BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals	))))	Case No. 10-2376-EL-UNC
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 No. 11-346-EL-SSO Case No. 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 No. 11-349-EL-AAM Case No. 11-350-EL-AAM
In the Matter of the Application of Columbus Southern Power Company to Amend its Emergency Curtailment Service Riders	))))	Case No. 10-343-EL-ATA
In the Matter of the Application of Ohio Power Company to Amend its Emergency Curtailment Service Riders	))))	Case No. 10-344-EL-ATA
In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company	))))	Case No. 10-2929-EL-UNC
In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Ohio Revised Code 4928.144	)))))	Case No. 11-4920-EL-RDR
In the Matter of the Application of Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Ohio Revised Code 4928.144	)))))	Case No. 11-4921-EL-RDR

JOINT INITIAL BRIEF OF THE UNDERSIGNED SIGNATORY PARTIES

Filed: November 10, 2011

TABLE OF ACRONYMS

ADIT	**Accumulated Deferred Income Tax**
AEP GenCo	**American Electric Power Generating Company**
AER	**Alternative Energy Rider**
AICUO	**Association of Independent Colleges and Universities of Ohio**
BCF	**Billion Cubic Feet**
CBP	**competitive bid process**
CHP	**Combined Heat and Power**
CRES	**competitive retail electric service**
DIR	**Distribution Investment Rider**
ECS	**Emergency Curtailment Services**
EDU	**Electric Distribution Utility**
ELPC	**Environmental Law & Policy Center**
EnerNOC	**EnerNOC, Corp.**
ESP	**Electric Security Plan**
ESP I	**Commission Case Nos. 08-917-EL-SSO and 08-918-El-SSO**
ESP II	**Commission Case Nos. 11-346-EL-SSO and 11-348-El-SSO**
ESRR	**Enhanced Service Reliability Rider**
Exelon	**Exelon Generation Corp.**
FAC	**Fuel Adjustment Clause**
FERC	**Federal Energy Regulatory Commission**
FES	**FirstEnergy Soultions, Corp.**
FPA	**Federal Power Act**
FRR	**Fixed Resource Requirement**
GPRR	**Green Power Portolio Rider**
GRR	**Generation Resource Rider**
GS	**Generation Service**
GWh	**Gigawatt hour**
IAA	**Interim Allowance Agreement**
IEU	**Industrial Energy Users-Ohio**
kW	**kilowatt**
kV	**kilovolt**
kWh	**kilowatt hour**
LED	**Light Emitting Diode**
LFP	**Load Factor Provision**
LMP	**Locational Marginal Price**
LSE	**Load Serving Entity**
MCL	**Master Customer List**
MLR	**Member Load Ratio**
MRO	**Market Rate Offer**
MTR	**Market Transition Rider**
MW	**Megawatt**
MWh	**Megawatt hour**
NCP	**Non-coincident peak**
NERC	**North American Electric Reliability Corporation**

NRDC	**Natural Resources Defense Council**
NSPL	**Network Service Peak Load**
O&M	**Operating & Maintenance**
OATT	**Open Access Transmission Tariff**
OCC	**Ohio Consumers' Counsel**
OEG	**Ohio Energy Group**
OGF	**Ohio Growth Fund**
OHA	**Ohio Hospital Association**
OMAEG	**Ohio Manufactures Association Energy Group**
OPAE	**Ohio Partners for Affordable Energy**
OSS	**Off system sales**
PEV	**plug-in electric vehicle**
PIRR	**Phase-In Recovery Rider**
PJM	**PJM Interconnection, LLC.**
PLC	**Peak Load Contributors**
PMR	**Pool Modification Rider**
POLR	**Provider of Last Resort**
PUCO	**Public Utilities Commission of Ohio**
PWO	**Partnership With Ohio**
RAA	**Reliability Assurance Agreement**
REC	**Renewable Energy Certificate**
REPA	**Renewable Energy Purchase Agreement**
RESA	**Retail Energy Supply Association**
RFP	**Request for Proposal**
ROE	**Return on Equity**
RPM	**Reliability Pricing Model**
SEET	**Significantly Excessive Earning Test**
SSO	**Standard Service Offer**
V	**Voltage**
WACC	**Weighted Average Cost of Capital**
WER	**Waste Energy Recovery**

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JOINT INITIAL BRIEF OF THE UNDERSIGNED SIGNATORY PARTIES

I. INTRODUCTION

On September 7, 2011, numerous parties filed a Stipulation and Recommendation ("Stipulation") before the Public Utilities Commission of Ohio ("Commission") to resolve the issues in the cases captioned above. The Stipulation being presented to the Commission is a package of recommendations to address important regulatory issues and resolve a number of contested cases pending before both this Commission and the Federal Energy Regulatory Commission (FERC). The Stipulation is supported by a substantial list of stakeholders representing a diverse group of interests. Not only does the Stipulation fundamentally restructure AEP Ohio's business model and drive the potential for achieving a statewide consensus model for an auction-based standard service offer ("SSO") (assuming for this purpose that the pending Duke Energy- Ohio settlement is also adopted), the negotiated result incorporates an impressive array of customer and public policy benefits that were achieved through staggering compromises among the Signatory Parties' litigation positions. While the Stipulation involves a host of important issues and proposals, the three most contentious (and equally vital) sets of issues are: (i) the terms and conditions of the ESP during the transition to full market (2012-2016); (ii) restructuring of AEP Ohio's business model; and (iii) the capacity price paid to AEP Ohio by CRES providers to support retail shopping.

<u>ESP During the Transition to Auction-Based ESP</u>

The Company's initial ESP Application filed by AEP Ohio on January 27, 2011 was significantly modified by the final Stipulation, and reflects the serious bargaining and compromise that occurred. The result is reasonable and supported by the record. Significantly, the Stipulation creates a transition period during which time the rates, terms and conditions of SSO service are known, just and reasonable.

The Stipulation also simplifies the number and operation of the proposed generation service riders. The Signatory Parties also agreed to: (i) establish fixed base generation rates during the pre-auction period of the ESP, which reflect a market-based rate re-design and a Market Transition Rider (MTR), (ii) establish a new interruptible credit, and (iii) establish a Load Factor provision to promote economic development and benefit high load factor customers. By dropping the non-bypassable riders and establishing fixed base generation rates, the Stipulation transfers substantial risk from customers to AEP Ohio while simultaneously improving rate certainty and stability for customers.

The Stipulation also provides for a non-bypassable rider, Generation Resource Rider (GRR), which shall act as a place-holder until such time as the Commission approves any project-specific costs to be included in the GRR. When seeking authorization from the Commission for cost recovery through the GRR, AEP must demonstrate how the proposed project satisfies all applicable requirements set forth in R.C. 4928.143(B)(2). Upon adoption of the Stipulation (including the GRR provision), both the parties and the Commission fully reserve their ability to support or oppose the future establishment of a non-zero charge for inclusion in the GRR. Conversely, rejecting the GRR would preclude the possibility that the Commission could subsequently approve the MR 6 shale gas project or the Turning Point solar project. Allowing for recovery of the costs of new generation plants dedicated to serving Ohio customers encourages the construction of new plants in Ohio that can: 1) enhance the reliability of the electric system; and 2) provide a cost-based hedge against fluctuations in market prices. As a related matter, AEP Ohio has committed to substantial fleet transformation and fuel diversification utilizing Ohio shale gas. In accordance with this key component of the Stipulation, which would not have been possible absent settlement, AEP Ohio will endeavor to enter into competitively priced long-term shale gas contracts for AEP Ohio generation plants with Ohio producers who commit to investment and employment growth in Ohio.

Restructuring of AEP Ohio

By adopting the Stipulation, the Commission will approve two significant structural changes to AEP Ohio that will enable AEP Ohio to implement an auction-based SSO after the ESP transition period: (i) the merger of CSP and OPCo; and (ii) full corporate separation of AEP Ohio's generation and wires businesses. The corporate restructuring is a cornerstone requirement to many of the individual provisions contained in the Stipulation. AEP Ohio has filed a separate application to implement structural corporate separate as contemplated in the Stipulation. The Commission has the necessary information, including, among other things, the rates through mid-2015 after which generation rates will be determined based on a competitive bidding process, in order to approve the corporate separation, which complies with Ohio law.

The Stipulation sets forth a schedule for conducting a Competitive Bidding Process (CBP) to supply its SSO for delivery within the ESP term during the period from June 1, 2015 through May 31, 2016, such that auctions are conducted in 2013, 2014 and 2015 leading up to that delivery period. The auction schedule is tied to other agreed upon provisions that are designed to ensure that AEP Ohio expeditiously obtains FERC approvals for corporate separation and that the AEP Generation Pool is terminated or modified. These provisions demonstrate AEP Ohio's commitment to transition to full market based rates after a brief and necessary transition.

Capacity Pricing

The appropriate pricing for capacity paid by competitive retail electric service (CRES) providers for use of AEP Ohio's capacity to support retail shopping is a contentious issue that the Stipulation fully and finally resolves – without the need to play out the substantial federal-state conflict that is currently staged and placed on hold at FERC pending consideration of the Stipulation. The issue was raised by the Commission in Case No. 10-2929-EL-UNC (the "*Ohio Capacity Charge Docket*") and its resolution by the Stipulation not only would resolve that case, but also the other pending proceedings before the FERC that address the same topic. The Stipulation's resolves the capacity charge issues to the satisfaction of all but one of the many CRES intervenors in the proceedings.

Prior to 2007, when PJM Interconnection, LLC (PJM) implemented a capacity market pricing construct known as Reliability Pricing Model (RPM), AEP, as well as other parties, expressed concern over the long-term negative impacts of the RPM capacity market on vertically integrated utilities and their customers. A special provision was drafted to ensure that those entities could request a cost-based method of recovering their capacity costs and avoid the RPM pricing; this provision is known as the Fixed Resource Requirement (FRR). AEP was the only FRR entity in PJM for years – and was applauded by this Commission for selecting the FRR option.

Because no CRES provider in Ohio self-supply their own generation resources to support retail service offerings, those providers act merely as a middle-man on capacity flowing from AEP Ohio to support retail generation service. While the RPM auction prices have fluctuated significantly, the auction prices for the next several years have dropped to levels that would prevent AEP Ohio from receiving anything remotely approaching full compensation from CRES providers for AEP Ohio's capacity costs. These dramatic price drops in the RPM market caused AEP Ohio to pursue its option before the FERC to establish a cost-based rate. While these CRES providers are using AEP Ohio's capacity resources, they (unlike AEP Ohio's non-shopping SSO customers) avoid paying the embedded generation capacity costs that are on the books of AEP Ohio.

The Stipulation proposes to resolve the capacity charge dispute through two primary provisions as well as other related provisions. In the first major component of the Stipulation's proposal for resolving the capacity pricing issues, the Signatory Parties recommend to establish a substantial set aside amount of RPM-priced capacity to preserve and expand retail shopping in AEP Ohio's service territory. Specifically, the 2012 set aside of 21% of AEP Ohio total retail load is approximately 10,000 GWh, which is roughly equal to the entire 2010 load of Toledo Edison Company. The potential 2013 set aside of 31% of AEP Ohio total retail load is approximately 15,000 GWh, which is roughly equal to the entire 2010 load of Dayton Power & Light Company. And the 2014-2015 set aside of 41% of AEP Ohio total retail load is approximately 20,000 GWh, which is roughly equal to the entire 2010 load of Duke Energy-Ohio.

The second major component of the Stipulation's proposed resolution of the capacity pricing dispute is the Signatory Parties recommendation, that the Commission set the capacity charge in Case No. 10-2929-EL-UNC to be the PJM RPM-based rate except that an interim rate of $255/MW-Day effective starting in January, 2012 will be charged to CRES providers for all shopping above the RPM set aside levels. After May 31, 2015, the Commission's State Compensation mechanism will expire and the capacity charge will be the PJM RPM-based capacity rate. This new interim capacity charge of $255/MW-Day will only be charged to CRES providers for any shopping above the RPM set aside levels. Even this limited non-RPM interim rate is substantially lower than the cost-based capacity charges proposed by AEP Ohio and supported in AEP Ohio's testimony of $355.72/MW-Day. The net result of the Stipulation's auction-based SSO and capacity transition is to achieve a fully competitive SSO in less than four years – much quicker than is possible under a Market Rate Offer (which involves a minimum of six years to achieve).

The Stipulation proposes to fully resolve the pending FERC litigation regarding capacity. This involves a process for holding in abeyance the *Section 205 FERC Application* and the *Section 206 FERC Complaint* until the Commission issues a final order adopting the Stipulation, after which time the FERC cases will be resolved as they affect Ohio. Thus, adoption of the Stipulation would resolve both the *Ohio Capacity Charge Docket* and the pending FERC litigation regarding the capacity charge dispute. By contrast, the consequences of failing to adopt the Stipulation's resolution of the capacity pricing issue must also be considered: protracted and extensive litigation at the Commission, at FERC, and in the federal and State courts.

Conclusion

Despite the tremendous compromise achieved and the benefits of the Stipulation, some parties oppose adoption of the Stipulation and would have the Commission turn its back on those opportunities and opt instead for extensive litigation and uncertainty. If the Commission does not approve the proposed ESP (as reflected in the Stipulation) and instead modifies the proposed ESP, AEP Ohio has the right to withdraw and file a new SSO either under the ESP statute or the MRO statute. This "consent" requirement is particularly important to bear in mind, as the Commission examines the terms of the Stipulation being voluntarily agreed to by AEP Ohio, since many of the significant provisions agreed to in the Stipulation would not be possible in the context of AEP Ohio's initially proposed ESP and a litigated outcome (*e.g.*, auction-based SSO, shale gas commitment, below-cost discount of wholesale capacity charge, reduction of approved carrying charge for deferred fuel, etc.) The evidence shows that the ESP passes the statutory requirements and that the Stipulation as a whole was negotiated by knowledgeable parties, is in the public interest and does not violate any regulatory principles. Accordingly, for the reasons set forth herein, the Commission should adopt the Stipulation without modification and approve AEP Ohio's ESP.

II. BACKGROUND

The Stipulation proposes to resolve five sets of AEP Ohio proceedings that are presently pending before the Commission. This section provides a brief procedural history of each proceeding.

A. Merger of CSP and OPCo: Case No. 10-2376-EL-UNC

On October 18, 2010, OPCo and CSP filed a joint application for authority to merge and related approvals.[1] The Commission set deadlines of February 25 and March 11, 2011, for the submission of initial comments and reply comments on the proposed merger and held that it would determine, after reviewing the comments, whether a hearing on the merger would be necessary.[2] Ohio Partners for Affordable Energy (OPAE), Direct Energy Services, LLC and Direct Energy Business, LLC (collectively, "Direct Energy"), the Ohio Manufacturers' Association Energy Group (OMAEG), The Office of the Ohio Consumers' Counsel (OCC), the Ohio Energy Group (OEG), Industrial Energy Users-Ohio (IEU), First Energy Solutions, Corp.

[1] *See In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals* (*In re AEP Ohio Merger*), Case No. 10-2376-EL-UNC, Application (Oct. 18, 2010).
[2] *In re AEP Ohio Merger*, Entry (Feb. 9, 2011).

("FES"), and The Kroger Co. (Kroger) provided comments on the merger application, largely requesting that the Commission allow for further factual development of the impact of the proposed merger on customers. AEP Ohio filed reply comments addressing commenter concerns on March 11, 2011. The Federal Energy Regulatory Commission (FERC) approved the merger on July 1, 2011.[3]

B. Emergency Curtailment Service Tariffs: Case Nos. 10-343/344-EL-ATA

AEP Ohio applied to amend CSP and OPCo's emergency curtailment service riders on March 19, 2010 to offer a new demand response program regarding customer participation in PJM Interconnection, L.L.C. (PJM) demand response programs.[4] IEU, Constellation NewEnergy, Inc. (Constellation), OCC, and EnerNOC, Inc. (EnerNOC) submitted comments on the application on May 28, 2010. AEP Ohio, OCC, and IEU each submitted reply comments on June 7, 2010. AEP Ohio amended its application on February 2, 2011.[5] EnerNOC provided comments on the amended application on March 15, 2011.

C. Capacity Charges: Case No. 10-2929-EL-UNC

On November 24, 2010, AEP Ohio filed an application with FERC in FERC Docket No. ER11-2183-000, seeking approval to make changes to the wholesale charges that CSP and OPCo assess for supplying capacity for retail loads served by CRES providers. On December 8, 2010, the Commission issued an entry in Case No. 10-2929-EL-UNC, seeking comments and

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[3] *In re AEP Ohio Merger*, Notice of Filing (July 1, 2011).

[4] *See In the Matter of Application of Columbus Southern Power Company and Ohio Power Company to Amend Their Emergency Curtailment Service Riders, et al.* (*Emergency Curtailment Service Case*), Case Nos. 10-343-EL-ATA, 10-344-EL-ATA, Application (Mar. 19, 2010).

[5] *Emergency Curtailment Service Case*, Amended Application (Feb. 2, 2011).

information from interested parties concerning AEP Ohio's FERC application.[6] The Commission adopted the three-year capacity auction conducted by PJM as the state compensation mechanism for the Companies on an interim basis during the pendency of the review. AEP Ohio, IEU, Constellation, Direct Energy, OEG, OPAE, FES, and OCC filed initial comments in January 2011. AEP Ohio also filed an application for rehearing on the Commission's December 8, 2010 Entry,[7] which the Commission granted.[8] The parties submitted reply comments in February. By Entry dated August 11, 2011, the Commission established the case's procedural schedule and set the hearing of the case for October 4, 2011.[9] Five witnesses for the Company submitted testimony on August 31, 2011.

D. Phase In Recovery Rider: Case Nos. 11-4920/4921-EL-RDR

On September 1, 2011, AEP Ohio submitted an application to recover the fuel costs that the Commission ordered to be deferred for later collection as part of the phase-in of rate changes ordered by the Commission in the Companies' ESP cases, 08-917-EL-SSOand 08-918-EL-SSO.[10]

E. ESP II: Case Nos. 11-346/348-EL-SSO and 11-349/350-EL-AAM

On January 27, 2011, CSP and OPCo jointly filed an SSO application for an ESP to be in effect from January 1, 2012 through May 31, 2014 and for approval of certain accounting

[6] *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company* (*Capacity Charge Case*), Case No. 10-2929-EL-UNC, Entry (Dec. 8, 2010).
[7] *Capacity Charge Case*, Application for Rehearing (Jan. 7, 2011).
[8] *Capacity Charge Case*, Entry (Feb. 2, 2011).
[9] *Capacity Charge Case*, Entry (Aug. 11, 2011).
[10] *In the Matter of Columbus Southern Power Company and Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Ohio Revised Code 4928.144, et al.*, Case Nos. 11-4920-EL-RDR, 11-4921-EL-RDR, Application (Sept. 1, 2011).

authority.[11] Eight witnesses for AEP Ohio submitted testimony on behalf of the Company in July 2011. Intervenor parties collectively filed testimony from at least 29 additional witnesses and Commission Staff sponsored 16 witnesses.

On September 7, 2011, after lengthy and serious negotiations, AEP Ohio and many Intervenors reached a settlement agreement relating to the ESP II case and the other cases described above and filed a Stipulation and Recommendation (Stipulation) that proposes to resolve each of the cases.[12] In addition to AEP Ohio and the Commission's Staff, the following parties to the ESP II proceeding submitted testimony is support of the Stipulation: City of Grove City, Association of Independent Colleges and Universities of Ohio (AICUO), Constellation, Retail Energy Supply Association (RESA), Exelon Generation Corp. (Exelon), EnerNOC, the Ohio Hospital Association (OHA), Paulding Wind Farm II, LLC, OMAEG, and OEG. IEU, OCC, and FES have submitted testimony in opposition to the Stipulation.

All of the above cases were consolidated for purposes of hearing to consider approval of the Stipulation, per the Attorney Examiner's September 16, 2011 Entry.

III. OVERVIEW OF STIPULATION

The Stipulation is the result of a lengthy process of negotiation involving experienced counsel representing members of every affected stakeholder group. The Parties met and communicated for several weeks before the Signatory Parties agreed to the Stipulation. The Stipulation was achieved through a process that included consideration of all parties and interest

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[11] *See 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 Section 4928.143, Revised Code, in the Form of an Electric Security Plan, et al.*, Case Nos. 11-346-EL-SSO, 11-348-EL-SSO, 11-349-EL-AAM, 11-350-EL-AAM (*In re AEP Ohio ESP II Case*), Application (Jan. 27, 2011).

[12] *In re AEP Ohio ESP II Case*, Stipulation and Recommendation (Sept. 7, 2011), Joint Exhibit 1.

groups represented in the proceedings. The Signatory Parties considered multiple proposals and counterproposals before ultimately reaching agreement on the Stipulation and Recommendation on September 7, 2011.

A host of parties representing a variety of diverse interests have signed the Stipulation and support the package of terms and conditions reflected in the agreement:

- **The Companies**: CSP and OPCo;
- **Independent Staff of the State Agency Balancing All Interests**: The Commission's Staff (Staff);
- **Industrial customers**: members of The OMA Energy Group and the Ohio Energy Group (whose members include Aleris International, Inc., Amsted Rail Company, Inc., AK Steel Corporation, ArcelorMittal, USA, BP-Husky Refining, LLC, E.I. DuPont de Nemours & Company, Ford Motor Company, GE Aviation, Proctor & Gamble Co., Linde, Inc., Praxair Inc., Severstal Wheeling, The Timken Company, and Worthington Industries);
- **Commercial customers**: members of The Ohio Hospital Association, The Kroger Co., Wal-Mart Stores East, LLP, and Sam's East, Inc., and The Association of Independent Colleges and Universities of Ohio;
- **Municipalities**: including their residential customers, namely, the City of Grove City, and the City of Hilliard;
- **CRES providers**: Constellation NewEnergy, Inc., LLC, Duke Energy Retail Sales, LLC, AEP Retail Energy Partners LLC, and the Retail Energy Supply Association (whose members include: Champion Energy Services, LLC, ConEdison Solutions, Constellation Energy, Inc.; Direct Energy Services, LLC, Engentrix, Inc, Energy Plus Holdings, LLC, Exelon Energy Company, GDF SUEZ Energy Resources NA, Inc., Green Mountain Energy Company, Hess Corporation, Integrys Energy Services, Inc., Just Energy, Liberty Power, MC Squared Energy Services, LLC, Mint Energy, LLC, MX Energy, NextEra Energy, Noble Americas Energy Solutions, PPL EnergyPlus, LLC; Reliant Energy, TriEagle Energy, L.P.).
- **Competitive generation suppliers**: including Constellation Energy Commodities Group, Exelon Generation Company, LLC, and the PJM Power Providers Group (whose members include: Public Service Enterprise Group Inc., Exelon Corp., Constellation Energy Group Inc., NextEra Energy Inc., NRG Energy Inc., Calpine Corp., PPL Corp., and GenOn Energy Inc.)
- **Alternative energy resource and demand response/energy efficiency providers**: including Paulding Wind Farm II, LLC, and EnerNOC; and
- **Environmental advocacy groups**: the Natural Resources Defense Council (NRDC), the Ohio Environmental Council (OEC), and the Environmental Law and Policy Center (ELPC).

The Stipulation addresses and resolves a large number of issues facing AEP Ohio and its customers, and it provides numerous benefits to customers and competitive suppliers. The Stipulation provides a reasonable and practical path to fully competitive markets for supplying electricity to AEP Ohio's customers. By agreeing to corporate separation of AEP Ohio's generation and non-generation functions, along with associated changes to AEP's business model, the path is being cleared for competitive auctions to serve AEP Ohio's Standard Service Offer (SSO) load. Implementing an auction-based SSO is not something the Commission can require of an EDU within an ESP; in that regard, the entire structure of the Stipulation is based on a negotiated result not possible in litigation that will yield a fully competitive SSO rate into the future. AEP Ohio will also switch to PJM's Reliability Pricing Model (RPM), thereby eliminating the distinction between the capacity compensation model for AEP Ohio's generating resources and the compensation model adopted by competitive retail electric suppliers.

During the brief transition period necessary to restructure AEP Ohio's business and become an RPM entity in the PJM market, AEP Ohio will provide discounted capacity prices to competitive suppliers for all of AEP Ohio's generation portfolio in order to support growth of robust competitive supply options for customers and to resolve the pending Capacity Charge Case for AEP Ohio. The generation prices for SSO customers during this transition will reflect a highly simplified pricing structure that essentially fixes the base generation rate and varies primarily based on the cost of fuel and other components of the FAC rate. With support from the new Distribution Investment Rider (DIR), the Company will be able to sustain critical investments that benefit customers by maintaining and improving service reliability.

Economic development and low income support from AEP shareholder funds are also provided in this Stipulation, along with a number of alternative and advanced energy programs.

The opportunity for AEP Ohio to build new generating resources that will be dedicated to its retail customers is a noteworthy element of this plan, in that it provides a path for cost-based generating pricing that can serve as a hedge against potentially volatile market prices. This plan represents a significant number of compromises for the Company, and provides for a balanced outcome for all stakeholders. The Stipulation assures the availability of reliable supplies of power at reasonable and stable rates for AEP Ohio's generation SSO customers, further enhances competitive opportunities for customers and suppliers, provides stable distribution rates for customers, provides for enhancements, both in the reliability and the manner in which customers can manage their consumption of electric services, promotes economic development, energy efficiency, and alternative energy resources, and provides continued support for low income customer programs.

Each of the Stipulation's major provisions will be discussed in greater detail below and are shown to be reasonable, in conjunction with an examination of the evidence of record and application of the three-part test applicable to contested settlement agreements.

IV. STANDARD OF REVIEW

Rule 4901-1-30, O.A.C, authorizes parties to Commission proceedings to enter into stipulations. Although it is not binding on the Commission, the terms of such agreements are accorded substantial weight. *See Consumers' Counsel v. Pub. Util Comm.* (1992), 64 Ohio St.3d 123,125, *citing Akron v. Pub. Util. Comm*. (1978), 55 Ohio St.2d 155. This concept is particularly valid where the stipulation is supported or unopposed by the vast majority of parties in the proceeding in which it is offered. *Columbus Southern Power Company*, Case No. 09-1089-EL-POR, May 13, 2010 Opinion and Order at 20. While the Commission may place substantial weight on the terms of a stipulation, it must determine from the evidence what is just and reasonable. *In re Columbus S. Power Co.*, 2011 Ohio 2383, P19 (Ohio 2011).

In evaluating the reasonableness of a settlement agreement that is opposed by some parties, the Commission uses the following well-established criteria:

> (a) Is the settlement a product of serious bargaining among capable, knowledgeable parties?
>
> (b) Does the settlement, as a package, benefit ratepayers and the public interest?
>
> (c) Does the settlement package violate any important regulatory principle or practice?

Columbus Southern Power Company, Case No. 09-1089-EL-POR, May 13, 2010 Opinion and Order at 21 (and cases cited therein). The well established three-part test for contested settlements has been endorsed by the Supreme Court of Ohio for use in this context. *Indus. Energy Consumer of Ohio Power Co. v. Pub. Util. Comm.*, 68 Ohio St.3d 559, 561 (1994), citing *Consumers' Counsel v. Pub. Util. Comm.*, 64 Ohio St.3d 123, 126 (1992).

Because the Stipulation also resolves AEP Ohio's pending application for approval of an Electric Security Plan, there are two additional legal standards that are pertinent here. First, AEP Ohio has the burden of proving that the ESP provisions of the Stipulation, including pricing and all other terms and conditions, are more favorable in the aggregate as compared to the expected results that would otherwise apply under a market rate offer (MRO). Ohio Rev. Code Ann. § 4928.143(C)(1). The details associated with this so-called "MRO test" will be discussed more extensively in Part IV of this brief.

Second, if the Commission does not approve the proposed ESP (as reflected in the Stipulation) and instead modifies the proposed ESP, AEP Ohio has the right to withdraw and file a new SSO either under the ESP statute or the MRO statute. Ohio Rev. Code Ann. §

4928.143(C)(2). The Signatory Parties expressly recognized this unqualified right of AEP Ohio to withdraw through Paragraph VI (page 29) of the Stipulation, should the Commission modify the proposed ESP. The "consent" requirement is particularly important to bear in mind, as the Commission examines the terms of the Stipulation being voluntarily agreed to by AEP Ohio, since many of the significant provisions agreed to in the Stipulation may not even be possible in the context of a litigated decision (*e.g.*, auction-based SSO, shale gas commitment, below-cost discount of wholesale capacity charge, reduction of approved carrying charge for deferred fuel, etc.) As demonstrated below, the Stipulation is reasonable and should be adopted as a package without modification.

V. THE STIPULATION AND RECOMMENDATION SATISFIES THE COMMISSION'S THREE-PART STANDARD FOR REVIEWING AND APPROVING CONTESTED STIPULATIONS.

A. The Stipulation Is The Result Of Serious Bargaining Among Capable, Knowledgeable Parties.

1. The Signatory Parties have demonstrated that the first prong of the three-part test is satisfied.

As attested to by AEP Ohio witness Hamrock, the Stipulation is the result of a lengthy process of negotiation involving experienced representatives of every affected stakeholder group, including industrial, commercial and residential customers, competitive generation suppliers, CRES providers, municipalities, alternative and advanced energy providers, curtailment service providers, and environmental groups. (AEP Ohio Ex. 8 at 9; *see also* Signatories' Joint Ex. 1 at 31-32 (signatory pages); Exelon Ex. 1 at 2; RESA Ex. 1 at 13; Constellation Ex. 1 at 13.) In addition, the Signatory Parties were represented by counsel with many years of experience in proceedings before the Commission. (*See* Staff Ex. 4 at 2.) The Parties negotiated over the course of several weeks before the Signatory Parties agreed to the Stipulation. (AEP Ohio Ex. 8 at 8-9.) As referenced above, the supporting parties represent a diverse group of interests and constitute an extensive list of signatories knowledgeable about the issues addressed in the Stipulation.

The Signatory Parties' knowledge with respect to the issues addressed in the Stipulation has also been informed through several of AEP Ohio's proceedings before the Commission pending over the past two years. For example, the Stipulation contains provisions regarding the Company's application to merge, which was filed in October 2010 and has been the subject of intervenor comments since that time. *See* Case No. 10-2376-EL-UNC. The Stipulation also contains provisions related to the Company's applications to amend emergency curtailment service riders, proceedings which began in March 2010 and which similarly involved many of the Signatory Parties and intervenors. *See* Case Nos. 10-343-EL-ATA, 11-344-EL-ATA. The dockets in these proceedings, as well as those in the other cases addressed in the Stipulation, demonstrate that the parties have engaged in extensive communication and information sharing – including discovery, depositions, hearing testimony, and briefing – regarding the issues addressed in the Stipulation. Thus, there should be no question that the Stipulation was created by capable, knowledgeable parties. The discovery process certainly informed parties about the issues in the case. Under the ESP case numbers alone, AEP Ohio responded to more than 2,187 discovery requests and, in so doing, served a huge volume of data and information on every party in the proceeding.

The Stipulation also is the result of serious bargaining amongst the knowledgeable and capable Signatory Parties. The Stipulation was achieved through a process that included consideration of all parties and interest groups represented in the proceedings. The Parties met and communicated for over a month before the Signatory Parties agreed to the Stipulation. (AEP Ohio Ex. 8 at 8-9.) AEP Ohio circulated its first proposed settlement term sheet to all of the Parties on August 3, 2011. Between August 3 and August 30, 2011, representatives of AEP Ohio, the Staff, and the Intervening Parties met five times to try and resolve the multiple issues and disagreements between the parties. (*Id.* at 9.) Representatives of every intervening stakeholder group affected by the Stipulation were present for and participated in those negotiations. (*Id*.; Exelon Ex. 1 at 2.) During that time period, AEP Ohio circulated revisions to its proposed term sheet a number of times to all of the Parties. (AEP Ohio Ex. 8 at 9.) The Staff met separately with representatives of the Intervening Parties without AEP Ohio for a period of nearly a week (starting on August 17) to develop counterproposals to AEP Ohio's proposals. (*Id*.) The outcome of that process also factored into the negotiation process.

Near the end of the negotiating process, it became clear that the settlement framework did not work for a few of the parties. AEP Ohio, Staff, and numerous intervenors filed a joint motion on August 30, 2011 (the "August 30 Motion"), requesting that the Commission continue the hearing date set for the Company's 2012 ESP proceeding to allow the Parties to engage in further settlement negotiations. (*Id.*) At that time, the OCC, IEU, FES and OPAE opposed the motion and chose to stop participating in the settlement negotiations. As stipulated during the evidentiary hearing those opposing Parties also admitted to entering into a Joint Defense Agreement on September 2, 2011 concerning the cases involved in the ongoing settlement talks they opposed continuing.[13] (Tr. Vol. VII at 1284). The resulting Signatory Parties met several more times and considered multiple proposal and counterproposals before ultimately reaching agreement on the Stipulation on September 7, 2011. (*See* Signatories' Joint Ex. 1.)

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13 The Appalachian Peace and Justice Network, another Non-Signatory Party, was also stipulated as a party to that Joint Defense Agreement. (Tr. at 1284).

Even during this period leading up to the Stipulation, however, AEP Ohio continued to reach out to Parties that were not participating in an attempt to keep an open settlement dialogue. (AEP Ohio Ex. 8 at 9; Tr. V-VI at 872, 941-42.) Moreover, the day before the Stipulation was finalized, AEP Ohio sent notice of intent to provide a copy later of the draft Stipulation and then a copy of the draft Stipulation to all Parties and requested a final counter-offer or solicitation for additional discussions. (AEP Ohio Ex. 8 at 9-10.) While this "final offer" to all of the parties was not a required step for finalizing the Stipulation, AEP Ohio wanted to solicit input from all parties and provide an opportunity for any and all parties to request further negotiations. Neither FES, IEU, OPAE, nor OCC made any such counter-offer or solicitation.

Staff witness Fortney, an experienced veteran of Commission proceedings including major rate cases, made the following observations about the negotiations leading up to the Stipulation:

> The bargaining process included various parties (or their representatives), including Staff, who are considered to be experts in each of their respective fields. They also have an extensive history of participation and experience in matters before the Commission. I might also add that in addition to being "serious," the bargaining was also "extensive" and "lengthy."

(Staff Ex. 4 at 2.) Exelon witness Dominguez also testified that the first prong of the three-part test was satisfied as follows:

> The Stipulation is the end result of weeks of intense negotiations among the parties in this proceeding. The parties to the Stipulation include the Company and the Commission Staff, together with more than 20 organizations, including generators, retail electricity marketers, environmental groups, demand response providers, commercial and industrial customers and communities, which collectively represent a critical mass of stakeholders and a broad range of diverse interests and points of view. The Commission Staff was an integral part of the process, helping to bridge gaps between AEP Ohio and intervenors, while also ensuring that Commission Staff's own concerns were addressed. The process was fair, transparent and open.

(Exelon Ex. 1 at 1-2; *see also* Constellation Ex. 1 at 13; RESA Ex. 1 at 13.) In short, there is abundant evidence supporting the conclusion that the Stipulation is the product of serious negotiations among capable, knowledgeable parties.

2. The arguments made by FES regarding the settlement process are without merit and must be rejected.

As a preliminary matter, AEP Ohio notes that, with regard to the fact that the opposing parties voluntarily chose not to continue discussions about the signatory parties' settlement framework, OCC did not submit testimony or conduct cross examination of Mr. Hamrock's testimony on this matter. As shown in AEP Ex. 17, OCC indicated admitted that counsel for AEP Ohio had reached out to ensure the OCC was not interested in continuing negotiations and counsel for OCC admitted that the agency declined to entertain further discussions and that it had informed counsel for AEP Ohio prior to its emails verifying that understanding. OPAE also did not submit testimony or cross examination in this regard. IEU witness Murray confirmed Mr. Hamrock's testimony during his cross examination. Specifically, during his cross examination, IEU witness Murray confirmed that during settlement discussions IEU "consistently conveyed the view that the framework of the settlement produces a result that's unlawful." (Tr. XI at 1847.) Mr. Murray also agreed that during the settlement negotiations, IEU stated that the settlement framework did not provide a basis for moving forward with further discussions on that basis. (*Id*. at 1847-1848, 1854.) Of the parties opposing the Stipulation, only FES has disputed the account that it was no longer interested in discussing the settlement framework that the signatory parties were pursuing. FES's challenge to the Signatory Parties' negotiations, however, is without merit.

Mr. Hamrock testified that the parties opposing the Stipulation, including FES, sent "very clear signals that the settlement talks were not constructive, were not productive, and were not leading to an outcome that they supported." (Tr. V at 870.) With respect to FES in particular, Mr. Hamrock testified that his conclusion was also based on a separate meeting that took place exclusively between AEP Ohio and FES on August 26:

> We had an individual AEP Ohio-FirstEnergy Solutions meeting that morning where it was clear that *the terms that were emerging with the parties in the settlement talks were not acceptable to FirstEnergy, they had very different terms, and it was clear that we were parting ways in that discussion*.
>
> We had a subsequent meeting of all the parties that afternoon, I remember that vividly, that Friday afternoon where we polled the parties to see who was willing to continue working within the framework that had been developed at that point, and *FirstEnergy Solutions* specifically walked out of that session and *indicated they were no longer interested in that framework.*
>
> *Even after the stipulation was filed we continued to try to work with FirstEnergy Solutions and other parties to find common ground within the framework and the overall envelope of the settlement agreement and have failed to find such common ground*.

(Tr. VI at 941 (emphasis added).)

FES witness Banks testified after Mr. Hamrock and narrowly disputed some of the phrasing used by Mr. Hamrock in this regard. Specifically, Mr. Banks stated that "FirstEnergy Solutions left the meeting with all the other parties when it was over, so unless the meeting was re-called to order without notifying FirstEnergy Solutions, we were at the complete meeting." (Tr. VII at 1186.) In other words, Mr. Hamrock's statement that "FirstEnergy Solutions specifically walked out of that session and indicated they were no longer interested in that framework" was interpreted by Mr. Banks as saying that FES left in the middle of the meeting and Mr. Banks wanted to narrowly rebut this by saying FES stayed for the whole meeting. In the context of his entire statement, however, Mr. Hamrock' was merely saying that FES – through its direct statements during the meeting – left at the end of the meeting with the state of affairs being that FES unequivocally opposed the settlement framework and believed it to be deficient. Saying FES walked out of that session registering their position not being interested in further discussions under those terms is not the same as saying FES physically left or stormed out during the middle of the meeting.

There is also a deeper pool of evidence in the record that gives context to FES misunderstanding of Mr. Hamrock's phrasing of his understanding of FES' unwillingness to further negotiate under the broader group's framework. As referenced above, Mr. Hamrock indicated several other times (besides the "walked out of that session" sentence) that FES made its position opposing the settlement framework clear. Mr. Banks also denied that FES had stated at the 2:00 p.m. meeting on August 26 that it was "no longer interested in talking about settlement." (Tr. VII at 1186.) This statement is also narrow and technical in its phrasing as Mr. Hamrock made no such statement. As such, Mr. Banks' statement fails to rebut or otherwise impeach Mr. Hamrock's testimony that FES indicated a negative response to AEP Ohio's polling of all parties at the August 26 meeting as to whether the settlement framework was an acceptable basis for continuing negotiations. In fact, Mr. Banks testified that he did not attend all of the different negotiation sessions as indicated by his absence from the private meeting between AEP Ohio and FES on the morning of August 26, 2011. (Tr. Vol. VII at 1283.) In that meeting, as discussed above, FES conveyed the same message that it did not intend to continue negotiating under the majority's framework directly to AEP Ohio on the morning of August 26. Notably, in this regard, Mr. Banks' carefully crafted statements did not deny the substance of Mr. Hamrock's account or claim that FES expressed a desire to participate in the ongoing negotiations.

Ultimately, neither FES nor any other party has a right to attend settlement meetings because there is no requirement that opposing parties be permitted to participate in ongoing settlement talks. Indeed, as the un-refuted evidence of record indicates, there were multiple settlement meetings stretching on for more than a week where AEP Ohio was not invited to the discussions. (AEP Ohio Ex. 8 at 9.) Obviously, any requirement that all parties must attend all meetings would severely hamper the openness and productivity of settlement discussions; not only would allowing opposing parties inside the negotiations prevent progress, it would also unfairly permit them to develop a litigation strategy for undermining the settlement just from being present. As indicated above the parties not interested in continuing had already signed a common Joint Defense Agreement to define its interests. Allowing that aligned block into negotiations that had closed ranks to oppose the majority group would be like having the other team in the opponent's locker room during a pre-game meeting where strategy was discussed and developed – it makes no sense and would simply be unfair and serve no legitimate purpose.

There is no basis in Commission practice or precedent for such a requirement. Parties are free to meet and discuss ideas without such restrictions – a right which the Supreme Court of Ohio has expressly recognized. *See Time Warner AxS v. Pub. Util. Comm.* (1996), 75 Ohio St. 3d 229, 233 n. 2 (stating, in dicta, "[w]e would not create a requirement that all parties participate in all settlement meetings."). Indeed, the Supreme Court has held that, even where a party is excluded from settlement discussions, a stipulation nonetheless satisfies the first prong of the Commission's test for stipulations so long as the exclusion was not directed at "an entire customer class." *Constellation NewEnergy v. Pub. Util. Comm.* (2004), 104 Ohio St.3d 530, 535-36. Here, other CRES providers, the customer class to which FES belongs, were present for settlement negotiations and became Signatory Parties to the Stipulation. The fact that FES did not participate in settlement discussions after August 30, 2011, therefore, does not prevent the Commission's approval of the Stipulation and Recommendation. As indicated above, AEP Ohio confirmed with a follow-up communication that OCC had already indicated that it was not interested in continuing discussions where OCC responded "OCC informed Mr. Nourse of its intentions to no longer be involved in the negotiations prior to receiving the e-mail. (See AEP Ex. 17).

The manifest weight of the record plainly supports Mr. Hamrock's testimony that the opposing parties decided that the negotiation framework was not acceptable and removed themselves from the continuing discussions. In any case, even if FES witness Banks' limited statements were found to support an implied (but not directly stated) suggestion that FES wanted to stay in the parties' discussions, neither FES nor any other party (including the utility) has a right to be present in all discussions among the signatory parties. More to the point, Mr. Banks' testimony does not provide a basis for concluding that the Stipulation was not the result of serious bargaining among capable, knowledgeable parties.

3. IEU's arguments under the first prong of the three-part test are without merit and should be rejected.

IEU witness Murray argues that the Stipulation does not satisfy the first prong of the three-part test by attempting to modify this first component of the established three-part test. Specifically, Mr. Murray adds to the first prong requirement that settlement being a product of serious compromise among capable, knowledgeable parties the additional language "that set about to produce a reasonable compromise of the contested issues based on the facts and the law." (IEU Ex. 9A at 3, 9; Tr. XI at 1836-1837.) IEU has no basis upon which to argue that the first component of the three-part test needs to be modified. IEU's testimony in this regard is based on an improper view of the applicable standard and should be rejected for that reason alone.

The Commission has never used the first prong of the three-part test to measure the substantive results of a settlement; rather, the first prong reviews the process and the signatory parties. In evaluating the first prong of the test to determine whether the stipulation is a product of "serious bargaining among capable, knowledgeable parties," the Commission has considered a number of factors, including:

- the extent to which the parties to the settlement negotiations regularly participate in proceedings before the Commission, are knowledgeable about regulatory matters, and were represented by experienced counsel and technical experts during negotiations;[14]
- whether the resulting stipulation represents "a comprehensive compromise of the issues raised by parties with diverse interests;"[15]
- the detail in which the issues in the case were discussed;[16]
- the extent to which all parties to the proceeding had an opportunity to express their opinions during settlement negotiations;[17] and
- the diversity of interests represented by the signatory parties to the stipulation.[18]

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[14] *In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Authority to Adjust its Distribution Replacement Rider Charges*, Case No. 11-2776-GA-RDR, Opinion and Order, at 7 (Aug. 24, 2011). *See also In the Matter of the Application for Establishment of a Reasonable Arrangement Between Marathon Petroleum Company LP and Ohio Power Company*, Case No. 10-2777-EL-AEC, Opinion and Order, at 7 (May 25, 2011) (finding that the parties' stipulation satisfied the first prong of the test because "[a]ll parties to the stipulation have been involved in numerous cases before the Commission and have consistently provided extensive and helpful information to the Commission."); *In the matter of the application of Columbus Southern Power Company and Ohio Power Company for approval of their plan to provide additional options for customer participation in the electric market*, Case No. 06-1153-EL-UNC, Opinion and Order, at 9 (May 2, 2007).

[15] *Id.*

[16] *See In the Matter of the Application of the Dayton Power and Light Company for a Finding that DP&L has Satisfied Program Portfolio Filing Requirements*, Case No. 09-1986-EL-POR, Opinion and Order, at 6 (holding that the first prong of the test was satisfied, in part based upon testimony that "the issues in the case were discussed in great detail through multiple meetings, telephone conversations, and email exchanges over the course of several weeks, with all negotiations being conducted at arm's length.").

[17] *See In the Matter of the Application of Duke Energy Ohio, Inc. for an Adjustment to Rider AMRP Rates*, Case No. 09-1850-GA-ATA, Opinion and Order, at 7 (Apr. 28, 2010).

[18] *In the Matter of the Regulation of the Purchased Gas Adjustment Clause Contained Within the Rate Schedules of Columbia Gas of Ohio, Inc. and Related Matters*, Case No. 08-221-GA-GCR, Opinion and Order, at 8-9 (Mar. 17, 2010).

These factors are addressed and satisfied through the testimony of Signatory Parties, as discussed above. Contrary to IEU witness Murray's testimony, however, there simply is no basis in Commission decisions addressing the first prong of the three-part test for the requirement that the "capable, knowledgeable parties" must "set about to produce a reasonable compromise of the contested issues based on the facts and the law." Mr. Murray's characterization of the first prong of the test, therefore, lacks any basis in Commission precedent. There is no reason to expand the well-established first prong of the test to include qualitative measurement of the substantive provisions of a settlement, as the second and third prong of the test already do that as appropriate.

Next, IEU witness Murray proceeds to misapply the first prong of the test as requiring each party to fully understand all provisions and implications of the Stipulation. In this regard, IEU advances a claim (unsubstantiated by evidence) that an appendix to the Stipulation was not provided far enough in advance to satisfy IEU that Signatory Parties were knowledgeable capable parties. (IEU Ex. 9A at 3-9.) Mr. Murray later admitted that he does not know whether or not any party other than IEU received the draft appendix. (Tr. XI at 1846.) Parties have their own reasons for supporting an agreement and can represent their own interests without getting approval from IEU that they are doing so properly.

Another related aspect of IEU's misguided argument in this regard is the claim that each party must do their own calculation of the statutory MRO test; otherwise, IEU concludes that such a party lacks "direct knowledge of whether the ESP, as modified by the Stipulation, is capable of satisfying statutory requirements." (IEU Ex. 9A at 7.) The MRO test, including the components and passing results, were discussed among the Signatory Parties and the Stipulation explicitly indicates the understanding of the Signatory Parties that "the ESP package included as part of the Stipulation is more favorable in the aggregate than the expected results under a MRO." (Signatories' Joint Ex. 1 at Par. IV.7.) While it does not constitute evidence in this case, the Company also filed testimony prior to the Stipulation demonstrating that the original as-filed ESP is more favorable in the aggregate than the expected results under an MRO. (January 27, 2011 Testimonies of Joseph Hamrock and Laura J. Thomas.) The Signatory Parties were aware of this testimony and that, given the many compromises conceded by the Company during negotiations, the positive aggregate MRO test results could only improve as a result of the Stipulation.

Moreover, the Signatory Parties' agreement in the Stipulation indicated that the MRO test results would be "further demonstrated through supporting testimony." (Joint Ex. 1 at Par. IV.7.) And the testimony of AEP Ohio witnesses Hamrock, Thomas, and Allen fulfill that commitment, as does the testimony of Staff witness Fortney. (*See* AEP Ohio Ex. 4, 5, 8, 20A, and 23; Staff Ex. 4.) Thus, while the Signatory Parties' agreement was made with the understanding that the aggregate MRO test applied to the ESP provisions of the Stipulation and would be demonstrated in the record to have been satisfied, there simply was no reason why each Signatory Party would need to do its own, independent analysis of the aggregate MRO as a condition precedent to signing the Stipulation. Mr. Murray acknowledged during cross examination that it is the utility's burden to prove that a SSO stipulation passes the aggregate MRO test and that it is not necessary for every party to present evidence about aggregate MRO test results as long as there is evidence in the record to support a Commission finding in this regard. (Tr. XI at 1842.) And while Mr. Murray argues in favor of elevating the importance of MRO test results in an individual intervenor's decision to support or oppose the Stipulation, Mr. Murray admitted that he does not even know whether IEU would reject a stipulation that benefits its members if there was a dispute about the aggregate MRO test results. (*Id*. at 1854.)

Ironically, while IEU wants to hold the supporting parties to a higher standard than the Commission has ever applied before in this context, IEU itself does not live up to the even more basic standard of deciding whether to support or oppose the Stipulation based on its own stated interests. Specifically, even though IEU intervened in these cases based on a stated interest in the price, adequacy, and reliability of AEP Ohio's retail electric service (*Id*. at 1799), it did not even calculate the rate impact of the Stipulation on each of its members in deciding to oppose the Stipulation (*Id*. at 1800). In discovery, AEP Ohio propounded to IEU the question whether the following members experienced rate savings under the ESP proposed in the Stipulation:

- Abbott Nutrition
- Anheuser-Busch Companies
- Globe Metallurgical Inc
- Columbus Steel Castings
- KRATON Polymers U.S LLC
- Marathon Oil Company
- Nationwide Insurance
- Eramet Marietta Ina
- The Cleveland Clinic

(AEP Ex. 12 at 3.) Mr. Murray confirmed that to his knowledge IEU had not performed the calculations for 2012-2015 – even after AEP Ohio had prompted that this analysis should be done. (Tr. XI at 1802-1803.) IEU's attempt to discredit the Signatory Parties should be rejected as misguided and disingenuous.

In a final attempt to claim that the Stipulation is not the result of serious bargaining, IEU witness Murray mistakenly asserts that the Stipulation is "not much of a compromise by the company" with respect to financial outcomes. (*Id*. at 1835.) Mr. Murray presented a calculation in his sworn testimony that purportedly demonstrates that "there is very little difference in the amount of the revenue ($9,614,274) produced by the Stipulation ESP as compared to the as-filed ESP application." (IEU Ex. 9A at 4.) In defending his erroneous analysis, Mr. Murray lectured during his cross examination that "if you simply do the math, you'll see that there's very little difference in the revenue that's produced under the stipulation versus what was characterized by the company as revenue under their application." (Tr. XI at 1823.) The context of his claim was to demonstrate that the opposing parties were not knowledgeable about the Stipulation. Ironically, Mr. Murray's attempt to undercut the knowledge of the opposing parties only served to expose major flaws in the analysis of IEU's own witness.

When Mr. Murray was asked to "simply do the math" and replicate his workpaper calculation supporting the claim that the Stipulation would produce only $9.6 million less revenue in 2012 than the Company's original ESP Application would have produced, Mr. Murray struggled to do so. After being guided through the calculation in his own workpaper and being asked to doublecheck his math, IEU requested a break in the hearing to replicate the calculation. (*Id*. at 1826.) After returning from the break, Mr. Murray stated that he had a chance to check his math and he explained that the calculation he performed was done incorrectly and the correct answer was now $2,188,570. (*Id*. at 1827.) After being asked again about his calculations, Mr. Murray then changed the answer to $21,885,700, agreeing that even his revised math was still in error by a factor of 10 and, after correction, resulted in a figure more than double his original calculation. (*Id.* at 1828.) He further recognized that his revenue comparison did not account for differences between the Application and Stipulation relating to distribution revenues, environmental revenues, or the effects of several other riders that were dropped as a result of the Stipulation – acknowledging that he simply had not done calculations to reflect these differences. (*Id*. at 1830-1833.) The reality is that, even after receiving multiple opportunities to "simply do the math" (to use his own words), Mr. Murray failed to present correct information comparing the revenue effects of the original Application with the Stipulation.

On rebuttal, AEP Ohio witness Roush addressed Mr. Murray's faulty analysis by correcting his arithmetic errors and making an appropriate apples-to-apples revenue comparison between the Application and the Stipulation. (AEP Ohio Ex. 22 at 6.) As shown in Exhibit DMR-R5 attached to Mr. Roush's rebuttal testimony, the Stipulation reflects a reduction from the Application of at least $352 million after correcting Mr. Murray's errors. Thus, when the correct number is compared to Mr. Murray's original calculation shown in IEU Ex. 9A of $9.6 million, one finds that <u>the correct calculation was more than *36 times* the amount originally calculated by Mr. Murray!</u> Such gross errors not only undercut Mr. Murray's testimony on this point but serve to undermine the general reliability and accuracy of his technical analysis as a whole and the positions of IEU. Regardless, his contention that the Stipulation gives up "very little" revenue as compared to the original Application is wrong – unless one considers $352 million an insignificant sum of money.

4. Conclusion regarding the first prong of the three-part test

Throughout this lengthy settlement process, AEP Ohio, the Staff, and the majority of intervening parties, representing a broad cross-section of interests, considered and debated the proposals of each customer class and interested group and ultimately reached agreement on the Stipulation. As supported by substantial and cumulative evidence of record, the Signatory Parties are plainly capable, knowledgeable parties. Likewise, the Stipulation is clearly the product of serious bargaining among those parties. While FES and IEU launch misguided attacks and assert erroneous arguments to the contrary, it cannot be reasonably disputed that the Stipulation satisfies the first prong of the Commission's three-part test.

B. The Stipulation Does Not Violate Any Important Regulatory Principle or Practice.

1. *ESP II*, Case Nos. 11-346/348-EL-SSO and 11-349/350-EL-AAM

a) The Generation Rate provisions of the Stipulation do not violate any important regulatory principles or policies because those provisions are reasonable as supported by evidence of record.

The ESP II Application proposed twenty (20) different riders related to generation service, including both bypassable and non-bypassable riders. (AEP Ohio Ex. 2, Exhibit DMR-4.) AEP Ohio's rider proposals were criticized as lacking transparency and as creating rate uncertainty and instability. While AEP Ohio viewed all of its rider proposals as being meritorious, the Company agreed to drop controversial non-bypassable rider proposals as part of the settlement. Specifically, the Stipulation eliminated seven (7) of those proposed riders, including the Provider of Last Resort Charge (non-bypassable as proposed), the Environmental Investment Carrying Cost Rider (non-bypassable as proposed), the Generation NERC Compliance Cost Recovery Rider (non-bypassable as proposed), the Facility Closure Cost Recovery Rider (non-bypassable as proposed), the Carbon Sequestration Rider (non-bypassable as proposed), the Rate Security Rider and the Emergency Curtailment Service Rider. (*Id.*) Further, of the remaining thirteen (13) generation riders, AEP Ohio agreed to modify nine (9) of its rider proposals as part of the settlement compromise. (*Id.*) The only four (4) riders that remain unmodified in the Stipulation are non-controversial riders such as the Universal Service Fund Rider, the kWh Tax Rider, the Fuel Adjustment Clause and the Energy Efficiency and Peak Demand Reduction Rider. In short, the Company's initial Application was barely recognizable in the Stipulation after the serious bargaining and compromise that had occurred. The result is reasonable and supported by the record.

In conjunction with simplifying the number and operation of the proposed generation service riders, the Signatory Parties agreed to: (i) establish fixed base generation rates during the pre-auction period of the ESP, which reflect a market-based rate re-design and a Market Transition Rider (MTR), (ii) establish a new interruptible credit, and (iii) establish a Load Factor provision to promote economic development and benefit high load factor customers. Each of these components of base generation rates will be discussed below in greater detail.

1) Fixed Base Generation Rates, including rate re-design and the Market Transition Rider [Par. IV.1.b, c, f]

AEP Ohio's ESP II Application (at 7-8) proposed to "rationalize the rate relationships based upon the manner in which the market would price such loads using the same methodology used to develop the competitive benchmark price and applying it to the class load shapes." The Application (at 8-9) also proposed a Market Transition Rider (MTR) to facilitate the transition from the Company's current generation rates to the market-based SSO generation rates. The Stipulation adopts AEP Ohio's proposed rate re-design of generation rates, including the MTR. (Par. IV.1.b.)

AEP Ohio witness Roush explained the reasons supporting the market re-design of the generation rates:

> CSP and OPCo's last rate cases were in the early 1990's. Since that time the Company's rates have been unbundled into generation, transmission and distribution components and subsequently adjusted based upon percentage adjustments to the then current unbundled rates. As such, the generation rates reflect an amalgamation of very old cost relationships, including any historical levels of cross-subsidization among tariff classes. In addition, the Stipulation provides for the merger of CSP and OPCo and the post-merger Company is what is reflected in the stipulated ESP rates. Lastly, since the Stipulation will result in SSO rates beginning in June 2015 being based upon a competitive bid process, it

> is important to begin the transition to such market based pricing during 2012 through May 2015.

(AEP Ex. 2 at 9.) Mr. Roush also explained the purpose and effect of the MTR rate design:

> Pursuant to Paragraphs IV.1.b and IV.1.c, the MTR as shown in Stipulation Appendix A is designed to facilitate the transition from CSP and OPCo's current generation rates to the market-based SSO Generation Service rates discussed above. The MTR is a nonbypassable rider designed to limit the first, second and third year changes in rates for all customer classes to uniformly accomplish 50% of the transition from current rates to market based rates. The MTR will end with the June 1, 2015 billing cycle. Any revenue shortfall that is produced by limiting the increases for certain customer classes is collected from those classes whose decreases are limited.

(*Id*. at 11.) Mr. Roush also explained that, pursuant to Paragraph IV.1.c of the Stipulation, schools that receive service under standard service offer or open access distribution service Schedules GS-1 and GS-2 are not subject to the MTR. (*Id*.) The sum of the credits provided, including the $10/MWh shopping credit provided in Paragraph IV.1.c, and charges collected under the MTR should be a $6 million quarterly charge until the end of 2012 or until securitization is completed, whichever is earlier, and $0 quarterly beginning with the first quarter of 2013 or the completion of securitization, whichever is earlier. (*Id*. At 11-12.)

As referenced above, the Signatory Parties agreed to establish fixed base generation rates during the pre-auction period of the ESP term. (Par. IV.1.f.) AEP Ohio witness Hamrock explained withdrawal of the nonbypassable generation riders and the proposal to establish fixed base generation rates:

> AEP Ohio's agreement to withdraw the nonbypassable riders is consistent with this transition to market. Elimination of these riders, along with implementation of a fixed base generation rate through the transition plan significantly improves rate stability and predictability for customers, while shifting risks to AEP Ohio. Of particular note, the significant environmental compliance investments AEP Ohio expects to make during the plan will not be associated with a rider designed to track those investments. Nor will AEP Ohio have a nonbypassable rider for recovering plant closure costs. AEP Ohio's agreement to provide fixed base generation rates without such variable rate mechanisms is a significant

> compromise by the Company, and provides customers with clear stable price signals during the plan.

(AEP Ex. 8 at 14.) By dropping the nonbypassable riders and establishing fixed base generation rates, the Stipulation transfers substantial risk from customers to AEP Ohio while simultaneously achieving one of the policy goals of R.C. 4928.02 and following the Commission's Mission, by improving rate certainty and stability for customers. (*See* R.C. 4928.02(A); and PUCO Mission Statement- Administratively Noticed Tr. Vol. VII at 1230.)

In order to achieve the fixed base generation rates each year during the pre-auction portion of the ESP term, automatic annual increases or decreases to the (non-fuel) bypassable base generation rate will be made as necessary to achieve an average rate of $.0245/kWh starting in January of 2012, $.0257/kWh in January of 2013, and $.0272/kWh in January of 2014 to be in effect through May 31, 2015. (Par. IV.1.f.) The automatic base generation rate changes are being proposed under §4928.143(B)(2)(d), Ohio Rev. Code. The only other bypassable generation rate that changes for customers during the pre-auction ESP term is the Fuel Adjustment Clause (FAC) rate, which currently includes renewable energy compliance costs associated with the new Alternative Energy Rider (AER). (Par. IV.1.l.)

OCC witness Dr. Duann maintains that the rate increases are unsupported by the cost to serve (OCC Ex. 1 at 22), yet he acknowledged on cross examination that the ESP statute does not specify a requirement that rate adjustments be cost-based. (Tr. VIII at 1590.) He openly explained that his expectations for a justified rate increase would only be met if OCC's position regarding the remand proceeding (already rejected) and the 2009 FAC proceeding (remains pending) were adopted. (Tr. VIII at 1596.) IEU witness Murray also argues that the Stipulation's rate design is unreasonable and inequitable. (IEU Ex. 9A at 19-22.)

OCC witness Dr. Duann also argues that residential customers receive a disproportionate share of the revenue increase justified by their share of energy usage and more specifically maintains that residential customers will shoulder an unfair burden of the generation rates. (OCC Ex.1 at 6, 21-23.) His position relies on the quantification on Table 1 (pages 21-22 of his testimony) but this data was shown on cross examination to be based on faulty assumptions and information. Specifically, he acknowledged that the rate increases portrayed in Table 1 reflect elimination of the PIRR. (Tr. VIII at 1577.) He admitted that he had not done a calculation of rate impacts without elimination of the PIRR and has not presented any such information in his testimony or exhibits. (Tr. VIII at 1578.)

After being tested on his zero PIRR position, Dr. Duann modified his claim to assert without basis that the 2009 FAC case would serve as a basis for excluding the $630 million regulatory asset. (Tr. VIII at 1579.) But OCC's litigation position in the 2009 FAC case, advanced through the testimony of Dr. Duann himself, does not even support such a result. Specifically, in his August 16, 2010 testimony in Case No. 09-872-EL-FAC, Dr. Duann clearly states (at 15) his opinion that the coal reserve asset is only worth a fraction of OPCo's fuel deferral balance. Ultimately, Dr. Duann admitted that he had not isolated the effect of the FAC on the PIRR or presented anything in his exhibits or workpapers to support such a calculation. (Tr. VIII at 1579-1580, 1585.) But he did agree that, only if the Commission decided the 2009 FAC case and ordered elimination of the entire deferred fuel balance ($630 million), that his numbers in Table 1 would be correct. (Tr. VIII at 1582-1583.)

AEP Ohio witness Roush demonstrated that the Stipulation's generation rates are reasonable and he rebutted OCC witness Dr. Duann's criticisms as well as those of IEU witness Murray and FES witness Lesser. In particular, Mr. Roush empirically demonstrated that the rate changes being made in the generation rate re-design of the Stipulation are reasonable. (AEP Ohio Ex. 22.) He also showed that the proposed rates are justified both by the elimination of historical subsidies among rate classes but also as an appropriate transition to market-designed rates during the pre-auction period of the ESP term. (*Id*. at 4-6.)

With regard to Dr. Duann's claim that the rate changes were not justified based on cost, Mr. Roush's Exhibit DMR-R1 showed that the historical level of cross-subsidization among the tariff classes that existed at the time of CSP's and OPCo's last base rate cases aligns remarkably well with the Stipulation changes in generation rates. (*Id*. at 3.) For example, CSP residential customers were receiving a $0.0081/kWh subsidy after the last base rate case and would receive a $0.0083/kWh increase in 2012 under the Stipulation. (*Id*. at Exhibit DMR-R1.)

Mr. Roush also explained the second major reason why it is important to implement the rate re-design during the pre-auction period of the ESP term, through a comparison to FirstEnergy rates:

> [S]ince the Stipulation will result in SSO rates beginning in June 2015 being based upon a competitive bid process, it is important to begin the transition to such market-based pricing during 2012 through May 2015. Exhibit DMR-R2 shows a comparison of the First Energy EDU's Generation Service Rider (RIDER GEN) to AEP Ohio's generation service rates before and with the Stipulation ESP. Since RIDER GEN is based upon the conversion of the results of a bidding process into rates by class under a Commission approved methodology, one would expect the rate relationships (but not the absolute values of the rates) to roughly approximate the outcome of such a process for AEP Ohio. As can be seen in Exhibit DMR-R2, the Stipulation rate relationships are significantly better aligned with RIDER GEN (and thus market based pricing) than are AEP Ohio's generation service rates before the ESP Stipulation.

(AEP Ohio Ex. 22 at 3.) Accordingly, the generation rate design is reasonable and appropriate.

Finally regarding generation rate design, FES witness Dr. Lesser testified in opposition to the MTR outlined in the Stipulation (FES Ex. 2 at 42-44.) Although recognizing that the MTR would be a credit to residential customers, Dr. Lesser still opposed the mechanism (Tr. VII at

1323.) Despite the criticisms of Dr. Lesser, the MTR is a valuable part of the Stipulation for customers to facilitate the transition from CSP's and OPCo's current generation rates to the market-based SSO generation service rates.

As AEP Ohio witness Roush testified, his Exhibit DMR-R4 clearly shows that the intent and purpose of the MTR is being accomplished. Column (5) of Exhibit DMR-R4 shows the change in rates after the MTR compared to the change in rates before the MTR in Column (3). (AEP Ohio Ex. 22 at Exhibit DMR-R4.) For example, the change for the CSP GS2 class before the MTR is a reduction of 2.35 cents per kWh and after the MTR is a reduction of 0.77 cents per kWh. (*Id.*) Conversely, the change for the CSP Residential class before the MTR is an increase of 0.60 cents per kWh and after the MTR is an increase of 0.30 cents per kWh. (*Id.*)

Fundamentally, the MTR manages the transition from today's rates (Point A) to the rates in June 2015 through May 2016 which will be based upon the results of a competitive bidding process (Point B). Rather than waiting until June 2015 and potentially subjecting customers to abrupt rate changes at that time, the Stipulation provides through the MTR a reasonable glide path through the MTR to get from Point A to Point B. Thus, the MTR is justified as being reasonable based on both cost and market relationships.

2) Interruptible Credit [Par. IV.1.b]

As part of the Stipulation, AEP Ohio agreed to restructure its existing interruptible service offering to reflect the transition to participation in the PJM Interconnection, LLC (PJM) Base Residual Auction in the June 2015 to May 2016 delivery year and the transition to the use of a competitive bid process to meet AEP Ohio's SSO obligation. As explained by AEP Ohio witness Roush:

> In today's environment, interruptible service is more typically represented as an offset or modifier to firm service rates rather than as a separate and distinct rate.

> As such, Schedule Interruptible Power – Discretionary (IRP-D) will be restructured as Rider IRP-D. For customers taking service under Schedule IRP-D as of December 2011, a modified Rider IRP-D will be made available to them. No new customers will be permitted to enroll under the terms of the tariff in Rider IRP-D.

(AEP Ohio Ex. 2 at 6.) Pursuant to Paragraph IV.1.b, the credit under Rider IRP-D will be $8.21 per kW per month through May 31, 2016. The additional credit provided by the Stipulation above the Company's originally proposed credit of $6.57 per kW per month will be included in the Economic Development Cost Recovery Rider. The incremental cost associated with this interruptible credit (approximately $5 million) shall be collected through the Economic Development Rider.

3) The Load Factor Provision [Par. IV.1.b]

Pursuant to Paragraphs IV.1.b, the Load Factor Rider is a nonbypassable, revenue neutral demand charge and energy credit applicable to all customers taking service under standard service offer or open access distribution service Schedules GS-2, GS-3 and GS-4 having monthly peak demands of less than or equal to 250 MW. The Load Factor Provision (LFP) is designed to further facilitate the transition from CSP and OPCo's current generation rates to the market-based SSO Generation Service rates discussed above. The LFP is authorized under multiple provisions within the ESP statute. Under R.C. 4928.143(B)(2), an ESP "may provide for or include, without limitation...[p]rovisions under which the electric distribution utility may implement economic development, job retention, and energy efficiency programs, which provisions may allocate program costs across all classes of customers of the utility and those of electric distribution utilities in the same holding company system." Under R.C. 4928.143(B)(2)(d), an ESP may also include provisions that "would have the effect of stabilizing or providing certainty regarding retail electric service." Accordingly, rate stability and certainty are recognized by the General Assembly as being appropriate considerations when analyzing an

ESP.

AEP Ohio witness Roush provided testimony concerning the details and design of the LFP:

> The demand charge is $6.57 per kW per month for Schedule GS-3 and GS-4 customers and $3.29 per kW per month for Schedule GS-2 customers. The energy credit is $0.01545 per kWh for Schedule GS-3 and GS-4 customers and $0.00228 per kWh for Schedule GS-2 customers. The Load Factor Rider will end on May 31, 2016. On a quarterly basis, the sum of the demand charges and energy credits under the Load Factor Rider should be zero (0). However, since actual customer usage by customer class will vary, the net of the actual charges and credits could be greater than or less than zero (0). Any over- or under-recoveries will be included in a quarterly Load Factor Rider reconciliation which will adjust the energy credits either up or down to achieve a net zero (0) collection under the Load Factor Rider.

(AEP Ex. 2 at 12-13.) OEG witness Baron also provided testimony highlighting the clear economic development benefits associated with the LFP:

> The LFP provides that a nonbypassable demand charge and nonbypassable energy credit will be established on a revenue-neutral basis among all demand-metered customers until May 31, 2016. *The LFP is intended to promote economic development and provide certainty and stability regarding retail electric service.* AEP Ohio does not earn any profit or margin on the LFP and it is therefore appropriate for the LFP to be nonbypassable. The LFP does not affect residential customers since residential customers are not in a demand metered customer class.
>
> The LFP recognizes the lower relative cost of serving high load factor customers (whether they are large or small; industrial or commercial) compared to lower load factor customers. By definition, high load factor customers use fixed generation assets more efficiently than lower load factor customers. Consequently, high load factor customers are less costly to serve. As a result, utility rates have traditionally been designed in order to recognize this difference in the cost of service for high load factor customers versus lower load factor customers. The LFP maintains an element of this cost-of-service rate design during the transition to full market pricing and complete divestiture. While on-peak and off-peak market energy pricing also recognizes the importance of load factor, it is to a lesser degree than under cost based ratemaking in which fixed costs are recovered through a kW demand charge for large customer rate classes. *The LFP provides rate certainty and stability to high load factor industrial and commercial customers during the transition to market rates contemplated by the Stipulation. This further promotes economic development. The LFP also encourages energy efficiency and peak demand reduction by rewarding the efficient use of generation resources.*

(OEG Ex. 1 at 6-7 (emphasis added).)

The Load Factor provision's design, including the limitation on the applicability, is reasonable and should be approved by the Commission. That limitation effectively excludes only one AEP Ohio customer – Ormet Primary Aluminum Corp. (Ormet). (OEG Ex. 1 at 7.) As discussed below, Ormet has frequently been treated differently than other AEP Ohio customers and therefore it is not unduly discriminatory to treat Ormet differently in this case. (*Id*. at 7-8.) Additionally, the inclusion of very large AEP Ohio customers in the LFP of the Stipulation would frustrate the intended purposes of the LFP.

i. The LFP's 250 MW monthly peak demand limit is reasonable, as Ormet has frequently been treated as a unique customer and it is not unduly discriminatory to treat them differently in this case.

An examination of Ormet's relationship with AEP Ohio over time reveals that Ormet has always been treated as unique:

1957-1997

In 1957, OPCo and Ormet entered into agreements that led to the construction of three power-generating units at the Kammer Generating Station to meet Ormet's electric consumption needs. Two of these units were actually owned by Ormet.[19] In 1966, Ormet and OPCo entered into a twenty-five year power agreement with a five-year extension option under which Ohio Power acquired full ownership of Ormet's units.[20] Pricing to Ormet was based only on the fuel

[19] *Ormet Primary Aluminum Corp. v. Ohio Power Co.*, 207 F.3d 687, 688 (4th Cir. 2000); *In the Matter of the Application of Ohio Power Company for Approval of a Special Contract Arrangement with Ormet Primary Aluminum Corporation* ("1996 Special Arrangement Case") Case No. 96-999-EL-AEC, Application (Sept. 19, 1996) at ¶3.
[20] 1996 Special Arrangement Case, Application at ¶3-4 (citing *In re Application of Ohio Power Company for Approval of a Power Agreement between Ohio Power Company and Ormet Corporation*, Case No. 34272, Finding and Order (Dec. 21, 1966); *In re Application of Ohio*

and capacity costs of the Kammer Station. Pricing was not based on OPCo's total system costs, which was the pricing method to all other customers. In that manner, from 1966-1997 Ormet was served as a stand alone customer on a basis different than all other ratepayers.

1998-2005

OPCo and Ormet agreed that the termination date for their 1966 agreement would be Nov. 30, 1997.[21] Consequently, OPCo asked the Commission for approval of an interim agreement to last until Dec. 31, 1999.[22] Concurrently, OPCo and South Central Power Company (South Central), a rural electric cooperative,[23] jointly petitioned the Commission for approval to reallocate their electric service territories so that all of Ormet's facilities in Hannibal, Ohio would be located in South Central's certified territory.[24] In other words, Ormet was seeking to change utility service territories from AEP to a rural electric cooperative not regulated by this Commission. Ormet sought this change in order shop for competitive generation at a time when the wholesale market price for power was lower than OPCo's cost-based rate. The Commission approved these requests on November 14, 1996.[25]

In its application for approval of the interim agreement, OPCo discussed the unique nature of its relationship with Ormet:

> Unlike typical special contracts which involve discounts from filed rates for customers meeting certain specified criteria, *the arrangement with Ormet is completely unique*. Since the mid-1950's, the historical relationship between Ohio Power's construction of the Kammer generating units to support this aluminum smelting operation has been recognized by this Commission. In rate

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Power Company for the Approval of the First Supplement between Ormet and Ohio Power Company, Case No. 36294, Finding and Order (Jan. 26, 1970)).

[21] 1996 Special Arrangement Case, Application at ¶4.

[22] 1996 Special Arrangement Case, Application at ¶6.

[23] South Central Power Company website available at http://www.southcentralpower.com/Default.aspx.

[24] 1996 Special Arrangement Case, Application at ¶5.

[25] 1996 Special Arrangement Case, Finding and Order (Nov. 14, 1996) at 8.

> and fuel proceedings, this has resulted in a segregation of the plant and expenses directly identified with the Ormet contract from the remaining jurisdictional expenses…*As has historically been the case, this proposed power supply arrangement is unique completely to Ormet*.[26]

Ormet and South Central executed a service agreement which provided for the sale of a certain amount of power to Ormet from South Central. Ormet would satisfy the rest of its electric needs from the market.[27] This agreement allowed Ormet to in effect shop for competitive generation four years before S.B. 3 gave that option to other customers. In this way Ormet was treated differently not just from all other OPCo ratepayers, but differently from all other ratepayers in the entire state of Ohio.[28]

2006-2009

On August 25, 2005, Ormet petitioned the Commission to reallocate electric service territories so that Ormet would once again be located in OPCo's certified territory.[29] One of the reasons Ormet cited was the rise in electric rates on the wholesale market.[30] When market rates were low Ormet convinced the Commission to change the certified territories in this state to allow Ormet to be served by an unregulated electric cooperative so that it could buy market power. But when market rates increased, Ormet convinced this Commission to allow it to come back to OPCo. The Commission approved the reallocation of territories on November 8, 2007, along with a Stipulation (Ormet Stipulation) that included an electric service agreement between Ormet and AEP Ohio.[31] Under the Ormet Stipulation, Ormet would pay $43/MWh for

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[26] 1996 Special Arrangement Case, Application at ¶11 (emphasis added).

[27] *In the Matter of the Complaint of Ormet Primary Aluminum Corp. and Ormet Aluminum Mill Products Corp. v. South Central Power Co. and Ohio Power Co.*, Case No. 05-1057-EL-CSS ("2005 Special Arrangement Case"), Supplemental Opinion and Order (Nov. 8, 2006) at 2.

[28] 2005 Special Arrangement Case, Supplemental Opinion and Order at 2.

[29] 2005 Special Arrangement Case, Petition (Aug. 25, 2005).

[30] 2005 Special Arrangement Case, Petition at 6.

[31] 2005 Special Arrangement Case, Supplemental Opinion and Order at 10.

generation service (a below market rate).[32] AEP Ohio was permitted to charge other customers for the differential between Ormet's below market $43/mwh rate and the higher revenue AEP would have realized by selling into the high priced wholesale market. This meant that all other ratepayers paid for Ormet's flip-flop. [33] Ormet's generation service rate was updated in later Commission proceedings.[34] On Dec. 29, 2008, Ormet and AEP Ohio filed an application requesting Commission approval of a temporary amendment to extend the Stipulation and to set Ormet's generation service rates at tariff rates.[35] The Commission approved the temporary amendment on January 7, 2009.[36]

2010-2018

On Feb. 17, 2009, Ormet requested Commission approval of a unique arrangement, which included provisions linking Ormet's electric rates from 2010-2018 to the price of aluminum reported on the London Metal Exchange.[37] When the price of aluminum was at a certain benchmark, Ormet would pay a set rate for power. If the price of aluminum remained below a certain benchmark, Ormet would get a very significant discount on power; if the price of

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[32] 2005 Special Arrangement Case, Supplemental Opinion and Order at 5.
[33] 2005 Special Arrangement Case, Supplemental Opinion and Order at 5.
[34] *In the Matter of the Application of Columbus Southern Power Co and Ohio Power Co to Set the 2007 Generation Market Price for Ormet's Hannibal Facilities,* Case No. 06-1504-EL-UNC, Finding and Order (June 27, 2007)(setting a price of $47.69/MWh for generation service to Ormet's Hannibal facilities); *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company to Set the 2008 Generation Market Price for Ormet's Hannibal Facilities*, Case No. 07-1317-EL-UNC, Finding and Order (Dec. 10, 2008)(setting a price of $53.03/MWh for generation service to Ormet's Hannibal facilities).
[35] *In the Matter of the Joint Application for Columbus Southern Power Co. and Ohio Power Co. and Ormet Primary Aluminum Mill Products Co. For Approval of a Temporary Amendment to their Special Arrangement*, Case No. 08-1339-EL-UNC ("2008 Temporary Arrangement Case"), Application.
[36] 2008 Temporary Arrangement Case, Finding and Order (Jan. 7, 2009).
[37] *In the Matter of the Application of Ormet Primary Aluminum Corporation for Approval of a Unique Arrangement with Ohio Power Company and Columbus Southern Power Company*, Case No. 09-119-EL-AEC, ("2009 Unique Arrangement Case"), Application.

aluminum increased greatly above the benchmark, Ormet would pay a very slight premium.[38] The Commission approved a modified unique arrangement and a maximum rate discount for Ormet of $60 million annually for 2010 and 2011.[39] The Commission capped the delta revenues paid by other customers to a maximum of $54 million in a given year, depending on the level of credit of provider-of-last-resort charges paid by Ormet to AEP.[40] Ormet has received the maximum $60 million annual subsidy the first two years of the contract.

As the above history reflects, Ormet has always been treated as a unique customer in the past, enjoying special arrangements for its electric service rates with a portion paid for by other customers. Further, since the passage of Senate Bill 3, Ormet has been exempt from paying the kilowatt hour tax under R.C. 5727.81. Division (D) of that statute exempts qualified end users of electricity from the kilowatt hour tax if they use more than three million kilowatt hours of electricity at one manufacturing location in this state for a calendar day for use in a qualifying manufacturing process. Ormet meets this criteria.

The kilowatt hour tax is charged to an electric distribution company on a monthly basis for all electricity distributed by the company during the month at the following rates: $0.00465 per kWh for the first 2,000 kWh; $0.00419 per kWh for the next 2,001 to 15,000 kWh; and $0.00363 per kWh for 15,001 kWh and above.[41] End users above 45 million kWh in annual consumption may register to self-assess the tax and pay $0.00257 per kWh on the first 500 million kWh and $0.001832 per kWh for each kWh in excess of 500 million distributed to their meter or location during the registration year.[42]

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[38] 2009 Unique Arrangement Case, Application at 6.
[39] 2009 Unique Arrangement Case, Opinion and Order (July 15, 2009) at 9-11.
[40] 2009 Unique Arrangement Case, Opinion and Order at 10.
[41] R.C. 5727.81(A).
[42] R.C. 5727.81(C)(2).

According to Ormet, "[f]ully operational, the Hannibal Facilities utilize up to 540 MW of electricity 24 hours per day, 365 days per year."[43] Through its exemption from the kilowatt hour tax, Ormet has avoided paying state and local governments tens of millions of dollars of revenue that those governments would have otherwise received from Ormet's substantial electric consumption. On a going forward basis, Ormet will continue to avoid payment of tens of millions of dollars to state and local governments because of the Ormet kWh tax exemption.

Because Ormet has frequently been treated differently than other AEP Ohio customers, it is not unduly discriminatory to treat Ormet differently in this case. The Commission should approve the limitation on the LFP's applicability as reflected in the Stipulation.

ii. Applying the Load Factor Provision to very large AEP Ohio customers would defeat the intended purpose of the provision.

Allowing the LFP to apply to very large AEP Ohio customers like Ormet frustrates the intended purpose of the provision. (OEG Ex. 1 at 7.) The LFP "is intended to promote economic development and provide certainty and stability regarding retail electric service." (OEG. Ex. 1 at 6; OMAEG Ex. 1 at 4.) If the LFP applied to very large AEP Ohio customers, like Ormet, these objectives would be undermined.

The application of the LFP to a customer like Ormet is adverse to AEP Ohio's other demand-metered customers, particularly industrial customers that are critical to Ohio's economy. OMA Energy Group witness Peggy Claytor testified that "[i]f the Load Factor Provision applied to the very largest customers in AEP Ohio's service territory, it would have a negative effect on all other customers by increasing the net charges and reducing the net credits." (OMAEG Ex. 1 at 3.) OEG witness Baron added that modifying the LFP to include customers with a customer like Ormet "would dramatically skew the intended results of the LFP and would result in a

[43] 2009 Unique Arrangement Case, Application at 1.

significant rate increase to all of the GS 2, GS 3 and GS 4 commercial and industrial customers of AEP Ohio." Mr. Baron quantified the impact of including Ormet in the customers eligible for the LFP, finding that extending the LFP's applicability to Ormet could cost AEP Ohio's GS2 customers approximately $11.9 million and would cost GS3/GS4 customers $50.9 million. (OEG Ex. 1 at 7.) The total cost to consumers of including Ormet in the LFP would therefore be $62.8 million.

The dramatic rate increase that would result from applying the LFP to large customers like Ormet is counter to the LFP's intended purpose of promoting economic development and rate stability. Without the rate stability and affordability provided by the LFP during AEP Ohio's transition to market, large customers that are critical to Ohio's economy may seek to locate in places other than Ohio where electric rates are lower and more predictable. To promote economic development and rate stability, the Commission should approve the LFP with the peak demand limitation as reflected in the Stipulation.

b) The Generation Resource Rider is reasonable and does not violate any important regulatory principles or practices. [Par. IV.1.d and 2.d]

Paragraph IV.1.d provides that AEP shall establish a nonbypassable rider, Generation Resource Rider (GRR), which shall act as a place-holder until such time as the Commission approves any project-specific costs to be included in the GRR. When seeking authorization from the Commission for cost recovery through the GRR, AEP must demonstrate how the proposed project satisfies all applicable requirements set forth in R.C. 4928.143(B)(2). Subject to resolution of a workable procedural schedule that will not endanger the viability of the project, the issues relating to a nonbypassable charge for the life of the Turning Point solar project will be moved into another docket. The Company agrees during the term of the ESP to only pursue approval of the Turning Point project and the MR 6 shale gas project under the GRR. The

Parties agree that any nonbypassable surcharge approved by the Commission for inclusion in the GRR shall reflect the net cost of the facility, including fuel and operating and maintenance costs, associated with the facility.

As AEP Ohio witness Allen testified, the GRR provision included in the Stipulation provides the Company with a mechanism to seek recovery of costs associated with the Turning Point solar project and the Muskingum River (MR 6) project during the term of the ESP, only if the Commission in a subsequent rider case approves a charge associated with one of those facilities. (AEP Ohio Ex. 4 at 4.) It is permissible under R.C. 4928.143(B)(2)(b) and (c) for the Commission to establish the GRR as part of approving 2012-2016 ESP with an initial rate of zero; there will only be a non-zero rate for the GRR after such time, if at all, that the Commission approves a project-specific charge for inclusion in the GRR as part of deciding a future rider case during the term of the ESP.

The GRR provisions in the Stipulation ensure that any future nonbypassable surcharge approved by the Commission for inclusion in the GRR will only reflect the net cost of the facility. (Par. IV.1.d and Par. IV.2.d) AEP Ohio witness Allen explained how this would operate in conjunction with the auction-based SSO:

> Under Paragraph IV.1.r (page 13) of the Stipulation, the manner in which to include any dedicated resources of the EDU in any auction-based SSO procurement process will be developed in a stakeholder process and addressed in any competitive bid process. The net cost concept can work whether the GRR unit supplies SSO load or is purely a financial transaction in the PJM market. SSO customers would pay the bid price of the unit if the unit bids and clears into the SSO auction. All customers pay the net cost of the unit – the total cost less the revenues received including those received either from the SSO auction or from the PJM market. Per Paragraph IV.2.d (page 24) of the Stipulation, all revenues, products, and services of the EDU associated with GRR projects will be used to offset the Commission approved cost of the plant. In times when market prices are high it is likely that the GRR unit will clear the SSO auction and provide lower cost energy for SSO customers. Even if the unit does not clear the

> SSO auction and market prices subsequently rise customers will benefit from the GRR unit as a result of increased revenues received in the market.

(AEP Ohio Ex. 4 at 4-5.)

OEG witness Baron testified in support of the GRR, noting the valuable hedging strategy that the GRR can serve for industrial customers:

> Allowing for recovery of the costs of new generation plants dedicated to serving Ohio customers encourages the construction of new plants in Ohio that can: 1) enhance the reliability of the electric system; and 2) provide a cost-based hedge against fluctuations in market prices. In contrast with a reliance on 100% market pricing for energy and capacity, a cost-based hedge would provide customers a blended rate that is mostly market but also part cost of service. While 100% market pricing is currently attractive, in years past that was not the case. Properly designed, a cost-based hedge can be a risk mitigation tool for consumers. Further, such costs would still be subject to Commission review and approval under R.C. 4928.143(B)(2)(b) and (c).

(OEG Ex. 1 at 12-13.) Thus, the GRR has the potential to provide rate stability and further promote economic development in AEP Ohio's service territory.

Under Paragraph IV.1.d (page 6) of the Stipulation, the Parties have reserved their right to contest or otherwise take positions in the separate future cases that will determine whether to establish a nonbypassable charge and the appropriate level of the charge through the GRR. The Stipulation's GRR provision specifies that establishment of the GRR does not constitute precedent for purposes of interpreting and applying R.C. 4928.143(B)(2)(b) and (c) and Parties reserve their right to contest or otherwise take positions in the separate future cases that will determine whether to establish a nonbypassable charge and the appropriate level of the charge through the GRR. Thus, upon adoption of the Stipulation (including the GRR provision), both the Parties and the Commission fully reserve their ability to support or oppose the future establishment of a non-zero charge for inclusion in the GRR. Conversely, rejecting the GRR would preclude the possibility that the Commission could subsequently approve the MR 6 shale gas project or the Turning Point solar project.

As indicated in the Stipulation the goal is to develop a workable schedule that will not endanger the viability of the Turning Point project. The Signatory Parties were clear that any decision on moving forward with the Turning Point project would be the subject to a future proceeding. AEP witness Allen replied on cross-examination that any prudence finding related to the Turning Point project would be part of that other proceeding to be determined. (Tr. III at 376.) AEP witness Thomas was also clear that any costs to be collected through the GRR and the timing of the Turning Point project would be a part of a separate proceeding. (Tr. IV at 597.) The Stipulation itself ensures that the satisfaction of the requirements of R.C. 4928.143(B)(2) will be considered in the future proceeding. Once the Commission makes its decision the timing of those separate proceedings can be considered. AEP witness Hamrock testified on cross-examination that the goal would be to stay the course laid out in the original filing and have the first phase of the project done in 2013. (Tr. V. at 863-864.) However, the ultimate decision lies in the hands of the Commission.

In sum, any charges approved under the GRR necessarily will comply with R.C. 4928.143(B)(2)(b) and (c), as determined by the Commission. All parties reserved their rights to debate and argue those issues in future proceedings under the GRR. As such, the GRR is reasonable and does not violate any important regulatory principles or practices.

c) The SEET threshold provision is reasonable and does not violate any important regulatory principles or practices. [Par.IV.1.g]

The Stipulation provides that the SEET threshold will be 13.5%. (Par. IV. 1.g.) If adopted, this would be the lowest SEET threshold established in any Commission proceeding under R.C. 4928.143 – by a substantial margin. Even OCC has submitted expert testimony in a litigated setting that the 2009 ROE threshold for AEP Ohio should not be any higher than 13.54%. (The Commission took administrative notice of its January 11, 2011 Opinion and Order in Case No. 10-1261-EL-UNC during this hearing, Tr. VIII at 1604, and that decision confirms (at page 18) that OCC's litigation position in that case was that the ROE threshold for significantly excessive earnings should not be higher than 13.54%.)

Because the proposed ESP term is longer than three years, the retrospective annual SEET review conducted by the Commission to date does not apply and, instead, a different SEET process applies under R.C. 4928.143(E), whereby the Commission only applies the applicable ROE threshold twice during the ESP term: (i) an initial, up front application through a *pro forma* evaluation, and (ii) in the fourth year of the plan. Both applications of the SEET test are to utilize the 13.5% ROE threshold per the Stipulation. Regarding the up front SEET review, AEP Ohio witness Allen demonstrated that the projected *pro forma* financial results for AEP Ohio during the ESP term are projected to fall substantially below even this low SEET threshold. (AEP Ohio Ex. 4 at page 6 of Exhibit WAA-5.) No opposing party submitted testimony challenging the Stipulation's SEET threshold or the projected *pro forma* financial results for AEP Ohio.

All of these factors definitively show that a SEET threshold of 13.5% is reasonable and does not violate any important regulatory practice or principle.

d) The gridSMART®, PEV, Green Power Portfolio and ESR riders are reasonable and do not violate any important regulatory principles or practices. [Par. IV. 1. h, i, k and o]

The Signatory Parties agreed in Paragraphs IV.1.h, i, k and o of the Stipulation to a variety of commitments supported by the record in these proceedings, none of which violate any important regulatory principles or practices.

1) Paragraph IV.1.h and i - gridSMART Phase 2 and PEV Commitments

In Paragraph IV 1.h, the Signatory Parties address the Company's plans for the next phase of the gridSMART project. Phase I of the gridSMART project was established in the Company's 2009-2011 ESP plan. (AEP Ohio Ex. 8, Testimony of Joseph Hamrock, at 22.) The Company proposed having the program deployed system-wide over a ten-year period. (*Id*. at 23.) However, as testified by AEP witness Hamrock, the "Stipulation implements the Signatory Parties' agreement to first complete and review Phase 1 before submitting and investing in gridSMART®-Phase 2 (Phase 2) programs." (*Id*. at 22-23.)

In Paragraph IV.1.i, the Signatory Parties address the Company's plans for the implementation of the Companies' proposed plug-in electric vehicle (PEV) tariff. The Signatory Parties included as a balancing term in the overall Stipulation that AEP Ohio "must absorb the cost of the proposed $2500 allowance per customer for installation of a charging station and a time-of-use meter, and shall not collect those costs associated with this pilot offering from customers." (*Id*. at 23.) Collectively these commitments place a greater burden on the Companies as a means of balancing the overall Stipulation presented to the Commission for approval.

As indicated in the testimony of AEP Ohio witness Hamrock, "[t]he agreement to delay the implementation of the next phase of the gridSMART® program to better understand the current data and the burden of establishing elements of the PEV tariff is a measured approach that will focus on understanding the customer's needs and motivations." (*Id*. at 24.) The commitments support the reasonableness of the Stipulation as a whole and are supported by the record.

2) Paragraph IV.1.k - Green Power Portfolio Commitment

In Paragraph IV 1.k, the Signatory Parties address the Companies' usage of the revenue received under AEP Ohio's Green Power Portfolio Rider (GPRR). As described by AEP Ohio witness David Roush explained, "AEP Ohio is adding a voluntary option for customers that wish to purchase a larger proportion of their electricity from renewable resources than the levels required under S.B. 221. The Green Power Portfolio Rider gives customers the option to purchase 25%, 50%, 75% or 100% of their energy usage from renewable resources." (AEP Ohio Ex. 2, Testimony of AEP Ohio Witness Roush, at 7.) To ensure the value customers seek under such a program, the Stipulation ensures that customers electing this option would be exempt from the Alternative Energy Rider (AER). (*Id.*) In fact, as testified by AEP Ohio witness Roush, "[a]ll amounts collected under the GPPR would be used to procure and retire RECs solely on behalf of the participants in the GPPR." (*Id.*) Specifically, the Signatory Parties agree that any revenue received under the rider will not be credited against the renewable energy certificate expense or used to reduce the rate charged to customers that do not participate in the GPPR. (Par.IV.1.k.) The mechanism agreed to by the Signatory Parties as part of the overall Stipulation provides a unique option for customers choosing to exercise their right to seek green power and retain the associated benefits with that choice. The Signatory Parties encourage the Commission to approve the Stipulation as a whole including this provision.

3) Paragraph IV.1.o - Enhanced Service Reliability Rider Extension

In Paragraph IV.1.o, the Signatory Parties address the continuation of the Enhanced Service Reliability Rider (ESRR) as proposed. As supported by the testimony of AEP Ohio witness Hamrock, "[t]he proposal was to continue the remaining two years of the five year program first proposed in the current ESP approved in Case Nos. 08-917-EL-SSO and 08-918-

EL-SSO with an incremental amount above the current base level of O&M expense required to maintain the program going forward." (AEP Ohio Ex. 8 at 21.) Mr. Hamrock testified that the "… recovery of costs under the [*ESRR]* should continue as proposed until the end of the Stipulation period. The total baseline for base spending should be the same $24,200,000 million agreed to with the Staff when applying the first three years of the program." (*Id*. at 22.) AEP Ohio witness Roush testified that "[t] he prudence of these costs will continue to be determined as part of the annual true-up filing in February of each year." (AEP Ohio Ex. 2 at 10).

The initial portion of the ESRR program already led to reductions in tree-caused outages and resulted in improved service reliability. (AEP Ohio Ex. 8 at 21.) The Stipulation is expected to benefit customers by continuing to improve reliability due to reduced tree related interruptions. (*Id*.) The customer benefit shown by AEP Ohio witness Hamrock should continue with approval of the Signatory Parties' agreement to continue the program as part of the overall Stipulation. The record supports continuation of the program approved by the Commission in the last ESP as a means to move AEP Ohio to a four year full circuit trimming cycle. This provision and the Stipulation as a package should be approved.

e) The Timber Road REPA is prudent and should be approved. [Par. IV.1.j]

The Signatory Parties agreed in Paragraph IV.1.j of the Stipulation to support the one-time upfront prudence approval for the Timber Road Renewable Energy Power Agreement (Timber Road REPA). In particular, the Signatory Parties agreed to the automatic recovery of costs through the fuel adjustment clause and/or the alternative energy rider during the contract term, subject to financial audit. The record fully supports a Commission finding authorizing the prudence and recovery of the Timber Road REPA costs as part of the overall Stipulation.

As evidentiary support, the Company provided the testimony of Peggy I. Simmons, the Company's representative responsible for administering the RFP process including verifying that it conformed with the intent to competitively bid and secure additional renewable resources. (AEP Ohio Ex. 1.) Ms. Simmons testified as to AEP's overall experience in securing renewable energy purchases stating that AEP has entered into nineteen (19) long-term renewable energy purchase agreements to serve customers of six (6) of its regulated electric operating companies. (*Id*. at 4.) Ms. Simmons also testified in support of the bid process used to select the Timber Road project and explained the corresponding benefits of the Timber Road REPA.

As supported by Ms. Simmons, AEP Ohio secured the contract through a request for proposal (RFP). The RFP was issued on June 1st, 2009 (see Exhibit JFG-1), seeking bids for 1,100 MW of renewable energy resources that would be interconnected to the PJM Interconnection (PJM) or the Southwest Power Pool (SPP) with a minimum 20 MW (nameplate) of new renewable generation capable of being operational by December 31, 2011. (AEP Ohio Ex.1 at 6.) However, as Ms. Simmons testified, AEP Ohio only considered project bids sited in Ohio due to its specific need for in-state renewable resources.

AEPSC received thirty-three (33) conforming bids from renewable energy developers for projects interconnected to PJM totaling roughly 3,450 MW of renewable energy nameplate capacity. Of the 33 bids, eight (8) bids were for projects located in Ohio. Based upon AEP Ohio's need for Ohio sourced RECs to meet its compliance benchmarks, only the bids for Ohio sited projects were considered. (AEP Ohio Ex.1 at 8.)

The Timber Road REPA under consideration in this proceeding is the result of the RFP process. AEP witness Simmons testified that "[b]ased on AEP Ohio's need for in-state renewables and a final analysis of all relevant factors affecting both AEP Ohio and its customers, AEPSC selected the proposal from Paulding Wind Farm II LLC (Paulding Wind), a subsidiary of EDP Renewables North America LLC (formerly known as Horizon Wind Energy LLC) ("EDPR NA")for its 99 MW (nameplate) Timber Road wind farm." (AEP Ohio Ex. 1 at 9.) As supported by the testimony of Ms. Simmons, the agreement with Paulding Wind was at an attractive contract price that benefits from federal grant funding administered under Internal Revenue Code Section 48(d) and Section 1603 of the American Recovery and Reinvestment Tax Act of 2009. (AEP Ohio Ex 1 at 10.) Ms. Simmons sponsored the exhibits detailing the confidential terms of the agreement with Paulding Wind. A summary of the terms and conditions of the Timber Road REPA resulting from the RFP process is found in Exhibits JFG-2A and JFG-2B (confidential and public versions), and the Timber Road REPA can be viewed in Exhibits JFG-3A, JFG-3B, JFG-4A and JFG-4B (confidential and public versions).

The Timber Road REPA will supply a 99 MW share of Timber Road wind farm's electrical output, capacity and environmental attributes to AEP Ohio for a period of twenty (20) years at a reasonable cost and favorable terms for the Companies and their customers and address state renewable requirements. Ms. Simmons testified to the fact that the Timber Road REPA fulfills AEP Ohio's need to secure additional in-state renewable energy to meet its annually increasing renewable energy benchmarks established by SB 221. (AEP Ohio Ex. 1 at 10.) The agreement also contains the ability to withdraw from the agreement if the Commission were to deny cost recovery. (*Id*.) In that instance, AEP Ohio would not be obligated under Article 6 of the REPA to purchase the output from the Timber Road wind farm. (*Id*.) However, AEP Ohio agreed to waive the ongoing termination rights in Article 6.1(G) of the REPA if the REPA is assigned as part of corporate separation on or after May 31, 2015 as indicated in the Stipulation. (See Par. IV.1.j; AEP Ohio Ex. 1 at 10.)

The Timber Road II wind project, which is owned by Paulding Wind, was developed under the direction of its parent company, EDPR NA, in Paulding County Ohio. (AEP Ohio Ex. 1 at 11.) EDPR NA develops, constructs, owns and operates wind farms throughout North America. Based in Houston TX, EDPR NA owns and operates twenty-eight (28) wind farms across the United States totaling more than 3,500 megawatts ("MW") of capacity, ranking EDPR NA third in the country in terms of net installed capacity. (Paulding Wind Farm Ex. 1 at 1.) The facility has a nameplate capacity (maximum output) of 99 MW and consists of fifty-five Vestas V100 – 1.8MW wind turbines. (AEP Ohio Ex. 1 at 11.) The Timber Road Wind Farm interconnects with the existing AEP Ohio transmission system at 138 kV and has reached commercial operation. (*Id*.)

AEP Ohio witness Simmons provided testimony establishing the benefits of the 20-year term of the Timber Road REPA to the consumer. She testified that "[t]he 20-year agreement, which is also the expected life of the technology, allows renewable energy resource providers to secure long-term financing, thereby amortizing the cost of their projects over a longer period. Such financing has the effect of reducing the upfront costs and allows for a more economically levelized price over the term of the contract. The 20-year term also provides price certainty for AEP Ohio's customers." (AEP Ohio Ex. 1 at 11.) Paulding Wind witness Irvin testified in support of the Stipulation that "[w]ind farms are capital-intensive but have the advantage of no fuel costs. Therefore, there are no significant cost variables that present long-term risk to ratepayers." (Paulding Wind Ex. 1 at 4.) AEP Ohio witness. Simmons also pointed out that the "Timber Road REPA stipulates that AEP Ohio will receive all current and future environmental attributes from the Project, including the associated Ohio non-solar RECs." (AEP Ohio Ex. 1 at 12.)

The Timber Road REPA provides AEP Ohio and its customers, with access to affordable renewable energy from an in-state resource. According to R.C. 4928.64(C)(3) half of the non-solar benchmark must be met with RECs produced by renewable energy resources sited in Ohio. AEP Ohio's year end non-solar renewable energy benchmark will increase from 1.44% in 2012 to 2.38% of sales in 2014. (AEP Ohio Ex. 1 at 12.) The Timber Road REPA will contribute to compliance with the in-state portion of the non-solar renewable energy benchmark. (*Id*. at 13.) The in-state support for renewable technology will also support the State policy goals found in R.C. 4928.02 including subsection (N) which calls for efforts to facilitate the state's effectiveness in the global economy. Investment in Ohio-based renewable resources is one way to facilitate those efforts. Paulding Wind witness Irvin stated in his direct testimony that "the Timber Road REPA serves as an example of the type of long-term contract that can spur development of additional, large-scale generation projects, ultimately increasing the likelihood of utility compliance [with the State's renewable energy requirements], and the realization of the market's full potential promised by SB 221." (Paulding Wind Ex. 1 at 5.) Without the support of long-term contracts, Mr. Irvin explained, "[s]ignificant new advanced energy generation resources are unlikely to be built in Ohio." (*Id.*)

IEU witness Murray raises a legal argument that the approval requested contradicts O.A.C. 4901:1-35-09 (IEU Ex. 9A at 25.) However, Mr. Murray misinterprets the rule and the role of this proceeding as it relates to the Timber Road REPA. AEP and the Signatory Parties are seeking a one-time upfront prudence approval of the Timber Road REPA in this case. Upon the Commission's approval of the Timber Road REPA's inclusion in the fuel adjustment clause, the costs of the REPA would then be reflected in the quarterly filings and then the annual audit of the full year– to the extent desired by the Commission. As interpreted and applied by

Commission Staff, however, the fuel audit rule at O.A.C. 4901:1-35-09 is intended to examine the prudence of the costs incurred under a fuel contract, and not the prudence of the underlying contract, in this case the Timber Road REPA, itself. The Stipulation provision relating to the Timber Road REPA therefore does not run afoul of Commission rules.

The Signatory Parties, including the Staff of the Commission, agreed to support the one-time upfront prudence approval for the Timber Road REPA. The REPA as supported by AEP witness Simmons was the result of a competitive bid process and resulted in a very competitive price. The 20-year term allows the Companies to lock in the attractive price. The dedicated output, including the RECs, will assist the Companies in complying with the renewable energy mandates while supporting the development of renewable resources in the State of Ohio. As stated by Paulding Wind witness Irvin in his direct testimony: "Commission approval of the Stipulation will provide critical regulatory certainty for the Timber Road II project, and recognize long-term contracts as an essential element in the development of Ohio's advanced energy marketplace." (Paulding Wind Ex. 1 at 3.) Non-signatory parties failed to offer any evidence to call into question the prudence or reasonableness of the Timber Road REPA.[44] Therefore, the only evidence of record for the Commission to base its decision is overwhelmingly in support of the Signatory Parties agreement to approve the prudency of the REPA for recovery through the fuel adjustment clause and alternative energy rider.

[44] IEU witness Murray raises a legal argument that the approval requested contradicts O.A.C. 4901:1-35-09 (IEU Ex. 9A at 25.) However, a closer examination shows that the one-time prudence review is being requested in this proceeding and once the Commission approves the REPA for inclusion in the fuel adjustment clause, the accounting associated with the REPA would then be reviewed in the financial audit portion of the normal fuel audit.

f) The Fuel Adjustment Clause and the Alternative Energy Rider are reasonable and do not violate any important regulatory principles or practices. [Par. IV.1.l and m]

Paragraph IV.1.m of the Stipulation provides that the current FAC mechanism continues through May 31, 2015. Upon implementation of full legal corporate separation and Pool modification/termination and until May 31, 2015, the FAC will accommodate pass through of bilateral contractual arrangements between AEP Ohio (or the successor electric distribution utility entity) and an AEP affiliate as needed to supply generation services, provided that customers will pay the equivalent non-fuel and fuel generation rates as they would pay under this Stipulation prior to full legal corporation separation and Pool modification/termination. In addition, a modified FAC mechanism will continue after May 31, 2015 in connection with a nonbypassable charge, if any, that is authorized for inclusion in the GRR.

Paragraph IV.1.l of the Stipulation provides that the Alternative Energy Rider (AER) will be subject to annual review in the FAC proceeding, including review by the FAC auditors. In addition to its other functions, the initial FAC proceeding under this ESP shall include a determination of the methodology for valuation of Renewable Energy Credits for bundled purchases and for self-generation. Regardless of the allocation methodology determined, however, AEP Ohio will be entitled to full recovery of prudently-incurred compliance costs through the AER.

AEP Ohio witness Allen sponsored the FAC and AER proposals in his testimony and AEP Ohio witness Roush discussed implementation of the FAC and AER riders in his testimony; both witnesses were subject to cross examination regarding the FAC and AER. (AEP Ohio Ex. 4 at 5-9; AEP Ohio Ex. 2 at 10.) The FAC is a well established and non-controversial rate adjustment mechanism based on R.C. 4928.143(B)(2)(a). Similarly, the AER is consistent with

R.C. 4928.143(B)(2)(a) and is essentially a partial unbundling of the FAC to provide price visibility for prudently-incurred REC compliance costs under R.C. 4928.66. AEP Ohio witness Allen explained the accounts that would be split out from the FAC into the AER. (AEP Ohio Ex. 4 at 5-8.) No party has challenged the continuance of the FAC or the establishment of the AER.

IEU witness Murray did complain that the FAC rates lack a connection to market rates and are the largest component of generation rates. (IEU Ex. 9A at 20-21.) But Mr. Roush demonstrated that Mr. Murray's criticism in this regard was academic, at best:

> [T]he Stipulation generation prices in <u>total</u> were established based upon market price relationships. The FAC was then subtracted to determine the base generation rates. Any extent to which the FAC may not be reflective of market is irrelevant, as the total generation prices are reflective of market. This is particularly true since SSO customers pay the total generation price (base generation rates plus the FAC), not simply one component or the other.

(AEP Ex. 22 at 5.) In other words, if there were a customer that paid only the FAC and not base generation rates, or vice versa, Mr. Murray's concerns might not be completely academic. But there is not such a customer and his criticisms are contrived.

The FAC and AER are reasonable and do not violate any important regulatory principle or practice.

g) The Distribution Investment Recovery rider is reasonable and does not violate any important regulatory principles or practices. [Par. IV.1.n]

As permitted under R.C. 4928.143, the Signatory Parties recommended the establishment of the Distribution Investment Rider (DIR) as a means to provide recovery of carrying costs associated with post-2000 investment in the distribution system as part of the ESP proposed in these proceedings. As indicated in the Stipulation, the carrying charge rate will include elements to allow an opportunity to recover property taxes, commercial activity tax, and associated income taxes and earn a return on and of plant in service associated with distribution net investment associated with FERC Plant Accounts 360-374. The return earned on such plant will be based on the cost of debt of 5.34% , a cost of preferred stock of 4.40%, and a return on common equity of 10.50% utilizing a 47.06% debt, 0.19% preferred stock and 52.75% common equity capital structure. The net capital additions included for recognition under the DIR will reflect gross plant-in-service incurred post-2000 adjusted for growth in accumulated depreciation. (Par.IV.1n.)

There are multiple options in the ESP statute for the Commission to base its approval of the DIR carrying charge. Two options that clearly rise to attention are R.C. 4928.143(B)(2)(d) and R.C. 4928.1443(B)(2)(h). Under R.C. 4928.143(B)(2)(d), an ESP can include terms, conditions, or charges relating to carrying costs. As AEP Ohio witness Hamrock stated, the "DIR will allow recovery of carrying costs on incremental distribution plant investment." (AEP Ohio Ex. 8 at 20; see also the description of the DIR in Par. IV.1.n.) The Commission also recently utilized this statutory provision in its Order on Remand in Commission Case Nos. 08-917-El-SSO and 08-918-EL-SSO as justification for environmental carrying costs as part of the Company's first ESP.

Another statutory basis for the Commission's approval of the DIR recommended by the Signatory Parties is under R.C. 4928.143(B)(2)(h). This statutory provision allows an ESP to include provisions regarding distribution infrastructure and modernization incentives for an electric distribution utility to recover costs and a reasonable rate of return on that infrastructure modernization. In its determination of approving such a cost under an ESP under division (B)(2)(h), the Commission shall examine the reliability of the electric distribution utility's distribution system and ensure that customers' and the electric distribution utility's expectations are aligned and that the electric distribution utility is placing sufficient emphasis on and dedicating sufficient resources to the reliability of its distribution system. The arguments of the Non-Signatory Parties that the record does not support approval of the DIR under R.C. 4928.143(B)(2)(h) are unfounded. The record in this case supports approval of the DIR under either of these statutory provisions.

The reliability of the AEP Ohio system is constantly under review by the Commission's Staff and through compliance filings. AEP Ohio witness Hamrock verified the involvement of the Commission Staff in the monitoring the reliability functions of the Companies. (AEP Ohio Ex. 19 at 3). Mr. Hamrock highlighted the Staff's involvement in the public Rule 10 reliability indices standard setting in Case No. 09-756-EL-ESS that provided the Commission with a recommended performance standard to measure system performance that followed the Commission enumerated rule process that includes a number of aspects related to system design and reliabiltiy. (*Id.*) In addition, Peter Baker, the Section Chief in the Reliability and Service Analysis Division of the Service Monitoring and Enforcement Department, also testified to the extensive review followed in setting these performance standards. (Staff Ex. 5 at 3-4.)

The Company is focused on the needs of the system and what is needed to maintain the system to meet customer expectations. "The failure rates of equipment in AEP Ohio's distribution infrastructure continue to rise and the level of funding is not present to improve the failure trends." (AEP Ohio Ex. 19 at 4.) Approval of the DIR will result in the Company conducting analyses and targeting infrastructure investment to maximize the improvement in reliability to customers and the distribution system. (*Id.*) The Company conducts surveys that show most customers are expecting to either maintain their current level of service or see an increase in the level of reliability in the next five years. (*Id.*; OCC Ex. 10 AEP Survey; Tr. XII at 2017-2025.) Staff witness Baker reinforced the point that the AEP Ohio customer surveys reviewed by the Commission Staff indicate a high percentage of AEP Ohio customers were satisfied with the service reliability received. (Staff Ex. 5 at 4). AEP Ohio witness Hamrock testified to the Companies commitment to reliability as a cornerstone of the business and that the DIR will allow the Companies to actively invest in sufficient resources in the reliability effort. (AEP Ohio Ex. 19 at 4.) That investment from the DIR is "… essential to maintaining the current level of reliability as well as to improve reliability in the future." (Tr. XII at 2043.)

The creation of the DIR as proposed does not violate any important regulatory principle. Contrary to the arguments raised by Non-Signatory Parties, the record supports the approval of the mechanism. IEU witness Bowser asserts that under R.C. 4928.143 the Stipulation must identify the specific statutory authority for the DIR mechanism. (IEU Ex. 8 at 6; Tr. VIII at 1511.) Nowhere in R.C. 4928.143 is there a requirement for what should be included in a settlement agreement filed before the Commission. It must be assumed that Mr. Bowser's legal sufficiency argument is meant to apply to the overall discretion of the Commission to approve the mechanism because nothing in the statute cited provides a proper basis for a proper argument to attack the validity of the content of a filed Stipulation. The statutory basis of the mechanism as a whole is a matter for the Commission and is discussed above in this post-hearing brief.

IEU cannot assert that a stipulation without specific statutory authority in each clause of the agreement violates regulatory principles without indicting past agreements approved by the Commission, in particular an agreement signed by IEU. As established in the record on cross examination, IEU had previously signed a stipulation in FirstEnergy's 10-388-EL-SSO Stipulation filed on March 23, 2010 that did not contain specific statutory authority. (Tr. VIII at 1502-1512.) The Commission approved the stipulation in that case that, as discussed in cross examination with IEU witness Bowser, contained provisions without explicit statutory basis included in the body of the stipulation. (*Id*.) The detailed content of the actual agreement is irrelevant to this argument. The fact that the Commission previously approved a stipulation signed by IEU without the explicit authority listed in each section, undermines IEU's argument that the present Stipulation violates a regulatory principle. Clearly IEU supported that Stipulation as not violating any regulatory principles or practices. IEU's argument in this area is representative of the type of arguments it offers throughout the testimony of both its witnesses. Essentially if IEU does not agree with the way the Signatory Parties structured a part of the agreement then it must be in violation of a regulatory principle or practice. The standard for a violation of a regulatory practice or principle is much higher than not being how IEU would prefer something be structured. The present Stipulation does not violate any regulatory principle and should be approved.

Perhaps IEU should be held to the standard initially offered by IEU witness Bowser. As part of his explanation of the test to apply to consider stipulations, IEU witness Bowser testified: "It is my understanding that a settlement cannot operate to delegate authority to the Commission or disrespect procedural or substantive requirements established by the General Assembly or the Commission's own rules." (IEU Ex. 8 at 4). Even though the rationale provided for each of the points raised by IEU witness Bowser are based on his opinion of how things should work he proffers a standard based in rules and laws.

Applying this standard to IEU witness Bowser's testimony shows that his own arguments do not satisfy his standard. Mr. Bowser raises concerns with the nonbypassability of the DIR and the associated carrying cost that do not fit his definition of violating a regulatory principle or practice. Yet when questioned on cross-examination, IEU witness Bowser admitted that his views on the nonbypassability and carrying cost were not based in a requirement from the

Commission or the General Assembly. (Tr. VIII at 1512-1513.) The issues raised by IEU witness Bowser were clearly solely based on his opinion of how he would structure things but nothing rose to the level of violating a regulatory practice or principle under any standard and certainly not as he defined that standard. IEU witness Bowser also admitted that his concerns with the DIR (related to being a lower financial risk) were related solely to the DIR on a stand-alone basis without the give and take from the rest of the Stipulation. (*Id*. at 1513.) Clearly the Commission considers Stipulations as a package and not on an individual basis to assess the overall balance of the reasonableness of an agreement. AEP Ohio witness Allen also rebutted Mr. Bowser's assertion stating that the investments included in the DIR are not financed by debt alone but are financed through a combination of debt and equity. (AEP Ex. 20A at 2.) Mr. Allen also pointed out that the investment is subject to a yearly prudence review each year carrying with it risk. (*Id*. at 2-3.) Mr. Allen also responded to IEU witness Bowser's claim that AEP Ohio somehow improperly omitted the benefit of the ability to take a deduction against taxable income that is calculated using accelerated depreciation of capital investments. Mr. Allen pointed out that IEU witness Bowser fails to realize that the DIR mechanism calculates a carrying charge for distribution assets going back to the year 2000, that includes increases associated with new assets and decreases associated with existing assets. (AEP Ex. 20A at 4.) Based on this mixing of old and new assets, AEP Ohio witness Allen testified that the decline in ADIT associated with older assets would tend to offset the increase in ADIT associated with new assets, making IEU witness Bowser's recommendation inappropriate. (*Id*.) Again, IEU witness Bowser provides preferences for the establishment of the DIR, but cannot show that the Signatory Parties' recommendation violate any regulatory practices or principles.

OCC witness Dr. Duann raises similar preferential concerns with the DIR mechanism. OCC witness Dr. Duann maintains that the DIR provides accelerated recovery of investments without a demonstration of benefits or need for this relief. (OCC Ex. 1 at 7-8.) As discussed above, AEP Ohio witness Hamrock supported the need to continue investment in the aging infrastructure to meet customer expectations and address issues on the system. Dr. Duann also asserts the 10.5% return on equity reflected in the DIR is too high. (OCC Ex. 1 at 8, 30-31.) This position lacks supporting evidence or any testimony establishing a different return on equity (ROE) that is more "reasonable" or should be exchanged for the amount agreed to by the Signatory Parties as part of the balance of all the terms in the Stipulation. The distribution case remains pending but a 10.5% ROE is more than reasonable in the context of an ESP rate adjustment. Dr. Duann stated his belief that OCC's position in the context of the 2009 SEET proceeding involving AEP Ohio advocated a ROE threshold of less than 10.5%. (Tr. VIII at 1591.)

In reality, OCC submitted expert testimony that the ROE threshold should not be any higher than 13.54%. (The Commission took administrative notice of its January 11, 2011 Opinion and Order in Case No. 10-1261-EL-UNC during this hearing, Tr. VIII at 1604, and that decision confirms (at page 18) that OCC's litigation position in that case was that the ROE threshold for significantly excessive earnings should not be higher than 13.54%.) OCC witness Dr. Duann recognized that rate base/ rate of return ratemaking was not applicable to the ESP case, even though his position regarding the 10.5% ROE was based on traditional cost-based ratemaking. (Tr. VIII at 1589-1590.) Finally, OCC witness Dr. Duann argues that the DIR has a potential for double recovery of the return on and of the involved distribution investments. (OCC Ex. 1 at 8-9, 31.) During cross examination, Dr. Duann stated that his double recovery concern regarding the DIR would be resolved if the rates established in the distribution base rate case recovered a return on and of the investments made as of the date certain and the DIR would only recover investments after the date certain. (Tr. VIII at 1594.) AEP Ohio witness Allen testified on rebuttal that any costs recovered through the Company's base distribution rates would not be recovered through the DIR. (AEP Ex. 20A at 5.)

The record supports the approval of the DIR mechanism as part of the ESP. The Commission has the discretion to approve the mechanism under either R.C. 4928.143(B)(2)(d) or (h), or any other provision the Commission deems appropriate. The structure of the mechanism provides the carrying cost basis for approval. The evidence of record supports the standard for approval under subsection "h" of the statute. Staff witness Baker testified that, based upon the Company's successful performance against the reliability standards, Staff believes the Company and the customers reliability expectations are aligned and the Company is dedicating sufficient resources to the reliability of the distribution system. (Staff Ex. 5 at 5.) As indicated by AEP Ohio witness Hamrock, reliability is an important part of the business and the DIR will allow the Company to move from a reactive to a proactive replacement strategy on its aging assets to meet customer expectations. (AEP Ohio Ex. 19 at 4.) The Commission should find that the DIR mechanism, as part of the overall package, does not violate any important regulatory principle or practice and should be approved.

h) The Provisions for Corporate Separation and Generation Pool Dissolution or Amendment are reasonable and do not violate any important regulatory principles or practices. [Par. IV.1.q, t, and IV.5]

The basic framework of, and many of the individual provisions within, the September 7, 2011 Stipulation and Recommendation in Case Nos. 11-346-EL-SSO et al. (Stipulation) are premised upon completion of full structural corporate separation by Columbus Southern Power

Company and OPCo Company (collectively referred to as "AEP Ohio"). Under the Stipulation, AEP Ohio agreed, upon receiving a final order from this Commission authorizing full legal corporate separation, provide notice to PJM that it intends to participate in the RPM Base Residual Auction for delivery years 2015-2016. (Par. IV.1.q.) Divestiture of generation assets from the electric distribution utility, in turn, causes AEP Ohio to force an amendment or dissolution of the 1951 vintage AEP Interconnection Agreement, commonly referred to as the "AEP Generation Pool" or simply as the "Pool." Since the Pool is a FERC-approved agreement, the amendment or dissolution of the Pool is a FERC-jurisdictional matter – a proceeding in which the Commission and other Ohio stakeholders are likely to actively participate. Thus, as part of the Stipulation, the Signatory Parties agreed to establish a Pool Modification Rider at a zero rate level, in order to preserve AEP Ohio's ability to seek recovery of the before/after impact of the Pool change if it is material (*i.e.*, more than $50 million).

The provisions for corporate separation and Pool modification are essential components of the restructuring needed for AEP Ohio to transition from a regulated ESP plan to an auction-based SSO. Completion of these steps is necessary for commencement of the SSO auction for delivery beginning in mid-2015. As further demonstrated below, these restructuring provisions are reasonable, are supported by evidence in the record and do not violate any important regulatory principle or practice.

1) Corporate Separation

Paragraph IV.1.q of the Stipulation specifically provides that "[a]pproval of this Stipulation will serve as the Commission's approval of full legal corporate separation (as contemplated by R.C. 4928.17(A) and also known as structural corporate separation) such that the transmission and distribution assets of AEP Ohio will be held by the electric distribution utility while any GRR assets will remain with the electric distribution utility." Completion of structural corporate separation by AEP Ohio necessitates approvals by not only the Ohio Commission but also the Federal Energy Regulatory Commission (FERC). Thus, by adopting the Stipulation, the Commission will approve full structural corporate separation by Columbus Southern Power Company (CSP) and OPCo, which is a cornerstone requirement to many of the individual provisions contained in the Stipulation.

AEP Ohio witness Nelson elaborates on Paragraph IV.1.q in his testimony by explaining that the "transmission- and distribution- related assets would remain in the (post-merger) electric distribution utility and AEP Ohio's generation, fuel and other assets would be transferred to a newly-created AEP generation affiliate (AEP GenCo)." (AEP Ohio Ex. 7 at Exhibit PJN-1.) Mr. Nelson further explains that the transfer will include AEP Ohio's existing generating units and contractual entitlements, existing fuel-related assets and contracts, and other assets related to the generation business. (*Id*.) The transactions implementing full legal corporate separation will not close until after the Commission adopts the Stipulation and the Federal Energy Regulatory Commission grants its approval.

The Stipulation also resolves case No. 10-2376-EL-UNC, which is the docket for CSP and OPCo's application for authority to merge. By adopting the Stipulation, the Commission will approve the merger of CSP into OPCo. The merger will close at a future date in 2011 after the Commission's adoption of the Stipulation. The merger of CSP into OPCo and subsequent corporate separation of OPCo as described above will impact the Companies' corporate separation plans or, put differently, the surviving corporation's – OPCo's – corporation separation plan, as CSP's plan will cease to exist.

Regarding the scope of the proposed transfer of generating assets, transmission-and distribution-related assets would remain in the (post-merger) electric distribution utility and AEP Ohio's generation, fuel and other assets would be transferred to a newly-created AEP generation affiliate, AEP GenCo. The transfer would include AEP Ohio's existing generating units and contractual entitlements referenced in Exhibit WAA-1 as part of the testimony of Company witness Allen, AEP Ohio Ex. 4. (AEP Ohio Ex. 7 at Exhibit PJN-1.)

With respect to the Stipulation's contingency for future approval of potential charges through the Generation Resource Rider (GRR) under Paragraph IV.1.d of the Stipulation, the corporate separation amendment would provide as follows. Regarding the replacement unit for Muskingum River Unit 5 (the so-called MR 6 project), Muskingum River Unit 5 would be approved for transfer subject to being retained by the electric distribution utility should a nonbypassable charge for the life of the facility be approved for MR 6 prior to completing the structural corporate separation transactions (which closing would not occur until after FERC approval of corporate separation). Regarding the Turning Point project, that contract would remain with the electric distribution utility since it would only go forward upon approval of a nonbypassable charge for the life of the facility. (AEP Ohio Ex. 7 at Exhibit PJN-1.)

Regarding the additional criteria in Ohio Admin. Code Rule 4901:1-37-09(C), the object and purpose of the proposed generating asset transfer is to fulfill the mandate of R.C. 4928.17 and terminate the "interim" plan of functional separation for AEP Ohio. The AEP GenCo affiliate would receive the legacy generating assets and could provide competitive retail generation services as well as engage in sales for resale as regulated by the FERC. The impact of corporate separation on the current and future SSO is outlined in the Stipulation. In short, structural corporate separation is needed in order to transform AEP Ohio's business model in order to facilitate an auction-based SSO. In achieving the statutory mandate of corporate separation as part of a package that also includes the other benefits conveyed through adoption of the Stipulation, approval of structural corporate separation advances the public interest. AEP Ohio would propose to transfer the generating assets at net book value and, to the extent necessary, would be granted a waiver of Ohio Admin. Code Rule 4901:1-37-09(C)(4).

AEP Ohio has filed a separate application, Case No. 11-5333-EL-UNC to implement structural corporate separation as contemplated in Paragraph IV.1.q of the Stipulation. As set forth in its 11-5333 Application, in order to complete structural corporate separation, AEP needs to create a separate generation affiliate to take the Companies' generation, fuel, and other assets. The generation affiliate will be a wholly-owned subsidiary of AEP created to fulfill this role. It will be organized for the purpose of planning, constructing, owning and operating the generating assets of AEP Ohio. Regardless of whether the implementation details to achieve legal corporate separation are finalized, it is crucial that the Commission fully and substantively approve legal corporate separation, including approval of the transfer of generation-related assets from the electric distribution utility to AEP Genco, as part of its decision adopting the Stipulation.

Opposing parties may argue that all of the details must be known before the Commission can approve corporate separation. But that is not the case, given that the ESP rates are known and established through the transition period until mid-2015 when generation rates will be determined based on a competitive bidding process going forward. In other words, the impact on ratepayers of generation divestiture will be established through adoption of the Stipulation and fully implementing the requirements of R.C. 4928.17 – not by developing all of the details for implementing structural separation.

2) AEP Generation Pool Modification or Termination

AEP Ohio witness Nelson provided details about the background and operation of the Pool in his testimony. (AEP Ohio Ex. 7 at 16-21.) Under the Pool, the AEP East operating Companies' generation resources effectively operate companion an integrated basis, utilizing the strengths of diversity to offset inherent risks associated with operating as smaller individual companies in PJM. (*Id.* at 18.) This means that each member receives additional supplies of embedded cost capacity and energy in addition to their individual generation supplies while also receiving the benefit of sharing the margins of off-system sales and the opportunity to purchase economic energy to offset more expensive market energy. Due to AEP's election to participate in the PJM Fixed Resource Requirement (FRR) option and as a result of the Pool construct, the cost to purchase capacity from other Pool Members is based on the embedded cost of installed capacity. From a cost of energy perspective, the Pool member companies sell or buy surplus energy to/from other members at a cost-based primary energy rate in addition to purchasing economic energy from the market at the Locational Marginal Price (LMP). (*Id.*)

Significant provisions of the Pool operate as follows:

- A demand allocator is established on the basis of each member's highest non-coincident peak (NCP) in the preceding twelve months. Member Load Ratio (MLR) is the ratio of a member's highest NCP in relationship to the total of all members' highest NCP demand in the preceding twelve months.
- There is a capacity settlement that equalizes reserve margins by assigning responsibility to each member for its MLR share of System capacity. To the extent that a member's capacity is less than its System responsibility, such deficit company is required to make up its shortfall by paying a capacity charge to the

surplus companies, based on the embedded cost of capacity of the surplus companies.

- Sales and purchases of energy among the member companies are provided at cost through primary energy transactions.
- Transmission facilities are made available to all members for the delivery and receipt of power; as members of PJM, each AEP East operating company takes transmission service under the FERC-approved OATT (Open Access Transmission Tariff).
- American Electric Power Service Corporation, as agent for the operating companies, buys and sells into the wholesale market for reliability and economic purposes [off-system purchases and off-system sales (OSS)].
- Off-System Sales margins are shared among members based on MLR.

In addition to the generation Pool, there are other agreements among the members of the East operating companies, most notably the Interim Allowance Agreement (IAA) that operates in conjunction with the Pool.

On December 17, 2010, AEP Ohio and other members of the Pool provided written notice to each other of their mutual desire to terminate the existing agreement on three years notice in accordance with Article 13.2 of the Pool. (AEP Ohio Ex. 7 at 19.) As Mr. Nelson testified, the Pool modification or termination process will likely be somewhat complex and may not yield quick results. (*Id*. at 20.) But since it is largely driven by compliance with AEP Ohio's corporate separation requirement and the need to adjust or dissolve the Pool based on AEP Ohio's generation divestiture, it should be driven to conclusion in a reasonable period of time and without much doubt as to the end goal of taking AEP Ohio out of the Pool. (*Id*.) Whether the Pool remains for some combination of the other three AEP-East operating companies is a matter for debate among those companies, their stakeholders and respective regulatory jurisdictions.

There are two sets of filings required in order to dissolve and/or modify the Pool in the context of corporate separation of AEP Ohio's generation function. First, FERC filings would be made under Section 205 of the FPA to (1) dissolve and/or modify the Pool, (2) substitute new agreements to address the Pool's dissolution and/or modification, and (3) address the rate impacts, if any, from corporate separation of AEP Ohio. Second, a FERC filing would be made under Section 203 of the FPA for approval of AEP Ohio's corporate separation. The specific timelines agreed to by the Signatory Parties are reflected in Appendix B to the Stipulation. The estimated timelines for the required Section 203 and Section 205 FERC proceedings involve a 450-day period to conduct the FERC proceedings, which would be initiated after receiving a final order from this Commission adopting the Stipulation. Whatever schedule is established by FERC, AEP Ohio agrees to diligently pursue approval of its Section 203 and 205 applications under the established schedule.

As referenced above, Paragraph IV.1.r sets forth a schedule for conducting a Competitive Bidding Process (CBP) to supply its SSO for delivery within the ESP term during the period from June 1, 2015 through May 31, 2016, such that auctions are conducted in 2013, 2014 and 2015 leading up to that delivery period. The auction schedule is tied to other agreed provisions that are designed to ensure that AEP Ohio expeditiously obtains FERC approvals for corporate separation and Pool termination/modification either by September 2013 or in the most expeditious manner reasonably possible. (Paragraph IV.1.t.) These provisions reflect the fundamental arm's length bargain negotiated by the Signatory Parties, being that AEP Ohio would agree to sustain a fully-competitive SSO after executing a brief interim transition plan..

Paragraph IV.1.t recognizes that AEP Ohio must achieve corporate separation and Pool termination/modification in order to transition from its current regulatory and business structure to one that involves an auction-based SSO. As AEP Ohio witness Nelson testified, these provisions are based on two common understandings among the Signatory Parties: (i) Pool termination/modification is needed when AEP Ohio corporately separates its generation function, and (ii) Pool termination/modification and corporate separation are both needed in order for AEP Ohio to effectively and prudently conduct an auction-based SSO. (AEP Ohio Ex. 7 at 23.) Corporate separation clearly precipitates secession from the Pool by AEP Ohio. It cannot reasonably be disputed that removing AEP Ohio's substantial generation assets from the Pool cannot be achieved without terminating or modifying the Pool.

Exelon witness Dominguez testified as follows about this provision:

> Paragraph IV.1.t also specifies the limited contingencies under which AEP Ohio may be relieved of its competitive procurement commitment, and prescribes the circumstances under which auctions may be held notwithstanding AEP Ohio's inability to achieve timely corporate separation of Pool modification/termination. This heavily negotiated provision strikes a fair balance between protecting what I believe to be AEP Ohio's legitimate economic interests (that may arise from termination of modification of the existing Pool agreement) and the ultimate goal of transitioning to a competitive market process for establishing the SSO price.

(Exelon Ex. 1 at 7.)

Regarding the second common understanding, it is understood by the Signatory Parties that AEP Ohio could not prudently establish an auction-based SSO as long as it owns generation assets and remains a member of the AEP generation Pool. (AEP Ohio Ex. 7 at 24.) Mr. Nelson testified that this is true for two primary reasons:

> First, conducting an SSO auction would have substantial impacts on the other Pool members and would expose both AEP Ohio and the other AEP-East operating companies to cost recovery risks in their respective regulated jurisdictions. Second, conducting an auction prior to corporate separation would create a financial exposure for AEP Ohio by wholly displacing the cost recovery for those generation assets that currently exists through SSO generation rates (based on the generation assets being dedicated to support retail generation service). It would also potentially remove the AEP Ohio generation from participating in the auction, due to the timing difference of the auction delivery period and the post-separation generation affiliate not yet owning the assets in order to be able to support bids into the forward auction with those generation assets.

(*Id*.)

The Signatory Parties agreed that a Pool Modification Rider for this purpose with an initial rate of zero is appropriate. (Par. IV.5.) If the impact of the Pool termination/modification on AEP Ohio during the ESP term is greater than $50 million prior to May 31, 2015, the Company may pursue cost recovery of the entire impact during the ESP term via a separate RDR application during the ESP term and obtain approval by the Commission. As Mr. Nelson testified, AEP Ohio's application in Case Nos. 11-346-EL-SSO proposed to recover material costs associated with the anticipated Pool termination/modification. (AEP Ohio Ex. 7 at 25.)

As part of the package of terms contained in the Stipulation, the Signatory Parties agreed to this provision. It is also significant, however, to note that the Signatory Parties explicitly reserved the right to challenge the amount and the recovery of these costs before the Commission and the FERC. (Par. IV.5.) Thus, even assuming the Pool termination/modification will cause an impact on AEP Ohio of more than $50 million and exceed the materiality threshold applicable to potential recovery under this provision, the ultimate issue of whether AEP Ohio would recover such costs is the subject of a future Commission proceeding.

In sum, the corporate separation and Pool modification provisions of the Stipulation are reasonable, supported by evidence of record and do not violate any important regulatory principle or practice.

i) The auction-based SSO incorporating a competitive bidding process determined, in part, by a stakeholder process is reasonable and does not violate any important regulatory principle or practice. [Par. IV.1.r]

The Stipulation provides that the AEP Ohio EDU will meet its SSO obligation using a competitive bidding process ("CBP") for the period June 1, 2015 to May 31, 2016. (Par. IV.1.r.) It further specifies certain agreed aspects of that process and provides that a stakeholder process will be employed to seek input into the design and remaining details of the CBP. The specific elements resolved as part of the Stipulation are as follows:

- The CBP will be for 1% slice-of-system tranches based on the auction format previously approved by the Commission for the FirstEnergy Companies in Case Nos. 08-935-EL-SSO and 10-388-EL-SSO (including Attachment A to that Order).
- The CBP and any contingency procurement will be conducted by an independent third-party bid manager.
- The CBP will utilize a standard SSO Supply Agreement.
- The CBP will include Communication Protocols.
- As part of the CBP, the EDU will provide relevant data and information to potential suppliers.
- Other necessary components of the CBP will be developed by the bid manager through a stakeholder process.
- An auction for 20 tranches will be held on or prior to September 1, 2013, an auction for 40 tranches will be conducted on or prior to September 1, 2014 and an auction for 40 tranches will be conducted by January 1, 2015. All tranches are for delivery during the period June 1, 2015 to May 31, 2016.
- The Commission will accept the results of the CBP within three days unless it finds that one or more of the following conditions is not met: (i) the process was oversubscribed; (ii) there were four or more bidders; and (iii) no party won more than 75% of the load. If an auction is rejected for any one of these reasons, a specific contingency plan is provided.
- Generation resources currently owned by AEP Ohio will not be precluded from supporting bids.
- Successful bidders will provide a full requirements, load-following service consistent with PJM's tariff and will assume all risks of providing such service including customer migration risks.

- AEP Ohio will be entitled to recover all costs of power acquired through the CBP and details, including rate recovery, will be addressed in the stakeholder process.
- Dedicated generation resources owned by the EDU and subject to a nonbypassable Generation Resource Rider ("GRR") charge will be bid into PJM markets and the stakeholder process will examine how these resources can be incorporated into the CBP.
- The parties will address the procurement of renewables in the context of the CBP through the stakeholder process.

(Par. IV.1.r.)

There are additional details of the CBP that will need to be specified and cannot be developed in isolation of participants in the process or in a short time. Resolving these additional issues through a stakeholder process is efficient and should increase participation of bidders that can learn about the opportunity of bidding in the CBP through the stakeholder process. Accordingly, the Signatory Parties agreed that CBP details not already decided in the Stipulation will be addressed through a stakeholder process, subject to Commission approval. (Par. IV.1.r.)

As AEP Ohio witness Dr. LaCasse testified, expects the stakeholder process to naturally divide into two "streams." (AEP Ohio Ex. 6.) One stream would deal with broad issues that are not associated with procurement *per se* or with the details of the SSO Supply Agreement. These could include issues such as rate design, treatment of EDU-owned generation subject to the GRR, and procurement of renewables. While potential suppliers need to know the resolution of these issues, some potential suppliers may not have a particular stake in exactly how these issues are resolved.

The second stream would involve details more directly applicable to procurement process and details of the SSO Supply Agreement. As Dr. LaCasse testified, AEP Ohio expects all parties to be interested in these issues but that potential suppliers would have a particular stake in the details of how these issues are resolved. Entities would not be precluded from either stream but would tend to naturally have different levels of interest in the two streams.

In sum, the CBP process will be patterned after the existing FirstEnergy auction process, as approved by the Commission. Additional details will be established using a stakeholder process that will also be subject to oversight and approval by the Commission. This is a reasonable approach that violates no important regulatory principle or practice.

j) The provisions that improve and streamline the process for CRES providers are reasonable and do not violate any important regulatory principles. [Par. IV.1.s]

The Signatory Parties improved and streamlined the process for CRES providers. Specifically, the Company agreed to add capacity (PLC) and transmission (NSPL) information to the Master Customer List (MCL) no later than January 1, 2012 and updated thereafter on an annual basis within fifteen (15) days of receipt of the necessary information from PJM. Within thirty (30) days after Commission approval of the Stipulation and until such information is added to the MCL, the Company will provide PLC and NSPL information via email to brokers and marketers within five (5) business days of receipt of an email request for such information (including a letter of authorization for making the request). For registered CRES providers, such information will be provided through the 867 historic usage response and the 814 enrollment response as part of the normal EDI process.

In addition, the Company agreed to modify the following tariff switching rules and notice provisions on the following agreed schedule of implementation:

1. By the end of 2011, the ninety (90)-day Notice Requirement that certain customers must give before they can enroll with a CRES provider will be eliminated;
2. As of January 2012, discuss reducing the $10 switching fee associated with enrollment with a CRES provider.

3. Effective by the June 1, 2015 SSO auction, the 12 month minimum stay requirements for industrial or large commercial customers will be eliminated.
4. Effective by the June 1, 2015 SSO auction, the provision that residential and small commercial customers that return in summer must stay until April 15th of the following year will be eliminated.

(Par. IV.1.s.) These improvements and agreed timeline will help promote competition in AEP Ohio's service territory, as testified to by Constellation witness Fein, Paragraph IV.1.s of the Stipulation "takes a number of important steps to remove certain barriers to retail competition that will facilitate the ability of CRES providers to provide service to retail customers." (Constellation Ex. 1 at 11.) (See also RESA Ex. 1, Ringenbach, at 10.) As such, Paragraph IV.1.s is reasonable and does not violate any important regulatory principle or practice.

k) Shareholder funding for the Partnership With Ohio initiative is reasonable and does not violate any important regulatory principles or practices. [Par. IV.1.u]

AEP Ohio has agreed to provide funding for the Partnership With Ohio (PWO) initiative of $3 million annually for the benefit of low-income customers during the ESP term, provided that AEP Ohio's return on equity exceeds 10% for the prior calendar year, and such funding will not be recoverable from customers. AEP Ohio agrees to collaborate with Staff for determining the uses of the PWO fund. (Par. IV.1.u.) This kind of shareholder funding is reasonable and does not violate any important regulatory principles or practices.

l) Shareholder funding for the Ohio Growth Fund initiative is reasonable and does not violate any important regulatory principles or practices. [Par. IV.1.v]

AEP Ohio will provide funding for the Ohio Growth Fund (OGF) initiative of $5 million annually for the benefit of economic development during the ESP term, provided that AEP Ohio's ROE exceeds 10% for the prior calendar year, and such funding will not be recoverable from customers. An advisory group of interested Signatory Parties, including Staff, industrial customers and municipal corporations, will be established to assist in developing the framework and criteria for AEP Ohio funding under the OGF. An initial commitment from the OGF will be $50,000 annually over the next three years for the Association of Independent Colleges and Universities of Ohio (AICUO) to utilize either for (i) scholarships in the area of alternative energy, or (ii) for alternative energy upgrades on its college campuses, as part of educational programs on energy efficiency/alternative energy. (Par. IV.1.v.) This kind of shareholder funding is reasonable and does not violate any important regulatory principles or practices.

m) The commitment to work to develop further opportunities for customer-sited resources is reasonable and does not violate any important regulatory principles or practices. [Par. IV.1.w]

Pursuant to Paragraph IV.1.w of the Stipulation, AEP Ohio has agreed to work with the Signatory Parties to further develop programs and opportunities for the commitment of customer-sited resources and, in exchange for incentive payments to the customer or exemptions from applicable cost recovery mechanisms, in order to help meet AEP Ohio's advanced energy mandates under R.C. 4928.64 and its energy efficiency and peak demand reduction mandates under R.C. 4928.66. This provision advances energy efficiency and peak demand reduction, two important policy objectives of the State of Ohio.

In addition, to advance the progress of state energy mandates, AEP Ohio also has committed to the City of Grove City and/or the City of Hilliard, in addition to any Commission approved financial incentives for LED traffic signals and street lighting, to develop a pilot program for: (i) municipally owned LED street lighting and (ii) municipally owned LED traffic signal conversion. AEP Ohio has committed to provide to each City for this pilot program an amount not to exceed $100,000, pursuant to cost recovery that AEP Ohio shall include in its 2012-2014 energy efficiency/peak demand reduction portfolio plan, to be filed with the PUCO under a separate application. This commitment benefits not only the residents of Grove City and Hilliard, but will provide meaningful data for future development of LED projects. (Par. IV.1.w.)

As a provision that advances important energy efficiency and peak demand policies, Paragraph IV.1.w is reasonable and violates no important regulatory principle or practice.

n) The commitment to pursue development of up to 350 MW total of combined heat & power, waste energy recovery and distributed generation resources is reasonable and does not violate any important regulatory principles or practices. [Par. IV.2.c]

As AEP Ohio witness Mr. Hamrock testified, another key benefit to Ohio customers that we do not believe could have resulted from litigation is the Signatory Parties' and AEP Ohio's agreement to pursue development of up to 350 MW, in total, of customer sited combined heat and power (CHP), waste energy recovery (WER) and distributed generation resources in its service territory, with the costs to be recovered through an appropriate rider. The details for pursuing this effort will be resolved in a separate proceeding before the Commission, and AEP Ohio has agreed to consult with the OEC, ELPC the OEG, and the OMAEG in developing the program, including the cost recovery mechanism within 12-months of the Commission adopting the Stipulation. (Par. IV.2.c.) As with the GRR and shale gas provisions, complaints about the potential outcome of the future proceedings under the CHP/WER/distributed generation provision are premature. This provision does encourage the development of distributed generation, a clear policy preference in R.C. 4928.02(C) and (K).

Paragraph IV.2.c is reasonable and does not violate any important regulatory principle or practice.

o) The provision to accelerate Ohio shale gas development is reasonable and does not violate any important regulatory principles or practices. [Par. IV.2.a]

As part of the Stipulation package, AEP Ohio has committed to substantial fleet transformation and fuel diversification utilizing Ohio shale gas. (Par. IV.2.a.) In accordance with this key component of the Stipulation, which would not have been possible absent settlement, AEP Ohio will endeavor to enter into competitively priced long-term shale gas contracts for AEP Ohio generation plants with Ohio producers who commit to investment and employment growth in Ohio. Total annual volumes are projected to grow to as much as 60 billion cubic feet (BCF) annually, based upon anticipated consumption by: a new combined cycle gas plant (MR 6) with a capacity of approximately 500 MW that will replace MR 5, which will be retired; and the existing AEP Ohio gas-fueled generating units, Darby Units 1-6 and the Waterford Energy Center. The costs of the new MR 6 unit will be subject to separate Commission approval in a future case provided the requirements of R.C. 4928.143(B)(2)(b) and (c) are found to have been satisfied. As Mr. Hamrock testified, AEP Ohio will file a plan with the Commission by the end of 2012 for retiring MR 5 and constructing MR 6. (AEP Ex. 8 at 17.) After a one-time up-front prudence review, the cost of the shale gas contracts for the existing AEP Ohio gas units will be recovered through the bypassable FAC during the term of the ESP for those non-dedicated generation assets; and through the GRR for the life of the facility for dedicated generation assets, such as MR-6. (Par. IV.2.a.)

While some parties may complain that they plan to oppose the MR 6 shale gas project or do not understand all of the details about it, such complaints are premature. Under Paragraph IV.1.d of the Stipulation, the Parties have reserved their right to contest or otherwise take positions in the separate future cases that will determine whether to establish a nonbypassable charge and the appropriate level of the charge through the GRR (including any charge associated with MR 6). Likewise, the Stipulation's GRR provision specifies that establishment of the GRR does not constitute precedent for purposes of interpreting and applying R.C. 4928.143(B)(2)(b) and (c) and Parties reserve their right to contest or otherwise take positions in the separate future cases that will determine whether to establish a nonbypassable charge and the appropriate level of the charge through the GRR. Thus, upon adoption of the Stipulation (including the GRR provision), both the parties and the Commission fully reserve their ability to support or oppose the future establishment of a non-zero charge for inclusion in the GRR. Conversely, rejecting the GRR would preclude the possibility that the Commission could subsequently approve the MR 6 shale gas project (or the Turning Point solar project).

In sum, any charges approved under the GRR for the MR 6 shale gas project necessarily will necessarily comply with R.C. 4928.143(B)(2)(b) and (c), as determined by the Commission in a future case. All parties reserved their rights to debate and argue those issues in future proceedings under the GRR. Similarly, costs under shale gas purchase contracts will only be recovered after being deemed prudent by the Commission. As such, the MR 6 shale gas provisions are reasonable and do not violate any important regulatory principle or practice. Preserving the ability for the state to capitalize on these unique opportunities for Ohio meets the state policy goal of facilitating the state's effectiveness in the global economy. *See* R.C. 4928.02(N).

2. The Stipulation's Resolution Of Capacity Pricing Issues Is Reasonable (Case No. 10-2929-EL-UNC)

The appropriate pricing for capacity paid by CRES providers for use of AEP Ohio's capacity to support retail shopping is a central issue that the Stipulation addresses. The issue was raised by the Commission in Case No. 10-2929-EL-UNC (the "*Ohio Capacity Charge Docket*") and its resolution by the Stipulation not only would resolve that case, but also other pending proceedings before the FERC that address the same topic.[45] In addition, the Stipulation's resolution of the capacity pricing issue also impacts and helps to resolve a number of significant aspects of the ESP II proceeding.

AEP Ohio witnesses Dr. Pearce and Mr. Nelson supported the reasonableness of the Stipulation's capacity pricing (Par. IV.2.b.) by comparing it to the cost-based pricing that AEP Ohio is advocating in Case No. 10-2929-EL-UNC based on its embedded costs of capacity. Dr. Pearce calculated that AEP Ohio's embedded cost of capacity, using FERC Form 1 data for 2010 and a formula methodology accepted by the FERC for setting wholesale prices, would be $355.72/MW-Day on a combined (CSP and OPCo merged) basis for AEP Ohio for the PJM Planning Year 2011/2012. (AEP Ohio Ex. 3 at 9-10, Ex. KDP-4.) If the Commission were to adopt an energy credit using AEP Ohio's methodology, Dr. Pearce estimated that the capacity price, on a combined basis, would be reduced to $338.14/MW-Day. (*Id.*) In comparison, the Stipulation's capacity pricing provides a two-tiered approach, including (1) a set aside of RPM-priced capacity in amounts that steadily increase during the ESP period of January 2012 through May 2015 period and (2) capacity priced at $255/MW-Day for amounts above the set-aside thresholds. When considered on a blended basis over the January 2012 through May 2015 period of the ESP, the Stipulation pricing equates to $201/MW-Day, as Mr. Nelson calculated in his rebuttal testimony. (AEP Ohio Ex. 21 at 6, Ex. PJN-R1.)

[45] As discussed in greater detail below, the involved cases before FERC are Docket No. ER11-2183-000 (this case is referred to as the "*Section 205 FERC Application*") and Docket No. EL11-32-000 (referred to as the "*Section 206 FERC Complaint*").

Accordingly, as both Dr. Pearce and Mr. Nelson demonstrated, when compared to what a cost-based methodology would produce, the Stipulation's capacity pricing represents a substantial compromise and is reasonable.

a) Background

AEP Ohio witness Nelson provided background for the capacity pricing issue. He first explained that in 2007, PJM implemented a capacity market pricing construct known as Reliability Pricing Model (RPM). Prior to 2007, and during the RPM auction development phase, AEP Ohio, as well as other parties, expressed concern over the long-term negative impacts of the RPM capacity market on vertically integrated utilities and their customers. A special provision was drafted to ensure that those entities could request a cost-based method of recovering their capacity costs – Section D.8 of Schedule 8.1 (Schedule D) of the PJM Reliability Assurance Agreement (RAA); this provision is known as the Fixed Resource Requirement (FRR). (AEP Ohio Ex. 21 at 4.)

The FERC agreed that it was not necessary or appropriate to force utilities such as the AEP Ohio utilities to participate in the RPM auction. In their April 20, 2006 Initial Order, FERC stated in paragraph 110 that "[w]e agree with AEP that [Load Serving Entities (LSEs)] and states should have the option of choosing an alternative to the forward procurement auction if they identify sufficient capacity to meet their loads…." *PJM Interconnection, L.L.C.*, FERC Docket Nos. EL05-148-000, ER05-1410-000, Initial Order on Reliability Pricing Model, at 46 (Apr. 20, 2006). As a result of a settlement process conducted by FERC, PJM and the PJM stakeholders entered into negotiations to develop an appropriate FRR process. These deliberations resulted in rules that enabled utilities such as the AEP Ohio utilities to meet their capacity obligations through use of their own generation (including bi-lateral arrangements) and to maintain reserve margins established by the PJM planning process, rather than through the auction process. This provided benefits to native load customers by giving the LSEs choices for meeting capacity requirements. (AEP Ohio Ex. 21 at 5-6.)

Mr. Nelson noted that, since the inception of its membership in PJM, AEP Ohio has participated exclusively as an FRR entity. He explained that, under the FRR provision of the RAA, there are essentially three options for pricing capacity provided to CRES providers: 1) a properly designed retail state compensation mechanism and in the absence of such a mechanism, 2) default rates based on the PJM RPM capacity auction price, and 3) a method based on the FRR entity's costs (a formula cost-based method) or such other cost basis shown to be just and reasonable. Schedule 8.1, Section D.8 to the PJM RAA. Thus, the FRR is an alternative method to participating in PJM's RPM capacity market. Mr. Nelson makes a very important point that as an FRR entity, AEP Ohio has self-supplied, through its own generation resources, the capacity needed to match its retail load (plus adequate reserve margins) since the RPM was established in June 2007 and, thus, has opted out of the PJM RPM auction market for purposes of meeting its load obligations each year through planning year 2014/2015. (*Id.* at 6-7.) This is important because it establishes the regime under which AEP Ohio has operated and based its decisions and planning upon as an Ohio utility.

Historically, AEP Ohio has been compensated at the adjusted PJM RPM auction price, pursuant to the second option under the FRR provision of the RAA, described above, for supplying capacity associated with load lost to CRES providers who have chosen not to self-supply their own capacity. The CRES providers who choose not to self-supply act merely as a middle-man on capacity flowing from AEP Ohio to support retail generation service. While the RPM auction prices have fluctuated significantly, the auction prices for the next several years have dropped to levels that would prevent AEP Ohio from receiving anything remotely approaching full compensation from CRES providers for AEP Ohio's capacity costs. These dramatic price drops in the RPM market caused AEP Ohio to pursue its option under the RAA to establish a cost-based rate. (*Id.*, at 7.)[46]

On November 1, 2010, AEP Ohio filed an application under the PJM RAA and Section 205 of the Federal Power Act (FPA) to initiate FERC Docket No. ER11-1995-000. On November 24, 2010, at the direction of FERC, AEP Ohio refiled its application in Docket No. ER11-2183-000 (This case is referred to as the "*Section 205 FERC Application*"). In its *Section 205 FERC Application*, AEP Ohio proposed cost-based formula tariffs that were based on the Companies' 2009 FERC Form 1 filings. AEP Ohio's application proposed to implement an existing clause within the PJM RAA (the third FRR pricing option noted above) to change the basis of compensation for use of its capacity by CRES providers to an AEP Ohio cost-based method. AEP Ohio's premise for filing the *Section 205 FERC Application* is that CRES providers were receiving a subsidy (through payment of a below-cost rate) for their use of the Companies' capacity due to the use of RPM auction-clearing prices as the basis for the capacity charge. In response to the *Section 205 FERC Application*, the Commission initiated the *Ohio Capacity Charge Docket* (Case No. 10-2929-EL-UNC) through a December 8, 2010 Entry, and the Commission represented to FERC that as of December 8, 2010 it was "adopt[ing] as the state compensation mechanism for the Companies the current capacity charges established by the

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[46] Mr. Nelson provided the following description of the scale of the financial impacts of RPM capacity pricing that led AEP Ohio to seek a cost-based capacity charge: at 100% shopping, the financial impacts to AEP Ohio if RPM-based pricing were to remain in effect would exceed $464 million (M) for 2011, $761M for 2012, and $968M for 2013. At a 50% shopping level, the impacts to AEP Ohio could exceed $232M for 2011, $380M for 2012, and $484M for 2013. (AEP Ohio Ex. 21 at 8; Tr. V at 675.)

three-year capacity auction conducted by PJM," which is the PJM RPM auction price, on an interim basis during the pendency of the review. (*Id.*, at 8.)

On January 20, 2011, FERC issued an Order rejecting the AEP Ohio rate proposal, not on the merits, but due to the Commission's December 8, 2010 Order stating that it was adopting an interim state compensation mechanism. AEP Ohio's application for rehearing of FERC's January 20, 2011 Order remains pending before FERC. AEP Ohio also filed a complaint case under Section 206 of the FPA, FERC Docket No. EL11-32-000, seeking modifications to Schedule D of the RAA that are designed to clarify the original intent as understood by AEP Ohio (referred to as the "*Section 206 FERC Complaint*"). Mr. Nelson explained that the purpose of the *Section 206 FERC Complaint* is to confirm that any state compensation mechanism must compensate FRR entities for capacity costs through charges included in retail rates and to preserve the FRR entities' right to submit filings to establish just and reasonable FRR charges for capacity provided to CRES providers. (*Id.* at 8-9.)

On August 11, 2011, at the conclusion of an initial and reply comment cycle in the *Ohio Capacity Charge Docket*, the Commission's attorney examiner issued an Entry adopting a procedural schedule, including an evidentiary hearing. That procedural schedule put the Commission on track to update the interim rate by the end of 2011 when the underlying ESP I term would end. According to the Entry, at Finding 6, the purpose of the hearing would be "to establish an evidentiary record on a state compensation mechanism [and that] parties should develop an evidentiary record on the appropriate capacity *cost pricing*/recovery mechanism including, if necessary, the appropriate components of any proposed capacity *cost recovery* mechanism." (Emphasis added). It is important to note that the Commission set the schedule on a cost recovery basis and not on a capacity market basis. On August 31, 2011, AEP Ohio filed its testimony supporting the cost-based establishment of cost recovery mechanism. However, per the September 16, 2011 Entry in these cases, the Attorney Examiner stayed the procedural schedule in Case No. 10-2929 pending consideration of the Stipulation.

b) Litigation positions of AEP Ohio and CRES providers

AEP Ohio's basic position in the *Ohio Capacity Charge Docket* (and in the pending FERC proceedings) is that the RPM-based pricing mechanism under-compensates AEP Ohio for the capacity it provides to CRES providers for resale to shopping retail customers. The impact on AEP Ohio's ability to be compensated for its costs has become significant due to the sharp downward trend in RPM auction prices, as well the growth in shopping by AEP Ohio customers whose CRES providers take advantage of the capacity supplied by AEP Ohio as opposed to supplying their own capacity. (*Id.* at 9-10.)

As described and submitted in its Initial Comments filed in the *Ohio Capacity Charge Docket*, AEP Ohio, as a Load Serving Entity (LSE) in PJM, does not participate in the PJM RPM auction market for the purposes of meeting AEP Ohio's load obligation. AEP Ohio's SSO generation rates for January 2012 through May 2014 are the subject of the Company's current 2012-2014 ESP application (Case Nos. 11-346-EL-SSO et al.) and are intended to cover AEP Ohio's non-fuel cost of generation, including the cost of capacity for non-shopping customers. However, CRES providers who serve shopping customers, and who did not plan in advance or choose not to self-supply capacity, are currently required to pay only the PJM RPM-based auction price, based on the interim rate established in the *Ohio Capacity Charge Docket*. Thus, while these CRES providers are using AEP Ohio's capacity resources, they (unlike AEP Ohio's non-shopping SSO customers) avoid paying the embedded generation capacity costs that are on AEP Ohio's books. AEP Ohio maintains that it should be allowed just and reasonable compensation from CRES providers based on AEP Ohio's embedded cost of capacity that will allow for continued investment in Ohio generation resources. (*Id.* at 10.)

Using 2010 FERC Form 1 data, AEP Ohio's cost-based formula capacity rates, as calculated by Company witness Pearce, would be $327.59/MW-day for CSP (AEP Ohio Ex. 3 at Ex. KDP-1, p. 1) and $379.23/MW-day for OPCo (*id.* at Ex.KDP-2, p. 1) or $355.72/MW-day (*id.* at Ex. KDP-4) on a combined basis for AEP Ohio. Dr. Pearce testified that the cost-based rate calculation that he used is formulaic in nature and currently utilized in many states by AEP for wholesale sales. He explained that the formulae for these rates use an average allocation of cost between the parties based on common cost allocation mechanisms. (*Id.* at 7.) Dr. Pearce testified that this cost-based rate approach provides a high degree of transparency. The bulk of the input information can be tied back to the FERC Form 1 annual reports of CSP and OPCo and the various work papers are readily available to the affected parties upon request for rate verification. (*Id.*)

Dr. Pearce also noted that the template selected for the cost-based rates that he supported is modeled after the recently FERC-approved template utilized by the Cities of Minden, Louisiana and Prescott, Arkansas and Southwestern Electric Power Company (SWEPCo), an AEP Ohio-affiliated operating company. He observed that these cities are full requirements customers taking both capacity and energy from SWEPCo under long term agreements. He noted that the formula rate template used to support the rates ultimately approved for those customers was the subject of a lengthy negotiation between the seller and purchasers and FERC Staff. In addition, he explained, the template adopted various modifications originating from FERC Staff. As such, in his opinion, this template represented a fair and reasonable formula for calculation of capacity costs. He used the capacity portion of this rate template, with certain modifications, to develop the proposed CSP and OPCo capacity rates. (*Id.* at 8.)

Intervening parties in the *Ohio Capacity Charge Docket*, the *Section 205 FERC Application*, and the *Section 206 FERC Complaint* have opposed AEP Ohio's proposed cost-based rates for capacity. They have maintained, instead, that the RPM price for capacity is appropriate and that there is no reason to adopt a cost-based capacity charge. CRES providers argue that adopting AEP Ohio's proposed cost-based charge now, at a time when RPM-based market prices are so low, will have an adverse impact on current and future retail shopping levels. While CRES parties have not yet been required to file testimony in the *Ohio Capacity Charge Docket*, it is anticipated that, if that proceeding were to go forward, they would continue to advocate that RPM prices should apply and would continue to oppose AEP Ohio's position that embedded cost-based rates should be used.

c) The Stipulation's resolution of capacity pricing issues

The Stipulation, through Paragraph IV.2.b, proposes to resolve the capacity charge dispute through two primary provisions as well as other related provisions. In the first major component of the Stipulation's proposal for resolving the capacity pricing issues, the Signatory Parties recommend, in Paragraph IV.2.b.3, to establish a set aside amount of RPM-priced capacity available as follows: 21% of AEP Ohio's total retail load in 2012 (based on total kWh retail sales), 29% in 2013 until securitization is completed when it will become 31% for the remaining portion of 2013 after which securitization is completed (if securitization is completed prior to January 1, 2013, then the applicable set aside for the entirety of 2013 will be 31%), and 41% in 2014 continuing through the first half of 2015. (*See* Signatories' Joint Ex. 1 at 21.) These substantial levels of RPM-priced capacity preserve and expand retail shopping in AEP

Ohio's service territory through a brief transition period and, given that there will be an auction-based SSO beginning in mid-2015, achieve a fully competitive SSO quicker than a Market Rate Offer (which involves a minimum of five years to achieve). Moreover, offering capacity at RPM rates as part of the larger settlement package is an obvious compromise compared to AEP Ohio's litigation position on these issues. (AEP Ohio Ex. 21 at 12.)

The RPM set aside levels foster considerable potential for the expansion of competitive market-based rates for significant retail loads within AEP Ohio's service territory. The 2012 set aside of 21% of AEP Ohio total retail load is approximately 10,000 GWh, which is roughly equal to the entire 2010 load of Toledo Edison Company. The potential 2013 set aside of 31% of AEP Ohio total retail load is approximately 15,000 GWh, which is roughly equal to the entire 2010 load of Dayton Power & Light Company. And the 2014-2015 set aside of 41% of AEP Ohio total retail load is approximately 20,000 GWh, which is roughly equal to the entire 2010 load of Duke Energy-Ohio. (*Id.* at 12-13.) As discussed by Company witness Allen (AEP Ohio Ex. 4 at Ex. WAA-4), the net present value of the discounted capacity provided by AEP Ohio to CRES providers under this provision is more than $850 million. (*Id.*)

The second major component of the Stipulation's proposed resolution of the capacity pricing dispute is the Signatory Parties recommendation, in Paragraph IV.2.b.1, that the Commission (upon acceptance of the Stipulation) set the capacity charge in Case No. 10-2929-EL-UNC to be the PJM RPM-based rate except that an interim rate of $255/MW-Day effective starting in January, 2012 will be charged to CRES providers for all shopping above the RPM set aside levels. (Signatories' Joint Ex. 1 at 20.) After May 31, 2015, the Commission's State Compensation mechanism will expire and the capacity charge will be the PJM RPM-based capacity rate (consistent with AEP Ohio's agreement in Paragraph IV.1.q to become an RPM entity by mid-2015). This new interim capacity charge of $255/MW-Day will only be charged to CRES providers for any shopping above the RPM set aside levels established in Paragraph IV.2.b.3. Even this limited non-RPM interim rate is substantially lower than the cost-based capacity charges proposed by AEP Ohio and supported in the testimony of Company witness Pearce ($355.72/MW-Day).

Moreover, Mr. Nelson calculated that when the RPM set-aside priced capacity is blended with the remaining capacity priced at $255/MW-Day, the result, on a blended basis is only $201/MW-Day. (AEP Ohio Ex. 7 at 13-14; AEP Ohio Ex. 21 at 6.) As such, the Stipulation's combination of RPM-priced and $255/MW-Day capacity reflects a significant compromise and contributes to a balanced package of terms that advance the public interest.

In implementing the RPM-priced capacity set aside levels, the Signatory Parties agreed to "grandfather" the existing shopping load as follows. Paragraph IV.2.b.2 provides that, with regard to customers who are receiving generation service from a CRES provider as of the time that the Stipulation is filed, the capacity rate to be paid by the CRES provider to AEP Ohio for that customer's load will continue to be charged the otherwise applicable RPM rate for the remaining period that the contract remains effective (including renewals). The load grandfathered under this paragraph will be counted toward the RPM-priced set aside limits and will remain subject to a RPM-priced capacity during the term of the ESP, provided the contract remains in effect during that period. (AEP Ohio Ex. 7 at 14.)

As Company witness Allen explained, Paragraph IV.2.b.3 also provides that the set aside of RPM-priced capacity shall be initially allocated on a *pro rata* basis among the residential, commercial and the industrial classes based upon projected kWh consumption for a period of approximately 4 months after the filing of the Stipulation. (AEP Ohio Ex. 4, at 13-14.)

Finally, Paragraph IV.2.b.4 proposes to resolve the pending FERC litigation. This provision involves a process for holding in abeyance the *Section 205 FERC Application* and the *Section 206 FERC Complaint* until the Commission issues a final order adopting the Stipulation, after which time the FERC cases will be resolved as they affect Ohio. In sum, adoption of the Stipulation would resolve both the *Ohio Capacity Charge Docket* and the pending FERC litigation regarding the capacity charge dispute. Consistent with that provision, AEP Ohio filed a notice of the Stipulation with FERC and requested that the decisions be held in abeyance pending the Commission's consideration of the Stipulation. If the Stipulation is not adopted, the FERC litigation will proceed forward from the point it was suspended.

d) The Stipulation's resolution of capacity pricing issues is reasonable.

Absent the Stipulation, AEP Ohio's position is that it is entitled to collect a cost-based capacity charge for all shopping load served by CRES providers. Opposing intervening parties have taken the position that the existing interim RPM-based compensation mechanism adopted by the Commission in the *Ohio Capacity Charge Docket* should continue into the next ESP term even though AEP Ohio is an FRR entity in PJM at least through mid-2015.

Notably, CRES Providers who are Signatory Parties concur that the Stipulation's resolution of the capacity pricing issues is a reasonable compromise of the competing positions. Exelon witness Dominguez noted that settlement of the *Ohio Capacity Charge Docket* (and the related FERC proceedings) eliminates the risk to CRES providers that AEP Ohio would be allowed to charge its proposed cost-based price for capacity of $355/MW-Day during the 41-month ESP and, in addition, provides that specified, negotiated, and increasing percentages of AEP Ohio's retail load will be served with RPM-priced capacity in 2012, 2013, and 2014. (Exelon Ex. 1, at 5.) Constellation witness Fein noted that the RPM-priced set-aside capacity is a significant benefit of the Stipulation, observed that the Stipulation's $255/MW-Day for shopping load that exceeds the set-aside amounts is significantly less than the cost-based pricing that AEP Ohio had requested, and concluded that the Stipulation provided a reasonable compromise of the parties' litigation positions. (Constellation Ex. 1 at 8-9.) RESA witness Ringenbach also testified in support of this compromise, and for similar reasons. (RESA Ex. 1 at 7-9.)

Dr. Pearce testified that, from the viewpoint of AEP Ohio's litigation position, the level of recovery of capacity costs from switching load provided by the Stipulation would not necessarily be a reasonable outcome for the *Ohio Capacity Charge Docket* absent the other negotiated terms included in the total package that the Stipulation provides. However, in light of the intervenors' positions in that docket advocating for a pure RPM-based capacity charge for all shopping load, and taking into account the complete package of negotiated terms included in the Stipulation, in his opinion the hybrid approach take in the Stipulation is reasonable and an appropriate result of negotiations. (AEP Ohio Ex. 3 at 13.)

In addition, the consequences of failing to adopt the Stipulation's resolution of the capacity pricing issue must also be considered. If the Stipulation's resolution of capacity pricing is not adopted, the alternative is protracted and extensive litigation at the Commission, at FERC, and in the federal and State courts. One of the significant benefits of the Stipulation is that it resolves the pending litigation in the Ohio *Capacity Charge Docket* (Signatories' Joint Ex. 1. at 20-23, ¶IV.2.b.1-3), the litigation currently being held in abeyance at the FERC will be withdrawn (*id.* at 23, ¶IV.2.b.4), and the prospect of related litigation in the courts will be avoided. Perhaps most significantly, the Stipulation weighs any allegation by AEP Ohio of confiscatory regulation arising from a fully-litigated decision on capacity pricing.

Thus, the Signatory Parties' proposed resolution of the capacity charge dispute is a reasonable result as part of the package of arm's length bargaining settlement terms contained in the Stipulation. Indeed, the hybrid solution of part RPM and part cost-based pricing resolves the disparate litigation positions of the parties through a classic middle ground compromise; this resolution is inherently reasonable.

e) The arguments raised by the parties opposing the Stipulation's resolution of capacity pricing issues are without merit.

The parties opposing the Stipulation raise several objections to the compromise pricing for capacity provided to CRES providers to serve shopping load. FES witness Shanker succinctly summarizes the opponents' primary objection, at page 3, of his Direct Testimony, which is that RPM pricing should be used because it is "the correct transfer price," and the Stipulation's pricing is should be rejected because it is "the wrong price." FES witnesses Lesser and Schnitzer attempt to undermine the Stipulation's pricing by arguing that AEP Ohio's cost-based capacity pricing proposal is incorrectly calculated. Consequently, they contend, the Stipulation's compromise is not meaningful. Several witnesses testifying on behalf of parties opposing the Stipulation contend that the Stipulation's capacity pricing will create a barrier to, or cap on, shopping. Dr. Lesser and Mr. Banks also contend that use of the wholesale capacity prices that the Stipulation establishes for CRES providers somehow amounts to an improper effort to recover stranded generation costs in conflict with provisions of S.B. 3.

1) FES Witness Shanker's View that Only RPM Pricing for Capacity May Be Adopted is in Error.

FES witness Dr. Shanker advocates pricing AEP Ohio's capacity at RPM-based prices, since anything more would be "above market." (FES Ex. 14 at 4.) While Dr. Shanker believes the capacity pricing is important, he acknowledged that there are other factors that influence whether a CRES provider would compete in Ohio. (Tr. VI at 1102-1103.) Further, while Dr. Shanker's position is heavily premised on the characterization of RPM as an effective and competitive market, he admitted during cross examination that RPM is really a hybrid of market-like mechanism that is subject to a host of rules that can be changed by the regulator. (*Id.* at 1118-1119.) In short, Dr. Shanker agreed that the RPM, at best, is a "regulated market" whereby the regulator can step in and change the rules. (*Id.*)

Dr. Shanker readily acknowledged that the RPM market as implemented reflects major flaws that result in a downward bias in auction-clearing prices: (1) the demand curve holdback rule understates demand and reduces the BRA resource clearing price, (2) regulatory backstops that limit excursions into the short supply side due to reliability concerns, thereby causing PJM to step in an use out of market procurement outside of the BRA process, and (3) the potential for buyers to artificially increase supply and depress Base Residual Auction (BRA) results. (*Id.* at 1111-1116.) On cross examination, Dr. Shanker admitted that none of these RPM flaws apply in the context of a cost-based rate established by a regulator. (*Id.* at 1117.)

Dr. Shanker acknowledged that the RPM model is biased to only attract low capital capacity investment like peaking units. (*Id.* at 1122.) Similarly, Dr. Shanker agreed that RPM results are volatile while a cost-based rate would not be volatile. (*Id.* at 1120-1121.) He also agrees that RPM auction clearing prices could be higher than cost-based rates, including AEP Ohio's litigation position proposal of $355/MW-Day. (*Id.* at 1123.)

CRES suppliers like FES simply want to achieve a transfer of wealth from AEP Ohio. Dr. Shanker understands that CRES providers can self-supply and avoid using AEP Ohio's capacity resources, subject to the same conditions that AEP Ohio participates as an FRR entity. (*Id.* at 1087-1088.) But he acknowledges that being an FRR entity and undertaking self-supply of capacity involves risks and a host of potential penalties that do not apply to CRES suppliers who take AEP Ohio's capacity:

- Capacity resource deficiency charge
- Generation resource rating test failure
- Peak season maintenance compliance penalty
- Unforced capacity availability penalty
- Peak hour period availability penalty
- Load management test failure penalty
- Demand resource and ILR compliance penalty

(*Id.* at 1094-1097.) In considering these potential penalties, Dr. Shanker agreed that taking on these additional risks would be a potential cost of undertaking self-supply. (*Id.* at 1094.) Indeed, Dr. Shanker openly admits that there is no reason for CRES providers to consider self-supply if the RPM pricing is used. (FES Ex. 14 at 7; Tr. VI at 1092-1093.) And he testified that he is not aware of any CRES provider in Ohio that has elected to undertake the self-supply option to date. (Tr. VI at 1101.) The Commission should not impose a requirement that AEP Ohio provide below-cost capacity to support competition from CRES suppliers that have no intention of developing their own capacity resources in Ohio or incentivize other parties to develop such capacity. Such an outcome does not and will not create effective competition in Ohio, only subsidized, opportunistic, and transitory competition.

Further, FES witness Dr. Shanker's position is rooted in hypothetical concerns involving the operation of the RPM "market." For example, Dr. Shanker elaborated during re-direct examination on the following example:

> And if you have a cost-based rate that is significantly higher than market, you create an incentive for people to divert resources from other reasonable applications into that high cost application to displace cost rates -- cost-based assets and you use them inefficiently.
>
> You're taking them away from an application where they are useful at say $150 in order to displace something at $350, and in doing so you're disturbing the market where the 150 asset was -- resided.

> In the original testimony that I provided I discussed how a likely result would be if prices were very high and AEP on retail, let's say the 350 level, <u>there would be an incentive for people to withdraw assets from the rest of PJM</u> where they're properly -- not properly, where they are valued at, say, 150 in the hypothetical, <u>and to direct them into AEP, and with the result being the prices would actually rise in the rest of PJM from the distortion of the resources.</u>

(Tr. VI at 1156-1157 (emphasis added).) In other words, Dr. Shanker is concerned that lower cost capacity resources might be drawn away from other states and used in Ohio to compete with higher priced capacity resources – such that Ohio customers would get lower prices for capacity but residents of another State might not keep their lower prices. AEP Ohio does not think that model or outcome would be so bad. It would involve real competition based on the prospect of bringing lower cost capacity resources, rather than the current arbitrage system that allows CRES providers to come and go with impunity and without any commitment or use of their own resources. In any case, Dr. Shanker's academic arguments incorporate no consideration of what is right for the State of Ohio or the customers in AEP Ohio's service territory; on the contrary, his arguments are premised on doing what is right for customers outside of Ohio. As such, they should not be relied upon by this Commission in deciding whether to adopt the two-tiered capacity discount reflected in the Stipulation.

In sum, Dr. Shanker's position that RPM pricing is the only appropriate method of charging for capacity, mainly because he claims it is a true market price, and that the *status quo* should be perpetuated (FES Ex. 14 at 5, 20, 24, 29) is flawed. Moreover, Dr. Shanker agreed that the outcome of the capacity pricing issue in a litigated context is uncertain , both within the pending proceeding before this Commission, Case No. 10-2929-EL-UNC, and the pending FERC § 205 and § 206 proceedings. (Tr. VI at 1135, 1140.)

Dr. Shanker also acknowledged that the Commission could change the interim capacity rate to be cost-based, separate and apart from adopting the Stipulation. (*Id.* at 1105.) He agreed that the FERC has not constrained this Commission to establishing a State Compensation Mechanism based on RPM pricing. (*Id.* at 1129-1130.) But he also maintains that the capacity charge is a wholesale charge that is a "FERC jurisdictional rate"; involves a purchase of capacity from AEP Ohio for resale to retail customers; and is a necessary input into retail shopping in Ohio. (*Id.* at 1106-1107.) Thus, absent adoption of the Stipulation, establishing a capacity charge under the State Compensation Mechanism provision in the RAA (or retaining the existing mechanism) will perpetuate substantial litigation and uncertainty regarding not only about the appropriate level of the charge but also concerning which entity has jurisdiction over the issue.

In sum, while Dr. Shanker heartily agrees with the long term result reached in the Stipulation of an auction-based SSO and having AEP Ohio become an RPM entity in the PJM market, he wants that outcome to be achieved overnight without a transition period. (FES Ex. 14 at 19-20; Tr. VI at 1133-1134.) Yet, he also acknowledged that AEP Ohio is locked into its FRR status until mid-2015 at the earliest. (FES Ex. 14 at 6; Tr. VI at 1089-1090.) And Dr. Shanker even agrees that the RAA allows AEP Ohio to charge a cost-based rate for capacity but quibbles with the notion that embedded cost can be recovered. (FES Ex. 14 at 9, 11.) His real issue is the timing of implementing a cost-based rate as he stated during cross examination: "If there was a cost-based rate proposed to begin in '15-'16, *I think that would be appropriate. I might not like it per se but I don't see any problem with it*." (Tr. VI at 1130-1131 (emphasis added).) But it is simply unrealistic and unreasonable to expect that AEP Ohio would wait until 2015 to collect its costs during a period in which it is unalterably still an FRR entity. The Stipulation strikes a reasonable balance by aggressively phasing in RPM capacity pricing and achieving a long term result through litigation avoidance that everyone – including FES – supports.

Accordingly, the Stipulation's two-tiered discounted pricing for capacity is reasonable, is fully supported by evidence of record, and is within the discretion of this Commission to adopt as a reasonable compromise of the parties' litigation positions.

2) FES Witnesses Lesser's and Schnitzer's Criticisms of AEP Ohio's Cost-Based Capacity Prices and of the Stipulation's Compromise Capacity Prices Are Fundamentally Flawed.

i. FES witness Lesser

Dr. Lesser attempted to undermine Dr. Pearce's cost-based methodology with two primary criticisms. (FES Ex. 2 at 23-28.) First, Dr. Lesser argues that AEP Ohio's cost-based capacity price fails to include contributions to embedded capacity costs from energy-related sales for resale. He concludes that his "energy credit" requires a $248,150,178 dollar reduction to capacity costs on a total (merged) company basis. (FES Ex. 2 at 28 (Table 5, line 20), 30 (Table 5, line 2).) His second criticism is that the formula cost-based price should reflect only generating plant investment that was in-service prior to January 1, 2001. He concludes that, in order to implement the January 1, 2001, limitation on generating plant in service, it is necessary to adjust on a total (merged) company basis the rate base and, thereby, the depreciation expense by $173,529.676; the return on rate base by $379,994,176; and income tax expense by $146,272,028. (FES Ex. 2 at 30 (Table 6, lines 5, 9, 15).) In sum, through these criticisms Dr. Lesser reduces total (merged) company capacity costs by $947,946,459, leaving $189,651,673 to be recovered through his version of a cost-based capacity charge. The result is Dr. Lesser's proposed capacity charge, on a total (merged) company basis, of $57.35/MW-Day.

Dr. Lesser's cost-based method has several fundamental flaws and his unfamiliarity with Ohio and AEP Ohio are at the root of his errors. His proposed energy credit of $248 million is grossly overstated as a result of several basic mistakes. First, although he acknowledged that the current ESP for AEP Ohio included fuel expense deferrals during 2010, he also conceded that the fuel expenses that he relied upon in his Table 5 to calculate his $248 million energy credit did not include expenditures for fuel made during 2010 but deferred for future recovery:

> Q. So, if it were recorded as an expense and hypothetically suppose it's $130 million that was deferred during the year that's evaluated in your Table 5, if it had not been deferred and the number was 130 million, then the number in line 1 would have been greater by 130 million? In the total column.
> A. If your – given your hypothetical, if there was no deferral and AEP's actual expenses were $130 million higher, then that's true.
> ***
> Q. In any event, would it be – if the number on line 1 in the Total column were $130 million higher, would the value in line 20 [$248,150,578] be lower?
> A. Yes, it would be lower.
> Q. You just don't know exactly how much it would be lower.
> A. Correct.
>
> (Tr. VII at 1368-60.)

Mr. Nelson confirmed on rebuttal that the actual expenditures for fuel by both OPCo and CSP during 2010 was $130 million greater that the amount reported in Account 501. (AEP Ohio Ex. 21 at 4.)

On rebuttal Mr. Nelson testified that for 2010 Account 501 fuel costs (the basis for line 1 of Dr. Lesser's Table 5) contained deferrals for both OPCo and CSP which on a combined basis amounted to $130 million. (*Id.*)

The second fundamental error in Dr. Lesser's calculation of his proposed energy credit is that he assumes that 100% of the margins for energy sales for resale are retained by AEP Ohio. In cross-examination by OEG's counsel, Dr. Lesser admitted that he is not familiar with the FERC-approved Interconnection Agreement (the Pool Agreement) to which the AEP Ohio companies are parties. Accordingly, he was not aware that the two AEP Ohio companies and all of their affiliates that are subject to the Interconnection Agreement share all margins from energy sales for resale according to each affiliate's member load rates. (Tr. VII at 1308-1311.)

Mr. Nelson explained on rebuttal that the merged AEP Ohio would retain only about 40% of energy margins generated by off-system energy sales for resale. (AEP Ohio Ex. 21 at 5.) Dr. Lesser simply was unaware of this, and based his testimony for the Commission's consideration on the incorrect assumption that AEP Ohio would retain 100% of these margins.

The third flaw in Dr. Lesser's approach is the assumption that, whatever energy sales for resale margins are generated by the "freed up" energy and retained by AEP Ohio, it would not be appropriate to credit all of those margins to capacity sales. As Dr. Pearce explained, if an energy credit based on such margins is considered, it should be on a shared basis. He suggested a reasonable 50% sharing mechanism.Such a sharing mechanism provides a fair sharing of risk that future margins would even be generated based on historical prices with no true-up mechanisms and is consistent with sharing arrangements in other contexts.

In short, there is no valid basis for Dr. Lesser's conclusion that an energy credit of $248 million should be used in a cost-based capacity pricing estimate for AEP Ohio. Indeed, there is no basis upon which to conclude that an energy credit greater than that calculated by Dr. Pearce (7.73/MW-Day for CPS, $9.94/MW-Day for OPCO, and $17.58MW-Day on a merged company basis) is appropriate. (AEP Ohio Ex. 3 at Ex. KDP-3, KPD-4.)

Dr. Lesser's second criticism of AEP Ohio's cost-based estimate of its capacity costs is that they should not include costs associated with generation plant investments made on and after January 1, 2001. The basis for this exclusion is his belief that including such investments in a cost-based methodology for determining wholesale capacity prices somehow would conflict with requirements of S.B. 3 and AEP Ohio's electric transition plans approved in 2000, which restricted recovery of stranded generation costs through retail transition charges. There are several flaws in this criticism, with some again based in his lack of knowledge of practice and law in Ohio, and these will be discussed below in conjunction with similar arguments made by other witnesses opposing the Stipulation.

In sum, the flaws in Dr. Lesser's criticisms of AEP Ohio's cost-based capacity pricing proposal and of the Stipulation's compromise capacity pricing are so numerous and fundamental that his conclusions should be given no weight by the Commission.

ii. FES witness Schnitzer

FES witness Schnitzer also computes a cost-based capacity price of $162/MW-Day for AEP Ohio, which he refers to as a "maximum above-market rate." Using 2009 data, he explains the calculation of his cost-based capacity price in detail at Exhibit MMS-5 of his Direct Testimony. (FES Ex. 3 at Ex. MMS-5.) First, he adds Fixed Production Costs ($1,498 million) and Variable Production Costs ($1,721 million), and then subtracts Non-AEP Pool Revenues ($2,153 million) and AEP Pool Revenue from Net Sales ($570 million), to compute the Capacity Revenue Requirement ($497 million). (*Id*. at Ex. MMS-5, p. 1-2.) Then he converts the Capacity Revenue Requirement of $497 million to $162/MW-Day.

On rebuttal, Mr. Nelson explained that there were serious flaws in the calculation of the energy offset which Mr. Schnitzer used to reduce the cost of capacity. The first error is that he did not remove fuel deferrals from the fuel costs (Variable Production Costs in Exhibit MMS-5) that he used in his calculation. This is the same flaw that affected Dr. Lesser's calculation. Mr. Nelson testified to the fact that Account 501 (Fuel) for 2010, contained deferrals for both OPCo and CSP which, on a combined basis, netted to $130 million. In his cross-examination testimony, Mr. Schnitzer recognized that, if there were fuel deferrals in 2010, they should be adjusted out of his calculation, and he stated he was not aware of the deferrals at the time he prepared his testimony. (Tr. VII at 1394-1396.) He went on to do a rough estimate, which he provided on the record, which would raise his "maximum" capacity rate from $162/MW-Day in his pre-filed testimony to over $200/MW-Day with just this correction. (Tr. VII 1457-1459.) The second error, which was also discussed during his cross-examination, is that he didn't model the AEP Pool as it exists today, but instead, modeled a hypothetical modified pool. (*Id.* at 1396-1403.) He ignored the requirement in the existing pool agreement to share energy margins with the other members of the pool. Mr. Nelson explained that this provision of the AEP Pool means that the merged AEP Ohio would retain only about 40% of the energy margins generated by the "freed up" energy, as opposed to the 100% Mr. Schnitzer used in his calculation. (*Id.* at 1404-1407.) Mr. Schnitzer incorrectly assumed that CSP could still purchase energy at cost from the other members just to "flip" the energy and make off-system sales and then keep the resulting margins. More importantly, Mr. Nelson testified that Mr. Schnitzer also credited AEP Ohio with the full capacity payments from the other pool members of $400 million, which significantly reduced his "maximum" capacity rate. Mr. Nelson testified that this is clearly erroneous. Mr. Nelson noted that it also appears Mr. Schnitzer used 2009 peaks for the Companies instead of 2010 peaks. This actually produces a lower capacity rate for 2010 than using the 2009 peaks. Mr. Nelson also explained that an adjustment for losses is also required in order to compare Mr. Schnitzer's corrected calculation to the stipulated capacity charge. (AEP Ohio Ex. 21 at 4-5.)

After correcting Mr. Schnitzer's calculations to remedy just these three flaws (adding $43/MW-Day to the capacity revenue requirement for deferred fuel expenses, adding $112/MW-Day to reflect the revenue sharing mechanism of the AEP Pool Agreement, and subtracting $14/MW-Day to correct for losses and the use of 2010 peaks), Mr. Nelson calculated that Mr. Schnitzer's cost-based capacity price, using his methodology, would be $303/MW-Day. Mr.

Nelson observed that this corrected cost-based capacity priced is well in excess of the stipulation's capacity pricing, which when it is blended over the January 2012 through May 2015 period of the ESP amounts to $201/MW-Day. (*Id*. at 6.) It is also well in excess of the Stipulation's price of $255/MW-Day for capacity in excess of the RPM set-aside amounts.

In sum, when corrected for just the most obvious errors discussed by Mr. Nelson, Mr. Schnitzer's cost-based capacity approach provides further support for the reasonableness of the Stipulation's treatment of capacity pricing.

3) The Stipulation's Capacity Pricing Will Not Create a Barrier To, or a Cap On, Shopping.

FES witness Banks contends that the Stipulation's capacity pricing will "effectively prevent 79% of customers from shopping between 2012 and mid-2015." (FES Ex. 1 at 10.) IEU witness Murray wrongly asserts that the set-aside levels of RPM-priced capacity will block shopping. (IEU Ex. 9A at 9, 14, 17-18.) These criticisms are without merit. First, RESA witness Ringenbach testified that her company (Direct Energy) currently is making competitive offers in the market based on the Stipulation's $255/MW-Day price. (Tr. IV at 544.) In addition, AEP Ohio witness Allen, in his rebuttal testimony, reported that in excess of 1,500 customers had switched to a CRES after September 7, 2011, in classes that had exceeded the initial RPM set-aside. (AEP Ohio Ex. 20B at 8-9.) Thus, the evidence of record supports the conclusion that shopping will continue under the Stipulation's two-tiered capacity discount structure.

Second, using data relied upon by FES witnesses Schnitzer (FES Ex. 3 at Ex. MMS-4), Mr. Allen, also on rebuttal, showed that there is potential "headroom" between the stipulated ESP prices and market prices under both RPM priced capacity and $255/MW-day priced capacity. He explained that this "headroom" is the amount remaining, after deducting market costs, that a CRES provider has available to cover overheads and margins. He further observed that additional "headroom" would be available to CRES providers if they have access to energy supplies at a cost below market, such as from owned assets or bilateral contracts. Tables 1 and 2, at page 8 of Mr. Allen's rebuttal testimony, provide the results of his analysis.

Mr. Allen also pointed out that CRES providers also have the option to structure multi-year contracts with customers that could allow them to purchase capacity at $255/MW-day in 2012 and 2013 and at RPM in the remaining years of the contract depending upon the customer's position in the RPM set-aside queue. For example, a CRES provider could offer a customer a 41-month contract starting in January 2012 to a customer that received an RPM set-aside allotment in January 2013. Under this scenario a CRES provider could offer customers a 5% discount to the price to compare and still have available headroom of approximately $5/MWh as shown in CONFIDENTIAL Exhibit WAA-R2A to AEP Ohio Ex. 20(A).

Third, Dr. Lesser also very effectively refuted the contention that the Stipulation's $255/MW-Day capacity price would cap shopping. (*See* FES Ex. 2 at 35-38.) He testified that, if one assumes that AEP Ohio's embedded capacity costs are $355/MW-Day, AEP Ohio's proposed 2012 ESP SSO generation rates will under-recover by $50 million the $949 million of non-shopping embedded costs. (Tr. VII at 1375-1377.) Consequently, he conceded that, on a percentage basis the under-recovery of capacity costs is, approximately, only 5 1/2 % and that the Stipulation's 2012 SSO rates would recover 94.5% of the $355/MW-Day capacity costs. (*Id.* at 1377.)

Although Dr. Lesser did not convert the 94.5% of $355/M-Day into a final figure on the stand, the simple arithmetic shows that it would be $335.5/MW-Day (94.5% x $355). In other words, Dr. Lesser's exercise that he presents on pages 35-38 and in Tables 7 and 9 of his Direct

Testimony shows that, even under his analysis, the Stipulation's 2012 ESP generation prices would recover through SSO rates over $335/MW-Day. That is $80/MW-Day more than the $255/MW-Day that the Stipulation capacity price would allow AEP Ohio to realize from capacity sales to CRES providers. Clearly, under Dr. Lesser's analysis, the $255/MW-Day Stipulation capacity price provides, by itself, substantial head room to CRES providers. Just as clearly, the Stipulation's $255/MW-Day creates no barrier to, or cap on, shopping.

When IEU witness Murray was questioned about his opinion, based on a statement by AEP Vice President Richard Munczinski during a conference call with investment analysts (Tr. XI at 1859), that shopping would be constrained above the Stipulation's RPM-priced set aside amounts of capacity, he conceded that AEP Ohio had provided the following context and explanation in a discovery response prepared by Mr. Munczinski,:

> In a strict economic sense, any increased price input for providing service acts as a constraint on retail shopping – albeit an appropriate cost based constraint. While shopping might increase if AEP Ohio provided free capacity for use by CRES providers, that would be inappropriate. The stipulated capacity rate of $255/MW-Day is reasonable and supported by the filed testimony. See the testimony of Company witnesses Munczinski [which Mr. Nelson adopted] and Pearce.

(*See* AEP Ohio Ex. 15.) The purpose of the Stipulation's provision for capacity pricing for shopping load is to provide some measure of compensation for AEP Ohio's capacity costs while providing substantial and increasing amounts of capacity at prices discounted to levels substantially below cost.

For his part, Mr. Murray subsequently acknowledged on cross examination that the Stipulation does not impose a literal or absolute cap and that his use of the cap terminology is based on economic considerations. (Tr. XI at 1883.) He also admitted that any projection that there will not be shopping based on the $255/MW-Day capacity charge is based on a series of factors that are not known and any predictions in this regard may simply end up being wrong.

(Tr. XI at 1863, 1886-1887.) Moreover, he admitted that the capacity charge paid by CRES providers who do not self-supply capacity to support their retail generation service is only one factor that drives the price of the CRES provider's retail price offers. (Tr. XI at 1863.)

The reality is that the Stipulation's RPM set aside levels foster considerable potential for the expansion of competitive market-based rates for significant retail loads within AEP Ohio's service territory. The 2012 set aside of 21% of AEP Ohio total retail load is approximately 10,000 GWh, which is roughly equal to the entire 2010 load of Toledo Edison Company. The potential 2013 set aside of 31% of AEP Ohio total retail load is approximately 15,000 GWh, which is roughly equal to the entire 2010 load of Dayton Power & Light Company. And the 2014-2015 set aside of 41% of AEP Ohio total retail load is approximately 20,000 GWh, which is roughly equal to the entire 2010 load of Duke Energy-Ohio. (*Id*. at 12-13.) Further, as discussed above, the evidence of record demonstrates that retail shopping has continued to expand after the Stipulation was signed – even above the RPM set aside levels. Thus, the Commission should ignore any rhetoric that falsely claims the Stipulation imposes caps on shopping.

4) FES's Arguments and Policies are not Focused on the Commission's Mission or the State's Goals as a Whole.

A review of the testimony of the only FES employee to testify in the case and the individual responsible for FES policy shows that FES's focus in this case is to expand its business enterprise, not to uphold the policy goals of the statute or even the mission statement of the Commission that it cites in its testimony. FES witness Banks testified that he was testifying in this proceeding to the overall position of FES as it relates to the Stipulation. (Tr. VII at 1207.) A significant portion of Mr. Banks testimony filed in this case involves his discussion of the impact of the Stipulation and particularly the tiered capacity offerings that he describes as discriminatory price caps that impede competition. (FES Ex. 1 at 5.)

The problem with the policy arguments provided by FES witness Banks is that they largely focus on the push for facilitation of competition to an exclusion of all other policy considerations in the state. When asked if a Commission order that restricts competition is automatically anticompetitive and against state policy Mr. Banks responded yes. (Tr. VII at 1226.) Mr. Banks attempted to give a different answer at the hearing then he had provided during his deposition earlier that week, but the deposition was used to impeach his inconsistent answer and show FES' policy position on the Commission's actions related to competition. It would appear that FES would view any action the Commission takes that FES believes restricts competition as automatically anticompetitive and against state policy. This policy position would essentially erase all other considerations of the Commission and force each and every action it takes to serve the single policy of facilitating competition. In an attempt to rehabilitate his credibility on this all-or-nothing policy vision, Mr. Banks stated on redirect when questioned by his own counsel that the Commission does have "some authority" concerning those automatic "violations" if it believes its action is substantiated by things that will negatively impact stability and certainty in retail generation. (*Id*. at 1289.) However, the attempt to rehabilitate FES' telling view of the Commission's authority to make decisions failed and instead further shows that FES views any decision[47] of the Commission that restricts competition is anticompetitive and a violation of state policy. Apparently, the only question is whether those presumptive anticompetitive Commission decisions that violate state policy can be allowed under the limited

[47] Mr. Banks clarified that "any action" of the Commission may be too broad so this discussion is limited to any decision of the Commission. (Tr. VII at 1289).

authority FES recognized on redirect that the Commission possesses only when determining if its violations are allowed under the circumstances.

FES' tunnel vision focused on its competitive business above all other interests in this case is also evident in Mr. Banks' view of the standards the Commission should use to evaluate the Stipulation. During cross examination FES witness Banks provided FES' narrow scope of consideration for the Commission's review of the Stipulation, not surprisingly focused on the impact on competitive markets. Specifically, the question and answer reads:

> Q. Do you have an opinion what standards the Commission should use when deciding whether to accept the stipulation or reject it as you propose?
>
> A. Well, generally I think that state policy would suggest that the utility provide nondiscriminatory services to customers and give them the opportunity to competitive markets and the ability to choose both supply and suppliers. I think those standards are standards that should be retained in evaluating the stipulation.

(Tr. VII at 1205.) We have already seen FES' attempt to judge all decisions against their view of competitive interests in Ohio and now the sole criterion to judge the reasonableness of the Stipulation is tied to the elements of its core business rooted in competition. Interestingly, it is only when asked a follow-up question about the public interest that FES witness Banks considers that as a possibility. Specifically, the transcript reads:

> Q. The public interest also is a standard the Commission should consider?
>
> A. The Commission can consider public interest as well.

(*Id*. at 1205-1206.) It is only upon the suggestion by opposing counsel that FES witness Banks even discusses the public interest. Interestingly, when given the opportunity to discuss the public interest as a point he thinks the Commission should consider, he provides a cursory response only that "the Commission can consider it as well." FES witness Banks' response is not that the Commission should consider the public interest, but that it can if it wants to consider that as well.

Clearly FES' focus is not on the public interest but on advancing competition and utilizing whatever tools support that limited view. In support of FES witness Banks' criticism of the decision he labeled to create discriminatory price caps prohibiting shopping (otherwise known to the Signatory Parties as the stipulated capacity price compromise), Mr. Banks asserted that "[s]uch a decision flies in the face of state law and policy, and the Commission's stated mission to 'facilitate an environment that provides competitive choices.'" (FES Ex. 1 at 5.) During cross examination it was established that Mr. Banks was quoting the Commission's Mission statement, but only referring to a portion of the statement. (Tr. Vol. VII at 1227-1228.) When asked about his decision to incorporate the Commission's mission statement, he indicated he believed this statement was part of the Commission's mission but that he did not remember the entire statement. (Id. at 1228.) Indeed as seen in the actual Mission statement administratively noticed[48] after Mr. Banks could not recall the entire statement, the portion cited in his testimony is in fact part of the Commission's stated mission. However the mission and accompanying commitments contain a lot more than the portion selected by FES' testimony. As provided on the Commission's website the PUCO Mission states:

> **PUCO Mission**
>
> Our mission is to assure all residential and business consumers access to adequate, safe and reliable utility services at fair prices, while facilitating an environment that provides competitive choices.
>
> **This mission is accomplished by:**
>
> - Mandating the availability of adequate, safe, and reliable utility service to all business, industrial, and residential consumers.
> - Ensuring financial integrity and service reliability in the Ohio utility industry.

[48] The Mission Statement and associated indicators of accomplishment wew administratively noticed at Tr. VII at 1230.

- Promoting utility infrastructure investment through appropriate regulatory policies and structures.

- Regulating utilities' rates and terms of service for monopoly and non-competitive services.

- Monitoring and Enforcing compliance with rules and statutory protections against deceptive, unfair, unsafe, and anti-competitive utility practices.

- Safeguarding the security of Ohio's regulated motor carrier and rail operations, through aggressive inspection, training, monitoring, and education programs.

- Enhancing safety at all public highway-railroad grade crossings in Ohio through education and the installation of lights and gates and other safety devices.

- Resolving through mediation, arbitration, and adjudication disputes between utilities and residential, commercial, and industrial customers, as well as between competing utilities.

- Fostering competition by establishing and enforcing a fair competitive framework for all utilities.

- Utilizing advanced technology for monitoring and enforcing utility compliance, facilitating the provision of information to stakeholders, and sharing information between state and federal agencies.

(http://www.puco.ohio.gov/puco/index.cfm/about-the-commission/mission-and-commitments/.) FES witness Banks declined to include the access to adequate, safe and reliable utility services at fair prices, the financial integrity and service reliability in the industry, the utility infrastructure investment through appropriate regulatory policies and structures, or even the resolution of disputes through alternative dispute means. Facilitating an environment that provides competitive choices is absolutely a part of the Commission's mission, but when asked if he was asking the Commission to only rely on that portion he cited, FES witness Banks responded that he was providing this portion for emphasis because he thought it was important to point out. (*Id.* at 1228-1229.)

FES is focused on one thing and one thing only, the advancement of a competitive framework that advances its business regardless of any collateral damage on the state, the industry, or the Commission. Even in this discussion of capacity pricing, Mr. Banks admitted that it does not matter what the costs are to the utility, that the Commission should ensure competitive suppliers access to RPM-based pricing for capacity. (Tr. VII at 1234.) The Commission should see through the tunnel vision of FES' policies and arguments focused solely on its bottom line and approve the Stipulation signed by a collaboration of stakeholders, including CRES providers like FES. The self-interested motivations of FES should be recognized and denied.

5) The Wholesale Capacity Prices that the Stipulation Establishes for CRES Providers Do Not Recover Stranded Generation Costs in Conflict with Provisions of S.B. 3.

FES witnesses Lesser and Banks and IEU-Ohio witness Murray claim that AEP Ohio is attempting to recover stranded costs through the Stipulation's capacity pricing in conflict with provisions of S.B. 3. (FES Ex. 1 at 6; FES Ex. 2 at 16-23; IEU-Ohio Ex. 9A at 9-16.) These claims are baseless. Under SB 3, electric utilities were given an opportunity to recover transition revenues that could include the amount of generation investment that would not be recoverable in a competitive market. The determination of whether such investments were stranded under SB 3 was done based on an analysis of 2000 vintage information as to whether the net book value for generation assets exceeded the market value of the assets (using forward market price estimates for electricity at that time). As part of a settlement in Case No. 99-1729-EL-ETP and 99-1730-EL-ETP (ETP Settlement), AEP Ohio agreed not to pursue SB 3's opportunity for recovery of stranded generation investment.

First, as Dr. Lesser admitted, capacity charges are wholesale prices (Tr. VII at 1339.) He also acknowledged that the electric transition plan cases from 2000 did not establish wholesale capacity prices for CSP and OPCo (*id.*), and that any generation transition charges established in those cases would have been retail charges. (*Id.* at 1338.) As Mr. Nelson explained on rebuttal, the ETP cases were retail cases and they have no bearing on a wholesale rate charged to CRES providers. (AEP Ohio Ex. 21 at 2.) Accordingly, any restrictions on recovery of generation costs through retail pricing that resulted from S.B. 3 and the Commission's 2000 orders in Case Nos. 99-1729-EL-ETP and 99-1730-EL-ETP are simply inapplicable to wholesale capacity pricing.

In addition, Dr. Lesser's understanding of Ohio regulation of AEP Ohio's generation SSO rates after the 2001-2001 period governed by the 2000 ETP orders in Case Nos. 99-1729-EL-ETP and 99-1730-EL-ETP is extremely limited. He did not review the Commission's orders in AEP Ohio's rate stabilization plan proceeding (Case No. 04-169-EL-UNC). (Tr. VII at 1345.) He was not familiar with the order in AEP Ohio's first ESP proceeding (Case Nos. 08-917-EL-SSO and 08-918-EL-SSO). (*Id.* at 1346.) Consequently, he was uninformed about the nature of the regulation of AEP Ohio companies' generation standard service offer since the 2000 ETP cases. Mr. Nelson explained on rebuttal that in the numerous proceedings before this Commission involving the AEP Ohio companies since the 2000 ETP cases, the Commission has not excluded any significant generation plant costs from the Companies' retail SSO rates. On the contrary, Mr. Nelson noted that in the cases after the ETP cases, including the 2004 RSP cases, the subsequent RSP "4%" cases, the initial ESP proceeding and the Remand proceeding for that ESP proceeding, the Commission supported specific recovery of environmental compliance investments that have allowed AEP Ohio's generation units to operate. Specifically, in those cases AEP Ohio presented evidence that it had spent over $2.5 billion since 2000 on projects that enabled AEP Ohio's generating plants to comply with environmental requirements. (AEP Ohio Ex. 21 at 2-3.)

Dr. Lesser was not familiar with, and he had no understanding of, the post-ETP regulatory proceedings, let alone the central role that recovery of environmental compliance investment costs played in them. He had no idea what the amount, if any, of the generation plant investments made after 2000 were for environmental compliance projects. (Tr. VII at 1346-47.) Nor did he know whether the AEP Ohio generating units would have been in compliance with applicable environmental laws today or over the last ten years if the investments had not been made. (*Id.* at 1347.) He agreed that if AEP Ohio's generating units were out of compliance with environmental requirements and they had to be shut down, then that would affect AEP's ability to sell power in the market, which in turn could affect the amount of off-system sales margins. (*Id.* at 1347-48.) But he did not take that impact into account as part of his analysis of available margins energy sales for resale. (*Id.* at 1348.)[49]

Similarly, IEU witness Murray alleges that the Stipulation contains a "second transition period" in violation of SB 3. (IEU Ex. 9A at 10-15.) But Murray agreed that stranded costs under SB 3 were determined based on then-forward projection of likely market prices and net book value of plants at that time. (Tr. XI at 1868.) Both factors have changed and AEP Ohio submits that any determination under SB 3 of whether or not a particular plant is stranded in the competitive market has no bearing on the current issues under the Stipulation.

[49] Dr. Lesser suggested that AEP Ohio could have bought SO_2 and NO_x offsets (emission allowances) as an alternative to the investments it did make post-2000 to enable the generating units to continue to operate during that period. (Tr. VII at 1347.) Mr. Nelson on rebuttal explained that the cost of such emission allowances would have been so high, the plants would not have dispatched in PJM at the same level. Mr. Nelson also pointed out that, while Dr. Lesser tried to defend his energy credit analysis by the emission allowance suggestion, he did not reflect the cost of additional allowances in his calculations. Mr. Nelson observed that Dr. Lesser's suggestion ignored that the variable cost of production would climb significantly if emission allowance had been purchased as a substitute for compliance investments, and that use of such a strategy for complying with environmental requirements would dramatically reduce any energy sales for resale margin and, thus, the amount of any energy credits. (AEP Ohio Ex. 21, at 3-4.)

IEU witness Murray agreed that forward market prices can and do change. (*Id*. at 1869.) He also acknowledged that the environmental costs based on the then-current view of environmental regulations would have been reflected in the forward market prices used at that time. Yet, Mr. Murray maintained that any capacity price above the RPM price is inappropriate based on the stranded costs argument. (*Id.* at 1870.) Thus, not only does Mr. Murray use an outdated and irrelevant basis for concluding that that AEP Ohio's cost-based capacity charge amounts to stranded investment, he also applies a measure of market prices for capacity that did not exist during SB 3's transition period (*i.e*., the RPM pricing). This flawed analysis should not be relied upon by the Commission.

Mr. Nelson explained on rebuttal that the ETP Settlement dealt with the market development (transition) period from 2001 through 2005, and envisioned that the Company's generation would be at market in 2006. Because of high market prices in 2006, the Commission encouraged the Company to file a rate stabilization plan to keep the retail customer from experiencing substantial increases in rates. (AEP Ohio Ex. 21at 7-11). Also, during this period AEP was encouraged to take over the service territory of Monongahela Power in Ohio to protect their customers from market prices for generation service. It was also around this time period that Ormet petitioned to return to service by AEP Ohio to avoid these high market prices as previously discussed.

The fact that a generation asset or fleet of assets was not found to be stranded investment under SB 3's opportunity for receipt of transition revenues does not preclude the Commission from presently adopting a cost-based capacity charge. This is especially compelling in light of the fact that AEP Ohio has avoided the volatile and uncertain Reliability Pricing (RPM) Market for capacity through its election to be a Fixed Resource Requirements (FRR) entity, which was applauded by the Commission at the time AEP Ohio made its election. It would be extremely unfair and disingenuous for the Commission to currently find that AEP Ohio's cost-based capacity charge is barred by virtue of a 2000 era market analysis done under the previously-effective provisions of SB 3 that were applied in a different factual and legal context.

Not only is the 2000 vintage view of stranded generation investment inapplicable to the current situation, taking a short-term view cannot support any valid conclusions about whether generation investment is stranded in a competitive market. Non-Signatory Parties take the view that the relatively brief period during which the Stipulated blended capacity charges would apply (*i.e.*, 2012- May 2015) should be used to judge whether a cost-based rate could be characterized as recovering costs stranded in a competitive market. The fact that RPM prices for some recent years and some projected years are above the Stipulated blended capacity charge undermines a conclusion that AEP Ohio's generation assets are stranded in a competitive market.

The Non-Signatory Parties' approach is even more inappropriate in light of the fact that the RPM auction-clearing prices simply do not represent a long-term view of market prices for capacity. By contrast, the view of stranded generation investment undertaken in connection with SB 3 was based on long-term projections for market prices of electricity. To now claim that, because the Company is receiving a negotiated rate that is well below its cost of capacity for a very short transition period, amounts to recovery of stranded cost is unfounded. As the history above demonstrates, stranded cost has not been an issue for AEP Ohio in the past and if one examined the whole period involved 2001 through the end of this ESP the Company's generation cost would be well below market during this time. (AEP Ohio Ex. 21 at 9-10.)

Perhaps the most glaring error in the stranded generation investment argument is that it ignores the fact that the entire regulatory regime for standard service offer pricing has substantially changed with the enactment of SB 221 in 2008. During the period 2001 through 2008, the Company's generation was well below market and the Company's retail customers benefited greatly. Yet, even though SB 3 was premised on the ability to charge market rates starting in 2006, at no time during the past decade was AEP Ohio ever permitted to charge a true market rate for its standard service offer. As IEU witness Murray admitted, however, while SB 3 was premised on collection of market rates after the transition period, AEP Ohio never got to charge those market rates and instead entered into a Rate Stabilization Plan at rates lower than projected market rates. (Tr. XI at 1871-1874.)

The ESP option under SB 221 now involves several cost-based rate adjustments and amounts to a hybrid system of regulation and market-based pricing. Even an MRO option under SB 221 involves an additional transition period of 6-10 years before a full market price is charged for the standard service offer. Another significant change made through SB 221 regarding generation assets is that a utility is required to obtain approval from the Commission to transfer generation assets. Under SB 3, an electric utility could freely transfer generation assets. In its first ESP filed under SB 221, the Company sought to transfer a limited amount of its generation and its request was denied. Yet another significant aspect of SB 221 is application of the significantly excessive earnings test. All of these factors limit an electric utility's ability to charge and retain market rates for generation service and manage the business and financial risks associated with its fleet of generation assets.

In sum, the Non-Signatory Parties' two-step argument, first characterizing a cost-based capacity charge as being recovery of stranded generation investment and second arguing that it is too late to recover stranded investment, is misguided. The inequitable result advocated by the Non-Signatory Parties is neither compelled nor supported by their misguided stranded investment analogy. The testimony filed in support of the Stipulation demonstrates that the Stipulated blended capacity charge is reasonable and should be adopted as a part of the overall compromise provided to the Commission to approve.

3. The Merger Of CSP And OPCo, Case No. 10-2376-EL-UNC, Meets The Requirements of R.C. §4905.06.

The proposed resolution of Ohio Power Company and Columbus Southern Power Company's Application for Authority to Merge and Related Approvals, Case No. 10-2376-EL-UNC (the "AEP Ohio Merger case"), also satisfies the second prong of the three-part test. With respect to that case, the Signatory Parties have proposed the following:

> The Signatory Parties recommend that the Commission would approve the merger and closing would occur after Commission approval of the Stipulation by the end of 2011, while maintaining separate rate zones for distribution rates until subsequently addressed by the Commission in a separate proceeding. Effective January 2012, CSP and OPCo transmission rates will be consolidated and CSP and OPCo generation rates (including the FAC rates) will also be consolidated.

(Signatories' Joint Ex. 1 at 24.) In its February 9, 2011 Entry in the AEP Ohio Merger case, the Commission held that "the proposed merger [of CSP and OPCo] will not result in a change in control of CSP and, thus, is not subject to review under Section 4905.402(B), Revised Code." *In the Matter of the Application of Ohio Power Co. and Columbus Southern Power Co. for Authority to Merge and Related Approvals*, Case No. 10-2376-EL-UNC, Entry at 2 (Feb. 9, 2011). Rather, the Commission determined, the application is subject to review under R.C. 4905.06, "to ensure that the merger will promote the public interest and not adversely affect any class of CSP or OP customer within the Commission's jurisdiction." *Id*.

As AEP Ohio witness Hamrock demonstrated, the proposed merger will promote the public interest. First, it will eliminate the need to maintain separate records and prepare separate financial statements, tax returns, and other financial and regulatory reports. (AEP Ohio Ex. 8 at

30.) This elimination will reduce AEP Ohio's administrative costs and the annual fees paid to independent auditors. (*Id*.) The merger also will eliminate the need to file separate regulatory filings for CSP and OPCo, thus lessening the burden on the Commission in AEP Ohio's proceedings before it. (*Id*.) The merger is also expected to reduce the number of bond issuances, which will reduce the merged Company's rating agency and internal labor expense. (*Id*.) A larger, merged Company is also expected to be more flexible and may be able to more efficiently meet Ohio's advanced energy portfolio standards, Ohio's energy efficiency and peak demand reduction requirements, and current and future environmental mandates. (*Id*.) Finally, the merger will result in a larger customer base and scale, which will reduce barriers to the deployment of new technologies and to conducting research and development projects. (*Id.)*

The proposed merger also will not adversely affect any class of CSP or OPCo customer. It should be noted first and foremost that the merger of CSP and OPCo will have no independent effect on the distribution rates charged to CSP and OPCo customers. (*Id*. at 31.) Those rates, as well as all of CSP's and OPCo's existing pre-merger regulatory obligations under Ohio law (including each company's obligation to comply with the Commission's electric service and safety standards) will be maintained after the merger unless and until they are modified in accordance with Ohio law. (Id. at 30.) After the merger, the merged Ohio Power Company will continue to provide retail electric services to customers within each company's pre-merger certified territory in accordance with the distribution rates, terms, and conditions that were in effect for each company prior to the merger. While CSP and OPCo's transmission and generation rates would be consolidated in January 2012, as well as consolidation of generation rates, those consolidations would not adversely affect any class of either company's customers. Because the proposed merger will promote the public interest and will not adversely affect any class of CSP or OPCo customers, it satisfies the Commission's requirements under Section 4905.06, Revised Code, as articulated in the Commission's February 9, 2011 Entry and, therefore, satisfies the second prong of the Commission's three-part test.

4. Phase In Recovery Rider, Case Nos. 11-4920/4921-EL-RDR, long term debt-only carrying cost reduces the WACC authorized by the Opinion and Order in Case Nos. 08-917/918-EL-SSO. [Par, IV. 6]

The Phase In Recovery Rider (PIRR) is supported by the Signatory Parties as a part of the overall agreement for approval in the Stipulation under Paragraph IV.6 at page 25 and settles the cases seeking to establish the rider to collect the phased-in recovery of the fuel expense.[50] The PIRR is designed to collect the phase-in regulatory assets resulting from the current 2009 – 2011 ESP over a seven year period. Collection under the PIRR will be by a rate per kWh which varies by service voltage. (AEP Ohio Ex. 2 at 13.) The collection period for the PIRR will begin on a combined Company basis for non-residential customers beginning January 1, 2012 and will include a debt carrying charge of 5.34% and calculated with no adjustment to the book balance as of year end 2011. (Signatory Parties' Ex. 1 at Par. IV.6.) The Signatory Parties agree that the PIRR will be in place for the entire amortization period or until the PIRR regulatory assets are securitized, whichever comes first. (*Id*.). As agreed in the Stipulation, collection of the PIRR for residential customers will be delayed for 12 months under the conditions specified therein. The Signatory Parties agreed to support the concept of securitization and the commitment to work in

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50 *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Ohio Revised Code 4928.144,* Case No. 11-4920-EL-RDR*; and In the Matter of the Application of Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Ohio Revised Code 4928.144,* Case No. 11-4921-EL-RDR (*PIRR Cases*).

good faith to support appropriate legislation to apply to the regulatory assets associated with the PIRR. (*Id*. at 25-26.)

IEU witness Bowser raises concerns with the PIRR that are not supported by the record and should be rejected by the Commission. Specifically, Mr. Bowser asserts that the single rate established to recover the PIRR is improper, that the balance being applied does not reduce for accumulated deferred income taxes (ADIT), and that the carrying charge of 5.34% to be collected on the unamortized phase-in deferral balance is unreasonable and excessive. As an initial point when IEU Witness Bowser was asked if there are any Commission rules or statutes requiring the treatment of the PIRR he advocates, his answer was no. (Tr. VIII at 1520-21.) As discussed above, according to Mr. Bowser the violation of a Commission rule or Ohio statute is the standard that he uses to define a regulatory principle or practice for purposes of judging a stipulation. Under his standard and admission that the PIRR does not violate that standard the Commission should find this portion of the Stipulation satisfies the review of the term as part of the overall Stipulation for approval by the Commission.

IEU witness Bowser's opinions sand preferences for the structure for the PIRR should also be rejected beyond the fact that they do not violate his definition of a regulatory principle or practice. The fact that the PIRR is being applied as a single rate is a matter addressed by AEP Ohio witness Roush, who pointed out the fact that the Stipulation calls for a merged company and that customers in Columbus Southern Power Company could benefit from reduced fuel adjustment clause costs as a result of the merger offsetting the costs of the PIRR. (AEP Ex. 22 at 7).

The agreement to include a debt carrying charge of 5.34% was a concession made by the Companies compared to the level requested in the *PIRR Cases* that were approved as part of the initial ESP and the ADIT issue is not a requirement of that Commission-approved methodology. As pointed out in the Application in the *PIRR Cases*, the Commission laid out the arguments made in its March 18, 2009 Opinion and Order in the 08-917 and 08-918-EL-SSO cases (*ESP I*), approving, the WACC as the appropriate carrying charge for the term of the recovery of the phased-in fuel expenses. Specifically, the Commission stated, "for purposes of a phase-in approach in which the Companies are expected to carry the fuel expenses incurred for electric service already provided to the customers, we find that the Companies have met their burden of demonstrating that the carrying cost rate calculated based on the WACC is reasonable as proposed by the Companies." *ESP I*, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO Opinion and Order at 23 (Mar. 18, 2009.) The Parties in the case had argued the use of WACC was not reasonable and recommended the use of current long-term or short-term debt as opposed to usage of the WACC. The movement from the WACC to the 5.34% presented as part of the Stipulation contributes to the overall balance of the agreement presented to the Commission and is and further evidence of the reasonableness of the Stipulation. Likewise, the adjustment asserted by IEU witness Bowser for the ADIT was not part of the proposal outlined by the Company that the Commission approved. It is simply a recommendation after the fact by IEU witness Bowser to further compromise the positions already conceded in part by AEP Ohio on this issue and should be rejected in favor of the Stipulation that does not violate any regulatory principles or practices.

The Commission already approved recovery of the phased-in deferrals associated with the unrecovered fuel costs. When the question of timing and length of recover arose the Commission was clear in finding, "that the collection of any deferrals, with carrying costs, created by the phase-in that are remaining at the end of the ESP term shall occur from 2012 to 2018 as necessary to recover the actual fuel expenses incurred plus carrying costs." (*Id*. at 23.).

The Stipulation provides for the recovery ordered by the Commission at a lower carrying charge and provides a resolution to the *PIRR Cases* that provides value to the overall balance of the Stipulation for Commission approval. The PIRR recommended by the Signatory Parties as part of the overall package to settle these cases does not violate any regulatory practices or principles and should be approved by the Commission.

5. Emergency Curtailment Service Tariffs, Case Nos. 10-343/344-EL-ATA, resolution by Stipulation is reasonable and lawful [Par. IV.4]

The Signatory Parties agreed to settle the Emergency Curtailment Service tariff cases (*ECS Cases*) at Paragraph IV.4 in the Stipulation.[51] Under the agreement reached by the Signatory Parties current and proposed emergency curtailment services tariffs are withdrawn and as AEP witness Roush testified the Stipulation allows retail customer participation in PJM demand response programs. (AEP Ex. 2 at 6.) This portion of the Stipulation includes a commitment that any customer already receiving an incentive payment through a reasonable arrangement that offer service discounts from the applicable tariff rates and would currently or would like to participate in PJM programs must agree to commit to the electric distribution utility the peak demand response attributes that have cleared in the PJM marked in a manner consistent with applicable statutes and rules at no cost to the utility for the duration of the arrangement. AEP Ohio witness Roush verified that this agreement is not to be interpreted as modifying the express specific terms of any agreement. (*Id*. at 7.) Also as part of the agreement,

[51] *In the Matter of the Application of Columbus Southern Power Company to Amend its Emergency Curtailment Service Riders*, Case No. 10-343-EL-ATA; *In the Matter of the Application of Ohio Power Company to Amend its Emergency Curtailment Service Riders*, Case No. 10-344-EL-ATA (collectively, *ECS Cases*).

AEP Ohio is also able to issue a request for proposal to meet its peak demand reduction mandates required by S.B. 221. (Signatories' Joint Ex. 1 at 24-25.)

This portion of the Stipulation was unchallenged and represents a reasonable result of the *ECS Cases* as part of the overall compromise in the Stipulation for Commission consideration. Developing competitive demand response opportunities in the State of Ohio can lead to significant economic development advantages for businesses in the State of Ohio -- particularly in industries with high energy costs or those with very competitive pricing. (EnerNOC Ex. 1 at 12.) This provision will help create additional revenues streams for companies in the State that can be important to a company's success. (*Id*.)

As indicated by EnerNOC witness Kenneth Schisler, AEP Ohio's agreement to withdraw the ECS tariffs was a "significant concession." (*Id*. at 6). EnerNOC witness Schisler testified that under the proposed tariffs that are being withdrawn "there were a number of aspects of AEP Ohio's proposed riders that [he] felt would limit the benefits to AEP Ohio customers and consequently the amount of demand response opportunities that would be available." (*Id*. at 8.) Significantly, AEP Ohio has agreed to permit customers to participate in PJM Demand Response Programs directly or through a Curtailment Service Provider. In addition, according to EnerNOC witness Schisler, AEP Ohio has agreed to allow customers with reasonable arrangements to participate in PJM Demand Response Programs – if they agree to commit their demand response attributes to their utility at no cost and he cited the recently released economic development tariff proposed by Staff that included this concept. (*Id*. at 10). The language in the Stipulation merely applies the Staff's proposed language from the proposed economic development tariff. (*Id*.)

The ability to issue a request for proposals (RFP) to meet AEP Ohio's peak demand reduction requirements addresses one of the Companies concerns and has been used in other territories. According to EnerNOC witness Schisler, the concept was utilized by FirstEnergy this past year as "an effective, and cost efficient alternative approach that will help AEP Ohio achieve the same result. The RFP program would allow AEP Ohio to receive peak demand reduction credits toward the AEP Ohio's S.B. 221 obligations at the lowest price possible from entities that are willing to provide that credit and at an agreed price." (*Id*. at 11.)

The Non-Signatory Parties did not file any testimony concerning this provision of the Stipulation. The compromise reached is beneficial and represents a compromise from the position filed by the Companies in the tariff application. The agreement to settle the cases also relieve the Commission docket of a case that was filed over 18 months ago. The initial tariff request was filed on March 19, 2010. The agreed resolution of the ECS Cases is reasonable and lawful and for purposes of Commission review of the Stipulation violates no regulatory principles or practices.

C. As a Package, the Stipulation Benefits Rate Payers and the Public Interest.

AEP Ohio witness Hamrock summarized many of the Stipulation benefits in his testimony. AEP Ohio witness Allen also quantified several of the Stipulation benefits in his testimony. Other supporting witnesses provide testimony of the Stipulation's benefits, including Staff witness Fortney, Exelon witness Dominguez, OEG witness Baron, OMAEG witness Claytor, Grove City witness Honsey, AICUO witness Jones, EnerNOC witness Schisler, Paulding Wind witness Irwin, RESA witness Ringenbach, and Constellation witness Fein. For efficiency and brevity, the list of major Stipulation benefits will be illustrated through a bullet point format for a streamlined presentation on brief.

- The Stipulation promotes sustainable retail competition by providing a reasonable and steady path to fully competitive markets for supplying electricity to AEP Ohio's customers, achieving a desirable long-term result voluntarily that the Commission cannot require of an EDU within an ESP; by agreeing to corporate separation of AEP Ohio's generation and non-generation functions the path is being cleared for competitive auctions to serve AEP Ohio's SSO load. (Par. IV.1.q, r and t.)
- AEP Ohio agreed to provide a two-tiered discount for capacity to CRES providers serving shopping customers, including substantial RPM-priced set asides for 2012 approximately equal to the entire load of Toledo Edison Company; for 2013 roughly equal to the entire load of Dayton Power & Light Company; and for 2013-14 equivalent to the entire load of Duke Energy-Ohio. (AEP Ohio Ex. 7 at 13.) Among others, Exelon witness Dominguez testified in support of the benefits established through this provision. (Exelon Ex. 1 at 4-5.)
- AEP Ohio agreed to slash the previously-authorized carrying charge for AEP Ohio's substantial fuel deferrals (resulting from the Commission's decision in the ESP I cases) by more than half from 11.15% to 5.34%, to the benefit of all customers. (Par. IV.6; AEP Ohio Ex. 4 at Ex. WAA-4.)
- Collection of the Phase In Recovery Rider will be delayed by 12 months for residential customers, saving them $34.4 million in 2012 or $2.32 per month for a typical customer using 1,000 kWh per month. (Par. IV.6.B; AEP Ohio Ex. 4 at 16, Ex. WAA-4.)

- AEP Ohio agreed to forego recovery from customers of generation-related costs associated with implementing corporate separation, to the benefit of all customers. (Par. IV.1.q.)
- AEP Ohio agreed to provide shareholder funds of $3 million annually for the Partnership With Ohio initiative, to benefit residential customers. (Par. IV.1.u.)
- AEP Ohio agreed to provide shareholder funds of $5 million annually for the Ohio Growth Fund initiative, to foster economic development for the benefit of all customers. (Par. IV.1.v.)
- A competitive market-based SSO procurement process is achieved faster than is possible under an MRO (3 ½ years under the Stipulation versus 6+ years under an MRO). (Par. IV.1.r.) Among others, Constellation witness Fein testified in support of the benefits established through this provision. (Constellation Ex. 1 at 5.)
- Through establishment of the Generation Resource Rider, the Stipulation creates a valuable hedging strategy into the future that can provide rate stability and promote economic development in AEP Ohio's service territory, as explained by OEG witness Baron. (OEG Ex. 1 at 12-13.)
- AEP Ohio agreed to application of a ROE threshold throughout the term of the ESP II of more than 400 basis points below the ROE threshold established by the Commission in the litigated 2009 SEET proceeding. (Par. IV.1.g.) Not only does this provide certainty and administrative ease in applying the contentious SEET provision of the ESP statute, but it operates as a highly restrictive check on AEP Ohio earnings during the ESP II term.

- The Stipulation is more favorable in the aggregate than the expected results under an MRO (the entire MRO test issue is discussed separately below in detail under Section VI of the Brief).
- The Stipulation supports development of Ohio renewable energy through one-time upfront prudence approval for the Timber Road Renewable Energy Power Agreement. (Par. IV.1.j.) Among others, Paulding Wind Farm witness Irvin testified in support of the benefits established through this provision. (Paulding Wind Farm Ex. 1 at 3-4.)
- AEP Ohio agreed to drop seven (7) of its controversial rider proposals as part of the settlement, including the Provider of Last Resort Charge (non-bypassable as proposed), the Environmental Investment Carrying Cost Rider (non-bypassable as proposed), the Generation NERC Compliance Cost Recovery Rider (non-bypassable as proposed), the Facility Closure Cost Recovery Rider (non-bypassable as proposed), the Carbon Sequestration Rider (non-bypassable as proposed), and the Rate Security Rider and the Emergency Curtailment Service Rider. (Par. IV.1.a and Par.IV.4.) Among others, City of Grove City witness Honsey testified in support of the benefits established through this provision. (Grove City Ex. 1 at 2.)
- By dropping non-bypassable rider proposals and establishing fixed base generation rates, the Stipulation transfers substantial risk from customers to AEP Ohio while simultaneously improving rate certainty and stability for customers. (Par. IV.1.a and f; AEP Ohio Ex. 8 at 14-15.)

- AEP Ohio has committed to substantial fleet transformation and fuel diversification utilizing Ohio shale gas. In accordance with this key component of the Stipulation, which would not have been possible absent settlement, AEP Ohio will endeavor to enter into competitively priced long-term shale gas contracts for AEP Ohio generation plants with Ohio producers who commit to investment and employment growth in Ohio. (Par. IV.2.a.)
- The Stipulation preserves the ability of AEP Ohio to support development of the 49.9 MW Turning Point solar project, by agreeing to move the pending issues regarding this project to another docket so long as a workable procedural schedule can be established by the Commission that does not endanger the viability of the project. (Par. IV.1.d.)
- Further development of programs and opportunities for the commitment of customer-sited resources and, in exchange for incentive payments to the customer or exemptions from applicable cost recovery mechanisms, in order to help meet AEP Ohio's advanced energy mandates under §4928.64, Ohio Rev. Code, and its energy efficiency and peak demand reduction mandates under §4928.66, Ohio Rev. Code. (Par. IV.1.w.) City of Grove City witness Honsey testified in support of the benefits established through this provision. (Grove City Ex. 1 at 3.)
- Pursue development of up to 350 MW, in total, of customer sited combined heat and power (CHP), waste energy recovery (WER) and distributed generation resources in its service territory. (Par. IV.2.c.)
- AEP Ohio has agreed to form an advisory group of interested Signatory Parties to discuss and explore a distribution rate decoupling mechanism, including rate

design changes for non-demand metered customers. The decoupling advisory group will begin meeting within forty-five days after the Commission's adoption of the Stipulation. (Par. IV.1.n.)

- Adoption of the Distribution Investment Rider (DIR) will allow scaled increases for continued maintenance and improved reliability of AEP Ohio's distribution infrastructure, based on verified and audited capital investments, which translate into additional reliability benefits for customers. (Par. IV.1.n.)
- AEP Ohio has committed to work with the Ohio Hospital Association to identify specific distribution circuit that serve hospitals for targeted reliability improvements under the DIR, subject to maximum investment commitments of $5 million per year during the term of the ESP. (Par. IV.1.n.) OHA witness Fraley testified in support of this provision. (OHA Ex. 1 at 2.)
- Funding of proactive vegetation management programs will continue under the Enhanced Service Reliability Rider (ESR) and is expected to benefit customers by continuing to improve reliability due to reduced tree related interruptions. (Par.IV.1.o; AEP Ohio Ex. 8 at 20-22.)
- AEP Ohio's proposed plug-in electric vehicle (PEV) tariff will be implemented, but the Company will absorb the cost of the proposed $2500 allowance per customer for installation of a charging station and a time-of-use meter (and shall not collect those costs associated with this pilot offering from customers). (Par. IV.1.i.)

As demonstrated and summarized through the foregoing, the Stipulation represents a unique package of substantial benefits for ratepayers that simply cannot be achieved in a litigated setting. The Stipulation also advances the public interest, not only through its compromise as a package of ratepayer benefits, but also in advancing key public policy objectives. Some of the benefits can be quantified and others are qualitative – though no less valuable. In any case, a detailed examination of these aspects of the Stipulation, as set forth above, yields the overwhelming conclusion that the settlement package benefits ratepayers and the public interest.

VI. THE ESP IS MORE FAVORABLE IN THE AGGREGATE AS COMPARED TO THE EXPECTED RESULTS OF AN MRO.

With regard to the Commission's review and approval of a proposed ESP, Revised Code §4928.143(C) provides in relevant part that:

> 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, is more favorable in the aggregate as compared to the expected results that would otherwise apply under section 4928.142 of the Revised Code.

Accordingly, if the proposed ESP, including its pricing and all other of its terms and conditions is more favorable than the expected results of an MRO, then the Commission shall approve the ESP.

AEP Ohio witnesses Hamrock, Thomas, and Allen provided testimony that confirmed that AEP Ohio's proposed ESP, including its pricing and all other terms and conditions, is more favorable in the aggregate as compared to the expected results of an MRO. Mr. Hamrock explained that there are three aspects of the MRO test. The first aspect is the comparison of the ESP pricing to the expected results from an MRO. (AEP Ohio Ex. 8 at 25.) Company witness Thomas provides this comparison. Based on removal of all POLR charges from current ESP prices, Ms. Thomas has estimated that the relative ESP price impact, calculated on a weighted average basis over the January 12 – May 2015 portion of the ESP, as compared to the price of an

MRO, amounts to $0.71/MWH. (AEP Ohio Ex. 5 at Ex. LJT-3.) Company witness Allen has quantified the present value of this calculation, for non-shopping customers, to be -$108 million. (AEP Ohio Ex. 4 at Ex. WAA-6.) Ms. Thomas also explained that if adjustments for future fuel and environmental carrying cost increases during the ESP were considered, which adjustments she did not include in her analysis, the - $0.71/MWH differential could readily become zero. (Tr, XIII at 2353-2354; AEP Ohio Ex. 23 at LJT-R1.)

The next aspect of the MRO test involves evaluating the other, non-price benefits that result from the ESP that would not be available under the MRO option. In addition to quantifying the pricing impact for non-shopping customers, Company witness Allen also quantifies the values of other non-price benefits. Mr. Allen testified that the net present value (NPV) of discounted capacity provided to CRES providers is $856 million, the NPV of the reduced carrying cost rater for the Phase-In Recovery Rider (PIRR) is $104 million, and the NPV of the Partnership With Ohio (PWO) and Ohio Growth Fund (OGF) initiatives is $27 million. He concludes that the aggregate value of the quantifiable price and non-price benefits is approximately $880 million. (*Id*.)

The third aspect of the test considers benefits of the ESP, not available in an MRO, that are not readily quantified yet are nevertheless of significant value. There are a number of such benefits that result from the stipulated ESP, which Mr. Hamrock and Staff witness Fortney describe. For example, the ESP provides a substantially earlier transition to fully market-based prices (about three-and-a-half years) than would be possible through an MRO. The elimination of all POLR charges, which would be in large part nonbypassable, is another such benefit. The commitment to pursue distribution revenue decoupling and alternative customer-sited generation resources are additional benefits not achievable through an MRO. Furthermore, under an MRO, future environmental costs would be explicitly recovered from customers, but will not be under the ESP. In addition, the Stipulation provides for the development of a new generation plant that uses exclusively Ohio shale natural gas, which is a very significant benefit not achievable through an MRO. (*See* AEP Ohio Ex. 8 at 28-29 (Hamrock); Tr. X at 1751-1752 (Fortney).)

All of these factors, which are described in detail below, confirm that the stipulated ESP is more favorable in the aggregate as compared to the expected results under an MRO. (AEP Ohio Ex. 8 at 25-26.)

A. MRO Price Test

AEP Ohio witness Thomas explained that the expected prices that would otherwise occur under an MRO are determined by a weighting of adjusted prior ESP prices and competitive market prices. In her Direct Testimony, Ms. Thomas addressed how the Stipulation ESP prices (provided by Mr. Roush, AEP Ohio Ex. 2), compare to MRO prices during the period of the stipulated ESP (January 2012 through May 2015) until an auction determines ESP prices (June 2015 through May 2016). (*See* AEP Ohio Ex. 5.)

Ms. Thomas explained that two prices are needed to determine the expected results of an MRO during the proposed ESP period – a Competitive Benchmark price and a generation Standard Service Offer price (SSO). (*Id.* at 4.) The Competitive Benchmark price is based on market data and includes the items that would be included by a supplier providing retail electric service to AEP Ohio customers. (*Id.*) The generation SSO price is a function of generation pricing from the Company's 2009-2011 ESP adjusted for certain generation-related items. (*Id.*)

1. Competitive Benchmark Price

With respect to the Competitive Benchmark price, the Company's approach was based on ten distinct components using verifiable, publicly available information for each component wherever possible. (*Id.* at 5-6.) Where more qualitative data was used, the experiences of various deregulated states were used to reflect a reasonable and balanced approach in determining an appropriate charge. (*Id.* at 6.) Based on the ten components, Competitive Benchmark prices were developed for the residential, commercial and industrial classes and were then weighted based on MWh to determine total Competitive Benchmark prices for AEP Ohio. Prices were also developed for three periods. The first period was 2012, the second was the 17-month period for January 2013 through May 2014, and the third period was for June 2014 through May 2015. (*Id.*)

> Other than the capacity component, the other nine components of the CBP are:
>
> 1. Simple Swap (SS) – this component is the "around the clock" price of the industry standard energy product.
>
> 2. Basic Adjustment – this adjustment is based on the historic relationship between pricing points. Applying such an adjustment to the AEP-Dayton Hub SS prices results in prices at the AEP load zone, which is where PJM settles all AEP Ohio loads.
>
> 3. Load Following/Shaping Adjustment – this adjustment, applied to the SS component, accounts for the fact that customers do not use a constant amount of energy across all hours of the day and that customers will deviate from their historic load profile.
>
> 4. Ancillary services – this component prices the cost of ancillary services required by PJM to serve load in the Company's service territory.
>
> 5. Alternative Energy Requirements – Section 4928.64, Ohio Revised Code requires that all suppliers meet certain requirements for the mix of alternative energy resources that must be used to serve load in Ohio.
>
> 6. ARR Credit – this item captures the credit allocated to offset PJM congestion charges.
>
> 7. Losses – this component captures the cost of distribution and fixed transmission losses that must be supplied in order to meet the customer's power requirements at the meter.
>
> 8. Transaction Risk Adder – this item reflects a variety of risks that vary based on the unique profile and business objectives of an individual bidder.

> 9. Retail Administration Charge – the component captures the costs that a supplier would incur to participate in an auction and fulfill the contractual obligations in the event the supplier was successful in the auction.

(*Id*. at 6-8.)

The final component of the CBP is the Capacity Component. Ms. Thomas explained that this component includes the capacity cost that a supplier, either a CRES (competitive electric retail service) provider or winning bidder in an auction, would incur to serve a retail customer in AEP Ohio's service territory. (*Id.* at 9.) The first capacity scenario is identified in Paragraph IV 2.b.1 of the Stipulation as $255/Mw-day for the period January 2012 through May 2015. The second capacity scenario is also identified in Paragraph IV 2.b.1 of the Stipulation as the "PJM RPM-based capacity rate." (Signatories' Joint Ex. 1 at 20-21.) Various adjustments are also identified as being applicable to the RPM-based capacity rate for billing purposes, including capacity losses, and the capacity rates vary by planning year. These rates, as supported by Company witness Pearce, are provided in Exhibit KDP-5 of his testimony, and are restated in Table 1 of Ms. Thomas's Direct Testimony. (AEP Ohio Ex. 5 at 7-10.)

Using the capacity prices for each of the two scenarios, Ms. Thomas calculated Competitive Benchmark prices, one for each capacity price, by customer class, for 2012, January 2013- May 2014, and June 2014 through May 2015. (*Id.* at 10-11, Tables 2 and 3.)

Ms. Thomas then determined the Expected Bid Price using the Competitive Benchmark prices that resulted from the $255/MW-Day and the RPM-based capacity prices. The Stipulation provides that certain amounts of capacity for shopping load will be priced at RPM levels. Amounts of capacity for shopping load beyond the RPM-set aside amounts will be billed at $255/MW-Day. Accordingly, the weighted average Expected Bid Price ($70.98MWh as shown on line 8 of Exhibit LJT-3) is based on a weighting of the two Competitive Benchmark prices that reflect those different capacity rates. The weightings by year were derived as shown in Table 5 of Ms. Thomas's Testimony. (*Id.* at 13.)

2. Most Recent Generation Price

The second price necessary to determine the expected results of an MRO during the proposed ESP period is, pursuant to § 4928.142(D), Ohio Rev. Code, the EDU's "most recent standard service offer price" which may be adjusted for any of four identified cost components. Those four cost components are fuel, purchased power, costs of satisfying supply and demand portfolio requirements for Ohio (renewable and energy efficiency requirements), and costs to comply with environmental laws and regulations. (*Id.* at 11.)

The Company's "most recent standard service offer price" is the current ESP's generation rate approved by the Commission. In order to make that generation rate comparable with the Competitive Benchmark, Ms. Thomas made an adjustment to utilize the most recent fuel costs approved by the Commission in Case No. 11-281-EL-FAC. (*Id.* at 12.) Ms. Thomas made no further adjustments other than reflecting the carrying costs of environmental capital investment through 2011. (*Id*.)

3. The MRO Annual Price

As described in Section 4928.142, Ohio Revised Code, the MRO Annual Price is determined by weighting the Generation Service Price and the Expected Bid Price. The prices are weighted for each "year" of the period (January 2012 through May 2015) resulting in the average MRO Annual Price shown in Line 13 of Exhibit LJT-3 ($60.44) of Ms. Thomas's Direct Testimony. This MRO Annual Price is the basis for comparison to the Stipulation ESP Prices for the period. AEP Ohio witness Roush supports the Stipulation ESP Prices shown on line 15 of Exhibit LJT-3 of Ms. Thomas's Direct Testimony. (AEP Ohio Ex. 5 at 13-14, Ex. LJT-3.)

If AEP Ohio were to be in an MRO, R.C. 4928.142(D) would require that the MRO be phased in. Accordingly, Ms. Thomas applied the appropriate MRO "blending" percentages to the Expected Bid Price and the Generation Service price for each of the three blending periods of the ESP. The weightings that she used for each period to determine the MRO Annual Prices are summarized in Table 6 of her Direct Testimony. (*Id.* at 14.) Even though there are only three distinct periods for the development of the Expected Bid Price, increased weightings were applied each year consistent with the increased weightings set forth in Section 4928.142(D), Ohio Revised Code. (*Id.* at 15.) For 2012, a weighting of 10% was applied to the Expected Bid Price. For the 17-month period of January 2013 – May 2014, a composite weighting of 23% was applied to the Competitive Benchmark price. A composite weighting of 34% was used for the third 12-month period of June 2014 – May 2015. (*Id.* at 14, Table 6.)

As shown in Exhibit LJT-3 to Ms. Thomas's Direct Testimony, the Stipulation ESP Price ($61.15) is slightly higher than the weighted average MRO Annual Price ($60.44), resulting in a value of ($71/MWh). However, this first element of the MRO/ESP comparison does not include all of the benefits provided by the Stipulation. As explained below, the additional quantitative and qualitative benefits of the Stipulation confirm that the Stipulation ESP is more beneficial than the expected result of an MRO.

B. Price And Non-Price Quantifiable Net Benefits Of The ESP

AEP Ohio witness Allen quantified non-price benefits of the Stipulation ESP and also summarized the net benefits of all readily quantifiable price and non-price impacts. (AEP Ohio Ex. 4 at 18-20.) Mr. Allen noted that as a part of the Stipulation ESP, AEP Ohio is providing capacity to CRES providers at a significant discount to the price at which AEP Ohio would be willing to provide capacity under an MRO. (*Id.* at 18.) In addition, AEP Ohio has agreed to reduce the carrying costs on the PIRR (Phase-In Recovery Rider) regulatory assets from the WACC rate previously approved by the Commission in Case Nos. 08-917-EL-SSO and 08-918-EL-SSO to a debt rate of 5.34%. (*Id.* at 18-19.) Mr. Allen noted that AEP Ohio has also agreed not to seek recovery from customers of generation-related costs associated with implementing corporate separation (paragraph IV.1.q, Page 11). (*Id.* at 19.) In addition, he recounted that AEP Ohio has agreed to provide funding for the Partnership With Ohio (PWO) initiative of $3 million annually and the Ohio Growth Fund (OGF) initiative of $5 million annually during the term of the ESP. (*Id.*)

He noted that in Case No. 10-1261-EL-UNC, Mr. Allen estimated the net present value (NPV) of each of these benefits. As shown in Exhibit WAA-6 to his Direct Testimony, the NPV benefit of the discounted capacity provided to CRES providers is $856 million, the NPV benefit of the reduced PIRR carrying cost rate is $104 million, and the NPV benefit of the PWO and OGF initiatives, collectively, is $27 million.

Witness Thomas shows that the MRO price test would result in a cost of $0.71/MWH on a weighted average basis over the ESP period prior to when an auction determines ESP pricing. (*See* AEP Ohio Ex. 5 at Ex. LJT-3.) Witness Allen has quantified the present value of this calculation, for non-shopping customers, to be -$108 million. (AEP Ohio Ex. 4 at Ex. WAA-6.) The other quantifiable benefits as reflected in Exhibit WAA-4, substantially outweigh this $108 million cost. Specifically, the sum of the quantifiable benefits of the Stipulation still would have a net present value of $880 million under this scenario. (*Id.* at 18-19, Ex. WAA-4.)

Mr. Allen also noted that the SEET ROE threshold included in Paragraph IV.l.g. of the Stipulation provided an additional substantial potential benefit. (*Id.* at 19.) He noted that in Case No. 10-1261-EL-UNC, the Commission determined that a SEET threshold of 17.6% was appropriate. Mr. Allen applied the 4.1% difference in the SEET threshold approved in that case and the threshold agreed to in the Stipulation to the expected 2015 equity balance and concluded that this provision of the Stipulation could result in added customer protection of approximately $120 million. (*Id*.)

C. Qualitative Benefits of the ESP

Mr. Hamrock testified to the substantial benefits that the Stipulation provides that are not as readily susceptible to quantification as those discussed above. He explained that consideration of these qualitative benefits must be included in the evaluation of whether the ESP in the aggregate is more beneficial than an MRO. There are a number of such benefits that the stipulated ESP provides, compared to what an MRO would provide, and they are significant. Mr. Hamrock observed that, as one example, for those customers (and marketers and suppliers) that want market-based generation prices sooner, rather than later, the ESP provides an earlier transition to fully market-based prices (about three-and-a-half years) than would be possible through an MRO, which requires a significantly longer period for the transition (at least six years). (AEP Ohio Ex. 8 at 29.) Staff witness Fortney identified AEP Ohio's commitment to support development of shale gas resources as another significant benefit of the Stipulation ESP that would not be available under an MRO. (Tr. X at 1752.)

As Staff witness Fortney testified, two of the biggest benefits of the Stipulation cannot be quantified but should weigh heavily in favor of finding that the MRO test is satisfied:

> Q. In your assessment and on behalf of staff do you believe that the package as a whole in the aggregate is more beneficial than an MRO and should be approved?
>
> A. I believe based upon two of those items that I mentioned as benefits to the stipulation but unquantifiable, one being AEP moving – changing their business structure and agreeing to go to a competitive bid in 2015 is that they would -- at that time would be at market, and also I believe that probably the biggest unquantifiable thing is the MR6, building a plant that uses natural gas, building a

> plant that uses exclusively Ohio shale natural gas is a benefit that is in line with what I understand to be the state policy, but I do not believe that anyone can possibly quantify the economic benefits of that provision.
>
> But certainly I would ask the examiners and the Commission to look at those two issues as important in being part of the comparison of the ESP to the MRO.

(Tr. X at 1752.)

Although not so readily quantifiable as other benefits, AEP Ohio's agreement to eliminate POLR charges that, in large part, are non-bypassable, is another significant benefit to customers. Even though the Commission's October 3, 2011 Remand Order eliminated the 2009-2011 POLR Charges, the Commission found that POLR charges are lawful and that AEP Ohio could implement such a charge if it provided sufficient evidence of its POLR costs; thus, giving up the POLR charge option as part of its ESP II plan still has value. In addition, Mr. Hamrock testified, as a result of the Stipulation, shopping customers who return during the new ESP, who waived POLR charges while away, may return at the SSO price, as opposed to being subject to market-based pricing for their SSO service upon return. (AEP Ohio Ex. 8 at 28.) AEP Ohio's commitment to pursue a distribution decoupling mechanism and alternative customer-sited generation resources are yet additional benefits not achievable through the MRO alternative. (*Id.* at 28-29.) Furthermore, under an MRO, future environmental costs would be explicitly recovered from customers, yet the stipulated ESP has no such recovery mechanism. (*Id.* at 29.) In addition, through the Stipulation's fixed non-fuel generation rates, customers will have known rate certainty over the transition period. AEP Ohio, on the other hand, faces the exposure to the risk of cost increases over this period which will have to be managed. (*Id*.)

Mr. Hamrock concluded that the ESP that results from the Stipulation is substantially more favorable than an MRO, in the aggregate, with regard to its pricing, its other quantifiable benefits, and its other less-quantifiable benefits.

D. Criticisms By Opponents Of The Stipulation That The Stipulation ESP Is Not More Favorable Than An MRO Are Without Merit.

The intervening parties opposing the Stipulation present a number of criticisms of AEP Ohio's assessment of the benefits of the Stipulation ESP, in the aggregate, compared to the expected results of an MRO. For example, FES witness Schnitzer contends that higher fuel costs, based on a nearly year-old forecast, should be incorporated into the assessment. Mr. Schnitzer and IEU witness Murray argue that the capacity component of the Competitive Benchmark Price can only be based upon RPM prices and that the capacity pricing that the Stipulation provides may not be used. Mr. Murray contends that prices from prior auctions conducted by FirstEnergy's EDUs should be used, instead of Competitive Benchmark prices, to establish expected market prices for AEP Ohio. Mr. Murray also contends that the June 2015 through May 2016 competitive auction year should be incorporated in the MRO price test computation. Mr. Schnitzer and Mr. Murray believe that estimates of the costs of the Turning Point Solar project should be included in the placeholder Generation Resource Rider (GRR) and, thus, in the MRO test's computation; Mr. Schnitzer additionally would estimate costs associated with modification or termination of the AEP Pool and include his estimated costs in the placeholder Pool Modification/Termination Rider. Mr. Murray also criticizes AEP Ohio for not including non-generation "costs" of the ESP in the MRO price test and for not presenting MRO price test results on an operating company (i.e., CSP and OPCo) specific basis. Each of the criticisms is without basis.

1. It Is Not Necessary To Use Forecasted Fuel Costs And Other Adjustments To The Most Recent Generation SSO Price, But Such Adjustments Would Not Adversely Affect the Results of the MRO Price Test.

In FES witness Schnitzer's Direct Testimony, at pages 14-16, and in his cross examination testimony, at Tr. Volume VII at pages 1427 through 1433, Mr. Schnitzer maintains that the Company underestimates the fuel cost component of the Stipulation ESP price. Generally, the Non-Signatory Parties contend that the Company erred by not including the forecasted fuel changes reflected on FES Exhibit 10 (Confidential) as part of the MRO Price Test.

First, it is not necessary to include forecasted fuel changes in the MRO Price Test. While § 4928.142(D), Ohio Revised Code, provides the option of adjusting 2011 prices for changes in 1) fuel, 2) renewable requirements, 3) purchased power and 4) environmental capital investment, it does not require such adjustments for purposes of the MRO Price Test. Notably, in prior SSO cases, the Commission has not required that such forecasted data be reflected in the MRO Price Test. *In Re AEP Ohio*, Case Nos. 08-917 and 08-918-EL-SSO, Staff Ex 1A, and Opinion and Order, at 71-72; *In Re Duke Energy Ohio*, Case No. 08-920-EL-SSO, Opinion and Order, at 11-13 and Attachment 2. Consequently, Ms. Thomas did not adjust any of these items in her MRO Price Test beyond reflecting the full costs of fuel for 2011 and incremental environmental investment in 2011. (AEP Ohio Ex. 5 at 12.)

Moreover, if adjustments are going to be made, Ms. Thomas observed there should be comparable treatment of all factors subject to adjustment; it would be inappropriate to change just one factor. That is, if fuel changes are forecasted for the period of January 2012 through May 2015, then so should any significant changes to any of the factors subject to adjustment under § 4928.142(D) listed above. The two most significant of these items are environmental and fuel. (AEP Ohio Ex. 23 at 3.) Notably, as explained below, Ms. Thomas showed in her rebuttal testimony that, if adjustments are made for both forecasted increases in fuel costs and environmental costs, the result would be an *increased ESP Price Benefit* under the MRO Price Test, compared to the results that she calculated in Ex. LJT-3 to her Direct Testimony, AEP Ohio Ex. 5.

Exhibit LJT-R1 to Ms. Thomas's rebuttal testimony, AEP Ohio Ex. 23, provides an analysis that includes forecasted fuel and environmental costs for the period January 2012 – May 2015.[52] Through that analysis she addresses the issue that Mr. Schnitzer raises. First, Ms. Thomas included the forecasted costs of additional environmental investments during that period. Next, she determined how much fuel costs could change during that period while still providing no adverse impact on the MRO Price Test results that she provided in her Exhibit LJT-3 to her Direct Testimony (AEP Ohio Ex. 5), which did not include forecasted changes in either environmental or fuel costs. As shown in her Exhibit LJT-R1, fuel costs would have to average more than $40.25/MWh during the period January 2012 – May 2015 to produce an adverse impact on her MRO Price Test.

Ms. Thomas explained that the level of fuel cost increase ($7.25/MWh) necessary to increase the total fuel cost from the level that Ms. Thomas used in her analysis to $40.25/MWh is highly unlikely for several reasons. First, the 2011 level of full fuel cost that Ms. Thomas utilizes is only $33/MWh. There is no record basis for believing that fuel costs will increase by an average of $7.25/MWh from that level during the 2012 –May 2015 period. (AEP Ohio Ex. 23.) Second, the Company's fuel forecast for 2012-2014, relied upon by FES witness Schnitzer

[52] Exhibit LJT-R1 uses an average of the high and low environmental costs presented by FES witness Schnitzer. Mr. Schnitzer provided this environmental data in Exhibit MMS-4, pages 2 and 4, of his revised testimony filed on October 13, 2011.

in his filed confidential testimonies and reflected on FES Confidential Exhibit 10 in this case, results in fuel costs less than the $40.25/MWh maximum amount determined in Exhibit LJT-R1. Consequently, even if the fuel cost increases that Mr. Schnitzer believes should be included in the analysis materialize, there would be no adverse impact on Ms. Thomas' MRO Price Test. In other words, the forecasted environmental cost increases offset the FES Exhibit 10-based forecasted fuel cost increases. Third, due to anticipated increased shopping under the Stipulation, there will be less non-shopping load during the ESP than was anticipated at the time that the forecast reflected in FES Ex. 10 was developed. Fuel factors generally decrease when less load is served and generation resources remain the same. Accordingly, AEP Ohio's fuel forecast for 2012-2014 as provided early in this case is likely overstated. (AEP Ohio Ex. 23 at 3.)

Based on the results of the analysis, the inclusion of forecasted fuel and environmental costs has no adverse impact on the MRO Price Test. In fact, the impact would be an increased ESP Price Benefit under the MRO Price Test. This result is obtained because forecasted fuel averages less than $40/MWh regardless of whether the Company's initial fuel forecast is used or a reduced forecast is used to reflect customer shopping under the Stipulation. Indeed, as Ms. Thomas explained, for every $1 that average fuel costs during the January 2012-May 2015 period are below $40.25/MWh, there would be an approximate $.25/MWh increased benefit (reduction) of the ESP price, compared to the MRO price. (Tr. XIII at 2353-54; AEP Ohio Ex. 23 at Ex. LJT-R1.) Consequently, the criticisms of the Non-Signatory Parties related to the fuel forecast and the MRO Price Test are meritless.

2. Stipulation Capacity Prices Are Appropriate To Use for the Capacity Component Of The Competitive Benchmark Price.

FES witness Schnitzer and IEU witness Murray object to AEP Ohio's use of the Stipulation's capacity pricing (RPM-priced capacity for load up to the set-aside levels and

$255/MW-Day for load above the set-aside levels) for purposes of calculating the capacity component of the Competitive Benchmark and, thus, for estimating expected market prices. They contend, apparently, that RPM prices (or pricing that approximates RMP prices) would be the only appropriate values that may be used for determining the Competitive Benchmark prices (FES Ex. 3 at 20-24 (Schnitzer); and IEU Ex. 9A, at 32-38 (Murray).)

These objections to the use of the Stipulation's capacity pricing for purposes of determining the capacity component of the Competitive Benchmark price are without basis. The Stipulation's capacity pricing, once adopted by the Commission, will establish the appropriate charges for use of AEP Ohio's capacity, both for the purpose of sales to CRES providers and for purposes of estimating the wholesale cost of capacity used by competitive bidders that would seek to provide generation service for the competitively bid portion of the hypothetical MRO. It is not only required by the Stipulation, it is within the Commission's discretion to use the capacity pricing levels established by the Stipulation to establish the capacity component of the Competitive Benchmark price. This is so because in order to calculate the benchmark, the Commission must select pricing for the capacity component, recognizing that AEP Ohio is an FRR entity during the period that Competitive Benchmark price is needed. The Stipulation's capacity pricing represents a negotiated compromise of the competing litigation positions of the parties in the *Ohio Capacity Pricing Docket*, Case No. 10-2929-EL-UNC and in the related FERC capacity pricing proceedings, *Section 205 FERC Application* and *Section 206 FERC Complaint.* If the Ohio Capacity Pricing Docket and the FERC capacity pricing proceedings were litigated to a conclusion, it is difficult to predict with certainty whether those conclusions would favor AEP Ohio (embedded cost-based capacity pricing at $355/MW-Day) or FES and IEU (RPM pricing). It is entirely reasonable for this Commission to conclude that the

Stipulation's capacity pricing is appropriate for the purpose of the capacity component of the Competitive Benchmark price.

Notably, IEU witness Murray actually supports the process used and, thus, the capacity pricing that the Stipulation provides, At page 37 of his Direct Testimony, IEU Ex. 9A, Mr. Murray recommends that "the Companies could negotiate a price at which they would sell capacity resources they have designated under their FRR Plan to potential suppliers in the CBP and bidders could reflect these prices in their bids." This is exactly what the Stipulation capacity prices represent – a negotiated price for capacity available to CRES providers and CBP bidders.

In sum, use of the Stipulation's capacity pricing to establish the capacity component of the Competitive Benchmark is reasonable and it is required by the Stipulation.

3. FE Auction Prices Are Not A Valid Proxy for AEP Ohio Expected Market Prices.

IEU witness Murray advocates that, instead of using an AEP Ohio-specific Competitive Benchmark price to determine expected market prices for the MRO Price Test, the Commission should use results from past FirstEnergy auctions as a proxy for expected market pricing for AEP Ohio. (IEU Ex. 9A, at 38-40.) Mr. Murray states that "It is unreasonable to resort to administratively determined estimates of competitive power prices when real results are readily available and more reliable." (Id., at 28-29; Tr. XI, at 1893, lines 3-25, and 1894, lines 1-3.) Accordingly, for the purposes of his MRO Price Test in Exhibit KMM-11 to IEU Ex. 9A , Mr. Murray uses the January 2011 FE Auction price for the June 2011 to May 2014 delivery period ($57.47/MWh). However, in both his prefiled direct testimony and on cross-examination, Mr. Murray fails to recognize the many reasons that these "real results" from FE's auction are not applicable to AEP Ohio. (Tr. XI, at 1897-1905.)

Ms. Thomas explained that there are numerous reasons, both quantifiable and non-quantifiable, why FE's auction results are not applicable to AEP Ohio. The first and most obvious difference is the delivery period for the FE auctions and the applicable period of the ESP for AEP Ohio. These periods are not the same and do not even include the same number of months as shown in Table 1 below. It would be inappropriate to assume that prices for two different delivery periods would be the same. (AEP Ohio Ex. 23 at 5 and Table 5.)

	FirstEnergy		AEP Ohio	
Year	Period	# Months	Period	# Months
2011	Jun-Dec	7	N/A	0
2012	Jan - Dec	12	Jan - Dec	12
2013	Jan - Dec	12	Jan - Dec	12
2014	Jan-May	5	Jan - Dec	12
2015	N/A	0	Jan - May	5
Total		36		41

'Ms. Thomas noted that, because the FE auction procured a full requirements product, it would include the items priced in the Company's Competitive Benchmark. IEU witness Murray acknowledges that the full requirements product would include energy (Tr. XI at 1898-1899.) Because the Simple Swap is the market price of energy, it is appropriate to use the Simple Swap as an estimate of the energy component of the FE auction price, contrary to Mr. Murray's assertion that there is nothing akin to a simple swap contained in the FE auction prices. (*Id*. at 6.)

In her rebuttal testimony, Ms. Thomas showed how Simple Swap prices moved based on market data for the dates where the FE auction has already been held. As shown in Table 2 of Ms. Thomas's rebuttal testimony (AEP Ohio Ex. 23 at 7), prices moved upward over the three-month period between FE auctions. For comparison purposes, also included are Simple Swap prices based on the five trading days used to determine the Simple Swap component of the Company's Competitive Benchmark price. Ms. Thomas observed that this price movement over time is one of the many reasons why the FE auction price established at a prior point in time would not be applicable to future AEP Ohio auctions. (*Id*. at 6-7.)

In addition to the Simple Swap, Ms. Thomas identified three other components of a full requirements product, excluding capacity, where the differences between the FE EDUs and AEP Ohio are easily quantifiable. She concluded that each of these differences would have a quantified impact on auction prices for AEP Ohio as well:

1. Basis Adjustment – FE and AEP Ohio are in different zones within PJM and prices can be different between those zones. Even FES witness Schnitzer recognizes that prices for the AEP zone have historically been about $3/MWh higher in the AEP zone than for FE. (Schnitzer July 25 testimony, page 27, line 26) This is consistent with Ms. Thomas's review of available information. (AEP Ohio Ex. 23 at 7-8.) The available information included FirstEnergy investor presentations differences between FirstEnergy and the AD Hub of $2.49/MWh plus the basis differential the company quantified of $0.58/MWh that produces a total of $3.07/MWh. (Tr. XIII at 2326-2327.)

2. Alternative Energy Requirement – Even Mr. Murray recognizes that the FE auction did not include costs to meet Ohio alternative energy requirements (IEU Ex. 9A at 39). Ms. Thomas calculated that the average cost included in the AEP Ohio's Competitive Benchmark price for such requirements is $0.69/MWh for January 2012 – May 2014. (AEP Ohio Ex. 23 at 8.)

3. Losses – Ms. Thomas explained that the FE EDUs' auction prices do not include losses because the prices apply to loss adjusted MWhs, i.e., losses are included in the

> MWh. AEP Ohio's Competitive Benchmark price applies to metered MWhs and therefore losses are included in the price. Ms. Thomas calculated that this results in an average price difference of $1.81. (*Id.*)

Ms. Thomas also explained that there is a fundamental difference in capacity pricing during the period of the Stipulation ESP between AEP Ohio and FE.   Ms. Thomas noted that, as discussed by Company witnesses Nelson and Pearce, and as addressed by the Stipulation, AEP Ohio is currently an FRR entity and will not change to RPM status until the planning year 2015-2016. On the other hand, as Mr. Murray acknowledges, FE held transitional FRR auctions to obtain capacity before becoming an RPM entity beginning in June 2013. (Tr. XI at 1899-1900.) Accordingly, FE's auction pricing takes into account the results of the transitional capacity auctions while AEP Ohio's Competitive Benchmark prices are appropriately based on the negotiated capacity pricing stated in the Stipulation which is a combination of RPM-based pricing and $255/MW-Day. (AEP Ohio Ex. 23 at 8.)

Ms. Thomas explained that, even for the RPM-based component of AEP Ohio's capacity price, there are differences between it and FE's capacity price. While the PJM auction is held three years in advance, FE's capacity auction was held in 2010 - only one year in advance for planning year 2011/2012 and only two years in advance for planning year 2012/2013. IEU witness Murray addresses differences in the base residual auction prices. However, he does not consider the adjusted prices that apply within each zone. (IEU Ex. 9A, at 33-34.) When considering the applicable scalars that apply to RPM-based prices in each zone, there is a difference in the pricing for each zone. Ms. Thomas calculated that the average difference in capacity pricing (considering RPM-based prices only) for the period June 2011 through May 2014 is approximately $0.43/MWh. (AEP Ohio Ex. 23 at 9.)

Ms. Thomas noted that, given the limitations of available data, she did not attempt to address the differences between FE and AEP Ohio regarding the Competitive Benchmark price components for Load Following/Shaping Adjustment, Ancillary Services, ARR Credit, Transaction Risk Adder and Retail Administration Charge. However, she testified, there is no reason to believe that pricing for those components would be the same for FE and AEP Ohio. (AEP Ohio Ex. 23 at 9.)

Ms. Thomas determined that, when the readily quantifiable differences are accounted for, there exists only a small remaining difference in price (less than $3.00/MWh) between the administratively-determined Competitive Benchmark price used to develop the Expected Bid Price for AEP Ohio, on the one hand, and the FE utilities' recent auction results. (*Id.* at 10, Table 3.) In other words, when properly adjusted for just some of the known differences between the circumstances of the FE auctions and those that would apply to AEP Ohio, it becomes evident that the Competitive Benchmark prices, and therefore the Expected Bid Price, that Ms. Thomas has calculated provides a reasonable estimate of expected market prices. When the other variances between the past FE auctions and future AEP Ohio auctions that Ms. Thomas points out are considered, including the fact that the delivery periods for the FE auctions differ from those that would apply to auctions conducted for AEP Ohio and the fact that the timing of FE auctions is much earlier than would occur for any AEP Ohio auctions, it is also evident that the FE auctions and their prices do not provide a suitable proxy for expected market prices for AEP Ohio. Moreover, the appropriateness of using Ms. Thomas's Competitive Benchmark prices and resulting Expected Bid Price is equally evident.

4. It Is Not Necessary To Include The Auction Year (June 2015-May 2016) In The MRO Price Test.

IEU witness Murray asserts that Ms. Thomas improperly omitted the initial auction year (Auction Year), which is the final twelve month-period June 2015 - May 2016 of the ESP, from her MRO Price Test analysis. Mr. Murray contends that, when that final year of the ESP is included in the MRO Price Test, the Stipulation ESP is less favorable than the expected result of an MRO by $.48/MWh or $92 million over the term of the ESP. Mr. Murray develops his MRO annual price for the auction year using a weighting of the 2011 ESP generation rate and the expected market price. (IEU Ex. 9A, at 43-44, Ex. KMM-11.)

Mr. Murray's criticism is incorrect. In compliance with Paragraph IV.1.r of the Stipulation, AEP Ohio will use a competitive bidding process (CBP) to meet its SSO obligation for the Auction Year and its retail tariff SSO generation rates will be set accordingly. As a result, the MRO Annual Price and the Stipulation ESP Price are equal to the Expected Bid Price (CBP or auction price). As shown in Exhibit LJT-R2, Page 1 of 2, this results in a zero benefit. That is, an ESP and a MRO would produce the same pricing result. (AEP Ohio Ex. 23, at 11.)

Contrary to Mr. Murray's argument, it is not appropriate to use any weighting of legacy generation rates for the Auction Year because 100% of the load will be subject to competitive bid. The blending percentages specified in Section 4928.142 (D), Ohio Revised Code, must correspond to the amount of load that is put up for competitive bid. Thus, if 10% of the load is competitively bid under the MRO, then the pricing is based on 10% market and 90% legacy generation rates. Mr. Murray's approach ignores that linkage by using a weighting that is based on 56% of load being priced at the legacy generation rate even though 100% of the load will be competitively bid. (*Id.*, at 11-12.)

Since 100% of the load is to be competitively bid for delivery in the Auction Year, it is nonsensical to impose pricing based on a blend of legacy ESP rates that include items such as the fuel adjustment clause (FAC). As explained in Paragraph IV.1.m of the Stipulation, the FAC, in its current form, will continue only through May 31, 2015. (*Id.* at 12.)

Because Mr. Murray uses an incorrect blending of prices in his MRO Price Test, it is not surprising that he arrives at an incorrect conclusion that the Auction Year has a negative impact on the MRO Price Test. The correct application, as shown in Exhibit LJT-R2, Page 1 of 2, shows the proper result. Because the proper application of the MRO Price Test to the last year of the ESP results in a zero impact, its inclusion or exclusion from the MRO Price Test has no impact on the ESP Price Benefit. (*Id.*)

The Commission has recognized the appropriateness of applying the MRO Price Test in this fashion when the ESP contains a period in which all SSO is being supplied through wholesale power purchased by a CPB. In its Opinion and Order, at page 44, in Case No. 10-388-EL-SSO, the Commission concluded that "[u]nder the proposed ESP in the Combined Stipulation, the rates to be charged customers will be established through a CBP; therefore, the rates in the ESP should be equivalent to the results which would be obtained under Section 4928.142, Revised Code …." Exhibit LJT-R2, page 1 of 2, illustrates, and implements, this conclusion.

Paragraph IV.1.r of the Stipulation requires that AEP Ohio use a CBP to meet its SSO obligation for the Auction Year. Also, Paragraph IV.1.q requires the Company to implement full legal corporate separation. As a result, when the CBP is used to supply SSO load beginning in June 2015, the EDU will have divested its generation. Therefore, the SSO load will be served with purchased power acquired through the CBP.

While the Company does not agree with Mr. Murray's approach, that approach does not account for the purchased power resulting from the CBP that would be required to meet the Company's SSO obligation. Section 4928.142(D) would permit an adjustment to the 2011legacy generation price to allow for increased purchased power expenses. If the legacy ESP price is adjusted for the purchased power resulting from the CBP and a weighting factor of 56% is applied to this price under IEU witness Murray's theory of the MRO test, the results, as shown in Exhibit LJT-R2, Page 2 of 2, are identical to those shown in Exhibit LJT-R2, Page 1 of 2. Each page shows that the MRO Annual Price and the Stipulation ESP Price are equal to the Expected Bid Price (i.e., the CBP or auction price). Therefore, even IEU witness Murray's theory of the MRO Price Test for the Auction Year, when it is implemented properly, demonstrates that there is no impact on the ESP Price Benefit (shown on line 16 of page 1 and on line 17 of page 2 of LJT-R2). (AEP Ohio Ex. 23, at 13-14 and Ex. LJT-R2.)

5. GRR and PMR Placeholder Riders

As explained above, the Stipulation would establish as placeholders a Generation Resource Rider (GRR) and a Pool Modification Rider (PMR). The GRR provision provides AEP Ohio with a mechanism to seek recovery of costs associated with the Turning Point Solar project and the MR6 project, only if the Commission in a subsequent rider case approves a charge associated with one of those facilities. There will only be a non-zero rate for the GRR after such time, if at all, that the Commission approves a project-specific charge. (AEP Ohio Ex. 4, at 3-4.) The PRM also is established with an initial rate of zero. Only if the impact of Pool termination/modification on AEP Ohio during the term of the ESP is greater than $50 million prior to May 31, 2015, may the Company apply for recovery of costs. Any such request for recovery would be through a separate rider case and subject to Commission review and approval.

(AEP Ohio Ex. 7. at 24-25.) In the case of both GRR and PRM, all parties would have the right to challenge whether and what amount of cost recovery is appropriate.

Because these two riders are placeholders with zero rates, and because at this point it is speculative to estimate whether, let alone what level of, rates AEP Ohio might propose for the riders during the Stipulation ESP, and because it would be speculative to estimate what cost-recovery the Commission might provide during the ESP if AEP Ohio would make such applications, AEP Ohio did not include in its MRO Price Test any amounts attributable to these riders.

Ms. Thomas and Mr. Allen explained that the GRR is simply a “place holder until such time as the Commission approves any project-specific costs to be included in the GRR.” (AEP Ohio Ex. 5 at 15; AEP Ohio Ex. 4 at 4; Tr. IV at 596-597.) Because the GRR does not presently account for or represent any charges, there are no charges under the GRR to be included in the MRO price test. Additionally, Ms. Thomas noted that because the GRR is a nonbypassable rider, whether it is included in the MRO price test or not has no impact on the outcome of the test. (AEP Ohio Ex. 5 at 16.) Further, as Mr. Allen pointed out in his Direct Testimony, under Paragraph IV.1.d of the Stipulation (Signatories’ Joint Ex. 1 at 6), the Signatory Parties have reserved the right to contest or otherwise take positions in the separate future cases that will determine whether to establish a nonbypassable charge and the appropriate level of the charge through the GRR. (*Id.*) Accordingly, because its inclusion would not impact the outcome of the test, and because any future charge proposed under the GRR will be subject to full consideration in a later proceeding, its exclusion from AEP Ohio’s MRO price test is of no consequence in evaluating the Stipulation ESP.

FES witness Schnitzer included a cost estimate for Turning Point in the GRR and an estimate for "low" and "high" pool modification costs in the PMR. (FES Ex. 3, at MMS-4.) IEU witness Murray includes a cost estimate for the Turning Point solar project, which he would include in the GRR. (IEU Ex. 9A, at Ex. KMM-11.)

The GRR and PMR have zero values now, and it simply is not possible to estimate what, if any, costs might be used to recover during the term of the Stipulation ESP. Mr. Schnitzer's and Mr. Murray's estimates of costs that will be recovered through these riders are speculation. Their proposals should be rejected.

6. Stipulation Opponents' Other Criticisms Are Meritless.

a) Inclusion of non-generation elements of the Stipulation in the MRO Price Test

Mr. Murray also criticizes AEP Ohio for not including certain non-generation "costs" of the Stipulation ESP in the MRO price test. Specifically, Mr. Murray asserts that AEP Ohio's MRO price test fails to recognize that the Company's current ESP includes the gridSMART Rider and Enhanced Service Reliability (ESR) Rider and fails to account for the DIR, Storm Damage Recovery Mechanism, and Generation Resource Rider (GRR) allowed under the Stipulation. (IEU Ex. 9A at 27, 40-41.) Each of Mr. Murray's criticisms, however, are unfounded, as AEP Ohio witnesses Thomas, Hamrock, and Allen explained in their Direct Testimony.

Each of these riders pointed to by Mr. Murray as unaccounted for in AEP Ohio's MRO test were not accounted for because it would be inappropriate to do so. Indeed, the remaining riders and the Storm Damage Recovery Mechanism are distribution-related riders and are not for generation-related service. (AEP Ohio Ex. 5 at 16; Tr. IV at 616-617.) Thus, they are not properly includable in the MRO price test. That these distribution-related riders were not included in the MRO price test itself does not, however, mean that they were not considered in evaluating whether the Stipulation ESP is more favorable in the aggregate than an MRO.

Ms. Thomas explained that inclusion of the DIR in the MRO price test is inappropriate because, as a distribution rider, it provides the Company the same rate relief that could be achieved in a base distribution rate case under an MRO. (Tr. IV at 593.) Mr. Hamrock pointed out that the same kinds of charges recovered through the DIR would be recoverable in the Company's distribution rate case under an MRO. (Tr. V at 851.) Mr. Hamrock also explained the benefits of the DIR that should be considered in evaluating whether the Stipulation ESP is more favorable, in the aggregate, than an MRO. The DIR will allow the Company to recovery carrying costs on incremental distribution plant investment. (AEP Ohio Ex. 8 at 20.) It also will allow scaled increases for continued maintenance and improved reliability of AEP Ohio's distribution infrastructure, based on verified and audited capital investments. (*Id.*) Investments aligned to Distribution Asset Management and Capacity Additions programs will be included in the DIR as well. (*Id.*) These investments will result in additional reliability benefits for customers receiving distribution service.

Company witness Allen testified that the Storm Damage Recovery Mechanism is an accounting mechanism with an annual baseline of $5.0 Million. (AEP Ohio Ex. 4 at 12.) He explained that the mechanism is beneficial because it preserves forecasted O&M for planned maintenance activities. (*Id.*) If the mechanism were not included and funds were constantly diverted to cover the expense of major storms, it could disrupt the completion of planned maintenance and ultimately have an impact on the reliability of AEP Ohio's distribution system. (*Id.*) The actual expense incurred in addressing damage caused by storms will be deferred above or below the baseline for future recovery or refund. (*Id.*) Any capital cost incurred as a result of a major storm would become a component of the DIR or would be included in rate base in a future distribution rate case. (*Id.*)

With respect to the ESR Rider, Mr. Hamrock testified that the Signatory Parties agreed with AEP Ohio that the ESR Rider should continue for the remaining two years of the five year program approved in Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, with an incremental amount above the current base level of O&M expense required to maintain the program going forward. (AEP Ohio Ex. 8 at 21.) He further explained that the programs implemented under the rider since the Company's 2008 ESP proceeding, including the comprehensive Distribution Asset Management and Capacity Additions programs, the Vegetation Management programs, the gridSMART program, have been designed and implemented to improve customer service and minimize the impact of service interruptions. (*Id.*)

AEP Ohio appropriately and fully assessed each of the non-generation "costs" that Mr. Murray described. Inclusion of these "costs" in the MRO price test was not required and would not have been proper because they are not generation-related impacts. Mr. Murray's criticisms on this point, therefore, are without merit.

b) Operating company detail

Finally, Mr. Murray claims that AEP Ohio's MRO price test "cannot be relied upon to test the Stipulation's ESP against the MRO alternative" because the Company compared the rates under an MRO with the Stipulation ESP for the Company as a merged entity, rather than individually for CSP and OPCo. (IEU Ex. 9A at 25-26.) As Ms. Thomas, demonstrated, however, AEP Ohio's MRO price test did, in fact, include the operating company detail that Mr. Murray claims is lacking. (See AEP Ohio Ex. 5 at 14-15, Ex. LJT-R3.) That this information was combined and presented on a merged Company basis is appropriate because the Stipulation expressly contemplates the merger and continued operation of CSP and OPCo as one entity. Therefore, the Commission's comparison of the benefits of the Stipulation ESP to an MRO on a merged company basis is not only appropriate but is also necessary.

VII. CONCLUSION

For the foregoing reasons, the undersigned Signatory Parties request that the Commission adopt the Stipulation without modification.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of Columbus Southern Power Company's and Ohio Power Company's Reply Brief was served by electronic mail upon the individuals listed below this 10th day of November, 2011.

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