FILE

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the 2010 Annual Filing of	:	
Columbus Southern Power Company and	:	Case Nos. 11-4571-EL-UNC
Ohio Power Company Required by Rule	:	11-4572-EL-UNC
4901:1-35-10, Ohio Administrative Code.	:	

POST-HEARING BRIEF
SUBMITTED ON BEHALF OF THE STAFF OF THE PUBLIC UTILITIES COMMISSION OF OHIO

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INTRODUCTION

As the Commission is aware, the application of the Significantly Excessive Earnings Test (SEET) to Columbus Southern and Ohio Power has been discussed several times and recently decided in 10-1261-EL-UNC. In this case the Staff duplicated the Commission-approved method with two exceptions. The Staff used a more transparent method to obtain a comparable group and, having determined a baseline for significantly excessive earnings, the Staff did not make an adjustment for additional factors as the Commission had done. The Staff's approach is reasonable, transparent, and leaves discretion to the Commission. It should be adopted.

DISCUSSION

Although the Company has submitted testimony in support of its standard deviation approach to the determination of significance, this method has already been rejected and should be again for the same reasons as before. (Legally, was their notice of the record in 10-1261 or is that needed for the Commission to consider the record from last year?) There is no need to reproduce that discussion here. That leaves two matters for the Commission's consideration: the determination of a comparable group; and the degree to which the baseline significantly excessive earnings should be adjusted for company-specific matters.

As to the adjustment of the baseline significantly excessive earnings, the Staff takes no position. This is a matter best left to the sound discretion of the Commission. The sides will present valid arguments for adjustments in both directions and only the Commission's calculus can reach an appropriate resolution.

The determination of a comparable group is a different matter, but interesting in its own right. Two methods are presented, that of the company witness Dr. Makhija and that of the Staff through Mr. Buckley. Although the methods are different in detail, the end result is very similar.[1] This points out a fundamental truth that should be fairly evident from the multiple times that the Commission has considered this question. The error bars around the result of the use of any particular method for determining a comparable group are greater than the difference between the results of various methods. It appears that any

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1 Rebuttal Testimony of Dr. Anil Makhija (AEP Ex. 11) at 2.

objective method, fairly applied is likely to lead to a very similar result, regardless of the particular details in question. It means that the Commission can choose between methods based on practical considerations rather than upon arcane technical ones. Indeed this is the very reason that the Commission should adopt the Staff approach rather than that of Dr. Makhija. The Staff's approach is open, uses publicly available data, and is quite reproducible by anyone. Dr. Makhija's approach is more idiosyncratic as it uses a greater degree of judgment and is not immediately reproducible by others. The Staff's method is clear. Staff used the companies that comprise the SPDR Select Sector Fund –Utility (XLU) as its comparable group. The Index primarily provides companies that produce, generate, transmit or distribute electricity or natural gas. XLU is the most widely traded utility ETF (electronically traded fund) and the components are selected by an independent third party that is not involved in this proceeding. This independence removes any bias in selecting the comparable group. The Staff totaled the net income earned by those companies and divided it by the total common equity of each of the companies.[2] The Staff's method is still complex, but the method can be duplicated by anyone.

AEP presents a large number of criticisms of the Staff approach. As noted above, the outcome of the two methods is remarkably similar so there is no practical consequence from AEP's criticisms. As such, the criticisms could, quite properly, be ignored. It may be useful to examine them however for the light that they cast on the

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2 Prefiled Testimony of Joseph P. Buckley (Staff Ex. 1).

nature of the examination in which we are engaged and for the support they unintentionally offer for the Staff's approach.

AEP will argue that the Staff's group includes non-electric utilities, as indeed, it does.[3] This is a strength of the approach. The statute contemplates that the comparable group is to include a variety of companies.[4] Staff's group is a better fit with the intention of the statute.

AEP will argue that the group average should not be weighted. This objection is difficult to understand. The criticism is that weighing emphasizes the larger members of the group. Indeed it does. That, in fact, is why it is done. Recognizing that bigger firms are bigger is a good thing not a shortcoming.

AEP will criticize the Staff approach because it does not take into consideration company-specific risks. This is merely a misunderstanding of the Staff approach. The Staff recognizes that there are company-specific matters that the Commission may want to consider, just as it did in last year's case. Staff merely takes no position about these matters. AEP and the other parties are free to make whatever arguments they choose.

AEP will make a number of arguments about the individual members of the Staff's comparable group, that the betas are different, or there was an extraordinary item, or that companies are too big. All of these miscellaneous complaints underscore Staff's fundamental point. It is possible to bicker endlessly about what the exactly correct

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3 Rebuttal Testimony of Dr. Anil Makhija (AEP Ex. 11).

4 Ohio Rev. Code Ann. § 4928.143(F) (West 2012).

members of a comparable group should be. Perhaps every individual analyst would create what, in that analyst's view, would be the perfect comparable group and no two would be the same. As we have seen, there is no point to this exercise. No matter how the deck chairs are arranged, the ship will still get to port.

As this is the simple fact of the situation, it behooves everyone concerned with this process, and Staff would certainly include investors and Wall Street advisors in that group, to utilize a method which is readily reproducible by any professional outsider. As recommended by Staff, this approach will reduce the uncertainty created by this very significantly excessive earnings process.

If the Commission were to endorse a more idiosyncratic approach to the selection of the comparable group, such as that used by Dr. Makhija, an investor or would be investor would be quite correct in viewing *all* the earnings of any Ohio electric utility to be subject to doubt and possible refund until the result of the SEET case was in. There would be no way to know in advance just what a comparable group would look like. This is a completely unnecessary and artificial risk. Using an objective index allows outsiders to recognize the practical scope of a potential refund. It allows much tighter and more realistic estimates to be made regarding a potential Commission order.

CONCLUSION

In sum, the Staff recommends that the Commission utilize the same methodology as it did in the previous case with one adjustment. Staff recommends that the Commission utilize the SPDR Select Sector Fund –Utility (XLU) as its comparable group. Use of such an index provides a clarity and transparency with no loss of accuracy but with the gain associated with the reduction of regulatory risk.

Respectfully submitted,

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PROOF OF SERVICE

I hereby certify that a true copy of the foregoing **Post-Hearing Brief** submitted on behalf of the Staff of the Public Utilities Commission of Ohio, was served by regular U.S. mail, postage prepaid, or hand-delivered, upon the following Parties of Record, this 31st day of January, 2012.

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