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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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

REPLY BRIEF OF INDUSTRIAL ENERGY USERS-OHIO

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On Thursday, July 31, 2008, Columbus Southern Power Company and Ohio Power Company (individually "CSP" and "OP", respectively, and collectively "Companies") filed an application for approval of standard service offers ("SSOs") under Section 4928.143, Revised Code (hereinafter referred to as "ESP Application" or "Proposed ESPs"). The Companies' Proposed ESPs raise "... issues that are broader than simply focusing on the SSO for competitive retail electric services."[1] In addition to raising a variety of issues beyond pricing of competitive retail electric service, the Companies' ESP Application indicates that the Companies would discuss "... their long-term vision for the future in some detail and address how the proposed ESP is designed to implement that vision."[2] The Companies' ESP Application requests the Public Utilities Commission of Ohio ("Commission") to:

[1] ESP Application at 2

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

1. approve their ESPs without modification, including all of the accounting authority to implement the ESPs as proposed;

2. provide such approval sufficiently in advance of the scheduled termination of their Rate Stabilization Plans ("RSP") approved by the Commission in Case No. 04-169-EL-UNC;[3]

3. approve their application to modify their corporate separation plan; and,

4. approve CSP's application to provide CSP the authority to sell or transfer certain of its recently acquired gas-fueled generating assets.

The Companies' broad request for relief is being contested by numerous parties and has been examined through the Commission's ajudicatory process, which includes the submission of briefs. Initial briefs in this proceeding were filed on December 30, 2008. In accordance with the briefing schedule, IEU-Ohio offers this reply brief for the Commission's consideration.

IEU-Ohio's reply brief does not attempt to address all the issues raised by the parties during the hearing or in their briefs. The failure of IEU-Ohio to address an issue in this reply brief is not a reflection of IEU-Ohio's position on the merits; it is a practical concession to the time and resources that IEU-Ohio must divide between many Commission cases.

I. THE COMPANIES' INITIAL BRIEF

The Companies' initial brief is mostly a restatement of the Companies' prepared testimony accompanied by selective references to portions of the testimony of other

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

witnesses that the Companies say support their request for relief.[4] In its initial brief, IEU-Ohio addressed the legal, factual and policy defects in the Companies' direct case and will strive to not repeat itself in this reply. As IEU-Ohio explained in its initial brief, the Companies' Proposed ESPs are unreasonable and unlawful.

The Companies' brief does make it easier to see some of the defects in their position on the meaning of the law and the nature of the Commission's authority under the law.

For example, the Companies construct a claim that Section 4928.143, Revised Code, requires the Commission to mechanically test the Proposed ESPs against the expected results of Section 4928.142, Revised Code, and mechanically approve the Proposed ESPs if they pass the benefit-in-the-aggregate test.[5] They go on to say, in effect, that only if the Commission finds that the Proposed ESPs flunk the benefit-in-the-aggregate test can the Commission proceed to modify the Proposed ESPs. They attempt to make their absurd interpretation of law less absurd by suggesting that "... customers are protected by the Significantly Excessive Earnings Test (SEET)" and "... that the protection provided by the SEET only benefits customers ...."[6]

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[4] For example, the Companies reference the testimony of Staff witness Johnson to support their position on the price that should be used to measure their proposed SSO against the expected result of Section 4928.142, Revised Code. They say that Mr. Johnson's testimony confirms that information from the fourth quarter of 2008 is not indicative of a shift in the long-term price trend. Companies Brief at 134. Regardless of the extent to which data from the fourth quarter of 2008 can be used to establish a long-term trend, the Companies have represented to the public that "[i]n nearly every aspect, Fall 2008 has no resemblance of the conditions that surrounded AEP and the entire utility industry in Fall 2007." IEU-Ohio Exhibit 5 at 4. The Companies' attempt to use the testimony of Mr. Johnson to support their claim that the Commission should, in effect, ignore everything that has happened since the Companies filed their ESP Application conflicts with the views they have expressed to the financial community.

[5] Companies Brief at 13-16.

[6] Companies Brief at 28. The Companies seem to ignore the fact that they have a right to terminate an ESP if the Commission reduces their revenue as a result of the SEET.

The Companies' brief also adds to the mysterious assembly of law, theory or facts they appear to be relying on to secure approval of their parade of automatic rate escalation mechanisms. The Companies make it clear that these automatic rate increase mechanisms are not based on cost, prudently incurred or otherwise.[7] Then they go on to assert that these automatic rate increases are designed to "... protect against the erosion in cost recovery that typically occurs over time."[8] The net effect of the Companies' justification for the proposed automatic rate increases seems to consist of two propositions which are in conflict with each other:

1 It is inappropriate to subject rate-escalation requests to cost-based analysis; and

2. Rate-escalation mechanisms, which cannot be subjected to a cost-based analysis, are nonetheless warranted because they will allow the Companies to collect sufficient revenue to recover their costs.

In the end, the Companies appear to be seeking approval of some form of cost-baseless ratemaking.

The Companies' brief also reveals more clearly the theory that they are relying on to increase rates and revenue for things like carrying costs. They assert that they are entitled to increase their **non-cost-based rates** if they can show that specific categories of **cost** are "... not currently reflected in their SSO rates."[9] But this theory has no place in ratemaking regardless of what method is used to determine if current rates and revenue are reasonable both for customers and the utility.

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[7] *Id.*

[8] *Id.*

[9] Companies Brief at 29.

In ratemaking, it is always the case that new types of costs show up from time to time or that the costs assumed for purposes of constructing a "test year" may actually be more or less than their test year level once new rates are put into effect. But, the ratemaking process established by law does not track costs by individual category; it produces a regulatory authorization to collect revenue through the application of rates and charges to the service provided by the utility. Once the ratemaking process has produced authority to bill and collect revenue for service, the rates and resulting revenue are presumed to be reasonable (for both the utility and customers).[10] A party seeking to increase the total revenue has the burden of proof and this allocation of the burden of proof is repeated in Section 4928.143(C), Revised Code.

A showing that a particular category of costs is not currently reflected in rates may be, circumstantially speaking, some indication that current rates and revenue may not provide adequate compensation but it is not proof that current rates and charges and the revenue derived therefrom are inadequate or unreasonable.

The Companies cannot have it both ways. They want to use traditional cost-based ratemaking selectively to increase rates where they believe particular categories of costs are not currently reflected in rates. Amended Substitute Senate Bill 221 ("SB 221") provides the Commission with the alternative authority to establish pricing for competitive services and this alternative authority has been described as a hybrid. But SB 221 does not require the Commission to selectively increase rates (which are not based on costs) because the non-cost-based rates do not reflect a particular category of costs. If the analysis starts with non-cost-based rates, it is not possible to say what

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[10] Section 4909.03, Revised Code. *See* IEU-Ohio's cross-examination of Mr. Cahaan at Tr. Vol. XII at 221-222.

particular costs are adequately covered by the revenue available from non-cost-based rates. In this circumstance, the Commission's exercise of its ratemaking discretion must include an examination of the relationship between total revenue and total allowable costs to determine if the rates and the compensation they provide are reasonable. An examination of total jurisdictional revenue and matched jurisdictional costs is not required because SB 221 restored traditional regulation. It is required to produce a reasonable and balanced end result.[11]

Once the Companies propose a rate increase based on a claim that their current revenues need to be increased to recover this or that cost of providing service, it is not legally sufficient to simply limit the inquiry to those cost categories that may not be currently reflected in rates. It is the Companies (and not the other parties) that have introduced cost-based ratemaking into this proceeding and the Companies cannot selectively close the cost-based examination door to let in only those costs that they believe might support an increase in revenue. The Companies' compartmentalized version of cost-based ratemaking precludes an examination of other cost categories that may have gone away or may remain at diminished levels and thereby demand less of the support provided by the revenue available from current rates.

For what it may be worth, the circumstantial evidence also shows that the Companies are seeking an increase in rates and revenue through their application of a

[11] In *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), the United States Supreme Court set the proper balance between investor and consumer interests by adopting what has become known as the "end-result" test. *See also Duquesne Light Co. v. Barach*, 109 S. Ct. 609 (1989).

compartmentalized version of cost-based ratemaking at a time when they appear to be obtaining adequate compensation from current rates and charges.[12]

The experience in this proceeding also illustrates the administrative difficulties that the Commission will need to contend with in the future should it endorse the Companies' combination of: (1) a compartmentalized version of cost-based ratemaking applied to selectively increase revenue; (2) base rates that are not based on cost to begin with; and, (3) automatic rate increase mechanisms that are not based on costs but are claimed to be needed to guard against erosion of the Companies' opportunity to recover costs. Regardless of whether the next proceeding to establish an SSO is conducted under Section 4928.142 or 4928.143, Revised Code, it is reasonable to expect a substantial amount of effort will be required to sort out just what rates approved in this proceeding cover or do not cover. So, in addition to its legal defects, the Companies' ratemaking "combo" is garnished with administrative complexities that will increase over time.

Next, the Companies restate the reasons they offered in testimony for why the Commission should approve their proposal to use wholesale market purchases of five, ten and fifteen percent of their requirements during 2009, 2010 and 2011, respectively, to meet their SSO supply obligations with the cost of such purchases passed on to their Ohio customers through their proposed more-than-fuel adjustment clause ("FAC").[13] The Companies' brief makes it clear that they do not need to source such supply from

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[12] *See* Staff Exhibit 10 at 3-4.

[13] Companies Brief at 37-41.

the market.[14] Rather than referencing need as their justification, the Companies make the same vague references to the requirements of Ormet, the former Ohio customers of Monongahela Power Company and their desire to continue the transition to market-based rates that peppered their prepared testimony. Oddly, the Companies' "slice-of-system" justification is diced into a claim that increasing rates will, somehow, promote economic development and retention.[15]

While the Companies' brief mentions the history of their relationship with Ormet and the former Ohio customers of Monongahela Power, they really do not explain the history.[16] IEU-Ohio suspects that the Companies did not supply this history in their brief because, as IEU-Ohio already identified in its initial brief, history indicates that the Companies' position is without merit.[17]

The Companies' claims regarding the arrangement that gave them the opportunity to meet the electric service obligations of Monongahela Power Company are likewise based on a tortured view of history. Under this arrangement, CSP purchased Monongahela Power's distribution system at net book value and the former Monongahela Power customers migrated to the much higher CSP tariff rates (then based on CSP's RSP). The transition featured an opportunity for CSP to collect revenues determined as though it had to rely on purchased power at market-based prices (rather than generation supply from the AEP pool or supply from OVEC at cost-

[14] Companies Brief at 39.

[15] *Id.* The Companies state that they are also asking the Commission to approve a non-bypassable economic development rider ("EDR"). *Id.* at 129-132. The Companies have never explained why both the EDR and slice-of-system are needed or how these two proposals might work in combination.

[16] *Id.* at 38.

[17] *See* IEU-Ohio Brief at 35-37.

based prices) plus reimbursement from customers for a $10,000,000 premium that was paid by CSP to Monongahela Power.[18] The above-tariff cost of the market-based purchases attributed to the service needs of the former Monongahela Power customers was, as in the case of Ormet, passed on to customers and not absorbed by CSP or its affiliates.

If history tells us anything about the effect of the Companies' resumed relationship with Ormet and new relationship with the former Ohio customers of Monongahela Power, it confirms that the Companies have been treated very well by the Commission and their Ohio customers. It confirms that the Companies will not agree to take on new load without at least asking to collect revenue which has the effect of attaching "market-based" prices to such new load at least where the new load is not within the Companies' existing certified service areas. During this period, the Companies have enjoyed good financial health.[19] And, the contribution to earnings provided by the gross revenue margin (revenue less fuel and purchased power expense)[20] per MWH of the Ohio Companies is the highest within the AEP system.[21]

The history and the Companies' own descriptions of the financial performance enabled by the regulatory decisions of the Commission conflict sharply with the Companies' claims that their current retail rates are cutting them short or that they are owed an opportunity to increase rates even more. And, from the gross indicators of the

[18] *In the Matter of the Transfer of Monongahela Power Company's Certified Territory in Ohio to the Columbus Southern Power Company*, Case No. 05-765-EL-UNC, Opinion and Order at 18 (November 9, 2005).

[19] *See* Staff Exhibit 10 at 3-4.

[20] Tr. Vol. IV at 285; *see also* IEU-Ohio Brief at 15, footnote 38.

[21] *See* IEU-Ohio Brief at 15.

Companies' expected performance, there is nothing to suggest that the profound changes in the economy that have occurred since the Companies filed their ESP Application on July 31, 2008[22] will negatively affect the earnings that the Companies will generate for their one shareholder, AEP.

II. THE SEET

The Companies' brief discusses the SEET throughout and devotes more than 20 pages specifically to the SEET. No other subject receives as much attention in the Companies' brief. Likewise, the Ohio Energy Group ("OEG") devotes a significant portion of its brief to the SEET. Both the Companies and OEG urge the Commission to determine the SEET methodology in this proceeding, a position which is contested by the other parties, including IEU-Ohio.

The amount of time that has been devoted in this proceeding to the debate over the SEET methodology implies that: (1) there is a clear choice between competing methodologies; (2) there is a clear need to make a decision now; and, (3) a decision now will resolve the issues. None of these implications is accurate.

For example, Dr. Makhija, the Companies' SEET champion, testified that: his particular methodology was disconnected from the Companies' Proposed ESPs;[23] and it would be appropriate to reexamine the methodology before using the methodology and to test its validity based on the then-existing conditions.[24] Dr. Makhija suggested that there may be alternative ways to control for excessive earnings but he narrowly

[22] IEU-Ohio Exhibit 5 at 4.

[23] Tr. Vol. IV at 33.

[24] Tr. Vol. IV at 34.

constrained his approach based upon his interpretation of Section 4928.143, Revised Code.[25] He also testified that having a different SEET for each electric distribution utility ("EDU") would make it difficult to meet the requirements of Section 4928.143, Revised Code.[26]

Additionally, Dr. Makhija acknowledged that earnings are what is left over after revenue is reduced by the cost of goods sold, including interest expense on debt and preferred dividends.[27] So before the Commission can determine the earned return rightly attributable to the revenue collected from the Companies' retail customers, it will have to determine the cost of service which should be used to residually define the earned return.

In this context, it is also worth noting that Section 4928.143(F), Revised Code, requires the Commission to make appropriate adjustments to capital structure for purposes of conducting the SEET. Of course, any adjustments to capital structure will depend on the conditions and facts as they exist when the SEET is applied.

OEG's witness on the application of the SEET, Mr. Kollen,[28] recommends that the Commission make numerous ratemaking adjustments to run the SEET. These adjustments have the effect of restating the earned return as reported by the Companies. He also testified that it would be appropriate to make at least some

[25] Tr. Vol. XIV at 36-38.

[26] Tr. Vol. XIV at 56-57.

[27] Tr. Vol. XIV at 33.

[28] Mr. Kollen testified that he was not OEG's witness on the SEET methodology. Tr. Vol. V at 125. However, his testimony contained several recommendations on the implementation of the SEET methodology and he agreed that he was carrying recommendations on how to compute earnings for purposes of conducting the SEET. Tr. Vol. V at 129-130.

adjustments to the earned returns of companies in the comparable group to measure comparable earnings for purposes of applying the SEET.[29] He did not identify what adjustments in the earned returns of the comparable companies would be appropriate. He testified that the methodology proposed by OEG was designed to be practical and that "... it doesn't get bogged down in all of this type of analytical detail where people could reasonably disagree but rather to simply take the information from a published source of financial information."[30] But, his approach requires getting bogged down in the detail and looking behind the financial information reported by the Companies. He just does not want the Commission to extend the detailed inquisition he recommends the Commission adopt to restate the Companies' financial performance to the information reported by the comparable companies.

In a recent case, the Commission addressed proposals to select a methodology for determining significantly excessive earnings.[31] There, the Commission agreed with a Staff recommendation to convene a workshop for the purpose of examining the methodology for the excessive earnings test, noting that the test itself will not actually be applied until 2010. The Commission should land on a similar result in this proceeding.

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[29] Tr. Vol. VII at 125-128.

[30] Tr. Vol. VII at 128.

[31] *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code in the Form of an Electric Security Plan*, Case No. 08-935-EL-SSO, Opinion and Order at 60-64 (December 19, 2008).

III. OFF-SYSTEM SALES OR SYNCHRONIZING COSTS AND BENEFITS

Many of the briefs devote attention to the treatment of off-system sales. For example, The Ohio Consumer and Environmental Advocates ("OCEA") urge the Commission to recognize the revenue from off-system sales, one way or the other, to reduce rates.[32] Relying on the ratemaking treatment in other jurisdictions, OEG urges the Commission to modify the Proposed ESPs to require the revenue from off-system sales to be applied to reduce the size of the proposed FAC.[33] Recommendations on the role of off-system sales revenue are similar to those regarding the role of capacity equalization revenue that is derived from the operation of the AEP pool.[34]

As IEU-Ohio discussed in its brief (at pages 9 to 15), the Companies' proposed FAC is designed to recover a broad range of costs, including capacity-related costs. This broad scope does much to prompt the search for appropriate offsets to the very large rate-escalating effects of the Companies' proposed FAC. But, the proper treatment of off-system revenues or capacity equalization revenues cannot be determined without a larger examination.

For example, OP has long had much more generating capacity than it needs to meet the needs of its retail customers.[35] In traditional rate cases, this condition prompted claims that OP had "excess capacity" or more generating capacity than was

[32] OCEA Brief at 57–59.

[33] OEG Brief at 10.

[34] *See* OCEA Brief at 59 and OEG Brief at 11.

[35] OP was and "... is part of the highly-integrated AEP power pool that is operated and planned as a single system." *In the Matter of the Application of Ohio Power Company for Authority to Amend its Filed Tariffs to Increase the Rates and Charges for Electric Service and Related Matters*, Case Nos. 94-996-EL-AIR *et al.*, Opinion and Order at 45 (March 23, 1995) (hereinafter cited as *OP's 1995 Case)*; IEU-Ohio Exhibit 3 at 1, 8-15.

necessary to reliably meet the needs of its Ohio customers.[36] Historically speaking, parties advanced an excess capacity claim as a predicate for recommending adjustments to the valuation of the "used and useful" property or "rate base" to remove the "excess" amount of the generating plant from the jurisdictional cost of service established by the traditional ratemaking formula.[37]

But, the Commission's traditional regulation precedent on excess capacity involved a two-part test. First, the Commission addressed the question of whether the actual generating capacity was physically excessive. If the answer to this question was positive, the Commission then conducted an economic analysis to determine if the excessive physical capacity was also excessive from an economic perspective. Only if the generating capacity was excessive from both a physical and economic perspective did the Commission then proceed to consider a cost of service reduction because of excessive capacity.[38]

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[36] *In Re Application of Ohio Power Company*, Case No. 85-726-EL-AIR (July 10, 1986) at *133-134; 76 P.U.R. 4th 121 (hereinafter cited as *OP's 1986 Case*).

[37] *Id.*

[38] In *In the Matter of the Application of The Cleveland Electric Illuminating Company to Increase Certain of its Filed Schedules Fixing Rates and Charges for Electric Service*, Case No. 78-677-EL-AIR, Opinion and Order at 8 (May 2, 1979), the Commission reviewed a Staff recommendation that no rate base adjustment be made despite finding that an electric utility had 15.06% more capacity than indicated by the Commission's twenty percent (20%) reserve margin benchmark for evaluating electric utilities capacity in accordance with Section 4905.70, Revised Code (repealed as part of Ohio's electric restructuring legislation):

> In deciding whether such an adjustment is appropriate, a number of vital considerations must be borne in mind. First, it is axiomatic that an electric utility is expected to construct and maintain capacity which is sufficient to provide reliable and adequate service to its customers on an ongoing basis, allowing for long term load growth, fluctuations in usage patterns, unscheduled outages, and a variety of other complex factors which impinge upon its ability to meet its load. Second, given the long lead time required for major power plant construction and the uncertainties inherent in long term load forecasting, it is totally unrealistic to expect that even the most prudent utility will have the precise amount of capacity it needs at a given point in time. Finally, given the fact that capacity must be added in fairly large increments, a utility's reserve margin can normally be expected to fluctuate from year to year. The relevant question, therefore, is not whether the

In OP's historical circumstance, this two-part excess capacity test resulted in the Commission rejecting proposed negative adjustments to the rate base valuation. While the Commission agreed that OP had excessive generating capacity from a physical perspective, it rejected a ratemaking adjustment because OP's ability to "... sell its excess capacity at profitable rates benefits its customers. These rates provide a means of reducing the jurisdictional revenue requirements that would otherwise be borne by the company's jurisdictional customers."[39]

So, at least from a historical perspective, OP's Ohio customers have carried responsibility (in their rates and charges) for costs of OP's generating assets which would have otherwise been excessive but for the reduction in the jurisdictional revenue requirements made possible by the contribution from non-jurisdictional sales. It appears that this balance of costs and benefits is reflected, to a currently unknown extent, in OP's present retail rates.[40]

As importantly, the Commission's two-part excess capacity test reflects application of a regulatory principle: The benefits produced from the incurrence of a cost of providing utility service are rightly allocated to the parties who are responsible for paying the costs.

> Applicant's reserve margin exceeds the optimum level, but whether it exceeds that level by an amount which is unreasonable in light of the foregoing factors, or which indicates that the Company acted imprudently in its capacity planning.

See also *In the Matter of the Application of the Dayton Power & Light Company for authority to modify and increase its rates for electric service to all jurisdictional customers*, Case No. 76-823-EL-AIR, Opinion and Order at 6-7 (July 22, 1977).

[39] *OP's 1986 Case* at *133.

[40] OP's most recent traditional rate case was resolved by the Commission's adoption of a settlement. *OP's 1995 Case*. Based on the content of the settlement, it is not possible to observe the rate base valuation that was used to form the signatory parties' recommendation that OP receive a revenue increase of $66,000,000. It is clear that the Commission did not address any excess capacity claim in OP's most recent traditional rate case.

The structure of the electric industry has changed significantly since the back-in-the-day debates over excess capacity and the extent to which revenue from off-system sales should be considered as a factor in making rate base adjustments to remove excess capacity. Today, there are many more opportunities for the Companies to deploy their generating assets into the various markets operated by PJM Interconnect LLC ("PJM") to gain revenue and net income and the Companies are taking advantage of these opportunities.

The Companies currently participate in PJM. All of their available generating capacity is bid into the PJM market. In other words, AEP, acting on behalf of each of its operating companies, offers the output of available generating units to PJM. It is up to PJM to determine what to do in response to these offers.[41] On any given day, the actual load presented by the Companies' customers could, in accordance with PJM's determinations, be served by generators other than those owned or operated by the Companies.[42] Regardless of who actually owns the generation capacity, PJM will dispatch available generation capacity to serve load and maintain real-time reliability.[43] Under the PJM rules, all suppliers with load serving responsibilities (including the Companies) must maintain adequate resources to reliably meet their customers' needs.[44]

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[41] Tr. Vol. XI at 56-57, 65.

[42] Tr. Vol. XI at 58.

[43] Tr. Vol. XI at 59-60.

[44] Tr. Vol. XI at 60-61. PJM's resource adequacy requirements and generating resource dispatch responsibilities also have significance relative to the Companies' claims regarding the risks they face because of their default supplier obligations.

While the subject of off-system sales was brought up repeatedly during the hearing, there was less attention paid to the other opportunities that the Companies have to benefit from the markets established by PJM. For example, the Companies have opportunities to generate revenue from their generating assets in PJM's capacity market and energy market.[45] And, the Companies have obtained revenue from these markets.[46] The Companies also have opportunities to sell into PJM's ancillary services market.[47]

Since PJM is a regional transmission organization ("RTO") that came into existence during the transition period,[48] the revenues which the Companies derive from participation in the PJM markets are not currently reflected in rates. Thus, if the Companies' compartmentalized version of ratemaking was going to be used to raise rates for costs that are not currently reflected in rates, it would seem appropriate to net these new PJM revenues against such costs.[49] But once this discussion moves beyond theory, it becomes difficult to determine the specific actions that should be taken for ratemaking purposes because the record does not provide a comprehensive examination of all the costs incurred and revenues available to the Companies.

If revenue from off-system sales is used as an offset to costs recoverable through the FAC and the Commission finds, based on the historical record, that current

[45] Tr. Vol. XI at 63.

[46] Tr. Vol. XI at 64.

[47] Tr. Vol. XI at 66-68.

[48] Tr. Vol. XI at 55-56.

[49] Mr. Strom made it clear that the scope of the proposed FAC should only be approved if the costs to be recovered through the FAC are not being recovered someplace else. Staff Exhibit 8 at 3. IEU-Ohio presumes that he would also agree that revenue should be neither over- nor under-counted.

rates reflect some credit for off-system sales revenue, then the Commission must (as is the case with fuel cost) synchronize the amount of off-system sales benefit that is embedded in current rates with any off-system sales benefit that is reflected in an FAC. Similarly, if the Commission agrees with the Companies that it is improper to consider the benefit of off-system sales, then the benefit and burden of off-system sales must be removed from base rates. Again, the record does not provide the Commission with the information required to make sure that the treatment of off-system sales in current rates and any treatment of off-system sales revenue in the FAC produces an outcome that is reasonable for customers as well as the Companies. For this reason, among others, IEU-Ohio has urged the Commission to reject the Companies' FAC proposal or, if the Commission does permit some fuel cost recovery mechanism, to narrow the scope of the mechanism so that: (1) it is specifically focused on actual variable acquisition and delivery costs of fuel consumed to generate electricity; and (2) the recovery of such costs is conditioned upon the Companies satisfying obligations like those previously included in the Commission's electric fuel component ("EFC") rule.

IEU-Ohio is sympathetic to the positions of parties who have recommended downward adjustments to the increases in revenue that the Companies propose to recover through the FAC. But, the record evidence does not provide any reason to expect that making these adjustments will properly balance the interests of customers and the Companies' owner. Adding the Companies' broadly-defined FAC to this context just makes things worse.

As IEU-Ohio has previously discussed, the problems presented by the Companies' proposed FAC are not limited to the three-year term of their Proposed

ESPs. The Companies have proposed that the FAC mechanism continue beyond such three-year term.

IV. MISCELLANEOUS

A. Portfolio Requirement Benchmarks and Interruptible Customers

At pages 112 to 115 of their brief, the Companies discuss their position on how interruptible capacity should be counted for purposes of determining compliance with peak demand reduction portfolio requirements of SB 221. IEU-Ohio agrees with the Companies and supports their proposal to count the amount of interruptible capacity that is available for interruption for purposes of satisfying the demand reduction benchmarks **provided that** the interruptible customers have committed this capability for integration into the Companies' portfolio. As the Companies explain, interruptible service arrangements provide an on-system capability to satisfy reliability and efficiency objectives as part of a larger planning process. As the record shows, the interruptible load of customers can be used to meet resource obligations established by RTOs regardless of the actual duration and frequency of interruptions.[50] The Staff's recommendation that interruptible capacity be counted only if it is actually interrupted seems to require the Companies to offer programs inferior to those available from RTOs and ultimately works against the type of resource planning that can provide reliability and price benefits for all customers.

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[50] Tr. Vol. IX at 53.

B. PJM Demand Response

In OP's last traditional rate case, the Commission approved a settlement that included the following statement:

> The Company supports the concept of electric utility retail customers being able to select electricity suppliers on the basis of price and service quality. The Company agrees, on behalf of itself and on behalf of any agent, not to use any restrictions on the provisions of transmission services to ultimate consumers contained in a tariff or rate schedule approved by the Federal Energy Regulatory Commission, as a defense to any action by a retail customer to obtain retail wheeling or as a reason to resist a requested retail wheeling transaction. Nothing in this section shall be construed as taking a position on the question of whether state or federal regulatory authorities have the jurisdiction to authorize transmission services for retail customers.[51]

The above quote indicates that the effort to reform or adapt Ohio's electric laws in favor of "customer choice" began in Ohio well before the enactment of Ohio's electric restructuring legislation. It also circumstantially confirms that utilities periodically use claims of exclusive state or federal jurisdiction to frustrate customers who are trying to get more value for their electricity dollars.

Some 13 years after the Commission approved the above-referenced settlement, the Companies are now before the Commission claiming that states have the exclusive right to determine when and how retail customers can participate in demand response programs offered by RTOs such as PJM. The Companies' prohibition request comes from the testimony of Mr. Roush (and not from their ESP Application). They acknowledge that the programs they offer customers are not attractive and seem inclined to tinker with their current programs rather than offer programs that are attractive to customers.

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[51] *OP's 1995 Case,* Stipulation and Recommendation at 14-15 (February 28, 1995).

Section 4928.40(D), Revised Code, clearly states that the Companies cannot impose an unreasonable restriction on resale. Yet, the Companies rely on sale-for-resale language in their tariffs to seek a prohibition on customer participation in RTO programs. IEU-Ohio reiterates its request that the Commission use this proceeding to confirm that customers, not the Companies, have the right to determine how, when and where their customer-sited capabilities will be deployed and that any other result would work against state and national policy.[52]

C. Demand Threshold

The Kroger Co. ("Kroger") argues in favor of requiring a 10 MW demand threshold in order to obtain an exemption from paying the rider to recover costs associated with AEP meeting the energy efficiency and peak demand reduction requirements contained within Section 4928.66, Revised Code.[53] Kroger reasons that such a threshold will ensure that Staff will not be overwhelmed by a large number of "opt out" applications while also allowing customers with the most sophisticated demand side management ("DSM") programs to "opt out" of AEP's likely redundant DSM programs.[54] Kroger further urges the Commission to require a customer wishing to "opt out" to certify that it has conducted an energy audit or analysis and has implemented or plans to implement the cost-effective measures identified in that audit or analysis.[55]

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[52] IEU-Ohio Brief at 30-31.

[53] Kroger Brief at 21; Kroger Exhibit 1 at 13.

[54] Kroger Brief at 21.

[55] *Id.*

The Commission already dealt with the "opt out" threshold issue as well as concerns about administrative feasibility in the Duke Energy Ohio ("DE-Ohio") ESP proceeding. The Commission rejected a proposed 3 MW demand threshold in order for a mercantile customer to obtain an exemption from DE-Ohio's rider to recover the costs of meeting the energy efficiency and peak demand reduction requirements in SB 221 as well as dismissed administrative concerns about processing large numbers of applications to "opt out" of the rider.[56] Specifically, the Commission stated that it does not believe "that the legislature intended us to approve a rider that bases the availability of the exemption on a different usage level than that approved in the definition of 'mercantile customer.' We also do not believe that the administrative concerns regarding the number of possible applications are tenable."[57] Consistent with Commission precedent and the plain language of Section 4928.66, Revised Code, the Commission should reject Kroger's argument and ensure that all mercantile customers are afforded the opportunity to obtain an exemption from AEP's rider. Finally, the Commission should evaluate each application for an exemption on a case-by-case basis and not require energy audits or analyses with each exemption application.

V. CONCLUSION

For the reasons explained in IEU-Ohio's initial brief and those stated above, the Companies have not shown that the relief that they have requested in this proceeding is warranted based on the objectives in Section 4928.02, Revised Code, or based on the parameters of Section 4928.143, Revised Code. Accordingly, the Commission cannot

[56] *In the Matter of the Application of Duke Energy Ohio, Inc., for Approval of an Electric Security Plan*, Case Nos. 08-920-EL-SSO, *et al.*, Opinion and Order at 37 (December 17, 2008).

[57] *Id.*

grant the relief requested by the Companies. As noted in IEU-Ohio's initial brief, the Companies' successful implementation of their business strategy is tied to recovery of cost in a manner that results in reasonable rates for customers while providing a fair return for shareholders through a stable stream of cash flows. Their business strategy is also based on operating generating assets to maximize productivity and profitability after meeting native load requirements. These objectives can be best accomplished through the establishment of a reasonable ESP. Accordingly, IEU-Ohio reiterates its request for the Commission to recommend that the Companies file a new ESP that is responsive to their business strategy and meets the needs of their customers.

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I hereby certify that a copy of the foregoing *Reply Brief of Industrial Energy Users-Ohio* was served upon the following parties of record this 14th day of January 2009, via electronic transmission, hand-delivery or first class mail, postage prepaid.

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