Before

**The Public Utilities Commission of Ohio**

In the Matter of the 2010 Annual Filing of )

Columbus Southern Power Company and )

Ohio Power Company Required by Rule ) Case No. 11-4571-EL-UNC

4901:1-35-10, Ohio Administrative ) Case No. 11-4572-EL-UNC

Code. )

# REPLY BRIEF OF INDUSTRIAL ENERGY USERS-OHIO

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# REPLY BRIEF OF INDUSTRIAL ENERGY USERS-OHIO

**I. Introduction**

Section 4928.143(F), Revised Code, requires the Public Utilities Commission of Ohio (“Commission”) to apply the Significantly Excessive Earnings Test (“SEET”), “with regard to the provisions that are included in an electric security plan,” (“ESP”) to determine if the electric distribution utility’s (“EDU”) earned return on common equity is significantly excessive. The Application and supporting testimony in this proceeding fail to present to the Commission the information necessary to apply the SEET to the Ohio Power Company and Columbus Southern Power Company (“OP”, “CSP”, or “Companies”). As a result there is no basis on which the Commission can legally determine if the Companies have significantly excessive earnings.

In addition to the Companies’ failure to present a case that conforms to the statutory requirements, the Companies have attempted to further weaken the SEET with claims for which there is no legal basis. As previously demonstrated[[1]](#footnote-1) and discussed again below, the Companies’ attempt to remove Off-System Sales (“OSS”) from the calculation of the earned return is incomplete and biased so as to understate the total-company return on equity (“ROE”). The Companies also present a thoroughly discredited bright-line test to set the threshold used to determine if the EDU has significantly excessive earnings. Additionally, the Companies seek to heighten the threshold for determining if their earned return on common equity is significantly excessive based on factors that have neither a statutory nor factual basis. Finally, the Companies offer that they are correctly applying the SEET while at the same time arguing that the statutory provision authorizing the SEET is void for vagueness. Each of these arguments should be rejected. Instead, the Commission must dismiss the Companies’ Application without prejudice and direct them to provide the information necessary to properly analyze their EDU-specific ESP-related earned return on common equity.

**II.** Argument

1. **The Companies Have Not Presented the Commission With an Earned Return on Common Equity Calculation That Complies with Section 4928.143(F), Revised Code.**

The Companies failed to provide the information necessary for the Commission to apply the SEET to the Companies’ 2010 ESP earned return on common equity. Although Section 4928.143(F), Revised Code, places the burden of proof on the Companies, the Companies have ignored the statutory mandates and filed information based on total-company data that includes activities outside of their ESPs and outside of the Commission’s jurisdiction. Because the Companies have not presented a case that complies with the statutory requirements, the Application should be dismissed without prejudice.

There is no disagreement as to the basic information that is contained in the Companies’ Application. The Companies acknowledged that they are engaged in lines of business outside their ESPs and that their Form 10-K and FERC Form 1 data are also total-company data.[[2]](#footnote-2) Relying on the total-company data, their Application did not jurisdictionalize the data to calculate the EDUs’ ESP-related earned return on common equity as required by Section 4928.143(F), Revised Code.[[3]](#footnote-3)

The intervening parties that offered testimony on the earned return on common equity calculation similarly relied upon total-company data. The Staff’s Witness, Mr. Buckley, accepted the Companies’ total-company calculation and focused his testimony on calculating the comparable group’s earned return on common equity.[[4]](#footnote-4) Similarly, the testimony filed by Ohio Energy Group (“OEG”) did not attempt to jurisdictionalize the Companies’ earnings attributable to their ESPs and those attributable to other business activities. While OEG’s Witness, Mr. Kollen, testified that one acceptable method to properly isolate the earned return on common equity of the ESP would require a full cost of service analysis,[[5]](#footnote-5) OEG’s position during this proceeding is that the Commission should use total-company data with no adjustment for OSS.[[6]](#footnote-6) Thus, no party has presented the Commission with a calculation of the Companies’ earned return on common equity “[w]ith regard to the provisions that are included in an electric security plan.”[[7]](#footnote-7)

The SEET is limited by the explicit terms of Section 4928.143(F), Revised Code, to a determination of the EDU’s ESP-related earned return on common equity. The Companies have the burden of proof to demonstrate that significantly excessive earnings did not occur. The failure of either EDU to present an application that would permit the Commission to determine if either OP or CSP is not earning significantly excessive earned return on common equity, thus, requires the Commission to dismiss the Application without prejudice and direct the EDUs to refile a proper application.

1. **The Companies’ Attempt to Apply the SEET Is Illegal and Unreasonable.**

In their Initial Brief, the Companies attempt to further weaken the SEET by arguing for an adjustment to remove OSS from the calculation of the earned return on common equity that is incomplete, for a statistical approach to set the SEET threshold that the Commission has previously determined is unreasonable, and for consideration of factors to increase the SEET threshold that are not based on the statutory requirements of the SEET or supported by the record. Each of these attempts should be rejected as illegal and unreasonable.

1. **The Companies’ Adjustment for OSS Is Unreasonable.**

Even if total-company data were an appropriate starting point, the OSS adjustment proposed by the Companies is unreasonable because it fails to adjust the denominator to account for all plant necessary to complete OSS transactions.

As the Companies indicate in their Initial Brief, their OSS adjustment contains two components: a modification to the numerator to remove OSS net margins; and a modification to the denominator based on a complex (and improper) allocation of equity.[[8]](#footnote-8) As presented by the Companies, the denominator adjustment does not account for transmission plant supporting OSS.[[9]](#footnote-9) But, as Companies’ Witness Mr. Hamrock testified, a physical sale of generation requires transmission plant for completion.[[10]](#footnote-10) The failure to account for transmission plant in the calculation of the common equity uniformly biases the application of the SEET in favor of the Companies.[[11]](#footnote-11) The Commission should reject the Companies’ unreasonable adjustment.

1. **The Companies’ Method of Calculating the SEET Threshold has Already Been Rejected as “Unrealistic and Indefensible”.**

Additionally, the Companies have again attempted to argue that the Commission should adopt a statistically-based bright-line test for setting the threshold for determining whether the earned return on common equity is significantly excessive. In support of that position, the Companies have presented the testimony of Dr. Makhija who opines that it is appropriate to set the SEET threshold at 1.96 standard deviations above the ROE mean of his comparable group of companies.[[12]](#footnote-12) Although the Companies assert that the SEET threshold should be calculated using this statistical approach, the Commission has already rejected reliance solely upon the application of a statistical analysis. In its Finding and Order in Case No. 09-786-EL-UNC, the Commission held that “[w]hile a number of commenters request a bright line statistical analysis test for the evaluation of earnings, and the Commission agrees that statistical analysis can be one of many useful tools, utilizing only a statistical method for establishing the SEET threshold is insufficient by itself to meet the electric utility's burden of proof pursuant to Section 4928.143(F), Revised Code.”[[13]](#footnote-13) Additionally, in its Opinion and Order in Case No. 10-1261-EL-UNC, the Commission specifically rejected the statistical approach the Companies have presented in this proceeding, finding the Companies approach “unrealistic and indefensible.”[[14]](#footnote-14) The Companies have not demonstrated any reason for the Commission to revise its view that a bright-line statistical test that results in a SEET threshold of 22.62%[[15]](#footnote-15) is unrealistic and indefensible.

1. **The Companies Do Not Demonstrate A Basis For Increasing the SEET Threshold.**

Finally, the Companies identify concerns[[16]](#footnote-16) that they claim would allow them to retain earnings that are otherwise deemed significantly excessive.[[17]](#footnote-17) The items identified by the Companies, however, can be readily dismissed. First, the statute does not provide any basis for such an adjustment.[[18]](#footnote-18) Second, as IEU-Ohio identified in its Initial Brief, the concerns the Companies identify do not provide a basis for an adjustment. For example, they have already been compensated for several items (gridSMART, environmental costs, energy efficiency and peak demand reduction (“EE/PDR”) programs, and provider of last resort (“POLR”) charges),[[19]](#footnote-19) other listed items do not represent substantial risks (EE/PDR programs and migration risks),[[20]](#footnote-20) or the listed item is the subject of a non-bypassable charge (deferrals[[21]](#footnote-21)). Thus, the Companies have not presented a basis—legal or factual—to support an adjustment that further weakens the SEET.

**C. The Statute Is Not Unconstitutionally Vague.[[22]](#footnote-22)**

Finally, the Companies renew their argument that the SEET violates their due process rights because Section 4928.143(F), Revised Code, is void for vagueness.[[23]](#footnote-23) At the outset it is important to note that the Commission has already determined that it is not the province of the Commission to determine the constitutionality of Section 4928.143(F), Revised Code.[[24]](#footnote-24) Furthermore, the Commission has also determined that there is “ample legislative direction to reasonably apply” Section 4928.143(F), Revised Code,[[25]](#footnote-25) noting that the concepts under review in the SEET were not “new or novel” and that the “Commission has extensive experience adjudicating” issues where the parties present differing views.[[26]](#footnote-26) The Commission also has stated that the SEET statute provided “a clear benchmark for identifying excessive earnings.”[[27]](#footnote-27) For these reasons the Commission found it had sufficient legislative direction to apply the SEET.

In any case, Section 4928.143(F), Revised Code, satisfies the requirements of due process so as to avoid a finding that it is void for vagueness. Generally, economic regulations, such as the SEET, are reviewed under a lower level of scrutiny.[[28]](#footnote-28) Once it is established that the statute is economic in nature, “[t]o succeed” on its void-for-vagueness claim the Companies “must demonstrate that the law is impermissibly vague in all of its applications.”[[29]](#footnote-29) As the Commission has previously determined, the terms of Section 4928.143(F), Revised Code, provide both sufficient direction and notice of their requirements so as to avoid arbitrary application, and the Companies were well aware of the Commission’s determinations as to scope and operation of the SEET. Thus, there is not a basis for finding that the SEET is unconstitutionally vague as applied in this case.

The Companies, nonetheless, argue that a higher level of review should be applied to determine that the statute is unconstitutionally vague, relying on *Norwood v. Horney*.[[30]](#footnote-30) The *Norwood* decision applied a heightened level of scrutiny because the Ohio Supreme Court determined that the ordinance under review could result in the exercise of eminent domain.[[31]](#footnote-31) In this case, however, the Companies have not demonstrated any legal interest that justifies the higher level of review. As presented by the Companies, they are claiming a right in the every dollar of revenue received under their ESPs.[[32]](#footnote-32) This claim obviously ignores the fact that the Companies’ ESPs were subject to the SEET and the possibility of a prospective rate change from the day the ESPs were approved and as long as the Companies did not withdraw from the ESPs.[[33]](#footnote-33) Moreover, there is no property interest in an excessive rate that would trigger a higher level of scrutiny. The constitutional interest in utility cases does not extend to rates that result in significantly excessive earnings. “All that is protected against, in a constitutional sense, is that the rates fixed by the Commission be higher than a confiscatory level.”[[34]](#footnote-34) Given that there is no property interest in retaining excessive rates which are subject to prospective adjustment, there is also no basis for asserting that the standard of review is heightened.

Even if there were a constitutionally protected property interest, the Companies have not shown that the statute is insufficiently clear to justify a finding that it is void. The Companies’ argument that the statute is vague rests on the fact that the parties have conflicting interpretations about the scope of Section 4928.143(F), Revised Code.[[35]](#footnote-35) Conflicting interpretations, however, are not the same as showing that the statute is unconstitutionally vague. Rather, the complaining party must demonstrate that it cannot conform its behavior because the statute is unclear. “[T]o succeed on a claim of unconstitutional vagueness …, the complaining party must do more than show that the statute ‘requires a person to conform his conduct to an imprecise but comprehensible normative standard.’ … Instead the complaining party must prove that ‘no standard of conduct is specified at all.’”[[36]](#footnote-36) In this case, however, it is clear that the Companies could manage rates and expenses to define income and capitalization so as to produce an earned return on common equity that would not cross a threshold of being significantly excessive. If nothing else, the Companies could have sought to reduce their rates. The Companies have failed to carry that heavy burden to demonstrate that the statute is unconstitutionally vague.

III. Conclusion

The Commission must dismiss the Companies’ Application because there is insufficient evidence in the record to apply the SEET to the Companies’ 2010 earnings. The Companies have not provided the Commission with the information necessary and legally required to perform the SEET. Moreover, the record further highlights why the statute requires a proper jurisdictionalization of each EDU’s earned return on common equity attributable to their ESPs. As noted in IEU-Ohio’s Initial Brief, strong circumstantial evidence exists to demonstrate that the Companies’ parent, American Electric Power (“AEP”), is leaning on Ohio customers, as evidenced by OP and CSP’s high rates and gross margins relative to other AEP affiliates.[[37]](#footnote-37) Until the Commission requires the Companies to properly jurisdictionalize its EDU-specific ESP-related earned return on common equity, the Commission will have acted outside the statutory requirements of the SEET and left Ohio customers without the protection the Ohio General Assembly sought to provide the Companies’ customers through the SEET.

For the reasons explained herein, IEU-Ohio respectfully urges the Commission to dismiss the Companies’ Application without prejudice and to direct the Companies to file new applications providing the information required by Section 4928.143(F), Revised Code.

Respectfully submitted,

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**Certificate of Service**

I hereby certify that a copy of the foregoing *Reply Brief of Industrial Energy Users-Ohio,* was served upon the following parties of record this 10th day of February, 2012, *via* electronic transmission, hand-delivery or first class U.S. mail, postage prepaid.

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1. Initial Brief of Industrial Energy Users-Ohio at 10-12 (January 31, 2012) (hereinafter “IEU-Ohio Initial Brief”). [↑](#footnote-ref-1)
2. Tr. Vol. I at 15. [↑](#footnote-ref-2)
3. *Id.* at 64; *see also* IEU-Ohio Initial Brief at 5-7 (demonstrating that the Companies’ numbers were tied to their FERC Form 1’s which are annually filed with FERC and contain total-company numbers for all lines of business that they are engaged in). [↑](#footnote-ref-3)
4. Staff Exhibit 1 at 2. [↑](#footnote-ref-4)
5. OEG Exhibit 1 at 9. [↑](#footnote-ref-5)
6. OEG Initial Brief at 4, 7. [↑](#footnote-ref-6)
7. Section 4928.143(F), Revised Code. [↑](#footnote-ref-7)
8. Companies’ Initial Brief at 11-12. [↑](#footnote-ref-8)
9. Tr. Vol. I at 72-73. [↑](#footnote-ref-9)
10. Tr. Vol. I at 16-17. [↑](#footnote-ref-10)
11. IEU-Ohio Initial Brief at 10-12. [↑](#footnote-ref-11)
12. Companies’ Exhibit 3 at 29-34. [↑](#footnote-ref-12)
13. *In the Matter of the Investigation into the Development of the Significantly Excessive Earnings Test Pursuant to Amended Substitute Senate Bill 221 for Electric Utilities*, Case No. 09-786-EL-UNC, Finding and Order at 29 (June 30, 2010). The Companies assert that the Commission previously found in Case No. 09-786-EL-UNC that “a statistical approach is an appropriate method for evaluating the earned return of an EDU under the SEET” to support an argument for adopting Companies’ Witness Dr. Makhija’s analysis. Companies’ Initial Brief at 27. As the text from Case No. 09-786-EL-UNC demonstrates, the Commission rejected a bright-line statistical test. [↑](#footnote-ref-13)
14. *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code*, Case No. 10-1261-EL-UNC, Opinion and Order at 24 (January 11, 2011) (hereinafter “*AEP’s 2009 SEET Proceeding*”). [↑](#footnote-ref-14)
15. Companies’ Exhibit 3 at 7. [↑](#footnote-ref-15)
16. The factors include: the Companies’ upcoming capital requirements (including investment in a solar farm and in its gridSMART program); the Companies’ most recently authorized return on equity; the Companies’ risk; management and performance benchmarks; innovation and leadership; and advancement of state policy. Companies’ Initial Brief at 40-46. [↑](#footnote-ref-16)
17. Companies’ Initial Brief at 39 (“The statutory language in R.C. 4928.143(F) . . . allows the Commission to permit an EDU to retain earnings that might otherwise be considered to be significantly excessive.”). [↑](#footnote-ref-17)
18. Section 4928.143(F), Revised Code. [↑](#footnote-ref-18)
19. IEU-Ohio Initial Brief at 12-15. [↑](#footnote-ref-19)
20. *Id.* at 14. [↑](#footnote-ref-20)
21. *Id.* at 14-15. [↑](#footnote-ref-21)
22. Although IEU-Ohio has argued in these cases and the review of the Companies’ 2009 earnings that the Commission has not applied the statute correctly, it does not support the Companies’ claim that the statute is unconstitutionally vague. IEU-Ohio reiterates that the proper application of the statute would require the Commission to order the Companies to file an application and supporting testimony that properly jurisdictionalizes the EDU’s financial data to identify the ESP-related earned return on common equity. [↑](#footnote-ref-22)
23. Companies’ Initial Brief at 6-10. [↑](#footnote-ref-23)
24. *AEP’s 2009 SEET Proceeding*, Opinion and Order at 9 (January 11, 2011). [↑](#footnote-ref-24)
25. *Id.* at 9. [↑](#footnote-ref-25)
26. *Id.* at 10. [↑](#footnote-ref-26)
27. *Id.* [↑](#footnote-ref-27)
28. *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc*., 455 U.S. 489, 498 (1982). [↑](#footnote-ref-28)
29. *Id.* at 497. [↑](#footnote-ref-29)
30. Companies’ Initial Brief at 7, citing *Norwood v. Horney*, 110 Ohio St. 3d 353 (2006). [↑](#footnote-ref-30)
31. 110 Ohio St. 3d at 380. [↑](#footnote-ref-31)
32. Companies’ Brief at 7-8. [↑](#footnote-ref-32)
33. Section 4928.143(F), Revised Code. [↑](#footnote-ref-33)
34. *See Federal Power Commission v. Texaco,* 417 U.S. 380, 391-92 (1974). [↑](#footnote-ref-34)
35. Companies’ Initial Brief at 9. [↑](#footnote-ref-35)
36. *Columbia Natural Resources, Inc. v. Tatum*, 58 F.3d 1101, 1108 (6th Cir. 1995). [↑](#footnote-ref-36)
37. IEU-Ohio Initial Brief at 8-10. [↑](#footnote-ref-37)