BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered under Ohio Revised Code 4928.144.	)))))	Case No. 11-4920-EL-RDR
In the Matter of the Application of Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered under Ohio Revised Code 4928.144.	)))))	Case No. 11-4921-EL-RDR

APPLICATION FOR REHEARING AND MEMORANDUM IN SUPPORT OF INDUSTRIAL ENERGY USERS-OHIO

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APPLICATION FOR REHEARING OF INDUSTRIAL ENERGY USERS-OHIO

Pursuant to Section 4903.10, Revised Code, and Rule 4901-1-35, Ohio Administrative Code ("O.A.C."), Industrial Energy Users-Ohio ("IEU-Ohio") respectfully submits this Application for Rehearing of the Finding and Order issued by the Public Utilities Commission of Ohio ("Commission") on August 1, 2012 approving Ohio Power Company's ("OP") (now merged with Columbus Southern Power Company or "CSP" as "AEP-Ohio") Application for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered under Ohio Revised Code 4928.144 ("PIRR" or "Application"). The August 1, 2012 Finding and Order permitted OP to continue to calculate carrying charges on a deferral balance without adjusting for accumulated deferred income taxes ("ADIT"). Although the failure to remove ADIT from the deferred balances prior to calculating carrying charges was a contested issue, the Commission did not require a hearing. Moreover, the Commission prohibited parties from submitting testimony regarding ADIT in AEP-Ohio's modified electric security plan ("ESP") application. Accordingly, the

Commission's August 1, 2012 Finding and Order is unlawful and unreasonable in the following respects:

1. **The Commission's Finding and Order is Unlawful and Unreasonable Because the Commission Failed to Require AEP-Ohio to Calculate Carrying Charges on Deferred Balances Adjusted for Accumulated Deferred Income Taxes; the Commission's Failure to Adjust the Deferred Balances for ADIT Violated Generally Accepted Accounting Principles, State Policy, Sound Regulatory Practices and Principles, and Precedent;**

2. **The Commission's Finding and Order is Unlawful and Unreasonable in that the Commission Authorizing AEP-Ohio to Increase Rates was Arbitrary and Capricious, and an Abuse of Discretion in Violation of Due Process;**

3. **The Commission's Failure to Reduce the Deferral Balance, that Customers will Pay, to Account for the Flow-through Effects of the Remand of the ESP I Order was Unlawful and Unreasonable.**

Respectfully submitted,

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MEMORANDUM IN SUPPORT OF INDUSTRIAL ENERGY USERS-OHIO

I. INTRODUCTION

On August 1, 2012, without holding a hearing, the Commission authorized AEP-Ohio to increase rates and establish a rider, the Phase-In Recovery Rider ("PIRR"), to begin amortization of amounts deferred during AEP-Ohio's first ESP. Because the Commission increased customer rates without holding a hearing, permitting the filing of testimony, or subjecting AEP-Ohio's positions to cross-examination, the Commission's Order increasing customer rates was arbitrary and capricious and violated due process. In addition to arbitrarily increasing customer rates, the Commission approved an unlawful and unreasonable method of calculating carrying charges on the deferred balances, because the deferred balances have not been adjusted for ADIT. By failing to require AEP-Ohio to adjust the deferred balances prior to calculating carrying charges, the Commission's Order authorizes AEP-Ohio to accrue carrying charges on overstated balances in violation of generally accepted accounting principles and sound regulatory policies. Such a result is not just and reasonable. Finally, the Commission's Order is unlawful because it failed to direct AEP-Ohio to adjust the deferral balance to account for the flow-through effects of the remand of AEP-Ohio's first ESPs.

II. BACKGROUND

In AEP-Ohio's first ESP case, the Commission authorized AEP-Ohio to increase rates by a total dollar amount.[1] A portion of that total increase was collected during the term of the ESP and a portion was deferred for potential future recovery through a non-bypassable rider after the term of the ESP, subject to necessary adjustments. The portion subject to future collection depended on the level of revenue collected by AEP-Ohio during the term of the ESP relative to the amount the Commission could lawfully authorize AEP-Ohio to collect and the appropriateness of AEP-Ohio's accounting regarding the deferral.[2] The Commission held that it would determine the amount of the deferral eligible for recovery at the conclusion of the ESP.[3]

As a result of the Supreme Court of Ohio decision holding that the Commission's determination with regard to the total increase in the first ESP case was illegally excessive[4] and subsequent Commission decisions finding that AEP-Ohio overstated

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[1] *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 Nos. 08-917-EL-SSO, *et al.*, Opinion and Order at 22-23 (Mar. 18, 2009) (hereinafter "*ESP I*").

[2] Section 4928.144, Revised Code, requires the Commission to order the creation of a regulatory asset pursuant to general accepted accounting principles.

[3] *ESP I* at 22-23.

[4] *See In re Application of Columbus Southern Power*, 128 Ohio St. 3d 512 (2011); *see also ESP I*, Order on Remand (Oct. 3, 2011).

fuel expense during 2009,[5] it is now clear that the amount accumulated by AEP-Ohio in the phase-in deferral balance is significantly excessive.

AEP-Ohio initiated this proceeding seeking authorization to commence amortization of the deferred amounts on September 1, 2011. On September 7, 2011, AEP-Ohio and others entered into a Stipulation and Recommendation ("Stipulation ESP") which purported to resolve several proceedings, including AEP-Ohio's ESP and the PIRR Case.[6] On December 14, 2011, the Commission authorized AEP-Ohio to increase electric rates as part of its decision in *ESP II* by adopting the Stipulation.[7] That Stipulation permitted AEP-Ohio to commence amortization of the phase-in deferral without a final determination regarding the amount eligible for recovery and without following generally accepted accounting principles.[8] The Opinion and Order approved the increase in rates to go into effect on a bills rendered basis effective January 1, 2012.[9] IEU-Ohio requested in its December 20, 2011 Motion[10] that rates be collected subject to reconciliation as the rates were still subject to final review[11] and the December 14, 2011 Opinion and Order must ultimately be rejected on rehearing. The

[5] *In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company*, Case Nos. 09-872-EL-FAC, *et al.*, Opinion and Order at 12 (Jan. 23, 2012).

[6] *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 Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, Case Nos. 11-346-EL-SSO, *et al.*, Stipulation and Recommendation (Sep. 7, 2011) (hereinafter "*ESP II*").

[7] *ESP II*, Opinion and Order at 57-59 (Dec. 14, 2011).

[8] *Id.*

[9] *Id.* at 67.

[10] Motion by Industrial Energy Users-Ohio for an Order Directing the Companies to Serve Tariffs and Supporting Workpapers on the Parties and For an Order that New Rates and Charges be Billed and Collected Subject to Reconciliation, and a Request for Expedited Ruling and Memorandum in Support (Dec. 20, 2011).

[11] *ESP II*, Opinion and Order at 67.

Commission has not ruled on that Motion. But, subsequently, on February 23, 2012, while the tariffs were still subject to final review, pursuant to Applications for Rehearing, the Commission determined that the Stipulation ESP was not in the public interest.[12]

As a result of rejecting the Stipulation ESP, the Commission set up a separate proceeding to address AEP-Ohio's proposal to commence amortization of the phase-in deferral through rate increases.[13] In response to AEP-Ohio's proposal to commence such amortization, the Commission requested comments.[14] The comments filed by parties including IEU-Ohio identified disputed issues of fact and contested other claims made by AEP-Ohio, including the calculation of carrying charges pursuant to generally accepted accounting principles on deferred balances adjusted for ADIT.[15] In a ruling in *ESP II* regarding the relevance of testimony regarding the amount of the deferral balance eligible for recovery and the application of generally accepted accounting principles to the deferred balances, the Commission held that these contested issues would be resolved in this separate proceeding, the PIRR Case, and struck IEU-Ohio's testimony on ADIT in *ESP II*.[16]

As evident from comments, testimony of Staff witnesses,[17] IEU-Ohio witness Bowser,[18] fuel audit reports,[19] the Commission's[20] and Supreme Court of Ohio's[21] past

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[12] Entry on Rehearing 11-12 (Feb. 23, 2012).

[13] PIRR Case, Entry at 3 (Mar. 14, 2012).

[14] *Id.*

[15] This issue was argued by IEU-Ohio, the Office of the Ohio Consumers' Counsel ("OCC"), Ohio Manufacturers Association Energy Group, Ohio Energy Group, Ormet Primary Aluminum Corporation, the Kroger Company, and Commission Staff.

[16] *ESP II*, Tr. Vol. IX at 2738-39 (Attachment A); *ESP II*, Tr. Vol. XIII at 3635-36 (Striking portions of IEU-Ohio Ex. 129) (Attachment B).

[17] *ESP II*, Staff Ex. 109 at 8 (stating, "The other critically important issues regarding PIRR mechanics should move forward on their own merits in Case Nos. 11-4920-EL-RDR, 11-4921-EL-RDR. Items of note

precedent and practice by other regulatory authorities having jurisdiction over AEP,[22] generally accepted accounting principles require the recognition of tax benefits available to the utility in determining the amount of a deferral that the utility may apply carrying charges to and recover from customers. One of those tax benefits is reflected in what is known as ADIT. As the audit report of AEP-Ohio's 2010 Fuel Adjustment Clause ("FAC") identified, "[i]f the ADIT balance related to the Company's FAC under-recovery balances is not considered, or deducted somewhere else, such as in rate base, ratepayers would be over-paying carrying costs by paying for carrying costs on the

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filed in Staff Comments on April 2, 2012 include the following . . . [t]he ending fuel deferral balance at the end of December 2011 should be reduced for Accumulated Deferred Income Taxes (ADIT) in the calculation of carrying costs for Rider PIRR.") (Attachment C).

[18] *See* Attachment D.

[19] Particularly, the audit report stated:

We recommend that AEP Ohio and the other parties to the case re-examine whether the Commission-authorized gross-of-tax WACC for debt and common equity capital should be applied to what such investors are actually financing of the fuel cost under-recovery balances, which would appear to be the Deferred Fuel amounts recorded in Account 182.3 less the directly related credit-balance ADIT for Deferred Fuel recorded in Account 283.

Comments of the Ohio Energy Group, Attachment page 18 (containing an excerpt from the audit of AEP-Ohio's 2010 FAC case).

[20] *ESP II*, Opinion and Order at 47.

[21] *Cincinnati v. Public Utilities Comm.*, 161 Ohio St. 395, 405-06 (1954); *Ohio Bell Telephone Co. v. Public Utilities Comm.*, 68 Ohio St. 2d 193, 194 (1981); *Cleveland Electric Illuminating Company v. Public Utilities Comm.*, 12 Ohio St. 2d 320, 323 (1984) (Determining that the Commission's order is consistent with the principle that tax benefits must be flow-through to customers).

[22] AEP-Ohio has testified in states that utilize traditional cost of service ratemaking that it would be appropriate to calculate carrying charges on a deferred balance adjusted for ADIT. Comments of the Ohio Energy Group, Attachment pages 10-13 (containing the testimony of AEP witness Mitchell in a West Virginia proceeding, recommending that carrying charges be calculated on a deferral balance adjusted for ADIT).

portion of the Deferred Fuel balance that has been financed by tax savings, *i.e.*, on the portion not financed with investor-supplied capital."[23]

Even though the comments identified contested issues and the Commission had previously held that these contested issues would be addressed in this proceeding, on August 1, 2012, the Commission authorized AEP-Ohio to increase electric rates to permit AEP-Ohio to commence amortization of an overstated phase-in deferral balance without holding a hearing and without addressing the issues that must be addressed under Section 4928.144, Revised Code and the contested issues framed by the comments. This action has an immediate impact on customers because it increases electric bills. While the Commission's Order indicates that the Commission may adjust the amount subject to amortization to correct for some of the overstatement of the deferred amount, it has also stated that it will not adjust the deferred amounts to flow-through the effects of the illegal increases in the *ESP I* case.[24] The Commission also refused to offset the deferred balances for the amounts charged pursuant to the now rejected Stipulation ESP, although those tariffs were subject to final Commission review at the time the Stipulation was ultimately rejected.

Further, no reconciliation is capable of undoing the harm done to customers during the period the amortization is permitted to proceed based on an overstated deferred balance and the deviation from generally accepted accounting principles — reconciliation does nothing for customers that will have already gone out of business by the time such reconciliation occurs. For example, recent press reports indicate that

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[23] Comments of the Ohio Energy Group, Attachment page 17 (containing an excerpt from the audit of AEP-Ohio's 2010 FAC Case).

[24] Finding and Order at 20.

Ormet Primary Aluminum Corporation ("Ormet") is preparing to idle its manufacturing operations and reduce employment as a result of the Commission-authorized rise in electric rates.[25] The same press report contains statements from AEP-Ohio indicating that one of the main causes of Ormet's rate increase is the amortization of the phase-in deferral.[26]

The Commission's decision to permit AEP-Ohio to commence amortization of the overstated phase-in deferral balance and without adhering to generally accepted accounting principles that, among other things, require an offset to the deferred balance to recognize ADIT is arbitrary, capricious, unreasonable and unlawful. The Commission's action in this proceeding also denies customers their due process rights.

III. ARGUMENT

1. The Commission's Finding and Order is Unlawful and Unreasonable Because the Commission Failed to Require AEP-Ohio to Calculate Carrying Charges on Deferred Balances Adjusted for Accumulated Deferred Income Taxes; the Commission's Failure to Require AEP-Ohio to Adjust the Deferred Balances for ADIT Violated Generally Accepted Accounting Principles, State Policy, Sound Regulatory Practices and Principles, and Precedent.

In this proceeding, the Commission is tasked with setting an appropriate rate for the PIRR. Pursuant to Section 4928.144, Revised Code, the Commission must ensure that the PIRR is just and reasonable, and the amounts deferred for collection through the PIRR comply with generally accepted accounting principles. The Commission's

[25] *Ormet Idling Production Line at Hannibal Plant, Columbus Dispatch (Aug. 28, 2012), available at: http://www.dispatch.com/content/stories/business/2012/08/28/ormet-idling-line-at-hannibal.html* (last viewed on Aug. 30, 2012).

[26] *Id.*

jurisdiction and supervision over the phase-in is ongoing.[27] Moreover, in ensuring that the PIRR is just and reasonable, the Commission must follow the policy and statutory requirements set forth under Chapter 4928, Revised Code.[28]

First, the phase-in authorized by the Commission fails to comply with generally accepted accounting principles because AEP-Ohio has been authorized to accrue carrying charges on deferred balances without an adjustment for ADIT. As Section 4928.144, Revised Code, states, the deferred balances are regulatory assets. CSP and OP record regulatory assets (deferred expenses) and regulatory liabilities (future revenue reductions or refunds) to reflect the economic effects of regulation by matching expenses with their recovery through regulated revenues and income with its passage to customers through the reduction of regulated revenues. This treatment is required under generally accepted accounting principles, specifically under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ASC 980 (former FASB 71). The regulatory asset is capitalized on the asset side of the balance sheet, just like electric plant investment in traditional ratemaking.

Also in accordance with generally accepted accounting principles, there is a book to tax timing difference that results from deferring expenses. That book to tax accounting difference results in ADIT being recorded on the liability side of the balance sheet. Likewise, in traditional cost of service ratemaking for electric plant investment there may be book to timing differences created by differences in book and tax

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[27] Finding and Order at 17-18; *see also In re Application of Columbus Southern Power Company et al to Adjust their Economic Development Cost Recovery Rider*,129 Ohio St.3d 568, 569-70 (2011)

[28] Section 4928.02, Revised Code, states that it is the policy of this state to ensure the availability of reasonably priced electric service, and promote customer choice and competition. Section 4928.06(A), Revised Code, requires the Commission to ensure that the policy goals enumerated in Section 4928.02, Revised Code, are effectuated. Thus, the Commission must ensure that its actions and orders further the state policy goals enumerated in Section 4928.02, Revised Code.

depreciation, which result in ADIT. The Commission's and Supreme Court of Ohio's practice has been that for capitalized assets where there is related ADIT, the ADIT must be recognized in determining the amounts that are eligible to be recovered from customers.[29]

To illustrate the mechanics of ADIT and economic impact of the Commission's unlawful and unreasonable Order, if AEP-Ohio's expenses were $200 but the rate cap was $100, AEP-Ohio would book $100 for purposes of book accounting, and defer the remaining $100. Yet, AEP-Ohio would be able to deduct $200 for tax purposes. Because AEP-Ohio can benefit from an immediate deduction without concurrently recognizing the total amount of expense on its books, there is an ADIT benefit equal to the $100 difference between the "book" and the "tax" expense, multiplied by the tax rate. Assuming a 35 percent tax rate, AEP-Ohio would reduce its federal income tax liability by $35. Because AEP-Ohio received $35 through the tax benefit, AEP-Ohio is able to finance $100 of the deferral with only $65 of either debt, equity, or a combination of both.

Carrying charges are intended to compensate the utility for the cost of financing. Because ADIT provides cost free capital that AEP-Ohio need not finance through debt or equity, in the example above, it would only be lawful to authorize AEP-Ohio to calculate carrying charges on a deferral balance of $65 — the remainder was financed by ADIT. To authorize AEP-Ohio to calculate carrying charges without an adjustment

[29] *Cincinnati v. Public Utilities Comm.*, 161 Ohio St. 395, 405-06 (1954); *Ohio Bell Telephone Co. v. Public Utilities Comm.*, 68 Ohio St. 2d 193, 194 (1981); *Cleveland Electric Illuminating Company v. Public Utilities Comm.*, 12 Ohio St. 2d 320, 323 (1984) (Determining that the Commission's order is consistent with the principle that tax benefits must be flow-through to customers).

for ADIT would allow AEP-Ohio to accrue carrying charges on an overstated balance and require customers to overcompensate AEP-Ohio for capital that was not financed.

As stated above, AEP-Ohio must account for ADIT on its books to comply with generally accepted accounting principles; thus, permitting AEP-Ohio to ignore the impact of cost free capital in the form of ADIT in calculating carrying charges would violate generally accepted accounting principles and overstate the balance upon which carrying charges are accrued. This conclusion is evident by comments, witness testimony, audit reports, and Commission and Supreme Court of Ohio[30] precedent: recognition of tax benefits available to the utility must be recognized in customer rates; otherwise, the utility will be overcompensated. Indeed, as the Commission recognized a week after the Finding and Order in this proceeding, the benefit of ADIT must be reflected in rates, stating:

> We agree with Staff and Kroger that the DIR mechanism be revised to account for ADIT. The Commission finds that it is not appropriate to establish the DIR rate mechanism in a manner which provides the Company with the benefit of ratepayer supplied funds. Any benefit resulting from ADIT should be reflected in the DIR revenue requirement. Therefore, the Commission directs AEP-Ohio to adjust its DIR to reflect the ADIT offset.[31]

Second, the Commission's determination that if AEP-Ohio was required to adjust the deferred balances for ADIT prior to calculating carrying charges AEP-Ohio would not recover all of its expense is incorrect. Specifically, the Commission stated:

> [C]arrying charges on the deferrals should be calculated without an adjustment for ADIT in order to ensure that AEP-Ohio recovers its actual

[30] *Cincinnati v. Public Utilities Comm.*, 161 Ohio St. 395, 405-06 (1954); *Ohio Bell Telephone Co. v. Public Utilities Comm.*, 68 Ohio St. 2d 193, 194 (1981); *Cleveland Electric Illuminating Company v. Public Utilities Comm.*, 12 Ohio St. 2d 320, 323 (1984) (Determining that the Commission's order is consistent with the principle that tax benefits must be flow-through to customers).

[31] *ESP II*, Opinion and Order at 47 (Aug. 8, 2012).

> fuel expenses, as required by Section 4928.144, Revised Code . . . . Intervenors and Staff have not persuaded the Commission that our approach in the ESP 1 Order was inconsistent with prior Commission precedent or sound regulatory practice.[32]

The Commission's claim that an ADIT adjustment will somehow prevent AEP-Ohio from collecting its actual expenses is incorrect. Calculating carrying charges on deferred balances adjusted for ADIT does nothing to prevent AEP-Ohio from eventually recovering each dollar that was expensed. Rather, an ADIT adjustment focuses on ensuring that carrying charges are accrued only on dollars that were financed. Otherwise, carrying charges would be accrued on overstated balances and AEP-Ohio would be overcompensated.

The Commission's Order confuses ADIT with the regulatory concept that the equity portion of the carrying cost charge must be "grossed up" to ensure the utility recovers all of its costs. Those concepts are further discussed below.

AEP-Ohio finances expenses through debt and equity. The cost of debt (debt interest) is tax deductible. The cost of equity, however, is not tax deductible. Accordingly, the equity component of the carrying cost charge must be "grossed up" in order for AEP-Ohio to recover its cost of equity. Because the cost of equity capital cannot be used to reduce the federal income tax liability, if the Commission does not "gross up" the equity portion, AEP-Ohio would not be permitted to recover its equity cost. For example, assuming a tax rate of 35 percent, the gross up factor for the equity component of the carrying charge rate is 1/.65 or 1.53. These two concepts — the treatment of the debt and equity portions of the carrying charge calculation — are relevant only to the portion of the expense that was financed by such debt and equity.

[32] Finding and Order at 19.

Because AEP-Ohio has cost free capital available in the form of ADIT, AEP-Ohio did not incur financing costs on the entire deferred amounts.

As the name "carrying charges" implies, carrying charges may only be lawfully applied to amounts that were "carried." Despite the fact that AEP-Ohio did not finance the entire deferred amounts, the Commission authorized AEP-Ohio to accrue carrying charges on the total deferred amount: the consequence of the Commission's determination is to permit AEP-Ohio to accrue carrying charges on overstated balances and require customers to pay excessive and unreasonable compensation to AEP-Ohio. Such a result is not just and reasonable, nor does it comply with generally accepted accounting principles, regulatory practices and principles, or precedent.

On rehearing, the Commission should direct AEP-Ohio to recalculate carrying charges with an adjustment for ADIT. The Commission has retained ongoing jurisdiction to modify the authority granted in *ESP I*. The Commission stated in the Finding and Order that it previously, pursuant to Section 4928.144, Revised Code, granted AEP-Ohio accounting authority "to establish a regulatory asset to record and defer" expenses,[33] but that authority is subject to modification. Moreover, the Commission contemplated setting the actual rate for the PIRR in this proceeding. Particularly, the Commission stated that it:

> [D]oes not agree with AEP-Ohio that the ESP 1 Order cannot be modified in any way by the Commission. On the contrary, AEP-Ohio's ESP, including the phase-in plan, is subject to the ongoing supervision and jurisdiction of the Commission. . . . the order also contemplated that the Company would file a separate application to establish a recovery mechanism, which the Company in fact filed in these cases on September 1, 2011, and is presently the subject of our review.[34]

[33] Finding and Order at 17.

[34] Finding and Order at 17-18.

Because the Commission has ongoing jurisdiction over the phase-in, and the accounting authority authorized by the Commission is subject to modification, the Commission should direct AEP-Ohio to recalculate carrying charges beginning in 2009 on deferred balances adjusted for ADIT. At a minimum, the Commission should direct AEP-Ohio to calculate carrying charges on deferred balances adjusted for ADIT during the recovery period. But that outcome would be an egregious result to ratepayers, because this issue has been before the Commission since the audit of AEP-Ohio's 2010 FAC.[35]

2. The Commission's Finding and Order is Unlawful and Unreasonable in that the Commission Authorizing AEP-Ohio to Increase Rates was Arbitrary and Capricious, and an Abuse of Discretion in Violation of Due Process;

The Commission arbitrarily and capriciously authorized AEP-Ohio to increase rates without affording Intervenors due process. IEU-Ohio has attempted to make its case that the Commission should direct AEP-Ohio to calculate carrying charges only on the deferred balances that AEP-Ohio financed, but the Commission has denied IEU-Ohio that opportunity. Particularly, the Commission has denied IEU-Ohio the opportunity to develop the above arguments through testimony and cross-examination of AEP-Ohio's witnesses. Without the ability to develop an appropriate record through testimony and exhibits and subject AEP-Ohio's positions to cross-examination, the fundamental due process rights are denied.

[35] Because the Commission has ongoing jurisdiction over the phase-in, and the 2010 FAC Case has not been resolved, if the Commission determines that it would be inappropriate to recalculate carrying charges prior to the time this issue has been raised, the Commission could still issue an order in the 2010 FAC Case directing AEP-Ohio to calculate carrying charges on the deferred balances adjusted for ADIT beginning in 2010.

Due process in a Commission proceeding requires that a party is: (1) given "ample notice;" (2) "permitted to present evidence through the calling of its own witnesses;" (3) permitted to "cross-examin[e] the other parties' witnesses;" (4) permitted to "introduce exhibits;" (5) permitted to "argue its position through the filing of post hearing briefs;" and, (6) permitted to "challenge the PUCO's findings through an application for rehearing."[36] Failure to develop an appropriate record as a basis for the Commission's decision is grounds for reversal.[37] Likewise, the Supreme Court of the United States has held that parties have the right to a fair hearing,[38] and that "[t]he right to such a hearing is one of 'the rudiments of fair play.'"[39] "[I]t has been distinctly recognized that administrative orders, quasi judicial in character, are void if a hearing was denied; if that [sic] granted was inadequate or manifestly unfair; if the finding was contrary to the 'indisputable character of the evidence.'"[40]

The Commission's actions failed to meet this standard. Despite the fact that every Intervenor's comments contested the manner in which carrying charges were calculated, the Commission failed to hold a hearing. In failing to hold a hearing, the Commission denied IEU-Ohio the opportunity to submit testimony, introduce exhibits, and subject AEP-Ohio's positions to cross-examination. Moreover, when IEU-Ohio

[36] *Vectren Energy Delivery of Ohio, Inc. v Pub Util. Comm.*, 113 Ohio St.3d 180, 192 (2007).

[37] *Tongren v. Pub. Util. Comm.*, 85 Ohio St. 3d 87, 92-93 (1999).

[38] *West Ohio Gas, Co. v. Pub. Util. Comm. of Ohio*, 294 U.S. 63, 70 (1935).

[39] *Ohio Bell Telephone Co. v. Pub. Util. Comm.*, 301 U.S. 292, 304 (1937).

[40] *Interstate Commerce Commission v. Louisville and Nashville Railroad Co.*, 227 U.S. 88, 91 (1913); *see also International Telepost v. Public Utilities Commission*, 119 Ohio St. 632, 642 (1929) (holding "[t]he suspension, modification, or vacation of an order previously made by the commission cannot be capricious or arbitrary. An administrative body must exercise its powers reasonably and lawfully. Thus administrative orders quasi judicial in character are void if a hearing was denied, or if granted on an inadequate or unfair hearing, or if the finding was contrary to the indisputable character of the evidence.")

attempted to develop a record on the issue of ADIT in the *ESP II* proceeding, the Commission struck IEU-Ohio's testimony,[41] claiming that IEU-Ohio would have the opportunity to argue its position in the PIRR Case. But that opportunity was denied. IEU-Ohio has been denied a meaningful opportunity in either this proceeding or the PIRR Case to demonstrate that carrying charges should be calculated on a deferral balance adjusted for ADIT: the combination of striking IEU-Ohio's testimony pertaining to ADIT, and denying IEU-Ohio the opportunity to present testimony in the PIRR Case and subject AEP-Ohio's position to cross-examination, violated due process.

3. The Commission's Failure to Reduce the Deferral Balance, that Customers will Pay, to Account for the Flow-through Effects of the Remand of the ESP I Order was Unlawful and Unreasonable

The calculation of the deferred balance was a residual calculation, which was impacted by the unlawful *ESP I* provider of last resort ("POLR") and 2001-2008 environmental investment carrying cost charges. In setting a rate in the PIRR, the Commission must recognize the flow-through effects of the remand of *ESP I*. The Commission failed to take this necessary action in the remand of AEP-Ohio's ESP. The Commission also rejected this argument in the Finding and Order setting the rate for the PIRR. The Commission's failure to recognize the flow-through effects of the remand is unlawful and unreasonable. IEU-Ohio has appealed the remand decision to the Supreme Court of Ohio and IEU-Ohio will not repeat its arguments here.[42] On rehearing, the Commission should recognize the flow-through effects of the remand and adjust the deferred balances.

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[41] *See* Attachment D.

[42] Notice of Appeal of IEU-Ohio, Case No. 2012-0187 (Feb 1. 2012).

IV. REQUESTED RELIEF

On rehearing, the Commission must withdraw its approval of the Application, as Intervenors have not been afforded due process. The Commission must set a procedural schedule, permit Intervenors to file testimony, permit discovery upon that testimony, and set the contested issues for hearing and briefing.

If IEU-Ohio had been given due process to make its case, IEU-Ohio would have demonstrated that carrying charges must be calculated on a deferral balance adjusted for ADIT. IEU-Ohio's testimony in *ESP II*, which the Attorney Examiner struck, would have demonstrated that carrying charges must be calculated in this manner. Moreover, sound regulatory practices and principles ingrained in Ohio precedent contradict the Commission's determination and further support IEU-Ohio's position.

The Commission recognized that it has ongoing jurisdiction to address the terms of the phase-in, and recognized that the calculation of carrying charges has been challenged, yet not resolved, since AEP-Ohio's 2010 FAC case. On rehearing, the Commission must direct AEP-Ohio to recalculate the carrying charges that AEP-Ohio has accrued on the deferred balances since 2009 to ensure that AEP-Ohio does not accrue carrying charges on cost free capital.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Application for Rehearing and Memorandum in Support of Industrial Energy Users-Ohio*, was served upon the following parties of record this 31th day of August, 2012, *via* electronic transmission, hand-delivery or first class U.S. mail, postage prepaid.

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ATTORNEY EXAMINER

A. Direct testimony of Daniel J Duann.

Q. Mr. Duann, do you have any additions or corrections or deletions to your testimony?

A. No.

Q. Was this testimony prepared by you or under your direct supervision and control?

A. Yes.

Q. If I were to pose the same questions that are posed in OCC Exhibit No. 111, would your answers be the same?

A. Yes.

MS. GRADY: Your Honors, at this time I move for the admission of OCC Exhibit No. 111, subject to cross-examination.

EXAMINER TAUBER: Before we begin cross-examination, there is an outgoing motion to strike Mr. Duann's testimony. And we are going to grant Ohio Power's motion to strike in part and deny in part.

Before we get into that, I would just like to explain overall, just so the record is clear, in the Commission's opinion and order -- actually, in the Commission entry from March 7, 2012, it was established that all of the cases from the stipulation proceeding would be separated out and that includes the deferred fuel cases in Case Nos. 11-4920 and 11-4921. And this was also further addressed in the April entry addressing Ohio Power Company's application for rehearing.

So, therefore, we will permit issues relating to the PIRR as proposed in this modified application which deals with the delay of the implementation of the PIRR.

Otherwise, any arguments will be addressed accordingly in the docket for 11-4920 and 11-4921.

So, with that, we will strike question 18, beginning on page 22; question 19 on page 23 --

MS. GRADY: Your Honor, could you slow down? I'm not quite there yet.

EXAMINER TAUBER: Okay. Question 18, beginning on line 22 of page 22; question 19 which carries over to page 24; question 20; and question 21.

MR. ALAMI: Your Honor, the company's motion to strike also included questions 22, 23, and 24.

EXAMINER TAUBER: And we're denying that part of the motion to strike.

MR. ALAMI: Okay.

MR. DARR: At this time I'd like to ask to have marked as IEU Exhibit 129 the prefiled testimony of Mr. Bowser.

EXAMINER SEE: The exhibit is so marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

Q. Do you have in front of you what's been marked as IEU Exhibit 129?

A. Yes, I do.

Q. Could you identify that for us, please?

A. Yes. It's my testimony filed on May 4th.

Q. Do you have any additions or corrections?

A. No, I don't.

Q. If asked today the questions that are contained in that prefiled testimony marked as IEU Exhibit 129, would your answers be the same?

A. Yes.

MR. DARR: With that, I submit the witness for cross-examination.

EXAMINER SEE: There was a motion to strike and a reply thereto. After considering that request and response the following portions of Mr. Bowser's testimony will be stricken: Page 11, lines 16 -- the sentence beginning on line 16 through line 19.

Question and answer 16 which starts on

page 18, carries over to page 21.

Question and answer 17 which starts on page 21 and carries through to page 25.

Question and answer 18 that starts on page 25 and carries through to page 27.

Question and answer 19, starts on page 27 and carries over to page 28.

Then lines 9 through 13 to the start of the sentence "What are your specific," that sentence stays.

Then the motion to strike is granted as to lines 16 through 20 on page 28.

Motion to strike is granted as to page 29, lines 4 through 22 on page 29, through line 15 on page 30.

Do I need to repeat any of that?

(No response.)

EXAMINER SEE: Any cross for this witness, Mr. Howard?

MR. HOWARD: No. Thank you, your Honor.

EXAMINER SEE: Mr. Barnowski?

MR. BARNOWSKI: No. Thank you, your Honor.

EXAMINER SEE: Mr. Siwo?

MR. SIWO: No questions, your Honor.

the implementation of the PIRR until June 2013. The other critically important issues regarding PIRR mechanics should move forward on their own merits in Case Nos. 11-4920-EL-RDR, 11-4921-EL-RDR. Items of note filed in Staff Comments on April 2, 2012 include the following:

1. Once Rider PIRR collection commences the carrying charges should be calculated on the most recently approved Commission debt rate (5.34%) and not the 11.26 % pre-tax weighted average costs of capital (WACC) as currently proposed by the Company.

2. The ending fuel deferral balance at the end of December 2011 should be reduced for Accumulated Deferred Income Taxes (ADIT) in the calculation of carrying costs for Rider PIRR.

3. The Company should be required to calculate the deferral balance "going forward" on annual compounding not monthly compounding.

13. Q. Doe this conclude your testimony?

A. Yes, it does. However, I reserve the right to submit supplemental testimony as described herein, as new information subsequently becomes available or in response to positions taken by other parties.

ATTACHMENT D

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

DIRECT TESTIMONY OF JOSEPH G. BOWSER ON BEHALF OF INDUSTRIAL ENERGY USERS-OHIO

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May 4, 2012

Attorneys for Industrial Energy Users-Ohio

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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DIRECT TESTIMONY OF JOSEPH G. BOWSER ON BEHALF OF INDUSTRIAL ENERGY USERS-OHIO

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DIRECT TESTIMONY OF JOSEPH G. BOWSER
ON BEHALF OF INDUSTRIAL ENERGY USERS-OHIO

I. INTRODUCTION

Q1. Please state your name and business address.

A1. My name is Joseph G. Bowser, 21 East State Street, 17th Floor, Columbus, Ohio 43215.

Q2. By whom are you employed and in what position?

A2. I am a Technical Specialist for McNees Wallace & Nurick LLC ("McNees"), providing testimony on behalf of the Industrial Energy Users-Ohio ("IEU-Ohio").

Q3. Please describe your educational background.

A3. In 1976, I graduated from Clarion State College with a Bachelor of Science degree in Accounting. In 1988, I graduated from Rensselaer Polytechnic Institute with a Master of Science degree in Finance.

Q4. Please describe your professional experience.

A4. I have been employed by McNees for over six years where I focus on assisting IEU-Ohio members address issues that affect the price and availability of utility services. As part of my responsibilities, I provide IEU-Ohio members assistance as they evaluate and act upon opportunities to secure value for their demand response and other capabilities in the base residual auction ("BRA") and incremental auctions conducted by PJM Interconnection LLC ("PJM") as part of the Reliability Pricing Model ("RPM"). Prior to joining McNees, I worked with the Office of the Ohio Consumers' Counsel ("OCC") as Director of Analytical Services. There I managed the analysis of financial, accounting, and ratemaking issues associated with utility regulatory filings. I also spent ten years at Northeast Utilities, where I held positions in the Regulatory Planning and Accounting Departments of the company, provided litigation support in regulatory hearings and assisted in the preparation of the financial/technical documents filed with state and federal regulatory commissions. I began my career with the Federal Energy Regulatory Commission ("FERC"), where I led and conducted audits of gas and electric utilities in the Eastern and Midwestern regions of the United States.

Q5. Have you previously submitted expert testimony before the Public Utilities Commission of Ohio ("Commission")?

A5. Yes, since 1996, I have submitted testimony as an expert on numerous regulatory accounting issues and how those issues should be resolved for purposes of establishing rates and charges of public utilities. A listing of cases in which I have submitted expert testimony is attached as Exhibit JGB-1.

Q6. What is the purpose of your testimony in this proceeding?

A6. The purpose of my testimony is to address the Phase-In Recovery Rider ("Rider PIRR"). As part of the March 30, 2012 proposed modified electric security plan ("Modified ESP"), Ohio Power Company (referred to herein as "AEP-Ohio"), an electric distribution utility or "EDU", has requested approval of Rider PIRR effective June 1, 2013.

I should note that although the separate operating companies, Columbus Southern Power Company ("CSP") and Ohio Power Company ("OP") (collectively referred to as "AEP-Ohio") merged as of December 31, 2011, I will occasionally refer to the separate OP and CSP operating companies for purposes of my testimony and recommendations. Maintaining this historical separation between CSP and OP for purposes of discussing the Rider PIRR is necessary, as I explain in my testimony, because the proposed Rider PIRR would generally create an improper mismatch between benefits and costs and more specifically conflict with rights that I understand are available to governmental aggregation programs in CSP's EDU service area to avoid Rider PIRR. As proposed in the Modified ESP, Rider PIRR would establish a charge payable by all AEP-Ohio distribution customers to amortize the allowable portion of the ESP I[1] rate increase that was phased-in through regulatory accounting and the Commission's use of the phase-in authority that I understand the Commission received as part of Amended Substitute Senate Bill 221 ("SB 221").

[1] *In the Matter of the Application of Columbus Southern Power Company for Approval of its Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case Nos. 08-917-EL-SSO, *et al.*, Application (July 31, 2008) (hereinafter referred to as "*AEP ESP I Proceedings*").

Q7. What did you review for purposes of preparing your testimony?

A7. I reviewed the testimonies and related schedules and workpapers filed in these proceedings addressing Rider PIRR, responses to discovery, and Commission entries in these proceedings and related proceedings such as Case Nos. 11-4920-EL-RDR, *et al.*, the ESP I proceedings, and the fuel adjustment clause ("FAC") proceedings involving AEP-Ohio.

My opinions and recommendations also reflect the knowledge I have accumulated throughout my career.

Q8. Please summarize your recommendations.

A8. My recommendations, which I support in my testimony below, are as follows:

(1) The Commission should require AEP-Ohio to undertake a competitive solicitation to identify the best and lowest cost means of financing the amortization of any phase-in deferral balance eligible for recovery from consumers.

(2) A debt-based carrying charge rate should be applied to the Rider PIRR unamortized balances during the amortization period as well as from January 1, 2012 up until the amortization period commences.

(3) In calculating carrying charges, the debt-based carrying charge rate should be applied to deferred balances that have been reduced by accumulated deferred income taxes ("ADIT"). Before approving implementation of Rider PIRR, the Commission should assure that all adjustments that should be made to the deferred balances have been

reflected, such as the adjustments from the FAC cases, the over-collection of provider of last resort ("POLR") revenue and the illegal revenue collected as a result of the Commission's authorization to recover 12 months over nine months as discussed, and the ESP I remand. In addition, as recommended in IEU-Ohio witness Hess' testimony, excessive amounts that AEP-Ohio has collected as a result of increases in capacity charges should be used to reduce such deferred balances.

(4) In my opinion, separate company Rider PIRR rates should be determined as CSP customers should be responsible for the CSP deferrals and OP customers should be responsible for the OP deferrals.

(5) If merged Rider PIRR rates are approved by the Commission in these proceedings, then Rider PIRR should not be applied to CSP customers in governmental aggregation programs.

(6) With respect to my recommendations (4) and (5) above, another option that I recommend the Commission consider is to account for any remaining deferral for CSP through a quarterly FAC filing so that this relatively small deferral could be eliminated, avoiding the accumulation of continued carrying charges over a multi-year period. If this option is utilized, there would be no deferral to be collected for CSP through Rider PIRR.

(7) Related to recommendation (3) above, the Commission should specify that Rider PIRR, if approved, be collected subject to reconciliation until such time as all outstanding Commission cases and appeals that may

impact the phase-in deferral balance and carrying costs included in such balance are resolved.

(8) I also recommend that AEP-Ohio be required to make annual informational filings regarding the collection balance of the Rider PIRR with separate CSP and OP division detail to assure that all necessary adjustments have been or will be reflected in the Rider PIRR calculations and to allow tracking of the unamortized balances.

II. PHASE-IN RECOVERY RIDER ("RIDER PIRR")

Q9. Before addressing AEP-Ohio's proposed Rider PIRR in these proceedings, did the Commission previously rule that Rider PIRR would be addressed in a separate case?

A9. Yes, in Case Nos. 11-4920-EL-RDR, *et al.* On September 1, 2011, AEP-Ohio filed an application in that case to establish a different Rider PIRR to recover the allowable portion of the deferred rate increase authorized in AEP-Ohio's ESP I proceedings that was properly deferred pursuant to the phase-in ordered by the Commission in the ESP I proceedings. In light of the Commission's rejection of the AEP-Ohio ESP II[2] Stipulation and Recommendation filed with the Commission on September 7, 2011 ("ESP II Stipulation") and which recommended approval of a different Rider PIRR recovery, there was an entry

[2] *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 Nos. 11-346-EL-SSO, *et al.* (hereinafter referred to as "*AEP ESP II Proceedings*").

issued which resumed consideration of the Rider PIRR proposed in Case Nos. 11-4920-EL-RDR, *et al.*

The application in Case Nos. 11-4920-EL-RDR, *et al.* proposed a Rider PIRR that allows carrying costs to continue at a level based on a weighted average cost of capital ("WACC") computation during the phase-in deferral amortization period. The proposed WACC carrying cost rate in Case Nos. 11-4920-EL-RDR, *et al.* is 11.15% thereby imposing on consumers a total estimated amortization period carrying cost of $279.4 million based on the AEP-Ohio recorded deferral balance of $628.1 million as of December 31, 2011. The Rider PIRR proposed in Case Nos. 11-4920-EL-RDR, *et al.* would collect the deferred balance from OP customers only since the remaining phase-in deferral balance proposed to be amortized is tied to the ESP I rate increase that was deferred for OP. Comments and reply comments have been filed by parties participating in Case Nos. 11-4920-EL-RDR, *et al.* and the Commission issued an Entry on Rehearing in Case Nos. 11-4920-EL-RDR, *et al.* on April 11, 2012. The Entry on Rehearing in Case Nos. 11-4920-EL-RDR, *et al.* states, among other things, that some of the issues raised through the rehearing process in Case Nos. 11-4920-EL-RDR, *et al.* will be addressed in the Deferred Fuel Cost Cases, i.e. Case Nos. 11-4920-EL-RDR, *et al.* I have attached IEU-Ohio's comments and reply comments in Case Nos. 11-4920-EL-RDR *et al.* to my testimony as well as the comments filed by the Commission's Staff as Exhibit JGB-2, Exhibit JGB-3 and Exhibit JGB-4, respectively.

Q10. So, there is a proposed Rider PIRR before the Commission, in Case Nos. 11-4920-EL-RDR *et al.* and a proposed Rider PIRR in these proceedings and the two proposals presently before the Commission are different. Is that correct?

A10. Yes, there are different Rider PIRR proposals before the Commission as things presently stand. The Modified ESP proposal filed in these proceedings was filed on March 30, 2012, while the application in Case Nos. 11-4920-EL-RDR *et al.* was filed on September 1, 2011. The Rider PIRR proposal contained in the Modified ESP calls for a delay in commencement of Rider PIRR recovery until June 2013 and comes with an AEP-Ohio suggestion that the procedural schedule in Case Nos. 11-4920-EL-RDR, *et al.* be suspended. As of the date my testimony was finalized for filing with the Commission, consideration of the Rider PIRR proposed in Case Nos. 11-4920-EL-RDR *et al.* continues and the Commission has not altered such consideration in light of AEP-Ohio's suggestion (in these proceedings) that consideration of the Rider PIRR proposed in Case Nos. 11-4920-EL-RDR *et al.* be suspended. To the extent the Commission takes up the version of the Rider PIRR included in the Modified ESP, I believe, based on advice of counsel, that the Modified ESP Rider PIRR must be considered a cost of the Modified ESP due to the proposed excessive and unreasonable carrying cost rate and the mismatch between costs and benefits that occurs because the Modified ESP Rider PIRR is to be collected from all AEP-Ohio distribution customers, including customers served by aggregation programs in the distribution service area of CSP. I have calculated this additional burden to be, at a minimum, approximately $186.4 million, which represents the difference between the present value of the future carrying charges through the amortization of Rider PIRR at a WACC carrying charge rate and the present value of the future carrying charges through the amortization of Rider PIRR at the debt-based carrying charge rate recommended by Staff, applied to a deferral balance net of ADIT. Mr. Murray, also testifying on behalf of IEU-Ohio, reflects the extra burden imposed on consumers by the Modified ESP version of Rider PIRR in his comparison of the ESP versus the market rate offer ("MRO") option.

Q11. Turning to the Modified ESP application filed on March 30, 2012, what has AEP-Ohio proposed with respect to Rider PIRR?

A11. In Companies witness Roush's testimony, AEP-Ohio is proposing to implement Rider PIRR for the combined distribution service areas of CSP and OP, effective June 1, 2013, and terminating December 31, 2018 (67-month period). Mr. Roush indicates that after approval of the Modified ESP and prior to June 2013, AEP-Ohio would submit a compliance filing computing the actual Rider PIRR charges based on the latest known and projected regulatory asset balances. Mr. Roush's testimony implies that these charges would then go into effect with little or no opportunity for parties to challenge the amounts or computations. Mr. Roush's Exhibit DMR-1 provides an estimate of Rider PIRR charges as of May 31, 2013. Exhibit DMR-1 indicates that the carrying charge to be applied to the deferred balance during the amortization period will be the WACC, estimated to be 11.26%. Exhibit DMR-1 indicates that the estimated deferred balances as of May 31, 2013 will be $7.8 million for the CSP Rate Zone and $612.9 million for the OP Rate Zone, for a total estimated deferred balance of $620.7 million. Using the AEP-Ohio WACC carrying charge rate of 11.26% would cause consumers to pay $218.2 million in carrying costs on top of the deferred balance of $620.7 million, assuming this is the deferred balance subject to amortization.

As discussed below, it was originally predicted that only OP would have a deferred balance by the time amortization of Rider PIRR commenced, but more contemporary figures from the Companies indicate that CSP will also have a balance, albeit a relatively small one compared to OP. As the Commission knows, there are open cases before the Commission including FAC proceedings involving OP and CSP and significantly excessive earnings test ("SEET") proceedings as well as appeals taken to the Ohio Supreme Court, the outcome of which may affect the amount of the phase-in deferred balance, including carrying costs, eligible for recovery from consumers. Also, Mr. Hess, who is testifying on behalf of IEU-Ohio, recommends that excessive amounts AEP-Ohio has collected as a result of increases in capacity charges be used to reduce such deferred balances.

Companies witness Dias also testifies on Rider PIRR for the Companies, stating that the Companies are also proposing to accrue a WACC carrying charge on the deferred balance up until the time that the Rider RIRR becomes effective on June 1, 2013. It is not clear from AEP-Ohio's testimony whether AEP-Ohio is proposing that Rider PIRR become effective on a bills-rendered or service-rendered basis.

Companies witness Hawkins testifies that AEP-Ohio plans to securitize the Rider PIRR balances once a final non-appealable order relating to the approval of the recovery of the underlying assets (the deferred balance) has been issued. In prior testimony on this subject, I have previously explained that AEP-Ohio and its affiliates have used securitization to reduce the carrying cost rate before securitization legislation was adopted in Ohio. For example, AEP-Ohio has improved its cash flow by securitizing receivables at a very low interest rate (about 0.31%).[3] AEP-Ohio does not explain why the securitization which it has used previously is not available to improve AEP-Ohio's cash flow and reduce the carrying cost that may be paid by consumers. I believe it is imprudent for AEP-Ohio, acting in its capacity as an EDU, to not explore and take advantage of opportunities to improve its cash flow while reducing the carrying cost burden that may land on consumers.

Q12. In addition to your views on AEP-Ohio's responsibilities to take advantage of opportunities to reduce the carrying cost associated with the deferred phase-in balance eligible for recovery from consumers, is the Modified ESP version of Rider PIRR otherwise reasonable?

A12. No, in my opinion, certain components of the calculation and application of Rider PIRR are not reasonable. In addition, before the Commission should approve Rider PIRR rates, there are several adjustments that need to be made to the phase-in deferral balance before any version of Rider PIRR is permitted to go into effect.

[3] OP's 2010 Securities and Exchange Form 10-K at 126-27, available at: http://services.corporate-ir.net/SEC/Document.Service?id=P3VybD1odHRwOi8vaXluaW50Lndlc3RsYXdidXNpbmVzcy5jb20vZG9jdW1lbnQvdjEvMDAwMDAwNDkwNC0xMS0wMDAwMzUvZG9jLzAwMDAwMDQ5MDQxMTAwMDAzNS5wZGYmdHlwZT0yJmZuPTAwMDAwMDQ5MDQxMTAwMDAzNS5wZGY=.

Q13. What components of Rider PIRR do you believe are not reasonable?

A13. There are a number of aspects of the Modified ESP version of Rider PIRR that I believe are not reasonable. First, the carrying charge rate applicable during the amortization period should be limited to no more than a debt-based carrying cost rate. The WACC carrying cost rate proposed by AEP-Ohio is significantly excessive and unreasonable. At present, seven-year BBB rated, newly issued corporate bonds are being issued at an interest rate of under 3.6%. Based on these prevailing interest rates, a relatively low debt-based carrying charge should be applied during the amortization period for any phase-in deferral eligible for recovery from consumers. The absolute maximum carrying charge rate that should be utilized would be a rate of 5.34%, as recommended in the comments of the Commission Staff in Case Nos. 11-4920-EL-RDR, *et al.* In that case, Staff recommended that once Rider PIRR collection commences, the carrying charges should not exceed a rate of 5.34% (the most recently approved Commission debt rate for the Companies). I would note that a carrying cost rate of 5.34% is still excessive because this carrying cost rate imposes a price on consumers for carrying the phase–in deferral balance eligible for recovery from consumers during the amortization period that is significantly above a reasonable cost of debt. The cost of debt capital, not the WACC, is the appropriate starting point for setting a carrying cost rate because the phase-in deferral is effectively a loan that AEP-Ohio made to consumers to phase-in any remaining portion of the lawful rate increase associated with the ESPs approved by the Commission in Case Nos. 08-917-EL-SSO and 08-918-EL-SSO. As indicated above, the current interest rate on seven-year BBB rated, newly issued corporate bonds are being issued at an interest rate of under 3.6%. AEP-Ohio currently has a BBB bond rating from Standard and Poor's. A debt interest rate of 3.6% or lower should be readily available to AEP-Ohio.

As part of the process for setting the carrying cost rate during the amortization period, I recommend that the Commission require AEP-Ohio to undertake a competitive solicitation to identify the best and lowest cost means of financing the amortization of any phase-in deferral balance eligible for recovery from consumers. This competitive solicitation process should be structured by the Commission with the transparent assistance of an independent consultant with appropriate expertise in this area. The results of the competitive solicitation process should be reported to the Commission by the independent expert and publically submitted to the Commission prior to AEP-Ohio filing to secure any approval to begin amortization of the phase-in deferral balance. This competitive solicitation process should be structured to provide the Commission with information to strike the right balance between the interests of AEP-Ohio's one shareholder and consumers. Once these results are reported, interested parties should have an opportunity to be heard on the question of the appropriate carrying cost rate to be used during the amortization period. Using a competitive solicitation process in the fashion that I recommend is consistent with Ohio's state policy that favors use of market-based approaches to advance the public interest in reasonable prices and adequate service. I also believe the use of this type of competitive solicitation process will help reduce the opportunity for an EDU to seek and obtain unfair and excessive compensation for financing a phase-in deferral.

I also believe that AEP-Ohio's proposal to continue applying a WACC-based carrying charge to the phase-in deferral balances up until the amortization is proposed to start (June 1, 2013) is unreasonable. The nature of the "investment," i.e. the phase-in deferral to which carrying charges are applied, is not similar to deferred capital investments, but rather the phase-in deferral represents a deferred increase in rates. The phase-in mechanism essentially allows consumers more time to pay their lawful electric bill so as to include the allowable amount of the electric bill that would have been collected but for the phase-in. Therefore a full WACC carrying charge is not appropriate and, if approved, will excessively compensate AEP-Ohio relative to a reasonable carrying cost.

If any incremental carrying cost is added during a delay in the commencement of the amortization to the excessive WACC carrying charge that has already been accumulated during the deferral period, that incremental carrying cost should not exceed the carrying cost computed using a debt-based rate for reasons explained above.

As with the carrying cost rate applied during the amortization period, I recommend that any carrying cost rate applied to the phase-in deferral balance starting on January 1, 2012 should be established by the Commission after my recommended competitive solicitation process designed to identify the best and lowest cost means of financing the deferral balance eligible for recovery from consumers. Through this competitive solicitation process, the Commission can consider actual financing cost options (rather than arbitrary or irrelevant carrying cost rates) and strike the proper balance between AEP-Ohio's shareholder and consumers. The phase-in deferral in this situation is related to default generation supply service and my recommended competitive solicitation also is consistent with the market-based approach to establishing prices for default generation supply prices. Had the Commission not authorized the phase-in, the full amount of the ESP I default generation supply price increase would have been avoidable by shopping customers. When this delayed increase is transformed into a phase-in recovery mechanism, it becomes, based on advice of counsel, non-bypassable. Thus, imposing some market-based discipline on the carrying cost associated with the phase-in is required to minimize the distortion caused by the use of a phase-in mechanism.

AEP-Ohio is effectively the middleman in the phase-in financing process and it should be held accountable to ensure that the carrying cost rate is as low as reasonably possible. The use of a competitive solicitation process for the purposes I recommend will help to ensure that a phase-in does not work against Ohio's broader market-based approach to establishing prices for default generation supply.

In my opinion, it is also not proper, nor consistent with good regulatory practices and principles, to calculate carrying charges on deferred balances that have not been reduced by any associated ADIT. AEP-Ohio's Rider PIRR is unreasonable because it fails to properly reduce the phase-in deferral balances to recognize the ADIT benefit AEP-Ohio received during the deferral period. The phase-in deferral associated with Rider PIRR creates a timing difference between the tax deduction for fuel expense and the book accounting treatment. This difference is reflected in the regulatory accounting that permits a phase-in deferral to be recorded on AEP-Ohio's financial books and records. The ADIT associated with that timing difference reduces AEP-Ohio's federal income tax liability before AEP-Ohio recognizes the fuel expense and collects it from customers. The ADIT associated with the timing difference must be used to reduce the deferred balance to which any carrying cost rate is applied to properly match costs and benefits associated with the phase-in. In short, the ADIT represents tax savings that have already been realized by the Companies. As a result of these tax savings, AEP-Ohio or CSP and OP are not financing 100% of the deferral, but only the phase-in deferral amount net of the ADIT effect. As indicated by the comments filed by the Commission's Staff attached to my testimony (Exhibit JGB-4), the Staff took a similar position in Case Nos. 11-4920-EL-RDR, *et al.* The Staff's comments recommended that the deferred balance as of December 31, 2011 be reduced by the ADIT effect and I agree that it is necessary to reduce the deferred balance by the ADIT offset.

Of note, in its West Virginia jurisdiction for Appalachian Power Company and Wheeling Power Company, AEP submitted rebuttal testimony of Companies witness Mitchell in Case No. 09-0177-E-GI.[4] In that proceeding, Mr. Mitchell indicated that an ADIT offset for calculating carrying charges would be appropriate to be applied to a phase-in plan deferral balance.

[4] *Appalachian Power Company and Wheeling Power Company,* West Virginia Public Service Commission, Case No. 09-0177-E-GI, Rebuttal Testimony of Thomas Mitchell at 7 (June 5, 2009), *available at*: http://www.psc.state.wv.us/scripts/WebDocket/ViewDocument.cfm?CaseActivityID=269707&NotType='WebDocket'.

AEP-Ohio is also proposing to implement Rider PIRR on a merged basis, meaning that identical Rider PIRR charges would apply to both CSP and OP customers, although AEP-Ohio estimates that there will be separate and different phase-in deferral balances for CSP and OP when the amortization of the deferrals begin. In my opinion, good regulatory policy and the principle of cost causation dictate that CSP customers should be responsible for the CSP deferrals and OP customers should be responsible for the OP deferrals. Since the Rider PIRR proposed in the Modified ESP does not maintain this distinction, it is my opinion that the Modified ESP version of Rider PIRR is unreasonable. The separation of the phase-in deferral balance between CSP and OP and any charges that permit amortization of any such balance is also necessary, as I understand the rights of governmental aggregation customers, to identify the portion of any phase-in deferral amortization charge that can be avoided by governmental aggregation customers to the extent that the amortization charge is disproportionate to the phase-in deferral benefit received by the aggregation customer.

Q14. What is your understanding of the right of governmental aggregation customers to avoid a phase-in deferral amortization charge?

A14. It is my understanding that, based on the advice of counsel, Section 4928.20(I), Revised Code, precludes the application of Rider PIRR to a governmental aggregation program customer where the charge is not proportionate to the benefits received by the customer.

Q15. Please continue to discuss the version of Rider PIRR included in the proposed Modified ESP.

A15. AEP-Ohio is proposing that the amortization period for Rider PIRR commence June 1, 2013 and terminate December 31, 2018, a period of 67 months. I believe it would be unreasonable to set the duration of the amortization period without having final information on the amount of the deferral balance that is eligible for recovery from consumers and the results of my recommended competitive solicitation process to establish a reasonable carrying cost during the phase-in deferral amortization period. The Commission should defer ruling on the length of the amortization period pending final determinations on the amount of the deferral balance subject to recovery from consumers and a reasonable carrying cost rate during any amortization period. The length of the amortization period should be established so as to reduce the total net present value of the amortization, preserve the ability of governmental aggregation customers to exercise their phase-in avoidance right, and mitigate any effect that the non-bypassable phase-in deferral mechanism may have on Ohio's efforts to promote customer choice.

Q16. You indicated earlier that there are adjustments that need to be made to the deferral balance for Rider PIRR. What are those adjustments?

A16. There are a number of adjustments that need to be made to the deferred balances, which AEP-Ohio has not reflected in the version of Rider PIRR included in the proposed Modified ESP, such as: (1) adjustments from the FAC cases, (2) adjustments from the SEET cases, and (3) the ESP I remand impacts such as illegal POLR charges.

I will discuss each of these adjustments in some detail below because this discussion may be helpful in illustrating why the Commission should reject the version of Rider PIRR included in the proposed Modified ESP.

The first adjustment required is related to the 2009 SEET case for CSP; Case No. 10-1261-EL-UNC. On January 11, 2011, the Commission issued its Opinion and Order, in which it found that CSP had excessive earnings in 2009 and such excess should first be applied to reduce the phase-in deferral fuel cost component (Rider PIRR deferrals) and any remaining balance was to be applied as credits to customers' bills. It is my understanding that the amount to be credited to the deferral was approximately $19 million. In the OP 2011 FERC Form 1 footnotes at page 123.20, OP discusses the $43 million refund from the 2009 SEET proceeding, noting that the proceeds were first to be applied to the phase-in deferral balance, with any remaining balance credited to customers. The disclosure in the FERC Form 1 indicates that AEP-Ohio has already made a reduction to the deferral related to the 2009 SEET for some reporting purposes.

The second adjustment is related to the 2009 FAC audit of OP and CSP in Case Nos. 09-872-EL-FAC, *et al.* Following an audit of OP's and CSP's FAC for 2009, the Commission issued an Opinion and Order on January 23, 2012, directing OP and CSP to credit against the phase-in deferral balance the benefits received from a settlement agreement with a coal supplier.

More specifically, the Commission directed OP to credit the deferred balance for the portion of a 2008 lump sum payment not already credited to OP ratepayers, as well as the value of the West Virginia coal reserve that OP booked below-the-line when the settlement agreement was executed. OP's below-the-line accounting treatment of the value it received for terminating the lower-priced coal contract resulted in an overstatement of the FAC which imposed the higher cost of replacement coal on consumers. The Commission further directed that an auditor determine the value of the coal reserve and that OP credit the additional value to the phase-in deferral balance.

It is my opinion that this credit must be applied to maximize the reduction in the carrying cost that OP has booked as part of the phase-in deferral balance to fairly and reasonably reflect the full effect of OP's overstatement of costs subject to recovery through the FAC. The Commission's January 23, 2012 Opinion and Order in Case Nos. 09-872-EL-FAC, *et al.* directed the immediate reduction of the phase-in deferral balance, but it did not address the treatment of the excessive carrying charges that have been accumulated in the phase-in deferral balance as a result of the overstatement of the FAC charges. While sound regulatory policy and applicable accounting principles dictate that the excessive portion of the associated carrying charges must also be removed from the phase-in deferral balance, IEU-Ohio requested that the Commission clarify this aspect of the Opinion and Order in IEU-Ohio's Application for Rehearing filed on February 22, 2012. OP also filed an Application for Rehearing on February 22, 2012. The Commission issued an Entry on Rehearing on April 11, 2012.

In the Entry on Rehearing, the Commission found that the phase-in deferral balance should be immediately credited to reflect the 2008 lump sum payment not already credited to OP ratepayers and the value of the coal reserve booked when the coal contract termination settlement agreement was executed. In addition, the Commission found that the phase-in deferral balance should be reduced to flow through to customers a carrying charge component. The phase-in deferral balance that is the starting point for the version of Rider PIRR included in the proposed Modified ESP does not reflect fully these adjustments which, once properly made, should significantly reduce the amount of the phase-in deferral eligible for recovery from customers through a non-bypassable charge.

Q17. What is the third adjustment, which you said is related to the ESP I remand?

A17. This adjustment is related to the Ohio Supreme Court remand of the Commission's final order in Case Nos. 09-817-EL-SSO and 09-818-EL-SSO (otherwise referred to in my testimony as "ESP I"). On March 18, 2009, the Commission issued an Opinion and Order approving the ESPs for CSP and OP. To mitigate somewhat the impact of the rate increases authorized by the Commission in the ESP I ESPs, the Commission authorized OP and CSP to defer a portion of the authorized increase that exceeded certain specified bill increase limitations. The Commission authorized OP and CSP to accrue carrying charges on the phase-in deferral balance eligible for collection from consumers following the end of the ESP I ESPs using a WACC rate (approximately 11%) and to recover the allowable amount of phase-in deferrals remaining at the end of the ESPs through a phase-in mechanism over the seven-year period 2012–2018. The Commission's final order in ESP I also allowed OP and CSP to charge POLR riders. The Commission allowed OP and CSP to recover 12 months of the authorized increase in revenue for all of 2009 over a nine-month period in 2009 that remained by the time the Commission issued its final order in the ESP I proceedings. In addition, the ESP I rate increases, including carrying charges on environmental-related investments made by OP and CSP between 2001 and 2008, were approved.

Parties appealed certain aspects of the Commission's March 18, 2009 Opinion and Order as adjusted through the rehearing process to the Ohio Supreme Court, and on April 19, 2011, the Ohio Supreme Court reversed the Commission's approval of POLR riders, held that the Commission's allowance of 12 months of the ESP I rate increases to be collected in the months remaining after the Commission's decision was illegal retroactive ratemaking amounting to approximately $63 million dollars and held that the Commission had improperly authorized CSP and OP to collect higher standard service offer ("SSO") rates as a result of charges related to carrying charges on environmental-related investments made by OP and CSP between 2001 and 2008 and POLR charges. The Court did not require the Commission to reduce the ESP I rates by the amounts that the Court held were not properly authorized by the Commission.

On May 4, 2011 and as a result of the Ohio Supreme Court's holdings, the Commission issued an entry that, among other things, directed OP and CSP to file proposed tariffs to remove the unlawful POLR charges and the carrying costs associated with environmental investments made in 2001-2008 from their tariffs and rates. OP and CSP sought rehearing of this entry and the Commission subsequently permitted OP and CSP to continue to collect the illegal charges pending the results of the remand portion of the ESP I cases and subject to refund.

On October 3, 2011, the Commission issued an Order on Remand finding that OP and CSP failed to prove their POLR charges were lawful, but had demonstrated that their carrying costs on pre-2009 environmental investments were lawful. The Commission directed OP and CSP to refund (with interest at the cost of long-term debt) the amount of POLR charges collected since the first billing cycle in June 2011 by crediting amounts first to any phase-in deferral balances on the books of either operating company (CSP and OP), and crediting any remaining balance back to customers on a per-kWh basis beginning with the first billing cycle of November 2011 through the end of the current ESPs.

The Commission further rejected arguments that it should prospectively reduce phase-in deferral balances by the amounts OP and CSP collected through POLR rates up until the PUCO's May 25 Entry (when the PUCO established that the POLR charge rates were subject to refund). In effect, the Commission's refusal to reduce the phase-in deferral balances by the amount of the illegally collected POLR charges or any other illegally collected charges results in an overstatement of the phase-in deferral balance because, but for the illegal charges, the phase-in deferral balance would have been significantly less than the amount booked by OP and CSP.

Because the POLR charges improperly inflated the accumulated amount of the phase-in deferral balance, IEU-Ohio recommended that the Commission eliminate the portion of the ESP I increase associated with the illegal POLR charges effective on January 1, 2009 from the phase-in deferral balance so as to remove the effect of the POLR charges on the residually-determined phase-in deferral balance, which would have substantially reduced that balance. More specifically, it was not sufficient to fully remove the POLR revenue from CSP's and OP's future rates and charges because the ESP I ESPs included a phase-in deferral computed based on the revenue collection including the POLR revenues and, therefore, the deferrals should be adjusted downward for amounts illegally collected for POLR charges back to January 2009. In addition, because the elimination of POLR revenues would affect the amount eligible for future collection as a result of the phase-in deferral, IEU-Ohio also recommended that certain other flow-through effects for the Universal Service Fund ("USF") Rider and the delta revenue related to reasonable arrangements must also be recognized.

IEU-Ohio also filed an Application for Rehearing arguing that the Commission erred in determining that the pre-2009 environmental investment carrying costs could be authorized under Section 4928.143(B)(2)(d), Revised Code, and that the Commission also erred in determining that it was retroactive ratemaking to prospectively reduce OP's and CSP's phase-in deferral balances. The PUCO denied both Applications for Rehearing in their entirety.[5]

On February 1, 2012, IEU-Ohio appealed the Commission's Order on Remand to the Ohio Supreme Court. As of the writing of this testimony, that appeal is still outstanding.

[5] *AEP ESP I Proceedings*, Entry on Rehearing (December 14, 2011).

I am not attempting to rehash or revisit the Commission's determinations to this point. Rather, I am relaying this documented history to identify open matters that, once resolved, will affect, and I believe significantly affect, the amount of any phase-in deferral balance recoverable from OP or CSP customers as a result of the ESP I ESPs.

Q18. To your knowledge, have any of the foregoing adjustments that you recommend actually been made to the phase-in deferral balances for OP and CSP?

A18. I am not aware of the extent, if any, of the adjustments to the phase-in deferral balance that have been directed by the Commission or that may yet be directed upon the final outcomes of open issues. However, the footnotes to AEP-Ohio's financial statements in the 2011 FERC Form 1 are informative. At page 123.20 of the footnotes, AEP-Ohio indicates that it took a pre-tax write-off of approximately $47 million for POLR revenue that was collected between June 2011 and October 2011, per the Commission's October 3, 2011 Order in the ESP I remand proceeding. This $47 million is not disaggregated to show the amount associated with CSP's POLR and OP's POLR. However, as I explained above, this $47 million tax-related adjustment for POLR revenue represents only a portion of the POLR revenue that I believe should be credited to the phase-in deferral balances of OP and CSP.

As I discussed earlier in my testimony, the AEP-Ohio 2011 FERC Form I footnotes also discuss the $43 million refund from the 2009 SEET proceeding, indicating that the proceeds were first to be applied to the deferral, with the remaining significantly excessive earnings credited to customers. Presumably, this disclosure indicates that CSP and OP made the appropriate reduction to the deferral related to the 2009 SEET. But, I recommend that this adjustment be audited by an independent auditor retained by the Commission to ensure that the adjustment has been made properly and in the full amount prior to authorizing AEP-Ohio to commence collection of any version of a Rider PIRR.

At page 123.22 of OP's 2011 FERC Form 1, AEP-Ohio reports that with respect to the 2009 FAC audit discussed above, AEP-Ohio has applied the remaining $65 million in proceeds from the 2008 coal contract settlement against the phase-in deferral balance, pending the Commission's decision on OP's February 2012 Application for Rehearing. This item is further supported by the response to Interrogatory OCC-01-07 in Case No. 11-4920-EL-RDR, *et al.* This response indicates a loss provision of $64.7 million has been recognized in computing the phase-in deferral balance as of March 31, 2012. But, I recommend that this adjustment be audited by an independent auditor retained by the Commission to ensure that the adjustment has been made properly and in the full amount prior to authorizing AEP-Ohio to commence collection of any version of a Rider PIRR.

In short, it appears that AEP-Ohio's financial reporting may reflect some of the required adjustments to the phase-in deferral balances of OP and CSP. It is unclear how these adjustments have been flowed into the regulatory accounting associated with the phase-in deferral balance that is reflected for ratemaking purposes. It would be improper to assume that the financial reporting fully identifies the regulatory accounting effects. For example, the accounting for financial purposes and regulatory purposes may be different because the return on equity ("ROE") component included in the WACC carrying cost rate is not booked to the deferral for financial reporting purposes but is booked for regulatory accounting purposes as part of the phase-in deferral balance. For these and other reasons, I have recommended that the regulatory and financial accounting of CSP and OP as well as AEP-Ohio be audited by an independent auditor retained by the Commission to ensure that the accounting is proper in all respects for regulatory and ratemaking purposes prior to the Commission authorizing AEP-Ohio to commence collection of any version of a Rider PIRR.

Q19. Are there potentially future adjustments that will be required to be made to the deferral amounts as a result of cases that are currently open?

A19. Yes. The 2010 and 2011 FAC audit cases for OP and CSP are still open. For instance, in the 2010 FAC audit case and as of the date I finalized my testimony, the Commission has not issued an order regarding the audit of OP's and CSP's 2010 FAC or 2011 FAC. A decision in either FAC proceeding may impact the level of the phase-in deferral balance and, thus, the amount eligible for collection from consumers through any version of Rider PIRR. The independent auditor in the 2010 FAC proceeding concluded that it appeared to be improper to permit OP and CSP to accrue carrying charges on the portion of the phase-in deferral balance that was financed by ADIT, because the Commission would be permitting OP and CSP to accrue carrying charges on cost free capital. (As indicated in my testimony, I also believe an adjustment to the phase-in deferral balance is necessary to reflect the benefit that OP and CSP received from the ADIT effect.) In AEP-Ohio's 2011 FERC Form 1 at page 123.22, AEP-Ohio disclosed that, pending a final decision from the Commission, AEP-Ohio is at risk for a carrying charge disallowance related to the 2010 FAC audit.

In addition, a decision has not been issued in the currently open 2010 SEET proceeding for CSP and OP, and there will be a CSP and OP SEET review for 2011. The potential exposure on the 2010 SEET case is noted by AEP-Ohio at page 123.20 of the 2011 FERC Form 1. There, AEP-Ohio discloses that it has established a reserve based on management's estimate of the probable amount for a Commission-ordered SEET refund.

III. RECOMMENDATIONS

Q20. You have discussed the aspects of the Rider PIRR proposal that you do not believe are reasonable, as well as adjustments that are required or may be required in the future to the phase-in deferral balance that is eligible for collection through any version of Rider PIRR. What are your specific recommendations on the version of Rider PIRR that is included in the proposed Modified ESP?

A20. My recommendations are summarized below.

(1) The Commission should require AEP-Ohio to undertake a competitive solicitation to identify the best and lowest cost means of financing the amortization of any phase-in deferral balance eligible for recovery from consumers.

(2) A debt-based carrying charge rate should be applied to the Rider PIRR unamortized balances during the amortization period as well as from January 1, 2012 up until the amortization period commences.

(3) In calculating carrying charges, the debt-based carrying charge rate should be applied to deferred balances that have been reduced by ADIT. Before approving implementation of Rider PIRR, the Commission should assure that all adjustments that should be made to the deferred balances have been reflected, such as the adjustments from the FAC cases, the over-collection of POLR revenue and the illegal revenue collected as a result of the Commission's authorization to recover 12 months over nine months as discussed, and the ESP I remand. In addition, as recommended in IEU-Ohio witness Hess' testimony, excessive amounts that AEP-Ohio has collected as a result of increases in capacity charges should be used to reduce such deferred balances.

(4) In my opinion, separate company Rider PIRR rates should be determined as CSP customers should be responsible for the CSP deferrals and OP customers should be responsible for the OP deferrals.

(5) If merged Rider PIRR rates are approved by the Commission in these proceedings, then Rider PIRR should not be applied to CSP customers in governmental aggregation programs.

(6) With respect to my recommendations (4) and (5) above, another option that I recommend the Commission consider is to account for any

remaining deferral for CSP through a quarterly FAC filing so that this relatively small deferral could be eliminated, avoiding the accumulation of continued carrying charges over a multi-year period. If this option is utilized, there would be no deferral to be collected for CSP through Rider PIRR.

(7) Related to recommendation (3) above, the Commission should specify that Rider PIRR, if approved, be collected subject to reconciliation until such time as all outstanding Commission cases and appeals that may impact the phase-in deferral balance and carrying costs included in such balance are resolved.

(8) I also recommend that AEP-Ohio be required to make annual informational filings regarding the collection balance of the Rider PIRR with separate CSP and OP division detail to assure that all necessary adjustments have been or will be reflected in the Rider PIRR calculations and to allow tracking of the unamortized balances.

Q21. Besides your specific recommendations on the version of Rider PIRR included in the proposed Modified ESP, are there any other perspectives that you believe need to be considered by the Commission relative to the issues associated with the amount and timing of any charges associated with the amortization of any phase-in deferral balance eligible for collection from consumers?

A21. Yes, I believe that the recovery of any such phase-in deferral balance must also be considered in the context of an equity and fairness and a "just and reasonable" perspective. The larger picture in this proceeding includes AEP-Ohio asking the Commission to approve various mechanisms that will provide the EDU with cash-flow support associated with generation-related functions. In at least one case (the Retail Stability Rider or "RSR" proposal), the request for enhanced generation function-related cash flow takes the form of a revenue and earnings protection guarantee funded by shopping and non-shopping customers alike. The above-market capacity charges and the RSR are addressed in more detail in the testimonies of IEU-Ohio witnesses Murray and Hess.

AEP-Ohio is advancing these Modified ESP proposals based on a claim that AEP-Ohio will experience financial problems associated with the generation business segment in the form of low returns on equity if the Commission does not approve these mechanisms to enhance earnings relative to what the earnings would be without these items. AEP-Ohio suggests, in its pleadings in these cases and elsewhere, that it wants, needs and is entitled to more time to adapt its business model to reflect the form of electric restructuring that went into effect in Ohio in 2001. But my review of the supporting testimony and other documents submitted by AEP-Ohio in support of its Modified ESP fails to identify any proactive discussion or consideration by AEP-Ohio of the abundant opportunities that OP and CSP have had since January 1, 2001 to get their financial house in order. These opportunities include numerous rate increases, very healthy returns on common equity and significant cash flow from both legal and illegal charges (such as the ESP I illegal POLR charges and the ESP I retroactive rate increase).

The bigger picture indicates that instead of preparing to be "fully on its own in the competitive market" [the words in the statute regarding the purpose of transition revenues (stranded cost recovery)],[6] AEP-Ohio wants to increase SSO rates and erect economic barriers to shopping so that it can do the things that other EDUs have already done.

Exhibit JGB-5 provides the earned ROE for CSP and OP from 2001 through 2010 and the consolidated ROE for OP for 2011. For the years 2001–2010, the un-weighted average ROEs of CSP and OP were 19.6% and 13.6%, respectively. These historical ROEs, ignored in AEP-Ohio's portrayal of the overall effect of Ohio's electric restructuring, suggest that consumers and the Commission have already made significant and perhaps excessive contributions to OP's and CSP's financial performance.

Exhibit JGB-5 also contains a summary of the dividend payments from each EDU up to the parent company for each year for the period 2001-2011. Dividends are paid out of retained earnings and therefore do not affect the computation of net income. Over the period 2001-2011, OP and CSP, and for 2011 AEP-Ohio, paid dividends up to the parent company (AEP) totaling $2.7 billion, including a $650 million dividend in 2011, representing approximately 140% of the Companies' combined net income for 2011 ($465 million).

Generally speaking, rate relief related to allegations of financial harm is the type of rate relief that is addressed by the Commission in response to applications for emergency rate relief. The Commission has developed long-standing criteria to

[6] Section 4928.38, Revised Code.

determine when and how much rate relief may be appropriate to avoid a financial problem. These factors were identified by the Commission in its Opinion and Order rejecting the emergency rate increase request of Akron Thermal, Limited Partnership in Case Nos. 09-453-HT-AEM, *et al.*

The Akron Thermal emergency rate increase was rejected in part because of problems related to the business model choice made by Akron Thermal. At pages 6 and 7 of the Opinion and Order, the Commission described the standards for reviewing applications for emergency rate relief as follows:

> First, the existence of an emergency is a condition precedent to any grant of temporary rate relief. Second, the applicant's supporting evidence will be reviewed with strict scrutiny, and that evidence must clearly and convincingly demonstrate the presence of extraordinary circumstances that constitute a genuine emergency situation. Next, emergency relief will not be granted pursuant to Section 4909.16, Revised Code, if the emergency request is filed merely to circumvent, and as a substitute for, permanent rate relief under Section 4909.18, Revised Code. Finally, the Commission will grant temporary rate relief only at the minimum level necessary to avert or relieve the emergency. [7]

The Commission added that its determinations under each part of Section 4909.16, Revised Code, are discretionary. The Commission went on to state that, as noted by the Supreme Court:

> "the determination of whether an emergency exists, warranting a temporary alteration of rates, and the length of time such emergency rates shall remain in effect are within the judgment and sound discretion of the Public Utilities Commission." Therefore, in considering this emergency rate application, we must first answer the threshold question of whether an emergency exists that imperils the public utility. As we noted, if the public utility fails to sustain its

[7] *In the Matter of the Application of Akron Thermal, Limited Partnership for an Emergency Increase in its Rates and Charges for Steam and Hot Water Service,* Case Nos. 09-453-HT-AEM, *et al.*, Opinion and Order at 6 (September 2, 2009).

> burden of proof on this issue, the Commission's inquiry is at an end.[8]

I believe the factors that the Commission has applied to address applications for emergency rate relief to address financial problems are relevant for purposes of evaluating the bigger picture claims that AEP-Ohio is making to support its proposed Modified ESP. More specifically, I do not believe that AEP-Ohio has shown that the generation business segment financial problems that it is relying upon have been shown clearly and convincingly to present a financial problem that is anything other than a problem created by the choices AEP-Ohio has or its affiliates have made since the enactment of Amended Substitute Senate Bill 3 ("SB 3"). It is my opinion that the financial support that AEP-Ohio is seeking for the benefit of the generation segment of its business circumvents the required division between competitive and non-competitive services and conflicts with the customer choice objectives embedded in SB 3. In addition, AEP-Ohio has not identified the minimum level of financial support that is necessary to address the alleged financial problem or the extent to which the financial problem could have been avoided or mitigated through actions other than actions to increase electric rates.

In summary, I believe it would be unjust and unreasonable for the Commission to approve proposals that raise rates, guarantee earnings and block customers from gaining access to suppliers offering lower electric bills based on generalized claims that AEP-Ohio's generation business will run into financial problems if the

[8] *Id.* at 7.

Modified ESP proposed by AEP-Ohio is not approved as-filed with the Commission.

Q22. Does this conclude your prepared direct testimony?

A22. Yes. However, I reserve the right to update this testimony for any outstanding discovery responses or additional information that is submitted by other parties in this case.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Direct Testimony of Joseph G. Bowser on Behalf of Industrial Energy Users-Ohio* was served upon the following parties of record this 4th day of May 2012, *via* electronic transmission, hand-delivery or first class mail, U.S. postage prepaid

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