FILE

BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

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**

COLUMBUS SOUTHERN POWER COMPANY'S AND OHIO POWER COMPANY'S MEMORANDUM CONTRA INTERVENORS' APPLICATIONS FOR REHEARING

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INTRODUCTION

Applications for Rehearing regarding one or more of the Commission's March 18, 2009 Opinion and Order (Order), March 30, 2009 Entry *Nunc Pro Tunc* and March 30, 2009 Entry, all issued in these dockets, were timely filed on behalf of the following intervenors: Industrial Energy Users-Ohio (IEU); Ohio Energy Group (OEG); Ohio Hospital Association (OHA); Ohio Manufacturers' Association (OMA); Ohio Association of School Business Officials, Ohio School Boards Association and The Buckeye Association of School Administrators (collectively, Schools); The Kroger Company (Kroger); and Ohio Consumers' Counsel (OCC). A single page letter on behalf of Abbott Nutrition dated April 13, 2009, but docketed on April 20, 2009 "request[s] a rehearing." The letter was not served on the parties and Abbott Nutrition is not a party of record. Similarly, the Stark County Commissioners sent to the Chair of the Commission a letter dated April 13, 2009. The letter which was docketed on April 23, 2009 and was not served on the parties requested a series of rehearings.[1]

Pursuant to §4901-1-35 (B), Ohio Admin. Code, Columbus Southern Power Company and Ohio Power Company, collectively AEP Ohio or the Companies, submit this Memorandum Contra to all of the above-referenced Applications for Rehearing.

ARGUMENT

The Commission Did Not Violate §4928.20 (J), Ohio Rev. Code. (OCC 9)

OCC contends that the Commission violated §4928.20 (J), Ohio Rev. Code, by requiring customers of governmental aggregators to pay a POLR charge even if that aggregation group gives notice to the Commission of its election to not receive standby service and to agree to pay market price for power incurred by the utility, along with other costs listed in that statute, to serve such customers that do return to the electric distribution utility's Standard Service Offer.

OCC's understanding of the Commission's Order is incorrect. As noted at page 40 of the Order, the Commission modified the ESP to allow:

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[1] It is not clear if Abbott Nutrition intended to file a formal application for rehearing or if because it mentions "rehearing" in its letter the Commission's docketing department simply designated the letter as such an application. To the extent the Commission treats the letter as a formal application for rehearing, it should be denied, along with the request from the Stark County Commissioners. Abbott Nutrition and the Stark County Commissioners are not parties of record and have not sought leave to file a rehearing application. (See §4903.10, Ohio Rev. Code). They have not met the further statutory requirements of establishing just cause for failing to enter an appearance prior to issuance of the order for which rehearing is sought; nor have they demonstrated that their interests were not adequately considered. (*Id*). Finally, their letters were docketed after the statutory time period for filing an application for rehearing and the letters were not served on the parties.

> customers that switch to an alternative supplier (either through a *governmental aggregation* or individual CRES providers) to agree to return to market price, and pay market price, if they return to the electric utility after taking service from a CRES provider, for the remaining period of the ESP term or until the customer switches to another alternative supplier. *In exchange for this commitment, those customers shall avoid paying the POLR charge.* We believe that this outcome is consistent with the requirement in Section 4928.20 (J), Revised Code, which allows governmental aggregations to elect not to pay standby service charges, in exchange for agreeing to pay market price for power if they return to the electric utility. (emphasis added).

In addition, the Provider of Last Resort Charge Rider filed in both Companies' tariffs addresses not only how individual customers that shop can avoid the POLR charge, but also states:

> Customers of a governmental aggregation where the legislative authority that formed such governmental aggregation has filed written notice with the Commission pursuant to Section 4928.20 (J), Ohio Revised Code, that it has elected not to receive default service from the Company at standard service offer rates shall not be subject to charges under this Rider.

Based on the Commission's Order and the Companies' compliance tariffs, it is clear that OCC simply misunderstands the import of the Order and has failed to review the POLR rider filed by the Companies. OCC's request for rehearing on this matter should be denied.

The POLR Riders Approved By the Commission Are Lawful and Reasonable. <u>(OEG 3; OHA 2; OMA 3; Kroger 1; OCC 7; IEU 2)</u>

Each of the applications for rehearing, except the application filed on behalf of the Schools, has raised at least one issue concerning the Provider of Last Resort charge authorized by the Commission. When considered collectively, these applications simply re-argue the points they presented in testimony, the points on which they conducted cross-examination, and the points they addressed in their post-hearing briefs. In other words, their arguments on rehearing amount to nothing more than a rehash of arguments the Commission already has considered and rejected. For this reason alone, rehearing on the POLR-related issues should be denied.

OEG argued at page 18 of its initial post-hearing brief, and again on rehearing, that customers should not have to pay a POLR charge if they do not want to "purchase" the option to shop. OMA raises the same argument in its application for rehearing. As the Companies explained in their Reply Brief, they are not selling the option to customers. The option to switch generation service to a competitive provider was legislatively provided by SB 3, and SB 221 enhances the opportunities for that option by providing added encouragement for government aggregation. (§§4928.20 (J) and (K), Ohio Rev. Code. There is no basis for the Commission to change its position regarding OEG's arguments.

OHA's arguments regarding the Commission's POLR charge determination are that the Commission's Staff took a position which differed from the Commission's ruling and that OMA relied on testimony of a witness who opposed the POLR charges. Simply relying on testimony the Commission already has regarded as non-compelling does not provide a basis for rehearing, even if the testimony is offered by the Staff. Further, with due respect for counsel for OMA, the fact that on brief he presented an argument similar to an argument made by a witness for another intervenor does not make the witness' testimony any more compelling.

OHA also challenges the Commission's reliance on the results of the Companies' use of the Black Sholes model. Kroger, OCC and IEU make their own arguments regarding the applicability of the Black Sholes model to determining costs associated with the POLR obligation. While most of these intervenors' arguments regarding the Black Sholes model are a rehash of their prior arguments, IEU adds a new dimension to its attack on the model by suggesting that the Black Sholes model helped send the nation's and the world's economy "into an abyss." (IEU Memorandum in Support p 16). Such melodramatic attacks do not inject any new support for these intervenors' arguments which already have been rejected. The Black Sholes model is an appropriate tool for measuring the Companies' risk associated with meeting their obligations as providers of last resort. The Commissions' reliance on the model's results is reasonable and well within the bounds of determinations the Commission can make in an ESP proceeding.

OCC continues to attack the Companies' inputs used for applying the Black Sholes model to the cost of the POLR obligation. OCC's pleading reflects an apparent lack of understanding of how the model works. OCC claims on rehearing, as it did in its post-hearing briefing, that the Companies used too high a market price, which resulted in too high a POLR cost. The fact is that the smaller the difference between the ESP and the market prices the greater the value of the optionality to switch and consequently, the greater the risk to the Companies of providing POLR service. Therefore, even assuming the Companies used too high a market price input, that would have the effect of <u>understating</u> the Companies' POLR risks. (Tr. XI, p. 156).[2]

[2] IEU makes the same mistaken argument as OCC, at pages 32 and 33 of its Memorandum in Support.

OCC and IEU also continue to focus on the percentage increases the Commission authorized for the POLR charges. These percentage increases say more about how low the prior POLR charge was than they do about the reasonableness of the new POLR charge.

The current POLR charges are an outgrowth of the Companies' Rate Stabilization Plan (RSP) proceeding.[3] The Companies did not request a POLR charge in that proceeding. Nonetheless, the Commission considered two aspects of the RSP proposed by the Companies – RTO administrative charges and carrying charges associated with Construction Work in Progress and in-service plant expenditures – and authorized the rate recovery amounts sought by the Companies for those items as POLR charges and established those POLR charges as unavoidable riders applicable to all distribution customers. (Opinion and Order, January 26, 2005, pp. 27, 29).

OCC witness Medine was generally familiar with the way the current POLR charges were set. (OCC Ex. 10, p. 33). Assuming OCC also understood the background of the current POLR charges, it is surprising that they would argue that there is no evidence that the pre-ESP charges – which have nothing to do with POLR cost – are insufficient. The Companies' burden in this case was to prove that its POLR rate proposals are reasonable, not that the prior POLR charge was unreasonable. Given the origin of the prior POLR charges, any attempt to compare those charges with the Companies' POLR charges authorized in this case is fruitless and should be rejected.

IEU yet again raises additional arguments concerning the Commission's POLR determination. For instance, while noting that its argument regarding the effect of the

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[3] *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.

Companies' participation in PJM already has been presented in its Reply Brief, IEU gives it another try. However, IEU's discussion at pages 27-30 of its Memorandum in Support focuses on capacity obligations and rights, whereas the POLR obligation risks as requested by the Companies in their testimony are *associated with* the energy requirements and costs. The Commission once again should reject IEU's PJM-related arguments.

IEU also reargues that the Companies can mitigate the POLR risk by purchasing "options to cover the risk." (*Id.* at 30). As Companies' witness Baker testified, customers should be indifferent to whether the Companies exercise an option related to the POLR obligation. (Tr. X, pp. 213, 214). This is because if the POLR risk has been properly priced, which it was, the POLR charge should reflect the cost of an option in the same sense that the cost of self-insuring should equal the cost of acquiring insurance.

IEU also criticizes the Commission's reference to the Companies' testimony in Mr. Baker's Limited Rebuttal Testimony (Companies' Ex. 2) that the Companies' pre-ESP POLR charge "is significantly below other Ohio electric utilities' POLR charges." (Order, p. 38). IEU's first criticism is that pursuant to a stipulation, the FirstEnergy companies do not have a charge comparable to the Companies' POLR charge. No conclusion can be reached about the reasonableness and significance of one provision of a 53-page settlement agreement, which incidentally, IEU, as a signatory to the stipulation, agreed "would not be offered or relied upon in any other proceedings, except as necessary to enforce the terms of this Stipulation." (Stipulation, p.45).

Moreover, IEU's reliance on the FirstEnergy companies' situation is misplaced since those are distribution-only companies which do not reserve generation for meeting their POLR obligation. Instead, those companies would pass on POLR risks to suppliers and would charge market prices for any POLR service that they provide in the future.

IEU's second criticism of the Commission is that Mr. Baker's testimony was offered only within the scope of the interim rate issues addressed at the outset of the hearing. IEU's narrow focus on the time period to which the testimony was to apply is inappropriate. Mr. Baker's testimony was accurate and was in the record. The Commission's reference to that portion of the Companies' testimony was appropriate.[4]

The Commission Explained the Bases For Its Determination of Issues in This Proceeding In a Manner That Satisfies §4903.09, Ohio Rev. Code. (IEU 1; OCC 14A)

IEU has identified the Commissions rulings on seven different issues which IEU believes do not comply with the requirements of §4903.09, Ohio Rev. Code regarding setting forth the reasons prompting the decisions arrived at. Those issues relate to the FAC, the allegedly "missing rate increase cap," carrying costs, Provider of Last Resort rider, the treatment of the generation asset transfer request, gridSMART and other distribution increases,[5] and the ESP versus MRO comparison.

As the Supreme Court of Ohio has held, "[i]n order to meet the requirements of R.C. 4903.09, * * * the PUCO's order must show, in sufficient detail, the facts in the record upon which the order is based, and the reasoning followed by the PUCO in

[4] IEU's reference to the Companies' willingness to accept half of their requested POLR increase for the interim period then being debated, does not support IEU's position that authorizing 90 percent of the increase in the ESP Order was unreasonable. Instead, Mr. Baker's Limited Rebuttal Testimony reflects the Companies' willingness to reach a reasonable compromise on the interim rate question. Unfortunately, many intervenors were unwilling to consider some compromise resolution regarding interim rates.

[5] OCC's Assignment of Error No. 14, Part A, concerning gridSMART, also alleges that the Commission did not comply with §4903.09, Ohio Rev. Code. OCC's claim is addressed below in connection with the other gridSMART issues.

reaching its conclusion." *Indus. Energy Users-Ohio v. Pub. Util. Comm.*, 117 Ohio St. 3d 486, 493 (2008 Ohio 990 ¶ 30) quoting *MCI Telecommunications Corp. v. Pub. Util. Comm.* (1987), 32 Ohio St.3d 306, 312, 513 N.E.2d 337. Strict compliance with the terms of § 4903.09, Ohio Rev. Code, which requires the Commission to file a written opinion setting forth its reasons for its decision, is not required but the Commission needs to have record support for its orders. *Tongren v. Pub. Util. Comm.* (1999), 85 Ohio St. 3d 87, 90, 1999 Ohio 206, 706 N.E.2d 1255; *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* (1996), 76 Ohio St. 3d 163, 166, 1996 Ohio 296, 666 N.E.2d 1372. Thus, as long as there is a basic rationale and record supporting the Order, no violation of §4903.09, Ohio Rev. Code, exists.

When evaluating the merits of IEU's claim under §4903.09, Ohio Rev. Code, it is necessary to consider the uniqueness of §4928.143, Ohio Rev. Code. Unlike the rate making statute found in Chapter 4909, Ohio Rev. Code, an Electric Security Plan is relatively unstructured. The utility's application is not based on a test year, date certain concept and no reasonable return on investment is determined. Instead, §4928.143 (B) (2), Ohio Rev. Code, lists nine different categories of components that can be included in an ESP. Further, as the Companies repeatedly have pointed out, those categories do not limit the components a utility can propose in an ESP.

Consistent with this lack of structure, it is not surprising that the General Assembly created a single test for approval of an ESP – is it more favorable in the aggregate than the expected results under an MRO. (§4928.143 (C) (1), Ohio Rev. Code). Contrary to IEU's assertion, the Commission addressed this test head on.

First, the Commission rejected the Companies' argument that the Commission's authority to modify the proposed ESP is limited to a determination of whether the proposed ESP is more favorable in the aggregate than an MRO. Having said that, the Commission went on to compare its modified ESP to the MRO and held that "the cost of the ESP is $673 million for CSP and $747 million for OP, and the cost of the MRO is $1.3 billion for CSP and $1.6 billion for OP." (Order, p. 72).

While the Companies do not agree that the Commission is free to make modifications to an ESP which already is more reasonable than an MRO, and IEU may not agree with the conclusions reached by the Commission based on the modified ESP versus MRO comparison, the obvious fact is that the Commission's reasoning is set out in sufficient detail to satisfy §4903.09, Ohio Rev. Code.

A similar analysis of the Commission's order regarding the FAC, carrying cost, POLR rider, generation asset transfer request and gridSMART/other distribution increases reveals the Commission's compliance with §4903.09, Ohio Rev. Code.[6] IEU might not like the reasons given by the Commission, but the reasons are there. The Commission's reasoning might seem more subjective to IEU than reasoning based on test year or date certain considerations with which IEU might be more familiar in the context of traditional rate making. That, however, is the product of the Commission modifying the proposed ESP in the context of the Commission's view that §4928.143, Ohio Rev. Code, permits modifications even if the proposed ESP is more favorable than an MRO.[7]

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[6] IEU's discussion of the issue regarding the allegedly missing rate increase cap does not address a failure to set forth the Commission's reasoning. Instead, it complains that the Commission has not addressed IEU's complaints, which "the Commission well knows." Those complaints do not implicate §4903.09, Ohio Rev. Code.

[7] The Companies continue to believe that such modifications are not permitted if the Commission determines that the proposed ESP is more favorable in the aggregate than the expected results of a MRO.

The Commission's Authorization of Recovery of the Revenue Requirement Associated With Specific Sources of Generation Supply Is Lawful and <u>Reasonable. (IEU 3)</u>

IEU's application for rehearing asserts that the Commission unlawfully and unjustly modified the proposed ESP by allowing the Companies to recover the jurisdictional share of costs associated with maintaining and operating electric generating facilities which are not included in rate base. IEU characterizes the Commission's modifications as a selective use of traditional cost-based rate making.

IEU's arguments overlook the unusual circumstances regarding these generating facilities. These facilities were acquired in 2007 (Darby) and 2005 (Waterford), under a regulatory structure that placed the entire cost and risk associated with these facilities on CSP. With the enactment of SB. 221, and the amendment to §4928.17 (E), Ohio Rev. Code, in particular, it was entirely reasonable for the Commission to conclude that if it were "going to require that the electric utilities retain these generating assets, then the Commission should also allow the Companies to recover Ohio customer's jurisdictional share of any costs associated with maintaining and operating such facilities." (Order, p. 52).[8]

The Commission's decision regarding this issue also is lawful. Arguments to the contrary ignore the relatively flexible nature of §4928.143, Ohio Rev. Code, in comparison to traditional rate making. While the Commission did not engage in a dissertation setting forth its legal reasoning, the decision is no less lawful. The adjustment made by the Commission, including the adjustment related to purchases from

[8] This explanation satisfies IEU's concern that the Commission did not comply with §4903.09, Ohio Rev. Code, regarding its decision on this issue.

Ohio Valley Electric Corporation, is lawful since there are no limits to the components that can be included in an ESP. Moreover, even with the adjustment the ESP is more favorable in the aggregate than the MRO alternative. IEU's application for rehearing of this issue should be denied.

The Commission's Comparison of the Modified ESP to the Results That Would Otherwise Apply Under a Market Rate Offer Is Lawful and Reasonable. (IEU 6)

IEU relies upon "common knowledge" of events occurring after the close of the record in this proceeding to argue that the Commission's ESP versus MRO comparison was flawed. IEU's suggestion that the Commission should have considered extra-record "common knowledge" is contrary to sound regulatory and evidentiary practices and must be rejected. Otherwise, there would be no end to an ESP proceeding as parties would have the Commission continuously evaluate the ESP versus MRO comparison as market prices fluctuate over an endless period of time. All parties had the opportunity to submit evidence while the record was open. Based on that evidence the Commission, as noted by IEU, used the market price supported by its Staff. It cannot be said that using Staff's market price was unlawful and IEU's assertion that based on post-hearing events the Commission now should use a lower market price in its analysis is unreasonable and unlawful and, therefore, should be rejected.

IEU attacks the ESP versus MRO comparison on two other fronts. First, IEU argues that the blending percentages for market price that the Commission used in valuing the MRO alternative were unreasonable. IEU alleges that the Commission used the worst case blending assumption and that doing so was unreasonable. As the

Companies previously have pointed out, the statutory blending percentages that were in effect at the time the Companies filed their application are applicable to this proceeding, not the percentages that subsequently became effective. Since the then-effective language in §4928.142 (D), Ohio Rev. Code, refers to ten per cent in year one and "not less than twenty per cent in year two, [and] thirty per cent in year three" the blending percentages used in the Commission's analysis were the *minimum* percentages that could be used. Even if lower percentages of market price blending could be used, IEU has not shown that the blending percentages used by the Commission were unreasonable.

Second, IEU argues that costs associated with the POLR obligation should not have been included in the MRO portion of the ESP versus MRO comparison. IEU's argument appears to be premised on the erroneous belief that the Companies' POLR obligation in some manner terminates in the MRO context. The Companies' risk associated with the POLR obligation under §§4924.14 and 4918.141, Ohio Rev. Code, continues regarding the non-market portion of the MRO. The Commission's analysis is consistent with that approach. It is unrealistic to evaluate the cost of the MRO without the POLR obligation being included.

Finally, IEU's arguments are internally inconsistent. If the Commission had used a lower market price in its ESP versus MRO comparison, as argued by IEU, that lower market price would result in a higher POLR charge being assigned to the MRO side of the comparison. This is because, as discussed in the Companies' Initial Post-Hearing Brief at page 44, the greater the spread between the market price and the SSO, the less value there is to the option to shop. Consequently, to the extent the market price is higher, the risk of the POLR obligation is lower. As Mr. Baker testified:

> "As a direct result of the difference between the Companies' proposed ESP rates and the much higher competitive retail electric service prices, the cost of fulfilling the Companies' POLR obligation is significantly lower than if the difference were not as large." (Companies Ex. 2A, p. 33)

IEU's argument should be rejected.

The Order's Provision For a Higher 2009 Revenue Entitlement is Not Retroactive Ratemaking and is Lawful and Reasonable. (OCC 4, 5, 6 and 8; OHA I; OMA I; Kroger III)

The Order, as clarified in the Entry *Nunc Pro Tunc*, provides for a modified ESP with a term commencing January 1, 2009 and ending December 31, 2011. (Entry *Nunc Pro Tunc*, p. 1). Because the Commission had previously extended the Companies' old rates into 2009 (when they were otherwise set to expire at the end of 2008), the Order provides that the new rates adopted in the ESP commenced with the first billing cycle of April 2009 and were to be offset by revenues collected from customers during the interim period. (*Id*, p. 2; Order, p. 64). In filing their compliance tariffs, the Companies accounted for that offset process and proposed rates that also complied with the other aspects of the Order, including the rate increase phase-in and increase percentage limits. The Commission issued an Entry on March 30, 2009 and determined the Companies' proposed tariff filing to be "reasonable and consistent with [the Order]." (March 30, 2009 Entry, p. 4).

OCC and other intervenors claim that the Order engages in unlawful retroactive ratemaking and raise multiple arguments in support of this claim. OCC raised four related and overlapping arguments in its attempt to portray the Order as engaging in retroactive ratemaking: (1) that the Order permits the Companies to apply their amended tariff schedules to services rendered prior to the Entry, in violation of §§4905.22 and

4905.32, Ohio Rev. Code [Assignment of Error 4]; (2) that the ESP term commencing January 1, 2009 and the required offset can only mean that the rates are retroactive in violation of Ohio statutes, Supreme Court case law and the Ohio and U.S. constitutions [Assignment of Error 5]; (3) that the Commission erred by denying the motion for stay or making the rates subject to refund [Assignment of Error 6]; and (4) that the POLR charge revenues allowed by the Order also amount to unlawful retroactive ratemaking [Assignment of Error 8]. OHA, OMA and Kroger also raise their own claims of unlawful retroactive ratemaking, though they are duplicative of OCC's claims and will not generally be discussed separately by AEP Ohio. These claims of retroactive ratemaking are all without merit and should be rejected.[9]

OCC's Assignment of Error 4 advances the notion that §§4905.22 and 4905.32, Ohio Rev. Code, are violated because the Order allows the rate increases on a "bills rendered" basis and allows billing for services that were provided prior to the effective date of the tariffs. (OCC Memorandum in Support, pp. 18-19). Section 4905.22, Ohio Rev. Code, requires a public utility to render charges that are "not more than the charges allowed by law or by order of the public utilities commission and no unjust or unreasonable charge shall be made . . . in excess of that allowed by law or by order of the commission." (§4905.22, Ohio Rev. Code). Similarly, §4905.32, Ohio Rev. Code, prohibits a public utility from charging a "different rate, rental, toll, or charge for any service rendered, or to be rendered, than that applicable to such service as specified in its

[9] OCC's endorsement of a functionally similar remedy, as proposed in Section V.E. of the Companies' ESP application, also demonstrates that a true-up provision is not necessarily unlawful. (*See* AEP Ohio Memorandum Contra Motion for Stay, pp. 1-3). Because the Commission found the proposal to be moot in light of the other provisions in the Order, it did not rule on the Companies' proposal. (Order, p. 64). But the Companies believe that the Commission should nonetheless render a finding on rehearing, in order to strengthen defense of the Order on appeal, that OCC previously endorsed Section V.E. of the Companies' ESP application as reasonable and should be estopped from pursuing its arguments concerning retroactive rates.

schedule filed with the public utilities commission which is in effect at the time." (§4905.22, Ohio Rev. Code). These statutes simply require that the public utility charge the rates that are authorized by the Commission, as reflected in approved tariffs at the time of the billing.

Although OCC claims these statutory violations, it does not even allege that AEP Ohio violated the Order or the approved compliance tariffs. And there can be no question that AEP Ohio has followed the Commission's Order and the compliance tariffs that were approved by the Commission. Rather, OCC's real disagreement is with the Commission Order and the Commission's practice, not the Companies' implementation of it. Indeed, OCC generally maintains that the Commission should adopt rate increases on a service-rendered basis rather than a bills-rendered basis. Ordering rate increases effective on a bills-rendered basis is a widely used and established practice in various types of rate cases. Thus, the broad issue raised by OCC in Assignment of Error 4 is not unique to the ESP rate increases or to the Order specifically. More importantly, the fact that OCC does not like the Order or the approved tariffs does not mean that AEP Ohio has violated either – AEP Ohio has followed the Order and the approved compliance tariffs and that is all that is required by §§4905.22 and 4905.32, Ohio Rev. Code. Accordingly, it cannot establish that §§4905.22 and 4905.32, Ohio Rev. Code, are violated because the Order was followed and the Companies' approved tariffs were followed.

OCC's Assignment of Error 5 contains the primary arguments in support of its unlawful retroactive ratemaking theory. First, OCC characterizes the Order as permitting the Companies to collect retroactive rates for the period of January 2009 through March 2009 and states that the effect of the Order "remains unchanged" by the Entry *Nunc Pro*

Tunc. (OCC Memorandum in Support, p. 20). OCC argues that the retroactive character of the Order is confirmed because the rates for 2009 are designed to collect twelve months of revenue in the remaining nine months of 2009. (*Id*). As a related matter, OCC asserts that the Order's provision for offsetting the new rates with revenue received by the Companies in the first quarter of 2009 "can only mean one thing – that the new rate increases are being implemented in a manner that allows the Companies' increased rates as if the newly announced increases were effective during the first three months of 2009, consistent with the term of the ESP beginning January 1, 2009." (*Id.*, p. 21). These characterizations of the Order are inaccurate, ignore the effect of the Entry *Nunc Pro Tunc* and are otherwise based on flawed assumptions.

The Order authorized approval of the three-year term for the ESPs from January 1, 2009 through December 31, 2011. (Order, p. 64). In doing so, the Commission also provided that the revenues collected during the interim period (as authorized by the orders in Case No. 08-1302-EL-ATA) must be recognized and offset by the new rates. (*Id*). Thus, the Commission did not establish retroactive rates but instead allowed for a prospective rate mechanism to implement its decision to approve the ESP for the full three-year term. While the Commission's decision may yield a similar financial impact as would have occurred if a decision had been issued by December 28, 2008 (the deadline for deciding AEP Ohio's case under §4928.143(C)(1), Ohio Rev. Code), it is not the same as making rates retroactive or backbilling individual customers for service already provided and paid for.

The Order and AEP Ohio's tariffs implementing the Order do not provide for new rates during the first quarter of 2009 and individual customers are not being re-billed for first quarter consumption at the higher rate. For example, if there is a flower shop business that only operates during the month of February or another business that operated during the first quarter and went out of business, neither business would receive a bill under the new rates for service billed and paid for under the previous tariffs. Rather, the Order and AEP Ohio's implementing tariffs provide for incrementally higher rates during the nine remaining months of 2009, which rates are designed to collect, on a total company basis for CSP and OP, the 2009 revenue authorized by the Order during the remaining months of 2009. There has been no retroactive application of the new rates and the approach taken in the Order is lawful and reasonable.

OCC maintains that the prospective rates authorized by the Order for 2009 nonetheless violate the longstanding principle established in *Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co.*, 166 Ohio St. 254 (1957) that retroactive ratemaking is prohibited. (OCC Memorandum in Support, pp.22-24). This argument misperceives *Keco* and its progeny. The key principles in the *Keco* decision form Ohio's version of the so-called "filed rate doctrine" and establish that:

- rates set by the Commission are lawful until such time as they are set aside by the Supreme Court and modified on remand by the Commission;
- a utility has no option but to collect the rates set by the Commission, unless a stay order is obtained;
- there is no automatic stay of any order and it is necessary for an aggrieved party to affirmatively obtain a stay and post a bond; and
- no action for unjust enrichment lies to recover the rates that were subsequently determined to be unlawful because the comprehensive regulatory scheme in Title 49 abrogates any common law action in this regard.

(*Keco*, 166 Ohio St. at 256-259).

Thus, *Keco* held that there is no retroactive judicial remedy for rates that were charged pending rehearing and appeal and were subsequently determined to be unlawful.

Keco addresses issues relating to a post-appeal remedy (or lack thereof) and does not restrict the Commission when initially establishing rates in a rate order. In effect, OCC turns *Keco* on its head by attempting to use the principles to block the effectiveness of the Commission's approved rates during rehearing and appeal. The distinction between a prospective adjustment (as contemplated by *Keco*) and retroactive ratemaking is not merely "form over substance" but is meaningful in that it reveals whether retroactive ratemaking has occurred. Here, it has not.

It is telling that OCC believes that the retroactive character of the Order is confirmed through rates for 2009 designed to collect the authorized 2009 revenue in the remaining nine months of 2009. (OCC Memorandum in Support, p. 20). OCC's application for rehearing is replete with references to cost and it persistently advocates matching rates to cost; yet, as discussed above, ESP rates under SB 221 need not be based on cost and the time period when rates are in effect need not match the costs incurred during that period. AEP Ohio submits that the reason that OCC opposes the concept of recovering twelve months of revenue over nine months is because it is so engrained in the traditional cost-based ratemaking formula under R.C. Chapter 4909. Traditional ratemaking might not permit such an approach because it is not strictly cost justified and would not match the expected expenses to the time period of revenues authorized. That appears to be the fundamental reason for OCC's position that the incrementally higher 2009 rates authorized by the Order amount to retroactive ratemaking – using a traditional view of ratemaking.

Yet, this position ignores the fundamental changes adopted both as part of SB 221 and the prior electric restructuring law, Senate Bill 3. Although the General Assembly has generally chosen to retain the use of traditional R.C. Chapter 4909 ratemaking for noncompetitive services (such as distribution services) outside the context of an ESP proceeding, competitive services (such as generation) and noncompetitive services considered as part of an ESP proceeding are not subject to rate regulation under R.C. Chapter 4909. (§4928.05, Ohio Rev. Code). Today, the parameters of an electric utility's Standard Service Offer is governed by §4928.141, Ohio Rev. Code, and other applicable provisions within SB 221.

The entirety of R.C. Chapter 4909 (including the detailed and prescriptive ratemaking formula found in §4909.15, Ohio Rev. Code) does not apply when setting ESP rates under §4928.143, Ohio Rev. Code. Hence, just because a rate or revenue authorization might not be permitted under the traditional ratemaking statutes does not mean that the same rate or revenue authorization is not permitted as part of an ESP adopted under SB 221. To this extent, the Commission (and perhaps ultimately the Supreme Court of Ohio) must fully examine the letter and spirit of SB 221 and avoid any notion of mechanically applying statutory or case law precedent developed in the context of traditional regulation. In other words, even if an aspect of the Order could be interpreted as retroactive ratemaking in a traditional sense, it should be the provisions within R.C. Chapter 4928 that determine whether it is prohibited – not a traditional concept that was developed in the context of R.C. Chapter 4909.

For example, §4928.143(B)(2), Ohio Rev. Code allows both riders that are based on cost and rate adjustments that are automatic or pre-determined; even cost-based riders are adjusted and reconciled to prior periods of usage and revenue collection. Such riders would necessarily be encompassed within OCC's broad view of retroactive ratemaking since they would "reach back" and adjust future rates "on the basis of the revenues collected in past rates." (OCC Memorandum in Support, pp. 23-24). An even more striking example is found in SB 221's "significantly excessive earnings test" that applies to ESPs adopted under §4928.143, Ohio Rev. Code. That provision could operate to reach back and capture earnings that were realized in prior years and refund them to customers through a prospective adjustment. That would clearly be considered retroactive ratemaking under any notion of traditional ratemaking. Of course, OCC does not discuss or even acknowledge such features of SB 221 when making its claim of retroactive ratemaking.

In any case, the Order's provision for incrementally higher rates in 2009 easily fits within the Commission's authority in approving an ESP under Section 4928.143, Ohio Rev. Code. SB 221, of course, did not implement a "typical rate making" process. Instead, it permits the Companies to propose an ESP that can include, without limitation, many different components. Those components are not to be judged on a component-by-component basis. The analysis is not to determine if each component is reasonable, cost based, prudent or on its own more favorable than a related component within a possible MRO. Instead, the components of the ESP are to be analyzed "in the aggregate" and the aggregate impact is to be compared to the expected results that otherwise would apply under an MRO.

Although AEP Ohio readily understood the Order prior to issuance of the March 30, 2009 Entry *Nunc Pro Tunc* (as is evident by AEP Ohio's March 27, 2009 Memorandum in Opposition to the Motion for Stay), the OCC continues to ignore the Order's prospective effect even after the Commission clarified its original intent. For this reason, the Commission may wish to further clarify the prospective nature of its order. In this regard, it should be noted that the additional revenue authorized for the remainder of 2009 was not necessarily related to the first quarter of 2009 but was a decision to grant an incrementally larger increase for the remainder of 2009 rates as part of the modified ESP package and to recognize the timing of the decision –all while ensuring that the statutory standard for approving an ESP was met (*i.e.*, it is more favorable in the aggregate than the expected results under an MRO). As a related matter, it is AEP Ohio's understanding that the "offset" required by the Order for revenues collected during the interim rate period was simply an equitable adjustment that the Commission thought would be fair in calculating the incrementally higher revenue approved for 2009, given the timing of the Commission's decision and the temporary implementation of interim rates during the first quarter of 2009 –this rationale may also prove useful to explain on rehearing.

Next, OCC argues that the Order also violates §4928.141, Ohio Rev. Code, based on the same mischaracterization that the Order retroactively changes the rates in effect from January 2009 through March 2009. (OCC Memorandum in Support, pp. 25-26). As discussed above, the incrementally higher 2009 rate increase authorized by the Order was not effective until the first billing cycle of April 2009 and no backbilling or rebilling of any kind occurred. The rates in effect during the first quarter of 2009 complied with the Commission's interpretation and application of §4928.141, Ohio Rev. Code, as reflected in the orders in Case No. 08-1302-EL-ATA. OCC's argument lacks any factual basis and must fail.

OCC's Assignment of Error 6 re-argues the motion for stay and, in the alternative, requests that the rates be implemented subject to refund. (OCC Memorandum in Support, pp. 27-29). To be clear, this argument does not challenge the Order but relates to the March 30, 2009 Entry in this case. OCC claims that the Commission did not set forth sufficient detail in that Entry so as to constitute a violation of §4903.09, Ohio Rev. Code. As discussed above, the Supreme Court of Ohio has held that, as long as there is a basic rationale and record supporting the Order, no violation of §4903.09, Ohio Rev. Code, exists. *Indus. Energy Users-Ohio v. Pub. Util. Comm.*, 117 Ohio St. 3d 486, 493 (Ohio 2008 990 ¶ 30) quoting *MCI Telecommunications Corp. v. Pub. Util. Comm.* (1987), 32 Ohio St.3d 306, 312, 513 N.E.2d 337; *Tongren v. Pub. Util. Comm.* (1999), 85 Ohio St. 3d 87, 90, 1999 Ohio 206, 706 N.E.2d 1255; *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* (1996), 76 Ohio St. 3d 163, 166, 1996 Ohio 296, 666 N.E.2d 1372. The Commission's Entry easily fulfills this standard.

The March 30 Entry contained a detailed recitation of the facts and arguments made regarding the stay request and directly indicated that the Commission is not persuaded that a stay is warranted under the circumstances of this proceeding. (Entry, pp. 1-3). The Entry went on to indicate that the movants had not demonstrated that the four-factor test governing a stay has been met. When considering that a Court typically enters a one-sentence order to dispose of a stay request and given the inherent discretion involved in ruling on such requests, the Commission's Entry seems more than sufficiently detailed. Nonetheless, the Commission could further clarify its reasoning on rehearing if it wishes to further discourage pursuit of this argument on appeal by OCC. If so, AEP Ohio refers the Commission to the detailed arguments made in its March 27, 2009 Memorandum Contra Motion Stay.

Finally regarding the retroactive ratemaking allegations, OCC launches a separate but indistinct attack on the approved POLR rates through its Assignment of Error 8. (OCC Memorandum in Support, pp. 34-36). OCC misperceives the risk associated with the POLR obligation under the new SSO versus the prior rate plan and concludes that the Order "allowed AEP to collect from customers revenues allegedly associated with a risk for a period when that risk, i.e., the difference between the SSO authorized in the Order and the market rate, did not exist." (OCC Memorandum in Support, p. 35). OCC goes on to claim that customers were charged twice for the POLR risk. (*Id*). Both of these claims are without merit.

As with the other rate components, AEP Ohio's compliance tariffs increased the POLR charge to reflect the Order's 2009 higher authorized revenue levels and offset the revenues collected in the first quarter. There simply was no double-recovery or overlap. Rather, as with the other rate components, the POLR charge for the remainder of 2009 is incrementally higher under the modified ESP.

As alluded to above, OCC is also wrong when it says the risk associated with the new POLR charge did not exist during the period of interim rates. AEP Ohio was not insulated from shopping or customer choice during the period of the interim rates.[10] The unique provisions and hybrid regulatory structure of SB 221 was in effect during the period of interim rates. Thus, the compliance tariffs' adjustment to the POLR charge is

[10] Indeed, it is a matter of record in this case that the members of the Schools, an active party and applicant for rehearing concerning shopping issues, are currently not buying generation service from the Companies. (Schools' Application for Rehearing, p. 1).

no different from any of the other rates concerning the retroactive ratemaking claims. OCC's arguments should be rejected.

The Order's adoption of CSP's gridSMART Phase I initiative is <u>lawful and reasonable. (OCC 14, IEU I.F and IV)</u>

The Order stated that the Commission "strongly supports" AEP Ohio's gridSMART Phase I proposal to implement AMI, DA and HAN. (Order, p. 37). In establishing the initial rider, the Commission noted that "recent federal legislation makes matching funds available to smart grid projects" and directed CSP "to make the necessary filing for federal monies under the American Recovery and Reinvestment Act of 2009 for the balance of the projected costs of gridSMART Phase I." (Order, p. 38). As a result, the Commission established the initial gridSMART rider to "half of the Companies' requested amount." (*Id.*) Notwithstanding the claims of OCC and IEU, AEP Ohio submits that the Order is lawful and reasonable in adopting the gridSMART Phase I initiative.[11]

OCC advances two primary points in support of its rehearing argument against the Commission's adoption of the gridSMART Phase I initiative, alleging that: (1) the Order does not satisfy the requirement of §4903.09, Ohio Rev. Code, to set forth reasons supporting its decision, and (2) the evidence presented at hearing does not support the Commission's authorization of the gridSMART Phase I initiative. (OCC Memorandum in Support, pp. 47-55). Similarly, IEU makes a claim that the Order violates §4903.09, Ohio Rev. Code, regarding adoption of the gridSMART proposal and did not sufficiently

[11] AEP Ohio requested that the Commission clarify on rehearing that it intended to fully fund the gridSMART Phase I initiative through rates, to whatever extent that federal funding is not received by AEP Ohio for this initiative. Subject to that clarification (or, in the alternative, request for rehearing), AEP Ohio submits that the Order is lawful and reasonable in supporting the gridSMART Phase I initiative.

demonstrate the cost-effectiveness of gridSMART Phase I. (IEU Memorandum in Support, pp. 21-22).[12] Through these arguments, OCC and IEU plainly attempt to second-guess the Commission's appraisal of the record evidence and those parties merely reveal that they disagree with the Commission's findings. The Order has ample record basis to support the conclusions reached and the fact that OCC or IEU oppose the result is not a valid basis for rehearing.

First, regarding the allegation that the Order does not satisfy the requirements of §4903.09, Ohio Rev. Code, as discussed above, the Supreme Court of Ohio has held that, as long as there is a basic rationale and record supporting the Order, no violation of §4903.09, Ohio Rev. Code, exists. *Indus. Energy Users-Ohio v. Pub. Util. Comm.*, 117 Ohio St. 3d 486, 493 (Ohio 2008 990 ¶ 30) quoting *MCI Telecommunications Corp. v. Pub. Util. Comm.* (1987), 32 Ohio St.3d 306, 312, 513 N.E.2d 337; *Tongren v. Pub. Util. Comm.* (1999), 85 Ohio St. 3d 87, 90, 1999 Ohio 206, 706 N.E.2d 1255; *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* (1996), 76 Ohio St. 3d 163, 166, 1996 Ohio 296, 666 N.E.2d 1372.

The Order specifically recognized the features and benefits of the proposed gridSMART Phase I initiative, as evidenced by detailed recitations of the pertinent record evidence on pages 34-37 of the Order. The Order proceeds to make specific findings that gridSMART Phase I "will provide CSP with beneficial information as to implementation,

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[12] IEU also criticizes the Order for approving a slightly higher distribution increase for 2009 than was proposed by AEP Ohio, even though the Commission did not accept part of the ESRP. (IEU Memorandum in Support, pp. 39-40). By focusing solely on 2009 in making this criticism, IEU fails to recognize: (1) that the Companies' proposal was to levelize costs over the three-year ESP term while, under the Order's approach, the 2010 and 2011 increases for gridSMART Phase I and ESRP will be *lower* than those proposed by the Companies, and (2) that the Companies had less than a full year to recover these revenues. Moreover, the Commission did not reject the Companies' proposed percentage distribution increase as being inappropriate or unreasonable; it deemed the proposal "unnecessary" because of the decision made on the ESRP and gridSMART riders. (Order, p. 38). Accordingly, this argument should be rejected or disregarded.

equipment preferences, customer expectations, and customer education requirements" and that "these advanced technologies are the foundation for AEP-Ohio providing its customers the ability to better manage their energy usage and reduce their energy costs." (Order, p. 37). These evidence recitations and findings are sufficient to explain the Commission's rationale for adopting the gridSMART Phase I initiative. Of course, if the Commission chooses to expand its reasoning and to detail the rationale supporting adoption of the gridSMART Phase I initiative through its entry on rehearing, that would further ensure that OCC's and IEU's claims cannot be successfully pursued.

OCC and IEU also argue that §§4928.02(D) and 4928.64(E), Ohio Rev. Code, require gridSMART to be cost-effective and that the Order does not support such a conclusion. (OCC Memorandum in Support, pp. 49-51; IEU Memorandum in Support, p. 22). Based on the quoted language, it is evident that OCC and IEU are actually intending to reference §4928.04(E), not §4928.64(E).[13] In any case, these "policy" arguments are not binding on the Commission and are otherwise misguided.

OCC and IEU focus on selected language within §4928.02(D), Ohio Rev. Code, while an unquoted portion of that policy statement also specifically includes deployment of advanced metering infrastructure as an example of cost-effective demand-side retail electric service. Another portion of that policy is to "encourage innovation and market access" for supply- and demand-side options such as time-differentiated pricing. Time-differentiated pricing that emulates market prices will be facilitated by deployment of

[13] Interestingly, the identical typographical references appear in both OCC's and IEU's briefs: although those parties had not made this argument before, the identical argument was made in OCEA's merit brief at pages 77-80 –including the same typographical reference to "4928.64(E)" in all three places. It would appear that, although OCEA has dropped the argument, OCC and IEU have merely done a "cut and paste" from OCEA's earlier argument without even checking or understanding the citations. This detracts credibility from an argument that otherwise lacks merit.

gridSMART Phase I, as was explained through the Companies' testimony. (Companies' Exhibit 1, p. 6; Tr. III, pp. 304-305). Further, OCC's and IEU's argument focuses solely on one policy while the Commission's responsibility is to consider all of the policies within §4928.02, Ohio Rev. Code. And the concept of being cost-effective does not mean that a network component (or group of components like the gridSMART initiative) pays for itself but, rather, that it is a reasonable and prudent approach to deploying needed functionalities and features. In any case, reliance on selected language within one of the policies does not provide support for OCC's or IEU's rehearing request.

As AEP Ohio argued on brief, the Commission should also consider the several provisions within SB 221 adopted by the General Assembly designed to promote the deployment of smart metering. Sec. 4905.31(E), Ohio Rev. Code, creates a specific cost recovery mechanism opportunity for "acquisition and deployment of advanced metering, including the costs of any meters prematurely retired as a result of the advanced metering implementation." Further, in setting forth the energy policy for the State of Ohio, the General Assembly also included new language to ensure that the Commission will encourage "implementation of advanced metering infrastructure." (§4928.02(D), Ohio Rev. Code). In the specific context of an ESP, the General Assembly included a long-term energy delivery infrastructure modernization plan as an item that can be included in an ESP. (§4928.143(C)(2)(h), Ohio Rev. Code).

Finally in this regard, given the potential for significant enhancements in customers' energy management capabilities that are associated with gridSMART technology, the General Assembly's inclusion of mandates in §4928.66, Ohio Rev. Code, for energy efficiency and peak demand reductions also implicitly supports deployment of advanced metering. Indeed, Ms. Sloneker testified that the demand response capabilities associated with gridSMART Phase I will be critical to achieving the benchmarks required by SB 221. (Tr. III, pp. 252-253). In short, the General Assembly's deliberate and consistent effort to promote advanced metering through the passage of SB 221 should be implemented by the Commission in considering AEP Ohio's gridSMART Phase I proposal.

OCC also re-argues its position that AEP Ohio should have been required to demonstrate customer and societal benefits. AEP Ohio addressed this issue in its merit brief and will not repeat that argument here. (Companies' Initial Brief, pp. 64-65). The Order sufficiently addressed this issue, concluding that "we do not believe that all information is required before the Commission can conclude that the program is beneficial to ratepayers and should be implemented." (Order, p. 38). OCC is merely re-asserting the same arguments and the Commission should, again, reject them on rehearing.

In a final effort to overturn the Commission's approval of gridSMART Phase I, OCC transparently attempts to impose its own standard of proof by claiming that "[g]iven the obvious ties between Phase I and the full gridSMART rollout, AEP Ohio should have been required to provide specific Phase I performance criteria and a detailed full system cost estimate and implementation plan before any Commission approval of Phase I." (OCC Memorandum in Support, p. 53). Again, the Order already rejects OCC's arguments that all the answers to all questions about the gridSMART initiative need to be answered up front, by concluding that "we do not believe that all information is required before the Commission can conclude that the program is beneficial to ratepayers and should be implemented." (Order, p. 38). The Commission should reject OCC's and IEU's bid to second-guess the approval of gridSMART Phase I.

The Order's Approval of the Enhanced Vegetation Management Initiative, Through Adoption of the Enhanced Service Reliability Plan <u>(ESRP) Rider, is Lawful and Reasonable. (OCC #15, 16, 17 and 18)</u>

The Order found that AEP Ohio's proposed enhanced vegetation initiative, with Staff's additional recommendations, is a reasonable program that will advance the state policy and approved the ESRP rider under §4928.143 (B)(2)(h), Ohio Rev. Code, to recover the associated prudently-incurred incremental costs. (Order, p. 34). OCC sets forth four arguments on rehearing to challenge the Commission's approval of the ESRP rider, alleging that: (1) the Order violates §4903.09, Ohio Rev. Code [OCC Assignment of Error 15]; (2) the Companies have not met the burden of proving that the vegetation management plan is in the public interest [Assignment of Error 16]; (3) the Commission erred by characterizing the vegetation management initiative as "cycle-based" [Assignment of Error 17]; and (4) that AEP Ohio's original ESRP filing does not comply with adopted filing requirements that just became effective after the merit decision in this case was issued [Assignment of Error 18] (OCC Memorandum in Support, pp. 55-65). An examination of each of these arguments against the vegetation management initiative reveals that OCC is again merely second-guessing the Commission's evaluation of the evidence and ignoring the Commission's statutory discretion to approve the program.

OCC's Assignment of Error 15 claims that the Order violates §4903.09, Ohio Rev. Code. As discussed above, the Supreme Court of Ohio has held that, as long as there is a basic rationale and record supporting the Order, no violation of §4903.09, Ohio

Rev. Code, exists. *Indus. Energy Users-Ohio v. PUC*, 117 Ohio St. 3d 486, 493 (Ohio 2008 990 ¶ 30) quoting *MCI Telecommunications Corp. v. Pub. Util. Comm.* (1987), 32 Ohio St.3d 306, 312, 513 N.E.2d 337; *Tongren v. Pub. Util. Comm.* (1999), 85 Ohio St. 3d 87, 90, 1999 Ohio 206, 706 N.E.2d 1255; *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* (1996), 76 Ohio St. 3d 163, 166, 1996 Ohio 296, 666 N.E.2d 1372. The ESRP findings within the Order easily meet this standard, and OCC's arguments should be rejected.

In support of its claim under §4903.09, Ohio Rev. Code, OCC argues that the ESRP rider amounts are not set forth in the Order; that the rider was not proposed by any of the parties; and that there has been no "proper review" of the Companies' prior vegetation management expenditures. (Order, pp. 55-57). As to the first point, there is no requirement that the Commission specify actual rates in its order within the context of an ESP case or within the context of any rate order. Historically, it has not been the Commission's practice to do so. Instead, the Commission generally decides the merit of issues affecting rates; tariffs containing the resulting rates are filed, reviewed and, if found to be compliant, are approved (either affirmatively or by not suspending the filed tariffs). This routine and well-established approach was used in this case and the Commission issued a separate Entry on March 30, 2009 finding that the proposed tariffs properly implemented the Order.

OCC's second supporting argument is equally unavailing: OCC claims that none of the parties proposed the rider and no testimony was provided, so the Commission violated §4903.09, Ohio Rev. Code, by adopting it. This claim is factually incorrect and legally without basis. In response to the Companies' proposal for a percentage distribution increase, Staff witness Scheck proposed a rider for the gridSMART Phase I initiative and Staff witness Baker recommended a rider for distribution automation and was cross examined extensively regarding the general operation of such a rider mechanism (which was part of gridSMART and part of ESRP). (Staff Ex. 3, pp. 4-5; Staff Ex. 5, pp. 6-7; Tr. XII, pp. 85-99). Moreover, the Companies affirmatively agreed that, in light of parties' concerns about the proposed distribution percentage increase, a rider would be acceptable since they merely sought to recover their incremental costs associated with the enhanced programs. (Companies' Reply Brief, pp. 62-63).

As a legal matter, the Commission's decision to adopt a rider instead of a percentage increase is a classic example of a rate design matter that is within the Commission's discretion and expertise. The Supreme Court of Ohio has often recognized the Commission's "unique rate design expertise" and the "wide discretion" afforded to the Commission on rate design issues. *Green Cove Resort I Owners' Ass'n v. Pub. Util. Comm.*, 103 Ohio St. 3d 125, 129 (2004); *Columbus S. Power Co. v. Pub. Util. Comm.*, 67 Ohio St. 3d 535, 540 (1993); *Gen. Motors Corp. v. Pub. Util. Comm.*, 47 Ohio St.2d 58, 351 N.E.2d 183 (1976). In considering these matters, the Order held that "in balancing the customers' expectations and needs with the issues raised by several intervenors" the Commission "approves the establishment of an ESRP rider as the appropriate mechanism pursuant to Section 4928.143(B)(2)(h), Revised Code, to recover such costs." (Order, p. 34).

Finally regarding its argument that the Order violates §4903.09, Ohio Rev. Code, OCC argues that there has been no "proper review" of the Companies' prior vegetation management expenditures. This complaint seems to misapprehend the ESRP rider approved by the Commission. Per the Order, only prudently-incurred incremental vegetation management costs will be collected through the ESRP rider. (Order, p.34). The Commission further provided that the ESRP rider will be "subject to Commission review and reconciliation on an annual basis." (*Id*). There can be no doubt that the Commission made clear that a "proper review" of the costs is integral to the ESRP rider approved in the Order. In short, the Commission's reasoning and record basis for adopting a rider is more than sufficient to pass muster under §4903.09, Ohio Rev. Code.

OCC's Assignment of Error 16 contends that §4928.143(B)(2)(h), Ohio Rev. Code, imposes the burden of proof on AEP Ohio to show that its vegetation management proposal is in the public interest, while the Order allegedly "places the burden on the parties to the case to disprove the enhanced nature of the programs." (OCC Memorandum in Support, pp. 57-61). OCC's claim that the burden of proof was improperly placed on the parties is based on the Commission's observation that "OCC offered no evidence that the proposed initiative is already included in the current vegetation management program, and thus, is not incremental." (Order, p. 33).

What OCC fails to acknowledge is that the quoted statement follows a direct and explicit finding in the Order that "[t]he Commission is satisfied that the Companies have demonstrated in the record that the costs associated with the proposed vegetation initiative, included as part of the proposed three-year ESRP, are incremental to the current Distribution Vegetation Management Program and the costs embedded in distribution rates." (*Id*). OCC also admits with consternation that the Commission accepted the Companies' record evidence in support of the ESRP regarding customer survey results in concluding that the enhanced vegetation management proposal better aligns the Companies' and customers' expectations as to tree-caused outages, service interruptions, and reliability of customers' service. (OCC Memorandum in Support, p. 59 citing Order, p. 33). Companies' witness Boyd also testified that the proposed ESRP programs were all designed to be incremental activities beyond existing activities and that the Companies were only seeking recovery of incremental vegetation management costs that are above current costs. (Companies' Ex. 11, p. 37; Tr. V., p. 179).

Thus, in reality, the burden of proof was not placed on the parties; the Companies satisfied their burden of proof and the opposing parties then bear the burden of going forward with contrary evidence (rather than just making bald assertions without support). The Commission found that the Companies met their burden of proof and the opposing parties failed to present sufficient evidence. Once again, although disguised as a legal argument regarding shifting the burden of proof, OCC merely disagrees with the Commission's assessment of evidence and reveals that a different result would be reached if OCC were charged with deciding the case.

OCC's Assignment of Error 17 attacks the ESRP rider because OCC believes that "the Commission erred in characterizing AEP-Ohio's proposed vegetation initiative as 'cycle-based.'" (OCC Memorandum in Support, pp. 61-63). In reality, the Order repeatedly recognized that the ESRP rider would involve an enhanced vegetation management initiative that moves toward a cycle-based approach – not that the transformation would occur instantaneously (as is apparently presumed by OCC). For example, the Order indicated the Commission's belief that the Companies should "have a balanced approach" and explicitly recognized that the Companies' proposal would "place a *greater emphasis* on cycle-based planning and scheduling." (Order, p.33) (emphasis added). Regarding the Staff's additional recommendations that were incorporated into the ESRP rider, the Commission also characterized the enhanced program as a "move to" a cycle-based approach. (*Id.*). Thus, OCC does not present any basis to conclude that the Commission erred or misapprehended the evidence.

Finally regarding the ESRP, OCC's Assignment of Error 18 claims that AEP Ohio's original ESRP filing proposal does not conform to the filing requirements found in adopted rule 4901:1-35-03(A) and that the Commission, after having granted the application, should require an amendment based on a failure to comply with the filing requirements. (OCC Memorandum in Support, pp. 64-65). This is an absurd conclusion that should be summarily rejected for several reasons: (1) the rules were not effective as of the date of the Order and substantive changes were made to the rule relied upon by OCC on March 18, 2009 – months after the ESP case was fully submitted and was to be decided under the statutory deadline, (2) §4928.143(A), Ohio Rev. Code, only requires an application filed before the effective date of the rules to be conformed "as the commission determines necessary", (3) AEP Ohio's waiver request covering such issues was denied and it subsequently made a compliance filing on October 16, 2008 in this docket stating its understanding of Staff's view that it substantially complied with the rules as proposed, (4) it is untimely for OCC to raise a filing compliance issue after the merit decision has been issued, and (5) OCC's argument is simply another form of second-guessing the Order's approval of the ESRP rider and is without merit.

In sum, the Commission's decision to adopt the vegetation management initiative was supported by a key finding that customer expectations are better aligned with the Companies' expectations under the enhanced vegetation management initiative, consistent with §4928.143 (B)(2)(h), Ohio Rev. Code. (Order, pp. 33-34). The Commission also cited Companies' witness Boyd's testimony as record support for finding that increased spending earmarked for specific vegetation management initiatives can reduce tree-caused outages, resulting in better reliability. (Order, p. 33). Consequently, the Commission had sufficient record basis for adopting the enhanced vegetation management initiative and OCC's attempt to merely re-argue the same determination on rehearing should be rejected.

The Order's Adoption of the Economic Development Rider is Reasonable and Lawful and OCC's Rehearing Requests Should be Denied. (OCC #11 and 19)

The OCC raises two challenges against the Economic Development Rider (EDR) approved by the Order. In Assignment of Error 11, OCC asserts that the Commission unreasonably discontinued its policy of dividing the recovery of foregone revenue subsidies equally between ratepayers and shareholders. (OCC Memorandum in Support, pp. 39-41). In Assignment of Error 19, OCC claims that the approved EDR is anticompetitive and does not ensure enforcement of customer commitments. (*Id.*, pp. 65-66). These attacks are misguided and, in some cases, premature.

In suggesting through Assignment of Error 11 that the Commission unreasonably modified its policy of delta revenue sharing, the OCC inexplicably starts its argument by acknowledging that "the amount and allocation of the costs to be recovered is up to the discretion of the Commission ..." (*Id.*, p. 39). It is not clear how the OCC can simultaneously claim that delta revenue sharing is within the Commission's discretion and claim that the Commission erred in not ensuring the sharing arrangement advocated by the OCC. Further, AEP Ohio does not agree with OCC's supposition that it was previously established Commission policy to require sharing of delta revenue, as that practice is not reflected in the few special arrangements that AEP Ohio has with its customers prior to implementation of SB 221. In any case, to the extent that the policy of not requiring sharing is considered a change that requires a reason, OCC's position fails to acknowledge that the new language added to §4905.31, Ohio Rev. Code, as amended by SB 221, provides an obvious and compelling basis for allowing full revenue recovery for economic development discounts. Specifically, the General Assembly explicitly included recovery of foregone revenue associated with an economic development contract, as part of the SB 221 amendments, as being recoverable under §4905.31(E), Ohio Rev. Code.

By claiming in Assignment of Error 19 that the approved EDR is anti-competitive and does not ensure enforcement of customer commitments, OCC raises issues that are premature. The Commission will address the specific circumstances of individual special arrangements as they are presented for approval. To the extent enforcement issues arise in the future, the Commission's continuing jurisdiction over special arrangements can be used to address those issues arise.

Finally, OCC challenges the non-bypassable nature of the EDR as being anti-competitive. (OCC Memorandum in Support, p. 66). On the contrary, that the EDR is non-bypassable helps to ensure that it is competitive-neutral; whereas, a bypassable EDR would give CRES providers an undue advantage. All customers and the public-at-large benefit from economic development discounts. Although CRES providers' rates are unregulated and their rates do not reflect recovery of such "public interest" discounts, an

EDU's SSO rates are regulated and do include the foregone delta revenue associated with economic development contracts. If a competitive rate were offered to a customer that is lower than the electric utility's SSO rate, there would be no need for an economic development discount from the utility. Thus, recovering economic development discounts from all distribution customers (regardless of whether they take generation service from the Companies) preserves a level playing field.

<u>**Fuel Adjustment Clause (FAC) Mechanism**</u>

a. The Baseline FAC Component Of The Current SSO Rate Cannot, And Should Not, Be Based On A Measure Of Actual 2008 Costs. (IEU 7; OCC 1)

At pages 18-19 of the Order, the Commission addressed what the appropriate FAC baseline component of the current SSO rate should be. The Commission adopted its Staff's recommendation to determine the FAC baseline component using 2007 actual cost data, escalated by 3 percent for CSP and 7 percent for OPCo, as a proxy for 2008 costs.

OCC recommended at the hearing and in its post-hearing initial brief, at pages 12-15, that the Commission use actual 2008 fuel costs to develop the FAC baseline components. The Commission rejected this approach, and observed that even OCC's witness for this issue conceded that 2008 actual fuel costs were not known at the time of the hearing, which took place in 2008. For their part, the Companies have asked the Commission, at pages 38-39 of their Application for Rehearing, to adopt their proposed methodology for identifying the baseline FAC components. Now OCC, at pages 12-14 of its rehearing application, contends again that the Commission erred by adopting a baseline for the FAC that was not based on actual 2008 cost data. OCC also claims that the Commission permitted the Companies "to manipulate the process." (p. 13).[14] IEU similarly argues, at pages 44-47 of its rehearing request, that using any basis other than 2008 actual fuel costs to determine the FAC baseline rate (and, thus, the non-FAC rate) is unjust and unreasonable.

The Commission has already considered and rejected OCC's and IEU's argument. As the Commission observed in its Order, at page 19, there is no – and indeed could not have been any – record evidence of calendar year 2008 actual costs because the Application was filed on July 31, 2008 and the hearing took place during 2008. In short, it is not feasible to do what OCC and IEU recommend because there is no record basis for it.

Nor is it possible (or appropriate) to overcome this deficiency by now adding evidence into the record regarding 2008 actual fuel costs. The evidentiary hearing was completed months ago, the record was closed, and the case was submitted to the Commission for decision based on that record.

In any event, even if there were evidence of 2008 actual costs available in the record, it would require substantial modification. As Companies' witness Mr. Nelson explained, the volatility of fuel costs in 2008 and the extraordinary nature of significant fuel procurement activities in 2008 would make use of such costs inappropriate, absent significant adjustments. (Companies' Ex. 7B, pp. 2-3; Tr. XIV, pp. 74-75). Moreover, as the Companies have argued, 2008 fuel costs are not the proper focus for setting the FAC baseline. Instead, the Commission should use the Companies' rate analysis for determining the FAC baseline.

[14] OCC's claim of "manipulating the process" is remarkable in light of OCC's well-documented abandonment of positions it took when urging the Commission to extend the procedural schedule for this proceeding.

b. The Commission Properly Rejected Arguments That Off-System Sales Margins Should Be Used To Offset FAC Costs. (OCC 3)

OCC argues, at pages 16-18 of its application for rehearing, that the Commission erred by not offsetting FAC costs by profits from off-system sales (OSS). OCC contends that offsetting FAC costs by OSS margins is consistent with Commission precedent for sharing profits from OSS between customers and utilities. OCC also claims that by not offsetting FAC costs by OSS margins the Commission has failed to respect its own precedents in violation of *Cleveland Electric Illum. Co. v. Pub. Util. Comm.*, 41 Ohio St.2d 403 (1975).

First, OCC's argument that OSS margins should be used to offset FAC costs is one that the Commission considered and rejected in its Order, at pages 16-17. Neither §4928.143(B)(2)(a), Ohio Rev. Code, which specifically authorizes the FAC, nor any other provision of SB 221, would permit requiring that an Ohio electric distribution utility (EDU) offset FAC charges with OSS margins.

Second, the Commission's decision is not inconsistent with any of its precedents regarding the sharing of profits from OSS between a utility and its customers. Those profits were not used as an offset to costs recoverable under the previously effective Electric Fuel Clause (EFC). The Commission's decision is in compliance with §4928.143(B)(2)(a), Ohio Rev. Code. Since there is no Commission precedent regarding OSS margins under that section that is inconsistent with its Order in this proceeding, *Cleveland Electric Illuminating* is inapplicable.

c. The Costs Recoverable Through The FAC Under §4928.143(B)(2)(a), Ohio Rev. Code Are Not Limited To Costs Recoverable Through the Prior EFC. (IEU 8)

At pages 47-50 of its rehearing application, IEU argues that the Commission erred by approving a FAC for the Companies that includes costs beyond those that the prior EFC statute (and related rule) permitted. This is the same argument that IEU made, at pages 9-13 of its Initial Post-hearing Brief. IEU's criticisms are objections to SB 221's provision that governs the FAC, §4928.143(B)(2)(a), Ohio Rev. Code, and the Commission's rule which will implement that statutory provision, Rule 4901:1-35-09, Ohio Admin. Code. IEU's EFC-based objections to the FAC that the Order has approved are irrelevant and meritless.

d. The Rate Design For The FAC That The Commission Approved Is Lawful. (IEU 8)

At page 50 of its application for rehearing IEU argues that a FAC that recovers costs on a per-kWh basis is unreasonable, unjust and unlawful based on Commission precedent. IEU provides no support for the proposition that the rate design the Order has approved for the Companies' FAC mechanism under §4928.143(B)(2)(a), Ohio Rev. Code, is inconsistent with that statute or with any other decision the Commission has rendered under that section. IEU's argument is without merit.

<u>Phase-in And FAC Deferrals (OCC 2, 12, 13; Schools 1)</u>

In order to moderate the rate impacts of the Companies' ESP, the Order concluded that a phase-in of the ESP rate increases, pursuant to §4928.144, Ohio Rev. Code, is appropriate. The phase-in of the rate increases is accomplished by, first, the deferral of a portion of FAC costs during the three-year ESP period and, subsequently, recovery of the deferred costs during 2012-2018 through non-bypassable charges. Carrying costs on deferred costs must be allowed (and also deferred) from the time costs are deferred until they are finally recovered in order to enable the deferrals and thus the phase-in of rates to occur. The Order specifically authorizes the cost deferrals, including carrying costs, that the statute required in order to enable the phase-in of rate increases.

OCC raises three objections to the Commission's decision to authorize a phase-in of rates and the underlying cost deferrals. At pages 42-44 of its rehearing request, OCC contends that FAC cost deferrals destabilize customer prices and introduce uncertainty regarding retail electric service. OCC argues that these results are incompatible with §4928.143(B)(2)(d), Ohio Rev. Code. After reviewing the record and all of the arguments, the Commission came to the opposite conclusion, stating "that a phase-in of the increases is necessary to ensure rate or price stability and to mitigate the impact on customers during this difficult economic period..." There is ample, indeed overwhelming, support for the Commission's decision in the record. The phase-in of rate increases, and the related cost deferrals, comply with the requirements of §4928.144, Ohio Rev. Code which is the basis for the Commission's decision (and it is also fully compatible with §4928.143(B)(2)(d)) Ohio Rev. Code.

OCC also argues, at pages 14-16 of its application for rehearing, that carrying costs on deferrals should be calculated on a net-of-tax basis. This is the same argument that OCC made in its Initial Post-hearing Brief, at pages 63-64. The Commission considered this argument thoroughly and rejected it, at pages 23-24 of its Order. The Commission noted that if it adopted OCC's argument, the Companies would not recover the full carrying charges on the authorized deferrals, which would be inconsistent with the explicit directive of §4928.144, Ohio Rev. Code. OCC tries to avoid this result by arguing that §4928.144, Ohio Rev. Code, does not apply because the Commission did not authorize a phase-in of rates, but rather only cost deferrals. This argument evinces a basic misunderstanding of what the Commission has done. As explained above, the FAC cost deferrals (and the carrying costs) are necessary to reflect on the Companies' books of account, the phase-in of rate increases through the deferral of fuel expense for future recovery. In short, the Commission did authorize a phase-in of rate increases.

OCC also criticizes the Commission for authorizing the use of a weighted average cost of capital (WACC) to calculate carrying costs for the FAC deferrals. OCC contends that a short-term debt interest rate, rather than the WACC, should be used. OCC Application for Rehearing, at pages 45-46. This is the same argument that OCC made at pages 64-66 and 92-93 of its Initial Post-hearing Brief, which the Commission reviewed, at page 21, and declined to accept, at page 23, of its Order. As the Companies explained, and the Commission agreed, because the period of cost deferrals and their subsequent recovery will take place over the next ten years (2009-2018), use of a WACC, which includes both the costs of equity and long-term debt capital, is appropriate. Even in situations where the carrying cost applies for significantly shorter periods, such as deferral of storm damages or the annually adjusted Transmission Cost Recovery Rider, the Commission permits the use of the long-term cost of debt.

The Schools raise an additional criticism of the Order's phase-in of rate increases. The Schools contend that by approving deferrals of FAC costs now and then allowing recovery of the deferred costs through a non-bypassable surcharge in the future, without establishing a credit for School Pool participants who buy generation service from competitive retail electric service providers, the Commission has unreasonably and unlawfully created a subsidy to SSO customers in violation of §4928.02(H), Ohio Rev. Code. The Schools request that the Commission provide a credit to School Pool participants on their monthly bills identical to the value of the FAC deferral.

The Schools' argument is not persuasive. As explained above, the Commission's decision to adopt a phase-in of rate increases is authorized by, and complies with the requirements of, §4928.144, Ohio Rev. Code. With respect to the Schools' contention regarding §4928.02(H), Ohio Rev. Code, the Commission explained that the policy provisions of §4928.02 are to be used "as a guide" in its decision-making in this proceeding. In that regard, the Commission specifically stated, at page 13 of its Order, that "[it] has reviewed the ESP proposal presented by AEP-Ohio, as well as the issues raised by the various intervenors, and we believe that, with the modifications set forth herein, we have appropriately reached a conclusion advancing the public interest."

Nor would it be appropriate, in any event, to give schools who shop during the term of the ESP a credit on their bills for distribution service in the amount of FAC deferrals. Essentially, the Schools are requesting a rate decrease for shopping schools during the term of the ESP in order to offset the impact of surcharges during the post-ESP period. But this is simply, at best, a proposal to make the future surcharges avoidable, in violation of the requirement in §4928.144, Ohio Rev. Code, that they be non-bypassable. There is no basis in the law for giving some customers a rate decrease today that they do not have any right to receive, in order to enable them to avoid a statutorily required rate increase in the future. The School rehearing request should be denied because their quarrel is with the Legislature, not the Commission.

Non-FAC Generation Rate Increases

a. The Commission Properly Approved The Companies' Proposal To Recover Capital Carrying Costs On Their Incremental 2001-2008 Environmental Investment (OCC 10)

The Companies included in their ESP a provision to enable them to recover the capital carrying costs of their 2001-2008 incremental environmental investments not already reflected in their existing rates through adjustment made during their RSP authority. In its Order, at page 28, the Commission agreed that the Companies should be allowed to recover those incremental capital carrying costs and approved this aspect of their ESP.

At pages 37 to 39 of its rehearing application, OCC contends that the Commission erred because §§4928.143(B)(2)(a) and (b) do not permit recovery of these costs in an ESP. These are the same arguments that OCC made in its Initial Post-hearing Brief, at pages 69-70, which the Commission thoroughly considered in its Order, at pages 25-26, but declined to accept, at page 28. The most glaring flaw in OCC's position is that it, again, has mischaracterized the statutory basis for the Companies' proposal. The Companies' primary source of statutory authority for their proposed recovery of the environmental capital carrying costs is the "without limitation" language of §4928.143(B)(2), Ohio Rev. Code. That section provides that an ESP may provide for or include *without limitation*, any of the provisions identified in paragraphs (a) through (i) of that subdivision. In other words, while the list of provisions may be illustrative, it is not exhaustive.

OCC continues to state, on rehearing, that the Companies are basing their recovery of carrying costs for the environmental capital investments on §4928.143(B)(2)(a), Ohio Rev. Code. That is incorrect, and OCC's arguments that flow from that incorrect assumption are also flawed as a result.

OCC's argument that §4928.143(B)(2)(b), Ohio Rev. Code, precludes the Companies from recovering these capital costs because that section requires the cost to be incurred on or after January 1, 2009, also remains misguided on rehearing. OCC made this same argument in its post-hearing initial brief at pages 58-70. As the Companies pointed out in their Reply Post-hearing Brief, at page 30, that statutory section does not prohibit the recovery of carrying costs on environmental investments, as long as those carrying costs are incurred on or after January 1, 2009. While the investments involved in this aspect of the Companies' ESP were made prior to January 1, 2009, "the carrying cost itself is the carrying cost [the Companies are] going to incur in 2009." (Tr. XIV, p., 93, 114 (Nelson)).

Similarly, OCC's argument that there must be an after-the-fact examination of whether the costs were prudently incurred before recovery of them may be permitted has no basis. Section 4928.143(B)(2), Ohio Rev. Code, does not require the Companies to wait for the completion of a future proceeding that does not even start until after the 2009-2011 carrying costs have been incurred before it may begin to recover those costs.

Significantly Excessive Earnings Test

In connection with the Significantly Excessive Earnings Test (SEET) that §4928.143(F), Ohio Rev. Code, requires after each year of the ESP, the Commission found that it should develop a common methodology for the SEET and directed its staff to convene a workshop for the purpose. However, the Commission did resolve two important issues regarding how the SEET would be applied. The Commission concluded that FAC cost deferrals, underlying the phase-in of rate increases, should not have an impact on the SEET until the revenues associated with the deferrals are received. In addition, in order not to discourage the efficient use of generation facilities, to the extent the Companies' earnings result from wholesale sources, the Commission determined that Off System Sales (OSS) profits should not be considered in the SEET calculation. Accordingly, the Commission found that a determination of the Companies' earnings as "significantly excessive" necessarily excludes the impacts of the cost deferrals and OSS margins.[15]

Several Intervenors raised objections to or sought clarification of the Commission's rulings regarding the SEET. OCC contends that the impact of deferrals may not be removed from the SEET. Second, while OEG agrees that an adjustment regarding the impact of deferrals on the SEET is appropriate, it requests a clarification regarding how the adjustment will occur. Third, Kroger, OMA, and OEG object to excluding OSS margins from the SEET.

a. OCC's Objection to Eliminating the Impact of FAC Cost Deferrals on the Companies Earnings When Applying The SEET Is Meritless (OCC 20)

[15] The Companies also requested additional clarification regarding the SEET and the scope of proposals that may be addressed in the upcoming workshop. Specifically, the Companies asked that the Commission clarify that treating them on a combined basis for purposes of the SEET and how that might be done is a proper subject for the workshop. They also asked the Commission to confirm that the Commission's finding that a common methodology for the SEET is appropriate does not mean that the methodology must be identical for each utility. Companies' Application for Rehearing, at pages 40-41.

The Companies explained in their testimony and in their Initial Post-Hearing Brief, at pages 139-140, that the deferral of FAC costs, which enable the phase-in of rate increases, will produce earnings. Yet, the Companies further explained, the reality is that the Companies will not obtain revenues from customers at the time those deferral-created earnings are produced. They will receive revenues from customers that correspond to the deferral-related earnings in future periods through the non-bypassable surcharge that allows them to recover the deferred costs. They pointed out that it would be inappropriate to base a finding of significantly excessive earnings on revenues that the Companies had not received and, worse, order them to return the revenues before customers had even paid them. The Commission agreed, and in its Order confirmed that such "paper" earnings should not be allowed to distort the SEET and, instead, should be excluded from the test.

OCC contends, at pages 67-68 of its rehearing application, that §4928.143(F), Ohio Rev. Code, prohibits the Commission from making this sensible adjustment, stating that "[t]here is no provision specifically permitting accounting adjustments for deferrals." Moreover, OCC contends, making such an adjustment would lead to a mismatch between expenses and revenues, and that the statute "does not permit the Commission to create such a distortion in earnings for the purpose of calculating the Test."

OCC has gotten both points exactly wrong. The statute nowhere says that the Commission may not, when determining what earnings to include in the calculation of the Companies' earned return, make an adjustment that is appropriate to obtain an accurate measure of earnings and, thus, an accurate measure of the earned return on equity. In any event, even if the statute was so rigidly interpreted as to preclude the

Commission from making such an adjustment to the earned return, there would be no barrier to the Commission's exercising its discretion to exclude deferral-created earnings from the determination of what is "significantly excessive."

b. The Commission Should Provide the Clarification That OEG Seeks Regarding How The FAC Cost Deferrals Should Be Treated For SEET Purposes. (OEG 2)

In the portion of its Order providing clarification as to how FAC deferrals would be treated in the context of the Significantly Excessive Earnings Test (SEET), the Commission noted "that deferrals should not have an impact on the SEET until the revenues associated with deferrals are received." (Order, p. 69). Based on that reasoning, the Commission held that "deferrals, as well as the related expenses associated with the deferrals," should be excluded from the SEET. (*Id.*)

In its application for rehearing, OEG asks the Commission to clarify how deferrals will be incorporated in the SEET. Specifically, OEG wants the Commission to clarify that during the deferral portion of the 10-year phase-in (2009-2011) all deferrals of expenses will be excluded from the SEET and during the recovery period of the phase-in (2012-2018) the amortization expenses associated with the amounts previously deferred i.e., the "related expenses" to which the Commission referred, will be excluded. As OEG explains, were it not for the symmetrical treatment it proposes, the deferred FAC expenses "would reduce earnings twice instead of only once." Memorandum in Support, pp. 4-5).

The Companies believe that the clarification sought by OEG is consistent with the Commission's Order and results in the proper treatment of deferred FAC costs and related carrying costs in the SEET. Therefore, the Commission should provide the clarification sought by OEG. In doing so it should be clear, however, that during the deferral portion of the phase-in (2009-2011), the SEET will reflect the actual FAC expenses, but will reflect only the FAC-related revenues that are collected. During the recovery period of the phase-in (2012-2018), the SEET will reflect the revenues to recover previously deferred FAC expenses and related carrying costs that are being recovered during that period. As explained by OEG, for accounting purposes the amortization of the deferral is an expense that will reduce earnings. For SEET purposes, however, the amortization expense would need to be eliminated during the recovery period just as the deferral of expenses needs to be eliminated during the deferral portion of the phase-in for SEET purposes. The one-time reduction of FAC expenses in the recovery portion of the phase-in by removing the amortization will match the one-time elimination of the credit to FAC expense during the deferral portion of the phase-in. For these reasons, the clarification sought by OEG should be provided in the Commission's entry on rehearing.

c. Intervenors' Contention That Off-System Sales Profits May Not Be Excluded From The SEET Is Meritless (OMA 2; OEG 1; Kroger 2)

OMA, OEG, and Kroger claim that the Order erred by excluding Off-System Sales margins from the SEET. OMA App. for Reh., at pages 4-5; OEG App. for Reh., at pages 1-4; Kroger App. for Reh., at pages 6-8.

OMA contends that excluding OSS profits renders the "comparables" test a fiction. OEG argues that it creates a fundamental asymmetry by comparing only a part of the Companies' earnings with the full earnings of the comparable companies. Kroger claims that the exclusion of the margins from the SEET is contrary to Ohio law, and that the Commission did not adequately explain its decision to exclude the margins from the SEET. Nevertheless, Kroger allows that, if the Commission would use the OSS margins as an offset to FAC costs, it would be appropriate to exclude those margins from the SEET.

The Intervenors' argument that the exclusion of OSS margins from the SEET renders the comparison of earned returns of the Companies and those of businesses that face comparable business and financial risks fictional, or asymmetrical, or otherwise in conflict with the requirements of §4928.143(F), Ohio Rev. Code, misses the point. The Commission's Order concluded that it would be inappropriate to treat OSS margins, which result from wholesale sources, as being, or causing, significantly excessive earnings under the SEET. The Commission thoroughly explained its reasoning why the OSS margins should not be, nor lead to, significantly excessive earnings. Accordingly, in order to effectuate that judgment, the Commission excluded the OSS margins from the SEET's calculations. Section 4928.143(F), Ohio Rev. Code, provides the Commission with the authority to make that judgment, and it does not prevent the Commission from effectuating that decision in the manner the Commission has selected.[16]

Kroger also criticizes the Commission's observation that it is inconsistent for Intervenors to argue that OSS margins should be used both to offset FAC costs and as a source of significantly excessive earnings. Kroger contends that by rejecting Intervenor requests to use OSS margins as an offset to FAC costs and then excluding them from the SEET, the Commission improperly has let the Companies "have it both ways." This criticism is not valid either. First of all, the Commission's observation – that Intervenors

[16] Kroger's concession that, if the Commission would use OSS margins as an offset to FAC costs, Kroger would agree that the Commission should exclude the margins from the SEET belies the notion that the Commission is statutorily precluded from excluding the margins from the SEET.

arguments that OSS margins should be used to offset FAC costs are inconsistent with an argument that OSS margins should also be used, again, to either inflate the Companies' earnings subject to the SEET or comprise "significantly excessive" earnings – is correct. Such arguments are not reconcilable because they would, essentially, credit customers with the same profits twice. However, it is not inconsistent to conclude, on the one hand, that OSS margins should not be used as an offset to FAC costs and to also conclude, on the other hand, that they should not be used in the SEET. In both cases, the rationale is that OSS margins should not be credited to (or shared) with customers as part of the ESP. Specifically, with regard to using those margins as an offset against FAC costs, §4928.143(B)(2)(a), Ohio Rev. Code, which governs the FAC, does not provide for such an offset. With regard to using the margins in the SEET, the Commission properly concluded that such margins should not be considered, in any event, as being, or causing, significantly excessive earnings. Indeed, including OSS margins in the SEET, after having first concluded that they should not be an offset to FAC costs, would have amounted to a reversal of that first conclusion. Accordingly, the Commission's decision to exclude OSS margins from the SEET was completely consistent with its decision that they could not be used as an offset to FAC costs.

CONCLUSION

Except as specifically noted herein, the Intervenors' applications for rehearing should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of Columbus Southern Power Company's and Ohio Power Company's Memorandum Contra Intervenor's Applications for Rehearing was served by electronic mail upon the individuals listed below this 27th day of April, 2009.

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