

FILE

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EXHIBIT NO. _____

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the 2009 Annual Filing)
of Columbus Southern Power Company)
And Ohio Power Company Required by)
Rule 4901:1-35-10, Ohio Administrative)
Code)

Case No. 10-1261-EL-UNC

DIRECT TESTIMONY
OF
JOSEPH HAMROCK
ON BEHALF OF
COLUMBUS SOUTHERN POWER COMPANY
AND
OHIO POWER COMPANY

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JOSEPH HAMROCK
CASE NO. 10-1261-EL-UNC

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CASE NO. 10-1261-EL-UNC

PERSONAL BACKGROUND

Q. WHAT IS YOUR NAME AND BUSINESS ADDRESS?

A. My name is Joseph Hamrock. My business address is 850 Tech Center Drive,
Gahanna, Ohio, 43230.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the American Electric Power Service Corporation (AEPSC). I
am President and Chief Operating Officer – AEP Ohio. I am directly responsible for the
day-to-day operations of Columbus Southern Power Company (CSP) and Ohio Power
Company (OPCo), collectively referred to as “AEP Ohio” or the “Companies.”

**Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL
EXPERIENCE?**

A. I earned a bachelor of engineering degree in electrical engineering in 1985 from
Youngstown State University. In 1999, I earned a master's degree in business
administration from the Massachusetts Institute of Technology in Cambridge where I was
a Sloan fellow.

I joined AEP in 1986 as an electrical engineer in transmission and distribution
planning at OPCo in Steubenville, Ohio, where I also served in commercial and industrial
customer services. I am a registered professional engineer in Ohio.

1 In 1993 I transferred to CSP in Columbus, Ohio to supervise the commercial marketing
2 and customer services staff. Since that time, I have held several other positions with
3 AEPSC, including Director – Strategic Development, Executive Assistant to E. Linn
4 Draper Jr. (AEP's former Chairman, President and Chief Executive Officer), Senior Vice
5 President, General Services and Senior Vice President and Chief Information Officer
6 (CIO). I have served in my role as President and Chief Operating Officer of AEP Ohio
7 since January 2008.

8 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY BEFORE A**
9 **REGULATORY AGENCY?**

10 A. Yes. I testified before the Public Utilities Commission of Ohio in Case Nos.
11 08-917-EL-SSO and 08-918-EL-SSO, AEP Ohio's Electric Security Plan (ESP)
12 cases. I also previously submitted testimony before the Public Utility Commission of
13 Texas in PUC Docket No. 33309.

14 **PURPOSE OF TESTIMONY**

15 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

16 A. I am AEP Ohio's overall policy witness in these cases, supporting AEP Ohio's
17 position that CSP and OPCo pass the statutory Significantly Excessive Earnings Test
18 (SEET) for 2009 under multiple scenarios that might be considered by the Commission.
19 This position is supported by other witnesses testifying on behalf of AEP Ohio in these
20 proceedings and I will explain how that testimony supports the conclusions reached in my
21 testimony. In addition, I will discuss future capital commitments of AEP Ohio and other
22 important factors that should be considered by the Commission in this context, consistent
23 with the Commission's directives concerning the 2009 SEET filing.

1 which § 4928.143(F)'s SEET applies is calendar year 2009. The Commission issued a
2 Finding and Order on June 30, 2010 ("June 30 Finding and Order") and an Entry on
3 Rehearing on August 25, 2010 ("August 25 Entry on Rehearing") in Case No. 09-786-
4 EL-UNC that provide additional guidance and directives regarding electric utilities' 2009
5 SEET filing that to be filed on September 1, 2010.

6 **Q. WHAT ARE THE INITIAL STEPS THAT SHOULD BE TAKEN IN**
7 **APPLYING THE SEET TO CSP AND OPCO FOR THE CALENDAR YEAR**
8 **2009?**

9 A. There are three basic steps to begin applying the SEET to CSP and OPCo for
10 2009. First, the average earned return on equity (ROE) during 2009 by publicly traded
11 firms with business and financial risks comparable to those that CSP and OPCo face must
12 be calculated. Second, the level above the average earned ROE of the comparable risk
13 group of firms, at which point the earned ROEs may become significantly excessive,
14 must also be determined. Third, CSP's and OPCo's earned ROEs for 2009 must be
15 determined. Once those calculations are made, a comparison can be made between the
16 significantly excessive earnings test benchmark and CSP's and OPCo's earned ROE for
17 2009. For AEP Ohio's 2009 SEET filing, AEP Ohio witness Dr. Makhija is performing
18 steps one and two in his testimony and AEP Ohio witness Mitchell is performing the
19 calculations to support the third step in his testimony. As further discussed below, the
20 results from these three initial steps are used to further evaluate whether significantly
21 excessive 2009 earnings exist for CSP and OPCo.

22 **Q. WHY IS THE SELECTION OF A PEER GROUP OF PUBLICLY**
23 **TRADED FIRMS THAT FACE RISKS AN IMPORTANT STEP IN THE**
24 **IMPLEMENTATION OF THE SEET?**

1 A. The selection of firms that face comparable risk is a critically important step in
2 the application of the SEET because the unique risks faced by electric utilities in Ohio
3 creates an expectation on the part of investors that returns will be commensurate with
4 those risks, but those comparable risks do not necessarily align with a traditional notion
5 of a utility's required ROE. Comparing the risks and returns of utilities in Ohio only to
6 other electric utilities in other states would fail to recognize the unique risks in Ohio,
7 particularly the risk of customer migration, and also other risks such as the SEET itself.
8 Similarly, using only other Ohio electric utilities as a comparison group would not
9 necessarily reflect comparable risks because risks among utilities in Ohio also vary due to
10 major differences such as whether the utility owns generation, and the unique mix of
11 customers served by each utility. Dr. Makhija's methodology carefully and objectively
12 develops a set of peer firms based on business and financial risk profiles that are
13 comparable to CSP and OPCo. This set of peers appropriately includes both utilities and
14 other firms.

15
16 **AVERAGE ROE EARNED DURING 2009 BY COMPARABLE PUBLICLY**
17 **TRADED FIRMS**
18

19 **Q. WHAT WAS THE ROE EARNED, ON AVERAGE, DURING 2009 BY**
20 **PUBLICLY TRADED FIRMS WITH BUSINESS AND FINANCIAL RISKS**
21 **COMPARABLE TO THOSE THAT CSP AND OPCO FACE?**

22 A. AEP Ohio witness Dr. Makhija has determined that the mean of the earned ROE
23 during 2009 for publicly traded firms that face comparable risks to CSP and OPCo, on
24 average, was 11.04%.

25
26 **THE LEVEL AT WHICH CSP'S AND OPCO'S EARNED ROE MAY BECOME**

SIGNIFICANTLY EXCESSIVE

Q. WHAT IS THE LEVEL FOR 2009, ABOVE THE AVERAGE EARNED ROE OF THE COMPARABLE RISK GROUP OF FIRMS, WHERE THE EARNED ROE BECOMES SIGNIFICANTLY IN EXCESS OF THE AVERAGE EARNED ROE?

A. Dr. Makhija has determined that the level at which CSP's and OPCo's earned ROE may become significantly in excess of the average earned ROE of the comparable risk group of publicly traded firms is 22.51%.

CSP'S AND OPCO'S EARNED ROE FOR 2009

Q. HOW WERE CSP'S AND OPCO'S EARNED RETURN ON EQUITY FOR 2009 CALCULATED?

A. AEP Ohio witness Mitchell has performed the calculations of the earned ROE for 2009. As Mr. Mitchell explains in greater detail, the denominator is the average book equity. The numerator is net income, excluding any non-ESP non-recurring items and also excluding any special and extraordinary items, as well as off-system sales (OSS) margins, as further discussed below. The calculations are presented for each Company on an individual basis.

Q. WHY IS IT APPROPRIATE TO EXCLUDE OSS EARNINGS TREATED IN THE CALCULATION OF THE EARNED ROE FOR 2009?

A. As discussed above, my understanding of Section 4928.143(F) is that it specifically provides that earnings resulting from adjustments included in the EDU's ESP are subject to the SEET. Off-system-sales margins, which result from wholesale, not retail, transactions, are not the result of a rate adjustment included in CSP's or OPCo's

1 ESP. They result from wholesale transactions approved by the Federal Energy
2 Regulatory Commission (FERC).

3 In addition, I am advised by counsel that it would be unlawful to treat earnings
4 that result from wholesale transactions and also that are not the result of any adjustment
5 included in a provision of the EDU's ESP as significantly excessive. AEP Ohio believes
6 that the most efficient approach to complying with §4928.143(F) and avoiding conflict
7 with the FERC's jurisdiction is to remove earnings resulting from OSS margins from the
8 calculation of CSP's and OPCo's earned ROE.

9 **Q. ARE THERE OTHER NON-JURISDICTIONAL EARNINGS OF CSP OR**
10 **OPCO THAT ALSO NEED TO BE EXCLUDED FROM THE SEET?**

11 A. While there are other non-jurisdictional activities and gains or losses that impact
12 CSP's and OPCo's earnings, the Companies did not attempt to fully jurisdictionalize the
13 2009 earnings for purposes of this discussion but reserves the right to do so if necessary.

14 **Q. WHAT WERE CSP'S AND OPCO'S EARNED ROE FOR 2009 BASED ON**
15 **THE ABOVE-DESCRIBED METHOD?**

16 A. Mr. Mitchell has determined CSP's and OPCo's earned ROE for 2009, calculated
17 in the manner described above, which are 18.31% for CSP and 9.42% for OPCo.

18

19 **COMPARISON OF CSP'S AND OPCO'S 2009 EARNED ROE TO**
20 **THE SEET BENCHMARK ROE**

21 **Q. HOW DO CSP'S AND OPCO'S EARNED ROE FOR 2009 COMPARE TO**
22 **THE SEET BENCHMARK ROE?**

23 A. Neither CSP's nor OPCo's 2009 earned ROE exceeds the SEET benchmark ROE.

24 **Q. WHAT IF THE COMMISSION REJECTS THE POSITION THAT OSS**
25 **MARGINS SHOULD BE EXCLUDED FROM EARNED ROE FOR PURPOSES**

1 **OF THE SEET?**

2 A. AEP Ohio would object to such findings. If the Commission were poised to reach
3 such a finding, notwithstanding AEP Ohio's objections, the Companies would suggest
4 that the Commission defer addressing those matters in connection with the 2009 SEET.
5 Because even the unadjusted 2009 ROE results for both CSP (20.84%) and OPCo
6 (10.81%) are below the 2009 ROE benchmark observed by Dr. Makhija (22.51%), the
7 issue of whether OSS margins should be excluded from earned ROE for purposes of the
8 SEET can be considered as an academic question relative to 2009 (presuming only that
9 the Commission accepts Dr. Makhija's 2009 ROE benchmark). Thus, while AEP Ohio
10 strongly advocates that the Commission resolve the uncertainty associated with the SEET
11 (carried over from the ESP Cases) by finding that earnings from OSS margins and other
12 non-jurisdictional activity should be excluded when applying the SEET, AEP Ohio would
13 prefer to debate that issue in a future year if relevant and appropriate rather than face a
14 negative finding for 2009 (and the resulting litigation and delays associated with such a
15 finding) – especially given that it is likely unnecessary to address the issue.

16
17 **ADDITIONAL FACTORS THAT THE COMMISSION INDICATED IT WOULD**
18 **CONSIDER**
19

20 **Q. IS DR. MAKHIJA'S STATISTICAL METHOD FOR QUANTIFYING**
21 **"SIGNIFICANTLY EXCESSIVE" THE ONLY ANALYSIS THAT THE**
22 **COMMISSION HAS INDICATED IT WOULD CONSIDER IN EVALUATING**
23 **WHAT IS SIGNIFICANTLY EXCESSIVE?**

24 A. Not necessarily. It is AEP Ohio's position that Dr. Makhija's determination of
25 the level at which earnings become significantly in excess of the average earned ROE of
26 the comparable risk group is well-supported and reliable methodology, both from a

1 statistical and an economics perspective. But, as indicated on page 29 of its June 30
2 Finding and Order, there are several additional factors that the Commission indicated it
3 would also consider in this regard prior to concluding that significantly excessive
4 earnings exist during a particular time period for a specific utility. The Commission
5 also established a "safe harbor" of 200 basis points above the mean of the comparable
6 group, below which the electric utility will be found not to have significantly excessive
7 earnings. While earning a return on equity that falls under the safe harbor ensures that no
8 significantly excessive earnings exist, my understanding of the Commission's orders is
9 that merely earning a return above the safe harbor does not in any way establish that
10 significantly excessive earnings exist.

11 **Q. DOES THE 200 BASIS POINT "SAFE HARBOR" APPLY TO CSP OR**
12 **OPCO FOR 2009**

13 A. Yes, it applies to OPCo. Since OPCo's 2009 earned ROE of 9.42% is less than
14 13.04% (200 basis points over Dr. Makhija's average 2009 ROE for the comparable
15 group), OPCo's 2009 earned ROE is within the "safe harbor" established by the
16 Commission and should not be subject to further SEET analysis. Because even the
17 unadjusted 2009 ROE results for OPCo (10.81%) are below the safe harbor limit, the
18 question of whether OPCo's earnings fall within the safe harbor for 2009 does not depend
19 on the Commission determining that OSS margins should be excluded from earned ROE
20 for purposes of the SEET.

21 **Q. WHAT ARE THE ADDITIONAL FACTORS THAT THE COMMISSION**
22 **INDICATED IT COULD ALSO CONSIDER?**

23 A. The Commission indicated that such factors include, for example, (1) the electric
24 utility's most recently authorized return on equity, (2) the electric utility's risk, including

whether the electric utility owns generation, whether the ESP includes a fuel and purchased power adjustment or similar mechanism, the rate design and the extent to which the electric utility remains subject to weather and economic risk; (3) capital commitments and future capital requirements; (4) indicators of management performance and benchmarks to other utilities; (5) innovation and industry leadership with respect to meeting industry challenges to maintain and improve the competitiveness of Ohio's economy, including research and development expenditures, investments in advanced technology and innovative practices; and (6) the extent to which the electric utility has advanced state policy. I will address each of these factors later in my testimony.

Q. PLEASE SUMMARIZE THE QUANTITATIVE RESULTS DISCUSSED TO THIS POINT, COMPARING CSP'S AND OPCO'S 2009 EARNINGS TO THE SEET BENCHMARK ROE AND SAFE HARBOR ROE TESTS.

A. While the additional factors discussed later in my testimony are not reflected here, the following chart summarizes the quantitative calculations discussed above:

Quantitative SEET Comparison for 2009	Safe Harbor ROE Test	Benchmark ROE Test
ROE Threshold	13.04%	22.51%
CSP Earned ROE	18.31% (20.84% unadjusted)	18.31% (20.84% unadjusted)
OPCo Earned ROE	9.42% (10.81% unadjusted)	9.42% (10.81% unadjusted)
Test Results	OPCo Passes	OPCo and CSP Pass

ESP ADJUSTMENTS THAT MAY BE SUBJECT TO REFUND IN THE EVENT THE COMMISSION DETERMINES THAT AN EDU'S EARNED RETURN EXCEEDS THE SEET BENCHMARK ROE

Q. WHAT ARE THE "ADJUSTMENTS" THAT ARE SUBJECT TO RETURN TO CUSTOMERS IN THE EVENT THE COMMISSION DETERMINES THAT AN ELECTRIC UTILITY'S EARNED ROE EXCEEDS THE SEET BENCHMARK ROE?

1 A. I have been advised by counsel that the scope of the SEET under R.C.
2 4928.143(F) extends only to significantly excessive earnings resulting from rate increases
3 included in an approved ESP. Thus, the earnings from ESP adjustments potentially
4 subject to a remedy/return to customers, in the event the Commission finds that the
5 EDU's earned ROE significantly exceed the SEET benchmark ROE over the same
6 period, are limited to: tariff rate increases, authorized by the ESP, paid by customers
7 during 2009, and that directly produced earnings (*i.e.*, not ESP adjustments that simply
8 provide for the recovery of costs).

9 **Q. IS THIS IMPLEMENTATION OF THE STATUTORY SEET**
10 **CONSISTENT WITH THE COMMISSION'S JUNE 30 FINDING AND ORDER**
11 **AND AUGUST 25 ENTRY ON REHEARING?**

12 A. Yes. The Commission's June 30 Finding and Order (at pages 14-15) found that
13 the clear, unambiguous language of the statute limits the scope of any refund to the rate
14 adjustments in the current ESP. In this regard, the Commission (at page 15) directed
15 electric utilities to include in their SEET filings the difference in earnings between the
16 ESP and what would have occurred had the preceding rate plan been in place. On
17 rehearing, the Commission did not modify the comparison requirement but merely
18 clarified (at page 5) that it would not need to be done for an electric utility whose return
19 on equity falls within the safe harbor limit. Accordingly, this comparison requirement
20 need not be done for OPco in connection with its 2009 filing. Calculating the total 2009
21 earnings resulting from the earnings-producing rate adjustments authorized under the
22 ESP, as AEP Ohio witness Mitchell has done at my request, directly quantifies the
23 difference in earnings between the ESP and what would have occurred had the preceding
24 rate plan been in place. Thus, Mr. Mitchell's calculations in this regard capture the

1 incremental earnings resulting from the ESP, beyond the level authorized under CSP's
2 preceding rate plan.

3 **Q. WHY ARE ESP RATE ADJUSTMENTS THAT ONLY RECOVER COSTS**
4 **NOT SUBJECT TO REMEDY/RETURN TO CUSTOMERS IN THE EVENT AN**
5 **EDU'S EARNED ROE EXCEEDS THE SEET BENCHMARK ROE?**

6 A. Such adjustments do not provide new earnings opportunities for an EDU. They
7 simply pass through cost recovery for specific types of expenses and thereby eliminate
8 the effect on earnings that might be caused by changes in those expenses. Returning any
9 portion of those revenues to customers would cause the companies to under-recover the
10 related expenses. The primary purpose of such mechanisms is to remove the impact on
11 earnings by merely passing through a specific cost of providing service. Linking the
12 recovery of such costs to earnings would erode the viability of those cost recovery
13 mechanisms. Because ESP provisions that allow for rate adjustments that recover costs
14 did not change the earnings that were achieved pursuant to the prior regulatory regime,
15 they do not result in additional earnings and, by definition, do not cause significantly
16 excessive earnings. Such adjustments are not eligible for remedy/return to customers in
17 the event the EDU's earned ROE exceeds the SEET benchmark.

18 **Q. IN THE EVENT THE COMMISSION FINDS THAT CSP'S EARNED ROE**
19 **EXCEEDED THE SEET BENCHMARK ROE FOR 2009, CAN YOU IDENTIFY**
20 **THE ADJUSTMENTS IN CSP'S ESP THAT WOULD BE INCLUDED IN**
21 **DETERMINING WHETHER THE ADJUSTMENTS, IN THE AGGREGATE,**
22 **RESULTED IN SIGNIFICANTLY EXCESSIVE EARNINGS?**

23 A. CSP's ESP adjustments that would be subject to remedy/return to customers
24 would be limited to:

- 1 1. Equity return on incremental 2001-2008 environmental
- 2 investments;
- 3 2. Equity return on the Enhanced Service Reliability rider
- 4 investments;
- 5 3. Equity return on gridSMARTsm investments; and
- 6 4. incremental POLR revenues over and above CSP's pre-ESP POLR
- 7 charges.

8 **Q. WHAT ABOUT THE EQUITY RETURN COMPONENT OF THE**
9 **WEIGHTED AVERAGE COST OF CAPITAL (WACC) ALLOWED FOR COST**
10 **DEFERRALS ASSOCIATED WITH THE FUEL ADJUSTMENT CLAUSE AND**
11 **WITH THE ECONOMIC DEVELOPMENT RIDER?**

12 A. As further discussed below, CSP submits that it is inappropriate for the
13 Commission to consider refunding earnings based on revenue that has not actually been
14 collected from customers. Therefore, the deferral earnings associated with fuel costs and
15 the economic development discounts that the Commission concludes result in
16 significantly excessive earnings in 2009 should only be considered during the subsequent
17 period when the revenues are actually collected from customers.

18 **Q. HAS MR. MITCHELL CALCULATED CSP'S AFTER-TAX 2009**
19 **EARNINGS ASSOCIATED WITH THE FOUR EARNINGS-PRODUCING RATE**
20 **ADJUSTMENTS FROM THE ESP?**

21 A. Yes. At my request, Mr. Mitchell calculated CSP's earnings associated with the
22 four above-listed ESP adjustments. CSP's 2009 total after-tax earnings associated with
23 the four adjustments are \$59.6 million.

24 **Q. DID MR. MITCHELL CALCULATE THE CORRESPONDING PRE-TAX**

1 MAXIMUM REVENUE AMOUNT BE THAT WOULD POTENTIALLY BE
2 SUBJECT TO REFUND TO CUSTOMERS BY CSP?

3 A. Yes, the figure for 2009 would be \$93.0 million for CSP.

4 Q. HOW SHOULD THE COMMISSION UTILIZE CSP'S CALCULATED
5 2009 EARNINGS ASSOCIATED WITH THE FOUR EARNINGS-PRODUCING
6 RATE ADJUSTMENTS FROM THE ESP, IN APPLYING THE SEET?

7 A. As referenced above, the SEET under R.C. 4928.143(F) only encompasses
8 significantly excessive earnings that result from rate adjustments included as part of an
9 approved ESP. Consequently, an amount up to the \$93.0 million for CSP associated with
10 earnings-producing rate adjustments under the ESP based on revenue actually collected
11 during 2009 could be subject to refund only if the Commission finds that: (i) CSP's 2009
12 earnings exceeded the 2009 benchmark ROE by up to the applicable amount, (ii) the
13 actual amount of significantly excessive earnings were the result of the earnings-
14 producing rate adjustments under CSP's ESP, and (iii) the additional factors to be
15 considered do not mitigate against a finding of significantly excessive earnings for 2009.

16
17 TREATMENT OF DEFERRALS AUTHORIZED UNDER THE ESP

18 Q. HOW SHOULD DEFERRALS, SUCH AS THE DEFERRALS OF FUEL
19 ADJUSTMENT CLAUSE (FAC) COSTS, BE TREATED IN THE COURSE OF
20 APPLYING THE SEET?

21 A. First, in the case of the FAC, I would reiterate that, with the exception of the
22 equity return component of the WACC used for the fuel deferrals, the FAC is not an
23 earnings-creating adjustment. It is a rate adjustment provision of the ESP that primarily
24 recovers costs. Consequently, with that exception, it is not an ESP adjustment that is
25 subject to remedy/return to customers under the SEET.

1 Second, an EDU should not be required to return to consumers amounts which it
2 has not yet collected from them. Consequently, even if the FAC were an earnings-
3 creating rate adjustment, it would be inappropriate to consider any refund under the
4 SEET until the deferrals are amortized and recovered through cash collections from
5 customers.

6 Third, the SEET should not be applied in a manner that undermines the
7 probability of future recovery of deferrals previously authorized. That would jeopardize
8 the EDU's ability to create the deferrals in the first place, and the Commission's ability to
9 implement rate increase phase-ins when appropriate. It would also be contrary to the
10 policy that Section 4928.144, Revised Code, promotes of allowing phase-ins and the
11 recovery by EDUs of the underlying deferrals.

12 **Q. HOW SHOULD DEFERRALS ASSOCIATED WITH THE ECONOMIC**
13 **DEVELOPMENT RIDER BE TREATED IN THE COURSE OF APPLYING THE**
14 **SEET?**

15 A. The same principles discussed above in connection with the fuel cost deferrals
16 apply to the economic development discounts deferred and subsequently recovered: an
17 EDU should not be required to return to consumers amounts that it has not yet collected
18 from them.

19 **Q. WHAT WAS THE MAGNITUDE OF THE FUEL AND ECONOMIC**
20 **DEVELOPMENT DEFERRALS AT THE END OF 2009?**

21 A. Mr. Mitchell reported (on Exhibit TEM-6, page 1 of 3) the total deferrals to be
22 \$47.2 million for CSP and \$305.2 million for OPCo. The after-tax effect of excluding the
23 deferrals would be to further reduce the ROE from 18.31% and 9.42% for CSP and
24 OPCo, respectively, to 15.99% and 2.54%.

1
2 **AEP OHIO'S CAPITAL BUDGET REQUIREMENTS FOR FUTURE**

3 **COMMITTED INVESTMENTS**

4 **Q. SHOULD THE COMMISSION CONSIDER FUTURE COMMITTED**
5 **INVESTMENTS OF AEP OHIO DURING THE ESP TERM?**

6 A. Yes. I have been advised by counsel that the statutory language in Section
7 4928.143(F) provides the Commission with flexibility to consider the EDU's upcoming
8 capital requirements when determining whether significantly excessive earnings exist.
9 Specifically, the statute gives the Commission the latitude to determine that if the EDU
10 has capital spending commitments that it must meet in the near future, its earnings should
11 not be considered significantly excessive. That language would also allow the
12 Commission to permit an EDU to retain earnings that might otherwise be considered to
13 be significantly excessive, under the implied theory that the EDU could use them to meet
14 its capital spending requirements for the future committed investments.

15 **Q. HOW SHOULD THE COMMISSION IDENTIFY THE CAPITAL**
16 **REQUIREMENTS OF FUTURE COMMITTED INVESTMENTS?**

17 A. Rule 4901:1-35-03(C)(10)(a)(iii), OAC, requires that with the annual SEET filing
18 during an ESP term, the EDU must provide "[c]apital budget requirements for future
19 committed investments in Ohio for each annual period remaining in the ESP." This rule
20 provision reinforces the notion that capital budget forecasts are indicative of the EDU's
21 "capital requirements for future committed investments."

22 **Q. PLEASE DESCRIBE AEP OHIO'S CAPITAL BUDGET FOR EACH**
23 **ANNUAL PERIOD IN THE ESP.**

24 A. AEP Ohio's actual and projected annual capital expenditures for 2007 through

1 2011 are contained in Exhibit JH-1 attached to my testimony.

2 **Q. WHAT DOES THE DATA DEMONSTRATE WITH RESPECT TO AEP**
3 **OHIO'S COMMITTED CAPITAL INVESTMENT DURING THE ESP TERM?**

4 A. Exhibit JH-1 shows that AEP Ohio has planned capital investments of
5 approximately \$1.67 billion during the ESP term alone. By any measure, this is a
6 substantial capital investment in Ohio and should carry significant weight in the
7 Commission's 2009 SEET analysis for AEP Ohio.

8 **Q. IS THIS CAPITAL BUDGETING INFORMATION RELIABLE AND**
9 **ACCURATE?**

10 A. Yes. This data, presenting three years of actual historical information and two
11 years of projected information, gives an accurate picture of AEP Ohio's present and
12 future capital investments in Ohio during the ESP term. The three years of actual data for
13 2007-2009 and the 2010 projected data agree with total construction expenditures per
14 AEP's December 31, 2009 10-K Form submitted to the Securities and Exchange
15 Commission.

16 **Q. IS THE CAPITAL BUDGETING INFORMATION REFLECTED IN**
17 **EXHIBIT JH-1 THE ONLY CAPITAL INVESTMENT INFORMATION THAT**
18 **COULD BE CONSIDERED BY THE COMMISSION IN APPLYING THE 2009**
19 **SEET TO AEP OHIO?**

20 A. Not necessarily. AEP Ohio is currently planning a long-term infrastructure
21 investment plan to present as part of its next distribution rate case before the
22 Commission. This plan involves an additional capital investment in Ohio expected to
23 exceed \$1 billion. This plan includes expansion of CSP's gridSMART program, which is
24 responsive to state policy and growing customer interest in enhanced information,

1 advanced control, and improved reliability and environmental performance. AEP Ohio
2 anticipates filing this plan early in 2011. While this comprehensive plan is not yet before
3 the Commission, let alone approved for timely recovery through rates, it nonetheless
4 further demonstrates that AEP Ohio continues to escalate its capital commitment to
5 investment in Ohio.

6
7 **OTHER "ADDITIONAL FACTORS" THAT THE COMMISSION INDICATED**
8 **COULD BE CONSIDERED**

9 **Q. THE COMMISSION'S JUNE 30 FINDING AND ORDER REFERENCED**
10 **AN ELECTRIC UTILITY'S PREVIOUSLY AUTHORIZED RETURN ON**
11 **EQUITY BEING A POSSIBLE ADDITIONAL FACTOR TO CONSIDER. DO**
12 **YOU THINK CSP'S AND OPCO'S PREVIOUSLY AUTHORIZED RETURN ON**
13 **EQUITY ARE PROBATIVE TO CONSIDER IN THIS CASE?**

14 **A.** No. It has been 19 years since the time CSP filed its last general rate case and 16
15 years since the time of OPCo filed its last general rate case. Thus, while the return on
16 equity authorized in those prior general rate cases might align with a utility's present
17 required return on equity when viewed under the lens of traditional regulation, the return
18 on equity approved in those cases is based on stale data and supporting information, and
19 any such alignment would be coincidental. As a related matter, any current return on
20 equity considerations should reflect the new risks attendant to an electric utility operating
21 under the new hybrid form of regulation in Ohio. Moreover, I have been advised by
22 counsel that the statutory language in the SEET ties the determination of significantly
23 excessive earnings to earnings attained by a comparable group of companies and would
24 not permit any direct consideration or critical reliance on previously-authorized return on

1 equity established in a traditional, general rate case involving a vertically integrated
2 utility prior to the advent of customer choice in Ohio.

3 **Q. PLEASE DISCUSS CSP'S AND OPCO'S RISK, INCLUDING WHETHER**
4 **THE COMPANIES OWN GENERATION, WHETHER THEIR ESPS INCLUDE**
5 **A FUEL AND PURCHASED POWER ADJUSTMENT OR SIMILAR**
6 **MECHANISM, THE RATE DESIGN AND THE EXTENT TO WHICH CSP AND**
7 **OPCO REMAIN SUBJECT TO WEATHER AND ECONOMIC RISK.**

8 A. Ohio electric utilities such as CSP and OPCo that own generation assets bear
9 additional risks as compared to utilities that do not own generation assets. The
10 generation-owning utilities in Ohio are no longer guaranteed recovery of their substantial
11 capital-intensive assets. Rather, under SB 221, the competitive nature of generation
12 service created a shopping and customer migration risk. Given the "hybrid" nature of SB
13 221, this risk goes beyond the risk presented in other retail choice states. A detailed list
14 of these unique business and financial risks is contained in Exhibit JH-2.

15 This is especially true for generation-owning utilities such as CSP and OPCo that
16 operate under an ESP, given that the approval standard can be applied as the lower of
17 market or cost. Moreover, individual utilities face specific risks based on the terms of
18 their ESP. For example, AEP Ohio's approved ESP incorporates the risk of an
19 unanticipated shutdown of generating stations between 2009 and 2011.¹

20 The hybrid and experimental nature of SB 221 may also present another risk for
21 generation-owning utilities, through the prospect of additional future industry
22 restructuring and uncertainty. There are additional inherent risks of fossil-based
23 regulation for utilities like CSP and OPCo – relative to the prospect of carbon regulation

¹ See AEP Ohio *ESP Cases*, March 18, 2009 Opinion and Order at 53.

1 and uncertain future market prices for generation-related services. Of course, the ever-
2 increasing panoply of environmental regulations that apply to fossil generation also
3 creates another distinct substantial capital-intensive challenge and associated uncertain
4 future market price impact for generation-related services.

5 Regarding rate design, CSP's and OPCo's revenue stream from retail rates is also
6 subject to variation and uncertainty based on weather risk and other economic factors –
7 such as those currently being experienced – that cause load to fluctuate substantially over
8 time. While CSP's and OPCo's ESP rates presently include a fuel and purchased power
9 cost recovery mechanism that includes recovery of environmental system consumables
10 costs and renewable power purchases required by SB221, those mechanisms are
11 bypassable by customers, thus exposing the companies to market risks for those
12 substantial costs.

13 All of these additional risks applicable to CSP and OPCo should be considered by
14 the Commission in implementing the SEET. In this SEET proceeding, the Commission
15 should carefully consider and recognize these risks and balance them against the
16 associated expectation by investors of returns commensurate with these risks. The
17 appropriate balance will ensure the ability to attract future capital investment to Ohio for
18 critical infrastructure needs.

19 **Q. Can YOU DISCUSS INDICATORS OF AEP OHIO'S MANAGEMENT**
20 **PERFORMANCE AND ADDRESS BENCHMARKS TO OTHER UTILITIES?**

21 A. Yes. AEP Ohio uses key indicators to gauge the company's performance,
22 including quarterly customer satisfaction tracking studies for both residential and small
23 commercial customers and distribution reliability indices.

24 Since 2005, AEP Ohio has consistently ranked in the first quartile for overall

1 satisfaction with residential customers when compared to a robust national peer group. In
2 2009, AEP Ohio ranked in the first decile for overall satisfaction with small commercial
3 customers. The company's reliability indices have followed a similar trend, improving
4 steadily since 2003 in both frequency and duration of outages. For example, the System
5 Average Interruption Frequency Index (SAIFI) in 2003 for CSP and Ohio Power was
6 1.95 and 1.21 respectively. In 2009, SAIFI was 1.31 for CSP and 0.91 for Ohio Power.
7 Both companies' Customer Average Interruption Duration Index (CAIDI) has shown
8 similar improvements. In 2003, CAIDI was 148.6 for CSP and 174.7 for Ohio Power.
9 Last year, CAIDI improved to 122.6 for CSP and 133.4 for Ohio Power.² These
10 improvements have been made while maintaining some of the lowest rates in the region.

11 **Q. PLEASE ADDRESS AEP OHIO'S INNOVATION AND INDUSTRY**
12 **LEADERSHIP WITH RESPECT TO MEETING INDUSTRY CHALLENGES TO**
13 **MAINTAIN AND IMPROVE THE COMPETITIVENESS OF OHIO'S**
14 **ECONOMY, INCLUDING RESEARCH AND DEVELOPMENT**
15 **EXPENDITURES, INVESTMENTS IN ADVANCED TECHNOLOGY AND**
16 **INNOVATIVE PRACTICES.**

17 A. For more than a century, AEP Ohio has been a pioneer of industry-leading
18 advances in electricity generation and transmission technologies that have dramatically
19 improved the reliability, cost effectiveness, and environmental performance of the power
20 grid. AEP Ohio's leadership and the associated investments have long been a source of
21 benefits for Ohio in several ways including; a secure and reliable supply of low cost
22 electricity to power Ohio's manufacturing economy, a steady stream of investment that
23 have maintained a significant tax base throughout the state, and a total economic impact

² Historical values were calculated using the new reporting guidelines under IEEE 1366.

1 that well exceeds \$2 billion per year including payroll for thousands of Ohioans, and
2 purchases of Ohio goods and services. Today AEP Ohio's leadership extends into the
3 distribution segment of the business through the industry-leading gridSMART initiative.
4 In collaboration with the Commission and the United States Department of Energy,
5 CSP's gridSMART Demonstration project is well on the way to implementation of the
6 first phase of new customer programs and technologies that are designed to modernize
7 the distribution system and significantly enhance customers' ability to save energy and
8 money through informed energy decisions and controls.

9 The CSP gridSMART Demonstration Project will provide a platform for ongoing
10 innovation by effectively integrating commercially available products, new technologies
11 and new consumer products and services within a single, secure two-way communication
12 network between the utility and its consumers.

13 Receiving the highest rating among all demonstration grant applications to the
14 U.S. Department of Energy, the gridSMART Project is a holistic approach to advancing
15 smart grid development, by testing some of the most advanced smart grid technologies in
16 central Ohio. AEP Ohio brings leadership in industry and technical innovation to this
17 project. AEP's Columbus-based Dolan Technology Center has an established smart grid
18 test bed providing a platform to gain experience with smart grid components that will
19 facilitate electric distribution system performance and customer service. AEP also
20 participates in various industry efforts aimed at strengthening interoperability standards
21 and cyber security, notably the National Electric Reliability Council (NERC) Critical
22 Infrastructure Protection (CIP) standards development team and National Institute of
23 Standards and Technology (NIST) development work on smart grid interoperability.

1 In addition, with greenhouse gas emission limits anticipated in the future, AEP
2 Ohio's parent company, American Electric Power, has collaborated with the United
3 States Department of Energy on an industry-leading carbon capture and sequestration
4 project at Appalachian Power's Mountaineer plant. Demonstration of such technologies
5 by AEP can ultimately lead to technology and knowledge transfer to AEP Ohio.

6 **Q. PLEASE ADDRESS WHETHER AEP OHIO HAS ADVANCED STATE**
7 **POLICY.**

8 A. In response to SB 221, AEP Ohio took the lead on implementing energy
9 efficiency and demand reduction programs that have the potential to save Ohio
10 consumers and businesses approximately \$630 million in reduced bills over the life of the
11 programs and reduce power plant emissions. As our Portfolio Status Report indicates,
12 AEP Ohio's energy efficiency and peak demand response programs were very successful
13 in 2009, achieving the benchmark requirements for both areas. For energy efficiency
14 programs, CSP achieved 202 percent of its benchmark requirement while Ohio Power
15 achieved 171 percent.

16 AEP Ohio has also contributed to the development of an emerging solar power
17 industry in Ohio by bringing to the state Ohio's first utility scale solar generation facility
18 located near Upper Sandusky in Wyandot County. The project officially began generating
19 renewable solar power on a commercial basis on May 16, 2010. The project was a direct
20 result of AEP Ohio's commitment to buy all of the facility's 10 megawatt output through
21 a 20-year power purchase agreement.

22 **Q. IS AEP OHIO'S ECONOMIC IMPACT IN OHIO LIMITED TO ITS**
23 **COMMITTED CAPITAL INVESTMENT?**

24 A. While AEP Ohio's capital programs are substantial and benefit the state in many

1 ways, as mentioned previously, AEP Ohio's annual economic impact in Ohio well
2 exceeded \$2 billion in 2009. This amount goes well beyond the impact of capital
3 investments and included more than \$730 million in Ohio payroll and over \$161 million
4 in property taxes, as well as state and local taxes, philanthropic contributions, and
5 purchases of Ohio goods and services. Sustaining the level of investment that underlies
6 this significant impact depends in large part on the investment climate that is created by
7 implementation of the significantly excessive earnings test.

8 **SUMMARY OF CONCLUSIONS**

9 **Q. PLEASE SUMMARIZE YOUR CONCLUSIONS THAT CONSTITUTE**
10 **AEP OHIO'S POSITION.**

11 A. I respectfully submit that the Commission should find that neither CSP's nor
12 OPCo's 2009 earnings were significantly excessive and that there is no basis for
13 returning any portion of those earnings to customers. I also request that the Commission
14 find the underlying methodology developed by Dr. Makhija to be in adherence to the
15 statute, and therefore a sound basis for future annual SEET filings. This is a critically
16 important construct that largely defines the investment climate in Ohio. Through
17 recognition of the proposed methodology as a sound framework for this and future SEET
18 filings, the Commission has an opportunity to resolve a significant uncertainty regarding
19 utility investment in Ohio while striking an appropriate balance between the needs of
20 investors and utility customers.

21 The level at which CSP's and OPCo's earned ROE may become significantly in
22 excess of the average earned ROE of the comparable risk group of publicly traded firms
23 is 22.51%. CSP's and OPCo's earned ROE for 2009, appropriately adjusted to exclude
24 OSS net margins, are 18.31% and 9.42%, respectively. Because even the unadjusted

1 2009 ROE results for both CSP (20.84%) and OPCo (10.81%) are below the 2009 ROE
2 benchmark observed by Dr. Makhija (22.51%), the issue of whether OSS margins should
3 be excluded from earned ROE for purposes of the SEET can be considered as an
4 academic question relative to 2009. Further, OPCo's 2009 earnings, both unadjusted
5 (10.81%) and adjusted (9.42%), are below the 200 basis point "safe harbor" of 13.04%
6 (based on Dr. Makhija's average 2009 ROE for the comparable group).

7 While we have presented data for CSP and OPCo separately throughout this filing
8 to adhere to the Commission's June 30 Finding and Order, the fact remains that the
9 companies are managed on an integrated basis as AEP Ohio. Accordingly, application of
10 the SEET methodology on a combined basis would be more appropriate in this case.
11 This is especially appropriate for a time period such as 2009 where the other affiliate
12 operating company (OPCo for 2009) has earnings that are well below the average 2009
13 earnings for firms with comparable risk.

14 To the extent the Commission somehow finds that CSP's or OPCo's 2009
15 earnings are significantly excessive, the Commission's June 30 Finding and Order (at
16 pages 14-15) found that the clear, unambiguous language of the statute limits the scope of
17 any refund to the rate adjustments in the current ESP. CSP's 2009 total earnings
18 associated with the four adjustments are \$59.6 million, which equates to revenues from
19 customers of \$93.0 million. Consequently, an amount up to the \$93.0 million for CSP
20 associated with earnings-producing rate adjustments under the ESP based on revenue
21 actually collected during 2009 could be subject to refund only if the Commission finds
22 that: (i) CSP's 2009 earnings exceeded the 2009 benchmark ROE by up to the applicable
23 amount, (ii) the actual amount of significantly excessive earnings were the result of the
24 earnings-producing rate adjustments under the ESP, and (iii) the additional factors to be

1 considered do not mitigate against a finding of significantly excessive earnings for 2009.
2 In addition, regarding the significant deferrals created by the ESP adopted by the
3 Commission (\$47.2 million for CSP and \$305.2 million for OPCo), the Companies
4 should not be required to return to consumers amounts which it has not yet collected from
5 them and, as discussed above, the SEET should not be applied in a manner that
6 undermines the probability of future recovery of deferrals previously authorized.

7 If the Commission's evaluation of the quantitative data were to somehow suggest
8 significantly excessive earnings, it is my understanding that the Commission has
9 flexibility to consider the EDU's upcoming capital requirements when determining
10 whether significantly excessive earnings exist and whether any refund should be ordered.
11 In this regard, AEP Ohio has committed capital investments of approximately \$1.67
12 billion during the ESP term alone. AEP Ohio is also currently planning a long-term
13 infrastructure investment plan to present as part of its next distribution rate case before
14 the Commission. This plan involves an additional capital investment in Ohio exceeding
15 \$1 billion. By any measure, these are substantial capital investments in Ohio that are
16 dependent upon a conducive investment climate in the state and should carry significant
17 weight in the Commission's 2009 SEET analysis for AEP Ohio. Finally, prior to
18 ordering any return of 2009 earnings to customers, the Commission should carefully
19 consider and recognize several additional factors and balance them against the associated
20 expectation by investors of returns commensurate with these risks: (i) the unique risks
21 imposed on AEP Ohio under its ESP, (ii) AEP Ohio's management and benchmark
22 performance, (iii) AEP Ohio's exemplary track record of innovation and industry
23 leadership, (iv) AEP Ohio's advancement of state policy, and (v) AEP Ohio's impact on
24 the Ohio economy.

- 1 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**
- 2 **A. Yes.**

AEP Ohio Construction Expenditures
2007 - 2009 Actual / 2010 - 2011 Forecast
\$ in thousands (excluding AFUDC)

<i>Actual</i>		
2007	2008	2009

<i>Forecast</i>	
2010	2011

CSP

New Generation	\$600	\$3,562	(\$51)
Environmental	\$129,971	\$163,812	\$73,826
Other Generation	\$43,904	\$55,783	\$52,585
Transmission	\$23,310	\$62,758	\$39,725
Distribution	\$95,660	\$131,073	\$77,910
gridSMART	\$0	\$0	\$25,630
Corp/Other	\$37,370	\$18,725	\$10,482
Total	\$330,815	\$435,713	\$280,108

	\$0	\$0
	\$76,620	\$20,614
	\$46,372	\$47,260
	\$30,888	\$29,234
	\$67,906	\$72,741
	\$28,030	\$11,146
	\$6,284	\$5,974
Total	\$256,100	\$186,969

OPCo

New Generation	\$600	\$0	\$0
Environmental	\$481,737	\$311,852	\$151,021
Other Generation	\$170,144	\$136,659	\$85,053
Transmission	\$40,061	\$66,303	\$54,827
Distribution	\$94,992	\$130,938	\$88,120
gridSMART	\$0	\$6,378	\$93
Corp/Other	\$18,431	\$23,057	\$10,757
Total	\$805,965	\$649,187	\$389,871

	\$0	\$0
	\$67,463	\$49,443
	\$92,156	\$86,490
	\$46,812	\$33,703
	\$83,177	\$85,963
	\$8	\$10
	\$12,207	\$11,744
Total	\$301,826	\$267,353

Business and Financial Risks Associated with SB 221

Migration Risk

- Customers have come and go rights (rules to be determined) - Company retains provider of last resort status at tariff rates
- Distributed generation is encouraged
- Governmental aggregation is promoted – including by-passability of charges
- Governmental agencies to pursue energy price risk management
- Competition from other EDUs that own generation

Asset Risk

- No future stranded cost recovery for historical “g” assets
- Performance standards and targets for service quality to customers
- Requirement to have T&D available for customer generation and distributed generation
- Risk that Commission requires separation from RTO participation (infrastructure investment associated with membership)
- Mandated compliance for advanced energy portfolio forces utilities to pursue/investment in technologies that may not perform as expected in introducing technical risk
- By-passability of advanced energy costs through shopping

Financial Risk

- Asymmetrical earnings test – set rates and claw back on one side – no true up on the other
- Prudency review of generation-related costs
- Penalties for under compliance with advanced energy/DSM/EE
- Commission can require phase-in of rates to ensure rate and price stability
- Lack of definition around earnings test-present and future

Transition to Market Risk

- Commission can stall the Market Rate Option (MRO) at 10% phase in after the first year – no ability to return to ESP
- Approved ESP can later be rejected before end of term if MRO provided better economics for customers

Litigation Risk

- Political uncertainty of implementation of new law presently and in the future as new deal structures and technologies emerge – or changing it in the future
- It may well be years before all of the provisions of the bill are resolved through court activity