BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	)))))))	Case No. 11-4571-EL-UNC
In the Matter of the Application of Ohio Power Company for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	)))))))	Case No. 11-4572-EL-UNC

OPINION AND ORDER

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The Commission, considering the application, the record of evidence, the applicable law, and being otherwise fully advised, hereby issues its Opinion and Order.

I. APPEARANCES:

Steven T. Nourse, American Electric Power Service Corporation, 1 Riverside Plaza, Columbus, Ohio 43215-2373, and Porter, Wright, Morris & Arthur, LLP, by Daniel R. Conway, 41 South High Street, Columbus, Ohio 43215-6194, on behalf of Columbus Southern Power Company and Ohio Power Company.

Mike DeWine, Attorney General of the State of Ohio, by Thomas W. McNamee, Assistant Attorney General, 180 East Broad Street, 6th Floor, Columbus, Ohio 43215-3793, on behalf of the Staff of the Public Utilities Commission of Ohio.

Bruce J. Weston, the Office of the Ohio Consumers' Counsel, by Melissa R. Yost and Kyle Kern, Assistant Consumers' Counsels, 10 West Broad Street, Suite 1800, Columbus, Ohio 43215-3485, on behalf of the residential utility customers of Columbus Southern Power Company and Ohio Power Company.

Boehm, Kurtz & Lowry, by Michael L. Kurtz and Jody Kyler, 36 East Seventh Street, Suite 1510, Cincinnati, Ohio 45202, on behalf of Ohio Energy Group, Inc.

McNees, Wallace & Nurick, LLC, by Frank P. Darr and Matt Pritchard, 21 East State Street, Suite 1700, Columbus, Ohio 43215-4228, on behalf of Industrial Energy Users-Ohio.

Colleen L. Mooney, Counsel, 231 West Lima Street, P.O. Box 1793, Findlay, Ohio 45839-1793, on behalf of Ohio Partners for Affordable Energy.

Bricker & Eckler, LLP, by J. Thomas Siwo, 100 South Third Street, Columbus, Ohio 43215-4291, on behalf of Ohio Manufacturers Association-Energy Group.

II. BACKGROUND:

Pursuant to Section 4928.141, Revised Code, electric utilities are required to provide consumers with a standard service offer (SSO), consisting of either a market-rate offer (MRO) or an electric security plan (ESP). Sections 4928.142(D)(4), 4928.143(E), and 4928.143(F), Revised Code, direct the Commission to evaluate the earnings of each electric utility's approved ESP or MRO to determine whether the plan or offer produces significantly excessive earnings for the electric utility.

In Case No. 11-1177-EL-WVR, Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly AEP-Ohio or Companies),[1] filed an application for a limited waiver of Rule 4901:1-35-10, Ohio Administrative Code (O.A.C.), to the extent that the rule requires the electric utilities to file their information for the application of the significantly excessive earnings test (SEET) by May 15, 2011.[2] By entry issued April 19, 2011, the Commission granted AEP-Ohio's request for an extension and directed AEP-Ohio to make its SEET filing by July 31, 2011.

On July 29, 2011, CSP and OP filed applications in Case Nos. 11-4571-EL-UNC and 11-4572-EL-UNC, respectively, for the administration of the SEET, as required by Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, O.A.C. In accordance with the entry issued August 25, 2011, motions to intervene and intervenor testimony were due by October 12, 2011, and Staff testimony was due by October 24, 2011.

Motions to intervene were filed by, and intervention granted to, the following entities: the Office of the Ohio Consumers' Counsel (OCC), Industrial Energy Users-Ohio (IEU), Ohio Partners for Affordable Energy (OPAE), Ohio Energy Group (OEG), and Ohio Manufacturers' Association Energy Group (OMAEG).

The hearing commenced on December 6, 2011, and reconvened on January 10, 2012, including rebuttal testimony by AEP-Ohio. At the hearing, AEP-Ohio presented the testimony of three witnesses: Joseph Hamrock (Cos. Ex. 1), Thomas E. Mitchell (Cos. Ex. 2), Dr. Anil K. Makhija (Cos. Ex. 3), and on rebuttal presented the testimony of Dr. Makhija (Cos. Ex. 11). OEG presented the testimony of Lane Kollen (OEG Ex. 1). The Staff offered the testimony of Joseph P. Buckley (Staff Exs. 1, 2 and 3) and the written redirect of Joseph P. Buckley (Staff Ex. 4).[3] Initial briefs were filed by AEP-Ohio, Staff, OPAE, IEU, OCC and OEG on January 31, 2012. Reply briefs were filed by AEP-Ohio, Staff, OPAE, OMAEG, OCC, IEU, and OEG on February 10, 2012.

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1 By entry issued on March 7, 2012, the Commission confirmed and approved the merger of CSP into OP, effective December 31, 2011, in Case No. 10-2376-EL-UNC. Although CSP and OP have merged, their rates have not been consolidated such that OP includes customers in the CSP rate zone.

2 Rule 4901:1-35-10, O.A.C., provides: By May 15 of each year, the electric utility shall make a separate filing with the commission demonstrating whether or not any rate adjustments authorized by the commission as part of the electric utility's electric security plan resulted in significantly excessive earnings during the review period as measured by division (F) of Section 4928.143, Revised Code. The process and timeframes for that proceeding shall be set by order of the commission, the legal director, or attorney examiner. The electric utility's filing shall include the information set forth in paragraph (C) of Rule 4901:1-35-03, O.A.C., as it relates to excessive earnings.

3 Attached to the direct testimony of Staff witness Buckley are exhibits which are marked as Staff Ex. 1 and 2. Attached to the redirect testimony of Mr. Buckley is a revised Staff Ex. 2. To avoid confusion, the exhibits attached to Mr. Buckley's testimony will hereinafter be referred to as JPB Ex.1 and JPB Ex. 2 and the exhibit attached to the redirect testimony as Revised JPB Ex. 2.

III. APPLICABLE LAW:

AEP-Ohio's first ESP, as adopted and modified by the Commission in Case Nos. 08-917-EL-SSO and 08-918-EL-SSO (ESP 1), was to be effective for a three-year period commencing January 1, 2009 and terminating on December 31, 2011. Section 4928.143(F), Revised Code, sets forth the statutory requirements of the SEET for an ESP with a term of three years. Section 4928.143, Revised Code, provides, in relevant part:

> (F) With regard to the provisions that are included in an electric security plan under this section, the commission shall consider, following the end of each annual period of the plan, if any such adjustments resulted in excessive earnings as measured by whether the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate. Consideration also shall be given to the capital requirements of future committed investments in this state. The burden of proof for demonstrating that significantly excessive earnings did not occur shall be on the electric distribution utility. If the commission finds that such adjustments, in the aggregate, did result in significantly excessive earnings, it shall require the electric distribution utility to return to consumers the amount of the excess by prospective adjustments; provided that, upon making such prospective adjustments, the electric distribution utility shall have the right to terminate the plan and immediately file an application pursuant to section 4928.142 of the Revised Code. Upon termination of a plan under this division, rates shall be set on the same basis as specified in division (C)(2)(b) of this section, and phase-in of any amounts that occurred prior to that termination and the recovery of those amounts as contemplated under that electric security plan. In making its determination of significantly excessive earnings under this division, the commission shall not consider, directly or indirectly, the revenue, expenses, or earnings of any affiliate or parent company.

Further, Rule 4901:1-35-03(C)(10)(a), O.A.C., provides:

For the annual review pursuant to division (F) of section 4928.143 of the Revised Code, the electric utility shall provide testimony and analysis demonstrating the return on equity that was earned during the year and the returns on equity earned during the same period by publicly traded companies that face comparable business and financial risks as the electric utility. In addition, the electric utility shall provide the following information:

(i) The federal energy regulatory commission form 1 (FERC form 1) in its entirety for the annual period under review. The electric utility may seek protection of any confidential or proprietary data if necessary. If the FERC form 1 is not available, the electric utility shall provide balance sheet and income statement information of at least the level of detail as required by FERC form 1.

(ii) The latest securities and exchange commission form 10-K in its entirety. The electric utility may seek protection of any confidential or proprietary data if necessary.

(iii) Capital budget requirements for future committed investments in Ohio for each annual period remaining in the ESP.

Further, by Finding and Order issued on June 30, 2010, as amended and clarified in accordance with the Entry on Rehearing issued August 25, 2010, the Commission provided guidance on the interpretation and application of Sections 4928.142(D)(4), 4928.143(E), and 4928.143(F), Revised Code to electric utilities. *In the Matter of the Investigation into the Development of the Significantly Excessive Earnings Test Pursuant to Amended Substitute Senate Bill 221 for Electric Utilities*, Case No. 09-786-EL-UNC (Generic SEET Case).

IV. PROCEDURAL ISSUES:

A. AEP-Ohio's void-for-vagueness constitutionality argument

AEP-Ohio argues Section 4928.143(F), Revised Code, is void and unenforceable, because it is impermissibly vague and fails to provide AEP-Ohio with fair notice, or the Commission with meaningful standards, as to what is meant by "significantly excessive

earnings." AEP-Ohio argues the purpose of the void-for-vagueness doctrine is first is to ensure fair notice to those subject to the law and second is to provide standards to guide those charged with enforcing the law. *Columbia Natural Resources, Inc. v. Tatum*, 58 F.3d 1101, 1104 (6th Cir. 1995). AEP-Ohio asserts that the Ohio Supreme Court has provided greater specificity related to the two primary goals of the void for vagueness doctrine. Where the vagueness doctrine imposes a criminal penalty, sanctions, or first amendment or other fundamental constitutional right, AEP-Ohio reasons that the statute must be more definitive like the Ohio Supreme Court applied in *Norwood v. Horney*, 110 Ohio St.3d 353, 2006-Ohio-379. *Norwood* involved a municipal ordinance that allowed the taking of private property by eminent domain and transfer of the property to a private developer. The ordinance in *Norwood* was determined to be unconstitutional although the ordinance carried no penalties or sanctions. AEP-Ohio asserts that similar to the eminent domain ordinance in the *Norwood* case, Section 4928.143(F), Revised Code, results in a taking of property as the Companies are being required to forfeit earnings lawfully gained through the efficient use of their own property so that those earnings can be redistributed to its customers, even though the customers indisputably paid a just and reasonable rate for the service they received. According to the Companies, Section 4928.143(F), Revised Code, fails to give any definitive notice or guidance as to what is meant by "significantly excessive earnings" or to ensure against arbitrary application of the statute. Section 4928.143(F), Revised Code, in AEP-Ohio's opinion, is unconstitutional on its face as well as in its application. The Companies allege that the statute fails to provide any definitions, standards or guidance to the electric utility of the risk of forfeiture or to give the Commission adequate standards to appropriately analyze and evaluate the SEET. Further, AEP-Ohio asserts, the parties to this proceeding have no common understanding of what level of earnings should be deemed "significantly excessive." The Companies hold out Staff's inability to explain its position on the SEET in this case, and the fact that Staff has proposed yet a different method to determine significantly excessive earnings in this proceeding than in the Companies prior SEET proceeding, as an example of the lack of common understanding of the statutory requirement of "significantly excessive earnings." (AEP-Ohio Br. at 6-10; Tr. at 133-140).

According to AEP-Ohio, because the Section 4928.143(F), Revised Code, provides virtually no guidance as to its proper application, the statute is barren of any practical meaning and violates the void-for-vagueness doctrine. AEP-Ohio argues the General Assembly failed to meet its heightened constitutional duty in this instance to assure that an electric utility had fair notice in advance of how its earnings would be measured and to assure that the Commission had clear direction on how the test was to be administered.

OCC, OEG, OPAE, and IEU argue that, as the Commission found in the Companies' prior SEET proceeding in Case No. 10-1261-EL-UNC, et al., (SEET 1), the constitutionality of the SEET statue is an issue which can not be decided by the Commission. The

intervenors argue that under these circumstances, it is the Commission's duty to proceed in accordance with the terms and provisions of the statute with the assumption of its constitutionality. *East Ohio Gas Co. v. Pub Util. Comm.* (1940), 137 Ohio St. 225, 238-239. Furthermore, IEU points out that economic regulation, like the SEET statute, are reviewed under a lower level of scrutiny as opposed to the higher level of scrutiny argued by AEP-Ohio. *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.* 455 U.S. 489, 498 (1982). Where the statute does not impinge on constitutionally protected conduct, it must be demonstrated that the statute is impermissibly vague in all of its applications. According to IEU, the Companies have not demonstrated and can not demonstrate that the higher level of scrutiny for vagueness is applicable. (OCC Reply Br. at 2-7; OEG Reply Br. at 7-8; OPAE Reply Br. at 1-2; IEU Reply Br. at 8-11.)

The Commission notes that AEP-Ohio presented similar arguments regarding the constitutionality of Section 4928.143(F), Revised Code, in SEET 1. In SEET 1, recognizing that the constitutionality of Section 4928.143(F), Revised Code, was in the province of the courts and not this Commission, the Commission found ample legislative direction to apply the statute. The Ohio Supreme Court affirmed the SEET 1 Order, reasoning that Section 4928.143(F), Revised Code, is directed to economic matters in a highly regulated industry and does not implicate any constitutionally protected conduct and, therefore, is subject to a more lenient standard of review of vagueness. Further, the Court found that the language of the statute provided considerable guidance to the Commission which was not nullified by the Commission's administrative process to further clarify Section 4928.143(F), Revised Code. Consistent with the Court's ruling on SEET 1, we reject AEP-Ohio's claims that Section 4928.143(F), Revised Code, is unconstitutionally vague.[4]

B. IEU's motion to dismiss

On December 1, 2011, IEU filed a motion to dismiss the Companies' application in this matter. IEU submits that CSP and OP have failed to meet their burden of proof to demonstrate that their respective ESP-related earned return on common equity results in significantly excessive earnings to the extent that CSP and OP failed to segregate their respective ESP earnings from total company income and equity information. IEU notes that each electric utility's calculation earned return is based on the earned return from the Federal Energy Regulatory Commission (FERC) Form 1, a total company earned return on common equity which permits unregulated business earnings to be included, on a total company basis, within the earned return on equity. IEU reasons that the Companies did not make any adjustment to their respective per book earnings on common equity to jurisdictionalize the ESP earnings. According to IEU, Section 4928.143(F), Revised Code, the SEET is limited to a review of the earned returns associated with the ESP. IEU bases its interpretation of Section 4928.143(F), Revised Code, on four specific references to limit the

4 *In re Application of Columbus S. Power Co.*, Slip Opinion No. 2012-Ohio-5690.

review to the ESP within in the language of the statute which IEU reasons is the General Assembly's to balance the risk between the electric utility and its retail customers. Thus, IEU reasons that the Companies' SEET application for review of 2010 earnings fails to comply with the statutory requirements and requests that the Commission dismiss the SEET application, without prejudice, and direct the Companies to refile.

IEU again makes the argument in its initial brief; however, IEU also incorporates an argument that the Commission's authority is limited to the scope of its jurisdiction which in turn defines the scope of the SEET review under Section 4928.143(F), Revised Code. In other words, according to IEU, the Commission must apply the SEET exclusively to retail ESP services under the Commission's jurisdiction. IEU notes that CSP and OP are engaged in lines of business other than the provision of retail electric service under the ESP. (IEU Br. at 2 -8; Tr. at 15-16.)

IEU notes that Staff witness Buckley and OEG witness Kollen accepted the Companies' calculation of the earned return on common equity based on total earnings. IEU contends that the gross margin of AEP-Ohio is higher than that of any other American Electric Power Corporation (AEP Corporation) affiliates and it is the obligation of the Commission to ensure that AEP-Ohio's customers are not overburdened with more than their fair share of the overall profitability of AEP Corporation. (Staff Ex. 1 at 2; Tr. at 102; IEU Br. at 9-10.)

On December 14, 2011, AEP-Ohio filed a memorandum contra to IEU's motion to dismiss. In the memorandum, AEP-Ohio notes that the Commission previously decided this issue in the SEET 1 proceeding and the issue has been appealed to the Ohio Supreme Court. AEP-Ohio rejects IEU's argument that Section 4928.143(F), Revised Code, requires a jurisdictionalized earnings allocation study. The statute does not specifically require, claims AEP-Ohio, that the Commission perform a comprehensive jurisdictional allocation study in order to determine an earned return on equity (ROE) appropriate for use in the SEET. Rather, the Companies submit, FERC Form 1 data provides a reasonable starting point from which appropriate adjustments can be made in order to develop an earned ROE.

AEP-Ohio also argues that IEU's references to the language in Section 4928.143(F), Revised Code, in support of its jurisdictional claims are misplaced. AEP-Ohio contends that all the references to which IEU reference relate to the ultimate determination under the statute of whether the ESP results in significantly excessive earnings not the segregation of the electric utility's earnings. According to the Companies, IEU is confusing the two distinct components of the SEET analysis; first, determining whether the electric utility's annual earnings are significantly excessive in comparison to the applicable

ROE threshold and, second, ensuring that only such significantly excessive earnings resulting from the ESP are subject to refund to customers.

As noted by IEU and the Companies, the Commission has already fully addressed and rejected IEU's argument regarding the need to segregate CSP's and OP's earnings in SEET 1.[5] We again reject IEU's arguments and deny the motion to dismiss CSP and OP's SEET applications. Had the General Assembly wished for the Commission to establish the electric utility's earned return on only the portion of earnings derived from jurisdictional activities, as IEU argues, we believe that the General Assembly would have incorporated such language in the statute. It did not.

Nor is the Commission persuaded by the nuance IEU adds to its arguments on brief that Section 4928.143(F), Revised Code, required a comprehensive jurisdictional allocation study to determine an earned ROE appropriate for use in the SEET. For the same reasons enunciated in AEP-Ohio's prior SEET review, we again deny IEU's motion to dismiss the applications for failure to jurisdictionalize earnings. We note that on appeal of this exact issue, the Ohio Supreme Court deferred to the Commission's judgment on this matter and affirmed the Commission's decision on the jurisdictionalization of AEP-Ohio's earnings.[6]

V. APPLICATION OF SEET ANALYSIS:

A. AEP-Ohio's Earned Return on Equity (ROE)

1. AEP-Ohio's determination of its 2010 ROEs and adjustments

AEP-Ohio witness Thomas E. Mitchell, Manager of Regulatory Accounting Services, presented testimony to support AEP-Ohio's calculation of CSP's and OP's earned ROE for the 2010 SEET, proposed adjustments to the each utility's ROE and quantified the revenue producing provisions of the Companies' ESP. AEP-Ohio witness Mitchell testified that there were no minority interest or extraordinary items for CSP or OP for the year 2010, so no such adjustments were necessary to adjust 2010 revenues. Mr. Mitchell determined each electric utility's ROE by using the net earnings available to common equity shareholders compared to the beginning and ending average equity for the year ended December 31, 2010, as directed in the Generic SEET Case. Thus, AEP-Ohio calculates the per book earned ROE to equal 9.70 percent for OP and 16.17 percent for CSP for the year 2010. (Cos. Ex. 2 at 1, 3-7, Rev. Ex. TEM-1 at 1.)

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5 *In re AEP-Ohio*, Case No. 10-1261-EL-UNC, Order at 11-14 (January 11, 2011); Entry on Rehearing at 4 (March 9, 2011).

6 *In re Application of Columbus S. Power Co.*, Slip Opinion No. 2012-Ohio-5690.

Further, AEP-Ohio witness Mitchell adjusted CSP's revenues to eliminate off-system sales (OSS) margins and to account for three non-recurring and special items: (1) workforce restructuring in April 2010; (2) changes in the Medicare Part D tax rules in March 2010; and (3) to account for the Order in the Companies 2009 SEET proceeding of $42.693 million in excessive earnings (Cos. Ex. 2 at 8-11).

AEP-Ohio also proposes an adjustment to account for the generation plant attributable to OSS. AEP-Ohio determines the ratio of megawatt hours of OSS sold to the megawatts generated at the plant and multiplies the ratio by the net book value of equity related to the generation plant. AEP-Ohio admits that the proposed adjustment to account for OSS is different from the method adopted by the Commission in the Companies previous SEET review, reasoning that the adjustment approved in SEET 1 used total sales for resale over the total sales, which included affiliated sales for resale and Transmission Cost Recovery Rider transactions which are unrelated to OSS, causing the allocation ratio to be distorted.[7] As calculated by AEP-Ohio, the adjustment for the net margins associated with OSS increases OP's ROE from 9.70 percent to 9.88 percent and increases CSP's ROE from 16.17 percent to 17.54 percent. (Cos. Ex. 2 at 6-7, Rev. Ex. TEM-1.)

AEP-Ohio also requests that the Commission recognize, as discussed in the Companies' 10-K filing, that the Patient Protection and Affordable Care Act and the related Health Care and Education Reconciliation Act (collectively Health Care Acts), amends the tax rules such that employers can no longer deduct certain Medicare Part D costs from their federal income taxes beginning after December 31, 2012. As such, AEP-Ohio increased the 2010 earnings of CSP and OP, by $2.871 million and $6.424 million, respectively, for purposes of the SEET analysis. (Cos. Ex. 2 at 9.) No party opposed AEP-Ohio's adjustments to CSP's and OP's 2010 earnings associated with the Health Care Acts.

2. Other Parties Position on AEP-Ohio's earned ROE and adjustments

Staff accepts AEP-Ohio's calculation of each electric utility's ROE, including the adjustments, to produce an ROE of 17.54 percent for CSP and an ROE of 9.88 percent for OP for 2010 (Staff Ex. 1 at 2-3). IEU states that the adjustment to account for OSS, as proposed by AEP-Ohio, does not account for transmission plant that supports OSS and, therefore, average common equity as calculated by AEP-Ohio is overstated. (Tr. at 72-73; IEU Br. at 10-11).

OEG, OCC and OPAE argue that CSP's per books earned ROE of 19.42 percent should be used for purposes of the SEET, without adjustment for OSS.[8] (OEG Ex. 1 at 3-4;

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7 *In re AEP-Ohio*, Case No. 10-1261-EL-UNC, Order (January 11, 2011); Entry on Rehearing (March 9, 2011).

8 OEG calculates the refund to be $19.478 million based on accepting AEP-Ohio's SEET threshold of 18.37, using the mean of the comparable group of companies as developed by Staff and a 60 percent adder

OEG Br. 4-7; OCC Br. at 11-14; OCC Reply Br. at 7-8; OPAE Br. at 1-2, OPAE Reply br. at 2-4.) As a threshold matter, OEG contends that AEP-Ohio has not met its burden to demonstrate that OSS will affect CSP's 2010 ROE. AEP-Ohio retorts that Mr. Mitchell demonstrated the effect of including OSS margins in the ROE calculation, where the numerator would be increased by $47,224,000 and the denominator would be increased by $114,003,000, resulting in an increase in CSP's ROE from 17.54 percent to 19.42 percent. (OEG Ex. 1 at 11-15; OEG Br. at 6-7; Cos. Ex. 2, Ex. TEM-1; Cos. Reply Br. at 4-5.)

OEG presented the testimony of Lane Kollen, Vice President and Principal with Kennedy and Associates, a utility rate and planning consultant firm. OEG witness Kollen advocates that OSS margins in net income and in common equity yields a retail jurisdictional return on equity consistent with cost of service principles and methodologies. Mr. Kollen recommends that CSP's earned return on common equity be 19.42 percent, irrespective of OSS, as opposed to AEP-Ohio's calculation of 17.54 percent, as a result of errors in the calculation. Putting aside OEG's position that the SEET analysis should include OSS, OEG claims that AEP-Ohio's proposal to exclude the effect of OSS from the SEET overlooks the elimination of fixed production expenses (such as fixed non-fuel operations and maintenance expenses (O&M), administration and general expenses, depreciation expense, property tax expense or other tax expenses) that are necessary for AEP-Ohio to benefit from OSS. According to OEG, AEP-Ohio's method only eliminated variable O&M expenses for OSS, understating the allocation of costs to wholesale jurisdiction and overstating the allocation of costs to the retail jurisdiction and causing the retail jurisdiction earned ROE to be understated. Mr. Kollen explains, and IEU endorses, that there are two common methods for the jurisdictional allocation of cost—a full jurisdictional cost allocation of all fixed and variable operating expenses and rate base components or the revenue credit method. According to Mr. Kollen, if the revenue credit allocation method is employed, only the net costs, after credits for wholesale revenues, are recovered through retail rates. OEG argues that AEP-Ohio's proposed method fails to remove all costs associated with the wholesale jurisdiction. Utilizing AEP-Ohio's OSS margin of 41.4 percent is, in OEG's words, unreasonable given the depressed prices in the wholesale market and the competitive nature of the market and the errors in the Companies method belie its inequities and bias. OEG recommends that the Commission either jurisdictionalize all costs or leave the OSS margins in both the numerator and the denominator. (OEG Ex. 1 at 1, 3, 4, 7-11; Cos. Ex. 2, Ex. TEM-1 at 2-5; IEU Br. at 12.)

Further, OEG witness Kollen claims AEP-Ohio's calculation to adjusted common equity for OSS includes errors that overstate the common equity and ultimately understate the return on common equity. OEG proposes that the adjustment to deduct OSS margins

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equals $19.478 million in excessive earnings, at a minimum. However, OEG recommends a 19.42 percent earned ROE and no adjustments, with a 17.22 percent SEET threshold for the comparable group and a 50 percent adder which yields a SEET refund of $40.810 million.

be corrected for certain mistakes. OEG argues that AEP-Ohio deleted the OSS margins from total company net income and OSS margins should also be removed from total company common equity, not only the portion allocated to production as AEP-Ohio does in its adjustment for OSS. OEG recommends that, absent a full cost allocation or determination that wholesale margins and retail margins are different, the Commission apply the same percentage as the adjustment to net income for OSS margins. OEG also asserts that AEP-Ohio's methodology fails to recognize that the effect of extracting OSS margins from common equity is cumulative (and reflected in the Companies' retained earnings). To account for the cumulative effect, OEG recommends that the adjustments to net income and common equity for prior years during the term of the ESP 1 be added to the current SEET analysis. According to OEG, AEP-Ohio incorrectly increased the common equity for the SEET refund ordered in the Companies' prior SEET proceeding, partially negating the effects of the SEET refund, increased the common equity for the reorganization charge, and increased the common equity for the Medicare Part D subsidy. OEG offers that the effect of the AEP-Ohio adjustment increases equity and allows AEP-Ohio to earn an equity return on the nonrecurring charges. Finally, OPAE and OCC endorse OEG's revisions to the adjustment to account for OSS if OSS is not included in CSP's earnings for purposes of SEET (OPAE Reply Br. at 2-4; OCC Br. at 13).

3. AEP-Ohio's reply

AEP-Ohio retorts that fixed costs are incurred by the Companies to meet their obligations as load serving entities and providers of last resort. AEP-Ohio argues that fixed costs are irrelevant to OSS and such costs are not incurred to make OSS which are opportunistic, discretionary transactions. Furthermore, AEP-Ohio contends that OEG's arguments ignore the fact that OSS earnings do not arise from adjustments made as a result of the ESP. (Tr. at 81-83; AEP-Ohio Reply Br. at 5.)

AEP-Ohio emphasizes that OSS are not derived from adjustments made as a part of an ESP, as required by the statute and further notes that the Commission has previously considered and rejected arguments that OSS should be include in earnings for purposes of the SEET analysis. As to OEG's claims regarding the adjustments to exclude OSS, AEP-Ohio submits that OEG's position that the percentage of equity deleted from the denominator of earned ROE should equal the percentage of OSS-related earnings removed from the numerator is based on OEG's belief that the profitability of OSS is the same as retail sales; a creative way to reassert that no adjustment should be made to exclude OSS. AEP-Ohio contends that, if you deduct from the denominator OSS-related earnings from prior years and the current year, as OEG recommends, the amount of equity deducted would double then triple, in subsequent years, arbitrarily increasing CSP's earned ROE. AEP-Ohio states that OEG has failed to offer any explanation why such a result is appropriate. AEP-Ohio also challenges OEG's opposition to increasing the numerator of the earned ROE. AEP-Ohio contends that if it is appropriate to put the Companies in the

position it would have been in but for those expenses then it is also appropriate to recognize that the equity would have likewise been greater by the same amount. (AEP-Ohio Br. at 15-18.)

4. Commission decision

We find the Companies' calculation of CSP's and OP's earned ROE for 2010 to be reasonable, consistent with the requirements of Section 4928.143(F), Revised Code, and the directives of the Commission as set forth in the Generic SEET Case.[9]

(a) Inclusion of OSS.

We again reject the claims of OEG, OCC and OPAE that OSS revenue should be included in earnings for purposes of the SEET. As the Commission explained in the Companies' 2009 SEET proceeding:

> Where it can be shown that the electric utility received a return on its OSS, which if included in the calculation could unduly increase its ROE for purposes of SEET comparisons, OSS margins and the related equity in generation facilities should be excluded from the SEET calculation. Thus, without reaching the federal and constitutional law arguments, we will exclude OSS and the portion of generation that supports OSS from the SEET analysis. (*SEET 1* at 30.)

As the Commission interprets the requirements of Section 4928.143(F), Revised Code, OSS are not derived from "the provisions that are included in an electric security plan..." and for that reason should be deleted from earnings for purposes of the SEET. None of the arguments presented by OCC, OPAE or OEG for the inclusion of OSS margins convince the Commission otherwise. Therefore, consistent with the Commission's rational presented in the Generic SEET proceeding and in the Commission's decision in the Companies' prior SEET for 2009 earnings, OSS margins will be excluded from the SEET analysis. We note that, on appeal, the Court deferred to the Commission's ruling on this aspect of the SEET 1 Order.

(b) Evidentiary OSS Threshold.

Further, despite the claims of OEG, the Commission finds that AEP-Ohio has demonstrated that CSP has sufficient OSS such that including OSS in the determination of its ROE would increase CSP's ROE for purposes of the SEET analysis. Based on the

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9 Generic SEET Case, Entry on Rehearing at 6 (August 25, 2010).

evidence presented by AEP-Ohio, OSS transactions are not *de minimums*. In fact, on a monetary basis, OSS is a significant portion of CSP's earnings. In light of the arguments presented by OEG, the issue in this SEET evaluation is how to best accomplish the OSS adjustment. OEG argues that AEP-Ohio's ability to make OSS is supported by generation and transmission assets and the fixed costs of those assets should be fairly allocated between SSO and the OSS transactions (OEG Br. at 7-9).

The Commission agrees that AEP-Ohio incurs fixed costs based on its obligations as a load serving entity. However, where the same facilities also provide AEP-Ohio an opportunity to make discretionary OSS, a portion of the transmission costs should be apportioned to OSS. It is inherently unfair to expect ratepayers to bear all the transmission costs and for AEP-Ohio to retain a disproportionate share of the benefits of OSS. Therefore, the Commission finds it appropriate to attribute a portion of the fixed generation and transmission costs to OSS. We find that utilizing the same method advocated by AEP-Ohio to allocate generation plant between OSS and ratepayers is also a reasonable method to account for that portion of the transmission plant associated with OSS (See Exhibit A). With the adjustment to allocate a portion of transmission plant to OSS, the Commission finds that OP's adjusted ROE equals 9.98 percent and CSP's adjusted ROE equals 17.90 percent.

5. Deferrals

In this SEET application, AEP-Ohio states that the Companies used per book earnings and did not exclude any deferrals for the calculation of the 2010 SEET ROE (Cos. Ex. 1 at 9). However, AEP-Ohio requests that the SEET evaluation recognize a deferral of $17.865 million (pre-tax) to account for the cost of the organization restructuring program as submitted in Case No. 11-351-EL-AIR, et al. (AEP-Ohio Distribution Rate Case). AEP-Ohio proposes a three year amortization of the restructuring costs. AEP-Ohio requests that if the Commission approves the distribution deferral and recovery, the deferral be treated like non-recurring expenses in the 2010 SEET calculation. (Cos. Ex. 2 at 8-9.)

In SEET 1, considering deferred fuel revenues, the Commission determined that unlike OSS, extraordinary or non-recurring items, deferrals should not be excluded from the electric utility's ROE. Deferred expenses and the associated regulatory liability are reflected on the electric utility's books when the expense is incurred, consistent with generally accepted accounting principles.[10] The Commission finds that AEP-Ohio fails to adequately justify the request to treat restructuring program costs like a non-recurring item. Accordingly, the Commission denies AEP-Ohio's request to reflect organization restructuring cost in the utility's ROE for SEET purposes.

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[10] *In re AEP-Ohio*, Case No. 10-1261-EL-UNC, Order at 31 (January 11, 2011).

B. ESP Refund Limits

Pursuant to Section 4928.143(F), Revised Code, when an electric utility's ROE exceeds the safe harbor threshold established in the Generic SEET Case, the Commission must attribute any such amount to and allocate it between earnings that are significantly excessive, as a result of adjustments in the utility's ESP, or to earnings that are not significantly excessive or are attributable to factors unrelated to the ESP.

AEP-Ohio witnesses Hamrock and Mitchell submit that only certain components of the ESP directly contribute to CSP's and OP's earnings. According to AEP-Ohio, the other components of the ESP employ regulatory accounting methods to ensure earnings neutrality for the recovery of costs, such as fuel costs, and for ESP-approved riders, such as the enhanced vegetation management rider and gridSMART rider. Based on the SEET analysis advocated by AEP-Ohio and its proposed mean ROE for the comparable group of companies, AEP-Ohio concludes that OP's earnings are within the safe harbor provision of 200 basis points above the mean of the comparable group of companies. On that basis, AEP-Ohio submits that OP did not have significantly excessive earnings for 2010 and does not calculate an ESP refund limit for OP (Cos. Ex. 1 at 7-8; Cos. Ex. 2 at 6).

For the ESP effective 2009 through 2011, the five components that directly contribute to CSP's 2010 after-tax earnings are: equity return on incremental environmental investments 2001-2008 of $9,017,000, environmental investments on incremental 2009 investments of $2,332,000, equity return on enhanced vegetation management investments of $105,000, equity return on gridSMART investments of $787,000 and net incremental provider of last resort revenues of $48,084,000. As computed by AEP-Ohio, the total after-tax rate adjustment attributable to the ESP which is subject to customer refund pursuant SEET is $60,325,000 ($93,935,000 before taxes). (Cos. Ex. 1 at 9-12; Cos. Ex. 2 at 11-18, Ex. TEM-2 -TEM-5.)

No party challenged AEP-Ohio's determination of the rate adjustments attributable to the ESP which is subject to customer refund pursuant SEET. Upon review, the Commission finds AEP-Ohio's calculation of the rate adjustments in ESP 1 which contributed to CSP's earnings for 2010, to be reasonable.

C. Capital requirements for future committed Ohio investments

1. AEP-Ohio's committed future investment claims and other considerations

Joseph Hamrock, President and Chief Operating Officer of AEP-Ohio, offered the Companies' actual and projected annual capital expenditures for 2009 through 2011 in support of AEP-Ohio's future committed investments. Mr. Hamrock testified that the

Companies spent or planned to spend approximately $1.6 billion over the term of ESP 1 and had spent $1.1 billion through December 31, 2010, in the categories of environmental, other generation, transmission, distribution, gridSMART and corporate/other. AEP-Ohio argues that its expenditures and future projected capital expenditures represent tremendous capital investment in Ohio, during these uncertain economic times. AEP-Ohio submits that CSP has committed to make an equity investment in and contracted for the output of a solar farm in Wyandot County, Ohio. AEP-Ohio requests that the Commission consider these capital commitments as part of the SEET analysis. (Cos. Ex. 1 at 1, 13, 15, 20-23, Ex. JH-1.)

In his testimony, Mr. Hamrock offers examples of AEP Corporation's leadership in the energy industry and AEP-Ohio's commitment to environmental compliance, including the alternative energy portfolio standards, demand-side management collaborative and gridSMART initiatives. AEP-Ohio also notes its initiative to develop and build renewable generation facilities in Ohio, such as the Timber Road wind project, and the jobs such projects will bring to the state. (Cos. Ex. 1 at 13-16.)

Mr. Hamrock testifies that AEP-Ohio faces several regulatory risks. AEP-Ohio will be retiring certain Ohio generation plants and units and will retrofit other Ohio units to comply with pending federal environmental regulations.[11] AEP-Ohio faces uncertainty with a rapidly changing market, the installation of environmental retrofits and cost recovery for generation assets and the environmental retrofits. AEP-Ohio witness Hamrock offered that in Ohio a combination of outstanding deferred assets, Senate Bill 221 requirements, environmental mandates and ESP timing forces the Companies into an elevated level of risk. The witness noted that AEP-Ohio's system average interruption frequency index for the 12 months ending 2010 had improved and although the customer average interruption duration index (CAIDI) had increased slightly, the CAIDI was comparable to previous years. Mr. Hamrock states CSP and OP also face significant customer migration. According to the witness, 9.3 percent of AEP-Ohio load had switched to a competitive retail electric service (CRES) provider and 19.6 percent had switched to a CRES in CSP's service area as of June 2011 further intensifying AEP-Ohio's cost recovery risk. The Companies have reached and significantly exceeded their energy efficiency/peak demand reduction benchmarks for 2010. AEP-Ohio notes that the electric utilities and their employees are significant contributing members of the communities they serve, not only in terms of payroll, property, state and local taxes, but the philanthropic contributions and purchases of Ohio goods and services. (Cos. Ex. 1 at 16-22.)

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11 See *AEP Shares Plan for Compliance with Proposed EPA Regulations*, Press Release (June 9, 2011).

2. Opposition to AEP-Ohio's committed future investment claims

IEU challenges AEP-Ohio's claims of industry leadership in transmission, renewable energy, gridSMART, fuel deferrals and new generation resources to the extent that the claims suggest a higher SEET threshold. IEU notes that the Companies' transmission activities are unrelated to the ESP and are regulated by FERC. Further, IEU emphasizes that AEP-Ohio is compensated for its environmental compliance through the recovery mechanism which incudes carrying costs, and compensated for renewable energy credits through the fuel adjustment clause (FAC). The Companies also were not exposed to the cost of environmental compliance, according to IEU, as AEP-Ohio was authorized to collect revenue on past environmental investments through the non-FAC generation rates and on post-2009 environmental investments via a rider approved in the ESP. IEU notes that customer migration for OP was insignificant in 2010 and CSP reported a gross margin reduction of $16 million, a portion of which CSP expects to recover through OSS.[12] IEU further offers that the fuel deferral charges created in ESP 1 are non-bypassable and include carrying costs. Thus, IEU reasons none of the issues raised by AEP-Ohio to support an increase in the SEET threshold are justified. (IEU Br. at 12-15.)

OCC submits that CSP's capital investments have significantly declined over the past few years. OCC notes that CSP's 2010 capital spending was $194.870 million, $93,195 million less than was spent in 2009, the first year of the ESP 1, and which is projected to decline to $186.912 million for 2011. Accordingly, OCC reasons such reduction in the electric utility's expenditures can not be the basis for increasing the baseline ROE for determining the SEET threshold. OCC also notes that AEP-Ohio's forecasted construction expenditures in its prior SEET proceeding were overstated, in comparison to the actual construction expenditures submitted in this proceeding, by $61,230 million ($256,100 million projected[13] - $194,870 million actual).[14] For these reasons, OCC contends a symmetrical downward adjustment in the threshold to determine significantly excessive earnings, is justified. OEG also endorses a reduction in the adder given that CSP's actual capital expenditures for 2010 were $85.237 million less than 2009. (OCC Br. at 8-11; OEG Reply Br. at 6.)

3. Commission Decision

The statute dictates that as part of the SEET analysis the Commission consider AEP-Ohio's capital requirements for future committed investments in the state. To that end, the Commission reiterates our expectation that AEP-Ohio expend $20 million, to the extent the it has not already done so, on Turning Point or another investment in a similar project

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12 Tr. at 34-35.

13 *In re AEP-Ohio*, Case No. 10-1261-EL-UNC, Order at 31 (January 11, 2011).

14 Tr. at 52-54.

subject to Staff approval, by the end of 2013. We note that in AEP-Ohio's SEET 1 proceeding, the Commission accounted for the same $20 million future committed investment by AEP-Ohio. Thus, we do not make any adjustment for such project in this proceeding.[15]

It is not unusual that an electric utility's capital investment projections or actual expenditures fluctuate over the years. Therefore, the Commission finds it unreasonable to conclude that the decline in capital spending, or any increase in capital spending in future years for that matter, should be the basis for adjusting the SEET threshold.

D. Comparable Group of Companies, ROE of Comparable Companies and SEET Threshold

One of the steps in the process to determine whether an electric utility has significantly excessive earnings is to compare the earned return on common equity of the electric utility to the earned return on common equity of a group of publicly traded companies, including utilities that face comparable business and financial risk. AEP-Ohio and Staff each offered a method to select the comparable group of publicly traded companies to develop the ROE to which AEP-Ohio's ROEs will ultimately be compared.

1. AEP-Ohio

AEP-Ohio presented the testimony of Dr. Anil Makhija, professor of finance at The Ohio State University. The process advocated by Dr. Makhija may be summarized as stated below. AEP-Ohio's proposed process evaluates all publicly traded U.S. firms to develop its comparable group of companies. To evaluate business risk, AEP-Ohio used unlevered betas and to evaluate financial risk, it used the book equity ratio. By using data from Value Line,[16] AEP-Ohio developed the comparable group of companies, irrespective of industry, by placing the firms into five different business risk groups and five different financial risk groups (listing each unlevered beta or book equity ratio lowest to highest). AEP-Ohio then selects the companies in the cell which include CSP and OP to determine comparable financial risk. For companies with comparable business risk, AEP-Ohio selects the cell which includes AEP Corporation as the comparable group companies. CSP and OP do not stock which is traded and, therefore, Dr. Makhija asserts their business risk is not directly observable. AEP-Ohio confirms the analysis by utilizing additional criteria for the business and financial risk for the comparable group of companies, including a measure of capital intensity. Using this method, AEP-Ohio determines the resulting comparable group of companies consists of 68 firms. (Cos. Ex. 3 at 5-6, 14, 16-18, 28, 36-38.)

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15 *In re AEP-Ohio*, Case No. 10-501-EL-FOR et al., Order at 27-28 (January 9, 2013).

16 *Value Line Standard Edition*, June 6, 2011.

AEP-Ohio advocates that an electric utility's earnings for 2010 not be considered significantly excessive if the annual earnings are less than 1.96 standard deviations above the mean ROE of the comparable group of companies. The Companies explain that 1.96 standard deviations is the most commonly applied standard which results in a reasonably acceptable risk of false positives. AEP-Ohio witness Makhija testified that the 1.96 standard deviation is equivalent to eliminating the likelihood of false positives to 5 percent or the traditional 95 percent confidence level. Further, the witness offered that the 95 percent confidence level is utilized by the U. S. Department of Education, the Federal Energy Regulatory Commission, the U.S. Department of Justice and Gallup to determine statistical significance. (Cos. Ex. 3 at 6, 32-33.)

Further, according to AEP-Ohio, this process for selection of the comparable group of companies is preferable, because it is consistent with the language of Section 4928.143(F), Revised Code, is objective, as it relies on market-based measures of risk, best targets comparable companies, delivers a reliably large sample of comparable companies and can be replicated in future proceedings. (Cos. Ex. 3 at 6.)

AEP-Ohio concludes that the mean ROE for the comparable risk group of companies for 2010 is 11.48 percent with a standard deviation of 5.68 percent. Multiplying the standard deviation of the comparable group of companies by 1.96 (corresponding to a 95 percent confidence level) yields an adder of 11.13 percent. Thus, AEP-Ohio's SEET analysis yields a threshold ROE, the point at which earnings should be considered significantly excessive for 2010, of 22.61 percent (11.48 +11.13) for CSP and OP. (Cos. Ex. 3 at 7, 40, 46.)[17]

2. Opposition to AEP-Ohio's proposed SEET analysis

Staff claims that AEP-Ohio's method for determining the comparable group of companies is overly complex, subject to bias, and not easily replicated. (Staff Ex. 1 at 4-5; Staff Reply Br. at 2; Tr. at 138, 140). OCC, OMAEG and IEU interpret the Commission's decision in the Companies prior SEET evaluation and the Generic SEET Case to be a rejection of AEP-Ohio's entire SEET analysis, including the development of the comparable group of companies and the establishment of the significantly excessive earnings threshold. On that basis, OCC, OMAEG and IEU advocate that the Commission again reject AEP-Ohio's proposed SEET analysis and its method for establishing the SEET threshold. (OCC Reply Br. at 9; OMAEG Reply Br. at 3; IEU Reply Br. at 5-7).

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[17] The Commission notes that Cos. Ex. 3 at 7 states AEP-Ohio's states that AEP-Ohio concludes that the threshold ROE for 2010 to be 22.62 percent but states at page 46 that the threshold ROE is 22.61 percent. The Commission notes that the correct calculation is 22.61 percent.

3. Staff

Staff presented the testimony of Joseph P. Buckley, a Utility Specialist with the Capital Recovery and Financial Analysis Division of the Utilities Department. Staff proposes that the process to determine the ROE for the comparable group of companies be simplified and transparent by utilizing the SPDR Select Sector Fund-Utility (SPDR-XLU) as its comparable group. Staff reasons that because the electric utility industry faces unique challenges, companies within the electric industry represent the best group of comparable companies. From the 33 companies in the select sector fund, the Staff then determined the ROE for the group of companies by totaling the net income earned by the select sector fund companies and dividing it by the total common equity of each of the companies as to establish the average ROE. Utilizing the companies in the select sector fund, Staff calculates the average ROE for the group of companies for 2010 to be 10.97 percent. Staff incorporates a 50 percent adder as a baseline, consistent with the Commission's decision in AEP-Ohio's previous SEET proceeding for 2009 earnings.[18] However, Staff acknowledges that the Commission has the discretion to adjust the 50 percent adder to recognize certain factors as set forth in the statute. Staff's SEET analysis yields a threshold ROE, the point at which CSP's and OP's earnings should be considered significantly excessive for 2010, of 16.46 (16.455 percent = (10.97 percent x 1.50)). (Staff Ex. 1 at 3-5, JPB Ex. 1 and 2, Staff Ex. 4, Revised JPB Ex. 2.)

OCC and OPAE expressly endorse the Staff's method of selecting the comparable group of companies particularly because the stock index is selected by an independent third party which eliminates the potential for bias, simplifies the SEET process, and produces an understandable process for the participating parties which facilitates greater participation in the SEET review (OCC Br. at 5-6; OPAE Reply Br. at 4-5).

4. Opposition to Staff's analysis

Companies' witness Makhija asserts a number of errors with Staff's determination of the comparable group of companies based on the SPDR XLU. First, while Staff acknowledges that electric utilities face unique challenges and asserts that as the rationale for using the select sector fund to establish the comparable group of companies, the select sector fund includes a number of companies that are not in the electric utility industry. Accordingly, AEP-Ohio recommends that five companies be eliminated form Staff comparable group of companies, AES Corporation, ONEOK Inc., NRG Energy, NiSource Inc. and Nicor Inc. Further, AEP-Ohio notes that the select sector fund also includes AEP Corporation, of which CSP and OP are subsidiaries, and recommends that AEP Corporation be removed from Staff's comparable group of companies. AEP-Ohio also notes that Staff implements a weighted average ROE for the select sector comparable

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18 *In re AEP-Ohio*, Case No. 10-1261-EL-UNC, Order at 27 (January 11, 2011).

group of companies which, according to AEP-Ohio, mismatches the risk of the larger firms in the Staff's comparable group against that of CSP and OP. AEP-Ohio also argues that Staff's methodology does not meet the requirements set forth in Section 4928.143(F), Revised Code. AEP-Ohio notes that Staff witness Buckley admits that the select sector fund does not include publicly traded companies other than utilities, does not take into account the business or financial risk of CSP and OP in comparison to Staff's comparable group of companies, and creates the same comparable group for all of the Ohio electric utilities. AEP-Ohio argues that the purpose of forming the select sector fund is intrinsically different than a comparison to the business and financial risk faced by CSP and OP. Further, AEP-Ohio offers that the Staff's reasoning for adopting a more predictable comparable risk group via the select sector fund, namely that the process is easily reproducible by financial analyst, simple, unbiased and expedient, ignores the rationale for rejecting other methods previously presented to the Commission in AEP-Ohio's prior SEET review and the Generic SEET Case. Further, AEP-Ohio argues that, according to Staff, the Commission has the discretion to adjust the SEET threshold adder for more subjective factors, and the adjustment of the adder eliminates the claims of predictability by independent financial analyst. (Staff Ex. 1 at 5; Tr. at 138-140; Cos. Ex. 11 at 1-7; Cos. Reply Br. 5-8.)

By eliminating the five non-electric utilities and AEP Corporation and recalculating the ROEs using Value Lines' net income before discontinued, non-recurring items and extras, in accordance with the Staff's method, AEP-Ohio concludes the mean ROE for the 27 electric select sector comparable group of companies for 2010 is 11.42 percent (Cos. Ex. 11 at 4-5, Ex. I and Ex. II).

Staff retorts that the statute contemplates that the comparable group will include a variety of companies including non-electric utilities. Staff views this as a strength of its method. Despite AEP-Ohio's opposition to weighting the group average ROE, Staff reasons that weighting the ROE appropriately recognizes the size of the company. Staff argues that AEP-Ohio's criticism that Staff's method for determining the comparable group of companies fails to account for company-specific risk is a misunderstanding of Staff's approach. Staff recognizes that there are company specific matters which the Commission may consider but Staff takes no position on those matters. As to AEP-Ohio's opposition to specific companies in the select sector fund comparable group, Staff contends that such is evidence that it is possible to disagree about the appropriate method to develop the comparable group of companies but claims that it behooves all interested in the SEET to utilize a method that is readily reproducible. Staff reasons that a simplified approach reduces the uncertainty created by the SEET process. (Staff Br. at 2-5.)

5. Commission decision on comparable companies and comparable companies' ROE

The Commission finds AEP-Ohio's method for determining the comparable group of companies to be complex and not easily replicated, as argued by Staff. However, contrary to the claims of certain intervenors, the Commission did not reject AEP-Ohio's method for determining the comparable group of companies in the previous SEET cases, but more specifically rejected AEP-Ohio's determination of the SEET threshold. We recognize AEP-Ohio's proposed group of comparable companies as one method to comply with the requirements of Section 4928.143, Revised Code.

The Commission interprets Section 4928.143(F), Revised Code, to allow for electric and non-electric utilities in the comparable group. In fact, the statutory language signifies to the Commission that similar companies from other industries must be included in the comparable group of companies. For that reason, the Commission is greatly concerned that AEP-Ohio's revisions to Staff's determination of the comparable companies, though consistent with the representations of Staff witness Buckley that electric utilities face unique risk, does not comply with the language of Section 4928.143(F), Revised Code, to include publicly traded companies, including utilities.

The Commission recognizes that the standard deviation of the comparable group of companies based on the select sector fund is 4.0163. Further, the Commission has minor concerns that Staff's proposed method for determining the comparable group of companies assumes that the select sector fund companies share some relation to the business and financial risk faced by CSP and OP, given that the companies in the group are selected by an independent third party, not for the purposes of the SEET analysis, and consist primarily of electric utilities as well as two power entities, two natural gas entities and an oil and gas distribution firm. Thus, at this time, the Commission also recognizes Staff's comparable group of companies, composed from the select sector fund, as another method to comply with the requirements of Section 4928.143, Revised Code.

In the SEET review of AEP-Ohio's 2009 earnings, the Commission acknowledged that, in the application of the SEET, it is appropriate to recognize a range of reasonableness as opposed to the accounting accuracy usually associated with public utility regulation.[19] Consistent with that reasoning, we emphasize the mean ROE of the comparable group of companies, as advocated by AEP-Ohio, the average ROE of the select sector fund companies, as recommended by Staff, and the revised average ROE of the select sector fund companies utilizing Staff's method, as revised by AEP-Ohio, respectively, 11.48 percent, 10.97 percent, and 11.42 percent,[20] represent a difference in the mean of the

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19 *In re AEP-Ohio*, Case No. 10-1261-EL-UNC, Order at 20-21 (January 11, 2011).

20 Cos. Ex. 11 at 2.

comparable companies of .53 percent. We, therefore, find validity in utilizing the select sector fund as a group of comparable companies by which to establish the SEET threshold range.

E. SEET Threshold

1. AEP-Ohio

AEP-Ohio reports the variation of the earned ROEs among its comparable group of companies to be 5.68 percent and, on that basis, recommends that the threshold adder be established at 11.13 percent.[21] AEP-Ohio argues that the point where an electric utility's earnings become significantly excessive, pursuant to Section 4928.143, Revised Code, be defined as more than 1.96 standard deviations above the mean ROE of the comparable group of companies. AEP-Ohio witness Makhija notes that a 1.96 standard deviation above the mean is equivalent to a 95 percent confidence level which is commonly used to determine if the difference between two numbers is significant and significantly reduces the likelihood of false positives. AEP-Ohio's position is identical to its position in the Companies' ESP 1 cases, the Generic SEET Case, and the Companies prior SEET review. All of the intervenors oppose AEP-Ohio's SEET threshold, with most intervenors noting that the Commission has previously considered and rejected similar arguments by AEP-Ohio.

2. Other parties

On the other hand, Staff advocates, based on the Commission's decision in the Companies prior SEET cases, that the adder to determine the threshold baseline be set at 50 percent, subject to further adjustment by the Commission (Staff Ex. 1 at 3-4; Staff Br. at 2). OPAE endorse the Staff's position of a 50 percent adder (OPAE Br. at 4-5). Based on the Commission's determination of the appropriate adder to determine the point of significantly excessive earnings used in the Companies' previous SEET, OCC supports Staff's recommended baseline adder of 50 percent. OCC reasons that the ROE for Staff's comparable group of 10.97 percent, if adjusted downward by 50 percent, would yield earnings similar to CSP's embedded cost of debt, 5.5 percent (OCC Br. at 6-7).[22]

OMAEG submits that the parties have misinterpreted the baseline adder as 50 percent. OMAEG argues that in the 2009 SEET case, the 50 percent baseline adder utilized by the Commission was premised on CSP's and OP's long-term cost of debt. OMAEG notes that in the Companies' most recent distribution case, the Commission determined a

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21 Cos. Ex. 3 at 7, 29-31. (5.68 % x 1.96 = 22.61 %)

22 *In re AEP-Ohio*, Case No. 10-1261-EL-UNC, Order at 25 (January 11, 2011).

combined long-term cost of debt of 5.34 percent.[23] Utilizing the method adopted by the Commission in AEP-Ohio's prior SEET cases, OMAEG proposes an adder of 48.5 percent. Further, OMAEG reasons that a downward adjustment of the adder is appropriate, in this instance, as AEP-Ohio has merely identified the Commission's use of the 60 percent adder in the previous SEET case but failed to support the same adder in this proceeding. (OMAEG Reply Br. at 3-6.)

OMAEG and OEG advocate that the Commission dismiss AEP-Ohio's method for determination of the SEET threshold based on 1.96 standard deviations for the same reasons noted previously by the Commission. OEG reasons that the baseline adder of 50 percent utilized in the Companies' 2009 SEET cases should be adopted in this proceeding. OEG further, reasons that the Commission improperly exceeds its authority by increasing the adder for subjective factors as discussed in the Generic SEET Order.[24] OEG and AEP-Ohio contend that Section 4928.143(F), Revised Code, list only one additional factor to be considered in the SEET analyses, the capital requirements of future committed investments in Ohio. On that basis OEG and AEP-Ohio contend that the Commission can not consider other additional factors in its development of the SEET threshold. More specifically, AEP-Ohio submits that the Commission lacks the authority to adjust the baseline ROE by subjective factors to determine the threshold to be compared to CSP's ROE. (OMAEG Reply Br. at 2-3; OEG Br. at 9-12; Cos. Reply Br. at 8-13.)

Furthermore, AEP-Ohio concludes that the Commission's finding of "significantly excessive" must be based on an objective determination of the utility's earnings in comparison to that of the comparable group of companies. AEP-Ohio contends that the baseline plus an adder approach, advocated by Staff and other intervenors, where the baseline ROE is adjusted by subjective factors to determine a threshold to be compared to CSP's ROE, is beyond the authority granted to the Commission pursuant to Section 4928.143(F), Revised Code. (Cos. Reply Br. at 8-13.)

3. Commission decision on SEET threshold ROE

In regards to the determination of the SEET threshold, in the Generic SEET Case a number of commenters requested a bright line statistical analysis test for the evaluation of earnings. While the Commission agreed that statistical analysis can be one of many useful tools, we declined to exclusively adopt such a test.[25] In these cases, AEP-Ohio presents substantially similar arguments for utilizing a statistical SEET threshold and suggests that use of the baseline plus an adder approach, as used in the 2009 SEET, exceeds the Commission's jurisdiction. We again reject AEP-Ohio's proposal to establish the SEET

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[23] *In re AEP-Ohio*, Case Nos. 11-351-EL-AIR, et al., Order at 7 (December 14, 2011).

[24] Generic SEET, Order at 29.

[25] Generic SEET, Order at 29.

threshold pursuant to its proposed statistical SEET threshold. The arguments presented by AEP-Ohio in these cases fails to persuade the Commission to reconsider its decision on the establishment of the SEET threshold.

The statute requires the Commission to measure excessive earnings by whether "the earned return on common equity of the electric distribution utility is *significantly* in excess of the return on common equity" earned by comparable companies. The statute does not dictate the method by which to determine "significantly in excess" and, as demonstrated by the proposals offered in the ESP proceedings before this Commission and the Generic SEET case, there are many methods by which to establish the threshold for significantly excessive earnings. Establishing that threshold at 1.96 standard deviations above the mean, which is equivalent to a confidence level of slightly more than 95 percent, virtually ensures, to the point of being unreasonable, that any electric utility's earnings will not be determined significantly excessive under the statute. Almost two standard deviations above the mean, in the Commission's opinion, fails to give meaning to the intent of the statute. While a statistical analysis of the variation in returns among companies facing comparable business and financial risks can provide useful information, as indicated in our decision in the Generic SEET Case, we will not rely exclusively on the statistical approach advocated by AEP-Ohio.

Although AEP-Ohio challenges the baseline plus adder approach, AEP-Ohio applies the 60 percent adder from the Companies 2009 SEET cases. However, the 60 percent adder from the 2009 SEET proceedings includes an upward adjustment to the 50 percent baseline as a result of the Commission's determination of the various business and financial risks faced by AEP-Ohio.[26] Thus, it is inappropriate to utilize the same percentage in this SEET analysis. In AEP-Ohio's previous SEET proceeding, the Commission determined a baseline adder of 50 percent over the mean of the earned ROE of the comparable companies, as compared to AEP-Ohio's cost of debt, was a reasonable measure of "significantly excessive earnings" under the statute. We acknowledge, as offered by OMAEG, that utilizing the same approach for AEP-Ohio's 2010 earnings as used in the 2009 SEET proceeding yields a 48.5 percent adder. Applying the adder equates to a SEET threshold of 16.29 percent,[27] based on Staff's proposed comparable group of companies and applying the adder of 48.5 percent, to AEP-Ohio's comparable group of companies, equals a threshold of 17.0478 percent.[28]

At 48.5 percent, the baseline adder approach advocated by Staff and the intervenors represents, assuming a normal distribution of ROEs among the comparable group of

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26 *In re AEP-Ohio*, Case No. 10-1261-EL-UNC, Order at 25- 27 (January 11, 2011).

27 10.97 x (1+48.5%) = 16.29 %

28 11.48 x (1+48.5%) = 17.0478 %

companies, a confidence level between 90 percent and 95 percent. However, we are concerned that Staff's comparable group of companies as derived from the select sector fund produces the same comparable group of companies for all Ohio electric distribution companies, assumes the business and financial risk similar to CSP and OP, and consist of an extremely limited sample of 33 firms. The comparable group of companies proposed by Staff consists of 33 electric utilities facing various levels of regulation, a range of generation-related and distribution-related risks and some gas utilities. On the other hand, AEP-Ohio's group of comparable companies, although determined through a relatively complex process, is composed of a reliably large sample of firms and appears to be objective as a result of its reliance on market-based measures to select the companies. Pursuant to statistical analysis theories, where the sample of comparable companies used in the SEET analysis is extremely limited (as to the population of all companies meeting the requirements in Section 4928.143, Revised Code), it is appropriate to use a higher confidence level. In this case, Staff's comparable group of 33 companies exhibits little variability and, therefore, statistical analysis theory suggests that the confidence level should increase to reduce the likelihood of false positives and the possibility of inappropriately determining that AEP-Ohio had significantly excessive earnings. For this reason, recognizing that the comparable group of companies proposed by Staff is significantly limited justifies use of a higher confidence level than that represented by 48.5 percent. Adjusting the confidence level to 95 percent or 1.64 standard deviations is equivalent to a SEET threshold of 17.56 percent based on the select sector fund group of comparable companies proposed by Staff.[29]

Recognizing AEP-Ohio's future committed investments in Ohio and acknowledging that the purpose of the SEET is to be a statutory check on rates that result in excessive earnings, the Commission believes that the record indicates that the appropriate SEET threshold is in the range of 17.05 percent to 17.56 percent. However, the Commission believes that the comparable group of companies composed by AEP-Ohio gives meaning to the terms and intent of the statute and, therefore, justifies establishing the SEET threshold at the top of this range.

F. Commission's Conclusions Regarding AEP-Ohio's 2010 SEET

In the Generic SEET Case, the Commission concluded that, for purposes of the SEET analysis, any electric utility's earnings found to be less than 200 basis points above the mean of the comparable group of companies would not be significantly excessive earnings.[30] In light of the Commission's conclusions regarding the SEET as applied to OP for 2010, the Commission finds that OP's earned ROE is 9.98 percent and CSP's earned ROE is 17.90 percent. The Commission observes that OP's adjusted ROE of 9.98 percent is

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29 17.56% [10.97% +(1.64 std. dev. x 4.0163 mean) = 10.97% + 6.5867% = 17.5567%

30 Generic SEET Case, Order at 29 (June 30, 2010).

below the ROE of the comparable group of companies, as proposed by either the Staff or AEP-Ohio, and, therefore by definition, less than 200 basis points above the mean ROE of the comparable group of companies. Accordingly, pursuant to the Commission's directives in the Generic SEET Case, we find that OP did not have significantly excessive earnings for 2010 pursuant to Section 4928.143(F), Revised Code.

However, as to CSP, the Commission finds that consistent with the findings discussed above, that CSP's 2010 earnings are significantly excessive and $ 6,937,925 must be returned to CSP's customers.

	CSP	OP
AEP-Ohio's adjusted earned ROE for 2010	16.17	9.70
Exclusion of OSS with equity effect	17.54	9.88
As adj. by Comm. to incl. transmission associated w/OSS (Comm. Ex. A)	**17.90**	**9.98**
Comparable Co. ROEs for 2010 SEET: 1. Staff - 10.97[31] 2. Staff as adj. by AEP-Ohio – 11.42[32] 3. AEP-Ohio - 11.48[33]	10.97 - 11.48	10.97- 11.48
Proposed point of significantly excessive earnings: Per Staff – 16.46[34] Staff as adj. by AEP-Ohio – 17.13/18.27 [35] Per AEP-Ohio 22.61[36]	16.46 – 22.61	WITH IN THE SAFE HARBOR
Commission's conclusion of threshold of significantly excessive earnings.	**17.56** %	
CSP's 2010 Significantly Excessive Earnings Subject to Return[37]	$ 4,438,000	
Gross Revenue Conversion Factor	156.331 %	
Pre-tax 2010 significantly excessive earnings to be Returned to CSP Customers[38]	$ **6,937,925**	

31 Staff Ex. 4, Revised Ex. JPB 2.

32 AEP-Ohio Ex. 11 at 5.

33 AEP-Ohio Ex. 3 at 7.

34 Staff Exs. 1-4, Revised Ex. JPB 2 [(10.97% x (1+50%) = 10.97% x 1.5 = 16.46%].

35 AEP-Ohio Ex. 11 at 2: (a) 17.13% = 11.42%x (1+50%); (b) 18.27% = 11.42%x (1+60%).

36 AEP-Ohio Ex. 3 at 7. [11.48%+(1.96 std. dev. x 5.68 % mean) = 11.48% + 11.13% = 22.61%

37 Comm. Ex. B

38 Comm. Ex. B

The Commission recognizes that in Case No. 10-2376-EL-UNC, *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals* (Merger Case), the Commission approved the Companies application to merge pursuant to an Agreement and Plan of Merger wherein CSP merged with and into OP and OP is the surviving entity. As the surviving entity, OP succeeded to and possesses and enjoys all of CSP's rights, privileges, powers, and franchises and is subject to all of the restrictions, disabilities, liabilities, and duties of the former CSP. Accordingly, the Commission directs that the significantly excessive earnings accrued by CSP, as determined in this Opinion and Order, be applied first to any deferrals in the FAC account on the books of CSP, as of the date of this order. We direct that CSP's significantly excessive earnings be applied first to FAC deferrals to reduce the carrying charges incurred which ultimately reduces the total FAC deferral to be paid by CSP ratepayers. Further, the Commission directs that any remaining significantly excessive earnings balance be credited to CSP rate zone customers on a per kilowatt hour basis, excluding all reasonable arrangement customers who receive service under a discount rate supported by delta revenue recovery. Additionally, the Commission finds that any balance credited to customers will not be deducted from the electric utility's earnings for purposes of the applicable annual SEET review.

The Commission reminds AEP-Ohio, as noted in the March 7, 2012, Entry in the Merger Case, because both CSP and OP each accrued earnings for the year 2011, the 2011 SEET evaluation will be as individual entities. Further, pursuant to our decision on the Companies' request for a waiver of Rule 4901:1-35-10, O.A.C., in Case No. 12-1177-EL-WVR, AEP-Ohio's 2011 SEET filing is due no later than one month after the issuance of this Order.[39]

VI. FINDINGS OF FACT AND CONCLUSIONS OF LAW:

(1) CSP and OP are public utilities as defined in Section 4905.02, Revised Code, and, as such, the companies are subject to the jurisdiction of this Commission.

(2) On July 29, 2011, CSP and OP filed applications for administration of the SEET in accordance with Section 4928.143(F), Revised Code.

(3) Intervention in this case was granted to OCC, IEU, OPAE, OEG, and OMAEG.

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39 *In re AEP-Ohio*, Case No. 12-1177-EL-WVR, Entry at 3 (April 25, 2012).

(4) The hearing was held on December 6, 2011, and January 10, 2012. Three witnesses testified on behalf of AEP-Ohio, one witness testified on behalf of OEG, and one witness testified on behalf of the Staff.

(5) Initial briefs and/or reply briefs were filed on January 31, 2012, and February 10, 2012, respectively, by AEP-Ohio, Staff, OPAE, OMAEG, IEU, OCC and OEG.

(6) AEP-Ohio waived its right to further jurisdictionalize its earnings in this SEET proceeding.

(7) The motion to dismiss AEP-Ohio's SEET applications is denied.

(8) OP did not have significantly excessive earnings for 2010 pursuant to Section 4928.143(F), Revised Code, and the Commission's safe harbor provision.

(9) CSP had significantly excessive earnings for 2010 pursuant to Section 4928.143(F), Revised Code.

VII. ORDER:

It is, therefore,

ORDERED, That IEU's motion to dismiss AEP-Ohio's 2010 SEET applications is denied. It is, further,

ORDERED, That AEP-Ohio apply the significantly excessive earnings, as determined in this Opinion and Order, first to any deferrals in the FAC account on CSP's books as of the date of this Order, with any remaining balance to be credited to CSP rate zone customers beginning with the first billing cycle in November 2013. The bill credit shall be on a kilowatt hour basis and be returned to customers over a period not to exceed three billing cycles. It is, further,

ORDERED, That a copy of this Opinion and Order be served upon all person of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Steven D. Lesser

Lynn Slaby

M. Beth Trombold

Asim Z. Haque

GNS/vrm

Entered in the Journal

OCT 23 2013

Barcy F. McNeal
Secretary

	CSP	OP
2009 Net Transmission Plant	385,647	667,309
2010 Net Transmission Plant	413,869	713,851
Total Transmission Plant	799,516	1,381,150
Avg. Transmission Plant (Total/2)	399,758	690,580
Percentage Avg. Transmission Plant	399,758	690,580
To Total Plant	3,263,204	6,274,622
Percentage (%)	12.2505	11.0059
Off-system sales in equity[1]	1,423,025	3,201,560
	12.2505%	11.0059%
	$174,320	$352,361
MWH Allocation	$174,320	$352,361
Percentage[2]	15.28%	8.87%
Transmission deduction from Equity	$26,636	$31,254
Adjusted Avg. Common SHE[3]	$1,334,661	$3,024,665
Deduction for transmission	26,636	31,254
Avg. Common SHE Adj. for OSS TR.	$ 1,308,025	$ 2,993,411
Adj. Net Income[4]	$ 234,127	$ 298,853
Common SHE Adj. for OSS TR.	$ 1,308,025	$ 2,993,411
ROE Adj. for OSS Transmission	17.8992%	9.9837%

1 AEP-Ohio Ex.2, Revised TEM-1 at 1.
2 AEP-Ohio Ex.2, Revised TEM-1 at 5.
3 AEP-Ohio Ex.2, Revised TEM-1 at 2.
4 AEP-Ohio Ex.2, Revised TEM-1 at 1.

	CSP (000)
Actual Adjusted Net Income (a)	$ 234,127
Adjusted Shareholder Equity (b)	$1,308025
Return on Equity (c)=(a)/(b)	17.90 %
Commission SEET Threshold (d)	17.56 %
Adjusted Shareholder Equity (b)	$1,308,025
Commission SEET Threshold (d)	17.56 %
Computed Net Income (e)= (b)*(d)	$ 229,689
Actual Adjusted Net Income (a)	$ 234,127
Computed Net Income (e)	$ 229,689
Amount of Excessive Earnings (f)	$ 4,438
Conversion Factor[5] (g)	156.33 %
Pre-tax Significantly Excessive Earnings (h)=(f)*(g)	**$ 6,937,925**

5 Staff Ex. 2