

**In The
SUPREME COURT OF OHIO**

ORIGINAL

Office of the Ohio Consumers' Counsel,	:	Case No. 12-2008
	:	
Appellant,	:	On Appeal from the Public Utilities
	:	Commission of Ohio, Case Nos. 11-
	:	4920-EL-RDR, <i>et al.</i> , <i>In the Matter of</i>
v.	:	<i>the Application of Columbus Southern</i>
	:	<i>Power Company for Approval of a</i>
The Public Utilities Commission of Ohio,	:	<i>Mechanism to Recover Deferred Fuel</i>
	:	<i>Costs Ordered Under Section 4928.144,</i>
	:	<i>Ohio Revised Code.</i>
Appellee.	:	

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

Bruce J. Weston (0016973)
Ohio Consumers' Counsel

Michael DeWine (0009181)
Ohio Attorney General

Terry L. Etter (0067445)
Counsel of Record

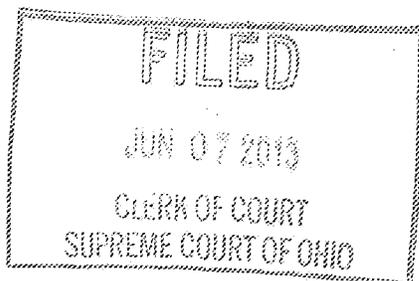
William L. Wright (0018010)
Section Chief

Maureen R. Grady (0020847)
Assistant Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, OH 43215-3485
614.466.8574 (telephone)
614.466.9475 (fax)
etter@state.oh.us
grady@occ.state.oh.us

Thomas W. McNamee (0017352)
Counsel of Record
Ryan P. O'Rourke (0082651)
Assistant Attorneys General
Public Utilities Section
180 East Broad Street, 6th Fl
Columbus, OH 43215-3793
614.466.4397 (telephone)
614.644.8764 (fax)
thomas.mcnamee@puc.state.oh.us
ryan.orourke@puc.state.oh.us

**Counsel for Appellee/Cross-Appellant,
Office of the Ohio Consumers' Counsel**

**Counsel for Appellee,
The Public Utilities Commission of Ohio**



Frank P. Darr (0025469)
Joseph E. Olikier (0086088)
Matthew R. Pritchard (0088070)
McNees Wallace & Nurick
21 East State Street, 17th Floor
Columbus, OH 43215
614.469.8000 (telephone)
614.469.4653 (fax)
sam@mwncmh.com
fdarr@mwncmh.com
joliker@mwncmh.com
mpritchard@mwncmh.com

**Counsel for Appellee/Cross-Appellant,
Industrial Energy Users-Ohio**

Mark A. Whitt (0067996)
Counsel of Record
Andrew J. Campbell (0081485)
Whitt Sturtevant
The KeyBank Building
88 East Broad Street, Suite 1590
Columbus, OH 43215
614.224.3911 (telephone)
614.224.3960 (fax)
whitt@whitt-sturtevant.com
campbell@whitt-sturtevant.com

**Counsel for *Amicus Curiae*,
The East Ohio Gas Company d/b/a
Dominion East Ohio**

Matthew J. Satterwhite (0071972)
Counsel of Record
Steven T. Nourse (0046705)
American Electric Power Corporation
1 Riverside Plaza, 29th Floor
Columbus, OH 43215
614.716.1915 (telephone)
614.716.2950 (fax)
mjsatterwhite@aep.com
stnourse@aep.com

Daniel R. Conway (0023058)
Kathleen R. Trafford (0021753)
Porter Wright Morris & Arthur
41 South High Street
Columbus, OH 43215
614.227.2270 (telephone)
614.227.2100 (fax)
dconway@porterwright.com
ktrafford@porterwright.com

**Counsel for Appellant/Cross-Appellee,
Ohio Power Company**

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**In The
SUPREME COURT OF OHIO**

Office of the Ohio Consumers’ Counsel,	:	Case No. 12-2008
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Appellant,	:	On Appeal from the Public Utilities Commission of Ohio, Case No. 11- 4920-EL-RDR, <i>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</i> and Case No. 11- 4921-EL-RDR, <i>In the Matter of the Application of Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Section 4928.144, Ohio Revised Code.</i>
v.	:	
The Public Utilities Commission of Ohio,	:	
Appellee.	:	

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

INTRODUCTION

The Commission’s orders should be affirmed. First, this Court’s prohibition against retroactive ratemaking barred the Commission from ordering that an adjustment be made for the unlawful provider-of-last-resort (“POLR”) charges that have already been collected from ratepayers. Failure to engage in a legally forbidden act does not constitute reversible error. Second, the Commission was not required by R.C. 4928.144 to account for the effects of accumulated deferred income taxes (“ADIT”) when it set the deferral balances for AEP-Ohio’s fuel costs. When a statute does not prescribe a

particular methodology for the Commission to follow, the Commission enjoys broad discretion in how it carries out the statutory mandate. The Commission acted well within its discretion by not accounting for the effects of ADIT.

STATEMENT OF THE FACTS AND CASE

The relevant facts and procedural history of this controversy were initially recounted in the Commission's first merit brief that was filed on April 19, 2013. Rather than repeating what has already been stated before, the Commission has opted, in the interest of brevity, to incorporate its prior treatment of the facts and procedural history here. To the extent that any additional background information is necessary to develop a particular argument, that information will be interwoven directly into the argument itself.

ARGUMENT

Proposition of Law No. I:

The phase-in recovery rider (“PIRR”) deferrals consist of fuel costs as a matter of fact. The Court will not substitute its judgment for that of the Commission on factual questions where there is sufficient probative evidence in the record to show that the Commission’s decision is not manifestly against the weight of the evidence and is not so clearly unsupported by the record to show misapprehension, mistake, or willful disregard of duty. *Elyria Foundry v. Pub. Util. Comm.*, 114 Ohio St.3d 305, 2007-Ohio-4164; *Ohio Edison Co. v. Pub. Util. Comm.*, 78 Ohio St.3d 466, 678 N.E.2d 922 (1997).

The case below concerns fuel costs, and only fuel costs, deferred by AEP-Ohio pursuant to a Commission ordered phase-in authorized under R.C. 4928.144. That the deferrals at issue consist of fuel costs was not challenged below. The Commission only authorized the deferral of fuel costs that exceeded the cap established in AEP-Ohio’s first electric security plan (“ESP 1”) case. Failure to comply with this order would have been a violation of R.C. 4905.54 subjecting AEP-Ohio to a forfeiture of up to \$10,000 per day. But AEP-Ohio did comply. The application in the case below shows that AEP-Ohio recorded fuel costs¹ in its deferral account. *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*, Case No. 11-4920-EL-RDR and *In the Matter of the Application of Ohio Power Company for Approval of a Mechanism to*

¹ The calculation of these fuel costs is the subject of the appeal in this docket.

Recover Deferred Fuel Costs Ordered Under Section 4928.144, Ohio Revised Code, Case No. 11-4921-EL-RDR (hereinafter “*In re AEP-Ohio Fuel Cost Rider*”) (Application) (September 1, 2011), OCC Supp. at 1-12.² The Commission refers to this fact twenty-four times in its Finding and Order. *Id.* (Finding and Order) (August 1, 2012), OCC App. at 560-581. This is as it should be. There is nothing whatever in this record which in any way challenges that the amounts recorded in this deferral account represent AEP-Ohio’s calculation³ of its fuel costs which were not collected from customers due to the ESP 1 rate cap. This is simply a fact—such a simple and obvious fact that it was assumed by all parties below.

This Court will not reweigh or substitute its judgment for that of the Commission on factual questions where there is sufficient probative evidence in the record to show that the Commission’s decision is not manifestly against the weight of the evidence and is not so clearly unsupported by the record to show misapprehension, mistake, or willful disregard of duty. *Elyria Foundry v. Pub. Util. Comm.*, 114 Ohio St.3d 305, 2007-Ohio-4164; *Ohio Edison Co. v. Pub. Util. Comm.*, 78 Ohio St.3d 466, 678 N.E.2d 922 (1997). The record shows that the amounts recorded in the deferrals were AEP-Ohio’s calculation of fuel costs and nothing else. This factual determination was obvious and not disputed below.

² References to OCC’s appendix are denoted “OCC App. at ____;” references to OCC’s supplement are denoted “OCC Supp. at ____;” and references to appellee’s appendix attached hereto are denoted “App. at ____.”

³ There is a dispute about what the actual per ton price of coal was during the period but no dispute about whether something other than fuel was included in the account.

Rather than disputing the facts, the Ohio Consumers' Counsel ("OCC") looks at the situation differently. It reasons that, had the POLR charge not have been imposed, a legal impossibility, there would never have been charges over the cap and, hence, no fuel costs would have been deferred. As will be shown in Proposition of Law III, this is legally meaningless. But for now it is sufficient to observe that OCC's analysis is contractual. The charges were what they were and the amounts recorded as the regulatory asset for deferred fuel costs were AEP-Ohio's estimate⁴ of deferred fuel costs and nothing else.

In sum, the Commission recognized the deferred fuel costs for what they were, deferred fuel costs. This determination should be affirmed.

Proposition of Law No. II:

Where the Commission authorizes a phase-in of rates in an electric security plan it must establish regulatory assets equal to the amount not collected plus carrying charges and authorize collection of those amounts through a nonbypassable charge and it has done so. R.C. 4928.144.

As discussed above, the Commission established a phase-in of AEP-Ohio's fuel charges pursuant to R.C. 4928.144. The Commission must follow the terms of that section. The statute is prescriptive. It provides:

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 authoriz-

⁴ As noted before, another issue in this case is whether those amounts reflect the correct price for coal but this POLR matter is extraneous to that question. The price of coal has no relationship to any POLR cost.

ing 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.

R.C. 4928.144. The Commission must create regulatory assets, it must provide carrying charges on the deferrals, and it must create a nonbypassable charge to collect both. These are not options. The Commission complied with these requirements. It stated:

In the ESP 1 Order, the Commission directed AEP-Ohio, pursuant to Section 4928.144, Revised Code, to phase-in a portion of the rate increase authorized over an established percentage for each year of the ESP, in order to mitigate the impact of the rate increase for customers. The Commission authorized AEP-Ohio to establish a regulatory asset to record and defer fuel expenses with carrying costs, at the weighted average cost of capital (WACC), with recovery through a nonbypassable surcharge to commence in 2012 and continue through 2018.

In re AEP-Ohio Fuel Cost Rider (Finding and Order at 1-2) (August 1, 2012), OCC App. at 560-561; see also *Id.* (Fifth Entry on Rehearing at 1, ¶ 2) (October 3, 2012), OCC App. at 506. Thus the Commission did exactly what it was obligated to do under the statute.⁵

OCC misunderstands the fundamental situation. There are two kinds of deferrals that are permitted, traditional and R.C. 4928.144. They are not the same.

Under the Commission's traditional accounting authority, R.C. 4905.13, it has established deferrals for many years. The purpose of these traditional deferrals is to

⁵ The statute does not mean that the Commission must pass through *anything* that the company records in the account. The Commission must still review the amounts recorded for their reasonableness and did so in this case. Adjustment mechanisms which are included in the original structure of the rate are permissible without violating retroactive ratemaking. *Lucas Cty. Comm'rs v. Pub. Util. Comm.*, 80 Ohio St.3d 344, 348, 686 N.E.2d 501 (1997).

record expenses for potential rate recovery in a later case. When the traditional deferral is established there is no determination made that any of the amounts to be deferred are properly recoverable. Indeed, the purpose of creating the traditional deferral is to preserve exactly that question for later decision rather than to make that determination at the time. OCC cites many instances of this. While these are accurate, they have no bearing on this case.

What is involved in this case is the other sort of deferral, one under R.C. 4928.144. A salient difference⁶ between the two types of deferrals is that when the Commission establishes the phase-in it *does determine* that the type of cost to be deferred *is* recoverable. This is clear from the statute which provides:

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.

R.C. 4928.144. Before the Commission can phase-in a rate, there must be a rate. The Commission must decide that the company is entitled to be paid for a particular thing. In this instance the Commission did so. It decided that AEP-Ohio was entitled to be paid for fuel costs, the Commission did not allow *all* the fuel costs to be collected immediately.⁷ The portion not collected immediately was deferred as R.C. 4928.144 allows.

⁶ There are others as noted above.

⁷ It likewise reserved the ability to review the amounts recorded.

The question of whether fuel costs should be recovered is closed. They should be recovered.⁸ This does leave the residual question of what the amount of those fuel costs should be. The Commission addressed this question and it is an area of disagreement between the Commission and AEP-Ohio. But this is a proper matter for discussion under the statute.

OCC however wants something different. It wants this Court to direct the Commission to adjust the fuel costs based on an unrelated matter: historic POLR charges. The statute does not allow this.

As noted previously, when the Commission orders a R.C. 4928.144 phase-in, it *must* establish a regulatory asset, provide carrying charges, and create a nonbypassable charge to collect both. The statute says nothing about adjusting the amount of the deferrals for extraneous matters and, therefore, the Commission cannot do so. But it can, and indeed must, review the amounts recorded to assure that they correctly reflect the type of cost that the Commission has authorized. The Commission cannot now determine that, although it previously decided that fuel costs were an item that should be recovered from customers, fuel costs are no longer recoverable because of some concern unrelated to fuel cost. OCC seeks a result that is not permitted by the statute.

OCC makes multiple references to adjustments that the Commission has ordered in fuel adjustment cases. Of course the Commission has done so. Making fuel cost

⁸ Indeed, the properly accrued phase-in costs *must* be allowed recovery even if there is a procedural flaw in the Commission's phase-in order. *Columbus S. Power Co. v. Pub. Util. Comm.*, 67 Ohio St.3d 535, 620 N.E.2d 835 (1993).

adjustments is the purpose of fuel adjustment cases. The problem is that OCC wants to do something else entirely. It wants to make a POLR adjustment in a fuel case. The purpose of the fuel case is to determine the actual cost of fuel, which is the type of cost that the Commission previously determined should be recovered. This has nothing whatever to do with POLR charges. OCC wishes to insert an entirely extraneous issue. This is improper and the Commission rightly refused to do it.

Even if trading one rate for another was not barred by R.C. 4928.144, it would be barred by this Court's jurisprudence. This Court has found that the Commission has no power to order a refund of a rate that has expired. *Lucas Cty. Comm'rs v. Pub. Util. Comm.*, 80 Ohio St.3d 344, 348, 686 N.E.2d 501 (1997). The POLR rate to which OCC objects no longer exists. Therefore no adjustment is possible as there is no POLR rate to adjust.

OCC misunderstands R.C. 4928.144 in another way as well. It argues that the Commission must find rates to be "just and reasonable" before it orders a phase-in under that section. That is not what the statute says. The relevant portion of the statute is:

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.

R.C. 4928.144 (emphasis added). It is the *phase-in* that must be just and reasonable, not the rate that is being phased-in. This is a simple matter of grammar. "Just and reasonable" modifies "phase-in" not "rate or price." The standard to be applied to the

rates themselves is that they must be part of an overall electric security plan which "...is more favorable in the aggregate as compared to the expected results that would otherwise apply under..." a market rate option. R.C. 4928.143(C)(1). The requirement that OCC imagines is not statutory and should, therefore, be ignored.

Both statute and precedent support the Commission's decision and it should be affirmed.

Proposition of Law No. III:

Where a rate has already been collected pursuant to a charge which no longer exists the Commission may not order a refund. *Lucas Cty. Comm'rs v. Pub. Util. Comm.*, 80 Ohio St.3d 344, 686 N.E.2d 501 (1997).

Fundamentally, what OCC and IEU-Ohio (collectively "Cross-Appellants") are asking this Court to do is rewrite history. That power does not exist. The history has been stated several times but it will be presented here again for clarity.

The Commission initially authorized AEP-Ohio to impose a number of charges in the ESP 1 case. These included a fuel charge and a POLR charge. The Commission was concerned that the total amount of the increases authorized would be so large as to pose a hardship for customers. It therefore imposed a cap on the total amount of the increase authorized that could be currently charged. To the extent that fuel costs would have taken the total amounts that would otherwise have been charged to customers above this cap, the extra fuel cost⁹ incurred by AEP-Ohio, but not charged to customers, was to be

⁹ Not all the fuel costs exceeded the cap. Some were collected currently.

deferred pursuant to R.C. 4928.144. The decision was taken to this Court and this Court found, among other things, that there was insufficient evidence to support the POLR charge and remanded the matter back to the Commission for further proceedings. *See In re Columbus S. Power*, 128 Ohio St.3d 512, 2011-Ohio-1788. When the Commission took the matter up on remand, it determined that the POLR charge could continue to be collected during the pendency of the remand proceeding but that money would be collected subject to refund if the Commission so ordered. Ultimately, the Commission issued a decision that agreed with the Court, finding that the POLR charge was not justified.

At that point the Commission did two things. It ordered the POLR charges which had been collected subject to refund to be given back to customers and it terminated future collections of the POLR charge. The refunds have occurred. At this point in time the POLR matter is closed. The POLR charge no longer exists and the refunds ordered have been completed. There is nothing more that can be done.

But the Cross-Appellants want more. Because this Court found the POLR charge unsubstantiated and the Commission ultimately found it unjustified, the Cross-Appellants want this Court to reach back and take the money paid under the POLR charge back. Because this cannot be done directly they want it done indirectly. They want the Court to take the fuel costs to which the company is entitled, but for which it has not yet been paid, and credit them against the POLR charges already paid. This would impermissibly re-write the history of this matter.

As the Court is well-aware, Commission orders are valid until replaced by new orders. *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.*, 46 Ohio St.2d 105, 346 N.E.2d 778 (1976). A utility may charge only the rates established by the Commission. R.C. 4905.32. AEP-Ohio did nothing wrong by charging the POLR rate ordered by the Commission. Indeed it could do nothing else. Where a rate has been charged and collected, there is no ability to obtain a refund, in the absence of a statute providing therefor, of those amounts collected even where the rate is subsequently found invalid. *KECO Industries Inc. v. Cincinnati & Suburban Bell Tel. Co.*, 166 Ohio St. 254, 141 N.E.2d 465 (1957).

This does not mean that customers are without recourse to obtain a refund of amounts collected during the pendency of an appeal. Cross-Appellants can seek a stay of the Commission order setting the rate. R.C. 4903.16. By posting a bond and convincing this Court that a stay is warranted, an appellant can avoid whatever charge the Commission has ordered while the Court considers the matter.

Although Cross-Appellants took an appeal from the Commission decision authorizing the POLR charge, they did not seek or obtain a stay under R.C. 4903.16. Instead they ask the Court to judicially create what the General Assembly legislatively has not—a way to bypass the stay requirement.

The real objection here is not with fuel costs but rather with an entirely different matter, POLR charges. These charges no longer exist. This Court has seen a similar situation in the past.

In *Lucas Cty., supra*, the Commission had established a pilot program which was intended to result in lower natural gas rates for customers. The pilot program had not performed as hoped and had resulted in higher costs for customers. The program was allowed to expire at the end of its term as a result. Later, a complaint was filed by the Lucas County Commissioners seeking an order which would pay back the effected customers the difference between what they had paid and what the rates would have been had there been no pilot program. The Commission denied the complaint and this Court affirmed stating:

The WNA program had been discontinued when the county filed its complaint pursuant to R.C. 4905.26. Therefore, as correctly found by the commission, 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, were the commission to order either a refund or a credit, 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*.

Lucas Cty. Comm'rs, 80 Ohio St. 3d at 348. This is exactly what OCC is seeking in this case. It is asking that future fuel cost collections be balanced against past POLR collections. But the POLR is gone. There is nothing to credit against. To do as OCC asks is, as the Court recognized, retroactive ratemaking and barred by statute.

Strangely, OCC cites to *Columbus S. Power v. Pub. Util. Comm.* 67 Ohio St. 3d 535, 620 N.E.2d 835 (1993) to support its position. The case, only relevant by analogy, stands for just the opposite result.

First, it should be noted that *Columbus S. Power* was decided under R.C. 4909.15, the traditional ratemaking statute. The case at issue here arose from an electric security plan decision under R.C. 4928.143. Chapter 4909 does not apply. The case is only instructive by analogy and the analogy points to the opposite conclusion from that suggested by OCC.

In *Columbus S. Power*, the Commission had determined a revenue requirement for the utility but ordered that revenue requirement phased-in over a period of time. This is to say, the Commission set rates which did not recover the entire revenue requirement immediately and deferred the additional amounts for later collection. On review, this Court determined that the Commission had no power to order a phase-in under R.C. 4909.15¹⁰ and that new rates should be established to collect the full amount of the approved revenue requirement going forward. In addition, the Court considered what to do about the amounts that had been deferred pursuant to the Commission's order prior to the Court's decision. This Court reasoned that those amounts had been found to be appropriate for recovery and the utility was therefore entitled to recover them. It reasoned that *KECO* did not apply because the Commission had already determined that recovery of those amounts was appropriate. Essentially, once the Commission decides that *something* is recoverable, that *thing* must be recovered. In the case below the Commission determined that a *type of cost* should be recoverable (leaving the actual computation of the amount to the true-up case). Reasoning by analogy, one should con-

¹⁰ This was prior to the enactment of R.C. 4928.144.

clude that the type of cost identified as recoverable, fuel costs, should therefore be recovered. This is in opposition to what OCC seeks. OCC would bar recovery of the category of fuel costs that the Commission previously approved for recovery to offset something entirely different, POLR charges from the past. *Columbus S. Power* militates against OCC's position.

Once the Commission has determined that a category of costs is recoverable, that category should be recovered. That is what the Commission has ordered as regards fuel costs here and its order should be affirmed.

Proposition of Law No. IV:

In all contested cases heard by the Commission, a complete record of all of the proceedings shall be made, including a transcript of all testimony and of all exhibits, and 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. R.C. 4903.09.

The Commission is obligated to explain the bases of its decisions. R.C. 4903.09. It has done so here. OCC claims that the Commission did not provide such a basis for its refusal to allow collection of the previously deferred amounts through rates *subject to refund*. The claim is nonsense. The Commission was presented with exactly the same argument that is presented here. *In re AEP-Ohio Fuel Cost Rider* (Finding and Order at 12, ¶ 22) (August 1, 2012), OCC App. at 571. The Commission clearly rejected the argument, reasoning:

Additionally, for 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.

Id. at 20, ¶ 35, OCC App. at 579. Thus it is quite clear that the Commission believed that a refund would be illegal. Making rates subject to an illegal refund would be irrational and the Commission, properly, refused to do so. Further the Commission referred to its earlier analysis in its ESP remand decision. That discussion is:

The Commission finds that the proposed adjustment to the FAC deferral balance, as recommended by OCC, OP&E, and IEU-Ohio, would be tantamount to unlawful retroactive rate-making. 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. 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. Although OCC, OP&E, 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.

In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan, Case Nos. 08-917-EL-SSO, et al. (Order on Remand at 35-36) (October 3, 2011), OCC App. at 179-180. The Commission could not be clearer than this. To refund these amounts would violate this Court's precedent. Setting rates subject to an illegal refund cannot be reasonable. The Commission has explained itself as the law requires. Its order should be affirmed.

Proposition of Law No. V:

R.C. 4928.144 does not require the Commission to adjust the deferral balances for accumulated deferred income taxes.

The Commission was not required by R.C. 4928.144 to make an adjustment for accumulated deferred income taxes ("ADIT") when it approved, with modifications, AEP-Ohio's application to recover deferred fuel costs via a phase-in recovery rider ("PIRR"). ADIT results from timing differences attributable to the recognition of revenue or expenses for regulatory accounting purposes versus income tax reporting purposes. *See Babbit v. Pub. Util. Comm.*, 59 Ohio St.2d 81, 84, 391 N.E.2d 1376 (1979). The dispute here centers on fuel expenses. For income tax reporting purposes, a utility will deduct its fuel expenses as they are incurred. Regulatory accounting principles, on the other hand, permit the utility to defer its fuel expenses for future recovery (this is what happened here). The resulting difference in the amount of fuel expenses reported for income tax purposes versus regulatory accounting purposes is referred to as ADIT.

At the outset, it is important to note that R.C. 4928.144 contains no express directive to the Commission about how to account for the effects of ADIT. Indeed, as the Commission found, the statute makes no reference to tax effects at all. *In re AEP-Ohio Fuel Cost Rider* (Fifth Entry on Rehearing at 8) (October 3, 2012), OCC App. at 513.

R.C. 4928.144 provides that the Commission may by order:

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. * * * 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 * * * .

The omission from R.C. 4928.144 about tax effects is a persuasive indicator that the General Assembly intended to grant the Commission broad discretion on whether to adjust the deferral balances for ADIT. “When a statute does not prescribe a particular formula, the PUCO is vested with broad discretion.” *Payphone Assn. v. Pub. Util. Comm.*, 109 Ohio St.3d 453, 2006-Ohio-2988, ¶ 25. *See also In re Columbus S. Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788, ¶ 68 (“Any lack of statutory guidance on that point should be read as a grant of discretion.”). The Court defers to the Commission on discretionary decisions. *See In re Columbus S. Power Co.*, 129 Ohio St.3d 46, 2011-Ohio-2383, ¶ 27. Unless the complainant can show an abuse of discretion, the Commission’s decision must be upheld. *Id.* at ¶ 28. IEU-Ohio cannot overcome this deferential standard of review.

The propriety of adjusting the deferral balances for the effects of ADIT was initially raised during the ESP 1 proceedings. There, as here, the Commission refused to take the effects of ADIT into account. The Commission noted that an adjustment for the effects of ADIT would, in contravention of R.C. 4928.144, preclude AEP-Ohio from recovering its actual fuel expenses. *In re AEP-Ohio Fuel Cost Rider* (Fifth Entry on Rehearing at 8) (October 3, 2012), OCC App. at 513. The Commission's resolution of the ADIT issue was also informed by the testimony of AEP-Ohio witness Assante, who explained the differences between traditional base rate proceedings and standard service offer proceedings. *ESP 1*, Tr. IV at 157-160, App. at 22-25. Whereas base rate proceedings are cost-based, and thus reflect the effects of ADIT in the utility's cost of capital, Assante observed that the generation component of a standard service offer is not cost-based, which therefore makes it "inappropriate" to account for the effects of ADIT. *Id.* *See also* (Finding and Order) (August 1, 2012), OCC App. at 569 (citing to Assante testimony).

While other parties took a contrary view on the ADIT issue, the Court has "consistently refused to substitute [its] judgment for that of the commission on evidentiary matters." *Cincinnati Bell Tel. Co. v. Pub. Util. Comm.*, 92 Ohio St.3d 177, 179, 749 N.E.2d 262 (2001). Moreover, the Court defers to the Commission's judgment "when the record supports either of two opposing positions." *Id.* at 180. Put simply, there was "sufficient record evidence" to support the Commission's refusal to account for the effects of ADIT in the ESP 1 proceeding. *Stephens v. Pub. Util. Comm.*, 102 Ohio St.3d 44, 2004-Ohio-1798, ¶ 16.

The Commission was equally justified in adhering to its decision on ADIT in these proceedings. Here, the Commission referred to its decision from the ESP 1 proceedings and explained that it had not been persuaded to take a different approach on the issue of ADIT. *In re AEP-Ohio Fuel Cost Rider* (Fifth Entry on Rehearing at 7-8) (October 3, 2012), OCC App. at 512-513. The Commission reiterated that ordering an adjustment for the effects of ADIT would, in contravention of R.C. 4928.144, preclude AEP-Ohio from recovering its actual fuel expenses. *Id.* at 8, OCC App. at 513, OCC App. at 513. Additionally, the Commission observed that its approach did not violate sound regulatory practice. *Id.*, OCC App. at 513. By adhering to the same position on ADIT across both proceedings, the Commission honored the Court’s instruction to “respect its own precedents in its decisions to assure the predictability which is essential in all areas of the law, including administrative law.” *In re Columbus S. Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788, ¶ 52 (quoting *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.*, 42 Ohio St.2d 403, 431, 330 N.E.2d 1 (1975)).

The reasoning from above is not altered by R.C. 4928.144’s requirement that the deferrals be created “pursuant to generally accepted accounting principles * * * .” IEU-Ohio argues that the Commission strayed from generally accepted accounting principles (“GAAP”) by not adjusting the deferral balances to account for ADIT. But this is mistaken. The flaw with this argument is that R.C. 4928.144 does not dictate to the Commission how it should calculate the deferral balance. IEU-Ohio confuses what should be done on the front-end (the calculation of what the deferral balance should be) with what should be done on the back-end (how AEP-Ohio carries the deferrals on its books). As

the Commission explained, “[we] believe[] that the question of whether ADIT should be reflected in the calculation of the carrying charges to be included in the PIRR is a matter separate and apart from how AEP-Ohio maintains its books pursuant to GAAP.” *In re AEP Fuel Cost Rider* (Fifth Entry on Rehearing at 8) (October 3, 2012), OCC App. at 513. This is exactly right.

The Commission is given broad authority under R.C. 4905.13 to “establish a system of accounts for public utilities and to prescribe the manner in which the accounts must be kept.” *Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St.3d 305, 2007-Ohio-4164, ¶ 18. The Court has observed that it “generally will not interfere with the accounting practices set by the commission.” *Id.* (quoting *Consumers’ Counsel v. Pub. Util. Comm.*, 32 Ohio St.3d 263, 271, 513 N.E.2d 243 (1987)). This deferential approach to the Commission’s accounting practices should apply here.

The interpretive guidance on specialized industry GAAP explains that “the regulatory process can result in the accounting recognition of an asset that would not otherwise be recognized by a commercial enterprise.” Joanne M. Flood, *Wiley GAAP 2013: Interpretation and Application of Generally Accepted Accounting Principles*, 1189 (2013); App. at 29. This is another way of saying that a “regulatory asset”¹¹ is an

¹¹ R.C. 4928.01(A)(26) defines “regulatory assets” as “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 convention that is unique to the regulatory world. In order for there to be accounting recognition of this regulatory asset, however, it must be “probable” that the costs will be recoverable by the utility in the future. *Id.* If recovery is “probable,” then the utility’s “costs can be capitalized even though a nonregulated enterprise would be required to expense these costs currently.” *Id.* Thus, when R.C. 4928.144 says that the Commission must provide for the creation of a regulatory asset pursuant to GAAP, it is speaking in terms of ensuring the probability of future recovery for AEP-Ohio’s deferred fuel costs, not in terms of ADIT. And here, there is not just a probability of future recovery, there is a virtual certainty of recovery via the nonbypassable charge authorized by R.C. 4928.144. The requirement in R.C. 4928.144 that GAAP be followed has been met.

IEU-Ohio’s invocation of state policy objectives works no better. While R.C. 4928.02(A) provides that it is the policy of this state to “[e]nsure * * * reasonably priced electric service,” this does not mean that the Commission is required to make adjustments for ADIT. The policy declaration embodied in R.C. 4928.02(A) says nothing about tax effects, let alone ADIT. The Court has confronted similar policy-based arguments in the past and held that, while declarations of policy serve as “guidelines” for the Commission to weigh when evaluating competing proposals, it is up to the Commission to determine

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.”

how best to carry out these policies. *In re Columbus S. Power Co.*, 2011-Ohio-1788, ¶ 62.

Nevertheless, the Commission's decision is congruent with state policy. In the ESP 1 order that created the deferrals, the Commission ordered AEP-Ohio to "phase-in any increase authorized over an established percentage for each year of the ESP as a means to mitigate the impact of the rate increase for customers." *In re AEP Fuel Cost Rider* (Finding and Order at 17) (August 1, 2012), OCC App. at 576. Further, the Commission rejected AEP-Ohio's request to set carrying charges at the WACC rate once collection of the deferrals commences. The Commission instead set the carrying charges at a lower rate, the long-term debt rate, to protect ratepayers "during this period of lingering economic recession." *Id.* at 18, OCC App. at 577. Finally, the Commission ordered the deferral balances to be compounded annually, rather than monthly as requested by AEP-Ohio. *Id.* at 19, OCC App. at 578. All of this works in favor of ratepayers and ensures reasonably priced electric services in conformity with R.C. 4928.02(A). The Commission's decision furthers state policy goals.

Lastly, it bears mentioning that the Commission's ESP 1 decision was appealed to this Court in 2011. *See In re Columbus S. Power Co.*, 2011-Ohio-1788. The Court addressed a host of areas, including reversal on the issues of whether AEP-Ohio should have been permitted to recover its POLR charges and environmental carrying costs. *Id.* at ¶ 29, 35. Importantly, however, none of the issues addressed by the Court concerned the Commission's refusal to make an adjustment for the effects of ADIT. This ought to have settled the matter—IEU-Ohio's thirteenth hour attempt to raise a stale issue should

not be countenanced by this Court. *See Consumers' Counsel v. Pub. Util. Comm.*, 16 Ohio St.3d 9, 10, 475 N.E.2d 782 (1985) (“In the interest of affording finality to the decisions of administrative bodies which are left unchallenged, we hereby determine that OCC lost its only opportunity to challenge the [issue] when it failed to appeal or to request a rehearing of the previous order.”).

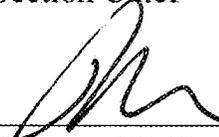
CONCLUSION

The Commission's orders correctly applied the law, are supported by the facts, and should be affirmed. The Commission properly implemented a phase-in pursuant to R.C. 4928.144, correctly refused to make an illegal retroactive adjustment, and acted within its discretion by declining to adjust the deferral balances to account for ADIT.

Respectfully submitted,

Michael DeWine (0009181)
Ohio Attorney General

William L. Wright (0018010)
Section Chief



Thomas W. McNamee (0017352)
Counsel of Record

Ryan P. O'Rourke (0082651)
Assistant Attorneys General
Public Utilities Section
180 East Broad Street, 6th Fl
Columbus, OH 43215-3793
614.466.4397 (telephone)
614.644.8764 (fax)
thomas.mcnamee@puc.state.oh.us
ryan.orourke@puc.state.oh.us

**Counsel for Appellee,
The Public Utilities Commission of Ohio**

PROOF OF SERVICE

I hereby certify that a true copy of the foregoing Third Merit Brief, submitted on behalf of appellee, the Public Utilities Commission of Ohio, was served by regular U.S. mail, postage prepaid, or hand-delivered, upon the following parties of record, this 7th day of June, 2013.



Thomas W. McNamee
Assistant Attorney General

Parties of Record:

Bruce J. Weston
Ohio Consumers' Counsel
Terry L. Etter
Maureen R. Grady
Assistant Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, OH 43215-3485

Frank P. Darr
Joseph E. Olikier
Matthew R. Pritchard
McNees Wallace & Nurick
21 East State Street, 17th Floor
Columbus, OH 43215

Mark A. Whitt
Andrew J. Campbell
Whitt Sturtevant
The KeyBank Building
88 East Broad Street, Suite 1590
Columbus, OH 43215

Matthew J. Satterwhite
Steven T. Nourse
American Electric Power Corporation
1 Riverside Plaza, 29th Floor
Columbus, OH 43215

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

APPENDIX

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4903.09 Written opinions filed by commission in all contested cases.

In all contested cases heard by the public utilities commission, a complete record of all of the proceedings shall be made, including a transcript of all testimony and of all exhibits, and 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.

4903.16 Stay of execution.

A proceeding to reverse, vacate, or modify a final order rendered by the public utilities commission does not stay execution of such order unless the supreme court or a judge thereof in vacation, on application and three days' notice to the commission, allows such stay, in which event the appellant shall execute an undertaking, payable to the state in such a sum as the supreme court prescribes, with surety to the satisfaction of the clerk of the supreme court, conditioned for the prompt payment by the appellant of all damages caused by the delay in the enforcement of the order complained of, and for the repayment of all moneys paid by any person, firm, or corporation for transportation, transmission, produce, commodity, or service in excess of the charges fixed by the order complained of, in the event such order is sustained.

4905.13 System of accounts for public utilities.

The public utilities commission may establish a system of accounts to be kept by public utilities or railroads, including municipally owned or operated public utilities, or may classify said public utilities or railroads and establish a system of accounts for each class, and may prescribe the manner in which such accounts shall be kept. Such system shall, when practicable, conform to the system prescribed by the department of taxation. The commission may prescribe the forms of accounts, records, and memorandums to be kept by such public utilities or railroads, including the accounts, records, and memorandums of the movement of traffic as well as of the receipts and expenditure of moneys, and any other forms, records, and memorandums which are necessary to carry out Chapters 4901., 4903., 4905., 4907., 4909., 4921., and 4923. of the Revised Code. The system of accounts established by the commission and the forms of accounts, records, and memorandums prescribed by it shall not be inconsistent, in the case of corporations subject to the act of congress entitled "An act to regulate commerce" approved February 4, 1887, and the acts amendatory thereof and supplementary thereto, with the systems and forms established for such corporations by the interstate commerce commission. This section does not affect the power of the public utilities commission to prescribe forms of accounts, records, and memorandums covering information in addition to that required by the interstate commerce commission. The public utilities commission may, after hearing had upon its own motion or complaint, prescribe by order the accounts in which particular outlays and receipts shall be entered, charged, or credited. Where the public utilities commission has prescribed the forms of accounts, records, or memorandums to be kept by any public utility or railroad for any of its business, no such public utility or railroad shall keep any accounts, records, or memorandums for

such business other than those so prescribed, or those prescribed by or under the authority of any other state or of the United States, except such accounts, records, or memorandums as are explanatory of and supplemental to the accounts, records, or memorandums prescribed by the commission. The commission shall at all times have access to all accounts kept by such public utilities or railroads and may designate any of its officers or employees to inspect and examine any such accounts. The auditor or other chief accounting officer of any such public utility or railroad shall keep such accounts and make the reports provided for in sections 4905.14 and 4907.13 of the Revised Code. Any auditor or chief accounting officer who fails to comply with this section shall be subject to the penalty provided for in division (B) of section 4905.99 of the Revised Code. The attorney general shall enforce such section upon request of the public utilities commission by mandamus or other appropriate proceedings.

4905.32 Schedule rate collected.

No public utility shall charge, demand, exact, receive, or collect a different rate, rental, toll, or charge for any service rendered, or to be rendered, than that applicable to such service as specified in its schedule filed with the public utilities commission which is in effect at the time. No public utility shall refund or remit directly or indirectly, any rate, rental, toll, or charge so specified, or any part thereof, or extend to any person, firm, or corporation, any rule, regulation, privilege, or facility except such as are specified in such schedule and regularly and uniformly extended to all persons, firms, and corporations under like circumstances for like, or substantially similar, service.

4905.54 Compliance with orders.

Every public utility or railroad and every officer of a public utility or railroad shall comply with every order, direction, and requirement of the public utilities commission made under authority of this chapter and Chapters 4901., 4903., 4907., and 4909. of the Revised Code, so long as they remain in force. Except as otherwise specifically provided in section 4905.95 of the Revised Code, the public utilities commission may assess a forfeiture of not more than ten thousand dollars for each violation or failure against a public utility or railroad that violates a provision of those chapters or that after due notice fails to comply with an order, direction, or requirement of the commission that was officially promulgated. Each day's continuance of the violation or failure is a separate offense. All forfeitures collected under this section shall be credited to the general revenue fund.

4909.15 Fixation of reasonable rate.

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

(1) The valuation as of the date certain of the property of the public utility used and useful or, with respect to a natural gas, water-works, or sewage disposal system company, projected to be used and useful as of the date certain, in rendering the public utility service for which rates are to be fixed and determined. The valuation so determined shall be the total value as set forth in divi-

sion (C)(8) of section 4909.05 of the Revised Code, and a reasonable allowance for materials and supplies and cash working capital as determined by the commission.

The commission, in its discretion, may include in the valuation a reasonable allowance for construction work in progress but, in no event, may such an allowance be made by the commission until it has determined that the particular construction project is at least seventy-five per cent complete.

In determining the percentage completion of a particular construction project, the commission shall consider, among other relevant criteria, the per cent of time elapsed in construction; the per cent of construction funds, excluding allowance for funds used during construction, expended, or obligated to such construction funds budgeted where all such funds are adjusted to reflect current purchasing power; and any physical inspection performed by or on behalf of any party, including the commission's staff.

A reasonable allowance for construction work in progress shall not exceed ten per cent of the total valuation as stated in this division, not including such allowance for construction work in progress.

Where the commission permits an allowance for construction work in progress, the dollar value of the project or portion thereof included in the valuation as construction work in progress shall not be included in the valuation as plant in service until such time as the total revenue effect of the construction work in progress allowance is offset by the total revenue effect of the plant in service exclusion. Carrying charges calculated in a manner similar to allowance for funds used during construction shall accrue on that portion of the project in service but not reflected in rates as plant in service, and such accrued carrying charges shall be included in the valuation of the property at the conclusion of the offset period for purposes of division (C)(8) of section 4909.05 of the Revised Code.

From and after April 10, 1985, no allowance for construction work in progress as it relates to a particular construction project shall be reflected in rates for a period exceeding forty-eight consecutive months commencing on the date the initial rates reflecting such allowance become effective, except as otherwise provided in this division.

The applicable maximum period in rates for an allowance for construction work in progress as it relates to a particular construction project shall be tolled if, and to the extent, a delay in the in-service date of the project is caused by the action or inaction of any federal, state, county, or municipal agency having jurisdiction, where such action or inaction relates to a change in a rule, standard, or approval of such agency, and where such action or inaction is not the result of the failure of the utility to reasonably endeavor to comply with any rule, standard, or approval prior to such change.

In the event that such period expires before the project goes into service, the commission shall exclude, from the date of expiration, the allowance for the project as construction work in progress from rates, except that the commission may extend the expiration date up to twelve months for good cause shown.

In the event that a utility has permanently canceled, abandoned, or terminated construction of a project for which it was previously permitted a construction work in progress allowance, the commission immediately shall exclude the allowance for the project from the valuation.

In the event that a construction work in progress project previously included in the valuation is removed from the valuation pursuant to this division, any revenues collected by the utility from its customers after April 10, 1985, that resulted from such prior inclusion shall be offset against future revenues over the same period of time as the project was included in the valuation as construction work in progress. The total revenue effect of such offset shall not exceed the total revenues previously collected.

In no event shall the total revenue effect of any offset or offsets provided under division (A)(1) of this section exceed the total revenue effect of any construction work in progress allowance.

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

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

(4) The cost to the utility of rendering the public utility service for the test period used for the determination under division (C)(1) of this section, less the total of any interest on cash or credit refunds paid, pursuant to section 4909.42 of the Revised Code, by the utility during the test period.

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

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

under section 4905.30 of the Revised Code. As used in division (A)(4)(b) of this section, "compliance facility" has the same meaning as in section 5727.391 of the Revised Code.

(B) The commission shall compute the gross annual revenues to which the utility is entitled by adding the dollar amount of return under division (A)(3) of this section to the cost, for the test period used for the determination under division (C)(1) of this section, of rendering the public utility service under division (A)(4) of this section.

(C)

(1) Except as provided in division (D) of this section, the revenues and expenses of the utility shall be determined during a test period. The utility may propose a test period for this determination that is any twelve-month period beginning not more than six months prior to the date the application is filed and ending not more than nine months subsequent to that date. The test period for determining revenues and expenses of the utility shall be the test period proposed by the utility, unless otherwise ordered by the commission.

(2) The date certain shall be not later than the date of filing, except that it shall be, for a natural gas, water-works, or sewage disposal system company, not later than the end of the test period.

(D) A natural gas, water-works, or sewage disposal system company may propose adjustments to the revenues and expenses to be determined under division (C)(1) of this section for any changes that are, during the test period or the twelve-month period immediately following the test period, reasonably expected to occur. The natural gas, water-works, or sewage disposal system company shall identify and quantify, individually, any proposed adjustments. The commission shall incorporate the proposed adjustments into the determination if the adjustments are just and reasonable.

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

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

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

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

(b) But not including the portion of any periodic rental or use payments representing that cost of property that is included in the valuation report under divisions (C)(4) and (5) of section 4909.05 of the Revised Code, fix and determine the just and reasonable rate, fare, charge, toll, rental, or service to be rendered, charged, demanded, exacted, or collected for the performance or rendition of the service that will provide the public utility the allowable gross annual revenues under division (B) of this section, and order such just and reasonable rate, fare, charge, toll, rental, or service to be substituted for the existing one. After such determination and order no change in the rate, fare, toll, charge, rental, schedule, classification, or service shall be made, rendered, charged, demanded, exacted, or changed by such public utility without the order of the commission, and any other rate, fare, toll, charge, rental, classification, or service is prohibited.

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

4928.02 State policy.

It is the policy of this state to do the following throughout this state:

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

(B) Ensure the availability of unbundled and comparable retail electric service that provides consumers with the supplier, price, terms, conditions, and quality options they elect to meet their respective needs;

(C) Ensure diversity of electricity supplies and suppliers, by giving consumers effective choices over the selection of those supplies and suppliers and by encouraging the development of distributed and small generation facilities;

(D) 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, waste energy recovery systems, smart grid programs, and implementation of advanced metering infrastructure;

(E) Encourage cost-effective and efficient access to information regarding the operation of the transmission and distribution systems of electric utilities in order to promote both effective customer choice of retail electric service and the development of performance standards and targets

for service quality for all consumers, including annual achievement reports written in plain language;

(F) Ensure that an electric utility's transmission and distribution systems are available to a customer-generator or owner of distributed generation, so that the customer-generator or owner can market and deliver the electricity it produces;

(G) Recognize the continuing emergence of competitive electricity markets through the development and implementation of flexible regulatory treatment;

(H) Ensure effective competition in the provision of retail electric service by avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service or to a product or service other than retail electric service, and vice versa, including by prohibiting the recovery of any generation-related costs through distribution or transmission rates;

(I) Ensure retail electric service consumers protection against unreasonable sales practices, market deficiencies, and market power;

(J) Provide coherent, transparent means of giving appropriate incentives to technologies that can adapt successfully to potential environmental mandates;

(K) Encourage implementation of distributed generation across customer classes through regular review and updating of administrative rules governing critical issues such as, but not limited to, interconnection standards, standby charges, and net metering;

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

(M) Encourage the education of small business owners in this state regarding the use of, and encourage the use of, energy efficiency programs and alternative energy resources in their businesses;

(N) Facilitate the state's effectiveness in the global economy.

In carrying out this policy, the commission shall consider rules as they apply to the costs of electric distribution infrastructure, including, but not limited to, line extensions, for the purpose of development in this state.

4928.143 Application for approval of electric security plan - testing.

(A) For the purpose of complying with section 4928.141 of the Revised Code, an electric distribution utility may file an application for public utilities commission approval of an electric security plan as prescribed under division (B) of this section. The utility may file that application prior to the effective date of any rules the commission may adopt for the purpose of this

section, and, as the commission determines necessary, the utility immediately shall conform its filing to those rules upon their taking effect.

(B) Notwithstanding any other provision of Title XLIX of the Revised Code to the contrary except division (D) of this section, divisions (I), (J), and (K) of section 4928.20, division (E) of section 4928.64, and section 4928.69 of the Revised Code:

(1) An electric security plan shall include provisions relating to the supply and pricing of electric generation service. In addition, if the proposed electric security plan has a term longer than three years, it may include provisions in the plan to permit the commission to test the plan pursuant to division (E) of this section and any transitional conditions that should be adopted by the commission if the commission terminates the plan as authorized under that division.

(2) The plan may provide for or include, without limitation, any of the following:

(a) Automatic recovery of any of the following costs of the electric distribution utility, provided the cost is prudently incurred: the cost of fuel used to generate the electricity supplied under the offer; the cost of purchased power supplied under the offer, including the cost of energy and capacity, and including purchased power acquired from an affiliate; the cost of emission allowances; and the cost of federally mandated carbon or energy taxes;

(b) A reasonable allowance for construction work in progress for any of the electric distribution utility's cost of constructing an electric generating facility or for an environmental expenditure for any electric generating facility of the electric distribution utility, provided the cost is incurred or the expenditure occurs on or after January 1, 2009. Any such allowance shall be subject to the construction work in progress allowance limitations of division (A) of section 4909.15 of the Revised Code, except that the commission may authorize such an allowance upon the incurrence of the cost or occurrence of the expenditure. No such allowance for generating facility construction shall be authorized, however, unless the commission first determines in the proceeding that there is need for the facility based on resource planning projections submitted by the electric distribution utility. Further, no such allowance shall be authorized unless the facility's construction was sourced through a competitive bid process, regarding which process the commission may adopt rules. An allowance approved under division (B)(2)(b) of this section shall be established as a nonbypassable surcharge for the life of the facility.

(c) The establishment of a nonbypassable surcharge for the life of an electric generating facility that is owned or operated by the electric distribution utility, was sourced through a competitive bid process subject to any such rules as the commission adopts under division (B)(2)(b) of this section, and is newly used and useful on or after January 1, 2009, which surcharge shall cover all costs of the utility specified in the application, excluding costs recovered through a surcharge under division (B)(2)(b) of this section. However, no surcharge shall be authorized unless the commission first determines in the proceeding that there is need for the facility based on resource planning projections submitted by the electric distribution utility. Additionally, if a surcharge is authorized for a facility pursuant to plan approval under division (C) of this section and as a condition of the continuation of the surcharge, the electric distribution utility shall dedicate to Ohio consumers the capacity and energy and the rate associated with the cost of that facility. Before

the commission authorizes any surcharge pursuant to this division, it may consider, as applicable, the effects of any decommissioning, deratings, and retirements.

(d) Terms, conditions, or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service, default service, carrying costs, amortization periods, and accounting or deferrals, including future recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service;

(e) Automatic increases or decreases in any component of the standard service offer price;

(f) 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 rate-making, 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.

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.

** EXCERPT*

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

- - -

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

In the Matter of the :
 Application of Ohio Power :
 Company for Approval of :
 its Electric Security : Case No. 08-918-EL-SSO
 Plan; and an Amendment to :
 its Corporate Separation :
 Plan. :

- - -

PROCEEDINGS

before Ms. Kimberly W. Bojko and Ms. Greta See,
 Hearing Examiners, at the Public Utilities Commission
 of Ohio, 180 East Broad Street, Room 11-C, Columbus,
 Ohio, called at 9:00 a.m. on Thursday, November 20,
 2008.

- - -

VOLUME IV

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ARMSTRONG & OKEY, INC.
 185 South Fifth Street, Suite 101
 Columbus, Ohio 43215-5201
 (614) 224-9481 - (800) 223-9481
 Fax - (614) 224-5724

Armstrong & Okey, Inc. Columbus, Ohio 614-224-9481

1 APPEARANCES:

2 American Electric Power

3 By Mr. Marvin I. Resnik

4 Mr. Steven T. Nourse

5 One Riverside Plaza

6 Columbus, Ohio 43215-2373

7 Porter, Wright, Morris & Arthur, LLP

8 By Mr. Daniel R. Conway

9 41 South High Street

10 Columbus, Ohio 43215-6194

11 On behalf of Columbus Southern Power
12 and Ohio Power Company.

13 Janine L. Migden-Ostrander

14 Ohio Consumers' Counsel

15 By Ms. Maureen R. Grady

16 Mr. Terry L. Etter

17 Ms. Jacqueline Lake Roberts

18 Mr. Michael E. Idzkowski

19 Mr. Richard C. Reese

20 Assistant Consumers' Counsel

21 Ten West Broad Street, Suite 1800

22 Columbus, Ohio 43215-3485

23 On behalf of the Residential
24 Ratepayers of Columbus Southern Power
25 and Ohio Power Company.

Sherry Maxfield, First Assistant

Attorney General

Duane W. Luckey

Senior Deputy Attorney General

Public Utilities Section

By Mr. Werner L. Margard III

Mr. John H. Jones

Mr. Thomas G. Lindgren

Assistant Attorneys General

180 East Broad Street, 9th Floor

Columbus, Ohio 43215-3793

On behalf of the staff of the Public
Utilities Commission of Ohio.

1 APPEARANCES (Continued):

2 Mr. Richard L. Sites
3 General Counsel, Ohio Hospital Association
4 155 East Broad Street, Floor 15
5 Columbus, Ohio 43215-3620

6 Bricker & Eckler, LLP
7 By Mr. Thomas J. O'Brien
8 100 South Third Street
9 Columbus, Ohio 43215-4291

10 On behalf of the Ohio Hospital
11 Association.

12 Mr. Joseph V. Maskovyak
13 Mr. Michael R. Smalz
14 Ohio State Legal Services Association
15 555 Buttles Avenue
16 Columbus, Ohio 43215

17 On behalf of the Appalachian People's
18 Action Coalition.

19 McNees, Wallace & Nurick
20 By Mr. Samuel C. Randazzo
21 Ms. Lisa McAlister
22 Mr. Joseph M. Clark
23 Fifth Third Center, Suite 1700
24 21 East State Street
25 Columbus, Ohio 43215

On behalf of the Industrial Energy
Users of Ohio.

McDermott, Will & Emery
By Ms. Grace C. Wung
600 Thirteenth Street, NW
Washington, DC 20005-3096

On behalf of Wal-Mart Stores East, LP,
Macy's, Inc., Sam's East, Inc.

1 APPEARANCES (Continued):

2 Boehm, Kurtz & Lowry
3 By Mr. David Boehm
4 Mr. Michael Kurtz
5 36 East Seventh Street
6 Suite 1510
7 Cincinnati, Ohio 45202-4454

8 On behalf of the Ohio Energy Group.

9 Chester, Willcox & Saxbe, LLP
10 By Mr. John W. Bentine
11 Mr. Matthew S. White
12 Mr. Mark S. Yurick
13 65 East State Street
14 Columbus, Ohio 43215

15 On behalf of the Kroger Company.

16 Bell Royer, Co., LPA
17 Mr. Langdon D. Bell
18 33 South Grant Avenue
19 Columbus, Ohio 43215-3927

20 On behalf of the Ohio Manufacturers
21 Association.

22 Bell Royer, Co., LPA
23 Mr. Barth E. Royer
24 33 South Grant Avenue
25 Columbus, Ohio 43215-3927

On behalf of the Ohio Environmental
Council and Dominion Retail.

Schottenstein, Zox & Dunn
By Mr. Andre Porter
Mr. Christopher Miller
Mr. Gregory Dunn
250 West Street
Columbus, Ohio 43215-2538

On behalf of the Association of
Independent Colleges and Universities of
Ohio.

1 APPEARANCES (Continued):

2 Vorys, Sater, Seymour and Pease, LLP
3 By Mr. M. Howard Petricoff
4 Mr. Michael J. Settineri
5 Ms. Betsy L. Elder
6 52 East Gay Street
7 Columbus, Ohio 43216-1008

8 Mr. Bobby Singh
9 300 West Wilson Bridge Road
10 Worthington, Ohio 43085

11 On behalf of Integrys Energy.

12 Vorys, Sater, Seymour and Pease, LLP
13 By Mr. M. Howard Petricoff
14 Mr. Michael J. Settineri
15 Ms. Betsy L. Elder
16 52 East Gay Street
17 Columbus, Ohio 43216-1008

18 Ms. Cynthia Fonner
19 500 West Washington Boulevard
20 Chicago, Illinois 60661

21 On behalf of the Constellation NewEnergy
22 and Constellation Commodity Energy Group.

23 Vorys, Sater, Seymour and Pease, LLP
24 By Mr. M. Howard Petricoff
25 Mr. Michael J. Settineri
Ms. Betsy L. Elder
52 East Gay Street
Columbus, Ohio 43216-1008

On behalf of EnerNoc, Inc. and
Consumer Powerline.

Vorys, Sater, Seymour and Pease, LLP
By Mr. M. Howard Petricoff
Mr. Michael J. Settineri
Ms. Betsy L. Elder
52 East Gay Street
Columbus, Ohio 43216-1008

On behalf of the Ohio Association of
School Business Officials.

1 APPEARANCES (Continued):

2 Mr. David C. Rinebolt
3 Ms. Colleen Mooney
4 231 East Lima Street
5 P.O. Box 1793
6 Findlay, Ohio 45839-1793

7 On behalf of Ohio Partners for
8 Affordable Energy.

9 - - -

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11
12
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1 CROSS-EXAMINATION

2 By Ms. Wung:

3 Q. Good after, Mr. Assante.

4 A. Good afternoon.

5 Q. Grace Wung for the Commercial Group here.

6 I just have a couple of quick questions.

7 Can you turn to your Exhibit LVA-1 in
8 your direct testimony. Are you there?

9 A. Yes.

10 Q. Thank you. Is the deferred carrying
11 charge that you have listed in the line item there on
12 your chart based on assumed rate of return of
13 11.15 percent times the deferred fuel adjustment
14 clause balance?15 A. Yes. It's 11.15 percent times the
16 unrecovered regulatory asset balance, yes.17 Q. And the underrecovered regulatory asset
18 based on your chart, it's the line item directly
19 above the deferred carrying charge.20 A. Well, the cumulative -- the cumulative
21 regulatory balance is the last line of the regulatory
22 asset balance.

23 Q. Right.

24 A. Last line on the chart.

25 Q. Okay. Thank you. But that line item is

1 the correct fuel deferred adjustment for expense
2 where you have credit listed there, that's where the
3 fuel adjustment clause balance is shown on that
4 chart.

5 A. The deferred FAC expense line you are
6 referring to?

7 Q. Yes.

8 A. That does not include deferrals for
9 carrying costs and, again, as I pointed out earlier,
10 the carrying costs compounds.

11 Q. So in response to OCC's counsel you said
12 that would be -- there would be carrying charges on
13 top of the carrying SSO; is that correct?

14 A. If -- if we are owed carrying charges,
15 then we would -- as time goes on we would get the
16 carrying charge on what we are owed, yes.

17 Q. Thank you. Is it possible then,
18 Mr. Assante, that these fuel adjustment clause
19 expenses would be considered expense for income tax
20 purposes in the year they were incurred whether or
21 not they are fully recovered by fuel adjustment
22 clause revenues?

23 A. That's correct.

24 Q. And then would the deferral of the fuel
25 expense create a deferred income tax balance until

1 the fuel cost is recovered?

2 A. That's correct, yes.

3 Q. And would that deferred income tax
4 balance provide AEP with temporary income tax
5 savings?

6 A. It would reduce our income tax.

7 Q. Yes. So that would potentially be a
8 savings for AEP.

9 A. It would -- yes, it would generate a
10 lower income tax.

11 Q. Could then the temporary tax savings be
12 used to help finance the unrecovered fuel balance as
13 a net deferred tax offset to the deferred fuel
14 balance?

15 A. No. No, that's not correct. I think you
16 are getting confused with what happens when you have
17 a traditional cost of service filing, a traditional
18 cost of service filing, which this is not, and
19 especially this fuel area because we are talking
20 about generation. Generation is not cost based. In
21 that type of a filing the deferred tax is used in the
22 computation of the cost of capital return. And if a
23 rate base -- you reduce the rate base by your
24 deferred taxes and that has the effect of reflecting
25 cost -- cost-free capital from a deferred tax in

1 determining a cost of capital return.

2 This is not a cost of service filing, ESP
3 filing. We are not determining the return based on a
4 cost of capital rate base approach. We are
5 determining that return based on what the company
6 owns as adjusted for by the earnings test, the
7 excessive earnings test. That earnings test is not
8 based on the company's cost of capital but rather is
9 based on the return of the companies with similar
10 risks, the actual earned return of those companies so
11 it's inappropriate in my opinion to offset the cost
12 of money benefited deferred taxes in determining the
13 carrying cost.

14 When you buy a car from a car company,
15 from a car dealership, you don't compute the interest
16 after -- after his tax deduction. You compute the
17 tax on the balance owed. In this case what is owed
18 us is the FAC deferrals plus the carrying cost. So
19 it's inappropriate to do what you are suggesting.

20 Q. In your opinion it's inappropriate. Is
21 it for any tax accounting purposes inappropriate?

22 A. For what?

23 Q. For any tax accounting purposes
24 inappropriate?

25 A. It's inappropriate in the context of this

1 filing. It's irrelevant and inappropriate in my
2 opinion.

3 Q. And that's your opinion.

4 A. That would be other people's opinion as
5 well.

6 Q. Thank you.

7 MS. WUNG: Thank you, Mr. Assante. I
8 have no further questions.

9 EXAMINER SEE: Mr. Kurtz.

10 MR. KURTZ: Thank you, your Honor.

11 - - -

12 CROSS-EXAMINATION

13 By Mr. Kurtz:

14 Q. The accumulated deferred income tax
15 balance would typically be a rate base also in a --
16 in a fully regulated environment?

17 A. In a cost-of-service filing, yes.

18 Q. And that's what would occur in the other
19 states where AEP operates?

20 A. Well, we are not subject to cost of
21 service in every state. Texas, for example, has also
22 gone through a restructuring, but in most of our
23 other states we are subject to cost-of-service
24 ratemaking, yes.

25 Q. Let me clarify. When I say AEP, I mean

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2013

Interpretation and Application of
GENERALLY ACCEPTED
ACCOUNTING PRINCIPLES

Joanne M. Flood



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agreement determine the contribution that will be made by the employer or participant into each account. Defined contribution health and welfare plans do not report information about benefit obligations because a plan's obligation is limited to the amounts accumulated in the participants' accounts.

Government Regulations

Pursuant to the requirements of ERISA, the federal government oversees the operating and reporting practices of employee benefit plans. ERISA establishes minimum standards for participation, vesting, and funding. It defines the responsibilities of plan fiduciaries and standards for their conduct. It requires plans to annually report summarized plan information to plan participants.

The Department of Labor (DOL) and the Internal Revenue Service (IRS) are authorized to issue regulations establishing reporting and disclosure requirements for employee benefit plans that are subject to ERISA. Each year, plans are required to report certain information to the DOL, the IRS, and the Pension Benefit Guaranty Corporation (if applicable). For many plans, the information is reported using Form 5500, which includes financial statements prepared in conformity with GAAP and additional supplementary financial schedules.

Various provisions of the Internal Revenue Code apply to employee benefit plans. If an employee benefit plan qualifies under Section §401(a) of the Code, certain favorable tax treatments apply. For example, if a plan is qualified, the plan sponsor receives current deductions for contributions to the plan, and the plan participants do not pay income taxes on those contributions or the accumulated earnings on them until benefits are distributed to them. In addition, plan participants may receive favorable tax treatment on the distributions. Qualified plans are exempt from income taxes, except for taxes on unrelated business income. Nonqualified plans, which generally provide benefits selectively only to a few key employees, are not entitled to those favorable treatments.

Terminating Plans

If a decision has been made to terminate a plan, the plan is a terminating plan, even if another plan will replace the terminated plan. A terminating plan may continue to operate for as long as necessary to pay accrued benefits. Prominent disclosure of the relevant circumstances is necessary in all financial statements issued by the plan after the decision to terminate is made. Financial statements of a terminating plan are prepared on the liquidation basis of accounting for plan years ending after the termination decision. For plan assets, the change to the liquidation basis may have little or no effect, since many assets are already reported at current fair value. However, the liquidation basis for accumulated plan benefits (defined benefit pension plans) and benefit obligations (defined benefit health and welfare plans) may differ from the actuarial present value of benefits for an ongoing plan. For example, certain or all benefits may become vested upon plan termination.

REGULATED OPERATIONS

PERSPECTIVE AND ISSUES

Although various businesses are subject to regulatory oversight to greater or lesser degrees, as used in GAAP the term regulated operations refers primarily to public utilities, whose ability to set selling prices for the goods or services they offer is constrained by government actions. Generally, the regulatory process has been designed to permit such enter-

prises to recover the costs they incur, plus a reasonable rate of return to stockholders. However, given the political process of rate-setting by regulatory authorities, and the fact that costs such as those for plant construction have escalated, the ability to recover all costs through rate increases has become less certain. For this and other reasons, specialized GAAP has been promulgated.

Major Topics and Subtopics in the
Financial Accounting Standards Board (FASB) Accounting Standards Codification

Liabilities	Liabilities—Asset Retirement and Environmental Obligations
410-20	
Industry	Regulated Operations
980	Regulated Operations—Deferred Costs and Other Assets
980-340	Regulated Operations—Revenue Recognition
980-605	Regulated Operations—Compensation-Retirement Benefits
980-715	

CONCEPTS, RULES, AND EXAMPLES

These accounting principles apply to regulated enterprises only if they continue to meet certain criteria, which relate to the intended ability to recover all costs through the rate-setting process. When and if these conditions are no longer met, due to deregulation or a shift to rate-setting which is not based on cost recovery, then application of the specialized GAAP is to terminate.

Asset Recognition

If certain costs are not recognized for current rate-setting purposes, but it is probable that the costs will be recovered through future revenue, then these costs can be capitalized even though a nonregulated enterprise would be required to expense these costs currently. Deferred costs can include an imputed cost of equity capital, if so accounted for rate-setting purposes, even though this would not normally be permitted under GAAP. Thus, the regulatory process can result in the accounting recognition of an asset that would not otherwise be recognized by a commercial enterprise. If at any time it becomes apparent that the incurred cost will not be recovered through generation of future revenue, that cost is to be charged to expense. If a regulator subsequently excludes specific costs from allowable costs, the carrying value of the asset recognized is to be reduced to the extent of the excluded costs. Should the regulator allow recovery of these previously excluded costs or any additional costs, a new asset is to be recognized and classified as if these costs had been initially included in allowable costs.

Imposition of Liabilities

In other situations, the regulatory process can result in the accounting recognition of a liability. This usually occurs when regulators mandate that refunds be paid to customers, which must be accrued when probable and reasonably estimable, per ASC 450, *Contingencies*. Furthermore, regulatory rates may be set at a higher level, in order to recover costs expected to be incurred in the future, subject to the caveat that such amounts will be refunded to customers if it later becomes apparent that actual costs incurred were less than expected. In such cases, the incremental rate increase related to recovery of future costs must be accounted for as a liability (unearned revenue), until the condition specified is satisfied. Finally, regulators may stipulate that a gain realized by the utility will be returned to customers over a specified future period; this will be accounted for by accrual of a liability rather than by recognition of the gain for accounting purposes.