ORIGINAL

IN THE SUPREME COURT OF OHIO

The Kroger Co.,	:	
Appellant,	:	CASE NO. 2013-0521
v.	:	On Appeal from the Public Utilities Commission of Ohio, Case No. 11-346-EL-SSO, 11-348-EL-SSO, 11-349-EL-AAM, 11-350-EL-AAM.
The Public Utilities Commission of Ohio,	:	
Appellee.	:	

MERIT BRIEF OF APPELLANT FIRSTENERGY SOLUTIONS CORP.

Mark A. Hayden (0081077)
Counsel of Record
FIRSTENERGY SERVICE COMPANY
76 South Main Street
Akron, Ohio 44308
(330) 761-7735
(330) 384-3875 (fax)
haydenm@firstenergycorp.com

James F. Lang (0059668)
N. Trevor Alexander (0080713)
CALFEE, HALTER & GRISWOLD LLP
1405 East Sixth Street
Cleveland, Ohio 44114
(216) 622-8200
(216) 241-0816 (fax)
jlang@calfee.com
talexander@calfee.com

David A. Kutik (0006418)
JONES DAY
901 Lakeside Avenue
Cleveland, Ohio 44114
(216) 586-3939
(216) 579-0212 (fax)
dakutik@jonesday.com

Attorneys for Appellant,
FirstEnergy Solutions Corp.

Michael DeWine (0009181)
Ohio Attorney General
William L. Wright (0018010)
Section Chief
Thomas McNamee (0017352)
John H. Jones (0051913)
Assistants Attorney General
180 E. Broad St., 6th Floor
Columbus, Ohio 43215
(614) 466-4397
(614) 644-8764 (fax)
william.wright@puc.state.oh.us
thomas.mcnamee@puc.state.oh.us
john.jones@puc.state.oh.us

Attorneys for Appellee,
The Public Utilities Commission of Ohio

Samuel C. Randazzo (0016386)
Counsel of Record
Frank P. Darr (0025469)
Joseph E. Oliker (0086088)
Matthew R. Pritchard (0088070)
MCNEES WALLACE & NURICK
21 East State Street, 17th Floor
Columbus, Ohio 43215
(614) 469-8000
(614) 469-4653 (fax)
sam@mwncmh.com
fdarr@mwncmh.com
joliker@mwncmh.com
mpritchard@mwncmh.com

*Attorneys for Appellant,
Industrial Energy Users-Ohio, Inc.*

Mark S. Yurick (0039176)
Zachary D. Kravitz (0084238)
TAFT, STETTINIUS & HOLLISTER, LLP
65 E. State St., Suite 1000
Columbus, Ohio 43215-3413
(614) 221-2838
(614) 221-2007 (fax)
myurick@taftlaw.com
zkravitz@taftlaw.com

Attorneys for Appellant, The Kroger Co.

Bruce J. Weston (0016973)
Ohio Consumers' Counsel
Maureen R. Grady (0020847)
Counsel of Record
Terry L. Etter (0067445)
Joseph P. Serio (0036959)
Assistant Consumers' Counsel
10 West Broad St., Suite 1800
Columbus, Ohio 43215
(614) 466-9585
(614) 466-9475 (fax)
grady@occ.state.oh.us
etter@occ.state.oh.us
serio@occ.state.oh.us

*Attorneys for Appellant,
Office of Ohio Consumers' Counsel*

Steven T. Nourse (0046705)
Counsel of Record
Matthew J. Satterwhite (0071872)
AMERICAN ELECTRIC POWER CORP.
1 Riverside Plaza, 29th Floor
Columbus, Ohio 43215
(614) 716-1608
(614) 716-2950 (fax)
stnourse@aep.com
mjsatterwhite@aep.com

Daniel R. Conway (0023058)
L. Bradfield Hughes (0070997)
PORTER WRIGHT MORRIS & ARTHUR LLP
41 South High Street
Columbus, Ohio 43215
(614) 227-2270
(614) 227-1000 (fax)
dconway@porterwright.com
bhughes@porterwright.com

*Attorneys for Cross-Appellant,
Ohio Power Company*

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I. INTRODUCTION

In Ohio, providing "generation" electric service is not subject to traditional state regulation. Such service is competitive and the recovery of the cost of providing such service is largely subject to the prices suppliers of that service can receive from the market. For those customers who do not seek and negotiate their own contracts – or "shop" – for this competitive service, Ohio law requires the customers' electric distribution utility ("EDU") to provide a Standard Service Offer ("SSO"). An SSO can be provided in one of two forms: an Electric Security Plan ("ESP") or a Market Rate Offer ("MRO"). Applications for an ESP or an MRO must be submitted to and approved by the Public Utilities Commission of Ohio (the "Commission").

Section 4928.143(C)(1) of the Ohio Revised Code commands that, in reviewing an application for an ESP, the Commission may only approve the ESP if "its pricing and all other terms and conditions" is "more favorable in the aggregate" than the expected results of an MRO. In this case, the Commission overstepped its authority and abused its discretion by approving an ESP for Ohio Power Company ("AEP Ohio") that is at least $386 million less favorable than the expected results of an MRO. Because the ESP fails the statutory test, the Commission should have rejected it.

There is no dispute that AEP Ohio's customers will pay at least $386 million more under the ESP than they would under an MRO. This is primarily because of a $388 million subsidy to AEP Ohio's generating assets through the "Retail Stability Rider," a subsidy that would not exist under an MRO. Indeed, the Commission's August 8, 2012 Order ("Order") approving the ESP states as much. The Commission primarily justified this huge above-market cost to customers – and correspondingly huge above-market subsidy to AEP Ohio – on the grounds that AEP Ohio's non-shopping customers ultimately will transition to 100% market pricing faster than under an

MRO. According to the Commission, this will provide non-quantifiable benefits for customers. However, because Ohio law requires AEP Ohio to provide generation service at no greater than market-based prices, there is no statutory authority for imposing huge costs on customers to persuade AEP Ohio to provide such market-based pricing. An ESP that costs $386 million more than an MRO cannot be more favorable in the aggregate than an MRO based on claimed "non-quantifiable" benefits, especially when such "benefits" are illusory and not supported by the record. Consequently, the Commission's Order should be overturned.

The Commission also erred by approving, as part of AEP Ohio's ESP, two nonbypassable generation-related riders that are not authorized by Ohio law: the Retail Stability Rider ("RSR") and Generation Resource Rider ("GRR"). Allowing these riders would eviscerate the requirements of Sections 4928.143(B) and 4928.64(E) of the Ohio Revised Code and this Court's decision in *In re Application of Columbus Southern Power Company*, 128 Ohio St.3d 512, 2011-Ohio-1788, 947 N.E.2d 655. There is no legal basis for the recovery of transition charges to subsidize electric generating assets in the guise of a nonbypassable stability rider; here, the RSR. Similarly, nonbypassable charges to recover the cost of renewable resources constructed to satisfy Ohio's alternative energy resource requirements, as contemplated by the GRR, are also unlawful.

Further, Ohio law does not permit cross-subsidies between an EDU and its competitive affiliate. Yet, remarkably, the Commission authorized AEP Ohio to transfer above-market revenues to its competitive generation affiliate in clear violation of Ohio law. The Commission erred by approving the pass-through to SSO customers of purchased power costs without the prudency review required by Revised Code Section 4928.143(B)(2)(a) and despite the undisputed fact that AEP Ohio could purchase both energy and capacity from competitive markets at prices significantly lower than what AEP Ohio would be paying its affiliate. The Commission erred by approving anticompetitive subsidies flowing from AEP Ohio to a competitive generation affiliate.

For these reasons, the Order should be reversed.

II. STATEMENT OF FACTS

A. Procedural History

On January 27, 2011, AEP Ohio submitted an application for a proposed ESP. Subsequently, AEP Ohio sought Commission approval of a modified ESP submitted through a Stipulation between AEP Ohio and some of the parties to the Commission proceeding. (Appendix to the Merit Brief of FirstEnergy Solutions Corp. ("Appx.") 14 [Order, p. 5].) FirstEnergy Solutions Corp. ("FES"), the Office of the Ohio Consumers' Counsel ("OCC") and the Industrial Energy Users-Ohio ("IEU"), among others, opposed this Stipulation. On December 14, 2011, the Commission issued an order approving the Stipulation with certain modifications. (Appx. 15.) Several parties, including FES, filed applications for rehearing of the December 14, 2011 Order. (*Id.*) On February 23, 2012, the Commission reversed itself, finding that "the Stipulation, as a package, did not benefit ratepayers and was not in the public interest." (*Id.*)

On March 30, 2012, AEP Ohio filed an application for approval of another modified ESP. (Appx. 15.) After an evidentiary hearing, the Commission approved that proposed ESP, with certain modifications, on August 8, 2012. (Appx. 86.) The Commission issued its Entry on Rehearing on January 30, 2013 ("Entry"), rejecting all substantive objections to the Order. (Appx. 74.)

In its Order, the Commission found that AEP Ohio's proposed ESP, as modified, was less favorable to customers than the expected results of an MRO by $386 million. (Appx. 84.)

Despite this finding, the Commission approved the ESP on the basis of the ESP's alleged non-quantifiable benefits. (*Id.*) However, the only non-quantifiable benefits of the ESP identified by the Commission were two distribution riders, known as gridSmart and the Enhanced Service Reliability Rider ("ESRR"), and a series of claims relating to AEP Ohio's transition to market pricing. (Appx. 85, 103 [Entry, p. 11].)

B. Ohio Has A Competitive Market For Retail Electric Generation Service.

In 1999, the Ohio General Assembly passed Am. Sub. S.B. 3 ("S.B. 3") that instituted a new framework for retail electric service. S.B. 3 ended Ohio's traditional regulation of certain parts of the electric industry. *Migden-Ostrander v. Pub. Util. Comm.*, 102 Ohio St.3d 451, 2004-Ohio-3924, 812 N.E.2d 955 (2004). S.B. 3 provided that, effective January 1, 2001, retail electric generation service – the power provided to customers – would be a competitive service. R.C. §§ 4928.03, 4928.01(A)(28). Any and all utility customers could "shop" for retail electric service from a competitive retail electric service ("CRES") provider. Following a market development period, EDUs were required to recover the costs of and investments in electric generating facilities solely through the competitive market, just like every other generation owner and CRES provider in that competitive market. *See* R.C. § 4928.38. Indeed, EDUs were required to separate their generating assets into an affiliate or to divest them completely so as to ensure electric generation services were provided on a level playing field. R.C. § 4928.17.

Under S.B. 3, electric utilities were given an opportunity during a transition period to recover certain "transition costs." These included any costs in a utility's generating facilities that were previously sunk (i.e., incurred prior to January 1, 2001) and that would be uneconomic, i.e., not recoverable or "stranded" in competitive markets. *See* R.C. §§ 4928.37-.40. These defined costs could be recovered over a term of years that was somewhat unique for each utility. *See* R.C. §§ 4928.40, 4928.31. However, in no case could such transition costs be recovered after

December 31, 2010. R.C. § 4928.40. S.B. 3 prohibited the Commission from authorizing after December 31, 2010, "the receipt of transition revenues or any equivalent revenues by an electric utility except as expressly authorized." R.C. § 4928.38. At the end of the transition period, "the utility shall be fully on its own in the competitive market." *Id.* As this Court observed, "In short, each service component was required to stand on its own" from 2001 forward. *Migden-Ostrander v. Pub. Util. Comm.,* 102 Ohio St.3d 451, 452 (2004).

C. Ohio Law Obligates A Utility To Provide Non-Shopping Customers With Pricing For Generation Service That Is At Least As Good As That Available In The Market.

In 2008, the General Assembly enacted Senate Bill 221 ("S.B. 221"). S.B. 221 gives each EDU two options for providing SSO service. The first option is a market-based offer determined by an open, transparent, competitive auction – an MRO under Revised Code Section 4928.142. The second option is an ESP under Revised Code Section 4928.143.

Although two options exist for default service to SSO customers, the statutory framework requires that <u>at minimum</u> customers be provided with market pricing. An EDU must provide a market-based SSO (the MRO) or a better-than-market SSO (the ESP). Under Section 4928.143, the Commission may only approve an ESP if it is "more favorable" than an MRO:

> [T]he commission by order shall approve or modify and approve an application . . . if it finds that the electric security plan so approved, including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under section 4928.142 of the Revised Code.

R.C. § 4928.143(C)(1).

As its name implies, an MRO establishes its pricing through a competitive bid process ("CBP"). R.C. § 4928.142(A)(1). However, for the first MRO application filed by an EDU that still owned generation as of July 31, 2008, the CBP result must be proportionately blended in with the most-recent SSO price, with some potential adjustments, over a five-year period. R.C. § 4928.142(D). The blending starts using 10% of the CBP result (and 90% of the then current SSO price) in the first year and for the next four years increases the CBP result to be used in 10% increments so that no more than 50% of the CBP-determined prices can be used in year 5 of the MRO. *Id.* The Commission also has the authority to speed up this transition by increasing the percentage of the CBP-determined prices after the first year. R.C. § 4928.142(E). After the five-year (or faster) blending period, customers receive fully market-priced generation service. *See* R.C. § 4928.142(A), (F).

D. Market Prices Are Substantially Below AEP Ohio's ESP Pricing.

There is no dispute that wholesale market prices for generation are projected to be substantially lower than AEP Ohio's ESP price for the entire ESP period. FES witness Michael Schnitzer analyzed the prices available in the competitive market and found that, for the period from June 2012 through May 2015 (the expected ESP term), the average wholesale market price for generation service that would result from an MRO would be $50.96/MWh.[1] (Supplement to the Merit Brief of FirstEnergy Solutions Corp. ("Supp.") 55 [FES Ex. 104, Direct Testimony of Michael Schnitzer ("Schnitzer Direct"), Ex. MMS-2].) Staff witnesses Daniel Johnson and Robert Fortney reached similar conclusions as to the market price under an MRO. (*See* Supp. 124 [Staff Ex. 110, Direct Testimony of Robert Fortney ("Fortney Direct"), Attachment A]; Supp. 130 [Direct Testimony of Daniel Johnson ("Johnson Direct"), Attachment. DRJ-4].) While the Commission's Order did not include a dollar per MWh ESP price comparable to the

[1] Mr. Schnitzer accepted, to the extent practicable, AEP Ohio's assumptions used to develop the MRO CBP price. (Supp. 22 [Schnitzer Direct, p. 18 n.28].) He substituted a market-based capacity price for the $355/MW-day capacity price used by AEP Ohio and made other minor adjustments to account for ripple effects of that change. (Supp. 21-22.)

projections used by the parties, the record shows that the total ESP pricing as approved by the Commission is much higher than an expected MRO's market pricing.[2]

III. ARGUMENT

A. <u>Proposition Of Law No. 1</u>: The Commission cannot lawfully or reasonably approve an ESP that is not more favorable in the aggregate than the expected results of an MRO.

Ohio law specifically prescribes the Commission's authority to approve an ESP. The Commission can approve an ESP <u>only</u> if the ESP is "more favorable in the aggregate as compared to the expected results that would otherwise apply under section 4928.142 of the Revised Code." R.C. § 4928.143(C)(1). The Commission erred in finding that AEP Ohio's ESP meets this statutory standard. Indeed, using the Commission's own math, there is no dispute that the ESP is a horrible deal for customers. The Commission recognized that the ESP, as approved and modified by the Commission, cost $386 million more than an MRO. (Appx. 84.) However, despite acknowledging that the ESP is less favorable to customers, the Commission approved the ESP by relying on "non-quantifiable aspects" of the ESP. (*Id.*) The Commission improperly determined that non-existent, qualitative benefits could outweigh the ESP's $386 million relative cost to make the ESP more favorable than an MRO. In so doing, the Commission erred. Given the lack of any record support for any sufficient non-quantifiable benefit, a plan that forces all of AEP Ohio's customers to pay $386 million more than they would under the MRO default option is simply not more favorable to those customers.

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[2] For example, using values for certain components of the ESP that were less than what was actually adopted by the Commission, Staff witness Fortney estimated that AEP Ohio's ESP would cost a monthly weighted average of $63.92/MWh over the term of the ESP. (Supp. 125 [Fortney Direct, Attachment B].)

1. The Commission's ESP v. MRO determination must be supported by record evidence.

While the Commission is authorized to review an ESP plan "in the aggregate," the Commission is not given a blank check. Although qualitative benefits are, by definition, not subject to quantification, the Commission should be able to do two things: (1) point to specific evidence in the record for any purported qualitative benefit of an ESP over an MRO; and (2) articulate some rationale, based on record evidence, as to why the alleged qualitative benefits of an ESP outweigh its costs. Otherwise, the Commission's ESP v. MRO analysis would, in every case, boil down to relying simply on the Commission's say so, leaving the Commission's decision beyond challenge or review. Faced with an ESP that costs hundreds of millions of dollars more than a MRO, the Commission cannot simply waive that cost burden away merely by saying there are countervailing non-quantitative benefits. There must be some tangible support in the record to determine whether the ESP's alleged non-quantitative benefits justifiably outweigh the ESP's costs. The Commission must provide the parties and this Court some reasonable basis in the record to conclude that the Commission's judgment is correct and should be affirmed.

Given its $386 million price tag, it is hard to imagine there could be any set of non-quantifiable benefits that could justify such a high cost. To be sure, in a case where an ESP and MRO result in roughly equivalent costs to customers, demonstrated qualitative factors might conceivably tip the balance in favor of an ESP. But this is not that case. Therefore, the Commission's decision should be overturned.

2. The non-quantifiable benefits relied on by the Commission do not outweigh hundreds of millions of dollars in above-market costs.

The Commission's conclusion that the non-quantifiable benefits of the ESP outweigh $386 million in quantifiable costs lacks record support. (*See* Appx. 85.) Not one witness, from

AEP Ohio or otherwise, testified that an ESP that fails the ESP v. MRO test by hundreds of millions of dollars could nevertheless be in the best interest of customers.

As previously noted by this Court, "a legion of cases establish that the commission abuses its discretion if it renders an opinion on an issue without record support." *Industrial Energy Users-Ohio v. Pub. Util. Comm.*, 117 Ohio St.3d 486, 2008-Ohio-990, 885 N.E.2d 195 (citing *Tongren v. Pub. Util. Comm.*, 85 Ohio St. 3d 87 (1999), and *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.*, 76 Ohio St. 3d 163 (1999)). The Commission's decision should be reversed where it is "manifestly against the weight of the evidence" or is "so clearly unsupported by the record as to show misapprehension, mistake, or willful disregard of duty." *Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St. 3d 305, 307, 2007-Ohio-4164, 871 N.E.2d 1176.

There is no dispute that AEP Ohio's ESP is substantially worse for customers than if customers paid blended market-based prices that would be available under an MRO. Staff witness Fortney acknowledged that MRO pricing was lower than the ESP price for the entire relevant period and relied on that in his ESP v. MRO analysis. (Supp. 124.) Staff witness Fortney testified, "I conclude that under all three of these quantitative scenarios the ESP as proposed by AEP is not more favorable than the blended MRO . . . ." (Supp. 123.)

In light of these undisputed points, the only way the Commission could approve the ESP was to: (1) modify the ESP to reduce its costs (which the Commission did not do); or (2) provide supporting evidence that the ESP contained specific non-quantifiable benefits that outweighed the ESP's quantifiable relative costs (which the Commission also did not do). Instead, the Commission cited, with no support, certain non-quantifiable alleged benefits to justify the huge price tag of the ESP. Specifically, the Commission asserted that there were three non-quantifiable benefits of the ESP: (1) the availability of certain distribution riders; (2) AEP

Ohio's supposed "faster" transition to market-based pricing; and (3) AEP Ohio's s purported "financial stability." None of these purported benefits is supported in the record; none is a non-quantitative benefit of the ESP; and none would overcome a quantitative differential of at least $386 million.

a. Distribution riders are equally an ESP and MRO benefit.

First, the Commission pointed to the ESP's distribution-related riders – i.e., the enhanced service reliability rider ("ESSR") and the gridSmart rider – as non-quantifiable benefits to customers that "would support reliability improvements." (Appx. 84-85.) These are not benefits of the ESP as compared to an MRO. By definition, distribution-related riders relate to distribution service, i.e., the delivery of electricity to customers, and not the provision of generation service. Distribution charges can be addressed through a traditional distribution rate case. Thus, the recovery of certain distribution-related costs is equally available under an ESP or an MRO. Any distribution costs that could be recovered through a rider as part of an ESP under Revised Code Section 4928.143(B)(2) could also conceivably be recovered as part of a distribution rate case outside of an ESP. *See* R.C. Chapters 4905, 4909. Thus, distribution riders are effectively a "wash" for purposes of the ESP v. MRO test. Indeed, in a case involving the FirstEnergy Ohio EDUs, the Commission held exactly that. *In the Matter of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Provide for a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, 299 P.U.R.4th 1, 43 (PUCO July 18, 2012). *See also In the Matter of the Application of Columbus Southern Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan,* Case No. 11-346-EL-SSO (Dec. 14, 2011 Opinion and Order) at 31.

Here, the costs for any needed "reliability improvements" also could be captured outside of an SSO proceeding through a distribution rate case. The potential for these improvements provides no benefits specific to this or any other ESP. Indeed, even the Commission did not appear to think that the benefits of the ESP's distribution riders outweighed $386 million in the ESP's relative costs. The Commission merely observed that the benefits of such riders would, over time, outweigh the riders' costs. (Appx. 84-85.) Thus, the ESP's distribution riders provide little, if any, weight in the ESP v. MRO test.

b. AEP Ohio's "faster" transition to market is quantifiable, was quantified, and largely is an illusion.

The Commission stated that the "most significant" of the non-quantifiable benefits of the ESP is AEP Ohio's overdue transition to market-based pricing. (Appx. 85.) The specific benefits identified were: (1) the faster time to an auction for 60% of the SSO load in 2014; and (2) the projected 100% SSO service auction beginning June 1, 2015 (after the term of the ESP). (Appx. 85, 103.) Neither of these is correctly viewed as a benefit of the ESP, and neither outweighs the $386 million relative cost of the ESP.

As noted, there is no dispute that market prices are substantially below AEP Ohio's current ESP prices. (*See* Supp. 55 [Schnitzer Direct, Ex. MMS-2]; Supp.124 [Fortney Direct, Attachment A].) Under the ESP, 60% of the SSO load will be priced at market (via an auction) for the period June 1, 2014 through December 31, 2014. (Appx. 49.) Under an MRO, given the blending requirements in Section 4928.142(D), only 30% of SSO load could be priced at market during this same period. (Supp. 125 [Fortney Direct, Attachment B]; Supp. 136-138 [AEP Ohio Ex. 114, Direct Testimony of Laura Thomas ("Thomas Direct"), Ex. LJT-1].) However, all of the witnesses who presented testimony comparing the ESP and an MRO included this difference in their calculations. (*See* Supp. 57-59 [Schnitzer Direct, Ex. MMS-4], Supp. 124-126 [Fortney

Direct, Atts. A, B, and C], Supp. 136-138 [Thomas Direct, Ex. LJT-1].) Thus, any benefit to a faster (or greater) access to market prices was already accounted for as part of the quantitative ESP v. MRO analyses. Indeed, since this price difference is obviously quantifiable for the specified period, the Commission erred simply by describing it as non-quantifiable.

Although the Commission stated that, if AEP Ohio were to file an MRO, "it is not feasible to conclude that energy would be at market prices prior June 1, 2015," **AEP Ohio concluded in its testimony that energy would be at 100% market prices under an MRO as of January 1, 2015**. (*See* Appx. 85.) According to AEP Ohio's witness, because of AEP Ohio's impending structural separation of its generating assets to an affiliate, the MRO price on and after January 1, 2015 would be equal to the modified ESP price. (Supp. 134-135, 139 [Thomas Direct, pp. 19-20 and Ex. LJT-3].) After structural separation, AEP Ohio will not have a base generation rate with which to blend its CBP results. It will, instead, satisfy its SSO obligation entirely through purchased power.[3] (*See* Supp. 139.) AEP Ohio witness Thomas confirmed that AEP Ohio's purchased power cost will be equal to the modified ESP price for energy on and after January 1, 2015. (Supp. 135.) Thus, except for the brief period between June 1, 2014 and December 31, 2014, the alleged qualitative benefit of the ESP moving faster to 100% market pricing is entirely illusory.

Moreover, regardless of whether the Commission were to approve an ESP or MRO through May 31, 2015, AEP Ohio will be providing its customers energy and capacity at market prices from June 1, 2015 forward. On rehearing, the Commission claimed, "the fact that AEP-Ohio will be delivering and pricing energy at market prices in two and a half years is an invaluable benefit of this ESP." (Appx. 103.) But the auction offered for energy to be delivered

[3] Under Revised Code Section 4928.142(D), the blending requirement is tied to an EDU's ownership of generating assets.

starting June 2015 is not a benefit provided by the ESP. AEP Ohio's auction for SSO service is a benefit of AEP Ohio finally completing corporate separation as mandated by Revised Code Section 4928.17 on or about January 1, 2014.[4] (Appx. 66; *see* Tr. Vol. II, pp. 504-05.) AEP Ohio has no choice but to hold a wholesale auction for SSO service (both energy and capacity) starting June 1, 2015, and it already has participated in PJM's capacity auction for the delivery year commencing June 1, 2015. (*See* Tr. Vol. II, pp. 399-400, 420-21, 570, 707.) In short, following corporate separation, AEP Ohio will have no generating assets and thus no other generation-related options other than to procure energy and capacity for its SSO load from wholesale suppliers. AEP Ohio's customers will benefit from an auction for SSO service as of June 1, 2015 simply because of the corporate restructuring requirements put in place for EDUs by the General Assembly in S.B. 3. Indeed, had AEP Ohio's corporate separation not been delayed for many years in favor of "functional" separation, AEP Ohio would have completed this corporate restructuring years ago and its customers would already be enjoying the benefits of a market-based SSO.

The Commission's statement that AEP Ohio's decision "to move towards competitive market pricing is voluntary under the statute" misses the point. (Appx. 85.) Revised Code Section 4928.141(A) requires AEP Ohio to provide a SSO to customers. As noted, this can happen in only one of two ways: as an MRO under Section 4928.142 or as an ESP under Section

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[4] *See In the Matter of the Application of Ohio Power Company for Approval of an Amendment to its Corporate Separation Plan*, PUCO Case No. 12-1126-EL-UNC, 2012 WL 5246651 (Finding and Order Oct. 17, 2012) ("AEP-Ohio reasons that full structural corporate separation will facilitate an auction-based SSO. Further, OP believes that structural corporate separation advances the public interest by achieving the statutory mandate of Section 4928.17, Revised Code."). The Commission approved AEP Ohio's corporate separation on October 17, 2012. *See id.* The Federal Energy Regulatory Commission ("FERC") approved AEP Ohio's corporate separation on April 29, 2013. *See Ohio Power Company & AEP Generation Resources Inc.*, 143 FERC ¶ 61,075 (FERC April 29, 2013).

4928.143. Under Section 4928.143, the Commission may only approve an ESP if it finds that the ESP "is more favorable in the aggregate" than an MRO. Thus, providing competitive market-based pricing or an SSO that provides better than market-based pricing is not voluntary; it is required by law. Regardless, as a result of AEP Ohio's full corporate separation, it will have no choice but to be at competitive market pricing as of June 1, 2015. Because the Commission failed to understand the import of AEP Ohio finally achieving corporate separation, what the Commission touted as the most significant benefit of the ESP is actually not in any way a benefit of the ESP.

c. Maintaining AEP Ohio's financial stability by charging all customers above-market rates is not a benefit of the ESP.

Another claimed benefit of the ESP, according to the Commission, was that AEP Ohio's generating assets would receive hundreds of millions of dollars in above-market subsidies to give AEP Ohio the "financial stability necessary to continue to provide adequate, safe, and reliable service to its customers." (*See* Appx. 85.) As discussed below in Proposition of Law No. 2, this is unlawful. Moreover, there is a surfeit of record evidence demonstrating that this massive subsidy was unnecessary for AEP Ohio to continue to provide adequate, safe and reliable service. AEP Ohio's distribution and transmission services remain fully regulated and are not at risk. *See* R.C. §§ 4928.03, 4928.11, 4928.111. Thus, the only conceivable "benefit" resulting from the subsidy would be higher returns for AEP Ohio's generating assets. Given that those assets are supposed to be competing for revenue in the competitive market, it is hard to understand how such an anti-competitive subsidy benefits customers.

The General Assembly has already mandated that customers receive the benefit of market-based pricing or better than market-based pricing – and customers are entitled to that benefit now. No claimed non-quantifiable "aspects" of the ESP offset what the Commission admits is the ESP's $386 million cost. Indeed, the Commission did not attempt to justify the value of the alleged qualitative benefits as being equal to or greater than $386 million. Nor could it. Thus, the Commission abused its discretion and lacked record support in approving the ESP. It is an abuse of discretion to require all AEP Ohio customers to pay $386 million so that SSO customers can access market-pricing already guaranteed to those customers by statute.

B. <u>Proposition Of Law No. 2</u>: The Commission may not lawfully and reasonably approve a Revenue Stability Rider where the rider does not meet the criteria established in Revised Code Section 4928.143(B)(2).

AEP Ohio's proposed nonbypassable RSR is intended to provide a $532 million subsidy to AEP Ohio.[5] (Appx. 44-45, 84.) AEP Ohio admitted that the RSR is a subsidy by acknowledging that the purpose of this rider is to "provide financial stability for AEP Ohio." (AEP Ohio Ex. 116, Testimony of William Allen, p. 14.) The Commission also acknowledged that the RSR is a subsidy. It approved the RSR under Revised Code Section 4928.143(B)(2)(d), finding that the RSR promoted stable retail electric service and ensured customer certainty, allowing customers to return to SSO service if market prices for energy unexpectedly increased. (Appx. 40-41.) In effect, the Commission held that this subsidy was necessary to compensate AEP Ohio for a provider of last resort ("POLR") risk if shopping customers wanted to return to SSO service. Each of these purported justifications lacks merit. The Commission's approval of the RSR should be reversed.

1. The RSR is not authorized by Revised Code Section 4928.143(B)(2)(d) and no other Ohio law authorizes the recovery of above-market, generation-related revenue.

The Commission's Order approves the RSR based on Section 4928.143(B)(2)(d). (*See* Appx. 40, 107-108.) Section 4928.143(B)(2)(d) authorizes ESPs to include:

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[5] The revenue provided to AEP Ohio through the RSR would total $532 million based on AEP Ohio's projected load and the charges approved by the Commission. (*See* Appx. 84, n.32.)

> Terms, conditions, or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service, default service, carrying costs, amortization periods, and accounting or deferrals, including future recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service. [Emphasis added.]

This statute does not authorize the subsidy provided to AEP Ohio through the RSR.

The Commission found that the RSR promotes retail stability by allowing "AEP-Ohio to maintain a fixed SSO rate." (Appx. 41; *see also* Appx. 40-41 ("any costs associated with the RSR are mitigated by the effect of stabilizing non-fuel generation rates")].) Yet, in approving the RSR, the Commission authorized AEP Ohio to increase SSO customers' generation-related prices in order "to establish a revenue target that will allow AEP-Ohio the opportunity to earn a reasonable rate of return." (Appx. 42.) Because SSO customers' rates are increasing through the RSR, the RSR does not provide any "stability" in retail rates. If AEP Ohio needs additional revenues to provide SSO service, it should recover those revenues through the base generation rate.

The Commission also found that the RSR "provides rate stability and certainty through CRES services . . . by allowing customers the opportunity to mitigate any SSO increases through increased shopping opportunities that will become available as a result of the Commission's decision in the Capacity Case." (Appx. 40.) A nonbypassable generation-related rider, of course, does not serve to increase shopping opportunities. An increase in costs to shopping customers does not provide "increased shopping opportunities." Such a charge may reduce "headroom" or margin for suppliers. Reduced margins reduce the opportunity for shopping. (*See* Supp. 47-50 [Schnitzer Direct, pp. 43-46].) Any suggestion otherwise is unsupported. By collecting generation costs not through a bypassable generation rate, but through a nonbypassable rider, the RSR shifts to shopping customers the revenues required for AEP Ohio to provide generation service to non-shopping customers. Thus, the RSR requires shopping customers to pay for services that they don't use. Further, the RSR will further allow AEP Ohio to keep its base generation price-to-compare artificially low and thus discourage additional shopping. Accordingly, the RSR is simply an anti-competitive subsidy.

The Commission's analysis of the RSR in its Entry was circular. (Appx. 107-108.) The Commission stated that the RSR was related to "default service" (i.e., service to non-shopping customers) because the RSR was included in the ESP intended to provide default service. (Appx. 107.) But under such an analysis literally any charge in an ESP would meet this loose definition simply as a result of its inclusion in an ESP. The proper analysis is whether the rider is authorized under Section 4928.143(B)(2) to be included in an ESP in the first place. Simply because the Commission approves a rider within an ESP does not mean that the rider is automatically authorized by statute. Otherwise, the statute would be meaningless and the Commission's authority would be without limitation.

The Commission's analysis is inconsistent with this Court's precedent. In *In re Application of Columbus Southern Power Company*, 128 Ohio St.3d 512, 2011-Ohio-1788, 947 N.E.2d 655, this Court considered carrying costs associated with environmental investments and rejected those costs as improper ESP charges. *Id.* ¶¶ 31-35. The Court held that Section 4928.143(B)(2) was not unlimited and did not authorize the Commission to approve an ESP containing "any" provision. *Id.* ¶ 32. Instead, the Court noted the Commission's authority to approve riders within an ESP is limited to only those types of provisions expressly authorized by Section 4928.143(B)(2). The Court noted, "[T]he appellees' interpretation would remove any substantive limit to what an electric security plan may contain, a result we do not believe the General Assembly intended." *Id.* ¶ 34.

The RSR also is not authorized by any other provision of Section 4928.143(B) and, indeed, the Commission did not identify any other statutory support for the rider. In approving the RSR, the Commission simply provided AEP Ohio with (improper) guaranteed generation-related revenue. Ohio law requires that AEP Ohio's distribution and generation functions must be treated separately and that the generating assets of EDUs must be fully on their own in the competitive market. *See* R.C. § 4928.17 (requiring separate accounting functions for competitive and noncompetitive services); R.C. § 4928.38 ("the utility shall be fully on its own in the competitive market"). Nothing in Ohio law provides for guaranteed returns or the Commission's protection to ensure an "opportunity to earn a reasonable rate of return" for generating assets. Accordingly, the Order's approval of the RSR is unlawful and unreasonable.

2. The RSR includes transition revenues that AEP Ohio is not entitled to recover.

EDUs had a limited period of time in which to recover transition costs and that time period has closed:

> Pursuant to a transition plan approved under section 4928.33 of the Revised Code, <u>an electric utility in this state may receive transition revenues under sections 4928.31 to 4928.40 of the Revised Code, beginning on the starting date of competitive retail electric service</u>. Except as provided in sections 4905.33 to 4905.35 of the Revised Code and this chapter, an electric utility that receives such transition revenues shall be wholly responsible for how to use those revenues and wholly responsible for whether it is in a competitive position after the market development period. <u>The utility's receipt of transition revenues shall terminate at the end of the market development period</u>. With the termination of that approved revenue source, the utility shall be fully on its own in the competitive market. <u>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.</u>

R.C. § 4928.38 (emphasis added). Thus, the Commission cannot authorize AEP Ohio to recover any "transition revenues or any equivalent revenues." However, the Commission has done just that in approving the RSR.

In trying to distinguish the RSR from transition revenues, the Commission stated:

> We reject the claim that the RSR allows for the collection of inappropriate transition revenues or stranded costs that should have been collected prior to December 2010 pursuant to Senate Bill 3, as AEP Ohio does not argue its ETP did not provide sufficient revenues . . . .

(Appx. 41; *see* Appx. 113.) But whatever the Commission or AEP Ohio may call it, the RSR provides for "transition revenue or other related revenue." The Commission's Order expressly linked the RSR to a "guarantee that, in less than three years, AEP-Ohio will establish its pricing based on energy and capacity auctions." (Appx. 40-41.) In fact, the Commission baldly stated that "but for the RSR it would be impossible for AEP-Ohio to completely participate in full energy and capacity based auctions beginning in June 1, 2015." (Appx. 85.) Thus, the RSR provides revenues that clearly are associated with AEP Ohio's transition to the competitive market. In fact, AEP Ohio's Chief Operating Officer acknowledged that the RSR was designed to provide revenues to AEP Ohio for the "transition to market": "The RSR will provide economic stability and certainty for AEP Ohio, our customers and other stakeholders during the market transition term of the modified ESP II and until corporate separation and the Pool Agreement elimination is complete." (AEP Ex. 101, Direct Testimony of Robert Powers, pp. 18-19 (emphasis added).)

The Commission's assertion that AEP Ohio does not agree that its transition charges were insufficient is irrelevant. However, it does beg the question as to why the Commission is providing AEP Ohio additional transition revenue if the transition revenue they already received was sufficient. In any event, this is a statutorily prohibited "second bite at the apple." Of course, as an initial matter, AEP Ohio's view of its transition charges is not a prerequisite to finding that the RSR recovers transition revenues. The key issue is: what is the nature of the cost that AEP Ohio seeks to recover through the RSR? As its own COO admitted, the RSR provides sufficient revenues to allow AEP Ohio to transition to a competitive market. AEP Ohio already was permitted to recover those costs. It is not permitted to do so after December 2010, let alone after December 2013 as the Commission has approved in this case.

The Commission additionally attempted to distinguish the RSR from transition cost recovery by noting that the RSR is justified by "events that occurred after the ETP proceedings." (Appx. 41.) But these post-transition to competition events are irrelevant. For example, in 2007, AEP Ohio was permitted to become a Fixed Resource Requirement ("FRR") entity under a tariff approved in 2007 by the Federal Energy Regulatory Commission ("FERC") called the Reliability Assurance Agreement ("RAA"). (Supp. 108-109 [FES Ex. 101, Direct Testimony of Robert B. Stoddard ("Stoddard Direct"), pp. 10-11].) As an FRR entity, AEP Ohio obligated itself to commit capacity to ensure reliability for all load in its territory, even for the part of that load that represents shopping customers. (Supp. 109.) This was an obligation that AEP Ohio undertook voluntarily. It could have merely done what every other generation supplier did – participate in the regional capacity market and allow that market to meet the capacity obligations in AEP Ohio's territory. (*See* Supp. 106-109.)

AEP Ohio's status as an FRR entity does not undo how transition costs can be recovered under Ohio law. In enacting S.B. 221, the General Assembly must be assumed to have been aware of the RAA and its effect (if any) on the obligations of generation suppliers in Ohio. However, the General Assembly did not alter the mandate that, following an EDU's recovery of authorized transition costs, the utility's generating assets shall be fully on their own in the competitive market. S.B. 221 was effective as of July 31, 2008, and it did not create an exception for AEP Ohio or any other FRR entity. Nor should it have. Any subsidy to deregulated generating assets can only harm the competitive market by favoring an EDU's assets over those of all other market participants in violation of Revised Code Sections 4928.17 and 4928.38. The Commission cannot avoid the prohibition on the recovery of transition charges now simply by relabeling those charges.

The RSR represents improper transition revenues that AEP Ohio is precluded from recovering and the Commission is prohibited from authorizing. Thus, the Commission's approval of the RSR is unlawful and unreasonable.

3. The Commission's calculation of the RSR lacks record support.

The Commission's approval of the RSR also is unreasonable because there is insufficient support for the arbitrary $826 million revenue target used to establish the RSR charge. (*See* Appx. 42.) The Commission explained its $826 million target as simply the result of "a benchmark . . . in the approximate middle" of AEP Ohio's proposed recovery under the RSR (that the Commission observed was "too high") and a proposal by Ohio Energy Group's witness Lane Kollen (that the Commission described as an "appropriate starting point"). (*Id.*) Further, the Commission actually <u>increased</u> the revenue to be received under the rider substantially above that proposed by AEP Ohio. (*See* Appx. 43-44.) AEP Ohio requested authority to receive a projected $284 million through the RSR over the ESP term; the Commission authorized AEP Ohio to receive *$104 million more* than it requested – $388 million.[6] (*See* Appx. 84, n.32.) Such a result is unlawful and highly unreasonable.

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[6] After subtracting the $104 million amount allocated to the recovery of certain capacity revenues authorized in Case No. 10-2929-EL-UNC (and on appeal in Ohio Supreme Court Case Nos. 2013-0228 *et al.*) from the $532 million in total revenue projected to be recovered under the

There is no probative record evidence that AEP Ohio warrants additional revenues to protect its financial integrity or ensure its stability to provide generation service under the ESP. The Commission stated that "no party disputes that the approval of the RSR will provide AEP-Ohio with sufficient revenue to ensure it maintains its financial integrity as well as its ability to attract capital." (Appx. 40.) Of course, no party would dispute that: no party could contest that this windfall would make AEP Ohio better off financially or that any windfall would help any utility maintain its financial integrity. The Commission misses the point. The relevant questions are: (1) is the Commission authorized to approve such revenues for an EDU (and as explained above, the answer is "no"); (2) does AEP Ohio <u>need</u> additional revenue to maintain its financial integrity and attract capital; and (3) if AEP Ohio does need additional revenue, what is the minimum amount necessary to protect AEP Ohio without exploiting consumers. *See Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168 (D.C. Cir. 1987) ("even where the sort of deep financial hardship described in *Hope* is present, the utility is entitled only to an 'end result' hearing, and is not entitled to any greater return on its investments unless it shows at the hearing both that the rate was unreasonable and that a higher return would not exploit consumers."); *20th Century Ins. Co. v. Garamendi*, 878 P.2d 566 (Cal. 1994), *cert. denied sub. nom.*, *Century-National Ins. Co. v. Quackenbush*, 513 U.S. 1153, 115 S.Ct. 1106, 130 L.Ed.2d 1072 (1995) ("[T]he inability to operate successfully is a necessary–but not a sufficient–condition of confiscation.")

There is no evidence showing that AEP Ohio needs revenue to protect its financial integrity and attract capital. In fact, the record evidence establishes, to the contrary, that AEP Ohio is financially strong, including:

RSR, AEP Ohio would receive $388 million in other revenues through the RSR. (*See* Appx. 84, n.32.)

- a projected $22 billion excess cash flow for the AEP East fleet over the next 30 years (Tr. Vol. III, pp. 854-855; OCC Ex. 104 (June 2011 AEP Recoverability Memo));

- substantial returns on equity above 12% for 2009, 2010 and 2011 (Tr. Vol. I, pp. 248-249, 251; FES Ex. 106 (reflecting that AEP Ohio enjoyed a 12.06% ROE in 2011, as shown on Exhibit WAA-6 in the direct testimony of AEP Ohio witness Allen));

- over $1 billion in net income from 2010 to 2011 (Tr. Vol. II, p. 363);

- first quarter 2012 net income of approximately $150 million, even with increased shopping (Tr. Vol. I, p. 364 (further acknowledging that the net income is potentially lower than otherwise expected because of a mild winter)); and

- the financial stability to project $300 million in dividends in 2012 and 2013 for AEP Ohio's parent, American Electric Power Co. (Tr. Vol. I, p. 321).

Plus, there is no evidence that the RSR is the minimum amount required or that it will not exploit consumers. Indeed, under a standard financial integrity analysis, a rate that exceeds market pricing necessarily exploits consumers. *Market Street Railway v. Railroad Commission of State of Cal.*, 324 U.S. 548, 567 (1945); *In re Southern California Edison Co.*, Decision 02-01-001, 2002 WL 407297, *8 (Cal. P.U.C., January 2, 2002) ("the government is not required to protect utilities against losses caused by the operation of market forces."). Ohio law mandates that AEP Ohio's generating assets be fully on their own in the competitive market, and AEP Ohio's financial integrity argument cannot justify the Commission's approval of an above-market subsidy for those generating assets.

The Commission's approval of the anti-competitive subsidy reflected in the RSR is thus unsupported and unreasonable.

C. <u>Proposition Of Law No. 3</u>: **The Commission may not lawfully approve a Generation Resource Rider where the rider is unauthorized by law and unsupported by fact.**

The GRR is a placeholder rider requested by AEP Ohio and approved by the Commission. (Appx. 28-29.) It is intended to recover the cost of new renewable generating resources owned by AEP Ohio. (Appx. 29.) The only project that was proposed to be included in this rider is the "Turning Point" solar project, which would assist AEP Ohio in complying with Ohio's renewable energy targets. (*Id.*) The Commission reserved for itself the ability to fund this rider in the future with nonbypassable charges as it saw fit, setting the values of this rider initially at zero. (*Id.*)

1. The GRR is prohibited by Sections 4928.64(E) and 4928.143(B).

The Commission is expressly barred from approving this "placeholder" rider by Revised Code Section 4928.64(E). Section 4928.64 requires EDUs and CRES providers to utilize certain amounts of renewable and alternative energy. The statute expressly mandates: "All costs incurred by an electric distribution utility in complying with the requirements of this section shall be bypassable by any consumer that has exercised choice of supplier under section 4928.03 of the Revised Code." (Emphasis added.)

By mandating that all costs of complying with renewable benchmarks be bypassable, the General Assembly guaranteed that customers would not be double charged for such costs. Section 4928.64(B) requires both EDUs and CRES providers to comply with Ohio's renewable energy standards. If these costs were not bypassable, then shopping customers could be charged for compliance with this statute: once by their EDU and once by their CRES provider.

The record testimony established, and the Commission also noted, that AEP Ohio sought approval of the GRR for the Turning Point Solar project, which it said is "needed" because of the statutory requirements of Section 4928.64 for solar resources. (Appx. 29, n.7; *see also* Tr. Vol. VI, p. 2058 (AEP Ohio witness Dias admitting that Turning Point "ties into the alternative energy requirement mandates that EDU has responsibility for"); Tr. Vol. II, p. 704 (AEP Ohio witness Nelson admitting that Turning Point will be used to help AEP Ohio meet its renewable energy requirements under S.B. 221)). Thus, the costs of the Turning Point Solar project sought to be included in the GRR would be "costs incurred by an electric distribution utility in complying with the requirements of" Section 4928.64. In direct violation of Section 4928.64(E), the Commission approved the GRR as a nonbypassable rider, rather than bypassable cost recovery. (Appx. 33 (approving the GRR as a nonbypassable rider "as long as AEP-Ohio takes steps to share the benefits of the project's energy and capacity . . . with all customers").) Accordingly, the Commission's approval of the GRR should be reversed.

After acknowledging FES' and other intervenors' arguments regarding the mandates of Section 4928.64(E), on rehearing, the Commission did not explain how it had statutory authority to approve this placeholder rider. Instead, it merely noted that the rider had a zero value because AEP Ohio had not met its burden of establishing that Turning Point was "needed." (Appx. 64.) That is simply not good enough. There is nothing prohibiting the Commission from putting other costs or charges for a re-submitted Turning Point facility in this "placeholder rider." Section 4928.64(E) is explicit and unconditional. If the requirements of that section were not met, a rider may not be approved thereunder.

After ignoring the specific limitations of Section 4928.64 for costs associated with alternative energy compliance, the Commission's approval of the GRR rested on Section 4928.143(B). Section 4928.143(B) authorizes, under certain conditions not met here, nonbypassable recovery of costs associated with generating facilities. Section 4928.143(B)(2)(c) provides:

> The establishment of a nonbypassable surcharge for the life of an electric generating facility that is owned or operated by the electric distribution utility, was sourced through a competitive bid process subject to any such rules as the commission adopts under division (B)(2)(b) of this section, and is newly used and useful on or after January 1, 2009, which surcharge shall cover all costs of the utility specified in the application, excluding costs recovered through a surcharge under division (B)(2)(b) of this section. However, no

> surcharge shall be authorized unless the commission first determines in the proceeding that there is need for the facility based on resource planning projections submitted by the electric distribution utility.

The reference to "an electric generating facility" is a general reference to any new generation facilities that may be provided and owned by EDUs. In contrast, cost recovery for renewable and alternative generation resources, as described in Section 4928.64, is more specific. Pursuant to Revised Code Section 1.51:

> If a general provision conflicts with a special or local provision, they shall be construed, if possible, so that effect is given to both. If the conflict between the provisions is irreconcilable, the special or local provision prevails as an exception to the general provision, unless the general provision is the later adoption and the manifest intent is that the general provision prevail.

Here, at the very least, any conflict between the bypassable mandate of Section 4928.64(E) and the nonbypassable option of Section 4928.143(B)(2)(c) must be said to be irreconcilable. Thus, the specialized provision of Section 4928.64(E) for the costs associated with renewable generation resources "prevails as an exception to the general provision" of Section 4928.143(B)(2)(c) for the costs theoretically associated with any type of new generation resources.

Further, the predominance of Section 4928.64(E)'s requirement for bypassable cost recovery is confirmed by the language of Section 4928.143(B). There, the statute expressly provides that Section 4928.143(B) would prevail over other statutory conflicts "<u>except . . . division (E) of section 4928.64</u>." Because the prohibition of Section 4928.64(E) for any nonbypassable renewable energy-related charges controls over any general cost recovery provided for under Section 4928.143(B), the Order's approval of the GRR, a nonbypassable rider intended to recover solar facility costs, is unlawful.

2. The GRR does not meet the requirements of Section 4928.143(B)(2)(c).

The Commission's reliance on Section 4928.143(B)(2)(c) to approve the GRR is unlawful and unreasonable. In its Order, the Commission approved the placeholder GRR pursuant to Section 4928.143(B)(2)(c), but repeatedly acknowledged that the GRR had not met the requirements of that statute:

> Staff notes that there are a number of statutory requirements pursuant to Section 4928.143(B)(2)(c), Revised Code, that [AEP Ohio] has not satisfied as a part of this modified ESP proceeding but will be addressed in a future proceeding, including the cost of the proposed facility, alternatives for satisfying the in-state solar requirements, a demonstration that Turning Point was or will be sourced by a competitive bid process, . . . the facility's output is dedicated to Ohio consumers and the cost of the facility, among other issues.

(Appx. 31 (emphasis added); *see also* Appx. 33 ("AEP-Ohio will be required to address each of the statutory requirements, in a future proceeding, and to provide additional information including the costs of the proposed facility, to justify recovery under the GRR.") (emphasis added).) AEP Ohio's failure to provide fundamental – and required – information about the proposed GRR precludes its approval. For example, AEP Ohio never showed that the Turning Point project would be competitively sourced (Supp. 118-119 [FES Ex. 102, Direct Testimony of Jonathan A. Lesser ("Lesser Direct"), pp. 67-68 ("AEP Ohio did not competitively bid Turning Point.")]; Tr. Vol. II, pp. 573-574 (AEP Ohio witness Nelson testifying that he did not know if the contracts associated with Turning Point have been competitively bid, or whether the selection of Turning Point or the acquisition of the solar panels was competitively bid).)

Nevertheless, the Commission approved the GRR on the grounds that the Commission has "discretion" to determine whether there is a "need" for the Turning Point Solar project in a separate proceeding. (Appx. 33.) Under Section 4928.143(B)(2)(c), however, "no surcharge shall be authorized unless the commission first determines in the proceeding that there is need for the facility based on resource planning projections submitted by the electric distribution utility" (emphasis added). Thus, determinations regarding this rider must be made in the ESP proceeding itself. This makes sense because the basis and extent of any riders in the ESP must be fully known and considered to permit the Commission to perform the ESP vs. MRO comparison properly. The Commission interpreted the statute "not to restrict our determination of the need and cost for the facility to the time an ESP is approved." (*Id.*) This conclusion simply reads the phrase "in the proceeding," out of the statute. (Emphasis added.) The "proceeding" referred to in the statute is the proceeding in which the ESP is being considered for approval. Notably, the General Assembly did not use the phrase "a proceeding," or "any proceeding," or "another proceeding." By using the article "the," the General Assembly could mean no other proceeding than the one relating to the approval of an ESP.

This reading is further supported by the General Assembly's additional directive that the Commission "first determine[] in the proceeding" that there is a need for the facility. (Emphasis added.) Thus, the need for the facility to be included in a rider as part of an ESP must be determined before the ESP is approved.

AEP Ohio failed to establish any "need" for the GRR or the Turning Point Solar project in the proceeding below. Indeed to the contrary, AEP Ohio admitted that it has no need for additional generation. (Tr. Vol. I, pp. 226-27.) Therefore, the Commission's approval of the GRR pursuant to Section 4928.143(B)(2)(c) is unlawful and unreasonable.

D. Proposition of Law No. 4: Under Revised Code Sections 4928.143(B)(2)(a) and 4928.02(H), the Commission cannot approve cross-subsidies between an EDU and its competitive generation affiliate.

The Order provided AEP Ohio broad (and vague) authority to pass numerous above-market revenue streams to AEP Ohio's competitive affiliate, AEP Generation Resources

("GenResources"), following full corporate separation. (*See* Appx. 67-69, 157.) This is unlawful because Ohio law and policy precludes such cross-subsidies.

1. The Commission lacks authority to approve the pass-through of purchased power costs that are not prudent as required by Section 4928.143(B)(2)(c).

Section 4928.143(B) limits the scope of purchased power costs that can be charged to customers through an ESP. Specifically, an ESP may only provide for:

> Automatic recovery of any of the following costs of the electric distribution utility, <u>provided the cost is prudently incurred</u>: the cost of fuel used to generate the electricity supplied under the offer; the <u>cost of purchased power supplied under the offer, including the cost of energy and capacity, and including purchased power acquired from an affiliate</u>; the cost of emission allowances; and the cost of federally mandated carbon or energy taxes.

R.C. § 4928.143(B)(2)(a) (emphasis added). As the Order acknowledges, after AEP Ohio's corporate separation (on or about January 1, 2014), AEP Ohio will be required to purchase both energy and capacity to supply the SSO load. (Appx. 66, 68-69 ("[T]he primary issues to be considered in this modified ESP proceeding is how the divestiture of the generation assets and the agreement between AEP-Ohio and GenResources will impact SSO rates.").) AEP Ohio has proposed to purchase energy and capacity for its SSO load from GenResources, an unregulated affiliate. (Appx. 66-67.) Therefore, pursuant to Section 4928.143(B)(2)(a), the costs of AEP Ohio's purchased power and capacity from GenResources must be shown to be "prudently incurred." The Commission failed to apply this statutory standard. As such, the Commission's grant of authority to AEP Ohio to transfer revenues to GenResources is unlawful.

AEP Ohio presented no evidence that its proposed purchased power price during the ESP term (particularly as purchased from its affiliate) would be prudent. In fact, the record evidence establishes that the proposed charges for power and capacity acquired from GenResources would be anything but prudent. For example, the proposed capacity price (at the $188.88/MW-day equivalent) is significantly higher than the average RPM market price for 2012-2015 of \$69.22/MW-day. (Tr. Vol. X, p. 2808; Supp. 114-117 [Lesser Direct, pp. 10, 13-15].) AEP Ohio admitted that it has done nothing to evaluate the terms of its proposed arrangement with GenResources or whether other lower-priced options for acquiring capacity are available in the competitive market. (Tr. Vol. II, pp. 523-524, 608.) This is particularly noteworthy, because, as the Commission acknowledged, other parties had offered to serve the SSO load "at a cost lower than [AEP Ohio] is proposing." (Appx. 69.) In short, AEP Ohio's proposal fails to meet the prudence requirements of Section 4928.143(B)(2)(a) because the proposal simply assumes that AEP Ohio can force customers to pay charges that are well above-market after corporate separation. As such, the Commission's Entry approving such a pass-through is unreasonable and unlawful.

2. The Commission unlawfully and unreasonably approved anticompetitive subsidies that are prohibited by law and policy.

The Commission detailed four revenue streams that AEP Ohio would transfer to its affiliate: (1) certain RSR revenues; (2) capacity revenues; (3) "generation-based new revenue"; and (4) "revenue associated with sales to shopping customers." (Appx. 69.) The Commission found it "appropriate and reasonable" for AEP Ohio to pass these revenues to its competitive generation affiliate. (*Id.*) The pass-through of each of these revenue streams is an improper cross-subsidy that will harm the competitive market that the Commission is charged to protect. *See, e.g.*, R.C. § 4928.06(A), (C), (E)(1).

It is the state's policy to "[e]nsure effective competition in the provision of retail electric service by <u>avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service</u>." R.C. § 4928.02(H) (emphasis added). The General Assembly directed that the Commission "shall ensure [that this policy, and all other state policy] is effectuated." R.C. § 4928.06(A) ("Beginning on the starting date of competitive retail electric service, the public utilities commission shall ensure that the policy specified in section 4928.02 of the Revised Code is effectuated."). Ohio law also prohibits AEP Ohio, after its corporate separation, from "extend[ing] any undue preference or advantage to any affiliate . . . engaged in the business of supplying the competitive retail electric service." R.C. § 4928.17(A)(3) (setting forth requirements for corporate separation plans). However, each of these four revenue streams provides a preference and competitive advantage to AEP Ohio's competitive affiliate.

a. The Order unlawfully approved the pass-through of non-deferral RSR revenues.

As explained in the Order, the RSR revenues were approved because the additional revenues "provide AEP-Ohio with sufficient revenue to ensure it maintains its financial integrity" and purportedly allow "AEP-Ohio to maintain a fixed SSO rate." (Appx. 40-41 (emphasis added).) There is absolutely no record evidence regarding GenResources' financial status, much less the revenues that it would need to maintain its "financial integrity" as a competitive entity. More importantly, the Commission has no authority to "ensure [GenResources] maintains its financial integrity" or to impose additional charges to allow "[GenResources] to maintain a fixed SSO rate."

b. The Order unlawfully approved the pass-through of embedded cost-based capacity revenue.

After it receives AEP Ohio's generating assets, GenResources will be a competitive generation provider in Ohio and thus must compete to provide such service. Accordingly, it is not entitled to receive any price for its capacity other than the competitive market-based price for capacity that all other generation providers receive – RPM prices. However, the Commission authorized AEP Ohio to pass through its embedded cost-based, above-market capacity price of

$188.88/MW-day (as discussed extensively in a related pending proceeding, Case Nos. 2013-0228 *et al.*) to GenResources. If GenResources is allowed to receive the equivalent of the $188.88/MW-day price for capacity provided to SSO and shopping customers, it will receive more revenue than every other generation provider in Ohio and every other generation provider in the unconstrained zone of PJM Interconnection, LLC, the regional transmission organization for AEP Ohio and all other Ohio EDUs. (*See* Supp. 103-104 [Stoddard Direct, pp. 5-6].) This will provide an improper, undue preference to GenResources based simply on its affiliated status with AEP Ohio, and will distort the competitive wholesale and retail market. Accordingly, it is unlawful and unreasonable for GenResources to receive an above-market price for capacity.

c. The Order unlawfully approved the pass-through of "generation based revenues from SSO customers."

The base generation price charged to SSO customers prior to AEP Ohio's auctions is a revenue stream that represents revenues to which GenResources is not entitled. AEP Ohio has admitted that its base generation price is not based on cost or market-priced components. (Tr. Vol. IV, p. 1112.) There is no record evidence, then, to support GenResources' right to recover an arbitrary (i.e., non-market-based) price for generation services from SSO customers, nor any Ohio law that supports GenResources' right to such recovery. GenResources should be required to compete on a level playing field with all other competitive providers in Ohio.

d. The Order unlawfully approved the pass-through of revenues associated with "energy sales to shopping customers."

It is unclear what revenues associated with "energy sales to shopping customers" AEP Ohio, an EDU, will have after corporate separation. To the extent this language would allow AEP Ohio to serve as a CRES provider or somehow pass through the retail costs of AEP Retail's energy sales, it is wholly inappropriate, imprudent, unreasonable and unlawful.

On rehearing, the Commission stated that AEP Ohio will be structurally separated at some point during the ESP term, but will nevertheless still be obligated to provide SSO service during that period. But this is a non-sequitur. There is no requirement that AEP Ohio provide SSO service from its own generation assets. Instead, generation service can be purchased from the market. There is no reason to approve an above-market subsidy for generation assets when generation service can and will be procured through the competitive markets.

GenResources is not entitled to receive any revenue from AEP Ohio that is not acquired through a prudent or competitive process. Thus, the Commission's approval of at least four above-market, arbitrary cross-subsidies violates Ohio law and policy.

IV. CONCLUSION

For the foregoing reasons, the Commission's Order and Entries on Rehearing are unlawful and unreasonable, and should be reversed.

Respectfully submitted,

Mark A. Hayden/ceW

Mark A. Hayden (0081077)
FIRSTENERGY SERVICE COMPANY
76 South Main Street
Akron, OH 44308
(330) 761-7735
(330) 384-3875 (fax)
haydenm@firstenergycorp.com

James F. Lang (0059668)
N. Trevor Alexander (0080713)
CALFEE, HALTER & GRISWOLD LLP
The Calfee Building
1405 East Sixth Street
Cleveland, OH 44114
(216) 622-8200
(216) 241-0816 (fax)
jlang@calfee.com
talexander@calfee.com

David A. Kutik (0006418)
JONES DAY
901 Lakeside Avenue
Cleveland, OH 44114
(216) 586-3939
(216) 579-0212 (fax)
dakutik@jonesday.com

Attorneys for Appellant FirstEnergy Solutions Corp.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Merit Brief of Appellant FirstEnergy Solutions Corp.*, including its Appendix and Supplement, was served this 12th day of August, 2013, via first-class U.S. mail, postage prepaid, upon the parties below.

Mark A. Hayden / cew
One of the Attorneys for FirstEnergy Solutions Corp.

Steven T. Nourse
Matthew J. Satterwhite
American Electric Power Corp.
1 Riverside Plaza, 29th Floor
Columbus, Ohio 43215

Daniel R. Conway
L. Bradfield Hughes
Porter Wright Morris & Arthur LLP
41 South High Street
Columbus, Ohio 43215

Attorneys for Cross-Appellant,
Ohio Power Company

Michael DeWine
Ohio Attorney General
William L. Wright
Thomas McNamee
John H. Jones
Assistants Attorney General
180 E. Broad St., 6th Floor
Columbus, Ohio 43215

Attorneys for Appellee,
The Public Utilities Commission of Ohio

Samuel C. Randazzo
Frank P. Darr
Joseph E. Oliker
Matthew R. Pritchard
McNees Wallace & Nurick
21 East State Street, 17th Floor
Columbus, Ohio 43215

Attorneys for Appellant,
Industrial Energy Users-Ohio, Inc.

Bruce J. Weston
Ohio Consumers' Counsel
Maureen R. Grady
Terry L. Etter
Joseph P. Serio
Assistant Consumers' Counsel
10 West Broad St., Suite 1800
Columbus, Ohio 43215

Attorneys for Appellant,
Office of Ohio Consumers' Counsel

Mark S. Yurick
Zachary D. Kravitz
Taft, Stettinius & Hollister, LLP
65 E. State St., Suite 1000
Columbus, Ohio 43215-3413

Attorneys for Appellant, The Kroger Co.