BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In The Matter Of The 2010 Annual Filing Of Columbus Southern Power Company And Ohio Power Company Required By Rule 4901:1-35-10, Ohio Administrative Code.	))))	Case No. 11-4571-EL-UNC Case No. 11-4572-EL-UNC

REPLY BRIEF OF THE OMA ENERGY GROUP

I. INTRODUCTION

On July 29, 2011, Columbus Southern Power Company ("CSP") and Ohio Power Company ("OP", collectively, "AEP-Ohio") filed an application before the Public Utilities Commission of Ohio ("Commission") for the administration of the significantly excessive earnings test ("SEET") as required by Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code. The Commission held a hearing on this case that was completed on January 10, 2012. On January 31, 2012, initial briefs were filed by AEP-Ohio, the Ohio Energy Group ("OEG"), the Ohio Consumers' Counsel ("OCC"), Ohio Partners for Affordable Energy ("OPAE"), Industrial Energy Users-Ohio ("IEU") and Staff of the Commission ("Staff"). The OMA Energy Group ("OMAEG") filed a letter indicating that it was not filing an initial brief but reserved the right to file a reply. In accordance with the schedule established by the Attorney Examiners in this proceeding, OMAEG respectfully submits its reply brief for the Commission's consideration.

II. ARGUMENT

This is not a case of first impression for the Commission. In fact, the issues are largely the same as those already considered and resolved by the Commission in AEP-

Ohio's first SEET case.[1] However, many of the parties appear to incorrectly assume that in the 2009 SEET Case, the Commission held that 50% is the default starting point for an adder to the comparable companies' return on equity ("ROE") to determine the significantly excessive earnings. For the reasons discussed below, the Commission should reject AEP-Ohio's proposed adder, clarify that 50% is not the default starting point for an adder and find that the adder should be less than 50%.

A. AEP-Ohio's proposed adder should be rejected.

AEP-Ohio has the burden of proving its earnings are not significantly excessive.[2] In order to determine the threshold level at which AEP-Ohio's ROE may become significantly in excess of the average earned ROE of the comparable risk group of publicly traded companies, AEP-Ohio relies on the methodology of Dr. Makhija.

Specifically, Dr. Makhija argues that once a comparable group of companies is determined, an adder should be formed "with multiples of standard deviations, corresponding to desirable levels of risk of a false positive determination of a significantly excessive ROE when it is truly not excessive."[3] Furthermore, Dr. Makhija argues that "an adder of 1.96 standard deviations reflects a reasonable 5% risk of a false positive conclusion."[4] The result is that Dr. Makhija would add 11.13% to the

[1] *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 at 24-25 (January 11, 2011) (hereinafter "2009 SEET Case").

[2] Section 4928.143(F), Revised Code.

[3] Cos. Ex. 11 at 2.

[4] *Id.* at 3.

comparable companies' mean ROE of 11.48% for a threshold of 22.61%.[5] Stated differently, AEP-Ohio's proposed adder based upon Dr. Makhija's methodology is 97% to the mean ROE of comparable companies.[6]

AEP-Ohio concludes that Dr. Makhija's methodology is the only methodology that is "conceptually sound, well-reasoned, well-supported and specifically-tailored to take into account each of the terms used in R.C. 4928.143(F)." AEP Brief at 29-30. AEP-Ohio then seems to imply that using any other methodology that does not have scientific support would be a "gut-call" and an abuse of discretion.

However, the Commission has already rejected Dr. Makhija's methodology in the 2009 SEET Case for inappropriately relying on a bright line statistical test and relying "on the statistical analysis to the point of producing an unrealistic and indefensible result."[7] Similarly, a result that would fail to find significantly excessive earnings unless CSP's ROE was 97% above the mean ROE of comparable companies is, again, an unrealistic and indefensible result. As Dr. Makhija did not make any changes to his methodology, for the same reasons the Commission identified in the 2009 SEET Case, Dr. Makhija's methodology should be rejected here again.

B. The default adder to the ROE of comparable companies is not necessarily 50%.

Several parties seem to assume without explanation that the default adder to the ROE of comparable companies is 50% and, from that starting point, the Commission has discretion to make upward or downward adjustments to find the appropriate SEET

[5] AEP Brief at 27. However, it should be noted that AEP-Ohio's description of an "adder" is not the same as what is used throughout this case by other parties and the Commission.

[6] 11.48 x (1+.97) = 22.61%

[7] 2009 SEET Case, Opinion and Order at 24.

threshold.[8] The Commission is not bound by a 50% adder to the comparable companies' ROE as a starting point and the Commission should not establish 50% as the starting point in this case without some reasoning and rationale.

In the 2009 SEET Case, the Commission adopted the Staff's methodology for determining the adder, which resulted in a 50% adder as the starting point for determining the significantly excessive earnings threshold -- the Commission did not conclude that a 50% adder is always an appropriate starting point.[9] Specifically, in the 2009 SEET Case, the Commission held:

> Although the purpose of the SEET is to be a statutory check on rates that result in excessive earnings, we find that one of the impacts of the SEET creates symmetry with our obligation to ensure that a company may operate successfully, maintain financial integrity, attract capital and compensate its investors for the risk assumed. Among the parties' positions we find that Staff's basic methodology best gives effect to the statutory design to create such symmetry. Specifically, the Commission is persuaded by the fact that Staff's proposed adder's impact, if subtracted from the comparable ROE benchmark yields a result that is similar to the company's cost of debt. Given the Commission's adoption of an 11 percent ROE, the impact of a 50 percent downward adjustment to the comparable ROE results in an earnings of 5.5 percent, which is similar to CSP's embedded cost of debt. Therefore, 50 percent is a reasonable guide for establishing an adder.[10]

In other words, in order to create a symmetry and balance, the starting point for an adder should produce a result that is similar to the company's cost of debt if subtracted from the comparable companies' ROE.

In AEP-Ohio's most recent distribution rate case (which AEP-Ohio relied on to compare the approved ROEs of 10.0% for CSP and 10.3% for OP to the 2010 ROEs), the Commission found that the long-term cost of debt for OP and CSP combined is

[8] *See, for example,* Staff Brief and Staff Ex. 4 at 2.

[9] 2009 SEET Case, Opinion and Order at 25.

[10] *Id.*

5.34%.[11] Thus, using the Staff's methodology from the 2009 SEET Case, the appropriate adder would be 48.5%, not 50%. The point is that the 2009 SEET Case did not establish a 50% adder as the default adjustment to the ROE of comparable companies. As such, the Commission is not bound to use 50% as a starting point and it should not be assumed that 50% is an appropriate default adder without further explanation or basis.

C. The Commission should consider a downward adjustment to the adder.

As noted above, AEP-Ohio's proposed adder of 97% should be rejected. While AEP-Ohio does not advocate in favor of an alternative adder, AEP-Ohio notes that the Commission used a 60% adder in the 2009 SEET Case.[12] AEP-Ohio calculates a threshold of 18.4 percent using Dr. Makhija's mean ROE of the comparable companies plus a 60% adder.[13] AEP-Ohio also identifies a number of factors that AEP-Ohio urges the Commission to consider, presumably to increase the adder.[14] Although AEP-Ohio identifies the fact that the Commission used a 60% adder in the 2009 SEET Case and describes factors for the Commission's consideration in determining the threshold SEET level, AEP-Ohio does not recommend or support a 60% adder. No other party supports

[11] *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company, Individually and, if Their Proposed Merger is Approved, as a Merged Company (collectively, AEP Ohio) for an Increase in Electric Distribution Rates*, Case Nos. 11-351-EL-AIR, *et al.,* Opinion and Order at 7 (December 14, 2011).

[12] Dr. Makhija notes several times that he does not subscribe to the methodology that leads to a threshold different from the one he calculated. Cos. Ex. 3 at 7.

[13] Cos. Ex. 3 at 7. Under either methodology, AEP-Ohio concludes that CSP did not have significantly excessive earnings with an earned ROE of 17.54%.

[14] AEP-Ohio Brief at 40-46.

or recommends a 60% adder either. In fact, the other parties all demonstrate that a 60% adder is unreasonable.[15]

Section 4928.143(F), Revised Code, requires the Commission to consider the capital requirements of future committed investments in this state. As noted by OCC, AEP-Ohio's capital requirements of future committed investments do not warrant an upward adjustment. Further, if the Commission is going to consider factors in addition to the capital requirements of future committed investments in the state, as it did in the 2009 SEET Case, for the reasons described above, the Commission should not increase the adder and, in fact, should consider a downward adjustment.

AEP-Ohio has the burden of proving that an upward adjustment is necessary and warranted and AEP-Ohio has not met that burden. As OEG witness Kollen succinctly concludes, "most of the 'other considerations' identified by Mr. Hamrock are actions that would be taken by AEP as a matter of law and/or good utility practice regardless of the SEET."[16]

III. CONCLUSION

For the foregoing reasons, the OMAEG respectfully requests that the Commission clarify that 50% is not necessarily the starting point for determining an adder to the comparable companies' ROE and find that the adder should be less than 50% for the reasons set forth herein.

[15] *See* OCC Brief at 7-11; IEU Brief at 12-15; OEG Brief at 12-13, and OPAE Brief at 4-5. While Staff did not take a specific position on the adder, Staff's witness calculated the refund amount based only upon a 50% adder.

[16] OEG Exhibit 1 at 17.

Respectfully submitted on behalf of
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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Reply Brief of the OMA Energy Group was served upon the parties of record listed below this 10th day of February 2012 *via* electronic transmission or first class mail.

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