BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to §4928.143, Ohio Rev. Code, in the Form of an Electric Security Plan.	)	**Case No. 11-346-EL-SSO** **Case No. 11-348-EL-SSO**
In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority.	)	**Case No. 11-349-EL-AAM** **Case No. 11-350-EL-AAM**

THE KROGER COMPANY'S POST-HEARING BRIEF

I. INTRODUCTION

The Kroger Company ("Kroger") is one of the largest grocers in the United States. Kroger has 93 facilities served by AEP-Ohio in the Columbus Southern Power ("CSP") service territory and 40 facilities served by AEP-Ohio in the Ohio Power ("OP") service territory that collectively consume over 240 million kWh per year. Kroger is a shopping customer in both service territories.

Given the broad scope of AEP-Ohio's modified ESP 2 application, Kroger's post-hearing brief focuses on three key issues. First, Kroger recommends that the Retail Stability Rider, as proposed in AEP-Ohio's application be rejected. Second, if a two-tiered capacity charge is adopted, as proposed by AEP-Ohio, the Company's proposal should be modified to permit Tier 1 pricing, effective June 1, 2012, for those customers who were already shopping on the date of the Commission's February 23, 2012 Entry in this docket, irrespective of customer class. Third, AEP-Ohio's Distribution Investment Rider should be rejected.

Kroger respectfully requests the Public Utilities Commission of Ohio ("Commission") to modify AEP-Ohio's modified ESP 2 application in order to ensure the continued competitiveness in the market and to maintain the ratemaking philosophy that costs are assigned on the basis of cost causation.

II. PROCEDURAL HISTORY

On January 27, 2011, Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, "AEP-Ohio") filed an application for a standard service offer ("SSO"), pursuant to Section 4928.141, Revised Code requesting approval of an electric security plan ("ESP 2"). On September 7, 2011, a Stipulation and Recommendation ("Stipulation") was filed for the purpose of resolving all the issues raised in the ESP 2 cases and several other AEP-Ohio cases pending before the Commission. On December 14, 2011, the Commission issued its Opinion and Order in the consolidated cases, finding that the Stipulation, as modified, be adopted and approved.

On January 1, 2012, CSP and OP merged into a single entity, AEP-Ohio.

In light of issues raised on rehearing, on February 23, 2012, the Commission determined in its Entry on Rehearing that the Stipulation, as a package, did not benefit ratepayers and the public interest and, thus, did not satisfy the three-part test for the consideration of stipulations.

On March 30, 2012, AEP-Ohio filed an application for approval of a standard service offer pursuant to Section 4928.141, Revised Code under an electric security plan in accordance with Section 4928.143, Revised Code.

On May 17, 2012, an evidentiary hearing commenced for AEP-Ohio's modified ESP 2 Application.

III. ARGUMENT

A. The Retail Stability Rider Should be Rejected by the Commission.

i. AEP-Ohio's Proposed Retail Stability Rider is not a decoupling mechanism and it should be rejected by the Commission.

The Retail Stability Rider ("RSR") is a new proposal by AEP-Ohio that would be a nonbypassable rider charged to all AEP-Ohio customers designed to collect a targeted amount of non-fuel generation revenues "similar to the level collected by AEP Ohio in 2011." (Direct Testimony of William A. Allen, p. 13, AEP-Ohio Ex. 116). The mathematical construct of the RSR is a formula to recover lost generation revenues due to AEP-Ohio providing CRES providers with purported discounted cost of capacity. (Allen Direct, p. 13). Specifically, AEP-Ohio attempts through the RSR to recover the difference between the price AEP-Ohio charges CRES for capacity and AEP-Ohio's embedded cost for capacity. (Cross-Examination of Allen, Tr. Vol. V., 1574). As proposed, the RSR would end on May 31, 2015, after which AEP-Ohio will no longer provide capacity to serve its entire load as a Fixed Resource Requirement ("FRR") entity. (*Id.*).

AEP-Ohio avers that the RSR is "similar" to a decoupling mechanism. (*Id.*) However, the RSR is actually an attempt to recover stranded costs. (Direct Testimony of Kevin C. Higgins, p. 7-8, Kroger Ex. 101). Specifically, the RSR is a renewed attempt by AEP-Ohio to seek transition cost recovery, *i.e.* an attempt by the Company to recover fixed generation costs that are "stranded" due to customer shopping for generation service with competitive suppliers. (*Id.*). AEP-Ohio ties this new version of transition cost recovery to the price of capacity provided by AEP-Ohio to CRES providers at a price that the Company argues is below its embedded cost of capacity of $355.72/MW-day. (*Id.*). AEP-Ohio witness Powers testified:

> From the Company's perspective, the need for a RSR charge stems largely from the financial harm to AEP Ohio that would otherwise result from the modified ESP package as a whole. For example, the three-year FRR commitment the Company has with PJM to supply capacity for AEP Ohio load, as well as the obligations that AEP Ohio has under the existing system Pool Agreement, must be considered as **AEP-Ohio transitions to market**.

(Direct Testimony of Powers, AEP-Ohio Ex. 101, p. 18) (emphasis added). It is clear that the basis and purpose of the RSR is to recover costs incurred as AEP-Ohio transitions to market.

However, AEP-Ohio's transition cost recovery was fully resolved over a decade ago in Case Nos. 99-1729-EL-ETP and 99-1730-EL-ETP[1] (the "ETP cases"). In the ETP cases, the Stipulation stated that "Neither Company will impose any lost revenue charges (generation transition charges (GTC) on any switching customer)." (ETP case Stipulation, p. 3, May 8, 2000). Now, using a different name – the Retail Stability Rider – AEP-Ohio attempts to recover lost revenue that AEP-Ohio expressly agreed not to recover after executing the Stipulation in the ETP cases. Furthermore, under the terms of the Stipulation, AEP-Ohio was permitted to recover regulatory transition costs as part

[1] Summary of the Commission's Opinion and Order of September 28, 2000 in the Columbus Southern Power Company and Ohio Power Company Electric Transition Plan Cases, esp. at 10-18.

of the ETP cases. (ETP case Stipulation, p. 4). Accordingly, the RSR should be rejected based on the ETP case Stipulation.

Additionally, no provision in SB 3 that provides for a new round of transition cost recovery for historically-incurred fixed generation costs. Because of the absence of express statutory support and the AEP-Ohio's transition cost recovery in the ETP cases, Kroger requests that the Commission reject the RSR on the grounds that it would constitute unreasonable and redundant transition cost recovery. (Higgins Direct, p. 8).

ii. <u>AEP-Ohio's RSR improperly recovers costs among customer classes.</u>

If the Commission is persuaded by AEP-Ohio that the RSR is justified, then Kroger recommends that AEP-Ohio's proposal be modified. First, the RSR rate design for demand-billed customers is improper and should be rejected by the Commission. AEP Witness Roush acknowledged that the RSR was "designed to recover fixed costs" and that "fixed costs usually necessitates (*sic*) or would indicate a demand allocation." (Cross-examination of Roush, Vol. IV, p. 1173-74). However, in AEP-Ohio's rate design for the RSR, costs are *allocated* to customer classes on a *demand* basis, but are *recovered* exclusively through an *energy* charge. (*Id.* at 1175; Higgins Direct, p. 8). Kroger witness Higgins explained that "[t]his obvious mismatch between cost allocation and revenue recovery results in unwarranted subsidies among customers." (Higgins Direct, p. 8).

Specifically, the subsidization would occur in the "GS-2/3/4, SBS, EHG, EHS, SS" grouping. AEP-Ohio allocates RSR-related costs to this group on the basis of the group's aggregate share of 5 CP demand. (Cross-examination of Roush, Vol. IV, p. 1175). AEP-Ohio then calculates a common energy charge for all customers in the group to recover this allocated cost by dividing the allocated cost by the metered energy for each customer class to determine the rate per kWh for each customer class. (*Id.* at 1176). Under the AEP-Ohio's proposal, customers with relatively high load factors would be forced to pay for a portion of the 5 CP costs attributable to lower-load factor customers. (*Id.* at 1179-1180; Higgins Direct, p. 8-9). In the customer classes included in the "GS-2/3/4, SBS, EHG, EHS, SS" grouping, the sales are to customers with demand meters. (Cross-examination of Higgins, Vol. VII, p. 2235). As such, costs and charges for this grouping should be aligned based on demand, not energy usage.

"It is a fundamental tenet of ratemaking that if costs are *allocated* on the basis of demand, then they should be *recovered* on the same basis, i.e. through a demand charge, to the greatest extent practicable, otherwise costs will be shifted among customers." (Higgins, p. 9). Indeed, AEP-Ohio witness Roush confirmed this principle when he testified that "cross-subsidization between and within classes should be avoided." (Cross-examination of Roush, Vol. IV, p. 1174). Moreover, he indicated that the RSR rate could have been "designed differently" using other methodologies that would implement a demand charge. (*Id.* at 1776-77).

Kroger witness Higgins calculated a far more balanced methodology for the RSR demand charge using the demand billing determinants provided by AEP-Ohio in the most recent distribution rate case for the demand-billed customers in this grouping. (Kroger Exhibit KCH-1). For the demand-billed customers in the grouping, the estimated RSR demand charge is $0.739 per kW, as compared to $.0016948 per kWh proposed by AEP-Ohio for this same grouping.[2] If the Commission decides to implement the RSR (which it should not), the Commission should adopt a rational

[2] Exhibit DMR-3.

demand charge rate design in line with Kroger witness Higgins' proposed RSR demand charge.

iii. <u>The Return On Equity proposed by AEP-Ohio for the RSR is excessive and should be reduced.</u>

The Company's proposed RSR revenue requirement is based on a return on equity ("ROE") of 10.5% on generation assets. (Allen Direct, p. 14). The average ROE awarded to electric utilities in the United States in 2011 was 10.22%. (Higgins Direct, p. 10). The RSR should not produce an ROE in the mid-to-upper part of the range of approved ROEs. (*Id.*). When AEP-Ohio's generation is favorably priced relative to market, the company is permitted to earn a ROE up to the threshold of a "significantly excessive" return. (*Id.*). Based on AEP-Ohio's two-tiered capacity approach, generation is *unfavorably* priced relative to market, and thus, if approved, Kroger recommends that the Commission should reduce AEP-Ohio's proposed ROE to a significantly *lower* end of the reasonable range of ROE.

B. AEP-Ohio's Proposed Two-Tier Capacity Charge for CRES Providers Serving Shopping Customers is Unreasonable and Anti-Competitive.

AEP-Ohio has proposed a two-tiered capacity pricing mechanism for non-SSO load. Specifically, all load of Ohio Power served by a CRES provider would be charged either $145.79/MW-day (Tier 1) or $255.00/MW-day (Tier 2). (Allen Direct, p. 6). Both the Tier 1 and 2 pricing are well above the PJM RPM delivered capacity prices for the 2012/2013 through 2014/2015 planning years. (FES witness Lesser Direct, p. 10). Over the three years, on average, the Tier 1 pricing is twice as high as the PJM RPM market delivered price, and the Tier 2 pricing is nearly four times higher than market. (*Id.*).

Under AEP-Ohio's approach, there would be a set-aside of Tier 1 priced capacity for 10,066,000 MWh (approximately 21%) of Ohio Power's retail load in 2012; 14,995,000 MWh (approximately 31%) in 2013; and 19,780,000 MWh (approximately 41%) in 2014 continuing through May of 2015. (*Id.*) The availability of Tier 1 pricing would be restricted by customer class. Approximately 30% would be reserved for Residential customers, 30% for Commercial customers, and 40% for Industrial customers. (*Id.* at 7).

The most reasonable, fair, rational and competitively neutral approach to the capacity issue is to charge all CRES customers shopping for generation in AEP's service territory the RPM price for capacity. As noted by many parties, and discussed at length in the direct testimony of many expert witnesses, capacity prices set according to the RPM are the only fair and equitable charges that may be charged to shopping customers. AEP's "embedded costs" are irrelevant. The only adequate, fair and rational method to measure the "worth" of capacity is an auction method such as RPM.

The tiered capacity pricing mechanism, as currently proposed, is unreasonable and inefficient because it requires existing shopping customers to pay Tier 2 prices while Tier 1 pricing remains unutilized by the load reserved for Residential customers. (Higgins Direct, p. 11). According to Exhibit WAA-1, as of March 1, 2012, the Tier 1 allocation proposed by AEP-Ohio for both the Commercial and Industrial classes was already over-subscribed, while the Residential allocation was significantly under-subscribed, including customers with pending and noticed intentions to switch to a CRES. (*Id.*).

In accordance with the State's policy to promote competition in the energy markets, a preferable alternative is to permit Tier 1 pricing for those customers who were already shopping on the date of the Commission's February 23, 2012 Entry, irrespective of class. Additionally, it would be reasonable for those customers who had pending and noticed intentions to switch as of this cutoff date to be next in line for Tier 1 pricing, irrespective of class. Finally, to the extent that class set-asides are considered desirable, such allocations could be applied on a going-forward basis with respect to the remaining Tier 1 pricing. (Higgins Direct, p. 11).

Kroger recommends the February 23 cutoff date because it is consistent with AEP-Ohio's alternative proposal in its Motion dated February 27, 2012, filed in Case No. 10-2929-EL-UNC. In that Motion, AEP-Ohio indicated that allowing Tier 1 pricing for those customers who were already shopping or had provided a switch request by February 23 was a "perfect compromise," albeit as an interim solution. Kroger agrees with AEP-Ohio's position in Case No. 10-2929-EL-UNC that the use of a cut-off date tied to the Commission's February 23, 2012 Entry is reasonable if a two-tiered capacity pricing regime is adopted.

In order to facilitate all shopping customers as of February 23, 2012 into Tier 1, the first tranche will be expanded from 21% to about 26%, based on the March 1, 2012 switching information provided in Exhibit WAA-1. Similarly, if all customers who had switches pending or had given notice on February 23, 2012 were permitted Tier 1 pricing in the second tranche (effective January 1, 2012), the second tranche will be expanded from 31% to about 37%. (Exhibit KCH-2).

C. The Commission Should Reject AEP-Ohio's Proposed Distribution Investment Rider.

i. The recovery of distribution related carrying costs should be addressed in a distribution rate case.

The Commission should reject the Distribution Investment Rider ("DIR") as proposed by AEP-Ohio. The DIR rider would allow recovery of carrying costs on incremental distribution plant. (Allen Direct, p. 9). The carrying charge rate would include elements that allow the Company an opportunity to earn a return on and of plant in service associated with distribution net investment associated with FERC Plant Accounts 360-374, as well as recover associated income taxes, property taxes, and commercial activity taxes. (*Id.* at 9).

The Modified ESP II case is not the proper forum to consider the recovery of distribution related carrying costs. In carrying out AEP-Ohio's lawfully mandated responsibility to invest and maintain its distribution system, AEP-Ohio is entitled to an opportunity to recover their prudently-incurred costs through a distribution rate case. (Cross-examination of Roush, Vol. IV, p. 1184; Direct Higgins, p. 14). However, a utility should not be granted a rider mechanism for such costs. Rather, the incremental costs that AEP wishes to recover through this proposed rider are best considered in the overall context of the utilities' total distribution revenues, expenses, and return on distribution rate base. The best forum for such consideration is a distribution rate case.

ii. If the Commission approves the DIR, it should be modified to incorporate Accumulated Deferred Income Taxes.

The DIR proposed by AEP-Ohio is flawed because it fails to take proper account of Accumulated Deferred Income Taxes ("ADIT"). (Higgins Direct, p. 14; Direct Testimony of Commission Staff witness McCarter, Staff Ex. 108, p. 3). If a DIR mechanism is approved by the Commission, it should be modified to reflect incremental ADIT as a credit against distribution net plant in the calculation of the DIR charge. (*Id.*).

As illustrated in AEP-Ohio Exhibit WAA-5, the DIR rate would be calculated by applying a carrying charge to the change in distribution net plant that has occurred since August 31, 2010 (i.e. distribution plant minus accumulated depreciation). This metric is incorrectly calculated because it omits ADIT, which is an important deduction against rate base.[3] ADIT will reduce the cost to customers of utility investment in incremental plant. (Higgins Direct, p. 15). As such, AEP-Ohio's failure to recognize ADIT in the DIR calculation would result in an over-recovery of distribution costs from customers.

In addition, the over-recovery of distribution costs would be enhanced when bonus tax depreciation is taken into account. Bonus tax depreciation refers to a greatly accelerated tax deduction for depreciation that has been permitted pursuant to several statutes signed into law in recent years to stimulate the economy.

Kroger witness Higgins explained the effect of bonus tax depreciation on ADIT:

> Bonus tax depreciation is a form of accelerated tax depreciation. As such, bonus tax depreciation affects rates through the same mechanics as standard accelerated depreciation, i.e., by reducing rate base due to increased ADIT. However, because the tax deduction for bonus depreciation is so large, i.e., 50% to 100% of the cost of the qualifying asset, the impact of bonus tax depreciation on ADIT in the years immediately following the placement of the qualifying plant into service is much more significant than occurs under standard accelerated tax depreciation. Consequently, the beneficial impact on customer rates is much more significant as well.

[3] Kroger witness Higgins' explained:

> ADIT is booked to take account of the timing difference between accelerated depreciation used by utilities for income tax purposes and book depreciation used for ratemaking. Generally, the tax benefits of accelerated depreciation are not passed through directly to ratepayers; instead, according to the conventions of income tax normalization, the benefit of a utility's accumulated deferred income tax is viewed as a source of zero-cost capital to the utility as part of the ratemaking process. Consequently, ADIT is booked as a credit against rate base, thereby reducing revenue requirements for customers.

(Higgins Direct, p. 17). The failure of AEP-Ohio's proposed DIR mechanism to take account of ADIT would unfairly enrich the Company at the expense of customers by depriving customers of the benefits of bonus tax depreciation as generally recognized in utility ratemaking.

iii. AEP-Ohio's proposal to aggregate the incremental distribution investment in OP's and CSP's former service territory should be rejected.

The DIR mechanism that AEP-Ohio is proposing aggregates the incremental distribution investment in both service territories and calculates an aggregated DIR charge.[4] Even after the merger, CSP and OP are distinct distribution territories with separate rates. The cost of providing distribution service can vary among distribution service territories "based on the characteristics of the load being served, the geography of the territories being served, including population densities, and the age of the distribution plant." (Higgins Direct, p. 18).

AEP-Ohio's proposal fails to assign costs on the basis of cost causation. The majority of AEP-Ohio's distribution costs relate to the recovery of fixed assets that uniquely serve specific geographic territories. The unique costs of CSP and OP distribution territories are known to AEP-Ohio because they were previously operated as separate utilities. The costs of each respective service territory should continue to be directly assigned to the customers in that territory. Doing so will be consistent with the fundamental tenets of cost causation. If a DIR is approved, AEP-Ohio's proposal to aggregate its DIR charges across both its service territories should be rejected.

[4] See Exhibit WAA-5.

IV. CONCLUSION

For the foregoing reasons, Kroger respectfully requests the Commission to reject the RSR and DIR rider and modify the two-tiered pricing mechanism in accordance with Section B of this post-hearing brief. If the Commission approves the RSR and the DIR, Kroger respectfully requests that the Commission modify the RSR and DIR in accordance with Kroger's recommending modifications found in Section A and C of this post-hearing brief, respectively.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *The Kroger Company's Post Hearing Brief* was served via electronic mail on this ____ day of June 2012 upon counsel for all parties of record in this case.

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