

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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

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

**REPLY BRIEF
SUBMITTED ON BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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INTRODUCTION

Shortly after initial post-hearing briefs were filed in this case, the Commission issued its decision in AEP-Ohio's "*Capacity Case*."¹ As staff noted in its initial brief, many of AEP-Ohio's (Company's) proposals in this case are closely related to the *Capacity Case*.

The Commission has now spoken in that case. The Commission approved a state compensation mechanism for capacity of \$188.88/MW-day, with CRES provider billings

¹

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 (Capacity Case).

to reflect an adjusted RPM-based price. The Commission further authorized deferral of capacity costs not recovered from CRES providers to the extent that the total incurred capacity costs do not exceed \$188.88/MW-day. It further stated that it “will establish an appropriate recovery mechanism for such deferred costs and address any additional financial considerations” in this proceeding.

In light of the Commission’s decision in the *Capacity Case*, staff reiterates its position that the Company should charge CRES providers the RPM rate, and adopts with approval both the capacity compensation mechanism and the deferral of unrecovered costs. To the extent that that decision modifies positions taken by staff either during this proceeding or in its initial brief, staff clarifies that it fully supports the Commission’s order in the *Capacity Case*.

DISCUSSION

I. ESP Versus MRO Test

As described in its initial brief, staff’s analysis demonstrates that the Company’s modified ESP, on a purely quantitative basis, fails the MRO test. The Commission must, however, consider qualitative factors, as well. Those factors are not insignificant. Staff believes that the Commission is properly committed to ensuring that consumers gain the benefits of market conditions and prices as expeditiously as possible. Further modifications to the Company’s proposal, specifically including those advocated by staff, could certainly justify approval of an ESP in this case.

A. RPM as the appropriate charge for capacity.

Aside from the recent developments in Case No. 10-2929-EL-UNC, staff still maintains that the Company charge CRES providers the prevailing RPM rate in the unconstrained region of PJM.² Staff, in its initial brief, proposed that the appropriate alternative, if the prevailing RPM rates during the proposed ESP period are found by the Commission to not be compensatory, is the capacity rate developed by staff witness Medine,³ \$146.41/MW-day, in Case No. 10-2929-EL-UNC.⁴ The Commission, in its July 2, 2012 order in Case No. 10-2929-EL-UNC, found that RPM rates during the proposed ESP period were indeed not compensatory and ordered a cost-based capacity charge of \$188.88/MW-day. The Commission, however, also ordered the Company to charge CRES providers (beginning on August 8, 2012, or sooner), the prevailing RPM rates during the proposed ESP period, in conjunction with an authorized deferral mechanism for the Company to recover any amount equivalent to the difference between the cost-based rate and the prevailing RPM rates during the proposed ESP period. The deferral mechanism will be defined in the upcoming order on, or prior to, August 8, 2012. Staff supports the findings in the July 2, 2012 order.

² Staff's Initial Brief at 7.

³ *Capacity Case* (Testimony of Emily S. Medine on behalf of Staff of the Public Utilities Commission of Ohio) (May 7, 2012).

⁴ Staff's Initial Brief at 7.

B. MRO Retail Pricing

Company witness Thomas offered an MRO retail pricing construct and staff witness Johnson conducted an independent test and predicted three sets of MRO prices based upon different assumptions regarding the price of capacity.⁵ Staff witness Fortney used those prices, accepting the generation rates and the resulting revenue impacts which the company proposed.⁶ As stated in his testimony, Mr. Fortney concluded that under *all three* of these scenarios the ESP as proposed by the Company is not more favorable than the blended MRO utilizing the forecasted market rates as determined by staff witness Johnson.⁷

The Company contends that staff's cost-based capacity price in Case No. 10-2929-EL-UNC contains "internal inconsistencies" that discredit staff's MRO Price Test.⁸ In specific, the Company states that rather than using the AURORA forecasted energy prices when estimated the energy credits, staff should have the used the ICE forward energy prices.⁹ The Company failed to discredit staff's analysis as the AURORA production simulation model is one of the models that is often used by electric utilities in the U.S., including AEP. Staff's consultant, EVA, in Case No. 10-2929-EL-UNC, developed an energy price forecast that was more robust then the Company's use of for-

⁵ Staff's Initial Brief at 11.

⁶ *Id.*

⁷ *Id.* at 12.

⁸ Company Initial Brief at 145.

⁹ *Id.*

ward energy prices.¹⁰ Staff demonstrated that significant changes frequently occur with forward energy market prices making it less reliable than the AURORA forecasted energy market prices.¹¹ As part of its FUELCAST services, EVA constantly updates its Aurora model with its ongoing short-term and long-term analyses of data regarding coal, natural gas, and emission allowances.¹² Additionally, forward energy prices are in fact used by EVA as the starting point of its analysis.¹³ EVA’s energy price forecasts incorporate expert intelligence of real world experience and granular transportation cost of delivering fuel to plant.¹⁴ Ultimately, in Case No. 10-2929-EL-UNC, staff and the Company offered separate and competing analyses; simply because AEP Ohio finds the results of staff’s analysis disadvantageous does not make EVA’s methodology and analysis results wrong.¹⁵ Therefore, the Company’s “flawed analysis” claim of staff’s methodology in the 10-2929 case has no merit, and staff’s MRO Price Test and results are reasonable.

The Company also suggests that staff understated its RPM capacity rates because it did not reflect the impacts of the scaling factor, Forecast Pool Requirement, and

¹⁰ *Capacity Case* (Staff Reply Brief at 18).

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.* at 20.

losses.¹⁶ The staff admitted that the scaling factor, Forecast Pool Requirement, and losses were not considered in its analysis as staff did not believe the inclusion of these adders is appropriate for the purpose of developing an MRO¹⁷, however, to the extent such adders were erroneously included in the development of an MRO, the impact these adders had on staff's analysis results would have been *de minimis*. On cross examination, Mr. Fortney testified that:

...using the scalers, loss factors, whatever those three components were, becomes \$20 million better than it previously was, but it still exceeds the cost of the MRO by \$445 million.¹⁸

Even with these items considered, the ESP price still exceeds the MRO by \$445 million, failing the MRO versus ESP quantitative test.

C. Qualitative Considerations.

The Commission may also take qualitative factors into consideration that may justify approval of the plan in some form. A number of such “benefits” were espoused, both by the Company and by staff.

Staff witness Fortney testified that a move to a full market rate could be achieved more quickly than through the blending phase-in of an MRO. Staff supports the Company's efforts to move to a fully competitive auction-based SSO structure, and agrees that

¹⁶ Company Initial Brief at 146-147.

¹⁷ Tr. at 2417-2418.

¹⁸ Tr. at 4647.

an ESP would permit the Company to do so more quickly than an MRO.¹⁹ Although the staff applauds the effort to introduce competitive SSO energy procurement before 2015, it would still prefer to see a much more aggressive transition to auction-based pricing. While a more efficient move to competition is not “required under current law,”²⁰ staff believes that it is consistent with the policy of the State of Ohio, and the Commission’s overall mission to protect EDUs, their customers, and statewide development as a whole.

Staff agrees with the Company that the proposed ESP would improve rate certainty and stability during the transition. As the Company properly noted, the proposal certainly simplifies the number and operation of the proposed generation service riders.²¹ The Company’s plan fixes base generation rates during the pre-auction period of the ESP. While IEU-Ohio claims that the various riders may well make bills less predictable²², staff believes that rate certainty and stability would be enhanced by adopting a modified version of the Company’s plan.

Finally, Mr. Fortney noted that the proposed GRR provides a mechanism to allow for the construction of additionally needed future generation facilities. As the Company properly noted in its brief, it must still demonstrate how any proposed project satisfies all

¹⁹ Company Brief at 6.

²⁰ *Id.* at 7.

²¹ *Id.* at 3.

²² IEU-Ohio Brief at 18.

applicable requirements set forth in R.C. 4928.143(B)(2) before obtaining cost recovery.²³ All parties would retain the ability to challenge the inclusion of costs in the rider. If, as IEU-Ohio argues²⁴, there truly is no need for additional generation resources, the General Assembly has provided the Commission with the authority to “a non-zero charge for inclusion in the GRR.”²⁵

II. Standard Service Offer Rate Provisions of the Modified ESP

A. Generation Rates

1. SSO Generation Service Rider (base generation rate)

The Company has proposed to freeze current non-fuel generation rates until such time as those rates are established through a competitive bidding process. Its only proposed change is to bundle the current Environmental Investment Carrying Charge Rider (EICCR) into the base generation rates.

Staff agrees that the Company’s proposal to freeze base generation rates until those rates are established through a competitive bidding process is reasonable and therefore provides rate stability and certainty for customers.

²³ Company Brief at 4.

²⁴ IEU-Ohio Brief at 19.

²⁵ Company Brief at 4.

2. Fuel Adjustment Clause

Staff has expressed its agreement with the Company's proposal to continue its Fuel Adjustment Clause (FAC), modified to remove renewable energy credits (RECs) and unifying the rates into a single set of merged rates. While staff supports these proposals, it reiterates its position that the Company should be supplying SSO load, or at least a substantially greater portion of it, through an auction process or processes during the period of the ESP between corporation separation (January 1, 2014) and the 2015 full requirements auction.

The Company is also proposing, however, to delay unification of the FAC rates until June 2013 to coincide with the implementation of the Phase-In Recovery Rider (PIRR). It correctly notes that staff witness Turkenton also recommended merging the FAC rates and agrees that the FAC and PIRR should be unified simultaneously.²⁶ But as staff noted in its initial brief, it recommends that the Company should merge their FAC rates and implement the merged PIRR without delay. The delay proposed by the Company would result in the unnecessary imposition of an additional \$71M in carrying charges.²⁷ The Company should be directed to merge both its FAC and the PIRR rates, and start collection as soon as practicable following a Commission order in this case. And the Company should be denied the recovery of carrying costs since it voluntarily elected to delay collections that were supposed to begin January 1, 2012.

²⁶ Company Brief at 27.

²⁷ Staff Ex. 109.

3. Alternative Energy Rider

The Company proposes establishing a bypassable Alternative Energy Rider (AER) for recovery of REC expense. Staff noted in its initial brief that it generally supports the concept of separately identifying and recovering costs associated with renewable energy requirements, but recommended that an auditing procedure be established. The Company noted staff agreement, and voiced no objection to staff witness Strom's audit proposals,²⁸ which the Commission should adopt as proposed.

4. Generation Resource Rider

The Company proposes establishing a new non-bypassable Generation Resource Rider (GRR) to collect costs associated with investment in generating facilities in accordance with Ohio Revised Code Section 4928.143 (B)(2)(c). The Company correctly notes that it is not seeking recovery of any at this time, nor is it now seeking approval of any GRR rates.²⁹ Any charges included in the GRR would need to be approved in a separate Commission proceeding. Staff witness Fortney testified in support of the GRR.³⁰

5. Interruptible Service Rates

The Company proposes to restructure and expand its existing interruptible service offerings. Based on approval of its proposed RSR, the Company has expressed a "will-

²⁸ Company Brief at 29.

²⁹ *Id.* at 30.

³⁰ Staff Ex. 110.

ingness” to increase the IRP-D credit to \$8.21 per kw-month. As the Company correctly notes, staff witness Scheck calculated the credit under the IRP-D rider to be \$3.34 per kw-month, based on staff’s position with respect to costs in the *Capacity Case*.

The Company claims that Mr. Scheck improperly relied on the price of capacity paid by shopping customers, and should have used fully embedded costs to be paid by non-shopping customers.³¹ While staff maintains the position that it took in the *Capacity Case*, it respectfully submits that the appropriate cost to use is the cost ultimately determined by the Commission in that case, and that the credit calculated by Mr. Scheck is both appropriate, and entirely consistent with the Company’s methodology.³²

6. Retail Stability Rider

The Company has proposed a non-bypassable Retail Stability Rider (RSR). It attempted to justify this rider by demonstrating that its proposed discounted capacity pricing plan would otherwise put it in a precarious financial position. The RSR is described as a generation revenue decoupling charge.

The Company also took great pains, both during the hearing and in its initial brief, to demonstrate that the RSR is “tied to the total ESP package and not just the discounted capacity pricing.”³³ But the inescapable fact is that the determination of the rider, and the

³¹ Company Brief at 33.

³² Applying the same methodology used by both the Company and Mr. Scheck, the amount of the credit would be \$4.29 per kw-month based on the Commission’s July 2, 2012 *Capacity Case* decision.

³³ Company Brief at 35.

impact that it will have on customer bills, is predicated upon the Company's capacity cost litigation position in Case No. 10-2929.

As noted in staff's initial brief, staff supported an RSR-type mechanism that would allow the Company to recover the difference between its cost of capacity and the rate that it will be allowed to charge CRES providers for capacity. Staff, however, reiterated *its* litigation position in the 10-2929 case, and argued that the recovery of any such difference should be, regardless of the resulting return on equity, between the state compensation mechanism for capacity *as determined by the Commission*, and the state-mandated rate that the Company can charge CRES providers, *as likewise determined by the Commission*.

Staff's position remains unchanged. The Commission has, of course, now spoken in the 10-2929 case. In doing so, the Commission approved a cost-based capacity charge of \$188.88/MW-day, with CRES provider billings to reflect an adjusted RPM-based price. In light of the Commission's decision in the *Capacity Case*, both the amounts that the Company should be entitled to recover, and the mechanism for doing so, are now clear.

The Company must charge CRES providers the prevailing RPM capacity rates in the unconstrained region of PJM. In addition, because the Commission has found that the prevailing RPM capacity rates during the June 1, 2012 through May 31, 2015 period are not appropriate, it has established a capacity charge of \$188.88/MW-Day as the state compensation mechanism. Staff recommended that the Company be permitted to recover the difference between these amounts.

Although staff had recommended that the difference be recovered through an RSR-type mechanism, the Commission has now authorized deferral of incurred capacity costs not recovered from CRES providers to the extent that the total incurred capacity costs do not exceed \$188.88/MW-day. It further stated that it “will establish an appropriate recovery mechanism for such deferred costs and address any additional financial considerations” in this proceeding.³⁴ Staff supports the deferral of those costs in this case.

B. Discounted Capacity Charges

The Company proposes to discount capacity charges during the remaining period that it remains a Fixed Resource Requirements (FRR) entity in the PJM Interconnection, LLC (PJM) capacity market. In its initial brief, staff stated that the Company should charge CRES providers the prevailing RPM capacity rates in the unconstrained region of PJM, but that staff had no objection to the Company offering a discount from the state compensation mechanism for capacity if one higher than the RPM rate was established. After the Capacity Case decision, the Company will only be permitted to charge prevailing RPM capacity rates to CRES providers. To the extent that the RPM rate is less than the state compensation mechanism for capacity, the Company should be entitled to recover that difference.

³⁴ *Capacity Case* (Opinion and Order at 23) (July 2, 2012).

C. Distribution Rates

1. Distribution Investment Rider

As part of its determination whether to allow an ESP to include the proposed Distribution Investment Rider (DIR) to provide capital funding for distribution assets, the Commission “shall examine the reliability of the electric distribution utility’s distribution system and ensure that customers’ and the electric distribution utility’s expectations are aligned and that the electric distribution utility is placing sufficient emphasis on and dedicating sufficient resources to the reliability of its distribution system.”³⁵ Staff agrees with the Company that this record adequately permits the Commission to conduct that examination.³⁶

But staff disagrees with the Company representation that the expectations of the customer and Company are aligned in this case. Staff witness Baker testified that the Company’s 2011 reliability measures showed worse performance in 2011 when compared with the previous year. Based on these results, Mr. Baker recommended that the Commission find that OPC’s reliability expectations are not currently in alignment with those of its customers.³⁷

The Company disputes Mr. Baker’s conclusion based on survey results. Customer surveys were used to establish standards. The Company claims that subsequent surveys

³⁵ R.C. 4928.143(B)(2)(h).

³⁶ Company Brief at 91.

³⁷ Staff Ex. 106.

showing almost identical results indicate that customers must still be satisfied, and that their interests are aligned with the Company. But the Commission has not taken a “survey says” approach. The original surveys were used to establish the standards that the Commission uses to determine whether reliability is being achieved. As Mr. Baker testified on cross-examination, the determination is “based on whether or not the standards are met. . . . [I]f the standards are later missed, then we believe that reliability expectations are not being met.”³⁸ Recent surveys are irrelevant. The simple fact is that the Company failed to meet the ordered standards.

The Company points to a number of factors that contributed, or may have contributed, to its failure to meet the standard. It further claims that, when these factors are taken into account, the Company actually fared better on reliability standards, not worse.³⁹ But this information was available to staff, and was analyzed and considered by staff, in reaching its conclusion.⁴⁰ Even with this information, staff witness Baker concluded that expectations between the Company and its customers were not aligned because the Company failed to meet a reliability standard.⁴¹ Information like that provided by the Company is intended to help development strategies for bringing the Company back into compliance, not for revising the standards. But as Staff noted, it is not recommending that the Commission *not* approve the DIR, but only that a number of con-

³⁸ Tr. at 4367.

³⁹ Company Brief at 94.

⁴⁰ Tr. at 4347.

⁴¹ Tr. at 4360.

ditions be imposed should it do so. The Company has not raised any objections to the conditions outlines in staff's testimony.

2. gridSMART Rider

The proposed ESP includes continuing the gridSMART Rider, unified into a single set of merged rates. Staff supports the continuation of the gridSMART Rider, but expressed a number of concerns. The Company made clear in its brief that staff's "view of moving forward on gridSMART is not inconsistent with the Company's filing."⁴² Staff's clarifications are set forth in its initial brief.

3. Enhanced Service Reliability Rider

The ESP includes continuation of the Enhanced Service Reliability Rider (ESRR), unified for each rate zone into a single set of merged rates. The ESRR enables the Company to recover the incremental costs associated with transitioning to a cyclical-based vegetation management program.

Staff supports continuation of the ESRR, but only through 2014. Staff recommends that the ESRR should not recover costs incurred after the end of 2014.⁴³ The Company claims that current O&M would not provide adequate funding.⁴⁴ The Company also submits that the base rates established in the Company's most recent distribution rate

⁴² Company Brief at 94.

⁴³ Staff Ex. 106.

⁴⁴ Company Brief at 99.

case establish an appropriate funding level for ongoing vegetation management. Indeed, staff argued that those rates reflect an *increase* in O&M expense recovery for vegetation management that actually justifies a *reduction* of the proposed ESSR.

The Staff Report of Investigation in Case Nos. 11-351-EL-AIR and 11-352-EL-AIR recommended a \$17.8 million adjustment to annual O&M expense recovery to support the Company's planned four-year cycle vegetation management program. The stipulation approved by the Commission's order in those cases provided that the parties agreed with all recommendations in the Staff Report[s] that did not directly contradict a provision of the stipulation, and admitted the reports as evidence in the case. A clear reading of the "black box" settlement, incorporating the staff report recommendations, leads to the undeniable conclusion that the agreement effectively granted the Company an increase in base rates that included that increase in O&M recovery. Consequently, the ESSR as proposed overstates the remaining cost of the transition to be incurred for the years 2012 through 2014, and should be reduced, by \$17.8 million. The Commission should further find that the base rates are sufficient to allow the Company to fully maintain its cyclical-based vegetation management program beyond 2014.

E. Energy Efficiency/Peak Demand Reduction Rider

The ESP includes modification and continuation of an Energy Efficiency/ Peak Demand Reduction Rider (EE/PDR), unified for each rate zone into a single set of merged rates. Staff supports the Company's proposal.

F. Economic Development Rider

The ESP includes continuation and modification of a nonbypassable Economic Development Rider (EDR), unified for each rate zone into a single set of merged rates. Staff supports the Company's proposal.

III. New Accounting Deferrals and Recovery of Existing Regulatory Assets

The Company filed Case Nos. 11-4920-EL-RDR and 11-4921-EL-RDR to establish a non-bypassable Phase-In Recovery Rider (PIRR) for collection of deferred fuel expenses. As noted above, the Company proposes to delay the commencement of PIRR recovery until June 2013 (with the end of the recovery period remaining as December 31, 2018), while staff recommends that the Company should implement the merged PIRR without delay.

The Company characterizes this difference in position as a debate coming “down to a balancing or prioritizing as between two legitimate goals: (i) the goal of mitigating present rate impacts, and (ii) the goal of reducing the total carrying charges to be paid. The Company's proposal was aimed at addressing the first goal and the Staff's position prioritizes the second goal.”⁴⁵ Staff respectfully submits that while its position admittedly does not mitigate present rate impacts, it does mitigate overall rate impacts, but minimizing the burden that ratepayers must ultimately bear. While both goals may be

⁴⁵ Company Brief at 109.

legitimate, they are not “equal,” and staff maintains that there is no just cause for further delay.

In doing so, staff reiterates that the other critically important issues regarding PIRR mechanics should move forward on their own merits in Case Nos. 11-4920-EL-RDR, 11-4921-EL-RDR. Those issues include:

- Once Rider PIRR collection commences the carrying charges should be calculated on the most recently approved Commission debt rate (5.34%) and not the 11.26 % pre-tax weighted average costs of capital (WACC) as currently proposed by the Company.
- The ending fuel deferral balance at the end of December 2011 should be reduced for Accumulated Deferred Income Taxes (ADIT) in the calculation of carrying costs for Rider PIRR.
- The Company should be required to calculate the deferral balance “going forward” on annual compounding not monthly compounding.⁴⁶

The Company should be directed to merge both its FAC and the PIRR rates, and start collection as soon as practicable following a Commission order in this case. And the Company should be denied the recovery of carrying costs since it voluntarily elected to delay collections that were supposed to begin January 1, 2012.

CONCLUSION

Staff is committed to encouraging the quickest possible orderly transition to full market. Staff believes that this approach is in the best interests of all market participants, and the State of Ohio as a whole. Such a transition should occur as quickly, and as completely, as practicable.

⁴⁶

Staff Ex. 109.

The Company's proposed modified ESP, although it fails a strictly quantitative comparison with an MRO approach, may, with modification, help to achieve this goal. Staff believes that there are significant qualitative factors that should be considered in determining whether to the ESP should be approved.

Staff has, however, a number of recommendations that should also be adopted if the Commission approves, as proposed or otherwise modified, the Company's plan. If the Commission approves an ESP in this proceeding, it should adopt the recommendations contained above and in staff's testimony in this case.

Respectfully submitted,

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PROOF OF SERVICE

I hereby certify that a true copy of the foregoing Reply Brief submitted on behalf of the staff of the Public Utilities Commission of Ohio, was served via electronic mail, upon the following parties of record, this 9th day of July, 2012.

/s/ Werner L. Margard III

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Summary: Reply Brief submitted on behalf of the Staff of the Public Utilities Commission of Ohio electronically filed by Kimberly L Keeton on behalf of Public Utilities Commission of Ohio