

ORIGINAL

IN THE SUPREME COURT OF OHIO

OHIO POWER COMPANY,)	Supreme Court Case No. 2012-2008
)	
Appellant/Cross-Appellee)	Appeal from the Public Utilities
)	Commission of Ohio
v.)	
)	
THE PUBLIC UTILITIES COMMISSION)	
OF OHIO,)	
)	PUCO Case Nos. 11-4920-EL-RDR and
Appellee)	11-4921-EL-RDR

FOURTH MERIT BRIEF OF
 APPELLEE/CROSS-APPELLANT INDUSTRIAL ENERGY USERS-OHIO

Samuel C. Randazzo (Reg. No. 0016386)
 (Counsel of Record)
Frank P. Darr (Reg. No. 0025469)
Joseph E. Olikar (Reg. No. 0086088)
Matthew R. Pritchard (Reg. No. 0088070)
 McNees Wallace & Nurick LLC
 21 East State Street, 17th Floor
 Columbus, OH 43215
 Telephone: (614) 469-8000
 Facsimile: (614) 469-4653
 sam@mwncmh.com
 fdarr@mwncmh.com
 joliker@mwncmh.com
 mpritchard@mwncmh.com

**COUNSEL FOR APPELLEE/CROSS-
 APPELLANT, INDUSTRIAL ENERGY
 USERS-OHIO**

Michael DeWine (Reg. No. 0009181)
 Attorney General of Ohio

William L. Wright (Reg. No. 0018010)
 Section Chief, Public Utilities Section
 (Counsel of Record)
Werner L. Margard III
 (Reg. No. 0024858)
Thomas W. McNamee (Reg. No. 0017352)
Ryan P. O'Rourke (Reg. No. 0082651)
 Assistant Attorneys General
 Public Utilities Commission of Ohio
 180 East Broad Street -- 6th Floor
 Columbus, OH 43215
 Telephone: (614) 466-4397
 Facsimile: (614) 644-8764
 william.wright@puc.state.oh.us
 werner.margard@puc.state.oh.us
 thomas.mcnamee@puc.state.oh.us
 ryan.orourke@puc.state.oh.us

**COUNSEL FOR APPELLEE,
 PUBLIC UTILITIES COMMISSION OF
 OHIO**

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 JUL 01 2013
 CLERK OF COURT
 SUPREME COURT OF OHIO

Matthew J. Satterwhite (Reg. No. 0071972)
(Counsel of Record)

Steven T. Nourse (Reg. No. 0046705)
American Electric Power Corporation
1 Riverside Plaza, 29th Floor
Columbus, OH 43215
Telephone: (614) 716-1915
Facsimile: (614) 716-2950
mjsatterwhite@aep.com
stnourse@aep.com

Daniel R. Conway (Reg. No. 0023058)

Kathleen M. Trafford (Reg. No. 0021753)
Porter Right Morris & Arthur LLP
41 S. High Street
Columbus, OH 43215
Telephone: (614) 227-1015
Facsimile: (614) 227-1000
dconway@porterwright.com
ktrafford@porterwright.com

**COUNSEL FOR APPELLANT/CROSS
APPELLEE, OHIO POWER
COMPANY**

Mark A. Whitt (Reg. No. 067996)
(Counsel of Record)

Andrew J. Campbell (Reg. No. 0081485)
Whitt Sturtevant
The KeyBank Building
88 East Broad Street, Suite 1590
Columbus, OH 43215
Telephone: (614) 224-3911
Facsimile: (614) 224-3960
whit@whitt-sturtevant.com
campbell@whitt-sturtevant.com

**COUNSEL FOR AMICUS CURIAE,
THE EAST OHIO GAS COMPANY
D/B/A DOMINION EAST OHIO**

Bruce J. Weston (Reg. No. 0016973)
Ohio Consumers' Counsel

Terry L. Etter (Reg. No. 0067445)
(Counsel of Record)

Maureen R. Grady (Reg. No. 0020847)
Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, OH 43215
Telephone: (614) 466-7964
Facsimile: (614) 466-9475
etter@occ.state.oh.us
grady@occ.state.oh.us

**COUNSEL FOR APPELLEE/CROSS
APPELLANT, OFFICE OF THE OHIO
CONSUMERS' COUNSEL**

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REPLY OF CROSS-APPELLANT INDUSTRIAL ENERGY USERS-OHIO

INTRODUCTION

In the proceeding below, the Public Utilities Commission of Ohio (“Commission”) authorized Ohio Power Company (“OPCo”) and Columbus Southern Power Company¹ (“CSP”) (collectively, “AEP-Ohio”) to establish a non-bypassable phase-in recovery rider (“PIRR”) to collect the portion of the higher total revenue amount that was authorized by the Commission but delayed for future collection in their first electric security plans (“ESP”).² The Commission’s Order (the “PIRR Order”) was unlawful and unreasonable in two respects. Embedded in the higher total revenue and the portion of such revenue delayed for future collection through non-bypassable charges are amounts that the Supreme Court of Ohio (“Court”) and the Commission have found were not legally includable in rates. In the PIRR Order, the Commission unreasonably and unlawfully refused to remove the illegally authorized revenue from the revenue delayed for future collection. In addition, the PIRR Order unreasonably and unlawfully authorized AEP-Ohio to inflate the revenue, the collection of which was delayed to the future, by an excessive carrying charge or interest component. The interest component allowed by the Commission was excessive, based on the evidence, the Commission’s precedent, and regulatory practices and principles, because the approved carrying charge methodology omitted the tax-related positive cash benefit available to AEP-Ohio.

¹ OPCo and CSP have merged.

² The Commission, in the same order, approved separate but nearly identical ESPs for CSP and OPCo. For purposes of this Merit Brief, Industrial Energy Users-Ohio (“IEU-Ohio”) refers collectively to CSP’s and OPCo’s ESPs as the AEP-Ohio ESP. Although CSP’s and OPCo’s ESPs produced separate delayed increases, this Merit Brief refers to the delayed increases collectively as the delayed increase or deferral balance.

LAW AND ARGUMENT

- 1. The Commission's Finding and Order is unlawful and unreasonable because the Finding and Order failed to reduce the phase-in deferral balance, that customers will pay, to account for the flow-through effects of the remand of the electric security plan**

On March 18, 2009, the Commission authorized AEP-Ohio to establish an ESP ("ESP I"). AEP-Ohio Appendix ("Appx.") at 83-159 (hereinafter "ESP I Order"). The ESP I Order authorized AEP-Ohio to establish Provider of Last Resort ("POLR") charges as well as the recovery of carrying costs of environmental investments made by AEP-Ohio from 2001 to 2008 that had not been previously included in rates (Pre-2009 Component). The Commission ordered AEP-Ohio to phase-in any authorized increase so as not to exceed, on a total bill basis, certain percentage increase levels for each of the three years of the ESP. Thus, the ESP I Order authorized AEP-Ohio to collect a total revenue amount, part of which was collectable during the three-year term of the ESP and part of which (the phase-in deferral portion) was delayed for future collection in an amount to be determined by the Commission.³ AEP-Ohio Appx. at 102-106.

The Court subsequently reversed the ESP I Order and directed the Commission to determine whether the POLR charges and Pre-2009 Component could be lawfully authorized as part of an ESP. *In re Application of Ohio Power Company*, 128 Ohio St.3d 512 (2011). In the remand proceeding, parties submitted testimony regarding these two issues and IEU-Ohio also submitted the testimony of Joseph Bowser stating that the portion of the increase eligible for future collection must be restated to account for the flow-through effects of the remand: "[t]o the extent the amount of revenue collected by the [AEP-Ohio] during the ESP period was based on

³ The ESP I Order made it clear that the ultimate amount of revenue which AEP-Ohio might collect in the future was something that was not resolved by the ESP I Order. AEP-Ohio Appx. at 97, 104-05.

items that [were] not properly includable in an ESP, the amount of revenue deferred for future collection has been overstated." IEU-Ohio Appx. at 418. To address the overstatement of the delayed collection revenue component, Mr. Bowser recommended that the Commission "reduce the total authorized revenue by the amounts not properly collectible as part of an ESP, and subtract the amount actually collected from the adjusted ESP total to determine how much, if any, of the authorized revenue is properly deferred for future collection." *Id.*

In the Order on Remand, the Commission determined that AEP-Ohio had failed to demonstrate that the POLR charges could be lawfully approved but that the Pre-2009 Component was supported by the record evidence. IEU-Ohio Appx. at 378-79 & 393-94. Additionally, the Commission denied IEU-Ohio's request to require AEP-Ohio to account for the flow-through effects of the remand, concluding that IEU-Ohio's requested relief was tantamount to retroactive ratemaking. IEU-Ohio Appx. at 400-01. After the Commission denied IEU-Ohio's Application for Rehearing, IEU-Ohio filed an appeal in Case No. 2012-0187. IEU-Ohio Appx. at 214-17.

During the pendency of IEU-Ohio's appeal, the Commission approved, in the PIRR Order, AEP-Ohio's request to commence collection of the delayed revenue component, which included the unlawfully authorized Pre-2009 Component and POLR charges. To ensure that a favorable determination in Case No. 2012-0187 does not result in a pyrrhic victory, IEU-Ohio reasserted, in this appeal, its claim that the Commission failed to account for the flow-through effects of the remand of AEP-Ohio's ESP. IEU-Ohio's reassertion of this claim here is designed to ensure that the benefit consumers should receive from a favorable decision by the Court in Case No. 2012-0187 is not denied or otherwise eroded by operation of the PIRR Order.

IEU-Ohio's Merit Brief will not completely rehash positions that have been fully briefed in Case No. 2012-0187. Rather, this Merit Brief addresses limited portions of the Commission's and AEP-Ohio's Merit Briefs. More specifically, this Merit Brief addresses:

- (1) The Commission's and AEP-Ohio's claim that accounting for the flow-through effects of the remand would constitute retroactive ratemaking, a claim premised upon the factual assertion that the revenue delayed for future collection pursuant to the Commission's phase-in authority is for fuel costs "as a matter of fact." Commission Merit Brief at 3-15.
- (2) The Commission's claim that the delayed revenue amount subject to collection from customers may be restated only to account for fuel cost disallowances. Commission Brief at 8-10.
- (3) The Commission's and AEP-Ohio's claim that the POLR charges and the Pre-2009 Component have already been collected from consumers. Commission Merit Brief at 11-12; AEP-Ohio Merit Brief at 28-32.

The Commission's and AEP-Ohio's claims work to deprive consumers of a meaningful remedy⁴ for the illegally authorized charges and are otherwise meritless.

Contrary to the Commission's claim (Commission Merit Brief at 3-4), IEU-Ohio has consistently contested the assertion that the portion of the revenue increase delayed for future collection is for fuel costs. As discussed above, the ESP I Order authorized AEP-Ohio to collect a total revenue amount, part of which was collected during the term of the ESP and part of which was delayed for collection in the future. AEP-Ohio Appx. at 102-106. As IEU-Ohio identified in its Application for Rehearing, the determination of the portion of the revenue delayed for

⁴ AEP-Ohio's efforts to block access to any meaningful remedy are, perhaps, understandable. The Commission's strained efforts to foreclose a meaningful remedy are, however, difficult to understand given the duties of this governmental agency. In any event Article I, Section 15 of Ohio's Constitution confirms that due process requires that there be a remedy for an injury.

future collection was identified by “a residual calculation, which was impacted by the unlawful *ESP I* provider of last resort charges (“POLR”) and 2001-2008 environmental investment carrying charges.” IEU-Ohio Appx. at 27. And, the residual amount of the total authorized revenue not collected during the ESP period was subject to further review and adjustment by the Commission. AEP-Ohio Appx. at 97. Thus, the residually calculated amount of revenue delayed for future collection in accordance with subsequent determinations by the Commission included the revenue effect of the unlawfully authorized POLR charges and Pre-2009 Component. Without the illegally authorized POLR charges, the residually determined revenue delayed for future collection would have been substantially less.

Even assuming that the magnitude of the revenue increase delayed for future collection was not subject to adjustment by the terms of the ESP I Order, the Commission’s claim that the amount of the revenue increase delayed for future collection can only be adjusted for fuel-related disallowances is directly in conflict with several Commission decisions.

In a July 29, 2009 Finding and Order, the Commission granted IEU-Ohio's Application for Rehearing and revoked authorization for AEP-Ohio to collect revenue associated with the Waterford and Darby generating facilities. IEU-Ohio Appx. at 468. Prior to the July 29, 2009 Finding and Order, AEP-Ohio collected the Waterford and Darby amount through rates initially authorized by the Commission. As a result of this revocation, the Commission directed AEP-Ohio to reconcile its revenue collection by removing the Waterford and Darby amount. More specifically, the Commission directed AEP-Ohio to reduce the magnitude of the revenue increase delayed for future collection by \$22 million. IEU-Ohio Appx. at 468. AEP-Ohio subsequently and unsuccessfully appealed the Commission’s disallowance and reconciliation. *In re Application of Columbus Southern Power Company*, 128 Ohio St.3d 402 (2011). Also, the

Commission directed AEP-Ohio to reduce the revenue increase delayed for future collection to account for \$41 million in significantly excessive earnings that were realized in 2009 as a result of the ESP I increase. *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.*, Case No. 10-1261-EL-UNC, Opinion and Order at 36-37 (Jan. 11, 2011) (IEU-Ohio Appx. at 464-465). By force of the Commission's own determinations, retroactive ratemaking is not a bar to reducing the revenue increase delayed for future collection by amounts that were unlawfully included in the Commission's specification of the total revenue increase authorized in the ESP I Order. And, as the Commission's decisions well show, the magnitude of the revenue increase delayed for future collection was subject to downward adjustments for much more than fuel-related disallowances.

Additionally, the Commission's Merit Brief concedes that the accounting associated with the establishment of the revenue increase subject to future collection does **not** generally raise retroactivity concerns. Commission Merit Brief at 6-7; *See Elyria Foundry Co. v. Pub. Util. Comm'n*, 114 Ohio St. 3d 305, 308-09 (2007) (holding that authorization of a deferral is independent of the decision to permit recovery in rates). Nonetheless, the Commission claims that delayed revenue collection authorized under R.C. 4928.144 is, somehow, "special". The remainder of its argument on this point, however, shows that all the Commission is really claiming is that the POLR charges and Pre-2009 Component were collected from customers and that the revenue increase delayed for future collection, contrary to what the Commission's adjustments discussed above would allow, is for fuel expense. Commission Merit Brief at 8-15. Thus, the "special deferral" argument is nothing more than a continuation of the Commission's

incorrect assertion that the illegally authorized amounts have already been collected from customers.

The Commission's claim that delayed revenue collection pursuant to R.C. 4928.144 is "special", is also not supported by that section. The section limits the Commission's authority to the approval of a phase-in that is "just and reasonable." It would be neither "just" nor "reasonable" for the Commission to authorize the collection of the revenue increase delayed for future collection without reconciliation to remove that portion of the delayed revenue that accumulated because of amounts unlawfully included in the total authorized revenue.

The Commission for the first time in either this proceeding or Case No. 2012-0187 argues that the just and reasonableness of the phase-in is only relevant to the initial order authorizing the phase-in, claiming that "[i]t is the *phase-in* that must be just and reasonable, not the rate that is being phased-in." Commission Merit Brief at 9. The Commission's strained and post-hoc justification cannot be raised at this very late date. The Court can only review the orders below and the reasoning provided therein. R.C. 4903.13 (on appeal, the Court reviews the lawfulness of the order from the proceeding below). Regardless, the Commission's claim has no merit and is inconsistent with the PIRR Order.

The PIRR Order stated "AEP-Ohio's ESP, including the phase-in plan, is subject to the ongoing supervision and jurisdiction of the Commission." AEP-Ohio Appx. at 26. And, the Commission directed AEP-Ohio to accrue interest or carrying charges at a reduced "debt rate" during the amortization period (the "Recovery Period") because "the Commission agrees with Staff and intervenors that it is **unreasonable** for a WACC rate to be imposed on the deferral balance after collection begins particularly during this period of lingering economic recession." *Id* (emphasis added). Thus, the Commission itself has determined that the creation **and**

implementation of a phase-in authorized pursuant to R. C. 4928.144 must be just and reasonable. The Commission invoked the requirement that the implementation of the phase-in must be reasonable when it directed AEP-Ohio to reduce the carrying charge rate to reflect a long-term debt rate (rather than the higher weighted-average-cost-of-capital or “WACC” rate) during the Recovery Period. The Commission’s selective and inconsistent application of the requirement that the phase-in be just and reasonable—within the same order—undermines the Commission’s strained and post-hoc attempt to legitimize its unlawful determination.

Also, the Commission’s use of its phase-in authority to effectively deprive consumers of a remedy for the illegally authorized portion of the total revenue increase which is subject to delayed collection through the phase-in mechanism is itself unjust and unreasonable. Following the Commission’s and AEP-Ohio’s reasoning, the Commission could illegally authorize the collection of revenue, delay the collection of the illegally authorized revenue through the application of the phase-in authority in R.C. 4928.144 and then claim that the revenue delayed for future collection cannot be modified or adjusted to remedy the illegality. The Court should not indulge the Commission’s and AEP-Ohio’s efforts to transform the consumer-oriented purpose of R.C. 4928.144 into a tool that is applied to deprive consumers of a meaningful remedy for illegally authorized charges.

- 2. The Commission’s Finding and Order is unlawful and unreasonable because the Commission failed to require AEP-Ohio to calculate carrying charges on the phase-in deferral balance through a method that recognizes the accumulated deferred income taxes (“ADIT”) benefit available to AEP-Ohio; the Commission’s failure to reduce the deferral balance in recognition of the ADIT benefit, for purposes of determining carrying charges, violated state policy, the Commission’s precedent, and sound regulatory practices and principles**

A carrying charge is an interest component that allows a utility to obtain compensation for a delay in the collection of revenue authorized by the Commission. *See* IEU-Ohio Supp.

“Supp.”) at 14-15 (Revised Comments and Recommendations Submitted on Behalf of the Staff of the Public Utilities Commission of Ohio); IEU-Ohio Supp. at 58 (containing an excerpt from the audit of AEP-Ohio’s 2010 Fuel Adjustment Clause); IEU-Ohio Appx. at 53-54 (Testimony of Joseph G. Bowser). Essentially, this compensation allowance recognizes the time value of money.

When a utility is authorized to utilize deferral accounting for regulatory purposes, the utility delays recognition of an expense (the recognition is deferred). However, in some cases, the expense is nonetheless recognized when incurred for purposes of tax accounting. IEU-Ohio Appx. at 53-54; Commission Merit Brief at 17. The tax accounting results in an immediate reduction to the utility’s federal income tax. *Id.* The tax benefit is known as ADIT, and it effectively provides a source of interest-free cash to the utility. *Id.*

To elaborate, when an expense is recognized for purposes of tax accounting but not for regulatory accounting, the income tax that otherwise would be paid by the utility is reduced, effectively creating a benefit in the form of more available cash. That benefit is equal to the difference between the income tax the company would pay if the recognized expense were the same for regulatory and tax accounting, and the income tax the company will pay as a result of the expense being recognized for tax accounting but not for regulatory accounting. Generally accepted accounting principles (“GAAP”) require that the tax impacts of differences between regulatory and tax accounting (timing differences) be recognized on a utility’s books as ADIT. IEU-Ohio Appx. at 491.

In the ESP I Order, and as explained above, the Commission authorized AEP-Ohio to collect a total revenue amount that was increased by the ESP I Order. Part of the revenue was collectible during the ESP period and part of the revenue was delayed for future collection in an

amount to be determined by the Commission. On the one hand, there is a time value of money (carrying cost) associated with the Commission authorizing a delay in the collection of revenue under the phase-in. But, on the other hand, there is a benefit that results from the phase-in deferral in the form of reduced income tax; the benefit increases the amount of cash available to AEP-Ohio. IEU-Ohio Appx. at 53-54 (Testimony of Joseph G. Bowser). For example, for every \$100 that was delayed for future collection, AEP-Ohio received a \$35 immediate tax benefit (assuming a 35% statutory federal income tax rate) due to the timing difference between tax and regulatory accounting. *Id.* The ADIT tax benefit increased AEP-Ohio's cash flow by \$35. Effectively, this tax-related improved cash flow position is like accessing a portion of the delayed revenue immediately.

The Commission acknowledges that the phase-in deferral (and AEP-Ohio does not dispute) made more cash available to AEP-Ohio by reducing AEP-Ohio's federal income tax obligation. Commission Brief at 17. But, the Commission ignored the increased cash flow when it established a carrying cost methodology to compensate AEP-Ohio for the time value associated with the delayed revenue collection. In its appeal, IEU-Ohio asks the Court to hold that the Commission's refusal to reflect the ADIT benefit in the carrying charge computation is unreasonable and unlawful. State policy requiring that customers have access to reasonably priced electricity, the Commission's precedent, and sound regulatory practices and principles all lead to the same answer—the carrying cost methodology must reflect the ADIT benefit.

Rather than addressing the substantive unreasonableness of overcompensating AEP-Ohio for the time value of money, the Commission's Merit Brief claims that the Commission has unfettered discretion to deny consumers the relief they deserve. Commission Merit Brief at 18-23. AEP-Ohio's Merit Brief claims that issues pertaining to ADIT were “decided in the *ESP I*

Order and [are] not properly before this Court at this time in this case.” AEP-Ohio Merit Brief at 25. Also, AEP-Ohio claims that “IEU asserts error by the Commission for a fact that was not even under review in the underlying proceeding.” AEP-Ohio Merit Brief at 24. AEP-Ohio and the Commission are wrong on all counts.

As the Commission noted in the PIRR Order, the ESP I Order established the manner in which AEP-Ohio would collect carrying charges during the ESP period (the “Deferral Period”). But the Commission provided that AEP-Ohio would file (and AEP-Ohio did file) a subsequent application to establish a carrying charge methodology for the Recovery Period. More specifically, the Commission stated that, the “order also contemplated that the Company would file a separate application to establish a recovery mechanism, which the Company in fact filed in these cases on September 1, 2011, and is presently the subject of our review.” AEP-Ohio Appx. at 26. Thus, The ESP I Order established the manner in which AEP-Ohio established carrying charge terms during the Deferral Period, and the PIRR Order established the manner in which AEP-Ohio calculated carrying charges during the Recovery Period. Contrary to AEP-Ohio’s claim that the ADIT issue was not under review in the PIRR Order, the Commission clearly addressed the issue but determined that “intervenors and Staff have not persuaded the Commission.” AEP-Ohio Appx. at 27.

To avoid addressing IEU-Ohio’s appeal on the merits, the Commission claims that it should be given broad deference because “R.C. 4928.144 contains no express directive to the Commission about how to account for the effects of ADIT.” Commission Merit Brief at 18. And the Commission claims that “[t]he 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.” *Id.* The Commission claims that IEU-Ohio cannot demonstrate that the Commission abused its discretion. *Id.*

The Commission’s Merit Brief ignores the clear limitations upon its authority contained in R.C. 4928.144, and the Commission’s determination is inconsistent with state policy contained in R.C. 4928.02, Commission precedent, and regulatory practices and principles.

As discussed above, the purpose of a carrying charge is to compensate AEP-Ohio for the time value of money associated with delayed revenue collection. A portion of the delayed revenue is already available to AEP-Ohio in the form of an ADIT tax benefit (cash). Failure to account for the ADIT tax benefit effectively authorizes AEP-Ohio to accrue carrying charges on cash that is already available to AEP-Ohio. The Commission’s authorization of AEP-Ohio to accrue carrying charges on cash that is already available to AEP-Ohio violated the requirements contained in R.C. 4928.144 that the phase-in be just and reasonable.

The Commission’s Merit Brief places much emphasis on the claim that GAAP does not specifically require carrying charges to be calculated on a phase-in deferred balance reduced by ADIT. The Commission, however, does not deny that GAAP requires AEP-Ohio to identify and account for the ADIT benefit on its books. IEU-Ohio Appx. at 491 (Accounting Standards Codification 740-10-25-2b).

And, once the tax-related cash flow increase has been identified—as required by GAAP—regulatory practices and principles, and sixty years of precedent hold that the utility must reflect the ADIT benefit in customer rates and charges. *Cleveland Electric v. Pub. Util. Comm’n*, 12 Ohio St.3d 320, 323 (1984); *Ohio Bell Tel. v. Pub. Util. Comm’n*, 68 Ohio St.2d 193, 194 (1981); *Cincinnati Gas and Electric v. Pub. Util. Comm’n*, 173 Ohio St. 473, 473-476 (1962); *see also Cincinnati v. Pub. Util. Comm’n*, 161 Ohio St. 395, 405-06 (1954).

Neither the Commission, nor AEP-Ohio, dispute that precedent requires utility rates to include a downward adjustment for tax benefits. Indeed, the Commission concedes that in a base rate proceeding, a utility must “reflect the effects of ADIT in the utility’s cost of capital.”

Commission Merit Brief at 19. Rather than addressing the precedent identified in IEU-Ohio’s Merit Brief, the Commission asserts two arguments. The Commission claims that it is adhering to the precedent established in AEP-Ohio’s first ESP. And, the Commission claims that, “[w]hereas 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.” Commission Merit Brief at 19-20. The Commission’s arguments lack merit.

The Commission’s claim that it is not appropriate to reflect the ADIT benefit in the carrying cost methodology because the phase-in deferral balance is related to the generation service component is a red herring and an attempt to mischaracterize the issue before the Court. Any ADIT benefit—regardless of its origin—provides a source of cash to the utility. Regardless of the source of the deferral (generation, transmission, or distribution), fairness requires the carrying cost methodology to reflect the ADIT benefit.

Moreover, the Commission’s ESP I Order determination to permit AEP-Ohio to accrue carrying charges during the Deferral Period without reflecting the ADIT benefit is an outlier that cannot be held out as precedent. Commission and Court precedent before the PIRR Order/ESP I Order and the Commission’s precedent after the PIRR Order all conclude that utilities must reflect tax benefits in their rates and charges. Indeed, within one week after issuing the PIRR Order in this proceeding, the Commission determined in AEP-Ohio’s second ESP that the ADIT benefit must be reflected in rates, stating:

We agree with Staff and Kroger that the DIR mechanism be revised to account for ADIT. The Commission finds that it is not appropriate to establish the DIR rate mechanism in a manner which provides the Company with the benefit of ratepayer supplied funds. Any benefit resulting from ADIT should be reflected in the DIR revenue requirement. Therefore, the Commission directs AEP-Ohio to adjust its DIR to reflect the ADIT offset. (IEU-Ohio Appx. at 132) (hereinafter "ESP II Order").

The Commission's Merit Brief fails to mention the ESP II Order. Yet, the Commission has clearly embraced the concept that utilities must reflect tax benefits in rates and charges. Thus, the PIRR Order stands on an island in a sea of cases that require utilities to reflect tax benefits in rates and charges. The Court has admonished the Commission for violating its precedent.

Cleveland Elec. Illum. Co. v. Pub. Util. Comm'n, 42 Ohio St. 2d 403, 431 (1975).

AEP-Ohio, while failing to address past precedent, argues that the ESP II Order is distinguishable because the:

DIR is a distribution rider with a specific purpose that is not comparable to the PIRR. The DIR seeks recovery for distribution items both already invested and still being developed under an investment plan filed with the Commission over a shorter period of time. The PIRR, in contrast, involves recovery of deferred fuel costs and associated carrying costs, not investment in the distribution system. The DIR also was part of an overall package approved by the Commission in the latest ESP proceeding, while the deferrals captured by the PIRR are a statutory requirement triggered by the Commission's exercise of its right to phase-in fuel elements of the electric security plan it authorized in a completely different case. (AEP-Ohio Merit Brief at 26).

AEP-Ohio's claim that it makes a difference that the PIRR is related to fuel expense (a contested claim) is without merit. As discussed above, the source of the ADIT benefit is irrelevant—any ADIT benefit provides a source of cash to AEP-Ohio. AEP-Ohio's claim that the Distribution Investment Rider ("DIR") was "part of an overall package approved by the Commission in the latest ESP proceeding" is absurd. AEP-Ohio Merit Brief at 26. Both the phase-in and the DIR originated in ESP proceedings. Moreover, AEP-Ohio contested the ADIT offset to the DIR in

the ESP proceeding. IEU-Ohio Appx. at 130-131. If the DIR was part of a “package”, AEP-Ohio contested its contents.

For the first time in this case, the Commission and AEP-Ohio offer a response to IEU-Ohio’s claim that failing to reflect the ADIT benefit in the carrying cost methodology is a violation of the state policy requirement that the Commission ensure that customers have access to reasonably priced electricity. Although IEU-Ohio raised this argument in its Application for Rehearing, the Commission failed to address the argument in either the PIRR Order or in the Entry on Rehearing. The Commission now claims that the state policy “says nothing about tax effects, let alone ADIT” and that state policy is only a guideline to weigh when evaluating competing proposals. Commission Merit Brief at 22. Also, the Commission claims that the phase-in initially authorized in the ESP I Order furthered state policy by mitigating the impact of the revenue increase authorized by the Commission. AEP-Ohio asserts a similar argument. AEP-Ohio Merit Brief at 25-26. The Commission also claims the PIRR Order advances state policy by directing AEP-Ohio to accrue carrying charges during the Recovery Period at a long-term debt rate. Commission Merit Brief at 23.

The Commission’s post-hoc attempts to shore up the PIRR Order lack merit. R.C. 4928.02(A) requires the Commission to ensure that customers have access to reasonably priced electricity, and R.C. 4928.06 requires the Commission to effectuate the state policy contained in R.C. 4928.02. It is irrelevant that R.C. 4928.02(A) does not mention tax effects. Although the ESP I Order delayed a portion of the total authorized revenue for future collection, AEP-Ohio had access to a portion of the delayed revenue immediately in the form of the ADIT tax benefit. It is inherently unreasonable that the Commission authorized AEP-Ohio to inflate the revenue

delayed for future collection by accruing interest on the portion of the delayed revenue that was already available to AEP-Ohio.

The Commission's claim that it only had an obligation to further state policy in the initial order that authorized the phase-in (ESP I Order) is incorrect. The Commission bifurcated its review of the phase-in. The ESP I Order addressed the Deferral Period, whereas the PIRR Order addressed the Recovery Period. Therefore, the Commission's determination in the ESP I Order that the phase-in promoted state policy, which related to a separate period of time, is irrelevant to whether the Commission's authorization of a carrying cost methodology in the Recovery Period promotes state policy.

Moreover, the Commission's directive that AEP-Ohio accrue carrying charges at a debt rate during the Recovery Period does not change the fact that the Commission authorized AEP-Ohio to apply the carrying charge rate to the portion of the phase-in deferral balance that was effectively already available to AEP-Ohio. Although a debt rate is the appropriate interest rate,⁵ the debt rate should be applied to the phase-in deferral balance after it has been reduced for the effects of the ADIT benefit.

Lastly, it is worth mentioning that the Commission appears to have retreated from its initial reasoning for refusing to direct AEP-Ohio to reflect the ADIT benefit in the carrying cost methodology. In the PIRR Order, the Commission stated that "carrying charges on the deferrals should be calculated without an adjustment for ADIT in order *to ensure that AEP-Ohio recovers its actual fuel expenses*, as required by Section 4928.144, Revised Code." AEP-Ohio Appx. at 27 (emphasis added). While the Commission's Merit Brief (at 20) and AEP-Ohio's Merit Brief

⁵ The 5.34% debt rate authorized by the Commission, however, does not reflect current market rates. IEU-Ohio Appx. at 50. As identified by IEU-Ohio witness Joseph Bowser, a more accurate debt rate would be 3.6%. IEU-Ohio Appx. at 50-51.

(at 25) note that the PIRR Order concluded that reflecting the ADIT benefit in the carrying cost methodology would prevent AEP-Ohio from recovering its actual expenses, neither the Commission's nor AEP-Ohio's Merit Briefs rely upon this justification as a basis to uphold the PIRR Order. IEU-Ohio's Merit Brief demonstrated that such a position is untenable. IEU-Ohio Merit Brief at 29-30. Calculating carrying charges on revenue delayed for future collection with a reduction for the effects of ADIT benefit does not prevent AEP-Ohio from recovering all of the revenue delayed for future collection. Reflecting the ADIT benefit in the carrying cost methodology merely impacts the amount of *carrying costs* that accrue on the principal that is deferred for future collection—the ADIT benefit adjustment has zero effect on the principal that AEP-Ohio will ultimately collect. *Id.*

CONCLUSION

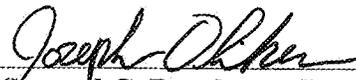
The ESP I Order authorized a total revenue increase for AEP-Ohio's ESP. A portion of the increase was subject to collection during the term of the ESP, and a portion of the increase was delayed for future collection. Because the Pre-2009 Component and POLR charge cannot be lawfully included in the total revenue authorized by the Commission, the portion of that total revenue that the Commission has allowed AEP-Ohio to collect through the PIRR is unreasonably and unlawfully overstated. Should the Court grant IEU-Ohio's appeal in Case No. 2012-0187, the Court must reverse and remand this case to account for the flow-through effects of the remand of AEP-Ohio's ESP.

In addition to unlawfully and unreasonably overstating the portion of the total revenue delayed for future collection, the PIRR Order unlawfully and unreasonably authorized AEP-Ohio to inflate such delayed amount by an excessive interest or carrying charge allowance. The interest or carrying charge allowance was excessive because it ignored the ADIT benefit

available to AEP-Ohio, a benefit which the Commission has previously recognized for purposes of making such carrying charge computations. The Commission's decision in this respect violated regulatory practices and principles, precedent, and, last but not least, common sense.

Therefore, IEU-Ohio respectfully requests that the Court deny AEP-Ohio's appeal and grant IEU-Ohio's cross-appeal. The Court should reverse and remand this case with the instruction that the Commission direct AEP-Ohio to accrue carrying charges on the deferred balance adjusted for ADIT and to account for the flow-through effects of the remand of AEP-Ohio's ESP.

Respectfully submitted



Samuel C. Randazzo (Reg. No. 0016386)

(Counsel of Record)

Frank P. Darr (Reg. No. 0025469)

Joseph E. Olikier (Reg. No. 0086088)

Matthew R. Pritchard (Reg. No. 0088070)

McNees Wallace & Nurick LLC.

21 East State Street, 17th Floor

Columbus, OH 43215

Telephone: (614) 469-8000

Facsimile: (614) 469-4653

sam@mwncmh.com

fdarr@mwncmh.com

joliker@mwncmh.com

mpritchard@mwncmh.com

**COUNSEL FOR APPELLEE/CROSS-
APPELLANT, INDUSTRIAL ENERGY
USERS-OHIO**

CERTIFICATE OF SERVICE

I hereby certify that a copy of this *Fourth Merit Brief of Appellee/Cross-Appellant Industrial Energy Users-Ohio* was sent by ordinary United States mail, postage prepaid or hand-delivered to all parties to the proceeding before the Public Utilities Commission of Ohio, listed below, and pursuant to Section 4903.13 of the Ohio Revised Code on this 1st day of July 2013.



Joseph E. Olikar
Counsel for Appellee/Cross-Appellant
Industrial Energy Users-Ohio

William L. Wright (Reg. No. 0018010)
Section Chief, Public Utilities Section
(Counsel of Record)

Werner L. Margard III
(Reg. No. 0024858)

Thomas W. McNamee (Reg. No. 0017352)

Ryan P. O'Rourke (Reg. 0082651)

Assistant Attorneys General
Public Utilities Commission of Ohio
180 East Broad Street – 6th Floor
Columbus, OH 43215

william.wright@puc.state.oh.us
werner.margard@puc.state.oh.us
thomas.mcnamee@puc.state.oh.us

**COUNSEL FOR APPELLEE,
PUBLIC UTILITIES COMMISSION OF
OHIO**

Matthew J. Satterwhite (Reg. No. 0071972)
(Counsel of Record)

Steven T. Nourse (Reg. No. 0046705)
American Electric Power Corporation
1 Riverside Plaza, 29th Floor
Columbus, OH 43215

mjsatterwhite@aep.com
stnourse@aep.com

Daniel R. Conway (Reg. No. 0023058)

Kathleen M. Trafford (Reg. No. 0021753)

Porter Right Morris & Arthur LLP

41 S. High Street

Columbus, OH 43215

dconway@porterwright.com

ktrafford@porterwright.com

**COUNSEL FOR APPELLANT/CROSS-
APPELLEE OHIO POWER COMPANY**

Mark A. Whitt (Reg. No. 0667996)

(Counsel of Record)

Andrew J. Campbell (Reg. No. 0081485)

Whitt Sturtevant

The KeyBank Building

88 East Broad Street, Suite 1590

Columbus, OH 43215

whit@whitt-sturtevant.com

campbell@whitt-sturtevant.com

**COUNSEL FOR AMICUS CURIAE,
THE EAST OHIO GAS COMPANY
D/B/A DOMINION EAST OHIO**

Terry L. Etter (Reg. No. 0067445)
(Counsel of Record)
Maureen R. Grady (Reg. No. 0020847)
Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, OH 43215
etter@occ.state.oh.us
grady@occ.state.oh.us

**COUNSEL FOR APPELLEE/CROSS-
APPELLANT, OFFICE OF THE OHIO
CONSUMERS' COUNSEL**