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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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PUCO

In the Matter of the Application of Columbus Southern Power Company for Approval of its Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generation Assets.	)	Case No. 08-917-EL-SSO
In the Matter of the Application of Ohio Power Company for Approval of its Electric Security Plan; and an Amendment to its Corporate Separation Plan.	)	Case No. 08-918-EL-SSO

POST-HEARING REPLY BRIEF ON REMAND
BY
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL
AND
OHIO PARTNERS FOR AFFORDABLE ENERGY

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I. INTRODUCTION

In response to the Ohio Supreme Court's Order on Remand,[1] the Public Utilities Commission of Ohio ("PUCO") permitted the AEP[2] Companies the opportunity to create a record to support the collection of POLR[3] and carrying charges on environmental investment from their 1.4 million Ohio customers. In the wake of the Court's reversal, AEP Ohio attempted to salvage its case by reintroducing the optionality pricing model originally proposed by Witness Baker, and presenting other analyses that allegedly confirm the results of the option pricing model. On the carrying charge issue, the Companies' sole foundation

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[1] *In re Application of Columbus Southern Power Company, et al.*, 2011 Ohio 1788.

[2] The AEP Companies are Columbus Southern Power Company and Ohio Power Company, referred to as "AEP Ohio."

[3] POLR refers to provider of last resort service.

for collecting such costs comes in the form of Witness Nelson's testimony. Ohioans should not have to pay another penny for either of these unjustified charges.

AEP Ohio's case was strongly challenged by Intervenors, who took issue with the very premise of POLR[4] and have argued on brief that the Companies have no guaranteed right to lost profits. This is significant because the optionality pricing model presented by the Companies produces estimates of lost profits. It is these estimated lost profits that the Companies allege represent the value of the shopping optionality to customers and at the same time, represent the "cost" to the Companies.

Based on the evidence submitted, and the legal arguments presented on brief, OCC and OPAE contend that AEP Ohio has failed to bear its burden of proving its case for POLR and environmental carrying charges. Consequently, the PUCO should order the return of $153 million, with interest, for the charges presently being collected subject to refund.[5] The Companies' rates for the remainder of 2011 should be set without the unjustified elements for POLR and carrying charges on environmental investment made before 2009.

Additionally, with respect to the phase-in deferrals to be collected from customers during 2012 through 2018, the PUCO should lower those prospective charges by approximately $633 million.[6] The PUCO is not precluded from doing so by law or by Commission precedent. This is because the Ohio Supreme Court has recognized that if

[4] IEU, OCC, OPAE, and seemingly the PUCO Staff, contend that POLR does not include migration risk. See Staff Post Hearing Remand Brief at 5 ("Staff tends to agree with Dr. Lesser that migration risk 'is a risk of competitive markets, not a risk of being a POLR provider.' IEU Remand Ex. 1 at 13.").

[5] See OCC Remand Ex. 2 at 11-12 and 29-30 (OCC Witness Duann testified that the POLR charge and environmental carrying charge being collected, subject to refund, should be returned in their entirety to customers). The refund should be approximately $153 million. OCC Remand Ex. 2 at Attachment DJD-D. An interest rate of 10.93% should be added to calculate the refund. This interest rate is consistent with the interest rate developed in the initial phase of the case for calculating the carrying costs on the FAC deferred balance. See OCC Remand Ex. 2 at 29 (citing DJD-F).

[6] See OCC Remand Ex. 2, Attachment DJD-E.

there is a mechanism in the original rates that allows for prospective adjustment, there is no retroactive ratemaking. That mechanism existed in the ESP rates by way of the phase-in deferrals which are inextricably linked to the capped ESP rates. Adjusting the deferrals to be collected from customers can be accomplished through the PUCO's accounting authority under R.C. 4905.13.

Making the prospective accounting adjustments to the regulatory deferrals is appropriate. It recognizes that these deferrals were unfounded in law due to overstated capped rates. The overstated capped rates were a function of including charges the Ohio Supreme Court found to be unjustified, based on the incomplete record before the PUCO.

II. ARGUMENT

A. The Scope Of The Remand Includes Arguments On How POLR Is To Be Defined Or The Remedy For Environmental Carrying Charges And POLR Flow Through Effects.

In their Initial Post Hearing Brief on Remand, the Companies argue that the proper scope of this remand proceeding is "narrow."[7] The Companies allege that the Court only directed the PUCO to determine whether there are "other options" within the ESP statute (R.C. 4928.143(B)(2)) that would permit recovery of environmental carrying charges.[8] On the POLR issue, the Companies argue that the Court merely sought clarification for the basis of POLR charges. According to the Companies, the Commission could comply with the Court's order by once again using the option model,

[7] Companies' Initial Post Hearing Brief on Remand at 1, 7-10 (Aug. 5, 2011).

[8] Id. at 8.

but providing a better explanation of the basis for the POLR charge.[9] The Companies are mistaken.

Under this constricted view, the scope of remand would not allow the Commission to contemplate the "flow through" effects of these charges.[10] In other words, the Companies interpret the scope of remand to preclude the Commission from adopting a remedy for the charges the Court determined were unjustifiably collected from customers prior to June 2011. In a similar vein, the Companies allege that the Commission may not reconsider whether they should be compensated for the risk of customers leaving ("migration risk"),[11] since these issues were not raised on rehearing or appealed by the intervenors. The issue of what charges POLR can include "has been conclusively determined in this proceeding and are not now open to debate," allege the Companies.[12]

These arguments should be rejected. When the Court's specific POLR remand language is scrutinized, it can be seen that the Court reversed the entire order authorizing POLR: "Ruling on an issue without record support is an abuse of discretion and reversible error. See, e.g., *Indus. Energy Users-Ohio v. Pub. Util. Comm.*, 117 Ohio St.3d 486, 2008-Ohio-990, 885 N.E.2d 195, ¶ 30. Therefore, we reverse the provisions of the order authorizing the POLR charge."[13]

The Court was not selective about what POLR findings were being reversed; rather it ordered the Commission to start with a blank slate on POLR by reversing all the

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[9] Id. at 9.

[10] Id. at 54-58.

[11] Id. at 33-34.

[12] Id. at 34.

[13] *In re Application of Columbus Southern Power Company, et al.*, 2011 Ohio 1788, ¶29.

provisions of the order authorizing POLR. Included in the provisions of the order authorizing POLR were Commission findings as to where the "costs" of POLR come from. The Commission erroneously determined the Companies have some "risks" associated with customers switching to CRES providers and further determined that the POLR rider should be "based on the 'cost' to the Companies to be the POLR and carry the risks associated therewith, including the migration risk."[14] The Court, however, found that there was no evidence suggesting that the POLR charge is related to any costs that AEP Ohio will incur, despite the Commission's repeated references to the "cost" of POLR.[15] The Court also questioned the relationship between the risks of POLR and the costs.[16]

Following the Court's remand, the PUCO directed AEP Ohio, by Entry,[17] to make an appropriate filing if it determined to seek a non-cost based POLR charge or a POLR charge based on costs or seek to collect environmental charges. AEP Ohio responded by filing, on May 20, 2011, an "Initial Merit Filing on Remand." There the Companies indicated they would present testimony that "further supports and explains the existence and magnitude of the POLR risks that it bears."[18] On June 6, 2011, the Companies filed their witnesses' testimony, including the direct testimony of Laura Thomas.[19] There Ms.

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[14] *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO, Opinion and Order at 40 (March 18, 2009).

[15] *In re Application of Columbus Southern Power Company, et al.*, 2011 Ohio 1788, ¶25.

[16] Id. at 27.

[17] *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO, Entry at ¶5 (May 4, 2011).

[18] AEP Ohio Initial Merit Filing on Remand at 6 (May 20, 2011).

[19] Companies' Remand Ex. 4.

Thomas addresses, among other things, the existence of POLR risks and includes in her testimony a definition of POLR that encompasses both switching and returning by customers. Remarkably, Ms. Thomas makes no reference to the PUCO Order that defined POLR.

Ms. Thomas' testimony was intended as a follow up to the Court's remand. Her testimony though opens the door to testimony on the definition of POLR. Intervenors, including OCC and IEU, then rebutted Ms. Thomas' testimony by properly defining POLR to include the risks of customers' returning only, minus migration.[20] The Companies did not move to strike these statements in either IEU's or OCC's testimony. The Companies cannot be heard now to complain about the scope of remand when their filings, which allegedly address the Court's reversal, confirm that that the entire POLR definition is in play.

In the same vein, the Companies' objections about the flow-through effects of both POLR and environmental carrying charges must be overruled. The Companies' position in this regard would hamstring the Commission from doing what is reasonable and proper under the law. The Commission could and should find the charges collected from customers are not justified, as OCC, OPAE, IEU, and others concluded in their briefs. The PUCO should adopt a remedy to address the unlawful charges that customers should be protected from paying under the Court's decision, and not be deterred by AEP's mistaken claims of limits on the scope of remand.

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[20] See OCC Remand Ex. 1 at 8-12; IEU Remand Ex. 1 at 12-13.

B. POLR Cannot Be Defined To Include Migration Risks Because Doing So Would Unlawfully Compensate The Companies For Lost Revenues.

Migration risks, or the risks of customers switching to alternative suppliers, are what AEP claims customers should pay for as part of the POLR risk. As Messrs. Thompson, Lesser, and Cahaan have testified, the ability of customers to switch and pursue their choice of generation supply is a business risk faced by electric distribution utilities ("EDUs") and competitive retail electric service ("CRES") providers alike under S.B. 221.[21] Defining POLR to include the risk of customer migration, as proposed by AEP Ohio Witness Thomas,[22] would compensate AEP Ohio for a business risk. This creates an undue advantage for AEP Ohio vis-à-vis the CRES providers, allowing AEP Ohio to collect "lost revenues" from customers for lost opportunity sales.

The Companies, however, argue that the migration risk is "very real and very different than the traditional risk of customer mobility shared by all providers."[23] Hence, the Companies argue that the PUCO should reaffirm its prior opinion that POLR includes migration risk.[24] The Companies equate "migration risks" to lost revenues.[25] According to the Companies, they are permitted to collect these lost revenues under R.C.

[21] OCC Remand Ex. 1 at 9; IEU Remand Ex. 1 at 4; Remand Tr. XIII at 55-56. See also Post Hearing Brief on Remand of Staff where "Staff tends to agree with Dr. Lesser that migration risk '"is a risk of competitive markets, not a risk of being a POLR provider.'" Remand Brief at 5 (Aug. 5, 2011).

[22] See Companies' Remand Ex 4 at 3.

[23] Companies' Initial Post Hearing Brief on Remand at 35.

[24] Id.

[25] Id at 18.

4928.143 "which broadly defines 'costs' to include lost revenues."[26] Further, the Companies construe R.C. 4928.143 to permit a non-cost based POLR charge.[27]

The Companies' statutory construction arguments must be closely scrutinized in order to understand their inherent fallacy. The Companies note that R.C. 4928.143(B)(2)(h) contains the phrase "lost revenue."[28] Because that specific subsection allows lost revenues for "a long-term energy delivery infrastructure modernization plan," the Companies believe they can extend the lost revenue concept to a different subsection—R.C. 4928.143(B)(2)(d): "Because the General Assembly contemplates that recoverable costs may include 'lost revenues' is (sic) subsection (B)(2)(h), it is proper for lost revenues to be considered a recoverable cost for purposes of subsection (B)(2)(d) as well. The two subsections are in the same statute and both provide for components that may be included in an ESP."[29]

This contrived construction is offered despite the fact that R.C. 4928.143 (B)(2)(d) contains no "lost revenue" language. The Companies' statutory construction of R.C. 4928.143(B)(2)(d) is just plain wrong, and the fact that the Companies did not cite to an iota of authority for it speaks volumes.

To the contrary, it is a well established principle of statutory construction that the Court (and the PUCO) must give effect to the words used in a statute—and cannot delete words or insert words not used.[30] Moreover, additional rules of statutory construction

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[26] Companies' Initial Post Hearing Brief on Remand at 27.

[27] Id.

[28] Companies' Initial Post Hearing Brief on Remand at 27.

[29] Id.

[30] *Cleveland Electric Illuminating Co. v. City of Cleveland*, 37 Ohio St.3d 50, 53-54 citing *Columbus Suburban Coach Lines v. Pub. Util. Comm.* (1969), 20 Ohio St.2d 125, 127.

would be violated as well under the Companies' tortured interpretation. For instance R.C. 1.47 requires that in enacting a statute, it is presumed that the entire statute is intended to be effective and that a just and reasonable result is intended. Here, if the Companies' interpretation is accepted, the provisions of S.B. 221 that are intended to advance competition will be substantially impaired. Moreover, policy objectives of the State of Ohio, set forth in R.C. 4928.02, will be thwarted. As OCC and OPAE argued in their Post Hearing Brief on Remand, POLR cannot be defined or compensated for in a way that foils the very purpose of S.B. 221.[31] And the Companies' definition of POLR that includes migration risk does just that. It compensates the Companies for a business risk creating an undue advantage for them.[32]

As OCC and OPAE explained in their Post Hearing Brief on Remand, there is no basis under the law for charging customers for lost revenues through a POLR rider.[33] No guarantee of lost revenues exists under S.B. 221. Lost revenues cannot be authorized as transition costs. Authorizing lost revenues through POLR would be inconsistent with the Commission Orders in this case and the CSP SEET case. For these reasons, the Companies' attempt at rewriting S.B. 221, to fit its pie-in-the-sky hopes of guaranteed recovery, should be rebuked.

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[31] See OCC Post Hearing Brief on Remand at 5-6.

[32] See OCC Remand Ex. 1 at 8-12; IEU Remand Ex. 1 at 12-13. See also the recent concurring Opinions of Chairman Snitchler and Commissioner Roberto, opposing the collection of lost distribution revenues pertaining to energy efficiency saving and peak demand reduction mandated by another section of S.B. 221, R.C. 4928.66. *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and the Toledo Edison Company for Approval of Their Energy Efficiency and Peak Demand Reduction Program Portfolio Plans for 2010 through 2012 and Associated Cost Recovery Mechanism,* Case Nos. 09-1947-EL-FOR et al.. Concurring Opinions of Chairman Todd A. Snitchler and Commissioner Cheryl Roberto (March 23, 2011).

[33] See OCC Post Hearing Brief on Remand at 15-21.

C. POLR Should Not Be Calculated On The Basis Of An Option Valuation Methodology.

The Companies support an option valuation methodology for the calculation of POLR. An option valuation methodology uses econometric modeling to determine the value of the option being considered. According to the Companies there is evidentiary support that such an option valuation appropriately measures POLR "costs."[34] The Companies then accuse the Court of failing to understand how the model values optionality to customers and how, at the same time, the value equals the cost of shopping risk to Companies: "The Court misunderstood how the model values the optionality."[35] OCC and OPAE respectfully submit that the Court did understand and got it right.

1. Value to customers is not equal to the cost to the Companies.

The Companies want to collect a lot of money from customers based on the notion that the value of the shopping options to customers equates to a "cost" to the Companies. The notion that value to customers[36] is the same as "cost" to the Companies is the notion the Court could not accept. And the Companies have done little to buttress their assertion. The Companies merely allege that both are calculated under the model.

[34] Companies' Initial Post Hearing Brief on Remand at 17-24. Dr. Makhija cannot be relied upon to support the Black Scholes results because he believes that an optionality model correctly applied would capture the value of optionality and yet he had not examined whether the Company correctly applied the model. Remand Tr. I at 38-39 (July 15, 2011). Similarly, Dr. LaCasse cannot be relied upon to support the appropriateness of using the Black Scholes model. Dr. LaCasse's expertise is as an auction manager, not an option modeling expert. Neither is she a Black Scholes expert or even a Monte Carlo modeling expert. Remand Tr. II at 133-140. Dr. LaCasse has never worked with the Black Scholes model or option model to price shopping risks. Remand Tr. II at 149-150 (July 19, 2011).

[35] Companies' Initial Post Hearing Brief on Remand at 17.

[36] As OCC Witness Thompson testified, the Black Scholes model does not calculate the value to customers. OCC Remand Ex. 1 at 22-24. If one accepts the Companies' position that value to customer equals cost to the company and Black Scholes does not calculate value to the customer, then it cannot calculate the cost to the Companies.

As OCC Witness Duann testified, the value of the switching option to customers is not the "opportunity cost" of POLR to the utility.[37] OCC Witness Duann recognized that Dr. Makhija fails to support this theory in his testimony. Furthermore, as noted by OCC Witness Duann, none of AEP Ohio's witnesses provide any empirical evidence that shows the value to customers is equal to the costs to AEP Ohio.[38] Such a statement, according to OCC Witness Duann, "lacks support in economic theory and in fact. It should be rejected."[39]

IEU Witness Lesser also testifies that this is an incorrect theory,[40] and IEU, in its Post Hearing Brief on Remand, correctly characterizes it as "economic nonsense."[41] Although the Companies point to Dr. LaCasse's testimony that allegedly responds to IEU Witness Lesser's criticism of the theory, such testimony is not persuasive. It fails because it is premised upon at least one faulty assumption. That assumption is the lost revenues associated with a customer choosing the alternative supplier (in Dr. Lesser's example a water supplier) are a "cost" to the losing supplier. As discussed in detail in the OCC and OPAE joint brief, lost revenues are not a cost to the supplier of water or the supplier of POLR service.[42]

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[37] OCC Remand Ex. 2 at 16.

[38] OCC Remand Ex. 2 at 17.

[39] Id at 17.

[40] IEU Remand Ex. 1 at 12-15.

[41] IEU Initial Brief on Remand at 29.

[42] See IEU Initial Brief on Remand at 30-31.

2. AEP misuses option pricing to ascribe a POLR "cost" – lost revenues-- to the Companies but the Companies have no basis to collect lost revenues under SB 221.

According to the Companies, the Black Scholes model calculates an objective and quantifiable difference in price.[43] And yet, the Companies continue to evade the inevitable truth about the Black Scholes model—it fails to calculate the Companies' actual out of pocket costs of POLR. Instead it computes lost revenues or lost opportunity costs. These "lost revenues" cannot be recognized as legitimate "costs" of POLR. There is no statutory or regulatory basis upon which such treatment can be grounded.[44]

Moreover, the Black Scholes model relies upon subjective inputs which the Intervenors dispute, and relies on assumptions that do not track reality. For instance, the Black Scholes model assumes that all customers will switch when there is a 1-cent differential in price between market and SSO price. This assumption flies in the face of reality. Customers do not switch solely on the basis of price, as the Intervenor Witnesses stated and the Companies' Witnesses acknowledged.[45]

3. There are no actual costs incurred by the Companies for POLR and thus no costs for Ohio customers to pay.

The Companies argue that they incur substantial and actual costs for POLR.[46] These costs are the "actual modeled cost of providing POLR optionality." These actual modeled costs, according to the Companies, confirm the reasonableness of the POLR charges.[47] The Companies' arguments to transform a concept into a cost for customers to

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[43] Companies' Initial Post Hearing Brief on Remand at 17.

[44] See OCC Post Hearing Brief on Remand at 13-20.

[45] See OCC Remand Ex. 1 at 20; IEU Remand Ex. 2 at 11-14; Companies' Remand Ex. 8 at 5-6; Remand Tr. I at 28-29.

[46] Companies' Initial Brief on Remand at 18, 21.

[47] Id. at 21.

pay -- through the talisman of an optionality model -- should be rejected. "Actual modeled costs" does not mean actual incurred costs. The Companies have incurred no actual out-of-pocket costs. Moreover, the modeling of costs is inconsistent with cost of service regulation, which focuses to a large extent on actually incurred expenses. And since POLR is a distribution service, it must be calculated consistent with cost of service regulation, under R.C. Chapters 4905 and 4909.[48]

a. The diminution in equity value is a not a true cost. It is a potential risk at best and is mitigated by the fuel adjustment clause in part or whole.

In an attempt to bolster their arguments that they have incurred POLR costs, the Companies allege that if POLR "risk" is not recovered, there will be a cost incurred which is a diminution in shareholder equity.[49] The Companies, however, produced no evidence that their shareholders concur with their assessment of the Companies' POLR risks. Additionally, Dr. Makhija, who introduces the diminution idea, freely admits his idea is untested and is not based on empirical evidence.[50] Dr. Makhija also agreed that if there were a mechanism that provides for collection of POLR costs, the diminution in equity would be limited.[51] Considering the fact that OCC Witness Thompson testified that the fuel adjustment clause protects the Companies from the POLR risks,[52]--which assertion was unchallenged--one can only assume the diminution in value, if it were to occur, would be limited. Finally, there is no statutory or regulatory authority cited by the Companies that supports the belief that S.B. 221 or traditional regulation under R.C.

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[48] See OCC Post Hearing Brief on Remand at 10-13.

[49] See Companies' Remand Ex. 1 at 5; Companies' Initial Post Hearing Brief on Remand at 19.

[50] See Remand Tr. I at 39(July 15, 2011).

[51] Remand Tr. I at 38-39.

[52] See OCC Remand Ex. 1 at 12-16.

Chapters 4909 and 4905 requires that the equity return of the Companies be guaranteed by customers. And the compensation to shareholders for a diminution in equity value amounts to such a guarantee.

b. Evidence that other entities have included shopping risk as part of risk premia in competitive bids does not confirm that AEP Ohio incurs costs of a similar nature.

The Companies, in the crusade to justify POLR as a "cost," attempt to latch onto limited anecdotal evidence that bidders in other jurisdictions have included shopping risks in their competitive bids. The Companies suggest that in the few competitive bids presented in Dr. LaCasse's testimony, there is a "risk premium" that is attributable, in some unknown part, to POLR-type risks.[53] Somehow the PUCO is expected to draw a correlation between the two case studies presented by Dr. LaCasse and apply the findings to Ohio to validate AEP Ohio's alleged POLR costs.

First and foremost, the premise is flawed because it assumes that what other utilities outside Ohio incur, subject to wholly different regulation, is somehow germane to the specific POLR "costs" incurred by AEP Ohio. It is not. Additionally, the information Dr. LaCasse presents is of little value as well due to the fact that the actual shopping risk premium is not discernable in the case studies presented. Both the NorthBridge study and Illinois Commerce Commission ("ICC") Staff study calculate the risk premium as a residual value that is left after all other "visible" cost components are identified.[54] Both the NorthBridge Study and the ICC Staff study include other elements besides shopping risk in the residual premium and the individual components cannot be

[53] See Companies' Initial Post Hearing Brief on Remand at 19-20, citing to the Northbridge Group Study and the ICC Staff analysis.

[54] See Remand Tr. II at 170-171 (NorthBridge study); Remand Tr. II at 176 (ICC Staff study).

separately identified or measured. In the NorthBridge study, the results reported on Dr. LaCasse's schedule CL-2 consist of eight different potential costs and risks, with shopping risk being one of the eight costs. Moreover, both studies were never ruled upon or accepted by any regulatory body, and the conductors of the studies were not subject to discovery or cross-examination for the record in these cases.[55]

The cross examination of Dr. LaCasse should lead the Commission to question whether the Northbridge and ICC Staff study are of any evidentiary value whatsoever. For instance, the Northbridge study pertains to bids made in November 2007 and March 2008, and Dr. LaCasse has not analyzed changes in the wholesale market conditions that have occurred since the winning bids were made.[56] In the NorthBridge study the bids were responding to limited groups of customers. These limits pertained to usage amounts, and certain levels of demand for specified customer classes.[57] Such restrictions are inconsistent with the Ohio POLR charges to all customers, with no restrictions.

D. The Black Scholes Model Utilized By The Companies Is Flawed.

OCC's and IEU's Witnesses testified that the Black Scholes model is flawed in many respects and cannot be relied upon to calculate the "costs" of POLR.[58] The primary reason the Black Scholes model should not be used to calculate POLR charges is that it purports to value the lost revenues associated with lost sales opportunities for the Companies. As OCC, OPAE, and IEU argued in their Initial Briefs, POLR does not

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[55] Remand Tr. II at 172-173; 178-179.

[56] Remand Tr. II at 172-173.

[57] Remand Tr. II at 174-175.

[58] See OCC Ex. Remand Ex. 1 at 19-36; IEU Remand Ex. 1 at 17-34.

equate to lost revenues.[59] Rather, the plain language of the POLR statutes establishes that POLR refers to actual out-of-pocket costs incurred for energy and capacity for returning customers.[60] Moreover, even if one were to accept lost revenues as a proper calculation of POLR, which OCC and OPAE do not, the Companies' model overstates the lost revenues. It does so because it ignores the fact that the costs of returning customers are picked up through the fuel clause, which includes purchased power, and the SSO rates. Instead it calculates hypothetical optimal levels of lost revenues which cannot possibly be achieved given the Companies' firm resource requirement ("FRR") capacity obligations and AEP pool arrangement pricing limitations.[61]

Beyond this very fundamental flaw to the Companies' approach to POLR, the Intervenors identified numerous flaws in both option models relied upon by the Companies—the constrained and unconstrained studies.[62] Interestingly, the Companies do not characterize these positions as incorrect or erroneous, but characterize the Intervenors' criticisms as "not persuasive."[63]

Apparently the Companies are not persuaded that their very basic assumption about underlying customer behavior--that is being modeled and drives the results--is unsound. As indicated throughout the record, the Companies' model assumes customers will switch when it is to their "economic benefit."[64] The Companies demarcate the

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[59] See OCC Post Hearing Brief on Remand at 7-21; IEU Initial Post Hearing Brief on Remand at 32-33.

[60] OCC Remand Ex. 1 at 12.

[61] See OCC Post Hearing Brief on Remand at 34-37.

[62] See OCC Remand Ex. 1 at 19-36; IEU Remand Ex. 1 at 17-34.

[63] Companies' Initial Post Hearing Brief on Remand at 46-51.

[64] See for example Remand Tr. II at 273 (Thomas).

economic benefit at a one cent per MWh[65] differential between market price and SSO price.[66] And the Companies' model assumes that at that 1-cent differential, 100% of its customers will switch.[67] Both Witnesses Thompson and Lesser testified there are many non-price factors that affect a customer's decision to shop.[68] Indeed Companies' Witnesses Makhija and LaCasse testified that there were additional factors --transaction costs, and stability of rates, that limit the degree to which customers may take full advantage of POLR.[69]

The Companies' response to the arguments is that an economic model such as Black Scholes cannot model "emotional behavior" of the customer.[70] While this may be true, the assumptions made in economic models can be adjusted to account for a more reasonable representation of customer behavior such as shopping. For instance in the NorthBridge study, NERA, in running a Monte Carlo model, created a cap on the number of customers switching and assumed various price differentials at which certain percentages of customers would switch.[71] AEP Ohio similarly could have adjusted its modeling to do so, but chose not to. Of course, AEP Ohio's declination to adjust its model means that customers would pay it more for POLR under its proposal.

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[65] The 1 cent per MWh pertains to the unconstrained model assumption. For the constrained model it is a penny differential over the entire horizon being evaluated which effectively is less than a penny per MWh. See Remand Tr. II at 273.

[66] OCC Remand Ex. 1 at 20.

[67] Id.

[68] OCC Remand Ex. 1 at 20; IEU Remand Ex. 1 at 19-20.

[69] Remand Tr. I at 28-29; Remand Tr. II at 167.

[70] Companies' Initial Post Hearing Brief on Remand at 47.

[71] See Remand Tr. II at 163-166.

With respect to the volatility errors noted by Staff Witness Benedict, OCC Witness Thompson, and IEU Witness Lesser,[72] the Companies broadly claim that using historical pricing for the volatility of energy is justified.[73] (Volatility is a measure of how much the commodity being valued changes over time). The Companies claim that they have applied a "conservative annual volatility measure to all components of the benchmark price."[74] While the use of an annual versus monthly volatility measure will likely tend to produce more conservative results, the Companies fail to address the essence of the Intervenors' arguments. While the volatility value of 33% may be appropriate for the energy component of the competitive benchmark price, the Companies have failed to show how the remaining eight components are related to energy, or have similar volatility values. Intervenors' criticisms thus have not been addressed. While both Witnesses Lesser and Thompson raised issues with respect to the use of the European versus American option, the Companies fail to satisfactorily address these as well.[75] Finally, the Companies fail to address in any respect the date error pointed out by OCC Witness Thompson.[76]

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[72] See Staff Remand Ex. 1 at 3-4; OCC Remand Ex. 1 at 28-30: IEU Remand Ex. 1 at 21-24.

[73] Companies' Initial Post Hearing Brief on Remand at 49-50.

[74] Id.

[75] The Companies cite to Thomas' remand testimony and her pictorial depiction of how the model works. Companies' Initial Post Hearing Brief on Remand at 50. Needless to say the pictorial depiction points out how complex the decision making process is that is modeled. That this is the model representing how customers make decision to shop is patently absurd.

[76] See OCC Remand Ex. 1 at 30-31.

E. Argument That POLR Need Not Be Cost Based Ignores The Fact That POLR Is Provided As A Monopoly Distribution Service Under Chapters 4909 And 4905.

The Companies present an alternative argument in their brief that POLR need not be cost based.[77] The Companies manufacture this argument by erroneously construing R.C. 4928.143(B)(2)(d). According to the Companies the statute provides that standby or default service need not be cost based, but must only meet the criteria that it has the effect of providing stability and certainty regarding the price customers will pay.[78]

This fallacious argument should be rejected outright. As fully explained in the OCC and OPAE post-hearing brief,[79] POLR has been recognized by the PUCO as a distribution-related service.[80] The PUCO *in this very case* approved the POLR charge as a distribution rider. It thus must be regulated by the PUCO under Chapters 4905 and 4909.[81] To adopt the Companies' interpretation would conflict with the General Assembly's statutory scheme whereby distribution service offered by EDUs would continue to be regulated. R.C. 4928.143 must be construed to effectuate the purpose of the statutory scheme. The Companies' feeble attempt to argue otherwise should be dismissed.

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[77] Companies' Initial Post Hearing Brief on Remand at 28.

[78] Id.

[79] See OCC and OPAE Post Hearing Brief on Remand at 10-13.

[80] *In re AEP Ohio's IGCC Proposal*, Case No. 05-376-EL-UNC, Opinion and Order at 17 (April 10, 2006).

[81] See R.C. 4928.01(B).

F. The Companies' "Me Too" Argument Must Fail, As The Commission Must Make A Determination In This Case Based On The Record Before It.

The Companies' struggle to bolster their case for POLR by arguing that the other Ohio EDUs get POLR and so should they.[82] In order to make this argument the Companies refer to outside the record information that has not been subject to cross-examination. The Companies should not be permitted to engage in such tactics.

The Commission should not consider this portion of the Companies' brief.[83] The PUCO is to make its "findings of fact and written opinions" with regard to the record of the case, under R.C. 4903.09. The hearing on remand provided the Companies with their opportunity to adduce evidence, such as through the "testimony and ... exhibits..." referenced in R.C. 4903.09. The Companies' brief does not present the Companies with an appropriate opportunity to present information to the PUCO as though it were evidence.

Moreover, the information relayed in AEP Ohio's non-record chart is not necessarily comparable. For instance, for DP&L, the charge listed as "monthly POLR" *apparently* refers to DP&L's "Rate Stabilization Charge" which under its tariffs is "intended to compensate DP&L for providing stabilized rates for customers and provider of last resort service."[84] Thus to characterize this approved charge as "POLR" that is comparable to AEP Ohio's POLR charges is simply misleading. Similarly, the characterization of a Duke "POLR" is suspect as well. There is no explicit tariff that

[82] Companies' Initial Post Hearing Brief on Remand at 29-31.

[83] OCC filed a motion to strike on this subject, dated August 10, 2011.

[84] See DP&L's Electric Generation Services Tariffs, PUCO No. 17, Electric Generation Service Rate Stabilization Charge, Second Revised Sheet No. G25.

contains a charge labeled "POLR" for Duke, and the rate listed in the table does not correspond to any stand-alone charge in Duke's current electric service tariffs. The Companies moreover, have failed to provide citations for the source of the "POLR" charge information.

Additionally, the "rate stabilization charge" of DP&L, even if comparable to AEP Ohio's POLR, was a provision as part of an "overall approach to rates" in a filed Stipulation and Recommendation,[85] which was later approved by PUCO Opinion and Order.[86] By the very terms of the approved Stipulation and Recommendation, the Stipulation was "submitted for purposes of this proceeding only, and is not deemed binding in any other proceeding, except as expressly provided herein, nor is it to be offered or relied upon in any other proceedings, except as necessary to enforce the terms of this Stipulation."[87] Thus, the Companies' use of such information as precedent in this proceeding is inappropriate by the terms of the DP&L Stipulation and Recommendation.

Finally, as the Commission is well aware, each case presents its own unique record—with facts, experts, and legal arguments. A case by case determination must be made under R.C. 4903.09. It would be an error for the PUCO to determine that AEP Ohio should have a POLR charge and that customers should pay AEP for POLR based on POLR values for other EDUs, especially where the POLR was established under a stipulated package. The Commission should ignore AEP Ohio's non-record information.

[85] *In the Matter of the Application of the Dayton Power and Light Company for Approval of its Electric Security Plan et al*, Case No. 08-1094-EL-SSO, Stipulation and Recommendation at ¶3, ¶35 (Feb. 24, 2009).

[86] *In the Matter of the Application of the Dayton Power and Light Company for Approval of its Electric Security Plan et al*, Case No. 08-1094-EL-SSO, Opinion and Order (June 24, 2009).

[87] *In the Matter of the Application of the Dayton Power and Light Company for Approval of its Electric Security Plan et al*, Case No. 08-1094-EL-SSO, Stipulation and Recommendation at ¶35.

G. Adjusting The Phase-In Deferrals Is Appropriate And Does Not Run Afoul Of Retroactive Ratemaking.

The Companies argue that OCC and IEU are either asking for a refund, or are asking that the Companies' customers receive a future rate credit equal to their past POLR charge and 2001-2008 EICC rate increases. Either request, according to the Companies, is prohibited under Ohio law.[88]

As fully explained in OCC and OPAE's Post Hearing Brief on Remand, the Ohio Supreme Court has recognized, when faced with retroactive ratemaking claims, that if there is a mechanism built into rates that allow for prospective rate adjustments, retroactive ratemaking does not exist.[89] Here, there was a specific mechanism due to the phase-in of the deferrals and their linkage to the capped ESP rates. Hence there is no retroactive ratemaking.

Moreover, under R.C. 4905.13, and consistent with R.C. 4928.20, the Commission can exercise its accounting authority to adjust value of the regulatory assets created under the phase-in. Indeed there is Commission precedent for revaluing or adjusting utility regulatory assets.[90] In exercising this accounting authority, the PUCO will not engage in "ratemaking," and thus, the issue of retroactive "ratemaking" is not present.[91]

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[88] The Companies cite to the Supreme Court's ruling on remand.

[89] See OCC and OPAE Post Hearing Brief on Remand at 44-47.

[90] See *In the Matter of the Application of the Toledo Company for Authority to Amend and Increase Certain of its Rates and Charges for Electric Service; In the Matter of the Application of the Cleveland Electric Illuminating Company for Authority to Amend and Increase Certain of its Rates and Charges for Electric Service;* Case Nos. 95-299-EL-AIR et al, Opinion and Order at 29 (April 11, 1996) (ordering a $1.25 billion revaluation of utilities' assets for regulatory purposes over a five year period).

[91] See *River Gas Company v. Pub. Util. Comm.* (1982), 69 Ohio St.2d 509, 512 ("It is axiomatic that before there can be retroactive ratemaking, there must, at the very least, be *Ratemaking*.") Cf. *Consumers' Counsel v. Pub. Util. Comm'n* (1983), 6 Ohio St.3d 377, 379 (deferral of costs incurred in the past does not constitute ratemaking).

H. The Commission Should Not Require Customers To Pay Carrying Charges On Environmental Investment That Was Made From 2001 Through 2008 Because S.B. 221 Does Not Permit The Companies To Collect These Costs.

AEP Ohio's arguments regarding carrying charges on environmental investments rely heavily on the PUCO's initial ESP Order.[92] With regard to that Order, the Supreme Court of Ohio stated:[93]

> OCC argues that this section [i.e. R.C. 4928.143(B)(2)] permits plans to include only listed items; the commission and AEP argues that (B)(2) permits *unlisted* items. We agree with OCC.

Incredibly, long after the original hearing and PUCO Order, the Companies have developed a new late-found argument that *three* enumerated items stated in R.C. 4928.143(B)(2) permit it to charge Ohio customers for carrying charges on pre-2009 environmental investment. This belated argument should be rejected, both as too late and wrong .[94]

AEP Ohio emphasizes that the ESP Order allowed collections from customers for millions of dollars in carrying charges on the Companies' environmental investments made from 2001 through 2008,[95] and that the PUCO Staff took this position before the appeal.[96] As conceded in AEP Ohio's Remand Brief,[97] the Commission did not make its original determination based upon locating support for the collection of these carrying charges in the specific provisions contained in R.C. 4928.143(B)(2). Rather, the PUCO

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[92] See, e.g., AEP Ohio's Initial Post Hearing Brief on Remand at 12 (August 5, 2011).

[93] *In re Application of Columbus Southern Power Company, et al.*, 2011 Ohio 1788. ¶31.

[94] AEP Ohio's Initial Post Hearing Brief on Remand at 13-16 (August 5, 2011).

[95] Id. The numerical value is also located in the PUCO's initial decision in this case. ESP Order at 24.

[96] AEP Ohio's Initial Post Hearing Brief on Remand at 11 (August 5, 2011) ("recommended that the Companies be allowed recovery").

[97] AEP Ohio's Initial Post Hearing Brief on Remand at 7-8 (August 5, 2011) ("it was clear").

allowed the collections from customers "pursuant to the broad language of Section 4928.143(B)(2), Revised Code, permitting recovery for *unenumerated expenses*."[98] The Supreme Court of Ohio determined that the expenses to be collected from customers must be enumerated in the statute. And the Court therefore reversed the PUCO's decision allowing the collections from customers.[99]

R.C. 4928.143(B)(2)(b) permits an ESP to include "a reasonable allowance . . . for an electric generating facility of the electric distribution utility, provided the cost is incurred or the expenditure occurs on or *after January 1, 2009*."[100] AEP Ohio states, in conclusory fashion, that "although the incremental capital expenditures . . . were made in 2001-2008, the carrying costs . . . were, or are being, incurred during 2009-2011."[101] AEP Ohio points to the testimony on remand by Witness Nelson, but that testimony merely refers to and repeats Mr. Nelson's testimony from before the appeal.[102] The carrying charges result from the continued use of the capital expenditures made prior to January 1, 2009. The original Nelson testimony shows that the carrying charges are nothing more than bookkeeping entries during the period that began on January 1, 2009.[103] They were neither incurred nor occurred after January 1, 2009, and as such are not collectable expenditures under R.C. 4928.143(B)(2)(b).

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[98] Entry on Rehearing at 12, ¶(38) (July 23, 2009) (emphasis added).

[99] *In re Application of Columbus Southern Power Company, et al.*, 2011 Ohio 1788. ¶33, referred to in AEP Ohio Initial Post Hearing Brief on Remand at 8 (August 5, 2011).

[100] Emphasis added.

[101] AEP Ohio's Initial Post Hearing Brief on Remand at 12 (August 5, 2011).

[102] Companies' Remand Ex. 7 at 2 ("recap of my testimony").

[103] Companies' Ex. 7 at 16 (Nelson). The Companies calculated a carrying cost rate of 5.8 percent for CSP and 16.38 percent for OP. See Companies' Ex. 1, Exhibit DMR-2 at 8 (Roush).

The carrying charges also do not fall within the remaining categories of permissible costs under the Supreme Court of Ohio's decision. The Companies' new position is that, in addition to R.C. 4928.143 (B)(2)(b) being applicable, R.C. 4928.143(B)(2)(d) and (B)(2)(e) also support charging carrying charges on 2001-2008 vintage environmental investments.[104] R.C. 4928.143(B)(2)(d) mentions "carrying charges" in the context of ESP components that "have the effect of stabilizing or providing certainty regarding retail electric service." The Companies argue, without citation to the record, that "the effect of perpetuating the useful lives of existing generation assets . . . would have the effect of stabilizing rates . . . ."[105] The rate-setting issue relates to assessing carrying charges on *past* environmental investments -- environmental investments too early for recognition by the General Assembly under R.C. 4928.143(B)(2)(b). AEP Ohio presented no testimony that these past investments will be affected by the increased rates sought by the Companies.

R.C. 4928.143(B)(2)(e), also mentioned in AEP Ohio's Remand Brief,[106] permits "[a]utomatic increases or decreases in any component of the standard service offer price." The Companies argue that "it is highly appropriate to allow automatic pass through of such prudently-incurred costs."[107] The carrying charges provision for rates under the ESP Order did not provide for adjustment to some other component of rates. The 2001-2008 vintage investments were past investments even at the time of the ESP Order, so nothing

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[104] AEP Ohio's Initial Post Hearing Brief on Remand at 13-15 (August 5, 2011).

[105] Id. at 13.

[106] Id. at 14.

[107] AEP Ohio's Initial Post Hearing Brief on Remand at 15 (August 5, 2011).

increased or decreased during the period of the ESP. R.C. 4928.143(B)(2)(e) is entirely inapplicable to the carrying charges sought by AEP Ohio.

Setting rates based upon carrying charges on 2001-2008 vintage environmental investments is not permitted by reference to "unenumerated expenses"[108] in R.C. 4928.143(B)(2). The Companies' new, late-found arguments--that the enumerated items stated in R.C. 4928.143(B)(2) permit the charges--should be rejected.

III. CONCLUSION

At issue here is more than a half a billion dollars of charges that Ohio customers should not have to pay for POLR and environmental carrying charges –charges the Ohio Supreme Court determined were not justified on the basis of the record before them. The Companies have failed to bear their burden of proving POLR costs and a legal basis for the environmental carrying charges. Accordingly, the PUCO should act now to protect customers from bearing any more of these unjustified charges.

The Commission should return to customers the revenues being collected subject to refund. The Commission should also adjust the phase-in deferrals that are to be collected from its customers, taking out the unlawful charges pertaining to April 2009-May 2011 collections. The Commission has the authority to do so, and should exercise that authority to protect Ohio customers from charges that the Supreme Court of Ohio found to be unjustified based on the record from the PUCO.

[108] Entry on Rehearing at 12, ¶(38) (July 23, 2009).

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Post-Hearing Reply Brief on Remand was served electronically to the persons listed below, on this 12th day of August 2011.

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