

ORIGINAL

IN THE SUPREME COURT OF OHIO

In the Matter of the Application of	:	Case No. 2013-0521
Columbus Southern Power Company and	:	
Ohio Power Company for Authority to	:	Appeal from the Public Utilities
Establish a Standard Service Offer	:	Commission of Ohio
Pursuant to §4928.143, Ohio Rev. Code,	:	
in the Form of an Electric Security Plan.	:	Public Utilities Commission of Ohio
	:	Case No. 11-346-EL-SSO
	:	Case No. 11-348-EL-SSO
In the Matter of the Application of	:	Case No. 11-349-EL-AAM
Columbus Southern Power Company and	:	Case No. 11-350-EL-AAM
Ohio Power Company for Approval of	:	
Certain Accounting Authority.	:	
	:	
The Kroger Company,	:	
	:	
and	:	
	:	
Industrial Energy Users-Ohio,	:	
	:	
Appellants,	:	
	:	
v.	:	
	:	
Public Utilities Commission of Ohio,	:	
	:	
Appellee.	:	

FIRST MERIT BRIEF OF APPELLANT INDUSTRIAL ENERGY USERS-OHIO

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TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION.....	1
II. STATEMENT OF THE CASE.....	1
III. STANDARD OF REVIEW.....	10
IV. ARGUMENT.....	10
A. <u>Proposition of Law No. I</u> : The ESP II Order is unlawful and unreasonable because the ESP, including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, is not more favorable in the aggregate as compared to the expected results that would otherwise apply under R.C. 4928.142.....	11
1. The Commission’s order approving the ESP is contrary to its own finding that the ESP is \$386 million worse than an MRO and is based on an unlawful subjective standard.....	13
2. The Commission understated the amount the ESP fails the ESP versus MRO test by several hundred million dollars.....	17
a. The Commission used \$188.88/MW-day as the price for the capacity component for generation supply associated with the MRO, thereby overstating the MRO pricing as compared to the ESP	17
b. The ESP II Order disregards the costs of the ESP for over 25% of the ESP term and fails to account for the known costs of Turning Point, the RSR, the Capacity Shopping Tax, the PTR, and the energy-only auctions	19
B. <u>Proposition of Law No. II</u> : The ESP II Order is unlawful and unreasonable because the nonbypassable RSR, Capacity Shopping Tax, and PTR cannot lawfully be included in an ESP	23
1. The ESP II Order is unlawful and unreasonable because it authorizes nonbypassable generation-related riders which are not included in the list of permissive provisions contained in R.C. 4928.143(B)(2).....	24
2. The ESP II Order is unlawful and unreasonable because the Commission’s finding that the RSR provides stable or certain “prices” is legally insufficient to meet the requirements of R.C. 4928.143(B)(2)(d). Any charge authorized under this Section must have the effect of making the supply of retail electric “service” more stable or certain, and the RSR does not have this effect. Further, the ESP does not provide stable or certain prices	25

3.	The ESP II Order is unlawful and unreasonable because the Commission’s findings do not support authorization of the PTR under R.C. 4928.143(B)(2)(d)	29
4.	The ESP II Order is unlawful and unreasonable because it concludes that the Capacity Shopping Tax can be authorized under R.C. 4928.144. The Capacity Shopping Tax does not arise from rates or prices authorized under R.C. 4928.141 to 4928.143.....	30
5.	The ESP II Order is unlawful and unreasonable because the RSR, PTR, and Capacity Shopping Tax will result in the recovery of generation-related revenue through nonbypassable charges which violates the State Energy Policy under R.C. 4928.02 and the requirements for corporate separation under R.C. 4928.17	31
C.	<u>Proposition of Law No. III:</u> The ESP II Order is unlawful and unreasonable because it authorizes AEP-Ohio to increase SSO prices so as to collect above-market generation-related revenue through the nonbypassable RSR, the Capacity Shopping Tax, and the PTR, thereby providing AEP-Ohio with the ability to collect transition revenue or its equivalent at a time when Ohio law commands that AEP-Ohio’s generation business be fully on its own in the competitive market	33
D.	<u>Proposition of Law No. IV:</u> The ESP II Order is unlawful and unreasonable because it assumes that the Commission may invent and apply a cost-based ratemaking methodology for purposes of authorizing a significant increase in the price for Capacity Service. It is similarly unlawful and unreasonable because it authorizes AEP-Ohio to defer the uncollected portion of this significant increase in the price for Capacity Service and then, after the term of the ESP, collect such portion plus interest charges through nonbypassable charges applicable to shopping and non-shopping customers.....	38
E.	<u>Proposition of Law No. V:</u> The ESP II Order is unlawful and unreasonable because it fails to recognize that the rates and charges applicable to non-shopping customers also are providing AEP-Ohio with compensation for Capacity Service, it ignores or disregards the fact that AEP-Ohio has maintained that non-shopping customers are, on average, paying nearly twice the \$188.88/MW-day price, and it fails to establish a mechanism to credit such excess compensation obtained from non-shopping customers against any deferred balance the ESP II Order in combination with the Capacity Order works to create.....	42
F.	<u>Proposition of Law No. VI:</u> The ESP II Order is unlawful and unreasonable because, without authority to do so under R.C. 4928.143, the ESP II Order conditionally approves a transfer of generating assets without making the findings required by R.C. 4928.17 and Rule 4901:1-37-09, OAC, and without netting the above-book market value of AEP-Ohio’s generating assets against the transition revenue which the ESP II	

Order authorizes AEP-Ohio to collect on a nonbypassable basis during and
after the term of the ESP45

V. CONCLUSION 49

TABLE OF AUTHORITIES

<u>Cases</u>	<u>Page</u>
<i>Allnet Communications v. Pub. Util. Comm’n of Ohio</i> , 32 Ohio St.3d 115 (1987).....	47
<i>American Electric Power Service Corporation</i> , FERC Docket No. ER11-2183-000 (Nov. 24, 2010).....	4
<i>Constellation NewEnergy, Inc. v. Pub. Util. Comm’n of Ohio</i> , 104 Ohio St.3d 530, 2004-Ohio-6767, ¶ 50	10
<i>Consumers’ Counsel v. Pub. Util. Comm’n of Ohio</i> 61 Ohio St.3d 396, 406 (1991) (quoting <i>Columbus v. Pub. Util. Comm’n of Ohio</i> , 58 Ohio St.2d 103, 104 (1979) (Brown, J., dissenting)).....	14
<i>Elyria Foundry v. Public Util. Comm’n of Ohio</i> , 114 Ohio St.3d 305 (2007)	32
<i>Elyria Foundry Co. v. Pub. Util. Comm’n of Ohio</i> , 118 Ohio St.3d 269, 2008-Ohio-2230, ¶ 13 (quoting <i>Ohio Edison Co. v. Pub. Util. Comm’n of Ohio</i> , 78 Ohio St.3d 466, 469 (1997)).....	10
<i>In re Columbus Southern Power Co.</i> , 128 Ohio St.3d 512, 519 (2011).....	10
<i>In re Columbus Southern Power Co.</i> , 128 Ohio St.3d at 517.....	28
<i>In re Columbus Southern Power Co.</i> , 128 Ohio St.3d at 519.....	14, 15
<i>In re Columbus Southern Power Co.</i> , 128 Ohio St.3d at 519-20.....	24, 44, 48
<i>Montgomery County Bd. of Comm’rs v. Pub. Util. Comm’n of Ohio</i> , 28 Ohio St.3d 171, 175 (1986) (citations omitted)	24
<i>Time Warner AxS v. Pub. Util. Comm’n of Ohio</i> , 75 Ohio St.3d 229, 234 (1996).....	39
<i>Tongren v. Pub. Util. Comm’n of Ohio</i> , 85 Ohio St.3d 87 (1998).....	47
 <u>Other Authorities</u>	
<i>In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company</i> , Case No. 10-2929-EL-UNC, Entry (Dec. 8, 2010).....	4

In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company,
Case No. 10-2929-EL-UNC, Opinion and Order (July 2, 2012).....4,
.....5, 6, 18, 19, 22, 31, 36, 39, 42

In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company,
Case No. 10-2929-EL-UNC, Entry on Rehearing (Oct. 17, 2012).....31

In the Matter of the Application of Ohio Power Company for Approval of Full Legal Corporate Separation and Amendment to its Corporate Separation Plan,
Case No. 12-1126-EL-UNC, Finding and Order (Oct. 17, 2012).....47

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 Nos. 11-346-EL-SSO, *et al.*, Opinion and Order (Aug. 8, 2012)1, 6, 7,
.....8, 9, 14, 18, 20, 22, 23, 24, 25, 26, 27, 31, 33, 36, 37, 39, 43, 44, 46, 47, 49

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Their electric Transition Plans and for Receipt of Transition Revenues,
Case Nos. 99-1729-EL-ETP, *et al.*, Opinion and Order (Sept. 28, 2000)33

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 Nos. 11-346-EL-SSO, *et al.*, Entry on Rehearing (Jan. 30, 2013).....8, 9,
.....10, 21, 23, 24, 25, 29, 30, 34, 39, 43 46

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 Nos. 11-346-EL-SSO, *et al.*, Second Entry on Rehearing (Mar. 27, 2013).....10

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 Nos. 08-917-EL-SSO, *et al.*, Opinion and Order (Mar. 18, 2009).....29

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 Assets,
Case Nos. 08-917-EL-SSO, *et al.*, Order on Remand (Oct. 3, 2011).....28

In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Approval of a Market Rate Offer to Conduct a Competitive Bidding Process for Standard Service Offer Electric Generation Supply, Accounting Modifications Associated with Reconciliation Mechanism, and Tariffs for Generation Service,
Case Nos. 08-936-EL-SSO, *et al.*, Opinion and Order at 13-14 (Nov. 25, 2008)32

In the Matter of the Application of The Cincinnati Gas & Electric Company to Modify its Nonresidential Generation Rates to Provide for Market-Based Standard Service Offer Pricing and to Establish an Alternative Competitive-Bid Service Rate Option Subsequent to the Market Development Period,
Case Nos. 03-93-EL-ATA, *et al.*, Order on Remand at 37 (Oct. 24, 2007)32

In the Matter of the Application of Ohio Power Company for Approval of the Shutdown of Unit 5 of the Philip Sporn Generating Station and to Establish a Plant Shutdown Rider,
Case No. 10-1454-EL-RDR, Finding and Order at 19 (Jan. 11, 2012)32, 41

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of their Electric Transition Plans and for Receipt of Transition Revenues,
Case Nos. 99-1729-EL-ETP, *et al.*, Opinion and Order (Sept. 28, 2000)33

In the Matter of the Commission’s Review of Customer Impacts from Ohio Power Company’s Transition to Market Based Rates,
Case No. 13-1530-EL-UNC, Entry (June 27, 2013).....38

Statutes

Ohio Revised Code

Chapter 492815, 16, 17, 41, 50
R.C. 4903.0914, 15, 22, 47
R.C. 4905.0431, 41
R.C. 4905.0531, 41
R.C. 4905.0631, 40, 41
R.C. 4905.1331, 41
R.C. 4905.2631
R.C. 4928.0126, 39, 40
R.C. 4928.0216, 31, 32, 33, 42, 48
R.C. 4928.0316, 39, 40, 41
R.C. 4928.05(A).....39, 41
R.C. 4928.0632, 42
R.C. 4928.1226
R.C. 4928.1415

R.C. 4928.17	16, 32, 33, 45, 48
R.C. 4928.20	29
R.C. 4928.31(A).....	34, 35
R.C. 4928.38	27, 35
R.C. 4928.39	34, 49
R.C. 4928.40	35
R.C. 4928.141	11, 17, 22, 31, 35, 40, 41
R.C. 4928.142	11, 12, 13, 21
R.C. 4928.143	5, 6, 11, 12, 13, 14, 15, 17, 20, 22, 24, 25, 26, 27, 29, 30, 31, 45, 48
R.C. 4928.144	22, 26, 31, 40, 41

Ohio Administrative Code

Rule 4901:1-37-09	45, 46, 47, 49
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U.S. Constitution

U.S. Const., Art. I, § 8, cl. 3.....	40
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I. INTRODUCTION

In the proceeding below,¹ Columbus Southern Power Company and Ohio Power Company (“AEP-Ohio”)² sought authorization for an electric security plan (“ESP”). In violation of the applicable law, the Public Utilities Commission of Ohio (“Commission”) modified and approved an ESP that is worse than the market-based alternative by at least \$386 million and permitted AEP-Ohio to collect above-market generation-related compensation through unlawful nonbypassable charges. Further, the Commission approved a transfer of generation assets that will maintain unlawful anticompetitive subsidies. Taken together, the Commission’s unlawful orders deprive AEP-Ohio’s customers of the benefits available in the retail electricity market and must be reversed.

II. STATEMENT OF THE CASE

AEP-Ohio filed for a new ESP on January 27, 2011.³ On September 7, 2011, AEP-Ohio and several intervenors filed a Stipulation and Recommendation (“Stipulation”) that proposed a resolution of the January 27, 2011 application and several other matters including a pending investigation into the compensation AEP-Ohio collected for generation-related capacity service (“Capacity Service”) supplied to competitive retail electric service (“CRES”) providers.⁴ The

¹ *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 Nos. 11-346-EL-SSO, *et al.* (Jan. 27, 2011) (“AEP-Ohio ESP II Case”).

² When the first application was filed in this case, Columbus Southern Power Company and the Ohio Power Company were separately certified electric distribution utilities (“EDUs”). On December 30, 2011, the EDUs merged and the Ohio Power Company was the surviving entity.

³ *AEP-Ohio ESP II Case*, Columbus Southern Power Company’s and Ohio Power Company’s Application (Jan. 27, 2011) (viewed at: <http://dis.puc.state.oh.us/TiffToPDF/A1001001A11A28A91210E97507.pdf>).

⁴ *AEP-Ohio ESP II Case*, Opinion and Order at 5 (Aug. 8, 2012) (“ESP II Order”) (Appendix at 28). References to the Appendix are hereafter abbreviated as Appx.

Stipulation was contested, and the Commission conducted hearings on the Stipulation.⁵ Over the objections of Industrial Energy Users-Ohio (“IEU-Ohio”) and others, the Commission approved the Stipulation on December 14, 2011, with rates becoming effective January 1, 2012.⁶ In response to the public outcry and applications for rehearing, the Commission subsequently found that two provisions of the Stipulation were not in the public interest and reversed its order approving the Stipulation.⁷ In the same Entry issued on February 23, 2012, the Commission directed AEP-Ohio to indicate what further action it intended to take on its ESP application.⁸ In response, AEP-Ohio filed a modified ESP application (“Application”) on March 30, 2012.⁹

In its Application, AEP-Ohio proposed a pricing scheme for Capacity Service that set the price for a percentage of Capacity Service at \$145.79/megawatt-day (“MW-day”) and the balance at \$255/MW-day.¹⁰ Additionally, it proposed three new unavoidable (nonbypassable) riders. It sought a Retail Stability Rider (“RSR”)¹¹ designed to collect \$284 million over the term of the ESP.¹² AEP-Ohio proposed a Generation Resource Rider (“GRR”) to recover costs associated with a proposed solar generation facility called Turning Point.¹³ AEP-Ohio also proposed a Pool Termination Rider (“PTR”) to recover revenue lost because of the dissolution of

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ *AEP-Ohio ESP II Case*, Ohio Power Company’s Modified Electric Security Plan (Mar. 30, 2012) (“Application”) (Supplement at 1). References to the Supplement are hereafter abbreviated Supp.

¹⁰ AEP-Ohio Ex. 116 at 6 (Supp. at 30).

¹¹ Application at 10 (Supp. at 10).

¹² AEP-Ohio Ex. 116 at 13-15 & Exhibit WAA-6 (Supp. at 37-39 & 54).

¹³ Application at 8-9 (Supp. at 8-9).

the AEP-East Interconnection Agreement (“Pool Agreement”), a wholesale revenue sharing agreement among the AEP-East operating companies.¹⁴

Additionally, AEP-Ohio stated that it would file a separate application seeking approval of the transfer of its generation assets to an unregulated competitive affiliate.¹⁵

More than 30 parties intervened and objected to every major provision in the Application. In particular, IEU-Ohio showed that neither the RSR nor PTR was permitted as a term of an ESP because either would authorize AEP-Ohio to unlawfully collect transition or equivalent revenue.¹⁶ Further, IEU-Ohio showed that the proposed scheme to price capacity at two different rates was unlawful and that the ESP failed the statutory test that precludes the Commission from approving an ESP unless it is more favorable in the aggregate than the market-based alternative.¹⁷

At the same time that AEP-Ohio was seeking to set prices for Capacity Service and new nonbypassable charges as part of its application for an ESP, it also was seeking increased compensation for the provision of Capacity Service in a separate proceeding that began in 2010.¹⁸ In November 2010, American Electric Power Service Corporation (“AEPSC”), on

¹⁴ AEP-Ohio Ex. 103 at 21 (Supp. at 79).

¹⁵ Application at 3 (Supp. at 3). The separate application was filed in *In the Matter of the Application of Ohio Power Company for Approval of Full Legal Corporate Separation and Amendment to its Corporate Separation Plan*, Case No. 12-1126-EL-UNC (Apr. 1, 2012) (“*Corporate Separation Case*”) (viewed at: <http://dis.puc.state.oh.us/TiffToPDF/A1001001A12D02A74438B73068.pdf>).

¹⁶ IEU-Ohio Ex. 124 (Supp. at 94).

¹⁷ IEU-Ohio Ex. 125 (Supp. at 137).

¹⁸ For a detailed description of the history of AEP-Ohio’s efforts to replace the federally and Commission-approved market-based method of establishing compensation for Capacity Service with a method that pushed its compensation significantly above market, see *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company*, Case No. 2013-228, Merit Brief of Appellant/Cross-Appellee Industrial Energy Users-Ohio at 2-8 (Ohio Sup. Ct. filed July 15, 2013).

behalf of Ohio Power Company and Columbus Southern Power Company, filed an application with the Federal Energy Regulatory Commission (“FERC”) for a formula-based capacity charge.¹⁹ In response to AEPSC’s FERC application, the Commission directed AEP-Ohio to continue to use market-based pricing for Capacity Service and opened an investigation on December 8, 2010.²⁰ After receiving comments, the Commission scheduled a hearing to commence on October 4, 2011 on the determination of a compensation mechanism.²¹ Before the hearing began, however, AEP-Ohio filed the Stipulation, which in addition to addressing the terms of an ESP, recommended that the Commission approve a capacity pricing scheme in which AEP-Ohio would be authorized to charge two different prices for Capacity Service. A percentage of the shopping load would be priced at the Reliability Pricing Model-Based Price (“RPM-Based Price”), a price for Capacity Service produced by an auction process used by the PJM Interconnection, LLC (“PJM”) that is generally referred to as the market-based pricing method.²² The balance of the Capacity Service was to be priced at an arbitrary amount of \$255/MW-day.²³ After the Commission rejected the Stipulation on February 23, 2012, the

¹⁹ *American Electric Power Service Corporation*, FERC Docket No. ER11-2183-000 (Nov. 24, 2010) (viewed at: <http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=12494894>).

²⁰ *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC, Entry (Dec. 8, 2010) (“*AEP-Ohio Capacity Case*”) (Supp. at 231).

²¹ *AEP-Ohio Capacity Case*, Opinion and Order at 5 (July 2, 2012) (“*Capacity Order*”) (Supp. at 238).

²² PJM is a regional transmission organization (“RTO”) that conducts auctions to set the price of generation-related capacity service used by load serving entities (“LSEs”) to secure capacity for reliability of electric service. IEU-Ohio Ex. 125 at 9, 18-19 (Supp. at 147, 156-57).

²³ *AEP-Ohio ESP II Case*, Stipulation and Recommendation at 19-23 (Sept. 7, 2011) (Supp. at 297-301).

Commission established a procedural schedule and conducted hearings in the *AEP-Ohio Capacity Case*.²⁴

The Commission issued an order on July 2, 2012 in the *AEP-Ohio Capacity Case* that invented and applied a cost-based ratemaking methodology to increase the compensation of AEP-Ohio for its provision of Capacity Service. The Commission found that “pursuant to [its] regulatory authority under Chapter 4905, Revised Code, as well as Chapter 4909, Revised Code, [] it is necessary and appropriate to establish a cost-based state compensation mechanism for AEP-Ohio.”²⁵ Using an invented cost-based ratemaking methodology, the Commission found AEP-Ohio’s “cost” of capacity is \$188.88/MW-day.²⁶ Thus, the Commission authorized AEP-Ohio to collect revenue for Capacity Service well in excess of the RPM-Based Prices that ranged from \$20.01/MW-day to \$153.89/MW-day over the relevant three year period of June 2012 to May 2015.²⁷

The Commission, however, held that it would not permit AEP-Ohio to collect immediately the full amount of the \$188.88/MW-day price for Capacity Service. Instead, it ordered AEP-Ohio to collect from CRES providers the RPM-Based Price and authorized accounting changes to allow AEP-Ohio to defer the difference, with carrying charges, between what it collected at the RPM-Based Price and \$188.88/MW-day (the “Capacity Shopping

²⁴ Capacity Order at 6 (Supp. at 239). The Commission also directed AEP-Ohio to restore the market-based pricing method of capacity that was in place prior to the ESP and in accordance with R.C. 4928.143(C)(2). AEP-Ohio did not comply with this directive; it continued to collect the above-market price for Capacity Service that was authorized as part of ESP that was contrary to the public interest.

²⁵ *Id.* at 22 (Supp. at 255).

²⁶ *Id.* at 22 & 36 (Supp. at 255 & 269).

²⁷ *Id.* at 10 (Supp. at 243).

Tax”).²⁸ The Commission concluded that it would establish a mechanism to amortize the Capacity Shopping Tax in the *AEP-Ohio ESP II Case* even though the record had already closed in that case.²⁹

Because the record had closed and parties had already filed initial briefs when the Commission issued the Capacity Order, the parties addressed the issues created by the Capacity Order in their reply briefs in the *AEP-Ohio ESP II Case*. Several, including IEU-Ohio, challenged the lawfulness of transferring the adoption of a recovery mechanism to the *AEP-Ohio ESP II Case*.³⁰ On August 8, 2012, the Commission issued the ESP II Order that authorized an RSR (a portion of which AEP-Ohio was directed to use to offset the Capacity Shopping Tax), a mechanism to amortize any remaining Capacity Shopping Tax after the term of the ESP ended, and the PTR.

To determine the amount of the RSR, the Commission set an annual revenue target of \$826 million based on the assumption that AEP-Ohio should have the opportunity to earn a reasonable rate of return.³¹ It then subtracted the revenue AEP-Ohio was expected to receive for competitive non-fuel generation service under the standard service offer (“SSO”), Capacity Service revenue for load provided to CRES providers, and revenue from off-system sales of energy.³² Based on the math used to calculate the RSR, the Commission authorized AEP-Ohio

²⁸ *Id.* at 23 (Supp. at 256).

²⁹ *Id.* at 23-24 (Supp. at 256-57). The initial briefs in the *AEP-Ohio ESP II Case* were filed on June 29, 2012. The Capacity Order was issued on July 2, 2012. The reply briefs in the *AEP-Ohio ESP II Case* were filed on July 9, 2012.

³⁰ ESP II Order at 51 (Appx. at 74).

³¹ *Id.* at 33 (Appx. at 56). Unlike the method of traditional cost-plus ratemaking contained in Chapter 4909, Revised Code, a reasonable rate of return is not a component of the market-based compensation approach embedded in R.C. 4928.143.

³² *Id.* at 33-34 (Appx. at 56-57).

to collect above-market revenue of \$508 million for the term of the ESP, which is scheduled to run through May 31, 2015.³³

The Commission on its own motion also approved a collection mechanism for the amount it permitted AEP-Ohio to defer in the Capacity Order. It held that AEP-Ohio must allocate \$1/megawatt-hour (“MWh”) of RSR revenue toward the Capacity Shopping Tax.³⁴ If there was any remaining balance at the conclusion of the ESP, the Commission authorized AEP-Ohio to collect that amount through another nonbypassable charge that might extend for another three years.³⁵ Based on AEP-Ohio’s own estimate of the amount of shopping load that would occur during the term of the ESP, IEU-Ohio estimated AEP-Ohio would collect an additional \$833 million above the market-based revenue.³⁶

In approving the PTR, the Commission authorized AEP-Ohio to collect additional above-market generation-related revenue based on the difference between the wholesale revenue it would recover under the Pool Agreement and what it would recover in the wholesale market after the Pool Agreement is terminated.³⁷ One intervenor estimated that the total above-market revenue collected through the PTR could reach \$410 million.³⁸

In addition to generation-related nonbypassable riders that authorize AEP-Ohio to collect above-market revenue, the Commission approved a nonbypassable rider, the GRR, for the

³³ *Id.* at 35 (Appx. at 58).

³⁴ *Id.* at 36 & 52 (Appx. at 59 & 75).

³⁵ *Id.*

³⁶ *AEP-Ohio ESP II Case*, Reply Brief of Industrial Energy Users-Ohio at 12-13 (July 9, 2012) (Supp. at 336-37).

³⁷ ESP II Order at 47-48 (Appx. at 70-71).

³⁸ FirstEnergy Solutions Corp. (“FES”) Ex. 104 at 31 (Supp. at 423).

recovery of costs associated with the proposed construction of Turning Point.³⁹ Although the Commission subsequently found that there was no need for Turning Point,⁴⁰ the GRR remains important because the Commission failed to fully account for its effect in assessing the ESP. At the time the Commission issued the ESP II Order, AEP-Ohio was still seeking to construct Turning Point and collect the costs through the nonbypassable GRR. The estimated cost of Turning Point for the life of the facility was \$357.2 million.⁴¹

After the Commission modified and approved the various riders that AEP-Ohio sought, the Commission then addressed whether the ESP as modified was more favorable in the aggregate than a Market Rate Offer (“MRO”) (“ESP versus MRO test”). The Commission used a three-step test similar to that advanced by AEP-Ohio, but rejected AEP-Ohio’s attempt to show that the ESP was more favorable because “AEP-Ohio made multiple errors in conducting the statutory test.”⁴² The Commission then began its own search of the record to “correct” AEP-Ohio’s errors.⁴³ Making several changes to AEP-Ohio’s treatment of costs in the ESP versus MRO test, the Commission concluded that the ESP, as modified by the Commission, was \$386 million *worse* than an MRO.⁴⁴ The Commission, however, did not account for benefits of the MRO for the full ESP term and understated or ignored the costs of the nonbypassable riders it

³⁹ ESP II Order at 19-25 (Appx. at 42-48).

⁴⁰ *AEP-Ohio ESP II Case*, Entry on Rehearing at 8 (Jan. 30, 2013) (Appx. at 114).

⁴¹ Office of the Ohio Consumers’ Counsel (“OCC”) Ex. 114 at 17-18 (based on the supplemental testimony of AEP-Ohio witnesses Thomas, Nelson, and Roush) (Supp. at 504-05).

⁴² ESP II Order at 73 (Appx. at 96).

⁴³ *Id.*

⁴⁴ *Id.* at 75 (Appx. at 98).

approved. Properly accounted for, these additional costs would substantially increase the amount that the ESP fails the ESP versus MRO test above \$386 million.⁴⁵

Despite finding that the ESP was substantially worse than an MRO, the Commission nevertheless concluded that “in weighing the statutory price test which favors the modified ESP by \$9.8 million, as well as the quantifiable costs and benefits associated with the modified ESP, and the non-quantifiable benefits, as we find the modified ESP, is more favorable in the aggregate than what would otherwise apply under an MRO [*sic*].”⁴⁶ The Commission assigned unexplained value to increased reliability in distribution service, the use of energy-only auctions to supply the SSO, and the use of auctions for both energy and capacity to supply the SSO after the term of the ESP ended.⁴⁷ In particular, the Commission found that the move to an auction-based SSO would be “invaluable.”⁴⁸

The Commission also conditionally approved the transfer of generation assets from AEP-Ohio to a competitive affiliate in the ESP II Order despite the fact that AEP-Ohio had filed a separate application for approval of the transfer.⁴⁹ With the transfer of the assets, the Commission also approved the pass-through of above-market generation revenue collected through nonbypassable charges to the unregulated competitive affiliate.⁵⁰

IEU-Ohio filed two applications for rehearing demonstrating that the Commission acted unlawfully and unreasonably when it found that the ESP satisfied the ESP versus MRO test,

⁴⁵ See discussion below.

⁴⁶ ESP II Order at 77 (Appx. at 100).

⁴⁷ *Id.* at 75-76 (Appx. at 98-99).

⁴⁸ Entry on Rehearing at 11 (Jan. 30, 2013) (Appx. at 117).

⁴⁹ *Corporate Separation Case*, Ohio Power Company’s Application for Approval of Full Legal Corporate Separation and Amendment to its Corporate Separation Plan (Apr. 1, 2012) (viewed at: <http://dis.puc.state.oh.us/TiffToPDF/A1001001A12D02A74438B73068.pdf>).

⁵⁰ ESP II Order at 57-60 (Appx. at 80-83).

approved riders not authorized by Ohio law, and conditionally authorized the transfer of the generation assets and the pass-through of above-market revenue to the competitive affiliate.⁵¹ The Commission denied the applications for rehearing.⁵² IEU-Ohio then filed its notice of appeal.⁵³

III. STANDARD OF REVIEW

“R.C 4903.13 provides that a [Commission] order shall be reversed, vacated, or modified by this court ... when, upon consideration of the record, the court finds the order to be unlawful or unreasonable.”⁵⁴ The Supreme Court (“Court”) “has ‘complete and independent power of review as to all questions of law’ in appeals from the commission.”⁵⁵ As to factual determinations, the Court will review the Commission action to determine if the Commission based its decision on the record: “[r]uling on an issue without record support is an abuse of discretion and reversible error.”⁵⁶

IV. ARGUMENT

Based on the applicable law and the record developed below, the Commission should have rejected the ESP because the ESP failed the ESP versus MRO test by at least \$386 million

⁵¹ Industrial Energy Users-Ohio’s Application for Rehearing of the August 8, 2012 Opinion and Order and Memorandum in Support (Sept. 7, 2012) (Appx. at 181); Application for Rehearing of the January 30, 2013 Entry on Rehearing and Memorandum in Support by Industrial Energy Users-Ohio (Mar. 1, 2013) (Appx. at 287).

⁵² Entry on Rehearing (Jan. 30, 2013) (Appx. at 107); Second Entry on Rehearing (Mar. 27, 2013) (Appx. at 173).

⁵³ Notice of Second Appeal of Appellant Industrial Energy Users-Ohio (May 8, 2013) (Appx. at 1).

⁵⁴ *Constellation NewEnergy, Inc. v. Pub. Util. Comm’n of Ohio*, 104 Ohio St.3d 530, 2004-Ohio-6767, ¶ 50.

⁵⁵ *Elyria Foundry Co. v. Pub. Util. Comm’n of Ohio*, 118 Ohio St.3d 269, 2008-Ohio-2230, ¶ 13 (quoting *Ohio Edison Co. v. Pub. Util. Comm’n of Ohio*, 78 Ohio St.3d 466, 469 (1997)).

⁵⁶ *In re Columbus Southern Power Company*, 128 Ohio St.3d 512, 519 (2011) (“Remand Case”).

and is in fact much worse when all of the costs are addressed properly. Further, the Commission should have rejected the nonbypassable riders that cannot be lawfully authorized as provisions of an ESP and that permit AEP-Ohio to collect above-market generation-related transition revenue. The Commission also unlawfully failed to comply with statutory and administrative requirements applicable to a transfer of generation assets, and in doing so engaged in a shell game depriving the parties of an opportunity to challenge the lawfulness of the terms of the generation asset transfer. For these reasons, the Court should reverse and remand the ESP II Order to the Commission and direct the Commission to find that the ESP fails the ESP versus MRO test and that the nonbypassable generation-related riders are not lawful, and further reverse the Commission's order conditionally authorizing the transfer of generation assets.

- A. Proposition of Law No. I: The ESP II Order is unlawful and unreasonable because the ESP, including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, is not more favorable in the aggregate as compared to the expected results that would otherwise apply under R.C. 4928.142**

Ohio law, following the adoption of Amended Substitute Senate Bill 221 ("SB 221"), requires an EDU to provide "a standard service offer of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service."⁵⁷ The SSO may be in one of two forms: an MRO⁵⁸ or an ESP.⁵⁹

The MRO is determined through a competitive bidding process ("CBP").⁶⁰ If an EDU files an application for an MRO, the Commission must determine whether the application complies with statutory requirements and Commission rules governing the solicitation, product

⁵⁷ R.C. 4928.141(A).

⁵⁸ R.C. 4928.142.

⁵⁹ R.C. 4928.143.

⁶⁰ R.C. 4928.142.

definition, evaluation criteria, and third party oversight of the CBP; further, the EDU must participate in an RTO.⁶¹ If the Commission makes a finding that the MRO complies with the requirements, the EDU may initiate the CBP.⁶² Upon completion of the CBP, the Commission then is to select the least-cost bid winner or winners of the CBP, and the winning bid or bids as prescribed as retail rates by the Commission become the EDU's SSO.⁶³

Ohio provides for one variation on the use of the CBP to set the MRO. A first application of an EDU that owned generation facilities as of July 31, 2008 requires that a portion of the SSO be competitively bid for the first five years of the MRO. The SSO price under the first application then shall be a proportionate blend of the bid price and a prior generation service price for the remaining load with the price of the latter equal to the EDU's most recent SSO price, subject to adjustments for prudently incurred costs of fuel, costs of purchased power, costs to comply with renewable energy and energy efficiency requirements, and costs to comply with environmental laws and regulations.⁶⁴

Instead of an MRO, the EDU may elect to provide default generation service through an ESP.⁶⁵ The ESP must contain provisions relating to the supply and pricing of electric generation service and may contain other provisions not available through an MRO.⁶⁶ The EDU has the burden to demonstrate that the ESP meets the statutory requirements governing an ESP.⁶⁷ The

⁶¹ R.C. 4928.142(B)(3).

⁶² *Id.*

⁶³ R.C. 4928.142(C). The Commission must reject the bid or bids if one of three criteria is met. *Id.*

⁶⁴ R.C. 4928.142(D). The portion competitively bid is to be 10% in the first year, up to 20% in the second year, 30% in the third year, 40% in the fourth year, and 50% in the fifth year. *Id.*

⁶⁵ R.C. 4928.143.

⁶⁶ R.C. 4928.143(B)(1) & (2).

⁶⁷ R.C. 4928.143(C)(1).

Commission may approve or modify and approve an ESP if the ESP, including its pricing and all other terms including any deferrals and the collection of those deferrals, is more favorable in the aggregate than an MRO (the ESP versus MRO test noted previously).⁶⁸ If the Commission modifies and approves an application for an ESP, the EDU may withdraw and thereby terminate the ESP.⁶⁹ If the ESP does not satisfy the ESP versus MRO test, the Commission must reject it.⁷⁰

In applying the ESP versus MRO test, the Commission must compare the ESP to the “expected results that would otherwise apply under section 4928.142 of the Revised Code”.⁷¹ R.C. 4928.143(C) does not define whether the MRO, for purposes of comparison, is an MRO based on a competitive bid for the entire SSO load or an MRO in which the price of the SSO is set through the alternative in which the price is blended. That question, however, is not before the Court. In this case, the parties uniformly used blended MRO prices in their comparisons to the ESP because AEP-Ohio owned generation facilities on July 31, 2008.

Based on its estimate that the ESP is \$386 million worse than an MRO, the Commission should have rejected the ESP. The Commission, however, erred by injecting subjectively valued and unexplained benefits to offset the substantial amount that the ESP failed the ESP versus MRO test. It further erred by misapplying the test to understate the total amount by which the ESP failed the ESP versus MRO test.

- 1. The Commission’s order approving the ESP is contrary to its own finding that the ESP is \$386 million worse than an MRO and is based on an unlawful subjective standard**

⁶⁸ *Id.*

⁶⁹ R.C. 4928.143(C)(2).

⁷⁰ R.C. 4928.143(C)(1).

⁷¹ *Id.*

To avoid rejecting the ESP as required by R.C. 4928.143(C)(1), the ESP II Order assigns some indeterminate, but apparently significant, weight to over-the-horizon qualitative benefits attributed to the as-approved ESP. The Commission's reliance on qualitative benefits to justify its conclusion that the ESP is more favorable than an MRO was unlawful and unreasonable for several reasons.

Initially, the Commission did not provide findings of fact to support its decision. In a contested case, R.C. 4903.09 requires the Commission to issue "findings of fact and [a] written opinion[] setting forth the reasons prompting the decision[] arrived at, based on said findings of fact." As the Court has indicated, the Commission in assessing the record must explain its rationale, respond to contrary positions, and support its decision with appropriate evidence.⁷² "The commission cannot decide cases on subjective belief, wishful thinking, or folk wisdom."⁷³ Thus, R.C. 4903.09 imposes on the Commission a requirement to apply an objective standard to the ESP versus MRO test.

In this case, however, the Commission ignored the requirement of R.C. 4903.09. Instead of rejecting the ESP based on the objective result that the ESP was \$386 million worse than the MRO, the Commission identified non-quantified benefits of increased reliability, alleged benefits of energy-only auctions, and a "quicker" move to an auction-based SSO that outweighed the costs of the ESP it did recognize.⁷⁴ The Commission does not explain the math it used to offset \$386 million, and its findings demonstrate that there is no value in the so-called non-quantified benefits of the ESP. In the case of the increased reliability, the Commission itself identified that

⁷² *Remand Case*, 128 Ohio St.3d at 519.

⁷³ *Consumers' Counsel v. Pub. Util. Comm'n of Ohio*, 61 Ohio St.3d 396, 406 (1991) (quoting *Columbus v. Pub. Util. Comm'n of Ohio*, 58 Ohio St.2d 103, 104 (1979) (Brown, J., dissenting)).

⁷⁴ ESP II Order at 75-76 (Appx. at 98-99).

the customers paid distribution-related riders to secure the reliability benefits, but does not explain how the benefits exceed the costs customers are paying.⁷⁵ The energy-only auctions will increase the cost of the SSO, as discussed separately below, and the ESP calculation should have incorporated these additional costs.⁷⁶ The only remaining asserted benefit is the move to an auction-based SSO after the term of the ESP. The Commission, however, never explains the math it is using to offset millions of dollars of costs. (As discussed below, it also refused to consider other costs of the ESP outside the term of the ESP such as the Capacity Shopping Tax and the GRR.) Without an objective, coherent, and articulated explanation of how these so-called qualitative benefits were weighted, the ESP II Order's subjective qualitative benefits test prevents the parties, the Court, and the public from assessing the validity of the Commission's decision. R.C. 4903.09 requires more than the "trust me" reasoning contained in the ESP II Order.⁷⁷

Additionally, the ESP II Order unlawfully and unreasonably assumes that the ESP will produce a qualitative "benefit" through some future default generation supply price outcome when that outcome is not within the control of the Commission. R.C. Chapter 4928 does not require AEP-Ohio to submit an SSO that establishes default generation supply prices based on a capacity and energy auction, and if the Commission orders an auction-based SSO as part of some future ESP, AEP-Ohio may reject it.⁷⁸ AEP-Ohio's assumed ability to terminate the ESP is particularly relevant in this case because AEP-Ohio's commitment to an auction-based ESP in 2015 was tied to numerous conditions, some of which (*e.g.*, adoption of AEP-Ohio's capacity

⁷⁵ *Id.* at 76 (Appx. at 99).

⁷⁶ *Id.* at 39-40 (Appx. at 62-63).

⁷⁷ *Remand Case*, 128 Ohio St.3d at 519.

⁷⁸ R.C. 4928.143(C)(2)(a) permits an EDU to withdraw its ESP application, thereby terminating it, if the Commission modifies and approves the application.

pricing scheme and RSR) have already been rejected by the Commission.⁷⁹ Under these circumstances, it is unreasonable and unlawful for the ESP II Order to conclude that the ESP provides a future qualitative benefit greater than its near-term quantitative disadvantage.

Finally, the ESP II Order's assumption that a move (faster or otherwise) to a CBP to set the default generation supply price will yield a qualitative benefit demonstrates that the ESP II Order is based on a fundamental misconception about the statutory outcomes required by R.C. Chapter 4928. The General Assembly has declared retail generation service to be a competitive service.⁸⁰ The SSO, whether based on an ESP or MRO, contains a default generation supply component for those customers not receiving competitive service from a CRES provider.⁸¹ The General Assembly's expressed goal is to encourage customer choice through actions by individual customers having comparable and non-discriminatory access to a diverse group of CRES providers.⁸² The goal includes a statutory scheme that specifically limits the role of the EDU to that of a default supplier of competitive services and prohibits an EDU from being directly engaged in the business of providing competitive services.⁸³ Yet, the ESP II Order authorizes an SSO that stabilizes AEP-Ohio's earnings and does not meet the ESP versus MRO test on the belief that a future SSO may, someday, produce a somewhat better, qualitatively speaking, default generation supply outcome. In other words, the ESP II Order wrongly elevates a future qualitative goal regarding the default generation supply available from an EDU and the near-term success of AEP-Ohio's competitive generation business above the present goal of

⁷⁹ AEP-Ohio Ex. 101 at 4-5 (Supp. at 522-23).

⁸⁰ R.C. 4928.03.

⁸¹ R.C. 4928.14.

⁸² R.C. 4928.02(A).

⁸³ R.C. 4928.17.

providing customers with meaningful access to the electricity market at a time when market prices are the lowest they have been in ten years.

By assigning some subjective, but apparently substantial, benefit to the “quicker” move to a competitively bid SSO, the ESP II Order unreasonably and unlawfully reverses the priorities clearly expressed in Ohio law. The Commission’s role in setting the SSO’s default generation supply price is specifically limited by R.C. 4928.141 through 4928.143. That role does not permit the Commission to subordinate the customer choice rights of individual customers because the Commission wants to help an EDU and its generation business evade the discipline provided by customer choice or because the Commission believes that a future default generation supply option may be better, qualitatively speaking. So the fundamental premise of the ESP II Order (a premise that permits future qualitative benefits⁸⁴ associated with an unknown default generation supply option outcome to override a clear, near-term quantitative customer choice disadvantage) unreasonably and unlawfully conflicts with the driving purpose of Ohio’s electric restructuring legislation contained in R.C. Chapter 4928.

2. The Commission understated the amount the ESP fails the ESP versus MRO test by several hundred million dollars

In addition to unlawfully injecting a subjective test into the ESP versus MRO test, the Commission made several errors quantifying the costs of the ESP and MRO. When the costs are properly accounted for, the ESP fails the ESP versus MRO test by much more than the \$386 million found by the Commission.

a. The Commission used \$188.88/MW-day as the price for the capacity component for generation supply associated with the

⁸⁴ Establishing the SSO’s default generation supply price by means of a CBP beginning in June 2015 produces, after the term of the as-approved Modified ESP, a disadvantage for non-shopping customers while hurting shopping and non-shopping customers in the meantime. IEU-Ohio Ex. 125 at 70 (Supp. at 208).

MRO, thereby overstating the MRO pricing as compared to the ESP

The ESP II Order assumes that the MRO SSO's generation supply price would compensate AEP-Ohio for Capacity Service based on a price of \$188.88/MW-day, the amount authorized by the Commission in the *AEP-Ohio Capacity Case* as the "state compensation mechanism."⁸⁵ The state compensation mechanism under Section D.8 of Schedule 8.1 of the Reliability Assurance Agreement ("RAA"), however, deals only with the compensation AEP-Ohio receives for load of switching customers, not that of SSO customers.⁸⁶ The winning generation supply bidders in this MRO SSO process do not serve retail customers; they provide generation supply, including capacity, on a wholesale basis to the EDU (AEP-Ohio in this case) with the delivered total price of the generation supply determined through the CBP. Regardless of what role the state compensation mechanism might have for determining the price CRES providers pay for capacity when such CRES providers are serving retail customers, the state compensation mechanism has no role in establishing AEP-Ohio's compensation if AEP-Ohio procures MRO generation supply through a wholesale CBP. The demand served by the supply provided by the bidder is not "switched load," it is the demand of non-shopping customers (non-switched load). As a result, the wholesale generation supplier bidding in the MRO CBP is free to secure capacity by contract with AEP-Ohio, provide its own capacity, or enter into a bilateral

⁸⁵ ESP II Order at 74 (Appx. at 97).

⁸⁶ Capacity Order at 23 (Supp. at 256). Schedule 8.1, Section D.8, of the RAA provides, "In the case of load reflected in the FRR Capacity Plan that switches to an alternative retail LSE, where the state regulatory jurisdiction requires switching customers or the LSE to compensate the FRR Entity for its FRR capacity obligations, such state compensation mechanism will prevail." *Id.* at 7 (Supp. at 240).

transaction for capacity with a third party, and it is unreasonable to assume that a bidding wholesale supplier would pay above-market prices for capacity.⁸⁷

During the term of the ESP, capacity prices that would be paid by auction bidders would be the prices set by RPM. The prices set through the RPM process were \$20.01/MW-day for the June 2012 to May 2013 planning year, \$33.71/MW-day for the June 2013 to May 2014 planning year, and \$153.89/MW-day for the June 2014 to May 2015 planning year.⁸⁸ The Commission, however, ignored the fact that the state compensation mechanism it determined in the *AEP-Ohio Capacity Case* does not apply to capacity supplied to bidders in the auction that would be used to set the MRO. By using \$188.88/MW-day as the price for the capacity component of the MRO's default generation supply price, the ESP II Order significantly overstated the cost of the MRO's default generation supply.

b. The ESP II Order disregards the costs of the ESP for over 25% of the ESP term and fails to account for the known costs of Turning Point, the RSR, the Capacity Shopping Tax, the PTR, and the energy-only auctions

In addition to overstating the price of the MRO by using the wrong capacity price, the Commission materially understated the difference between the ESP and MRO by leaving out nearly 25% of the ESP term, failing to include the known costs of Turning Point, excluding the collection of the above-market costs of Capacity Service, and assigning a qualitative benefit to energy-only auctions that increased the cost of the ESP.

The ESP II Order states that the Commission must “begin evaluating the statutory price test analysis approximately ten months from the present” and, thus, the test is limited to a

⁸⁷ IEU-Ohio Ex. 125 at 64 (Supp. at 202).

⁸⁸ Capacity Order at 10 (Supp. at 243).

comparison of the ESP versus an MRO between June 1, 2013 and May 31, 2015.⁸⁹ According to the Commission, this limitation results from the fact that AEP-Ohio's quantitative analysis was prepared by assuming that the ESP would be effective in June 2012 and the Order was not issued until August 2012. The ESP II Order further states that the Commission would evaluate the ESP beginning ten months after its start because a witness for a CRES provider offered testimony that AEP-Ohio *could* participate in a 100% energy-only auction by June 2013.⁹⁰ By law, the Commission must account for all provisions of the approved ESP, not a shortened one. In failing to consider the full term of the ESP, the Commission understated the cost of the more expensive ESP relative to the MRO.

The Commission correctly assumed that Turning Point would be recovered as a "known" cost during the term of the ESP through the GRR (\$8 million), but ignored the balance of the \$357.2 million life-time cost of Turning Point in performing the ESP versus MRO test.⁹¹ As noted above, the Commission must account for all pricing, terms, and conditions of the ESP in the ESP versus MRO test. Since the Commission approved the GRR and the charge would have been effective for the life of Turning Point,⁹² the proper accounting for the GRR is the full life cost of the facility. By considering only the costs collected during the term of the ESP, the Commission again understated the cost of the ESP.

The ESP II Order also authorizes the RSR, but excluded \$144 million of the \$508 million it authorized AEP-Ohio to collect from the cost of the ESP in the ESP versus MRO test.⁹³

⁸⁹ ESP II Order at 74 (Appx. at 97).

⁹⁰ *Id.*

⁹¹ *Id.* at 75 (Appx. at 98); OCC Ex. 114 at 17-18 (based on the supplemental testimony of AEP-Ohio witnesses Thomas, Nelson, and Roush) (Supp. at 504-05).

⁹² R.C. 4928.143(B)(2)(c).

⁹³ ESP II Order at 75 (Appx. at 98).

Further, it did not include any cost for the balance of the Capacity Shopping Tax authorized to be collected after the term of the ESP. According to the Commission, \$144 million of the RSR and the balance of the Capacity Shopping Tax should not be included as a cost of the ESP because the total costs are unknown and dependent on customer shopping.⁹⁴ It also stated that the “costs associated with the deferral would fall on either side of the statutory test.”⁹⁵

The Commission’s conclusion that the Capacity Shopping Tax was not known is plainly wrong. Based on AEP-Ohio’s assertions regarding shopping, IEU-Ohio was able to estimate that the Capacity Shopping Tax would reach \$833 million.⁹⁶ If that estimate was incorrect, the Commission has only itself to blame for the lack of record because it transferred this issue to the *AEP-Ohio ESP II Case* after the record closed, and then refused to reopen the record to address the new issue.

Its assertion that the Capacity Shopping Tax would apply to both sides of the ESP versus MRO test also is legally incorrect. The amortization of the Capacity Shopping Tax is not an adjustment permitted through an MRO. R.C. 4928.142(D), the section that defines the MRO used in the ESP versus MRO test for AEP-Ohio, states the specific adjustments to an MRO that the Commission may authorize, and each of these is limited to the legacy SSO price that is blended with auction results to produce the MRO price. None of those adjustments permits the Commission to adjust the MRO for deferred amounts associated with capacity provided to shopping customers.

⁹⁴ Entry on Rehearing at 9 (Jan. 30, 2013) (Appx. at 115).

⁹⁵ *Id.*

⁹⁶ *AEP-Ohio ESP II Case*, Reply Brief of Industrial Energy Users-Ohio at 12-13 (July 9, 2012) (Supp. at 336-37).

Likewise, the Commission cannot authorize the collection of the unamortized portion of the Capacity Shopping Tax in an SSO. Under R.C. 4928.144, the Commission may phase-in a rate established under R.C. 4928.141 to 4928.143. As the Commission made clear in its *AEP-Ohio Capacity Case* decision, it authorized the Capacity Service compensation and accounting modifications that would allow AEP-Ohio to defer the amounts at issue here under provisions of R.C. Chapters 4905 and 4909.⁹⁷ Thus, there is no legal basis for the Commission to approve the collection of the Capacity Shopping Tax under R.C. 4928.144 as part of an MRO or ESP.

The Commission also excluded revenue that may be collected through the PTR from its application of the ESP versus MRO test. AEP-Ohio had the burden to demonstrate that the ESP, including the PTR, satisfied the ESP versus MRO test, but it failed to carry that burden. The only testimony it provided was that the PTR should have an initial rate of zero, and it would seek authority to set a rate greater than zero if the Commission modified its proposal to transfer generation assets.⁹⁸ In fact, the Commission did modify the terms of the transfer with regard to the treatment of pollution control bonds, thus triggering a condition that would permit AEP-Ohio to implement the PTR.⁹⁹ Yet, the Commission did not address the potential cost of the PTR.

FES demonstrated that the PTR's impact could be as much as \$410 million for the period of January 1, 2014 to May 31, 2015.¹⁰⁰ The Commission rejected that estimate, but did not explain why it did not find FES's estimate credible.¹⁰¹ Under R.C. 4903.09, the Commission is required to explain how it reaches this important conclusion, but it does not.

⁹⁷ Capacity Order at 23 (Supp. at 256).

⁹⁸ AEP-Ohio Ex. 103 at 21-23 (Supp. at 79-81).

⁹⁹ ESP II Order at 59 (Appx. at 82).

¹⁰⁰ FES Ex. 104 at 31 (Supp. at 423).

¹⁰¹ ESP II Order at 47-49 (Appx. at 70-72).

The ESP II Order also concludes that an expansion of the energy-only auctions is a qualitative benefit of the ESP¹⁰² because the costs of various distribution riders that the Commission continued and the Distribution Investment Rider (“DIR”) it newly approved “will be mitigated by the increase in [energy-only] auction percentages.”¹⁰³ AEP-Ohio, however, provided testimony that the administratively determined competitive benchmark prices used to support its ESP would increase the SSO price (a quantitative disadvantage).¹⁰⁴ When IEU-Ohio in its application for rehearing raised this obvious problem with the Commission’s conclusion, the Commission stated that the evidence showing the increase in cost of the ESP due to the CBP was “conclusory in nature,”¹⁰⁵ but offers no explanation on how the auction prices would be lower than the evidence demonstrated. The Commission once again, and without explanation, ignored the record in its effort to support the unlawful and unreasonable conclusion that the ESP was more favorable than the MRO.

Collectively, the errors the Commission made in applying the ESP versus MRO test increase the disadvantage of the ESP relative to the MRO by several hundred million dollars. Based on an objective application of the ESP versus MRO test, the ESP does not pass. The Commission, however, misapplied the test and refused to correct the obvious errors. Thus, the Court must reverse the Commission’s order and direct the Commission to find that the ESP fails the ESP versus MRO test.

B. Proposition of Law No. II: The ESP II Order is unlawful and unreasonable because the nonbypassable RSR, Capacity Shopping Tax, and PTR cannot lawfully be included in an ESP

¹⁰² *Id.* at 76 (Appx. at 99).

¹⁰³ *Id.*

¹⁰⁴ IEU-Ohio Ex. 125 at 72-74 (referencing AEP-Ohio testimony) (Supp. at 210-12).

¹⁰⁵ Entry on Rehearing at 11 (Jan. 30, 2013) (Appx. at 117).

1. The ESP II Order is unlawful and unreasonable because it authorizes nonbypassable generation-related riders which are not included in the list of permissive provisions contained in R.C. 4928.143(B)(2)

In the ESP II Order, the Commission held that it could authorize two nonbypassable generation-related riders, the RSR and PTR, under R.C. 4928.143(B)(2)(d).¹⁰⁶ Because that Section does not allow for the creation of a nonbypassable rider, the ESP II Order is unlawful and unreasonable.

Operating as a definitional section, R.C. 4928.143(B) limits the terms of an ESP to those specified in the Section.¹⁰⁷ R.C. 4928.143(B)(2) provides only two instances in which the Commission may authorize a nonbypassable rider, divisions (b) and (c). Under those two divisions, a nonbypassable charge is available to recover costs associated with generating facilities under construction or constructed after 2009 that meet additional statutory requirements. R.C. 4928.143(B)(2)(d) does not similarly provide that a rider approved under that division may be nonbypassable.

By authorizing nonbypassable riders in only two instances, the General Assembly did not provide the Commission with authority to approve a nonbypassable rider under R.C. 4928.143(B)(2)(d).

As a general rule of statutory construction, the specific mention of one thing implies the exclusion of another. This principle is especially pertinent where, as in the cases *sub judice*, the statute involved is a definitional provision. Had the General Assembly intended to allow the utilities to recapture other types of expenses through this rate, it would have expanded the definitions. In addition, it is well-settled “that the General Assembly’s own construction of its language, as provided by definitions, controls in the application of a statute.”¹⁰⁸

¹⁰⁶ ESP II Order at 32 (Appx. at 55); Entry on Rehearing at 58 (Jan. 30, 2013) (Appx. at 164).

¹⁰⁷ *Remand Case*, 128 Ohio St.3d at 519-20.

¹⁰⁸ *Montgomery County Bd. of Comm’rs v. Pub. Util. Comm’n of Ohio*, 28 Ohio St.3d 171, 175 (1986) (citations omitted).

Despite the limitations on the Commission's authority to authorize nonbypassable riders, the Commission unlawfully authorized the RSR and PTR as nonbypassable riders.

2. **The ESP II Order is unlawful and unreasonable because the Commission's finding that the RSR provides stable or certain "prices" is legally insufficient to meet the requirements of R.C. 4928.143(B)(2)(d). Any charge authorized under this Section must have the effect of making the supply of retail electric "service" more stable or certain, and the RSR does not have this effect. Further, the ESP does not provide stable or certain prices**

The Commission held that the RSR could be authorized pursuant to R.C. 4928.143(B)(2)(d) because the RSR "promotes stable retail electric service *prices* and ensures customer certainty regarding retail electric service."¹⁰⁹ It further explained that the RSR "freezes any non-fuel generation *rate increase* that might not otherwise occur absent the RSR."¹¹⁰ The Commission also held that the RSR "provides *rate* stability and certainty through CRES services."¹¹¹ The Commission did not make a finding that retail electric service itself will be more stable or certain. Because the RSR does not have the effect of stabilizing or providing certainty regarding the supply of retail electric service, the Commission cannot lawfully authorize it under R.C. 4928.143(B)(2)(d).

R.C. 4928.143(B)(2)(d) addresses the physical delivery of electricity. It provides that an ESP may include "[t]erms, conditions, or charges relating to limitations on customer shopping for retail electric generation service, bypassability, ... [and] default service ... as would have the effect of stabilizing or providing certainty regarding retail electric service." "Retail electric service" is defined to mean the "supplying or arranging for the supply of electricity to ultimate

¹⁰⁹ ESP II Order at 31 (emphasis added) (Appx. at 54); *see, also*, Entry on Rehearing at 15-16 (Jan. 30, 2013) (Appx. at 121-22).

¹¹⁰ ESP II Order at 31 (emphasis added) (Appx. at 54).

¹¹¹ *Id.*

customers in this state, from the point of generation to the point of consumption.”¹¹² Thus, the Commission may authorize a term, condition, or bypassable charge that makes the *supply or arranging for supply* of retail electric *service* more stable or certain.

Had it intended to address price stability, the General Assembly would have specified that requirement as it did in R.C. 4928.144. R.C. 4928.144 authorizes the use of a phase-in of a rate or price “to ensure rate or price stability for consumers.” Instead, the General Assembly made clear that the charges that could be authorized under R.C. 4928.143(B)(2)(d) were to assure that physical supply of electricity would be made more stable and certain. Thus, the Commission’s determination that the RSR provides price stability and certainty cannot serve as a basis to approve the RSR under R.C. 4928.143(B)(2)(d).¹¹³

Additionally, the Commission’s finding that the RSR provided for stable generation rates¹¹⁴ is unreasonable when the ESP, as a total package, is considered. As approved, the ESP has eight generation, distribution, and transmission-related riders besides the RSR that can and will fluctuate,¹¹⁵ and the Commission indicated that it may adjust the RSR due to changes in

¹¹² R.C. 4928.01(A)(27).

¹¹³ Further, there is no factual basis to approve the RSR because it would provide supply certainty or stability. Generation-related reliability is no longer a function of AEP-Ohio, the EDU. AEP-Ohio operates within the PJM system and the reliability of retail electric generation service is a function under PJM’s control. Tr. Vol. V at 1495-96 (Supp. at 544-45). If AEP-Ohio did not have any generating facilities, PJM would still dispatch supply-side resources under its control to satisfy the needs of AEP-Ohio’s customers. *Id.* R.C. 4928.12 confirms that regional transmission entities such as PJM are responsible for maintaining reliability.

¹¹⁴ ESP II Order at 31-32 (Appx. at 54-55).

¹¹⁵ AEP-Ohio may seek to adjust the Fuel Adjustment Clause (“FAC”), the Alternative Energy Rider (“AER”), the Distribution Investment Rider (“DIR”), the gridSMART Rider, the Transmission Cost Recovery Rider (“TCRR”), the Enhanced Service Reliability Rider (“ESRR”), the Energy Efficiency and Peak Demand Reduction Rider (“EE/PDR”), and the Economic Development Rider (“EDR”). *Id.* at 16-18, 42, 61-67 (Appx. at 39-41, 65, 84-90).

non-shopping load.¹¹⁶ Additionally, the Commission approved the GRR and the PTR that are initially set at zero but could eventually be authorized to allow AEP-Ohio to collect hundreds of millions of dollars.¹¹⁷ The moving parts of the ESP thus preclude pricing stability and certainty.

The Commission gave three other justifications for the RSR, but they do not satisfy the requirements of R.C. 4928.143(B)(2)(d) either. Initially, the Commission stated that the RSR would provide AEP-Ohio with financial integrity.¹¹⁸ This outcome is not relevant to the requirements of R.C. 4928.143(B)(2)(d), nor is the financial integrity of an EDU's generation, as a general matter, relevant in an ESP proceeding. Since the end of AEP-Ohio's Market Development Period ("MDP") on December 31, 2005, AEP-Ohio's generation business has been required to be on its "own in the competitive market."¹¹⁹

The Commission also stated that the RSR allows AEP-Ohio to transition to a CBP to set its default SSO generation supply price in under three years instead of the five-year timeframe under an initial MRO application.¹²⁰ Even if this were a benefit (which, as discussed above, it is not), there is no basis in R.C. 4928.143, or elsewhere in Ohio law, for such a transition rider.¹²¹

Finally, the ESP II Order states that the RSR allows AEP-Ohio to "keep[] a reasonably priced SSO offer on the table in the event market prices increase."¹²² This reasoning essentially

¹¹⁶ *Id.* at 37-38 (Appx. at 60-61).

¹¹⁷ *Id.* at 19-25 & 47-49 (Appx. at 42-48 & 70-72).

¹¹⁸ *Id.* at 31 (Appx. at 54).

¹¹⁹ R.C. 4928.38. Additionally, the Commission has previously concluded that AEP-Ohio's earnings for its generation business are not a relevant consideration when fixing its default SSO rates. IEU-Ohio Ex. 119 at 18 (Supp. at 563).

¹²⁰ ESP II Order at 36 (Appx at 59).

¹²¹ R.C. 4928.38 (limiting the collection of transition riders and the collection of transition revenue to an EDU's market development period, which could end no later than December 31, 2005).

¹²² ESP II Order at 37 (Appx. at 60).

treats the RSR as a provider of last resort (“POLR”) charge. The POLR obligation is the “obligation to stand ready to accept returning customers.”¹²³ POLR costs are “those costs incurred by [the utility] for risks associated with its legal obligation as the default provider, or electricity provider, of last resort, for customers who shop and then return to [the utility] for generation service.”¹²⁴

The Court has admonished the Commission to consider carefully what costs it is attributing to POLR obligations.¹²⁵ Responding to the Court’s direction, the Commission has required that there be a showing of cost to establish a POLR charge.¹²⁶ The Commission has also held that a POLR obligation and its costs relate only to the cost of returning customers, not lost revenue resulting from migration.¹²⁷ “Migration risk is more properly regarded as a business risk faced by all retail suppliers as a result of competition rather than a risk resulting from an EDU’s POLR obligation.”¹²⁸

Once again, the Commission has ignored the Court’s admonition to consider carefully the costs it attributes to POLR obligations. The RSR does not recover AEP-Ohio’s cost of satisfying a POLR obligation. It is designed to provide AEP-Ohio with revenue that it might not otherwise receive because other market-based revenue does not generate the target revenue AEP-Ohio

¹²³ *Remand Case*, 128 Ohio St.3d at 517.

¹²⁴ *Id.* at 517-18.

¹²⁵ *Id.* at 518.

¹²⁶ *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 Assets*, Case Nos. 08-917-EL-SSO, *et al.*, Order on Remand at 22 (Oct. 3, 2011) (“*ESP I Case*”) (Supp. at 608).

¹²⁷ *Id.* at 31-32 (Supp. at 617-18).

¹²⁸ *Id.*

desires. Because the RSR does not compensate AEP-Ohio for POLR costs, the RSR cannot be lawfully authorized as a POLR charge.

Additionally, even if the RSR could lawfully be considered a POLR charge, it would have to be bypassable in accordance with R.C. 4928.20 and Commission precedent. R.C. 4928.20(J) provides that customers served by governmental aggregation programs may bypass a POLR charge upon election by the relevant unit of government and upon the condition that any customer that returns to the SSO must agree to do so at market-based prices. In AEP-Ohio's first ESP proceeding, the Commission held that consistent with the rationale of R.C. 4928.20(J), AEP-Ohio's POLR charge must also be bypassable by any customer who agreed to return to the SSO at market rates.¹²⁹ Thus, even if the RSR could be approved as a POLR charge, the Commission violated Ohio law and its precedent by failing to make the rider conditionally bypassable.

In summary, the RSR does not satisfy the statutory requirements of R.C. 4928.143(B)(2)(d), violates other statutory requirements, and is inconsistent with Commission precedent. The Commission's authorization of the rider, therefore, was unlawful and unreasonable.

3. The ESP II Order is unlawful and unreasonable because the Commission's findings do not support authorization of the PTR under R.C. 4928.143(B)(2)(d)

The PTR is designed to collect any decrease in AEP-Ohio's wholesale revenue because of AEP-Ohio's termination of the Pool Agreement.¹³⁰ Estimates of the amount of lost wholesale revenue that the PTR might collect exceeded \$400 million.¹³¹

¹²⁹ *ESP I Case*, Opinion and Order at 40 (Mar. 18, 2009), (viewed at: <http://dis.puc.state.oh.us/ViewImage.aspx?CMID=A1001001A09C18B42525F08513>).

¹³⁰ Entry on Rehearing at 60 (Jan. 30, 2013) (Appx. at 166).

The Commission initially found that the PTR could be authorized under R.C. 4928.143(B)(2)(h); however, the Commission granted rehearing and instead found that the rider could be authorized under R.C. 4928.143(B)(2)(d). The Commission held that the rider met the statutory requirements of that Section because: (1) termination of AEP-Ohio's wholesale pooling agreement is a pre-requisite to full corporate separation, (2) the Commission expects that the number of CRES offers to SSO customers and shopping customers will "increase and improve" after CRES providers secure capacity in the market, and (3) "termination of the Pool Agreement is key to the establishment of effective competition."¹³²

Even if these claims are assumed to be true, they do not satisfy the requirements of R.C. 4928.143 (B)(2)(d) that PTR is necessary to make retail electric service more stable or certain. None of the Commission's findings establishes that retail electric service will be more certain or stable.

Further, there is no record to demonstrate that authorization of the PTR will affect the certainty or stability of retail electric service.¹³³ PJM provides operational stability in the region in which AEP-Ohio operates.¹³⁴ In light of the operational role of PJM, the stability or certainty of retail electric generation service will not change if AEP-Ohio legally separates its generation assets into a separate affiliate or there are more CRES providers. Thus, the findings on which the Commission based its authorization of the PTR are legally insufficient.

4. The ESP II Order is unlawful and unreasonable because it concludes that the Capacity Shopping Tax can be authorized under R.C.

¹³¹ FES presented evidence that shows that the PTR's impact could be as much as \$410 million. FES Ex. 104 at 31 (Supp. at 423).

¹³² Entry on Rehearing at 60 (Jan. 30, 2013) (Appx. at 166).

¹³³ An AEP-Ohio witness testified only as to the financial effect of the termination of the Pool Agreement. AEP-Ohio Ex. 103 at 21-23 (Supp. at 79-81).

¹³⁴ IEU-Ohio Ex. 125 at 18-19 (Supp. at 156-57).

4928.144. The Capacity Shopping Tax does not arise from rates or prices authorized under R.C. 4928.141 to 4928.143

After the record closed in the hearing on the Application, the Commission issued its order in the *AEP-Ohio Capacity Case*. Relying on R.C. Chapters 4905 and 4909, the Commission invented and applied a cost-based ratemaking methodology to develop a price for Capacity Service of \$188.88/MW-day and authorized AEP-Ohio to collect part of that price now (through RPM-Based Pricing) and to modify its accounting procedures to defer any additional amount, the Capacity Shopping Tax.¹³⁵ In the *AEP-Ohio ESP II Case*, the Commission then authorized AEP-Ohio to amortize a portion of the Capacity Shopping Tax through the RSR and the remainder through another nonbypassable rider pursuant to R.C. 4928.144.¹³⁶

The Commission's order permitting the recovery of the Capacity Shopping Tax violates the requirements of R.C. 4928.144. That section applies to only the "phase-in of any electric distribution utility rate or price established under sections 4928.141 to 4928.143 of the Revised Code." In the ESP II Order, the Commission held that the price it was phasing-in was established in the Capacity Order.¹³⁷ In the Capacity Order, the Commission established the price for Capacity Service pursuant to R.C. 4905.04, 4905.05, 4905.06, 4905.13 and 4905.26 and R.C. Chapter 4909.¹³⁸ Because the price was not authorized pursuant to R.C. 4928.141 to 4928.143, the Commission was without authority to phase-in the price through the Capacity Shopping Tax under R.C. 4928.144. Thus, the order permitting the phase in was unlawful.

5. The ESP II Order is unlawful and unreasonable because the RSR, PTR, and Capacity Shopping Tax will result in the recovery of

¹³⁵ Capacity Order at 23 (Supp. at 256).

¹³⁶ ESP II Order at 36 & 52 (Appx. at 59 & 75).

¹³⁷ *Id.* at 51 (Appx. at 74).

¹³⁸ Capacity Order at 12 (Supp. at 245); *AEP-Ohio Capacity Case*, Entry on Rehearing at 9 (Oct. 17, 2012) (Supp. at 721).

generation-related revenue through nonbypassable charges which violates the State Energy Policy under R.C. 4928.02 and the requirements for corporate separation under R.C. 4928.17

R.C. 4928.06 requires the Commission to effectuate the state policies contained in R.C. 4928.02, and the Commission has found that an EDU's SSO must comply with those state policies.¹³⁹ Additionally, R.C. 4928.17 sets forth Ohio's corporate separation requirements, including a requirement that the EDU operate under a corporate separation plan that is consistent with the state policies.

The state policies, in combination with the corporate separation requirements, are designed to support customer choice and reliance on competitive markets to set prices for competitive services such as generation service, and to provide certain market protections to ensure that the competitive markets function properly. More specifically, R.C. 4928.02(H) seeks to ensure effective competition by "prohibiting the recovery of any generation-related costs through distribution or transmission rates." The Commission has held that R.C. 4928.02(H) prohibits nonbypassable charges that are designed to collect generation-related costs.¹⁴⁰

¹³⁹ *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Approval of a Market Rate Offer to Conduct a Competitive Bidding Process for Standard Service Offer Electric Generation Supply, Accounting Modifications Associated with Reconciliation Mechanism, and Tariffs for Generation Service*, Case Nos. 08-936-EL-SSO, *et al.*, Opinion and Order at 13-14 (Nov. 25, 2008), (viewed at: <http://dis.puc.state.oh.us/TiffToPDF/A1001001A08K25B35520116384.pdf>); *see also*, *Elyria Foundry v. Public Util. Comm'n of Ohio*, 114 Ohio St.3d 305 (2007); *In the Matter of the Application of The Cincinnati Gas & Electric Company to Modify its Nonresidential Generation Rates to Provide for Market-Based Standard Service Offer Pricing and to Establish an Alternative Competitive-Bid Service Rate Option Subsequent to the Market Development Period*, Case Nos. 03-93-EL-ATA, *et al.*, Order on Remand at 37 (Oct. 24, 2007), (viewed at: <http://dis.puc.state.oh.us/TiffToPDF/A1001001A07J24B41421C94009.pdf>).

¹⁴⁰ *In the Matter of the Application of Ohio Power Company for Approval of the Shutdown of Unit 5 of the Philip Sporn Generating Station and to Establish a Plant Shutdown Rider*, Case No. 10-1454-EL-RDR, Finding and Order at 19 (Jan. 11, 2012), ("*Sporn*") (viewed at: <http://dis.puc.state.oh.us/ViewImage.aspx?CMID=A1001001A12A11B35831F43601>).

The generation-related and nonbypassable RSR, PTR and Capacity Shopping Tax provide AEP-Ohio's generation line of business with above-market revenue to which other market participants do not have access. Because the riders are generation-related and nonbypassable, they violate the prohibition in R.C. 4928.02(H) for the recovery of generation-related costs through distribution or transmission rates.

Further, the riders violate R.C. 4928.17(A)(2) and (3) by allowing AEP-Ohio, the EDU, to provide an unfair competitive advantage to its competitive generation line of business.¹⁴¹ The violation will continue after AEP-Ohio transfers the generation assets to an unregulated competitive affiliate because the Commission authorized AEP-Ohio to pass through revenue collected through the nonbypassable riders to the affiliate.¹⁴² Accordingly, the Commission's authorization of these riders is unlawful and unreasonable.

- C. **Proposition of Law No. III: The ESP II Order is unlawful and unreasonable because it authorizes AEP-Ohio to increase SSO prices so as to collect above-market generation-related revenue through the nonbypassable RSR, the Capacity Shopping Tax, and the PTR, thereby providing AEP-Ohio with the ability to collect transition revenue or its equivalent at a time when Ohio law commands that AEP-Ohio's generation business be fully on its own in the competitive market**

Over the objections of IEU-Ohio that recovery of the above-market generation-related revenue violated the prohibition on transition revenue and AEP-Ohio's Electric Transition Plan ("ETP") Stipulation,¹⁴³ the Commission approved the RSR, Capacity Shopping Tax, and PTR. The Commission offered two rationales for its decision: "AEP-Ohio does not argue its ETP did not provide sufficient revenues, and, in light of events that occurred after the ETP proceedings,

¹⁴¹ AEP-Ohio Ex. 103 at 6-8 (Supp. at 64-66).

¹⁴² ESP II Order at 60 (Appx. at 83).

¹⁴³ *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of their Electric Transition Plans and for Receipt of Transition Revenues*, Case Nos. 99-1729-EL-ETP, *et al.*, Opinion and Order (Sept. 28, 2000) (Supp. at 628).

including AEP-Ohio's status as an FRR entity, AEP-Ohio is able to recover its actual costs of capacity, pursuant to our decision in the Capacity Case."¹⁴⁴ When IEU-Ohio again urged the Commission to correct its error on rehearing, the Commission pointed to the Capacity Order and denied rehearing because "the Commission previously dismissed these arguments."¹⁴⁵ AEP-Ohio, however, has no legal claim to the additional transition revenue the Commission authorized.

Under Amended Substitute Senate Bill 3 ("SB 3"), an EDU had a single opportunity to secure transition revenue. Within 90 days of adoption of SB 3, an EDU was required to file an ETP.¹⁴⁶ As part of that plan, it could request transition revenue.¹⁴⁷ Transition revenue was based on a determination of transition costs. Before authorizing collection of any transition revenue, the Commission had to find that the costs were "prudently incurred," "legitimate, net, verifiable, and directly assignable or allocable to retail electric generation service provided to electric consumers in this state," "the costs [were] unrecoverable in a competitive market" and the EDU "would otherwise be entitled an opportunity to recover the costs."¹⁴⁸

If the Commission determined that the EDU had a legitimate claim to transition revenue, it could authorize the collection of transition revenue for a finite period. For certain transition revenue recovery, the period was defined by the MDP that could not extend beyond 2005.¹⁴⁹ For transition costs identified as regulatory assets, the collection period could not extend beyond

¹⁴⁴ *Id.* at 32 (Supp. at 662).

¹⁴⁵ Entry on Rehearing at 21 (Jan. 30, 2013) (Appx. at 127).

¹⁴⁶ R.C. 4928.31(A).

¹⁴⁷ *Id.*

¹⁴⁸ R.C. 4928.39.

¹⁴⁹ *Id.*

2010.¹⁵⁰ R.C. 4928.141, enacted as part of SB 221, precluded any further recovery of transition costs “effective on and after the date that the allowance is scheduled to end under the utility’s rate plan.”¹⁵¹ Thus, Ohio law now bars AEP-Ohio and all other EDUs from collecting transition revenue.¹⁵²

Additionally, AEP-Ohio agreed to limit its collection of transition revenue in two settlements. In its ETP application, AEP-Ohio presented claims for both above-market generation-related transition revenue and regulatory assets as part of its ETP.¹⁵³ It settled the transition revenue claims in the ETP Stipulation. AEP-Ohio agreed to forgo collecting above-market transition revenue associated with its generation assets, promising it would not “impose any lost revenue charges (generation transition charges (GTC)) on any switching customer.”¹⁵⁴ The ETP Stipulation, however, recommended that AEP-Ohio be permitted to collect a significant amount of transition charges for regulatory assets with the transition charges ending on December 31, 2007 for Ohio Power Company and December 31, 2008 for Columbus Southern Power Company.¹⁵⁵ The Commission approved the transition revenue provisions of the ETP

¹⁵⁰ *Id.*

¹⁵¹ R.C. 4928.141.

¹⁵² R.C. 4928.40. As R.C. 4928.38 states:

The utility’s receipt of transition revenues shall terminate at the end of the market development period. With the termination of that approved revenue source, the utility shall be fully on its own in the competitive market. The commission shall not authorize the receipt of transition revenues or any equivalent revenues by an electric utility except as expressly authorized in sections 4928.31 to 4928.40 of the Revised Code.

¹⁵³ IEU-Ohio Ex. 124 at 10 (Supp. at 105).

¹⁵⁴ *Id.* at 13 (Supp. at 108).

¹⁵⁵ *Id.*

Stipulation that were then reaffirmed and incorporated into AEP-Ohio's Rate Stabilization Plan settlement ("RSP").¹⁵⁶

In violation of the statutory bar and the commitments of the ETP Stipulation and RSP, the Commission has authorized AEP-Ohio to collect above-market generation-related transition revenue or its equivalent through the RSR, Capacity Shopping Tax, and PTR. For example, the RSR permits AEP-Ohio to collect \$508 million in above-market transition revenue. To calculate the total revenue recoverable through the RSR, the Commission set an annual revenue target of \$826 million to produce a desired return on equity.¹⁵⁷ From \$826 million, the Commission subtracted the annual non-fuel generation revenue that AEP-Ohio would receive from its competitive retail and wholesale generation lines of business.¹⁵⁸ The total non-fuel generation revenue is \$508 million less than the annual target revenue of \$826 million over the term of the ESP.¹⁵⁹ The Commission then authorized AEP-Ohio to implement the RSR to bill and collect the \$508 million in additional above-market generation-related transition revenue.

The Capacity Shopping Tax, likewise, is authorized to collect above-market generation revenue. The amount AEP-Ohio may defer is the difference between the \$188.88/MW-day total compensation for Capacity Service that the Commission authorized in the *AEP-Ohio Capacity Case* and the amounts AEP-Ohio collects for the supply of Capacity Service at the RPM-Based Price.¹⁶⁰ The revenue collected through the Capacity Shopping Tax is, thus, the difference between the amount that can be collected through the competitive price for Capacity Service, the

¹⁵⁶ IEU-Ohio Ex. 119 at 9 (Supp. at 554).

¹⁵⁷ ESP II Order at 34 (Appx. at 57).

¹⁵⁸ *Id.* at 35 (Appx. at 58).

¹⁵⁹ *Id.*

¹⁶⁰ Capacity Order at 33 (Supp. at 266).

RPM-Based Price, and the so-called cost-based price of \$188.88/MW-day. Thus, the revenue collected by the Capacity Shopping Tax also is above-market transition revenue.

The PTR is designed “to offset the revenue losses caused by the termination of the Pool Agreement” that “cannot be mitigated by off-system sales in the market alone.”¹⁶¹ As with the other two riders, the calculation is designed to ensure that AEP-Ohio can continue to recover above-market generation-related transition revenue.¹⁶²

Despite the bar on the collection of transition revenue, however, the Commission authorized the nonbypassable riders. Its rationale boils down to the following conclusions: the above-market charges are not transition charges because AEP-Ohio did not claim it did not receive sufficient revenue under the ETP or seek transition revenue; AEP-Ohio is entitled to collect its actual cost of capacity because of changes that have occurred since the ETP Stipulation.

Contrary to the Commission’s finding, AEP-Ohio claimed that its prior rates were insufficient.¹⁶³ In any case, however, AEP-Ohio’s past recovery of transition revenue under its ETP is not relevant to the question of whether the Commission can lawfully authorize additional transition revenue. By law, it cannot.

Additionally, nothing has happened over the last thirteen years that changes the legal framework that governs what the Commission can authorize in transition revenue. Based on Ohio law and AEP-Ohio’s ETP and RSP settlements, the Commission is without any legal basis

¹⁶¹ ESP II Order at 48 (Appx. at 71).

¹⁶² IEU-Ohio Ex. 124 at 21-23 (Supp. at 116-18).

¹⁶³ AEP-Ohio Ex. 101 at 7-9 (Supp. at 525-27) (the Commission “acted to prevent utilities from collecting the higher market-based rates.”).

to authorize additional transition revenue.¹⁶⁴ Yet the Commission permits AEP-Ohio to collect transition revenue as if the period for transitioning EDUs has not ended.¹⁶⁵

The one-and-done opportunity to recover above-market generation-related transition revenue was through the ETP process.¹⁶⁶ The time for that recovery is long over (and AEP-Ohio agrees).¹⁶⁷ Based on the unequivocal restriction on the Commission's authority, the ETP and RSP settlements, and the unrebutted testimony that the RSR, Capacity Shopping Tax, and the PTR authorize the collection of above-market generation-related transition revenue, the ESP II Order unlawfully and unreasonably authorized these three provisions of the ESP.

D. Proposition of Law No. IV: The ESP II Order is unlawful and unreasonable because it assumes that the Commission may invent and apply a cost-based ratemaking methodology for purposes of authorizing a significant increase in the price for Capacity Service. It is similarly unlawful and unreasonable because it authorizes AEP-Ohio to defer the uncollected portion of this significant increase in the price for Capacity Service and then, after the term of the ESP, collect such portion plus interest charges through nonbypassable charges applicable to shopping and non-shopping customers

¹⁶⁴ The Commission's authorization of the Capacity Shopping Tax also is based on the faulty premise that AEP-Ohio is an FRR Entity. It was not contested that AEPSC made an FRR Alternative election under the RAA for the combined pool of American Electric Power Co., Inc. ("AEP") operating companies in PJM, which includes AEP-Ohio. IEU-Ohio Ex. 125 at 23 (Supp. at 161); AEP-Ohio. Ex. 103 at 9 (Supp. at 67). "Through the PJM planning year 2014/2015 (PY14/15) AEP Ohio together with the other AEP East operating companies, APCo, I&M, KPCo, Kingsport Power Company and WPCo, have elected as a group (East System) to be under the FRR option in PJM. This requires the East System to provide its own capacity resources to meet its load obligations rather than rely on the PJM RPM market to provide capacity resources." *Id.* Additionally, AEP-Ohio's status as an FRR Entity, if it is one, is irrelevant to the determination of whether the Commission has the authority to approve additional transition revenue.

¹⁶⁵ The Commission's misunderstanding of Ohio law continues. It opened an investigation on June 27, 2013 to address rate impacts on AEP-Ohio's customers "during the transition to market based rates." *In the Matter of the Commission's Review of Customer Impacts from Ohio Power Company's Transition to Market Based Rates*, Case No. 13-1530-EL-UNC, Entry (June 27, 2013) (viewed at: <http://dis.puc.state.oh.us/TiffToPDF/A1001001A13F27B05920I20554.pdf>).

¹⁶⁶ IEU-Ohio Ex. 124, *passim* (Supp. at 94).

¹⁶⁷ *Id.* at 14 (Supp. at 109).

After the record in the *AEP-Ohio ESP II Case* closed, the Capacity Order passed to the *AEP-Ohio ESP II Case* the determination of how the Capacity Shopping Tax would be collected.¹⁶⁸ The ESP II Order then authorized AEP-Ohio to collect the Capacity Shopping Tax through the RSR and a post-ESP nonbypassable rider.¹⁶⁹

Besides challenging the authority of the Commission to approve the collection of the difference under the ESP, IEU-Ohio sought rehearing of the Commission's decision to authorize the Capacity Shopping Tax because the authorizations were based on the same legally flawed reasoning the Commission used to increase AEP-Ohio's total compensation for supplying Capacity Service in the *AEP-Ohio Capacity Case*.¹⁷⁰ The Commission does not have legal authority to invent and apply a cost-based ratemaking methodology and the authorization of the collection of the deferred amounts is unlawful.

The Commission may only exercise that authority conferred upon it by the Ohio Revised Code.¹⁷¹ With the enactment of SB 3, generation-related retail electric service became, and remains, a competitive retail electric service,¹⁷² and the Commission, with minor exceptions, has no authority to regulate and price generation-related retail electric service.¹⁷³

R.C. 4928.01, in combination with the declarations and limitations in R.C. 4928.03 and 4928.05, makes clear that the Commission may not supervise or regulate any service involved in

¹⁶⁸ Capacity Order at 23 (Supp. at 256).

¹⁶⁹ ESP II Order at 36 (Appx. at 59).

¹⁷⁰ IEU-Ohio's Application for Rehearing of the August 8, 2012 Opinion and Order and Memorandum in Support at 57 (Sept. 7, 2012) (Appx. at 243). The Commission denied IEU-Ohio's request for rehearing on the ground that it had denied rehearing on the same issue in the *AEP-Ohio Capacity Case*. Entry on Rehearing at 20 (Jan. 30, 2013) (Appx. at 126).

¹⁷¹ *Time Warner AxS v. Pub. Util. Comm'n of Ohio*, 75 Ohio St.3d 229, 234 (1996).

¹⁷² R.C. 4928.03.

¹⁷³ R.C. 4928.05(A).

supplying or arranging for the supply of electricity to ultimate consumers in Ohio, from the point of generation to the point of consumption, once that service is declared competitive, except under very narrowly defined circumstances. From these definitions and limitations, this conclusion holds irrespective of the force of federal preemption regarding sales for resale transactions¹⁷⁴ and regardless of whether the service is called wholesale or retail.

The definition of “retail electric service” includes *any service, i.e.,* generation, transmission, and distribution service, from the point of generation to the point of consumption.¹⁷⁵ Since January 1, 2001, the effective date of competitive retail electric service, generation service has been declared competitive.¹⁷⁶

Because the General Assembly declared retail electric generation service competitive, that service (which includes any generation service from the point of generation to the point of consumption) is not subject to the Commission’s supervision or regulation except as may be specifically permitted by R.C. 4928.141 to 4928.144 (which relate exclusively to the establishment of an SSO for *retail* electric customers), and R.C. 4905.06 as it provides for safety

¹⁷⁴ Of course, the Commission can exercise no authority except that authority that has been delegated to it by the General Assembly. To have any jurisdiction over wholesale services, the Commission would thus have to find some specific grant of authority by the General Assembly and this fundamental principle is true irrespective of the powers conveyed to the federal government. But the General Assembly could not lawfully delegate authority to the Commission to regulate or supervise wholesale electric transactions because the authority to regulate commerce among the states is reserved to the federal government. U.S. Const., Art. I, § 8, cl. 3.

¹⁷⁵ R.C. 4928.01(A)(27).

¹⁷⁶ R.C. 4928.03 provides:

Beginning on the starting date of competitive retail electric service, retail electric generation, aggregation, power marketing, and power brokerage services supplied to consumers within the certified territory of an electric utility are competitive retail electric services that the consumers may obtain subject to this chapter from any supplier or suppliers.

and reliability.¹⁷⁷ Thus, the Commission is barred from using its supervisory powers or the regulatory authority in R.C. Chapters 4905, 4909, and 4928 except as specifically noted, to address pricing for any retail electric generation service from the point of generation to the point of consumption.

The Commission has recognized that R.C. Chapter 4928 narrowly confines its authority to regulate competitive retail electric generation service. When AEP-Ohio sought to recover costs of closing one of its generation facilities, the Commission refused to approve the request, stating:

Pursuant to Sections 4928.03 and 4928.05(A)(1), Revised Code, retail electric generation service is a competitive retail electric service and, therefore, not subject to Commission regulation, except as otherwise provided in Chapter 4928, Revised Code. Just as the construction and maintenance of an electric generating facility are fundamental to the generation component of electric service, we find that so too is the closure of an electric generating facility.

...

OP also requests approval of a rider to collect the costs associated with the closure of Sporn Unit 5. As discussed above, Section 4928.05(A)(1), Revised Code, generally prohibits Commission regulation of retail electric generation service. However, that section expressly provides that it does not limit the Commission's authority under Sections 4928.141 to 4928.144, Revised Code.¹⁷⁸

Despite the Commission's acknowledgement that it can only regulate retail electric service rates as part of an SSO, the Commission in the *AEP-Ohio Capacity Case* authorized AEP-Ohio to collect an above-market price for Capacity Service under its general supervisory powers under R.C. 4905.04, 4905.05, 4905.06, and authorized accounting changes under R.C. 4905.13 to permit AEP-Ohio to establish a deferred balance of the amounts in excess of the

¹⁷⁷ R.C. 4928.05(A).

¹⁷⁸ *Sporn*, Finding and Order at 16-17 (viewed at: <http://dis.puc.state.oh.us/ViewImage.aspx?CMID=A1001001A12A11B35831F43601>).

RPM-Based Prices for load supplied to CRES providers.¹⁷⁹ Under the provisions declaring competitive retail generation service competitive, the Commission's invention and application of a cost-based ratemaking methodology to uniquely set AEP-Ohio's compensation for Capacity Service was unlawful. The Commission then compounded the Capacity Order's errors by unlawfully authorizing AEP-Ohio to recover the Capacity Shopping Tax in the ESP II Order. Because the Commission could not authorize the above-market compensation for competitive generation-related service the riders are designed to collect, the Commission's orders authorizing the riders to collect the Capacity Shopping Tax also are unlawful and unreasonable and must be reversed.

- E. Proposition of Law No. V: The ESP II Order is unlawful and unreasonable because it fails to recognize that the rates and charges applicable to non-shopping customers also are providing AEP-Ohio with compensation for Capacity Service, it ignores or disregards the fact that AEP-Ohio has maintained that non-shopping customers are, on average, paying nearly twice the \$188.88/MW-day price, and it fails to establish a mechanism to credit such excess compensation obtained from non-shopping customers against any deferred balance the ESP II Order in combination with the Capacity Order works to create**

R.C. 4928.06(A) mandates that the Commission "ensure that the policy specified in section 4928.02 of the Revised Code is effectuated." The primary policy of the State under R.C. 4928.02(A) is to "[e]nsure the availability to consumers of adequate, reliable, safe, efficient, *nondiscriminatory*, and reasonably priced retail electric service." (Emphasis added.) Based on the findings of the Commission and the claims of AEP-Ohio in support of its proposed ESP, shopping customers are paying twice the cost of capacity identified by the Commission. As a result, the Commission failed to ensure that ESP retail electric service available to consumers is priced in a nondiscriminatory way.

¹⁷⁹ Capacity Order at 12-13, 23 (Supp. at 245-46, 256)

According to AEP-Ohio, it was receiving, on average and prior to the ESP II Order, compensation at a rate of \$355/MW-day for the generation capacity it provided to SSO customers.¹⁸⁰ The Commission, however, determined that the price of Capacity Service was \$188.88/MW-day, and the Commission used that amount to set the rate that a bidder would pay to secure Capacity Service to price the auction bids it used to set the MRO in the ESP versus MRO test.¹⁸¹ Thus, the Commission concluded that AEP-Ohio's price of Capacity Service is \$188.88/MW-day, whether it is used to serve the load of SSO or shopping customers. Despite its determination of AEP-Ohio's price of Capacity Service, the Commission approved a freeze of AEP-Ohio's non-fuel generation rates embedded in the SSO at the higher \$355/MW-day rate.¹⁸² Thus, SSO customers are providing AEP-Ohio with significantly more compensation for generation-related capacity than AEP-Ohio would be able to obtain if the Commission-specified \$188.88/MW-day price governed compensation for Capacity Service from SSO customers.

When parties challenged the unlawful discrimination embedded in the base generation rates the Commission approved, the Commission responded that the lawfulness of the base generation freeze could be determined by the number of opponents to the freeze ("AEP-Ohio's base generation rates were almost unanimously unopposed by all parties who intervened in this proceeding, which included intervenors representing small business customers, commercial customers, and industrial customers"¹⁸³). The Commission additionally stated that "AEP-Ohio is not offering discriminatory rates between its non-shopping customers and those customers who

¹⁸⁰ Tr. Vol. V at 1438 (Supp. at 680).

¹⁸¹ ESP II Order at 74 (Appx. at 97).

¹⁸² *Id.* at 15-16 (Appx. at 38-39).

¹⁸³ Entry on Rehearing at 33 (Jan. 30, 2013) (Appx. at 139).

shop, as AEP-Ohio provides different services to shopping and non-shopping customers.”¹⁸⁴

Neither explanation justifies the unlawful discrimination.

The Commission’s reliance on who was for and against the base generation freeze is plain error. The lawfulness of a rate cannot be decided by the number of parties who are for, against, or indifferent to its effects. By that standard, the Commission should have disapproved the nonbypassable charges since all the nonbypassable riders were opposed by a majority of intervenors. The Commission cannot determine if the results of its order are lawful by conducting a popularity contest.

Further, the Commission’s rationale that AEP-Ohio is providing different products to SSO customers and CRES providers is so clearly unsupported by the record as to be unreasonable.¹⁸⁵ AEP-Ohio itself demonstrated that the non-fuel base generation rate revenue and capacity revenue from its proposed cost-based capacity charge were for the same service and that it was recovering \$355/MW-day for capacity in its SSO non-fuel base generation rates.¹⁸⁶ After AEP-Ohio set out the amount it was recovering at \$355/MW-day for non-fuel generation in its SSO rates, however, the Commission determined that the level of compensation for capacity supplied to CRES providers should be set at a much lower rate of \$188.88/MW-day. The Commission was so confident in that price that it used it to determine the Capacity Shopping Tax¹⁸⁷ and set the price of the MRO in its application of the ESP versus MRO test.¹⁸⁸

¹⁸⁴ *Id.*

¹⁸⁵ *Remand Case*, 128 Ohio St.3d at 519-20.

¹⁸⁶ AEP-Ohio Ex. 116 at 9 (Supp. at 33).

¹⁸⁷ ESP II Order at 51-52 (Appx. at 74-75).

¹⁸⁸ *Id.* at 74 (Appx. at 97).

Because the Commission is to ensure that retail electric service is provided on a nondiscriminatory basis, it is unreasonable and unlawful for the Commission to ignore the excessive generation-related capacity service compensation available to AEP-Ohio through the SSO. Customers receive no protection when the Commission authorized AEP-Ohio to bill and collect the much higher level of Capacity Service compensation available to AEP-Ohio through its SSO.

Because the results of the Commission's refusal to eliminate the discrimination are unlawful, the Court should reverse and remand the ESP II Order to the Commission. Additionally, the Court should order the Commission to remedy the collection of overstated deferred amounts. To eliminate this non-comparable, unreasonable, and unlawful discrimination between generation-related capacity service compensation of SSO customers and shopping customers and to avoid overstating the deferred amounts payable by shopping and non-shopping customers if any is found lawful, the Court should order the Commission to direct AEP-Ohio to credit the amount of generation-related capacity service compensation received from SSO customers above the \$188.88/MW-day price against the deferred amount eligible for recovery through the RSR and post-ESP nonbypassable charge.

- F. Proposition of Law No. VI: The ESP II Order is unlawful and unreasonable because, without authority to do so under R.C. 4928.143, the ESP II Order conditionally approves a transfer of generating assets without making the findings required by R.C. 4928.17 and Rule 4901:1-37-09, OAC, and without netting the above-book market value of AEP-Ohio's generating assets against the transition revenue which the ESP II Order authorizes AEP-Ohio to collect on a nonbypassable basis during and after the term of the ESP**

Although AEP-Ohio filed testimony discussing its plan to transfer generation assets to a competitive unregulated affiliate with its Application, it did not request approval of amendments to its corporate separation plan or the generation transfer. That request was filed in the

Corporate Separation Case. Because AEP-Ohio did not move to consolidate the *Corporate Separation Case* with the *AEP-Ohio ESP II Case*, the Commission stated that “the primary issues [*sic*] to be considered in this modified ESP proceeding is how the divestiture of the generation assets and the agreement between AEP-Ohio and [Genco] will impact SSO rates.”¹⁸⁹ Despite stating that its review in the *AEP-Ohio ESP II Case* was limited to the impact of the transfer on SSO rates, the Commission conditionally approved the generating asset transfer and authorized the pass-through of above-market nonbypassable revenue to the unregulated competitive affiliate after the generation assets are transferred.¹⁹⁰

IEU-Ohio’s application for rehearing argued that the Commission had failed to comply with the statutory and administrative requirements applicable to the transfer of generation assets and unlawfully authorized the pass-through of revenue to the unregulated competitive affiliate. The Commission, however, refused to grant rehearing. On the first issue, it stated that it addressed the requirements in its decision in the *Corporate Separation Case*.¹⁹¹ On the second issue, the Commission concluded that it had found that the pass-through was reasonable in its Opinion and Order and that the state energy policy did not impose strict requirements preventing the subsidy.¹⁹² Neither justification provides a lawful basis for the Commission’s orders.

The Commission cannot lawfully rely on the *Corporate Separation Case* decision to justify its conditional approval of the generation asset transfer. By Commission rule, the Commission was required to conduct an evidentiary hearing.¹⁹³ Rather than conduct the required

¹⁸⁹ *Id.* at 59 (Appx. at 82).

¹⁹⁰ *Id.* at 59-60 (Appx. at 82-83).

¹⁹¹ Entry on Rehearing at 62 (Jan. 30, 2013) (Appx. at 168).

¹⁹² *Id.* at 64-65 (Appx. at 170-71).

¹⁹³ Rule 4901:1-37-09(D), Ohio Administrative Code (“OAC”), requires a hearing when the transfer of the assets would alter the Commission’s jurisdiction over those assets.

evidentiary hearing in the *Corporate Separation Case* as requested by the intervening parties, however, the Commission waived hearing, stating, “Given the fact that we have already approved the divestiture of OP’s generating assets as a component of the modified ESP 2 cases, subject to approval of the amended corporate separation plan, and that such decision was reached following an extensive hearing, which included testimony in support of the divestiture of the generating assets, we find that the requirements of Rule 4901:1-37-09(D), OAC, do not apply to this proceeding.”¹⁹⁴

As is evident from the Commission’s Entry on Rehearing, the Commission played a shell game with the parties’ right to hearing and notice of the issues the Commission would decide. When IEU-Ohio challenged the Commission’s conditional approval in the *AEP-Ohio ESP II Case*, the Commission refused to grant rehearing because the Commission would address the divestiture and its terms in the *Corporate Separation Case*. When IEU-Ohio sought the hearing the Commission rule required in the *Corporate Separation Case*, the Commission responded that the divestiture had been addressed in the *AEP-Ohio ESP II Case*. This shell game is unlawful.¹⁹⁵

Additionally, the ESP II Order’s conditional approval of the generation asset transfer was unlawful because approval was not sought as part of the Application. AEP-Ohio explicitly stated that it was not requesting approval of its corporate separation plan and divestiture in this proceeding.¹⁹⁶ Instead, it filed a separate application and did not move to consolidate the two

¹⁹⁴ *Corporate Separation Case*, Finding and Order at 11 (Oct. 17, 2012) (Supp. at 697) (emphasis added).

¹⁹⁵ *Tongren v. Pub. Util. Comm’n of Ohio*, 85 Ohio St.3d 87 (1998) (reliance in a second case on a record that did not comply with requirements of R.C. 4903.09 from a prior case is reversible error); *Allnet Communications v. Pub. Util. Comm’n of Ohio*, 32 Ohio St.3d 115 (1987) (Commission improperly dismissed complaint seeking review of issues that Commission had not previously addressed and reserved for future hearing).

¹⁹⁶ Application at 3-4 (Supp. at 3-4); ESP II Order at 57 (Appx. at 80).

cases. As a result, the ESP II Order's conditional approval of the transfer of generation assets is beyond the scope of the proceeding to approve the ESP.

It was also beyond the authority of the Commission to approve the generation asset transfer in an ESP proceeding. The terms the Commission may authorize in an ESP are set out in R.C. 4928.143(B). The Commission is without authority to expand those terms.¹⁹⁷ There is no provision in that Section to permit the Commission to authorize a transfer of assets. That authority rests only in R.C. 4928.17. Thus, the Commission acted without statutory authority when it conditionally approved the transfer of the generation assets in the ESP II Order.

Even if the generation asset transfer was properly before the Commission in the *AEP-Ohio ESP II Case*, the Commission unlawfully failed to apply the state energy policy prohibiting the subsidy of competitive generation. As discussed above, the Commission's order authorizes AEP-Ohio to flow-through to its competitive generation segment and unregulated competitive affiliate above-market revenue the EDU collects through nonbypassable charges. The Commission has already concluded in the *Sporn* case that a nonbypassable generation-related charge violates the prohibition in R.C. 4928.02(H), which prohibits "the recovery of any generation-related costs through distribution or transmission rates." By the same authority, the Court should reject the Commission's authorization of the pass-through of nonbypassable charges.

Further, the ESP II Order does not contain any of the findings necessary to approve the transfer of assets. Commission rules contain detailed requirements governing the approval of a transfer of generation assets that are intended to assist the Commission in determining whether

¹⁹⁷ *Remand Case*, 128 Ohio St.3d at 519-20.

the transfer is just, reasonable, and in the public interest.¹⁹⁸ The Commission provided no analysis of the lawfulness of its conditional approval under its own administrative requirements.

In particular, the Commission approved the transfer without requiring AEP-Ohio to provide the Commission with the net book and market value of its generating assets.¹⁹⁹ Review of the value of the assets was not only required by Commission rules, but also should have triggered another assessment of the need for nonbypassable riders such as the RSR. In this instance, AEP-Ohio is authorized to collect additional transition revenue,²⁰⁰ to transfer above-market revenue to the competitive affiliate²⁰¹ and intends to transfer assets with a market value exceeding their net book value to that affiliate.²⁰² It is unreasonable and unlawful for the ESP II Order, on one hand, to permit AEP-Ohio to collect above-market charges for generation-related services and, on the other hand, permit AEP-Ohio to avoid netting the above-book market value of any of its generating assets to determine the amount of any transition revenue recoverable from shopping and non-shopping customers as required by R.C. 4928.39. By permitting AEP-Ohio to avoid the requirement to provide asset values as required by Commission rules, the Commission conditionally approved an unlawful and unreasonable transfer of value to AEP-Ohio and its sole stockholder, AEP.

V. CONCLUSION

The ESP II Order affords AEP-Ohio revenue protections that are not permitted under Ohio law. The effect of the illegal order is to deny AEP-Ohio's customers the benefits of

¹⁹⁸ Rule 4901:1-37-09, OAC.

¹⁹⁹ Rule 4901:1-37-09(C)(4), OAC.

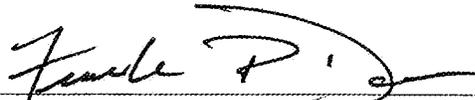
²⁰⁰ ESP II Order at 26-38 (RSR) (Appx. at 49-61); *id.* at 47-49 (PTR) (Appx. at 70-72).

²⁰¹ *Id.* at 60 (Appx. at 83).

²⁰² OCC Ex. 104 at 1 (Supp. at 681); IEU-Ohio Ex. 117 (Supp. at 686).

customer choice that are available in the current retail electric market. Because the ESP II Order is unlawful and unreasonable, the Court must reverse the Commission's order and direct the Commission to bring the rates and charges of AEP-Ohio into compliance with the requirements of R.C. Chapter 4928. Further, the Court should direct the Commission to reverse its conditional approval of the generation asset transfer, including the order approving the unlawful transfer of above-market revenue to the competitive unregulated affiliate.

Respectfully submitted

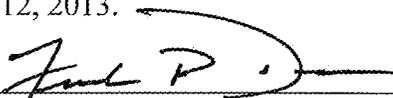


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CERTIFICATE OF SERVICE

I hereby certify that a copy of this *First Merit Brief of Appellant Industrial Energy Users-O*
hio was sent by ordinary United States mail, postage prepaid or hand-delivered to all parties to
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