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**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

**In the Matter of Aligning Electric)
Distribution Utility Rate Structure With)
Ohio's Public Policies to Promote) Case No. 10-3126-EL-UNC
Competition, Energy Efficiency, and)
Distributed Generation)**

**COMMENTS OF COLUMBUS SOUTHERN POWER COMPANY
AND OHIO POWER COMPANY
TO THE PUBLIC UTILITIES COMMISSION OF OHIO'S
DECEMBER 29, 2010 ENTRY**

INTRODUCTION

On December 29, 2010, the Public Utilities Commission of Ohio (Commission) issued an entry considering how or whether to modify Ohio's electric distribution utilities' rate structures to better align performance with public policy. Specifically, the Commission established a process to gather additional facts, solicit presentations from diverse viewpoints, and encourage public comment on questions of policy.

Columbus Southern Power Company and Ohio Power Company (collectively "AEP Ohio" or "Companies") appreciate the Commission's request for industry comments on this topic. As discussed in the comments, the Companies have certain concerns with a full decoupling of distribution rates under the present statutory structure enforced by the Commission. However, there are elements of decoupling, most notably a move to a Straight-Fixed-Variable (SFV) proportion that could be implemented under the present structure for distribution pricing. It should also be clear that these comments are provided with the understanding that the Commission is limiting its generic review to traditional electric distribution service and not any type of generation provided service.

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The Commission asked specific questions relating to its generic discussion for industry comments to consider. In all, the Commission included seven questions for consideration by the industry. The Commission ordered comments to be filed by February 11, 2011. The Entry stresses that the comments are intended solely for the purpose of having parties aid the Commission in determining the appropriate questions and data necessary to be considered in this review, and that it will consider additional opportunities for input later.

AEP Ohio appreciates the ability to provide its input on the issues raised for generic discussions in Ohio. AEP Ohio offers these observations in the abstract for this generic docket and states that its views or concerns could change depending on the facts and circumstances in the future. AEP Ohio offers these comments as a resource for the Commission in an attempt to provide the Commission some general input on the issues requested.

COMMISSION'S 12-29-10 QUESTIONS

Q1. Are there fundamental operational distinctions between natural gas and electric utilities that must be considered in determining whether and how to eliminate or mitigate the throughput incentive in electric distribution rates?

A1. In the context of how to eliminate or mitigate a perceived 'throughput incentive' in electric distribution rates, natural gas and electric distribution utilities are fundamentally similar. Both types of entities are primarily responsible for making substantial capital investments in largely fixed-cost assets for delivery of a public-need commodity under a regulatory compact. In addition, both types of entities have traditionally recovered a large portion of fixed-costs with a volumetric charge for certain customer classes, in

particular, residential and small commercial. This was historically due to the lack of cost-effective demand metering. This misalignment of the recovery of fixed costs with a volumetric energy charge is the fundamental problem that causes the perceived 'throughput incentive.'

In order to address this issue, the Commission has within the past three years considered and adopted a modified Straight-Fixed-Variable (SFV) rate design for all four major natural gas utilities in Ohio. *See e.g., In re Duke Energy Ohio*, Case No. 07-589-GA-AIR, Opinion and Order (May 28, 2008) ("*Duke Case*"); *In re Dominion East Ohio*, Case No. 07-829-GA-AIR, Opinion and Order (October 15, 2008) ("*DEO Case*"). The Commission is now considering options to address this issue with electric distribution companies. As the fundamental issue is the same, the Commission should consider applying a similar SFV approach to remedy it.

In addition, the embracing of energy efficiency (EE) efforts was cited as a major motivating factor for adopting a modified SFV rate design. While this approach does eliminate the perceived throughput disincentive inherent with the successful implementation of EE programs, it does not guarantee recovery of EE program costs or provide for an investment incentive. In other words, simply having a mechanism, such as SFV rate design, in place does not "open the flood gates" for significant increases in EE program spending without assured cost recovery and an appropriate incentive structure.

In both the *Duke* and *DEO* cases, the Commission also noted the pre-existing subsidy of residential customers by commercial/industrial customers with respect to the costs of natural gas distribution. The Commission found that a modified SFV rate design would help cure this cost disparity by providing a more equitable cost recovery

mechanism for customers regardless of usage. Implementing a SFV rate design based upon the electric distribution utility's actual cost could likewise address this issue.

For the Companies, and particularly for non-demand metered customers, distribution costs have been recovered through a minimal customer charge and mostly through variable charges. Movement to a SFV rate design not only eliminates any perceived 'throughput incentive,' but is consistent with cost causation of electric distribution investment.

In addition to the above and as further discussed in response to Question No. 6 below, there are different legal limitations on the Commission's ability to implement full distribution revenue decoupling for electric utilities (as compared to gas utilities who are subject to alternative regulation under R.C. Chapter 4929).

Q2. Are there factual or policy considerations that suggest electric distribution rate design should be constructed differently from natural gas?

A2. Generically, there are few factual or policy considerations that suggest electric distribution rate design should be essentially different from natural gas distribution rate design. Under traditional natural gas distribution rate design, a utility's ability to recover its fixed distribution costs depended largely on the level of gas sales. *See e.g., Duke Case and DEO Case* cited above. In these cases, the Commission determined that the SFV rate design decoupled the utility's recovery of the costs of delivering gas from the amount of gas customers actually use, and that ratepayers benefited by reducing the companies' incentive to sell more gas. The Commission further determined that the SFV rate design not only removed the disincentive to promote energy conservation and efficiency, but produced more stable customer bills by spreading the recovery of fixed distribution costs

more evenly through all seasons. *See e.g. Ohio Consumers' Counsel et al. v. Public Utilities Commission of Ohio et. al.* (2010) 125 Ohio St. 3d 57. According to the Commission, a SFV distribution rate design was aligned with the public policy goals outlined in R.C. 4929.02. Ultimately, a move toward including a greater proportion of electric distribution costs in a fixed customer charge and/or demand charge with an offsetting smaller proportion represented in volumetric charges would help to better align recovery of distribution costs with electric distribution cost causation.

Further, state policy enumerated in R.C. 4928.02 is similar to state policy enumerated in R.C. 4929.02. Both sections of the revised code encourage the availability of options for the consumers and promote energy efficiency. Accordingly, if a SFV rate design in the natural gas industry was found to further the stated policy in 4929.02, it follows then, given that enumerated state policy is similar for the two industries, a SFV distribution rate design in the electric industry would also promote the policy stated in 4928.02.

Q3. If the Commission adopts a decoupling rate design, which rate design should it use: SFV, decoupling adjustment, lost revenue recovery adjustment, or some combination of these?

A3. First, it is prudent to point out that the effectiveness of distribution decoupling depends on the form of decoupling used and the present and future circumstances of the particular utility. Major factors can affect financial performance: the level and trend of fixed costs, load projections, weather patterns, load growth, economic development, competitive aspects of the business, financial risk projections, utility cost controls and regional and/or national economic conditions. The starting point or current distribution

revenue stability of a utility also affects the evaluation of effectiveness. A utility may already employ mechanisms that help promote distribution revenue stability, such as customer charges, demand charges, demand ratchet provisions, declining block rates and formula rates. In fact, the Companies already do employ all of these mechanisms. In short, there is no simple or accurate way to generalize the cost-effectiveness of distribution decoupling.

The Companies recommend that should the Commission have an interest in addressing the perceived 'throughput incentive,' a logical first step is to address the volumetric recovery of fixed distribution costs. Currently, for a residential customer using 1,000 kWhs per month, the fixed distribution customer charge represents only about 9%, on average, of the customer's total distribution charges, meaning that the vast majority of the Companies' fixed distribution costs are recovered through volumetric energy charges. This issue is most directly remedied by correcting rate designs so that a greater proportion of fixed distribution costs are represented in fixed customer and/or demand charges with an offsetting smaller proportion represented in the volumetric charges. While SFV rate designs are the ultimate extension of this concept, pragmatically the full implementation is difficult due to the potential bill impacts for particular customers. By moving incrementally toward a greater share of fixed distribution costs recovered through customer and/or demand charges, the Commission could begin to move in the direction of aligning fixed distribution costs with fixed charges and variable distribution costs with variable charges, thus directly addressing the underlying problem. This approach is consistent with cost causation principles and will weaken the link between revenues and sales volume, expressly what the Commission is

interested in accomplishing for electric distribution. Moreover, customers will still have appropriate and sufficient price signals from volumetric charges, particularly generation energy charges, to encourage energy efficiency (i.e., a reduction in usage could still materially reduce bills).

Under this approach, there would remain a portion of fixed distribution charges that would not be collected from customers that implement utility-sponsored energy efficiency programs. Therefore, this approach would need to be coupled with the continued use of a lost distribution revenue recovery mechanism. This mechanism allows for targeted recovery of only those distribution lost revenues directly attributable to the implementation of energy efficiency and demand response (EE/DR) programs, and allows the Companies the opportunity to recover their Commission-approved retail distribution revenue requirement and not be unfairly penalized for implementing the policy goals of the State. In other words, it allows for recovery of the lost contribution to fixed distribution costs inherent in the successful implementation of EE/DR programs. In addition, with a lesser proportion of fixed distribution costs recovered through volumetric charges, net lost distribution revenues, while still necessary, would be reduced.

Further, any other type of decoupling adjustment will create notable unintended consequences. Most significantly, utilization of a decoupling adjustment fundamentally fails to distinguish increases or decreases in revenues attributed to utility-sponsored EE/DR programs from variables having nothing to do with such policy objectives, such as weather vacillations and economic swings. Additionally, it fails to address the underlying cause of the original problem (i.e., existing recovery of fixed distribution

costs through volumetric charges). Moreover, it introduces yet another artificial adjustment, further distorting the proper direct economic alignment of costs with charges.

Q4. If the Commission adopts a decoupling rate design in electric distribution rates:

(a) Should that rate design be applied only to residential rate classes? What other rate classes should be considered?

(b) How often should the Commission require the utility to update its distribution revenue requirement?

(c) Should the company's return on equity be reduced to reflect a reduced risk to the company?

A4. If the Commission adopts a decoupling rate design in electric distribution rates:

(a) The rate design should be applied to residential rate schedules and non-demand metered commercial rate schedules, excluding non-metered lighting and other non-metered accounts, such as traffic signals. For demand-metered commercial and industrial rate schedules, a SFV distribution rate design is generally accepted as the industry standard.

(b) The utility's distribution revenue requirement could be updated no later than every three years, but the utility should not be precluded from updating its distribution revenue requirement on an annual basis if necessary.

(c) A utility's return on equity (ROE) should not be negatively impacted by such a ruling. Any determination regarding the ROE of utilities needs to consider the topic holistically. Further, any simplistic conclusion that a distribution decoupling mechanism automatically reduces risk to the Companies ignores the reciprocal nature of decoupling

adjustments. Lastly, this line of reasoning discounts the additional negative implications to the Companies that may occur during times of load growth under a distribution decoupling adjustment mechanism other than SFV rate design.

Determination of a Company's ROE is a fundamental consideration of regulatory oversight, and is comprised of numerous factors that must be carefully balanced. A company's return on equity must be commensurate with the return on investments in other enterprises with similar risk and sufficient to assure confidence in the ongoing financial integrity of a firm to maintain access to capital. The existence of a decoupling mechanism alone cannot be used as the basis to reduce a utility's return on equity. As the Commission pointed out in its Opinion and Order in Case No. 10-1261-EL-UNC at pages 25 and 26, the Companies, specifically Columbus Southern Power (CSP), face various business and financial risks. Therefore, a more comprehensive analysis is required taking all risk factors into account.

Distribution decoupling mechanisms other than SFV rate design must be designed to be reciprocal. In essence, the utility is permitted to recover its approved revenue requirement regardless of fluctuations in sales levels. This results in either a credit to customers if actual sales exceeded the approved revenue requirement or a surcharge to customers if actual sales fell below the approved revenue requirement. The utility is protected from sales deficiencies, but no longer can retain sales that exceed their revenue requirement. Any reasoning that a given utility's risk had been reduced due to a decoupling mechanism, based solely on attainment of the utility's revenue requirement, would be narrow and flawed.

Additionally, there are potential negative implications for utilities that may occur during times of load growth under a decoupling adjustment mechanism other than SFV rate design. For instance, the utility is giving up the ability to retain earnings that exceed their approved revenue requirement. These "upside" earnings provide needed support for, among other things, capital expenditures. As demand grows, there is a concurrent need to fund additional investment. These funds are provided through the natural growth of revenues in traditional ratemaking, but given up under most decoupling mechanisms. Specifically for the Companies, the natural growth of revenues would provide cash for capital expenditures to meet their obligations.

Q5. If the Commission adopts some element of a decoupling rate design:

- (a) Should adjustments be made on a total revenue, per customer revenue, or some other basis?**
- (b) Should adjustments be normalized for weather?**
- (c) Should the Commission adopt any special features to shield consumers from volatile adjustments (e.g., caps, collars, bands)?**

A5. If the Commission adopts some element of a decoupling rate design:

(a) Should the Commission adopt something other than SFV rate design, then adjustments should be made on a distribution revenue per customer class or per rate schedule basis. This would allow some flexibility for the mechanism to account for customer growth.

(b) Should the Commission adopt something other than SFV rate design, then weather-normalized adjustments to distribution revenues should not be performed. The

main reason for this is that weather-normalizing methods can be complicated and subject to scrutiny since there is no universally accepted methodology.

(c) Should the Commission adopt something other than SFV rate design for distribution, then no special features, such as caps, collars or bands, to shield customers from volatile adjustments should be employed. Decoupling adjustments should work both ways, providing both refunds and surcharges to customers. The use of caps, collars or bands creates deferrals of regulatory assets with undetermined recovery periods, exacerbating regulatory lag.

Further, in both the *Duke Case* (07-589-GA-AIR at p. 19) and the *DEO Case* (07-829-GA-AIR at p. 26), the Commission noted that crucial to their decision to implement a SFV rate design was the implementation of a low income/low use program aimed at helping those customers pay their bills. As the Companies already have in place such a program, the Commission need not go further by ordering caps, collars or bands. In addition, phasing-in the new SFV distribution rate design would also help shield consumers from initial volatile adjustments.

Q6. If the Commission determines that a decoupling rate design should be implemented to eliminate or mitigate the throughput incentive in electric distribution rates:

(a) When should this change occur (i.e., in what types of actions before the Commission should this change be implemented)?

(b) Should it be phased in?

(c) Over what period of time?

A6. If the Commission determines that a decoupling rate design should be implemented to eliminate or mitigate the throughput incentive in electric distribution rates:

(a) A logical time to consider and implement a SFV rate design would be during an electric utility's distribution rate case. This allows for consideration of the current levels of fixed and variable costs to be reflected in the respective elements of the distribution rates. In both the *Duke* and *DEO Cases*, the modified SFV rate design was ultimately implemented as part of the respective utilities' distribution rate cases. The Commission noted that modifications to rate designs may also be proposed as part of a utility's Electric Security Plan (ESP). In addition, R.C. 4928.66(D) provides for a statutory mechanism for electric utilities to submit applications for Commission approval of a distribution revenue decoupling mechanism related to implementing energy efficiency programs. As noted above in response to Question No. 1, there are legal limitations to the Commission's implementation of full distribution revenue decoupling for electric utilities. Full distribution revenue decoupling typically involves an annual retrospective true-up rate adjustment, which is a departure from the prospective test period ratemaking methodology embodied in R.C. Chapter 4909 and arguably constitutes unlawful retroactive ratemaking. Consequently, absent legislation enabling the Commission to implement full distribution revenue decoupling in the context of a traditional distribution rate case, the Commission can only entertain components of distribution revenue decoupling that fit within the rubric of distribution rate design – such as SFV.

(b) A phase-in period would be appropriate if moving toward a SFV type of distribution rate design to allow customers time to adjust. The Commission, pursuant to R.C. 4928.144, has the authority to phase in electric distribution rates. In both *Duke's* and *DEO's* rate cases, the Commission chose to phase in new rates as a way to lessen the impact on customers, particularly low income/usage customers.

(c) DEO's rates were phased in over a period of two years and Duke's were phased in over a three-year period. A similar phase-in period would reasonably be warranted in a move to SFV distribution rates in the electric sector. However, if the Commission moves to only modestly increase fixed customer charges, as the Companies have suggested, then a phase-in period may not be needed.

Q7. In order to review the various decoupling rate designs, the Commission will need necessary data such as that included in Appendix B. Is the data contained in Appendix B: (a) Burdensome? (b) Appropriate? (c) A comprehensive list of the necessary data? (d) Proprietary?

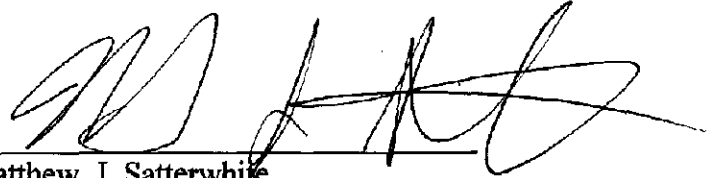
A7. The Companies would not identify the enumerated data on Appendix B as confidential or proprietary information per se. The data enumerated is similar to the data that is typically provided to the Commission in a distribution rate case. It is possible that in some circumstances some of the data could be considered confidential or will be the subject of a protective order in a particular case. But for purposes of a generic question like the one asked by the Commission, it appears that the data listed is generally not considered confidential.

In addition, whether the requested information is a comprehensive list of necessary data would appear to be a determination that is better left to the Commission.

The Companies assume that it would be appropriate to use the information available in the most recent distribution rate case for any cost component information.

CONCLUSION

Columbus Southern Power Company and Ohio Power Company respectfully offers the preceding comments to assist the Commission in its review of the issues raised in the December 29, 2010 Entry.

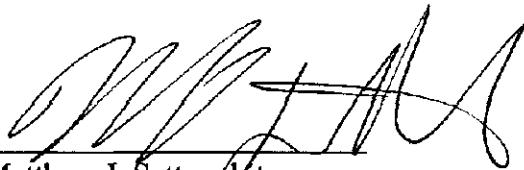


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On Behalf of Ohio Power Company and
Columbus Southern Power Company

CERTIFICATE OF SERVICE

I certify that Columbus Southern Power Company's and Ohio Power Company's foregoing **Comments of Columbus Southern Power Company and Ohio Power Company to the Public Utilities Commission of Ohio's December 29, 2010 Entry** was served by First-Class U.S. Mail upon counsel for all parties of record identified below this 11th day of February, 2011.



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