

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio )  
Power Company for Administration of )  
the Significantly Excessive Earnings ) Case No. 13-2249-EL-UNC  
Test under R.C. 4928.143(F) and Ohio )  
Adm.Code 4901:1-35-10. )

In the Matter of the Application of )  
Columbus Southern Power Company )  
for Administration of the Significantly ) Case No. 13-2250-EL-UNC  
Excessive Earnings Test under R.C. )  
4928.143(F) and Ohio Adm.Code 4901:1- )  
35-10. )

OPINION AND ORDER

The Commission having considered the applications, the evidence, the applicable law, and the Stipulation and Recommendation, and being otherwise fully advised, hereby issues its Opinion and Order.

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, Ohio Attorney General, 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, Ohio Consumers' Counsel, by Kyle L. Kern and Maureen R. Grady, 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, 36 East Seventh Street, Suite 1510, Cincinnati, Ohio 45202, on behalf of Ohio Energy Group, Inc.

Carpenter, Lipps & Leland LLP, by Mallory M. Mohler and Kimberly W. Bojko, 280 North High Street, Suite 1300, Columbus, Ohio 43215, on behalf of Ohio Manufacturers' Association Energy Group.

OPINION:

I. History of the proceedings

Pursuant to R.C. 4928.141 electric utilities are required to provide consumers with a standard service offer, consisting of either a market-rate offer (MRO) or an electric security plan (ESP). R.C. 4928.142(D)(4), 4928.143(E), and 4928.143(F) 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.

On April 6, 2012, in *In the Matter of the Application of Ohio Power Company for a Limited Waiver of Rule 4901:1-35-10, Ohio Administrative Code*, Case No. 12-1177-EL-WVR (*SEET Waiver Case*), Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly AEP-Ohio or Companies)<sup>1</sup> filed a motion for waiver of Ohio Adm.Code 4901:1-35-10. In the motion, the Companies requested an extension of time to file the applications for administration of the significantly excessive earnings test (SEET) for 2011 earnings. The Companies requested, and the Commission granted, an extension of time until the later of July 31, 2012, or one month after the Commission issued its decision in the Companies' 2010 SEET proceedings, in *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, et al. (*2010 SEET Cases*). The Commission issued its Opinion and Order in the *2010 SEET Cases* on October 23, 2013. *SEET Waiver Case*, Entry (April 25, 2012) at 3.

Consistent with the directives in the *SEET Waiver Case*, on November 22, 2013, OP and CSP filed applications in Case Nos. 13-2249-EL-UNC and 13-2250-EL-UNC, respectively, for the administration of the SEET, as required by R.C. 4928.143(F) and Ohio Adm.Code 4901:1-35-10. In accordance with the procedural entry issued December 10, 2013, motions to intervene and intervenor testimony were due by January 21, 2014, and January 27, 2014, respectively, Staff testimony was due by February 7, 2014, and the hearing was scheduled to commence on February 25, 2014.

Motions to intervene were timely filed by the Office of the Ohio Consumers' Counsel (OCC), Ohio Energy Group (OEG), and Ohio Manufacturers' Association Energy Group (OMAEG). By entry issued February 19, 2014, intervention was granted to OCC, OEG, and OMAEG. None of the intervenors filed testimony. Staff testimony was timely filed on February 6, 2014. On February 24, 2014, AEP-Ohio and Staff filed a Stipulation

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<sup>1</sup> 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.

and Recommendation (Stipulation) to resolve all the issues raised in these SEET proceedings.

The hearing was held, as scheduled, on February 25, 2014. At the hearing, AEP-Ohio offered into evidence the filed testimony of AEP-Ohio witnesses Gary O. Spitznogle (AEP-Ohio Ex. 1), Thomas E. Mitchell (AEP-Ohio Ex. 2), and Dr. Anil K. Makhija (AEP-Ohio Ex. 3), and the Stipulation (Joint Ex. 1). The Staff offered the filed testimony of Joseph P. Buckley (Staff Ex. 1).<sup>2</sup>

## II. Applicable law

AEP-Ohio's first ESP, as adopted and modified by the Commission in Case No. 08-917-EL-SSO, et al. (ESP 1) was to be effective for a three-year period commencing January 1, 2009 and terminating on December 31, 2011. *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO et al., Order (March 18, 2009), Entries on Rehearing (July 23, 2009, Nov. 4, 2009). R.C. 4928.143(F) sets forth the statutory requirements of the SEET for an ESP with a term of three years. R.C. 4928.143 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

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<sup>2</sup> Attached to the testimony of Staff witness Buckley is an Exhibit 1. To avoid confusion, the exhibit attached to Mr. Buckley's testimony will hereinafter be referred to as JPB Ex. 1.

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, Ohio Adm.Code 4901:1-35-03(C)(10)(a) 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, the Commission provided guidance on the interpretation and application of R.C. 4928.142(D)(4), 4928.143(E), and 4928.143(F) to electric utilities in *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), Finding and Order (June 30, 2010), Entry on Rehearing (August 25, 2010).*

### III. Application of SEET

#### A. AEP-Ohio's analysis

In its applications and supporting testimony, AEP-Ohio submits that the Companies earned per books return on equity (ROE) for 2011 was 15.28 percent for CSP and 7.75 percent for OP. AEP-Ohio adjusted earnings to eliminate off-system sales margins and special accounting items such as minority interest and non-recurring or extraordinary items. According to AEP-Ohio, there were no special accounting items in 2011. Adjusting earnings to eliminate off-system sales margins, AEP-Ohio calculates an adjusted ROE of 12.12 percent for CSP and 8.56 percent for OP. (AEP-Ohio Ex. 2 at 5-6, Ex. TEM-1.)

To determine whether an electric utility has significantly excessive earnings, under R.C. 4928.143(F), the Commission must 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.

AEP-Ohio advocated, as it had in the Companies' SEET proceedings for 2009 and 2010 earnings, a process to evaluate all publicly traded U.S. firms to develop its comparable group of companies. First, AEP-Ohio determines the business risk and financial risk of CSP and OP based on unlevered betas and the book equity ratio. Next, AEP-Ohio determines the comparable group of companies' utilizing the Value Line database.<sup>3</sup> To prevent biasing the sample of firms, AEP-Ohio eliminated firms domiciled outside of the United States, eliminated firms for which all needed data was not available, omitted firms with a negative or zero book equity ratio. This process reduced the number of firms from the 1,700 included in Value Line to 1,380 firms. Next, the Companies ranked and grouped the remaining firms by their unlevered betas and book equity ratios. Using the unlevered beta of AEP Corporation has a proxy for CSP and OP, AEP-Ohio proposes a comparable group of 74 companies, including 44 utility companies. The mean ROE for AEP-Ohio's comparable group of companies is 11.97 percent with a standard deviation of 6.30 percent. AEP-Ohio submits that the process it advocates is consistent with the language of R.C. 4928.143(F), 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. (AEP-Ohio Ex. 3 at 5-6, 34-39.)

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<sup>3</sup> Value Line Standard Edition, October 7, 2013.

Further, AEP-Ohio primarily reiterates its arguments offered in previous SEET cases, that an electric utility's earnings 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 state that 1.96 standard deviations is the most commonly applied standard which results in a reasonably acceptable risk of false positives. (AEP-Ohio Ex. 3 at 6, 28-32.)

AEP-Ohio concludes that the mean ROE for the comparable risk group of 74 companies for 2011 is 11.97 percent with a standard deviation of 6.30 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 12.35 percent. Thus, AEP-Ohio's SEET analysis yields a threshold ROE, the point at which earnings should be considered significantly excessive for 2011, of 24.32 percent (11.97 +12.35) for CSP and OP. (AEP-Ohio Ex. 3 at 7, 41.)<sup>4</sup>

#### B. Staff's analysis

Staff presented the testimony of Joseph P. Buckley, a Utility Specialist with the Capital Recovery and Financial Analysis Division of the Utilities Department. Staff accepts AEP-Ohio's calculation of each electric utility's ROE, including the adjustments, to produce an ROE of 12.12 percent for CSP and an ROE of 8.56 percent for OP for 2011. Staff proposes that the process to determine the ROE for the comparable group of companies be a simple, independent process that produces consistent, reasonable results. Staff advocates the SPDR Select Sector Fund-Utility (SPDR-XLU) as the comparable group of companies for purposes of the SEET. From the 29 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 company's to establish the average ROE. Utilizing the companies in the select sector fund, Staff calculates the average ROE for the group of companies for 2011 to be 11.03 percent with a standard deviation of 3.64 percent. Staff's SEET process incorporates a confidence level of 95 percent or 1.64 standard deviations. Staff's SEET analysis results in an adder of 5.9368 percent (3.62 percent x 1.64). For 2011, Staff's SEET calculation yields a threshold ROE of 16.97 percent (11.03 percent + 5.9368 percent).<sup>5</sup> (Staff Ex. 1 at 2-6, JPB Ex. 1.)

#### C. Summary of the 2011 SEET Stipulation

On February 24, 2014, AEP-Ohio and Staff (signatory parties) filed a Stipulation to resolve all the issues presented in these cases. The other parties to the proceedings, OCC,

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<sup>4</sup> The Commission notes that in AEP-Ohio Ex. 3 AEP-Ohio states that the adder for 2011 is 12.34 percent in at page 7 and then states the adder is 12.35 percent at page 41 of the exhibit.

<sup>5</sup> Staff's SEET threshold equals 16.9668 percent and has been rounded to 16.97 percent.

OEG, and OMAEG, do not oppose the Stipulation. The signatory parties agree that based on a review of the 2011 FERC Form 1 for OP and for CSP, after adjustments for off-system sales and special accounting items consistent with the methodology incorporated by the Commission in the Companies' 2010 SEET Case Order, the earned ROE was 8.56 percent and 12.12 percent, respectively. Further, the signatory parties agree that the record supports a finding that the mean ROE earned by publicly traded companies, including utilities, that face comparable business and financial risks as OP and CSP for 2011 is 11.03 percent and AEP-Ohio's testimony supports a finding that the comparable risk group's mean earned ROE is 11.97 percent. On that basis, the signatory parties recommend that the Commission find that the comparable risk group's earned ROE for 2011 is within the range of 11.03 to 11.97 percent. The signatory parties stipulate that, pursuant to the provisions of R.C. 4928.143(F) and the *Generic SEET Case*, any electric utility's earnings determined to be less than 200 basis points above the mean ROE of the comparable risk group of public traded companies, is not significantly excessive (safe harbor). *Generic SEET Case*, Finding and Order (June 30, 2010) at 29, Entry on Rehearing (Aug. 25, 2010) at 7-10. In the Stipulation, AEP-Ohio and Staff submit that the safe harbor ROE range applicable to OP and CSP for 2011 is 13.03 to 13.97 percent and OP's and CSP's adjusted ROE fall below the safe harbor range. Accordingly, the signatory parties agree that neither OP nor CSP had significantly excessive earnings for 2011 pursuant to R.C. 4928.143 and the Commission's safe harbor provision. (Joint Ex. 1 at 4-6.)

#### CONCLUSION:

Ohio Adm.Code 4901-1-30 authorizes parties to Commission proceedings to enter into stipulations. Although not binding on the Commission, the terms of such an agreement are accorded substantial weight. See, *Consumers' Counsel v. Pub. Util. Comm.*, 64 Ohio St.3d 123, 125 (1992), citing *Akron v. Pub. Util. Comm.*, 55 Ohio St.2d 155 (1978). This concept is particularly valid where the stipulation is unopposed by any party and resolves most of the issues presented in the proceeding in which it is offered.

The standard of review for considering the reasonableness of a stipulation has been discussed in a number of prior Commission proceedings. See, e.g., *Cincinnati Gas & Electric Co.*, Case No. 91-410-EL-AIR (April 14, 1994); *Western Reserve Telephone Co.*, Case No. 93-230-TP-ALT (March 30, 1004); *Ohio Edison Co.*, Case No. 91-698-EL-FOR et al. (December 30, 1993); *Cleveland Electric Illum. Co.*, Case No. 88-170-EL-AIR (January 30, 1989); *Restatement of Accounts and Records (Zimmer Plant)*, Case No. 84-1187-EL-UNC (November 26, 1985). The ultimate issue for our consideration is whether the agreement, which embodies considerable time and effort by the signatory parties, is reasonable and should be adopted. In considering the reasonableness of a stipulation, the Commission has used the following criteria:

- (1) Is the settlement a product of serious bargaining among capable, knowledgeable parties?
- (2) Does the settlement, as a package, benefit ratepayers and the public interest?
- (3) Does the settlement package violate any important regulatory principle or practice?

The Ohio Supreme Court has endorsed the Commission's analysis using these criteria to resolve issues in a manner economical to ratepayers and public utilities. *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.*, 68 Ohio St.3d 547 (1994) (citing *Consumers' Counsel*, supra, at 126). The court stated in that case that the Commission may place substantial weight on the terms of a stipulation, even though the stipulation does not bind the Commission.

In this case, the signatory parties submit that the Stipulation violates no regulatory principle or precedent, is the product of serious arm's length bargaining among capable, knowledgeable parties. Further, the signatory parties state that the Stipulation represents a comprehensive compromise of issues raised by parties representing diverse interest and the Stipulation, as a whole, presents a fair and reasonable result that benefits customers and the public interest. (Joint Ex. 1 at 2.)

Gary O. Spitznogle, vice president, regulatory and finance for AEP-Ohio, testified in support of the Stipulation. The witness stated that the Stipulation meets the criteria employed by the Commission to evaluate the reasonableness of stipulations. Mr. Spitznogle testified that the Stipulation is the product of serious bargaining between AEP-Ohio and Staff. The witness submitted that, although OCC, OEG and OMAEG are not signatory parties, each had the opportunity to review and analyze the Stipulation and is not opposing the Stipulation. Mr. Spitznogle asserts that the Stipulation, as a whole, benefits the public interest in that the Stipulation confirms, pursuant to R.C. 4928.143(F), that neither CSP nor OP had significantly excessive earnings for 2011. Further, the witness contends that the Stipulation does not violate any important regulatory practice or principle. According to Mr. Spitznogle, the Stipulation is consistent with regulatory principles and practices and the requirements of R.C. 4928.143(F). (Tr. at 11-14, 18-19.)

The Commission finds, based on our review of the three-pronged test, the first criterion, that the process involved serious bargaining by knowledgeable, capable parties, is clearly met. The Stipulation filed in this case appears to be the product of serious bargaining among capable, knowledgeable parties familiar with regulatory proceedings. All parties in this matter, AEP-Ohio, Staff, OCC, OEG, and OMAEG have been involved in numerous cases before the Commission. Further, the Commission concludes that the Stipulation meets the second criterion. As a package, the Stipulation advances the public



interest by resolving all the issues raised in this matter consistent with R.C. 4928.143(F), the *Generic SEET Case*, and the methodology implemented by the Commission in the *Companies' 2010 SEET Case* without extensive litigation. *Generic SEET Case*, Finding and Order (June 30, 2010), Entry on Rehearing (August 25, 2010); *2010 SEET*, Order (Oct. 23, 2013) 10-29. Finally, the Commission finds that the Stipulation meets the third criterion because it does not violate any important regulatory principle or practice. *Consumers' Counsel*, supra, at 126. Accordingly, we find that the Stipulation filed by AEP-Ohio and Staff is reasonable and should be adopted.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

- (1) CSP and OP are public utilities as defined in R.C. 4905.02, and, as such, the companies are subject to the jurisdiction of this Commission.
- (2) On November 22, 2013, CSP and OP filed applications for administration of the SEET in accordance with Section 4928.143(F), Revised Code.
- (3) Intervention was granted to OCC, OEG, and OMAEG.
- (4) On February 24, 2014, AEP-Ohio and Staff filed a Stipulation to resolve all the issues raised in these matters. OCC, OEG, and OMAEG do not oppose the Stipulation.
- (5) The hearing was held on February 25, 2014.
- (6) The Stipulation submits that neither OP nor CSP had significantly excessive earnings for 2011 pursuant to R.C. 4928.143(F).
- (7) The Commission finds that the Stipulation filed in these cases is reasonable and, therefore, should be approved and adopted in its entirety.

ORDER:

It is, therefore,


ORDERED, That the Stipulation filed by AEP-Ohio and Staff be approved and adopted in its entirety. It is, further,

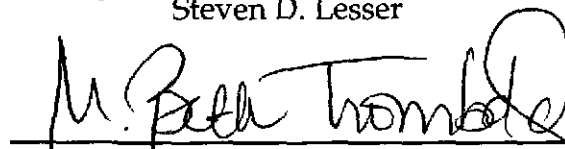
ORDERED, That a copy of this Opinion and Order be served upon all person of record.


THE PUBLIC UTILITIES COMMISSION OF OHIO

  
Todd A. Snitchler, Chairman

  
Steven D. Lesser

  
Lynn Slaby

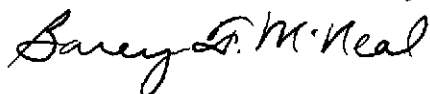
  
M. Beth Trombold

  
Asim Z. Haque

GNS/vrm

Entered in the Journal

**MAR 26 2014**



Barcy F. McNeal  
Secretary