

FILED

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of)	
Columbus Southern Power Company and)	
Ohio Power Company for Authority to)	Case No. 11-346-EL-SSO
Establish a Standard Service Offer)	Case No. 11-348-EL-SSO
Pursuant to Section 4928.143, Revised)	
Code, in the Form of an Electric Security)	
Plan.)	

In the Matter of the Application of)	
Columbus Southern Power Company and)	Case No. 11-349-EL-AAM
Ohio Power Company for Approval of)	Case No. 11-350-EL-AAM
Certain Accounting Authority.)	
)	

DIRECT TESTIMONY OF

JOSEPH DOMINGUEZ

ON BEHALF OF

EXELON GENERATION COMPANY, LLC

July 25, 2011

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1 **I. BACKGROUND**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 **A.** My name is Joseph Dominguez. My business address is 10 South Dearborn, Chicago,
4 Illinois 60603.

5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 **A.** I am the Senior Vice President for Federal Regulatory Affairs, Public Policy &
7 Communications for Exelon Corporation (“Exelon”) and Senior Vice President for State
8 Governmental Affairs for Exelon Generation Company, LLC (“Exelon Generation”).

9 **Q. PLEASE PROVIDE A DESCRIPTION OF EXELON’S BUSINESS.**

10 **A.** The Exelon family of companies employs nearly 19,000 people in 16 states. Exelon
11 comprises three principal operating subsidiaries: Exelon Generation, its power generation
12 affiliate, and two transmission and distribution affiliates, Commonwealth Edison Company
13 (“ComEd”) and PECO Energy Company (“PECO”).

14 ComEd and PECO serve over 5.4 million customers in Northern Illinois and Southeastern
15 Pennsylvania, respectively. Both utilities operate in markets with customer choice and purchase
16 energy through competitive procurements to serve non-shopping customers.

17 Exelon Generation owns or controls approximately 30,000 megawatts (“MW”) of
18 generation, including nuclear, fossil, hydroelectric, solar, landfill gas, and wind generation
19 assets. It is the nation’s largest nuclear operator with 17 reactors located in Illinois,
20 Pennsylvania and New Jersey and has a growing renewable energy business. It is the nation’s
21 ninth largest wind energy generator. In addition, Exelon Generation operates the nation’s largest
22 urban solar power plant, Exelon City Solar, a 10 MW solar installation located on a 41-acre

1 brownfield in Chicago, and two of the largest hydroelectric facilities in the Eastern United States,
2 Conowingo Hydroelectric Generating Station and Muddy Run Pumped Storage Facility totaling
3 nearly 1,600 MWs of capacity.

4 Exelon Generation markets wholesale energy and capacity products to municipal,
5 cooperative, and investor-owned utilities, retail suppliers, retail energy aggregators, merchant
6 participants, power marketers, and major commodity trading houses. Exelon's retail marketing
7 operation Exelon Energy Company ("Exelon Energy"), a subsidiary of Exelon Generation, is a
8 licensed competitive retail electric service ("CRES") provider in Ohio and several other states.
9 Exelon Energy has over 20,000 retail electric and gas customers across this region, mainly
10 comprising industrial and large commercial customers. Our business is growing in Ohio and is
11 poised to grow even more depending upon the outcome of this proceeding.

12 **Q. PLEASE DESCRIBE YOUR POSITION WITH EXELON?**

13 **A.** I am responsible for directing and implementing regulatory and legislative policies for
14 Exelon Generation's retail and wholesale business as well as the overall federal regulatory policy
15 for all Exelon subsidiaries. My team is responsible for preparing and advocating policy positions
16 for the Exelon companies regarding wholesale and retail competition, transmission issues and
17 other energy matters. Prior to my current role, I served in various positions within Exelon,
18 including General Counsel for Exelon Generation and General Counsel for PECO. In the latter
19 role, I helped develop procurement plans for non-shopping customers to ensure that default
20 service electricity and capacity is obtained through least-cost competitive procurements.

21 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

22 **A.** I earned a Bachelor of Science in Mechanical Engineering in 1984 and a Juris Doctorate
23 in 1990.

1 **II. EXELON GENERATION SUPPORTS CUSTOMER CHOICE**

2 **Q. DESCRIBE EXELON’S INTEREST IN THIS PROCEEDING.**

3 **A.** Exelon Generation has several interests in the Electric Security Plan (“ESP”) filed by
4 Columbus Southern Power Company (“CSPC”) and Ohio Power Company (“OPC”)
5 (collectively, “AEP Ohio”), as well as in AEP Ohio’s filings before the Public Utilities
6 Commission of Ohio (the “Commission”) and the Federal Energy Regulatory Commission
7 (“FERC”) concerning capacity charges.

8 First, Exelon Generation has an interest in retail electricity sales in the Ohio AEP service
9 territory as its affiliate, Exelon Energy, is a licensed CRES provider in Ohio. We believe that the
10 proposed ESP, as filed, will destroy retail competition in the AEP Ohio service territory and
11 deprive AEP Ohio customers of valuable options for alternative supply.

12 Second, Exelon Generation can offer AEP Ohio low cost supply to serve the Ohio non-
13 shopping customers who remain on the default or Standard Service Offer (“SSO”) rate. Mr.
14 Michael Schnitzer’s testimony filed concurrently in this proceeding, and with which Exelon
15 Generation agrees, describes a modified ESP based on competitive wholesale market offerings
16 that over the 29-month ESP period would allow AEP Ohio default customers to avoid an
17 unnecessary up to 23% rate increase, saving those customers \$1.6 to \$2 billion compared to AEP
18 Ohio’s current rates.¹ Stated succinctly, we think that we are one of a number of companies that
19 can make these savings a reality by offering electricity at prices well below the proposed ESP
20 rates. As described further below, we are prepared to provide an all-in energy and capacity,
21 load-following product at a fixed price without hidden surcharges of any kind. Just as AEP

¹ See Direct Testimony of Michael M. Schnitzer on Behalf of FirstEnergy Solutions Corp. (“FirstEnergy”), at p. 5 lines 12-17.

1 sometimes outbids Exelon Generation in competitive solicitations in Illinois and Pennsylvania,
2 we believe that we can outbid AEP Ohio for the right to serve some of the default AEP Ohio
3 load if we are permitted to compete on a best-price basis.

4 *Third, we have an interest in expanding our generation business into Ohio, when the*
5 *Commission determines that generation is needed. Thus, to the extent that additional generation*
6 *is built in Ohio, we would like to be allowed to compete to build, own, and operate that*
7 *generation. We seek an outcome in this proceeding that would open AEP Ohio's service*
8 *territory to other companies that might offer to build new power plants at a lower cost and with*
9 *less risk to customers through a competitive power purchase agreement process. We are*
10 *troubled by the provisions of the proposed ESP that imply only AEP Ohio will be permitted to*
11 *build and own the generation, even if another party could build at a lower cost or more cost*
12 *effectively meet supply needs from existing resources. Such provisions are apparently designed*
13 *to and would perpetuate AEP Ohio's stranglehold over wholesale and retail competition at the*
14 *expense of its own customers.*

15 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

16 **A.** The purpose of my testimony is to help explain why the proposed ESP should be rejected
17 and to respectfully recommend some ideas for how the Commission can modify AEP Ohio's
18 proposal so as to obtain lower costs for default customers and robust competitive retail offers for
19 shopping customers. Specifically, I developed my testimony and recommendations to
20 accomplish the goals of Sections 4928.143(C)(1) and 4928.02 of the Ohio Revised Code which
21 respectively: (1) require that AEP Ohio prove in the aggregate its proposed ESP is preferable to

1 the results expected under a Market Rate Offer (“MRO”); and (2) establish Ohio’s policy to
2 *support retail competition and avoid anti-competitive subsidies.*²

3 **III. CONCLUSIONS AND RECOMMENDATIONS**

4 **Q. PLEASE SUMMARIZE YOUR CONCLUSIONS.**

5 **A.** First, I conclude that AEP Ohio has failed to prove that its proposed ESP is more
6 favorable in the aggregate than an MRO or, alternatively, a modified ESP that embeds a
7 competitive procurement process. As detailed in Mr. Schnitzer’s testimony, AEP Ohio witnesses
8 made a number of errors in calculating the competitive benchmark and failed to fully quantify
9 the costs of all of the surcharges AEP Ohio proposes in its ESP.³ When these errors are
10 corrected, the proposed ESP would impose unnecessary rate increases upon AEP Ohio’s default

² Section 4928.143(C)(1) of the Ohio Revised Code provides the following:

“The burden of proof in the proceeding shall be on the electric distribution utility...Subject to division (D) of this section, the commission by order shall approve or modify and approve an application filed under division (A) of this section if it finds that the electric security plan so approved, including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under section 4928.142 of the Revised Code...Otherwise, the commission by order shall disapprove the application.”

Section 4928.02 of the Ohio Revised Code provides, in relevant part, the following:

“It is the policy of this state to do the following throughout this state: ... (B) Ensure the availability of unbundled and comparable retail electric service that provides consumers with the supplier, price, terms, conditions, and quality options they elect to meet their respective need;... [and] (H) Ensure effective competition in the provision of retail electric service by avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service or to a product or service other than retail electric service, and vice versa, including by prohibiting the recovery of any generation-related costs through distribution or transmission rates;”

³ See Direct Testimony of Michael M. Schnitzer on Behalf of FirstEnergy, at p. 17 lines 6-8 (“Adding the costs associated with these proposed generation-related riders increases AEP Ohio’s Proposed ESP Price by \$10 to \$14 per MWh – from \$59.82 per MWh to a range between \$69.89 and \$73.49 per MWh.”). All future references to the proposed ESP rate refer to the corrected ESP rate unless otherwise noted.

1 and shopping customers as compared to an MRO or an ESP that embeds a competitive
2 procurement process.

3 I agree with Mr. Schnitzer's testimony on these critical points, but my conclusion that
4 AEP Ohio has overstated the cost of competitive offerings for energy and capacity is further
5 supported by proof of *actual offers* from Exelon Generation to American Electric Power Service
6 Corporation ("AEPSC"), a subsidiary of American Electric Power Company Inc. ("AEP"). ■

7 [REDACTED]
8 [REDACTED]
9 [REDACTED]
10 [REDACTED]
11 [REDACTED]
12 [REDACTED]
13 [REDACTED]
14 [REDACTED]
15 [REDACTED]
16 [REDACTED]
17 [REDACTED]
18 [REDACTED]

⁴ See AEP Ohio Interrogatory Response, Industrial Energy Users, Set 2, INT-092, Attachment 1. The proceeding in question is Case No. 10-2929-EL-UNC. Laura Thomas acknowledges, this value represents a capacity rate that AEP Ohio proposed in comments to the Commission on January 27, 2011 in pending litigation. See Direct Testimony of Laura Thomas on Behalf of CSPP and OPC, filed January 27, 2011, at p. 7, lines 14-16. In fact, the effective capacity price for the proposed ESP period could be even higher than the \$347.97 per MW-day proposed by Ms. Thomas because the \$347.97 per MW-day does not include potential capacity charge overlap with the costs that are covered in AEP Ohio rates and proposed non-bypassable surcharges.

1 [REDACTED]

2 [REDACTED]

3 Second, I conclude that AEP Ohio's proposed ESP lacks basic and fundamental
4 safeguards necessary to ensure that AEP Ohio is procuring the lowest cost supply for its
5 customers, especially when that objective lies in conflict with the interests of AEP shareholders
6 to protect AEP's plants and profits. As a matter of public policy, AEP Ohio should act in a more
7 even-handed way to protect the interests of its customers, and this Commission should ensure
8 that it does so. But AEP Ohio's proposed ESP offers no mechanism for the Commission or other
9 interested parties to see, let alone consider, competitive offerings -- like the Exelon Generation
10 proposal -- even though those proposals might save customers hundreds of millions of dollars
11 over time. *Without such safeguards, AEP Ohio has an incentive to charge customers more for*
12 *energy and capacity procured from its own generation fleet from which AEP Ohio earns*
13 *lucrative off-system sales and a handsome return,*⁵ *instead of using lower cost competitive*
14 *options from which AEP Ohio earns no profits. As described more fully below, the lack of*
15 *safeguards is exacerbated by AEP's position in the related capacity proceedings before the FERC*
16 *that the Commission has no jurisdiction over the capacity rates AEP Ohio charges CRES*
17 *providers doing business in the AEP Ohio zone.*

18 Third, I conclude that AEP Ohio's proposed ESP would effectively end retail competition
19 in the AEP Ohio zone by providing AEP Ohio massive, above-market subsidies unavailable to
20 any other supplier and by embedding those subsidies in generation-related non-bypassable
21 surcharges to shopping customers. Unfortunately, eliminating competition appears to be AEP

⁵ "Columbus Southern - another AEP-owned subsidiary - 'is earning returns of up to 22%'". See Virginia State Corporation Commission Final Order, Case No. PUE-2009-00030, July 15, 2010, at p. 13.

1 Ohio's explicit goal. As AEP's Chairman Michael Morris admitted during a 2010 investor call,
2 "I don't like customers switching in Ohio"⁶ Later, in 2011, Mr. Morris explained that the
3 proposed ESP was designed to eliminate retail competition: "[t]he rate design activities that are
4 filed in the ESP when we get to 2012, I think you will see a real drop-off in the number of
5 shopping customers. They'll still be there and still have the freedom to do that, but their
6 economic advantage will be to stay on the AEP system as a retail customer".⁷ Through the
7 FERC proceeding, AEP Ohio aims to couple its generation-related non-bypassable surcharges
8 with capacity charges to CRES providers – the same charges AEP Ohio asserts the Commission
9 has no jurisdiction to review – which far exceed the cost of capacity in the PJM RPM. In effect,
10 AEP Ohio has decided to take all of the cost categories where AEP Ohio's own fleet is not
11 competitive and remove those costs from competitive pressures by embedding them in non-
12 bypassable surcharges and capacity costs. If AEP Ohio succeeds with its proposed ESP, or with
13 its FERC strategy of precluding the Commission's jurisdiction over capacity costs, retail
14 competition will die and wholesale competition benefits will never be realized.

15 Fourth, I propose that the Commission exercise its authority over ESP proposals by
16 ordering a competitive PPA process that allows all suppliers to participate for the right to build
17 new generation in Ohio or supply such needs through long-term contracts with existing
18 resources. This alternative will ensure both that customers benefit from the lowest price and that
19 energy company shareholders, not customers, properly bear the substantial construction risks for

⁶ See American Electric Power Service Corporation 3rd Quarter Earnings Analysts Conference October 19, 2010.

⁷ See American Electric Power Service Corporation 4th Quarter Earnings Analysts Conference January 28, 2011.

1 these new resources. As Steve Elsea, an Ohio customer and the witness for COMPETE⁸
2 correctly observed in testimony filed concurrently in this proceeding: “The imposition of non-
3 bypassable riders to recover generation-related costs inappropriately places the financial risks of
4 AEP Ohio’s business decisions squarely on the shoulders of its customers. . . . Business risks for
5 generation-related costs rightly belong with the shareholders of AEP Ohio.”⁹

6 Fifth, I conclude that AEP Ohio falsely justifies its overall strategy to increase rates and
7 thwart competition as a necessary step to protect Ohio generation jobs and to promote economic
8 development. AEP Ohio claims that it will “abandon” investment in Ohio if it does not get its
9 way.¹⁰ AEP Ohio aims an empty pistol. Investment in economic generation in Ohio will
10 continue with, or without, AEP Ohio’s participation. Moreover, AEP Ohio has not been shy to
11 eliminate jobs when in its shareholder interests to do so.¹¹ But even more fundamentally, the
12 Commission must consider carefully whether to adopt protectionist policies which effectively
13 preclude others from competing in the AEP Ohio zone and saddle industries in the AEP Ohio
14 zone with above market power prices. The Commission adopted non-protectionist policies with

⁸ COMPETE Coalition (“COMPETE”) is an organization of 572 electricity stakeholders, including customers, suppliers, generators, transmission owners, trade associations, environmental organizations and economic development corporations, all of whom support well-structured competitive electricity markets for the benefit of consumers.

⁹ See Direct Testimony of Steve Elsea on Behalf of COMPETE, at p. 3 lines 9-14.

¹⁰ See American Electric Power Service Corporation 1st Quarter Earnings Analysts Conference April 21, 2011. On April 21, 2011 at the AEP Q1 2011 Earnings Call AEP’s Chairman said “We’ve also all made it very clear that if we don’t receive the appropriate message [from the Commission], that capital investment in Ohio and the generation fleet will simply not go forward.”

¹¹ See generally “AEP to cut up to 10% of workers Despite big profit, costs are too high, utility’s CEO says,” COLUMBUS DISPATCH, April 15, 2010. See also “AEP to Run 10 Old Coal Units Part-Time Due [to] Economy,” REUTERS, May 27, 2010. In May 2010 AEP announced plans to reduce its workforce by 1,000-2,000 jobs and substantially reduce operations at plants representing nearly 2,000 MWs of capacity, attributing these actions to corporate cost reductions measures that were needed “after the recession reduced consumer power demand and a decline in natural gas prices made gas plants less expensive than the older coal units in the company’s Eastern footprint.”

1 the northern electric utilities. The Cleveland Electric Illuminating Company, Toledo Edison
2 Company, and Ohio Edison Company (collectively, the “FirstEnergy Ohio Utilities”) auction
3 was so successful because it allowed the engine of competition, including winning bids from
4 AEP, to drive the best prices for Ohio customers.

5 Ohio has historically been an exporter of electricity to markets in surrounding states that
6 are open to Ohio generators. Ohio is well-positioned to continue to export power as the state
7 develops its burgeoning shale gas resources and takes advantage of its geographic location and
8 access to robust transmission. As I previously noted, AEP has availed itself of opportunities to
9 win competitive load auctions to serve FirstEnergy Ohio Utilities SSO customers in Ohio and
10 ComEd default customers in Illinois, and to make off-system sales of energy to entities in
11 surrounding states that freely permit competition from Ohio power plants. Although it may be
12 tempting for AEP Ohio to seek protection from competition in its own backyard so it can
13 continue competing in open markets, including the FirstEnergy Ohio Utilities zone, that strategy
14 is neither sound policy nor sustainable. Protectionism breeds protectionism and in the long term
15 inevitably undermines both consumers’ and Ohio’s interests. Surrounding states’ efforts to
16 protect their own power plants through generation-related non-bypassable surcharges and
17 subsidies would imperil Ohio’s position as an exporter. Robust retail choice and competition,
18 however, benefits consumers and will better serve the long-term interests of Ohio customers,
19 especially where, as here, AEP Ohio has failed to prove under Section 4928.143(c)(1) that its
20 proposed ESP is better in the aggregate than a competitive solution. Threats to “abandon”
21 investment in Ohio and reduce jobs should not alter the Commission’s resolve to ensure that
22 Ohio customers receive the full benefits of the law.

1 **Q. PLEASE DESCRIBE YOUR RECOMMENDATIONS.**

2 **A.** I respectfully suggest that the Commission modify the proposed ESP to achieve the
3 following three objectives.

4 First, with regard to non-shopping customers, the Commission should adopt a process
5 that requires AEP Ohio's power plants to compete on a best-price basis with other resources in
6 the market for the right to serve default customer load. I recommend that the Commission
7 establish a competitive process that allows interested parties, including AEP or an AEP
8 subsidiary, to bid an all-in, load following product including capacity, without surcharges or
9 riders of any kind. A competitive process will yield lower default service rates and will aid retail
10 competition by giving customers a fixed-rate, default offer that they can readily compare to retail
11 offers.

12 Second, the Commission should continue current practice and permit AEP Ohio to charge
13 CRES providers only the equivalent PJM Reliability Pricing Model ("RPM") price for capacity.

14 Third, assuming *arguendo* that the Commission approves some surcharges, the
15 Commission should reject AEP Ohio's proposal to make the generation-related surcharges non-
16 bypassable. Generation-related, non-bypassable surcharges thwart competition and, in Mr.
17 Morris' own words, are designed to eliminate any "economic advantage" from shopping. By
18 eliminating such non-bypassable surcharges and by continuing the practice of allowing AEP
19 Ohio to charge CRES providers only the PJM RPM-equivalent price for capacity, the
20 Commission can avoid having shopping customers effectively subsidize AEP Ohio by paying
21 generation-related costs to serve default customers. Permitting such a subsidy, in turn, would
22 unfairly provide AEP Ohio an insurmountable competitive advantage over CRES providers in
23 violation of Section 4928.02.

1 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

2 **A.** In Section IV, A, I provide some background into the current market and the inter-
3 relationship of AEP Ohio's proposed ESP and the related capacity charge proceedings at FERC.
4 I explain how these filings would thwart competition and provide AEP Ohio with anti-
5 competitive subsidies that unfairly advantage its retail affiliate.

6 In Section IV, B, I explain how AEP Ohio has failed to demonstrate that its proposed
7 ESP is more favorable in the aggregate than an MRO or modified ESP with a competitive
8 procurement process.

9 In Section IV, C, I detail my recommendations and explain how a competitive process
10 would provide price certainty, would give the Commission greater control over default service
11 rates, and would provide important incentives to avoid subordinating the interests of customers
12 to those of shareholders in acquiring electricity and capacity to serve default customers.

13 In Section IV, D, I explain how *competitive procurement mechanisms* could be used to
14 build generation, when needed.

15 **IV. AEP OHIO'S PROPOSED ESP HARMS CONSUMERS**

16 **A. AEP OHIO'S PROPOSED ESP AND RELATED FILINGS REFLECT A**
17 **COMPREHENSIVE STRATEGY TO THWART COMPETITION**

18 **Q. EARLIER YOU SAID THAT THE EFFECT OF AEP OHIO'S ESP STRATEGY**
19 **WAS TO PREVENT COMPETITION. PLEASE EXPLAIN WHAT YOU MEAN AND**
20 **HOW THE PROPOSED ESP WOULD HARM COMPETITION.**

21 **A.** Let me begin by taking a step backwards and describe the changing landscape in the
22 electricity business and how it affects public policy for competition and choice. Several years
23 ago, market prices for electricity were substantially higher, driven by natural gas prices

1 exceeding \$10/MMBtu. In that environment, AEP Ohio's fleet was very competitive. AEP
2 Ohio enjoyed a large so-called "dark spread" of profits measured as the difference between its
3 production price and the market price of electricity set by natural gas-fired generation. As
4 detailed in Mr. Schnitzer's testimony, AEP Ohio profited handsomely from off-system sales of
5 energy and capacity into surrounding markets, often earning annual revenues exceeding \$300
6 million¹² which it was not required to share with customers. In those days, AEP Ohio was
7 comfortable charging PJM RPM capacity prices to CRES providers because its energy revenues
8 were so strong it needed no capacity charges.¹³ And, CSPC earned some of the highest returns in
9 the entire Nation, exceeding a 20% return on equity.¹⁴

10 But the world has changed. New discoveries of domestically produced natural gas from
11 shale formations, including the Marcellus and Utica shale formations underlying Ohio, have
12 driven down the cost of electric power generation. Today, low wholesale market electricity
13 prices are the new norm and competitive procurements are producing exceptionally low prices as
14 evidenced by FirstEnergy Ohio Utilities' auctions held in October 2010 and January 2011. As
15 shown in the Table "Comparison Between Actual FirstEnergy Ohio Utilities Solicitations
16 Results, Ms. Thomas' Competitive Benchmark Price Estimate, Schnitzer Corrected ESP Price

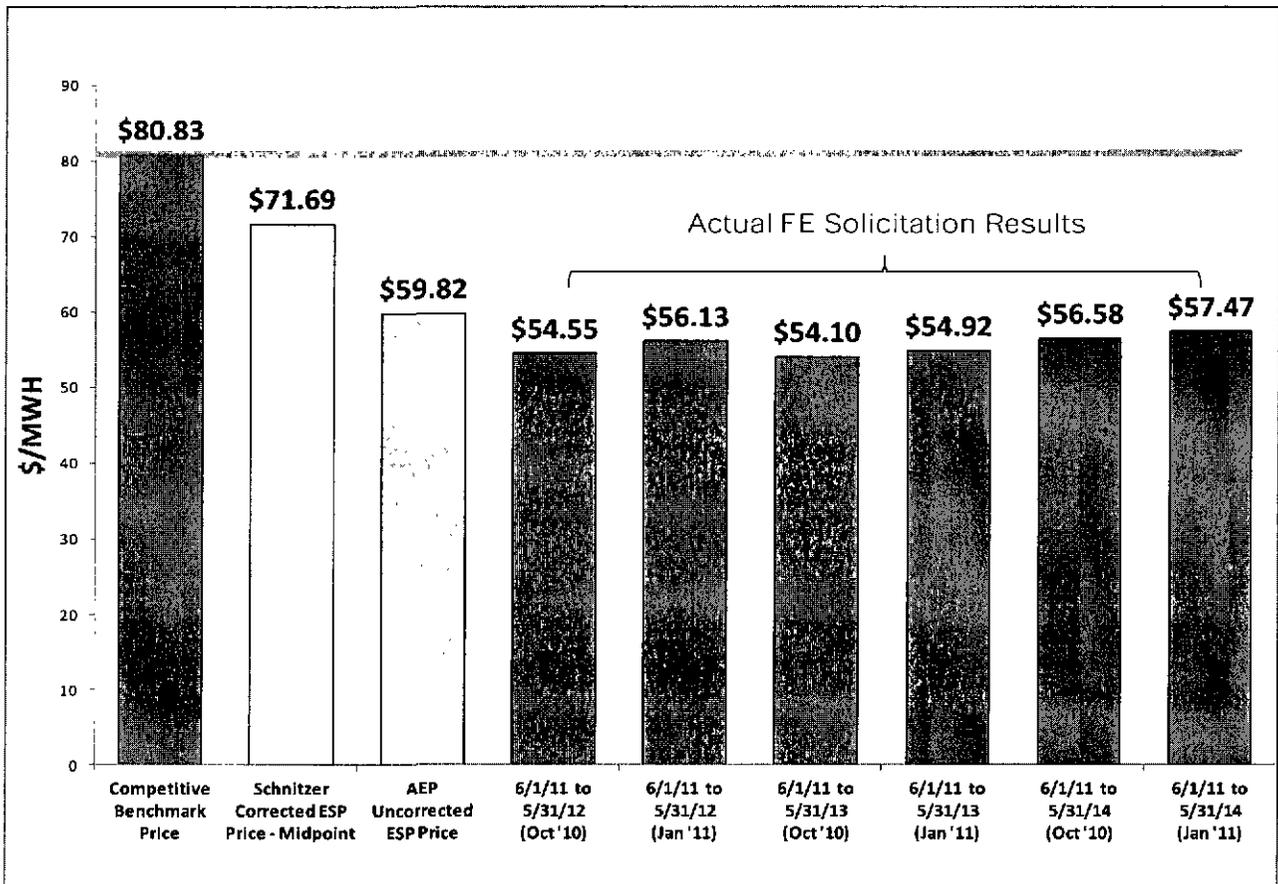
¹² See Direct Testimony of Michael M. Schnitzer on Behalf of FirstEnergy, at p. 117 ("AEP Ohio Shareholders Retain Substantial Margins From Off-System Energy Sales"). Mr. Schnitzer's testimony further provides that "According to AEP Ohio's forecast, these margins are expected to be significant, totaling over \$770 million pre-tax during the 2012-2014 period." See *id.* at p. 116 lines 10-11.

¹³ Mr. Schnitzer deduces that in 2009 the "maximum above-market" capacity charge would have been higher (\$219 per MW-day) due to lower market energy prices, while in 2008, when market energy prices were significantly higher, the "maximum above-market" capacity charge would have been negative (-\$202 per MW-day), suggesting that AEP Ohio would have exceeded its total generation revenue requirement if it had received market energy revenues. See *id.* at p. 50 ("All of the Alternative Capacity Price Benchmarks Confirm that the Capacity Price Used by AEP Ohio in this Case Is Far Too High").

¹⁴ See Virginia State Corporation Commission Final Order, Case No. PUE-2009-00030, July 15, 2010, at p. 13.

1 and AEP Ohio Uncorrected ESP Price” below, the FirstEnergy Ohio Utilities prices are
 2 considerably lower than the AEP Ohio proposed ESP price – even before factoring in the
 3 additional charges AEP Ohio proposes to recover in new, non-bypassable surcharges and
 4 provider of last resort charges. When the additional costs of the proposed surcharges are
 5 included, the competitive prices represent an enormous discount for customers relative to AEP
 6 Ohio’s proposed ESP. These actual auction results also illustrate the tremendous gulf between
 7 Ms. Thomas hypothetical competitive price and real life.

8 **COMPARISON AMONG ACTUAL FIRSTENERGY OHIO UTILITIES SOLICITATIONS**
 9 **RESULTS, MS. THOMAS’ COMPETITIVE BENCHMARK PRICE ESTIMATE, SCHNITZER**
 10 **CORRECTED ESP PRICE AND AEP OHIO UNCORRECTED ESP PRICE**



11

1 To compound matters, by its own admission, in the coming years AEP faces higher
2 Environmental Protection Agency (“EPA”) compliance costs than do other competitors. Thus,
3 AEP finds itself in a difficult position of seeking the same high profits in the face of lower
4 demand, collapsed “dark spreads”, and increased competition from lower cost suppliers for the
5 right to serve the customer.

6 Recognizing that it would lose customers and profits in head-to-head competition over a
7 fixed price, AEP Ohio seeks to protect its own generation and profits by assessing a web of non-
8 bypassable surcharges and above-market capacity charges against both shopping and non-
9 shopping customers. The effect -- if not the goal -- is to remove from competition and create a
10 pass-through for costs that make some of AEP Ohio’s power plants uneconomic. While AEP
11 Ohio portrays its proposed ESP as necessary to protect Ohio jobs and preserve the Commission’s
12 control, the reality is that the ESP simply protects AEP Ohio’s profits by trapping customers in
13 non-bypassable rates without any means of escape. AEP Ohio’s ESP strategy undermines Ohio
14 policymakers’ explicit goal for retail competition: to provide customers the right to choose less
15 costly options rather than be captive to one provider and its uneconomic costs.

16 AEP Ohio’s strategy is played out through the generation-related non-bypassable
17 surcharges in its proposed ESP as well as through related filings before the FERC and the
18 Commission concerning capacity charges to CRES providers. In a nutshell, here is how it works.
19 AEP Ohio elects to self-supply capacity in its zone by electing what is called the Fixed Resource
20 Requirement (“FRR”) option under the PJM Reliability Assurance Agreement (the “PJM
21 Tariff”). Although nothing prevents AEP Ohio from procuring some of that capacity from others
22 in the market (a wise choice in an environment where surplus capacity could have been
23 purchased at prices of around \$20 per MW-day during 2012 and 2013), AEP Ohio ignores these

1 lower cost competitive alternatives. Instead, AEP Ohio designates its own plants as the capacity
2 resource at prices well over \$300 per MW-day. In AEP Ohio's view, FRR allows AEP Ohio to
3 charge everyone its capacity costs irrespective of less costly alternatives.

4 This strategy's financial advantages for AEP Ohio are plain. By designating its own
5 units as the capacity resource, AEP Ohio avoids meaningful competition and protects its ability
6 to earn a generous return on its plants, while keeping 100% of the off-system sales revenues
7 from those plants. Deploying an alternative, pro-consumer strategy using less expensive
8 capacity to fulfill its FRR requirements, would eliminate these shareholder profit mechanisms.

9 AEP Ohio's strategy has a few holes in it, however. It faces migration risk unless it can
10 charge these above market capacity prices to shopping customers or otherwise can transfer the
11 charges through non-bypassable riders. It also faces a practical optics problem in that the AEP
12 Ohio rates will be higher than the rates in the neighboring FirstEnergy Ohio Utilities zone where,
13 *ironically, AEP successfully bid lower prices than it offers to its own default customers.*¹⁵

14 AEP Ohio attempts to fix the first problem through the generation related non-bypassable
15 riders proposed in its ESP and by asking FERC to preclude the Commission's jurisdiction over
16 the capacity charges for CRES providers' customers. AEP Ohio purports to solve the optics
17 problem by mischaracterizing its unsupported rate increases and anti-competitive behaviors as
18 required, both to protect the Commission's control over generation (a curious argument in light
19 of AEP's contention at FERC that the Commission has no jurisdiction over capacity charges) and

¹⁵ See Direct Testimony of Michael M. Schnitzer on Behalf of FirstEnergy, at p. 29 lines 6-14. An affiliate of AEP Ohio won a total of 24 tranches in two FirstEnergy Ohio Utilities' auctions in 2010 and 2011 and as a result will be serving 24% of the non-shopping default service load in the FirstEnergy Ohio Utilities zone beginning June 2011. *Id.*

1 to “preserve” investment in Ohio under the threat that it will “abandon” investment if it does not
2 get what it wants.

3 **Q. PLEASE EXPLAIN HOW THE FRR ALTERNATIVE WORKS.**

4 **A.** As an alternative to participating in PJM’s annual RPM auctions, the PJM Tariff gives a
5 load serving entity (“LSE”), like AEP Ohio, the option to elect to self-supply under the FRR
6 alternative.¹⁶ To elect the FRR alternative, an LSE must notify PJM of such election in writing
7 at least two months before the PJM RPM auction.¹⁷ Each eligible LSE choosing this alternative
8 must submit a capacity plan for all load in the intended FRR service area, demonstrating how it
9 will meet its capacity requirement with specific capacity resources.¹⁸ The PJM Tariff allows
10 FRR entities to use the most economic combination of its own units and purchased capacity
11 through bilateral agreements with other suppliers inside and, in certain circumstances, outside
12 PJM.¹⁹ Because of the robust transmission system linking the AEP Ohio zone to the rest of PJM,
13 capacity resources in any part of the 13-state PJM regional transmission organization can be used
14 to support capacity needs in the AEP Ohio zone. Thus, AEP Ohio has the luxury of seeking the
15 lowest priced capacity in PJM – *if it so chooses.*

16 **Q. YOU HAVE MENTIONED SOME “RELATED FILINGS” TO THIS CASE,**
17 **PLEASE IDENTIFY THESE FILINGS.**

¹⁶ See PJM Tariff, Schedule 8.1.

¹⁷ *Id.* at Schedule 8.1(C)(1).

¹⁸ *Id.* at Schedule 8.1(D).

¹⁹ *Id.* at Schedule 8.1, Section (D)(4), “[a]n FRR Capacity Plan may include bilateral transactions that commit capacity....”

1 A. I am referring to the related capacity cases at FERC and before the Commission
2 concerning the appropriate capacity charge to CRES providers. There are two FERC cases.
3 First, on November 1, 2010, on behalf of AEP Ohio, AEP filed an application under Section 205
4 of the Federal Power Act (“FPA”) (the “205 Proceeding”²⁰) to change the basis of its
5 compensation for capacity sold to CRES providers under the PJM Tariff. The 205 Proceeding
6 sought FERC approval to charge CRES providers over \$300 per MW-day for capacity, instead of
7 PJM’s RPM capacity price. The Commission and other parties intervened and opposed AEP’s
8 request, arguing that the PJM Tariff provides a “state compensation mechanism will prevail” in
9 setting capacity costs to CRES providers,²¹ and that since the inception of AEP Ohio’s SSO, the
10 state implicitly adopted PJM’s RPM auction price to value capacity. As of December 8, 2010,
11 the Commission expressly adopted the use of PJM’s RPM auction price as its state compensation
12 mechanism.²² On January 20, 2011, FERC rejected AEP’s filing. AEP has sought rehearing of
13 this Order. FERC has yet to act upon this request.

14 In response to the FERC’s order in the 205 Proceeding, AEP initiated a second
15 proceeding at FERC pursuant to Section 206 of the FPA,²³ by filing a complaint alleging that the
16 PJM Tariff is unjust and unreasonable and the Commission had no authority over wholesale
17 capacity rates.

²⁰ Docket No. ER11-2183-000. AEP re-filed its application on November 24, 2010.

²¹ *American Elec. Power Serv. Corp.*, 134 FERC ¶ 61,039 at pp. 8-13 (2011).

²² In December, this Commission initiated Case No. 10-2929-EL-UNC seeking comments on the following questions: (i) what changes to the current state mechanism are appropriate to determine AEP Ohio’s capacity prices to Ohio CRES providers; (ii) the degree to which AEP Ohio’s capacity charges are currently being recovered through retail rates approved by the Commission or other capacity charges; and (iii) the impact of AEP Ohio’s capacity charges upon CRES providers and retail competition in Ohio. The Commission has stated that it reserves the right to conduct an evidentiary hearing to address these issues but has yet to do so.

²³ Docket No. EL11-32-000.

1 The inconsistency between AEP Ohio’s argument at FERC and in the proposed ESP is
2 fairly remarkable. On the one hand, the generation-related subsidies that AEP Ohio proposes in
3 the proposed ESP in the form of non-bypassable surcharges are needed to maintain Ohio’s
4 control over generation. Yet, in its next breath, AEP Ohio seeks to have FERC declare that
5 Ohio has no jurisdiction to determine the capacity rates from that same generation to CRES
6 providers.

7 AEP Ohio’s FERC filings underscore the radical changes AEP Ohio proposes to protect
8 its generation in this new world of lower competitive prices. AEP Ohio seeks to declare
9 unlawful a tariff that it historically supported, *including* the provision explicitly giving the
10 Commission the right to set the capacity rate AEP Ohio charges CRES providers.²⁴

11 **Q. HOW DO THESE FILINGS RELATE TO THE PROPOSED ESP?**

12 **A.** They relate in several ways.

13 First, of course, these filings are part of the overall scheme to eliminate the “economic
14 advantage” of retail choice through generation-related non-bypassable surcharges and above-
15 market capacity charges.

16 Second, AEP Ohio must prove that its proposed ESP is more favorable in the aggregate
17 than an MRO. AEP Ohio’s proof hinges on the proposition that the competitive MRO price
18 would include its \$347.97 per MW-day²⁵ capacity rate and not the lower price of the PJM RPM
19 capacity price. But AEP Ohio’s case is fatally flawed. Its proof depends on a capacity price

²⁴ Moreover, with regard to default rates, AEP Ohio historically has acknowledged in proceedings before the Commission that the MRO comparison price should be based upon a competitive price build-up including the PJM RPM capacity price.

²⁵ AEP Ohio Interrogatory Response, Industrial Energy Users, Set 2, INT-092, Attachment 1. The proceeding in question is Case No. 10-2929-EL-UNC.

1 established in no other proceeding. Moreover, Commission precedent -- supported by AEP Ohio
2 itself -- is to use the far lower PJM RPM equivalent price for purposes of the comparison.

3 Third, AEP Ohio provides insufficient cost data explaining whether the capacity charges
4 overlap with the costs already covered in its rates and AEP Ohio's proposed surcharges. Thus,
5 the proposed ESP creates a significant risk that AEP Ohio will be over-compensated.

6 **Q. ARE YOU SAYING THAT AEP OHIO'S FRR STATUS MUST CHANGE?**

7 **A.** Not at all. AEP Ohio does not need to change its FRR status; however, I respectfully
8 contend that it does need to change its perspective. AEP Ohio noticed the low PJM RPM
9 capacity price and apparently concluded it was a problem for its shareholders, when it should
10 have seen an opportunity for its customers. AEP Ohio can retain its FRR status and embrace
11 competition. These goals are not inconsistent. It is the way AEP Ohio implements FRR which
12 thwarts competition. As I explained earlier, the problem is AEP Ohio's decision to rely only on
13 its own resources to fulfill its FRR commitment in spite of less expensive options for its
14 customers.

15 **Q. WITH REGARD TO THE COMPETITIVE CAPACITY AUCTION, HOW**
16 **SHOULD THAT PROCESS ALIGN WITH THE FRR COMMITMENT PERIOD**
17 **WHICH OCCURS THREE YEARS BEFORE THE DELIVERY YEAR?**

18 **A.** Over time, I suggest that the Commission align the competitive capacity procurement
19 with AEP Ohio's FRR commitment. Thus, for example, in April 2011, AEP Ohio filed its FRR
20 commitment with PJM for PJM planning year 2014/15. By failing to conduct a competitive
21 procurement prior to April 2011, AEP Ohio lost a valuable opportunity to explore whether less
22 expensive capacity might be available in PJM for AEP Ohio customers.

1 **Q. WHY DO YOU SAY IT “LOST” THE OPPORTUNITY?**

2 **A.** I say that because the lowest cost capacity was committed into PJM’s May RPM auction.

3 AEP Ohio needed to act on offers before the capacity was committed. For example, [REDACTED]

4 [REDACTED]

5 [REDACTED]

6 [REDACTED]

7 [REDACTED]

8 [REDACTED]

9 [REDACTED]

10 [REDACTED]

11 Based upon our review of AEP Ohio’s filings and its proposed ESP, AEP apparently
12 intends that the Commission not have any oversight over AEP Ohio’s capacity decisions. To
13 protect customer interests, AEP Ohio should not be making capacity decisions involving
14 hundreds of millions of dollars without such oversight. [REDACTED]

15 [REDACTED]

16 [REDACTED] Unless such a process is established
17 before next April, it is entirely possible that AEP Ohio will again forego less costly capacity
18 opportunities.

19 **Q. IS THIS CAPACITY PRICE COMPARISON SOMEWHAT UNFAIR BECAUSE**
20 **IT IGNORES THE COST-BASED ENERGY ASSOCIATED WITH THE AEP OHIO**
21 **CAPACITY THAT IS PURCHASED UNDER THE ESP?**

22 **A.** Since AEP Ohio is long generation, customers will be paying \$347.97 per MW-day for
23 marginal AEP Ohio energy that will be used for off-system sales. Given that customers do not

1 share in off-system sale energy margins in the AEP Ohio territory, customers receive no benefit
2 from the low priced energy associated with the marginal generation that the [REDACTED]
3 offer would replace. Only AEP shareholder benefits would be reduced. Furthermore, I do
4 compare a combined market-based energy plus capacity offer to Mr. Schnitzer's corrected ESP
5 price, which incorporates this cost-based energy. This market-based offer easily beats the
6 proposed cost-based ESP rate.

7 **B. AEP OHIO FAILS TO PROVE THAT ITS PROPOSED ESP IS MORE**
8 **FAVORABLE IN THE AGGREGATE THAN AN MRO OR MODIFIED ESP**

9 **Q. LET'S DIVE A LITTLE DEEPER INTO THE POINT THAT YOU MADE A**
10 **MOMENT AGO ABOUT THE ERRORS IN MS. THOMAS' CALCULATION OF THE**
11 **COMPETITIVE BENCHMARK PRICE AS PART OF A HYPOTHETICAL MRO THAT**
12 **SHE THEN USED TO COMPARE TO THE PROPOSED ESP. ISN'T IT TRUE THAT**
13 **AEP OHIO HAS THE ONLY AVAILABLE CAPACITY AND THAT ALL BIDDERS**
14 **WOULD PAY AEP OHIO'S \$347.97 PER MW-DAY PRICE IF THE COMMISSION**
15 **ORDERED A COMPETITIVE PROCESS?**

16 **A.** No. It is true that AEP Ohio owns substantial capacity in the zone, but capacity outside
17 the zone can be used to meet the obligation at prices considerably lower than \$347.97 per MW-
18 day. Thousands of MWs of surplus capacity that failed to clear in recent capacity auctions can
19 be used to meet the capacity obligation in the AEP Ohio zone. As Mr. Glen Thomas notes in his
20 testimony on behalf of the PJM Power Providers filed concurrently in this proceeding, in the
21 PJM RPM capacity auction for each year of the proposed ESP period, over 5,000 MW of

1 capacity failed to clear, will receive no PJM RPM capacity compensation for that delivery year
2 and likely could provide far lower cost capacity for AEP Ohio's customers.²⁶

3 [REDACTED]
4 [REDACTED]
5 [REDACTED]
6 [REDACTED]
7 [REDACTED]
8 [REDACTED]

9 The bottom line is that actual procurements and offers could have resulted in prices far
10 lower than \$347.97 per MW-day. The only reason AEP Ohio's price is so high is that it has
11 ignored these less expensive options and will continue to do so unless otherwise ordered.

12 What Ms. Thomas fails to recognize is that in a competitive process for capacity to serve
13 AEP Ohio customers, all bidders would seek the least costly capacity, not the most expensive.
14 The uncleared capacity in the PJM RPM auctions would compete with the most expensive of
15 AEP Ohio's capacity, driving the price far lower than its \$347.97 per MW-day rate. As AEP
16 Ohio implicitly acknowledged in the build-up of the competitive price in its 2008 ESP case, the
17 capacity price in a competitive procurement would likely converge on the PJM RPM capacity
18 price.²⁷

²⁶ See Direct Testimony of Glen Thomas on Behalf of PJM Power Providers Group ("P3"), at p. 6 lines 1-6. P3 is a nonprofit corporation dedicated to promoting policies that allow the PJM region to fulfill the promise of its competitive wholesale electricity markets. P3 members own over 87,000 MW of power and over 51,000 miles of transmission lines, serve nearly 12.2 million customers and employ over 55,000 people in the PJM region.

²⁷ See Direct Testimony of J. Craig Baker on Behalf of CSPC and OPC, filed July 31, 2008, at p. 11 lines 11-14.

1 Q. LET'S TALK SOME MORE ABOUT THE PRICES THAT COMPETITION
2 COULD OFFER RELATIVE TO THE PROPOSED ESP RATE, WHAT DO YOU
3 THINK COMPETITION MIGHT YIELD?

4 A. As to the overall market, I rely on Mr. Schnitzer's analysis of AEP Ohio's proposed rate
5 over the 29-month ESP period as compared to a competitive benchmark price. After adjusting
6 for Ms. Thomas' errors and the true cost of the non-bypassable surcharges, Mr. Schnitzer's
7 analysis shows that competitive rates are about \$19 per MWh lower than AEP's proposed ESP
8 rate.²⁸ If a competitive process were held in the AEP Ohio zone, Exelon Generation would
9 participate and would be able to offer a price lower than the uncorrected ESP rate of \$59.82 per
10 MWh,²⁹ let alone the corrected \$69.89-\$73.49 per MWh ESP rate deduced in Mr. Schnitzer's
11 testimony.³⁰ [REDACTED]

12 [REDACTED]
13 [REDACTED]

14 [REDACTED] Thus, I think that competition not only can beat the ESP rate now, but also can beat it
15 through at least May 31, 2016, notwithstanding the fact that energy prices in the underlying
16 markets are projected to rise over that period. To reiterate, Exelon Generation's offers for stand-
17 alone capacity or energy and capacity would be fixed without surcharges of any kind. [REDACTED]

18 [REDACTED]

19 [REDACTED] In short, I believe that competitive offers will be favorable as compared to AEP Ohio's
20 proposed ESP rate for the long term because, as I said earlier, we have entered an entirely new

²⁸ See Direct Testimony of Michael M. Schnitzer on Behalf of FirstEnergy, at p. 24 lines 9-11.

²⁹ See Direct Testimony of Laura Thomas on Behalf of CSPC and OPC, at Exhibit LJT-2 and at p. 12, lines 5-10.

³⁰ See Direct Testimony of Michael M. Schnitzer on Behalf of FirstEnergy, at p. 17 line 8.

1 era in which, in our view, natural gas prices and, in turn, competitive market prices will be
2 relatively low for a long time. I am not alone in that thinking. As one of AEP's other utility
3 presidents, Appalachian Power Company's ("APC") Charles Patton, recently observed:

4 "There is an abundance of natural gas in the Marcellus shale and other shale
5 formations . . . *Our guys say there will be cheap gas for 30 years.* The new
6 generating plants we build will be natural gas plants, make no mistake about it."³¹

7 That is not to say that Exelon Generation believes that natural gas prices will remain in the \$4-
8 \$4.50 spot price range or that energy prices will stay this low forever, but I am saying that even
9 with the expected recovery of gas prices, competitive rates will be lower than the proposed ESP
10 rate. We see nothing on the horizon that increases competitive prices to the levels AEP Ohio
11 demands. [REDACTED]

12 [REDACTED]

13 [REDACTED]

14 [REDACTED]

15 [REDACTED]

16 [REDACTED]

17 [REDACTED]

18 [REDACTED]

19 [REDACTED]

20 [REDACTED]

21 [REDACTED]

³¹ "Appalachian Power chief has blunt message on energy," May, 19, 2011 - Charleston Daily Mail (WV). (Emphasis added).

- 1 [REDACTED]
- 2 [REDACTED]
- 3 [REDACTED]
- 4 [REDACTED]
- 5 [REDACTED]
- 6 [REDACTED]
- 7 [REDACTED]
- 8 [REDACTED]
- 9 [REDACTED]
- 10 [REDACTED]
- 11 [REDACTED]
- 12 [REDACTED]
- 13 [REDACTED]
- 14 [REDACTED]
- 15 [REDACTED]
- 16 [REDACTED]
- 17 [REDACTED]
- 18 [REDACTED]
- 19 [REDACTED]
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- 22 [REDACTED]

1 [REDACTED]
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5 [REDACTED]
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7 [REDACTED]
8 [REDACTED]
9 [REDACTED]
10 [REDACTED]
11 [REDACTED]
12 [REDACTED]
13 [REDACTED]
14 [REDACTED]
15 [REDACTED]
16 [REDACTED]
17 [REDACTED]
18 [REDACTED]
19 [REDACTED]
20 [REDACTED]
21 [REDACTED]
22 [REDACTED]
23 [REDACTED]

1 [REDACTED]
2 [REDACTED] AEP Ohio's generation fleet comprises many different
3 units: although some are inefficient, older and face significant environmental investments, many
4 are very efficient and highly economic. Indeed, AEP has won recent competitive procurements
5 for load in areas like the ComEd zone and the FirstEnergy Ohio Utilities zone, even without a
6 locational advantage. Most of AEP Ohio's units are well positioned in the grid to support the
7 CSPC and OPC load, meaning that transmission basis costs are lower. The quality and location
8 of AEP Ohio's good assets will position it very well to secure substantial load in its own
9 backyard through any competitive process. That is why I observed earlier that it is a real stretch
10 to characterize AEP Ohio's proposed ESP as necessary to preserve generation investment in
11 Ohio; Ohio generation will continue to do well in a competitive environment.³²

12 **C. THE COMMISSION SHOULD USE COMPETITIVE PROCESSES TO DRIVE**
13 **THE BEST RESULTS FOR CONSUMERS AND SHOULD NOT ALLOW AEP**
14 **OHIO TO UNDERMINE RETAIL COMPETITION WITH GENERATION-**
15 **RELATED NON-BYPASSABLE SURCHARGES AND ABOVE MARKET**
16 **CAPACITY CHARGES**

17 **Q. HOW COULD AEP OHIO'S PROPOSED ESP BE MODIFIED TO ACHIEVE**
18 **LESS COSTLY RATES AND TO SUPPORT RETAIL CHOICE?**

19 **A.** With regard to retail competition, the Commission should continue its practice of
20 allowing AEP Ohio to charge CRES providers the PJM RPM equivalent capacity price, no more
21 and no less. Promoting retail competition will provide the greatest single incentive for AEP
22 Ohio to lower costs. With this critical incentive, when lower cost capacity is available AEP Ohio

³² When discussing recovery of expenditures for pollution control technologies, replacement or additional generation and associated operating costs AEP provided that "We should be able to recover these expenditures through market prices in deregulated jurisdictions." See AEP, 2010 10-K, at p. 141; OPC, 2010 10-K, at p. 141; CSPC, 2010 10-K, at p. 124.

1 will take advantage of those opportunities, not ignore them. Likewise, the Commission should
2 reject generation-related non-bypassable surcharges. The primary reason for retail competition is
3 to give customers options to bypass high default costs through real competitive offers.

4 Regarding default service, the Commission can modify the ESP to allow for some
5 competition to serve default supply, providing bidders the opportunity to supply energy and
6 capacity as part of a full requirements bid. If AEP Ohio has the lowest cost available capacity,
7 then bidders will buy that capacity from AEP Ohio. If not, then they will buy capacity from
8 other resources. But in either case, AEP Ohio customers will be given access to the lowest
9 overall price. Alternatively, the Commission may order AEP Ohio to conduct a competitive
10 procurement for capacity and then have AEP Ohio provide that to winning bidders for default
11 service. These recommendations would require AEP Ohio to seek the lowest prices. In contrast,
12 if the regulatory construct gives AEP Ohio the unfettered right to use its FRR status to shield its
13 fleet from competition, then AEP Ohio will continue to focus on preserving its fleet and profits
14 rather than seeking lower cost alternatives for consumers. The Commission has the ability to
15 alter the proposed ESP, and should do so by ordering a competitive procurement. It should not
16 relinquish that authority solely to protect shareholders to the detriment of customers.

17 **Q. WHAT DO YOU SAY TO THOSE WHO MIGHT CONTEND THAT**
18 **COMPETITION WOULD ERODE THE COMMISSION'S ABILITY TO CONTROL**
19 **GENERATION?**

20 **A.** Competition increases, not diminishes, the Commission's control. The real question is
21 whether the Commission can control default service rates, not necessarily specific generation
22 assets.

1 A competitive process for energy and capacity for some, or the entire, default load, would
2 give the Commission substantially more control over default service rates than it would have
3 under AEP Ohio's ESP proposal. Make no mistake, AEP Ohio's proposal is about control, but
4 control resting in AEP Ohio's hands, not in the hands of Ohio policymakers and regulators.
5 Indeed, eliminating the Commission's control is exactly why AEP Ohio is arguing at FERC that
6 the Commission has no authority over capacity charges to CRES providers in Ohio.

7 Competition **will** fail if the Commission allows AEP Ohio to unfairly advantage its own
8 fleet through generation-related non-bypassable surcharges or uncompetitive capacity charges to
9 suppliers competing to serve retail customers or provide default supply for non-shopping
10 customers. If competitors leave AEP Ohio and the Ohio market, then AEP Ohio would control
11 default service rates for all practical purposes.

12 On the other hand, a properly structured competitive process would enable the
13 Commission to moderate default service rates by permitting some amount of less costly
14 generation to compete for the right to serve default customers. As a practical matter, given the
15 favorable location and composition of its generation fleet, AEP Ohio will still have enormous
16 competitive advantages, but true competitive pressures will ensure it is not given a blank check.
17 This is particularly important where AEP Ohio's rates are not cost-based³³ and where it appears
18 to seek the recovery of the same or similar costs in different forums and proceedings.

19 **Q. EARLIER YOU SPOKE ABOUT THE COMMISSION'S CONTROL OVER**
20 **DEFAULT SERVICE RATES AND SUGGESTED THAT SOME SAFEGUARDS ARE**
21 **NECESSARY TO ENSURE THAT THE INTERESTS OF AEP OHIO CUSTOMERS**

³³ AEP Ohio's Interrogatory Response, Exelon Generation, Set 1, INT-1-015.

1 ARE NOT SUBORDINATED TO THE INTERESTS OF SHAREHOLDERS. HOW
2 WILL A COMPETITIVE PROCESS ADDRESS THOSE CONCERNS?

3 A. In discovery, AEP Ohio responded that “[d]uring the course of routine business
4 operations, AEPSC [as agent for the AEP East Power Pool, of which AEP Ohio is a member]
5 receives bilateral wholesale offers for terms that could potentially apply to the reference period
6 of 2012 through 2014.”³⁴ [REDACTED]

7 [REDACTED]
8 [REDACTED]
9 [REDACTED]³⁵

10 It appears AEP Ohio believes its FRR status gives it *carte blanche* authority to accept or
11 reject competitive offers without any Commission oversight or input. Such lack of Commission
12 oversight creates the risk that suppliers could make offers to AEP Ohio that are lower cost for
13 consumers than AEP Ohio’s proposed ESP rate, but AEP Ohio could reject those offers in favor
14 of more expensive, self serving solutions. On the one hand, AEP Ohio should seek to obtain the
15 lowest costs for consumers, on the other hand, it wants to keep operating as much of its own fleet
16 for as long as possible to earn a higher return on equity, and increase off-system sales revenue
17 and other income. If AEP Ohio -- and AEP Ohio alone -- controls the decision whether to accept
18 or reject offers from other suppliers, there is a real risk that it will favor not Ohio’s consumers,
19 but its own shareholders by keeping uneconomic resources alive. A similar problem occurred in
20 Virginia where that Public Utility Commission reached the conclusion that “Indeed, it can be
21 reasonably argued, as Consumer Counsel has done, that over the past several years AEP has

³⁴ AEP Ohio Interrogatory Response, COMPETE, Set 1, INT-001 through INT-004.

³⁵ See AEP Ohio Interrogatory Response, Exelon Generation, Set 4, INT-4-056, Attachment 1, COMPETITIVELY-SENSITIVE CONFIDENTIAL.

1 repeatedly taken actions in assigning capacity that have harmed [APC] and its customers while
2 benefitting other AEP subsidiaries.”³⁶

3 **Q. WHAT CONCLUSIONS SHOULD THE COMMISSION DRAW** [REDACTED]

4 [REDACTED]

5 [REDACTED]

6 [REDACTED]

7 [REDACTED]

8 [REDACTED] The

9 *Commission must ask itself a few basic questions:*

- 10 • How does it know whether AEPSC as agent for AEP Ohio has solicited or obtained more
- 11 favorable energy and/or capacity offers for consumers?
- 12 • [REDACTED]
- 13 [REDACTED]
- 14 • Where is the check and balance between AEP Ohio’s shareholders and customers?
- 15 • Does AEP Ohio have an irreconcilable conflict of interest that cannot be resolved without
- 16 some process that independently considers the best opportunities for consumers?

17 I do not think the ESP process answers any of these questions, nor has AEP Ohio answered any
18 of these questions through discovery.

19 All of this leads me to conclude that the proposed ESP and related filings wrest control
20 from the Commission and undermine, if not eliminate competition. A competitive process

³⁶ See Virginia State Corporation Commission Final Order, Case No. PUE-2009-00030, July 15, 2010, at p. 13.

1 overseen by the Commission cannot be manipulated and would put control over default service
2 rates back into the hands of the Commission where it properly belongs.

3 **D. THE COMMISSION SHOULD PERMIT COMPETITION FOR NEW**
4 **GENERATION THAT PROTECTS CUSTOMERS FROM CONSTRUCTION**
5 **COST OVERRUNS AND OPERATIONAL RISKS**

6 **Q. WHAT IF THE COMMISSION LATER DETERMINES NEW GENERATION IS**
7 **NEEDED, OR DOUBTS THE MARKET WILL CONTINUE TO PROVIDE**
8 **ADVANTAGES BEYOND THE PROPOSED ESP PERIOD? HOW CAN THOSE**
9 **ISSUES BE ADDRESSED IN A COMPETITIVE SSO?**

10 **A.** Competition can help not only in procuring the least-cost new resource, but also in
11 determining whether there is actually a need for that resource. A long-term competitive process
12 that is open to both new and existing resources will accomplish both goals.

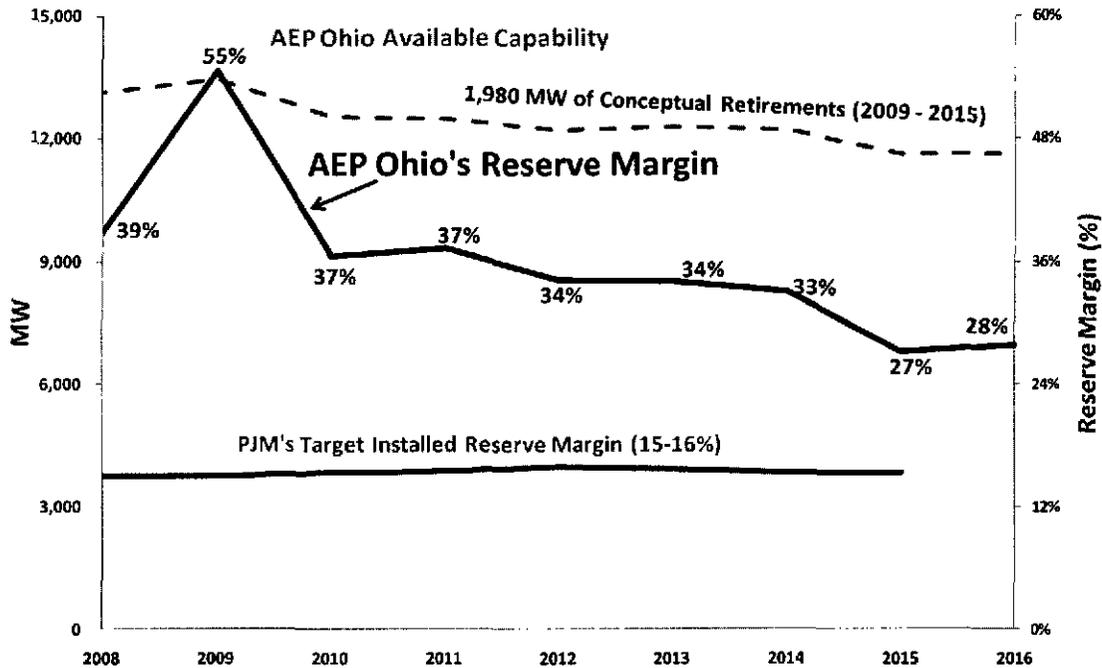
13 If the Commission eventually determines longer term supply such as new generation is
14 needed, then it could structure a wholesale Request for Proposals (RFP) or SSO to acquire bids
15 for long-term power purchase agreements to meet Ohio customers' demand – such a process
16 would be open to all bidders, not just AEP Ohio. At the moment there is a surplus of generation
17 to support capacity for AEP Ohio customers. As referenced in Mr. Schnitzer's testimony, "AEP
18 Ohio's reserve margin was about 55% in 2009, 37% in 2010, and is expected to gradually
19 decline to about 28% by 2016, even after assuming 2.0 GW in [recently announced] plant
20 retirements."³⁷ These numbers far exceed PJM's target installed reserve margin of 15-16%.

³⁷ See Direct Testimony of Michael M. Schnitzer on Behalf of FirstEnergy, at p. 90 lines 7-10; see also *id.*
at pp. 90-91 n.141 (



1 Below I have included Figure "AEP Ohio's Reserve Margin" from page 98 of Mr. Schnitzer's
2 testimony to highlight the ample surplus.

3 **AEP Ohio's Reserve Margin**



4 Source: AEP Filing, PUCO Case Nos. 11-2501-EL-FOR and 11-2502-EL-FOR, 4/15/2011, pp. 140-141. Retirements include Phil Sporn 5 (440 MW, 2010),
5 Conesville 3 (165 MW, 2012), Muskingum River 2&4 (395 MW, 2012), Muskingum River 1&3 (380 MW, 2014), Muskingum River S (600 MW, 2015). OPCo and
6 CSP's Non-Coincident Peak Loads have been scaled to reflect AEP Ohio's expected share of PJM 1CP, based upon AEP Ohio's SCP contribution to PJM's SCP in
7 2009. Available Capability is net of an average of 1.0 GW in annual net sales over the 2008-2016 period. PJM's Target IRM is known through FY14/15.

8 Likewise, as I understand the statute, the proposed ESP period could be extended beyond the 29-
9 months that AEP proposes to cover, but the Commission should be skeptical of arguments that
10 propose higher near term prices in favor of "forecasted" future savings over the long term.
Nonetheless, if the Commission wants to test whether market prices continue to offer value over
a longer 5-10 year term, the Commission could include some longer term competitive
procurements in the ESP. As I stated earlier, I believe that natural gas discoveries from shale



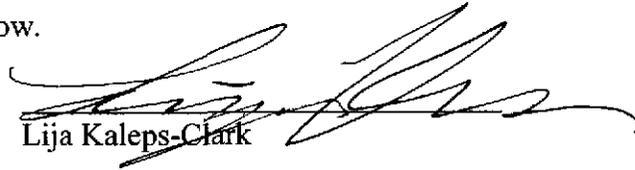
1 formations in states like Ohio and Pennsylvania have transformed electricity markets and that
2 competition will provide low cost options for years beyond the proposed 29-month ESP period.
3 Exelon Generation is prepared to offer to sell electricity and capacity for longer than 29-months
4 if that is what the Commission orders.

5 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

6 **A.** Yes, although I reserve the right to file rebuttal testimony.

CERTIFICATE OF SERVICE

I hereby certify that the foregoing document was served this 25th day of July, 2011 by electronic mail, upon the persons listed below.


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