

IN THE SUPREME COURT OF OHIO

In the Matter of the Application of Ohio)
 Power Company for Approval of a)
 Mechanism to Recover Deferred Fuel Costs) Supreme Court Case No. 2012-2008
 Ordered Under Section 4928.144, Ohio)
 Revised Code.)
)
) Appeal from the Public Utilities Commission
) of Ohio
)
) Case Nos. 11-4920-EL-RDR and
) 11-4921-EL-RDR

SECOND MERIT BRIEF OF
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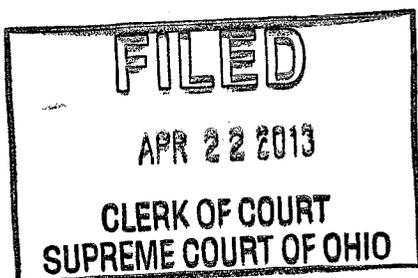
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I. INTRODUCTION

This is the second case brought before this Court involving the issue of the collection of deferred fuel costs from the customers of Columbus Southern Power Company (“CSP”) and Ohio Power Company (“OP”) (together, “AEP”). In a previous appeal of the decision by the Public Utilities Commission of Ohio (“PUCO”) regarding AEP’s electric security plan, the Court determined that the record did not justify the provider of last resort (“POLR”) charges and remanded the case to the PUCO.¹ On remand, the PUCO ruled that AEP had not shown its POLR charges to be cost based and thus had not justified the level of POLR charges in its rates.² The PUCO, however, refused to lower the fuel deferral balance – which would lower the rates paid by AEP’s customers – by the unjustified POLR charges.³ The PUCO’s decision on remand has been appealed in Supreme Court Case No. 2012-0187.

There are similar issues in this appeal. Here, the Office of the Ohio Consumers’ Counsel (“OCC”) challenges the lawfulness of the PUCO’s decision to allow AEP to collect deferred fuel costs through a mechanism called the phase-in recovery rider (“PIRR”). In particular, OCC challenges the lawfulness of the PUCO’s refusal to reduce the amount collected through the PIRR by the amount of the unjustified POLR charges collected from customers during April 2009 through May 2011. OCC also challenges the lawfulness of the PUCO’s refusal to make the collection of the PIRR subject to refund.

¹ *In re: Application of Columbus S. Power Co.*, 128 Ohio St.3d 512, 519, 2011-Ohio-1788, 947 N.E.2d 655 (“*Columbus S. Power Co. (2011)*”). (Appx. 011-033).

² *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 Generation Assets*, Pub. Util. Comm. Nos. 08-917-EL-AIR et al., Opinion and Order (Oct. 3, 2011) (“*Remand Order*”) at 33. (Appx. 177).

³ *Id.* at 35-36. (Appx. 179-180).

II. STANDARD OF REVIEW

R.C. 4903.13 governs this Court's review of PUCO Orders. It provides in pertinent part: "A final order made by the public utilities commission shall be reversed, vacated, or modified by the supreme court on appeal, if, upon consideration of the record, such court is of the opinion that such order was unlawful or unreasonable * * *." The Court has interpreted this standard as one turning upon whether the issue presents a question of law or a question of fact.

As to questions of fact, the Court has held that it will not reverse the PUCO unless the PUCO's findings are manifestly against the weight of the evidence or are so clearly unsupported by the record as to show misapprehension, mistake, or willful disregard of duty.⁴ But questions of law, such as those raised by OCC's Proposition of Law No. 1, are held to a different standard of review.

This Court has complete, independent power of review on questions of law.⁵ Accordingly, legal issues are subject to a more intensive examination than are factual questions. OCC's Proposition of Law No. 1 challenges the PUCO's determination that it cannot prospectively adjust the remaining electric security plan rates because doing so would be retroactive ratemaking. In addressing this error the Court will need to determine whether the adjustments OCC requests would amount to retroactive ratemaking under the case precedent established by this Court. This requires a *de novo* review. In this context, the Court must consider and resolve the errors alleged by OCC.

⁴ *Cleveland Elec. Illuminating Co. v. Pub. Util. Comm.*, 42 Ohio St.2d 403, 330 N.E.2d 1, ¶ 8 of the syllabus (1975), *appeal after remand*, 46 Ohio St.2d 105, 346 N.E.2d 778 (1976).

⁵ *Office of Consumers' Counsel v. Pub. Util. Comm.*, 58 Ohio St.2d 108, 110, 388 N.E.2d 1370 (1979).

III. STATEMENT OF FACTS

The decisions being appealed are the PUCO's Finding and Order entered in its Journal on August 1, 2012 ("*PIRR Order*") (Appx. 560-581), and its Fifth Entry on Rehearing entered in its Journal on October 3, 2012 in PUCO Case Nos. 11-4920-EL-RDR and 11-4921-EL-RDR (Appx. 526-541). At issue in this appeal are \$368 million of unlawful deferrals, in the form of unjustified POLR charges, currently being collected from more than 1.4 million AEP customers.

The PIRR was authorized in the PUCO's March 18, 2009 Opinion and Order that approved but modified AEP's first electric security plan.⁶ The electric security plan rate was to be collected through a generation charge, a fuel adjustment charge, and other charges collected as add-ons to customers' bills, called "riders."⁷ One such rider is the PIRR, which is a mechanism designed for AEP to collect fuel costs that were deferred because AEP's rates were capped during the term of the electric security plans. (Appx. 337-339).

With few exceptions,⁸ the rate increases the PUCO authorized in the *ESP 1 Order* were "capped" for the term of the electric security plan, from 2009 through 2011, in order to lessen the

⁶ *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 Generation Assets*, Pub. Util. Comm. Nos. 08-917-EL-AIR et al., Opinion and Order (Mar. 18, 2009) ("*ESP 1 Order*"). (Appx. 316-392).

⁷ Under the electric security plan, rate increases were granted to cover generation charges, environmental investment, enhanced vegetation management, provider of last resort service, energy efficiency and peak demand costs, and economic development. *Id.* at 14-18, 27, 34, 40, 46-47, 48 (Appx. 329-333, 342, 349, 355, 361-362, 363).

⁸ Exceptions to the "capped" increases included increases associated with the transmission cost recovery rider, increases associated with any new government mandates, future adjustments to the energy efficiency/peak demand reduction rider, and revenue increases associated with any future distribution base rate case. See *Id.* at 20; *AEP ESP 1*, Entry on Rehearing (July 23, 2009) at 9. (Appx. 335, 269).

immediate impact on customers.⁹ Customers began to pay the increased rates for electric service, subject to the yearly caps, beginning in April 2009. Importantly though, these rates were only temporarily capped or limited. Any and all revenue increases above the capped rates would be collected from customers later, just not in 2009-2011, but from 2012 through 2018. (Appx. 338). AEP would call these later rate increases “incremental fuel expenses,” even though the rate increases under AEP’s electric security plans were composed of many different provisions that had nothing to do with fuel expenses.¹⁰

But deferring the collection of the revenue increases above the capped rates came at a cost to customers. Customers were required to finance the deferred increases starting in 2009 at a substantial interest rate tied to AEP’s cost of capital.¹¹ (Appx. 338).

The PUCO authorized AEP to treat the increases in this manner because it was *one way*¹² to keep rates more affordable during 2009-2011, a time that the PUCO described as “a difficult economic period.” (Appx. 337). AEP requested accounting authority from the PUCO to delay charging customers for these increases, and the PUCO gave AEP the accounting authority it requested. (Appx. 338). AEP used its fuel adjustment clause to carry out the deferral accounting

⁹ The PUCO ordered a cap for CSP of 7% for 2009, 6% for 2010, and 6% for 2011. For OP, the PUCO adopted a cap of 8% for 2009, 7% for 2010, and 8% for 2011. *See ESP 1 Order* at 22. (Appx. 337).

¹⁰ Under the electric security plan, rate increases were granted to cover provider of last resort service, environmental investment, generation charges, enhanced vegetation management, economic development, and energy efficiency and peak demand costs. *See* footnote 7, *supra*

¹¹ AEP’s cost of capital is referred to as the weighted average cost of capital or “WACC.” AEP derived its cost of capital from a capital structure composed equally of equity and long-term debt. *See id.* at 24. (Appx. 339). The WACC changes monthly, but for 2009-2011, the PUCO approved a rate of 11.15%. *See PIRR Order* at 17. (Appx. 576).

¹² OCC and others (including the PUCO Staff) opposed creating such long-term deferrals. *See ESP 1 Order* at 20. (Appx. 335). OCC opposed the phase-in on numerous grounds, including that the PUCO should not permit rate increases at such a high level that necessitates a phase-in plan. Moreover, OCC expressed concern with the added costs of deferrals.

plan. (Appx. 335-339). Through the deferral accounting, a three-year phase-in of rate increases was implemented, with customers paying part of the electric security plan increases later instead of immediately.

Under the phase-in plan, AEP would bill customers for all of the authorized rate increases, up to the specific yearly rate caps. If there was a difference between the yearly rate cap and the authorized increases, AEP deferred the difference and called it “deferred fuel expenses.” (See Supp. 2). As explained earlier, however, the authorized rate increases that were deferred included many elements unrelated to the cost of fuel. AEP was thus permitted to phase-in the authorized increases and defer authorized rate increases in 2009, 2010 and 2011, as needed to meet the rate caps.

The deferrals created under the three-year phase-in were authorized to be booked as “regulatory assets” for accounting purposes. (See Appx. 576). The deferrals/regulatory assets and the carrying costs created by the phase-in would be collected from customers over seven years – from 2012 to 2018. The PUCO directed AEP to collect the deferrals and carrying costs created by the phase-in through “an unavoidable surcharge.” (See Appx. 576). The PUCO did not, however, approve a specific mechanism for collecting the unavoidable surcharge.

The unavoidable surcharge to collect the deferred revenue increases and carrying costs, though approved in principle, would not be implemented until 2012. Attempts to implement the unavoidable surcharge would be made in AEP’s subsequent ESP filing, Case No. 11-346-EL-SSO, as well as in separate applications.¹³

¹³ See *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Ohio Revised Code 4928.144*, Pub. Util. Comm. Nos. 11-4920-EL-RDR, et al., Application (Sept. 1, 2011). (Supp. 1-12).

Several appeals of the PUCO's *ESP 1 Order* were filed, and on April 19, 2011, this Court issued its decision on the appeals. With respect to the rate increases for provider of last resort service, the Court found that the manifest weight of the evidence contradicted the PUCO's finding that the POLR charge was based on cost.¹⁴ The Court reversed the PUCO's Order authorizing rate increases for POLR. The Court noted that the PUCO on remand, "may re-visit the issue"¹⁵ and advised that "[h]owever the commission chooses to proceed, it should explain its rationale, respond to contrary positions, and support its decision with appropriate evidence."¹⁶

In the Remand proceeding, OCC, along with a number of other intervening parties, requested that the PUCO either stay the collection of the POLR charge, or collect the charge subject to refund. (*See Appx. 180*). On May 4, 2011, the PUCO directed AEP to remove both the POLR and the environmental carrying charges¹⁷ from its tariffs. (*Appx. 183*). Subsequently, on May 25, 2011, the PUCO determined that the POLR charges should instead be collected subject to refund as of June 2011, until specifically ordered otherwise. (*Appx. 184*). In July 2011, the PUCO conducted an evidentiary hearing regarding the POLR charges in the Remand proceeding.

On September 1, 2011, AEP filed an application in the proceeding below requesting authority to collect, through the PIRR beginning in January 2012, the deferrals created under the phase-in of the ESP 1 rates. The application was not immediately addressed because the PIRR was included in a stipulation that several parties – not including OCC, IEU Ohio and some other

¹⁴ *Columbus S. Power Co. (2011)*, 128 Ohio St.3d 512, 519, 947 N.E.2d 655.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Carrying charges associated with environmental investment were also reversed in the *Columbus S. Power Co.* appeal and were remanded back to the PUCO with instructions that the PUCO "may determine whether any of the listed categories of [4928.143](B)(2) authorize recovery of environmental carrying charges." *Id.* at 520.

intervenors – agreed to in AEP’s second electric service plan case. The PIRR was a subject broached in the hearing as to whether the stipulation meets the three-prong test for PUCO approval of stipulations.¹⁸

On October 3, 2011, the PUCO issued its Order on Remand in the ESP 1 case. (Appx. 145-185). The PUCO concluded that AEP failed to produce evidence of its actual POLR costs, despite being given the full opportunity to do so.¹⁹ Additionally, the PUCO found that the cost modeling done by AEP failed to measure POLR costs.²⁰ Further the PUCO determined that “migration risk,” or the risk of customers leaving AEP to shop, is not properly a part of a POLR charge.²¹

In the *Remand Order*, the PUCO directed AEP to refund the POLR charges collected subject to refund since June 2011. (Appx. 178). Specifically, AEP was ordered to apply the POLR revenues collected to any deferrals in the fuel adjustment accounts on each of AEP’s books as to the date of the Order. Any remaining balance was to be credited to customers (on a per kilowatt hour basis) beginning in November 2011.²² AEP was ordered to include interest at a rate equal to its long-term cost of debt, commencing with June 2011 until all the charges subject to refund are returned. (Appx. 178).

The PUCO, however, declined to use the \$368 million of POLR revenues (plus carrying costs) collected from customers from April 2009 through May 2011 to reduce the deferrals, as requested by OCC and IEU Ohio. The PUCO concluded that such a proposed adjustment

¹⁸ *In re: AEP Ohio ESP Cases*, Case No. 11-346-EL-SSO, et al. (“AEP ESP 2”), Opinion and Order (December 14, 2011) (“ESP 2 Order”) at 26-29, 57-59. (Appx. 102-105, 133-135).

¹⁹ *Remand Order* at 18-24. (Appx. 162-168).

²⁰ *Id.* at 24-29. (Appx. 168-173).

²¹ *Id.* at 30-32. (Appx. 174-176).

²² *Id.* at 38. (Appx. 182).

“would be tantamount to unlawful retroactive ratemaking.”²³ The PUCO noted that it “cannot order a prospective adjustment to account for past rates that have already been collected from customers and subsequently found to be unjustified.”²⁴ After the PUCO denied rehearing on this issue, IEU Ohio and OCC appealed the PUCO’s decision.²⁵

On December 14, 2011, the PUCO approved AEP’s second electric security plan, and ordered tariffs to be filed to implement its order.²⁶ Rates under the new tariffs would become effective January 1, 2012. As part of these tariffs, there was a “phase-in recovery rider” that began collecting the ESP 1 deferrals from all customers, except residential customers, who were exempted from collection of the PIRR for 12 months under the stipulation. In a decision on rehearing issued on February 23, 2012, however, the PUCO reversed itself and rejected AEP’s second electric security plan. (Appx.0 41-053). The PUCO ordered AEP to replace the ESP 2 rates (which had been in effect for six weeks) with rates from its previous electric security plan, ESP 1.²⁷ In response to the PUCO order, AEP filed tariffs on February 28, 2012 proposing a phase-in recovery rider to collect its ESP 1 deferrals.

In response to the tariff filing, OCC, jointly with the Appalachian Peace and Justice Network (“APJN”), opposed the phase-in recovery rider, as did numerous other parties. OCC and other parties argued that the rider was improper because no specific recovery mechanism – other than “an unavoidable surcharge” – had been authorized in the *ESP 1 Order*. (See Appx.

²³ *Id.* at 36. (Appx. 180).

²⁴ *Id.*

²⁵ Supreme Court Case No. 2012-0187.

²⁶ *ESP 2 Order* at 67. (Appx. 143).

²⁷ *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*, Pub. Util. Comm. Nos. 11-346-EL-SSO et al., Entry on Rehearing (Feb. 23, 2012) at 12. (Appx. 052).

036-037). In a motion, OCC/APJN requested that the PUCO reject the phase-in recovery rider. OCC/APJN also requested that the PUCO stay rider or, alternatively, order the rider collected subject to refund, in order to protect customers. (See Appx. 036).

On March 7, 2012, the PUCO ruled that the continued rates should not include the phase-in deferrals.²⁸ Instead the PUCO ruled that it would address this issue in the PIRR cases. (Appx. 038). On March 14, 2012, the PUCO issued an Entry in the case below seeking comments and reply comments on AEP's rider applications.²⁹ In comments filed on April 2, 2012, OCC opposed the collection of the rider on grounds, *inter alia*, that the deferrals identified should be reduced by the POLR revenues collected from April 2009 through May 2011.

On August 1, 2012, the PUCO issued its Opinion and Order in the case below, approving the PIRR application with some modifications. The PUCO authorized AEP to collect carrying charges on the deferral balance based on the weighted average cost of capital rate, but only until the collection period begins, at which time carrying charges will be calculated at AEP's long-term cost of debt rate.³⁰ The PUCO also ordered AEP to use annual compounding to calculate its deferred fuel balance on a going-forward basis.³¹

The PUCO, however, declined to reduce the deferral balance to account for the flow-through effects of the remand of the *ESP 1 Order* or of the rejected ESP 2 stipulation,³² declined

²⁸ *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*, Pub. Util. Comm. Nos. 11-346-EL-SSO et al., Entry (Mar. 7, 2012) at 5. (Appx. 038).

²⁹ *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Section 4928.144, Ohio Revised Code*, Pub. Util. Comm. Nos. 11-4920-EL-RDR et al., Entry (Mar. 14, 2012). (R. 219).

³⁰ *PIRR Order* at 18. (Appx. 501).

³¹ *Id.* at 19. (Appx. 502).

³² *Id.* at 20. (Appx. 503).

to order the PIRR to be collected subject to refund and declined to require that carrying charges be calculated on a net-of-tax basis.³³

On August 31, 2012, OCC filed a timely Application for Rehearing from the August 1, 2012 Finding and Order, in accordance with R.C. 4903.10. The PUCO issued an Entry on Rehearing dated September 26, 2012, to further consider the matters specified in numerous parties' applications, including OCC's Application for Rehearing. OCC's Application for Rehearing was denied by the Fifth Entry on Rehearing.

IV. LAW AND ARGUMENT

A. STATEMENT OF THE LAW

Electric distribution utilities, such as AEP, have the duty to establish a standard service offer in Ohio, either as an electric security plan or a market rate offer.³⁴ AEP chose to establish a standard service offer through an electric security plan. An electric security plan is subject to R.C. 4928.143 (Appx. 004-007). Under R.C. 4928.143(B)(2), an electric security plan may include any of the provisions listed within that section. As this Court determined, however, if a given provision does not fit within one of the categories listed "following" (B)(2), it is not authorized by statute.³⁵

Additionally, the PUCO may, under R.C. 4928.144 (Appx. 009), authorize a "just and reasonable" phase-in plan. Under that statute, the PUCO may order a "just and reasonable" phase-in of "any rate or price established" under the standard service offer

³³ *Id.* at 19. (Appx. 502).

³⁴ R.C. 4928.141. (Appx. 008).

³⁵ *Columbus. S. Power Co. (2011)*, 128 Ohio St.3d 512, 519-520, 947 N.E.2d 655.

plan, inclusive of carrying charges. The statute requires the phase-in to be “just and reasonable” and “necessary to ensure rate or price stability for consumers.”³⁶

If the electric security plan includes a phase-in, the statute directs the PUCO to allow regulatory assets to be created, consistent with generally accepted accounting principles.³⁷ It refers to the PUCO authorizing the deferral of “incurred costs” equal to the amount not collected, plus carrying charges.³⁸ “Regulatory assets” generally refer to nonrecurring costs approved by regulators that are collected over a period of years instead of at the time the expenditures are made, thereby lessening the immediate impact of such increases. The regulatory assets created here are the revenue increases that were deferred for later collection in order to maintain the PUCO-ordered rate caps. The statute clarifies that the deferrals should be collected through a non-bypassable surcharge on “any such rate or price so established” for the utility.³⁹

B. ARGUMENTS IN SUPPORT OF CROSS-APPEAL

Proposition of Law No. 1:

The PUCO erred when it failed to credit (i.e., reduce) the electric security plan residual phase-in deferrals by the amount of the unjustified POLR charges collected from customers during April 2009 through May 2011.

- 1. The phase-in deferrals violated R.C. 4928.143 because they were residually created by electric security plan rates that included POLR charges that AEP did not justify under R.C. 4928.143(B)(2).**

Like the appeal of the *Remand Order*, this case involves the PUCO’s mishandling of rates that include the unlawful POLR charges from AEP’s first electric security plan case. The PIRR is the mechanism for collecting AEP’s rate increases authorized in the *ESP 1 Order* that

³⁶ R.C. 4928.144. (Appx. 008).

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

AEP could not collect because of the yearly capped rates. AEP characterized this deferred amount as “fuel costs.” (Supp. 1). However, the authorized rate increases that were deferred included many elements unrelated to the cost of fuel. The rate increases included costs associated with AEP’s provider of last resort service, environmental investment, generation charges, enhanced vegetation management, economic development, and energy efficiency and peak demand costs.

AEP’s first electric security plan ended in December 2011, and the amount of the deferred balance at that time will be collected from AEP’s customers increased rates through the PIRR. But before AEP could begin collecting the increased rates from customers, the PUCO first had to determine whether AEP bore its burden of proving that the charges are reasonable and lawful under R.C. 4928.143(B)(2)(a). (Appx. 004). The PUCO also had to determine whether the balance of deferred fuel costs and its collection amounted to a just and reasonable phase-in under R.C. 4928.144. (Appx. 009).

The balance of the deferred fuel costs that AEP sought to collect from its customers was overstated. This is because the phase-in rates, which directly drive the deferred balance, included all authorized ESP rate increases, including rates for POLR that the PUCO had authorized AEP to collect in the *ESP 1 Order*. This Court, however, subsequently determined that the record of the ESP 1 case contained no justification for the POLR charges. The Court reversed the PUCO’s authorization of the POLR charges and remanded the issue to the PUCO.

In the Remand proceeding, the PUCO found that AEP still had not demonstrated that the POLR charges requested in its ESP were cost-based or that they were reasonable and lawful.⁴⁰ The PUCO, however, refused to adjust the deferred fuel balance, which is to be collected through

⁴⁰ *Remand Order* at 22-24, 37. (Appx. 166-168, 181).

the PIRR, because it would be “tantamount to unlawful retroactive ratemaking.”⁴¹ This is one issue also in the appeal of the PUCO’s *Remand Order*.

The removal of the unlawful POLR charges from the rates customers pay also was an issue addressed in the PIRR proceeding.

2. **The electric security plan that produced the phase-in deferrals was not “just and reasonable” and contained deferrals that were unrelated to “incurred costs” of the electric security plan, all in violation of R.C. 4928.144.**

R.C. 4928.144 (Appx. 009) allows the PUCO to “authorize any just and reasonable phase-in” of any rate or price established under an electric security plan “as the commission considers necessary to ensure rate or price stability for consumers.” In addition, the statute provides that any phase-in of a rate or price in an electric security plan “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.” The phase-in plan for the collection of deferred fuel expenses through the PIRR, authorized by the PUCO, does not meet these statutory criteria.

First, the PUCO cannot by law approve the collection of the deferred costs through the PIRR unless the phase-in plan that created the deferrals is found to be “just and reasonable.”⁴² It is axiomatic that if the rates established under R.C. 4928.143 are not found to be reasonable and lawful, then the phase-in plan implementing those rates cannot be “just and reasonable” as required under R.C. 4928.144.

The rates from AEP’s first electric security plan, which are the basis for the rates to be collected through the PIRR, have been shown to be unlawful by both this Court, in the appeal of

⁴¹ *Id.* at 35-36. (Appx. 179-180).

⁴² R.C. 4928.144. (Appx. 009).

the ESP 1 Order, and the PUCO, in the *Remand Order*. Nevertheless, the PUCO approved AEP's application to charge customers through the PIRR, with some modifications.⁴³

In the proceeding below, the PUCO did not determine that AEP carried its burden of proving that the charges are reasonable and lawful under R.C. 4928.143(B)(2)(a). The PUCO also did not determine that the phase-in plan that created the deferrals is just and reasonable. Instead, the PUCO merely stated the following: "Upon review, the Commission finds that AEP-Ohio's application for a mechanism to recover its deferred fuel costs is, for the most part, consistent with the phase-in plan authorized in the ESP 1 Order and should, therefore, be approved, to the extent set forth herein. Accordingly, the Commission finds that AEP-Ohio's proposed PIRR should be established, consistent with the phase-in plan authorized in the ESP 1 Order and this finding and order, pursuant to Section 4928.144, Revised Code."⁴⁴

In its *PIRR Order*, the PUCO failed to make the findings required by law. Thus, the PUCO's approval for AEP to collect the PIRR from customers is unlawful, and the Court should reverse the PUCO's decision.

Second, the amounts to be collected through the PIRR include amounts not related to fuel costs AEP deferred in its first electric security plan. Under the phase-in plan in its first electric security plan, AEP was ordered to phase-in "any authorized increases" so as to not exceed specified rate caps.⁴⁵ The "authorized increases" were attributable to a number of provisions in AEP's electric security plan, and not necessarily tied to cost-based or incurred fuel expenses. Those sources of increased revenues included a fuel component as well as non-fuel components

⁴³ *PIRR Order* at 17-19. (Appx. 500-502). The modifications concerned the interest to be used once collection of the deferrals begins and the use of annual, rather than monthly, compounding of the deferral balance on a going-forward basis.

⁴⁴ *Id.* at 17. (Appx. 500).

⁴⁵ The rate caps are discussed in footnote 9, *supra*.

that were part of the approved electric security plan. These other charges that were considered components of the “authorized increases” included charges for environmental capital investment, transmission, and provider of last resort service.⁴⁶

AEP will charge these increases to customers through the non-bypassable surcharge for the phase-in deferrals and will be collected from customers over a six-year period, 2012 through 2018. These rate increases are significant, and include the overstated (by \$368 million) deferred revenue increases and the financing costs associated with carrying the deferrals from 2009 through 2018. The collection of these unlawful and unreasonable rates is detrimental to consumers.

The PUCO’s approval of the non-bypassable surcharge, based on charges that were not established as reasonable and lawful under R.C. 4928.143 (Appx. 004-007), will significantly harm customers. This harm to customers could have been avoided if the PUCO had followed the law by ensuring that the phase-in of the deferred fuel expenses was just and reasonable.⁴⁷ But it did not. Because the phase-in recovery rider rates do not result in reasonably priced electric retail service, customers are not receiving the protections accorded them under the law. The PUCO’s Order is unreasonable in this regard, as well as unlawful.

3. The PUCO unlawfully and unreasonably determined that it was precluded from crediting (i.e., reducing) the electric security plan residual phase-in deferrals by the amount of unjustified POLR charges because doing so would allegedly amount to retroactive ratemaking.

In the Order below, the PUCO refused to reduce the deferral balance to account for the flow-through effects of the remand of the *ESP 1 Order* or of the rejected *ESP 2* stipulation. The PUCO cited to the reasons set forth in the *Remand Order*, in particular the view that adjusting

⁴⁶ See footnote 7, supra.

⁴⁷ See R.C. 4928.144. (Appx. 009).

the balance would be tantamount to unlawful retroactive ratemaking: “[F]or the reasons set forth in the ESP 1 Remand Order, the Commission declines to adjust the deferral balance to account for the flow through effects of the Ohio Supreme Court’s remand of the ESP 1 Order or the rejected ESP 2 Stipulation. As addressed in the ESP 1 Remand Order, the adjustments proposed by OCC and IEU-Ohio would be tantamount to unlawful retroactive ratemaking.”⁴⁸

The PUCO’s decision, however, reveals a misunderstanding of the ratemaking rule and Ohio Supreme Court precedent. While the PUCO in the *Remand Order*, and by extension the Order below, cited to *Lucas County*,⁴⁹ it misinterpreted the holdings of that case, and failed to recognize that retroactive ratemaking does not exist if a mechanism in the rates permits a prospective rate adjustment. In cases involving retroactive ratemaking claims, the Court has recognized that if a mechanism built into the rates allows for prospective rate adjustments, retroactive ratemaking does not exist.⁵⁰ In this proceeding, the structure of the electric security plan rates and their inherent linkage to the phase-in deferrals allow for prospective rate adjustments to protect customers.

When a utility’s rates are reversed on appeal, the PUCO as a matter of course implements revised rates minus the unlawful elements. This provides some degree of relief for customers, on a prospective basis, because the remaining rates no longer contain the unlawful elements. In the *Remand Order*, however, the PUCO again departed from its previous practice, to the detriment of customers. The unlawful electric security plan rates continued in effect for customers, in the form of the deferred expenses that were approved as part of the phase-in plan. The proceeding

⁴⁸ *PIRR Order* at 20 (citation omitted). (Appx. 503).

⁴⁹ *Lucas County Commrs. v. Pub. Util. Comm.* (1997), 80 Ohio St.3d 344, 348-349, 686 N.E.2d 501.

⁵⁰ *Id.*

below provided the PUCO with a mechanism to reduce the electric security plan rates to be collected through the PIRR on a going-forward basis, rather than retroactively.

The structure of the electric security plan rates specifically linked the rates charged in 2009-2011 to the phase-in deferrals that are being collected through the PIRR. The phase-in deferrals were created as a residual value, flowing from the electric security plan rates in 2009-2011. The existence of phase-in deferrals created a mechanism that permits the PUCO to make future rate adjustments to fully remedy the POLR overcharges found by the Court.

The PUCO should have removed the unlawful elements from rates that will prospectively be charged to customers. But it did not. The rates containing the POLR costs that this Court found to be without justification, and which the PUCO also found to be unjustified in its Remand Order, remain as part of the phase-in deferrals being collected from customers through the PIRR.

It is difficult for customers to understand that nothing can be done to reimburse them for the millions of dollars AEP collected from them in rates that this Court, and the PUCO in the Remand Order, found to be unjustified. Indeed this Court noted the “apparent unfairness” of such a proposition in its decision in *Columbus S. Power Co (2011)*. There, the Court determined that there could be no refund even though the PUCO unlawfully allowed AEP to collect \$63 million from customers.⁵¹

This Court need not automatically and uncritically accept whatever the PUCO does.⁵² That especially applies to protecting Ohio consumers here, where there was a lawful and reasonable basis for the PUCO to act and yet it chose not to. The PUCO failed to act to protect

⁵¹ *Columbus S. Power Co. (2011)*, 128 Ohio St.3d 512, 515-517, 947 N.E.2d 655.

⁵² *Consolidated Rail Corp. v. Pub. Util. Comm.*, 47 Ohio St.3d 81, 84, 547 N.E.2d 1176 (1989); see also *Ohio Bell Tel. Co. v. Pub. Util. Comm.*, 301 U.S. 292, 303-305, 57 S.Ct. 724, 81 L.Ed.2d 1093 (1989).

customers and ensure reasonably priced electric service. That is reason enough for the Court to reverse the PUCO's decision.

a. In order for there to be retroactive ratemaking there must be ratemaking.

In the *Remand Order*, the PUCO found that AEP failed to provide any evidence of its actual POLR costs.⁵³ On that basis the PUCO directed AEP to refund the POLR revenues collected subject to refund since June 2011. Specifically AEP was ordered to apply those POLR revenues to any deferrals in the fuel adjustment accounts on AEP's books as of the date of the Order. Any remaining balance was to be credited to customers beginning in November 2011.⁵⁴

With respect to the \$368 million of POLR charges collected from April 2009 through May 2011, however, the PUCO declined to act, both in the Remand proceeding and the case below. The PUCO determined applying the unlawfully collected revenue to offset the deferrals "would be tantamount to unlawful retroactive ratemaking."⁵⁵ The PUCO, however, is mistaken. This Court has repeatedly determined that there can be no "retroactive ratemaking" if there is no "ratemaking."

The line of Ohio Supreme Court cases establishing this principle began in 1977, when the Court addressed a gas cost provision known as the purchased gas cost adjustment in *Ford Motor Co. v. Pub. Util. Comm.*, 52 Ohio St.2d 142, 370 N.E.2d 468 (1977). In that case, one of the issues before the Court was whether a utility's gas purchases that pre-dated the purchased gas adjustment clause, and were deferred, could be collected without engaging in retroactive

⁵³ *Remand Order* at 22-24. (Appx. 166-168).

⁵⁴ *Id.* at 38. (Appx. 182).

⁵⁵ *PIRR Order* at 20. (Appx. 503).

ratemaking.⁵⁶ The purchased gas adjustment clause allows gas companies to adjust rates according to fluctuations in the cost of procuring the gas sold to customers.⁵⁷ The process provides for the filing of schedules allowing for increases and decreases independently of proceedings under R.C. 4909.18. Finding that the utility sought no increase, but rather sought to modify a schedule, this Court concluded that there was no retroactivity.⁵⁸

In 1982, the Court was again faced with a challenge to the uniform purchased gas adjustment clause. This time the appeal focused on the gas cost recovery rate component and whether the PUCO's order to pass through supplier refunds from prior periods constituted retroactive ratemaking. The Court concluded there was no retroactive ratemaking because there was no ratemaking: "It is axiomatic that before there can be retroactive ratemaking, there must, at the very least, be ratemaking. We are not convinced that the commission's actions at issue herein constitute ratemaking as that term is customarily defined."⁵⁹

Moreover, the Court went on to address the applicability of *Keco*,⁶⁰ assuming, *arguendo*, that the PUCO engaged in ratemaking. It concluded that appellants' reliance on *Keco* was "misplaced."⁶¹ The Court found that the PUCO had determined gas costs to be collected prospectively from customers, and that it was appropriate (and also required) to deduct supplier refunds.

⁵⁶ See Ohio Constitution, Article II, Section 28: "The general assembly shall have no power to pass retroactive laws * * * ." (Appx. 010).

⁵⁷ R.C. 4905.302(A)(1)(a). (Appx. 001).

⁵⁸ *Ford Motor Co.*, 52 Ohio St.2d at 149-150, 370 N.E.2d 468.

⁵⁹ *River Gas Co. v. Pub. Util. Comm.*, 69 Ohio St.2d 509, 512, 433 N.E.2d 568 (1982).

⁶⁰ *Keco Industries v. Cincinnati & Suburban Bell Tel. Co.* (1957), 166 Ohio St. 254, 141 N.E.2d 465.

⁶¹ *River Gas Co.* 69 Ohio St.2d at 513-514, 433 N.E.2d 568.

- b. **There is no ratemaking where the PUCO merely grants a utility accounting authority to defer the collection of rate increases.**

In order to facilitate the phase-in, the PUCO permitted AEP accounting authority to defer “any amount over the allowable total bill increase percentage levels.”⁶² In other words, the PUCO permitted the deferral of any of the “authorized increases” as was necessary to keep the annual rate increase (fuel and non-fuel increases) within the PUCO-ordered rate caps in AEP’s first electric security plan. Carrying charges were to be booked on the uncollected deferrals starting in 2009 and ending in 2018.

With the booking of the deferrals, regulatory assets were created. Thus, what the PUCO approved was phase-in rates, rate caps, the phase-in methodology, and the deferral accounting that was to occur to facilitate the phase-in.

When the PUCO approves deferral accounting for a utility, it does not equate to the unequivocal right to collect the deferral.⁶³ Indeed this Court has duly noted that accounting and ratemaking are not functionally equivalent.⁶⁴ Instead, the Court has recognized a distinction exists between accounting practices and ratemaking.⁶⁵

⁶² *ESP 1 Order* at 22. (Appx. 337).

⁶³ *See 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*, Pub. Util. Comm. No. 09-786-EL-UNC, Finding and Order (June 30, 2010) at 16 (Appx. 235) (in discussing how deferrals should be treated for purposes of the significantly in excess earnings test of R.C. 4928.143(f), the PUCO noted the authority to defer is not the authority to collect).

⁶⁴ *Dayton Power & Light Co. v. Pub. Util. Comm.*, 4 Ohio St.3d 91, 104, 447 N.E.2d 733 (1983).

⁶⁵ *Office of Consumers’ Counsel v. Pub. Util. Comm.*, 6 Ohio St.3d 377, 378, 453 N.E.2d 673 (1983); *see also Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St.3d 305, 308-309, 2007-Ohio-4164, 871 N.E.2d 1176 (holding that the PUCO’s accounting authority is distinct from the ratemaking statutes).

The PUCO itself has embraced this distinction on many occasions.⁶⁶ For instance, after FirstEnergy withdrew its electric security plan (after the PUCO modified and approved it), FirstEnergy filed to implement a “Rider FUEL” to collect the cost of purchasing power to provide its standard service offer.⁶⁷ FirstEnergy sought the relief because the rates in effect after it withdrew its application did not contain a mechanism to collect purchased power.

The PUCO ultimately approved FirstEnergy’s Rider FUEL to collect “actual, reasonable, and prudently incurred purchased power costs.” (Appx. 401). The PUCO gave one of FirstEnergy’s subsidiaries the accounting authority to defer, with carrying costs, any amount exceeding the Rider FUEL.⁶⁸ Specifically with respect to the accounting authority granted, the PUCO noted that the “reasonableness of the deferred amounts and recovery thereof, if any, will

⁶⁶ See, e.g., *In re: Columbus S. Power Company for an Accounting Order To Defer Demand Side Management Program Expenditures and Net Lost Revenues*, Pub. Util. Comm. No. 94-2308-EL-AAM, Entry (Apr. 13, 1995) (finding that the deferral and collection of expenses, including carrying costs, are accounting matters, not ratemaking matters) (Appx. 467-474); *In re: Application of CEI to Modify Current Accounting Procedures to Defer and Amortize Operating Expenses for Perry Nuclear Plant*, Pub. Util. Comm. No. 87-109-EL-AAM, 1998 Ohio PUC LEXIS 163, Entry (Feb. 2, 1988) (approving the deferral of operating expenses incurred after the nuclear unit’s in service date was found to be a matter of accounting, not ratemaking) (Appx. 475-479); *In the Matter of the Application of Duke Energy Ohio, Inc. for Authority to Defer Environmental Investigation and Remediation Costs*, Pub. Util. Comm. No. 09-712-GA-AAM, 2010 Ohio PUC LEXIS 47, Entry on Rehearing (Jan. 7, 2010) (allowing the deferral of environmental and remediation costs, but noting that approval of deferral accounting is not ratemaking) (Appx. 253-260); *In the Matter of the Application of Ohio Edison to Continue and Modify Certain Regulatory Accounting Practices and Procedures to Establish a New Tariff Option as Part of a Rate Stabilization and Service Area Development Program*, Pub. Util. Comm. No. 92-1424-EL-AAM, 1992 Ohio PUC LEXIS 1019, Entry on Rehearing (Dec. 2, 1992) (allowed utility to accrue and capitalize carrying charges on deferred expenses related to Beaver Valley 2 nuclear unit, and declared that this accounting entry, like other PUCO accounting entries, does not control ratemaking treatment). (Appx. 453-454).

⁶⁷ *In the Matter of the Application of OE, CEI and TE for approval of Rider FUEL and Related Accounting Authority*, Pub. Util. Comm. Nos. 09-21-EL-ATA; 09-22-EL-ATA (“*FirstEnergy Rider FUEL case*”), Finding and Order (Jan. 14, 2009) at 1-2, clarified by Entry Nunc Pro Tunc (Jan. 29, 2009). (Appx. 396-397).

⁶⁸ *Id.* at 6-7. (Appx. 401-402).

be examined and addressed in a future proceeding before the Commission.”⁶⁹ The PUCO then reiterated that “deferrals do not constitute ratemaking,” and cited to *Elyria Foundry*.⁷⁰

Another recent example of the PUCO acknowledging the distinction between accounting and ratemaking occurred in a case involving an application filed by Duke Energy of Ohio (“Duke”) in conjunction with its electric security plan case. Duke sought authority to defer and create regulatory assets and carrying charges for costs incurred during the 2008 wind storm caused by the remnants of Hurricane Ike.⁷¹ Duke proposed to collect the charges through a mechanism, Rider DR-IKE, with the initial rider set at zero.⁷² Under the plan, Duke would later file for Rider DR-IKE to collect the deferred storm costs and carrying charges over three years.⁷³

The PUCO allowed Duke to defer its costs, over the objections of OCC: “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.”⁷⁴ Duke then filed its application to set its Rider DR-IKE to collect the 2008 storm costs that it had received accounting authority to defer.⁷⁵ Significantly the PUCO ruled that, *inter alia*, approximately \$14

⁶⁹ *Id.* at 7. (Appx. 402).

⁷⁰ *Id.*

⁷¹ *In the Matter of Duke Energy Ohio for Authority to Change Accounting Methods*, Pub. Util. Comm. No. 08-711-EL-AAM, Finding and Order (Jan. 14, 2009) at 2. (Appx. 406).

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.* at 3, citing *Elyria Foundry*. (Appx. 407).

⁷⁵ *In the Matter of the Application of Duke Energy Ohio, Inc. to Establish and Adjust the Initial Level of Its Distribution Reliability Rider*, Pub. Util. Comm. No. 09-1946-EL-RDR (“*Duke Rider case*”), Opinion and Order (Jan. 11, 2011) at 2. (Appx. 195).

million of the deferred expenses would be disallowed because Duke failed to prove that the expenses were reasonable and prudently incurred.⁷⁶

The PUCO's Order in the subsequent Duke rider filing case, disallowing the collection of previously deferred expenses, shows an example, post-S.B. 221, of the distinction between ratemaking and accounting. Had there been no difference, there would have been no basis to disallow the collection of storm rider deferrals. The collection of deferred storm expenses from customers would not have been able to be challenged as the PUCO had already "authorized" their recovery. But, as indicated in the *Duke Rider case* and the *FirstEnergy Rider FUEL case* discussed above, there is a distinction between authorizing revenues or expenses to be deferred and authorizing the "recovery" of such revenues or expenses from customers. Granting a utility the right to defer revenues or expenses does not equate to the unequivocal right to collect the deferred revenue or expense from customers. This is inherently tied to the fact that deferral accounting is not ratemaking.

When the PUCO permitted AEP to defer incremental revenue increases under the phase-in of rates, it was merely giving AEP accounting authority to create the deferrals. It was not ruling upon whether the deferrals could be collected for ratemaking purposes. Nor was it ruling upon the appropriateness of the deferral balance. That decision would have to be made later, when AEP seeks to actually collect the deferrals from customers. As the PUCO made clear in those cases, there is a distinction between deferral accounting and ratemaking. As the PUCO noted, deferral accounting is not ratemaking.

⁷⁶ *Id.* at 17. (Appx. 210). This Court recently affirmed the PUCO's Order, which was appealed by Duke. *In re: Application of Duke Energy Ohio, Inc.*, 131 Ohio St. 3d 487, 2012-Ohio-1509, 967 N.E.2d 201.

When there is no ratemaking, there can be no retroactive ratemaking.⁷⁷ On this basis the Court should determine that the PUCO was not precluded from adjusting the deferral balance to give customers the protection of its earlier decision, even if the adjustment was retroactive in nature.

c. When rates have not been fully collected, the PUCO may order a credit to customers without engaging in retroactive ratemaking.

In the Order below, the PUCO found that proposed adjustments to the fuel deferral balance recommended by OCC and others would be “tantamount to unlawful retroactive ratemaking,” for the reasons set forth in the *Remand Order*. (Appx. 503). In the *Remand Order*, the PUCO reasoned that it had authorized AEP to defer any increased revenues over the capped increase, pursuant to R.C. 4928.144, and had directed that any deferred balance remaining at the end of 2011 would be collected through a non-bypassable surcharge from 2012 through 2018. (Appx. 180). There, the PUCO noted 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.” (Appx. 180). In the *Remand Order*, the PUCO stated that “[W]e cannot order a prospective adjustment to account for past rates that have already been collected from customers and subsequently found to be unjustified.” (Appx 180).

But such reasoning mischaracterizes what occurred, as explained below, and reveals a misunderstanding of the principles of retroactive ratemaking and this Court’s precedent. When the PUCO stated that the past rates “have already been collected from customers” it was not factually correct. While *some* of the past 2009-2011 ESP rates have been collected from

⁷⁷ *River Gas Co.*, 69 Ohio St.2d at 512, 433 N.E.2d 568.

customers, a large portion of those rates – the portion related to the deferred revenue increases that were authorized under AEP’s standard service offer – are yet to be collected from customers.

The fact that a deferred component of the 2009-2011 electric security plan rates continues to exist and will be collected over the next six years is an important point. It is a distinguishing factor the PUCO failed to recognize when it concluded that OCC’s proposed adjustment could not be undertaken.

The key distinction is that the rates examined in the cases cited by the PUCO had been fully collected and were not continuing into the future. Thus, any adjustments would necessarily reach back to past (expired) rates and would be made to different future rates, running directly into the retroactive ratemaking prohibition first announced in *Keco*. For instance, in *Lucas County Commrs.*, the rates the appellant sought to remedy, through a refund, were rates that had expired.⁷⁸ The rates at issue there stemmed from a Columbia Gas “weather normalization adjustment program” that was a pilot program effective for a limited time.⁷⁹ After the pilot expired, Lucas County filed a complaint with the PUCO alleging that the weather normalization adjustment mechanism was unjust and unreasonable, and caused customers to overpay the utility by \$8.5 million.⁸⁰ Lucas County sought an \$8.5 million refund, through a rebate or service credit. Columbia Gas moved to dismiss the complaint, claiming that such a refund would violate *Keco*.⁸¹ The PUCO granted the motion to dismiss, and Lucas County appealed.

⁷⁸ *Lucas County Commrs.*, 80 Ohio St.3d at 348, 686 N.E.2d 501.

⁷⁹ *Id.*

⁸⁰ *Id.* at 344.

⁸¹ *Id.*

This Court noted that the weather normalization program was an experimental program.⁸² Importantly, the Court observed that the PUCO had not approved any mechanism for adjusting the rates of the weather normalization program. Additionally, the Court emphasized that Lucas County failed to seek relief during the time that the weather normalization program and the rates associated with the program were in effect.⁸³ Instead, Lucas County filed its complaint after the weather normalization program had terminated. The Court affirmed the PUCO, concluding that “there simply was no revenue from the challenged program against which the utilities commission could balance alleged overpayments, or against which it could order a credit. Absent such revenue, the commission would be ordering Columbia Gas to balance a past rate with a different future rate and would thereby be engaging in retroactive ratemaking, prohibited by *Keco*.”⁸⁴

A fair reading of *Lucas County Commrs.* is that if there was revenue against which the PUCO could have ordered a credit, then there would be no retroactive ratemaking. So if the rates were not yet fully collected and were continuing, an adjustment, such as the one sought by Lucas County, could have been made. Such an adjustment would not be balancing past rates with a different future rate that is impermissible under *Keco*. Instead, the adjustment could have lawfully occurred within the same continuing, existing rates – rates (in the form of deferred balances) that had not been fully collected.

The Court came to a similar conclusion, with a similar fact pattern, in the appeal of AEP’s first electric security plan. In that appeal, the Court addressed OCC’s request to remedy what the Court determined was unjustified PUCO action allowing the utility to collect \$63

⁸² *Id.* at 348.

⁸³ *Id.*

⁸⁴ *Id.* at 348-349.

million from customers through retroactive rates.⁸⁵ The retroactive ratemaking that OCC complained of pertained to adjusting two different sets of rates. The PUCO was prospectively adjusting new electric security plan rates based on lower revenues collected in past pre-electric service plan rates. The pre-electric service plan rates in fact had expired when the electric security plan rates were implemented.⁸⁶ Thus, the PUCO was balancing past rates, which had expired, with different future rates. The Court found the PUCO violated the case precedent against retroactive ratemaking as well as R.C. 4928.141(A).⁸⁷ (Appx. 008).

When it came time to remedy this retroactive ratemaking, however, the Court determined that it could not do so.⁸⁸ The Court noted that the “unlawful rate increase” – the separable \$63 million element – “lasted until the end of 2009 and has been fully recovered, so reversing the retroactive increase will not reduce ongoing rates.”⁸⁹ The Court’s holding was based on a fact pattern similar to that found in *Lucas County Commrs.*, where the rates had been fully collected and their collection was not continuing. In the facts at issue in the *Columbus S. Power (2011)* appeal, the discrete \$63 million rate component (allowing 12 months of revenue to be collected in nine months) was identifiable and could be segregated out of the 2009 ESP rate increase. That component was in effect only from April 1, 2009 through December 31, 2009. The rate element relating to the retroactive piece (collecting 12 months of revenue in nine months) had been fully collected by December 31, 2009, and was not a part of rates that continued into the future. Starting January 1, 2010, there were to be new electric security plan standard service offer rates

⁸⁵ *Columbus S. Power Co. (2011)*, 128 Ohio St.3d 512, 515-517, 947 N.E.2d 655.

⁸⁶ *Id.* at 514.

⁸⁷ *Id.* at 514, 515.

⁸⁸ *Id.* at 515-517.

⁸⁹ *Id.* at 515.

implemented, subject to discrete rate caps, with no rate element pertaining to collecting 12 months of revenue in nine months.

In comparison, in the proceeding below, there was no separable, short-term rate element that had expired. Unlike the separable rate element in *Columbus S. Power Co. (2011)*, the POLR rate element was a direct part of the electric security plan rates beginning in April 2009. The POLR charge was in effect until the PUCO ordered it taken out in October 2011 in the *Remand Order*.

And the POLR charge had a significant impact on the remaining electric security plan rates that are to be collected from customers through the phase-in recovery rider. POLR collections contributed to more than half of the unamortized deferral balance that will be collected through the rider. This is because \$457 million of POLR charges, along with the other ESP rate increases, were lumped together in order to set the value of the phase-in rates. The value of the phase-in rates drove the level of deferred electric security plan rate increases. Thus, reversing the POLR element, by crediting the unamortized deferral balance, will reduce ongoing rates. These “ongoing rates” are the PIRR rates being collected from 2012 through 2018.

Unlike the cases cited above, the electric security plan rates that OCC seeks to adjust have not been fully collected. A significant portion of the standard service offer rates from AEP’s 2009-2011 electric security plan – the deferred revenue increases created as a result of phase-in rates – continues into the future, where they will be collected from customers through AEP’s PIRR. In this case, the adjustment for past unjustified collections is not being sought against different, future rates. Rather, the adjustment for customers that OCC seeks is against the remaining portion of the rate increases from AEP’s first electric security plan – the deferred revenue increases. There is no attempt to balance past rates with different, future rates. There is

but one set of rates at issue that the Court may adjust. They relate to the revenue increases authorized under AEP's standard service offer that were deferred to meet the rate caps.

The existence of phase-in deferrals creates a mechanism that permits the PUCO to make rate adjustments for customers to fully remedy the POLR overcharges, without running afoul of retroactive ratemaking. Such rate adjustments are akin to the adjustment this Court permitted in *Columbus S. Power Co. (1993)*⁹⁰ despite claims that the adjustment constituted retroactive ratemaking. In that case, this Court considered the utility's request to order the PUCO (on remand) to provide a mechanism to collect revenues that had been deferred by the utility, in response to a PUCO phase-in order.⁹¹ The PUCO's phase-in order was reversed on appeal and the utility sought to undo the accounting and collect the revenues deferred while the appeal was pending.⁹²

In addressing whether such recovery is prohibited by *Keco*, the Court found no retroactive ratemaking, determining that the utility's collection of deferred revenues would not violate the prohibition on retroactive ratemaking.⁹³ The Court ruled that the PUCO's initial order had specifically authorized collection of the deferred revenues and thus the revenues constitute a portion of the rates to which the utility was entitled.⁹⁴

The significance of the Court's ruling for the case at hand is the Court recognized that deferrals resulting from a phase-in plan are an inherent component of the rates that were

⁹⁰ *Columbus S. Power Co. v. Pub. Util. Comm.*, 67 Ohio St.3d 535, 620 N.E.2d 835 (1993). See also *Cincinnati Gas & Electric Co. v. Pub. Util. Comm.*, 67 Ohio St.3d 517, 620 N.E.2d 821 (1993) (the companion case where the same issues and arguments were presented).

⁹¹ *Columbus S. Power Co. (1993)*, 67 Ohio St.3d at 541, 620 N.E.2d 835.

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.*

approved by the PUCO. Thus, any rate adjustment made by the Court was an adjustment to existing rates that continued to be collected, not an adjustment of past rates against different future rates.

This appeal and *Columbus S. Power Co (1993)* are similar. In the present case, there was also a phase-in plan (albeit a lawful one), where revenues were deferred for future collection. Like the utility in *Columbus S. Power Co. (1993)*, OCC is seeking to adjust the remaining electric security plan rates (the deferred revenue increase portion) in response to a Supreme Court decision. OCC's request to adjust the remaining electric security plan rates is not retroactive ratemaking, just as the utility's request in *Columbus S. Power Co. (1993)* was not.

Moreover, the PUCO itself has on a number of occasions made adjustments to deferral balances, at times overruling parties' objections on the basis of retroactive ratemaking. For instance, the PUCO, in 2011, ordered Duke to modify a rider to remove the collection of lost generation revenues beginning on December 10, 2009.⁹⁵ The PUCO did so even though it had approved the rider in the context of another case, Duke's electric security plan case.⁹⁶ Duke argued that the PUCO's action amounted to retroactive ratemaking. The PUCO found there was no retroactive ratemaking. (Appx. 189).

⁹⁵ *In the Matter of the Report of Duke Energy Ohio, Inc. Concerning its Energy Efficiency and Peak-Demand Reduction Programs and Portfolio Planning*, Pub. Util. Comm. No. 09-1999-EL-POR, Entry on Rehearing (Feb. 9, 2011) at 7. (Appx. 192).

⁹⁶ *In the Matter of the Application of Duke Energy Ohio Inc., for Approval of an Electric Security Plan*, Pub. Util. Comm. No. 08-920-EL-SSO et al., Opinion and Order (Dec. 17, 2008). (Appx. 409-452).

In another Order, the PUCO reduced the jurisdictional allocation factor used to collect deferred capital and operating costs.⁹⁷ The utility objected to this ruling because the allocation factor was different than the factor the utility had used in its deferral accounting approved by the PUCO. The utility argued that the change in allocation factors of the deferrals was retroactive ratemaking. The PUCO disagreed.⁹⁸

Most recently, the PUCO rejected claims of retroactive ratemaking in AEP's 2009 fuel audit proceeding,⁹⁹ and ultimately ordered a remedy that OCC has sought in this appeal. The PUCO credited AEP's fuel deferrals to compensate customers for overpayments related to a pre-fuel audit period.¹⁰⁰

The PUCO's actions in this closely related case reveal an apparent inconsistency between that case and this case, which is not easily explained. The 2009 Fuel Audit proceeding was explicitly contemplated in AEP's electric security plan case.¹⁰¹ It was the first of three annual proceedings in which the cost of fuel used to generate electricity supplied for 2009-2011 was to be reviewed for prudence, reconciliation, and accounting. As part of the proceeding, financial and management/performance audits were conducted. Numerous audit recommendations were made, including *inter alia*, recommendations pertaining to the causes of a large under-recovery

⁹⁷ *In the Matter of the Application of Ohio Edison Company for Authority to Change Certain of Its Filed Schedules Fixing Rates and Charges for Electric Service*, Pub. Util. Comm. No. 89-1001-EL-AIR, 1990 Ohio PUC LEXIS 1125, Entry on Rehearing (Oct. 11, 1990). (Appx. 455-466).

⁹⁸ *Id.*

⁹⁹ *In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company*, Pub. Util. Comm. Nos. 09-872-EL-FAC, Opinion and Order (Jan. 23, 2012) ("FAC Order"). (Appx. 054-073).

¹⁰⁰ *Id.* at 12. (Appx. 065).

¹⁰¹ *See ESP 1 Order* at 14-15. (Appx. 329-330).

of fuel costs in 2009.¹⁰² The auditor singled out two contract events that were the sources of the large under-recovery of fuel costs.¹⁰³ One of the events pertained AEP's buyout of a coal contract with a supplier in 2008. This buyout led to an increase in AEP's 2009 fuel (mostly coal) expenses. The 2008 buyout was structured as a settlement agreement where in return for AEP buying out the long-term coal contract, it received a lump sum payment (\$30 million) and a coal reserve in West Virginia. AEP booked the coal reserve as an unregulated asset in 2008, and valued it at \$41 million.¹⁰⁴

The auditor recommended that the PUCO review whether any proceeds from the settlement agreement should be credited against AEP's fuel expense under-recovery.¹⁰⁵ The PUCO concluded that the contract was an AEP asset and the value associated with it would have flowed through to AEP's customers had there not been a buyout of the contract.¹⁰⁶ As it were, the difference between the replacement coal and the contract price of the coal caused a drastic increase in the cost of fuel, and the large AEP fuel expense under-recovery.¹⁰⁷ The auditor noted that "[e]quity suggests that the Commission should consider whether some of the realized value should be credited against the under-recovery,"¹⁰⁸ meaning equity warranted providing a benefit for customers.

¹⁰² *FAC Order* at 3-6. The under-recovery of fuel costs in 2009 was \$37.5 million for CSP and \$297.6 million for OP. (Appx. 056-059).

¹⁰³ *Id.* at 4. (Appx. 057).

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 5. (Appx. 058).

¹⁰⁶ *Id.*

¹⁰⁷ *Id.* at 4. (Appx. 057).

¹⁰⁸ *Id.* at 6. (Appx. 059).

In its January 2012 *FAC Order*, the PUCO determined that all of the realized value from the settlement agreement should be credited against AEP's fuel expense under-recovery.¹⁰⁹ The realized value to be credited included the portion of the \$30 million 2008 lump sum payment not already credited to AEP's customers as well as the \$41 million value of the West Virginia coal reserve that AEP booked when the settlement agreement was executed. Additionally, the PUCO ordered that AEP hire an auditor specifically to examine the value of the West Virginia coal reserve and to make a recommendation as to whether there is any increased value associated with the coal reserve that could be credited against the fuel expense under-recovery.

In reaching its decision, the PUCO described the long-term coal agreement as a utility asset whose value (lower coal costs) would have been given to customers but for the early contract termination. The PUCO determined that the real economic cost of coal used during the audit period should include "more of the value realized by AEP" for entering into the settlement agreement. That value should have accrued to the utility's customers through a credit to the under-recovery and deferrals.

In its decision, the PUCO discussed in detail AEP's arguments opposing crediting of the fuel deferrals with the revenues of the settlement agreement.¹¹⁰ AEP had argued that the PUCO was prohibited from making such retroactive adjustments under *Keco* and *Lucas County Comms*. The PUCO deemed AEP's arguments to be "unavailing."¹¹¹ *Keco*, the PUCO announced, did not apply in that 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

¹⁰⁹ *Id.* at 12. (Appx. 065).

¹¹⁰ *Id.* at 13-14. (Appx. 066-067).

¹¹¹ *Id.* at 13. (Appx. 066).

proceeds from the Settlement Agreement to OP's deferral balance, is establishing a future rate based upon the real cost of coal used by AEP to generate electricity during the 2009 FAC audit period."¹¹²

Likewise the PUCO found that *Lucas County Commrs.* did not apply: "In *Lucas Cty.*, the Court held that the PUCO 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 PUCO has not made a determination modifying the rate AEP collected during 2009. Additionally, there is no experimental rate program involved in the current case. Thus, *Lucas Cty.* does not apply in this matter."¹¹³

This PUCO Order is instructive because the fuel cost deferrals which were credited for the settlement agreement proceeds in that proceeding are the very same fuel deferrals that OCC argues should be adjusted for POLR revenues collected from customers in this case. But in the fuel adjustment clause proceeding, the PUCO determined that the fuel deferrals *can* be reduced on a going forward basis to adjust for a past event – a 2008 settlement agreement – without amounting to retroactive ratemaking. While in the fuel proceeding the PUCO stated it was establishing a future rate, in the proceeding below the PUCO failed to recognize that OCC is seeking to accomplish a similar objective here – establishing a future phase-in recovery rate based upon the real costs of the standard service offer, which should reflect no POLR element.

OCC seeks the same type of crediting in this appeal where the fuel deferrals to be collected from customers are reduced on a going forward basis to adjust for the past unjustified collection of POLR charges. The adjustments OCC seeks in this appeal are not retroactive

¹¹² *Id.*

¹¹³ *Id.* at 14. (Appx. 067).

ratemaking, just like the adjustments the PUCO authorized in the fuel proceeding were not.

There is no attempt to balance past rates with future different rates.

There is but one set of rates at issue here. They are the remaining 2009-2011 electric security plan rates that have not been collected and will continue to be collected from 2012 through 2018. These 2012 through 2018 phase-in recovery rates are but a continuation of the 2009-2011 ESP rates. Because the rates continue to be collected from customers and have not been fully collected, there is no balancing of past rates with different future rates. Thus, there is no retroactive ratemaking.

Proposition of Law No. 2:

The PUCO erred when it failed to order the PIRR to be collected subject to refund to customers and did not set forth the reasons for why the PIRR should not be collected subject to refund. The PUCO thus violated R.C. 4903.09, which requires it to issue a written opinion setting forth the reasons prompting its decisions in all contested cases.

R.C. 4903.09 requires that, in all contested cases, “the commission shall file, with the records of such cases, findings of fact and written opinions setting forth the reasons prompting the decisions arrived at, based upon said findings of fact.” The Court has recognized that the PUCO must comply with this statute for the Court to fulfill its responsibility to review the order being appealed.¹¹⁴ In the *PIRR Order*, the PUCO merely referred to its discussion in the *Remand Order* that rejected the proposal to adjust the deferral balance to flow through the unlawfully collected POLR rates.¹¹⁵ OCC’s proposal to collect the PIRR rates subject to refund, however, was not presented in the Remand proceeding, and thus was not addressed in the *Remand Order*.

¹¹⁴ See, e.g., *Allnet Communications v. Pub. Util. Comm.* (1994), 70 Ohio St.3d 202, 209, 638 N.E.2d 516.

¹¹⁵ *PIRR Order* at 20, citing *Remand Order* at 34-36. (Appx. 503).

By not explaining why it did not grant OCC's proposal to collect the PIRR rates subject to refund, the PUCO violated R.C. 4903.09. Without sufficient detail, the Court will be unable to determine the PUCO's reasoning for its decision. Thus, the purpose of R.C. 4903.09 will be thwarted and the review that OCC is entitled to, under R.C. 4903.09 and 4903.10, cannot occur.

The PUCO declined to adjust the deferral balance to account for the flow-through effects of the Court's remand of the *ESP 1 Order*. The PUCO stated that "[a]s addressed in the ESP 1 Remand Order, the adjustments proposed by OCC and IEU-Ohio would be tantamount to unlawful retroactive ratemaking."¹¹⁶

C. RESPONSE TO APPELLANT AND AMICUS BRIEFS

1. **The PUCO Acted Reasonably and Lawfully in Ordering AEP to Use Its Cost of Long-Term Debt in Calculating Carrying Charges on the Deferrals During the Collection Period.**

In the *PIRR Order*, the PUCO approved a mechanism for AEP to collect fuel costs, plus carrying charges, deferred from AEP's first ESP case. Under the *PIRR Order*, AEP is able to collect carrying charges calculated by using its weighted average cost of capital ("WACC") until the collection period begins.¹¹⁷ During the collection period, the carrying charges will be calculated using AEP's cost of long-term debt, which would result in a much lower charge to customers than the weighted average cost of capital.¹¹⁸

In its brief, AEP Ohio asserts that it was unlawful for the PUCO to use the cost of long-term debt instead of the WACC for calculating carrying charges during the collection period. AEP's basic argument is that the doctrine of res judicata applies in this case because the issue had been litigated in the *ESP 1 Order*, which only specified the WACC for calculating carrying

¹¹⁶ *Id.* at 19. (Appx. 502).

¹¹⁷ *Id.* at 18. (Appx. 501).

¹¹⁸ *Id.* at 18-19. (Appx. 501-502).

charges.¹¹⁹ In addition, the basis of the entire brief of East Ohio Gas is that the PUCO unlawfully modified the *ESP 1 Order* retroactively by applying the modification to AEP's past conduct.¹²⁰ Both AEP and East Ohio Gas are wrong.

AEP fails to recognize that the proceeding below, albeit related to ESP 1, is a separate and distinct proceeding from ESP 1. In the *ESP 1 Order*, the PUCO approved the **creation** of the fuel deferrals with carrying charges calculated using the WACC.¹²¹ But the Commission did not approve the **mechanism** for collecting the deferrals and carrying charges in the *ESP 1 Order*. AEP recognized as much in its application in this proceeding, where AEP stated that it "seek[s] approval of a mechanism to recover the fuel costs ordered to be deferred for later collection by the Commission as part of the phase-in of rate changes ordered by the Commission in the Companies' ESP cases, 08-917-EL-SSO and 08-918-EL-SSO * * *."¹²²

The PUCO also recognized the distinction between the ESP 1 case and the case below when it ordered AEP to remove the phase-in recovery rider from its tariffs after the PUCO vacated its order approving AEP's second electric security plan application. In vacating the *ESP 2 Order*, the PUCO "direct[ed] AEP-Ohio to file, no later than February 28, 2012, new proposed tariffs to continue the provisions, terms, and conditions of its previous electric security plan, including but not limited to the base generation rates as approved in ESP I, along with the current uncapped fuel costs * * *."¹²³ AEP's proposed tariffs, however, included a phase-in recovery

¹¹⁹ AEP Brief at 5-9.

¹²⁰ See East Ohio Gas Brief at 4.

¹²¹ *ESP 1 Order* at 23-24. (Appx. 338-339)

¹²² Application (Sept. 1, 2011) at 1. (Supp. 1).

¹²³ *ESP 2*, Entry on Rehearing (Feb. 23, 2012) at 12. (Appx. 052).

rider.¹²⁴ Subsequently, the PUCO ordered AEP to remove the rider from its tariffs, stating: “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.”¹²⁵

Thus, the proceeding below and the ESP 1 proceeding are separate and distinct. Nevertheless, “[w]hen the commission has made a lawful order, it is bound by certain institutional constraints to justify that change before such order may be changed or modified.”¹²⁶ In the *PIRR Order*, the PUCO justified its modification of the carrying charge rate.

In its brief, AEP claims the PUCO’s decision to change the carrying charge rate to AEP’s cost of long-term debt in the *PIRR Order* was based on the same factors underlying its decision in the *ESP 1 Order* to allow AEP to use the WACC. AEP asserts, “The costs associated with the generation were phased-in over time to mitigate the impact on customers in a difficult economic time (in exchange they were deferred with a certain level of guaranteed carrying charges). Then when it comes time to collect those deferrals and carrying charges created by the Commission to assist customers in difficult economic times, the Commission finds that economic times are difficult and so it will further change its initial order and take away those ordered carrying costs that were relied upon by Company. A concern for the economic situation led to the initial adjudicatory finding and cannot be used as a new fact justifying a modification at this point in time based on the same concern.”¹²⁷ AEP, however, is wrong.

¹²⁴ *ESP 2*, Entry (March 7, 2012) at 3. (Appx. 036).

¹²⁵ *Id.* at 5 (emphasis added). (Appx. 038).

¹²⁶ *Consumers’ Counsel v. Pub. Util. Comm.* (1984), 10 Ohio St.3d 49, 50; 461 N.E.2d 303; 1984 Ohio LEXIS 1061; 10 Ohio B. Rep. 312.

¹²⁷ AEP Brief at 16.

In the *PIRR Order*, the PUCO gave a reasoned explanation for deciding that AEP's cost of long-term debt is more appropriate for calculating carrying charges during the collection period. The PUCO stated, "Once collection begins, the risk of non-collection is significantly reduced and, as such, it is more appropriate to use the long-term cost of debt rate, which is consistent with sound regulatory practice and longstanding Commission precedent."¹²⁸ In addition, in justifying its decision, the PUCO acknowledged that securitization of regulatory assets has become easier since the *ESP 1 Order*: "[T]he General Assembly has provided electric utilities with new authority to securitize regulatory assets to reduce long-term borrowing costs to be recovered from ratepayers."¹²⁹ This new securitization authority was not in effect when the PUCO adopted its *ESP 1 Order*.

Further, the PUCO did not apply its modified order to AEP's past conduct, as East Ohio Gas asserts. Instead, the interest rate approved in the *PIRR Order* applies only during the collection period, which runs from 2012 through 2018 – after the date of the *PIRR Order*.¹³⁰ As the PUCO clearly stated, "the Commission finds that AEP-Ohio should be authorized to collect carrying charges on the deferral balance based on the WACC rate, but only until such time as the recovery period begins. Thereafter, AEP-Ohio should be authorized to collect carrying charges at its long-term cost of debt rate."¹³¹ The recovery period, i.e., the time in which AEP collects the *PIRR* charges from customers through the rider, had not yet begun when the Order was issued because AEP had not yet been authorized to collect the charges. The arguments put forth by East Ohio Gas are without merit.

¹²⁸ *PIRR Order* at 18 (citation omitted). (Appx. 577).

¹²⁹ *Id.* at 18-19. (Appx. 577-578).

¹³⁰ *Id.* at 18. (Appx. 577).

¹³¹ *Id.*

This Court has recognized that “as a general rule, the commission has discretion to revisit earlier regulatory decisions and modify them prospectively.”¹³² The PUCO lawfully ordered that carrying charges accrued during the collection period should be calculated using AEP’s cost of long-term debt. The Court should reject AEP’s appeal of the *PIRR Order*.

2. The PUCO’s Order Did Not Deny AEP the Ability to Exercise Its Statutory Right to Withdraw from the Expired ESP 1.

R.C. 4928.143(C)(2)(a) (Appx. 006) allows an electric distribution utility to withdraw its ESP application and file a new ESP if the PUCO modifies the original application. AEP claims that the PUCO modified the *ESP 1 Order* in this proceeding, and thus denied AEP the ability to exercise its statutory right to withdraw from its first electric security plan because the plan has expired.¹³³ AEP contends that “[t]he Commission is estopped by R.C. 4928.143 from unilaterally changing its prior findings in an ESP proceeding relied upon by the Company when such change effectively negates the utility from exercising its right under the statute to withdraw from the plan based on such modifications.”¹³⁴ Once again, AEP’s argument is baseless.

The argument here has the same flaw as AEP Ohio’s res judicata argument addressed above. As with its res judicata argument, AEP does not recognize that this is a separate and distinct proceeding from ESP 1. ESP 1 dealt with the creation of the deferral; the proceeding below addressed the mechanism for collecting the deferrals from customers. Thus, the PUCO is not estopped from implementing a collection mechanism that has its own characteristics.

¹³² *Columbus Southern Power Co. (2011)*, 129 Ohio St.3d at 569, 947 N.E.2d 655.

¹³³ AEP Brief at 21-23.

¹³⁴ *Id.* at 21.

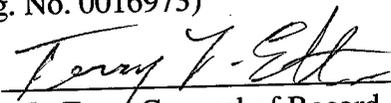
Contrary to AEP's assertions, the Order below has no bearing on AEP's rights to withdraw the electric security plan under R.C. 4928.143(C)(2)(a). The Court should reject AEP's appeal.

V. CONCLUSION

The PUCO lawfully modified the carrying cost rate during AEP's collection of the PIRR. But, the PUCO erred when it refused to flow through to customers the effect of the unlawfully collected POLR charges. As a result, AEP's customers continue to pay costs that this Court, and the PUCO, deemed to be unjustified. This Court should instruct the PUCO to provide prospective relief to customers through reduced phase-in recovery rates for the unjustified POLR charges collected.

Respectfully submitted,

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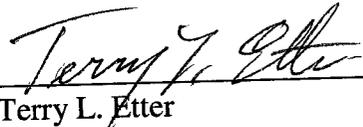
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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Brief of the Office of the Ohio Consumers' Counsel was served upon all parties of record by regular U.S. Mail this 22nd day of April 2013.


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