11

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

FILE

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to § 4928.143, Ohio Rev. Code, in the Form of an Electric Security Plan.	:	Case Nos. 11-346-EL-SSO 11-348-EL-SSO
In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority.	:	Case Nos. 11-349-EL-AAM 11-350-EL-AAM

PREFILED TESTIMONY
OF
TIMOTHY W. BENEDICT

ON BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO
ENERGY &ENVIRONMENT DEPARTMENT
MARKET ANALYSIS & PLANNING DIVISION

STAFF EX. ___

August 4, 2011

1. Q. Please state your name and business address.

A. My name is Timothy W. Benedict. I am employed by the Public Utilities Commission of Ohio, 180 E. Broad St, Columbus, OH 43215.

2. Q. What is you current position at the Commission?

A. I am a Utility Specialist in the Division of Planning and Market Analysis, Department of Energy and Environment. My responsibilities include economic analysis of wholesale and competitive markets, demand forecasting and resource planning.

3. Q. Please summarize your educational background and work experience.

A. I received a B.A. in Economics from the University of Vermont and a M.A. in Economics from Cleveland State University. I have been employed by the Staff of the Public Utilities Commission of Ohio since December 2009.

4. Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address the Companies' proposed POLR (Provider of Last Report) rider.

5. Q. What is your understanding of the risks identified by the Companies as comprising the POLR obligation?

A. The Companies identify two risks that comprise the POLR obligation, migration risk and return risk. Migration risk refers to the risk that customers can forego SSO generation service at any time to take service from a CRES provider. Return risk refers to the risk that customers who have switched may return to the Companies' SSO at any time. The Companies claim that there is a definite and significant cost associated with providing this flexibility or "optionality" for which they must be adequately compensated.

6. Q. Do you believe that the Companies have properly defined the nature of the POLR obligation?

A. No. It is my opinion that the POLR obligation includes only the risks associated with the possibility that customers may return to the SSO price at any time, which is the risk identified as the "return risk". While the return risk is related to migration risk, the migration risk itself simply reflects the possibility that customers may take advantage of the opportunity afforded to them by law to shop for generation service. What the Companies have identified as "migration risk," or shopping risk, reflects a risk that exists for all firms operating in a competitive market. The return risk, however, is a unique responsibility in that the EDU is obligated to stand ready to provide generation service to all customers at any time, and it is this risk which comprises the POLR obligation. The Companies have identified the return risk as comprising 12% of the total POLR cost in the proposed constrained model, valued at $0.34 / MWh.[1]

7. Q. What costs could the Companies incur as a result of their POLR obligation?

A. Should a customer return to SSO service, it is likely because market prices have risen above the ESP price, creating an economic incentive for customers who have already switched generation providers to return to SSO service. The Companies would then incur any incremental capacity and energy costs associated with serving these customers.

8. Q. Do the Companies have the opportunity to recover such costs through existing rate mechanisms?

A. Yes. It is my understanding that any increase necessary for incremental fuel or purchase power to serve a returning customer could be collected through the FAC rider. Therefore, the Companies are not fully exposed to the risks associated with serving returning customers in a scenario where market prices are above the ESP price. Alternatively, returning customers could be required to pay a market-based rate in lieu of the SSO rate,

---

1 *In re Columbus Southern Power and Ohio Power Company*, Case No. 11-346-EL-SSO, *et al.* (*2011 ESP Cases*) (OCC RPD-026 at Attachment 1).

effectively mitigating the risk to the Companies of providing standby service.

9. Q. What is your understanding of the mechanism by which the Companies propose to value the POLR obligation?

A. The Companies have proposed to value the POLR obligation using the Black model, which is a mathematical model used to derive the theoretical value of a financial option. An option is the right, but not the obligation, to buy or sell an asset at a specified price. The Black model is a variant of the more widely recognized Black-Scholes model, and is used when the model is applied to futures contracts. In this context the model calculates, on an a priori basis, the expected value to customers of the option to shop, as well as the option to return to SSO rates. The Companies claim that this value is equal to the cost to the Companies of providing the optionality, and is therefore the proper level of collection. A particularly troubling extension of this logic is that by setting the POLR rate equal to the value of the optionality to customers, the Companies are essentially extracting from customers the entire economic value afforded to them by the right to shop for a generation supplier.

10. Q. Do you believe that the Black model as presented by the Companies will result in an accurate valuation of the optionality available to customers?

11. A. The Black model, like any other model, must make certain limiting assumptions in order to achieve mathematical precision. The result may be that it does not fully reflect the specific situation it is intended to address, as the model is insufficiently equipped to account for the various factors that influence actual customer behavior.

For example, the model assumes that there are no transaction costs associated with exercising the option, which implies that all customers will switch in each and every instance in which the option is "in the money." This simplifying assumption is likely violated in reality for a number of reasons. The Companies seem to have acknowledged that the model is subject to certain sources of error and have "continued to refine and improve the option model."[2] This lead to the development of the "constrained model," which accounts for tariff-based switching constraints that limit the value of the option. Nonetheless, in reviewing the use of the model in prior years, the limited evidence that exists seems to indicate that the shopping behavior and attendant risks predicted by the model simply did not materialize.

12. Q. Does this conclude your testimony?

A. Yes, it does.

[2] *2011 ESP Cases* (Direct Testimony of Laura J. Thomas at 13) (January 27, 2011).

PROOF OF SERVICE

I hereby certify that a true copy of the foregoing **Prefiled Testimony of Timothy W. Benedict,** submitted on behalf of the Staff of the Public Utilities Commission of Ohio, was served by regular U.S. mail, postage prepaid, or hand-delivered, upon the following Parties of Record, this 4th day of August, 2011.

John H. Jones
Assistant Attorney General

Parties of Record:

Matthew J. Satterwhite
Steven T. Nourse
American Electric Power
1 Riverside Plaza
Columbus, OH 43215
mjsatterwhite@aep.com
stnourse@aep.com

Daniel Conway
Porter, Wright, Morris & Arthur
41 South High Street
Columbus, OH 4321
dconway@porterwright.com

ON BEHALF OF COLUMBUS SOUTHERN POWER COMPANY AND OHIO POWER COMPANY

Colleen L. Mooney
Ohio Partners for Affordable Energy
231 West Lima Street
Findlay, OH 45840
cmooney2@columbus.rr.com

ON BEHALF OF OHIO PARTNERS FOR AFFORDABLE ENERGY

Dorothy Corbett
Duke Energy Ohio
139 East Fourth Street
Suite 1303
P.O. Box 960
Cincinnati, OH 45201
dorothy.corbett@duke-energy.com

Philip P. Sineneng
Thompson Hine
41 South High Street, Suite 1700
Columbus, OH 43215
Phillip.sineneng@thompsonhine.com

ON BEHALF OF DUKE ENERGY RETAIL SALES

Michael Smalz
Joseph Maskovyak
Ohio Poverty Law Center
555 Buttles Avenue
Columbus, OH 43215-1137
msmalz@ohiopovertlaw.org
jmaskovyak@ohiopovertylaw.org

ON BEHALF OF THE APPALACHIAN PEACE AND JUSTICE NETWORK

David Boehm
Michael L. Kurtz
Boehm Kurtz &Lowry
36 East Seventh Street
Suite 1510
Cincinnati, OH 45202
dboehm@bkllawfirm.com
mkurtz@bkllawfirm.com

ON BEHALF OF THE OHIO ENERGY GROUP

John Bentine
Mark Yurick
Chester Willcox & Saxbe
65 East State Street
Suite 100
Columbus, OH 43215
jbentine@cwslaw.com
myurick@cwslaw.com

ON BEHALF OF THE KROGER CO.

Lisa G. McAlister
Matthew W. Warnock
Bricker & Eckler
100 South Third Street
Columbus, OH 43215-4291
lmcalister@bricker.com
mwarnock@bricker.com

ON BEHALF OF OMA ENERGY GROUP

Jay E. Jadwin
American Electric Power Service Corp.
1 Riverside Plaza, 29th Floor
Columbus, OH 43215
jedjadwin@aep.com

ON BEHALF OF AEP RETAIL ENERGY PARTNERS

Terry Etter
Maureen R. Grady
Assistant Consumers' Counsel
Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, OH 43215
etter@occ.state.oh.us
grady@occ.state.oh.us

ON BEHALF OF THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

Richard L. Sites
Ohio Hospital Association
155 East Broad Street, 15th Floor
Columbus, OH 43215
ricks@ohanet.com

Thomas J. O'Brien
Bricker & Eckler
100 South Third Street
Columbus, OH 43215-4291
tobrien@bricker.com

ON BEHALF OF OHIO HOSPITAL ASSOCIATION

Terrence O'Donnell
Christopher Montgomery
Bricker & Eckler
100 South Third Street
Columbus, OH 43215
todonnell@bricker.com
cmontgomery@bricker.com

ON BEHALF OF PAULDING WIND FARM II AND THE DISTRIBUTED WIND ENERGY ASSOCIATION

Gregory Poulos
EnerNOC, Inc.
101 Federal Street
Suite 1100
Boston, MA 02110
gpoulos@enernoc.com

ON BEHALF OF ENERNOC, INC.

Tara Santarelli
Environmental Law & Policy Center
1207 Grandview Avenue
Suite 201
Columbus, OH 43212
tsantarelli@elpc.org

ON BEHALF OF THE ENVIRONMENTAL LAW & POLICY CENTER

Glen Thomas
1060 First Avenue
Suite 400
King of Prussia, PA 19406
gthomas@gtpowergroup.com

Laura Chappelle
4218 Jacob Meadows
Okemos MI 48864
laurac@chappellconsulting.net

ON BEHALF OF PJM POWER PROVIDERS GROUP

William L. Massey
Covington & Burling
1201 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
wmassey@cov.com

Joel Malina
Compete Coalition
1317 F Street, N.W.
Washington, D.C. 2004
malina@wexlerwalker.com

ON BEHALF OF THE COMPETE COALITION

Mark A. Hayden
FirstEnergy Corp.
76 South Main Street
Akron, OH 44308
haydenm@firstenergycorp.com

James F. Lang
Laura McBride
N. Trevor Alexander
Calfee Halter & Griswold
800 Superior Avenue
Cleveland, OH 44114
jlang@calfee.com
lmcbride@calfee.com
talexander@calfee.com

David Kutik
Jones Day
North Point
901 Lakeside Avenue
Cleveland, OH 44114
dakutik@jonesday.com

Allison E. Haedt
Jones Day
P.O. Box 165017
Columbus, OH 43216-5017
aehaedt@jonesday.com

ON BEHALF OF FIRSTENERGY SOLUTIONS CORP.

M. Howard Petricoff
Stephen M. Howard
Vorys, Sater, Seymour and Pease
52 East Gay Street
P.O. Box 1008
Columbus, OH 43215-1008
mhpetricoff@vorys.com
smhoward@vorys.com

ON BEHALF OF PJM POWER PROVIDERS GROUP AND THE RETAIL ENERGY SUPPLY ASSOCIATION

Douglas G. Bonner
Emma F. Hand
Keith C. Nusbaum
Sonnenschein Nath & Rosenthal
1301 K Street, N.W.
Suite 600 East Tower
Washington, D.C. 20005
doug.bonner@snrdenton.com
emma.hand@snrdenton.com
keith.nusbaum@snrdenton.com

ON BEHALF OF ORMET PRIMARY ALUMINUM CORPORATION

Henry W. Eckhart
1200 Chambers Road
Suite 106
Columbus, OH 43212
henryeckhart@aol.com

Shannon Fisk
Natural Resources Defense Council
2 North Riverside Plaza, Suite 2250
Chicago, IL 60606
sfisk@nrdc.org

ON BEHALF OF THE NATURAL RESOURCES DEFENSE COUNCIL AND THE SIERRA CLUB

M. Howard Petricoff
Michael J. Settineri
Vorys, Sater, Seymour and Pease
52 East Gay Street
P.O. Box 1008
Columbus, OH 43215-1008
mhpetricoff@vorys.com
mjsettineri@vorys.com

ON BEHALF OF CONSTELLATION NEWENERGY, INC., CONSTELLATION ENERGY COMMODITIES GROUP, INC., AND THE COMPETE COALITION

David Fein
Cynthia Fonner Brady
Constellation Energy Resources
550 West Washington Boulevard
Suite 300
Chicago, IL 60661
david.fein@constellation.com
cynthia.brady@constellation.com

ON BEHALF OF CONSTELLATION NEWENERGY, INC. AND CONSTELLATION ENERGY COMMODITIES GROUP, INC.

Samuel C. Randazzo
Frank P. Darr
Joseph E. Oliker
McNees Wallace & Nurick
21 East State Street, 17th Floor
Columbus, OH 43215
sam@mcwncmh.com
fdarr@mwncmh.com
joliker@mwncmh.com

ON BEHALF OF INDUSTRIAL ENERGY USERS-OHIO

Barth Royer
Bell & Royer
33 South Grant Avenue
Columbus, OH 43215-3927
barthroyer@aol.com

Gary A. Jeffries
Dominion Resources Services, Inc.
501 Martindale Street, Suite 400
Pittsburgh, PA 15212-5817
gary.a.jeffries@aol.com

ON BEHALF OF DOMINION RETAIL

Pamela A. Fox/C. Todd Jones
Steven J. Smith/Christopher Miller
Gregory Dunn/Asim Haque
Schottenstein Zox and Dunn
250 West Street, Suite 500
Columbus, OH 43215
pfox@szd.com
cmiller@szd.com
gdunn@szd.com
ahaque@szd.com

ON BEHALF OF THE CITY OF HILLIARD, OHIO, THE CITY OF GROVE CITY, OHIO, AND THE ASSOCIATION OF INDEPENDENT COLLEGES AND UNIVERSITIES OF OHIO

Kenneth P. Kreider
Keating Muething & Klekamp
One East Fourth Street
Suite 1400
Cincinnati, OH 45202
gkreider@kmklaw.com

Holly Rachel Smith
Hitt Business Center
3803 Rectortown Road
Marshall, VA 20115-3338
holly@raysmithlaw.com

Steve W. Chriss
Wal-Mart Stores, Inc.
Bentonville, AR 72716-0550
stephen.chriss@wal-mart.com

ON BEHALF OF WAL-MART STORES EAST AND SAM'S EAST

Sandy Grace
Exelon Business Services Company
101 Constitution Avenue, N.W.
Suite 400 East
Washington, D.C. 20001
sandy.grace@exeloncorp.com

Jesse A. Rodriguez
Exelon Generation Company
300 Exelon Way
Kennett Square, PA 19348
jesse.rodriguez@exeloncorp.com

M. Howard Petricoff
Vorys, Sater, Seymour and Pease
52 East Gay Street
P.O. Box 1008
Columbus, OH 43215-1008
mhpetricoff@vorys.com

David M. Stahl
Arin C. Aragona
Scott C. Solberg
Elmer Stahl Klevorn & Solberg
224 South Michigan Avenue
Suite 1100
Chicago, IL 60604

Anastasia Polek-O'Brien
Exelon Generation Company
10 South Dearborn Street, 49th Floor
Chicago, IL 60603

ON BEHALF OF EXELON GENERATION COMPANY

Nolan Moser
Trent A. Dougherty
Ohio Environmental Council
1207 Grandview Avenue
Suite 201
Columbus, OH 43212-3449
nolan@theoec.org
trent@theoec.org

ON BEHALF OF THE OHIO ENVIRONMENTAL COUNCIL