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IN THE SUPREME COURT OF OHIO

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The Ohio Energy Group	:	Case No. 11-0751
Appellants,	:	
v.	:	
	:	Appeal from the Public
Public Utilities Commission of Ohio	:	Utilities Commission Of Ohio
	:	
Appellee.	:	**Public Utilities Commission of Ohio**
	:	**Case No. 10-1261-EL-UNC**

NOTICE OF APPEAL OF APPELLANTS, THE OHIO ENERGY GROUP

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NOTICE OF APPEAL OF APPELLANTS, THE OHIO ENERGY GROUP

Appellant, the Ohio Energy Group ("OEG"), a party of record in the above-styled proceedings, hereby gives notice of its appeal, pursuant to R.C. 4903.11 and 4903.13 and Supreme Court Rule of Practice 2, Section 3(B), to the Supreme Court of Ohio and Appellee, from an Opinion and Order entered January 11, 2011 (Exhibit A), Finding and Order entered January 27, 2011 (Exhibit B), and an Entry of Rehearing entered March 9, 2011 (Exhibit C) of Appellee, Public Utilities Commission of Ohio ("PUCO" or "Commission") in PUCO Case No. 10-1261-EL-UNC.

Appellant was and is a party of record in PUCO Case No. 10-1261-EL-UNC, and timely filed its Application for Rehearing of the Appellee's January 11, 2011 Opinion and Order in accordance with R.C. 4903.10. Appellant's Application for Rehearing was denied, with respect to the issues on appeal herein, by Entry of March 9, 2011.

The Appellant complains and alleges that the Appellee's January 11, 2011 Opinion and Order, January 27, 2011 Finding and Order, and the Commission's March 9, 2011 Entry on Rehearing in PUCO Case No. 10-1261-EL-UNC are unlawful, unjust and unreasonable in the following respects, as set forth in Appellant's Application for Rehearing.

1. The PUCO erred by unlawfully excluding the profits from off-system sales from the earned return of Columbus Southern Power Company. The exclusion of these profits results in a biased comparison between Columbus Southern Power Company and publicly traded companies that face comparable business and financial risk, and thus is contrary to R.C. 4928.143(F), thereby denying customers part of the refund they should have received from Columbus Southern.

WHEREFORE, Appellant respectfully submits that Appellee's January 11, 2011 Opinion and Order, Appellee's January 27, 2011 Finding and Order, and Appellee's March 9, 2011 Entry on Rehearing in Case No. 10-1261-EL-UNC are unlawful, unjust and unreasonable and should be reversed. This case should be remanded to Appellee with instructions to correct the errors complained of herein.

Respectfully submitted,

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May 5, 2011

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Notice of Appeal of the Ohio Energy Group was served upon the Chairman of the Public Utilities Commission of Ohio by leaving a copy at the office of the Chairman in Columbus and upon all parties of record by overnight mail (unless otherwise noted) this 5th day of May, 2011.

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CERTIFICATE OF FILING

I certify that this Notice of Appeal has been filed with the docketing division of the Public Utilities Commission of Ohio in accordance with sections 4901-1-02(A) and 4901-1-36 of the Ohio Administrative Code.

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THE OHIO ENERGY GROUP

EXHIBIT A

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	))))))))	Case No. 10-1261-EL-UNC

OPINION AND ORDER

The Commission, considering the application, the evidence of record, the applicable law, and being otherwise fully advised, hereby issues its Opinion and Order.

APPEARANCES:

Steven T. Nourse, American Electric Power Service Corporation, One Riverside Plaza, Columbus, Ohio 43215, and Porter, Wright, Morris & Arthur, by Daniel R. Conway, 41 South High Street, Columbus, Ohio 43215, on behalf of Columbus Southern Power Company and Ohio Power Company.

Mike DeWine, Attorney General of the State of Ohio, by William Wright, Section Chief, and Thomas W. McNamee, Assistant Attorney General, 180 East Broad Street, Columbus, Ohio 43215, on behalf of the Staff of the Public Utilities Commission of Ohio.

Janine L. Migden-Ostrander, the Office of the Ohio Consumers' Counsel, by Maureen R. Grady, Melissa Yost, and Kyle Lynn Verrett, Assistant Consumers' Counsels, 10 West Broad Street, Columbus, Ohio 43215-3485, on behalf of the residential utility consumers of Columbus Southern Power Company and Ohio Power Company.

Boehm, Kurtz & Lowry, by Michael L. Kurtz, 36 East Seventh Street, Suite 1510, Cincinnati, Ohio 45202, on behalf of Ohio Energy Group.

Michael R. Smalz and Joseph M. Maskovyak, Ohio Poverty Law Center, 555 Buttles Avenue, Columbus, Ohio 43215, on behalf of the Appalachian Peace and Justice Network.

McNees, Wallace & Nurick, LLC, by Samuel C. Randazzo and Joseph Oliker, 21 East State Street, 17th Floor, Columbus, Ohio 43215-4228, on behalf of Industrial Energy Users-Ohio.

David C. Rinebolt and Colleen L. Mooney, Counsel, 231 West Lima Street, P.O. Box 1793, Findlay, Ohio 45839-1793, on behalf of Ohio Partners for Affordable Energy.

Bricker & Eckler, Thomas J. O'Brien, 100 South Third Street, Columbus, Ohio 43215 and Richard L. Sites, 155 East Broad Street, 15th Floor, Columbus, Ohio 43215-3620, on behalf of Ohio Hospital Association.

Bricker & Eckler, Thomas J. O'Brien, 100 South Third Street, Columbus, Ohio 43215, on behalf of Ohio Manufacturers' Association.

BACKGROUND:

I. Significantly Excessive Earnings Test Background

On May 1, 2008, the governor signed into law Amended Substitute Senate Bill No. 221 (SB 221), amending various statutes in Title 49 of the Ohio Revised Code. Among the statutory amendments were changes to Section 4928.14, Revised Code, to establish a standard service offer (SSO). Pursuant to the amended language of Section 4928.14, Revised Code, electric utilities are required to provide consumers with a SSO, consisting of either a market-rate offer (MRO) or an electric security plan (ESP). Sections 4928.142(D)(4), 4928.143(E), and 4928.143(F), Revised Code, direct the Commission to evaluate the earnings of each electric utility's approved ESP or MRO to determine whether the plan or offer produces significantly excessive earnings for the electric utility.

After considering the arguments raised in the ESP and/or MRO proceedings of the electric utilities, the Commission concluded that initially the methodology for determining whether an electric utility has significantly excessive earnings as a result of an approved ESP or MRO should be examined within the framework of a workshop.[1] The Commission directed Staff to conduct a workshop to allow interested stakeholders to present concerns and to discuss and clarify issues raised by Staff. Accordingly, Case No. 09-786-EL-UNC, *In the Matter of the Investigation into the Development of the Significantly Excessive Earnings Test Pursuant to Amended Substitute Senate Bill 221 for Electric Utilities* (09-786) was opened. The workshop was held on October 5, 2009. Staff filed its recommendations in 09-786 on November 18, 2009.

In 09-786, by Finding and Order issued on June 30, 2010, as amended and clarified in accordance with the entry on rehearing issued August 25, 2010, the Commission

1 *In re Ohio Edison Company, The Cleveland Electric Illuminating Company, and the Toledo Edison Company*, Case No. 08-935-EL-SSO, Opinion and Order at 64 (December 19, 2008) (FirstEnergy ESP case); and *In re Columbus Southern Power Company and Ohio Power Company*, Case No. 08-917-EL-SSO, et al., Opinion and Order at 68 (March 18, 2009) (AEP-Ohio ESP cases).

provided guidance on the interpretation and application of Sections 4928.142(D)(4), 4928.143(E), and 4928.143(F), Revised Code.

On April 16, 2010, in 09-786 and in Case No. 10-517-EL-WVR, Columbus Southern Power Company (CSP) and Ohio Power Company(OP) (jointly AEP-Ohio or Companies) filed an application for a limited waiver of Rule 4901:1-35-10, Ohio Administrative Code (O.A.C.), to the extent that the rule requires the electric utility to file their SEET information by May 15, 2010.[2] By entry issued May 5, 2010, the Commission granted AEP-Ohio's request for an extension and directed AEP-Ohio to make its SEET filing by July 15, 2010. The due date for Companies to file their SEET information was further extended to September 1, 2010, pursuant to entry issued July 14, 2010, in 09-786.

On September 1, 2010, AEP-Ohio filed an application in Case No. 10-1261-EL-UNC, for the administration of the SEET, as required by Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C. By entry issued September 21, 2010, as amended on October 8, 2010, a procedural schedule was established for this proceeding. Pursuant to the procedural schedule, motions to intervene were due by October 8, 2010.

Motions to intervene were filed by, and intervention granted to, the following entities: the Office of the Ohio Consumers' Counsel (OCC), Industrial Energy Users-Ohio (IEU-Ohio), Ohio Partners for Affordable Energy (OPAE), Ohio Energy Group (OEG), Appalachian Peace and Justice Network (APJN), Ohio Manufacturers Association (OMA) and Ohio Hospital Association (OHA).

The hearing commenced, as scheduled, on October 25, 2010, and concluded on November 1, 2010, including rebuttal testimony offered by AEP-Ohio. At the hearing, AEP-Ohio presented the direct testimony of three witnesses: Thomas E. Mitchell (Cos. Ex. 4), Dr. Anil K. Makhija (Cos. Ex. 5), Joseph Hamrock (Cos. Ex. 6) and on rebuttal presented the testimony of Dr. Makhija (Cos. Ex.7) and Mr. Hamrock (Cos. Ex. 8). OCC, OMA, OHA, APJN and OEG (jointly Customer Parties) presented the testimony of Dr. J. Randall Woolridge (Joint Inv. Exs. 1 and 1-A) and Lane Kollen (Joint Inv. Ex. 2). The Staff offered the testimony of Richard Cahaan (Staff Ex. 1). Initial briefs and reply briefs were filed by AEP-Ohio, Staff, Customer Parties,[3] IEU-Ohio, and OPAE.

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2 By May 15 of each year, the electric utility shall make a separate filing with the commission demonstrating whether or not any rate adjustments authorized by the commission as part of the electric utility's electric security plan resulted in significantly excessive earnings during the review period as measured by division (F) of Section 4928.143, Revised Code. The process and timeframes for that proceeding shall be set by order of the commission, the legal director, or attorney examiner. The electric utility's filing shall include the information set forth in paragraph (C) of Rule 4901:1-35-03, O.A.C., as it relates to excessive earnings.

3 The reply brief filed by Customer Parties did not include OMA or OHA as a party to the brief. Only OCC, APJN, and OEG are listed as parties to the reply brief.

On November 30, 2010, AEP-Ohio, Staff, OHA, OMA, The Kroger Company (Kroger), and Ormet Primary Aluminum Corporation (Ormet) filed a Joint Stipulation and Recommendation (Stipulation) in this case and in Case Nos. 09-872-EL-FAC and 09-873-EL-FAC, *In the Matter of the Review of the Fuel Adjustment Clauses of Columbus Southern Power Company and Ohio Power Company*, (Fuel Adjustment Clause (FAC) or FAC cases).[4] The Stipulation included a proposed procedural schedule for the consideration of the Stipulation. Further, as part of the Stipulation, AEP-Ohio agreed to withdraw its opposition to Kroger's request to intervene and, pursuant to the entry issued December 1, 2010, Kroger was granted limited intervention to participate in the SEET case. On December 16, 2010, AEP-Ohio filed a notice of withdrawal of the Stipulation. The Companies' withdrawal, as any party to a Stipulation may, dissolves, terminates and voids the Stipulation. Nonetheless, in its notice of withdrawal, AEP-Ohio unilaterally and voluntarily agreed to fulfill its obligations in the Stipulation to: (1) contribute $1 million of shareholder funds for OMA to be used to assist its members with programs and initiatives designed to bring energy-related benefits to Ohio manufacturers; (2) contribute $1 million of shareholder funds for OHA to be used to assist its members with programs and initiatives designed to bring energy-related benefits to hospitals as those institutions continue to serve their communities; and (3) promote the accelerated deployment and use of new energy efficiency technologies by contributing $100,000 of shareholder funds towards Kroger's energy efficiency projects that may not otherwise be eligible for recovery under a reasonable arrangement or pass the total resource cost test as defined in Rule 4901:1-39-01, O.A.C. AEP-Ohio stated that there would be no deadline or time limitation to deploy Kroger's projects and that the contribution would not expire, but may be used by Kroger on acceptable energy efficiency projects until the contribution amount is exhausted. Kroger is required to commit its energy usage reductions resulting from energy efficiency projects funded by AEP-Ohio's $100,000 contribution to AEP-Ohio so that AEP-Ohio may meet its energy efficiency requirements under Section 4928.66, Revised Code. Further, in the notice of withdrawal, CSP agreed, as part of its upcoming ESP filing to propose and work with the Staff to develop a Phase II pilot program for AEP-Ohio's gridSMART program beyond the current footprint of Phase I, which will include dynamic pricing options.

<u>APPLICABLE LAW:</u>

Section 4928.143(F), Revised Code, provides, in relevant part:

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[4] On May 14, 2010, in Case Nos. 09-872-EL-FAC and 09-873-EL-FAC, AEP-Ohio filed its 2009 report of the management/performance and financial audits of its FAC (FAC cases). Motions to intervene in the FAC cases were timely filed by, and intervention granted to the following entities: OCC, IEU-Ohio, and Ormet. The hearing in the FAC cases commenced, as scheduled, on August 23, 2010, and concluded on August 24, 2010. Briefs and reply briefs were filed on September 23, 2010, and October 15, 2010, respectively.

(F) 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 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 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.

Further, Rule 4901:1-35-03(C)(10)(a), O.A.C., as effective May 7, 2009, provides:

For the annual review pursuant to division (F) of section 4928.143 of the Revised Code, the electric utility shall provide testimony and analysis demonstrating the return on equity that was earned during the year and the returns on equity earned during the same period by publicly traded companies that face comparable business and financial risks as the electric utility. In addition, the electric utility shall provide the following information:

(i) The federal energy regulatory commission form 1 (FERC form 1) in its entirety for the annual period under review. The electric utility may seek protection of any confidential or proprietary data if necessary. If the FERC form 1 is not available, the electric utility shall provide balance sheet and income statement information of at least the level of detail as required by FERC form 1.

(ii) The latest securities and exchange commission form 10-K in its entirety. The electric utility may seek protection of any confidential or proprietary data if necessary.

(iii) Capital budget requirements for future committed investments in Ohio for each annual period remaining in the ESP.

I. PROCEDURAL ISSUES:

A. AEP-Ohio's void-for-vagueness constitutionality argument

Section 4928.143(F), Revised Code, is void and unenforceable, AEP-Ohio claims, because it is impermissibly vague and fails to provide CSP and OP with fair notice, or the Commission with meaningful standards, as to what is meant by "significantly excessive earnings." According to AEP-Ohio, the void-for-vagueness doctrine has two primary goals. The first is to ensure "fair notice" to those subject to the law and the second is to provide standards to guide those charged with enforcing the law. Citing to *Columbia Natural Resources, Inc. v. Tatum*, 58 F.3d 1101, 1105 (6th Cir. 1995), AEP-Ohio asserts that the Supreme Court has provided greater specificity related to the two primary goals. The Companies acknowledge that the vagueness doctrine arises most often in the context of criminal laws that implicate First Amendment values. However, the Companies argue that laws that impose criminal penalties or sanctions or that reach a substantial level of constitutionally protected conduct must satisfy a "higher level of definiteness." *Belle Maer Harbor v. Charter Township of Harrison*, 170 F.3d 553, 557 (6th Cir. 1999). The Ohio Supreme Court applied this heightened standard of scrutiny, claims AEP-Ohio, in *Norwood v. Horney*, 110 Ohio St.3d 353, 2006-Ohio-379; a case involving a municipal ordinance that allowed a taking of property by eminent domain even though the statute carried no penalties or sanctions.

Similar to the *Norwood* case cited above, AEP-Ohio claims that Section 4928.143(F), Revised Code, results in a taking of private property rights as the Companies are being required to forfeit earnings lawfully gained through the efficient use of their own property so that those earnings can be redistributed to its customers, even though the customers indisputably paid a just and reasonable rate for the service they received. According to the Companies, Section 4928.143(F), Revised Code, fails to give any definitive notice or guidance as to what is meant by "significantly excessive earnings." For example, AEP-Ohio states that there are no definitions, standards or guidance in the statute providing the electric utility fair notice of the risk of forfeiture or giving the Commission adequate standards to appropriately judge the result as is evident by the parties' starkly conflicting positions in this case. Further, AEP-Ohio asserts, the parties have no common understanding of what level of earnings should be deemed "significantly excessive," whether off-system sales should be included in the net earnings used to calculate the return on equity, how write-offs and deferrals should be treated, how to identify companies that face "comparable business and financial risk" or what is meant by the reference to "adjustments in the aggregate."

According to AEP-Ohio, the vagueness of Section 4928.143(F), Revised Code, is further compounded because the statute applies in a retrospective manner, requiring an electric utility to forfeit earnings from a prior year; because it is the electric utility's burden to prove its earnings in the prior year were not significantly excessive; and because the statute penalizes an electric utility for excess earnings in the prior year but does not insulate the electric utility from prior year earnings that fall significantly below what was earned in the same period by companies with comparable business and financial risk. Given the asymmetric consequences leveled by a determination of significantly excessive earnings, and the burden on the electric utility to prove that its earnings were not significantly excessive, the General Assembly, AEP-Ohio argues, failed to meet its heightened constitutional duty in this instance to assure that an electric utility had fair notice in advance of how its earnings would be measured and to assure that the Commission had clear direction on how the test was to be administered.

AEP-Ohio also argues that the Commission had the opportunity to cure, or at least ameliorate, the effects of the statute's vagueness but that the Commission failed to do so. The Companies claim that it pointed out the uncertainty associated with the SEET in its ESP case, and the Commission initially recognized the importance of giving AEP-Ohio the requested clarification at least with respect to OSS and deferrals. However, the Companies aver, the Commission inexplicably reversed itself even as to those two issues on rehearing.[5] Additionally, the workshop proceeding in 09-786, which was intended to bring clarity to the statute, did not conclude until August 25, 2010, and even then several critical uncertainties remained. AEP-Ohio concludes that, because the SEET offers virtually no guidance as to its proper application and because the Commission failed to cure the uncertainties involved, Section 4928.143(F), Revised Code, is unconstitutionally vague and the Commission's only recourse now to ameliorate the consequences of the statute's constitutional infirmity is to adopt the position advanced by the Companies' witnesses which assures that AEP-Ohio will not be wrongfully deprived of its property.

On reply, Customer Parties (members include OCC, APJN, and OEG) and OPAE argue that constitutional issues are not within the jurisdiction of the Commission and the void-for-vagueness doctrine is inapplicable to Section 4928.143(F), Revised Code.

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5 AEP-Ohio ESP, Entry on Rehearing at 45-49 (July 23, 2009).

Referring to *East Ohio Gas Co. v. Pub. Util. Comm.* (1940), 137 Ohio St. 225, 238-239, 28 N.E.2d 599, Customer Parties claim that the Ohio Supreme Court has long held that it is the duty of the Commission to assume the constitutionality of a statute and further that the "constitutionality of statutes is a question for the courts and not for a board or commission." Similarly, in *Consumers' Counsel v. Pub. Util. Comm.* (1994), 70 Ohio St.3d 244, 247, 638 N.E.2d 550, the Ohio Supreme Court stated that "an administrative agency such as the commission may not pass upon the constitutionality of a statute." Citing to *Monongahela Power Co. v. Schriber* (S.D. Ohio 2004), 322 F. Supp.2d 902, 911, Customer Parties assert that the Commission has also acknowledged its lack of authority to determine constitutional issues. In short, therefore, Customer Parties and OPAE submit that the Commission must presume the constitutionality of Section 4928.143(F), Revised Code, and any challenges to the constitutionality of that statute must be decided by the Ohio Supreme Court on appeal.

In arguing that the Companies void-for-vagueness argument is misplaced, improperly applied, and inapplicable to Section 4928.143(F), Revised Code, Customer Parties assert that, as acknowledged by AEP-Ohio, the vagueness doctrine is rarely ever applicable to statutes other than criminal laws. Moreover, Customer Parties argue, the case law that the Companies rely on and discuss in great length on brief is simply not relevant to the Commission's consideration of the SEET as established by Section 4928.143(F), Revised Code. In fact, it is significant, Customer Parties note, that AEP-Ohio failed to cite any public utility cases where a statute had been challenged on vagueness grounds. This is easily explained, according to Customer Parties, because the vagueness doctrine is a constitutional law concept that was created to protect individuals from statutes that are too vague for the average citizen to understand in the criminal realm. *Connally v. General Construction Co.* (1926), 269 U.S. 385. Customer Parties submit that there is little question that the vagueness doctrine was not intended to apply to a statute like Section 4928.143(F), Revised Code and that it was never intended to protect utilities from returning significantly excessive earnings to ratepayers.

Customer Parties also disagree with AEP-Ohio's position that the statute is so vague that it provides no standard at all. To support this contention, Customer Parties point out that AEP-Ohio's witnesses garnered sufficient guidance from the statute to draft prefiled testimony and discussed, at great length in detail over 60-plus pages of its initial brief, the meaning and application of the SEET. Moreover, Customer Parties note, the SEET standard is arguably more detailed than the "just and reasonable" standard used in most jurisdictions, including Ohio, for distribution rate cases.

Citing to *Alliance v. Carbone* (2009), 181 Ohio App.3d 500, 2009-Ohio1197, Customer Parties assert that the courts have held that a statute is not void merely because it could have been worded more precisely. Rather, the critical question is whether the statute affords a reasonable person of ordinary intelligence fair notice and sufficient definition and guidance to enable the individual to conform his or her conduct to the law. In this case, Customer Parties aver, the meaning of Section 4928.143(F), Revised Code, is not under debate but rather which expert witness' methodology the Commission will adopt to determine whether CSP's earnings were significantly excessive in 2009.

Customer Parties also reject AEP-Ohio's complaint that the Commission failed to cure the vagueness of the SEET when it had the opportunity to do so. Customer Parties point out that the Commission did provide further guidance and clarity regarding the application of Section 4928.143(F), Revised Code, through the SEET order and entry on rehearing in 09-786 and the SEET workshop.[6] To support this position, Customer Parties assert that Ohio's other electric utilities had no difficulty understanding the SEET or the proper application of Section 4928.143(F), Revised Code. In summary, Customer Parties submit that the Companies' vagueness doctrine argument should be rejected as the Commission cannot decide constitutional issues and must presume the constitutionality of Section 4928.143(F), Revised Code, and that, in any event, the doctrine of vagueness is inapplicable to the SEET provision set forth in Section 4928.143(F), Revised Code.

After reviewing the arguments and case law of record, the Commission determines that it is the province of the courts, and not the Commission, to judge the constitutionality of Section 4928.143(F), Revised Code. Thus, the appropriate venue for AEP-Ohio to raise its constitutional challenges to the SEET is at the Ohio Supreme Court. Without addressing the constitutional threshold issue propounded by AEP-Ohio, the Commission determines, for the reasons that follow, that there is ample legislative direction to reasonably apply the statute in this case.

Initially, we note that, pursuant to *Connally*, supra, the typical due process claim of vagueness seeks to bar enforcement of "a statute which either forbids or requires the doing of an act." Section 4928.143(F), Revised Code, is not such a statute. This statute does not forbid or require the doing of an act but merely directs that prospective adjustments to rates be made in a future period if there is a finding that past rate adjustments resulted in significantly excessive earnings. Nor is AEP-Ohio penalized for its earnings under this statute. The fact that there would be a SEET review was known to the Companies when the rate plans were proposed.

The Commission also determines that Section 4928.143(F), Revised Code, is part of a comprehensive regulatory framework for setting rates under the provisions of S.B. 221. S.B. 221 created an approach to establishing ESP rates with significant regulatory flexibility including flexibility in what the utility may propose, a scope that may include distribution as well as generation charges and the option for the utility to withdraw any rate plan

6 09-786, Finding and Order (June 30, 2010); Entry on Rehearing (August 25, 2010).

modified by the Commission. The SEET examination included in S.B. 221 provides a check to this flexible approach.

Contrary to AEP-Ohio's argument, Section 4928.143(F), Revised Code, provides a clear benchmark for identifying "excessive earnings." For example, the statute defines earnings as excessive "as measured by whether the earned return on common equity of the electric 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." Additionally, the statute directs the Commission to make "such adjustments for capital structure as may be appropriate." Further, the Commission is to consider "the capital requirements of future committed investments in this state." Finally, the Commission is directed to "not consider, directly or indirectly, the revenue, expenses, or earnings of any affiliate or parent company." These concepts are not new or novel and have been traditionally applied in the regulatory ratemaking process. *Federal Power Commission v. Hope Natural Gas Co.* (1944), 320 U.S. 591.

Moreover, the fact that there may be disagreement about how to define and apply this benchmark is not new. Parties frequently present the Commission with different views about a utility's return on common equity. The Commission has extensive experience adjudicating this issue. Utility regulation is not so mechanical that it can be performed without any expert judgment. The General Assembly has directed the Commission to utilize its experience and technical expertise in deciding a broad range of ratemaking issues. We do not find this issue to be fundamentally different from those which the Commission regularly decides under Ohio's statutory provisions for utility regulation. For these reasons, we find that Section 4928.143(F), Revised Code, provides sufficiently definitive guidance to the Commission to conduct the SEET.

B. <u>IEU-Ohio's motion to dismiss</u>

On the opening day of hearing before AEP-Ohio called its first witness, IEU-Ohio made an oral motion to dismiss the Companies' application in this matter. In support of its motion, IEU-Ohio claims that CSP and OP failed to come forward with evidence that satisfies the Companies' burden of proving that the Companies did not have significantly excessive earnings for calendar year 2009. IEU-Ohio renewed its motion to dismiss AEP-Ohio's application at the close of the evidentiary record. Both motions to dismiss were denied by the bench. (Tr. at 18-26, 746-747.)

Pursuant to Rule 4901-1-15(F), O.A.C., IEU-Ohio challenged, on brief, the hearing examiner's rulings on the motions to dismiss. In support, IEU-Ohio submits that the Commission does not have subject matter jurisdiction to adopt an earnings test other than the earnings test outlined in Section 4928.143, Revised Code, or apply the required earnings test other than as mandated by Section 4928.143, Revised Code. IEU-Ohio argues that AEP-Ohio's application includes more than retail services in its earned return on equity (ROE), includes revenues for a period less than one year, includes nonretail transactions such as those subject to Federal Energy Regulatory Commission (FERC) jurisdiction and considers revenue, expenses and earnings of any affiliate or parent company.

Citing to the testimony of record, IEU-Ohio submits that AEP-Ohio witness Mitchell utilized earned ROE numbers for 2009 that were driven by total company numbers from all lines of business and not just the equity earned as a result of the ESP.[7] AEP-Ohio witness Hamrock confirmed that CSP and OP engage in multiple lines of business including nonutility business and that the calculations in AEP-Ohio's testimony includes income from FERC-jurisdictional activities.[8] Further, IEU-Ohio claims that all other witnesses in this proceeding relied upon AEP-Ohio's non-jurisdictionalized total company numbers as the starting point for developing their recommendations. Thus, IEU-Ohio argues, under the provisions of Section 4928.143, Revised Code, the Commission can proceed no further in its analysis of AEP-Ohio's SEET.

IEU-Ohio next submits that, even if the evidence presented by AEP-Ohio and the other parties conformed to the requirements of Section 4928.143, Revised Code, the Commission would not be able to rely on such evidence without correcting the math to eliminate other problems with the numbers used by the parties to present their recommendations. For example, pointing to the AEP-Ohio ESP order, IEU-Ohio submits that AEP-Ohio was instructed to remove the annual recovery of $51 million of expenses, including associated carrying charges, related to the Waterford Energy Center and the Darby Electric Generating Station.[9] However, pointing to the testimony of AEP-Ohio witness Hamrock, the expenses associated with the Waterford Energy Center and the Darby Electric Generating Station are included in the per book net income for CSP for 2009. IEU-Ohio claims that, in order to properly measure CSP's electric utility earned return from the ESP, 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 in order to apply the SEET to the ESP currently in effect. (Tr. at 139-141.)

Even if the Commission ignores the fact that SEET requires reliance upon the electric utility and retail jurisdictional numbers, IEU-Ohio argues, the total company analysis provided by AEP-Ohio is based on one-sided, selective and misleading adjustments to the total company numbers. For example, AEP-Ohio removed off-system sales (OSS) net margins from CSP's total company dollar return on equity for 2009 because

7 Cos. Ex. 4 at 4-5; Tr. I at 37-39.

8 Cos. Ex. 6 at 6; Tr. I at 134, 136-137, 141-152.

9 AEP-Ohio ESP cases, Order at 51-52 (March 18, 2009); Entry on Rehearing at 35-36 (July 23, 2009); and Second Entry on Rehearing at 2-4 (November 4, 2009).

OSS margins result from wholesale transactions subject to FERC jurisdiction and not retail transactions. AEP-Ohio admits, however, that there are other nonjurisdictional activities that the Companies did not attempt to fully jurisdictionalize for 2009 earnings purposes although the Companies claim the right to do so, if necessary. The importance of AEP-Ohio's selective application between SEET and jurisdictional rate plan transactions was discussed by Staff witness Cahaan. Mr. Cahaan testified that if the OSS were excluded from the net income (numerator) then there should have been an adjustment made to the common stock equity (denominator). Failure to make such an adjustment tends to lower the overall return on equity. (Cos. Ex. 4 at 5; Cos. Ex. 6 at 6-7; Tr. at 36; Staff Ex. 1 at 19-20.)

AEP-Ohio submits that IEU-Ohio's motion to dismiss based upon IEU-Ohio's reading of Section 4928.143, Revised Code, as well as IEU-Ohio's criticisms of the Companies exclusions and deferrals for purposes of performing ROE calculations is without merit. Regarding IEU-Ohio's contention that the first annual period for the calculation of SEET began on April 1, 2009, and ended on March 31, 2010, AEP-Ohio claims that this position is contrary to determinations made by the Commission in the Companies' ESP proceedings. The Companies state that the Commission specifically found that AEP-Ohio's ESP was authorized effective January 1, 2009.[10] The Commission later confirmed the January 1, 2009, start date of the Companies' ESP in a March 30, 2009, entry *nunc pro tunc* and in an entry on rehearing issued on July 23, 2010. Therefore, AEP-Ohio argues, the first annual period of the Companies' ESP is calendar year 2009, and IEU-Ohio's contention otherwise is incorrect.

IEU-Ohio's argument that Section 4928.143(F), Revised Code, requires a jurisdictionalized earnings allocation study, based on ESP rate plan-approved services, is also incorrect, AEP-Ohio argues. The statute does not specifically require, claims AEP-Ohio, that the Commission perform a comprehensive jurisdictional allocation study in order to determine an earned ROE appropriate for use in the SEET. Rather, the Companies submit, FERC Form 1 data provides a reasonable starting point from which appropriate adjustments can be made in order to develop an earned ROE.

Next, AEP-Ohio disputes IEU-Ohio's contention that the Companies' filing contains faulty data insofar as the net income reflects inclusion of the expenses associated with CSP's Waterford and Darby generating stations. Adopting IEU-Ohio's logic, AEP-Ohio claims, would mean that every item of expense not related to an ESP rate adjustment would be adjusted out of expenses resulting in an artificial inflation of earnings for purposes of applying the SEET. Such a position is inappropriate, the Companies claim, because such an approach reflects a traditional ratemaking analysis pursuant to Section 4909.15, Revised Code, rather than favorably comparing the ESP to the expected results of

[10] AEP-Ohio ESP cases, Order at 64 (March 18, 2009).

a MRO as intended by the General Assembly. AEP-Ohio urges the Commission to reject IEU-Ohio's position for purposes of developing the SEET analysis in this proceeding.

Lastly, AEP-Ohio's arguments responding to intervenors concerns regarding the exclusion of OSS, deferrals, and the failure to fully account for other nonjurisdictional activities are addressed under specific topic areas and not further addressed in this section of the Commission's decision.

IEU-Ohio's motion to dismiss is denied. The Commission has already fully addressed the start date of AEP-Ohio's ESP.[11] Likewise, we reject IEU-Ohio's contention that the Companies' application cannot proceed as AEP-Ohio did not perform a comprehensive jurisdictional allocation study. Nowhere in Section 4928.143(F), Revised Code, is a comprehensive jurisdictional allocation study required in order to determine an earned ROE appropriate for use in the SEET. Nor do we find that a comprehensive jurisdictional allocation study is the only manner in which to determine an earned ROE for SEET. Rather, we find that it is acceptable to make appropriate adjustments to FERC Form 1 data in order to develop an earned ROE for SEET. In making this determination, we note that, under applicable provisions of Section 4928.01, Revised Code, and under Section 4905.03, Revised Code, an electric utility is not limited to a subset of a firm's activities that may be regulated under an ESP. Additionally, the definition of an electric light company explicitly covers firms engaged in both activities subject to rate regulation by this Commission and activities such as transmission that are, in large part, subject to federal jurisdiction. Thus, while adjustments to FERC Form 1 data may be appropriate to isolate the effects on ROE of the adjustments in the ESP under review, the SEET, in the first instance, may be measured based upon the return of common equity of the electric utility viewed as a company without a complete jurisidictional cost and revenue allocation study.

Regarding IEU-Ohio's argument that the Companies' filing contains faulty data insofar as the net income reflects inclusion of expenses associated with CSP's Waterford and Darby generating stations, this argument is also rejected. In the Companies' ESP proceedings, the Commission had authorized CSP to increase revenues by $51 million to recover jurisdictional expenses associated with the Waterford and Darby facilities.[12] The Waterford and Darby facilities had never before been included in rate base. In response to IEU-Ohio's application for rehearing, the Commission agreed with IEU-Ohio that the Companies had not demonstrated that their current revenue was inadequate to cover the costs associated with the generating facilities. Therefore, the Commission directed AEP-Ohio to modify its ESP and remove the annual recovery of $51 million of expenses,

11 AEP-Ohio ESP, Order at 64 (March 18, 2009); Entry *Nunc Pro Tunc* (March 30, 2009); Entry on Rehearing at 41-45 (July 23, 2009).

12 AEP-Ohio ESP, Order at 51-52 (March 18, 2009).

including associated carrying charges related to these generation facilities.[13] Today, AEP-Ohio is in the same position regarding the Waterford and Darby facilities as it was before issuance of the ESP Order and, therefore, excluding an additional $51 million would be unreasonable.

II. APPLICATION OF SEET ANALYSIS:

A. Comparable Group of Companies, ROE of Comparable Companies and SEET Threshold

1. AEP-Ohio

One of the steps in the process to determine whether an electric utility has significantly excessive earnings is to compare the earned return on common equity of the electric utility to the earned return on common equity of a group of publicly traded companies, including utilities that face comparable business and financial risk. AEP-Ohio, Customer Parties and Staff advocate different methods to select the comparable group of publicly traded companies to develop the ROE to which AEP-Ohio's ROEs will ultimately be compared.

AEP-Ohio presented the testimony of Dr. Anil Makhija, professor of finance at The Ohio State University (Cos. Ex. 5). The process advocated by Dr. Makhija may be summarized as stated below. AEP-Ohio's proposed process evaluates all publicly traded U.S. firms to develop its comparable group of companies. To evaluate business risk, AEP-Ohio used unlevered betas and to evaluate financial risk, it used the book equity ratio. By using data from Value Line,[14] AEP-Ohio applies the standard decile portfolio technique to divide the companies into five different business risk groups and five different financial risk groups (listing each unlevered beta or book equity ratio lowest to highest). AEP-Ohio defines business risk as evolving from the day-to-day operations of CSP and OP, including the uncertainty associated with revenue stream, operating and maintenance expenses, regulatory risks, and fluctuations in weather and demand. AEP-Ohio equates financial risk with the debt obligation of CSP and OP. AEP-Ohio then selects the companies in the cell which includes AEP Corporation (AEP) as the comparable group companies. To account for the fact that the business and financial risks of CSP and OP may differ from AEP, this aspect of the process is repeated for CSP and OP and taken into consideration in determining whether CSP's or OP's ROEs are excessive. (Cos. Ex. 5 at 5-6, 13-18, 24-27.)

AEP-Ohio accounts for the risk faced by common equity holders by using the Capital Asset Pricing Model (CAPM), and then attempts to verify its findings by repeating

13 AEP-Ohio ESP cases, Order at 51-52 (March 18, 2009); Entry on Rehearing at 35-36 (July 23, 2009); and Second Entry on Rehearing at 2-4 (November 4, 2009).

14 *Value Line Standard Edition* as of June 1, 2010.

the analysis using capital intensity and the ratio of revenues to total assets as screens. AEP-Ohio argues that CAPM, which is used to measure total market-related risks, is "by far the most widely used model for taking risk into account." AEP-Ohio uses Value Line betas for AEP, as compared to the betas of CSP and OP, to confirm the conservative nature of AEP-Ohio's proposed method. To account for any difference in the capital structure of CSP or OP, as compared to the capital structure of the companies in the comparable group companies, the electric utility examines the unlevered beta and the debt/equity ratio of the publicly traded comparable companies as a part of determining their ROE. (Cos. Ex. 5 at 18-25.)

AEP-Ohio again advocates, as it proposed in its ESP proceeding and in 09-786, that an electric utility's earnings not be considered significantly excessive if the annual earnings are less than two standard deviations above the mean ROE of the comparable group of companies. The Companies explain that approximately two standard deviations (which is equivalent to a 1.96 standard deviation adder for SEET purposes) is equivalent to the traditional 95 percent confidence level, and the 95 percent confidence level provides for a reasonably acceptable risk of false positives. Further, this process for selection of the comparable group of companies is preferable, according to AEP-Ohio, because it is objective, as it relies on market-based measures of risk, best targets comparable companies, delivers a reliably large sample of comparable companies and can be replicated in future proceedings. Further, AEP-Ohio confirms its proposed method by repeating the analysis using other business and financial risk measures and a larger population of companies to form the comparable group of companies. (Cos. Ex. 5 at 5-6, 13.)

AEP-Ohio concludes that the mean ROE for the comparable group of companies for 2009 is 11.04 percent with a standard deviation of 5.85 percent. Multiplying the standard deviation of the comparable group of companies by 1.96 (corresponding to a 95 percent confidence level) yields an adder of 11.47 percent. Thus, AEP-Ohio's SEET analysis yields a threshold ROE, the point at which earnings should be considered significantly excessive for 2009, of 22.51 percent (11.04 +11.47) for CSP and OP. (Cos. Ex. 5 at 39, 45.)

<u>Opposition to AEP-Ohio's proposed SEET analysis</u>

Customer Parties and Staff argue that there are a number of errors with the method advocated by AEP-Ohio. First, Customer Parties claim that AEP-Ohio's approach for determining the comparable group companies identifies comparable utility and publicly traded companies based on the business and financial risk profile of AEP and not CSP (or OP) in contradiction of the language in Section 4928.143(F), Revised Code, which directs the Commission not to consider the revenues, expenses, or earnings of the electric utility's affiliates or its parent company. Second, Customer Parties contend that AEP-Ohio's process establishes an ROE threshold for SEET based on a 95 percent confidence interval and, as such, only 2.5 percent of companies would ever be determined to have significantly excessive earnings. Customer Parties argue that using such a high confidence interval results in an excessively high ROE SEET threshold. Third, Customer Parties argue that AEP-Ohio's method does not directly adjust the ROE for the capital structure and cost of debt of CSP to appropriately account for the differences in financial risk between CSP and the comparable companies. Ultimately, Customer Parties contend that AEP-Ohio's proposed SEET analysis does not provide a direct ROE SEET for CSP. (Joint Inv. Ex. 1 at 24-26.)

Staff notes a number of advantages and some disadvantages with AEP-Ohio's SEET process. Staff supports AEP-Ohio's proposed SEET process to the extent that it yields a reliably large sample and is objective as a result of its reliance on market-based measures. However, Staff asserts that AEP-Ohio's process very significantly reduces any aspect of judgment as to the appropriateness of any company included in the comparable group of companies. Staff also argues that AEP-Ohio's implementation of the CAPM does not allow for the consideration of the type of business risk and, thus, creates a group of comparable companies with diverse business risk which produces a large variance. Staff argues that AEP-Ohio's use of CAPM to evaluate business risk is misplaced. Staff interprets Section 4928.143(F), Revised Code, to focus on the company's business risk as opposed to the investor's diversifiable business risk. Staff also dislikes AEP-Ohio's reliance on unlevered betas as a part of the SEET process. Staff reasons that unlevered beta measures are not stable. Finally, Staff rejects a statistical definition of "significantly" for three reasons. In this case, it is Staff's opinion that the Companies' proposal for statistical significance is egregiously excessive and counter-intuitive to the requirements of SB 221. According to Staff, a statistical definition of "significant" does not provide a useful or satisfactory interpretation of the legislative language, common sense or the ordinary meaning of the words as used in the English language. Staff believes that there is no reason to implement a scientific process for statistical inference when direct observation to reach a conclusion is feasible. Although Staff recognizes that direct observation to surmise a result could put the electric utility in the position of trying to prove a negative, Staff believes it is in essence a method to avoid false negatives like the Companies' proposed method is designed to avoid false positives. (Staff Ex. 1 at 3-9, 12-16.)

2. <u>Customer Parties</u>

Customer Parties advocate a seven-step process by which to determine the SEET threshold ROE which may be summarized as follows: (1) identify a proxy group of electric utility companies (electric proxy group); (2) identify a list of business and financial risk measures for the electric proxy group; (3) establish the ranges for the business and financial risk indicators for the companies in the electric proxy group; (4) screen the *Value Line* database to identify a group of comparable public companies, including electric utilities, whose business and financial risk indicators fall within the ranges of the electric proxy group; (5) compute the benchmark ROE for the group of comparable public companies, including electric utilities; (6) adjust the benchmark ROE for the capital structures of CSP; and (7) add a ROE premium to establish the SEET threshold ROE. (Joint Inv. Ex. 1 at 8.)

Customer Parties first created an electric proxy group by reviewing utilities in the *AUS Utility Reports* based on four criteria. The electric proxy group includes 15 electric utilities with: (1) at least 75 percent of revenue from regulated electric; (2) an investment grade bond rating; (3) total revenue of less than $10 billion; and (4) a three-year history of paying cash dividends (2007–2010) with no dividend reductions.[15] Customer Parties reason that this aspect of its proposed SEET analysis is appropriate, as it is common to use this screening process in estimating the cost of capital in public utility rate cases and because the process results in a group of businesses with similar business and financial characteristics to the utility at issue, in this case CSP. After excluding foreign companies, Customer Parties use three business and financial risk indicators, beta, asset turnover and common equity ratios, from the electric proxy group to establish ranges for beta, asset turnover and common equity to develop the comparable group of companies as required in Section 4928.143(F), Revised Code. (Joint Inv. Ex. 1 at 9-15.)

Step 4 of the process advocated by Customer Parties is to screen the *Value Line Investment Analyzer 2010* to develop the comparable group companies with business and financial risk indicators within the range of the electric utility proxy group. Forty-five companies compose Customer Parties' comparable group of companies with 15 electric utilities, 28 gas and electric utilities and only two nonutility companies. Under Customer Parties' proposed SEET, the next step is to determine the median ROE for the comparable group companies, in this case, 9.55 percent for 2009. Customer Parties argue that it is appropriate to use the median ROE, as opposed to the mean ROE, to avoid the impact of outliers in the distribution of the ROEs, as the presence of outliers can greatly inflate the standard deviation of the comparable group companies and ultimately inflate the SEET threshold ROE. (Joint Inv. Ex. 1 at 15-21; JRW-2; JRW-3; Cos. Br. at 32.)

Next, Customer Parties adjust the benchmark ROE of the comparable group companies for the capital structure of CSP to account for the differences in financial risk between the comparable group of companies and CSP. Under Customer Parties' proposed SEET analysis, the benchmark ROE for CSP is 9.58 percent and the benchmark ROE for the comparable group of companies is 9.55 percent. Customer Parties recommend a 200 to 400 basis point premium adder to the benchmark ROE of the comparable group of companies ROE to establish the threshold ROE for significantly excessive earnings for the year 2009. Customer Parties emphasize that the 200-400 basis points premium should not be considered an unchanging precedent but is based on the ROE adder used by the FERC for transmission investments that are not routine and riskier than the usual investments made

[15] Joint Inv. Ex. 1 at 10, Table 1.

by transmission companies. The rationale is that the basis points premium is an administrative standard based on informed judgment for additional risk. In comparison, Customer Parties offer that setting the SEET threshold 200 basis points over the returns of the comparable group of companies is an appropriate proxy for the significantly excessive earnings threshold for AEP-Ohio and, in its opinion, is consistent with the Commission's adoption of the 200 basis points "safe harbor" provision as set forth in 09-786. Under this analysis, Customer Parties argue that the threshold ROE for CSP is 11.58 percent to 13.58 percent. OPAE supports the SEET analysis advocated by Customer Parties (Joint Inv. Ex. 1 at 7-8, 17-23; OPAE Br. at 6-7.)

Opposition to Customer Parties' proposed SEET analysis

AEP-Ohio argues that Customer Parties' proposed SEET analysis does not meet the objective required by the statute that the comparable group of companies match the business and financial risk of CSP and OP. AEP-Ohio also asserts that Customer Parties' method presupposes what kind of companies ought to be a match for CSP or OP by use of the electric proxy group, limits the sample of companies available and rules out publicly traded companies that may have been a better match to the electric utility. AEP-Ohio also reasons that Customer Parties' process does not produce a reliably large sample of comparable companies. AEP-Ohio suggests that Customer Parties implicitly recognize the relatively small sample size by modifying the results to eliminate outliers and by using the median rather than the mean based on a misinterpretation of Section 4928.143(F), Revised Code. AEP-Ohio reasons that the median is inadequate for purposes of the SEET analysis because it does not respond to the variation in the ROEs among the comparable group of companies. AEP-Ohio advocates that the mean and standard deviation better capture the information regarding the ROEs of the comparable group of companies and the distribution of their ROEs. AEP-Ohio notes that the mean ROE of the electric proxy group is 9.74 percent. The Companies contend that Customer Parties' proposed SEET analysis process includes the FERC adder based on an arbitrary calculation that has no connection to the comparable group of companies to whose mean or median the ROE is applied. AEP-Ohio asserts that the Customer Parties' approach lacks objectivity. Further, AEP-Ohio argues that Customer Parties' method produces the same result for all electric utilities in Ohio as well as others across the country and includes only two non-utility companies out of the 45 that form the Customer Parties' group of comparable companies. (Cos. Ex. 7 at 1-5, 7-9.)

AEP-Ohio contends that Customer Parties' use of the beta range produced by the electric proxy group is inappropriate to compare to the year-end value for CSP. Because CSP's beta is higher, since it is a smaller company, Customer Parties' analysis necessarily puts CSP's beta outside of the range of the electric proxy group beta, causing a misguided comparable group of companies to be composed. According to AEP-Ohio, Customer Parties' method implements a screen for business risk too late in the process and utilizes inappropriate screens. AEP-Ohio contends that Customer Parties' proposal mixes business and financial risks where SB 221 requires the consideration of both business and financial risks in the formation of the comparable group of companies. (Cos. Ex. 7 at 5-6.)

Further, AEP-Ohio asserts that Customer Parties failed to correctly adjust the data for the comparable group of companies for the capital structure of CSP. The Companies contend that Customer Parties should have considered short-term debt as well as long-term debt, preferred and common equity. (Cos. Ex. 7 at 6-7.)

Finally, AEP-Ohio argues that Customer Parties' adder is arbitrary and produces an unreasonably high number of companies that would fail the SEET. With the 200 basis points adder, and using Customer Parties' benchmark ROE of 9.58 percent, and a threshold ROE minimum of 11.58 percent, AEP-Ohio concludes that almost one in every four companies in Customer Parties' comparable group of companies would have significantly excessive earnings. Further, AEP-Ohio reasons that, pursuant to Customer Parties' SEET analysis, if applied symmetrically, to a mean below 7.58 percent and above 11.58 percent, nearly half the comparable group companies would have earnings that were significantly excessive or deficient under Customer Parties' proposed 200 points adder. AEP-Ohio argues that such results demonstrate excessive failure rates in the application of the SEET with dire consequences for attracting capital to Ohio's utilities. (Cos. Ex. 7 at 10-11; Joint Int. Ex. 1 at Ex. JRW-4.)

3. Staff

Staff presented the testimony of Richard Cahaan, consultant to the Capital Recovery and Financial Analysis Division of the Utilities Department. Staff's SEET analysis proposal is based on a three-step process: (1) determine the ROE for the group of companies with comparable business and financial risks; (2) establish a threshold ROE that is significantly in excess of the ROE for the comparable group of companies; and (3) calculate AEP-Ohio's ROE for use in the SEET. (Staff Ex. 1 at 1-2.)

After evaluating the SEET analyses offered by AEP-Ohio and by Customer Parties in this proceeding, as well as the model advocated by Dr. Vilbert in the FirstEnergy Companies SEET case,[16] Staff posits that, while each approach is considerably different, the results are not so different. Staff characterizes AEP-Ohio's model as theoretical, abstract and academic and Customer Parties' model as more traditional. Staff claims that the Customer Parties' comparable group of companies includes an anomaly company or isolated outlier with one portion of its business that is characteristically quite different

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[16] *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Administration of the Significantly Excessive Earnings Test Under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code,* Case No. 10-1265-EL-UNC.

from utility generation and distribution assets. Staff reasons that it is not unusual to eliminate the highest and lowest observations in a sample to calculate the mean and, if the high and low outliers were omitted from the Customer Parties' process, the mean would be 10.06 percent. In light of such a comparison, Staff reasons that Customer Parties' 9.58 percent ROE for the comparable group of companies is low. However, the witness acknowledges that, if the median ROE is used, Staff's proposed adjustment to eliminate the outliers would have no affect on the ROE of the comparable group of companies. (Staff Ex. 1 at 3-9, 12; Tr. III at 518).

In the application of SEET, the Staff declares that it is appropriate to recognize a range of reasonableness as opposed to the accounting accuracy usually associated with public utility regulation. Consistent with that reasoning, Staff notes that the ROE as presented in two exchange funds, namely *iShares Dow Jones U.S. Utilities Sector Index Fund* and *Utilities Select Sector SPDR Fund*, have a weighted average ROE of 11.15 percent and 11.39 percent, respectively. Staff offers that these independently determined ROEs confirm the reasonableness of the ROE offered by the parties to this case. Considering the SEET analyses offered and Staff's expressed advantages and disadvantages of each parties' proposal, Staff witness Cahaan believes that the mean ROE for the group of comparable companies is reasonably within the 10 percent to 11 percent range with a bit more evidence on the higher side of the range. (Staff Ex. 1 at 3, 11-13.)

Operating under the theory that "significantly excessive" is a concept of fairness, Staff advocates that, rather than a 200-400 basis points adder to the mean of the comparable group companies' ROE, the threshold ROE be expressed as a percentage of the comparable group companies' benchmark ROE. The benefits of using a percentage of the comparable group companies' benchmark ROE incorporates an adjustment that works and is reasonable in deflationary and inflationary economic conditions. Staff advocates a 50 percent adder to the comparable group of companies' ROE to establish the SEET threshold. Staff explains that, in this case for 2009, the 50 percent adder is in the reasonable range by comparing it to CSP's current embedded cost of debt. Staff argues that if the result of subtracting the adder from the comparable ROE yields a result that is near CSP's cost of debt, the adder is reasonable. Staff, therefore, recommends a SEET threshold for CSP of 16.05 percent before the company's earnings may be considered significantly excessive. (Staff Ex. 1 at 13-17).

Finally, for efficiency of the annual SEET analysis, Staff proposes that, in future SEET cases, the Commission direct Staff to offer a benchmark ROE based on an index or combination of indices announced in advance and that parties to the case put forward analysis for adjustments or modifications to the indexed benchmarks (Staff Ex. 1 at 12).

Opposition to Staff's analysis

AEP-Ohio argues that Staff's proposed 50 percent adder is roughly equivalent to less than one standard deviation and is too low when the frequency with which a company will be considered to have significantly excessive earnings is considered. According to AEP-Ohio, the 50 percent adder would cause more than one out of every three companies to be found to have significantly excessive earnings. Further, AEP-Ohio notes that under Staff's proposal, where the comparable group of companies are right-skewed and fat-tailed, an even greater portion of companies would be beyond the threshold ROE. (Cos. Ex. 5 at 39-40; Cos. Br. at 40-41.)

4. Commission decision on comparable companies and comparable companies' ROE

Contrary to Customer Parties' claims, AEP-Ohio took into account the business and financial risks of the electric utility in determining its comparable group of companies and adjusted for the capital structure of the electric utility. AEP-Ohio's determination of the comparable group of companies was initially determined by publicly traded companies that share similar business and financial risks, and the use of the beta of AEP-Ohio, as opposed to the beta of CSP or OP, does not negate the validity of the comparable group of companies selected under AEP-Ohio's analysis. The Commission is concerned that Customer Parties' determination of the comparable group of companies was developed from an electric only proxy group which predetermines, to some extent, the characteristics of the comparable group without any direct relationship to the electric utility, and, most significantly, produces the same comparable group of companies for all Ohio's electric utilities.

Given the divergent methods with which each party computed the comparable companies' ROE, including Staff's use of two independent indices to confirm the reasonableness of the resulting ROEs, the evidence indicates the comparable benchmark ROE is in the general range of between 10 percent and 11 percent. Thus, this is the range within which the mean of the comparable companies should be established. However, we believe that the reasons cited by Staff and AEP-Ohio warrant establishing the benchmark at the top of the range, 11 percent, rather than the 10.7 percent recommended by the Staff.

B. AEP-Ohio 2009 Earned ROEs

AEP-Ohio witness Thomas E. Mitchell presented testimony that supported the Companies' calculation of CSP's and OP's earned ROE for the 2009 SEET, proposed deductions to the Companies' ROEs and quantified the revenue producing provisions of the Companies' ESP. AEP-Ohio calculates each electric utility's ROE by using the net earnings available to common equity shareholders compared to the beginning and ending average equity for the year ended December 31, 2009, as dictated by the Commission in 09-786. AEP-Ohio witness Mitchell testified that there were no minority interest, non-recurring, special or extraordinary items for CSP or OP for the year 2009. Thus, without any further adjustments, AEP-Ohio determined an ROE for OP of 10.81 percent and for CSP of 20.84 percent for 2009. AEP-Ohio acknowledges that included in the earnings of CSP and OP are nonjurisdictional earnings (excluding as it proposes off-system sales) that it did not attempt to fully jurisdictionalize for purposes of the 2009 SEET analysis; however, AEP-Ohio asserts to reserve the right to further jurisdictionalize its earnings if necessary. (Cos. Ex. 4 at 3-5, Ex. TEM-1 at 1; Cos. Ex. 6 at 7.)

Based on the Companies' determination of the mean ROE of the comparable group of companies of 11.04 percent, the Companies concluded that OP was within the safe harbor provision of 200 basis points above the mean of the comparable group of companies and, thus, did not have significantly excessive earnings for 2009 (Cos. Ex. 4 at 3-5; Cos. Ex. 6 at 7-9).

Customer Parties and Staff accepted the Companies' calculation of CSP's ROE of 20.84 percent for 2009 and OP's ROE of 10.81 percent for 2009, excluding any adjustments (Joint Inv. Ex. 2 at 18; Staff Ex 1 at 18).[17]

1. Commission decision on SEET Threshold

First, to the extent that AEP-Ohio failed to further jurisdictionalize its 2009 earnings for the SEET proceeding, AEP-Ohio has waived its right to do so subsequent to the issuance of this Order. The parties to this proceeding should not be required to revise their position or the Commission reconsider its Order because AEP-Ohio elected not to further jurisdictionalize its earnings before the application was filed.

In 09-786, the Commission concluded that, for purposes of the SEET analysis, any electric utility earnings found to be less than 200 basis points above the mean of the comparable group of companies would not be significantly excessive earnings.[18] In this case, depending on the comparable group of companies selected and the range of the comparable companies' ROEs, the ROE spans from 9.58 percent, as proposed by Customer Parties, to 11.04 percent, as proposed by AEP-Ohio. The Commission observes that under any parties' proposed SEET analysis presented in this proceeding, OP's earned ROE is less than 200 basis points above the mean of the comparable group of companies. Thus, we find that OP did not have significantly excessive earnings for 2009 pursuant to Section

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17 Customer Parties nonetheless note that it computes CSP's ROE for 2009 as slightly more, 20.86 percent, and that SNL Financial database computes CSP's ROE at 20.82 percent. Customer Parties concede that the difference is immaterial. (Joint Inv. Ex. 2 at 18.)

18 09-786, Order at 29 (June 30, 2010).

4928.143(F), Revised Code, or pursuant to the Commission's directives in 09-786 and we will not further analyze the earnings of OP as a part of this 2009 SEET proceeding.

Further, we find the Companies' straight-forward calculation of CSP's and OP's earned ROE for 2009 to be reasonable, consistent with the requirements of Section 4928.143(F), Revised Code, and the directives of the Commission as set forth in 09-786.[19] We address the related arguments of IEU-Ohio regarding the jurisdictionalization of CSP's and OP's revenues above in the procedural section of this order and, therefore, see no reason to restate our findings on the issue again here.

To recap the position of the parties, AEP-Ohio advances a 2009 SEET threshold for CSP of 22.51 percent. At the other end of the spectrum is Customer Parties, who argue that, under its proposed SEET analysis, the threshold ROE for CSP is in the range of 11.58 percent to 13.58 percent. Staff advocates a 50 percent adder to the ROE of the comparable group of companies which when added to its recommended benchmark ROE of 10.70 yields, in this case, a SEET threshold of 16.05 percent for CSP.

In regards to the determination of the SEET threshold, in 09-786, a number of commenters requested a "bright line statistical analysis test for the evaluation of earnings." While the Commission agreed that "statistical analysis can be one of many useful tools," we declined to adopt such a test. We concluded, instead, that "significantly excess earnings should be determined based on the reasonable judgment of the Commission on a case-by-case basis." Our Order noted the significant variation among Ohio electric utilities and went on to identify specific factors which the Commission would consider in its case-by-case analysis.

> [T]he Commission will give due consideration to certain factors, including, but not limited to, the electric utility's most recently authorized return on equity, the electric utility's risk, including the following: whether the electric utility owns generation; whether the ESP includes a fuel and purchased power adjustment or other similar adjustments; the rate design and the extent to which the electric utility remains subject to weather and economic risk; capital commitments and future capital requirements; indicators of management performance and benchmarks to other utilities; and 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

[19] 09-786, Entry on Rehearing at 6 (August 25, 2010).

> practices; and the extent to which the electric utility has advanced state policy.

In the current case, AEP-Ohio again proposes a bright line SEET threshold based exclusively on a statistical analysis of comparable companies, with some regard for the Commission's directives. The Companies' recommendation is unreasonable and inconsistent with the statute. As we clearly stated in 09-786:

> [U]tilizing only a statistical method for establishing the SEET threshold is insufficient by itself to meet the electric utility's burden of proof pursuant to Section 4928.143(F), Revised Code. Section 4928.143(F), Revised Code, places on the utility "the burden of proof for demonstrating that significantly excessive earnings did not occur." Passing a statistical test does not, in and of itself, demonstrate that excessive earnings did not occur.

The statute requires us to measure excessive earnings by whether "the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity" earned by comparable companies. Section 4928.143(F), Revised Code. Whether any differential between the ROE of the electric utility and that of the comparable companies is significant necessarily depends on factors related to the individual electric utility under review. While a statistical analysis of the variation in returns among companies facing comparable business and financial risks can provide useful information, as indicated in our decision in 09-786, we will not rely exclusively on a statistical approach or set a generic bright line threshold based only on variations in the returns of the comparable companies.

We find that not only does AEP-Ohio's proposed SEET analysis rely exclusively on a bright line statistical test for its SEET threshold, it relies on the statistical analysis to the point of producing an unrealistic and indefensible result. If the Commission were to accept AEP-Ohio's SEET analysis to determine the threshold ROE for CSP at 22.51 percent, the Commission would be forced to accept an electric utility ROE of less than 22.51 percent as not significantly excessive. Without additional comparisons to justify its SEET threshold for CSP as reasonable, we conclude that AEP-Ohio improperly relied on a statistical test for its SEET threshold. In light of the Commission's rejection of Customer Parties' development of the comparable group of companies, we also reject their SEET threshold range of 11.58 to 13.58 percent. Not only do we reject Customer Parties' SEET threshold range in this case, we do not believe that their use of a 200-400 basis points adder to the benchmark ROE of the comparable group of companies is optimally related to the purpose of the SEET. We find the conceptual construct of Staff's proposal to use a percentage of the average of the comparable companies to be more appropriately related to the purpose of the SEET.

Although the purpose of the SEET is to be a statutory check on rates that result in excessive earnings, we find that one of the impacts of the SEET creates symmetry with our obligation to ensure that a company may operate successfully, maintain financial integrity, attract capital and compensate its investors for the risk assumed. Among the parties' positions we find that Staff's basic methodology best gives effect to the statutory design to create such symmetry. Specifically, the Commission is persuaded by the fact that Staff's proposed adder's impact, if subtracted from the comparable ROE benchmark yields a result that is similar to the company's cost of debt. Given the Commission's adoption of an 11 percent ROE, the impact of a 50 percent downward adjustment to the comparable ROE results in an earnings of 5.5 percent, which is similar to CSP's embedded cost of debt. Therefore, 50 percent is a reasonable guide for establishing an adder.

Additionally, when there is a differential by which the return for a specific electric utility exceeds the safe harbor threshold established in 09-786, the Commission must attribute any such amount to and allocate it between earnings that are significantly excessive as a result of adjustments in the utility's ESP, or to earnings that are not significantly excessive because they reflect utility specific factors, are reasonable given the utility's actual performance or are attributable to factors unrelated to the ESP.

Turning first to utility specific factors related to investment requirements, risk, and investor expectations, the Commission must recognize that a comparison to other firms will not fully capture company specific factors which influence whether a return is significantly excessive. On a going forward basis, the Commission expects to refine the quantitative analysis associated with these factors through future SEET proceedings.

In its SEET application, as set forth in the Order in 09-786, Mr. Hamrock discusses at length in his testimony the various factors which the Commission indicated it would take into consideration in the establishment of the level of significantly excessive earnings. Mr. Hamrock discussed the capital commitments made by CSP for both 2010 and 2011, as well as the various business and financial risks faced by CSP. The witness also explained several ways in which CSP has demonstrated positive management performance in several areas. He discussed the improved service reliability experienced by CSP customers from 2003 to 2009 and the various technological innovations CSP has initiated, such as gridSMART, to its leadership in energy efficiency and peak demand response programs. CSP continues to make extensive capital investments in the state of Ohio. Customer Parties raised a concern that CSP was not making a firm commitment to its 2010 budget. The Commission notes that, on cross-examination, it was demonstrated that CSP is indeed committed to spending the projected capital budget for 2010.

In terms of the various business and financial risks discussed by Mr. Hamrock in his testimony, the Commission concurs that CSP is facing various business and financial risks. Despite the use of riders, some bypassable and other nonbypassable riders, the fact remains that initial capital outlays must be made to fund many of the activities enumerated by CSP. In addition to initial capital outlays that CSP must make in order to fund its obligations under its ESP and its provision of service in general, there are other risks, not clearly associated with a rider, of which the Commission must remain mindful. For example, the Commission concurs with CSP that electric utilities are not assured recovery of their generation assets due to the change in the regulatory environment; the prospect of future industry restructuring and carbon regulation is unknown; and market prices for generation-related services are volatile. Lastly, the Commission gives consideration to the challenge of fulfilling the various mandates of SB 221, within the context of a rapidly changing electric market.

The Commission also takes into consideration the fact that CSP's service reliability, both in terms of the number of outages experienced by its customers and the length of those outages, has improved. CSP's actual frequency of outages (SAIFI) went from 1.91 in 2003 to 1.31 in 2009. During the same period, CSP's number and duration of outages (CAIDI) went from 148.6 to 122.6.

Additionally, the Commission notes that CSP's most recently authorized ROE was 12.46 and, while dated, it may still be influencing earned returns and should be acknowledged and considered. We also believe, in light of the current economic situation across the state, it is unreasonable to overlook economic volatility in the SEET analysis.

The Commission also believes consideration should be given to CSP's commitment to innovation. In particular, the Commission believes that consideration should be given to CSP's gridSMART program. CSP's gridSMART program is a holistic approach to the deployment of gridSMART and, as such, as noted by Mr. Hamrock, received the highest rating among all demonstration grant applications to the U. S. Department of Energy. Further CSP has agreed to initiate a Phase 2 gridSMART program.[20]

Lastly, the Commission must also include in its consideration CSP's efforts to advance Ohio's energy policy and future committed capital investments. CSP far exceeded the established benchmark requirements both in the area of energy efficiency and peak demand response. CSP continues its innovation efforts and dedication to Ohio's energy policy by its commitment to provide $20 million in funding to a solar project in Cumberland, Ohio. Not only will this project advance the state's energy policy, but it will also bring much needed economic development activity to Ohio. Various parties noted that this commitment was contingent on several other factors and questioned the appropriateness of giving any consideration to this investment. The Commission remains confident that this project will move forward and the funds will be expended for this project in the near future. Nevertheless, should this project not move forward in 2012,

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20 See AEP-Ohio Notice of Withdrawal of the Stipulation filed December 16, 2010.

such that the funds are expended in 2012, the Commission requires the $20 million to be spent in 2012 on a similar project.

Giving due consideration to the aforementioned factors, and keeping in mind the nature of the SEET, the Commission believes that Staff's 50 percent baseline adder should be adjusted upward. Thus, the appropriate percentage to be added to the mean of the comparable group companies is 60 percent which in this case yields a SEET threshold of 17.6 percent.

C. Adjustments to CSP's 2009 Earnings

1. Off-system sales

(a) AEP-Ohio's SEET application excludes OSS

AEP-Ohio submits that its ROEs should be reduced for OSS margins (after federal and state income taxes). Based on AEP-Ohio's interpretation of Section 4928.143(F), Revised Code, only those earnings resulting from adjustments included in AEP-Ohio's ESP are part of the SEET analysis process. AEP-Ohio reasons that OSS margins are based on wholesale transactions, approved by FERC, and excluding OSS margins from SEET complies with well-settled federal constitutional law. AEP-Ohio argues that under federal constitutional law, the State is preempted from interfering with the Companies' ability to realize revenue rightfully received from wholesale power sales pursuant to contracts or rates approved by FERC. *Pacific Gas & Electric v. Energy Resources Comm.*, 461 U.S. 190 (1983) (*Energy Resources Comm.*); *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) (*Nantahala*); *Mississippi Power & Light v. Mississippi*, 487 U.S. 354 (1988) (*MP&L*); *Pacific Gas & Electric Co. v. Lynch*, 216 F. Supp. 2d 1016 (N.D. Cal. 2002) (*Lynch*). AEP-Ohio extends that reasoning to conclude that, just as the state may not trap FERC-approved wholesale power costs, it may not, in effect capture or siphon off the revenue the Companies receive from FERC-approved wholesale sales for the purpose of reducing the retail rates paid by Ohio customers. Any such order by the Commission, according to AEP-Ohio, would conflict with the Federal Power Act and Congress' power under the Supremacy Clause. AEP-Ohio further alleges that this type of economic protectionism would also violate the federal Commerce Clause. *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982) (NEPC). Thus, AEP-Ohio declares that it would be unlawful for the Companies' OSS earnings to be included in the computation of any significantly excessive earnings. To that end, AEP-Ohio proposes that, to avoid any jurisdictional conflict, OSS margins be excluded from AEP-Ohio's earnings to comply with Section 4928.143(F), Revised Code. Consistent with this reasoning, AEP-Ohio reduces it earnings attributable to common stock after taxes and adjusts its ROE for CSP from 20.84 percent to 18.31 percent. (Cos. Ex. 4 at 5-6, Ex. TEM-1; Cos. Ex. 6 at 6-7.)

(b) Staff's positions as to OSS

Staff takes no position on the inclusion or exclusion of OSS from the SEET analysis. However, Staff argues that the Companies' calculation to exclude OSS from CSP's earned ROE is incorrect. According to Staff, to appropriately exclude OSS margins from CSP's earned ROE there must be an adjustment to the equity base of the ROE. Staff adjusts the denominator, common stock equity, to account for that part of the equity which finances the generation plant which facilitates OSS. To make the adjustment, Staff first calculates the amount of equity that supports production plant, which is 51.5 percent of CSP's total equity. The next step is to allocate that portion of equity to OSS by using the ratio of sales for resale revenues to total sales revenues, which equals 13.9 percent. Staff's calculation results in $93.4 million of the total average equity of $1,302.6 million being allocated to OSS, leaving the remaining average equity balance at $1,209.2 million. As adjusted by Staff, CSP's ROE after excluding OSS, acknowledging the corresponding equity effect, produces an earned ROE of 19.73 percent as opposed to the 18.31 percent offered by CSP. (Staff Ex. 1 at 19-21, Ex. 3.)

Customer Parties oppose any adjustment to CSP's earned ROE of 20.84 percent. Nonetheless, if the Commission elects to exclude OSS margins from CSP's earned ROE, Customer Parties admit that the Staff's proposed revision to the calculation is an appropriate starting point although it understates the company's earned return. (Joint Inv. Br. at 29-31.)

AEP-Ohio explains that, despite Staff's claims that the Companies' calculation to exclude OSS from CSP's earned ROE needs to be refined, according to AEP-Ohio, the calculation is consistent with the Commission's directive as to the calculation of equity in 09-786 (Cos. Ex. 4 at 4-5; Tr. at 78).[21]

(c) Customer Parties' position on OSS

Customer Parties, as supported by OPAE, vehemently oppose any adjustment to CSP's earned ROE of 20.84 percent including OSS. Customer Parties reason that OSS are sales by the utility to individuals or entities that are not Ohio retail customers. OSS are possible, Customer Parties explain, by generation plant that otherwise produces power for Ohio retail electric customers; generation facilities built for the benefit of and funded by Ohio customers. Customer Parties are adamant that CSP's jurisdictional customers have funded a return on as well as a return of the generation assets used for OSS transactions. Thus, Customer Parties and OPAE reason that it is only equitable to include OSS earnings in CSP's SEET calculation. (Joint Inv. Ex. 2 at 22-24; OPAE Br. at 4-7.)

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21 09-786, Order at 18 (June 30, 2010); Entry on Rehearing at 6 (August 25, 2010).

Customer Parties offer that in 2009, CSP's earnings from OSS were $32,977 million, in comparison to CSP's total earnings of $271,504 million, 12.1 percent of CSP's total earnings. If, as AEP-Ohio requests, earnings from OSS are excluded from the SEET analysis, Customer Parties argue that the Commission would be comparing 87.9 percent of CSP's earnings to 100 percent of the earnings of the comparable group of companies, biasing the SEET analysis in favor of AEP-Ohio. Customer Parties plead that such a comparison is in conflict with the language of Section 4928.143(F), Revised Code, and will render the SEET analysis meaningless and asymmetrical. Further, Customer Parties contend that OSS are an inherent component of the company's earnings, as prescribed by generally accepted accounting principles, as such earnings are reported to the Securities and Exchange Commission (SEC) and FERC. Customer Parties declare that modifying such reported earnings would be inconsistent with federal law as well as FERC and SEC accounting standards. (Joint Inv. Ex. 2 at 21-24; Cos. Ex. 4 at Ex. TEM-1.)

Moreover, Customer Parties note that Ohio customers are paying CSP for its energy efficiency programs instituted pursuant to Section 4928.64, Revised Code, which facilitate OSS. On that basis, Customer Parties believe it is unreasonable to exclude OSS margins from the SEET analysis. Incorporating OSS margins in the SEET analysis serves as a form of off-set to the energy efficiency costs incurred by CSP's customers and promotes the policy of the state, under Section 4928.02(A), Revised Code, to ensure the availability of reasonably priced retail electric service to Ohio's consumers. (Joint Int. Ex. 2 at 23-24; Tr. 253-254.)

In regard to the FERC jurisdictional claims made by AEP-Ohio, Customer Parties retort that there is no valid federal preemption prohibiting consideration of OSS earnings in retail ratemaking. Customer Parties assert that several other state commissions have done so. (Joint Inv. Ex. 2 at 24.)

(d) Commission decision on OSS margins

Initially, the issue of OSS margins in the SEET analysis was considered by the Commission in AEP-Ohio's ESP proceedings. Numerous interested stakeholders also participated in 09-786 and offered their position on the issue of OSS in that proceeding. While the Commission offered guidance on numerous aspects of the issues raised as to the application of the SEET, in regards to OSS, the Commission determined that the issue was more appropriately addressed in the individual SEET proceedings. As the Commission had hoped, in this case the Companies and Customer Parties have expanded and clarified their positions and have provided context to the effects of each position presented as part of this SEET analysis.

We are required to consider not only whether the electric utility had significantly excessive earnings but also whether its earnings are the result of adjustments in its ESP. Where it can be shown that the electric utility received a return on its OSS, which if included in the calculation could unduly increase its ROE for purposes of SEET comparisons, OSS margins and the related equity in generation facilities should be excluded from the SEET calculation. Thus, without reaching the federal and constitutional law arguments, we will exclude OSS and the portion of generation that supports OSS from the SEET analysis.

With the exclusion of OSS margins from the SEET analysis, we find it necessary to correct, as Staff recommends and Customer Parties at least accept as conceptually correct, to account for the equity effect of the exclusion. Therefore, we reduce CSP's earnings to exclude OSS and similarly adjust the calculation to account for that portion of the generation facilities that supports OSS. Accordingly, the Commission recalculates CSP's ROE, excluding OSS and incorporating the equity effect of excluding OSS, to be 19.73 percent.

2. <u>Deferrals</u>

(a) <u>AEP-Ohio</u>

In AEP-Ohio's SEET application, the Companies exclude what it refers to as "significant" deferrals- deferred fuel adjustment clause revenues (including the interest on carrying costs and the equity carrying costs component on the deferred fuel) and deferred economic development rider (EDR) revenues from CSP's ROE for SEET purposes, thereby reducing CSP's ROE from 18.31 percent (with OSS excluded) to 15.99 percent (excluding both OSS and deferrals) for 2009. AEP-Ohio calculates CSP's deferrals to total $47.2 million. AEP-Ohio argues that this exclusion is critical for the Companies to preserve the probability of recovery of the deferred fuel cost as it is a necessary basis for the utility to record and maintain the regulatory asset on its balance sheet and for the Commission to direct the phase-in of rate increases as permitted pursuant to Section 4928.144, Revised Code. The Companies also argue it is inappropriate for the Commission to consider refunding earnings through the SEET analysis that the Companies have not actually collected from customers. (Cos. Ex. 6 at 13-15; Cos. Ex. 4 at 12-16, Ex. TEM-6.)

(b) <u>Other parties' position regarding deferrals</u>

(1) <u>Customer Parties</u>

Customer Parties view FAC and EDR deferred revenues as deferred rate increases pursuant to the ESP which contribute to the earnings approved by the Commission and subject to refund to customers. Customer Parties argue that deferred expenses only affect earnings in the year of the deferral and there is no effect on earnings in future years. In future years, revenues and expenses are matched with no effect on earnings. Customer Parties recommend that any excess earnings first be used to eliminate or reduce the regulatory asset created by the deferral on the electric utility's books as of the date the refund is effective. (Joint Inv. Ex. 2 at 6-7, 15-16, 25-26.)

(2) Staff

Like OSS, Staff takes no position on the inclusion or exclusion of deferrals from the SEET analysis. However, like the adjustment for OSS, Staff argues that the Companies' calculation to exclude deferrals from CSP's earned ROE is incorrect and requires an adjustment to the denominator to account for the equity effect of the exclusion from revenue. As adjusted by Staff, CSP's ROE to exclude deferrals, acknowledging the corresponding equity effect, produces an earned ROE of 18.74 percent as opposed to the 18.52 percent (deferrals only excluded) offered by CSP. (Staff Ex. 1 at 19-21, Ex. 3.)

(c) Commission decision on deferrals

Unlike OSS or extraordinary or non-recurring items, deferrals should not be excluded from the electric utility's ROE as requested by AEP-Ohio. Consistent with generally accepted accounting principles, deferred expenses and the associated regulatory liability are reflected on the electric utility's books when the expense is incurred. Subsequently, with the receipt of deferred revenues, there is an equal amortization of the deferred expenses on the electric utility's books, such that there is no effect on earnings in future years. Accordingly, we are not persuaded by the arguments of AEP-Ohio to adjust CSP's 2009 earnings to account for certain significant deferred revenue.

D. Capital requirements for future committed Ohio investments

In support of its future committed investments, AEP-Ohio offered its actual construction expenditures for 2007 through 2009 and capital budget forecast for 2010 and 2011 categorized by new generation, environmental, other generation, transmission, distribution, gridSMART and corporate/other. For the ESP period, AEP-Ohio offers a plan to invest $1.67 billion in Ohio. More specifically, AEP-Ohio had total construction expenditures for the year 2009 for CSP of $280,108 million, and for 2010 and 2011 projected construction expenditures of $256,100 million, and $186,969 million, respectively. Over and above the future committed investments set forth in the Companies' construction expenditures and budget projections, AEP-Ohio notes a commitment to make a capital investment associated with the company's compliance with its alternative energy portfolio requirements pursuant to Section 4928.64, Revised Code. CSP has made a commitment to invest $20 million to support the development of a large solar farm near Cumberland, Ohio, and entered into a 20-year purchase agreement for all of the facility's power. CSP also plans to expand its gridSMART project to its entire service territory. (Cos. Ex. 6 at 16-18, Ex. JH-1; Cos. Ex. 8 at 7; Cos. Br. at 67-72; Tr. 289-290, 687-690.)

1. Opposition to the committed future investment claims

Customer Parties opine that consideration of future committed investments is a factor to be considered in association with the development of comparable companies, the establishment of the threshold ROE and any adjustment to the threshold. To that end, Customer Parties note that its development of the comparable group of companies includes consideration of the fixed asset turnover ratio as part of the business and financial risk measures. IEU-Ohio and Customer Parties also note that, using CSP's 2009 construction expenditures as a baseline of $280.108 million, CSP's budgeted projections are declining through 2011. The intervenors argue that the Commission should only consider future committed investments during the ESP period that are funded by the electric utility itself and which are beyond the utility's normal rate of funding. Further, Customer Parties challenge AEP-Ohio's commitment to construct the projects on which the budget projections are developed. In light of the tenuous nature of the committed future investments, and the fact that CSP's future capital commitments are declining during the ESP period, Customer Parties implore the Commission that, although it is required to give consideration to the electric utility's future committed capital investments in Ohio, in this instance, it is not appropriate to take future investments into consideration. OPAE joins Customer Parties in its conclusion that there should not be an upward adjustment in the SEET or a reduction in any refund due customers for future committed investments. (Joint Inv. Ex. 1 at 13; Joint Inv. Ex. 2 at 29-30; Joint Inv. Br. at 47-56; OPAE Reply Br. at 9; IEU-Ohio Br. at 22-24.)

In its response, AEP-Ohio notices that Staff did not acknowledge the evidence offered concerning the Companies' committed capital investments and states that the other parties to the proceeding mischaracterize the approximately $1.7 billion investments as merely "business as usual." AEP-Ohio argues that Section 4928.143(F), Revised Code, clearly allows the consideration of the utility's future committed investments without limitations as to ESP period and no language in the statute requires that the investment be unreimbursed shareholder-funded contributions. AEP-Ohio is of the opinion that the statute does not require the future investment to be extraordinary in comparison to an historical baseline of investments. The Companies rely on the language in Rule 4901:1-35-03(C)(10)(a)(iii), O.A.C., in support of the notion that the capital budget forecasts are indicative of the electric utility's "capital requirements for future committed investments." AEP-Ohio contends it would be arbitrary and capricious to only consider the electric utility's incremental future capital investments that increase annually year-after-year. AEP-Ohio reiterates that while all of the projects in the forecasted budget have not completed the management review process, approximately 90 percent of the projects listed for 2010 and 70-80 percent of the projects listed for 2011 have received the necessary management approvals. (Cos. Reply Br. at 28-35.)

Commission Decision

As required by the statute and as discussed above, the Commission considered the electric utility's future committed capital investments when rendering its decision on the SEET.

2. Other adjustments to CSP's 2009 Earnings

(a) AEP-Ohio

As part of its SEET application, AEP-Ohio presented a narrative of information regarding the Companies' risk and performance. AEP-Ohio notes that as an Ohio electric utility that owns generation, it faces numerous risks including risks associated with: the lack of guaranteed recovery for generation assets; customer shopping; the term of the Companies' approved ESP and the unanticipated shutdown of generation stations; environmental regulation; and market-price impact for generation-related services. Further, the Companies contend that they face risks associated with the variability and uncertainty of its retail revenue stream and weather.

As for the Companies management performance and industry benchmarks, AEP-Ohio notes that since 2005, CSP and OP have consistently performed very well on customer satisfaction surveys. Further, AEP-Ohio notes that its SAIFI and CAIDI have improved since 2003 through 2009. The Companies state that they are leaders in the industry regarding advances in electric generation and transmission technologies. CSP and OP invest in Ohio and maintain a significant tax base throughout the state with a total economic impact that exceeds $2 billion per year. CSP states that its gridSMART project received the highest rating among all such applications presented to the U.S. Department of Energy (US DOE). AEP-Ohio asserts the Companies regularly participate in various industry efforts to strengthen interoperability standards and cyber security. AEP-Ohio is working in collaboration with US DOE to advance carbon capture and sequestration technologies. AEP-Ohio also claims that its energy efficiency and demand reduction programs have the potential to save Ohio consumers $630 million and reduce power plant emissions. Finally, AEP-Ohio emphasizes that CSP achieved 202 percent and OP achieved 171 percent of their respective energy efficiency benchmarks for 2009. (Cos. Ex. 6 at 19-24, Ex. JH-2.)

(b) Other parties' position

Customer Parties reason that any consideration of the additional factors offered as directed in *09-786* do not negate any significantly excessive earnings by CSP in 2009 and any consideration of such factors as to CSP and OP, jointly, or AEP-Ohio, are prohibited pursuant to the language of the statute. Indeed, Customer Parties assert that the return on equity in CSP's last general rate case was 12.46 percent,[22] the most recent ROE in CSP's rider cases of 10.50 percent,[23] and the company's 2009 actual ROE of 20.84 percent is a strong indicator of significantly excessive earnings. Further, Customer Parties argue that evidence presented by AEP-Ohio on the business and financial risks faced by CSP does not justify any additional further consideration than what the Companies have reflected in their comparable group of companies. Customer Parties and OPAE offer that only a small portion of CSP's customers are actually shopping and, according to their calculations, CSP has been sufficiently compensated for the shopping risk by the provider of last resort (POLR) charge. (Joint Inv. Ex. 2 at 30; Joint Inv. Reply Br. at 40-43; OPAE Br. at 6.)

In addition, Customer Parties argue there are other factors that reduce or neutralize the risks alleged by AEP-Ohio. Customer Parties note that CSP's ESP includes a FAC that protects CSP and OP against rising fuel costs. Customer Parties also note that CSP's ROE of 20.84 percent was the highest reported by Ohio's electric utilities; the highest among the company's affiliates in the AEP East power pool; and the highest ROE among all investor-owned regulated electric utilities in the United States. Customer Parties submit that these factors likewise must be considered by the Commission in making its decision as to CSP's 2009 earnings. (Joint Inv. Ex. 2 at 18-20; Joint Inv. Reply Br. at 44-48.)

Commission decision on additional factors

As discussed previously in our discussion of the SEET threshold, the Commission has considered these arguments in its establishment of the threshold.

Commission's Conclusions Regarding AEP-Ohio's 2009 SEET

In consideration of the Commission's conclusion as discussed above regarding the application of the SEET to OP for 2009, the Commission finds that under any parties' proposed SEET analysis presented in this proceeding, OP's earned ROE is less than 200 basis points above the mean of the comparable group of companies. Thus, the

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22 Tr. at 214-216.

23 *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company to Establish Environmental Investment Carrying Cost Riders*, Case No. 10-155-EL-RDR, Finding & Order (August 25, 2010); and *In the Matter of the Application of Columbus Southern Power Company to Update its gridSMART Rider*, Case No. 10-164-EL-RDR, Finding & Order (August 11, 2010).

Commission concludes that OP did not have significantly excessive earnings for 2009 pursuant to Section 4928.143(F), Revised Code, and the Commission's directives in 09-786. Next, in regard to CSP, consistent with the findings discussed above, the Commission finds:

	Percent	$ in millions
CSP's earned ROE for 2009	20.84	271.504
Exclusion of OSS with equity effect	19.73	
Threshold ROE for 2009 SEET	17.6	
Difference (19.73 – 17.6) x $ 20.039[24]	2.13	42.683
CSP's 2009 Significantly Excessive Earnings Subject to Return		42.683

The Commission directs CSP to apply the significantly excessive earnings, as determined in this Opinion and Order, first to any deferrals in the FAC account on CSP's books as of the date of this order, with any remaining balance to be credited to CSP's customers on a per kilowatt hour basis beginning with the first billing cycle in February 2011 and coinciding with the end of the current ESP period. Additionally, the Commission finds that any balance credited to CSP's customers will not be deducted from the Company's earnings for purposes of the 2011 SEET review.

In the Companies' ESP case, the Commission approved an increase in rates for 2011 of six percent of total bill. With the Commission's determination of significantly excessive earnings for CSP in 2009, the Commission directs CSP, consistent with this Opinion and Order, to adjust its tariff rates, accordingly.

Finally, in regards to Staff' recommendation to offer a benchmark ROE based on an index or combination of indices as the starting point for the annual SEET, the Commission will continue to consider the proposal and address any amendment to the SEET process by entry to be issued in the near future.

24 Joint Int. Ex. 2 at 17.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

(1) CSP and OP are public utilities as defined in Section 4905.02, Revised Code, and, as such, the companies are subject to the jurisdiction of this Commission.

(2) On September 1, 2010, CSP and OP filed an application for administration of the SEET in accordance with Section 4928.143(F), Revised Code.

(3) Intervention in this case was granted to OCC, IEU-Ohio, OPAE, OEG, APJN, OMA, OHA and The Kroger Company.

(4) The hearing in this case commenced on October 25, 2010, and concluded on November 1, 2010. Three witnesses testified on behalf of AEP-Ohio, two witnesses testified on behalf of Customer Parties, and one witnesses testified on behalf of the Commission Staff.

(5) Initial briefs were filed on November 19, 2010 and/or reply briefs were on filed on November 30, 2010, by AEP-Ohio, Staff, Customer Parties,[25] IEU-Ohio and OPAE.

(6) AEP-Ohio waived its right to further jurisdictionalize its earnings in this SEET proceeding.

(7) OP did not have significantly excessive earnings for 2009 pursuant to Section 4928.143(F), Revised Code, and the Commission's safe harbor provision.

(8) CSP had significantly excessive earnings for 2009 pursuant to Section 4928.143(F), Revised Code.

ORDER:

It is, therefore,

ORDERED, That IEU-Ohio's motion to dismiss AEP-Ohio's SEET application is denied. It is, further,

ORDERED, That CSP apply the significantly excessive earnings, as determined in this Opinion and Order, first to any deferrals in the FAC account on CSP's books as of the date

[25] The reply brief filed by Customer Parties did not include OMA or OHA as a party to the brief. Only OCC, APJN and OEG are listed as parties to the reply brief.

of this Order, with any remaining balance to be credited to CSP's customer bills beginning with the first billing cycle in February 2011. The bill credit shall be on a kilowatt hour basis and coincide with the end of the current ESP period. It is, further,

ORDERED, That AEP-Ohio comply with its commitments as set forth in its notice of withdrawal of the Stipulation. It is, further,

ORDERED, That a copy of this Opinion and Order be served upon all parties and other interested person of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Steven D. Lesser, Chairman

Paul A. Centolella

Valerie A. Lemmie

Concurring

Cheryl L. Roberto

GNS/JRJ/vrm

Entered in the Journal
JAN 11 2011

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	)	Case No. 10-1261-EL-UNC

CONCURRING OPINION OF COMMISSIONER CHERYL L. ROBERTO

I generally concur with my colleagues as to the matters discussed within the majority opinion and with the conclusion that CSP enjoyed significantly excessive earnings which must be returned to consumers.

However, I would have preferred that my colleagues and I could have considered another alternative to the timing and methodology for the consideration of Off Systems Sales (OSS). Recognizing that we may only consider excessive earnings resulting from "adjustments" granted in an electric security plan, we account for this by excluding the OSS from the return on equity (ROE) reported by CSP on its FERC Form No. 1, thereby reducing the reported ROE of 20.84 percent to 19.73 percent for purposes of the SEET analysis. I am concerned that this method may skew the SEET analysis by an improper weighting of OSS while also failing to account for any other earnings that were not the result of "adjustments." A better practice may have been first to determine what earnings are significantly excessive by calculating all earnings over the SEET threshold (i.e., earnings that increased the ROE from 17.6 percent to 20.84 percent). Recognizing that some of these earnings were due to "adjustments" but the remaining were due to any number of factors, including but not limited to OSS, one could allocate the earnings between adjustment-related and nonadjustment-related earnings. The most straight-forward method to accomplish this would be to calculate a simple ratio of total revenue resulting from adjustments (collected and deferred) to total earnings. It is that ratio applied to the calculated significantly excessive earnings that would reasonably identify what proportion of those earnings resulted from adjustments. However, because the record does not contain total earnings resulting from adjustments both collected and deferred, this calculation is not possible.

Therefore, I concur with the majority.

Cheryl L. Roberto

Cheryl L. Roberto

EXHIBIT B

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	))))))))	Case No. 10-1261-EL-UNC

FINDING AND ORDER

The Commission finds:

(1) By Opinion and Order issued January 11, 2011 (SEET Order), the Commission concluded that pursuant to Section 4928.143(F), Revised Code, Columbus Southern Power Company (CSP) had significantly excessive earnings of $42.683 million for 2009. The Commission directed CSP to apply the significantly excessive earnings first to any deferred fuel adjustment clause (FAC) costs on CSP's books as of the date of the SEET Order, with any remaining balance to be credited to CSP's customers on a per kilowatt (kWh) hour basis beginning with the first billing cycle in February 2011 and coinciding with the end of the current ESP period.

(2) On January 21, 2011, CSP filed tariffs to implement the directives in the SEET Order. The proposed tariffs are to be effective with the first billing cycle of February 2011 and expire with the last billing cycle of December 2011. CSP proposes that any over or under reconciliation be addressed in the subsequent FAC audit. Based on CSP's calculations, all CSP customers, including special contract customers, will receive a credit of $.001256 per kWh.

(3) Upon further consideration of the application of the credit to all customer bills, the Commission clarifies that reasonable arrangement customers who receive service under a discount rate supported by delta revenue recovery are not entitled to both the discount rate and a SEET credit. Accordingly, CSP is directed to revise the SEET credit calculation to omit such reasonable arrangement customers and file revised tariffs.

(4) CSP is directed to immediately file revised tariffs consistent with this Order to be effective with the first billing cycle of February 2011 and expire with the last billing cycle of December 2011. In light of the short timeframe remaining before these tariffs must go into effect, the Commission finds that the revised tariffs shall be approved to be effective as of the date of filing, contingent upon final review by Staff.

It is, therefore,

ORDERED, That CSP's January 21, 2011, tariff filing, as modified by this finding and order, should be approved as set forth in findings (3) and (4). It is, further,

ORDERED, That CSP be authorized to immediately file, in final form four complete copies of tariffs consistent with this finding and order. CSP shall file one copy in this case docket and one copy in the company's TRF docket (or may make such filing electronically, as directed in Case No. 06-900-AU-WVR). The remaining two copies shall be designated for distribution to Staff. It is, further,

ORDERED, That the effective date of the new tariffs shall not be a date earlier than the date on which the revised tariffs are filed and the date this finding and order is issued for bills rendered with the first billing cycle of February 2011. It is, further,

ORDERED, That nothing in this finding and order shall be binding upon this Commission in any subsequent investigation or proceeding involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further, ORDERED, That a copy of this Finding and Order be served upon all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Steven D. Lesser, Chairman

- Concur in result

Paul A. Centolella

Valerie A. Lemmie

Cheryl L. Roberto

GNS/ vrm

Entered in the Journal

JAN 27 2011 JAN 27 2011

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	)	Case No. 10-1261-EL-UNC

<u>CONCURRING OPINION OF COMMISSIONER PAUL A. CENTOLELLA</u>

I concur in the result of the Commission's Finding and Order in that it produces an impact for consumers that largely approximates that which I believe to be appropriate. While I find the Order's impact to be reasonable, for customers who are served under the Commission-approved special arrangements addressed in the Finding and Order, I would have preferred to make the prospective adjustments required under Section 4928.143(F), Ohio Revised Code, by reducing the costs, incentives, and foregone revenues recoverable through the Company's unavoidable Economic Development Rider.

Paul A. Centolella, Commissioner

EXHIBIT C

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	))))))	Case No. 10-1261-EL-UNC

ENTRY ON REHEARING

The Commission finds:

(1) On July 31, 2008, Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, AEP-Ohio or the Companies) filed an application for a standard service offer (SSO) pursuant to Section 4928.141, Revised Code. The application was for an electric security plan (ESP) in accordance with Section 4928.143, Revised Code.

(2) On March 18, 2009, the Commission issued its opinion and order (ESP Order) modifying and approving AEP-Ohio's ESP.[1] By entries on rehearing issued July 23, 2009 (First ESP EOR), and November 4, 2009 (Second ESP EOR), the Commission affirmed and clarified certain issues raised in AEP-Ohio's ESP Order.

(3) On September 1, 2010, AEP-Ohio filed the instant application for the administration of the significantly excessive earnings test (SEET), as required by Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code (O.A.C.). By entry issued September 21, 2010, as amended on October 8, 2010, a procedural schedule was established for this proceeding.

(4) Motions to intervene were timely filed by, and intervention granted to, the following entities: the Office of the Ohio Consumers' Counsel (OCC), Ohio Energy Group (OEG), Appalachian Peace and Justice Network (APJN), Ohio Manufacturers' Association (OMA), Ohio Hospital Association (OHA), Ohio Partners for Affordable Energy (OPAE), and

1 *In re AEP-Ohio,* Case Nos. 09-917-EL-SSO and 09-918-EL-SSO.

Industrial Energy Users-Ohio (IEU-Ohio). Pursuant to the entry issued December 1, 2010, The Kroger Company (Kroger) was granted limited intervention to participate in the SEET case.

(5) On January 11, 2011, the Commission issued its Opinion and Order (SEET Order), pursuant to the requirements of Section 4928.143(F), Revised Code, and the Commission's directives in *In the Matter of the Investigation into the Development of the Significantly Excessive Earnings Test Pursuant to Amended Substitute Senate Bill 221 for Electric Utilities*, Case No. 09-786-EL-UNC (09-786). In the SEET Order, the Commission found that under any party's proposed SEET analysis presented in this proceeding, OP's earned return on equity (ROE) is less than 200 basis points above the mean of the comparable group of companies. Thus, the Commission concluded that OP did not have significantly excessive earnings for 2009 pursuant to Section 4928.143(F), Revised Code, and the Commission's directives in 09-786.

As to CSP, the Commission ultimately concluded that, based on an earned ROE of 20.84 percent for 2009, CSP had significantly excessive earnings of $42.683 million. Accordingly, the Commission directed CSP to apply the significantly excessive earnings, first to any deferrals in the fuel adjustment clause (FAC) account on CSP's books as of the date of the SEET Order, with any remaining balance to be credited to CSP's customers on a per kilowatt hour (kWh) basis beginning with the first billing cycle in February 2011 and coinciding with the end of the current ESP period. The Commission also concluded that any balance credited to CSP's customers would not be deducted from CSP's earnings for purposes of the 2011 SEET review.

(6) Section 4903.10, Revised Code, states that any party to a Commission proceeding may apply for rehearing with respect to any matter determined by the Commission, within 30 days of the entry of the order upon the Commission's journal.

(7) On February 10, 2011, applications for rehearing were filed by Customer Parties,[2] CSP, IEU-Ohio and OPAE. Memoranda

[2] Originally, Customer Parties included OMA and OHA. However, neither the reply brief nor the application for rehearing filed by Customer Parties included OMA or OHA as parties to the pleadings. Only OCC, APJN, and OEG are listed as parties to the reply brief and application for rehearing.

contra the various applications for rehearing were filed by CSP, IEU-Ohio, Customer Parties, and OPAE. In their applications for rehearing, the parties raise a number of assignments of error, alleging that the SEET Order is unjust, unreasonable, and/or unlawful.

(8) On January 21, 2011, CSP filed tariffs to implement the directives in the SEET Order. CSP proposed that any over or under reconciliation be addressed in the subsequent FAC audit and determined that based on its calculations, all CSP customers, including reasonable arrangement customers, will receive a credit of $.001256 per kWh. By entry issued January 27, 2011, the Commission approved the proposed SEET tariff, with clarification that reasonable arrangement customers who receive service under a discount rate supported by delta revenue recovery are not entitled to both the discount rate and a SEET credit. Therefore, the Commission directed CSP to revise the SEET credit calculation to omit such reasonable arrangement customers and file revised tariffs.

(9) The Commission has reviewed and considered all of the arguments on rehearing. Any arguments on rehearing not specifically discussed herein have been thoroughly and adequately considered by the Commission and are being denied.

<u>Constitutionality and Application of Section 4928.143(F), Revised Code</u>

(10) CSP argues that the Commission erred by concluding that Section 4928.143(F), Revised Code, provides ample direction to reasonably apply the statute in this case. CSP presents three arguments in support of this assignment of error. First, CSP notes that the Commission erred by concluding that Section 4928.143(F), Revised Code, is not void for vagueness. Next, CSP claims that the Commission erred by determining that there is ample legislative direction to reasonably apply Section 4928.143(F), Revised Code, in this case. Last, CSP asserts that the Commission erred in finding that the SEET issue is not fundamentally different from concepts the Commission regularly decides under Ohio's statutory provisions for utility regulation. (CSP App. at 4-6.)

(11) The Commission fully addressed the arguments CSP raises in its first assignment of error at pages 9-10 of the SEET Order. As CSP has raised no new argument not already considered and addressed by the Commission, we find that CSP's first assignment of error should be denied.

(12) IEU-Ohio raised eight arguments in support of its position that the SEET Order was unjust and unreasonable.[3] IEU-Ohio argues that it was unreasonable for the Commission to have failed to order CSP and OP to refile their testimony and supporting materials to properly address the requirements of Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C. IEU-Ohio next submits that the Commission erred by failing to properly apply the SEET as outlined in Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C. Next, IEU-Ohio argues that the Commission erred by determining that the SEET may be measured by the total company return on common equity rather than the electric distribution utility's (EDU) earned return on common equity from the ESP. Even if reliance on total company data was lawful, IEU-Ohio asserts that the Commission failed to adjust appropriately net income and common equity to account fully for the removal of off-system sales (OSS) and other non-jurisdictional effects from the calculation of excessive earnings. (IEU-Ohio App. at 5-14.)

(13) The Commission fully addressed at pages 13-14 of the SEET Order the first four arguments raised by IEU-Ohio in its application for rehearing. As IEU-Ohio has raised no new argument not already considered and addressed by the Commission, we find that IEU-Ohio's first four arguments of error should be denied.

(14) IEU-Ohio next argues that the Commission erred by failing to use the appropriate annual period to conduct the SEET as required by Section 4928.143(F), Revised Code. IEU-Ohio submits that the start date of the ESP was April 1, 2009, and thus, the annual period should have ended on March 31, 2010, but that the Commission once again relied on the noncompliant position that the ESP was retroactive to January 1, 2009. (IEU-Ohio App. at 14-15.)

3 IEU-Ohio's first four assignments of error were grouped together for discussion in its application for rehearing and will be treated similarly in this entry on rehearing.

(15) As noted in the SEET Order at page 13, the Commission has on several prior occasions addressed the start date of AEP-Ohio's ESP. *See* AEP-Ohio ESP Order at 64; Entry Nunc Pro Tunc (March 30, 2009); and First ESP EOR at 41-45. As the Commission has already fully addressed this issue and because IEU-Ohio has raised no new argument not already fully considered and addressed by the Commission, we deny IEU-Ohio's assignment of error on this matter.

(16) IEU-Ohio further argues that the SEET Order was unlawful and unreasonable because the Commission failed to comply with the policy of the state as outlined in Section 4928.02, Revised Code, to ensure the availability to consumers of reasonably priced electric service and encourage the competitiveness of Ohio's economy (IEU-Ohio App. at 17-19).

(17) IEU-Ohio's concern with the Commission's order on this issue appears to be one of degree as the Commission sided with IEU-Ohio and with the intervenors on the argument that CSP benefitted from significantly excessive earning during 2009. In other words, IEU-Ohio's argument appears to be predicated on the position that the Commission's order did not go far enough in ordering customer refunds. IEU-Ohio's assignment of error is predicated on the position that there may be an understatement of the amounts by which CSP exceeded the significantly excessive threshold and that Ohio's competitiveness is being harmed because AEP-Ohio retail customers may be carrying more than their fair share of the profitability achieved by the parent, American Electric Power Company, Inc. The Commission fully explained, in the SEET Order, the rationale for rendering the determination that CSP benefitted from significantly excessive earnings during 2009 and the appropriate level of refunds to be returned to customers pursuant to Section 4928.143(F), Revised Code. Aside from the issues addressed in the SEET Order, IEU-Ohio has not demonstrated the presence of any other significant factors that has caused Ohio customers to carry more than their fair share of the parent company's profitability. IEU-Ohio's assignment of error on this matter is, therefore, denied.

Comparable Group of Companies, Return on Equity of Comparable Companies and SEET Threshold

(18) OPAE argues the SEET Order is unreasonable and unlawful under the requirements of Section 4928.143(F), Revised Code, in its rejection of Customer Parties' methodology and composition of the comparable group of companies, the comparable companies' benchmark ROE of 9.58 percent, and the establishment of the SEET threshold range of 11.58 percent to 13.58 percent based on a 200-400 basis points adder over the comparable companies' ROE. OPAE also argues that the SEET Order is unreasonable and unlawful for failing to make, in OPAE's opinion, the statutory refund required based on the arguments of Customer Parties. (OPAE App. at 3-8, 14-16.)

(19) Similarly, CSP also argues that the SEET Order is unlawful and unreasonable in its failure to adopt AEP-Ohio's method for establishing the benchmark ROE, determination of significantly excessive earnings at approximately two standard deviations above the benchmark ROE, and adoption of the 2009 SEET threshold of 22.51 percent (CSP App. at 7-9). Customer Parties and OPAE support the Commission's rejection of CSP's proposed method for establishing and adopting the SEET threshold (Customer Parties Memo at 2-4; OPAE Memo at 4-5). IEU-Ohio, however, maintains that CSP and OP failed to file a SEET application which complied with the statutory requirement to demonstrate that the electric utilities did not have significantly excessive earnings. (IEU-Ohio Memo at 5-6.)

(20) The Commission thoroughly considered and discussed in the SEET Order each party's process to determine the comparable group of companies, the comparable companies' benchmark ROE, and the SEET threshold to determine the significantly excessive earnings subject to refund. The SEET Order also presented the Commission's rationale and justification for its decision on each component of the SEET analysis. Neither OPAE nor CSP presents any new arguments that the Commission did not already consider. Accordingly, OPAE's and CSP's requests for rehearing, on the basis that the Commission did not adopt their respective positions, are denied.

(21) OPAE contends that the SEET Order is unreasonable and unlawful to the extent that it adopts Staff's proposed 50 percent

adder to the benchmark ROE and considered "utility specific factors related to investment requirements, risk and investor expectations" to adjust the adder applied to the mean ROE of the comparable group of companies. OPAE insists that the Commission should have only considered CSP's capital requirements for future committed investments in Ohio to occur during the current ESP period, through December 2011, which are not funded by riders paid by ratepayers. OPAE argues that CSP's capital investment budget for 2009 was below its actual construction expenditures in 2007 and 2008. For these reasons, OPAE concludes that the Commission should not have accorded any consideration to the solar project, the gridSMART project, future environmental investments, or for any shopping risk. (OPAE App. at 8-12.)

(22) As the Commission indicated in the order and entry on rehearing in 09-786 and as thoroughly discussed in the SEET Order at pages 23-27, the Commission must recognize, in applying the SEET, the variation among Ohio's electric utilities and our obligation to ensure that the electric utility is allowed to operate successfully, to maintain its financial integrity, attract capital, and to compensate its investors. OPAE has not raised any new arguments for the Commission's consideration. As such, the Commission affirms its decision in the SEET Order and denies OPAE's request for rehearing on this matter.

Adjustments to CSP's 2009 Earnings

(23) OPAE and Customer Parties request that the Commission reconsider the exclusion of OSS margins from CSP's earnings for the SEET. OPAE and Customer Parties assert that OSS are an inherent component of CSP's earnings and further argue that excluding OSS from CSP's earnings skews the comparison to the earnings of the comparable group of companies in violation of the language in Section 4928.143(F), Revised Code. (OPAE App. at 13; Customer Parties App. at 6-7.)

(24) These are the same arguments presented to the Commission on brief by Customer Parties and OPAE regarding OSS in the SEET calculation and considered in the Commission's decision. OPAE and Customer Parties have not presented any new arguments for the Commission's consideration. As such, the requests for rehearing regarding the exclusion of OSS from the SEET calculation are denied.

(25) Further, Customer Parties and OPAE argue that the Commission's adoption of the Staff's adjustment to account for the impact of excluding OSS from the SEET calculation is incomplete as no evidence was presented to correctly quantify the necessary adjustment. Customer Parties and OPAE claim that the adjustment in the SEET Order understates the significantly excessive earnings subject to refund and argue that, because there is a lack of record evidence to correctly quantify the exclusion of OSS, CSP failed to meet its burden of proof in accordance with Section 4928.143(C)(1), Revised Code. Therefore, Customer Parties and OPAE contend that the Commission must include OSS in CSP's earnings for purposes of the SEET. (OPAE App. at 13-14; Customer Parties App. at 3-5.)

(26) The arguments presented by Customer Parties and OPAE on rehearing do not persuade the Commission that OSS should be included in the electric utility's earnings for purposes of the SEET. We also note that, in their brief, Customer Parties acknowledged, at least conceptually, Staff's adjustment as a starting point for excluding OSS. The Commission affirms its decision to exclude CSP's OSS from the SEET analysis for the reasons stated in the SEET Order. Further, while it is always our intent to correctly calculate any adjustment, in this instance we used the best information available in the record to account for the equity effect in the numerator and the denominator. Thus, we affirm the SEET Order and deny Customer Parties' and OPAE's requests for rehearing on this matter.

(27) IEU-Ohio also finds error in the Commission failing to remove the operating expenses of the Waterford and Darby generating stations from the calculation of the SEET when the Commission previously ordered that the expenses be removed from the ESP (IEU-Ohio App. at 15-17).

(28) The Commission fully addressed this issue at pages 13 and 14 of the SEET Order. Having raised no new argument for the Commission's consideration, IEU-Ohio's assignment of error on this issue is denied.

(29) CSP contends that the SEET Order is unlawful and unreasonable to the extent the Commission included non-cash earnings, deferrals of FAC revenues, and economic development rider revenues in the calculation of the company's

earnings. CSP reiterates its position that including deferrals in the company's earnings jeopardizes the electric utility's ability to create deferrals and the Commission's ability to phase-in rate increases in contrast to the policy expressed in Section 4928.144, Revised Code. CSP argues that if an electric utility is determined to have significantly excessive earnings and has deferrals, the electric utility should not have to refund amounts not yet received nor refund amounts that are merely a recovery of costs which do not contribute to earnings. CSP advocates that, in the year the deferral is collected, when cash is received from customers, if the electric utility has significantly excessive earnings in that year, an adjustment be made to exclude the amortized deferral expenses to recognize recovered revenues in the earnings subject to refund. (CSP App. at 10-11.)

(30) Consistent with the Commission's conclusion in the SEET Order, Customer Parties, OPAE, and IEU-Ohio ask the Commission to deny CSP's request for rehearing on this issue. IEU-Ohio explains that CSP's process would shift earnings to later periods and, by definition, understates income. Customer Parties offer that deferrals fall within the definition of "rate adjustments" as adopted in 09-786 and, because deferrals are included in the ROE reported for financial accounting purposes, it is appropriate to include deferrals in CSP's earnings for the SEET analysis. (OPAE Memo at 5; IEU-Ohio Memo at 6; Customer Parties Memo at 4-7.)

(31) The Commission thoroughly considered AEP-Ohio's position and presented the Commission's justification for including deferrals in the SEET analysis at pages 30-31 of the SEET Order. CSP has not presented any new arguments for the Commission's consideration on rehearing. Accordingly, CSP's request for rehearing on this issue is denied.

(32) CSP also argues that the SEET Order is unreasonable and unsupported by the record to the extent that the Commission required CSP to expend $20 million by the end of 2012 on the Turning Point solar project in Cumberland, Ohio, or other similar project. CSP states that, although it is fully committed to the solar project, there are outstanding details, including federal loan guarantees and state and local tax incentives, which must be finalized for the project to go forward. The company argues that the regulatory requirement to spend $20 million by the end of 2012 is detrimental to CSP's ability to

negotiate the best terms for its investment and, therefore, is not in the public interest, which is not ameliorated by the option to invest in another similar project. CSP requests the flexibility necessary to make the best decision as to how the Turning Point project or similar project is structured and implemented. CSP expects that sufficient progress will be made in the upcoming months to allow the company to propose a firm schedule for the solar project or similar project, during the course of its next ESP proceeding.[4] In the alternative, CSP asks that the Commission require the company to submit a status report on the Turning Point project or other similar project in 2012 so that the Commission can consider and determine whether sufficient progress is being made. (CSP App. at 11-13.)

(33) As part of the Commission's application of the SEET, the Commission gave consideration to CSP's future committed capital expenditure in the Turning Point solar project. Given the Commission's consideration of CSP's expenditure in a solar project in the development of the 2009 SEET threshold, it is reasonable for the Commission to require that the expenditure occur by a date certain. However, we agree that CSP should propose, during the course of its next ESP proceeding, a firm schedule setting forth its expenditure in the Turning Point solar project or other similar project. Accordingly, we deny CSP's request for rehearing.

<u>Application of the SEET Credit</u>

(34) IEU-Ohio offers that the SEET Order, as implemented by the January 27, 2011 entry, addressing the applicable tariffs, is unreasonable and unlawful to the extent that reasonable arrangement customers paying rates under the SSO do not receive the SEET credit in violation of Sections 4928.143(F) and 4903.09, Revised Code (IEU-Ohio App. at 19-21).

(35) Special arrangement customers receive a discount off of the otherwise applicable tariff rate and the difference between the tariff rate and the discounted rate is recoverable from the electric utility's remaining customers. As such, special

4 *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan,* Case Nos. 11-346-EL-SSO and 11-348-EL-SSO; and *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority,* Case Nos. 11-349-EL-AAM and 11-350-EL-AAM.

arrangement customers did not fully contribute to CSP's 2009 significantly excessive earnings as determined in the SEET Order and should not be entitled to the SEET credit. Accordingly, the Commission denies IEU-Ohio's request for rehearing on this issue.

Other Issues

(36) Customer Parties argue that the SEET Order is unreasonable and inconsistent with paragraphs (A) and (L) of Section 4928.02, Revised Code, as the Order failed to require CSP to honor the $1 million commitment to the Partnership with Ohio, as set forth in the Stipulation filed November 30, 2010. Given the slow economic recovery in the state, Customer Parties admonish the Commission for not requiring CSP to honor the $1 million commitment to the Partnership with Ohio. (Customer Parties App. at 7-10.)

(37) Customer Parties note, but then ignore the fact, that CSP withdrew from the Stipulation but "unilaterally and voluntarily agreed" to fulfill certain obligations under the Stipulation which did not include the negotiated commitment to the Partnership with Ohio. The SEET Order merely recognized CSP's voluntary agreement to fulfill certain obligations with shareholder funds pursuant to its notice of withdrawal of the Stipulation. Since the Stipulation was withdrawn, the Commission finds it inappropriate to hold any party to a select provision of the Stipulation unless the party elects to do so voluntarily. Accordingly, Customer Parties' request for rehearing to enforce the Partnership with Ohio provision of the withdrawn Stipulation is denied.

It is, therefore,

ORDERED, That the applications for rehearing be denied. It is, further, ORDERED, That a copy of this entry on rehearing be served upon all parties and other interested persons of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Valerie A. Lemmie

Steven D. Lesser

Cheryl L. Roberto

GNS/JRJ/vrm

Entered in the Journal

MAR 09 2011

Reneé J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	)	Case No. 10-1261-EL-UNC

CONCURRING AND DISSENTING OPINION
OF COMMISSIONER CHERYL L. ROBERTO

I concur with my colleagues in each aspect of the majority opinion, excepting the demarcation as to which "consumers" are due SEET credit.

We previously found, and affirm here on rehearing, that CSP, as a result of provisions (or "adjustments")[1] included in its most recent electric security plan, enjoyed significantly excessive earnings of $42.683 million. Pursuant to Section 4928.143(F), Revised Code, having made such a finding, the Commission "shall require the electric distribution utility to return to consumers the amount of the excess by prospective adjustment...." It falls to the Commission to identify which consumers are due SEET credit.

CSP's electric security plan included provisions (adjustments) relating to the supply and pricing of generation service, as well as provisions relating to CSP's distribution service. Any or all of these provisions could have been the source of the significantly excessive earnings. In the absence of a record otherwise, we must assume that all such provisions did contribute to the significantly excessive earnings and, as such, any consumer class[2] that contributed revenue pursuant to one of these provisions is due SEET credit. Thus, on the facts before us, a SEET credit would be due to any consumer on CSP's distribution system.

On a more complete record, I believe it would have been possible and appropriate for the Commission to determine that the significantly excessive earnings were principally due to provisions relating to supply and pricing of generation service. On these

1 Section 4928.143, Revised Code, uses "provisions" and "adjustments" interchangeably.

2 Because Section 4928.143, Revised Code, directs that significantly excessive earnings must be returned to consumers "by prospective adjustment," I believe we must reject any of the arguments on rehearing that suggest an individual consumer's status or magnitude of usage during the previous year is relevant to whether the consumer receives a SEET credit. The "return" of significantly excessive earnings is prospective not retrospective. Thus, the "return" is to a consumer class prospectively. Those current members of the recipient class will be the consumers receiving the SEET credit.

hypothetical facts, the consumers due a SEET credit would be those consumers purchasing power pursuant to the standard service offer only. On these circumstances, it would have been appropriate to exclude from receipt of the SEET credit any consumer who does not purchase power from CSP via the standard service offer, e.g. consumers on reasonable arrangements or consumers who shop competitive suppliers for their energy.

In the case before us, however, we have made no finding that the significantly excessive earnings were due principally to provisions relating to supply and pricing of generation. Yet the majority excludes CSP distribution service consumers who purchase power via a reasonable arrangement from receipt of the SEET credit. The majority, however, does not exclude CSP distribution consumers who shop for their energy. In ruling thus, the majority has stated that "reasonable arrangement customers who receive service under a discount rate supported by delta revenue recovery are not entitled to both the discount rate and a SEET credit." I can find no statutory support for this distinction, therefore I dissent from this portion of the Entry on Rehearing.

Cheryl L. Roberto

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