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**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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

In the Matter of the Application of)
Ohio Power Company for Approval of its) Case No. 08-918-EL-SSO
Electric Security Plan; and an Amendment)
to its Corporate Separation Plan)

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**POST-HEARING BRIEF
SUBMITTED ON BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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INTRODUCTION

Columbus Southern Power Company (CSP) and the Ohio Power Company (OPCO), collectively the Companies, filed their application for a Standard Service Offer (SSO) on July 31, 2008. On March 18, 2009, the Commission issued its Opinion and Order (O&O) approving the application, with modifications. The Commission issued its Entry on Rehearing on July 23, 2009, from which appeals were taken. On April 19, 2011, the Ohio Supreme Court issued a decision that affirmed the Commission in part, reversed in part, and remanded the case for further consideration. *In re Application of Columbus S. Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788 (2011).

Specifically, the Court concluded that the Commission's decision that the Companies' POLR (Provider of Last Resort) charge was cost-based was against the manifest weight of the evidence. While the Court specifically stated that "we express no opinion on whether a formula-based POLR charge is per se unreasonable or unlawful," *Id.* at ¶30, the Court noted two other methods by which the Commission may establish the POLR charge: a non-cost-based POLR charge or evidence of AEP-Ohio's actual POLR costs. The Court directed the Commission to "explain its rationale, respond to contrary positions, and support its decision with appropriate evidence." *Id.*

The Court also concluded that Ohio Rev. Code Section 4928.143(B)(2) does not authorize the Commission to allow recovery of items not included in the section. The Court remanded the case to the Commission to "determine whether any of the listed categories set forth in Section 4928.143(B)(2), Revised Code, authorize recovery of environmental carrying charges." *In re Application of Columbus S. Power Co.* at ¶35.

On May 25, 2011, the Commission issued an Entry adopting a procedural schedule to afford AEP-Ohio and interveners an opportunity to present testimony and additional evidence in regard to the POLR and environmental carrying charges remanded to the Commission. An evidentiary hearing commenced July 15, 2011, and concluded on July 28, 2011.

Provider of Last Resort Charges

In its March 18, 2009 Opinion and Order, the Commission found that "the Companies do have some risks associated with customers switching to CRES providers

and returning to the electric utility's SSO rate at the conclusion of CRES contracts or during times of rising prices.” O&O at 40. The Commission further found “that the POLR rider will be based on the cost to the Companies to be the POLR and carry the risks associated therewith, including the migration risk.” *Id.* It accepted the Companies’ witness’s quantification of the risk “to equal 90 percent of the estimated POLR costs”. *Id.*

On appeal, the Court could “find no evidence suggesting that AEP’s POLR charge is related to any costs it will incur.” *In re Application of Columbus S. Power Co.* at ¶25. The Court also concluded that “[v]alue to customers (what the [Black-Scholes] model shows) and cost to AEP (the purported basis of the order) are simply not the same thing.” *Id.* at ¶26. It did so because it could not “see how the amount a customer would be willing to pay for the right to shop necessarily establishes AEP’s costs to bear the attendant risks. The order does not explain the relationship between the two.” *Id.* at ¶27. Finding no evidence that the charge was based on cost, it reversed the provisions of the order authorizing the POLR charge.

The Court has previously admonished the Commission to “carefully consider what costs it is attributing” to “POLR obligations.” *Ohio Consumers’ Counsel v. Pub. Util. Comm.*, 114 Ohio St.3d 340, 2007-Ohio-4276, 872 N.E.2d 269, ¶ 26. Consequently, it charged the Commission in this case to explain its rationale, and specifically to “respond to contrary positions, and support its decision with appropriate evidence.” *In re Application of Columbus S. Power Co.* at ¶30.

The testimony on remand is clear. The Companies are not claiming any out of pocket cost relating to their POLR obligation. The Companies’ claimed POLR cost is an

ex ante valuation of benefits that customers can claim by shopping. To the extent that customers are shopping because market conditions make alternative sources more attractive, the Companies lose a corresponding opportunity to generate revenue from those customers, a loss they cannot recover in the market. That potential for loss creates a liability for the Companies that results in a diminution in shareholder equity.

Q: [Attorney Margard] What I'm looking for is the relationship between value of the option, benefit to the customer and cost to the company. We've had a number of questions and responses that discuss the value of the option. And I understand your testimony to equate the value of the option to the benefit to the customer, and that that benefit then is the cost to the company. Is that a fair characterization or do you wish to clarify?

A: [Company witness LaCasse] That's correct.

Remand Tr. Vol. V at 706-707.

Staff believes that the Companies face risks that impose costs, and that those costs may properly be recovered through a POLR charge. Staff has concerns, however, about whether the Companies have properly valued those costs. Staff has concerns regarding the risks faced by the Companies, with the use of the Black model in general, and with the inputs used by the Companies in running the Black model.

In its initial Opinion and Order, the Commission found “that the Companies do have some risk associated with customers switching to CRES providers and returning to the electric utility's SSO rate at the conclusion of CRES contracts or during times of rising prices.” O&O at 40. As IEU-Ohio witness Jonathan Lesser correctly noted in his direct remand testimony, the Supreme Court referred to POLR risk as the obligation “to

stand ready to accept returning customers.” *In re Application of Columbus S. Power Co.* at ¶23. Staff tends to agree with Dr. Lesser that migration risk “is a risk of competitive markets, not a risk of being a POLR provider.” IEU Remand Ex. 1 at 13.

To the extent that the Black model used by the Companies to determine customer benefit / option value / company cost is a reasonable model to use, its calculations measure both a “call” and a “put,” as earlier described by Companies witness Baker. Tr. Vol. X (Dec. 2, 2008), page 111. These calculations represent the modeled costs associated with return risk and migration risk, respectively.

The Commission noted that Companies’ witness Baker estimated that migration risk was equal to approximately 90 percent of the Companies’ POLR costs. O&O at 39. Staff respectfully concurs that this “migration risk,” or shopping risk, reflects a risk that exists for all firms operating in a competitive market. Only the return risk represents the unique responsibility that electric distribution utilities are obligated to stand ready to provide to all customers at any time, and it is this risk which comprises the POLR obligation. Should the Commission determine that the Black model is indeed a reasonable methodology for valuing the POLR obligation, Staff believes that it significantly overstates the costs for which the Companies should be compensated.

Finally, as Staff witness Benedict demonstrated, certain inputs and parameters used by the Companies in its application of the Black model will likely result in an incorrect option valuation. Specifically, Mr. Benedict showed that the assumptions for interest rate, market price volatility, and term of the option should be modified if the

model is to be used to determine POLR costs. The net effect of these recommendations would be a reduced value of the option. Staff Remand Ex. 1.

It is Staff's opinion that the POLR function does impose costs on the Companies. Staff does not reject an *ex ante* definition of those costs, but submits that the Black model as adopted by the Companies significantly overstates the extent to which the Companies should be compensated.

Carrying Costs on Environmental Investments

In its March 18, 2009 Opinion and Order, the Commission found that "AEP-Ohio should be allowed to recover the incremental capital carrying costs that will be incurred after January 1, 2009, on past environmental investments (2001-2008) that are not presently reflected in the Companies' existing rates." O&O at 28. The Companies argued that the "without limitation" language in Ohio Rev. Code Section 4928.143(B)(2) supported recovery of these costs.

The Supreme Court, however, disagreed. It specifically "reverse[d] the commission's legal determination that Ohio Rev. Code Section 4928.143(B)(2) permits ESPs to include unlisted items." *In re Application of Columbus S. Power Co.* at ¶35. The Court remanded the case to the Commission for further proceedings in which "the Commission may determine whether any of the listed categories set forth in Section 4928.143(B)(2), Revised Code, authorize recovery of environmental carrying charges." *Id.*

S.B. 221 does, in fact, permit the recovery of carrying charges in an ESP. Such costs are an explicitly enumerated category in Ohio Rev. Code 4928.143(B)(2)(d):

- (d) Terms, conditions, or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service, default service, carrying costs, amortization periods, and accounting or deferrals, including future recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service;

(Emphasis added.) Although the statute does not specify *environmental* carrying costs, there can be no doubt that an ESP can include charges that relate to the recovery of carrying charges.

The Commission found that the Companies were incurring incremental capital carrying costs, incurred after January 1, 2009, on past environmental investments (2001-2008) that were not then reflected in the Companies' existing rates. The inclusion and recovery of these costs are clearly permitted by Ohio Rev. Code 4928.143(B)(2)(d), and the Commission should so find.

CONCLUSION

Staff respectfully urges the Commission to adopt the recommendations Staff has advanced in this brief.

Respectfully submitted,

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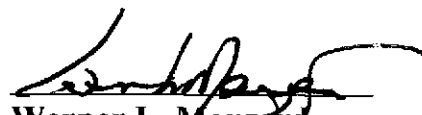
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