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FILE

FAX

BOEHM, KURTZ & LOWRY
ATTORNEYS AT LAW
36 EAST SEVENTH STREET
SUITE 1510
CINCINNATI, OHIO 45202
TELEPHONE (513) 421-2255

TELECOPIER (513) 421-2764

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Public Utilities Commission of Ohio
PUCO Docketing
180 E. Broad Street, 10th Floor
Columbus, Ohio 43215

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

Dear Sir/Madam:

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

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

Respectfully yours,

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

MLKkew
Encl.
Cc: Certificate of Service
Chairman Alan R. Schriber
Ronda Hartman Fergus
Valerie A. Lemmie
Paul A. Centolella
Cheryl Roberto
Kim Bojko, Hearing Examiner
Greta See, Hearing Examiner

CERTIFICATE OF SERVICE

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

David F. Boehm, Esq.
Michael L. Kurtz, Esq.

OHIO POWER COMPANY SELWYN J. R. DIAS SUITE 800 88 E. BROAD STREET COLUMBUS OH 43215-3550	RESNIK, MARVIN AMERICAN ELECTRIC POWER SERV CORPORATION 1 RIVERSIDE PLAZA, 29TH FLOOR COLUMBUS OH 43215
*PETRICOFF, HOWARD VORYS, SATER, SEYMOUR AND PEASE LLP 52 E. GAY STREET COLUMBUS OH 43215	DEBROFF, SCOTT ATTORNEY AT LAW SMIGEL, ANDERSON & SACKS RIVER CHASE CENTER 4431 NORTH FRONT STREET HARRISBURG PA 17110
ROBERTS, JACQUELINE ATTORNEY AT LAW OHIO CONSUMERS' COUNSEL 10 WEST BROAD STREET SUITE 1800 COLUMBUS OH 43215	SCHMIDT, KEVIN (RETURNED MAIL) 33 NORTH HIGH STREET COLUMBUS OH 43215
CONWAY, DANIEL PORTER WRIGHT MORRIS & ARTHUR LLP 41 SOUTH HIGH STREET COLUMBUS OH 43215	GRADY, MAUREEN OFFICE OF CONSUMERS' COUNSEL 10 W. BROAD STREET SUITE 1800 COLUMBUS OH 43215-3485
*MANCINO, DOUGLAS M. MR. MCDERMOTT WILL & EMERY LLP 2049 CENTURY PARK EAST, SUITE 3800 LOS ANGELES CA 90067	HAND, EMMA F SONNENSCHEIN NATH & ROSENTHAL LLP 1301 K STREET NW SUITE 600 EAST TOWER WASHINGTON DC 20005
RII, ETHAN E SONNENSCHEIN NATH & ROSENTHAL 1301 K STREET NW SUITE 600 EAST TOWER WASHINGTON DC 20005	EDWARDS, BENJAMIN ATTORNEY AT LAW ONE EAST LIVINGSTON AVE COLUMBUS OH 43215
FONNER, CYNTHIA A CONSTELLATION ENERGY GROUP, INC. 550 W. WASHINGTON ST. SUITE 300 CHICAGO IL 60661	ETTER, TERRY OHIO CONSUMERS' COUNSEL 10 W. BROAD STREET SUITE 1800 COLUMBUS OH 43215
*HOWARD, STEPHEN M VORYS, SATER SEYMOUR AND PEASE LLP 52 EAST GAY STREET P. O. BOX 1008 COLUMBUS OH 43216-1008	MCALISTER, LISA MCNEES, WALLACE & NURIK 21 EAST STATE STREET, 17TH FLOOR COLUMBUS OH 43215-4228
ROMEO, STEPHEN J SMIGEL ANDERSON & SACKS RIVER CHASE OFFICE CENTER 4431 NORTH FRONT STREET HARRISBURG PA 17110	WUNG, GRACE C MCDERMOTT WILL & EMERY LLP 600 THIRTEENTH STREET NW WASHINGTON DC 20005

BELL, LANGDON D BELL & ROYER CO., LPA 33 SOUTH GRANT AVENUE COLUMBUS OH 43215	GOODMAN, CRAIG PRESIDENT NATIONAL ENERGY MARKETERS ASSOC. 3333 K. STREET, N.W. SUITE 110 WASHINGTON DC 20007
REED, PRESLEY R SONNENSCHEIN NATH & ROSENTHAL LLP 1301 K STREET NW SUITE 600 EAST TOWER WASHINGTON DC 20005	NEILSEN, DANIEL J ATTORNEY AT LAW MCNEES WALLACE & NURICK LLC FIFTH THIRD CENTER, 17TH FL. 21 EAST STATE STREET COLUMBUS OH 43215
*RANDAZZO, SAMUEL C. MCNEES WALLACE & NUICK 21 EAST STATE ST, 17TH FLOOR COLUMBUS OH 43215	ALLEN COUNTY COMBINED HEALTH DISTRICT, DEPT OF PUBLIC HEALTH WIC DIVISION 219 EAST MARKET ST PO BOX 1503 LIMA OH 45802-1503
CITY OF CAMBRIDGE MAYOR'S OFFICE 1131 STEUBENVILLE AVE CAMBRIDGE OH 43752 COMMUNITY IMPROVEMENT CORPORATION NORM BLANCHARD 806 COCHRAN AVE CAMBRIDGE OH 43725-9317 COSHOCTON PORT AUTHORITY 106 SOUTH FOURTH STREET COSHOCTON OH 43812 DELPHOS SENIOR CITIZENS INC 301 EAST SUTHOFF STREET DELPHOS OH 45833 ENVIRONMENT OHIO-ENVIRONMENTAL ADVOCATE AMY GOMBERG 203 EAST BROAD STREET, STE 3 COLUMBUS OH 43215 FAIRFIELD COUNTY ECONOMIC DEVELOPMENT WILLIAM R ARNETT 210 EAST MAIN ST ROOM 404 LANCASTER OH 43130-3879 FOSTORIA AREA CHAMBER OF COMMERCE 121 NORTH MAIN ST FOSTORIA OH 44830	MCDERMOTT WILL & EMERY LLP 28 STATE STREET BOSTON MA 02109 BLOOMFIELD, SALLY ATTORNEY AT LAW BRICKER & ECKLER LLP 100 SOUTH THIRD STREET COLUMBUS OH 43215-4291 SMALZ, MICHAEL ATTORNEY AT LAW OHIO STATE LEGAL SERVICE ASSOC. 555 BUTTLES AVENUE COLUMBUS OH 43215-1137 PETRICOFF, M. VORYS, SATER, SEYMOUR & PEASE 52 EAST GAY STREET P.O. BOX 1008 COLUMBUS OH 43216-1008 ROYER, BARTH E BELL & ROYER CO LPA 33 SOUTH GRANT AVENUE COLUMBUS OH 43215-3927 CLARK, JOSEPH M ATTORNEY AT LAW MCNEES WALLACE & NURICK LLC 21 EAST STATE STREET, 17TH FL. COLUMBUS OH 43215-4228 ECKHART, HENRY ATTORNEY AT LAW 50 WEST BROAD STREET SUITE 2117 COLUMBUS OH 43215-3301

MORGAN STANLEY CAPITAL GROUP, INC
1585 BROADWAY 4TH FLOOR
NEW YORK NY 10036

SOUTHGATE CORPORATION
1499 WEST MAIN ST P.O. BOX 397
NEWARK OH 43058-0397

ST STEPHEN'S COMMUNITY HOUSE
MICHELLE M MILLS
1500 EAST 17TH AVENUE
COLUMBUS OH 43219

BUCKEYE ASSOCIATION OF SCHOOL ADMINISTRATORS
M. HOWARD PETRICOFF
52 EAST GAY STREET PO BOX 1008
COLUMBUS OH 43216

CONSTELLATION ENERGY COMMODITIES, GROUP, INC. VP REGULATORY AFFAIRS
JOHN ORR
111 MARKET PLACE, 5TH FL
BALTIMORE MD 21202

DIRECT ENERGY SERVICES, LLC
ERIC STEPHENS
5400 FRANTZ ROAD SUITE 250
DUBLIN OH 43016

DOMINION RETAIL, INC.
GARY A. JEFFRIES
501 MARTINDALE STREET SUITE 400
PITTSBURGH PA 15212-5817

MACY'S INC
TIM LEIGH
5985 STATE BRIDGE ROAD
DULUTH GA 30097

NATURAL RESOURCES DEFENSE COUNCIL
101 N WACKER DR SUITE 609
CHICAGO IL 60606

Steve Nourse @ stnourse@aep.com
Dan Conway @ dconway@porterwright.com
Werner L. Margard III @ werner.margard@puc.state.oh.us
Thomas G. Lindgren @ thomas.lindgren@puc.state.oh.us
John H. Jones @ John.jones@puc.state.oh.us
Ed Hess, Esq. @ ed.hess@puc.state.oh
Rick Cahaan @ Richard.Cahaan@puc.state.oh.us
Tom McNamee, Esq. @ thomas.mcnamee@puc.state.oh.us

PAULDING COUNTY ECONOMIC DEVELOPMENT INC
101 E PERRY ST
PAULDING OH 45879

AMERICAN WIND ENERGY ASSOC.
1101 14TH STREET NW 12TH FLOOR
WASHINGTON DC 20005

APPALACHIAN PEOPLE'S ACTION, COALITION
MICHAEL R. SMALZ
OHIO STATE LEGAL SERVICE ASSOC. 555 BUTTLES AVENUE
COLUMBUS OH 43215

CONSTELLATION NEWENERGY, INC.
DAVID I. FEIN
SUITE 300 550 W. WASHINGTON BLVD.
CHICAGO IL 60661

CONSUMERPOWERLINE
17 STATE STREET 19TH FLOOR
NEW YORK NY 10004

DIRECT ENERGY SERVICES, LLC
ERIC STEPHENS
5400 FRANTZ ROAD SUITE 250
DUBLIN OH 43016

INTEGRYS ENERGY SERVICES INC
BOBBY SINGH
300 WEST WILSON BRIDGE ROAD SUITE 350
WORTHINGTON OH 43085

BEFORE THE
PUBLIC UTILITY COMMISSION OF Ohio

IN RE:	**IN THE MATTER OF THE APPLICATION OF COLUMBUS SOUTHERN POWER COMPANY FOR APPROVAL OF ITS ELECTRIC SECURITY PLAN; AN AMENDMENT TO ITS CORPORATE SEPARATION PLAN; AND THE SALE OR TRANSFER OF CERTAIN GENERATING ASSETS**	)	**Case No. 08-917-EL-SSO**
	IN THE MATTER OF THE APPLICATION OF OHIO POWER COMPANY FOR APPROVAL OF ITS ELECTRIC SECURITY PLAN; AND AN AMENDMENT TO ITS CORPORATE SEPARATION PLAN	)	**Case No. 08-918-EL-SSO**

REPLY BRIEF OF THE OHIO ENERGY GROUP
ON LONG TERM ESP

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

OEG submits this reply brief on the long term ESP.

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ARGUMENT

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

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

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

AEP Companies' Proposed ESP Rate Increases
5%, 10%, and 15% Purchases at Market Included in Fuel Adjustment Clause Increases
($Million)

	Columbus and Southern Power Co.				Ohio Power Co.			
AEP Companies' Proposed ESP	**2009**	**2010**	**2011**	**Total ESP**	**2009**	**2010**	**2011**	**Total ESP**
Fuel Adjustment Clause (No Phase-In at Max Amounts)[1]	260	507	780	1,547	367	574	812	1,753
Environmental Carrying Costs 2001-2008[2]	26	26	26	78	84	84	84	252
POLR[3]	94	94	94	282	21	21	21	63
Annual 3%/7% Non-FAC Increases in Basic Generation Rates[2]	14	29	44	87	42	86	134	262
Energy Efficiency and Peak Demand Reduction[1]	14	29	39	82	17	35	47	99
Other[1]	-81	-81	-58	-220	-27	-27	-12	-66
Annual 7%/6.5% Distribution Increases[2]	24	50	77	151	21	44	68	133
Total Estimated Cost of AEP Companies' ESP	351	654	1,002	2,007	525	817	1,154	2,496
2008 Total Revenues Before ESP Rate Increases	1,779	1,779	1,779		1,726	1,726	1,726	
Cumulative ESP Percentage Rate Increases	19.7%	36.8%	56.3%		263.0%	47.3%	66.9%	

Notes
[1] Source: Roush Exhibit DMR-1 (annual increases were accumulated for each subsequent year)
[2] Source: Baker Exhibit JCB-2
[3] Source: Baker Exhibit JCB-2 adjusted to remove POLR recoveries under existing rates using amounts from Roush Exhibit DMR-1

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

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

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

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

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

[1] Direct Testimony of Lane Kollen at p. 10.

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

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

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

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

[2] Id.
[3] Id.

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

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

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

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

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

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

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

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

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

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

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

Even if the non-market portion of OPC's and CSP's MRO could include the recovery of fuel, the Companies' comparison is flawed. At most, the non-market portion of an MRO can include the "*cost of fuel used to produce electricity.*" This means coal, natural gas and oil. But AEP's ESP fuel adjustment clause includes much more. AEP's ESP fuel adjustment clause incorporates the automatic recovery of the costs of coal, fuel oil, natural gas, purchased power from non-affiliated companies, purchased power pursuant to the AEP Interconnection Agreement (Pool Energy), SO_2 and NO_X emission allowances, gains and losses on the sale of emission allowances, ash handling, fuel procurement unloading and handling, ash sales proceeds, gypsum handling and disposal costs, depreciation and capacity costs of long-term purchase power agreements, capacity equalization payments made under the AEP Interconnection Agreement (Pool Capacity), PJM Emergency Energy purchases, Renewable Energy Credits, and Emission Control Chemicals.[5]

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

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

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

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

[5] Exhibit PJN-1 and PJN-2.
[6] Direct Testimony of Lane Kollen at p. 14.

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

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

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

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

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

a. What proportion of the MRO will be market-based? 10%, 20%, and 30% in years one, two and three, or would a future Commission order some lesser percentage to prevent "*an abrupt or significant change*" in rates for all or some classes?

b. For the market portion of an MRO what will be the market price? Suffice it to say that electricity is one of the most volatile commodities in this country.

c. Would CSP and OPC be authorized to include fuel costs in an MRO despite the fact that fuel costs are not included in their "*most recent standard service offer price*"?

d. If fuel cost recovery is included in an MRO would the cost be limited to coal, natural gas and oil, or would a "*kitchen sink*" FAC that includes many other items be approved?

e. What "*benefits*" would be used to offset the costs of an MRO?

f. How would the prospective earnings test in an MRO be applied and would it be used to eliminate all or some increases in the non-market portion of an MRO?

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

"In enacting a statute, it is presumed that:

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

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

(C) A just and reasonable result is intended;

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

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

Respectfully submitted,

David F. Boehm, Esq.
Michael L. Kurtz, Esq.
BOEHM, KURTZ & LOWRY
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202
Ph: (513) 421-2255 Fax: (513) 421-2764
E-Mail: dboehm@BKLlawfirm.com
mkurtz@BKLlawfirm.com

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COUNSEL FOR THE OHIO ENERGY GROUP