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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

and )

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 OHIO ASSOCIATION OF SCHOOL BUSINESS OFFICIALS,  
THE OHIO SCHOOL BOARDS ASSOCIATION  
AND THE BUCKEYE ASSOCIATION OF SCHOOL ADMINISTRATORS**

**I. Introduction and Statement of Issues**

The Ohio Association of School Business Officials, the Ohio School Boards Association and the Buckeye Association of School Administrators ("Jointly School Administrators") are non-profit organizations made up of public school administrators. The purpose of the School Administrators is to share best practices and information concerning the operation of public educational institutions. Subsequent to the passage of Senate Bill 3 which provided for open access to generation, the School Administrators have run a program called "SchoolPool". SchoolPool is an aggregation of school buildings which allows schools to purchase generation on the open market for less than the tariff because of their load profile. The potential for school buildings to purchase

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generation for less than tariff exists because many school buildings are closed during the summer when electric utilities generally experience their peak load. School Administrator's expert witness Mark Frye testified that "While other consumers may not be able to realize savings [by shopping], it is reasonable to expect that schools generally lower summer consumption will allow at least some of them to secure power at a price lower than offered under the SSO"<sup>1</sup>. That is certainly the case today, for even though the rates of Ohio Power and Columbus Southern Power (Jointly AEP) are some of the lowest in the state, currently some 386 school accounts<sup>2</sup> purchase power via the SchoolPool program in the open market for less than tariff<sup>3</sup>. The annual savings by these 386 school accounts last year was roughly \$420,000<sup>4</sup> or the equivalent of some nine \$50,000 per year teaching posts.

The passage of Senate Bill 221 earlier this year modified the manner in which generation for a standard service offer could be supplied and priced, but it did not alter the basic right of any retail customer to purchase generation on the open market. In fact as noted in the testimony of AEP witness Baker "S.B. 221 makes clear that the promotion of retail competition, including large scale governmental aggregation, is one of the policy goals of the state"<sup>5</sup>.

On July 31, 2008 pursuant to Section 4928.143, Revised Code AEP filed for an Electric Security Plan covering calendar years 2009, 2010 and 2011 ("Application"). The Application featured two significant rate increases that affect SchoolPool customers. The first was a significant increase in both the non fuel generation and fuel generation cost

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<sup>1</sup> Schools Exhibit No. 1, Direct Prepared Testimony of Mark Frye, p. 5.

<sup>2</sup> An account may be one or more buildings aggregated for billing purposes.

<sup>3</sup> *Id.* p. 3.

<sup>4</sup> *Id.*

<sup>5</sup> AEP Exhibit No. 2B Direct Prepared Testimony of Craig Baker, p. 33.

components of the Standard Service Offer. As detailed below these are costs which shopping customers, like the SchoolPool participants, should be able to by pass. AEP however is deferring some or potentially all of these generation costs. The deferral then will be collected as a non by-passable wires charge from all customers – including shopping customers who did not receive the Standard Service Offer generation.

Second, AEP seeks a redesigned Provider of Last Resort (“POLR”) Charge. Under the new POLR charge, Ohio Power customers will face a 153% increase in their POLR fee while Columbus Southern customers will face a whopping 742% increase<sup>6</sup>. The triple digit percentage increases in POLR fee do not provide retail customers of AEP any new or enhanced services. The increases are purely to compensate AEP for what it perceives to be the risk that customers may someday shop and possibly return to the Standard Service Offer<sup>7</sup>.

The School Administrators believe that a need for a deferral has not been established and if a deferral is needed it cannot be administered in such a fashion that customers who do not benefit from the deferral still pay for it. The School Administrators also believe that the proposed POLR fee design and increase requested by AEP is unjust and unreasonable and as such must be rejected. The current POLR is acceptable. If AEP wants additional protection in lieu of its increase in generation costs at a time of falling energy prices, the current POLR could be replaced by one in which there is no POLR fee and customers who return pay the market rate instead of the established Standard Service Offer.

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<sup>6</sup> Schools Exhibit No. 1, Direct Prepared Testimony of Mark Frye, p. 6.

<sup>7</sup> AEP Exhibit 2B, Direct Prepared Testimony of Craig Baker, p. 29-30.

## **II. The Issues**

### **A. The FAC Deferral**

The Application features two significant cost increases for standard service customers purchasing generation. First, AEP seeks a non-fuel generation rate increase of some 3% for Columbus Southern Power customers and 7% for Ohio Power customers<sup>8</sup>. In addition to the non-fuel generation expenses, the proposed ESP calls for the addition of a Fuel Adjustment Clause ("FAC") for both Columbus Southern Power and Ohio Power. The FAC would cover all increases in the cost of coal, gas and oil actually burned in AEP's generation facilities<sup>9</sup> plus the costs associated with capacity and energy from independent suppliers or acquired via the AEP Pool<sup>10</sup>. SchoolPool participants would normally be indifferent to these proposed increases, for since they purchase their generation from Competitive Retail Electric Suppliers, they should not be paying any costs associated with supplying generation to Standard Service Offer customers. The Application though has a deferral provision. Under the deferral provision AEP plans on deferring part or all of the FAC charges<sup>11</sup>. The deferred fuel and purchased power costs which make up the FAC will then be charged back to all customers via a FAC deferral rider whether or not they used the fuel or purchased power .

AEP witness Baker testified that all the cost components of the FAC are generation costs<sup>12</sup>. Further, the FAC (if it is not deferred) is by passable for all shopping customers<sup>13</sup>. AEP however takes the position that by merely deferring the fuel and

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<sup>8</sup> AEP Exhibit No. 2B Direct Prepared Testimony of Craig Baker Attachment exhibit JCB-2 and Direct Prepared Testimony of David Roush Attachment exhibit DMR-1.

<sup>9</sup> Tr. XI, 11.

<sup>10</sup> Id. p. 12-13.

<sup>11</sup> Tr. XI, 25.

<sup>12</sup> Id. at 36.

<sup>13</sup> Id. at 23.

purchased power costs of serving Standard Service Customers, it may charge FAC expenses as a wire surcharge to all customers.

By proposing that generation charges be assessed against customers who do not take generation service, the Application is in violation of the State Energy Policy (Section 4928.02 (H), Revised Code) which states that the Commission shall:

Ensure 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. (emphasis added)

The Commission has recently ruled that the State Energy Policy must be followed in evaluating an Electric Security Plan.

The Commission believes that state policy codified by the General Assembly in Chapter 4928, Revised Code, sets forth important objectives which the Commission must keep in mind when considering all cases filed pursuant to that chapter of the code. Therefore, in determining whether the ESP meets the requirements of Section 4928.143, Revised Code the Commission takes into consideration the policy provisions of Section 4928.02, Revised Code, and we use these policies as a guide in our implementation of Section 4928.143, Revised Code.

In re FirstEnergy, Case No. 08-935-EL-SSO, Opinion and Order, (December 19, 2008) p. 10.

Besides violating the State Energy Policy, the proposed deferral of FAC charges is inequitable because it requires shopping customers to pay for generation they do not receive. AEP witness Mr. Baker acknowledged that a customer who is shopping will not benefit from fuel or purchased power used to supply Standard Service Offer customers,

yet under the FAC Deferral shopping customers will have to pay for a portion of the fuel and purchased power provided to other customers.

Q. Let's take an example now of a customer who is shopping, and they continue to shop through the whole ESP period 2009, 2010, and 2011. Will they have to pay the FAC deferrals in 2012?

A. Yes, they would.

Q. Did they get any benefit of delaying the fuel – do they get any benefit from the fuel costs that were delayed?

A. If they left before the ESP started and truly stayed off the system for the entire three –year period, they would not have gotten any direct benefit associated with the deferral.<sup>14</sup>

Making customers pay for a service they do not receive violates the basic standard that utility rates must be just and reasonable. In this case it will result in shopping customers paying their supplier for generation fuel, purchased power and capacity and also paying AEP for generation fuel, purchased power and capacity. Making shopping customers pay twice for generation expenses violates another State Energy Policy Provision. Section 4928.02 (D), Revised Code requires the Commission to:

Ensure diversity of electricity supplies and suppliers, by giving consumers the effective choices over the selection of those supplies and suppliers and by encouraging the development of distributed and small generation facilities.

School expert witness Frye quantified the impact of the FAC deferral on the current participants if they remained in the SchoolPool programs for the ESP period at the current usage and found it to be \$735,000. In other words, if the deferral was approved, the amount of the double payment for generation, fuel and purchased power to the SchoolPool participants would be roughly three quarters of a million dollars – a

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<sup>14</sup> Tr. XI, 33.

significant amount for public institutions who are struggling with diminishing tax revenues due to the current economic conditions.

In sum, the deferral of FAC charges as proposed does not meet the statutory requirements that generation costs cannot be charged to customers who do not take generation, and that making shopping customers pay for generation fuel and purchased power they do not use is anticompetitive. Even if these statutory provisions did not exist the record in this case does not support the deferrals. Staff Witness Cahaan advised against acceptance of the FAC Deferral noting “Our experience with deferrals shows that they cause many problems and should be avoided whenever possible”<sup>15</sup>. Further, while the cost of the deferrals is estimated at \$461 million<sup>16</sup> over the 36 month period, AEP is yet to articulate why the deferral is needed to ensure price stability. Section 4928.144, Revised Code provides that the Commission “may” approve a phase in, but the criterion for doing so is the need for price stability. At the end of the ESP period customers will be facing a price increase up to the true cost of fuel and purchased power, plus the impact of the FAC deferral. In other words, the proposed deferral appears to create a potential price spike for 2012. No party save AEP supports the FAC deferral and the Commission should simply modify the ESP plan as presented by eliminating the FAC deferral.

#### **B. The POLR Increases are Not Supported by Law or Fact**

Currently, both Ohio Power and Columbus Southern Power charge a non-by passable POLR charge. The POLR charge was established in Case No. 04-169-EL-UNC as part of the Rate Stabilization Program. It entitles a customer who shops to return to the Standard Service Offer at the Standard Service Price then being offered. As the

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<sup>15</sup> Staff Exhibit No. 10, Direct Prepared Testimony of Richard Cahaan, p. 5.

<sup>16</sup> OCC Exhibit 10, Direct Prepared Testimony of Lee Smith, p. 34.

Schools witness Frye aptly described it, the POLR fee is effectively electric price supply insurance<sup>17</sup>. In its Application AEP seeks to increase the POLR fee to some \$108 million dollars for Columbus Southern Power and \$60.9 million annually for Ohio Power<sup>18</sup>. The rates themselves are set out at Mr. Roush's Direct Prepared Testimony Exhibits DMR-9, page 133 of 285 for Columbus Southern and Exhibit DMR-10, page 134 of 295 for Ohio Power. The basis for the new POLR rates is the application of a Black-Scholes model that AEP believes values the option open to a customer to either shop or take the Standard Service Offer at the established Standard Service Offer price. Section 4928.143 (C) (1), Revised Code places upon the utility the burden of proving its ESP rate changes. Thus, in the matter at bar, AEP must show that its new POLR meets the statutory standard. Since only a utility can provide the POLR service, the POLR service is a non competitive service under Section 4928.03, Revised Code and, as such, must meet the standards that it is just and reasonable as required of all utility fees under Section 4905.22, Revised Code.

School expert witness Frye finds three flaws with the use of the Black-Scholes model to set the POLR rate<sup>19</sup>. First, there is no demonstration that the POLR fee requested is based on a cost to the utility. AEP describes the Black-Scholes model as an options model, but neglects to state whether AEP plans to buy such options<sup>20</sup>. Nor is any other cost presented to offset the estimated \$507 million of POLR fees AEP is expected to collect in POLR fees during the ESP<sup>21</sup>. Second, the Black-Scholes model, when determining the risk upon which the option value was set, assumed all customers would

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<sup>17</sup> Schools Exhibit No. 1, Direct Prepared Testimony of Mark Frye, p. 7.

<sup>18</sup> AEP Exhibit 2B Direct Prepared Testimony of Craig Baker, p. 34.

<sup>19</sup> Schools Exhibit No. 1, Direct Prepared Testimony of Mark Frye, p. 7.

<sup>20</sup> Id.

<sup>21</sup> Id.



switch if the market price fell below the Standard Service Offer price. Mr. Frye points that this fails to consider the impediments a consumer or consumer group would face if they return<sup>22</sup>. A customer is unlikely to return even if the Standard Service price falls below the market price if the customer is contractually obligated for an established term of a third party supply agreement. Staff Witness Cahaan<sup>23</sup> had a similar concern with the use of an option trading model to determine a risk of migration, observing that while it is relatively easy to know when an option is “in the money” the same kind of price transparency is not always available for generation contracts.

Third, Mr. Frye observed that there are minimum stay provisions. If commercial customers such as the participants in SchoolPool were to decide to return to Standard Service, they would be obligated to stay with the Standard Service for the designated period of time. This time period could be up to a year even if the market price was then lower than the Standard Service price.

To meet its burden of proof, AEP Ohio should have first shown that the Black-Scholes model was appropriate for pricing POLR services. No such predicate was presented. In fact, the record reveals that neither Mr. Baker nor any other expert witness knew of another utility using or of a state Commission approving Black-Scholes as a method to determine POLR charges<sup>24</sup>. Further, to meet the dictates of Section 4905.22, Revised Code, AEP had to not only establish that the Black-Scholes model was a reasonable method to use to establish a POLR fee, but that the POLR fee itself was just and reasonable. The record in this matter shows that AEP has no greater anticipated

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<sup>22</sup> *Id.* at 8

<sup>23</sup> Staff Exhibit No.10, Direct Prepared Testimony of Richard Cahaan, p. 7.


<sup>24</sup> Expert witness Emily Medine also knew of no application of Black-Scholes by a utility to compute a POLR price OCC Exhibit No. 11, Direct Prepared Testimony of Emily Medine, p. 17.

expense to provide essentially the same POLR service it provides now. Further, the record reveals that AEP cannot face a wave of shopping customers returning to Standard Service. Mr. Baker testified that there were very few shopping customers at this time<sup>25</sup>. Thus, there is no potential for a wave of shopping customers to return. Since AEP has not presented any evidence that the current POLR charge is not adequate to meet the expense of shopping customers, the POLR rate should not increased.

### III. Conclusion

WHEREFORE, the School Administrators request that the Commission reject the FAC deferral and the proposed increase in the POLR charges requested in the Application.

Respectfully Submitted,

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<sup>25</sup> TR. Vol. XI, p. 33.

## CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and accurate copy of the foregoing document was served this 30<sup>th</sup> day of December, 2008 by regular U.S. mail, postage prepaid, or by electronic mail, upon the persons listed below.



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