

**FILE**

**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

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**BRIEF OF INDUSTRIAL ENERGY USERS-OHIO**

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Samuel C. Randazzo (Counsel of Record)  
Joseph E. Olikier  
McNees Wallace & Nurick LLC  
21 East State Street, 17th Floor  
Columbus, OH 43215  
Telephone: (614) 469-8000  
Telecopier: (614) 469-4653  
sam@mwncmh.com  
joliker@mwncmh.com

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**Attorneys for Industrial Energy Users-Ohio**

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**I. INTRODUCTION AND SUMMARY OF POSITION**

This proceeding is the first proceeding in which issues related to the significantly excessive earnings test ("SEET") in Section 4928.143(F), Revised Code, are being contested. By law, the SEET must be applied to Columbus Southern Power Company ("CSP") and Ohio Power Company ("OP") (collectively "AEP-Ohio") in their individual capacity as an "electric distribution utility" ("EDU"). CSP and OP are wholly owned by American Electric Power ("AEP")<sup>1</sup> and they engage in various lines of business including retail and wholesale lines.

Section 4928.143(F), Revised Code, states (emphasis added):

**With regard to the provisions that are included in an electric security plan under this section, the commission shall consider, following the end of each annual period of the plan, if any such adjustments resulted in excessive earnings as measured by whether the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate. Consideration also shall be given to the capital requirements of future committed investments in this state. The**

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<sup>1</sup> Tr. Vol. III at 440-441.

burden of proof for demonstrating that significantly excessive earnings did not occur shall be on the **electric distribution utility**. If the commission finds that such adjustments, in the aggregate, did result in significantly excessive earnings, it shall require the **electric distribution utility** to return to consumers the amount of the excess by prospective adjustments; provided that, upon making such prospective adjustments, the electric distribution utility shall have the right to terminate the plan and immediately file an application pursuant to section 4928.142 of the Revised Code. Upon termination of a plan under this division, rates shall be set on the same basis as specified in division (C)(2)(b) of this section, and the commission shall permit the continued deferral and phase-in of any amounts that occurred prior to that termination and the recovery of those amounts as contemplated under that electric security plan. In making its determination of significantly excessive earnings under this division, **the commission shall not consider, directly or indirectly, the revenue, expenses, or earnings of any affiliate or parent company.**

For the reasons explained herein, the Industrial Energy Users-Ohio ("IEU-Ohio") respectfully urges the Public Utilities Commission of Ohio ("Commission") to hold that neither OP nor CSP met its burden to show that it did not experience significantly excessive earnings as a result of their individual electric security plans ("ESP") in the first annual period. The law requires the Commission to make this finding for both OP and CSP because, as a threshold matter, neither OP nor CSP offered any evidence to show their EDU earned return on equity arising from their particular ESP during the required annual period.<sup>2</sup> IEU-Ohio also respectfully urges the Commission to find that it can go no further in this proceeding because the evidence does not permit the Commission to identify or resolve the quantitative issues framed by the SEET as specified by Section 4928.143(F), Revised Code.

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<sup>2</sup> Mr. Hamrock testified, speaking on advice of counsel, that the scope of the SEET under Section 4928.143(F), Revised Code, is confined to an examination of earnings produced by the rate plan approved by the Commission for the EDU. Companies Exhibit 6 at 3. As explained herein, the return on equity calculations relied upon by AEP-Ohio to support its proposed application of the SEET do not identify or apply CSP's and OP's earned returns in their capacity as an EDU and from their respective retail rate plans. In other words, AEP-Ohio did not follow the advice of its counsel.

As IEU-Ohio previously explained (through a motion to dismiss without prejudice made in the alternative),<sup>3</sup> the design and conduct of this proceeding violates Section 4928.143(F), Revised Code. While IEU-Ohio is eager to have the Commission remove the significantly excessive economic burden ("SEEB") that was imposed on customers when the Commission approved the OP and CSP ESPs,<sup>4</sup> the Commission does not have subject matter jurisdiction to: (1) adopt a SEET other than the SEET specified in Section 4928.143(F), Revised Code; or, (2) apply the required SEET other than as mandated by Section 4928.143(F), Revised Code.

Based on the law and the evidence in this proceeding, the Commission must find that AEP-Ohio failed to provide the analysis required by the SEET and direct OP and CSP to file an application that complies with the SEET. In other words, the Commission must direct CSP and OP to start over.

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<sup>3</sup> Tr. Vol. I at 18-25. The ruling on this motion as well as other rulings is contested below.

<sup>4</sup> The Commission has had and has opportunities to mitigate the SEEB it imposed on electric customers when the Commission approved the OP and CSP ESPs and it has not responded positively or, in some cases, at all as these opportunities have been presented to the Commission. For example, when IEU-Ohio demonstrated that the rate increase that OP and CSP claimed was needed to cover the cost of compliance with Ohio's portfolio requirements was unnecessarily excessive (that compliance could be achieved at a lower cost) and then urged the Commission to spare customers from paying even higher rates to fund the excessive compliance cost estimate, the Commission ignored the issue. *In the Matter of the Application of Columbus Southern Power Company for Approval of its Program Portfolio Plan and Request for Expedited Consideration*, Case Nos. 09-1089-EL-POR, et al., Finding and Order (May 13, 2010); Entry on Rehearing (July 14, 2010). Also, the Commission has done nothing to address OP's and CSP's collection of about \$24 million in revenue made possible by the Commission's illegal actions in *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Recover Costs Associated with the Ultimate Construction and Operation of an Integrated Gasification Combined Cycle Electric Generation Facility*, Case No. 05-376-EL-UNC, Opinion and Order (April 10, 2006) ("IGCC Order"); Entry on Rehearing (June 28, 2006), even though the Commission has been subject to a mandate from the Ohio Supreme Court to cure the illegal IGCC Order since March 13, 2008. *Indus. Energy Users-Ohio v. Pub. Util. Comm.*, 117 Ohio St.3d 486 (2008). Both the Office of the Ohio's Consumers' Counsel ("OCC") and IEU-Ohio have filed motions (OCC on September 17, 2008 and IEU-Ohio on September 18, 2009) urging the Commission to direct AEP-Ohio to refund the money (with interest) illegally collected from customers.

The decision in this proceeding is going to be appealed to the Ohio Supreme Court regardless of how the contested issues are resolved on the merits (assuming they are resolved on the merits). When taken, the appeal will involve procedural and substantive issues of first impression. The public interest would be far, far better served if the issues taken up on appeal are not encumbered by an evidentiary record that is devoid of the information which the Commission must consider for purposes of constructing and applying the SEET mandated by Section 4928.143(F), Revised Code.

## **II. THE MEANING OF SEET**

Section 4928.143(F), Revised Code, contains words that are defined by Ohio law and, as stated in Section 4929.01, Revised Code, these definitions control for purposes of constructing and applying the SEET.

For example, Section 4928.01, Revised Code, defines "electric distribution utility" as an "electric utility" that supplies retail electric distribution service and defines an "electric utility" as an "electric light company"; the entity that has an Ohio certified territory and also provides retail service in Ohio.

The definitions in Section 4928.01, Revised Code, apply to Section 4928.143(F), Revised Code, and these definitions control the scope of the SEET. Based on these definitions and the plain meaning of Section 4928.143(F), Revised Code, the SEET must be applied to measure the earned equity return on the EDU's retail service which is the service that is subject to the Commission's jurisdiction.<sup>5</sup> This is the only service

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<sup>5</sup> The legal fact that the Commission's authority is limited to the scope of its jurisdiction is and has been fundamental to defining the Commission's authority. This subject matter jurisdiction limitation grows from the separation of powers achieved by the United States Constitution and authority that has been placed in Congress as compared to the authority reserved to the various states. Indeed, utility applications for rate

that can be covered by a rate plan that the Commission is empowered to approve under Section 4928.143, Revised Code. Therefore, the SEET mandated by Section 4928.143(F), Revised Code, requires the Commission to design and apply the SEET to identify the EDU's earned return on equity as that earned return is measured from retail service rate plan approved by the Commission under Section 4928.143, Revised Code.

Section 4928.143(F), Revised Code, also requires that the SEET be applied following the end of each annual period. The start date of the first ESP annual period for OP and CSP was April 1, 2009. Mr. Mitchell testified that the revenue collection opportunity enabled by the retail rate plan did not commence until April 1, 2009. Tr. Vol. I at 44-46. As the Commission knows from its own public records, the first effective date of the rates and charges collected by CSP and OP pursuant to the retail rate plan approved by the PUCO is also April 1, 2009. The annual period commencing on April 1, 2009 ends on March 31, 2010. Reliance on data for the calendar year 2009 for purposes of applying the SEET also violates Section 4928.143(F), Revised Code.

By operation of law, the SEET cannot include any consideration of net income and the earned return on equity attributable to non-retail transactions such as those subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC").

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increases have historically been filed with explicit reference to the service that is subject to the Commission's jurisdiction. *In the Matter of the Application of The Toledo Edison Company for Authority to Amend and Increase Certain of its Rates and Charges for Electric Service*, Case Nos. 95-299-EL-AIR, et al., Opinion and Order (April 11, 1996). Section 4928.39, Revised Code, required the Commission to jurisdictionalize any transition cost allowance that the Commission authorized EDUs to collect in conjunction with Ohio's approach to restructuring its electric laws and regulations. *In the Matter of the Application of FirstEnergy Corp. on Behalf of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Approval of Their Transition Plans and for Authorization to Collect Transition Revenues*, Case Nos. 99-1212-EL-ETP, et al., Opinion and Order at 31-36 (July 19, 2000). The notion that the Commission must apply the SEET to respect this fundamental legal principle is hardly new. But whether new or old, this principle must also be respected because this respect is an explicit requirement of Section 4928.143(F), Revised Code.

Section 4928.143(F), Revised Code, also prohibits the Commission from considering, "... directly or indirectly, the revenue, expenses, or earnings of any affiliate or parent company."

### **III. SEET HAPPENS**

The testimony (prefiled and oral) and exhibits sponsored by all the witnesses in this proceeding demonstrate that none of the witnesses based their calculations and opinions on parameters required by Section 4928.143(F), Revised Code. The problem is not limited to the analysis that focused on CSP.

In AEP-Ohio's case, this fundamental failure has substantive legal consequences. Section 4928.143(F), Revised Code, imposes the burden of demonstrating no significantly excessive earnings on the EDU. Since neither OP nor CSP offered evidence that conforms to the SEET requirements, the Commission must find that OP and CSP failed to meet their burden to come forward with the required evidence. But, beyond holding that OP and CSP failed to meet their burden to come forward with evidence showing no significantly excessive earnings as measured by the SEET, the Commission can go no further.

The record is devoid of the information required to apply the SEET. At best, the record documents an irrelevant debate over how to measure the total company earned return on common equity for CSP and OP for calendar year 2009.

AEP-Ohio's witnesses frequently invoked the advice-of-counsel mantra. But, AEP-Ohio's earned return calculation witness, Mr. Mitchell, did not develop his calculations or opinions based on the understanding that "electric distribution utility" and



"electric utility" are defined terms under Ohio law. Prior to the hearing, Mr. Mitchell did not ask if these terms have specific meaning in Ohio. Tr. Vol. I at 36. During the hearing and after sponsoring his prepared testimony, he apparently became aware that these terms are defined by Ohio law. Tr. Vol. I at 36-39.

Mr. Mitchell's testimony and attached exhibits show that the math behind his earned return on equity numbers for 2009 is driven by total company numbers. For CSP and OP, he used \$271.5 million and \$305.8 million, respectively, as the earned return on common equity for 2009.<sup>6</sup> These 2009 earned return on equity numbers are the total company earned returns for OP and CSP. In other words, Mr. Mitchell's earned return on common equity math produces a 2009 earned return on equity for all lines of CSP and OP business, not just the equity return earned by each EDU as a result of the retail rate plan. Tr. Vol. I at 37-38. As he explained, his calculation of the earned return on common equity for 2009 includes income from wholesale transactions involving affiliates of OP and CSP and subject to FERC's jurisdiction. Tr. Vol. I at 43.

AEP-Ohio's "cleanup" witness, Mr. Hamrock, confirmed that CSP and OP are engaged in multiple lines of business including nonutility business. He also confirmed that the net income and earned return calculations contained in AEP-Ohio's testimony include income from FERC-jurisdictional activities, including the various pool agreements that allocate costs and revenue among and between other operating companies affiliated with OP and CSP. Tr. Vol. I at 134, 136-137, 141-152. In his testimony, Mr. Hamrock conceded that AEP-Ohio's total company earned return on equity calculations for OP and CSP operate to include non-jurisdictional activities and

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<sup>6</sup> Companies Exhibit 4, Exhibit TEM-1.

gains or losses affecting CSP's and OP's earnings. He testified that " ... there are ... non-jurisdictional activities and gains or losses that impact CSP's and OPCo's earnings ..." but that "... the Companies did not attempt to fully jurisdictionalize the 2009 earnings ...." Companies Exhibit 6 at 7.

Like Mr. Mitchell and Mr. Hamrock, Dr. Makhija's analysis was conducted without knowledge that "electric utility" has a specific statutory definition for purposes of the SEET. Tr. Vol. I at 100-101. During cross-examination, he acknowledged that the term "electric distribution utility" is "...suggestive of distribution activities" and that the earned return calculations required by the SEET are to be focused on the EDU. Tr. Vol. I at 102.

Dr. Makhija was not responsible for calculating the EDU earned returns on common equity. Tr. Vol. I at 103-104. Mr. Mitchell was responsible for OP's and CSP's earned return on equity calculations and, as documented above, OP's and CSP's earned return on equity calculations were not based on the EDU earnings from the Commission-approved rate plan. The calculations were based on total company data. Since Mr. Mitchell and Mr. Hamrock used total company numbers to lay a foundation for Dr. Makhija, they thereby rendered Dr. Makhija's opinions irrelevant.

Professor Woolridge did not look at OP's earnings; he limited his analysis to CSP. Tr. Vol. II at 319. He did not know that "electric distribution utility" and "electric utility" are defined terms in Ohio. Tr. Vol. II at 320. He testified that if there are statutory definitions for these terms, then he did not take them into account. Tr. Vol. II at 320-321.

The direct case presented by the Joint Intervenors<sup>7</sup> was structured so that Mr. Kollen's opinions and recommendations relied significantly on the opinions of Professor Woolridge. Tr. Vol. II at 385. Mr. Kollen did not address the SEET as applied to OP and he did not take issue with Mr. Mitchell's calculation of CSP's earned return<sup>8</sup> even though (as explained above) Mr. Mitchell relied on total company numbers.

Like Mr. Mitchell, Mr. Hamrock, Dr. Makhija and Professor Woolridge, Mr. Kollen was, when he offered his testimony, unaware that "electric utility" is a defined term in Ohio. Tr. Vol. II at 387. By focusing on the total company numbers for CSP, Mr. Kollen adopted OP's and CSP's erroneous approach to calculating the earned return on equity component of the SEET. Tr. Vol. II at 387. During cross-examination, Mr. Kollen acknowledged that CSP has various lines of business (involving generation, transmission and distribution functions) and that he did not know the extent to which each line of business was responsible for the significantly excessive earnings in 2009. Joint Intervenors Exhibit 2 at 27; Tr. Vol. II at 400.

Like Professor Woolridge and Mr. Kollen, Mr. Cahaan offered no testimony on the SEET as applied to OP. Tr. Vol. III at 445. Like Mr. Mitchell, Mr. Hamrock, Dr. Makhija, Professor Woolridge and Mr. Kollen, Mr. Cahaan did not approach his assignment with an understanding that "electric utility" is a defined term in Ohio. Tr. Vol. III at 444. Like Mr. Mitchell, Mr. Hamrock, Dr. Makhija, Professor Woolridge and Mr. Kollen, Mr. Cahaan also relied on total company numbers.

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<sup>7</sup> OCC, the Ohio Manufacturers' Association, the Ohio Hospital Association, Appalachian Peace and Justice Network and the Ohio Energy Group are the "Joint Intervenors." Joint Intervenors Exhibit 2 at 2.

<sup>8</sup> Joint Intervenors Exhibit 2 at 18.

- Q. Now, the numbers that appear at line 11, the net income number –
- A. What page are we on?
- Q. Page 19. I'm sorry.
- A. Yes, I see it.
- Q. The 271.5 million,<sup>9</sup> that would be a total Columbus & Southern Company number?
- A. Yes, it would.
- Q. Yeah. And when I say "total," as you understand it it's referring to all the various lines of business that Columbus & Southern is in? That would include wholesale, retail, and other.
- A. Oh, definitely.<sup>10</sup>

By the command of Section 4928.143(F), Revised Code, the Commission has no authority to measure significantly excessive earnings based on total company earnings. The SEET must be applied based on the earnings achieved by an EDU as a result of an ESP. Accordingly, the Commission must find that the evidence in this proceeding is incapable of being used to apply the SEET because it includes earnings from lines of business other than those of an EDU, includes earnings from other than the rate plan, and examines earnings for a time interval that is less than the annual period mandated by Section 4928.143(F), Revised Code.

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<sup>9</sup> The \$271.5 million net income in Mr. Cahaan's testimony is the same total company net income number (\$271.5 million) identified in Mr. Mitchell's testimony.

<sup>10</sup> Tr. Vol. III at 474-475.

#### **IV. OTHER LEGAL AND ANALYTICAL ERRORS**

Even if the evidence presented by AEP-Ohio, Joint Intervenors and the Commission's Staff had conformed to the requirements of Section 4928.143(F), Revised Code, the Commission would not be able to rely on such evidence without correcting the recommended math to eliminate other problems with the numbers that these parties relied upon to present their recommendations. Some of the other problems are discussed below.

##### **A. Waterford Energy Center and the Darby Electric Generating Station**

In *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case Nos. 08-917-EL-SSO, et al., Opinion and Order at 51-52 (March 18, 2009) (hereinafter referred to as the "AEP-Ohio ESP Case"), the Commission initially authorized CSP to increase revenues for the jurisdictional portion of expenses associated with certain generating facilities (Waterford Energy Center and the Darby Electric Generating Station). However, the Commission subsequently altered this determination based on the fact that AEP-Ohio had not presented evidence showing that the revenue produced by its rates was insufficient to cover such expenses and directed "... AEP-Ohio to modify its ESP and remove the annual recovery of \$51 million of expenses including associated carrying charges related to these generation facilities." *AEP-Ohio ESP Case*, Entry on Rehearing at 35-36 (July 23, 2009). CSP subsequently perfected an appeal to the Ohio Supreme Court alleging that the "... Commission unlawfully and unreasonably denied CSP the authority to recover, as part of its Electric Security Plan, costs associated with

its ownership of the Waterford Energy Center and the Darby Electric Generating Station". *In Re Columbus Southern Power Company v. The Public Utilities Commission of Ohio*, Ohio Supreme Court Case No. 09-2298, Notice of Appeal of Columbus Southern Power Company at 3 (December 22, 2009).

In addition to the other legal defects in the evidence offered by AEP-Ohio, Joint Intervenors and the Commission's Staff, the net income and earned return computations performed by each of these parties includes expenses associated with the Waterford Energy Center and the Darby Electric Generating Station as expenses that are properly recoverable under the CSP ESP; such expenses are included in CSP's 2009 per book net income number. Tr. Vol. I at 139-140. To exclude such expenses, it would be necessary to make an adjustment to CSP's 2009 per book net income number. Tr. Vol. I at 141. As explained above, AEP-Ohio, Joint Intervenors and the Commission's Staff copied AEP-Ohio's net income number into their analysis and thereby picked up AEP-Ohio's inclusion of the expenses associated with the Waterford Energy Center and the Darby Electric Generating Station in their otherwise defective recommendations regarding the SEET.

By comparing the AEP-Ohio position on the Commission's treatment of any expenses associated with the Waterford Energy Center and the Darby Electric Generating Station as expressed to the Ohio Supreme Court (the Commission precluded recovery) with the position AEP-Ohio has expressed in this proceeding, it is possible to see the creativity that AEP-Ohio has applied to its mathematical computations depending on the purpose of the math. For purposes of contesting the Commission's exclusion of any expenses associated with the Waterford Energy Center and the Darby

Electric Generating Station in the *AEP-Ohio ESP Case*, AEP-Ohio has alleged in its appeal to the Ohio Supreme Court that the Commission prevented AEP-Ohio from recovering such costs. But, for purposes of determining CSP's EDU net income and earned return from the rate plan approved by the Commission in the *AEP-Ohio ESP Case*, AEP-Ohio has included such expenses. And when such expenses are included in the total company earned return for CSP, AEP-Ohio has admitted that CSP's total company earned return on equity for 2009 exceeded 20 percent.

Since the earned return on equity in any time period is tied to net income for the same time period (the numerator in the percentage earned return math) and since expenses are deducted from revenue for purposes of determining net income,<sup>11</sup> CSP either recovered the expenses associated with the Waterford Energy Center and the Darby Electric Generating Station in calendar year 2009 or its computation of the total company earned return for 2009 is wrong.<sup>12</sup>

In any event and to properly measure CSP's EDU earned return from the ESP as approved by the Commission for purposes of the SEET, the income statement (expenses, revenue and net income) and balance sheet (common equity) effects attributable to the Waterford Energy Center and the Darby Electric Generating Station must be removed<sup>13</sup> to apply the SEET to the plan that is currently in effect.

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<sup>11</sup> Tr. Vol. IV at 730-731.

<sup>12</sup> IEU-Ohio suggests that CSP's own computations of the 2009 total company earned return for 2009 confirm that the Commission was correct when it held, in effect and in the *AEP-Ohio ESP Case*, that CSP did not need incrementally higher rates to cover the costs of the jurisdictional portion of the Waterford Energy Center and the Darby Electric Generating Station.

<sup>13</sup> Similar adjustments are required for the Lawrenceburg Generating Station. Tr. Vol. I at 141-142.

## **B. AEP-Ohio's Selective and Misleading Adjustments**

As discussed above, AEP-Ohio "... did not attempt to fully jurisdictionalize ..." the total company earnings. Companies Exhibit 6 at 7. But even if the Commission ignores the fact that the SEET requires reliance upon the EDU and retail jurisdictional numbers, the total company analysis provided by AEP-Ohio is based on one-sided, selective and misleading adjustments to the total company numbers.

For example and with regard to the math performed by AEP-Ohio in the case (and only in the case) of CSP, AEP-Ohio reduced CSP's total company net income by the "net margins" which AEP-Ohio attributed to off-system sales ("OSS"). Companies Exhibit 4 at 5. Mr. Mitchell was responsible for the computation performed to remove OSS net margins from CSP's total company dollar return on equity (the numerator in the percentage earned return calculation) for 2009 but he was directed to make this adjustment by Mr. Hamrock. Companies Exhibit 4 at 3; Companies Exhibit 6 at 6-7; Tr. Vol. I at 35.

In his testimony, Mr. Hamrock claimed that the adjustment to CSP's total company net income to remove "net margins" which AEP-Ohio attributed to "OSS" was required because the "[o]ff-system-sales margins, which result from wholesale, not retail, transactions, are not the result of a rate adjustment included in CSP's or OPG's ESP. They result from wholesale transactions approved by the Federal Energy Regulatory Commission (FERC)." Companies Exhibit 6 at 6-7. Mr. Hamrock also acknowledged, however, that "... there are other non-jurisdictional activities and gains or losses that impact CSP's and OPG's earnings ..." but that "... the Companies did not attempt to fully jurisdictionalize the 2009 earnings ...." Companies Exhibit 6 at 7.



AEP-Ohio's testimony, therefore, acknowledged that its adjustment to CSP's total company earnings or net income for 2009 to remove net margins from OSS is a selective application of AEP-Ohio's theory regarding the relationship between SEET and jurisdictional transactions and that a comprehensive application of this theory was not attempted by AEP-Ohio.

Mr. Cahaan's testimony identified one effect (at least directionally) of AEP-Ohio's selective application of AEP-Ohio's theory regarding the relationship between SEET and jurisdictional rate plan transactions. As Mr. Cahaan testified, the theory relied upon by AEP-Ohio to adjust the numerator (net income available for common shareholders) would require, if adopted, an adjustment to the denominator (the dollar value of common shareholder equity). Staff Exhibit 1 at 19-21. While Mr. Cahaan's testimony demonstrated the one-sided and misleading effect of AEP-Ohio's selective application of its theory, his quantification of the effect of this theory on the denominator (the dollar value of common shareholder equity) relied upon assumptions that let AEP-Ohio off cheap and disadvantaged customers. For example, he assumed that there was no transmission investment associated with making OSS; an assumption that has no support in the record or anywhere else. Tr. Vol. III at 477; Tr. Vol. I at 137.

## **V. THE IMPORTANCE OF GETTING THE SEET RIGHT**

As the record shows, CSP was already earning a high return on equity prior to the very significant ESP rate increases that the Commission authorized at a time when many of AEP-Ohio's customers were out of work and worried about whether they could keep their homes. As Mr. Kollen testified, it was very predictable that CSP would be earning even higher returns on equity once the Commission approved the ESP. Tr.

Vol. II at 386. While much of the focus of testimony in this proceeding was on CSP because of CSP's own very rich 2009 earned return numbers, the obligation to apply the mandated SEET to OP seems to have been assumed away based on an erroneous and customer-unfriendly reading of Section 4928.143(F), Revised Code.

The discussion herein regarding the meaning of SEET applies equally to OP and, accordingly, the total company OP earned return numbers that have been submitted to the Commission in this proceeding reflect an unlawful application of the SEET. As is the case with CSP, the OP earned return number must, as a matter of law, be calculated based on the earned return from the OP rate plan using jurisdictionalized numbers reflecting the retail service subject to the Commission's jurisdiction.

The position that IEU-Ohio urges the Commission to adopt in this proceeding is warranted because all the applications of the SEET presented in testimony suffer from a common and fundamental problem. The recommendations are tied to a version of SEET that the Commission is not authorized to apply pursuant to Section 4928.143(F), Revised Code. The record also contains strong circumstantial evidence indicating that a properly applied SEET would restore the type of customer/utility-owner balance that is required by Chapter 4928, Revised Code.

On cross-examination, Mr. Cahaan described the structure of AEP and how CSP and OP fit within that holding company structure. He testified that: AEP owns all the common equity of CSP and OP;<sup>14</sup> CSP and OP pay common stock dividends to their parent corporation (AEP); and, excessive earnings yield a greater facility to pay such

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<sup>14</sup> Tr. Vol. III at 440-441.

dividends.<sup>15</sup> He observed that OP's dividend pattern is not that of an independent company and that the same dividend pattern has the effect of depressing OP's earned return on common equity.<sup>16</sup>

While Section 4928.143(F), Revised Code, precludes the Commission from considering the earnings of affiliates or parent companies for purposes of applying the SEET, the record evidence indicates that OP and CSP (and therefore their retail customers) are carrying more than their fair share of the pooled costs. Getting the SEET right – looking at the EDU's earned return from the Commission-approved rate plan based on a fully jurisdictionalized analysis – will provide information that is required to make sure that AEP-Ohio's retail customers are not carrying too much responsibility for AEP's overall profit objectives.

The record evidence shows that even though the costs of providing generating and transmission service are shared throughout the AEP-East system,<sup>17</sup> the rates in Ohio tend to be the highest among all the AEP-East operating companies. IEU-Ohio Exhibit 3 at 8 (a presentation that AEP made on June 23, 2010) shows residential rate comparisons for the AEP-East operating companies for 2009.<sup>18</sup>

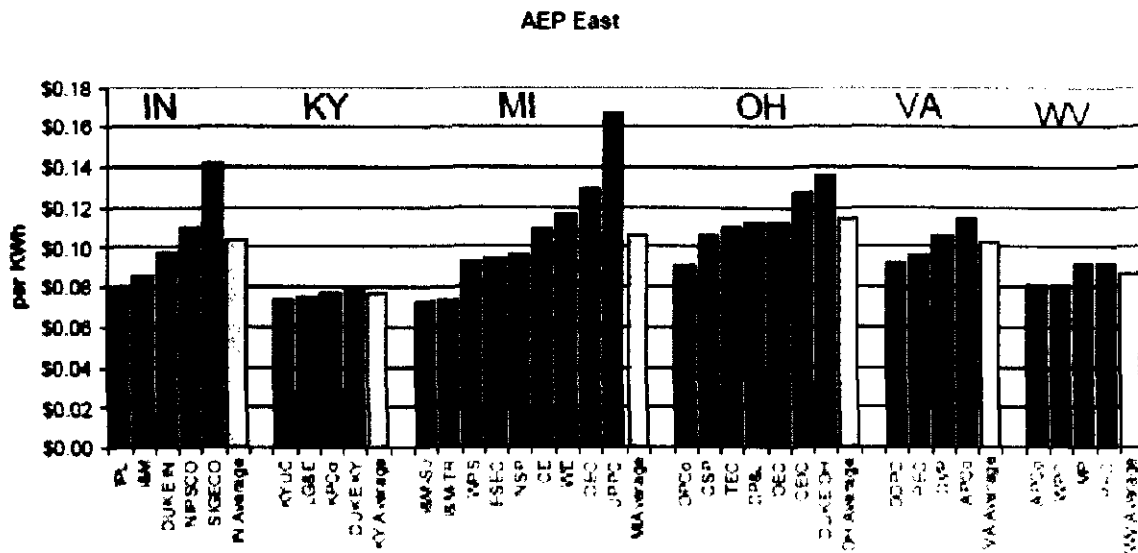
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<sup>15</sup> Tr. Vol. III at 441.

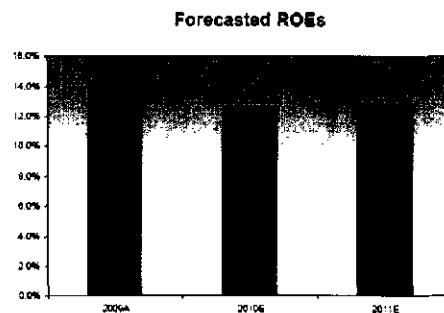
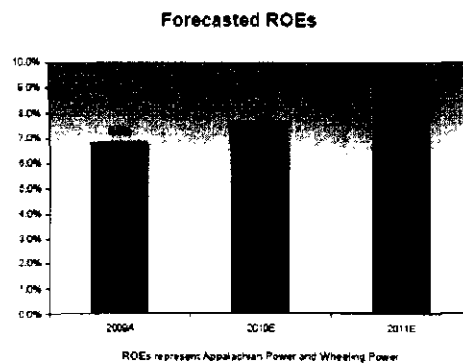
<sup>16</sup> Tr. Vol. III at 450-452.

<sup>17</sup> The various pool agreements are described and discussed in AEP's Form 10-K, Companies Exhibit 3 at 12-19, C-1 (CSP) and E-2 (OP).

<sup>18</sup> As the Commission knows, OP's and CSP's 2010 rates are higher than the rates that were in effect in 2009.

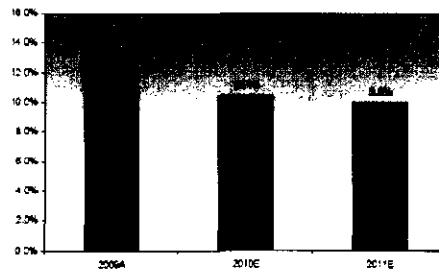


IEU-Ohio Exhibit 2 beginning at page 36 shows the AEP-East operating company (total company) earned returns on common equity for 2009 as well as estimated returns for 2010 and 2011. As Mr. Kollen explained, higher returns on common equity generally indicate higher electric rates. Tr. Vol. II at 392-393.



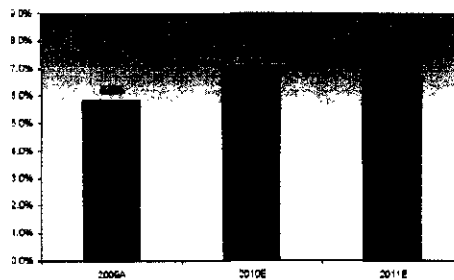
### AEP Ohio (OP and CSP)

Forecasted ROEs



### Indiana Michigan

Forecasted ROEs



### Kentucky Power

AEP presentations such as the one designated as IEU-Ohio Exhibit 3 also contain information on the relative level of gross margin that AEP collected in 2009 from the various divisions with the AEP system. AEP computes gross margin by subtracting, from revenue, the related direct cost of fuel including consumption of chemicals, emission allowances and purchased power. Tr. Vol. II at 395.

2009 Actual: \$2.97

American Electric Power  
2009 Actual vs. 2010 Guidance

2010E: \$2.80-\$3.20

	Performance Driver	2009 Actual (\$ millions)	Performance Driver	2010 Guidance (\$ millions)
<b>UTILITY OPERATIONS:</b>				
<b>Gross Margin:</b>				
1	East Regulated Integrated Utilities	66,976 GWh @ \$ 38.0 /MWhr = 2,544	66,249 GWh @ \$ 42.2 /MWhr = 2,878	
2	Ohio Companies	47,488 GWh @ \$ 57.6 /MWhr = 2,733	47,922 GWh @ \$ 63.6 /MWhr = 3,048	
3	West Regulated Integrated Utilities	38,947 GWh @ \$ 30.0 /MWhr = 1,167	41,165 GWh @ \$ 31.3 /MWhr = 1,287	
4	Texas Wires	27,573 GWh @ \$ 20.7 /MWhr = 571	27,510 GWh @ \$ 22.2 /MWhr = 610	
5	Off-System Sales (net of sharing)	14,795 GWh @ \$ 16.7 /MWhr = 247	23,992 GWh @ \$ 13.7 /MWhr = 329	
6	Transmission Revenue - 3rd Party	354	352	
7	Other Operating Revenue	767	541	
8	Utility Gross Margin	8,383	9,045	
9	Operations & Maintenance	(3,410)	(3,620)	
10	Depreciation & Amortization	(1,561)	(1,637)	
11	Taxes Other than Income Taxes	(751)	(793)	
12	Interest Exp & Preferred Dividend	(919)	(957)	
13	Other Income & Deductions	128	148	
14	Income Taxes	(553)	(736)	
15	Utility Operations On-Going Earnings	1,317	1,450	
16	Transmission Operations On-Going Earnings	4	9	
<b>NON-UTILITY OPERATIONS:</b>				
17	AEP River Operations	47	43	
18	Generation & Marketing	41	2	
19	Parent & Other On-Going Earnings	(47)	(63)	
20	ON-GOING EARNINGS	1,362	1,441	

The above gross margin data show that the "Ohio Companies" (CSP and OP) provided a gross margin of \$57.6 per MWhr in 2009 and are expected to provide (as of June 23, 2010) \$63.6 per MWhr in 2010.<sup>19</sup> The actual per MWhr 2009 gross margin from the Ohio Companies was 51% higher than the per MWhr gross margin from the balance of the AEP-East operating companies. The next highest gross margin number anywhere within AEP is \$38 per MWhr from the balance of the AEP-East Companies. In 2009, the Ohio Companies accounted for about 41% of combined Ohio Companies and East Companies GWh sales but over 51% of the comparable gross margin revenue.

Section 4928.02, Revised Code, requires the Commission to, among other things, administer Chapter 4928 in ways that facilitate Ohio's competitiveness. Businesses in Ohio compete with businesses in Indiana, Michigan, Kentucky and West Virginia. If the retail customers of AEP-Ohio are carrying more than their fair share of

<sup>19</sup> IEU-Ohio Exhibit 3 at 10.

the costs associated with meeting the combined needs of customers within the AEP-East footprint and are currently responsible for more than their fair share of the overall profitability of AEP, the Commission is obliged to take action because this undue burden on Ohio customers affects their ability to, among other things, compete in the global economy.

We are tasked, under Chapter 4928 of the Revised Code, with approving generation charges that are market-based and consistent with the state policy set forth in this chapter. Although, in some instances, costs or changes in costs may serve as proxies for reasonable market valuations or changes in such valuations, this is not the same as establishing prices based on costs. Similarly, a market-based standard service offer price is not the same as a deregulated price. Standard service offers remain subject to Commission jurisdiction under Chapter 4928 of the Revised Code. And, standard service offers must be consistent with state policy under Section 4928.02, Revised Code. *Elyria Foundry Co. v. Pub. Util. Comm.* (2007), 114 Ohio St. 3d 305. Thus, while a standard service offer price need not reflect the sum of specific cost components, the result must produce reasonably priced retail electric service, avoid anticompetitive subsidies flowing from noncompetitive to competitive services, be consistent with protecting consumers from market deficiencies and market power, and meet other statutory requirements.<sup>20</sup>

Running the SEET to identify the revenues, costs, net income available for common shareholders and the portion of OP's and CSP's equity capital directly assignable or allocable to the retail service provided by each EDU pursuant to the retail rate plan (making sure the SEET is applied to the retail jurisdiction subject to the Commission's jurisdiction) is required by law. Based on the evidence in this record, applying the SEET as written by the General Assembly may also help to identify and eliminate a significantly excessive burden that now rests on the backs of the retail

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<sup>20</sup> *In the Matter of the Consolidated Duke Energy Ohio, Inc. Rate Stabilization Plan Remand and Rider Adjustment Cases*, Case Nos. 03-93-EL-ATA, *et al.*, Order on Remand at 36-37 (October 24, 2007).

customers of AEP-Ohio in ways that will permit the Commission to also discharge its duties under Section 4928.02, Revised Code.

## **VI. OTHER CONSIDERATIONS**

### **A. Consideration of Capital Requirements of Future Committed Investments in Ohio**

AEP-Ohio's direct and rebuttal evidence included allegations that the very rich total company earned return for CSP should be ignored because of its capital budget forecasts. Companies Exhibit 6 at 16. However, during cross-examination, Mr. Hamrock admitted that the capital budget that AEP-Ohio referenced in its testimony was nothing more than "business as usual":

- Q. ... In any event, now is it your suggestion, Mr. Hamrock, that the information that's contained within this AEP Ohio 2010 capital budget is somehow greater than it would otherwise be, that you're investing capital sooner than you otherwise would, or that this is in some way different than business as usual?
- A. Relative to a non-SEET – I'm not sure what to compare it to.
- Q. Ah-ha, that's exactly my problem. Do you mean to suggest that AEP is doing something exceptional with its capital budget here such that the Commission, should it find excess earnings, it should discount those significantly excess earnings because of the additional capital investment or the earlier capital investment or some such thing that AEP is doing as reflected in OCC Exhibit 8 here?
- A. If anything, I would characterize it as even in view of and in light of the unique risks we face in Ohio we continue to invest substantially.
- Q. So there's really nothing unusual about this budget, this is the same sort of budgeting that you've done in the past and would continue to do in the future?
- A. That's correct.<sup>21</sup>

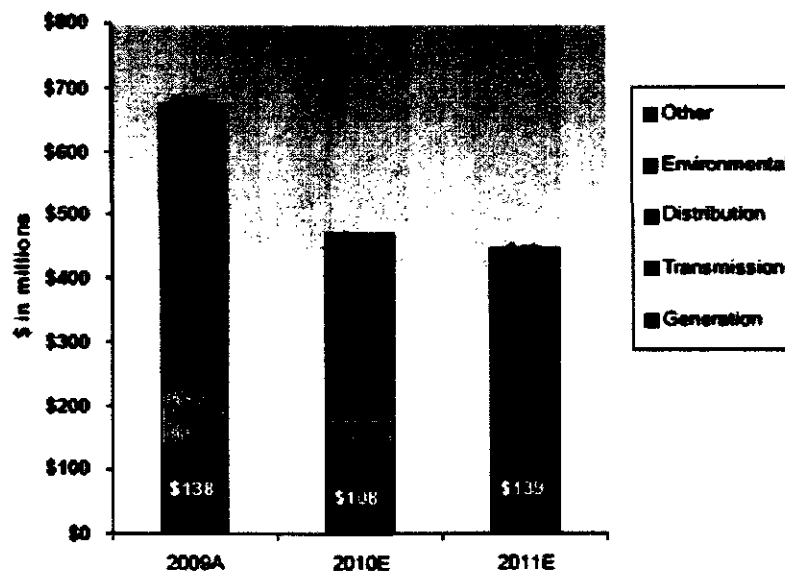
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<sup>21</sup> Tr. Vol. II at 289-290.



IEU-Ohio Exhibit 2 contains the presentation slides that AEP used during its most recent quarterly earnings call on October 19, 2010. Page 38 of this exhibit provides the actual level of capital spending for 2009 and the capital forecast of AEP-Ohio for 2010 and 2011.

### Capital Forecast



According to the information that AEP distributed to its shareholders and members of the investment community on October 19, 2010, AEP-Ohio's capital forecast shows a large year-to-year decline from 2009 to 2010 and a further, although modest, decline from 2010 to 2011. When you compare these numbers to the actual and forecasted earned return numbers for the various AEP operating companies, it is difficult to see how the friendly regulatory environment that AEP-Ohio has enjoyed in Ohio is doing anything to motivate AEP to invest AEP-Ohio's excessive profits back into Ohio.

In his rebuttal testimony, Mr. Hamrock embellished upon the capital spending point he made in his direct testimony by making references to a "confidential"

investment in a solar ("or similar") project in Cumberland, Ohio. Companies Exhibit 8 at 7. While Mr. Hamrock strained to portray this solar ("or similar") project as the real deal during his rebuttal testimony, AEP sang a different tune during its October 19, 2010 earnings call:

So you may have seen a couple weeks ago we announced a contract to take the commitment for our solar requirements, **if and only if** the solar manufacturing facility is built in Ohio, bringing in 600 jobs. That goes back to the point that was raised back here: you get a lot of upward pressures on things like renewables. **We're only going to do that inside an envelope that makes sense.** Again, if you look at the gigawatt hours that AEP Ohio sells, buying a few megawatt hours – gigawatt hours of solar is not going to move the needle a great deal.<sup>22</sup>

While Section 4928.143(F), Revised Code, requires the Commission to consider capital requirements of future committed investments in Ohio, there is nothing in the record evidence that suggests that this required consideration works to give AEP-Ohio a pass on significantly excessive earnings. If anything, the record evidence demonstrates that AEP has responded to its favorable regulatory treatment and excessive earnings in Ohio with capital investment that can best be characterized as business-as-usual.

## **B. The Role of Shopping and Other Risks**

AEP-Ohio's advocacy in this proceeding included several theories that hold that utility regulation must provide a utility with the opportunity to double-dip into the pockets of customers. For example, it sponsored a witness (Dr. Makhija) who presented a benchmark return on equity for the Commission's use and consideration in applying the SEET. Dr. Makhija very clearly testified that his analysis fully reflected and internalized all the risks within the model he employed to develop his recommended benchmark

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<sup>22</sup> IEU-Ohio Exhibit 1 at 40 (emphasis added).

return on equity.<sup>23</sup> Yet, the testimony of AEP-Ohio's other witnesses presented a parade of so-called incremental risks that they urged the Commission to use to mitigate any amount of significantly excessive earnings found by the Commission.<sup>24</sup>

In his rebuttal testimony, Mr. Hamrock challenged Mr. Kollen's views regarding shopping risk in 2009. More specifically, Mr. Hamrock testified that CSP has \$440 million in non-fuel generation revenue at risk in 2009 and that "... commercial shopping has increased significantly since that time." Companies Exhibit 8 at 8. In his discussion of shopping risk, Mr. Hamrock failed to mention the customer-funded and very expensive Provider of Last Resort ("POLR") insurance policy which the Commission gave CSP to compensate CSP for the risks of customers shopping and also the risk of customers retuning to CSP after shopping. Even though the Commission required customers to pay the very expensive POLR insurance premium, it does not appear that CSP has actually purchased any insurance.<sup>25</sup>

In any event, the statements of Mr. Hamrock during the October 19, 2010 above-described earnings call provide a very different impression than the impression created by Mr. Hamrock's testimony in this proceeding.

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<sup>23</sup> Tr. Vol. I at 116.

<sup>24</sup> Companies Exhibit 6 at 18-20; Companies Exhibit 8 at 8.

<sup>25</sup> Tr. Vol. IV at 720.

**Robert P. Powers, President, AEP Utilities**

Okay Joe, let's dig in just a little bit more on something that you alluded to in your comments and that's customer choice in Ohio, what do you see is the opportunities and the challenges of customer choice for Columbus Southern and AEP Ohio?

**Joseph Hamrock, President and Chief Operating Officer, AEP Ohio**

Sure, sure. Customers have long had choice in Ohio, since Senate Bill 3 passed nearly a decade ago. It actually passed more than a decade ago. The customers have had the opportunity for choice and up until about the midpoint of this year we saw very low switching rates in the Ohio companies, our rates have been low historically and we saw market prices that were well above the tariff rates that we presented.

Of course we all know that's changed this year. We saw low rates of switching through mid year, that started to tick up here in the last quarter or so, but still very low rates. We're at about 2% of our customers migrating away through September, just less than 5% of the load having switched at this point. And we've got projections in the next year that show some increase in that.

But one of the things that our team has done is our customers nearly always reach out to our team. Many of my colleagues have talked about the relationships that we have and customers when presented with these options and these opportunities to switch, always come to us and ask, how should I evaluate this? And we want them to do that in the most informed way possible that includes a look forward. Many of the opportunities that they see today are for prices that will lock them in for two and a half up to three years in some cases and the rates that we have in place expire at the end of next year. So we encourage them to make sure they make an informed decision that they take a look at all of the options that they have, including the tariffs that CSP and OP provide.

And so, we're proactively reaching out to customers, making sure that they're making informed decisions. We think that will help with switching that will be very rational in the near term and will allow to position more competitively in the longer term with those customers.<sup>26</sup>

AEP-Ohio has cried about risks to the Commission for purposes of the SEET while it has been assuring members of the investment community that the same risks

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<sup>26</sup> IEU-Ohio Exhibit 1 at 16.

are nonexistent or effectively managed into a non-consequential zone. If nothing else, the Commission should find that AEP-Ohio's multi-sided positioning regarding its business risk and its alternative characterizations of such risk depending on the audience work against AEP-Ohio's credibility and the weight that the Commission might otherwise assign to the evidence presented by AEP-Ohio.

## **VII. RULINGS ON ADMISSION OF EXHIBITS AND MOTIONS TO DISMISS**

Section 4901-1-15(F), Ohio Administrative Code, states:

Any party that is adversely affected by a ruling issued under rule 4901-1-14 of the Administrative Code or any oral ruling issued during a public hearing or prehearing conference and that (1) elects not to take an interlocutory appeal from the ruling or (2) files an interlocutory appeal that is not certified by the attorney examiner **may still raise the propriety of that ruling as an issue for the commission's consideration by discussing the matter as a distinct issue in its initial brief** or in any other appropriate filing prior to the issuance of the commission's opinion and order or finding and order in the case. (emphasis added).

As noted above, IEU-Ohio moved to dismiss the application filed in this proceeding without prejudice because, as demonstrated above, the application and prefiled testimony did not conform to the SEET required by Section 4928.143(F), Revised Code.<sup>27</sup> IEU-Ohio renewed this motion at the close of the evidentiary record.<sup>28</sup> Both motions were denied.<sup>29</sup> For the reasons explained above, both rulings were and are incorrect as a matter of law. Accordingly, the Commission must find that IEU-Ohio's motions to dismiss, without prejudice, should have been sustained as a matter of law.

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<sup>27</sup> Tr. Vol. I at 18-26.

<sup>28</sup> Tr. Vol. IV at 746-747.

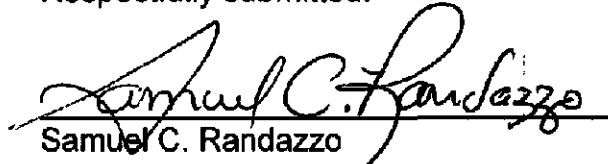
<sup>29</sup> Tr. Vol. I at 25; Tr. Vol. IV at 747.

## **VIII. CONCLUSION**

For the reasons explained herein, IEU-Ohio respectfully urges the Commission to hold that neither OP nor CSP met its burden to show that it did not experience significantly excessive earnings as a result of their individual ESPs in the first annual period. The law requires the Commission to make this finding for both OP and CSP because neither OP nor CSP offered any evidence to show their EDU earned return on equity arising from their particular ESP during the required annual period. IEU-Ohio also respectfully urges the Commission to find that it can go no further in this proceeding because the evidence does not permit the Commission to identify or resolve the quantitative issues framed by the SEET as specified by Section 4928.143(F), Revised Code.

In other words, the Commission must direct CSP and OP to start over.

Respectfully submitted.



Samuel C. Randazzo

Joseph E. Olikar

MCNEES WALLACE & NURICK LLC

21 East State Street, Suite 1700

Columbus, OH 43215-4228

Telephone: 614-469-8000

Telecopier: 614-469-4653

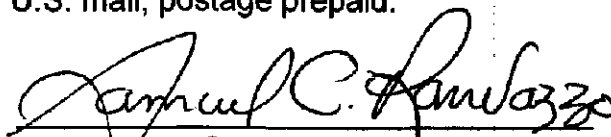
sam@mwncmh.com

joliker@mwncmh.com

**Attorneys for Industrial Energy Users-Ohio**

## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Brief of Industrial Energy Users-Ohio* was served upon the parties of record this 19<sup>th</sup> day of November 2010 via electronic transmission, hand-delivery, or ordinary U.S. mail, postage prepaid.

  
Samuel C. Randazzo

Steven T. Nourse  
Senior Counsel—Regulatory Services  
American Electric Power  
1 Riverside Plaza  
Columbus, OH 43215  
[stnourse@aep.com](mailto:stnourse@aep.com)

**ON BEHALF OF COLUMBUS SOUTHERN POWER  
COMPANY AND OHIO POWER COMPANY**

Janine L. Migden-Ostrander  
Consumers' Counsel  
Maureen R. Grady, Counsel of Record  
Melissa Yost  
Kyle Verrett  
Terry L. Etter  
Michael E. Idzkowski  
Assistant Consumers' Counsel  
Office of the Ohio Consumers' Counsel  
10 West Broad Street, Suite 1800  
Columbus, OH 43215-3485  
[grady@occ.state.oh.us](mailto:grady@occ.state.oh.us)  
[yost@occ.state.oh.us](mailto:yost@occ.state.oh.us)  
[verrett@occ.state.oh.us](mailto:verrett@occ.state.oh.us)  
[etter@occ.state.oh.us](mailto:etter@occ.state.oh.us)  
[idzkowski@occ.state.oh.us](mailto:idzkowski@occ.state.oh.us)

**ON BEHALF OF THE OFFICE OF THE OHIO  
CONSUMERS' COUNSEL**

David C. Rinebolt  
Colleen L. Mooney  
Ohio Partners for Affordable Energy  
231 West Lima Street  
Findlay, OH 45839-1793  
[Cmooney2@columbus.rr.com](mailto:Cmooney2@columbus.rr.com)  
[drinebolt@ohiopartners.org](mailto:drinebolt@ohiopartners.org)

**ON BEHALF OF OHIO PARTNERS FOR AFFORDABLE  
ENERGY**

David F. Boehm  
Michael L. Kurtz  
Boehm, Kurtz & Lowry  
36 East Seventh Street, Suite 1510  
Cincinnati, OH 45202  
[dboehm@BKLlawfirm.com](mailto:dboehm@BKLlawfirm.com)  
[mkurtz@BKLlawfirm.com](mailto:mkurtz@BKLlawfirm.com)

**ON BEHALF OF THE OHIO ENERGY GROUP**

Michael R. Smalz, Counsel of Record  
Joseph Maskovyak  
Ohio Poverty Law Center  
555 Buttles Avenue  
Columbus, OH 43215  
[msmalz@ohiopoveritylaw.org](mailto:msmalz@ohiopoveritylaw.org)  
[mjaskovyak@ohiopoveritylaw.org](mailto:mjaskovyak@ohiopoveritylaw.org)

**ON BEHALF OF THE APPALACHIAN PEACE AND  
JUSTICE NETWORK**

Richard L. Sites  
General Counsel & Senior Director of Health  
Policy  
Ohio Hospital Association  
155 East Broad Street, 15<sup>th</sup> Floor  
Columbus, OH 43215-3620  
[ricks@ohanet.org](mailto:ricks@ohanet.org)

Thomas J. O'Brien  
Bricker & Eckler LLP  
100 South Third Street  
Columbus, OH 43215-4291  
[tobrien@bricker.com](mailto:tobrien@bricker.com)

**ON BEHALF OF THE OHIO HOSPITAL ASSOCIATION**

Thomas J. O'Brien  
Bricker & Eckler LLP  
100 South Third Street  
Columbus, OH 43215-4291  
[tobrien@bricker.com](mailto:tobrien@bricker.com)

**ON BEHALF OF THE OHIO MANUFACTURERS'  
ASSOCIATION**

John W. Bentine, Counsel of Record  
Mark S. Yurick  
Matthew S. White  
Chester Willcox & Saxbe, LLP  
65 E. State St., Suite 1000  
Columbus, OH 43215  
[jbentine@cwsllaw.com](mailto:jbentine@cwsllaw.com)  
[myurick@cwsllaw.com](mailto:myurick@cwsllaw.com)  
[mwhite@cwsllaw.com](mailto:mwhite@cwsllaw.com)

**ON BEHALF OF THE KROGER CO.**

Thomas McNamee  
Sarah Parrot  
Assistant Attorneys General  
Ohio Attorney General's Office  
Chief, Public Utilities Section  
180 East Broad Street, 6th Floor  
Columbus, OH 43215  
[thomas.mcnamee@puc.state.oh.us](mailto:thomas.mcnamee@puc.state.oh.us)  
[sarah.parrot@puc.state.oh.us](mailto:sarah.parrot@puc.state.oh.us)

**ON BEHALF OF THE STAFF OF THE PUBLIC  
UTILITIES COMMISSION OF OHIO**

Greta See  
Jeff Jones  
Attorney Examiners  
Public Utilities Commission of Ohio  
180 East Broad Street, 12<sup>th</sup> Floor  
Columbus, OH 43215  
[Greta.See@puc.state.oh.us](mailto:Greta.See@puc.state.oh.us)  
[Jeff.jones@puc.state.oh.us](mailto:Jeff.jones@puc.state.oh.us)