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

POST-HEARING BRIEF SUBMITTED ON BEHALF OF THE STAFF OF THE PUBLIC UTILITIES COMMISSION OF OHIO

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TABLE OF CONTENTS

Introduction 1

I. Generation 2

A. Fuel Adjustment Clause 2

1. Projected 2009 Costs 3

2. Purchased Power Costs 3

3. Environmental Compliance Costs 4

B. Non-FAC Component 5

II. Distribution 7

A. Annual Percentage Increases in Distribution Rates 7

1. Enhanced Distribution Service Reliability 8

2. Implementation of gridSMART 10

B. Riders 15

1. POLR 15

2. Energy Efficiency & Peak Demand Reduction 17

C. Line Extension Charges 20

D. Regulatory Asset Recovery Rider 20

III. Phase-In 21

IV. Other Provisions 22

A. Corporate Separation 22

1. Functional Separation 22

2. Generation Assets Not in Rate Base (Waterford & Darby) 24

B. Net Metering 24

V. Miscellaneous 25

A. Possible Early Plant Closures 25

VI. ESP/MRO Comparison 26

VII. Significantly Excessive Earnings Test 26

VIII. Conclusion 27

PROOF OF SERVICE 29

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Introduction

SB 221 became effective on July 31, 2008. The same day, Columbus Southern Power (CSP) and the Ohio Power Company (OPCO) (the Companies) filed an application for a standard service offer (SSO) pursuant to Ohio Rev. Code §4928.141. The application seeks approval of an electric security plan (ESP) in accordance with Ohio Rev. Code §4928.143.

Section 4928.143 sets out the requirements for an ESP. Under Ohio Rev. Code §4928.143(B), an ESP must include provisions relating to the supply and pricing of generation service. ESP may also provide for, among other things, the automatic recovery of certain costs, conditions or charges relating to customer shopping, automatic increases or decreases, provisions related to distribution service, and provisions regarding economic development.[1] The

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1 Ohio Rev. Code §4928.143(B).

Commission is required to approve, or modify and approve, the ESP if the plan, including its pricing and all other terms and conditions, including deferrals and future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under an Ohio Rev. Code §4928.142 Market Rate Option (MRO).[2]

As a general principle, the Commission Staff believes that the Companies' proposed ESP is more favorable than what would be expected under an MRO proposal. Staff believes, however, that modifications to the Companies' proposal are necessary to make it reasonable. With the changes noted, Staff recommends that the Companies' proposal be approved. To the extent that the Staff did not offer testimony addressing issues raised in the Companies' application, Staff accepts and adopts the Companies' proposals.

I. Generation

A. Fuel Adjustment Clause

The Companies propose a Fuel Adjustment Clause (FAC). This mechanism would recover the cost of fuel and fuel-related components such as purchased power, emission allowances, and consumables related to environmental compliance, as well as the costs associated with carbon-related regulation.[3]

Staff witness Strom testified that the costs sought to be recovered are appropriate for inclusion in the FAC, and that recovering them in a single rate makes logical sense.[4]

2 *Ohio* Rev. Code §4928.143(B)(2).

3 Columbus Southern Power Company's and Ohio Power Company's Application ("Application") at 4.

4 Direct Testimony of Raymond W. Strom, Staff Ex. 8, at 3.

1. Projected 2009 Costs

In 2009, the proposed FAC would reflect projected costs. The first step in determining the FAC is to establish a baseline. This is necessary to ensure that the FAC does not recover fuel costs already being recovered in rates. The difference between projected costs and the baseline would determine costs to be recovered through the FAC. The Companies proposed using 1999 rates, brought forward to 2005, and then escalated by 3% annually for CSP, and 7% for OPCO.

Staff believes that actual costs should be used for determining the baseline.[5] Staff witness Cahaan recommended using 2007 data since all of that information would be readily available and would be a reasonable proxy for the current year.[6] Using actual costs is appropriate since the Companies are obviously currently recovering all of their fuel-related costs. Significantly, Companies' witness Nelson testified that Staff's proposal produces a known result very close to the Companies' method that would not significantly change the results of the Companies' overall plan.[7]

2. Purchased Power Costs

The Companies propose to purchase incremental power on a "slice of the system basis" to serve the Companies' loads. The Companies propose to make purchases equal to 5% of each company's load in 2009, 10% in 2010, and 15% of load in 2011.[8]

Staff believes that the Companies should be permitted to purchase power sufficient to meet the additional load responsibilities that they assumed for Ormet and the former Mon Power

5 Direct Testimony of Richard Cahaan, Staff Ex. 10, at 3-4.

6 Tr. Vol. XII at 244.

7 Rebuttal Testimony of Philip J. Nelson, Companies Ex. 7B, at 4.

8 Application at 5.

service territory. But that additional responsibility only amounts to about 7½% of the Companies' load.[9] Consequently, Staff has recommended that the purchased power authorization be that amount on average, in increments of 5%, 7½%, and 10% during the ESP.

3. Environmental Compliance Costs

The FAC also will reflect projected costs of the Companies' compliance with the renewable energy mandates, including solar energy requirements, set out in Ohio Rev. Code §4928.64. The Companies propose a methodology for determining the extent of the renewable mandates and present projected cost estimates for achieving these mandates.

Staff conducted reviewed the Companies' projected costs for 2009. While Staff witness Siegfried recognized that the estimates are subject to some uncertainty, he nonetheless testified that the projections overall were reasonable.[10] Staff did express the expectation that the actual costs would be reviewed more closely during annual FAC audits.

Staff witness Siegfried did note, however, that S.B. 221 provides that all costs of alternative energy portfolio standards (AEPS) compliance "shall be bypassable."[11] Under the Companies' proposal, excess FAC costs would be deferred for later recovery through a rider. To the extent that any part of the deferred amount includes R.C. 4928.64 compliance costs, recovery of such costs through a non-bypassable rider (as proposed by the Companies) would violate the statutory requirement that mandates that such costs be bypassable or avoidable. Companies' witness Assante testified in cross-examination that the Companies would commit that any AEPS

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9 Direct Testimony of Richard Cahaan, Staff Ex. 10, at 5.

10 Direct Testimony of Stuart M. Siegfried, Staff Ex. 4, at 9.

11 Ohio Rev. Code §4928.64(E).

costs would be recovered only through the part of the FAC that is recovered through a bypassable rider.[12] Staff recommends that the Commission reiterate this in its order in this case.

Ohio Rev. Code §4928.64(C)(3) includes language that excuses EDU compliance with annual AEPS benchmarks where their annual compliance costs exceed a certain level. While Commission rules on this "cost cap" provision are not yet final, Staff is concerned that artificially reducing current generation prices through use of deferred cost recovery, as the Companies proposes, could negatively impact the effective implementation of this statutory provision by reducing or effectively diluting the three percent threshold created in the statute. While in the absence of final Commission rules it is not possible to identify with any exactitude the impacts that generation-related deferrals could have on cost-cap calculations, the Staff nonetheless believes it appropriate to bring this issue to the Commission's attention at this time.[13]

B. Non-FAC Component

The Companies propose to increase the non-fuel portion of each company's generation rates to recover incremental carrying costs associated with capitalized investments to comply with environmental requirements made between 2001 and 2008. The Companies also propose to recover the carrying costs of additional capital investments for environmental compliance during the term of the ESP.

Staff recommends that the Companies be allowed to recover carrying costs associated with these investments. The Companies were previously allowed recovery of carrying costs for

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12 Tr. Vol. IV at 201.

13 Direct Testimony of Stuart M. Siegfried, Staff Ex. 4, at 8.

certain environmental investments as part of their Rate Stabilization Plan (RSP).[14] The requested increase would allow recovery of carrying costs not already being recovered.

But Staff does not believe that the Companies should be granted the entire requested increase in non-FAC rates. The Companies propose to increase the non-FAC rates of CSP and OPCO by 3% and 7% per year, respectively, during the ESP. Staff believes that a more appropriate increase of the non-FAC generation component would be half of the proposed amounts, or 1.5% for CSP and 3.5% for OPCO. Staff witness Cahaan testified that changes in economic conditions since the filing of the application necessitate such an adjustment.[15] Staff believes that this reduction represents a reasonable balance between the Companies' duties and costs involved in providing electricity, and consumers who are struggling in the midst of a recession.[16]

The Companies also request authority to recover carrying costs associated with capital investments made during the ESP period to comply with environmental regulation. Staff witness Soliman testified that compliance with current and future environmental requirements is in the public interest, and recommended that the Companies be authorized to recover carrying costs for environmental investments made during the ESP period.[17]

Staff does not contemplate that this recovery would occur as part of the proposed (or Staff-adjusted) annual increase to the non-FAC portion of generation rates. Rather, Staff recommends that the Companies file an application in 2010 to request recovery of the additional

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14 Direct Testimony of Ibrahim Soliman, Staff Ex. 6, at 3.

15 Direct Testimony of Richard Cahaan, Staff Ex. 10, at 4.

16 Tr. Vol. XII at 211.

17 Direct Testimony of Ibrahim Soliman, Staff Ex. 6, at 5.

carrying cost for 2009 actual environmental investment, and annually for each succeeding year. This would permit recovery of carrying costs associated with actual investment.[18]

II. Distribution

A. Annual Percentage Increases in Distribution Rates

The Companies also propose increases to their distribution rates to recover costs associated with service reliability improvements and implementation of its gridSMART programs.[19] The Companies propose annual distribution rate increases of 7% for CSP, and 6½% for OPCO. The Companies also propose a number of riders.

The Staff recommends that the Companies be allowed recovery of Energy Efficiency and Peak Demand Reduction programs as a distribution charge. But Staff recommends that the Companies file a base rate case to recover the costs of the additional reliability programs, line extension, and amortization of regulatory assets that have been requested in this case.

There are a number of reasons why Staff believes that a separate distribution rate case should be filed. First, the last base rate case filed by these companies was seventeen years ago for CSP and fourteen years ago for OPCO. Staff believes that the Companies' rates and tariffs should be thoroughly examined to account both for the significant industry-wide changes in the past 15 years, and company-specific changes in the revenue requirement and cost of service studies. Staff witness Hess testified that the change from a vertically integrated utility to a distribution utility alone would justify a complete review of current rates in a distribution rate case.[20]

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18 Tr. Vol. XII at 132.

19 Application at 6.

20 Direct Testimony of J. Edward Hess, Staff Ex. 1, at 6.

Second, the terms and conditions of the individual companies' tariffs are different and should be re-written to be consistent with each other.[21]

Third, there are distribution system issues that should be publicly addressed. Staff witness Hess noted that there has been public criticism of costs relating to the 2004/2005 ice storms and the 2008 hurricane damage.[22] A distribution rate case would provide all interested parties the opportunity to address those issues.

Finally, as noted below, Staff believes that the Companies should file a new corporate separation plan once recently adopted Commission rules become effective. A distribution rate case would give parties an opportunity to fully consider that plan.

Staff recognizes that S.B. 221 permits companies to request distribution rate relief as part of an ESP plan. Staff does not believe that the relief sought by the Companies in this case should be granted in this proceeding. As the Commission properly decided in the recent FirstEnergy SSO case, many of the "expenses which the Companies seek to recover . . . are best reviewed in a distribution rate case where all components of distribution rates are subject to review."[23]

1. Enhanced Distribution Service Reliability

The Companies have proposed an Enhanced Distribution Service Reliability Plan. The plan would include a number of initiatives, including: Enhanced Overhead Line Inspection

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21 *Id.*

22 *Id.*

23 In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and the Toledo Edison Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan, Case No. 08-935-EL-SSO (Opinion and Order) (December 19, 2008) at 37.

Initiative, an Enhanced Vegetation Initiative, an Enhanced Underground Cable Initiative, and a Distribution Automation (DA) Initiative.

Staff believes that the Companies' proposed Enhanced Overhead Line Inspection Initiative will improve service reliability.[24] Inspection, coupled with timely repair or replacement, should result in a reduction in the number of sustained outages. But these are efforts that the Companies could, and should, already have been performing.[25] And the mitigation efforts proposed are the same mitigation efforts that the Companies have been using.

The companies have also proposed an Enhanced Vegetation Initiative. The companies plan to enhance their program by moving towards a more cycled-based approach. Cycle-based vegetation programs are more proactive than performance-based programs. Since tree-caused outages have such a negative impact on system performance, the Staff believes that the companies should move to a four-year cycle-based approach to vegetation management. Staff witness Roberts recommended that this initiative also include the following:

- "End-to-end" circuit rights-of-way inspections and maintenance;
- Mid-point circuit inspections to review vegetation clearance from conductors, equipment and facilities;
- Greater clearance of all overhang above three-phase primary lines and single-phase lines;
- Removal of danger trees located outside of the companies' rights-of-ways where property owner's permission can be secured; and
- Using technology to collect tree inventory data to optimize planning and scheduling.[26]

The companies also proposed an Enhanced Underground Cable Initiative. Staff agrees that such an initiative would be beneficial, especially for SCP customers. But Staff has been unable to ascertain the real magnitude of the problem or the types of cable causing these

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24 Direct Testimony of Duane A. Roberts, Staff Ex. 2, at 4.

25 *Id.* at 5.

26 *Id.* at 13.

interruptions because of the Companies' lack of information. Consequently, Staff is unable to determine the effectiveness of the proposal overall on system performance. Staff recommends that the Commission require the companies to re-submit a more aggressive proposal that addresses significantly more miles of underground power cable each year.[27]

The Companies propose the installation of 20 DA switches on circuits in areas not included in its gridSMART Phase I implementation effort. The Companies did not, however, make any reliability calculation for DA outside of its gridSMART Phase I plan.[28] Staff does not support the proposal to install DA outside the gridSMART Phase I area because the Companies cannot predict the reliability improvement expected to result from those DA installations.[29]

In summary, Staff recommends that the Commission require the companies to implement the following list of proposed initiatives:

- Enhanced overhead inspection and mitigation work initiative;
- Replacement of cutouts;
- Installation and replacement of arresters;
- Replacement of three-phase reclosers with three single-phase reclosers;
- Enhance the protection on existing 34.5kV circuits;
- Installation of fault indicators on all three-phase overhead switches, all feeder exit riser poles and underground residential distribution (URD) riser poles; and
- Enhanced vegetation management initiative.[30]

2. Implementation of gridSMART

The Companies propose a phased-in implementation of their gridSMART initiative, a multi-year initiative that includes a suite of customer programs, new energy delivery system

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27 *Id.* at 17.

28 Direct Testimony of Peter K. Baker, Staff Ex. 5, at 4-5.

29 *Id* at 6.

30 Direct Testimony of Duane A. Roberts, Staff Ex. 2, at 18.

technologies, integrated future generation and storage devices, and advanced internal system efficiencies.[31] These initiatives have three components: 1) Advanced Meter Infrastructure (AMI); 2) Distribution Automation (DA); and Home Area Network (HAN).[32] The Companies propose to implement gridSMART Phase I in the northeast area of central Ohio and install DA, AMI and HAN in phases over a three-year period.[33] The Companies also propose to implement DA outside the gridSMART Phase 1 area as part of its Enhanced Distribution Service Reliability Plan.

While Staff supports the Companies' AMI proposal, it is concerned about the level of overhead costs associated with meter acquisition. Staff recommends that costs associated with meter purchasing overhead be reviewed before approval to ensure that they are not duplicative of the overhead meter purchasing costs that are already part of the Companies' current rate recovery.[34]

Staff supports the DA portion of gridSMART Phase 1 implementation. This initiative represents a modernization program that benefits a significant number of circuits by substantially improving their reliability performance.[35] The Companies calculated a reliability improvement of 44 percent in SAIDI[36] performance for deployment of DA in the Phase I area.

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31 Direct Testimony of Karen Sloneker, AEP Ex. 4, at 3-4.

32 Direct Testimony of Karen Sloneker, AEP Ex. 4, at 9-11.

33 *Id.* at 12, 14.

34 Direct Testimony of Gregory C. Scheck, Staff Ex. 3, at 3.

35 Direct Testimony of Peter K. Baker, Staff Ex. 5, at 6.

36 SAIDI (System Average Interruption Duration Index) represents the average time each customer is interrupted.

The Companies' HAN proposal would limit access to a programmable communicating thermostat (PCT) only to those customers who have air conditioning.[37] There is no need for this restriction. It is Staff's position that any customer who would like to have a PCT to control other electrical end-use appliances should be able to have one.[38]

While Staff generally otherwise supports the Companies' gridSMART proposals, it is not without concerns. Customers who have invested in the advanced technological equipment for gridSMART will not benefit from dynamic pricing and time differentiated rates without a simultaneous rollout of a rate design.[39]. Customers should not have to wait until the Companies fully deploy its Phase I before taking advantage of any time differentiated rate or other dynamic pricing opportunities.[40] Staff recommends that the Companies offer some form of a Critical Peak Pricing Rebate for residential customers and some form of a hedged price for commercial customers for a fixed amount of the customers' demand.[41] The residual demand could be tied to a day-ahead market based price.[42] This would let customers know in advance that they would pay a fixed amount for a portion of their consumption, but could pay more or less depending what they did on the margin.[43]

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37 Tr. Vol. III at 303-304.

38 Direct Testimony of Gregory C. Scheck, Staff Ex. 3, at 6.

39 Tr. Vol. III at 304-305.

40 Direct Testimony of Gregory C. Scheck, Staff Ex. 3, at 5.

41 Direct Testimony of Gregory C. Scheck, Staff Ex. 3, at 5.

42 *Id.*

43 *Id.*

The Companies' gridSMART proposal does not contain much in terms of risk sharing, operational savings, or cost/benefit analysis. The Companies expect the business and technological risks associated with gridSMART to be borne completely by ratepayers and not by AEP shareholders.[44] The expected net savings are quite small, only $2.7 million or the first three years from the investment of $109 million.[45]

The Companies did not attempt to quantify any customer and societal benefits of its proposed gridSMART initiative.[46] They have not estimated any customers' bill savings from this initiative nor have they conducted any studies on how much customers are going to reduce their energy use based on gridSMART.[47] There is no analysis to support the Companies' representation that this initiative will create jobs and reduce its impact on the environment.[48] And because the Companies are not planning to implement the DA component to Phase I until year three, the earliest an overall evaluation of gridSMART Phase I could begin wouldn't be until after three years.[49]

The Companies intend to recover the costs of its gridSMART initiative by adjusting its current distribution rates.[50] Staff does not support increasing distribution rates.[51] Staff believes that the Companies' current distribution rates provide enough revenues to begin some of these

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44 Tr. Vol. III at 246-247.

45 *Id.* at 302.

46 Direct Testimony of Karen Sloneker, AEP Ex. 4, at 17.

47 Tr. Vol. III at 213-218.

48 *Id.* at 302-303.

49 Tr. Vol. III at 246.

50 Tr. Vol. III at 309; Direct Testimony of David M Roush, AEP Ex. 1, at 11 and Ex. DMR-4.

51 Direct Testimony of Peter K. Baker, Staff Ex. 5, at 6.

programs.[52] Instead, Staff supports a rider, set at zero, as a placeholder.[53] A rider has several advantages over a distribution rate adjustment: 1) separate accounting; 2) opportunity to approve an updated plan each year; 3) assurance that expenditures are made before cost recovery occurs; and 4) opportunity to audit expenditures prior to recovery.[54]

Staff recommends the following with respect to the Companies' gridSMART initiative. First, AEP should share, with customers, the financial risks associated with its gridSMART initiative by having some portion of this investment and cost paid for by the AEP shareholders. This gridSMART investment benefits AEP just as much as it does its customers. Second, AEP should have some accountability for having its gridSMART initiative meet the minimum reliability standards. Staff does not support AEP's proposal to install DA outside the gridSMART Phase I area. Third, AEP should be prepared to offer specific tariff and rate provisions for customers who have already received the enabling gridSMART technology or, in the alternative, AEP should offer a critical peak pricing rebate to residential customers and a hedged price to commercial customers until its tariff rates become available to customers. Fifth, AEP should recover its DA initiative costs through a DA Rider. Sixth, the PCT under AEP's HAN should be made available to all customers who want to control their central air conditioning or other electrical end-use appliances. Finally, AEP should conduct a study that quantifies both the customer and societal benefits of its proposed gridSMART initiative.

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52 Direst Testimony of J. Edward Hess, Staff Ex. 1, at 7.

53 *Id.*; Direct Testimony of Gregory C. Scheck, Staff Ex. 3 at 4.

54 Direct Testimony of Peter K. Baker, Staff Ex. 5, at 7.

B. Riders

1. POLR

AEP included a non-bypassable Provider of Last Resort (POLR) Rider in its proposed distribution rates.[55] Under AEP's proposal shopping and non-shopping customers would pay the POLR charge.[56]

It is AEP's position that those CRES customers who switch can choose to return to their incumbent utility for generation service at a tariff rate.[57] Similarly, if the CRES provider or the government aggregation group to whom customers switched default in their service obligation, those customers can also return to the incumbent utility.[58]

The Companies state that rational customers will exercise their flexibility to change providers when it becomes apparent that there are economic benefits from switching between a competitive supplier and the ESP price.[59] They proposed an option pricing model provides an effective way to calculate the cost of their POLR obligation.[60]

Staff has identified two risks: 1) the optionality associated with leaving in the first place; and 2) the optionality associated with returning.[61] Customer who leave are more properly a

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55 Application at 6-8.

56 Tr. Vol. XI at 46.

57 *Id.* at 26; Tr. Vol. X at 252-253.

58 *Id.*

59 Direct Testimony of Craig Baker, AEP Ex. 2A, at 30-31.

60 *Id.*

61 Direct Testimony of Richard Cahaan, Staff Ex. 10, at 6.

migration risk, not a POLR risk.[62] Returning customers present a POLR risk.[63] Staff believes the risks associated with returning customers can be avoided.[64] This can be done by requiring the returning customer to pay back at market prices and not the SSO price.[65] The key guarantee against the risk is not the price a returning customer must pay, but the source of generation services for the returning customer.[66] If the ESP specifically provided that the additional power could be procured on the market, then the companies would be protected.[67] Either the returning customers would pay market prices or the incremental costs of the purchased power would be recovered through the FAC.[68] The Companies can avoid the returning customer / POLR risk by procuring power from the market to serve this load and charging them that market price.[69] Staff's proposal would put the risk and cost of the POLR obligation with respect to customers returning down to zero.[70]

Regarding the optionality of allowing customers to leave when market prices are low, the problem lies in establishing a value for this risk.[71] Staff believes a financial option will certainly be exercised once it is "in the money," but there are many reasons to think that substantial

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[62] Tr. Vol. XIII at 30.

[63] *Id.* at 35

[64] Direct Testimony of Richard Cahaan, Ex. 10, at 6.

[65] *Id.*

[66] *Id.*

[67] *Id.*

[68] *Id.*

[69] Tr. Vol. XIII at 36.

[70] Tr. Vol. XII at 256.

[71] Direct Testimony of Richard Cahaan, Staff Ex. 10, at 7.

migration will not quickly occur, even if the market price falls below the SSO price.[72] It is Staff's position that a migration charge, if one is considered appropriate for customers leaving, would be significantly below what the Companies are requesting.[73] More specifically it is Staff's position that the current level of the POLR charge under the Rate Stabilization Plan (RSP) would be more reasonable.[74]

In summary, Staff supports a migration charge for leaving customers; not a POLR charge because Staff doesn't believe leaving is POLR related. Staff supports the current level of the POLR charge under the RSP to serve as the migration charge. Staff recognizes that returning customers present a POLR risk, but it does not support a POLR charge for returning customers because this risk can be avoided under Staff's proposal. The Companies can manage the POLR risk for returning customers by having the cost at times when market prices are high borne by the customer who returns.

2. Energy Efficiency & Peak Demand Reduction

Under Ohio Rev. Code §4928.66, all EDUs are required to implement energy efficiency programs that will achieve energy savings equivalent to at least 0.3 of one percent of their total annual average normalized kilowatt-hour sales, as determined from what the utility sold in the preceding three years, to their customers in 2009. In addition, each EDU must implement peak demand reduction programs that are designed to achieve a 1 percent reduction, as determined from the average peak demand on the utility in the preceding three years, in the EDU's peak demand for 2009.

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72 *Id.*

73 *Id.*; Tr. Vol. XIII at 38.

74 Direct Testimony of Richard Cahaan, Staff Ex. 10, at 7; Tr. Vol. XIII at 38-39; Tr. Vol. X at 217.

The Companies are proposing to implement a non-bypassable Energy Efficiency and Peak Demand Reduction Programs Rider to recover the costs of achieving mandated energy savings and programs designed to reduce peak demand. The Companies propose a 2009 baseline for energy savings by using total normalized retail kilowatt hours sold in 2006, 2007 and 2008, adjusted for new economic growth in the Companies' certified territories.[75] The Companies propose to recover their cost of complying with the energy savings and peak demand reduction programs through a separate distribution rider.[76]

Staff generally approves of the Companies' efforts, with some modifications. First, Staff witness Scheck testified that a number of the proposed programs were expensive, and unlikely to pass the Total Resource Cost Test. Staff recommends that the Companies evaluate and pursue those programs that are most cost-effective.[77]

Staff likewise generally accepts the Companies baseline determination and adjustments, with one notable exception. The Companies propose to take an adjustment credit for the sales and peak load associated with the acquisition of the former Monongahela Power Company's service territory by Columbus Southern Power. Because Staff does not consider this load to be truly economic development, and inasmuch as CSP acquired this load outside of the three year average for determining the baselines; (i.e. before calendar year 2006), this is not considered a reasonable adjustment by the Staff.[78] Staff would similarly need to consider whether the remaining adjustments were due to economic development efforts made by the Companies

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75 Application at 9.

76 Application at 10.

77 Direct Testimony of Gregory C. Scheck, Staff Ex. 3, at 6.

78 Id. at 8.

during the baseline period (calendar years 2006 through 2008). Staff determined a preliminary estimate of the KWh savings and peak demand reductions that should be achieved by the companies for the calendar year 2009. Those estimates are contained in Exhibit GCS-1 and Exhibit GCS-2.[79]

Staff is not opposed to including the energy savings and peak demand reduction efforts from mercantile customers toward adjusting the electric utility's baseline. However, Staff recommends that the electric distribution utilities make a case-by-case submittal to the Commission to receive such credits. In addition, the mercantile customers demand response, energy efficiency, and peak demand reduction programs would need to commit those capabilities to the electric distribution utility's energy efficiency and peak demand reduction programs for integration.[80]

Because programs like PJM's demand response programs are not committed for integration into AEP-Ohio's distribution utilities energy efficiency and peak reduction programs, Staff does not believe that such efforts should be credited towards reducing the electric distribution utilities annual benchmarks.[81] Retail customers who have made such arrangements should not receive an exemption from the Companies' energy efficiency cost recovery mechanism.

But Staff does not recommend any credits being given towards the annual peak demand reduction targets for the Companies' interruptible programs unless reductions actually occur.[82]

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79 Direct Testimony of Gregory C. Scheck, Staff Ex. 3.

80 *Id.* at 10.

81 *Id.*

82 *Id.* at 11.

C. Line Extension Charges

The Companies claim that expenses associated with line extensions have increased dramatically. They seek to modify their line extension policies and charges in this case.[83]

Staff does not agree that it is appropriate to address in this ESP. Staff recognizes that S.B. 221 permits companies to request distribution rate relief as part of an ESP plan. Staff does not believe that the relief sought by the Companies should be granted in this proceeding. The Staff has recommended that the Companies file a base rate case in 2009 and that the distribution-related costs and issues be examined in that case. That review should include the line extension issues that have been raised by the Companies in this case.[84] As the Commission decided in the recent FirstEnergy SSO case, many of the "expenses which the Companies seek to recover . . . are best reviewed in a distribution rate case where all components of distribution rates are subject to review."[85]

D. Regulatory Asset Recovery Rider

The Companies have created various distribution regulatory assets. The Companies propose to amortize these regulatory assets beginning in 2011 over an eight-year period. Carrying charges on the unamortized balances will be accrued through the eight-year amortization period and the deferrals will be recovered through the Regulatory Asset Recovery Rider.[86]

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83 Application at 11-12.

84 Direct testimony of J. Edward Hess, Staff Ex. 1, at 4.

85 *In re FirstEnergy*, Case No. 08-935-EL-SSO (Opinion and Order) (December 19, 2008) at 37.

86 Application at 12.

The Staff has recommended that the Companies file a base rate case in 2009 and that the distribution-related costs and issues be examined in that case. That review should include the amortization of regulatory assets that have been requested by the Companies in this case.[87]

III. Phase-In

The impact of the Companies' proposal on customer rates is significant. In recognition of that impact, the Companies propose to limit customer increases over the next three years by deferring incremental FAC expenses so that no rate schedule would increase more than approximately 15%.[88]

The Companies propose to phase in the new ESP rates by deferring a portion of the proposed annual incremental FAC costs in 2009, 2010 and 2011. The deferred FAC costs would be recovered with a carrying cost over seven years from 2012 to 2018.[89] The deferrals, along with the associated carrying charges, would be collected through a non-bypassable surcharge.

The Commission has acknowledged that Ohio Rev. Code §4928.144 authorizes the Commission to order an electric utility to phase-in any rate established under R.C. §4928.143 in order to ensure rate stability.[90] Staff, however, recommended that the Companies not be permitted to defer costs past the three-year ESP period. Staff believes that deferrals should be avoided whenever possible.[91] Staff also believes that its adjustments to the proposed FAC

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87 Direct testimony of J. Edward Hess, Staff Ex. 1, at 4.

88 Application at 6.

89 Application at 12-13.

90 *In re FirstEnergy*, Case No. 08-935-EL-SSO (Opinion and Order) (December 19, 2008) at 16.

91 Direct Testimony of Richard Cahaan, Staff Ex. 10, at 5.

baseline and non-FAC increases sufficiently minimize rate shock so that deferrals are not necessary.

If the Commission determines that a phase-in of the first year increase is needed, Staff recommends that it be levelized over the three year ESP period. While not recommending a specific "phase-in," Staff has recommended that deferrals not extend beyond the length of the ESP.[92]

This would appear to be consistent with the Commission's recent decision in FirstEnergy's SSO case. There the Commission noted that the short-term benefits of lower billed generation rates by deferring expenses has the potential to damage Ohio's competitiveness in the global economy over the long-term.[93] But the Commission also took note of the significant economic difficulties facing Ohio residents.[94] As in *FirstEnergy*, the record in this case clearly demonstrates the change in circumstances since the Companies' case was first filed. On cross-examination, Staff witness Cahaan recognized that current economic conditions have made arguments for deferrals more reasonable.[95]

IV. Other Provisions

A. Corporate Separation

1. Functional Separation

The Companies request that they be permitted to remain functionally separated. They have further requested that their corporate separation plans be modified to provide that each

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92 Tr. XII at 251.

93 *In re FirstEnergy*, Case No. 08-935-EL-SSO (Opinion and Order) (December 19, 2008) at 17.

94 *Id.*

95 Tr. Vol. XII at 260-261.

Company retain its distribution and, for now, transmission assets. The generating assets would be transferred or sold when functional separation expires.[96]

In Staff's opinion, the Companies' generating assets have not been structurally separated from the operating companies.[97] Staff witness Buckley testified that those assets "have not been moved out of the operating companies into a separate affiliate."[98]

As the Commission is aware, it has adopted rules, subject to rehearing, governing corporate separations.[99] The rules would, among other things, require companies to file an application requesting approval of their corporate separation plan. Staff respectfully submit that that is the proceeding where the Commission should consider the Companies' proposal.[100] This is precisely what the Commission found in the FirstEnergy SSO case.[101] While the Companies may be authorized to request approval in this case, requiring them to file for approval after adoption of final rules would allow interested parties easy access to the plan and subsequent updates.[102]

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96 Application at 14.

97 Direct Testimony of Joseph P. Buckley, Staff Ex. 7, at 1-2.

98 Tr. Vol. XII, p. 144.

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

100 Direct Testimony of Joseph P. Buckley, Staff Ex. 7, at 3.

101 *In re FirstEnergy*, Case No. 08-935-EL-SSO (Opinion and Order) (December 19, 2008) at 17.

102 Direct Testimony of Joseph P. Buckley, Staff Ex. 7, at 3-4.

2. Generation Assets Not in Rate Base (Waterford & Darby)

CSP requests authority to sell or transfer two generating facilities not currently included in rate base. These facilities are the Waterford Energy Center and the Darby Electric Generating Station.[103]

Staff does not object to the sale or transfer of these assets, but submits that this is not the appropriate time to grant that authority. CSP has no immediate plan to sell or transfer those facilities. The Commission's pending rules would address such transfers.[104] Staff believes that the Commission should not grant the requested authority to transfer. Instead, CSP should be required to file a separate application when they are prepared to transfer the assets. This would, as Staff witness Buckley noted, give parties an opportunity to fully evaluate the transaction and its potential consequences.[105]

B. Net Metering

The Companies have proposed a standard net metering tariff for hospitals. In addition, the Companies are proposing other changes to their net metering rate schedule.[106]

Staff believes the Companies were premature in filing this tariff before the new net metering requirements have become effective.[107] The Commission has adopted new

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103 Application at 14.

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

105 Direct Testimony of Joseph P. Buckley, Staff Ex. 7, at 3.

106 Application at 17.

107 Direct Testimony of Peter K. Baker, Staff Ex. 5, at 9.

requirements, subject to rehearing.[108] Staff recommends that the Companies withdraw their proposed net metering tariffs and re-file versions consistent with the new requirements either after the rule becomes effective, or together with its next base rate case application, whichever comes first.

V. Miscellaneous

A. Possible Early Plant Closures

The Companies claim that there is a possibility that it may be economically necessary to close generating plants earlier than assumed for depreciation accrual purposes. In that case, the Companies propose to defer any net undepreciated plant investment and any other early closure costs for future recovery.[109] Specifically, the Companies have requested that the net loss be deferred as a regulatory asset to be recovered through a non-by-passable rider over a reasonable relatively short period of years.

Staff believes that customers should not have to bear the costs of uneconomic plants without recognizing an offset for the positive economic value of the rest of the Companies' generating fleet.[110] Staff assumes that the net value of the Companies' generating fleet is positive. If the Companies decide to close a unit before its retirement date for depreciation accrual purposes, the Companies should request appropriate treatment for such accelerated depreciation and other early closure costs from the Commission at that time.

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

109 Application at 18-19.

110 Direct Testimony of J. Edward Hess, Staff Ex. 1 at 8.

VI. ESP/MRO Comparison

To approve the Companies' ESP, the Commission must find that the Plan is more favorable, in the aggregate, than the expected results of a market rate offer (MRO) under Ohio Rev. Code §4928.142. S.B. 221 offers little guidance on what "more favorable" and "expected results" mean, leaving these matters to the Commission's judgment.

Staff witness Hess testified that the Companies' proposed ESP rates, adjusted for the Staff's recommendations would result in reasonable rates.[111] Based on revisions to the Companies' estimated market rate proposed by Staff witness Johnson, Staff witness Hess's exhibits demonstrate that the Companies' ESP proposal is more favorable in the aggregate as compared to the expected results that would otherwise apply under a market rate option.[112]

VII. Significantly Excessive Earnings Test

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

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

In making this determination "[t]he burden of proof for demonstrating that significantly excessive earnings did not occur shall be on the electric distribution utility."[113] The pivotal phrase in this undertaking is "significantly excessive", a term not defined in the law. The Companies take the view that this is a matter for statistical analysis, that the phrase is used in a

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[111] *Id.*

[112] Revised Exhibit JEH-1, Staff Ex. 1A.

[113] Ohio Rev. Code §4928.143(F)

technical, statistical sense. Staff and other witnesses have shown that using the incorrectly formulated statistical test begs the question by shifting the burden of proof to other parties.

There is nothing in the statute that requires a statistical analysis. Indeed reading the terms "significantly in excess" or "significantly excessive" as requiring a statistical interpretation would violate the rule of construction requiring that terms be construed according to common usage. The statute does not speak of confidence intervals, arithmetic means, standard deviations, sample sizes or any other matter statistically related. There is only the coincidental similarity between the statistical term "significance" and the statutory use of the term "significantly." The statutory language does not suggest any intent whatsoever to use "significantly" in any technical sense.

The Commission has already addressed this very issue. In the FirstEnergy case the Commission noted that:

> the test itself will not be actually applied until 2010. Therefore, the Commission agrees with Staff that it would be wise to examine the methodology for the excessive earnings test set forth in the statute within the framework of a workshop. The goal of the workshop would be for the Staff to develop a common methodology for the excessive earnings test that should be adopted for all of the electric utilities and then report back to the Commission on its findings. According, the Commission finds that Staff should convene a workshop consistent with this determination.[114]

The Staff feels strongly that a single methodology should be adopted across all EDUs, and urges the Commission to reiterate its decision in the FirstEnergy case here.

VIII. Conclusion

Staff respectfully urges the Commission to adopt the recommendations Staff has advanced in this brief.

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114 *In re FirstEnergy*, Case No. 08-935-EL-SSO (Opinion and Order) (December 19, 2008) at 64.

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PROOF OF SERVICE

I hereby certify that true copy of the foregoing Post-Hearing Brief on Behalf of the Staff of the Public Utilities Commission of Ohio, was served by regular U.S. mail, postage prepaid, hand-delivered, and/or delivered via electronic mail, upon the following parties of record, this 30th day of December, 2008.

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