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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company For Approval of its Electric Security Plan Including Related Accounting Authority; an Amendment to its Corporate Separation Plan; and the Sale or Transfer Certain Generating Assets	)	**Case No. 08-917-EL-SSO**
In the Matter of the Application of Ohio Power Company for Approval of its Electric Security Plan Including Related Accounting Authority; and an Amendment to its Corporate Separation Plan	)	**Case No. 08-918-EL-SSO**

INITIAL BRIEF OF THE KROGER CO.

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I. INTRODUCTION

On July 31, 2008 the Columbus Southern Power Company ("CSP") and the Ohio Power Company ("OPC") (collectively referred to herein as "AEP" or "the Company") filed a request for a rate increase pursuant to sections 4928.141 and 4928.143 of the Ohio Revised Code ("R.C."), enacted by amended substitute Senate Bill 221 ("S.B. 221"). Under these sections, electric distribution utilities ("EDU's") are permitted to file an application to establish a standard service offer price for retail electric generation service delivered by the EDU under an electric security plan ("ESP").

On September 16, 2008, the Public Utilities Commission of Ohio ("Commission") issued an entry granting The Kroger Co.'s Motion to Intervene in this proceeding. The Kroger Co. has been an active participant throughout. As part of the evidentiary hearing in this proceeding, The Kroger Co. submitted the expert direct testimony of Kevin C. Higgins ("Higgins"), in which he discusses numerous issues presented by AEP's ESP.

The Kroger Co. is one of the largest grocers in the United States. The Kroger Co.'s grocery and related business requires that The Kroger Co. utilize substantial amounts of electric power and energy. The Kroger Co. has facilities in the service territories of both OPC and CSP that collectively consume over 230 million kWh per year. Therefore, The Kroger Co. has a substantial interest in the rates proposed to be charged by AEP.

II. SUMMARY

R.C. 4928.143 states that the Commission shall approve, or modify and approve, an application for an ESP if the Commission finds that the proposed ESP is more favorable in the aggregate than what would otherwise be expected to be obtained in a Market Rate Offer ("MRO") under §4928.142 of the Revised Code. The Kroger Co. contends that AEP has not proven its proposed ESP is more favorable in the aggregate than an MRO[1] and therefore should be modified before being approved by the Commission. The Kroger Co. recommends the following modifications to AEP's ESP:

(1) It is undisputed that AEP's rate proposal results in rates that are not cost based. However, the retail price to electric customers under an ESP is subject to a Significantly Excessive Earnings Test, which by its nature, requires some nexus with cost of service. The complete absence of evidence presented by AEP showing the relationship between the prices the Company seeks to charge for electric service and the overall cost to AEP of providing the service raises serious concerns about whether AEP's proposed ESP would produce significantly excessive earnings. It is not in the public interest to adopt an ESP that is likely to fail the Significantly Excessive Earnings Test. Therefore, AEP's ESP should not be approved until they can show its ESP has some rational relationship to the cost of providing electricity to its customers.

(2) AEP's proposed fuel adjustment clause ("FAC") rider must be modified to incorporate a credit to customers for each respective utility's share of off-system sales margins. A FAC charge without such a credit is asymmetrical and fundamentally unreasonable. At a minimum, any portion of the off-system sales margins that are not

[1] While AEP has not proposed an MRO, R.C. 4928.143(C) still requires that the ESP be more favorable in the aggregate than "the expected results that would otherwise apply" to an MRO.

credited to customers must be recognized in the Significantly Excessive Earnings Test, contrary to AEP's unsupportable position that these margins should be excluded.

Further, AEP has not provided an analysis of its cost of providing generation service. Absent such an analysis, it is not possible to determine whether current generation charges need to be increased in order to enable AEP to recover its prudently-incurred variable generation expenses. For example, it is possible that AEP's FAC-related expenses are already being fully recovered, or even over-recovered, in current rates. In such a case, although FAC-related expenses can be separately stated and recovered, it would not be necessary to increase rates for AEP to fully recover its variable generation expenses. The upshot is that if rates are to be increased to recover FAC-related costs, then it is reasonable for AEP to be required first to demonstrate that such an increase is necessary for the Company to recover its generation-related costs. AEP has not done so.

(3) AEP's proposed "slice-of-system" purchases should be eliminated from AEP's FAC proposal. There is no reason for AEP to purchase power from the market to serve customers when AEP is proposing to sell power from its own generating assets to non-AEP customers. The only apparent purpose of these slice-of-system purchases is to increase prices charged to customers, increase off-system sales margins and thus result in significantly excessive earnings for AEP.

(4) Modification of AEP's one-sided FAC proposal, through a credit to customers for off-system sales margins and the elimination of slice-of system market power purchases would also likely eliminate the need to defer charges for later recovery,

which in itself raises serious concerns with respect to inter-generational equity. Deferrals should not be included in AEP's ESP.

(5) The non-FAC portion of AEP's generating rates should be modified to appropriately account for *all* costs associated with non-FAC electric generation. While AEP proposes a non-FAC rate increase to recover capital carrying costs associated with environmental additions, AEP's proposed non-FAC recovery mechanism does not account for the increased accumulated depreciation of existing generation plant in service. A rate increase associated with the non-FAC costs should not be approved unless AEP can demonstrate that there has been a *net* increase in the costs of providing non-FAC services.

(6) AEP proposes to charge customers in excess of $500 million through a provider of last resort ("POLR") rider to recover the costs of risks associated with customers shopping for electric service. AEP Black-Scholes option pricing model is not an appropriate mechanism to accurately price AEP's POLR risk and significantly overprices the risk AEP actually faces from customer shopping. Requiring *all* customers to pay an upfront premium to cover the costs of the POLR risk is unnecessary and will result in AEP recovering far more than the costs AEP actually faces due to the cost of shopping customers. AEP's ESP should be modified to replace the proposed POLR rider with a rider that is designed to recover only actually-incurred costs for the term of the ESP.

(7) AEP is proposing a significant rate increase in its distribution rates due to costs associated with the gridSMART initiative and other distribution reliability investments. In light of the numerous complex issues facing the Commission in this

proceeding, and the enormity of the overall rate increase AEP is proposing, the best forum for evaluating the reasonable recovery of distribution costs is a distribution rate case. Such a forum would allow for the full consideration of distribution rate base, revenues and expenses, as well as rate of return. However, if distribution investments that involve smart metering technologies are approved by the Commission in this proceeding, customers must have full access to the metering information obtained through this advance metering technology.

(8) AEP is proposing a non-bypassable Energy Efficiency and Peak Demand Cost Reduction Rider. The proposal should be modified to incorporate an exemption or opt-out provision for non-residential customers above a threshold size of 10 kWh per year aggregate load size who individually pursue energy efficiency and/or demand reduction investments (collectively, "DSM"). An opt-out mechanism is consistent with R.C. 4928.66(A)(2)(c) and is appropriate because customers who pursue DSM on their own benefit the system and AEP without using program dollars.

(9) AEP's ESP should be modified to incorporate a generation aggregation program that would allow a customer with multiple accounts taking service under the GS-3 rate schedule to aggregate its loads for the purpose of determining its monthly peak demand for generation service. Such an aggregation program will allow multi-site customers the opportunity to benefit appropriately from the operational diversity of their loads on the system and therefore better aligns costs with cost causation.

III. ARGUMENT

AEP has not proven under R.C. 4928.143 that its ESP proposal is more favorable than an MRO. In order to satisfy the mandates of SB 221 and the Ohio Revised Code, the Commission must modify the ESP as set forth below before approval. The Kroger Co. does not address all aspects of the Company's proposal, but absence of comment on a particular feature of the proposal does not in any way convey support of, or opposition to, that feature.

A. Overall Rates

AEP's ESP proposal is a contrived hybrid of cost-based and non cost-based rate making. Certain proposed rate components, such as environmental carrying costs recovery and distribution reliability investments are calculated based on the components' costs to AEP. The costs of these components are then added to existing rates which are not cost-based.[2] The resulting proposed rates are, therefore, not cost-based. As The Kroger Co. witness Higgins states "a cost-based component added to a non-cost based rate produces another non-cost-based rate."[3]

AEP's hybrid rate making is a case of AEP desiring to have its cake and eat it too. AEP uses increasing costs of some components to justify increasing customer's rates, but AEP disregards the *overall* cost of electric procurement to customers by adding non-cost variables to the rates.

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[2] See J. Craig Baker Direct Testimony at p. 19, lines 7-14.

[3] The Kroger Co. Exhibit 1, Testimony of Kevin Higgins (hereinafter "The Kroger Co. Ex. 1") at p. 6, lines 15-21.

Despite AEP's disregard costs when such disregard is convenient, the retail price to electric customers under an ESP is subject to a Significantly Excessive Earnings Test.[4] This test by its nature, requires some nexus with cost of service.[5] A careful examination of AEP's ESP proposal "as is", gives no indication whether AEP's proposal would pass a Significantly Excessive Earnings Test, because there is no to determine the overall costs to AEP to provide electricity to customers.

As Mr. Higgins notes in his testimony "it would not be in the public interest to knowingly adopt an ESP proposal that was expected to fail a Significantly Excessive Earnings Test."[6] Therefore, AEP's ESP proposal should not be adopted until AEP can show that there is a reasonable cost based justification for increasing its *overall* rates.

B. Generation Rates

AEP's generation rate design suffers from many of the same flaws as its overall rate design. AEP uses a contrived hybrid cost-based/non-cost-based methodology to determine its generation rate increases. AEP uses increased costs of certain components to justify increases in its generation rates when it is "convenient" to do so, but ignores other cost based factors, such as off-system sales margins, when such factors result in more earnings to AEP. Such an approach is inherently unfair to customers and is likely to result in significantly excessive earnings for AEP.

A specific example of this hybrid rate making approach is the method AEP uses to calculate its fuel adjustment clause ("FAC") portion of its generation rates. AEP

[4] R.C. 4928.143(E) requires that AEP be able to show that its return on common equity is not significantly in excess of the return on common equity that is likely to be earned by a similarly situated company.
[5] The Kroger Co. Ex. 1 at p. 7, lines 18-20.
[6] Id. at p. 8, lines 1-2.

recommends that generation rates be increased to recover the difference between variable costs AEP proposes for recovery in the FAC and the Company's estimate of FAC-related costs in current rates. As current rates are not based on costs, the estimation of the latter is simply a calibration exercise in which a portion of existing generation rates are allocated to FAC-related expenses based on a 1999 baseline.[7] All remaining revenues currently recovered in AEP's generation rates are *deemed* to be non-FAC-related, without any actual alignment of non-FAC related costs.[8]

This approach is erroneous, because if AEP is recovering more non-FAC related revenues than non-FAC related costs, AEP could easily be recovering its increased FAC related expenses in its current generation rates. AEP does not demonstrate that its FAC related expenses are not offset by an increase in it its non-FAC related revenues or a decrease in its non-FAC related expenses.

Again, AEP is trying to have its cake, by seeking an overall rate increase for increased FAC related expense, and eat it too, by failing to show its non-FAC expenses are in line with its non-FAC revenues. As Mr. Higgins notes "if rates are to be increased to recover FAC-related costs, then it is reasonable for AEP to be required first to demonstrate that such an increase is necessary for the Company to recover its generation-related costs."[9] Before the Commission approves the substantial generation rate increase that AEP is seeking, at the very least, AEP should be required to show that *net* generation costs have increased and not just the FAC portion of those costs.

[7] See J. Craig Baker Direct Testimony, p. 19, lines 15-19.
[8] The Kroger Co. Ex. 1 at p. 8, lines 11-15.
[9] Id. at p. 8 lines 22-23, p. 9, line 1.

(i) AEP's FAC Rider Should Credit Customers for Off-System Sales.

AEP's proposed ESP inappropriately allocates off-system sales margins to AEP.[10] Off-systems sales margins were created from assets which AEP customers financed through generation rates. AEP customers are entitled to benefit when these assets produce off-system sales. However, AEP retains for itself all of the off-system sales margins without reasonable justification.

AEP's proposal to allocate off-system sales margins is even more egregious considering AEP also proposes "slice-of-system" purchases which procure a certain percentage of electric supply from the electric market.[11] Under AEP's proposed ESP, AEP would be able to sell excess power to the market when the price of electricity is high, keep all of the profits from the sale of that power, and then under the slice-of-system, AEP's customers will be paying the higher rates for market electricity purchases through FAC charges, whether deferred or not.[12] As AEP's witness Assante explains, AEP proposes a periodic on-going FAC cost true-up of 100% of the FAC cost recoveries.[13]

In order to remedy the obvious inequities in AEP's proposal, customers should receive a *full* credit for off-system sales margins. This credit could be made directly to the FAC charge. It is the customers who face the risk of higher rates if AEP's FAC costs increase. Therefore, customers should also be entitled to share in the benefits if AEP's generating assets make a profit.

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[10] J Craig Baker Direct Testimony at p. 38, lines 11-12.

[11] Id. at p. 21, lines 17-20 (AEP proposes market purchases of five percent in 2009, ten percent in 2010 and fifteen percent in 2011)

[12] AEP proposed to defer any FAC increase, in excess of the proposed rate increase, to be paid for by customers after the ESP term.

[13] Assante at p. 5, lines 1-5.

As Mr. Higgins notes in his testimony, "a FAC charge without such a credit is asymmetrical and fundamentally unreasonable."[14] Not only is a credit for off-system sales margins fair and reasonable to customers, but AEP affiliates in West Virginia and Virginia already credit customers with off-system sales margins as an offset to fuel-related charges.[15] Ohio customers deserve the same treatment as customers in West Virginia and Virginia. To not do so is inequitable.

AEP's proposal to exclude off-systems sales margins from the Excessive Earnings Test[16] also suggests that the failure to grant customers a credit for off-system sales profits will result in failure of a Significantly Excessive Earning Test. However, as many top executives of the troubled financial firms have discovered, a simple shift in accounting is not a real solution the underlying inequity, and will only serve to exacerbate the problem down the road. While AEP strongly urges the Commission to grant customers a credit for off-system sales margins, *at a minimum*, , any portion of the off-system sales margins that are not credited to customers should be included in AEP's significantly excessive earnings calculations.[17]

(ii) The Slice-Of-System Proposal Should Not be Included in AEP's ESP.

AEP's proposal to purchase a certain percentage of power from the market through a "slice-of system" auction should not be included in its ESP. If AEP wanted market based rates, they should have applied for an MRO. AEP's proposed slice-of-system purchases will not benefit customers. Rather the slice-of-system purchases will

[14] The Kroger Co. Ex. 1 at p. 9, lines 19-20.
[15] Id. at p. 9, lines 8-10.
[16] See J Craig Baker Direct Testimony at p. 39, lines 3-7.
[17] The Kroger Co. Ex. 1 at p. 9, lines 13-14.

only expose customers to increasingly volatile market rates, even though these customers have already financed generation assets.

Rather than purchasing power from the market, AEP should use its apparent over capacity from its generating assets to supply power directly to customers. Instead, AEP would rather use those assets to generate windfall profits for AEP through off-system sales. As Mr. Higgins notes "the only apparent purpose of these slice-of-system purchases is to serve as a device for increasing prices charged to customers and therefore should not be included in AEP's ESP."[18]

(iii) Generation Charges Should Not be Deferred For Payment At a Later Date.

In an attempt to obscure the massive rate increases proposed by AEP's one sided FAC proposal, AEP offers to defer any rate increase that would exceed fifteen (15) percent in a given year.[19] Unfortunately, simply deferring charges to be paid in the future does not adequately remedy AEP request for a rate increase in excess 15 percent annually despite plummeting energy and fuel prices and the worst economic crisis since the Great Depression.

Rather than benefit customers, deferrals will only force customers to pay more in the future, for electricity used now, because they must pay carrying costs for that electricity. Further as Mr. Higgins notes, the use of deferrals "raises serious concerns with respect to inter-generational equity."[20] AEP's proposed deferral of generation rates

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[18] The Kroger Co. Ex. 1 at p. 9, lines 21-23.
[19] Assante Direct Testimony at p. 5, lines 15-23.
[20] The Kroger Co. Ex. 1 at p. 9, lines 9-10.

will not benefit customers; rather the deferrals benefit AEP in the sense that deferrals give the false impression that AEP is not increasing its rates.

It is not a good public policy to accumulate debt indefinitely. The Kroger Co. does not support AEP's proposed rate increase in excess of 15 percent annually; however, deferrals should not be used as a tool to hide the underlying rate increases in order to blunt the psychological blow of increased rates to customers.

(iv) All Costs Should Be Appropriately Accounted For in The Non-FAC Portion of AEP's Generation Rates.

As noted above, AEP does not appropriately account for costs associated with the Non-FAC portion of its generation rates. Specifically, AEP proposes a non-FAC rate increase to recover capital carrying costs associated with environmental additions[21]; however, AEP's proposed non-FAC recovery mechanism does not account for the accumulated depreciation of these assets which may date back as far as 2001. Moreover, while the adjustment recognizes an offset for the environmental-related component of prior RSP increases, by proposing to add this component to existing rates, AEP does not recognize any increase in accumulated depreciation of existing generation plant in service.[22]

As noted above, this problem arises from the way AEP calculates its increase in generation rates. Rather than accounting for all the non-FAC costs associated with providing generating service, AEP merely assigns the revenues it received from what AEP deems to be the non-FAC portion of its current generation rates. This methodology,

[21] Nelson Direct Testimony at p. 15, lines 18-23 p. 16, lines 1-11.
[22] The Kroger Co. Ex. 1 at p. 10, lines 16-23.

in addition to conflating the concept of revenues and cost, is highly likely to lead to the over recovery on non-FAC rates, because it is susceptible to leaving important parts of the non-FAC costs out of the non-FAC rate calculation. This is evident from AEP's exclusion of the accumulated depreciation of AEP's environmental assets and the increased accumulated depreciation of existing generation plant in service, from the calculation of AEP's non-FAC generation rates.

Before AEP is granted a rate increase to recover capital carrying costs for environmental investments, AEP should be required to demonstrate that these costs represent an increase in the *net* cost of providing non-FAC-related generation service.[23] Specifically, AEP should be required to show that the accumulated depreciation of AEP's environmental assets and the increased accumulated depreciation of existing generation plant in service are included in AEP's non-FAC generation rates.

C. POLR Charge

AEP proposes a recovery of over $500 million throughout the ESP period through a non-bypassable rider to compensate AEP for the risk AEP faces for being the provider of last resort of electricity to customers.[24] AEP calculated this cost recovery through the use of the Black-Scholes option pricing model, which was designed to price options for publicly traded securities.[25] The Black-Scholes model is not an appropriate mechanism to price the "option" that customers have to switch to a competitive retail electric supplier ("CRES"), and accordingly dramatically overprices the risk AEP faces for being a POLR supplier. Further, AEP could easily be compensated for the risk of being a POLR

[23] Id. at p. 11, lines 2-3.
[24] Direct Testimony of J. Craig Baker at p. 34, lines 14-23
[25] Id. at p. 31, lines 8-11.

supplier through a true-up mechanism which will allow AEP to recover the *actual* costs incurred due to customer shopping.

The Black-Scholes model was designed to price options in markets that operate efficiently.[26] Notwithstanding arguments as to whether the market for publicly traded securities operates efficiently, clearly, the Ohio markets for the retail supply of electricity are not "efficient". There are no CRES suppliers operating actively in AEP's Ohio service territory, so it would be very difficult for customers to actually exercise their theoretical option, when no one, other than AEP, is willing to supply them with electricity. Additionally, the vast majority of customers do not check electric prices the way option traders check stock prices. Even if the market price of retail electricity fell below AEP's electric rates, it is unlikely that a large majority of customers would not bother to switch from AEP, especially over the brief three year ESP period.

The result of this "inefficiency" in the markets for retail supply of electricity is a vast over pricing of the "option" for customers.[27] Conversely, the use of the Black-Scholes pricing model to price POLR risk in the inefficient electric retail supply market results in a windfall recovery for AEP. Every time a customer does not switch to a CRES supplier when it is in the customers "economic best interest" to do so (i.e. the market price of electricity falls below AEP's price of electricity), AEP in essence retains the value of the option without actually taking on any risk.[28] The Black-Scholes model was designed to price options that are exercised *every time* it is economically beneficial to do

[26] Transcript Vol. X, Baker, at p. 270, lines 1-6 (Dec. 2, 2008).
[27] AEP's witness Baker admits in cross examination that if it were difficult to exercise an option, the price of the option would go down ,Transcript Vol. X, Baker, at p. 270, lines 1-6 (Dec. 2, 2008).
[28] An analogous scenario would be a brokerage firm selling options, knowing that the buyer of the option is likely not to exercise the option, even if the stock price underlying the option is "in the money".

so. In an environment when the option is not exercised *every time* it is beneficial to do so, than Black-Scholes model will necessarily overprice the option.

Rather than using a complex financial formula which was not designed to be used in the context of pricing electric customer shopping risk, there is a *very simple* way to allow AEP to recover costs AEP may incur due to customer shopping.[29] Rather than build the POLR risk into an up-front premium, the cost of shopping customers can be recovered in a rider to true-up the cost AEP actually incurs due to customer shopping for the term of the ESP. The Kroger Company fails to see how this proposal is any different from AEP's true-up proposals in its generation rates or for its DSM rider.[30] As Mr. Higgins notes in his testimony, this true-up proposal will "remove the POLR risk from AEP and, along with it, the claim that $500 million in POLR charges is necessary to compensate for the risk."[31]

D. Distribution Rates

(i) Any Distribution Rate Increase Should Be Resolved in a Distribution Rate Case.

AEP is proposing to increase CSP distribution rates seven percent each year from 2009-2011 to recover costs associated with its gridSMART initiative and distribution reliability investments. AEP is also proposing to increase OPC distribution rates 6.6 percent each year from 2009-2011 to recover costs associated with distribution reliability investments. AEP is entitled to recover its prudently-incurred costs of providing

[29] AEP's witness Baker admits in cross examination that no other state uses the Black Scholes Model to quantify the price of POLR risk, ,Transcript Vol. XI, Baker, at p. 224 -226.
[30] See Assante Direct Testimony at p. 5, lines 1-5 (AEP proposes a periodic on-going FAC cost true- up of 100% of the FAC cost as part of its generation rate proposal); See also, Assante Direct Testimony at p. 47, lines 22-23, p. 48, lines 1-5.
[31] The Kroger Co. Ex. 1 at p. 11, lines 19-20.

distribution service; however, the best forum for evaluating the reasonable recovery of such costs is a distribution rate case.[32]

Throughout its ESP proposal, AEP proposes several rate adjustments that if adopted would result in a 15 percent annual, and an over fifty percent overall, rate increase for AEP's customers.[33] Additionally, many complex issues have been raised in AEP's proposal, which the Commission and other intervening parties have a limited time to adjudicate, considering the time constraints imposed by SB 221. In light of the substantial rate increase being proposed and the complex issues under consideration in a time constrained proceeding, a separate distribution rate case would allow for the full consideration of distribution rate base, revenues and expenses, as well as rate of return. As Mr. Higgins states in his testimony, "adopting a distribution rate increase based on partial cost information would not be a reasonable course of action."[34]

Separating the distribution portion from the remaining ESP is not unprecedented in the state of Ohio. In FirstEnergy's ESP proceeding, the Commission declined to resolve the issues involved in FirstEnergy's distribution rate case in the context of its ESP.[35] The Commission should follow its own precedent and decline to resolve the distribution rate issues in the context of an ESP for AEP as well. If AEP claims it is entitled to a distribution rate increase, it should do so in the context of a distribution rate case.

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[32] Id. at p.12, lines 13-15.
[33] These numbers do not include any potential transmission rate increases or the proposed deferrals in AEP's generation rate.
[34] Id. at p. 12, lines 19-20.
[35] *Finding and order that the application of FirstEnergy be modified and approved*; PUCO Case No. 08-0935-EL-SSO (December 19, 2008).

(ii) Customers Should Be Granted Full Access to Their Metering Information.

AEP is proposing significant investment in its CSP service territory for advanced metering technology. While any distribution rate increases should be determined in the context of a distribution rate case, The Kroger Co. contends that if this investment is approved by the Commission, customers must have full access to the metering information obtain through this advance metering technology. This access should be granted on a real-time basis without additional charge to customers.

Allowing customers to have full, cost free, access to their own advanced meter reading devices will enable the meters to be used for the purposes for which they were installed. Customers, should be able to use the information to determine when to reduce energy consumption, when necessary, which will thus reduce energy demand on the electric grid as a whole. This practice is in accordance with the principles and mandates of energy efficiency and demand response outlined in SB 221 and the Ohio Revised Code.

In order for customers to use the advanced metering equipment most effectively, customers must be granted access to this information, without additional cost, and on a real-time basis. Customers should not be required to pay an additional charge to access meters which they will already be paying through AEP's distribution rates. As Mr. Higgins notes in his direct testimony "it is important that the propagation of advanced metering be a two-way street, and that providing information to customers be made a high priority if this expenditure is to be justified."[36]

[36] The Kroger Co. Ex. 1 at p. 13, lines 4-6.

E. Energy Efficiency and Peak Demand Cost Reduction Rider

AEP is proposing a new rider that is intended to recover the 2009 costs of energy efficiency and peak demand reduction ("DSM") programs proposed by AEP. The rider would be trued-up annually to reconcile actual recovery and actual program costs. The annual filing would also establish a recovery level for the following year.[37] AEP's ESP proposal should be modified to incorporate an exemption or opt-out provision for non-residential customers above a threshold aggregate load size who pursue DSM investments on their own.[38]

While The Kroger Co. supports efforts to conserve energy and reduce peak demand, these efforts are thwarted if non-residential customers who pursue DSM investments on their own cannot opt-out of the proposed DSM rider. A non-bypassable DSM rider penalizes customers who are already implementing cost efficient DSM investments, and incents them to stop such investments and wait to implement DSM measures until an EDU pays them to implement DSM. This is certainly not an effective or appropriate way to increase energy efficiency and reduce peak demand.

Customers have done quite well achieving energy efficiency and demand reduction on a voluntary basis. Since 1970, U.S. energy consumption, as measured per economic output, has been reduced by 50%. Also, given the right choices of investments in many *cost effective* but under utilized energy efficiency technologies, it is estimated that the United States can *cost effectively* reduce energy consumption by 25-30% more in

[37] Assante Direct Testimony at p. 47, lines 22-23, p. 48, lines 1-5.
[38] The Kroger Co. Ex. 1 at p. 13, lines 17-20.

the next 20-25 years.[39] A non-bypassable DSM rider will hinder this already proven "market based" approach to achieving DSM.

Moreover, an opt-out mechanism for customers who achieve DSM on their own is supported by Ohio Law. R.C. 4928.66(A)(2)(c) provides that any mechanism designed to recover the cost of energy efficiency and peak demand reduction programs may exempt mercantile customers with existing or new demand- response, energy efficiency, or peak demand reduction capability under certain conditions.

For these reasons any ESP approved by the Commission must include a mechanism for customers to opt-out of AEP's DSM rider. A reasonable threshold for opting-out is a minimum monthly demand of 10 MW at a single site, or aggregated at multiple sites within the AEP Ohio service territories.[40] A 10 MW threshold will ensure that Staff will not be overwhelmed by a large number of applications to "opt-out" of AEP's DSM rider, yet will allow customers with the most sophisticated DSM programs to "opt-out" of AEP's likely redundant DSM programs.

An opt-out provision should balance the need for assurance of *bona fide* DSM activity with administrative feasibility. At the time of the election to opt-out, the customer should be required to self-certify or attest to AEP that, for each facility, or aggregated facilities, for which the customer seeks to opt-out, the customer has conducted an energy audit or analysis within the past three years and has implemented, or has plans for implementing, the cost effective measures identified for installation in that audit or analysis. AEP should collect and maintain the self-certifications for the duration of the

[39] See *The Invisible Energy Efficiency Boom: American Council of Energy Efficiency Economy Report*; May 15, 2008, http://aceee.org/press/e083pr.htm.
[40] The Kroger Co. Ex. 1 at p. 13, lines 20-22.

program and make them available to the Commission at its request, subject to appropriate confidential treatment of materials.[41]

F. Generation Aggregation

AEP's ESP should be modified to incorporate a generation aggregation program that would allow customers with multiple accounts taking service under the GS-3 rate schedule to aggregate loads for the purpose of determining monthly peak demand for generation service.[42] This approach allows multi-site customers the opportunity to benefit appropriately from the operational diversity of their loads, provides an additional incentive for these customers to control loads, and most appropriately aligns cost with causation.

Currently, the customer is billed for generation service based on each individual account's peak demand during the month. A generation aggregation program would instead bill the customer for power supply demand based on the customer's peak demand for its aggregated load. This billing method is superior because it gives incentive to a multi-sited customer to coordinate its electric use between each site and thus reduce peak demand. For instance, a generation aggregation program could provide incentives customers to implement rolling peak operational periods for each site, so that no two sites are at peak demand at the same time.

Load aggregation for multi-sited customers also more accurately aligns cost with causation. Multi-sited customers are less expensive to serve as a whole, than individual customers with the same number of sites. This is evidenced by the fact that ordinarily a

[41] The Kroger Co. Ex. 1 at p. 14, lines 14-16.
[42] Id. at p. 14, lines 20-23.

competitive supplier will consider a customer's load as a whole and not just consider the load of each of the customer's individual sites.[43]

The benefits of a generation aggregation program are only enhanced by AEP's intent to take advantage of advanced metering technology.[44] Advanced metering technology, which gives a customer up to the minute information on its electric consumption, will allow multi-site customers to partake in load coordination on a real-time basis. It is conceivable that a multi-sited customer, through advanced metering technology, could notice that its load at a site is high on a particular day, and then order that another site reduce consumption in an effort to reduce overall peak demand.

Generation aggregation would reduce the total billing demand for the rate schedule, thereby requiring a small, revenue-neutral increase in the demand charge for the rate schedule. The amount of adjustment needed in the demand charge can be constrained at the outset through implementation on a pilot basis.[45]

If it would improve the prospect of program acceptance, the generation aggregation program could be implemented on a pilot basis. Consumers Energy Company and Detroit Edison in Michigan have generation aggregation pilot programs in place. In the Consumers Energy program, a customer must have at least seven accounts with an average billing demand of 250 kW on the same rate schedule that can be aggregated. The Detroit Edison program requires at least seven accounts with a minimum aggregate demand of 5 MW. Either of these requirements would constitute reasonable parameters for an AEP Ohio program.[46]

[43] Id. at p. 15, lines 11-12.
[44] Id. at p. 15, lines 12-14.
[45] Id. at p. 16, lines 5-8.
[46] Id. at p. 15, lines 18-23, p. 16, lines 1-2.

IV. CONCLUSION

AEP's proposed ESP contains several proposals that are designed to generate revenue for AEP without any connection to AEP's actual costs. However, in other portions of AEP's proposal, AEP uses cost based rationales as justification to increase rates. This mix and match approach to rate making does not benefit customers, is not more favorable in the aggregate than an MRO and is very likely to generate significantly excessive earnings for AEP.

Before AEP is permitted to increase rates, AEP should be required to show that its *overall* cost of supplying electricity to customers has increased. Rather, in its ESP proposal, AEP vaguely references cost increases when such increases are convenient to justify increased rates, without showing how those cost increases fit into the overall cost of supplying electricity. This hybrid cost based/ non-cost based approach to rate making is problematic and is likely to lead to significantly excessive earnings for AEP. While it may not bother AEP to generate significantly excessive earnings in the midst of the most severe financial crisis since the Great Depression, significantly excessive earnings at any time is not permitted under SB 221. The Commission should modify AEP's ESP so it is likely to pass the Significantly Excessive Earnings Test.

Specifically, the Commission should not approve AEP's proposed FAC increases until AEP can show that there has been an overall increase in the cost of generating electricity. Along those same lines, no increase in the non-FAC generating rates should be approved until AEP can demonstrate that its net non-FAC costs have increased. Tying rate increases to actual cost increases is inherently fair to customers, and is the only way to know that AEP will be likely to pass the Significantly Excessive Earnings Test.

In order to ensure customers get an appropriate share of off system sales margins, a credit for off system sales margins should be applied to the FAC charge. Also, AEP's unnecessary and unwise "slice-of-system" plan to purchase power from the market should be eliminated from its ESP. Finally, AEP's proposed POLR rider, which is likely to create a windfall recovery for AEP, should be rejected and should be replaced by a recovery mechanism that will allow AEP to recover only actual costs incurred due to shopping customers. These measures would help to ensure AEP does not generate significantly excessive earnings from its ESP and would alleviate the perceived need for AEP to implement costly and unwise deferrals in its rates.

There are additional measures that the Commission should take to ensure that AEP's ESP remains more favorable in the aggregate than an MRO. The Commission should approve a mechanism for large non-residential customers to opt-out of AEP's DSM programs and related rider in order to ensure that these customers are not discouraged from making DSM investments on their own. Further, in order to facilitate greater demand reduction, the Commission should create a generation aggregation program that allows customers served under the GS-3 rate schedule to aggregate their loads for the purpose of determining monthly peak demand. These measures would be in line with SB 221's mandates to achieve energy efficiency and peak demand reduction.

Finally, because there has not been enough time and resources to fully deliberate all of the distribution issues in this ESP proceeding, the Commission should follow its own precedent and deny resolving distribution rate issues in the context of an ESP. If the Commission must resolve distribution rate issues in the context of this ESP, the Commission should ensure that customers have full, cost free, real-time access to any advance metering equipment that the Commission approves for installation.

The modifications The Kroger Co. proposes to AEP's ESP must be made in order to ensure that AEP's ESP is more favorable than an MRO and does not generate significantly excessive earnings for AEP.

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