ORIGINAL

IN THE SUPREME COURT OF OHIO

THE KROGER CO.,	:	
	:	**Case No. 2013-0521**
Appellant,	:	
	:	**Appeals from the Public Utilities**
	:	**Commission of Ohio**
v.	:	
	:	
THE PUBLIC UTILITIES	:	**Public Utilities Commission of Ohio**
COMMISSION OF OHIO,	:	**Case Nos. 11-346-EL-SSO,**
	:	**11-348-EL-SSO, 11-349-EL-AAM,**
Appellee.	:	**11-350-EL-AAM.**

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INTRODUCTION

The Public Utilities Commission of Ohio's ("PUCO" or the "Commission") modification and approval of Cross-Appellant Ohio Power Company's ("AEP Ohio" or the "Company") second Electric Security Plan (ESP) will enable customers to shop for competitive generation service and save money while also facilitating a transition to full competition in half the time it would take under the "market rate offer" alternative to an ESP. For the most part, the Commission's exercise of its broad discretion was reasonable and lawful. AEP Ohio nonetheless raises three meritorious challenges that should be addressed. First, the Commission violated the controlling statute, R.C. 4928.143(F), when it improperly decided to impose a flat 12% earnings cap for the three-year duration of the Company's ESP. Second, the Commission erred in deferring the resolution of key financial decisions to another docket and leaving them open in the decision below, thus undercutting AEP Ohio's statutory right to timely withdraw from the ESP. Finally, the Commission improperly extended its so-called state compensation mechanism – established for wholesale pricing of capacity service – in the context of the retail rate plan.

LAW AND ARGUMENT

Proposition of Law No. VII. The Commission's imposition of a significantly excessive earnings test (SEET) threshold of 12 percent for AEP Ohio, to be applied annually during the term of the ESP, was unreasonable and unlawful.[1]

The Commission violated R.C. 4928.143(F) and this Court's decision in *In re Columbus S. Power Co.*, 134 Ohio St.3d 392, 2012-Ohio-5690, 983 N.E.2d 276, when it prospectively established a 12 percent significantly excessive earnings test (SEET) threshold to be applied to the Company's earnings for the duration of the ESP. (AEP Ohio Second Br. at 42-45.) In response, the Commission claims that it followed the statutory SEET test, and it argues that the

[1] AEP Ohio inadvertently mis-numbered the propositions of law set forth in the Cross Appeal portion of its Second Brief, labeling them "VI, VIII, IX" rather than "VII, VIII, IX." To avoid confusion, AEP Ohio has corrected that error herein.

Court should reject AEP Ohio's challenge as prematurely seeking an advisory opinion. (PUCO Third Br. at 5-7.) Both arguments lack merit.

A. The Commission's SEET threshold decision unreasonably and unlawfully disregarded the SEET test, in violation of R.C. 4928.143(F).

The Commission's choice of a 12 percent SEET threshold violates R.C. 4928.143(F) in several ways. As an initial matter, there can be no serious dispute that the Commission's SEET threshold, which has been set prospectively for the term of the Company's ESP, is improper. The text of the statute could not be more clear that the SEET test is to be applied retrospectively:

> 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.

(Emphasis added.) R.C. 4928.143(F), IEU Appx. at 360; *compare* R.C. 4928.143(E), IEU Appx. at 359 (prospective earnings review permitted only for an ESP whose term "exceeds three years," which does not apply to the Company's ESP II). The SEET threshold plainly does not comply with these statutory requirements. By setting a prospective 12 percent SEET threshold, the Commission ignores the statute's directive to consider whether earnings are excessive "following the end of each annual period of the plan."

The Commission also improperly established the SEET threshold based upon AEP Ohio's expected, rather than earned return on equity. Indeed, as the Commission itself notes, its Entry on Rehearing demonstrates that it established the SEET threshold based upon evidence regarding "what an appropriate ROE would be for AEP-Ohio." (*See* PUCO Third Br. at 6 (citing *ESP II* Entry on Rehearing at 41-42, IEU Appx. at 147-148)); *see also ESP II* Order at 37, IEU

Appx. at 60. But the statute requires the SEET threshold to be based on "earned return," not expected return. R.C. 4928.143(F), IEU Appx. at 360.

The Commission also failed to undertake the required statutory analysis of comparable companies. (*See* AEP Ohio Second Br. at 43.) The statute expressly provides that the Commission "shall consider" (retrospectively, after the end of each plan year) earnings "measured by" a comparison against what was "earned" by publicly traded companies facing comparable risks. R.C. 4928.143(F), IEU Appx. at 360. The Commission urges that it "had testimony from multiple witnesses addressing the earnings of groups of companies that the witnesses presented as being comparable to AEP Ohio." (PUCO Third Br. at 6.) But none of the three expert witnesses who testified "at length" about an appropriate forward-looking return-on-equity target for AEP Ohio considered the *actual earnings* of comparable companies with similar risk. *See ESP II*, AEP Ohio Ex. 116, Fourth Supp.[2] at 1-34 (does not discuss comparable companies or their returns); OEG Ex. 101 at 4-6, Fourth Supp. at 36-38 (does not discuss comparable companies or their equity returns); FES Ex. 103 at 79-80, Fourth Supp. at 40-41 (does not discuss comparable companies or their returns). In fact, of all the witnesses who offered testimony regarding the level at which the Commission should set the Company's return-on-equity, only Ormet witness Wilson included an analysis of other companies' earnings to reach his recommendation. But he made no retrospective comparison of those companies. *See ESP II*, Ormet Ex. 107 at 8-30, Fourth Supp. at 43-65. Nor could he have done so, without a crystal ball, as the SEET statute requires a retrospective analysis and comparison of the electric distribution utility's actual earnings "following the end of each annual period of the plan." R.C. 4928.143(F), IEU Appx. at 360. Simply put, the Commission did not consider companies that

[2] AEP Ohio's Supplement filed with this brief is referred to as "Fourth Supp."

face comparable business and financial risk, as R.C 4928.143(F) requires.[3] Indeed, it is simply impossible in 2012 (when the decision was made below) to examine actual earnings of AEP Ohio for a future period that included 2013, 2014, and 2015.

The Commission likewise failed to identify how much in excess of those (unidentified) companies' earnings AEP Ohio's earnings would have to be to qualify as "significantly excessive." As AEP Ohio explained in its Second Brief, the statute limits the Commission to precluding only those earnings that are "significantly in excess" of the earnings of comparable risk companies. (AEP Ohio Second Br. at 44-45.) *See also In the Matter of the Application of Columbus S. Power Co. and Ohio Power Co.*, PUCO Case No. 10-1261-EL-UNC, Opinion and Order, 2011 Ohio PUC LEXIS 49, *62-64 (Jan. 11, 2011). For this reason too, the Commission's contention that it satisfied R.C. 4928.143(F)'s requirements when it established the SEET threshold is without merit and should be disregarded.

B. The Commission's SEET threshold decision is ripe for review.

The Commission cannot save its failure to perform the required statutory analysis by arguing that AEP Ohio is seeking an improper advisory opinion. AEP Ohio's appeal regarding this issue does not, as the Commission contends, seek the Court to settle an "abstract proposition." (PUCO Third Br. at 7.) On the contrary, it challenges an affirmative decision by the Commission to establish a 12% earnings cap. That decision injures AEP Ohio because it limits the Company's future earnings over the term of the ESP.

This Court has already rejected a similar argument. *See Ohio Consumers' Counsel v. Pub. Util. Comm.*, 111 Ohio St.3d 384, 2006-Ohio-5853, 856 N.E. 2d 940, ¶ 24-25. In *Ohio*

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[3] Had the Commission performed the proper analysis, the SEET threshold would have exceeded 12 percent by a considerable margin. (*See* AEP Ohio Second Br. at 43-44 & n.12 (listing approved SEET thresholds ranging from 15% to 17.6%).)

Consumers' Counsel, this Court addressed whether OCC could appeal Commission orders allowing two electric distribution utilities to change their accounting procedures even though later Commission orders would result in more direct effects when rate changes were approved pursuant to those accounting procedures. *Id.* The Commission argued that the orders "simply allowed [two utilities] to change their accounting procedures," so any appeal would be premature until the Commission "approved a change in the rates charged to those companies' customers." *Id.* at ¶ 24. The Court flatly rejected that argument. It held that "[t]he fact that subsequent orders may result in more direct effects does not mean that the orders [at issue in the appeal] are not final." *Id.* at ¶ 25. The same is true here. Regardless of whether a "subsequent order" adjusts AEP Ohio's earnings downward to comply with the SEET threshold, the Commission's decision to establish a cap on earnings in the first instance harms AEP Ohio no less than a change in accounting procedures allowed the OCC to sue in *Ohio Consumers' Counsel*. In both scenarios, the Commission's decision is ripe regardless of whether a party may be further harmed at some point in the future.

Moreover, the Company is challenging whether it is unreasonable and unlawful for the Commission to prospectively establish the SEET threshold in the manner it has. The Commission chose to establish the SEET threshold in this proceeding without following the requirements set forth in R.C. 4928.143(F), and it incorporated this flawed SEET threshold into the very text of the Order being appealed here. AEP Ohio is entitled to challenge that affirmative decision on direct appeal.

The Commission's position appears to be that, although the SEET threshold was ripe for *its* determination in the case below, *AEP Ohio* should be prevented from challenging that determination until years from now, when AEP Ohio's 2012, 2013, 2014, and 2015 SEET cases

are adjudicated. But if AEP Ohio fails to challenge the SEET threshold established by the Commission in the Order appealed here, and waits until those later adjudications, the Commission would surely argue that such a challenge by AEP Ohio would be barred by the doctrines of waiver or *res judicata*. Such gamesmanship should be rejected. *Accord In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedules of the Ohio Edison Company and Related Matters*, PUCO Case No. 93-04-EL-EFC, Entry on Rehearing, 1994 Ohio PUC LEXIS 333, *2 (Apr. 27, 1994) (noting "the Commission's policy of refusing to rule on issues which are not yet ripe"), citing *In the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedules of Ohio Power Company and Related Matters*, PUCO Case No. 86-01-EL-EFC, Opinion and Order, 1986 Ohio PUC LEXIS 17 (Nov. 12, 1986); *Allnet v. Ohio Bell*, PUCO Case No. 86-771-TP-CSS, Entry, 1986 Ohio PUC LEXIS 849, *4 (Nov. 5, 1986).

Because the Commission's establishment of a SEET threshold for the term of the Company's ESP directly and injuriously affects the Company, AEP Ohio's challenge to that unreasonable and unlawful decision is proper. Accordingly, the Court should reject the Commission's meritless argument that the SEET threshold is immune from appellate review.[4]

Proposition of Law No. VIII. It was unlawful and unreasonable for the Commission to approve the ESP while deferring final decision of issues critical to the ESP to other dockets, thus infringing AEP Ohio's right under R.C. 4928.143(C)(2)(a) to withdraw from ESP modifications imposed by the Commission.

The Commission unreasonably and unlawfully infringed on the Company's statutory right under R.C. 4928.143(C)(2)(a) to withdraw from Commission-imposed ESP modifications by deferring to other dockets issues critical to the design and operation of the ESP. (AEP Ohio

[4] In the unlikely event that the Court deems the 12 percent SEET threshold issue unripe for review, the Court should confirm that AEP Ohio may challenge the threshold (and its application) in any later SEET adjudication conducted pursuant to R.C. 4928.143(F).

Second Br. at 45-47.) The Commission's arguments to the contrary have no merit. (*See* PUCO Third Br. at 8-12.) The Commission contends that AEP Ohio is "free to walk away" from the modified ESP at any time while simultaneously stating that "it is by no means certain that [AEP Ohio] even continues to have the right to do so." (*Id.* at 8-9.) This flip-flopping by the Commission demonstrates that even the Commission is unsure about the practical effects of its *ESP II* decision on AEP Ohio's rights under R.C. 4928.143(C)(2)(a).

More fundamentally, the Commission, FirstEnergy Solutions Corp. (FES), and Industrial Energy Users – Ohio (IEU) all assert that an electric distribution utility's (EDU) statutory right to withdraw is meaningless. (*Id.* at 11; FES Third Br. at 25; IEU Third Br. at 49.) According to the Commission, for example, an EDU must be able to determine whether to exercise its withdrawal right without the benefit of "perfect, or even useful, information with which to make a decision." (PUCO Third Br. at 11.) This Court should reject that interpretation of R.C. 4928.143(C)(2)(a) because it would render the statute meaningless by requiring EDUs to exercise their right to withdraw before they know whether it would be prudent to do so. *See Canton v. Imperial Bowling Lanes, Inc.*, 16 Ohio St. 2d 47, 242 N.E.2d 566 (1968), paragraph 4 of the syllabus; *Davis v. State*, 118 Ohio St. 25, 27, 160 N.E. 473 (1928); R.C. 1.47. Simply put, it is bad policy, bad business, and harmful to ratepayers for an EDU to be precluded, as a practical matter, from withdrawing from an ultimately unfavorable ESP modification, or to be required to do so arbitrarily and without the information necessary to make a reasoned decision. R.C. 4928.143(C)(2)(a) should not be construed in a manner that strips AEP Ohio of the practical ability to make a rational business determination to accept or withdraw from the modified ESP.

The Commission, FES, and IEU wrongly assert that AEP Ohio encouraged or invited the Commission to create the untenable position in which the Company has been left. (*See* PUCO

Third Br. at 12; FES Third Br. at 23-25; IEU Third Br. at 49.) Although AEP Ohio agreed that details regarding the Company's Competitive Bidding Process could be determined through a separate proceeding,[5] and that the Commission addressed some auction design issues in this proceeding (*see* FES Third Br. at 22), the Company in no way contemplated that the Commission would defer decision on substantive rate impact and other basic auction design issues. As AEP Ohio explained in its Second Brief, deferral of those issues was unreasonable and unlawful. (*See* AEP Ohio Second Br. at 46.)

The Commission also argues that it has unfettered authority to defer to future dockets and decisions issues critical to the content and impact of the Company's ESP because it "may modify orders as long as it justifies those changes." (PUCO Third Br. at 10.) In the cases the Commission cites, however, the modifications at issue altered orders made in the same proceeding. (*See id.* (citing *Ohio Consumers' Counsel*, 2006-Ohio-5789, at ¶ 34; *Consumers' Counsel v. Pub. Util. Comm.*, 10 Ohio St.3d 49, 50-51, 461 N.E.2d 303 (1984).) Those cases do not and cannot stand for the proposition that the Commission has the power to defer decisions essential to the design and operation of the Company's ESP to some unknown and uncertain proceeding in the future. The Court should remand to the Commission the consideration of and decision on those issues the Commission has improperly deferred to other dockets. AEP Ohio cannot intelligently or meaningfully withdraw from an ESP, as the General Assembly expressly intended, where critical facets of that ESP have yet to be considered or decided and have been deferred to some future proceeding.

[5] PUCO Case No. 12-3254-EL-UNC.

Proposition of Law No. IX. The Commission erred by extending the state compensation mechanism to SSO auctions and non-shopping customers.

Finally, AEP Ohio's Second Brief explains that the Commission acted unreasonably and unlawfully when it adopted the state compensation mechanism, which it previously established in the *Capacity Case*[6] for capacity that the Company supplies to CRES providers on a wholesale basis, as a maximum price at which the Company must sell capacity into retail SSO energy auctions or to non-shopping retail customers. (AEP Ohio Second Br. at 47-49.) That decision was unreasonable and unlawful both because it was unexplained (*see id.* at 48), and because it precludes AEP Ohio from the possibility of recovering its full capacity costs and, therefore, imposes confiscatory rates. (*Id.* at 49.)

The Commission responds to these arguments with post-hoc justifications that were not explained in the underlying proceeding and not included in the orders that are the subject of this appeal. (*See* PUCO Third Br. at 13-16.) For example, although the Commission now argues that shopping and non-shopping customers are similarly situated and that the capacity service that AEP Ohio provides to SSO customers is the same as that supplied to CRES providers (*see id.* at 14-15), the Commission's orders below do not address these issues. (*See* AEP Ohio Second Br. at 48-49.)[7] But "courts may not accept appellate counsel's post hoc rationalizations for agency action." *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168, 83 S. Ct. 239, 9 L. Ed. 2d 207 (1962). Indeed, it is a bedrock principle of agency law that a court "can sustain an agency action only on a ground upon which the agency itself relied." *Lacson v. U.S. Dep't of*

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[6] PUCO Case No. 10-2929-EL-UNC, on appeal before this Court in Case Nos. 12-2098 and 13-0228. As the Company has previously explained, if the Court were to reverse the state compensation mechanism at issue in those appeals because it undercompensates AEP Ohio, it should likewise reverse the *ESP II* Order that is based on the same price for capacity.

[7] Similarly, the Commission now contends that AEP Ohio's position regarding the capacity price to be included in SSO rates and sold into the SSO energy auctions is "improper and discriminatory" (*see* PUCO Third Br. at 14), a finding it never made below.

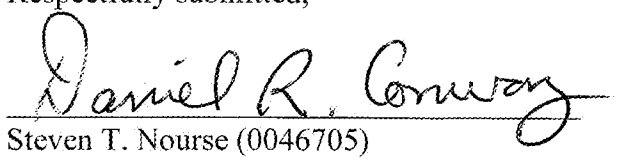
Homeland Sec., 726 F.3d 170, 177 (D.C. Cir. 2013) (citing *SEC v. Chenery Corp.*, 318 U.S. 80, 95, 63 S. Ct. 454, 87 L. Ed. 626 (1943)). Consistent with that principle, this Court has required the Commission to "explain its rationale, respond to contrary positions, and support its decision with appropriate evidence." *In re Columbus S. Power Co.*, 128 Ohio St. 3d 512, 2011-Ohio-1788, 947 N.E.2d 655, ¶ 30. The Commission's failure to do so here compels a remand on that basis alone.

In any event, the Commission's argument cannot be reconciled with its previous decisions in the *Capacity Case*, in which the Commission expressly recognized that retail electric service and capacity service are not the same. *See Capacity Case*, Opinion and Order at 13 (July 2, 2012) (finding that the capacity service supplied to CRES providers "is not a retail electric service as defined by Ohio law"); *Capacity Case,* Entry on Rehearing at 28 (Oct. 17, 2012) (again finding that "the capacity service at issue is a wholesale rather than retail electric service"). There is no reason to reverse those findings. This Court should reverse and remand the Commission's unsupported (and unsupportable) extension of the <u>wholesale</u> state compensation mechanism established in the *Capacity Case* to <u>retail</u> SSO energy auctions and retail SSO customers.

CONCLUSION

For the foregoing reasons and those set forth in AEP Ohio's Second Merit Brief, the Court should grant the relief that AEP Ohio seeks in its cross-appeal.

Respectfully submitted,



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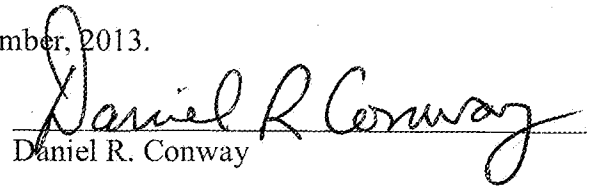
I certify that the foregoing *Fourth Merit Brief of Appellee/Cross-Appellant Ohio Power Company* was served by First-Class U.S. Mail or hand delivery upon counsel for parties to this proceeding, identified below, this 30th day of December, 2013.



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