BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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
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

ORDER ON REMAND

The Commission, coming now to consider the evidence presented in these proceedings, pursuant to the Supreme Court of Ohio's remand in *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, the transcripts of the hearing, and briefs of the parties, hereby issues its order on remand.

APPEARANCES:

The following parties made appearances in the remand phase of these proceedings:

Steven T. Nourse and Matthew J. Satterwhite, American Electric Power Corporation, One Riverside Plaza, 29th Floor, 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, Ohio Attorney General, by John H. Jones, Assistant Section Chief, and Werner L. Margard, 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, Ohio Consumers' Counsel, by Maureen R. Grady and Jeffrey L. Small, Assistant Consumers' Counsel, 10 West Broad Street, Suite 1800, Columbus, Ohio 43215, on behalf of the residential utility consumers of Columbus Southern Company and Ohio Power Company.

Boehm, Kurtz & Lowry, by David F. Boehm, Michael L. Kurtz, and Jody M. Kyler, 36 East Seventh Street, Suite 1510, Cincinnati, Ohio 45202, on behalf of the Ohio Energy Group.

Chester, Willcox & Saxbe LLP, by John W. Bentine, Mark S. Yurick, and Zachary D. Kravitz, 65 East State Street, Suite 1000, Columbus, Ohio 43215, on behalf of The Kroger Company.

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

David C. Rinebolt and Colleen L. Mooney, 231 West Lima Street, Findlay, Ohio 45839, on behalf of Ohio Partners for Affordable Energy.

Vorys, Sater, Seymour & Pease LLP, by M. Howard Petricoff, Stephen M. Howard, and Lija Kaleps-Clark, 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216, and Cynthia Fonner Brady, Constellation Energy Resources, LLC, 550 West Washington Boulevard, Suite 300, Chicago, Illinois 60661, on behalf of Constellation NewEnergy, Inc., and Constellation Energy Commodities Group, Inc.

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

Bricker & Eckler LLP, by Matthew W. Warnock, 100 South Third Street, Columbus, Ohio 43215, on behalf of the Ohio Manufacturers' Association.

Sonnenschein, Nath & Rosenthal LLP, by Emma F. Hand, Clinton A. Vince, and Presley R. Reed, 1301 K Street NW, Suite 600, East Tower, Washington, DC 20005, on behalf of Ormet Primary Aluminum Corporation.

OPINION:

I. HISTORY OF THE PROCEEDINGS

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.

By entries issued August 5, 2008, and September 5, 2008, the procedural schedule in these matters was established. A technical conference was held regarding AEP-Ohio's application on August 19, 2008, and a prehearing conference occurred on November 10, 2008. The evidentiary hearing commenced on November 17, 2008, and concluded on

December 10, 2008. The Commission also held five local public hearings throughout the Companies' service area.

At the evidentiary hearing, AEP-Ohio offered the testimony of 11 witnesses in support of the Companies' application, 22 witnesses testified on behalf of various intervenors, and 10 witnesses testified on behalf of Staff. At the local public hearings, 124 witnesses testified. Briefs were filed on December 30, 2008, and reply briefs were filed on January 14, 2009.

On March 18, 2009, the Commission issued its opinion and order regarding AEP-Ohio's application (ESP Order). By entries on rehearing issued July 23, 2009 (First ESP EOR) and November 4, 2009, the Commission affirmed and clarified certain issues raised in the ESP Order. As ultimately modified and adopted by the Commission, AEP-Ohio's ESP directed, among other things, that AEP-Ohio be permitted to recover the incremental capital carrying costs that would be incurred after January 1, 2009, on past environmental investments (2001-2008) and approved a provider of last resort (POLR) charge for the ESP period.[1]

The Commission's decision was appealed to the Supreme Court of Ohio. On April 19, 2011, the Court affirmed the ESP Order in numerous respects, but remanded the proceedings to the Commission with regard to two portions of the Commission's decision. The Court determined that Section 4928.143(B)(2), Revised Code, does not authorize the Commission to allow recovery of items not enumerated in the section. The Court remanded the cases to the Commission for further proceedings in which the Commission may determine whether any of the listed categories set forth in Section 4928.143(B)(2), Revised Code, authorize recovery of environmental investment carrying charges.[2] Regarding the POLR charge, the Court concluded that the Commission's decision that the POLR charge is cost-based was against the manifest weight of the evidence, an abuse of the Commission's discretion, and reversible error. The Court noted two methods by which the Commission may consider the POLR charge on remand, specifically, as either a non-cost-based POLR charge or by way of evidence of AEP-Ohio's actual POLR costs.[3]

By entry issued May 4, 2011, the Commission directed AEP-Ohio to file proposed tariffs removing the POLR and environmental carrying charges from its rates by May 11, 2011. The entry also directed AEP-Ohio, if it intended to seek recovery of the POLR or environmental carrying charges, pursuant to the Court's remand, to make the appropriate filing with the Commission. On May 11, 2011, the Companies filed proposed tariffs, under protest, and corrections on May 13, 2011. AEP-Ohio also filed motions requesting that the

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1 AEP-Ohio ESP Order at 24-28, 38-40; First ESP EOR at 10-13, 24-27.

2 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 520.

3 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

Commission either establish a procedural schedule for the remand proceedings and reject or hold in abeyance the proposed tariffs eliminating the POLR and environmental carrying charges, or collect the existing tariff rates subject to refund pending the Commission's decision on remand. By responses filed May 16, 2011, the Ohio Energy Group (OEG), Ohio Manufacturers' Association (OMA), and Ohio Hospital Association (OHA) endorsed the collection of the existing rates, subject to refund. In various filings, other parties, namely, the Office of the Ohio Consumers' Counsel (OCC), Ohio Partners for Affordable Energy (OPAE), and Industrial Energy Users-Ohio (IEU-Ohio) opposed AEP-Ohio's motions.

On May 20, 2011, AEP-Ohio filed what it referred to as an initial merit filing on remand. In the filing, the Companies state that there is sufficient evidence in the record for the Commission to find that the environmental carrying costs are recoverable under one of the provisions in Section 4928.143(B)(2)(a) through (h), Revised Code, without further proceedings. While AEP-Ohio argued for the Commission to determine the level of POLR charges due the Companies based on the existing record and made various arguments in support thereof, AEP-Ohio also recognized that the Commission may schedule hearings and admit additional evidence regarding the Companies' POLR obligation.

By entry issued May 25, 2011, the Commission directed AEP-Ohio to file revised tariffs by May 27, 2011, making the POLR and environmental carrying charges subject to refund, as of the first billing cycle of June 2011, until the Commission specifically orders otherwise on remand. The Commission specified that, if it ultimately determines in the remand proceedings that any POLR or environmental carrying charges are to be refunded to customers, interest may be imposed on the amounts collected. The Commission concluded that making the current tariff rates subject to refund, pending the outcome of the remand proceedings, is the most reasonable means to facilitate a just process for customers and the Companies, and to avoid rate volatility for some customers. In the May 25, 2011, entry, the Commission also established a procedural schedule to afford AEP-Ohio and the intervenors an opportunity to present testimony and to offer additional evidence in regard to the POLR and environmental carrying charges remanded to the Commission. The parties were specifically directed to address the amount of POLR charges at issue and the rate of interest charges applicable, if any. On May 27, 2011, AEP-Ohio filed revised tariffs in accordance with the May 25, 2011, entry.

Following issuance of the May 25, 2011, entry, FirstEnergy Solutions Corp. (FES), Appalachian Peace and Justice Network (APJN), and Exelon Generation Company, LLC (Exelon) filed motions to intervene in these proceedings. By entry issued June 16, 2011, the attorney examiner denied the motions, finding that they were filed nearly three years past the established intervention deadline and that the movants had not demonstrated extraordinary circumstances justifying late intervention. On June 29, 2011, the Commission affirmed the attorney examiner's ruling and denied the interlocutory appeals of FES, APJN, and Exelon.

Pursuant to the procedural schedule established in the May 25, 2011, entry, as modified by entries of June 23, 2011, and June 30, 2011, a prehearing conference was held on July 8, 2011. The hearing commenced on July 15, 2011, and continued on July 19, 2011, through July 21, 2011. The hearing concluded with rebuttal testimony on July 28, 2011.

At the hearing, AEP-Ohio presented the testimony of Dr. Anil Makhija (Cos. Remand Ex. 1), Dr. Chantale LaCasse (Cos. Remand Ex. 3), and Laura J. Thomas (Cos. Remand Ex. 4), regarding the Companies' POLR obligation, and the testimony of Philip J. Nelson (Cos. Remand Ex. 2), regarding the environmental investment carrying charges incurred during the ESP for investments made from 2001-2008.[4] The Companies also offered the rebuttal testimony of Dr. Chantale LaCasse (Cos. Remand Ex. 5), Thomas E. Mitchell (Cos. Remand Ex. 7), and Laura J. Thomas (Cos. Remand Ex. 8).

Six witnesses testified for various intervenors: on behalf of OCC, Mack A. Thompson (OCC Remand Ex. 1) and Dr. Daniel J. Duann (OCC Remand Ex. 2); on behalf of IEU-Ohio, Dr. Jonathan A. Lesser (IEU-Ohio Remand Ex. 1), Kevin M. Murray (IEU-Ohio Remand Ex. 2), and Joseph G. Bowser (IEU-Ohio Remand Ex. 3); and on behalf of Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc. (jointly, Constellation), David I. Fein (Constellation Remand Ex. 1). Staff presented the testimony of Timothy W. Benedict (Staff Remand Ex. 1).

At the conclusion of the hearing on July 28, 2011, IEU-Ohio, joined by OCC, moved to dismiss these cases, asserting that AEP-Ohio failed to sustain its burden of proof. The attorney examiner deferred ruling on the motion to dismiss.

Initial briefs were filed on August 5, 2011, by AEP-Ohio, Staff, IEU-Ohio, and Constellation. Joint briefs were filed by OCC and OPAE, as well as OMA and OHA. Additionally, FES filed a motion for leave to file an *amicus curiae* brief attached to its motion. On August 10, 2011, AEP-Ohio filed a memorandum contra FES' motion. FES filed a reply on August 15, 2011.

On August 10, 2011, OCC and OPAE filed a motion to strike a portion of AEP-Ohio's initial brief. IEU-Ohio filed a similar motion on August 11, 2011. AEP-Ohio filed a memorandum contra the motions to strike on August 16, 2011. OCC, OPAE, and IEU-Ohio filed a joint reply on August 18, 2011.

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4 References to exhibits or transcripts from the remand proceedings will specifically be designated as such in this order. All other references refer to evidence from the original record compiled in 2008.

Reply briefs were filed on August 12, 2011, by AEP-Ohio, IEU-Ohio, and Constellation. Joint reply briefs were filed by OCC and OPAE, as well as OMA and OHA. On August 17, 2011, OCC, OPAE, and IEU-Ohio filed a joint motion to strike portions of AEP-Ohio's reply brief. AEP-Ohio filed a memorandum contra the motion to strike on August 24, 2011. OCC, OPAE, and IEU-Ohio filed a joint reply on August 29, 2011.

II. PROCEDURAL ISSUES

A. IEU-Ohio's Motion to Dismiss

As noted above, IEU-Ohio moved to dismiss these cases at the conclusion of the hearing on July 28, 2011, and OCC joined the motion. With respect to AEP-Ohio's POLR charges, IEU-Ohio contends that the Companies asserted during the remand proceedings that their POLR costs are based on the value to customers of the option to switch to an alternative supplier, which IEU-Ohio believes is the same argument that was previously rejected by the Supreme Court of Ohio. Regarding environmental carrying charges, IEU-Ohio argues that the Companies have failed to identify any category within Section 4928.143(B)(2), Revised Code, that supports their recovery of such costs. IEU-Ohio concludes that the Companies have failed to meet their burden of proof. (Remand Tr. V at 894-895.)

AEP-Ohio responds with respect to the POLR charges that the Court's decision does not dictate a particular outcome in these cases or prevent the Commission from reaching the same result as in the original proceedings. The Companies argue that the evidence should be considered by the Commission. On the subject of environmental carrying charges, AEP-Ohio maintains that it has identified multiple bases in the statute that support recovery of its costs. (Remand Tr. V at 895-897.)

The Commission finds that AEP-Ohio has presented sufficient evidence, as addressed in detail below, such that we may decide these matters on the record. Accordingly, IEU-Ohio's motion to dismiss should be denied.

B. FES' Motion to File *Amicus Curiae* Brief

On August 5, 2011, FES filed a motion for leave to file an *amicus curiae* brief in these proceedings. FES notes that its brief addresses AEP-Ohio's POLR charges. According to FES, it has extensive experience on the subject of POLR risk, given that it has assumed such risk in competitive auctions as a competitive retail electric service (CRES) provider. FES believes that its experience may be beneficial to the Commission. FES notes that it was denied intervention in these proceedings and that, in other cases, the Commission has permitted *amicus* filings by entities denied intervention or even where intervention was not sought. FES asserts that its brief will not delay the proceedings or expand on the issues, as FES does not seek to introduce new evidence. FES points out that the Commission's decision will have a significant impact on CRES providers operating in AEP-Ohio's service territory and that the Commission should have as much information as possible in making its decision.

In its memorandum contra, AEP-Ohio responds that FES was properly denied intervention in these cases and that its participation at this point adds no value to the record. The Companies further note that FES has identified no legal basis authorizing FES to file an *amicus curiae* brief. AEP-Ohio disputes FES' claim that it does not intend to seek new evidence, pointing out that FES attached a non-record exhibit to its brief. The Companies maintain that FES has no unique POLR experience to share with the Commission and that the perspective of CRES suppliers has already been provided by Constellation, which is a party to these proceedings. AEP-Ohio notes that the Commission has not solicited FES' *amicus* filing, as it has from other entities in prior cases, and that FES' true concerns are those of a competitor of the Companies and not an aide to the Commission.

The Commission finds no basis under the present circumstances to justify permitting FES to file an *amicus curiae* brief. As discussed above, FES' late motion for intervention was denied. In the entry of June 29, 2011, we noted that FES was granted intervention in AEP-Ohio's pending ESP case, Case No. 11-346-EL-SSO, *et al.*, and that our decision was not intended to prevent FES from presenting its arguments with respect to AEP-Ohio's POLR charges or from otherwise fully participating in those proceedings, regardless of the outcome of the present cases. Additionally, as AEP-Ohio notes, the perspective of CRES providers is already represented in these proceedings by Constellation, which has provided expert testimony, as well as filed initial and reply briefs. Finally, we find that FES' *amicus curiae* brief raises no issue that has not also been raised by Constellation or the other parties. For these reasons, FES' motion for leave to file an *amicus curiae* brief should be denied.

C. <u>Motions to Strike of OCC, OPAE, and IEU-Ohio</u>

1. <u>Testimony</u>

a. <u>Rebuttal Testimony of Dr. LaCasse</u>

During the remand hearing, OCC, joined by IEU-Ohio, OPAE, Constellation, and OHA, moved to strike a portion of the rebuttal testimony of Companies witness LaCasse. The motion to strike was denied by the attorney examiner. (Remand Tr. V at 637-643, 653.) In their initial brief, OCC and OPAE renew the motion to strike, request that the Commission find that the attorney examiner's ruling was erroneous, and ask that the rebuttal testimony and related testimony on cross-examination be disregarded. Regarding the specific portion of the rebuttal testimony in question, which pertains to Monte Carlo model results offered in support of the Companies' option model results (Cos. Remand Ex. 5 at 7-11), OCC and OPAE argue that proper rebuttal testimony does not include subjects that could have been presented during the party's direct case. OCC and OPAE note that AEP-Ohio indicated in its initial merit filing of May 20, 2011, that it intended to support the reasonableness of its POLR charges based on additional modeling, which could include the results of a Monte Carlo model. OCC and OPAE assert that the late arrival of a study is insufficient justification for its presentation in rebuttal testimony and that the late admission into the record of the Monte Carlo results was highly prejudicial. AEP-Ohio responds that Dr. LaCasse offered proper rebuttal testimony and that, because OCC failed to take an interlocutory appeal of the attorney examiner's ruling, it may not now be attacked on brief.

Initially, the Commission notes that OCC and OPAE may raise the propriety of the attorney examiner's ruling for the Commission's consideration pursuant to Rule 4901-1-15(F), Ohio Administrative Code (O.A.C.). We find, however, that the attorney examiner properly denied the motion. The rebuttal testimony of Dr. LaCasse regarding the results of the Monte Carlo model was specifically provided in response to the direct testimony of IEU-Ohio witness Lesser, stating that "options must be valued using empirical models, such as [M]onte-[C]arlo models" if the strike price is correlated with the price of the underlying asset and that "one cannot use either the Black-Scholes or Black models to do so" (IEU-Ohio Remand Ex. 1 at 22; Cos. Remand Ex. 5 at 7). As Dr. LaCasse's rebuttal testimony was specifically offered in response to Dr. Lesser's testimony, it could not have been offered as part of the Companies' direct case, given that the Companies' direct testimony was filed before the intervenors'. Further, OCC and OPAE have offered no support for their contention that the Monte Carlo results were presented in rebuttal testimony because they were late. Neither have OCC and OPAE demonstrated how the admission of the testimony into the record caused them prejudice. Both parties were afforded the opportunity to cross-examine Dr. LaCasse regarding the Monte Carlo results.

b. <u>Direct Testimony of Mr. Nelson</u>

OCC also moved during the remand hearing to strike a portion of the direct testimony of Companies witness Nelson. This motion was also denied by the attorney examiner. (Remand Tr. I at 69-70, 78.) OCC and OPAE, in their initial brief, ask that the Commission reverse the ruling. In the relevant portion of the testimony, Mr. Nelson identified three statutory bases in support of the Companies' recovery of environmental carrying costs (Cos. Remand Ex. 2 at 4). OCC and OPAE move to strike this testimony on the grounds that Mr. Nelson is not qualified to offer a legal opinion.

The Commission finds that this motion to strike was also properly denied. Mr. Nelson explained that his testimony was offered based on the advice of counsel (Cos. Remand Ex. 2 at 4) and that he was not testifying as an expert in legal matters (Remand Tr. I at 78). Mr. Nelson's testimony was thus not offered as a legal opinion.

2. <u>Initial Brief</u>

On August 10, 2011, OCC and OPAE filed a motion to strike a portion of AEP-Ohio's initial brief referring to the POLR charges of other electric distribution utilities (EDUs) in Ohio. IEU-Ohio filed a similar motion on August 11, 2011. OCC, OPAE, and IEU-Ohio argue that the POLR charges of the other EDUs were not introduced or admitted into evidence and that the Companies' attempt to rely on non-record information should be rejected. They further assert that the Commission must base its decision on the record before it, as required by Section 4903.09, Revised Code. OCC, OPAE, and IEU-Ohio add that they have concerns about the relevancy, comparability, and accuracy of the charges listed for the other EDUs, which they would have raised if the information had been introduced during the hearing.

AEP-Ohio responds that the information that OCC, OPAE, and IEU-Ohio seek to strike was taken directly from tariffs that have been approved by the Commission and that the Commission has the authority to recognize its own decisions and approved tariffs, which have the effect of a statute. The Companies argue that the Commission has previously taken administrative notice of tariff provisions for comparison purposes and may do so here, if necessary. They note that the information was provided to assist the Commission in applying its prior decisions to the present cases. AEP-Ohio contends that the circumstances surrounding approval of the other EDUs' POLR charges are known by the Commission and may be weighed accordingly.

OCC, OPAE, and IEU-Ohio reply that it is inappropriate to take administrative notice of the information after the record is closed, as it denies them the opportunity to explain and rebut the information through cross-examination, contrary to Ohio Supreme Court and Commission precedent. They add that the Companies have offered no reason for having waited until the briefing stage to present the information.

The Commission agrees with OCC, OPAE, and IEU-Ohio that they should have been afforded the opportunity to challenge the information in question during the hearing and that it would be improper to take administrative notice of the information at this stage in the proceedings. AEP-Ohio admits that the table in its brief was included in its initial merit filing of May 20, 2011, but offers no explanation as to why it was not presented during its direct case. Additionally, the Commission questions whether the information presented in the table may properly be used for the purpose of comparison. As the intervenors note, the rates and charges of the other EDUs shown in the table do not appear to relate solely to their POLR obligation and, in any event, were determined in the context of Commission-approved stipulations. Accordingly, the motions to strike should be granted, such that the first paragraph on page 30 of AEP-Ohio's initial brief, including the table, should be stricken.

3. Reply Brief

On August 17, 2011, OCC, OPAE, and IEU-Ohio filed a motion to strike two portions of AEP-Ohio's reply brief. The first portion is a sentence pertaining to the POLR charges of the other EDUs. The second portion pertains to statements made by OCC witness Medine regarding the Black-Scholes model in a Commission-ordered audit report in the Companies' fuel adjustment clause (FAC) proceedings, Case No. 10-268-EL-FAC, *et al.* With respect to both portions, OCC, OPAE, and IEU-Ohio argue that the Companies' attempts to rely on non-record information should be rejected for the same reasons advanced in their motions to strike a portion of AEP-Ohio's initial brief, as discussed above.

Likewise, AEP-Ohio raises the same arguments asserted in its response to the motions to strike a portion of its initial brief. Regarding the statements of OCC witness Medine on the subject of the Black-Scholes model, the Companies argue that whether to take administrative notice is a case by case determination and that, under the circumstances, it is appropriate for the Commission to do so in order to be able to compare Ms. Medine's testimony in these cases, as addressed by OCC and OPAE in their initial brief, with her statements in the audit report in the FAC proceedings.

The Commission finds that the motion to strike should be granted for the same reasons addressed above. We find that it is improper to take administrative notice of the information in question, which was not presented until the reply brief was filed and thus foreclosed the intervenors from challenging the information. Therefore, the motion to strike should be granted, such that both portions of AEP-Ohio's reply brief, as identified by OCC, OPAE, and IEU-Ohio, should be stricken.

III. DISCUSSION

A. Incremental Carrying Cost for 2001-2008 Environmental Investment

1. Supreme Court's Directive

In the ESP Order, the Commission authorized AEP-Ohio "to recover the incremental capital carrying costs that will be incurred after January 1, 2009, on past environmental investments (2001-2008) that are not presently reflected in the Companies' existing rates."[5] The Commission interpreted Section 4928.143(B)(2), Revised Code, to permit AEP-Ohio to include, in the ESP, environmental investment carrying costs incurred during the ESP term. The Commission found that "[t]he carrying costs on the environmental investments fall within the ESP period and, therefore, may be included in the ESP pursuant to the broad language of Section 4928.143(B)(2), Revised Code, permitting recovery for unenumerated expenses."[6] The Commission authorized the Companies to collect a revenue requirement of $26 million for CSP and $84 million for OP. On appeal, the Supreme Court of Ohio determined that Section 4928.143(B)(2), Revised Code, does not authorize the Commission to allow recovery of items not enumerated in the section. The Court remanded the cases to the Commission for further proceedings in which the Commission may determine whether any of the listed categories set forth in Section 4928.143(B)(2), Revised Code, authorize recovery of environmental investment carrying charges.[7]

2. <u>Applicable Law</u>

Section 4928.143(B)(1), Revised Code, provides that an ESP "shall include provisions relating to the supply and pricing of electric generation service." Additionally, Section 4928.143(B)(2), Revised Code, enumerates specific categories of items that an ESP may include.

3. <u>Arguments</u>

In their application, the Companies requested increases to their base, non-FAC generation rates for recovery of carrying costs for environmental investments made during 2001-2008 that were not currently reflected in their SSO rates, or an annual amount of $26 million for CSP and $84 million for OP. The Commission approved the Companies' request.

AEP-Ohio asserts that the narrow legal issue remanded to the Commission may be readily addressed by substantiating its recovery of carrying costs on 2001-2008 environmental investments by way of any one of multiple provisions within Section 4928.143(B)(2), Revised Code. First, the Companies state that Section 4928.143(B)(2)(d), Revised Code, authorizes the Commission to establish terms relating to carrying costs, as would have the effect of stabilizing rates. In their brief, the Companies note that the effect of perpetuating the useful lives of existing generation assets through prudent environmental investments is to stabilize rates, particularly when compared to the cost of investing in new generation. As another statutory basis, AEP-Ohio points to Section

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5 ESP Order at 28.

6 First ESP EOR at 12.

7 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 520.

4928.143(B)(2)(e), Revised Code, which authorizes automatic increases in any component of the SSO price. The Companies claim that, because compliance with environmental regulations is compulsory when operating a generating station, it is appropriate to allow automatic pass-through of prudently incurred carrying costs on environmental investments. Finally, AEP-Ohio identifies Section 4928.143(B)(2)(b), Revised Code, as another legal basis for its recovery of such costs, noting that the provision allows cost recovery for an environmental expenditure for an electric generating facility of an EDU, provided the cost is incurred or the expenditure occurs on or after January 1, 2009. The Companies explain that, although the environmental investments were made prior to that date, the carrying costs on those investments were incurred in 2009 and beyond.

Staff agrees with AEP-Ohio that Section 4928.143(B)(2)(d), Revised Codes, allows for recovery of the Companies' environmental investment carrying costs, given that "carrying costs" are specifically enumerated in that provision.

IEU-Ohio argues that AEP-Ohio has failed to demonstrate that the carrying charges on 2001-2008 environmental investments are lawful. Initially, IEU-Ohio notes that the Companies have not claimed that the revenues from their other rates and charges are inadequate to compensate the Companies for their environmental investment carrying costs. IEU-Ohio further argues that AEP-Ohio failed to offer any evidence in support of its claim for recovery and instead merely referred to certain provisions in the statute, without demonstrating that it satisfies the criteria of any of those provisions. With regard to those provisions, IEU-Ohio asserts that Section 4928.143(B)(2)(b), Revised Code, pertains only to recovery of expenses related to construction work in progress occurring on or after January 1, 2009, and is not applicable to AEP-Ohio's carrying costs. Regarding Section 4928.143(B)(2)(d), Revised Code, IEU-Ohio contends that Companies witness Nelson failed to demonstrate how the carrying charges stabilize or provide certainty regarding retail electric service. Finally, with respect to Section 4928.143(B)(2)(e), Revised Code, IEU-Ohio notes that the carrying charges do not constitute an automatic increase or decrease.

OCC and OPAE contend that the carrying costs were not incurred on or after January 1, 2009, because they pertain to environmental investments that occurred from 2001-2008, and that the carrying costs, therefore, may not be recovered pursuant to Section 4928.143(B)(2)(b), Revised Code. With respect to Section 4928.143(B)(2)(d), Revised Code, OCC and OPAE argue that there is no evidence that carrying charges on older environmental investments benefit customers in terms of stability or certainty regarding retail electric service. Finally, OCC and OPAE assert that Section 4928.143(B)(2)(e), Revised Code, is inapplicable, as the carrying charges are a distinct component of the SSO, rather than an adjustment mechanism for a component.

4. Conclusion

The Supreme Court of Ohio directed that "[o]n remand, the [C]ommission may determine whether any of the listed categories of (B)(2) authorize recovery of environmental carrying charges."[8] AEP-Ohio submits that three of the categories listed in Section 4928.143(B)(2), Revised Code, including Section 4928.143(B)(2)(d), Revised Code, authorize recovery of its environmental investment carrying charges.

Section 4928.143(B)(2)(d), Revised Code, provides that an ESP may include "[t]erms, conditions, or charges relating to...carrying costs, amortization periods, and accounting or deferrals, including recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service." Section 4928.01(A)(27), Revised Code, defines "retail electric service" as "any service involved in supplying or arranging for the supply of electricity to ultimate consumers in this state, from the point of generation to the point of consumption" and specifically includes "generation service."

The Commission agrees with AEP-Ohio and Staff that Section 4928.143(B)(2)(d), Revised Code, authorizes the Companies' recovery of incremental capital carrying costs that are incurred after January 1, 2009, on past environmental investments (2001-2008) that were not previously reflected in the Companies' existing rates prior to the ESP Order. Section 4928.143(B)(2)(d), Revised Code, specifically authorizes recovery of carrying costs. There is no dispute among the parties on this point.

As an initial matter, IEU-Ohio asserts that the Companies have failed to show that their rates, excluding the environmental investment carrying charges, do not provide adequate compensation. IEU-Ohio, however, offers no support for its position that AEP-Ohio is required to make such a showing or pass an earnings test as a condition of recovery of its incremental environmental investment carrying costs.

OCC, OPAE, and IEU-Ohio argue that the Companies failed to demonstrate how their carrying costs stabilize or provide certainty regarding retail electric service. OCC and OPAE further add that the determination regarding the stabilizing effect must be made from the perspective of the customer and that the Companies have not shown that their customers benefit from the carrying charges on past environmental investments. We disagree with the arguments raised by OCC, OPAE, and IEU-Ohio. During the initial hearing, Companies witness Nelson testified:

> The capital carrying cost is the annual cost associated with the investment of a dollar of capital asset investment. Capital expenditures are typically long lived assets that are recovered over the life of the asset. Investors require

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8 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 520.

> both a return on and of their capital expenditures....The carrying cost rate includes the cost of money (weighted average cost of capital), a depreciation component, an income tax component, property and other taxes component and an administrative and general component.

(Cos. Ex. 7 at 15-16.) He further testified:

> These environmental investments are necessary to keep the Companies' low-cost coal-fired generating units running. The customers will benefit because the operating costs of these units remain well below the cost of securing the power on the market. The Companies are passing the lower-cost power through the FAC.

(Cos. Ex. 7B at 6.)

We find that the environmental investment carrying charges have the effect of providing certainty to both the Companies and their customers regarding retail electric service, specifically generation service. With respect to AEP-Ohio, inclusion of the carrying charges in the ESP compensates the Companies for their investment in their generating plant. Companies witness Nelson explained that the Companies' investors expect to earn a return on their capital investments and that the carrying cost rate includes the cost of money, among other components. AEP-Ohio's recovery of the carrying costs works to ensure that the investors earn a return on their investment.

However, customers benefit as well. As Mr. Nelson pointed out, the carrying charges recover the ongoing costs of environmental investments that were necessary to continue operation of the Companies' generation units and extend the useful lives of those facilities. Customers benefit from the lower cost power that they receive as a result. The alternative to the investments in the Companies' generation assets would be increased use of purchased power to serve the Companies' SSO load. The record reflects that this cost of the environmental investments was below the market rate for purchased power at the time the Commission considered the ESP. Thus, we agree with Staff that "[t]he [C]ompanies' compliance with the current and future environmental requirements is in the public interest, and they should continue investing in environmental equipment" (Staff Ex. 6 at 5). As AEP-Ohio's environmental investment carrying charges have the effect of providing certainty regarding retail electric service, Section 4928.143(B)(2)(d), Revised Code, authorizes their inclusion in the ESP.

With respect to the argument raised by OCC and OPAE that, because the carrying costs pertain to environmental investments that occurred from 2001-2008, the carrying costs may not be recovered pursuant to Section 4928.143(B)(2)(b), Revised Code, the

Commission notes that Section 4928.143(B)(2)(b), Revised Code, applies only to nonbypassable surcharges. Since the carrying costs at issue are recovered through rates which are bypassable, the limitation to environmental expenditures incurred on or after January 1, 2009, contained in Section 4928.143(B)(2)(b), Revised Code, is inapplicable in this case.

The Commission further notes that our decision in this case is consistent with the broad authority granted to the Commission by Section 4928.143(B)(1), Revised Code, which authorizes ESPs to include "provisions relating to the supply and pricing of electric generation service." The carrying charges are a specific component of the Companies' standard service offer generation rates and are directly related to environmental investments made at generating facilities which are used to serve standard service offer customers.

The Commission concludes that AEP-Ohio should be authorized to continue its recovery of incremental capital carrying costs that are incurred after January 1, 2009, on past environmental investments (2001-2008) that were not previously reflected in the Companies' existing rates prior to the ESP Order. The Companies should file revised tariffs, consistent with this order on remand, reflecting that the environmental investment carrying charges are no longer subject to refund. The effective date of the new tariffs should be the date of this order, or the date upon which four complete, printed copies of the final tariffs are filed with the Commission, whichever date is later.

B. POLR Rider

1. Supreme Court's Directive

In the ESP Order, the Commission found that "the Companies do have some risks associated with customers switching to CRES providers and returning to the electric utility's SSO rate at the conclusion of CRES contracts or during times of rising price."[9] The Commission concluded that "the Companies' proposed ESP should be modified such that the POLR rider will be based on the cost to the Companies to be the POLR and carry the risks associated therewith, including the migration risk." The Commission approved recovery of 90 percent of the estimated POLR costs presented by the Companies, or the approximate portion representing the migration risk, and authorized the Companies to collect a revenue requirement of $97.4 million for CSP and $54.8 million for OP. The Commission also specified that "the POLR rider shall be avoidable for those customers who shop and agree to return at a market price and pay the market price of power incurred by the Companies to serve the returning customers."

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9 ESP Order at 40.

On appeal, the Supreme Court of Ohio concluded that the Commission's decision that the POLR charge is cost-based, which determination was based on the results of "a mathematical formula" known as the Black-Scholes model, was against the manifest weight of the evidence, an abuse of the Commission's discretion, and reversible error.[10] Additionally, the Court stated:

> To be clear, we express no opinion on whether a formula-based POLR charge is per se unreasonable or unlawful, and the [C]ommission may consider on remand whether a non-cost-based POLR charge is reasonable and lawful. Alternatively, the [C]ommission may consider whether it is appropriate to allow [AEP-Ohio] to present evidence of its actual POLR costs. However the [C]ommission chooses to proceed, it should explain its rationale, respond to contrary positions, and support its decision with appropriate evidence.

2. Applicable Law

An EDU's POLR obligation is derived from several statutory provisions in Chapter 4928, Revised Code. Section 4928.141(A), Revised Code, provides, in part:

> Beginning January 1, 2009, an electric distribution utility shall provide consumers, on a comparable and nondiscriminatory basis within its certified territory, a standard service offer of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service.

Additionally, Section 4928.14, Revised Code, provides, in part:

> The failure of a supplier to provide retail electric generation service to customers within the certified territory of an electric distribution utility shall result in the supplier's customers, after reasonable notice, defaulting to the utility's standard service offer under sections 4928.141, 4928.142, and 4928.143 of the Revised Code until the customer chooses an alternative supplier.

In its decision in these cases, the Supreme Court of Ohio described the EDU's POLR obligation as the "obligation to stand ready to accept returning customers."[11]

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10 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518-519.

11 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 517.

3. Issues

On appeal, the Supreme Court of Ohio found "no evidence suggesting that [AEP-Ohio's] POLR charge is related to any costs it will incur."[12] Regarding the Black-Scholes model used by the Companies to determine their POLR costs, the Court stated that "[v]alue to customers (what the model shows) and cost to [AEP-Ohio] (the purported basis of the order) are simply not the same thing" and "we fail to see how the amount a customer would be willing to pay for the right to shop necessarily establishes [AEP-Ohio's] costs to bear the attendant risks."

AEP-Ohio claims that the evidentiary record on remand fully supports the Companies' existing POLR charges and addresses the Court's concerns as to how the charges are cost-based. The Companies urge the Commission to approve again their existing POLR charges. Numerous intervenors, including OCC, OPAE, IEU-Ohio, Constellation, OMA, and OHA, argue that the Companies have failed to sustain their burden of proof and should, therefore, refund to customers the POLR charges collected since the first billing cycle of June 2011 and cease any further collection of such charges.

a. Legal Basis for POLR Charge

i. Arguments

AEP-Ohio notes that all EDUs have a mandatory, continuing obligation to stand as the POLR in their respective service territories and that the Supreme Court of Ohio has recognized that EDUs are entitled to be compensated for discharging their POLR obligations.[13] Additionally, the Companies state that, pursuant to Section 4928.143(B)(1), Revised Code, an ESP is required to include provisions related to the supply and pricing of electric generation service. They also note that, pursuant to Section 4928.143(B)(2)(d), Revised Code, an ESP may include charges relating to bypassability, standby service, and default service, as would have the effect of stabilizing or providing certainty regarding retail electric service. AEP-Ohio contends that recoverable costs may include lost revenues due to its POLR obligation, pointing out that Section 4928.143(B)(2)(h), Revised Code, expressly authorizes recovery of lost revenues related to distribution infrastructure and modernization incentives. The Companies assert that this provision confirms that the components of an ESP may be based on lost revenues.

The Companies further state that, although the record demonstrates that the POLR charges are cost-based, the charges would nevertheless be lawful even if they could not be justified on a cost basis, as they have the effect of providing stability and certainty

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12 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518.

13 *Constellation NewEnergy, Inc. v. Pub. Util. Comm.* (2004), 104 Ohio St.3d 530.

regarding the price that customers will pay for retail electric service, consistent with Section 4928.143(B)(2)(d), Revised Code. Finally, AEP-Ohio argues that, because POLR costs are recovered by the other EDUs or through the competitive bid prices of SSO suppliers, it would be unfair and unlawful to deny the Companies the same right to recover such costs.

IEU-Ohio asserts that the Companies have not demonstrated any legal basis for their POLR charges. Noting that the POLR charges were proposed as a distribution rider, IEU-Ohio contends that the charges do not qualify under Section 4928.143(B)(2)(h), Revised Code, which authorizes only certain types of distribution charges. IEU-Ohio further notes that the Companies have identified no legal authority that would justify the POLR charges as a generation rider.

ii. Conclusion

As an initial matter, the Commission clarifies that AEP-Ohio's POLR rider should properly be classified as a generation service rider. Although the POLR obligation is an exclusive obligation of the EDUs, it pertains to the provision of generation service.[14] The Commission agrees with the Companies that Section 4928.143(B)(1), Revised Code, provides a statutory basis for their recovery of POLR costs, which relate to the pricing of electric generation service. Additionally, Section 4928.143(B)(2)(d), Revised Code, provides that an ESP may include "[t]erms, conditions, or charges relating to...standby, back-up, or supplemental power service, [and] default service...as would have the effect of stabilizing or providing certainty regarding retail electric service." As AEP-Ohio must stand ready to provide SSO service to returning customers, and customers have the option to return at any time, we find that the charges associated with the Companies' POLR obligation, which are charges related to standby and default service, provide certainty for both the Companies and their customers regarding retail electric service.

b. POLR Cost

i. Arguments

According to AEP-Ohio, the record establishes that the Companies incur substantial costs associated with providing customers with the optionality to switch away from, and to return to, the SSO generation rates that the Companies have committed to make available for the duration of the ESP term (POLR optionality) (Cos. Remand Ex. 1 at 3-5; Cos. Remand Ex. 3 at 5-7; Cos. Remand Ex. 4 at 3). AEP-Ohio describes the POLR optionality as enabling customers to take service from the Companies at SSO rates until

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14 *Ohio Consumers' Counsel v. Pub. Util. Comm.* (2007), 114 Ohio St.3d 340, 344-346.

market prices decline below the SSO rates such that it becomes advantageous to switch to a CRES provider. The POLR optionality also allows customers who have switched to a CRES provider to return to the Companies at SSO rates if market prices rise above the SSO rates or the CRES provider defaults in providing service.

Companies witness LaCasse described the costs associated with the POLR optionality in terms of shopping-related risks:

> If market prices fall sufficiently so that SSO customers shop, a portion of the generation output that the EDU expected would serve SSO customers instead would be sold at prices below the ESP price, leading to a shortfall in revenue. If instead market prices rise sufficiently so that customers taking service from CRES providers return to SSO, the EDU would divert a portion of the generation output that could have been sold at those higher market prices to serve SSO customers, or the EDU would purchase from the market at those higher market prices to serve SSO customers, leading to additional unexpected cost.

(Cos. Remand Ex. 3 at 7.) In further support of AEP-Ohio's claim that it incurs POLR costs as a result of shopping-related risks, Dr. LaCasse provided examples of analyses of SSO auction results that quantified the risks, including shopping-related risks, associated with providing wholesale supplies for customers that take SSO-type service (Cos. Remand Ex. 3 at 18-20).

Companies witness Makhija used a hypothetical situation to describe the effect of the POLR obligation as a diminution in equity value, by comparing Utility A, which has the same POLR obligation as the Companies, with Utility B, which does not:

> The earnings of Utility A will have greater variability because its customers are likely to depart when the market price falls below its SSO price, and to return when the market price goes above the SSO price. This makes Utility A riskier and its equity requires a higher required rate of return compared to Utility B. That is, shareholders for Utility A have a higher risk premium (and, hence, a higher cost of equity capital) as a result of the optionality it is required to provide to its customers. Cash flows for Utility A should be discounted at the higher cost of capital, which amounts to a diminution of shareholders equity for Utility A.

(Cos. Remand Ex. 1 at 5.)

Dr. Makhija further testified that the cost to AEP-Ohio, as the provider of the POLR optionality, is "no more or less than the value of the options received by the customers" (Cos. Remand Ex. 1 at 4). Additionally, Dr. LaCasse testified that the value of the option (*i.e.*, the expected value of the difference between the ESP price and the market price at which customers choose to shop) is also the amount by which realized revenue for AEP-Ohio can be expected to be below the ESP revenue that AEP-Ohio would have received absent the customer shopping. She explained that the Companies experience an actual, quantifiable loss in that they are left to make an alternate sale at the lower market price, leading to a loss in revenue. (Cos. Remand Ex. 3 at 5; Cos. Remand Ex. 5 at 6.) Similarly, according to Dr. Makhija, AEP-Ohio incurs a cost, due to its POLR obligation, in the form of a lost opportunity, as measured by the difference between the SSO price and the market price (Remand Tr. I at 49).

Companies witness Thomas explained that AEP-Ohio estimates, by way of an option model, the value of the POLR optionality given to customers to determine the cost imposed on the Companies from their POLR obligation. Ms. Thomas adopted the results from the unconstrained option model proposed originally by Companies witness Baker, which were modified and used by the Commission as the basis for the existing POLR charges. Ms. Thomas also reported the results of the Companies' constrained option model, which refines the original unconstrained option model by incorporating switching constraints, to confirm that the results from the unconstrained option model are reasonable and should be retained. (Cos. Remand Ex. 4 at 12-16.) Additionally, on rebuttal, Dr. LaCasse offered the results of a Monte Carlo model as support for the magnitude of the POLR costs calculated by the Companies' constrained option model (Cos. Remand Ex. 5 at 10).

The Companies contend that their POLR costs are not based on a subjective determination of the amount that a customer would be willing to pay for the right to shop, as discussed in the Supreme Court's decision,[15] but rather are based on forward-looking, market-based measurements that objectively quantify their costs using an option model, which also quantifies the value of the POLR optionality to customers. Because the POLR obligation is undertaken by AEP-Ohio at the outset of the ESP term, the Companies argue that their POLR risk should be modeled at that point (Cos. Remand Ex. 3 at 12-13; Cos. Remand Ex. 8 at 2-4).

AEP-Ohio concludes that its testimony sufficiently explains the rationale for using an option model to estimate its POLR costs, as well as how the value of the POLR optionality to its customers relates to the cost to the Companies of providing the POLR optionality. The Companies submit that that their modeled cost of providing the POLR

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15 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518.

optionality, as supported by the record, confirms the reasonableness of their existing POLR charges.

Numerous parties, including Staff, OCC, OPAE, IEU-Ohio, Constellation, OMA, and OHA, respond that AEP-Ohio has identified no out-of-pocket costs associated with its POLR obligation. They note that none of the Companies' witnesses performed an out-of-pocket cost calculation or even found such costs relevant (Remand Tr. I at 17-18; Remand Tr. II at 152-153, 244-245; OCC Remand Ex. 1 at 36-37). OCC, OPAE, Constellation, OMA, and OHA contend that, by failing to present any evidence showing that their POLR charges are indeed based on cost, the Companies have effectively chosen a non-cost-based approach, despite their insistence to the contrary.

OCC and OPAE assert that Chapter 4928, Revised Code, contains no guarantee that AEP-Ohio will be made whole for generation sales lost to CRES providers and that lost revenues may not be recovered through a POLR charge. OCC and OPAE argue that POLR costs should be limited to verifiable, out-of-pocket costs for incremental energy and capacity that are incurred to serve returning customers (OCC Remand Ex. 1 at 12). They state that the POLR obligation is a non-competitive, distribution-related service that should be priced based on actual, prudently incurred costs, according to traditional cost-of-service principles under Chapters 4905 and 4909, Revised Code (OCC Remand Ex. 2 at 21-22). OCC and OPAE also note that allowing the Companies to recover lost off-system sales opportunities would be contrary to the ESP Order,[16] as well as the Commission's recent order reviewing the Companies' annual earnings,[17] in which the Commission found that off-system sales were irrelevant.

IEU-Ohio witness Murray testified that AEP-Ohio may have a negative financial risk if the cost of serving a returning customer is greater than the fixed cost of serving that customer that is already embedded in the SSO rate (IEU-Ohio Remand Ex. 2 at 7). IEU-Ohio argues, however, that the Companies failed to offer any evidence that their current SSO rates do not already compensate the Companies for the fixed costs associated with their POLR obligation. According to IEU-Ohio, the Companies cannot likely make such a showing because the fixed costs of capacity were known when the Companies sought their current SSO rates (OCC Remand Ex. 1 at 13-14; Remand Tr. II at 223-223). Additionally, IEU-Ohio disputes the Companies' claim that the value of the option equals the POLR cost to the Companies. IEU-Ohio witness Lesser testified that it is a false assumption that value to a customer is exactly equal to the cost to AEP-Ohio (IEU-Ohio Remand Ex. 1 at

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16 ESP Order at 17.

17 *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 (January 11, 2011), at 30.

12-15). IEU-Ohio contends that only if lost revenues are costs can the argument be made that there may be some equality between value and cost, and lost revenues are not recoverable as part of the Companies' POLR obligation.

Constellation also argues that lost opportunity costs are not properly included in a POLR charge, given that AEP-Ohio is not entitled to revenue from a set amount of sales. Constellation witness Fein testified that other EDUs in Ohio and other jurisdictions do not recover lost opportunity costs (Constellation Remand Ex. 1 at 11-13). Further, Constellation points out that AEP-Ohio has conducted no study to show that the purported benefit to customers is equal to the cost to the Companies.

ii. Conclusion

In the ESP Order, the Commission stated that it "believes that the Companies do have some risks associated with customers switching to CRES providers and returning to the electric utility's SSO rate at the conclusion of CRES contracts or during times of rising prices."[18] We continue to believe that the Companies have such risks and that the costs associated with such risks may be recovered through a POLR charge. The Commission is concerned, however, that AEP-Ohio has not properly valued its POLR costs or adhered to the clear directive from the Supreme Court of Ohio. The Court afforded two avenues for consideration of AEP-Ohio's POLR charges on remand, stating that "the [C]ommission may consider on remand whether a non-cost-based POLR charge is reasonable and lawful. Alternatively, the [C]ommission may consider whether it is appropriate to allow [AEP-Ohio] to present evidence of its actual POLR costs."[19]

AEP-Ohio has advocated its belief throughout the remand proceedings that its POLR charges are indeed based on cost, leaving the Commission to pursue the latter of the two approaches sanctioned by the Court (*i.e.*, consideration of whether the Companies have presented evidence of their actual POLR costs).[20] Upon review of the record, it is clear that the Companies have not presented any evidence of their actual, out-of-pocket POLR costs (Remand Tr. I at 17-18, 37-38; Remand Tr. II at 152-153, 237-238, 244-247; OCC

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18 ESP Order at 40.

19 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

20 Although AEP-Ohio has asserted throughout these remand proceedings that its POLR charges are cost-based, AEP-Ohio suggests, for the first time in a single section of its brief, that the charges can be justified alternatively on a non-cost basis. The Companies contend that non-cost-based POLR charges are lawful pursuant to Section 4928.143(B)(2)(d), Revised Code. However, the Companies offered no evidence to demonstrate that their POLR charges, if considered non-cost-based, are reasonable, as required by the Court. The Companies' reference on brief to their exposure to market risk is not by itself sufficient to justify the proposed POLR charge as a non-cost based charge. *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519. The Companies' belated argument that their POLR charges can be justified alternatively on a non-cost basis will, therefore, not be addressed further in this order.

Remand Ex. 1 at 36-37; OCC Remand Ex. 2 at 22; IEU-Ohio Remand Ex. 1 at 34; IEU-Ohio Remand Ex. 2 at 4-5; Constellation Remand Ex. 1 at 14). Rather, the Companies' claimed POLR costs are derived from an *ex ante* valuation of the benefit that customers are afforded by their option to shop for an alternative supplier (Cos. Remand Ex. 3 at 12-13; Cos. Remand Ex. 8 at 2-4). In simple terms, AEP-Ohio equates the value of the option with the benefit to the customer, which, in turn, the Companies equate with their costs (Cos. Remand Ex. 1 at 4; Cos. Remand Ex. 3 at 12; Remand Tr. I at 38; Remand Tr. II at 242, 260; Remand Tr. V at 706-707). Describing their costs in terms of lost revenues or a diminution of shareholder equity (Cos. Remand Ex. 1 at 5; Cos. Remand Ex. 3 at 5; Cos. Remand Ex. 5 at 6), the Companies contend that they have now sufficiently demonstrated that the value of the POLR optionality to their customers is precisely equal to the cost to the Companies of providing the POLR optionality.

The Companies' theory, however, has been directly refuted by OCC witness Thompson and IEU-Ohio witness Lesser (OCC Remand Ex. 1 at 37; IEU-Ohio Remand Ex. 1 at 12-15) and questioned by other intervenors and Staff. Further, no empirical evidence was offered by the Companies in support of their theory. Although Companies witness Makhija testified that the Companies' POLR costs would be reflected as a diminution of equity, neither Dr. Makhija nor any other witness provided the Companies' books or any other evidence in support of Dr. Makhija's theory (Remand Tr. I at 20, 45-46). Similarly, Companies witness LaCasse, as well as Dr. Makhija, spoke of the Companies' costs in terms of lost revenues, but provided no evidence of any revenues that the Companies actually lost (Remand Tr. II at 221). Instead, AEP-Ohio put forth the very same modeled or "formula-based" costs that were rejected by the Court. The Companies apparently equate modeled costs, which by definition provide a simulation or representation, with actual costs. We do not agree with the Companies on this point. Although actual costs may encompass more than just out-of-pocket costs, they must reflect some definite and concrete component that is able to be quantified and verified through the Companies' books, records, receipts, or other tangible documentation.

The Companies insist that an *ex post* determination of their POLR costs would be a "speculative re-enactment" and that their POLR risk should be assessed at the outset of the ESP term, which is when the risk is incurred (Cos. Remand Ex. 3 at 12-13; Cos. Remand Ex. 8 at 2-4). Under the present circumstances, where these proceedings were remanded to the Commission in the third and final year of the ESP, the Commission believes that it would have been reasonable for AEP-Ohio to undertake an *ex post* analysis of its POLR costs. Such an analysis would have enabled the Commission to compare the projected results of the Companies' option model with their actual costs incurred to date, a comparison that would have been highly useful in ensuring that customers are not paying unwarranted POLR charges. In the absence of such a comparison, AEP-Ohio has neglected to alleviate the Court's concern that "[a]t the very least, all this evidence raises doubts about the proposition that [AEP-Ohio] would justifiably expend $500 million to bear the POLR risk."[21] Upon review of the record on remand, the Commission shares this concern. We conclude that AEP-Ohio has failed to present evidence of its actual POLR costs and has not justified recovery of POLR charges at the level reflected in its existing rates.

c. Option Valuation Methodology

i. Arguments

Throughout these proceedings, AEP-Ohio has contended that modeling is a reasonable economic tool for the Commission to use as a basis for determining POLR costs. In their application, the Companies quantified their POLR costs by calculating the value of the POLR optionality using the Black-Scholes model, which is an economic model used to value stock and other spot options (Cos. Remand Ex. 4 at 12; IEU-Ohio Remand Ex. 1 at 5-6, 7). The inputs to the model consisted of the Companies' proposed first-year ESP price as the strike price; the then current competitive benchmark price as the market price; the three-year ESP term as the term of the option; the London Interbank Offered Rate (LIBOR) as the risk-free interest rate; and a measure of annual average volatility, based on historical data, as the volatility.[22] As originally proposed, the Companies' option model did not incorporate the shopping rules contained in their tariffs and is thus now referred to as the unconstrained option model. Since 2008, the Companies have developed a constrained option model, which incorporates the shopping rules, utilizes ESP prices that change over the ESP term, and reflects the fact that customers essentially receive a series of options to buy SSO generation service at the ESP price during the ESP term. The constrained option model is based on the Black model, which is used to value options on futures contracts. (Cos. Remand Ex. 3 at 16-17; Cos. Remand Ex. 4 at 12, 13; IEU-Ohio Remand Ex. 1 at 10.)

Companies witness Thomas used the constrained option model, including updated inputs to incorporate the SSO rates approved by the Commission and the decreased market prices occurring between the time of the Companies' application and the ESP Order, to determine the Companies' POLR costs during the ESP term. AEP-Ohio asserts that the results of the constrained option model are comparable to the conservative results of the unconstrained option model. (Cos. Remand Ex. 4 at 15-16.)

Companies witness LaCasse reviewed both models and found that option valuation as a methodology for determining costs associated with shopping-related risks is

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21 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

22 ESP Order at 38-39.

conceptually valid. She further found that certain aspects of the unconstrained option model tended to either understate or overstate the Companies' POLR charges. She explained that, in the constrained option model, only the factors tending to overstate the POLR charges were corrected for the most part. Dr. LaCasse concluded that the results of the constrained option model are apparently conservative estimates of the Companies' POLR costs. (Cos. Remand Ex. 3 at 18.) On rebuttal, Dr. LaCasse presented the results of a Monte Carlo model, using the same basic inputs used in the constrained option model, as an alternative to option valuation. She concluded that the results of the Monte Carlo model support the reasonableness of the results derived from the constrained option model. Although the results from the Monte Carlo model are approximately 80 percent of the constrained model results, Dr. LaCasse explained that the decision-making process of the customer that the Monte Carlo model assumes tends to understate the Companies' POLR costs as compared to the constrained option model, which considers the possible future customer movements that may occur. (Cos. Remand Ex. 5 at 7-11.)

According to the Companies, the results of the constrained option model and the Monte Carlo model support the reasonableness of the results of the unconstrained option model, which, in turn, should be used as the basis for approval of their existing POLR charges. AEP-Ohio also notes that the Commission has already approved its application of the unconstrained option model to measure its POLR costs. The Companies assert that this aspect of the ESP Order was not challenged by any party on rehearing or appeal and is thus a final order of the Commission.

The intervenors and Staff identify numerous problems with AEP-Ohio's option valuation methodology. For their part, OCC and OPAE argue that the Companies' option model assumes that every customer will switch for a penny differential in generation price and ignores numerous non-price and other price considerations, such as transaction costs, that determine customer switching (OCC Remand Ex. 1 at 20; Remand Tr. I at 27-29; Remand Tr. II at 167; Remand Tr. V at 859), which overstates the results. OCC and OPAE further contend that AEP-Ohio made significant errors in its volatility and date assumptions, which, if corrected, would reduce the POLR charges by at least 80 percent and possibly to zero (OCC Remand Ex. 1 at 28-36). Because the model predicts lost revenues (Remand Tr. II at 143-144), OCC and OPAE argue that it does not measure true POLR costs, being the costs to provide incremental energy and capacity to returning customers beyond what is already collected in SSO rates (OCC Remand Ex. 1 at 21-22). They further assert that the model fails to reflect the value of the POLR optionality to customers, because it wrongly assumes that the SSO price is fixed and does not account for the variable nature of the FAC and other riders (OCC Remand Ex. 1 at 22). OCC and OPAE point out that the model overstates lost revenues in that it does not account for restrictions on the Companies with respect to off-system energy and capacity sales (OCC Remand Ex. 1 at 25-27). Finally, they argue that AEP-Ohio is already fully compensated for its POLR obligation because its incremental energy and capacity costs are recovered through the FAC (OCC Remand Ex. 1 at 12-14).

IEU-Ohio contends that the Companies' implementation of the option model is flawed because it measures, if anything, lost revenues rather than costs (Cos. Remand Ex. 3 at 12); overstates the lost revenues because it fails to account for capacity payments from CRES providers (IEU-Ohio Remand Ex. 2 at 15-19); and fails to satisfy the necessary assumptions on which the Black-Scholes model is based (IEU-Ohio Remand Ex. 1 at 18-25). Specifically, IEU-Ohio notes that the Black-Scholes model assumes that markets are perfect with no transaction costs; customers are perfectly rational and will act on any price advantage, even a difference of one cent; price volatility is constant; the strike price is constant; returns are lognormally distributed; and the option can be exercised only on its expiration date. IEU-Ohio argues that none of these assumptions holds true in the context within which the Companies have used the model and concludes that the Black-Scholes model simply was not designed to estimate the cost of the risk assumed by the seller of an option. (IEU-Ohio Remand Ex. 1 at 18-25.)

OMA and OHA argue that AEP-Ohio's use of what is effectively a non-cost-based option model is fundamentally inappropriate, unreasonable, and unlawful because it ignores the Companies' actual, small shopping numbers (Cos. Remand Ex. 4 at Ex. LJT-2); it is not used for the purpose to which it was put (Remand Tr. II at 286-287); and, even assuming that it truly measures the value of shopping to customers, the measurement of value by way of a mathematical formula is not a proper basis for establishing charges in utility regulation.

Constellation contends that the Commission should reject the Companies' unconstrained option model as it is based on the unsupported premise that the value of a customer's option to shop equals the POLR cost to the Companies. Additionally, Constellation argues that neither the Black-Scholes model nor the Black model has been shown to be a generally accepted method for determining POLR costs and, regardless, the inputs used by the Companies are inappropriate. Constellation notes that these models were designed to value stock options, not customer options related to competitive retail electric generation, and that AEP-Ohio knows of no other utility or state regulatory agency that uses them to establish POLR charges (IEU-Ohio Remand Ex. 1 at 7-10; Remand Tr. II at 286-287). Constellation further points out that AEP-Ohio admits that there are numerous non-cost factors that were not modeled even though these factors affect the value of the option to shop (Cos. Remand Ex. 8 at 6; Remand Tr. V at 837-838).

Staff notes that it has general concerns with the model used by the Companies. In addition, with respect to the inputs used by the Companies, Staff asserts that the interest rate, market price volatility, and option term inputs are likely to result in an overstated option value and, therefore, recommends that adjustments be made to these inputs such that the Companies' POLR charges would be lower, if the Commission initially determines that use of the model is reasonable (Staff Remand Ex. 1 at 2-4). Constellation agrees with Staff that the volatility input should be reduced by 20 percent as an adjustment to the capacity component of the market price (Staff Remand Ex. 1 at 3). IEU-Ohio also contends that the volatility input is overstated (IEU-Ohio Remand Ex. 1 at 26-30).

Numerous parties, including IEU-Ohio, OMA, OHA, and Constellation, dispute AEP-Ohio's claim that it would be inappropriate to compare modeled results with actual shopping levels during the ESP term. They note that AEP-Ohio has made no attempt, by way of a study or any other means, to compare modeled and actual results (Remand Tr. II at 221). OMA, OHA, and Constellation argue that the Companies should have used these remand proceedings as an opportunity to compare projected and actual results, but instead elected to present a second time the results of the same option model that was criticized by the Court. OMA and OHA further note that it is thus unreasonable to use the results of the constrained option model to corroborate the results of the unconstrained option model. OCC, OPAE, and IEU-Ohio add that the constrained option model suffers from most of the same problems as the unconstrained option model and that it makes no sense to compare the results of two flawed models. OMA, OHA, and Constellation question the testimony of Companies witness LaCasse in support of the Companies' option model, given that she had not used the Black-Scholes model prior to these proceedings nor had she used an option model to price shopping-related risks (Remand Tr. II at 149-150). Constellation concludes that AEP-Ohio has failed to verify empirically the model's use in this context and that the Companies' witnesses are not qualified to determine appropriate inputs.

IEU-Ohio agrees that the results of the Companies' model are unverified, given that the constrained option model suffers from the same flaws as the unconstrained option model. Additionally, IEU-Ohio contends that the analyses of SSO auction results cited by Companies witness LaCasse incorporated much more than POLR risk (Cos. Remand Ex. 3 at 18-20), making a true comparison with the Companies' POLR charges difficult. With respect to the Monte Carlo model used by Dr. LaCasse, IEU-Ohio argues that, like the Black-Scholes model, the Monte Carlo model fails to measure the cost to stand ready to serve returning customers (Cos. Remand Ex. 5 at 9). IEU-Ohio further notes that the Monte Carlo model was not verified against the actual customer switching that occurred and that the Companies failed to demonstrate that the model was verified or tested in any way (Remand Tr. V at 694-698, 699-700).

ii. Conclusion

In the ESP Order, the Commission modified and approved AEP-Ohio's quantification of its POLR costs based on the Black-Scholes or unconstrained option model.[23] As an initial matter, the Companies point out that the Commission has already approved their use of the unconstrained option model as a means to determine their POLR costs. However, the issue of the Commission's approval of the Companies' POLR charges was appealed to the Supreme Court of Ohio, which then specifically questioned the Companies' use of the Black-Scholes model to determine their POLR costs. Finding an absence of record support, the Court reversed the provisions of the ESP Order that authorized the POLR charges,[24] which would include those pertaining to the Black-Scholes or unconstrained option model. Therefore, we find it appropriate to review on remand the Companies' use of the unconstrained option model to measure their POLR costs.

Upon review of the record, and in light of the Court's decision, the Commission finds that the unconstrained option model fails to provide a reasonable measure of the Companies' POLR costs. The Court found that AEP-Ohio's unconstrained option model does not reveal the Companies' POLR costs, but rather purports to measure the value of the POLR optionality provided to customers.[25] The Court specifically determined that value to customers and cost to AEP-Ohio are not the same thing.[26] The Companies have nevertheless asserted that very same argument on remand, contending that the Court did not understand that the model objectively measures the value of the POLR optionality, rather than subjectively determines how much a customer would be willing to pay for the right to shop. Regardless, we agree with the Court that the model simply does not measure POLR costs.

As discussed above, AEP-Ohio maintains that the value of the option or benefit to the customer is equal to its costs (Cos. Remand Ex. 1 at 4; Cos. Remand Ex. 3 at 12; Remand Tr. I at 38; Remand Tr. II at 242, 260; Remand Tr. V at 706-707). Having already been rejected by the Court, this argument that the option value is exactly the same as the cost to the Companies was further discredited by the intervenors during the remand proceedings (OCC Remand Ex. 1 at 37; IEU-Ohio Remand Ex. 1 at 12-15). As we agree with the Court and intervenors that the value to customers does not equal the Companies' costs, we find that the unconstrained option model, which measures the value of the POLR optionality to customers (Cos. Remand Ex. 3 at 12; Cos. Remand Ex. 4 at 10; Remand Tr. I at 38), cannot also measure the Companies' costs. Additionally, even assuming that the

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23 ESP Order at 38-40; First EOR at 26.

24 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

25 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518.

26 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518.

results of the model do truly calculate the Companies' POLR costs, we are concerned that several of the inputs, particularly the interest rate, market price volatility, and option term, may result in an overstated option value, as noted by Staff and others (Staff Remand Ex. 1 at 2-4; OCC Remand Ex. 1 at 28-30; IEU-Ohio Remand Ex. 1 at 26-30).

The Commission further adds that, although modeling may be appropriate in certain contexts (*e.g.*, rate of return analysis), we question its use to predict costs that are readily measurable and verifiable through more reliable means. As the record reflects, POLR costs may be determined in numerous ways, such as hedging, competitive bidding, or an after-the-fact calculation of any incremental energy and capacity costs incurred to serve returning customers (Remand Tr. I at 44-45, 56; Cos. Remand Ex. 3 at 8-9, 11; Remand Tr. II at 144-145; IEU-Ohio Remand Ex. 1 at 31-34; IEU-Ohio Remand Ex. 2 at 8-9; Remand Tr. IV at 577-579). The Companies have pursued none of these options and instead have elected to present again the results of their unconstrained option model, as purportedly backed by the results of the constrained option model and the Monte Carlo analysis performed by Companies witness LaCasse. Given our finding that the unconstrained option model fails to measure AEP-Ohio's POLR costs and our reluctance to apply modeling in this context, we are not persuaded that the results of the constrained option model or the Monte Carlo model support the reasonableness of the results of the unconstrained option model.

As previously discussed, the Commission shares the concern of the intervenors that AEP-Ohio has made no attempt to compare the results of its unconstrained option model with its actual costs incurred over the ESP term to date based on actual shopping levels (Cos. Remand Ex. 8 at 2-4; Remand Tr. II at 221). The Court specifically addressed the lack of shopping in the Companies' service territories as a reason to "call into question the accuracy of [AEP-Ohio's] POLR theory."[27] Although shopping levels appear to have increased somewhat throughout the ESP term, at least for CSP (Cos. Remand Ex. 4 at 8-9, Ex. LJT-2; Remand Tr. II at 299-300; IEU-Ohio Remand Ex. 6 at 31), the level of shopping is still sufficiently small enough to cast "doubts about the proposition that [AEP-Ohio] would justifiably expend $500 million to bear the POLR risk."[28] In any event, AEP-Ohio has not offered any evidence that its modeled costs bear any relation to any actual costs incurred due to shopping.

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27 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

28 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

d. POLR Risk

i. Arguments

In the ESP Order, two types of POLR risks were addressed, namely the risk associated with customers switching to a CRES provider (migration risk) and the risk related to customers returning to the EDU's SSO rates from service with a CRES provider (return risk).[29] The Commission found that the return risk may be mitigated "by requiring customers that switch to an alternative supplier (either through a governmental aggregation or individual CRES providers) to agree to return to market price, and pay market price, if they return to the electric utility after taking service from a CRES provider, for the remaining period of the ESP term or until the customer switches to another alternative supplier." The Commission determined that such customers would thereby avoid the POLR charge. Regarding the migration risk, the Commission accepted the quantification of Companies witness Baker that such risk comprises 90 percent of the Companies' estimated POLR costs and modified the Companies' proposed POLR revenue requirements on that basis. On remand, Companies witness Thomas testified that she had not determined what the Companies' POLR costs would be, if the portion attributable to migration risk were removed (Remand Tr. V at 884).

AEP-Ohio notes that the Commission's determination regarding migration risk was not at issue on appeal and thus is not properly before the Commission at this time. AEP-Ohio asserts that the issue before the Commission is the appropriate level for the Companies' POLR charges and not whether there should be a POLR charge or whether such charge should compensate for migration risk. AEP-Ohio claims that nothing in the Supreme Court's decision redefined the POLR obligation to exclude migration risk.

AEP-Ohio further contends that its migration risk is different than the competitive risk of customer mobility shared by all providers. Due to its statutory POLR obligation, AEP-Ohio contends that its migration risk is unique in that customers may switch to a CRES provider when the market price falls below the SSO rate, leaving the Companies to sell electricity that they were required to have available to satisfy their SSO obligation at the reduced market price rather than the SSO rate.

AEP-Ohio also notes that the migration risk exists due to the fact that customers can switch; it is not based on whether they in fact exercise their right to switch. Regardless, AEP-Ohio contends that shopping levels have increased substantially for the Companies during the term of the ESP, which the Companies cite as additional evidence that they incur substantial risk (Cos. Remand Ex. 4 at 8-9).

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29 ESP Order at 38-40.

Many of the intervenors and Staff argue that migration risk is a business risk that is not unique to AEP-Ohio and that compensating the Companies for this risk disadvantages other market participants to the detriment of the competitive market and retail choice. Staff, OCC, OPAE, IEU-Ohio, and Constellation point out that the Court has referred to the POLR obligation as the "obligation to stand ready to accept returning customers"[30] and, therefore, they argue that migration risk is not part of the Companies' POLR obligation. Staff agrees with IEU-Ohio witness Lesser that migration risk exists for all suppliers operating in a competitive market (IEU-Ohio Remand Ex. 1 at 13). According to Staff, only the return risk is unique to the POLR obligation and thus comprises the POLR risk. Noting that migration risk constitutes 90 percent of the Companies' estimated POLR costs as originally proposed in their application, Staff contends that the Companies' option model significantly overstates their POLR costs.

Constellation notes that the risk that AEP-Ohio will not be able to sell generation at a price that is at or above the SSO price due to customer migration is a competitive generation risk and is not related to the non-competitive POLR obligation. Constellation argues that only approximately 10 percent of the value of shopping may legally be attributed to POLR risk and that the remaining 90 percent is attributable to migration risk and lost opportunity costs, which is not legally supported and constitutes an anticompetitive subsidy.

OCC, OPAE, and IEU-Ohio add that recognizing migration risk as part of the Companies' POLR costs would run afoul of Section 4928.38, Revised Code, as it would allow them to recover, after the market development period, revenues that would not be available due to competition, which would effectively be transition revenues. IEU-Ohio witness Lesser notes that the time for recovering losses due to competition has past (IEU-Ohio Remand Ex. 1 at 12-13; Remand Tr. III at 337).

ii. Conclusion

As discussed above, the Court reversed the provisions of the ESP Order that authorized the Companies' POLR charges,[31] which would include the portion of the ESP Order that addresses migration risk, which was the basis for the charges. Therefore, the Commission finds, as an initial matter, that it is appropriate to consider the issue of migration risk on remand. Having reviewed the arguments of the parties, as well as the Court's precedent regarding the POLR obligation, we find that migration risk is more properly regarded as a business risk faced by all retail suppliers as a result of competition

[30] *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 517.

[31] *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 519.

rather than a risk resulting from an EDU's POLR obligation. We find the arguments of the intervenors and Staff on this issue to be persuasive, recognizing that migration risk exists for any supplier, whether CRES provider or EDU, that operates in the competitive generation market. Thus, compensation for migration risk by means of an EDU's POLR charge would provide an advantage over its CRES competitors. Although the Companies may suffer lost revenues as a result of customer switching, the same is true for all suppliers competing in the market. The risk of lost revenues due to customer migration is simply not a risk derived from an EDU's POLR obligation. (OCC Remand Ex. 1 at 8-12; IEU-Ohio Remand Ex. 1 at 12-13.) We agree that the return risk, however, is unique to EDUs, which must be ready to serve customers returning to SSO service from another supplier, pursuant to their statutory obligation.

Our conclusion that migration risk, although a real risk, is not a risk directly resulting from AEP-Ohio's POLR obligation is consistent with the Court's precedent. The Court defines POLR costs as "those costs incurred by [the EDU] for risks associated with its legal obligation as the default provider, or electricity provider, of last resort, for customers who shop and then return to [the EDU] for generation service."[32] Recently, the Court reaffirmed that "POLR charges compensate utilities for standing ready to serve 'customers who shop and then return,'"[33] and, in these very cases, described the POLR obligation as the "obligation to stand ready to accept returning customers."[34] These cases confirm that migration risk alone is not uniquely associated with the POLR obligation. Rather, it is the customer's subsequent return that imposes the POLR risk and attendant costs.

e. Bypassability of POLR Charge

i. Arguments

In the ESP Order, the Commission stated:

> As noted by several intervenors and Staff, the risk of returning customers may be mitigated, not eliminated, by requiring customers that switch to an alternative supplier (either through a governmental aggregation or individual CRES providers) to agree to return to market price, and pay market price, if they return to the electric utility after taking service from a CRES provider, for the remaining period of the ESP term or until the

32 *Constellation NewEnergy, Inc. v. Pub. Util. Comm.* (2004), 104 Ohio St.3d 530, 539 n.5.

33 *In re Application of Ormet Primary Aluminum Corp.* (2011), 129 Ohio St.3d 9, 11, *quoting Constellation NewEnergy, Inc. v. Pub. Util. Comm.* (2004), 104 Ohio St.3d 530, 539 n.5.

34 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 517.

customer switches to another alternative supplier. In exchange for this commitment, those customers shall avoid paying the POLR charge.[35]

Constellation contends that the Companies' POLR charges are contrary to the ESP Order in that they are essentially nonbypassable. Constellation asserts that AEP-Ohio has led shopping customers to believe that, by waiving the POLR charge, they must indefinitely pay market rates upon return to the Companies, rather than until the end of the ESP term (Remand Tr. II at 296). Constellation points out that Companies witness Thomas characterizes the POLR charge as nonbypassable; admits that customers are only given information regarding waiver of the charge upon request; and testified that 98 percent of customers have elected not to waive the charge (Cos. Remand Ex. 4 at 5, 7-8; Remand Tr. II at 247-248). If AEP-Ohio is permitted to continue to collect POLR costs, Constellation argues that the Companies should inform their shopping customers that they may elect to waive POLR charges and still obtain SSO rates if they return to the Companies after the initial ESP term has ended. AEP-Ohio responds that the existing POLR charge is bypassable at the customer's option and that Constellation has not shown that AEP-Ohio is inappropriately implementing the ESP Order with respect to the customer's right to waive the POLR charge.

ii. Conclusion

In light of our decision in this order on remand, that the POLR charges are not supported by the record, Constellation's arguments on this issue are moot, as customers will return to the Companies' service at the standard service offer rate for the remainder of the term of this ESP.

4. Overall Conclusion on POLR Rider

In sum, the Commission concludes that AEP-Ohio has not provided any evidence of its actual POLR costs, the unconstrained option model does not measure POLR costs, and migration risk is not properly part of a POLR charge. In accordance with the Court's decision, we thus find that AEP-Ohio's increased POLR charges authorized as a part of the ESP Order are insufficiently supported by the record on remand. Accordingly, the Commission finds that AEP-Ohio should back out the amount of the POLR charges authorized in the ESP Order and file revised tariffs, consistent with this order on remand. The effective date of the new tariffs should be the date of this order, or the date upon which four complete, printed copies of the final tariffs are filed with the Commission, whichever date is later.

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35 ESP Order at 40.

The Commission further directs the Companies to refund the amount of the POLR charges which have been collected subject to refund since the first billing cycle in June 2011, to customers by applying that amount, as determined in this order, first to any deferrals in the FAC accounts on the Companies' books as of the date of this order, with any remaining balance to be credited to customers on a per kilowatt hour basis beginning with the first billing cycle in November 2011 and coinciding with the end of the current ESP period.

The Commission's May 25, 2011, entry stated that "if the Commission ultimately determines in the remand proceeding that any environmental or POLR charges are to be refunded to AEP-Ohio customers, interest may be imposed on the amounts collected." The Commission further stated that the "parties may address ... the rate of interest charges applicable, if any." During the remand proceedings, AEP-Ohio testified that the minimum interest rate of three percent applied to customer deposits, as set forth in Rule 4901:1-17-05, O.A.C., would be appropriate (Cos. Remand Ex. 2 at 5).

OCC and OPAE contend that the interest rate should be 10.93 percent, which is equivalent to the interest rate used to calculate AEP-Ohio's carrying costs on the FAC deferral balance (OCC Remand Ex. 2 at 29-30). OCC and OPAE note that even the Companies' tariffs provide for an interest rate on customer deposits of five percent or more (Remand Tr. I at 86-87). They argue that Rule 4901:1-14-05, O.A.C., is more comparable to the present circumstances than the rule cited by the Companies. Rule 4901:1-14-05, O.A.C., provides for an interest rate of 10 percent on adjustments to a gas utility's gas cost recovery rate that are ordered by the Commission following a hearing.

Where the Commission authorizes the creation of a regulatory asset including carrying charges, such charges are typically based on the utility's cost of long-term debt. We find that this practice is equally applicable in the converse situation presented here. Therefore, the amount of the POLR charges to be refunded to customers by the Companies should include interest at the rate equal to the Companies' long-term cost of debt commencing with the June 2011 billing cycle until all the charges subject to refund are returned.

C. Flow-Through Effects of Remand

The ESP Order authorized a phase-in of the Companies' ESP rates during the term of the ESP by deferring a portion of the annual incremental FAC costs such that the amount of the incremental FAC expense to be recovered from customers would be limited so as not to exceed certain percentage increases on a total bill basis.[36]

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[36] ESP Order at 20-24.

OCC, OPAE, and IEU-Ohio argue that AEP-Ohio should adjust the FAC deferral balance associated with the phase-in to address, on a prospective basis, the unjustified POLR and environmental carrying charges collected from April 2009 through May 2011 (*i.e.*, from the beginning of the ESP term through the point at which the charges became subject to refund). They argue that the amount of deferred FAC expenses to be collected from customers from 2012 through 2018 should be recalculated consistent with the outcome of the remand proceedings (OCC Remand Ex. 1 at 6, 38; OCC Remand Ex. 2 at 5-6, 23-28; IEU-Ohio Remand Ex. 3 at 9-11). Citing Ohio Supreme Court precedent,[37] OCC and OPAE assert that there is no violation of the prohibition against retroactive ratemaking addressed by the Court in *Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co.* (1957), 166 Ohio St. 254, where there is a mechanism built into rates that allows for prospective rate adjustments. IEU-Ohio maintains that the amount of the phase-in must be just and reasonable, pursuant to Section 4928.144, Revised Code. IEU-Ohio also contends that there are other areas in which the Commission should address the effects of the remand, such as AEP-Ohio's recovery of delta and Universal Service Fund revenues; the significantly excessive earnings test of Section 4928.143(F), Revised Code; and the Companies' pending ESP application in Case No. 11-346-EL-SSO, *et al.*

AEP-Ohio responds that attempts to expand the narrow scope of the remand proceedings should be rejected. The Companies contend that the scope of the remand proceedings is governed by the Court's remand instructions and that the Commission may not consider issues, such as flow-through effects, that were not remanded by the Court. Relying on the Court's decision in these cases and others,[38] AEP-Ohio further argues that the position of OCC, OPAE, and IEU-Ohio on flow-through effects is contrary to the prohibition against retroactive ratemaking and refunds. The Companies assert that OCC, OPAE, and IEU-Ohio seek to adjust previously approved rates on a retroactive basis by providing a future credit to customers and that the Commission lacks the authority to order such a credit. AEP-Ohio maintains that the exclusive remedy for a purportedly unlawful rate increase is to seek a stay and post a bond pursuant to Section 4903.16, Revised Code, and notes that no intervenor elected to pursue this option. According to the Companies, an adjustment to the calculation of FAC costs, which were incurred and deferred during the ESP term, so as to deny recovery of revenue that the Commission previously authorized to be collected from 2012 through 2018 would constitute retroactive ratemaking; violate Section 4928.144, Revised Code; and be contrary to the ESP Order.

The Commission finds that the proposed adjustment to the FAC deferral balance, as recommended by OCC, OPAE, and IEU-Ohio, would be tantamount to unlawful

[37] *Lucas County Com'rs v. Pub. Util. Comm.* (1997), 80 Ohio St.3d 344, 348-349; *Columbus S. Power Co. v. Pub. Util. Comm.* (1993), 67 Ohio St.3d 535, 541.

[38] *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 516-517; *Lucas County Com'rs v. Pub. Util. Comm.* (1997), 80 Ohio St.3d 344, 348-349.

retroactive ratemaking. In the ESP Order, we authorized AEP-Ohio to defer any FAC amount over the allowable total bill increase percentage levels pursuant to Section 4928.144, Revised Code, and directed that any deferred FAC expense balance remaining at the end of 2011 is to be recovered via an unavoidable surcharge from 2012 to 2018.[39] The Commission agrees with AEP-Ohio that an adjustment to the FAC deferral balance, which we previously authorized to be collected as a means to recover the Companies' actual fuel expenses incurred plus carrying costs, would be contrary to the Court's prohibition against retroactive ratemaking and refunds.[40] Although OCC, OPAE, and IEU-Ohio characterize their proposed adjustment as a prospective offset to amounts deferred for future collection, they essentially ask the Commission to provide customers with a refund to account for the Companies' past POLR and environmental carrying charges, which were collected from April 2009 through May 2011. Consistent with the Court's precedent, we cannot order a prospective adjustment to account for past rates that have already been collected from customers and subsequently found to be unjustified. The Commission likewise disagrees with IEU-Ohio's contention that there are other areas in which we should similarly address the purported flow-through effects of the Court's remand.

<u>FINDINGS OF FACT AND CONCLUSIONS OF LAW</u>:

(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 July 31, 2008, AEP-Ohio filed an application for an SSO in accordance with Section 4928.141, Revised Code. AEP-Ohio's application was filed pursuant to Section 4928.143, Revised Code, which authorizes the electric utilities to file an ESP as their SSO.

(3) On March 18, 2009, the Commission issued its opinion and order regarding AEP-Ohio's ESP application. Following entries on rehearing, the Commission's decision was appealed to the Supreme Court of Ohio.

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39 ESP Order at 22-23.

40 *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 516 (stating that "the law does not allow refunds in appeals from [C]ommission orders"); *Ohio Consumers' Counsel v. Pub. Util. Comm.* (2009), 121 Ohio St.3d 362, 367 (noting that "any refund order would be contrary to our precedent declining to engage in retroactive ratemaking"); *Lucas County Com'rs v. Pub. Util. Comm.* (1997), 80 Ohio St.3d 344, 348 (determining that "utility ratemaking by the Public Utilities Commission is prospective only").

(4) On April 19, 2011, the Court issued an opinion in *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, remanding these cases back to the Commission on two grounds.

(5) A hearing on remand commenced on July 15, 2011, and concluded on July 28, 2011, for the purpose of gathering such additional evidence as might be necessary to comply with the Court's remand order. Five witnesses testified on behalf of AEP-Ohio, six witnesses testified on behalf of various intervenors, and one witness testified on behalf of Staff.

(6) Briefs and reply briefs were filed on August 5, 2011, and August 12, 2011, respectively.

(7) Sections 4928.143(B)(1), and 4928.143(B)(2)(d), Revised Code, authorize the Companies' recovery of incremental capital carrying costs that are incurred after January 1, 2009, on past environmental investments (2001-2008) that were not previously reflected in the Companies' existing rates prior to the ESP.

(8) On remand, the Ohio Supreme Court directed the Commission to consider evidence of a cost-based POLR charge or to determine whether a non-cost based POLR charge is reasonable and lawful.

(9) AEP-Ohio did not demonstrate that its POLR charges requested in the ESP are cost-based nor demonstrate that its non-cost based POLR charges requested in the ESP were reasonable and lawful.

(10) AEP-Ohio's POLR charges, as approved in the ESP Order, are not supported by the record on remand.

(11) AEP-Ohio is directed to refund the POLR charges collected subject to refund since the first billing cycle in June 2011 by first applying that amount to any deferrals in the FAC accounts on each Companies' books as of the date of this order, with any remaining balance to be credited to customers on a per kilowatt hour basis beginning with the first billing cycle in November 2011 and coinciding with the end of the current ESP period.

(12) The proposed ESP, as modified by this order on remand, including its pricing and all other terms and conditions, including deferrals and future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142, Revised Code.

ORDER:

It is, therefore,

ORDERED, That IEU-Ohio's motion to dismiss these cases be denied. It is, further,

ORDERED, That FES' motion for leave to file an *amicus curiae* brief be denied. It is, further,

ORDERED, That the motions of OCC and OPAE to strike certain testimony be denied. It is, further,

ORDERED, That the motions of OCC, OPAE, and IEU-Ohio to strike certain portions of AEP-Ohio's initial and reply briefs be granted to the extent set forth herein. It is, further,

ORDERED, That the Companies' ESP, pursuant to Sections 4928.141 and 4928.143, Revised Code, be modified to the extent set forth herein. It is, further,

ORDERED, That the Companies be authorized to file, in final form, four complete copies of their tariffs, consistent with this order on remand. Each utility shall file one copy in its TRF docket (or may make such filing electronically as directed in Case No. 06-900-AU-WVR) and one copy in these case dockets. The remaining two copies shall be designated for distribution to the Rates and Tariffs, Energy and Water Division, of the Commission's Utilities Department. It is, further,

ORDERED, That the effective date of the new tariffs shall be a date not earlier than the date of this order on remand, or the date upon which four complete, printed copies of the final tariffs are filed with the Commission, whichever date is later. It is, further,

ORDERED, That the Companies notify all affected customers of the changes to the tariffs via bill message or bill insert within 30 days of the effective date of the tariffs. A copy of the customer notice shall be submitted to the Commission's Service Monitoring and Enforcement Department, Reliability and Service Analysis Division, at least 10 days prior to its distribution to customers. It is, further, ORDERED, That the Companies refund, with interest, the amount of the POLR charges, which has been collected subject to refund since the first billing cycle in June 2011, to customers by applying that amount, as determined in this order, first to any deferrals in the FAC accounts on the Companies' books as of the date of this order, with any remaining balance to be credited to customers on a per kilowatt hour basis beginning with the first billing cycle in November 2011 and coinciding with the end of the current ESP period. It is, further,

ORDERED, That nothing in this order on remand shall be binding upon this Commission in any future proceeding or investigation involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That a copy of this order on remand be served upon all persons of record in these cases.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Paul A. Centolella

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto — see concurring

SJP/GNS/sc

Entered in the Journal

OCT 03 2011

Betty McCauley

Betty McCauley
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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
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

CONCURRING OPINION OF COMMISSIONER CHERYL L. ROBERTO

I concur in today's decision and write separately only to amplify the analysis upon which I relied to reach these findings of fact and conclusions of law. As I wrote in my concurrence of the Commission Entry on Rehearing in this matter on July 23, 2009 and as I continue to believe today, we are mandated to approve or modify and approve an electric security plan (ESP) when we find that the plan or modified plan, including its pricing and all other terms and conditions, including any deferrals and future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under Section 4928.142 of the Revised Code. Section 4928.142(C)(1), Revised Code.

While an ESP may include components described in Section 4928.143(B)(2), Revised Code, nothing in S.B. 221 requires that it be built on a component by component basis. As I observed in my prior concurrence, given that the ESP is not cost-based, focusing on any component in which a cost increase is expected or demonstrated obscures the failure to conduct the corollary examination of components of the base rate in which savings have occurred or in which revenue has increased. Thus, it is not only not useful to use a cost-based component by component basis to evaluate an ESP it is misleading as we are practically limited in our examination of an ESP to the aggregate impact. The Ohio Supreme Court in its remand to us has not suggested that this Commission is required to use a cost-based analysis, merely that if we do we must have a record to support it. To the contrary, the Court has invited the Commission to consider "whether a non-cost-based POLR charge is reasonable and lawful." *In re Application of Columbus S. Power Co.* (2011), 128 Ohio St.3d 512, 518-519.

Having rejected a cost-based analysis in my concurrence to our original order, I specifically declined to find that Section 4928.13(B)(2)(b), Revised Code, contemplates recovery for pre-January 1, 2009 environmental expenditures or that carrying costs for environmental expenditures should be accrued at the weighted average cost of capital when there has been no finding that the debt has been prudently incurred taking into account the availability of pollution control funds. I also declined to find as to the provider of last resort cost that the Black Scholes model was appropriate tool to determine a cost-based POLR charge or that an increased risk of migration exists which requires an incremental increase in POLR, as a POLR component was already included within the Companies' existing base rates. Nonetheless, I believed and continue to believe that the test of reasonableness and lawfulness for an ESP is whether in the aggregate the ESP is more favorable than the results otherwise to be expected pursuant to Section 4928.142, Revised Code. Whether characterized as environmental expenditures or a POLR requirement, AEP sought to increase its authorized revenue. This increase in revenue which when combined with revenue from existing rates would result in a particular price for retail electric service. It is this price together with all the terms and conditions of the modified ESP that we must judge to be more favorable in the aggregate than the results otherwise to be expected in order for the modified ESP to be approved.

The Court remanded this matter to the Commission because it found that the Commission majority relied upon a cost-basis for POLR that was unsupported by the record and upon a too expansive reading of Section 4928.143(B)(2), Revised Code. Upon remand, AEP had the opportunity to provide argument and demonstrate within the record that the revenue requirement that it sought was reasonable and lawful. We have found that AEP successfully demonstrated that the environmental costs could be appropriately supported pursuant to divisions (B)(1) and (B)(2)(d) of Section 4928.143, Revised Code. AEP continued to advocate that its POLR charge was cost-based as supported by the Black Scholes model. I concur that it had not on the previous record nor has it on the remand record established the POLR charge to be cost-based. AEP, however, made no argument and offered no record support that, as the Supreme Court invited the Commission to consider, the POLR charges were non-cost-based yet nonetheless reasonable and lawful. As I indicated in my original concurring opinion, I believe that it may have been possible to demonstrate this successfully but having no record or argument before me to support it, I concur with my colleagues that the POLR charge can not be supported.

Cheryl L. Roberto

Cheryl L. Roberto, Commissioner

/dah

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Betty McCauley

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Secretary