91

FILE

RECEIVED-DOCKETING DIV

2009 JAN 14 PM 5:14

PUCO

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

REPLY BRIEF ADDRESSING COLUMBUS SOUTHERN POWER COMPANY AND OHIO POWER COMPANY ELECTRIC SECURITY PLANS BY THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

JANINE L. MIGDEN-OSTRANDER
CONSUMERS' COUNSEL

Maureen R. Grady, Counsel of Record
Terry L. Etter
Jacqueline Lake Roberts
Michael E. Idzkowski
Richard C. Reese
Assistant Consumers' Counsel

Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485
Telephone: (614) 466-8574
grady@occ.state.oh.us
etter@occ.state.oh.us
roberts@occ.state.oh.us
idzkowsi@occ.state.oh.us
reese@occ.state.oh.us

January 14, 2009

TABLE OF CONTENTS

PAGE

TABLE OF CONTENTS cont'd.

PAGE

TABLE OF CONTENTS cont'd.

PAGE

TABLE OF CONTENTS cont'd.

PAGE

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

REPLY BRIEF ADDRESSING COLUMBUS SOUTHERN POWER COMPANY AND OHIO POWER COMPANY ELECTRIC SECURITY PLANS BY THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

I. INTRODUCTION

On December 30, 2008, the Ohio Power Company ("OP") and Columbus Southern Power ("CSP") ("Companies" or "AEP Ohio") filed their briefs to convince the PUCO to increase rates to customers by approximately $3.1 billion over the next three years. The Office of the Ohio Consumers' Counsel ("OCC") and the Sierra Club, Ohio Chapter ("the Ohio Consumer and Environmental Advocates" or "OCEA") filed a joint brief to protect the Companies' 1.2 million residential consumers from the unprecedented rate increases requested, urging the Commission to say no to the unreasonable proposals of the Companies. These proposals seek to shift all regulatory risks to customers and extract from customers incredible amounts of money, made all the worse in these times of significant economic difficulties for Ohioans. OCEA instead urged the Commission to implement S.B. 221 in a manner that was intended, and as proposed in OCC's testimony--with reasonable electric rates for Ohioans.

OCC files this Reply Brief to respond to arguments made by the Companies and others in their initial briefs. As discussed in detail, OCC continues to maintain that the Commission should modify the Companies' ESP plans in order to assure that the policies of the state, as established by the General Assembly in R.C. 4928.02 and amended by S.B. 221, are met. Given the economic challenges facing Ohioans, as testified to in the numerous local public hearings, first and foremost consideration should be given to the policy which establishes "the availability to consumers of adequate, reliable, safe, efficient, non-discriminatory, and reasonably priced retail electric service." It is with this policy in mind, that OCC presents its arguments.

II. THE COMPANIES' OVERVIEW OF S.B.221 IS AS ERRONEOUS AS IT IS ILLOGICAL AND CONFLICTS WITH THE RECENT PRONOUNCEMENTS OF THE COMMISSION IN THE FIRST ENERGY MRO AND ESP CASES.

In an attempt to frame the Commission's review of their ESP Application in a light most favorable to them, the Companies present within their brief an overview of the applicable law.[1] This overview, however, should not be heeded as it incorrectly construes the legislation to an unsupportable and illogical end.

The Companies begin their argument by acknowledging that although S.B. 221 is a complex piece of legislation, it is written in plain language.[2] Nonetheless, despite the

[1] See Companies' Brief at 12-18.

[2] Id. at 12.

plain language, according to the Companies, two aspects of the ESP have caused "considerable discussion"—the contents of the ESP and the basis for approving, modifying and approving, or disapproving the application.[3]

The Companies conclude that the contents of the ESP are controlled by R.C. 4928.143(B), which provides what may be required as well as what may be included in the ESP.[4] The language in subdivision (B)(2) that an ESP plan can include "without limitation" is championed by the Companies as permitting limitless adjustments to the ESP—in the Companies' perspective perhaps only limited by their imagination. Indeed the Companies have taken great liberties with respect to this phrase, bringing costs into the ESP which impose significant burdens upon the Companies' customers. For instance, the Companies have construed this language to permit recovery of $330 million of carrying charges on 2001-2008 investment. The Companies propose as well to collect from all customers $1.32 billion in increased rates attributed to purchased power to serve Ormet and former Monongahela Power ("Mon Power") customers-- despite the fact that purchased power is not needed and can be supplied internally or through the AEP system power pool, all at much cheaper prices to customers. And yet, the "without limitation" language is disregarded by the Companies when it comes to crediting customers for some portion of the $791 million of AEP Ohio's off-system sales profits—profits derived from the very generation units customers have funded since they were placed in service and included in rates.

---

[3] Id. at 13.

[4] Id. at 14.

According to the Companies the basis for approving the ESP is found in the language of R.C. 4928.143(C)(1).[5] That basis is singular in the Companies' myopic approach and rests squarely upon the oft-quoted phrase of "more favorable in the aggregate," which includes "pricing and other terms and conditions."

The Companies claim that there is no generally applicable cost of service standard, least cost standard, or just and reasonable standard set out in S.B. 221.[6] Intervenors, who rely on the state policy contained in R.C. 4928.02(A) of ensuring "reasonably priced retail electric service" are, according to the Companies, mistaken in their reliance because R.C. 4928.02 was a S.B. 3 standard applicable to a market-based pricing regime.[7] "[T]here is no general 'public interest' standard for approving an ESP," the Companies boldly boast.[8] Rather, the public interest is served simply if the ESP is more favorable in the aggregate than the expected results of an MRO. Under the Companies' view, once the Commission determines that the ESP meets the more favorable in the aggregate standard, it has no choice but to approve the ESP.

While the Companies' arguments began by stressing the plain language of S.B. 221, the Companies nonetheless gloss over the plain language provisions of R.C. 4928.02, which list 14 objectives for Ohio's electric policy—objectives that have remained largely in place since 1999. AEP Ohio would have the Commission ignore these explicit statutory policies in favor of the nebulous "more favorable in the

[5] Id.

[6] Companies' Brief at 15.

[7] Id.

[8] Id.

aggregate" standard. The Companies' argument, is however, not logical, nor is it consistent with Commission precedent in determining the reasonableness of retail electric rates.

Although, as AEP Ohio pointed out,[9] the Legislative Service Commission recognized that S.B. 221 "provides a different pricing context for implementing the objective's concept of 'reasonably priced retail electric service,'"[10] it is illogical for the Commission to ignore the reasonableness of an EDU's retail price. In order to determine whether an ESP's "pricing and other terms and conditions, including any deferrals and any future recovery of deferrals, are more favorable in the aggregate as compared to the expected results that would otherwise apply under an MRO," the Commission must individually examine each part of the ESP, in light of the policy objectives of R.C. 4928.02.

The Commission's recent pronouncements in the *FirstEnergy MRO* and *FirstEnergy ESP* cases[11] embrace this approach. In November 2008, the Commission, in analyzing FirstEnergy's application for a standard service offer through a MRO, emphasized the need to examine FirstEnergy's application in light of R.C. 4928.02:

> Chapter 4928 of the Revised Code provides a roadmap of regulation in which specific provisions were put forth to advance state policies of ensuring access to adequate, reliable, and reasonably priced electric service in the context of significant

[9] Id.

[10] S.B. 221 Bill Analysis at 11.

[11] *In the Matter of the Application of Ohio Edison company, the Cleveland Electric Illuminating Company, and the Toledo Edison Company for Approval of a Market Rate Offer to Conduct a Competitive Bidding Process for Standard Service Offer Electric Generation Supply, Accounting Modifications Associated with Reconciliation Mechanism, and Tariffs for Generation Service*, Case No. 08-936-EL-SSO, Opinion and Order (Nov. 25, 2008) ("*FirstEnergy MRO Order*"); *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-SS), Opinion and Order (Dec. 19, 2008) ("*FirstEnergy ESP Order*").

> economic and environmental challenges. In reviewing the Companies' application for an MRO, the commission is aware of the challenges facing Ohioans and the electric power industry and will be guided by the policies of the state as established by the General Assembly in Section 4928.02, Revised Code, as amended by Amended Substitute Senate bill No. 221 (SB 221), effective July 31, 2008.
>
> ...
>
> In determining whether an MRO meets the requirements of Section 4828.142(A) and (B), Revised Code the Commission must read those provisions together with the policies of this state as set forth in Section 4928.02, Revised Code. Accordingly, the policy provisions of Section 4928.02, Revised Code, will guide the Commission in its implementation of the statutory requirements of Section 4928.142(A) and (B), Revised Code.[12]

Moreover, despite FirstEnergy's argument that R.C. 4928.02 is merely a redundant standard once the requirements of "more favorable in the aggregate" standard has been met, the Commission determined otherwise: "The Commission notes that Section 4928.06, Revised Code, makes the policy specified in Section 4928.02, Revised Code, more than a statement of general policy objectives. Section 4928.06(A), Revised Code, imposes on the Commission a specific duty to 'ensure the policy specified in section 4928.02 of the Revised Code is effectuated.'"[13]

The Commission dismissed as well FirstEnergy's arguments that R.C. 4928.02 does not impose any obligations or duties upon utilities.[14] In doing so the Commission relied upon the Ohio Supreme Court holding in *Elyria Foundry v. Pub. Util. Comm.*,[15]

---

[12] *In the Matter of the Application of Ohio Edison company, the Cleveland Electric Illuminating Company, and the Toledo Edison Company for Approval of a Market Rate Offer to Conduct a Competitive Bidding Process for Standard Service Offer Electric Generation Supply, Accounting Modifications Associated with Reconciliation Mechanism, and Tariffs for Generation Service*, Case No. 08-936-EL-SSO, Opinion and Order at 5 (Nov. 25, 2008).

[13] Id. at 13

[14] Id.

[15] See (2007), 114 Ohio St. 3d 305.

where the Court held that the Commission may not approve a rate plan that violates the policy provisions of R.C. 4928.02. Accordingly, the Commission opined that an electric utility should be deemed to have met the "more favorable in the aggregate" standard "only to the extent that the electric utility's proposed MRO is consistent with the policies set forth in section 4928.02, Revised Code."[16]

Less than a month later, the Commission cemented its interpretation that each piece of the SSO must be examined in light of the policy objectives of R.C. 4928.02, but this time addressed FirstEnergy's ESP, not its MRO application. "Chapter 4928 of the Revised Code provides an integrated system of regulation in which specific provisions were designed to advance state policies of ensuring access to adequate, reliable, and reasonably priced electric service in the context of significant economic and environmental challenges."[17] Rather than ignoring the state policies enumerated in R.C. 4928.02, as AEP Ohio suggested in its brief, in the *FirstEnergy ESP* case the Commission embraced the policies in order to give meaning to R.C. 4928.143:

> The Commission believes that the state policy codified by the General Assembly in Chapter 4928, Revised Code, sets forth important objectives which the Commission must keep in mind when considering all cases filed pursuant to that chapter of the code. Therefore, in determining whether the ESP meets the requirements of Section 4928.143, Revised Code, the Commission takes into consideration the policy provisions of Section 4928.02, Revised Code, and we use these policies as a guide in our implementation of Section 4928.143, Revised Code.[18]

Notably, FirstEnergy had submitted arguments not unlike those proposed here by AEP Ohio. Like AEP Ohio, FirstEnergy asserted that R.C. 4928.02 does not impose

---

[16]*First Energy MRO* Opinion and Order at 14.

[17]*First Energy ESP* Order at 8.

[18]Id. at 12.

requirements on an ESP and the ESP should not be rejected or modified if it fails to satisfy the policies of the state.[19] According to FirstEnergy the "more favorable in the aggregate" test of R.C. 4928.143 fails to refer to the state policies of R.C. 4928.02 and the Commission cannot expand the criteria of R.C. 4928.143 to include R.C. 4928.02.[20]

Nonetheless, the Commission appropriately dismissed FirstEnergy's arguments as it should dismiss the Companies' arguments here. Indeed the Commission remained true to its words as can be seen throughout the *FirstEnergy ESP order*. For instance, in recognition of the need to ensure reasonably priced service (under R.C. 4928.02(A)), the Commission reduced the base generation rates of FirstEnergy--"mindful of the significant economic difficulties facing residents in Ohio at this time."[21] The Commission also eliminated other provisions in FirstEnergy's ESP plan that significantly increased costs to customers--the deferred generation cost rider was eliminated, saving customers approximately $500 million in carrying costs. There the Commission concluded that this savings will help promote the competitiveness of Ohio in the global economy, a state policy enumerated in R.C. 4928.02(N).[22] In evaluating the distribution service improvement rider, although the Commission noted that the rider was permissible under R.C. 4929.143(B)(2)(h), it nonetheless found that the "sound policy goals" of R.C. 4928.02 required the rider to be limited to "prudently incurred costs."[23] Since FirstEnergy's rider was not cost based, the Commission found it should not be approved

[19]Id. at 12.

[20]Id.

[21]Id. at 17.

[22]Id. at 25.

[23]Id. at 41.

unless it is shown "to comply with both the intent and scope of the statute (R.C. 4928.02)." With respect to First Energy's capital improvement program for its distribution system, the Commission ordered FirstEnergy to work to develop a program that "advances state policy."[24]

In order to ensure that the rates paid by AEP Ohio customers are reasonable, the Commission should reject AEP Ohio's convoluted reading of S.B. 221 in favor of a broader well reasoned approach that considers each aspect of the ESP in light of whether it furthers the policy objectives of R.C. 4928.02, including ensuring "reasonably priced electric retail service." This is the approach urged by OCC and the other intervenors for implementing S.B. 221 in the fair way intended for customers. Notably it is the approach followed by this Commission in the recent *FirstEnergy ESP* and *MRO* cases to protect customers in northern Ohio, just as the customers of AEP Ohio now need protection.

III. THE FUEL ADJUSTMENT CLAUSE

Under R.C. 4928.143(B)(2)(a), the Companies are permitted, in the context of an electric security plan ("ESP"), to enact a fuel clause to automatically recover costs of fuel used to generate electricity. The Companies propose to re-establish a fuel clause[25] by creating a baseline that purports to represent fuel costs currently being collected in rates. The baseline for the fuel clause sets the amount of fuel costs to be collected from customers for the next three years. The baseline also establishes other portions of rates to be charged to customers, including the non- FAC ("fuel adjustment clause") portion of the standard service offer.

[24] Id at 41-42.

[25] With the passage of S.B. 3, fuel clauses were repealed. There has been no fuel clause in existence for AEP Ohio since 1999.

OCC proposed to set the baseline for the FAC based on actual 2008 costs with rate adjustments that exclude market rate purchased power, offset increases by off-system sales profits, and include capacity equalization revenues received by OP.[26] OCEA's approach is consistent with and remains true to fuel clause methodology used historically in the PUCO's regulation of electric companies. Moreover, it is verifiable and relies on cost-based principles.

The Companies however, claim that the frozen 1999 rates and 1999 data for the other FAC components, coupled with adjustments that Mr. Nelson made, properly identify the current baseline FAC rates for fuel, purchased power and environmental expenses within the Companies' most recent standard service offer ("SSO").[27] The Companies argue that starting with the actual rates at the time of unbundling and "conservatively" reflecting the impact of subsequent actual changes is a "straight-forward and accurate method for identifying the existing FAC rates within the Companies' current SSO."[28]

The Companies attack OCC's baseline FAC on the basis that it will lead to "arbitrary" results.[29] According to the Companies, using fuel *costs*, rather than fuel *rates*, results in the non-FAC portion of the generation rates "floating" with whatever assumption is made regarding FAC costs.[30] The Companies argue that using FAC costs

[26] OCEA Initial Brief at 47-69.

[27] Companies' Brief at 22.

[28] Id. at 23.

[29] Id., citing Companies' Ex. 7B at 2-5 (Nelson).

[30] The "floating" argument can be dismissed summarily. It is incorrect. There will be data on all actual FAC 2008 costs by the conclusion of this proceeding. Nothing is left to "float."

as proposed by OCC Witness Smith is "subjective and arbitrary."[31] Moreover, the Companies believe that using fuel costs for 2008 would be inappropriate because 2008 is such a volatile period, and that if 2008 were used, there would be "protracted disputes about out of period adjustments that impact the 2008 data."

The Companies also introduce a new concept for how the FAC rider will work. "Should projected FAC expense in a given period during 2009-2011 be less than these maximum phase-in rates, the Commission would have the option of increasing the FAC rates to the maximum levels in order to reduce any existing deferred FAC expense balance."[32]

Additionally, the Companies claim they are "not proposing to collect carrying charges in the event of an under-recovery in one quarterly period until there is reconciliation in the subsequent period."[33] Similarly, the Companies note there are no carrying charges on the "over-recovery" of costs.

---

[31]Id. The Companies similarly characterize as "subjective" and "arbitrary" the Staff's approach to calculating a baseline, though do not believe it to be as erroneous as OCC's approach, with its "practical infeasibility." Companies' Brief at 24.

[32]Companies' Brief at 25.

[33]Id. at 27.

A. A Baseline FAC Founded Upon The Most Recent Actual Costs And Consumption Is Most Appropriate To Implement.

1. Using the latest known actual fuel cost is neither arbitrary or subjective, but rather brings transparency into the process by replacing the judgment of the Companies' with verifiable data. Moreover, using actual costs comports with the traditional way in which the EFC historically functioned and is consistent with S.B. 221 standards.

Under the approach used by OCC, the latest known actual fuel costs for 2008 would establish the baseline FAC. Because the Companies have not presented information on actual 2008 costs, and have failed to estimate the actual costs for 2008, they should be ordered to produce this data to enable the Commission to develop this appropriate baseline.

The actual fuel costs of the Companies' are verifiable and known (though not provided by the Companies). There is little, if any, judgment involved in using actual fuel costs. The costs are what the costs are. In using actual costs for the baseline, there is transparency introduced into this process, a transparency that enables customers and others to understand the basis of the costs being flowed though on their bills. Use of actual costs in the baseline FAC is much less subjective and arbitrary than the Companies' approach which relies on judgment and interpretation on many levels. For instance, the Companies' approach requires the Commission to accept that the fuel costs increased during 2005 through 2007 at exactly the rates that were escalated under the

RSP case.[34] However, the escalation of the rates in the RSP cases was not based on any cost or cost assumptions but rather on the Companies' judgment.[35]

Moreover, use of actual fuel costs and usage to establish the baseline for the fuel clause is consistent with how the Electric Fuel Component ("EFC") rate functioned in the pre-S.B. 3 era. Only actual acquisition and delivery costs of fuel consumed and used to generate electricity were permitted to be recovered in the EFC.[36] It is curious that although the Companies now want to re-implement the fuel clause, they choose to ignore the key element of the fuel clause in establishing the baseline – that being that only actual costs are permitted to be recovered.

Finally, the use of actual usage and costs as a baseline as recommended by OCC Witness Smith is consistent with the standards of S.B. 221. Under S.B. 221, a fuel clause may be part of an ESP and may be used to recover the costs of fuel used to generate the electricity supplied under the SSO, along with other costs (purchased power supplied under the SSO), purchased power acquired from an affiliate, the cost of emission allowances, and federally mandated carbon or energy taxes.[37] S.B. 221 requires, however, that these costs be "prudently incurred."[38] The language must be read to allow recovery of only actual costs, not costs established by fabricating a baseline that has little relation to the actual costs of fuel.

---

[34]*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).

[35]Id., citing Mr. Baker's testimony, AEP Ex. 2 at 12.

[36]Chapter 4901:1-11 established the enabling rules for the EFC. Specifically, Rule 4901:1-11-1(O) defined fuel costs as "actual acquisition and delivery costs of fuel consumed, including the amortized costs of nuclear fuel expended, to generate electricity..."

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

[38]Id.

As recommended by OCC Witness Smith the baseline should be actual 2008 fuel costs. Use of such costs is consistent with Commission precedent that the EFC rates should be based upon actual data to the extent that it is possible to obtain such data.[39] It is here. The Commission should modify the baseline FAC consistent with OCEA's recommendations.

2. The Companies' arguments that suggest the need to engage in prolonged disputes over adjustments to actual data are misguided.

Although the Companies argue that use of actual data to establish a baseline FAC will result in disputes over adjustments to the actual data, such arguments are misguided. As discussed earlier, actual customer usage and costs will be known through at least November 2008 and may be known for the entire 2008 year by the conclusion of this case. Moreover, while arguments over the appropriateness of actual data can occur when setting rates through a traditional base rate case with a test period concept, they are out-of-place when rates are instead set through a fuel clause adjustment.

Under a traditional rate case, the goal of expenditure allowances *is* to establish a reasonable annual allowance for normal and necessary utility functions.[40] The purpose is not to guarantee dollar-for-dollar recovery of specific actual expenses.[41] Thus to the extent that test period data is not representative of normal test period obligations,

---

[39]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 28, 1983); 1983 Ohio PUC Lexis 57.

[40]*In the Matter of the Dayton Power and Light Company for Authority to Modify and Increase its Rates for Electric Service to all Jurisdictional Customers*, Case No. 81-21-EL-AIR, Opinion and Order at 63 (Feb. 3, 1982); 1982 Ohio PUC LEXIS 8.

[41]Id.

arguments can be made that could lead to prolonged disputes over adjustments to the data used to set base rates.

A fuel clause, on the other hand, is premised on an entirely different ratemaking theory – that of a dollar-for-dollar recovery of actual expenditures. It is not a purpose of a fuel clause to establish representative rates or rates that prove to be a reasonable annual allowance for fuel expenditures. Hence, "out of period adjustments that impact the 2008 data" should not even be considered in the implementation of the fuel clause. The fuel clause is established to collect actual fuel costs, nothing more, nothing less, provided such costs have been prudently incurred. To suggest that protracted arguments will ensue under OCC's approach interjects an element of uncertainty into the process, when no such uncertainty exists. The Companies' arguments therefore should be disregarded in this respect.

In determining the baseline FAC, OCC urges the Commission to adopt the actual 2008 fuel costs. This is an especially important issue because the FAC portion, once set, determines the non-base portion of the FAC that customers will pay. As Ms. Smith testified, if the Companies' artificially created FAC is too low, the base portion of the generation rates will be too high, and customers will pay more for the standard offer service than is reasonable.[42] Thus, the Companies' proposal to understate the baseline FAC would permit the Companies to seek more of a rate increase from customers through the base non-FAC portion, which would then be escalated under the Companies' proposed ESP.

[42] OCC Ex. 10 at 13.

B. The Commission Should Not Adjust The FAC To Permit A 15% Increase Per Year, Regardless Of The Projected Costs Of The FAC.

For the very first time in this proceeding, the Companies have introduced on brief the concept that the Companies should be able to impose a FAC of 15% regardless of whether the projections support a FAC of less than 15%. It would appear that this new proposal is aimed at reducing any regulatory deferrals that may have been created under the 15% cap approach. Under such a proposal the Company would then be able to use the FAC revenues in excess of projected costs to offset carrying costs of any deferrals accrued to date. Indeed, it would appear from the pro forma projections of the Companies, at least with respect to CSP, there is an assumption that the 15% FAC increase in 2010 and 2011 may not be needed to cover fuel expenses under the FAC.[43] Hence, the Companies' new proposal here is likely to cause CSP customers to be charged 15% for two years in which the actual fuel costs do not equate to a need to increase the FAC by 15%.

While the Companies' argument might have some merit if it was shown to produce lower rates for the Companies' customers, the argument must be considered in light of what is permissible under S.B. 221 and other applicable sections of the Revised Code. The fuel clause language of S.B. 221 permits the establishment of a fuel clause to automatically recover costs of fuel used to generate electricity supplied under the ESP. This language can be read to preclude using the revenues collected for the costs of fuel for other purposes such as drawing down deferrals.

[43] See OCC Ex. 6, Attachment 1 page 1 of 12.

Indeed, deferrals and phase-ins are discussed in numerous separate sections of S.B. 221 – sections which are unrelated to Section 4928.143(B)(2)(a)--the automatic fuel clause portion of S.B. 221. Specifically, deferrals and phase-ins are addressed in R.C. 4928.143(B)(2)(d) and 4928.144. These provisions are outside the automatic adjustment provisions of S.B. 221. Thus, it is reasonable to conclude that had the Legislature intended deferrals to be automatically recovered it would have said so in R.C. 4828.143(B)(2)(a). But it did not. And the Commission, as a creature of statute[44], may not legislate to achieve the result requested by the Companies. Moreover, the mere fact that deferrals are specifically addressed in other sections of S.B. 221 speaks to the fact that the Legislature was aware of the need for deferrals and phase-ins, specifically providing for such deferrals to be addressed outside of the automatic fuel clause mechanism.

The Commission should not adjust the FAC automatically to collect 15% per year from the Companies' customers, irregardless of the projected or actual costs of fuel. Doing so is contrary to S.B. 221 and inconsistent with notion that the fuel clause should only collect the actual costs of fuel used to generate electricity.

C. Carrying Costs Should Be Implemented For Over-Collection And Under-Collection Of The FAC On A Year To Year Basis.

OCC Witness Medine stressed the importance of symmetry in the over- and under-recovery of fuel costs in the Companies' ESP.[45] While it appears that the Companies are proposing symmetrical treatment for over- and under-recovery of fuel

[44]See for example *Dayton Communications Corp. v. Pub. Util. Comm.*, 64 Ohio St. 2d 302, 307 (1980).
[45]Tr. VI at 209-211.

costs, their proposal to not include carrying charges on either over- or under-recoveries is still objectionable. OCC Witness Medine testified that establishing carrying charges for both under- and over-recoveries makes sense in order to incent the Companies to be accurate in their fuel clause expense projections.[46] By waiving payments, such an incentive is lost.[47] OCC supports the recommendations of Witness Medine on this issue and urges the Commission to modify the ESP to provide for carrying charges on the over- and under-collection of fuel costs under the FAC.

D. Permitting The Companies To Go To Market To Meet The Needs Of Ormet And Former Monongahela Power ("Mon Power") Customers, Thereby Creating A "Market Delta" To Be Recovered In The FAC, Is Not Prudent, Nor Is It Just And Reasonable. Such Market Purchases Instead Will Adversely Impact The Companies' Customers And Thus Should Be Excluded From The Allowable Purchased Power Expenses.

The Companies propose that all customers pay for power purchased to serve the needs of Ormet (a manufacturer in OP territory) and former Mon Power customers. The Companies have included market-priced purchased power, in increasing increments (5%, 10%, and 15%), to be recovered from customers through the FAC for the ESP period. OCEA and other intervenors oppose this provision of the FAC for a number of reasons. First, the Companies do not need to make these purchases to meet the load associated with Ormet and former Mon Power customers.[48] Second, the cost of purchased power that the Companies intend to recover from customers is not least-cost. In fact it is

---

[46]Id.

[47]Id.

[48]See OEG Ex. 3 at 3; OCEA Brief at 54.

unreasonable especially since it significantly exceeds the cost the Companies would pay to purchase power from the AEP system pool.[49]

The Companies argue that including market-priced purchased power for the Ormet and former Mon Power customers in the FAC is an appropriate way to collect 100% of these costs from all customers.[50] The Companies are quick to point out that the purchased power is not proposed as a component of the FAC. Instead it is based on the phrase of R.C. 4928.143(B)(2) that permits an electric security plan to "provide for or include without limitation...."[51]

The Industrial Energy Users Group ("IEU") and others oppose the collection of these purchased power expenses through the FAC.[52] Instead, IEU recommends that if a delta revenue is created, it should be allocated to customers under the economic development rider.[53]

The purchased power, according to the Companies, represents an "appropriate continuation" of the Ormet and Mon Power loads and reflects a "continuing transition to market-based rates."[54] The Companies note that the Commission previously authorized rate mechanisms under which the Companies were able to recover market-based generation prices for serving these loads, and believe that at least for the ESP period, they should be able to continue to recover market-based generation prices for serving these

---

[49]OEG Ex. 3 at 10.

[50]Companies' Brief at 37.

[51]Id.

[52]See IEU Brief at 9-13; Commercial Group Exhibit 1 at 4.

[53]IEU Brief at 34-37.

[54]Companies' Brief at 37-38.

loads.[55] The Companies claim that it was their "expectation" when they agreed to supply service to these loads, they would be able to continue to recover market-priced power *after 2008* for such loads, citing Mr. Baker's testimony in this regard.[56] The Companies also claim--in response to the Staff proposal to limit purchases to approximately 7.5 % of the load--that the purchased power will help the Companies promote economic development.[57] The Companies conclude that the purchased power is reasonable, when evaluated on a stand-alone basis in light of the history of the Ormet and Mon Power cases.[58]

1. The appropriate standard for judging the Companies' proposal is not on a stand-alone basis, in light of the history of the transactions. Rather, as part of the FAC permitted under S.B. 221, the Companies must show that the purchased power is "prudently incurred." They have failed to do so.

Under S.B. 221, the Companies are permitted in the context of an ESP to establish a fuel clause to automatically recover a number of costs, including purchased power.[59] In order for purchased power expenses to be automatically recovered from customers under R.C. 4928.143(B)(2)(a), the Companies must show that the costs have been "prudently incurred." S.B. 221 is quite clear in this regard.

The Companies however argue that purchased power expenses do not fall under subsection (B)(2)(a) but rather are captured by the catch-all phrase preceding that section which states "The plan may provide for or include, without limitation, any of the

[55]Id.

[56]Companies' Ex. 2E at 6.

[57]Companies' Brief at 39.

[58]Id. at 41.

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

following."[60] It would appear that the Companies make this argument to evade the "prudently incurred" standard that clearly applies to purchased power expense in R.C. 4928.143(B)(2)(a). Their argument suggests that there is no standard under S.B. 221 that applies to purchased power.

The Companies' theory, however, of general statutory language applying and controlling specific statutory language, is contrary to Ohio rules of legislative construction. Under R.C. 1.51, if a general provision conflicts with a special or local provision, it is to be construed to give effect to both. And if the conflict is irreconcilable, the special provision is to prevail.[61] Applying these rules leads one to conclude that the general provision, with no standard of review, should be read to incorporate the prudent standard of the specific provision, thereby reconciling the two provisions. Thus, even if one were to concur with the Companies' view that the general provision is the one that addresses purchased power expenses, Ohio provisions of statutory construction would nonetheless require a prudence standard to be applied in order to reconcile the general provision with the specific provision.

Proving the prudence of this purchased power falls upon the Companies, who bear the burden of proof in this proceeding, as provided for under R.C. 4928.143(C)(1). According to the Companies, the Ormet purchases should be judged under the following standard: purchased power expenses may be passed along in the fuel clause so long as the purchases are reasonable on a stand-alone basis given the history of the purchased power transactions. The Companies conclude that the purchases are "reasonable"

[60]See R.C. 4928.143(B)(2).

[61]Id.

because they are consistent with their expectations of what the Commission would give them in return for taking on the "burden" of Ormet.[62]

In this regard, it would appear that the Companies' held the expectation that at the time the special arrangement was approved and a market delta created,[63] the Commission would continue to allow them to reap the benefits of going to market beyond 2008.[64] Staff Witness Hess testified that there was no secret deal or arrangement between the Commission and the Companies other than what was contained in the Opinion and Order.[65] Notably that Opinion and Order permitted the market delta through the end of 2008 only.

The Companies have fallen far short here of demonstrating that the market purchased power to serve Ormet is reasonable or prudent. The intervenors have come forward producing the following evidence to rebut the Companies' arguments. The evidence is that (1) purchased power is not needed to serve Ormet or former Mon Power customers[66] and (2) the effect of going to the market for such purchased power will be to

---

[62] In reality all the burden of these special arrangements has been borne by the Companies' customers since the arrangement was approved, with customers picking up 100% of the costs, costs which are very significant. For example, during the first two years of the special arrangements, market delta revenues amounted to $43 million (2007) and $48 million (2008). *See In the Matter of the Application of Columbus Southern Company and Ohio Power Company to set the 2007 Generation Market Price for Ormet's Hannibal facilities,* Case No. 06-1504-EL-UNC, Application Attachment 1 (Dec. 26, 2006); *In the matter of the Application of Columbus Southern Power Company's and Ohio Power Company's to set the 2008 Generation Market Price for Ormet Hannibal Facilities*, Case No. 07-1317-EL-UNC, Application Attachment 1 (Dec. 27, 2008).

[63] See *In the Matter of the Petition of Ormet Primary Aluminum Corporation and Ormet Aluminum Mill Products to Transfer Rights to Furnish Electric Service and/or Reallocate Certified Electric Service Territories and a Complaint against South Central Power Company and Ohio Power Company for alleged Unjust, Unreasonable, and Discriminatory Proposed Rates,* Case No. 05-1057-EL-CSS Supplemental Opinion and Order (Nov. 8, 2006).

[64] See Tr. XIV at 142-147 (C.Baker).

[65] Tr. XIII at 92-93.

[66]OEG Ex. 3 at 9.

substantially increase the costs of purchased power for all customers.[67] The Companies have failed to address the Intervenors' arguments other than to say in so many words that the Commission owes them for taking back Ormet and Mon Power customers and the use of the market pricing is how the Companies get paid back.

The Companies' theory, while interesting, is not borne out by the Opinion and Order approving the Ormet special arrangement. The Opinion and Order permitted market pricing through 2008—it did not address what happens in 2009, 2010, and 2011. Thus, it is up to the Companies to establish the reasonableness and prudence of market power purchases in 2009-2011 to serve Ormet. They have failed to do so here. The Commission should modify the ESP to exclude market purchased power expenses[68] from the FAC.

2. Since the Ormet purchase is an economic development arrangement, the Companies also bear the burden of showing that the purchases are non-discriminatory and will not adversely affect other customers' rates and services. The Companies have failed to sustain the burden of proof in this respect as well.

The Ormet arrangement falls under the special arrangements provisions of the Revised Code[69], and while special arrangements are permissible under certain

[67]OEG Ex. 3 at 10-12.

[68]This past summer, the Commission held that a delta from a special arrangement contract, based on market price, should not be based on the full market price, but should be based on 60% of the market price *In the Matter of the Application for Approval of a Contract for Electric Service Between Columbus Southern Power Company and Solsil, Inc.*, Case No. 08-883-EL-AEC Finding and Order at 4 (Jul. 31, 2008). Thus, even if the Commission determines that it is appropriate to create a market delta, it may shield customers from inordinate increases by only permitting a delta at a portion of market price, as they did in Case No. 08-883-EL-AEC.

[69] R.C. 4905.31.

circumstances, such arrangements must meet Commission criteria[70] and cannot run afoul of other provisions of the Revised Code. The Companies however, have not demonstrated that the Ormet special arrangement passes this test. In fact, it does not and thus cannot be approved as part of the ESP.

The Companies propose to continue to discount rates in favor of one select customer, Ormet. The Companies seek to discriminate against the rest of the Companies' customer base, and intend to increase purchased power expenses to all customers to recover the costs of the discounted Ormet rates—through market power purchases.

The Companies' proposal is discriminatory, and should be rejected. This aspect of the ESP violates R.C. 4905.33, R.C. 4928.02(A), and R.C. 4905.35 by providing reduced charges to a select customer--Ormet. R.C. 4905.33(A) prohibits the offering of special rates for like service under substantially the same conditions:

> No public utility shall *directly or indirectly*, or by any special rate, rebate, drawback, or other device or method, *charge, demand, collect, or receive from any person, firm, or corporation n a greater or lesser compensation for any services rendered, or to be rendered*, except as provided in Chapters 4901., 4903., 4905., 4907., 4909., 4921., and 4923. of the Revised Code, than it charges, demands, collects, or receives from any other person, firm, or corporation *for doing a like and contemporaneous service under substantially the same circumstances and conditions.*[71]

[70]The Commission has a written policy on the criteria that economic development arrangements must meet. It is set forth as the "Ohio Electric Innovative Rates Program, (June 28, 1983) (OCC Attachment A). OCC believes the policy remains intact and complements the provisions of S.B. 221 that address such arrangements.

[71]Emphasis added.

Additionally, R.C. 4905.35 prohibits utilities from giving "undue or unreasonable preference or advantage to any … corporation …." Specifically with regard to the electric industry, it is the policy of the State of Ohio to "[e]nsure the availability to consumers . . . *nondiscriminatory* retail electric service."[72]

The Companies propose to provide a discount to one specific SSO generation service customer, discriminating against other customers whose service characteristics are similar to Ormet's. The Companies also propose to discriminate between similarly situated SSO generation customers, favoring Ormet over similarly situated customers. This part of the ESP is therefore on its face discriminatory, violating R.C. 4905.33, 4905.35, and 4928.02(A).

Beyond the issue of the discriminatory nature of the Ormet proposal, the special arrangement, as it flows through the ESP, is unjust and unreasonable and will adversely affect other customers' rates and services, violating the Commission's long standing policy that the application of the rate should not "adversely affect other customer services and rates."[73] Other customers' rates (i.e. purchased power expenses) will be increased considerably to effectuate the provision within the ESP that flows through the Ormet special arrangement. The Companies have failed to show that it is appropriate at this time to continue the delta revenue recovery that was approved for 2007 and 2008. Nor have they shown that if it is appropriate to continue discounting rates to Ormet, the discount should be created using a market price.

[72]R.C. 4928.02(A) (emphasis added).

[73]See Attachment A, page 5 of 11 (June 28, 1983), which contains the Commission's policy on economic development arrangements.

Although S.B. 221 explicitly permits reasonable arrangements based on economic development, there is nothing in its provisions that suggest the Commission's criteria for evaluating economic development arrangements need to be changed. Rather S.B. 221 makes it clear that all such arrangements are to be filed with and approved by the PUCO.[74] Moreover, such arrangements are to be under the supervision and regulation of the Commission and are subject to "change, alteration, or modification" by the Commission.

The PUCO recently promulgated rules[75] specifically addressing "reasonable arrangements."[76] Under 4901:1-38-03(B)(3), an electric utility seeking approval of an economic development arrangement to retain an existing customer, such as Ormet, has the burden of proof as to the "reasonableness of the arrangement requested" and must submit "verifiable information detailing the rationale for the arrangement." The rules provide for the filing of specific information,[77] none of which has been provided by the Companies in this or any other docket.

The Companies' approach in this proceeding has been to ignore the Commission policy and practices which call for thoroughly reviewing special arrangements prior to requiring customers to fund the delta revenues from such arrangements. While S.B. 221 allows for special arrangements, it does not require the type of hands-off approach the

---

[74]R.C. 4905.31.

[75]These rules are not final due to a Commission Entry granting application on rehearing, *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. 22,* Case No. 08-777-EL-ORD, Entry on Rehearing (Nov. 5, 2008).

[76] Chapter 4901:1-38.

[77] Ohio Adm.. Code 4901:1-38-03(B)(1)(2).

Companies seem to urge here. In keeping with the established standards for reviewing special arrangements discussed above, the Commission should deny the portion of the ESP which would automatically allow market purchases to made, and the entire costs of these purchases charged to the Companies' customers through the FAC.

3. The Companies have failed to justify requiring customers to fund 100% of the delta revenues created under the Ormet special arrangement.

The Companies have failed to prove that it is reasonable to require all other customers to pay 100% of the delta revenues associated with this special arrangement. Pushing 100% of the delta revenues to all of the Companies' customers is unjust and unreasonable and is inconsistent with Commission policy and precedent on this issue. In regards to allocating delta revenues, the Commission has held "that a 50/50 split properly recognizes that both the company and its customers benefit from the company's policy of providing economic incentive rates to certain customers to attract new business in the utility's service territory."[78] Furthermore, this 50/50 sharing of the delta revenues is consistent with other decisions which addressed the issue.[79]

Although S.B. 221 does allow a utility to recover "revenues foregone" as a result of an economic development arrangement,[80] the rules make it clear that the

---

[78]*In the Matter of the Application of Columbus Southern Power Company for Authority to Amend its Filed Tariffs to Increase the Rates and Charges for Electric Service*, 91-418-EL-AIR, Opinion and Order at 110 (May 12 1992).

[79]See *Ohio Edison Company*, Case No. 89-1001-EL-AIR, Opinion and Order at 40-41 (August 16, 1990), at 40-41 and *Cleveland Electric Illuminating Co.*, Case No. 88-170-EL-AIR, Opinion and Order at 18-19 (Jan. 31, 1989).

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

collection of delta revenues from other customers is a matter within the discretion of the Commission.[81] Most recently in the context of the *FirstEnergy ESP case*,[82] the Commission acknowledged its 50/50 delta revenue sharing policy.[83] While noting the restructuring under S.B. 221 may warrant an increase in percentage of revenue recovered by the electric utilities, the Commission indicated that it did not believe 100% recovery of delta revenues from other customers will always be warranted.[84] Rather it acknowledged that the proportion of delta revenues that utilities collect from other customers would be dealt with on a case by case basis.[85]

OCC submits that in the ESP it is not appropriate to have customers pick-up 100% of the delta revenues created by the Ormet deal. Especially in these dire economic times, the Companies' customers' needs must be considered and balanced carefully against the needs of the shareholders.

An appropriate balance in this proceeding, that would further the policy objectives of R.C. 4928.02(A) by ensuring reasonable electric rates, would be a 50/50 sharing, *if* it is determined that the arrangement is not discriminatory, and is just and reasonable and not harmful to the interests of the customers. Moreover, the delta revenues, as discussed above, should not be based on a market price, because doing so will impose significant unreasonable and unjust increases upon customers.

---

[81]Ohio Admin. Code 4901:1-38-08(A)(1).

[82]*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.

[83]Id. Opinion and Order at 55 (Dec. 19, 2008).

[84] Id.

[85] Id.

4. The purchased power proposal requiring market purchases to serve Ormet will not aid economic development any more or less than supplying the power from the Companies' own generation would.

The Companies seek to justify the Ormet power purchases by claiming that the purchases at the 5%, 10%, and 15% levels will "help the Companies encourage economic development in their service territories."[86] On cross-examination it became clear what this really means. Mr. Baker testified that if purchased power is permitted in the increments contained in the ESP plan, the Companies would have more supply available at known prices.[87] This in turn would help the state "go after" economic development with prices that would be competitively attractive.[88]

While it cannot be disputed that purchasing power will result in the Companies having more supply available, the current power supplied internally by Ohio Power and CSP is significantly in excess of what is needed for internal generation.[89] The record reflects that there is a great deal of excess power for AEP Ohio that goes to off-system sales,[90] further lining the shareholders' pockets with profits.[91] This excess power is expected to last at least during the ESP period and will enable the state to encourage economic development. And the generation prices of the Companies' own generation is known as well.[92] Hence, purchased power will not aid economic development to any

[86]Companies' Ex. 2E at 7 (C. Baker rebuttal).

[87]Tr. XIV at 150.

[88]Id.

[89]See OEG Ex. 3 at 9.

[90]See OEG Ex. 3 at 14.

[91]See OCC Ex. 7, showing the off-system sales profits for the ESP period projected to be $791 million, on a total AEP Ohio basis.

[92]Tr. XIV at 150.

greater extent than the Companies own generation, the Companies' arguments, notwithstanding. Moreover, purchasing power will raise the overall cost of power – not reduce it. The least cost option for the Companies customers is to use the Companies' power to serve all its customers.

E. Allocation Of FAC Costs, Including Purchased Power, Should Be On An Energy/Kwh Basis Under The FAC, Rather Than Allocated Through The Economic Development Rider Or Some Other Basis

IEU notes that the Companies' proposed FAC causes purchased power capacity costs to be allocated and recovered from customers on an energy or kilowatt hour basis.[93] IEU alleges that this is inappropriate, relying upon the testimony of Commercial Group Witness Gorman. IEU also argues that the recovery of fixed capacity or demand related costs on a volumetric or kWh basis conflicts with the precedent of the Commission.[94] IEU proposes that the capacity portion of the Ormet purchased power, if allowed, be collected through the Economic Development rider.[95] Under the Economic Development rider costs are allocated on a percentage of revenue basis—clearly not in line with IEU's

[93] IEU Brief at 12, citing Tr. IV at 257; Tr. V at 204.

[94] Id. The cases cited by IEU as evincing Commission precedent against recovering fixed capacity or demand costs on a volumetric basis bear some discussion here because, contrary to IEU assertions otherwise, the precedent is much more limited in scope. In 08-936-EL-SSO, the Commission was addressing time of day and interruptible rates. In 08-935-EL-SSO, the Commission noted its general agreement with issues related to including demand components in generation rate design and the need to address those through a different rate design rather than that proposed by the Companies. In 07-333-EL-UNC, the Commission addressed the power acquisition rider ("PAR") and determined that allocating PAR on a uniform percentage basis was appropriate.

While these cases reflect some movement away from allocating on the basis of volume, they should not be broadly construed as IEU would do, to stand for the proposition that the Commission precedent does not allow recovery of fixed charges through a demand basis. Indeed, residential rates include demand costs, even though there is no demand component of the rates. There never has been and there never will be a one to one collection of demand costs in a demand charge.

[95] IEU Brief at 34-38.

supposed attempt to have all rate components designed to specifically collect a cost component in the exact manner in which the costs occurred.

The Commercial Group, through its Witness Gorman, opposes not only the collection of purchased power capacity costs through the FAC, but opposes the collection of other components as well. Mr. Gorman testified that fuel handling expenses and "all other costs that do not vary with energy (kWh) should continue to be recovered in the Company's non-FAC generation charges."[96] Mr. Gorman fails to identify what these "other costs" are and Commercial Group's brief does not provide any further assistance in this regard.

OCC supports including the capacity costs of purchased power, if the costs are prudently incurred, as discussed *supra*, through the FAC. Additionally, OCC supports including fuel handling expenses as part of the FAC.

As Mr. Nelson testified, the costs that the Companies are proposing to include in the FAC *are* variable costs directly related to energy produced or purchased to serve the internal load customer.[97] Neither IEU nor Commercial Group sufficiently rebutted these claims by Mr. Nelson.

Additionally, as noted by Mr. Nelson, S.B. 221 provides for a broader cost-based adjustment than permitted under the former Electric Fuel Component. Specifically the language of S.B. 221 states that:

> (2) The plan may provide for or include, without limitation, any of the following:
>
> (a) Automatic recovery of any of the following costs of the electric distribution utility, provided the cost is

[96]Commercial Group Ex. 1 at 4-5.

[97]Companies' Ex. 7 at 4.

> 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.[98]

Thus, the Companies proposal to include additional S.B. 221 expenses, including fuel handling and capacity and demand charges related to purchased power, in its FAC, the automatic recovery mechanism, is consistent with the express provisions of S.B. 221 that permit automatic recovery of "the cost of purchased power supplied under the offer."

Finally, the use of this single cost recovery mechanism rather than several separate mechanisms is reasonable and efficient, as testified to by Mr. Nelson.[99] Staff Witness Strom concurred as well and supported including the additional S.B. 221 expenses in the Companies' FAC.[100] Doing so, he concluded, will remove incentives that would otherwise exist that are inconsistent with minimizing overall costs.[101]

IEU's and Commercial Group's claims that the capacity portion of purchased power expenses and other unspecified fixed costs should be collected on a fixed basis should be dismissed. The Companies' proposal to recover such charges through an energy basis in the FAC is consistent with S.B. 221 and is an efficient way to collect such charges. The Companies' approach should be affirmed.

[98]R.C. 4928.143(B)(2).

[99]Companies' Ex. 7 at 4.

[100]Staff Ex. 8 at 3.

[101]Id.

F. FAC Deferrals Should Be Calculated On A Net Of Tax Basis

The Companies claim that a recommendation to permit FAC deferrals to be calculated on a net of tax basis is inappropriate.[102] According to Mr. Assante, this improperly injects traditional cost of service ratemaking into a generation pricing proceeding that is not a cost of service filing.[103]

While OCC would agree that there are parts of this proceeding that are not based on cost of service ratemaking, the Fuel Adjustment Clause mechanism, as set forth in S.B. 221 and as proposed by the Companies, is. Expenditures collected under the fuel adjustment clause are explicitly for actual costs incurred, with a dollar-for-dollar recovery of those costs. The FAC is to operate as a traditional fuel clause. Thus, arguments can and should be made that traditional cost of service principles apply to the FAC, including those which recognize that the actual federal tax expenses to be charged to customers should be on a net of tax basis.[104] Moreover, nothing in the law prohibits the Commission

---

[102] Companies' Brief at 56.

[103] Tr. IV at 158-160; Companies' Brief at 56.

[104] See for example, *In the Matter of the Application of the Cleveland Electric Illuminating Company for Authority to Amend and Increase Certain of its Filed Schedules Fixing Rates and Charges for Electric Service,* Case No. 81-1378-EL-AIR, Opinion and Order at 42 (Jan. 5, 1983), (establishing Quarto coal cost deferrals on a net of tax basis); *In the Matter of the Application of the Monongahela Power Company for Authority to Modify Current Accounting Procedures to Defer Expenditures and Net Lost Revenues Associated with the Implementation of Various cost-Effective Demand Side Management Options*, Case No. 93-2043-EL-AAM, Entry at 4 (Nov. 3, 1994), 1994 Ohio PUC LEXIS 907(deferred taxes should be provided for carrying charges on a net of tax basis); *In the Matter of the Application of the Cincinnati Gas and Electric Company and Columbus Southern Power Company for Authority to Capitalize and Defer Interest Expense on Certain Capitalized and Deferred costs Related to the Wm. H. Zimmer Generating Station Investment and Operating Costs*, Case No. 90-2017-EL-AAM, Entry at 6 (Jan. 10, 1992), 1992 Ohio PUC LEXIS 48 (permitting the accrual of carrying charges on deferred expenses using an uncompounded embedded interest cost net of tax); *In the Matter of the East Ohio Gas Company Application for Authority to Modify its Accounting Procedures to Accumulate Post In-Service Carrying Charges and to Defer and Subsequently Amortize Depreciation and Other Expenses Associated with the Protection of Gas Pipelines*, Case No. 92-555-GA-AAM, Entry at 2 (Apr. 30, 1992), 1992 Ohio PUC LEXIS 329 (permitting deferred taxes on depreciation and other deferred expenses at net of tax rates).

from using its discretion to consider the reasonableness of costs based on cost of service principles.

Notably, the Commission ruled on this very issue in the recent *FirstEnergy SSO case*. There the Commission found that the calculation of carrying charges on a net of tax basis is in accordance with "sound ratemaking theory", as well as Commission precedent.[105] The Commission should stand by its decision in the *First Energy SSO case* and rule here that the FAC deferrals should be on a net of tax basis.

IV. CONTRARY TO THE COMPANIES' ASSERTIONS, S.B. 221 DOES NOT PRECLUDE THE USE OF THE CRITERIA RECOMMENDED BY OCC WITNESS SMITH IN DETERMINING WHETHER AEP OHIO MAY COLLECT FROM CUSTOMERS CARRYING COSTS ON 2001-2008 INCREMENTAL ENVIRONMENTAL INVESTMENTS.

OCC Witness Smith stated that the Companies should not be allowed to collect from customers carrying charges on incremental environmental investments. To do so, according to Ms. Smith, "implies that 1) either the Companies do not have enough earnings to pay for these investments or that 2) the Companies will not make these investments without additional revenues and they are investments which are in the public interest."[106] In this proceeding, the Companies have not demonstrated that they do not have the earnings or that they will not make these investments without additional revenues.[107]

[105] *FirstEnergy SSO*, Opinion and Order at 58, citing *FirstEnergy Distribution Rate Case* Staff Ex. 16 at 8, 12, *In re Cleveland Electric Illuminating Co.*, Case No. 88-205-EL-AAM, Entry (Feb. 17, 1988); *In re Cleveland Electric Illuminating Co.*, Case No. 92-713-EL-AAM, Entry (Dec. 17, 1992).

[106] OCC Ex. 10 at 29.

[107] Id. at 29-30. Kroger Witness Higgins came to a similar conclusion. See Kroger Ex. 1 at 10-11.

The Companies argued that the Commission should reject these criteria because they are not included in S.B. 221,[108] and thus the criteria are not "permitted."[109] Of course, the Companies do not assert that S.B. 221, or any Ohio statute, **prohibits** the use of such criteria or specifies any other criteria for determining the rates that an electric company charges its customers; indeed, Ohio law does not. Moreover, AEP Ohio Witness Nelson confirmed that nothing in S.B. 221 specifically allows the Companies to collect from customers carrying charges for environmental investments made prior to the effective date of S.B. 221.[110]

Ohio law, however, does direct the Commission to ensure that the rates electric companies charge their customers are just and reasonable,[111] and that electric companies' rates of return are just and reasonable.[112] The criteria suggested by Ms. Smith are essential for the Commission to make a determination whether rates charged to customers are just and reasonable, or a utility earns a just and reasonable rate of return.

AEP Ohio also asserted that "Ms. Smith's testimony exhibited a basic misunderstanding. If the Companies are not paid for such investments, shareholders will not reap any benefits associated with the investments."[113] This statement, however, is not

---

[108] Companies' Brief at 34.

[109] See Companies' Ex. 7B at 4; see also Tr. XIV at 84 (Nelson).

[110] Tr. XIV at 93.

[111] See, e.g., R.C. 4909.15; R.C. 4928.144.

[112] See, e.g., R.C. 4928.143(B)(2)(h), addressing infrastructure modernization.

[113] Companies' Brief at 34, citing Companies' Ex. 7B at 6.

entirely correct. As AEP Ohio Witness Nelson admitted, shareholders might benefit from investments for which the Companies are not paid, under some circumstances.[114]

The Companies' claim also ignores one basic fact of corporate life: shareholders do not always reap benefits from all investments. Although EDUs are guaranteed a just and reasonable rate of return, that return is not guaranteed for each and every investment an EDU makes. For example, some environmental investments are necessary in order to meet state and/or federal laws, a "reasonable allowance" for which may be included in an ESP if the costs or expenditures are incurred after January 1, 2009.[115] Other environmental investments may be the result of corporate policies.

The Companies went on to state:

> [B]y implying that these investments do not benefit customers, Ms. Smith appears to misunderstand the nature of the investments. Mr. Nelson explained that investment in environmental equipment is necessary to keep the Companies' low-cost coal-fired generating units running. Customers benefit because the operating costs of these units remain well below the cost of purchased power, which would be the alternative source for power if the units were shut down because they did not comply with environmental requirements. Mr. Nelson noted that the Companies' customers and the State of Ohio further benefit when the Companies purchase locally produced high-sulfur coal for use in their generating units, which these environmental investments facilitate.[116]

This statement mischaracterizes the nature of Ms. Smith's testimony. Ms. Smith addressed the issue of "whether the proposed ESPs are 'more favorable in the aggregate'

[114] See Tr. XIV at 99-100 (where Company Witness Nelson recognized that shareholders would benefit, even if not paid for the investment, if off-system sales of power are made from that plant and the profits therefrom collected).

[115] R.C. 4928.143(B)(2)(b).

[116] Companies' Brief at 34-35 (citations omitted).

than the MROs, and whether the proposed ESPs should be accepted by the Commission."[117] Thus, Ms. Smith conducted the analysis required under R.C. 4928.143(C)(1),[118] which is not a cost-benefit analysis.[119] Because an MRO should also take into consideration the need to maintain the operation of the Companies' coal-fired generating units, the benefit that would accrue to consumers and the State of Ohio by the continued operation of the Companies' coal-fired generating units is irrelevant to Ms. Smith's analysis.

The Companies have the burden of proving that they should be allowed to collect from customers the carrying costs on incremental environmental investments incurred from 2001-2008.[120] The record demonstrates that the Companies have failed to carry this burden. In addition, allowing the Companies to collect the carrying costs on incremental environmental investments incurred from 2001-2008 could result in retroactive ratemaking, which is not permitted.[121] Thus, AEP Ohio should not be allowed to collect these carrying costs from customers in the Companies' ESP.

[117] OCC Ex. 10 at 2.

[118] R.C. 4928.143(C)(1) states, in relevant part: "[T]he commission by order shall approve or modify and approve an application filed under division (A) of this section 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."

[119] The only reference to benefits in R.C. 4928.143(C)(1) is that if a nonbypassable surcharge is established for construction work in progress, "the benefits derived for any purpose for which the surcharge is established are reserved and made available to those that bear the surcharge." This does not apply to the issue of collecting carrying costs for past environmental-related investments.

[120] See R.C. 4928.143(C)(1).

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

V. THE RECORD IN THIS PROCEEDING DOES NOT SUPPORT EITHER THE IMPLEMENTATION OF OR THE COST RECOVERY FOR GRIDSMART THAT AEP OHIO HAS PROPOSED.

A. AEP Ohio Has Not Shown That Consumers Will Benefit From The Implementation Of gridSMART That The Companies Propose.

AEP Ohio proposes to implement Phase 1 of gridSMART in a portion of CSP's service territory that includes approximately 110,000 meters and 70 distribution circuits.[122] This implementation will include all three of gridSMART's main components: Advanced Meter Infrastructure ("AMI"), Distribution Automation ("DA") and Home Area Network ("HAN").[123] AMI involves the use of "smart" meters, two-way communications networks and information technology systems to support their interaction.[124] HAN is a system located within customers' homes that allows customers to use a Programmable Communicating Thermostat and a Load Control Switch to reduce energy consumption through increased usage information and interactive control of their electric usage.[125] DA involves the use of various line devices such as reclosers and switches to conduct remote switching operations that can reduce average power outage durations by re-routing power around fault locations.

OCC Witness Finamore expressed doubt that AEP Ohio is technologically ready to implement HAN fully:

> [N]o utility to my knowledge has considered broad based implementation of HAN technologies without first installing a working AMI and meter data management (MDM) system combination to manage the large amount of data traffic, including

[122] See Companies' Brief at 62.

[123] Id.

[124] See id. at 61.

[125] Id.

> interval meter consumption data, which would be produced from the AMI system. From the information provided, AEP-Ohio has not included any plans for MDM implementation in its Phase I program, which suggests that general availability of HAN features, including time-differentiated rates, is many years away.[126]

Because AEP Ohio has not laid the technological groundwork to implement HAN, Mr. Finamore suggested that HAN implementation, except for technology review and program planning, be delayed until the next ESP to help ensure "that future HAN technology is properly aligned with AEP-Ohio's AMI solution and is capable of supporting the demand response programs needed to meet the longer term goals outlined in amended SB 221."[127] Mr. Finamore also suggested that the DA portion of gridSMART should be handled through AEP Ohio's proposed Enhanced Service Reliability Plan, with an opportunity for recovery of any incremental costs to be addressed in a future distribution rate case.

In their brief, the Companies addressed this issue in cursory fashion, stating only that "[t]he Companies believe their configuration of AMI, DA and HAN strikes an appropriate balance of using new technology, cost considerations and providing customer benefits."[128] The record in this proceeding, however, does not support AEP Ohio's claims. Specifics on key issues regarding gridSmart implementation -- such as the types and capabilities of the technology to be installed -- are absent from the record. None of the proposed benefits from AMI, DA and HAN have been quantified in the record and

[126] OCC Ex. 12 at 7.

[127] Id. at 16. OPAE Witness Alexander also suggested delaying HAN implementation for technological and customer privacy reasons. See OPAE Ex. 1 at 26-27.

[128] Companies' Brief at 69.

everything being stated regarding proposed benefits is hypothetical since no specific equipment solutions and costs have been provided.

Given that AEP Ohio is asking the Commission to approve $109 million for Phase I of gridSmart,[129] the Commission should ensure that the HAN technology is adequate for gridSmart purposes. The Commission should delay HAN implementation until after AMI and MDM are implemented, as Mr. Finamore suggested, and should confirm that projected network reliability improvements are achieved before granting rate relief for the DA implementation.

B. Contrary To The Companies' Assertions, OCC Witness Finamore Proposed A Reasonable Implementation Of gridSmart That Would Share The Risk Between AEP Ohio And Its Customers, Rather Than Having Customers Bear All The Risk, As The Companies Propose.

In addition, the Companies propose that customers bear the entire cost, and thus the entire risk, of gridSmart implementation. Mr. Finamore and Staff Witness Sheck both addressed this issue. Because of "the minimal risks the companies are undertaking with this investment relative to the minimal potential gain for ratepayers," Mr. Scheck proposed that "Phase 1 gridSMART investment be pulled out of the general distribution rates and be set aside in a separate rider, set at $0.00 dollars, until a further, more detailed investigation can be completed."[130] The Companies opposed this proposal, stating that "putting off the decision would seem to be the same as denying it for purposes of this

[129] See OCC Ex. 12 at 6.

[130] Staff Ex. 3 at 4.

case. Similarly, setting the rider at zero dollars would not allow CSP to timely recover costs associated with gridSMART Phase 1."[131]

Mr. Finamore proposed that the Companies and its customers share the risk. He recommended that the Commission treat deployment of gridSmart Phase I as a pilot project with the Companies and its customers sharing the cost and risk of performance.[132] The Companies could collect half of the Phase I costs as the technology is deployed and made operable, and the other half if the Commission approves full deployment of gridSmart.

The Companies asserted that Mr. Finamore's proposal is "unreasonable," but without explanation as to what is "unreasonable" about it.[133] Apparently, AEP Ohio believes that it must recover **all** projected costs associated with gridSmart Phase I up-front, without showing that gridSmart will work or that customers will receive the promised benefits at the end of the seven-to-ten-year implementation period. This is contrary to S.B. 221.

R.C. 4928.143(B)(2)(h) allows EDUs to receive a "just and reasonable" rate of return on their infrastructure modernization investments. No anticipated Phase I or full project savings have been quantified to demonstrate that the project will provide a reasonable return on investment. AEP Ohio stated that it would be inappropriate to consider long term operational cost savings when the long term (full deployment) costs have not been submitted for recovery.[134] Yet the long term costs have a direct bearing on

---

[131] Companies' Brief at 67.

[132] OCC Ex. 12 at 19.

[133] Companies' Brief at 67.

[134] Id. at 63.

the validity of whether Phase I should be authorized at all. Without an estimate of long term costs and benefits, the actual merit of going forward with Phase I deployment cannot be reasonably justified.

AEP Ohio claimed that if there are cost overruns for information technology in implementing Phase I, then "AEP Ohio takes the risk of such cost overruns under its proposed cost recovery method."[135] It is more likely, however, that such overruns are pushed out into the full project estimate, since there are no specific AMI or HAN performance criteria upon which to judge Phase I performance. Without a full project cost estimate, it is not possible to evaluate the true cost of information technology software that may be implemented over the seven-to-ten-year period of deployment. It is therefore possible that AEP Ohio has understated Phase I software costs knowing that they can be included in the full system cost once it is revealed.

Contrary to AEP Ohio's view, Mr. Finamore's proposal is very reasonable. As Mr. Finamore noted, AEP Ohio's plan would "expose customers to potential cost risk without sufficient confidence that gridSMART will eventually produce the desired benefits to justify the cost."[136] Mr. Finamore's proposal would protect AEP Ohio's customers by helping to ensure that the Companies' return on infrastructure modernization is "just and reasonable," as required by R.C. 4928.143(B)(2)(h). The Commission should adopt Mr. Finamore's recommendation.

[135] Id. at 66.

[136] OCC Ex. 12 at 18.

VI. THE COMMISSION SHOULD NOT COUNT INTERRUPTIBLE LOADS IN DETERMINING WHETHER THE COMPANIES MEET THE PEAK DEMAND REDUCTION REQUIREMENTS OF S.B. 221.

Staff argues in its brief that no credits should be given towards the annual peak demand reduction targets for the Companies' interruptible programs "unless reductions actually occur."[137] AEP Ohio rejects the Staff position and attempts in its brief to draw a legal distinction between energy efficiency, where an "achieved" standard is contemplated, and peak demand reductions, where a lesser "designed to achieve" standard is implied.[138] The Companies state that "[i]n contrast to the requirement in Sec. 4928.66(A)(1)(a), Ohio Rev. Code, for an EDU to implement programs that 'achieve' specified levels of energy savings, Sec. 4928.66(A)(1)(b), Ohio Rev. Code, requires an EDU to implement programs 'designed to achieve' specified peak demand reductions."[139] Because interruptible customers may use buy-through provisions in the Companies' tariff in order to avoid interrupting when called on by the Companies during an event, actual peak reductions may be lower than projected by the Companies.

In this case OCC, agrees with the Staff's position.[140] Interrupting load is not the only way to meet the demand reductions under S.B. 221. The demand reduction results for S.B. 221 purposes can also be achieved through a variety of programs, such as peak time rebates and critical peak pricing.

---

[137] Staff Brief at 19.

[138] Companies' Brief at 112-115.

[139] Id. at 113.

[140] OCEA Brief at 102-103.

VII. DEFERRALS OF FAC COSTS

A. AEP Ohio's Proposed "Phase-In," or Deferral, of FAC Costs Will Not Mitigate Rate Impact.

The Companies contended in their Brief that they are attempting to mitigate the impact of their proposed ESP rates[141] through a "phase-in" process, where the Companies will defer a portion of the proposed annual incremental FAC costs in 2009, 2010, and 2011.[142] The Companies proposed to defer these un-recovered fuel costs, along with carrying costs at the Companies' weighted average cost of capital, as a non-bypassable surcharge from 2012 to 2018.[143] The Companies' Witness Roush testified that, beginning in 2012, the FAC costs will operate in a "traditional manner" with periodic adjustments to recover the next period's actual FAC costs and any under- or over-recovery from the prior period.[144]

1. Rather than benefit customers, the "phase-in" or deferral proposed by the Companies would only hurt customers by disguising the true rate increase and forcing customers to ultimately pay more in the future for their electric service.

Rather than mitigating the shock of the Companies' proposed rates, a "phase-in" or deferral of FAC costs until after the three-year ESP period simply disguises a rate increase, and pushes it, plus the added impact of carrying costs,[145] to customer bills arriving after the three-year ESP period. According to the Companies' Witness Assante, the phase-in and deferrals proposed by AEP Ohio will result in customers paying $461.2

---

[141] Companies' Brief at 9.

[142] Companies' Ex. 6 at 5; Companies' Ex. 1 at 15; Exhibit DMR-8.

[143] Companies' Ex. 6 at 8-9.

[144] Companies' Ex. 1 at 15.

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

million in carrying costs in the years 2012-2018.[146] Thus, the deferral of FAC costs until after the three-year ESP period would force customers to ultimately pay much more for their electric service, and do so perhaps unknowingly. Such a disguised increase would create confusing price signals for customers.

2. Mitigation of rate increases would not be necessary if generation rates are "reasonably priced," as required by R.C. 4928.02(A) and considering the current economic environment.

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."[147] When setting rates that are "reasonable," the Commission must consider the effect of the rate increases proposed by the Companies, plus the additional burden of carrying costs. As it was[148] recognized in the recent *FirstEnergy ESP* decision, the Commission should also be mindful of the significant economic difficulties facing Ohio and the Companies' customers at this time. Any price increases sought by the Companies at this time needs to be weighed carefully, and if appropriate, revised downward to a reasonable level.[149]

Further, the Companies' FAC should be modified to include the establishment of an appropriate baseline FAC rate based on 2008 actual known fuel-related costs,[150] the exclusion of market-rate purchased power, and the adjustment of fuel-related costs by

---

[146] Companies' Ex. 6 (Assante) at Exhibit LVA-1; OCC Ex. 10 at 34 (Smith).

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

[148] *FirstEnergy ESP* Order at 17, (Dec. 19, 2008).

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

[150] Id. at 3.

off-system sales margins[151] and capacity equalization revenues.[152] If these modifications are applied, the projected fuel cost increases, if any, for 2009, 2010, and 2011 will be very limited.

Also, deferral of FAC costs could be avoided by using more recent fuel-related costs. The Companies' estimated increases in incremental fuel-related costs, and thus, the justification for implementing fuel costs and other cost deferrals are largely unsupported by today's prevailing commodities prices. To illustrate, based on the data set forth in AEP Ohio Exhibit DMR-7 regarding 2008 embedded FAC costs, AEP Ohio projects that in 2009 alone, FAC costs will increase approximately 42% for CSP and 71% for OP.[153]

3. The "phase-in" or deferral of FAC costs proposed by the Companies would not stabilize rates or provide certainty regarding retail electric service as required by R.C. 4928.143(B)(2)(d).

S.B. 221 requires that any deferral of FAC costs by the Companies stabilize rates or provide certainty regarding retail electric service: "The plan may provide for 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."[154] The Companies' proposed deferral of FAC costs does not meet this test.

---

[151] 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).

[152] OEG Ex. 3 at 16.

[153] Companies' Ex. DMR-7.

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

AEP Ohio Witness Assante testified at hearing that any under-recovery under the annual FAC true-up mechanism proposed by AEP Ohio would increase the deferral amount[155] and that such an under-recovery is not unlikely.[156] Thus, the amount of costs deferred until after the three-year ESP period is impossible to estimate with any specificity. Such unstable revenues, with the likelihood of either over- or under-recovery, would not constitute evidence of stabilization or certainty regarding retail electric service and, thus, would not comply with R.C. 4928.143(B)(2)(d).

4. Deferrals, if necessary, should take the form of a levelization of rates during the ESP period.

Due to problems encountered with deferrals in the past, Staff generally recommends against deferrals.[157] But if the Commission were to consider a phase-in of rates under the Companies' ESP proposal, Staff recommended that a phase-in be adjusted to a more reasonable level than that recommended by the Companies.[158] The Staff also recommended a levelized increase not extending beyond the life of the ESP.[159]

Staff's position in this case is consistent with the Commission's recent decision in the *FirstEnergy SSO* case.[160] In that case, the Commission noted that, with modifications to the average base generation rates, no deferrals would be necessary.[161] The Commission further pointed out that lower short- term generation rates allowed by the deferral of

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

[156] Id. at 111.

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

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

[159] Tr. XII at 251 (Cahaan).

[160] *FirstEnergy ESP Order* at 17 (Dec. 19, 2008)(First Energy SSO Case").

[161] Id. at 17.

certain expenses could ultimately damage Ohio's competitiveness in the global economy.[162] The Commission should, consistent with its recent findings in the *First Energy SSO* case, decline to permit deferrals for this reason and others espoused here.

VIII. THE ECONOMIC DEVELOPMENT RIDER

A. The Appropriate Split Of Delta Revenue Between Shareholders And Ratepayers Is A Case By Case Determination That Should Be Guided By The General Commission Policy Of A 50/50 Sharing.

As part of their ESP, the Companies proposed the implementation of a non-bypassable Economic Development Rider.[163] In a discussion of that Economic Development Rider in their Brief, the Companies argued against OCC's position that the Commission should continue its longstanding policy of splitting the cost of the delta revenue equally between shareholders and customers.[164] The Companies summarily contended that this policy "is of no relevance for 'continuation' under S.B. 221."[165]

Regarding the Companies' contention that the 50/50 splitting of the cost of the delta revenue equally between shareholders and customers is no longer appropriate,[166] Mr. Yankel strongly disagrees. His testimony stresses that while the electric industry in Ohio is undergoing change, "it is important that procedures and programs from the past, [such as economic development and incentive rates,] reflect the realities under the new

[162] Id..

[163] Companies' Application at 8-9.

[164] Companies' Brief at 131, referencing OCC Ex. 14 at 4.

[165] Id.

[166] Companies' Brief at 131.

environment."[167] This concerns the new regulatory reality, not the old. Further, pushing 100% of the delta revenues to the remaining Companies' customers is unjust, unreasonable, and inconsistent with the Commission's past precedent on this issue. The Commission has previously held "that a 50/50 split properly recognizes that both the company and its customers benefit from the company's policy of providing economic incentive rates to certain customers to attract new business in the utility's service territory."[168]

Most recently in the context of the *FirstEnergy ESP* case, the Commission acknowledged its 50/50 delta revenue sharing policy.[169] While noting the restructuring under S.B. 221 may warrant an increase in the percentage of revenue recovered by the electric utilities, the Commission indicated that it did not believe 100% recovery of delta revenues will always be proper.[170] Rather, it recognized that the proportion of delta revenues recovered would be dealt with on a case by case basis.[171] Without a sharing of delta revenue, customers would have to bear the full costs, while shareholders, who benefit through customer retention and earnings stability, would do so at no cost. This is contrary to Commission policy and precedent.

Moreover, the Commission should exercise caution in espousing a case by case approach. In recent special arrangements approved by the Commission, the contracts

---

[167] OCC Ex. 14 at 4-5.

[168] *In the Matter of the Application of Columbus Southern Power Company for Authority to Amend its Filed Tariffs to Increase the Rates and Charges for Electric Service*, Case No. 91-418-EL-AIR, Opinion and Order at 110 (May 12, 1992).

[169] *FirstEnergy ESP Order* at 55 (Dec. 19, 2008).

[170] Id.

[171] Id.

between AEP and its customers called for 100% of the delta revenues to be absorbed by the Companies' customers or the arrangement would be invalidated. Thus, if it is not the Commission's intent to unfairly thrust the full economic benefit cost on customers – many of whom will not participate in that benefit – the Commission should either here and now reaffirm its 50-50 split or it should put all utilities on notice that it may strike that provision from the special arrangements that are filed.

B. OCC Supports Economic Development Provided That Such Efforts Are Reasonable And Necessary.

In that discussion, the Companies claimed that OCC failed to recognize the benefits from Commission-approved special arrangements related to economic development and job retention.[172] The Companies' Brief paraphrases OCC Witness Yankel's testimony, stating, "Instead, Mr. Yankel indicated during cross-examination that his recommendation is also intended, in part, to 'sharpen' the Companies' judgment so as to only enter into reasonable arrangements necessary to promote economic development."[173] The Companies mischaracterize OCC's position. More accurately and to the point, Mr. Yankel's direct testimony discussed how "economic development has the potential to be abused by utilities [to their benefit] as a means of subsidizing certain customers in a manner that would allow the utilities to retain or gain the generation business of some customers that may be contemplating buying power from an alternative

[172] Companies' Brief at 131.

[173] Id. at 131-132.

electric service supplier."[174] Mr. Yankel adds that such activity by a utility would be anticompetitive, should not be allowed, and should not be subsidized by customers.[175]

IX. AEP OHIO'S PROPOSED ENHANCED SERVICE RELIABILITY PLAN

The Companies maintain that the proposed Enhanced Service Reliability Plan ("ESRP") is needed "in order to maintain and enhance reliability."[176] AEP Ohio also claims that such enhancements are necessary to meet the "reliability expectations" of its customers.[177] While the Companies assert that the ESRP consists of "detailed set of plans and programs" the component parts of the ESRP are nebulously described as "adjustable as circumstances warrant."[178]

In its Initial Brief, AEP Ohio repeats the claim, first made in direct testimony by AEP Ohio Witness Boyd, that it is facing an "aging infrastructure challenge" and that the Companies are unable to maintain their existing level of reliability "due to the inflation/cost escalation and increasing asset failure rates."[179] The Companies further state that the ESRP aligns their customers interests with that of AEP Ohio and, therefore, is "appropriate" under the ESP provisions of S.B. 221 and R.C. 4928.143(B)(2)(h).[180] The Companies contend that customer surveys, conducted on behalf of AEP Ohio,

---

[174] OCC Ex. 14 at 5.

[175] Id.

[176] AEP Ohio Brief at 72.

[177] Id.

[178] Id.

[179] Id. at 74.

[180] Id. at 75.

confirm that the ESRP aligns the Companies' interests with that of customers.[181] The Companies' contention is based on the findings of the surveys in which a minority of AEP Ohio customers believe that some day they will have more reliable service.

AEP Ohio contends that PUCO Staff Witness Roberts takes the position that the Companies "are already required to do what they have never done."[182] The Companies also assert that OCC Witness Cleaver and Staff Witness Roberts are inconsistent in their analyses of the Companies' current reliability and in their expectations of the future performance.[183] Finally, AEP Ohio claims that single-issue ratemaking is clearly contemplated under the provisions of R.C. 4928.143(B)(2)(h) and that "test year and rate base concepts, which Mr. Hess stated would apply to his suggested cost deferrals, would not apply in the context of single issue rate making."[184]

A. AEP Ohio Has Provided No Evidence That The Enhanced Service Reliability Plan Provides For "Enhanced" Service.

AEP Ohio initially defends the implementation of its ESRP by merely repeating unsubstantiated assertions made by Mr. Boyd in his direct testimony.[185] As noted above, Mr. Boyd claims in his testimony, for example, that AEP Ohio has an "aging infrastructure"[186] and that AEP is suffering from an "increasing asset failure rate."[187] In making these claims, Mr. Boyd attempts to support the Companies' proposal to enhance

---

[181] Id.

[182] Id. at 78.

[183] Id. at 77-78, 82.

[184] Id. at 84.

[185] AEP Ohio Brief at 74-75.

[186] AEP Ohio Ex. 11 at 15 (Boyd).

[187] Id. at 10.

the electric distribution system through the implementation of the ESRP. Mr. Boyd, however, provides no documented support for his assertions. Mr. Boyd's assertions, however, raise troubling questions.

Certainly all electric distribution utilities have "aging" infrastructure. Poles, transformers, switches, and other components of the electric distribution system begin "aging" immediately once installed by electric distribution utilities. Customers of AEP Ohio, however, have always paid for the upkeep and replacement of "aging" infrastructure through their rates.[188]

It is also quite perplexing that AEP Ohio has only recently discovered that its infrastructure is old.[189] AEP Ohio's Witness Boyd noted in his direct testimony: "Just because equipment is old and/or beyond its original expected useful life does not mean it will fail in the near future."[190] Since "old" equipment does not necessarily need to be replaced in the near future, OCC does not understand the Companies' urgent concern with its "aging" infrastructure.

AEP Ohio takes offense to the responses by OCC Witness Cleaver, under cross-examination, that the alleged enhancements offered under the ESRP consist primarily of "good industry practice that AEP should already be doing."[191] PUCO Staff Witness Roberts offered a similar opinion under cross-examination which also troubles AEP

[188] AEP provides no parameters for what constitutes an "aging" infrastructure.

[189] AEP initially made its claim that its infrastructure is aging as part of its Enhanced Distribution System Reliability Plan ("EDSRP") in *In re the Self-Complaint of Columbus Southern Power Company and Ohio Power Company Concerning the Implementation of Programs to Enhance Distribution System Reliability*, Case No. 06-222-EL-SLF, Plan at 2 (Oct. 6, 2006)("AEP Reliability Case").

[190] AEP Ohio Ex. 11 at 15.

[191] AEP Ohio's Brief at 77.

Ohio.[192] In attempting to paint OCC Witness Cleaver's positions as inconsistent, AEP Ohio repeatedly mischaracterizes his responses during cross-examination. Mr. Cleaver was asked on cross-examination whether all electric distribution utilities should implement all the components of the ESRP.[193] Mr. Cleaver did not support such programs across the board for each utility, adding that it would depend on the circumstances of each utility.[194] Mr. Cleaver's position is also consistent with the current Electric Service and Safety Standards ("ESSS").

The notion that the individual component parts of the ESRP provide enhancements to the reliability of service provided by AEP Ohio is unsupported in the Companies' Application. OCC Witness Cleaver did acknowledge that the ESRP proposed that AEP Ohio would perform more extensive distribution reliability activities, as part of several of its programs, than the Companies currently perform.[195] What Mr. Cleaver also recognized, however, is that the Companies have not made the case that their distribution system reliability and maintenance activities are sufficient at this time.[196] OCC does not support the concept that the Companies will enhance the reliability experienced by customers merely by performing more of certain reliability activities.

AEP Ohio also asserts, unconvincingly, that the ESSS rules "themselves do not purport to promulgate good industry practice or mandatory compliance activities."[197] The

[192] Id. at 78.

[193] Tr. VII at 77 (Cleaver).

[194] Id.

[195] Id. at 66.

[196] OCC Ex. 13 at 43-44 (Cleaver).

[197] Id. at 77-78.

Commission and PUCO Staff should be surprised at this notion. Ohio law 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 * * *. R.C. 4928.11(A).

The Commission rules do, in fact, "provide minimum standards for uniform and reasonable practices."[198] The ESSS also require several annual and/or periodic reports regarding utilities' reliability performance under the ESSS.[199] The fact that AEP Ohio has individualized performance targets does not suggest that there are not ESSS requirements that are common to all electric utilities.[200] For instance, the ESSS require:

> (E) Transmission and distribution inspection, maintenance, repair, and replacement programs.
>
> (1) Each electric utility shall establish and maintain written programs, procedures and schedules for the inspection, maintenance, repair, and replacement of its transmission and distribution circuits and equipment. These programs shall establish preventative requirements for the electric utility to maintain safe and reliable service. Programs shall include, but are not limited to, the following facilities:
>
> (a) Poles and towers;
> (b) Conductors;
> (c) Pad-mounted transformers;
> (d) Line reclosers;
> (e) Line capacitors;

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

[199] Ohio Adm. Code 4901:1-10-9(C)(1), Ohio Adm. Code 4901:1-10-10(C)(2), Ohio Adm. Code 4901:1-10-11(C), Ohio Adm. Code 4901:1-10-26(A), Ohio Adm. Code 4901:1-10-27(E)(2).

[200] AEP Ohio Brief at 78.

(f) Right-of-way vegetation control; and
(g) Substations.[201]

The programs required by this rule may vary in detail from utility to utility and still should constitute "good industry practice."[202] Mr. Cleaver merely recognized this in his response to the Companies' questions:

> Q. Does OCC believe it's good industry practice for all the Ohio electric distribution utilities to undertake all the programs in the ESRP that's being proposed by AEP?
>
> * * *
>
> A. No.
>
> Q. If it's good industry practice, why shouldn't everybody do it?
>
> A. I think it's going to depend. It will depend on the individual utility, their historical reliability performance or history and their design, their geography, I think, so you have to look at each individual utility.[203]

Mr. Cleaver's position coincides with the requirements of ESSS Rule 27(E)(2) cited above. The fact that the ESRP plans to be more "comprehensive" in its approach to replacing equipment[204] and overhead line inspections[205] would seem to be a welcome addition to the Companies' current practices. OCC, however, fails to understand what the distinction is between the level of service currently provided by the Companies and the level of service proposed by AEP Ohio Witness Boyd. OCC believes that the current ESSS and Ohio law already provide for comprehensive maintenance and inspection

---

[201] Ohio Adm. Code 4901:1-10-27(E)(2).

[202] Id. at 77. AEP Ohio ridicules the contention by Mr. Cleaver that good industry practice can vary between utilities.

[203] Tr. VII at 76-77 (Cleaver).

[204] AEP Ohio Ex. 11 at 16.

[205] Id. at 19.

programs. OCC does not believe the Companies are entitled to a rate increase for providing thorough reliability programs.

AEP Ohio has the audacity to suggest that the Commission has previously recognized that the Companies have provided enhanced reliability to its customers.[206] The Companies ironically cite from a Commission Finding and Order in the *AEP Service Quality Case* to support this proposition.[207] What the Companies neglect to mention is that AEP Ohio, in fact, failed to meet the terms of the Stipulation with the PUCO Staff in that case and its service performance declined in many of its circuits.[208] If anything, the *AEP Service Quality Case* supports the proposition that if reliability resources are not allocated properly, customers *will not* experience enhanced reliability.

B. AEP Ohio's Reliability Performance And Its Enhanced Service Reliability Plan Should Be Considered In Separate Commission Proceedings.

AEP Ohio's request for a rate increase to fund its ESRP should be considered in a rate case. The ESRP proposes "an increase in revenues for AEP without any commitment to actually making expenditures to improve reliability, reaching any benchmarks, or being subject to any consequences for failure to achieve any reliability goals."[209] Staff Witness Hess's recommendation -- that distribution rates should be adjusted in comprehensive distribution rate proceedings conducted according to R.C.

---

[206] AEP Ohio Brief at 79. "What the Commission has recognized is the distinction between ESSS compliance and improving service quality in a manner that exceeds the requirements of ESSS."

[207] *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, Finding and Order at 2 (Jul.26, 2006) ("*AEP Service Quality Case*").

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

[209] Brief of Appalachian People's Action Coalition and Ohio Partners for Affordable Energy at 19.

Chapter 4909 -- should be adopted.[210] As the Commission has stated in the *FirstEnergy ESP Case*:

> Although Section 4928.143(B)(2)(h), Revised Code, does provide for distribution modernization riders as part of an ESP * * * the Commission believes that such riders should be based upon prudently incurred costs, including a reasonable return on investment for the electric utility. However, the Companies have not demonstrated that the proposed Rider DSI is based on a reasonable, forward-looking distribution modernization program.[211]

While the ESRP, as proposed by AEP Ohio, calls for a distribution rate increase as opposed to a rider, there has been no demonstration that AEP Ohio's proposal is based on "prudently incurred costs." The Companies have also failed to demonstrate that the proposed rate increase will provide for a "reasonable" distribution modernization program. Hence, following the precedent established in the *FirstEnergy ESP case*, the Commission should not permit, as part of this ESP, the distribution rate increases to purportedly implement the Companies' ESRP.

The Consumers for Reliable Electricity in Ohio ("CREO") have recently requested that the Commission investigate the reliability of the electric service currently being provided by Ohio's electric distribution utilities, including AEP Ohio.[212] A comprehensive review and investigation of AEP's distribution system reliability should

---

[210] 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."

[211] *FirstEnergy ESP case*, Opinion and Order at 41.

[212] *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 (Dec.15, 2009) ("Request for Investigation").

be undertaken in a proceeding such as that requested by CREO. The record of that proceeding should be considered in the rate case which considers AEP Ohio's proposed distribution rate increase. The rate case proceeding should be held subsequent to a full investigation of the Companies' electric distribution system reliability as contemplated by Ohio law:

> [t]he commission shall examine the reliability of the electric distribution utility's distribution system and ensure that customers' and the electric distribution utility's expectations are aligned and that the electric distribution utility is placing sufficient emphasis on and dedicating sufficient resources to the reliability of its distribution system. R.C. 4928.143(B)(2)(h).

In any event, the full panoply of the Companies' distribution system reliability issues should be investigated in a separate Commission proceeding.

X. THE ESP, IF APPROPRIATELY MODIFIED, IS SLIGHTLY MORE FAVORABLE FOR CUSTOMERS THAN THE MRO.

A. The Market Price Used By The Companies Is Unreasonable.

The Companies do not use the correct data to determine the market price. The Companies attempt to justify their selection of 3 quarters of data from 2008 to project the market price that would impact the MRO, even though market prices in the 4th quarter were significantly lower than the numbers which they used. Their rationale is that "there is no basis to assume the 4th quarter shift was an abrupt change to a long-term trend."[213] The long term price trend was never estimated or even claimed to be measured. There was actual data that did provide a basis to assume that the 4th quarter reflected a real shift from the first 3 quarters of the year, and that it was likely to represent market prices in the

[213] Companies' Brief at 135.

near future. That data include forward price data including fuel and gas price data. Market prices are driven largely by fuel prices, and particularly gas prices. While the Companies used the most recent quarterly data in their Application for determining market price, when that same data demonstrated a decline in market price, the Companies' rejected it. It appears the Companies' proposal of market prices is based upon principles of calculating the highest market price possible and not based upon objective, informed analyses of data.

The Companies also inflated their estimate of market price by including values for transaction costs and market administration costs that are excessive and unrepresentative of what would be included in a market price.[214] For example, the Companies justified the market administration costs by referring to a value which the state of Connecticut allowed to bring wholesale prices closer to retail prices.[215] It does not represent actual or even an estimate of wholesale costs.

B. The Companies Fail To Demonstrate That The ESP Is More Favorable Than The MRO.

Most importantly, the Companies did not, and have not demonstrated, their claim that the ESP is more favorable than the MRO. In fact, Mr. Baker did not even properly compare the cost of an MRO-based SSO with an ESP-based SSO. Instead he compared the cost of market based power in an MRO and an ESP, and reflected other incremental cost increases. His analysis did not reflect the total cost of either the MRO or the ESP, and it could not, as it did not include the cost of the differing amounts of power that

[214] Companies' Ex 2A at 13 (Baker); OCC Ex. 9 at 25 (Smith).

[215] OCC Ex. 9 at 22 (Smith).

would be supplied at SSO prices under either option. OCC Witness Smith's analysis, which was not disputed by any party, demonstrated that the ESP as proposed was significantly more expensive than the MRO. While the Companies claim that the ESP provides non-price benefits, they have never demonstrated that those benefits are "more favorable in the aggregate"[216] and worth paying more for SSO under the ESP.

While a numerical analysis seems necessary for the indicated comparison, the statute also requires consideration of "all other terms and conditions" – including the negative effect related to the change of regulatory oversight on the electric distribution utility.

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.[217]

The Companies did not present any evidence to rebut this 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.[218] Mr. Baker provided no evidence to support this assertion. Finally, and of critical importance, Mr. Baker's 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 an FAC component.

---

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

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

[218] Id.

In conclusion, for all these reasons, Mr. Baker's comparison of the ESP and MRO fail. Only with his significant reductions,[219] possibly combined with the elimination of market-based power in the ESP, will the ESP be more favorable than the MRO.

C. The Companies Have Not Justified A "POLR" Charge.

The Companies have not disputed OCC's testimony that the POLR charge is unsupported. The Companies are correct that S.B. 221, like S.B. 3, gives Ohio retail customers the right to shop. It has been painfully obvious over the past several years in Ohio that the right to shop does not mean there are CRES providers *willing to sell.* According to the Companies' own testimony, it is only when AEP Ohio is subject to both the risks of customers leaving and returning that it experiences the POLR risk for which it seeks compensation.[220] AEP Ohio concedes its method of calculating the POLR fails to account for the reality of how long it will take customers to see choice in AEP Ohio's service territories – and how quickly customers switch to a CRES provider.[221] It has not been shown that the buying or selling of power will even occur during the ESP period. Were the Commission to consider these timing issues – even assuming *arguendo* that AEP Ohio is correct in how the POLR charge should be calculated -- it is obvious that

[219] 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 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 CSP and eliminated for OP, under the conditions recommended by OCC Witness Finamore; OCC Ex. 9 at 40 (Smith).

[220] AEP Ohio is assuming that the option value it calculates with the Black-Scholes model is equal to the risk to shareholders. AEP Ohio has provided no evidence through shopping studies or the like that this is the case.

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

the POLR charge should not be implemented at the beginning of the ESP period and certainly not until a threshold number of customers actually leave the system.

As if the above reasons are not enough to reject AEP Ohio's proposed POLR charge, AEP Ohio's insistence that the POLR risk is real and must be addressed by the Commission belies its failure to include increased shopping levels in its financial budget forecasts.[222] This is, of course, the real test of whether any company genuinely believes there will be a financial detriment to shareholders. If AEP Ohio believes shopping imposes a $500,000,000 risk to its shareholders, it has a fiduciary obligation to its shareholders to include such a risk in its financial projections. It also has a duty under Sarbanes-Oxley to accurately report business risks that will have a material impact on its performance. The Companies have not done this with its claimed $500,000,000 POLR risk in either its internal financial statements nor in its filings with the SEC.

The Companies claim they had a POLR rate in the RSP, supporting their request for a POLR charge in the ESP. OCC Witness Medine explained that this was not the decision of the Commission. In Case No. 04-169-EL-UNC the POLR charge was related to distinct regional transmission operational costs expected to be incurred during the Rate Stabilization Period, and were "based upon the specific circumstances ... in this proceeding. Nothing in this decision is intended to be precedent-setting ..."[223] This testimony is undisputed by the Companies.

---

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

[223] Id.

That risk, however, is practically nonexistent.[224] Customers should not be assessed a POLR charge that is unrelated in any way to whether customers shop or what the impact on the Companies is of customers who do shop.[225]

The Companies also dismiss Staff and OCC Witnesses' reasonable proposals to handle shopping costs through the FAC as not addressing the "optionality" measured by the Black-Scholes model.[226] Such weight should not be accorded a formula that is not used by other utilities to calculate POLR charges,[227]

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. In conclusion, the non-bypassable POLR charge proposed by the Companies should be rejected by the Commission on both qualitative and policy grounds.

Moreover, customers should be able to choose whether to pay the POLR charge to have the right to return to the SSO or to not pay the POLR charge and return at market. This right is specifically accorded to customers who are part of an aggregation under R.C. 4928.20.

---

[224] See id.

[225] 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.

[226] Staff Ex. 10 at 6 (Cahaan); Id at 13, 14.

[227] OCC Ex. 11 at 17, citing Baker Deposition, Page 29 and Response to OCC Interrogatory Request 5-111; AEP Ohio Initial Brief at 27.

D. 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' position regarding the non-FAC automatic increases is that "These automatic increases[228] are specifically permitted pursuant to R.C. Sec. 4928.143 (B)(2) (e)."[229] However, SB 221 does not require the Commission to authorize non-cost-based, unsubstantiated, rate increases for the Companies.[230] The Companies admit in their Brief that these non-FAC annual rate increases are not based upon the Companies' costs.[231] The Companies have not, and do not intend to, demonstrate that these additional revenues are actually needed by them, as a prerequisite to collecting these costs from customers, as shown from the testimony of the Companies' 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.[232]

---

[228] AEP Ohio proposes that the non-FAC portion of the standard service offer be increased by 3% for CSP and 7% for OP annually over the period of the ESP.

[229] Id.

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

[231] Id.

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

There has been no demonstration that the Companies are not collecting standard service revenues sufficient to recover all of these costs. Moreover, the Commission should not require customers to turn over their hard-earned cash to the Companies just because they can. The Commission should reject the Companies' proposed automatic rate increases.

E. 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 object to the opposition to CSP's request to sell or transfer certain generating assets.[233] This opposition is based primarily upon two factors: 1) that Companies have no present plan to exercise the authority they have requested; and 2) the PUCO is issuing new rules regarding corporate separation which the Companies should comply with before this action is authorized by the Commission. This is a proper basis upon which to deny CSP's request.

Also, the Companies must comply with the recently proposed corporate separation rules issued by the Commission in the SSO Rules Case.[234] The Companies are required to file for approval of the corporate separation plan within 60 days after the rules become effective. The plan would require an audit by an independent auditor within the first year of approval of the ESP funded by the Companies, but managed by Staff. The audit would cover compliance with the Commission's rules on corporate separations.[235]

---

[233] AEP Ohio Brief at 88.

[234] *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, 4828.17, and 4905.31, Revised Code, as amended by Amended Substitute Senate Bill No. 221,* Case No. 08-777-EL-ORD, Opinion and Order (Sept. 9, 2008).

[235] *FirstEnergy ESP Order* at 60 (Dec.19, 2008).

Specifically, the Companies request 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 representing 1300 MW of capacity.[236]

For these reasons, the Commission should deny the Companies' request to sell or transfer the Waterford and Darby generating assets. Should such authority be granted, it should require the Companies to undergo the 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.

F. 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[237] 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.[238] Both Witnesses Assante[239] and Baker[240] testified that the Companies had no plans for any early plant closures, but requested these accounting treatments because of the Companies experience with other early plant closures. "Mr. Assante testified that in 2005, when the Companies no longer were under SFAS 71 CSP's

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

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

[238] Id at 51, 52.

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

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

Conesville Units 1 and 2 were forced to close due to safety concerns that would not have been cost-effective to address. Since CSP's rates were fixed under its Electric Transition Plan, CSP recognized a $39 million net loss that included undepreciated investment and unusable M&S inventory. This loss was not recovered from customers."[241] Yet during this period, the Companies' earnings have been robust, demonstrating that although there was a net loss, the recovery of additional revenues was not required.

Based upon these two factors, that Companies have no plans or expectations that there will be early plant closures. If there are early plant closures, there has been no showing that the Companies will be prejudiced by such closures. There is no basis or requirement for the Commission to consider the request during the term of the ESP.

The Companies failed to address in their Initial Brief OCC and Staff testimony regarding early plant closure that customers should not bear the costs/risk of these uneconomic plants without accounting for the offset of the positive economic value of the rest of the Companies' generating fleet.[242] Staff Witness Hess believed that there is a positive economic value of the fleet even though there could be costs associated with the closure of uneconomic plants.[243]

For all these reasons, the proposed accounting treatment for early plant closure should be rejected at this time. If it is considered by the Commission at a later date, the recommendations of Staff Witness Hess should be adopted to protect the Companies' customers.

---

[241] AEP Ohio Brief at 91.

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

[243] Id.

G. The Statutory Test For Significantly Excessive Earnings Should Not Be Determined In This Proceeding. If It Is Determined, Companies' Testimony Should Be Rejected.

The Companies propose a method for determining whether CSP or OP has not earned significantly excessive earnings instead of whether the Companies have earned significantly excessive earnings (as required by the statute).[244] The Companies' proposed method shifts the burden of proof created by the statute away from the Companies and onto other parties to the case. The Companies also improperly request adjustments to the test to exclude revenues that could guarantee CSP and OP will never achieve such excessive earnings. Regarding the exclusion of revenues:

> Mr. Baker noted, at pages 37-38 of Companies' Ex. 2A (as did Companies' Witness Assante, at pages 16-17 of Companies' Ex. 6), that the phase-in deferrals would result in earnings as if there had not been a phase-in. Yet, the reality is that customers will not have paid rates that reflect the amounts of the deferrals. (Companies' Ex. 2A, p. 38).[245]

Mr. Baker is correct that the Companies' published financials would indicate the Companies received revenues in the amount of the deferrals when in fact the customers would not pay such revenues to the Companies until 2012. What Mr. Baker did not explain is that the expenses that are the basis of the deferrals, and therefore the basis of the revenues reported in the Companies' public financial statements, are also reported in

[244] R.C. 4928.143(F); R.C. 4928.143(C)(1).

[245] Companies' Brief at 139.

the same period as the deferrals. This means there is a perfect match between the Companies' fuel-related expenses and the attendant revenues (reported as deferrals). To eliminate deferrals from the Significantly Excess Earnings (SEE) test would drastically reduce the revenues for the period without a concomitant removal of the underlying expenses. This would result in a severe understatement of the Companies' revenues used in calculating the SEE test, thereby substantially lowering the earnings of Companies for that period. If Mr. Baker's recommended elimination of deferrals from the SEE test is accepted it would mean that commencing in 2012 when the deferrals are collected the Companies' revenues would be substantially overstated as compared with its costs. But of course, the ESP would have expired and there would be no SEE test to compensate for the customers for the Companies' extraordinary earnings.

The Companies also asked the Commission to remove revenues associated with off-system sales ("OSS") from the calculation of SEE. As Dr. Woolridge testified[246] there is no basis for eliminating revenues that are not one-time write-offs or non-recurring. This would simply reduce the revenues used in the test, making it less likely that the Companies would have significantly excessive earnings. Had this been intended by the legislature, it would have been so stated in S.B. 221. The Companies' proposal should be rejected by the Commission. The Companies' proposals to eliminate publicly-reported revenues from the SEE test should be rejected.

Regarding the test itself, no one in this case – or any of the ESP cases – has supported the use of a purely statistical Standard Deviation method alone to measure significantly excessive earnings – except the utilities themselves, including the

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

Companies. Thus, OCC 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.

OCEA's recommendation stands that the Commission should reject the Companies' purely statistical test in this and all other ESP cases. The proposed method is nothing more that a statistical formula that determines variance and measures no other qualitative or quantitative data.[247]

Should the Commission reject the testimony of Staff Witness Makhija, it should adopt the approach proposed by Mr. Cahaan, who also supported the approach of OCC Witness Dr. 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.[248] The recommendations of these witnesses regarding what the appropriate adder should be are strikingly similar. [249] It is important to recognize that the midpoints of these recommendations are identical.[250] This is another demonstration that Dr. Woolridge's 150 basis point adder is reasonable and should be adopted.

The Companies did not address in their Initial Brief Staff's and OCC's criticisms of their interpretation of the statutory language concerning significantly excessive earnings. Companies' Witness Makhija's interpretation was that the statute must call for a statistical standard deviation methodology because is measures whether the data variance "significant" – and this is the word used in the statute to describe excess

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

[248] Id.

[249] Staff Ex. 10 at 24.

[250] Dr. Woolridge's recommendation regarding the equity adder as a measure of SEE is 150 basis points. Mr. Cahaan's recommends a 200-400 basis points adder. Staff Ex.10 at 24 (Cahaan).

earnings. Such an interpretation ignores the clear meaning of the statute. If the General Assembly intended significantly excessive earnings to be measured by a standard deviation test, they could have included specific language to that effect in the statute.

For all these reasons, the Companies' purely statistical approach to determining significantly excessive earnings should be rejected. In addition, OCEA urges the Commission to defer the determination of the methodology for measuring comparable company business and financial risks and adjustments to capital structure in a separate proceeding, as was done in the FirstEnergy case.[251] This approach would provide stakeholders an opportunity to determine a methodology that can be applied across Ohio.

XI. CONCLUSION

The issues presented by the Companies' Application are numerous and complex. If the Companies' ESP is approved, without modification, their customers will be saddled with an unjustifiable $3.2 billion increase in rates. Moreover, the Companies' request for a rate increase comes at a dire time when the Companies' customers are facing difficult challenges, as so many of the customers testified at the local hearing.

It is up to the Commission to sort through the Application, culling the necessary increases from increases that are unreasonable and lack justification. In doing so, the Commission must follow the roadmap of regulation set out under Chapter 4928 of the Revised Code. That map puts into focus the state policies that underlie an electric utility's application for an ESP or MRO. First and foremost is the policy under R.C.

[251] *FirstEnergy ESP Order* at 64 (Dec. 19, 2008).

4928.02(A) that ensures "the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service."

In order to breathe life into this statutory policy, the Commission must make many changes to the Companies' ESP, changes called for by OCC and OCEA through testimony and briefs. Only with such changes can the rates established under the Companies' ESP meet the objective of "reasonably priced retail electric service."

On behalf of the 1.2 million AEP Ohio customers, struggling to pay bills, having to make choices, and seeking to make the best life they can for their families in Ohio, OCC and OCEA urge the Commission to say no to the extravagant and absurd proposals in the proposed ESP which are intended to impose unreasonable and unjustified costs on AEP Ohio customers. Instead, OCC and OCEA ask the Commission to implement an ESP in the manner that it was intended—consistent with the objective of ensuring reasonably priced electric retail service for Ohioans.

Respectfully submitted,

JANINE L. MIGDEN-OSTRANDER
CONSUMERS' COUNSEL

Maureen R. Grady, Counsel of Record
Terry L. Etter
Jacqueline Lake Roberts
Michael E. Idzkowski
Richard C. Reese
Assistant Consumers' Counsel

Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485
Telephone: (614) 466-8574
grady@occ.state.oh.us
etter@occ.state.oh.us
roberts@occ.state.oh.us
idzkowsi@occ.state.oh.us
reese@occ.state.oh.us

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Office of the Ohio Consumers' Counsel's Reply Brief Addressing the Columbus Southern Power Company and Ohio Power Company Electric Security Plans was served electronically to the persons listed below, on this 14th day of January, 2009.

Maureen R. Grady
Assistant Consumers' Counsel

PARTIES SERVED

sbaron@jkenn.com
lkollen@jkenn.com
charlieking@snavely-king.com
mkurtz@bkllawfirm.com
dboehm@bkllawfirm.com
stnourse@aep.com
dconway@porterwright.com
jbentine@cwslaw.com
myurick@cwslaw.com
mwhite@cwslaw.com
khiggins@energystrat.com
barthroyer@aol.com
gary.a.jeffries@dom.com
nmoser@theOEC.org
trent@theOEC.org
henryeckhart@aol.com
nedford@fuse.net
rstanfield@nrdc.org
dsullivan@nrdc.org
ed.hess@puc.state.oh.us
thomas.lindgren@puc.state.oh.us
werner.margard@puc.state.oh.us
john.jones@puc.state.oh.us
sam@mwncmh.com
lmcalister@mwncmh.com
jclark@mwncmh.com
drinebolt@aol.com
cmooney2@columbus.rr.com
msmalz@oslsa.org
jmaskovyak@oslsa.org
ricks@ohanet.org
tobrien@bricker.com
todonnell@bricker.com
cvince@sonnenschein.com
preed@sonnenschein.com
ehand@sonnenschein.com
tommy.temple@ormet.com
steven.huhman@morganstanley.com
dmancino@mwe.com
glawrence@mwe.com
gwung@mwe.com
stephen.chriss@wal-mart.com
lgearhardt@ofbf.org
cmiller@szd.com
gdunn@szd.com
aporter@szd.com
erii@sonnenschein.com
agamarra@wrassoc.com
kschmidt@ohiomfg.com
sbloomfield@bricker.com
cynthia.a.fonner@constellation.com
david.fein@constellation.com
mhpetricoff@vssp.com
smhoward@vssp.com
bsingh@integrysenergy.com
cgoodman@energymarketers.com
lbell33@aol.com
miresnik@aep.com
Greta.See@puc.state.oh.us
Kim.Bojko@puc.state.oh.us

CAMERA OPERATOR

ATTACHMENT II

POLICY PRECEDENT FILE

TITLE Ohio Electric Innovative Rates Program	Page 1 of 11
Ohio Economic Recovery Initiatives	Approved by J. D. Borrows, D. R. Maag
Electric Rate Incentives	Date Effective 6 / 28/ 83

1.0 Staff Treatment	2.0 Legal Authority	3.0 Applied Treatment
1.1 Current	2.1 Statute	3.1 Methodology
1.2 Alternative Approaches - Not Current Treatment	2.2 PUCO Rule	3.2 Adjustments
1.3 Rationale	2.3 Commission Orders	3.3 Staff Report Language
1.4 Background	2.4 Appellate Decisions	

1.0 STAFF TREATMENT

1.1 Current Staff Treatment

The Staff policy is to recommend Commission approval of reasonable utility proposals as short-term electric rate economic recovery incentives. Approved incentives are of two types;

- Individualized service and rate agreements between a utility and a customer, pursuant to Section 4905.31, Ohio Revised Code (Reasonable Arrangements Allowed; Variable Rate), and

- Modifications to Tariff rate schedule provisions, providing for wavier of minimal bills pursuant to Section 4909.18 Ohio Revised Code (Application for Tariff Approval, Not For An Increase In Rates).

Staff recommended rate incentives apply to customers with the following characteristics;

- New customers and corresponding new load, which otherwise would not have occurred, resulting in marginal revenue, not otherwise received, or

- Existing customers with load which otherwise would not have occurred, resulting in marginal revenue, not otherwise received, or

- Maintenance of existing customers and load which otherwise would be lost.

1.2 Alternative Approaches - Not Current Treatment

Alternative treatment of the unrecovered cost of service, resulting from sales attrition, is to allocate it among all classes of customer rates.

1.3 Rationale

The Electric Economic Recovery Rate Program is designed only to recapture sales attrition, incrementally improve efficiency or use of existing facilities and thereby contribute to the maintenance of all customer class rate levels.

POLICY PRECEDENT FILE

TITLE Ohio Electric Innovative Rates Program   Page 2 of 11

Ohio Economic Recovery Initiatives   Approved by J. D. Borrows, D. R. Maag

Electric Rate Incentives   Date Effective 6 / 28/ 83

1.0 Staff Treatment	2.0 Legal Authority	3.0 Applied Treatment
1.1 Current	2.1 Statute	3.1 Methodology
1.2 Alternative Approaches - Not Current Treatment	2.2 PUCO Rule	3.2 Adjustments
1.3 Rationale	2.3 Commission Orders	3.3 Staff Report Language
1.4 Background	2.4 Appellate Decisions	

Significant attrition of electric, industrial and commerical sectors sales occurred from 1979 through 1983. Such sales attrition significantly reduced revenue coverage of the embedded cost of service, reduced the efficiency of existing facilities used and reduced load factor by three percent. Based on the short run definition, sales and load attrition results in less efficient use of facilities, currently included in established rates. Such revenue attrition requires that the unrecovered cost of service and the less efficient use of existing facilities be allocated to other customer class rates.

1.4 History of Program

Industrial and commercial customer sales and load statistics for the period 1979 through 1983 showed significant sales attrition and revenue erosion. On June 20, 1983, the Commission solicited electric utility comments and proposals to spur short-term industrial production opportunities. On June 28, pursuant to the Commission Chairman's solicitation, the Commission, Staff and utility representatives met at the Commission offices and exchanged economic development incentives. The result is the current Commission and Staff electric economic recovery rate program. The attachments document this program's evolution.

POLICY PRECEDENT FILE

TITLE Ohio Electric Innovative Rates Program Page 3 of 11

Ohio Economic Recovery Initiatives Approved by J. D. Borrows, D. R. Maag

Electric Rate Incentives Date Effective 6 / 28/ 83

1.0 Staff Treatment	2.0 Legal Authority	3.0 Applied Treatment
1.1 Current	2.1 Statute	3.1 Methodology
1.2 Alternative Approaches - Not Current Treatment	2.2 PUCO Rule	3.2 Adjustments
1.3 Rationale	2.3 Commission Orders	3.3 Staff Report Language
1.4 Background	2.4 Appellate Decisions	

2.0 LEGAL AUTHORITY

2.1 Statute

Applicable Sections: 4905.31 O.R.C., 4909.18 O.R.C .

Section 4905.31 O.R.C. specifies that a public utility may enter into any reasonable arrangement with its customers providing for any financial device that may be practicable or advantageous to the parties interested. No such arrangement is lawful unless it is filed with and approved by the PUCO and under the supervision and regulation of the Commission. The Ohio Electric Innovative Rates Program, with the authority of §4905.31, is not violative of O.R.C. §4905.33, which prohibits a public utility from furnishing free service or service for less than actual cost.

Section 4909.18, O.R.C., requires a public utility desirous of modifying any existing rates to file a written application with the PUCO according to the specifications under that and other applicable statutes.

2.2 PUCO Rule - None Specifically Applicable

2.3 Commission Orders

The Opinion & Order issued by the Commission for the consolidated cases 83-1342-EL-ATA/83-1343-HT-ATA, comments on §4905.31 O.R.C. as follows:

> "Thus ... arrangements must be reviewed and approved by the Commission before it becomes effective so as to ensure that it is just and reasonable and to ensure that it will not adversely affect the balance of the company's customers."

The Commission also recognized that "so long as the company does not provide this service at a loss, it is better off with some revenue than it is with no revenue, the situation which would obtain if a given customer was not on the system at all. In general, the balance of the company's customers benefit from this maximization of revenues, for it tends to forestall the company's next general rate application."

POLICY PRECEDENT FILE

TITLE Ohio Electric Innovative Rates Program Page 4 of 11

Ohio Economic Recovery Initiatives Approved by J. D. Borrows, D. R. Maag

Electric Rate Incentives Date Effective 6 / 28/ 83

1.0 Staff Treatment	2.0 Legal Authority	3.0 Applied Treatment
1.1 Current	2.1 Statute	3.1 Methodology
1.2 Alternative Approaches - Not Current Treatment	2.2 PUCO Rule	3.2 Adjustments
1.3 Rationale	2.3 Commission Orders	3.3 Staff Report Language
1.4 Background	2.4 Appellate Decisions	

Although the Commission denied CEI's request to amend its filed schedules for electric service and steam service in this case, it did so because:

1. CEI wished to provide electric and steam service to certain customers without regard to cost of service considerations in order to be competitive with other energy sources (possibly causing the existing customers to subsidize this service).

2. CEI wished to use its own discretion for each individual case, violative of O.R.C. §4905.31 and 4909.18.

2.4 Appellant Decisions - None Specifically Applicable

1.0 Staff Treatment	2.0 Legal Authority	3.0 Applied Treatment
1.1 Current	2.1 Statute	3.1 Methodology
1.2 Alternative Approaches - Not Current Treatment	2.2 PUCO Rule	3.2 Adjustments
1.3 Rationale	2.3 Commission Orders	3.3 Staff Report Language
1.4 Background	2.4 Appellate Decisions	

3.0 APPLIED TREATMENT

3.1 Methodology

Staff determines reasonable incentive rate proposals based on a combination of the following criteria:

- The term of the rate initiative is short-term; i.e. five years.
- The short run marginal revenue derived from application of the rate incentive is greater than the short run marginal cost of providing the service.
- The rate incentive applies primarily to increases in usage and load from that which occurred on a historical, or base level.
- Incremental usage and load occurs in combination with increased short-term customer production, and corresponding increases employment and local economic activity.
- The proposing utility reasonably satisfies utility specific regulatory reporting requirements for identifying and quantifying the short-term effects of the specific proposed initiative.
- The application of a rate incentive does not discriminate against other customers and does not adversely affect other customer services and rates.
- The rate initiative, terms and conditions of the proposal are understandable and is administratively convenient to apply.

3.2 Adjustments

Appropriate treatment of the Economic Recovery Rate contract customers will require modification of traditional cost of service methodology and rate treatment. In order that all customers receive benefits and that no customers be adversely affected, it is necessary to distinctly identify the special contract customers as a separate rate class. The creation of a separate customer class will assure equitable treatment for all ratepayers.

POLICY PRECEDENT FILE

TITLE Ohio Electric Innovative Rates Program Page 6 of 11

Ohio Economic Recovery Initiatives Approved by J. D. Borrows, D. R. Maag

Electric Rate Incentives Date Effective 6 / 28/ 83

1.0 Staff Treatment	2.0 Legal Authority	3.0 Applied Treatment
1.1 Current	2.1 Statute	3.1 Methodology
1.2 Alternative Approaches - Not Current Treatment	2.2 PUCO Rule	3.2 Adjustments
1.3 Rationale	2.3 Commission Orders	3.3 Staff Report Language
1.4 Background	2.4 Appellate Decisions	

Special attention is directed towards treatment of the revenue difference between that actually recovered under the Economic Recovery Rate and what would have been recovered had the sales been made at the applicable standard rate. This difference is the "Delta Revenue".

If not recovered, this "Delta Revenue" would constitute a shortfall, or deficiency, in the utility's proposed or Commission authorized revenue. There are a number of methods by which the deficiency could be recovered.

Staff recommends that the Economic Recovery Rate Program contract revenue deficiency be recovered on a shared or "split" basis; a portion to be recovered by the general customers and the remainder contributed by the utility. In the Staff's opinion, it is equitable that both the benefits and the costs of economic recovery be distributed to both customers and the company. The short run marginal sales in revenue from the Economic Recovery Rate Program contracts are a benefit to both the general ratepayers and the utility. The additional sales and revenue help to utilize the system more efficiently, provide increased coverage of fixed costs, incrementally improve the utility's operating income and result in a lesser cost of service by reducing the level of capacity which otherwise would be allocated to all customer classes.

The following chart is a hypothetical example to show the magnitude of revenue and deficiency under the Economic Recovery Rate Program contracts compared to the otherwise applicable tariffed rate revenue.

ECONOMIC RECOVERY RATE PROGRAM CONTRACT COMPARISONS*

	Average Tariffed Rates	Average Contract Rates	Contract Revenue Deficiency
Revenue	$ 600	$ 500	$ 100
Rate Base	$1,000	$1,000	N.A.
Operating Income	$ 138	$ 38	$ 100
Rate of Return	13.8%	3.8%	10%

* This example is not reflective of any tax effects.

The Economic Recovery Rate Program contracts earned a 3.8% rate of return compared with the tariffed schedule rates (13.8%), resulting in a revenue deficiency of $100 in the form of operating income. The operating income deficiency should be distributed among the individual class rates and the utility as a contribution to the economic recovery effort. Staff recommends that half of the deficiency be borne by the utility as its contribution and half of the revenue deficiency be distributed to customers in accordance with the Staff recommended interclass revenue distribution. The following chart shows a hypothetical example of the manner in which the Economic Recovery Rate Program contract revenue deficiency should be recovered.

ECONOMIC RECOVERY RATE PROGRAM DEFICIENCY RECOVERY

	Residential	General Service	Other	Utility	Total
Revenue	$ 4,000	$3,000	$3,000	N.A.	$10,000
Percent Revenue	40%	30%	30%	N.A.	100%
Economic Recovery Rate Program Contributions	$ 20.00	$15.00	$15.00	$50.00	$ 100

3.3 Staff Report Language

The Economic Recovery Rate Program is designed such that each contract is evaluated separately. The individual utilities are providing information on a contract by contract basis. The review process by the Staff is evolutionary. The following is an excerpt from a recent Staff Report. This information must be looked upon as specifically tailored to Ohio Edison Company and its contract customers. Subsequent Staff Report language may be modified to appropriately address existing circumstances.

POLICY PRECEDENT FILE

TITLE Ohio Electric Innovative Rates Program Page 8 of 11

Ohio Economic Recovery Initiatives Approved by J. D. Borrows, D. R. Maag

Electric Rate Incentives Date Effective 6 / 28/ 83

1.0 Staff Treatment	2.0 Legal Authority	3.0 Applied Treatment
1.1 Current	2.1 Statute	3.1 Methodology
1.2 Alternative Approaches - Not Current Treatment	2.2 PUCO Rule	3.2 Adjustments
1.3 Rationale	2.3 Commission Orders	3.3 Staff Report Language
1.4 Background	2.4 Appellate Decisions	

Ohio Electric Innovative Rate Programs - Ohio Edison Company
Case No. 84-1359-EL-AIR

On September 25, 1981, Staff issued its document entitled "Ohio Electric Innovative Rate Programs". The document represents an effort on the part of the Commission to separate the topics of rate levels from rate design in order to better understand utility pricing policies, philosophies and related operations. The study was prepared by the Staff and representatives of the state's investor-owned electric utilities. The participants met regularly over the course of fifteen months during 1980 and 1981 with the intention of elaborating on specific rate design objectives and activities which are conducted to support and encourage innovations. The resulting report was directed at initiating a better structure for identifying innnovative rate opportunities.

Staff finds that the individual electric utility submittals to the Innovative Rate Program are beneficial to the Staff and Commission. Utility statements of rate design philosophy, policies, objectives and corresponding implementation activities provide an additional basis for better evaluating specific utility rates and rate schedule proposals. In the Staff's opinion, utility rationale of this nature should be relatively consistent with respect to desired longer term achievements and may add elements of integrity and credibility to rate proposals beyond that which may exist in case specific applications. Such a presentation by the utility may help to minimize the resources required by the Staff and Commission to evaluate rate proposals. And, Staff finds that the Innovative Rate Document could provide a basis for establishing an additional level of utility accountability, particularly with respect to authorized innovations.

Continued emphasis should be placed on promoting economic efficiencies. This can be achieved by promoting the use of the product (electricity) which will create increases in revenues and lessen the need for continual rate increase requests. It must be stressed that the goal is to more efficiently utilize existing facilities rather than creating a worse situation whereby additional facilities will need to be built to overcome a deteriorating system load factor.

Staff recommended in Case No. 83-1130-EL-AIR that within forty-five days subsequent to the issuance of the Commission's Opinion and Order, the Applicant submit to the Staff a document updating and revising the contents of its

POLICY PRECEDENT FILE

TITLE Ohio Electric Innovative Rates Program Page 9 of 11

Ohio Economic Recovery Initiatives Approved by J. D. Borrows, D. R. Maag

Electric Rate Incentives Date Effective 6 / 28/ 83

1.0 Staff Treatment	2.0 Legal Authority	3.0 Applied Treatment
1.1 Current	2.1 Statute	3.1 Methodology
1.2 Alternative Approaches - Not Current Treatment	2.2 PUCO Rule	3.2 Adjustments
1.3 Rationale	2.3 Commission Orders	3.3 Staff Report Language
1.4 Background	2.4 Appellate Decisions	

Electric Innovative Rate Program. Applicant submitted the requested information after the filing of the above case, in the format requested. Applicant also appropriately filed the up-date to incorporate any additions or revisions which included the Special Arrangements for Economic Development Program (SAED).

The SAED Program incorporates limited term billing demand discounts, as an incentive to new industrial customers to locate in Applicant's service area, and also encourages existing customers to expand their operations. In both instances exist the possibility for new or retained jobs in addition to increased revenue from sales.

Applicant has filed with the Commission, on a case by case basis, applications for Special Arrangements for Economic Development approval. Applicant is actively encouraging industrial load growth by this program to better utilize the capital investment in plant facilities and to add jobs in its service territory.

Staff believes that Applicant, prudently, is attempting to better its financial position and also the economic well-being of its customers by offering programs that will encourage the recovery of revenue from investment in plant, thereby bringing stability to its service area.

Staff finds that in each SAED filing, Applicant represented to the Commission that the approval would not operate to the detriment of any of its customers. In the instant case, Applicant did not consider the annualized impact of the loads of the customers (SAED) coming on line nor did Applicant introduce the revenue effect experienced by Applicant through the demand discount incentive. Staff has found in its investigation that, to date, the SAED customers coming on Applicant's system represent a load addition of less than 2/10 of 1% related to total system load.

In answer to Staff's Data Request, Applicant stated that "all demand and KWH data in the [instant] case has been projected without regard to these programs". Applicant will propose a methodology to adjust for and appropriately split benefits when they experience a significant impact.

POLICY PRECEDENT FILE

TITLE Ohio Electric Innovative Rates Program	Page 10 of 11
Ohio Economic Recovery Initiatives	Approved by J. D. Borrows, D. R. Maag
Electric Rate Incentives	Date Effective 6 / 28/ 83

1.0 Staff Treatment	2.0 Legal Authority	3.0 Applied Treatment
1.1 Current	2.1 Statute	3.1 Methodology
1.2 Alternative Approaches - Not Current Treatment	2.2 PUCO Rule	3.2 Adjustments
1.3 Rationale	2.3 Commission Orders	3.3 Staff Report Language
1.4 Background	2.4 Appellate Decisions	

Staff recommends that, within 60 days subsequent to the issuance of the Commission's Opinion and Order, the Commision order Applicant to submit to the Staff a report demonstrating the following:

(1) All probable benefits, direct and indirect, to each specific customer class.

(2) All possible detriments, direct and indirect, to each specific customer class.

(3) A case study of an actual SAED customer, measuring and detailing, with specificity, the revenue and expense differences between the regular rate and SAED rate and the effect it has on the following:

(a) Applicant's corporate structure

(i) Financial

(ii) Production and reserve balances

(iii) Transmission and distribution systems

(b) Inter class effect

(c) Intra class effect

(d) Jurisdictional service area economic impact study demonstrating the effect on, but not limited to, the following:

(i) Company revenue and expense

(ii) Property tax base

(iii) New Jobs

(iv) New housing starts

(v) Support systems (i.e., new commercial development)

(vi) Other

(4) Case studies of various load levels (i.e., 25MW, 50MW, 100MW, 200MW) employing the average load factor for the GS-Large Customer Class, and, where appropriate, using the data developed in No. 3 above as a model.

(5) Specifically detail the criteria upon which Applicant will determine if the revenue and expense effect is significant enough to apply a methodology of treatment.

(6) Applicant's methodology(ies) for treatment of the revenue and expense effect, caused by the program, in future rates cases.