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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of The AES Corporation, Dolphin Sub, Inc., DPL Inc. and The Dayton Power and Light Company for Consent and Approval for a Change of Control of The Dayton Power and Light Company.	)	Case No. 11-3002-EL-MER
In the Matter of the Application of The Dayton Power and Light Company for Approval of Its Electric Security Plan.	)	Case No. 08-1094-EL-SSO
In the Matter of the Application of The Dayton Power and Light Company for Approval of Revised Tariffs.	)	Case No. 08-1095-EL-ATA
In the Matter of the Application of The Dayton Power and Light Company for Approval of Certain Accounting Authority Pursuant to Section 4905.13, Revised Code.	)	Case No. 08-1096-EL-AAM
In the Matter of the Application of The Dayton Power and Light Company for Approval of Its Amended Corporate Separation Plan.	)	Case No. 08-1097-EL-UNC
In the Matter of the Application of The Dayton Power and Light Company for Approval of its Market Rate Offer.	)	Case No. 12-426-EL-SSO

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In the Matter of the Application of The Dayton)
Power and Light Company for Approval of) Case No. 12-427-EL-ATA
Revised Tariffs.

In the Matter of the Application of The Dayton)
Power and Light Company for Approval of) Case No. 12-428-EL-AAM
Certain Accounting Authority.)

In the Matter of the Application of The Dayton)
Power and Light Company for the Waiver of) Case No. 12-429-EL-WVR
Certain Commission Rules.)

In the Matter of the Application of The Dayton)
Power and Light Company to Establish) Case No. 12-672-EL-RDR
Tariff Riders.)

REPLY TO MEMORANDUM OF THE DAYTON POWER AND LIGHT COMPANY IN OPPOSITION TO JOINT MOTION SEEKING ENFORCEMENT OF APPROVED SETTLEMENT AGREEMENTS AND ORDERS ISSUED BY THE PUBLIC UTILITIES COMMISSION OF OHIO

October 18, 2012

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REPLY TO MEMORANDUM OF THE DAYTON POWER AND LIGHT COMPANY IN OPPOSITION TO JOINT MOTION SEEKING ENFORCEMENT OF APPROVED SETTLEMENT AGREEMENTS AND ORDERS ISSUED BY THE PUBLIC UTILITIES COMMISSION OF OHIO

I. INTRODUCTION

On June 24, 2009, the Public Utilities Commission of Ohio ("Commission") issued an Opinion and Order ("ESP I Order") in Case Nos. 08-1094-EL-SSO, *et al.* ("*ESP I Case*") adopting a stipulation and recommendation ("ESP I Settlement") and approving an electric security plan ("ESP") for The Dayton Power & Light Company ("DP&L"). Among other things, the ESP I Settlement contained the following provisions:

> The current RSS [RSC] charge will continue as a nonbypassable charge through December 31, 2012. Through December 31, 2012, shopping customers who return to DP&L shall pay the Standard Service Offer ("SSO") rate under the applicable tariff. In 2011 and 2012, governmental aggregation customers who elect not to pay the RSS [RSC] will return to

> DP&L at a market-based rate. DP&L will develop and file for approval a market-based rate calculated consistent with Section 4928.20(J), Revised Code, by July 1, 2010.[1]
>
> * * *
>
> DP&L will file a new ESP and/or MRO case by March 31, 2012 to set SSO rates to apply for period beginning January 1, 2013. At least 120 days prior to March 31, 2012, DP&L will consult with interested Signatory Parties to discuss the filing.[2]

The above-quoted language makes it clear that the scope and duration of the non-bypassable Rate Stabilization Charge ("RSC") were addressed by the Commission-approved ESP I Settlement. The scope of the non-bypassable RSC was limited to shopping customers other than the shopping customers participating in a government aggregation program electing to return to default generation supply at a market-based rate. The duration of the non-bypassable status of the RSC was limited to December 31, 2012. If the RSC continues beyond December 31, 2012 by operation of law, there is nothing in the Commission-approved ESP I Settlement that permits the RSC to remain non-bypassable beyond that date.

On November 22, 2011, the Commission issued a Finding and Order ("Merger Order") in Case No. 11-3002-EL-MER ("*Merger Case*") adopting stipulations and recommendations ("Merger Settlement") and authorizing a change in control resulting in DPL Inc. ("DPL", DP&L's parent corporation) becoming a wholly-owned subsidiary of The AES Corporation ("AES"). Prior to the Merger Order, AES, DPL and DP&L represented to the Commission that the merger would result in reasonable rates. More specifically, AES, DPL and DP&L represented that:

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[1] ESP I Settlement at 4 (Section 3).

[2] *Id.* at 7 (Section 9).

> The Commission is required to determine whether the merger will result in service at a "reasonable rate." Ohio Rev. Code § 4905.402(B). In the Application (p.10), Applicants demonstrated that the merger would not affect DP&L's rates because DP&L has an established Electric Security Plan ("ESP") from Case No. 08-1094-EL-SSO that extends through December 31, 2012.[3]

In compliance with the deadline established by the ESP I Settlement and on March 30, 2012, DP&L filed an application seeking approval of a market rate offer ("MRO") form of standard service offer ("SSO") under Sections 4928.141 and 4928.142, Revised Code, as well as other relief in Case Nos. 12-426-EL-SSO, *et al.* (*"MRO Case"*). On September 7, 2012, DP&L filed a Notice of Withdrawal of Market Rate Offer Application ("MRO Withdrawal Notice") containing the following sentence:

> Please take notice that Applicant The Dayton Power and Light Company withdraws without prejudice its March 30, 2012 Application for a Market Rate Offer in this docket.[4]

Also on September 7, 2012, in the *MRO Case* and before filing either a new MRO application or an ESP application, DP&L filed a Motion to Set Procedural Schedule for Its Electric Security Plan Filing ("ESP II Procedural Motion"). In the ESP II Procedural Motion, DP&L stated that it would file an ESP application ("ESP II Application") on or before October 8, 2012 in the *MRO Case*.[5]

Late on Friday, October 5, 2012, DP&L filed its ESP II Application (which appears to be missing required information).[6] Among other things, the ESP II

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[3] *Merger Case*, Applicants' Reply Comments at 11 (August 18, 2011).

[4] MRO Withdrawal Notice at 1.

[5] DP&L's ESP II Procedural Motion has since been rejected. Entry at 2 (Sept. 27, 2012).

[6] For example, the ESP II Application does not provide information identifying the effects of several new non-bypassable riders on "customer choice" and does not quantify the effect of these riders for purposes of conducting the required ESP v. MRO test. Section 4901:1-35-03, Ohio Administrative Code ("O.A.C.").

Application contains a request for waivers from Commission requirements related to an ESP application, an unreasonable proposed procedural schedule (which is opposed in a memorandum contra filed on October 16, 2012[7]) and a request (at page 11) that the Commission authorize DP&L to continue its current rates if the Commission does not issue a final order regarding the ESP II Application by January 1, 2013.

DP&L's unilaterally-made decisions regarding how and when to request Commission approval of a successor SSO have now made it improbable and perhaps impossible for a new ESP ("ESP II") or an MRO to be lawfully approved by the Commission prior to January 1, 2013. In this circumstance, Ohio law specifies that ESP I shall continue until such time as the Commission lawfully approves a successor SSO. Of course, DP&L's statutory right to withdraw and terminate the ESP II Application if modified and approved by the Commission provides DP&L with considerable discretion to affect the potential life extension of ESP I. In any event, this legal reality requires an identification of ESP I provisions that will survive beyond December 31, 2012.

On September 26, 2012, numerous parties filed a Joint Motion Seeking Enforcement of Approved Settlement Agreements and Orders Issued by the Public Utilities Commission of Ohio ("Joint Motion"). The Joint Motion proactively requests that the Commission require DP&L to comply with Commission-approved settlement agreements. More specifically, the Joint Motion requested that the Commission direct DP&L to file revised SSO tariffs deleting the non-bypassable status of the RSC

[7] *MRO Case*, Joint Memorandum Contra Dayton Power and Light Company's Proposed Procedural Schedule (Oct. 16, 2012). Since the procedural schedule proposed by DP&L in its ESP II Application is being contested in a separate pleading, this Reply will not restate or repeat the objections to such proposed procedural schedule. To the extent necessary, such objections are incorporated herein by reference.

provision to be effective for all bills rendered on or after January 1, 2013. The portions of the ESP I settlement quoted above clearly state that the RSC's status, as a **non-bypassable** charge, only continues through December 31, 2012.

The legal question raised by the Joint Motion is not a question of first impression. This legal question was previously addressed by the Commission in *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison 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 No. 08-935-EL-SSO, Finding and Order (Jan. 7, 2009) ("*FirstEnergy ESP I Case*" *and* "FirstEnergy Order," respectively). In the *FirstEnergy ESP I Case*, the Commission addressed the question of what rate plan provisions continued once the Commission had modified and approved an ESP and the electric distribution utility ("EDU") elected to withdraw and terminate the ESP. There, the Commission held that rate plan continuation provisions of Ohio law require a determination of what "*provisions, terms, and conditions of the utility's most recent standard service offer*"[8] may be properly included in a rate plan extended by operation of law. The Commission also held that because the provisions of the prior rate plan specified a termination date, the provisions could not be carried over into the extended rate plan by operation of law.[9]

On October 11, 2012, DP&L filed a memorandum in opposition to the Joint Motion ("DP&L Memorandum"). While the DP&L Memorandum contests the relief requested by the Joint Motion, the DP&L Memorandum (like DP&L's ESP II Application at page 11) nonetheless acknowledges that Commission action is necessary to

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[8] FirstEnergy Order at 8.

[9] *Id.* at 8, 9.

authorize continuation of ESP provisions beyond January 1, 2013. More specifically and at page 14 of the DP&L Memorandum, DP&L states that it will file a motion to continue the ESP I rates into 2013 if the Commission does not issue a final order regarding the ESP II Application. Thus, the Joint Motion, the ESP II Application and the DP&L Memorandum express the shared view that the Commission should address the question of what happens on January 1, 2013 if the Commission has not lawfully authorized a successor SSO before that date. DP&L would have the Commission delay this determination and keep everyone guessing based on the fanciful forecast that the contested issues raised by the ESP II Application will be resolved by a final order prior to January 1, 2013. The Joint Motion reflects the view that delaying action on the relief requested in the Joint Motion is, under the facts and circumstances presented here, ill-advised.

It is now up to the Commission to judge if it is reasonable to delay answering this important question based on DP&L's view that the Commission will issue a final order on DP&L's ESP II Application by January 1, 2013. As already noted, DP&L did not file its ESP II Application until late Friday, October 5, 2012.

Below, this Reply addresses other claims made by DP&L in the DP&L Memorandum.

II. DP&L'S CLAIMS

A. DP&L Claim No. 1: Ohio Law Requires the Terms of DP&L's Existing ESP Continue Until a New SSO Is Approved

The question presented by the Joint Motion does not contest the position that the current ESP continues in some form into 2013 if the Commission has not lawfully authorized a new SSO prior to January 1, 2013. The Joint Motion asks the Commission to determine if the non-bypassable status of the RSC is a part of any ESP I that may continue beyond December 31, 2012.

As already noted, DP&L's ESP II Application and the DP&L Memorandum concede that Commission authorization is required to extend anything in ESP I beyond December 31, 2012. Thus, DP&L has agreed that any continuation of ESP I that may occur by operation of law is not self-executing. The DP&L Memorandum contests the Joint Motion's request that the Commission make this determination promptly. All parties agree that a Commission determination is required.

B. DP&L Claim No. 2: The Joint Motion Misstates the Terms of ESP I

The DP&L Memorandum states that because language in paragraph 1 of the ESP I Settlement is the same or similar to language in the separate paragraph regarding the RSC, the language sameness defeats the Joint Motion. The separate paragraph regarding the non-bypassable status of the RSC, however, indicates that the Commission-approved ESP I Settlement assigned meaning to the language used in the separate RSC paragraph. DP&L's interpretation of the ESP I Settlement effectively reads the separate RSC paragraph out of the ESP I Settlement and would have the Commission find that the separate RSC paragraph has no meaning whatsoever. DP&L's effort to make the RSC paragraph meaningless is unreasonable and unlawful; it violates the rule of construction (applied to both legislation and agreements) that requires that meaning be assigned to all terms and provisions and the assigned meaning be based on the entire agreement.[10]

The history of the RSC and the language in the ESP I Settlement point to a result that is consistent with the relief requested in the Joint Motion and inconsistent with DP&L's claim that the ESP I Settlement language regarding the RSC is meaningless.

On April 4, 2005, in Case No. 05-276-EL-AIR, DP&L filed its application to establish a rate stabilization surcharge ("RSS") and increase its distribution rates. On December 28, 2005, the Commission approved, with modifications, a stipulation which, among other terms, established an RSC, and extended DP&L's rate stabilization plan to December 31, 2010.[11] In doing so, the Commission held that one of the goals of rate stabilization plans ("RSP") was to further develop competitive markets.[12] In effect, then, the RSP and RSC were both part of a package that was designed to promote further development of a competitive market.

The ESP I Settlement was also submitted and approved as a package.[13] The ESP I Settlement states that:

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[10] "One may not regard only the right hand which giveth, if the left hand also taketh away. The intention of the parties must be derived instead from the instrument as a whole, and not from detached or isolated parts thereof." *Gomolka. v. State Automobile Ins. Co.*, 70 Ohio St.2d 166, 172 (1982); *In re All Kelley & Ferraro Asbestos Cases*, 104 Ohio St.3d 605, 2004-Ohio-7104 at ¶ 29 (*citing Foster Wheeler Enviresponse, Inc. v. Franklin Cty. Convention Facilities Auth.*, 78 Ohio St.3d 353, 361 (1997)) ("Where possible, a court must construe the agreement to give effect to every provision in the agreement."); *Molnar v. Castle Bail Bonds, Inc.*, 4th Dist. No. 04CA-2808, 2005-Ohio-6643 at ¶ 42 (*quoting Bank v. Insurance Co.*, 83 Ohio St.309 (1911) ("In the construction of a contract courts should give effect, if possible, to every provision therein contained, and if one construction of a doubtful condition written in a contract would make that condition meaningless, and it is possible to give it another construction that would give it meaning and purpose, then the latter construction must obtain.").

[11] *In the Matter of the Application of The Dayton Power and Light Company for the Creation of a Rate Stabilization Surcharge Rider and Distribution Rate Increase*, Case No. 05-276-EL-AIR, Opinion and Order (Dec. 28, 2005).

[12] *Id.* at 9

[13] ESP I Settlement at 2, 18-19; *ESP I Case*, Opinion and Order at 4, 12-13 (June 24, 2009).

> This Stipulation is supported by adequate data and information; as a package, the Stipulation benefits customers and the public interest; promotes effective competition and the development of a competitive marketplace; represents a just and reasonable resolution of all issues in this proceeding; violates no regulatory principle or practice; and complies with and promotes the policies and requirements of Chapter 4928, Revised Code.[14]

The above-quoted language from the ESP I Settlement clearly indicates that the goal of the "package" is to promote effective competition and the development of a competitive marketplace and to promote the policies in Chapter 4928, Revised Code.

Maintaining a non-bypassable RSC beyond December 31, 2012 is a result that cannot be fairly reconciled with the goals specifically articulated in the ESP I Settlement or the policies and requirements of Chapter 4928, Revised Code. The ESP I Settlement calls for the RSC to have a non-bypassable status through December 31, 2012. Chapter 4928, Revised Code, is clearly tilted against non-bypassable generation-related SSO charges. The package presented by the ESP I Settlement includes clear and specific language that embraces the pro-competitive mission of Chapter 4928, Revised Code, which has been repeatedly applied by the Commission to block, remove or limit non-bypassable generation-related charges where they must give way to the force of law and policy.[15]

The significance of this history is compelled here because the uncontested information before or available to the Commission shows that the retail market for competitive retail electric services ("CRES") providers has developed significantly in

[14] ESP I Settlement at 2.

[15] *In the Matter of the Application of Ohio Power Company for Approval of the Shutdown of Unit 5 of the Philip Sporn Generating Station and to Establish a Plant Shutdown Rider*, Case No. 10-1454-EL-RDR, Finding and Order at 16 (Jan. 11, 2012); *see* FirstEnergy Order at 8-9.

DP&L's distribution service area. This development has occurred in no small measure as a result of the active role of DP&L's affiliated CRES provider, DPLER. According to the Form 10-K filed with the Securities and Exchange Commission by DP&L and DPL ("2011 10-K"),[16] DP&L's parent, for twelve months ended December 31, 2011:

- Since January 2001, DP&L's electric customers have been permitted to choose their retail electric generation supplier.[17]
- Market prices for power, as well as government aggregation initiatives within DP&L's service territory, have led and may continue to lead to the entrance of *additional* competitors in our service territory. At December 31, 2011, there were **fourteen** CRES providers in DP&L's service territory. DPLER, an affiliated company and one of the fourteen registered CRES providers, has been marketing supply services to DP&L customers. During 2011, DPLER accounted for approximately 5,731 million kWh of the total 6,593 million kWh supplied by CRES providers within DP&L's service territory. Also during 2011, 27,812 customers with an annual energy usage of 862 million kWh were supplied by other CRES providers within DP&L's service territory. **The volume supplied by DPLER represents approximately 41% of DP&L's total distribution sales volume during 2011**.[18]
- Several communities in DP&L's service area have passed ordinances allowing the communities to become government aggregators for the purpose of offering alternative electric generation supplies to their citizens. To date, nine organizations have filed with the PUCO to initiate aggregation programs.[19]
- In 2010, DPLER began providing CRES services to business customers in Ohio who are not in DP&L's service territory.[20]
- DPL is a regional electric energy and utility company. DPL's two reporting segments are the Utility segment, comprised of its DP&L subsidiary, and

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[16] According to the 2011 10-K at 31, "DPL is a holding company and parent of DP&L and other subsidiaries." "DPL's cash flow is dependent on the operating cash flows of DP&L and its other subsidiaries and their ability to pay cash to DPL." "All of the outstanding common stock of DPL is owned indirectly by AES and directly by an AES wholly-owned subsidiary, and as a result is not listed for trading on any stock exchange. DP&L's common stock is held solely by DPL and, as a result, is not listed for trading on any stock exchange." 2011 10-K at 33.

[17] *Id.* at 12.

[18] *Id.* at 12 (emphasis added).

[19] *Id.* at 12

[20] *Id.* at 12.

the Competitive Retail segment, comprised of its DPLER subsidiary and DPLER's subsidiary, MC Squared, LLC.[21]

- The Competitive Retail segment's [DPLER and MC Squared, LLC] electric energy used to meet its sales obligations **was purchased from DP&L and PJM. During 2010, we implemented a new wholesale agreement between DP&L and DPLER. Under this agreement, intercompany sales from DP&L to DPLER were based on the <u>market prices for wholesale power</u>.**[22]
- **All of the power produced at the generation plants is sold to an RTO and we in turn purchase it back from the RTO to supply our customers.** These power sales and purchases are reported on a net hourly basis as **revenues or purchased power** on our statements of results of operations.[23]
- Approximately 17% of DPL's and 35% of DP&L's electric revenues for the year ended December 31, 2011 were from sales of excess energy and capacity in the wholesale market (DP&L's electric revenues in the wholesale market are reduced for sales to DPLER). Energy in excess of the needs of existing retail customers is sold in the wholesale market when we can identify opportunities with positive margins.[24]

The above-quoted statements from DPL's and DP&L's 2011 10-K show that there is an active and growing competitive retail market in DP&L's service territory. The ESP II Application indicates that the amount of shopping has increased since the end of 2011. Ending the non-bypassable status of the RSC is consistent with the language in the ESP I Settlement as that language is informed by the purpose of the ESP I Settlement and the current facts and circumstances. More specifically, ending the non-bypassable status of the RSC as requested in the Joint Motion will promote further development of the competitive marketplace. These facts and circumstances include an affiliate generation supply relationship between DP&L and DPLER through which DP&L is providing DPLER with generation supply at market-based rates that have

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[21] *Id.* at 36.

[22] *Id.* at 141 (emphasis added).

[23] *Id.* at 152 (emphasis added).

[24] *Id.* at 66.

enabled DPLER to become, by a very large margin, the largest CRES provider in DP&L's service territory. DP&L is selling all of the output of its generating assets to PJM Interconnection, L.L.C. ("PJM") and purchasing the generation supply back from PJM through the wholesale market to meet the requirements of customers. Since DP&L is purchasing all of its generation supply and its current fuel cost recovery rider permits DP&L to recover purchased power associated with the generation supply needs of its SSO customers, DP&L's current SSO provides DP&L with the opportunity to recover all of its prudently incurred generation supply costs associated with SSO customers.

During the life of the RSC, DP&L has achieved stunningly high returns on common equity. DP&L's returns on common equity for 2009, 2010, and 2011 were 18.4%, 20.1%, and 14.2%, respectively, based on ending period common equity.[25] Basing the calculations on average common equity, DP&L's returns on common equity for 2009, 2010, and 2011 were 17.9%, 19.9%, and 14.1%, respectively.[26]

Nobody is attempting to deprive DP&L or DPL of the financial gains enjoyed as a result of the ESP I Settlement and prior rate plans. The past is just that. But now, DP&L is asking the Commission to disregard or render meaningless the specifically

[25] For 2011 and 2010, return on equity ("ROE") calculations, *see* ESP II Application, Testimomy of Craig L. Jackson, Exhibit CLJ-1 for 2010 and 2011 figures and 2010 and 2011 FERC Form 1 data. For 2009 figures, source is the DP&L 2009 FERC Form 1 data. See http://www.puco.ohio.gov/apps/directorylister/annualreports.cfm?path=2011%5C12%2D01%2DEL%2DRPT%20%20%20%20%20Electric%20Distribution%20Utility%20Companies%5C&filearea=3. ROE is computed by dividing the numerator (net income less preferred stock dividends) by the denominator (ending common equity). Common equity is calculated as total proprietary capital less preferred stock.

[26] The 2009, 2010, and 2011 figures are per the FERC Form 1 data noted above. ROE for each year is computed by dividing the numerator (net income less preferred stock dividends) by the denominator (average of beginning and ending common equity).

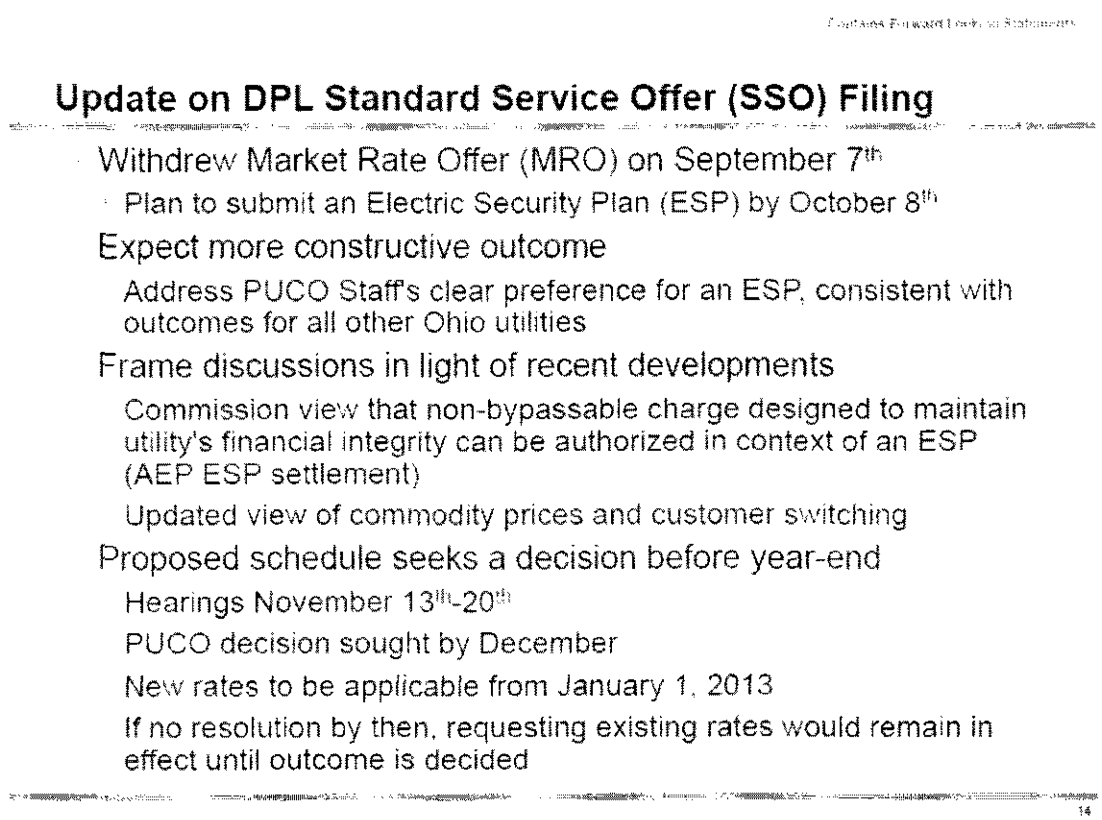
articulated goals of the ESP I Settlement based on DP&L's claims regarding the financial consequences of providing all customers, beginning January 1, 2013, with the full measure of the "customer choice" dividend that is presently available by switching to DPLER or any other CRES provider. This is not in the public interest and it is not something that assigns fair meaning to the RSC paragraph in the ESP I Settlement.

In this context, DP&L is effectively asking the Commission to maintain the non-bypassable generation-related RSC into 2013 (effectively demanding that it be allowed to continue to collect above-market generation-related compensation from shopping and non-shopping customers) while it is selling the output of its generating plants (including the output that is made available to DPLER) at market-based prices. In its current form, the RSC is bypassable by customers served through government aggregation programs that elect to return to default generation supply at market-based rates should they return to SSO service. The relief requested by the Joint Motion would eliminate the current discrimination between shopping customers not participating in government aggregation and customers that do; it would level the playing field between government aggregation program style shopping and individual customer shopping.

Maintaining the RSC as a non-bypassable charge beyond December 31, 2012 will not promote further development of the competitive market. The Commission should assign meaning to the RSC-related language in the ESP I Settlement. The meaning that is assigned to this language must be aligned with the central goal of the ESP I Settlement which is to promote further development of the competitive market. The ESP I Settlement, considered as a package and in its entirety, calls for the non-bypassable status of the RSC to end on December 31, 2012. The Commission should grant the relief requested by the Joint Motion.

C. DP&L Claim No. 3: The Impact on DP&L's Financial Integrity Precludes the Commission from Granting the Relief Requested in the Joint Motion

On September 20, 2012, AES made a presentation to the financial community in which it explained AES's motivation behind the ESP II Application. That presentation is available *via* AES' website and the Internet.[27] Page 14 of the AES presentation is inserted below.



This AES presentation slide explains the strategic significance of the MRO withdrawal and subsequent ESP II Application. AES's September 20, 2012

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27 http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTUzNjg4fENoaWxkSUQ9LTF8VHlwZT0z&t=1 (last accessed October 18, 2012).

presentation says (at page 14), that AES's regulatory strategy in Ohio will "[f]rame discussions in light of recent developments" and be implemented based on AES' understanding that the Commission will, in an ESP, authorize a "... non-bypassable charge designed to maintain utility's financial integrity... ." AES's presentation then points to Commission decisions regarding requests by the Ohio Power Company and Columbus Southern Power Company[28] to support its view that the Commission will approve a non-bypassable charge in an ESP if a utility advances a financial integrity claim. This presentation makes it clear that AES, through DPL and DP&L, has altered its swing so as to implement a strategy designed to hit the cash-loaded regulatory piñata that the Commission suspended, through the AEP-Ohio decisions, from the regulatory ceiling.[29] Again, this presentation (which includes an unreasonable procedural schedule) was made by AES on September 20, 2012, more than two weeks before the ESP II Application arrived at the Commission late on Friday, October 5, 2012. In any event, the financial integrity claims advanced in the DP&L Memorandum are clearly part of the AES regulatory strategy as AES explained in the September 20, 2012 presentation.

The DP&L Memorandum asserts that DP&L will be unable to maintain its financial integrity if the RSC is eliminated and projects (in redacted format) **total**

[28] Ohio Power Company and Columbus Southern Power Company merged in 2011. Collectively they are referred to as AEP-Ohio. AEP-Ohio is a wholly-owned operating utility of American Electric Power ("AEP").

[29] AES and DP&L are not alone. On August 29, 2012, a few weeks after the Commission's July 2, 2012 AEP-Ohio decision, Duke Energy Ohio, Inc. ("Duke"), also an FRR Entity, filed an application with the Commission in Case Nos. 12-2400-EL-UNC, *et al.* (*In the Matter of the Application of Duke Energy Ohio, Inc. for the Establishment of a Charge Pursuant to Section 4909.18, Revised Code,* Case No. 12-2400-EL-UNC, *et al.*, hereinafter "*Duke Capacity Case*"), seeking what the Commission awarded AEP-Ohio. Duke states that the Commission's AEP-Ohio decisions entitle Duke to an increase of some $776 million in compensation for generation capacity service payable through non-bypassable charges applicable to shopping and non-shopping retail customers.

company ROE consequences based on the complete elimination of the RSC. Thus, the DP&L Memorandum incorrectly portrays the relief requested by the Joint Motion. The Joint Motion asks the Commission to eliminate the non-bypassable status of the RSC.

It is also important to note that the RSC is presently bypassable in the case of government aggregation programs and the DP&L Memorandum completely ignores this uncontested fact.

More specifically and assuming that DP&L's financial integrity claim is available as a defense against compliance with the ESP I Settlement and Merger Settlement, the DP&L Memorandum makes no attempt to isolate the effect of making the RSC bypassable for all shopping customers instead of just those shopping customers participating in government aggregation programs.

The ROE projections contained in the DP&L Memorandum also misstate the scope and significance of the relief requested by the Joint Motion because DP&L's ROE projections are based on the total company common equity balance (the denominator) and total company income (the numerator). Neither the numerator nor the denominator have been specified so as to focus only on the distribution-related investment reflected in the total company common equity balance nor the distribution-related income. This renders the ROE projections unreasonable and unlawful since DP&L is, in the SSO and ESP context, an EDU that may not provide a competitive service except through a corporately separated entity.[30] DP&L's corporately separated competitive generation

[30] Section 4928.17, Revised Code.

business, including the market-based sales to DPLER and other wholesale customers,[31] is a competitive business by operation of Ohio law (Section 4928.05, Revised Code) and must be fully on its own in the competitive market.[32] The financial integrity picture painted by the DP&L Memorandum assumes that the Commission can make DP&L's distribution service customers responsible for underwriting the financial performance of lines of business which the Commission may not regulate or supervise and which must be on their own in the competitive market.

The problems presented by DP&L's reliance on a total company numerator and denominator for purposes of portraying its projected ROE are not academic or trivial problems. As the 2011 10-K documents show through the text quoted below, they are very significant:

- The Competitive Retail segment's [DPLER and MC Squared, LLC] electric energy used to meet its sales obligations **was purchased from DP&L and PJM. During 2010, we implemented a new wholesale agreement between DP&L and DPLER. <u>Under this agreement, intercompany sales from DP&L to DPLER were based on the market prices for wholesale power.</u>**[33]

[31] As quoted above, DPL's and DP&L's 2011 10-K states that "[a]pproximately 17% of DPL's and 35% of DP&L's electric revenues for the year ended December 31, 2011 were from sales of excess energy and capacity in the wholesale market." 2011 10-K at 66. The scope of DP&L's wholesale business has also been described by DP&L in its October 15, 2012 Motion to Intervene and Memorandum in Support which DP&L filed in the *Duke Capacity Case* (involving Duke's application to substantially increase its compensation for generation capacity service). At page 3, DP&L states that it was "...a winning bidder in Duke's SSO auction..." and "...is currently providing full service requirements for a portion of Duke Energy Ohio's Standard Service Offer load." *Duke Capacity Case,* DP&L's Motion to Intervene at 3 (Oct. 15, 2012). Ironically, DP&L goes on to say that Duke's proposal to secure above-market compensation for generation capacity service (similar to the object of DP&L's ESP II Application which is not narrowly focused on capacity compensation) could harm it because "...the proposal may have a negative impact on the viability and health of the competitive markets both within Duke Energy Ohio's territory and throughout the state." *Id.*

[32] Section 4928.38, Revised Code. Section 4928.38, Revised Code, precludes the Commission from awarding DP&L any above-market compensation for generation-related service except as may be available through Sections 4928.31 to 4928.40, Revised Code.

[33] 2011 10-K at 141 (emphasis added).

- The volume supplied by DPLER represents approximately **41%** of DP&L's total distribution sales volume during 2011.[34]
- Customer switching from DP&L to DPLER reduces DPL's revenues since the generation rates charged by DPLER are less than the SSO rates charged by DP&L.[35]
- DP&L's current rate structure provides for a nonbypassable charge to compensate DP&L for this POLR obligation. The PUCO may decrease or discontinue this rate charge at some time in the future.[36]
- Several communities in DP&L's service area have passed ordinances allowing the communities to become government aggregators for the purpose of offering alternative electric generation supplies to their citizens. To date, nine organizations have filed with the PUCO to initiate aggregation programs.[37]
- In 2010, DPLER began providing CRES services to business customers in Ohio who are not in DP&L's service territory.[38]
- DP&L declares and pays dividends to its parent DPL from time to time as declared by the DPL board. Dividends in the amount of $220.0 million, $300.0 million and $325.0 million were paid in the years ended December 31, 2011, 2010 and 2009, respectively.[39]
- As a result of the Merger, including the assumption of the merger-related debt, DPL and DP&L were downgraded by all three major credit rating agencies. We do not anticipate that these reduced ratings will have a significant effect on our liquidity; however, **we expect that our cost of capital will increase**.[40]
- **All of the power produced at the generation plants is sold to an RTO and we in turn purchase it back from the RTO to supply our customers.** These power sales and purchases are reported on a net hourly basis as **revenues or purchased power** on our statements of results of operations.[41]
- Approximately 17% of DPL's and **35% of DP&L's electric revenues for the year ended December 31, 2011 were from sales of excess energy and capacity in the wholesale market** (DP&L's electric revenues in the

[34] *Id.* at 12 (emphasis added).

[35] *Id.* at 22.

[36] *Id.* at 23.

[37] *Id.* at 12.

[38] *Id.* at 12.

[39] *Id.* at 33.

[40] *Id.* at 37 (emphasis added).

[41] *Id.* at 152 (emphasis added).

> wholesale market are reduced for sales to DPLER). Energy in excess of the needs of existing retail customers is sold in the wholesale market when we can identify opportunities with positive margins.[42]

Beyond DP&L's use of incorrect numerators and denominators for purpose of portraying its ROE, Ohio law holds that neither AES, DPL nor DP&L can obtain their financial objective by simply chanting the words "financial integrity" as if these words have some magical properties.

Historically, the Commission has carefully considered the claims of utilities seeking rate relief to avoid financial harm and it has used its authority under Section 4909.16, Revised Code, to carefully respond when necessary. But, here again, DP&L has not attempted to satisfy any of the requirements that must be met before the Commission can grant rate relief based on utility claims of financial harm:

> [w]hen the public utilities commission deems it necessary to prevent injury to the business or interests of the public or of any public utility of this state in case of any emergency to be judged by the commission, it may temporarily alter, amend, or, with the consent of the public utility concerned, suspend any existing rates, schedules, or order relating to or affecting any public utility or part of any public utility in this state. Rates so made by the commission shall apply to one or more of the public utilities in this state, or to any portion thereof, as is directed by the commission, and shall take effect at such time and remain in force for such length of time as the commission prescribes.[43]

The Commission has held that the ultimate question for the Commission to decide in a financial integrity rate relief case is "whether, absent emergency relief, the public utility will be financially imperiled or its ability to render service will be impaired."[44]

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[42] *Id.* at 66 (emphasis added).

[43] Section 4909.16, Revised Code.

[44] *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 (Sept. 2, 2009).

As noted above, here the public utility is an EDU. Additionally, "[i]f the applicant fails to sustain its [heavy] burden of proof on this issue, the Commission's inquiry is at an end."[45] To review the "ultimate question," the Commission has developed a four-step process.

> [f]irst, 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.[46]

In this proceeding, DP&L has not offered any evidence demonstrating the nature and extent to which DP&L, the EDU, will be financially imperiled or its ability to render service will be impaired but for maintaining the RSC as a non-bypassable charge. Generalized and unsubstantiated claims of lower returns on common equity than the ROE that DP&L has previously enjoyed as a result of its SSO prices do not get the job done.

In conjunction with the financial integrity chanting, the DP&L Memorandum tosses around the word "taking"[47] much the way of its AEP-Ohio model. Here again, the Commission's AEP-Ohio decisions are held out by DP&L as precedent.[48] But the law requires more than an ability to write the words "taking" or "confiscation" before they can have any legal significance in this setting.

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[45] *Id.*

[46] *Id.*

[47] *See, e.g.*, DP&L Memorandum at 11.

[48] *Id.*

DP&L's taking or confiscation claim is directed at the relief requested in the Joint Motion. As explained above, DP&L has misstated the relief requested by the Joint Motion and used inaccurate and misleading total company numbers to portray projected ROEs.

The law recognizes that the Commission sets or approves rates. *See Duquesne Light Co. v. Barasch*, 488 U.S. 299, 314 (1989). In the present context, the Commission approved the *ESP I Settlement* which DP&L signed and supported and to which DP&L is bound. Enforcing the ESP I Settlement and the Merger Settlement, to which DP&L is also bound, cannot give rise to a DP&L taking or confiscation claim. Beyond this fundamental problem, the DP&L Memorandum misstates and misconstrues the role of any taking or confiscation claim in the present context.

In the context of utility ratemaking, the definition of confiscation and challenges that must be met to sustain a confiscation claim are well defined. In *Dayton Power & Light Company v. Public Utilities Commission of Ohio et al.*, the Ohio Supreme Court described the fundamental elements of a confiscation claim:

> The first is that "* * * he who would upset the rate order * * * carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." The second precept is that a challenged rate order must be "viewed in its entirety" to determine whether the rates set pursuant to the order fall within "the broad zone of reasonableness."[49]

[49] The Court, in *Washington Gas Light Co. v. Baker*, explained the broad zone of reasonableness:

> So long as the public interest — i.e., that of investors and consumers — is safeguarded, it seems that the Commission may formulate its own standards. But there are limits inherent in the statutory mandate that rates be "reasonable, just, and non-discriminatory." Among those limits are the minimal requirements for protection of investors outlined in the Hope case. And from the earliest cases, the end of public utility regulation has been recognized to be protection of consumers from exorbitant rates. Thus, there is a zone of reasonableness within which rates may properly fall. It is bounded at one end by the investor interest against confiscation and at the other by the consumer interest against exorbitant rates.

Washington Gas Light Co. v. Baker, 188 F.2d 11 at 15 (D.C. Cir. 1950) (internal citations omitted).

Dayton Power & Light Company v. Public Utilities Commission of Ohio et al., 4 Ohio St.3d 91 at 97-98 (April 13, 1983) (internal citations omitted) (hereinafter "*Dayton*").

Justice Black, in his dissenting opinion in *McCart v. Indianapolis Water Co.*, 302 U.S. 419, summarized the evolution in the U.S. Supreme Court's approach to confiscation claims arising in the context of economic regulation:

> For the first hundred years of this Nation's history, federal courts did not interfere with state legislation fixing maximum rates for public services performed within the respective states. The state legislatures, according to a custom which this Court declared had existed "from time immemorial" decided what those maximum rates should be. This Court also said that "for protection against abuses by legislatures the people must resort to the polls, -not to the courts." It was not until 1890 that a divided court finally repudiated its earlier constitutional interpretation and declared that due process of law requires judicial invalidation of legislative rates which the courts believe confiscatory.

McCart v. Indianapolis Water Co., 302 U.S. 419, 427-428 (1938) (internal citations omitted).

In order to determine whether a rate was confiscatory, courts previously attempted to test the method by which the rates were set. However, in *Fed. Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) (hereinafter "*Hope*"), the Court departed from its traditional detailed scrutiny of the ratemaking methodology, and adopted a deferential and methodology neutral standard of review. *Id.* at 602. The Court stated, "It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end." *Id.; see also Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).

In a case involving a challenge to maximum rates set by the Federal Power Commission ("FPC"), the Court continued the *Hope* Court's "total effect" test for confiscation in holding that the Constitution does not forbid the imposition, in appropriate circumstances, of maximum prices upon commercial and other activities. *Permian Basin Area Rate Cases*, 390 U.S. 747 at 768-770 (1968) (hereinafter "*Permian Basin*"). The *Permian Basin* Court fleshed out the *Hope* Court's "total effect" test and described the balance that should be struck when examining the total effect of the rates on utilities:

> No constitutional objection arises from the imposition of maximum prices merely because "high cost operators may be more seriously affected . . . than others," *Bowles v. Willingham, supra,* at 518, or because the value of regulated property is reduced as a consequence of regulation. *FPC v. Hope Natural Gas Co., supra,* at 601. Regulation may, consistently with the Constitution, limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness. *Covington & Lexington Turnpike Co. v. Sandford,* 164 U.S. 578, 596.
>
> It is, however, plain that the "power to regulate is not a power to destroy," *Stone* v. *Farmers' Loan & Trust Co.,* 116 U.S. 307, 331; *Covington & Lexington Turnpike Co. v. Sandford, supra,* at 593; and that maximum rates must be calculated for a regulated class in conformity with the pertinent constitutional limitations. Price control is "unconstitutional . . . if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt. . . ." *Nebbia v. New York,* 291 U.S. 502, 539. Nonetheless, the just and reasonable standard of the Natural Gas Act [or SB 3] "coincides" with the applicable constitutional standards, *FPC v. Natural Gas Pipeline Co., supra,* at 586, and any rate selected by the Commission from the broad zone of reasonableness permitted by the Act [or SB 3] cannot properly be attacked as confiscatory. Accordingly, there can be no constitutional objection if the Commission, in its calculation of rates, takes fully into account the various interests which Congress has required it to reconcile. We do not suggest that maximum rates computed for a group or geographical area can never be confiscatory; we hold only that any such rates, determined in conformity with the Natural Gas Act, and intended to "balanc[e] . . . the investor and the consumer interests," are constitutionally permissible. *FPC v. Hope Natural Gas Co., supra,* at 603.

Id. at 769-770. The *Hope* Court also required a balancing of investor and consumer interests.

DP&L has one shareholder. Its sole shareholder is DPL, and DPL is wholly owned by AES. Therefore, DP&L's confiscation claim requires an examination of the effect of the relief requested by the Joint Motion on the interests of AES. In *Hope*, the U.S. Supreme Court reviewed the earnings history (spanning several years) of Hope Natural Gas and its status as a wholly-owned subsidiary of Standard Oil Company on the way to finding that the "end result" fashioned by the FPC (now the Federal Energy Regulatory Commission or "FERC") was not confiscatory. *Hope* at 603.

The Ohio Supreme Court discussed the balance that must be struck to resolve a confiscation claim in the *Dayton* case. In a ratemaking context in the *Dayton* case, the Court determined that the Ohio General Assembly adopted an appropriate balance between investor and consumer interests as "investors are assured a fair and reasonable return on property that is determined to be used and useful, R.C. 4909.15(A)(2), plus the return of costs incurred in rendering the public service, R.C. 4909.15(A)(4), while consumers may not be charged for 'utility investments and expenditures that are neither included in the rate base nor properly categorized as costs.'" *Dayton* at 103 (internal citations omitted).[50] The *Dayton* Court concluded, "To prevail [on issues of confiscation], appellant must prove not only the unreasonableness of the [underlying statutory determinations] but also the confiscatory effect [these

[50] Of course, the statements from the *Dayton* case describe the balance that was struck by the General Assembly with regard to the Commission's authority to regulate prices for non-competitive electric services. In the case of competitive electric services and an EDU's default supply obligation, the Commission may not use its traditional ratemaking authority to establish default generation supply prices and must use a market-based yardstick to determine an EDU's compensation for such service. It is important to note that DP&L's assertions regarding confiscation and taking do not include any representation that terminating the non-bypassable status of the RSC will prohibit DP&L from recovering the cost of generation supply to meet the needs of SSO customers which it purchases (as DP&L explains in its 2011 10-K) from PJM.

determinations] had on the rates established by the commission, viewing the rate order in its entirety."[51]

In another case involving a rate increase prosecuted by Ohio Edison Company, the Ohio Supreme Court emphasized the public interest aspect of the balancing test to determine reasonableness:

> Even though Ohio Edison acknowledges that [*Dayton*] is controlling in this case, it argues that *Hope's* "end result" test requires the commission to consider the effects of its rate order on the company's financial integrity, irrespective of the appropriateness of the underlying statutory determinations. To accept the company's position, we would have to ignore the "broad public interests" recognized in *Permian Basin* and raise the investor concerns listed in *Hope* to a constitutional level. The federal constitutional cases do not support such a result. Rather, these cases recognize investor concerns as only one factor that the commission is to consider in setting just and reasonable (*i.e.,* constitutional) rates. Once these interests are appropriately balanced, the rates' effect on the company's financial integrity (*i.e.,* debt rating and dividend level) is but another of the risks which a utility, as any other unregulated enterprise, must bear.

Ohio Edison at 564-565 (internal citations omitted).

The *Dayton* Court went as far as stating:

> The Constitution no longer provides any special protection for the utility investor. Regulation is deemed no different from any other governmental action; it can limit stringently the profitability of his investment in endeavoring to balance the broad public interest entrusted to its protection.

Dayton at 100.

The Ohio Supreme Court has also declined to find a confiscation when the Commission has "simply ordered appellant to do only that which appellant had a statutory obligation to provide for the public." *Columbus & Southern Ohio Electric Company v. Public Utilities Commission of Ohio*, 64 Ohio St.2d 175 at 177 (1980)

[51] *See Ohio Edison Company v. Public Utilities Commission of Ohio et al.*, 63 Ohio St. 3d 555 at 564 (1992) (hereinafter "*Ohio Edison*") (citing *Dayton* at 106).

(hereinafter "*Columbus & Southern*"). In *Columbus & Southern*, the EDU attempted to pass through to customers $6 million in non-fuel costs, through a temporary surcharge, that it was required to incur pursuant to a Commission order during an emergency period resulting from the United Mine Workers' strike. The EDU argued, among other things, that the Commission's failure to permit recovery of costs it had to incur was confiscatory. The Court found no merit in the EDU's contention and held that:

> Dispositive of appellant's claim of an unjust taking of private property is the fact that appellee simply ordered appellant to do only that which appellant had a statutory obligation to provide for the public. * * * Therefore, appellee imposed no new or additional obligations upon appellant but rather reaffirmed existing statutory obligations. Therefore, there was no taking of private property and, thus, no due process violations.

Id.[52]

The ESP I Settlement obligates each party that signed the settlement, including DP&L, to support the ESP I Settlement. DP&L urged the Commission to adopt the ESP I Settlement and agreed to honor its requirements in the Merger Settlement. Accordingly and even if a "taking" or "confiscation" claim might be relevant to the relief requested by the Joint Motion, DP&L is estopped by the principles of *res judicata* and collateral estoppel from interposing such claims as a defense against the enforcement of the ESP I Settlement. It must also show by clear and convincing evidence that granting the Joint Motion will deprive DP&L of its ability to recover the cost of the generation supply it purchases to meet the needs of SSO customers, that such costs were incurred prudently, and that such costs are eligible for recovery.

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[52] The Court also noted that "a public utility has no constitutional right to recover past and unrecovered costs through present and future rates." *Id.* at 178 (citing *Bluefield W.W. & Improvement Co. v. Public Service Comm.*, 262 U.S. 679 (1923)).

If the words "taking" and "confiscation" have a life in the present context, the applicable precedent holds that DP&L has a heavy burden of proving the relief requested in the Joint Motion is confiscatory; it must prove that the balance struck with its support in the ESP I Settlement is unreasonable and unlawful such that it produces a total effect that is outside the broad zone of reasonableness. The DP&L Memorandum, like DP&L's ESP II Application, makes no attempt to satisfy this heavy burden of proof.

D. DP&L's Claim No. 4: A Hearing is Required

DP&L's Memorandum claims that a hearing is required before the Commission can grant the relief requested in the Joint Motion. The claim is based on DP&L's assertion that the Commission must hold a hearing before it can lower a utility's rates.[53] Thus, the claim that a hearing is required is based on an incorrect premise.

The Joint Motion does not seek to lower DP&L's rates. It seeks to enforce the terms of the ESP I Settlement by removing the non-bypassable status of the RSC as DP&L agreed to do as part of the Commission-approved ESP I Settlement. And it is important to note that the Joint Motion was made necessary as a result of the unilateral decisions by DP&L to dither while the ESP I clock was ticking towards January 1, 2013.

III. CONCLUSION

For the reasons expressed in the Joint Motion and herein, the parties listed below urge the Commission to promptly grant the relief requested by the Joint Motion.

It is ill-advised to further delay addressing the issues raised by the Joint Motion as DP&L would have the Commission do.

[53] DP&L Memorandum at 12.

The relief requested by the Joint Motion is supported by the RSC-specific language in the ESP I Settlement as the meaning of such language is informed by the ESP I Settlement when it is viewed as a package.

AES's September 20, 2012 presentation to the financial community makes it clear that AES, through DPL and DP&L, has decided to position its ESP II Application so that DP&L might benefit from the Commission's hotly contested decisions regarding AEP-Ohio's recently-approved ESP and do so in ways that leave little time before the critical January 1, 2013 day arrives.

The relief requested in the Joint Motion is just and reasonable. And, it is a proper time for the Commission to say so.

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Certificate of Service

I hereby certify that a copy of the foregoing *Reply to Memorandum of the Dayton Power and Light Company in Opposition to Joint Motion Seeking Enforcement of Approved Settlement Agreements and Orders Issued by the Public Utilities Commission of Ohio and Memorandum in Support* was served upon the following parties of record this 18th day of October 2012, *via* hand-delivery, electronic transmission, or first class mail, U.S. postage prepaid.

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