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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; and Amendment to its Corporate Separation Plan; and the Sale or Transfer of 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; and an Amendment to its Corporate Separation Plan.	))))	Case No. 08-918-EL-SSO

REPLY BRIEF OF THE APPALACHIAN PEOPLE'S ACTION COALITION AND OHIO PARTNERS FOR AFFORDABLE ENERGY

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INTRODUCTION

The standard for approval of an Standard Service Offer ("SSO") under R.C. 4928.143, is whether "the electric security plan ("ESP") so approved, including its pricing and all other terms and conditions, including deferrals and any future recovery of deferrals, is more favorable in the aggregate" than a Market Rate Option ("MRO"). R.C. 4928.143(C)(1). Although this is the standard articulated, one must examine the test within the entire statutory framework, which provides for much more than whether the ESP is $1 less than the MRO, the myopic view that AEP seems to endorse. The ESP proposed by Columbus Southern Power Company ("CSP") and Ohio Power Company ("OPCO"), (collectively "AEP" or "the Companies") fails the test. The 'Competitive Benchmark', as AEP terms the MRO defined and priced by the Companies, clearly overstates wholesale market prices. This is not surprising given the dysfunctional wholesale market, a primary reason the General

Assembly passed Am. Sub. SB 221 ("SB 221").[1] As a result, making a comparison between the two options – ESP and MRO -- *as defined in the Application* cannot occur. Add to that the overwhelming excesses of the proposed distribution charges and the entire enterprise implodes in the face of statutory requirements. The point is not to design an ESP that is just ever so slightly better than an MRO. It is to design a regulated package of services that provides a reasonable rate, adequate service, and strategies to hedge against future environmental and fuel costs.

SB 221 did not repeal the public interest. The statute represents transparency, an attempt to grapple with wholesale markets that cannot support retail competition, and an effort to balance the interests of customers with monopoly distribution utilities and unregulated oligopolies in the wholesale generation markets. This requires looking forward, attempting to forecast the evolving wholesale market, and establishing rational baselines from which to determine future costs. State policy is reaffirmed, revised, and supplemented in order to provide the Public Utilities Commission of Ohio ("PUCO") with principles to be used to guide application of the statute. The new law reflects the need for reasonable and stable rates despite the immaturity of the wholesale market. It requires investment in energy efficiency and demand reduction, the least cost supply options. And, it requires investments in renewable energy to mitigate the risks of cost increases resulting from future carbon dioxide standards not to mention those ongoing costs to control conventional pollutants such as fine particulates and mercury, and sulfur dioxide. The SSO is insurance for ratepayers, insurance against continuing wholesale and retail market failure.

[1] Company Witness Baker notes that "over the last ten years, wholesale power prices have proven to be one of the most volatile commodities traded." AEP Exhibit 2E at 10, *Post-Hearing Brief* at 45.

SSO procurement must guard against unknown risks, from which AEP also seeks to insulate itself.

CSP and OPCO take a schizophrenic approach to interpreting the statute, shifting between past, present, and future, the only common denominator being the approach serves to maximize the revenue due AEP. The Companies reach back to 1999 to determine the appropriate fuel cost baseline. Environmental compliance costs look back to 2001, the opening of competition in Ohio. Monongahela Power and ORMET obligations date to after the Rate Stabilization Plan but prior to the point where "the Companies' Standard Service Offer (SSO) would be fully market based". *AEP Post-Hearing Brief* at 40 (Baker). So in the view of the Companies the ESP should reflect excessive fuel cost increases, environmental compliance costs the Companies agreed could be funded without rendering the powerplants 'above-market', and, perpetual compensation for the privilege of serving new customers – the Monongahela Power and ORMET loads.

Customers have paid in excess of the rates a competitive market should provide since 2001. The disconnect between the promise of the market and the reality of monopoly prompted the Governor and the General Assembly to once again take up the issue of utility regulation in 2007-08. The balance struck in SB 221 recognized the stark economic reality faced by its customers, large and small. It also recognized the need to consider the imperative to provide the lowest possible rates in light of the necessity of providing utilities with adequate revenue to compensate their shareholders and more importantly discharge the corporate responsibilities as the monopoly provider of a Standard Service Offer and distribution services.

Energy, including electricity, is an essential service in a modern society. Customers cannot afford the price AEP wants us to pay for monopoly services. The Companies will generate adequate profits at lower rates. SB 221 does not authorize maximum rates, it requires reasonably priced electric service. R.C. 4928.02(A). The record supports a clear path to equitable rates and the Commission should either reject the application or modify it as necessary to provide the appropriate balance between customer and utility. Our state's economy and the welfare of our citizenry depend on it.

ARGUMENT -- The ESP proposed by AEP is not more favorable in the aggregate than a market rate option and should be modified or rejected by the Commission.

Few of the elements in the ESP proposed by the Companies are justified. AEP views the statute as permitting recovery of revenues "without limitation"; cost is irrelevant. R.C. 4928.143(B)(2). The Companies ignore, however, the details and criteria of the following divisions (2)(a) through (h), many of which require cost justification. The Application's provisions are designed to produce, in the aggregate, a revenue target of more than $3 billion per year over three years (partially deferred) and determined by the management of AEP to maximize the return to its shareholders. That is, according to conventional wisdom, the most important function of a business, to maximize the return to shareholders. Ohio law, as established by SB 221, requires a more balanced and equitable approach. It requires the price charged for the SSO to be justified and reasonable. Simply providing an SSO at a rate below a price yielded by an inflated 'market rate' fails to pass muster.

The Fuel Adjustment Clause ("FAC")

Including variable costs in an adjustable rider can be an appropriate recovery mechanism under SB 221. The obvious question is the appropriate baseline by which to measure changes in the cost. AEP reaches back to the unbundled fuel cost in the original capped rate defined by SB 3 which reflects fuel costs established in early 1990s rate cases. Staff and the OCC offer more rational proposals. They assume that current rates recover current fuel costs and that future adjustments should reflect upward or downward variance from present costs. It is reasonable to presume that AEP did not shortchange itself in the ETP stipulation or the RSP and RCP agreements and fail to recover the revenue necessary to defray the cost of fuel, emissions allowances, and purchased power as can be determined from FERC filings. In 2007, CSP had an ROE of 22.12%, while OPCO earned 11.72%; in neither case is the utility suffering from under-recovery. OEG Exhibit 3, Exhibit LK-2, 1 of 2 (Kollen). As a result, current costs represent the best baseline from which to calculate future adjustments.

The proposal by the Companies to incorporate slice-of-system purchases of 5, 10, and 15 percent of loads in 2009, 2010, and 2011 suffers from a different flaw. AEP proposes to bid this load out and price it at 'market' based on a full-requirements purchase, essentially laundering power from its own plants through the wholesale market resulting in higher profits for the Companies. The Commission has already rejected a slice-of-system procurement process absent a showing that the auction approach meets the policy requirements of R.C.

4928.02. See Case No. 08-935-EL-SSO, Opinion and Order at 17. (November 25, 2008). As noted by the Commission, "...a procurement process where the Companies obtain blocks of wholesale power, rather than full requirements service, may result in significantly reduced cost...." Id.

AEP attempts to justify this flawed procurement process by recalling the requirements of meeting the Monongahela Power and ORMET loads. *AEP Initial Brief* at 37-28. Once again, AEP is looking backwards rather than forwards as required by the new law. As Company Witness Baker acknowledges, former Monongahela Power customers are now customers of CSP as is ORMET. Tr.Vol X at 268. While it may be that a larger customer base should be "reflected in the ESP" as noted by Mr. Baker, there is no justification for charging prices determined through an auction process already rejected by the Commission. AEP Exhibit 2E at 7.

The Companies also seek to justify this less than sophisticated purchase proposal under the rallying cry of economic development. Unfortunately, the causal relationship of overpriced procurement of electric power to economic development is tenuous at best. AEP's approach to economic development is to purchase power at a price higher than market, sell the power at heavily discounted prices to favored mercantile and industrial customers, and charge all other customers for the delta revenue – the difference between the cost of the power and the price it is sold. That's not economic development, it is taking from the 'poor' – AEP residential, small commercial, small industrial customers -- and giving to those not quite so destitute – AEP's preferred customers.

Generation Price adjustments unrelated to fuel.

Justification for other generation increases outside the FAC –referred to as non-FAC – also fail to pass any rational basis test. AEP, with its massive fleet of coal-fired power plants, is constantly litigating against and investing in environmental control systems. The Companies acknowledged that wholesale prices would cover the costs of additional environmental controls when it negotiated the settlement of its ETP under SB 3. Recovery for environmental compliance costs was provided under the RSP, which presumably fully compensated AEP. Now the Companies seek to revive costs dating back to 2001 for recovery. As noted above, current rates should be presumed to compensate the Companies for their costs; AEP negotiated the agreements presumably to cover its costs and, based on the record, provide a handsome profit. The Commission affirmed the agreements. The issue now is costs going forward. Those are the only costs for which recovery through an ESP is authorized.

AEP also requests a continuation of the 3 percent and 7 percent increases in base (non-FAC) generation rates over the next three years, doubling the increased offerings already digested by the Companies. AEP Witness Baker acknowledges the rate hikes are not based on price, but contends the increases qualify for automatic recovery under R.C. 4029.143(2)(a). The problem is that the division permits automatic recovery only if "the cost is prudently incurred". Id. It is difficult to conclude that a fixed price increase that is not justified by actual costs can be prudent within the meaning of the statute. Yes, there are risks of all types that a utility may confront, but utility commissions generally, and the Ohio Commission in particular, have never been shy about springing to the rescue of a utility in financial distress. Customers would rather pay the actual cost should some horrible event increase utility expenses than insure a monopoly utility against unquantifiable risk. This is the functional equivalent of including storm recovery costs in base rates, compensating a utility for extraordinary costs through ordinary revenues. Even if current recovery includes some projected extraordinary event, the Companies are likely to request additional funding if the event actually occurs. The Companies expressly reject the need to justify a charge that has no basis other than to extract additional revenue from customers.

That brings us to the Provider of Last Resort ("POLR") charge, a charge that has little relationship to market realities. CSP and OPCO have, for all intents and purposes, no shopping customers. There are no competitive offers available to residential and most other customers. One might reasonably conclude (correctly) that the likelihood of customers switching from the SSO would be slight. AEP, however, comes up with an option pricing model, the Black-Scholes Model, that it says will do the trick of pricing its POLR risk. We should ignore that the Model has provided the foundation for the speculation in options and derivatives that have broken stock markets internationally in recent weeks. we should also remain oblivious to the fact that the Model has never been used to price POLR risk in any of the states that have deregulated.

Cutting to the quick, there is no need for a model to tell us what we know: there is no POLR risk to AEP. The Federal Energy Regulatory Commission may not find customers to be captive if they have the legal right to shop, but that cannot obscure the fact that virtually no AEP customers have an actual ability to shop. The Companies retreat to remarkable leaps in logic to justify their excessive POLR, arguing that the General Assembly could not have contemplated an ESP rate based on market prices, which is what would result if shopping customers returned at a price based on wholesale, and would change the law if such a thing occurred! Unjustified speculation on the course of action a future General Assembly may choose cannot provide a justification for such significant increase in rates. An ESP must be "better in the aggregate" than an MRO but that does not mean a lower price for returning customers. If a customer wants to live by the market, he theoretically has that option under Ohio's hybrid regulatory scheme. That does not negate the justification for an ESP nor the advantages such a plan can provide to utilities, including the ability to add nonbypassable charges that impede shopping like the POLR charge proposed by AEP.

AEP proposes to defer portions of the FAC for future recovery in order to keep the generation rate increase below 15 percent per year. As APAC and OPAE have noted, this amounts to putting costs above a certain level on a credit card customers will pay off between 2012 and 2019 at interest rates that far exceed current market rates. As indicated by the discussion above, there is no reason to defer portions of the increases because the overall increases are not justified. Customers will pay a reasonable rate now. There is no need to defer a portion of reasonable charges into the future.

Distribution Charges

The Companies, as a part of the continuing saga of AEP's reliability problem, ask for fixed annual increases to improve the operation of the distribution system. Unfortunately, there is no plan to justify the investment by customers, simply broad expense categories with no defined outcomes. The Companies are already required to provide reliable service; the authority under R.C. 4928.143(B)(2)(h) is for enhancements, which are never defined. AEP's plan hardly represents an "alignment of interests" between a utility and its customers as contemplated by SB 221. Id.

AEP's smartGrid proposal – which definitely resembles a research and development project – explicitly ignores any analysis of cost and benefit. Instead, the proposal will lead to large distribution rate increases without any significant offsetting benefits, particularly for at-risk customers who lack the income necessary to make the investments necessary to produce any savings. Tr. III at 271 (Sloneker). It lumps together a reasonable proposal, distribution automation, with two other components – advanced meters and home area networks – that are nothing more than cartoons in the Application.

The only part of the proposal which makes any sense is the proposed energy efficiency and demand response collaborative process. With the commitment of the Companies and other parties, it can succeed. But the measures of success of the collaborative are required by the statute, so it can hardly be enough to render this ESP more favorable in the aggregate given the other endemic flaws of the Application. The statute requires compliance with efficiency and demand response standards because it must be done under either the MRO or ESP option.

CONCLUSION

APAC and OPAE have offered a path that will result in an SSO through a modification of the proposed ESP that complies with statutory requirements. AEP should conduct a procurement planning process based on an integrated resource plan that is designed to provide a reasonable, stable rate for the ESP period. The provisions related to energy efficiency, demand reduction, and advanced energy targets should be incorporated using a longer planning horizon. Collectively, these mandates – which reflect the least-cost options for the future – should be used to define the energy and capacity that must be obtained from existing generation owned by the Company and the market, as appropriate.

SB 221 does not authorized electric utilities to establish a revenue target for a multi-year period and create a series of revenue streams from base rate and rider charges that are not justified. It cannot compare that rate option with a competitive benchmark that is excessive and based on a theoretical auction process for a product the Commission has already ruled fails to comply with the statute. Add in the distribution elements, which involve large infusions of money for ill-defined outcomes (other than the efficiency and demand reduction collaborative), and the ESP package is simply not "more favorable in the aggregate" than the price even this wholesale market could produce.

The Commission should consider stripping most of the distribution provisions, other than the collaborative, from the plan and defer their consideration to a long overdue distribution rate case. Slice-of-system purchases should be rejected in favor of portfolio planning that takes into account legislative mandates to adopt new technology. The Companies should be adequately compensated for their generation, with recovery of prudently incurred variable costs. The rates should be set with a recognition that the investment of SSO purchasers is for only three years, not for the lifetime of the plants. There is no justification for short-term purchases to shoulder the burdens of future investments in generation for which they will see no benefit. Most importantly, the plan approved by the Commission should recognize Ohio's current economic situation in order to properly address the public interest. The General Assembly affirmed the regulatory authority of the Commission and the goal of reasonable rates. APAC and OPAE urge the Commission to follow that path.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of this Reply Brief was served by regular U.S. Mail, postage prepaid, and electronically upon the parties of record identified below on this 14th day of January, 2009.

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