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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 Generation 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 ADDRESSING COLUMBUS SOUTHERN POWER COMPANY AND OHIO POWER COMPANY ELECTRIC SECURITY PLANS BY THE OHIO CONSUMER AND ENVIRONMENTAL ADVOCATES

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TABLE OF CONTENTS

PAGE

I. INTRODUCTION 1

II. PUBLIC INPUT 6

III. AEP OHIO'S ESP PROPOSAL 14

IV. APPLICABLE LAW 16

V. ARGUMENT 19

A. The ESP, If Appropriately Modified, Is Slightly More Favorable For Customers Than The MRO. 19

B. The Companies Have Not Justified a "POLR Charge." 24

C. The Non-FAC And Non-Cost-Based Annual Rate Increases Of 3% And 7% During The ESP Period Are Unwarranted And Should Be Rejected By The Commission. 29

D. AEP's "Enhanced" Service Reliability Plan Is Deficient Under Ohio Law And The Commission's Rules. 31

1. The Companies propose to collect $445 million from customers to fund their reliability plan. 31

2. Ohio Law provides that AEP Ohio has the burden of proof in ensuring that its Enhanced Service Reliability Plan is in the public interest and complies with R.C. 4928.143(B)(2)(h). 32

3. AEP Ohio's Application is deficient under the Commission's pending rules. 34

a. The Enhanced Service Reliability Plan does not address cost savings and does not align customers' interests with that of the Companies. 34

b. The Companies have failed to provide specific information that would enable the Commission to properly evaluate the efficacy of the Companies' Enhanced Service Reliability Plan. 36

4. The Companies' recent efforts in providing reliable distribution service have failed to meet ESSS requirements and the Enhanced Service Reliability Plan provides no assurances that their reliability performance will improve. 37

5. AEP Ohio's proposed Enhanced Service Reliability Plan is not an enhancement to current, required reliability programs and does not ensure reliable service to its customers. 41

6. In lieu of imposing rate increases in the Enhanced Service Reliability Plan for the Companies' distribution program, the Commission should address system reliability improvements in a separate proceeding. 44

7. Conclusion 46

E. The Fuel Adjustment Clause ("FAC") Proposed By The Companies To Collect Millions Of Dollars From Customers Is Unjust And Unreasonable And Will Result In Unjustified Increases. The FAC Should Not Be Adopted Unless The Commission Significantly Modifies It. Reasonable Modifications Should Include Establishing An Appropriate Baseline FAC, Excluding Market Rate Purchased Power, And Assuring That Any Fuel Costs Are Properly Offset By Off-System Sales Margins And Capacity Equalization Revenues. 47

1. In establishing a baseline for the fuel clause, the Commission should reject the bottom-up approach of the Companies and instead adopt a baseline using latest known actual fuel costs for 2008. 48

2. In calculating the incremental fuel costs for 2009 through 2011, the Companies should be precluded from increasing customers' rates to cover power purchased at an inflated market rate purported to meet the needs of Ormet and former Mon Power customers 53

3. In calculating the incremental fuel costs for 2009 through 2011, the Commission should credit customers for revenues received from off-system sales. Alternatively the Commission could adjust the ESP to fully credit generation base rates under the ESP with the profits from off-system sales 57

4. In calculating the incremental fuel costs for 2009 through 2011, capacity equalization revenues as well as expenses should be included. 59

F. If There Is An Over-Collection Of Fuel Expenses, Regardless Of Whether Deferrals Exist, The Companies Should Refund To Customers The Over-Collection In The Following Fuel Clause Period, Rather Than Allow The Companies To Use The Over-Collections To Reduce Deferrals Collected From Customers In 2012-2018. 60

G. OCC Recommends Against Creating Any Long-Term Deferrals Under The FAC. However, If Deferrals Are Approved By The Commission, Such Deferrals Should Be Financed In Part By The Tax Savings Generated By The Companies Deferred Tax Obligation. Additionally, The Carrying Charges On The Deferrals Should Reflect The Actual Cost Of Short-Term Debt (Excluding Equity). 62

1. Deferred Fuel expenses should be calculated on a net of tax basis 63

2. The carrying costs on the fuel deferrals should reflect the actual short-term cost of debt, excluding equity, if the Companies need to go to the outside capital market to finance the deferrals 64

H. The Commission Should Implement Recommendations Made By OCC Witness Medine Related To Audit Issues Likely To Arise In The Context Of The Companies' Future Periodic Fuel Clause Filings. 67

I. The Companies Have Not Justified The Amounts They Have Proposed For Environmental Carrying Charges. 69

1. The Commission should not require customers to pay carrying charges for environmental investment that was made from 2001 through 2008 because S.B. 221 does not permit the Companies to recover these costs in their ESP. 69

2. The Companies' proposed carrying charges for environmental investments for 2009 to 2011 are not based on actual investment and thus should be rejected. 71

3. If the Commission determines to require customers to pay carrying charges on either the past or future environmental investment, which it should not, it should assure that the carrying charges are appropriate. 71

4. Customers should gain the benefits of Internal Revenue Code Section 199 deductions. 74

J. The Commission Should Not Approve and AEP Ohio's Customers Should Not Have To Pay for the Companies' GridSMART Phase 1 Deployment As Proposed Because The Companies' Filing Regarding Its GridSMART Phase 1 Deployment And Its Overall GridSMART Program Deployment Is Deficient. 76

1. AEP's ESP filing fails to demonstrate that gridSMART Phase I or full gridsSMART deployment will be cost effective. 77

2. AEP Ohio's ESP filing fails to provide sufficient detail to warrant the Commission's approval of gridSMART Phase 1 or full gridSMART deployment 83

3. With a properly detailed proposal submitted by AEP Ohio, the Commission could approve the AMI and DA portions of the Companies' proposed gridSMART Phase 1. 84

K. Because AEP Ohio Has Not Demonstrated That Its Costs Have Increased, AEP Ohio Has Not Demonstrated That Its Proposed Increases In Line Extension Charges Are Justified. 85

L. The Commission Should Deny AEP Ohio's Proposed Deferral Of FAC Costs. 87

1. Deferrals are incompatible with the policy set forth in R.C. 4928.143(B)(2)(d) because they destabilize customer prices and introduce uncertainty regarding retail electric service. 87
2. Because of the problems associated with deferrals, the OCC and PUCO Staff recommend against deferrals, and support, if necessary, a levelization of rates during the ESP period. 89
3. Mitigation of rate increases would not be necessary if generation rates are "reasonably priced" under R.C. 4928.02(A). 90
4. If the Commission approves deferrals, AEP Ohio's proposed carrying costs should be based on the short-term cost of debt or another reasonable basis. 92
5. Intergenerational deferrals are unfair and unreasonable. 93

M. The $75 Million Low Income/Economic Development Fund Should Be For New Programs, Not Just For Continuation Of Existing Programs That May Already Be Funded Through Customers' Rates. 93

N. The Companies' DSM/Energy Efficiency Proposals Do Not Meet the Requirements of S.B. 221. 94

O. The Companies Should Be Required to Continue Their Green Pricing Program. 97

P. The Companies Have Requested No Authority From The Commission Concerning The IGCC. 98

Q. The Commission Should Not Grant The Proposed Modification Of The Corporate Separation Plan And Should Not Authorize The Sale Or Transfer Of Generating Assets. 99

R. The Commission Should Not Make Any Determinations Regarding Deferring The Costs Of Early Plant Closures. 101

S. The Companies Should Not Be Allowed To Count Potential Interruptible Load Toward The Requirements Of S.B. 221. 102

T. The Commission Should Clarify Some Areas Of The Companies' Riders In Order To Minimize Anti-Competitive Behavior. 103

1. Economic Development Cost Recovery Rider 82 should allocate costs to all customers on the basis of total revenue collected. 103
   a. The Commission should annually review economic development arrangements. 105
   b. All parties should be allowed to participate in the review of economic development arrangements. 106

2. Energy Price Curtailable Service Rider 72 should treat any discounts as being associated with non-retail costs in the Companies' Fuel Adjustment Clause Rider 80, as opposed to being collected as if any revenue shortfall should come from retail customers. 106

3. The Commission should clarify the treatment of revenues, credits, and expenses in order to properly assign cost responsibility to the Companies' operations benefitting from curtailments, interruptions, and buy-through power. 108

U. The Statutory Test For Significantly Excessive Earnings Should Not Be Determined In This Proceeding. If It Is Determined, AEP Ohio's Testimony Should Be Rejected 109

1. OCEA's recommendation is to reject the Companies' test in the event the Commission does adopt a methodology for determining significantly excessive earnings in this ESP case 111

VI. CONCLUSION 115

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I. INTRODUCTION

The outcome of the first-ever electric security plans for Columbus Southern Power Company ("CSP") and Ohio Power Company ("OP") (collectively, "AEP Ohio" or "Companies") will significantly affect nearly 2.1 million consumers, by establishing the rates they pay and the quality of service they will receive through 2011 and beyond. Electric security plans are part of the new statutory scheme that resulted from the Ohio General Assembly passing Amended Substitute Senate Bill No. 221 ("S.B. 221") on April 23, 2008. Among other things, S.B. 221 changed the rate structure for Ohio's electric utilities and established requirements for reliability of electric service and for the use of alternative energy resources by electric utilities. Governor Strickland signed S.B. 221 on May 1, 2008, and the legislation became effective on July 31, 2008.

On July 31, 2008, the Companies filed in this case their application ("Application") for approval of an initial electric security plan ("ESP"). AEP Ohio's Application included testimony to explain the ESP proposal.[1] If granted by the Public Utilities Commission of Ohio ("PUCO" or "Commission"), the Application will impose significant rate increases upon AEP Ohio's customers.[2]

AEP Ohio's ESP would allow the Companies over a three-year ESP period to collect from customers higher generation rates due to increases in the cost of fuel through a fuel adjustment clause ("FAC"), plus automatic increases in what the Companies define as the non-FAC portion of their current standard service offer rate. The ESP would also allow the Companies to increase customers' rates via annual rate adjustments for components not reflected in the current standard service offer rate, including environmental capital carrying costs, a base distribution rate increase for

[1] Joseph Hamrock, AEP Ohio's President and Chief Operating Officer; J. Craig Baker, Senior Vice President - Regulatory Services; David M. Roush, Manager - Regulated Pricing and Analysis; Gregory A. Earl, Customer Services & Marketing Manager for the Columbus Region of AEP Ohio; Leonard V. Assante, Vice President of Regulatory Accounting Services for American Electric Power Service Corporation ("AEPSC"); Karen L. Sloneker, AEPSC's Director of Customer Services and Marketing; Jay F. Godfrey, Managing Director - Renewable Energy for AEPSC; Philip J. Nelson, Director of Strategic Initiatives in AEPSC's Corporate Budgeting and Planning Department; William K. Castle, Director - DSM and Resource Planning for AEPSC; Karl. G. Boyd, Vice President of Distribution Operations for AEPSC; and Dr. Anil Makhija, Professor of Finance at Ohio State University.

[2] Section V.E. of the Companies' Application included a contingency plan in the event that the PUCO does not reach a decision on their ESP by the statutorily imposed deadline of 150 days, and before the expiration of the Companies' existing rate plan on January 1, 2009, as required under R.C. 4928.143(C)(1). The proposed contingency plan would provide the Companies with a mechanism to collect from customers what the Companies claim may be under-charges, without any corresponding proposal to credit customers in the event that the rates ultimately approved by the PUCO result in over-charges. See Tr. Vol. II at 53 (Baker). The proceeding was bifurcated in order to separately address AEP Ohio's Section V.E Plan, as well as an alternative proposal proffered by the PUCO Staff. A hearing on the issue was held on November 21-22, 2008, and briefs addressing the issue were filed on December 6, 2008.

enhanced reliability and the Companies' modernized grid management program (called gridSMART), an energy efficiency and demand reduction rider, an economic development rider and collection of previously authorized distribution regulatory assets. The ESP also includes a Provider of Last Resort ("POLR") charge that would be borne by all customers.

If approved as filed, AEP Ohio's ESP would increase the cost of electric generation service for AEP Ohio's customers by about 15% in 2009 alone.[3] In addition, CSP customers would pay 7% more for distribution and OP customers would be charged 6½% more for distribution.[4]

Over the three years of the plan, AEP Ohio claims that it will collect increased revenues from CSP customers of $889 million and collect increased revenues from OP customers of $853 million, as shown by the following tables:[5]

Increased Costs to CSP Customers Under the Plan

Year	FAC Increase	Non-FAC Increase	Total Increase
2009	$147,939,677	$90,549,167	$238,488,844
2010	$247,612,870	$54,955,368	$302,568,238
2011	$273,242,516	$74,710,957	$347,953,473
Total for the three years	$668,795,063	$220,215,492	$889,010,555

Increased Costs to OP Customers Under the Plan

Year	FAC Increase	Non-FAC Increase	Total Increase
2009	$66,614,486	$157,839,504	$224,453,990
2010	$207,444,763	$85,128,437	$292,573,200
2011	$237,578,113	$98,881,066	$336,459,179
Total for the three years	$511,637,362	$341,849,007	$853,486,369

[3] See Application at 6.

[4] Id.

[5] See Companies Ex. 1 at Exhibit DMR-1.

These estimates do not include costs passed on to customers through the Transmission Cost Recovery Rider, and other riders including riders to collect the cost of government mandates or economic development costs.[6] The proposed increases also do not reflect the full impact of increases in fuel costs; the increases do not reflect any FAC deferrals.[7]

At hearing, however, it became apparent that the total actual costs to customers would be much more. In discussing the CSP cost structure on cross examination, AEP Ohio witness Roush explained that the first and second year costs would carry over to subsequent years: "If we're building a pyramid, in the first year rates would go up 238 million, and that 238 million would continue all three years so there's – in 2010 you'd add another layer of 302 million, and that 302 million would continue for two years, and then in 2011 there would be an additional 347 million."[8]

Thus, based on Mr. Roush's explanation, the total costs of the ESP for the Companies' customers would be more than 75% higher than that estimated in Mr. Roush's direct testimony, as the following tables show:

Increased Costs to CSP Customers Under the Plan

Year	2009 Costs	2010 Costs	2011 Costs	Total Increase
2009	$238,488,844	N/A	N/A	$238,488,844
2010	$238,488,844	$302,568,238	N/A	$541,057,082
2011	$238,488,844	$302,568,238	$347,953,473	$889,010,555
Total for the three years				$1,668,556,481

[6] See Tr. Vol. IV at 112 (Assante); Tr. Vol. IX at 83 (Roush).

[7] Tr. Vol. IX at 202 (Roush).

[8] Id. at 201 (Roush).

Increased Costs to OP Customers Under the Plan

Year	2009 Costs	2010 Costs	2011 Costs	Total Increase
2009	$224,453,990	N/A	N/A	$224,453,990
2010	$224,453,990	$292,573,200	N/A	$517,027,190
2011	$224,453,990	$292,573,200	$336,459,179	$853,486,369
Total for the three years				$1,594,967,549

Several intervenors offered testimony regarding AEP Ohio's ESP proposal. The Office of the Ohio Consumers' Counsel ("OCC"), a member of the Ohio Consumer and Environmental Advocates ("OCEA"), presented the testimony of seven expert witnesses: Lee Smith, Managing Consultant and Senior Economist at La Capra Associates; Anthony J. Yankel, President of Yankel and Associates, Inc.; Emily S. Medine, a principal of Energy Ventures Associates; Edmund P. Finamore, President of ValuTech Solutions; J. Randall Woolridge, Professor of Finance at the Pennsylvania State University; Wilson Gonzalez, a Principal Regulatory Analyst at OCC; and David W. Cleaver, OCC's Senior Electrical Engineer-Energy Analyst. Testimony was also submitted by Industrial Energy Users-Ohio,[9] Integrys Energy Services,[10] the Ohio Hospital Association,[11] Ohio Partners for Affordable Energy,[12] the Commercial Group,[13] Ohio Energy Group,[14] the Kroger Co.,[15]

[9] Joseph G. Bowser and Kevin M. Murray, Technical Specialists for McNees Wallace & Nurick LLC.

[10] Samuel R. Wolfe, a Commercial and Industrial Originator with Integrys.

[11] Michael J. McGarry, Sr., President and Chief Executive Officer of Blue Ridge Consulting Services, Inc.; Howard Solganick, a Principal of Energy Tactics & Services, Inc. and a Senior Technical Consultant with Blue Ridge Consulting Services; and Peter B. Fleming, System Vice President, Real Estate and Construction for OhioHealth.

[12] Barbara R. Alexander, an independent consumer affairs consultant.

[13] Michael Gorman, managing principal with Brubaker & Associates, Inc.

[14] Charles W. King, president of Snavely King Majoios O'Connor & Lee, Inc.; Stephen J. Baron, president of J. Kennedy and Associates, Inc.; and Lane Kollen, vice president of Kennedy and Associates.

[15] Kevin C. Higgins, a principal in Energy Strategies, LLC.

Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc.,[16] and Ohio School Boards Association, Ohio Association of School Business Officials and Buckeye Association of School Administrators.[17]

The Commission took evidence at five local public hearings throughout the state between October 14, 2008 and October 27, 2008.[18] The hearing at the PUCO's offices commenced on November 21, 2008 and concluded on December 10, 2008.

II. PUBLIC INPUT

In these times of economic hardship for Ohioans, customers participated in this case to inform their state regulator, the PUCO, of their opposition[19] to AEP's proposed rate increases. Customers participated in the case by presenting testimony at five local public hearings throughout the state between October 14, 2008 and October 27, 2008 in the cities of Marietta, Lima, Columbus, and Canton.[20] Customers also participated by sending many, many letters, including e-mails, to the PUCO to express, in the docket, their concerns about rate increases.

The public's participation in the docket is compelling. The Commission should consider the Companies' application with the public participation in mind. As one consumer aptly noted, "[a]s a regulatory agency you need to be

[16] David I. Fein, vice president of Energy Policy in the Midwest for Constellation Energy Group, Inc.

[17] Mark R. Frye, president of Palmer Energy Company.

[18] See Entry (Sept. 24, 2008) at 1-2.

[19] A small minority of the Companies' customers filed letters in support of the increase and those filings reflected support based solely on economic development partnerships with AEP.

[20] See Entry (Sept. 24, 2008) at 1-2.

responsible to the consumers of Ohio and the reality of what the average person is facing."[21]

Witness after witness testified that they are already struggling to pay utility bills and if the 15% per year increase is granted over the next three years, they would be forced to make choices—choices that no one should have to make:

> "We see vulnerable, low income elderly people, single parent families that cannot afford their electric bill right now, let alone bear a 15% increase over the next three years.
>
> You know it goes back to that old saying and I know everybody has heard it before that, you know, people start making crazy choices. Its like what am I going to do? Am I going to pay my electric bill or am I going to buy some food? Am I going to buy my kids something to eat, you know? They have to make some serious choices when it comes to paying their bills."[22] --Sandra Pyles, HEAP Director Stark County

Customers testified again and again that granting the increase will cause hardships on all the customers: "I think if you allow that [15% per year increase], I think it's wrong. What I really think, if you do that, you better build some more homeless shelters because that's going to put a lot more of us in there."[23] Business owners testified as well that granting the increase will devastate them and could be the death knell to their business. For example, Ron Wesel, of Mondo Polymer Technologies, testified at the Marietta local hearing to the stark reality of the increase upon his business:

> "Companies in this area in Southeast, Ohio just cannot afford that kind of an increase. I mean, I can't believe that the PUCO cannot see what impact all those things are having on business in Ohio.

[21] Paula Thimmes (correspondence docketed Aug. 20, 2008).

[22] Canton Local Public Hearing, Tr. at 56 (Oct. 16, 2008); Marietta Local Public Hearing, Tr. at 20-21 (Oct. 14, 2008).

[23] John Kern. Columbus Local Public Hearing, Tr. at 48 (Oct. 21, 2008).

> We're losing business every day in Ohio and southeast Ohio and to try to push through a 15 percent increase, companies here just cannot afford it. I mean, do we want to push all our business to some other country, some other state? People here just can't afford it. I mean, I have to lay off people. It could put us out of business."[24]

These same concerns were echoed by customers in other areas of the Companies' service territories, as illustrated by the testimony of Russ Murray, from Ohio Cast Metals Association:

> "It is unfathomable to perceive a public interest that allows AEP to raise its rate by 15 percent per year for the next three years that would create 50 percent higher costs for Ohio metal casters and other Ohio manufacturers that would endanger their profitability, if not their viability, and endanger the many tens of thousands of jobs that could be lost if these proposed increases are allowed to stand."[25]

Representatives from schools testified that they cannot afford this increase and testified to the negative impacts upon the education provided to children if the increase is imposed: "As you can see, an increase such as this will have a devastating effect on our district along with many other districts. Cuts will have to be made, certainly some that will directly impact the education that students receive."[26]

Other customers struck at the timing of the Companies' request. Many customers testified that the increase comes at a most vulnerable time in the economy—at a time when there are rampant job losses, home foreclosures, and stock market crashes, to name a few of the current problems facing the state and national economies. Some customers noted that they had yet to bounce back from the last recession, let alone get by the present

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[24]Marietta Tr. at 41-42.

[25] Columbus Whetstone Local Public Hearing, Tr. at 54-57 (Oct. 27, 2008).

[26] Brenda Stocker, Elida Local Schools, Lima Local Public Hearing, Tr. at 13-15 (Oct. 20, 2008).

one.[27] Customer Rosemary Applegate from Columbus testified that the increase sought to be imposed by AEP may be the last straw:

> "I think if we raise the rates now, especially at 15 percent now and for two years, AEP may be part of the spiral that takes us down. It may be a small part but it could very easily be part of the financial problems being worsened and causing more problems for our country. It started in New York. Then it went to the country, and now it has spread throughout the world. It's like a plague.
>
> And I implore you to consider this. I think your timing is incredibly bad. Did everybody see the Dispatch this morning? 14 percent up since last year of shut-offs. We all know that's a high percentage. That's double digits, and it could get worse, and that's even without the increase, people....
>
> I ask AEP to go back to the drawing board, step back for a year, come back in a year, leave the rates the way they are, and find out what you can do to have a more efficient company. And I ask you again to step back and wait. This is no time to raise rates."[28]

The timing of the rate increase provoked anger and frustration in many of the Companies' customers, including customer Matt Vaccaro who testified. "So we're all angry. We're all frustrated. We are at a time when the markets are out of control. I feel a 15 percent rate increase every year for the next three years is going to be a nail in my coffin."[29] Customer Sheryl Schall made similar statements-- "With the economy in a meltdown as they say I don't believe that now is the time for any rate increase."[30] Ms. Schall also expressed skepticism regarding the Companies' sudden need to deal with aging infrastructure:

[27] "The community did not see a bounce back from the last recession. We're still in the last recession. We haven't gotten to this one yet and so our community is very sensitive to these changes." --Sharon Wolboldt, Marietta Tr. at 9.

[28] Columbus Whetstone Tr. at 11-16.

[29] Columbus Whetstone Tr. at 16-22; see also correspondence of Earl Sapp (docketed Oct. 10, 2008) and correspondence of Linda Fitzpatrick (docketed Oct. 9, 2008).

[30] Sheryl Schall (correspondence docketed Oct. 22, 2008).

> I understand the need for updated equipment to meet the greater demands required. But what has AEP been doing with the money they've been making from their customers? Why haven't they been replacing and updating all throughout the years. * * * Why did they wait and let things get this bad?[31]

The e-mail, docketed at the Commission, of customer David Chauvaux reiterated these concerns: "This rate hike is excessive to the point that it will damage the base of our state's economy and drive more people away. Considering the current state of the economy, state and national, we can afford none of this. I implore you to oppose this drastic rate hike."[32] Customer William Rudinsky put it a bit differently, but made the same point: "If the PUCO wants to undermine the economy of OHIO by forcing business and residential consumers alike to cut other spending to absorb unprecedented rate increases, then the rate hikes should be implemented as proposed."[33]

Customers testified against the magnitude of the increase as well, finding it to be "devastating,"[34] "extremely exorbitant,[35]" "astronomical,"[36] "way past excessive,[37]" and even "absurd"[38] to list a few of the descriptions. One customer from Columbus called it "another poison pill for the Ohio economy."[39] Others described it as "gouging"-- "Its just an excuse for them to gouge us more money and get their hands deeper and deeper into

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[31] Id.

[32] David Chauvaux (e-mail docketed October 24, 2008).

[33] William Rudinsky (letter docketed Oct. 27, 2008).

[34] Ernest Biehl, Marietta Tr. at 27.

[35] John Poling, Marietta Tr. at 34.

[36]Brenda Cabus (letter docketed Oct. 15, 2008).

[37] Rodney Bodwalk, Columbus Tr. at 49.

[38] Donielle Hunter (e-mail docketed Oct. 21, 2008).

[39] Tom Moore, Columbus Whetstone Tr. at 68-72.

my pockets and everybody else's pocket here."[40] Many customers noted that a 15% increase per year is unheard of in the private sector: "I read in the newspaper where AEP wants 15, 15 and 15. I thought it was a joke but it's not a joke. Let's put it this way, if I was an employee of AEP and asked for a wage increase of 15 percent per year for the next three years they'd think I was nuts. They'd go through the roof."[41] Customer Rick Johnson of Lima lamented this as well: "I don't know how much more people can take in this country. For one thing, they want 45 percent in three years. Does any of us get a raise of 45% in three years? I want to know that. I mean, the numbers, you just can't keep up. If everything keeps going like it is, everybody is going to be out in a cardboard box one of these days with no electric, no food."[42] Customers complained that granting the Companies the 15% increase per year puts them in an unwanted game of playing "catch-up"—"I'm going to get further and further behind, because what's happening is, you're socking us with 45 percent over a three-year period, and persons on a limited income, if they get 3 percent per year, they are lucky. So we are always playing catch-up. We get 9 percent, you get the 45."[43]

The testimony at the public hearings also focused, and correctly so, on what the Companies are doing to stem the bleeding. Much testimony called for "belt tightening" by the Companies, a suggestion that should not go unanswered:

- "I think the PUCO should go back to AEP tell them go back and cut your costs."[44]—Raymond Fernandez

[40] William Daugherty, Canton Local Public Hearing, Tr. at 45 (Oct.16, 2008).

[41] Raymond Fernandez, Marietta Tr. at 20-23.

[42] Rick Johnson, Lima Tr. at 17.

[43] James Fernhough, Marietta Tr. at 16.

[44] Marietta Tr. at 22.

- "…prior to coming to the commission and seeking an exorbitant rate increase, which is what I believe a 15 percent per year increase is for three years, that there should be further belt tightening that the organization—that AEP needs to go back and once again look through all of their processes, what are they doing, what is necessary, how can it be streamlined. If they're able to minimize costs, they may be able to come back to the Commission with a more reasonable request for a rate increase."[45]—John Clark

- "As a small business owner I'm certain that I will not be able to increase my prices to my customers by 15 percent for the next three years and likely neither will they. Like other businesses and individuals, I'll tighten my belt and work to reduce costs internally, and I will look for alternative opportunities for business building and profit. I believe that AEP should be required to do the same….Before the PUCO considers any rate increase for AEP shouldn't AEP be required to look inward? In these times of obscenely paid, unaccountable executives leading their companies to government bailouts, corporate America must reform itself starting at the top. A public utility whose customers have no choice of supplier should be absolutely required to do so."[46]—Ann Miller

- "As far as the corporate structure goes, every state agency straight across the board, Governor Strickland: Trim-trim-trim. What's wrong with the CEO of AEP telling all his departments to do the same thing while maintaining federal and state compliance?"[47]—Mark Harville

- "If AEP has the money to give $20 million to its CEO and $10 million to Mayor Coleman's park downtown, I think it has room in its budget to trim some fat and withdraw the plan to raise our rates by 45 percent."[48] —Seth Porter
- "They need to do what all of us are doing, tighten their belts – now; not three months from now and all that, now. We're doing it. They need to do it."[49]—Rod Bodwalh

[45]Columbus Tr. at 28-30.

[46]Columbus Tr. at 46.

[47]Columbus Whetstone Tr. at 34-38.

[48]Columbus Whetstone Tr. at 47.

[49]Columbus Whetstone Tr. at 66-68.

- "We in the trenches are taking quite a 'hit' and why should AEP not engage in some major redesign of its own administration?"[50] —S.A. Linden

- "This country is awakening to the hum of greed, power and corruption. It hints of an ugly blackness with a beast in the closet. AEP does not need such a huge increase in rates; employers do not give their employees a 45% raise in the span of three years. Perhaps AEP should reevaluate their needs and come up with a figure less alarming."[51]—Vera Bagent

- "As a customer of both of the above companies who lives on a fixed income (I am not 65) in a single income home, I can not afford their increases. Their requests in today's economy coupled with their rising profits are way out of line. They need to trim their budgets just as I have had to trim and trim mine every year."[52]—Paula Thimmes

Many more customers testified that the Companies should trim the fat as well[53] and yet no evidence was produced at the evidentiary hearing that the Companies had done so or are willing to do so.

The ultimate issue the Commission must decide is whether, in these troubled economic times, it is appropriate to impose a 15% per year increase on the Companies' customers. OCEA (The Office of the Ohio Consumers' Counsel and The Sierra Club Ohio Chapter) urges the Commission to hear the many voices of the customers--customers who are angry, frustrated, and are struggling currently to pay their bills. What

[50]Correspondence (docketed Oct. 15, 2008).

[51] Correspondence (docketed Oct. 17, 2008).

[52] Correspondence (docketed Aug. 20, 2008).

[53] See also testimony of Dr. Barbara Thomson, Columbus Tr. at 39-45; testimony of Andrew Reidy, Columbus Tr. at 68, testimony of Angela Kypriotis, Columbus Whetstone Tr. at 63-66.

will 15% yearly increases over the next year mean to them and the economy in the state of Ohio? The answer is clear: the testimony of the Companies' customers call for the Commission to "just say no" to unreasonable rate increases.

III. AEP OHIO'S ESP PROPOSAL

AEP Ohio's ESP proposal consists of six parts: the generation rate; the distribution rate; corporate separation; alternative energy and energy efficiency resources; governmental aggregation; and smart metering. The generation rate would be comprised of a FAC that would collect the cost of fuel and fuel-related components plus an escalated non-FAC generation charge, carrying costs associated with capitalized environmental-related investments made from 2001 through 2008, and the cost of environmental-related capitalized investments that would be made from 2009 through 2011.[54] The Companies propose an annual 15% increase in total rates for the three years of the ESP, excluding cost increases recoverable through the Transmission Cost Recovery Rider and cost increases associated with any new government mandates.[55] The proposed increases would be higher except that the Companies propose to defer enough incremental FAC costs to hold the percentage increases to 15%.

The ESP contains eight components related to the Companies' proposed distribution rates: (1) enhanced distribution service reliability; (2) implementation of Phase 1 of gridSMART in CSP's service territory; (3) the POLR service obligation; (4) economic development/job retention programs; (5) energy efficiency/peak demand

[54] See Application at 4-6.

[55] See id. at 6.

reduction requirements; (6) alternate feed service; (7) line extension charges; and (8) Commission-authorized distribution regulatory assets. The Companies estimate that the enhanced distribution service reliability programs and gridSMART will result in annual increases to the Companies' distribution rates of 7% for CSP customers and 6½ % for OP customers.[56] For the POLR obligation, the Companies propose approximately a 6-mill per kWh charge for CSP customers and approximately a 2.5-mill per kWh charge for OP customers,[57] that will cost customers $508 million over three years.[58]

For alternate feed service charges, AEP Ohio proposes CSP rates of $2.54 per kW for service at primary voltage and $4.19 per kW for service of secondary voltage and OP rates of $3.07 per kW for service at primary voltage and $4.92 per kW for service at secondary voltage.[59] The proposed charges for customers needing a line extension are $200 per unit for a multi-family project, $500 per unit for a single family dwelling in a development and $500 per lot plus 100% of line extension cost in excess of $5,000 (including tax gross up) for a single family dwelling not in a development.[60] In addition, all three customer classes would be charged 100% of incremental cost plus a tax gross up.[61]

The Companies estimate $120.5 million of regulatory assets for CSP and $80.3 million for OP that would be collected through a regulatory asset recovery rider.[62] The

[56] Id.

[57] Id. at 8.

[58] See Companies' Ex. 2A at Exhibit JCB-2.

[59] Application at 10. The secondary voltage offer is available only to existing secondary voltage customers.

[60] Id. at 11.

[61] Id.

[62] Id. at 12.

economic development/job retention and energy efficiency/peak demand costs would be collected through nonbypassable riders.[63]

The Companies estimate that the plan would increase CSP customers' rates by $889 million and OP customers' rates by $853 million, over the three years of the plan,[64] although as noted in Section I above, the costs could actually be $1.668 billion for CSP customers and $1.594 billion for OP for OP.[65]

As discussed herein, the Companies have not justified the various costs associated with the proposed ESP. As a result, customers bear a significant risk that they will be overpaying for the Companies' electric service, with no opportunity for the overcharges to be refunded.[66] Given that Ohio customers are already disproportionately contributing to the profit margins of the Companies' parent corporation,[67] the Commission should not authorize the Companies' proposed increased under an ESP. The ESP must be modified.

IV. APPLICABLE LAW

Ohio's recently enacted legislation regarding the regulation of electric utilities, S.B. 221, altered R.C. Chapter 4928. S.B. 221 contains numerous "start up" provisions regarding the treatment of utilities' initial applications that are submitted for the PUCO's determination of the SSO that customers will pay beginning January 1, 2009. Pursuant to R.C. 4928.141(A), the utility's SSO may be established "in accordance with section

[63] Id. at 8, 9.

[64] See Companies' Ex. 1 (Roush) at Exhibit DMR-1.

[65] See Tr. IV at 112 (Assante); Tr. Vol. IX at 83 (Roush). These estimates do not include costs passed on to customers through the Transmission Cost Recovery Rider, a rider to collect the cost of government mandates or the economic development rider.

[66] See Tr. VI at 181 (Smith).

[67] See Tr. IV at 282-288 (Nelson).

4928.142 or 4928.143 of the Revised Code." The Companies' Application in this proceeding is based upon R.C. 4928.143 that provides for setting the SSO according to an ESP.

For purposes of this proceeding, R.C. 4928.143(B)(2) provides that an ESP may include any of the following:

- Automatic recovery of the following costs, provided they are prudently incurred: the cost of fuel used to generate the electricity supplied under the offer; the cost of purchased power supplied under the offer, including the cost of energy and capacity, and including purchased power acquired from an affiliate; the cost of emission allowances; and the cost of federally mandated carbon or energy taxes.[68]

- Terms, conditions, or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service, default service, carrying costs, amortization periods, and accounting or deferrals, including future recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service.[69]

- Automatic increases or decreases in any component of the standard service offer price.[70]

- Provisions for the EDU to securitize any phase-in, inclusive of carrying charges, of the utility's SSO price, which phase-in is authorized in accordance with R.C. 4928.144; and provisions for the recovery of the utility's cost of securitization.[71]

- Provisions relating to transmission, ancillary, congestion, or any related service required for the SSO, including

[68] R.C. 4928.143(B)(2)(a).

[69] R.C. 4928.143(B)(2)(d).

[70] R.C. 4928.143(B)(2)(e).

[71] R.C. 4928.143(B)(2)(f).

provisions for the recovery of any cost of such service that the EDU incurs on or after that date pursuant to the SSO;[72]

- Provisions regarding the utility's distribution service, including provisions regarding single issue ratemaking, a revenue decoupling mechanism or any other incentive ratemaking; and provisions regarding distribution infrastructure and modernization incentives for the electric distribution utility, which may include a long-term energy delivery infrastructure modernization plan for that utility or any plan providing for the utility's recovery of costs, including lost revenue, shared savings, and avoided costs, and a just and reasonable rate of return on such infrastructure modernization. In determining whether an EDU's ESP may include any of these provisions, the Commission must examine the reliability of the EDU's distribution system and ensure that customers' and the EDU's expectations are aligned and that the EDU is placing sufficient emphasis on and dedicating sufficient resources to the reliability of its distribution system.[73]

- Provisions under which the EDU may implement economic development, job retention, and energy efficiency programs, which provisions may allocate program costs across all classes of customers of the utility and those of EDUs in the same holding company system.[74]

R.C. 4928.143(C)(1) places the burden of proof in this proceeding on AEP Ohio. The section also requires the Commission to issue an order on an application not later than 150 days after the Application's filing date. The Commission's order must approve, or modify and approve, an application **only if** the Commission finds that the ESP as approved, including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, "**is more favorable in the aggregate** as compared to the **expected** results that would otherwise apply" under a market-rate offer filed under

[72] R.C. 4928.143(B)(2)(g).

[73] R.C. 4928.143(B)(2)(h).

[74] R.C. 4928.143(B)(2)(i).

R.C. 4928.142.[75] In addition, under R.C. 4928.143(C)(1), if the PUCO approves an application that contains a facility surcharge, the Commission must ensure that the benefits derived for any purpose for which the surcharge is established are reserved and made available to those that bear the surcharge. If the Commission cannot ensure this, the Commission's order must disapprove the application.

The ESP proposed by AEP Ohio is flawed in many respects. To protect Ohio consumers, the Commission's order in this case should direct the Companies to correct the numerous deficiencies in their proposal, as discussed below.

V. ARGUMENT

A. The ESP, If Appropriately Modified, Is Slightly More Favorable For Customers Than The MRO.

Revisions to R.C. Chapter 4928 by S.B. 221 introduced the concepts of an ESP and a market-rate offer ("MRO") for providing the SSO to retail customers. R.C. 4928.143(C)(1) states:

> [T]he commission by order shall approve or modify and approve an application filed under division (A) of this section [i.e. the ESP] if it finds that the electric security plan so approved, including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under section 4928.142 of the Revised Code.

The "otherwise apply" portion of the quoted statute refers to the provision of generation service by a market means and setting distribution rates as provided in R.C. Chapter 4909. While a numerical analysis seems necessary for the indicated comparison, the statute also requires consideration of "all other terms and conditions." Thus, any

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[75] R.C. 4928.143(C)(1) (emphasis added).

distortive effect or negative effect on regulatory oversight of the electric distribution utility must also be considered.

OCC Witness Smith testified that the Companies' comparison of the ESP and the MRO is flawed in that it significantly overstates the cost of market-priced power. This results from several factors that are addressed below.

First, the MRO filed by the Companies establishes the average energy price based upon forward markets and adds estimates of PJM Interconnection LLP capacity obligation, transaction risk, and retail administrative charges. This approach is used as a proxy for the results of a competitive bid.[76] The data that AEP Ohio used overstate the prices of market power. AEP Ohio did not account in the data for the downward trend in energy and fuel prices[77] and AEP Ohio overstated the adders it makes to the market price.[78] AEP Ohio correctly used the most recent data at the time they made their filing; however, AEP Ohio refused to update that data to current forward prices[79] when the dramatic drop in forward prices occurred in the 4th quarter.[80]

Witness Smith's market price updates showed a decline in AEP's price of $57.84 to $49.82 for the MRO. Adjustments to reflect what costs are appropriate to add to the market price to achieve a bid proxy further reduced the MRO to $73.94 for CSP and $71.07 for OP as compared with the Companies' filed rates of $88.15 for CSP and $85.32 for OP, representing about a 17% reduction in the average MRO.

[76] OCC Ex. 9 at 15 (Smith).

[77] Id.

[78] Id.

[79] AEP Ohio Ex. 2E at 21 (Baker).

[80] Id at 16-20.

In addition to correcting the cost of market-priced power in the Companies' Application, Ms. Smith testified to the statute's fundamental test for whether the proposed ESPs can be approved: that an ESP is more favorable in the aggregate than the results expected under the MRO. Ms. Smith testified that the ESP adjusted as she proposes is \$9 - \$38 million (for CSP) and \$31 - \$131 (OP)[81] million more favorable to customers than the results expected under the MRO. However, the ESP and MRO prices are distorted in the Application and cannot be viewed as calculated on a comparable basis for two primary reasons: 1) a blended purchased power rate is included in the MRO at twice the level in the ESP, and 2) the non-FAC rate in the ESP is automatically increased each year, but this increase is not included in the MRO.[82]

The Companies did not present any evidence to rebut the fundamental conclusion that the proposed ESP is not more favorable than the MRO. In rebuttal testimony, Mr. Baker simply asserted that he reviewed the FAC portion of costs and concluded that the ESP was more favorable.[83] Mr. Baker provided no evidence to support this assertion. Moreover, his statement indicates that he did not do a full analysis of costs, as the standard service offer power will include a non-FAC cost component as well as a FAC component.

Ms. Smith testified that the ESP will not be more favorable than the MRO unless her proposed adjustments are accepted which reduce the ESP cost. She recommends various adjustments to the ESPs.[84] The proposed adjustments include 1) rejection of the

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[81] OCC Ex. 9, LS Exhibit 2 (Smith).

[82] S.B. 221 allows an increase only in the FAC portion for the MRO. R.C. 4928.142(D).

[83] Id.

[84] OCC Ex. 9 at 3 (Smith).

POLR charge of about $500 million; 2) rejecting the automatic rate increases of 3% for CSP and 7% for OP on the non-FAC portion of the SSO representing about $xx million; 3) rejecting the FAC deferral scheme, which is not quantifiable;[85] 4) adjusting the FAC to use actual fuel costs as the baseline; and 5) a reducing the MRO price. Only with these significant reductions, possibly combined with the elimination of market-based power in the ESP, will the ESP be more favorable than the MRO.

These reductions in the ESP are also mandated by the terms and principles of S.B. 221.[86] In addition, the rate increase for the 2001-2008 carrying costs related to environmental investments is not permitted under the statutory terms of the ESP. Mr. Baker claimed that these costs would be allowed under R.C. 4928.143[87] because they relate to promoting diversity of supplies. The environmental measures in question *have already been installed.* It is hard to imagine that fuel diversity and emissions reductions will be promoted by charging customers in 2009-2011 for these past investments.

AEP Ohio witness Baker was only able to quantify a benefit to customers for the ESP over the MRO of $49 million (CSP) and $43 million (OP) in the first year of the ESP.[88] If the MRO and the ESP each contained the same blend of market power[89] in each year of the ESP, the MRO would be more favorable to customers in year one by $51 million (CSP) and $197 million (OP). In year two, the MRO would be more favorable

[85] This is because future fuel costs are unknown. This affects the level of deferrals and the carrying costs fort the deferrals.

[86] AEP Ohio's automatic increase in the base component of the standard service price, the distortion caused by the blend of market rates in the ESP and MRO, and the non-FAC automatic increase in the ESP are discussed, *supra*. The inappropriateness of the POLR price is discussed, *infra*.

[87] Tr. VI at 186 (Smith).

[88] AEP Ohio Ex. 2A, JCB2 (Baker).

[89] The ESP blends market power into the rate at 10%, 20% and 30%, respectively during the three year ESP while the MRO blends only 5%, 10% and 15%. Id.

for CSP customers by $105 million and for OP customers by $399 million. In year three the MRO would be more favorable to CSP customers by $461 million and for OP customers by $245 million.[90] It should be noted that these comparisons do not reflect any of the adjustments identified above. The net benefit in the final table prepared by OCC Witness Smith shows for the three year ESP period there is only a slight benefit to customers if the ESP is adopted. As compared to the MRO, the ESP benefit to customers ranges from $5 million to $139 over the entire ESP period.[91] As OCC Witness Smith testified, this determination that the ESP is only slightly more favorable than the MRO is based upon the Commission adopting the following adjustments:

- There should be no deferral provision;
- A detailed FAC should be approved which includes carrying charges on annual under-or over-recoveries at the same weighted average cost of long-term debt;
- The base generation rate should not increase;
- No POLR charges should be allowed in the ESP;
- Rates should not be increased by the carrying costs on the incremental environmental capital expenditures; and
- The distribution increase should be reduced for CSPCO and eliminated for OPSCO, under the conditions recommended by OCC witness Finamore.[92]

In conclusion, adopting Witness Smith's recommendations demonstrate that the ESPs are more favorable to customers than the MROs. However, this conclusion could

[90] OCC Ex. 9, LS Exhibit 2 (Smith).

[91] Id.

[92] OCC Ex. 9 at 40 (Smith).

easily change depending upon the Commission's decision about the distortive effects of the proposed ESP on the pricing of electricity over time, the level of distribution rates, and service quality costs and issues. All these modifications proposed by OCC should be accepted and the Commission would have to adopt significant modifications to the Companies' ESP if it is to be found more favorable to customers than the MRO.

B. The Companies Have Not Justified a "POLR Charge."

The Companies seek approval of a Provider of Last Resort ("POLR") charge that would require customers to pay a proposed $508 million over the three-year ESP.[93] The Companies claim this charge is to compensate them for the financial risk that customers will purchase their generation from a competitive retails electric service ("CRES") supplier and later decide to return to the Companies for their generation service.[94] The Companies suggest this is a continuation of the Commission's recognition that a POLR charge is appropriate and therefore should be continued in the ESP.[95] In fact, the POLR charge in the current rate stabilization plan is not related to shopping risk. As OCC Witness Smith noted, "[T]he major reason for the request is the Companies' claim that the legislature or regulators may change an existing element of S.B. 221, should a municipal aggregation return to SSO service when market prices are higher than the cost of SSO service."[96] That risk, however, is practically nonexistent.[97] The fact that the

[93] AEP Ohio Ex. 2A, Ex. JCB-2 (Baker).

[94] AEP Ohio Ex. 2A at (Baker).

[95] OCC Ex. 11 at 8 (Medine)

[96] OCC Ex. 10 at 33.

[97] See id.

Companies' have a POLR charge now does not support their request for one in the ESP, as OCC Witness Medine testified:

> In the last case that addressed a POLR charge, Case No. 04-169-EL-UNC, the PUCO made it clear that the POLR charge provided to AEP was "based upon *the specific circumstances ... in this* proceeding. Nothing in this decision is intended to be precedent-setting ..." Moreover, the POLR charge there was related to distinct regional transmission operational costs expected to be incurred during the period the Rate Stabilization Plan ("RSP") was in effect, through December 2008.[98]

The past POLR charge was not based upon shopping risk. The POLR charge as proposed by Companies in this filing is not related to the cost of generation from, or based on the results of, any cost-based analytical study relating to whether customers are likely to shop.[99] In fact, Companies have not budgeted for any additional shopping over current levels, calling into question whether the Companies genuinely believe shopping will occur.[100] The Companies propose to estimate the dollar value of the POLR "financial risk" using a method developed for hedging equities.[101] The Companies did not use the inputs required by the model. The inputs were replaced with inputs selected by the Companies in their sole and unsupported judgment.[102] These "new AEP Ohio" inputs are unverified and untested as producing accurate results. They have not been used in any

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[98] Id.

[99] Tr. XI at 214 (Baker): Q. In the final analysis, Mr. Baker, aren't you effectively taking the position that Senate Bill 221 creates a right for customers for which AEP has the right to impose a charge, regardless of whether or not the customer wants that right, exercises it, or will exercise that right? And by "customer" I mean customers plural, your customer base. A. Subject to all of the caveats I gave you before, I'd say yes.

[100] Tr. XIV at 247, 248 (Baker).

[101] The Black Scholes Model; OCC Ex. 11 at (Medine).

[102] OCC Ex. 11 at 15 (Medine).

other proceeding in this or any other state. This adulterated "method" results in costs to customers of more than $500 million.

The Companies' failures to provide an empirical basis for its requested POLR revenues and to actually evaluate customer behavior and market realities during the ESP period are particularly disturbing because this non-bypassable POLR charge figures prominently as a barrier to competitive choices for customers (discussed later).

AEP Ohio's only rationale for the POLR charge is the Black-Scholes Model ("BSM"), a quantitative model which employs empirical inputs.[103] As explained above, the Companies substitute the BSM empirical inputs with their own qualitative inputs.[104] The use of the Companies' qualitative inputs has never been tested or analyzed, save for the "indeterminate number of times"[105] the model was run by the Companies before they arrived at the POLR charges they included in the ESP filing. AEP Ohio witness Baker could not identify any other 1) utility that uses the BSM for calculating a POLR charge[106] or 2) utility that even uses Black-Scholes for any purpose other than fuel hedges.[107] In fact, *not even AEP uses Black-Scholes* to value coal hedges, a common and accepted use of this methodology:

> Q. DOES AEPSC[108] USE THE BLACK-SCHOLES MODEL TO EVALUATE COAL OPTIONS?

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[103] The five inputs for Black-Scholes are: (1) the current price of the stock, (2) the strike price of the option, (3) the amount of time remaining until the option expires, (4) the current interest rate, and (5) the value of the volatility parameter for the stock.

[104] AEP Ohio Ex. 2A at 25-35 (Baker).

[105] Tr. XI at 223-225 (Baker).

[106] Id at 28 (Baker).

[107] Id.

Tr. Vol. I, X, XIV at (Baker)

[108] American Electric Power Service Company

A. No. AEPSC[109] has indicated on more than one occasion that it does not believe the Black-Scholes model is a reliable tool for this purpose.[110]

AEP Ohio insists Black-Scholes accurately calculates the "optionality" associated with shopping customers, which means the Companies could purchase a hedge to protect themselves from the "shopping risk' they have quantified. Yet AEP Ohio will not make a commitment to use customers' $508 million to purchase a hedge for this POLR "risk." This lack of commitment by the Companies calls into question the validity of the theory that the POLR charge represents compensation for tangible and significant risks to the Companies, as well as whether Black-Scholes is a valid measure of the risk, if there is any.[111]

The Application and testimony presented by the Companies claim that the proposed ESP is more favorable that the alternative. Assuming *arguendo* that this is true, the Companies' proposal regarding a standby charge seeks compensation for a market risk that does not exist. The implication of the Companies' proposal for a sizable POLR charge is that the ESP is less favorable than the alternative.

The BSM is not designed to, and is incapable of, accounting for any customer behavior or market development progress.[112] Staff Witness Cahaan testified that "there are many reasons to think that substantial migration will not quickly occur, even if the market price falls below the SSO price."[113] Thus, the POLR charge proposal by the

[109] Id.

[110] OCC Ex. 11 at 11 (Medine).

[111] Tr. IV at 200 (Baker).

[112] Tr. XI at 214 (Baker).

[113] Staff Ex. 10 at 7 (Cahaan).

Companies is the same whether there is 95% shopping or 5% shopping.[114] The POLR charge proposal by the Companies is the same whether CRES providers require a three-year term contract or no term contract for shopping customers. The POLR charge proposal by the Companies is the same whether the market rate is higher than the ESP (which would provide an economic disincentive to customers to shop) or the ESP is higher than the MRO (which would provide the customers an economic incentive to shop). *The fact is that the POLR charge proposal by the Companies is the same, regardless of the circumstances of the markets or customers or shopping -- period.*

Staff Witness Cahaan opposed the Companies' POLR charge. He testified that:

> The risks associated with returning customers can be avoided. Usually, the means of avoiding this risk is to require that a returning customer pay back at market prices and not the SSO price....the returning customers would [either] pay market prices or the incremental costs of the purchased power would be recovered through the FAC.[115]

OCC Witness Medine also opposed the POLR charges and stated most succinctly:

> The Companies have not demonstrated a need for customers to make a payment related to the POLR obligation as part of the ESP. Nor have they demonstrated the appropriateness of using the Black-Scholes model for this application. As proposed, the Companies' proposal for customers to make a POLR payment should not be approved.[116]

Moreover, OCC Witness Medine explained that any POLR risks to which the Companies are exposed can be compensated through the FAC.

> Under the FAC provisions, the Companies will recover the costs included in Account 555. According [sic] Witness Nelson, (t)his account records the cost of electricity purchased including

[114] Tr. XI, at 210 (Baker).

[115] Staff Ex. 10 at 6 (Cahaan).

[116] OCC Ex. 11 at 2 (Medine).

> transactions under the AEP Power Pool. It includes both energy and demand or capacity charges." Witness Baker confirmed that if the Companies fulfilled their POLR obligations through purchased power, the related purchased power costs would be recoverable through the FAC.[117]

Ms. Medine testified, "I am not aware of any utilities that use the Black-Scholes model for this purpose [calculating a POLR charge]. More importantly, Witness Baker is not aware of any other utilities that use the Black-Scholes model for this purpose."[118] In conclusion, the non-bypassable POLR charge proposed by the Companies should be rejected by the Commission on both qualitative and policy grounds.

Finally, it should be noted that the POLR charge under the existing Rate Stabilization Plan is approximately $.001 per kilowatt hour, substantially less than what is proposed in the instant proceedings. Yet there is no record evidence to demonstrate that the current POLR charge is insufficient and requires such a dramatic increase.

C. The Non-FAC And Non-Cost-Based Annual Rate Increases Of 3% And 7% During The ESP Period Are Unwarranted And Should Be Rejected By The Commission.

The Companies are requesting recovery of a variety of costs through annual automatic rate increases during the ESP period.[119] It is proposed that the non-FAC portion of the standard service offer be increased by 3% for CSP and 7% for OP annually. According to the Companies these non-FAC annual rate increases are not based upon the Companies' costs.[120] Rather, the automatic rate increases are supposed to recover 1) the 2009 carrying costs associated with the 2001-2008 environmental

[117] Id at 13, 14.

[118] OCC Ex. 11 at 17, citing Baker Deposition, Page 29 and Response to OCC Interrogatory Request 5-111.

[119] AEP Ex. 2A at 24 (Baker).

[120] Id.

investments; 2) the carrying costs associated with the 2009-2011 additional environmental investment,[121] 3) increases related to inflationary factors during the three-year ESP period; 4) unanticipated cost increases; and 5) non-mandated generation-related cost increases.[122] The Companies have not, and do not intend to, demonstrate that additional standard service revenues are actually needed, as a prerequisite to collecting these costs from customers, as shown from the testimony of AEP Witness Baker:

> Q. And this is because you can't know what the amount of those costs are.
>
> A. It's because we're permitted to have automatic increases.
>
> Q. Well, don't you justify it here by saying that we can't know what those costs are?
>
> A. I don't think I need to justify it. I think we're allowed to put automatic increases in, and I'm just explaining the thought process of there are reasons to put automatic increases in. It is not cost based.
>
> Q. So the question of whether those costs will even materialize is not relevant.
>
> A. No.[123]

Further, the Companies do not provide any legal authority for what amounts to retroactive ratemaking and a violation of the Electric Transition Plan (ETP) Stipulation and Order and the Rate Stabilization Plan (RSP) Order issued by the Commission.[124] The ETP included provisions that capped rates for 2001 through 2005 and the RSP set forth

[121] Tr. Vol. XI at 219, 220 (Baker).

[122] Id.

[123] Tr. XIV at 208, 209 (Baker).

[124] PUCO Case Nos. 99-1729-EL-ETP and 99-1730-EL-ETP, Order Approving Stipulation at 47, 48 (September 28, 2000); and PUCO Case No. 04-169-EL-UNC,RSP Order at 20, 21 and 39 (January 25, 2005).

limitations as to the amount that rates could increase from 2006 through 2008. Neither of these Orders included provisions that allowed the Companies the discretion to collect additional customer dollars for costs incurred during that period.[125] Rather, the rates were "all in." Customers could not seek to reduce the rates nor could the Companies seek to increase them beyond the levels agreed to. Thus, the Companies cannot now seek to breach their ETP Settlement or ignore Commission orders in order to recover costs incurred prior to 2009 and the Commission should not sanction such a request.

There has been no demonstration that the Companies are not collecting standard service revenues sufficient to recover all of these costs. The Commission should reject the Companies' proposed automatic rate increases.

D. AEP's "Enhanced" Service Reliability Plan Is Deficient Under Ohio Law And The Commission's Rules.

1. The Companies propose to collect $445 million from customers to fund their reliability plan.

As part of its Application, the Companies have proposed a three-year "Enhanced Service Reliability Plan" ("ESRP"). The ESRP is one of the elements of the Companies' proposed increase to distribution rates. The Companies' ESRP consists of four major components.

- Enhanced overhead line inspection approach, targeting specific asset modernization/replacements and reliability enhancements;
- Enhanced vegetation management (right-of-way clearing);
- Targeted distribution automation; and

[125] Id.

- Targeted underground residential distribution cable replacement and rejuvenation.

Over the three years of the ESRP, the Companies propose to collect $445 million for these programs, including $163 million of O&M and $283 million of capital improvements.[126] The Companies plan to pay for the ESRP through a distribution rate increase.[127] The ESRP is proposed to "modernize and improve" the Companies' distribution systems.[128] The Companies claim that without the funding of the ESRP they will be unable to maintain its current level of service.[129] While OCEA does not accept AEP Ohio's claim at face value, the Companies need to improve the reliability of their electric distribution system moving forward. In addition, OCEA maintains that if AEP Ohio had devoted sufficient resources to its distribution system in the past, the proposed rate increase would be unnecessary.

2. Ohio Law provides that AEP Ohio has the burden of proof in ensuring that its Enhanced Service Reliability Plan is in the public interest and complies with R.C. 4928.143(B)(2)(h).

The Ohio General Assembly charged the PUCO with the responsibility to ensure that electric utilities provide "necessary and adequate" service to Ohio consumers and businesses.[130] The General Assembly also established the policy of Ohio that retail electric service must be "adequate, reliable, safe, efficient..."[131] Perhaps most

[126] AEP Ohio Ex. 11 at 37 – Chart 10 (Boyd).

[127] OCC Ex. 9A, Interrogatory 3-94. Of CSP's proposed 7% distribution rate increase, approximately 4.06% is directed to the ESRP while 2.94% is directed to gridSMART. OP's entire distribution rate increase of 6.5% is targeted to the ESRP.

[128] Id. at 3.

[129] AEP Ohio Ex. 11 at 8 (Boyd).

[130] R.C. 4905.22.

[131] R.C. 4928.02(A).

importantly, Ohio law places the "burden of proof" on AEP Ohio in this proceeding.[132] AEP Ohio has not demonstrated that its proposed ESRP is in the public interest. The ESRP promises all residential customers of the Companies higher distribution rates but falls short of defining any tangible benefits. The Companies fall far short of meeting the burden of proof that they have dedicated sufficient resources to maintain their distribution system reliability in the past.

The ESP case has cast grave doubt as to whether AEP Ohio has been providing reliable service at the levels contemplated by the statute. If AEP Ohio has not, in fact, been providing adequate and reliable service to its customers, it should first be determined how much AEP Ohio has been spending before the Companies receive additional funds from its customers.[133]

Ohio law also provides that the Commission must adopt rules that:

> include prescriptive standards for inspection, maintenance, repair, and replacement of the * * * distribution systems of electric utilities; shall apply to each substantial type of * * * distribution equipment or facility; * * * and shall otherwise provide for high quality, safe, and reliable electric service; shall include standards for operation, reliability, and safety during periods of emergency and disaster * * *.[134]

These rules "[a]re intended to promote safe and reliable service to consumers and the public, and to provide minimum standards for uniform and reasonable practices."[135] The Commission has such rules in place as part of the Electric Service and Safety Standards ("ESSS"). Ohio Adm. Code 4901:1-10. The ESSS provide for outage restoral

[132] R.C. 4928.143(C)(1).

[133] OCC Ex. 13 at 10-11 (Cleaver).

[134] R.C. 4928.11(A).

[135] Ohio Adm. Code 4901:1-10-02(A)(2).

"targets"[136] and circuit reliability standards,[137] as well as the inspection and maintenance of distribution facilities on a routine basis.[138]

Under S.B. 221, the legislature determined that as part of an electric utility's ESP, the Commission is required to "examine the reliability of the electric distribution utility's distribution system," "ensure that customers' and the electric distribution utility's expectations are aligned," and determine that the electric distribution utility is "placing sufficient emphasis on and dedicating sufficient resources to the reliability of its distribution system."[139] AEP Ohio's ESRP with its accompanying distribution rate increases, provides no disincentives for failure of the plan to meet any of its vague objectives.[140] The goals of the ESRP that are provided by AEP Ohio Witness Boyd are amorphous and impossible to measure. AEP Ohio fails to meet its statutory burden of aligning its customers' expectations with the reliability efforts it proposes as part of its ESRP.

3. AEP Ohio's Application is deficient under the Commission's pending rules.

a. The Enhanced Service Reliability Plan does not address cost savings and does not align customers' interests with that of the Companies.

The Commission recently adopted rules regarding the contents of SSO applications which implement the provisions of R.C. 4928.143(B)(2)(h) discussed

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[136] Ohio Adm. Code 4901:1-10-10(B)(2).

[137] Ohio Adm. Code 4901:1-10-11(C).

[138] Ohio Adm. Code 4901:1-10-27(A), (D).

[139] R.C. 4928.143(B)(2)(h)

[140] AEP Ohio Ex. 11 at 17 (Boyd). According to Mr. Boyd, "The Plan, therefore, focuses on the leading outage causes (both momentary and sustained) to significantly enhance the overall customer experience."

above.[141] In those pending rules, the Commission is developing rules which include procedural and filing requirements for applications for a MRO and ESP.[142]

As with the relevant statutes, a review of the pending rules also reveals flaws with the ESRP. The ESRP does not address potential cost savings to the Companies, does not state how it avoids duplicative cost recovery from customers, and does not align the Companies' interests with that of its customers.[143]

The "alignment" of electric utility and consumer interests is flawed because the application and AEP Ohio testimony merely attempt to measure, through the use of customer surveys, whether customers expect reliable service.[144] The surveys do not address consumers' concerns regarding the duration or the frequency of outages or other ESSS standards. There actually is no alignment with customers' interests provided in the Application or in AEP Ohio's testimony.[145] There is no provision in the plan for a review of the expenditures and what to do with funds allocated for the various reliability programs that are not spent. In addition, there is no quantification of the overall rate impact, much less by customer class. Because the ESRP fails to provide for a review

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[141] *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, (September 17, 2008). Applications for Rehearing are currently being considered by the Commission.

[142] Proposed Ohio Adm. Code 4901:1-35

[143] Proposed Ohio Adm. Code 4901:1-35-03(C)(9)(g).

[144] AEP Ohio Ex. 11 at 12-13 (Boyd). These surveys are conducted quarterly for AEP Ohio by Marketing Strategies, International. Witness Boyd's testimony is that surveys reveal that some customers think they will expect more reliable service in the future. Such a finding certainly does not advance the need for the ESRP and higher distribution rates.

[145] OCC Ex. 13 at 12 (Cleaver). "The 'alignment' of the AEP and consumer interests though the ESRP is flawed because the application and testimony merely attempt to measure whether customers expect reliability [sic] service. There is no provision in the ESRP for a review of the expenditures and what to do about funds allocated for various reliability programs that are not spent."

process and does not address past reliability issues the ESRP should not be approved by the Commission.

b. The Companies have failed to provide specific information that would enable the Commission to properly evaluate the efficacy of the Companies' Enhanced Service Reliability Plan.

The Commission's proposed rules require that an Application for an ESP contain sufficient detail to allow "appropriate evaluation" of its infrastructure modernization plans.[146] The Companies' ESRP is impossible to properly evaluate due to its lack of detail. AEP Ohio's Application does not provide an implementation schedule that is geographically targeted and does not reflect the number of its customers "directly impacted" by the ESRP.[147] AEP Ohio's proposed schedule for its ESRP consists merely of projecting its expenditures for the various ESRP program(s) for 2009-2011. The Application also lacks an appropriate description of the "benefits" of the ESRP because it *does not address the number of customers affected, the number of circuits affected, and* fails to account for any possible savings to the Companies.[148] Perhaps most importantly in terms of evaluating the ESRP, there are no "milestones" to measure the outcome of the incremental programs proposed in the ESRP.[149]

The ESRP proposed by AEP Ohio Witness Boyd in his testimony provides scarce information of the impact of portions of the plan on current reliability. The lack of attention to how the proposed ESRP will improve (or not improve) service quality indicates that the Companies do not consider it important to meet reliability targets.

[146] Proposed Ohio Adm. Code 4901:1-35-03(C)(9)(g).

[147] Proposed Ohio Adm. Code 4901:1-35-03(C)(9)(g)(i).

[148] OCC Ex. 13 at 12 (Cleaver).

[149] Proposed Ohio Adm. Code 4901:1-35-03(C)(9)(g)(ii).

Other portions of the plan, including the discussion of vegetation management, lack detail on how such proposed actions will affect outages and other ESSS measures. The number of circuits impacted, the number of customers impacted, and performance/outcome measurements are not provided. As stated by OCC Witness Cleaver "AEP Ohio has not shown that the additional investment it has proposed as part of its ESRP will noticeably enhance distribution system reliability."[150] AEP Ohio has provided no evidence that the ESRP provides for modernization of its infrastructure above and beyond what is required by the Commission's existing rules and provided for in existing rates. The ESRP does not adequately align customer and utility expectations nor does it evaluate such expectations by customer class.[151] Finally, AEP Ohio provides no detail on past expenditures and what factors led to the described deterioration in the Companies' distribution plant.[152] This lack of detail provided with the proposed ESRP heightens OCEA's concern that neglect of the AEP Ohio's existing distribution plant may have led to the current problems with the Companies' reliability.

4. The Companies' recent efforts in providing reliable distribution service have failed to meet ESSS requirements and the Enhanced Service Reliability Plan provides no assurances that their reliability performance will improve.

OCEA's position in this case is that AEP Ohio's distribution system reliability efforts in recent years have been inadequate and have not ensured safe and reliable

[150] OCC Ex. 13 at 8.

[151] Proposed Ohio Adm. Code 4901:1-35-03(C)(9)(g)(v).

[152] R.C. 4928.143(B)(2)(h) requires that the Commission review the past and current practices of AEP Ohio related to distribution system reliability in considering whether to grant an infrastructure modernization plan.

service for AEP Ohio's customers – a position that is shared by the PUCO Staff.[153] AEP Ohio's distribution system reliability has been criticized in several recent proceedings before the Commission.[154] These proceedings called into question AEP Ohio's "degradation in performance" on a number of reliability measures.[155] The evidence of recent distribution system reliability problems alone is enough for the Commission to decline to consider the Companies' ESRP as part of its Application.

AEP Ohio's vegetation management practices, as currently employed by the Companies and as proposed in the ESRP, provide an excellent example of the laissez faire approach of AEP Ohio to following required inspection and maintenance programs. The Commission's ESSS "are intended to promote safe and reliable service to consumers and the public, and to provide minimum standards for uniform and reasonable practices."[156] AEP Ohio does not guarantee that it will follow such standards which provide for "uniform" and "reasonable" practices in implementing its ESRP.

[153] Another exchange between Staff Witness Roberts and Counsel for AEP highlights the need for the Commission to consider AEP's historical reliability problems. Tr. VIII at 81-82 (Roberts). "Q. Okay. So did the staff * * * indicate to the company that additional activities and the manner and extent of those activities need to be increased or expanded to match what Mr. Boyd is describing in the ESRP? Did that communication occur in the past? A. Yes, it did. Q. And in what form? A. In the form of -- in the 03-2570 case it was done in the form of a Stipulation. In the 06-222 case it was done -- the Commission decided additional maintenance based on dollars spent on vegetation clearance. Q. Your understanding of the '03 Stipulation * * * was that all the same things that have been described and you've referenced several times now in the overhead inspection program were required, specifically required by the company? A. The Stipulation did not specifically address that. The discussions the staff had with the company, communications with the company, recommended that the company do a lot more of these type of maintenance activities. Q. Are you referring to verbal communication? A. Verbal and written. Q. And so it's your understanding that there's a written communication from the staff to the company that indicates all these things that Mr. Boyd described in the enhanced inspection program should be done in the same manner he's describing in his testimony in this case? A. Yes, there has."

[154] *In the Matter of the Commission Consideration of a Settlement Agreement between the Staff of the PUCO and Columbus Southern Power and Ohio Power Company*, Case No. 03-2570-EL-UNC, Stipulation (December 31, 2003) ("AEP Service Quality Case") and In re AEP's Self-Complaint Regarding Service Reliability, Case No. 06-222-EL-SLF, Complaint (January 31, 2006) ("Self-Complaint Case").

[155] AEP Service Quality Case, Commission Ordered Investigative Report by Commission Staff (April 17, 2006) at 2.

[156] Ohio Adm. Code 4901:1-10-02(A)(2).

While AEP Ohio Witness Boyd did provide assurances that all the funds allocated to the vegetation management program would be spent, he provided no such assurance that the ESRP's vegetation management program would be followed as proposed.[157] Any reliability improvements promised by AEP Ohio in return for approval of a distribution rate increase must be quantified and verified by the Commission.[158] The ESRP's lack of clear-cut measurements to determine the ESRP's success and the Companies' compliance with the plan is reflected by an AEP Ohio response to OCC discovery:

> Q. To the extent the Company has not followed its vegetation management plan as filed with the PUCO, what are the reasons for deviation from the vegetation management plan and how has each deviation been communicated to the PUCO?"
>
> A. The company has not deviated from the vegetation management plan because the plan is intended to change as circumstances warrant.[159]

The Companies' ESRP also appears to allow for changes "as circumstances warrant." The ESRP provides no assurance that any of the proposed programs will be completed as set forth in the ESRP.

OCEA questions the adequacy of the resources that the Companies have dedicated to reliable service over the last decade. The Staff Investigative Report in the AEP Ohio Self-Complaint Case and the testimony of OCC's witness in the proceeding explored in great detail the declining performance of AEP Ohio since 1999. The

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[157] Tr. V at 179-181.

[158] Staff Ex. 2 at 19 (Roberts).

[159] OCC Ex. 9A, OCC Interrogatory 3-50.

Commission should not ignore the record of past problems with AEP Ohio's distribution service reliability in considering the Companies' Application.

OCEA's position continues to be that AEP Ohio's performance on key reliability measures has been insufficient in the past and continues to be lacking. As in the Self-Complaint case, OCC believes insufficient resources have been dedicated to vegetation management and other key reliability programs required by Ohio Adm. Code 4901:1-10-27 of the ESSS. The various components of AEP Ohio's proposed ESRP are routine distribution reliability matters.

For example, AEP Ohio proposes in the ESRP that AEP Ohio change its vegetation management program from a performance based program to a cycle-based tree-trimming program. A "performance-based" vegetation management program is based on several factors including inspection results, tree-related reliability performance, and other factors. OCEA considers the use of this vegetation management policy, which rations tree trimming and other vegetation management activities only to those distribution circuits that exhibit especially poor electric service reliability, to come at a cost to overall system reliability.[160] Cycle-based vegetation management, on the other hand, is a more proactive approach and results in each circuit being trimmed end-to-end on a regular basis. Cycle-based trimming had been a common industry practice for decades and one which AEP Ohio had employed in prior years.[161] A cycle-based vegetation management plan is a routine reliability matter and should any additional costs result from implementation of such a program, the costs should not be borne by

[160] OCC Ex. 13 at 32 (Cleaver).

[161] Tr. Vol. V at 221 (Boyd).

ratepayers. Further, the Commission should recognize that the ESP proceeding is not the proper forum for considering and rectifying AEP Ohio's reliability problems. AEP's ongoing reliability problems should be addressed in a separate proceeding as discussed below.

5. AEP Ohio's proposed Enhanced Service Reliability Plan is not an enhancement to current, required reliability programs and does not ensure reliable service to its customers.

AEP Ohio offers no information regarding its overall level of expenditures for distribution system reliability-related O&M and capital beyond the incremental expenditures provided for under the ESRP. The Commission cannot determine the efficacy and effectiveness of the ESRP without this crucial information. The Companies also provide no guarantee of success of the ESRP because "consideration must be given to the potentially limited availability of both human and material resources in order to implement the plan" as well as the potential effects of inflation on the Companies' cost projections for the program.[162]

Further, the ESRP is merely a modified version of the plan AEP Ohio proposed as part of its Self-Complaint case.[163] The updated plan (the ESRP) has insufficient supporting detail and lacks appropriate goals - as did the prior plan offered in 2006. The ESRP is business as usual for AEP Ohio and it suffers from the following flaws:

- The Companies' proposed Vegetation Management Programs, while an improvement over its current performance-based program, is not an enhancement but rather a reflection of additional tree trimming needed as a result of the Companies' prior programs.

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[162] AEP Ohio Ex. 11 at 37 (Boyd).

[163] Self-Complaint Case.

- AEP Ohio's proposed Overhead Circuit Inspection and Mitigation Initiative is not truly enhanced but rather a plan which AEP Ohio should be following as required by Ohio Adm. Code 4901:1-10-27 in the normal course of business.

- The programs proposed by AEP Ohio, such as accelerated replacement of defective equipment and hardware, are not enhancements but rather examples of merely following good industry practices. As discussed above, the Companies are characterizing as an "enhancement" to maintenance activities that should have been conducted as business-as-usual.

- The Companies' proposed Underground Mitigation Program is not an enhanced program but rather a part of normal utility system maintenance. AEP Ohio has also neglected to provide data to show the expected improvement in service reliability resulting from investing in such an expensive program.[164]

The Companies also fail to support the claim that the ESRP truly modernizes AEP Ohio's infrastructure.[165] Instead, the Companies offer a series of incremental spending plans which will be funded by increases to distribution rates.

AEP Ohio has provided no support that its proposed incremental or "enhanced" programs go beyond what it should be doing on a normal basis.[166] As Staff Witness Roberts stated:

> [t]hese areas and the proposed enhancements, most of those resources as far as the tools have been available to the company to perform, and it is my opinion that they should have been performing these for a number of years.[167]

For instance, the Company's proposed overhead line inspection program may improve reliability but is not an "enhancement" to service reliability. Rather it is an

[164] OCC Ex. 13 at 44-46 (Cleaver).

[165] AEP Ohio's Ex. 11 at 3 (Boyd).

[166] OCC Ex. 13 at 30 (Cleaver).

[167] Tr. VIII at 65 (Roberts).

attempt on the Companies' part to play "catch-up" for the inadequacy of prior programs.[168] AEP Ohio's existing inspection program does not meet the standard contained in ESSS Rule 27 (E)(1) which requires such programs to "establish preventative requirements" for the electric utility to maintain safe and reliable service. AEP Ohio acknowledges that the Companies do not perform preventative maintenance as part of their program.

In response to a PUCO Staff Interrogatory the Companies stated that "Only repairs of a critical or safety-related nature were performed as part of the inspection program.[169] AEP Ohio is long overdue in pursuing the appropriate level of distribution system reliability. This exchange between Staff Witness Roberts and Counsel for AEP Ohio is consistent with OCEA's position regarding AEP Ohio's current reliability efforts:

> Q. Okay. Now, as I understand it, in your prior answers you were saying that because those activities were available and could have been done, they should have already been done; is that correct?
>
> A. They should have been -- a lot of what the company's calling *enhanced really is just ongoing maintenance, and they've always* had these resources available to them. They should have done them. They should have introduced this and performed this before now and it should have been implemented back when staff first came to the company with issues, and that would have been back in 2003.[170]

The Commission has yet to deal with a number of questions regarding AEP Ohio's distribution system reliability. With such issues as yet unaddressed, AEP Ohio's Application lacks support under Ohio law and the Commission's rules.

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[168] OCC Ex. 13 at 30 (Cleaver).

[169] OCC Ex. 9A. AEP Ohio Response to Staff Interrogatory 25.

[170] Tr. VIII at 72.

The record concerning AEP Ohio's distribution system reliability calls into question the ongoing maintenance practices of the Companies and the efficacy of their programs required by the ESSS. AEP Ohio's ESRP does provide for distribution modernization as contemplated by the statute. The plan is flawed, however, because the requested revenue increase is not dependent upon the Companies' reliability performance. In fact, as with the ESSS, there is no penalty for the Companies' failure to implement any part of the ESRP. The plan is devoid of any goals or milestones.

6. In lieu of imposing rate increases in the Enhanced Service Reliability Plan for the Companies' distribution program, the Commission should address system reliability improvements in a separate proceeding.

AEP Ohio's proposed distribution rate increases would increase distribution rates in a manner that is inconsistent with protections for customers found in normal distribution ratemaking. Those protections in a rate case include public hearings and a review of the Companies' overall rate structure to determine if AEP Ohio's rates are reasonable.[171] Staff Witness Hess's recommendation – that distribution rates should be adjusted in comprehensive distribution rate proceedings conducted according to R.C. Chapter 4909 -- should be adopted.[172]

The circumstances that led to AEP Ohio's alleged "aging" infrastructure, are undocumented in the record of this case. AEP Ohio has not demonstrated that the ability to maintain a reliable distribution system is beyond its existing resources. The record

[171] R.C. 4909.15.

[172] Tr. XIII at 125 (Hess). "Q. Okay. And they would be reviewed apparently not just in the context of whether those programs were reasonable and should have been undertaken, but, as you say at page 7, line 17, "whether there was a material impact on the Applicant's ability to recover a reasonable return for the distribution service." A. Yes."

established that AEP Ohio's alleged aging distribution system is a product of its own policies and procedures.

AEP Ohio's proposed distribution rate increase should be rejected under the Commission's review (as contemplated by R.C. 4928.143(B)(2)(h)) regarding the reliability of AEP Ohio's distribution system and the absence of assurances that additional resources will actually result in distribution reliability improvements. The Consumers for Reliable Electricity in Ohio ("CREO") recently requested that the Commission investigate the reliability of the electric service currently being provided by Ohio's electric distribution utilities, including AEP Ohio.[173] The record of the resulting proceeding, which investigates the reliability of the electric distribution utilities, should be considered in the upcoming AEP distribution rate case.

AEP Ohio's proposed distribution rate increase, related mostly to its ESRP, appears to have been developed to cope with past failures in the Companies' planning and budgeting processes. The lack of planning and proper budgeting have resulted in deteriorating distribution system reliability and the ESRP may be intended to rectify these past failures. On the other hand, the proposal of the ESRP may be as simple as an effort by AEP Ohio to take advantage of the provisions of R.C. 4928.143 to increase AEP Ohio's distribution-related profits. AEP Ohio should be held accountable for its past and ongoing reliability problems, and distribution rates should be determined in rate cases.

[173] *In the Matter of a Commission Investigation Into the Reliability of the Electric Distribution Service Provided by Ohio's Investor-Owned Electric Companies*, Case No. 08-1299-EL-UNC, Request for Investigation (December 15, 2009) ("Request for Investigation").

7. Conclusion

The Companies' proposed ESRP is fatally flawed and it should be rejected by the Commission. The ESRP does not comply with R.C. 4928.143(B)(2)(h) as discussed above. The ESRP does not ensure that the Companies' customers will receive reliable service. AEP Ohio's customers are entitled to reliable electric service under law and rule and currently pay for what should be reliable service.

Moreover, nothing in the Companies' plan ensures that its customers will receive an "enhanced" level of service that the Companies are seeking to charge customers $445 million for. AEP Ohio's proposed ESRP consists of routine distribution reliability matters and AEP Ohio has not shown that the proposed distribution rate increase is necessary to obtain and maintain distribution system reliability.

With these provisions in mind, the PUCO should reject AEP Ohio's ESRP. AEP Ohio has not demonstrated that it has dedicated sufficient resources to the reliability of its distribution system. The Companies' claim that they will be unable to maintain their current level of service[174] without the funding provided through the ESRP is quite troublesome considering the overall decline in reliability as measured by the frequency and duration of outages.[175]

AEP Ohio's Application and its ESRP do not comply with Ohio law, are inconsistent with the Commission's rules, and offer no assurances of improved distribution system reliability. The ESRP should be rejected in its entirety. Nevertheless, much work needs to be done to improve AEP Ohio's poor reliability. The Commission

[174] Id. at 8.

[175] OCC Ex. 13 at 22 – Table 10 (Cleaver).

should address this issue separately through an investigation as requested by OCEA.[176] AEP Ohio should be required to file a plan for providing reliability as part of the reliability investigation which OCC and other parties have requested, that is more detailed and ensures improved reliability of AEP Ohio's electric distribution system. Further, AEP Ohio, as part of distribution rate case, should be ordered to provide an accounting of the amounts it has expended over the last five years as compared to what it has been authorized to spend over that period.

E. The Fuel Adjustment Clause ("FAC") Proposed By The Companies To Collect Millions Of Dollars From Customers Is Unjust And Unreasonable And Will Result In Unjustified Increases. The FAC Should Not Be Adopted Unless The Commission Significantly Modifies It. Reasonable Modifications Should Include Establishing An Appropriate Baseline FAC, Excluding Market Rate Purchased Power, And Assuring That Any Fuel Costs Are Properly Offset By Off-System Sales Margins And Capacity Equalization Revenues.

Under R.C. 4928.143(B)(2)(a), the Companies are permitted, in the context of an ESP, to enact a fuel clause to automatically recover a number of "costs." Under S.B. 221 such costs may include fuel used to generate electricity supplied under the SSO, and emissions costs and the costs of purchased power, including energy and capacity. Automatic recovery of such costs under the ESP is permitted, however, only if the costs are "prudently incurred." The burden of proving such costs are prudently incurred rests with the Companies under R.C. 4928.143(C)(1).

The Companies propose that the expenses to be recovered in the fuel adjustment clause ("FAC") be cost based.[177] The automatic recovery of fuel costs allowed in the

[176] Request for Investigation.

[177] OCC Ex. 11 at 19.

legislation functions much like the fuel adjustment clause known as the electric fuel component ("EFC") that was established under Ohio Revised Code § 4905.30.1, which was repealed with the passage of S.B. 3 in 1999. The EFC was a semi-annual rate adjustment to recover costs of fuel, purchased power, and certain environmental items.[178] The Companies seek to re-implement a fuel clause in accordance with S.B. 221, which "provides for a broader cost-based adjustment" for prudently incurred fuel, purchased power, and environmental components.[179] Thus, traditional cost of service concepts such as those applied in EFC proceedings are applicable to this portion of the ESP. Indeed S.B. 221's notion of "prudently incurred" costs, as set forth in R.C. 4928.143(B)(2)(a), is synonymous with cost- based regulation that the PUCO has historically provided for electric utilities.

1. In establishing a baseline for the fuel clause, the Commission should reject the bottom-up approach of the Companies and instead adopt a baseline using latest known actual fuel costs for 2008.

Since the Companies have not had a fuel clause in place for a number of years (prior to S.B. 3), the Companies propose to reestablish a cost-based fuel clause as permitted under S.B. 221. S.B. 221 allows a utility to recover all prudently incurred fuel and prudently incurred purchased power, along with emission allowances and federally mandated carbon or energy taxes related to electricity provided under the standard service offer.[180] In re-implementing a fuel clause, the Companies propose to establish a baseline rate that represents fuel costs currently being collected in rates. The difference between

[178] Companies' Ex. 7 at 3.

[179] Id. at 4.

[180] Companies' Ex. 7 at 3-4 (Nelson); R.C. 4928.143(B)(2)(a).

the baseline and the actual fuel costs are to be the basis for the fuel costs to be collected through the FAC from customers for the next three years.[181] The baseline will not be trued-up to reflect any actual 2008 fuel expenses.[182] Through what Staff Witness Cahaan characterizes as a "bottom up" approach (Tr. XII at 206) the Companies identified the 1999 frozen EFC rate component of the unbundled rates that were in effect from 1999 through 2005, and the costs of additional S.B. 221 accounts at 1999 levels.[183] According to Company witness Nelson, this additional step "places the base FAC in the most recent SSO on a comparable basis to the 2009 FAC."[184] Then the Companies escalated this rate to account for generation rate increases allowed in the rate stabilization plans for 2006, 2007, and 2008.[185] The allowed increases were 7% per year for OP and 3% per year for CSP.[186] Further adjustments were also made for the power acquisition rider for CSP (4.43% in 2007, Companies' Ex. 7 at 9) and for changes in the regulatory asset charge for OP.[187] Then the rate was applied to 2008 forecasted customer usage to arrive at a baseline FAC.

OCC Witness Smith testified that the Companies' approach is flawed, as it does not even attempt to reflect actual power costs that are incurred in the most recent generation standard service.[188] Even though actual costs for fuel, purchased power, and emissions allowances are known through October 2008 (Tr. V at 21), under the

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[181] Companies' Ex. 2A at 18 (C. Baker).

[182] Tr. IX at 95 (Roush).

[183] Companies' Ex. 7 at 8.

[184] Id.

[185] OCC Ex. 10 at 12 (Smith).

[186] Id.

[187] Id.

[188] OCC Ex. 10 at 11-13.

Companies' approach the actual costs are ignored. Instead fuel rates are created to purportedly reflect what increases were permitted in the rate stabilization plan ("RSP") cases -- where rate increases were based upon the Companies' "judgment"[189] as to what overall increase in generation rates was needed. As OCC Witness Smith notes, over the RSP period fuel costs experienced by the Companies may have increased more or less than the escalation to rates assumed in the Companies' approach.[190] And if fuel costs increased more from 1999 to 2008 than assumed by the Companies, then the Companies' 2008 baseline rate will have understated 2008 fuel costs.[191] An understated baseline rate for the FAC may be corrected through the future truing-up of FAC costs, but whether customers are treated fairly in this truing-up depends up the specific provisions of the FAC. There is another significant impact of the FAC baseline rate, which is that it determines the non-FAC portion of the standard service offer rate. Ms. Smith testified that if the Companies' artificially created FAC is too low, the base portion of generation rates will be too high, and customers will pay more for standard offer service than allowed.[192] Moreover, such a black box approach to establishing a baseline rate is especially unreasonable when actual fuel cost data is available to use to set the baseline fuel rate.

The baseline fuel adjustment clause from which incremental increases for the ESP are premised should be created using latest known fuel costs for 2008. Since actual

[189] See *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, Opinion and Order at 15 (Jan. 26, 2005).

[190] Id.

[191] OCC Ex. 10 at 12.

[192] OCC Ex. 10 at 13.

customer usage is known through at least October 2008, (Tr. V at 21 (Nelson)), the baseline should consist of nine months of actual 2008 fuel costs and three months of estimated 2008 fuel costs.[193] The Companies should be ordered to produce such data,[194] and use the actual customer usage to develop an appropriate baseline FAC.

Use of the latest known actual fuel costs (derived from actual consumption) is appropriate since the fuel component portion of the ESP is a cost-based rate. Traditionally fuel costs were carved out of the total cost of electric service and treated in a separate fuel clause, trued-up to actual figures.[195] Thus, use of actual fuel costs is consistent with and remains true to the fuel clause methodology used historically in the PUCO's regulation of electric companies' fuel costs. OCC's approach, which relies upon latest known actual fuel costs is reasonable because it is verifiable, consistent with fuel adjustment principles, and relies upon cost based principles, rather than some vaguely defined notion of what, in the utility's mind, is needed, though not based on any cost justification. Additionally, it has the benefit of reflecting actually incurred costs, rather than reflecting projected costs based on assumptions about cost and usage --assumptions which are never trued-up to actual costs.

Using actual fuel costs, rather than 1999 rates with arbitrary escalation for non-cost based increases in the total standard service offer rate, is more appropriate for

[193] OCC Ex. 10 at 14.

[194] The Companies have presented no information about actual costs to date, nor have they estimated actual costs for the year 2008.

[195] Tr. XII at 222.

establishing the baseline of what is currently in the standard service offer ("SSO"), as Staff Witness Cahaan testified.[196] As noted by Mr. Cahaan, the Companies were obviously covering their fuel costs during not only 2007 (Id), but also during 2008, otherwise their earnings would have been negative.[197]

While Staff Witness Cahaan prefers to use 2007 actual costs to establish the baseline, he admits that this is a proxy for actual data.[198] For under the Staff approach, to get to 2008 fuel costs to establish the baseline FAC, Staff must escalate the 2007 costs by 3% and 7%. In doing so Staff must rely upon the RSP non-cost based increases -- which was based upon the companies' judgment as to what revenues it needed -- determined in Case No. 04-169-EL-UNC. While Staff's "top down" approach to establishing the baseline for the FAC is founded in part upon the cost basis inherent in fuel clauses, Staff errs in escalating the 2007 costs when at least nine months of actual 2008 costs are available and should be used along with three months of estimated data.[199] Consistent with the historic EFC provisions contained in the Revised Code prior to S.B. 3, the latest known actual fuel costs (derived largely from actual consumption) should be used to set rates, rather than some other basis. The Commission has recognized that the EFC

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[196] Staff Ex. 10 at 3.

[197] Indeed Kroger Witness Higgins makes an argument that the Companies' FAC related expenses may already be recovered in rates and urges the Commission to require AEP to demonstrate that an increase in the FAC rate is necessary for the Companies to recover their generation related costs. Kroger Ex. 1 at 8-9. Tr. XII at 243.

[198] Tr. XII at 244.

[199] Tr. VI at 111.

calculations should be based upon actual data to the extent that it is possible to obtain such data.[200]

While the Companies argue that the latest known fuel costs should not be used due to recent volatility of fuel costs (Companies' Ex. 7B at 3), it is clear that the Companies are relatively unaffected by the volatility of coal prices which are the bulk of the Companies' fuel costs. The Companies are locked into long term contracts for the majority of their coal supply, leaving very little coal to be purchased in 2009 on the spot market.[201] The Companies' actual experience in fuel procurement and fuel costs further demonstrates that the proposed 2009 FAC rate is not consistent with past, current, and likely future market conditions prevailing for various energy sources.

2. In calculating the incremental fuel costs for 2009 through 2011, the Companies should be precluded from increasing customers' rates to cover power purchased at an inflated market rate purported to meet the needs of Ormet and former Mon Power customers

Within their fuel adjustment clauses the Companies propose to include market priced purchased power equal to 5%, 10%, and 15% of their native load for 2009, 2010, and 2011, respectively. The Companies seek to justify their purchased power plans based upon the commitments they have undertaken related to serving Ormet and the former Mon Power customers.[202] Additionally, the Companies claim to have included the

[200] See for example, *In the Matter of the Regulation of the electric Fuel Component contained within the Rate Schedules of Columbus and Southern Ohio Electric Company and Related Matters*, Case No. 82-162-EL-EFC (Subfile A), Opinion and Order at 16-17 (June 29, 1983); 1983 Ohio PUC Lexis 57.

[201] Tr. XIV at 74-78 (Nelson); Tr. VI at 200-201 (Medine).

[202] Tr. XII at 213 (Cahaan).

amounts of market priced purchased power in their ESP as part of a "continuing transition to market rates."[203]

As OEG Witness Kollen testified, the Commission should reject the Companies' requests to collect the costs of market-priced purchased power from customers because such purchases are not prudent.[204] First, the companies do not need to make these purchases to meet the load associated with Ormet and former Mon Power customers.[205] Rather, the Companies have the opportunity to supply power for this load from internally generated power or from power purchased in the AEP system pool, both options that are available and cheaper than going to market. This is evidenced by the fact that the Companies currently have excess power which is turned into non-requirements sales for resale (to the other AEP Companies and to the AEP system pool).[206] Indeed, in 2009, by the Companies' own projections they will have significant non-requirements sales for resale, as shown by Company Witness Nelson on Exhibits PJN-6 and PJN-7.

Second, apart from the fact that the Companies need not purchase power on the market to meet load associated with Ormet and former Mon Power customers, it is clear that the costs of such purchased power are not least-cost. It is far greater than the cost the Companies would pay to purchase power from the AEP system pool.[207] Under the AEP

[203] Companies' Exhibit 2A at 22 (C. Baker). While the blending of purchases priced at market rates and the most recent SSO rate is permitted under a market rate option ("MRO"), IEU Witness Bowser correctly notes there is no such concomitant language for an ESP plan. See also testimony of OCC Witness Smith, OCC Ex. 10 at 6-7.

[204] OEG Ex. 3 at 3 (Kollen). IEU and Kroger also oppose this provision of the ESP. IEU Witness Bowser recommends that the Commission disapprove this aspect of the ESP. See IEU Ex. 10 at 9. Kroger Witness Higgins recommends that the FAC be modified to exclude "these contrived purchases" because the "only apparent purpose" is to increase prices charged to customers. Kroger Ex. 1 at 9.

[205] Id. at 9.

[206] See OEG Ex. 3 at 9.

[207] OEG Ex. 3 at 10.

Interconnection Agreement the Companies are entitled to purchase power from the pool companies at a FERC regulated rate, which over the past 12 months has averaged $25.61/mwh for Ohio Power and $27.21/mwh for CSP.[208] When these prices are compared to the Companies' proposal to purchase large blocks of power at market rates of $85.32 for Ohio Power and $88.15 for CSP, it is clear that the Companies' market purchase plan will cause its customers to bear unreasonably excessive purchased power costs.[209] Under the ESP plan, the cost of this purchased power over the three year period is expected to be $600 million for CSP customers and $720 million for OP customers.[210]

Additionally, since the Companies are obligated under the AEP Interconnection Agreement to sell available power to other pool members, they will have to sell the excess power resulting from the market purchases at significantly lower rates than they paid on the market.[211] Thus, the resale of power into the AEP pool will result in significant losses on such transactions. OEG Witness Baron quantified the increase in the Companies fuel and purchased power expense associated with the 5%, 10%, and 15% purchases of total load. Over the three year ESP term, Mr. Baron calculated the harm to CSP customers to be $418 million and the harm to OP customers to be $452 million.[212]

To add salt to the wound, the Companies and other AEP affiliate entities, not AEP's Ohio customers, will be benefiting from the power purchases as these purchases will free up low-cost power -- power which can be turned over to the pool and purchased

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[208] Id. at 11.

[209] Id.

[210] Id. at 9.

[211] Id at 11.

[212] OEG Ex. 3 at 13.

by other AEP members or sold in off-system sales to third parties.[213] The freeing up of lower-cost power picked up by the other AEP system members will benefit customers in other retail jurisdictions such as West Virginia, Virginia, Kentucky, Indiana, and Michigan.[214] Transferring the lower cost power to the AEP system will also allow the Companies to sell more power as off-system sales to third parties, increasing off-system sales margins for AEP.[215] And under the Companies' ESP proposal, such off-system sales revenues are not used to offset ESP costs. The profits from off-system sales inure to the operating companies.[216] Nor are off-system sales margins used in the calculation of the Significant Excess Earnings test.[217]

The Companies' proposal to charge its customers excessive rates to cover purchased power that is not least-cost and is not needed is imprudent and will cause rates to be unjust and unreasonable. It results in customers paying to increase the profits of the Companies and does not provide any equitable benefits that might otherwise occur if a portion of the profits from off-system sales was shared with customers. Thus, the Companies' proposal fails to assure that reasonably priced electric service is available, contravening R.C. 4928.02(A) and should be rejected. If the Commission does allow some market-priced power in the ESP over the objections of OCC and others, it should

[213] Id. at 14.

[214] In the past, the Commission has noted that benefits, including off-system sales revenues received from an electric utility's out-of-state operations, should not be allocated to Ohio. *Re: Monogahela Power Company*, Case No. 04-880-EL-UNC *Opinion and Order* at 18 (Dec. 8, 2004); 2004 WL 3132307 (Ohio PUC). Using that same logic here dictates that the Commission in turn should not permit benefits created within Ohio to flow to the out of state operations of AEP.

[215] Id.

[216] Tr. X at 261 (C. Baker).

[217] Tr. X at 227 (C. Baker).

require that the estimate of the cost of this power be corrected as recommended by witness Smith.[218]

3. In calculating the incremental fuel costs for 2009 through 2011, the Commission should credit customers for revenues received from off-system sales. Alternatively the Commission could adjust the ESP to fully credit generation base rates under the ESP with the profits from off-system sales.

As part of the fuel adjustment clause the Companies propose to exclude the benefits associated with off-system sales, including profits associated with off-system sales.[219] The profits from off-system sales are significant. In 2007, the profits from off-system sales received by OP were $146.7 million and $124 million for CSP.[220] The Companies project that the margins[221] from off-system sales during the ESP period will be $791 million.[222] On a per company basis those projected margins amount to $431 million for Ohio Power and $360 million for CSP.[223]

The Companies claim that by assigning off-system sales expenses away from native load customers in the FAC, the result is the same as if one included the revenues from off-system sales.[224] The Companies admitted, though that they had not verified that in practice the result would be the same.[225] Given the significant margins from off-system sales, there should be little confidence that allocating away from internal load the off-

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[218] See OCC Ex. 10 at 15-25.

[219] Tr. IV at 258 (Nelson).

[220] See OEG Ex. 3 at 14.

[221] On cross examination by various parties, the term "profits" was used interchangeably with "margins."

[222] OCC Ex. 7.

[223] OCC Ex. 6 at 7, 8.

[224] Tr. IV at 253-256 (Nelson).

[225] Tr. IV at 256.

system sales expenses, shown, for example, on the FAC base period calculation on Exhibit PJN-1 and 3, provides customers with the full benefit of off-system sales that the Commission has deemed appropriate to provide to customers under traditional regulation.[226]

Recognizing off-system sales profits is consistent with Commission precedent upholding a sharing of the profits of off-system sales between customers and utilities. The Commission has in the past required electric utilities to share the revenue received from off-system sales of electricity with jurisdictional customers and to account for this revenue in the rates charged to jurisdictional customers.[227] The Commission has recognized that if plant has been constructed for the benefit of jurisdictional customers, in fairness there should be some sharing of revenues realized by the utility utilizing that plant when it makes non-jurisdictional or off-system sales.[228] Moreover, the Commission has determined that providing off-system sales revenue to jurisdictional customers can assist in achieving the goal of providing reliable and safe service to customers at the lowest reasonable cost[229] which is consistent with the mandates of R.C. 4928.02(A) of S.B. 221.

If the Commission determines that off-system sales are not a proper offset to the FAC component of the ESP, the Commission should nonetheless adjust the ESP SSO

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[226] PJN-1 (Rev.) and PJN-3 indicate that, for the FAC base period, fuel expenses allocated away from internal load amounted to approximately $30 million for CSP and $40 million for Ohio Power. This pales in comparison to the yearly profit margins generated by AEP's off-system sales.

[227] See, *In the Matter of the Application of the Cleveland Electric Illuminating Company for an Increase in Rates*, Case No. 84-188-EL-AIR, *Opinion and Order* at 21 (March 7, 1985).

[228] Id at 21.

[229] See, *In the Matter of the Application of the Cincinnati Gas & Electric Company for an Increase in its Rates for Gas Service to All Jurisdictional Customers*, Case Nos. 95-656-GA-GCR, Entry on Rehearing (Feb. 12, 1997).

generation base rates to give customers the full credit for off-system sales profits. This method would be more consistent with the Commission's past treatment of off-system sales profits as a reduction to electric base rates.[230]

The sharing of off-system sales profits with customers, either through an offset to the FAC, or an adjustment to base rates, is permissible under S.B. 221. In defining an electric security plan under R.C. Sec. 4928.143, the broad prefatory language of subsection (B)(2) provides that "[t]he plan may provide for or include, without limitation, any of the following..." Hence, the plan could provide for the sharing of off-system sales profits with customers, even though AEP Ohio chose not to include such a provision. The Commission may modify the ESP, under R.C. Sec. 4928.143(C)(2)(a), to bring in off-system sales profits to offset the rate increases proposed for the Companies' customers. This would promote the policy of the state, explicitly recognized in R.C. Sec. 4928.02(A) -- to "ensure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and *reasonably priced retail electric service*." (Emphasis added.)

4. In calculating the incremental fuel costs for 2009 through 2011, capacity equalization revenues as well as expenses should be included.

As explained by OEG Witness Kollen, under the AEP Interconnection Agreement capacity deficit members must pay a monthly capacity equalization charge to capacity

[230] See, for example, *Re: the Dayton Power and Light Company*, Case No. 98-105-EL-EFC Opinion and Order at 16, which noted that the Commission has generally considered revenue and costs associated with off-system sales in base rate proceedings, not EFC proceedings.

surplus members.[231] CSP is a deficit capacity member and must pay surplus members a fee to equalize the capacity costs. OP, on the other hand, is a surplus member and thus receives capacity revenues. While the Companies propose to include the capacity payments made by CSP in the FAC 2009 forecast,[232] they have not included any of the capacity equalization revenues received by OP in OP's FAC 2009 forecast.[233] Thus, pool capacity receipts will be retained by OP and are not flowed through to customers who have paid for the generation from which the revenues are derived.[234] In fairness, as proposed by OEG Witness Kollen, the Commission should require that if the capacity equalization payments made by CSP are charged to customers in the FAC, then the capacity equalization revenues received by OP should be credited in the FAC.[235] Thus, the ESP should be modified to reflect this symmetry.

F. If There Is An Over-Collection Of Fuel Expenses, Regardless Of Whether Deferrals Exist, The Companies Should Refund To Customers The Over-Collection In The Following Fuel Clause Period, Rather Than Allow The Companies To Use The Over-Collections To Reduce Deferrals Collected From Customers In 2012-2018.

Under the Companies' FAC proposal, there may be under and over-collection of fuel costs, as actual fuel costs may vary from the Companies' projected fuel costs.[236] The Companies propose a true-up to actual costs under some periodic time frame.[237] Under-

[231] OEG Ex. 3 at 15.

[232] See PJN-2 showing CSP incurring $33.8 million capacity payment (Account 555, line 38), while PJN-4 (Revised) shows no credits to OP under pool capacity.

[233] OEG Ex. 3 at 16.

[234] Id.

[235] Id.

[236] Companies' Ex. 1 at 16 (Roush).

[237] Id.

collection could result if the fuel expenses incurred are higher than what is being recovered in the FAC rate or if fuel expenses rise above the 15% level set by the Companies.[238] Under the Companies' phase-in concept, the rate increases are limited to approximately 15% per year, which may cause the need to defer fuel expenses for future recovery.[239] Such deferred expenses (with carrying costs) would then be collected from customers during a time outside the ESP period from 2012 to 2018.[240]

Over-collection of fuel costs from customers may also result from the Companies' proposed FAC. The Companies present two scenarios to address over-collection of fuel costs when deferrals exist but appear to leave it to the Commission to adopt one of these scenarios.[241] Under the first option, the over-recovery of fuel costs from customers is addressed in the immediate succeeding fuel period, with the over-recovery reducing the cost of fuel to be charged to customers in that subsequent period. This is traditionally how fuel clauses work. The other option would forego the subsequent reconciliation of fuel costs related to the over-recovery, and the over-recovery instead would be used to reduce the deferrals (regulatory assets) that will be collected from customers in the 2012-2018 time period.

Although the Companies do not appear to prefer one approach over the other (Tr. IX at 103 (Roush)), it is OCC's position that customers would benefit more if the reconciliation of over-collection occurs in the following fuel period, as contemplated

[238] Companies' Ex. 6 at 5-7 (Assante).

[239] Companies' Ex. 6 at 4, 9 (Assante).

[240] Id. at 5 (Assante).

[241] Companies' Ex. 1 at 15 (Roush).

under traditional fuel clauses.[242] This approach provides relief to customers on a more immediate basis than is provided under the alternate approach. Moreover, under this approach there is little likelihood of intergeneration inequity--customers who "overpay" not receiving the over-payment back. Under the alternate scenario a customer who overpays in 2008 may not receive credit due to over-payment until the 2012-2018 time period. Further, this alternative scenario does not appear to include interest payments to compensate customers for the time value of over-payments.

G. OCC Recommends Against Creating Any Long-Term Deferrals Under The FAC. However, If Deferrals Are Approved By The Commission, Such Deferrals Should Be Financed In Part By The Tax Savings Generated By The Companies Deferred Tax Obligation. Additionally, The Carrying Charges On The Deferrals Should Reflect The Actual Cost Of Short-Term Debt (Excluding Equity).

For the reasons set forth fully in section L of this brief, OCC does not support increasing customers' rates by $461 million through long-term deferrals for fuel costs, as proposed by the Companies. However, if the Commission is going to permit deferrals, it should only permit short-term deferrals of fuel costs during the three year ESP period under the following conditions. First, the deferred fuel expenses should be calculated to reflect the net of applicable deferred income taxes, as recommended by Commercial Group Witness Gorman.[243] Second, the carrying charges on the deferrals should be calculated to reflect the short-term actual cost of debt, excluding equity.

[242] The FAC must also provide symmetrical treatment of under and over-collections, so that if customers pay more than the actual costs that get trued-up, they receive the benefit of carrying charges on these over-collections. The Companies' testimony on how the FAC functions does not clearly adopt this symmetrical approach although the record at hearing suggests that the FAC would function this way. The Commission should require as a pre-condition to approving the FAC the earning of interest on under-and over-recoveries.

[243] See Commercial Ex. 1 at 10.

1. Deferred Fuel expenses should be calculated on a net of tax basis

Calculating deferred fuel expenses on a net of tax basis is not a new issue for the Commission. In fact, this is the method utilized by OCC Witness Effron in the *First Energy Distribution Rate Case.*[244] In his testimony regarding the RCP distribution deferrals, OCC Witness Effron provided an illustration of the concept behind calculating carrying charges net of applicable deferred income taxes:

> Carrying charges should be calculated on the net cash investment in the deferrals. If a particular cost is deductible for income tax purposes as incurred, then the net cash investment to fund the deferred recovery of such a cost is reduced by the income tax savings associated with the tax deduction. For example, if a cost of $1,000 is deferred for future recovery from ratepayers but that cost is deductible for income tax purposes as incurred and the income tax rate is 35%, then the cost will reduce income tax expense by $350 (35% * $1,000). The net cash to carry the deferral is $650 ($1,000 - $350), and that is the balance on which carrying costs should be accrued.[245]

During the deferral period, the balance on which the carrying charges are accrued should be reduced by the applicable deferred taxes. The deferred fuel expenses create a deferred tax obligation that reduces the Companies' current tax expense.[246] As such the Companies will only need to rely on short-term debt borrowed from the capital market to support the net of tax balance of deferred fuel expense until the expense is recovered from customers.[247] If the Companies are permitted to accrue carrying charges on the gross

[244] *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices and for Tariff Approvals*, Case No. 07-551-EL-AIR et al, OCC Ex 1 at 22 (Effron).

[245] Id. at 22-23.

[246] Id.

[247] Id.

balance, it will be over-collecting the actual carrying costs of these deferred fuel balances.[248]

2. The carrying costs on the fuel deferrals should reflect the actual short-term cost of debt, excluding equity, if the Companies need to go to the outside capital market to finance the deferrals

The Companies propose to calculate carrying costs for deferrals (including fuel and environmental investment) at the weighted average cost of capital (WACC) rate.[249] According to Witness Assante the WACC includes "actual debt costs" and a return on equity of 10.5%.[250] However, the record established at the hearing should compel the Commission to disregard the Companies' WACC and instead utilize the actual short-term cost of debt.

According to information presented by Mr. Morris at the EEI 2008 Conference, AEP reports that for 2009 its source of cash used to support $3,602 million of capital spending, investment, and dividends is expected to come primarily from operations ($2,729 million).[251] Only $150 million of the $3,602 million is expected from the issuance of common equity, with another $316 million resulting from debt.[252] This information suggests that financing for deferrals on a short-term basis (i.e. the three year ESP period) may not require access to capital markets at all. And the Companies

[248] Id. Like the situation regarding transition tax deferrals -- where Staff Witness Castle stated that Mr. Effron's approach was "sound ratemaking theory" (Case No. 07-551-EL-AIR, Staff Ex. 16 at 12) Staff agreed that tax effects should be considered in the calculation of the RCP distribution deferrals. Id. at 8 (Castle) ("Staff agrees with this part of the objection"). Staff in this case appeared to take no position on this issue.

[249] Companies' Ex. 6 at 8.

[250] Id.

[251] IEU Ex. 7 also reflects the fact that in 2008, the cash usage was considerably greater ($4.865 million) with a higher use of debt financing than projected for 2009.

[252] IEU Ex. 5 at 8.

provided little if any evidence to establish a case that the short-term deferrals would create a need to access the capital markets.

Setting the carrying cost at the weighted cost of capital is not reasonable and results in excessive payments by customers.[253] Instead carrying charges on deferrals should be based on the actual financing required to carry the deferrals during the short-term period. If the Companies provides evidence that access to capital markets will be required to finance the short-term deferrals, then the carrying charges should be based on the current (not embedded) cost of short-term debt.[254] OCC Witness Smith testified that current cost of debt is most appropriate if the Companies actually do go to the capital markets to obtain financing for the deferrals.[255] If the Commission approves deferrals for recovery only during the ESP three-year period, Ms. Smith supports short-term debt cost, not long-term debt cost.[256]

Thus, OCC believes that carrying charges on short-term deferrals should be based on the actual short-term cost of debt. This is consistent with practices used by other Ohio electric distribution utilities[257] and consistent with recent rulings by the Commission that have limited carrying charges on riders and deferrals to the interest rate of debt only.[258] Most recently, the Companies filed for accounting treatment that would create deferrals

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[253] OCC Ex. 10 at 34.

[254] Id.

[255] Tr. VI at 157-158.

[256] Tr. VI at 157-158.

[257] See Staff Audit Finding at 3 (December 8, 2008) in *In the Matter of the Application of Columbus Southern Company and Ohio Power Company to Adjust Each Companies' Transmission Cost Recovery Rider*, Case No. 08-1202-EL-UNC.

[258] See for example, *In the Matter of the Application of Columbus Southern Company and Ohio Power Company to Adjust Each Companies' Transmission Cost Recovery Rider*, Case No. 08-1202-EL-UNC, Finding and Order at 4 (December 17, 2008) (Where the Commission adopted the Staff's Audit finding recommending carrying costs at interest only).

of their alleged storm damage expenses.[259] The Companies asked for carrying charges based on their weighted average cost of debt. The Commission rejected the Companies' request and instead held that carrying charges on the deferrals should be based on the actual cost of debt.[260]

Consistent with the Commission precedent, the Companies should only be permitted carrying costs on short-term deferrals based on their actual cost of short-term debt. If however, the Commission does base carrying costs on the weighted average cost of capital -- which OCC and other parties oppose – it should at least utilize AEP and not the operating companies' capital structures in the average cost calculation.[261]

[259] See *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Modify Their Accounting Procedure for Certain Storm-Related Services Restoration* Costs, Case No. 08-1301-EL-AAM, Application (Dec. 15, 2008).

[260] Id, Finding and Order at 3 (Dec. 19, 2008).

[261] In calculating the carrying charges on the deferrals, the Companies proposed to use a 50% debt and 50% equity capital structure. Companies' Ex. 6 at 8; Ex. 7 at 16. According to Company Witness Nelson this represents the recent capital structure of the Companies-(AEP Ohio) and is consistent with how the Companies (AEP Ohio) intend to be capitalized over the ESP period. Companies' Ex. 7 at 16.

However, as noted by Company Witness Makhija, OP and CSP are wholly owned subsidiaries of AEP and share in the electric and financial pools. Companies' Ex. 5 at 5. Additionally OP and CSP debt levels and book equity are ultimately supported by AEP. Id. at 12. Hence, the carrying charges would be funded by AEP and not the individual operating companies such as CSP and OP.

Consequently, the capital structure of AEP is most relevant and should be used in calculating the carrying charges for deferrals, included deferred fuel. According to information recently presented by Mr. Morris, Chairman, President, and CEO of AEP at the Edison Electric Institute Conference in Phoenix ("EEI 2008 Conference")(Tr. XI at 97) the actual capital structure of AEP as of 9/30/2008 reflects 61.2% debt with 38.8% equity. IEU Ex. 7 at 125. Moreover, AEP's objective is to maintain a 60/40% debt to capital ratio. Id. The approximate 60/40 debt to capital ratio then should be used in the carrying cost calculation.

H. The Commission Should Implement Recommendations Made By OCC Witness Medine Related To Audit Issues Likely To Arise In The Context Of The Companies' Future Periodic Fuel Clause Filings.

Under the ESP plan proposed by the Companies, there will be periodic filings and audits.[262] OCC Witness Medine, who was involved in 11 prior management audits of the Companies (OCC Ex. 11 at 1) reviewed the fuel procurement practices of the Companies as part of the Companies' ESP filing. Based upon her review of the Companies' fuel procurement activities, Ms. Medine made a number of recommendations regarding the scope of the future FAC audits.[263]

While the Companies seem to question whether it is important for the PUCO to address Ms. Medine's recommendations (Tr. VI at 263-264), Ms Medine reiterated the importance of her recommendations:

> Q. Would it be appropriate for the Commission if it decided that it needed to prioritize the issues and challenges that it faces and decided to defer, you know, addressing all of these recommendations now but rather address them, say, next year, would that be acceptable to you?
>
> A. I think that the point is, is that with your fuel costs, and with that – with the ability to recover your fuel costs, you have an obligation to demonstrate their prudence, so to the extent that the recommendations address issues and you're demonstrating the prudence of these fuel costs, I think they can't be delayed.[264]

OCC Witness Medine's recommendations are as follows:

- AEP should update its policies and procedures manual which guides its fuel procurement activities, as specified at OCC Ex. 11 at 31;

[262] Companies' Ex. 1 at 14.

[263] OCC Ex. 11 at 31-40.

[264] Tr. VI at 263-264.

- AEP should work to replenish its stock in 2009 subject to coal availability and priced. As testified by OCC Witness Medine, having stockpiles at target levels provides a cushion in the event of supply disruptions and limits potential costs associated with possible coal conservation efforts.[265]

- The Commission should closely scrutinize any price relief (additional payments above contract price) given by AEP to its long term contract suppliers in order to protect CSP and OP customers in the long term.[266]

- AEP should be required to provide documentation of supplier performance and the actions it has taken to insure full receipt of coal contract volume.[267]

- AEP should update their forecast of fuel costs for 2009 to reflect the recent marked decline in coal and oil prices and reflect undershipped volumes of coal to be made up in 2009.[268] This would then provide the Commission with the best available numbers to use to establish initial 2009 FAC costs.

- AEP should consider new strategies related to coal procurement, including financial hedging for coal procurement and active management of existing commitments in order to capture potential value for customers.[269] Hedging strategies could be of value in either an escalating or deescalating coal market.[270]

- The audit of the FAC should at a minimum include a review of policies and procedures, a review of contract performance and enforcement, a review of contracting practices, a review of spot procurements, fuel costs, benchmarking of performance, costs and level of purchased power, and a review of inventory management.[271]

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[265] OCC Ex. 11 at 33.

[266] OCC Ex. 11 at 37.

[267] OCC Ex. 11 at 37-38.

[268] OCC Ex. 11 at 40.

[269] OCC Ex. 11 at 3; 37-38.

[270] Tr. VI at 202.

[271] OCC Ex. 11 at 5.

I. The Companies Have Not Justified The Amounts They Have Proposed For Environmental Carrying Charges.

1. The Commission should not require customers to pay carrying charges for environmental investment that was made from 2001 through 2008 because S.B. 221 does not permit the Companies to recover these costs in their ESP.

The Companies propose to charge customers for approximately $330 million in carrying charges from environmental-related investments for the years 2001 through 2008.[272] The Companies propose to collect this carrying charge from customers via a non-FAC generation increase, subject to the 15% cap.[273] The Companies claim that R.C. 4928.143(B)(2)(a) provides a statutory basis for collecting environmental-related carrying charges.[274] That provision, however, allows only for recovery of "the cost of fuel used to generate the electricity supplied under the offer; the cost of purchased power supplied under the offer, including the cost of energy and capacity, and including purchased power acquired from an affiliate; the cost of emission allowances; and the cost of federally mandated carbon or energy taxes," but only if they are "prudently incurred."

S.B. 221 provides that EDUs may recover "[a] reasonable allowance for construction work in progress for any of the electric distribution utility's cost of constructing an electric generating facility or for an environmental expenditure for any

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[272] The Companies proposed to collect from customers $110 million – $26 million per year from CSP customers and $84 million per year from OP customers – in environmental-related carrying charges each year of the three-year ESP. See Companies' Ex. 7 at Exhibit PJN-8; Companies' Ex. 1 at Exhibit DMR-1.

[273] See Companies' Ex. 2A at 24. The Companies also propose to incorporate into their ESP a provision that will allow them to charge customers for carrying charges on environmental investment made on a going forward basis from 2009-2011. The Companies claims that the carrying charges associated with this going-forward investment will be collected as part of the 3% and 7% non-FAC increase. See Companies' Ex. 7 at 17. The comments here on carrying charges apply equally to that proposal.

[274] See Tr. V at 12 (Nelson). AEP Ohio witness Baker also asserted that S.B. 221 provided for such a collection, but cited no specific statutory basis other than the general policies of R.C. 4928.02 (A) and (C). See Companies' Ex. 2A at 25.

electric generating facility of the electric distribution utility, **provided the cost is incurred or the expenditure occurs on or after January 1, 2009.**"[275] Both of the limitations of that provision require after-the-fact determinations, and thus the expenditures should not be considered in this proceeding. In addition, the Companies – who have the burden of proof in this proceeding – have not shown that they lacked the earnings to make the investments or that they would not have made them without additional revenues.[276]

Furthermore, attempting to recover costs for the period of the ESP would be unlawful for several reasons. First, this would be tantamount to retroactive ratemaking which is not permitted.[277] Second, Senate Bill 3, which was the governing law from 2001 to 2005, put in place a rate cap.[278] The Companies cannot collect now for costs incurred at that time because it would violate the rate cap *and* the Stipulation and Commission Order implementing the rate cap during the electric transition plan.[279] As to the period of 2006 through 2008, the law against retroactive ratemaking is equally applicable. Moreover, during the three years of the Rate Stabilization Plan, limits were placed on the amount that rates could be increased. To now ask for recovery of those amounts would violate the Commission Order in which limitations on rate increases were set.

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[275] R.C. 4928.143(B)(2)(b) (emphasis added).

[276] See OCC Ex. 10 at 32.

[277] *Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co.*, 166 Ohio St. 25 (1957).

[278] R.C. 4928.34(A)(6).

[279] *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Their Electric Transition Plans and for Receipt of Transition Revenues*, Case Nos. 99-1729-EL-ETP and 99-1730-EL-ETP, Opinion and Order (April 8, 2002).

2. The Companies' proposed carrying charges for environmental investments for 2009 to 2011 are not based on actual investment and thus should be rejected.

The Companies' proposed carrying charges on environmental investment for 2009 through 2011 are based on "actual and forecast" environmental expenditures.[280] Because there may be delays in expenditures due to the vacatur of CAMR and CAIR and downturns in the economy, the Commission should reject the Companies' proposal to collect these carrying charges from customers.

Any collection of environmental costs incurred during 2009 to 2011 should be based on actual investments made during this period, not simply on the projections provided by the Companies. Customers should not be saddled with rate increases that reflect investments that might not occur.

3. If the Commission determines to require customers to pay carrying charges on either the past or future environmental investment, which it should not, it should assure that the carrying charges are appropriate.

The Commission should not permit the Companies to collect from customers the carrying costs associated with past environmental or future investments. If the Commission does allow such a collection, however, it needs to make several modifications to the Companies' approach. Such modifications should reduce the amount of increase collected from the Companies' customers.

As discussed in the previous two sections, there should be an actual basis for determining carrying charges that customers should pay. The Companies' proposals do not have such a basis.

[280] See Companies' Ex. 7 at Exhibit PJN-9.

By assuming a 25-year life of investment, the Companies proposed a carrying charge of 13.98% for OP and 14.94% for CSP.[281] AEP Ohio witness Nelson stated that these carrying charges include the cost of money (weighted average cost of capital), depreciation, income tax gross up, property and other taxes, and an administrative and general component.[282] A capital structure of 50% equity and 50% debt was used in calculating the weighted average cost of capital.[283]

There are several issues related to these unusually high carrying charges. First, the Companies provided no explanation of or support for the calculation of the component of Property Taxes and General and Administrative Expenses, which total 2.95% for CSP and 2% for OP.[284] These expenses account for very significant portions (about 15% to 20%) of the respective annual capital carrying charges. The Commission should not allow the Companies to collect these undocumented and unsupported charges from customers.

Second, the proposed carrying charges appear to not reflect any actual financing, such as pollution control bonds, for environmental investments that would lower the cost of capital to the Companies on these types of capital investments. The record reflects that in fact the Companies have secured such financing over the years and recently.[285] The Companies would have customers pay for those environmental investments at a much higher carrying cost than the actual cost of capital that AEP Ohio might incur. Regarding the financing of these environmental investments, PUCO Staff witness Cahaan stated that

[281] See Companies' Ex. 7 at Exhibit PJN-8.

[282] Id. at 16.

[283] Id.

[284] See id. at Ex. PJN-10.

[285] See Tr. Vol. XI at 111-113 (J. Craig Baker); IEU Ex. 7 at 132-133.

"if specific financing mechanisms can be identified that would be appropriate and applicable to the assets being financed, I see no reason why those shouldn't be specifically used."[286]

Third, the Companies propose to calculate carrying costs for deferrals of environmental costs at the WACC rate.[287] As discussed above regarding carrying costs on deferred fuel expenses, however, the record established at the hearing should compel the Commission to disregard the Companies' WACC and instead utilize the actual short-term cost of debt.

Fourth, at least for the past environmental investment, the Companies testified that they calculated the carrying charges based on the original cost of the environmental investment.[288] This is inappropriate when considered with the calculation of the carrying cost itself. In calculating the carrying cost of environmental investment, the Companies have included depreciation, income tax expense and administrative and general expenses.[289] The Companies thus are seeking a return on and a return of traditional rate base[290] and yet in traditional rate making, ratebase value equals original cost less depreciation. But the base value of the environmental investment is applied at original cost, not original cost less depreciation and other factors. This results in the depreciation expense being overstated to the detriment of customers.

Fifth, the 13.98% and 14.94% carrying costs are simply too high and would be significantly burdensome on the Companies' customers in this extremely challenging

[286] Tr. Vol. XII at 237 (Cahaan).

[287] Companies' Ex. 7 at 16.

[288] Tr. Vol. V at 55 (Nelson).

[289] See Companies' Ex. 7 at Exhibit PJN-10.

[290] See Tr. Vol. V at 68-69 (Nelson).

economic environment. Imposing such a significant burden on customers is not in the public interest.

4. Customers should gain the benefits of Internal Revenue Code Section 199 deductions.

The Commission should not allow the Companies to include in the FAC any federally mandated production taxes without also accounting for the deduction against federal taxable income for "qualified production activities income," which includes the production of electricity, under Section 199 of the Internal Revenue Code. The deduction is equal to 6% of qualified income in years 2007 through 2009, and 9% for 2010 and thereafter.

Although the Companies have stated that the Section 199 tax deduction is not reflected in carrying cost calculations,[291] the Companies have left open the possibility that "environmental, fuel, purchased power, renewable costs or taxes" may be included in the FAC in the future.[292] If the Companies intend to collect these taxes from customers, however, customers should also receive the tax benefits associated with the Section 199 deduction, since the tax benefit is also related to electricity generation.[293]

Such an offset is consistent with the PUCO's treatment of the Section 199 deduction under the Companies' RSP and in the recent First Energy ESP case. In the RSP proceeding, the Commission determined that because the Companies qualify for the Section 199 deduction, it was "appropriate to adjust AEP-Ohio's request for environmental carrying costs to better reflect the current tax rates and the taxes paid by CSP and OP. Accordingly, AEP-Ohio's carrying cost should be adjusted to account for

[291] See Tr. IV at 163 (Assante).

[292] Companies' Ex. 7 at 7.

[293] See IEU Ex. 10 at 4-8.

the Section 199 tax deduction of 6 percent."[294] In the First Energy case, the Commission relied on its treatment of the Section 199 tax deduction in the Companies' RSP case and "agree[d] that applicable Section 199 deductions should be taken into consideration."[295]

The Commission should follow these precedents and order a similar offset in this proceeding. R.C. 4928.143(B)(2)(a) allows EDUs to automatically recover "the cost of federally mandated carbon or energy taxes." Customers, however, should not have to bear the entire cost of these taxes. Instead, customers should also receive the benefit of the Section 199 tax deduction that is available to the Companies.

As IEU witness Bowser pointed out:

> According to Mr. Nelson's testimony at page 15, the revenue increase requested by the Companies in this case is needed, in part, to cover carrying charges on generation-related environmental expenditures that are not currently reflected in rates. As indicated on Exhibits PJN-10 and PJN-11 of Mr. Nelson's testimony, the carrying cost rate includes, among other components, an income tax component, and a rate of return based upon a weighted cost of capital calculation. The carrying charge rate should be adjusted to reflect the lower effective tax rate that results from application of the Section 199 deduction.[296]

OCEA concurs. The Commission should provide AEP Ohio's customers with the benefit of the Section 199 deduction by lowering the carrying charge rate accordingly.

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[294] *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of an Additional Generation Service Rate Increase Pursuant to Their Post-Market Development Period Rate Stabilization Plans*, Case No. 07-63-EL-UNC, Opinion and Order (October 3, 2007) at 16.

[295] *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, Finding and Order (December 19, 2008) at 19.

[296] IEU Ex. 10 at 6. See also OEG Ex. 3 at 23.

J. The Commission Should Not Approve and AEP Ohio's Customers Should Not Have To Pay for the Companies' GridSMART Phase 1 Deployment As Proposed Because The Companies' Filing Regarding Its GridSMART Phase 1 Deployment And Its Overall GridSMART Program Deployment Is Deficient.

As part of its ESP, AEP Ohio proposes the initiation of a program of technological infrastructure deployment and integration AEP Ohio calls "gridSMART." AEP Ohio describes gridSMART as "a suite of customer programs and advanced technology initiatives"[297] and contends that its gridSMART will "move the company into a new era of energy delivery and customer service."[298] As proposed, gridSMART will be a multi-phase, 7–10 year endeavor, but at this time, AEP Ohio is requesting the approval of only gridSMART Phase 1, which is expected to take three years, cost $109.7 million, and affect 110,000 CSP customers (approximately 8% of AEP Ohio's total of 1.4 million customers[299]). With its ESP, AEP Ohio has asked customers to pay for approximately $64.5 million in gridSMART Phase 1 costs. The Companies propose that the remainder of the capital costs will be collected from customers over the expected lifetime of the capital investment, which AEP Ohio indicates may vary between five and thirty years. The total gridSMART Phase 1 capital costs, including carrying charges collected from customers, is expected to be approximately $134.1 million.[300]

The three main technological components of gridSMART will be (1) Automated Meter Infrastructure ("AMI"), (2) Distribution Automation ("DA") and (3) Home Area

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[297] Executive Summary of AEP Ohio's Electric Security Plan, p. 2.

[298] *Executive Summary of AEP Ohio's Electric Security Plan, p. 2.*

[299] Companies' Ex. 4 at 14 (Sloneker).

[300] Ex. DMR-4; Staff Ex. 3 at 4.

Networks ("HAN"). As proposed, AMI involves the use of so-called "smart" meters, DA involves control and monitoring components connected within the distribution system by a two-way wireless communication system to AEP Ohio's dispatch operations center, and HAN involves components such as a programmable connecting thermostat and a Load Control Switch.[301]

AEP Ohio witness Slonaker, provides certain details of these components and lists some of the benefits of gridSMART, but her testimony and exhibits fail to demonstrate that gridSMART Phase I or full gridSMART deployment will be cost effective. AEP Ohio fails to provide sufficient detail to support the approval of Phase 1 of gridSMART. Therefore, the Commission should not approve the Companies' proposed gridSMART Phase 1 program, and AEP Ohio's customers should not be asked to pay the costs of the program.

1. AEP's ESP filing fails to demonstrate that gridSMART Phase I or full gridsSMART deployment will be cost effective.

Under S.B. 221, there is ample justification for a utility to propose to deploy an advanced metering infrastructure and information system to promote more customer choice and better service quality for consumers, as long as these programs are "cost effective." R.C. 4928.02(D) provides that it is the policy of the state to "[e]ncourage innovation and market access for **cost effective** supply and demand-side electric service including . . . demand-side management, time-differentiated pricing and implementation of advanced metering infrastructure." [Emphasis added.] In addition, R.C. 4928.64(E) encourages "**cost-effective** and efficient access to information regarding the operation of

[301] Companies' Ex. 4 at 9-12 (Sloneker).

transmission and distribution systems of electric utilities in order to promote both effective customer choice of retail electric service and the development of performance standards and targets for service quality for all consumers . . . ." [Emphasis added.]

Further, R.C. 4928.64(F) provides that it is state policy to "[e]nsure that an electric utility's transmission and distribution systems are available to a customer-generator or owner of distributed generation so that the customer-generator or owner can market and deliver the electricity it produces." AEP Ohio's ESP filing, however, fails to demonstrate the necessary criterion that its gridSMART program is cost effective, and as a result, AEP Ohio fails to meet its burden of proof.

The above-cited statutes notwithstanding, AEP Ohio contends that it need not demonstrate that the gridSMART program is cost-effective. AEP Ohio's witness Sloneker, who filed testify in support of gridSMART, believes that the language of S.B. 221 assumes the technology provides sufficient societal and customer benefits, and that such benefits are self evident:

> . . . AEP Ohio does not believe it is necessary for the Commission to make specific findings about the quantification of customer and societal benefits as part of approving gridSMART Phase 1 in this case. Smart metering deployment will clearly empower customers with information and capabilities that will help them use energy more wisely and ultimately control their energy bills, while also improving reliability. S.B. 221's reference to "acquisition and deployment of advanced metering, including the costs of any meters prematurely retired as a result of the advance metering implementation" suggests that the General Assembly has already recognized the potential customer and societal benefits. And if the Commission's vision of the future is clearly aligned with the capabilities and benefits associated with smart metering and smart grid technologies, deployment of the technology becomes a critical step toward realizing those capabilities. To that end, the customer and societal benefits of smart metering are already sufficiently evident to support a decision to deploy the technology without imposing a requirement that all such quantified benefits be

> specifically monetized and mathematically shown to equal or exceed the net costs.[302]

On cross-examination, Ms. Sloneker offered little additional support or explanation of how gridSMART provides customer and societal benefits. Although Ms. Sloneker testified that gridSMART will provide a benefit to customers in the form of bill savings,[303] Ms. Sloneker admitted on cross-examination that AEP Ohio has not attempted to estimate this bill savings in any way.[304] Ms. Sloneker claimed that gridSMART will "help enable customers to become more energy efficient" and have "greater control with pricing information,"[305] but no one from AEP Ohio has sought to determine whether gridSMART will reduce customers' energy use.[306]

Regarding gridSMART's benefits to society, such as lessening AEP Ohio's negative impact on the environment or creating jobs, Ms. Sloneker admitted that AEP Ohio has not attempted to estimate any impact gridSMART would have on either the environment or job creation.[307] At the same time, AEP Ohio anticipates that gridSMART will reduce its operational costs,[308] and has attempted to quantify the benefits it may achieve through gridSMART related to reduced operating costs and improvements in system efficiency and reliability.[309]

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[302] Companies' Ex. 4 at 17 (Sloneker); See also, Tr. III at 218 (Sloneker).

[303] Companies' Ex. 4 at 16 (Sloneker).

[304] Tr. III at 213 (Sloneker).

[305] Companies' Ex. 4 at 4 (Sloneker).

[306] Tr. III at 214 -.215, 253 (Sloneker).

[307] Id. at 217.

[308] Id. at 6-11.

[309] Id. at 236-237; Id. at 247-248; Exhibit KLS-1 at 6.

Moreover, even though the Companies are seeking to collect over $100 million from customers to implement gridSMART Phase 1, AEP Ohio has not put together a full implementation plan or attempted to calculate its total cost.[310] AEP Ohio does not know how many phases will be necessary for full implementation,[311] does not know the anticipated life cycle of the various components of gridSMART,[312] and has not devised a methodology by which it will evaluate gridSMART Phase 1.[313] AEP Ohio has also not attempted to determine whether a fully implemented gridSMART system will ever break even, in terms of costs and benefits, much less save AEP Ohio money.[314] All we really know regarding gridSMART's cost is that AEP Ohio wants its customers, not AEP Ohio shareholders, to bear it.[315]

OCC witness Finamore (who is an expert with 33 years of experience in the utility and related industries field, and who was responsible for the installation of the Duquesne Light Company's Advanced Metering Infrastructure ("AMI") system in the late 1990s) expressed concern about the cost-effectiveness of AEP Ohio's gridSMART program: ". . . Ms. Sloneker has described a range of typical benefits that can be achieved through gridSMART without acknowledging that full system implementation would be required before many of these benefits could actually be realized."[316] Mr. Finamore was further dissatisfied with the lack of detail in the gridSMART proposal: "No detailed equipment

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[310] Id. at 230, 223.

[311] Id. at 229-230.

[312] Id. at 226.

[313] Id. at 241-243.

[314] Id. at 218.

[315] Id. at 246-247.

[316] OCC Ex. 12 at 6 (Finamore).

specifications have been provided, and there is no evidence that a rigorous analysis of potential operating savings, revenue enhancements and other benefits has been performed to identify what offsetting operating benefits, such as savings in manual meter reading costs, can be credited to these large capital expenditures."[317] " . . . AEP-Ohio seeks Commission approval to deploy DA equipment totaling $34.6 million of the $109 million Phase 1 cost without providing detail concerning the equipment that will be used or committing to achieve any specific performance measures or metrics from which the Commission can gauge Phase 1 success."[318]

Similarly, PUCO Staff witness Scheck expressed concern that AEP Ohio's proposed gridSMART program was not cost-effective. Mr. Scheck noted that "the estimated operational savings for the first three years is expected to be only about $2.7 million. From the Staff's perspective, the relative amount of operational savings is quite small compared to the amount of expenditures for the Smartgrid [sic] initiative over the ESP period."[319] In particular, Mr. Scheck noted the minimal risks being borne by the Companies and the minimal gain expected: "The main point the Staff is making with respect to the gridSMART Phase 1 costs relate[s] to the minimal risks the companies are undertaking with this investment relative to the minimal potential gain for ratepayers."[320]

Regarding AEP Ohio's demonstration of cost-effectiveness, Mr. Finamore offered the following recommendation:

> Phase 1 should have its own set of performance measures upon which the Commission can assess overall performance. Before

[317] Id. at 9.

[318] Id. at 6-19.

[319] Staff Ex. 3 at 16-21 (Scheck).

[320] Id. at 4.

proceeding with the remainder of gridSMART, a more detailed project plan involving budget, resource allocations and life cycle operating cost projections for the full 7-10 year implementation period and beyond should be submitted for Commission approval, along with a specific set of performance measures and metrics that will apply to full system implementation.[321]

Upon completing his review of AEP's gridSMART filing, Staff witness Scheck offered this specific recommendation:

> I would recommend that the companies' proposed Phase 1 gridSMART investment be pulled out of the general distribution rates and be set aside in a separate rider, set at $0.00, until a further, more detailed investigation can be completed. Based on company witness Ms. Sloneker, the companies did not attempt to quantify any customer or societal benefits with respect to its smartGRID [sic] analysis. Without any customer or societal benefits associated with the companies' smartGRID analysis, it is not clear whether the companies truly want to assist customers in to make [sic] wiser energy choices. In the event that the Commission recommends the companies go forward with its Phase 1 gridSMART proposal, the Staff would recommend that there should be an annual cost and performance review of this initiative.[322]

Thus, both Staff and OCC agree that AEP Ohio should provide more details in this case regarding the costs and benefits of gridSMART Phase 1, and that annual performance reviews are a necessary element of deployment. Mr. Scheck further recommended that AEP Ohio propose specific tariff and rate provisions that it will offer should enabling gridSMART technology be introduced, so that customers would know in advance what they would pay for their consumption.[323]

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[321] OCC Ex. 12 at 8.

[322] Staff Ex. 3 at 4-5 (Scheck).

[323] Id. at 5-6.

2. AEP Ohio's ESP filing fails to provide sufficient detail to warrant the Commission's approval of gridSMART Phase 1 or full gridSMART deployment.

In addition to failing to demonstrate that gridSMART will be cost effective, AEP Ohio's ESP filing fails to provide sufficient detail regarding nearly every element of its proposed gridSMART program. As to the overall costs of gridSMART, customers are being asked to commit $109 million for Phase 1 funding when no future projections of capital and operation costs beyond the initial 3-year period have been submitted. In addition, AEP-Ohio has failed to offer any examples of actual operating experience within the utility industry for similar initiatives.[324]

Given the obvious ties between Phase 1 and the full gridSMART rollout, AEP Ohio should be required to provide specific Phase 1 performance criteria and a detailed full system cost estimate and implementation plan before any Commission approval of Phase 1.[325] AEP Ohio has not provided any detail concerning vendors, the specific technologies it will employ, or the timing or manner in which the features will be provided.[326]

No information has been provided that describes the type of HAN technologies needed for Phase 1 deployment, or shows that the planned technologies are presently commercially available and capable of supporting future Market Potential Study ("MPS") programs.[327] From the information provided, AEP-Ohio has not included any plans for a meter data management system to be implemented in its Phase 1 program, which

[324] OCC Ex. 12 at 8 (Finamore).

[325] Id. at 10 (Finamore).

[326] Id. at 8.

[327] Id. at 13.

suggests that the general availability of HAN features, including time-differentiated rates, is many years away.[328] Finally, many of the benefits of AEP Ohio's gridSMART initiative cannot be realized until a full system installation, with software systems not identified in Phase 1, has been substantially completed.[329]

3. With a properly detailed proposal submitted by AEP Ohio, the Commission could approve the AMI and DA portions of the Companies' proposed gridSMART Phase 1.

OCC would generally support the AMI portion of Phase 1 if AEP Ohio provides an AMI requirements document that describes in detail what AEP-Ohio hopes to accomplish with AMI, and if the parties have the opportunity to review such a document and advocate for necessary modifications to the provisions therein. This requirements document should spell out AEP Ohio's objectives and the specific functional capabilities of the Companies' AMI system. This requirements document should also include specific performance measures that govern network build out and are used to evaluate AMI system performance in the future.[330]

Also, AEP Ohio should file with the Commission a detailed AMI implementation plan covering the deployment strategy, budget, timetable, resource requirements and other relevant deployment issues related to Phase 1 and full system gridSMART deployment, and which would require Commission approval to proceed. This implementation plan should provide all details related to deployment of the meters, head end software, communications infrastructure and associated computer software to be

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[328] Id. at 7.

[329] Id. at 18.

[330] Id. at 13-14.

deployed over the 3-7 year period of the plan.[331] The Commission's requirement of such an AMI implementation plan is consistent with its December 19, 2008 Opinion and Order in Case No. 08-935-EL-SSO (FirstEnergy's ESP case).[332]

Specific to the DA portion of gridSMART Phase 1, which represents only 2.6% of AEP Ohio's Enhanced Service Reliability Plan expenditures over the next three years,[333] OCC witness Finamore recommends that AEP Ohio proceed with the Phase 1 DA deployment as part of its normal distribution network maintenance and upgrade programs.[334]

K. Because AEP Ohio Has Not Demonstrated That Its Costs Have Increased, AEP Ohio Has Not Demonstrated That Its Proposed Increases In Line Extension Charges Are Justified.

AEP Ohio's Application seeks Commission approval of increases in residential and non-residential line extension charges. According to the Application, the Companies' current line extension terms and conditions were established pursuant to the Commission's investigation in Case No. 01-2708-EL-COI. AEP Ohio contends that these lines extension charges should be increased because "[s]ince the time of that investigation, expenses associated with line extensions have increased dramatically."[335]

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[331] Id. at 14-15.

[332] *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 45 (Dec. 19, 2008).

[333] Id. at 15.

[334] Id. at 15.

[335] Columbus Southern Power Company's and Ohio Power Company's Application, Part III, G. p. 11.

Gregory Earl, AEP Ohio's chief witness supporting AEP Ohio's request for increases in line extension charges, testified that increased material costs necessitate increased charges for line extensions:

> The basic justification for the increase in [the Companies' line extension] charges is the significant increase in costs that has occurred over the last several years. . . . The underlying driver in these project cost increases is the sharp increase in material costs over the last several years. Steel, copper and aluminum prices have soared in recent years. These raw material prices have directly impacted AEP Ohio's costs for such fundamental distribution system components as transformers and wires.[336]

On cross-examination, Mr. Earl admitted that he, personally, did not track or know the price of steel, copper and aluminum, but instead, relied on AEP Ohio witness Boyd for the prices of steel, copper and aluminum.[337]

Although Mr. Boyd's filed testimony discussed price increases on copper and steel, it provided no information, whatsoever, on aluminum.[338] In addition, his testimony provides no data regarding the price of steel or copper after June of 2008.[339] In his cross-examination on November 21, 2008, Mr. Boyd admitted that he did not know the present price of these commodity metals.[340] Thus, AEP Ohio's claim that metals prices, and as a result, AEP Ohio's material costs, have increased is not supported by the record in this case. To the extent that AEP Ohio is justifying its request for line extension charge increases on the argument that "current" metals prices have increased, AEP Ohio has not met its burden of proof.

[336] Companies' Ex. 10 at 7 (Earl).

[337] Tr. V at 145-146, 155-156 (Earl).

[338] Companies' Ex. 11 at 9 (Boyd).

[339] Id. at 9, see Chart 1.

[340] Tr. V at 197-198 (Boyd).

The Staff's position is that the Companies file a distribution rate case in 2009 and that distribution-related issues and costs such as those related to line extensions be examined in that case.[341] OCC recommends that AEP Ohio be required in that case to meet its burden of proof by demonstrating that its costs related to line extensions have, in fact, increased sufficiently to justify the increased charges requested.

L. The Commission Should Deny AEP Ohio's Proposed Deferral Of FAC Costs.

Under the Companies' ESP filing, generation service rate increases are capped at 15% per year for the 2009 to 2011 period. If fuel costs incurred during that period are greater than covered by the 15% increase, AEP Ohio proposes to defer the increased costs.[342] The Companies propose to defer the increased, un-recovered fuel costs, along with carrying costs at the Companies weighted average cost of capital. Then beginning in 2012, the Companies would collect the resultant regulatory assets created by the deferrals over a seven-year period. The Companies intend to recover the deferrals from all SSO customers through a non-bypassable charge in future ESP or MRO filings.[343]

1. Deferrals are incompatible with the policy set forth in R.C. 4928.143(B)(2)(d) because they destabilize customer prices and introduce uncertainty regarding retail electric service.

Although S.B. 221 permits a utility to include deferrals under an ESP plan, it limits the deferrals to those that stabilize or provide certainty: "The plan may provide for

[341] Staff Ex. 13 at 4 (Hess).

[342] Companies' Ex. 6 at 5.

[343] Id. at 8-9.

or include, without limitation, any of the following . . . [t]erms, conditions or charges relating to . . . amortization periods, and accounting or deferrals, including future recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service."[344] Thus, for a deferral to be permissible, it must be shown by the Companies to provide a stabilizing effect or provide certainty to AEP Ohio's customers.

The Companies argue that the deferral of FAC costs until after the three-year ESP period keeps current customer bill impacts down, thereby providing a stabilizing effect on current prices. Such a view, however, is extremely short-sighted, as any credit card user realizes a month after a purchase. In reality, deferrals simply push rate increases, plus the added impact of carrying costs,[345] to customer bills after the three-year ESP period. According to Assante Exhibit LVA-1, the phase-in and deferrals proposed by AEP Ohio will result in customers paying $461.2 million in carrying costs in the years 2012-2018.[346] This, by itself, constitutes a significant and unnecessary increase in rates to customers.

As the record contains no projection that electric rates will decrease following the ESP period, these deferrals will have a de-stabilizing effect on customers' electric bills starting in 2012. As AEP Ohio witness Assante testified at hearing, any under-recovery under the annual FAC true-up mechanism proposed by AEP Ohio would increase the deferral amount.[347] Mr. Assante further admitted that such an under-recovery is not

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[344] R.C. 4928.143(B)(2)(d).

[345] Tr. IV at 117 (Assante).

[346] Assante Exhibit LVA-1; OCC Ex. 10 at 34 (Smith).

[347] Tr. IV at 110 (Assante).

unlikely.[348] Thus, the amount that would be deferred until after the three-year ESP period is impossible to predict, introducing further uncertainty regarding future customer electric rates and potentially destabilizing future prices. Such additional rate increases will have a devastating impact on residential customers already facing bleak economic conditions. In addition, the longer the recovery period of deferrals, the greater the ultimate total cost to customers.[349] As time goes on, existing carrying costs are compounded, i.e., AEP Ohio would earn carrying costs on carrying costs.[350] This causes further uncertainty regarding the rates customers will pay for electricity in the future.

2. Because of the problems associated with deferrals, the OCC and PUCO Staff recommend against deferrals, and support, if necessary, a levelization of rates during the ESP period.

There are several problems with the Companies' proposed phase-in and deferrals. OCC witness Smith noted that the phase-in and deferral will result in customers paying a projected additional $461.2 million in carrying costs in the years 2012 – 2018 (Assante Exhibit LVA-1). Pushing these costs to future ratepayers will mean that customers will pay more even if all customers are then paying market prices, or it will likely be a reason proffered in the future to not move to a competitive market for generation. In addition, it is unreasonable to charge these carrying costs to customers who are currently shopping and thus, will not receive the "benefit" of those deferrals.

Staff witness Richard Cahaan similarly found problems with AEP Ohio's proposed deferrals of FAC costs: "The Staff recommends against deferrals. Our

[348] Id. at 111.

[349] Id. at 114.

[350] Tr. IV at 157.

experience with deferrals shows that they cause many problems and should be avoided whenever possible. . . . Staff would not be opposed to smoothing out rate shock problems by some kind of levelization process within the ESP period, but does not recommend a process that extends the collection through an unavoidable charge beyond the ESP period."[351]

Staff witness Hess similarly recommended against AEP Ohio's proposed referrals: "The Staff is recommending . . . [t]hat the AEP companies not be allowed to defer costs past the three-year ESP period, but if a phase-in of the first year increase is needed[,] . . . it [should be] . . . levelized over the three year ESP period and the carrying cost [should] be adjusted to a more reasonable level than the carrying cost recommended by the Applicant for its phase-in calculation."[352] Based on the recommendations of the OCEA and Staff, the Commission should deny AEP Ohio's proposal to defer FAC costs.

3. Mitigation of rate increases would not be necessary if generation rates are "reasonably priced" under R.C. 4928.02(A).

R.C. 4928.02(A) provides, "It is the policy of this state to . . . (A) ensure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service."[353] When approving rates that are "reasonable," the Commission must consider the rate increases proposed by AEP Ohio in the context of the present economic situation facing the country and, in particular, Ohio and AEP Ohio's customers. Staff witness Cahaan set forth Staff's view of AEP Ohio's proposed rates, stating, "With the recent financial crises, we are entering a recessionary, and

[351] Staff Ex. 10 at 5 (Cahaan).

[352] Staff Ex. 1 at 3-4 (Hess).

[353] R.C. 4928.92(A).

possibly a deflationary, period, and any expectations of price increases need to be revised downward."[354]

As discussed in previous sections, the Companies' Fuel Adjustment Clause contained in the ESP should be modified. These modifications include the establishment of an appropriate baseline FAC rate based on 2008 actual known fuel-related costs, the exclusion of market-rate purchased power, the use of reasonably projected 2009 fuel costs consistent with current and future energy market conditions, and adjustment of fuel-related costs by off-system sales margins and capacity equalization revenues. Once these modifications are applied, the projected fuel cost increases, if any, for 2009, 2010, and 2011 will be very limited, if not completely eliminated.

Deferrals could also be eliminated by using more recent fuel-related costs. The Companies' projected incremental fuel-related costs, and thus the justification for implementing fuel costs and other cost deferrals are based largely on totally unjustified and unsupported projections of increase in fuel-related costs. Based on the data contained in AEP Nelson Exhibit DMR-7, for the year 2009 alone, AEP Ohio projects that the fuel-related costs, i.e., the FAC factor, will increase approximately 42% for CSP and 71% for OPCO. The application of a more reasonable and realistic rate of increase for fuel-related costs is very likely to reduce, if not negate, the need for any fuel cost deferral.[355]

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[354] Staff Ex. 10 at 4 (Cahaan).

[355] According to OCC Ex. 6, the Companies project, at least for CSP, that there will be over-recovery of fuel expenses, negating any need for deferrals in the second and third year of the ESP. OCC Ex. 6, Attachment 1, 1 of 12.

4. If the Commission approves deferrals, AEP Ohio's proposed carrying costs should be based on the short-term cost of debt or another reasonable basis.

On any approved deferrals, AEP Ohio proposes that it be paid a carrying cost based on the weighted cost of capital. This rate is not reasonable, as it would result in excessive payments by customers.[356] It is well established precedent that utilities are allowed to earn a return on plant investment, but carrying costs are another matter, especially the carrying cost for any fuel cost deferral. OCC has outlined several general objections to AEP Ohio's calculation of the carrying cost. These objections include (1) any deferred fuel expenses created under the FAC should be financed in part by the tax savings generated by the Companies' deferred tax obligation, (2) the component of Property Taxes and General and Administrative Expenses embedded in the carrying costs should be eliminated because the Companies provided no explanation or support on their calculation, and (3) carrying charges should reflect the actual short-term cost of debt, excluding equity.

Fuel cost deferral is basically an accounting cost recovery mechanism. It is used primarily to recover costs incurred in procuring fuel and fuel-related items, and not to yield a return for shareholders. The lead time between incurring fuel-related costs and recovery of those fuel-related costs under a traditional fuel clause is generally very limited, thus negating the need for deferrals. Also, the recovery of fuel-related costs under the FAC proposed by the Companies is guaranteed further reducing risk of

[356] OCC Ex. at 34 (Smith).

recovery. Instead, as OCC witness Smith recommended, a more appropriate rate for any carrying costs approved by the Commission is the short-term cost of debt.[357]

5. Intergenerational deferrals are unfair and unreasonable.

On cross-examination, AEP Ohio witness Assante admitted that deferrals of FAC costs to be paid by customers after the ESP period could result in AEP Ohio recovering revenues from certain customers that were not customers of AEP Ohio at the time the FAC costs were deferred.[358] OCC witness Smith testified that it is unreasonable to charge carrying costs to future AEP Ohio customers who are currently shopping and thus will not have received the "benefit" of the deferrals.[359] In either case, deferrals cause one set of customers to pay for the benefits received by another, which is unfair and unreasonable.

M. The $75 Million Low Income/Economic Development Fund Should Be For New Programs, Not Just For Continuation Of Existing Programs That May Already Be Funded Through Customers' Rates.

As part of its ESP, AEP Ohio proposes to allocate $75 million to what the Companies call a "Partnership With Ohio" fund.[360] Approximately half the fund would be used for low-income assistance and energy efficiency programs for customers who are not eligible for other forms of assistance.[361] The other half would be used for economic development programs,[362] such as "increased support to local economic development

[357] Id. at 35.

[358] Tr. IV at 190.

[359] OCC Ex. 10 at 34 (Smith).

[360] See Companies' Ex. 3 at 16.

[361] Tr. Vol. III at 118 (Hamrock).

[362] Id.

organizations, continued support for regional and state economic development organizations, development of a learning/educational component, and research and marketing establishment of an economic development grant fund."[363]

OCEA supports the general concept of this fund, but is concerned that many of the "economic development" programs are nothing more than continuations of programs the Companies currently undertake. Because some of these programs may already be funded through customers' rates, funding the programs through the economic development portion of the ESP would be tantamount to a rate increase for customers. The Commission should ensure that this does not occur.

N. The Companies' DSM/Energy Efficiency Proposals Do Not Meet the Requirements of S.B. 221.

Under S.B. 221, the Companies must, beginning in 2009, implement energy efficiency programs that achieve specific annual energy savings by the end of 2025. The energy efficiency programs must achieve energy savings in 2009 of at least 0.3% of the total, annual average, and normalized kWh sales during the preceding three calendar years. The required savings increase to 0.5% in 2010, 0.7% in 2011, 0.8 % in 2012, 0.9% in 2013, 1% per year from 2014 to 2018, and 2% per year thereafter, so that by the end of 2025, the programs will have achieved a cumulative energy savings of 22.2%.

S.B. 221 also requires the Companies to implement in 2009 peak demand reduction programs designed to achieve specified peak demand reductions by 2018. The programs must be designed to reduce peak demand by 1% in 2009, with an additional reduction of 0.75% each year through 2018.

[363] See Companies' Ex. 3 at 16.

These energy efficiency and peak demand reduction requirements are often referred to as Demand Side Management, or DSM. AEP Ohio has proposed to meet S.B. 221's DSM requirements with a portfolio of programs. They include:

- Residential Standard Offer Program, Small Commercial and Industrial Standard Offer Program and Commercial and Industrial Standard Offer Program;
- Targeted Energy Efficient Weatherization Program;
- Low Income Weatherization Program;
- Residential and Small Commercial Compact Fluorescent Lighting Program;
- Commercial and Industrial Lighting Program;
- State and Municipal Light Emitting Diode Program;
- Energy Star® New Homes Program;
- Renewable Energy Technology Program; and
- Industrial Process Partners Program.[364]

The Companies intend to collect the estimated annual DSM program costs through an energy efficiency and peak demand reduction cost recovery rider.[365] The Companies propose that recoveries under the rider will be compared to the amortization of the actual deferral on an annual basis and trued-up to actual through an annual tracker mechanism.[366]

Although AEP Ohio's proposed program for low income customers appears to be adequate, the Companies' proposal is not broad enough to achieve the DSM results

[364] See Companies' Ex. 4 at 20.

[365] See Companies' Ex. 6 at 47-48.

[366] Id. at 48.

envisioned in S.B. 221. The Commission should order AEP Ohio to make its DSM program available to all of its residential customers in Ohio, as recommended by OCC witness Gonzalez.[367] Programs for consumers with incomes above 150% of the poverty line should be competitively bid out and should have a sliding payment scale so customers pay according to their means. In addition, all programs should be reviewed for cost-effectiveness, using at least the Total Resource Cost test advocated by Mr. Gonzalez.[368] The Commission should also encourage AEP Ohio to work with Columbia Gas to implement a joint gas and electric "one-stop shop" Home Performance program for customers by the second year of the ESP.

OCEA is also concerned about the relatively high levels of administrative cost projected in all of the Companies' programs. Using non-Ohio estimates, AEP Ohio witness Sloneker estimated that the percentage of administrative costs as a percentage of program costs range from 25.8% to 48.3% for residential programs and from 26% to 43.4% for commercial and industrial programs.[369] By comparison, Columbia Gas of Ohio's energy efficiency filing kept total administrative, education, and marketing costs to less than 8.3% for five of its six residential programs and below 17.4% for three of its five commercial programs.[370] Similarly, the overall administrative and marketing costs in Duke Energy of Ohio's residential and small business customer programs for 2006 averaged 23%.[371] AEP Ohio's costs are considerably higher than the administrative costs

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[367] See OCC Ex. 5 at 9.

[368] Id.

[369] See Companies' Ex. 4 at Exhibit KLS-2.

[370] See OCC Ex. 5 at 8.

[371] Id.

of similar programs conducted in Ohio, and demonstrate the lack of efficiency on the part of AEP Ohio in program delivery.

In order to avoid passing these higher costs on to consumers, the Commission should adopt the recommendations of OCC witness Gonzalez.[372] Customer funding of administrative, educational and marketing expenses should be determined in the Companies' DSM collaborative. In addition, these expenses combined should not exceed 25% of the DSM program cost, unless modified for a specific program by the DSM collaborative group. Limiting the administrative expenditures assures that the bulk of program dollars go directly to customers to implement energy efficiency measures. The Companies should make available a more detailed dollar breakdown of the $15 million that AEP Ohio is budgeting in its General Energy Education Program, and amounts that can be attributed to specific programs should be accounted for in those specific program budgets.

O. The Companies Should Be Required to Continue Their Green Pricing Program.

The Commission should require AEP Ohio, with the assistance of the DSM collaborative, to continue its Green Pricing Program, which is set to expire on December 31, 2008.[373] Further, AEP Ohio should be ordered to develop within the first three months of 2009 a separate residential and small commercial net-metering customer renewable energy credit ("REC") purchase program. This will help customers pay for the

[372] See id. at 8-9.

[373] The Commission has approved the Companies' application for several tariff revisions, including the expiration of the Green Pricing Program. *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Modify the Expiration Dates on Certain Rate Schedules and Riders*, Case No. 08-1302-EL-ATA, Finding and Order (December 19, 2008).

cost of owning and using renewable energy. Further, it will assist the Companies in meeting the statutory mandate of 12.5 % renewable energy (including the solar set-aside), of which 50% must come from installations within Ohio.

For renewable net-metering customers of 50 kW or less, the Companies should develop and implement a standard offer program to purchase the RECs generated at no less than an Ohio mandatory market based rate (with one rate for in-state solar electricity applications and a different rate for in-state wind and other renewable resources). The program design should make the program easily accessible, with easy to understand rules, should contain transparent market based pricing incentives, should provide for a stable and long-term revenue stream, and should contain REC prices that adjust to changing conditions, (e.g., new tax credits or change in panel or electricity prices).

P. The Companies Have Requested No Authority From The Commission Concerning The IGCC.

The Companies identify "barriers" to construction of the proposed IGCC (Integrated Gasification Combined Cycle) generating plant in Meigs County that they believe are created in S.B. 221. These include the treatment of construction work in progress ("CWIP") and how IGCC costs are accounted for in the ESP.

S.B. 221 did not eliminate the existing requirements the utility companies must satisfy in order to take advantage of authorization by the Commission to earn a return on CWIP. The requirements stem from the time of regulated utility services when generation and distribution services rates were bundled in Ohio. For example, the Companies opine that the limit on CWIP as a percentage of total rate base is of questionable applicability under current law.[374] Also, the CWIP requirement that the plant be seventy-five per cent complete is also questioned by the Companies.[375] To address these issues the Companies' stated they will work with the Administration and General Assembly to enact legislation to address these factors which they consider to be barriers.[376]

The Companies do not ask for any action or determination by the Commission, so there is nothing required of the Commission at this time -- nor at any definite time in the future -- regarding the proposed IGCC plant. For these reasons the Commission should take no action on this issue.

Q. The Commission Should Not Grant The Proposed Modification Of The Corporate Separation Plan And Should Not Authorize The Sale Or Transfer Of Generating Assets.

The Companies have requested the Commission to authorize an amendment of their corporate separation plans to permit legal separation of the generation assets by sale or transfer instead of maintaining the functional separation in their current plan. As part of the legal separation proposal, the Companies are requesting authority to sell or transfer, in the future, certain generating assets. Specifically, CSP requests the authority to sell the Waterford and Darby generating stations, representing about 1300 MW of capacity.[377]

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[374] AEP Ohio Ex. 2A at p. 52-56 (Baker).

[375] Id.

[376] Id.

[377] AEP Ohio Ex. 2A at 42 (Baker).

However, during the term of the ESP the functional separation of generation will be maintained.[378] Because no ownership change will occur during the ESP, there is no reason for the Commission to consider granting at this time the authority requested by the Companies for the sale of assets.[379] Much can change in 3 years and it is prudent to wait until the Companies request the authority to dispose of these generating assets at a time closer to the date of any expected sale or transfer. Their request is premature at best.

In the event the Commission authorizes the transfer of the generating assets, Companies must comply with the recently adopted corporate separation rules issued by the Commission in the SSO Rules Case.[380] The Companies would file for approval of its corporate separations plan within 60 days after the rules become effective and would further be audited by an independent auditor within the first year of approval of the ESP. The audit should be funded by the Companies, but managed by Staff, and the audit should cover compliance with the Commission's rules on corporate separation.[381]

For these reasons, the Commission should not grant the Companies authority to sell or transfer the Waterford and Darby generating assets at this time, and should such authority be granted, it should require Companies to undergo an independent audit, described, *supra*. However, because the Companies have no current plans to sell the assets any time before the expiration of the ESP the request is untimely.

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[378] Id at 41.

[379] Id.

[380] PUCO Case No. 08-777-EL-ORD.

[381] *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*, PUCO Case No. 08-935-EL-SSO, Order at 60 (December 19, 2008).

R. The Commission Should Not Make Any Determinations Regarding Deferring The Costs Of Early Plant Closures.

The Companies have asked the Commission to determine the accounting treatment and rate recovery[382] for possible early plant closures in the event a plant cannot cost-effectively continue to operate and this occurs at a date earlier than the date assumed for depreciation accrual purposes.[383] Both Witnesses Assante[384] and Baker[385] testified that the Companies had no plans for any early plant closures. Based upon this testimony alone, there is no basis or requirement for the Commission to consider the request in this proceeding because there is no planned early plant closure *during the term of the ESP.*

Staff Witnesses Hess' testified regarding early plant closure. When asked whether he agreed with AEP's proposal regarding early plant closure, he stated:

> No. The economic value of the generating fleet was measured in AEP companies Electric Transition Plan, Case Nos. 99-1729-EL-ETP and 99-1730-EL-ETP. The AEP companies stipulated in that case that they would not impose any lost generation charges on any switching customers during the market development period (2001-2005). Although the economic value of generating fleet was never specifically addressed by the Commission, it could be assumed that the net value of the companies' fleet was not stranded. We are not recommending that the Commission require the customers to bear the costs/risk of these uneconomic plants without accounting for the offset of the positive economic value of the rest of the AEP companies' generating fleet. Given that the market rates have increased significantly since it was measured in Case Nos. 99-1729-EL-ETP and 99-1730-EL-ETP, we are assuming that net value of the generating fleet is still positive.[386]

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[382] AEP Ohio Ex. 2A at 52 (Baker); AEP Ohio Ex. 6 at 23, 24-30 (Assante).

[383] Id at 51, 52.

[384] Tr. IV at 155 (Assante).

[385] Application, at 18, section VI.C.

[386] Staff Ex. 1 at 8; Tr. VIII at 83 (Hess).

The proposed accounting treatment for early plant closure is wrong and must be rejected. When the Companies requested that plant be included in rate base under traditional regulation to enable them to earn a return on their investment, they accepted the risk that the plant might not be fully depreciated when it was removed from service. It does not seem fair to the Companies' customers to guarantee that the Companies can recover their entire investment by amortizing the undepreciated portion of the investment.[387]

If the Commission determines to allow such unreasonable accounting treatment, over OCC and others' objections, it should at least adopt Staff Witness Hess' "offset" recommendation to protect the Companies' customers.

S. The Companies Should Not Be Allowed To Count Potential Interruptible Load Toward The Requirements Of S.B. 221.

The Companies assert that, for purposes of meeting S.B. 221's demand reduction requirements, they should be able "to count the load that is capable of being reduced towards peak reduction goals, even if that load was not reduced at the time of peak because operational and/or market conditions did not dictate the need for a reduction."[388] They assert that this would "protect customers from unnecessary interruptions."[389] The Commission should reject the Companies' recommendation.

AEP Ohio's proposal is contrary to law. S.B. 221 mandates a peak reduction program in order to improve the reliability of the grid.[390] The Companies' proposal

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[387] See for example *In the Matter of the Application of Ohio Power Company to Increase Certain of its Filed Schedules Fixing Rates and Charges for Electric Service*, Case No. 85-726-EL-AIR, Opinion and Order at 34; 1986 Ohio PUC LEXIS 49 (where the Commission disallowed recovery of undepreciated investment in the Otisca plant).

[388] Companies' Ex. 1 at 6.

[389] Id.

[390] R.C. 4928.66(b).

would provide a false representation of the grid's reliability, and thus would thwart the objectives of S.B. 221. Further, part of the interruptible load that the Companies would count toward the peak reduction requirements would be non-mandatory reductions that customers can control through the amount of kWh and/or the amount of time that the load was reduced.[391] Because customers are able to control the load, it should not be counted as peak reduction by the Companies for purposes of meeting S.B. 221's goals.

In addition, the Companies would reap an inequitable benefit from their proposal. An interruptible load that is not reduced at peak allows the Companies to either sell the load or avoid buying additional power.[392] In either event, the Company is allowed to benefit, without passing that benefit on to customers.

T. The Commission Should Clarify Some Areas Of The Companies' Riders In Order To Minimize Anti-Competitive Behavior.

OCC witness Anthony Yankel analyzed the riders that are part of the Companies' ESP and found no major concerns, but offered the following recommendations in order to minimize anti-competitive behavior:

1. Economic Development Cost Recovery Rider 82 should allocate costs to all customers on the basis of total revenue collected.

R.C. 4905.31(E) provides that a "reasonable arrangement" filed with the PUCO may include provisions to recover costs incurred with economic development programs and revenue foregone due to those programs.[393] Also, R.C. 4928.143(B)(2)(i) provides

[391] See Tr. at 87-91 (Roush).

[392] See id. at 68-69 (Roush).

[393] R.C. 4905.31(E).

that a utility may file an ESP with provisions to implement economic development programs and seek that program costs for economic development be recovered from, and be allocated to, all customer classes.[394] The amount and allocation of the costs to be recovered is up to the discretion of the Commission, which has had a long-standing policy of equally splitting the cost of the foregone revenue subsidy (a.k.a., "delta revenue") between shareholders and customers.[395]

In its ESP, the Companies propose what they call their "Partnership with Ohio" in which the Companies commit to a shareholder contribution of $75 million for economic development and their "at risk" (low income) customers. The Companies propose to recover additional economic development costs through a non-bypassable Economic Development Cost Rider 82. This rider will be "the mechanism by which the Companies recover the costs, incentives and revenues foregone associated with Commission-approved special arrangements, including special arrangements for economic development, job retention, energy efficiency, and peak demand reduction purposes."[396] "Thus, as proposed by the Companies, any economic incentives offered to customers or revenues foregone will be picked up by the customers and not the Companies themselves."[397]

Under the Companies' ESP, customers will have an opportunity to shop for generation service from either the Companies or a Competitive Retail Electric Service ("CRES") supplier. In the new world where it is possible there may be other providers of

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[394] R.C. 4928.143(B)(2)(i); OCC Ex. 14 at 4 (Yankel).

[395] OCC Ex. 14 at 4.

[396] Companies' Ex. 1 at 12 (Roush) Yet, the Companies failed to provide any estimate of what the increased costs to customers would be under such an approach.

[397] OCC Ex. 14 at 6 (Yankel).

the largest component of a customer's electric bill, OCC witness Yankel stressed that it is imperative that economic development rate rules reflect such possibilities.[398] He testified that economic development may become a means by which a utility could subsidize certain customers in a manner that would allow the utility to gain or retain the generation business of customers that may be thinking about buying power from alternative supplier.

OCC witness Yankel testified that because Economic Development Cost Recovery Rider 82 is designed as a non-bypassable rider, paid for by shopping and non-shopping customers alike, it is abusive, anticompetitive, and not proper.[399] Yankel further testified that because of the nature of the economic incentives involved, incentives and/or discounts will likely not be offered to shopping customers.[400]

It does not appear possible to structure Rider 82 in a manner that prevents the Companies from using it for anticompetitive purposes, if they choose to do so, but the Commission can make abuse less likely by (1) making Rider 82 bypassable, or (2) establishing that the charge is based on a percentage of the AEP Ohio customer's entire bill, rather than just a percentage of distribution charge.[401] This will greatly reduce the relative portion of these costs collected from shopping customers.

a. The Commission should annually review economic development arrangements.

Another recommendation by OCC Witness Yankel regarding economic development arrangements is to require an annual review of each approved arrangement

[398] OCC Ex. 14 at 5 (Yankel).

[399] Id.

[400] Id. at 7.

[401] Id. at 8.

to ensure the customer-recipient is meeting its part of the bargain. If the Commission determines that the customer-recipient has not fulfilled its obligations under the arrangement, then the arrangement should be cancelled, the delta revenue subsidy should be paid back by the customer-recipient to the Companies, and the Companies should credit back customers for the portion of the discount they funded.[402]

b. All parties should be allowed to participate in the review of economic development arrangements.

In both the initial approval and annual review processes by the Commission, all parties should be allowed to actively participate. Economic development contracts proposed for recovery under Rider 82 will have an impact on more than just the utility and the individual customer. For that reason, all parties should have the opportunity to review the contracts initially and the implementation of the contracts over time. This participation would allow all parties to argue for modifications of the contracts and participate in the annual review.

2. Energy Price Curtailable Service Rider 72 should treat any discounts as being associated with non-retail costs in the Companies' Fuel Adjustment Clause Rider 80, as opposed to being collected as if any revenue shortfall should come from retail customers.

Rider 72 establishes a credit for a customer willing to curtail a portion of its load during times when the cost of generation/supply is "high." The Rider gives the Companies options to reduce their marginal cost of supply.

Mr. Yankel testified that although there is an obvious benefit to the Companies by avoiding the need to generate or purchase power when costs are high, this did not directly

[402] Id. at 8.

translate into a benefit to the retail, non-shopping customers.[403] At the same time, economic curtailments and buy-through purchases make the standard resource stack more complicated. The customers that would be offering to curtail under Rider 72 and receive a credit are retail customers of the Companies. Given that the Companies propose to use an appropriate resource stack (where retail customers get the lower priced resources),[404] the curtailment of Rider 72 customers would reduce the Companies' highest/marginal cost resources used to serve non-retail load.[405] As a result, under the proposed rider, the Companies' generation service to non-retail load customers will benefit—while there is no impact upon the costs to serve retail customers.[406]

Mr. Yankel recommended that any discounts associated with these customers be treated as non-retail costs in the Companies' Fuel Adjustment Clause Rider 80 as opposed to being collected as if any revenue shortfall should come from retail customers. He further recommended that because the credit that is developed under Rider 72 from these curtailments is ultimately for the benefit of the Companies' marginal costs and their non-retail load, the cost of these credits must be placed on the Companies and the non-retail load portion of the resource stack, not the retail customers.[407]

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[403] Id. at 10.

[404] Tr. V at 45-46 (Nelson).

[405] Tr. IX at 68-71 (Rousch).

[406] Id.

[407] Id. at 11.

3. The Commission should clarify the treatment of revenues, credits, and expenses in order to properly assign cost responsibility to the Companies' operations benefitting from curtailments, interruptions, and buy-through power.

Another situation similar to that of Rider 72 involves Interruptible Schedule IRP-D, where the Commission should clarify the treatment of revenues, credits and expenses in order to properly assign cost responsibility. Here, a customer can elect to be "interrupted" at the Companies' discretion. This flexibility is good for the Companies and benefits customers subjecting themselves to interruption. However, in the case where the Companies are serving both retail and non-retail customers, interruptions are not being made for retail customers taking the SSO. Rather, interruptions would be occurring when the Companies' marginal costs are highest. Given an appropriate resource stack, in which the lowest cost resources are dedicated to retail SSO customers, the interruption of these IRP-D customers would save/avoid only the highest/marginal system costs – the costs that should be assigned to the Companies' competitive side and not to SSO customers.[408]

OCC witness Yankel recommends that any discounts associated with these customers be treated as non-retail costs in the Companies' Fuel Adjustment Clause Rider 80, as opposed to being collected as if any revenue shortfall should come from retail customers. Mr. Yankel also recommends that if the resource stack is appropriate, these system costs, which would only be saving/avoiding the highest/marginal system costs, should be assigned to the Companies' competitive side and not to SSO customers. Since

[408] Id at 12.

Schedule IRP-D will operate for the benefit of non-retail load and not SSO customers, any perceived revenue shortfall should not be assigned or attributed to SSO customers. Further, the ESP needs to clearly state that SSO customers will not be charged for any perceived revenue shortfall, delta revenue, or economic development costs that may be attributed to IRP-D.[409]

In addition, under IRP-D, there is a provision for replacement of electricity that may be purchased by the customer during such a discretionary interruption event, if the customer desires. By their nature, these purchases are taking place at the margin, when prices are very high, and these costs are not being incurred to serve SSO customers. These costs should not be allocated to SSO customers, but rather, should be assigned to competitive side of the Companies' business. Again, the Companies' ESP does not describe how this is going to be handled. Therefore, buy-through power that is purchased on behalf of these customers should be treated as belonging to non-retail customers as well. Finally, the Companies' ESP needs to clearly state that SSO customers will NOT be charged for any purchases of power that are made specifically at the request of one of these individual, "buy-through" customers.[410]

U. The Statutory Test For Significantly Excessive Earnings Should Not Be Determined In This Proceeding. If It Is Determined, AEP Ohio's Testimony Should Be Rejected.

R.C. Chapter 4928 requires a determination, on an annual basis, of whether an electric distribution utility is earning significantly excessive earnings ("SEE").

> [T]he commission shall consider, **following the end of each annual period** of the plan, if any such adjustments resulted in

[409] Id. at 11-12.

[410] OCC Ex. 14 at 11-13.

> excessive earnings as measured by whether the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate. Consideration also shall be given to the capital requirements of future committed investments in this state. The burden of proof for demonstrating that significantly excessive earnings did not occur shall be on the electric distribution utility..., In making its determination of significantly excessive earnings under this division, the commission shall not consider, directly or indirectly, the revenue, expenses, or earnings of any affiliate or parent company.[411] (emphasis added).

A proper interpretation of this language leads to the conclusion that the first such review of the Companies' earnings from an ESP plan modified by the Commission would take place in 2010. Additionally, there is no requirement in the statute that the Commission determines how such a test will be conducted at the time an ESP is reviewed. Thus, OCEA recommends that the Commission not determine a methodology for the significantly excessive earnings test in this ESP case. Rather, the methodology should be determined in a workshop so that a uniform method emerges.

The Companies' proposal in this proceeding on the subject of the appropriate test prompted a lively debate among the witnesses and that debate demonstrates that Staff Witness Cahaan is correct that the Commission should wait to determine what the test will be and how it should be applied in future proceedings as the Commission ruled in the FirstEnergy ESP case.[412]

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[411] R. C. 4828.143(F).

[412] *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, Order at 64 (December 19, 2008).

1. OCEA's recommendation is to reject the Companies' test in the event the Commission does adopt a methodology for determining significantly excessive earnings in this ESP case

The Companies ask the PUCO to adopt a statistical standard deviation methodology to determine whether earnings are significantly excessive. The standard deviation test is a simple measure of variance and measures no other qualitative or quantitative data.[413]

Standard deviation is a measure of how data points vary from one another when the data points form an ideal bell curve (which they do not in Dr. Makhija's analysis). Standard deviation is measured by various confidence levels, i.e., how likely is it that a data point will not fall within the bell curve data. The higher the confidence level, the greater the number of data points that are captured, and the less likely any one data point will fall be outside the defined area. Dr. Makhija used a 95% confidence level.[414] Dr. Woolridge used an 85% confidence level.[415] As Dr. Makhija testified, this means it is much more difficult for the Companies to earn significantly excessive earnings when using Dr. Makhija's data than if Dr. Woolridge data were used:

> Q. And if you raise the confidence level, there's less likelihood that you will identify companies with significantly excess earnings?
>
> A. That is correct.[416]

As is evident from the description of this statistical test, it bears little, if any, resemblance to any language in the statute, except that standard deviation determines

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[413] Tr. XIII at 22 (Cahaan).

[414] AEP Ohio Ex. 5, Exhibits III – VII and X (Makhija).

[415] OCC Ex. 2 at 12, 13 (Woolridge).

[416] Tr. XIV at 42 (Makhija).

"significance," and "significantly" is used in SB 221 regarding when earnings are excessive. As Staff Witness Cahaan observed, Dr Makhija also determines when excessive earnings *are not significant*, as opposed to the requirements of the statute to establish when excessive earnings *are significant.*[417] These failures of applicability and measure should compel the Commission to reject Dr. Makhija's proposed test.

SB 221 requires that significantly excessive earnings be determined based upon how "publicly traded companies including utilities that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate."[418] Staff also agrees that this is not the time or the case for the Commission to decide how to satisfy this statutory test. Specifically, Mr. Cahaan testified:

> I propose some process (workshop or technical conference) outside of a formal hearing for all interested parties to explore the issue, hammer out their disagreements, and see if they can agree on a method to use in the "comparable group earnings" part of the 'significantly excess earnings' test.[419]

This reasonable approach would facilitate a consistent test for all Ohio utilities. Mr. Cahaan's recommendation in this regard should be adopted by the Commission.

Mr. Cahaan also supported the approach of OCC Witness Woolridge and OEG Witness King to use return on equity adders to frame a zone of reasonableness for the purpose of defining when earnings are SEE.[420] The Commission should adopt the equity adder approach proposed by witnesses Cahaan, Woolridge and King. In fact, Dr. Woolridge's recommendation regarding the equity adder as a measure of SEE is 150

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[417] Staff Ex. 10 at 16 (Cahaan).

[418] R. C. Chapter 4828.143(F).

[419] Staff Ex. 10 at 8 (Cahaan).

[420] Id.

basis points.[421] Mr. Cahaan's recommends a 200-400 basis points adder.[422] It is important to recognize the midpoints of these recommendations are identical. This is another demonstration that Dr. Woolridge's 150 basis point adder is reasonable and should be adopted.

Should the Commission decline to defer the measures of comparable companies and comparable risks adjusted for capital structure and adopt the equity adder, the Commission must not adopt Companies' witness Makhija's standard deviation measure for determining when the Companies have earned significantly excessive earnings. OCC witness Woolridge rejected using the statistical standard deviation method as the *only* measure of SEE. Staff witness *Cahaan rejected this method outright*:

> Q. In what respects do you disagree with this methodology?
>
> A. In three respects. First the level of "significance" to demonstrate "significantly excessive" is itself excessive. Second, and independent of the first criticism, the very test to determine "significance" has been constructed in a way counter to that required by S.B. 221. Third, I do not think that the statistical definition of 'significant' provides a useful or satisfactory interpretation of the legislative language.[423]

Staff Witness Cahaan expressed concern with Companies' witness Makhija's purely statistical approach: "I do not think that the concept of "significant" as used in statistics is really useful or relevant to making decisions regarding the word "significantly" in S.B. 221."[424] Mr. Cahaan also objected to the Companies' statistical methodology as shifting the burden of proof to determine SEE away from the company: "The methodology

[421] OCC Ex. 2 at 20, 22 (Woolridge).

[422] Staff Ex. 10 at 24.

[423] Id at 10; see also Id. at 22.

[424] Id at 18.

proposed by the EDUs would be equivalent to requiring the FDA to grant approval unless it could prove the drug was harmful.'"[425]

The Companies also asked the Commission to remove off-system sales ("OSS") from the calculation of SEE. As Dr. Woolridge testified[426] there is no basis for eliminating revenues that are not one-time write-offs or non-recurring. Removing OSS from the test reduces the revenues used in the test. Companies do not base the removal of OSS on any accounting principles. They do not base their request on any regulatory matching principles. The request is based upon reducing earnings making it less likely that the test would be failed. Companies' proposal should be rejected by the Commission.

Finally, R.C. 4928.143(F) regarding electric security plans places the burden of proof on the utility regarding the test for SEE and AEP Ohio fails to meet its burden on this issue. The test proposed by the Companies measures when earnings *are not* significantly excessive – not *when they are significantly excessive* – which the statute requires.[427]

The Companies' approach should be rejected for all the reasons offered by Dr. Woolridge and Staff Witness Cahaan as discussed above. Also, the Commission should defer the determination of the methodology for determining comparable company business and financial risks and adjustments to capital structure. This approach would provide stakeholders an opportunity to determine a methodology that can be applied across Ohio.

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[425] Id at 17.

[426] OCC Ex. 2 at 21 (Woolridge).

[427] Staff Ex. 10 at 16 (Cahaan).

VI. CONCLUSION

The Commission has many issues to decide in these cases—issues that will affect the Companies' 1.2 million residential customers for the next three years, and beyond. The Companies' have requested everything imaginable in their applications—from $500 million for a provider of last resort risk (which is very unlikely to materialize) to collecting money for depreciation reserve deficiencies that may or may not occur in the future for unknown plants. The applications reveal what the Companies are really seeking--to be relieved of risks, risks that historically have gone along with providing monopoly service as a part of the regulatory compact in this state. Moreover, these so-called risks have not been reasonably demonstrated so as to require the extravagant sums of customer' funds being requested.

The risks the Companies are seeking to shift to customers mean one thing—customers will pay increased rates. And the rate increases requested are significant. Fifteen percent per year, plus any additional increases to cover costs the Companies incur that exceed the fifteen percent. As many customers testified, a 15% increase per year in any commodity (wages, prices) is unacceptable in today's economy. Such an increase must be closely scrutinized in light of statutory mandates under the Ohio Revised Code.

Under R.C. 4928.02(A) it is the policy of the state to "ensure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and *reasonably priced retail electric service*." In today's economy that means saying "no" to many of the proposals in the Companies' application. "No" to long-term deferrals which will unnecessarily increase the ultimate costs to customers. "No" to $500 million in POLR "risk." "No" to automatic increases in generation rates that are not cost based. "No" to writing a blank check for gridSMART activities. "No" to $445 million in distribution improvements that the Companies' have failed to prove are necessary and not already being compensated for in rates. "No" to $330 million in carrying charges for past environmental investments. "No" to underwriting purchased power to serve Ormet and former Mon Power customers when cheaper alternatives are available.

Now is the time for the Commission to take a stand, and modify the ESP presented by the Companies. Modify it so that customers will be protected from unreasonable and unnecessary rate increases. Modify it in these tough economic times when customers on fixed incomes will be forced to choose between paying electric bills and food bills. Modify it to protect small businesses and schools who testified that they will be forced to make cuts and lay-offs to survive if this increase is granted in its full scope. Modify the ESP so that it is part of the solution and not part of the problem. Modify it so that the economy of Ohio can begin to mend. The PUCO should send the message back to the Companies that they must look inward to see what they can do to tighten their belt and keep costs in control—for the record in this proceeding is absolutely devoid of any evidence in that regard.

These are the comments and concerns voiced by so many of the Companies' customers from all parts of the state--Lima, Marietta, Canton, and Columbus. These customers who took the time to attend public hearings, submit letters, and send e-mails to voice their opposition to the application before the Commission. These voices can not be silenced, nor should they be. They should not only be heard, but they should be listened to. And the resounding message from the Companies' customers, and OCEA is "just say no" to the unreasonable proposals of AEP. The PUCO should instead say yes to implementing S.B. 221 in the manner that it was intended--and that OCEA has proposed—with reasonable electric rates for Ohioans.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing the OCEA's Post-Hearing Brief Addressing the Columbus Southern Power Company and Ohio Power Company Electric Security Plans was served electronically to the persons listed below, on this 30th day of December 2008.

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