BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company.	)))	Case No. 09-872-EL-FAC Case No. 09-873-EL-FAC

MEMORANDUM CONTRA OHIO POWER COMPANY'S APPLICATION FOR REHEARING BY THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

Respectfully submitted,

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I. INTRODUCTION

On February 22, 2012, Ohio Power Company ("OP") and Columbus Southern Power Company ("CSP") (collectively, "Company" or "AEP Ohio")[1] filed an application for rehearing in these proceedings that, if granted, would increase the rates the Company's customers pay for electricity. As part of advocating that residential consumers receive adequate service at reasonable rates, the Office of the Ohio Consumers' Counsel ("OCC") submits this memorandum contra the Company's application for rehearing.[2]

AEP Ohio is seeking rehearing of the Opinion and Order ("O&O") that the Public Utilities Commission of Ohio ("Commission" or "PUCO") issued on January 23, 2012. In the O&O, the Commission established the amount that the Company may collect from customers for fuel expenses related to the production of power in 2009.

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[1] Effective at the end of 2011, OP and CSP (both of which were operating companies of AEP Ohio) merged, with OP becoming the successor in interest to CSP. See *In re: AEP Ohio ESP Cases*, Case No. 11-346-EL-SSO, et al. ("ESP 2"), OP Application for Rehearing (January 13, 2012) at 2.

[2] Ohio Adm. Code 4901-1-35(B).

In its application for rehearing, the Company asserted that the O&O was unreasonable and unlawful because the Commission, among other things, engaged in retroactive ratemaking, retroactively modified its decision in the Company's first electric security plan ("ESP") case, modified the fuel adjustment clause ("FAC") baseline established in the ESP 1 Order,[3] impaired a 2008 settlement agreement between the Company and a coal supplier, concluded that the value of the coal reserve property acquired as a result of the settlement agreement should be offset against FAC costs, ignored a production bonus agreement that increased fuel expenses, and concluded that a delivery shortfall agreement and a contract support agreement may be examined by a future audit.[4]

As discussed herein,[5] the Company's arguments provide no basis for the Commission to modify or abrogate the O&O under Ohio law.[6] The Commission should deny the Company's application for rehearing.

II. ARGUMENT

A. The Commission Lawfully Protected AEP Ohio's Customers Without Engaging in Selective and Unlawful Retroactive Ratemaking, as the Company Contends.

In the O&O, the Commission ordered the Company to credit the realized value from the 2008 Settlement Agreement with a coal supplier against the Company's FAC

[3] *In re: AEP-Ohio ESP Cases*, Case Nos. 08-917-EL-SSO, et al., Opinion and Order (Mar. 18, 2009) ("ESP 1 Order").

[4] See OP Application for Rehearing (February 22, 2012) at 1-2.

[5] If OCC does not respond to a specific argument the Company made in its application for rehearing, that fact should not be construed as acquiescence by OCC to that argument.

[6] See R.C. 4903.10.

under-collection that occurred in 2009.[7] The Commission ordered the Company to credit the portion of the $30 million 2008 lump sum payment from the supplier that was not already credited against the under-collection, as well as the $41 million value of the West Virginia coal reserve that AEP Ohio had booked when the Settlement Agreement was executed.[8] As a result, customers' payments to AEP Ohio for fuel costs would be reduced.

The Commission explained that this is not retroactive ratemaking, as the Company had argued on brief. Rather than modifying a previous rate established by a Commission order through the ratemaking process, the Commission instead "is establishing a future rate based upon the real cost of the coal used by the Companies to generate electricity during the 2009 FAC audit period."[9] The Commission noted that the proceeds the Company received for entering into the Settlement Agreement are one of the many components that impacted the Company's cost to provide electricity during 2009.[10]

In its application for rehearing, the Company claimed that the "practical consequence" of the Commission's decision "is that Commission has retroactively reduced the rates that OPCo charged customers in 2008 for SSO generation service by the amount of the offset to the 2009 costs."[11] The Company asserted that "[t]he fact that the 'remedy' is a prospective adjustment to rates is unavailing as that is always true in cases involving unlawful retroactive ratemaking."[12] The Company claimed that crediting

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[7] O&O at 12.

[8] Id.

[9] Id. at 13.

[10] Id. at 13-14.

[11] OP Application for Rehearing at 19.

[12] Id. at 20.

amounts booked in 2008 during the prior rate plan would "violate the longstanding prohibition against retroactive ratemaking established in *Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel Co.* (1957), 166 Ohio St. 254."[13] The Company also asserted that the O&O is counter to the Supreme Court's decision in *Lucas Cty. Commrs. v. Pub. Util. Comm.* (1997), 80 Ohio St.3d 344, which held that the Commission has no statutory authority to order refunds.[14] The Company's argument, however, is faulty.

As the Commission noted in the O&O, this case does not involve the modification of a previous rate established through a Commission order in the ratemaking process, as was the case in *Keco*.[15] Instead, this proceeding involves the establishment of the Company's FAC that was approved in the Company's first ESP case. In addition, *Lucas Cty.* does not apply because the case does not involve a refund after the utility unlawfully collected a rate.[16] The facts of *Keco* and *Lucas Cty.* make them inapplicable to this case.

The Company itself made a similar distinction in its brief defending the Commission's ratemaking in AEP Ohio's ESP 1 case. There, the Company set forth the difference between the prohibition against the Commission ordering a refund of rates and the Commission's ability to prospectively set rates:

> The issue in this appeal involves neither a refund of, nor credit for charges previously collected by a utility which have been found to be unlawful or unreasonable. This case involves the Commission's approval of an ESP under R.C. 4928.143. In *Lucas County* the appellant filed a complaint asserting the utility had collected excessive charges due to its collection of rates associated with a terminated pilot program. In other words, it was a direct appeal concerning the *refund of, or credit for charges previously*

[13] Id. at 17.

[14] Id. at 18.

[15] O&O at 13.

[16] Id. at 14.

> *approved by the Commission and collected by the utility* that the Court assumed to be unjust for purposes of reviewing the Commissions [sic] dismissal of appellants' complaint. This appeal, as it relates to charges collected from January 2009 through March 2009, does not involve a refund of or credit for charges found to be unlawful or unreasonable. In contrast to *Keco* and *Lucas County*, this appeal challenges the rates approved and in effect from Apri1 2009 through December 2011 – rates that were approved by the Commission and prospectively applied by the Companies. The rates approved by the Commission did not seek to serve as a refund of, or credit for charges previously collected unjustly. The Commission set the rates necessary to implement its approval of the ESP plan prospectively.[17]

Although the Supreme Court ultimately determined that Commission had, in fact, engaged in unlawful retroactive ratemaking in the ESP 1 Case, it was for a reason not relevant to this case: regulatory delay.[18] In the ESP 1 Case, the Commission had set the Company's rates for April 2009-December 2009 at a level that would compensate the Company for lost revenues for the January 2009-March 2009 period. The Commission did so because it had not issued its ESP 1 Order in time for the rates to be effective January 1, 2009.[19] There was no regulatory delay in this proceeding.

In the O&O in this proceeding, the Commission did not use prospective rates to adjust past rates, as the Company claims. Rather, the Commission determined the Company's true cost of producing power in 2009 and used that cost to set the prospective FAC the Company will collect from customers. That is the proper function of FAC cases.

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[17] *In Re Application of Columbus S. Power Co.*, Supreme Court Case No. 2009-2022, Merit Brief of Intervening Appellees Columbus Southern Power Company and Ohio Power Company (March 5, 2010) at 47-48 (emphasis in original).

[18] Id., Slip Opinion No. 2011-Ohio-1788, ¶ 14.

[19] Id., ¶ 10.

The Commission acted lawfully in ordering the Company to give customers the protection of a credit for the realized value from the 2008 Settlement Agreement against the Company's FAC under-collection that occurred in 2009. The Commission should deny the Company rehearing on this issue.

B. In Protecting AEP Ohio's Customers by Ordering the Company to Credit the Realized Value from the 2008 Settlement Agreement Against the FAC Under-Collection, the Commission Did Not Retroactively Modify Its Prior Regulatory Decisions in the ESP 1 Case.

In its application for rehearing, the Company claimed that, in ordering the credit of the realized value of the 2008 Settlement Agreement against the Company's FAC under-collection, the Commission unlawfully retroactively modified its prior regulatory decisions in the ESP 1 Case. In this regard, the Company complained that the O&O was not consistent with the annual FAC audits included in the ESP 1 Case.[20] Further, the Company accused the Commission of expanding the scope of the annual audit to include aspects of the Company's rate plan that preceded the Company's first ESP.[21] Again, the Company's arguments are baseless.

As is the nature of PUCO prudence audits, the audit in this proceeding was conducted to assist the Commission in determining the prudence and true cost of the Company's fuel-related purchases for the production of power during 2009, so that Ohio customers pay no more than what is reasonable for electricity.[22] In the course of the audit, the auditor determined that the 2008 Settlement Agreement was an issue because if the contract with the coal supplier had not been terminated early, the Company's

[20] OP Application for Rehearing at 20-22.

[21] Id. at 22-24.

[22] R.C. 4905.22.

customers would have received benefits of the contract (in the form of a much lower cost for coal procurement) within the ESP period.[23] The auditor recommended that the Commission should consider whether some of the realized value of the Settlement Agreement should be credited against the under-collection in the FAC.[24]

Thus, in ordering the Company to credit the realized value of the Settlement Agreement against the FAC under-collection, the Commission merely acted in accordance with a recommendation of the auditor and the requirement of the law that the FAC should collect from customers only the actual fuel costs the Company incurred.[25] The recommendation was based on the auditor's finding that the Settlement Agreement affected the rates that the Company's customers paid during 2009. The proceeds of the Settlement Agreement are relevant to this proceeding and within the scope of the audit.

As in its initial brief,[26] the Company argued that the Commission had already adjudicated and decided the establishment of the FAC baseline in the ESP 1 case, and thus the FAC baseline is res judicata and cannot be relitigated or reapplied on a retroactive basis.[27] The Commission discounted this argument in the O&O by explaining that it had not adjusted the baseline for the 2009 period as decided in the Company's ESP 1 Cases, but instead had engaged "in a reconciliation and accounting which was explicitly contemplated by the ESP cases in future FAC proceedings."[28]

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[23] O&O at 5.

[24] Id. at 6.

[25] See OCC Initial Brief (September 23, 2010) at 6-7.

[26] Initial Merit Brief of OP and CSP (September 23, 2010) at 20-25.

[27] OP Application for Rehearing at 25-29.

[28] O&O at 13.

Nevertheless, the Company raises the issue again, claiming that the Commission did not simply reconcile the costs incurred in a prior FAC period with those in a subsequent FAC period.[29] Now the Company claims that the Commission, "as a practical matter," has instead raised the FAC baseline.[30] According to the Company, "the Commission established the FAC baseline to put the prior no-FAC period behind everyone and transition to the ESP's active FAC mechanism and it violates the decision in the ESP Cases to now reach back into 2008 for purposes of adjusting prudently-incurred costs in the current 2009 audit period."[31] This is just not true.

As OCC noted in its initial brief,[32] the short discussion of the Company's FAC baseline in the ESP 1 Order relates to "methodologies to obtain a proxy for 2008 fuel costs."[33] That portion of the ESP 1 Order determines the Company's 2009 fuel cost, and does not address review of the Company's 2009 fuel cost under R.C. 4928.143(B)(2)(a). The Company's 2009 fuel cost and the financial benefits flowing to the Company through its 2007-2008 fuel procurement contracts related to its 2009 fuel were not considered or addressed in the ESP 1 case. The Company's 2009 fuel cost was neither an action based upon a claim arising out of a transaction that was the subject matter of the ESP 1 proceeding, nor an issue that has been actually and necessarily litigated and determined in a prior action that was based on a different cause of action.[34] Therefore,

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[29] OP Application for Rehearing at 29.

[30] Id.

[31] Id.

[32] See OCC Initial Brief at 12-13.

[33] ESP 1 Order at 19.

[34] See *State ex rel. Nickoli v. Erie Metroparks* (2009), 124 Ohio St.3d 449, 453, 923 N.E.2d 588, 592, citing *Ft. Frye Teachers Assn. OEA/NEA v. State Emp. Relations Bd.* (1998), 81 Ohio St.3d 392, 395.

the doctrine of res judicata does not bar consideration of the Company's financial benefits acquired through its 2007-2008 fuel procurement contracts in this proceeding.

The Company's assertions that the Commission unlawfully modified its decisions in the ESP 1 Case are wrong. The Commission should deny the Company's requested rehearing on this issue and thereby protect Ohio customers.

C. The Commission Did Not Impair the 2008 Settlement Agreement, But Rather Acted Lawfully to Protect Ohio Customers in Light of the PUCO Auditor's Recommendation that Equity for Customers Should Be Served.

The Company claimed that by ordering the netting of amounts in the 2008 Settlement Agreement, the Commission impaired the agreement. The Company argued that although the Commission did not find the agreement to be imprudent, "the practical effect of the Commission's decision is that it is [sic] amounts to a conflicting finding of imprudence with regard to OPCo entering into the Settlement Agreement."[35] The Company's view is misguided.

The Commission did not find that it was imprudent for the Company to enter into the Settlement Agreement. Instead, the Commission – noting the unique nature of the transaction – merely followed through on the auditor's recommendation that, as a matter of equity for customers, the Commission should consider netting the proceeds of the transaction against the FAC under-collection[36]:

> While we do not find any motivation by AEPSC to transfer value from ratepayers during the ESP to an earlier date, nevertheless, the long-term coal agreement was an OP asset for which the value would have flowed through to OP ratepayers through the ESP period but for the extraordinary circumstances related to the early contract termination. Given these factors, we agree with Staff that,

[35] OP Application for Rehearing at 31.

[36] O&O at 5-6, citing Audit Report at 1-6; 2-21 through 2-22.

> in order to determine the real economic cost of coal used during the audit period, more of the value realized by AEP for entering into the Settlement Agreement should flow through to OP ratepayers through a credit to OP's under-recovery and deferrals.[37]

The result of the Commission's decision is not a de facto finding of imprudence, as the Company argued. Rather, the Commission merely made sure that customers received a benefit that would have accrued to them, had it not been for the early termination of the coal contract. The Commission should deny the Company's request for rehearing on this issue.

D. The Commission Properly Offset the Value of the West Virginia Coal Reserve Against the FAC Under-Collection, So as to Give Customers the Benefit of the Lower Coal Costs They Would Have Received But for AEP Ohio's Settlement Agreement with the Coal Supplier.

In its application for rehearing, the Company also argued that in ordering the value of the West Virginia coal reserve to be offset against the FAC under-collection, the Commission "**essentially** converted it into a ratepayer-owned asset…."[38] The Company cited to a 1988 Commission decision regarding the Company's sale of the Conesville Coal Preparation Plant for the proposition that the payment of electricity rates does not give customers an ownership interest in equipment.[39] That case, however, does not serve as precedent for the Commission to abrogate or modify the O&O in this proceeding.

The 1988 decision involved the proceeds from the dissolution of a joint venture between Simco, a wholly-owned subsidiary of CSP, and Peabody Coal Company.[40] OCC had argued that customers should have benefited from the gain on the sale of the

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[37] Id. at 13.

[38] OP Application for Rehearing at 33 (emphasis added).

[39] Id. at 32-33, citing Case No. 88-102-EL-EFC, Opinion and Order (October 28, 1988) ("Conesville Order").

[40] See Conesville Order, 1988 Ohio PUC LEXIS 995, *34.

depreciable assets because the charge per ton for Simco-Peabody coal included a component for equipment rental,[41] through a sale/leaseback agreement between the Company and the Conesville Coal Preparation Company.[42] OCC also argued that CSP's customers had been purchasing an interest in these assets through the cost of coal and therefore should reap the benefit from the sale of the assets.[43] In the 1988 case, the Commission disagreed with OCC's position.

The facts of the Conesville case are different from the facts in this proceeding. This proceeding does not involve the *sale* of an asset by the Company. Instead, this proceeding involves the *procurement* of the West Virginia coal reserve by the Company through the 2008 Settlement Agreement. Thus, the only gain at issue is the difference in value between the below-market price of coal under the original contract and the market value of the coal reserve. Because the Company's customers would have benefited from the below-market cost of coal under the contract during the ESP period,[44] the value of the coal reserve procured in the Settlement Agreement is relevant to the Company's cost of fuel during 2009. Nevertheless, in this proceeding the Commission did not recognize that the Company's customers have any ownership interest in the West Virginia coal reserve.

In ordering that the difference between the contract price and the value of the coal reserve be offset against the FAC under-collection, the Commission did not convert – explicitly or "essentially" – the West Virginia coal reserve into a customer-owned asset. The Commission acted to ascertain the true cost of the Company's fuel during 2009. The

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[41] Id.

[42] See id., 1988 Ohio PUC LEXIS 995, *17.

[43] Id., 1988 Ohio PUC LEXIS 995, *34.

[44] See O&O at 5.

Company's assertions are wrong, and the Commission should deny the Company's request for rehearing on this issue.

E. Although the Commission in this Proceeding Should Have Ordered the Company to Credit Customers for the Increased Price Per Ton of Coal under the Contract Support Agreement, It May Examine the Contract Support Agreement and the Delivery Shortfall Agreement in Future Audits.

As OCC noted in its own pending Application for Rehearing of the O&O, the Commission erred in not ordering the Company to credit customers for the increased price per ton of coal under the Contract Support Agreement in this proceeding.[45] The Commission instead delayed further examination of the Agreement until a future audit.[46]

The Company, however, claims that the Commission may not examine either that agreement or the Delivery Shortfall Agreement in any future audit. The Company bases this claim on arguments it advanced regarding other aspects of the O&O.[47] OCC has already addressed most of these arguments, and the Company's argument here fails for the same reasons as noted above. The Commission should deny the Company's request for rehearing on this issue, and thereby preserve the necessary future opportunity to protect customers' electricity rates.

III. CONCLUSION

Although the O&O erred in several respects regarding the treatment of the lump sum payment and the West Virginia coal reserve, as OCC pointed out in its own pending Application for Rehearing, the claims of error alleged by the Company are baseless. As discussed herein, the Company has presented no valid reasons for the Commission to

[45] OCC Application for Rehearing (January 23, 2012) at 11-12.

[46] O&O at 14.

[47] OP Application for Rehearing at 34.

abrogate or modify the O&O in the manner requested by the Company and thus cause even greater rate increases for customers. The Commission should deny rehearing as requested by the Company.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Memorandum Contra by the Office of the Ohio Consumers' Counsel was served via electronic transmission, to the persons listed below, on this 5th day of March 2012.

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Summary: Memorandum Memorandum Contra Ohio Power Company's Application for Rehearing by the Office of the Ohio Consumers' Counsel electronically filed by Ms. Deb J. Bingham on behalf of Etter, Terry L.