IN THE SUPREME COURT OF OHIO

ORIGINAL

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

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TABLE OF CONTENTS

TABLE OF AUTHORITIES I

I. INTRODUCTION 1

II. ARGUMENT 3

A. FES Proposition Of Law No. 1: The Commission cannot lawfully or reasonably approve an ESP that is not more favorable in the aggregate than the expected results of a MRO. 3

1. The Court Has The Authority To Review The Commission's Decision Approving The ESP. 3

2. The Qualitative Benefits Identified By The Commission Do Not Offset The $386 Million Cost Of The ESP Under Any Reasonable Analysis. 6

a. The Claimed "Benefits" Of A Faster Move To Market Were Quantified And Do Not Exist After January 1, 2015 6

b. The "Benefits" Of Frozen Base Generation Rates Are Not Supported By The Record. 8

c. AEP Ohio's Financial Stability Is Not Grounds For Imposing $386 Million In Costs On Customers. 9

d. Any "Benefits" of Distribution Programs Are A "Wash." 9

B. FES Proposition of Law No. 2: The RSR Is Not Authorized Under Ohio Law. 11

1. The RSR Includes Transition Revenues (Or Their Equivalent) That AEP Ohio Is Barred From Recovering. 11

a. The RSR Provides AEP Ohio With Transition Revenues Directly Prohibited By R.C. 4928.38. 11

b. R.C. 4928.38 Does Not Conflict With R.C. 4928.143(B)(2)(d). 12

2. The RSR Is Not Authorized By R.C. 4928.143(B)(2)(d). 13

3. No Evidence Supports The Amount Of The RSR As Necessary To Stabilize Retail Electric Service. 13

C. FES Proposition Of Law No. 3: The Commission May Not Lawfully Approve A Generation Resource Rider ("GRR") Where The Rider Is Unauthorized By Law And Unsupported By Fact. 15

1. The GRR Is Prohibited As A Matter Of Law. 15

2. There Is No Record Support For The GRR. 17

3. The GRR Issue Is Ripe. 18

D. FES Proposition of Law No. 4: Under R.C 4928.143(B)(2)(a) and 4928.02(H), the Commission cannot approve cross-subsidies between an EDU and its competitive generation affiliate. 19

1. AEP Ohio's 2010 Capacity Costs Are Not Relevant As To Whether There Is An Above-Market Subsidy Provided By AEP Ohio To Its Competitive Generation Affiliate. 20

2. The Commission's Approval Of The Pass-Through Of Revenues To GenResources Is Appealable. 21

E. AEP Ohio Proposition of Law No. VII: Because AEP Ohio Specifically Requested That The Commission Defer Decisions On Major Issues, It May Not Credibly Object To Any Invited Error. 21

1. The Commission Addressed Auction Design Issues In This Proceeding. 22

2. AEP Ohio Invited Any Error By The Commission. 23

3. AEP Ohio Has The Ability To Withdraw The ESP If It Disagrees With The Later Determinations Of The Commission On The Open Issues. 25

F. AEP Ohio Proposition Of Law No. IV: If A Cost-Based Capacity Rate Is Appropriate, The Commission Did Not Error In Applying That Rate To SSO Customers. 26

III. CONCLUSION 27

TABLE OF AUTHORITIES

Cases

4928.38 12
Burger Brewing Co. v. Liquor Control Com., Dep't of Liquor Control, 34 Ohio St. 2d 93, 97, 296 N.E.2d 261 (1973) 19
Case No. 10-2929-EL-UNC 14
Case Nos. 2013-0228 *et al.* 14
Columbus Southern 5
Constellation NewEnergy, Inc. v. Pub. Util. Comm., 104 Ohio St. 3d 530, 2004-Ohio-6767, 820 N.E.2d 885, ¶ 36-40 19
division (E) of section 4928.64 16
Fostoria v. Ohio Patrolmen's Benevolent Assn., 106 Ohio St.3d 194 (2005) (citing *Lester v. Leuck*, 142 Ohio St. 91, 92 (1943) 25
In re Akron Thermal, Ltd. Partnership, Case No. 00-2260-HT-AEM, Opinion and Order at p. 3 (Jan. 25, 2001) 15
In re Application of Columbus S. Power Co., 128 Ohio St. 3d 512, 2011-Ohio-1788, 947 N.E.2d 655, ¶ 23 13
In re Application of Columbus Southern Power Co., 128 Ohio St.3d 512, 2011-Ohio-1788, 947 N.E.2d 655 4
In the Matter of Application of Duke Energy Ohio, Inc. for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan, Accounting Modifications, and Tariffs for Generation Service, PUCO Case Nos. 11-3549-EL-SSO, et al., Opinion & Order (November 22, 2011) 24
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) 10
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, PUCO Case No. 12-1230-EL-SSO, Opinion & Order (July 18, 2012) 24
In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan, Case No. 11-346-EL-SSO, Opinion and Order, p. 31 (Dec. 14, 2011) 10
In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and the Toledo Edison Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan, PUCO Case No. 10-388-EL-SSO, Opinion & Order (Aug. 25, 2010) 24
In the Matter of the Application of Ohio Power Company to Establish a Competitive Bidding Process for Procurement of Energy to Support its

Standard Service Offer, Case No. 12-3254-EL-UNC, Opinion and Order at pp. 12, 14 (Nov. 13, 2013) 22
Market St. Ry. Co. v. Railroad Commission of State of Cal., 324 U.S. 548, 566-67, 65 S.Ct. 770, 89 L.Ed. 1171 (1945) 26
State ex rel. Gains v. Rossi, 86 Ohio St.3d 620, 622, 716 N.E.2d 204 (1999) 12
State ex rel. Johnson v. Ohio Adult Parole Auth., 95 Ohio St.3d 463, ¶ 6 (2002) 25

Statutes

R.C. 4928.03 9
R.C. 4928.11 9
R.C. 4928.111 9
R.C. 4928.38 11
R.C. 4928.02 3
R.C. 4928.142(D) 6, 7
R.C. 4928.143 1
R.C. 4928.143(B)(2) 5
R.C. 4928.143(B)(2)(d) ..... passim
R.C. 4928.143(C)(1) 1, 3, 4, 5
R.C. 4928.38 ..... 11, 12, 13
R.C. 4928.64(E) 2, 15, 16
R.C. 1.52(A) 12
R.C. 4928.02(H) 20
R.C. 4928.143(C)(2)(a) 25
R.C. 4928.143(C)(2)(b) 25
R.C. 4928.143(B) 16
R.C. 4928.143(B)(2)(c) 16, 17, 19
R.C. 4928.64 16
R.C. 4928.64(B) 16

I. INTRODUCTION

This case primarily presents two issues: (1) whether there is any limit on the Public Utilities Commission of Ohio's ("Commission") discretion under R.C. 4928.143 to approve an electric security plan ("ESP"); and (2) whether there is any limit on the Commission's authority under R.C. 4928.143(B)(2)(d) to subsidize an electric distribution utility's generating assets at customers' expense. The Commission and the Ohio Power Company ("AEP Ohio") believe the Commission's discretion in these areas is unlimited. The law and common sense dictate otherwise. For starters, the statutory test in R.C. 4928.143(C)(1) provides a specific directive to the Commission. The Commission's decision in approving an ESP must be based on evidence and that evidence must be carefully analyzed and explained. If the rule was that the Commission's view of whether an ESP satisfies the statutory test must be approved simply because the Commission so believed, then the Commission's rulings on that subject could never be meaningfully reviewed, much less reversed.

Here, by the Commission's own admission, AEP Ohio's ESP will cost customers at least $386 million more than a market rate offer ("MRO"). AEP Ohio and the Commission claim that this $386 million "ESP v. MRO" test failure is immaterial because R.C. 4928.143(C)(1) allows the Commission to consider "nonquantifiable benefits" of the ESP, regardless of the lack of record support. AEP Ohio and the Commission are wrong. The Commission must be able to articulate some rationale as to <u>why</u> the alleged qualitative benefits of an ESP outweigh its costs and to base that rationale on record evidence. Any other rule would allow the Commission's ESP v. MRO analysis to be based merely on the Commission's say so, leaving the Commission's decision essentially beyond challenge or review. In this case, the qualitative benefits touted by the Commission are either non-existent or, under any reasonable analysis, less than $386 million.

A similar issue arises about the type of charges the Commission may authorize. AEP Ohio and the Commission argue that there are basically no limits on the types of charges that may be authorized under R.C. 4928.143(B)(2)(d). Under this view, literally any charge would be allowable, so long as the Commission found that the charge increased the utility's stability. Yet, any rate increase arguably increases a utility's stability. Thus, in the Commission's view, there is no limit to the charges authorized under the statute. However, because the statute requires that a charge "have the effect of stabilizing or providing certainty regarding retail electric service," it is not AEP Ohio's financial integrity that matters but AEP Ohio's ability to provide stable retail electric service. AEP Ohio and the Commission focused exclusively on propping up AEP Ohio's finances, but no record evidence demonstrates that the financial support provided is the minimum amount necessary to ensure stable retail electric service. Given this glaring lack of evidence, the Commission's approval of AEP Ohio's Retail Stability Rider ("RSR") cannot stand.

Similarly, the Generation Resource Rider ("GRR") authorized by the Commission lacks record support and violates R.C. 4928.64(E). Although AEP Ohio and the Commission argue that challenges to this rider are not ripe, those arguments fail given that FES and other parties are challenging the GRR approved by the Commission, not some future adjustment. In the same way, although the Commission argues that its approval of the pass-through of generation costs to AEP Ohio's competitive generation affiliate is properly a question for the Federal Energy Regulatory Commission ("FERC"), FES and other parties are challenging the pass-through authorized in this proceeding by the Commission, not some future FERC decision.

AEP Ohio's two propositions advanced in its cross-appeal are striking in their lack of record support and reason. AEP Ohio first argues that the Commission erred by deferring certain

auction design and rate design questions to future proceedings, but AEP Ohio expressly invited deferral of the auction design issues and is not prejudiced by the Commission's reservation of rights to review rate design questions in the future. AEP Ohio also argues that the Commission erred in directing AEP Ohio to use a cost-based rate for capacity that supports the energy-only auctions, but the rate authorized allows AEP Ohio to recover all of its capacity costs and any higher rate would be even more unreasonable.

The Court should reverse the Commission's decision and follow longstanding precedent holding that there are reasonable limits on the Commission's discretion.

II. ARGUMENT

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

Even using the Commission's (incorrect) math, there can be 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 a MRO. (Appx. 84.) The Commission nevertheless approved the ESP by relying on "non-quantifiable aspects" of the ESP. (*Id.*) The Commission and AEP Ohio claim that this Court should defer to the Commission's judgment in approving the ESP. PUCO Brief, pp. 4-5; AEP Ohio Brief, pp. 34-36. But this Court is not obligated to accept blindly the Commission's "judgment," especially one based on irrelevant arguments and no evidence at all. Under no reasonable analysis could these "non-quantifiable benefits" offset the $386 million cost of the ESP.

1. The Court Has The Authority To Review The Commission's Decision Approving The ESP.

The Commission claims that, under R.C. 4928.143(C)(1), it has substantial discretion in reviewing a proposed ESP, and that it may use this authority to further the goals of R.C. 4928.02.

PUCO Brief, p. 4. Accordingly, the Commission claims that it may find an ESP to be more beneficial "in the aggregate" under R.C. 4928.143(C)(1) even where the ESP costs more than an MRO. FES does not dispute that proposition. The Commission errs, however, in the next step of its analysis. The Commission contends that, because it explained "why it believed the qualitative benefits of the ESP made it more favorable than the MRO in its decision," the Court may not overturn the Commission's decision weighing those qualitative benefits. PUCO Brief, p. 5. This overstates the Commission's authority.

In reviewing an ESP plan "in the aggregate" versus an MRO, the Commission is not given a blank check. Although qualitative benefits are, by definition, not subject to quantification, the Commission must articulate some rationale for 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 whatever the Commission said, leaving the Commission's decision beyond challenge or review. Because, under the statute, an ESP must be better than a standard service offer based on market prices (*i.e.*, an MRO), the statutory test promotes competitive markets and market-based pricing. The statutory test was not designed to allow the Commission unfettered discretion to disregard and interfere with those markets. Therefore, if the Commission is going to approve an ESP that fails the statutory test quantitatively, the Commission must explain why the qualitative benefits outweigh the quantitative costs. Further, that explanation must be based on evidence in the record.

Although there is scant authority regarding the scope of the Commission's authority under the "in the aggregate" standard in R.C. 4928.143(C)(1), a recent decision of this Court confirms that the Commission's discretion is not unlimited. In *In re Application of Columbus Southern Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788, 947 N.E.2d 655, the Court

conducted an extensive analysis of AEP Ohio's 2009 ESP. Among other issues, the Court addressed whether charges not specifically listed in R.C. 4928.143(B)(2) could be included in an ESP. The Court rejected the Commission's interpretation, which would have given unlimited discretion to the Commission as to the types of charges to be imposed. "[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.

This decision is relevant here. The Commission claims that R.C. 4928.143(C)(1) essentially provides the Commission with unlimited discretion to determine whether non-quantifiable benefits outweigh the real cost to customers of (at minimum) $386 million. As the Commission's statutory interpretation was with respect to AEP Ohio's 2009 ESP, its interpretation here also is overbroad and unreasonable. The General Assembly did not authorize the Commission to approve any ESP it saw fit. Instead, the General Assembly limited the Commission's power to approve an ESP with only statutorily defined charges and with pricing, terms and conditions that based on the record evidence are, in the aggregate, more favorable than a MRO. The Court should reach the same result as it did in *Columbus Southern* and hold that there are reasonable statutory limits on the Commission's discretion to approve an above-market ESP.

The Commission's reliance on "qualitative" benefits cannot be blindly accepted. The Commission must provide a reasonable explanation for why the qualitative benefits outweigh the quantitative costs; and those qualitative benefits and the basis for their outweighing real costs must be found in the record. Here, there are no qualitative elements of the ESP that could provide so substantial of a benefit to customers that, individually or collectively, would outweigh the $386 million cost of the ESP, and therefore the Commission's decision should be overturned.

2. The Qualitative Benefits Identified By The Commission Do Not Offset The $386 Million Cost Of The ESP Under Any Reasonable Analysis.

Both the Commission and AEP Ohio argue that a series of alleged non-quantifiable benefits justify the Commission's decision to impose huge costs on customers. PUCO Brief, pp. 4-5; AEP Ohio Brief, pp. 35-37. No reasonable analysis could find these alleged benefits offset at least $386 million in direct costs of this ESP. Therefore, the Court should accept the Commission's finding of fact regarding the $386 million cost of the ESP, but should reject the Commission's legal conclusion that these non-quantifiable benefits outweigh the direct costs. Each alleged non-quantifiable benefit is discussed below.

a. The Claimed "Benefits" Of A Faster Move To Market Were Quantified And Do Not Exist After January 1, 2015.

The Commission claims that moving to market-based pricing in two and a half years is one of the "most significant qualitative benefits" of the ESP. PUCO Brief, pp. 6-9. AEP Ohio echoes this argument and relies upon the mandatory MRO blending percentages in R.C. 4928.142(D). AEP Ohio Brief, p. 35. These arguments overlook that the price benefits of the faster move to market in two and a half years have already been quantified. The ESP v. MRO price test incorporates the statutory blending percentages for the expected MRO (10% market in year one, 20% market in year two, etc.), which the Commission compared to the modified ESP. (Appx. 82-84.) Thus, the price benefits to be gained through accessing the market are included in the Commission's $386 million cost calculation. (*See* Supp. 122, 124 [Staff Ex. 110, Direct Testimony of Robert Fortney ("Fortney Direct"].) Because the faster transition to market provided by the ESP can be, and has been, quantified, there is no meaningful additional "qualitative benefit" whatsoever.

The Commission believes that AEP Ohio would require at least six years under a MRO to move fully to market-based pricing (because the blended MRO pricing required by R.C.

4928.142(D)[1] would exceed market-based pricing for the first five years). This is wrong and is contradicted by AEP Ohio's own testimony. To support its ESP v. MRO calculation, AEP Ohio sponsored witness Laura Thomas. In her calculations, Ms. Thomas used the same market generation price for both a MRO and AEP Ohio's proposed ESP after January 1, 2015. Ms. Thomas observed, "Since the Company has divested its generation [as of January 2015], it no longer has a Base ESP 'g' Rate, TCRR 'G' component, EICCR or Fuel Cost." (FES Supp., p. 139 [Direct Testimony of Laura J. Thomas, Ex. LJT-3].) Instead, as Ms. Thomas testified, purchased power costs will replace these old ESP components that will not exist as of January 2015. (Supp. 134, 139.) Thus, AEP Ohio's MRO pricing as of January 2015 would equal the auction price regardless of the blending required by R.C. 4928.142(D). (*Id.*)

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[1] R.C. 4928.142(D) provides in relevant part:

> The first application filed under this section by an electric distribution utility that, as of July 31, 2008, directly owns, in whole or in part, operating electric generating facilities that had been used and useful in this state shall require that a portion of that utility's standard service offer load for the first five years of the market rate offer be competitively bid under division (A) of this section as follows: ten per cent of the load in year one, not more than twenty per cent in year two, thirty per cent in year three, forty per cent in year four, and fifty per cent in year five. Consistent with those percentages, the commission shall determine the actual percentages for each year of years one through five. The standard service offer price for retail electric generation service under this first application shall be a proportionate blend of the bid price and the generation service price for the remaining standard service offer load, which latter price shall be equal to the electric distribution utility's most recent standard service offer price, adjusted upward or downward as the commission determines reasonable, relative to the jurisdictional portion of any known and measurable changes from the level of any one or more of the following costs as reflected in that most recent standard service offer price:
>
> (1) The electric distribution utility's prudently incurred cost of fuel used to produce electricity;
>
> (2) Its prudently incurred purchased power costs;
>
> (3) Its prudently incurred costs of satisfying the supply and demand portfolio requirements of this state, including, but not limited to, renewable energy resource and energy efficiency requirements;
>
> (4) Its costs prudently incurred to comply with environmental laws and regulations, with consideration of the derating of any facility associated with those costs.

The Commission deals with this fact by pretending it doesn't exist and noting that it decided not to use Ms. Thomas' blending percentages. PUCO Brief, pp. 7-8 (citing Order, p. 75). But the Commission never explained why Ms. Thomas' different blending percentages would change the MRO price. Given Ms. Thomas' testimony, because the ESP and MRO will both be based on market prices as of January 1, 2015, the difference in blending percentages between what the Commission used and what Ms. Thomas used is irrelevant.[2] The Commission may wish that it were otherwise, but a wish is not record evidence.

To the extent that the timing of AEP Ohio's move to market can be considered a benefit of the ESP, that benefit is already part of the ESP v. MRO quantitative comparison. There is no justification for any additional weighting of that "benefit" and certainly none that comes close to the ESP's $386 million cost.

b. The "Benefits" Of Frozen Base Generation Rates Are Not Supported By The Record.

The Commission claims that the ESP Order froze base generation rates for customers until rates are established through a competitive bidding process, which gives customers a "safe harbor in the event there is any uncertainty in the competitive markets." PUCO Brief, p. 5; Appx. 85. The question is whether this safe harbor is worth the price. All concerned parties testified that market prices during the ESP period would be well below AEP Ohio's frozen base generation rates. (*See, e.g.*, Supp. 44 [FES witness Schnitzer]; Supp. 124 [Staff witness Fortney]; Supp. 130 [Staff witness Johnson].) Thus, this alleged "benefit" cannot offset the $386 million cost of the ESP.

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[2] The Commission used blending percentages for the January-May 2015 period of 80% for the generation service price and 20% for the market price. (Appx. 84.) As shown on LJT-3, both prices will be equal to the auction price in 2015. (Supp. 139.) Blending at 70%/30% or 0%/100% does not alter the result. In every case, Ms. Thomas testified that AEP Ohio is at 100% market pricing as of January 1, 2015. (Supp. 134, 139.)

c. AEP Ohio's Financial Stability Is Not Grounds For Imposing $386 Million In Costs On Customers.

AEP Ohio relies on the Commission's Order to claim that its financial stability was a significant benefit of the ESP. AEP Ohio Brief, p. 36. However, there is no record evidence showing that the massive subsidy awarded to AEP Ohio was needed by AEP Ohio to continue to provide adequate, safe and reliable service. FES Brief, p. 14 and Proposition of Law No. 2. AEP Ohio's distribution and transmission services remain fully regulated and are not at risk. *See* R.C. 4928.03, 4928.11, 4928.111. Ensuring AEP Ohio's financial stability as a vertically integrated utility cannot be counted as a "benefit" of the ESP without record evidence that customers would be harmed but for the level of financial stability guaranteed to AEP Ohio.

AEP Ohio claims that there is record evidence suggesting that the RSR was needed to provide financial stability to AEP. AEP Ohio Brief, p. 36. However, the evidence cited by AEP Ohio contains a key flaw: it discusses total company (*i.e.*, regulated and unregulated business) return on equity rather than AEP Ohio's ability to provide safe and reliable service. AEP Ohio's distribution and transmission services remain fully regulated and are entitled to a regulated rate of return. There is a significant difference between AEP Ohio not making as much money as it would like in the short term and AEP Ohio being unable to provide SSO service. There is no evidence of a service benefit to customers that could offset the $386 million cost to customers of the ESP. Thus, AEP Ohio's financial stability cannot be a qualitative benefit of the ESP.

d. Any "Benefits" of Distribution Programs Are A "Wash."

The Commission and AEP Ohio both claim that the distribution riders are a qualitative benefit of the ESP. However, there is no dispute that the costs of distribution riders could also be recovered under a MRO. *See* AEP Ohio Brief, p. 37. Therefore, any benefit to customer reliability associated with investment in distribution riders would occur on both sides of the ESP

v. MRO test, making this rider irrelevant to the statutory test. Indeed, the Commission has traditionally treated the quantitative aspects of distribution related riders as a "wash" for purposes of the ESP v. MRO test. *See 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); *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, Case No. 11-346-EL-SSO, Opinion and Order, p. 31 (Dec. 14, 2011). The Commission erred in not doing so here.[3]

AEP Ohio and the Commission may argue that, by their nature, non-quantifiable benefits are not subject to review in this manner, and therefore the Commission's decision on this point is entitled to deference. This is wrong; the Commission's interpretation of those benefits must be reasonable and based on record evidence. If the Commission is not held to this standard, then the ESP v. MRO test becomes meaningless and essentially will avoid review by this Court. Even if there were evidence to support the Commission's belief that certain aspects of the ESP will result in non-quantifiable benefits to customers, no reasonable person could find that those alleged benefits offset the $386 million cost of the ESP. The Commission's fear that competitive markets will have a negative financial impact on AEP Ohio is not a valid reason to approve this ESP. This Court should not sanction what the Commission has done.

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[3] The fact that these riders are a "wash" rebuts AEP Ohio's claim that customers somehow benefit by a reduction of "regulatory lag" involved in the recovery of such costs under an ESP. AEP Ohio Brief, p. 37.

B. FES Proposition of Law No. 2: The RSR Is Not Authorized Under Ohio Law.

1. The RSR Includes Transition Revenues (Or Their Equivalent) That AEP Ohio Is Barred From Recovering.

Ohio law prohibits AEP Ohio from recovering transition costs or their equivalent. FES Brief, pp. 18-21. After the end of the market development period, each utility's generating assets were to be "fully on their own in the competitive market." R.C. 4928.38. Thus, the Commission cannot authorize AEP Ohio to recover any "transition revenues or any equivalent revenues." *Id.*

a. The RSR Provides AEP Ohio With Transition Revenues Directly Prohibited By R.C. 4928.38.

AEP Ohio and the Commission argue that the RSR is not unlawful transition revenue because the RSR is not directly tied to stranded cost recovery. PUCO Brief, pp. 32-33 ("The Commission specifically noted that AEP Ohio had not argued that its Electric Transition Plan ('ETP') did not provide it with sufficient revenues."); AEP Ohio Brief, p. 26. But whether the additional revenues received through the RSR are proper does not depend on what AEP Ohio calls them. In this case, AEP Ohio claimed – and the Commission agreed – that AEP Ohio needed additional revenues that are to be recovered through the RSR. The need for these additional revenues was based, at least in some part, on maintaining AEP Ohio's rate of return as it transitions to market-based pricing. Indeed, AEP Ohio argues that RSR revenues are "revenues related to moving to a competitive generation market in Ohio" (AEP Ohio Brief, p. 29-30), and that RSR revenues are an incentive to complete corporate separation (*id.*, p. 30). Thus, to justify the RSR revenues to have the opportunity to earn a reasonable return, at least one of two things must be true: (1) AEP Ohio needs the RSR due to its historic costs (which were to be compensated as transition costs under R.C. 4928.38); or (2) AEP Ohio needs the RSR due to its more recent costs (which is also prohibited under the dictate of R.C. 4928.38 that generation be "fully on its own in the competitive market"). In either case, the RSR cannot be approved.

AEP Ohio and the Commission also argue that the RSR is somehow related to wholesale capacity pricing rather than retail recovery of transition costs. AEP Ohio Brief, p. 26; PUCO Brief, p. 34. This is wrong as a matter of fact and law. Of the $508 million of projected RSR revenue, only $120 million is allocated to capacity costs. The remaining $388 million is a subsidy wholly unrelated to the capacity charge. (Appx. 45, 84 n. 32.) The RSR is unlawful.

b. R.C. 4928.38 Does Not Conflict With R.C. 4928.143(B)(2)(d).

Amicus Curiae Dayton Power & Light ("DP&L") offers an additional argument that, even if the RSR is unlawful transition revenue, it should nevertheless be approved because the RSR is authorized by a statute passed more recently in time than the enactment of R.C. 4928.38. This is wrong. If statutes are irreconcilable, the later in date of enactment prevails. R.C. 1.52(A). If the statutes are not in direct conflict, however, then both statutes should be given their plain meaning. *State ex rel. Gains v. Rossi*, 86 Ohio St.3d 620, 622, 716 N.E.2d 204 (1999) (finding that "in interpreting related and co-existing statutes, we must harmonize and accord full application to each of these statutes unless they are irreconcilable and in hopeless conflict").

Here, there is no irreconcilable conflict between R.C. 4928.143(B)(2)(d) and 4928.38. R.C. 4928.38 prohibits recovery of transition revenues or their equivalent and mandates that the generation function shall be fully on its own in the competitive market. R.C. 4928.143(B)(2)(d) authorizes a stability charge in limited situations where such a charge "would have the effect of stabilizing or providing certainty regarding retail electric service." This does not necessarily conflict with R.C. 4928.38 because a stability charge can be authorized without becoming a generation subsidy. For example, the Commission could authorize a distribution investment rider that provides increased certainty for retail electric customers. The Commission could also authorize a charge for an electric distribution utility that does not own generation assets. This would meet all of the statutory criteria under R.C. 4928.143(B)(2)(d) without running afoul of

the restrictions on generation subsidies in R.C. 4928.38. As the statutes at issue may be read together without conflict, DP&L's statutory timing argument fails.

2. The RSR Is Not Authorized By R.C. 4928.143(B)(2)(d).

The RSR is not authorized by R.C. 4928.143(B)(2)(d). *See* FES Brief, pp. 15-18 (anticipating Commission and AEP Ohio arguments). The RSR does not provide stability or certainty to customers. Instead, the RSR only provides return on equity certainty to AEP Ohio. The statute does not authorize such a subsidy.

The Commission and AEP Ohio argue that the RSR provides stability because the frozen base generation rates are available to customers who may chose to return to AEP Ohio's generation service. PUCO Brief, p. 20; AEP Ohio Brief, p. 9. However, the obligation to stand ready to provide service for shopping customers who may return is considered part of a utility's Provider of Last Resort ("POLR") obligation. *In re Application of Columbus S. Power Co.*, 128 Ohio St. 3d 512, 2011-Ohio-1788, 947 N.E.2d 655, ¶ 23. If the RSR charge is intended to compensate AEP Ohio for providing POLR service, then the charge must be rejected. There is no record evidence establishing that the RSR is in any way related to the cost of providing POLR service. AEP Ohio did not present any evidence of its POLR costs whatsoever. The Court has previously rejected AEP Ohio's attempt to receive POLR revenue that was not supported by the record. *Id.* ¶ 24. It should do so again here.

3. No Evidence Supports The Amount Of The RSR As Necessary To Stabilize Retail Electric Service.

There is a substantial lack of record evidence supporting the Commission's calculation of the RSR. As previously shown, there is no record evidence establishing the arbitrary $826 million revenue target used to establish the RSR charge. (FES Brief, pp. 21-23; Appx. 42.) The Commission acknowledged that its $826 million target was simply the result of "a benchmark . .

. in the approximate middle" of AEP Ohio's proposed recovery and the proposal from an intervenor group. (*Id.*) Using this midpoint, the Commission authorized AEP Ohio to receive *$104 million more* than it requested – $388 million.[4] (*See* Appx. 84, n.32.) While the propriety of calculating the RSR in this "split the difference" manner is at least debatable, more problematic is the lack of any foundation for any amount whatsoever for the RSR charge. AEP Ohio failed to establish the following necessary factual preconditions for approving the RSR under R.C. 4928.143(B)(2)(d): (1) AEP Ohio needed additional revenue to maintain its financial integrity; (2) the amount requested was the minimum amount necessary to accomplish this goal; and (3) this huge subsidy to maintain AEP Ohio's financial integrity was necessary to stabilize retail electric service. *See* FES Brief, pp. 22-23. To be sure, AEP Ohio attempted to tie the RSR to its financial integrity. But no evidence exists to support the second and third requirements noted above.

The Commission argues that using a midpoint is an appropriate way to determine the amount of the RSR. PUCO Brief, p. 35. This misunderstands FES's position. The issue is not whether there was record evidence establishing return on equity targets for utilities. The question is whether there is any evidence establishing that AEP Ohio needed the RSR to maintain its financial integrity and, if so, what amount of RSR was the minimum needed to do so. The Commission cites no such evidence in its brief. The reason for this omission is obvious: no such evidence was presented at hearing. If there is no record evidence establishing that the RSR is the minimum amount needed to ensure AEP Ohio's financial integrity, there is no record

[4] After subtracting the $120 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 $508 million in total revenue projected to be recovered under the RSR, AEP Ohio would receive $388 million in other revenues through the RSR. (*See* Appx. 84, n.32.)

evidence supporting the Commission's decision to establish the charge under R.C. 4928.143(B)(2)(d).

AEP Ohio claims that the "Commission's findings are well supported" and that FES asks this Court to "re-weigh the evidence." AEP Ohio Brief, p. 21. However, the testimony cited by AEP Ohio does not establish: (1) the need for an RSR; (2) that the RSR is the minimum amount needed to ensure financial integrity; or (3) that this level of financial integrity is the minimum level needed to stabilize retail electric service. AEP Ohio did not even attempt to satisfy these criteria. Indeed, all of the testimony cited by AEP Ohio relates to the impact of its generation operations on its return on equity; AEP Ohio cites nothing relating to AEP Ohio's ability to provide reliable service. *See* AEP Ohio Brief, p. 21; AEP Ohio Supp. 108-109; AEP Ohio Supp. 112-114 (both relating to return on equity). AEP Ohio has offered no testimony establishing that the RSR is temporary relief "only at the minimum level necessary to avert or relieve the emergency." *In re Akron Thermal, Ltd. Partnership*, Case No. 00-2260-HT-AEM, Opinion and Order at p. 3 (Jan. 25, 2001). AEP Ohio has also offered no evidence explaining how the RSR would lead to safe and reliable service. Instead, it provided only evidence regarding its return on equity.

The Commission has improperly expanded R.C. 4928.143(B)(2)(d) beyond its intended purpose. This Court should hold that the Commission's decision approving the RSR is unlawful and unreasonable.

C. FES Proposition Of Law No. 3: The Commission May Not Lawfully Approve A Generation Resource Rider ("GRR") Where The Rider Is Unauthorized By Law And Unsupported By Fact.

1. The GRR Is Prohibited As A Matter Of Law.

R.C. 4928.64(E) mandates that all costs associated with meeting Ohio's renewable energy benchmarks be bypassable. FES Brief, pp. 23-28. This requirement is logical because

R.C. 4928.64(B) requires both utilities and competitive retail electric service ("CRES") providers to comply with Ohio's renewable energy standards. If these costs were not bypassable, then shopping customers could be charged twice for compliance with this statute: once by their utilities and once by their CRES provider. Such double charging obviously would be inappropriate from a policy perspective. Among other reasons, it would discourage shopping and the development of a competitive market. Accordingly, the General Assembly mandated bypassable cost recovery for these types of charges.

That renewable compliance costs must be bypassable is also made clear in R.C. 4928.143(B). That statute expressly provides that R.C. 4928.143(B) would prevail over other statutory conflicts "except . . . division (E) of section 4928.64." (Emphasis added.) Because the prohibition of R.C. 4928.64(E) for any nonbypassable renewable energy-related charges controls over any general cost recovery provided for under R.C. 4928.143(B), the Commission's approval of the GRR – a nonbypassable rider intended to recover solar facility costs incurred under R.C. 4928.64 – is unlawful.

AEP Ohio does not contest that the GRR is intended to ensure compliance with renewable energy goals. Instead, AEP Ohio claims that the GRR can nevertheless be approved under R.C. 4928.143(B)(2)(c). AEP Ohio goes so far as to claim that FES "overlooks" this statute (AEP Brief, p. 31), despite the fact that FES quotes the statute in whole in its brief. FES Brief, p. 25. In any event, R.C. 4928.143(B)(2)(c) permits a nonbypassable surcharge for a generation facility where there is a need for the facility based on resource planning projections submitted by the utility. However, nothing in this statute exempts this general grant of authority from the very specific mandates of R.C. 4928.64(E). Moreover, as noted, R.C. 4928.143(B) expressly makes R.C. 4928.143(B)(2)(c) subject to R.C. 4928.64(E). The Commission may

approve additional generation under R.C. 4928.143(B)(2)(c) where that generation is needed to ensure reliability. As a matter of law, however, the Commission may not approve a nonbypassable charge for a utility's costs to comply with its renewable energy benchmarks.

2. There Is No Record Support For The GRR.

In addition to being without legal basis, the GRR also must be rejected for lack of record evidence under R.C. 4928.143(B)(2)(c). The Commission acknowledged that AEP Ohio had failed to meet its burden to establish a "need" for this rider in this case. Appx. 31. The Commission nevertheless 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 R.C. 4928.143(B)(2)(c), however, "no surcharge [in an ESP] 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, the statute requires that determinations regarding this rider must be made in the ESP proceeding itself.

AEP Ohio does not contest that it failed to provide the factual evidence that is statutorily required to be provided before the GRR could be approved under R.C. 4928.143(B)(2)(c). AEP Ohio Brief, p. 32. Instead, AEP Ohio argues that the Commission has discretion to manage its dockets, and therefore can defer the presentation of that factual evidence for a later proceeding. *Id.* AEP Ohio is wrong as a matter of law. The Commission may not ignore plain statutory authority under the guise of "docket management." R.C. 4928.143(B)(2)(c) expressly requires that the determination regarding this rider be made "in the proceeding," not at some later date. This makes sense because the basis and extent of any riders in an ESP must be fully known and considered to permit the Commission to perform the ESP vs. MRO comparison properly. Because the statute unambiguously requires proof of the need for a facility "in the proceeding,"

and because the Commission acknowledged that AEP Ohio failed to provide this proof (Appx. 33), the Commission may not waive the express statutory requirement under its general discretion to manage dockets.

3. The GRR Issue Is Ripe.

The Commission does not offer any substantive arguments regarding the GRR. Instead, the Commission argues that the GRR is merely a placeholder rider that it created because a "GRR can only be established as part of an ESP" and "will be available should the need arise." PUCO Brief, p. 39. The Commission claims that it will conduct a later proceeding to determine whether Turning Point (the proposed facility that may be potentially funded through the GRR) meets the statutory criteria, and that any decision at this point would therefore be an advisory opinion. PUCO Brief, pp. 39-40.

This is wrong because the Commission expressly approved the GRR in this proceeding. Appx. 32-34. Regardless of whether the GRR charges are currently being recovered, the GRR is a rider that was approved here and will negatively affect the retail electric market even as a "placeholder."[5] This approval violates the statutory authority requiring riders like the GRR to be considered as part of the ESP proceeding. Therefore, the question of the propriety of the GRR is not an "advisory opinion." The Court can and should rule on whether this rider – even set at zero – is an appropriate part of the ESP approved by the Commission in this case.

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[5] *See* Direct Testimony of Jonathan A. Lesser dated May 4, 2012, p. 53 ("The reason that even a "placeholder" can harm competition is because it introduces additional uncertainty for CRES providers and their customers of higher costs if they shop. Specifically, CRES providers (and, hence, their customers) would have to pay twice for resources acquired: first through the nonbypassable charge and second for the resources they must secure to serve their customers. This uncertainty over having to pay twice will raise CRES providers' costs to provide competitive retail electric services, thus reducing competition and providing AEP Ohio an unfair competitive advantage.") *See also id.*, pp. 73-75.

AEP Ohio makes a similar argument, arguing that the GRR issue is not yet ripe because the Commission has yet to find a "need" for the Turning Point facility or approve cost recovery for the facility. AEP Ohio Brief, pp. 30-31. This argument fails for the same reasons as the Commission's argument. The Court will only reject issues on ripeness grounds where there is not "a controversy between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment." *Burger Brewing Co. v. Liquor Control Com., Dep't of Liquor Control*, 34 Ohio St. 2d 93, 97, 296 N.E.2d 261 (1973) (citations omitted). Here, the Commission has approved the GRR in this proceeding. It did so because R.C. 4928.143(B)(2)(c) requires that any rider of that type be approved as part of an ESP proceeding. Therefore, the issue is ripe for adjudication because the parties have adverse legal interests and are disputing a rider which the Commission was statutorily required to consider in this proceeding and expressly approved as part of the Order.

Whether customers are currently paying the rider is irrelevant, as shown by the authority cited by AEP Ohio. In *Constellation NewEnergy, Inc. v. Pub. Util. Comm.*, 104 Ohio St. 3d 530, 2004-Ohio-6767, 820 N.E.2d 885, ¶ 36-40, the Commission approved an RSS rider which would be charged to customers in the future. Much like the GRR, the RSS was not automatic, and needed to be justified in future proceedings. The Commission therefore argued that the RSS was not yet ripe for review. The Court rejected this argument, finding that the RSS issues were ripe for appeal because they had been expressly addressed in the Commission's order. The Court should reach the same conclusion here.

D. <u>FES Proposition of Law No. 4</u>: Under R.C 4928.143(B)(2)(a) and 4928.02(H), the Commission cannot approve cross-subsidies between an EDU and its competitive generation affiliate.

The Commission provided AEP Ohio with the authority to pass numerous above-market revenue streams to AEP Ohio's competitive affiliate, AEP Generation Resources

("GenResources"), following corporate separation. (*See* Appx. 67-69, 157.) It is the state's policy to "[e]nsure effective competition in the provision of retail electric service by avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service." R.C. 4928.02(H) (emphasis added). Rather than abiding by this clear policy, the Commission approved AEP Ohio to transfer to GenResources: (1) certain non-capacity RSR revenues; (2) capacity revenues; (3) "generation-based new revenue"; and (4) "revenue for energy sales to shopping customers." (Appx. 69.) These revenue streams are well in excess of the market prices for capacity and energy. (Supp. 55.) This transfer of above-market revenues is unlawful because Ohio law and policy precludes such cross-subsidies. *See* FES Brief, pp. 28-33.

1. AEP Ohio's 2010 Capacity Costs Are Not Relevant As To Whether There Is An Above-Market Subsidy Provided By AEP Ohio To Its Competitive Generation Affiliate.

AEP Ohio argues that its pass-through of capacity revenues to GenResources may be approved because AEP Ohio must provide capacity to customers even after corporate separation. AEP Ohio Brief, p. 29. AEP Ohio contends that, since it is providing capacity service at a cost-based rate (as is currently being litigated in the AEP Ohio Capacity Case), it may pass through the revenues from cost-based charges to its competitive affiliate. *Id.*, p. 30. However, AEP Ohio fails to show that what it proposes to pay to GenResources after corporate separation is just and reasonable. The capacity costs at issue here are based on AEP Ohio's 2010 full embedded costs (Tr. Vol. II, p. 589; Supp. 104). The RSR revenue is based on AEP Ohio's financial stability and AEP Ohio's return on equity. (Appx. 41-44.) Only the fuel and transmission revenues being passed through to GenResources are tied to GenResources' costs. (Appx. 66-67; AEP Ohio Second Supp. 40.) Even assuming it is appropriate for AEP Ohio to pay a cost-based charge to GenResources, there is no evidence (except with regard to fuel) that the revenues being passed

through to GenResources are payment for GenResources' costs. As such, the Commission's grant of authority to AEP Ohio to transfer revenues to GenResources is unlawful and unreasonable.

2. The Commission's Approval Of The Pass-Through Of Revenues To GenResources Is Appealable.

The Commission argues that the contract between AEP Ohio and GenResources will be approved by the FERC, and therefore is beyond the Commission's jurisdiction. PUCO Brief, p. 40. The Commission's factual assertion is correct, but its conclusion regarding its jurisdiction is not. Wholesale contracts are indeed approved by the FERC. However, the Commission expressly authorized the pass-through of revenues to GenResources in its Order. The Order discussed the pass-through of revenues directly, finding that "it is appropriate and reasonable for certain revenue to pass-through AEP Ohio to GenResources." (Appx. 69.) Indeed, the Commission cites the specific authorizing language in its brief. PUCO Brief, p. 42. Given that the Commission directly addressed the pass-through of these revenue streams, the Commission can hardly now credibly claim that this decision is left to the FERC.

E. AEP Ohio Proposition of Law No. VII: Because AEP Ohio Specifically Requested That The Commission Defer Decisions On Major Issues, It May Not Credibly Object To Any Invited Error.

AEP Ohio claims that the Commission erred by delaying decisions on certain items, causing AEP Ohio to lose the ability to withdraw the ESP. AEP Ohio Brief, pp. 45-47. However, AEP Ohio's claims are factually wrong. In any event AEP Ohio invited any error made by the Commission by specifically requesting the Commission to delay decisions on important issues. As such, AEP Ohio's argument should be rejected.

1. The Commission Addressed Auction Design Issues In This Proceeding.

AEP Ohio claims that the Commission erred by failing to address in this proceeding issues relating to the design of auctions for SSO load. This is wrong. The Commission addressed auction design issues in this proceeding – AEP Ohio just did not like the Commission's decision. In a brief before the Commission, AEP Ohio requested that the Commission freeze base generation rates throughout the period of the competitive auctions. Appx. 128. The Commission rejected this request explicitly in its Entry on Rehearing:

> We find that AEP-Ohio's request to continue to freeze base generation rates through the auction process is inappropriate and should be rejected. The entire crux of the Opinion and Order was the value in providing customers with the opportunity to take advantage of market-based prices and the importance of establishing a competitive electric marketplace. AEP-Ohio's proposal is completely inconsistent with the Commission's mission and would preclude AEP-Ohio customers from realizing any potential savings that may result from its expanded energy auctions. This is precisely the reason why the Commission expanded and accelerated the CBP in the first place.[6]

(Appx. 128.) Because the Commission has conclusively rejected AEP Ohio's position, finding a freeze in base generation rates through the auction process "completely inconsistent with the Commission's mission," this issue has been expressly addressed.

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[6] The Commission recently rejected AEP Ohio's similar attempts to circumvent the auction design that the Commission approved in this ESP proceeding. *See In the Matter of the Application of Ohio Power Company to Establish a Competitive Bidding Process for Procurement of Energy to Support its Standard Service Offer*, Case No. 12-3254-EL-UNC, Opinion and Order at pp. 12, 14 (Nov. 13, 2013) ("The Commission finds that AEP Ohio's auction rate proposal is inconsistent with the Commission's ESP II Order and subsequent Application for Rehearing . . . . Even if, arguendo, our rejection of AEP Ohio's assignments of error were in any way unclear, we note that AEP Ohio did not file an additional application for rehearing on this matter in the ESP II proceeding nor did AEP Ohio seek clarification on any part of the Entry on Rehearing."). The cap proposed by certain intervenors, which AEP Ohio points to in its Second Brief as an issue left open, also was rejected by the Commission. *Id.* at p. 18. The Commission also pushed back the first two dates when auction rates become effective to February 1, 2014 for 10% of load and November 1, 2014 for 60% of load, while retaining the January 1, 2015 start date for 100% of load. *Id.* at p. 5.

AEP Ohio also confuses what the Commission authorized in this proceeding with regard to rate design and what it reserved for consideration in future proceedings. In this proceeding, the Commission approved AEP Ohio's rate design for its base generation rates and also reserved "the right to implement a new base generation rate design on a revenue neutral basis for all customer classes at any time during the term of the modified ESP." (Appx. 24-25.) Any revenue neutral changes to rates would not prejudice AEP Ohio and, thus, are not relevant here. *See Ohio Edison Co. v. Pub. Util. Comm.*, 173 Ohio St. 478, 184 N.E.2d 70 (1962), syllabus para. 10. AEP Ohio objects that the Commission was unwilling to limit what the Commission might decide in a separate, future docket to revenue neutral actions. AEP Ohio especially criticizes the Commission's reservation potentially to consider "means to mitigate any potential adverse rate impacts for customers upon rates being set by auction." (AEP Brief, p. 46; *see* Appx. 24-25.) But the Commission merely reserved its right to initiate such an investigation if made necessary by disparate rate impacts resulting from AEP Ohio's SSO auctions. (Appx. 130-31.) AEP Ohio can show no prejudice by the Commission's reservation of its lawful right to conduct an investigation in the future.

This proposition of law should therefore be rejected.

2. AEP Ohio Invited Any Error By The Commission.

AEP Ohio's argument that it was "unlawful and unreasonable to approve the ESP while deferring final decisions of issues critical to the ESP to other dockets" (AEP Ohio Proposition of Law No. VII, AEP Brief, p. 45) also should be rejected because AEP Ohio requested that the Commission defer several important decisions for a later date. For example, AEP Ohio requested that the Commission approve the Pool Termination Rider ("PTR") as a placeholder rider "initially set at zero." Appx. 56. AEP Ohio made the same request regarding the GRR. Appx. 29.

It appears that AEP Ohio's complaint is that it won't know the specific design of the auctions for the SSO load. AEP Ohio omits the fact that AEP Ohio proposed such auctions in the first place and intentionally excluded from this proceeding any details regarding the auction process. Instead, it proposed that it would file a detailed competitive bid auction process in a future proceeding that would mimic the process approved by the Commission for other Ohio utility competitive bidding processes. (AEP Second Appx. 20-21.) The Commission only accelerated when such auctions would occur.

AEP Ohio's pretense of some quandary as to the basic design of SSO auctions is belied by the Commission's experience with SSO auctions for other utilities. *See 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*, PUCO Case No. 12-1230-EL-SSO, Opinion & Order (July 18, 2012) (authorizing descending-clock auction); *In the Matter of Application of Duke Energy Ohio, Inc. for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan, Accounting Modifications, and Tariffs for Generation Service*, PUCO Case Nos. 11-3549-EL-SSO, et al., Opinion & Order (November 22, 2011) (same); *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and the Toledo Edison Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, PUCO Case No. 10-388-EL-SSO, Opinion & Order (Aug. 25, 2010) (same). Given that the likely basic design of the SSO auctions is known, AEP Ohio's demand for greater certainty is merely make-weight, undeserving of serious consideration.

More importantly, however, as a matter of law, AEP Ohio cannot request the Commission to keep certain items open for later decision, while at the same time claim that utilizing the structure proposed by AEP Ohio constitutes reversible error. AEP Ohio's actions implicate the "invited error" doctrine. Under long established Ohio law, "[i]t is the well-settled rule that a party will not be permitted to take advantage of an error which he himself invited or induced the trial court to make." *Fostoria v. Ohio Patrolmen's Benevolent Assn.*, 106 Ohio St.3d 194 (2005) (citing *Lester v. Leuck*, 142 Ohio St. 91, 92 (1943); *State ex rel. Johnson v. Ohio Adult Parole Auth.*, 95 Ohio St.3d 463, ¶ 6 (2002)). Because AEP Ohio specifically invited the Commission to keep certain items open for further consideration, AEP Ohio invited any error made by the Commission. This proposition of law should be rejected.

3. AEP Ohio Has The Ability To Withdraw The ESP If It Disagrees With The Later Determinations Of The Commission On The Open Issues.

AEP Ohio concludes by arguing that deferring important decisions "cannot be reconciled with AEP Ohio's statutory right to withdraw." AEP Ohio overstates the risk to its operations. AEP Ohio may withdraw its ESP at any time after modification. R.C. 4928.143(C)(2)(a). There is no statutory limit on the timing of this right. *Id.* Therefore, if AEP Ohio is truly harmed by a later Commission decision on one of the remaining open issues, then it can simply withdraw from the ESP at that point. If AEP Ohio exercises this right, then "the commission shall issue such order as is necessary to continue the provisions, terms, and conditions of the utility's most recent standard service offer. . ." with certain modifications until a new SSO is authorized. R.C. 4928.143(C)(2)(b). As the statutory scheme specifically provides AEP Ohio with the authority to withdraw from the modified ESP, the Commission Order does not prejudice AEP Ohio in any way.

F. AEP Ohio Proposition Of Law No. IV: If A Cost-Based Capacity Rate Is Appropriate, The Commission Did Not Error In Applying That Rate To SSO Customers.

In the AEP Capacity Case, the Court will determine whether the Commission can or should establish a cost-based capacity rate for AEP Ohio, and whether that cost-based rate was appropriately set by the Commission. Even though AEP Ohio demanded a cost-based rate in that proceeding, it now argues that the Commission erred by using that cost-based rate to compensate AEP Ohio for capacity it provides to support the SSO energy-only auction. AEP Ohio argues that an average cost rate should not be used because it imposes an improper cap on price. AEP Ohio Brief, p. 49. This is nonsense.

In its ESP application, AEP Ohio proposed to provide capacity at $255/MW-day to serve SSO auction load. (AEP Second Supp. 20.) However, the Commission determined that this price exceeded AEP Ohio's costs of service, finding that AEP Ohio would be adequately compensated using a rate of $188/MW-day. (Appx. 129.) Incredibly, AEP Ohio objects to $188/MW-day capacity pricing when market prices for capacity are $16.46, $27.73 and $125.99 (all in $/MW-day) for the three-year period at issue. (Supp. 124.) At $188/MW-day, AEP Ohio will receive well in excess of the market rate. Therefore, the rate approved by the Commission is by definition not confiscatory. *See Market St. Ry. Co. v. Railroad Commission of State of Cal.*, 324 U.S. 548, 566-67, 65 S.Ct. 770, 89 L.Ed. 1171 (1945) (a regulated utility is not guaranteed a profit when competitive forces prevent it from recovering its costs).

AEP Ohio includes an argument on price volatility, arguing that capping recovery in each auction at average cost could prohibit full cost recovery. AEP Ohio Brief, pp. 49-50. This argument does not make sense because AEP Ohio's recovery for capacity will not fluctuate with auction results. As AEP Ohio notes in its brief, $188/MW-day approximates AEP Ohio's fully allocated costs plus a reasonable return. AEP Ohio Brief, p. 47. AEP Ohio is guaranteed

$188/MW-day for capacity pricing for serving auction load. Thus, there will be no price volatility whatsoever for capacity. AEP Ohio will recovery its average cost throughout the ESP term. Therefore, leaving aside the issues in the Capacity Case, there is no justification for using any rate other than $188/MW-day to support the auction results.

III. CONCLUSION

For the foregoing reasons and for reasons stated in its initial Merit Brief, FES respectfully requests that the Commission's Order and Entries on Rehearing are unlawful and unreasonable, and should be reversed.

Respectfully submitted,

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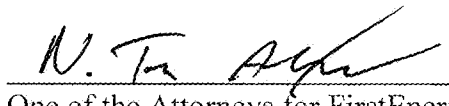
CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Appellant FirstEnergy Solutions Corp.'s Third Merit Brief* was served this 10th day of December, 2013, via first-class U.S. mail, postage prepaid, upon the parties below.



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