FILE

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 Company.	)))	Case No. 10-2929-EL-UNC

INDUSTRIAL ENERGY USERS-OHIO'S APPLICATION FOR REHEARING OF THE JULY 2, 2012 OPINION AND ORDER AND MEMORANDUM IN SUPPORT

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TABLE OF CONTENTS

I. BACKGROUND 9

II. ASSIGNMENTS OF ERROR 22

1. The July 2nd Order is unlawful and unreasonable since any authority the Commission may have to approve prices for generation capacity service does not permit the Commission to apply a cost-based methodology or resort to Chapters 4905 and 4909, Revised Code, to supervise and regulate pricing for generation capacity services. Similarly, the order is unreasonable and unlawful to the extent that it states or otherwise suggests that AEP-Ohio has a right to establish rates for generation-related services that are based on any cost-based ratemaking method including the ratemaking methodology identified or referenced in Chapters 4905 and 4909, Revised Code 22

2. Assuming for purposes of argument that the Commission has authority to authorize the billing and collection of a generation capacity service charge pursuant to Chapters 4905 and 4909, Revised Code, the July 2nd Order is nonetheless unreasonable and unlawful because AEP-Ohio failed to present the required evidence and the Commission failed to comply with the substantive and procedural requirements contained in such Chapters 25

3. The July 2nd Order is unreasonable and unlawful because it unreasonably impairs the value of contracts entered into with CRES providers by retroactively altering the capacity pricing method that was in place when such contracts were executed. The unlawful and unreasonable impairment arises, in the particular circumstances presented by this case, because the RPM-Based Pricing method establishes generation service capacity prices three years in advance and the July 2nd Order alters the capacity prices that had been fixed and were known and certain at the time such contracts were executed. To the extent the Commission has any authority to approve prices for generation capacity services by altering the ratemaking methodology, that authority may not be lawfully exercised to affect the prices established by the capacity pricing method previously approved by the Commission, in force by operation of law and known and certain for contracts entered into prior to the effective date of the new capacity pricing method. 30

4. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission failed to restore RPM-Based Pricing as

required by Section 4928.143(C)(2)(b), Revised Code, when it rejected AEP-Ohio's ESP in February 2012. 33

5. The July 2nd Order is unlawful and unreasonable inasmuch as it authorized AEP-Ohio to collect an above-market rate for generation capacity service, which will allow AEP-Ohio to collect transition revenue or its equivalent in violation of Ohio law and AEP-Ohio's Commission-approved commitment to not impose lost generation-related revenue charges on shopping customers. 34

6. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission failed to adopt the uncontested recommendation of IEU-Ohio witness Kevin Murray contained at pages 33-34 of IEU-Ohio Exhibit 102A, which, if adopted, would provide much needed transparency to the process AEP-Ohio used to derive the billing determinants for generation capacity service. 36

7. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission authorized AEP-Ohio to collect above-market prices for generation capacity service, which will provide AEP-Ohio's generation business with an unlawful subsidy in violation of Section 4928.02(H), Revised Code. 38

8. The July 2nd Order is unlawful and unreasonable inasmuch as it violates the comparability requirements in Chapter 4928, Revised Code, which requires the generation capacity service rate applicable to CRES providers or otherwise to shopping customers to be comparable to the generation capacity service rate embedded in AEP-Ohio's SSO rates. 40

9. The July 2nd Order setting a generation capacity rate under PJM's RAA is unlawful and unreasonable inasmuch as the order violates the plain language of the RAA, which must be interpreted under Delaware law (the controlling law under the RAA). 42

   a. The administratively-determined "cost-based" rates for AEP-Ohio's certified electric distribution service area contained in the July 2nd Order violate the plain language of Article 2 of the RAA that states the RAA has a region-wide focus and pro-competitive purpose. 45

   b. Even if cost-based rates were established pursuant to the RAA, the Commission unlawfully and unreasonably based its determination of "cost" upon the embedded cost of AEP-Ohio's owned and controlled generating assets based on a defective assumption that such generating assets are the source of capacity available to

CRES providers serving customers in AEP-Ohio's certified electric distribution service area. The RAA requires that any change to the default pricing, RPM-Based Pricing, must be just and reasonable and looks to the FRR Entity, and the FRR Entity's Service Area and the Capacity Resources in the FRR Entity's Capacity Plan to establish any pricing other than RPM-Based Pricing. Based on the plain meaning of the word "cost", the July 2nd Order's sanctioning of the use of embedded cost to establish generation capacity services is arbitrary and capricious. In addition, the uncontested evidence demonstrates that AEP-Ohio is not an FRR Entity, AEP-Ohio's owned and controlled generating assets are not dedicated to serve Ohio load and also demonstrates that AEP-Ohio's owned and controlled generating assets are not the Capacity Resources in the FRR Entity's Capacity Plan. In such circumstances, the Commission's reliance upon embedded cost data for AEP-Ohio's owned and controlled generating assets to establish the cost incurred to provide generating capacity services to CRES providers is arbitrary and capricious. 48

10. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission violated Section 4903.09, Revised Code, by failing to properly address all material issues raised by the parties; the Ohio Supreme Court has held that the failure to address all material matters brought to the Commission's attention is a reversible error. 59

11. The July 2nd Order, which offers AEP-Ohio the opportunity to obtain above-market compensation for generation capacity service through a deferred revenue supplement [computed based upon the difference between RPM-Based Pricing and $188.88/megawatt-day ("MW-day"), including interest charges] is unlawful and unreasonable for the reasons detailed below..... 61

    a. The above-market supplement conflicts with the policies contained in Section 4928.02, Revised Code, which relies upon market forces, customer choice and prices disciplined by market forces to regulate prices for competitive electric services..... 62

    b. The Commission is prohibited under Section 4928.05(A), Revised Code, from regulating or otherwise creating a deferral associated with a competitive retail electric service under Section 4905.13, Revised Code. The Commission may only authorize deferred collection of a generation service-related price under Section 4928.144,

Revised Code, and any such deferral must be related to a rate established under Sections 4928.141 to 4928.143, Revised Code. 64

c. The Commission unlawfully and unreasonably authorized AEP-Ohio to defer the collection of generation capacity service revenue. Under generally accepted accounting principles, only an incurred cost can be deferred for future collection. To the extent that the July 2nd Order implies the Commission's intended use of Section 4928.144, Revised Code, that Section also requires the Commission to identify the incurred cost that is associated with any deferral, a requirement unreasonably and unlawfully neglected by the July 2nd Order. 66

d. The Commission unlawfully and unreasonably determined that allowing AEP-Ohio to impose above-market prices for generation capacity service was appropriate to address AEP-Ohio's claims regarding the financial performance of its generation business, the competitive business segment under Ohio law. 66

e. The Commission unlawfully and unreasonably authorized AEP-Ohio to increase the above-market revenue supplement by adding carrying charges to the deferred supplement without any evidence that carrying charges, or any specific level of carrying charges, are lawful or reasonable. To the extent that the carrying charge allowance is computed based on a weighted average cost of capital ("WACC") method or AEP-Ohio's embedded cost of long-term debt, it is also unreasonable and unlawful because it is excessive, arbitrary, capricious, and contrary to Commission precedent. 67

f. The July 2nd Order is unlawful and unreasonable because it fails to recognize that the rates and charges applicable to non-shopping customers also are providing AEP-Ohio with compensation for generation capacity service, it ignores or disregards the fact that AEP-Ohio has maintained that non-shopping customers are, on average, paying nearly twice the $188.88/MW-day price, and it fails to establish a mechanism to credit such excess compensation obtained from non-shopping customers against any deferred balance the July 2nd Order works to create by comparing RPM-Based Pricing to the $188.88/MW-day price. The non-symmetrical and arbitrary bias embedded in the July 2nd Order's

description of how the deferred revenue supplement shall be computed guarantees that AEP-Ohio shall collect, in the aggregate, total revenue for generation capacity service substantially in excess of the revenue produced by using the $188.88/MW-day price to determine generating capacity service compensation for shopping and non-shopping customers. 68

12. In addition to the individual errors committed by the Commission which are referenced or identified herein, the totality of the Commission's conduct throughout this proceeding, including the July 2nd Order, is arbitrary and capricious, an abuse of discretion, otherwise outside the law and "... at variance with 'the rudiments of fair play' (*Chicago, Milwaukee & St. Paul Ry. Co. v. Polt*, 232 U.S. 165, 232 U. S. 168) long known to our law." "The Fourteenth Amendment condemns such methods and defeats them." *West Ohio Gas Co. v. Public Utilities Commission*, 294 U.S. 63 (1935). 69

13. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission failed to direct AEP-Ohio to refund the above-market portion of capacity charges in place since January 2012 or credit the excess collection against regulatory asset balances otherwise eligible for amortization through retail rates and charges..... 89

III. CONCLUSION 90

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INDUSTRIAL ENERGY USERS-OHIO'S APPLICATION FOR REHEARING OF THE JULY 2, 2012 OPINION AND ORDER

Pursuant to Section 4903.10, Revised Code, and Rule 4901-1-35, Ohio Administrative Code ("O.A.C."), Industrial Energy Users-Ohio ("IEU-Ohio") respectfully submits this Application for Rehearing of the Opinion and Order issued by the Public Utilities Commission of Ohio ("Commission") on July 2, 2012 authorizing Ohio Power Company ("OP") (now merged with Columbus Southern Power Company or "CSP" as "AEP-Ohio") to increase the price competitive retail electric service ("CRES") providers pay for generation capacity service. The July 2, 2012 Opinion and Order ("July 2nd Order") significantly increased AEP-Ohio's capacity price from the market-based price established by PJM Interconnection, LLC's ("PJM") Reliability Pricing Model ("RPM") ("RPM-Based Pricing"). RPM-Based Pricing is the default pricing mechanism under PJM's Reliability Assurance Agreement or "RAA" (which, by its terms, is governed by Delaware law) and the pricing mechanism adopted by the Commission as part of AEP-Ohio's current standard service offer ("SSO") rates.

The July 2nd Order also authorized AEP-Ohio to charge above-market and arbitrary prices for capacity through the extension of AEP-Ohio's two-tiered generation

capacity service pricing scheme (as altered by the Commission to move prices further away from the market-based price), and authorized AEP-Ohio to defer for future collection an amount in excess of RPM-Based Pricing ("Delayed Recognition Pricing Scheme"). The July 2nd Order is unlawful and unreasonable in the following respects:

1. **The July 2nd Order is unlawful and unreasonable since any authority the Commission may have to approve prices for generation capacity service does not permit the Commission to apply a cost-based methodology or resort to Chapters 4905 and 4909, Revised Code, to supervise and regulate pricing for generation capacity services. Similarly, the order is unreasonable and unlawful to the extent that it states or otherwise suggests that AEP-Ohio has a right to establish rates for generation-related services that are based on any cost-based ratemaking method including the ratemaking methodology identified or referenced in Chapters 4905 and 4909, Revised Code.**

2. **Assuming for purposes of argument that the Commission has authority to authorize the billing and collection of a generation capacity service charge pursuant to Chapters 4905 and 4909, Revised Code, the July 2nd Order is nonetheless unreasonable and unlawful because AEP-Ohio failed to present the required evidence and the Commission failed to comply with the substantive and procedural requirements contained in such Chapters.**

3. **The July 2nd Order is unreasonable and unlawful because it unreasonably impairs the value of contracts entered into with CRES providers by retroactively altering the capacity pricing method that was in place when such contracts were executed. The unlawful and unreasonable impairment arises, in the particular circumstances presented by this case, because the RPM-Based Pricing method establishes generation service capacity prices three years in advance and the July 2nd Order alters the capacity prices that had been fixed and were known and certain at the time such contracts were executed. To the extent the Commission has any authority to approve prices for generation capacity services by altering the ratemaking methodology, that authority may not be lawfully exercised to affect the prices established by the capacity pricing method previously approved by the Commission, in force by operation of law and known and certain for contracts entered into prior to the effective date of the new capacity pricing method.**

4. **The July 2nd Order is unlawful and unreasonable inasmuch as the Commission failed to restore RPM-Based Pricing as required by Section 4928.143(C)(2)(b), Revised Code, when it rejected AEP-Ohio's ESP in February 2012.**

5. The July 2nd Order is unlawful and unreasonable inasmuch as it authorized AEP-Ohio to collect an above-market rate for generation capacity service, which will allow AEP-Ohio to collect transition revenue or its equivalent in violation of Ohio law and AEP-Ohio's Commission-approved commitment to not impose lost generation-related revenue charges on shopping customers.

6. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission failed to adopt the uncontested recommendation of IEU-Ohio witness Kevin Murray contained at pages 33-34 of IEU-Ohio Exhibit 102A, which, if adopted, would provide much needed transparency to the process AEP-Ohio used to derive the billing determinants for generation capacity service.

7. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission authorized AEP-Ohio to collect above-market prices for generation capacity service, which will provide AEP-Ohio's generation business with an unlawful subsidy in violation of Section 4928.02(H), Revised Code.

8. The July 2nd Order is unlawful and unreasonable inasmuch as it violates the comparability requirements in Chapter 4928, Revised Code, which requires the generation capacity service rate applicable to CRES providers or otherwise to shopping customers to be comparable to the generation capacity service rate embedded in AEP-Ohio's SSO rates.

9. The July 2nd Order setting a generation capacity rate under PJM's RAA is unlawful and unreasonable inasmuch as the order violates the plain language of the RAA, which must be interpreted under Delaware law (the controlling law under the RAA).

   a. The administratively-determined "cost-based" rates for AEP-Ohio's certified electric distribution service area contained in the July 2nd Order violate the plain language of Article 2 of the RAA that states the RAA has a region-wide focus and pro-competitive purpose.

   b. Even if cost-based rates were established pursuant to the RAA, the Commission unlawfully and unreasonably based its determination of "cost" upon the embedded cost of AEP-Ohio's owned and controlled generating assets based on a defective assumption that such generating assets are the source of capacity available to CRES providers serving customers in AEP-Ohio's certified electric distribution service area. The RAA requires that any change to the default pricing, RPM-Based Pricing, must be just and reasonable and looks to the FRR Entity, and the FRR Entity's Service Area and the

Capacity Resources in the FRR Entity's Capacity Plan to establish any pricing other than RPM-Based Pricing. Based on the plain meaning of the word "cost", the July 2nd Order's sanctioning of the use of embedded cost to establish generation capacity services is arbitrary and capricious. In addition, the uncontested evidence demonstrates that AEP-Ohio is not an FRR Entity, AEP-Ohio's owned and controlled generating assets are not dedicated to serve Ohio load and also demonstrates that AEP-Ohio's owned and controlled generating assets are not the Capacity Resources in the FRR Entity's Capacity Plan. In such circumstances, the Commission's reliance upon embedded cost data for AEP-Ohio's owned and controlled generating assets to establish the cost incurred to provide generating capacity services to CRES providers is arbitrary and capricious.

10. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission violated Section 4903.09, Revised Code, by failing to properly address all material issues raised by the parties; the Ohio Supreme Court has held that the failure to address all material matters brought to the Commission's attention is a reversible error.

11. The July 2nd Order, which offers AEP-Ohio the opportunity to obtain above-market compensation for generation capacity service through a deferred revenue supplement [computed based upon the difference between RPM-Based Pricing and $188.88/megawatt-day ("MW-day"), including interest charges] is unlawful and unreasonable for the reasons detailed below.

    a. The above-market supplement conflicts with the policies contained in Section 4928.02, Revised Code, which relies upon market forces, customer choice and prices disciplined by market forces to regulate prices for competitive electric services.

    b. The Commission is prohibited under Section 4928.05(A), Revised Code, from regulating or otherwise creating a deferral associated with a competitive retail electric service under Section 4905.13, Revised Code. The Commission may only authorize deferred collection of a generation service-related price under Section 4928.144, Revised Code, and any such deferral must be related to a rate established under Sections 4928.141 to 4928.143, Revised Code.

    c. The Commission unlawfully and unreasonably authorized AEP-Ohio to defer the collection of generation capacity service revenue. Under generally accepted accounting principles, only an incurred cost can be deferred for future collection. To the extent that the July 2nd Order implies the Commission's intended use of Section 4928.144, Revised Code, that Section

also requires the Commission to identify the incurred cost that is associated with any deferral, a requirement unreasonably and unlawfully neglected by the July 2nd Order.

d. The Commission unlawfully and unreasonably determined that allowing AEP-Ohio to impose above-market prices for generation capacity service was appropriate to address AEP-Ohio's claims regarding the financial performance of its generation business, the competitive business segment under Ohio law.

e. The Commission unlawfully and unreasonably authorized AEP-Ohio to increase the above-market revenue supplement by adding carrying charges to the deferred supplement without any evidence that carrying charges, or any specific level of carrying charges, are lawful or reasonable. To the extent that the carrying charge allowance is computed based on a weighted average cost of capital ("WACC") method or AEP-Ohio's embedded cost of long-term debt, it is also unreasonable and unlawful because it is excessive, arbitrary, capricious, and contrary to Commission precedent.

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12. In addition to the individual errors committed by the Commission which are referenced or identified herein, the totality of the Commission's conduct throughout this proceeding, including the July 2nd Order, is arbitrary and capricious, an abuse of discretion, otherwise outside the law and "... at variance with 'the rudiments of fair play' (*Chicago, Milwaukee & St. Paul Ry. Co. v. Polt*, 232 U.S. 165, 232 U. S. 168) long known to our law." "The Fourteenth Amendment condemns such methods and defeats them." *West Ohio Gas Co. v. Public Utilities Commission*, 294 U.S. 63 (1935).

13. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission failed to direct AEP-Ohio to refund the above-market portion of capacity charges in place since January 2012 or credit the excess collection against regulatory asset balances otherwise eligible for amortization through retail rates and charges.

On July 20, 2012, American Electric Power Service Corporation ("AEPSC"), acting as agent for AEP-Ohio, filed a renewed motion and request for expedited rulings with the Federal Energy Regulatory Commission ("FERC") in Docket Nos. ER11-2183-001 and EL11-32-000. In this renewed motion, AEP-Ohio has once again asked FERC to use its authority to bypass the Commission so that AEP-Ohio can obtain higher compensation for generation capacity service than the compensation specified in the July 2nd Order. Thus, in AEP-Ohio's view, the Commission only has jurisdiction to address generation capacity service pricing so long as the Commission sets the price high enough and in a way that feeds AEP-Ohio's ambitions to block shopping. In other words, the unreasonable and unlawful actions by the Commission discussed herein are now being used by AEP-Ohio as a platform to launch further initiatives to insulate its generation business from the discipline of market forces and bring injury to Ohio and its citizens. AEP-Ohio's conduct shows that AEP-Ohio sees the July 2nd Order's disregard for the law and policy of Ohio as a Commission invitation to escalate its anti-consumer and anticompetitive campaign. If the Commission persists in its illegal and unreasonable tolerance of AEP-Ohio's bad legal theory and behavior, it will further position AEP-Ohio and its affiliates to plunder the public interest.

The focus here is mostly on the anticompetitive and excessive compensation consequences of the July 2nd Order. Yet, these unreasonable and unlawful consequences lead to other major problems. The confusion created by the flip-flopping, the multi-venue-multi-case process that has transformed adjudication at the

Commission into an endurance contest, the litigation churning and forum shopping has left customers and, to a lesser extent, CRES providers without the ability to make informed decisions about how and when customer choice rights can be exercised in furtherance of Ohio's stated policies. What AEP-Ohio has been unable to thwart through its anticompetitive and excessive pricing, AEP-Ohio is freezing out through the creation and maintenance of perpetual mysteries that defy "apples to apples" comparisons.

As discussed in the memorandum in support attached hereto, IEU-Ohio respectfully requests that the Commission grant this application for rehearing; forthwith terminate any authority that may permit AEP-Ohio to bill or collect compensation based on its two-tiered capacity charges or based upon the Delayed Recognition Pricing Scheme; "issue such order as is necessary to continue the provisions, terms, and conditions of the utility's most recent standard service offer..."[1] which, in this case, includes the establishment of generation service capacity prices by means of RPM-Based Pricing, and to refund to customers the above-market capacity revenues AEP-Ohio has collected since January 2012.

Even if the Commission's good intentions are behind the July 2nd Order, the Commission must now surely see that the Commission's good intentions only work to enable and inspire behavior by AEP-Ohio that cannot be reconciled with the public interest.

[1] Section 4928.143(C)(2)(b), Revised Code.

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MEMORANDUM IN SUPPORT

I. BACKGROUND

At issue in this proceeding is the level of compensation AEP-Ohio receives from CRES providers for the capacity AEP-Ohio has dedicated to its regional transmission operator ("RTO"), PJM, which directs the operation of AEP-Ohio's high voltage transmission facilities. PJM is tasked with ensuring the high voltage transmission facilities under its supervisory control operate safely and reliably.[2] Unlike most commodities, electricity cannot be readily or economically stored in sufficient quantities to meet day-to-day demand. Therefore, to meet the needs of electricity consumers, PJM has established market-based mechanisms to compensate resources ("Capacity Resources" as defined by PJM) required to maintain a proper balance between supply and demand.

To obtain the Capacity Resources[3] PJM determines are necessary to maintain reliability, PJM operates markets to solicit and obtain sufficient resources.[4] These markets are governed by rules embodied in PJM's RAA,[5] a FERC-approved contract

[2] IEU-Ohio Ex. 102A at 6.

[3] As capitalized herein, "Capacity Resources" carries the definition supplied under the RAA. FirstEnergy Solutions Corp. ("FES") Ex. 110A at 6.

[4] IEU-Ohio Ex. 102 at 5-6.

[5] *Id.* at 10. The RAA is FES Ex. 110A.

that all load serving entities ("LSEs") within PJM must execute. The RAA provides two options for LSEs to demonstrate that they have adequate Capacity Resources,[6] which as defined under the RAA include both supply-side and demand-side resources.[7]

RPM is the primary approach relied upon by the majority of LSEs to meet their capacity obligation within the PJM region. Under RPM, PJM conducts periodic capacity auctions to obtain a level of Capacity Resources necessary to meet forecasted load levels plus a sufficient reserve amount.[8] Capacity Resources are offered into the auctions at a specific price at which the bidder is willing to commit its capabilities to PJM for an upcoming delivery year.[9] PJM stacks the Capacity Resources by their offer prices and the auction clears the required level of Capacity Resources based upon the lowest offer prices to meet the specified target level.[10] The last and highest price offer that is needed to satisfy PJM's target capacity level determines the clearing price paid to all resources. Capacity Resources receive this clearing price for the quantity of capacity that clears in the auction for the entire delivery year. All LSEs pay RPM-Based Pricing for the capacity obligation associated with the load they serve; this payment is mitigated to the extent the LSE cleared a Capacity Resource in the RPM auctions.

As an alternative to RPM, an LSE can elect the FRR Alternative option under the RAA; LSEs that select this option are defined as an FRR Entity.[11] FRR Entities do not participate in PJM's periodic capacity auctions. Instead, PJM determines a required

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[6] IEU-Ohio Ex. 110A at 9.

[7] FES Ex. 110A at 6; Tr. Vol. XI at 2531.

[8] IEU-Ohio Ex. 102A at 7-8.

[9] *Id.*

[10] Although PJM conducts a single system-wide capacity auction, transmission constraints may cause pricing separation between zones within PJM. *Id.* Additionally, because of limitations on availability, there can be price separation between generation and demand response resource clearing prices.

[11] IEU-Ohio Ex. 102A at 9. "FRR Entity" is defined at page 10 of FES Ex. 110A.

quantity of Capacity Resources that the FRR Entity must have ownership or contractual rights to.[12] The FRR Entity is required to submit an FRR Capacity Plan[13] to PJM that demonstrates it holds adequate levels of Capacity Resources.[14]

In states that allow retail competition, such as Ohio, alternative LSEs (under Ohio law, an alternative LSE is called a CRES provider) pay RPM-Based Pricing for capacity for all load acquired from an LSE who participated in the RPM auctions.[15] If the alternative LSE acquired load from an FRR Entity, the default price that the alternative LSE pays to PJM, which is then remitted to the FRR Entity, is based on the RPM-Based Pricing methodology.[16] This description of the role of the RAA and RPM-Based Pricing has not been contested.

The default RPM-Based Pricing that the alternative LSE is required to pay to the FRR Entity can be displaced if a state lawfully adopts a "state compensation mechanism," in which case the state compensation mechanism controls.[17] If a state that allows retail competition has not lawfully adopted a state compensation mechanism, the FRR Entity can file an application with FERC under Section 205 of the Federal Power Act ("FPA"), seeking to change the compensation from RPM-Based Pricing "to a method based on the FRR Entity's cost or such other basis shown to be just and reasonable."[18]

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[12] IEU-Ohio Ex. 102A at 9.

[13] FES Ex. 110A at 109-111. "FRR Capacity Plan" is defined at page 10 of FES Ex. 110A.

[14] *Id.* at 109.

[15] *Id.* at 33.

[16] *Id.* at 111.

[17] FES Ex. 110A at 111.

[18] *Id.*

By its terms, the RAA applies to the FRR Entity, and as the record demonstrates AEPSC made an FRR election on behalf of the pool of AEP operating companies (including AEP-Ohio) known as AEP East. With the inception of PJM's capacity market in 2007, AEP-Ohio has charged and advocated for RPM-Based Pricing to establish the compensation it receives from CRES providers pursuant to the RAA and from SSO customers.[19] Indeed, AEP-Ohio relied upon RPM-Based Pricing to develop the capacity component of the competitive benchmark prices that AEP-Ohio used to compare the results under Section 4928.142, Revised Code (the market rate offer or "MRO" option), and Section 4928.143, Revised Code (the ESP option), in the ESP proceeding ("ESP I")[20] that produced the current SSO rates.[21] The Commission has also held that AEP-Ohio's ESP I rates were based upon the assumption that RPM-Based Pricing would continue.[22]

On November 1, 2010, AEPSC acting in the agent role it frequently plays within American Electric Power Co. Inc. ("AEP") (AEP-Ohio's parent company), filed an application with FERC requesting authorization to establish a "cost-based" ratemaking methodology to determine compensation for generation capacity service relying upon Section D.8 of Schedule 8.1 of PJM's RAA and to make the compensation methodology uniquely applicable to CRES providers serving retail customers located in AEP-Ohio's certified electric distribution service area. AEPSC claimed that there was no state

[19] Tr. Vol. II at 401.

[20] *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 Nos. 08-917-EL-SSO, *et al.* (hereinafter "*ESP I*").

[21] IEU-Ohio Ex. 103 at 11, 13-14.

[22] Entry at 2 (Dec. 8, 2010).

compensation mechanism in place and that it was entitled to prosecute its claim based on Section 205 of the FPA (hereinafter referred to as "the Section 205 Filing").[23]

In recognition of the clear and present danger presented by the Section 205 Filing, the Commission issued an Entry in this proceeding on December 8, 2010. Among other things and in case the Commission's prior determinations had left any doubt, the December 8, 2010 Entry adopted, pursuant to Section D.8 of Schedule 8.1 of the RAA, RPM-Based Pricing as the state compensation mechanism for AEP-Ohio. The December 8, 2010 Entry also opened this proceeding and solicited comments from interested parties. AEP-Ohio challenged the December 8, 2010 Entry. In an application for rehearing filed with the Commission on January 7, 2011, AEP-Ohio alleged the Commission erred in adopting a state compensation mechanism because the Commission lacked the authority to do so.[24] AEP-Ohio also claimed that RPM-Based Pricing would not allow it to recover its "cost."[25]

On August 11, 2011, the Commission issued an entry establishing a procedural schedule to conduct an evidentiary hearing in this proceeding. On August 31, 2011, AEP-Ohio filed testimony in the proceeding seeking to increase its capacity charges from RPM-Based Pricing to $355.55/MW-day, based on high level summaries of unaudited FERC Form 1 data for the year 2010.[26]

While the RAA allows, with FERC's approval, deviation from the default RPM-Based Pricing for entities that have elected the FRR Alternative, the deviation

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[23] *American Electric Power Service Corporation*, FERC Docket No. ER-11-2183, Application at 3 (Nov. 24, 2010) (hereinafter "*the Section 205 Filing*").

[24] Ohio Power Company's and Columbus Southern Power Company's Application for Rehearing at 3, 18-31 (Jan. 7, 2011).

[25] *Id.* at 3, 5-18.

[26] AEP-Ohio Ex. 102 at 21.

provided for by the RAA is not the deviation that AEP-Ohio asked the Commission to authorize in this proceeding. It is undisputed that AEP-Ohio is not the FRR Entity; rather, AEPSC made the FRR Alternative election on behalf of AEP East.[27] Thus, to the extent the Commission has authority to apply the RAA, it is not applicable to AEP-Ohio directly, or to AEP-Ohio's owned or controlled generating assets.

Shortly after AEP-Ohio filed its testimony seeking Commission approval of a $355/MW-day charge, on September 7, 2011, AEP-Ohio, along with a number of other parties, submitted a stipulation and recommendation ("Stipulation") to resolve AEP-Ohio's pending ESP proceeding and several other pending cases, including this proceeding.[28]

Relevant to this proceeding, the Stipulation recommended that the Commission approve a two-tiered pricing scheme for generation capacity service available to CRES providers to be adopted prospectively as the state compensation mechanism. The first tier of the Stipulation's recommended CRES capacity price was tied to RPM-Based Pricing. The second tier, applicable to all capacity available to CRES providers not subject to RPM-Based Pricing, was set at $255/MW-day, a substantial increase to the otherwise applicable RPM-Based Price. The $255/MW-day price was arbitrary and based neither on a market-based pricing method nor a cost-based pricing method. In other words, the Stipulation recommended that the Commission approve a wholesale capacity price, even though AEP-Ohio[29] and AEPSC[30] had repeatedly claimed the Commission was without subject matter jurisdiction to do so.

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[27] *See* Assignment of Error No. 9, *infra* at 42-59.

[28] Stipulation and Recommendation (Sept. 7, 2011) (hereinafter "*Stipulation*").

[29] Ohio Power Company's and Columbus Southern Power Company's Application for Rehearing at 8, 18-21 (Jan. 7, 2011).

During a September 7, 2011 conference call with the investment community held shortly after the Stipulation was filed with the Commission, AEP-Ohio acknowledged that the above-market second tier charge was designed to block the ability of retail customers to enjoy the full benefits of the "customer choice" rights provided by Ohio law.[31] Based on AEP-Ohio's own public representations of the purpose of the Stipulation's recommended two-tiered capacity pricing scheme, it was thus beyond doubt as of September 7, 2011 that the Stipulation was fundamentally and purposefully dedicated to a mission in conflict with Ohio law and the policy set forth in Section 4928.02, Revised Code.

After hearings on the Stipulation, on December 14, 2011, the Commission issued its order ("Stipulation Order")[32] approving the Stipulation with modifications, including modifications to expand the availability of the tier-one RPM-Based Pricing. Following the Stipulation Order, applications for rehearing were submitted on January 13, 2012 by various parties including IEU-Ohio. Among other things, the applications for rehearing claimed that the Commission had erred in concluding that the package presented by the Stipulation was just and reasonable and in the public interest. By entry dated February 1, 2012, the Commission granted rehearing for further consideration of the matters specified in the applications for rehearing of the Stipulation Order.

By the time the applications for rehearing were submitted to the Commission, the rate shock and shopping-blocking consequences of the Stipulation (which AEP-Ohio had masked in its on-average mumbo jumbo and untimely reporting of shopping data)

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[30] *The Section 205 Filing*, Request for Rehearing of American Electric Power Service Corporation at 8, 12-13 (Feb. 22, 2011).

[31] FES Ex. 102 at Ex. TCB-4.

[32] Opinion and Order (Dec. 14, 2011) (hereinafter "*Stipulation Order*").

began to arrive in relentless proportions. As AEP-Ohio's customers opened the electric bills that arrived after the Stipulation Order, customers' outrage overtook AEP-Ohio's managed message. Also, the results of the bill-reducing competitive bidding process ("CBP") used to set the generation supply price for SSO customers of Duke Energy Ohio ("Duke") sharpened the contrast between the arbitrary and excessive administratively-determined prices authorized by the Stipulation Order and the SSO prices established through a CBP.[33] Additionally, the Commission had access to filings that AEP-Ohio, or its agent AEPSC, made at FERC to implement the unlawful corporate separation provisions of the Stipulation and observed glaring inconsistencies between the content of such filings and the expectations created by the Stipulation.

On February 23, 2012, the Commission granted, in part, IEU-Ohio's and FES' applications for rehearing and rejected the Stipulation, ultimately finding, for multiple reasons, that the Stipulation was not in the public interest.

> As discussed below, upon review of the applications for rehearing, the Commission has determined that the Stipulation, as a package, does not benefit ratepayers and the public interest and, thus, does not satisfy our three-part test for the consideration of stipulations. Accordingly, the Commission will reject the Stipulation.[34]

Because the Commission's Stipulation Rehearing Entry rejected the proposed ESP contained in the Stipulation and in accordance with the requirements of Section 4928.143(C)(2)(b), Revised Code,[35] the Stipulation Rehearing Entry directed AEP-Ohio to file tariffs to provide its SSO pursuant to its previously authorized ESP:

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[33] PUCO Press Release, *Duke Energy auction leads to lower electric prices in 2012* (Dec. 15, 2011) (accessible *via* the internet at: http://www.puco.ohio.gov/puco/index.cfm/media-room/media-releases/duke-energy-auction-leads-to-lower-electric-prices-in-2012/?border=off; last visited July 31, 2012).

[34] Entry on Rehearing at 4 (Feb. 23, 2012) (hereinafter "*Stipulation Rehearing Entry*").

[35] Section 4928.143(C)(2)(b), Revised Code, states (emphasis added):

> Therefore, we direct AEP-Ohio to file, no later than February 28, 2012, new proposed tariffs to continue the provisions, terms, and conditions of its previous electric security plan, including but not limited to the base generation rates as approved in ESP I, along with the current uncapped fuel costs and the environmental investment carry cost rider set at the 2011 level, as well as modifications to those rates for credits for amounts fully refunded to customers, such as the significantly excessive earnings test (SEET) credit, and **an appropriate application of capacity charges under the approved state compensation mechanism established in the Capacity Charge Case.**[36]

On February 27, 2012 and for the benefit of its sole shareholder, AEP, AEP-Ohio filed a motion for relief seeking to reintroduce AEP-Ohio's interpretation of the Stipulation's scheme to block customer choice. In other words, AEP-Ohio once again asked the Commission to approve a capacity price applicable to CRES providers while AEP-Ohio was contemporaneously asserting that the Commission does not have subject matter jurisdiction to do so.

While numerous parties (including many that previously supported the Stipulation) opposed AEP-Ohio's unlawful and unjust motion for relief, the Commission granted the requested temporary relief. Thus, what was contrary to the public interest when presented in the Stipulation as a package was extracted from the package and made available to AEP-Ohio so that AEP-Ohio could temporarily continue its shopping-blocking scheme. The Commission made the above-market shopping tax temporary and held that it would terminate on May 31, 2012.[37]

> If the utility terminates an application pursuant to division (C)(2)(a) of this section or if the commission disapproves an application under division (C)(1) of this section, the commission **shall issue such order as is necessary to continue the provisions, terms, and conditions of the utility's most recent standard service offer, along with any expected increases or decreases in fuel costs from those contained in that offer, until a subsequent offer is authorized pursuant to this section or section 4928.142 of the Revised Code, respectively**.

[36] *Stipulation Rehearing Entry* at 12 (emphasis added).

[37] Entry at 17 (Mar. 7, 2012) (hereinafter "*March 7, 2012 Entry*").

Subsequent to the Stipulation Rehearing Entry, on March 23, 2012, AEP-Ohio filed revised testimony in this proceeding again seeking an increase in its capacity rates based on its so-called cost-based formula rate method, which produced a rate of about $355/MW-day. A capacity price of $355/MW-day would have sharply increased capacity prices and produced a price about five times higher than the average fixed, known and measurable RPM-Based Pricing during the three delivery years commencing June 1, 2012 (a three-year average of $70/MW-day).[38]

AEP-Ohio claimed that its significantly above-market charge was necessary to allow AEP-Ohio to recover its cost and to promote investment in generation.[39] However, as this case progressed, the justification switched from recovering cost and promoting investment in generation to protecting AEP-Ohio's financial integrity[40] by providing AEP-Ohio with a transition to a fully competitive market.[41] Ohio law, however, provided a temporary opportunity to collect above-market, generation transition revenue as Ohio deregulated and moved towards competition for retail electric generation service. The timeframe to collect such transition revenue has long since passed. AEP-Ohio has admitted as much, stating electric distribution utilities ("EDUs") "were given a temporary opportunity to recover stranded generation investments during a transition period. That transition period is over."[42] The evidence in this case demonstrates AEP-Ohio is not entitled to transition revenue, even if the Commission

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[38] *See* IEU-Ohio Ex. 102A at 23.

[39] AEP-Ohio Ex. 101 at 8-9 (RPM-Based Pricing "provides little or no incentive to invest in Ohio asset generation.").

[40] Ohio Power Company's Initial Post-Hearing Brief at 1 (May 23, 2012) (the Commission's "task here is to ... preserve the financial integrity of the affected utility.").

[41] *Id.* at 2 ("The scope of this proceeding [is] establishing a three-year transitional (rather than permanent) capacity charge").

[42] IEU-Ohio Ex. 101 at 13.

had authority to adopt a cost-based ratemaking methodology to establish the compensation available to AEP-Ohio for generation service capacity available to CRES providers serving customers in AEP-Ohio's certified electric distribution service area.

While the evidentiary hearing was still ongoing, AEP-Ohio filed a motion requesting that the Commission extend and increase the two-tiered capacity charges beyond May 31, 2012. Despite its prior holding on the temporary nature of the two-tiered capacity charges, on May 30, 2012, the Commission authorized AEP-Ohio to extend use of the two-tiered charges through July 2, 2012.[43] The May 30, 2012 Entry also authorized AEP-Ohio to increase the price in the first tier from RPM-Based Pricing (roughly $20/MW-day beginning June 1, 2012) to $146/MW-day.[44]

On July 2, 2012, the Commission issued its decision in this proceeding (the July 2nd Order) and held it had jurisdiction under its general supervisory powers to adopt a cost-based ratemaking method to establish prices for wholesale capacity service available to CRES providers.[45] The July 2nd Order rejected AEP-Ohio's conclusion that its "cost" was $355/MW-day; however the Commission adopted AEP-Ohio's cost-based ratemaking methodology as the starting point and found AEP-Ohio's "cost" of capacity was $188.88/MW-day.[46] Although the Commission held AEP-Ohio's "cost" was $188.88/MW-day, it also held that, no later than August 8, 2012, AEP-Ohio must restore RPM-Based Pricing as the price for generation capacity service paid by CRES providers serving customers in AEP-Ohio's certified electric distribution service area.[47] The

[43] Entry at 7-8 (May 30, 2012) (hereinafter "*May 30, 2012 Entry*").

[44] *Id.*

[45] *July 2nd Order* at 12-13.

[46] *Id.* at 33.

[47] *Id.* at 23.

Commission further held that AEP-Ohio could defer the difference between RPM-Based Pricing and $188.88/MW-day (the "Delayed Recognition Pricing Scheme").[48] The Commission stated that it would disclose, in AEP-Ohio's pending ESP proceeding,[49] how, when and who will pick up the tab for the Delayed Recognition Pricing Scheme (including interest).[50] The Commission stated that AEP-Ohio could add a carrying charge to the amount deferred computed at AEP-Ohio's WACC until such time as recovery was authorized in the ESP II proceeding.[51] Thereafter, AEP-Ohio could carry the deferral balance at a long-term debt rate.[52]

The Commission held that AEP-Ohio must restore RPM-Based Pricing to establish the compensation available from CRES providers for generation capacity service because "RPM-based capacity pricing will promote retail electric competition."[53] The Commission found that "RPM-based capacity pricing will stimulate true competition among suppliers in AEP-Ohio's service territory" and will "incent shopping."[54] The Commission also found that RPM-Based Pricing has "been successfully used throughout Ohio and the rest of the PJM region and puts electric utilities and CRES providers on a level playing field."[55] Thus, the Commission found that RPM-Based Pricing promoted State policy and competition in line with Ohio law and policy and the Commission's duty to effectuate that policy. Implicitly, the July 2nd Order stands for the

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[48] *Id.*

[49] *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, *et al.* (hereinafter "*ESP II*").

[50] *July 2nd Order* at 23.

[51] *Id.* at 23-24.

[52] *Id.* at 24.

[53] *Id.* at 23.

[54] *Id.*

[55] *Id.*

proposition that capacity pricing other than RPM-Based Pricing does not promote retail electric competition, incent shopping or create a level playing field. In any event, the Commission made no finding, for it could not, that a capacity price of $188.88/MW-day has any of these virtues.

The Commission, however, failed to include in its July 2nd Order the specific details necessary for customers and CRES providers to understand the true impact of the Commission's order. Who will have to pay for the deferral? How long will the deferral last? When will customers/CRES providers have to begin payment for the deferral? How will a deferral based upon a difference in rates, instead of a deferred expense, be estimated, calculated, implemented, or even audited? The only information given by the Commission on these very important questions amounted to notice that they were being kicked down the road and somehow into AEP-Ohio's ESP II proceeding.[56] The Commission did not explain how it would or could address a deferral of the capacity price in the ESP II proceeding after the record in that case had closed.

The July 2nd Order also recognized IEU-Ohio had presented the Commission with uncontested evidence that AEP-Ohio's proposed compensation methodology for generation capacity service would allow for recovery of additional transition revenue, in contravention of the Ohio Revised Code, and commitments AEP-Ohio made to resolve issues in its electric transition plan ("ETP") proceeding.[57] The July 2nd Order, however, was devoid of any analysis or resolution of this issue. The July 2nd Order also failed to address several other issues raised by IEU-Ohio through testimony and on brief. These issues concern comparability requirements, the prohibition on anticompetitive subsidies,

[56] *Id.*

[57] *Id.* at 30-31.

and an uncontested information disclosure recommendation presented by IEU-Ohio witness Murray.

As demonstrated below, the Commission must grant rehearing for the reasons discussed in this application for rehearing and others which have been granted by the Commission in this proceeding. The relief that IEU-Ohio seeks through its application for rehearing is prompt and full restoration of RPM-Based Pricing as required by the Ohio Revised Code and the express terms of the RAA.

II. ASSIGNMENTS OF ERROR

1. The July 2nd Order is unlawful and unreasonable since any authority the Commission may have to approve prices for generation capacity service does not permit the Commission to apply a cost-based methodology or resort to Chapters 4905 and 4909, Revised Code, to supervise and regulate pricing for generation capacity services. Similarly, the order is unreasonable and unlawful to the extent that it states or otherwise suggests that AEP-Ohio has a right to establish rates for generation-related services that are based on any cost-based ratemaking method including the ratemaking methodology identified or referenced in Chapters 4905 and 4909, Revised Code.

The Commission's July 2nd Order is unlawful and unreasonable because the Commission is prohibited from applying cost-based ratemaking principles or resorting to Chapters 4905 and 4909, Revised Code, to supervise and regulate generation capacity services.[58] The Commission is a creature of statute and may exercise only that authority granted to the Commission by statute.[59]

[58] Section 4928.05(A)(1), Revised Code; *see, e.g., Indus. Energy Users-Ohio v. Pub. Util. Comm.*, 117 Ohio St.3d 486, 2008-Ohio-990 at ¶ 20.

[59] *Lucas County Commissioners v. Pub. Util. Comm'n of Ohio*, 80 Ohio St.3d 344, 347 (1997) ("The commission may exercise only that jurisdiction conferred by statute.").

The definitions in Section 4928.01, Revised Code,[60] in combination with the declaration in Section 4928.03, Revised Code, make it clear that the Commission may not lawfully supervise or regulate any service involved in supplying or arranging for the supply of electricity to ultimate consumers in Ohio, from the point of generation to the point of consumption, once such service is declared competitive except in certain statutorily defined circumstances.[61] From these definitions, this conclusion holds regardless of whether the service is called wholesale or retail. The definition of "retail electric service" includes "*any service*" from the point of generation to the point of consumption.[62]

Section 4928.05, Revised Code, makes it clear that the removal of the Commission's supervisory and regulatory powers extends to the service component or

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[60] "'Retail electric service' means 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. For the purposes of this chapter, retail electric service includes one or more of the following service components: generation service, aggregation service, power marketing service, power brokerage service, transmission service, distribution service, ancillary service, metering service, and billing and collection service." Section 4928.01(A)(27), Revised Code.

"Competitive retail electric service" means a component of retail electric service that is competitive as provided under division (B) of Section 4928.01, Revised Code.

[61] Section 4928.05(A)(1), Revised Code, provides:

> On and after the starting date of competitive retail electric service, a competitive retail electric service supplied by an electric utility or electric services company shall not be subject to supervision and regulation by a municipal corporation under Chapter 743. of the Revised Code or by the public utilities commission under Chapters 4901. to 4909., 4933., 4935., and 4963. of the Revised Code, except sections 4905.10 and 4905.31, division (B) of section 4905.33, and sections 4905.35 and 4933.81 to 4933.90 ; except sections 4905.06, 4935.03, 4963.40, and 4963.41 of the Revised Code only to the extent related to service reliability and public safety; and except as otherwise provided in this chapter. The commission's authority to enforce those excepted provisions with respect to a competitive retail electric service shall be such authority as is provided for their enforcement under Chapters 4901. to 4909., 4933., 4935., and 4963. of the Revised Code and this chapter. Nothing in this division shall be construed to limit the commission's authority under sections 4928.141 to 4928.144 of the Revised Code. On and after the starting date of competitive retail electric service, a competitive retail electric service supplied by an electric cooperative shall not be subject to supervision and regulation by the commission under Chapters 4901. to 4909., 4933., 4935., and 4963. of the Revised Code, except as otherwise expressly provided in sections 4928.01 to 4928.10 and 4928.16 of the Revised Code.

[62] Section 4928.01(A)(27), Revised Code (emphasis added).

function (generation, transmission, distribution) where the service component is declared competitive. Section 4928.03, Revised Code, states:

> Beginning on the starting date of competitive retail electric service, retail electric generation, aggregation, power marketing, and power brokerage services supplied to consumers within the certified territory of an electric utility are competitive retail electric services[63] that the consumers may obtain subject to this chapter from any supplier or suppliers.

Section 4928.05, Revised Code, states that competitive retail electric service (which by definition includes any generation service from the point of generation to the point of consumption) is not subject to the Commission's regulation except as may be specifically allowed in Sections 4928.141 to 4928.144, Revised Code (which relate exclusively to the establishment of an SSO for *retail* electric customers). No party disputes that capacity service is a generation service. Section 4928.05(A), Revised Code, also specifically precludes the Commission from regulating such a service under Chapter 4909, Revised Code.

While Section 4928.05(A)(1), Revised Code, allows the Commission to supervise a competitive retail electric service under Section 4905.06, Revised Code, that authority is limited to supervising "the adequacy or accommodation afforded by [the] service, the safety and security of the public and [the utility's] employees, and [the utility's] compliance with all laws, orders of the commission, franchises, and charter requirements." Section 4905.06, Revised Code, does not allow the Commission to establish a rate for a competitive retail electric service. As mentioned above, the Commission's ability to regulate competitive retail electric rates is limited to the Commission's authority under Sections 4928.141 to 4928.144, Revised Code. As the

[63] The definition of "retail electric service" (in combination with the balance of Chapter 4928) also makes it clear that a service component or function is either competitive or non-competitive. Because non-competitive service components are defined to be everything except competitive service components or functions, a service component must either be competitive or non-competitive.

Ohio Supreme Court has held, when the General Assembly enacts ratemaking statutes, the Commission cannot usurp those statutes by relying on its general supervisory authority.[64] Because Sections 4928.141 to 4928.144, Revised Code, detail with specificity the means by which the Commission may regulate and establish rates for competitive retail electric services, the Commission cannot bypass those requirements by relying on its general supervisory powers contained in Sections 4905.04, 4905.05, and 4909.06, Revised Code.

Notwithstanding the Commission's July 2nd Order, the Commission is specifically barred from using its supervisory powers or the regulatory authority in Chapters 4905 and 4909, Revised Code, to address pricing for any generation service from the point of generation to the point of consumption.[65] Whatever authority the Commission has with regard to generation service, it is limited to the authorization of retail prices that the Commission must establish in conformance with the requirements of Sections 4928.141 to 4928.144, Revised Code. Because the Commission's authority to regulate generation service is limited to retail SSO rates, the July 2nd Order is unlawful and unreasonable.

2. Assuming for purposes of argument that the Commission has authority to authorize the billing and collection of a generation capacity service charge pursuant to Chapters 4905 and 4909, Revised Code, the July 2nd Order is nonetheless unreasonable and unlawful because AEP-Ohio failed to present the required evidence and the Commission failed to comply with the substantive and procedural requirements contained in such Chapters.

In the Commission's discussion on whether it had jurisdiction to approve AEP-Ohio's capacity proposal, the Commission held that it did not need to determine if

[64] *Columbus S. Power Co. v. Pub. Util. Comm.*, 67 Ohio St.3d, 535, 620 N.E.2d 835, 840 (1993).

[65] Section 4928.05, Revised Code.

the generation capacity service is a competitive service (subject to limited regulation under Chapter 4928, Revised Code) or a noncompetitive service (subject to regulation under Chapter 4909, Revised Code).[66] Rather than determining that the Commission could regulate generation capacity service under Chapter 4909, Revised Code, the Commission held it could do so under its general supervisory powers in combination with the RAA.[67] However, the Commission ended up referencing Chapter 4909, 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.[68]

The Commission's modifications to AEP-Ohio's implementation of a so-called "cost-based" ratemaking methodology also made it abundantly clear that it was applying Chapter 4909, Revised Code, when it established a "cost-based" rate under the Delayed Recognition Pricing Scheme.

As part of the July 2nd Order, the Commission adopted in part Staff's recommended adjustments to AEP-Ohio's "cost-based" ratemaking methodology. While Staff urged the Commission to adopt RPM-Based Pricing and simply illustrated adjustments required to AEP-Ohio's cost-based ratemaking methodology, Staff claimed that its adjustments were required based upon Chapter 4909, Revised Code.[69] The Commission also rejected several of Staff's adjustments, finding that the adjustments were not consistent with AEP-Ohio's recent distribution service (a non-competitive

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[66] *July 2nd Order* at 13.

[67] *Id.* at 12-13.

[68] *Id.* at 22 (emphasis added).

[69] *See* Staff Ex. 103 at 14-15 (removing CWIP from AEP-Ohio's "cost" calculation based upon Section 4909.15, Revised Code).

service) rate case.[70] That case, of course, was governed by Chapter 4909, Revised Code.[71] Although the Commission invoked Chapter 4909, Revised Code, neither the Commission nor AEP-Ohio complied with the statutory requirements in Chapter 4909, Revised Code, which, once satisfied, would permit the Commission to consider and potentially approve an application to increase rates and charges.

The first mandatory step in securing an increase in rates under Chapter 4909, Revised Code, is for the EDU to file a notice of its intention to seek an increase in rates.[72] The notice of intent must be sent to the mayor and legislative authority of each municipality served by the EDU.[73] At least thirty days later, the EDU may then file its application to increase rates.[74] The president or vice-president and the secretary or treasurer of the public utility must also verify the accuracy of the application.[75] The application itself must also contain extensive details.[76]

An application to increase rates must include a description of its property used and useful in rendering service to the public as laid out in Section 4909.05, Revised Code. An application to increase rates must also include a list of current rate schedules and the proposed rate schedules.[77] Further, the application must contain: a "complete operating statement of its last fiscal year, showing in detail all its receipts, revenues, and incomes from all sources, all of its operating costs and other expenditures, and any

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[70] *July 2nd Order* at 34 (Staff's adjustment was "inconsistent with Staff's recommendation in [AEP-Ohio's] recent distribution rate case.").

[71] Tr. Vol. IX at 1944.

[72] Section 4909.43, Revised Code; Rule 4901-7-1, O.A.C., Appendix at 7.

[73] Section 4909.43, Revised Code.

[74] *Id.*

[75] Section 4909.18, Revised Code.

[76] *See* Section 4909.18, Revised Code; Section 4909.19, Revised Code; Section 4909.05, Revised Code.

[77] Section 4909.18, Revised Code.

analysis such public utility deems applicable to the matter referred to in said application;" "a statement of the income and expense anticipated under the application filed;" and "a statement of financial condition summarizing assets, liabilities, and net worth."[78]

Once the proper application and all the appropriate information have been filed with the Commission, the Staff at the Commission is required by statute to investigate the facts contained in the rate increase application and issue a report (commonly referred to as the Staff Report of Investigation).[79]

Once complete, the Staff Report of Investigation must be docketed with the Commission and served on the mayors of all municipalities within the public utility's service territory.[80]

Parties that have intervened in the proceeding are then afforded a statutory right to object to the Staff Report of Investigation and thereby frame issues that must be addressed and resolved by the Commission.[81]

These above elements in Ohio's law regarding how and when the Commission may authorize an increase in rates pursuant to the authority delegated to the Commission by Chapter 4909, Revised Code, are only some of the statutory requirements that must be satisfied. Notably, AEP-Ohio and the Commission did not satisfy any of the requirements contained in Chapter 4909, Revised Code. AEP-Ohio did not file a notice of intent to file an application for a rate increase. AEP-Ohio did not present any evidence that it served a notice on the mayor and legislative authority of

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[78] *Id.*

[79] Section 4909.19(C), Revised Code.

[80] *Id.*

[81] *Id.*

each municipality served by the EDU. AEP-Ohio did not present any evidence as to what property was used and useful in rendering generating capacity service to the public, nor did AEP-Ohio have its information verified by the proper personnel.

Indeed, AEP-Ohio's witnesses claimed to not have a clue as to what "Capacity Resources" were being relied upon to satisfy the PJM resource adequacy obligation and the Commission's Staff knew no more about this subject.[82] And while AEP-Ohio's so-called cost-based methodology explained by AEP-Ohio witness Dr. Pearce explicitly assumes that AEP-Ohio's generation assets are the source of capacity that is available to CRES providers,[83] this assumption is contrary to the testimony of the AEP-Ohio witnesses that AEP-Ohio offered as "experts" on the subject. Even the AEP-Ohio witnesses who had not fully read the RAA were aware that the Capacity Resources that were associated with satisfying the capacity obligation of an FRR Entity are **not** composed of the generating assets owned or controlled by AEP-Ohio. More directly, Dr. Pearce's explicit assumption that AEP-Ohio's generation assets are the source of capacity available to CRES providers and thereby must be used to identify a cost-based price is, as Mr. Murray testified, fiction.[84]

The admissions by AEP-Ohio's witnesses render AEP-Ohio's so-called cost-based methodology "used and useless" even if law and reality are suspended to indulge consideration of AEP-Ohio's proposal to increase capacity prices by resorting to a so-called cost-based methodology.

The Commission's Staff also did not conduct the statutorily required investigation. In fact, during cross-examination of a Staff witness, Staff's counsel

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[82] Tr. Vol. XI at 2529-2534; Tr. Vol. XI at 1795-1799.

[83] *See* AEP-Ohio Ex. 102 at 3-24.

[84] Tr. Vol. VI at 1346-47.

objected on grounds of relevance stating "[t]he record is clear that [Staff witness Smith's testimony] is not a staff report of investigation pursuant to 4909.18."[85] Because the Commission Staff's adjustments to AEP-Ohio's cost-based methodology nonetheless rely on AEP-Ohio's approach to justify a huge increase in the lawful capacity price, the Staff's reworked cost-based method (one that the Staff ultimately did not recommend be adopted by the Commission) suffers from the same fundamental legal defects that are embedded in AEP-Ohio's proposal. There has not been any review of the property used and useful in rendering service to the public, as required by statute.[86] Thus, the very foundation for the creation of a cost-based rate under Ohio law was ignored.

In this proceeding, AEP-Ohio did not satisfy the statutory requirements that would allow the Commission to approve an application to increase rates pursuant to Chapter 4909, Revised Code. The Commission did not follow the procedural requirements associated with ratemaking under Chapter 4909, Revised Code. The Commission did not make the determinations required to authorize an increase in rates under Chapter 4909. Therefore, the Commission's reliance upon Chapter 4909, Revised Code, as the ratemaking means by which the Commission authorized an increase in the price for generation capacity service is unlawful and unreasonable.

3. The July 2nd Order is unreasonable and unlawful because it unreasonably impairs the value of contracts entered into with CRES providers by retroactively altering the capacity pricing method that was in place when such contracts were executed. The unlawful and unreasonable impairment arises, in the particular circumstances presented by this case, because the RPM-Based Pricing method

[85] Tr. Vol. IX at 1948.

[86] Section 4909.05, Revised Code. Although IEU-Ohio's witness Hess and Staff identified a non-exhaustive list of the flaws that AEP-Ohio's formula rate suffered from under traditional cost-based ratemaking, neither of their recommendations concluded what property was used and useful in rendering service to the public , and neither claimed that their review or recommendations were comprehensive. IEU-Ohio Ex. 101 at 17-18; *see* Staff Ex. 103 at 8 (Mr. Smith testified that he did not comprehensively address all the issues that might exist with regard to AEP-Ohio's proposal).

establishes generation service capacity prices three years in advance and the July 2nd Order alters the capacity prices that had been fixed and were known and certain at the time such contracts were executed. To the extent the Commission has any authority to approve prices for generation capacity services by altering the ratemaking methodology, that authority may not be lawfully exercised to affect the prices established by the capacity pricing method previously approved by the Commission, in force by operation of law and known and certain for contracts entered into prior to the effective date of the new capacity pricing method.

The July 2nd Order is unreasonable and unlawful inasmuch as it unreasonably impairs the value of contracts entered into between customers and CRES providers. Due to the nature of PJM's capacity market, capacity prices are established three years in advance of the delivery period for that capacity. RPM values are generally known through May 31, 2015.[87] These known capacity prices serve as a basis for establishing CRES providers' offers to customers.[88] From the inception of PJM's capacity market in 2007 to January 1, 2012, the only capacity pricing method that had been lawfully approved by the Commission or FERC and applicable to CRES providers in AEP-Ohio's territory was the RPM-Based Pricing method. Beginning January 1, 2012, AEP-Ohio's two-tiered charges temporarily went into effect, but still provided customers an opportunity to secure RPM-Based Pricing. And the temporary displacement of RPM-Based Pricing came with Commission representations that RPM-Based Pricing would be fully restored in compliance with Ohio law. Thus, up until May 30, 2012, customers and CRES providers were entering into contracts on the warranted assumption that RPM-Based Pricing controlled.[89]

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[87] The subsequent incremental auctions are for relatively small amounts of capacity and therefore have minimal effect on the prices established through the initial auction, the base residual auction ("BRA"). The BRAs for the delivery periods through May 31, 2015 have been conducted, and the results are known.

[88] Tr. Vol. VIII at 1572-1575, 1691-1697.

[89] *May 30 Entry* at 7-8.

Because CRES providers and customers entered into contracts based upon the warranted expectations that RPM-Based Pricing would set the compensation for generation capacity service or was setting such compensation, the July 2nd Order retroactively works to arbitrarily and unreasonably impair the value of contracts by displacing the previously-approved RPM-Based Pricing in favor of a method producing a much higher price. As explained by FES witness Banks:

> The [RPM-Based Pricing] could swing. For example, the current capacity charge is about $145 a megawatt day. On June 1 it goes to about $16 a megawatt-day. That's a swing. On June 1st of the following year it goes to about $27 a megawatt-day. That's a swing.
>
> Those things are okay because those things were known. It was known by the entire market that the capacity cost of a shopping customer that would be charged to a CRES provider was going to be those numbers, absent the adjustment to get to AEP's zone, but everyone knew that.
>
> All of a sudden now the capacity charge is asked to be different midstream based on the [Stipulation] that was filed in September, and then asked to be different again in this capacity case, then asked to be different again in the modified ESP. So that's the problem.[90]

To the extent that the Commission asserts jurisdiction over capacity pricing, it must also assure that the value of contracts already entered into at a time when either RPM-Based Pricing controlled or at a time when the Commission had held that RPM-Based Pricing would be restored as required by Ohio law is not impaired.[91]

Most customers that moved to a CRES provider have contracted with the CRES provider on the assumption that the CRES provider would be billed based on the RPM-Based Price.[92] Allowing AEP-Ohio to bill CRES providers at rates above RPM-Based Pricing or effectively doing the same thing by making such customers responsible for

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[90] Tr. Vol. VIII at 1703.

[91] *Utility Serv. Partners, Inc. v. Pub. Util. Comm'n of Ohio,* 124 Ohio St.3d 284 (2009).

[92] Tr. Vol. VIII at 1696-97 (cross-examination of FES witness Banks).

paying all or part of the difference between the RPM-Based Price and $188.88/MW-day for contracts that have already been executed when RPM-Based Pricing was in place or the Commission held that it would be in place, will cause losses that could not be anticipated or may trigger "regulatory out" clauses that could result in the termination of the contract.[93] Thus, the Commission should grant rehearing, and to the extent it allows the deferred revenue supplement portion of the Delayed Recognition Pricing Scheme to remain in place, the Commission must hold that the above-market capacity charges or any equivalent charge shall not apply to contracts that have already been entered into at a time when RPM-Based Pricing applied or the Commission had caused customers to believe that it would be fully restored as required by Ohio law.

4. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission failed to restore RPM-Based Pricing as required by Section 4928.143(C)(2)(b), Revised Code, when it rejected AEP-Ohio's ESP in February 2012.

As discussed above, AEP-Ohio's ESP I rates were benchmarked to and were based on AEP-Ohio charging RPM-Based Pricing for generation capacity service.[94] After AEP-Ohio attempted to bypass this reality through the Section 205 Filing, the Commission eliminated any doubt, and held it had adopted the RPM-Based Pricing methodology as the state compensation mechanism.[95] Thus, AEP-Ohio's SSO rates, as established in the ESP I proceeding, included RPM-Based Pricing for generation capacity service and that pricing controlled until the Commission authorized new SSO rates for AEP-Ohio.

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[93] Tr. Vol. VIII at 1688-89 & 1694.

[94] IEU-Ohio Ex. 103 at 11, 13-14.

[95] *Entry* at 2 (Dec. 8, 2010).

On December 14, 2011, the Commission issued the Stipulation Order and adopted the Stipulation's recommended prices for generation capacity service. As discussed above, those rates were separated into two tiers with the first tied to RPM-Based Pricing and the second tier set at $255/MW-day, an entirely arbitrary number.[96] Ultimately, the Commission determined the Stipulation was not in the public interest and rejected the Stipulation. Upon rejecting the Stipulation, the Commission was required, in accordance with Section 4928.143(C)(2)(b), Revised Code, to restore the "the provisions, terms, and conditions of the utility's most recent standard service offer."

Although the Commission recognized that it was bound by Section 4928.143(C)(2)(b), Revised Code, upon rejecting the Stipulation, the Commission has nonetheless sustained AEP-Ohio's lawless demands. Specifically, as it relates to the July 2nd Order, the Commission authorized AEP-Ohio to increase its generation capacity service revenue by charging prices substantially in excess of RPM-Based Pricing. The Commission, however, is required to issue such orders as necessary to continue "the provisions, terms, and conditions" of AEP-Ohio's ESP I rates until the Commission authorizes a subsequent SSO under either Sections 4928.142 or 4928.143, Revised Code. The Commission ignored this mandate, and therefore the July 2nd Order is unlawful and unreasonable.

5. The July 2nd Order is unlawful and unreasonable inasmuch as it authorized AEP-Ohio to collect an above-market rate for generation capacity service, which will allow AEP-Ohio to collect transition revenue or its equivalent in violation of Ohio law and AEP-Ohio's Commission-approved commitment to not impose lost generation-related revenue charges on shopping customers.

[96] *Stipulation* at 20-22.

As demonstrated by IEU-Ohio through the testimony of its witnesses[97] and its initial brief,[98] among other pleadings before the Commission,[99] the authorization of an above-market price for generation capacity service will allow AEP-Ohio to collect transition revenue (also referred to as "stranded costs") in violation of Ohio law and commitments AEP-Ohio it made as part of a Commission-approved settlement in AEP-Ohio's ETP proceedings.[100] In lieu of repeating all of the transition revenue/stranded costs discussion in IEU-Ohio's initial brief, IEU-Ohio hereby incorporates it by reference.[101]

Under Ohio law, AEP-Ohio was given an opportunity to collect generation-related transition revenue while it prepared for competition.[102] The "transition" period is over, and Ohio law now prohibits the collection of transition revenue.[103] Additionally, AEP-Ohio agreed to forgo collecting above-market transition revenue associated with its generation assets promising it would not "impose any lost revenue charges (generation transition charges (GTC)) on any switching customer."[104] That commitment was

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[97] IEU-Ohio Ex. 101, *in passim*; IEU-Ohio Ex. 102A at 15-20.

[98] IEU-Ohio Post-Hearing Brief at 16-25, 47-50 (May 23, 2012).

[99] IEU-Ohio Reply Brief at 5-7 (Nov. 18, 2011); Application for Rehearing and Memorandum in Support of IEU-Ohio at 36-39 (Jan. 13, 2012); IEU-Ohio Memorandum Contra Ohio Power Company's February 27, 2012 Motion for Relief and Request for Expedited Ruling at 15-16 (March 2, 2012); IEU-Ohio Application for Rehearing of the March 7, 2012 Entry and Memorandum in Support at 18-20 (March 27, 2012); IEU-Ohio Application for Rehearing of the May 30, 2012 Entry and Memorandum in Support at 12 (June 19, 2012).

[100] Additionally, the briefs of FES, Ohio Manufacturers' Association ("OMA"), Ohio Hospital Association ("OHA"), The Kroger Company ("Kroger"), Dominion Retail, Inc. ("Dominion"), and Interstate Gas Supply ("IGS") support IEU-Ohio's arguments that AEP-Ohio is barred from collecting stranded costs. *See* July 2nd Order at 30-31.

[101] IEU-Ohio Post-Hearing Brief at 16-25, 47-50 (May 23, 2012); IEU-Ohio Reply Brief at 6-7 (May 30, 2012).

[102] Sections 4928.37 to 4928.40, Revised Code.

[103] Section 4928.40, Revised Code.

[104] IEU-Ohio Ex. 101 at 10-11; FES Ex. 106.

reaffirmed and incorporated into AEP-Ohio's Rate Stabilization Plan ("RSP") proceeding.[105]

The above-market generation capacity service charges sought by AEP-Ohio and approved by the Commission through the Delayed Recognition Pricing Scheme are based on the same assumptions as the transition revenue claim AEP-Ohio previously made and agreed to forgo in its ETP proceeding.[106] Both were based on AEP-Ohio's total net book value of its generation assets, and both included assumptions on the generation-related revenue that AEP-Ohio would be able to receive in the electric market (wholesale and retail).[107]

Because the July 2nd Order will allow AEP-Ohio to collect above-market generation-related revenue, the Commission has unlawfully approved transition revenue for AEP-Ohio. Therefore, the Commission must grant rehearing, and vacate any portion of the July 2nd Order that may permit AEP-Ohio to increase or collect rates that provide AEP-Ohio with transition revenue or the equivalent.

6. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission failed to adopt the uncontested recommendation of IEU-Ohio witness Kevin Murray contained at pages 33-34 of IEU-Ohio Exhibit 102A, which, if adopted, would provide much needed transparency to the process AEP-Ohio used to derive the billing determinants for generation capacity service.

The Commission unlawfully and unreasonably failed to ensure that AEP-Ohio's generation capacity service charge will be billed in accordance with a customer's Peak Load Contribution ("PLC") factor that is the controlling billing determinant under the

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[105] *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of a Post-Market Development Period Rate Stabilization Plan*, Case No. 04-169-EL-UNC, Opinion and Order at 9, (Jan. 26, 2005) (hereinafter "*RSP Proceeding*").

[106] *Id.* at 8-9, 11.

[107] IEU-Ohio Ex. 101 at 8-9, 11-13, 18.

RAA. IEU-Ohio witness Murray testified that "[t]he Commission should require AEP-Ohio to document to customers and CRES providers that the PLC factor it is assigning to customers corresponds with the customers' PLC value recognized by PJM."[108] No party cross-examined Mr. Murray on this issue, or challenged Mr. Murray's recommendations in their briefs. IEU-Ohio again requested the Commission to require AEP-Ohio to bring such much needed transparency to the billing determinant specification in its briefs.[109] The July 2nd Order, however, failed to address the recommendation.

As explained by Mr. Murray:

> For settlement purposes, each PJM electric distribution company ("EDC") is responsible for allocating its normalized previous summer's peak to each customer in the zone (both wholesale and retail). According to PJM's business practice manuals, the process used by an EDC to allocate peak load contributions to its customers is supposed to be based upon rules negotiated with the EDC's regulators. To assist in performing these allocations, PJM publishes information known as the five coincident peaks or 5CP for each summer, typically by mid-October. The 5CP reflects the five highest non-holiday weekday RTO unrestricted daily peaks from the summer. An individual customer's usage during those five hours is known as the peak load contribution or PLC. PJM calculates the capacity obligation for the FRR Entity based upon its load forecast. From the FRR Entity's capacity obligation the FRR Entity is required to allocate its obligation between wholesale and retail customers based upon the customer's PLC. PJM publishes its 5 coincident peak ("CP") data for each year to assist each electric distribution company in PJM to make an appropriate allocation of the entity's capacity obligation to customers. The CPs correspond to the five hours with the highest demand on the PJM system for a given PJM delivery year.[110]

The means by which AEP-Ohio is specifying each customer's PLC has never been identified by AEP-Ohio. And, as mentioned above, AEP-Ohio did not challenge IEU-Ohio's recommendation that the Commission direct AEP-Ohio to make the capacity

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[108] IEU-Ohio Ex. 102A at 34.

[109] IEU-Ohio Reply Brief at 10, 35 (May 30, 2012).

[110] IEU-Ohio Ex. 102A at 9.

charge billing determinant specification transparent. However, the Commission's July 2nd Order failed to require this much needed transparency. The issue is material to the ultimate outcome of this case because, without disclosure of the means by which the PLC is disaggregated from AEP East down to AEP-Ohio and then down to each AEP-Ohio customer, it is not possible to test AEP-Ohio's specification of PLCs, determine whether Ohio customers are disproportionately covering the AEP East FRR capacity obligation, or whether certain customers or customer classes within AEP-Ohio's territory are unfairly being assigned their PLCs.

The Commission must grant rehearing and require AEP-Ohio to publicly disclose the means by which the PLC is disaggregated from AEP East down to AEP-Ohio and then down to each AEP-Ohio customer. This action is required regardless of the pricing method used to identify capacity charges because any capacity charge must be applied to the proper billing determinant. IEU-Ohio would also note that this PLC specification transparency requirement is also a critically important determination of how much revenue AEP-Ohio may eventually be able to collect for generation capacity service through the Delayed Recognition Pricing Scheme since RPM-Based Pricing applies to the PLC. Calculating the difference between RPM-Based Pricing and $188.88/MW-day requires a transparent and proper identification of PLCs.

7. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission authorized AEP-Ohio to collect above-market prices for generation capacity service, which will provide AEP-Ohio's generation business with an unlawful subsidy in violation of Section 4928.02(H), Revised Code.

As demonstrated through IEU-Ohio's testimony,[111] and its initial brief,[112] the approval of an above-market generation capacity service charge (collected

[111] *Id.* at 14, 20-26.

contemporaneously and in the future) would unlawfully subsidize AEP-Ohio's competitive "deregulated" generation business.

Among the many other fundamental defects in the July 2nd Order, the establishment of an above-market price for capacity is contrary to the State's policies proscribing subsidies from flowing between competitive and noncompetitive services, to the detriment of generation function competitors and shopping and non-shopping customers alike.[113] Section 4928.02(H), Revised Code, states that it is the policy of the State of Ohio to:

> Ensure effective competition in the provision of retail electric service by avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service or to a product or service other than retail electric service, and vice versa, including by prohibiting the recovery of any generation-related costs through distribution or transmission rates

In AEP-Ohio's *Sporn* proceeding, the Commission held that Section 4928.02(H), Revised Code:

> requires the Commission to avoid subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service. OP seeks to establish a nonbypassable charge that would be collected from all distribution customers by way of the PCCRR. Approval of such a charge would effectively allow the Company to recover competitive, generation-related costs through its noncompetitive, distribution rates, in contravention of the statute.[114]

Despite the plain meaning of Section 4928.02(H), Revised Code, and the Commission's recent refusal to authorize the recovery of the unamortized Sporn 5 plant investment through a nonbypassable charge, the July 2nd Order authorized AEP-Ohio to charge

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[112] IEU-Ohio Post-Hearing Brief at 56-59 (May 23, 2012).

[113] *See* Section 4928.02(H), Revised Code; *In the Matter of the Application of Ohio Power Company for Approval of the Shutdown of Unit 5 of the Philip Sporn Generating Station and to Establish a Plant Shutdown Rider*, Case No. 10-1454-EL-RDR, Finding and Order at 19 (Jan. 11, 2012) (hereinafter "*Sporn Decision*").

[114] *Id.*

arbitrary above-market generation prices prior to August 8, 2012 and above-market charges (computed as the difference between RPM-Based Pricing and $188.88/MW-day), thereafter thereby providing AEP-Ohio's competitive generation business with a unique and anticompetitive subsidy in violation of Ohio law.

8. The July 2nd Order is unlawful and unreasonable inasmuch as it violates the comparability requirements in Chapter 4928, Revised Code, which requires the generation capacity service rate applicable to CRES providers or otherwise to shopping customers to be comparable to the generation capacity service rate embedded in AEP-Ohio's SSO rates.

As demonstrated through IEU-Ohio's testimony,[115] and its initial brief,[116] the Ohio Revised Code[117] and the Commission's rules require generation capacity service prices in AEP-Ohio's SSO to be comparable and non-discriminatory relative to the prices applicable to CRES providers/shopping customers. Section 4928.02(B), Revised Code, provides that it is policy of the State of Ohio to "[e]nsure the availability of unbundled and comparable retail electric service that provides consumers with the supplier, price, terms, conditions, and quality options they elect to meet their respective needs."

The July 2nd Order adopts RPM-Based Pricing to establish the wholesale generation capacity service compensation available from CRES providers. The July 2nd Order indicates (and does so unlawfully and unreasonably in IEU-Ohio's view) that the Commission may yet permit AEP-Ohio to collect revenue to supplement the RPM-Based Pricing compensation available from CRES providers and that such revenue supplement will be addressed in future Commission decisions. The revenue supplement aspect of the Commission order does not alter the fact that, as between

[115] IEU-Ohio Ex. 102A at 14, 29-32.

[116] IEU-Ohio Post-Hearing Brief at 59-61 (May 23, 2012).

[117] See Sections 4928.02(B), 4928.15 and 4928.35(C), Revised Code; Rule 4901:1-35-01(L), O.A.C.

AEP-Ohio and CRES providers and for the wholesale transaction, the PUCO has again adopted RPM-Based Pricing as the price CRES providers are required to pay for generation capacity service.

There is no explicit generation service capacity charge in AEP-Ohio's SSO rates[118] to compare to the generation capacity service rates applicable to CRES providers. The SSO charge for generation capacity service is not unbundled, separately stated or driven by the PLC billing determinant. Although there is not an unbundled or explicit capacity charge in AEP-Ohio's SSO, AEP-Ohio witness Allen testified that the AEP-Ohio SSO provides AEP-Ohio with, on average, compensation for generation capacity service at a rate of $355/MW-day.[119] The total compensation available from the July 2nd Order for generation capacity service (a total of $188.88/MW-day plus interest on the deferred revenue supplement) is substantially less than the amount of compensation for generation capacity service that AEP-Ohio has admitted it is obtaining from its SSO. Thus, the SSO is not comparable, it is discriminatory and it is providing AEP-Ohio, according to AEP-Ohio, with excessive compensation for generation capacity service.

To ensure comparability, non-discrimination and to implement the Commission's July 2nd Order, the Commission must unbundle the generation capacity service embedded in the SSO, establish a comparable and non-discriminatory price and rate design for such unbundled component (with a proper and transparent recognition of the PLC) and use the generation capacity service compensation that AEP-Ohio has obtained through the SSO that is above the $188.88/MW-day price as an offset to any

[118] AEP-Ohio Ex. 101 at 10; FES Ex. 108 at 3; Tr. Vol. I at 67-70.

[119] Tr. Vol. III at 635-637.

opportunity that the Commission may provide AEP-Ohio to obtain supplemental revenue under the Delayed Recognition Pricing Scheme. Otherwise, the Commission's July 2nd Order produces a non-comparable and discriminatory result that is unreasonable and unlawful.

9. The July 2nd Order setting a generation capacity rate under PJM's RAA is unlawful and unreasonable inasmuch as the order violates the plain language of the RAA, which must be interpreted under Delaware law (the controlling law under the RAA).

Despite the legal barriers discussed above, the Commission adopted a cost-based ratemaking methodology in part based on its views about the language in Section D.8 of Schedule 8.1 of the RAA. Even if the General Assembly had delegated authority to the Commission to use a cost-based ratemaking method to establish prices for generation capacity service or it was possible (and it is not) for the RAA to be a source of the Commission subject matter jurisdiction, the Commission's July 2nd Order violates the plain meaning of the RAA.

The RAA states the RAA has a region-wide focus and a pro-competitive purpose; the July 2nd Order ignores both. Additionally, to the extent the RAA allows an FRR Entity to request a change in compensation for its load that switches to an alternative LSE such as a CRES provider, the RAA looks to the FRR Entity, its FRR Capacity Plan, the Capacity Resources that make up that plan, and the FRR Service Area to determine an appropriate alternative compensation method. Any alternative compensation method must be just and reasonable and comply with tariff filing and approval requirements established by federal law. And, there is nothing in the RAA that supports the view that the word "cost" as it appears in Section D.8 of Schedule 8.1 of the RAA means "embedded cost" or the type of cost that the Commission may consider for purposes of ratemaking under Chapter 4909, Revised Code.

The RAA states that it is governed by Delaware law. AEP-Ohio has not made any claims related to the meaning of Delaware law and the Commission has thus far failed to consider Delaware law (something that IEU-Ohio has previously suggested).[120]

Based on the rules of construction formed by Delaware law (discussed below), it is patently unreasonable for the Commission to extract the word "cost" from the RAA and transform the word into a meaning that embraces the embedded cost-based ratemaking method that appears to be the foundation of the July 2nd Order.

The United States Supreme Court ("Court"), when confronted with an analogous situation of a competitive supplier required to compensate an incumbent owner of network resources for the use of those resources, addressed the issue of what "cost" should form the basis for the payments by the competitive supplier to the incumbent utility. In *Verizon Communications Inc. v. Federal Communications Commission*,[121] the Court sustained the Federal Communications Commission's ("FCC") application of the word "cost" without reference to or use of "rate-of-return or other rate-based proceeding."[122] The Court found that the FCC's approach to establish compensation for the use of monopoly service, without reference to the actual or historical "cost" of a facility, was both supported by the Telecommunications Act of 1996 and sufficient under the U.S. Constitution.[123] Beginning at page 498 of the decision, the Court stated:

> At the most basic level of common usage, "cost" has no such clear implication. A merchant who is asked about "the cost of providing the goods" he sells may reasonably quote their current wholesale market price, not the cost of the particular items he happens to have on his shelves, which may have been bought at higher or lower prices.

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[120] IEU-Ohio Reply Brief at 11-12 (May 30, 2012).

[121] 535 U.S. 467 (2002) (hereinafter "*Verizon*").

[122] *Verizon* at 498-501.

[123] *Verizon* at 497-501.

> When the reference shifts from common speech into the technical realm, the incumbents still have to attack uphill. To begin with, even when we have dealt with historical costs as a ratesetting basis, the cases have never assumed a sense of "cost" as generous as the incumbents seem to claim. "Cost" as used in calculating the rate base under the traditional cost-of-service method did not stand for all past capital expenditures, but at most for those that were prudent, while prudent investment itself could be denied recovery when unexpected events rendered investment useless, *Duquesne Light Co.* v. *Barasch,* 488 U.S., at 312. And even when investment was wholly includable in the rate base, ratemakers often rejected the utilities' "embedded costs," their own book-value estimates, which typically were geared to maximize the rate base with high statements of past expenditures and working capital, combined with unduly low rates of depreciation. See, *e. g., Hope Natural Gas,* 320 U.S., at 597— 598. It would also be a mistake to forget that "cost" was a term in value-based rate making and has figured in contemporary state and federal ratemaking untethered to historical valuation.[18]

AEP-Ohio's proposed formula-derived "cost" calculation (which the July 2nd Order adopted as a starting point to reach the conclusion that AEP-Ohio's cost of capacity is $188.88/MW-day) is not based upon any of the defined terms in the RAA. The July 2nd Order's reliance on an embedded cost ratemaking methodology is (as discussed previously) precluded by Ohio law and conflicts with the procompetitive purpose of the RAA (as specified in the RAA's Article 2), is incompatible with the controlling provisions of Delaware law, and conflicts with the U.S. Supreme Court's holding about the meaning of the word "cost" in an analogous situation. Thus, to the extent the Commission could establish a cost-based state compensation mechanism for generation capacity service pursuant to Ohio law, the Commission's determination violates the express terms of or is otherwise incompatible with the RAA which the Commission has no authority to modify or ignore and is therefore unlawful and unreasonable.

a. The administratively-determined "cost-based" rates for AEP-Ohio's certified electric distribution service area contained in the July 2nd Order violate the plain language of Article 2 of the RAA that states the RAA has a region-wide focus and pro-competitive purpose.

The RAA is an agreement or contract among parties that was approved by FERC with the support of AEP-Ohio and its affiliates. The RAA was initially executed as of June 1, 2007 and the current parties to the RAA are set forth in Schedule 17. The express terms of the RAA make it clear that it is a PJM region-wide mutual assistance agreement.[124] Article 2 of the RAA sets forth the purpose of the RAA and states:

> This Agreement is intended to ensure that adequate Capacity Resources, including planned and Existing Generation Capacity Resources, planned and existing Demand Resources, Energy Efficiency Resources, and ILR 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. **Further, it is the intention and objective of the Parties to implement this Agreement in a manner consistent with the development of a robust competitive marketplace. ...** [125]

PJM has also described the RAA as a mutual assistance agreement:

> The RAA, with its roots in PJM's prior existence as a power pool, is an agreement among load serving entities to share a common capacity obligation across a broad region, and through that sharing to reduce the capacity burden that each would face on its own.[126]

Additionally, the RAA is governed by Delaware law;[127] however, the July 2nd Order failed to address this legal fact. Under Delaware law, when interpreting a

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[124] FES Ex. 110A at 4, 21; Tr. Vol. VI. at 1346-1348.

[125] FES Ex. 110A at 21.

[126] IEU-Ohio Ex. 110 at 9.

[127] AEP-Ohio has not made any claims related to the meaning of Delaware law. In *Matria Healthcare, Inc. v. Coral SR LLC*, 2007 WL 763303 at *1, 6 (Del. Ch., March 1, 2007), the Delaware Chancery Court addressed fundamental contract interpretation principles under Delaware law.

> In construing contracts, the function of the Court is to ascertain the shared intentions of the contracting parties when they entered into their agreement. The first level of analysis is deceptively simple: give the words chosen by the parties their ordinary meaning.

contract, the reviewing authority should "attempt to fulfill, to the extent possible, the reasonable shared expectations of the parties at the time they contracted."[128] As discussed above the RAA states that it is the expectation of the parties to the RAA "to implement [the RAA] in a manner consistent with the development of a robust competitive marketplace."[129] The authorization of an above-market anti-competitive capacity price is incompatible with the stated objectives regarding the implementation of the RAA.

> Disputes over a contract negotiated by sophisticated parties typically fall into three broad categories. First, the parties did not anticipate and provide for future events. Thus, the contract fails to address (or to address fully) the responsibilities of the parties in a particular factual setting. Second, the parties (or their lawyers) understand that there are drafting imperfections, perhaps because the parties cannot devise a mutually acceptable resolution to certain issues. The parties do not want what (at that time) are viewed as minor impediments to derail the transaction. They hope that the identified risks will not materialize and trust that, if the unlikely events occur, some judge will fill in the gaps in a way that substantially preserves the benefits of the bargain for each side. Finally, there are disputes like the one now pending. The words, when fairly read and given their ordinary meaning, lead to a result that the Court cannot believe is what reasonable parties would have intended. In a sense, one party's argument boils down to a plea of: "We couldn't have been that obtuse (or worse)." The result reached here is, in large part, unpalatable; it is the product, however, of words chosen by sophisticated parties who drafted a complex and comprehensive agreement. More importantly, it is not for some judge to substitute his subjective view of what makes sense for the terms accepted by the parties.
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> * * *
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> When interpreting a contract, the Court's function is to "attempt to fulfill, to the extent possible, the reasonable shared expectations of the parties at the time they contracted." The Court does this by initially looking to the contract's express terms. If the terms are clear on their face and reasonably susceptible to only one meaning, then the Court gives those terms the meaning that would be ascribed to them by a reasonable third party. If, however, a contract's language is ambiguous, then the Court will look beyond the "four corners" of the agreement to extrinsic evidence. A contract is not ambiguous merely because the parties disagree as to its proper construction. Instead, ambiguity exists when the terms of a contract are reasonably susceptible to different interpretations or have two or more different meanings. Also, when possible, the Court should attempt to give effect to each term of the agreement and to avoid rendering a provision redundant or illusory. (internal citations omitted).

[128] *Id.*

[129] FES Ex. 110A at 21.

The RAA is a multi-party agreement and any attempt to adjudicate the rights of any party to the agreement may affect the rights of other parties to the agreement.[130] Article 6 of the RAA states:

> Except as otherwise provided herein, this Agreement shall be managed and administered by the Parties, Members, and State Consumer Advocates through the Members Committee and the Markets and Reliability Committee as a Standing Committee thereof, except as delegated to the Office of the Interconnection and except that only the PJM Board shall have the authority to approve and authorize the filing of amendments to this Agreement with the FERC.[131]

Thus, to the extent the Commission had any authority to establish a cost-based price for generation capacity service in accordance with the RAA, the Commission's July 2nd Order missed the mark. While the Commission recognized that RPM-Based Pricing supports competition, it nonetheless authorized AEP-Ohio to collect significantly above-market anti-competitive rates through a deferral mechanism that only looks to the capacity compensation AEP-Ohio obtains when customers are served by a CRES provider. And the Commission limited its focus to AEP-Ohio's certified electric distribution service area without addressing the region-wide focus of the RAA. The Commission also completely ignored Delaware law in interpreting the RAA. For these reasons, the Commission's attempt to establish a cost-based rate for generation capacity service under the RAA is unlawful and unreasonable as the Commission's decision violates the plain meaning and stated objective of the RAA.

[130] Ohio R. Civ. P. 19.

[131] FES Ex. 110A at 30.

b. **Even if cost-based rates were established pursuant to the RAA, the Commission unlawfully and unreasonably based its determination of "cost" upon the embedded cost of AEP-Ohio's owned and controlled generating assets based on a defective assumption that such generating assets are the source of capacity available to CRES providers serving customers in AEP-Ohio's certified electric distribution service area. The RAA requires that any change to the default pricing, RPM-Based Pricing, must be just and reasonable and looks to the FRR Entity, and the FRR Entity's Service Area and the Capacity Resources in the FRR Entity's Capacity Plan to establish any pricing other than RPM-Based Pricing. Based on the plain meaning of the word "cost", the July 2nd Order's sanctioning of the use of embedded cost to establish generation capacity services is arbitrary and capricious. In addition, the uncontested evidence demonstrates that AEP-Ohio is not an FRR Entity, AEP-Ohio's owned and controlled generating assets are not dedicated to serve Ohio load and also demonstrates that AEP-Ohio's owned and controlled generating assets are not the Capacity Resources in the FRR Entity's Capacity Plan. In such circumstances, the Commission's reliance upon embedded cost data for AEP-Ohio's owned and controlled generating assets to establish the cost incurred to provide generating capacity services to CRES providers is arbitrary and capricious.**

The Commission unreasonably and unlawfully adopted AEP-Ohio's starting point for its "cost-based" ratemaking calculation, which starting point was based upon the "embedded cost" of AEP-Ohio's generating assets (including year-end plant balances). AEP-Ohio claimed that "[t]he plain language of Schedule 8.1, Section D.8 of the RAA establishes AEP-Ohio's right to elect to charge a cost-based rate to CRES providers."[132] The RAA, however, allows an FRR Entity to request deviation from the default RPM-Based Pricing, and the RAA defines the information necessary to deviate from the default compensation methodology. Because the Commission's determination was based upon a flawed starting point, its "cost" calculation violates the plain language of the RAA.

[132] AEP-Ohio Initial Brief at 13 (May 23, 2012).

Schedule 8.1, Section D.8 of the RAA 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 [RPM-Based Pricing], 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.[133]

Like most contracts having regulatory significance, the RAA contains a definition section where "Agreement," "Capacity Resources," "Fixed Resource Requirement Alternative or FRR Alternative," "FRR Capacity Plan," "FRR Entity," "FRR Service Area," "IOU," "Load Serving Entity or LSE," "Party," "PJM Region," "Planning Period," "Self-Supply,"[134] "State Regulatory Change" and other terms having significance for purposes of the RAA are defined.

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[133] FES Ex. 110A at 111 (emphasis added).

[134] The RAA definition of Self-Supply incorporates the definition of Self-Supply that appears in Attachment DD (Section 2.65, page 2305) to PJM's FERC-approved tariff (emphasis added):

> "Self-Supply" shall mean Capacity Resources secured by a Load-Serving Entity, **by ownership or contract**, outside a Reliability Pricing Model Auction, and used to meet obligations under this Attachment or the Reliability Assurance Agreement through submission in a Base Residual Auction or an Incremental Auction of a Sell Offer indicating such Market Seller's intent that such Capacity Resource be Self-Supply. **Self-Supply may be either committed regardless of clearing price or submitted as a Sell Offer with a price bid. A Load Serving Entity's Sell Offer with a price bid for an owned or contracted Capacity Resource shall not be deemed "Self-Supply," unless it is designated as Self-Supply and used by the LSE to meet obligations under this Attachment or the Reliability Assurance Agreement.**

FES Ex. 110C at 2305.

Assuming, *arguendo*, that the Commission could make determinations regarding the rights and obligations of parties to the RAA, the plain meaning of the above language makes it applicable, if at all, only to an FRR Entity and then only to the FRR Entity's Capacity Plan.

As the evidence in this proceeding demonstrates, and as admitted by AEP-Ohio, AEP-Ohio is not an FRR Entity. Rather, AEPSC is the FRR Entity as agent for the aggregated load of the combined AEP operating companies (including AEP-Ohio) known as AEP East.[135]

AEP-Ohio also failed to identify or introduce the FRR Capacity Plan to which the above-quoted plain language refers. Section 1.29 of the RAA defines "FRR Capacity Plan" as follows:

> FRR Capacity Plan shall 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.[136]

AEP-Ohio further failed to identify the FRR Service Area that must be identified according to the above-quoted language. Section 1.31 of the RAA defines "FRR Service Area" as follows:

> FRR Service Area shall mean (a) the service territory of an IOU as recognized by state law, rule or order; (b) the service area of a Public Power Entity or Electric Cooperative as recognized by franchise or other state law, rule, or order; or (c) a separately identifiable geographic area that is: (i) bounded by wholesale metering, or similar appropriate multi-site aggregate metering, that is visible to, and regularly reported to, the Office of the Interconnection, or that is visible to, and regularly reported to an Electric Distributor and such Electric Distributor agrees to aggregate the load data from such meters for such FRR Service Area and regularly report such aggregated information, by FRR Service Area, to the Office of

[135] *Id.* at 475-476; *see also* Tr. Vol. II at 436-437; Tr. Vol. XI at 2533-2534.

[136] FES Ex. 110A at 10.

> the Interconnection; and (ii) for which the FRR Entity has or assumes the obligation to provide capacity for all load (including load growth) within such area. In the event that the service obligations of an Electric Cooperative or Public Power Entity are not defined by geographic boundaries but by physical connections to a defined set of customers, the FRR Service Area in such circumstances shall be defined as all customers physically connected to transmission or distribution facilities of such Electric Cooperative or Public Power Entity within an area bounded by appropriate wholesale aggregate metering as described above.[137]

And on this subject, AEP-Ohio's witnesses agreed that PJM does not look to AEP-Ohio for purposes of the FRR election but to AEPSC as agent for the aggregated group of the AEP East operating companies including AEP-Ohio.[138] So whatever the FRR Service Area is, it is clear from the record evidence that the FRR Service Area is not coextensive with AEP-Ohio's certified electric distribution service area. AEP-Ohio also failed to identify the FRR capacity obligation that is referenced in the above-quoted language.

Further, the word cost is not used in conjunction with the "state compensation mechanism" (regardless of whether it is defined as "embedded cost" or defined as "avoided cost," which would be more in keeping with the content of the RAA and other governing PJM documents). Schedule 8.1, Section D.8 (quoted above) does not provide AEP-Ohio with the unilateral right to compensation for capacity that is based on AEP-Ohio's embedded cost. Schedule 8.1, Section D.8 permits an FRR Entity to seek a change in the method of compensation to a method that is based "... on the FRR Entity's cost or such other basis shown to be just and reasonable."[139]

The plain language of the RAA destroys the foundation of AEP-Ohio's claim that "... Schedule 8.1, Section D.8 of the RAA establishes AEP Ohio's right to elect to

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[137] *Id.* at 10-11.

[138] Tr. Vol. XI at 2533-2534.

[139] FES Ex. 110A at 111.

charge a cost-based rate to CRES providers."[140] Since AEP-Ohio did not advance any other legal theory to support its claimed unilateral right to use a so-called embedded cost method to set the CRES capacity price, the Commission's inquiry should have ended with a rejection of AEP-Ohio's claim. Instead, the Commission attempted to take AEP-Ohio's formula derived "cost" calculation and make certain adjustments to the calculation.[141] Assuming the Commission had authority to approve cost-based ratemaking methodology to establish compensation for generation capacity service under the RAA, the Commission's starting point fundamentally missed the mark.

The above-quoted language from the RAA requires specific information to evaluate an FRR Entity's proposal to change the method of compensation for the FRR Entity's capacity obligation. That information was never introduced into the record and therefore the Commission's "cost" determination does not comply with the RAA.

Instead of applying the framework set out by the RAA (as discussed above), AEP-Ohio tied its "cost" calculation to AEP-Ohio witness Dr. Pearce's opinions. He claimed that "because [AEP-Ohio] is self-supplying its own generation resources to satisfy these load obligations, the cost to provide this capacity is the *actual embedded capacity cost* of CSP's and OPCO's generation."[142] But Dr. Pearce made clear at page 5 of his direct testimony that he relied upon AEP-Ohio witnesses Munczinski and Horton for his statement that AEP-Ohio elected to utilize the FRR option as a predicate for his embedded-cost driven formula rate proposal. And the record evidence – including the admissions by AEP-Ohio witnesses Horton and Nelson – shows that: (1) AEP-Ohio did

[140] AEP-Ohio Initial Brief at 15 (May 23, 2012).

[141] *See July 2nd Order* at 33-35.

[142] *Id.* at 36 (emphasis in original).

not make an FRR election for its certified electric distribution service area;[143] (2) no FRR election is associated uniquely with AEP-Ohio's certified electric distribution service area;[144] and, (3) AEP-Ohio's owned and controlled generating assets are not the source of capacity available to a CRES provider serving retail customers in AEP-Ohio's certified electric distribution service area.[145]

Thus, Dr. Pearce's embedded-cost formula rate math has no relationship to reality even if: (1) AEP-Ohio had demonstrated that a change from RPM-Based Pricing is warranted based on the facts and law; and (2) the Commission has authority to adopt a cost-based pricing method for generation capacity service.

As already discussed, the RAA itself dispels the notion that capacity anywhere in PJM, regardless of FRR or RPM status, is dedicated to specific customers or load. The RAA is a mutual assistance agreement through which Capacity Resources are shared on a region-wide basis within PJM. Schedule 8.1.A dealing with the FRR Alternative makes this clear (emphasis added):

> The Fixed Resource Requirement ("FRR") Alternative provides an alternative means, under the terms and conditions of this Schedule, for an eligible Load-Serving Entity to satisfy its obligation hereunder to commit Unforced Capacity **to ensure reliable service to loads in the PJM Region.**[146]

Schedule 8.1.B.2 of the RAA does permit a party to elect the FRR Alternative for a portion of its load within the PJM Region, but a partial FRR Alternative election triggers specific requirements:

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[143] Tr. Vol. II at 429, 475; Tr. Vol. XI at 2530-2534.

[144] *Id.*

[145] *Id.* at 2530-2531, 2533; *see also* Tr. Vol. XI at 2543-2547.

[146] FES Ex. 110A at 106 (*emphasis added*).

> A Party eligible under B.1 above may select the FRR Alternative only as to all of its load in the PJM Region; provided however, that a Party may select the FRR Alternative for only part of its load in the PJM Region if (a) the Party elects the FRR Alternative for all load (including all expected load growth) in one or more FRR Service Areas; (b) the Party complies with the rules and procedures of the Office of the Interconnection and all relevant Electric Distributors related to the metering and reporting of load data and settlement of accounts for separate FRR Service Areas; and (c) the Party separately allocates its Capacity Resources to and among FRR Service Areas in accordance with rules specified in the PJM Manuals.[147]

Section 1.67 of the RAA defines PJM Region as follows:

> PJM Region shall have the same meaning as provided in the Operating Agreement.[148]

Section 1.35A of the PJM Operating Agreement[149] defines PJM Region as follows (emphasis added):

> "PJM Region" shall mean **the aggregate of** the MAAC Control Zone, the PJM West Region, and VACAR Control Zone.

AEP-Ohio has not claimed that a partial FRR Alternative election was made, nor has AEP-Ohio offered any evidence showing that the FRR Alternative was uniquely elected for the AEP-Ohio certified electric distribution service area.[150]

The fact that PJM treats Capacity Resources as a PJM Region resource was also acknowledged by several AEP-Ohio witnesses.[151] On a day-to-day basis, the output of all the generating assets of the AEP East operating companies (including AEP-Ohio) are bid into PJM's market by AEPSC with an offer price.[152] On a region-wide basis, PJM

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[147] *Id.* at 107.

[148] *Id.* at 15.

[149] PJM Operating Agreement at 22. The PJM Operating Agreement is available *via* the internet at: http://www.pjm.com/documents/~/media/documents/agreements/oa.ashx (last visited July 31, 2012).

[150] Tr. Vol. II at 476.

[151] *Id.* at 484-485.

[152] Tr. Vol. XI at 2544-2545.

then determines which resources are actually dispatched to serve load in the PJM Region.[153]

On any given day, AEP-Ohio's actual load requirements are not required to be satisfied from AEP-Ohio's owned and controlled generating assets.[154] The operation of AEP-Ohio's "deregulated"[155] generating assets cannot be separated from the operation of the combined generation fleet of the AEP East operating companies.[156] On an after-the-fact basis, allocations are performed to attribute AEP generation output to off-system sales.[157] It is impossible to simulate a dispatch of the AEP-Ohio owned or controlled generating assets without performing a dispatch for the entire AEP system.[158]

Additionally, AEP-Ohio witness Nelson, as well as other AEP-Ohio and intervenor witnesses, testified that the demand response capability of AEP-Ohio's retail customers can be used as Capacity Resources to satisfy the capacity obligation of the FRR Entity in addition to the undisclosed generation assets included in the FRR Capacity Plan.[159] Again, AEP-Ohio did not introduce the FRR Capacity Plan so the specific Capacity Resources relied upon are not known. So, Dr. Pearce's exclusive reliance on embedded costs he attributed to AEP-Ohio's generating plants is not consistent with reality or the definition of Capacity Resources in the RAA. Even if Dr. Pearce would have offered a formula rate proposal that looked to the entire fleet of the AEP East operating companies' generating assets, it would still be out of touch with

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[153] *Id.*

[154] *Id.* at 2546-2547.

[155] *Id.* at 2536-2537.

[156] *Id.* at 2545-2547.

[157] *Id.* at 2547-2550.

[158] *Id.* at 2545-2547.

[159] *See e.g.*, Tr. Vol. XI at 2531.

reality because PJM relies upon Capacity Resources for the entire PJM Region and Capacity Resources includes both demand and supply-side Capacity Resources, not just generating plants.

As already discussed, the RAA calls for an FRR Entity to submit an FRR Capacity Plan. The RAA defines the FRR Capacity Plan as follows:

> FRR Capacity Plan shall 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.[160]

If AEP-Ohio was actually engaged in the kind of "Self-Supply" of Capacity Resources as is permitted under the RAA, Schedule 7 of the RAA would apply. Schedule 7 of the RAA states as follows (emphasis added):

SCHEDULE 7

PLANS TO MEET OBLIGATIONS

A. Each Party that elects to meet its estimated obligations for a Delivery Year by Self-Supply of Capacity Resources shall notify the Office of the Interconnection via the Internet site designated by the Office of the Interconnection, prior to the start of the Base Residual Auction for such Delivery Year.

B. A Party that Self-Supplies Capacity Resources to satisfy its obligations for a Delivery Year **must submit a Sell Offer as to such resource in the Base Residual Auction for such Delivery Year, in accordance with Attachment DD to the PJM Tariff.**

C. If, at any time after the close of the Third Incremental Auction for a Delivery Year, including at any time during such Delivery Year, a Capacity Resource that a Party has committed as a Self-Supplied Capacity Resource becomes physically incapable of delivering capacity or reducing load, the Party may submit a replacement Capacity Resource to the Office of the Interconnection. Such replacement Capacity Resource (1) may not be previously committed for such Delivery Year, (2) shall be capable of providing the same quantity of megawatts of capacity or load reduction as the originally committed Capacity Resource, and (3) shall meet the

[160] FES Ex. 110A at 10.

> same locational requirements, if applicable, as the originally committed resource. In accordance with Attachment DD to the PJM Tariff, the Office of the Interconnection shall determine the acceptability of the replacement Capacity Resource.[161]

Accordingly, satisfaction of the Capacity Resource obligation established by the RAA through Self-Supply calls for the submission of a sell offer in the BRA. In other words, the Self-Supply option is only available to LSEs participating in the RPM BRA, and as AEP-Ohio has repeatedly stated, its legal theory relates only to the FRR Alternative. The Self-Supply RPM market option defined in the RAA is mutually exclusive from the Capacity Resources that are designated as part of the FRR Entity's FRR Capacity Plan. AEP-Ohio cannot be an FRR Entity and "Self-Supply" Capacity Resources.

Thus, Dr. Pearce's threshold assumptions – that AEP-Ohio is an FRR Entity and that AEP-Ohio's owned and controlled generating assets are the source of capacity provided to a CRES provider serving retail customers in AEP-Ohio's certified electric distribution service area – are wrong. Because these threshold assumptions are wrong, the mathematical computations embedded in Dr. Pearce's proposed formula rate therefore cannot identify any type of cost of capacity provided to a CRES provider serving retail customers in AEP-Ohio's certified electric distribution service area. Because of the fundamental errors made by Dr. Pearce, the Staff's recommended adjustments that the Commission accepted, in part, are victims of the defects in Dr. Pearce's assumptions and his assumption-driven math. And the Commission's statement at page 33 of the July 2nd Order indicating that no party seriously challenged the Staff's cost-based methodology ignores the serious challenge that IEU-Ohio made

[161] *Id.* at 101 (emphasis added).

and repeats here. After all was said and done during the evidentiary phase of this proceeding, even the Staff urged the Commission to adopt RPM-Based Pricing.

Had AEP-Ohio actually been Self-Supplying Capacity Resources or had it actually been a stand-alone FRR Entity, it would have been a simple matter for AEP-Ohio to have identified the FRR Capacity Plan or the Self-Supply resources that it is relying on to meet the RAA obligations. AEP-Ohio did not do so. Instead, it resorted to false assumptions and then embedded the false assumptions in the math associated with a proposed mathematical formula that pulls garbage in and pushes garbage out.

Despite these fundamental flaws, Staff used AEP-Ohio's "cost" methodology and then made certain adjustments to AEP-Ohio's calculation. These adjustments included changes to: return on equity; rate of return; construction work in progress, plant held for future use; cash working capital; certain prepayments; accumulated deferred income taxes; payroll and benefits for eliminated positions; 2010 severance program cost; capacity equalization revenue; ancillary services revenue; and energy sales margins.[162] Staff's adjustments resulted in a "cost" of capacity of $146.41/MW-day.[163] The Commission accepted some of Staff's adjustments, modified one adjustment, and rejected others.[164] The result of the Commission's modification to Staff's calculation was a computed "cost" of capacity of $188.88/MW-day detached from any determination of such things as a test year, a date certain used and useful rate base valuation, test year expenses, test year revenue at current rates and the total authorized revenue that AEP-Ohio should have an opportunity to collect in the future. Because the Staff's calculation relied upon AEP-Ohio's methodology, and the Commission's

[162] *July 2nd Order* at 25.

[163] *Id.*

[164] *Id.* at 33-35.

adjustments relied upon Staff's calculation, the Staff and the Commission's calculation suffer from the same fundamental flaws discussed above. Neither the methodology nor its application has been connected to an FRR Entity, the relevant FRR Capacity Plan, and the actual Capacity Resources relied upon by the FRR Entity to satisfy its capacity obligation to PJM.

Thus, even if the Commission had authority to permit AEP-Ohio to change from RPM-Based Pricing to a cost-based ratemaking method to determine the compensation for generation capacity service available to CRES providers serving retail customers in AEP-Ohio's certified electric distribution service area, the so-called embedded cost-based methodology used as the starting point for the Commission's determination was based on bankrupt assumptions and numerical inputs that are wrong. For this reason, the Commission's July 2nd Order is unlawful and unreasonable.

10. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission violated Section 4903.09, Revised Code, by failing to properly address all material issues raised by the parties; the Ohio Supreme Court has held that the failure to address all material matters brought to the Commission's attention is a reversible error.

Section 4903.09, Revised Code, requires the Commission to sufficiently detail "the reasons prompting the decisions arrived at."[165] It is reversible error if the Commission "initially failed to explain a material matter," that matter was again brought "to the commission's attention through an application for rehearing ... [and] the commission still failed to explain itself" on rehearing.[166]

IEU-Ohio raised material issues through its testimony and briefs that the Commission failed to address in the July 2nd Order. Specifically, IEU-Ohio presented

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[165] *See also In re Application of Columbus S. Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788 at ¶¶ 70-71.

[166] *Id.* at ¶ 71.

the Commission with evidence that any above-market rate for generation capacity service would allow AEP-Ohio to collect transition revenue ("stranded cost") in violation of Ohio law and AEP-Ohio's commitments made in its ETP proceeding.[167] The July 2nd Order recognized that parties had raised this issue, summarizing the stranded cost arguments raised by IEU-Ohio and other intervening parties.[168] However, the order failed to address the issue. This issue is material to the resolution of this case, because if the Commission determines an above-market generation capacity service would provide AEP-Ohio with transition revenue as IEU-Ohio believes the Commission must, Ohio law requires the Commission to reject the proposed above-market charge.

IEU-Ohio also presented unchallenged recommendations to bring much needed transparency to the billing determinant specification and billing process behind generation capacity service, which the Commission failed to address. Additionally, IEU-Ohio contested the cost-based ratemaking proposals because they produced non-comparable and discriminatory results.[169] IEU-Ohio contested the Commission's ability to approve the proposed above-market generation charge because the Commission lacks jurisdiction to use cost-based ratemaking to increase rates for generation service or through the exercise of general supervisory authority. Further, IEU-Ohio contested the use of a cost-based methodology as presented by AEP-Ohio (and illustrated by the Commission's Staff) because the resulting above-market generation capacity service price applicable to CRES providers provides AEP-Ohio an anticompetitive subsidy in violation of Section 4928.02(H), Revised Code. IEU-Ohio also contested the cost-

[167] IEU-Ohio Ex. 101, *in passim*; IEU-Ohio Ex. 102A at 15-20.

[168] *Id.*

[169] *Id.* at 9, 29-32.

based ratemaking proposal because they conflicted with the plain language of the RAA (as discussed above).[170]

These contested issues – all material issues – are presented herein to the Commission again. The Ohio Revised Code requires the Commission to address these issues and the failure to do so on rehearing is grounds for reversal.

11. The July 2nd Order, which offers AEP-Ohio the opportunity to obtain above-market compensation for generation capacity service through a deferred revenue supplement [computed based upon the difference between RPM-Based Pricing and $188.88/megawatt-day ("MW-day"), including interest charges] is unlawful and unreasonable for the reasons detailed below.

The Commission's July 2nd Order is unlawful and unreasonable inasmuch as the deferral that was created is riddled with legal and factual errors and omissions. Legally, there has not been a finding that a rate in excess of RPM-Based Pricing would promote the pro-competitive State policies contained in Section 4928.02, Revised Code, or that AEP-Ohio is entitled to increase rates based on the ratemaking method set forth in Chapter 4909, Revised Code. Additionally, the Commission does not have authority to authorize the recovery of a generation-related deferral unless the deferral is a result of a phase-in of a lawfully approved rate under Sections 4928.141 to 4928.143, Revised Code.[171] Further, any justification for approving an above-market price for generation capacity service based upon financial harm that might occur to AEP-Ohio is, based on prior Commission rulings, irrelevant.

From an accounting perspective, it is impossible to defer and create a regulatory asset measured by the difference in two revenue streams (in this case, a revenue stream tied to RPM-Based Pricing and a revenue stream tied to a 188.88/MW-day

[170] See Assignment of Error No. 8, *supra*, at 40-42; IEU-Ohio Post-Hearing Brief at 52-55 (May 23, 2012); IEU-Ohio Reply Brief at 18-25 (May 30, 2012).

[171] Section 4928.144, Revised Code.

price); only an incurred expense can be deferred through the creation of a regulatory asset. To the extent a deferral could be created, there is no evidence that a carrying cost on the deferral is appropriate, let alone one established at AEP-Ohio's WACC or embedded (historic) cost of long-term debt. Finally, the July 2nd Order failed to recognize that SSO customers are, according to AEP-Ohio, providing AEP-Ohio with compensation for generation capacity service that is nearly double the $188.88/MW-day charge. In this circumstance, the July 2nd Order is unreasonable and unlawful because it failed to establish a mechanism to credit such excess compensation against any deferred balance the July 2nd Order works to create by comparing RPM-Based Pricing to the $188.88/MW-day price associated with shopping customers.

a. The above-market supplement conflicts with the policies contained in Section 4928.02, Revised Code, which relies upon market forces, customer choice and prices disciplined by market forces to regulate prices for competitive electric services.

Section 4928.02, Revised Code, contains State policies which the Commission is obligated to effectuate pursuant to Section 4928.06, Revised Code. These policies generally support reliance on market-based approaches to set prices for competitive services such as generation service and strongly favor competition to discipline prices of competitive services. In the Stipulation Order, the Commission espoused on the pro-competitive State policies in the context of AEP-Ohio's requested generation resource rider:

> We will first look to the market to build needed capacity. ... [Any cost-based generation facility] must be based upon a demonstration of need under the integrated resource planning process and be narrowly tailored to advance the policy provision contained in Section 4928.02, Revised Code ... .[172]

[172] *Stipulation Order* at 39-40.

In this proceeding, the Commission reaffirmed Section 4928.02, Revised Code, favors market-based approaches to set prices and compensation for competitive services. The Commission rejected imposing the significantly above-market $188.88/MW-day charge on CRES providers. Instead, the Commission held that AEP-Ohio would have to begin, shortly, charging the market-based RPM-Based Pricing so as to "promote retail competition."[173]

The Commission found that "RPM-based capacity pricing will stimulate true competition among suppliers in AEP-Ohio's service territory" and will "incent shopping."[174] The Commission also found that RPM-Based Pricing has "successfully been used throughout Ohio and the rest of the PJM region and puts electric utilities and CRES providers on a level playing field."[175] Thus, the Commission found that RPM-Based Pricing promoted State policy and competition in line with Ohio law and policy and the Commission's duty to effectuate that policy.

The July 2nd Order did not find that an above-market capacity charge could comply with Section 4928.02, Revised Code, and the Commission's reasoning implicitly rejects such a finding. Because the above-market deferred revenue supplement contained in the Delayed Recognition Pricing Scheme does not comply with Section 4928.02, Revised Code, the Commission's authorization of this component of the pricing scheme was unlawful and unreasonable.

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[173] *July 2nd Order* at 23.

[174] *Id.*

[175] *Id.*

b. The Commission is prohibited under Section 4928.05(A), Revised Code, from regulating or otherwise creating a deferral associated with a competitive retail electric service under Section 4905.13, Revised Code. The Commission may only authorize deferred collection of a generation service-related price under Section 4928.144, Revised Code, and any such deferral must be related to a rate established under Sections 4928.141 to 4928.143, Revised Code.

As part of the July 2nd Order, the Commission held it was authorizing AEP-Ohio to defer for future collection the difference between RPM-Based Pricing and $188.88/MW-day under Section 4905.13, Revised Code.[176] As discussed above, the Commission's ability to regulate competitive retail electric services is generally limited to Sections 4928.141 to 4928.144, Revised Code.[177] As part of that authority, the Commission has authority to authorize a phase-in of generation rates thereby creating a regulatory asset, *i.e.* a deferral, ***only if*** it is the result of a phase-in of an SSO rate. Section 4928.144, Revised Code, states that the Commission:

> may authorize any just and reasonable phase-in of any electric distribution utility rate or price established under sections 4928.141 to 4928.143 of the Revised Code, and inclusive of carrying charges, as the commission considers necessary to ensure rate or price stability for consumers. If the commission's order includes such a phase-in, the order also shall provide for the creation of regulatory assets pursuant to generally accepted accounting principles, by authorizing the deferral of incurred costs equal to the amount not collected, plus carrying charges on that amount. Further, the order shall authorize the collection of those deferrals through a nonbypassable surcharge on any such rate or price so established for the electric distribution utility by the commission.

Outside of this authority, the Commission is otherwise without authority to authorize an EDU to defer for future collection any generation-related costs.[178] In the July 2nd Order, however, the Commission held that it was not authorizing the generation

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[176] *July 2nd Order* at 23.

[177] Section 4928.05, Revised Code.

[178] *See* Section 4928.05, Revised Code (generally limiting the Commission's jurisdiction to regulate generation service to Section 4928.141 to 4928.144, Revised Code).

capacity service rate as part of an SSO under Sections 4928.141 to Section 4928.143, Revised Code, but rather under its general supervisory jurisdiction contained in Sections 4905.04, 4905.05, and 4905.06, Revised Code.[179] Because the Commission did not (and it could not) authorize the Delayed Recognition Pricing Scheme under Sections 4928.141 to 4928.143, Revised Code, the Commission is without authority to authorize a phase-in, and the resulting deferral.

Additionally, any use of phase-in authority under Section 4928.144, Revised Code, requires the Commission to identify, as part of the phase-in accounting, the "incurred costs" that are deferred for future collection. Neither AEP-Ohio nor the Commission has identified the "incurred cost" that the Commission must specify to lawfully proceed with the phase-in authority in Section 4928.144, Revised Code, even if such authority could be used in the case of generation capacity service rates. Absent the required identification of "incurred costs", there is no means proposed by AEP-Ohio or identified by the Commission to ensure that the deferral is necessary to compensate AEP-Ohio for "incurred costs." This point takes on added significance since the "cost" calculation, which is the foundation for the Delayed Recognition Pricing Scheme, was based on a "formula rate" methodology that bears no relationship to AEP-Ohio's cost to meet its FRR obligation. For these reasons, the July 2nd Order was unlawful and unreasonable.

[179] *July 2nd Order* at 12-13.

c. The Commission unlawfully and unreasonably authorized AEP-Ohio to defer the collection of generation capacity service revenue. Under generally accepted accounting principles, only an incurred cost can be deferred for future collection. To the extent that the July 2nd Order implies the Commission's intended use of Section 4928.144, Revised Code, that Section also requires the Commission to identify the incurred cost that is associated with any deferral, a requirement unreasonably and unlawfully neglected by the July 2nd Order.

The Commission's July 2nd Order was unlawful and unreasonable because the Commission authorized AEP-Ohio to defer the difference between an RPM-Based Pricing rate and a rate set at $188.88/MW-day. Under generally accepted accounting principles, only an expense, *i.e.*, a "cost", can be deferred. Because the issue of a deferral was not created until the Commission issued its July 2nd Order, there is no evidence in the record on this issue. Thus, the Commission must grant rehearing and remove the deferred revenue component of the July 2nd Order.

d. The Commission unlawfully and unreasonably determined that allowing AEP-Ohio to impose above-market prices for generation capacity service was appropriate to address AEP-Ohio's claims regarding the financial performance of its generation business, the competitive business segment under Ohio law.

The Commission unreasonably and unlawfully determined that AEP-Ohio could suffer financial harm if it charged RPM-Based Pricing and by establishing compensation for generation capacity service designed to address the financial performance of AEP-Ohio's competitive generation business.[180]

Following each EDU's market development period ("MDP"), which could end no later than December 31, 2005,[181] the generation function of the EDU was "fully on its

[180] *See July 2nd Order* at 23.

[181] Section 4928.40, Revised Code.

own in the competitive market."[182] As AEP-Ohio has argued before, and the Commission has confirmed, AEP-Ohio's earnings do not matter for purposes of establishing generation rates.[183] Thus, the Commission's reliance upon consideration of the financial implications for AEP-Ohio's generation business resulting from maintaining RPM-Based Pricing was unreasonable and unlawful.[184]

If AEP-Ohio, in its operation as an EDU, is facing financial harm, it can avail itself of the Commission's emergency ratemaking authority under Section 4909.16, Revised Code, as applied by the Commission's long standing criteria.[185] Because AEP-Ohio's generation business is on its own in the competitive market by operation of law, the Commission's holding that above-market compensation for generation capacity service is warranted to prevent financial harm to AEP-Ohio's generation business is unlawful and unreasonable.

e. The Commission unlawfully and unreasonably authorized AEP-Ohio to increase the above-market revenue supplement by adding carrying charges to the deferred supplement without any evidence that carrying charges, or any specific level of carrying charges, are lawful or reasonable. To the extent that the carrying charge allowance is computed based on a weighted average cost of capital ("WACC") method or AEP-Ohio's embedded cost of long-term debt, it is also unreasonable and unlawful because it is excessive, arbitrary, capricious, and contrary to Commission precedent.

The Commission's July 2nd Order is unlawful and unreasonable because there was no evidence introduced to support any level of carrying charges. Despite the lack

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[182] Section 4928.38, Revised Code.

[183] *RSP Proceeding*, Opinion and Order at 18 (Jan. 26, 2005).

[184] *July 2nd Order* at 23 (*citing* AEP-Ohio Ex. 104 at 3-5, Ex. WAA-1).

[185] *See also In the Matter of the Application of Akron Thermal, Limited Partnership for an Emergency Increase in its Rates and Charges for Steam and Hot Water Service*, Case Nos. 09-453-HT-AEM, *et al.*, Opinion and Order at 6 (Sept. 2, 2009).

of record support, the Commission held AEP-Ohio could defer the difference in rates with a carrying charge on the deferral based on AEP-Ohio's "weighted average cost of capital [WACC], until such time as a recovery mechanism is approved" in the ESP II proceeding.[186] Thereafter, the Commission held AEP-Ohio could collect carrying charges at its long-term cost of debt.[187] The Ohio Supreme Court has held it is reversible error when the Commission acts without any evidentiary record.[188] Because there was no evidence introduced to support any level of carrying charges the Commission's July 2nd Order adopting the same is unlawful and unreasonable. If the Commission deems it necessary to authorize carrying charges on the deferred revenue supplement, the Commission must grant rehearing and allow for the introduction of additional evidence.

The Commission's unilateral decision to act without evidentiary support by creating a deferral with carrying charges has deprived parties of their due process rights. Accordingly, the July 2nd Order is unlawful and unreasonable.

f. The July 2nd Order is unlawful and unreasonable because it fails to recognize that the rates and charges applicable to non-shopping customers also are providing AEP-Ohio with compensation for generation capacity service, it ignores or disregards the fact that AEP-Ohio has maintained that non-shopping customers are, on average, paying nearly twice the $188.88/MW-day price, and it fails to establish a mechanism to credit such excess compensation obtained from non-shopping customers against any deferred balance the July 2nd Order works to create by comparing RPM-Based Pricing to the $188.88/MW-day price. The non-symmetrical and arbitrary bias embedded in the July 2nd Order's description of how the deferred revenue supplement shall be computed guarantees that AEP-Ohio shall collect, in the aggregate, total revenue for

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[186] *July 2nd Order* at 23-24.

[187] *Id.* at 24.

[188] *Tongren v. Pub. Util. Comm.* 85 Ohio St. 3d 87 (1999), quoting *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.*, 76 Ohio St.3d 163 (1996).

generation capacity service substantially in excess of the revenue produced by using the $188.88/MW-day price to determine generating capacity service compensation for shopping and non-shopping customers.

If the Commission proceeds in AEP-Ohio's ESP II proceeding to create the deferral and recovery mechanism for the difference between RPM-Based Pricing and $188.88/MW-day that is vaguely described in the July 2nd Order, the Commission must recognize the fact that AEP-Ohio has maintained that non-shopping customers are, on average, paying nearly twice the $188.88/MW-day price for generation capacity service. According to AEP-Ohio, the current SSO provides AEP-Ohio with compensation for capacity on par with a $355/MW-Day charge.[189] Thus, SSO customers are paying excessive amounts for capacity that are not based upon either market (RPM-Based Pricing) or cost ($188.88/MW-day as determined by the Commission). As further explained in Assignment of Error No. 8 of this application for rehearing, the Commission must grant rehearing and remedy the non-symmetrical and arbitrary treatment between the capacity compensation embedded in the SSO and eliminate the excessive compensation embedded in the SSO or credit the amount of such compensation above $188.88/MW-day against any amount deferred based on the difference between RPM-Based Pricing and $188.88/MW-day.

12. **In addition to the individual errors committed by the Commission which are referenced or identified herein, the totality of the Commission's conduct throughout this proceeding, including the July 2nd Order, is arbitrary and capricious, an abuse of discretion, otherwise outside the law and "... at variance with 'the rudiments of fair play' (*Chicago, Milwaukee & St. Paul Ry. Co. v. Polt*, 232 U.S. 165, 232 U. S. 168) long known to our law." "The Fourteenth Amendment condemns such methods and defeats them." *West Ohio Gas Co. v. Public Utilities Commission*, 294 U.S. 63 (1935).**

[189] Tr. Vol. III at 635-637.

The totality of the Commission's actions during the course of this proceeding combine to violate IEU-Ohio's due process rights under the Fourteenth Amendment. Throughout this proceeding, the Commission has repeatedly granted applications for rehearing indefinitely tolling them, preventing parties from taking an unobstructed appeal to the Ohio Supreme Court. In fact, AEP-Ohio's application for rehearing challenging the Commission's jurisdiction to set a generation capacity service compensation from CRES providers has been tolled and pending since February 2, 2011.[190] Additionally, the Commission has repeatedly granted AEP-Ohio authority to temporarily impose various forms of its two-tiered and shopping-blocking capacity charges without any record support for the charges. Those charges continue today. Further, and despite finally issuing a decision on the merits, the Commission ignored addressing major issues raised by parties in violation of Section 4903.09, Revised Code. The Commission also violated parties' due process rights by creating an incomplete deferral component of the Delayed Recognition Pricing Scheme without any evidence in the record to support a deferral, and then moving the completion of the deferral component to a separate proceeding where the evidentiary record has already closed. Finally, the Commission violated parties' due process rights by authorizing carrying charges on the deferral component at a WACC rate without record support. The totality of the Commission's actions is a violation of IEU-Ohio's due process rights.

As the Commission is aware, AEP-Ohio and AEPSC on behalf of AEP-Ohio have both challenged the Commission's authority to regulate generation capacity service applicable to CRES providers serving retail customers in AEP-Ohio's certified electric distribution service area. Specifically, on January 7, 2011, AEP-Ohio filed an

[190] Entry on Rehearing at 2 (Feb. 2, 2011).

application for rehearing contesting the December 8, 2010 Entry on several grounds. Among other things, AEP-Ohio asserted that the Commission lacked subject matter jurisdiction to address the level of compensation that may be obtained for generation capacity service provided to a CRES provider and that the Entry "... was issued in a manner that denied AEP Ohio due process and violated statutes within Title 49 of the Revised Code, including Sections 4903.09, 4905.26, and 4909.16, Revised Code."[191] On February 2, 2011, the Commission granted AEP-Ohio's application for rehearing saying (emphasis added):

> The Commission grants AEP-Ohio's application for rehearing. We believe that sufficient reason has been set forth by AEP-Ohio to warrant further consideration of the matters specified in the application for rehearing. **However, the Commission notes that the state compensation mechanism adopted in our December 8, 2010, Finding and Order will remain in effect during the pendency of our review.**[192]

Since granting AEP-Ohio's application for rehearing on February 2, 2011, the Commission has not taken up or addressed the substantive and procedural issues which the Commission found, based on AEP-Ohio's rehearing request, were worthy of further consideration. The Commission has not identified, as required by Section 4903.10, Revised Code, the scope of any additional evidence which will be taken.

Beginning in early January 2011, parties filed comments requested by the Commission in the December 8, 2010 Entry. The written comments highlighted the contested issues that have since churned confusingly in various Commission proceedings and at FERC. In its written comments at page 3, AEP-Ohio acknowledged that: "... the PJM capacity auction price in section 8.1 of the RAA is ... a backstop

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[191] Ohio Power Company's and Columbus Southern Power Company's Application for Rehearing at 2 (Jan. 7, 2011).

[192] Entry on Rehearing at 2 (Feb. 2, 2011).

mechanism ... if no others exist."[193] Of course, on December 8, 2010, the Commission made it clearer that it had adopted and was adopting RPM-Based Pricing. In any event and in 19 plus months since this proceeding was initiated, the Commission has not responded to the comments it received beginning in early January 2011.

As AEP-Ohio has acknowledged, the RAA specifies that absent a lawful state compensation mechanism, RPM-Based Pricing controls unless and until FERC approves an alternative. Thus, if the Commission was without authority to regulate generation capacity service applicable to CRES providers in AEP-Ohio's certified electric distribution service area, as AEP-Ohio has repeatedly claimed, the RAA obligated AEP-Ohio to apply RPM-Based Pricing unless and until FERC approved otherwise. AEP-Ohio and AEPSC say as much at pages 9 to 12 of the July 20, 2012 Renewed Motion filed with FERC: "any wholesale FRR capacity charges must be approved or accepted by the Commission [FERC] before they may go into effect."[194]

On January 27, 2011, AEP-Ohio filed an application to replace its current ESP (ESP I) with a new ESP (ESP II).[195] Under Ohio law, ESP I remains in effect until the Commission lawfully approves ESP II under Sections 4928.141 and 4928.143, Revised Code, or an MRO under Sections 4928.141 and 4928.142, Revised Code.

On August 11, 2011, more than nine months after this proceeding was initiated, the Commission issued an entry establishing a procedural schedule to conduct an evidentiary hearing.[196] In accordance with the procedural schedule and on August 31,

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[193] Ohio Power Company's and Columbus Southern Power Company's Initial Comments at 3 (Jan. 7, 2011).

[194] *The Section 205 Filing*, Renewed Motion of American Electric Power Service Corporation for Expedited Rulings at 10 (July 20, 2012.

[195] *ESP II,* Application (Jan. 27, 2011).

[196] Among other things, the Attorney Examiner's Entry (Finding No. 6) stated:

2011, AEP-Ohio filed direct testimony of five witnesses. The pre-filed direct testimony of Richard E. Munczinski repeated (at page 3) AEP-Ohio's assertion that FERC, not the Commission, had jurisdiction over generation capacity service applicable to CRES providers. AEP-Ohio's pre-filed testimony did ***not*** contain detailed information on the financial impact of maintaining RPM-Based Pricing. Rather, the AEP-Ohio direct testimony asserted that displacing RPM-Based Pricing with AEP-Ohio's proposed formula rate method of compensation would facilitate generation-related investment.

On September 7, 2011, AEP-Ohio, along with number of other parties, submitted the Stipulation to resolve issues in AEP-Ohio's pending ESP proceeding and several other pending cases, including this proceeding.

On September 8, 2011, a number of parties that had signed the Stipulation filed a joint motion to consolidate ***for purposes of considering the adoption of the Stipulation***. At page 6 of the joint motion's memorandum in support, the movants stated (emphasis added):

> This motion for consolidation for hearing purposes differs from the February 18, 2011 motion filed by the Industrial Energy Users-Ohio in three important ways. First, consolidation here is needed because the Stipulation, as opposed to the respective Applications are broader in its impact on the merger, energy curtailment, capacity charge and fuel deferral. ***Second, the request is only to consolidate the matter for hearing of the Stipulation.*** That is of smaller scope than the motion filed by the Industrial Energy Users-Ohio for consolidation of the cases in their entirety and ***should the Attorney Examiners reject the Stipulation, the cases would return for individual process on their own with no further consolidation***. Finally, the consolidation request here involves

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> Having fully reviewed the comments and reply comments, the attorney examiner now determines that a procedural schedule for hearing should be adopted in order to establish an evidentiary record on a state compensation mechanism. Interested parties should develop an evidentiary record on the appropriate capacity cost pricing/recovery mechanism including, if necessary, the appropriate components of any proposed capacity cost recovery mechanism.

Entry at 2 (Aug. 11, 2011).

> less cases than the IEU request and is fully warranted as described herein.[197]

On September 14, 2011, IEU-Ohio filed a memorandum in support of the proposed consolidation ***for the purpose of considering the Stipulation***. On September 16, 2011, an Attorney Examiner issued an Entry granting the September 8, 2011 motion to consolidate ***for the purpose of considering the Stipulation*** and staying the procedural schedule in this proceeding. The Attorney Examiner's September 16, 2011 Entry was ***not*** issued or filed in this proceeding.

The Stipulation recommended that the Commission approve prospectively a two-tiered pricing scheme for generation capacity service available to CRES providers as the state compensation mechanism. In other words, the Stipulation recommended that the Commission approve a wholesale capacity compensation mechanism that AEPSC and AEP-Ohio were (and are) claiming the Commission is powerless to approve.

On the afternoon of September 7, 2011, AEP-Ohio hosted a conference call with the investment community to discuss the Stipulation filed with the Commission earlier in the day. During the call, AEP-Ohio acknowledged that the Stipulation was designed to block the ability of retail customers to enjoy the full benefits of the "customer choice" rights provided by Ohio law.[198] Based on AEP-Ohio's own public descriptions of the purpose of the Stipulation's recommended capacity pricing proposal and irrespective of whatever authority the Commission may have to authorize a capacity charge applicable

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[197] Joint Motion to Consolidate at 6 (Sept. 8, 2011).

[198] FES Ex. 102 at Ex. TCB-4:

> What happens is those customers that get the discount as Brian mention are allowed - are priced out at the RPM prices. So the $100, the $16, and I think the $26 going forward. Over those percentages, if you want to shop, you pay the full cost of $255 per megawatt day. So the thought and the theory is that the shopping will be constrained to the discounted RPM price.

to CRES providers, the Commission has known for many months that the generation capacity service charge provision in the Stipulation violated Ohio law and the policy set forth in Section 4928.02, Revised Code.

After hearings on the Stipulation, on December 14, 2011, the Commission issued the Stipulation Order approving the Stipulation with modifications including modifications to expand the availability of RPM-Based Pricing.

Following the Stipulation Order, applications for rehearing were submitted on January 13, 2012 by various parties including IEU-Ohio. Among other things, the applications for rehearing claimed that the Commission had erred in concluding that the package presented by the Stipulation was just and reasonable and in the public interest. By Entry dated February 1, 2012, the Commission granted rehearing for further consideration of the matters specified in the applications for rehearing of the Stipulation Order.

On February 23, 2012, the Commission granted, in part, IEU-Ohio's and FES' applications for rehearing, and rejected the Stipulation, ultimately finding, for multiple reasons, that the package contained in the Stipulation was not in the public interest.

> As discussed below, upon review of the applications for rehearing, the Commission has determined that the Stipulation, ***as a package***, does not benefit ratepayers and the public interest and, thus, does not satisfy our three-part test for the consideration of stipulations. Accordingly, the Commission will reject the Stipulation.[199]

The rejection of the Stipulation on rehearing occurred because the Commission eventually agreed that the signatory parties to the Stipulation had not met their burden of demonstrating that the Stipulation, as a package, benefited ratepayers and the public

[199] *Stipulation Rehearing Entry* at 4 (emphasis added).

interest as required by the Commission's three-part test for the consideration of settlements.

Because the Commission's Stipulation Rehearing Entry rejected the proposed ESP contained in the Stipulation and in accordance with the requirements of Section 4928.143(C)(2)(b), Revised Code,[200] the Stipulation Rehearing Entry directed AEP-Ohio to file tariffs to provide SSO pursuant to its previously-authorized ESP:

> Therefore, we direct AEP-Ohio to file, no later than February 28, 2012, new proposed tariffs to continue the provisions, terms, and conditions of its previous electric security plan, including but not limited to the base generation rates as approved in ESP I, along with the current uncapped fuel costs and the environmental investment carry cost rider set at the 2011 level, as well as modifications to those rates for credits for amounts fully refunded to customers, such as the significantly excessive earnings test (SEET) credit, and ***an appropriate application of capacity charges under the approved state compensation mechanism established in the Capacity Charge Case.***[201]

The Stipulation Rehearing Entry also directed the Attorney Examiners assigned to this case to establish a new procedural schedule.

On February 27, 2012 and for the benefit of its sole shareholder, AEP, AEP-Ohio filed a motion seeking to delete RPM-Based Pricing and insert AEP-Ohio's interpretation of the Stipulation's two-tiered charges. In other words, AEP-Ohio extracted the capacity pricing provision from the Stipulation's package and once again asked the Commission to approve a wholesale capacity price applicable to CRES

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[200] Section 4928.143(C)(2)(b), Revised Code, states (emphasis added):

> If the utility terminates an application pursuant to division (C)(2)(a) of this section or if the commission disapproves an application under division (C)(1) of this section, the commission ***shall issue such order as is necessary to continue the provisions, terms, and conditions of the utility's most recent standard service offer, along with any expected increases or decreases in fuel costs from those contained in that offer, until a subsequent offer is authorized pursuant to this section or section 4928.142 of the Revised Code, respectively***.

[201] *Stipulation Rehearing Entry* at 12 (emphasis added).

providers while AEP-Ohio was simultaneously asserting that the Commission lacked subject matter jurisdiction to do so.

In its memorandum in support attached to the February 27, 2012 motion, AEP-Ohio alleged that:

(1) "If the Commission implements full RPM pricing pending the outcome in this proceeding, AEP Ohio will suffer immediate and irreparable harm. ... Using the same two-tiered capacity pricing proposed in the Stipulation offers the most stability and represents a reasonable middle ground;"[202]

(2) "As an FRR entity, AEP Ohio reasonably relied upon its expected ability to establish cost-based rates should the RPM-based rates become unjust and unreasonable;"[203] and

(3) "The reasonableness of the interim capacity pricing is demonstrated by comparing it to the pricing that AEP Ohio is advocating and that Dr. Pearce's prefiled testimony supports in Case No. 10-2929-EL-UNC'"[204]

(4) "A ***perfect compromise*** in this situation where a temporary solution is needed until a more permanent decision is made is to 'split the baby' by (i) allowing RPM pricing for customers being served by CRES providers or having provided a switch request as of the February 23 Entry on Rehearing, and (ii) charging $255/MW-Day for all other customers (including additional aggregation load) for customers who shop before the case is decided."[205]

For the first time, AEP-Ohio's February 27, 2012 motion alleged that following the law and restoring RPM-Based Pricing to its rightful position as the Commission had directed would cause financial harm to AEP-Ohio's generation business, the business that is supposed to be on its own in the competitive market.[206]

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[202] AEP-Ohio's Motion for Relief and Request for Expedited Ruling at 4 (Feb. 27, 2012).

[203] *Id.* at 5.

[204] *Id.* at 10.

[205] *Id.* at 15 (citation omitted).

[206] AEP-Ohio's Motion for Relief and Request for Expedited Ruling at 1, 3-5 (Feb. 27, 2012). Also, Section 4928.39, Revised Code, states:

> With the termination of that approved revenue source, the utility shall be fully on its own in the competitive market. The commission shall not authorize the receipt of transition

While numerous parties (including many that previously supported the Stipulation's package) opposed AEP-Ohio's unlawful and unjust request to bypass RPM-Based Pricing, the Commission granted the requested relief in its March 7, 2012 Entry.[207] At page 15 of the March 7, 2012 Entry, the Commission stated:

> We reject claims that the interim relief is not based upon record evidence. The instant proceeding was consolidated with 11-346 and the cases enumerated in footnote three of this entry for purposes of considering the ESP 2 Stipulation. All of the testimony and exhibits admitted into the record for purposes of considering the ESP 2 Stipulation are part of the record in this proceeding. Our subsequent rejection of the ESP 2 Stipulation did not remove such evidence from the record, and we may, and do, rely upon such evidence in our decision granting interim relief.[208]

The above Commission statement is irreconcilable with the purpose of the consolidation as approved by the Commission on September 16, 2011. That consolidation specifically limited the consolidation to consideration of the Stipulation ***as a package***. Once the Commission rejected the Stipulation, no evidence from the consolidated proceeding was available to the Commission to address contested issues in this proceeding.

Nonetheless, the Commission's approval came before parties had an opportunity to test the merit of AEP-Ohio's claims and the Commission ignored requests that the Commission only grant AEP-Ohio's motion subject to reconciliation and refund.

The Commission imported evidence from other proceedings into this proceeding even though the imported evidence was presented ***only*** to determine if the signatory parties to the Stipulation had met their burden of demonstrating that the Stipulation, as a package, benefited ratepayers and the public interest as required by the Commission's

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revenues or any equivalent revenues by an electric utility except as expressly authorized in sections 4928.31 to 4928.40 of the Revised Code.

[207] *March 7, 2012 Entry* at 17.

[208] *Id.* at 15.

three-part test for the consideration of settlements. Thus, the capacity charge provision the Commission ultimately concluded was contrary to the public interest when presented in the Stipulation, as a package, was extracted from the package submitted in different cases and made available in this proceeding to AEP-Ohio so that AEP-Ohio could continue the shopping-blocking two-tiered capacity charges that became void when the Commission rejected the Stipulation. Nothing effectuating compensation other than RPM-Based Pricing was filed at FERC. As if lawless acts are less lawless when their tenure is limited, the Commission made AEP-Ohio's "shopping tax" temporary and held that it would end on May 31, 2012 with the restoration of RPM-Based Pricing effective June 1, 2012.[209]

In response to the Commission's unlawful and unreasonable flip-flop, various applications for rehearing were filed contesting the March 7, 2012 Entry on procedural and substantive grounds. No application for rehearing was filed by AEP-Ohio (AEP-Ohio did not contest the Commission's determination that RPM-Based Pricing be restored effective June 1, 2012).

On April 11, 2012, some 16 months after this proceeding was initiated, the Commission again granted rehearing for the purpose of giving itself more time to consider the rehearing requests filed in response to the March 7, 2012 Entry. Like the written comments submitted by interested parties beginning in early January 2011 and AEP-Ohio's granted application for rehearing filed on January 7, 2011, the granted applications for rehearing related to the Commission's March 7, 2012 Entry have not been further acted upon by the Commission.

[209] *March 7, 2012 Entry* at 17.

The evidentiary hearing phase of this proceeding subsequently commenced on April 17, 2012 and concluded on May 15, 2012. At the conclusion of the evidentiary hearing, parties were given a very short amount of time to submit initial and reply briefs addressing many of the same issues that have been before the Commission since the December 8, 2010 Entry. Initial briefs were due and filed on May 23, 2012 (one week after the close of the evidentiary hearing) and reply briefs were due a week later on May 30, 2012.

Based on the evidence that is before the Commission in this proceeding, it is repetitively clear that the allegations in AEP-Ohio's February 27, 2012 motion for relief were and are false. For example, the evidence shows that AEP-Ohio is not an FRR Entity[210] and that there was never any analysis done to identify if the FRR Alternative was the best option for AEP-Ohio.[211]

Unlike when the two-tiered capacity pricing proposal was presented as part of the Stipulation's package of terms and conditions, no other party supports AEP-Ohio's above-market charges. Indeed, all parties except AEP-Ohio urged the Commission to issue a merit-based decision restoring RPM-Based Pricing.

The evidence shows that AEP-Ohio previously committed to not impose any lost generation-related revenue charges on shopping customers as part of a Commission-approved settlement agreement which is final and binding.[212] The July 2nd Order failed

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[210] Tr. Vol. II at 455-476, 436; Tr. Vol. XI at 2533-2534; *see also* IEU-Ohio Post-Hearing Brief at 52-55 (May 23, 2012) and IEU-Ohio Reply Brief at 18-29 (May 30, 2012). FRR Entity is a defined term under the RAA. FES Ex. 110A at 10.

[211] Tr. Vol. II at 493-494.

[212] FES Ex. 106 at 3; *In the Matter of the Applications of Columbus Southern Power Company and Ohio Power Company for Approval of Their Electric Transition Plans and for Receipt of Transition Revenues*, Case Nos. 99-1729-EL-ETP, *et al.*, Opinion and Order at 16 (Sept. 28, 2000); *see also* Tr. Vol. I at 49-56, 146-147; Tr. Vol. V. at 883.

to address this, despite the Commission summarizing the transition revenue/stranded cost arguments raised by various parties including IEU-Ohio.

Additionally, the so-called cost-based methodology advanced by AEP-Ohio witness Dr. Pearce was shown to be fundamentally defective because it relied on the false assumption that the generation assets owned or controlled by AEP-Ohio are the source of capacity available to CRES providers serving retail customers located in AEP-Ohio's certified electric distribution service area.[213] Likewise, AEP-Ohio's claim (a threshold assumption by Dr. Pearce) that AEP-Ohio's owned and controlled generation assets are dedicated to its Ohio load is, as AEP-Ohio's witnesses agreed, untrue.

On April 30, 2012, while the evidentiary hearings were in progress, and after AEP-Ohio had concluded its case-in-chief, AEP-Ohio filed a motion seeking to undo the "***perfect compromise***" it previously advanced to displace the RPM-Based Pricing method previously adopted by the Commission and required by the RAA. More specifically, AEP-Ohio asked the Commission to: (1) extend the Commission-specified life of its two-tiered charges; and, (2) increase the revenue collected by AEP-Ohio by means of such charges. In other words, AEP-Ohio once again asked the Commission to engage in ratemaking that AEP-Ohio has repeatedly asserted was beyond the Commission's subject matter jurisdiction. AEP-Ohio's motion was essentially an untimely application for rehearing regarding the Commission's March 7, 2012 Entry, which specifically held that the unlawful shopping-blocking two-tiered charges that AEP-Ohio proposed in its February 27, 2012 motion for interim relief would end on May 31, 2012.

[213] Tr. Vol. II at 429; Tr. Vol. XI at 2530-2534.

AEP-Ohio's April 30, 2012 motion was strongly opposed by numerous parties who have actively participated in this proceeding.

Without citing evidence or addressing dispositive motions or the pending applications for rehearing that had previously been granted by the Commission, the Commission granted AEP-Ohio's April 30, 2012 motion to extend the life of its two-tiered charges and increase the revenue collected by AEP-Ohio by means of such charges. By this action on the day reply briefs were filed, the Commission flip-flopped again for the benefit of AEP-Ohio and modified the March 7, 2012 Entry.[214] Again, nothing was filed at FERC to effectuate the new and higher-priced version of the shopping-blocking two-tiered capacity compensation mechanism.

The Commission's action on May 30, 2012, coming more than 17 months after this proceeding was initiated, extended the life of the two-tiered charges and increased the revenue that AEP-Ohio collects through those charges. In doing so, the Commission set AEP-Ohio free to collect more revenue than permitted under the "***perfect compromise***" that AEP-Ohio identified in the February 27, 2012 motion seeking interim relief. Again disregarding the requests by parties, the Commission's May 30, 2012 Entry made no provision for reconciliation and refund.

When this proceeding began in late 2010, RPM-Based Pricing controlled for all shopping in AEP-Ohio's service area either as a result of the Commission's adoption of a state compensation mechanism or as a result of the RAA which requires RPM-Based Pricing when there is no state compensation mechanism. RPM-Based Pricing was the *status quo*.

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[214] *May 30, 2012 Entry* at 7-8.

Yet, beginning with bills rendered in January 2012, AEP-Ohio has not used RPM-Based Pricing to set all capacity prices for CRES providers. Instead and over persistent objections, the Commission has permitted AEP-Ohio to implement its anticompetitive two-tiered charges through a Commission-approved-then-rejected Stipulation. When the Stipulation fell under its own weight, the Commission then allowed AEP-Ohio to ignore the required restoration of RPM-Based Pricing without making any provision for reconciliation and refund. Just as the Commission-ordered restoration of RPM-Based Pricing was about to occur on June 1, 2012, the Commission intervened again to allow AEP-Ohio to continue to stiff-arm the market discipline of RPM-Based Pricing and, adding insult to injury, give AEP-Ohio the opportunity to increase its capacity-related revenue.[215]

On June 19, 2012, IEU-Ohio filed an application for rehearing from the Commission's May 30, 2012 Entry, again repeating the claims the Commission has continued to dodge: its jurisdictional authority, stranded cost recovery, and comparability, among others. Other parties also filed applications for rehearing focused on the May 30, 2012 Entry. On July 11, 2012, the Commission granted the applications for rehearing filed by IEU-Ohio, the OMA and FES. These granted applications for rehearing, like many others that came before them, have not been further addressed by the Commission.

On July 2, 2012, the Commission issued a decision in this case; however, the Commission again ignored the law and the facts and the opposing arguments raised continuously by the parties. Despite the limitations placed upon the Commission by the General Assembly, the Commission found that it could use its cost-based ratemaking

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[215] *Id.*

authority to regulate a competitive service. And in using its cost-based ratemaking authority, the Commission entirely failed to comply with the statutorily imposed requirements for running the cost-based ratemaking methodology that is specified in Ohio law. Instead, the Commission applied the "principles" of its cost-based ratemaking while asserting general supervisory jurisdiction. The Ohio Supreme Court has held, however, that the Commission cannot use general supervisory authority to evade the specific ratemaking methods contained in the Ohio Revised Code.[216]

Despite the Commission's previous holding that the financial consequences of prices authorized by the Commission for competitive services are irrelevant, the Commission's July 2nd Order adopting the $188.88/MW-day price nonetheless attempts to justify this result based on the effects of generating capacity service compensation on the financial performance of AEP-Ohio's competitive generation business.[217]

Further, and despite IEU-Ohio's and other parties' repeated protests, the Commission did not discuss whether or not the Delayed Recognition Pricing Scheme would unlawfully allow AEP-Ohio to collect transition revenue, whether or not the scheme would result in comparable rates, or whether the scheme would unlawfully subsidize AEP-Ohio's generation business. These issues were not new or novel (not that that would somehow excuse the Commission from addressing the issues). IEU-Ohio has continuously brought these issues before the Commission.[218]

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[216] *Columbus S. Power Co. v. Pub. Util. Comm.*, 67 Ohio St.3d 535, 620 N.E.2d 835, 840 (1993); *see also* IEU-Ohio Initial Brief at 40-41 (May 23, 2012).

[217] *July 2nd Order* at 23.

[218] IEU-Ohio Reply Brief at 5-7 (Nov. 18, 2011); Application for Rehearing and Memorandum in Support of IEU-Ohio at 36-39 (Jan. 13, 2012); IEU-Ohio Memorandum Contra Ohio Power Company's February 27, 2012 Motion for Relief and Request for Expedited Ruling at 15-16 (March 2, 2012); IEU-Ohio Application for Rehearing of the March 7, 2012 Entry and Memorandum in Support at 18-20 (March 27, 2012); IEU-Ohio Post-Hearing Brief at 16-25, 47-50 (May 23, 2012); IEU-Ohio Reply Brief at 6 (May 30, 2012); IEU-Ohio Application for Rehearing of the May 30, 2012 Entry and Memorandum in Support at 12 (June 19, 2012).

In the July 2nd Order, the Commission also extended the May 30, 2012 version of AEP-Ohio's two-tiered capacity charges. The Commission held the two-tiered charges could continue until the earlier of a Commission decision in AEP-Ohio's pending ESP proceeding or August 8, 2012. The Commission made this determination even though it held RPM-Based Pricing was necessary to promote the State policy contained in Section 4928.02, Revised Code, and despite the Commission finding AEP-Ohio's "cost" was $188.88/MW-day. Following its order, there is absolutely no basis for an "interim" pricing scheme, as it is neither cost-based nor market-based, nor does it support State policy. Finally, the Commission stated that it would address the above-market deferral portion of the Delayed Recognition Pricing Scheme in AEP-Ohio's ESP II proceeding (although the record in that case had already closed).

When parties injured by the Commission's stunning indulgence of AEP-Ohio's illegal demands have objected, the Commission has turned a deaf ear and not addressed the merits of the objections. Instead, the Commission has repeatedly maneuvered the can down the road while granting rehearing to give itself and AEP-Ohio more time to operate outside the law. The effect of the Commission grants of rehearing is to block the ability of the injured parties to pursue an unobstructed appeal to the Ohio Supreme Court.

When the Commission has engaged in ratemaking based on evidence not in the record or failed to allow parties to refute evidence, the United States Supreme Court has held that the Commission violated the due process rights of parties: "[t]his is not the fair hearing essential to due process. It is condemnation without trial."[219] The United States Supreme Court has also held that regulation by a public utilities

[219] *Ohio Bell Tel. Co. v. Public Utilities Commission of Ohio*, 301 U.S. 292, 300 (1937).

commission in accordance with the jurisdiction's applicable law "meets the requirements both of substantive and procedural due process ***when it is not arbitrarily and capriciously exercised.***"[220]

Similarly, the Ohio Supreme Court has held due process in a Commission proceeding occurs ***when*** parties are given: (1) "ample notice;" (2) "permitted to present evidence through the calling of its own witnesses;" (3) permitted to "cross-examin[e] the other parties' witnesses;" (4) introduce exhibits; (5) "argue its position through the filing of posthearing briefs;" and (6) "challenge the PUCO's findings through an application for rehearing."[221] Further, the Ohio Supreme Court has held that the Commission must, in order to comply with the law, provide "in sufficient detail, the facts in the record upon which the order is based, and the reasoning followed by the PUCO in reaching its conclusion."[222]

> The commission cannot decide cases on subjective belief, wishful thinking, or folk wisdom. Its decision must be based on a record containing "sufficient probative evidence to show that the commission's determination is not manifestly against the weight of the evidence and is not so clearly unsupported by the record as to show misapprehension, mistake or willful disregard of duty."[223]

The Commission abuses its discretion if it renders an opinion without record support.[224] Ruling on an issue without record support is an abuse of discretion and reversible error.[225]

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[220] *Public Utilities Commission of District of Columbia v. Pollak*, 343 U.S. 451, 465 (1952) (emphasis added).

[221] *Vectren Energy Delivery of Ohio, Inc. v. Pub. Util. Comm.*, 113 Ohio St.3d 180, 863 N.E.2d 599; 2006-Ohio-1386 at ¶ 53.

[222] *Tongren v. Pub. Util. Comm.* 85 Ohio St.3d 87, 89 (1999).

[223] *Consumers' Counsel v. Pub. Util. Comm.*, 61 Ohio St.3d 396, 406 (1991) *dissenting opinion of Justice Herbert Brown (quoting Columbus v. Pub. Util. Comm.* (1979), 58 Ohio St.2d 103, 104).

[224] *Tongren v. Pub. Util. Comm.* 85 Ohio St. 3d 87 (1999), quoting *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.*, 76 Ohio St.3d 163 (1996).

The capacity service available to CRES providers is undisputedly a generation service. This service is undisputedly a wholesale service. Yet, the Commission has indulged AEP-Ohio's claim that it is entitled to use cost-based ratemaking to establish compensation for a competitive service even while AEP-Ohio has been simultaneously claiming the Commission lacks subject matter jurisdiction to address the question of capacity compensation.

This proceeding is not an ESP or MRO proceeding and it is not a traditional rate case proceeding.

The Ohio Supreme Court has held on several occasions that the generation component of retail electric service is not subject to Commission regulation:

> It is well settled that the generation component of electric service is not subject to commission regulation. In *Constellation NewEnergy, Inc.*, 104 Ohio St.3d 530, 2004-Ohio-6767, 820 N.E.2d 885, ¶ 2, we stated that S.B. 3 'provided for restructuring Ohio's electric-utility industry to achieve retail competition with respect to the generation component of electric service.' R.C. 4928.03 specifies that retail electric-generation service is competitive and therefore not subject to commission regulation, and R.C. 4928.05 expressly removes competitive retail electric services from commission regulation.[226]

The Ohio Supreme Court has held that concerns about the future do not empower the Commission to create remedies beyond those permitted by the law.[227]

When the Commission issues a lawful order, it must provide acceptable justification and follow the required statutory process before the Commission can modify such order.[228]

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[225] *See, e.g., Indus. Energy Users-Ohio v. Pub. Util. Comm.*, 117 Ohio St.3d 486, 2008-Ohio-990 at ¶ 30.

[226] *Id.* at ¶ 20.

[227] *Id.*

[228] *See Cleveland Elec. Illum. Co. v Pub. Util. Comm.*, 42 Ohio St.2d 403 (1975).

The law and evidence did not permit the Commission to approve the Stipulation and the Commission eventually relented. Once the Stipulation was rejected, the Commission was obligated to restore RPM-Based Pricing. This is a duty placed on the Commission (not AEP-Ohio) by Section 4928.143, Revised Code, as the Commission held in its Stipulation Rehearing Entry rejecting the Stipulation. The record shows that the Commission did not comply with its obligation to restore RPM-Based Pricing.

Soon after the Stipulation was rejected, AEP-Ohio inspired the Commission to embrace a stand-alone version of the shopping-blocking, two-tiered capacity charges that had been previously considered and addressed only as part of the Stipulation's larger package. No evidence had been taken in this proceeding when the Commission granted the temporary and illegal relief requested by AEP-Ohio. The Commission also ignored requests to set up a refund and reconciliation mechanism. The Commission held that its lawless fling with the stand-alone version of the two-tiered charges would end on May 31, 2012 and that RPM-Based Pricing would be restored on June 1, 2012. Rehearing applications were filed by parties other than AEP-Ohio and the Commission granted rehearing thereby delaying its accountability for addressing the merits of the granted rehearing applications.

A day before the lawless fling with the stand-alone version of the shopping-blocking, two-tiered charges was scheduled to end by the force of the Commission's prior holding, the Commission extended the fling and authorized AEP-Ohio to move even further away from RPM-Based Pricing. The Commission also permitted AEP-Ohio to increase generation-related rates for shopping customers and elevate the hurdle that non-shopping customers must clear to reduce their electric bills by shopping. Again, in the July 2nd Order, the Commission authorized a continuation of the May 30, 2012

version of the two-tiered capacity charges that have no basis in this record, or in the Commission's order.

The Commission's conduct throughout this proceeding has subjected parties objecting to AEP-Ohio's demands to condemnation without trial. Throughout this proceeding, the Commission has taken it upon itself to rewrite the law and claim authority it does not have. Repeatedly, the Commission has acceded to AEP-Ohio's demands, granting rehearing and then doing nothing to put things right. The Commission has repeatedly refused to make its AEP-Ohio friendly decisions subject to reconciliation and refund so as to protect the interests of parties injured by the Commission's AEP-Ohio-inspired rush to judgment. The totality of the Commission's conduct throughout this proceeding is arbitrary and capricious, an abuse of discretion, otherwise outside the law and "... at variance with 'the rudiments of fair play' (*Chicago, Milwaukee & St. Paul Ry. Co. v. Polt*, 232 U.S. 165, 232 U.S. 168) long known to our law". "The Fourteenth Amendment condemns such methods and defeats them."[229]

13. The July 2nd Order is unlawful and unreasonable inasmuch as the Commission failed to direct AEP-Ohio to refund the above-market portion of capacity charges in place since January 2012 or credit the excess collection against regulatory asset balances otherwise eligible for amortization through retail rates and charges.

For the reasons expressed above, the Commission must immediately grant rehearing and permanently restore RPM-Based Pricing, eliminating the deferral component of the Delayed Recognition Pricing Scheme. Because the Commission was obligated to restore RPM-Based Pricing upon rejection of the Stipulation ESP, the Commission must require AEP-Ohio to refund all revenue collected above RPM-Based Pricing. If the Commission is unwilling to require AEP-Ohio to refund the compensation

[229] *West Ohio Gas Co. v. Public Utilities Commission*, 294 U.S. 63 (1935).

billed and collected in excess of RPM-Based Pricing, it should direct AEP-Ohio to apply such excess as a credit to regulatory asset balances otherwise eligible for amortization through retail rates in order to provide consumers with some "rough justice" for the Commission's violation of its statutory duty.

III. CONCLUSION

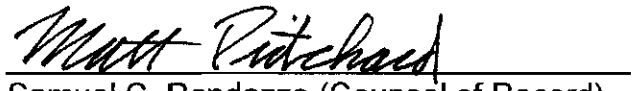
As discussed herein, the July 2nd Order creating the Deferred Recognition Pricing Scheme is unlawful and unreasonable. As a matter of State law, and because it is the default option under the RAA, the Commission must fully restore RPM-Based Pricing as the exclusive means by which AEP-Ohio may obtain compensation for generation capacity service available to CRES providers serving retail customers in AEP-Ohio's certified electric distribution service area.

The purpose of economic regulation is to simulate the forces of a competitive market.[230] The regulatory structure in Ohio is designed to let competition do directly what prior forms of economic regulation did poorly or not at all. Instead of serving the fundamental purposes of economic regulation and following the law, the Commission has acted to provide AEP-Ohio with above-market compensation and impose Ohio's monopoly rent on consumers.

This is not right. It is not lawful. Enough is enough.

[230] Principles of Utility Corporate Finance, Leonardo R. Giacchino, Ph.D. & Jonathan A. Lesser, Ph.D., Public Utility Report, Inc.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Industrial Energy Users-Ohio's Application for Rehearing of the July 2, 2012 Opinion and Order and Memorandum in Support* was served upon the following parties of record this 1st day of August 2012, *via* electronic transmission, hand-delivery or first class U.S. mail, postage prepaid.

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