FILE

44

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 OF INDUSTRIAL ENERGY USERS-OHIO

RECEIVED-DOCKETING DIV

2008 DEC 30 PM 4:38

PUCO

Samuel C. Randazzo (Counsel of Record)
Lisa G. McAlister
Joseph M. Clark
MCNEES WALLACE & NURICK LLC
21 East State Street, 17TH Floor
Columbus, OH 43215
Telephone: (614) 469-8000
Telecopier: (614) 469-4653
sam@mwncmh.com
lmcalister@mwncmh.com
jclark@mwncmh.com

December 30, 2008

Attorneys for Industrial Energy Users-Ohio

TABLE OF CONTENTS

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 OF INDUSTRIAL ENERGY USERS-OHIO

I. INTRODUCTION

After the General Assembly's prolonged examination of efforts to enable competition in the electric industry and almost unanimous action by the General Assembly, Governor Ted Strickland signed into law Amended Substitute Senate Bill 221 ("SB 221") on May 1, 2008. SB 221 modified, among other things, Chapter 4928 of the Revised Code. Section 4928.141, Revised Code, requires each electric distribution utility ("EDU") to establish a standard service offer ("SSO") in accordance with Sections 4928.142 or 4928.143, Revised Code.[1]

On Thursday, July 31, 2008, Columbus Southern Power Company and Ohio Power Company (individually "CSP" and "OP", respectively, and collectively "Companies") filed an Application for approval of SSOs under Section 4928.143,

[1] Section 4928.142, Revised Code, governs market rate offer ("MRO") plans while Section 4928.143, Revised Code, is controlling in the case of electric security plans ("ESP").

Revised Code (hereinafter referred to as "ESP Application" or "Proposed ESPs"). The Companies' Proposed ESPs raise "... issues that are broader than simply focusing on the SSO for competitive retail electric services."[2] In addition to raising a variety of issues beyond pricing of competitive retail electric service, the Companies' ESP Application indicates that the Companies would discuss "... their long-term vision for the future in some detail and address how the proposed ESP is designed to implement that vision."[3] The Companies' ESP Application requests the Public Utilities Commission of Ohio ("Commission" or "PUCO") to:

1. approve their ESPs without modification including all of the accounting authority to implement the ESPs as proposed;
2. provide such approval sufficiently in advance of the scheduled termination of their Rate Stabilization Plans ("RSP") approved by the Commission in Case No. 04-169-EL-UNC;[4]
3. approve their application to modify their corporate separation plans; and,
4. approve CSP's application to provide CSP the authority to sell or transfer certain of its recently acquired gas-fueled generating assets.

The generation rate proposal contained in the Companies' ESP Application calls for taking the current generation component in the SSO, breaking out costs associated with an enhanced fuel adjustment clause (referred to as the "FAC") and then using the FAC to track and recover the many FAC-eligible costs on a going-forward basis. From

---

[2] ESP Application at 2

[3] *Id.* at 2-3. Mr. Hamrock testified that the Companies' ESP Application is designed to implement the first phase of a number of aspects of the Companies' long-term vision for the future (beyond three years). However, the Companies did not include their long-term vision as part of their ESP Application or their testimony. Tr. Vol. III at 64.

[4] "The Companies' Rate Stabilization Plans established the SSO that will be in effect on the effective date of S.B.221. Consequently, they are 'rate plans' as that term is defined by §4928.01 (A)(33), Ohio Rev. Code." ESP Application at 4, footnote 2.

there, the Companies' proposal calls for adding carrying costs associated with environmental-related capitalized investments made between 2001 and 2008 (and amounting to a seven percent (7%) and eighteen percent (18%) increase for CSP and OP, respectively) to the non-FAC generation rate component, and also adding ***annually*** three percent (3%) and seven percent (7%) to the non-FAC components of CSP and OP, respectively, for additional but unspecified carrying costs and the effects of inflation on the non-FAC component during 2009, 2010 and 2011.[5]

Because of the size of the proposed rate increases in the Companies' SSO, the Companies propose a mechanism to limit the rate increases during 2009, 2010 and 2011 so that "... for each year of the ESP no customer rate schedule will experience an increase in excess of approximately fifteen percent" (hereinafter referred to as the "15% Limit").[6] The ESP Application proposes that the 15% Limit be enabled by deferring incremental FAC expenses and then recovering, through a non-bypassable surcharge, the deferred portion plus carrying charges over seven years outside the term of their Proposed ESPs from 2012 to 2018.[7] The Companies' ESP Application characterizes the combination of the 15% Limit, deferral and subsequent recovery through a non-bypassable surcharge as a phase-in "... specifically contemplated by §4928.144, Ohio Rev. Code."[8]

---

[5] ESP Application at 5-6.

[6] The Companies' Proposed ESPs excluded cost increases recoverable through their Transmission Cost Recovery Rider ("TCRR") and cost increases associated with any new "government mandates" from the measurement of the 15% Limit. *Id.* at 6.

[7] *Id.* at 6, 12-13.

[8] *Id.* at 13.

The Companies' ESP Application also states that the Companies are requesting Commission approval of a means to adjust their distribution rates to reflect **costs** associated with the following eight components:

1. enhanced distribution service reliability;
2. implementation of Phase 1 of gridSMART [in] CSP's service territory,[9]
3. provider of last resort ("POLR") service obligation;
4. economic development/job retention programs;
5. energy efficiency/peak demand requirements;
6. alternate feed service;
7. line extension charges; and,
8. Commission-authorized distribution regulatory assets.[10]

The Companies' ESP Application also includes a proposed ***annual*** distribution rate increase of seven percent (7%) and six and one-half percent (6.5%) for CSP and OP, respectively, that the Companies say, in very general terms, are warranted because of the first two distribution-related items (enhanced distribution service reliability and implementation of Phase 1 of gridSMART in CSP's service territory). In addition, the Companies' ESP Application seeks authority to establish new riders or charges for the remaining six distribution-related items.[11]

---

[9] The Companies' enhanced distribution system and gridSMART[SM] proposals are plans that were underway well before SB 221 was enacted. They are discussed at page 5 of 68 of Exhibit JH-1 (the Corporate Sustainability Report) attached to Mr. Hamrock's testimony (Companies Exhibit 3). According to page 7 of 68 of Exhibit JH-1, the Corporate Sustainability Report for 2007 was designated as the 2008 report to convey the Companies' desire to "look forward".

[10] ESP Application at 6.

[11] *Id.* at 6-12.

The Companies' Proposed ESPs also contain other provisions that, if approved by the Commission, will: (1) permit the Companies to maintain functional separation;[12] (2) permit the Companies to sell or transfer certain interests in generating assets even though there are no plans to do so;[13] (3) establish the baseline for compliance with the alternative energy resources requirements in SB 221;[14] (4) address whether the costs of complying with the alternative energy resources requirements in SB 221 will exceed, by three percent or more, the expected costs of otherwise producing or acquiring the requisite electricity;[15] (5) permit the Companies to recover the cost of renewable resource requirements in SB 221 through the proposed enhanced FAC mechanism (which is bypassable during the nominal three-year term of the proposed FAC but may be included in the non-bypassable cost of the proposed phase-in which is proposed to be recovered during the period from 2012 through 2018);[16] (6) allow governmental aggregation programs to elect to allow their participating customers to avoid the proposed POLR charge and, for the term of the ESP and upon return, pay a market-based price plus Section 4928.64, Revised Code, compliance costs;[17] (7) make SB 221 compliance-related changes to the current net metering tariff;[18] (8) provide the Companies with a to-be-determined opportunity to submit filings during the nominal

---

[12] *Id.* at 14.

[13] *Id.* at 14-15.

[14] *Id.* at 15-16.

[15] *Id.* at 16.

[16] *Id.*

[17] *Id.* at 17.

[18] *Id.*

three-year term of the Proposed ESPs for the purpose of recovering costs incurred in conjunction with compliance with a government mandate imposed after the July 31, 2008 filing of the ESP Application;[19] and, (9) permit the Companies to defer any net undepreciated plant investment and other costs associated with "early closure" of generating plants with the Companies coming back to the Commission to determine the appropriate treatment for such "... accelerated depreciation and other early closure costs."[20]

In view of the amount of time consumed during the discovery and litigation phases of these proceedings, it is ironic that the ESP Application does not say anything about a test for determining if and to what extent the Companies may experience significantly excessive earnings during the proposed ESP term. The same goes for the Companies' proposed reliance on escalating percentages of purchased power at market-based prices to meet a portion of their ESP/SSO generation supply needs during 2009, 2010 and 2011. This "slice-of-system" aspect of the Companies' Proposed ESPs was described in the Companies' prefiled testimony but not mentioned in the ESP Application itself. In addition, the Companies' ESP Application did not include a request for authority to prohibit customer participation in demand response programs offered by PJM Interconnect LLC ("PJM").

On December 10, 2008, the evidentiary phase of these proceedings concluded. In accordance with the briefing schedule established by Attorney Examiners See and Bojko, this Brief contains conclusions of fact and law as well as the arguments of the Industrial Energy Users-Ohio ("IEU-Ohio") for the Commission's consideration and use.

---

[19] *Id.* at 18.

[20] *Id.* at 18-19.

IEU-Ohio has not addressed every aspect in the Companies' Proposed ESPs. But this is just a practical concession to time and resource demands and does not signify support or opposition.

The discussion below separates the Companies' main proposals into two broad categories: (1) Competitive Service Pricing; and, (2) Non-competitive Service Pricing. This separation is necessary because Ohio law continues to require the Commission to approach ratemaking for these two service categories differently. The Companies' Proposed ESPs and their direct evidence do not respect these ratemaking differences and this produces legal barriers to the Commission's approval of the Proposed ESPs.

Ohio law and more specifically Sections 4928.03 and 4928.04, Revised Code, make it clear that ***distribution and ancillary services are <u>not</u> competitive services*** unless and until the Commission says so. Section 4928.15, Revised Code, makes it clear that traditional regulation attaches to establish the revenue collection opportunity for ***non-competitive services*** and that charges for non-competitive services must be established by means of an application made pursuant to Section 4909.18, Revised Code, and in accordance with Chapters 4905 and 4909, Revised Code.

While the "notwithstanding" introductory language in Section 4928.143, Revised Code, may provide some license for the Commission to establish prices for some distribution or non-competitive functions using alternative ratemaking methods, Section 4928.142, Revised Code, does not. Under Section 4928.142, Revised Code, prices for non-competitive services must be established in accordance with Chapters 4905 and 4909, Revised Code. Thus, to properly compare the ESP and MRO results, the Commission must either price the non-competitive service elements in a proposed

{C27017:4}

Section 4928.143, Revised Code, plan based on traditional cost-based regulation or identify any deviation from cost-based regulation so that the deviation can be accounted for in the Section 4928.143, Revised Code, aggregate effect test. One way or the other, Ohio law requires that the results of cost-based regulation for non-competitive services must be demonstrated and respected quantitatively before the Commission can discharge its duties under Section 4928.143, Revised Code.

The above discussion is not offered to support the view that SB 221 restored traditional cost-based regulation over competitive services to Ohio's regulatory system. It is designed to focus attention (at a relatively high level) on some of the fundamental defects in the Companies' Proposed ESPs. IEU-Ohio readily acknowledges that SB 221 did not, for example, restore the Commission's authority to reduce rates for competitive services based on a finding that the current revenue produced by the rates are in excess of the allowable costs of providing service, including a reasonable return on investment.

But, just as clearly, SB 221 did not set up a regulatory structure that permits the Commission to arbitrarily slice and dice methods of economic regulation, mix their applications to competitive and non-competitive services, entertain, directly or indirectly, something other than cost-based justification for pricing of non-competitive services or invent a system of economic regulation that is incapable of examination or audit based on quantitative methods.

Also, SB 221's grant of authority to the Commission for the purpose of enabling cost adjustment mechanisms does so for ***prudently incurred*** costs in both Sections 4928.142 and 4928.143, Revised Code. SB 221 did not give the Commission the power to authorize, as the Companies have proposed,[21] cost adjustment mechanisms that are based on forecasted or budgeted costs.

As the above discussion suggests, it is IEU-Ohio's position that much of the Companies' ESP Application seeks relief that is outside the Commission's authority and this is particularly so in the case of those proposals that are related to non-competitive services.

II. COMPETITIVE SERVICE PRICING

Section 4928.03, Revised Code, declares that retail electric generation, aggregation and power marketing services are competitive retail electric services. The Companies' ESP Application proposes significant increases in current prices for competitive services.

A. The FAC Component

IEU-Ohio agrees with the Companies on the starting point for developing pricing for retail electric generation service provided as part of an SSO. More specifically, IEU-Ohio agrees that SB 221 requires the development of pricing of retail electric generation service for ESP purposes to commence with the existing retail electric generation service price as the foundation.

From this starting point, the Companies propose to modify the current retail electric service generation price and introduce the FAC. To evaluate and potentially implement this proposal, it is necessary to unbundle the FAC and non-FAC portions of the current retail electric generation price and determine what level of FAC costs are actually embedded in the currently bundled retail electric service generation price.

[21] Tr. Vol. IX at 74; OCC Exhibit 11 at 19; Companies Exhibit 7 at 11-12.

Some things are easier said than done. And the doing in these cases is complicated by a lack of detail on just what the Companies are specifically asking the Commission to approve. As Ms. Smith testified, the Companies' proposed FAC does not include a "fully fleshed out FAC tariff."[22]

Based on what the Companies do say about their FAC proposal, it is clear that the scope of the Companies' proposed FAC includes costs related to much more than the costs of fuel consumed to produce electricity; the costs which were historically subject to recovery through the Electric Fuel Component ("EFC") rate.[23] As the Commission knows, the EFC was established by rule (Chapter 4901:1-11, Ohio Administrative Code) for uniform application to all electric utilities.[24] Under Rule 4901:1-11-1(O), Ohio Administrative Code, "fuel costs" were defined as the "... actual acquisition and delivery costs of fuel consumed, including the amortized costs of nuclear fuel expended, to generate electricity, unless otherwise provided in this chapter." But, the opportunity to use the EFC to recover costs through an active adjustment clause came with obligations and a defined process by which compliance could be audited and evaluated by the Commission.

The EFC mechanism was also predicated on the Commission's ability to regulate the operation of the utility's generating units. For example, Rule 4901:1-11-02(A), Ohio

---

[22] Tr. Vol. VI at 79; OCC Exhibit 9 at 31.

[23] OCC Exhibit 11 at 20. These additional elements comprise 21% of CSP's and 11% of OP's estimated FAC.

[24] In 1998, the Commission completed its periodic review of Chapter 4901:1-11, Ohio Administrative Code, as required by Section 119.032(B), Revised Code, in Case No. 98-967-EL-ORD, concluding that no amendments to the rule were necessary. For purposes of this Brief, IEU-Ohio's citations to the EFC rule are citations to the rule attached to the Commission's July 2, 1998 Entry in Case No. 98-967-EL-ORD, which was the version of the rule in place when the EFC was eliminated by Ohio's electric restructuring legislation.

Administrative Code, required an electric utility to "... procure fuel, purchase power, and operate its generation, dispatch, transmission, and distribution systems at a ***minimum overall cost***, taking into consideration its voltage, frequency, reliability, safety, environmental, and service quality requirements, as well as its existing contractual obligations." (emphasis added). And, Rule 4901:1-11-02(B), Ohio Administrative Code, required an electric utility to "... operate on an economic dispatch basis."

The Companies' FAC proposal is focused exclusively on obtaining authority to automatically adjust rates to recover a broad range of costs. The Companies are not proposing to take on the obligations that have been historically part of a fuel adjustment clause, including the obligation to operate generation, transmission and distribution systems for the benefit of their retail customers subject to the regulatory oversight of the Commission. Therefore, the Companies' proposed FAC is fundamentally unbalanced. For this reason alone, the Commission should not and cannot give the Companies authority to implement the proposed FAC. But there are other problems with the Companies' proposed FAC.

As explained above, the Companies' proposed FAC includes a broad range of costs[25] that were not previously recoverable under the Commission's EFC rule.[26] For example, the Companies' proposed FAC would, if approved, provide the Companies with the ability to recover demand and capacity-related costs that were not subject to recovery through the Commission's EFC rule.[27] The Companies' proposed FAC causes

[25] Tr. Vol. IV at 249-252.

[26] OCC Exhibit 11 at 20.

[27] Tr. Vol. IV at 249-257; Tr. Vol. VI at 203-204; § 4901:1-11-04(D), Ohio Admin. Code; *See In Re the Electric Fuel Component of Ohio Power Company and Columbus Southern Power,* Case Nos. 98-101-EL-EFC and 98-102-EL-EFC (May 27, 1999).

these capacity or demand-related costs to be allocated to and recovered from customers on an energy or kilowatt-hour ("kWh") basis.[28] As Mr. Gorman explained, "... the Company's proposal to recover non-variable [or fixed] costs through the FAC, is inappropriate for several reasons."[29] Recovery of fixed, capacity or demand-related costs on a volumetric or kWh basis also conflicts with the long-standing precedent of the Commission.[30]

The Companies' proposed FAC plays a "catch all" role which partly explains its broad scope. For example, the proposed FAC is where the Companies propose to recover the costs associated with the "slice-of-system" costs.[31] While the Commission Staff provided some support for the scope of the Companies' proposed FAC, Mr. Strom made it clear that the scope of the proposed FAC should only be approved if the costs to be recovered through the FAC are not being recovered someplace else.[32]

[28] Tr. Vol. IV at 257; Tr. Vol. V at 204.

[29] Commercial Group Exhibit 1 at 4.

[30] *In the Matter of the Complaint and Appeal of Columbia Gas of Ohio, Inc., from Ordinance No. 1192-76, of Columbus, Ohio, on July 19, 1976, to continue the Presently Established Schedules of Rates Being charged by Columbia Gas of Ohio, Inc., for Gas Service in the City of Columbus, Ohio, until August 1, 1978,* Case No. 76-704-GA-CMR, Opinion and Order at 7 (June 29, 1977); *In the Matter of the Application of Columbus Southern Power Company to Adjust its Power Acquisition Rider Pursuant to its Post-Market Development Period Rate Stabilization Plan*, Case No. 07-333-EL-UNC (July 27, 2007); *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Approval of a Market Rate Offer*, Case No 08-936-EL-SSO, Opinion and Order at 22-24 (November 25, 2008, subject to application for rehearing); *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 at 19-23 (December 19, 2008).

[31] The "slice-of-system" costs that the Companies estimate will be recovered through the FAC total $1.320 billion. IEU-Ohio Exhibit 10 at 8; OEG Exhibit 3 at 9. Mr. Bowser (IEU-Ohio Exhibit 10) and Mr. Kollen (OEG Exhibit 3) address specific problems with the slice-of-system proposal. But, the Commission need not address the more-specific problems with the slice-of-system proposal if it, as IEU-Ohio recommends here, rejects the Companies' proposed FAC.

[32] Staff Exhibit 8 at 3.

Unfortunately, the justification that the Companies have provided for their other ESP components does not include a showing that current revenues are inadequate to provide compensation for slice-of-system or any other costs. As Mr. Cahaan testified, the Companies were obviously recovering their fuel costs (which he defines to include purchased power) in 2007 or their earnings would have been insufficient.[33]

The Companies' proposed FAC is mysterious enough as the proposal relates to the nominal three-year term of the Proposed ESPs. But, cross-examination of the Companies' witnesses revealed that the Companies are actually proposing that their proposed FAC survive the nominal three-year ESP term.[34] The FAC mechanism that the Companies propose survive beyond three years would include the items that the Companies have proposed be recovered through the FAC.[35] If the FAC survives beyond the three-year ESP term, the Companies have not explained how the FAC will be integrated with a subsequent SSO that includes pricing based on Section 4928.142, Revised Code. Regardless of the implication of this mysterious facet of the Companies' Proposed ESPs, the effect of the FAC's survival is not recognized in the results of the *aggregate benefit* test as presented by Mr. Baker or Mr. Hess.[36]

Based on the record evidence, the Companies' FAC proposal suffers from the following defects:

1. There is no fully fleshed out FAC tariff;

---

[33] Staff Exhibit 10 at 3.

[34] Tr. Vol. IX at 143-146.

[35] *Id.* at 144.

[36] The comparisons shown in Companies Exhibit 2B, JCB-2 and Staff Exhibit 1, JEH-1 are limited to the period 2009 through 2011.

2. The proposed FAC is not limited to the term of the ESPs and its effects beyond the term of the ESPs are not identified;
3. The FAC proposal is fundamentally unbalanced because it would enable automatic recovery of a broad range of costs without regard to customer-focused performance obligations that, among other things, would require the Companies to operate generation, transmission and distribution systems for the benefit of their customers;
4. It is impossible to determine if the Companies will otherwise receive adequate compensation under their current rates or the current rates as modified by the proposed ESPs for costs they also propose to include in the FAC; and
5. The cost distribution effects of the proposed FAC conflict with the Commission's precedent regarding the allocation of demand and capacity-related costs.

IEU-Ohio recommends that the Commission reject the Companies' request for approval of their FAC.

IEU-Ohio is not necessarily opposed to the establishment of an active fuel cost recovery mechanism provided that it is specifically focused on actual variable acquisition and delivery costs of fuel consumed to generate electricity and that the recovery of such costs is conditioned upon the Companies satisfying obligations like those previously included in the Commission's EFC rule. In any event, the Commission's determination regarding the costs subject to recovery through an active fuel cost recovery mechanism must be provided before it is possible to unbundle the current SSO generation price component between the fuel and non-fuel components. Until then and as Mr. Cahaan testified,[37] the earned returns on common equity indicate that the Companies' current rates are providing sufficient revenue to cover their fuel costs as well as all other costs.

[37] Staff Exhibit 10 at 3.

In addition to the conclusion regarding the adequacy of the Companies' current rates suggested by Mr. Cahaan's observation regarding the sufficiency of the Companies' earnings, there are other indications that the revenues available to the Companies under current rates are sufficient to provide adequate compensation. For example, the gross revenue margin (revenue **less** fuel and purchased power expense)[38] per MWH of the Ohio Companies[39] suggests that the customers of the Ohio Companies are and have been carrying their weight (and perhaps more) when it comes to fairly compensating the Companies. As shown at page 11 of IEU-Ohio Exhibit 2,[40] the gross margin per MWH reported for the Ohio Companies for the third quarter of 2008 was $43.9 per MWH compared to $46.8 per MWH for the corresponding quarter in 2007. In both quarters, the next highest gross margin per MWH contribution to earnings per share by any American Electric Power ("AEP") business unit came from Off System Sales (at between $32 and $33 per MWH).

AEP Quarterly Performance Comparison

American Electric Power
Financial Results for 3rd Quarter 2008 Actual vs 3rd Quarter 2007 Actual

		2007 Actual			2008 Actual		
		Performance Driver	($ millions)	EPS	Performance Driver	($ millions)	EPS
	UTILITY OPERATIONS:						
	Gross Margin:						
1	East Regulated Integrated Utilities	18,677 GWh @ $28.6 /MWhr =	534		18,080 GWh @ $27.6 /MWhr =	499	
2	Ohio Companies	13,464 GWh @ $46.8 /MWhr =	629		13,127 GWh @ $43.9 /MWhr =	577	
3	West Regulated Integrated Utilities	12,468 GWh @ $26.9 /MWhr =	336		12,070 GWh @ $28.2 /MWhr =	341	
4	Texas Wires	7,721 GWh @ $19.8 /MWhr =	152		7,981 GWh @ $19.3 /MWhr =	153	
5	Off-System Sales	10,164 GWh @ $32.4 /MWhr =	329		9,777 GWh @ $33.0 /MWhr =	322	
6	Transmission Revenue - 3rd Party		81			85	
7	Other Operating Revenue		126			150	
8	Utility Gross Margin		2,187			2,127	

[38] Tr. Vol. IV at 285. The "East Integrated Utilities" line includes Appalachian Power Company, Kentucky Power Company, I&M [Indiana Michigan Power], Wheeling Power and Kingsport Power Company. Tr. Vol. IV at 287.

[39] The term "Ohio Companies" refers to CSP and OP. Tr. Vol. IX at 112.

[40] IEU-Ohio Exhibit 2 is the 2008 earnings release presentation for the third quarter which was issued by AEP on October 31, 2008. Tr. Vol. IV at 285.

B. The Non-FAC Component

As explained above, the Companies' Proposed ESPs also include provisions to escalate the current SSO generation price excluding costs that the Companies propose be recovered through the FAC. The Companies' ESP Application indicates that the first adjustment to the non-FAC generation component is necessary to permit the Companies to recover carrying costs associated with environmental-related capitalized investments made between 2001 and 2008 [adjustments amounting to a seven percent (7%) and eighteen percent (18%) increase for CSP and OP, respectively]. In addition, the Companies propose to make further adjustments to the non-FAC generation rate component that add ***annually*** three percent (3%) and seven percent (7%) to the non-FAC components of CSP and OP, respectively. The Companies claim that these extra adjustments are needed to permit them to collect more revenue to cover additional but unspecified carrying costs and to offset the effects of inflation on the non-FAC component during 2009, 2010 and 2011.[41]

Before addressing the Companies' position regarding these additional adjustments to the non-FAC generation component, it is important to review just what SB 221 did or did not do to prior law.

The Companies submit their non-FAC rate increase proposals without attempting to tie them to specific costs of providing service based on their view that cost of service ratemaking is not part of Ohio's current law.[42] This affirmative defense is a bit odd since

---

[41] ESP Application at 5-6.

[42] Companies Exhibit 2E at 2-5; Tr. Vol. VI at 97; Tr. Vol. V at 102-103.

the Companies' current goals and mission statement[43] seem to fit best with a system of traditional regulation that is based on compensation tied to costs including a reasonable return for shareholders. But in any event, the Companies' defense of their non-FAC increases wrongly assumes the prior and existing law closed off an examination of costs for purposes of establishing prices for competitive services.

As the Commission knows, the Companies' prior RSP proposal called for automatic annual escalations in the unbundled generation price over a period of three years. The evidence in the Companies' RSP proceeding confirmed that the market had not matured as expected when SB 3 was enacted (1999) but the record did not include any estimate of market-based prices. In this context, some parties – including IEU-Ohio – argued that the Commission should use the reasonable rate policy statement in Section 4928.02, Revised Code, and the just and reasonable requirement in Section 4909.18, Revised Code, to consider whether, after considering the underlying costs, the amount and frequency of the utility's proposed automatic price escalations would excessively burden the Companies' customers if included in the RSP pricing structure. In response to these legal arguments, the Commission said:

> Many of the parties object to this provision because they contend that AEP is already earning too much. However, these parties seem to forget that, with the expiration of the MDP, generation rates are subject to the market (not the Commission's traditional cost-of-service rate regulation) and that the plan was an option that AEP voluntarily proposed. Section 4928.05(A)(1), Revised Code. We make this observation to point out that, under the statutory scheme, company earnings levels would not come into play for establishing generation rates – market tolerances would otherwise dictate, just as AEP argued (AEP Reply Br. 26-27).[44]

[43] *See* Companies Exhibit 3, JH-1 at 68 of 68, for example.

[44] *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of a Post-Market Development Period Rate Stabilization Plan*, Case No. 04-169-EL-UNC,

Thus, the Commission rejected, initially, any consideration of costs for purposes of evaluating the automatic generation increases proposed by the Companies to simulate market-based prices. But, the Commission's discussion of this issue and subject did not end with the Companies' RSP case.

On October 24, 2007, the Commission issued an RSP-related order in a Duke Energy-Ohio proceeding initiated as a result of the Ohio Supreme Court remanding the case to the Commission to correct errors. In this order, the Commission described the nature and scope of its market-based ratemaking authority differently and more broadly than it did in the earlier AEP RSP case:

> We are tasked, under Chapter 4928 of the Revised Code, with approving generation charges that are market-based and consistent with the state policy set forth in this chapter. Although, in some instances, costs or changes in costs may serve as proxies for reasonable market valuations or changes in such valuations, this is not the same as establishing prices based on costs. Similarly, a market-based standard service offer price is not the same as a deregulated price. **Standard service offers remain subject to Commission jurisdiction under Chapter 4928 of the Revised Code. And, standard service offers must be consistent with state policy under Section 4928.02, Revised Code....Thus, while a standard service offer price need not reflect the sum of specific cost components, the result must produce reasonably priced retail electric service, avoid anticompetitive subsidies flowing from noncompetitive to competitive services, be consistent with protecting consumers from market deficiencies and market power, and meet other statutory requirements.**[45]

The Commission's interpretations of the law prior to SB 221 show that prior law permitted the Commission to consider costs and changes in cost for the purpose of

---

Opinion and Order at 18 (January 26, 2005). Throughout this RSP proceeding, the Companies indicated that the Commission had to endorse the Companies' proposal or they would "flash cut" to market.

[45] *In the Matter of the Consolidated Duke Energy Ohio, Inc. Rate Stabilization Plan Remand and Rider Adjustment Cases*, Case Nos. 03-93-EL-ATA *et al.*, Order on Remand at 36-37 (October 24, 2007) (emphasis added).

establishing prices for competitive services and meeting the state policy. Both before and after SB 221, the Commission's ability to look at costs and changes in costs was and is not tied to reestablishment of traditional rate-base-rate-of-return regulation. The Commission's ability to look at costs and changes in cost is a function of its larger responsibility based on the objectives of Chapter 4928, Revised Code. The Commission's decisions since the enactment of SB 221 confirm that the state policy objectives in Section 4928.02, Revised Code, must be used as a guide to implement Section 4928.143, Revised Code.[46] The Companies' claim that the Commission cannot consider costs and changes in costs is linked to their assertion that the Commission's consideration of costs requires the reestablishment of traditional regulation.[47] The Companies use these linked claims to bridge to their conclusion that anything they propose in an ESP meets the requirements of Section 4928.143, Revised Code, so long as the ESP is "... more favorable in the aggregate than the expected results under an MRO."[48] But the Companies' bridge is a "bridge to nowhere" given the larger obligations of the Commission to produce results that are driven by the state policy.[49]

[46] *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 at 12 (December 19, 2008).

[47] Companies Exhibit 2E at 2-5.

[48] *Id.* at 4.

[49] The Companies' position regarding the meaning of SB 221 would have the Commission approve rate increases for their Ohio customers so long as the end result is less than an alternative market price computation. As shown by comparing the average per kWh prices in IEU-Ohio Exhibit 7 at pages 22, 26, 30, 34 and 38, the Companies have some of the highest rates when compared to their affiliated operating companies providing service in nearby states. In this context, the Companies' proposal to raise the prices of their Ohio customers requires the Commission to, among other things, examine the proposal to see how it responds to the Section 4928.02, Revised Code, objective of "[f]acilitating the state's effectiveness in the global economy". *See Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St.3d 305, 2007-Ohio-4164, at ¶ 47-58.

1. Carrying Costs Associated with Environmental-Related Capitalized Investments Made Between 2001 and 2008

The record does not clearly indicate what provision in SB 221 the Companies are relying on to seek and obtain authority to increase current SSO generation prices upwards to include carrying costs on 2001-2008 environmental investments. Mr. Nelson testified that the investments were "... necessary to keep the Companies' low-cost coal-fired generating units running" and that "customers will benefit because the operating costs of these units remain well below the cost of securing the power on the market."[50] Thus, it appears that the Companies are basing their proposal to increase rates to include carrying costs on 2001-2008 environmental investments based on the broad theory that customers will somehow benefit from the operation of these low-cost assets. The Companies did not explain how this benefit will be preserved for or conveyed to their customers. Thus, the Companies' proposal fails to show how the costs that their proposal will impose upon customers will be aligned with the benefits identified by the Companies.

The importance of the cost/benefit matching principle is made clear by the letter of SB 221 in Section 4928.143(C)(1) [as it relates to a surcharge under Section 4928.143(B)(2)(b) or (c)] and Section 4928.142(D), Revised Code [as it relates to adjustments to the most recent standard service offer used to establish an SSO based on the market-rate offer methodology]. The Commission is required to disapprove an application that includes a Section 4928.143(B)(2)(b), Revised Code, allowance for an eligible environmental expenditure (one occurring after January 1, 2009) unless the Commission ensures "... that the benefits derived for any purpose for which the

[50] Companies Exhibit 7B at 6.

surcharge is established are reserved and made available to those that bear the surcharge."[51] Accordingly, the Companies' proposal to increase current rates for carrying costs on 2001-2008 environmental investments cannot be approved.

Beyond the Companies' failure to show how the benefits derived from the carrying costs on 2001-2008 environmental investments will be aligned with the cost responsibility they seek to impose on customers, this aspect of the Companies' proposal suffers from numerous other problems.[52] For example, the calculation of the carrying charge rate fails to reflect certain tax benefits.[53] Also, the 50/50 capital structure used by the Companies to compute the carrying cost rate appears to ignore the fact that specific types of debt instruments are used extensively to finance environmental plant and equipment.[54] Of course, the higher the common equity portion of the capitalization ratio used to compute the carrying cost rate, the higher the carrying cost rate and the larger the resulting rate increase for customers.[55] Despite the proposed use of a 50/50 capitalization ratio, AEP's actual capitalization ratio appears to be closer to 60% debt and 40% equity.[56] Also, Mr. Cahaan agreed that it would be appropriate to look at the cost rates for financing instruments peculiar to environmental

[51] Section 4928.143(C)(1), Revised Code.

[52] Mr. Kollen discussed the problems at pages 20 to 23 of OEG Exhibit 3. Mr. Higgins discussed the problems at page 4 of Kroger Exhibit 1.

[53] IEU-Ohio Exhibit 10 at 4-7. *See also 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 at 19 (December 19, 2008).

[54] IEU-Ohio Exhibit 7 at 132-133; IEU-Ohio Exhibit 9.

[55] Tr. Vol. XIV at 107.

[56] IEU-Ohio Exhibit 7 at 125.

plant and equipment for purposes of computing carrying costs on such plant and equipment.[57]

For the reasons expressed above, IEU-Ohio recommends that the Commission reject the Companies' proposal to increase existing SSO generation prices to include carrying costs on 2001-2008 environmental investments.

2. Annual Three Percent (3%) and Seven Percent (7%) Increases in the Non-FAC Generation Price for CSP and OP, Respectively

The Companies' proposal to ***annually*** increase the non-FAC portion of generation prices by three percent (3%) and seven percent (7%) for CSP and OP, respectively, was mathematically illustrated but never justified by the Companies.[58] The Companies' ESP Application states that these annual price escalations are necessary to recognize additional but unspecified carrying costs and the effects of inflation on the non-FAC component during 2009, 2010 and 2011.[59] Mr. Cahaan offered the Staff response to the Companies' proposal saying that the current financial crisis suggests that we may be entering a deflationary period rather than a period of price increases. He then substituted a lower (but still arbitrary) number for the annual escalator proposed by the Companies; Mr. Cahaan recommended that the Companies' proposal be cut in half.[60]

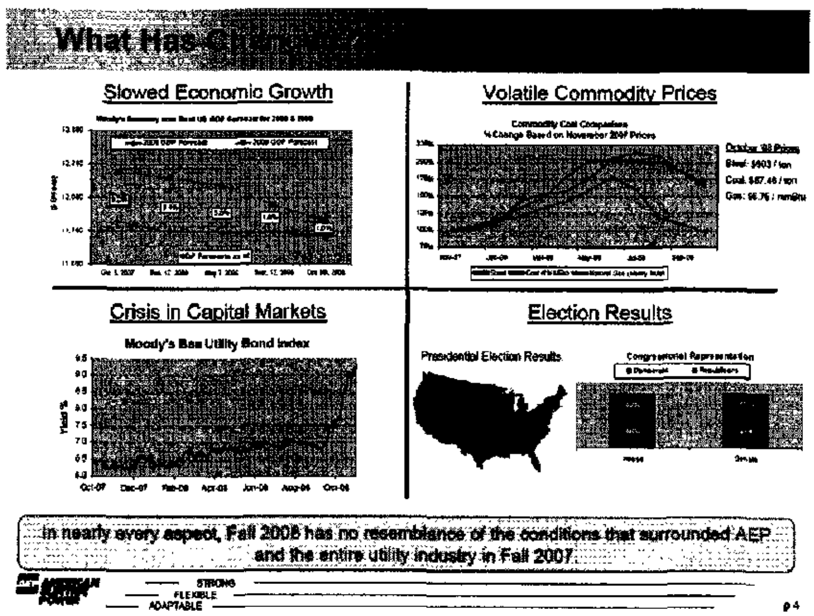
Whatever the Companies may have anticipated when their ESP Application was filed, they now understand that "[i]n nearly every aspect, Fall 2008 has no resemblance of the conditions that surrounded AEP and the entire utility industry in Fall 2007."

[57] Tr. Vol. XII at 236-237.

[58] OEG Exhibit 3 at 18.

[59] ESP Application at 5-6.

[60] Staff Exhibit 10 at 4.



[61]

Despite indications in the Companies' ESP Application and prefiled testimony that expected increases in investments related to environmental compliance support certain provisions in the Proposed ESP to escalate SSO prices, the historical and projected environmental investments shown at page 7 of the most recent Form 10-K filed with the Securities and Exchange Commission ("SEC") by AEP indicate that CSP's and OP's estimated annual investments in 2009 and 2010 are well below the actual investments for 2007.[62] And, according to IEU-Ohio Exhibit 6 at page 4, AEP recently reduced its projected total capital spending for 2009 by $750 million, thereby reducing its need to access capital markets in 2009.[63] IEU-Ohio Exhibit 6 shows that AEP's environmental-related capital spending is estimated for 2008 at $877 million and was initially estimated for 2009 at $668 million. IEU-Ohio Exhibit 6 (at page 4) also shows

[61] IEU-Ohio Exhibit 5 at 4.

[62] IEU-Ohio Exhibit 3. According to the Form 10-K, the dollar amounts for investments exclude AFUDC or capitalized interest.

[63] IEU-Ohio Exhibit 6 at page 3 shows that AEP anticipates that capital spending in 2009 will closely match 2009 cash flow from operations.

that AEP's revised 2009 estimate for environmental-related capital spending has declined to $507 million. IEU-Ohio Exhibit 6 at page 6 also shows a downward trend in both AEP-Dayton hub electric prices and NYMEX coal prices.

So, Mr. Cahaan was correct when he testified that expectations that may have existed when the Companies filed their ESP Application have changed significantly.[64] But, expectations about where conditions in the general economy may or may not go in the future are not a basis to increase the Companies' revenue and prices under SB 221 regardless of whether SSO prices are established under Section 4928.143 or Section 4928.142, Revised Code. In fact, under Section 4928.142(D), Revised Code, any adjustment to the current generation portion of the SSO prices is limited to known and measurable changes arising from certain prudently incurred costs adjusted to reflect the benefits and subject to such conditions as the Commission may impose to ensure that the benefits are properly aligned with the associated cost responsibility.

For the reasons expressed above, the Companies' proposal to annually increase the non-FAC portion of generation prices by three percent (3%) and seven percent (7%) for CSP and OP, respectively, must be rejected.

III. NON-COMPETITIVE SERVICES

In their ESP Application, the Companies request Commission approval of a means to increase their distribution rates to reflect **costs** associated with the eight components listed above,[65] including: enhanced distribution service reliability; CSP's implementation of Phase 1 of gridSMART; POLR obligations; economic

---

[64] Staff Exhibit 10 at 4.

[65] *See* page 4, *infra.*

{C27017:4}

development/job retention programs; energy efficiency/peak demand requirements; alternate feed service, line extension charges; and, Commission-authorized distribution regulatory assets.[66]

As explained above, pricing of non-competitive services is governed by the process and procedures that apply to traditional ratemaking. To the extent that Section 4928.143, Revised Code, provides the Commission with the flexibility to approve distribution-related riders as part of an ESP, the Commission has concluded that such riders should be based on prudently incurred costs, including a reasonable return on investment for the utility.[67] While it is tempting to devote great attention in this Brief to things like the Companies' proposed POLR charge and the theoretical issues raised by the Companies' reliance on the Black-Sholes model, it would be a waste of time since the Black-Sholes model has nothing to do with predicting the prudently incurred cost associated with the POLR function. Also, with regard to things like the alternate feed service and line extension charges, it seems clear that these items would be better addressed in the context of a complete distribution rate case where all distribution-related costs and revenues can be taken into account.[68]

Based on the Commission's precedent regarding distribution riders that can be approved pursuant to Section 4928.143, Revised Code, IEU-Ohio recommends that the Commission reject the Companies' proposed riders because they are not limited to the

---

[66] ESP Application at 6.

[67] *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 at 41 (December 19, 2008).

[68] Staff Exhibit 1 at 4; IEU-Ohio Exhibit 10 at 11.

recovery of prudently incurred costs. IEU-Ohio would also note that where adjustment mechanisms are constrained to recover only prudently incurred costs (including a reasonable rate of return), they cannot, by definition, be responsible for producing significantly excessive earnings. Therefore, if the Commission applies its own precedent to these proceedings, there is no need to pick, in these proceedings, a method for determining how to measure significantly excessive earnings.[69]

IV. CORPORATE SEPARATION AND SALE OR TRANSFER OF GENERATING ASSETS

The Companies' ESP Application asks the Commission to permit the Companies to remain functionally separated but, upon termination of their functional separation, to permit them to sell or transfer generating assets. In a related matter, the Companies request immediate authority to sell or transfer certain generating assets even though they have no immediate plans to transfer or sell such generating assets. The Companies also advise the Commission that they have contractual entitlements to output from generating facilities of the Ohio Valley Electric Corporation ("OVEC") and that they intend to sell or transfer their OVEC entitlements.[70]

IEU-Ohio supports the Companies' request for such authority as may be needed to remain functionally separated. For several reasons, IEU-Ohio opposes the Companies' request to sell or transfer interests in generating assets until such request

---

[69] In *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 at 60-64 (December 19, 2008), the Commission recently addressed proposals to select a methodology for determining significantly excessive earnings. There, the Commission agreed with a Staff recommendation to convene a workshop for the purpose of examining the methodology for the excessive earnings test, noting that the test itself will not actually be applied until 2010.

[70] ESP Application at 14-15.

is accompanied by sufficient detail to allow the proposed sale or transfer to be evaluated based on how the sale or transfer might serve to advance the state policy in Section 4928.02, Revised Code.

IEU-Ohio also notes that the Companies' interest in OVEC is clearly more significant than contractual entitlements to the output of OVEC's generating units. As explained by Mr. Bowser, CSP owns a portion of OVEC[71] and OVEC itself is an affiliate of the Companies. AEP owns a 43.5% interest in OVEC.[72]

IEU-Ohio notes that because the output of OVEC's generating units is priced based on a traditional cost of service model rather than market-based pricing (with average expected costs of $40 MWH for 2008),[73] it would appear prudent for the Companies to call on their OVEC entitlement to meet their customers' needs prior to resorting to market-based purchases. Indeed, given the **cost-based pricing for this source of supply until at least March 13, 2026**,[74] the OVEC output available to the Companies might be something that could be utilized in conjunction with a more specific and attractive program to promote economic development and retention.

V. PHASE-IN

The Companies' proposed phase-in is based on the fact that their various price escalating proposals result in annual increases substantially above the 15% Limit that

[71] IEU-Ohio Exhibit 10 at 13-14.

[72] IEU-Ohio Exhibit 7 at 80.

[73] IEU-Ohio Exhibit 2 at 2.

[74] IEU-Ohio Exhibit 8 at 8.

the Companies used as a bill increase tolerance threshold.[75] As discussed above, the Companies' proposed phase-in of the total amount of their total increases relies on deferred cost accounting, the creation of regulatory assets and the use of a non-bypassable charge to amortize the regulatory assets plus carrying costs during the period 2012 to 2018.[76] The Companies rely on Section 4928.144, Revised Code, as the source of the Commission's legal authority to approve their proposed phase-in.

IEU-Ohio supports the use of a phase-in mechanism to ensure rate or price stability for customers (the explicit purpose of a phase-in pursuant to Section 4928.144, Revised Code). As Mr. Hess testified, conditions in the general economy make it appropriate to consider phasing-in increases even at the lower level of increases that come with the Staff's recommendation.[77] However, Section 4928.144, Revised Code, is available to the Commission to moderate the effect of rate increases irrespective of whether the increases arise because of an MRO or the ESP. Also, the plain language of Section 4928.144, Revised Code, indicates that the amortization or collection of any deferrals created by the phase-in must occur through a non-bypassable surcharge on the rate or charge established by the Commission by application of Section 4928.142, Revised Code, or Section 4928.143, Revised Code. Section 4928.144, Revised Code, does not authorize the Commission to establish a non-bypassable surcharge that applies to some price or rate that may be established in the future after the current MRO or ESP terminates. In other words, Section 4928.144, Revised Code, requires the

[75] As previously explained, the measurement of the 15% Limit excludes consideration of increases or decreases in costs subject to recovery through the Companies' TCRR and costs associated with new government mandates.

[76] ESP Application at 12-13.

[77] Tr. Vol. XIII at 89-90.

regulatory asset created by the phase-in to be amortized during the term of the ESP or MRO that makes the phase-in necessary and to ensure rate or price stability for customers. Thus, the Companies' proposal to establish a non-bypassable charge under Section 4928.144, Revised Code, for collection during the period 2012 to 2018, is not permitted by Section 4928.144, Revised Code.

If the Commission adopts IEU-Ohio's recommendations, no phase-in is needed because IEU-Ohio's recommendations favor retaining the current rates until such time as the Companies can demonstrate that their current rates must be increased based on the objectives in Section 4928.02, Revised Code.[78] Should the Commission nonetheless authorize the Companies to increase rates and charges, IEU-Ohio supports the use of a phase-in to ensure rate or price stability for customers.

VI. MISCELLANEOUS

A. The Companies' Proposed Ban on PJM Demand Response Participation by Customers

Through the testimony of Mr. Roush (and not in their ESP Application), the Companies request that they be permitted to modify their general terms and conditions of service so that they expressly prohibit participation in PJM's demand response programs.[79] This portion of the Companies' Proposed ESPs seems to be tied to a

[78] In *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 at 13 (December 19, 2008), the Commission discussed the current state of the economy and numerous uncertainties in the future. The Commission concluded that the plan it approves "... be one that initially requires revenue neutrality for the Companies, provides future revenue certainty of the Companies, and affords rate predictability for the customers."

[79] Companies Exhibit 1 at 6-8; IEU-Ohio Exhibit 1 at 11.

philosophical position held by the Companies[80] and the Companies' desire to limit customers' participation to those programs that may be offered by the Companies.[81] The Companies also appear to view a reduction in demand by a customer in conjunction with a PJM program to be a sale of electricity for resale or something that they believe is precluded by their current tariff. Companies Exhibit 1 at 7. But, even if a demand response could be viewed as a sale for resale, Section 4928.40(D), Revised Code, clearly states that the Companies cannot impose an unreasonable restriction on resale. In any event, this portion of the Companies' Proposed ESPs was strongly opposed by most of the other parties that participated in these proceedings.

The Companies are currently using the capabilities of their interruptible customers to help the Companies satisfy the resource adequacy requirements (generating capacity requirements) of PJM.[82] Thus, the real question raised by the Companies' request for authority to modify their general terms and conditions of service so that they expressly prohibit participation in PJM's demand response programs is whether the Companies' customers should be allowed to do directly what the Companies are already doing indirectly. SB 221 decidedly answers this question in the affirmative.

As Mr. Murray explained, SB 221 gives mercantile customers a choice about whether to dedicate their customer-sited capabilities to the Companies for integration

[80] Tr. Vol. III at 68.

[81] The Companies have not done any studies to compare their programs to programs available from PJM. Tr. Vol. IX at 47. PJM's programs are very attractive to customers as compared to the Companies' interruptible service offerings. Tr. Vol. IX at 48.

[82] Tr. Vol. IX at 53, 117-118.

into the Companies' portfolio. Customers, not the Companies, have the right to select how and when their demand response capabilities should be deployed.[83]

The Companies' request for authority to modify their general terms and conditions of service for the purpose of expressly prohibiting participation in PJM's demand response programs must be denied. The Commission should use these proceedings to confirm that customers, not the Companies, have the right to determine how, when and where their customer-sited capabilities will be deployed.

B. Partial Service, Cogeneration, Energy Efficiency, Peak Demand Reduction and Customer-Sited Programs

Mr. Murray recommended modifications to the Companies' partial service and cogeneration tariffs because of SB 221's emphasis on increasing the role of customer-sited capabilities in meeting electricity price and reliability objectives. More specifically, he recommended that demand charges be reduced and that the avoided cost of purchase power rates be updated.[84] IEU-Ohio urges the Commission to accept Mr. Murray's recommendations regarding the partial service and cogeneration tariffs.

Mr. Murray also testified that the Companies' ESP Application and supporting testimony did not address how customer-sited capabilities will be used to meet their portfolio obligations.[85] He recommended that the Commission establish the "...

[83] IEU-Ohio Exhibit 1 at 12.

[84] *Id.* at 13-14.

[85] *Id.* at 5.

actionable details for customer-sited projects ..." in these proceedings.[86] IEU-Ohio urges the Commission to accept Mr. Murray's recommendation.[87]

C. Interruptible Service Tariffs

The Companies propose that the participation limitation in OP's current interruptible service tariff be modified to permit a greater amount of participation. The Companies propose no change to CSP's limit on the availability of interruptible service.[88] The Companies have taken a step in the right direction but they have not gone far enough. Mr. Murray recommended that there be no limitation on the amount of interruptible service available from the Companies and IEU-Ohio recommends that the Commission adopt Mr. Murray's proposal.[89]

D. Benefit-in-the-Aggregate Test

The Companies' support for their requested relief includes information that they have assembled to show that their Proposed ESPs pass the benefit-in-the-aggregate test which they must pass to obtain the Commission's approval pursuant to Section 4928.143, Revised Code.[90] The Commission Staff has used a very similar format to

---

[86] *Id.*

[87] Mr. Murray also provided a recommendation on how to treat interruptible customer (tariff and contract) revenue for purposes of the Companies' proposed rider to collect revenues foregone as a result of customers who commit, through a reasonable arrangement, their customer-sited capabilities for integration into the Companies' portfolio. *Id.* at 10. He recommended that the revenue from such customers be treated as a revenue credit against the total revenue that would otherwise be collected from the Companies' firm service customers. *Id.* at 10-11. This revenue credit approach would reduce the need for a rider to recover "delta revenue" and convey to firm service customers the benefits of customer-sited capabilities that have been committed for integration into the Companies' portfolio. IEU-Ohio urges the Commission to accept Mr. Murray's recommendation regarding this revenue credit approach.

[88] Companies Exhibit 1 at 5.

[89] IEU-Ohio Exhibit 1 at 10.

[90] Companies Exhibit 2B, JCB-2.

show the Staff's numbers.[91] As discussed above, neither the Companies' nor the Staff's application of the benefit-in-the-aggregate test recognizes the significant projected cost of the deferrals that the Companies' proposal will, if approved, recover through a non-bypassable charge during the period 2012 through 2018. Thus, both the Companies' and the Staff's application of the benefit-in-the-aggregate test is incomplete.

Both Staff's and the Companies' application of the benefit-in-the-aggregate test assumes that the Commission will permit the maximum blending percentages allowed under Section 4928.142, Revised Code. The Companies acknowledge that the version of SB 221 they are relying on to support maximum blending was modified by the General Assembly to make this outcome less realistic.[92]

Both the Companies' and Staff's application of the benefit-in-the-aggregate test fail to make an adjustment to the estimated cost of the MRO option to show the incremental effects the maximum blending percentages (10%, 20% and 30%) would have on the FAC costs associated with the Companies' Proposed ESPs.[93]

Beyond questions about which MRO price should be used to run the benefit-in-the-aggregate test, the benefit-in-the-aggregate test used by the Companies and Staff cannot be relied upon to compare the effects of the Companies' Proposed ESPs to the results expected under Section 4928.142, Revised Code.

---

[91] Staff Exhibit 1, JEH-1.

[92] Companies Exhibit 2A at 4-5; Staff Exhibit 1, JEH-1.

[93] Tr. Vol. XI at 78-82; Tr. Vol. XIII at 87-88.

E. Last Minute Joint Application

'Twas the night before brief filing and the Companies filed a Joint Application ("Joint Application") seeking accounting authority and approval of an interim arrangement with Ormet Primary Aluminum Mill Products Corporation ("Ormet").[94] The Joint Application: (1) observes that the current arrangement with Ormet is scheduled to end on December 31, 2008[95] (hardly a new fact); (2) asserts that the Companies' Proposed ESPs contain a "slice-of-system" proposal that "... was based, in part, on addressing the Companies' acceptance in Case No 05-1057-EL-CSS of the Ormet load obligation and, if adopted, could result in Ormet taking service under the standard service offer for generation";[96] (3) observes that unlike other electric distribution utilities, the Commission is not likely to decide the Companies' ESP cases until the end of February, 2009;[97] (4) asserts that the Companies and Ormet have "... been working in good faith to try to negotiate a mutually agreeable solution that would directly address a longer-term service agreement ...";[98] (5) asserts that the Companies expect to file a longer-term service agreement with the Commission prior to the expected time of the Commission's decision in their ESP cases;[99] and, (6) assert that the proposed interim arrangement and deferred accounting authority will permit the Companies to maintain

---

[94] In the Matter of the Joint Application of Columbus Southern Power Company and Ohio Power Company and Ormet Primary Aluminum Mill Products Corporation for Approval of a Temporary Amendment to Their Special Arrangement, PUCO Case Nos. 08-1339-EL-UNC, *et al.*, Application (December 29, 2008) (hereinafter referred to "Joint Application").

[95] *Id.* at 1.

[96] *Id.* at 3.

[97] *Id.* at 2.

[98] *Id.* at 3.

[99] *Id.* at 3.

service to Ormet while awaiting the Commission's decision on the Proposed ESPs.[100] The Joint Application states that the proposed interim arrangement would price generation service to Ormet based on a blend of the Companies' current SSO rates and that the accounting authority will, if approved, permit the Companies to establish a regulatory asset by deferring for future recovery the difference between the blended SSO rate and 2008 market price (the Companies call this difference the "market delta"). The Joint Application states that the regulatory asset will be established effective January 1, 2009 and continue to grow until the interim arrangement is superseded by a new special arrangement or the Commission's approval of final tariffs effectuating the Commission's ESP order. The Joint Application also states that Companies propose to amortize or recover the deferred "market delta" through the "catch all" FAC mechanism "... detailed[101] in the Companies pending ESP cases, beginning immediately following the Commission's decision in the ESP cases."[102]

The Joint Application as well as the positions advanced by the Companies in these proceedings suggest that the Companies believe that they are owed something extra for taking on the Ormet service obligation. History suggests a different context.

The historical record shows that the rates that OP charged Ormet pursuant to a "reasonable arrangement" were not providing OP with a reasonable return. Indeed, an analysis conducted by the Commission's Staff in OP's last rate case indicated that "... there may actually be a net loss to the company associated with the R&O contracts."

---

[100] *Id.* at 3.

[101] As described above, there are a lot of things that can be said about the FAC mechanism proposed by the Companies in these proceedings and "detailed" is not on the list!

[102] Joint Application at 5.

{C27017:4}

In the Matter of the Application of Ohio Power Company for Authority to Amend its Filed Tariffs to Increase the Rates and Charges for Electric Service and Related Matters, Case No. 94-996-EL-AIR, Opinion and Order at 40 (February 28, 1995). In this context, Ormet's departure from OP's service area, a departure that occurred only after OP consented, might have been reason for OP to celebrate.

In 1996, the Commission approved a joint application of OP and South Central Power Company for a reallocation of service territory so that Ormet would be served by South Central Power Company and any other supplier as necessary.[103] The reallocation was to take effect on December 31, 1999, two years after an agreement between OP and Ormet entered into in 1966 was set to expire. In the interim period, however, Ormet and OP received approval of an Interim Agreement from the Commission whereby OP served Ormet from November 30, 1997 through December 31, 1999.[104]

In a complaint filing,[105] Ormet subsequently sought to reverse the previously requested and obtained service area assignment and obtain access to OP tariff rates and charges (not its prior contract with OP). In the end, Ormet did not return to OP's

---

[103] *See In the Matter of the Application of the Joint Petition of Ohio Power Company and South Central Power Company for Reallocation of Territory*, Case No. 96-1000-EL-PEB, Finding and Order (November 14, 1996).

[104] *See In the Matter of the Application of Ohio Power Company for Approval of a Special Contract Arrangement with Ormet Primary Aluminum Corporation,* Case No. 96-999-EL-AEC, Finding and Order (November 14, 1996).

[105] On August 25, 2005, Ormet Primary Aluminum Corporation and Ormet Aluminum Mill Products Corporation (herein referred to as "Ormet") filed Petition to Transfer Rights to Furnish Electric Service and/or Reallocate Certified Electric Service Territories; Complaint for Inadequate Service; and Complaint for Unjust, Unreasonable and Discriminatory Proposed Rates against Ohio Power Company and South Central Power Company in *In the Matter of Ormet Primary Aluminum Corporation and Ormet Aluminum Mill Products Corporation v. South Central Power Company and Ohio Power Company*, Case No. 05-1057-EL-CSS, Application (August 25, 2005).

service area based on standard rates and charges. It returned at a contract price above the standard tariff rates with other customers responsible, indirectly or directly, for making up the difference between the "market price" as approved by the Commission and the Ormet contract price.

Regardless of what the historical record shows, the Companies are collecting prices that provide them with the largest gross margin per MWH of all the business units within the AEP system.[106] The record in these proceedings shows that the broad scope and structure of the FAC mechanism will negatively affect high load factor/energy-intensive customers in the Companies' service areas.[107] Expanding the FAC mechanism as the Companies now propose through the Joint Application and **not** as part of their Proposed ESPs will, if approved, make it even harder for the energy-intensive businesses located in the Companies' service areas to survive in these troubled times. The proposed use of the FAC to recover the "market delta is also inconsistent with the Companies' Proposed ESPs.

In the Companies' Proposed ESPs, they seek authority to recover delta revenues associated with PUCO-approved special arrangements through the proposed Economic Development Cost Recovery Rider.[108] More specifically, the Companies proposed to track delta revenue amounts and make a quarterly filing to "establish rates which will be a percentage of base distribution revenue to recover those amounts resulting from

[106] IEU-Ohio Exhibit 2 at 2.

[107] See above discussion regarding the FAC mechanism.

[108] ESP Application at 8; Companies Exhibit 1 at 12.

Commission-approved special contracts."[109] Thus, the Joint Application represents a collateral attack on the Proposed ESPs' treatment of delta revenue.

During the discussions regarding SB 221, IEU-Ohio was a strong supporter of proposals to maintain a robust opportunity for the Commission to approve reasonable arrangements that serve economic development and retention objectives. IEU-Ohio has no objection to the Companies' belated attempt to do something that recognizes the current Ormet arrangement expires tomorrow on December 31, 2008. But IEU-Ohio is strongly opposed to the Companies' collateral effort to prop up their Proposed ESPs through the submission of the Joint Application and any effort by the Companies to expand the scope of an already out-of-control FAC mechanism. As suggested above in conjunction with IEU-Ohio's discussion of the Companies' proposal regarding OVEC, IEU-Ohio believes that the Federal Energy Regulatory Commission ("FERC")-approved, cost-based pricing for this source of generation supply should be considered for use in developing specific and long-term generation supply arrangements that are determined to have merit by the Commission relative to Ohio's economic development and retention objectives.

VIII. CONCLUSION

The Companies have not shown that the relief that they have requested in these proceedings is warranted based on the objectives in Section 4928.02, Revised Code, or based on the parameters of Section 4928.143, Revised Code. Accordingly, the Commission cannot grant the relief requested by the Companies. Nonetheless, the

[109] Companies Exhibit 1 at 12.

Companies' successful implementation of their business strategy[110] and access by their customers to reliable service at reasonable rates depend, ultimately, on the establishment of a reasonable ESP. Accordingly, IEU-Ohio also urges the Commission to recommend that the Companies file a new ESP that is based on their business strategy and meets the needs of their customers.

Respectfully submitted,

Samuel C. Randazzo
Lisa G. McAlister
Joseph M. Clark
McNees Wallace & Nurick LLC
21 East State Street, 17[TH] Floor
Columbus, OH 43215
Telephone: (614) 469-8000
Telecopier: (614) 469-4653
sam@mwncmh.com
lmcalister@mwncmh.com
jclark@mwncmh.com

Attorneys for Industrial Energy Users-Ohio

[110] AEP business strategy states that it "... will seek to recover the cost of new utility investments in a manner that results in reasonable rates for our customers while providing a fair return for our shareholders through a stable stream of cash flows, enabling us to pay dependable, competitive dividends" and that it "...operate[s] ... generating assets to maximize ... productivity and profitability after meeting ... native load requirements." IEU-Ohio Exhibit 7 at 7; *see also* Companies Exhibit 3, JH-1 at 10 of 68.

Certificate Of Service

I hereby certify that a copy of the foregoing *Post Hearing Brief of Industrial Energy Users-Ohio* was served upon the following parties of record this 30th day of December 2008, via electronic transmission, hand-delivery or first class mail, postage prepaid.

Lisa G. McAlister

Marvin I. Resnik, Counsel of Record
Steven T. Nourse
American Electric Power Service Corporation
1 Riverside Plaza, 29th Floor
Columbus, OH 43215

Selwyn J. R. Dias
Columbus Southern Power Company
Ohio Power Company
88 E. Broad Street – Suite 800
Columbus, OH 43215

Daniel R. Conway
Porter Wright Morris & Arthur
Huntington Center
41 S. High Street
Columbus, OH 43215

On Behalf of Columbus Southern Power and Ohio Power Company

David F. Boehm
Michael L. Kurtz
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, OH 45202

On Behalf of Ohio Energy Group

John W. Bentine
Mark S. Yurick
Matthew S. White
Chester, Willcox & Saxbe LLP
65 East State Street, Suite 1000
Columbus, OH 43215-4213

On Behalf of The Kroger Co.

Janine L. Migden-Ostrander
Consumers' Counsel
Maureen R. Grady, Counsel of Record
Terry L. Etter
Jacqueline Lake Roberts
Michael E. Idzkowski
Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, OH 43215-3485

On Behalf of the Office of the Ohio Consumers' Counsel

Barth E. Royer, Counsel of Record
Bell & Royer Co. LPA
33 South Grant Avenue
Columbus, OH 43215-3927

Nolan Moser
Air & Energy Program Manager
The Ohio Environmental Council
1207 Grandview Avenue, Suite 201
Columbus, OH 43212-3449

Trent A. Dougherty
Staff Attorney
The Ohio Environmental Council
1207 Grandview Avenue, Suite 201
Columbus, OH 43212-3449

On Behalf of The Ohio Environmental Council

David C. Rinebolt
Colleen L. Mooney
Ohio Partners for Affordable Energy
231 West Lima Street
Findlay, OH 45839

On Behalf of Ohio Partners for Affordable Energy

Michael R Smalz
Joseph V. Maskovyak
Ohio State Legal Services Association
555 Buttles Avenue
Columbus, OH 43215-1137

ON BEHALF OF APPALACHIAN PEOPLE'S ACTION COALITION

Richard L. Sites
Ohio Hospital Association
155 E. Broad Street, 15th Floor
Columbus, OH 43215-3620

ON BEHALF OF THE OHIO HOSPITAL ASSOCIATION

David I. Fein
Cynthia Fonner
Constellation Energy Group
550 W. Washington Street, Suite 300
Chicago, IL 60661

ON BEHALF OF CONSTELLATION ENERGY GROUP

Bobby Singh
Integrys Energy Services, Inc.
300 West Wilson Bridge Road, Suite 350
Worthington, OH 43085

ON BEHALF OF INTEGRYS ENERGY SERVICES, INC.

Howard Petricoff
Stephen M. Howard
Vorys, Sater, Seymour & Pease LLP
52 E. Gay Street
Columbus, OH 43215

ON BEHALF OF CONSTELLATION NEW ENERGY AND CONSTELLATION NEW ENERGY COMMODITIES GROUP, DIRECT ENERGY SERVICES, LLC, INTEGRYS ENERGY SERVICES, INC., NATIONAL ENERGY MARKETERS ASSOCIATION, OHIO SCHOOL OF BUSINESS OFFICIALS, OHIO SCHOOL BOARDS ASSOCIATION, BUCKEYE ASSOCIATION OF SCHOOL ADMINISTRATORS, AND ENERNOC, INC.

Craig G. Goodman
National Energy Marketers Association
3333 K. Street, N.W., Suite 110
Washington, D.C. 20007

ON BEHALF OF NATIONAL ENERGY MARKETERS ASSOCIATION

Barth Royer
Bell & Royer Co. LPA
33 South Grant Avenue
Columbus, OH 43215-3927

Gary Jeffries
Dominion Resources Services
501 Martindale Street, Suite 400
Pittsburgh, PA 15212-5817

ON BEHALF OF DOMINION RETAIL, INC.

Henry W. Eckhart
50 West Broad Street #2117
Columbus, OH 43215

ON BEHALF OF THE SIERRA CLUB, OHIO CHAPTER, AND THE NATURAL RESOURCES DEFENSE COUNCIL

Langdon D. Bell
Bell & Royer Co., LPA
33 South Grant Ave.
Columbus, OH 43215

Kevin Schmidt
The Ohio Manufacturers' Association
33 North High Street
Columbus, OH 43215

ON BEHALF OF THE OHIO MANUFACTURERS' ASSOCIATION

Larry Gearhardt
Ohio Farm Bureau Federation
280 North High Street, P.O. Box 182383
Columbus, OH 43218

ON BEHALF OF THE OHIO FARM BUREAU FEDERATION

Clinton A. Vince
Presley R. Reed
Emma F. Hand
Ethan E. Rii
Sonnenschein Nath & Rosenthal
1301 K Street NW
Suite 600, East Tower
Washington, DC 20005

ON BEHALF OF ORMET PRIMARY ALUMINUM CORPORATION

Stephen J. Romeo
Scott DeBroff
Alicia R. Peterson
Smigel, Anderson & Sacks
River Chase Office Center
4431 North Front Street
Harrisburg, PA 17110

Benjamin Edwards
Law Offices of John L. Alden
One East Livingston Ave.
Columbus, OH 43215

ON BEHALF OF CONSUMERPOWERLINE

Grace C. Wung
McDermott Will & Emery LLP
600 Thirteenth Street, NW
Washington, DC 20005

Douglas M. Mancino
McDermott Will & Emery LLP
2049 Century Park East
Suite 3800
Los Angeles, CA 90067

Steve W. Chriss
Manager, State Rate Proceedings
Wal-Mart Stores, Inc.
2001 SE 10th Street
Bentonville, AR 72716

ON BEHALF OF THE WAL-MART STORES EAST LP, MACY'S INC., AND SAM'S CLUB EAST, LP

Sally W. Bloomfield
Terrence O'Donnell
Bricker & Eckler
100 South Third Street
Columbus, OH 43215

ON BEHALF OF AMERICAN WIND ENERGY ASSOCIATION, WIND ON THE WIRES AND OHIO ADVANCED ENERGY

C. Todd Jones
Christopher Miller
Gregory Dunn
Andre Porter
Schottenstein Zox and Dunn Co., LPA
250 West Street
Columbus, OH 43215

ON BEHALF OF THE ASSOCIATION OF INDEPENDENT COLLEGES AND UNIVERSITIES OF OHIO

Douglas M. Mancino
McDermott Will & Emery LLP
2049 Century Park East
Suite 3800
Los Angeles, CA 90067

Gregory K. Lawrence
McDermott Will & Emery LLC
28 State Street
Boston, MA 02109

Steven Huhman
Vice President
MSCG
200 Westchester Ave.
Purchase, NY 10577

ON BEHALF OF MORGAN STANLEY CAPITAL GROUP, INC.

John Jones
Thomas Lindgren
Werner Margard
Assistant Attorneys General
Public Utilities Section
180 East Broad Street
Columbus, OH 43215

ON BEHALF OF THE PUBLIC UTILITIES COMMISSION OF OHIO

Kimberly Bojko
Attorney Examiner
Public Utilities Commission of Ohio
180 East Broad Street, 12th Floor
Columbus, OH 43215

Greta See
Attorney Examiner
Public Utilities Commission of Ohio
180 East Broad Street, 12th Floor
Columbus, OH 43215

ATTORNEY EXAMINERS