

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. 13-2251-EL-UNC  
Test under R.C. 4928.143(F) and Ohio       )  
Adm.Code 4901:1-35-10.                       )

OPINION AND ORDER

The Commission having considered the application, 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, on behalf of 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.

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 November 22, 2013, Ohio Power Company (AEP-Ohio or Company) filed its application and supporting testimony for the administration of the significantly excessive earnings test (SEET) for 2012 revenues, as required by R.C. 4928.143(F) and Ohio Adm.Code 4901:1-35-10. By entry issued February 21, 2014, the procedural schedule was established for this case. No motions to intervene were filed in this matter. Staff testimony was timely filed on April 7, 2014. On April 16, 2014, AEP-Ohio and Staff filed a Stipulation and Recommendation (Stipulation) to resolve all the issues raised in this case. The hearing was held, as scheduled, on April 29, 2014.

At the hearing, the following exhibits were offered and admitted into the record of evidence: the 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), the Stipulation (Joint Ex. 1) and the testimony of Staff witness Joseph P. Buckley (Staff Ex. 1).<sup>1</sup>

## II. Applicable law

AEP-Ohio's first ESP, as adopted and modified by the Commission, was to be effective from January 1, 2009 through December 31, 2011 but ultimately continued through September 2012. *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., Opinion and Order (March 18, 2009), Entries on Rehearing (July 23, 2009, Nov. 4, 2009). AEP-Ohio's current ESP commenced September 2012 and is scheduled to continue until June 2015. *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, Case No. 11-346-EL-SSO et al., Opinion and Order (Aug. 8, 2012), Entries on Rehearing (Jan. 30, 2013, March 27, 2013). 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

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<sup>1</sup> Attached to the testimony of Staff witness Buckley is an Exhibit 2 for 2012. To avoid confusion, the exhibit attached to Mr. Buckley's testimony will hereinafter be referred to as JPB Ex. 2.

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, 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

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 (ROE) of the electric utility to the earned ROE of a group of publicly traded companies, including utilities that face comparable business and financial risk. Both AEP-Ohio and Staff advocated a method to select the comparable group of publicly traded companies to develop the SEET ROE.

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

In its application and supporting testimony, AEP-Ohio submits that the Company's earned per books ROE for 2012 was 7.65 percent. AEP-Ohio adjusted earnings to eliminate off-system sales margins and special accounting items. AEP-Ohio witness Mitchell submits that the special accounting items relate to impairment of certain AEP-Ohio generating units and certain restructuring charges. The 2012 after tax amounts for each specific item have been added back to net earnings available for common shareholders and common shareholder equity. Further, AEP-Ohio adjusted earnings to eliminate off-system sales margins. Accordingly, AEP-Ohio calculates an adjusted ROE of 9.76 percent for 2012. (AEP-Ohio Ex. 2 at 5-7, Ex. TEM-1.)

AEP-Ohio advocated, as it has in all prior SEET proceedings, a process to evaluate all publicly traded firms domiciled in the United States (U.S.) to develop its comparable group of companies. AEP-Ohio's process may be summarized as follows. First, AEP-Ohio determines its business risk using unlevered beta and the Company's financial risk based on its book equity ratio. Next, AEP-Ohio determines the comparable group of companies utilizing the Value Line database.<sup>2</sup> To prevent biasing the sample of firms, AEP-Ohio eliminated firms domiciled outside of the U.S., eliminated firms for which all needed data was not available, and 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 1,339 firms. Next, the Company ranked and grouped the remaining firms by their unlevered betas and book equity ratios. Using the unlevered beta of American Electric Power Corporation (AEP Corporation) has a proxy for AEP-Ohio's business risk, the Company proposes a comparable group of 75 companies, including 51 natural gas, electric, oil and gas distribution and telephone utility companies, but specifically excluding AEP Corporation. The mean ROE for AEP-Ohio's comparable group of companies is 12.47 percent with a standard deviation of 6.89 percent. AEP-Ohio submits that the process it advocates is

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<sup>2</sup> Value Line Standard Edition, October 7, 2013.

consistent with the language of R.C. 4928.143(F). Further, AEP-Ohio reasons its method of determining the comparable group of companies is objective since it relies on market-based measures of risk and is not derived from a predetermined group of companies based on industry affiliation. The Company also notes that its process delivers a reliably large sample of comparable companies and can be replicated in future SEET proceedings. (AEP-Ohio Ex. 3 at 5, 14-16, 21-26, 34-41.)

Primarily reiterating arguments offered in previous SEET cases, AEP-Ohio contends that an electric utility's earnings should 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 Company states 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 5-6, 27-32.)

AEP-Ohio concludes that the mean ROE for the comparable risk group of 75 companies for 2012 is 12.47 percent with a standard deviation of 6.89 percent. Multiplying the standard deviation of AEP-Ohio's comparable group of companies by 1.96 (corresponding to a 95 percent confidence level) yields an adder of 13.50 percent. Thus, AEP-Ohio's SEET analysis yields a threshold ROE, the point at which earnings should be considered significantly excessive for 2012, of 25.98 percent (12.47 + 13.50) for AEP-Ohio. (AEP-Ohio Ex. 3 at 7, 40-41.)

#### B. Staff's analysis

Staff witness Buckley accepted AEP-Ohio's calculation of the Company's ROE, including the adjustments, to produce an ROE of 9.76 percent for 2012. 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 as the comparable group of companies for purposes of the SEET. From the 28 companies, including AEP Corporation, in the SPDR Select Sector Fund-Utility, the Staff then determined the ROE for the group of companies by totaling the net income earned by the select sector fund companies, dividing the total net income earned by the total common equity of the companies to establish the average ROE. Utilizing the companies in the select sector fund, Staff calculates the average ROE for the group of companies for 2012 to be 10.29 percent with a standard deviation of 3.06 percent. Staff's SEET process uses 1.64 standard deviations above the mean, which Staff asserts equates to a confidence level of 95 percent. Staff's SEET analysis results in an adder of 5.01 percent (3.06 percent  $\times$  1.64 = 5.0184).<sup>3</sup> For 2012, Staff's SEET calculation yields a threshold ROE of 15.31 percent (10.29 percent + 5.02 percent). (Staff Ex. 1 at 3-6, JPB Ex. 2.)

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<sup>3</sup> The Staff's adder has been rounded up from 5.0184 to 5.02.

### C. Summary of the 2012 SEET Stipulation

On April 16, 2014, AEP-Ohio and Staff (Signatory Parties) filed a Stipulation to resolve all the issues presented in this case. AEP-Ohio and Staff agree that based on a review of the 2012 FERC Form 1 for AEP-Ohio, after adjustments for off-system sales and special accounting items, AEP-Ohio's earned ROE was 9.76 percent. AEP-Ohio and Staff aver that the method for determining AEP-Ohio's earned ROE for 2012 earnings is consistent with the methodology utilized by the Commission in the Company's SEET proceedings for 2010 and 2011 earnings. See *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. 11-4571-EL-UNC, et al. (2010 SEET Case), Opinion and Order (Oct. 23, 2013), Entry on Rehearing (Dec. 18, 2013); *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Administration of the Significantly Excessive Earnings Test under R.C. 4928.143(F) and Ohio Adm.Code 4901:1-35-10*, Case Nos. 13-2249-EL-SSO and 13-2250-EL-SSO (2011 SEET Case), Opinion and Order (March 26, 2014). (Joint Ex. 1 at 4.)

Further, the Signatory Parties agree that the Staff's testimony supports a finding that the mean ROE earned by publicly traded companies, including utilities, that face comparable business and financial risks as AEP-Ohio for 2012 is 10.29 percent and AEP-Ohio's testimony supports a finding that the comparable risk group's mean earned ROE is 12.74 percent. On that basis, the Signatory Parties recommend that the Commission find the comparable risk group's earned ROE for 2012 is within the range of 10.29 percent to 12.74 percent. (Joint Ex. 1 at 5.)

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 AEP-Ohio for 2012 is 12.29 percent to 14.74 percent. The Signatory Parties agree that AEP-Ohio's adjusted earned ROE of 9.76 percent falls below the low end of the safe harbor ROE range. Accordingly, the Signatory Parties agree that AEP-Ohio did not have significantly excessive earnings for 2012 pursuant to R.C. 4928.143(F) and the Commission's safe harbor provision. (Joint Ex. 1 at 5-6.)

### 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, 1994); *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 knowledgeable and capable parties in an open and cooperative process. Further, the Signatory Parties state that the Stipulation represents a comprehensive compromise of issues raised by parties representing diverse interests and the Stipulation presents a fair and reasonable result that, as a package, benefits ratepayers and is in 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 he was familiar with the three part test used by the Commission to evaluate stipulations and that the Stipulation filed in this case meets those criteria. Mr. Spitznogle testified that the Stipulation is the product of

serious bargaining between AEP-Ohio and Staff. 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 AEP-Ohio did not have significantly excessive earnings for 2012. 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 4-11.)

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. Counsel for and each of the parties in this matter, AEP-Ohio and Staff 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 Company's prior SEET proceedings, the *2010 SEET Case* and *2011 SEET Case*, without extensive litigation. *Generic SEET Case*, Finding and Order (June 30, 2010), Entry on Rehearing (August 25, 2010); *2010 SEET*, Opinion and Order (Oct. 23, 2013) at 10-29; *2011 SEET Case*, Opinion and Order (March 26, 2014). 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 on April 16, 2014, is reasonable and should be adopted.

#### FINDINGS OF FACT AND CONCLUSIONS OF LAW:

- (1) AEP-Ohio is a public utility as defined in R.C. 4905.02, and, as such, is subject to the jurisdiction of this Commission.
- (2) On November 22, 2013, AEP-Ohio filed its application for administration of the SEET in accordance with Section 4928.143(F), Revised Code.
- (3) On April 16, 2014, AEP-Ohio and Staff filed a Stipulation to resolve all the issues raised in this proceeding.
- (4) The hearing was held on April 29, 2014.
- (5) In the Stipulation, the Signatory Parties agree that AEP-Ohio did not have significantly excessive earnings for 2012 pursuant to R.C. 4928.143(F).



- (6) The Commission finds that the Stipulation is supported by the record and reasonable. On that basis, the Commission finds that the Stipulation should be adopted in its entirety.

ORDER:

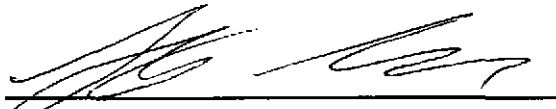
It is, therefore,

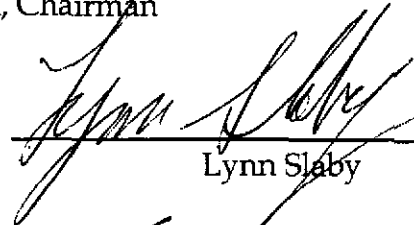
ORDERED, That the Stipulation filed by AEP-Ohio and Staff in this matter be adopted in its entirety. It is, further,

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

THE PUBLIC UTILITIES COMMISSION OF OHIO

  
Thomas W. Johnson, Chairman

  
Steven D. Lesser

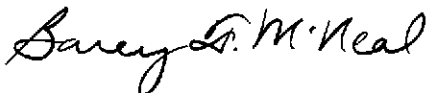
  
Lynn Slaby

  
M. Beth Trombold

  
Asim Z. Haque

GNS/vrm

Entered in the Journal **MAY 28 2014**



Barcy F. McNeal  
Secretary