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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO 2009 JAN 14 PM 4:50

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In the Matter of the Application of Columbus & Southern Power Company For The Approval of its Electric Security Plan And 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 OF THE OHIO MANUFACTURERS' ASSOCIATION
ON THE
COLUMBUS & SOUTHERN POWER COMPANY
AND THE OHIO POWER COMPANY'S
ELECTRIC SECURITY PLAN

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I.

INTRODUCTION

The OMA will not attempt to replicate the 160-page length of AEP-Ohio's Initial Post—Hearing Brief herein, in which AEP-Ohio offers up a lengthy "tutorial" on both the expansiveness of its ESP and the legislation under which it was filed. Suffice it to state one should not confuse the "length" of an argument with the "strength" of an argument any more so than one should confuse the "weight" of a post-hearing brief with the weight of the "evidence" upon which the brief is based.

AEP-Ohio's lengthy exposé is the result of the enormity of the task it has undertaken and the circular reasoning it employs in its effort to persuade the Commission to impose upon its customers a multi-billion dollar rate increase at a time the State of Ohio is experiencing a debilitating economic recession. The "tutorial" is apparently deemed necessary to convince the Commission that SB 221 was not enacted to avoid the massive rate increases experienced in other states with expiring economic regulation of their utilities, but instead SB 221 was enacted to encourage massive rate increases – so long as those massive rate increases are slightly less burdensome than would occur in a totally unregulated marketplace, particularly if such increases are complimented with policies advancing some societally desirable objective. The OMA submits that the passage of SB 221 a brief six months prior to the expiration of the rate certainty plan in AEP-Ohio was expressly designed to avoid the very results the Companies' ESP here produces!

AEP-Ohio's circular reasoning is evidenced in the alternative, and often conflicting, rationale selected to support individual components of AEP-Ohio's multi-faceted electric security plan proposal. AEP-Ohio seeks to portray the vast authority the General Assembly and Governor vested in the Commission with the enactment of SB 221 as an affirmation of the legislature's desire that the Commission affirmatively exercise such authority by granting the companies' proposed ESP without alteration or modification. AEP-Ohio goes so far as to warn the Commission of possible consequences should it even chose to leave any significant issues unresolved:

> "[I]f those significant issues are simply left open; that would likely be evaluated by the Companies as if their positions are not addressed when considering whether to accept any modifications to the proposed ESP."[1]

[1] Applicant's Brief at p. 104.

The Commission has determined that it has the authority to accept, reject, or modify a proposed ESP in the FirstEnergy ESP Case Order issued December 19, 2008 and it should similarly exercise such authority in this proceeding, as recognized in the Applicant's brief herein.

AEP-Ohio's circular reasoning can also be found in the Companies' efforts to create a problem so as to justify it's providing a solution. For instance, it seeks these massive rate increases, the effect of which can only encourage "shopping," for which "problem" it proposes the "solution" of gigantic non-bypassable $115 million annual POLR charge increases to purportedly compensate it for the alleged "incremental" shopping risk it has incrementally imposed upon itself. And, this circular reasoning again appears when the alleged goal of the Companies' proposed ESP is to "transition" the Companies to an "unregulated" market and then these same Companies seek this Commission's regulatory assurances that billions of dollars of "deferred" accounting revenues will be recovered from its customers over a future period extending as far out as 2018 – seven years after the expiration of its proposed "transitional" ESP. Simply stated AEP-Ohio requests continued regulation extending out to 2018 while its ESP transition-to-market period extends only to 2011. What then??? As detailed in OMA's initial brief in this case, AEP-Ohio's proposed ESP is inconsistent and in conflict with its corporate reaffirmed *regulated business plan*, a plan that has served it so well!.

On one hand, the Companies seeks to reach <u>back</u> in time to prospectively recover single item carrying costs on incremental environmental investments made as long as eight years ago, during which years the Company recovered all its costs and a return on equity that would be the envy of many. On the other hand, the Companies also seek to reach <u>forward</u> over the three years of its ESP to recover the projected impact of inflation upon its generating operations during a recessionary period in which deflation – not inflation – looms. It seeks to inappropriately recover those revenues through a much expanded fuel adjustment clause, and non-cost based generation and distribution flat percentage increases. As argued in OMA's initial brief, AEP-Ohio views SB 221 as simply an attractive vehicle to enhance its already enviable returns on equity. It does do by advancing alternative rationales and circular reasoning as it looks both forward and backward in its quest for billions of dollars in additional revenues. In the main, the Companies' initial post-hearing brief constitutes but a recitation of its direct case, demanding little response beyond that presented in OMA's initial brief.[2] The Companies' initial brief does, however, provide an opportunity to buttress the arguments previously advanced by the OMA that these Companies have not provided justification -- by any measure – for the increases requested, beyond the bare enactment of SB 221.

II.

THE ESP'S PROPOSED FUEL ADJUSTMENT CLAUSE (FAC) SHOULD BE REJECTED

As revealed in Companies' Exhibit DMR-1 and as argued in the initial OMA brief filed herein, the Companies improperly propose increases in excess of 100% be imposed upon customers' fuel costs over the next three years via its proposed fuel adjustment clause (FAC). In large measure these increases are predicated upon the Companies' purchasing power to meet increasing 5%, 10%, 15% components of the Companies' rather flat native load requirements at inflated, estimated, market prices in 2009, 2010, and 2011, notwithstanding the acknowledged fact that the actual power used to serve the load requirements will continue to be generated by the Companies' own generating units as dispatched by PJM for the LSE. In its post-hearing

[2] Which OMA reiterates herein.

brief,[3] AEP-Ohio seeks to "relate" these power "purchases" to specifically designated customers (formerly served by Monongahela Power Company and to Ormet Aluminum Corporation) and its "expectation" at the time it would subsequently receive market based pricing for its acceptance of these loads and the economic benefits it's serving such customers brought to the service area. The OMA submits that the "expectations"[4] of AEP-Ohio provide a most fragile foundation upon which the Company is attempting to justify its requested FAC rate increase.

Both these loads were voluntarily acquired by AEP-Ohio over three years ago, under both the encouragement and authorization provided by this Commission. The loads contributed by these customers have not been demonstrated in this proceeding to have been served below cost or to have produced an unacceptable AEP-Ohio return on equity. To the contrary, the returns on equity by both CSP and OP for 2007 and 2008 belie any such suggestion. Under such circumstances these customers and their loads should be treated no differently than all the other customers of these Companies for purposes of identifying the Companies' revenue entitlement. They do not provide any basis for granting AEP-Ohio any "premium" increases in its generaton FAC or non-FAC rates.[5]

Indeed, AEP-Ohio recognized as much in its initial brief, referencing its witness Mr. Baker:

> "He concluded by noting that while he could not speak to *how long the Companies' expectation, should be honored by the Commission,* the limited question before the Commission is whether that expectation should be honored for the duration of the

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[3] Company brief @ p.2.
[4] Company brief @ p. 40.
[5] The OMA is aware of the Commission's January 7, 2009 authorization to defer as a regulatory asset beginning in 2009 the difference between the 2008 market price approved by the Commission for use in administering the special arrangement and a blend of CSP's and Ohio Power's current standard service offer generation rates (market delta), *"which should not be considered precedent for further consideration of a long term arrangement in either AEP-Ohio's ESP proceeding or any application for a reasonable arrangement"* PUCO Case No. 08-1339-EL-UNC. The OMA adopts herein the arguments advanced by the Office of Consumers Counsel in its January 7, 2009 Motion to Intervene, which arguments were not addressed in the Commission's Order of even date.

three year ESP period. 'My answer to that question is that it definitely should be reflected in the ESP.' "[6]

Next, AEP-Ohio asserts that its witness Nelson's tortuous exercise[7] to divine the current 2009 baseline FAC rate for fuel, purchased power and environmental variable expenses within the most recent SSO for each company is preferable to the methods advanced by intervenors and Staff in the establishment of an FAC rate[8] The sole basis upon which the Company advances its witness Nelson's torturous approach is that both intervenors and Staff used a "cost-based" approach to identifying a proper FAC, and which "effectively applies an earnings test" that AEP-Ohio incorrectly opines is inapplicable, and not permitted by SB 221.[9] While cost "based" or "related" rates are not required to be applied to competitive generation by SB 221, neither are they forbidden by the statute as a "point of reference" for the Commission in evaluating whether the result produced by the ESP is "reasonably priced retail electric service.".

Compounding the problems associated with the Companies' projected and expanded FAC costs and cost deferrals of amounts in excess of the 15% annual capped increases[10] is the volumetric recovery of fixed capacity related KW costs in the kWh based FAC. While such a recovery mechanism penalizes high load factor customers, sends false price signals, and stifles economic development, perhaps its biggest flaw rests in the instability of its production of revenues. During periods of stable or increasing energy consumption – as existed when this proposal was filed – a variable energy based recovery of fixed costs will result in revenue over-

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6 Company's Brief @ p. 40. The fact Mr. Cahaan agreed with that position based upon his opinion the Companies were "pushed" into assuming "the additional responsibilities" is now irrelevant three years later (Tr. XIII, p. 60).

7 By starting with frozen electric fuel component rates that are ten years old; expanding it to reflect the additional categories of expenses it now seeks to recover; and, then arbitrarily applying the 3% (CSP) and 7% (OP) annual overall RSP rate increases as a surrogate to the actual fuel costs increases sustained during this extended period.

8 Company's Brief @ p. 19 – 24.

9 Company's Brief @ p. 24.

10 To be amortized and collected through a non-by passable rider in effect during the period 2012 through 2018 and recovered from an entirely different set of customers than those consuming the power that gives rise to the charge during the 2009 – 2011 period. Company's Brief, p. 25.

recovery, to the benefit of the company. However, where – as is currently the case – energy consumption is declining, brought about by the deteriorating economy, such a recovery base will result in revenue under-recovery. Thus, rejection of the Company's July 31, 2008 proposed recovery under currently prevailing circumstances actually serves to benefit the Companies, as well as its customers.

As if the foregoing FAC and non-FAC increases were not sufficiently burdensome to its customers (even with the mitigating 15% annual "cap") AEP-Ohio also seeks "to keep the door open"[11] to defer for future recovery any net un-depreciated plant investments and any other early closure costs associated with unanticipated plant shutdowns, and to return to the Commission during the ESP period, if necessary, to seek appropriate rate treatment pertaining to its Gavin Plant scrubber lease. Such a "return" to the Commission during the term of its ESP is at odds with the Companies' alleged justification for automatic annual non-FAC increases that it cannot seek adjustments, as "the ESP is for a set period of time." Both of these proposals have not been established to address known events, but instead seek to address speculative future events not contemplated by SB 221. Either the Companies have set rates for the ESP's entire three term or they have not!

III.

NON-FAC GENERATION RATE INCREASES

As reflected in AEP-Ohio's initial brief[12] the Company proposes to increase the non-FAC generation rates by 3% (for CSP) and 7% (for OP) for each of the three years of the proposed ESP. These cumulative 9% and 21% automatic rate increases are not directed or intended to

[11] Company brief @ p. 5,
[12] Company Brief @ p. 5.

address any known or identifiable cost increase or revenue requirements during the three-year period. Instead, they are intended to provide a "recovery mechanism" for increases in generating costs which may, or may not, be experienced over that period. As stated by the company, this component of its ESP is designed "to protect against erosion in cost recovery that typically occurs over time."[13] The amount of that "protection" over the three year ESP period is $349 million.[14] The Companies' response to charges this is unreasonable is that it is possible cost increases may exceed the revenues these automatic increases will generate. This reasoning provides scant justification for a $349 million increase in rates.

While admittedly SB 221 provides the Commission with the authority to authorize or permit such automatic rate increases over the course of an ESP, the legislation neither mandates or encourages the same be authorized. Stated differently, the mere existence of the authority does not warrant its exercise. AEP-Ohio has not demonstrated the same to be necessary, justified, or desirable, given its experienced earned return on equity. The Companies are controlling their non-fuel generation operation and maintenance costs as they respond to current economic conditions by also reducing their capital expenditures, as discussed in the OMA's initial brief. These are prudent actions the Companies should be encouraged, by the Commission, to continue during these difficult times.

IV.

THE DISTRIBUTION INCREASES

Given the acknowledged expanded authority SB 221 provides the Commission within the context of an ESP proceeding, AEP-Ohio requests non-cost based flat percentage distribution rate increases of 7% and 6.5% with similar justification to that advanced for the flat percentage

[13] Company's Brief @ p. 28.
[14] Rebuttal testimony of Steven Baron @ p. 2.

based non-FAC generation increases proposed by the Company. In the aggregate these distribution increases over the ESP period aggregate an additional $284 million of "protection" against inflationary factors bearing upon its distribution operations.[15] Once again, AEP-Ohio makes this request simply because the Commission possesses the authority to do so as part of an ESP under SB 221. While it might be argued that there is some value to be had in the "certainty" of customers knowing what both their generation and distribution rates will be over the three years of the ESP, that value is of little comfort to the Companies' ratepayers being asked to shoulder an additional $284 million rate burden having absolutely no relationship of any kind to the cost of providing the service in that period. The value of that "certainty" further evaporates with the Companies' proposal of a number of "riders" enabling it to recover "grid SMART"[16] and Enhanced Distribution Service Reliability ("EDSR")[17] program costs potentially reaching $109 million and $445 million respectively over the period of the ESP.

While the record in this case establishes some value resides in the grid-SMART and EDSR proposed programs, the Commission's Staff properly observed that it has been over a decade since the Companies' distribution service rates and tariffs have been examined in light of current industry-wide practices, costs, and revenue requirements and that these proposed distribution related increases should be examined in the context of a regulation based distribution rate case.[18]

The Staff's recommendation is particularly appropriate given the reservations of Staff and intervenor witnesses as to whether the Companies proposed EDSR constitutes a new "enhancement" of reliability or simply a "make-up" for past deficiencies in reliability service

[15] Exhibit JCB-2.
[16] Company brief @ p. 62.
[17] Company brief @ p. 76.
[18] Staff's brief @ p. 7 et seq.

practices. The OMA fully supports the Staff recommendations, particularly in view of the pendency of other current Commission proceedings questioning the adequacy of the Companies' distribution maintenance practices.

V.

RESPECTIVE CARRYING COSTS ON 20011-2008 ENVIRONMENTAL INVESTMENTS

The Companies have proposed in this case the prospective recovery of carrying costs on environmental capital additions made during the period 2001 – 2008. OEG witness Lane Kollen observed that the receipt of carrying charges on such investments is improper for the reason the existing RSP rates provide for recovery of generation costs including environmental capital additions through December 31, 2008, reflected in the Commission's Order in case No. 07-63-EL-UNC.[19] The prospective recovery of carrying costs associated with electric generation environmental expenditures are only permitted if such costs or expenditures "occur on or after January 1, 2009."[20] As these environmental expenditures occurred prior to January 1, 2009 they are both reflected in current rates and not subject to the duplicative recovery prohibited by SB 221.

VI.

THE PROPOSED SIGNIFICANTLY EXCESSIVE EARNINGS' TEST

The Companies have advanced a statistically based methodology for the Commission's consideration in determining, or "testing," in retrospect, whether the Company has earned significantly excessive earnings in a given year, commencing with the year 2009. As part of its

[19] Direct testimony of OEG witness Lane Kollen, p. 20, 21.
[20] RC 4928.143 (B)(2)(b).

proposed "test" the Company proposes a number of ad hoc "adjustments" to a.) combine the two Companies;[21] b.) expand the annual measurement period to three years; and, c.) to exclude certain revenues and add certain costs, the affect of which is to reduce the earnings subject to such a test. While SB 221 does not specify the manner or method by which the Commission is to determine whether "the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities that face comparable business and financial risks with such adjustment for capital structure as may be appropriate,[22] the "adjustments" proposed by the Companies herein are not "adjustments for capital structure," but simply adjustments directed to assure the Companies "pass" the subject significantly excessive earnings' test. Intervenors' witnesses recommend that the Commission establish a baseline or threshold earned rate of return on common equity and then provide an "adder" of 200 basis points, as utilized by FERC to encourage investment in transmission facilities, over which a resultant equity return would constitute "significantly excessive earnings."

Using the earning's test recommended by OEG witness King, illustratively applied to the year 2007 the Companies' earnings would have exceeded the threshold by 7.9%, requiring a refund to customers of $150 million,[23] while OP would have fallen below the threshold by 2.52% or $93.24 million.[24] It is Staff's position the significantly excessive earnings issue need not be addressed in this proceeding, but assigned to a working group – which recommendation was accepted by the Commission in the First Energy ESP proceeding, PUCO Case No. 08-935-EL-SSO, December 19, 2008. OEG takes the position the issue should be resolved in the current

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[21] Whose revenues are being individually determined on a stand-alone basis.
[22] RC 4928.143 (F).
[23] Rebuttal testimony of OEG witness Baron; OEG Exhibit LK-2; direct testimony of Lane Kollen.
[24] Suggesting that Company could have been entitled to such an increase in revenue before a refund would be required.

case, and in no event, later than the end of this year as utilities are required to recognize a liability in the year in which it arises, for refund in the following year,[25] as the significantly excessive earning's test will first be applied in 2010 to the Companies' 2009 earnings.

The OMA recognizes the value inherent in the test recommended by OEG but is somewhat concerned that OEG's proposed "adder" may be somewhat excessive as it is predicated upon transmission investments which tend to be somewhat more risky than distribution investments. In any event, the complexity of the issue being addressed by the subject test, its monetary impact upon both electric distribution companies' ratepayers and shareholders,[26] together with the Staff's desire to secure a uniform method applicable too all the state's electric distribution companies warrant the focused attention of a technically qualified work group, selected by the Commission or its Staff and representing the interests of all the affected stakeholders, for making a recommendation to the Commission on an appropriate "significantly excessive earning's test..

VII

CONCLUSION

In the final analysis a durable electric security plan must "secure" the interests of consumers in having "adequate, reliable, safe, efficient, non-discriminatory, and reasonably priced retail electric service,"[27] inclusive of generation provided within a competitive marketplace, either via an MRO or an ESP. In either event, the serving electric distribution utility is subject to the significantly excessive "earning's" test regardless of whether the serving vehicle is an MRO or an ESP. There is one and only one way "earnings" can be measured.

25 OEG brief @ p. 21.

26 As witnessed by the results produced through OEG proposed test's application to the individual AEP-Ohio Companies herein.

27 4928.02 (1), RC.

Earnings can only be established through some acceptable measurement of the "relationship" between revenues and costs. The cost of providing service is an inherent, essential, component in determining "reasonable priced retail electric service." "Common sense also tells us that an electric security plan should provide a degree of stability of rates over time, such that revenues are not authorized at a level and point in time that they are likely to be "clawed back" the following year as being significantly excessive in the return they produce. This involves the use of *informed judgment* in both the initial ESP revenue authorization or the MRO CBP authorization as well as in the subsequent application of the significantly excessive earning's test so as to align the results produced by both exercises.

It is respectfully submitted that the exercise of such informed judgment by the five members of this Commission, based upon the record of this case, will not allow for the approval of the proposed ESP. The Companies should be directed to file a new or amended ESP consistent with their corporate regulated business model and in full recognition of the economic environment likely to exist during the term of the new or amended ESP.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that this 14th day of January 2009, a copy of the foregoing Reply Brief was served on all parties of record via electronic mail.

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