

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission Review of)
the Capacity Charges of Ohio Power)
Company and Columbus Southern Power) Case No. 10-2929-EL-UNC
Company.)

OPINION AND ORDER

The Commission, coming now to consider the evidence presented in this proceeding, the transcripts of the hearing, and briefs of the parties, hereby issues its opinion and order.

APPEARANCES:

Steven T. Nourse, Matthew J. Satterwhite, and Yazen Alami, American Electric Power Service Corporation, One Riverside Plaza, 29th Floor, Columbus, Ohio 43215, Porter, Wright, Morris & Arthur, LLP, by Daniel R. Conway and Christen M. Moore, 41 South High Street, Columbus, Ohio 43215, and Quinn, Emanuel, Urquhart & Sullivan, LLP, by Derek L. Shaffer, 1299 Pennsylvania Avenue NW, Suite 825, Washington, D.C. 20004, on behalf of Ohio Power Company.

Mike DeWine, Ohio Attorney General, by John H. Jones, Assistant Section Chief, and Steven L. Beeler, Assistant Attorney General, 180 East Broad Street, Columbus, Ohio 43215, on behalf of the Staff of the Public Utilities Commission of Ohio.

Bruce J. Weston, Ohio Consumers' Counsel, by Kyle L. Kern and Melissa R. Yost, Assistant Consumers' Counsel, 10 West Broad Street, Suite 1800, Columbus, Ohio 43215, on behalf of the residential utility consumers of Ohio Power Company.

Boehm, Kurtz & Lowry, by David F. Boehm, Michael L. Kurtz, and Jody M. Kyler, 36 East Seventh Street, Suite 1510, Cincinnati, Ohio 45202, on behalf of the Ohio Energy Group.

Taft, Stettinius & Hollister LLP, by Mark S. Yurick and Zachary D. Kravitz, 65 East State Street, Suite 1000, Columbus, Ohio 43215, on behalf of The Kroger Company.

McNees, Wallace & Nurick LLC, by Samuel C. Randazzo, Frank P. Darr, and Joseph E. Olikier, 21 East State Street, 17th Floor, Columbus, Ohio 43215, on behalf of Industrial Energy Users-Ohio.

Vorys, Sater, Seymour & Pease LLP, by M. Howard Petricoff and Lija Kaleps-Clark, 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216, on behalf of Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc.

Vorys, Sater, Seymour & Pease LLP, by M. Howard Petricoff and Lija Kaleps-Clark, 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216, on behalf of Direct Energy Services, LLC and Direct Energy Business, LLC.

Vorys, Sater, Seymour & Pease LLP, by M. Howard Petricoff and Lija Kaleps-Clark, 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216, on behalf of the Retail Energy Supply Association.

Vorys, Sater, Seymour & Pease LLP, by M. Howard Petricoff and Lija Kaleps-Clark, 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216, Eimer Stahl LLP, by David M. Stahl, 224 South Michigan Avenue, Suite 1100, Chicago, Illinois 60604, and Sandy I-ru Grace, 101 Constitution Avenue NW, Suite 400 East, Washington, D.C. 20001, on behalf of Exelon Generation Company, LLC.

Mark A. Hayden, FirstEnergy Service Company, 76 South Main Street, Akron, Ohio 44308, Calfee, Halter & Griswold, LLP, by James F. Lang, Laura C. McBride, and N. Trevor Alexander, 1400 KeyBank Center, 800 Superior Avenue, Cleveland, Ohio 44114, and Jones Day, by David A. Kutik and Allison E. Haedt, 901 Lakeside Avenue, Cleveland, Ohio 44114, on behalf of FirstEnergy Solutions Corp.

Bricker & Eckler LLP, by Thomas J. O'Brien, 100 South Third Street, Columbus, Ohio 43215, and Richard L. Sites, 155 East Broad Street, 15th Floor, Columbus, Ohio 43215, on behalf of the Ohio Hospital Association.

Bricker & Eckler LLP, by Lisa G. McAlister, 100 South Third Street, Columbus, Ohio 43215, on behalf of the Ohio Manufacturers' Association.

Jeanne W. Kingery and Amy B. Spiller, 139 East Fourth Street, Cincinnati, Ohio 45202, on behalf of Duke Energy Retail Sales, LLC and Duke Energy Commercial Asset Management, Inc.

Whitt Sturtevant LLP, by Mark A. Whitt, Andrew J. Campbell, and Melissa L. Thompson, PNC Plaza, Suite 2020, 155 East Broad Street, Columbus, Ohio 43215, and Matthew White, 6100 Emerald Parkway, Dublin, Ohio 43016, on behalf of Interstate Gas Supply, Inc.

Bailey Cavalieri LLC, by Dane Stinson, 10 West Broad Street, Suite 2100, Columbus, Ohio 43215, on behalf of the Ohio Association of School Business Officials, Ohio School Boards Association, Buckeye Association of School Administrators, and Ohio Schools Council.

Kegler, Brown, Hill & Ritter, LPA, by Roger P. Sugarman, 65 East State Street, Suite 1800, Columbus, Ohio 43215, on behalf of the National Federation of Independent Business, Ohio Chapter.

Bell & Royer Co., LPA, by Barth E. Royer, 33 South Grant Avenue, Columbus, Ohio 43215, on behalf of Dominion Retail, Inc.

Ice Miller LLP, by Christopher L. Miller, Asim Z. Haque, and Gregory H. Dunn, 250 West Street, Columbus, Ohio 43215, on behalf of the Association of Independent Colleges and Universities of Ohio.

Ice Miller LLP, by Asim Z. Haque, Christopher L. Miller, and Gregory H. Dunn, 250 West Street, Columbus, Ohio 43215, on behalf of the city of Grove City, Ohio.

OPINION:

I. HISTORY OF THE PROCEEDING

On November 1, 2010, American Electric Power Service Corporation (AEPSC), on behalf of Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, AEP-Ohio or the Company),¹ filed an application with the Federal Energy Regulatory Commission (FERC) in FERC Docket No. ER11-1995. On November 24, 2010, at the direction of FERC, AEPSC refiled the application in FERC Docket No. ER11-2183 (FERC filing). The application proposed to change the basis for compensation for capacity costs to a cost-based mechanism, pursuant to Section 205 of the Federal Power Act (FPA) and Section D.8 of Schedule 8.1 of the Reliability Assurance Agreement (RAA) for the regional transmission organization (RTO), PJM Interconnection, LLC (PJM), and included proposed formula rate templates under which AEP-Ohio would calculate its capacity costs.

On December 8, 2010, the Commission found that an investigation was necessary in order to determine the impact of the proposed change to AEP-Ohio's capacity charge. Consequently, the Commission sought public comments regarding the following issues: (1) what changes to the current state compensation mechanism are appropriate to determine AEP-Ohio's fixed resource requirement (FRR) capacity charge to Ohio competitive retail electric service (CRES) providers, which are referred to as alternative load serving entities (LSE) within PJM; (2) the degree to which AEP-Ohio's capacity charge is currently being recovered through retail rates approved by the Commission or other capacity charges; and (3) the impact of AEP-Ohio's capacity charge upon CRES providers and retail competition in Ohio. The Commission invited all interested stakeholders to submit written comments in

¹ By entry issued on March 7, 2012, the Commission approved and confirmed the merger of CSP into OP, effective December 31, 2011. *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.

the proceeding within 30 days of issuance of the entry and to submit reply comments within 45 days of the issuance of the entry. Additionally, in light of the change proposed by AEP-Ohio, the Commission explicitly adopted as the state compensation mechanism for the Company, during the pendency of the review, the current capacity charge established by the three-year capacity auction conducted by PJM based on its reliability pricing model (RPM).

On January 20, 2011, AEP-Ohio filed a motion to stay the reply comment period and to establish a procedural schedule for hearing. In the alternative, AEP-Ohio requested an extension of the deadline to file reply comments until January 28, 2011. In support of its motion, AEP-Ohio asserted that, due to the recent rejection of its application by FERC based on the existence of a state compensation mechanism, it would be necessary for the Commission to move forward with an evidentiary hearing process to establish the proper state compensation mechanism. AEP-Ohio argued that, in light of this recent development, the parties needed more time to file reply comments.

By entry issued on January 21, 2011, the attorney examiner granted AEP-Ohio's motion to extend the deadline to file reply comments and established the new reply comment deadline as February 7, 2011. The January 21, 2011, entry also determined that AEP-Ohio's motion for the Commission to establish a procedural schedule for hearing would be considered after the reply comment period had concluded.

On January 27, 2011, in Case No. 11-346-EL-SSO, *et al.* (11-346), AEP-Ohio filed an application for a standard service offer (SSO) pursuant to Section 4928.141, Revised Code.² The application was for an electric security plan (ESP) in accordance with Section 4928.143, Revised Code.

Motions to intervene in the present case were filed and intervention was granted to the following parties: Ohio Energy Group (OEG); Industrial Energy Users-Ohio (IEU-Ohio); Ohio Consumers' Counsel (OCC); Ohio Partners for Affordable Energy (OPAE)³; Ohio Manufacturers' Association (OMA); Ohio Hospital Association (OHA); Direct Energy Services, LLC and Direct Energy Business, LLC (jointly, Direct Energy); Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (jointly, Constellation); FirstEnergy Solutions Corp. (FES); Duke Energy Retail Sales, LLC and Duke Energy Commercial Asset Management, Inc. (jointly, Duke); Exelon Generation Company, LLC (Exelon); Interstate Gas Supply, Inc. (IGS); Retail Energy Supply Association (RESA);

² *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*, Case Nos. 11-346-EL-SSO and 11-348-EL-SSO; *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority*, Case Nos. 11-349-EL-AAM and 11-350-EL-AAM.

³ On November 17, 2011, OPAE filed a notice of withdrawal from this case.

Ohio Association of School Business Officials, Ohio School Boards Association, Buckeye Association of School Administrators, and Ohio Schools Council (collectively, Schools); Ohio Farm Bureau Federation (OFBF); The Kroger Company (Kroger); Ohio Chapter of the National Federation of Independent Business (NFIB); Dominion Retail, Inc. (Dominion Retail); Association of Independent Colleges and Universities of Ohio (AICUO); city of Grove City, Ohio (Grove City); and Ohio Construction Materials Coalition (OCMC).⁴

Initial comments were filed by AEP-Ohio, IEU-Ohio, OMA, OHA, Constellation, Direct Energy, OEG, FES, OPAC, and OCC. Reply comments were filed by AEP-Ohio, OEG, Constellation, OPAC, FES, and OCC.

By entry issued on August 11, 2011, the attorney examiner set a procedural schedule in order to establish an evidentiary record on a proper state compensation mechanism. The evidentiary hearing was scheduled to commence on October 4, 2011, and interested parties were directed to 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. In accordance with the procedural schedule, AEP-Ohio filed direct testimony on August 31, 2011.

On September 7, 2011, a stipulation and recommendation (ESP 2 Stipulation) was filed by AEP-Ohio, Staff, and other parties to resolve the issues raised in 11-346 and several other cases pending before the Commission (consolidated cases),⁵ including the above-captioned case. Pursuant to an entry issued on September 16, 2011, the consolidated cases were consolidated for the sole purpose of considering the ESP 2 Stipulation. The September 16, 2011, entry also stayed the procedural schedules in the pending cases, including this proceeding, until the Commission specifically ordered otherwise. The evidentiary hearing on the ESP 2 Stipulation commenced on October 4, 2011, and concluded on October 27, 2011.

On December 14, 2011, the Commission issued an opinion and order in the consolidated cases, modifying and adopting the ESP 2 Stipulation, including its two-tier

⁴ On April 19, 2012, OCMC filed a corrected cover sheet to its motion for intervention, indicating that it did not intend to seek intervention in this case.

⁵ *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 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 Pursuant to Section 4928.144, Revised Code*, 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 Pursuant to Section 4928.144, Revised Code*, Case No. 11-4921-EL-RDR.

capacity pricing mechanism. Subsequently, on February 23, 2012, the Commission issued an entry on rehearing in the consolidated cases, granting rehearing in part. Finding that the signatory parties to the ESP 2 Stipulation had not met their burden of demonstrating that the stipulation, as a package, benefits ratepayers and the public interest, as required by the Commission's three-part test for the consideration of stipulations, the Commission rejected the ESP 2 Stipulation. The Commission directed AEP-Ohio to file, no later than February 28, 2012, new proposed tariffs to continue the provisions, terms, and conditions of its previous ESP, including an appropriate application of capacity charges under the approved state compensation mechanism established in the present case.

By entry issued on March 7, 2012, in the above-captioned case, the Commission implemented an interim capacity pricing mechanism proposed by AEP-Ohio in a motion for relief filed on February 27, 2012. Specifically, the Commission approved a two-tier capacity pricing mechanism modeled after the one recommended in the ESP 2 Stipulation. Approval of the interim capacity pricing mechanism was subject to the clarifications contained in the Commission's January 23, 2012, entry in the consolidated cases, including the clarification to include mercantile customers as governmental aggregation customers eligible to receive capacity pricing based on PJM's RPM. Under the two-tier capacity pricing mechanism, the first 21 percent of each customer class was entitled to tier-one, RPM-based capacity pricing. All customers of governmental aggregations approved on or before November 8, 2011, were also entitled to receive tier-one, RPM-based capacity pricing. For all other customers, the second-tier charge for capacity was \$255/megawatt-day (MW-day). In accordance with the March 7, 2012, entry, the interim rate was to remain in effect until May 31, 2012, at which point the charge for capacity under the state compensation mechanism would revert to the current RPM price in effect pursuant to the PJM base residual auction for the 2012/2013 delivery year.

By entry issued on March 14, 2012, the attorney examiner established a procedural schedule, which included a deadline for AEP-Ohio to revise or update its August 31, 2011, testimony. A prehearing conference occurred on April 11, 2012. The evidentiary hearing commenced on April 17, 2012, and concluded on May 15, 2012. During the evidentiary hearing, AEP-Ohio offered the direct testimony of five witnesses and the rebuttal testimony of three witnesses. Additionally, 17 witnesses testified on behalf of various intervenors and three witnesses testified on behalf of Staff.

On April 30, 2012, AEP-Ohio filed a motion for extension of the interim relief granted by the Commission in the March 7, 2012, entry. By entry issued on May 30, 2012, the Commission approved extension of the interim capacity pricing mechanism through July 2, 2012.

Initial briefs were filed by the parties on May 23, 2012, and reply briefs were filed on May 30, 2012.

II. APPLICABLE LAW

AEP-Ohio is an electric light company as defined by Section 4905.03(A)(3), Revised Code, and a public utility pursuant to Section 4905.02, Revised Code. AEP-Ohio is, therefore, subject to the jurisdiction of the Commission pursuant to Sections 4905.04, 4905.05, and 4905.06, Revised Code.

In accordance with Section 4905.22, Revised Code, all charges for service shall be just and reasonable and not more than allowed by law or by order of the Commission. Additionally, Section D.8 of Schedule 8.1 of the RAA, which is a portion of PJM's tariff approved by FERC, is informative in this case. It states:

In a state regulatory jurisdiction that has implemented retail choice, the FRR Entity must include in its FRR Capacity Plan all load, including expected load growth, in the FRR Service Area, notwithstanding the loss of any such load to or among alternative retail LSEs. In the case of load reflected in the FRR Capacity Plan that switches to an alternative retail LSE, where the state regulatory jurisdiction requires switching customers or the LSE to compensate the FRR Entity for its FRR capacity obligations, such state compensation mechanism will prevail. In the absence of a state compensation mechanism, the applicable alternative retail LSE shall compensate the FRR Entity at the capacity price in the unconstrained portions of the PJM Region, as determined in accordance with Attachment DD to the PJM Tariff, provided that the FRR Entity may, at any time, make a filing with FERC under Sections 205 of the Federal Power Act proposing to change the basis for compensation to a method based on the FRR Entity's cost or such other basis shown to be just and reasonable, and a retail LSE may at any time exercise its rights under Section 206 of the FPA.

III. DISCUSSION AND CONCLUSIONS

A. Procedural Issues

1. Motion to Dismiss

On April 10, 2012, as corrected on April 11, 2012, IEU-Ohio filed a motion to dismiss this case. In its motion, IEU-Ohio asserts that the Commission lacks statutory authority to authorize cost-based or formula-based compensation for AEP-Ohio's FRR capacity obligations from CRES providers serving retail customers in the Company's service territory. On April 13, 2012, AEP-Ohio filed a memorandum in partial opposition to IEU-Ohio's motion to dismiss. AEP-Ohio argues that the establishment of wholesale rates to be charged to CRES providers for the provision of capacity for resale to retail customers is a matter governed by federal law. AEP-Ohio notes, however, that IEU-Ohio's untimely position in its motion to dismiss is severely undercut by its previous arguments regarding Ohio law. AEP-Ohio further notes that IEU-Ohio requests that the Commission order a return to RPM-based capacity pricing upon concluding that it has no jurisdiction. AEP-Ohio argues that, if the Commission concludes that it lacks jurisdiction, it must revoke the state compensation mechanism established in its December 8, 2010, entry, revoke its orders issued in this case, and leave the matter to FERC. IEU-Ohio filed a reply to AEP-Ohio's memorandum on April 16, 2012, reiterating its request for dismissal of the case and implementation of RPM-based capacity pricing. On April 17, 2012, RESA filed a memorandum contra IEU-Ohio's motion to dismiss. RESA contends that the Commission has jurisdiction pursuant to its general supervisory powers under Sections 4905.04, 4905.05, and 4905.06, Revised Code, as well as pursuant to Section 4928.143, Revised Code, to establish a state compensation mechanism and that IEU-Ohio's motion is procedurally improper and should be denied.

At the outset of the hearing on April 17, 2012, the attorney examiner deferred ruling on IEU-Ohio's motion to dismiss (Tr. I at 21-22). Upon conclusion of AEP-Ohio's direct case, IEU-Ohio made an oral motion to dismiss the proceeding, asserting that the Company had failed to meet its burden of proof such that the Commission could approve the proposed capacity charge based on either its authority to set rates for competitive or noncompetitive retail electric service, or its authority to set rates pursuant to Section 4909.16, Revised Code (Tr. V at 1056-1059). Again, the attorney examiner deferred ruling on the motion (Tr. V at 1061).

In its brief, IEU-Ohio argues that the Commission should dismiss this case and require AEP-Ohio to reimburse all consumer representative stakeholders for the cost of participation in this proceeding and 11-346, as such costs were incurred by all consumer representative stakeholders who opposed the ESP 2 Stipulation, with reimbursement occurring through a cash payment. IEU-Ohio contends that AEP-Ohio's proposed capacity charge is unlawful and contrary to the public interest based on the common law principles

codified in Chapter 1331, Revised Code, which is known as the Valentine Act and governs monopolies and anticompetitive conduct. IEU-Ohio asserts that the Valentine Act compels the Commission to reject AEP-Ohio's anticompetitive scheme to preclude free and unrestricted competition among purchasers or consumers in the sale of competitive generation service. According to IEU-Ohio, if the AEP East Interconnection Agreement (pool agreement) and the RAA are agreements having the effect of precluding free and unrestricted competition between the parties to such agreements, purchasers, or consumers, the agreements are void by operation of Ohio law. AEP-Ohio responds that IEU-Ohio urges the Commission to rely on a statute that it has no jurisdiction to enforce, noting that authority to enforce the Valentine Act is vested in the courts of common pleas, pursuant to Section 1331.11, Revised Code. AEP-Ohio adds that IEU-Ohio's request for reimbursement of litigation costs is unjustified under the circumstances of this case, unsupported by any statute or rule, and should be denied.

The Commission agrees with AEP-Ohio that it has no authority with respect to Chapter 1331, Revised Code. However, the Commission finds that it has jurisdiction to establish a state compensation mechanism, as addressed further below. IEU-Ohio's motion to dismiss this proceeding is, therefore, without merit and should be denied. In addition, IEU-Ohio's request for reimbursement of its litigation expenses is unfounded and should likewise be denied.

2. Motion for Permission to Appear *Pro Hac Vice Instante*

On May 9, 2012, as supplemented on May 14, 2012, a motion for permission to appear *pro hac vice instante* on behalf of AEP-Ohio was filed by Derek Shaffer. No memoranda contra were filed. The Commission finds that the motion for permission to appear *pro hac vice instante* is reasonable and should be granted.

B. Substantive Issues

The key substantive issues before the Commission may be posed as the following questions: (1) *does the Commission have jurisdiction to establish a state compensation mechanism*; (2) *should the state compensation mechanism for AEP-Ohio be based on the Company's capacity costs or on another pricing mechanism such as RPM-based auction prices*; and (3) *what should the resulting compensation be for AEP-Ohio's FRR capacity obligations*. In addressing this final question, there are a number of related issues to be considered, including whether there should be an offsetting energy credit, whether AEP-Ohio's proposed cost-based capacity pricing mechanism constitutes a request for recovery of stranded generation investment, and whether OEG's alternate proposal should be adopted by the Commission.

1. Does the Commission have jurisdiction to establish a state compensation mechanism?

a. AEP-Ohio

Article 2 of the RAA provides that the RAA's purpose is "to ensure that adequate Capacity Resources, including planned and Existing Generation Capacity Resources, planned and existing Demand Resources, Energy Efficiency Resources, and [Interruptible Load for Reliability] will be planned and made available to provide reliable service to loads within the PJM Region, to assist other Parties during Emergencies and to coordinate planning of such resources consistent with the Reliability Principles and Standards." It further provides that the RAA should be implemented "in a manner consistent with the development of a robust competitive marketplace." Under Section 7.4 of the RAA, "[a] Party that is eligible for the [FRR] Alternative may satisfy its obligations hereunder to provide Unforced Capacity by submitting and adhering to an FRR Capacity Plan."

In accordance with the RAA, AEP-Ohio elected to opt out of participation in PJM's RPM capacity market and instead chose to become an FRR Entity that is obligated to provide sufficient capacity for all connected load, including shopping load, in its service territory. AEP-Ohio will remain an FRR Entity through May 31, 2015 (AEP-Ohio Ex. 101 at 7-8), and, accordingly, the Company has committed to ensuring that adequate capacity resources exist within its footprint during this timeframe. Under the RAA, the default charge for providing this service is based on PJM's RPM capacity auction prices. According to AEP-Ohio, due to the decrease in RPM auction prices as reflected below and the onset of retail shopping in the Company's service territory in 2010, the adverse financial impact on the Company from supplying CRES providers with capacity at prices below cost has become significant.

| PJM Delivery Year | \$/MW-day | |
|---|---------------------------------------|------------------|
| | PJM Base Residual Auction (BRA) Price | Capacity Charge* |
| 2010/2011 | \$174.29 | \$220.96 |
| 2011/2012 | \$110.00 | \$145.79 |
| 2012/2013 | \$16.46 | \$20.01 |
| 2013/2014 | \$27.73 | \$33.71 |
| 2014/2015 | \$125.99 | \$153.89 |
| *BRA adjusted for final zonal capacity price, scaling factor, forecast pool requirement, and losses | | |

As a result, AEP-Ohio made the decision to seek approval, pursuant to the RAA, to collect a cost-based capacity rate from CRES providers. In its FERC filing, AEP-Ohio proposed cost-based formula tariffs that were based on its FERC Form 1 for 2009. In response to the FERC filing, the Commission opened this docket and, in the December 8, 2010, entry, adopted capacity pricing based on the RPM auction price as the state compensation mechanism for AEP-Ohio's FRR capacity obligations. Subsequently, FERC rejected AEP-Ohio's proposed formula rate in light of the state compensation mechanism.

AEP-Ohio asserts that, because FERC has jurisdiction over wholesale electric rates and state commissions have jurisdiction over retail rate matters, it is evident that the reference to a state compensation mechanism in Section D.8 of Schedule 8.1 of the RAA contemplates a retail, not a wholesale, capacity pricing mechanism. AEP-Ohio believes that the provision of generation capacity to CRES providers is a wholesale transaction that falls within the exclusive ratemaking jurisdiction of FERC. In its brief, AEP-Ohio states that the purpose of this proceeding is to establish a wholesale capacity pricing mechanism and that retail rates cannot change as a result of this case. AEP-Ohio notes that intervenors universally agreed that the compensation paid by CRES providers to the Company for its FRR capacity obligations is wholesale in nature (Tr. IV at 795; Tr. V at 1097, 1125; Tr. VI at 1246, 1309).

b. Intervenors

As discussed above with respect to its motion to dismiss, IEU-Ohio contends that the Commission lacks statutory authority to approve a cost-based rate for capacity available to CRES providers serving retail customers in AEP-Ohio's service territory. IEU-Ohio argues that, if the Commission concludes that the provision of capacity to CRES providers is subject to the Commission's economic regulation jurisdiction, it must determine whether the service is competitive or noncompetitive. IEU-Ohio notes that generation service is classified as a competitive service under Section 4928.03, Revised Code. IEU-Ohio emphasizes that no party has claimed that capacity is not part of generation service. IEU-Ohio asserts that, if the provision of capacity is in fact considered a competitive generation service, the Commission's economic regulation jurisdiction is limited to Sections 4928.141, 4928.142, and 4928.143, Revised Code, which pertain to the establishment of an SSO. IEU-Ohio notes that these sections contain various substantive and procedural requirements that must be satisfied prior to the lawful establishment of an SSO, none of which has been satisfied in the present case, which precludes the Commission from considering or approving AEP-Ohio's proposed cost-based capacity pricing mechanism. IEU-Ohio adds that Section 4928.05, Revised Code, prohibits the Commission from regulating competitive retail electric service under its traditional cost-based ratemaking authority contained in Chapter 4909, Revised Code. IEU-Ohio continues that, if the provision of capacity is nevertheless deemed a noncompetitive service, the Commission cannot approve AEP-Ohio's proposed capacity pricing mechanism because the Company has failed to satisfy any

of the statutory requirements found in Chapter 4909, Revised Code. IEU-Ohio also argues that AEP-Ohio has failed to satisfy the requirements of Section 4909.16, Revised Code, which must be met before the Commission can authorize a rate increase to avoid financial harm. Finally, IEU-Ohio maintains that the Commission's general supervisory authority is not a basis for approving rates. Even aside from the question of the Commission's jurisdiction, IEU-Ohio contends that AEP-Ohio has not met the burden of proof that would apply pursuant to Section 4909.16, 4909.18, or 4928.143, Revised Code.

RESA and Direct Energy (jointly, Suppliers) argue that the Commission has authority under state law to establish the state compensation mechanism. The Suppliers contend that the Commission, pursuant to its general supervisory authority contained within Sections 4905.04, 4905.05, and 4905.06, Revised Code, may initiate investigations to review rates and charges, as it has done in this case to consider AEP-Ohio's capacity pricing mechanism for its FRR obligations. The Suppliers point out that, in the December 8, 2010, entry, the Commission even referenced those sections and noted that it has the authority to supervise and regulate all public utilities within its jurisdiction. Additionally, the Suppliers believe that the Commission may establish the state compensation mechanism pursuant to Sections 4928.141(A) and 4928.143(B)(2)(d), Revised Code, which enable the Commission to set rates for certain competitive services as part of an ESP. The Suppliers also assert that the provision of capacity is a retail electric service, as defined by Section 4928.01(A)(27), Revised Code, given that it is a service arranged for ultimate consumers in this state.

In response to the Suppliers, IEU-Ohio argues that the Commission's general supervisory authority does not provide it with unlimited powers to approve rates. IEU-Ohio further disputes the Suppliers' claim that Section 4928.143(B)(2)(d), Revised Code, offers another statutory basis upon which to approve capacity pricing for CRES providers, noting, among other reasons, that this is not an SSO proceeding.

c. Conclusion

As a creature of statute, the Commission has and may exercise only the authority conferred upon it by the General Assembly. *Tongren v. Pub. Util. Comm.*, 85 Ohio St.3d 87, 88 (1999). Thus, as an initial matter, the Commission must determine whether there is a statutory basis under Ohio law upon which it may rely to establish a state compensation mechanism. As we noted in the December 8, 2010, entry, Sections 4905.04, 4905.05, and 4905.06, Revised Code, grant the Commission authority to supervise and regulate all public utilities within its jurisdiction. We further noted that AEP-Ohio is an electric light company as defined in Section 4905.03(A)(3), Revised Code, and a public utility as defined in Section 4905.02, Revised Code, and, as such, is subject to the jurisdiction of the Commission. We affirm our prior finding that Sections 4905.04, 4905.05, and 4905.06, Revised Code, grant the Commission the necessary statutory authority to establish a state compensation mechanism.

IEU-Ohio contends that the Commission must determine whether capacity service is a competitive or noncompetitive retail electric service pursuant to Chapter 4928, Revised Code. Section 4928.05(A)(1), Revised Code, provides that competitive retail electric service is, to a large extent, exempt from supervision and regulation by the Commission, including pursuant to the Commission's general supervisory authority contained in Sections 4905.04, 4905.05, and 4905.06, Revised Code. Section 4928.05(A)(2), Revised Code, provides that noncompetitive retail electric service, on the other hand, generally remains subject to supervision and regulation by the Commission. Prior to determining whether a retail electric service is competitive or noncompetitive, however, we must first confirm that it is indeed a retail electric service. Section 4928.01(A)(27), Revised Code, defines a retail electric service as "any service involved in supplying or arranging for the supply of electricity to ultimate consumers in this state, from the point of generation to the point of consumption." In this case, the electric service in question (*i.e.*, capacity service) is provided by AEP-Ohio for CRES providers, with CRES providers compensating the Company in return for its FRR capacity obligations. Such capacity service is not provided directly by AEP-Ohio to retail customers. (AEP-Ohio Ex. 101 at 11; Tr. I at 63.) Although the capacity service benefits shopping customers in due course, they are initially one step removed from the transaction, which is more appropriately characterized as an intrastate wholesale matter between AEP-Ohio and each CRES provider operating in the Company's service territory. As AEP-Ohio notes, many of the parties, including the Company, regard the capacity compensation assessed by the Company to CRES providers as a wholesale matter (Tr. IV at 795; Tr. V at 1097, 1125; Tr. VI at 1246, 1309). We agree that the provision of capacity for CRES providers by AEP-Ohio, pursuant to the Company's FRR capacity obligations, is not a retail electric service as defined by Ohio law. Accordingly, we find it unnecessary to determine whether capacity service is considered a competitive or noncompetitive service under Chapter 4928, Revised Code.

The Commission recognizes that, pursuant to the FPA, electric sales for resale and other wholesale transactions are generally subject to the exclusive jurisdiction of FERC. In this case, however, our exercise of jurisdiction, for the sole purpose of establishing an appropriate state compensation mechanism, is consistent with the governing section of the RAA, which, as a part of PJM's tariffs, has been approved by FERC and was accepted by AEP-Ohio when the RAA was signed on its behalf by AEPSC.⁶ Section D.8 of Schedule 8.1 of the RAA acknowledges the authority of a state regulatory jurisdiction, such as the Commission, to establish a state compensation mechanism. It further provides that a state compensation mechanism, once established, prevails over the other compensation methods that are addressed in that section. Additionally, FERC has found that the RAA does not

⁶ In its order rejecting the FERC filing, FERC noted its approval of the RAA pursuant to a settlement agreement. *American Electric Power Service Corporation*, 134 FERC ¶ 61,039 (2011), citing *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331 (2006), *order on reh'g*, 119 FERC ¶ 61,318, *reh'g denied*, 121 FERC ¶ 61,173 (2007), *aff'd sub nom. Pub. Serv. Elec. & Gas Co. v. FERC*, D.C. Circuit Case No. 07-1336 (March 17, 2009) (unpublished); FERC also noted that the RAA was voluntarily signed on behalf of AEP-Ohio.

permit AEPSC to change the state compensation mechanism. In fact, FERC rejected AEPSC's proposed formula rate, given the existence of the state compensation mechanism established by the Commission in its December 8, 2010, entry.⁷

2. Should the state compensation mechanism for AEP-Ohio be based on the Company's capacity costs or on another pricing mechanism such as RPM-based auction prices?

a. AEP-Ohio

As an initial matter, AEP-Ohio notes that it recently declared that it will not continue its status as an FRR Entity and instead will fully participate in the RPM capacity market auctions, beginning on June 1, 2015, which is the earliest possible date on which to transition from an FRR Entity to a full participant in the RPM capacity market. AEP-Ohio points out that this development narrows the scope of this proceeding to establishing a three-year transitional, rather than permanent, form of compensation for its FRR capacity obligations.

AEP-Ohio argues that it is entitled to full compensation for the capacity that it supplies to CRES providers pursuant to its FRR obligations. Specifically, AEP-Ohio contends that Section D.8 of Schedule 8.1 of the RAA grants the Company the right to establish a rate for capacity that is based on cost. AEP-Ohio notes that, by its plain language, the RAA allows an FRR Entity like AEP-Ohio to change the basis for capacity pricing to a cost-based method at any time. AEP-Ohio also notes that no party to this proceeding challenges the Commission's discretion under the RAA to establish cost-based capacity pricing as the state compensation mechanism. According to AEP-Ohio, the term "cost" as used in Section D.8 of Schedule 8.1 of the RAA refers to embedded cost. AEP-Ohio adds that its proposed cost-based capacity rate of \$355.72/MW-day advances state policy objectives enumerated in Section 4928.02, Revised Code, as well as the Commission's objectives in this proceeding of promoting alternative competitive supply and retail competition, while also ensuring the Company's ability to attract capital investment to meet its FRR capacity obligations, which were set forth by the Commission in response to the FERC filing (OEG Ex. 101 at 4). With respect to promoting alternative competitive supply and retail competition, AEP-Ohio asserts that the Commission's focus should be on fairness and genuine competition, rather than on the manufacture of artificial competition through subsidization. AEP-Ohio believes that, because shopping will still occur and CRES providers will still realize a significant margin at the Company's proposed rate (Tr. XI at 2330-2333), the rate is consistent with the Commission's first objective. AEP-Ohio also believes that its proposed rate satisfies the Commission's second objective of ensuring the Company's ability to attract capital investment to meet its FRR capacity obligations. AEP-Ohio contends that its proposed rate would enable the Company to continue to attract

⁷ *American Electric Power Service Corporation*, 134 FERC ¶ 61,039 (2011).

capital and satisfy its FRR capacity obligations without harm to the Company, while providing customers with reliable and reasonably priced retail electric service as required by Section 4928.02, Revised Code. AEP-Ohio argues that cost-based capacity pricing would encourage investment in generation in Ohio and thereby increase retail reliability and affordability, as well as adequately compensate the Company for its capacity obligations as an FRR Entity.

AEP-Ohio contends that, during the period in which it remains an FRR Entity, RPM-based capacity pricing is not appropriate. As an FRR Entity, AEP-Ohio notes that it does not procure capacity for its load obligations in PJM's RPM auctions or even participate in such auctions, except to the extent that the Company has capacity that it does not need for its native load. AEP-Ohio points out that, under such circumstances, its auction participation is limited to 1,300 MW. (AEP-Ohio Ex. 105 at 8; Tr. III at 661-662.) AEP Ohio argues that, as an FRR Entity, it would not recover its capacity costs, if capacity pricing is based on RPM prices, and the difference is not made up by its SSO customers (Tr. I at 64). AEP-Ohio maintains that, because its obligations as an FRR Entity are longer and more binding reliability obligations than a CRES provider's obligations as an alternative LSE, an RPM-based price for capacity would not be compensatory or allow the Company to recover an amount even remotely approaching its embedded costs for the 2011-2012 and 2012-2013 PJM planning years, and should thus be rejected (Tr. II at 243). According to AEP-Ohio, RPM-based capacity pricing would also give CRES providers an unfair advantage over the members of the pool agreement, which purchase capacity based on embedded costs (Tr. I at 59-60), and discriminate against non-shopping customers.

Additionally, AEP-Ohio claims that RPM-based capacity pricing would cause substantial, confiscatory financial harm to the Company. According to AEP-Ohio witness Allen, the Company would earn a return on equity of 7.6 percent in 2012 and a return on equity of 2.4 percent in 2013, with a \$240 million decrease in earnings between 2012 and 2013, if RPM-based capacity pricing is adopted (AEP-Ohio Ex. 104 at 3-5, Ex. WAA-1; Tr. III at 701).

Finally, AEP-Ohio notes that RPM-based capacity pricing is inappropriate because it would constitute an illegal subsidy to CRES providers in violation of Section 4928.02(H), Revised Code.

b. Staff

In its brief, Staff contends that AEP-Ohio should receive compensation from CRES providers for the Company's FRR obligations in the form of the prevailing RPM rate in the unconstrained region of PJM. Staff opposes the Company's request to establish a capacity rate that is significantly above the market rate. Staff notes that other investor-owned utilities in Ohio charge CRES providers RPM-based capacity pricing and that such pricing

should, therefore, also be appropriate for AEP-Ohio. Staff further notes that the evidentiary record does not support AEP-Ohio's proposed capacity pricing of \$355.72/MW-day.

c. Intervenors

All of the intervenors in this case agree that the Commission should adopt RPM-based capacity pricing as the state compensation mechanism. Many of the intervenors note that AEP-Ohio has used RPM-based capacity pricing since 2007, without incurring financial hardship or compromising service reliability for its customers. They further note that AEP-Ohio will continue to use RPM-based capacity pricing, at the Company's own election, beginning on June 1, 2015. They believe, therefore, that the Commission should adopt RPM-based capacity pricing as the state compensation mechanism for the intervening three-year period for numerous reasons, including for the sake of competition and continuity.

FES argues that RPM-based capacity pricing is the proper state compensation mechanism for AEP-Ohio. FES contends that a market-based state compensation mechanism, specifically one that adopts the RPM price as the best indicator of the market price for capacity, is required because Ohio law and policy have established and promoted a competitive market for electric generation service; RPM-based pricing is supported by sound economic principles and avoids distorted incentives for CRES providers; and AEP-Ohio's return on equity is more than sufficient under RPM-based pricing, given that the Company's analysis is based on unrealistic shopping assumptions. FES adds that, even if cost-based pricing were appropriate, AEP-Ohio has dramatically overstated its costs. FES argues that AEP-Ohio's proposed capacity pricing mechanism is not based on the costs associated with the capacity provided by AEP-Ohio to Ohio customers; includes all costs, rather than just those avoidable costs that are relevant in economic decision making; includes stranded costs that may not be recovered under Ohio law; and fails to include an appropriate offset for energy sales. FES notes that, if the Commission were to allow AEP-Ohio to charge CRES providers any rate other than the RPM-based rate, the Company would be the only capacity supplier in PJM that could charge shopping customers its full embedded costs for generation, which, according to FES, is a concept that is not found within the RAA, whereas there are numerous provisions referring to "avoidable costs."

FES believes that AEP-Ohio's proposed capacity pricing would preclude customers from receiving the benefits of competition. Specifically, FES argues that competition is state law and policy, and benefits customers; AEP-Ohio's price of \$355.72/MW-day would harm competition and customers; and its proposed price would provide improper, anti-competitive benefits to the Company.

IEU-Ohio contends that AEP-Ohio has failed to demonstrate that its proposed capacity pricing mechanism is just and reasonable, as required by Section 4905.22, Revised Code. IEU-Ohio asserts that RPM-based capacity pricing is the appropriate market pricing

for capacity. IEU-Ohio believes that RPM-based capacity pricing is consistent with state policy, whereas AEP-Ohio's proposed capacity pricing mechanism would unlawfully subsidize the Company's position with regard to the competitive generation business, contrary to state policy. IEU-Ohio notes that neither AEP-Ohio's status as an FRR Entity nor the pool agreement is a basis for the Company's cost-based capacity pricing mechanism. IEU-Ohio points out that AEP-Ohio used RPM-based capacity pricing from 2007 through 2011, during which time the Company was an FRR Entity and the pool agreement was in effect. IEU-Ohio further argues that AEP-Ohio's proposed cost-based capacity pricing mechanism would produce results that are not comparable to the capacity price paid by SSO customers, contrary to state law. IEU-Ohio further notes that AEP-Ohio has not identified the capacity component of its SSO rates and that it is thus impossible to determine whether the proposed capacity pricing for CRES providers would be comparable to the capacity component of its SSO rates. (IEU-Ohio Ex. 102A at 29-32, Ex. KMM-10.) Regardless of the method by which the capacity pricing mechanism is established, IEU-Ohio requests that AEP-Ohio be directed to provide details to customers and CRES providers that show how the peak load contribution (PLC) that the Company assigns to a customer corresponds with the customer's PLC recognized by PJM. IEU-Ohio contends that this information is necessary to ensure that capacity compensation is being properly applied to shopping and non-shopping customers. (IEU-Ohio Ex. 102A at 33-34.)

The Suppliers argue that a capacity rate based on AEP-Ohio's embedded costs is not appropriate under the plain language of the RAA. Citing Section D.8 of Schedule 8.1 of the RAA, the Suppliers contend that AEP-Ohio may seek a cost-based rate by making a filing at FERC under Section 205 of the FPA, but only if there is no state compensation mechanism in place. The Suppliers add that the purpose of this proceeding is to establish the appropriate state compensation mechanism and that a state compensation mechanism based on AEP-Ohio's embedded costs would be contrary to the intent of the RAA, which refers only to the avoided cost rate. The Suppliers also note that allowing AEP-Ohio to recover its embedded costs would grant the Company a higher return on equity (12.2 percent in 2013) than has been allowed for any of its affiliates in other states and that is considerably higher than what the Commission granted in the Company's last rate case (RESA Ex. 103). Finally, the Suppliers maintain that AEP-Ohio's proposed cost-based capacity pricing mechanism would preclude CRES providers from making attractive offers, could result in shopping customers subsidizing non-shopping customers, and would destroy Ohio's growing competitive retail electricity market.

The Suppliers also believe that the two-tier capacity pricing mechanism that has been in effect is inequitable and inefficient and that a single RPM-based rate should be in place for all shopping customers. The Suppliers argue that the RPM price is the most transparent, market-based price for capacity, and is necessary as part of AEP-Ohio's three-year transition to market.

OEG argues that the Commission should establish either the annual or the average RPM price for the next three PJM planning years as the price that AEP-Ohio can charge CRES providers under the state compensation mechanism for its FRR capacity obligations. OEG notes that use of the three-year average RPM price of \$69.20/MW-day would mitigate some of the financial impact on AEP-Ohio from fluctuating future RPM prices and ease the Company's transition out of FRR status. OEG adds that the two-tier capacity pricing mechanism should not be continued and that a single price should be charged for all CRES providers. OEG notes that its position in this case has been guided by the Commission's twin goals, as expressed to FERC, of promoting competition, while also ensuring that AEP-Ohio has the necessary capital to maintain reliability. OEG believes that AEP-Ohio's proposed capacity pricing mechanism represents a drastic departure from past precedent that would deter shopping and undermine the benefits of retail competition, which is contrary to the Commission's goal of promoting competition. With respect to OEG's position that a three-year RPM price average could be used, AEP-Ohio notes that the concept was raised for the first time in OEG's initial brief, is without evidentiary support, and should be rejected.

OMA and OHA assert that, because the Commission has already established RPM-based capacity pricing as the state compensation mechanism, AEP-Ohio has the burden, as the entity challenging the state compensation mechanism, of proving that it is unjust and unreasonable. OMA and OHA further assert that AEP-Ohio has failed to sustain its burden. OMA and OHA believe that RPM-based capacity pricing is a just, reasonable, and lawful basis for the state compensation mechanism. According to OMA and OHA, AEP-Ohio has not demonstrated that RPM-based capacity pricing would cause substantial financial harm to the Company. OMA and OHA note that AEP-Ohio's projections are based on unrealistic and unsubstantiated shopping assumptions, with 65 percent of residential customers, 80 percent of commercial customers, and 90 percent of industrial customers switching by the end of 2012 (AEP-Ohio Ex. 104 at 4-5). OMA and OHA believe that RPM-based capacity pricing would not impact AEP-Ohio's ability to attract and invest capital, noting that the Company continues to invest capital regardless of its capacity costs for shopping customers and has no need or plan to attract or invest capital in additional capacity (IEU-Ohio Ex. 104; Tr. I at 36, 128-131; Tr. V at 868). On the other hand, OMA and OHA argue that AEP-Ohio's proposed capacity pricing mechanism would substantially harm customers and CRES providers and violate state policy, as it would significantly restrict the ability of customers to shop and enjoy savings; would unfairly deny customers access to market rates for capacity when market rates are low, and subject customers to market rates when they are high; and would harm economic development and recovery efforts. OMA and OHA urge the Commission to ensure that all customers in Ohio are able to take advantage of historically low capacity prices and have access to the lowest possible competitive electricity rates, as a means to stimulate and sustain economic growth.

OCC contends that AEP-Ohio's proposed capacity pricing mechanism should be rejected because it is contrary to the plain language of the RAA, which provides that, if a state compensation mechanism exists, its pricing prevails. According to OCC, the Commission established RPM-based capacity pricing as the state compensation mechanism in its December 8, 2010, entry. OCC notes that FERC has already rejected AEPSC's attempt to establish a formula rate for capacity in Ohio in light of the Commission's adoption of RPM-based capacity pricing as the state compensation mechanism. OCC further notes that AEP-Ohio's proposed capacity pricing mechanism is inconsistent with economic efficiency and contrary to state policy. OCC's position is that the Commission should find that RPM-based capacity pricing is appropriate, given the precedent already established by the Commission and FERC, and in light of the fact that AEP-Ohio has historically used RPM-based pricing for capacity sales to CRES providers.

NFIB urges the Commission to base AEP-Ohio's capacity compensation on RPM prices. NFIB adds that AEP-Ohio's proposed capacity pricing mechanism does not promote competition and would prevent small business owners from taking advantage of historically low market prices over the next several years. NFIB believes that AEP-Ohio would earn a healthy return on equity under RPM-based capacity pricing and that the Company has failed to establish how it would be better equipped to transition to the RPM market, if its cost-based pricing mechanism is approved.

Dominion Retail recommends that the Commission continue to employ RPM-based capacity pricing as the state compensation mechanism, as market-based pricing is fundamental to the development of a robust competitive market in AEP-Ohio's service territory. According to Dominion Retail, RPM-based capacity pricing would not require AEP-Ohio, shareholders, or SSO customers to subsidize CRES providers, as the Company contends. Dominion Retail notes that AEP-Ohio proposed cost-based capacity pricing only when it became apparent that market-based energy and capacity charges would permit CRES providers to compete effectively for customers in the Company's service territory for the first time. Dominion Retail adds that AEP-Ohio's underlying motivation is to constrain shopping and that allowing the Company to charge a cost-based capacity rate would be contrary to the state policy of promoting competition. Dominion Retail argues that Ohio law does not require that capacity pricing be based on embedded costs. Dominion Retail points out that AEP-Ohio's status as an FRR Entity does not mean that the state compensation mechanism must be based on embedded costs. Dominion Retail notes that Duke Energy Ohio, Inc. will also be an FRR Entity until mid-2015, and that it nevertheless uses RPM-based capacity pricing. Dominion Retail further notes that Amended Substitute Senate Bill No. 3 (SB 3) eliminated cost-of-service-based ratemaking for generation service. Dominion Retail asserts that AEP-Ohio is unrealistic in assuming that CRES providers would be able to compete successfully if AEP-Ohio's proposed capacity pricing is adopted. Dominion Retail points out that even AEP-Ohio witness Allen agrees that the Company's proposed capacity pricing would stifle competition in the residential market (Tr. III at 669-

670). Finally, Dominion Retail points out that AEP-Ohio's proposed cost-based capacity pricing mechanism is nowhere near the Company's capacity proposal pending in 11-346, which would provide for a capacity rate of \$146/MW-day for some shopping customers and \$255/MW-day for the rest. Dominion Retail contends that this fact demonstrates AEP-Ohio's willingness to provide capacity at a rate less than what it has proposed in this case and also undercuts the Company's confiscation argument.

The Schools also request that the Commission retain RPM-based capacity pricing. The Schools argue that, if AEP-Ohio's proposed capacity pricing mechanism is adopted, the rate would likely be passed through to the Ohio schools that are served by CRES providers, and that these schools would suffer rate shock in violation of Section 4928.02(A), Revised Code (Schools Ex. 101 at 9). Additionally, the Schools believe that Ohio schools that do not currently receive generation service from a CRES provider would be deprived of the opportunity to shop, in violation of Section 4928.02(C), Revised Code (Schools Ex. 101 at 10-11). Finally, the Schools contend that approval of AEP-Ohio's proposed capacity pricing mechanism would likely result in cuts to teaching and staff positions, materials and equipment, and programs, in violation of Section 4928.02(N), Revised Code (Schools Ex. 101 at 10).

Duke also contends that the Commission should adopt RPM-based capacity pricing as the state compensation mechanism, which is consistent with state policy supporting competition. Duke asserts that, pursuant to the RAA, an FRR Entity may only apply to FERC for cost-based compensation for its FRR capacity obligations, if there is no state compensation mechanism in place. According to Duke, neither the RAA nor Ohio law grants AEP-Ohio the right to recover its embedded costs. Duke notes that, under Ohio law, capacity is a competitive generation service that is not subject to cost-based ratemaking.

Exelon and Constellation assert that, if AEP-Ohio's proposed capacity pricing mechanism is approved, retail competition in the Company's service territory will be stifled and customers will bear the cost. Exelon and Constellation cite numerous reasons supporting their position that AEP-Ohio's proposal should be rejected in favor of RPM-based capacity pricing: Ohio law does not require that the state compensation mechanism be based on cost; AEP-Ohio's status as an FRR Entity does not entitle it to cost-based capacity pricing; AEP-Ohio, even as an FRR Entity, could have elected to participate in the RPM auction for 2014, rather than self-supply more expensive capacity, putting its own interests above those of customers; RPM-based capacity pricing is consistent with state policy promoting the development of competitive markets, whereas the Company's proposal is not; the Company should not be allowed to unilaterally apply better-of-cost-or-market pricing; CRES providers are captive to AEP-Ohio, given the requirement that capacity be committed more than three years in advance of delivery; Ohio law requires comparable and nondiscriminatory access to CRES and RPM-based capacity pricing is used throughout Ohio except in AEP-Ohio's service territory; and adopting RPM-based capacity

pricing would avoid the need to determine an arbitrary estimate of the Company's cost of service for capacity and, in any event, SB 3 eliminated full cost-of-service analysis. Exelon and Constellation note that 11-346 is the proper forum in which to determine whether AEP-Ohio requires protection to maintain its financial integrity. Exelon and Constellation further note that they would support reasonable measures that comport with a timely transition to a fully competitive market and resolution of related issues in 11-346, if such measures are shown to be necessary.

IGS contends that RPM-based capacity pricing is the clear choice over AEP-Ohio's proposed capacity pricing mechanism. IGS points out that RPM-based capacity pricing already exists, was neutrally created, applies all over the region, is market-based, is nondiscriminatory, and provides the correct incentives to assure investment in generation resources. On the other hand, AEP-Ohio's proposal, according to IGS, was devised by the Company, for this case and this case only, returns Ohio to a cost-based generation regulatory regime, shows no relationship to short- or long-term generation adequacy, and could stifle competition. IGS notes that RPM-based capacity pricing fully comports with Ohio law in that it is market-based pricing and would support the continued development of Ohio's competitive market; would avoid subsidies and discriminatory pricing; would assure adequate resources are available to provide stable electric service; and would avoid any legal problems associated with extending the transition to competition. IGS asserts that AEP-Ohio's proposed capacity pricing would be contrary to Ohio law in that it would harm the development of competition; result in anticompetitive subsidies; and violate Ohio's transition laws. IGS also notes that AEP-Ohio's justifications for recovering embedded costs are refuted by the evidence and disregard state policy. IGS contends that RPM-based capacity pricing does not raise reliability concerns or subsidize CRES providers. IGS argues that AEP-Ohio has a fundamental disagreement with state policy. IGS notes that AEP-Ohio's judgment as to the wisdom of state policy is irrelevant, given that it has been codified by the General Assembly and must be effectuated by the Commission.

Finally, Kroger asserts that the most economically efficient price and the price that AEP-Ohio should be required to charge CRES providers for capacity is the RPM price.

d. Conclusion

Initially, the Commission notes that a state compensation mechanism, as referenced in the RAA, has been in place for AEP-Ohio for some time now, at least since issuance of the December 8, 2010, entry, which expressly adopted RPM-based capacity pricing as the state compensation mechanism for the Company during the pendency of this case. The state compensation mechanism was subsequently modified by the Commission's March 7, 2012, and May 30, 2012, entries granting AEP-Ohio's requests for interim relief. No party appears to dispute, at least in this proceeding, that the Commission has adopted a state compensation mechanism for AEP-Ohio.

Given that there is, and has continually been, a state compensation mechanism in place for AEP-Ohio from the beginning of this proceeding, the issue for our consideration is whether the state compensation mechanism, on a going-forward basis, must or should be modified such that it is based on cost. AEP-Ohio contends that the state compensation mechanism must be amended so that the Company is able to recover its embedded costs of capacity. All of the intervenors and Staff oppose AEP-Ohio's request and advocate instead that the Commission retain the RPM-based state compensation mechanism, as it was established in the December 8, 2010, entry.

Pursuant to Section 4905.22, Revised Code, all charges for service shall be just and reasonable and not more than allowed by law or by order of the Commission. In this case, AEP-Ohio asserts that its proposed compensation for its FRR capacity obligations is just and reasonable and should be adopted by the Commission. Specifically, AEP-Ohio asserts that its proposed cost-based capacity pricing is consistent with state policy, will promote alternative competitive supply and retail competition, and will ensure the Company's ability to attract capital investment to meet its FRR capacity obligations. All of the intervenors and Staff, on the other hand, recommend that market-based RPM capacity pricing should be approved as the state compensation mechanism for AEP-Ohio. As discussed above, there is a general consensus among these parties that RPM-based capacity pricing is just and reasonable, easily implemented and understood, and consistent with state policy. Staff and intervenors further agree that RPM-based capacity pricing will fulfill the Commission's stated goals of both promoting competition and ensuring that AEP-Ohio has the required capital to maintain service reliability.

As discussed above, the Commission finds that it has jurisdiction to establish a state compensation mechanism in this case pursuant to its general supervisory authority found in Sections 4905.04, 4905.05, and 4905.06, Revised Code. We further find, pursuant to our regulatory authority under Chapter 4905, Revised Code, as well as Chapter 4909, Revised Code, that it is necessary and appropriate to establish a cost-based state compensation mechanism for AEP-Ohio. Those chapters require that the Commission use traditional rate base/rate of return regulation to approve rates that are based on cost, with the ultimate objective of approving a charge that is just and reasonable consistent with Section 4905.22, Revised Code. Although Chapter 4928, Revised Code, provides for market-based pricing for retail electric generation service, those provisions do not apply because, as we noted earlier, capacity is a wholesale rather than a retail service. The Commission's obligation under traditional rate regulation is to ensure that the jurisdictional utilities receive reasonable compensation for the services that they render. We conclude that the state compensation mechanism for AEP-Ohio should be based on the Company's costs. Although Staff and intervenors contend that RPM-based capacity pricing is just and reasonable, we note that the record indicates that the RPM-based price for capacity has decreased greatly since the December 8, 2010, entry was issued, and that the adjusted RPM

rate currently in effect is substantially below all estimates provided by the parties regarding AEP-Ohio's cost of capacity (AEP-Ohio Ex. 102 at 21, 22; FES Ex. 103 at 55; Staff Ex. 105 at Ex. ESM-4). *The record further reflects that, if RPM-based capacity pricing is adopted, AEP-Ohio may earn an unusually low return on equity of 7.6 percent in 2012 and 2.4 percent in 2013, with a loss of \$240 million between 2012 and 2013 (AEP-Ohio Ex. 104 at 3-5, Ex. WAA-1; Tr. III at 701).* In short, the record reveals that RPM-based capacity pricing would be insufficient to yield reasonable compensation for AEP-Ohio's provision of capacity to CRES providers in fulfillment of its FRR capacity obligations.

However, the Commission also recognizes that RPM-based capacity pricing will further the development of competition in the market (Exelon Ex. 101 at 7; OEG Ex. 102 at 11), which is one of our primary objectives in this proceeding. We believe that RPM-based capacity pricing will stimulate true competition among suppliers in AEP-Ohio's service territory. We also believe that RPM-based capacity pricing will facilitate AEP-Ohio's transition to full participation in the competitive market, as well as incent shopping. RPM-based capacity pricing has been used successfully throughout Ohio and the rest of the PJM region and puts electric utilities and CRES providers on a level playing field (FES Ex. 101 at 50-51; FES Ex. 102 at 3). RPM-based capacity pricing is thus a reasonable means of promoting shopping in AEP-Ohio's service territory and advancing the state policy objectives of Section 4928.02, Revised Code, which the Commission is required to effectuate pursuant to Section 4928.06(A), Revised Code.

Therefore, with the intention of adopting a state compensation mechanism that achieves a reasonable outcome for all stakeholders, the Commission directs that the state compensation mechanism shall be based on the costs incurred by the FRR Entity for its FRR capacity obligations, as discussed further in the following section. However, because the record in this proceeding demonstrates that RPM-based capacity pricing will promote retail electric competition, we find it necessary to take appropriate measures to facilitate this important objective. For that reason, the Commission directs AEP-Ohio to charge CRES providers the adjusted final zonal PJM RPM rate in effect for the rest of the RTO region for the current PJM delivery year (as of today, approximately \$20/MW-day), and with the rate changing annually on June 1, 2013, and June 1, 2014, to match the then current adjusted final zonal PJM RPM rate in the rest of the RTO region. Further, the Commission will authorize AEP-Ohio to modify its accounting procedures, pursuant to Section 4905.13, Revised Code, to defer incurred capacity costs not recovered from CRES provider billings during the ESP period to the extent that the total incurred capacity costs do not exceed the capacity pricing that we approve below. Moreover, the Commission notes that we will establish an appropriate recovery mechanism for such deferred costs and address any additional financial considerations in the 11-346 proceeding. We also find that AEP-Ohio should be authorized to collect carrying charges on the deferral based on the Company's weighted average cost of capital, until such time as a recovery mechanism is approved in 11-346, in

order to ensure that the Company is fully compensated. Thereafter, AEP-Ohio should be authorized to collect carrying charges at its long-term cost of debt.

Additionally, the Commission directs that the state compensation mechanism that we approve today shall not take effect until our opinion and order is issued in 11-346, or until August 8, 2012, whichever is sooner. Until that time, the interim capacity pricing mechanism that we approved on March 7, 2012, and extended on May 30, 2012, shall remain in place. In further extending the interim capacity pricing mechanism, we recognize that 11-346 and the present proceeding are intricately related. In fact, AEP-Ohio has put forth an entirely different capacity pricing mechanism in 11-346 as a component of its proposed ESP. Although this case has proceeded separately so that an evidentiary record on the appropriate capacity cost pricing/recovery mechanism could be developed, there is an overlap of issues between the two proceedings. For that reason, we find that the state compensation mechanism approved today should become effective with the issuance of our order in 11-346, which will address AEP-Ohio's comprehensive rate package, including its capacity pricing proposal, or August 8, 2012, whichever occurs first.

We note that the state compensation mechanism, once effective, shall remain in effect until AEP-Ohio's transition to full participation in the RPM market is complete and the Company is no longer subject to its FRR capacity obligations, which is expected to occur on or before June 1, 2015, or until otherwise directed by the Commission.

The Commission believes that the approach that we adopt today appropriately balances our objectives of enabling AEP-Ohio to recover its costs for capacity incurred in fulfilling its FRR capacity obligations, while promoting the further development of retail competition in the Company's service territory.

3. What should the resulting compensation be for AEP-Ohio's FRR capacity obligations?

a. AEP-Ohio

AEP-Ohio's position is that the appropriate cost-based capacity price to be charged to CRES providers is \$355.72/MW-day, on a merged company basis, before consideration of any offsetting energy credit. AEP-Ohio notes that the formula rate approach recommended by Company witness Pearce is based upon the average cost of serving the Company's LSE obligation load (both the load served directly by AEP-Ohio and the load served by CRES providers) on a dollar-per-MW-day basis. AEP-Ohio further notes that, because the Company supplies its own generation resources to satisfy these load obligations, the cost to provide this capacity is the actual embedded capacity cost of its generation. AEP-Ohio's formula rate template was modeled after, and modified from, the capacity portion of a FERC-approved template used to derive the charges applied to wholesale sales made by Southwestern Electric Power Company, an affiliate of the Company, to the cities of Minden,

Louisiana and Prescott, Arkansas. AEP-Ohio notes that Dr. Pearce's formula rate approach is transparent and, if adopted, would be updated annually by May 31 to reflect the most current input data, most of which is publicly available and taken directly from the Company's FERC Form 1 and audited financial statements (AEP-Ohio Ex. 102 at 8). AEP-Ohio adds that its proposed formula rate template would promote rate stability and result in a reasonable return on equity of 12.2 percent in 2013, based on a capacity price of \$355.72/MW-day (Tr. II at 12-25; AEP-Ohio Ex. 142 at 21-22).

AEP-Ohio contends that its proposed cost-based capacity pricing roughly approximates and is, therefore, comparable to the amount that the Company receives from its SSO customers for capacity through base generation rates (AEP-Ohio Ex. 142 at 19-20; Tr. II at 304, 350).

b. Staff

If the Commission determines that RPM-based capacity pricing is not appropriate for AEP-Ohio, Staff proposes an alternate capacity rate of \$146.41/MW-day, which accounts for energy margins as well as certain cost adjustments to the Company's proposed capacity pricing mechanism. Staff notes that its alternate rate may offer more financial stability to AEP-Ohio than RPM-based capacity pricing over the next three years, and is just and reasonable unlike the Company's excessive rate proposal. Staff finds that its alternate rate would appropriately balance the interests of AEP-Ohio in recovering its embedded costs to meet its FRR capacity obligations and attracting capital investment, while also promoting alternative competitive supply and retail competition.

According to Staff, the reduction of AEP-Ohio's proposed rate of \$355.72/MW-day to Staff's alternative recommendation of \$146.41/MW-day is a result of removing and adjusting numerous items, including return on equity; rate of return; construction work in progress (CWIP); plant held for future use (PHFFU); cash working capital (CWC); certain prepayments, including a prepaid pension asset and the related accumulated deferred income taxes; accumulated deferred income taxes; payroll and benefits for eliminated positions; 2010 severance program cost; income tax expense; domestic production activities; payroll tax expense; capacity equalization revenue; ancillary services revenue; and energy sales margin and ancillary services receipts. In terms of the return on equity, Staff witness Smith used ten percent for CSP and 10.3 percent for OP, because these percentages were adopted by the Commission in AEP-Ohio's recent distribution rate case (Staff Ex. 103 at 12-13).⁸ Staff notes that CWIP was properly excluded from rate base because AEP-Ohio has not demonstrated that the requirements of Section 4909.15 or 4928.143, Revised Code, have been met (Staff Ex. 103 at 14-15). Staff also excluded PHFFU from rate base, as the plant in

⁸ *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company, Individually and, if Their Proposed Merger is Approved, as a Merged Company (collectively, AEP Ohio) for an Increase in Electric Distribution Rates*, Case No. 11-351-EL-AIR, et al.

question is not used and useful and AEP-Ohio has given no indication as to when it will become so (Staff Ex. 103 at 16). CWC was excluded by Staff because AEP-Ohio did not prepare a lead-lag study or otherwise demonstrate a need for CWC (Staff Ex. 103 at 18-21). Staff excluded AEP-Ohio's prepaid pension asset for numerous reasons, mainly because the Company did not demonstrate that it has a net prepaid pension asset and its FERC Form 1 for 2010 suggests that there is actually a net liability; pension funding levels are the result of discretionary management decisions regarding the funding of defined benefit pensions; and pension expense is typically included in the determination of CWC in a lead-lag study, which was not provided (Staff Ex. 103 at 21-31). Staff further excluded nonrecurring costs related to the significant number of positions that were permanently eliminated as a result of AEP-Ohio's severance program in 2010 (Staff Ex. 1-3 at 43-52).

AEP-Ohio responds that Mr. Smith's downward adjustments and elimination of certain costs from Dr. Pearce's calculations are fundamentally flawed in that Dr. Pearce's formula rate approach is based on a formula rate template that was approved by FERC. AEP-Ohio also counters that adjustments made by Mr. Smith to the return on equity, operations and maintenance expenses attributable to severance programs, prepaid pension assets, CWC, CWIP, and PHFFU understate the Company's costs and contradict prior orders and practices of both the Commission and FERC. With respect to the return on equity, AEP-Ohio notes that Mr. Smith's adjustment was inappropriately taken from the stipulation in the Company's recent distribution rate case and that Mr. Smith agreed that the competitive generation business is more risky than the distribution business (Staff Ex. 103 at 12-13; Tr. IX at 1991, 1993; AEP-Ohio Ex. 142 at 17). AEP-Ohio contends that the Commission should adopt a return on equity of 11.15 percent as recommended by Dr. Pearce or, at a minimum, a return on equity of 10.5 percent, which AEP-Ohio claims is consistent with a return on equity that the Commission has recently recognized for certain generating assets of the Company (AEP-Ohio Ex. 142 at 17-18). AEP-Ohio further contends that Mr. Smith's elimination of certain severance costs and prepaid pension expenses is inconsistent with the Commission's treatment of such costs in the Company's recent distribution rate case, and that the \$39.004 million in severance costs should be amortized over three years (AEP-Ohio Ex. 142 at 17). AEP-Ohio argues that Mr. Smith's elimination of CWIP and CWC is inconsistent with FERC practice.

Additionally, AEP-Ohio asserts that Staff witnesses Smith and Harter failed to account for nearly \$66.5 million in certain energy costs incurred by the Company, including Production-Related Administrative & General Expenses, Return on Production-Related Investments, Production-Related Depreciation Expenses, and Production-Related Income Taxes. According to AEP-Ohio, due to these trapped costs, Mr. Smith's capacity charge is understated by \$20.11/MW-day on a merged company basis (AEP-Ohio Ex. 143 at 3, 5-6). AEP-Ohio witness Allen incorporated this amount in his calculation of what Staff's capacity rate would be, as modified by his recommended energy credit and cost-of-service

adjustments, and reached a resulting capacity rate of \$291.58/MW-day (AEP-Ohio Ex. 142 at 18; Tr. XI at 2311).

c. Intervenors

If the Commission believes that it is appropriate to consider AEP-Ohio's embedded costs, FES argues that the Company's true cost of capacity is \$78.53/MW-day, after adjustments are made to reflect the removal of stranded costs and post-2001 generation investment, as well as an appropriate offset for energy sales. At most, FES contends that it should be \$90.83/MW-day, if a further adjustment is made to credit back to AEP-Ohio the capacity equalization payments for the Company's Waterford and Darby plants, which were acquired in 2005 and 2007. FES also recommends that the Commission require AEP-Ohio to unbundle its base generation rate into energy and capacity components, which would ensure that the Company is charging the same price for shopping and non-shopping customers and allow customers to compare offers from CRES providers with the Company's tariff rates (FES Ex. 103 at 22).

The Suppliers note that, if the Commission finds that RPM-based capacity pricing is confiscatory or otherwise fails to compensate AEP-Ohio adequately, a nonbypassable stabilization charge, such as the rate stability rider rate proposed by the Company in 11-346, would be appropriate and should be considered in that case. OMA and OHA respond by arguing that any suggestion that rates should be raised without any justification, other than reaching a level that is high enough to ensure that CRES providers are able to compete with AEP-Ohio, tramples on customer interests and should be rejected by the Commission.

As discussed in greater detail below, OEG recommends that AEP-Ohio's capacity charge should be no higher than \$145.79/MW-day, which was the RPM-based price for the 2011/2012 PJM delivery year, and only if the Commission determines that the prevailing RPM price is not sufficient compensation (OEG Ex. 102 at 9-10). OEG argues that a capacity charge of \$145.79/MW-day provided a more than sufficient return on equity for AEP-Ohio, as well as fostered retail competition in its service territory (OEG Ex. 102 at 10-11). As part of this recommendation, OEG urges the Commission adopt an earnings stabilization mechanism (ESM) in the form of an annual review to gauge whether AEP-Ohio's earnings are too high or too low (OEG Ex. 102 at 15-21).

(i) Should there be an offsetting energy credit?

a) AEP-Ohio

AEP-Ohio does not recommend that the Commission adopt an energy credit offset to the capacity price, given that PJM maintains separate markets for capacity and energy (AEP-Ohio Ex. 102 at 13). AEP-Ohio witness Pearce, however, offers a recommendation for how an energy credit should be devised, if the Commission determines that an energy

credit is appropriate. Dr. Pearce's template for the calculation of energy costs is derived from the same formula rate template discussed above and approved by FERC (AEP-Ohio Ex. 102 at 14). The energy credit would be calculated as the difference between the revenues that the historic load shapes for CSP and OP, including all shopping and non-shopping load, would be valued at using locational marginal prices (LMP) that settle in the PJM day-ahead market, less the cost basis of this energy (AEP-Ohio Ex. 102 at Ex. KDP-1 through KDP-5). According to Dr. Pearce, the calculation relies upon a fair and reasonable proxy for the energy revenues that could have been obtained by CSP and OP by selling equivalent generation into the market (AEP-Ohio Ex. 102 at 15). AEP-Ohio contends that, if an energy credit is used to partially offset the demand charge, it should reflect actual energy margins for 2010 in order to best match the corresponding cost basis for calculating the demand charge. Dr. Pearce recommends that energy margins from OSS that are properly attributed to capacity sales to CRES providers should be shared on a 50/50 basis between AEP-Ohio and CRES providers (AEP-Ohio Ex. 102 at 18). Additionally, Dr. Pearce recommends that any energy credit be capped at 40 percent of the capacity charge that would be applicable with no energy credit, as a means to ensure that the credit does not grow so large as to reduce greatly capacity payments from CRES providers in times of high prices (AEP-Ohio Ex. 102 at 18).

b) Staff

As discussed above, Staff recommends that AEP-Ohio's compensation for its FRR capacity obligations be based on RPM pricing. Alternatively, Staff proposes a capacity rate of \$146.41/MW-day, which includes an offsetting energy credit and ancillary services credit. In calculating its proposed energy credit, Staff developed a forecast of total energy margins for AEP-Ohio's generating assets, using a dispatch market model known as AURORAxmp, which is licensed by Staff's consultant in this case, Energy Ventures Analysis, Inc. (EVA), as well as by AEP-Ohio and others (Staff Ex. 101 at 6; Tr. X at 2146, 2149; Tr. XII at 2637).

AEP-Ohio contends that Staff's black-box methodology for calculation of the energy credit is flawed in several ways and produces unrealistic and grossly overstated results. Specifically, AEP-Ohio argues that the AURORAxmp model used by Staff witnesses Harter and Medine is not well-suited for the task of computing an energy credit and that EVA implemented the model in a flawed manner through use of inaccurate and inappropriate input data and assumptions, which overstates gross energy margins for the period of June 2012 through May 2015 by nearly 200 percent (AEP-Ohio Ex. 144 at 8-25; AEP-Ohio Ex. 142 at 2-14). AEP-Ohio notes that, among other flaws, Staff's proposed energy credit understates fuel costs for coal units, understates the heat rates for gas units, overstates market prices (e.g., use of zonal rather than nodal prices, use of forecasted LMP rather than forward energy prices), fails to account for the gross margins allocable to the Company's full requirements contract with Wheeling Power Company, and fails to account for the fact

that the pool agreement limits the gross margins retained by the Company. AEP-Ohio argues that Company witness Allen proposed a number of conservative adjustments that should, at a minimum, be made to Staff's approach, resulting in an energy credit of \$47.46/MW-day (AEP-Ohio Ex. 142 at 4-14). AEP-Ohio adds that the documentation of EVA's approach is incomplete, inadequate, and cannot be sufficiently tested or validated; the data used in the model and the model itself cannot be reasonably verified; EVA's quality control measures are deficient; and the execution of EVA's analysis contains significant errors and has not been performed with requisite care (AEP-Ohio Ex. 144 at 13-18).

Additionally, AEP-Ohio points out that Staff's proposed energy credit wrongly incorporates OSS margins not related to capacity sales to CRES providers and also fails to properly reflect the impact of the pool agreement. Specifically, AEP-Ohio contends that, if an energy credit is adopted, it should reflect only the OSS margins attributable to energy that is freed up due to capacity sales to CRES providers. AEP-Ohio further notes that Staff inappropriately assumes that 100 percent of the margins associated with retail sales to SSO customers are available to be offset against the cost of capacity sold to CRES providers, which is inconsistent with the terms of the pool agreement, pursuant to which the Company's member load ratio share is 40 percent. AEP-Ohio believes that there is no reason to include margins associated with retail sales to SSO customers in an energy credit calculation intended to price capacity for shopping load. In accordance with Mr. Allen's recommendations, AEP-Ohio concludes that, if Staff's proposed energy credit is adopted by the Commission, it should be adjusted to \$47.46/MW-day. Alternatively, AEP-Ohio notes that Mr. Allen's proposed adjustments (AEP-Ohio Ex. 142 at 14) to Staff's energy credit could be made individually or in combination to the extent that the Commission agrees with the basis for each adjustment. AEP-Ohio adds that Company witness Nelson also offered additional options for an energy credit calculation, with the various methods converging around \$66/MW-day for the energy credit (AEP-Ohio Ex. 143 at 8, 12-13, 17). As a final option, AEP-Ohio states that the Commission could direct Staff to calculate an energy credit that is consistent with the forward prices recommended by Staff for use in the market rate option price comparison test in 11-346, which the Company believes would reduce Staff's energy credit by approximately \$50/MW-day.

c) Intervenors

FES argues that AEP-Ohio's formula rate should include an offset for energy-related sales or else the Company would double recover its capacity costs. FES notes that an energy credit is appropriate because AEP-Ohio recovers a portion of its fixed costs through energy-related sales for resale, and is also necessary to avoid an above-market return on equity for the Company. (FES Ex. 103 at 45-46, 49-50.) FES adds that all of AEP-Ohio's OSS revenues should be included as a credit against capacity costs and that no adjustment should be made to account for the pool agreement, given that the pool agreement could have been modified to account for retail shopping, as well as that the Company proposes to recover its

embedded capacity costs both from shopping customers and off-system energy sales (FES Ex. 103 at 47; Tr. I at 29-30). At minimum, FES believes that AEP-Ohio should account for its portion of OSS revenues, after pool sharing, in its capacity price. (FES Ex. 103 at 48-49.) If RPM-based capacity pricing is not required by the Commission, FES recommends that FES witness Lesser's energy credit, which simply uses AEP-Ohio's FERC account information without adjustments to account for the pool agreement, be adopted. FES notes that Dr. Lesser determined that AEP-Ohio overstated its capacity costs by \$178.1 million by failing to include an offset for energy sales.

OCC notes that it would be unjust and unreasonable for AEP-Ohio to be permitted to recover any of its embedded generation costs from customers, particularly without any offset for energy sales. OCC argues that, if the Commission adopts a cost-based capacity pricing mechanism, an energy credit that accounts for profits from OSS is warranted to ensure that AEP-Ohio does not recover embedded capacity costs from CRES providers, as well as recover some of those same costs from off-system energy sales, resulting in double recovery.

(ii) Does the Company's proposed cost-based capacity pricing mechanism constitute a request for recovery of stranded generation investment?

a) Intervenors

FES argues that SB 3 required that all generation plant investment occurring after January 1, 2001, be recovered solely in the market. FES notes that AEP-Ohio admits, in its recently filed corporate separation plan,⁹ that it can no longer recover stranded costs, as the transition period for recovery of such costs is long over. FES adds that AEP-Ohio witness Pearce failed to exclude stranded costs from his calculation of capacity costs. FES points out that, pursuant to the stipulation approved by the Commission in AEP-Ohio's electric transition plan (ETP) case, the Company waived recovery of its stranded generation costs and, in any event, through depreciation accruals, has already fully recovered such costs. FES also notes that Dr. Pearce's calculation inappropriately includes costs for generation plant investments made after December 31, 2000, and also seeks to recover the costs of assets that will no longer be owned by the Company as of January 1, 2014, but will rather be owned by AEP Generation Resources.

IEU-Ohio agrees with FES that AEP-Ohio agreed to forgo any claim for stranded generation costs, which bars the Company's untimely claim to generation plant-related transition revenues. IEU-Ohio contends that AEP-Ohio seeks to impose what IEU-Ohio considers to be a lost revenue charge on CRES suppliers serving shopping customers.

⁹ *In the Matter of the Application of Ohio Power Company for Approval of Full Legal Corporate Separation and Amendment to its Corporate Separation Plan*, Case No. 12-1126-EL-UNC.

Citing Sections 4928.141, 4928.38, and 4928.40, Revised Code, as well as AEP-Ohio's agreement to forgo recovery of generation transition revenues in its ETP case (Tr. I at 49-50; FES Ex. 106; FES Ex. 107), OMA and OHA likewise contend that Ohio law prohibits the Commission from establishing a state compensation mechanism that would authorize the receipt of transition revenues or any equivalent revenues by AEP-Ohio as a means to recover its above-market capacity costs.

Kroger argues that AEP-Ohio, through its requested compensation for its FRR capacity obligations, seeks recovery of stranded generation transition costs in this case. Kroger contends that such costs must be recovered in the market and that AEP-Ohio should not be permitted to renege on the stipulation in the ETP case. Dominion Retail likewise argues that AEP-Ohio should not be permitted to violate the terms of the ETP stipulation and recover stranded above-market generation investment costs after the statutory period for such recovery has expired. Dominion Retail believes that AEP-Ohio is effectively seeking a second transition plan in this case. IGS adds that the law is meaningless if utilities may continue to require all customers to pay embedded generation costs after the transition period has ended and that approval of AEP-Ohio's proposed capacity pricing mechanism would be contrary to the statutory requirements found in Sections 4928.38, 4928.39, and 4928.40, Revised Code.

b) AEP-Ohio

AEP-Ohio responds that neither the provisions of SB 3 nor the ETP stipulation are applicable to this case. AEP-Ohio notes that the purpose of this proceeding is to establish a wholesale capacity pricing mechanism based on the Company's embedded capacity costs, as opposed to the retail generation transition charges authorized by Section 4928.40, Revised Code, which is what the Company agreed to forgo during the market development period as part of the ETP stipulation. AEP-Ohio asserts that the issue of whether the Company could recover stranded asset value from retail customers under SB 3 is a separate matter from establishing a wholesale price that permits the Company's competitors to use that same capacity. AEP-Ohio adds that a conclusion that SB 3 precludes the Company from recovering its capacity costs through a wholesale rate would conflict with the RAA and be preempted under the FPA.

(iii) Should OEG's alternate proposal be adopted?

a) OEG

OEG recommends that AEP-Ohio's capacity pricing mechanism should be based on RPM prices. As an alternative recommendation, if the Commission determines that AEP-Ohio's capacity pricing should be higher than the prevailing RPM price, OEG suggests that the capacity price should be no higher than \$145.79/MW-day, which was the RPM-based

price for the 2011/2012 PJM delivery year. OEG believes that such price has proven effective in providing a more than sufficient return on equity for AEP-Ohio, while still fostering retail competition in the Company's service territory. (OEG Ex. 102 at 10-11). Additionally, OEG witness Kollen recommends that the Commission adopt an ESM to ensure that AEP-Ohio's earnings are neither too high nor too low and instead are maintained within a Commission-determined zone of reasonableness. OEG believes that such an approach is appropriate, given the significant uncertainty regarding both the proper compensation for AEP-Ohio's FRR capacity obligations and the impact of various charges on the Company's earnings. In particular, Mr. Kollen suggests that an earnings bandwidth be established, with a lower threshold return on equity of seven percent and an upper threshold return on equity of 11 percent. If AEP-Ohio's earnings fall below the lower threshold of seven percent, then the Company would be allowed to increase its rates through a nonbypassable ESM charge sufficient to increase its earnings to the seven percent level. If earnings exceed the upper threshold of 11 percent, then AEP-Ohio would return the excess earnings to customers through a nonbypassable ESM credit. If AEP-Ohio's earnings are within the earnings bandwidth, there would be no rate changes other than those that operate to recover defined costs such as through the fuel adjustment clause. Finally, Mr. Kollen notes that the Commission would have the discretion to make modifications as circumstances warrant. (OEG Ex. 102 at 15-21.) OEG believes that its recommended lower threshold is reasonable as confirmed by the recent actual earned returns of the AEP East affiliates, which averaged 6.8 percent in 2010 and 7.8 percent in 2011 (OEG Ex. 102 at 13). Additionally, AEP-Ohio's adjusted return in 2011 was 11.42 percent, just above its suggested upper threshold (OEG Ex. 102 at Ex. LK-3). Mr. Kollen explained that AEP-Ohio's earned return on equity would be computed in the same manner as under the significantly excessive earnings test (SEET) of Section 4928.143(F), Revised Code, although he believes that OSS margins should be included in the computation to be consistent with certain other parties' recommended approach of accounting for energy margins in the calculation of a cost-based capacity price (OEG Ex. 102 at 10, 15, 18; Tr. VI at 1290.)

b) AEP-Ohio

AEP-Ohio urges the Commission to reject OEG's alternate proposal. AEP-Ohio notes that the upper threshold of 11 percent is significantly lower than any SEET threshold previously applied to the Company and that the proposal would essentially render the statutory SEET obsolete. According to AEP-Ohio, the Commission is without jurisdiction to impose another, more stringent, excessive earnings test on the Company. AEP-Ohio also argues that OEG's proposal would preclude the Company from exercising its right under Section D.8 of Schedule 8.1 of the RAA to establish a cost-based compensation method. AEP-Ohio believes that Mr. Kollen's excessive earnings test would offer no material protection to the Company from undercompensation of its costs incurred to furnish capacity to CRES providers, and that the test would be difficult to administer, cause

prolonged litigation on an annual basis, and create substantial uncertainty for the Company and customers.

d. Conclusion

As discussed above, the Commission believes that AEP-Ohio's capacity costs, rather than RPM-based pricing, should form the basis of the state compensation mechanism established in this proceeding. Upon review of the considerable evidence in this proceeding, we find that the record supports compensation of \$188.88/MW-day as an appropriate charge to enable AEP-Ohio to recover its capacity costs for its FRR obligations from CRES providers. We also find that, as a means to encourage the further development of retail competition in AEP-Ohio's service territory, the Company should modify its accounting procedures to defer the difference between the adjusted RPM rate currently in effect and AEP-Ohio's incurred capacity costs, to the extent that such costs do not exceed the capacity charge approved today. We believe that this approach successfully balances the Commission's objectives and the interests of the many parties to this proceeding.

The record reflects a range in AEP-Ohio's cost of capacity from a low of \$78.53/MW-day, put forth by FES, to the Company's high of \$355.72/MW-day, as a merged entity, with Staff and OEG offering recommendations more in the middle of the range (AEP-Ohio Ex. 102 at 21; FES Ex. 103 at 55; Staff Ex. 105 at Ex. ESM-4; OEG Ex. 102 at 10-11). The Commission finds that Staff's determination of AEP-Ohio's capacity costs is reasonable, supported by the evidence of record, and should be adopted as modified in this order. Initially, we note that no party other than AEP-Ohio appears to seriously challenge Staff's recommended cost-based capacity pricing mechanism in this case. Additionally, we do not believe that AEP-Ohio has demonstrated that its proposed charge of \$355.72/MW-day falls within the zone of reasonableness, nor do we believe that FES' proposed charge of \$78.53/MW-day would result in reasonable compensation for the Company's FRR capacity obligations.

The Commission believes that the approach used by Staff is an appropriate method for determining AEP-Ohio's capacity costs. In deriving its recommended charge, Staff followed its traditional process of making reasonable adjustments to AEP-Ohio's proposed capacity pricing mechanism, which is based on the capacity portion of a formula rate template approved by FERC for one of the Company's affiliates and was modified by the Company for use in this case with data from its FERC Form 1 (Staff Ex. 103 at 10-12; AEP-Ohio Ex. 102 at 8, 9). As AEP-Ohio notes, FERC-approved formula rates are routinely used by the Company's affiliates in other states (AEP-Ohio Ex. 102 at 8; Tr. II at 253). Given that compensation for AEP-Ohio's FRR capacity obligations from CRES providers is wholesale in nature, we find that AEP-Ohio's formula rate template is an appropriate starting point for determination of its capacity costs. From that starting point, Staff made a number of reasonable adjustments to AEP-Ohio's proposal in order to be consistent with the Commission's ratemaking practices. Staff further adjusted AEP-Ohio's proposed capacity

pricing to account for margins from off-system energy sales and ancillary receipts (Staff Ex. 101 at 4). We agree with Staff, FES, and OCC that an offset for energy-related sales is necessary to ensure that AEP-Ohio does not over recover its capacity costs through recovery of its embedded costs as well as OSS margins (FES Ex. 103 at 45-46).

AEP-Ohio takes issue with the adjustments made by Staff witness Smith as well as with EVA's calculation of the energy credit. The Commission believes that the adjustments to AEP-Ohio's proposed capacity pricing mechanism that were made by Staff witness Smith are, for the most part, reasonable and consistent with our ratemaking practices in Ohio. With regard to AEP-Ohio's prepaid pension asset, however, we agree with the Company that Mr. Smith's exclusion of this item was inconsistent with Staff's recommendation in the Company's recent distribution rate case (AEP-Ohio Ex. 129A; AEP-Ohio Ex. 129B), as well as with our treatment of pension expense in other proceedings.¹⁰ We see no reason to vary our practice in the present case and, therefore, find that AEP-Ohio's prepaid pension asset should not have been excluded. The result of our adjustment increases Staff's recommendation by \$3.20/MW-day (AEP-Ohio Ex. 142 at 16, Ex. WAA-R7). Similarly, with respect to AEP-Ohio's severance program costs, we find that Mr. Smith's exclusion of such costs was inconsistent with their treatment in the Company's distribution rate case. Amortization of the severance program costs over a three-year period increases Staff's recommendation by \$4.07/MW-day. (AEP-Ohio Ex. 142 at 16-17.) Further, upon consideration of the arguments with respect to the appropriate return on equity, we find that AEP-Ohio's recommendation of 11.15 percent is reasonable and should be adopted. As AEP-Ohio notes, Staff's recommended return on equity was solely based on the negotiated return on equity in the Company's distribution rate case (Staff Ex. 103 at 12-13), which has no precedential effect pursuant to the express terms of the stipulation adopted by the Commission in that case. Our adoption of a return on equity of 11.15 percent increases Staff's recommendation by \$10.09/MW-day (AEP-Ohio Ex. 142 at 17). We also agree with AEP-Ohio that certain energy costs were trapped in Staff's calculation of its recommended capacity charge, in that Staff witness Smith regarded such costs as energy related and thus excluded them from his calculations, while EVA disregarded them in its determination of the energy credit. Accordingly, we find that Staff's recommendation should be increased by \$20.11/MW-day to account for these trapped costs. (AEP-Ohio Ex. 143 at 5-6.)

Additionally, the Commission finds, on the whole, that Staff's recommended energy credit, as put forth by EVA, is reasonable. AEP-Ohio raises a number of arguments as to why Staff's energy credit, as calculated by EVA, should not be adopted by the Commission. In essence, AEP-Ohio fundamentally disagrees with the methodology used by EVA. Although we find that EVA's methodology should be adopted, we agree with AEP-Ohio

¹⁰ See, e.g., *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices, and for Tariff Approvals*, Case No. 07-551-EL-AIR, et al., Opinion and Order (January 21, 2009), at 16.

that EVA's calculation should have accounted for the Company's full requirements obligation to serve Wheeling Power Company, a point that Staff did not dispute in its briefs. As AEP-Ohio witness Allen testified, the Company's sales to Wheeling Power Company reduce the quantity of generation available for OSS and thus should have been reflected in EVA's calculation of OSS margins. (AEP-Ohio Ex. 142 at 10-11, Ex. WAA-R5). The result of this adjustment reduces Staff's recommended energy credit by \$5/MW-day (AEP-Ohio Ex. 142 at 11, Ex. WAA-R5) to \$147.41/MW-day. The overall effect of this adjustment, in combination with the adjustments for AEP-Ohio's prepaid pension asset, severance program costs, return on equity, and trapped costs, results in a capacity charge of \$188.88/MW-day.

We note that a charge of \$188.88/MW-day is fairly in line with OEG's alternate recommendation that the capacity charge not exceed \$145.79/MW-day, which was the adjusted RPM rate in effect in the prior PJM delivery year that recently concluded (OEG Ex. 102 at 10-11). The close proximity of our approved charge with OEG's recommendation is further confirmation that the approved charge falls within the zone of reasonableness. Additionally, as OEG notes, a charge of \$145.79/MW-day afforded AEP-Ohio an adequate return on equity. In 2011, AEP-Ohio earned a per books, unadjusted return of 10.21 percent, or an adjusted return of 11.42 percent after adjustments for plant impairment expense and certain non-recurring revenue (OEG Ex. 102 at 11, Ex. LK-3). At the same time, the capacity charge was not so high as to hinder retail competition in AEP-Ohio's service territory. In the first quarter of 2011, the RPM price was \$220.96/MW-day and only 7.1 percent of AEP-Ohio's total load had switched to a CRES provider. However, by the end of the year, with a lower RPM price of \$145.79/MW-day in effect, shopping had significantly increased in AEP-Ohio's service territory, with 19.10 percent of the Company's total load having elected to shop (specifically, 5.53 percent of the residential class, 33.88 percent of the commercial class, and 18.26 percent of the industrial class). (OEG Ex. 102 at 11.) We expect that the approved compensation of \$188.88/MW-day for AEP-Ohio's FRR capacity obligations will likewise ensure that the Company earns an appropriate return on equity, as well as enable the further development of competition in the Company's service territory.

Although AEP-Ohio criticizes Staff's proposed capacity pricing mechanism for various reasons, the Commission finds that none of these arguments has merit. First, as a general matter, AEP-Ohio argues that Staff failed to follow FERC practices and precedent. We agree with Staff that FERC has different requirements for items such as CWC and CWIP than are found in Ohio. As Staff notes, the outcome of this case should not be dictated by FERC practices or precedent but should instead be consistent with Ohio ratemaking principles. Although FERC practices and precedent may be informative in some instances, the Commission is bound by Ohio law in establishing an appropriate state compensation mechanism. In response to AEP-Ohio's specific argument regarding the exclusion of CWIP, Staff explained that Section 4909.15(A)(1), Revised Codes, requires that construction projects

must be at least 75 percent complete in order to qualify for a CWIP allowance and that AEP-Ohio failed to demonstrate compliance with this requirement.

As previously mentioned above, AEP-Ohio raises numerous concerns regarding Staff's proposed energy credit and offered the rebuttal testimony of Company witness Meehan in an effort to critique EVA's testimony. Upon review of all of the testimony, the Commission finds that it is clear that the dispute between AEP-Ohio and Staff amounts to a fundamental difference in methodology in everything from the calculation of gross energy margins to accounting for operation of the pool agreement. AEP-Ohio claims that Staff's inputs to the AURORAxmp model result in an overstated energy credit, while Staff argues that the Company's energy credit is far too low. Essentially, AEP-Ohio and Staff have simply offered two quite different approaches in their attempt to forecast market prices for energy. The Commission concludes that AEP-Ohio has not shown that the process used by Staff was erroneous or unreasonable. We further find that the approach put forth by EVA is a proper means of determining the energy credit and produces an energy credit that will ensure that AEP-Ohio does not over recover its capacity costs.

Accordingly, we adopt Staff's proposed energy credit, as modified above to account for AEP-Ohio's full requirements contract with Wheeling Power Company, and find that a capacity charge of \$188.88/MW-day is just, reasonable, and should be adopted. The Commission agrees with AEP-Ohio that the compensation received from CRES providers for the Company's FRR capacity obligations should reasonably and fairly compensate the Company and should not significantly undermine the Company's ability to earn an adequate return on its investment. The Commission believes that, by adopting a cost-based state compensation mechanism for AEP-Ohio, with a capacity charge of \$188.88/MW-day, in conjunction with the authorized deferral of the Company's incurred capacity costs, to the extent that the total incurred capacity costs do not exceed \$188.88/MW-day not recovered from CRES provider billings reflecting the adjusted RPM-based price, we have accomplished those objectives, while also protecting the interests of all stakeholders.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

- (1) AEP-Ohio is a public utility as defined in Section 4905.02, Revised Code, and, as such, is subject to the jurisdiction of this Commission.
- (2) On November 1, 2010, AEPSC, on behalf of AEP-Ohio, filed an application with FERC in FERC Docket No. ER11-1995, and on November 24, 2010, refiled its application, at the direction of FERC, in FERC Docket No. ER11-2183. The application proposed to change the basis for compensation for capacity costs to a cost-based mechanism and included proposed formula rate

templates under which AEP-Ohio would calculate its capacity costs under Section D.8 of Schedule 8.1 of the RAA.

- (3) By entry issued on December 8, 2010, the Commission initiated an investigation in the present case to determine the impact of AEP-Ohio's proposed change to its capacity charge.
- (4) The following parties were granted intervention in this proceeding: OEG, IEU-Ohio, OCC, OP&E, OMA, OHA, Direct Energy, Constellation, F&S, Duke, Exelon, IGS, RESA, Schools, OF&B, Kroger, NFIB, Dominion Retail, AICUO, Grove City, and OCMC.
- (5) On September 7, 2011, the ESP 2 Stipulation was filed by AEP-Ohio, Staff, and other parties to resolve the issues raised in the consolidated cases, including the present case.
- (6) On December 14, 2011, the Commission adopted the ESP 2 Stipulation with modifications.
- (7) By entry on rehearing issued on February 23, 2012, the Commission revoked its prior approval of the ESP 2 Stipulation, finding that the signatory parties had not met their burden of demonstrating that the stipulation, as a package, benefits ratepayers and the public interest.
- (8) By entry issued on March 7, 2012, the Commission approved, with modifications, AEP-Ohio's proposed interim capacity pricing mechanism.
- (9) A prehearing conference occurred on April 11, 2012.
- (10) A hearing commenced on April 17, 2012, and concluded on May 15, 2012. AEP-Ohio offered the direct testimony of five witnesses and the rebuttal testimony of three witnesses. Additionally, 17 witnesses testified on behalf of various intervenors and three witnesses testified on behalf of Staff.
- (11) Initial briefs and reply briefs were filed on May 23, 2012, and May 30, 2012, respectively.
- (12) By entry issued on May 30, 2012, the Commission approved an extension of AEP-Ohio's interim capacity pricing mechanism through July 2, 2012.

- (13) The Commission has jurisdiction in this matter pursuant to Sections 4905.04, 4905.05, and 4905.06, Revised Code.
- (14) The state compensation mechanism for AEP-Ohio, as set forth herein, is just and reasonable and should be adopted.

ORDER:

It is, therefore,

ORDERED, That IEU-Ohio's motion to dismiss this case be denied. It is, further,

ORDERED, That the motion for permission to appear *pro hac vice instantanter* filed by Derek Shaffer be granted. It is, further,

ORDERED, That the state compensation mechanism for AEP-Ohio be adopted as set forth herein. It is, further,

ORDERED, That AEP-Ohio be authorized to defer its incurred capacity costs not recovered from CRES provider billings to the extent the total incurred capacity costs do not exceed \$188.88/MW-day. It is, further,


ORDERED, That the interim capacity pricing mechanism approved on March 7, 2012, and extended on May 30, 2012, shall remain in place until the earlier of August 8, 2012, or such time as the Commission issues its opinion and order in 11-346, at which point the state compensation mechanism approved herein shall be incorporated into the rates to be effective pursuant to that order. It is, further,

ORDERED, That nothing in this opinion and order shall be binding upon this Commission in any future proceeding or investigation involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

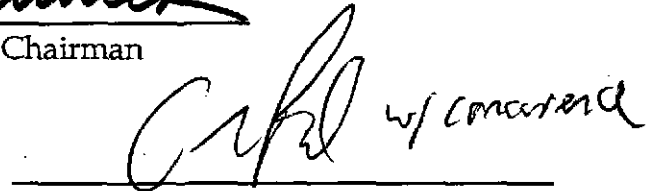
ORDERED, That a copy of this opinion and order be served upon all parties of record in this case.

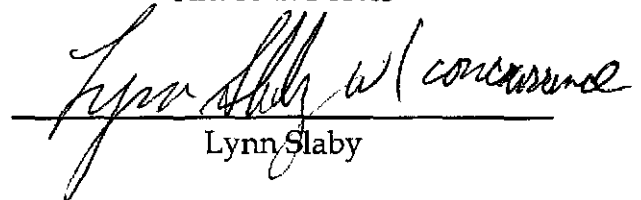
THE PUBLIC UTILITIES COMMISSION OF OHIO


Todd A. Snitchler, Chairman


Steven D. Lesser

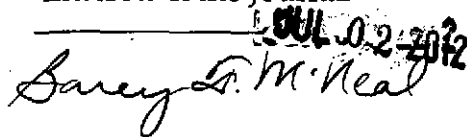

Cheryl L. Roberto


Andre T. Porter


Lynn Slaby

SJP/GNS/sc

Entered in the Journal


Barcy F. McNeal
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission Review of)
the Capacity Charges of Ohio Power)
Company and Columbus Southern Power) Case No. 10-2929-EL-UNC
Company.)

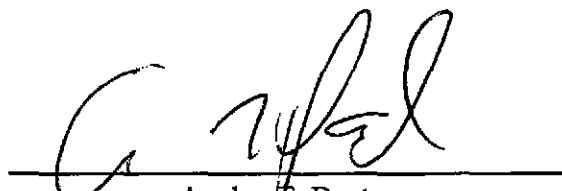
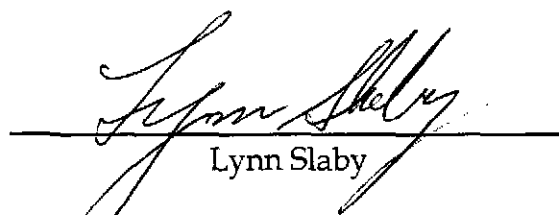
CONCURRING OPINION
OF COMMISSIONERS ANDRE T. PORTER AND LYNN SLABY

The majority opinion and order balances the interests of consumers, suppliers, and AEP-Ohio. It provides certainty for consumers and suppliers by resolving questions about whether there will be a competitive electricity market in the AEP-Ohio territory, specifically, and across this state, generally. It does so by establishing a state compensation mechanism pursuant to which competitive retail electric suppliers have access to RPM-based market capacity pricing, which will encourage competition among those suppliers, resulting in the benefit to consumers of the lowest and best possible electric generation rates in the AEP-Ohio territory.

Moreover, it recognizes the important function and commitment of AEP-Ohio as a fixed resource requirement entity having dedicated capacity to serve consumers in its service territory. However, these resources are not without cost. Accordingly, the order allows AEP-Ohio to receive its actual costs of providing the capacity through the deferral mechanism described therein, which we have determined, after thorough consideration of the record in this proceeding, to be \$188.88/MW-day. This result is a fair balance of all interests because rather than subjecting AEP-Ohio to RPM capacity rates that were derived from a market process in which AEP-Ohio did not participate, the order allows AEP-Ohio to recover the costs of the agreement to which it was a participant—dedicating its capacity to serve consumers in its service territory. Our opinion of this result, in this case, should not be misunderstood as it relates to RPM; *by joining the majority opinion, we do not, in any way, agree to any description of RPM-based capacity rates as being unjust or unreasonable.*

Finally, while we prefer to have the state compensation mechanism effective as of today, we join with the majority in setting the effective date of August 8, 2012, or to coincide with our as-yet unissued opinion and order in Docket No. 11-346-EL-SSO, whichever is earlier. In an attempt to balance the deferral authorization created in this proceeding and


the anticipated mechanism to be considered as part of Docket No. 11-346-EL-SSO to administer the deferral, we agree that it is equitable to tie the decision being made in this order to that in 11-346-EL-SSO. However, we caution that the balance is only achieved within an expeditious resolution of the 11-346-EL-SSO docket by August 8, 2012.


Andre F. Porter
Lynn Slaby

ATP/LS/sc

Entered in the Journal

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Barcy F. McNeal

Barcy F. McNeal
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission Review of)
the Capacity Charges of Ohio Power) Case No. 10-2929-EL-UNC
Company and Columbus Southern Power)
Company.)

CONCURRING AND DISSENTING OPINION
OF COMMISSIONER CHERYL L. ROBERTO

I join my colleagues in updating the state compensation method for the Fixed Resource Requirement from that originally adopted implicitly in AEP-Ohio's first ESP case, Case No. 08-917-EL-SSO, *et al.*, and explicitly in this matter to a cost-based rate of \$188.88/MW-day.

I depart from the majority, however, in the analysis of the nature of the Fixed Resource Requirement and, as a result, the basis for the Commission's authority to update the state compensation method for the Fixed Resource Requirement.

Additionally, I dissent from those portions of the majority opinion creating a deferral of a portion of the authorized cost-based Fixed Resource Requirement rate adopted today.

What is a Fixed Resource Requirement?

In order to assure that the transmission system is reliable, PJM requires any one who wishes to transmit electricity over the system to their customers¹ to provide reliability assurance that they have the wherewithal - or *capacity* - to use the transmission system without crashing it or otherwise destabilizing it for everyone else.² The protocols for making this demonstration are contained in the Reliability Assurance Agreement. Each transmission system user must show that they possess Capacity Resources sufficient to meet their own needs plus a margin for safety. These Capacity Resources may include a combination of generation facilities, demand resources, energy efficiency, and Interruptible

¹ These transmission users are known as a "Load Serving Entity" or "LSE." LSE shall mean any entity (or the duly designated agent of such an entity), including a load aggregator or power marketer, (i) serving end-users within the PJM Region, and (ii) that has been granted the authority or has an obligation pursuant to state or local law, regulation or franchise to sell electric energy to end-users located within the PJM Region. *Reliability Assurance Agreement Among Load Serving Entities in the PJM Region, PJM Interconnection, L.L.C., Rate Schedule FERC No. 44* (effective date May 29, 2012) (hereinafter Reliability Assurance Agreement), Section 1.44.

² Section 5, Capacity Resource Commitment, PJM Open Access Transmission Tariff (effective date June 8, 2012), at 2395-2443.

Load for Reliability.³ Capacity Resources may even include a transmission upgrade.⁴ The Fixed Resource Requirement is nothing more than an enforceable agreement that for a finite period one transmission user will demonstrate on behalf of other transmission users within a specified territory that sufficient Capacity Resources exist to meet all of their respective reliability needs. During this period, the transmission user offering to provide the Fixed Resource Requirement is the sole authorized means by which a transmission user who opts to use this service may demonstrate the adequacy of their Capacity Resources.⁵ This demonstration is embodied in a Fixed Resource Requirement Capacity Plan that describes a portfolio of the generation, demand resources, energy efficiency, Interruptible Load for Reliability, and transmission upgrades it plans to use to meet the Capacity Resource requirements for the territory.⁶ The Ohio Supreme Court has noted that regional transmission organizations, such as PJM, provide transmission services through FERC approved rates and tariffs.⁷ Thus, the Fixed Resource Requirement is a commitment to provide a transmission service pursuant to the tariffs filed by PJM with FERC.

As established in this matter, AEP-Ohio has committed to provide the Fixed Resource Requirement for all transmission users offering electricity for sale to retail customers within the footprint of its system. No other entity may provide this service during the term of the current AEP-Ohio Fixed Resource Requirement Capacity Plan.

Commission Authority to Establish State Compensation Method
for the Fixed Resource Requirement Service

Chapter 4928, Revised Code, defines “retail electric service” to mean any service involved in the supply or arranging for the supply of electricity to ultimate consumers in this state, from the point of generation to the point of consumption. For purposes of Chapter 4928, Revised Code, retail electric service includes, among other things, transmission service.⁸ As discussed, *supra*, AEP-Ohio is the sole provider of the Fixed Resource Requirement service for other transmission users operating within its footprint until the expiration of its obligation on June 1, 2015. As such, this service is a “noncompetitive retail electric service” pursuant to Sections 4928.01(A)(21) and 4928.03, Revised Code. This Commission is empowered to set rates for noncompetitive retail electric services. While PJM could certainly propose a tariff for FERC adoption directing PJM to

³ Reliability Assurance Agreement, Schedule 6, Procedures for Demand Resources, ILR, and Energy Efficiency.

⁴ Reliability Assurance Agreement, Schedule 8.1, Section D.6.

⁵ Reliability Assurance Agreement, Section 1.29 defines the Fixed Resource Requirement Capacity Plan to mean a long-term plan for the commitment of Capacity Resources to satisfy the capacity obligations of a Party that has elected the FRR Alternative, as more fully set forth in Schedule 8.1 to this Agreement.

⁶ Reliability Assurance Agreement, Section 7.4, Fixed Resource Requirement Alternative.

⁷ *Ohio Consumers' Counsel v. PUCO*, 111 Ohio St.3d. 384, 856 N.E.2d 940 (2006).

⁸ Section 4928.01(A)(27), Revised Code.

establish a compensation method for Fixed Resource Requirement service, it has opted not to do so in favor of a state compensation method when a state chooses to establish one. When this Commission chooses to establish a state compensation method for a noncompetitive retail electric service, the adopted rate must be just and reasonable based upon traditional cost-of-service principles.

This Commission previously established a state compensation method for AEP-Ohio's Fixed Resource Requirement service within AEP-Ohio's initial ESP. AEP-Ohio received compensation for its Fixed Resource Requirement service through both the provider of last resort charges to certain retail shopping customers and a capacity charge levied on competitive retail providers that was established by the three-year capacity auction conducted by PJM.⁹ Since the Commission adopted this compensation method, the Ohio Supreme Court reversed the authorized provider of last resort charges,¹⁰ and the auction value of the capacity charges has fallen precipitously, as has the relative proportion of shoppers to non-shoppers.

I agree with the majority that the Commission is empowered pursuant to its general supervisory authority found in Sections 4905.04, 4905.05, and 4905.06, Revised Code to establish an appropriate rate for the Fixed Resource Requirement service. I also agree that pursuant to regulatory authority under Chapter 4905, Revised Code, as well as Chapter 4909, Revised Code a cost-based compensation method is necessary and appropriate. Additionally, I find that because the Fixed Resource Requirement is a noncompetitive retail electric service, the Commission must establish the appropriate rate based upon traditional cost of service principles. Finally, I find specific authority within Section 4909.13, Revised Code, for a process by which the Commission may cause further hearings and investigations and may examine into all matters which may change, modify, or affect any finding of fact previously made. Given the change in circumstances since the Commission adopted the initial state compensation for AEP-Ohio's Fixed Resource Requirement service, it is appropriate for the Commission to revisit and adjust that rate to reflect current circumstances as we have today.

"Deferral"

In prior cases, this Commission has levied a rate or tariff on a group of customers but deferred collection of revenues due from that group until a later date. In this instance, the majority proposes to establish a rate for the Fixed Resource Requirement service provided

⁹ *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO, *et al.*, Opinion and Order (March 18, 2009), Entry on Rehearing (July 23, 2009); *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, Entry (December 8, 2010).

¹⁰ *In re Application of Columbus S. Power Co.*, 128 Ohio St.3d 512 (2011).

by AEP-Ohio to other transmission users but then to discount that rate such that the transmission users will never pay it. The difference between the authorized rate and that paid by the other transmission users will be booked for future payment not by the transmission users but by retail electricity customers. The stated purpose of this device is to promote competition.

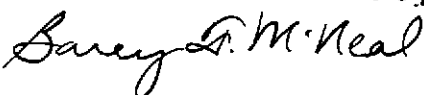
As an initial matter, I am not convinced on the record before us that competition has suffered sufficiently or will suffer sufficiently during the remaining term of the Fixed Resource Requirement as the result of the state compensation method to warrant intervention in the market. If it did, the Commission could consider regulatory options such as shopping credits granted to the consumers to promote consumer entry into the market. With more buyers in the market, in theory, more sellers should enter and prices should fall. The method selected by the majority, however, attempts to entice more sellers to the market by offering a significant, no-strings-attached, unearned benefit. This policy choice operates on faith alone that sellers will compete at levels that drop energy prices while transferring the unearned discount to consumers. If the retail providers do not pass along the entirety of the discount, then consumers will certainly and inevitably pay twice for the discount today granted to the retail suppliers. To be clear, unless every retail provider disgorges 100 percent of the discount to consumers in the form of lower prices, shopping consumers will pay more for Fixed Resource Requirements service than the retail provider did. This represents the first payment by the consumer for the service. Then the deferral, with carrying costs, will come due and the consumer will pay for it all over again – plus interest.

I find that that the mechanism labeled a “deferral” in the majority opinion is an unnecessary, ineffective, and costly intervention into the market that I cannot support. Thus, I dissent from those portions of the majority opinion adopting this mechanism.


Cheryl L. Roberto

CLR/sc

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Barcy F. McNeal
Secretary