BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Procurement of	:	
Standard Service Offer Generation for	:	Case No. 17-1230-EL-UNC
Customers of Ohio Power Company	:	

POST-HEARING BRIEF

SUBMITTED ON BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO

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INTRODUCTION

The Ohio Power Company did not experience significantly excessive earnings in 2016. Whether the case is viewed through either of Staff's two analyses, that of the Ohio Power Company itself or through the lens of the three part test, the conclusion is the same. Consumers' Counsel's argument to the contrary is merely a manipulation to try to obtain an unwarranted credit for customers. The Commission should reject the Consumers' Counsel's argument and find that there were no significantly excessive earnings.

STAFF ANALYSES

The Commission is required to perform an annual analysis to determine if an EDU has achieved significantly excessive returns under an ESP. Specifically the statute provides:

> 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 the commission shall permit the continued deferral 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.

R.C. 4928.143(F). Essentially the Commission must determine if the EDU in question experienced returns on equity not merely in excess of that obtained by a group of similar companies during the same period but *significantly* in excess.

To accomplish this statutory comparison the Commission has endorsed a straight-forward and transparent procedure.[1] The first step of this procedure is to take the arithmetic mean of the returns on common equity achieved during the relevant year by the companies included in the SPDR Select Sector Fund-Utility (XLU). Using the XLU as the statutory comparable group has the significant benefit of transparency. The existence of the SEET creates a significant element of risk for the investing public. It creates the possibility of a potentially large credit back to customers for reasons that may be entirely outside the control of the subject EDU. Without some publicly available comparable group it would be impossible for a potential investor or Wall Street analyst to understand the scope of the EDU's exposure to the possibility of refund. This would make the EDU appear to be more risky and less credit worthy than would otherwise be the case. Using the XLU helps to reduce[2] this artificial perception of risk. Using the XLU as the comparable group means that any member of the public can determine the scope of a potential credit under the SEET test. This minimizes the riskiness of an investment in the EDU to the benefit of the public at large and ratepayers in particular who would have to pay higher rates to cover any increased credit costs that might arise from the risk that the

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1 *See In the Matter of the Application of Columbus Southern Power Company and 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 Number 11-4571-EL-UNC (Opinion and Order) (Oct. 23, 2013).

2 It merely reduces this effect. It does not eliminate it.

SEET test inherently creates. The Staff's first step in this case, as always, was to make this calculation and it resulted in an arithmetic mean return on equity of 5.71 percent for the year 2016.[3]

The next step in the methodology is to calculate the standard deviation of the returns in the group and multiply it by 1.64. This method uses the statistical standard of 95% for significance.[4] This value is added to the mean return. Thus if an EDU has achieved a return on equity that is greater than 1.64 times the standard deviation of the group, it has earned return significantly in excess of the comparable group. In the case at hand the adder was calculated as 34% giving a resulting in an earnings threshold of 39.7%.[5] As Ohio Power's return was 14.97% in 2016, the traditional test reveals that Ohio Power did not experience significantly excessive earnings in 2016.

The Staff did not stop its analysis there. In examining the XLU the Staff found three companies which experienced exceptionally large negative returns, specifically FirstEnergy -66.2%, AES -72.8%, and NRG -17.3%. While it is conceivable that a regulated company in Ohio Power might have a minor negative return in a year, these three companies deviated from the average of the XLU by more than 400%.[6] The presence of these outliers is why the standard deviation is so large. It is difficult for the Staff to

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3 Staff Ex. 1 at 4.

4 *Id.*

5 *Id.*

6 *Id.*

accept that such massive negative returns would be possible for a regulated entity and thus these returns are not comparable or at least might be viewed as not comparable.

To address this potential concern the Staff removed the three large negative return entities and performed the analysis again. This recalculation resulted in a new mean of 8.76% and an earnings threshold of 16.08%.[7] This level is much more in keeping with the values that have been observed historically and the Staff believes this better reflects a realistic comparison group. It again shows that Ohio Power Company did not obtain significantly excessive returns in 2016.

Consumers' Counsel will argue that an additional company should be removed, Entergy with a -6.73% return. In Staff's view this is a step too far. It is conceivable that a regulated company might experience a one year, single digit negative return. As this is plausible, Entergy should remain in the group. Although its performance is unusual, it is within the range of reasonable outcomes and so should remain. It is not an outlier.

The Staff recognizes that this dispute with the Consumers' Counsel is exactly the sort of discussion that the Staff sought to avoid with its original recommendation of the use of the XLU. Disputes over what the makeup of the comparable group, with the wide-ly varying results that can be obtained depending on the specific make up of that group, are exactly what create the risk associated with the SEET. If there is no agreement on the comparable group, from an outside investor's perspective, there is no way to estimate

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[7] Staff Ex. 1 at 5.

what the exposure to refund might be. Could it be $0, or $100 million? Yes it could. There is no way to put a fence around the exposure, thus Ohio Power Company appears riskier, not because of anything that it did or failed to do, but simply because of after-the-fact decisions about group make up.

While the Staff would have preferred not to have stirred this pot again, its interest is in obtaining an accurate result no matter what that result is. Removal of the three obvious outliers with their massive losses is the best way to reach that end, but whether they are in or out, the result is the same. Ohio Power Company did not have excessive earnings in 2016.

THREE-PART TEST

A stipulation was filed in this case.[8] As the Commission is well aware, in cases where a stipulation has been submitted, the Commission applies the three part test. Specifically this test asks, was the stipulation the result of bargaining between knowledgeable parties, does it violate any important regulatory policies, and does it benefit the public? The stipulation easily passes this review.

As there are only three parties to this case, all of whom are certainly knowledgeable, the discussions were quite simple. Because the Staff's analyses and the company's analysis agreed on the result, reaching an agreement between the two was trivial. Discussion were also held between the company and the Consumers' Counsel.[9]

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[8] Joint Ex. 1

[9] Tr. At 43 and 93.

These discussions were not successful and Consumers' Counsel did not join the stipulation. There was no physical meeting of the three parties in person. None is required. All that is required is that discussions were had and they were. The gulf between the parties was simply too large to be bridged. The first prong has been satisfied.

Certainly the stipulation violates no regulatory policy. To the contrary it provides for a result which implements the statute in a clear and transparent fashion. In a circumstance where the record evidence shows that there are no significantly excessive earnings, it recommends that the Commission so find. Far from violating regulatory policy the stipulation furthers it by recommending the correct legal result to the only issue in the case. The second prong of the test is met.

The stipulation also benefits the public. It avoids the need for disagreements between the Staff and the company over the variation in their analytic approaches, simplifying the presentation of the case. More significantly the stipulation recommends the correct outcome of the case. The public is always benefitted by the correct application of the law to the facts presented. Further it does this in a transparent fashion which helps to reduce the risk that is inherently created by the SEET itself. As discussed previously, the cost of this risk is something that would ultimately be borne by the consuming public. The third prong of the test has been met.

Having shown that the stipulation meet all three prongs of the test, its recommendations should be adopted by the Commission.

Conclusion

In sum, regardless of how this case is examined, whether one looks to either of the Staff analyses, the company's analysis, or the result of the three part test, the outcome of the case is the same. The Ohio Power Company did not experience significantly excessive earnings in 2016 within the meaning of the statute. The Commission should so find.

Respectfully submitted,

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PROOF OF SERVICE

I certify that a true copy of the foregoing **Post-Hearing Brief** submitted on behalf of the Staff of the Public Utilities Commission of Ohio was served by regular U.S. mail, postage prepaid, or via electronic mail, upon the following parties of record, this 1st day of May, 2018.

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