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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 an Electric Security Plan; an 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**

COLUMBUS SOUTHERN POWER COMPANY'S AND OHIO POWER COMPANY'S INITIAL MERIT FILING ON REMAND

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BACKGROUND

On April 19, 2011, the Supreme Court of Ohio issued a Slip Opinion in Case No. 2009-2022 regarding the 13 alleged errors raised by the Ohio Consumers' Counsel (OCC) and the Industrial Energy Users-Ohio (IEU) in connection with the Commission's 2009 decision in AEP Ohio's ESP in Case Nos. 08-917-EL-SSO and 08-918-EL-SSO. *See* Supreme Court of Ohio Slip Opinion No. 2011-Ohio-1788. More specifically regarding the April 19 Decision, the Court reversed the Commission's ESP order on three issues and remanded two of those issues (Provider of Last Report (POLR) charge and environmental carrying charge) to the Commission for further consideration, since the first issue was essentially moot. The Court did not attempt to apply its decisions to AEP Ohio's existing rates; in fact, the Court explicitly left open the option for the Commission to provide further basis and authority for the decision the Commission already made in a remand proceeding.

Regarding the Companies' POLR charges, the Court held that the record did not provide adequate support for approving the charges on the basis of out-of-pocket costs. Accordingly, the Court held that the Commission had abused its discretion in approving the POLR charges. (Decision, ¶ 29.) Regarding the non-fuel generation rate increase based on environmental investment carrying costs, the Court reversed the Commission's legal determination that Ohio Rev. Code §4928.143(B)(2) permits ESP's to include rate adjustments not specifically enumerated in paragraphs (a) through (h) of division (B)(2). The Court affirmed the Commission's decision in all other respects, specifically rejecting all other propositions of law proffered by the appellant customer representatives.

On May 4, 2011, the Court issued its mandate – making the Slip Opinion the final decision of the Court and passing jurisdiction back to the Commission in order to conduct a

remand proceeding (hereinafter referred to as the Court's "Decision"). Also on May 4, 2011, the Commission issued an Entry: (1) ordering that AEP Ohio file proposed tariffs that would remove the authorized POLR and specific environmental rate increases, and (2) permitting AEP Ohio to come back with a new filing to substantiate the POLR charge and/or the environmental carrying charge. In response to the May 4 Entry, AEP Ohio filed the compliance tariffs under protest, along with an application for rehearing and pending motions requesting that the Commission reject or hold in abeyance the tariffs (or, in the alternative, to prospectively convert the two involved rate increases to being collected subject to refund during the pending remand proceeding). This initial merit filing addresses the issues remanded to the Commission by the Court's Decision and is also designed to initiate the process contemplated in paragraph 5 of the May 4 Entry for supporting and/or reinstating the POLR and environmental charges.

SUMMARY OF ARGUMENT

1. AEP Ohio's position on remand regarding the ESP Order's non-fuel generation rate increase for carrying costs on pre-ESP environmental investment (Proposition of Law No. I)

Regarding the non-fuel generation rate increase associated with 2001-2008 environmental investment, the Court held only that R.C. 4928.143(B)(2) does not permit ESPs to include the recovery of costs not specifically enumerated in the statute. (Decision, ¶ 35.) The Court remanded this issue to the Commission for a narrow legal determination of whether any of the listed categories of (B)(2) authorize the recovery of such environmental carrying charges. (Decision, ¶35.) In other words, the Commission can determine on remand the portion of the ESP statute supports recovery of these same environmental carrying costs.

Whatever the Commission's reservations or concerns may be about the basis for the POLR charge, there is no dispute that the specific environmental carrying charges was based on:

(1) environmental investments that were required under State and Federal law, (2) the underlying investments were incremental costs not previously reflected in rates, and (3) the investments were prudently-incurred costs that were actually made by AEP Ohio. This type of investment is fundamental to the operation of fossil-fuel based generation facilities and supports considerable economic development in Ohio.

The Commission can simply verify that an alternative basis in the ESP statute exists to support the existing charge that was adopted for all the factual and policy reasons initially set forth in the ESP order – independent of any process employed to address the POLR charge issues. As discussed further below, paragraph (B)(2)(d) of the ESP statute authorizes the Commission to establish "terms, conditions, or charges relating to … carrying costs …" That provision provides the Commission with an alternative basis to support the continued recovery of the challenged environmental carrying charge. In addition, at least two other subdivisions of the ESP statute also provide a statutory basis for the environmental carrying cost charges: (B)(2)(b) (an environmental expenditure for any generating facility of the electric distribution utility) and (B)(2)(e) (which authorizes automatic increases in any component of the standard service price). There is no reason to conduct a lengthy remand proceeding regarding this narrow legal question. Rather, the Commission should act expeditiously to determine on remand (even if it is separate from any determination regarding the POLR charge) that the environmental charge be sustained. This type of investment is fundamental for operating utility-owned fossil-fuel generation and if the Commission doe not support such basic cost recovery for incremental environmental investments not previously reflected in rates, then maintaining and continuing to operate existing fossil-fuel generation within the State of Ohio will simply become uneconomic for traditional investor-owned utilities.

2. AEP Ohio's position on remand regarding the POLR charges adopted in the ESP Order (Proposition of Law Nos. II-VI)

The ESP Order approved POLR charges for the Companies, finding that "the POLR rider will be based on the cost to the Companies to be the POLR and carry the risks associated therewith . . . ." Opinion and Order March 19, 2009 at page 40. Again, on rehearing in the ESP Cases, the Commission stated that it had "determined that the Companies should be compensated for the cost of carrying the risk associated with being the POLR provider." Entry on Rehearing, at page 26, ¶ 76 (July 23, 2009). Thus, the premise of the ESP Order's decision to permit an increase in the POLR charge was to compensate AEP Ohio for carrying the POLR risk – not to reimburse the Company for an out-of-pocket expenditure. The Court reversed and remanded the provisions of the Commission's order authorizing the POLR charge solely because it found "the manifest weight of the evidence contradicts the commission's conclusion that the POLR charge is based on cost." (Decision, ¶ 29.)

The Court was concerned by the Commission's characterization of the POLR charge as "cost-based" because it could not find in its own review of the record any evidence "suggesting that AEP's POLR charge is related to any costs it will incur." (Decision, ¶ 24-25.) The Court appears to have expected an out-of-pocket expense (as opposed to an opportunity cost, a projected cost or a modeled cost). (Decision, ¶ 27.) The Court also criticized the Commission for not explaining the relationship between the value to the customer for the optionality of shopping and the cost to the Companies for the associated POLR risk. (Decision, ¶ 26-27.)

Thus, the Court's reversal as to the POLR issue was a reversal due to insufficient explanation or documentation; it was not a reversal on the merits of the Commission's approval of the increased POLR charges over the three years of the ESP. Significantly, the Court

affirmatively stated that the Commission "may revisit this issue" on remand and explicitly left it open for the Commission to rely on a model or some other formula-based POLR justification not dependent upon evidence of out-of-pocket costs. (Decision, ¶ 30.) As to the POLR issue, the Court concluded: "However the commission chooses to proceed, it should explain its rationale, respond to contrary positions, and support its decision with appropriate evidence." (*Id.*)

As a prefatory matter, AEP Ohio maintains (Proposition of Law No. II) that the only debate on remand should be reconsidering the appropriate compensatory level of the POLR charges – not whether the entire POLR charge increase awarded by the ESP Order should be eliminated. AEP Ohio's POLR obligations under SB 221 will continue to apply and the POLR risk was widely acknowledged during the hearing in this case. Further, as referenced above, the ESP Order clearly intended to compensate AEP Ohio for the POLR risk, not to reimburse AEP Ohio for out-of-pocket expenses that were incurred. POLR risk creates a real cost as a result of the diminution of shareholder's equity stemming from the increased risk premium required to compensate for the POLR obligation. Moreover, the business and financial aspects of the POLR risk were real at the time of the ESP Order and have been confirmed since that time through actual customer shopping. Another reason to reject the idea that the ESP Order's POLR charge increase should be eliminated is that the Commission has authorized all of the other Ohio electric distribution utilities to collect comparable POLR charges.

In that context, AEP Ohio's first recommended POLR remand option (Proposition of Law No. III) is to request that the Commission re-evaluate the existing evidentiary record and provide a clarified explanation of the basis for retaining the existing POLR charges. The Court's determination that the existing record does not support the Commission's characterization of the POLR charges as "cost-based" (as narrowly viewed by the Court to mean out-of-pocket expense)

does not mean that the existing record cannot support the reasonableness of the POLR charges. As discussed below in detail, there is an adequate basis in the existing record to support a finding on remand that the POLR charges continue to be appropriate, without regard to whether or the extent to which the Companies incur out-of-pocket costs or expenses while bearing the POLR risk. The Court's Decision merely requires a clarified explanation of the approved charge. Accordingly, the Companies request that the Commission establish a schedule for a full briefing by all parties of the adequacy of the existing record to support the current POLR charges.

In the event that the Commission concludes that the existing record may not provide sufficient evidentiary support for the POLR charges in light of the Court's Decision, the Companies' second POLR remand option (Proposition of Law No. IV) is that the Commission schedule a hearing at which the Companies can introduce additional evidence in support of POLR charges that compensate them for discharging their POLR obligations. AEP Ohio has retained independent subject matter experts to help present additional information and evidence to the Commission as is necessary – two affidavits are attached to this brief outlining some of the basic positions to be offered. Thus, AEP Ohio intends to present testimony that further supports and explains the existence and magnitude of the POLR risks that it bears as a result of the optionality that Ohio law has given to all customers to choose an alternative generation supplier and also to return to AEP Ohio's SSO generation service. The evidence will further demonstrate that the POLR risks, whether viewed as imposing costs on the Companies or as creating greater risks for shareholders that diminish the Companies' value, require compensation. The evidence will also provide additional bases for quantifying the appropriate level of compensation, through POLR charges, that the Companies should receive.

Finally, to the extent that the Commission believes that additional evidence is necessary to support the POLR charges for the remainder of the existing ESP term, AEP Ohio's third alternative POLR remand option (Proposition of Law No. V) is that the Commission utilize the upcoming hearing scheduled in Case Nos. 11-346 EL-SSO and 11-348-EL-SSO, in order to efficiently and singularly address the issue of the appropriate level of the POLR charges. For efficiency and to avoid overlapping parallel litigation on closely related matters, the Companies would propose under this option that the upcoming Commission decision regarding the appropriate POLR charges for the new ESP also be used to establish the appropriate POLR charges, based on the record established in a consolidated hearing process, for the portion of the period of the current ESPs governed by the Commission's remand order. As explained below, these options are paired with a modified procedural schedule in the pending ESP cases and a remand decision ordering that the POLR charges are prospectively converted into being collected subject to refund based on the final outcome of the consolidated POLR decision.

ARGUMENT

I. Regarding the non-fuel generation rate increase reflecting a carrying charge on pre-ESP environmental investment, the narrow legal question on remand can be easily addressed by substantiating the rate increase based on one of multiple provisions within the ESP statute.

The Commission should conduct an expedited remand process to verify that an alternative basis in the ESP statute exists to support the non-fuel generation rate increase based on the carrying cost for pre-ESP environmental investments – independent of the process employed to address the POLR charge issues. There are multiple bases upon which the environmental carrying costs can be substantiated in the ESP statute, as discussed below. These

environmental investments were prudent and were not previously reflected in rates. As such, the remand issue is a very narrow legal question that can quickly and independently be addressed without waiting for disposition of the relatively more complex POLR issues.

The Companies have made, and continue to make, significant capital investments in environmental facilities. They requested to include, in their ESPs, increases to their base (non-FAC) generation rates specifically for recovery of carrying costs for the incremental amounts of these investments made during the 2001-2008 period that were not currently reflected in their SSO rates. Companies' witness Nelson supported the Companies' proposal. (Companies' Ex. 7, pp. 15-20 and Exhibits PJN-8 through PJN-12). The annual capital carrying costs for the incremental 2001-2008 environmental investments not currently reflected in rates amounted to $84 million for OPCo and $26 million for CSP. Exhibit PJN-8 provided the calculation of these amounts.

Mr. Nelson testified that the annual carrying cost on incremental capital investments made through 2008 is based on the 2001-2008 net cumulative environmental capital expenditures for each Company multiplied by its carrying cost rate. (*Id.*, at 16-17). The Staff recommended that the Companies be allowed recovery of these capital carrying costs on 2001-2008 environmental investments that were not presently reflected in their existing rates. (Staff Ex. 6, p. 5). Staff witness Soliman stated that "[t]he companies' compliance with the current and future environmental requirements is in the public interest, and they should continue investing in environmental equipment." (*Id.*).

The Commission approved the Companies' proposal for recovery of the carrying costs on the incremental capital expenditures in the Opinion and Order and, in its July 23rd Entry on Rehearing, at page 12, again confirmed that the carrying costs fall within the ESP period and,

therefore, may be included in the ESP. (ESP Order, at 28; Entry on Rehearing, at 12). As such, the Commission approved provisions in AEP Ohio's ESP for recovery of the capital carrying costs of investments in environmental control facilities made during 2001-2008 but not already reflected in their rates through adjustments made during their prior RSP proceedings. Although the incremental capital expenditures involved in that provision of the ESPs were made in 2001-2008, the carrying costs that the provision enables the Companies to recover were, or are being, incurred during 2009-2011.

Nothing in the Court's Decision undermines the legitimacy or record support for these prudent environmental investments, nor does the Decision take issue with the Commission's finding that the investments were not already reflected in rates. In short, there is no policy or record basis to curtail or discontinue AEP Ohio's recovery of the non-fuel generation rate increase related to the environmental carrying charges – provided the Commission can determine an alternative legal basis supporting the recovery other than the "without limitation" language in division (B)(2) of the ESP statute that was originally relied upon.

Regarding the narrow legal issue on remand as to whether alternative legal bases exist to support the environmental investment carrying cost recovery, there are multiple bases in the ESP statute to support such recovery. For example, division (B)(2)(d) authorizes the Commission to establish "terms, conditions, or charges relating to … carrying costs …" In addition, at least two other subdivisions of ESP statute also provide a statutory basis for the environmental carrying cost charges: (B)(2)(e) (which authorizes automatic increases in any component of the standard service price) and (B)(2)(b) (an environmental expenditure for any generating facility of the electric distribution utility). Each of these three legal bases will be briefly addressed.

First, division (B)(2)(d) authorizes the Commission to establish "terms, conditions, or charges relating to ... carrying costs ..." That provision provides the Commission with an alternative basis (besides division (B)(2)'s "without limitation" clause) to support the continued recovery of the challenged environmental carrying charge. There is no more reasonable and appropriate basis for a generation charge than carrying charges on generation-related capital investments. Because division (B)(2)(d) expressly permits recovery of carrying costs, this provision supports continued recovery of environmental carrying costs. And, per the statute, the effect of perpetuating the useful lives of existing generation assets through prudent, economic environmental investments would have the effect of stabilizing rates – especially when compared to the cost of investing in new generation.

A second equally applicable legal basis to support the recovery of environmental carrying costs is found in division (B)(2)(e) of the ESP statute. That provision authorizes automatic increases in any component of the standard service price. Allowing automatic rate increases for environmental investment carrying costs is not a new concept. Under AEP Ohio's prior rate plan (Rate Stabilization Plan), automatic rate increases were permitted based on demonstrating that environmental investments were actually made. AEP Ohio notes in this regard that the Commission found, on page 28 of the ESP Order, that its initial decision regarding the recovery of continuing carrying costs on environmental investments "is consistent with our decision in the 07-63 Case and the RSP 4 Percent Cases." Division (B)(2)(e)'s allowance for automatic rate increases applies here and it would be appropriate to invoke that provision as an additional legal basis for supporting the ESP order's decision to permit a non-fuel generation rate increase to recover carrying costs for environmental investments

Another legal basis to support the recovery of environmental carrying costs is division (B)(2)(b) of the ESP statute. Division (B)(2)(b), in pertinent part, allows inclusion in an ESP of a provision that provides cost recovery "for an environmental expenditure for an electric generating facility of the [EDU], provided the cost is incurred or the expenditure occurs on or after January 1, 2009". The non-fuel generation rate increase permitted recovery of the carrying costs for the capital environmental expenditures, not the capital expenditures themselves. The current record confirms that while the capital expenditures were made prior to January 1, 2009, "the carrying cost itself is the carrying cost [the Companies are] going to incur in 2009" and thereafter. (Tr. XIV, pp. 93, 114). As the Commission correctly found in its Entry on Rehearing, at page 12, "[t]he carrying costs on the environmental investments fall within the ESP period" and properly concluded that the carrying costs should be included in the ESP. Since division (B)(2)(b) allows a reasonable surcharge to recoup an environmental investment, certainly the carrying costs reflected in the ESP Order's non-fuel generation rate increase would qualify.

In sum, the Commission has multiple alternative bases for continuing or reinstating the ESP Order's non-fuel generation rate increase related to carrying costs for environmental investments *and should do so without delay.*

II. Regarding the POLR charge, the only debate during the remand proceeding should be reconsidering the appropriate level of the charge, not whether the ESP Order's entire POLR charge increase should be eliminated – because the POLR obligation under Ohio law continues to exist and be discharged by AEP Ohio.

Eliminating the ESP Order's entire POLR charge increase in response to the Court's decision would not be reasonable, for a number of reasons. AEP Ohio's legal obligation to be the POLR will continue to exist and compensation for discharging the obligations needs to be

addressed, not ignored. Other utilities have POLR charges that are comparable in level to AEP Ohio's current charges. Consequently, the only debate about the POLR charge during the remand proceeding should be around an appropriate compensatory level of the charge – not whether the entire POLR charge increase should be eliminated.

A. AEP Ohio's POLR obligations under the law continue.

Am. Sub. S.B. No. 3, 1999 Ohio SB 3, effective October 5, 1999 (SB 3), restructured regulation of electric utilities and introduced retail customer choice for electric generation service, largely deregulating generation service in Ohio. Am. Sub. S.B. No. 221, 2007 Ohio SB 221, effective July 31, 2008 (SB 221), modified the method for setting standard service offer (SSO) rates for electric service and created new requirements for alternative energy, energy efficiency and peak demand reductions. Thus, through the enactment of SB 3 by the General Assembly (and retained by SB 221), customers were given the statutory right to shop for generation service on their own or as part of an aggregated group. Of equal importance here, SB 3 granted customers the related right to avoid market-based rates by taking service under the SSO of their electric distribution utility (EDU). Ohio Rev. Code Ann. 4928.141. As a related but distinct matter, customers can also return to the EDU's SSO if they shopped for generation service and subsequently decided to return or if their competitive service provider defaulted on its obligation to serve. Ohio Rev. Code Ann. 4928.14. Despite significant changes made to the regulatory framework established by SB 3 back in 1999, the enactment of SB 221 in 2008 retained the same "customer choice" components as the cornerstone of the continuing structure for deregulation of electric service in Ohio.

A corollary to these customer rights is the EDU's obligation to be the Provider of Last Resort (POLR), a requirement imposed on EDUs by multiple statutory provisions. R.C. 4928.141(A) imposes on an EDU the requirement to provide consumers within its certified service territory "a standard service offer of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service." Ohio Rev. Code Ann. 4928.141(A). When coupled with the right to choose a retail generation supplier, availability of the SSO to any customer means that a customer can freely leave the EDU when the market price is lower than the SSO rate and can just as easily return when the market price rises above the stabilized SSO rate. Given the volatile nature of market prices for electricity, there exists a potential for "churn" or migration of customers on and off SSO service. Another POLR obligation is based on R.C. 4928.14, which provides that customers of a defaulting competitive provider may return to the EDU's SSO until the customers choose an alternative supplier. Ohio Rev. Code Ann. 4928.14. EDUs such as AEP Ohio must stand ready to serve in these situations and fulfill their statutory POLR obligation. There should be no question that AEP Ohio is entitled to fair compensation for discharging its mandatory POLR obligation.

B. AEP Ohio's POLR risks and costs were widely acknowledged by Staff and other Intervenors during the hearing in this case.

Even the Staff and Intervenors that opposed the level of the Company's proposed POLR charge in the original proceeding recognized and acknowledged the POLR risk, translated into the opportunity or obligation cost, associated with the Companies' POLR obligation. Mr. Frye, a witness for a large group of intervening school boards and administrators, acknowledged that in a prior proceeding he testified that "POLR is a financial obligation an electric distribution company (EDU) incurs in the competitive generation market created by SB 3 whereby the EDU

accepts revenue in return for the obligation to sell power to returning customers at its market-based standard service offer." (Tr. XII, pp. 48, 49; Co. Supp. pp. 8, 9). This "financial obligation" is even greater in an ESP under SB 221 since that SSO rate available to returning customers is not market-based.

In addition to Mr. Frye's testimony, the Staff's witness Mr. Cahaan, testified:

> There are actually two risks involved. The risk that is usually discussed in the context of the POLR obligation is the risk of customers coming back. But before a customer comes back, the customer must leave in the first place, so there is also the optionality associated with leaving. The companies are claiming that this optionality also has a value for which compensation must be made. (Staff Ex. 10, p. 6; Co. Supp. p. 32).[1]

Mr. Cahaan further testified:

> If the Commission allows customers to return to the standard service offer without any conditions or barriers, and if they can take the standard service offer price, then the company is bearing a risk that has been traditionally identified as a POLR risk. (Tr. XIII, pp. 36, 37; Co. Supp.10, 11).

In addition, Mr. Barron, a witness for intervenor Ohio Energy Group (OEG), while not endorsing the Companies' POLR charge computation, "certainly accept[s] the concept of a POLR charge and that there are risks....OEG and I agree that the concept of a POLR charge to recognize some measure of risk is not unreasonable." (Tr. II, 146; Co. Supp. p. 1).

Even OCC's witness, Ms. Medine, testified that there is a POLR cost associated with customers that switch to a rate from a competitive supplier offering a rate below the ESP rate. She agreed during cross-examination that "the POLR cost is the difference between the standard service offer price and what [the Companies] were able to realize on that power that they previously had been using to serve those customers. (Tr. VI, p. 221; Co. Supp. p. 4). All of this evidence abundantly and cumulatively supports the Commission findings that POLR risks and

[1] While the Staff thought there were ways to reduce the compensation associated with these POLR risks, the Companies, and more importantly the Commission, rejected Staff's alternatives.

related costs exist and the EDU should be compensated. That has not changed as a result of the Court's Decision regarding the ESP Order's rationale supporting the specific charge that was adopted.

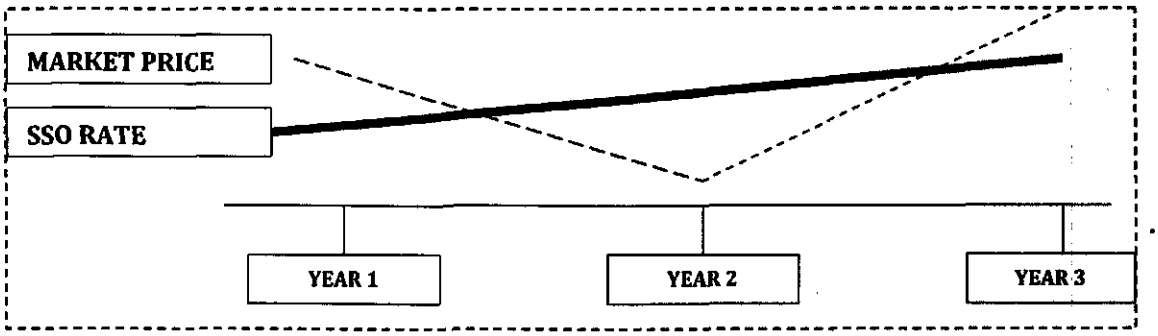
C. The business and financial aspects of POLR risk faced by AEP Ohio were real at the time of the ESP Order and have been confirmed since that time through actual shopping.

Regarding the migration risk (that customers could leave, *i.e.*, migrate, when market prices drop below the SSO rate during the period of the ESP), the ESP Order acknowledged that risk and agreed that 90% of the requested POLR revenue requirement should be allowed to compensate AEP Ohio for that migration or shopping risk. (*ESP Cases*, Opinion and Order at 39-40.) Regarding the second risk (a shopping customer subsequently returning to the SSO rate when the market price goes up), the Commission separately acknowledged that risk and permitted shopping customers to only bypass the POLR charge if they agree to pay a market price when/if they subsequently return to SSO service; otherwise, shopping customers would continue to pay the POLR charge during the time they received service by a competitive service provider. (*Id.* at 40.) Thus, AEP Ohio's approved POLR charge is based on the interrelationship between the cost to the Companies of providing this service and the value to the customers of having the "optionality" provided by SB 221.

Economically rational customers will exercise their rights to change providers when the economic benefits are apparent. On the other side of the transaction, however, AEP Ohio bears the difference between market and ESP prices as a loss and collecting the approved POLR charge enables it to stand ready to discharge its POLR obligations. The value of the customers' right to switch under S.B. 221 comes from the *option* customers are given to switch suppliers, while still having the safety net of the ESP rate to come back to, *if* electricity prices move in a

way that makes switching back to the Companies an economically attractive choice or if their supplier defaults.

The value of that option exists at the beginning of the ESP term, independent of the actual outcomes that materialize in the future. AEP Ohio committed at the outset of the term of their ESP, based on current circumstances and uncertainties, to provide an SSO price for the full three-year term and undertake the attendant POLR risk. The diagram below illustrates this relationship through a hypothetical example:

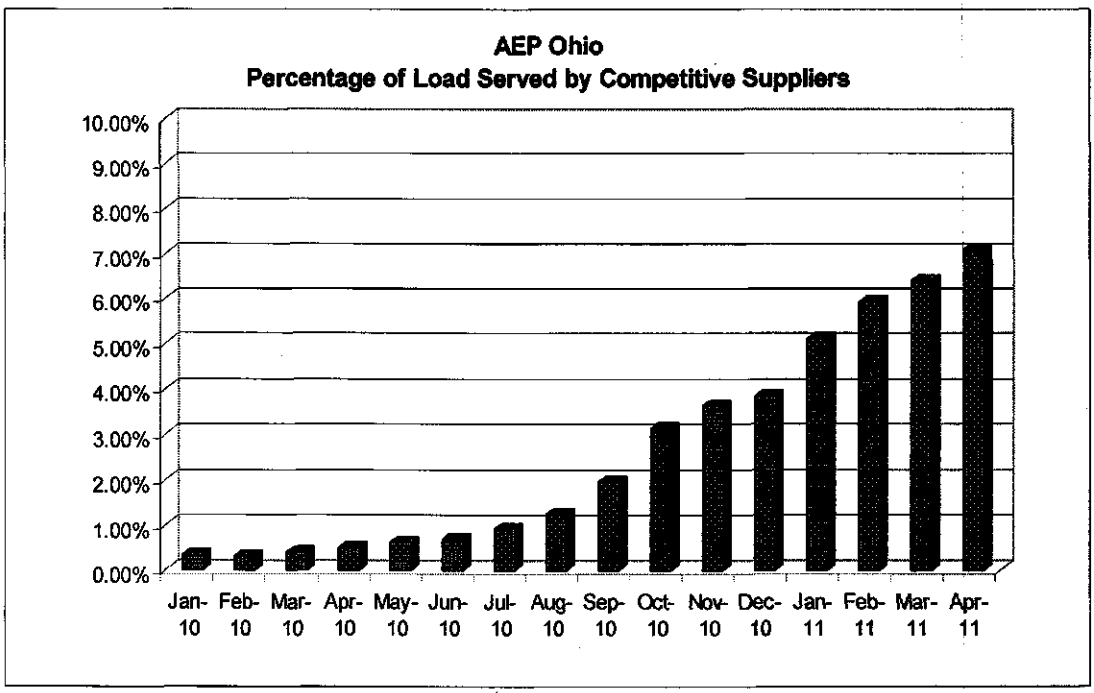


Under this hypothetical, customers are likely to stay on (or return to) the SSO rate in years 1 and 3, while they would likely shop in the market during year 2. At the outset of AEP Ohio's three-year ESP, nobody (including AEP Ohio) could predict with certainty where the market price (dotted line) would go during the subsequent three years. There are a myriad of factors that affect the market price of electricity, causing it to be volatile over any given period of time. Yet, AEP Ohio's obligation to support the SSO price during the entire ESP term was *firmly established on the first day of the ESP*. The migration risk, for which the Commission authorized AEP Ohio's POLR charge, is illustrated in year 2 when customers could leave the SSO to pursue more favorable market prices. The amount collected through the POLR charge allowed AEP Ohio to ride out those fluctuations in market price.

The POLR risk exists because customers can switch; it is not based on whether they exercise their right to switch. An option gives one a right (but not the obligation) to do

something, and one pays for that right and another is appropriately compensated for ensuring that right. The value and legitimacy of the option is not dependent upon whether it is exercised. Like purchasing casualty or fire insurance covering one's home, it is common to pay for insurance coverage and the event being insured against never occurs. The fact that an insured event may not occur does not diminish the value that such insurance coverage provides to the policy holder. Nonetheless, the insurance company stands ready to cover damages arising from a fire or casualty and is obligated to do so and, of course, there are costs to the insurance company to stand ready to pay any valid claim. However, in the event of a fire or casualty, the insurance company is obligated to abide by the policy and cover the loss. Similarly, a customer can return to SSO service from the Company when market rates go up – because they have paid the POLR charge.

Even though the up front POLR risk is not tied to the actual level of shopping (because all customers have to option to shop during the entire ESP term and market prices during the ESP term are unknown), shopping levels for AEP Ohio customers have increased substantially during the term of the ESP. As of April 2011, 4.1 billion kWh of AEP Ohio's retail sales have switched to CRES providers with nearly 14,000 customers switching and another 1,100 customers currently with switch orders pending (the actual switches for those will occur in May or June). The acceleration of customer shopping in AEP Ohio's service territory is rapid, as reflected in the following table:



AEP Ohio notes that its current 10% shopping range is where Duke and DP&L were less than two years ago and those companies are presently experiencing 40-70% shopping of their retail load. There is no feasible argument that AEP Ohio does not face and experience substantial POLR risk that results from being required to offer all customers at all times its SSO price while those same customers have the right to accept or reject that price at any time. Nor can there be any doubt that carrying that risk creates a significant liability and, thus, costs for the Companies.

Moreover, empirically speaking, AEP Ohio's customers recognize the value received in exchange for the current POLR charge. *Specifically, the overwhelming majority of AEP Ohio's shopping customers recognize the value of the current POLR charge and have voluntarily elected to keep paying it during the time they are shopping.* Only a small fraction of customers has opted to bypass the POLR charge and pay market prices if they return (currently only about 358 out of 13,951 shopping customers – or less than 3% – have viewed the risk of returning at market price as being acceptable in order to bypass the POLR charge while shopping). In any

case, because AEP Ohio's POLR obligation is statutory and will not be eliminated during the term of the ESP, the approved POLR charge should not be eliminated.

D. Other Electric Distribution Utilities have POLR charges that are comparable to the level of AEP Ohio's current charge.

Further evidence that it would be unreasonable to simply eliminate the current POLR charge is found in the fact that all of the other Ohio EDUs have comparable POLR charges. While the specifics of the other EDUs' POLR charges differ in scope and degree, they all have POLR charges that are at least compensatory at some level. Thus, it would be unfair, unreasonable, and constitute disparate treatment of AEP Ohio if the Commission were to over-react to the Supreme Court's Decision by eliminating the entire POLR increase awarded in the ESP Order.

Each of the Ohio electric utilities which own generation currently have POLR charges that were established under their respective ESPs. For Duke Energy Ohio (Duke) and The Dayton Power and Light Company (DP&L), the Commission has approved non-bypassable charges for providing stable pricing during the ESP period and for providing POLR service The charges themselves vary by company, and the supporting analyses for the charges do not rely upon out-of-pocket expenditures by the utilities for their POLR service.

For a typical residential customer using 1000 kWh or less, the table below summarizes the POLR charges for each Ohio utility that owns generation. As shown in the table, the POLR charges for OPCo and CSP, approved by the Commission in Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, are comparable to, if not less than, the charges approved for Duke and DP&L.

Typical Residential (1,000 kWh) Monthly POLR Charge

Company	Block	Rate	Monthly POLR
DP&L	0-750 kWH	$0.0063400	
	750-1000 kWh	$0.0051700	$6.05
Duke	All kWh	$0.0026740	$2.67
CSP	All kWh	$0.0056955	$5.70
OPCo	All kWh	$0.0023366	$2.34

Note: May 11, 2011 tariff submission shows monthly POLR of $0.82 for CSP and $1.62 for OPCo.

FirstEnergy's (FE) Ohio electric utilities, which no longer own generation, collect POLR charges in a different manner. FE's POLR charges are embedded in the SSO generation rates which are the result of a competitive bidding process. This process essentially moves the risks of serving customers at the SSO price, and the migration risk, from FE to the winning auction bidders (*i.e.*, the actual suppliers of generation service). Accordingly, one of the components included in the auction clearing prices for a "slice of system" is the risk that customers will migrate away from and/or return to the SSO offer. This element is not provided separately in FE's tariffs, but is included in SSO prices produced by the competitively bidding process. Moreover, FE has a separate tracker for reimbursement of any supplier default costs incurred in connection with that aspect of its POLR risk. In Case No. 04-1371-EL-ATA, the PUCO recognized that these migration risks affect the competitive bid price and, thus, the cost of the SSO generation service that is paid by customers. Specifically, in making an apples-to-apples comparison between the auction clearing prices and FE's market-based SSO price, the Commission's auction consultant, Charles River Associates Incorporated, explicitly factored in a migration risk for the shopping risk not covered by the customer choice hedge fee. (See December 8, 2004 Post-Auction Report)

AEP Ohio submits that the POLR risk is substantial and verifiable, and it applies to all EDUs in Ohio. To the extent that the Commission is not comfortable with the supporting basis for AEP Ohio's current POLR charges, perhaps the Commission should initiate a generic

investigation to establish parameters for addressing POLR in a more consistent manner among all Ohio EDUs. That is the approach the Commission took in connection with SB 221's significantly excessive earnings test. Regardless of whether the Commission decides to initiate a generic electric utility proceeding or not, it should permit AEP Ohio an opportunity to fully address those issues through a fair and deliberate process prior to considering changing, or at the extreme, eliminating the entire POLR charge increase authorized in the ESP Order.

III. The existing evidentiary record provides an adequate basis for the current POLR charges that the Commission established in the ESP Order.

The Court's Decision stated, at ¶28, that the "evidence raises doubts about the proposition that AEP would justifiably *expend* $500 million to bear the POLR risk." (Emphasis added.) And, at ¶30, the Court allowed that, as one alternative on remand, the Commission may consider whether it is appropriate to allow AEP to present evidence of its "*actual* POLR costs." (Emphasis added.) Accordingly, one premise of the Court's conclusion that the Commission erred by characterizing that the POLR charges as cost-based appears to be that the measure of costs that the Commission relied upon was out-of-pocket expenditures by the Companies. It is true that there is not existing evidence of out-of-pocket expenditures that supports the Companies' POLR charges (*i.e.*, an invoice, purchase order, etc.). However, there is ample evidence in the existing record regarding the substantial risks that the Companies face to discharge their POLR obligations, ample evidence of the modeled or projected costs of managing and absorbing those risks – whether characterized as opportunity costs, accounting costs, financial obligations, economic costs, or out-of-pocket expenditures - and ample evidence that the POLR charges that the Commission established for them provide reasonable compensation to the Companies for bearing the POLR risks.

A. The Existing Record Adequately Supports the Conclusion That the POLR Obligation, Through Which Customers Receive the Option to Switch to Competitive Suppliers of Generation Service and Then Back to the EDU, Creates Substantial Risks for and Imposes Significant Costs on the EDU.

In his direct testimony Companies witness Baker described the risks that the Companies face as the provider of last resort operating under an ESP. The risks include the possibility that customers will migrate away from the Companies' SSO generation service during the term of the ESP when market prices are relatively low compared to the SSO price (migration risk), and then return to the Companies' SSO if market prices increase back above the SSO level or if the customer's CRES provider defaults (return risk):

> This flexibility leaves the Companies in the precarious position of being exposed to losing generation service load when the market price is low but needing to stand ready to begin serving that load again when the market price is high, and the case of a CRES or other supplier default, doing so at a moment's notice. There is a definite and significant cost associated with providing this flexibility.
> (Cos. Ex. 2A, p. 26.)

Staff witness Cahaan agreed that the Companies face migration risk (Tr. Vol. XIII, pp. 37-39) and, if customers who migrate are allowed to return at the ESP SSO price, the Companies also face return risk (Tr. Vol. XIII, pp. 36-37).

Mr. Baker next explained how the risks of the Companies' POLR responsibility create very real and significant costs. He also explained that an option pricing model is a useful tool for estimating the costs of the POLR obligation:

> The costs of AEP's POLR obligation can be best understood in light of potentially having to buy high and sell low. Wholesale price volatility and the asymmetric impacts of retail choice - i.e., the customer is the party who holds the ability to choose if and when they want to take service from a competitive retail provider or under the utility's ESP plan – are the keys to understanding AEP's cost of providing its POLR obligation. The customers' option to switch providers can be demanded opportunistically, at the economic convenience of customers. In fact, Ohio's desire to create structures and incentives to encourage customer switching is one of the stated policy goals of SB 221. When determining the cost of AEP's POLR obligation, it is important to realize that in financial terms, such one-sided rights that customers receive through retail choice are

equivalent to a series of options on power. When it becomes apparent that there are economic benefits from switching between a competitive supplier and the ESP price, the rational customer will exercise his or her flexibility to change providers. AEP, however, will bear the difference between market and ESP prices as a loss. Thus, an option pricing model provides an effective way to calculate the cost of AEP's POLR obligation.

(Cos. Ex. 2A, pp. 30-31.)

Mr. Baker testified on rebuttal that the "migration risk" that the Companies face as the result of being required to offer to all customers the SSO generation service, as part of their ESP, is above and beyond the migration risk that EDUs face as a result of customers leaving or arriving on their systems as part of the normal ebb and flow of the customer base:

> The "migration risk" we are talking about now, however, is in addition to the ebb and flow of the customer base. Now, customers can stay on the Companies' systems, but switch to a competitive generation supplier. . . . [Staff witness] Mr. Cahaan, [OEG witness] Mr. Baron and [OCC witness] Ms. Medine agree that this risk exists. Mr. Cahaan also acknowledges that this component of risk would be reflected as part of the price in the context of competitive bidding for a power auction in a deregulated state.

(Cos. Ex. 2E, p. 13.)

Mr. Baker emphasized, also on rebuttal, that, even with the POLR charges that the Companies proposed, they remained exposed to costs far greater that the amounts that customers would pay through those charges. He also observed that failing to recognize the significant risks and the costs to the Companies that resulted would be fundamentally unfair:

> The Companies are committing now, based on current circumstances and uncertainties, to provide an SSO price for the full three-year period of the ESP. The seller of that option, in this case the Companies not a third party supplier responding to an auction, assumes the *risk* of customer switching. The consequences leave the Companies exposed to costs far in excess of the amount customers paid for the option. The source of the value for the customer, given to them through the right to switch providers, comes from the choice they have in the future to switch if it is to their benefit, and to return to the ESP price when the option is to their benefit. The cost of the POLR obligation for the Companies arises from the fact that the Companies must manage their portfolio recognizing the options given to customers – or face much higher costs when the option is exercised. Such a "heads I lose, tails I lose" proposition, which would result from not compensating the Companies for the risk, is fundamentally unfair.

(Cos. Ex. 2E, p. 15.)

The existing record demonstrates that the POLR migration and return risks that the Companies bear are substantial and the costs that those risks cause are significant.

B. The Existing Record Provides Adequate Support for Using the Black-Scholes Model to Estimate the Costs to Provide a POLR Service

Mr. Baker described in detail the Black-Scholes option pricing model that the Companies relied upon to estimate their costs of bearing the combined migration and return risks that Ohio law imposes on them. (Cos. Ex. 2A, pp. 31-33.) He also supported the appropriateness of relying upon the Black-Scholes model for estimating the costs of providing the optionality that creates the POLR migration and return risks. Mr. Baker also testified about the optionality risk associated with competitive power auctions in connection with retail choice jurisdictions:

> Let's think about the environment in those states, the PJM states with competition and customer choice. In those states the distribution companies do not have generation assets and are not required to put those generation assets for supply to the customers for them to come and go at a tariff-based rate that is not market.
>
> What happens in those states is the distribution company generally goes out for an auction. In the auction the POLR responsibility and the effects of customers coming and going then sits with the supplier...
>
> (Tr. Vol. XI, p. 162.)

Mr. Baker explained that, in his opinion, the optionality that the Companies are required to furnish in Ohio in their role as the EDU providing SSO generation service under an ESP is similar to the optionality provided by a third-party supplier of POLR generation service in a fully deregulated state. Consequently, in his view, use of the Black-Scholes model is appropriate for pricing the cost of providing the optionality in connection with POLR auctions in deregulated states and it is appropriate for the Companies to use that model to estimate their costs of providing customers similar optionality through their ESP SSOs:

> I'm saying the use of the model is an effective tool to price optionality, so I see it similar between the optionality that the distribution company in this case provides

customers as a to a supplier who provides the optionality to customers in a deregulated state like Maryland or New Jersey.

(Tr. Vol. XI, p. 164.)

Mr. Baker also addressed the question of whether the Companies would purchase hedging contracts using amounts collected from customers through the POLR charges. He explained that the Company could choose to either purchase such hedges or just take the risk on itself, i.e., self-insure against the risk. (Tr. Vol. XI, p. 172.) Mr. Baker also explained that customers are indifferent to the Company's decisions in that regard. (Tr. Vol. X, p. 214.)

The record provides ample support for use of the Black-Scholes model as a means to estimate the costs that the Companies incur to bear the POLR migration and return risks. While the costs that the Companies incur may not result from cash expenditures, the costs that they bear are nevertheless very real and significant, and they should be compensated for those costs.

C. The Existing Record Demonstrates That the Application of the Black-Scholes Model Using the Inputs Selected by the Companies and Approved by the Commission Produced Conservative Estimates (i.e., likely underestimated) the costs to the Companies of bearing and fulfilling their POLR obligations during the 2009-2011 Term of the ESP.

The record also demonstrated that the levels of the existing POLR charges that the Commission approved as part of their ESPs provide reasonable compensation for the POLR risks that the Companies bear. Mr. Baker addressed concerns and suggestions about several of the inputs that he used to run the Black-Scholes model. In particular, he responded to criticisms that a lower competitive wholesale market rate during the ESP should have been assumed. He addressed suggestions that a U.S. Treasury-type rate should have been used instead of the higher London Interbank Offered Rate (LIBOR) as a measure of risk-free debt. He also addressed concerns that for purposes of the model he had assumed that the ESP SSO prices would remain fixed for the three-year term of the ESP instead of increasing from in the second and third years.

His response to these criticisms and questions was simple and straightforward. The assumptions that he used in each case led to lower option prices and, thus, lower POLR cost estimates than what would have resulted if he had used the alternatives suggested:

> I am confident that if we changed all the inputs, as people have suggested, changed – lower the market price, go to a Treasury-type rate, change the ESP [strike price] to be the three-year ESP [strike prices], if we made all those changes, I'm confident that the POLR charge would be higher.

(Tr. Vol. XI, pp. 174-175.)

Mr. Baker also responded to suggestions that the Black-Scholes model, and the costs that it estimated for the Companies' POLR risks, might overestimate those costs because it assumes that customers will make economic choices. He explained that, while the model did not assume that some customers would not choose to migrate away or return when the economic choice would be to migrate or return, the conservative assumptions he made regarding the model's inputs would offset any impact of customers not acting in their economic self interest:

> The use of the Black-Scholes model, as I said, doesn't build in a customer who does not take the economic option, but I would say that that doesn't discount the use of the model, number one, or necessarily say the number is wrong because in doing it, as we've told you, we took a lot of conservative approaches on the other side which kept the POLR down.
>
> So there are balancing, for example, the fact that we used a single ESP price rather than increasing it for the price of the ESP for each of the three years, which would have driven it up significantly higher, or the change in market prices that some people have suggested. So there are things on both sides of the model, so I think it's a valid number.

(Tr. Vol. XIV, pp. 224-25.)

Accordingly, the record supported the reasonableness of the Black-Scholes model as a means to accurately estimate the costs (not simply limited to out-of-pocket costs) to the Companies, and, thus, the compensation they should receive, for bearing the POLR risks. The Companies believe that the Black-Scholes model applied in the manner that Mr. Baker's

testimony supported using the existing record also can be considered as resulting in a formula-based POLR charge. The Court's Decision left open for the Commission the option of using a formula-based approach to establish POLR charges for the Companies. In this instance use of the Black-Scholes model as the basis for POLR charge formula, while not also based on out-of-pocket expenditures, would have the virtue of being based on a reasonable estimate of the costs of the Companies' POLR risks.

IV. In the event the Commission determines that the existing record does not contain sufficient evidence to adequately support the current POLR charges, it should promptly schedule a hearing process in which AEP Ohio may provide additional evidence to support more of a cost-based POLR charge.

In the event that the Commission concludes that the existing record might not provide a sufficient evidentiary basis for confirming that the current POLR charges are appropriate, the Companies are prepared to present additional evidence in support of those charges. This approach would involve an additional litigation schedule providing for expeditious testimony and briefing. In the mean time, one of the remedies outlined in the Companies' May 11 Motions should be implemented pending the outcome of the remand proceeding on the merits.

A. AEP Ohio can present independent expert testimony to further demonstrate that POLR costs are substantial and verifiable

One approach that the Companies intend to use to support the reasonableness of the current POLR charges is through the presentation of additional cost-based approaches. Supporting this filing is an attached affidavit from an independent energy auction and power market expert, Dr. Chantale LaCassse of NERA Economic Consulting – an individual with a firm that is familiar to the Commission as having been integrally involved in energy auctions

conducted in Ohio.[2] NERA and Dr. LaCasse are prepared to file testimony supporting the development of a cost-based POLR charge for AEP Ohio.

Specifically, Dr. LaCasse maintains that bidders participating in the auctions utilize various methods to determine the shopping risk premium that is included in their bids. (LaCasse Affidavit, Ex. A, at ¶ 7.) For the auctions conducted to date in Ohio, she confirms that the clearing price resulting from the competitive bidding process to procure SSO supply reflects an incremental price premium associated with the shopping risk since winning suppliers are required to supply load that fluctuates for shopping. (LaCasse Affidavit, Ex. A, at ¶ 8.) For an EDU operating under an ESP rate plan that relies on a supply of generation procured through a competitive bidding process, the shopping risk is transferred to the winning suppliers. (LaCasse Affidavit, Ex. A, at ¶¶ 8-10.) But for an EDU supplying its own generation resources through an ESP rate plan, Dr. LaCasse opines that such an EDU would bear the entire shopping risk for 100% of the SSO generation load. (LaCasse Affidavit, Ex. A, at ¶ 11.) Since the same shopping risk is involved in both situations, Dr. LaCasse maintains that it is reasonable and appropriate to use the same methods described above in connection with competitive bidding process suppliers. (LaCasse Affidavit, Ex. A, at ¶ 11.) In addition to the existing methods being used by suppliers, NERA is working with AEP Ohio to evaluate and develop other methods of determining the cost of the shopping risk. (LaCasse Affidavit, Ex. A, at ¶ 12.) Accordingly, AEP Ohio requests an opportunity to do so – not only in the remand proceeding but for the purpose of the pending ESP proceeding (Case Nos. 11-346-EL-SSO et al.).

[2] Because Dr. LaCasse was traveling at the time her affidavit was executed, a true and accurate copy of the affidavit is attached as Exhibit A. Counsel will submit for the docket the original notarized affidavit, upon receipt.

B. The appropriateness of compensating the Companies for their POLR risks is also demonstrated by recognition of the premium that their investors require as a result Ohio's unique POLR risks.

Another way to confirm the proposition that the POLR obligation imposes substantial risks and, thus, costs on the Companies is through the perspective of the investors. The Companies' intend to present testimony that supports findings that investors regard Ohio's unique POLR obligation as creating additional risks, compared to firms that do not have them; and that investors require a premium for that additional risk, compared to firms that do not have them. Notably, in the Companies' recent SEET proceeding, Case No. 10-1261-EL-UNC, Joseph Hamrock, AEP Ohio's President, testified regarding the unique and elevated risk that Ohio electric utilities that own generation, such as the Companies, face as a result of their POLR obligations:

> Ohio electric utilities such as CSP and OPCO that own generation assets bear additional risks as compared to utilities that do not own generation assets. The generation-owning utilities in Ohio are no longer guaranteed recovery of their substantial capital-intensive assets. Rather, under SB 221, the competitive nature of generation service created a shopping and customer migration risk. Given the "hybrid" nature of SB 221, this risk goes beyond the risk presented in other retail choice states.
> (Cos. Ex. 6, p. 19, in Case No. 10-1261-EL-UNC)

In the attached affidavit of Dr. Anil K, Makhija, Dr. Makhija explains that, unless shareholders are compensated through some recovery process, they will lose the equivalent of the benefit given to customers through the POLR provision. (Makhija Affidavit, Ex. B, at ¶ 5.) He observes that this loss to the shareholders can be estimated because it should be no more or less than the benefit gained by customers. (Makhija Affidavit, Ex. B, at ¶ 5.) Dr. Makhija asserts that the gain to the customers is represented by the option that they obtained, which can be assessed using, for example, an option-pricing method. (Makhija Affidavit, Ex. B, at ¶ 5.) Dr. Makhija also explains that the fact that the firm did not make a cash outlay to third parties

related to its POLR obligation does not alter the diminution in shareholders' equity on account of the option handed over to customers. (Makhija Affidavit, Ex. B, at ¶ 5.)

V. The Commission could also address the issue of the appropriate level of the POLR charges as part of the upcoming hearing process in the pending ESP cases (Case Nos. 11-346 EL-SSO et al.)

If the Commission concludes that additional evidence is required before it can determine the appropriate POLR charges, the Companies recommend that the Commission consolidate that aspect of their remand with the portion of the upcoming hearings in their pending ESP proceeding, Case Nos. 11-346 and 11-348-EL-SSO, that also address their POLR charges. If consolidation is ordered, the Companies further recommend that the POLR charges that are determined to be appropriate should be used not only as the charges for the next ESP, but also as the charges for the remaining term of the Companies' current ESPs. In that event, the Companies would not object, assuming that the Commission accepted the Companies' proposal to make their POLR charges collected during the remaining term of their current ESP, June 1 through December 31, 2011, subject to refund, to using the charges established in the consolidated hearing as the basis for reconciliation.

There are several benefits that a consolidated approach to conducting any remand hearing would provide. One benefit would be the substantial efficiency of holding one hearing on the POLR charges, rather than two. The economies and savings of the resources of interested parties and the Commission would be significant. Another benefit would be the consistency in the POLR charges during the remaining term of the current ESPs and the next one. Moreover, a consolidation approach would involve a process to resolve the remand issues concerning the Companies' current POLR charges through a deliberate and reasoned litigation process that is

fair to all interested parties. It would arguably be inefficient and wasteful to conduct two parallel litigation proceedings that would establish differing evidentiary records and foster an environment that could produce differing and potentially conflicting results.

AEP Ohio clarifies, however, that it is not proposing, nor does it consent to, any process or remedy that has the effect of limiting participation by all five Commissioners in deciding the pending ESP cases (Case Nos. 11-346-EL-SSO et al.) While two Commissioners have abstained from the May 4 Entry, accepting AEP Ohio's proposal to tie the substantive outcome of the remand proceeding to the outcome of the pending POLR issues for the new ESP only means that the final order in the pending ESP cases will be applied to reconcile the current POLR charges with that outcome for the remainder of 2011. Hence, this approach builds on the alternative request in the Companies' May 11 motion to begin collecting the POLR charge subject to refund. More specifically, the interim remedy for the remand proceeding would be implemented subject to the final substantive outcome of the POLR issues in the pending ESP cases (and would be reconciled back to the first billing cycle of June 2011 at the time of the final decision in the ESP cases). The decision in the pending ESP would need to be a separate decision made by the full Commission. In addition to governing the POLR treatment for the new ESP, the final ESP decision concerning POLR would also apply to reconcile the POLR charge being collected during the remand proceeding (presuming for this purpose that the three-Commissioner decision in the remand proceeding decides to prospectively convert the POLR charges to being collected subject to refund based on the outcome of the POLR issues in the new ESP cases).

CONCLUSION

Regarding the non-fuel generation rate increase associated with 2001-2008 environmental investment, the Commission has multiple alternative bases for continuing or reinstating the ESP Order's non-fuel generation rate increase related to carrying costs for environmental investments *and should do so without delay.* The Commission can simply verify that an alternative basis in the ESP statute exists to support the existing charge that was adopted for all the factual and policy reasons initially set forth in the ESP order – independent of any process employed to address the POLR charge issues

Regarding the POLR charges, AEP Ohio maintains that the only debate on remand should be reconsidering the appropriate compensatory level of the POLR charges – not whether the entire POLR charge increase awarded by the ESP Order should be eliminated. AEP Ohio's first recommended POLR remand option is to request that the Commission re-evaluate the existing evidentiary record and provide a clarified explanation of the basis for retaining the existing POLR charges. The Companies second POLR remand option is that the Commission schedule a hearing at which they can introduce additional evidence in support of POLR charges that appropriately compensate them for discharging their POLR obligations. Finally, to the extent that the Commission believes that additional evidence is necessary to support the POLR charges for the remainder of the existing ESP term, AEP Ohio's third alternative POLR remand option is that the Commission utilize the upcoming hearing scheduled in Case Nos. 11-346 EL-SSO and 11-348-EL-SSO, in order to efficiently and singularly address the issue of the appropriate level of their POLR charges.

Regardless of which of these paths may be pursued, the Commission should either uphold the current rates or give AEP Ohio a chance to further address the merits of setting a new POLR charge prior to implementing any reductions as a result of the Court Decision.

Respectfully Submitted,

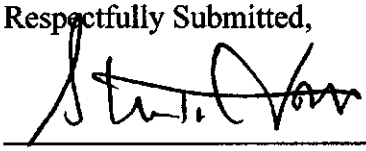


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Exhibit A
LaCasse Affidavit

EXHIBIT A

AFFIDAVIT OF DR. CHANTALE LACASSE

Dr. Chantale LaCasse, upon her oath, deposes and states:

1. I am a Senior Vice President with NERA Economic Consulting ("NERA"). Before joining NERA in 2001, I held various full-time academic positions in Canada where I taught economics to graduate and undergraduate students, and conducted original research on competitive bidding processes and other issues in economic policy. My consulting experience at NERA has principally consisted of designing and implementing competitive bidding processes for the procurement of default service for Electric Distribution Utilities ("EDUs"). My recent engagements include assisting EDUs in Pennsylvania and in New Jersey with the design and implementation of competitive bidding processes for the procurement of default service for their customers. In particular, I lead the NERA team that manages the default service auctions for the Pennsylvania FirstEnergy EDUs (Pennsylvania Power Company, Metropolitan Edison Company, and Pennsylvania Electric Company).

2. In 2004 the Public Utilities Commission of Ohio ("PUCO" or "Commission") ordered the FirstEnergy Ohio EDUs to hold a descending-price clock auction as a market test for their filed Rate Stabilization Plan. The PUCO had the choice between accepting the results of the auction to procure full-requirements service for FirstEnergy's Standard Service Offer ("SSO") Load for the period January 1, 2006 to December 31, 2008 or rejecting the auction results in favor of the Rate Stabilization Plan Pricing. I provided advice regarding the detailed auction rules, designed the bidding procedure, and served as Auction Manager. I am familiar with the auctions that the FirstEnergy Ohio EDUs currently conduct to procure full-requirements supply for SSO customers under their Electric Security Plan ("ESP"). The auctions use a descending-price clock format in which bidders bid on all products simultaneously over multiple rounds. In

a round, a bidder bids by stating the number of tranches it wishes to supply at prices announced by the Auction Manager. If there is excess supply on a product, the price is reduced in the next round, and bidders submit new bids at the reduced prices. The auction closes when supply is just sufficient for what is needed. The Ohio market test auction that I managed and the auctions of the Pennsylvania FirstEnergy EDUs that I currently implement, among others, also use this same descending clock auction format to procure full-requirements tranches.

3. A more complete curriculum vitae is attached to this affidavit as Attachment 1.

4. I have reviewed and am familiar with the 2009 final order issued by the Public Utilities Commission of Ohio in Case Nos. 08-917-EL-SSO et al. ("ESP Order"), authorizing an increase in the Provider of Last Resort ("POLR") charges for Columbus Southern Power Company and Ohio Power Company (collectively, "AEP Ohio").

5. I have reviewed and am familiar with the April 19, 2011 decision by the Supreme Court of Ohio in Case No. 2009-2022, reversing and remanding to the Commission POLR charge increase approved in the ESP Order.

6. I have reviewed and am familiar with the May 4, 2011 Entry issued by the Commission in the ESP Cases.

7. I am familiar with the provisions of Ohio law requiring EDUs such as AEP Ohio to provide to all consumers, on a comparable and non-discriminatory basis within its certified service territory, a SSO of all competitive retail electric services necessary to maintain essential electric service, including a firm supply of electric generation service. I understand that EDUs can provide their SSO through either an ESP or a Market Rate Offer ("MRO"). Under either option, the EDU provides default generation service for any customer that does not acquire

generation service from a competitive retail electric service ("CRES") provider at a price that is substantially fixed. The EDU must honor the SSO price regardless of market price fluctuations during the term of the rate plan. The customers' ability to shop imposes a costly risk upon the EDU. If market prices fall sufficiently, CRES providers will be able to beat the SSO price and customers will have an incentive to take service from a CRES provider. An EDU that uses its own generation assets to meet its SSO obligation would find that a portion of the output that it expected to use to serve SSO customers would instead need to be sold at below expected prices leading to a loss in revenue. If instead market prices rise sufficiently, customers that are taking service from a CRES provider will find it advantageous to return to SSO. An EDU would be required to divert a portion of the output of its own generation assets or purchase from the market to meet its SSO obligation at a higher than expected cost. Market price fluctuations lead to customer demand that is variable and uncertain. The obligation to maintain a stable price in the face of demand that fluctuates with market conditions prevents the EDU from optimally managing its generation on a forward basis and imposes costs on the EDU in conditions both of rising and declining market prices. Another obligation of the EDU is to provide the SSO to any group of customers served by a CRES provider that defaults on its service obligations. Collectively, I will refer to these obligations as the EDU's POLR obligations, which exist under both the ESP and MRO options.

8. A common method used by EDUs (without generation assets) to manage the costs and risks associated with POLR obligations is to transfer these risks to procure supply for their POLR customers using a competitive bidding process for full-requirements contracts. Under such contracts, winning bidders agree to bear the various POLR risks including shopping-related risk. A competitive procurement process is used to arrive at a market determination of the costs associated with providing full-requirements service and all related risks. Bidders must quantify

the costs of these risks prior to bidding. I expect that the clearing prices for auctions conducted to date in Ohio reflect the bidders' assessment of all risks associated with providing SSO supply including shopping-related risk since winning suppliers are required to meet a percentage of SSO load that fluctuates with shopping. An EDU that uses such a procurement process in effect transfers the POLR risks to the winning bidders.

9. I expect bidders in SSO auctions to utilize different sophisticated and proprietary strategies to manage POLR risks, including shopping-related risk, which they bear when they accept the obligations of the full-requirements contract. A bidder in an SSO auction can be expected to quantify the cost of POLR risks, including shopping-related risk, on the basis of the strategies that it employs to manage such risks. For example, in an environment with little or no shopping, a bidder may partially hedge the risk of increased shopping by acquiring an instrument that would increase in value if market prices declined (such as a gas or power put option). Conversely, in an environment with significant shopping, a bidder may partially hedge the risk of returning customers by acquiring an instrument that would increase in value if market prices increased (such as a gas or power call option). The costs of such instruments would be part of the quantification of such risks. A bidder that does not hedge a particular risk, such as shopping-related risk, may use a financial model such as Black Sholes or statistical analyses such as Monte Carlo simulations to price residual risk and measure the cost of self-insurance. The competitive aspect of the procurement process means that winning bidders tend to be those that are most efficient at managing POLR risks. The POLR price paid by SSO customers includes the bidders' costs for bearing the POLR risks associated with supplying these customers.

10. The cost of meeting a POLR load shape can be estimated using market data assuming away uncertainty in demand, cost component risk, and shopping-related risk. The

difference between this estimate and the price that results form a competitive solicitation for full-requirements contracts is sometimes referred to as a "premium". It is in fact in some ways analogous to an insurance premium as supply purchased through the auction provides SSO customers with the certainty of a stable POLR price in the face of fluctuating market conditions. As with any insurance there is a cost to the insurer. The premium reflects the costs of bearing POLR risks recognizing that there are a variety of ways to manage such risks.

11. An EDU that uses its own generation assets to meet its SSO obligation also bears shopping-related risk to the same degree as winning bidders in a competitive solicitation for SSO supply. The winning bidder in a competitive solicitation for SSO supply is compensated for bearing shopping-related risk with respect to the portion of POLR load that it serves. An EDU that uses its own generation assets to meet its SSO obligation bears the shopping-related risk for 100% of the SSO load. Such an EDU accepts effectively the same POLR obligations as a winning bidder that wins a full-requirements contract in a competitive solicitation but it does so for 100% of the SSO load. Since obligations and risks are common to both situations, I believe it is reasonable and appropriate to assume that the approaches used to quantify shopping-related risk would be very similar. The same methods described above in connection with bidders in SSO auctions could be applied by an EDU to quantify its cost for assuming shopping-related risk. I do not mean that the EDU and the winning bidder in an SSO auction are in identical circumstances. However, both the EDU and the winning bidder face shopping-related risk and the tools that can be used to cost such risk are common to both.

12. NERA is working with AEP Ohio to evaluate and develop methods of quantifying shopping-related risk. I anticipate that these methods could include examining the costs that would be incurred to hedge these risks, using Monte Carlo modeling, and potentially other

statistical methods to estimate cost in the absence of hedges. NERA has previously used a statistical analysis to quantify explicitly the cost of shopping-related risk. This study was performed for Allegheny Power and Baltimore Gas and Electric Company and presented to the Maryland Public Service Commission. I believe that it is clear that there are risks to providing SSO related to shopping that cause a provider to incur costs and that methods to quantify these costs exist that would address and satisfy the concerns set forth in the Supreme Court's April 19 Decision.

Further the Affiant sayeth nothing more.

Dated: May 20, 2011

Chantale LaCasse.

Dr. Chantale LaCasse

STATE OF PENNSYLVANIA)
)
COUNTY OF PHILADELPHIA)

Chantale LaCasse appeared before me, a Notary Public in and for this County and District, and swore that the foregoing statements are true.

Michelle L. Ulaschkin
Printed

Michelle L. Ulaschkin
Signature

My Commission Expires:

August 19, 2013

My County of Residence:

Pennsylvania

COMMONWEALTH OF PENNSYLVANIA
NOTARIAL SEAL
MICHELLE L. ULASCHKIN, Notary Public
City of Philadelphia, Phila. County
My Commission Expires August 19, 2013

Attachment 1

NERA
Economic Consulting

Chantale LaCasse
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CHANTALE LACASSE
SENIOR VICE PRESIDENT

Dr. Chantale LaCasse is a Senior Vice President with NERA Economic Consulting. Her practice concentrates on helping energy clients design, implement, and manage auctions. Before joining NERA in 2001, Dr. LaCasse was a respected academic in Canada; she trained Ph.D. students in game theory and she conducted research in auctions, competition policy, and other issues in economic policy. At NERA, Dr. LaCasse testified as an expert witness before state regulatory agencies on matters related to the design and implementation of auctions. She has provided conceptual advice to utilities and regulators on the design of auctions for and she has developed detailed rules for their implementation. She has provided advice on competition issues and has held the TD MacDonald Chair at the Competition Bureau. She has been involved in the design and management of auctions in several jurisdictions in the United States, including New Jersey, Illinois, Ohio, Pennsylvania, as well as in other countries such as Canada, Spain, and Ireland. Dr. LaCasse is fluent in English and French and has a good knowledge of Spanish.

Education

University of Western Ontario
Ph.D., Economics, 1991
M.A., Economics, 1986

University of Ottawa
B.A. Honors, Mathematics, 1984
B.Soc.Sc. Honors, Economics, 1983

Professional Experience

NERA Economic Consulting

2005- Senior Vice President
Provide advice on competitive bidding processes, auctions, procurement, market design, regulatory issues, and antitrust matters.

2003-2005 Vice President

2001-2003 Senior Consultant
Member of team that advised energy market participants on market design, regulatory issues, and antitrust matters.

University of Alberta, Department of Economics

1998-2000 Associate Professor

Competition Bureau, Industry Canada

1997-1998 T.D. MacDonald Chair of Industrial Economics

Universitat Autonoma de Barcelona, Departament d'Economia I d'Història Econòmica

1997 Visiting Professor

University of Toronto, Institute for Policy Analysis

1996-1997 Visiting Professor

University of Ottawa, Department of Economics

1998 Associate Professor

1991-1998 Assistant Professor

1990-1991 Lecturer

Brock University, Department of Economics

1989-1990 Lecturer

Honors and Professional Activities

John Vanderkamp Prize for the best article in *Canadian Public Policy/Analyse de politiques* for 2000 (for the article with Vicky Barham and Rose Anne Devlin, "Are the New Child-Support Guidelines 'Adequate' or 'Reasonable'?" Vol. XXVI, No. 1)

Named T.D. MacDonald Chair of Industrial Economics at the Competition Bureau, Industry Canada, 1997-1998

Courses taught include Microeconomics, Law and Economics, Industrial Organization, Game Theory, Probability, and Statistics

Professional Development for attorneys, *The Economics of Competition Policy*, Competition Bureau, March 1998

Referee, *L'actualité économique*, *Journal of Labor Economics*, *The American Economic Review*, *The Energy Journal*, *Canadian Journal of Economics*, *Dialogue*

Consulting Experience

Auction Manager for the four New Jersey Electric Distribution Companies for the sale of their Solar Renewable Energy Credits.

Advice to the New England Independent System Operator on rules of the market for capacity.

Procurement Administrator for the Illinois Power Agency's 2010 procurement of renewable energy and renewable energy credits through twenty-year contracts.

Solicitation Manager for Jersey Central Power & Light, Atlantic City Electric, and Rockland Electric in their SREC-Based Financing Program for the procurement of long-term solar contracts.

Auction Manager for Public Service Electric and Gas for the sale of their Solar Renewable Energy Credits.

Expert testimony and advice to Penn Power concerning its Default Service Program in Pennsylvania.

Lead of team serving as Independent Evaluator for Met-Ed, Penelec, and Penn Power implementing its descending-price auctions to procure supply under their Default Service Programs in Pennsylvania.

Part of team retained by the Illinois Power Agency to manage RFPs for block energy and renewable energy credits on behalf of Commonwealth Edison:

- 2011

- 2010
- 2009

Part of team advising PECO and implementing its RFPs to procure supply under its Default Service Program

Part of team that manages RFPs for PPL Electric Utilities to procure supply under its Default Service Program in Pennsylvania.

Lead of team advising Commonwealth Edison Company on its Procurement Plan and the design of RFPs for block energy and renewable energy products.

Lead of team that provides advice to the Legal Services Commission in its design of a Best Value Tendering system for criminal defense services (UK).

Part of team that designed and managed the CESUR auctions for the Comisión Nacional de Energía (Spain).

Advice to NY Independent System Operator on their design of a forward capacity market.

Bidding advice for an energy auction client.

Part of team that managed RFPs for PPL Electric Utilities (Pennsylvania) for its Bridge Plan.

Auction Manager for Commonwealth Edison Company and the Ameren Utilities for their procurement of supply for default service (2005-2006).

Part of team that advised Penelec and Met-Ed on their RFP for retail customers in Pennsylvania.

Part of team that advised Penn Power on its RFP for POLR Load in Pennsylvania and that managed the process.

Expert testimony and auction design advice for Commonwealth Edison Company and the Ameren Utilities in support of their proposal to use an auction for the procurement of their default service customers (2005).

Part of team that served as Independent Auction Manager for a clock auction for the FirstEnergy Ohio Utilities:

- 2005
- 2004

Part of team that advised Acquirente Unico on power auction.

Part of team that advised the Ministry of Energy (Ontario, Canada) for their procurement of new generation capacity.

Expert testimony on the use of sealed bid auctions for the sale of generation assets.

Auction Manager for the four New Jersey utilities (PSE&G, JCP&L, AECO, and RECO) in their electronic clock auctions (fixed price and hourly electric price) for the provision of Basic Generation Service:

- 2010-2011
- 2009-2010
- 2008-2009
- 2007-2008
- 2006-2007
- 2005-2006
- 2004-2005
- 2003-2004
- 2002-2003
- 2001-2002.

Part of team that advised the four New Jersey utilities (PSE&G, JCP&L, AECO, RECO) on their proposal for an auction for the provision of Basic Generation Service:

- 2010-2011
- 2009-2010
- 2008-2009
- 2007-2008
- 2006-2007
- 2005-2006
- 2004-2005
- 2003-2004
- 2002-2003
- 2001-2002.

Advice on market definition in Canadian competition matter.

Part of team that advised PJM Interconnection, New York ISO, and the New England ISO on the design of markets for capacity.

Financial evaluation of bids for the Commission of Energy Regulation (Ireland) in their tender for additional capacity.

Part of team that advised the Commission of Energy Regulation (Ireland) regarding their tender for additional capacity.

RFP Manager for JCP&L's RFP for Green Power.

Part of team that advised Public Service Electric & Gas on design of auction for provision of Basic Generation Service.

Part of NERA and Navigant Consulting team that reported on competitiveness of Alberta wholesale electricity market and advised the Alberta Balancing Pool on long-term options for management of unsold Power Purchase Arrangements.

Part of team that advised Singapore IDA on design on Singapore 3G and 2G electronic auctions.

Provided on-site bidding advice for EPCOR in the PPA auction (Alberta, Canada).

Provided advice to Industry Canada in preparation for their first spectrum auction.

As part of a team from the Competition Bureau, evaluated spectrum auction rules for Canada.

Part of team that first drafted the Intellectual Property Enforcement Guidelines issued by the Competition Bureau, Industry Canada.

Provided expert opinion on a merger, a price-fixing case and a monopolization case while T.D. MacDonald Chair at the Competition Bureau.

Testimony

Regulatory hearings held by the New Jersey Board of Public Utilities. September 2010. Oral testimony regarding the advantages of the auction process proposed by the four New Jersey utilities.

Pennsylvania Power Company (Docket No. P-2010-2157862). Petition for the approval of its Default Service Plan filed with the Commonwealth of Pennsylvania Public Utility Commission. Direct Testimony (February 2010).

Regulatory hearings held by the New Jersey Board of Public Utilities. September 2009. Oral testimony regarding the advantages of the auction process proposed by the four New Jersey utilities.

Metropolitan Edison Company (Docket No. P-2009-2093053) and Pennsylvania Electric Company (Docket No. P-2009-2093054). Petition for the approval of their Default Service Plan filed with the Commonwealth of Pennsylvania Public Utility Commission. Direct Testimony (March 10, 2009). Rebuttal Testimony (June 12, 2009).

PECO Energy Company, Docket No. P-2008-2062739, testimony on behalf of the Petition of PECO Energy Company for Approval of its Default Service Program and Rate Mitigation Plan filed with the Commonwealth of Pennsylvania Public Utility Commission. Direct testimony (September 10, 2008), Supplemental testimony (November 14, 2008). Rebuttal testimony (January 30, 2009).

Regulatory hearings held by the New Jersey Board of Public Utilities. September 2008. Oral testimony regarding the advantages of the auction process proposed by the four New Jersey utilities.

Regulatory hearings held by the New Jersey Board of Public Utilities. September 2007. Oral testimony regarding the advantages of the auction process proposed by the four New Jersey utilities.

Illinois Commerce Commission, Docket No. 06-0800, Investigation of Rider CPP of Commonwealth Edison Company, and Rider MV of Central Illinois Light Company d/b/a AmerenCILCO, of Central Illinois Public Service Company d/b/a AmerenCIPS, and of Illinois Power Company d/b/a AmerenIP, pursuant to Commission Orders regarding the Illinois Auction. Direct testimony (March 2007), Rebuttal testimony (April 2007) on potential improvements to the Illinois Auction. Testimony before the Illinois Commerce Commission (April 25, 2007).

Regulatory hearings held by the New Jersey Board of Public Utilities. September 2006. Oral testimony regarding the advantages of the auction process proposed by the four New Jersey utilities.

Committee Hearing of the Telecommunications and Utilities Committee of the New Jersey General Assembly. June 2006. Oral testimony regarding New Jersey procurement of electricity and market trends.

Regulatory hearings held by the New Jersey Board of Public Utilities. April 2006. Oral testimony regarding the procurement process to be used in 2007.

Commonwealth of Pennsylvania Public Utility Commission, Docket No. P-00052188, testimony on behalf of the Petition of Pennsylvania Power Company for approval of their Interim POLR Supply Plan. Direct testimony (October 11, 2005), Supplemental testimony (November 11, 2005) and rebuttal testimony (December 23, 2005). Testimony before the Commonwealth of Pennsylvania Public Utility Commission (January 10, 2006).

Illinois Commerce Commission, Docket 05-0159, Commonwealth Edison Company proposed tariffs filed pursuant to Article IX of the Public Utilities Act defining a competitive supply procurement process and, pursuant to Section 16-112(a) of the Act, establishing a market value methodology to be effective post-2006; providing for Power Purchase Options and for recovery of transmission charges post-2006; and enabling subsequent restructuring of rates and unbundling of prices for bundled service pursuant to Sections 16-109A and 16-111(a) of the Act. Direct testimony (February 2005), Rebuttal testimony (July 2005), Surrebuttal testimony (August 2005) on auction design and management. Testimony before the Illinois Commerce Commission (September 8-9, 2005).

Illinois Commerce Commission, Dockets 05-0160, 05-0161, 05-0162 (consolidated), Central Illinois Light Company, Central Illinois Public Service Company, Illinois Power Company (the "Ameren Companies") proposed tariffs to establish basic generation services, the procurement process by which the Companies will acquire supply to provide basic generation services, and the method by which auction prices will be translated into prices that customers will pay. Direct

testimony (February 2005), Rebuttal testimony (July 2005), and Surrebuttal testimony (August 2005) on auction design and management. Testimony before the Illinois Commerce Commission (September 8-9, 2005).

Regulatory hearings held by the New Jersey Board of Public Utilities. September 2004. Oral testimony regarding the advantages of the auction process proposed by the four New Jersey utilities.

Public Utility Commission of Texas, SOAH Docket No. 473-04-2459 and PUC Docket No. 29206, Application of Texas-New Mexico Power Company, First choice Power, Inc and Texas Generating Company, L.P. to finalize stranded costs under PURA 39.262. Rebuttal Testimony regarding the choice of a sealed bid auction (April 8, 2004). Testimony before the Commission (April 17, 2004).

Regulatory hearings held by the New Jersey Board of Public Utilities. September 2003. Oral testimony regarding the advantages of the auction process proposed by the four New Jersey utilities.

Regulatory hearings held by the New Jersey Board of Public Utilities. September 2002. Oral testimony regarding the advantages of the auction process proposed by the four New Jersey utilities.

Regulatory hearings held by the New Jersey Board of Public Utilities. September 2001. Oral testimony regarding the advantages of the auction process proposed by the four New Jersey utilities.

Publications

"Maryland versus New Jersey: Is There a Best Competitive Bid Process?" (with Thomas Wininger), *The Electricity Journal*, Vol. 20, Issue 3, April 2007, pp. 46-59.

"Chores" (with Clara Ponsatí and Vicky Barham), *Games and Economic Behavior*, Vol. 39, No. 2, May 2002, pp. 237-281.

"The Intellectual Property Enforcement Guidelines and the Treatment of Innovation: Assessment and Comparison with the U.S. approach" (with Brian Rivard), *Canadian Competition Record*, Vol. 20, No. 3, Summer 2001, pp. 90-109.

"Child-Support Guidelines and the Welfare of Children" (with Vicky Barham and Rose Anne Devlin), *Policy Options*, March 2000.

"Are the New Child-Support Guidelines 'Adequate' or 'Reasonable'?" (with Vicky Barham and Rose Anne Devlin), *Canadian Public Policy*, Vol. XXVI, No. 1, 2000.

"Federal Sentencing Guidelines and Mandatory Minimum Sentences: Do Defendants Bargain in the Shadow of the Judge?" (with A. Abigail Payne), *Journal of Law & Economics*, Vol. XLII, No. 1, Part 2, April 1999; reprinted in *The Economics of Crime* , Volume 3, Isaac Ehrlich and Zhiqiang Liu editors, International Library of Critical Writings in Economics series, pp. 274-298.

"Morality's Last Chance" (with Don Ross), Chapter 16 in *Modeling, Rationality, Morality and Evolution*, Peter Danielson (editor), New York: Oxford University Press, 1998, pp. 340-375.

"Secret Reşerve Prices in a Bidding Model with a Resale Option" (with Ignatius J. Horstmann), *American Economic Review*, Vol. 87, No. 4, September 1997, pp.663 684.

"Toward a New Philosophy of Positive Economics" (with Don Ross), Dialogue, *Canadian Philosophical Review*, Vol. XXXIV (Special Issue: Economics and Philosophy), No. 3, 1995, pp. 467 93.

"Bid Rigging and the Threat of Government Prosecution," *RAND Journal of Economics*, Vol. 26, No. 3, Autumn 1995, pp. 398 417.

"On the Renewal of Concern for the Security of Oil Supply" (with André Plourde), *The Energy Journal*, Vol. 16, No. 2, 1995, pp. 1 23.

"The Microeconomic Interpretation of Games" (with Don Ross), *PSA 1994*, Volume 1, D. Hull, M. Forbes and R. Burian eds., Proceedings of the 1994 Biennial Meeting of the Philosophy of Science Association, New Orleans, 1994, pp. 379 387.

"Towards an Operational Definition of Security of Oil Supply" (with André Plourde) in Volume 1 of *Coping with the Energy Future: Markets and Regulations*, Denis Babusiaux, editor; Proceedings of the 15th Annual International Conference of the International Association for Energy Economics, Tours, 1992, pp. F39 F46.

"Reply to Norman, 'Has Rational Economic Man a Heart?'" (with Don Ross), *Eidos*, VIII, 2, 1991, pp. 235 246.

"Compte Rendu : *Éléments de Microéconomie* par Louis Eeckhoudt et Francis Calcoen," *L'Actualité Économique*, Vol. 67, No. 3, septembre 1991, pp. 418 421.

Presentations *(Last 7 Years)*

"Lowering Prices by Raising Costs: Market Rule Responses to 'Sponsored' Entry", presentation and panel discussion, Harvard Electricity Policy Group, Rancho Palos Verdes, California, February 24, 2011.

"The Role of the Independent Evaluator", presentation and panel discussion, Wholesale Load-Serving Procurement Roundtable, Western Power Trading Forum, May 20, 2008.

"Retail Procurement", presentation and panel discussion, Harvard Electricity Policy Group forty-eighth plenary session, John F. Kennedy School of Government, Cambridge, Massachusetts, October 4, 2007.

"Managing a Fair and Transparent Auction Process", NARUC convention, Miami, November 14, 2006.

"Challenges of Utility Procurement in a High Cost Environment", Ninth Annual Energy Conference held by McDermott, Will & Emery, Washington, DC, October 19, 2006.

"Auction Models," Resource Procurement in Restructured Markets, Edison Electric Institute, Seattle, WA, September 2004.

"Auctions and POLR Procurement," Beyond 2006: Making Competition Work, The Institute for Regulatory Policy Studies, Illinois State University, Springfield, IL, May 2004.

May 2011

Exhibit B
Makhija Affidavit

EXHIBIT B

BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an 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**

AFFIDAVIT OF ANIL K. MAKHIJA

I, Anil K. Makhija , being first duly sworn, hereby depose and state as follows based on my personal knowledge and belief:

1. I am employed by The Ohio State University. My business address is 842 Fisher Hall, Fisher College of Business, The Ohio State University, Columbus, Ohio 43210.

2. I am a Professor of Finance. I am a tenured full Professor, and I hold the Dean's Distinguished Professorship at the Fisher College of Busines, The Ohio State University. Previously, I have served as the Chairman of the Finance Department at the Fisher College of Business, and as an Associate Dean for the Fisher College. I have a Bachelors Degree (B.Tech.) in Chemical Engineering from the Indian Institute of Technology, New Delhi, a Masters of Business Administration (MBA) with a Management Science major from Tulane University in New Orleans, and a Doctorate (PhD) in Finance from the University of Wisconsin – Madison.

3. I have been asked to explain the impact of a provider of last resort (POLR) obligation, such as the POLR obligation that Ohio electric utilities bear, on an electric utility's

cost of equity, compared to the cost of equity of a similar electric utility that does not have that obligation.

4. Let us compare two utilities, A and B, such that A carries a POLR obligation, while B does not. This means that Utility A has some risks that Utility B does not face. As one example, it is reasonable to assume that it is costly for Utility A when its customers leave to get generation service from an alternative supplier. In that situation, Utility A must dispose of the generation output previously used to serve those now-departed customers at a price that is likely less than the SSO price. After all, market rates are likely to be below the SSO price when customers depart. As another example, it is also reasonable to assume that the requirement to serve customers who return to the SSO after having shopped for generation service is similarly costly. After all, market rates are likely to be above the SSO rates when customers are likely to return. The earnings of Utility A will have greater variability due to this POLR obligation than the earnings of Utility B.

5. Consequently, Utility A is a riskier firm, and its equity requires a higher required rate of return compared to Utility B, all else being equal with utility B. That is, shareholders for Utility A have a higher risk premium (and hence, cost of equity capital). Cash flows for Utility A should be discounted at the higher cost of capital, which amounts to a diminution of shareholders' equity for Utility A. What has transpired here is that shareholders of Utility A have, unless they are compensated through some recovery process, lost the equivalent of the benefit given to customers through the POLR provision. We can estimate this loss to the shareholders because it should be no more or less than the benefit gained by customers. The gain to the customers is represented by the option that they obtained, which can be assessed using, for example, option-pricing methods. That the firm did not make a cash outlay to third parties

related to its POLR obligation does not alter the diminution in shareholders' equity on account of the option handed over to customers. The risk and the consequent cost to Utility A (as well as the value of the option which customers gain through the their right to choose alternative suppliers) arises from the potential future shopping by customers, which is not equivalent to past shopping behavior.

6. The firm could have alternatively bought hedges, but that would have cost the same as that calculated by, for example, an option pricing method, since the provider of the hedge would assume equivalent risk and require compensation for it. Instead, AEP-Ohio assumed a liability for future costs of customers exercising their options.

FURTHER AFFIANT SAYETH NAUGHT.

Anil K. Makhija

Anil K. Makhija

Sworn to before me and subscribed in my presence this 20th day of May, 2011.

Cynthia L. Karnes

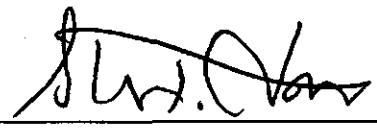
Notary Public

NOTARIAL SEAL STATE OF OHIO

HIA L. KARNES
ublic, State of Ohio
My commission Expires 09-01-12

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing Columbus Southern Power Company's and Ohio Power Company's Initial Merit Filing has been served upon the below-named counsel and Attorney Examiners via electronic mail this 20th day of May, 2011.



Steven T. Nourse

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drinebolt@aol.com	cmiller@szd.com
cmooney2@columbus.rr.com	gdunn@szd.com
sarah.parrot@puc.state.oh.us	greta.see@puc.state.oh.us