***OCC EXHIBIT\_\_\_\_\_\_\_***

**BEFORE THE**

**PUBLIC UTILITIES COMMISSION OF OHIO**

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| In the Matter of the Application Seeking Approval of Ohio Power Company’s Proposal to Enter into an Affiliate Power Purchase Agreement for Inclusion in the Power Purchase Agreement RiderIn the Matter of the Application of Ohio Power Company for Approval of Certain Accounting Authority  | ))))))))) | Case No. 14-1693-EL-RDRCase No. 14-1694-EL-AAM |

**DIRECT TESTIMONY**

**OF**

**KENNETH ROSE, Ph.D.**

**On Behalf of**

**The Office of the Ohio Consumers' Counsel**

*10 West Broad Street, Suite 1800*

*Columbus, Ohio 43215-3485*

**SEPTEMBER 11, 2015**

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# I. INTRODUCTION

***Q1. PLEASE STATE YOUR NAME AND AFFILIATION.***

***A1.***My name is Kenneth Rose, an independent consultant based in Chicago, Illinois. I have been retained by the Office of the Ohio Consumers’ Counsel for purposes of this proceeding.

***Q2. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.***

***A2.*** I received my B.S., M.A., and Ph.D. in economics from the University of Illinois at Chicago. I have been an independent consultant since 2002. Previously, I was a Senior Institute Economist at the National Regulatory Research Institute (“NRRI”) at The Ohio State University from 1989 to 2002, and was an economist in the Energy and Environmental Systems Division at Argonne National Laboratory from 1984 to 1989. I have also been a lecturer for the School of Public Policy and Management (1998 to 2002) and the John Glenn School of Public Affairs (2009 to 2011) at The Ohio State University. I have been a Senior Fellow with the Institute of Public Utilities at Michigan State University since 2002.

***Q3. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY OR TESTIFIED BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO OR OTHER AGENCIES?***

***A3.*** Yes,I have submitted testimony before the Public Utilities Commission of Ohio (“PUCO” or “Commission”) in the Dayton Power and Light Electric Security Plan (“ESP”) case (Case Nos. 12-426-EL-SSO, et al.), the Duke Energy Ohio, Inc., cases in 2012 and 2013 for certain tariff and accounting changes (Case Nos. 12-2400-EL-UNC, 12-2401-EL-AAM, and 12-2402-EL-ATA), and Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company ESP case (Case No. 14-1297-EL-SSO). I have also testified before Ohio legislative committees and before other state commissions and legislative bodies. They are listed in Attachment KR-1 to my testimony.

I have also worked with the Ohio Legislative Service Commission (“LSC”) on the drafting of legislation that became Senate Bill 3 (“S.B. 3”), which is explained in more detail later in my testimony.

# II. PURPOSE OF TESTIMONY

***Q4. WHAT IS THE PURPOSE OF YOUR TESTIMONY?***

***A4.*** The purpose of my testimony is to provide my analysis and recommendations regarding Ohio Power Company’s (“AEP Ohio” or “Utility”) proposal to use a Power Purchase Agreement Rider (“PPA Rider”).

The PPA Rider would be a non-bypassable charge to customers when wholesale market prices remain at what AEP Ohio describes as current “low” levels and below the formula contract price between AEP Ohio and AEP Generation Resources, Inc., (“AEPGR”). If wholesale market prices increase and are above the formula contract price between AEP Ohio and AEPGR, the PPA Rider would be a net credit to customers according to the Utility. Utility witness Allen describes how the Rider would work.

# III. RECOMMENDATIONS AND ANALYSIS

***Q5. PLEASE SUMMARIZE YOUR CONCLUSION.***

***A5.*** Based on my review and analysis, I conclude as follows.

First, the customers of AEP Ohio should not be required to pay additional money in the form of the PPA Rider to protect AEPGR, an unregulated power producer, against any losses that may occur in a competitive wholesale generation market.

Second, any regulatory actions at this time that allow collection of generating costs from customers in excess of market prices would be giving the generator or supplier unfair advantages (subsidies).

Third, the proposed PPA Rider, if approved, will harm customers by undermining the State’s Retail Electric Service Policies. In particular, the state’s policy to avoid anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail service (R.C. 4928.02(H)).

I conclude that the PPA Rider and its associated Power Purchase Agreements between AEP Ohio and its unregulated affiliate, AEPGR (“Affiliate PPA”) are not in the public interest and will not benefit the customers of AEP Ohio. Therefore, a PPA Rider greater than zero should be denied by the PUCO.

***Q6. WHAT IS THE MAIN FEATURE OF THE PROPOSED PPA RIDER?***

***A6.*** In his direct testimony, Utility witness Vegas lists 20 generating units that would be part of the PPA Rider calculation. This includes 9 units of AEPGR and 11 OVEC units. According to Mr. Vegas, the “Affiliated PPA” is an agreement between AEP and AEPGR. Under that agreement, AEP Ohio will receive output (specifically, capacity, energy, and ancillary services) from the units owned by AEPGR and AEP Ohio will pay (that is, their customers will pay through AEP Ohio) AEPGR its costs of owning and operating the generation units. Mr. Vegas also states that AEP Ohio has an entitlement to OVEC units in Ohio and Indiana. The revenues and costs associated with the OVEC units will also be included in the PPA Rider.

What is clear from the Utility’s description is that the costs and revenues associated with these units are generation costs of units that are owned by an unregulated affiliate of AEP and are operating in the wholesale PJM Interconnection L.L.C. (“PJM”) market.

***Q7. WHAT IS THE PROPOSED PPA RIDER IN THE ESP?***

***A7.*** In summary, the proposed PPA Rider would be a non-bypassable generation charge (credit) that would be collected from all captive distribution customers of AEP Ohio. The charge (credit) would be calculated as the difference between the wholesale market revenues from sales of energy, capacity, and ancillary services from specified power sources and AEPGR’s cost of owning and operating the generating units. It would also include the net impacts of the Utility’s contractual entitlement to a share of the electrical output of generating unites owned by OVEC. The “PPA Rider Units” are listed in Table 2 of Utility witness Vegas Direct Testimony (May 15, 2015). There would also be an annual update and reconciliation of charges/credits to customers.

***Q8. HOW WILL COSTS AND REVENUES ASSOCIATED WITH THE PPA RIDER BE REVIEWED?***

***A8.*** The Company proposes in the Power Purchase and Sale Agreement (Exhibit KDP-1 of Utility witness Pearce) to use an “Operating Committee” that will, according to Utility witness Vegas (pages 27-28),

“include a representative from AEP Ohio. This Committee will provide oversight over all major decisions and operation of the PPA Units. Subsequently, AEP Ohio can provide, on a periodic basis as determined by the Commission, summaries and/or details of the Committee’s actions. . . . All costs will be reviewed and approved for payment to AEPGR by AEP Ohio’s Vice President, Regulatory and Finance.”

This clearly uses a self-regulation mechanism between AEP’s own affiliates. This self-regulation creates a conflict of interest between the affiliated companies’ interest (AEPGR) and the public’s interest that is the result of the companies involved regulating themselves.

AEP Ohio witness Vegas (page 29) also states that “[t]he Commission will have the ability to audit the accuracy of the costs and revenues included in the PPA Rider as well as a prudence review of actions and decisions undertaken by AEP Ohio or its agents.” How this will occur is not clear, given the Operating Committee’s role. Also not clear is how the PUCO would review the costs and revenues associated with an affiliate that is unregulated by, and cannot be regulated by, the PUCO without legislative change. This limitation of the PUCO’s ability to regulate the price of generation is explained in more detail below.

An arrangement of the sort proposed by AEP Ohio is basically a return to cost-based regulation—but without the historic review process that the PUCO and other commissions used to ensure that customers do not pay for unreasonable costs. This is also discussed in more detail below.

***Q9. WHY HAS THE UTILITY PROPOSED THE PPA RIDER AND ITS ASSOCIATED POWER PURCHASE AGREEMENT IN THE ESP?***

***A9.*** It appears that AEP would like to reduce the risk they face in the wholesale market and have guaranteed cost recovery and return on equity through the PPA for its generation resources. Utility witness Vegas, on p. 11 of his direct testimony, states:

The Affiliated PPA will provide the PPA Units with a known revenue stream commensurate with the actual costs associated with providing this generating capability. The PPA Units will be less reliant on the volatile capacity market prices to support their continued operation, allowing those assets to be managed based on well-informed long term investment decisions with a more certain and transparent view of how they will ultimately recover their expenditures . . .

This type of assurance, as Utility witness Vegas (page 24) says in his direct testimony, is consistent with states that remain regulated:

Ohio’s neighbors – Indiana, Michigan, Virginia, West Virginia, and Kentucky all provide regulated recovery of generation investments providing investors more clarity regarding the return on such large investments. Virginia not only provides regulated cost recovery, but also employs rate incentives and accelerated cost recovery mechanisms to encourage new generation investments to serve native load.

Clearly that’s what AEP Ohio seeks—an assurance of cost recovery that usually accompanies a cost-based regulated environment.

***Q10. DO YOU CONCUR WITH THE AEP OHIO’S RATIONALE FOR PROPOSING THE PPA RIDER?***

***A10.*** No. Essentially, the proposed PPA Rider, if approved, would amount to a bail-out funded by the customers of AEP Ohio for unregulated generation plants that operate in the wholesale market.

However, after the market development period, utilities are required under Ohio law to be fully on their own in the competitive market (R.C. 4928.38). The market development period for AEP Ohio ended on December 31, 2005. Being on your own in the competitive market means that AEPGR (AEP Ohio’s unregulated generation affiliate) cannot be aided by a subsidy—especially one paid for by AEP Ohio’s distribution customers.

***Q11. DO YOU AGREE THAT AEP OHIO SHOULD BE ALLOWED TO COLLECT AND TRANSFER TO AEPGR (AN UNREGULATED AFFILIATE OF AEP OHIO) THE COMPENSATION FOR THE DEREGULATED GENERATION ASSETS COVERED UNDER THE PROPOSED PPA RIDER?***

***A11.*** No, I do not believe that AEP Ohio should be allowed to collect the above-market “costs” for those plants owned by AEPGR from their customers and transfer the collected revenue to AEPGR through a bilateral contract (where the price is not regulated by the Federal Energy Regulatory Commission (“FERC”) or the PUCO).

It should also be noted that AEP Ohio does not own any generation plants at this time except the entitlement to OVEC. The power plants to be included in the PPA Rider (except OVEC) are owned and operated by AEPGR, an unregulated affiliate of AEP Ohio. I do not believe that the AEP Ohio should be allowed to collect above-market generation costs from customers and transfer the collected revenues to its unregulated affiliates.

My opinion is based on my knowledge of established and sound regulatory policy as a regulatory economist and on my understanding of Ohio laws that limit charges to customers for competitive generation market losses by electric utilities.

***Q12. DO YOU AGREE THAT THE COMPANY SHOULD BE ALLOWED TO COLLECT FROM CUSTOMERS ITS SHARE OF COSTS OF THE OVEC GENERATION UNITS?***

***A12.*** No. I do not believe that the Company should be allowed to collect the above-market “costs” for OVEC units and then transfer the collected revenue to OVEC through a bilateral contract not price regulated by the FERC or the PUCO. Again, these generation costs are to be recovered in the generation market, not through a rider mechanism charged to captive retail customers.

***Q13. IS THE UTILITY’S PPA RIDER PROPOSAL CONSISTENT WITH OHIO POLICIES, AS OUTLINED IN THE LAWS THAT GOVERN THE PROVISION OF ELECTRIC GENERATION IN OHIO?***

***A13.*** No.

***Q14. PLEASE DESCRIBE YOUR UNDERSTANDING OF THE OHIO LAWS THAT YOU REFERENCE IN YOUR PRECEDING ANSWER.***

***A14.*** In the late 1990s, while I was employed at NRRI at The Ohio State University, I worked for the Ohio Legislative Service Commission (“LSC”) directly assisting the legislators tasked with drafting what became S.B. 3. In particular, my work was directly related to the drafting of language (statutes) regarding “transition costs” or “stranded cost” recovery and the methods for determining the standard service offer rate. S.B. 3 became the law in Ohio in 1999[[1]](#footnote-1) and the specific provisions pertaining to stranded investment, R.C. 4928.38 and 4928.39, remain applicable today.

It is my understanding, as confirmed by counsel, that the legislative goals of S.B. 3 were to deregulate the generation market and end the use of cost-based rates for pricing generation services in the state of Ohio.[[2]](#footnote-2) Cost-based regulation was to be replaced by market competition as a means to determine the wholesale and retail generation price for all electricity customers. Consequently, after the enactment of S.B. 3, market forces are to determine which power plants should be operated and which power plants should be retired if they are inefficient and uneconomic.

However, there is an important analytic point to be made in that regard. The test for economic viability of the PPA Units is whether PJM market prices are sufficiently high to cover the supplier’s average variable costs, i.e., costs that vary with output.

But under the Utility’s proposal, customers will be charged the full embedded costs of generation plants including a return on and a return of legacy capital. Thus, it is entirely possible that the PPA Rider would “produce” a “loss” that customers pay for (meaning full cost of service exceeds PJM revenue from the generation) even though the PJM market prices are still high enough to cover average variable costs. Thus, the fact that the PPA Rider produces a loss for customers does not mean that absent that rider the PPA Units would or should be retired.

***Q15. IS THE UTILITY’S PPA RIDER PROPOSAL CONSISTENT WITH S.B. 3?***

***A15.*** No. The fundamental idea behind this deregulation of the generation business (S.B. 3) is that retail customers should not now be asked to protect Ohio electric utilities from competitive generation market risks or losses.

A market development period was provided under S.B. 3. The intent of the market development period was to provide electric utilities in Ohio time to prepare for a competitive environment. That market development period has elapsed. It is no longer the AEP Ohio’s customers’ obligation to cover the operating generating costs and guarantee a return on equity for AEP Ohio’s unregulated affiliate. The Company is now “wholly responsible” for whether it is in a competitive position in the generation market. Captive retail customers should not be asked to guarantee the profitability of the Company’s deregulated affiliate-owned generation units.

***Q16. WHY IS THE PROPOSED PPA RIDER CONTRADICTING THE LEGISLATIVE INTENT AND THE POLICY GOALS OF ELECTRICITY DEREGULATION IN OHIO, IN PARTICULAR S.B. 3?***

***A16*** From a policy perspective, the Utility’s proposed PPA Rider is based on a mistaken premise. That premise is that captive retail customers should make up the potential losses of certain generation assets owned and operated by unregulated affiliate, AEPGR, and ultimately, AEP Ohio’s parent company, AEP; and to the OVEC owners, for those units’ output. This is contrary to Ohio’s policy direction since 1999. The proposed PPA charge is an attempt to re-introduce revenue guarantees for the specified unregulated (and currently uneconomic) generation assets.

What the Company has proposed regarding the PPA Rider can be viewed as either (1) a continuation of transition or “stranded” cost recovery for those power plants, which as explained below should no longer be permitted, or (2) a loosely-designed cost-based regulation that incorporates a revenue guarantee for those generation plants. This is problematic because the “cost” (or PPA contract price) of the specific generation assets is determined through bilateral contracts between affiliated companies, and the “cost” (or contract price) are not set by FERC or the PUCO. As noted, this is essentially self-regulation and creates a conflict of interest between the AEP affiliates and the public (and in particular the consumers’) interest.

***Q17. DO YOU HAVE CONCERNS FOR CUSTOMERS REGARDING THE UTILITY’S ATTEMPT TO RE-INTRODUCE A REVENUE GUARANTEE INTO THEIR UNREGULATED BUSINESS?***

**A17.** Yes, I do. This approach is a loosely based attempt at “re-regulation” (or more precisely the re-introduction of revenue guarantee through unregulated bilateral contracts between affiliated entities. This type of re-regulation is even *better,* from AEP’s perspective, than cost-based regulation. AEP Ohio’s proposal is an attempt to “re-regulate” the very service (competitive generation) that has been the focus of attempts to deregulate, at both the federal and state levels.

However, the proposed PPA Rider is considerably inferior to the traditional cost-based regulation because it is actually a revenue guarantee masked as partial cost-based regulation. As discussed above, AEP Ohio’s proposal lacks the important checks and balances that usually accompany traditional or cost-based regulation, such as a review by the PUCO of costs incurred.

Under the proposed PPA Rider, in a broader sense, the AEP parent company would be collecting additional revenues (that are above market price) from captive retail customers of its regulated distribution subsidiaries, AEP Ohio. And then the revenues would be transferred to the unregulated subsidiary AEPGR (the entity that actually owned generation assets that are no longer price-regulated by the State of Ohio). By doing so, the AEP parent company will receive a guaranteed return on some of its generation capital investments. These revenues would provide the AEP parent company, or its unregulated subsidiary AEP Ohio, additional dollars that it allegedly otherwise cannot collect by selling generation services in the wholesale or retail market.

This scheme is contrary to the legislative intent of S.B. 3 to create a competitive generation market in the state. If the proposed PPA Rider were granted by the Commission, some of AEPGR’s generation plants would receive this additional revenue in the form of a guaranteed return. But other unregulated electric suppliers, who are in direct competition with AEPGR, would not receive any similar guaranteed return. The approval of the PPA Rider and its associated power purchase agreement will place generators other than AEP at a competitive disadvantage in the market. And the PPA Rider will impair the operation of a competitive market that is intended to provide reasonably priced generation service for Ohio electric customers.

***Q18. SIXTEEN YEARS AFTER SENATE BILL 3’S ENACTMENT, SHOULD THE COMPANY’S TRANSITION TO COMPETITION BE DONE?***

***A18.*** Yes. The Company should no longer charge customers a PUCO regulated price, especially one that includes a guaranteed return, for generation service.

***Q19. DOES OHIO LAW PROVIDE THE COMPANY WITH AN ADDITIONAL TRANSITION PERIOD?***

***A19.*** No. My understanding of S.B. 3, confirmed by counsel, is that Ohio law prohibits utilities from collecting from customers stranded costs or transition costs or “equivalent revenues” beyond the “market development period.” That time period expired on December 31, 2005.

 Specifically, Section 4928.38 of the Revised Code, as adopted on October 5, 1999, provides that an electric utility may receive transition revenues from the starting date of competitive retail electric service through the end of the market development period. Further, that section of the Revised Code provides that once the utility’s market development period ends, it “shall be fully on its own in the competitive market.” Being fully on its own in the competitive market means that the utility (and its affiliate) are not charging captive retail customers of regulated services for revenues to support power plants.

***Q20. WHAT TYPE OF COSTS IS AEP OHIO TRYING TO COLLECT FROM CUSTOMERS THROUGH THE PROPOSED PPA RIDER AND ITS ASSOCIATED PPA?***

**A20.**Specifically, the Utility is seeking to charge customers for above-market generation costs of its unregulated affiliate, AEPGR, and for the OVEC generation units.

***Q21. IS THE COMPANY ATTEMPTING TO COLLECT TRANSITION COSTS OR ITS EQUIVALENT, ABOVE MARKET GENERATION COSTS?***

***A21.*** Yes. Section 4928.39 of the Revised Code defines transition costs. It clearly states that the costs unrecoverable in a competitive environment are considered a part of the transition costs. At this time in 2015, the Utility is claiming that revenue derived from a competitive marketplace is insufficient to cover the cost of operating the plants. That the cost of generation plants exceeds the market price is essentially the very definition of transition cost. The Company should not now be allowed to collect these costs ten years after the transition period ended.

***Q22. DID SB 221 (PASSED IN 2008) CHANGE OHIO LAW WITH RESPECT TO PROVIDING THE COMPANY ANY ADDITIONAL TIME FOR THE TRANSITION PERIOD?***

***A22.*** No, SB 221 did not invalidate or repeal the relevant sections of SB 3 on recovery of transition costs. Nor did it provide any additional time for collecting transition costs.

***Q23. WOULD IT BE PROPER FOR THE COMPANY TO NOW CHARGE CUSTOMERS FOR GENERATION-RELATED TRANSITION COSTS, OR ABOVE MARKET GENERATION COSTS, AND TRANSFER THOSE COLLECTED REVENUES TO THEIR OWNERS IN ORDER TO KEEP THE UNREGULATED POWER PLANTS IN OPERATION?***

***A23.*** No. The law is very clear that “[w]ith the termination of that approved revenue source, the utility shall be fully on its own in the competitive market” (R.C. 4928.38) and that the commission “shall not authorize the receipt of transition revenues or any equivalent revenues” (R.C. 4928.38) after the termination of the market development period. This means that AEP Ohio cannot charge customers of the regulated distribution business dollars that subsidize AEP’s non-regulated generation service. But that’s just what the Company has proposed to do.

In addition, the Company has not demonstrated that it is in the best interests of the customers or the state of Ohio, at this time in 2015, to support those power plants covered under the proposed PPA Rider through hundreds of millions or even billions of dollars in subsidies. Those power plants should compete in the market with other power plants, on their own without customer-provided subsidies. Therefore, the Company’s proposal violates Ohio’s retail electric service policy and Ohio law. AEP Ohio’s proposal should be rejected by the PUCO.

***Q24. IS THE PROPOSED PPA RIDER CONSISTENT WITH THE STATE OF OHIO’S ELECTRIC SERVICE POLICY OF AVOIDING ANTICOMPETITIVE SUBSIDIES FLOWING FROM A NONCOMPETITIVE RETAIL ELECTRIC SERVICE TO A COMPETITIVE RETAIL SERVICE?***

***A24.*** No, it is not. R.C. 4928.02(H) states that the state’s policy is 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 or to a product or service other than retail electric service, and vice versa, including by prohibiting the recovery of any generation-related costs through distribution or transmission rates.”

This is often referred to as cross-subsidization, which includes, for example, having non-competitive services (such as distribution) subsidize competitive services (such as generation). Because the PPA Rider is a non-bypassable generation charge assessed through the distribution company, AEP Ohio, and collected from all captive retail distribution customers, it is an example of cross-subsidization of generation service by distribution customers.

An approval of the PPA Rider is a violation of this state policy. The non-bypassable charge collected through PPA Rider only benefits one supplier, and provides additional revenue to that supplier, that other suppliers in the market do not receive.

***Q25. DO YOU HAVE ANY COMMENT ON the COMMISSION’S AEP Ohio Order?***

***A25.*** Yes. In the February 26, 2015 Opinion and Order issued in Case No. 13-2385-EL-SSO, the Commission identified it would consider to approve cost recovery under the PPA Rider effective only during the three year ESP period. The Commission authorized AEP Ohio to establish a “placeholder” PPA Rider, however the Commission set it at zero.

The Commission also identified several factors that AEP Ohio should address and the Commission will consider when deciding whether to approve the request for cost recovery from the utility. These are enumerated below.[[3]](#footnote-3)

1. “financial need of the generating plant;”
2. “necessity of the generating facility, in light of future reliability concerns, including supply diversity;”
3. “description of how the generating plant is compliant with all pertinent environmental regulations and its plan for compliance with pending environmental regulations; and”
4. “the impact that a closure of the generating plant would have on electric prices and the resulting effect on economic development within the state.”

If the Commission decides to use these factors, it is important that the Commission also consider the impact on the competitive retail market that these considerations will have if they set a non-zero PPA Rider.

***Q26. SHOULD THE PUCO CONSIDER THE FIRST FACTOR FROM THE AEP ORDER, WHICH REQUIRES A UTILITy TO ADDRESS WHETHER THE GENERATING PLANTS HAVE A FINANCIAL NEED?***

***A26.*** No. The first factor clearly suggests that generators in the state would be able to recover their costs based on “financial need.”

This is more consistent with a policy of cost-based regulation of generation than a restructured retail market that aims to foster a competitive retail generation market. The term “financial need” is undefined by the Commission. But in competitive markets if a generating unit cannot clear its output in the wholesale market (PJM), by producing a price-competitive product, then it will be replaced by lower offers for generation in the wholesale market.

Moreover, financial need is a subjective factor that should only be evaluated by the generation owner based on whether costs are being met. Financial need of a generation plant should not be a consideration for the Commission to evaluate in a deregulated market-based generation environment. By considering the financial need of a generating plant, the PUCO leads the state in a direction that is contrary to the direction Ohio has been moving since 1999—that is, toward competitive retail markets, as required by current Ohio law.

***Q27. are there any other reasons why the first FACTOR IS not a good metric by which to measure a ppa rider?***

***A27.*** Yes. As previously mentioned, the PUCO does not define what they mean by the phrase “financial need.” In the competitive market, “financial need” is determined by the unregulated owner of the generation unit. While some may argue that there is no financial need as long as the revenues exceed the variable costs of the plant, the owners of the plants, especially when seeking a subsidy with a guaranteed return, would argue that there is financial need as long as the guaranteed return is not achieved. Again, this is a consideration that would be expected in a regulated environment, not a market-based environment.

***Q28. SHOULD THE PUCO CONSIDER THE SECOND FACTOR FROM THE AEP ORDER, WHICH REQUIRES UTILITIES TO ADDRESS THE NEED FOR THE GENERATING PLANTS?***

***A28.*** No. The second factor, “necessity of the generating facility, in light of future reliability concerns, including supply diversity,” is an important issue but not an appropriate consideration for the operation of a competitive market. Subsidizing one supplier and not others may discourage new entry rather than encouraging new entrants, thereby harming reliability in the long run. Creating such a barrier to new entry will also result in a more concentrated market (fewer suppliers with larger market shares), which makes it more likely that suppliers (for example, AEP) would be able to raise prices above competitive levels.

The need for generating units in a Regional Transmission Organization (“RTO”), such as PJM, is determined by the RTO’s procedures for meeting reliability to ensure there is enough capacity to fill the customer demand. This is not an issue to be determined by the PUCO on a plant-by-plant basis; rather, it is a determination for the RTO based on market forces for the entire region.

***Q29. SHOULD THE PUCO CONSIDER THE THIRD FACTOR FROM THE AEP ORDER, WHICH REQUIRES THE UTILITIES TO ADDRESS HOW THE GENERATING UNITS ARE COMPLIANT WITH ALL PERTINENT AND PENDING ENVIRONMENTAL REGULATIONS?***

***A29.*** No. The third factor, “description of how the generating plant is compliant with all pertinent environmental regulations and its plan for compliance with pending environmental regulations” is an issue faced industry-wide and by nearly every state. The state of Ohio, like all states, needs to address this issue comprehensively at a state-wide level, not by one utility at a time and certainly not one plant at a time. Subsidies for existing fossil plants may encourage them to remain operating and delay retirement. Whether a unit or plant should remain operating or retire should be based on the economic decisions of the owner considering price signals from the competitive market, in compliance with state and federal environmental regulation. This is further explained in OCC Witness Jackson’s testimony.

***Q30. SHOULD THE PUCO CONSIDER THE FOURTH FACTOR FROM THE AEP ORDER, WHICH REQUIRES THE UTILITIES TO ADDRESS THE IMPACT THAT CLOSURE OF THE GENERATING PLANTS WOULD HAVE ON ELECTRIC PRICES AND ECONOMIC DEVELOPMENT IN THE STATE?***

***A30.*** No. The fourth factor, “the impact that a closure of the generating plant would have on electric prices and the resulting effect on economic development within the state” gets back to why the restructuring efforts began in the first place – to moderate prices to customers and retain and attract new businesses to the state. The best way to do this is to keep prices relatively low and maintain existing reliability. By allowing a special class of generation owners to pass their above-market costs through to captive retail customers will simply increase prices within the state, discourage entry by other suppliers, and not help develop a functioning retail market that would benefit the state in the long run.

The Commission cannot unilaterally, even by public rulemaking, revert back to previous regulations, institute a different regulatory regime of its own, or insert mechanisms that were not intended by or are contrary to current law.

***Q31. PLEASE SUMMARIZE YOUR CONCLUSION AND RECOMMENDATION REGARDING THE PROPOSED PPA RIDER IN THE PROPOSED ESP.***

***A31.*** My primary recommendation is that the PUCO should reject the proposed PPA Rider. AEP Ohio should not be allowed to collect above-market generation costs (or contract rates), through the PPA Rider, from the customers for the electricity produced by the generation units. And the Company should not be allowed to then transfer the collected revenues to their unregulated affiliate, AEPGR, or the OVEC owners.

As discussed before, the above-market generation costs (or contract rates), charged to the customers of the Company, are inconsistent with the legislative intent of a deregulated generation market in the state of Ohio. The imposition of the PPA Rider on the customers amounts to providing an unjust subsidy to the generator owners (AEPGR and OVEC). The approval of PPA Rider will distort a competitive generation market. The approval of PPA Rider will likely impose substantial and additional costs on the captive retail customers of AEP Ohio. And the PUCO will have almost no recourse to undo the damages to customers and the competitive generation market if the difference between generation costs and market prices persists well into the future.

The four factors on which the PUCO focuses in the AEP Ohio Order ignore the anti-competitive nature of the PPA Rider; instead focusing on the individual needs of the deregulated generation facilities. Approval of the PPA Rider would distort the retail generation market and will likely impose substantial and additional costs to the customers of the Company.

***Q32. DOES THIS CONCLUDE YOUR TESTIMONY?***

***A32.*** Yes. However, I reserve the right to incorporate new information that may subsequently become available through outstanding discovery or otherwise.

**CERTIFICATE OF SERVICE**

I hereby certify that a true copy of the foregoing *Direct* *Testimony of Kenneth Rose, Ph.D. on Behalf of the Office of the Ohio Consumers’ Counsel,* was served via electronic transmission to the persons listed below on this 11th day of September 2015.

 */s/ William J. Michael*

 William J. Michael

 Assistant Consumers’ Counsel

**SERVICE LIST**

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| Steven.beeler@puc.state.oh.usWerner.margard@puc.state.oh.ushaydenm@firstenergycorp.comjmcdermott@firstenergycorp.comscasto@firstenergycorp.comjlang@calfee.comtalexander@calfee.commyurick@taftlaw.comtony.mendoza@sierraclub.orgtodonnell@dickinsonwright.comtdougherty@theOEC.orgtwilliams@snhslaw.comjeffrey.mayes@monitoringanalytics.comricks@ohanet.orgtobrien@bricker.commhpetricoff@vorys.commjsettineri@vorys.comglpetrucci@vorys.commdortch@kravitzllc.comjoliker@igsenergy.commswhite@igsenergy.comsechler@carpenterlipps.comgpoulos@enernoc.comsfisk@earthjustice.orgKristin.henry@sierraclub.orgchris@envlaw.comAttorney Examiners:Sarah.parrot@puc.state.oh.usGreta.see@puc.state.oh.us | stnourse@aep.commjsatterwhite@aep.commsmckenzie@aep.commkurtz@BKLlawfirm.comkboehm@BKLlawfirm.comjkylercohn@BKLlawfirm.comsam@mwncmh.comfdarr@mwncmh.commpritchard@mwncmh.comKurt.Helfrich@ThompsonHine.comScott.Campbell@ThompsonHine.comStephanie.Chmiel@ThompsonHine.comlhawrot@spilmanlaw.comdwilliamson@spilmanlaw.comcharris@spilmanlaw.comStephen.Chriss@walmart.comSchmidt@sppgrp.comBojko@carpenterlipps.comhussey@carpenterlipps.commfleisher@elpc.orgmsmalz@ohiopovertylaw.orgcmooney@ohiopartners.orgghull@eckertseamans.commsoules@earthjustice.orgjennifer.spinosi@directenergy.comlaurie.williams@sierraclub.org |

1. As Passed by the Ohio 123rd General Assembly, 1999. [↑](#footnote-ref-1)
2. Legislative Service Commission, Final Analysis, Am. Sub. S.B. 3, 123rd General Assembly, 1999. [↑](#footnote-ref-2)
3. AEP Ohio Order (February 25, 2015), p. 25, numbers added. [↑](#footnote-ref-3)