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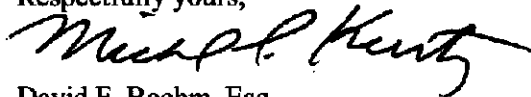
In re: Case No. 08-917-EL-SSO and 08-918-EL-SSO

Dear Sir/Madam:

Please find enclosed an original and twenty (20) copies of the REPLY BRIEF OF THE OHIO ENERGY GROUP ON LONG TERM ESP fax-filed today in the above-referenced matter.

Copies have been served on all parties on the attached certificate of service. Please place this document of file.

Respectfully yours,



David F. Boehm, Esq.
Michael L. Kurtz, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
Encl.

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CERTIFICATE OF SERVICE

I hereby certify that true copy of the foregoing was served by electronic mail (when available) or ordinary mail, unless otherwise noted, this 14th day of January, 2009 to the individuals listed on the attached certificate of service:



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**BEFORE THE
PUBLIC UTILITY COMMISSION OF Ohio**

IN RE: 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 THE OHIO ENERGY GROUP
ON LONG TERM ESP**

The members of the Ohio Energy Group ("OEG") who take service from Ohio Power or Columbus Southern Power are: AK Steel Corporation, Aleris International, Inc., ArcelorMittal USA, BP-Husky Refining, Brush Wellman, E.I., DuPont de Nemours & Company, Ford Motor Company, GE Aviation, Griffin Wheel, PPG Industries Inc., The Procter & Gamble Co., Republic Engineered Products, Inc., Severstal Wheeling (formerly Wheeling Pittsburgh Steel), and Worthington Industries.

OEG submits this reply brief on the long term ESP.

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ARGUMENT

1. AEP's Brief Completely Ignores The Dollar Impact (\$4.503 billion, not \$5.823 billion) Of Its ESP To Consumers.

Nowhere in AEP's 160-page initial brief is there any discussion of the overall rate impact on consumers of its proposed ESP. AEP has intentionally avoided discussing the enormous amount of money that its ESP would drain from the economy of Ohio over the next three years. We believe that it would be irresponsible for the Commission to decide this case in an economic vacuum as AEP suggests.

OEG's initial brief quantified the dollar impact of each element of this proposed ESP. Our conclusion was that AEP's proposed ESP would cost consumers \$5.823 billion over three years. However, based upon the representations made on page 37 of AEP's initial brief, we now conclude that our revenue impact analysis double counted the effect of the 5%, 10% and 15% market purchases. Because the costs of the 5%, 10% and 15% market purchases (\$1.320 billion) are included in AEP's forecasted fuel adjustment clause revenues, the total cost over three years of this ESP is only \$4.503 billion. We have reproduced below the rate impact chart from our initial brief to remove the 5%, 10% and 15% market purchase double count.

AEP Companies' Proposed ESP Rate Increases 5%, 10%, and 15% Purchases at Market Included in Fuel Adjustment Clause Increases (\$Million)								
AEP Companies' Proposed ESP	Columbus and Southern Power Co.				2009	Ohio Power Co.		
	2009	2010	2011	Total ESP		2010	2011	Total ESP
Fuel Adjustment Clause (No Phase-In at Max Amounts) ¹	260	507	780	1,547	367	574	812	1,753
Environmental Carrying Costs 2001-2008 ²	26	26	26	78	84	84	84	252
POLR ³	94	94	94	282	21	21	21	63
Annual 3%/7% Non-FAC Increases in Basic Generation Rates ²	14	29	44	87	42	86	134	262
Energy Efficiency and Peak Demand Reduction ¹	14	29	39	82	17	35	47	99
Other ¹	-81	-81	-58	-220	-27	-27	-12	-66
Annual 7%/6.5% Distribution Increases ²	24	50	77	151	21	44	68	133
Total Estimated Cost of AEP Companies' ESP	351	654	1,002	2,007	525	817	1,154	2,496
2008 Total Revenues Before ESP Rate Increases	1,779	1,779	1,779		1,726	1,726	1,726	
Cumulative ESP Percentage Rate Increases	19.7%	36.8%	56.3%		263.0%	47.3%	66.9%	
Notes	¹ Source: Roush Exhibit DMR-1 (annual increases were accumulated for each subsequent year) ² Source: Baker Exhibit JCB-2 ³ Source: Baker Exhibit JCB-2 adjusted to remove POLR recoveries under existing rates using amounts from Roush Exhibit DMR-1							

Only \$4.503 billion. That is still an enormous and unnecessary drain on Ohio's struggling economy. It represents rate increases of 56.3% for CSP and 66.9% for OPC. Another fact completely ignored in AEP's initial brief is that for the first nine months of 2008 the after-tax returns of equity for CSP and OPC were 23.48% and 13.5%, respectively.

We believe that for the Commission to approve an ESP the applicant must prove that: 1) the ESP is "*more favorable in the aggregate*" than the forecasted results of an MRO (R.C. §4928.143(C)(1)); 2) that the costs in the ESP were "*prudently incurred*" (R.C. §4928.143(B)(2)(a)); and 3) that the ESP conforms to Ohio's policy requirements, including that the ESP result in "*reasonably priced retail electric service.*" (R.C. §4928.02(A)). Raising rates by \$4.503 billion during an economic depression so that two extremely profitable utilities can become even more profitable fails the statutory criteria.

2. **The Ormet and Former Monongahela Power Loads Provide No Justification For The 5%, 10% And 15% Market Purchases.**

OPC and CSP seek to justify purchasing 5%, 10% and 15% of their retail needs at market (total cost of \$1.320 billion) because Ormet and the former customers of Monongahela Power are now their ratepayers. (AEP Initial Brief at 37-38). OPC and CSP apparently feel that they have some equitable entitlement to receive market revenues from these customers for at least the next three years. But the Companies cite no provision of S.B. 221 to justify this position.

Ormet and the former customers of Mongahela Power are now ratepayers of CSP/OPC. By law, they are entitled to the filed rates just like everyone else. AEP has already been fully compensated for taking on this added load and neither Company needs to make market purchases to supply them. Both Companies are long on energy. OPC's 2009 forecasted off-system sales of 27,027,000 mWh are almost equal to its 2009 forecasted native load sales of 28,151,000 mWh.¹ For CSP, its 2009 forecasted off-system sales are more than 25% of its forecasted

¹ Direct Testimony of Lane Kollen at p. 10.

native load.² If either Company does need energy in the future, it is available from their affiliates under the AEP Interconnection Agreement at low, cost-based rates (\$21.88/mWh – \$27.21 mWh).³ The plan to buy 5%, 10% and 15% market purchases simply frees up more power for off-system sales which primarily benefits AEP's shareholders and the ratepayers of West Virginia, Virginia, Kentucky, Indiana, and Michigan.

Ormet is legally entitled to have its load served at 50% CSP Rate GS-4 and 50% OPC Rate GS-4. Service under these standard large industrial tariff rates will result in a substantial reduction in Ormet's power cost compared to its two-year generation supply contract which expired on December 31, 2008. The fewer of AEP's unreasonable, imprudent or unlawful ESP charges are approved, then the lower the tariff rates will be for Ormet, and for everyone else. However, if it is later determined that a special arrangement for Ormet is in the public interest, then any delta revenue should be calculated with the tariff (not market) as the starting point. This is the methodology which the Commission adopted for Solsil, Inc. Case No. 08-883-EL-AEC. The Solsil methodology would give Ormet the full value of any PUCO approved special arrangement, but with a lower delta revenue to be socialized by other customers.

3. Profits From Off-System Sales Cannot Be Excluded From The Significantly Excessive Earnings Test.

At pages 140-141 of their initial brief the Companies assert that it would be unlawful for the Commission to include profits from off-system sales in the significantly excessive earnings test. The Companies cite no provision of S.B. 221 in support of this assertion, and they cannot. The only carve out from the earnings test is that "*the Commission shall not consider, directly or indirectly, the revenue, expense, or earnings of any affiliate or parent company.*" R.C. §4928.143(F). Profits from off-system sales are directly included on the utilities' income statements, not the financial statements of an affiliate or parent. Therefore, S.B. 221 requires that these profits be included in the earnings test.

² Id.

³ Id.

In footnote 47 at page 140 the Companies argue that a state commission is preempted from using profits from off-system sales as a revenue requirement off-set. This must be news to the public utility commissions in West Virginia, Virginia, Kentucky, Indiana, and Michigan because the AEP utilities in those states all pass through to ratepayers (in base rates or the fuel adjustment clause) all or part of their profits from off-system sales.⁴ Far from resulting in economic protectionism, AEP's position would discriminate against Ohio.

4. **AEP Failed To Prove That Its ESP Is More Favorable In The Aggregate Than The Expected Results Of An MRO.**

AEP claims that the only applicable legal standard for approving its ESP is that the Commission determine that it is "*more favorable in the aggregate*" than the expected results of an MRO. (AEP Initial Brief at pages 13-17). We disagree that this is the only applicable legal standard. However, even if AEP's legal position is accepted, its ESP/MRO comparison at pages 132-137 is flawed and unreliable.

a. **AEP's ESP/MRO Comparison Failed To Consider That The PUCO May Authorize An MRO Transition To Market Pricing At Some Level Less Than 20% In Year Two And 30% In Year Three.**

The Companies' ESP/MRO comparison is contained on Exhibit JCB-2. This exhibit purports to show the incremental differences between its proposed ESP and the expected results of an MRO.

Exhibit JCB-2 assumes that the Commission would allow the Companies in an MRO to transition to market pricing on the fastest track allowed by law. Am. Sub. H.B. 562 amended R.C. §4928.142(d) to limit the second and third year market amounts to not more than 20% in year two and not more than 30% in year three. AEP assumed that the Commission would authorize the transition to market pricing at these maximum levels. No sensitivity analysis was done to compare the proposed ESP to an MRO with less than the maximum market levels. In other words, AEP assumed the Commission would approve a worst-case MRO scenario for consumers. To be reliable, a study of this nature must compare the ESP to a series of MROs with less than 20% market in year two and less than 30% market in year three. S.B. 221 clearly envisions this possibility.

⁴ TE Vol. XIV at 232-233; Direct Testimony of Lane Kollen at 33-35.

R.C. §4928.142(E) allows the Commission beginning in the second year of an MRO to stop the transition to market pricing for up to ten years in order to avoid “*an abrupt or significant change*” in the standard offer price for any rate group or rate schedule. Under this provision, AEP’s MRO could be limited to 10% market pricing (for all or some rate classes) for ten years. The failure to consider this possibility, or any other possibility, renders AEP’s ESP/MRO comparison unreliable.

b. AEP’s ESP/MRO Comparison Overstated The Costs Of The Non-Market Portion Of An MRO.

AEP’s ESP/MRO comparison contains other flaws. AEP has overstated the cost of the non-market portion of its expected MRO. Under R.C. §4928.142(D), the non-market blend of an MRO “*shall be equal to the electric distribution utility’s most recent standard service offer price, adjusted upward or downward as the commission determines reasonable, relative to the jurisdictional portion of any known and measurable changes from the level of any one or more of the following costs as reflected in that most recent standard service price: (i) The electric distribution utility’s prudently incurred cost of fuel used to produce electricity.*”

AEP’s comparison incorrectly assumes that fuel recovery would be the same in an MRO and ESP. The “*most recent standard service offer price*” of OPC and CSP (their RSP pricing) does not include a fuel recovery component. By contrast, the RSP standard offer pricing for Duke Ohio and Dayton Power & Light does include a fuel component. Therefore, for OPC and CSP, the non-market portion of any MRO cannot include a fuel adjustment clause. This means that the non-market portion of an MRO would be much less costly to consumers than an ESP which includes fuel recovery. AEP’s comparison assumes the opposite.

Even if the non-market portion of OPC’s and CSP’s MRO could include the recovery of fuel, the Companies’ comparison is flawed. At most, the non-market portion of an MRO can include the “*cost of fuel used to produce electricity.*” This means coal, natural gas and oil. But AEP’s ESP fuel adjustment clause includes much more. AEP’s ESP fuel adjustment clause incorporates the automatic recovery of the costs of coal, fuel oil, natural gas, purchased power from non-affiliated companies, purchased power pursuant to the AEP Interconnection Agreement (Pool Energy), SO₂ and NO_x emission allowances, gains and losses on the sale of

emission allowances, ash handling, fuel procurement unloading and handling, ash sales proceeds, gypsum handling and disposal costs, depreciation and capacity costs of long-term purchase power agreements, capacity equalization payments made under the AEP Interconnection Agreement (Pool Capacity), PJM Emergency Energy purchases, Renewable Energy Credits, and Emission Control Chemicals.⁵

Because the bare bones fuel recovery allowed in an MRO is much less costly to consumers than the “kitchen sink” fuel adjustment clause proposed in this ESP, AEP’s assumption that fuel costs are the same in its comparison is flawed. This also renders the study unreliable.

R.C. §4928.142(D) also requires the Commission to offset the non-market portion of an MRO with the “benefits that may become available to the electric distribution utility” as a result of any adjustment. AEP made no attempt to quantify any such “benefits”. One glaring omission is the benefit of profits from off-system sales. In 2007, the profit from off-system sales to OPC was \$146.7 million and to CSP was \$124.1 million.⁶ Over three years, this “benefit” could reduce the cost of the MRO by \$812.4 million. The failure to consider this or any other “benefit” renders AEP’s ESP/MRO comparison flawed.

c. AEP’s ESP/MRO Comparison Failed To Consider That The Earnings Test In An MRO Is Prospective And Could Eliminate Any Increases In The Non-Market Portion Of An MRO.

In an ESP the significantly excessive earnings test is applied yearly in retrospect. In an MRO the significantly excessive earnings test is applied prospectively. In an MRO, the Commission can deny any increase to the non-market portion if “the adjustment will cause the electric distribution utility to earn a return” that is excessive. R.C. §4928.142(D)(4). “The burden of proof for demonstrating that significantly excessive earnings will not occur shall be on the electric distribution utility.”. *Id.* The MRO’s prospective earnings test could be used to deny all increases to the non-market portion of an MRO. Given that the after-tax returns on equity during the first nine months of 2008 for CSP and OPC were 23.48% and 13.5%, respectively, this would be a distinct possibility.

⁵ Exhibit PJN-1 and PJN-2.

⁶ Direct Testimony of Lane Kollen at p. 14.

d. The Results Of AEP's ESP/MRO Comparison Cannot Be Relied On.

In a "best case" scenario for consumers, the non-market portion of an MRO could be frozen at today's level (because of the exclusion of fuel, the inclusion of "benefits", and the prospective earnings test) and could constitute up to 90% of the standard service offer price for up to ten years. AEP's MRO forecast is the "worst case" scenario for consumers. The "expected result" is likely in between. By failing to consider alternative MRO possibilities AEP's analysis is unreliable and it failed to carry its burden of proof.

5. AEP's Interpretation Of The "More Favorable In The Aggregate" Provision Of S.B. 221 Cannot Feasibly Be Executed By The Commission, Will Not Lead To A Just And Reasonable Result, And Is Therefore Invalid Under The Rules Of Statutory Construction Including R.C. §1.47.

At pages 13-17 of its initial brief AEP argues that the single standard for approving an ESP is whether the ESP "including its pricing and all other terms and conditions, including any deferrals is more favorable in the aggregate as compared to the expected results that would otherwise apply under [an MRO]." R.C. §4228.143(C)(1). "More favorable in the aggregate" is a judgmental standard that assumes some element of discretion on the part of the Commission. But AEP's interpretation would strip the Commission of any discretion by assuming a level of mathematical certainty that does not exist.

AEP asserts that no element of its ESP needs to be justified as cost-based, reasonable or prudent, and that its ESP must be approved so long as it is even one dollar less expensive than the "expected results" of an MRO. To accept this interpretation the Commission would need a very shiny crystal ball. To execute AEP's interpretation of the statute the Commission would need to calculate the three-year costs of an MRO with mathematical precision. This is not possible. To precisely calculate the costs of a three-year MRO this Commission would need to precisely predict these issues, at a minimum:

- a. What proportion of the MRO will be market-based? 10%, 20%, and 30% in years one, two and three, or would a future Commission order some lesser percentage to prevent "an abrupt or significant change" in rates for all or some classes?
- b. For the market portion of an MRO what will be the market price? Suffice it to say that electricity is one of the most volatile commodities in this country.

- c. Would CSP and OPC be authorized to include fuel costs in an MRO despite the fact that fuel costs are not included in their "*most recent standard service offer price*"?
- d. If fuel cost recovery is included in an MRO would the cost be limited to coal, natural gas and oil, or would a "*kitchen sink*" FAC that includes many other items be approved?
- e. What "*benefits*" would be used to offset the costs of an MRO?
- f. How would the prospective earnings test in an MRO be applied and would it be used to eliminate all or some increases in the non-market portion of an MRO?

The mathematical certainty required for AEP's interpretation is impossible in practice and cannot feasibly be executed by the Commission. Therefore, AEP's interpretation violates one of the cardinal rules of statutory interpretation. R.C. §1.47 (Intentions In The Enactment Of Statutes) provides:

"In enacting a statute, it is presumed that:

(A) Compliance with the constitutions of the state and of the United States is intended;

(B) The entire statute is intended to be effective;

(C) A just and reasonable result is intended;

(D) A result feasible of execution is intended."

When this cardinal rule of statutory construction is applied to S.B. 221, the Commission is fully justified in treating the state policies of R.C. §4928.02 as substantive provisions. This is necessary to achieve the "*just and reasonable result*" that we must presume the Legislature and Governor intended.

Respectfully submitted,



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January 14, 2008

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