrying charges were not reflected in the Companies' existing rates prior to our approval in the ESP 1 Order (ESP 1 Order at 28; First ESP 1 EOR at 12-13). Thus, contrary to IEU-Ohio's claim, there was an economic basis upon which to authorize recovery of such costs. Accordingly, IEU-Ohio's second assignment of error is without merit and should be denied.

(17) In its third assignment of error, IEU-Ohio argues that the Commission erred in finding that recovery of the environmental investment carrying charges is authorized pursuant to Section 4928.143(B)(1), Revised Code, as no party advanced this argument. Further, IEU-Ohio contends that the

Commission's determination is beyond the scope of the Court's remand and violates the law of the case doctrine. (IEU-Ohio App. at 9-13.)

(18) AEP-Ohio asserts that IEU-Ohio cites no authority for the proposition that the Commission must confine its analysis of an issue to only those arguments advanced by the parties. The Companies further contend that IEU-Ohio misstates the law of the case doctrine. AEP-Ohio also notes that IEU-Ohio does not, and cannot, criticize the merits of the Commission's conclusion, in that the environmental investment carrying charges are properly recoverable pursuant to Section 4928.143(B)(1), Revised Code. (Cos. Memo Contra at 14-16.)

(19) It is well within the Commission's discretion to cite and rely upon statutory authority even where such authority is not referenced by any party to the proceedings. The Court has stated that "nothing precludes the [C]ommission from passing upon the proper application or construction of a statute."[5] Additionally, the Commission finds no merit in IEU-Ohio's assertion that the Remand Order violates the law of the case doctrine, which "provides that the decision of a reviewing court in a case remains the law of that case on the legal questions involved for all subsequent proceedings in the case at both the trial and reviewing levels."[6] Pursuant to the doctrine, "an inferior court has no discretion to disregard the mandate of a superior court in a prior appeal in the same case," absent extraordinary circumstances.[7] In its remand decision in the present cases, the Court reversed and remanded the issue of environmental investment carrying charges, stating that "[o]n remand, the [C]ommission may determine whether any of the listed categories of [Section 4928.143(B)(2), Revised Code] authorize recovery of environmental carrying charges."[8] The Commission fully complied with this mandate and found that Section 4928.143(B)(2)(d), Revised Code, authorizes such recovery. Although the Court's decision addresses Section 4928.143(B)(2), Revised Code, which was the statutory provision in question on appeal, nothing in the decision

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5 *Consumers' Counsel v. Pub. Util. Comm.* (1994), 70 Ohio St.3d 244, 248.

6 *Nolan v. Nolan* (1984), 11 Ohio St.3d 1, 3.

7 *Id.* at 5.

8 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 520.

precludes the Commission from considering other statutory provisions that may be relevant in resolving the remanded matter of the Companies' environmental carrying charges. The law of the case doctrine does not limit the Commission's authority to fully consider the issues remanded by the Court. IEU-Ohio's third assignment of error, therefore, should be denied.

(20) In its fourth assignment of error, IEU-Ohio argues that the Commission unlawfully and unreasonably permitted collection of the environmental carrying charges during a period in which there was no legal authority to permit collection of those revenues. Specifically, IEU-Ohio asserts that the Companies were permitted to collect and retain such revenues without legal authorization from the point at which the charges became subject to refund to the point at which the Commission issued the Remand Order. IEU-Ohio claims that collection of the environmental carrying charges was not legally authorized until the Remand Order was issued on October 3, 2011. (IEU-Ohio App. at 13-15.)

(21) AEP-Ohio submits that, notwithstanding the Court's remand decision, the rates and charges approved by the Commission in the ESP 1 Order remained the lawful rates and charges to be collected from customers until the Commission issued the Remand Order (Cos. Memo Contra at 5).

(22) The Commission finds that IEU-Ohio's argument is contrary to precedent holding that "[w]hen this court reverses and remands an order of the Public Utilities Commission establishing a revised rate schedule for a public utility, the reversal does not reinstate the rates in effect before the [C]ommission's order or replace that rate schedule as a matter of law, but is a mandate to the [C]ommission to issue a new order, and the rate schedule filed with the [C]ommission remains in effect until the [C]ommission executes this court's mandate by an appropriate order."[9] Thus, the environmental investment carrying charges approved for the Companies in the ESP 1 Order remained in effect during the course of the remand proceedings. Even though the remanded charges were made subject to refund pursuant to the May 25, 2011, entry, the

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9 *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* (1976), 46 Ohio St.2d 105, 105 (syllabus).

charges remained valid throughout the pendency of these proceedings to the point at which we executed the Court's mandate and issued the Remand Order, reaffirming the charges. For this reason, IEU-Ohio's fourth assignment of error should be denied.

POLR Rider

(23) AEP-Ohio requests that the Commission grant rehearing and fully restore the POLR charges as approved in the ESP 1 Order or, alternatively, restore the charges to the level in place prior to the ESP 1 Order. AEP-Ohio raises six arguments in support of its position that the Remand Order and Tariff Approval Order are unjust and unreasonable with respect to the Companies' POLR charges. In its first assignment of error, AEP-Ohio argues that the Remand Order's finding that the Companies failed to present evidence of their actual POLR costs and did not justify recovery of their POLR charges at the level reflected in their existing rates is unlawful, unreasonable, and against the manifest weight of the evidence. AEP-Ohio states that the Commission's finding is predicated on the erroneous belief that it would have been reasonable for the Companies to have undertaken an *ex post* analysis of their POLR costs. AEP-Ohio claims that there is no evidence in the record that it was possible to conduct such an analysis. According to the Companies, the Commission's finding is also inconsistent with the Court's recognition that POLR charges may be justified for reasons other than actual costs. AEP-Ohio argues that the Commission unreasonably refused to address its alternative justification for non-cost-based POLR charges. (Cos. App. at 1-5.)

(24) OCC/OPAE respond that the Commission correctly determined that AEP-Ohio failed to present evidence of its actual POLR costs or evidence demonstrating that the Companies' POLR charges, if non-cost-based, are reasonable (OCC/OPAE Memo Contra at 3-6). IEU-Ohio adds that AEP-Ohio's first assignment of error should be rejected as meritless, given the Commission's rejection of the unconstrained option model, and that there was nothing to prevent the Companies from determining their actual, after-the-fact POLR costs. IEU-Ohio also argues that the record does not support a conclusion that the unconstrained option model would be appropriate to

establish a non-cost-based POLR charge. (IEU-Ohio Memo Contra at 2-6.)

(25) In the Remand Order, the Commission concluded that "AEP-Ohio has failed to present evidence of its actual POLR costs and has not justified recovery of POLR charges at the level reflected in its existing rates" (Remand Order at 24). We thoroughly reviewed and cited to ample evidence in the record in reaching this conclusion. We rejected AEP-Ohio's theory that the value of the POLR optionality to customers is precisely equal to the Companies' costs and found that the Companies' modeled costs should not be equated with actual costs. We also addressed AEP-Ohio's alternative justification for non-cost-based POLR charges. As another matter, we noted that it would have been reasonable for the Companies to carry out an *ex post* analysis of their actual POLR costs, given the Court's concerns, and in light of the unique circumstances of these remand proceedings. (Remand Order at 22-23.) The Companies' testimony suggests that it would in fact be possible to identify after-the-fact POLR costs, despite their concerns about the appropriateness of such an analysis, and does not directly refute the possibility (Cos. Remand Ex. 3 at 12-13; Remand Tr. II at 246-247). In any event, our conclusion that AEP-Ohio failed to present evidence of its actual costs was not predicated on the lack of an *ex post* analysis. Additionally, as we addressed in the Remand Order, the Companies did not demonstrate that their POLR charges, if considered non-cost-based, are reasonable, as required by the Court. Although AEP-Ohio points to evidence that purportedly establishes that the POLR charges are lawful pursuant to Section 4928.143(B)(2)(d), Revised Code, AEP-Ohio did not demonstrate how the charges derived from the option model are reasonable in concept or magnitude. For these reasons, AEP-Ohio's first assignment of error has no merit and should be rejected.

(26) In its second assignment of error, AEP-Ohio asserts that the Remand Order's finding that the unconstrained option model fails to provide a reasonable measure of the Companies' POLR costs is unreasonable and against the manifest weight of the evidence particularly given the Commission's finding that the Companies have POLR risks and that the costs associated with such risks may be recovered through a POLR charge. AEP-

Ohio states that the Commission's finding is predicated on the incorrect assumption that the Court rejected the model as a means to measure the Companies' POLR costs. (Cos. App. at 5-8.)

(27) OCC/OPAE reply that the Commission correctly determined that AEP-Ohio's unconstrained option model fails to reasonably measure POLR costs and that the Companies failed to meet their burden of proof (OCC/OPAE Memo Contra at 6-7). IEU-Ohio likewise argues that the Commission should reject AEP-Ohio's second assignment of error, as the option model fails to provide the cost of POLR service (IEU-Ohio Memo Contra at 6-8).

(28) The Court found that the unconstrained option model "does not reveal 'the cost to the Companies to be the POLR and carry the risks associated therewith.'"[10] On remand, the Commission considered all of the evidence with respect to the unconstrained option model. We agreed with the Court that the model, which purportedly measures the value of the POLR optionality to customers, does not disclose AEP-Ohio's POLR costs, in light of our finding that the value of the POLR optionality provided to customers does not equal the Companies' costs. (Remand Order at 28-29.) There is thus no merit in AEP-Ohio's argument that we wrongly applied the Court's decision. Neither was it unreasonable or unlawful to eliminate the Companies' POLR charges. Although we indeed recognized that AEP-Ohio has POLR risks and that the costs associated with such risks may be recovered through a POLR charge (Remand Order at 22), the model fails to measure such costs. AEP-Ohio failed to support its proposed POLR charges and, without evidence in the record to establish an appropriate amount for recovery, the Commission did not err in eliminating the POLR charges. AEP-Ohio's second assignment of error should be denied.

(29) AEP-Ohio next argues that the Remand Order exceeds the scope of the Commission's jurisdiction in finding that the POLR risk of an electric distribution utility (EDU) does not include migration risk and conflicts with Sections 4928.14 and 4928.141, Revised Code. According to the Companies,

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10 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518 (quoting ESP 1 Order at 40).

migration risk was not properly an issue for the Commission's consideration in the remand proceedings. Additionally, AEP-Ohio contends that the Remand Order contains conflicting findings regarding migration risk. (Cos. App. at 8-13.)

(30) According to OCC/OPAE, the Commission acted within its discretion in its conduct of the remand proceedings in allowing the scope of the proceedings to include definition of POLR risks. OCC/OPAE assert that the Court reversed the entire order authorizing the Companies' POLR charges. (OCC/OPAE Memo Contra at 8-10.) IEU-Ohio contends that the Commission correctly followed the Court's decision to conclude that POLR risk does not include migration risk or the related lost revenues (IEU-Ohio Memo Contra at 8-11).

(31) The Commission disagrees with AEP-Ohio's argument that the Remand Order contains conflicting findings regarding migration risk. The first finding refers to the "'risks associated with customers switching to [competitive retail electric service] providers and returning to the electric utility's [standard service offer] rate'" and the Commission's continued belief that "the Companies have such risks and that the costs associated with such risks may be recovered through a POLR charge" (Remand Order at 22, quoting ESP 1 Order at 40). This finding was not intended to specifically distinguish between migration risk and return risk or to imply that migration risk is a proper component of a POLR charge. In the second finding, however, we specified that "migration risk is more properly regarded as a business risk faced by all retail suppliers as a result of competition rather than a risk resulting from an EDU's POLR obligation" (Remand Order at 31-32). With respect to AEP-Ohio's remaining arguments on the subject of migration risk, the Companies have presented no new arguments for our consideration. Accordingly, the Companies' third assignment of error should be denied.

(32) In its fourth assignment of error, AEP-Ohio asserts that the Remand Order and Tariff Approval Order exceed the scope of the Commission's jurisdiction in eliminating the POLR charges in full. The Companies argue that the Commission is precluded from eliminating that portion of the POLR charges that the Commission approved in the RSP Case prior to the ESP 1 Order as it was not open to challenge in these

proceedings or called into question by the Court's remand decision. (Cos. App. at 13-17.)

(33) In response, OCC/OPAE contend that the Commission acted within its discretion when it ordered the elimination of the entire POLR charges from the Companies' tariffs. OCC/OPAE note that the Commission approved POLR charges in the ESP 1 Order that were based on pre-ESP 1 rates plus an additional amount. (OCC/OPAE Memo Contra at 11-12.) IEU-Ohio points out that the POLR charges approved in the ESP 1 Order, which are based on the unconstrained option model, have no continuing relationship with any amount authorized for collection in the RSP Case. According to IEU-Ohio, once the Commission rejected the option model, there was no basis for authorizing any POLR charges. (IEU-Ohio Memo Contra at 11-13.)

(34) The Commission notes that AEP-Ohio originally proposed POLR charges that would collect a revenue requirement of $108.2 million for CSP and $60.9 million for OP (ESP 1 Order at 38). Specifically, the Companies adjusted the POLR charges authorized in the RSP Case such that the proposed new level of costs, which were based on the option model, would be recovered (Cos. Ex. 1 at 12, Ex. DMR-5; Cos. Ex. 2-A at 31). In the ESP 1 Order, we approved 90 percent of the proposed charges, finding that "the POLR rider shall be established to collect a POLR revenue requirement of $97.4 million for CSP and $54.8 million for OP" (ESP 1 Order at 40). The Court subsequently reversed the provisions of the ESP 1 Order that authorized the Companies' POLR charges.[11] As the ESP 1 Order specifically addressed the full amount of the proposed revenue requirements, not just the increased amount, and authorized 90 percent of the proposed charges, we find no error in having eliminated the charges in their entirety. AEP-Ohio's fourth assignment of error is thus denied.

(35) AEP-Ohio next claims that the Remand Order and Tariff Approval Order are unreasonable and unlawful in ordering the elimination of the POLR charges in full given the Commission's findings in the Remand Order that "the Companies have such risks and that the costs associated with such risks may be

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

recovered through a POLR charge" (Remand Order at 22) and that AEP-Ohio "has not justified recovery of POLR charges at the level reflected in its existing rates" (Remand Order at 24). AEP-Ohio maintains that it is unreasonable based on the record to conclude that the Companies should receive no compensation for the unique POLR risks that the law imposes. (Cos. App. at 17-19.)

(36) OCC/OPAE respond that the Commission's elimination of AEP-Ohio's POLR charges was not unreasonable or unlawful because the Companies failed to meet their burden of proving their out-of-pocket POLR costs (OCC/OPAE Memo Contra at 13). IEU-Ohio adds that AEP-Ohio essentially seeks to continue to collect POLR charges at the level authorized in the RSP Case based on no record support and a claim that it is entitled to some level of compensation in light of the Commission's finding that the Companies have POLR risks (IEU-Ohio Memo Contra at 13-15).

(37) As discussed above, the Companies did not justify their proposed POLR charges, which were derived from a model that does not measure POLR costs. In the absence of evidence as to the appropriate amount for recovery, the Commission did not err in fully eliminating the POLR charges. AEP-Ohio's fifth assignment of error should be denied.

(38) In its sixth assignment of error, AEP-Ohio argues that the Tariff Approval Order is unlawful in that it circumvents the jurisdictional rehearing process and fails to set forth the reasons prompting the Commission to reverse its conclusion in the Remand Order that only the "increased POLR charges authorized as a part of the ESP Order are insufficiently supported by the record on remand" (Remand Order at 33). AEP-Ohio asserts that it has consistently advocated that the scope of the remand proceedings is jurisdictionally limited to the amount of the POLR increase authorized in the ESP 1 Order, although other parties contend that the POLR charges should be eliminated in their entirety. The Companies claim that the Commission resolved this dispute in their favor in the Remand Order but reversed course, without explanation, in the Tariff Approval Order. (Cos. App. at 19-22.)

(39) In reply, OCC/OPAE argue that the Tariff Approval Order is lawful, noting that the Commission routinely approves tariffs prior to the resolution of applications for rehearing. OCC/OPAE also assert that the Remand Order was not dispositive of the issue of whether the Companies' POLR charges should be eliminated in full or in part. (OCC/OPAE Memo Contra at 13-14.) IEU-Ohio agrees with OCC/OPAE that the Tariff Approval Order is a valid order. According to IEU-Ohio, in the Remand Order, the Commission concluded that the Companies' POLR charges cannot be authorized and directed them to file tariffs removing the POLR charges. Accordingly, IEU-Ohio claims that the Tariff Approval Order cannot properly be described as an "unexplained reversal." (IEU-Ohio Memo Contra at 15-17.)

(40) Upon consideration of AEP-Ohio's sixth assignment of error, the Commission finds it necessary to clarify the intent of the Remand Order, as the parties differ considerably in their understanding of whether the Companies' POLR charges were expected to be eliminated in full or in part. Although AEP-Ohio quotes several portions of the Remand Order that purportedly support its argument that the Commission intended to eliminate the POLR charges only in part, it was our intent in the Remand Order to direct the Companies to eliminate the POLR charges in their entirety, consistent with our finding that the Companies failed to provide any evidence of their actual POLR costs and that the unconstrained option model does not measure POLR costs. The portions of the Remand Order cited by AEP-Ohio were meant to convey that the full amount of the POLR charges authorized in the ESP 1 Order, and not just the amount of the increase over the prior POLR charges authorized in the RSP Case, should be pulled out of the revised tariffs. As discussed above, the ESP 1 Order addressed the full amount of the Companies' proposed POLR revenue requirements, not just the increased amount, and authorized 90 percent of their proposed charges. Accordingly, we find no merit in AEP-Ohio's argument that the Commission reversed course in the Tariff Approval Order and circumvented the rehearing process. AEP-Ohio's sixth assignment of error should be denied.

Flow-Through Effects of Remand

(41) IEU-Ohio's fifth, sixth, seventh, and eighth assignments of error pertain to the Commission's treatment in the Remand Order of the flow-through effects of the Court's remand. In its fifth assignment of error, IEU-Ohio argues that the Commission unlawfully and unreasonably failed to order an adjustment of OP's phase-in deferral balance caused by the ESP 1 rate caps on the theory that the proposed adjustment would be tantamount to retroactive ratemaking. IEU-Ohio next submits that the Commission unlawfully and unreasonably failed to order an adjustment of OP's phase-in deferral balance based on a finding that the past rates have already been collected from customers, which is not supported in the record. In its seventh assignment of error, IEU-Ohio argues that the Commission unlawfully and unreasonably extended the prohibition on retroactive ratemaking to prevent an adjustment of phase-in deferral balances that have not been collected from customers and were subject to further adjustment by the ESP 1 Order, which established the basis for the deferral balances. Finally, IEU-Ohio contends that the Commission unlawfully and unreasonably failed to address the flow-through effects of the Court's remand on deferral balances; recovery of delta and Universal Service Fund revenues; earnings of the Companies pursuant to the significantly excessive earnings test of Section 4928.143(F), Revised Code; and the Companies' pending ESP application in Case No. 11-346-EL-SSO, *et al.* (IEU-Ohio App. at 15-25.)

(42) Similarly, OCC/OPAE argue that the Commission erred when it failed to reduce the phase-in deferrals by the amount of the unjustified POLR charges collected from April 2009 through May 2011 (*i.e.*, from the beginning of the ESP 1 term through the point at which the charges became subject to refund). Specifically, in their first assignment of error, OCC/OPAE assert that the deferrals violate Section 4928.143, Revised Code, in that the deferrals are a direct result of rates that the Companies did not justify under Section 4928.143(B)(2), Revised Code (OCC/OPAE App. at 6-10). In their second assignment of error, OCC/OPAE claim that the phase-in is not just and reasonable and includes deferrals that are not related to the incurred costs of ESP 1, in violation of Section 4928.144, Revised Code (OCC/OPAE App. at 10-11). Next, OCC/OPAE

contend that, in failing to reduce the amount of the deferrals, the Commission violated Section 4928.06, Revised Code, and the state policies found in Section 4928.02(A) and (L), Revised Code (OCC/OPAE App. at 11-12). In their fourth assignment of error, OCC/OPAE dispute the Commission's conclusion that an adjustment to the deferrals would constitute retroactive ratemaking. OCC/OPAE maintain that, where there is a rate mechanism that provides for a prospective adjustment, there is no retroactive ratemaking. (OCC/OPAE App. at 12-14.)

(43) In a similar vein, OCC/OPAE argue in their fifth assignment of error that the Commission should have ordered the Companies to compensate customers for POLR charges collected from April 2009 through May 2011 in the form of interest at a rate of 10.93 percent (OCC/OPAE App. at 14-15).

(44) AEP-Ohio argues that the Commission properly rejected the flow-through arguments of IEU-Ohio and OCC/OPAE because revenues collected under tariffs approved by the Commission are lawfully collected, notwithstanding the fact that the Ohio Supreme Court subsequently reverses and remands the Commission's order approving the tariffs (Cos. Memo Contra at 3-6). Additionally, the Companies contend that the deferrals were properly approved in the Commission's ESP 1 Order and cannot now be collaterally attacked in the remand proceedings (Cos. Memo Contra at 6-7). AEP-Ohio also asserts that a reduction in the deferrals would constitute retroactive ratemaking (Cos. Memo Contra at 7-11). Finally, the Companies claim that, if the Commission were to order an adjustment to the deferrals, it would undermine state policy, contrary to the argument of OCC/OPAE (Cos. Memo Contra at 11).

(45) The Commission affirms its decision to decline to order an adjustment to the FAC deferral balance as any such adjustment would constitute unlawful retroactive ratemaking. As we thoroughly discussed in the Remand Order, IEU-Ohio and OCC/OPAE seek what would essentially amount to a refund or credit of the Companies' unjustified charges, which is not a permissible remedy pursuant to Court precedent. We find that many of the arguments raised by IEU-Ohio and OCC/OPAE with regard to the flow-through effects of the Court's remand

were already raised by the parties and have been fully addressed (Remand Order at 34-36).

(46) In its sixth assignment of error, IEU-Ohio challenges the Commission's finding that "[c]onsistent with the Court's precedent, we cannot order a prospective adjustment to account for past rates that have already been collected from customers and subsequently found to be unjustified" (Remand Order at 36). Specifically, IEU-Ohio disputes that the rates have already been collected from customers, noting that the deferrals created as a result of the ESP 1 Order are for amounts that have not yet been collected from customers. We note, however, that the past rates to which we were referring are not the deferrals but rather the rates associated with the unjustified POLR charges that have in fact already been collected from customers. Therefore, we find no merit in IEU-Ohio's contention that the Remand Order is premised on an incorrect factual assertion, and IEU-Ohio's sixth assignment of error should be denied.

(47) Given our finding that an adjustment to the FAC deferral balance would constitute unlawful retroactive ratemaking, the Commission finds no merit in OCC/OPAE's arguments that the Remand Order violates Sections 4928.02, 4928.06, 4928.143, and 4928.144, Revised Code. Further, with respect to OCC/OPAE's contention that the phase-in includes deferrals that are not related to the incurred costs of ESP 1, we note that the deferred costs in question are FAC, not POLR, costs. Accordingly, OCC/OPAE's first, second, and third assignments of error should be denied.

(48) For the reasons provided in response to the parties' other arguments related to flow-through effects (Remand Order at 35-36), OCC/OPAE's fifth assignment of error regarding interest on the unjustified POLR charges for the period of April 2009 through May 2011 is without merit and should be denied.

(49) In sum, we find that IEU-Ohio's fifth, sixth, seventh, and eighth assignments of error, as well as the five assignments of error raised by OCC/OPAE, should be denied.

It is, therefore,

ORDERED, That the applications for rehearing filed by AEP-Ohio, IEU-Ohio, and OCC/OPAE on November 2, 2011, be denied. It is, further,

ORDERED, That a copy of this entry on rehearing be served upon all persons of record in these cases.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

SJP/GNS/sc

Entered in the Journal

DEC 14 2011

Betty McCauley
Secretary

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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

OPINION AND ORDER

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

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OPINION:

I. HISTORY OF PROCEEDINGS

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

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

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

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

A. Summary of the Local Public Hearings

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

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

B. Procedural Matters

1. Motion to Strike

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

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

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

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

2. Motion for AEP-Ohio to Cease and Desist

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

territory, Constellation and KOREnergy, Ltd., filed memoranda in support of Integrys' motion.[2]

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

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

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

## II. DISCUSSION

### A. Applicable Law

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

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

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

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

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

(3) Ensure diversity of electric supplies and suppliers.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

B. State Policy – Section 4928.02, Revised Code

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

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

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

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

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

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

C. Application Overview

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

## III. GENERATION

### A. Fuel Adjustment Clause (FAC)

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

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

1. FAC Costs

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

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

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

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

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

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

(a) Market Purchases

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

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

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

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

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

(b) Off-System Sales (OSS)

Kroger and OEG contend that FAC costs must be offset by a credit for OSS margins, stating that other jurisdictions governing other operating companies of AEP Corporation require such an OSS offset to revenue requirements (Kroger Br. at 11-12; Kroger Ex. 1 at 3, 9, 10; OEG Br. at 10; OEG Ex. 3 at 14-15, 16-17). Kroger argues that it is incongruent to allow a rate increase based on certain costs without examining AEP-Ohio's

net costs to determine that AEP-Ohio's costs have actually increased (Kroger Br. at 11-12). OEG notes that the Companies' profits for 2007 from off-system sales were $146.7 million for OP and $124.1 million for CSP (OEG Ex. 3 at 14). OEG reasons that because the cost of the power plants used to generate off-system sales are included in rates, all revenue from the power plants should be a rate credit (OEG Br. 10). OCEA raises similar arguments to those of OEG and Kroger in its brief (OCEA Br. at 57-59). More specifically, OCEA argues that the Companies' proposal to eliminate off-system sales expenses from Ohio ratepayers is not equivalent to providing customers the benefit of off-system sales margins. OCEA notes that, in other cases, the Commission has required electric utilities to share the benefits of off-system sales revenue with jurisdictional customers (OCEA Br. at 58-59).

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

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

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

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

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

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

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

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

2. FAC Baseline

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

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

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

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

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

3. FAC Deferrals

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

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

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

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

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

AEP-Ohio, on the other hand, argued that the calculation of carrying charges for the deferrals should not be done on a net-of-tax basis. AEP-Ohio witness Assante testified that limiting the application of the carrying cost rate to a net-of-tax balance of FAC deferrals improperly utilizes a traditional cost-of-service ratemaking approach in a generation pricing proceeding (Tr. Vol. IV at 158-160). Additionally, while the Companies proposed the phase-in proposal to help mitigate increases and believe that their proposal

is reasonable, in light of the opposition received from several parties, the Companies stated that they would accept a modification to their ESP that eliminated such deferrals (Cos. Reply Br. at 41-42).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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15 *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Their Electric Transition Plans and for Receipt of Transition Revenues*, Case Nos. 99-1729-EL-ETP and 99-1730-EL-ETP, Opinion and Order (September 28, 2000).

16 Tr. Vol. XII at 237.

17 Id.

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

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

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

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

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

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

C. Annual Non-FAC Increases

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

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

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

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

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

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

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

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

## IV. DISTRIBUTION

### A. Annual Distribution Increases

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

#### 1. Enhanced Service Reliability Plan (ESRP)

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

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

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

(a) Enhanced vegetation initiative

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

(b) Enhanced underground cable initiative

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

(c) Distribution automation (DA) initiative

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

(d) Enhanced overhead inspection and mitigation initiative

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

asset initiatives, including cutout replacement, arrester replacement, recloser replacement, 34.5 kV protection, and fault indicator (Id. at 20-22).

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

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

Nonetheless, the Commission finds that AEP-Ohio has demonstrated in the record of this proceeding that it faces increased costs for vegetation management and that a specific need exists for the implementation of the enhanced vegetation initiative, as proposed as part of the three-year ESRP, to support an incremental level of reliability activities in order to maintain and improve service levels. The Companies' current

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

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

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

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

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

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

2. GridSMART

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

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

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

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

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

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

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

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

The Commission believes it is important that steps be taken by the electric utilities to explore and implement technologies, such as AMI, that will potentially provide long-term benefits to customers and the electric utility. GridSMART Phase I will provide CSP with beneficial information as to implementation, equipment preferences, customer expectations, and customer education requirements. A properly designed AMI system and DA can decrease the scope and duration of electric outages. More reliable service is clearly beneficial to CSP's customers. The Commission strongly supports the implementation of AMI and DA, with HAN, as we believe these advanced technologies are the foundation for AEP-Ohio providing its customers the ability to better manage their energy usage and reduce their energy costs. Thus, we encourage CSP to be more expedient in its efforts to implement these components of gridSMART. While we agree

that additional information is necessary to implement a successful Phase I program, we do not believe that all information is required before the Commission can conclude that the program is beneficial to ratepayers and should be implemented. Therefore, we will approve the development of a gridSMART rider, as we agree with the Staff that a rider has several benefits over the proposed annual increase to distribution rates, including separate accounting for gridSMART, an opportunity to approve and update the plan each year, assurance that expenditures are made before cost recovery occurs, and an opportunity to audit expenditures prior to recovery. The Commission notes that recent federal legislation makes matching funds available to smart grid projects. Accordingly, the Companies' gridSMART proposal contained in its proposed ESP to recover $109 million over the term of ESP, should be revised to $54.5 million, which is half of the Companies' requested amount. Additionally, we direct CSP to make the necessary filing for federal matching funds under the American Recovery and Reinvestment Act of 2009 for the balance of the projected costs of gridSMART Phase I. The gridSMART rider shall be initially established at $33.6 million for the 2009 projected expenses subject to annual true-up and reconciliation based on the company's prudently incurred costs.

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

B. Riders

1. Provider of Last Resort (POLR) Rider

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

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

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

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

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

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

2. Regulatory Asset Rider

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

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

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

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

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

(a) Energy Efficiency and Peak Demand Reduction

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

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

(b) Baselines and Benchmarks

In the ESP, the Companies have established the baselines for meeting the benchmarks for statutory compliance by weather normalizing retail sales, excluding

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

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

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

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

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

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

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

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

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

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

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

(c) Energy Efficiency and Peak Demand Reduction Programs

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

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

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

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

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

(d) Interruptible Capacity

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

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

The Companies argue that capacity associated with interruptible customers should be counted toward compliance with the requirements of Section 4928.66, Revised Code, as the ability to interrupt is a significant demand reduction resource to AEP-Ohio. Further, the Companies state that interruptions have a real impact on customers and the Companies do not want to interrupt service when there is no system or market requirement to do so (Cos. Ex. 1 at 6). The Companies note that Section 4928.66(A)(1)(b), Revised Code, requires the electric utility to implement programs "designed to achieve" a specified peak demand reduction level as opposed to "achieve" a specified level of energy savings as required by Section 4928.66(A)(1)(a), Revised Code. Staff witness Scheck admits that the plain meaning of "designed to achieve" and "achieve" are different (Tr. Vol. VIII at 208). The Companies argue that the different language in the statutory requirements is intended to recognize the differences between energy efficiency programs

and peak demand reduction programs. As such, the Companies contend that Staff's position is not supported by the language of the statute and it does not overcome the policy rationale presented by the Companies. The Companies also note that, in the context of integrated resource planning, interruptible capabilities are counted as capacity and evaluated in the need to plan for new power facilities. Finally, the Companies note that the Commission defines native load as internal load minus interruptible load.[26] For these reasons, the Companies contend that their interruptible capacity should be counted toward their compliance with the peak demand reduction benchmarks (Cos. Br. 114-115; Cos. Reply Br. at 90-93).

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

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

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

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

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

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

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

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

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

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

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

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

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

C. Line Extensions

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

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

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

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

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

## V. TRANSMISSION

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

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

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

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

## VI. OTHER ISSUES

### A. Corporate Separation

#### 1. Functional Separation

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

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

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

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

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

2. Transfer of Generating Assets

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

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

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

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

pursuant to Section 4928.17(E), Revised Code, at the time of the actual sale or transfer (OCEA Br. at 100; IEU Br. at 26-27; OEG Br. at 16).

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

B. Possible Early Plant Closures

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

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

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

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

C. PJM Demand Response Programs

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

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32 *In the Matter of the Applications of Columbus Southern Power Company and Ohio Power Company for Approval of Their Electric Transition Plans and for Receipt of Transition Revenues*, Case Nos. 99-1729-EL-ETP and 99-1730-EL-ETP, Opinion and Order at 15-18 (September 28, 2000).

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

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

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

complementary retail tariff programs and to pursue mercantile customer-sited arrangements to achieve benchmark compliance, thus allowing the Companies to avoid duplicate supply costs (Cos. Br. at 124-126).

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

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

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

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

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

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

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

Integrys argues that the Companies' claim that taking SSO and participating in a wholesale demand response program is a resale of power and a violation of the terms and conditions of their tariffs is misplaced. Integrys opines that there is no actual resale of energy, but, instead, there is a reduction in the customer's consumption of energy upon a call from the regional transmission operator (in this case, PJM). The customer is not purchasing energy from AEP-Ohio, so any energy purchased by AEP-Ohio can be

transferred to another purchaser. Thus, Integrys asserts that AEP-Ohio's argument regarding participation in a wholesale demand response program is fiction and not based on FERC's interpretation of participation in such programs. Finally, Integrys contends that AEP-Ohio's proposal is a violation of Section 4928.40(D), Revised Code, as such prohibits electric utilities from prohibiting the resale of electric generation service.

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

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

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

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

the "relevant electric retail regulatory authority." We are not convinced by Integrys' arguments that a specific act of the General Assembly is necessary to grant the Commission the authority to determine whether or not Ohio's retail customers are permitted to participate in the RTO's demand response programs.

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

D. Integrated Gasification Combined Cycle (IGCC)

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

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

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

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

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

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

E. Alternate Feed Service

As part of the ESP, the Companies propose a new alternate feed service (AFS) schedule. For customers who desire a higher level of reliability, a second distribution feed, in addition to the customer's basic service, will be offered. Existing AEP-Ohio customers that are currently paying for AFS will continue to receive the service at the same cost under the proposed tariff. Existing customers who have AFS and are not paying for the service will continue to receive such service until AEP-Ohio upgrades or otherwise makes a new investment in the facilities that provide AFS to that customer. At such time, the customer will have 6 months to decide to discontinue AFS, take partial AFS, or continue AFS and pay for the service in accordance with the effective tariff schedule (Cos. Ex. 1 at 8). While OHA supports the implementation of an AFS schedule offering with clearly defined terms and conditions, OHA takes issue with two aspects of the AFS proposal. OHA witness Solganick testified that it is his understanding that the

customer will have six months after the customer is notified by the company to make a decision (OHA Ex. 4 at 15). However, OHA witness Solganick advocated that six months was insufficient because critical-use customers, like hospitals, require more lead time to evaluate their electric supply infrastructure and needs (Id.). As such, he argued that 24 months would be more appropriate for planning purposes (Id.). Moreover, OHA argued that, because this issue involves the overall management and cost of operating AEP-Ohio's distribution system, the Commission should defer consideration of the proposed AFS until AEP-Ohio's next distribution rate case where there will be a more deliberate treatment of the issue as opposed to this 150-day proceeding (OHA Br. at 23). OHA believes that a distribution rate proceeding would better ensure that the underlying rate structure for AFS is correct, similar to the argument for deferring decision on other distribution rate issues presented in this ESP proceeding (Id.). Staff and IEU also agree that the issue should be addressed in a distribution rate case (Staff Ex. 1 at 4; IEU Ex. 10 at 11). However, IEU further recommends that the Commission deny the Companies' request because it is not based on prudently incurred costs (IEU Br. at 25-26).

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

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

F. Net Energy Metering Service

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

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

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

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

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

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

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

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

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

G. Green Pricing and Renewable Energy Credit Purchase Programs

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

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

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

H. Gavin Scrubber Lease

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

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

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

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

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

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

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

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

I. Section V.E (Interim Plan)

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

We find Section I.E of the proposed ESP to be moot with this opinion and order. The Commission issued finding and orders on December 19, 2008, and February 25, 2009, interpreting the statutory provision in Section 4928.14(C)(1), Revised Code, and approving rates for an interim period until such time as the Commission issues its order on AEP's proposed ESP.[39] Those rates have been in effect with the first billing cycle in January 2009. Consistent with Section 4928.141, Revised Code, which requires an electric utility to provide consumers, beginning on January 1, 2009, a SSO established in accordance with Section 4928.142 or 4928.143, Revised Code, and given that AEP-Ohio's proposed ESP term begins on January 1, 2009, and continues through December 31, 2011, we are authorizing the approval of AEP's ESP, as modified herein, effective January 1, 2009. However, any revenues collected from customers during the interim period must be recognized and offset by the new rates and charges approved by this opinion and order.

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[39] *In re Columbus Southern Power Company and Ohio Power Company*, Case No. 08-1302-EL-ATA, Finding and Order at 2-3 (December 19, 2008) and Finding and Order at 2 (February 25, 2009).

## VII. SIGNIFICANTLY EXCESSIVE EARNINGS TEST (SEET)

Section 4928.143(F), Revised Code, requires that, at the end of each year of the ESP, the Commission shall consider if any adjustments provided for in the ESP:

> ...resulted in excessive earnings as measured by whether the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate.

AEP-Ohio's proposed ESP SEET process may be summarized as follows: The book measure of earnings for CSP and OP is determined by calculating net income divided by beginning book equity. The Companies then propose that the ROE for CSP and OP should be blended as the book equity amounts for AEP-Ohio is more meaningful since CSP and OP are supported by AEP Corporation. To develop a comparable risk peer group, including public utilities, with similar business and financial risk, AEP-Ohio's process includes evaluating all publicly traded U.S. firms. By using data from both Value Line and Compustat, AEP-Ohio applies the standard decile portfolio technique, to divide the firms into 10 different business risk groups and 10 different financial risk groups (lowest to highest). AEP-Ohio would then select the cell which includes AEP Corporation. To account for the fact that the business and financial risks of CSP and OP may differ from AEP Corporation, this aspect of the process is repeated for CSP and OP and taken into consideration in determining whether CSP's or OP's ROEs are excessive. The ESP evaluates business risk by using unlevered Capital Asset Pricing Model betas (or asset betas) and the financial risk by evaluating the book equity ratio. The Companies assert that the book equity ratio is more stable from year to year and, therefore, is considered by fixed-income investors and credit rating agencies. The ESP utilized two standard deviations (which is equivalent to the traditional 95 percent confidence level) about the mean ROEs of the comparable risk peer group and the utility peer group to determine the starting point for which CSP's or OP's ROE may be considered excessive (Cos. Ex. 5 at 13-42). Finally, AEP-Ohio advocates that the earnings for each year the SEET is applied should be adjusted to exclude the margins associated with OSS and accounting earnings for fuel adjustment clause deferrals for which the Companies will not have collected revenues (Cos. Ex. 2-A at 37-38; Cos. Ex. 6 at 16-17; Cos. Ex. 2 at 39-40).

OCC, OEG, and the Commercial Group each take issue with the development of the comparable firms and the threshold of significantly excessive earnings. Kroger and OCEA argue that the Companies' statistical process for determining when CSP and OP

have earned significantly excessive earnings improperly shifts the burden of proof set forth in the statute from the company to other parties.

OCC witness Woolridge developed a proxy group of electric utilities to establish the business and financial risk indicators, then uses Value Line to develop a data base of companies with business and financial risk indicators within the range of the electric utility proxy group. Woolridge suggests computing the benchmark ROE for the comparable companies and adjusting the benchmark ROE for the capital structure of Ohio's electric utility companies and adjusting the benchmark by the FERC 150 basis points ROE adder to determine significantly excessive earnings (OCC Ex. 2 at 5-6, 20). AEP-Ohio argues that OCC's process is contrary to the language and spirit of Section 4928.143(F), Revised Code, as the statute requires the comparable firms include non-utility firms. The SEET proposed by OCC witness Woolridge results in the same comparable list of firms for each Ohio electric utility evaluated (Cos. Ex. 5-A at 5-6).

OEG proposes a method to establish the comparable group of firms by utilizing the entire list of publicly traded electric utilities in Value Line's Datafile,[40] and one group of non-utility firms. The comparable non-utility group is composed of Companies' with gross plant to revenue between 1.2 and 5.0, gross plant in excess of $1 billion and companies for which Value Line has a beta (OEG Ex. 4 at 4-6). OEG then calculates the difference in the average beta of electric utility group and the non-utility group and adjust it by the average historical risk premium for the period 1926 to 2008, which equals 7.0 percent to determine the adjustment to account for the reduced risk associated with utilities. Thus, for example, for the year 2007 OEG determined that the average non-utility earned return of 14.14 percent yields a risk-adjusted return of 12.82 percent. OEG then applies an adjustment to recognize the financial risk differences of AEP-Ohio to the utility and non-utility comparison groups. Finally, to determine the level at which earnings are "significantly excessive," OEG suggests an adder of the 200 basis points to encourage investments (OEG Ex. 4 at 7-9). OEG argues that the use of statistical confidence ranges as proposed by AEP-Ohio would severely limit any finding of excessive earnings as a two-tailed 95 percent confidence interval would mean that only 2.5 percent of all observations of all the sample company groups would be deemed to have excessive earnings. Further, OEG argues that as a statistical analysis the AEP-Ohio-proposed method eliminates most, if not all, of the Commission's flexibility to adjust to economic circumstances and determine whether the utility company's earnings are significantly excessive (OEG Ex. 4 at 9-10).

AEP-Ohio contends that OEG's SEET method fails to comply with the statutory requirements for the SEET, fails to control for financial risk of the comparable sample groups, fails to account for business risk and will, like the process proposed by OCC,

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[40] OEG would eliminate one company with a significant negative return on equity for 2007.

produce the same comparable non-utility and utility group for each of the Ohio electric utilities (Cos. Ex. 5-A at 8-9).

The Commercial Group asserts that AEP-Ohio's proposed SEET methodology will produce volatile earned return on equity thresholds and, therefore, does not meet the primary objective of an ESP' which is to stabilize rates and support the economic development of the state. Further, AEP-Ohio's SEET method, according to the Commercial Group, fails to compose a comparable proxy group with business risk similar to CSP and OP, including unregulated nuclear subsidiaries and deregulated generation subsidiaries. Thus, Commercial Group recommends a comparable group consist of publicly traded regulated utility companies as determined by the Edison Electric Institute (EEI). Commercial Group witness Gorman notes that using EEI's designated group of regulated entities and Value Lines earned return on common equity shows that the regulated companies had an average return on equity of approximately 9 percent for the period 2005 through 2008. Witness Gorman contends that over the period 2005 through 2008 and projected over the next 3 to 5 years, approximately 85 percent of the earned return on equity observations for the designated regulated electric utility companies will be at 12.5 percent return on equity or less. Therefore, Commercial Group recommends that the SEET test be based on the Commission-approved return on equity plus a spread of 200 basis points. Commercial Group witness Gorman reasons that the average risk, extreme risk and beta spread over AEP-Ohio's proxy group suggest that a 2 percent/200 basis points is a conservative determination of the excessive earnings threshold (Commercial Group Ex. 1 at 3, 12-17).

AEP-Ohio argues that the Commercial Group's proposed SEET fails to develop a comparable group as required by the SEET and ignores the fact that the rate of return is a forward-looking analysis and the SEET is retrospective. Thus, AEP-Ohio concludes that this method does not address the measurement of financial and business risk (Cos. Ex. 5-A at 9-10).

OCC opposes the exclusion of accounting earnings for fuel adjustment clause deferrals and the deduction of revenues associated withOSS, as OSS are not one-time write-offs or non-recurring items (OCC Ex. 2 at 21). OCC contends that revenues associated with the deferrals are reported during the same period with the Companies fuel-related expenses and to eliminate the deferrals, as AEP-Ohio proposes, would reduce the revenues for the period without deducting for the underlying expense (OCC Reply Br. 69-70). Similarly, Kroger proposes that AEP-Ohio credit the fuel adjustment clause for the margin generated by OSS and notes that AEP Corporation's West Virginia and Virginia electric distribution subsidiaries currently do so despite AEP-Ohio's assertion that such is in violation of federal law (Kroger Ex. 1 at 9).

Staff advocates a single SEET methodology for all electric distribution utilities as to the selection of comparable firms and, further, proposes a workshop or technical conference to develop the process to determine the "comparable group earnings" for the SEET. Staff witness Cahaan reasons that the SEET proposed by AEP-Ohio as a technical, statistical analysis, if incorrectly formulated shifts the burden of proof from the company to the other parties. Staff also contends that the Companies' SEET proposal is based upon a definition of significance which would create internal inconsistencies if applied to the statute. Further, Staff believes the "zone of reasonable" earnings can be framed by a return on equity with an adder in the range of 200 to 400 basis points. Further, Staff recognizes that if, as AEP-Ohio suggests, revenues from OSS are excluded from SEET, other adjustments would be required. Staff believes it would be unreasonable to predetermine those other adjustments as this time. Thus, Staff proposes that this proceeding determine the method of establishing the comparable group and specify the basis points that will be used to determine "significantly excessive earnings." Staff claims that under its proposed process, at the end of the year, the ROE of the comparable group could be compared to the electric utility's 10-K or FERC-1 and, if the electric utility's ROE is less than that of the sum of the comparable group's ROE plus the adder, it will be presumed that the electric utility's earnings were not significantly excessive. Further, Staff asserts that any party that wishes to challenge the presumption would be required to demonstrate otherwise. If, however, the electric utility's earned ROE is greater than the average of the comparable group plus the adder, the electric utility would be required to demonstrate that its earnings are not significantly excessive (Staff Ex. 10 at 8, 16, 19, 21-24, 26-27; Staff Br. at 27).

OCEA, OMA, and the Commercial Group recommend that the comparable firm process for the SEET be determined, as Staff proposes, as part of a workshop (OCEA Br. at 110; OMA Br. at 13; Commercial Group Br. at 9).

The Commission believes that the determination of the appropriate methodology for the SEET is extremely important. As evidenced by the extensive testimony in this case concerning the test, there are many different views concerning what is intended by the statute and what methodology should be utilized. However, as pointed out by several parties, whatever the ultimate determination of what the methodology should be for the test, the test itself will not be actually applied until 2010 and, as proposed by the Companies, will not commence until August 2010, after Compustat information is made publicly available (Cos. Ex. 5 at 11-12). Therefore, consistent with our opinion and order issued in the FirstEnergy ESP Case,[41] the Commission agrees with Staff that it would be wise to examine the methodology for the excessive earnings test set forth in the statute within the framework of a workshop. This is consistent with the Commission's finding that the goal of the workshop will be for Staff to develop a common methodology for the

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

excessive earnings test that should be adopted for all of the electric utilities and then for Staff to report back to the Commission on its findings. Despite AEP-Ohio's assertions that FirstEnergy's ESP is no longer applicable since the FirstEnergy companies rejected the modified ESP, the Commission finds that a common methodology for significantly excessive earnings continues to be appropriate given that other ESP applications are currently pending and, even under AEP-Ohio's ESP application, the SEET information is not available until the July of the following year. Accordingly, the Commission finds that Staff should convene a workshop consistent with this determination. However, notwithstanding the Commission's conclusion that a workshop process is the method by which the SEET will be developed, we recognize that AEP-Ohio must evaluate and determine whether to accept the ESP as modified herein or reject the modified ESP and, therefore, require clarification of our decision as to OSS and deferrals (Cos. Reply Br. at 134). We find that a determination of the Companies' earnings as "significantly excessive" in accordance with Section 4928.143(F), Revised Code, necessarily excludes OSS and deferrals, as well as the related expenses associated with the deferrals, consistent with our decision regarding an offset to fuel costs for any OSS margins in Section III.A.1.b of this order. The Commission believes that deferrals should not have an impact on the SEET until the revenues associated with deferrals are received. Further, although we conclude that it is appropriate to exclude off-system sales from the SEET calculation, we do not wish to discourage the efficient use of OP's generation facilities and, to the extent that the Companies' earnings result from wholesale sources, they should not be considered in the SEET calculation.

## VIII. MRO V. ESP

The Companies argue that "[t]he public interest is served if the ESP is more favorable in the aggregate than the expected results of an MRO" (Cos. Br. at 15). The Companies' further argue that the state policy set forth in Section 4928.02(A), Revised Code, is satisfied if the price for electric service, as part of the ESP as a whole, is more favorable than the expected results of an MRO (Id.). The Companies aver that not only is the SSO proposed under the ESP more attractive than the SSO resulting froman MRO, other non-SSO factors exist adding to the favorability of the ESP over the MRO (Cos. Ex. 2-A at 4, 8; Cos. Ex. 3 at 14-19). Specifically, AEP calculated the market price competitive benchmark for the expected cost of electricity supply for retail electric generation SSO customers in the Companies' service territories for the next three years as $88.15 per MWH for CSP and $85.32 per MWH for OP for full requirements service (Cos. Ex. 2-A at 5). These competitive benchmark prices were calculated by AEP using market data from the first five days of each of the first three quarters of 2008, and averaging the data (Id. at 15).

AEP-Ohio witness Baker then compared the ESP-based SSO with the MRO-based SSO, analyzing the following components: market prices for 2009 through 2011; the

phase-in of the MRO over a period of time pursuant to Section 4928.142, Revised Code, at 10 percent, 20 percent, and 30 percent; the full requirements pricing components of the states of Delaware and Maryland; PJM costs; incremental environmental costs, POLR costs, and other non-market portions of an MRO-based SSO (Cos. Ex. 2-A at 3-17). AEP-Ohio witness Baker also considered non-SSO costs in the comparison, such as the distribution-related costs of $150 million for CSP and $133 million for OP (Id. at 16-17). AEP-Ohio concluded that the cost of the ESP is $1.2 billion and the cost of the MRO is $1.5 billion for CSP, while the cost of the ESP is $1.4 billion and the cost of the MRO is $1.7 billion for OP (Cos. Ex. 2-B, Revised Exhibit JCB-2). Therefore, AEP-Ohio states that the ESP for the Companies in the aggregate and for each individual company is clearly more favorable for customers, and would result in a net benefit to the customers under the ESP as compared to the MRO of $ 292 million for CSP and $262 million for OP (Id.; Cos. Br. at 135).

The Companies state that, in addition to the generation component, the ESP has other elements that, when taken in the aggregate, make the ESP considerably more favorable to customers than an MRO alternative (Cos. Ex. 2-A at 17-18). AEP-Ohio explains that the benefits in the ESP that are not available in an MRO, include: a shareholder-funded commitment focused on economic development and low-income customer assistance programs; price certainty and stability for generation service for a specified three-year period; and gridSMART and enhanced distribution reliability initiatives (Cos. Ex. 2-A at 17-18; Cos. Ex. 3 at 16-18; Cos. Br. at 135-137).

The Companies contend that once the Commission determines that the ESP is more favorable in the aggregate, then the Commission is required to approve the ESP. If the Commission determines that the ESP is not more favorable in the aggregate, then the Commission may modify the ESP to make it more favorable or it may disapprove the ESP application.

Staff states that, as a general principle, Staff believes that the Companies' proposed ESP is more favorable than what would be expected under an MRO (Staff Br. at 2). However, Staff explains that modifications to the proposed ESP are necessary to make the ESP reasonable (Id.). With Staff's proposed adjustments to the ESP rates, Staff witness Hess testified that the Companies' proposed ESP "results in very reasonable rates" (Staff Ex. 1 at 10). Furthermore, Staff witness Hess demonstrated, utilizing Staff witness Johnson's estimated market rates, that the ESP is more favorable in the aggregate as compared to the expected results of an MRO (Staff Ex. 1-A, Revised Exhibit JEH-1; Staff Br. at 26).

Several intervenors are critical of various components of AEP-Ohio's proposed ESP and thus conclude that the ESP, as proposed, is not more favorable in the aggregate and should be rejected or substantially modified, or that AEP-Ohio has failed to meet its

burden of proof under the statute that the proposed ESP, in the aggregate, is more favorable than an MRO (OPAE Br. at 3, 22-23; OMA Br. at 3; Kroger Br. at 4; OHA Br. at 11; Commercial Group Br. at 2-3; OEG Br. at 2-3; Constellation Br. at 16-18). More specifically, OHA contends that the Commission must take into account all terms and conditions of the proposed ESP, not just pricing (OHA Br. at 8-9). OHA further explains that the Commission must weigh the totality of the circumstances presented in the proposed ESP with the totality of the expected results of an MRO (Id. at 9). OHA also states that the proposed ESP fails to mitigate the harmful effects of new regulatory assets, proposed deferrals, and rate increases on hospitals and, therefore, the ESP does not provide benefits that make it more favorable than a simple MRO (Id. at 11). IEU asserts that both the Companies' and Staff's comparison of the ESP to an MRO are flawed because the comparisons fail to reflect the projected costs of deferrals, assume the maximum blending percentages allowed under 4928.142, Revised Code, and fail to demonstrate the incremental effects of the maximum blending percentages on the FAC costs (IEU Br. at 33, citing Cos. Ex. 2-A, Staff Ex. 1, Exhibit JEH-1, Tr. Vol. XI at 78-82, and Tr. Vol. XIII at 87-88).

OCEA disputes the Companies' comparison of the ESP to the MRO, stating that the Companies have overstated the competitive benchmark prices (OCC Ex. 10 at 15; OCEA Br. at 19-24). Based on data from the fourth quarter 2008, and taking in consideration adjustments for load shaping and distribution losses, OCC calculates that the updated competitive benchmark prices should be $73.94 for CSP and $71.07 for OP (OCC Ex. 10 at 15-24). OCEA also questioned other underlying components of AEP witness Baker's comparison of the MRO to the ESP regarding the proposed ESP, as well as the exclusion of certain costs in the MRO calculation (Id. at 37-40). Nonetheless, OCEA ultimately concludes that AEP's ESP, if appropriately modified, is more favorable than an MRO (OCEA Br. at 19-24; OCC Ex. 10 at 39). Constellation also submits that the forward market prices for energy have fallen significantly since the Companies' filed their application and submitted their supporting testimony (Constellation Ex. 2 at 16).

Contrary to the position taken by Constellation and OCEA,[42] AEP-Ohio contends that the market price analysis supplied in support of the ESP does not need to be updated in order for the Commission to determine whether the ESP is more favorable that the expected result of the MRO. Furthermore, AEP-Ohio responds that the appropriate method is to look over a longer period of time, and not just focus on the recent decline in forward market prices. (Cos. Reply Br. at 130-131).

Contrary to arguments raised by various intervenors, AEP-Ohio avers that the legal standard to approve the ESP is not whether the Commission can make the ESP even more favorable, whether the rates are just and reasonable, whether the costs are prudently

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[42] Constellation Br. at 17; OCEA Br. at 19-24.

incurred, whether the plan provisions are cost-based, or whether each provision of the plan is more favorable than an MRO (Cos. Reply Br. at 1-6). The Companies contend that the Commission only has authority to modify a proposed ESP if the Commission determines that the ESP is not more favorable than the expected results of an MRO (Id. at 4). As some intervenors have recognized,[43] the Commission does not agree that our authority to make modifications is limited to an after-the-fact determination of whether the proposed ESP is more favorable in the aggregate. Rather, the Commission finds that our statutory authority includes the authority to make modifications supported by the evidence in the record in this case. Based upon our opinion and order and using Staff witness Hess' methodology of the quantification of the ESP v. MRO comparison, as modified herein, we believe that the cost of the ESP is $673 million for CSP and $747 million for OP, and the cost of the MRO is $1.3 billion for CSP and $1.6 billion for OP.

Accordingly, upon consideration of the application in this case and the provisions of Section 4928.143(C)(1), Revised Code, the Commission finds that the ESP, including its pricing and all other terms and conditions, including deferrals and future recovery of deferrals, as modified by this order, is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142, Revised Code.

## IX. CONCLUSION

The Commission believes that it is essential that the plan we approve be one that provides rate stability for the Companies, provides future revenue certainty for the Companies, and affords rate predictability for the customers. Upon consideration of the application in this case and the provisions of Section 4928.143(C)(1), Revised Code, the Commission finds that the ESP, including its pricing and all other terms and conditions, including deferrals and future recovery of deferrals, as modified by this order, is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142, Revised Code. Therefore, the Commission finds that the proposed three-year ESP should be approved with the modifications set forth in this order. To the extent that intervenors have proposed modifications to the Companies' ESP that have not been addressed by this opinion and order, the Commission concludes that the requests for such modifications are denied.

Furthermore, the Commission finds that the Companies' should file revised tariffs consistent with this order, to be effective with bills rendered January 1, 2009. In light of the timing of the effective date of the tariffs, the Commission finds that the revised tariffs shall be approved upon filing, effective January 1, 2009, as set forth herein, and contingent upon final review by the Commission.

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[43] OEG Br. at 3.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

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

(2) On July 31, 2008, CSP and OP filed applications for an SSO in accordance with Section 4928.141, Revised Code.

(3) On August 19, 2008, a technical conference was held regarding AEP-Ohio's applications and on November 10, 2008, a prehearing conference was held in these matters.

(4) On September 19, 2008, and October 29, 2008, intervention was granted to: OEG; OCC; Kroger; OEC; IEU-Ohio; OPAE; APAC; OHA; Constellation; Dominion; NRDC; Sierra; NEMA; Integrys; Direct Energy; OMA; OFBF; Wind Energy; OASBO/OSBA/BASA; Ormet; Consumer Powerline; Morgan Stanley Capital Group Inc.; Commercial Group; EnerNoc, Inc.; and AICUO.

(5) The hearing in these proceedings commenced on November 17, 2008, and concluded on December 10, 2008. Eleven witnesses testified on behalf of AEP-Ohio, 22 witnesses testified on behalf of various intervenors, and 10 witnesses testified on behalf of the Commission Staff.

(6) Five local hearings were held in these matters at which a total of 124 witnesses testified.

(7) Briefs and reply briefs were filed on December 30, 2008, and January 14, 2009, respectively.

(8) AEP-Ohio's applications were filed pursuant to Section 4928.143, Revised Code, which authorizes the electric utilities to file an ESP as their SSO.

(9) The proposed ESP, as modified by this opinion and order, including its pricing and all other terms and conditions, including deferrals and future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142, Revised Code.

ORDER:

It is, therefore,

ORDERED, That the Companies' application for approval of an ESP, pursuant to Sections 4928.141 and 4928.143, Revised Code, be modified and approved, to the extent set forth herein. It is, further,

ORDERED, That the Companies file their revised tariffs consistent with this opinion and order and that the revised tariffs be approved effective January 1, 2009, on a bills-rendered basis, contingent upon final review and approval by the Commission. It is further,

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

ORDERED, That the Companies notify all affected customers of the changes to the tariff via bill message or bill insert within 45 days of the effective date of the tariffs. A copy of this customer notice shall be submitted to the Commission's Service Monitoring and Enforcement Department, Reliability and Service Analysis Division at least 10 days prior to its distribution to customers. It is, further,

ORDERED, That a copy of this opinion and order be served on all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Paul A. Centolella

Ronda Hartman Fergus

Valerie A. Lemmie

Cheryl L. Roberto

KWB/GNS:vrm/ct

Entered in the Journal
MAR 18 2009

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

CONCURRING OPINION OF CHAIRMAN ALAN R. SCHRIBER

AND COMMISSIONER PAUL A. CENTOLELLA

We agree with the Commission's decision and write this concurring opinion to express additional rationales supporting the Commission's decision in two areas.

gridSMART Rider

The Order sets the initial amount to be recovered through the gridSMART rider based on the availability of federal matching funds for smart grid demonstrations and deployments under the American Recovery and Reinvestment Act of 2009. AEP-Ohio should promptly take the necessary steps to apply for available federal funding. Additionally, AEP-Ohio should work with staff and the collaborative established under the Order to refine its Phase 1 plan and initiate deployments in a timely and reasonable manner.

The foundation of a smart grid is an open-architecture communications system which, first, provides a common platform for implementing distribution automation, advanced metering, time-differentiated and dynamic pricing, home area networks, and other applications and, second, integrates these applications with existing systems to improve reliability, reduce costs, and enable consumers to better control their electric bills.

These capabilities can provide significant consumer and societal benefits. In the near term, participating consumers will have new capabilities for managing their energy usage to take advantage of lower power costs and reduce their electric bills. AEP-Ohio will be able to provide consumers feedback regarding their electric usage patterns and improved customer service. And, the combination of distribution automation and advanced metering should enable AEP-Ohio to rapidly locate damaged and degraded

distribution equipment, reduce outages, and minimize the duration of any service interruptions. We expect that consumers will experience a material improvement in service and reliability.

SB 221 made it state policy to encourage time-differentiated pricing, implementation of advanced metering infrastructure, development of performance standards and targets for service quality for all consumers, and implementation of distributed generation. Section 4928.02 of the Revised Code. The Commission's Order advances these policies.

AEP-Ohio and its customers are likely to face significant challenges over the next decade from rising costs, requirements for improved reliability, and environmental constraints. Our Order will enable AEP-Ohio to take a first step in developing a modern grid capable of providing affordable, reliable, and environmentally sustainable electric service into the future.

PJM Demand Response Program

First, we wish to emphasize that the Commission supports demand response initiatives.

Second, it is essential that consumers benefit from demand response in terms of a reduction in the capacity for which AEP-Ohio customers are responsible. We encourage AEP-Ohio to work with PJM, the Commission, and interested stakeholders to ensure that predictable consumer demand response is recognized as a reduction in capacity that it must carry under PJM market rules.

Finally, consumers should have the opportunity to see and respond to changes in the cost of the power that they use. While an ESP may set the overall level of prices, consumers should have additional opportunities to benefit by reducing consumption when wholesale power prices are high. We would encourage the companies to work with staff to develop additional dynamic pricing options for commercial and industrial SSO customers who have the interval metering needed to support such rates. Such options should enable eligible consumers to directly manage risk and optimize their energy usage.

Alan R. Schriber

Paul A. Centolella

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

ENTRY

The Commission finds:

(1) On March 18, 2009, the Commission issued its opinion and order in Columbus Southern Power Company's (CSP) and Ohio Power Company's (OP) (jointly, AEP-Ohio or the Companies) electric security plan (ESP) cases (ESP Order).[1] By entries on rehearing issued July 23, 2009 (First ESP EOR) and November 4, 2009 (Second ESP EOR), the Commission affirmed and clarified certain issues raised in AEP-Ohio's ESP Order. As ultimately modified and adopted by the Commission, AEP-Ohio's ESP directed, among other things, that AEP-Ohio be permitted to recover the incremental capital carrying costs that would be incurred after January 1, 2009, on past environmental investments (2001-2008)[2] and approved a provider of last resort (POLR) charge for the ESP period.

(2) The Commission's decision in the AEP-Ohio ESP cases was appealed to the Ohio Supreme Court. The Ohio Supreme Court determined that Section 4928.143(B)(2), Revised Code, does not authorize the Commission to allow recovery of items not included in the section. The Court remanded the case to the Commission for further proceedings that "the Commission may determine whether any of the listed categories set forth in

1 In re AEP-Ohio ESP cases, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Opinion and Order (March 18, 2009).

2 ESP Order at 24-28; First ESP EOR at 10-14.

Section 4928.143(B)(2), Revised Code, authorize recovery of environmental carrying charges."

(3) Further, as to the POLR charge approved in the AEP-Ohio ESP cases, the Court declared that concluding that the POLR charge is cost based is against the manifest weight of the evidence, an abuse of the Commission's discretion and reversible error. While the Court specifically stated that "we express no opinion on whether a formula-based POLR charge is per se unreasonable or unlawful," the Court noted two other methods by which the Commission may establish the POLR charge: a non-cost-based POLR charge or evidence of AEP-Ohio's actual POLR costs.

(4) Pursuant to the Court's decision, the Commission directs AEP-Ohio to file by May 11, 2011, proposed revised tariffs that would remove the POLR charges and environmental carrying cost charges associated with investments made 2001-2008, from the Companies' tariffs.

(5) In addition, in the event that AEP-Ohio intends to seek a non-cost-based POLR charge or a POLR charge based upon costs or to seek recovery of environmental carrying charges pursuant to the Court's remand, the Commission directs AEP-Ohio to make the appropriate filing in these proceedings and the Commission will establish an appropriate procedural schedule.

It is, therefore,

ORDERED, That AEP-Ohio file proposed revised tariffs as directed in finding (4). It is, further,

ORDERED, That a copy of this entry be served upon all persons of record in these cases.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

GNS/vrm

Entered in the Journal
MAY 04 2011

Betty McCauley
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

ENTRY

The Commission finds:

(1) On March 18, 2009, the Commission issued its opinion and order in Columbus Southern Power Company's (CSP) and Ohio Power Company's (OP) (jointly, AEP-Ohio or the Companies) electric security plan (ESP) cases (ESP Order).[1] By entries on rehearing issued July 23, 2009 (First ESP EOR) and November 4, 2009 (Second ESP EOR), the Commission affirmed and clarified certain issues raised in AEP-Ohio's ESP Order. As ultimately modified and adopted by the Commission, AEP-Ohio's ESP directed, among other things, that AEP-Ohio be permitted to recover the incremental capital carrying costs that would be incurred after January 1, 2009, on past environmental investments (2001-2008)[2] and approved a provider of last resort (POLR) charge for the ESP period.

(2) The Commission's decision in the AEP-Ohio ESP cases was appealed to the Ohio Supreme Court. The Ohio Supreme Court determined that Section 4928.143(B)(2), Revised Code, does not authorize the Commission to allow recovery of items not included in the section. The Court remanded the case to the Commission for further proceedings in which "the Commission may determine whether any of the listed categories set forth in Section 4928.143(B)(2), Revised Code,

1 *In re AEP-Ohio ESP cases*, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Opinion and Order (March 18, 2009).

2 AEP-Ohio ESP Order at 24-28, 38-40; First ESP EOR at 10-13, 24-27.

authorize recovery of environmental carrying charges."[3] In regards to the POLR charges, the Court concluded that the Commission's decision that the POLR charge is cost-based is against the manifest weight of the evidence, an abuse of the Commission's discretion and reversible error. While the Court specifically stated that "we express no opinion on whether a formula-based POLR charge is per se unreasonable or unlawful," the Court noted two other methods by which the Commission may establish the POLR charge: a non-cost-based POLR charge or evidence of AEP-Ohio's actual POLR costs.

(3) By entry issued May 4, 2011, the Commission directed AEP-Ohio to file proposed tariffs removing the POLR charges and environmental carrying cost charges from the rates by May 11, 2011. Further, the May 4, 2011 entry directed that if AEP-Ohio intends to seek recovery of the environmental or POLR charges, pursuant to the Court's remand, to make the appropriate filing with the Commission.

(4) On May 6, 2011 and May 16, 2011, respectively, AEP-Ohio and Industrial Energy Users-Ohio (IEU) filed applications for rehearing of the Commission's May 4, 2011 entry.

(5) On May 11, 2011, the Companies filed proposed revised tariffs, under protest, as corrected on May 13, 2011. AEP-Ohio also filed motions and a request for expedited ruling on the motions. AEP-Ohio requests that the Commission establish a procedural schedule for the remand proceedings, reject or hold in abeyance the proposed revised tariffs eliminating the environmental and POLR charges, or collect the existing tariff rates subject to refund pending the decision on remand. AEP-Ohio asserts that ordering the reduction of the tariff rates before considering the issues on remand is premature, contrary to the Commission's usual remand process, and would cause substantial harm to AEP-Ohio. Further, AEP-Ohio claims that the two-step change in rates will be confusing and irritating to customers.

(6) By responses filed May 16, 2011, Ohio Energy Group (OEG), Ohio Manufacturers Association (OMA), and the Ohio Hospital

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3 *In re Application of Columbus S. Power Co.*, Slip Opinion No. 2011-Ohio-1788.

Association (OHA) endorse the collection of the existing rates, subject to refund. OEG explains that the proposal is a reasonable method to expeditiously address the factual and legal issues on remand while ensuring the rates ultimately charged to customers are lawful and reasonable. Likewise, OMA and OHA do not oppose the Companies' proposal to make the collection of the existing POLR and environmental charges subject to refund.

(7) Other parties to AEP-Ohio's ESP cases, namely, the Office of the Ohio's Consumers' Counsel (OCC), Ohio Partners for Affordable Energy (OPAE), and IEU oppose AEP-Ohio's request to reject or hold in abeyance the tariffs filed pursuant to the May 4, 2011 entry. In various filings, OCC and OPAE argue that the tariffs filed by AEP-Ohio do not comply with the May 4, 2011 entry and encourage the Commission to reject the tariffs and direct AEP-Ohio to completely remove all POLR charges from the tariffs. IEU contends that the effect of the Court's remand of the POLR charges extends beyond just the elimination of the POLR charges as proposed by AEP-Ohio in its tariff filing.

(8) On May 20, 2011, AEP-Ohio filed what it calls an "initial merit filing on remand." In the filing, the Companies state that there is sufficient evidence in the record for the Commission to find that the environmental carrying costs are recoverable under one of the provisions in Section 4928.143(B)(2)(a) through (h), Revised Code, without further proceedings. While the Companies argue for the Commission to determine the level of POLR due AEP-Ohio based on the existing record and makes various arguments in support thereof, the Companies also recognize that the Commission may schedule hearings and admit additional evidence regarding the Companies' POLR obligation.

(9) The Commission notes that there is significant disagreement among the parties as to the level of POLR charges at issue pursuant to the Court's remand. We also note that certain commercial and industrial customer representatives endorse the collection of the current tariff rates, subject to refund, and that initially OCC accepted the collection of the current rates, subject to refund, as a course of action available to the

Commission although such was not OCC's preference. Upon further consideration of the issues raised by the parties to these ESP remand proceedings, we find AEP-Ohio's motion to make the currently effective tariff rates, subject to refund, to be a reasonable request until the Commission specifically orders otherwise on remand. Accordingly, we direct AEP-Ohio to file revised tariffs specifically stating that the POLR riders and the environmental carrying charges are subject to refund by May 27, 2011, to be effective as of the first billing cycle of June 2011. Until the Commission issues its decision on remand, AEP-Ohio shall continue to collect the current tariff rates, subject to refund, commencing with the first billing cycle of June 2011. Further, if the Commission ultimately determines in the remand proceeding that any environmental or POLR charges are to be refunded to AEP-Ohio customers, interest may be imposed on the amounts collected.

(10) The Commission finds that making the current tariff rates subject to refund, pending the outcome of the remand proceedings, to be the most reasonable means to facilitate a just process for AEP-Ohio customers and the Companies, and to avoid rate volatility for some customers.

(11) Further, the Commission finds that AEP-Ohio and the intervenors should be afforded an opportunity to present testimony and to offer additional evidence in regard to the POLR and environmental carrying charges remanded to the Commission. The parties may address the amount of POLR charges at issue and the rate of interest charges applicable, if any. Accordingly, the following procedural schedule should be established:

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| AEP-Ohio testimony: | June 6, 2011 |
| Intervenor testimony: | June 23, 2011 |
| Final discovery request (excluding notices of depositions): | June 29, 2011 |
| Prehearing conference: | July 7, 2011 |
| Hearing: | July 12, 2011 |

(12) Accordingly, a prehearing shall be held on Thursday, July 7, 2011 at 10:00 a.m., at the offices of the Commission, Hearing Room 11-D, 180 E. Broad Street, Columbus, Ohio. The hearing in this matter shall commence on Tuesday, July 12, 2011, at 10:00 a.m., at the offices of the Commission, Hearing Room 11-A.

(13) In light of the time frame for preparation for the remand hearing, any motion made in this proceeding, and any memoranda contra shall be required to be filed within five business days after the service of such motion, and any reply memorandum within three business days after the service of a memorandum contra. Paragraph (B) of Rule 4901-1-07, Ohio Administrative Code (O.A.C.), which permits three additional days to take action if service is made by mail, will not apply. Parties are encouraged to take advantage of paragraph (C) of Rule 4901-1-05, O.A.C., which provides that service of pleadings may occur by facsimile transmission or electronic message. In addition, response time for discovery should be shortened to 10 days. Discovery requests and replies shall be served by hand delivery, e-mail or facsimile (unless otherwise agreed by the parties). An attorney serving a discovery request shall attempt to contact the attorney upon whom the discovery request will be served in advance to advise him/her that a request will be forthcoming (unless otherwise agreed by the parties). To the extent that a party has difficulty responding to a particular discovery request within the 10-day period, counsel for the parties should discuss the problem and work out a mutually satisfactory solution.

It is, therefore,

ORDERED, That AEP-Ohio shall file, by May 27, 2011, tariff pages that reflect that the POLR riders and environmental carrying charges included in rates are being collected subject to refund as to be determined by the Public Utilities Commission of Ohio. AEP-Ohio is authorized to file, in final form, four, complete copies of the tariff page consistent with this order. AEP-Ohio shall file one copy in its TRF docket (or may make such filing electronically as directed in Case No. 06-900-AU-WVR) and one copy in these case dockets. The remaining two copies shall be designated for distribution to the Rates and Tariffs, Energy and Water Division, of the Commission's Utilities Department. It is, further,

ORDERED, That the procedural schedule for the remand proceedings be adopted as set forth in Findings (11) and (12). It is, further,

ORDERED, That the parties comply with the directives set forth in Finding (13). It is, further,

ORDERED, That a copy of this entry be served upon all persons of record in these cases.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

GNS/vrm

Entered in the Journal

MAY 25 2011

Betty McCauley

Betty McCauley
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

ORDER ON REMAND

The Commission, coming now to consider the evidence presented in these proceedings, pursuant to the Supreme Court of Ohio's remand in *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, the transcripts of the hearing, and briefs of the parties, hereby issues its order on remand.

APPEARANCES:

The following parties made appearances in the remand phase of these proceedings:

Steven T. Nourse and Matthew J. Satterwhite, American Electric Power Corporation, One Riverside Plaza, 29th Floor, Columbus, Ohio 43215, and Porter, Wright, Morris & Arthur, by Daniel R. Conway, 41 South High Street, Columbus, Ohio 43215, on behalf of Columbus Southern Power Company and Ohio Power Company.

Mike DeWine, Ohio Attorney General, by John H. Jones, Assistant Section Chief, and Werner L. Margard, Assistant Attorney General, 180 East Broad Street, Columbus, Ohio 43215, on behalf of the Staff of the Public Utilities Commission of Ohio.

Janine L. Migden-Ostrander, Ohio Consumers' Counsel, by Maureen R. Grady and Jeffrey L. Small, Assistant Consumers' Counsel, 10 West Broad Street, Suite 1800, Columbus, Ohio 43215, on behalf of the residential utility consumers of Columbus Southern Company and Ohio Power Company.

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

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

McNees, Wallace & Nurick LLC, by Samuel C. Randazzo, Frank P. Darr, and Joseph E. Oliker, 21 East State Street, 17th Floor, Columbus, Ohio 43215, on behalf of Industrial Energy Users-Ohio.

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

Vorys, Sater, Seymour & Pease LLP, by M. Howard Petricoff, Stephen M. Howard, and Lija Kaleps-Clark, 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216, and Cynthia Fonner Brady, Constellation Energy Resources, LLC, 550 West Washington Boulevard, Suite 300, Chicago, Illinois 60661, on behalf of Constellation NewEnergy, Inc., and Constellation Energy Commodities Group, Inc.

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

Bricker & Eckler LLP, by Matthew W. Warnock, 100 South Third Street, Columbus, Ohio 43215, on behalf of the Ohio Manufacturers' Association.

Sonnenschein, Nath & Rosenthal LLP, by Emma F. Hand, Clinton A. Vince, and Presley R. Reed, 1301 K Street NW, Suite 600, East Tower, Washington, DC 20005, on behalf of Ormet Primary Aluminum Corporation.

OPINION:

I. HISTORY OF THE PROCEEDINGS

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

By entries issued August 5, 2008, and September 5, 2008, the procedural schedule in these matters was established. A technical conference was held regarding AEP-Ohio's application on August 19, 2008, and a prehearing conference occurred on November 10, 2008. The evidentiary hearing commenced on November 17, 2008, and concluded on

December 10, 2008. The Commission also held five local public hearings throughout the Companies' service area.

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

On March 18, 2009, the Commission issued its opinion and order regarding AEP-Ohio's application (ESP Order). By entries on rehearing issued July 23, 2009 (First ESP EOR) and November 4, 2009, the Commission affirmed and clarified certain issues raised in the ESP Order. As ultimately modified and adopted by the Commission, AEP-Ohio's ESP directed, among other things, that AEP-Ohio be permitted to recover the incremental capital carrying costs that would be incurred after January 1, 2009, on past environmental investments (2001-2008) and approved a provider of last resort (POLR) charge for the ESP period.[1]

The Commission's decision was appealed to the Supreme Court of Ohio. On April 19, 2011, the Court affirmed the ESP Order in numerous respects, but remanded the proceedings to the Commission with regard to two portions of the Commission's decision. The Court determined that Section 4928.143(B)(2), Revised Code, does not authorize the Commission to allow recovery of items not enumerated in the section. The Court remanded the cases to the Commission for further proceedings in which the Commission may determine whether any of the listed categories set forth in Section 4928.143(B)(2), Revised Code, authorize recovery of environmental investment carrying charges.[2] Regarding the POLR charge, the Court concluded that the Commission's decision that the POLR charge is cost-based was against the manifest weight of the evidence, an abuse of the Commission's discretion, and reversible error. The Court noted two methods by which the Commission may consider the POLR charge on remand, specifically, as either a non-cost-based POLR charge or by way of evidence of AEP-Ohio's actual POLR costs.[3]

By entry issued May 4, 2011, the Commission directed AEP-Ohio to file proposed tariffs removing the POLR and environmental carrying charges from its rates by May 11, 2011. The entry also directed AEP-Ohio, if it intended to seek recovery of the POLR or environmental carrying charges, pursuant to the Court's remand, to make the appropriate filing with the Commission. On May 11, 2011, the Companies filed proposed tariffs, under protest, and corrections on May 13, 2011. AEP-Ohio also filed motions requesting that the

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1 AEP-Ohio ESP Order at 24-28, 38-40; First ESP EOR at 10-13, 24-27.

2 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 520.

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

Commission either establish a procedural schedule for the remand proceedings and reject or hold in abeyance the proposed tariffs eliminating the POLR and environmental carrying charges, or collect the existing tariff rates subject to refund pending the Commission's decision on remand. By responses filed May 16, 2011, the Ohio Energy Group (OEG), Ohio Manufacturers' Association (OMA), and Ohio Hospital Association (OHA) endorsed the collection of the existing rates, subject to refund. In various filings, other parties, namely, the Office of the Ohio Consumers' Counsel (OCC), Ohio Partners for Affordable Energy (OPAE), and Industrial Energy Users-Ohio (IEU-Ohio) opposed AEP-Ohio's motions.

On May 20, 2011, AEP-Ohio filed what it referred to as an initial merit filing on remand. In the filing, the Companies state that there is sufficient evidence in the record for the Commission to find that the environmental carrying costs are recoverable under one of the provisions in Section 4928.143(B)(2)(a) through (h), Revised Code, without further proceedings. While AEP-Ohio argued for the Commission to determine the level of POLR charges due the Companies based on the existing record and made various arguments in support thereof, AEP-Ohio also recognized that the Commission may schedule hearings and admit additional evidence regarding the Companies' POLR obligation.

By entry issued May 25, 2011, the Commission directed AEP-Ohio to file revised tariffs by May 27, 2011, making the POLR and environmental carrying charges subject to refund, as of the first billing cycle of June 2011, until the Commission specifically orders otherwise on remand. The Commission specified that, if it ultimately determines in the remand proceedings that any POLR or environmental carrying charges are to be refunded to customers, interest may be imposed on the amounts collected. The Commission concluded that making the current tariff rates subject to refund, pending the outcome of the remand proceedings, is the most reasonable means to facilitate a just process for customers and the Companies, and to avoid rate volatility for some customers. In the May 25, 2011, entry, the Commission also established a procedural schedule to afford AEP-Ohio and the intervenors an opportunity to present testimony and to offer additional evidence in regard to the POLR and environmental carrying charges remanded to the Commission. The parties were specifically directed to address the amount of POLR charges at issue and the rate of interest charges applicable, if any. On May 27, 2011, AEP-Ohio filed revised tariffs in accordance with the May 25, 2011, entry.

Following issuance of the May 25, 2011, entry, FirstEnergy Solutions Corp. (FES), Appalachian Peace and Justice Network (APJN), and Exelon Generation Company, LLC (Exelon) filed motions to intervene in these proceedings. By entry issued June 16, 2011, the attorney examiner denied the motions, finding that they were filed nearly three years past the established intervention deadline and that the movants had not demonstrated

extraordinary circumstances justifying late intervention. On June 29, 2011, the Commission affirmed the attorney examiner's ruling and denied the interlocutory appeals of FES, APJN, and Exelon.

Pursuant to the procedural schedule established in the May 25, 2011, entry, as modified by entries of June 23, 2011, and June 30, 2011, a prehearing conference was held on July 8, 2011. The hearing commenced on July 15, 2011, and continued on July 19, 2011, through July 21, 2011. The hearing concluded with rebuttal testimony on July 28, 2011.

At the hearing, AEP-Ohio presented the testimony of Dr. Anil Makhija (Cos. Remand Ex. 1), Dr. Chantale LaCasse (Cos. Remand Ex. 3), and Laura J. Thomas (Cos. Remand Ex. 4), regarding the Companies' POLR obligation, and the testimony of Philip J. Nelson (Cos. Remand Ex. 2), regarding the environmental investment carrying charges incurred during the ESP for investments made from 2001-2008.[4] The Companies also offered the rebuttal testimony of Dr. Chantale LaCasse (Cos. Remand Ex. 5), Thomas E. Mitchell (Cos. Remand Ex. 7), and Laura J. Thomas (Cos. Remand Ex. 8).

Six witnesses testified for various intervenors: on behalf of OCC, Mack A. Thompson (OCC Remand Ex. 1) and Dr. Daniel J. Duann (OCC Remand Ex. 2); on behalf of IEU-Ohio, Dr. Jonathan A. Lesser (IEU-Ohio Remand Ex. 1), Kevin M. Murray (IEU-Ohio Remand Ex. 2), and Joseph G. Bowser (IEU-Ohio Remand Ex. 3); and on behalf of Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc. (jointly, Constellation), David I. Fein (Constellation Remand Ex. 1). Staff presented the testimony of Timothy W. Benedict (Staff Remand Ex. 1).

At the conclusion of the hearing on July 28, 2011, IEU-Ohio, joined by OCC, moved to dismiss these cases, asserting that AEP-Ohio failed to sustain its burden of proof. The attorney examiner deferred ruling on the motion to dismiss.

Initial briefs were filed on August 5, 2011, by AEP-Ohio, Staff, IEU-Ohio, and Constellation. Joint briefs were filed by OCC and OPAE, as well as OMA and OHA. Additionally, FES filed a motion for leave to file an *amicus curiae* brief attached to its motion. On August 10, 2011, AEP-Ohio filed a memorandum contra FES' motion. FES filed a reply on August 15, 2011.

On August 10, 2011, OCC and OPAE filed a motion to strike a portion of AEP-Ohio's initial brief. IEU-Ohio filed a similar motion on August 11, 2011. AEP-Ohio filed a memorandum contra the motions to strike on August 16, 2011. OCC, OPAE, and IEU-Ohio filed a joint reply on August 18, 2011.

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4 References to exhibits or transcripts from the remand proceedings will specifically be designated as such in this order. All other references refer to evidence from the original record compiled in 2008.

Reply briefs were filed on August 12, 2011, by AEP-Ohio, IEU-Ohio, and Constellation. Joint reply briefs were filed by OCC and OPAE, as well as OMA and OHA. On August 17, 2011, OCC, OPAE, and IEU-Ohio filed a joint motion to strike portions of AEP-Ohio's reply brief. AEP-Ohio filed a memorandum contra the motion to strike on August 24, 2011. OCC, OPAE, and IEU-Ohio filed a joint reply on August 29, 2011.

## II. PROCEDURAL ISSUES

### A. IEU-Ohio's Motion to Dismiss

As noted above, IEU-Ohio moved to dismiss these cases at the conclusion of the hearing on July 28, 2011, and OCC joined the motion. With respect to AEP-Ohio's POLR charges, IEU-Ohio contends that the Companies asserted during the remand proceedings that their POLR costs are based on the value to customers of the option to switch to an alternative supplier, which IEU-Ohio believes is the same argument that was previously rejected by the Supreme Court of Ohio. Regarding environmental carrying charges, IEU-Ohio argues that the Companies have failed to identify any category within Section 4928.143(B)(2), Revised Code, that supports their recovery of such costs. IEU-Ohio concludes that the Companies have failed to meet their burden of proof. (Remand Tr. V at 894-895.)

AEP-Ohio responds with respect to the POLR charges that the Court's decision does not dictate a particular outcome in these cases or prevent the Commission from reaching the same result as in the original proceedings. The Companies argue that the evidence should be considered by the Commission. On the subject of environmental carrying charges, AEP-Ohio maintains that it has identified multiple bases in the statute that support recovery of its costs. (Remand Tr. V at 895-897.)

The Commission finds that AEP-Ohio has presented sufficient evidence, as addressed in detail below, such that we may decide these matters on the record. Accordingly, IEU-Ohio's motion to dismiss should be denied.

### B. FES' Motion to File *Amicus Curiae* Brief

On August 5, 2011, FES filed a motion for leave to file an *amicus curiae* brief in these proceedings. FES notes that its brief addresses AEP-Ohio's POLR charges. According to FES, it has extensive experience on the subject of POLR risk, given that it has assumed such risk in competitive auctions as a competitive retail electric service (CRES) provider. FES believes that its experience may be beneficial to the Commission. FES notes that it was denied intervention in these proceedings and that, in other cases, the Commission has permitted *amicus* filings by entities denied intervention or even where intervention was

not sought. FES asserts that its brief will not delay the proceedings or expand on the issues, as FES does not seek to introduce new evidence. FES points out that the Commission's decision will have a significant impact on CRES providers operating in AEP-Ohio's service territory and that the Commission should have as much information as possible in making its decision.

In its memorandum contra, AEP-Ohio responds that FES was properly denied intervention in these cases and that its participation at this point adds no value to the record. The Companies further note that FES has identified no legal basis authorizing FES to file an *amicus curiae* brief. AEP-Ohio disputes FES' claim that it does not intend to seek new evidence, pointing out that FES attached a non-record exhibit to its brief. The Companies maintain that FES has no unique POLR experience to share with the Commission and that the perspective of CRES suppliers has already been provided by Constellation, which is a party to these proceedings. AEP-Ohio notes that the Commission has not solicited FES' *amicus* filing, as it has from other entities in prior cases, and that FES' true concerns are those of a competitor of the Companies and not an aide to the Commission.

The Commission finds no basis under the present circumstances to justify permitting FES to file an *amicus curiae* brief. As discussed above, FES' late motion for intervention was denied. In the entry of June 29, 2011, we noted that FES was granted intervention in AEP-Ohio's pending ESP case, Case No. 11-346-EL-SSO, *et al.*, and that our decision was not intended to prevent FES from presenting its arguments with respect to AEP-Ohio's POLR charges or from otherwise fully participating in those proceedings, regardless of the outcome of the present cases. Additionally, as AEP-Ohio notes, the perspective of CRES providers is already represented in these proceedings by Constellation, which has provided expert testimony, as well as filed initial and reply briefs. Finally, we find that FES' *amicus curiae* brief raises no issue that has not also been raised by Constellation or the other parties. For these reasons, FES' motion for leave to file an *amicus curiae* brief should be denied.

C. Motions to Strike of OCC, OPAE, and IEU-Ohio

1. Testimony

a. Rebuttal Testimony of Dr. LaCasse

During the remand hearing, OCC, joined by IEU-Ohio, OPAE, Constellation, and OHA, moved to strike a portion of the rebuttal testimony of Companies witness LaCasse. The motion to strike was denied by the attorney examiner. (Remand Tr. V at 637-643, 653.) In their initial brief, OCC and OPAE renew the motion to strike, request that the Commission find that the attorney examiner's ruling was erroneous, and ask that the

rebuttal testimony and related testimony on cross-examination be disregarded. Regarding the specific portion of the rebuttal testimony in question, which pertains to Monte Carlo model results offered in support of the Companies' option model results (Cos. Remand Ex. 5 at 7-11), OCC and OPAE argue that proper rebuttal testimony does not include subjects that could have been presented during the party's direct case. OCC and OPAE note that AEP-Ohio indicated in its initial merit filing of May 20, 2011, that it intended to support the reasonableness of its POLR charges based on additional modeling, which could include the results of a Monte Carlo model. OCC and OPAE assert that the late arrival of a study is insufficient justification for its presentation in rebuttal testimony and that the late admission into the record of the Monte Carlo results was highly prejudicial. AEP-Ohio responds that Dr. LaCasse offered proper rebuttal testimony and that, because OCC failed to take an interlocutory appeal of the attorney examiner's ruling, it may not now be attacked on brief.

Initially, the Commission notes that OCC and OPAE may raise the propriety of the attorney examiner's ruling for the Commission's consideration pursuant to Rule 4901-1-15(F), Ohio Administrative Code (O.A.C.). We find, however, that the attorney examiner properly denied the motion. The rebuttal testimony of Dr. LaCasse regarding the results of the Monte Carlo model was specifically provided in response to the direct testimony of IEU-Ohio witness Lesser, stating that "options must be valued using empirical models, such as [M]onte-[C]arlo models" if the strike price is correlated with the price of the underlying asset and that "one cannot use either the Black-Scholes or Black models to do so" (IEU-Ohio Remand Ex. 1 at 22; Cos. Remand Ex. 5 at 7). As Dr. LaCasse's rebuttal testimony was specifically offered in response to Dr. Lesser's testimony, it could not have been offered as part of the Companies' direct case, given that the Companies' direct testimony was filed before the intervenors'. Further, OCC and OPAE have offered no support for their contention that the Monte Carlo results were presented in rebuttal testimony because they were late. Neither have OCC and OPAE demonstrated how the admission of the testimony into the record caused them prejudice. Both parties were afforded the opportunity to cross-examine Dr. LaCasse regarding the Monte Carlo results.

b. Direct Testimony of Mr. Nelson

OCC also moved during the remand hearing to strike a portion of the direct testimony of Companies witness Nelson. This motion was also denied by the attorney examiner. (Remand Tr. I at 69-70, 78.) OCC and OPAE, in their initial brief, ask that the Commission reverse the ruling. In the relevant portion of the testimony, Mr. Nelson identified three statutory bases in support of the Companies' recovery of environmental carrying costs (Cos. Remand Ex. 2 at 4). OCC and OPAE move to strike this testimony on the grounds that Mr. Nelson is not qualified to offer a legal opinion.

*The Commission finds that this motion to strike was also properly denied.* Mr. Nelson explained that his testimony was offered based on the advice of counsel (Cos. Remand Ex. 2 at 4) and that he was not testifying as an expert in legal matters (Remand Tr. I at 78). Mr. Nelson's testimony was thus not offered as a legal opinion.

2. Initial Brief

On August 10, 2011, OCC and OPAE filed a motion to strike a portion of AEP-Ohio's initial brief referring to the POLR charges of other electric distribution utilities (EDUs) in Ohio. IEU-Ohio filed a similar motion on August 11, 2011. OCC, OPAE, and IEU-Ohio argue that the POLR charges of the other EDUs were not introduced or admitted into evidence and that the Companies' attempt to rely on non-record information should be rejected. They further assert that the Commission must base its decision on the record before it, as required by Section 4903.09, Revised Code. OCC, OPAE, and IEU-Ohio add that they have concerns about the relevancy, comparability, and accuracy of the charges listed for the other EDUs, which they would have raised if the information had been introduced during the hearing.

AEP-Ohio responds that the information that OCC, OPAE, and IEU-Ohio seek to strike was taken directly from tariffs that have been approved by the Commission and that the Commission has the authority to recognize its own decisions and approved tariffs, which have the effect of a statute. The Companies argue that the Commission has previously taken administrative notice of tariff provisions for comparison purposes and may do so here, if necessary. They note that the information was provided to assist the Commission in applying its prior decisions to the present cases. AEP-Ohio contends that the circumstances surrounding approval of the other EDUs' POLR charges are known by the Commission and may be weighed accordingly.

OCC, OPAE, and IEU-Ohio reply that it is inappropriate to take administrative notice of the information after the record is closed, as it denies them the opportunity to explain and rebut the information through cross-examination, contrary to Ohio Supreme Court and Commission precedent. They add that the Companies have offered no reason for having waited until the briefing stage to present the information.

The Commission agrees with OCC, OPAE, and IEU-Ohio that they should have been afforded the opportunity to challenge the information in question during the hearing and that it would be improper to take administrative notice of the information at this stage in the proceedings. AEP-Ohio admits that the table in its brief was included in its initial merit filing of May 20, 2011, but offers no explanation as to why it was not presented during its direct case. Additionally, the Commission questions whether the information presented in the table may properly be used for the purpose of comparison. As the intervenors note, the rates and charges of the other EDUs shown in the table do not appear

to relate solely to their POLR obligation and, in any event, were determined in the context of Commission-approved stipulations. Accordingly, the motions to strike should be granted, such that the first paragraph on page 30 of AEP-Ohio's initial brief, including the table, should be stricken.

3. Reply Brief

On August 17, 2011, OCC, OPAE, and IEU-Ohio filed a motion to strike two portions of AEP-Ohio's reply brief. The first portion is a sentence pertaining to the POLR charges of the other EDUs. The second portion pertains to statements made by OCC witness Medine regarding the Black-Scholes model in a Commission-ordered audit report in the Companies' fuel adjustment clause (FAC) proceedings, Case No. 10-268-EL-FAC, *et al.* With respect to both portions, OCC, OPAE, and IEU-Ohio argue that the Companies' attempts to rely on non-record information should be rejected for the same reasons advanced in their motions to strike a portion of AEP-Ohio's initial brief, as discussed above.

Likewise, AEP-Ohio raises the same arguments asserted in its response to the motions to strike a portion of its initial brief. Regarding the statements of OCC witness Medine on the subject of the Black-Scholes model, the Companies argue that whether to take administrative notice is a case by case determination and that, under the circumstances, it is appropriate for the Commission to do so in order to be able to compare Ms. Medine's testimony in these cases, as addressed by OCC and OPAE in their initial brief, with her statements in the audit report in the FAC proceedings.

The Commission finds that the motion to strike should be granted for the same reasons addressed above. We find that it is improper to take administrative notice of the information in question, which was not presented until the reply brief was filed and thus foreclosed the intervenors from challenging the information. Therefore, the motion to strike should be granted, such that both portions of AEP-Ohio's reply brief, as identified by OCC, OPAE, and IEU-Ohio, should be stricken.

## III. DISCUSSION

### A. Incremental Carrying Cost for 2001-2008 Environmental Investment

#### 1. Supreme Court's Directive

In the ESP Order, the Commission authorized AEP-Ohio "to recover the incremental capital carrying costs that will be incurred after January 1, 2009, on past environmental investments (2001-2008) that are not presently reflected in the Companies'

existing rates."[5] The Commission interpreted Section 4928.143(B)(2), Revised Code, to permit AEP-Ohio to include, in the ESP, environmental investment carrying costs incurred during the ESP term. The Commission found that "[t]he carrying costs on the environmental investments fall within the ESP period and, therefore, may be included in the ESP pursuant to the broad language of Section 4928.143(B)(2), Revised Code, permitting recovery for unenumerated expenses."[6] The Commission authorized the Companies to collect a revenue requirement of $26 million for CSP and $84 million for OP. On appeal, the Supreme Court of Ohio determined that Section 4928.143(B)(2), Revised Code, does not authorize the Commission to allow recovery of items not enumerated in the section. The Court remanded the cases to the Commission for further proceedings in which the Commission may determine whether any of the listed categories set forth in Section 4928.143(B)(2), Revised Code, authorize recovery of environmental investment carrying charges.[7]

2. Applicable Law

Section 4928.143(B)(1), Revised Code, provides that an ESP "shall include provisions relating to the supply and pricing of electric generation service." Additionally, Section 4928.143(B)(2), Revised Code, enumerates specific categories of items that an ESP may include.

3. Arguments

In their application, the Companies requested increases to their base, non-FAC generation rates for recovery of carrying costs for environmental investments made during 2001-2008 that were not currently reflected in their SSO rates, or an annual amount of $26 million for CSP and $84 million for OP. The Commission approved the Companies' request.

AEP-Ohio asserts that the narrow legal issue remanded to the Commission may be readily addressed by substantiating its recovery of carrying costs on 2001-2008 environmental investments by way of any one of multiple provisions within Section 4928.143(B)(2), Revised Code. First, the Companies state that Section 4928.143(B)(2)(d), Revised Code, authorizes the Commission to establish terms relating to carrying costs, as would have the effect of stabilizing rates. In their brief, the Companies note that the effect of perpetuating the useful lives of existing generation assets through prudent environmental investments is to stabilize rates, particularly when compared to the cost of investing in new generation. As another statutory basis, AEP-Ohio points to Section

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5 ESP Order at 28.

6 First ESP EOR at 12.

7 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 520.

4928.143(B)(2)(e), Revised Code, which authorizes automatic increases in any component of the SSO price. The Companies claim that, because compliance with environmental regulations is compulsory when operating a generating station, it is appropriate to allow automatic pass-through of prudently incurred carrying costs on environmental investments. Finally, AEP-Ohio identifies Section 4928.143(B)(2)(b), Revised Code, as another legal basis for its recovery of such costs, noting that the provision allows cost recovery for an environmental expenditure for an electric generating facility of an EDU, provided the cost is incurred or the expenditure occurs on or after January 1, 2009. The Companies explain that, although the environmental investments were made prior to that date, the carrying costs on those investments were incurred in 2009 and beyond.

Staff agrees with AEP-Ohio that Section 4928.143(B)(2)(d), Revised Codes, allows for recovery of the Companies' environmental investment carrying costs, given that "carrying costs" are specifically enumerated in that provision.

IEU-Ohio argues that AEP-Ohio has failed to demonstrate that the carrying charges on 2001-2008 environmental investments are lawful. Initially, IEU-Ohio notes that the Companies have not claimed that the revenues from their other rates and charges are inadequate to compensate the Companies for their environmental investment carrying costs. IEU-Ohio further argues that AEP-Ohio failed to offer any evidence in support of its claim for recovery and instead merely referred to certain provisions in the statute, without demonstrating that it satisfies the criteria of any of those provisions. With regard to those provisions, IEU-Ohio asserts that Section 4928.143(B)(2)(b), Revised Code, pertains only to recovery of expenses related to construction work in progress occurring on or after January 1, 2009, and is not applicable to AEP-Ohio's carrying costs. Regarding Section 4928.143(B)(2)(d), Revised Code, IEU-Ohio contends that Companies witness Nelson failed to demonstrate how the carrying charges stabilize or provide certainty regarding retail electric service. Finally, with respect to Section 4928.143(B)(2)(e), Revised Code, IEU-Ohio notes that the carrying charges do not constitute an automatic increase or decrease.

OCC and OPAE contend that the carrying costs were not incurred on or after January 1, 2009, because they pertain to environmental investments that occurred from 2001-2008, and that the carrying costs, therefore, may not be recovered pursuant to Section 4928.143(B)(2)(b), Revised Code. With respect to Section 4928.143(B)(2)(d), Revised Code, OCC and OPAE argue that there is no evidence that carrying charges on older environmental investments benefit customers in terms of stability or certainty regarding retail electric service. Finally, OCC and OPAE assert that Section 4928.143(B)(2)(e), Revised Code, is inapplicable, as the carrying charges are a distinct component of the SSO, rather than an adjustment mechanism for a component.

4. Conclusion

The Supreme Court of Ohio directed that "[o]n remand, the [C]ommission may determine whether any of the listed categories of (B)(2) authorize recovery of environmental carrying charges."[8] AEP-Ohio submits that three of the categories listed in Section 4928.143(B)(2), Revised Code, including Section 4928.143(B)(2)(d), Revised Code, authorize recovery of its environmental investment carrying charges.

Section 4928.143(B)(2)(d), Revised Code, provides that an ESP may include "[t]erms, conditions, or charges relating to...carrying costs, amortization periods, and accounting or deferrals, including recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service." Section 4928.01(A)(27), Revised Code, defines "retail electric service" as "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" and specifically includes "generation service."

The Commission agrees with AEP-Ohio and Staff that Section 4928.143(B)(2)(d), Revised Code, authorizes the Companies' recovery of incremental capital carrying costs that are incurred after January 1, 2009, on past environmental investments (2001-2008) that were not previously reflected in the Companies' existing rates prior to the ESP Order. Section 4928.143(B)(2)(d), Revised Code, specifically authorizes recovery of carrying costs. There is no dispute among the parties on this point.

As an initial matter, IEU-Ohio asserts that the Companies have failed to show that their rates, excluding the environmental investment carrying charges, do not provide adequate compensation. IEU-Ohio, however, offers no support for its position that AEP-Ohio is required to make such a showing or pass an earnings test as a condition of recovery of its incremental environmental investment carrying costs.

OCC, OPAE, and IEU-Ohio argue that the Companies failed to demonstrate how their carrying costs stabilize or provide certainty regarding retail electric service. OCC and OPAE further add that the determination regarding the stabilizing effect must be made from the perspective of the customer and that the Companies have not shown that their customers benefit from the carrying charges on past environmental investments. We disagree with the arguments raised by OCC, OPAE, and IEU-Ohio. During the initial hearing, Companies witness Nelson testified:

> The capital carrying cost is the annual cost associated with the investment of a dollar of capital asset investment. Capital expenditures are typically long lived assets that are recovered over the life of the asset. Investors require

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8 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 520.

> both a return on and of their capital expenditures....The carrying cost rate includes the cost of money (weighted average cost of capital), a depreciation component, an income tax component, property and other taxes component and an administrative and general component.

(Cos. Ex. 7 at 15-16.) He further testified:

> These environmental investments are necessary to keep the Companies' low-cost coal-fired generating units running. The customers will benefit because the operating costs of these units remain well below the cost of securing the power on the market. The Companies are passing the lower-cost power through the FAC.

(Cos. Ex. 7B at 6.)

We find that the environmental investment carrying charges have the effect of providing certainty to both the Companies and their customers regarding retail electric service, specifically generation service. With respect to AEP-Ohio, inclusion of the carrying charges in the ESP compensates the Companies for their investment in their generating plant. Companies witness Nelson explained that the Companies' investors expect to earn a return on their capital investments and that the carrying cost rate includes the cost of money, among other components. AEP-Ohio's recovery of the carrying costs works to ensure that the investors earn a return on their investment.

However, customers benefit as well. As Mr. Nelson pointed out, the carrying charges recover the ongoing costs of environmental investments that were necessary to continue operation of the Companies' generation units and extend the useful lives of those facilities. Customers benefit from the lower cost power that they receive as a result. The alternative to the investments in the Companies' generation assets would be increased use of purchased power to serve the Companies' SSO load. The record reflects that this cost of the environmental investments was below the market rate for purchased power at the time the Commission considered the ESP. Thus, we agree with Staff that "[t]he [C]ompanies' compliance with the current and future environmental requirements is in the public interest, and they should continue investing in environmental equipment" (Staff Ex. 6 at 5). As AEP-Ohio's environmental investment carrying charges have the effect of providing certainty regarding retail electric service, Section 4928.143(B)(2)(d), Revised Code, authorizes their inclusion in the ESP.

With respect to the argument raised by OCC and OPAE that, because the carrying costs pertain to environmental investments that occurred from 2001-2008, the carrying costs may not be recovered pursuant to Section 4928.143(B)(2)(b), Revised Code, the

Commission notes that Section 4928.143(B)(2)(b), Revised Code, applies only to nonbypassable surcharges. Since the carrying costs at issue are recovered through rates which are bypassable, the limitation to environmental expenditures incurred on or after January 1, 2009, contained in Section 4928.143(B)(2)(b), Revised Code, is inapplicable in this case.

The Commission further notes that our decision in this case is consistent with the broad authority granted to the Commission by Section 4928.143(B)(1), Revised Code, which authorizes ESPs to include "provisions relating to the supply and pricing of electric generation service." The carrying charges are a specific component of the Companies' standard service offer generation rates and are directly related to environmental investments made at generating facilities which are used to serve standard service offer customers.

The Commission concludes that AEP-Ohio should be authorized to continue its recovery of incremental capital carrying costs that are incurred after January 1, 2009, on past environmental investments (2001-2008) that were not previously reflected in the Companies' existing rates prior to the ESP Order. The Companies should file revised tariffs, consistent with this order on remand, reflecting that the environmental investment carrying charges are no longer subject to refund. The effective date of the new tariffs should be the date of this order, or the date upon which four complete, printed copies of the final tariffs are filed with the Commission, whichever date is later.

B. POLR Rider

1. Supreme Court's Directive

In the ESP Order, the Commission found that "the Companies do have some risks associated with customers switching to CRES providers and returning to the electric utility's SSO rate at the conclusion of CRES contracts or during times of rising price."[9] The Commission concluded that "the Companies' proposed ESP should be modified such that the POLR rider will be based on the cost to the Companies to be the POLR and carry the risks associated therewith, including the migration risk." The Commission approved recovery of 90 percent of the estimated POLR costs presented by the Companies, or the approximate portion representing the migration risk, and authorized the Companies to collect a revenue requirement of $97.4 million for CSP and $54.8 million for OP. The Commission also specified that "the POLR rider shall be avoidable for those customers who shop and agree to return at a market price and pay the market price of power incurred by the Companies to serve the returning customers."

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9 ESP Order at 40.

On appeal, the Supreme Court of Ohio concluded that the Commission's decision that the POLR charge is cost-based, which determination was based on the results of "a mathematical formula" known as the Black-Scholes model, was against the manifest weight of the evidence, an abuse of the Commission's discretion, and reversible error.[10] Additionally, the Court stated:

> To be clear, we express no opinion on whether a formula-based POLR charge is per se unreasonable or unlawful, and the [C]ommission may consider on remand whether a non-cost-based POLR charge is reasonable and lawful. Alternatively, the [C]ommission may consider whether it is appropriate to allow [AEP-Ohio] to present evidence of its actual POLR costs. However the [C]ommission chooses to proceed, it should explain its rationale, respond to contrary positions, and support its decision with appropriate evidence.

2. Applicable Law

An EDU's POLR obligation is derived from several statutory provisions in Chapter 4928, Revised Code. Section 4928.141(A), Revised Code, provides, in part:

> Beginning January 1, 2009, an electric distribution utility shall provide consumers, on a comparable and nondiscriminatory basis within its certified territory, a standard service offer of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service.

Additionally, Section 4928.14, Revised Code, provides, in part:

> The failure of a supplier to provide retail electric generation service to customers within the certified territory of an electric distribution utility shall result in the supplier's customers, after reasonable notice, defaulting to the utility's standard service offer under sections 4928.141, 4928.142, and 4928.143 of the Revised Code until the customer chooses an alternative supplier.

In its decision in these cases, the Supreme Court of Ohio described the EDU's POLR obligation as the "obligation to stand ready to accept returning customers."[11]

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10 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518-519.

11 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 517.

3. Issues

On appeal, the Supreme Court of Ohio found "no evidence suggesting that [AEP-Ohio's] POLR charge is related to any costs it will incur."[12] Regarding the Black-Scholes model used by the Companies to determine their POLR costs, the Court stated that "[v]alue to customers (what the model shows) and cost to [AEP-Ohio] (the purported basis of the order) are simply not the same thing" and "we fail to see how the amount a customer would be willing to pay for the right to shop necessarily establishes [AEP-Ohio's] costs to bear the attendant risks."

AEP-Ohio claims that the evidentiary record on remand fully supports the Companies' existing POLR charges and addresses the Court's concerns as to how the charges are cost-based. The Companies urge the Commission to approve again their existing POLR charges. Numerous intervenors, including OCC, OPAE, IEU-Ohio, Constellation, OMA, and OHA, argue that the Companies have failed to sustain their burden of proof and should, therefore, refund to customers the POLR charges collected since the first billing cycle of June 2011 and cease any further collection of such charges.

a. Legal Basis for POLR Charge

i. Arguments

AEP-Ohio notes that all EDUs have a mandatory, continuing obligation to stand as the POLR in their respective service territories and that the Supreme Court of Ohio has recognized that EDUs are entitled to be compensated for discharging their POLR obligations.[13] Additionally, the Companies state that, pursuant to Section 4928.143(B)(1), Revised Code, an ESP is required to include provisions related to the supply and pricing of electric generation service. They also note that, pursuant to Section 4928.143(B)(2)(d), Revised Code, an ESP may include charges relating to bypassability, standby service, and default service, as would have the effect of stabilizing or providing certainty regarding retail electric service. AEP-Ohio contends that recoverable costs may include lost revenues due to its POLR obligation, pointing out that Section 4928.143(B)(2)(h), Revised Code, expressly authorizes recovery of lost revenues related to distribution infrastructure and modernization incentives. The Companies assert that this provision confirms that the components of an ESP may be based on lost revenues.

The Companies further state that, although the record demonstrates that the POLR charges are cost-based, the charges would nevertheless be lawful even if they could not be justified on a cost basis, as they have the effect of providing stability and certainty

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12 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518.

13 *Constellation NewEnergy, Inc. v. Pub. Util. Comm.* (2004), 104 Ohio St.3d 530.

regarding the price that customers will pay for retail electric service, consistent with Section 4928.143(B)(2)(d), Revised Code. Finally, AEP-Ohio argues that, because POLR costs are recovered by the other EDUs or through the competitive bid prices of SSO suppliers, it would be unfair and unlawful to deny the Companies the same right to recover such costs.

IEU-Ohio asserts that the Companies have not demonstrated any legal basis for their POLR charges. Noting that the POLR charges were proposed as a distribution rider, IEU-Ohio contends that the charges do not qualify under Section 4928.143(B)(2)(h), Revised Code, which authorizes only certain types of distribution charges. IEU-Ohio further notes that the Companies have identified no legal authority that would justify the POLR charges as a generation rider.

ii. Conclusion

As an initial matter, the Commission clarifies that AEP-Ohio's POLR rider should properly be classified as a generation service rider. Although the POLR obligation is an exclusive obligation of the EDUs, it pertains to the provision of generation service.[14] The Commission agrees with the Companies that Section 4928.143(B)(1), Revised Code, provides a statutory basis for their recovery of POLR costs, which relate to the pricing of electric generation service. Additionally, Section 4928.143(B)(2)(d), Revised Code, provides that an ESP may include "[t]erms, conditions, or charges relating to...standby, back-up, or supplemental power service, [and] default service...as would have the effect of stabilizing or providing certainty regarding retail electric service." As AEP-Ohio must stand ready to provide SSO service to returning customers, and customers have the option to return at any time, we find that the charges associated with the Companies' POLR obligation, which are charges related to standby and default service, provide certainty for both the Companies and their customers regarding retail electric service.

b. POLR Cost

i. Arguments

According to AEP-Ohio, the record establishes that the Companies incur substantial costs associated with providing customers with the optionality to switch away from, and to return to, the SSO generation rates that the Companies have committed to make available for the duration of the ESP term (POLR optionality) (Cos. Remand Ex. 1 at 3-5; Cos. Remand Ex. 3 at 5-7; Cos. Remand Ex. 4 at 3). AEP-Ohio describes the POLR optionality as enabling customers to take service from the Companies at SSO rates until

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14 *Ohio Consumers' Counsel v. Pub. Util. Comm.* (2007), 114 Ohio St.3d 340, 344-346.

market prices decline below the SSO rates such that it becomes advantageous to switch to a CRES provider. The POLR optionality also allows customers who have switched to a CRES provider to return to the Companies at SSO rates if market prices rise above the SSO rates or the CRES provider defaults in providing service.

Companies witness LaCasse described the costs associated with the POLR optionality in terms of shopping-related risks:

> If market prices fall sufficiently so that SSO customers shop, a portion of the generation output that the EDU expected would serve SSO customers instead would be sold at prices below the ESP price, leading to a shortfall in revenue. If instead market prices rise sufficiently so that customers taking service from CRES providers return to SSO, the EDU would divert a portion of the generation output that could have been sold at those higher market prices to serve SSO customers, or the EDU would purchase from the market at those higher market prices to serve SSO customers, leading to additional unexpected cost.

(Cos. Remand Ex. 3 at 7.) In further support of AEP-Ohio's claim that it incurs POLR costs as a result of shopping-related risks, Dr. LaCasse provided examples of analyses of SSO auction results that quantified the risks, including shopping-related risks, associated with providing wholesale supplies for customers that take SSO-type service (Cos. Remand Ex. 3 at 18-20).

Companies witness Makhija used a hypothetical situation to describe the effect of the POLR obligation as a diminution in equity value, by comparing Utility A, which has the same POLR obligation as the Companies, with Utility B, which does not:

> The earnings of Utility A will have greater variability because its customers are likely to depart when the market price falls below its SSO price, and to return when the market price goes above the SSO price. This makes Utility A riskier and its equity requires a higher required rate of return compared to Utility B. That is, shareholders for Utility A have a higher risk premium (and, hence, a higher cost of equity capital) as a result of the optionality it is required to provide to its customers. Cash flows for Utility A should be discounted at the higher cost of capital, which amounts to a diminution of shareholders equity for Utility A.

(Cos. Remand Ex. 1 at 5.)

Dr. Makhija further testified that the cost to AEP-Ohio, as the provider of the POLR optionality, is "no more or less than the value of the options received by the customers" (Cos. Remand Ex. 1 at 4). Additionally, Dr. LaCasse testified that the value of the option (*i.e.*, the expected value of the difference between the ESP price and the market price at which customers choose to shop) is also the amount by which realized revenue for AEP-Ohio can be expected to be below the ESP revenue that AEP-Ohio would have received absent the customer shopping. She explained that the Companies experience an actual, quantifiable loss in that they are left to make an alternate sale at the lower market price, leading to a loss in revenue. (Cos. Remand Ex. 3 at 5; Cos. Remand Ex. 5 at 6.) Similarly, according to Dr. Makhija, AEP-Ohio incurs a cost, due to its POLR obligation, in the form of a lost opportunity, as measured by the difference between the SSO price and the market price (Remand Tr. I at 49).

Companies witness Thomas explained that AEP-Ohio estimates, by way of an option model, the value of the POLR optionality given to customers to determine the cost imposed on the Companies from their POLR obligation. Ms. Thomas adopted the results from the unconstrained option model proposed originally by Companies witness Baker, which were modified and used by the Commission as the basis for the existing POLR charges. Ms. Thomas also reported the results of the Companies' constrained option model, which refines the original unconstrained option model by incorporating switching constraints, to confirm that the results from the unconstrained option model are reasonable and should be retained. (Cos. Remand Ex. 4 at 12-16.) Additionally, on rebuttal, Dr. LaCasse offered the results of a Monte Carlo model as support for the magnitude of the POLR costs calculated by the Companies' constrained option model (Cos. Remand Ex. 5 at 10).

The Companies contend that their POLR costs are not based on a subjective determination of the amount that a customer would be willing to pay for the right to shop, as discussed in the Supreme Court's decision,[15] but rather are based on forward-looking, market-based measurements that objectively quantify their costs using an option model, which also quantifies the value of the POLR optionality to customers. Because the POLR obligation is undertaken by AEP-Ohio at the outset of the ESP term, the Companies argue that their POLR risk should be modeled at that point (Cos. Remand Ex. 3 at 12-13; Cos. Remand Ex. 8 at 2-4).

AEP-Ohio concludes that its testimony sufficiently explains the rationale for using an option model to estimate its POLR costs, as well as how the value of the POLR optionality to its customers relates to the cost to the Companies of providing the POLR optionality. The Companies submit that that their modeled cost of providing the POLR

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

optionality, as supported by the record, confirms the reasonableness of their existing POLR charges.

Numerous parties, including Staff, OCC, OPAE, IEU-Ohio, Constellation, OMA, and OHA, respond that AEP-Ohio has identified no out-of-pocket costs associated with its POLR obligation. They note that none of the Companies' witnesses performed an out-of-pocket cost calculation or even found such costs relevant (Remand Tr. I at 17-18; Remand Tr. II at 152-153, 244-245; OCC Remand Ex. 1 at 36-37). OCC, OPAE, Constellation, OMA, and OHA contend that, by failing to present any evidence showing that their POLR charges are indeed based on cost, the Companies have effectively chosen a non-cost-based approach, despite their insistence to the contrary.

OCC and OPAE assert that Chapter 4928, Revised Code, contains no guarantee that AEP-Ohio will be made whole for generation sales lost to CRES providers and that lost revenues may not be recovered through a POLR charge. OCC and OPAE argue that POLR costs should be limited to verifiable, out-of-pocket costs for incremental energy and capacity that are incurred to serve returning customers (OCC Remand Ex. 1 at 12). They state that the POLR obligation is a non-competitive, distribution-related service that should be priced based on actual, prudently incurred costs, according to traditional cost-of-service principles under Chapters 4905 and 4909, Revised Code (OCC Remand Ex. 2 at 21-22). OCC and OPAE also note that allowing the Companies to recover lost off-system sales opportunities would be contrary to the ESP Order,[16] as well as the Commission's recent order reviewing the Companies' annual earnings,[17] in which the Commission found that off-system sales were irrelevant.

IEU-Ohio witness Murray testified that AEP-Ohio may have a negative financial risk if the cost of serving a returning customer is greater than the fixed cost of serving that customer that is already embedded in the SSO rate (IEU-Ohio Remand Ex. 2 at 7). IEU-Ohio argues, however, that the Companies failed to offer any evidence that their current SSO rates do not already compensate the Companies for the fixed costs associated with their POLR obligation. According to IEU-Ohio, the Companies cannot likely make such a showing because the fixed costs of capacity were known when the Companies sought their current SSO rates (OCC Remand Ex. 1 at 13-14; Remand Tr. II at 223-223). Additionally, IEU-Ohio disputes the Companies' claim that the value of the option equals the POLR cost to the Companies. IEU-Ohio witness Lesser testified that it is a false assumption that value to a customer is exactly equal to the cost to AEP-Ohio (IEU-Ohio Remand Ex. 1 at

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16 ESP Order at 17.

17 *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code*, Case No. 10-1261-EL-UNC, Opinion and Order (January 11, 2011), at 30.

12-15). IEU-Ohio contends that only if lost revenues are costs can the argument be made that there may be some equality between value and cost, and lost revenues are not recoverable as part of the Companies' POLR obligation.

Constellation also argues that lost opportunity costs are not properly included in a POLR charge, given that AEP-Ohio is not entitled to revenue from a set amount of sales. Constellation witness Fein testified that other EDUs in Ohio and other jurisdictions do not recover lost opportunity costs (Constellation Remand Ex. 1 at 11-13). Further, Constellation points out that AEP-Ohio has conducted no study to show that the purported benefit to customers is equal to the cost to the Companies.

ii. Conclusion

In the ESP Order, the Commission stated that it "believes that the Companies do have some risks associated with customers switching to CRES providers and returning to the electric utility's SSO rate at the conclusion of CRES contracts or during times of rising prices."[18] We continue to believe that the Companies have such risks and that the costs associated with such risks may be recovered through a POLR charge. The Commission is concerned, however, that AEP-Ohio has not properly valued its POLR costs or adhered to the clear directive from the Supreme Court of Ohio. The Court afforded two avenues for consideration of AEP-Ohio's POLR charges on remand, stating that "the [C]ommission may consider on remand whether a non-cost-based POLR charge is reasonable and lawful. Alternatively, the [C]ommission may consider whether it is appropriate to allow [AEP-Ohio] to present evidence of its actual POLR costs."[19]

AEP-Ohio has advocated its belief throughout the remand proceedings that its POLR charges are indeed based on cost, leaving the Commission to pursue the latter of the two approaches sanctioned by the Court (*i.e.*, consideration of whether the Companies have presented evidence of their actual POLR costs).[20] Upon review of the record, it is clear that the Companies have not presented any evidence of their actual, out-of-pocket POLR costs (Remand Tr. I at 17-18, 37-38; Remand Tr. II at 152-153, 237-238, 244-247; OCC

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18 ESP Order at 40.

19 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

20 Although AEP-Ohio has asserted throughout these remand proceedings that its POLR charges are cost-based, AEP-Ohio suggests, for the first time in a single section of its brief, that the charges can be justified alternatively on a non-cost basis. The Companies contend that non-cost-based POLR charges are lawful pursuant to Section 4928.143(B)(2)(d), Revised Code. However, the Companies offered no evidence to demonstrate that their POLR charges, if considered non-cost-based, are reasonable, as required by the Court. The Companies' reference on brief to their exposure to market risk is not by itself sufficient to justify the proposed POLR charge as a non-cost based charge. *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519. The Companies' belated argument that their POLR charges can be justified alternatively on a non-cost basis will, therefore, not be addressed further in this order.

Remand Ex. 1 at 36-37; OCC Remand Ex. 2 at 22; IEU-Ohio Remand Ex. 1 at 34; IEU-Ohio Remand Ex. 2 at 4-5; Constellation Remand Ex. 1 at 14). Rather, the Companies' claimed POLR costs are derived from an *ex ante* valuation of the benefit that customers are afforded by their option to shop for an alternative supplier (Cos. Remand Ex. 3 at 12-13; Cos. Remand Ex. 8 at 2-4). In simple terms, AEP-Ohio equates the value of the option with the benefit to the customer, which, in turn, the Companies equate with their costs (Cos. Remand Ex. 1 at 4; Cos. Remand Ex. 3 at 12; Remand Tr. I at 38; Remand Tr. II at 242, 260; Remand Tr. V at 706-707). Describing their costs in terms of lost revenues or a diminution of shareholder equity (Cos. Remand Ex. 1 at 5; Cos. Remand Ex. 3 at 5; Cos. Remand Ex. 5 at 6), the Companies contend that they have now sufficiently demonstrated that the value of the POLR optionality to their customers is precisely equal to the cost to the Companies of providing the POLR optionality.

The Companies' theory, however, has been directly refuted by OCC witness Thompson and IEU-Ohio witness Lesser (OCC Remand Ex. 1 at 37; IEU-Ohio Remand Ex. 1 at 12-15) and questioned by other intervenors and Staff. Further, no empirical evidence was offered by the Companies in support of their theory. Although Companies witness Makhija testified that the Companies' POLR costs would be reflected as a diminution of equity, neither Dr. Makhija nor any other witness provided the Companies' books or any other evidence in support of Dr. Makhija's theory (Remand Tr. I at 20, 45-46). Similarly, Companies witness LaCasse, as well as Dr. Makhija, spoke of the Companies' costs in terms of lost revenues, but provided no evidence of any revenues that the Companies actually lost (Remand Tr. II at 221). Instead, AEP-Ohio put forth the very same modeled or "formula-based" costs that were rejected by the Court. The Companies apparently equate modeled costs, which by definition provide a simulation or representation, with actual costs. We do not agree with the Companies on this point. Although actual costs may encompass more than just out-of-pocket costs, they must reflect some definite and concrete component that is able to be quantified and verified through the Companies' books, records, receipts, or other tangible documentation.

The Companies insist that an *ex post* determination of their POLR costs would be a "speculative re-enactment" and that their POLR risk should be assessed at the outset of the ESP term, which is when the risk is incurred (Cos. Remand Ex. 3 at 12-13; Cos. Remand Ex. 8 at 2-4). Under the present circumstances, where these proceedings were remanded to the Commission in the third and final year of the ESP, the Commission believes that it would have been reasonable for AEP-Ohio to undertake an *ex post* analysis of its POLR costs. Such an analysis would have enabled the Commission to compare the projected results of the Companies' option model with their actual costs incurred to date, a comparison that would have been highly useful in ensuring that customers are not paying unwarranted POLR charges. In the absence of such a comparison, AEP-Ohio has neglected to alleviate the Court's concern that "[a]t the very least, all this evidence raises

doubts about the proposition that [AEP-Ohio] would justifiably expend $500 million to bear the POLR risk."[21] Upon review of the record on remand, the Commission shares this concern. We conclude that AEP-Ohio has failed to present evidence of its actual POLR costs and has not justified recovery of POLR charges at the level reflected in its existing rates.

c. Option Valuation Methodology

i. Arguments

Throughout these proceedings, AEP-Ohio has contended that modeling is a reasonable economic tool for the Commission to use as a basis for determining POLR costs. In their application, the Companies quantified their POLR costs by calculating the value of the POLR optionality using the Black-Scholes model, which is an economic model used to value stock and other spot options (Cos. Remand Ex. 4 at 12; IEU-Ohio Remand Ex. 1 at 5-6, 7). The inputs to the model consisted of the Companies' proposed first-year ESP price as the strike price; the then current competitive benchmark price as the market price; the three-year ESP term as the term of the option; the London Interbank Offered Rate (LIBOR) as the risk-free interest rate; and a measure of annual average volatility, based on historical data, as the volatility.[22] As originally proposed, the Companies' option model did not incorporate the shopping rules contained in their tariffs and is thus now referred to as the unconstrained option model. Since 2008, the Companies have developed a constrained option model, which incorporates the shopping rules, utilizes ESP prices that change over the ESP term, and reflects the fact that customers essentially receive a series of options to buy SSO generation service at the ESP price during the ESP term. The constrained option model is based on the Black model, which is used to value options on futures contracts. (Cos. Remand Ex. 3 at 16-17; Cos. Remand Ex. 4 at 12, 13; IEU-Ohio Remand Ex. 1 at 10.)

Companies witness Thomas used the constrained option model, including updated inputs to incorporate the SSO rates approved by the Commission and the decreased market prices occurring between the time of the Companies' application and the ESP Order, to determine the Companies' POLR costs during the ESP term. AEP-Ohio asserts that the results of the constrained option model are comparable to the conservative results of the unconstrained option model. (Cos. Remand Ex. 4 at 15-16.)

Companies witness LaCasse reviewed both models and found that option valuation as a methodology for determining costs associated with shopping-related risks is

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21 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

22 ESP Order at 38-39.

conceptually valid. She further found that certain aspects of the unconstrained option model tended to either understate or overstate the Companies' POLR charges. She explained that, in the constrained option model, only the factors tending to overstate the POLR charges were corrected for the most part. Dr. LaCasse concluded that the results of the constrained option model are apparently conservative estimates of the Companies' POLR costs. (Cos. Remand Ex. 3 at 18.) On rebuttal, Dr. LaCasse presented the results of a Monte Carlo model, using the same basic inputs used in the constrained option model, as an alternative to option valuation. She concluded that the results of the Monte Carlo model support the reasonableness of the results derived from the constrained option model. Although the results from the Monte Carlo model are approximately 80 percent of the constrained model results, Dr. LaCasse explained that the decision-making process of the customer that the Monte Carlo model assumes tends to understate the Companies' POLR costs as compared to the constrained option model, which considers the possible future customer movements that may occur. (Cos. Remand Ex. 5 at 7-11.)

According to the Companies, the results of the constrained option model and the Monte Carlo model support the reasonableness of the results of the unconstrained option model, which, in turn, should be used as the basis for approval of their existing POLR charges. AEP-Ohio also notes that the Commission has already approved its application of the unconstrained option model to measure its POLR costs. The Companies assert that this aspect of the ESP Order was not challenged by any party on rehearing or appeal and is thus a final order of the Commission.

The intervenors and Staff identify numerous problems with AEP-Ohio's option valuation methodology. For their part, OCC and OPAE argue that the Companies' option model assumes that every customer will switch for a penny differential in generation price and ignores numerous non-price and other price considerations, such as transaction costs, that determine customer switching (OCC Remand Ex. 1 at 20; Remand Tr. I at 27-29; Remand Tr. II at 167; Remand Tr. V at 859), which overstates the results. OCC and OPAE further contend that AEP-Ohio made significant errors in its volatility and date assumptions, which, if corrected, would reduce the POLR charges by at least 80 percent and possibly to zero (OCC Remand Ex. 1 at 28-36). Because the model predicts lost revenues (Remand Tr. II at 143-144), OCC and OPAE argue that it does not measure true POLR costs, being the costs to provide incremental energy and capacity to returning customers beyond what is already collected in SSO rates (OCC Remand Ex. 1 at 21-22). They further assert that the model fails to reflect the value of the POLR optionality to customers, because it wrongly assumes that the SSO price is fixed and does not account for the variable nature of the FAC and other riders (OCC Remand Ex. 1 at 22). OCC and OPAE point out that the model overstates lost revenues in that it does not account for restrictions on the Companies with respect to off-system energy and capacity sales (OCC Remand Ex. 1 at 25-27). Finally, they argue that AEP-Ohio is already fully compensated

for its POLR obligation because its incremental energy and capacity costs are recovered through the FAC (OCC Remand Ex. 1 at 12-14).

IEU-Ohio contends that the Companies' implementation of the option model is flawed because it measures, if anything, lost revenues rather than costs (Cos. Remand Ex. 3 at 12); overstates the lost revenues because it fails to account for capacity payments from CRES providers (IEU-Ohio Remand Ex. 2 at 15-19); and fails to satisfy the necessary assumptions on which the Black-Scholes model is based (IEU-Ohio Remand Ex. 1 at 18-25). Specifically, IEU-Ohio notes that the Black-Scholes model assumes that markets are perfect with no transaction costs; customers are perfectly rational and will act on any price advantage, even a difference of one cent; price volatility is constant; the strike price is constant; returns are lognormally distributed; and the option can be exercised only on its expiration date. IEU-Ohio argues that none of these assumptions holds true in the context within which the Companies have used the model and concludes that the Black-Scholes model simply was not designed to estimate the cost of the risk assumed by the seller of an option. (IEU-Ohio Remand Ex. 1 at 18-25.)

OMA and OHA argue that AEP-Ohio's use of what is effectively a non-cost-based option model is fundamentally inappropriate, unreasonable, and unlawful because it ignores the Companies' actual, small shopping numbers (Cos. Remand Ex. 4 at Ex. LJT-2); it is not used for the purpose to which it was put (Remand Tr. II at 286-287); and, even assuming that it truly measures the value of shopping to customers, the measurement of value by way of a mathematical formula is not a proper basis for establishing charges in utility regulation.

Constellation contends that the Commission should reject the Companies' unconstrained option model as it is based on the unsupported premise that the value of a customer's option to shop equals the POLR cost to the Companies. Additionally, Constellation argues that neither the Black-Scholes model nor the Black model has been shown to be a generally accepted method for determining POLR costs and, regardless, the inputs used by the Companies are inappropriate. Constellation notes that these models were designed to value stock options, not customer options related to competitive retail electric generation, and that AEP-Ohio knows of no other utility or state regulatory agency that uses them to establish POLR charges (IEU-Ohio Remand Ex. 1 at 7-10; Remand Tr. II at 286-287). Constellation further points out that AEP-Ohio admits that there are numerous non-cost factors that were not modeled even though these factors affect the value of the option to shop (Cos. Remand Ex. 8 at 6; Remand Tr. V at 837-838).

Staff notes that it has general concerns with the model used by the Companies. In addition, with respect to the inputs used by the Companies, Staff asserts that the interest rate, market price volatility, and option term inputs are likely to result in an overstated

option value and, therefore, recommends that adjustments be made to these inputs such that the Companies' POLR charges would be lower, if the Commission initially determines that use of the model is reasonable (Staff Remand Ex. 1 at 2-4). Constellation agrees with Staff that the volatility input should be reduced by 20 percent as an adjustment to the capacity component of the market price (Staff Remand Ex. 1 at 3). IEU-Ohio also contends that the volatility input is overstated (IEU-Ohio Remand Ex. 1 at 26-30).

Numerous parties, including IEU-Ohio, OMA, OHA, and Constellation, dispute AEP-Ohio's claim that it would be inappropriate to compare modeled results with actual shopping levels during the ESP term. They note that AEP-Ohio has made no attempt, by way of a study or any other means, to compare modeled and actual results (Remand Tr. II at 221). OMA, OHA, and Constellation argue that the Companies should have used these remand proceedings as an opportunity to compare projected and actual results, but instead elected to present a second time the results of the same option model that was criticized by the Court. OMA and OHA further note that it is thus unreasonable to use the results of the constrained option model to corroborate the results of the unconstrained option model. OCC, OPAE, and IEU-Ohio add that the constrained option model suffers from most of the same problems as the unconstrained option model and that it makes no sense to compare the results of two flawed models. OMA, OHA, and Constellation question the testimony of Companies witness LaCasse in support of the Companies' option model, given that she had not used the Black-Scholes model prior to these proceedings nor had she used an option model to price shopping-related risks (Remand Tr. II at 149-150). Constellation concludes that AEP-Ohio has failed to verify empirically the model's use in this context and that the Companies' witnesses are not qualified to determine appropriate inputs.

IEU-Ohio agrees that the results of the Companies' model are unverified, given that the constrained option model suffers from the same flaws as the unconstrained option model. Additionally, IEU-Ohio contends that the analyses of SSO auction results cited by Companies witness LaCasse incorporated much more than POLR risk (Cos. Remand Ex. 3 at 18-20), making a true comparison with the Companies' POLR charges difficult. With respect to the Monte Carlo model used by Dr. LaCasse, IEU-Ohio argues that, like the Black-Scholes model, the Monte Carlo model fails to measure the cost to stand ready to serve returning customers (Cos. Remand Ex. 5 at 9). IEU-Ohio further notes that the Monte Carlo model was not verified against the actual customer switching that occurred and that the Companies failed to demonstrate that the model was verified or tested in any way (Remand Tr. V at 694-698, 699-700).

ii. Conclusion

In the ESP Order, the Commission modified and approved AEP-Ohio's quantification of its POLR costs based on the Black-Scholes or unconstrained option model.[23] As an initial matter, the Companies point out that the Commission has already approved their use of the unconstrained option model as a means to determine their POLR costs. However, the issue of the Commission's approval of the Companies' POLR charges was appealed to the Supreme Court of Ohio, which then specifically questioned the Companies' use of the Black-Scholes model to determine their POLR costs. Finding an absence of record support, the Court reversed the provisions of the ESP Order that authorized the POLR charges,[24] which would include those pertaining to the Black-Scholes or unconstrained option model. Therefore, we find it appropriate to review on remand the Companies' use of the unconstrained option model to measure their POLR costs.

Upon review of the record, and in light of the Court's decision, the Commission finds that the unconstrained option model fails to provide a reasonable measure of the Companies' POLR costs. The Court found that AEP-Ohio's unconstrained option model does not reveal the Companies' POLR costs, but rather purports to measure the value of the POLR optionality provided to customers.[25] The Court specifically determined that value to customers and cost to AEP-Ohio are not the same thing.[26] The Companies have nevertheless asserted that very same argument on remand, contending that the Court did not understand that the model objectively measures the value of the POLR optionality, rather than subjectively determines how much a customer would be willing to pay for the right to shop. Regardless, we agree with the Court that the model simply does not measure POLR costs.

As discussed above, AEP-Ohio maintains that the value of the option or benefit to the customer is equal to its costs (Cos. Remand Ex. 1 at 4; Cos. Remand Ex. 3 at 12; Remand Tr. I at 38; Remand Tr. II at 242, 260; Remand Tr. V at 706-707). Having already been rejected by the Court, this argument that the option value is exactly the same as the cost to the Companies was further discredited by the intervenors during the remand proceedings (OCC Remand Ex. 1 at 37; IEU-Ohio Remand Ex. 1 at 12-15). As we agree with the Court and intervenors that the value to customers does not equal the Companies' costs, we find that the unconstrained option model, which measures the value of the POLR optionality to customers (Cos. Remand Ex. 3 at 12; Cos. Remand Ex. 4 at 10; Remand Tr. I at 38), cannot also measure the Companies' costs. Additionally, even assuming that the

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23 ESP Order at 38-40; First EOR at 26.

24 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

25 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518.

26 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518.

results of the model do truly calculate the Companies' POLR costs, we are concerned that several of the inputs, particularly the interest rate, market price volatility, and option term, may result in an overstated option value, as noted by Staff and others (Staff Remand Ex. 1 at 2-4; OCC Remand Ex. 1 at 28-30; IEU-Ohio Remand Ex. 1 at 26-30).

The Commission further adds that, although modeling may be appropriate in certain contexts (*e.g.*, rate of return analysis), we question its use to predict costs that are readily measurable and verifiable through more reliable means. As the record reflects, POLR costs may be determined in numerous ways, such as hedging, competitive bidding, or an after-the-fact calculation of any incremental energy and capacity costs incurred to serve returning customers (Remand Tr. I at 44-45, 56; Cos. Remand Ex. 3 at 8-9, 11; Remand Tr. II at 144-145; IEU-Ohio Remand Ex. 1 at 31-34; IEU-Ohio Remand Ex. 2 at 8-9; Remand Tr. IV at 577-579). The Companies have pursued none of these options and instead have elected to present again the results of their unconstrained option model, as purportedly backed by the results of the constrained option model and the Monte Carlo analysis performed by Companies witness LaCasse. Given our finding that the unconstrained option model fails to measure AEP-Ohio's POLR costs and our reluctance to apply modeling in this context, we are not persuaded that the results of the constrained option model or the Monte Carlo model support the reasonableness of the results of the unconstrained option model.

As previously discussed, the Commission shares the concern of the intervenors that AEP-Ohio has made no attempt to compare the results of its unconstrained option model with its actual costs incurred over the ESP term to date based on actual shopping levels (Cos. Remand Ex. 8 at 2-4; Remand Tr. II at 221). The Court specifically addressed the lack of shopping in the Companies' service territories as a reason to "call into question the accuracy of [AEP-Ohio's] POLR theory."[27] Although shopping levels appear to have increased somewhat throughout the ESP term, at least for CSP (Cos. Remand Ex. 4 at 8-9, Ex. LJT-2; Remand Tr. II at 299-300; IEU-Ohio Remand Ex. 6 at 31), the level of shopping is still sufficiently small enough to cast "doubts about the proposition that [AEP-Ohio] would justifiably expend $500 million to bear the POLR risk."[28] In any event, AEP-Ohio has not offered any evidence that its modeled costs bear any relation to any actual costs incurred due to shopping.

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

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

d. POLR Risk

i. Arguments

In the ESP Order, two types of POLR risks were addressed, namely the risk associated with customers switching to a CRES provider (migration risk) and the risk related to customers returning to the EDU's SSO rates from service with a CRES provider (return risk).[29] The Commission found that the return risk may be mitigated "by requiring customers that switch to an alternative supplier (either through a governmental aggregation or individual CRES providers) to agree to return to market price, and pay market price, if they return to the electric utility after taking service from a CRES provider, for the remaining period of the ESP term or until the customer switches to another alternative supplier." The Commission determined that such customers would thereby avoid the POLR charge. Regarding the migration risk, the Commission accepted the quantification of Companies witness Baker that such risk comprises 90 percent of the Companies' estimated POLR costs and modified the Companies' proposed POLR revenue requirements on that basis. On remand, Companies witness Thomas testified that she had not determined what the Companies' POLR costs would be, if the portion attributable to migration risk were removed (Remand Tr. V at 884).

AEP-Ohio notes that the Commission's determination regarding migration risk was not at issue on appeal and thus is not properly before the Commission at this time. AEP-Ohio asserts that the issue before the Commission is the appropriate level for the Companies' POLR charges and not whether there should be a POLR charge or whether such charge should compensate for migration risk. AEP-Ohio claims that nothing in the Supreme Court's decision redefined the POLR obligation to exclude migration risk.

AEP-Ohio further contends that its migration risk is different than the competitive risk of customer mobility shared by all providers. Due to its statutory POLR obligation, AEP-Ohio contends that its migration risk is unique in that customers may switch to a CRES provider when the market price falls below the SSO rate, leaving the Companies to sell electricity that they were required to have available to satisfy their SSO obligation at the reduced market price rather than the SSO rate.

AEP-Ohio also notes that the migration risk exists due to the fact that customers can switch; it is not based on whether they in fact exercise their right to switch. Regardless, AEP-Ohio contends that shopping levels have increased substantially for the Companies during the term of the ESP, which the Companies cite as additional evidence that they incur substantial risk (Cos. Remand Ex. 4 at 8-9).

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29 ESP Order at 38-40.

Many of the intervenors and Staff argue that migration risk is a business risk that is not unique to AEP-Ohio and that compensating the Companies for this risk disadvantages other market participants to the detriment of the competitive market and retail choice. Staff, OCC, OPAE, IEU-Ohio, and Constellation point out that the Court has referred to the POLR obligation as the "obligation to stand ready to accept returning customers"[30] and, therefore, they argue that migration risk is not part of the Companies' POLR obligation. Staff agrees with IEU-Ohio witness Lesser that migration risk exists for all suppliers operating in a competitive market (IEU-Ohio Remand Ex. 1 at 13). According to Staff, only the return risk is unique to the POLR obligation and thus comprises the POLR risk. Noting that migration risk constitutes 90 percent of the Companies' estimated POLR costs as originally proposed in their application, Staff contends that the Companies' option model significantly overstates their POLR costs.

Constellation notes that the risk that AEP-Ohio will not be able to sell generation at a price that is at or above the SSO price due to customer migration is a competitive generation risk and is not related to the non-competitive POLR obligation. Constellation argues that only approximately 10 percent of the value of shopping may legally be attributed to POLR risk and that the remaining 90 percent is attributable to migration risk and lost opportunity costs, which is not legally supported and constitutes an anticompetitive subsidy.

OCC, OPAE, and IEU-Ohio add that recognizing migration risk as part of the Companies' POLR costs would run afoul of Section 4928.38, Revised Code, as it would allow them to recover, after the market development period, revenues that would not be available due to competition, which would effectively be transition revenues. IEU-Ohio witness Lesser notes that the time for recovering losses due to competition has past (IEU-Ohio Remand Ex. 1 at 12-13; Remand Tr. III at 337).

ii. Conclusion

As discussed above, the Court reversed the provisions of the ESP Order that authorized the Companies' POLR charges,[31] which would include the portion of the ESP Order that addresses migration risk, which was the basis for the charges. Therefore, the Commission finds, as an initial matter, that it is appropriate to consider the issue of migration risk on remand. Having reviewed the arguments of the parties, as well as the Court's precedent regarding the POLR obligation, we find that migration risk is more properly regarded as a business risk faced by all retail suppliers as a result of competition

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30 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 517.

31 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

rather than a risk resulting from an EDU's POLR obligation. We find the arguments of the intervenors and Staff on this issue to be persuasive, recognizing that migration risk exists for any supplier, whether CRES provider or EDU, that operates in the competitive generation market. Thus, compensation for migration risk by means of an EDU's POLR charge would provide an advantage over its CRES competitors. Although the Companies may suffer lost revenues as a result of customer switching, the same is true for all suppliers competing in the market. The risk of lost revenues due to customer migration is simply not a risk derived from an EDU's POLR obligation. (OCC Remand Ex. 1 at 8-12; IEU-Ohio Remand Ex. 1 at 12-13.) We agree that the return risk, however, is unique to EDUs, which must be ready to serve customers returning to SSO service from another supplier, pursuant to their statutory obligation.

Our conclusion that migration risk, although a real risk, is not a risk directly resulting from AEP-Ohio's POLR obligation is consistent with the Court's precedent. The Court defines POLR costs as "those costs incurred by [the EDU] for risks associated with its legal obligation as the default provider, or electricity provider, of last resort, for customers who shop and then return to [the EDU] for generation service."[32] Recently, the Court reaffirmed that "POLR charges compensate utilities for standing ready to serve 'customers who shop and then return,'"[33] and, in these very cases, described the POLR obligation as the "obligation to stand ready to accept returning customers."[34] These cases confirm that migration risk alone is not uniquely associated with the POLR obligation. Rather, it is the customer's subsequent return that imposes the POLR risk and attendant costs.

e. Bypassability of POLR Charge

i. Arguments

In the ESP Order, the Commission stated:

> As noted by several intervenors and Staff, the risk of returning customers may be mitigated, not eliminated, by requiring customers that switch to an alternative supplier (either through a governmental aggregation or individual CRES providers) to agree to return to market price, and pay market price, if they return to the electric utility after taking service from a CRES provider, for the remaining period of the ESP term or until the

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32 *Constellation NewEnergy, Inc. v. Pub. Util. Comm.* (2004), 104 Ohio St.3d 530, 539 n.5.

33 *In re Application of Ormet Primary Aluminum Corp.* (2011), 129 Ohio St.3d 9, 11, *quoting Constellation NewEnergy, Inc. v. Pub. Util. Comm.* (2004), 104 Ohio St.3d 530, 539 n.5.

34 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 517.

customer switches to another alternative supplier. In exchange for this commitment, those customers shall avoid paying the POLR charge.[35]

Constellation contends that the Companies' POLR charges are contrary to the ESP Order in that they are essentially nonbypassable. Constellation asserts that AEP-Ohio has led shopping customers to believe that, by waiving the POLR charge, they must indefinitely pay market rates upon return to the Companies, rather than until the end of the ESP term (Remand Tr. II at 296). Constellation points out that Companies witness Thomas characterizes the POLR charge as nonbypassable; admits that customers are only given information regarding waiver of the charge upon request; and testified that 98 percent of customers have elected not to waive the charge (Cos. Remand Ex. 4 at 5, 7-8; Remand Tr. II at 247-248). If AEP-Ohio is permitted to continue to collect POLR costs, Constellation argues that the Companies should inform their shopping customers that they may elect to waive POLR charges and still obtain SSO rates if they return to the Companies after the initial ESP term has ended. AEP-Ohio responds that the existing POLR charge is bypassable at the customer's option and that Constellation has not shown that AEP-Ohio is inappropriately implementing the ESP Order with respect to the customer's right to waive the POLR charge.

ii. Conclusion

In light of our decision in this order on remand, that the POLR charges are not supported by the record, Constellation's arguments on this issue are moot, as customers will return to the Companies' service at the standard service offer rate for the remainder of the term of this ESP.

4. Overall Conclusion on POLR Rider

In sum, the Commission concludes that AEP-Ohio has not provided any evidence of its actual POLR costs, the unconstrained option model does not measure POLR costs, and migration risk is not properly part of a POLR charge. In accordance with the Court's decision, we thus find that AEP-Ohio's increased POLR charges authorized as a part of the ESP Order are insufficiently supported by the record on remand. Accordingly, the Commission finds that AEP-Ohio should back out the amount of the POLR charges authorized in the ESP Order and file revised tariffs, consistent with this order on remand. The effective date of the new tariffs should be the date of this order, or the date upon which four complete, printed copies of the final tariffs are filed with the Commission, whichever date is later.

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35 ESP Order at 40.

The Commission further directs the Companies to refund the amount of the POLR charges which have been collected subject to refund since the first billing cycle in June 2011, to customers by applying that amount, as determined in this order, first to any deferrals in the FAC accounts on the Companies' books as of the date of this order, with any remaining balance to be credited to customers on a per kilowatt hour basis beginning with the first billing cycle in November 2011 and coinciding with the end of the current ESP period.

The Commission's May 25, 2011, entry stated that "if the Commission ultimately determines in the remand proceeding that any environmental or POLR charges are to be refunded to AEP-Ohio customers, interest may be imposed on the amounts collected." The Commission further stated that the "parties may address ... the rate of interest charges applicable, if any." During the remand proceedings, AEP-Ohio testified that the minimum interest rate of three percent applied to customer deposits, as set forth in Rule 4901:1-17-05, O.A.C., would be appropriate (Cos. Remand Ex. 2 at 5).

OCC and OPAE contend that the interest rate should be 10.93 percent, which is equivalent to the interest rate used to calculate AEP-Ohio's carrying costs on the FAC deferral balance (OCC Remand Ex. 2 at 29-30). OCC and OPAE note that even the Companies' tariffs provide for an interest rate on customer deposits of five percent or more (Remand Tr. I at 86-87). They argue that Rule 4901:1-14-05, O.A.C., is more comparable to the present circumstances than the rule cited by the Companies. Rule 4901:1-14-05, O.A.C., provides for an interest rate of 10 percent on adjustments to a gas utility's gas cost recovery rate that are ordered by the Commission following a hearing.

Where the Commission authorizes the creation of a regulatory asset including carrying charges, such charges are typically based on the utility's cost of long-term debt. We find that this practice is equally applicable in the converse situation presented here. Therefore, the amount of the POLR charges to be refunded to customers by the Companies should include interest at the rate equal to the Companies' long-term cost of debt commencing with the June 2011 billing cycle until all the charges subject to refund are returned.

C. Flow-Through Effects of Remand

The ESP Order authorized a phase-in of the Companies' ESP rates during the term of the ESP by deferring a portion of the annual incremental FAC costs such that the amount of the incremental FAC expense to be recovered from customers would be limited so as not to exceed certain percentage increases on a total bill basis.[36]

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[36] ESP Order at 20-24.

OCC, OPAE, and IEU-Ohio argue that AEP-Ohio should adjust the FAC deferral balance associated with the phase-in to address, on a prospective basis, the unjustified POLR and environmental carrying charges collected from April 2009 through May 2011 (*i.e.*, from the beginning of the ESP term through the point at which the charges became subject to refund). They argue that the amount of deferred FAC expenses to be collected from customers from 2012 through 2018 should be recalculated consistent with the outcome of the remand proceedings (OCC Remand Ex. 1 at 6, 38; OCC Remand Ex. 2 at 5-6, 23-28; IEU-Ohio Remand Ex. 3 at 9-11). Citing Ohio Supreme Court precedent,[37] OCC and OPAE assert that there is no violation of the prohibition against retroactive ratemaking addressed by the Court in *Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co.* (1957), 166 Ohio St. 254, where there is a mechanism built into rates that allows for prospective rate adjustments. IEU-Ohio maintains that the amount of the phase-in must be just and reasonable, pursuant to Section 4928.144, Revised Code. IEU-Ohio also contends that there are other areas in which the Commission should address the effects of the remand, such as AEP-Ohio's recovery of delta and Universal Service Fund revenues; the significantly excessive earnings test of Section 4928.143(F), Revised Code; and the Companies' pending ESP application in Case No. 11-346-EL-SSO, *et al.*

AEP-Ohio responds that attempts to expand the narrow scope of the remand proceedings should be rejected. The Companies contend that the scope of the remand proceedings is governed by the Court's remand instructions and that the Commission may not consider issues, such as flow-through effects, that were not remanded by the Court. Relying on the Court's decision in these cases and others,[38] AEP-Ohio further argues that the position of OCC, OPAE, and IEU-Ohio on flow-through effects is contrary to the prohibition against retroactive ratemaking and refunds. The Companies assert that OCC, OPAE, and IEU-Ohio seek to adjust previously approved rates on a retroactive basis by providing a future credit to customers and that the Commission lacks the authority to order such a credit. AEP-Ohio maintains that the exclusive remedy for a purportedly unlawful rate increase is to seek a stay and post a bond pursuant to Section 4903.16, Revised Code, and notes that no intervenor elected to pursue this option. According to the Companies, an adjustment to the calculation of FAC costs, which were incurred and deferred during the ESP term, so as to deny recovery of revenue that the Commission previously authorized to be collected from 2012 through 2018 would constitute retroactive ratemaking; violate Section 4928.144, Revised Code; and be contrary to the ESP Order.

The Commission finds that the proposed adjustment to the FAC deferral balance, as recommended by OCC, OPAE, and IEU-Ohio, would be tantamount to unlawful

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[37] *Lucas County Com'rs v. Pub. Util. Comm.* (1997), 80 Ohio St.3d 344, 348-349; *Columbus S. Power Co. v. Pub. Util. Comm.* (1993), 67 Ohio St.3d 535, 541.

[38] *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 516-517; *Lucas County Com'rs v. Pub. Util. Comm.* (1997), 80 Ohio St.3d 344, 348-349.

retroactive ratemaking. In the ESP Order, we authorized AEP-Ohio to defer any FAC amount over the allowable total bill increase percentage levels pursuant to Section 4928.144, Revised Code, and directed that any deferred FAC expense balance remaining at the end of 2011 is to be recovered via an unavoidable surcharge from 2012 to 2018.[39] The Commission agrees with AEP-Ohio that an adjustment to the FAC deferral balance, which we previously authorized to be collected as a means to recover the Companies' actual fuel expenses incurred plus carrying costs, would be contrary to the Court's prohibition against retroactive ratemaking and refunds.[40] Although OCC, OPAE, and IEU-Ohio characterize their proposed adjustment as a prospective offset to amounts deferred for future collection, they essentially ask the Commission to provide customers with a refund to account for the Companies' past POLR and environmental carrying charges, which were collected from April 2009 through May 2011. Consistent with the Court's precedent, we cannot order a prospective adjustment to account for past rates that have already been collected from customers and subsequently found to be unjustified. The Commission likewise disagrees with IEU-Ohio's contention that there are other areas in which we should similarly address the purported flow-through effects of the Court's remand.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

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

(2) On July 31, 2008, AEP-Ohio filed an application for an SSO in accordance with Section 4928.141, Revised Code. AEP-Ohio's application was filed pursuant to Section 4928.143, Revised Code, which authorizes the electric utilities to file an ESP as their SSO.

(3) On March 18, 2009, the Commission issued its opinion and order regarding AEP-Ohio's ESP application. Following entries on rehearing, the Commission's decision was appealed to the Supreme Court of Ohio.

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39 ESP Order at 22-23.

40 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 516 (stating that "the law does not allow refunds in appeals from [C]ommission orders"); *Ohio Consumers' Counsel v. Pub. Util. Comm.* (2009), 121 Ohio St.3d 362, 367 (noting that "any refund order would be contrary to our precedent declining to engage in retroactive ratemaking"); *Lucas County Com'rs v. Pub. Util. Comm.* (1997), 80 Ohio St.3d 344, 348 (determining that "utility ratemaking by the Public Utilities Commission is prospective only").

(4) On April 19, 2011, the Court issued an opinion in *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, remanding these cases back to the Commission on two grounds.

(5) A hearing on remand commenced on July 15, 2011, and concluded on July 28, 2011, for the purpose of gathering such additional evidence as might be necessary to comply with the Court's remand order. Five witnesses testified on behalf of AEP-Ohio, six witnesses testified on behalf of various intervenors, and one witness testified on behalf of Staff.

(6) Briefs and reply briefs were filed on August 5, 2011, and August 12, 2011, respectively.

(7) Sections 4928.143(B)(1), and 4928.143(B)(2)(d), Revised Code, authorize the Companies' recovery of incremental capital carrying costs that are incurred after January 1, 2009, on past environmental investments (2001-2008) that were not previously reflected in the Companies' existing rates prior to the ESP.

(8) On remand, the Ohio Supreme Court directed the Commission to consider evidence of a cost-based POLR charge or to determine whether a non-cost based POLR charge is reasonable and lawful.

(9) AEP-Ohio did not demonstrate that its POLR charges requested in the ESP are cost-based nor demonstrate that its non-cost based POLR charges requested in the ESP were reasonable and lawful.

(10) AEP-Ohio's POLR charges, as approved in the ESP Order, are not supported by the record on remand.

(11) AEP-Ohio is directed to refund the POLR charges collected subject to refund since the first billing cycle in June 2011 by first applying that amount to any deferrals in the FAC accounts on each Companies' books as of the date of this order, with any remaining balance to be credited to customers on a per kilowatt hour basis beginning with the first billing cycle in November 2011 and coinciding with the end of the current ESP period.

(12) The proposed ESP, as modified by this order on remand, including its pricing and all other terms and conditions, including deferrals and future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142, Revised Code.

ORDER:

It is, therefore,

ORDERED, That IEU-Ohio's motion to dismiss these cases be denied. It is, further,

ORDERED, That FES' motion for leave to file an *amicus curiae* brief be denied. It is, further,

ORDERED, That the motions of OCC and OPAE to strike certain testimony be denied. It is, further,

ORDERED, That the motions of OCC, OPAE, and IEU-Ohio to strike certain portions of AEP-Ohio's initial and reply briefs be granted to the extent set forth herein. It is, further,

ORDERED, That the Companies' ESP, pursuant to Sections 4928.141 and 4928.143, Revised Code, be modified to the extent set forth herein. It is, further,

ORDERED, That the Companies be authorized to file, in final form, four complete copies of their tariffs, consistent with this order on remand. Each utility shall file one copy in its TRF docket (or may make such filing electronically as directed in Case No. 06-900-AU-WVR) and one copy in these case dockets. The remaining two copies shall be designated for distribution to the Rates and Tariffs, Energy and Water Division, of the Commission's Utilities Department. It is, further,

ORDERED, That the effective date of the new tariffs shall be a date not earlier than the date of this order on remand, or the date upon which four complete, printed copies of the final tariffs are filed with the Commission, whichever date is later. It is, further,

ORDERED, That the Companies notify all affected customers of the changes to the tariffs via bill message or bill insert within 30 days of the effective date of the tariffs. A copy of the customer notice shall be submitted to the Commission's Service Monitoring and Enforcement Department, Reliability and Service Analysis Division, at least 10 days prior to its distribution to customers. It is, further,

ORDERED, That the Companies refund, with interest, the amount of the POLR charges, which has been collected subject to refund since the first billing cycle in June 2011, to customers by applying that amount, as determined in this order, first to any deferrals in the FAC accounts on the Companies' books as of the date of this order, with any remaining balance to be credited to customers on a per kilowatt hour basis beginning with the first billing cycle in November 2011 and coinciding with the end of the current ESP period. It is, further,

ORDERED, That nothing in this order on remand shall be binding upon this Commission in any future proceeding or investigation involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That a copy of this order on remand be served upon all persons of record in these cases.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto see concurring

SJP/GNS/sc

Entered in the Journal

OCT 03 2011

Betty McCauley
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

CONCURRING OPINION OF COMMISSIONER CHERYL L. ROBERTO

I concur in today's decision and write separately only to amplify the analysis upon which I relied to reach these findings of fact and conclusions of law. As I wrote in my concurrence of the Commission Entry on Rehearing in this matter on July 23, 2009 and as I continue to believe today, we are mandated to approve or modify and approve an electric security plan (ESP) when we find that the plan or modified plan, including its pricing and all other terms and conditions, including any deferrals and future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142 of the Revised Code. Section 4928.142(C)(1), Revised Code.

While an ESP may include components described in Section 4928.143(B)(2), Revised Code, nothing in S.B. 221 requires that it be built on a component by component basis. As I observed in my prior concurrence, given that the ESP is not cost-based, focusing on any component in which a cost increase is expected or demonstrated obscures the failure to conduct the corollary examination of components of the base rate in which savings have occurred or in which revenue has increased. Thus, it is not only not useful to use a cost-based component by component basis to evaluate an ESP it is misleading as we are practically limited in our examination of an ESP to the aggregate impact. The Ohio Supreme Court in its remand to us has not suggested that this Commission is required to use a cost-based analysis, merely that if we do we must have a record to support it. To the contrary, the Court has invited the Commission to consider "whether a non-cost-based POLR charge is reasonable and lawful." *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518-519.

Having rejected a cost-based analysis in my concurrence to our original order, I specifically declined to find that Section 4928.13(B)(2)(b), Revised Code, contemplates recovery for pre-January 1, 2009 environmental expenditures or that carrying costs for

environmental expenditures should be accrued at the weighted average cost of capital when there has been no finding that the debt has been prudently incurred taking into account the availability of pollution control funds. I also declined to find as to the provider of last resort cost that the Black Scholes model was appropriate tool to determine a cost-based POLR charge or that an increased risk of migration exists which requires an incremental increase in POLR, as a POLR component was already included within the Companies' existing base rates. Nonetheless, I believed and continue to believe that the test of reasonableness and lawfulness for an ESP is whether in the aggregate the ESP is more favorable than the results otherwise to be expected pursuant to Section 4928.142, Revised Code. Whether characterized as environmental expenditures or a POLR requirement, AEP sought to increase its authorized revenue. This increase in revenue which when combined with revenue from existing rates would result in a particular price for retail electric service. It is this price together with all the terms and conditions of the modified ESP that we must judge to be more favorable in the aggregate than the results otherwise to be expected in order for the modified ESP to be approved.

The Court remanded this matter to the Commission because it found that the Commission majority relied upon a cost-basis for POLR that was unsupported by the record and upon a too expansive reading of Section 4928.143(B)(2), Revised Code. Upon remand, AEP had the opportunity to provide argument and demonstrate within the record that the revenue requirement that it sought was reasonable and lawful. We have found that AEP successfully demonstrated that the environmental costs could be appropriately supported pursuant to divisions (B)(1) and (B)(2)(d) of Section 4928.143, Revised Code. AEP continued to advocate that its POLR charge was cost-based as supported by the Black Scholes model. I concur that it had not on the previous record nor has it on the remand record established the POLR charge to be cost-based. AEP, however, made no argument and offered no record support that, as the Supreme Court invited the Commission to consider, the POLR charges were non-cost-based yet nonetheless reasonable and lawful. As I indicated in my original concurring opinion, I believe that it may have been possible to demonstrate this successfully but having no record or argument before me to support it, I concur with my colleagues that the POLR charge can not be supported.

Cheryl L. Roberto

Cheryl L. Roberto, Commissioner

/dah

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OCT 03 2011

Betty McCauley

Betty McCauley
Secretary

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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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# APPLICATION FOR REHEARING OF ORDER ON REMAND AND MEMORANDUM IN SUPPORT OF INDUSTRIAL ENERGY USERS-OHIO

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**November 2, 2011**

**Attorneys for Industrial Energy Users-Ohio**

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**BEFORE**
**THE PUBLIC UTILITIES COMMISSION OF OHIO**

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**APPLICATION FOR REHEARING OF ORDER ON REMAND OF INDUSTRIAL ENERGY USERS-OHIO**

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Pursuant to Section 4903.10, Revised Code, and Rule 4901-1-35, Ohio Administrative Code ("O.A.C."), Industrial Energy Users-Ohio ("IEU-Ohio") respectfully submits this Application for Rehearing of the Order on Remand issued by the Public Utilities Commission of Ohio ("Commission") on October 3, 2011 concerning the electric security plans ("ESP") of Columbus Southern Power Company and Ohio Power Company (individually "CSP" and "OP," respectively, and collectively "Companies" or "AEP-Ohio"). The Commission's Order on Remand is unlawful and unreasonable in the following respects:

1. The Commission's finding that the Companies may collect revenues for the carrying costs of 2001-2008 incremental environmental investments ("pre-2009 Component") pursuant to Section 4928.143(B)(2)(d), Revised Code, is unlawful and unreasonable because the Companies failed to demonstrate that granting such collection would have the effect of providing certainty regarding retail electric service.

2. The Commission's finding that the Companies may collect revenues for the pre-2009 Component pursuant to Section 4928.143(B)(2)(d), Revised

Code, is unlawful and unreasonable because the Companies failed to demonstrate that their other revenues did not provide adequate compensation.

3. The Commission's authorization of the pre-2009 Component pursuant to Section 4928.143(B)(1), Revised Code, was unlawful and unreasonable in that it is based on a statutory provision that was not advanced by any party to the proceeding and was beyond the scope of the Supreme Court's remand directing the Commission to determine if a provision of Section 4928.143(B)(2), Revised Code, supports collection of these revenues.

4. The Commission unlawfully and unreasonably permitted collection of the pre-2009 Component during a period in which there was no legal authority to permit collection of those revenues.

5. The Commission's Order on Remand is unlawful and unreasonable because it failed to order the adjustment of phase-in deferral balances of OP caused by the ESP rate caps on the theory that the proposed adjustment "would be tantamount to retroactive ratemaking."

6. The Commission's Order on Remand is unlawful and unreasonable because it failed to order the adjustment of the phase-in deferral balances of OP based on a finding not supported in the record that the "past rates ... have already been collected from customers."

7. The Commission's Order on Remand is unlawful and unreasonable in that it extended the prohibition of retroactive ratemaking to prevent the adjustment of phase-in deferral balances that had not been collected from customers and which were subject to further adjustment by the Commission's order establishing the basis for those deferral balances.

8. The Commission's Order on Remand is unlawful and unreasonable in that it failed to address the flow-through effects of Supreme Court's finding that the Commission's original Opinion and Order on deferral balances, recovery of delta revenues, and the earnings of the Companies.

As discussed in greater detail in the Memorandum in Support attached hereto, IEU-Ohio respectfully requests that the Commission grant this Application for Rehearing, immediately provide consumers relief from the unreasonable and unlawful rates, or, alternatively, condition receipt of any revenues from such rates on a refund obligation through the reconciliation associated with any deferral amortization.

Respectfully submitted,

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**BEFORE**
**THE PUBLIC UTILITIES COMMISSION OF OHIO**

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**MEMORANDUM IN SUPPORT**

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## I. INTRODUCTION

On October 3, 2011, the Commission issued its Order on Remand in these matters. IEU-Ohio seeks rehearing regarding three significant areas addressed by the Order on Remand. Initially, IEU-Ohio seeks rehearing on the Commission's decision to permit the recovery of carrying charges on incremental 2001-2008 environmental investments (pre-2009 Component). Second, IEU-Ohio seeks rehearing of the Commission's order permitting the Companies to retain revenues due to the pre-2009 Component between the time when the Commission made collection subject to refund and the date of the Order on Remand. Third, IEU-Ohio seeks rehearing on the Commission's refusal to flow-through the effects of the findings that the charges at issue in these cases were not properly authorized.

## II. ARGUMENT

### 1. The Commission's finding that the Companies may collect revenues for the carrying costs of 2001-2008 incremental environmental investments ("pre-2009 Component") pursuant to Section 4928.143(B)(2)(d), Revised Code, is unlawful and unreasonable because the Companies failed to demonstrate that granting such collection would have the effect of providing certainty regarding retail electric service.

In the October 3, 2011 Order on Remand, the Commission found that the requirements of Section 4928.143(B)(2)(d), Revised Code, were satisfied and allowed collection of the pre-2009 Component.[1] In support of its decision, the Commission relied on testimony in the initial 2008 hearings indicating that a carrying cost is related to long-term investment and that pre-2009 Component investments are necessary to keep coal-fired facilities running.[2] The Commission resorted to reliance on the prior record because the Companies offered no new testimony in support of the pre-2009 Component during the remand hearing.[3] Given the lack of evidence to support a finding that the pre-2009 Component would have "the effect of stabilizing or providing certainty regarding retail electric service,"[4] the Commission's decision to authorize recovery of the pre-2009 Component because it had the effect of making retail electric service more certain was unlawful and unreasonable.

Section 4928.143(B)(2)(d), Revised Code, provides in relevant part that an ESP may include provisions including "charges relating to ... carrying costs ... as would have

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[1] Order on Remand at 14.

[2] *Id.* citing the direct and rebuttal testimony of Philip Nelson.

[3] Cos. Remand Ex. 2. Mr. Nelson summarized his prior testimony and testified that he had been advised by counsel that various provisions of Section 4928.143(B)(2), Revised Code, authorized recovery of the revenues.

[4] Section 4928.143(B)(2)(d), Revised Code.

the effect of ... providing certainty regarding retail electric service." "Certainty" denotes that the retail electric service is made probable of occurrence. "Retail electric service" is statutorily defined to mean "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."[5] The burden of demonstrating that the charge makes more certain the provision of retail electric service rests with the Companies.[6] Thus, Section 4928.143(B)(2)(d), Revised Code, requires the Companies to provide evidence to demonstrate a basis on which the Commission can find that the pre-2009 Component is necessary to make retail electric service probable.

In authorizing collection of the pre-2009 Component, however, the Commission did not the factual basis necessary to show that the statutory requirements were met. As noted above, the first reference to the 2008 hearing testimony merely describes the nature of a carrying charge and states that it is the annual cost associated with a capital investment.[7] The second reference is to testimony regarding the use of investments in environmental plant to keep low-cost coal-fired generation running.[8] The Commission then supports its finding by reference to Commission Staff's ("Staff") testimony from the 2008 hearings that investment supporting compliance with environmental requirements is in the public interest.[9] The testimony relied upon by the Commission does not

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[5] Section 4928.01(A)(27), Revised Code.

[6] Section 4928.143(C), Revised Code.

[7] Order on Remand at 13-14.

[8] *Id.* at 14.

[9] *Id.*

connect the outcome required by Section 4928.143(B)(2)(d), Revised Code, to the pre-2009 Component.

Although it lacked a record to support a finding that the authorization of the pre-2009 Component was authorized by Section 4928.143(B)(2)(d), Revised Code, the Commission attempted to legitimize its decision by offering that the investments allow the continued operation of coal-fired generation plants. As a result, the Commission concluded customers benefit because the costs of these investments would be lower than if purchased power was used to satisfy customer demand.[10] However, this discussion comes with no quantification and does not address whether there is a need to fund incremental environmental investments so as to provide certainty regarding retail electric service. Thus, the Commission buttressed its decision with a discussion that has nothing to do with the statutory finding the Commission was required to make under Section 4928.143(B)(2)(d), Revised Code. The discussion that the pre-2009 Component might produce a lower cost than the purchase of power says nothing regarding whether that investment was necessary to make retail electric service more certain.

Further the Commission's "finding" regarding the benefits of company generation is not consistent with the manner in which generation resources are dispatched to service CSP and OP customers. CSP and OP are members of PJM Interconnection, Inc. ("PJM"). "PJM dispatches resources based upon the least cost set of offer prices to meet actual load that materializes within the PJM footprint and without regard to things like retail service areas. Thus, the dispatching of generation to meet the load of the

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[10] *Id.*

Companies' customers is managed by PJM."[11] The assertion that CSP and OP customers benefited from lower cost coal fired generation, therefore, finds no support in the manner power is actually dispatched to those customers.

OP and CSP did not provide any evidence that the pre-2009 Component is necessary to provide certainty in the provision of retail electric service, and the two references to the record used by the Commission to support authorization of the pre-2009 Component fail to demonstrate that the statutory requirements of Section 4928.143(B)(2)(d), Revised Code, are satisfied. Moreover, the Commission's suggestion that customers benefited from environmental investments is inconsistent with the unrefuted testimony of both the Companies and IEU-Ohio regarding the manner in which electric service is dispatched by PJM. Because there is no record to support a finding authorizing the pre-2009 Component under Section 4928.143(B)(2)(d), Revised Code, the Commission's decision is unlawful and unreasonable.

**2. The Commission's finding that the Companies may collect revenues for the pre-2009 Component pursuant to Section 4928.143(B)(2)(d), Revised Code, is unlawful and unreasonable because the Companies failed to demonstrate that their other revenues did not provide adequate compensation.**

The Companies, through the entirety of these proceedings, have made no claim that the revenue from the rates and charges other than those found illegal by the Supreme Court's April 19, 2011 decision is inadequate to compensate the Companies for standard service offer ("SSO") service. IEU-Ohio noted that there was not an economic basis for authorizing recovery, but the Commission rejected IEU-Ohio's

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[11] Direct Testimony of Kevin M. Murray on Behalf of Industrial Energy Users-Ohio (June 30, 2011) at 6-7. The Companies' testimony in the 2008 hearings is consistent with Mr. Murray's description. Vol. XI at 58-60.

position, stating that there was no support "that AEP-Ohio is required to make such a showing or pass an earnings test as a condition of recovery."[12] In this regard, the Commission has violated its own policy regarding the legal basis for authorizing rate increases under Section 4928.143(B)(2), Revised Code, and the resulting decision is unlawful and unreasonable.

This failure is no small defect, given the Commission's prior rulings on the Companies' proposed charges which the Commission rejected because the Companies failed to make such a demonstration. For example, the Commission refused to approve a separate rider for various elements of the Companies' proposed Enhanced Service Reliability Plan without addressing those costs in the context of a full rate review.[13] Thus, the Commission's approval of additional compensation for the pre-2009 Component without a demonstration that the Companies were not properly compensated for their incremental environmental investments violates Commission policy without explanation and is a separate basis for finding that the recovery of revenues under Section 4928.143(B)(2)(d), Revised Code, is unlawful and unreasonable.

**3. The Commission's authorization of the pre-2009 Component pursuant to Section 4928.143(B)(1), Revised Code, was unlawful and unreasonable in that it is based on a statutory provision that was not advanced by any party to the proceeding and was beyond the scope of the Supreme Court's remand directing the Commission to determine if a provision of Section 4928.143(B)(2), Revised Code, supports collection of these revenues.**

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[12] Order on Remand at 13.

[13] See, e.g., Opinion and Order at 34 (Mar. 18, 2009) (enhanced service reliability).

In remanding the pre-2009 Component for the Commission's further review, the Supreme Court was specific as to the scope of the review the Commission could undertake. After rejecting the Commission's argument that it had the authority to approve the pre-2009 Component without reference to a specific provision of Section 4928.143(B)(2), Revised Code, the Court went on to state "the commission may determine whether any of the listed categories of (B)(2) authorize recovery of environmental carrying charges."[14] As dictated by the Supreme Court's decision, the scope of the remand was limited to whether a provision of Section 4928.143(B)(2), Revised Code, provided a basis for authorization of the pre-2009 Component.

Despite the express limitation contained in the Court's remand, the Commission concluded "that our decision in this case is consistent with the broad authority granted to the Commission by Section 4928.143(B)(1), Revised Code."[15] The Commission then added that "[t]he carrying charges are a specific component of the Companies' standard service offer generation rates and are directly related to environmental investments made at generating facilities which are used to serve standard service offer customers."[16]

The alternative theory the Commission offered for authorizing the pre-2009 Component was not supported by any party, including the Companies, as a basis for these revenues. A review of the Companies' testimony and post-hearing initial and reply briefs demonstrates that the only grounds on which the Companies sought

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[14] *In re Columbus S. Power* Co, 128 Ohio St. 3d 512, 520 (2011) (Remand Decision).

[15] Order on Remand at 15.

[16] *Id.*

recovery of the pre-2009 Component were various subdivisions of Section 4928.143(B)(2), Revised Code.[17] The intervenors opposing the Companies did not support any recovery, but their attention also was properly directed at the application of Section 4928.143(B)(2), Revised Code. As the Commission notes in the Order on Remand, the Staff similarly premised its support for authorization on Section 4928.143(B)(2)(d), Revised Code.[18] Thus, the Commission reached well-beyond the basis on which any of the parties argued to find some justification for allowing the Companies to continue to recover the pre-2009 Component in their rates.

In reaching beyond Section 4928.143(B)(2), Revised Code, to justify authorization for the pre-2009 Component, the Commission not only unfairly injected an alternative theory of recovery but also violated the law of the case established by the Supreme Court's remand. Applicable to both judicial and administrative proceedings,[19] the doctrine of the law of the case provides "that the decision of a reviewing court in a case remains the law of that case on legal questions involved for all subsequent proceedings in the case at both the trial and reviewing levels."[20] As the Supreme Court has found, "the rule is necessary to ensure consistency of results in a case, to avoid endless litigation by settling the issues, and to preserve the structure of superior and

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[17] Columbus Southern Power Company's and Ohio Power Company's Initial Post-Hearing Brief on Remand at 13-15 (Aug. 5, 2011); Columbus Southern Power Company's and Ohio Power Company's Reply Brief on Remand at 35-37 (Aug. 12, 2011).

[18] Order on Remand at 12.

[19] *Worthington City Schools Board of Education v. Franklin County Board of Revision*, 129 Ohio St. 3d 3, 949 N.E.2d 986, 990 n.2 (2011); *Colonial Village, Ltd., v. Washington County Board of Revision*, 123 Ohio St. 3d 268, 272-73 (2009).

[20] *Nolan v. Nolan*, 11 Ohio St. 3d 1, 3 (1984).

inferior courts as designed by the Ohio Constitution."[21] The effect of applying the law of the case to a remand results in a narrowing of the legal arguments that may be further litigated: "Thus, where at a rehearing following remand a trial court is confronted with substantially the same facts and issues as were involved in the prior appeal, the court is bound to adhere to the appellate court's determination of the applicable law."[22]

The Supreme Court's order regarding the pre-2009 Component was specific: the Commission was to determine if the pre-2009 Component was supported by a provision of Section 4928.143(B)(2), Revised Code. The parties understood the Court's directive and followed it. Nonetheless, the Commission went beyond the law of the case and found that authorizing the pre-2009 Component was consistent with 4928.143(B)(1), Revised Code.

The failure to follow the law of the case renders the decision unlawful and unreasonable. "[A]bsent extraordinary circumstances, such as an intervening decision by [the Supreme Court], an inferior court has no discretion to disregard the mandate of a superior court in a prior appeal in the same case."[23] Failure to follow the law of case is a ground for reversal.[24]

In this instance, the Commission's failure to follow the law of case requires the Commission to grant rehearing to remove any reliance on Section 4928.143(B)(1), Revised Code, from its consideration of the issues remanded to the Commission. As discussed above, the Commission's findings authorizing recovery under Section

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[21] *Id.*

[22] *Id.*

[23] *Nolan v. Nolan*, 11 Ohio St. 3d at 5.

[24] *Id.*

4928.143(B)(2)(d), Revised Code, do not find support in the record. Thus, the Commission's resort to an alternative basis for authorizing the pre-2009 Component under Section 4928.143(B)(1), Revised Code, is unlawful and highly prejudicial.

**4. The Commission unlawfully and unreasonably permitted collection of the pre-2009 Component during a period in which there was no legal authority to permit collection of those revenues.**

By the terms of the Order on Remand, the Commission permitted the Companies to continue to collect the pre-2009 Component from the time of the Supreme Court's remand through the date the Commission issued the Order on Remand.[25] In permitting the Companies to retain the revenues from the time the Commission made the relevant tariffs subject to refund through the time that the Commission issued its Order on Remand, the Commission unlawfully and unreasonably permitted the Companies to collect revenues for which there was no legal authorization.

Under Section 4928.141, Revised Code, an electric distribution utility ("EDU") is authorized to establish a SSO in the form of either a Market Rate Offer under Section 4928.142, Revised Code, or an ESP under Section 4928.143, Revised Code. If the EDU selects an ESP, then the authorized ESP may contain only those provisions set out in Section 4928.143(B)(1) and (2), Revised Code. While (B)(1) states that the SSO shall include a provision for the supply and pricing of electric generation service, other provisions may be authorized under (B)(2), but only if those provisions fall within the

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[25] Order on Remand at 15.

terms of the list contained in (B)(2). "So if a given provision does not fit within one of the categories listed 'following' (B)(2), it is not authorized by statute."[26]

In its April 19, 2011 decision, the Supreme Court found that the Commission had failed to provide a legal justification supporting the collection of revenues for the pre-2009 Component. Following the Court's decision, the Commission did not issue any order or entry that found that the pre-2009 Component was properly recoverable under Section 4928.143(B)(2), Revised Code, until October 3, 2011. Notably, the Commission, in the May 4, 2011 Entry, recognized that the Companies had no claim to continue to collect these revenues and ordered revised tariffs reducing the Companies' rates by removing the pre-2009 Component.[27] The Commission subsequently permitted the Companies to continue to collect its then-current rates subject to refund on May 25, 2011 beginning with the June 2011 billing cycle,[28] but it did not make any finding that the pre-2009 Component was lawfully includable in rates. Only after the Commission issued the Order on Remand can it be claimed that collection of the the pre-2009 Component on October 3, 2011 was authorized. [29]

For the period of April 19, 2011 until October 3, 2011, therefore, the continued collection of the pre-2009 Component was without legal authority. The Supreme Court had found that the Commission's justification for allowing collection of the pre-2009

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[26] *Remand Decision*, 128 Ohio St. 3d at 520.

[27] Entry (May 4, 2011).

[28] Entry (May 25, 2011).

[29] The legality of the authorization to collect the pre-2009 Component remains at issue, as discussed above. Here the focus is on the unlawfulness of the collection of the pre-2009 Component following the Court's decision and the Commission's Order on Remand.

Component was unlawful. Tariffs recognizing the Court's decision became effective for the June 2011 billing cycle.[30] That situation remained unchanged until October 3, 2011. As a result, the pre-2009 Component was not lawfully authorized for the May 25, 2011-October 3, 2011 period. On rehearing, the Commission must modify the Order on Remand to assure that customers are properly compensated (as in a reduction of deferrals) for this portion of the pre-2009 Component that was improperly collected from them.

5. **The Commission's Order on Remand is unlawful and unreasonable because it failed to order the adjustment of phase-in deferral balances of OP caused by the ESP rate caps on the theory that the proposed adjustment "would be tantamount to retroactive ratemaking."**

6. **The Commission's Order on Remand is unlawful and unreasonable because it failed to order the adjustment of the phase-in deferral balances of OP based on a finding not supported in the record that the "past rates ... have already been collected from customers."**

7. **The Commission's Order on Remand is unlawful and unreasonable in that it extended the prohibition of retroactive ratemaking to prevent the adjustment of phase-in deferral balances that had not been collected from customers and which were subject to further adjustment by the Commission's order establishing the basis for those deferral balances.**

8. **The Commission's Order on Remand is unlawful and unreasonable in that it failed to address the flow-through effects of Supreme Court's finding that the Commission's original Opinion and Order on deferral balances, recovery of delta revenues, and the earnings of the Companies.**

As part of the evidence presented in the remand hearing, IEU-Ohio and the Ohio Consumers' Counsel ("OCC") offered a reasonable and legally proper way to assure

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[30] In contrast to the situation presented by deferrals discussed below, revenues collected prior to the May 25, 2011 Entry could not be refunded to customers absent either a party entering into an appropriate bond or a Commission order making the collection subject to refund.

that phase-in deferral balances were properly restated so as to avoid charging customers for amounts that were not properly included in rates. IEU-Ohio further recommended that adjustments needed to be made in other areas directly impacted by the Court's decision. In its Order on Remand, however, the Commission refused to implement those recommendations on the basis that the proposed adjustment to deferrals "would be tantamount to unlawful retroactive ratemaking."[31] The Commission also asserted that the prohibition on retroactive ratemaking applied because the Commission could not "order a prospective adjustment to account for past rates that have already been collected from customers."[32] The Commission further rejected IEU-Ohio's recommendation that the Commission address other matters affected by the Supreme Court's remand.[33] Because the Commission improperly found that the prohibition of retroactive ratemaking applied, the Commission's decision to refuse to adjust the deferrals and other related issues was unlawful and unreasonable.

The rationale for adjusting deferrals for flow-through effects of the remanded issues is straight-forward. Prior to the Commission's May 4, 2011 Entry, OP estimated that the accumulated deferred revenue eligible for future collection would be $643 million by late 2011. However, OP's estimate of deferred revenue eligible for future collection is a residual calculation. It is the difference between the revenue collected during the ESP period subject to the bill increase limitations and the revenue increases that would have otherwise occurred without such limitations. OP's estimate of deferred

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[31] Order on Remand at 35-36.

[32] *Id.* at 36.

[33] *Id.*

revenue is significantly excessive because embedded in the math that produced OP's estimate is an allowance for revenues which cannot be lawfully recognized for purposes of establishing rates and charges.

The 2009 ESP Opinion and Order authorized OP and CSP to, individually, collect a total revenue amount, part of which was collectable during the term of the current ESP and part of which was deferred for collection in the future.[34] The portion of such total authorized revenue deferred for future collection (through a phase-in mechanism) is a subset of the total revenue collection that the Commission may lawfully authorize through the exercise of its authority in Section 4928.143, Revised Code. The amount of the revenue deferred for future collection through a phase-in mechanism must also be "just and reasonable."[35]

In keeping with this "just and reasonable" standard, the Commission must, in compliance with the Supreme Court's decision, reduce the total authorized revenue in the current ESP Opinion and Order by the amount of revenue that the Commission previously included in this total. Because the portion of the total authorized revenue that was deferred for collection is defined by a residual calculation, the deferred revenues must be reduced by an amount equal to that portion of the revenues authorized by the Commission in its ESP Opinion and Order that the Supreme Court determined were unlawful. If OP is permitted to collect deferred revenues calculated as though the revenue amounts the Commission authorized in the current ESP Opinion

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[34] Opinion and Order at 20-24 (Mar. 18, 2009).

[35] Section 4928.144, Revised Code.

and Order were lawful, the requirement that the phase-in rates are just and reasonable cannot be satisfied.

Thus, Section 4928.144, Revised Code, and the recent Supreme Court decision require a restatement of the amount of deferred revenue eligible for future collection to properly reflect the value associated with the Companies' unlawfully authorized revenue increases plus an appropriate allowance for carrying charges. Unless the deferred revenue balance is restated and substantially lowered, the amount of revenue increase which the Supreme Court has held to be unlawful will be embedded in the amount of revenue deferred for future collection. Unless the deferred revenue balance is restated, the injustice of the unlawfully authorized increases will be perpetuated for seven years through a phase-in rider that ignores reality and the law.

Commission action regarding the effect of the remand, however, is not limited to the deferred balances OP will be seeking to recover. The second illustrative area concerns the amount of revenue which OP and CSP may lawfully collect through mechanisms that allow, as permitted by the Commission, recovery of "delta revenue." Delta revenue is the revenue difference between rates and charges in a reasonable arrangement and the revenue produced by rates and charges in an otherwise applicable tariff schedule. For example, the Commission has authorized delta revenue recovery as a result of a reasonable arrangement for Ormet Primary Aluminum Corporation ("Ormet").[36] The unlawful revenue increases identified by the Supreme Court are embedded in the revenue produced by the otherwise applicable rate(s) for

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[36] *In the Matter of the Application of Ormet Primary Alum. Corp. for Approval of a Unique Arrangement with Ohio Power Co. and Columbus Southern Power Co.*, Case No. 09-119-EL-AEC, Opinion and Order (July 15, 2009).

Ormet. Thus, the amount of delta revenue eligible for collection as a result of the Ormet reasonable arrangement has been unlawfully overstated in the past and will be unlawfully overstated going forward unless the unlawfully authorized revenue is removed from the rates and charges in the otherwise applicable tariff schedule(s).

Similarly, the operation of the Universal Service Fund ("USF") generates revenue recovery that is overstated. This fund provides bill payment assistance to income eligible residential consumers, and other consumers pay USF charges to make OP and CSP whole for the difference in the amount collected from income eligible customers and the amount such customers would have paid on the otherwise applicable rate. As in the case of the delta revenue illustration above, the unlawfully authorized revenue caused the otherwise applicable rate to be higher than the lawful rate and, in turn, increased the magnitude of the USF charges that have been paid and will continue to be paid until the unlawfully authorized revenue and all of its implications are stripped from all rates and charges (including riders).

The third illustrative area involves the effect of the unlawfully authorized revenue increases and the operation of the retrospective significantly excessive earnings test ("SEET").[37] Revenues unlawfully authorized and collected must, for ratemaking and SEET purposes, be classified, dollar-for-dollar, as revenues the utility actually received as a result of the ESP (after taxes, the revenues become net income on the Companies' income statements). If the Commission properly jurisdictionalizes the income statement and the balance sheet values that drive the SEET determination (as IEU-Ohio has previously and unsuccessfully – to this point – argued is required by Ohio law), the

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

SEET can provide the Commission with an opportunity to rectify, at least in part, the effect of unlawfully authorized and collected revenue.

The fourth illustrative area concerns the relationship between the Companies' current ESPs (with the embedded unlawfully authorized revenue therein) and the plan filed in the 2011 ESP Application. The revenue produced by the current ESPs (including the embedded unlawfully authorized revenue) provides the revenue foundation for the 2011 ESP.[38] This foundation is excessive by the unlawfully authorized amount of revenue and is itself unlawful to that extent. Although the 2011 ESP is currently the subject of a partial stipulation, the Commission has not yet ruled on the stipulation and may be required to conduct hearing on the original applications if the Stipulation is rejected or withdrawn. Thus, the effects of the remand remain relevant to the 2011 ESP Application.

In summary, the Supreme Court has determined that the Commission authorized CSP and OP to unlawfully bill and collect increased revenue. More than two years have passed since the Companies implemented the unlawful authority to increase revenue, rates, and charges over the objections of every consumer group that participated in these proceedings. Hundreds of millions of dollars of consumers' wealth have already been unlawfully transferred to the Companies, and this unlawful wealth transfer will be perpetuated in numerous ways until the Commission strips away all the effects of the unlawfully authorized revenue increases.

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[38] *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to 4928.143, Ohio Rev. Code, in the Form of an Electric Security Plan,* Case No. 11-346-EL-SSO, *et al.*, Testimony of David Roush, Exhibit DMR-2 (January 27, 2011) ("*2011 ESP Application*").

Requiring a proper restatement of amounts of deferrals that may be collected in rates is not novel. This Commission has recognized its duty to supervise what is recovered from customers regardless of the accounting treatment the Companies have used to state the values of assets. In the 1991 CSP rate case, for example, the Commission applied the terms of the Zimmer Restatement Case settlement to reduce a booked allowance for funds used during construction ("AFUDC") to restate the rate base for the Zimmer plant because the amounts booked were inconsistent with proper regulatory accounting and the terms of the settlement.[39] Thus, regulatory law drives accounting decisions, and not the other way around.

The Commission itself recognized in the Opinion and Order that the deferrals booked by the Companies were not sacrosanct. In setting the bill limiters, the Commission held: "[W]e exercise our authority pursuant to Section 4928.144, Revised Code, and find that the Companies should phase-in any authorized increases so as not to exceed, on a total bill basis, an increase of 7 percent for CSP and 8 percent for OP for 2009, an increase of 6 percent for CSP and 7 percent for OP for 2010, and an increase of 6 percent for CSP and 8 percent for OP for 2011 are more appropriate levels."[40] The Commission continued that "[a]ny amount over the *allowable total bill increase* percentage levels will be deferred."[41] The resulting surcharge was to be based

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[39] *In the Matter of the Application of Columbus Southern Power Co. for Authority to Amend its Filed Tariffs to Increase the Rates and Charges for Electric Service*, Case No. 91-418-EL-AIR, Opinion and Order at 15-18 (May 12, 1992).

[40] Opinion and Order at 22 (March 18, 2009).

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

on the balance remaining at the end of 2011.[42] The Companies themselves recognize that the amounts that may be collected through the phase-in rider are subject to continuing review through fuel adjustment clause ("FAC") proceedings that are ongoing.

When the Supreme Court subsequently found the POLR charge and the pre-2009 Component to be illegal, the Commission was required to determine before collections started how much if any of the deferrals were properly collectable. Just as the Companies recognized when they filed tariffs in compliance with the May 4, 2011 Commission Entry and in the tariffs approved on October 26, 2011, the effect of the remand is to require an evaluation of what is allowed to be recovered. One obvious change is the effect of the Order on Remand on the current FAC rates and deferrals. Part of the process also includes recognition of any changes that result from the 2009 and 2010 FAC reviews that are on-going. Another part is the recognition that the deferrals on the Companies' books are improperly inflated because the POLR charges and incremental environmental investments were included in the revenue calculation subject to the bill limiters when they should not have been.

The Order on Remand, however, concludes that the Commission cannot adjust deferrals or address the related issues because it cannot engage in retroactive ratemaking. The Commission's reliance on prohibition on retroactive ratemaking to prevent it from addressing the flow-through effect, however, is misplaced.

Initially, the Commission relies on the Supreme Court's remand decision in this case.[43] The filed rate problem in this case arose when the Commission permitted the

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[42] *Id.* at 22-23. The Commission recognized that the deferrals could be adjusted throughout the ESP term if the FAC expense in a given period was less than the maximum phase-in FAC rate. *Id.* at 22.

Companies to recover three months of rate increases, $62 million, prior to the effective date of the tariffs authorized by the Opinion and Order. Finding that the Commission engaged in retroactive ratemaking, the Supreme Court stated that "present rates may not make up for dollars lost 'during the pendency of commission proceedings,'" and concluded that "the commission violated the law when it granted AEP additional rates to make up for regulatory delay."[44] The filed rate doctrine, however, prevented the Court from ordering a refund of the $62 million already collected from customers. In contrast, IEU-Ohio seeks to have the Commission address the revenues that OP (or the merged OP and CSP[45]) will be seeking through the phase-in rider from 2012 to 2018 as a result of the bill limits. Inasmuch as OP will be seeking additional revenues estimated at $642 million and inasmuch as the Commission has not determined whether any of the deferred revenues are allowable, the Court's holding concerning the filed rate doctrine does not prevent the Commission from requiring the Companies to restate the deferred revenues or take into account the remand in addressing other related issues such as delta revenue recovery.

The Commission's reliance on the *Lucas County* and *Ohio Consumers' Counsel* cases[46] is similarly misplaced. In the *Lucas County* case, the Supreme Court agreed that the Commission properly dismissed a complaint seeking a refund when the

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[43] Order on Remand at 36 n.40.

[44] Remand Decision, 128 Ohio St. 3d at 515.

[45] The Companies have a filed a partial stipulation with the Commission that is currently under review. By the terms of the partial stipulation, the Companies would be authorized to collect a recovery rider from both OP and CSP customers. *2011 ESP Application*, Stipulation at 26 (Sept. 7, 2011).

[46] *Id.*, citing *Lucas County Commissioners v. Pub. Util. Commission*, 80 Ohio St. 3d 344 (1997) and *Ohio Consumers' Counsel v. Public Utilities Commission of Ohio*, 121 Ohio St. 3d 362 (2009).

complaint was filed after the challenged rates had been collected. In affirming the Commission's decision, the Supreme Court stated, "The Public Utilities Commission of Ohio is not statutorily authorized to order a refund of, or credit for, charges previously collected by a public utility where those charges were calculated in accordance with an experimental rate program which was approved by the commission, but which has expired by its own terms."[47] In the *Ohio Consumer's Counsel* case, the Commission moved to dismiss an appeal on the basis that the underlying order had been superseded by the Commission's adoption of a new order, thus precluding any prospective relief for consumers. In contrast to the situations presented in each of these cases, IEU-Ohio is not seeking a Commission order for a refund. If the Commission takes the actions recommended by IEU-Ohio, it instead would be setting the just and reasonable level of the prospective recovery as required by Section 4928.144, Revised Code, and adjusting the recovery of other revenues in a manner consistent with the terms of the remand.

Indeed, the only way the Commission can reach a conclusion that it is prohibited from acting on the requested adjustments to phase-in deferral amounts is by asserting that IEU-Ohio's recommendations if adopted would be "tantamount" to unlawful retroactive remaking and concluding that rates have already been paid by customers. The factual assertion that the Companies have collected these funds is not correct. The deferrals created as a result of the March 18, 2009 Opinion and Order are for amounts that have not been collected from customers. Rather they are uncollected amounts that remain subject to adjustments that even the Companies concede can and will be made

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[47] *Lucas County Commissioners*, 80 Ohio St. 3d at 349.

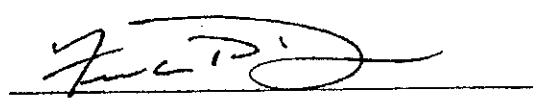
in the recoverable totals, and only upon approval of a recovery mechanism by the Commission. Thus, when the Commission concluded in the Order on Remand that it "cannot order a prospective adjustment to account for past rates that have already been collected from customers and subsequently found to be justified,"[48] the decision is premised on a condition (that rates have already been collected from customers) that is not correct.

Because the premise for applying the prohibition of retroactive ratemaking is wrong, the Commission's decision is unlawful and unreasonable. In order to assure that consumers are not further burdened by rates that illegally generated deferrals and affected other matters such as delta revenues, the Commission must flow-through the effects of the Supreme Court's remand.

## III. CONCLUSION

For the reasons outlined above, the Commission should grant rehearing to remove the pre-2009 Component from rates, refund amounts improperly collected for the pre-2009 Component from June to November 2011, and properly flow-through the effects of the Supreme Court's decision. Failure to do so would be unlawful and unreasonable and would shoulder consumers with additional revenue responsibility that cannot be legally justified.

Respectfully submitted,



Samuel C. Randazzo

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[48] Order on Remand at 36.

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## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Application for Rehearing of Order on Remand and Memorandum in Support of Industrial Energy Users-Ohio* was served upon the following parties of record this 2nd day of November 2011, via electronic transmission, hand-delivery or first class mail, postage prepaid.

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**ON BEHALF OF THE PUBLIC UTILITIES COMMISSION OF OHIO**

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Columbus, OH 43215

**ATTORNEY EXAMINER**

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

ENTRY ON REHEARING

The Commission finds:

(1) On March 18, 2009, the Commission issued its opinion and order in Columbus Southern Power Company's and Ohio Power Company's (jointly, AEP-Ohio or the Companies) electric security plan (ESP 1) cases (ESP 1 Order).[1] By entries on rehearing issued July 23, 2009 (First ESP 1 EOR) and November 4, 2009, the Commission affirmed and clarified certain issues raised in AEP-Ohio's ESP 1 Order. As ultimately modified and adopted by the Commission, AEP-Ohio's ESP 1 directed, among other things, that AEP-Ohio be permitted to recover the incremental capital carrying costs that would be incurred after January 1, 2009, on past environmental investments (2001-2008)[2] and approved a provider of last resort (POLR) charge for the term of ESP 1.

(2) The Commission's decision in AEP-Ohio's ESP 1 cases was appealed to the Ohio Supreme Court. The Ohio Supreme Court determined that Section 4928.143(B)(2), Revised Code, does not authorize the Commission to allow recovery of items not enumerated in the section. The Court remanded the case to the Commission for further proceedings in which "the

1 *In re AEP-Ohio ESP cases*, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Opinion and Order (March 18, 2009).

2 ESP 1 Order at 24-28, 38-40; First ESP 1 EOR at 10-13, 24-27.

Commission may determine whether any of the listed categories set forth in Section 4928.143(B)(2), Revised Code, authorize recovery of environmental carrying charges."[3] In regards to the POLR charges, the Court concluded that the Commission's decision that the POLR charge is cost-based was against the manifest weight of the evidence, an abuse of the Commission's discretion and reversible error. While the Court specifically stated that "we express no opinion on whether a formula-based POLR charge is per se unreasonable or unlawful," the Court noted two other methods by which the Commission may establish the POLR charge: a non-cost-based POLR charge or evidence of AEP-Ohio's actual POLR costs.

(3) By entry issued May 25, 2011, the Commission directed AEP-Ohio to file tariff pages that reflect that the POLR riders and environmental carrying charges included in rates are being collected subject to refund, until the Commission specifically orders otherwise on remand. Additionally, the Commission adopted a procedural schedule for the remand proceedings in order to afford AEP-Ohio and intervenors the opportunity to present testimony and additional evidence in regard to the POLR and environmental carrying charges remanded to the Commission.

(4) On October 3, 2011, the Commission issued its order on remand (Remand Order). The Commission concluded that, in accordance with the provisions of Section 4928.143(B)(2)(d), Revised Code, the Companies should be authorized to continue to recover the incremental capital carrying costs incurred after January 1, 2009, on environmental investments made from 2001-2008. As to the POLR charges, the Commission ruled that AEP-Ohio had not provided any evidence of its actual POLR costs, found that its unconstrained option model did not measure its POLR costs, and, therefore, directed AEP-Ohio to deduct the amount of the POLR charges reflected in the Companies' rates and file revised tariffs consistent with the Remand Order.

(5) On October 6, 2011, AEP-Ohio filed two sets of tariffs in response to the Remand Order. AEP-Ohio advocated that the

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3 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512.

first set of tariffs, which reflected a reduction of the POLR charges to the level in effect prior to the implementation of the ESP 1 Order, were appropriate. The POLR charges reflected in this version were as established in Case No. 04-169-EL-UNC, *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of a Post-Market Development Period Rate Stabilization Plan.* In the alternative, in the event that the Commission intended that the POLR charges be eliminated in their entirety, AEP-Ohio offered a second set of tariffs, reflecting the elimination of all POLR charges, without conceding its right to request rehearing on the issue.

(6) By finding and order issued October 26, 2011, the Commission found, without prejudging any issue that may be raised on rehearing in these matters, that the second set of tariffs eliminating all POLR charges from the Companies' rates should be approved to be effective with the first billing cycle of November 2011, subject to Commission review and subsequent adjustment, if appropriate (Tariff Approval Order).

(7) Section 4903.10, Revised Code, states that any party who has entered an appearance in a Commission proceeding may apply for a rehearing with respect to any matters determined therein by filing an application within 30 days after the entry of the order upon the Commission's journal.

(8) On November 2, 2011, applications for rehearing of the Remand Order were filed by AEP-Ohio, Industrial Energy Users-Ohio (IEU-Ohio), and jointly by the Ohio Consumers' Counsel (OCC) and Ohio Partners for Affordable Energy (OPAE) (jointly, OCC/OPAE). On November 10, 2011, AEP-Ohio filed a memorandum contra the applications for rehearing of IEU-Ohio and OCC/OPAE. On November 14, 2011, IEU-Ohio and OCC/OPAE filed memoranda contra AEP-Ohio's application for rehearing. In their applications for rehearing, the parties raise a number of assignments of error, alleging that the Remand Order is unreasonable and unlawful. In addition to its arguments pertaining to the Remand Order, AEP-Ohio raises further arguments and seeks rehearing with respect to the Tariff Approval Order.

(9) The Commission believes that sufficient reason has been set forth by AEP-Ohio, IEU-Ohio, and OCC/OPAE to warrant further consideration of the matters specified in their applications for rehearing. Accordingly, the applications for rehearing filed by AEP-Ohio, IEU-Ohio, and OCC/OPAE should be granted.

It is, therefore,

ORDERED, That the applications for rehearing filed by AEP-Ohio, IEU-Ohio, and OCC/OPAE be granted for further consideration of the matters specified in the applications for rehearing. It is, further,

ORDERED, That a copy of this entry on rehearing be served upon all persons of record in these cases.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

SJP/GNS/sc

Entered in the Journal

NOV 22 2010

Betty McCauley

Betty McCauley
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

The Commission finds:

(1) On March 18, 2009, the Commission issued its opinion and order in Columbus Southern Power Company's and Ohio Power Company's (OP) (jointly, AEP-Ohio or the Companies) electric security plan (ESP 1) cases (ESP 1 Order).[1] By entries on rehearing issued July 23, 2009, (First ESP 1 EOR) and November 4, 2009, the Commission affirmed and clarified certain issues raised in AEP-Ohio's ESP 1 Order. As ultimately modified and adopted by the Commission, AEP-Ohio's ESP 1 directed, among other things, that AEP-Ohio be permitted to recover the incremental capital carrying costs that would be incurred after January 1, 2009, on past environmental investments (2001-2008) and approved a provider of last resort (POLR) charge for the term of ESP 1.[2]

(2) The Commission's decision in AEP-Ohio's ESP 1 cases was appealed to the Ohio Supreme Court. The Ohio Supreme Court determined that Section 4928.143(B)(2), Revised Code, does not authorize the Commission to allow recovery of items not enumerated in the section. The Court remanded the case to the Commission for further proceedings in which "the Commission may determine whether any of the listed

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categories set forth in Section 4928.143(B)(2), Revised Code, authorize recovery of environmental carrying charges."[3] In regards to the POLR charges, the Court concluded that the Commission's decision that the POLR charge is cost-based was against the manifest weight of the evidence, an abuse of the Commission's discretion, and reversible error. While the Court specifically stated that "we express no opinion on whether a formula-based POLR charge is per se unreasonable or unlawful," the Court noted two other methods by which the Commission may establish the POLR charge: a non-cost-based POLR charge or evidence of AEP-Ohio's actual POLR costs.

(3) By entry issued May 25, 2011, the Commission directed AEP-Ohio to file tariff pages that reflect that the POLR riders and environmental carrying charges included in rates are being collected subject to refund until the Commission specifically orders otherwise on remand. Additionally, the Commission adopted a procedural schedule for the remand proceedings in order to afford AEP-Ohio and intervenors the opportunity to present testimony and additional evidence in regard to the POLR and environmental carrying charges remanded to the Commission.

(4) On October 3, 2011, the Commission issued its order on remand (Remand Order). The Commission concluded that, in accordance with the provisions of Section 4928.143(B)(2)(d), Revised Code, the Companies should be authorized to continue to recover the incremental capital carrying costs incurred after January 1, 2009, on environmental investments made from 2001-2008. As to the POLR charges, the Commission ruled that AEP-Ohio had not provided any evidence of its actual POLR costs, found that its unconstrained option model did not measure its POLR costs, and, therefore, directed AEP-Ohio to deduct the amount of the POLR charges reflected in the Companies' rates and file revised tariffs consistent with the Remand Order.

(5) On October 6, 2011, AEP-Ohio filed two sets of tariffs in response to the Remand Order. AEP-Ohio advocated that the first set of tariffs, which reflected a reduction of the POLR charges to the level in effect prior to the implementation of the

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ESP 1 Order, were appropriate. The POLR charges reflected in this version were as established in Case No. 04-169-EL-UNC, *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of a Post-Market Development Period Rate Stabilization Plan* (RSP Case). In the alternative, in the event that the Commission intended that the POLR charges be eliminated in their entirety, AEP-Ohio offered a second set of tariffs, reflecting the elimination of all POLR charges, without conceding its right to request rehearing on the issue.

(6) By finding and order issued October 26, 2011, the Commission found, without prejudging any issue that may be raised on rehearing in these matters, that the second set of tariffs eliminating all POLR charges from the Companies' rates should be approved to be effective with the first billing cycle of November 2011, subject to Commission review and subsequent adjustment, if appropriate (Tariff Approval Order).

(7) Section 4903.10, Revised Code, states that any party who has entered an appearance in a Commission proceeding may apply for a rehearing with respect to any matters determined therein by filing an application within 30 days after the entry of the order upon the Commission's journal.

(8) On November 2, 2011, applications for rehearing of the Remand Order were filed by AEP-Ohio, Industrial Energy Users-Ohio (IEU-Ohio), and jointly by the Ohio Consumers' Counsel (OCC) and Ohio Partners for Affordable Energy (OPAE) (jointly, OCC/OPAE). On November 10, 2011, AEP-Ohio filed a memorandum contra the applications for rehearing of IEU-Ohio and OCC/OPAE. On November 14, 2011, IEU-Ohio and OCC/OPAE filed memoranda contra AEP-Ohio's application for rehearing. In their applications for rehearing, the parties raise a number of assignments of error, alleging that the Remand Order is unreasonable and unlawful. In addition to its arguments pertaining to the Remand Order, AEP-Ohio raises further arguments and seeks rehearing with respect to the Tariff Approval Order.

(9) By entry on rehearing issued November 22, 2011, the Commission granted the applications for rehearing to allow

further consideration of the matters specified in the applications.

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

Incremental Carrying Cost for 2001-2008 Environmental Investment

(11) IEU-Ohio raises four arguments in support of its position that the Remand Order was unjust and unreasonable with respect to the subject of the carrying costs on 2001-2008 environmental investments. In its first assignment of error, IEU-Ohio asserts that the Commission's finding that AEP-Ohio may recover environmental investment carrying costs pursuant to Section 4928.143(B)(2)(d), Revised Code, is unlawful and unreasonable because the Companies failed to demonstrate that granting such recovery would have the effect of providing certainty regarding retail electric service. IEU-Ohio argues that AEP-Ohio provided no evidence on remand that the environmental carrying charges in question are "necessary to provide certainty in the provision of retail electric service" and that the evidence relied upon by the Commission fails to demonstrate how the requirements of Section 4928.143(B)(2)(d), Revised Code, are satisfied such that the charges are "necessary to make retail electric service probable." Finally, IEU-Ohio avers that the Commission's determination that customers benefit from the lower cost power received as a result of the environmental investments is inconsistent with the manner in which electric service is dispatched by PJM Interconnection, LLC, (PJM) based on the least cost set of offer prices. (IEU-Ohio App. at 5-8.)

(12) As an initial matter, AEP-Ohio responds that IEU-Ohio has raised no new arguments for the Commission's consideration. Further, AEP-Ohio argues that IEU-Ohio's reading of the statute is unnatural, pointing out that a charge may have the effect of stabilizing or providing certainty regarding retail electric service, without being necessary to make the service certain or probable. The Companies also dispute IEU-Ohio's contention that there is no support in the record for the Commission's finding that the environmental carrying charges

have the effect of providing certainty to both the Companies and their customers. AEP-Ohio further notes that the Companies pass the benefit of lower cost power to customers through the fuel adjustment clause (FAC) and that the manner in which PJM dispatches resources does not negate this established practice. (Cos. Memo Contra at 11-13.)

(13) The Commission thoroughly reviewed the record established in both the initial and remand proceedings and found evidence in the record offered by AEP-Ohio (Cos. Ex. 7 at 15-16; Cos. Ex. 7B at 6), which supports a finding that the Companies' environmental investment carrying charges have the effect of providing certainty to both the Companies and their customers regarding retail electric service.[4] This evidence is part of the record; it makes no difference that it was offered by AEP-Ohio during the initial, rather than the remand, proceedings. Additionally, we explained in the Remand Order how the Companies' testimony satisfies the requirements of Section 4928.143(B)(2)(d), Revised Code (Remand Order at 13-14). Further, we find no merit in IEU-Ohio's argument that the environmental carrying charges must be necessary to make retail electric service "probable." Section 4928.143(B)(2)(d), Revised Code, requires only that the carrying charges "have the effect of stabilizing or providing certainty regarding retail electric service." Finally, we find no relevance in IEU-Ohio's argument regarding the dispatch of power by PJM, as AEP-Ohio, in actual practice, generally uses its own generating units to serve its customers and passes the benefit of the lower cost power to its customers through the FAC (Tr. XI at 58, 60; Cos. Ex. 7B at 6). Moreover, the presence of lower cost units in the PJM market will tend to lower current and future PJM energy market prices and contribute to stabilizing prices for the benefit of the Companies' customers. Therefore, IEU-Ohio's first assignment of error should be rejected.

(14) IEU-Ohio next asserts that the Commission's finding that AEP-Ohio may recover the carrying costs on 2001-2008 environmental investments pursuant to Section 4928.143(B)(2)(d), Revised Code, is unlawful and unreasonable because the Companies failed to demonstrate that their other

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4 References to exhibits or transcripts from the remand proceedings will specifically be designated as such in this order. All other references refer to evidence from the original record compiled in 2008.

revenues do not provide adequate compensation. IEU-Ohio argues that, in not requiring AEP-Ohio to make such a showing, the Commission has violated, without explanation, its own policy regarding the legal basis for authorizing rate increases under Section 4928.143(B)(2), Revised Code. As evidence of this alleged Commission policy, IEU-Ohio points to the Commission's determination in the ESP 1 Order that AEP-Ohio's enhanced service reliability plan (ESRP) rider should be based on the Companies' prudently incurred costs subject to Commission review in the context of a distribution rate case. (IEU-Ohio App. at 8-9.)

(15) AEP-Ohio responds that the ESRP rider was proposed and approved pursuant to a different statutory provision, specifically, Section 4928.143(B)(2)(h), Revised Code. The Companies assert that the Commission's determination that Section 4928.143(B)(2)(h), Revised Code, requires a cost basis for approval of the recovery of distribution-related infrastructure improvements does not call into question the Commission's determination that Section 4928.143(B)(2)(d), Revised Code, contains no similar requirement. (Cos. Memo Contra at 13-14.)

(16) Upon consideration of IEU-Ohio's second assignment of error, the Commission finds that IEU-Ohio has raised no new argument on rehearing that would warrant reconsideration of the Remand Order. IEU-Ohio cites no authority that would require AEP-Ohio to address adequacy of revenue, and we find no such requirement or Commission policy with respect to Section 4928.143(B)(2)(d), Revised Code. Further, the environmental investment carrying charges were not reflected in the Companies' existing rates prior to our approval in the ESP 1 Order (ESP 1 Order at 28; First ESP 1 EOR at 12-13). Thus, contrary to IEU-Ohio's claim, there was an economic basis upon which to authorize recovery of such costs. Accordingly, IEU-Ohio's second assignment of error is without merit and should be denied.

(17) In its third assignment of error, IEU-Ohio argues that the Commission erred in finding that recovery of the environmental investment carrying charges is authorized pursuant to Section 4928.143(B)(1), Revised Code, as no party advanced this argument. Further, IEU-Ohio contends that the

Commission's determination is beyond the scope of the Court's remand and violates the law of the case doctrine. (IEU-Ohio App. at 9-13.)

(18) AEP-Ohio asserts that IEU-Ohio cites no authority for the proposition that the Commission must confine its analysis of an issue to only those arguments advanced by the parties. The Companies further contend that IEU-Ohio misstates the law of the case doctrine. AEP-Ohio also notes that IEU-Ohio does not, and cannot, criticize the merits of the Commission's conclusion, in that the environmental investment carrying charges are properly recoverable pursuant to Section 4928.143(B)(1), Revised Code. (Cos. Memo Contra at 14-16.)

(19) It is well within the Commission's discretion to cite and rely upon statutory authority even where such authority is not referenced by any party to the proceedings. The Court has stated that "nothing precludes the [C]ommission from passing upon the proper application or construction of a statute."[5] Additionally, the Commission finds no merit in IEU-Ohio's assertion that the Remand Order violates the law of the case doctrine, which "provides that the decision of a reviewing court in a case remains the law of that case on the legal questions involved for all subsequent proceedings in the case at both the trial and reviewing levels."[6] Pursuant to the doctrine, "an inferior court has no discretion to disregard the mandate of a superior court in a prior appeal in the same case," absent extraordinary circumstances.[7] In its remand decision in the present cases, the Court reversed and remanded the issue of environmental investment carrying charges, stating that "[o]n remand, the [C]ommission may determine whether any of the listed categories of [Section 4928.143(B)(2), Revised Code] authorize recovery of environmental carrying charges."[8] The Commission fully complied with this mandate and found that Section 4928.143(B)(2)(d), Revised Code, authorizes such recovery. Although the Court's decision addresses Section 4928.143(B)(2), Revised Code, which was the statutory provision in question on appeal, nothing in the decision

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5 *Consumers' Counsel v. Pub. Util. Comm.* (1994), 70 Ohio St.3d 244, 248.

6 *Nolan v. Nolan* (1984), 11 Ohio St.3d 1, 3.

7 *Id.* at 5.

8 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 520.

precludes the Commission from considering other statutory provisions that may be relevant in resolving the remanded matter of the Companies' environmental carrying charges. The law of the case doctrine does not limit the Commission's authority to fully consider the issues remanded by the Court. IEU-Ohio's third assignment of error, therefore, should be denied.

(20) In its fourth assignment of error, IEU-Ohio argues that the Commission unlawfully and unreasonably permitted collection of the environmental carrying charges during a period in which there was no legal authority to permit collection of those revenues. Specifically, IEU-Ohio asserts that the Companies were permitted to collect and retain such revenues without legal authorization from the point at which the charges became subject to refund to the point at which the Commission issued the Remand Order. IEU-Ohio claims that collection of the environmental carrying charges was not legally authorized until the Remand Order was issued on October 3, 2011. (IEU-Ohio App. at 13-15.)

(21) AEP-Ohio submits that, notwithstanding the Court's remand decision, the rates and charges approved by the Commission in the ESP 1 Order remained the lawful rates and charges to be collected from customers until the Commission issued the Remand Order (Cos. Memo Contra at 5).

(22) The Commission finds that IEU-Ohio's argument is contrary to precedent holding that "[w]hen this court reverses and remands an order of the Public Utilities Commission establishing a revised rate schedule for a public utility, the reversal does not reinstate the rates in effect before the [C]ommission's order or replace that rate schedule as a matter of law, but is a mandate to the [C]ommission to issue a new order, and the rate schedule filed with the [C]ommission remains in effect until the [C]ommission executes this court's mandate by an appropriate order."[9] Thus, the environmental investment carrying charges approved for the Companies in the ESP 1 Order remained in effect during the course of the remand proceedings. Even though the remanded charges were made subject to refund pursuant to the May 25, 2011, entry, the

9 *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* (1976), 46 Ohio St.2d 105, 105 (syllabus).

charges remained valid throughout the pendency of these proceedings to the point at which we executed the Court's mandate and issued the Remand Order, reaffirming the charges. For this reason, IEU-Ohio's fourth assignment of error should be denied.

POLR Rider

(23) AEP-Ohio requests that the Commission grant rehearing and fully restore the POLR charges as approved in the ESP 1 Order or, alternatively, restore the charges to the level in place prior to the ESP 1 Order. AEP-Ohio raises six arguments in support of its position that the Remand Order and Tariff Approval Order are unjust and unreasonable with respect to the Companies' POLR charges. In its first assignment of error, AEP-Ohio argues that the Remand Order's finding that the Companies failed to present evidence of their actual POLR costs and did not justify recovery of their POLR charges at the level reflected in their existing rates is unlawful, unreasonable, and against the manifest weight of the evidence. AEP-Ohio states that the Commission's finding is predicated on the erroneous belief that it would have been reasonable for the Companies to have undertaken an *ex post* analysis of their POLR costs. AEP-Ohio claims that there is no evidence in the record that it was possible to conduct such an analysis. According to the Companies, the Commission's finding is also inconsistent with the Court's recognition that POLR charges may be justified for reasons other than actual costs. AEP-Ohio argues that the Commission unreasonably refused to address its alternative justification for non-cost-based POLR charges. (Cos. App. at 1-5.)

(24) OCC/OPAE respond that the Commission correctly determined that AEP-Ohio failed to present evidence of its actual POLR costs or evidence demonstrating that the Companies' POLR charges, if non-cost-based, are reasonable (OCC/OPAE Memo Contra at 3-6). IEU-Ohio adds that AEP-Ohio's first assignment of error should be rejected as meritless, given the Commission's rejection of the unconstrained option model, and that there was nothing to prevent the Companies from determining their actual, after-the-fact POLR costs. IEU-Ohio also argues that the record does not support a conclusion that the unconstrained option model would be appropriate to

establish a non-cost-based POLR charge. (IEU-Ohio Memo Contra at 2-6.)

(25) In the Remand Order, the Commission concluded that "AEP-Ohio has failed to present evidence of its actual POLR costs and has not justified recovery of POLR charges at the level reflected in its existing rates" (Remand Order at 24). We thoroughly reviewed and cited to ample evidence in the record in reaching this conclusion. We rejected AEP-Ohio's theory that the value of the POLR optionality to customers is precisely equal to the Companies' costs and found that the Companies' modeled costs should not be equated with actual costs. We also addressed AEP-Ohio's alternative justification for non-cost-based POLR charges. As another matter, we noted that it would have been reasonable for the Companies to carry out an *ex post* analysis of their actual POLR costs, given the Court's concerns, and in light of the unique circumstances of these remand proceedings. (Remand Order at 22-23.) The Companies' testimony suggests that it would in fact be possible to identify after-the-fact POLR costs, despite their concerns about the appropriateness of such an analysis, and does not directly refute the possibility (Cos. Remand Ex. 3 at 12-13; Remand Tr. II at 246-247). In any event, our conclusion that AEP-Ohio failed to present evidence of its actual costs was not predicated on the lack of an *ex post* analysis. Additionally, as we addressed in the Remand Order, the Companies did not demonstrate that their POLR charges, if considered non-cost-based, are reasonable, as required by the Court. Although AEP-Ohio points to evidence that purportedly establishes that the POLR charges are lawful pursuant to Section 4928.143(B)(2)(d), Revised Code, AEP-Ohio did not demonstrate how the charges derived from the option model are reasonable in concept or magnitude. For these reasons, AEP-Ohio's first assignment of error has no merit and should be rejected.

(26) In its second assignment of error, AEP-Ohio asserts that the Remand Order's finding that the unconstrained option model fails to provide a reasonable measure of the Companies' POLR costs is unreasonable and against the manifest weight of the evidence particularly given the Commission's finding that the Companies have POLR risks and that the costs associated with such risks may be recovered through a POLR charge. AEP-

Ohio states that the Commission's finding is predicated on the incorrect assumption that the Court rejected the model as a means to measure the Companies' POLR costs. (Cos. App. at 5-8.)

(27) OCC/OPAE reply that the Commission correctly determined that AEP-Ohio's unconstrained option model fails to reasonably measure POLR costs and that the Companies failed to meet their burden of proof (OCC/OPAE Memo Contra at 6-7). IEU-Ohio likewise argues that the Commission should reject AEP-Ohio's second assignment of error, as the option model fails to provide the cost of POLR service (IEU-Ohio Memo Contra at 6-8).

(28) The Court found that the unconstrained option model "does not reveal 'the cost to the Companies to be the POLR and carry the risks associated therewith.'"[10] On remand, the Commission considered all of the evidence with respect to the unconstrained option model. We agreed with the Court that the model, which purportedly measures the value of the POLR optionality to customers, does not disclose AEP-Ohio's POLR costs, in light of our finding that the value of the POLR optionality provided to customers does not equal the Companies' costs. (Remand Order at 28-29.) There is thus no merit in AEP-Ohio's argument that we wrongly applied the Court's decision. Neither was it unreasonable or unlawful to eliminate the Companies' POLR charges. Although we indeed recognized that AEP-Ohio has POLR risks and that the costs associated with such risks may be recovered through a POLR charge (Remand Order at 22), the model fails to measure such costs. AEP-Ohio failed to support its proposed POLR charges and, without evidence in the record to establish an appropriate amount for recovery, the Commission did not err in eliminating the POLR charges. AEP-Ohio's second assignment of error should be denied.

(29) AEP-Ohio next argues that the Remand Order exceeds the scope of the Commission's jurisdiction in finding that the POLR risk of an electric distribution utility (EDU) does not include migration risk and conflicts with Sections 4928.14 and 4928.141, Revised Code. According to the Companies,

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10 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518 (quoting ESP 1 Order at 40).

migration risk was not properly an issue for the Commission's consideration in the remand proceedings. Additionally, AEP-Ohio contends that the Remand Order contains conflicting findings regarding migration risk. (Cos. App. at 8-13.)

(30) According to OCC/OPAE, the Commission acted within its discretion in its conduct of the remand proceedings in allowing the scope of the proceedings to include definition of POLR risks. OCC/OPAE assert that the Court reversed the entire order authorizing the Companies' POLR charges. (OCC/OPAE Memo Contra at 8-10.) IEU-Ohio contends that the Commission correctly followed the Court's decision to conclude that POLR risk does not include migration risk or the related lost revenues (IEU-Ohio Memo Contra at 8-11).

(31) The Commission disagrees with AEP-Ohio's argument that the Remand Order contains conflicting findings regarding migration risk. The first finding refers to the "'risks associated with customers switching to [competitive retail electric service] providers and returning to the electric utility's [standard service offer] rate'" and the Commission's continued belief that "the Companies have such risks and that the costs associated with such risks may be recovered through a POLR charge" (Remand Order at 22, quoting ESP 1 Order at 40). This finding was not intended to specifically distinguish between migration risk and return risk or to imply that migration risk is a proper component of a POLR charge. In the second finding, however, we specified that "migration risk is more properly regarded as a business risk faced by all retail suppliers as a result of competition rather than a risk resulting from an EDU's POLR obligation" (Remand Order at 31-32). With respect to AEP-Ohio's remaining arguments on the subject of migration risk, the Companies have presented no new arguments for our consideration. Accordingly, the Companies' third assignment of error should be denied.

(32) In its fourth assignment of error, AEP-Ohio asserts that the Remand Order and Tariff Approval Order exceed the scope of the Commission's jurisdiction in eliminating the POLR charges in full. The Companies argue that the Commission is precluded from eliminating that portion of the POLR charges that the Commission approved in the RSP Case prior to the ESP 1 Order as it was not open to challenge in these

proceedings or called into question by the Court's remand decision. (Cos. App. at 13-17.)

(33) In response, OCC/OPAE contend that the Commission acted within its discretion when it ordered the elimination of the entire POLR charges from the Companies' tariffs. OCC/OPAE note that the Commission approved POLR charges in the ESP 1 Order that were based on pre-ESP 1 rates plus an additional amount. (OCC/OPAE Memo Contra at 11-12.) IEU-Ohio points out that the POLR charges approved in the ESP 1 Order, which are based on the unconstrained option model, have no continuing relationship with any amount authorized for collection in the RSP Case. According to IEU-Ohio, once the Commission rejected the option model, there was no basis for authorizing any POLR charges. (IEU-Ohio Memo Contra at 11-13.)

(34) The Commission notes that AEP-Ohio originally proposed POLR charges that would collect a revenue requirement of $108.2 million for CSP and $60.9 million for OP (ESP 1 Order at 38). Specifically, the Companies adjusted the POLR charges authorized in the RSP Case such that the proposed new level of costs, which were based on the option model, would be recovered (Cos. Ex. 1 at 12, Ex. DMR-5; Cos. Ex. 2-A at 31). In the ESP 1 Order, we approved 90 percent of the proposed charges, finding that "the POLR rider shall be established to collect a POLR revenue requirement of $97.4 million for CSP and $54.8 million for OP" (ESP 1 Order at 40). The Court subsequently reversed the provisions of the ESP 1 Order that authorized the Companies' POLR charges.[11] As the ESP 1 Order specifically addressed the full amount of the proposed revenue requirements, not just the increased amount, and authorized 90 percent of the proposed charges, we find no error in having eliminated the charges in their entirety. AEP-Ohio's fourth assignment of error is thus denied.

(35) AEP-Ohio next claims that the Remand Order and Tariff Approval Order are unreasonable and unlawful in ordering the elimination of the POLR charges in full given the Commission's findings in the Remand Order that "the Companies have such risks and that the costs associated with such risks may be

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11 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

recovered through a POLR charge" (Remand Order at 22) and that AEP-Ohio "has not justified recovery of POLR charges at the level reflected in its existing rates" (Remand Order at 24). AEP-Ohio maintains that it is unreasonable based on the record to conclude that the Companies should receive no compensation for the unique POLR risks that the law imposes. (Cos. App. at 17-19.)

(36) OCC/OPAE respond that the Commission's elimination of AEP-Ohio's POLR charges was not unreasonable or unlawful because the Companies failed to meet their burden of proving their out-of-pocket POLR costs (OCC/OPAE Memo Contra at 13). IEU-Ohio adds that AEP-Ohio essentially seeks to continue to collect POLR charges at the level authorized in the RSP Case based on no record support and a claim that it is entitled to some level of compensation in light of the Commission's finding that the Companies have POLR risks (IEU-Ohio Memo Contra at 13-15).

(37) As discussed above, the Companies did not justify their proposed POLR charges, which were derived from a model that does not measure POLR costs. In the absence of evidence as to the appropriate amount for recovery, the Commission did not err in fully eliminating the POLR charges. AEP-Ohio's fifth assignment of error should be denied.

(38) In its sixth assignment of error, AEP-Ohio argues that the Tariff Approval Order is unlawful in that it circumvents the jurisdictional rehearing process and fails to set forth the reasons prompting the Commission to reverse its conclusion in the Remand Order that only the "increased POLR charges authorized as a part of the ESP Order are insufficiently supported by the record on remand" (Remand Order at 33). AEP-Ohio asserts that it has consistently advocated that the scope of the remand proceedings is jurisdictionally limited to the amount of the POLR increase authorized in the ESP 1 Order, although other parties contend that the POLR charges should be eliminated in their entirety. The Companies claim that the Commission resolved this dispute in their favor in the Remand Order but reversed course, without explanation, in the Tariff Approval Order. (Cos. App. at 19-22.)

(39) In reply, OCC/OPAE argue that the Tariff Approval Order is lawful, noting that the Commission routinely approves tariffs prior to the resolution of applications for rehearing. OCC/OPAE also assert that the Remand Order was not dispositive of the issue of whether the Companies' POLR charges should be eliminated in full or in part. (OCC/OPAE Memo Contra at 13-14.) IEU-Ohio agrees with OCC/OPAE that the Tariff Approval Order is a valid order. According to IEU-Ohio, in the Remand Order, the Commission concluded that the Companies' POLR charges cannot be authorized and directed them to file tariffs removing the POLR charges. Accordingly, IEU-Ohio claims that the Tariff Approval Order cannot properly be described as an "unexplained reversal." (IEU-Ohio Memo Contra at 15-17.)

(40) Upon consideration of AEP-Ohio's sixth assignment of error, the Commission finds it necessary to clarify the intent of the Remand Order, as the parties differ considerably in their understanding of whether the Companies' POLR charges were expected to be eliminated in full or in part. Although AEP-Ohio quotes several portions of the Remand Order that purportedly support its argument that the Commission intended to eliminate the POLR charges only in part, it was our intent in the Remand Order to direct the Companies to eliminate the POLR charges in their entirety, consistent with our finding that the Companies failed to provide any evidence of their actual POLR costs and that the unconstrained option model does not measure POLR costs. The portions of the Remand Order cited by AEP-Ohio were meant to convey that the full amount of the POLR charges authorized in the ESP 1 Order, and not just the amount of the increase over the prior POLR charges authorized in the RSP Case, should be pulled out of the revised tariffs. As discussed above, the ESP 1 Order addressed the full amount of the Companies' proposed POLR revenue requirements, not just the increased amount, and authorized 90 percent of their proposed charges. Accordingly, we find no merit in AEP-Ohio's argument that the Commission reversed course in the Tariff Approval Order and circumvented the rehearing process. AEP-Ohio's sixth assignment of error should be denied.

Flow-Through Effects of Remand

(41) IEU-Ohio's fifth, sixth, seventh, and eighth assignments of error pertain to the Commission's treatment in the Remand Order of the flow-through effects of the Court's remand. In its fifth assignment of error, IEU-Ohio argues that the Commission unlawfully and unreasonably failed to order an adjustment of OP's phase-in deferral balance caused by the ESP 1 rate caps on the theory that the proposed adjustment would be tantamount to retroactive ratemaking. IEU-Ohio next submits that the Commission unlawfully and unreasonably failed to order an adjustment of OP's phase-in deferral balance based on a finding that the past rates have already been collected from customers, which is not supported in the record. In its seventh assignment of error, IEU-Ohio argues that the Commission unlawfully and unreasonably extended the prohibition on retroactive ratemaking to prevent an adjustment of phase-in deferral balances that have not been collected from customers and were subject to further adjustment by the ESP 1 Order, which established the basis for the deferral balances. Finally, IEU-Ohio contends that the Commission unlawfully and unreasonably failed to address the flow-through effects of the Court's remand on deferral balances; recovery of delta and Universal Service Fund revenues; earnings of the Companies pursuant to the significantly excessive earnings test of Section 4928.143(F), Revised Code; and the Companies' pending ESP application in Case No. 11-346-EL-SSO, *et al.* (IEU-Ohio App. at 15-25.)

(42) Similarly, OCC/OPAE argue that the Commission erred when it failed to reduce the phase-in deferrals by the amount of the unjustified POLR charges collected from April 2009 through May 2011 (*i.e.*, from the beginning of the ESP 1 term through the point at which the charges became subject to refund). Specifically, in their first assignment of error, OCC/OPAE assert that the deferrals violate Section 4928.143, Revised Code, in that the deferrals are a direct result of rates that the Companies did not justify under Section 4928.143(B)(2), Revised Code (OCC/OPAE App. at 6-10). In their second assignment of error, OCC/OPAE claim that the phase-in is not just and reasonable and includes deferrals that are not related to the incurred costs of ESP 1, in violation of Section 4928.144, Revised Code (OCC/OPAE App. at 10-11). Next, OCC/OPAE

contend that, in failing to reduce the amount of the deferrals, the Commission violated Section 4928.06, Revised Code, and the state policies found in Section 4928.02(A) and (L), Revised Code (OCC/OPAE App. at 11-12). In their fourth assignment of error, OCC/OPAE dispute the Commission's conclusion that an adjustment to the deferrals would constitute retroactive ratemaking. OCC/OPAE maintain that, where there is a rate mechanism that provides for a prospective adjustment, there is no retroactive ratemaking. (OCC/OPAE App. at 12-14.)

(43) In a similar vein, OCC/OPAE argue in their fifth assignment of error that the Commission should have ordered the Companies to compensate customers for POLR charges collected from April 2009 through May 2011 in the form of interest at a rate of 10.93 percent (OCC/OPAE App. at 14-15).

(44) AEP-Ohio argues that the Commission properly rejected the flow-through arguments of IEU-Ohio and OCC/OPAE because revenues collected under tariffs approved by the Commission are lawfully collected, notwithstanding the fact that the Ohio Supreme Court subsequently reverses and remands the Commission's order approving the tariffs (Cos. Memo Contra at 3-6). Additionally, the Companies contend that the deferrals were properly approved in the Commission's ESP 1 Order and cannot now be collaterally attacked in the remand proceedings (Cos. Memo Contra at 6-7). AEP-Ohio also asserts that a reduction in the deferrals would constitute retroactive ratemaking (Cos. Memo Contra at 7-11). Finally, the Companies claim that, if the Commission were to order an adjustment to the deferrals, it would undermine state policy, contrary to the argument of OCC/OPAE (Cos. Memo Contra at 11).

(45) The Commission affirms its decision to decline to order an adjustment to the FAC deferral balance as any such adjustment would constitute unlawful retroactive ratemaking. As we thoroughly discussed in the Remand Order, IEU-Ohio and OCC/OPAE seek what would essentially amount to a refund or credit of the Companies' unjustified charges, which is not a permissible remedy pursuant to Court precedent. We find that many of the arguments raised by IEU-Ohio and OCC/OPAE with regard to the flow-through effects of the Court's remand

were already raised by the parties and have been fully addressed (Remand Order at 34-36).

(46) In its sixth assignment of error, IEU-Ohio challenges the Commission's finding that "[c]onsistent with the Court's precedent, we cannot order a prospective adjustment to account for past rates that have already been collected from customers and subsequently found to be unjustified" (Remand Order at 36). Specifically, IEU-Ohio disputes that the rates have already been collected from customers, noting that the deferrals created as a result of the ESP 1 Order are for amounts that have not yet been collected from customers. We note, however, that the past rates to which we were referring are not the deferrals but rather the rates associated with the unjustified POLR charges that have in fact already been collected from customers. Therefore, we find no merit in IEU-Ohio's contention that the Remand Order is premised on an incorrect factual assertion, and IEU-Ohio's sixth assignment of error should be denied.

(47) Given our finding that an adjustment to the FAC deferral balance would constitute unlawful retroactive ratemaking, the Commission finds no merit in OCC/OPAE's arguments that the Remand Order violates Sections 4928.02, 4928.06, 4928.143, and 4928.144, Revised Code. Further, with respect to OCC/OPAE's contention that the phase-in includes deferrals that are not related to the incurred costs of ESP 1, we note that the deferred costs in question are FAC, not POLR, costs. Accordingly, OCC/OPAE's first, second, and third assignments of error should be denied.

(48) For the reasons provided in response to the parties' other arguments related to flow-through effects (Remand Order at 35-36), OCC/OPAE's fifth assignment of error regarding interest on the unjustified POLR charges for the period of April 2009 through May 2011 is without merit and should be denied.

(49) In sum, we find that IEU-Ohio's fifth, sixth, seventh, and eighth assignments of error, as well as the five assignments of error raised by OCC/OPAE, should be denied.

It is, therefore,

ORDERED, That the applications for rehearing filed by AEP-Ohio, IEU-Ohio, and OCC/OPAE on November 2, 2011, be denied. It is, further,

ORDERED, That a copy of this entry on rehearing be served upon all persons of record in these cases.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

SJP/GNS/sc

Entered in the Journal

DEC 14 2011

Betty McCauley
Secretary

128 Ohio St.3d 512, 947 N.E.2d 655, Util. L. Rep. P 27,139, 2011 -Ohio- 1788

Briefs and Other Related Documents
Judges and Attorneys

Supreme Court of Ohio.
IN RE APPLICATION OF COLUMBUS SOUTHERN POWER COMPANY et al.; Office of the Ohio Consumers' Counsel et al., Appellants; Public Utilities Commission et al., Appellees.

No. 2009–2022.
Submitted Feb. 2, 2011.
Decided April 19, 2011.

**Background:** Office of the Ohio Consumers' Counsel (OCC) and association of large industrial energy consumers appealed decision of Public Utilities Commission (PUC), 2009 WL 803606, authorizing new generation rates for two utilities in utilities' electric security plan (ESP). Operating company of the utilities intervened in support of PUC.

**Holdings:** The Supreme Court, Lundberg Stratton, J., held that:
(1) PUC unlawfully granted operating company a retroactive rate increase;
(2) Supreme Court could not order refund to OCC;
(3) PUC's approval of provider of last resort (POLR) charge was an abuse of discretion;
(4) deadline for PUC to authorize an ESP was directory, not mandatory; and
(5) association failed to show error in PUC approving electric utility's charges related to a pair of generation stations.

Affirmed in part, reversed in part, and remanded.

West Headnotes

[1] KeyCite Citing References for this Headnote

145 Electricity
145k11.3 Regulation of Charges
145k11.3(1) k. In general. Most Cited Cases

Public Utilities Commission (PUC) unlawfully granted operating company of utilities a retroactive rate increase, where operating company sought a rate increase effective January 2009, but the PUC did not issue an order until mid-March, company collected less revenue than it would have, had the application been approved before January 1, and PUC set rates at a level intended to permit the utilities to recover 12 months of revenue over a 9–month–period. R.C. § 4903.16.

[2] KeyCite Citing References for this Headnote

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak120 k. Nature and extent in general. Most Cited Cases

Utility may not charge increased rates during proceedings before the Public Utilities Commission (PUC) seeking same; and, losses sustained thereby while the case is pending may not be recouped.

[3] KeyCite Citing References for this Headnote

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak120 k. Nature and extent in general. Most Cited Cases

Present rates may not make up for dollars lost during the pendency of Public Utilities Commission (PUC) proceedings.

[4] KeyCite Citing References for this Headnote

145 Electricity
145k11.5 Discrimination and Overcharge
145k11.5(2) k. Actions by consumers. Most Cited Cases

Law did not allow refunds in appeals from Public Utilities Commission (PUC) orders, and any refund order by Supreme Court in appeal from PUC order would have been retroactive ratemaking, thus, Supreme Court could not order refund to Ohio Consumers' Counsel (OCC) in challenge to new generation rates for two utilities, although PUC engaged in retroactive ratemaking by setting rates at a level intended to permit utilities to recover 12 months of revenue over a 9-month-period to make up for three month regulatory delay in approval of the rates, and no refund rule transformed OCC's win on the merits into a somewhat hollow victory. R.C. § 4903.16.

[5] KeyCite Citing References for this Headnote

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak123 k. Reasonableness of charges in general. Most Cited Cases

Statutes protect against unlawfully high utility rates by allowing stays. R.C. § 4903.16.

[6] KeyCite Citing References for this Headnote

317A Public Utilities
317AII Regulation
317Ak111 k. In general. Most Cited Cases

It is the prerogative of the General Assembly to establish the bounds and rules of public-utility regulation.

[7] KeyCite Citing References for this Headnote

317A Public Utilities
317AII Regulation
317Ak114 k. Service and facilities. Most Cited Cases

Utility customers may purchase generation service from a competitive supplier.

[8] KeyCite Citing References for this Headnote

317A Public Utilities
317AII Regulation
317Ak114 k. Service and facilities. Most Cited Cases

Utility's statutory obligation to stand ready to accept customers returning after they had chosen competitive supplier that failed to provide service makes the utility the provider of last resort (POLR). R.C. § 4928.14.

[9] KeyCite Citing References for this Headnote

145 Electricity
145k11.3 Regulation of Charges
145k11.3(4) k. Operating expenses. Most Cited Cases

There was no evidence in the Public Utilities Commission (PUC) record that suggested that electric utility's provider of last resort (POLR) charge of over $500 million over the term of the electric security plan (ESP) was related to any costs that utility would incur, and, thus, PUC's approval of charge was an abuse of discretion and reversible error.

[10] KeyCite Citing References for this Headnote

145 Electricity
145k11.3 Regulation of Charges
145k11.3(4) k. Operating expenses. Most Cited Cases

Electric utility could not recover certain carrying costs associated with environmental investments, where they were not specifically authorized by statute. R.C. § 4928.143(B)(2).

[11] KeyCite Citing References for this Headnote

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k227 k. Construction as mandatory or directory. Most Cited Cases

As a general rule, a statute which provides a time for the performance of an official duty will be construed as directory so far as time for performance is concerned, especially where the statute fixes the time simply for convenience or orderly procedure; this is so unless the nature of the act to be performed or the phraseology of the statute or of other statutes relating to the same subject-matter is such that the designation of time must be considered a limitation upon the power of the officer.

[12] KeyCite Citing References for this Headnote

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k227 k. Construction as mandatory or directory. Most Cited Cases

Deadlines concerned with the prompt conduct of the public business should be considered directory, not mandatory; use of the word "shall" to institute the deadline does not change this.

[13] KeyCite Citing References for this Headnote

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k227 k. Construction as mandatory or directory. Most Cited Cases

A deadline provision that does not mandate any particular result if the decision is untimely further supports an interpretation that deadline should be considered directory, not mandatory.

[14] KeyCite Citing References for this Headnote

145 Electricity
145k11.3 Regulation of Charges
145k11.3(6) k. Proceedings before commissions. Most Cited Cases

Deadline for Public Utilities Commission (PUC) to authorize an electric security plan (ESP) within the 150-day time frame was directory, not mandatory; General Assembly enacted the 150-day deadline to ensure prompt review of initial ESP applications and hasten the filing and review of initial ESPs, not to set a jurisdictional bar. R.C. § 4928.143(C)(1).

[15] KeyCite Citing References for this Headnote

145 Electricity
145k11.3 Regulation of Charges
145k11.3(7) k. Judicial review and enforcement. Most Cited Cases

Utility could accept Public Utilities Commission's (PUC) modification and approval of electric security plan (ESP) and file an appeal to Supreme Court; law permitted utilities to withdraw modified ESPs, but did not require it.

[16] KeyCite Citing References for this Headnote

30 Appeal and Error
30XVI Review
30XVI(A) Scope, Standards, and Extent, in General
30k838 Questions Considered
30k843 Matters Not Necessary to Decision on Review
30k843(1) k. In general. Most Cited Cases

Supreme Court does not address hypothetical questions.

[17] KeyCite Citing References for this Headnote

145 Electricity
145k11.3 Regulation of Charges
145k11.3(6) k. Proceedings before commissions. Most Cited Cases

Public Utilities Commission (PUC) adequately explained why it departed from its precedents by allowing electric utility to keep all proceeds from off-system sales, meaning unregulated sales to other resellers and not to retail customers, rather than requiring utility to give the net profits of those sales as a rate credit to consumers as it had done in the past.

[18] KeyCite Citing References for this Headnote

317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(B) Proceedings Before Commissions
317Ak168 k. Findings. Most Cited Cases

If Public Utilities Commission (PUC) changes course with respect to its precedents, it must explain why.

[19] KeyCite Citing References for this Headnote

145 Electricity
145k11.3 Regulation of Charges
145k11.3(7) k. Judicial review and enforcement. Most Cited Cases

Association of large industrial energy consumers failed to show error concerning the approval by Public Utilities Commission (PUC) of electric utility's charges related to a pair of generation stations, where it cited generally to uncodified statute that was 50 pages long, and general citation did not provide enough guidance. R.C. § 4903.13; 152 Ohio Laws, p. 905.

[20] KeyCite Citing References for this Headnote

317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(C) Judicial Review or Intervention
317Ak188 Appeal from Orders of Commission
317Ak195 k. Presumptions in favor of order or findings of commission. Most Cited Cases

A party who contends that rates and charges are unreasonable has the statutory burden on appeal to the Supreme Court of showing that they are unjust, unreasonable, or unlawful. R.C. § 4903.13.

[21] KeyCite Citing References for this Headnote

317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(C) Judicial Review or Intervention
317Ak188 Appeal from Orders of Commission
317Ak194 k. Review and determination in general. Most Cited Cases

Conclusory assertions that the Public Utilities Commission (PUC) cannot do something fall well short of demonstrating reversible error.

[22] KeyCite Citing References for this Headnote

145 Electricity
145k11.3 Regulation of Charges
145k11.3(7) k. Judicial review and enforcement. Most Cited Cases

Association of large industrial energy consumers failed to show error concerning the approval by Public Utilities Commission (PUC) of electric utility's charges related to enhanced vegetation

management, where PUC explained why it considered one distribution program, but not the other.

[23] KeyCite Citing References for this Headnote

145 Electricity
145k11.3 Regulation of Charges
145k11.3(7) k. Judicial review and enforcement. Most Cited Cases

Association of large industrial energy consumers failed to show error concerning the approval by Public Utilities Commission (PUC) of electric utility's charges related to smart-grid programs; statute that established that public policy was to encourage innovation and market access for cost-effective supply- and demand-side retail electric service including, but not limited to, demand-side management, time-differentiated pricing, and implementation of advanced metering infrastructure did not require anything, PUC plainly weighed this policy consideration in reviewing the programs, and the programs advanced the policies. R.C. § 4928.02(D).

[24] KeyCite Citing References for this Headnote

317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(A) In General
317Ak145 Powers and Functions
317Ak146 k. Legislative and judicial powers and functions. Most Cited Cases

Statutory policy statements are guidelines for the Public Utilities Commission (PUC) to weigh in evaluating utility proposals to further state policy goals; it is left to the PUC to determine how best to carry them out. R.C. § 4928.02.

[25] KeyCite Citing References for this Headnote

145 Electricity
145k11.3 Regulation of Charges
145k11.3(7) k. Judicial review and enforcement. Most Cited Cases

Association of large industrial energy consumers failed to show error concerning the setting by Public Utilities Commission (PUC) of electric utility's charges related to fuel-cost baseline, where PUC adopted its staff's fuel-cost estimates, only actual costs would be recovered, and they would be subject to prudence review. R.C. § 4928.143(B)(2)(a).

[26] KeyCite Citing References for this Headnote

145 Electricity
145k11.3 Regulation of Charges
145k11.3(7) k. Judicial review and enforcement. Most Cited Cases

Association of large industrial energy consumers did not specifically explain how the Public Utilities Commission (PUC) failed to explain itself in orders and entries on rehearing which totaled 140 pages relating to authorization of new generation rates in utilities' electric security plan (ESP).

[27] KeyCite Citing References for this Headnote

317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(C) Judicial Review or Intervention
317Ak188 Appeal from Orders of Commission
317Ak194 k. Review and determination in general. Most Cited Cases

Appellant needs to show three things to prevail under statute that requires Public Utilities Commission (PUC) to issue findings of fact and written opinions setting forth the reasons prompting the decisions arrived at, based upon said findings of fact: first, that the PUC initially failed to explain a material matter, second, that appellant brought that failure to the PUC's attention through an application for rehearing, and third, that the PUC still failed to explain itself.

***658** Janine L. Migden-Ostrander, Consumers' Counsel, and Terry L. Etter, Maureen R. Grady, and Richard C. Reese, Assistant Consumers' Counsel, for appellant Ohio Consumers' Counsel.

McNees, Wallace & Nurick, L.L.C., Samuel C. Randazzo, Columbus, Joseph E. Oliker, and Frank P. Darr, Delaware, for appellant Industrial Energy Users-Ohio.

Michael DeWine, Attorney General, and William L. Wright, Werner L. Margard III, Thomas G. Lindgren, and John H. Jones, Assistant Attorneys General, for appellee Public Utilities Commission of Ohio.

Porter, Wright, Morris & Arthur, L.L.P., and Daniel R. Conway, Columbus; and Steven T. Nourse and Matthew J. Satterwhite, Columbus, for intervening appellees, Columbus Southern Power Company and Ohio Power Company.

LUNDBERG STRATTON, J.

***512** {¶ 1} This appeal stems from a major proceeding in which the Ohio Public Utilities Commission authorized new generation rates for the American Electric Power operating companies ("AEP") Columbus Southern Power Company and Ohio Power Company. The appellants, the Office of the Ohio Consumers' Counsel ("OCC") and Industrial Energy Users-Ohio ("IEU"), raise 13 propositions of law. We hold that the commission committed reversible error on three grounds, affirm on all other issues, and remand the order to the commission for further proceedings.

****659 *513 I. Factual Background**

{¶ 2} In 2008, the General Assembly enacted Senate Bill 221, 2008 Am.Sub.S.B. No. 221 ("S.B. 221"), which substantially revised the regulation of electric service in Ohio. Before S.B. 221, there was Senate Bill 3. Adopted in 1999, Senate Bill 3, 148 Ohio Laws, Part IV, 7962, was designed "to facilitate and encourage development of competition in the retail electric market." *AK Steel Corp. v. Pub. Util. Comm.* (2002), 95 Ohio St.3d 81, 765 N.E.2d 862. Competition, however, "fail[ed] * * * to develop according to expectations." *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 114 Ohio St.3d 340, 2007-Ohio-4276, 872 N.E.2d 269, ¶ 3.

{¶ 3} This failure followed a nationwide trend. Soon after several states passed deregulatory laws, "two tumultuous events—the crisis of electric power in California and the collapse of the world's largest electric trading corporation, Enron"—"cast something of a cloud over the deregulation movement, which had been almost the signature cause of the 1980s and 1990s." Cudahy, Whither Deregulation: A Look at the Portents (2001), 58 N.Y.U. Ann.Surv.Am.Law 155, 155. Beyond these particular crises, "the cost of generating power increased significantly, due primarily to increases in the costs of the underlying fuel sources." Van Nostrand, Constitutional Limitations on the Ability of States to Rehabilitate Their Failed Electric Utility Restructuring Plans (2008), 31 Seattle U.L.Rev. 593, 593-594. Several states experimenting with deregulation found, as did Ohio, that "the anticipated competition did not develop." Id. at 593.

{¶ 4} Faced with a lack of competition, rising electricity prices, and unpalatable market-based rates, the commission and utilities responded with various rate plans not expressly contemplated by statute. In reviewing these plans, we recognized the possibility that additional legislative action might be required. In *Ohio Consumers' Counsel*, 114 Ohio St.3d 340, 2007-Ohio-4276, 872 N.E.2d 269, ¶ 41, we observed, "[A]s we continue to see the rate-stabilization plans appealed from the commission, we presume that the commission is sharing its evaluations and reports on the effectiveness of competition with the legislature, * * * so that it can continue to evaluate the need for further legislative action."

{¶ 5} "[F]urther legislative action" arrived with S.B. 221. The bill addressed several areas of concern with electric markets. Pertinent here, it established new standards to govern generation rates. See R.C. 4928.141 through 4928.144. Broadly speaking, the new regulatory regime requires electric-distribution utilities to provide consumers with "a standard service offer of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service." R.C. 4928.141(A). The utility may provide the offer in one of two ways: through a "market rate offer" under R.C. 4928.142 or through an "electric security plan" under R.C. 4928.143. ***514** The market-rate offer, as the name implies, sets rates using a competitive-bidding process to harness market forces.

{¶ 6} AEP applied for the second option, an electric security plan ("ESP"). It filed its application on July 31, 2008, and multiple parties intervened. A hearing was held from November to December 2008, briefing was completed over the holidays, and on March 18, 2009, the commission issued a 77-page opinion and order modifying and approving the plan. Two rounds of rehearing applications followed, resolved by entries on July 23 and November 4. OCC and IEU appealed. AEP has intervened in support of the commission.

## **660 II. Discussion

{¶ 7} The appellants have raised 13 propositions of law, which we have reduced to ten issues. We begin with the three issues in which the appellants have demonstrated error.

### *A. OCC Propositions of Law 1, 2, and 3: The commission violated the law by granting a retroactive rate increase, but OCC is not entitled to a monetary refund*

{¶ 8} In its first three propositions of law, OCC argues that the commission unlawfully granted AEP a $63 million retroactive rate increase, in violation of R.C. 4928.141(A), as well as the rule established in *Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co.* (1957), 166 Ohio St. 254, 2 O.O.2d 85, 141 N.E.2d 465. We agree with OCC on the merits: the commission unlawfully granted a retroactive rate increase. For reasons discussed, however, OCC has not established that it is entitled to its requested remedy of a refund.

#### *1. The commission unlawfully granted AEP a retroactive rate increase*

[1] {¶ 9} AEP had sought a rate increase effective January 2009, but the commission did not issue an order until mid-March. Thus, from January through March, AEP collected less revenue than it would have if the application had been approved before January 1. In response to this delay in rate relief, the commission set AEP's rates at a level "intended to permit the companies to recover 12 months of revenue over a 9-month period." The additional increase totaled $63 million.

{¶ 10} This was retroactive ratemaking. Although the commission did not authorize AEP to rebill customers for usage from January through March, it reached the same financial result by setting rates from April through December 2009 at a level sufficient to recover lost revenues from January through March. In AEP's words, "the Commission's decision * * * yield[s] a similar financial impact as would have occurred if a decision had been issued by December 28, 2008 * * *." By approving rates that recouped losses due to past regulatory ***515** delay, the commission violated this court's case law on retroactive ratemaking, as well as provisions of S.B. 221.

[2] [3] {¶ 11} A rate increase making up for revenues lost due to regulatory delay is precisely the action that we found contrary to law in Keco. "[A] utility may not charge increased rates during proceedings before the commission seeking same[,] and losses sustained thereby"—that is, while the case is pending—"may not be recouped." Keco, 166 Ohio St. at 259, 2 O.O.2d 85, 141 N.E.2d 465. Likewise, in Lucas Cty. Commrs. v. Pub. Util. Comm. (1997), 80 Ohio St.3d 344, 348, 686 N.E.2d 501, we ruled that "utility ratemaking * * * is prospective only" and that R.C. Title 49 "prohibit[s] utilities from charging increased rates during the pendency of commission proceedings and appeals." Id. These cases make plain that present rates may not make up for dollars lost "during the pendency of commission proceedings." Id. That is exactly what occurred here.

{¶ 12} The appellees respond by arguing that Keco 's rule does not apply in proceedings under the new statutes of S.B. 221. We need not decide whether Keco continues to apply, as the ruling also violates a provision of S.B. 221 itself, under R.C. 4928.141(A). That section specifically prescribes the applicable rates if a new standard service offer has not been approved by January 1, 2009: preexisting rates " *shall* continue * * * until a standard service offer is first authorized under section * * * 4928.143." (Emphasis added.) R.C. 4928.141(A); see R.C. 4928.01(A)(33) ***661** (" '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").

{¶ 13} This section rules out retroactive rate increases. The requirement to continue existing rates is mandatory. Although the statute does not expressly prohibit a retroactive rate increase, the express remedy (to "continue" existing rates until new rates are approved) rules out nonexpress remedies (such as tracking and restoring the difference between old and new rates if approval is delayed). See, e.g., Myers v. Toledo, 110 Ohio St.3d 218, 2006-Ohio-4353, 852 N.E.2d 1176, ¶ 24 ("the express inclusion of one thing implies the exclusion of the other"). This statutory and case law concerning retroactive ratemaking spans nearly 50 years. Cf. Clark v. Scarpelli (2001), 91 Ohio St.3d 271, 278, 744 N.E.2d 719 ("It is presumed that the General Assembly is fully aware of any prior judicial interpretation of an existing statute when enacting an amendment").

{¶ 14} Thus, under either the case law or under R.C. 4928.141(A), the commission violated the law when it granted AEP additional rates to make up for the regulatory delay.

*2. OCC did not avail itself of the remedy provided by law*

{¶ 15} This conclusion leads to the more difficult question: What remedy is available for OCC? The unlawful rate increase lasted until the end of 2009 and ***516** has been fully recovered, so reversing the retroactive increase will not reduce ongoing rates. The rule against retroactive rates, however, also prohibits refunds.

[4] {¶ 16} OCC argues that the commission should have made the entire rate increase subject to refund but cites no authority under which the commission could have done so. As OCC recognizes, under Keco, we have consistently held that the law does not allow refunds in appeals from commission orders. As we stated only two years ago, "any refund order would be contrary to our precedent declining to engage in retroactive ratemaking." Ohio Consumers' Counsel v. Pub. Util. Comm., 121 Ohio St.3d 362, 2009-Ohio-604, 904 N.E.2d 853, ¶ 21; see also, e.g., Green Cove Resort I Owners' Assn. v. Pub. Util. Comm., 103 Ohio St.3d 125, 2004-Ohio-4774, 814 N.E.2d 829, ¶ 27 ("Neither the commission nor this court can order a refund of previously approved rates, however, based on the doctrine set forth in Keco * * * "); Keco, 166 Ohio St. 254, 2 O.O.2d 85, 141 N.E.2d 465, paragraph two of the syllabus (R.C. Title 49 "affords no right of action for restitution of the increase in charges collected during the pendency of the appeal"). These precedents remain good law and still apply to these facts, thus prohibiting the granting of a refund.

[5] {¶ 17} We recognize that the no-refund rule transforms OCC's win on the merits into a somewhat hollow victory. Any apparent unfairness, however, remains a policy decision mandated by the larger legislative scheme. As *Keco* and other cases have noted, the statutes protect against unlawfully high rates by allowing stays. R.C. 4903.16 authorizes the court to stay execution of commission orders. This section makes "clear that the General Assembly intended that a public utility shall collect the rates set by the commission's order, giving, however, to any person who feels aggrieved by such order a right to secure a stay of the collection of the new rates after posting a bond." *Keco*, 166 Ohio St. at 257, 2 O.O.2d 85, 141 N.E.2d 465. The stay remedy "completely ****662** abrogated" the form of refund (a restitution order) sought in that case. Id. at 259.

{¶ 18} The difficulty for OCC is that to obtain such a stay, it must "execute an undertaking * * * conditioned for the prompt payment by the appellant of all damages caused by the delay in the enforcement of the order." R.C. 4903.16; see also *Office of Consumers' Counsel v. Pub. Util. Comm.* (1991), 61 Ohio St.3d 396, 403-404, 575 N.E.2d 157 (the bond requirement applies to OCC under "R.C. 4903.16, and this court's interpretation thereof"). OCC acted with diligence and speed to secure a financial remedy in this case: it filed an action in prohibition, a quick—and premature—appeal, an action for a writ of procedendo, and a motion to suspend the order in this case. Critically, however, OCC did not seek to post a bond—in fact, it affirmatively sought to avoid doing so.

[6] ***517** {¶ 19} OCC concedes that it failed to post bond, but asserts that it is "not financially capable of posting any bond other than a nominal amount," a circumstance that makes "a stay * * * truly an illusory remedy at best unless the Court relieves OCC from filing a bond." To the degree that the bond requirement poses a barrier, however, it is one that must be cured by the General Assembly. Unquestionably, it is the prerogative of the General Assembly to establish the bounds and rules of public-utility regulation. See, e.g., *Akron v. Pub. Util. Comm.* (1948), 149 Ohio St. 347, 359, 78 N.E.2d 890 ("the legislative branch of the state government may confer upon" the commission "very broad [powers]" for the "supervision, regulation and, in a large measure, control of the operation of public utilities"). And our "revisory jurisdiction" over agency proceedings is limited to that "conferred by law." Section 2(d), Article IV, Ohio Constitution.

{¶ 20} The legislature has seen fit to attach a significant requirement to the court's stay power: the posting of a bond sufficient to protect the utility against damage. R.C. 4903.16. If the General Assembly so desired, it could remove or loosen this condition on the stay power. It has not done so, despite decades of cases refusing to grant a refund. At bottom, then, the statutory scheme creates OCC's problem. We understand the difficulty a public agency such as OCC faces in dealing with the bond requirement. Nevertheless, the statute is clear, and it clearly applies. Whether it is wise to apply the bond requirement to OCC is a matter for the General Assembly to consider, not this court.

{¶ 21} For these reasons, we hold that the commission's decision to authorize a retroactive rate increase was unlawful, but we deny OCC's refund request.

*B. IEU Proposition of Law 3; OCC 5: In approving a provider-of-last-resort charge, the commission relied on a justification lacking any record support*

{¶ 22} The commission approved the recovery of roughly $500 million in provider-of-last-resort ("POLR") charges over the three years of the plan. OCC and IEU attack the charge on several grounds, including that the commission lacked record support.

[7] [8] {¶ 23} Under Ohio law, customers may purchase generation service from a competitive supplier. If such a supplier fails to provide service, "the supplier's customers * * * default[ ] to the utility's standard service offer * * * until the customer chooses an alternative

supplier." R.C. 4928.14. This obligation to stand ready to accept returning customers makes the utility the "provider of last resort," or "POLR." See, e.g., ****663** *Constellation NewEnergy, Inc. v. Pub. Util. Comm.*, 104 Ohio St.3d 530, 2004-Ohio-6767, 820 N.E.2d 885, ¶ 39, fn. 5 ("POLR costs are those costs incurred by [the utility] for risks associated with its legal obligation as the default provider, or electricity provider, of last resort, for customers who shop and then return to [the utility] for generation service"). In ***518** other reviews of POLR charges, we have admonished the commission to "carefully consider what costs it is attributing" to "POLR obligations." *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 114 Ohio St.3d 340, 2007-Ohio-4276, 872 N.E.2d 269, ¶ 26.

[9] {¶ 24} Below, the commission approved a POLR charge totaling over $500 million over the term of the ESP. It described the charge as *cost*-based. "[T]he POLR rider will be based on *the cost* to the Companies to be the POLR and carry the risks associated therewith * * *." (Emphasis added.) Likewise, it stated that it was allowing recovery of "estimated POLR *costs.*" (Emphasis added.) Again on rehearing, the commission stated that it had "determined that the Companies should be compensated for the *cost* of carrying the risk associated with being the POLR provider." (Emphasis added.) This characterization of the POLR charge as cost-based lacks any record support; therefore, we reverse the portion of the order approving the POLR charge.

{¶ 25} We have carefully reviewed the record, and we can find no evidence suggesting that AEP's POLR charge is related to any costs it will incur. AEP derived its charge using a mathematical formula created to price exchange-traded options. The company analogized an option to buy and sell securities to the statutory right to shop for power, changed some variables, and applied the formula. This formula, called "the Black–Scholes model" after two of its creators, is the only evidence AEP presented in support of its POLR charge.

{¶ 26} Contrary to the order, this formula simply does not reveal "the cost to the Companies to be the POLR and carry the risks associated therewith." The record shows that the model does not even purport to estimate costs, but instead tries to quantify "the value of the optionality [to shop for power] that is provided to customers under Senate Bill 221." Value to customers (what the model shows) and cost to AEP (the purported basis of the order) are simply not the same thing. AEP's own witness made this clear—"[t]rying to recover the *costs of the Companies' POLR obligation* retrospectively would fail, because it ignores the very nature of the POLR obligation. The *value of the customers' right to switch* under S.B. 221 comes from the option customers are given to switch suppliers, while still having the safety net of the ESP rate * * *." (Emphases added.)

{¶ 27} Even assuming that AEP accurately priced the option, we fail to see how the amount a customer would be willing to pay for the right to shop necessarily establishes AEP's costs to bear the attendant risks. The order does not explain the relationship between the two. And witnesses for other parties confirmed that the POLR charge was not based on cost. A witness for OCC testified that AEP has "not identified any specific costs they are incurring related to the POLR obligation." Another witness agreed that AEP does "not appear to have an actual out of pocket expense." Along similar lines, a member of the ***519** commission's staff stated that "a POLR charge, if one is considered appropriate, would be significantly below what AEP is requesting."

{¶ 28} Other facts in the record further call into question the accuracy of AEP's POLR theory. The record showed that ****664** AEP has had "virtually no" shopping in the last eight years, including no residential shoppers. No countervailing evidence predicted an uptick in shopping. No witness testified that more switching could be expected in the future, and AEP performed no "actual customer surveys" or "studies apart from the Black–Scholes model" to determine whether shopping was likely to increase. On the contrary, the commission's own economist testified that "there are many reasons to think that substantial migration will not quickly occur, even if the market price falls below the SSO [standard service offer] price." Even AEP's witness testified that "[d]esire to switch, in [his] view, will be when there's an economic advantage," but

that "today," there is "no economic advantage." Accordingly, AEP did not even "have a plan to purchase" options to hedge its own POLR risk. At the very least, all this evidence raises doubts about the proposition that AEP would justifiably expend $500 million to bear the POLR risk.

{¶ 29} In short, the manifest weight of the evidence contradicts the commission's conclusion that the POLR charge is based on cost. In contrast with our recent admonition that the commission must "carefully consider what costs it is attributing" to "POLR obligations," *Ohio Consumers' Counsel*, 114 Ohio St.3d 340, 2007-Ohio-4276, 872 N.E.2d 269, ¶ 26, no evidence supports the commission's characterization of this charge as based on cost. Ruling on an issue without record support is an abuse of discretion and reversible error. See, e.g., *Indus. Energy Users-Ohio v. Pub. Util. Comm.*, 117 Ohio St.3d 486, 2008-Ohio-990, 885 N.E.2d 195, ¶ 30. Therefore, we reverse the provisions of the order authorizing the POLR charge.

{¶ 30} On remand, the commission may revisit this issue. To be clear, we express no opinion on whether a formula-based POLR charge is per se unreasonable or unlawful, and the commission may consider on remand whether a non-cost-based POLR charge is reasonable and lawful. Alternatively, the commission may consider whether it is appropriate to allow AEP to present evidence of its actual POLR costs. However the commission chooses to proceed, it should explain its rationale, respond to contrary positions, and support its decision with appropriate evidence.

*C. OCC Proposition of Law 6: The commission erred in determining that ESPs may include items not specifically authorized by statute*

[10] {¶ 31} In its sixth proposition of law, OCC argues that R.C. 4928.143(B)(2) does not permit AEP to recover certain carrying costs associated with environmental investments. That section states, "The [electric security] plan may provide for or ***520** include, without limitation, any of the following," and then lists nine categories of cost recovery. OCC argues that this section permits plans to include *only listed* items; the commission and AEP argue that (B)(2) permits *unlisted* items. We agree with OCC.

{¶ 32} By its terms, R.C. 4928.143(B)(2) allows plans to include only "any of the following" provisions. It does not allow plans to include "any provision." So if a given provision does not fit within one of the categories listed "following" (B)(2), it is not authorized by statute.

{¶ 33} The commission believes that the phrase "without limitation" allows unlisted items, asserting that the nine categories are "illustrative, * * * not exhaustive." But this phrase does not allow unlisted items. Rather, it allows unlimited inclusion of listed items. The list limits *the type* of categories a plan may include, while the phrase "without limitation" allows *as many or as much* of the listed categories as the commission finds reasonable****665** —subject to any other applicable limits, which we do not consider here.

{¶ 34} The plain language of the statute controls, and this interpretation leads to a reasonable result. However, the appellees' interpretation would remove any substantive limit to what an electric security plan may contain, a result we do not believe the General Assembly intended.

{¶ 35} For the foregoing reasons, we reverse the commission's legal determination that R.C. 4928.143(B)(2) permits ESPs to include unlisted items. On remand, the commission may determine whether any of the listed categories of (B)(2) authorize recovery of environmental carrying charges.

*D. IEU Proposition of Law 1: The commission did not lose jurisdiction over the case when the 150-day approval deadline expired*

{¶ 36} In its first proposition of law, IEU argues that the commission "lost jurisdiction over AEP-Ohio's July 31, 2008 ESP Application when it failed to authorize an ESP within the 150-day time frame required by R.C. 4928.143." We disagree.

[11] {¶ 37} " 'As a general rule, a statute which provides a time for the performance of an official duty will be construed as directory so far as time for performance is concerned, especially where the statute fixes the time simply for convenience or orderly procedure.' " *In re Davis* (1999), 84 Ohio St.3d 520, 522, 705 N.E.2d 1219, quoting *State ex rel. Jones v. Farrar* (1946), 146 Ohio St. 467, 471-472, 32 O.O. 542, 66 N.E.2d 531. "This is so 'unless the nature of the act to be performed or the phraseology of the statute or of other statutes relating to the same subject-matter is such that the designation of time must be considered a limitation upon the power of the officer.' " Id., quoting *State ex rel. Smith v. Barnell* (1924), 109 Ohio St. 246, 255, 142 N.E. 611.

[12] [13] ***521** {¶ 38} Under this principle, deadlines concerned with "the prompt conduct of the public business" should be considered "directory," not mandatory. *Jones* at 472. The use of the word "shall" to institute the deadline does not change this. See *Davis* at 522 ("even with 'shall' as the operative verb, a statutory time provision may be directory"). And a deadline provision that does not "mandate any particular result if the * * * decision is untimely" further supports a directory interpretation. *State ex rel. Larkins v. Wilkinson* (1997), 79 Ohio St.3d 477, 479, 683 N.E.2d 1139; see also, e.g., *Davis* at 522 (a deadline was directory where it did "not include any expression of intent to restrict the jurisdiction of the court for untimeliness").

[14] {¶ 39} Applying these standards, we hold that R.C. 4928.143(C)(1)'s 150-day deadline is directory and that the commission retained jurisdiction over the case when the deadline expired.

{¶ 40} R.C. 4928.143(C)(1) provides: "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."

{¶ 41} Considering the act as a whole, we find it plain that the General Assembly enacted the 150-day deadline to ensure prompt review of initial ESP applications. To begin with, that is how we generally interpret such provisions, *In re Davis*, 84 Ohio St.3d at 522, 705 N.E.2d 1219, and numerous provisions of S.B. 221 confirm that the general rule applies here. For example, the introductory section of S.B. 221 requires electric distribution utilities ****666** to provide a standard service offer by a specific date, January 1, 2009. R.C. 4928.141(A). Given that the law took effect July 31, 2008, the utilities and the commission had not quite six months to have new rates put into effect. Six months is a comparatively short amount of time for a major rate proceeding; the commission is given almost twice as much time (275 days) to resolve a distribution-rate proceeding, see R.C. 4909.42, and later ESP proceedings. See R.C. 4928.143(C)(1). Moreover, the statute expressly permits utilities to file their applications "prior to the effective date of any rules the commission may adopt for the purpose of this section." R.C. 4928.143(A).

{¶ 42} All this suggests that the General Assembly meant to hasten the filing and review of initial ESPs, not set a jurisdictional bar. IEU points to no factors that suggest the opposite. For example, R.C. 4928.143 does not impose any consequence for exceeding the 150-day deadline. It does not mandate dismissal and refiling. Notably, this consequence is required in other scenarios, but not for expiration of the 150-day deadline. See R.C. 4928.143(C)(2)(a) and (b).

***522** {¶ 43} R.C. 4928.143(C)(1)'s deadline effectuates "the proper, orderly, and prompt" resolution of initial ESP applications. *Jones*, 146 Ohio St. at 472, 32 O.O. 542, 66 N.E.2d 531. The deadline is not jurisdictional, and we reject IEU's first proposition of law.

*E. IEU Proposition of Law 2: IEU has not shown error in AEP's acceptance and appeal of its ESP*

[15] {¶ 44} In its second proposition of law, IEU argues that the commission should have "prohibit[ed] AEP-Ohio from accepting the benefits of the higher rates approved in the ESP while simultaneously preserving the right to withdraw and terminate the approved ESP." This argument lacks merit.

{¶ 45} Under R.C. 4928.143(C)(1), the commission must do one of three things when an ESP is filed: it must "approve," "modify and approve," or "disapprove" the application. "If the commission modifies and approves an application," the utility "may withdraw the application, thereby terminating it, and may file a new standard service offer." R.C. 4928.143(C)(2)(a).

{¶ 46} In this case, the commission modified and approved the ESP. AEP filed tariffs instituting the new rates but stated in its cover letter, "The Companies do not waive * * * their right under § 4928.143(C)(2), Ohio Rev.Code, regarding withdrawal of their Application." According to IEU, AEP "has never formally accepted its approved ESP, is still taking the benefits of the ESP, and has filed an appeal of its ESP to this Court." IEU contends that a utility "cannot accept the benefits of the rates approved in an ESP while simultaneously preserving the right to withdraw and terminate the ESP."

{¶ 47} IEU has not met its burden of showing error. The law permits utilities to withdraw modified ESPs, but does not require it, R.C. 4928.143(C)(2)(a), and IEU cites no authority requiring "formal acceptance" of an ESP. The fact that AEP has neither withdrawn nor formally accepted its application does not show error.

[16] {¶ 48} We will not weigh in on whether AEP could collect ESP rates for some period of time and then withdraw the plan. AEP has not done so, and we do not address hypothetical questions. See *State ex rel. Elyria Foundry Co. v. Indus. Comm.* (1998), 82 Ohio St.3d 88, 89, 694 N.E.2d 459; *Cincinnati Gas & Elec. Co. v. Pub. Util. Comm.*, 103 Ohio St.3d 398, 2004-Ohio-5466, 816 N.E.2d 238, ¶ 17.

****667** {¶ 49} IEU has failed to demonstrate legal error, and we reject its second proposition of law.

*F. OCC Proposition of Law 4: The commission adequately explained why it was not following prior decisions in allowing AEP to keep the proceeds of "off-system sales"*

[17] {¶ 50} In its fourth proposition of law, OCC argues that the order departed from precedent without sufficient explanation. The commission allowed AEP to ***523** keep all proceeds from "off-system sales," meaning unregulated sales to other resellers and not to retail customers, rather than requiring AEP to give the net profits of those sales as a rate credit to consumers. OCC asserts that in past cases, the commission required utilities to share with customers the revenue from such sales. According to OCC, the commission has departed from this precedent without sufficient explanation.

{¶ 51} At the outset, we note that OCC does *not* argue that the underlying decision was *substantively* unlawful and unreasonable. In fact, OCC concedes that the law "does not require profits from off-system sales to be included in the ESP rates" that is, shared with customers. Its argument is procedural and limited to whether the commission "failed to explain why it was departing from precedent."

[18] {¶ 52} It is true that we have instructed the commission to "respect its own precedents in its decisions to assure the predictability which is essential in all areas of the law, including administrative law." *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* (1975), 42 Ohio St.2d 403, 431, 71 O.O.2d 393, 330 N.E.2d 1, superseded on other grounds by statute as recognized in *Babbit v. Pub. Util. Comm.* (1979), 59 Ohio St.2d 81, 89, 13 O.O.3d 67, 391 N.E.2d 1376. This does not mean that the commission may never revisit a particular decision, only that if it does change course, it must explain why. See, e.g., *Util. Serv. Partners, Inc. v. Pub. Util. Comm.*, 124 Ohio St.3d 284, 2009-Ohio-6764, 921 N.E.2d 1038, ¶ 18; *Office of Consumers' Counsel v. Pub. Util. Comm.* (1985), 16 Ohio St.3d 21, 21–22, 16 OBR 371, 475 N.E.2d 786 ("A few simple sentences in the commission's order in this case would have sufficed" to explain why a previous order had been overruled). The new course also must be substantively reasonable and lawful, but OCC, as noted, has not placed that at issue here.

{¶ 53} Here, the commission explained why it did not follow the cases cited by OCC as precedent. None of them arose under the applicable body of law, S.B. 221. And the commission further concluded that the applicable law now in place does not even require OCC's requested treatment, a point that OCC concedes.

{¶ 54} The commission adequately explained why it did not follow the cases cited by OCC. As this is the only basis on which OCC attacks the commission's treatment of off-system sales, we reject its fourth proposition of law.

*G. IEU Proposition of Law 4: IEU fails to show error concerning the approval of charges related to a pair of generation stations*

[19] {¶ 55} In its fourth proposition of law, IEU argued that the commission should not have allowed recovery of charges associated with a pair of generation stations. According to IEU, the commission "cannot use traditional *cost-based ratemaking* selectively to increase rates where it believes particular categories of ***524** *competitive generation* costs are not currently reflected in rates." (Emphases sic.)

[20] {¶ 56} " '[A] party who contends' " that rates and charges are unreasonable ****668** " 'has the burden on appeal to the Supreme Court under Section 4903.13, Revised Code, of showing that they are unjust, unreasonable or unlawful.' " *AT & T Communications of Ohio, Inc. v. Pub. Util. Comm.* (1990), 51 Ohio St.3d 150, 154, 555 N.E.2d 288, quoting *Columbus v. Pub. Util. Comm.* (1959), 170 Ohio St. 105, 10 O.O.2d 4, 163 N.E.2d 167, paragraph two of the syllabus. IEU fails to carry its burden here. At no point does appellant even purport to cite a specific legal authority that prohibits cost-based rates in an ESP. Several times, it asserts that S.B. 221 prohibits the commission's action. S.B. 221, however, is over 50 pages long, so this general citation does not provide enough guidance.

[21] {¶ 57} Conclusory assertions that the commission cannot do something fall well short of demonstrating reversible error. IEU's argument in its fourth proposition is inadequately developed, and we reject it on that basis.

*H. IEU Proposition of Law 5: IEU fails to show error in the approval of AEP's vegetation-management and smart-grid programs*

[22] {¶ 58} In its fifth proposition of law, IEU challenges the commission's approval of parts of AEP's proposed enhanced-vegetation-management [FN1] and smart-grid programs. Neither challenge succeeds.

FN1. "Vegetation management" refers to trimming trees, clearing rights-of-way, and other activities necessary to keep wires clear. See generally *Corrigan v. Illum. Co.*, 122 Ohio St.3d

265, 2009-Ohio-2524, 910 N.E.2d 1009, ¶ 15.

{¶ 59} Regarding the vegetation-management program, IEU faults the commission for inconsistency—it approved this distribution charge but not others that had been requested. AEP had proposed four types of charges related to distribution service. The commission decided not to address three of the four, finding it better to examine those charges in "a distribution rate case where all components of distribution rates are subject to review." Nevertheless, it allowed recovery of an "enhanced vegetation initiative," based on its findings that "a specific need exists" for the initiative and that the charges were necessary to expand the current program.

{¶ 60} IEU asserts that this decision to approve some but not all distribution charges was unexplained. That is not true. The commission did explain why it considered one distribution program but not the others—"AEP-Ohio has demonstrated in the record of this proceeding that it faces increased costs for vegetation management and that a specific need exists for the implementation of the enhanced vegetation initiative * * *." IEU does not explain in any further detail ***525** *what else* the commission should have explained, so this portion of its argument is settled.

[23] {¶ 61} In the other part of its fifth proposition, IEU argues that the commission approved AEP's "gridSMART" proposal "without any showing that [it] satisfied the cost-effectiveness requirements of R.C. 4928.02(D)." The provision cited by IEU states that "it is the policy of the state" to "[e]ncourage innovation and market access for cost-effective supply- and demand-side retail electric service including, but not limited to, demand-side management, time-differentiated pricing, and implementation of advanced metering infrastructure." IEU has not demonstrated legal error.

[24] {¶ 62} To begin with, and contrary to IEU's assumption, R.C. 4928.02(D) does not impose strict "cost-****669** effectiveness requirements" on any given program—indeed, by its terms, it does not *require* anything. It simply expresses state policy. As we have held, such policy statements are "guideline [s] for the commission to weigh" in evaluating utility proposals to further state policy goals, and it has been "left * * * to the commission to determine how best to carry [them] out." *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 125 Ohio St.3d 57, 2010-Ohio-134, 926 N.E.2d 261, ¶ 39-40. The commission plainly weighed this policy consideration in reviewing the programs. That alone is grounds to reject IEU's argument.

{¶ 63} In any event, the commission acted in step with the policy of R.C. 4928.02(D). By approving the initiation of the smart-grid program, the commission "[e]ncourage[d] innovation and market access" for "supply- and demand-side retail electric services," specifically including "implementation of advanced metering infrastructure." R.C. 4928.02(D). As to cost-effectiveness, the commission imposed several requirements to ensure prudent spending: "separate accounting for gridSMART, an opportunity to approve and update the plan each year, assurance that expenditures are made before cost recovery occurs, and an opportunity to audit expenditures prior to recovery." Moreover, the commission cut in half the proposed cost-recovery and required AEP to seek federal stimulus funding. These provisions reduced costs and imposed mechanisms to protect consumers from unwarranted spending.

{¶ 64} For the foregoing reasons, we reject IEU's fifth proposition of law.

*I. IEU Proposition of Law 6: IEU has not demonstrated error in the commission's setting of AEP's fuel-cost baseline*

[25] {¶ 65} ESPs may provide for "[a]utomatic recovery" of "the cost of fuel used to generate the electricity supplied under the offer," "provided the cost is prudently incurred." R.C. 4928.143(B)(2)(a). In its sixth proposition of law, IEU asserts that the commission violated the

prudently-incurred-cost requirement when it ***526** used certain estimated fuel-cost figures in establishing AEP's base rate. This argument lacks merit.

{¶ 66} We note up front that IEU does not attack the use of an estimate *per se,* but merely the commission's *choice* of what estimate to use. IEU, AEP, and the commission's staff each proposed fuel-cost estimates; the commission adopted staff's. And we further note, because the record confirms, that no matter which estimate was used, only actual costs were to be recovered.

{¶ 67} IEU argues that the commission's choice of estimate violates R.C. 4928.143(B)(2)(a). That section authorizes "[a]utomatic recovery" of "the cost of fuel" "provided the cost is prudently incurred." The commission complied with this section. As noted above, only actual costs will be recovered, and as the commission stated in its order, they will be subject to prudence review ("the FAC [fuel adjustment clause] mechanism includes a quarterly reconciliation to actual FAC costs incurred," and the staff recommendation was adopted for "an annual prudency and accounting review" of the FAC).

{¶ 68} Moreover, IEU points to no legal authority that speaks to how the commission should determine or estimate fuel-cost baselines. Any lack of statutory guidance on that point should be read as a grant of discretion. See, e.g., *Payphone Assn. v. Pub. Util. Comm.*, 109 Ohio St.3d 453, 2006-Ohio-2988, 849 N.E.2d 4, ¶ 25 ("When a statute does not prescribe a particular formula, the PUCO is vested with broad discretion"). IEU simply has not shown an abuse of discretion. It asserts that the ****670** commission's estimate has the effect of "pushing too much money associated with the FAC into the deferral bucket." But while IEU explains why it does not like that decision, it neither cites legal authority prohibiting the commission's approach nor persuasively explains how the order was objectively unreasonable. That is not enough to demonstrate reversible error.

{¶ 69} We reject IEU's sixth proposition of law.

*J. IEU Proposition of Law 7: IEU fails to demonstrate any violation of R.C. 4903.09's requirement of a reasoned explanation*

[26] {¶ 70} Last, in its seventh proposition of law, IEU alleges that the commission violated R.C. 4903.09 by failing to sufficiently detail "the reasons prompting the decisions arrived at." R.C. 4903.09. IEU lodges this objection at a fatally high level of generality. Had the commission issued a one-page summary order to resolve this case, it might suffice to assert simply that "the Orders omit the required documentation of the Commission's reasoning." But the order and entries on rehearing fill 140 pages—while we do not equate breadth with depth, IEU must do more to show error.

[27] ***527** {¶ 71} Given the rehearing requirements, IEU needs to show at least three things to prevail under R.C. 4903.09: first, that the commission initially failed to explain a material matter; second, that IEU brought that failure to the commission's attention through an application for rehearing; and third, that the commission still failed to explain itself. IEU's nonspecific allegations establish none of these points. (The only example developed by IEU concerns the POLR charge, which we have already discussed.)

{¶ 72} IEU has not specifically explained how the commission failed to explain itself. On that basis, we reject its seventh proposition of law.

**III. Conclusion**

{¶ 73} Some of the issues raised are best left to the General Assembly, which has the responsibility to monitor the development and implementation of the new regulatory regime. We can resolve legal disputes, but we cannot fill gaps. While our goal is always to determine the intent of the General Assembly, we also recognize that our decisions may reveal gaps unintended

by that body. If that occurs, or the law otherwise fails to achieve its policy objectives, the legislature is the appropriate body to determine those issues.

{¶ 74} For the foregoing reasons, we reverse in part, affirm in part, and remand this case to the commission.

Order affirmed in part and reversed in part, and cause remanded.

O'CONNOR, C.J., and PFEIFER, O'DONNELL, LANZINGER, CUPP, and MCGEE BROWN, JJ., concur.

Ohio,2011.
In re Application of Columbus S. Power Co.
128 Ohio St.3d 512, 947 N.E.2d 655, Util. L. Rep. P 27,139, 2011 -Ohio- 1788

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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| In the Matter of the Application of Columbus Southern Power Company for Authority to Amend its Filed Tariffs to Increase the Rates and Charges for Electric Service. | Case No. 91-418-EL-AIR |

OPINION AND ORDER

The Commission, coming now to consider the above-entitled matter, specifically the application of Columbus Southern Power Company filed pursuant to Section 4909.18, Revised Code; the Staff Report of Investigation issued pursuant to Section 4909.19, Revised Code; having appointed its attorney examiners, Ann K. Reinhard and Mary K. Fenlon, pursuant to Section 4901.18, Revised Code, to conduct the public hearings and to certify the record directly to the Commission; having reviewed the testimony and exhibits introduced into evidence at the public hearings; and being otherwise fully advised of the facts and issues in this case, hereby issues its opinion and order.

APPEARANCES:

Marvin I. Resnik, James R. Bacha, and Kevin F. Duffy, American Electric Power Service Corporation, One Riverside Plaza, Columbus, Ohio 43215, and F. Mitchell Dutton, Columbus Southern Power Company, 215 North Front Street, Columbus, Ohio 43215-2291, on behalf of Columbus Southern Power Company.

Lee Fisher, Attorney General of Ohio, by James B. Gainer, Section Chief, and Ann E. Henkener, Thomas W. McNamee, William L. Wright, and Steven Nourse, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio 43266-0573, on behalf of the staff of the Public Utilities Commission of Ohio.

William A. Spratley, Consumers' Counsel, by Michael McCord, Evelyn Robinson-McGriff, Thomas Atzberger, Colleen Mooney, and Barry Cohen, Associate Consumers' Counsel, 77 South High Street, Columbus, Ohio 43266-0550, on behalf of the residential customers of Columbus Southern Power Company.

Emens, Kegler, Brown, Hill & Ritter, by Samuel C. Randazzo and Richard P. Rosenberry, 65 East State Street, Columbus, Ohio 43215, on behalf of Anheuser-Busch Companies, Inc., General Motors Corporation, LTV Steel Company, Owens-Illinois, Inc., PPG Industries, Inc., The Timken Company, and Pillsbury Company, known collectively as the Industrial Energy Consumers.

and the litigation proceeds relate to the construction of Zimmer as a nuclear plant (OCC Ex. 1, at 9). Columbus Southern, along with the other owners, settled the nuclear Zimmer construction lawsuits it had pending against these firms. Columbus Southern received approximately $15,000,000 in cash, $7,803,520 from GE and $7,031,002 from S&L (OCC Ex. 39, Attach. 2, at 8). These amounts were credited against the write-off. As part of the settlement of the litigation, Columbus Southern was required to pay S&L $3,221,002 (Id.). This amount, along with the remainder of the wind-down costs, was charged to the cost of the plant (OCC Ex. 1, at 9). According to Mr. Effron, this treatment results in a higher cost of plant for which ratepayers must provide a return because the litigation proceeds received by the company were applied only to the write-off, while the amount paid out by the company was added to the cost of the plant (Id. at 11-12). Although it does not dispute the company's accounting treatment of the GE and S&L litigation proceeds, OCC argues that the wind-down costs must be treated consistently with the litigation proceeds and should not be added to the valuation of Zimmer.

Columbus Southern and the staff offer essentially the same argument that was advanced regarding the nuclear fuel issue. Both claim that the stipulation settled once and for all the nuclear Zimmer issues and that the parties contemplated that nuclear wind-down costs would be covered by the disallowed amount. Staff witness Tucker testified that, in his view, nuclear wind-down costs and litigation proceeds are independent issues. Mr. Tucker explained that he likens the nuclear wind-down costs to site preparation necessary to allow conversion construction to proceed, while the litigation proceeds are related to recovery of construction costs caused by shortcomings of the contractors (Staff Ex. 15, at 8-9).

As indicated in our discussion above, the Commission has rejected the arguments that the $861 million disallowance accounted for all nuclear investment for all time. The stipulation provided for the disposition of Zimmer plant investment as of a certain date, January 31, 1984. Sunk costs remaining as of January 31, 1984, would not be challenged on specific grounds. The nuclear wind-down costs were not part of the January 31, 1984 plant investment and were not covered by the stipulated amounts and are subject to challenge in this case. Under the company's interpretation, the Commission in 1985 would having been giving it carte blanche to charge any then unknown cost associated with nuclear Zimmer to the coal-fired plant. This would render meaningless the express provision of the stipulation that any cost after January 31, 1984 was subject to challenge by the parties.

We also agree with Mr. Effron that consistency requires similar accounting treatment for the nuclear-related litigation proceeds and nuclear wind-down costs. While Columbus Southern may

wish to maximize the benefits of these transactions for its shareholders, the Commission must consider the disparate results of the company's actions on behalf of ratepayers. It is clearly not equitable to allow the litigation proceeds to be credited entirely against the write-off, while other nuclear-related costs are capitalized, thereby increasing the valuation of Zimmer. Under the company's approach, money received goes to the benefit of the shareholders, and money paid goes to the benefit of the shareholders. When do the customers benefit? The Commission finds that the nuclear wind-down costs identified by Mr. Effron are not related to anything used and useful in the Zimmer coal-fired plant and should be excluded from plant in service.

Accrual of AFUDC Since February 1984

The stipulation adopted by the Commission in the Zimmer Restatement Case provided as follows:

> In the event that the Owners determine to go forward with construction of the converted 1300 MW coal-fired Zimmer facility and the same is completed and brought into service, there is agreement that the sunk costs remaining as of January 31, 1984 after the total Disallowed Amount (including AFUDC properly accrued thereon subsequent to January 31, 1984) will not be challenged by any of the parties hereto as being: (1) the result of mismanagement and/or (2) not being used and useful in the converted Zimmer facility. (Emphasis added.)

Zimmer Restatement Case, Appendix at 6. The IEC and OCC argue that the language "AFUDC properly accrued" precludes the company from accruing AFUDC from February 1984 through February 1987 on the Zimmer plant investment remaining after the $861 million write-off (the sunk cost) because physical construction on the conversion project was suspended during that period pending receipt of the Section 10/404 permit from the U.S. Army Corps of Engineers. According to the intervenors, AFUDC may not be properly accrued during periods of interrupted construction pursuant to FERC accounting standards.

The FERC electric plant instructions do not contain a definition of the term "construction" nor do they define precisely when the accrual of AFUDC should begin. However, FERC Accounting Release 5 (revised) (AR-5) does provide guidance regarding the proper period for capitalization of interest during construction. AR-5 provides, in pertinent part, as follows:

> Interest during construction may be capitalized starting from the date that construction costs are incurred on a planned progressive basis.... No interest should be accrued during period (sic) of interrupted construction unless the company can justify the interruption as being reasonable under the circumstances.

(OCC Ex. 40, at 2). In recommending that AFUDC on the sunk cost during this time period be excluded from the cost of Zimmer, OCC witness Effron testified that there was no actual physical construction on Zimmer as a coal plant during the time February 1984 through February 1987. Therefore, there should be no allowance for funds used during construction during this time period (OCC Ex. 1, at 16). Mr. Effron calculated the AFUDC accrued from February 1984 through February 1987 plus cumulative AFUDC through completion of the plant in March 1991 to be $133,349,000 (Id.).

IEC witness Selecky recommended that at least $99.8 million of AFUDC should be excluded from the capitalized cost of Zimmer. This estimate reflects the removal of 1984 and 1985 AFUDC, the impact of compounding this AFUDC through 1990, and lowering the return on equity component of the remaining AFUDC to 13 percent. The 1984 and 1985 AFUDC were removed because construction of Zimmer as a nuclear generating plant ceased not later than January 20, 1984, and construction to convert the unit to a coal plant commenced on March 17, 1987. Mr. Selecky further indicated that if the 1986 through February 1987 AFUDC were excluded from the capitalized cost of Zimmer, the final cost of the plant would be reduced by an additional $48.4 million, excluding the effect of compounding AFUDC (IEC Ex. 1, at 18; Tr, XXI, 8).

The company and the staff contend that, although nuclear Zimmer construction was abandoned in January 1984, a number of events and activities were ongoing, both on-site and off-site, throughout the period in question. The applicant and staff claim that the FERC accounting statements cited by the intervenors do not refer to "actual physical construction" but, in any event, construction was proceeding on a planned, progressive basis. Company witness Jones testified that on-site activities during the period in question included project planning and scheduling, engineering, design, and procurement, site investigation, licensing and permitting, site construction activities, and existing facility modifications and maintenance (Co. Ex. R-12, at 2). The company and the staff also contend that a FERC audit, which resulted in the company being required to make another adjustment regarding AFUDC accrual, did not suggest that the company's accrual of AFUDC from February 1984 through February 1987 was improper. Likewise, the company's independent auditors found nothing improper during the time (Staff Ex. 10, at 6-8).

The Commission, having reviewed the record on this issue, finds that it was not proper for the company to accrue AFUDC on the sunk costs during the period of interrupted construction. This is true from both an accounting and a regulatory perspective. The record clearly indicates that construction at the Zimmer site was interrupted by the NRC in late 1982. On January 20, 1984, the owners entered into an agreement to abandon nuclear Zimmer, reallocate the ownership interests, and use their best efforts to convert Zimmer to a coal-fired plant (Co. Ex. 12, at II-1). It was not until August 1, 1984, that the owners announced their decision to convert the plant to a 1300 MW unit similar to other AEP 1300 MW units (Id.). AEP was also chosen as the project manager. Although the owners had selected an alternative and a project manager, they identified three areas where risk and uncertainty needed to be reduced to a manageable level before proceeding with actual construction. These areas were financial, regulatory, and environmental. AEP Service Corporation was instructed to proceed with licensing, engineering, and design, but major commitments for equipment fabrication and construction could not be made until these areas were addressed. In general, according to company witness Jones, this process ended with the receipt of the U.S. Army Corps of Engineers Permit which allowed construction to proceed. (Id. at III-4, III-5). The permit in question was issued on March 17, 1987 (Co. Ex. R-12, at 5).

Although the applicant and the staff attempted to portray the activities on the conversion project as constituting construction, the type of work performed at the site, as well as relatively minimal level of investment during the time period, indicate that actual construction had not begun beginning in 1984. By March 1987, only $54,978,963 had been incurred for the conversion project activities (Co. Ex. R-12, at 7), and many of the activities undertaken were not conversion specific. For example, inspection and maintenance of existing facilities was performed and a dehumidification system was installed to prevent deterioration of existing equipment (Id. at 5-6). Other projects such as dredging of the Ohio River and off-site erection of the precipitators did not commence until late 1986 (Co. Ex. 12, Attach. XI-2). The Commission also does not believe that any evidence has been presented to demonstrate that the interruption was reasonable under the circumstances. Of course, the companies were required by the NRC to cease construction. This does not make the interruption reasonable. The NRC halted construction because of quality assurance concerns. These concerns were never satisfied by the companies. The company presented no further arguments on this point. Accordingly, the Commission finds that AFUDC accrued during the period of interrupted construction was not proper.

Having determined that it was not proper to accrue AFUDC during the period of interrupted construction, it must now be

determined when sufficient construction began which would warrant a finding that accrual of AFUDC on the sunk costs should properly commence. Both OCC witness Effron and IEC witness Selecky contend that actual physical construction on the Zimmer site did not begin until March 17, 1987, and these parties argue that AFUDC on the sunk costs was not properly accrued until March 1987. However, Mr. Selecky also suggests that only the 1984 and 1985 AFUDC be excluded (IEC Ex. 1, at 18). A review of the record, however, indicates that major construction contracts were awarded during February 1986. Specifically, the boiler contract was awarded on February 4, 1986; the precipitator contract was awarded on February 22, 1986; and the scrubber material contract was awarded on February 29, 1986 (Staff Ex. 16A, Ex. I-1). Thus, it is clear that, as of March 1986, the owner companies were legally obligated and committed to proceeding with the Zimmer 1300 MW coal conversion project. Given the evidence, the Commission believes that conversion construction costs were being incurred on a planned progressive basis and that the interruption had ceased by March 1986. Thus, beginning in March 1986, the suspension had ended and AFUDC on the sunk costs was properly accrued. The AFUDC accrued on the sunk costs prior to March 1986 was not proper and should be excluded from the valuation of the Zimmer plant. The Commission notes that even if accrual of AFUDC were acceptable from an accounting perspective, as the staff and the company argued, the Commission believes that from a ratemaking point of view, it would be totally unreasonable for ratepayers to pay for AFUDC on the sunk costs during the period of interrupted construction.

The AFUDC Rate

IEC witness Selecky also presented testimony that the actual AFUDC rate used by the company was excessive. Mr. Selecky proposed adjusting the AFUDC rates used by the company between 1986 and 1991 to reflect a 13 percent rate of return on common equity. Mr. Selecky believed that the 14.69 percent rate of return on common equity, which was authorized in the company's last base rate case, was too high to use (IEC Ex. 1, at 17). Although Mr. Selecky conceded that from 1984 through March 1991, the common equity rate used by the company in determining AFUDC rates was less than 14.69 percent in all months except the first three months of 1991 (Tr. XXI, 74-75), he still believes that a rate in excess of 13 percent is excessive. Mr. Selecky determined that 13 percent is a reasonable rate of return on common equity based on his experience and his review of commission orders in more than 50 regulatory cases (Tr. XXI, 99, 101-102).

The Commission is of the opinion that the adjustment recommend by Mr. Selecky should be rejected. There is no evidence to support a readjustment to the AFUDC rates used by the company in this case. The FERC electric plant instructions state that "allowance for funds used during construction ... includes the net

cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used, not to exceed, without prior approval of the Commission, allowances computed in accordance with the formula prescribed..." (FERC Electric Plant Instruction 17). The instructions further state that "the cost for common equity shall be the rate granted common equity in the last rate proceeding before the ratemaking body having primary rate jurisdiction." (FERC Electric Plan Instruction 17b). The evidence shows that the AFUDC calculated by Columbus Southern did not exceed the allowances prescribed by the FERC formula. Further, Mr. Selecky's 13 percent return on equity is not in any way related to what may be reasonable for Columbus Southern specifically. It is based on a review of what other Commissions have done with other companies during the period reviewed by Mr. Selecky. Just as we reject reliance on comparable company analysis in setting rate of return, so too should we reject such an analysis when used to restate the company's AFUDC. Accordingly, Mr. Selecky's adjustment shall not be adopted.

Zimmer Alternative Rate Base Treatment

On page 39 of the Staff Report, the staff presented a discussion of "alternatives" that, as staff witness Cahaan testified, were "not unreasonable" perspectives which the Commission may consider in determining the valuation of the Zimmer plant (Staff Ex. 3, at 2). The Staff Report indicates that a reasonable cost range in the 1984-1985 time period for a comparable greenfield plant coming on line in 1991 would be in the range of $1560 to $2160 per kilowatt of capacity (S.R. at 39). The Staff Report also states that, due to the unusually long construction period for Zimmer, an equitable remedy for sharing the inflated costs due to the construction delays would be a disallowance of the equity portion of the AFUDC on costs associated with the conversion (Id.). Another possible alternative offered by the staff was a method for maximizing the AFUDC on the disallowance provided for in the Zimmer Restatement Case. According to the staff, if the applicant, in writing off the agreed upon amount, had maximized to the extent possible AFUDC instead of direct plant cost, the effect in this rate case would be a $2,820,000 reduction in the revenue requirement (Id.). The staff is not proposing that these alternatives be adopted, but has presented the concepts for the Commission's consideration (Staff Ex. 3, at 2; Staff Ex. 10, at 4). No party, including the staff, supports these alternatives, and the Commission concludes that they should not be adopted.

The city of Columbus presented Dr. Rosen who testified that the valuation of the Zimmer plant should be significantly decreased. According to Dr. Rosen, the Commission should, in valuing the reasonable cost of Zimmer, compare the costs and benefits of Zimmer to the costs and benefits of the lowest cost

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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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| In the Matter of the Application of The Dayton Power and Light Company for Authority to Modify its Accounting Procedure for Certain Storm-Related Services Restoration Costs. | ) ) ) ) ) | Case No. 08-1332-EL-AAM |

FINDING AND ORDER

The Commission finds:

(1) The Dayton Power and Light Company (DP&L or the Company) is a public utility as defined by Sections 4905.02 and 4905.03(A)(4), Revised Code.

(2) On December 26, 2008, DP&L filed an application in this proceeding, seeking authority to defer, as a regulatory asset, a portion of its Operation and Maintenance (O&M) expenses associated with restoring electric service to its customers in the aftermath of Hurricane Ike's destructive wind storm beginning on September 14, 2008. The portion of the O&M expenses the Company proposes to defer is the amount by which the total O&M expenses associated with the Hurricane Ike-related service restoration expenses and other storms experienced in 2008 exceeds the three-year average service restoration O&M expenses associated with major storms. The Company proposes to defer, for future recovery, these O&M expenses, with carrying costs based on its actual cost of debt of 5.86 percent, as filed in Case No. 08-1094-EL-SSO.

(3) In support of the Company's application, DP&L cites the Commission's decision in its Rate Stabilization Plan (RSP),[1] the Commission's approval of the Company's Electric Transition Plan (ETP),[2] and the Commission's authorization

1 *In the Matter of the Application of the Continuation of the Rate Freeze and Extension of the Market Development Period for The Dayton Power and Light Company*, Case No. 02-2779-EL-ATA, et al., Opinion and Order (September 2, 2003).

2 *In the Matter of the Application of Dayton Power and Light Company for Approval of its Transition Plan Pursuant to Section 4928.3, Revised Code and for the Opportunity to Receive Transition Revenues as authorized Under Sections 4928.31 to 4928.40, Revised Code*, Case No. 99-1687-EL-ETP, et al., Opinion and Order (August 31, 2000).

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to recover O&M expenses associated with extraordinary ice storms that occurred in December 2004 and January 2005.[3] The application asserts that the present application is consistent with the Company's application approved in Case No. 05-1090-EL-ATA, which was approved pursuant to the Company's RSP and ETP. The Company is not requesting, at this time, to commence recovery of the O&M expenses associated with repairing/replacing the distribution facilities damaged by Hurricane Ike. Rather, it seeks approval to defer the related O&M expenses, with carrying costs, for future recovery under its approved RSP from all customers, over a twelve-month period, beginning at a date determined by the Commission in a future proceeding.

(4) The Commission finds that the application seeking authority to modify the Company's accounting procedures to defer incremental O&M expenses associated with the September 14, 2008, wind storm, with carrying costs, is reasonable and should be approved.

(5) DP&L is directed to separately identify and record in a sub-account of Account 182, Other Regulatory Assets, all O&M costs to be deferred by the Company.

(6) The determination of the reasonableness of the deferred amounts and the recovery thereof, if any, will be examined and addressed in a future proceeding before the Commission. As the Supreme Court has previously held, deferrals do not constitute ratemaking. *See Elyria Foundry Co. v. Pub. Util. Comm.* (2007), 114 Ohio St.3d 305.

It is, therefore,

ORDERED, That the application by DP&L to modify accounting procedures to defer incremental O&M costs related to the September 14, 2008, wind storm service restoration expenses, with carrying costs, as set forth in findings (4) thru (6) is approved. It is, further,

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3 *In the Matter of the Application of Dayton Power and Light Company for Approval of Tariff Changes Associated With a Request to Implement a Storm Cost Recovery Rider*, Case No. 05-1090-EL-ATA, Finding and Order (July 12, 2006).

ORDERED, That nothing in this Entry shall be binding upon the Commission in any subsequent investigation or proceeding involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That a copy of this entry be served upon DP&L.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Paul A. Centolella

Ronda Hartman Fergus

Valerie A. Lemmie

Cheryl L. Roberto

RW:sm

Entered in the Journal
JAN. 1 4 2009

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

OPINION AND ORDER

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

APPEARANCES:

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

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

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

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

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

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

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

OPINION:

I. History of the Proceeding

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

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

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

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

II. Discussion and Conclusions

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

Ormet also contends that the proposed unique arrangement furthers the policy of the State of Ohio as codified in Section 4928.02, Revised Code. Ormet claims that the

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

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

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

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

The Commission finds that Ormet's application for a unique arrangement should be approved subject to a number of modifications set forth below. The evidence in the record of this proceeding demonstrates that Ormet provides significant economic benefits to the region. Specifically, the evidence demonstrates that Ormet provides $195 million in total employee compensation and benefits to the regional economy (Ormet Ex. 5 at 1). The evidence also indicates that Ormet is a key employer for the region (Ormet Ex. 5 at 3-4) and that Ormet's operations are responsible, indirectly, for the creation of an additional 2,400 jobs in the region (Tr. 1 at 262-263). Further, the record shows that Ormet's operations generate over $6.7 million in tax revenue each year (Tr. 1 at 271). Finally, although OCC and OEG, as well as Staff, claim that the increased rates paid by ratepayers

will have a negative economic effect on the state's economy, no party presented evidence in the record which quantified this negative effect (TR. 1 at 264-265).

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

A. Terms of the Unique Arrangement for Calendar Year 2009

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

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

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

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

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

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

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

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

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

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

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

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

1) Proposed Discount and Delta Revenue Recovery

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

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

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

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

AEP-Ohio believes that the amount of any discount to be provided to Ormet is a matter for the Commission's judgment. However, AEP-Ohio claims that, under Section 4905.31(E), Revised Code, AEP-Ohio must be provided full recovery of all delta revenues under the unique arrangement because the statute specifies that all costs of an economic

development program or job retention program are recoverable by an electric utility, including all "revenue forgone."

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

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

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

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

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

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

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

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

Therefore, the Commission will modify the proposed unique arrangement to set the maximum rate discount at $60 million for calendar years 2010 and 2011. The Commission has based the floor upon the variable costs of production of the electricity consumed by Ormet at full capacity, which the testimony at hearing indicates would be approximately $90 million. However, testimony in the record also indicates that, at the time of the hearing, Ormet was in the process of curtailing production to 4 potlines (Tr. 1 at 70-71). This curtailment of operations should reduce Ormet's demand for electricity by

approximately one-third; therefore, the Commission has reduced the estimate of the variable costs of production of the electricity of $90 million by one-third to $60 million. The Commission finds that this is an appropriate floor or maximum discount for Ormet. This floor will be subject to two adjustments: a flexible phase down and a reduction in the discount due to reductions in employment, both of which will be discussed below.

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

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

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

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

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

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

2) Potential Delta Revenue Credits

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

OCC and OEG also allege that, under the proposed unique arrangement, AEP-Ohio's ratepayers bear great risks related to the price of aluminum while receiving little benefit if the price of aluminum rises. OCC and OEG cite to the testimony of OCC witness Ibrahim that the proposed unique arrangement lacks symmetry regarding the risks and benefits born by AEP-Ohio's customers (OCC Ex. 3 at 14-15). OCC and OEG claim that, if aluminum prices double from the price when Dr. Ibrahim filed his testimony, the possible benefit to AEP-Ohio's ratepayers would only be $3.6 million to $8.9 million (OCC Ex. 3 at 15). On the other hand, if the futures price for July 2010 accurately reflects the actual LME price for July 2010, Ormet will be paid $77.1 million to use power in 2010 and ratepayers would be responsible for delta revenues of $281.1 million. OCC and OEG contend that

this asymmetry is extremely disadvantageous to AEP-Ohio's ratepayers because these ratepayers will bear huge risks for delta revenues while the benefits are extremely unlikely and minimal compared to the risks. Consequently, OCC and OEG recommend that a reasonable symmetry would require Ormet to pay a rate that exceeds the tariff rate by $0.049 per MWh times 50 percent for each $1 per tonne when the actual LME price exceeds the target price. AEP-Ohio would receive delta revenue credits for the amount that Ormet pays in excess of tariff rates with a maximum delta revenue credit cap of $16.35 million per year.

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

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

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

3) POLR Charges

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

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

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

The Commission finds that, under the terms of the unique arrangement, AEP-Ohio will be the exclusive supplier to Ormet (Tr. I at 37-38; Tr. IV at 484). Therefore, there is no risk that Ormet will shop for competitive generation and then return to AEP-Ohio's POLR service. If AEP-Ohio were to retain these charges, AEP-Ohio would be compensated for a service it would not be providing. Moreover, our decision in the AEP-Ohio electric security plan is inapplicable to this case because that holding addressed customers receiving service under AEP-Ohio's standard service offer rather than a customer

receiving service under a unique arrangement specifically approved by the Commission. Therefore, the Commission finds that the unique arrangement should be modified such that any POLR charges paid by Ormet are used to reduce the AEP-Ohio's ratepayers' obligations under the unique arrangement. During the term of the unique arrangement, AEP-Ohio shall credit any POLR charges paid by Ormet to its economic development rider in order to reduce the impact of the unique arrangement on other ratepayers' bills.

4) Deposit and Advance Payment Provisions

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

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

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

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

5) Future Review of the Proposed Unique Arrangement

In addition, IEU-Ohio claims that the proposed unique arrangement would prohibit the Commission and other stakeholders from seeking to modify the unique arrangement, except in very limited circumstances, while allowing Ormet to request modifications that

would further benefit Ormet. Likewise, OCC and OEG claim that the proposed unique arrangement would unlawfully limit the Commission's jurisdiction to review and modify the agreement. Kroger also states that the Commission must have the ability to periodically review and, if necessary, modify the unique arrangement. Further, Kroger claims that ten years is an unreasonable amount of time to expose ratepayers to the risk and cost of a unique arrangement; thus there must be a reasonable time limit on the unique arrangement. Staff agrees that there should be some limit upon the length of the unique agreement. Thus, Staff believes that there should be periodic reviews of whether the unique agreements should continue.

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

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

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

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

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

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

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

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

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

ORDER:

It is, therefore,

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

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

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

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

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

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Ronda Hartman Fergus

Paul A. Centolella

Valerie A. Lemmie

Cheryl L. Roberto

GAP:ct

Entered in the Journal

JUL 15 2009

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

OPINION AND ORDER

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

APPEARANCES:

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

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

Janine L. Migden-Ostrander, the Office of the Ohio Consumers' Counsel, by Maureen R. Grady, Melissa Yost, and Kyle Lynn Verrett, Assistant Consumers' Counsels, 10 West Broad Street, Columbus, Ohio 43215-3485, on behalf of the residential utility consumers of Columbus Southern Power Company and Ohio Power Company.

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

Michael R. Smalz and Joseph M. Maskovyak, Ohio Poverty Law Center, 555 Buttles Avenue, Columbus, Ohio 43215, on behalf of the Appalachian Peace and Justice Network.

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

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

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

Bricker & Eckler, Thomas J. O'Brien, 100 South Third Street, Columbus, Ohio 43215, on behalf of Ohio Manufacturers' Association.

BACKGROUND:

I. Significantly Excessive Earnings Test Background

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

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

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

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

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

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

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

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

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

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

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

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

APPLICABLE LAW:

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

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

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

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

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

(i) The federal energy regulatory commission form 1 (FERC form 1) in its entirety for the annual period under review. The electric utility may seek protection of any confidential or proprietary data if necessary. If the FERC form 1 is not

available, the electric utility shall provide balance sheet and income statement information of at least the level of detail as required by FERC form 1.

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

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

I. PROCEDURAL ISSUES:

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

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

Similar to the *Norwood* case cited above, AEP-Ohio claims that Section 4928.143(F), Revised Code, results in a taking of private property rights as the Companies are being required to forfeit earnings lawfully gained through the efficient use of their own property so that those earnings can be redistributed to its customers, even though the customers indisputably paid a just and reasonable rate for the service they received. According to the Companies, Section 4928.143(F), Revised Code, fails to give any definitive notice or guidance as to what is meant by "significantly excessive earnings." For example, AEP-Ohio states that there are no definitions, standards or guidance in the statute providing the electric utility fair notice of the risk of forfeiture or giving the Commission adequate

standards to appropriately judge the result as is evident by the parties' starkly conflicting positions in this case. Further, AEP-Ohio asserts, the parties have no common understanding of what level of earnings should be deemed "significantly excessive," whether off-system sales should be included in the net earnings used to calculate the return on equity, how write-offs and deferrals should be treated, how to identify companies that face "comparable business and financial risk" or what is meant by the reference to "adjustments in the aggregate."

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

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

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

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

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

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

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

Citing to *Alliance v. Carbone* (2009), 181 Ohio App.3d 500, 2009-Ohio1197, Customer Parties assert that the courts have held that a statute is not void merely because it could have been worded more precisely. Rather, the critical question is whether the statute affords a reasonable person of ordinary intelligence fair notice and sufficient definition

and guidance to enable the individual to conform his or her conduct to the law. In this case, Customer Parties aver, the meaning of Section 4928.143(F), Revised Code, is not under debate but rather which expert witness' methodology the Commission will adopt to determine whether CSP's earnings were significantly excessive in 2009.

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

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

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

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

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

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

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

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

B. <u>IEU-Ohio's motion to dismiss</u>

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

Pursuant to Rule 4901-1-15(F), O.A.C., IEU-Ohio challenged, on brief, the hearing examiner's rulings on the motions to dismiss. In support, IEU-Ohio submits that the Commission does not have subject matter jurisdiction to adopt an earnings test other than the earnings test outlined in Section 4928.143, Revised Code, or apply the required earnings test other than as mandated by Section 4928.143, Revised Code. IEU-Ohio argues

that AEP-Ohio's application includes more than retail services in its earned return on equity (ROE), includes revenues for a period less than one year, includes nonretail transactions such as those subject to Federal Energy Regulatory Commission (FERC) jurisdiction and considers revenue, expenses and earnings of any affiliate or parent company.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## II. APPLICATION OF SEET ANALYSIS:

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

#### 1. AEP-Ohio

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

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

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

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

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

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

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

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

Opposition to AEP-Ohio's proposed SEET analysis

Customer Parties and Staff argue that there are a number of errors with the method advocated by AEP-Ohio. First, Customer Parties claim that AEP-Ohio's approach for determining the comparable group companies identifies comparable utility and publicly traded companies based on the business and financial risk profile of AEP and not CSP (or OP) in contradiction of the language in Section 4928.143(F), Revised Code, which directs the Commission not to consider the revenues, expenses, or earnings of the electric utility's affiliates or its parent company. Second, Customer Parties contend that AEP-Ohio's process establishes an ROE threshold for SEET based on a 95 percent confidence interval and, as such, only 2.5 percent of companies would ever be determined to have

significantly excessive earnings. Customer Parties argue that using such a high confidence interval results in an excessively high ROE SEET threshold. Third, Customer Parties argue that AEP-Ohio's method does not directly adjust the ROE for the capital structure and cost of debt of CSP to appropriately account for the differences in financial risk between CSP and the comparable companies. Ultimately, Customer Parties contend that AEP-Ohio's proposed SEET analysis does not provide a direct ROE SEET for CSP. (Joint Inv. Ex. 1 at 24-26.)

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

2. Customer Parties

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

companies, including electric utilities; (6) adjust the benchmark ROE for the capital structures of CSP; and (7) add a ROE premium to establish the SEET threshold ROE. (Joint Inv. Ex. 1 at 8.)

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

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

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

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

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

Opposition to Customer Parties' proposed SEET analysis

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

AEP-Ohio contends that Customer Parties' use of the beta range produced by the electric proxy group is inappropriate to compare to the year-end value for CSP. Because CSP's beta is higher, since it is a smaller company, Customer Parties' analysis necessarily puts CSP's beta outside of the range of the electric proxy group beta, causing a misguided comparable group of companies to be composed. According to AEP-Ohio, Customer Parties' method implements a screen for business risk too late in the process and utilizes

inappropriate screens. AEP-Ohio contends that Customer Parties' proposal mixes business and financial risks where SB 221 requires the consideration of both business and financial risks in the formation of the comparable group of companies. (Cos. Ex. 7 at 5-6.)

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

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

3. Staff

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

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

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

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

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

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

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

Opposition to Staff's analysis

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

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

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

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

B. AEP-Ohio 2009 Earned ROEs

AEP-Ohio witness Thomas E. Mitchell presented testimony that supported the Companies' calculation of CSP's and OP's earned ROE for the 2009 SEET, proposed deductions to the Companies' ROEs and quantified the revenue producing provisions of the Companies' ESP. AEP-Ohio calculates each electric utility's ROE by using the net earnings available to common equity shareholders compared to the beginning and ending

average equity for the year ended December 31, 2009, as dictated by the Commission in 09-786. AEP-Ohio witness Mitchell testified that there were no minority interest, non-recurring, special or extraordinary items for CSP or OP for the year 2009. Thus, without any further adjustments, AEP-Ohio determined an ROE for OP of 10.81 percent and for CSP of 20.84 percent for 2009. AEP-Ohio acknowledges that included in the earnings of CSP and OP are nonjurisdictional earnings (excluding as it proposes off-system sales) that it did not attempt to fully jurisdictionalize for purposes of the 2009 SEET analysis; however, AEP-Ohio asserts to reserve the right to further jurisdictionalize its earnings if necessary. (Cos. Ex. 4 at 3-5, Ex. TEM-1 at 1; Cos. Ex. 6 at 7.)

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

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

1. Commission decision on SEET Threshold

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In terms of the various business and financial risks discussed by Mr. Hamrock in his testimony, the Commission concurs that CSP is facing various business and financial risks. Despite the use of riders, some bypassable and other nonbypassable riders, the fact

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

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

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

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

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

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

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

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

C. Adjustments to CSP's 2009 Earnings

1. Off-system sales

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

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

(b) Staff's positions as to OSS

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

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

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

(c) Customer Parties' position on OSS

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

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

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

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

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

(d) Commission decision on OSS margins

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

We are required to consider not only whether the electric utility had significantly excessive earnings but also whether its earnings are the result of adjustments in its ESP. Where it can be shown that the electric utility received a return on its OSS, which if

included in the calculation could unduly increase its ROE for purposes of SEET comparisons, OSS margins and the related equity in generation facilities should be excluded from the SEET calculation. Thus, without reaching the federal and constitutional law arguments, we will exclude OSS and the portion of generation that supports OSS from the SEET analysis.

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

2. Deferrals

(a) AEP-Ohio

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

(b) Other parties' position regarding deferrals

(1) Customer Parties

Customer Parties view FAC and EDR deferred revenues as deferred rate increases pursuant to the ESP which contribute to the earnings approved by the Commission and subject to refund to customers. Customer Parties argue that deferred expenses only affect earnings in the year of the deferral and there is no effect on earnings in future years. In future years, revenues and expenses are matched with no effect on earnings. Customer Parties recommend that any excess earnings first be used to eliminate or reduce the

regulatory asset created by the deferral on the electric utility's books as of the date the refund is effective. (Joint Inv. Ex. 2 at 6-7, 15-16, 25-26.)

(2) Staff

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

(c) Commission decision on deferrals

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

D. Capital requirements for future committed Ohio investments

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

1. Opposition to the committed future investment claims

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

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

Commission Decision

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

2. Other adjustments to CSP's 2009 Earnings

(a) AEP-Ohio

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

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

(b) Other parties' position

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

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

Commission decision on additional factors

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

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

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

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22 Tr. at 214-216.

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

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

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

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

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

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

24 Joint Int. Ex. 2 at 17.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

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

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

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

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

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

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

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

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

ORDER:

It is, therefore,

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

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

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

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

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

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

THE PUBLIC UTILITIES COMMISSION OF OHIO

Steven D. Lesser, Chairman

Paul A. Centolella

Valerie A. Lemmie

Cheryl L. Roberto Concurring

Cheryl L. Roberto

GNS/JRJ/vrm

Entered in the Journal
JAN 11 2011

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

CONCURRING OPINION OF COMMISSIONER CHERYL L. ROBERTO

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

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

Therefore, I concur with the majority.

Cheryl L. Roberto

Cheryl L. Roberto

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

| | | |
|---|---|---|
| In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company. | ) ) ) | Case No. 09-872-EL-FAC<br>Case No. 09-873-EL-FAC |

OPINION AND ORDER

The Public Utilities Commission of Ohio, having considered the record in these matters and the stipulation and recommendation submitted by the signatory parties, and being otherwise fully advised, hereby issues its opinion and order.

APPEARANCES:

Steven T. Nourse, One Riverside Plaza, Columbus, Ohio 43215-2373, and Daniel R. Conway, Porter, Wright, Morris & Arthur, LLP, 41 South High Street, Columbus, Ohio 43215, on behalf of Columbus Southern Power Company and Ohio Power Company.

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

Janine L. Migden-Ostrander, Ohio Consumers' Counsel, by Maureen Grady, Melissa Yost, and Kyle Lynn Verrett, Assistant Consumers' Counsel, 10 West Broad Street, Suite 1800, Columbus, Ohio 43215, on behalf of the residential utility consumers of Columbus Southern Power Company and Ohio Power Company.

McNees, Wallace & Nurick, by Samuel C. Randazzo, Joseph Clark, and Joseph Oliker, Fifth Third Center, Suite 1700, 21 East State Street, Columbus, Ohio 43215, on behalf of Industrial Energy Users of Ohio.

OPINION:

I. Background

Columbus Southern Power Company (CSP) and Ohio Power Company (OP) are public utilities as defined in Section 4905.02, Revised Code, and, as such, are subject to the jurisdiction of this Commission.

On March 18, 2009, the Commission issued its Opinion and Order in CSP's and OP's (jointly, AEP-Ohio or Companies) electric security plan (ESP) cases (ESP Order).[1] By entries on rehearing issued July 23, 2009, and November 4, 2009, the Commission affirmed and clarified certain issues raised in AEP-Ohio's ESP Order. In the ESP Order, the Commission approved fuel adjustment clauses (FAC) for the Companies including an annual audit of the FAC. Further, in the ESP cases, the Commission authorized 2010 rate increases of six percent for CSP and seven percent for OP and 2011 rate increases of six percent for CSP and eight percent for OP.

Pursuant to the Commission entry issued January 7, 2010, in Case Nos. 09-872-EL-FAC and 09-873-EL-FAC (2009 FAC cases), Energy Ventures Analysis, Inc., (EVA) was selected to perform AEP-Ohio's FAC audit for 2009. In accordance with the request for proposal, EVA is performing the audits for 2010 and 2011, unless the Commission determines otherwise. Pursuant to the request for proposal, the Commission reserves the right to rescind the award of future audits.

On May 14, 2010, both redacted and unredacted versions of EVA's management/performance (m/p) and financial audit of AEP-Ohio's FAC for 2009 (audit report) were filed in these cases. By entry issued June 29, 2010, the attorney examiner granted AEP-Ohio's motion for protective treatment regarding certain information contained in the audit report for a period of 18 months, ending on December 29, 2011.

The office of the Ohio Consumers' Counsel (OCC), Industrial Energy Users-Ohio (IEU-Ohio), and Ormet Primary Aluminum Company (Ormet) were granted intervention in the 2009 FAC cases in a Commission finding and order issued on January 7, 2010.

In accordance with the attorney examiner's June 29, 2010, entry, the hearing was held in these matters on August 23 and August 24, 2010, at the offices of the Commission. At the hearing, AEP-Ohio submitted a stipulation and recommendation (Ormet stipulation) which was filed in these dockets on August 23, 2010, and signed by the Companies, Staff, OCC, IEU-Ohio, and Ormet Primary Aluminum Corporation (Jt. Ex. 1). Additionally, at the hearing, AEP-Ohio submitted the public and rebuttal testimony of four individuals (AEP-Ohio Exs. 1 and 1A through 7 and 7A) while OCC and IEU-Ohio each offered the testimony of one witness (OCC Exs. 1 and 1A; IEU-Ohio Exs. 1 and 1A). In addition, the redacted and unredacted versions of the audit report were entered into the record without objection (Bench Exs. 1A and 1B).

As stated previously, a stipulation, signed by AEP-Ohio, Staff, OCC, IEU-Ohio, and Ormet was submitted on the record, at the hearing held on August 23, 2010. Through the stipulation, the parties agree that a determination on the collection of deferrals and

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[1] *In re AEP-Ohio ESP cases*, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Opinion and Order (March 18, 2009).

carrying charges associated with an Ormet Interim Agreement is the subject of a pending case before the Commission, *In the Matter of the Application of Columbus Southern Power and the Ohio Power Company to Recover Commission-Authorized Deferrals Through each Company's Fuel Adjustment Clause*, Case No. 09-1094-EL-FAC, and that issues associated with the Ormet Interim Agreement will be addressed in that proceeding.

On November 30, 2010, a stipulation and recommendation intended to resolve all the issues in this FAC proceeding as well as in the Companies significantly excessive earnings proceeding, Case No. 10-1261-EL-UNC *In the Matter of the 2009 Annual Filing of Columbus Southern Power Company and Ohio Power Company Required by Rule 4901:1-35-10, Ohio Administrative Code*, was filed on behalf of AEP-Ohio, Staff, the Ohio Hospital Association, the Ohio Manufacturers' Association, The Kroger Company, and Ormet. On December 16, 2010, the Companies filed a notice of withdrawal from the November 30, 2010, stipulation and recommendation thus rendering the stipulation moot.

II. Summary of the Audit Report

The audit report submitted by EVA and its subcontractor Larkin and Associates PLLC (Larkin) presents the results of the m/p and financial audit for the fuel adjustment clause which is the mechanism being used to recover prudently incurred fuel, purchased power, and other miscellaneous expenses. The FAC includes: Account 501 (Fuel); Account 502 (Steam Expenses); Account 509 (Allowances); Account 518 (Nuclear Fuel Expense); Account 547 (Non-Steam Fuel); Account 555 (Purchased Power); Account 507 (Rents); Account 557 (Other Expenses); Accounts 411.8 and 411.9 (Gains and Loses from Disposition of Allowance); and Other Accounts. EVA and Larkin (jointly, auditors) conducted this audit through a combination of document review, interrogatories, site visits, and interviews. Additionally, EVA and Larkin visited the Conesville Coal Preparation Plant and the Conesville power plant. In its initial ESP application, the Companies proposed mitigating the rate impact of any FAC increases on customers by phasing in the new ESP rates by deferring a portion of the annual incremental FAC costs such that total bill increases to customers would not exceed 15 percent during each year of the ESP. The Commission's ESP order, issued on March 18, 2009, modified AEP-Ohio's proposal to mitigate the rate impact on customers by limiting the phase-in of any FAC increases on a total bill basis by seven, six, and six percent for CSP and by eight, seven, and eight percent for OP for years, 2009, 2010, and 2011, respectively. The Commission's ESP order also stated that the collection of any deferrals including carrying costs remaining at the end of the ESP shall occur from 2012 through 2018 as necessary to recover the actual fuel expense incurred plus carrying costs. (Jt. Ex. 1 at 1-2 through 1-3; ESP order at 23.)

The audit report found that AEP-Ohio's fleet is largely coal-based and coal procurement costs are by far the largest component of the FAC. The auditors noted that

since mid-2007, the coal industry has demonstrated unprecedented volatility which has resulted in utility fuel procurement personnel facing enormous challenges. Additionally, from mid-2007 until the third quarter of 2008, a global coal supply/demand imbalance increased the demand for and price of United States (U.S.) coals. In the auditors' opinion, American Electric Power Service Corporation (AEPSC) did an exceptional job during this period particularly with those suppliers that faced financial difficulties. Since the third quarter of 2008, electricity demand slowed as a result of the severe economic recession thus leading many utilities to end up with more coal under contract than needed. Thus, from mid-2007 through the end of 2008, electric utilities went from having to acquire coal under contract to having to manage a surplus of coal inventories. In the auditors' view, AEPSC also did an outstanding job managing its excess coal inventories. The auditors found this to be the case based, in part, on the treatment AEPSC afforded its suppliers, many of which were willing to defer shipments at no cost. Additionally, the auditors noted, AEPSC chose to allow stockpiles to increase rather than pay for reduced shipments which should benefit ratepayers in the long term. AEP's coal costs in 2009 were, according to the auditors, comparable to the coal procurement costs of other nearby utilities. (Jt. Ex. 1 at 1-4 through 1-5.)

The audit report further determines that, at the end of the first year of the FAC, AEP-Ohio experienced a large under-recovery. The under-recovery amounts to $37.5 million for CSP and $297.6 million for OP. The auditors note that there many components contributing to the under-recovery but that two coal contract events alone explain more than half of OP's under-recovery. The first decision attributing to the under-recovery was the decision to increase the contract price under two contracts in 2009. This surcharge under the two contracts at issue was a well-considered decision at a difficult time according to the audit report. While expensive, the auditors note that, without the surcharge, an insolvency of this coal supplier would have led to greater expense for AEP-Ohio and ultimately its ratepayers. The second contributing factor was a buy-out of a coal contract in 2007 which resulted in an increase in 2009 fuel expenses. The 2007 buy-out was structured as a Settlement Agreement arising out of contract dispute. According to the auditors, a hindsight review of such a Settlement Agreement is always difficult because its merits need to be considered at the time it was entered into. This Settlement Agreement was effectively a buy-out of the contract with this supplier after 2008. Otherwise, shipments would have continued under the contract through the ESP period. In return for agreeing to the buy-out, AEP received a settlement and a coal reserve in West Virginia. AEP booked the coal reserve as an un-regulated asset in 2008. (*Id.* at 1-5.)

The audit report further found that AEPSC's fuel procurement operation is run in a professional manner using leading industry practices in acquiring coal and transportation. To support this position, the audit report notes that AEPSC uses a portfolio strategy to purchase coal such that its market exposure at any one time is limited. Moreover, AEPSC purchases most of its coal through competitive solicitations, and AEPSC uses active

management of its coal supply to match deliveries and burn where possible. The auditors noted that AEPSC was in the process of revising its fuel procurement manual to guide its practices (*Id.*)

The audit report also addresses AEP-Ohio's coal supply and scrubber retrofit at various generating facilities as well as the reduction in the need for washed coal from the Conesville Coal Preparation Plant due to the conversion of an existing coal supply agreement from unwashed coal to washed coal. The audit report notes that AEP-Ohio has met its 2009 alternative energy obligations through compliance with reduced solar obligations, the purchase of non-solar renewable energy credits (RECs) from wind and landfill gas, purchased solar (RECs), solar installations on two AEP-Ohio service centers, and wind from two purchase power agreements (PPAs). During 2009, the Companies entered into three 20-year PPAs: two for wind and one for solar. The auditors note that the resulting power prices under all three PPAs are high compared to current power prices although competitive with current market prices for renewable power. These PPAs provide no market reopeners or early outs thereby obligating AEP-Ohio to these high rates for 20 years. The auditors note that AEPSC's strategy is to continue to examine all options including self-build options (*Id.* at 1-6.) Finally, the auditors found that the quarterly FAC filings were made in a timely manner and contained sufficient documentation to support the numbers therein. However, the back-up documentation was less well organized making the audit trail more difficult. Also, the auditors reported that AEPSC was notably well-prepared and responsive to the auditors (*Id.*)

## III. Management Audit Recommendations[2]

### A. Auditors' Recommendations

The audit report recommends that the Commission should review whether any proceeds from the Settlement Agreement (i.e., the 2008 lump sum payment AEP-Ohio received as well as the West Virgnia coal reserve) should be credited against OP's FAC under-recovery. The auditors note that this buy-out was unique as it occurred during a period in which fuel cost recovery was not regulated yet the entire value received was for tons of coal that would have been shipped during the ESP period. The auditors do not suggest any motivation on the part of AEPSC to transfer value from ratepayers in 2009 to 2011 to an earlier date. Clearly, it was the coal supplier who initiated the Settlement Agreement because the contract price was well below market. Nonetheless, the contract was an OP asset and the value associated with it would have flowed through to OP ratepayers through the ESP period had there not been an early termination of the contract. Further, the difference between the price of the replacement coal and the contract price is

2 The following is a summary of the recommendations from the audit report. The Commission notes that these summaries are in no way intended to replace or supplement the text of the audit report.

one factor behind the large OP FAC under-recovery. Equity suggests that the Commission should consider whether some of the realized value should be credited against the under-recovery according to the auditors. (*Id.* at 1-6; 2-21 through 2-22.)

The audit report also recommends that coal could become the new swing fuel; therefore, AEPSC should reconsider new coal procurement strategies to avoid over-commitments in the future. Further, the audit report recommends that the next m/p auditor review the Cardinal 1 scrubber situation and determine what, if any, FAC costs are due to this situation. AEPSC should also undertake a study to determine whether there is an economic justification for continuing to operate the Conesville Coal Preparation Plant. The auditors next recommend that AEPSC should finalize the update of its policies and procedures manual to reflect current business practices and that both the policies and procedures manual and the Conesville Coal Preparation Plant study should be reviewed in the next m/p audit. Lastly, the audit report recommends that prior to entering into long-term agreements for renewables with fixed pricing, AEP-Ohio should fully evaluate self-build and biomass co-firing alternatives and should explore contract options that would provide some protection in the event that the contract pricing for power and/or RECs diverge with market prices. (*Id.* at 1-7.)

B. AEP-Ohio's Position on Management Audit Recommendations

AEP-Ohio witnesses generally testified that the Companies are either in agreement with or not opposed to the auditor's m/p recommendations 2 through 6 found at pages 1-7 of the audit. Regarding m/p audit recommendation 2, the reconsideration of new coal procurement strategies, AEP-Ohio witness Rusk testified that the Companies agree with the recommendation and are currently undertaking such an effort (Co. Ex. 2 at 3). AEP-Ohio witness Nelson testified regarding m/p audit recommendation 3 that the Companies are not opposed to a review of the audit period operational issues concerning the Cardinal 1 scrubber in the next fuel adjustment clause proceeding (Co. Ex. 3 at 8-9). Regarding m/p audit recommendation 4, AEP-Ohio witness Rusk explained that AEPSC has already begun an effort to study the continued use of the Conesville Preparation Plant with the goal of formulating a recommendation on this facility for the next management performance audit (Co. Ex. 2 at 4). AEP-Ohio witness Rusk also testified regarding m/p audit recommendation 5. Mr. Rusk observed that AESPC is currently updating its fuel procurement policies and should have those updates in time for the next m/p audit. However, Mr. Rusk clarified that these revisions are focused on procurement policies and not focused on procurement procedures as the Companies believe that the current approach results in the efficient procurement of fuel at the lowest reasonable cost. (*Id.* at 5.) Regarding m/p audit recommendation 6, that the Companies should fully evaluate and explore self-build and biomass co-firing alternatives before entering long-term agreements for renewables with fixed pricing, AEP-Ohio witness Simmons testified the Companies are constantly exploring the most cost effective sources of renewable generation. Witness Simmons explained that bio-mass is one renewable already under

consideration. The witness discussed two requests for proposal issued by AEPSC in 2010, one for bio-mass and one for a pre-blended bio-mass and coal mixture. Additionally, AEPSC is also considering other co-firing alternatives such as biodiesel. Finally, witness Simmons testified that the self-build option is being evaluated but is less likely without a clear cost recovery path. (Co. Ex. 4 at 4-6.) The sole m/p audit recommendation that generated substantial disagreement among the parties and was the primary focus of the hearing and post-hearing briefs involved m/p audit recommendation 1 discussed in detail below.

C. Disputed Management Audit Recommendation 1

Management audit recommendation 1 states that:

> EVA believes that the PUCO should review whether any proceeds from the Settlement Agreement should be a credit against OPCO's FAC under-recovery. This buy-out is somewhat unique as it occurred during a period in which fuel cost recovery was not regulated yet the entire value received was for tons that would have been shipped during the ESP period.

1. AEP-Ohio's Position

AEP-Ohio maintains that, contrary to the position of OCC and IEU-Ohio, it is important to note that the explicit language of m/p audit recommendation 1 is limited to deciding whether proceeds from the 2008 Settlement Agreement should be used to offset OP's under-recovery of fuel costs in 2009 (Jt. Ex. 1 at 1-6). The Companies explain that the proceeds of the 2008 Settlement Agreement include a lump sum payment (made in three equal payments) and a coal reserves asset located in West Virginia AEP-Ohio witness Dooley testified that a substantial portion of the lump sum payment was already credited, in part, against 2009 fuel costs flowed through the FAC with the other portion to be credited against 2010 fuel costs flowed through the FAC (Cos. Ex. 1 at 4). Moreover, according to AEP-Ohio, the present value of the undeveloped, unpermitted coal reserve is simply not known, but, in any event, the coal reserve is an OP asset that ratepayers have no claim upon. Additionally, the Companies note, the auditor clarified that the separate 2008 Delivery Shortfall Agreement was not a part of the equity issue raised in m/p audit recommendation 1. The auditor further clarified, according to the Companies, that EVA was not making a recommendation but merely felt that the Commission should consider the issue (Tr. I at 38). AEP-Ohio states that, while the auditor may have had good intentions in raising this equity issue, it would be inappropriate for the Commission to entertain the notion because it creates a host of legal issues and because the issue is susceptible to expansion of the issue as OCC and IEU-Ohio have done.

Contrary to the positions of IEU-Ohio and OCC, discussed below, the Companies, citing to the ESP Cases order at 20-22, assert that the Commission fully understood and

expected that the projected magnitude of the OP fuel deferrals by the end of the ESP was approximately $550 million and the Commission built this factor into the structure of the rate cap/phase-in plan as part of the modified ESP. AEP-Ohio claims that the opportunistic positions of OCC and IEU-Ohio constitute selective and unlawful retroactive ratemaking in violation of *Keco Industries, Inc., v. Cincinnati & Suburban Bell Tel. Co.* (1957), 166 Ohio St. 254 and *Lucas Cty. Commrs. v. Pub. Util. Comm.* (1997), 80 Ohio St.3d 344. Additionally, the Companies maintain that, pursuant to the determinations made in the ESP cases and the entry in this proceeding, the audit period is for 2009 and the prudence review must be limited to 2009 fuel procurement activities. These two key Commission determinations involving operation of the FAC mechanism during the ESP were fully adjudicated and decided as part of the Commission's decision in the ESP case. Thus, these determinations are res judicata and cannot be relitigated or reapplied on a retroactive basis. See *Ohio Consumers' Counsel v. Pub. Util. Comm.* (2006), 111 Ohio St.3d 300, 318; *Ohio Consumers' Counsel v. Pub. Util. Comm.* (1985), 16 Ohio St.3d 9, 10.

Moreover, the Companies assert that the FAC baseline was a hotly contested, fully litigated issue decided in the ESP cases and cannot now be modified in this case. AEP-Ohio asserts that the Commission and the parties understood in the ESP cases that adopting a lower FAC baseline created a higher non-FAC generation rate which when coupled with the rate caps adopted as part of the modified ESP resulted in large fuel deferrals recoverable in the future through a nonbypassable surcharge on all customers in order to mitigate a larger initial rate increase. These are the same fuel deferrals OCC and IEU-Ohio are challenging at the Ohio Supreme Court claims AEP-Ohio. Since these same issues have been appealed to the Ohio Supreme Court, the Companies aver that any attempt to collaterally attack the FAC in this proceeding should not be entertained. As a final matter AEP-Ohio opines that each of the 2008 agreements raised by OCC and IEU-Ohio were prudently adopted and the Commission should not disturb any continuing effects of those agreements, especially given that each agreement was entered into by OP prior to commencement of the ESP's new FAC and before the 2009 audit period.

2. <u>IEU-Ohio's Position</u>

IEU-Ohio maintains that the record reflects that the Companies received benefits or value in return for the voluntarily renegotiated contracts, that the Companies accounting failed to flow through the benefits of the voluntarily renegotiated contracts, and that, as a result, customers paid more in fuel costs in 2009 than they would have had AEP-Ohio not renegotiated certain contracts. Specifically, IEU-Ohio states that the Commission should credit to customers the full benefit of the voluntary 2008 Settlement Agreement. In this regard, IEU-Ohio recommends crediting the full lump sum cash payment resulting from the 2008 Settlement Agreement rather than only a portion of the lump sum payment as the Companies have done (IEU-Ohio Ex. 1 at 6). Additionally, IEU-Ohio argues that the Commission should direct the auditor in the next m/p audit to review and provide a current valuation of the West Virginia coal reserve to be credited against OP's FAC under-

recovery that AEP-Ohio will begin collecting in 2012. In the meantime, however, IEU-Ohio recommends that the Commission use the booked value of the West Virginia coal reserve to make an initial downward adjustment to the OP FAC under-recovery. (*Id.* at 7.) Crediting the booked value to the under-recovery now, claims IEU-Ohio, will ensure that customers do not pay carrying costs associated with the booked value while the Commission works to ensure a more accurate valuation of the West Virginia coal reserve. Additionally, claims IEU-Ohio, the booked reserve credit will not impact rates or harm OP's cash flow due to OP's FAC under-recovery deferral. IEU-Ohio also maintains that the Commission should credit against the OP FAC under-recovery the full value of the note receivable by the Companies for the remaining 2008 tonnage that was never delivered as a result of the 2008 Buyout Agreement (*Id.* at 5).

As an alternative recommendation, IEU-Ohio states that the Commission credit against OP's FAC under-recovery the difference between the coal contract price under the contract subject to the 2008 Settlement Agreement and the price per ton paid for the replacement coal multiplied by the number of replacement tons of coal purchased during 2009 (*Id.* at 8). The primary benefit of this option is one of administrative convenience claims IEU-Ohio as it does not require either a future auditor or the Commission to make a subsequent determination of the value of the West Virginia coal reserve (*Id.*). Adopting this option would moot the need to determine whether the full benefit of the lump sum 2008 Settlement Agreement should be credited to customers, the need to properly determine the value of the West Virginia coal reserve, and a determination of whether to credit customers for the proceeds of from the subsequent 2008 Buyout Agreement (*Id.* at 9).

The last adjustment recommended by IEU-Ohio involves a 2008 Contract Support Agreement. Under the 2008 Contract Support Agreement, CSP agreed to increase the base price for a certain tonnage of coal during 2009 with the option for CSP to acquire coal at a discount off the market price per ton for two three-year extensions of the agreement beginning in 2013. IEU-Ohio recommends that the Commission require CSP to refund the increased price per ton that AEP-Ohio agreed to pay for coal during 2009 as part of the 2008 Contract Support Agreement to its FAC customers and account for the total increase as a deferred expense with no carrying costs (*Id.* at 11-12). Should the Commission determine that carrying costs on the deferred expense are appropriate, IEU-Ohio argues that the carrying costs should be a debt-only rate. The deferred expense would then be amortized if and when CSP actually exercises the options for the respective three-year extensions of the 2008 Contract Support Agreement beginning in 2013. (*Id.*) Without this adjustment, IEU-Ohio claims that the present customers incurred higher costs for coal in 2009 but have no assurance that they will receive any of the future benefits. IEU-Ohio concludes by noting that its recommendations more fairly balance the benefits and costs associated with the coal supply contracts.

In response to AEP-Ohio's case-in-chief, IEU-Ohio urges the Commission to direct the Companies to provide its customers the benefits due them from the voluntary coal contract negotiations. IEU-Ohio also took issue with the Companies' claims that the relief requested by the intervenors and by Staff involves retroactive ratemaking and is prohibited under *Keco* and *Lucas Cty*. *Keco* is inapplicable, argues IEU-Ohio, as that case involved traditional regulation and did not involve issues associated with a self-reconciling automatic adjustment clause. Even if the Commission were to find some credibility in AEP-Ohio's argument, IEU-Ohio maintains that the Commission could easily remedy that situation by merely repricing the coal as outlined in the testimony of IEU-Ohio witness Hess (*Id.* at 7-8).

IEU-Ohio also urges the Commission to reject the Companies' claims that the Commission is merely limited to looking at fuel procurement activities during calendar year 2009. IEU-Ohio notes that AEP-Ohio's own witness acknowledged that in conducting the 2009 audit that it was necessary for the auditor to determine whether contracts entered into prior to the audit period had any impact on audit period costs (Tr. I at 162-163). AEP-Ohio's claims of res judicata are also suspect, IEU-Ohio avers, as neither claim preclusion nor issue preclusion, two necessary components of res judicata, apply in this instance. IEU-Ohio next takes issue with the Companies' position that the parties are attempting to illegally relitigate the FAC baseline established in the ESP case. Neither the intervenors nor Staff advanced proposals to modify the FAC baseline asserts IEU-Ohio.

IEU-Ohio next disputes the Companies' argument that the intervenors are claiming a property ownership interest in the coal reserve for ratepayers. IEU-Ohio asserts that nowhere did the intervenors or Staff claim such an ownership interest but simply that the benefits that have been deprived of OP customers be netted against the costs that OP has billed and collected from customers. Next, IEU-Ohio maintains that it is not challenging the appropriateness of the accounting based on any conflict with GAAP, but rather makes a ratemaking recommendation for the Commission's consideration. Lastly, IEU-Ohio avers that, contrary to the Companies position, IEU-Ohio did consider the production bonus payment made in 2008 and agreed that the FAC customers had paid their fair share of the costs of that contract (Tr. II at 255). For these reasons, IEU-Ohio urges the Commission to adopt its recommendations to more fairly balance the benefits and the costs associated with the coal supply contracts discussed in this proceeding.

3. OCC's Position

OCC submits that AEP-Ohio is attempting to pass on to its customers all of the Companies costs under certain fuel procurement contracts, while keeping the majority of the benefits acquired in the contracts, thereby causing its customers to pay more fuel cost than authorized by law in violation of Section 4928.143(B)(2)(a), Revised Code, and Rule 4901:1-35-03(C)(9)(a)(ii), O.A.C. For example, similar to the position taken by IEU-Ohio, OCC asserts that the Companies 2008 Settlement Agreement produced added costs for

customers while AEP-Ohio only shared a portion of the lump sum payments the Companies received as well as only a portion of the West Virginia coal reserve. Another example of AEP-Ohio passing along increased costs while keeping the majority of the benefits is the renegotiated coal procurement contract whereby AEP-Ohio agreed to pay the coal provider an increased price of coal per ton during 2009 while having the opportunity to receive a per ton discount on all tons of coal delivered from 2013-2018.

To prevent AEP-Ohio from recovering more fuel cost from its customers than the Companies should under law, OCC submits that the Commission should order that AEP-Ohio's customers receive the financial benefits from the Companies fuel procurement contracts through immediate credits to AEP-Ohio's FAC deferral balance. As previously discussed, those fuel procurement benefits that should be credited against the FAC deferral balance include the full lump sum payment and the fair value of the West Virginia coal reserve that was part of the settlement agreement as well as the fair value of the coal market price discount option for future coal delivery negotiated as part of the 2008 Contract Support Agreement. Any delay in applying these credits will unnecessarily increase the burden to the customers of OP because the carrying charges associated with OP's fuel cost deferral can exceed $10 million every three months (OCC Ex. 1 at 16).

Responding to the Companies' arguments, OCC asserts that the underlying ESP decision and the January 7, 2010, entry in this case do not limit the Commission's review of AEP-Ohio's fuel procurement contracts to only those entered into during the 2009 FAC period. Additionally, OCC argues that neither OCC nor IEU-Ohio are attempting to "claw back" revenue from a prior rate plan as argued by AEP-Ohio. Moreover, the FAC baseline is not relevant, claims OCC, to the issue of requiring AEP-Ohio to recover only its actual fuel cost nor does the FAC baseline constitute res judicata. OCC's final argument is that requiring AEP-Ohio to recover only its actual fuel cost does not constitute selective or retroactive ratemaking as argued by the Companies.

4. Staff's Position

As a general matter, Staff supports the findings and recommendations contained in the Audit Report and recommends that those recommendations be adopted by the Commission. Staff acknowledges that the Companies are entitled to recover the costs of fuel but only to recover the true cost incurred. In other words, Staff asserts that any proceeds received offsetting the cost of fuel should be credited against under-recoveries, regardless of the period in which the proceeds are recognized. Since the value of such credits cannot be determined at this time, Staff recommends that the Commission direct the auditor to evaluate the value of proceeds received by the Companies and not credited either to the FAC or to deferred under-recoveries and make recommendations in the next audit proceeding as to the value to be credited.

Responding to a number of AEP-Ohio arguments, Staff notes that arguments concerning prohibited retroactive ratemaking and imprudence are irrelevant and have not been raised by the auditor's report. AEP-Ohio's arguments concerning regulatory accounting are rejected by Staff as the Commission and not the Companies determine the appropriate accounting for regulatory purposes. Staff does agree with the Companies that Ohio ratepayers do not own the coal reserves that were part of the Settlement Agreement, however, Staff asserts that the value of the coal reserves is part of the cost of fuel and therefore should be examined by the next auditor.

D. Commission Conclusion on Management Audit Recommendations

Initially, the Commission notes that there were very few concerns raised by the parties as to the auditor's m/p recommendations 2 through 6 found at pages 1-7 of the audit. Therefore, the Commission will adopt the auditor's m/p recommendations 2 through 6 as outlined in the audit. The Commission notes that there were, however, widely contrasting positions taken by the parties concerning m/p audit recommendation 1 which recommends that the Commission should review whether any proceeds from the Settlement Agreement (i.e., the 2008 lump sum payment AEP-Ohio received as well as the West Virginia coal reserve) should be a credit against OP's FAC under-recovery.

Following a thorough review of the record and the arguments raised by the parties in this matter, the Commission determines that all of the realized value from the Settlement Agreement should be credited against OP's FAC under-recovery namely the portion of the $30 million 2008 lump sum payment not already credited to OP ratepayers as well as the $41 million value of the West Virginia coal reserve that AEP booked when the Settlement Agreement was executed. Additionally, because the value of the West Virginia coal reserve is not clear and because AEP had planned to begin the permitting process at the time of the audit which should enhance the value of the coal reserve, we direct AEP to hire an auditor specifically to examine the value of the West Virginia coal reserve and to make a recommendation to the Commission as to whether the increased value, if any above the $41 million already required to be credited against OP's under-recovery, should accrue to OP ratepayers beyond the value of the reserve that AEPSC booked under the Settlement Agreement. The Commission will issue by subsequent entry a Request for Proposal to hire the auditor discussed above.

In making the above determination the Commission notes that the record reflects that the Settlement Agreement was entered into in order to terminate a long-term coal supply agreement, entered into in 1992, because the price of coal under the agreement was significantly below market in mid-2007. This long-term agreement was replaced with a new agreement which resulted in OP ratepayers paying significantly more for coal beginning in 2009, the start of the ESP period, than would have been paid had the Settlement Agreement not been entered into. We recognize that this situation is somewhat unique given that OP's fuel costs were not regulated during the period when the buyout

occurred and the benefits booked yet the value was realized from coal that should have been delivered during the ESP period. While we do not find any motivation by AEPSC to transfer value from ratepayers during the ESP to an earlier date, nevertheless, the long-term coal agreement was an OP asset for which the value would have flowed through to OP ratepayers through the ESP period but for the extraordinary circumstances related to the early contract termination. Given these factors, we agree with Staff that, in order to determine the real economic cost of coal used during the audit period, more of the value realized by AEP for entering into the Settlement Agreement should flow through to OP ratepayers through a credit to OP's under-recovery and deferrals.

Citing to the ESP cases (Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Opinion and Order, March 18, 2009, at pages 14-15) and an earlier entry in this proceeding, AEP-Ohio argues that the Commission limited the audit period and the prudence review in this case to 2009 procurement activities and that the only relevant factor is the price the Companies paid for coal during 2009. The Commission disagrees. Contrary to the Companies argument, the Commission is not seeking to reach into another audit period in order to modify rates charged during the audit period but rather is rendering its decision in order to match the revenues and benefits incurred during the audit period. Nor has the Commission found that entering into the Settlement Agreement was imprudent. Again, the Commission is only finding that to determine the real economic cost of coal during the audit period, the Commission must consider both the revenues and the benefits received by the Companies pursuant to the Settlement Agreement and not rely solely on the price paid for coal during 2009. AEP-Ohio further claims that the parties in this case are attempting to illegally relitigate the FAC baseline established in the ESP cases. AEP-Ohio's claims are without merit as the Commission has not adjusted the baseline for the 2009 period as decided in the Companies ESP cases. Rather, the Commission, in this case, is engaging in a reconciliation and accounting which was explicitly contemplated by the ESP cases in future FAC proceedings. Otherwise, there would be no rationale for undertaking an annual audit. In this case, the Commission is making an accounting adjustment to recognize extraordinary events affecting 2009 costs such that the Companies 2009 real costs will be comparable to the proxy baseline selected in the ESP proceedings.

AEP-Ohio's arguments concerning the applicability of *Keco* and *Lucas Cty.* are likewise unavailing. According to the Companies, any attempt to credit amounts booked in 2008 during the prior rate plan would violate the longstanding prohibition against retroactive ratemaking established in *Keco*. However, *Keco* does not apply in this situation. The Commission is not considering modifying a previous rate established by a Commission order through the ratemaking process as the Court considered in *Keco*. Rather, the Commission, by ordering the Companies to credit more of the proceeds from the Settlement Agreement to OP's deferral balance, is establishing a future rate based upon the real cost of the coal used by the Companies to generate electricity during the 2009 FAC audit period. The proceeds AEP-Ohio received for entering into the Settlement Agreement

are but one of the components which impact the Companies cost to provision electricity during 2009. Likewise, *Lucas Cty.* does not apply to the present situation. In *Lucas Cty.*, the Court held that the Commission was not statutorily authorized to order a refund of, or credit for, charges previously collected by a public utility where those charges were calculated in accordance with an experimental rate program which has expired. As noted above, the Commission has not made a determination modifying the rate the Companies collected during 2009. Additionally, there is no experimental rate program involved in the current case. Thus, *Lucas Cty.* does not apply in this matter.

As to any benefits associated with the delivery shortfall agreement and the contract support agreement that OCC and IEU-Ohio assert should also be factored into the Companies FAC under-recovery, the Commission determines that any effect these agreements may have had on AEP-Ohio's fuel costs, if any, would appear to apply in time periods outside of the current audit. Therefore, while those agreements may be examined by a future audit, those agreements will not be further examined as part of the current audit.

IV. Financial Audit Recommendations

The audit report also included six financial audit recommendations. In the first recommendation, the auditors submit that the FAC workbooks should be modified to include explanations that identify and/or explain differences between includable FAC amounts recorded in the general ledger versus includable FAC amounts derived from other sources (e.g., Monthly Purchase Summary Reports). Additionally, these explanations should also apply to issues such as timing differences and/or prior period adjustments. The second recommendation is that CSP and OP should include the reconciliation of the fuel and purchased power accounts that have been designated as includable FAC costs with the monthly FAC workbooks, to facilitate a clear audit trail. The third financial audit recommendation is that the Companies overall should provide a better audit trail for tracing costs. Fourth, the auditors suggest that the Commission may want to have AEP-Ohio explain further how the four generating units designated as "must run" units by PJM are affecting the costs that are recoverable in the FAC. The fifth financial audit recommendation is that the Companies should update and/or modify its systems in order to better indicate hourly or 24-hour dispatch costs and off-system sales cost information related to forced outages.

AEP-Ohio witness Dooley testified that the Companies agree with and plan to implement the auditors recommendations regarding financial audit items 1, 2, and 3 (Co. Ex. 1 at 6). The Companies' witnesses did not specifically address financial audit recommendations 4 and 5. The Companies otherwise did acknowledge, however, that AEP-Ohio agreed with and planned to implement the financial audit recommendations as clarified in the Companies' testimony (Cos. Brief at 51).

As AEP-Ohio does not challenge financial audit recommendations 1 through 5, the Commission will adopt such recommendations made in the audit report.

The final financial audit recommendation involves the River Transportation Division (RTD) and has 10 sub-components. The audit report suggests that RTD should respond to the following prior to the next audit and that the next auditor should review the results of this additional information:

(a) RTD should be required to explain and justify the rationale of the Net Investment Base and Cost of Capital Billing Adder formula presented in EVA 4-5, Confidential Attachments 1 and 2.

(b) RTD should be required to provide a procedure for updating the cost of capital and the Return on Equity (ROE) component that is commensurate with the risk of the operation.

(c) An Over Collection by RTD indicates that RTD collected too much from the affiliated companies for barge operations in a particular year. The Over Collection should be a subtraction from the Investment Base (rather than an addition to RTD's expenses).

(d) RTD should provide documentation that it corrected its calculation of the 2008 Working Capital Requirement and the 2009 Working Capital Requirement and the resulting credits $43,314 (2008) and $45,117 (2009) to RTD's customers were recorded in its 2nd Quarter's 2010 true up and credited to the operating companies in August 2010. OP's portion of these credits is $15, 298 (2008) and $17,325 (2009).

(e) Balance Sheet items such as Prepayments, Materials and Supplies inventory and Other Current and Accrued Liabilities, if considered in developing a utility's rate base, are typically added or subtracted on a 13-month average balance basis. RTD should be required to explain why its current methodology of dividing balance sheet items (such as prepayments, materials and supplies inventory, and other current and accrued liabilities) by eight to derive the Investment Base is a reasonable and appropriate method.

(f) OP, RTD and other AEP affiliates that utilize the RTD should work together to revise the RTD formula to conform with generally accepted public utility industry rate base and ratemaking standards. OP should report quarterly concerning the progress of these efforts by including a description of progress made in its quarterly FAC filings.

(g) The details of RTD charges including, but not limited to, Other Administration Expenses and "AEP Admin Charges" such as those provided by AEP in response to LA 7-17, should be reviewed in detail in the next audit period.

(h) RTD should prepare a justification for how RTD's income tax expense and Accumulated Deferred Income Taxes are handled.

(i) RTD should explain the Accumulated Deferred Income Taxes (ADIT) amounts on its Balance Sheet and identify any amounts and components related to the use of accelerated tax depreciation.

(j) To the extent that RTD has cost-free capital in the form of ADIT related to the use of accelerated tax depreciation (which would typically be associated with credit-balance ADIT amounts), RTD should prepare an explanation why that cost-free capital should not be subtracted in deriving the Investment Base, similar to how ADIT balances would be subtracted in deriving a utility's rate base.

Regarding financial audit recommendations 6a, 6e, 6f, and 6j, the Companies state that, although the current treatment is a reasonable approach, AEP-Ohio is willing to have the RTD division amend its calculation to be in accordance with the traditional base treatment recommended by the audit report starting January 1, 2011 (Co. Ex. 3 at 11). Financial audit recommendation 6b is unnecessary, says AEP-Ohio, because there is already a procedure in place for updating the cost of capital and Return on Equity component commensurate with the risk (*Id.*). AEP-Ohio witness Nelson testified that the ROE is adjusted on January 1 each year to the return allowed by FERC. In the absence of a recent FERC order, the ROE becomes that established by the Indiana Utility Regulatory Commission in its most recent order (*Id.* at 11-12). Regarding financial audit recommendations 6c and 6d, the Companies explain that RTD has made all necessary changes to correct the Working Capital Requirement for 2008 and 2009 and will appropriately credit the applicable operating companies including OP. Documentation will be available for the next audit states AEP-Ohio (Co. Ex. 1 at 6). Similarly, the Companies have no objections to financial audit recommendations 6g, 6h, and 6i. AEP-

Ohio commits that the necessary explanations will be available for the next audit (Co. Ex. 1 at 6-7; Co. Ex. 3 at 12).

Generally, the Companies agree with and plan to implement financial audit recommendations 6a through 6i. Regarding financial audit recommendation 6b, the Companies have adequately explained and thus have complied with the auditors' recommendation. Therefore, no further action is required by the Companies on financial audit recommendation 6b. The Commission adopts as its determinations in this matter, financial audit recommendations 6a through 6i with the exclusion of recommendation 6b discussed in the preceding sentence.

V. Ormet stipulation

Rule 4901-1-30, Ohio Administrative Code, authorizes parties to Commission proceedings to enter into a stipulation. Although not binding on the Commission, the terms of such an agreement are accorded substantial weight. *Consumers' Counsel v. Pub. Util. Comm.* (1992), 64 Ohio St.3d 123, 125, *citing Akron v. Pub. Util. Comm.* (1978), 55 Ohio St.2d 155. This concept is particularly valid where the stipulation is unopposed by any party and resolves all issues presented in the proceeding in which it is offered.

The standard of review for considering the reasonableness of a stipulation has been discussed in a number of prior Commission proceedings. *Cincinnati Gas & Electric Co.*, Case No. 91-410-EL-AIR (April 14, 1994); *Western Reserve Telephone Co.*, Case No. 93-230-TP-ALT (March 30, 1994); *Ohio Edison Co.*, Case No. 91-698-EL-FOR *et al.* (December 30, 1993); *Cleveland Electric Illum. Co.*, Case No. 88-170-EL-AIR (January 30, 1989); *Restatement of Accounts and Records (Zimmer Plant)*, Case No. 84-1187-EL-UNC (November 26, 1985). The ultimate issue for our consideration is whether the agreement, which embodies considerable time and effort by the signatory parties, is reasonable and should be adopted. In considering the reasonableness of a stipulation, the Commission has used the following criteria:

(1) Is the settlement a product of serious bargaining among capable, knowledgeable parties?

(2) Does the settlement, as a package, benefit ratepayers and the public interest?

(3) Does the settlement package violate any important regulatory principle or practice?

The Ohio Supreme Court has endorsed the Commission's analysis using these criteria to resolve issues in a manner economical to ratepayers and public utilities. *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.* (1994), 68 Ohio St.3d 559, *citing*

*Consumers' Counsel, supra,* at 126. The court stated in that case that the Commission may place substantial weight on the terms of a stipulation, even though the stipulation does not bind the Commission (*Id.*).

We find that the Ormet stipulation entered into by the stipulating parties is reasonable and should be adopted. In making this determination, the Commission notes that the Ormet stipulation is a product of serious bargaining among capable, knowledgeable parties and is the product of an open process. Moreover, as a package, the Ormet stipulation benefits ratepayers and furthers the public interest as a more thorough examination involving the collection of deferrals and carrying charges associated with the provision of service to Ormet is already the subject of a pending case before the Commission in *In the Matter of the Application of Columbus Southern Power and the Ohio Power Company to Recover Commission-Authorized Deferrals Through each Company's Fuel Adjustment Clause,* Case No. 09-1094-EL-FAC (09-1094). Therefore, a detailed examination of the complex issues surrounding AEP-Ohio's provision of service to Ormet, the largest, most energy-intensive customer that the Companies serve in Ohio, does not have to be considered in this proceeding. Finally, the Commission finds that there is no evidence that the stipulation violates any important regulatory principle or practice and, therefore, the stipulation meets the third criterion. Accordingly, the Ormet stipulation is approved.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

(1) CSP and OP are public utilities under Section 4905.02, Revised Code, and are subject to the jurisdiction of this Commission.

(2) These cases relate to the Commission's review of CSP and OP's fuel costs during the period from January 1, 2009, through December 31, 2009.

(3) By entry issued January 7, 2010, the Commission selected EVA to perform CSP and OP's audit for the period of January 1, 2009, through December 31, 2009. On May 14, 2010, EVA filed its audit report.

(4) On January 7, 2010, IEU-Ohio, OCC, and Ormet were granted intervention in these cases.

(5) A hearing in these matters was held on August 23 and August 24, 2010.

(6) Briefs and reply were filed on September 23, 2010, and October 15, 2010, respectively.

(7) At the hearing, a stipulation was submitted acknowledging that a determination on the collection of deferrals and carrying charges associated with an Ormet Interim Agreement is the subject of a pending case before the Commission and that the issues associated with the Ormet Interim Agreement would be addressed in that proceeding. The stipulation was signed by AEP-Ohio, Staff, OCC, IEU-Ohio, and Ormet. The stipulation meets the criteria used by the Commission to evaluate stipulations, is reasonable, and should be adopted.

ORDER:

It is, therefore,

ORDERED, That the Companies credit OP's FAC under-recovery as discussed herein. It is, further,

ORDERED, That the Companies hire an auditor as discussed herein. It is, further,

ORDERED, That the stipulation entered into by AEP-Ohio, Staff, OCC, IEU-Ohio, and Ormet be adopted and approved. It is, further,

ORDERED, That AEP-Ohio take all necessary steps to carry out the terms of this opinion and order. It is, further,

ORDERED, That nothing in this opinion and order shall be binding upon the Commission in any future proceeding or investigation involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That a copy of this opinion and order be served upon each party of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

JRJ/vrm

Entered in the Journal
JAN 23 2012

Betty McCauley
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

| | | |
|---|---|---|
| In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals. | ) | Case No. 10-2376-EL-UNC |
| In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan. | ) | Case No. 11-346-EL-SSO<br>Case No. 11-348-EL-SSO |
| In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority. | ) | Case No. 11-349-EL-AAM<br>Case No. 11-350-EL-AAM |
| In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company to Amend their Emergency Curtailment Service Riders. | ) | Case No. 10-343-EL-ATA<br>Case No. 10-344-EL-ATA |
| In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company. | ) | Case No. 10-2929-EL-UNC |
| In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Mechanisms to Recover Deferred Fuel Costs Ordered Under Section 4928.144, Revised Code. | ) | Case No. 11-4920-EL-RDR<br>Case No. 11-4921-EL-RDR |

ENTRY

The Commission finds:

(1) On January 27, 2011, in Case Nos. 11-346-EL-SSO, 11-348-EL-SSO, 11-349-EL-AAM and 11-350-EL-AAM, Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, AEP-Ohio or the Companies) filed an application for a standard service offer (SSO) pursuant to Section 4928.141, Revised Code (ESP 2).

(2) On September 7, 2011, a Stipulation and Recommendation (Stipulation) was filed for the purpose of resolving all the issues raised in the ESP 2 cases and several other AEP-Ohio cases pending before the Commission, Case No. 10-2376-EL-UNC, *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals* (Merger Case); Case No. 10-343-EL-ATA, *In the Matter of the Application of Columbus Southern Power Company to Amend its Emergency Curtailment Service Riders* and Case No. 10-344-EL-ATA, *In the Matter of the Application of Ohio Power Company to Amend its Emergency Curtailment Service Riders* (jointly Curtailment Cases); Case No. 10-2929-EL-UNC, *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company* (Capacity Charges Case); and Case No. 11-4920-EL-RDR, *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144, Revised Code*, and Case No. 11-4921-EL-RDR, *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144, Revised Code* (jointly Deferred Fuel Cost Cases).

(3) On December 14, 2011, the Commission issued its Opinion and Order in the consolidated cases, finding that the Stipulation, as modified, be adopted and approved.

(4) However, on February 23, 2012, the Commission issued its Entry on Rehearing determining that the Stipulation, as a package, did not benefit ratepayers and the public interest and, thus, did not satisfy the three-part test for the consideration of stipulations. The Commission directed AEP-Ohio to file new proposed tariffs to continue the provisions, terms, and conditions of its previous electric security plan no later than February 28, 2012.

(10) Also on March 6, 2012, FirstEnergy Solutions (FES) filed objections to AEP-Ohio's proposed tariffs. FES opines that no recovery mechanism for the PIRR has been authorized, and AEP-Ohio failed to include a TCRR rate for its IRP-D customers.

(11) AEP-Ohio filed revised tariffs on March 6, 2012, that reinserted terms and conditions that were omitted from the proposed tariffs filed on February 28, 2012. Also on March 6, 2012, AEP-Ohio filed a reply to objections filed by IEU-Ohio, Ormet, and OCC/APJN. AEP-Ohio asserts that the Commission already merged the FAC in a separate docket in Case No. 11-5906-EL-FAC (11-5906), and it would be impractical and unnecessary to revise not only the FAC provisions, but also the TCRR implementation. AEP-Ohio argues the inclusion of the PIRR was appropriate, and the capacity charges are appropriate as they do not relate to the implementation of the prior retail rate plan. Further, AEP-Ohio urges the Commission to reject OCC's requests to stay the prior rate plan or make the rates subject to refund.

(12) The Commission finds that, with the exception of the tariffs for the PIRR, FAC, and TCRR, the tariffs filed by AEP-Ohio are consistent with its February 23, 2012, Entry on Rehearing, do not appear to be unjust or unreasonable, and should be approved, effective March 9, 2012.

(13) Regarding the FAC and TCRR, the Commission finds that, pursuant to AEP-Ohio's application in the Merger Case, the approval of the merger will not affect CSP and OP's rates. Specifically, the application provides that CSP and OP shall continue service to customers within the pre-merger certified territories in accordance with their respective rates and terms and conditions in effect until such time as the Commission approves new rates and terms and conditions. While AEP-Ohio is correct that its FAC rates were approved in 11-5906, the rates were approved in light of the Commission's approval of the Stipulation in the ESP 2 proceedings, which was subsequently disapproved on February 23, 2012. Accordingly, OP shall file final unblended TCRR and FAC rates to be effective March 7, 2012, subject to subsequent Commission review. Further, FES correctly points out that AEP-Ohio failed

to include a TCRR rate for its IRP-D customers. Therefore, we direct AEP-Ohio to amend Original Sheet No. 475-1 to make it consistent with ESP 1's terms and conditions.

(14) With respect to the PIRR, AEP-Ohio is directed to file, in final form, new tariffs removing the PIRR at this time. The Commission will address AEP-Ohio's application to establish the PIRR by subsequent entry in the Deferred Fuel Cost Cases.

(15) Further, as AEP-Ohio filed corrections to its compliance filing on March 6, 2012, we do not need to address IEU-Ohio's objection that AEP-Ohio incorrectly omitted key terms and conditions of service.

(16) In addition, as the captioned cases were consolidated by the Stipulation which the Commission disapproved, all future filings should be made in the appropriate case docket, as the consolidated case matters will no longer be docketed in all of the above-captioned cases.

(17) Finally, the Commission notes that, on March 5, 2012, AEP-Ohio filed its notice of intent to file a modified ESP application. The Commission expects that such modified ESP application will include a thorough discussion of: any plans of AEP-Ohio to divest its generation assets, including provisions to ensure that adequate capacity will be available on an on-going basis to Ohio customers, notwithstanding any potential plant retirements; provisions to address rate design concerns for small commercial customers and residential customers in the former CSP service territory using more than 800 kWh in winter months; provisions regarding plans to take advantage of a territory-wide deployment of emerging metering technology to provide ample choices regarding pricing, information, and electric energy services for customers in a competitive market, including provisions that AEP-Ohio does not foreclose the possibility of working collaboratively with other utilities, retail energy suppliers, and interested stakeholders to explore cost saving and market development opportunities; provisions to take advantage of the deployment of emerging distribution system technologies in all locations where they can cost-effectively improve the efficiency of the distribution system or enhance reliability consistent with the value customers place on

> service reliability; provisions for reasonable support for the development of technologies that could provide significant economic benefits; provisions ensuring that AEP-Ohio has the ability to meet Ohio's renewable energy standards over the long-term; provisions that any proposed retail stability charge be applied to all customers within AEP-Ohio service territory; provisions addressing the prompt modification or termination of the AEP Interconnection Agreement to reflect State law and policies; or provisions that provide for market-based pricing for standard service offer customers in a manner more expeditious than proposed within AEP-Ohio's Notice of Intent. The Commission further expects that AEP-Ohio will look to recent Commission precedent for guidance in formulating its modified ESP in considering how to best ensure its customers have market-based standard service offer pricing in an efficient and expeditious manner. (See *In the Matter of Application of Duke Energy Ohio, Inc. for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code,* Case No. 11-3549-EL-SSO; *In the Matter of Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code,* Case No. 10-388-EL-SSO.)

It is, therefore,

ORDERED, That, with the exception of the tariffs for the PIRR, TCRR, and FAC, the tariffs filed on February 28, 2012, by AEP-Ohio be approved, effective for bills rendered on or after March 9, 2012. It is, further,

ORDERED, That OP file unblended TCRR and FAC rates to be effective March 9, 2012, subject to Commission review. It is, further,

ORDERED, That OP file tariffs including a TCRR rate for IRP-D customers, consistent with ESP 1's terms and conditions. It is, further,

ORDERED, That AEP-Ohio file new tariffs removing the PIRR at this time. The Commission will address AEP-Ohio's applications in the Deferred Fuel Cost Cases. It is, further,

ORDERED, That the Companies file in final form four complete copies of tariffs. One copy shall be filed with this case docket, one shall be filed with each company's TRF docket, and the remaining two copies shall be designated for distribution to the Rates and Tariffs Division of the Commission's Utilities Department. The Companies shall also update their respective tariffs previously filed electronically with the Commission's Docketing Division. It is, further,

ORDERED, That the Companies shall notify their customers of the changes to the tariff via bill message or bill insert within 30 days of the effective date. A copy of this notice shall be submitted to the Commission's Service Monitoring and Enforcement Department prior to its distribution to customers. It is, further,

ORDERED, That a copy of this entry be served on all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

JJT/sc

Entered in the Journal

MAR 07 2012

Barcy F. McNeal

Barcy F. McNeal
Secretary

# 4901:1-38-01 Definitions.

(A) "Affidavit" means a written declaration made under oath before a notary public or other authorized officer.

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

(C) "Delta revenue" means the deviation resulting from the difference in rate levels between the otherwise applicable rate schedule and the result of any reasonable arrangement approved by the commission.

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

(E) "Energy efficiency production facilities" means any customer that manufactures or assembles products that promote the more efficient use of energy (i.e., increase the ratio of energy end use services (i.e., heat, light, and drive power) derived from a device or process to energy inputs necessary to derive such end use services as compared with other devices or processes that are commonly installed to derive the same energy use services); or, any customer that manufactures, assembles or distributes products that are used in the production of clean, renewable energy.

(F) "Mercantile customer" shall have the meaning set forth in division (A)(19) of section 4928.01 of the Revised Code.

(G) "Nonfirm electric service" means electric service provided pursuant to a schedule filed under section 4905.30 or 4928.141 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 the electric utility.

(H) "Staff" means the staff of the commission or its authorized representative.

Effective: 04/02/2009

R.C. 119.032 review dates: 09/30/2013

Promulgated Under: 111.15

Statutory Authority: 4905.04, 4905.06

Rule Amplifies: 4905.31, 4928.02

# 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.

Amended by 128th General Assembly File No. 47, SB 181, § 1, eff. 9/13/2010.

Amended by 128th General Assembly File No. 48, SB 232, § 1, eff. 6/17/2010.

Amended by 128th General Assembly File No. 9, HB 1, § 101.01, eff. 10/16/2009.

Effective Date: 10-05-1999; 01-04-2007; 2008 SB221 07-31-2008

# 4928.51 Universal service fund.

(A) There is hereby established in the state treasury a universal service fund, into which shall be deposited all universal service revenues remitted to the director of development under this section, for the exclusive purposes of providing funding for the low-income customer assistance programs and for the consumer education program authorized under section 4928.56 of the Revised Code, and paying the administrative costs of the low-income customer assistance programs and the consumer education program. Interest on the fund shall be credited to the fund. Disbursements from the fund shall be made to any supplier that provides a competitive retail electric service or a noncompetitive retail electric service to a customer who is approved to receive assistance under a specified low-income customer assistance program and to any authorized provider of weatherization or energy efficiency service to a customer approved to receive such assistance under a specified low-income customer assistance program.

(B) Universal service revenues shall include all of the following:

(1) Revenues remitted to the director after collection by an electric distribution utility beginning July 1, 2000, attributable to the collection from customers of the universal service rider prescribed under section 4928.52 of the Revised Code;

(2) Revenues remitted to the director that have been collected by an electric distribution utility beginning July 1, 2000, as customer payments under the percentage of income payment plan program, including revenues remitted under division (C) of this section;

(3) Adequate revenues remitted to the director after collection by a municipal electric utility or electric cooperative in this state not earlier than July 1, 2000, upon the utility's or cooperative's decision to participate in the low-income customer assistance programs.

(C)(1) Beginning July 1, 2000, an electric distribution utility shall transfer to the director the right to collect all arrearage payments of a customer for percentage of income payment plan program debt owed to the utility on the day before that date or retain the right to collect that debt but remit to the director all program revenues received by the utility for that customer.

(2) A current or past percentage of income payment plan program customer is relieved of any payment obligation under the percentage of income payment program for any unpaid arrears accrued by the customer under the program as of the effective date of this section if the customer, as determined by the director, meets both of the following criteria:

(a) The customer as of that date has complied with customer payment responsibilities under the program.

(b) The customer is permanently and totally disabled as defined in section 5117.01 of the Revised Code or is sixty-five years of age or older as defined in that section.

(D) The public utilities commission shall complete an audit of each electric utility by July 1, 2000, for the purpose of establishing a baseline for the percentage of income payment plan program component of the low-income assistance programs.

Effective Date: 10-05-1999

# 4928.141 Distribution utility to provide standard service offer.

(A) Beginning January 1, 2009, an electric distribution utility shall provide consumers, on a comparable and nondiscriminatory basis within its certified territory, a standard service offer of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service. To that end, the electric distribution utility shall apply to the public utilities commission to establish the standard service offer in accordance with section 4928.142 or 4928.143 of the Revised Code and, at its discretion, may apply simultaneously under both sections, except that the utility's first standard service offer application at minimum shall include a filing under section 4928.143 of the Revised Code. Only a standard service offer authorized in accordance with section 4928.142 or 4928.143 of the Revised Code, shall serve as the utility's standard service offer for the purpose of compliance with this section; and that standard service offer shall serve as the utility's default standard service offer for the purpose of section 4928.14 of the Revised Code. Notwithstanding the foregoing provision, the rate plan of an electric distribution utility shall continue for the purpose of the utility's compliance with this division until a standard service offer is first authorized under section 4928.142 or 4928.143 of the Revised Code, and, as applicable, pursuant to division (D) of section 4928.143 of the Revised Code, any rate plan that extends beyond December 31, 2008, shall continue to be in effect for the subject electric distribution utility for the duration of the plan's term. A standard service offer under section 4928.142 or 4928.143 of the Revised Code shall exclude any previously authorized allowances for transition costs, with such exclusion being effective on and after the date that the allowance is scheduled to end under the utility's rate plan.

(B) The commission shall set the time for hearing of a filing under section 4928.142 or 4928.143 of the Revised Code, send written notice of the hearing to the electric distribution utility, and publish notice in a newspaper of general circulation in each county in the utility's certified territory. The commission shall adopt rules regarding filings under those sections.

Effective Date: 2008 SB221 07-31-2008



000000380

# 4928.142 Standard generation service offer price - competitive bidding.

(A) For the purpose of complying with section 4928.141 of the Revised Code and subject to division (D) of this section and, as applicable, subject to the rate plan requirement of division (A) of section 4928.141 of the Revised Code, an electric distribution utility may establish a standard service offer price for retail electric generation service that is delivered to the utility under a market-rate offer.

(1) The market-rate offer shall be determined through a competitive bidding process that provides for all of the following:

(a) Open, fair, and transparent competitive solicitation;

(b) Clear product definition;

(c) Standardized bid evaluation criteria;

(d) Oversight by an independent third party that shall design the solicitation, administer the bidding, and ensure that the criteria specified in division (A)(1)(a) to (c) of this section are met;

(e) Evaluation of the submitted bids prior to the selection of the least-cost bid winner or winners. No generation supplier shall be prohibited from participating in the bidding process.

(2) The public utilities commission shall modify rules, or adopt new rules as necessary, concerning the conduct of the competitive bidding process and the qualifications of bidders, which rules shall foster supplier participation in the bidding process and shall be consistent with the requirements of division (A)(1) of this section.

(B) Prior to initiating a competitive bidding process for a market-rate offer under division (A) of this section, the electric distribution utility shall file an application with the commission. An electric distribution utility may file its application with the commission prior to the effective date of the commission rules required under division (A)(2) of this section, and, as the commission determines necessary, the utility shall immediately conform its filing to the rules upon their taking effect. An application under this division shall detail the electric distribution utility's proposed compliance with the requirements of division (A)(1) of this section and with commission rules under division (A)(2) of this section and demonstrate that all of the following requirements are met:

(1) The electric distribution utility or its transmission service affiliate belongs to at least one regional transmission organization that has been approved by the federal energy regulatory commission; or there otherwise is comparable and nondiscriminatory access to the electric transmission grid.

(2) Any such regional transmission organization has a market-monitor function and the ability to take actions to identify and mitigate market power or the electric distribution utility's market conduct; or a similar market monitoring function exists with commensurate ability to identify and monitor market conditions and mitigate conduct associated with the exercise of market power.

(3) A published source of information is available publicly or through subscription that identifies pricing information for traded electricity on- and off-peak energy products that are contracts for delivery beginning at least two years from the date of the publication and is updated on a regular basis. The commission shall initiate a proceeding and, within ninety days after the application's filing date, shall determine by order whether the electric distribution utility and its market-rate offer meet all of the foregoing requirements. If the finding is positive, the electric distribution utility may initiate its competitive bidding process. If the finding is negative as to one or more requirements, the commission in the order shall direct the electric distribution utility regarding how any deficiency may be remedied in a timely manner to the commission's satisfaction; otherwise, the electric distribution utility shall withdraw the application. However, if such remedy is made and the subsequent finding is positive and also if the electric distribution utility made a simultaneous filing under this section and section 4928.143 of the Revised Code, the utility shall not initiate its competitive bid until at least one hundred fifty days after the filing date of those applications.

(C) Upon the completion of the competitive bidding process authorized by divisions (A) and (B) of this section, including for the purpose of division (D) of this section, the commission shall select the least-cost bid winner or winners of that process, and such selected bid or bids, as prescribed as retail rates by the commission, shall be the electric distribution utility's standard service offer unless the commission, by order issued before the third calendar day following the conclusion of the competitive bidding process for the market rate offer, determines that one or more of the following criteria were not met:

(1) Each portion of the bidding process was oversubscribed, such that the amount of supply bid upon was greater than the amount of the load bid out.

(2) There were four or more bidders.

(3) At least twenty-five per cent of the load is bid upon by one or more persons other than the electric distribution utility. All costs incurred by the electric distribution utility as a result of or related to the competitive bidding process or to procuring generation service to provide the standard service offer, including the costs of energy and capacity and the costs of all other products and services procured as a result of the competitive bidding process, shall be timely recovered through the standard service offer price, and, for that purpose, the commission shall approve a reconciliation mechanism, other recovery mechanism, or a combination of such mechanisms for the utility.

(D) The first application filed under this section by an electric distribution utility that, as of July 31, 2008, directly owns, in whole or in part, operating electric generating facilities that had been used and useful in this state shall require that a portion of that utility's standard service offer load for the first five years of the market rate offer be competitively bid under division (A) of this section as follows: ten per cent of the load in year one, not more than twenty per cent in year two, thirty per cent in year three, forty per cent in year four, and fifty per cent in year five. Consistent with those percentages, the commission shall determine the actual percentages for each year of years one through five. The standard service offer price for retail electric generation service under this first application shall be a proportionate blend of the bid price and the generation service price for the remaining standard service offer load, which latter price shall be equal to the electric distribution utility's most recent standard service offer price, adjusted upward or downward as the commission determines reasonable, relative to the jurisdictional portion of any known and measurable changes from the level of any one or more of the following costs as reflected in that most recent standard service offer price:

(1) The electric distribution utility's prudently incurred cost of fuel used to produce electricity;

(2) Its prudently incurred purchased power costs;

(3) Its prudently incurred costs of satisfying the supply and demand portfolio requirements of this state, including, but not limited to, renewable energy resource and energy efficiency requirements;

(4) Its costs prudently incurred to comply with environmental laws and regulations, with consideration of the derating of any facility associated with those costs. In making any adjustment to the most recent standard service offer price on the basis of costs described in division (D) of this section, the commission shall include the benefits that may become available to the electric distribution utility as a result of or in connection with the costs included in the adjustment, including, but not limited to, the utility's receipt of emissions credits or its receipt of tax benefits or of other benefits, and, accordingly, the commission may impose such conditions on the adjustment to ensure that any such benefits are properly aligned with the associated cost responsibility. The commission shall also determine how such adjustments will affect the electric distribution utility's return on common equity that may be achieved by those adjustments. The commission shall not apply its consideration of the return on common equity to reduce any adjustments authorized under this division unless the adjustments will cause the electric distribution utility to earn a return on common equity that is significantly in excess of the return on common equity that is earned by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate. The burden of proof for demonstrating that significantly excessive earnings will not occur shall be on the electric distribution utility. Additionally, the commission may adjust the electric distribution utility's most recent standard service offer price by such just and reasonable amount that the commission determines necessary to address any emergency that threatens the utility's financial integrity or to ensure that the resulting revenue available to the utility for providing the standard service offer is not so inadequate as to result, directly or indirectly, in a taking of property without compensation pursuant to Section 19 of Article I, Ohio Constitution. The electric distribution utility has the burden of demonstrating that any adjustment to its most recent standard service offer price is proper in accordance with this division.

(E) Beginning in the second year of a blended price under division (D) of this section and notwithstanding any other requirement of this section, the commission may alter prospectively the proportions specified in that division to mitigate any effect of an abrupt or significant change in the electric distribution utility's standard service offer price that would otherwise result in general or with respect to any rate group or rate schedule but for such alteration. Any such alteration shall be made not more often than annually, and the commission shall not, by altering those proportions and in any event, including because of the length of time, as authorized under division (C) of this section, taken to approve the market rate offer, cause the duration of the blending period to exceed ten years as counted from the effective date of the approved market rate offer. Additionally, any such alteration shall be limited to an alteration affecting the prospective proportions used during the blending period and shall not affect any blending proportion previously approved and applied by the commission under this division.

(F) An electric distribution utility that has received commission approval of its first application under division (C) of this section shall not, nor ever shall be authorized or required by the commission to, file an application under section 4928.143 of the Revised Code.

Effective Date: 2008 SB221 07-31-2008; 2008 HB562 09-22-2008

# 4928.143 [Effective Until3/22/2012] 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.

Effective Date: 2008 SB221 07-31-2008

This section is set out twice. See also § 4928.143, as amended by 129th General Assembly File No. 61, HB 364, § 1, eff. 3/22/2012.

**4928.143 [Effective3/22/2012] 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) Consistent with sections 4928.23 to 4928.2318 of the Revised Code, both of the following:

(i) 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;

(ii) 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



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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.

Amended by 129th General Assembly File No. 61, HB 364, § 1, eff. 3/22/2012.

Effective Date: 2008 SB221 07-31-2008

This section is set out twice. See also § 4928.143, effective until 3/22/2012.



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# 4928.144 Phase-in of electric distribution utility rate or price.

The public utilities commission by order may authorize any just and reasonable phase-in of any electric distribution utility rate or price established under sections 4928.141 to 4928.143 of the Revised Code, and inclusive of carrying charges, as the commission considers necessary to ensure rate or price stability for consumers. If the commission's order includes such a phase-in, the order also shall provide for the creation of regulatory assets pursuant to generally accepted accounting principles, by authorizing the deferral of incurred costs equal to the amount not collected, plus carrying charges on that amount. Further, the order shall authorize the collection of those deferrals through a nonbypassable surcharge on any such rate or price so established for the electric distribution utility by the commission.

Effective Date: 2008 SB221 07-31-2008



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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

ENTRY ON REHEARING

The Commission finds:

(1) On March 18, 2009, the Commission issued its opinion and order in Columbus Southern Power Company's and Ohio Power Company's (jointly, AEP-Ohio or the Companies) electric security plan (ESP) cases (ESP Order).[1] By entries on rehearing issued July 23, 2009 (First ESP EOR) and November 4, 2009, the Commission affirmed and clarified certain issues raised in AEP-Ohio's ESP Order. As ultimately modified and adopted by the Commission, AEP-Ohio's ESP directed, among other things, that AEP-Ohio be permitted to recover the incremental capital carrying costs that would be incurred after January 1, 2009, on past environmental investments (2001-2008)[2] and approved a provider of last resort (POLR) charge for the ESP period.

(2) The Commission's decision in the AEP-Ohio ESP cases was appealed to the Ohio Supreme Court. The Ohio Supreme Court determined that Section 4928.143(B)(2), Revised Code, does not authorize the Commission to allow recovery of items not enumerated in the section. The Court

1 *In re AEP-Ohio ESP cases*, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Opinion and Order (March 18, 2009).

2 AEP-Ohio ESP Order at 24-28, 38-40; First ESP EOR at 10-13, 24-27.

remanded the case to the Commission for further proceedings in which "the Commission may determine whether any of the listed categories set forth in Section 4928.143(B)(2), Revised Code, authorize recovery of environmental carrying charges."[3] In regards to the POLR charges, the Court concluded that the Commission's decision that the POLR charge is cost-based was against the manifest weight of the evidence, an abuse of the Commission's discretion and reversible error. While the Court specifically stated that "we express no opinion on whether a formula-based POLR charge is per se unreasonable or unlawful," the Court noted two other methods by which the Commission may establish the POLR charge: a non-cost-based POLR charge or evidence of AEP-Ohio's actual POLR costs.

(3) By entry issued May 4, 2011, the Commission directed AEP-Ohio to file proposed tariffs removing the POLR charges and environmental carrying cost charges from the rates by May 11, 2011. Further, the May 4, 2011, entry directed that, if AEP-Ohio intends to seek recovery of the environmental or POLR charges pursuant to the Court's remand, AEP-Ohio should make the appropriate filing with the Commission.

(4) Section 4903.10, Revised Code, states that any party who has entered an appearance in a Commission proceeding may apply for a rehearing with respect to any matters determined therein by filing an application within 30 days after the entry of the order upon the Commission's journal.

(5) On May 16, 2011, Industrial Energy Users-Ohio (IEU-Ohio) filed an application for rehearing of the May 4, 2011, entry, which was subsequently denied by operation of law pursuant to Section 4903.10, Revised Code.

(6) In response to various filings of the parties, the Commission issued an entry on May 25, 2011, directing AEP-Ohio to file tariff pages that reflect that the POLR riders and environmental carrying charges included in

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3 *In re Application of Columbus S. Power Co.*, Slip Opinion No. 2011-Ohio-1788.

rates are being collected subject to refund, until the Commission specifically orders otherwise on remand. Additionally, the Commission adopted a procedural schedule for the remand proceedings in order to afford AEP-Ohio and intervenors the opportunity to present testimony and additional evidence in regard to the POLR and environmental carrying charges remanded to the Commission. The entry specified that the parties may address the amount of POLR charges at issue and the rate of interest charges applicable, if any.

(7) On June 1, 2011, IEU-Ohio filed an application for rehearing of the May 25, 2011, entry. In its first ground for rehearing, IEU-Ohio asserts that the entry unreasonably and unlawfully fails to identify fully the flow-through effects on consumers' electric bills as necessary to comply with the Court's remand.[4] Specifically, IEU-Ohio identifies the following issues that should be addressed by the Commission in addition to the issues enumerated in the May 25, 2011, entry: deferrals enabled by bill increase limitations; delta revenues from reasonable arrangements and Universal Service Fund collection; calculation of base revenues; recovery of revenues through the Companies' environmental riders; and reviews of the Companies' earnings pursuant to the significantly excessive earnings test (SEET) of Section 4928.143(F), Revised Code.

IEU-Ohio admits that it would be sensible to read the Commission's May 4, 2011, and May 25, 2011, entries as a logical first step in the Commission's effort to comply with the Court's remand. IEU-Ohio, however, states that its application for rehearing was filed in light of its concern for arguments that AEP-Ohio is expected to advance in the coming days, which, if accepted by the Commission, would constrain the Commission's ability to address the full range of the revenue effects of the remanded issues.

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4 IEU-Ohio notes that a full range of effects is illustrated in its motion of May 10, 2011, which requests that the Commission take additional steps to identify and address the full effects of the Court's decision. IEU-Ohio incorporates by reference its motion in its application for rehearing, which IEU-Ohio acknowledges was filed to protect its position set forth in the motion. This entry on rehearing does not address IEU-Ohio's motion of May 10, 2011.

(8) On June 10, 2011, AEP-Ohio filed a memorandum contra IEU-Ohio's application for rehearing of the May 25, 2011, entry. With respect to IEU-Ohio's first ground for rehearing, the Companies argue that adjustments to their future recovery of deferred fuel costs or delta revenues to offset the POLR and environmental carrying cost charges would constitute impermissible retroactive ratemaking, contrary to the Court's decision in these cases and in *Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co.* (1957), 166 Ohio St. 254. Additionally, AEP-Ohio asserts that IEU-Ohio's arguments with respect to the SEET are irrelevant to the remand proceedings, which are not the proper forum for addressing IEU-Ohio's position on how the SEET should be applied by the Commission.

(9) The Commission notes that the May 25, 2011, entry established a procedural schedule for addressing the Court's remand of these cases, which includes the filing of intervenor testimony on June 23, 2011, and an evidentiary hearing to commence on July 12, 2011. The remand proceedings established in the May 25, 2011, entry will afford IEU-Ohio the opportunity to offer testimony and present its arguments, as well as to respond to any arguments advanced by the Companies, which the Commission will then consider at that time. The May 25, 2011, entry thus does not preclude IEU-Ohio from asserting, during the remand proceedings established by the entry, that the Commission should consider any flow-through effects on customers' bills, as may be necessary to comply with the Court's remand. Accordingly, with this clarification, IEU-Ohio's first ground for rehearing, as set forth in its application for rehearing of the May 25, 2011, entry, should be denied.

(10) In its second ground for rehearing, IEU-Ohio argues that the May 25, 2011, entry unreasonably and unlawfully fails to suspend the Companies' Environmental Investment Carrying Cost Rider (EICCR) tariffs or direct the Companies to file tariffs that permit collection subject to refund. Relying on the Court's decision with respect to 2001-2008 incremental environmental investment carrying cost charges, IEU-Ohio asserts that the ESP Order fails to

identify any statutory basis for recovery of 2009 incremental environmental investment carrying cost charges. According to IEU-Ohio, the entry is thus unlawful and unreasonable because it fails to address the effect of the Court's decision on AEP-Ohio's EICCR.

(11) In response, the Companies state that IEU-Ohio's second ground for rehearing should be denied as it is beyond the scope of the Court's remand, which is limited to a reconsideration of the statutory basis for recovery of 2001-2008 incremental environmental investment carrying costs. Further, AEP-Ohio argues that IEU-Ohio seeks to bypass the requirements for seeking rehearing and appealing an order of the Commission, as set forth in Sections 4903.10 and 4903.11, Revised Code. AEP-Ohio maintains that no party sought rehearing or appealed the issue of recovery of carrying costs on 2009, 2010, and 2011 incremental environmental investments and that the Commission's decision to permit recovery of these costs is a final, non-appealable order that may not be challenged by IEU-Ohio at this stage in the proceedings.

(12) The Commission notes that, in the ESP Order, we approved AEP-Ohio's recovery of carrying costs on incremental environmental investments for the ESP period (2009-2011), with such recovery to occur through annual proceedings.[5] In a separate section of the ESP Order, we also approved the Companies' recovery of carrying costs incurred after January 1, 2009, on past environmental investments for the period of 2001-2008.[6] Although the latter decision was appealed to the Court by the Ohio Consumers' Counsel (OCC), the Commission's approval of the Companies' recovery of carrying costs for 2009, 2010, and 2011 incremental environmental investments was not an issue that was appealed by OCC, IEU-Ohio, or any other party. Neither was the issue raised on rehearing before the Commission by any party to these proceedings.

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5 AEP-Ohio ESP Order at 28-30.

6 AEP-Ohio ESP Order at 24-28.

With respect to the issue of the 2001-2008 incremental environmental carrying costs, OCC clearly stated in its notice of appeal that "[t]he Commission erred by requiring customers to pay, on a going forward basis, carrying charges on environmental investments made from 2001 through 2008...."[7] Likewise, OCC asserted in its application for rehearing before the Commission that "the Commission erred by requiring customers to pay carrying charges for an environmental investment that was made from 2001 through 2008...."[8] Thus, the issue that was decided by the Court and remanded to the Commission is whether there is a statutory basis for AEP-Ohio's recovery of the 2001-2008 incremental environmental carrying costs. IEU-Ohio admits as much in its application for rehearing, stating that the "Court's decision was limited to the revenue effects of the 2001-2008 incremental environmental investment carrying costs."[9]

Sections 4903.10 and 4903.11, Revised Code, set forth the jurisdictional requirements for seeking rehearing and appealing a Commission order. As neither IEU-Ohio nor any other party appealed the Commission's decision with respect to recovery of carrying costs on incremental environmental investments for 2009, 2010, and 2011, or even sought rehearing on this issue, our approval of such recovery is a final and non-appealable order of the Commission and is not subject to attack at this point in the proceedings. Accordingly, we find that IEU-Ohio's second ground for rehearing in its application for rehearing of the May 25, 2011, entry should be denied.

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7 *In re AEP-Ohio ESP cases*, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Notice of Appeal (September 10, 2009) at 2.

8 *In re AEP-Ohio ESP cases*, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Application for Rehearing (April 17, 2009).

9 *In re AEP-Ohio ESP cases*, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Application for Rehearing (June 1, 2011) at 7.

It is, therefore,

ORDERED, That the application for rehearing filed by IEU-Ohio on June 1, 2011, be denied. It is, further,

ORDERED, That a copy of this entry on rehearing be served upon all persons of record in these cases.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

SJP/sc

Entered in the Journal
JUN 22 2011

Betty McCauley
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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| In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals. | ) | Case No. 10-2376-EL-UNC |
| In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan. | ) | Case No. 11-346-EL-SSO<br>Case No. 11-348-EL-SSO |
| In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority. | ) | Case No. 11-349-EL-AAM<br>Case No. 11-350-EL-AAM |
| In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company to Amend their Emergency Curtailment Service Riders. | ) | Case No. 10-343-EL-ATA<br>Case No. 10-344-EL-ATA |
| In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company. | ) | Case No. 10-2929-EL-UNC |
| In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Mechanisms to Recover Deferred Fuel Costs Ordered Under Section 4928.144, Revised Code. | ) | Case No. 11-4920-EL-RDR<br>Case No. 11-4921-EL-RDR |

ENTRY

The Commission finds:

(1) On January 27, 2011, in Case Nos. 11-346-EL-SSO, 11-348-EL-SSO, 11-349-EL-AAM and 11-350-EL-AAM, Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, AEP-Ohio or the Companies) filed an application for a standard service offer (SSO) pursuant to Section 4928.141, Revised Code (ESP 2).

(2) On September 7, 2011, a Stipulation and Recommendation (Stipulation) was filed for the purpose of resolving all the issues raised in the ESP 2 cases and several other AEP-Ohio cases pending before the Commission, Case No. 10-2376-EL-UNC, *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals* (Merger Case); Case No. 10-343-EL-ATA, *In the Matter of the Application of Columbus Southern Power Company to Amend its Emergency Curtailment Service Riders* and Case No. 10-344-EL-ATA, *In the Matter of the Application of Ohio Power Company to Amend its Emergency Curtailment Service Riders* (jointly Curtailment Cases); Case No. 10-2929-EL-UNC, *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company* (Capacity Charges Case); and Case No. 11-4920-EL-RDR, *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144, Revised Code,* and Case No. 11-4921-EL-RDR, *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144, Revised Code* (jointly Deferred Fuel Cost Cases).

(3) On December 14, 2011, the Commission issued its Opinion and Order in the consolidated cases, finding that the Stipulation, as modified, be adopted and approved.

(4) However, on February 23, 2012, the Commission issued its Entry on Rehearing determining that the Stipulation, as a package, did not benefit ratepayers and the public interest and, thus, did not satisfy the three-part test for the consideration of stipulations. The Commission directed AEP-Ohio to file new proposed tariffs to continue the provisions, terms, and conditions of its previous electric security plan no later than February 28, 2012.

(5) On February 28, 2012, AEP-Ohio submitted its proposed compliance tariffs containing the provisions, terms, and conditions of its previous electric security plan, as approved in Case No. 08-917-EL-SSO (ESP 1) et al. *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan.* AEP-Ohio further explains that the implementation of the phase-in recovery rider (PIRR), as approved in ESP 1, was recalculated on its January and February collections and carrying costs for those two months based on the long term debt rate. Therefore, AEP-Ohio states that the new PIRR rates are designed to collect the revised balance over the remaining 82 months of the amortization period.

(6) On March 2, 2012, Industrial Energy Users-Ohio (IEU-Ohio) filed objections to AEP-Ohio's compliance tariffs. In its objections, IEU-Ohio asserts that AEP-Ohio's compliance tariffs contain a blended fuel adjustment clause (FAC) transmission cost recovery rider (TCRR) for both Ohio Power Company and Columbus Southern Power Company instead of individual provisions, improperly included the PIRR in its compliance tariffs, and failed to file an appropriate application of its capacity charges. IEU-Ohio also maintains that AEP-Ohio incorrectly omitted key terms and conditions of service.

(7) On March 5, 2012, Ormet filed an objection to AEP-Ohio's compliance tariffs. Ormet contends that the inclusion of the PIRR in the compliance tariffs is improper and unauthorized.

(8) On March 5, 2012, AEP-Ohio filed a Notice of Intent that it intends to submit a modified ESP pursuant to Section 4928.143, Revised Code, by March 30, 2012.

(9) On March 6, 2012, the Ohio Consumers' Counsel and the Appalachian Peace and Justice Network (collectively OCC/APJN) filed a motion to reject portions of AEP-Ohio's compliance filing that implement the PIRR. In the alternative, OCC/APJN request that the Commission issue an order to stay the collection of the PIRR rates or order the PIRR rates be collected subject to refund.

(10) Also on March 6, 2012, FirstEnergy Solutions (FES) filed objections to AEP-Ohio's proposed tariffs. FES opines that no recovery mechanism for the PIRR has been authorized, and AEP-Ohio failed to include a TCRR rate for its IRP-D customers.

(11) AEP-Ohio filed revised tariffs on March 6, 2012, that reinserted terms and conditions that were omitted from the proposed tariffs filed on February 28, 2012. Also on March 6, 2012, AEP-Ohio filed a reply to objections filed by IEU-Ohio, Ormet, and OCC/APJN. AEP-Ohio asserts that the Commission already merged the FAC in a separate docket in Case No. 11-5906-EL-FAC (11-5906), and it would be impractical and unnecessary to revise not only the FAC provisions, but also the TCRR implementation. AEP-Ohio argues the inclusion of the PIRR was appropriate, and the capacity charges are appropriate as they do not relate to the implementation of the prior retail rate plan. Further, AEP-Ohio urges the Commission to reject OCC's requests to stay the prior rate plan or make the rates subject to refund.

(12) The Commission finds that, with the exception of the tariffs for the PIRR, FAC, and TCRR, the tariffs filed by AEP-Ohio are consistent with its February 23, 2012, Entry on Rehearing, do not appear to be unjust or unreasonable, and should be approved, effective March 9, 2012.

(13) Regarding the FAC and TCRR, the Commission finds that, pursuant to AEP-Ohio's application in the Merger Case, the approval of the merger will not affect CSP and OP's rates. Specifically, the application provides that CSP and OP shall continue service to customers within the pre-merger certified territories in accordance with their respective rates and terms and conditions in effect until such time as the Commission approves new rates and terms and conditions. While AEP-Ohio is correct that its FAC rates were approved in 11-5906, the rates were approved in light of the Commission's approval of the Stipulation in the ESP 2 proceedings, which was subsequently disapproved on February 23, 2012. Accordingly, OP shall file final unblended TCRR and FAC rates to be effective March 7, 2012, subject to subsequent Commission review. Further, FES correctly points out that AEP-Ohio failed

to include a TCRR rate for its IRP-D customers. Therefore, we direct AEP-Ohio to amend Original Sheet No. 475-1 to make it consistent with ESP 1's terms and conditions.

(14) With respect to the PIRR, AEP-Ohio is directed to file, in final form, new tariffs removing the PIRR at this time. The Commission will address AEP-Ohio's application to establish the PIRR by subsequent entry in the Deferred Fuel Cost Cases.

(15) Further, as AEP-Ohio filed corrections to its compliance filing on March 6, 2012, we do not need to address IEU-Ohio's objection that AEP-Ohio incorrectly omitted key terms and conditions of service.

(16) In addition, as the captioned cases were consolidated by the Stipulation which the Commission disapproved, all future filings should be made in the appropriate case docket, as the consolidated case matters will no longer be docketed in all of the above-captioned cases.

(17) Finally, the Commission notes that, on March 5, 2012, AEP-Ohio filed its notice of intent to file a modified ESP application. The Commission expects that such modified ESP application will include a thorough discussion of: any plans of AEP-Ohio to divest its generation assets, including provisions to ensure that adequate capacity will be available on an on-going basis to Ohio customers, notwithstanding any potential plant retirements; provisions to address rate design concerns for small commercial customers and residential customers in the former CSP service territory using more than 800 kWh in winter months; provisions regarding plans to take advantage of a territory-wide deployment of emerging metering technology to provide ample choices regarding pricing, information, and electric energy services for customers in a competitive market, including provisions that AEP-Ohio does not foreclose the possibility of working collaboratively with other utilities, retail energy suppliers, and interested stakeholders to explore cost saving and market development opportunities; provisions to take advantage of the deployment of emerging distribution system technologies in all locations where they can cost-effectively improve the efficiency of the distribution system or enhance reliability consistent with the value customers place on

> service reliability; provisions for reasonable support for the development of technologies that could provide significant economic benefits; provisions ensuring that AEP-Ohio has the ability to meet Ohio's renewable energy standards over the long-term; provisions that any proposed retail stability charge be applied to all customers within AEP-Ohio service territory; provisions addressing the prompt modification or termination of the AEP Interconnection Agreement to reflect State law and policies; or provisions that provide for market-based pricing for standard service offer customers in a manner more expeditious than proposed within AEP-Ohio's Notice of Intent. The Commission further expects that AEP-Ohio will look to recent Commission precedent for guidance in formulating its modified ESP in considering how to best ensure its customers have market-based standard service offer pricing in an efficient and expeditious manner. (See *In the Matter of Application of Duke Energy Ohio, Inc. for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code,* Case No. 11-3549-EL-SSO; *In the Matter of Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code,* Case No. 10-388-EL-SSO.)

It is, therefore,

ORDERED, That, with the exception of the tariffs for the PIRR, TCRR, and FAC, the tariffs filed on February 28, 2012, by AEP-Ohio be approved, effective for bills rendered on or after March 9, 2012. It is, further,

ORDERED, That OP file unblended TCRR and FAC rates to be effective March 9, 2012, subject to Commission review. It is, further,

ORDERED, That OP file tariffs including a TCRR rate for IRP-D customers, consistent with ESP 1's terms and conditions. It is, further,

ORDERED, That AEP-Ohio file new tariffs removing the PIRR at this time. The Commission will address AEP-Ohio's applications in the Deferred Fuel Cost Cases. It is, further,

ORDERED, That the Companies file in final form four complete copies of tariffs. One copy shall be filed with this case docket, one shall be filed with each company's TRF docket, and the remaining two copies shall be designated for distribution to the Rates and Tariffs Division of the Commission's Utilities Department. The Companies shall also update their respective tariffs previously filed electronically with the Commission's Docketing Division. It is, further,

ORDERED, That the Companies shall notify their customers of the changes to the tariff via bill message or bill insert within 30 days of the effective date. A copy of this notice shall be submitted to the Commission's Service Monitoring and Enforcement Department prior to its distribution to customers. It is, further,

ORDERED, That a copy of this entry be served on all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

JJT/sc

Entered in the Journal

MAR 07 2012

Barcy F. McNeal

Barcy F. McNeal
Secretary