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IN THE SUPREME COURT OF OHIO

INDUSTRIAL ENERGY USERS - OHIO	:	**Case No. ~~2012-2089~~ 2012-2098**
Appellant	:	**Appeal from the Public Utilities Commission of Ohio**
v.	:	
THE PUBLIC UTILITIES COMMISSION OF OHIO,	:	**Public Utilities Commission of Ohio Case No. 10-2929-EL-UNC**
Appellee.	:	

NOTICE OF CROSS-APPEAL OF OHIO POWER COMPANY

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NOTICE OF CROSS-APPEAL OF OHIO POWER COMPANY

Cross-Appellant, Ohio Power Company ("OPCo"), hereby gives notice of its cross-appeal, pursuant to R.C. 4903.13 and Supreme Court Rule of Practice 10.02(A)(3), to the Supreme Court of Ohio and Appellee, the Public Utilities Commission of Ohio ("Commission" or "PUCO"), from an Opinion and Order entered on July 2, 2012 (Attachment A), an Entry on Rehearing entered October 17, 2012 (Attachment B), and an Entry on Rehearing entered December 12, 2012 (Attachment C), in PUCO Case No. 10-2929-EL-UNC. That case involved the Commission's determination of the rate that OPCo may charge its retail competitors, Competitive Retail Electric Service or "CRES" providers, for generation capacity resources that OPCo supplies to them. This cross-appeal is filed within sixty days of the Commission's December 12, 2012 Entry on Rehearing.

OPCo is a party in PUCO Case No. 10-2929-EL-UNC and timely filed an Application for Rehearing of the Commission's July 2, 2012 Opinion and Order in accordance with R.C. 4903.10. OPCo raised each of the assignments of error listed below in its July 20, 2012 Application for Rehearing.

Appellant, the Industrial Energy Users – Ohio (IEU) initiated this appeal two days after the December 12, 2012 Entry on Rehearing (Attachment C) was issued and an additional rehearing request was subsequently filed concerning the same decision (*i.e.*, the third round of rehearing involving this decision). Consequently, there is a question as to whether the December 12, 2012 Entry on Rehearing (Attachment C) finalized the Commission's decision for purposes of appeal before this Court. On that basis, the Commission filed a motion to dismiss this appeal

on January 18, 2013. On January 30, 2013, the Commission issued its Third Entry on Rehearing in the case below and IEU again pursued a quick appeal by filing a notice of appeal to initiate Case No. 2013-228 before this Court within a few days of the decision. In sum, there is uncertainty as to which decision of the Commission was a final order for purposes of appeal and, by extension, which appeal before this Court is proper and should go forward. Consequently, Cross-Appellant intends to also file a separate notice of cross-appeal in Case No. 2013-228 prior to expiration of the statutory deadline.[1]

The Commission's July 2, 2012 Opinion and Order, October 17, 2012 Entry on Rehearing, and December 12, 2012 Entry on Rehearing (collectively, the "Commission's Orders") are unlawful and unreasonable in the following respects:

I. The Commission's Orders unreasonably and unlawfully understate OPCo's cost of providing generation capacity resources to CRES providers because the energy credit that the Commission applied to reduce OPCo's cost-based capacity rate is unreasonably and unlawfully overstated.

   a. The energy credit that the Commission adopted is unreasonably and unlawfully overstated because it is based on a static shopping assumption that is lower than, and not reflective of, the amount of shopping taking place at the time of the hearing, the amount of shopping taking place on the date of the Commission's Order, or the amount of shopping that is currently occurring.

   b. The energy credit that the Commission adopted is unreasonably and unlawfully overstated, is based on a host of fundamental technical and calculation errors, and is against the manifest weight of the evidence. *Inter alia*, the methodology used to calculate the energy credit does not withstand basic scrutiny and is largely a "black box;" it was not properly calibrated; it did not utilize the correct forward energy prices; it utilized inaccurate and understated fuel costs; it did not utilize the correct heat rates to capture minimum and start time operating constraints and associated cost impacts; it wrongly incorporates off-system sales margins; it fails to properly reflect the operation and impact of the AEP System

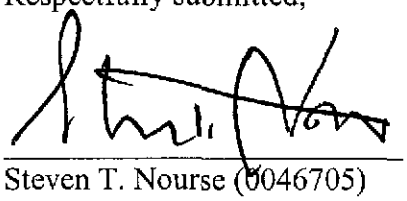
[1] *Curiously, after having moved for dismissal of this appeal, the Commission (jointly with IEU) moved the Court* for briefing consolidation of this appeal with Case No. 2013-228. Cross-Appellant expects that one of the two appeals, which are otherwise duplicative, will be dismissed and that both of the redundant appeals would not be heard and decided by the Court.

Interconnection Agreement; and it overstates OPCo's relevant forecasted future gross margins.

II. The Commission's Orders are confiscatory, unjust, and unreasonable, and they result in an unconstitutional taking of OPCo's property without just compensation. *Fed. Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978).

WHEREFORE, Cross-Appellant Ohio Power Company respectfully submits that the Commission's July 2, 2012 Opinion and Order, October 17, 2012 Entry on Rehearing, and December 12, 2012 Entry on Rehearing are unlawful, unjust, and unreasonable and should be reversed. The case should be remanded to the Commission to correct the errors complained of herein.

Respectfully submitted,



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ATTACHMENT A

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

OPINION AND ORDER

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

APPEARANCES:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

OPINION:

I. HISTORY OF THE PROCEEDING

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

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

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1 By entry issued on March 7, 2012, the Commission approved and confirmed the merger of CSP into OP, effective December 31, 2011. *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals*, Case No. 10-2376-EL-UNC.

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

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

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

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

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

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

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

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

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

By entry issued on August 11, 2011, the attorney examiner set a procedural schedule in order to establish an evidentiary record on a proper state compensation mechanism. The evidentiary hearing was scheduled to commence on October 4, 2011, and interested parties were directed to develop an evidentiary record on the appropriate capacity cost pricing/recovery mechanism, including, if necessary, the appropriate components of any proposed capacity cost recovery mechanism. In accordance with the procedural schedule, AEP-Ohio filed direct testimony on August 31, 2011.

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

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

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

5 *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals*, Case No. 10-2376-EL-UNC; *In the Matter of the Application of Columbus Southern Power Company to Amend its Emergency Curtailment Service Riders*, Case No. 10-343-EL-ATA; *In the Matter of the Application of Ohio Power Company to Amend its Emergency Curtailment Service Riders*, Case No. 10-344-EL-ATA; *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC; *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144, Revised Code*, Case No. 11-4920-EL-RDR; *In the Matter of the Application of Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144, Revised Code*, Case No. 11-4921-EL-RDR.

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

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

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

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

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

II. APPLICABLE LAW

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

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

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

III. DISCUSSION AND CONCLUSIONS

A. Procedural Issues

1. Motion to Dismiss

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

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

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

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

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

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

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

B. Substantive Issues

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

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

a. AEP-Ohio

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

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

	$/MW-day	
PJM Delivery Year	PJM Base Residual Auction (BRA) Price	Capacity Charge*
2010/2011	$174.29	$220.96
2011/2012	$110.00	$145.79
2012/2013	$16.46	$20.01
2013/2014	$27.73	$33.71
2014/2015	$125.99	$153.89

*BRA adjusted for final zonal capacity price, scaling factor, forecast pool requirement, and losses

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

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

b. Intervenors

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

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

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

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

c. Conclusion

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

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

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

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

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

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

a. AEP-Ohio

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

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

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

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

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

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

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

b. Staff

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

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

c. Intervenors

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

d. Conclusion

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

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

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

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

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

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

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

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

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

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

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

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

a. AEP-Ohio

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

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

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

b. Staff

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

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

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

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

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

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

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

c. Intervenors

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

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

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

(i) Should there be an offsetting energy credit?

a) AEP-Ohio

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

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

b) Staff

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

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

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

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

c) Intervenors

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

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

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

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

a) Intervenors

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

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

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

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

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

b) AEP-Ohio

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

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

a) OEG

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

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

b) AEP-Ohio

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

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

d. Conclusion

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

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

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

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

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

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

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

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

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

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

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

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

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

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

(1) AEP-Ohio is a public utility as defined in Section 4905.02, Revised Code, and, as such, is subject to the jurisdiction of this Commission.

(2) On November 1, 2010, AEPSC, on behalf of AEP-Ohio, filed an application with FERC in FERC Docket No. ER11-1995, and on November 24, 2010, refiled its application, at the direction of FERC, in FERC Docket No. ER11-2183. The application proposed to change the basis for compensation for capacity costs to a cost-based mechanism and included proposed formula rate

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

(3) By entry issued on December 8, 2010, the Commission initiated an investigation in the present case to determine the impact of AEP-Ohio's proposed change to its capacity charge.

(4) The following parties were granted intervention in this proceeding: OEG, IEU-Ohio, OCC, OPAE, OMA, OHA, Direct Energy, Constellation, FES, Duke, Exelon, IGS, RESA, Schools, OFBF, Kroger, NFIB, Dominion Retail, AICUO, Grove City, and OCMC.

(5) On September 7, 2011, the ESP 2 Stipulation was filed by AEP-Ohio, Staff, and other parties to resolve the issues raised in the consolidated cases, including the present case.

(6) On December 14, 2011, the Commission adopted the ESP 2 Stipulation with modifications.

(7) By entry on rehearing issued on February 23, 2012, the Commission revoked its prior approval of the ESP 2 Stipulation, finding that the signatory parties had not met their burden of demonstrating that the stipulation, as a package, benefits ratepayers and the public interest.

(8) By entry issued on March 7, 2012, the Commission approved, with modifications, AEP-Ohio's proposed interim capacity pricing mechanism.

(9) A prehearing conference occurred on April 11, 2012.

(10) A hearing commenced on April 17, 2012, and concluded on May 15, 2012. AEP-Ohio offered the direct testimony of five witnesses and the rebuttal testimony of three witnesses. Additionally, 17 witnesses testified on behalf of various intervenors and three witnesses testified on behalf of Staff.

(11) Initial briefs and reply briefs were filed on May 23, 2012, and May 30, 2012, respectively.

(12) By entry issued on May 30, 2012, the Commission approved an extension of AEP-Ohio's interim capacity pricing mechanism through July 2, 2012.

(13) The Commission has jurisdiction in this matter pursuant to Sections 4905.04, 4905.05, and 4905.06, Revised Code.

(14) The state compensation mechanism for AEP-Ohio, as set forth herein, is just and reasonable and should be adopted.

ORDER:

It is, therefore,

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

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

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

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

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

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

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

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Steven D. Lesser

Andre T. Porter w/ concurrence

Cheryl L. Roberto

Lynn Slaby w/ concurrence

SJP/GNS/sc

Entered in the Journal

JUL 02 2012

Barcy F. McNeal

Barcy F. McNeal
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

CONCURRING OPINION
OF COMMISSIONERS ANDRE T. PORTER AND LYNN SLABY

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

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

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

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

Andre T. Porter

Lynn Slaby

ATP/LS/sc

Entered in the Journal

JUL 02 2012

Barcy F. McNeal

Barcy F. McNeal
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

CONCURRING AND DISSENTING OPINION
OF COMMISSIONER CHERYL L. ROBERTO

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

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

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

What is a Fixed Resource Requirement?

In order to assure that the transmission system is reliable, PJM requires any one who wishes to transmit electricity over the system to their customers[1] to provide reliability assurance that they have the wherewithal – or *capacity* – to use the transmission system without crashing it or otherwise destabilizing it for everyone else.[2] The protocols for making this demonstration are contained in the Reliability Assurance Agreement. Each transmission system user must show that they possess Capacity Resources sufficient to meet their own needs plus a margin for safety. These Capacity Resources may include a combination of generation facilities, demand resources, energy efficiency, and Interruptible

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

"Deferral"

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

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9 *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO, *et al.*, Opinion and Order (March 18, 2009), Entry on Rehearing (July 23, 2009); *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC, Entry (December 8, 2010).

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

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

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

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

Cheryl L. Roberto

CLR/sc

Entered in the Journal
JUL 02 2012
Barcy F. McNeal

Barcy F. McNeal
Secretary

ATTACHMENT B

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

ENTRY ON REHEARING

The Commission finds:

(1) On March 18, 2009, in Case No. 08-917-EL-SSO, *et al.*, the Commission issued its opinion and order regarding the application for an electric security plan (ESP) for Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (jointly, AEP-Ohio or the Company),[1] pursuant to Section 4928.143, Revised Code (ESP 1 Order).[2] The ESP 1 Order was appealed to the Ohio Supreme Court and subsequently remanded to the Commission for further proceedings.

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

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1 By entry issued on March 7, 2012, the Commission approved and confirmed the merger of CSP into OP, effective December 31, 2011. *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals*, Case No. 10-2376-EL-UNC.

2 *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO; *In the Matter of the Application of Ohio Power Company for Approval of its Electric Security Plan; and an Amendment to its Corporate Separation Plan*, Case No. 08-918-EL-SSO.

(3) By entry issued on December 8, 2010, in the above-captioned case, the Commission found that an investigation was necessary in order to determine the impact of the proposed change to AEP-Ohio's capacity charge (Initial Entry). Consequently, the Commission sought public comments regarding the following issues: (1) what changes to the current state compensation mechanism (SCM) were appropriate to determine AEP-Ohio's fixed resource requirement (FRR) capacity charge to Ohio competitive retail electric service (CRES) providers, which are referred to as alternative load serving entities within PJM; (2) the degree to which AEP-Ohio's capacity charge was currently being recovered through retail rates approved by the Commission or other capacity charges; and (3) the impact of AEP-Ohio's capacity charge upon CRES providers and retail competition in Ohio. Additionally, in light of the change proposed by AEP-Ohio, the Commission explicitly adopted as the SCM for the Company, during the pendency of the review, the current capacity charge established by the three-year capacity auction conducted by PJM based on its reliability pricing model (RPM).

(4) Section 4903.10, Revised Code, states that any party who has entered an appearance in a Commission proceeding may apply for a rehearing with respect to any matters determined therein by filing an application within 30 days after the entry of the order upon the Commission's journal.

(5) On January 7, 2011, AEP-Ohio filed an application for rehearing of the Initial Entry. Memoranda contra AEP-Ohio's application for rehearing were filed by Industrial Energy Users-Ohio (IEU-Ohio); FirstEnergy Solutions Corp. (FES); Ohio Partners for Affordable Energy (OPAE)[3]; and Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (jointly, Constellation).

(6) On January 27, 2011, in Case No. 11-346-EL-SSO, *et al.*, AEP-Ohio filed an application for a standard service offer

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

(SSO) in the form of a new ESP, pursuant to Section 4928.143, Revised Code (ESP 2 Case).[4]

(7) By entry dated February 2, 2011, the Commission granted rehearing of the Initial Entry for further consideration of the matters specified in AEP-Ohio's application for rehearing. The Commission noted that the SCM adopted in the Initial Entry would remain in effect during the pendency of its review.

(8) By entry issued on August 11, 2011, the attorney examiner set a procedural schedule in order to establish an evidentiary record on a proper SCM. The evidentiary hearing was scheduled to commence on October 4, 2011, and interested parties were directed to develop an evidentiary record on the appropriate capacity cost pricing/recovery mechanism, including, if necessary, the appropriate components of any proposed capacity cost recovery mechanism.

(9) On September 7, 2011, a stipulation and recommendation (ESP 2 Stipulation) was filed by AEP-Ohio, Staff, and other parties to resolve the issues raised in the ESP 2 Case and several other cases pending before the Commission (consolidated cases),[5] including the above-captioned case. Pursuant to an entry issued on September 16, 2011, the consolidated cases were consolidated for the sole purpose of considering the ESP 2 Stipulation. The September 16, 2011, entry also stayed the procedural schedules in the

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4 *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 No. 11-346-EL-SSO and 11-348-EL-SSO; *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority*, Case No. 11-349-EL-AAM and 11-350-EL-AAM.

5 *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals*, Case No. 10-2376-EL-UNC; *In the Matter of the Application of Columbus Southern Power Company to Amend its Emergency Curtailment Service Riders*, Case No. 10-343-EL-ATA; *In the Matter of the Application of Ohio Power Company to Amend its Emergency Curtailment Service Riders*, Case No. 10-344-EL-ATA; *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC; *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144, Revised Code*, Case No. 11-4920-EL-RDR; *In the Matter of the Application of Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Pursuant to Section 4928.144, Revised Code*, Case No. 11-4921-EL-RDR.

pending cases, including this proceeding, until the Commission specifically ordered otherwise. The evidentiary hearing on the ESP 2 Stipulation commenced on October 4, 2011, and concluded on October 27, 2011.

(10) On December 14, 2011, the Commission issued an opinion and order in the consolidated cases, modifying and adopting the ESP 2 Stipulation, including its two-tier capacity pricing mechanism (Initial ESP 2 Order). On January 23, 2012, the Commission issued an entry clarifying certain aspects of the Initial ESP 2 Order (Initial ESP 2 Clarification Entry). Subsequently, on February 23, 2012, the Commission issued an entry on rehearing in the consolidated cases, granting rehearing in part (Initial ESP 2 Entry on Rehearing). Finding that the signatory parties to the ESP 2 Stipulation had not met their burden of demonstrating that the stipulation, as a package, benefits ratepayers and the public interest, as required by the Commission's three-part test for the consideration of stipulations, the Commission rejected the ESP 2 Stipulation. The Commission directed AEP-Ohio to file, no later than February 28, 2012, new proposed tariffs to continue the provisions, terms, and conditions of its previous ESP, including an appropriate application of capacity charges under the approved SCM established in the present case.

(11) By entry issued on March 7, 2012, in the above-captioned case, the Commission implemented an interim capacity pricing mechanism proposed by AEP-Ohio in a motion for relief filed on February 27, 2012 (Interim Relief Entry). Specifically, the Commission approved a two-tier capacity pricing mechanism modeled after the one recommended in the ESP 2 Stipulation. Approval of the interim capacity pricing mechanism was subject to the clarifications contained in the Initial ESP 2 Clarification Entry issued in the consolidated cases, including the clarification to include mercantile customers as governmental aggregation customers eligible to receive capacity pricing based on PJM's RPM. Under the two-tier capacity pricing mechanism, the first 21 percent of each customer class was entitled to tier-one, RPM-based capacity pricing. All customers of governmental aggregations approved on or

before November 8, 2011, were also entitled to receive tier-one, RPM-based capacity pricing. For all other customers, the second-tier charge for capacity was $255/megawatt-day (MW-day). In accordance with the Interim Relief Entry, the interim rate was to remain in effect until May 31, 2012, at which point the charge for capacity under the SCM would revert to the current RPM price in effect pursuant to the PJM base residual auction for the 2012/2013 delivery year.

(12) On March 14, 2012, an application for rehearing of the Interim Relief Entry was filed by the Retail Energy Supply Association (RESA). Applications for rehearing were also filed by FES and IEU-Ohio on March 21, 2012, and March 27, 2012, respectively. Memoranda contra the applications for rehearing were filed by AEP-Ohio.

(13) By entry issued on April 11, 2012, the Commission granted rehearing of the Interim Relief Entry for further consideration of the matters specified in the applications for rehearing filed by RESA, FES, and IEU-Ohio.

(14) The evidentiary hearing in this case commenced on April 17, 2012, and concluded on May 15, 2012.

(15) On April 30, 2012, AEP-Ohio filed a motion for extension of the interim relief granted by the Commission in the Interim Relief Entry. By entry issued on May 30, 2012, the Commission approved an extension of the interim capacity pricing mechanism through July 2, 2012 (Interim Relief Extension Entry).

(16) On June 15, 2012, an application for rehearing of the Interim Relief Extension Entry was filed by FES. Applications for rehearing were also filed by IEU-Ohio and the Ohio Manufacturers' Association (OMA) on June 19, 2012, and June 20, 2012, respectively. A memorandum contra the applications for rehearing was filed by AEP-Ohio on June 25, 2012.

(17) By opinion and order issued on July 2, 2012, the Commission approved a capacity pricing mechanism for AEP-Ohio (Capacity Order). The Commission established

$188.88/MW-day as the appropriate charge to enable AEP-Ohio to recover its capacity costs pursuant to its FRR obligations from CRES providers. However, the Commission also directed that AEP-Ohio's capacity charge to CRES providers should be the RPM-based rate, including final zonal adjustments, on the basis that the RPM-based rate will promote retail electric competition. The Commission authorized AEP-Ohio to modify its accounting procedures to defer the incurred capacity costs not recovered from CRES providers, with the recovery mechanism to be established in the ESP 2 Case.

(18) By entry on rehearing issued on July 11, 2012, the Commission granted rehearing of the Interim Relief Extension Entry for further consideration of the matters specified in the applications for rehearing filed by FES, IEU-Ohio, and OMA.

(19) On July 20, 2012, AEP-Ohio filed an application for rehearing of the Capacity Order. The Ohio Energy Group (OEG) filed an application for rehearing and a corrected application for rehearing of the Capacity Order on July 26, 2012, and July 27, 2012, respectively. On August 1, 2012, applications for rehearing of the Capacity Order were filed by IEU-Ohio; FES; Ohio Association of School Business Officials, Ohio School Boards Association, Buckeye Association of School Administrators, and Ohio Schools Council (collectively, Schools); and the Ohio Consumers' Counsel (OCC). OMA and the Ohio Hospital Association (OHA) filed a joint application for rehearing on August 1, 2012. Memoranda contra the various applications for rehearing were filed by Duke Energy Retail Sales, LLC (Duke); IEU-Ohio; FES; Schools; OMA; OCC; OEG; AEP-Ohio; RESA; and Interstate Gas Supply, Inc. (IGS). Joint memoranda contra were filed by Constellation and Exelon Generation Company, LLC (Exelon)[6]; and by Direct Energy Services, LLC and Direct Energy Business, LLC (jointly, Direct Energy), along with RESA.

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6 The joint memorandum contra was also signed on behalf of Exelon Energy Company, Inc., which has not sought intervention in this proceeding. As a non-party, its participation in the joint memorandum contra was improper and, therefore, will not be afforded any weight by the Commission.

(20) On August 7, 2012, OEG filed a motion for leave to reply and reply to the memorandum contra filed by AEP-Ohio on August 6, 2012. On that same date, AEP-Ohio filed a motion to strike OEG's motion and reply on the grounds that Rule 4901-1-35, Ohio Administrative Code (O.A.C.), does not provide for the filing of a reply to a memorandum contra an application for rehearing.

The Commission finds that OEG's motion is procedurally deficient in several respects. First, as we have recognized in prior cases, Rule 4901-1-35, O.A.C., does not contemplate the filing of a reply to a memorandum contra an application for rehearing.[7] Additionally, although OEG's filing is styled as a motion and reply, the filing is essentially a reply only, lacking a motion and memorandum in support. OEG, therefore, also failed to comply with the requirements for a proper motion, as specified in Rule 4901-1-12, O.A.C. In any event, the Commission has reviewed OEG's filing and finds that OEG merely reiterates arguments that it has already raised elsewhere in this proceeding. Accordingly, OEG's motion for leave to file a reply should be denied and its reply should not be considered as part of the record in this proceeding. Further, AEP-Ohio's motion to strike should be denied as moot.

(21) On August 15, 2012, the Commission issued an entry on rehearing, granting rehearing of the Capacity Order for further consideration of the matters specified in the applications for rehearing filed by AEP-Ohio, OEG, IEU-Ohio, FES, Schools, OMA, OHA, and OCC.

(22) The Commission has reviewed and considered all of the arguments raised in the applications for rehearing of the Initial Entry, Interim Relief Entry, Interim Relief Extension Entry, and Capacity Order. In this entry on rehearing, the Commission will address all of the assignments of error by subject matter as set forth below. Any arguments on rehearing not specifically discussed herein have been

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7 *See, e.g., In the Matter of the Commission Investigation of the Intrastate Universal Service Discounts*, Case No. 97-632-TP-COI, Entry on Rehearing (July 8, 2009).

thoroughly and adequately considered by the Commission and are being denied.

Initial Entry

Jurisdiction and Preemption

(23) AEP-Ohio asserts that the Initial Entry is unreasonable and unlawful because the Commission, as a creature of statute, lacks jurisdiction under both federal and state law to issue an order that affects wholesale rates regulated by FERC. According to AEP-Ohio, the provision of generation capacity to CRES providers is a wholesale transaction that falls within the exclusive ratemaking jurisdiction of FERC. AEP-Ohio adds that no provision of Title 49, Revised Code, authorizes the Commission to establish wholesale prices for the Company's provision of capacity to CRES providers. Additionally, AEP-Ohio believes that Section D.8 of Schedule 8.1 of the RAA does not allow the Commission to adopt RPM-based capacity pricing as the SCM. AEP-Ohio argues that RPM-based capacity pricing, as the default option, is an available pricing option only if there is no SCM.

(24) On a related note, AEP-Ohio also contends that the portions of the Initial Entry relating to the establishment of an SCM are in direct conflict with, and preempted by, federal law. AEP-Ohio notes that Section D.8 of Schedule 8.1 of the RAA is a provision of a FERC-approved tariff that is subject to FERC's exclusive jurisdiction. AEP-Ohio further notes that the provision of capacity service to CRES providers is a wholesale transaction that falls exclusively within FERC's jurisdiction. Accordingly, AEP-Ohio argues that the Commission's initiation of this proceeding was an attempt to delay or derail FERC's review of the Company's FERC filing and to usurp FERC's role in resolving this matter, and that the Commission has acted without regard for the supremacy of federal law.

(25) In its memorandum contra, IEU-Ohio contends that the Commission has not exercised jurisdiction over any subject that is within FERC's exclusive jurisdiction. According to IEU-Ohio, because AEP-Ohio's POLR charge was proposed

and approved as a distribution charge and distribution service is subject to the exclusive jurisdiction of the Commission, the Commission's determination as to what compensation is provided by the POLR charge raises no issue that is subject to FERC's jurisdiction. IEU-Ohio also notes that the Commission has previously rejected the argument that a specific grant of authority from the General Assembly is required before it can make a determination that has significance for purposes of implementing a requirement approved by FERC.

(26) FES argues that, pursuant to Section D.8 of Schedule 8.1 of the RAA, AEP-Ohio, as an FRR Entity, has no option to seek wholesale recovery of capacity costs associated with retail switching, if an SCM is in place. Additionally, FES asserts that the Commission has jurisdiction to review AEP-Ohio's rates. FES emphasizes that AEP-Ohio admits that the Commission has broad authority to investigate matters involving Ohio utilities and that the Commission may explore such matters even as an adjunct to its own participation in FERC proceedings.

(27) As stated in the Initial Entry, Sections 4905.04, 4905.05, and 4905.06, Revised Code, grant the Commission authority to supervise and regulate all public utilities within its jurisdiction. The Commission's explicit adoption of an SCM for AEP-Ohio was well within the bounds of this broad statutory authority. Additionally, we stated in the Initial Entry that, in light of AEPSC's FERC filing, a review was necessary to evaluate the impact of the proposed change to AEP-Ohio's existing capacity charge. Section 4905.26, Revised Code, provides the Commission with considerable authority to initiate proceedings to investigate the reasonableness of any rate or charge rendered or proposed to be rendered by a public utility, which the Ohio Supreme Court has affirmed on several occasions.[8] We therefore, grant rehearing for the limited purpose of clarifying that the investigation initiated by the Commission in this proceeding was consistent with Section

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8 *See, e.g., Ohio Consumers' Counsel v. Pub. Util. Comm.*, 110 Ohio St.3d 394, 400 (2006); *Allnet Communications Services, Inc. v. Pub. Util. Comm.*, 32 Ohio St.3d 115, 117 (1987); *Ohio Utilities Co. v. Pub. Util. Comm.*, 58 Ohio St.2d 153, 156-158 (1979).

4905.26, Revised Code, as well as with our authority under Sections 4905.04, 4905.05, and 4905.06, Revised Code.

The Commission disagrees with AEP-Ohio that we have acted in an area that is reserved exclusively to FERC or that our actions are preempted by federal law. Although wholesale transactions are generally subject to the exclusive jurisdiction of FERC, the Commission exercised jurisdiction in this case for the sole purpose of establishing an appropriate SCM upon review of AEP-Ohio's proposed capacity charge. In doing so, the Commission acted consistent with the governing section of the RAA, which, as a part of PJM's tariffs, has been approved by FERC. Section D.8 of Schedule 8.1 of the RAA acknowledges the authority of the Commission to establish an SCM that, once established, prevails over the other compensation methods addressed in that section. In fact, following issuance of the Initial Entry, FERC rejected AEPSC's proposed formula rate in light of the fact that the Commission had established the SCM.[9] Therefore, we do not agree that we have intruded upon FERC's domain.

Provider of Last Resort (POLR) Charge

(28) AEP-Ohio contends that the Initial Entry is unlawful and unreasonable in finding that the POLR charge approved in the ESP 1 Order reflected the Company's cost of supplying capacity for retail loads served by CRES providers and that the POLR charge was based upon the continued use of RPM pricing to set the capacity charge for CRES providers. AEP-Ohio notes that the POLR charge related to an entirely different service and was based on an entirely different set of costs than the capacity rates provided for under Section D.8 of Schedule 8.1 of the RAA. Specifically, AEP-Ohio points out that the POLR charge was based on the right of retail customers to switch to a CRES provider and subsequently return to the Company for generation service under SSO rates, whereas the capacity charge compensates the Company for its wholesale FRR capacity obligations to CRES providers that serve shopping customers. AEP-Ohio argues that its retail POLR charge was not the SCM

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

envisioned under the RAA and did not compensate the Company for the wholesale capacity that it makes available as an FRR Entity under the RAA.

(29) In its memorandum contra, IEU-Ohio argues that AEP-Ohio's POLR charge, as it was proposed by the Company and largely approved by the Commission in the ESP 1 Order, included compensation for capacity costs. FES agrees with IEU-Ohio that the POLR charge recovered capacity costs associated with retail switching. Both IEU-Ohio and FES note that AEP-Ohio's testimony in support of the POLR charge indicated that the charge would compensate the Company for the challenges of providing capacity and energy on short notice. FES adds that AEP-Ohio's POLR charge and its wholesale capacity charge were both intended to recover capacity costs associated with accommodating retail choice and ultimately pay for the same generating capacity. FES and Constellation assert that AEP-Ohio's POLR charge was the SCM, contrary to the Company's claim.

(30) In the Initial Entry, the Commission noted that it had approved retail rates for AEP-Ohio, including recovery of capacity costs through the POLR charge to certain retail shopping customers, based upon the continuation of the current capacity charges established by PJM's capacity auction. We find no error in having made this finding. The Commission approved AEP-Ohio's retail rates, including the POLR charge, in the ESP 1 Order. For the most part, the POLR charge was approved by the Commission as it was proposed by AEP-Ohio.[10] AEP-Ohio's testimony in support of the POLR charge indicates that various inputs were used by the Company to calculate the proposed charge.[11] One of these inputs was the market price, a large component of which was intended to reflect AEP-Ohio's capacity obligations as a member of PJM. Although the purpose of the POLR charge was to compensate AEP-Ohio for the risk associated with its POLR obligation, we nonetheless find that the POLR charge was approved, in

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10 ESP 1 Order at 38-40.

11 Cos. Ex. 2-A at 12-14, 31-32; Tr. XI at 76-77; Tr. XIV at 245.

part, to recover capacity costs associated with customer shopping. Accordingly, we find that AEP-Ohio's request for rehearing should be denied.

Due Process

(31) AEP-Ohio argues that the Initial Entry was issued in a manner that denied the Company due process and violated various statutes, including Sections 4903.09, 4905.26, and 4909.16, Revised Code. AEP-Ohio notes that, absent an emergency situation under Section 4909.16, Revised Code, the Commission must provide notice and a hearing before setting a rate. AEP-Ohio argues that there is no emergency in the present case and that the Commission was, therefore, required to provide notice and a hearing pursuant to the procedural requirements of Section 4905.26, Revised Code, prior to imposing a capacity pricing mechanism that is different from the mechanism proposed by the Company in its FERC filing. Additionally, AEP-Ohio argues that the Initial Entry was issued in the absence of any record and that it provides little explanation as to how the Commission arrived at its decision to establish a capacity rate, contrary to Section 4903.09, Revised Code.

(32) IEU-Ohio responds that the Initial Entry did not establish or alter any of AEP-Ohio's rates or charges and that the entry merely confirmed what the Commission had previously determined.

(33) The Commission finds no merit in AEP-Ohio's due process claims. The Initial Entry upheld a charge that had been previously established in the ESP 1 Order. The Initial Entry did not institute or even modify AEP-Ohio's capacity charge, which was based on RPM pricing both before and after issuance of the entry. The purpose of the Initial Entry was to expressly establish the SCM and maintain RPM pricing as the basis for the SCM during the pendency of the review of AEP-Ohio's proposed change to its capacity charge. Additionally, we find that the rationale behind the Initial Entry was sufficiently explained, consistent with the requirements of Section 4903.09, Revised Code. The Commission clearly indicated that it was necessary to explicitly establish the SCM based on RPM capacity pricing

in light of AEPSC's FERC filing proposing a cost-based capacity charge. Thus, AEP-Ohio's request for rehearing should be denied.

Interim Relief Entry

Jurisdiction

(34) IEU-Ohio argues that the Interim Relief Entry is unlawful because the Commission is without subject matter jurisdiction to establish a cost-based capacity charge in this proceeding. IEU-Ohio notes that the Commission's ratemaking authority under state law is governed by statute. According to IEU-Ohio, this case is not properly before the Commission, regardless of whether capacity service is considered a competitive or noncompetitive retail electric service.

(35) As discussed above with respect to the Initial Entry and addressed further below in regard to the Capacity Order, the Commission finds that it has jurisdiction under state law to establish an SCM, pursuant to the general supervisory authority granted by Sections 4905.04, 4905.05, and 4905.06, Revised Code, and that our review was consistent with our broad investigative authority under Section 4905.26, Revised Code. The Ohio Supreme Court has recognized the Commission's authority to investigate an existing rate and, following a hearing, to order a new rate.[12] Additionally, we believe that a cost-based SCM may be established for AEP-Ohio's FRR capacity obligations, pursuant to our regulatory authority under Chapter 4905, Revised Code, as well as Chapter 4909, Revised Code, which enable the Commission to use its traditional regulatory authority to approve rates that are based on cost. We find, therefore, that IEU-Ohio's request for rehearing should be denied.

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12 *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 110 Ohio St.3d 394, 400 (2006); *Ohio Utilities Co. v. Pub. Util. Comm.*, 58 Ohio St.2d 153, 156-158 (1979).

Process

(36) FES and IEU-Ohio contend that the Interim Relief Entry is unreasonable, unlawful, and procedurally defective because it effectively allowed AEP-Ohio to avoid the statutory procedures to seek the relief granted by the entry.[13] FES and IEU-Ohio argue that there is no remedy or procedure to seek relief from a Commission order other than to file an application for rehearing pursuant to Section 4903.10, Revised Code, and that the Commission, in granting AEP-Ohio's motion for relief, allowed the Company to bypass the rehearing process. IEU-Ohio adds that the Commission abrogated its prior order directing the Company to implement RPM-based capacity pricing upon rejection of the ESP 2 Stipulation, without determining that the prior order was unjust or unwarranted.

(37) IEU-Ohio also asserts that the Interim Relief Entry is unlawful and unreasonable because the Commission failed to comply with the emergency rate relief provisions found in Section 4909.16, Revised Code. IEU-Ohio adds that AEP-Ohio has not invoked the Commission's emergency authority pursuant to that statute and, in any event, the Company failed to present a case supporting emergency rate relief.

(38) AEP-Ohio responds that its motion for relief did not seek to revise the Initial ESP 2 Entry on Rehearing, which rejected the ESP 2 Stipulation. Rather, AEP-Ohio submits that the motion was filed, pursuant to Rule 4901-1-12, O.A.C., for the purpose of seeking interim relief during the pendency of the ESP 2 Case and the present proceedings. AEP-Ohio adds that the motion for relief was properly granted based on the evidence and that arguments to the contrary have already been considered and rejected by the Commission.

(39) The Commission finds that no new arguments have been raised regarding the process by which AEP-Ohio sought, and the Commission granted, interim relief. Although we recognized in the Interim Relief Entry that AEP-Ohio may

[13] IEU-Ohio joins in the application for rehearing filed by FES, in addition to raising its own assignments of error.

have other means to challenge or seek relief from an interim SCM based on RPM capacity pricing, we also found that the Commission is vested with the authority to modify the SCM that we established in the Initial Entry. We continue to believe that, just as we have the necessary authority to establish the SCM, as discussed elsewhere in this entry, so too may we modify the SCM. Accordingly, FES' and IEU-Ohio's assignments of error should be denied.

Evidentiary Record and Basis for Commission's Decision

(40) FES asserts that the Interim Relief Entry is unlawful and unreasonable in that it authorized AEP-Ohio to recover a capacity rate allegedly based on its full embedded costs, which costs are not authorized by the RAA, are not recoverable under Ohio law, and do not reflect an offset for energy revenues. FES contends that, because the ESP 2 Stipulation was rejected, the Commission lacks a record basis to approve the negotiated rate of $255/MW-day as an element of the interim SCM.

(41) FES further argues that the Interim Relief Entry is not based on probative evidence that AEP-Ohio would suffer immediate or irreparable financial harm under RPM-based capacity pricing. FES adds that the Commission erred in relying on AEP-Ohio's loss of revenues from its unlawful POLR charge as further justification for the tier-two rate of $255/MW-day.

(42) AEP-Ohio replies that FES' arguments regarding the two-tiered capacity pricing structure have already been considered and rejected by the Commission on more than one occasion.

(43) IEU-Ohio asserts that the Interim Relief Entry is unlawful and unreasonable because there is no record to support the Commission's finding that the SCM could risk an unjust and unreasonable result. Like FES, IEU-Ohio argues that it was unreasonable for the Commission to rely on the fact that AEP-Ohio is no longer recovering its POLR costs as support for the interim SCM, when the Commission previously determined that the POLR charge was not

justified. Further, IEU-Ohio contends that the Commission unreasonably relied on evidence supporting the ESP 2 Stipulation, given that the Commission rejected the stipulation and elected instead to restart this proceeding. Finally, regarding the Commission's reasoning that AEP-Ohio must share off-system sales (OSS) revenues with its affiliates pursuant to the AEP East Interconnection Agreement (pool agreement), IEU-Ohio notes that there is no evidence addressing any shortfall that may occur.

(44) AEP-Ohio contends that its motion for relief was properly made and properly granted by the Commission based on probative evidence in the record. According to AEP-Ohio, the Commission recognized that the Company's ability to mitigate capacity costs with off-system energy sales is limited. AEP-Ohio adds that the Commission's eventual determination that the Company may not assess a POLR charge does not contradict the fact that the Commission initially relied upon the Company's POLR charge in setting RPM-based capacity pricing as the SCM in the Initial Entry.

(45) IEU-Ohio also argues that the Interim Relief Entry is unlawful and unreasonable because the rate increase is not based on any economic justification as required by Commission precedent. According to IEU-Ohio, the Commission stated, in the ESP 1 Order, that AEP-Ohio must demonstrate the economic basis for a rate increase in the context of a full rate review. IEU-Ohio argues that, contrary to this precedent, AEP-Ohio made no showing, and the Commission made no finding, that the Company was suffering an economic shortfall.

(46) The Commission again rejects claims that the relief granted in the Interim Relief Entry was not based on record evidence. The present case was consolidated with the ESP 2 Case and the other consolidated cases for the purpose of considering the ESP 2 Stipulation. As we noted in the Interim Relief Entry, the testimony and exhibits admitted into the record for that purpose remain a part of the record in this proceeding. Although the Commission subsequently rejected the ESP 2 Stipulation, that action did not purge the evidence from the record in this case. It was thus appropriate for the Commission to rely upon that

evidence as a basis for granting AEP-Ohio's motion for interim relief.

In the Interim Relief Entry, the Commission cited three reasons justifying the interim relief granted, specifically the elimination of AEP-Ohio's POLR charge, the operation of the pool agreement, and evidence indicating that RPM-based capacity pricing is below the Company's capacity costs. With respect to the POLR charge, we merely noted that AEP-Ohio was no longer receiving a revenue stream that was intended, in part, to enable the Company to recover capacity costs. Although the Commission determined that AEP-Ohio's POLR charge was not supported by the record on remand, nothing in that order negated the fact that there are capacity costs associated with an electric distribution utility's POLR obligation and that such costs may be properly recoverable upon a proper record.[14] Having noted that AEP-Ohio was no longer receiving recovery of capacity costs through the POLR charge, the Commission next pointed to evidence in the record of the consolidated cases indicating that the Company's capacity costs fall somewhere within the range of $57.35/MW-day to $355.72/MW-day, as a merged entity. Finally, we noted that, although AEP-Ohio may sell its excess supply into the wholesale market when retail customers switch to CRES providers, the pool agreement limits the Company's ability to fully benefit from these sales, as the margins must be shared with its affiliates.[15] Although IEU-Ohio argues that AEP-Ohio failed to demonstrate any shortfall resulting from the operation of the pool agreement or any other economic justification for the interim rate relief, IEU-Ohio offers insufficient support for its theory that the Company must make such a showing. We have previously rejected IEU-Ohio's argument that the Commission broadly stated in the ESP 1

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14 *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO, *et al.*, Order on Remand (October 3, 2011).

15 AEP-Ohio Ex. 7 at 17.

Order that AEP-Ohio must demonstrate the economic basis for a rate increase in the context of a full rate review.[16]

In light of the evidence discussed above, the Commission reasonably concluded that an SCM based on the current RPM pricing could risk an unjust and unreasonable result for AEP-Ohio. We determined that the two-tier capacity pricing mechanism, as proposed by AEP-Ohio and modified by the Commission, should be approved on an interim basis, with the first tier based on RPM pricing, and the second tier fixed at $255/MW-day, representing a reasonable charge in the mid portion of the range reflected in the record. Upon review of the arguments raised on rehearing, we continue to believe that our rationale for granting AEP-Ohio's interim relief was thoroughly explained, warranted under the unique circumstances, and supported by the evidence of record in the consolidated cases. Accordingly, FES' and IEU-Ohio's requests for rehearing should be denied.

Discriminatory Pricing

(47) FES argues that the Interim Relief Entry established an interim SCM that imposed on certain customers a capacity price that was two times more than other customers paid, contrary to the Commission's duty to ensure nondiscriminatory pricing and an effective competitive market, and in violation of Sections 4905.33, 4905.35, 4928.02, and 4928.17, Revised Code.

(48) Similarly, IEU-Ohio contends that the Interim Relief Entry is unlawful because the resulting rates were unduly discriminatory and not comparable. IEU-Ohio notes that the interim SCM authorized two different capacity rates without any demonstration that the difference was justified. IEU-Ohio adds that there has been no showing that the capacity rates for CRES providers were comparable to the capacity costs paid by SSO customers.

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16 *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO, *et al.*, Entry on Rehearing (December 14, 2011), at 5-6.

(49) In response to many of IEU-Ohio's various arguments, including its discrimination claim, AEP-Ohio contends that IEU-Ohio improperly attempts to relitigate issues that have already been considered and rejected by the Commission.

(50) The Commission does not agree that the interim capacity pricing authorized by the Interim Relief Entry was unduly discriminatory or otherwise unlawful. We recognize that customers who acted earlier than others to switch to a CRES provider benefitted from their prompt action. However, as we have determined on prior occasions, this does not amount to undue preference nor create a case of discrimination, given that all customers had an equal opportunity to take advantage of the allotted RPM-based capacity pricing.[17] Rehearing on this issue should thus be denied.

Transition Costs

(51) IEU-Ohio maintains that the Interim Relief Entry is unlawful and unreasonable because it permitted AEP-Ohio to recover transition costs in violation of state law. According to IEU-Ohio, AEP-Ohio's opportunity to recover transition costs has ended, pursuant to Section 4928.38, Revised Code. AEP-Ohio responds that IEU-Ohio merely repeats an argument that the Commission has previously rejected.

(52) The Commission disagrees that the Interim Relief Entry authorized the recovery of transition costs. We do not believe that the capacity costs associated with AEP-Ohio's FRR obligations constitute transition costs. Pursuant to Section 4928.39, Revised Code, transition costs are costs that, among meeting other criteria, are directly assignable or allocable to retail electric generation service provided to electric consumers in this state. AEP-Ohio's provision of capacity to CRES providers, as required by the Company's FRR capacity obligations, is not a retail electric service as

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17 *See, e.g., In the Matter of the Application of The Cincinnati Gas & Electric Company for Approval of its Electric Transition Plan, Approval of Tariff Changes and New Tariffs, Authority to Modify Current Accounting Procedures, and Approval to Transfer its Generating Assets to an Exempt Wholesale Generator*, Case No. 99-1658-EL-ETP, *et al.*, Opinion and Order (August 31, 2000), at 41.

defined by Section 4928.01(A)(27), Revised Code. The capacity service in question is not provided directly by AEP-Ohio to retail customers, but is rather a wholesale transaction between the Company and CRES providers. Because AEP-Ohio's capacity costs are not directly assignable or allocable to retail electric generation service, they are not transition costs by definition. IEU-Ohio's assignment of error should be denied.

Allocation of RPM-Based Capacity Pricing

(53) RESA requests that the Commission grant rehearing for the purpose of clarifying that the Interim Relief Entry did not authorize AEP-Ohio to revoke RPM-based capacity pricing to any customer who received such pricing pursuant to the Commission's approval of the ESP 2 Stipulation. RESA asserts that, in order to maintain the status quo, commercial customers that have been receiving RPM-based capacity pricing should have continued to receive such pricing. According to RESA, the Interim Relief Entry did not direct AEP-Ohio to decrease the number of commercial customers that were receiving RPM-based capacity pricing. RESA notes that the Interim Relief Entry states that the first 21 percent of each class shall receive RPM-based capacity pricing, but it did not require that only 21 percent can receive such pricing.

RESA argues that it would be unjust and unreasonable to charge customers that were shopping and receiving RPM-based capacity pricing prior to the Commission's rejection of the ESP 2 Stipulation, and while the ESP 2 Stipulation was in place, the tier-two price for capacity. RESA also argues that it is unjust and unreasonable to decrease the amount of RPM-based capacity pricing for the commercial class from the level authorized in the Initial ESP 2 Order, in light of the fact that the Commission ordered an expansion of RPM-based capacity pricing for governmental aggregation. RESA concludes that the Commission should clarify that any customer that began shopping prior to September 7, 2012, and received RPM-based capacity pricing shall be charged such pricing during the period covered by the Interim Relief Entry.

(54) Like RESA, FES also notes that AEP-Ohio has interpreted the Interim Relief Entry to allow RPM-based capacity pricing to be taken away from a significant number of customers that were shopping as of September 7, 2011, when the ESP 2 Stipulation was filed. FES notes that both the ESP 2 Stipulation and the Initial ESP 2 Order recognized that all shopping customers qualifying for RPM-based capacity pricing as of September 7, 2011, would be entitled to continue to receive such pricing. FES argues that the Commission should have established an interim SCM based on RPM prices or, alternatively, should confirm that, during the interim period, all customers that were shopping as of September 7, 2011, should receive RPM-based capacity pricing.

(55) AEP-Ohio contends that the applications for rehearing of RESA and FES should be denied, because they are essentially untimely applications for rehearing of the Initial ESP 2 Clarification Entry in the consolidated cases. AEP-Ohio asserts that the Interim Relief Entry merely confirmed that the capacity pricing requirements of the Initial ESP 2 Clarification Entry were to continue on an interim basis, even though the Commission rejected the ESP 2 Stipulation. AEP-Ohio believes that RESA and FES should have raised their objections to the capacity pricing requirements by seeking rehearing of the Initial ESP 2 Clarification Entry. AEP-Ohio further argues that RESA and FES ignore the fact that the ESP 2 Stipulation was rejected by the Commission in its entirety, which eliminated all of the benefits of the stipulation, and, therefore, RESA and FES have no basis upon which to claim that CRES providers should receive those benefits.

Next, AEP-Ohio disputes RESA's characterization of the status quo, and argues that the Commission maintained the status quo by retaining the capacity pricing set forth in the Initial ESP 2 Clarification Entry. Finally, AEP-Ohio asserts that the Initial ESP 2 Clarification Entry, which remained in effect pursuant to the Interim Relief Entry, required that each customer class receive an allocation of RPM-based capacity pricing for 21 percent of its load, and did not permit the reallocation of capacity from one customer class

to another. AEP-Ohio argues that RESA has misconstrued the Interim Relief Entry in representing the 21 percent as a minimum, not a maximum.

(56) Initially, the Commission disagrees with AEP-Ohio's argument that RESA's and FES' applications for rehearing of the Interim Relief Entry are essentially untimely applications for rehearing of the Initial ESP 2 Clarification Entry. Although the Interim Relief Entry was subject to the clarifications in the Initial ESP 2 Clarification Entry, the entries are otherwise entirely distinct and were issued for different purposes. Whereas the Initial ESP 2 Clarification Entry was issued to clarify the terms of our approval of the ESP 2 Stipulation, the Interim Relief Entry was issued to approve an interim SCM in light of our subsequent rejection of the ESP 2 Stipulation. We find that the applications for rehearing of RESA and FES were appropriate under the circumstances.

Further, the Commission clarifies that all customers that were shopping as of September 7, 2011, should have continued to receive RPM-based capacity pricing during the period in which the interim SCM was in effect. Pursuant to the terms of the ESP 2 Stipulation as approved by the Commission in the Initial ESP 2 Order, customers that were taking generation service from a CRES provider as of the date of the ESP 2 Stipulation (*i.e.*, September 7, 2011) were to continue to be served under the RPM rate applicable for the remainder of the contract term, including renewals.[18] In the Initial ESP 2 Clarification Entry, the Commission confirmed that it had modified the ESP 2 Stipulation to prohibit the allocation of RPM-based capacity pricing from one customer class to another and that this modification dated back to the initial allocation among the customer classes based on the September 7, 2011, data. This clarification was not intended to adversely impact customers already shopping as of September 7, 2011. Likewise, the Interim Relief Entry, which was subject to the clarifications in the Initial ESP 2 Clarification Entry, was not intended to discontinue RPM-based capacity

18 Initial ESP 2 Order at 25, 54.

pricing for customers shopping as of September 7, 2011. AEP-Ohio is directed to make any necessary adjustments to CRES billings that occurred during the interim period, consistent with this clarification.

Interim Relief Extension Entry

Evidentiary Record and Basis for Commission's Decision

(57) FES argues that the Interim Relief Extension Entry is unreasonable and unlawful because it is not based on probative or credible evidence that AEP-Ohio would suffer immediate or irreparable financial harm under RPM-based capacity pricing. FES asserts that AEP-Ohio's claims regarding the purported harm that would result from RPM-based capacity pricing are overstated and unsupported by any evidence in the record. FES adds that AEP-Ohio made no attempt to comply with the requirements for emergency rate relief.

Additionally, FES contends that the Interim Relief Extension Entry is unreasonable and unlawful because it is in direct conflict with the RAA and RPM, pursuant to which capacity pricing is not based on a traditional cost-of-service ratemaking methodology, but is instead intended only to compensate RPM participants, including FRR Entities, for ensuring reliability. According to FES, capacity pricing is not intended to compensate AEP-Ohio for the cost of its generating assets and only the Company's avoidable costs are relevant.

FES also argues that the Interim Relief Extension Entry is unreasonable and unlawful because it imposed capacity pricing above the RPM-based price on tier-one customers that have always been entitled to RPM-based capacity pricing, without any explanation or supporting evidence. FES adds that tier-one customers and CRES providers will be severely prejudiced by the Commission's modification.

Finally, FES argues that the Interim Relief Extension Entry is unreasonable and unlawful because it extended an improper interim SCM without sufficient justification as to why the Commission elected to continue above-market

capacity pricing, despite its earlier determination that the interim rates should only remain in effect though May 31, 2012. FES contends that the Commission relied on traditional cost-of-service concepts that have no relevance in this proceeding.

(58) OMA argues that the Commission's approval of AEP-Ohio's proposal to increase and extend the Company's interim capacity pricing is not supported by record evidence. OMA adds that a majority of the Commission was unable to agree on a rationale for granting the extension. OMA concludes that the Commission should reverse its decision to grant the extension or, in the alternative, retain the interim capacity pricing adopted in the Interim Relief Entry.

(59) AEP-Ohio responds that the majority of the arguments raised by FES and OMA have already been considered and rejected by the Commission on numerous occasions during the course of the proceeding and should again be rejected. Regarding the remaining arguments, AEP-Ohio notes that the Commission thoroughly addressed all of the arguments that were raised in response to the Company's motion for extension.

(60) As discussed above, the Commission finds that we thoroughly explained the basis for our decision to grant interim relief and approve an interim capacity pricing mechanism as compensation for AEP-Ohio's FRR obligations. In granting an extension of the interim relief, the Commission found that the same rationale continued to apply. In the Interim Relief Extension Entry, we explained that, because the circumstances prompting us to grant the interim relief had not changed, it was appropriate to continue the interim relief, in its current form, for an additional period while the case remained pending. The Commission also specifically noted that various factors had prolonged the course of the proceeding and delayed a final resolution, despite the Commission's considerable efforts to maintain an expeditious schedule. We uphold our belief that it was reasonable and appropriate to extend the interim capacity pricing mechanism under these circumstances. Therefore, rehearing should be denied.

Extension of Interim SCM

(61) FES argues that the Interim Relief Extension Entry is unreasonable and unlawful because it authorized the extension of an interim SCM that is unlawful, as demonstrated in FES' application for rehearing of the Interim Relief Entry. Similarly, IEU-Ohio reiterates the arguments raised in its briefs and application for rehearing of the Interim Relief Entry. AEP-Ohio replies that the Commission has already addressed intervenors' arguments in the course of this proceeding.

(62) As addressed above, the Commission does not agree that the interim SCM was unlawful. For the same reasons enumerated above with respect to the Interim Relief Entry, the Commission finds nothing improper in our extension of the interim SCM for a brief period.

Due Process

(63) IEU-Ohio contends that the totality of the Commission's actions during the course of this proceeding violated IEU-Ohio's due process rights under the Fourteenth Amendment. IEU-Ohio believes the Commission's conduct throughout this proceeding has subjected the positions of parties objecting to AEP-Ohio's demands to condemnation without trial. In its memorandum contra, AEP-Ohio argues that IEU-Ohio's lengthy description of the procedural history of this proceeding negates its due process claim.

(64) The Commission finds no merit in IEU-Ohio's due process claim. Pursuant to the procedural schedule, all parties, including IEU-Ohio, were afforded ample opportunity to participate in this proceeding through means of discovery, a lengthy evidentiary hearing with cross-examination of witnesses and presentation of exhibits, and briefing. IEU-Ohio was also afforded the opportunity to respond to AEP-Ohio's motion for interim relief, as well as its motion for an extension of the interim relief. As the record reflects, IEU-

Ohio took full advantage of its opportunities and, accordingly, its request for rehearing should be denied.

Requests for Escrow Account or Refund

(65) OMA asserts that the Interim Relief Extension Entry undermined customer expectations and substantially harmed Ohio manufacturers and other customers. OMA notes that, as a result of the Interim Relief Extension Entry, all customers, including customers in tier one, were required to pay capacity rates that were substantially higher than the current RPM-based capacity price, contrary to their reasonable expectations, and to the detriment of their business arrangements and the competitive market. OMA adds that the Commission failed to consider its recommendation that AEP-Ohio deposit the difference between the two-tiered interim relief and the RPM-based capacity price in an escrow account.

(66) IEU-Ohio asserts that the Commission should direct AEP-Ohio to refund all revenue collected above RPM-based capacity pricing, or at least to credit the excess collection against regulatory asset balances otherwise eligible for amortization through retail rates and charges.

(67) In response to IEU-Ohio, AEP-Ohio asserts that many of IEU-Ohio's arguments are irrelevant to the Interim Relief Extension Entry and thus inappropriate for an application for rehearing. Further, AEP-Ohio disagrees with OMA that there is no evidence that the Company would suffer harm from RPM-based capacity pricing. AEP-Ohio also contends that neither customers nor CRES providers can claim a continuing expectation of such pricing or rely upon the now rejected ESP 2 Stipulation.

(68) For the reasons previously discussed, the Commission finds that the brief extension of the interim capacity pricing mechanism, without modification, was reasonable under the circumstances. Accordingly, we do not believe that IEU-Ohio's request for a refund of any amount in excess of RPM-based capacity pricing and OMA's request that an escrow account be established are necessary or appropriate. Further, if intervenors believed that extraordinary relief

from the Interim Relief Extension Entry was required, the appropriate course of action would have been to seek a stay of the entry.

We do not agree that the Interim Relief Extension Entry undermined customer expectations or caused substantial harm to customers. This case was initiated by the Commission nearly two years ago for the purposes of reviewing AEP-Ohio's capacity charge and determining whether the SCM should be modified in order to promote competition and to enable the Company to recover the costs associated with its FRR capacity obligations. In any event, as with any rate, there is no guarantee that the rate will remain unchanged in the future. We find that the Interim Relief Extension Entry appropriately balanced the interests of AEP-Ohio, CRES providers, and customers, which has been the Commission's objective throughout this proceeding.

Capacity Order

Jurisdiction

(69) IEU-Ohio argues that the Capacity 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 service from the point of generation to the point of consumption. IEU-Ohio contends that it makes no difference whether the service is termed wholesale or retail, because retail electric service includes any service from the point of generation to the point of consumption. IEU-Ohio asserts that the Commission's authority with respect to generation service is limited to the authorization of retail SSO rates that are established in conformance with the requirements of Sections 4928.141 to 4928.144, Revised Code.

(70) The Schools contend that the Commission lacks authority to set cost-based capacity rates, because AEP-Ohio's capacity service is a deregulated generation-related service. The Schools believe the Commission's authority regarding

capacity service is limited to effectuating the state's energy policy found in Section 4928.02, Revised Code.

(71) In the Capacity Order, the Commission determined that it has authority pursuant to Sections 4905.04, 4905.05, and 4905.06, Revised Code, to establish the SCM. We determined that AEP-Ohio's provision of capacity to CRES providers is appropriately characterized as a wholesale transaction rather than a retail electric service. We noted that, although wholesale transactions are generally subject to the exclusive jurisdiction of FERC, our exercise of jurisdiction in this case was for the sole purpose of establishing an appropriate SCM and is consistent with Section D.8 of Schedule 8.1 of the FERC-approved RAA. Additionally, we noted that FERC had rejected AEPSC's proposed formula rate in light of the fact that the Commission had established an SCM in the Initial Entry.[19] The Commission further determined, within its discretion, that it was necessary and appropriate to establish a cost-based SCM for AEP-Ohio, pursuant to our regulatory authority under Chapter 4905, Revised Code, as well as Chapter 4909, Revised Code, which authorized the Commission to use its traditional regulatory authority to approve rates that are based on cost, such that the resulting rates are just and reasonable, in accordance with Section 4905.22, Revised Code. Because the capacity service at issue is a wholesale rather than retail electric service, we found that, although market-based pricing is contemplated in Chapter 4928, Revised Code, that chapter pertains solely to retail electric service and is thus inapplicable under the circumstances. The Commission concluded that we have an obligation under traditional rate regulation to ensure that the jurisdictional utilities receive just and reasonable compensation for the services that they render. However, rehearing is granted to clarify that the Commission is under no obligation with regard to the specific mechanism used to address capacity costs. Such costs may be addressed through an SCM that is specifically crafted to meet the stated needs of a particular utility or through a rider or other mechanism.

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

The Commission carefully considered the question of whether we have the requisite statutory authority in this matter. We affirm our findings in the Capacity Order that capacity service is a wholesale generation service between AEP-Ohio and CRES providers and that the provisions of Chapter 4928, Revised Code, that restrict the Commission's regulation of competitive retail electric services are inapplicable. The definition of retail electric service found in Section 4928.01(A)(27), Revised Code, is more narrow than IEU-Ohio would have it. As we discussed in the Capacity Order, retail electric service is "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." Because AEP-Ohio supplies the capacity service in question to CRES providers, rather than directly to retail customers, it is not a retail electric service, as IEU-Ohio appears to contend, or a deregulated service, as the Schools assert.

Additionally, as discussed above, we note that Section 4905.26, Revised Code, grants the Commission considerable authority to review rates[20] and authorizes our investigation in this case. The Commission properly initiated this proceeding, consistent with that statute, to examine AEP-Ohio's existing capacity charge for its FRR obligations and to establish an appropriate SCM upon completion of our review. We grant rehearing for the limited purpose of clarifying that the Capacity Order was issued in accordance with the Commission's authority found in Section 4905.26, Revised Code, as well as Sections 4905.04, 4905.05, and 4905.06, Revised Code.

Cost-Based SCM

(72) OCC argues that the Commission erred in adopting a cost-based SCM rather than finding that the SCM should be based on RPM pricing. Similarly, the Schools argue that the Commission failed to find that RPM-based capacity

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20 *See, e.g., Ohio Consumers' Counsel v. Pub. Util. Comm.*, 110 Ohio St.3d 394, 400 (2006); *Allnet Communications Services, Inc. v. Pub. Util. Comm.*, 32 Ohio St.3d 115, 117 (1987); *Ohio Utilities Co. v. Pub. Util. Comm.*, 58 Ohio St.2d 153, 156-158 (1979).

pricing is reasonable and lawful and should be reinstated as the SCM. AEP-Ohio replies that the arguments raised by OCC and the Schools are unsupported and have already been considered and rejected by the Commission. AEP-Ohio notes that the Commission determined that it has the authority to establish an SCM based on the costs associated with the Company's FRR capacity obligations.

(73) FES contends that the Capacity Order unlawfully and unreasonably established an SCM based on embedded costs. Specifically, FES argues that, pursuant to the language and purpose of the RAA, the only costs that can possibly be considered for pricing capacity in PJM are avoidable, not embedded, costs and that AEP-Ohio's avoidable costs would be fully recovered using RPM-based pricing. FES asserts that AEP-Ohio's FRR capacity obligations are not defined by the cost of its fixed generation assets but are instead valued based on PJM's reliability requirements. FES believes that the Capacity Order provides a competitive advantage to AEP-Ohio in that the Company will be the only capacity supplier in PJM that is guaranteed to recover its full embedded costs for generation. FES notes that AEP-Ohio's status as an FRR Entity does not justify different treatment, as there is no material difference between the FRR election and participation in PJM's base residual auction.

(74) AEP-Ohio argues that the Commission appropriately determined that cost, as the term is used in Section D.8 of Schedule 8.1 of the RAA, refers to embedded cost. AEP-Ohio notes that no reference to avoided cost is contained within Section D.8 of Schedule 8.1 of the RAA and that, as a participant in the drafting of the RAA, the Company understood that the reference to cost was intended to mean embedded cost. AEP-Ohio contends that, because avoided costs are bid into the RPM's base residual auction, FES' argument renders the option to establish a cost-based capacity rate under Section D.8 of Schedule 8.1 of the RAA meaningless.

(75) Like FES, IEU-Ohio argues that the Capacity Order is in conflict with the RAA for numerous reasons, including that the order does not account for Delaware law; ignores the

RAA's focus on the entire PJM region and the RAA's objective to support the development of a robust competitive marketplace; finds that use of the term "cost" in the RAA means embedded cost; and is based on AEP-Ohio's flawed assumptions that the Company is an FRR Entity with owned and controlled generating assets that are the source of capacity provided to CRES providers serving retail customers in the Company's certified electric distribution service area.

(76) In its memorandum contra, AEP-Ohio notes that IEU-Ohio fails to explain how the application of Delaware law would make any practical difference with respect to the Commission's interpretation of the RAA. AEP-Ohio argues that the RAA cannot be interpreted to mean that state commissions are constrained by Delaware law in establishing an SCM. AEP-Ohio also contends that, if the reference to cost in Section D.8 of Schedule 8.1 of the RAA is interpreted as avoidable cost, it would render the provision meaningless. AEP-Ohio adds that IEU-Ohio relies on inapplicable U.S. Supreme Court precedent in support of its argument that cost does not mean embedded cost.

(77) The Commission finds that the arguments raised by the Schools, OCC, FES, and IEU-Ohio have already been thoroughly considered by the Commission and should again be denied. As discussed above, the Commission has an obligation to ensure that AEP-Ohio receives reasonable compensation for the capacity service that it provides. We continue to believe that the SCM for AEP-Ohio should be based on the Company's costs and that RPM-based capacity pricing would prove insufficient to yield reasonable compensation for the Company's provision of capacity to CRES providers in fulfillment of its FRR capacity obligations.

Initially, the Commission finds no merit in IEU-Ohio's claim that AEP-Ohio is not an FRR Entity. Although AEPSC signed the RAA, it did so on behalf of the Company. The Commission also disagrees with FES' contention that the Capacity Order affords an undue competitive advantage to AEP-Ohio over other capacity

suppliers in PJM. The Commission initiated this proceeding solely to review AEP-Ohio's capacity costs and determine an appropriate capacity charge for its FRR obligations. We have not considered the costs of any other capacity supplier subject to our jurisdiction nor do we find it appropriate to do so in this proceeding. Further, the Commission does not agree that the SCM that we have adopted is inconsistent with the RAA. Section D.8 of Schedule 8.1 of the RAA provides only that, where the state regulatory jurisdiction requires that the FRR Entity be compensated for its FRR capacity obligations, such SCM will prevail. There are no requirements or limitations for the SCM in that section or elsewhere in the RAA. Although Section D.8 of Schedule 8.1 of the RAA specifically contemplates that an SCM may be established by the state regulatory jurisdiction, neither that section nor any other addresses whether the SCM may provide for the recovery of embedded costs, nor would we expect it to do so, given that the FRR Entity's compensation is to be provided by way of a state mechanism. The Commission finds that we appropriately adopted an SCM that is consistent with Section D.8 of Schedule 8.1 of the RAA and state law and that nothing in the Capacity Order is otherwise contrary to the RAA.

Energy Credit

(78) AEP-Ohio raises numerous issues with respect to the energy credit recommended by Staff's consultant in this case, Energy Ventures Analysis, Inc. (EVA), which was adopted by the Commission in the Capacity Order. In its first assignment of error, AEP-Ohio contends that the Commission's adoption of an energy credit of $147.41/MW-day was flawed, given that EVA assumed a static shopping level of 26.1 percent throughout the relevant timeframe. AEP-Ohio notes that, according to Staff's own witness, the energy credit should be lower based upon the established shopping level of thirty percent as of April 30, 2012. AEP-Ohio adds that the energy credit should be substantially lower based upon the increased levels of shopping that will occur with RPM-based capacity pricing. AEP-Ohio believes that there is an inconsistency

between the Commission's recognition in the Capacity Order that RPM-based pricing will cause shopping to increase and the Commission's adoption of EVA's methodology without an adjustment to reflect a higher level of shopping. At a minimum, AEP-Ohio argues that the Commission should account for the actual shopping level as of the date of the Capacity Order.

(79) IEU-Ohio responds that the arguments raised by AEP-Ohio in its application for rehearing assume that the Commission may act beyond its statutory jurisdiction to set generation rates and that the Commission may unlawfully authorize the Company to collect transition revenue. IEU-Ohio also contends that all of AEP-Ohio's assignments of error that relate to the energy credit are based on the flawed assumption that the Company identified and established the incurred cost of satisfying the FRR Entity's capacity obligations. IEU-Ohio notes that AEP-Ohio's cost-based methodology relies on the false assumption that the Company's owned and controlled generating assets are the source of capacity available to CRES providers serving customers in the Company's distribution service territory.

(80) AEP-Ohio also argues that there are a number of errors in EVA's energy credit, resulting in an energy credit that is unreasonable and against the manifest weight of the evidence. AEP-Ohio contends that the Commission adopted EVA's energy credit without meaningful explanation or analysis and abdicated its statutory duty to make reasonable findings and conclusions, in violation of Section 4903.09, Revised Code.

Specifically, AEP-Ohio asserts that EVA's methodology does not withstand basic scrutiny and is largely a black box that cannot be meaningfully tested or evaluated by others; EVA failed to calibrate its model or otherwise account for the impact of zonal rather than nodal prices; EVA erred in forecasting locational marginal prices (LMP) instead of using available forward energy prices, which were used by Staff in the ESP 2 Case; EVA used inaccurate and understated fuel costs; EVA failed to use correct heat rates to capture minimum and start time operating constraints and associated cost impacts; EVA wrongly incorporated

traditional OSS margins and otherwise failed to properly reflect the impact of the pool agreement; and EVA's estimate of gross margins that AEP-Ohio will earn from June 2012 through May 2015 are overstated by nearly 200 percent. AEP-Ohio argues that, at a minimum, the Commission should conduct an evidentiary hearing on rehearing to evaluate the accuracy of EVA's energy credit compared to actual results. In support of its request, AEP-Ohio proffers that EVA's forecasted energy margins for June 2012 were more than three times higher than the Company's actual margins, resulting in an energy credit that is overstated by $91.52/MW-day, and that provisional data for July 2012 confirms a similar degree of error in EVA's projections.

AEP-Ohio also points out that Staff admitted to significant, inadvertent errors in Staff witness Harter's testimony regarding calculation of the energy credit and that Staff was granted additional time to present the supplemental testimony of Staff witness Medine in an attempt to correct the errors. AEP-Ohio notes that Staff presented three different versions of EVA's calculation of the energy credit, which was revised twice in order to address errors in the calculation. AEP-Ohio asserts that the Commission nevertheless adopted EVA's energy credit without mention of these procedural irregularities. In any event, AEP-Ohio believes that Ms. Medine's testimony only partially and superficially addressed Mr. Harter's errors. According to AEP-Ohio, the Commission should grant the Company's application for rehearing and address the remaining fundamental deficiencies in EVA's methodology in order to avoid a reversal and remand from the Ohio Supreme Court.

(81) FES responds that the Commission already considered and rejected each of AEP-Ohio's arguments. FES adds that there are flaws in the energy credit calculated by AEP-Ohio's own witness and that the Company's criticisms of EVA's approach lack merit.

(82) The Commission finds that AEP-Ohio's assignments of error regarding the energy credit should be denied. First, with respect to EVA's shopping assumption, we find

nothing inappropriate in EVA's use of a static shopping level of 26 percent, which reflects the actual level of shopping in AEP-Ohio's service territory as of March 31, 2012, which was around the time of EVA's analysis. We recognize that the level of shopping will continually fluctuate in both directions. For that reason, we believe that it was appropriate for EVA to use the actual level of shopping as of a recent date, rather than a projection, and find that EVA's figure is a reasonable approximation. EVA's use of a static shopping level provides certainty to the energy credit and capacity rate. The alternative would be to review the level of shopping at regular intervals, an option that would unreasonably necessitate continual recalculations of the energy credit to reflect the shopping level of the moment, while introducing uncertainty into the capacity rate. The Commission also notes that, contrary to AEP-Ohio's assertion, Staff witness Medine did not testify that the energy credit should be adjusted to reflect the current level of shopping. Rather, Ms. Medine testified only that EVA assumed a shopping level of 26 percent, which was the level of shopping as of March 31, 2012, and that this figure was used as a conservative approach.[21]

Regarding the alleged errors in EVA's approach, the Commission notes initially that we explained the basis for our adoption of EVA's energy credit in the Capacity Order, consistent with the requirements of Section 4903.09, Revised Code. A review of the testimony of Staff witnesses Medine and Harter reflects that EVA sufficiently described its methodology, including the fuel costs and heat rates applied in this case; its decision to use zonal prices and forecasted LMP; and its accounting for OSS margins and operation of the pool agreement.[22] We affirm our finding that, as a whole, EVA's energy credit, as adjusted by the Commission, is reasonable. Although AEP-Ohio contends that EVA should have used different inputs in a number of respects, we do not believe that the Company has demonstrated that the inputs actually used by EVA are unreasonable. AEP-Ohio's preference for other inputs that

21 Tr. X at 2189, 2194; Staff Ex. 105 at 19.

22 Staff Ex. 101 at 6-11, 105 at 4-19.

would result in an outcome more to its liking is not a sufficient ground for rehearing. Neither do we find any relevance in AEP-Ohio's claimed procedural irregularities with respect to EVA's testimony. Essentially, the Commission was presented with two different methodologies for calculating the energy credit, both of which were questioned and criticized by the parties. Overall, the Commission believes that EVA's approach is the more reasonable of the two in projecting AEP-Ohio's future energy margins and that it will best ensure that the Company does not over recover its capacity costs.

Authorized Compensation

(83) OCC argues that the Commission erred in finding that compensation of $188.88/MW-day is an appropriate charge to enable AEP-Ohio to recover its capacity costs for its FRR obligations from CRES providers. OCC notes that there is no evidence to support the Commission's finding, given that no party recommended a charge of $188.88/MW-day. OCC further notes that the Commission adopted AEP-Ohio's unsupported return on equity (ROE), without explanation, in violation of Section 4903.09, Revised Code.

(84) In response to OCC, as well as similar arguments from OMA and OHA, AEP-Ohio asserts that the ROE approved by the Commission is supported by relevant and competent evidence and that the ROE is appropriate for the increased risk associated with generation service. Given the considerable evidence in the record, AEP-Ohio contends that the rationale for the Commission's rejection of Staff's proposed downward adjustment to the Company's proposed ROE is evident.

(85) In the Capacity Order, the Commission explained thoroughly based on the evidence in the record how it determined that $188.88/MW-day is an appropriate capacity charge for AEP-Ohio's FRR obligations. We also explained that we declined to adopt Staff's recommended ROE, given that it was solely based on a stipulated ROE from an unrelated case, and concluded that the ROE proposed by AEP-Ohio was reasonable under the

circumstances in the present case. The evidence of record reflects that AEP-Ohio's proposed ROE is consistent with the ROEs that are in effect for the Company's affiliates for wholesale transactions in other states.[23] Therefore, the requests for rehearing should be denied.

Deferral of Difference Between Cost and RPM

Deferral Authority

(86) IEU-Ohio argues that 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, and that the Commission may only authorize a deferral resulting from a phase-in of an SSO rate pursuant to Section 4928.144, Revised Code. IEU-Ohio further notes that, under generally accepted accounting principles (GAAP), only an incurred cost can be deferred for future collection, and not the difference between two rates. IEU-Ohio also asserts that the Commission unreasonably and unlawfully determined that AEP-Ohio might suffer financial harm if it charged RPM-based capacity pricing and established compensation for generation capacity service designed to address the financial performance of the Company's competitive generation business, despite the Commission's prior confirmation that the Company's earnings do not matter for purposes of establishing generation rates.

(87) AEP-Oho asserts that it was unreasonable and unlawful for the Commission to adopt a cost-based SCM and then order the Company to charge CRES providers the lower RPM-based capacity pricing. Specifically, AEP-Ohio contends that it was unreasonable and unlawful to require the Company to charge any price other than $188.88/MW-day, which the Commission established as the just and reasonable cost-based rate. AEP-Ohio argues that the Commission has no statutory authority to require the Company to charge CRES providers less than the cost-

23 Tr. II at 305.

based capacity rate that the Commission determined was just and reasonable.

(88) In its memorandum contra, IEU-Ohio argues that AEP-Ohio assumes that the Commission may act beyond its statutory jurisdiction to set generation rates and that the Commission may unlawfully authorize the Company to collect transition revenue. IEU-Ohio adds that customer choice will be frustrated if the Commission grants the relief requested by AEP-Ohio in its application for rehearing.

(89) The Schools respond that AEP-Ohio should not complain that the Commission lacks authority to order a deferral, given that the Company has refused to accept the ratemaking formula and related process contained in Sections 4909.15, 4909.18, and 4909.19, Revised Code. The Schools add, however, that the Commission has wide discretion to issue accounting orders under Section 4905.13, Revised Code, in cases where the Commission is not setting rates pursuant to Section 4909.15, Revised Code.

(90) RESA and Direct Energy argue that the Commission's approach is consistent with Ohio's energy policy, supported by the record, and reasonable and lawful. RESA and Direct Energy believe that the Commission pragmatically balanced the various competing interests of the parties in establishing a just and reasonable SCM.

(91) Noting that nothing prohibits the Commission from bifurcating the means of recovery of a just and reasonable rate, Duke replies that AEP-Ohio's argument is not well founded, given that the Company will be made whole through the deferral mechanism to be established in the ESP 2 Case.

(92) In the Capacity Order, the Commission authorized AEP-Ohio to modify its accounting procedures to defer the incurred capacity costs not recovered from CRES providers and indicated that a recovery mechanism for the deferred capacity costs would be established in the ESP 2 Case. We find nothing unlawful or unreasonable in this approach. We continue to believe that it appropriately balances our objectives of enabling AEP-Ohio to fully recover its

capacity costs incurred in carrying out its FRR obligations, while encouraging retail competition in the Company's service territory.

The Commission finds no merit in the arguments that we lack the authority to order the deferral. As we noted in the Capacity Order, the Commission relied upon the authority granted to us by Section 4905.13, Revised Code, in directing AEP-Ohio to modify its accounting procedures to defer a portion of its capacity costs. Having found that the capacity service at issue is not a retail electric service and thus not a competitive retail electric service, IEU-Ohio's argument that the Commission may not rely on Section 4905.13, Revised Code, is unavailing. Neither do we find that authorization of the deferral was contrary to GAAP or prior Commission precedent, as IEU-Ohio contends. The requests for rehearing of IEU-Ohio and AEP-Ohio should, therefore, be denied.

Competition

(93) AEP-Ohio contends that it was unreasonable and unlawful for the Commission to require the Company to supply capacity to CRES providers at a below-cost rate to promote artificial, uneconomic, and subsidized competition that is unsustainable and likely to harm customers and the state economy, as well as the Company.

(94) Duke disagrees, noting that the evidence is to the contrary. Duke adds that the other Ohio utilities use RPM-based capacity pricing without causing a flood of unsustainable competition or damage to the economy in the state. FES responds that the deferral authorized by the Commission is an appropriate way to spur real competition and to prevent the chilling effect on competition that would result from above-market capacity pricing. FES contends that there is nothing artificial in allowing customers to purchase capacity from willing sellers at market rates. RESA and Direct Energy agree, noting that the Capacity Order will promote real competition among CRES providers to the benefit of customers.

(95) As the Commission thoroughly addressed in the Capacity Order, we believe that a capacity charge assessed to CRES providers on the basis of RPM pricing will advance the development of true competition in AEP-Ohio's service territory. We do not agree with AEP-Ohio that there is anything artificial in charging CRES providers the same market-based pricing that is used throughout PJM. Lacking any merit, AEP-Ohio's assignment of error should be denied.

Existing Contracts

(96) AEP-Ohio argues that it was unreasonable and unlawful, as well as unnecessary, for the Commission to extend RPM-based pricing to customers that switched to a CRES provider at a capacity price of $255/MW-day. AEP-Ohio asserts that CRES providers will enjoy a significant windfall to the Company's financial detriment. According to AEP-Ohio, the Capacity Order should not apply to existing contracts with a capacity price of $255/MW-day.

(97) Duke responds that AEP-Ohio offers no evidence that these contracts prohibit renegotiation of pricing for generation supply. IEU-Ohio asserts that AEP-Ohio's argument must be rejected because the Company may not charge a rate that has not been authorized by the Commission, and the Company has not demonstrated that it has any valid basis to charge $255/MW-day for capacity supplied to CRES providers. IEU-Ohio adds that there is likewise no basis to conclude that CRES providers will enjoy a windfall, given the fact that the Commission earlier indicated that RPM-based capacity pricing would be restored and such pricing comprised the first tier of the interim capacity pricing mechanism. FES also contends that there is no justification for discriminating against customers formerly charged $255/MW-day for capacity by requiring them to continue to pay above-market rates. RESA and Direct Energy add that customers that were charged $255/MW-day elected to shop with the expectation that they would eventually be charged RPM-based capacity pricing. OMA agrees that customers had a reasonable expectation of RPM-based capacity pricing, regardless of when they elected to shop.

OMA notes that AEP-Ohio's argument is contrary to state policy, which requires that nondiscriminatory retail electric service be available to consumers.

(98) The Commission finds no merit in AEP-Ohio's argument and its request for rehearing should, therefore, be denied. The contracts in question are between CRES providers and their customers, not AEP-Ohio. It is for the parties to each contract to determine whether the contract pricing will be renegotiated in light of the Capacity Order. As between AEP-Ohio and CRES providers, the Company should charge the applicable RPM-based capacity pricing as required by the Capacity Order.

State Policy

(99) IEU-Ohio believes the deferral mechanism is in conflict with the state policy found in Section 4928.02, Revised Code, which generally supports reliance on market-based approaches to set prices for competitive services such as generation service and strongly favors competition to discipline prices of competitive services.

(100) AEP-Ohio asserts that it was unreasonable and unlawful for the Commission to rely on the state policies set forth in Sections 4928.02 and 4928.06(A), Revised Code, as justification for reducing CRES providers' price of capacity to RPM-based pricing, after the Commission determined that Chapter 4928, Revised Code, does not apply to the capacity charge paid by CRES providers to the Company. AEP-Ohio argues that the Commission determined that the chapter is inapplicable to the Company's capacity service but then unreasonably relied upon it anyway.

(101) Duke disagrees, noting that the impact of AEP-Ohio's capacity charge on retail competition in Ohio is an issue for Commission review in this proceeding and that the issue cannot be considered without reference to state policy. IEU-Ohio adds that AEP-Ohio has urged the Commission in this proceeding to rely on the state policy found in Section 4928.02, Revised Code. IEU-Ohio also points out that the Commission is required to apply the state policy in making decisions regarding generation capacity service.

FES contends that, if the Commission has the authority to create a cost-based SCM, then it also has the authority to follow the express guidance of Chapter 4928, Revised Code, and encourage competition through the use of market pricing. RESA and Direct Energy note that Section 4928.02, Revised Code, contains the state's energy policy, parts of which are not limited to retail electric services. RESA and Direct Energy contend that the Capacity Order is consistent with Section 4928.02(C), Revised Code, which requires a diversity of electricity supplies and suppliers.

(102) Initially, the Commission notes that, although we determined that Chapter 4928, Revised Code, has no application in terms of the Commission's authority to establish the SCM, we have made it clear from the outset that one of the objectives in this proceeding was to determine the impact of AEP-Ohio's capacity charge on CRES providers and retail competition in Ohio. The Commission cannot accomplish that objective without reference to the state policy found in Section 4928.02, Revised Code. Further, as the Commission stated in the Capacity Order, we believe that RPM-based capacity pricing is a reasonable means to promote retail competition, consistent with the state policy objectives enumerated in Section 4928.02, Revised Code. We do not agree with IEU-Ohio that the deferral of a portion of AEP-Ohio's capacity costs is contrary to any of the state policy objectives identified in that section. The assignments of error raised by AEP-Ohio and IEU-Ohio should be denied.

Evidentiary Record and Basis for Commission's Decision

(103) OCC contends that there is no evidence in the record that supports or even addresses a deferral of capacity costs and that the Commission, therefore, did not base its decision on facts in the record, contrary to Section 4903.09, Revised Code. OCC also asserts that the Commission erred in authorizing carrying charges based on the weighted average cost of capital (WACC) until such time as a recovery mechanism was approved in the ESP 2 Case.

OCC believes that any carrying charges should be calculated based on AEP-Ohio's long-term cost of debt.

(104) AEP-Ohio responds that OCC's argument is moot. AEP-Ohio explains that the SCM and associated deferral did not take effect until August 8, 2012, which was the date on which the Commission approved a recovery mechanism in the ESP 2 Case, and, therefore, the WACC rate did not apply.

(105) Like OCC, IEU-Ohio contends that the Commission's authorization of carrying charges lacks any supporting evidence in the record and that the carrying charge rates approved are excessive, arbitrary, capricious, and contrary to Commission precedent.

(106) The Commission notes that OCC appears to assert that the Commission may not authorize a deferral unless it has first been proposed by a party to the proceeding. We find no basis for OCC's apparent contention that the Commission may not authorize a deferral on our own initiative. As discussed above, the Commission has the requisite authority pursuant to Section 4905.13, Revised Code. Further, the reasons prompting our decision were thoroughly explained in the Capacity Order and supported with evidence in the record, as reflected in the order. We thus find no violation of Section 4903.09, Revised Code.

Regarding the specific carrying cost rates authorized, the Commission finds that it was appropriate to approve the WACC rate until such time as the recovery mechanism was established in the ESP 2 Case, in order to ensure that AEP-Ohio was fully compensated, and to approve the long-term debt rate from that point forward. As we have noted in other proceedings, once collection of the deferred costs begins, the risk of non-collection is significantly reduced. At that point, it is more appropriate to use the long-term cost of debt rate, which is consistent with sound regulatory practice and Commission precedent.[24] In any event, as

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24 *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company to Adjust Each Company's Transmission Cost Recovery Rider*, Case No. 08-1202-EL-UNC, Finding and Order (December 17, 2008); *In the Matter of the Application of Columbus Southern Power Company and Ohio*

AEP-Ohio notes, OCC's argument is moot. Because the SCM took effect on the same date on which the deferral recovery mechanism was approved in the ESP 2 Case, there was no period in which the WACC rate applied. Accordingly, OCC's and IEU-Ohio's assignments of error should be denied.

Recovery of Deferred Capacity Costs

(107) OCC argues that the Commission erred in allowing wholesale capacity costs, which should be the responsibility of CRES providers, to be deferred for potential collection from customers through the Company's rates for retail electric service established as part of its ESP. OCC asserts that the Commission has no jurisdiction to authorize AEP-Ohio to collect wholesale costs for capacity service from retail SSO customers. OCC contends that nothing in either Chapter 4905 or 4909, Revised Code, enables the Commission to authorize a deferral of wholesale capacity costs that are to be recovered by AEP-Ohio through an ESP approved for retail electric service pursuant to Section 4928.143, Revised Code.

(108) IGS responds that OCC's argument should be addressed in the ESP 2 Case, which IGS believes is the appropriate venue in which to determine whether the deferred capacity costs may be collected through an ESP.

(109) OEG argues that the Commission has no legal authority to order future retail customers to repay the wholesale capacity cost obligations that unregulated CRES providers owe to AEP-Ohio. OMA and OHA agree with OEG that the Commission has neither general ratemaking authority nor any specific statutory authority that applies under the circumstances to order the deferral of costs that the utility is authorized to recover, and that retail customers may not lawfully be required to pay the wholesale costs owed by

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Power Company for Authority to Modify Their Accounting Procedure for Certain Storm-Related Services Restoration Costs, Case No. 08-1301-EL-AAM, Finding and Order (December 19, 2008); *In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Section 4928.144, Ohio Revised Code*, Case No. 11-4920-EL-RDR, *et al.*, Finding and Order (August 1, 2012).

CRES providers to AEP-Ohio. OEG contends that the deferral authorized by the Commission will result in future customers paying hundreds of millions of dollars in above-market capacity rates as well as interest on the deferral. According to OEG, CRES providers should pay the full cost-based capacity price of $188.88/MW-day as AEP-Ohio incurs its capacity costs. Noting that shopping occurred in AEP-Ohio's service territory with a capacity charge of $255/MW-day, OEG asserts that the record does not indicate that a capacity charge of $188.88/MW-day will hinder retail competition and, therefore, there is no reason to transfer the wholesale capacity payment obligation from CRES providers to future retail customers.

Alternatively, OEG requests that the Commission clarify that customers that have reasonable arrangements and certify that they did not shop during the three-year ESP period are exempt from repayment of AEP-Ohio's deferred capacity costs; any deferred capacity costs will be allocated and recovered on the same basis as if the CRES providers were charged the full capacity rate in the first place (*i.e.*, on the basis of demand); and the Company is required to reduce any deferred capacity costs by the relevant accumulated deferred income tax during the recovery period so that the interest expense reflects its actual carrying costs. OEG asserts that payment of the deferred capacity costs should be collected only from CRES providers or shopping customers, which are the entities that will have benefitted from the initial RPM-based capacity pricing.

(110) AEP-Ohio and numerous intervenors disagree with OEG's characterization of the Capacity Order as having represented that the deferral is an amount owed by CRES providers to the Company. AEP-Ohio asserts that the Commission clearly indicated that all customers, including customers with reasonable arrangements, should pay for the deferral because they benefit from the opportunity to shop that is afforded by RPM-based capacity pricing. AEP-Ohio offers a similar response to the contentions of OCC and OMA/OHA that the deferral is solely the obligation of CRES providers. AEP-Ohio notes that all customers benefit

from the provided capacity, which was developed or obtained years ago for all connected load based on the Company's FRR obligations. AEP-Ohio argues that, if the Commission does not permit recovery of the deferred capacity costs from retail customers, the deferred amount should be recovered from CRES providers. AEP-Ohio also requests that the Commission create a backstop remedy to ensure that the full deferred amount is collected from CRES providers, in the event the Company is not able to recover the deferred costs from retail customers as a result of an appeal.

In response to arguments that the Commission lacks statutory authority to approve the deferral, AEP-Ohio asserts, as an initial matter, that such arguments should be raised in the ESP 2 Case, because recovery of the deferral is to be addressed in those proceedings. AEP-Ohio adds that the Commission explained in the Capacity Order that it may authorize an accounting deferral, pursuant to Section 4905.13, Revised Code, and also noted, in the ESP 2 Case, that it may order a just and reasonable phase-in, pursuant to Section 4928.144, Revised Code, for rates established under Section 4928.141, 4928.142, or 4928.143, Revised Code.

(111) FES responds to OEG that the only amount that AEP-Ohio can charge CRES providers for capacity is the RPM-based price and that the deferral does not reflect any cost obligation on the part of CRES providers. FES adds that the deferral authorized by the Commission is an above-market subsidy intended to provide financial benefits to AEP-Ohio and that should thus be paid for by all of the Company's customers, if it is maintained as part of the SCM. FES also asserts that OEG's argument regarding the Commission's lack of statutory authority to order the deferral is flawed, because the Commission's authority to establish the SCM is not based on Chapter 4909, Revised Code, but rather on the RAA.

(112) RESA agrees with FES that the deferred amount is not owed by CRES providers and that the Commission clearly indicated that CRES providers should only be charged RPM-based capacity pricing. RESA notes that, practically

speaking, the deferral authorized by the Commission is the only way in which to maintain RPM-based capacity pricing in AEP-Ohio's service territory, while also ensuring the Company recovers its embedded costs until corporate separation occurs. RESA adds that all customers should pay for the deferral, because all customers have the opportunity to shop and receive the benefit of the RPM-based capacity pricing. RESA contends that the fact that some level of competition may still occur is not justification alone to charge CRES providers $188.88/MW-day. According to RESA, the Commission has the necessary authority to establish the deferral and design the SCM as it did.

(113) According to Duke, OEG misconstrues the nature of a deferral. Duke points out that OEG incorrectly characterizes the deferral as an amount owed to the FRR Entity, rather than an amount reflecting costs incurred but not recovered. Duke also notes that the Commission has specifically directed that CRES providers not be charged more than the RPM-based price. Duke argues that the deferred amount is, therefore, not the obligation of CRES providers. Duke disagrees with OEG's argument that the Commission has no authority to authorize a deferral, noting that, although the Ohio Supreme Court has held that the Commission must fix rates that will provide a utility with appropriate annual revenues, it has not determined that the Commission is barred from ordering a deferral.

(114) The Schools contend that collection of the deferral from CRES providers or customers would cause Ohio's schools serious financial harm. The Schools believe that CRES providers may pass the increase through to their shopping customers under existing contracts or terminate the contracts altogether. The Schools add that, pursuant to AEP-Ohio's proposal for a retail stability rider (RSR) in the ESP 2 Case, the capacity charge adopted by the Commission in this case could result in an increase to the RSR of approximately $550 million, which could lead to rate shock for Ohio's schools.

(115) OMA and OHA contend that the authorized deferral is so large that it will substantially harm customers. They assert that, if AEP-Ohio's shopping projections come to fruition, the amount of the deferral will be approximately $726 million, plus carrying charges, which renders the capacity charge unjust and unreasonable, contrary to Section 4905.22, Revised Code. OMA and OHA conclude that, on rehearing, the Commission should revoke the deferral authority granted to AEP-Ohio or, at a minimum, find that Staff's recommended ROE is reasonable and reduce the cost of the Company's capacity charge by $10.09/MW-day.

(116) AEP-Ohio replies that the arguments of the Schools and OMA and OHA regarding the size and impact of the deferral are premature and speculative, given that their projections are based on a number of variables that are uncertain, such as future energy prices, future shopping levels, and the ultimate outcome in the ESP 2 Case.

(117) FES asserts that, if AEP-Ohio is permitted to recover its full embedded costs, the Commission should clarify that the deferral recovery mechanism is nonbypassable because the excess cost recovery serves only as a subsidy to the Company and, therefore, all of its customers should be required to pay for it. FES believes that a nonbypassable recovery mechanism is necessary to fulfill the Commission's goal of promoting competition. FES also asserts that the Commission should recognize AEP-Ohio's impending corporate separation and direct that the SCM will remain in place only until January 1, 2014, or transfer of the Company's generating assets to its affiliate, in order to avoid an improper cross-subsidy to a competitive, unregulated supplier.

(118) OEG asserts that FES mischaracterizes the Capacity Order in describing the deferral as an above-market subsidy. OEG also contends that the SCM established by the Commission does not consist of a wholesale market-based charge and a cost-based retail charge, as FES believes. According to OEG, the Capacity Order explicitly states that $188.88/MW-day is an appropriate charge to enable AEP-Ohio to recover its capacity costs for its FRR obligations from CRES providers. OEG also notes that the RAA does

not permit capacity costs to be recovered from non-shopping customers pursuant to the SCM. Because the Commission established a wholesale cost-based capacity charge of $188.88/MW-day, OEG believes that the charge must be paid by CRES providers. OEG argues that state law does not authorize the Commission to assess a wholesale charge directly to shopping customers. OEG concludes that the SCM can only apply to CRES providers and that the Commission has no authority to direct that deferred capacity costs be recovered on a nonbypassable basis. OCC agrees with the arguments made by OEG and notes that there is no statutory basis upon which the Commission may order recovery of the deferred capacity costs from all customers under the provisions of an ESP.

(119) OCC also argues that FES' argument for a nonbypassable cost recovery mechanism should be rejected because CRES providers should be responsible for paying capacity costs. OCC notes that, if a wholesale charge applies to retail customers, the result will be unfair competition, double payments, and discrimination in violation of Sections 4905.33, 4905.35, 4928.02(A), 4928.02(L), and 4928.141, Revised Code. OCC argues that non-shopping customers should not have to pay for an anticompetitive subsidy for the sake of competition, which is contrary to Section 4928.02(H), Revised Code. OCC also disagrees with FES' characterization of the Capacity Order as providing a subsidy to AEP-Ohio. According to OCC, there can be no subsidy where AEP-Ohio is receiving compensation for its cost of capacity, as determined by the Commission.

(120) IEU-Ohio also urges the Commission to reject FES' request for clarification and argues that an unlawful and unreasonable charge cannot be made lawful and reasonable simply by making it a nonbypassable charge.

(121) AEP-Ohio argues, in response to FES, that it is lawful and reasonable to continue recovery of the deferral after corporate separation occurs. AEP-Ohio notes that the Commission already rejected FES' arguments in the ESP 2 Case. AEP-Ohio notes that, because its generation affiliate will be obligated to support SSO service through the

provision of adequate capacity and energy, it is appropriate that the affiliate receive the associated revenues.

(122) IEU-Ohio asserts that the Capacity Order does not ensure comparable and non-discriminatory capacity rates for shopping and non-shopping customers, contrary to Sections 4928.02(B), 4928.15, and 4928.35(C), Revised Code. According to IEU-Ohio, the Commission must recognize 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. IEU-Ohio contends that the Commission must 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 capacity pricing and $188.88/MW-day. IEU-Ohio also believes that the Commission's approval of an above-market rate for generation capacity service will unlawfully subsidize AEP-Ohio's competitive generation business by allowing the Company to recover competitive generation costs through its noncompetitive distribution rates, which is contrary to Section 4928.02(H), Revised Code.

(123) Similarly, OCC argues that both shopping and non-shopping customers will be forced to pay twice for capacity in violation of Sections 4928.141, 4928.02(A), and 4928.02(L), Revised Code, and that non-shopping customers will pay more for capacity than shopping customers in violation of Sections 4928.141, 4928.02(A), 4905.33, and 4905.35, Revised Code. OCC believes that, if the deferral is collected from retail customers, the Commission will have granted an unlawful and anticompetitive subsidy to CRES providers in violation of Section 4928.02(H), Revised Code.

(124) In response to OCC, IGS replies that the Capacity Order does not result in a subsidy to CRES providers. IGS notes that the capacity compensation authorized by the Commission is for AEP-Ohio, not CRES providers.

(125) The Commission notes that several of the parties have spent considerable effort in addressing the mechanics of

the deferral recovery mechanism, such as whether CRES providers or retail customers should be responsible for payment of AEP-Ohio's deferred capacity costs, whether such costs should be paid by non-shopping customers as well as shopping customers, and whether the deferral results in subsidies or discriminatory pricing between non-shopping and shopping customers. We find that all of these arguments were prematurely raised in this case. The Capacity Order did not address the deferral recovery mechanism. Rather, the Commission merely noted that an appropriate recovery mechanism would be established in the ESP 2 Case and that any other financial considerations would also be addressed by the Commission in that case. The Commission finds it unnecessary to address arguments that were raised in this proceeding merely as an attempt to anticipate the Commission's decision in the ESP 2 Case. Accordingly, the requests for rehearing or clarification should be denied.

Process

(126) AEP-Ohio asserts that it was unreasonable and unlawful for the Commission to authorize the Company to collect only RPM-based pricing and require deferral of expenses up to $188.88/MW-day without simultaneously providing for recovery of the shortfall. AEP-Ohio argues that the Commission's decision to establish an appropriate recovery mechanism for the deferral in the ESP 2 Case rather than in the present case was unreasonable, because the two proceedings involve unrelated issues and each will be subject to a separate rehearing and appeal process.

(127) OCC agrees that the Commission's decision to address the issue of recovery of the deferral in the ESP 2 Case was unreasonable and unlawful. OCC argues that there is no evidence in the ESP 2 Case related to an appropriate recovery mechanism, which is a separate and distinct proceeding, and that it was particularly unreasonable to defer the issue for decision just one week prior to the filing of reply briefs in the ESP 2 Case.

(128) IGS disagrees with OCC and argues that the Commission's decision to address the deferral in the ESP 2 Case was not unreasonable. IGS points out that the Commission has discretion to decide how to manage its dockets and that it should consider the deferral in the context of AEP-Ohio's total package of rates, which is at issue in the ESP 2 Case.

(129) Constellation and Exelon respond that AEP-Ohio's argument is contrary to its position in September 2011, when the Company sought to consolidate this case and the ESP 2 Case for the purpose of hearing in light of related issues. Duke agrees that AEP-Ohio has invited the review of one issue in multiple dockets and adds that the Commission is required to consider the deferral mechanism in the ESP 2 Case.

(130) RESA and Direct Energy argue that there is no statute or rule that requires the Commission to establish a deferral and corresponding recovery mechanism in the same proceeding. They add that, because recovery of the deferral will require an amendment to AEP-Ohio's retail tariffs, the proper forum to establish the recovery mechanism is the ESP 2 Case.

(131) Additionally, the Schools argue that the Capacity Order is unlawful, because the Commission failed to follow the traditional ratemaking formula and related processes prescribed by Sections 4909.05, 4909.15, 4909.18, and 4909.19, Revised Code. The Schools add that neither Section 4905.22, Revised Code, nor the Commission's general supervisory authority contained in Sections 4905.04, 4905.05, and 4905.06, Revised Code, authorizes the Commission to establish cost-based rates. FES and IEU-Ohio raise similar arguments.

(132) AEP-Ohio responds that arguments that the Commission and the Company were required to conduct a traditional base rate case, following all of the procedural and substantive requirements in Chapter 4909, Revised Code, relevant to applications for an increase in rates, are without support, given that the Commission was acting under its general supervisory authority found in Sections 4905.04, 4905.05, and 4905.06, Revised Code, and pursuant to

Section D.8 of Schedule 8.1 of the RAA. AEP-Ohio asserts that the adjudicatory process used by the Commission was more than sufficient, consisting of extensive discovery, written and oral testimony, cross-examination, presentation of evidence through exhibits, and briefs. AEP-Ohio adds that, even if the ratemaking requirements were strictly applicable, the Commission could have determined that these proceedings involve a first filing of rates for a service not previously addressed in a Commission-approved tariff, pursuant to Section 4909.18, Revised Code. AEP-Ohio argues that the process adopted by the Commission in this case far exceeded the requirements for a first filing.

(133) IEU-Ohio argues that the Commission failed to restore RPM-based capacity pricing, as required by Section 4928.143(C)(2)(b), Revised Code, due to its rejection of the ESP 2 Stipulation. IEU-Ohio contends that the Commission was required to restore the prior provisions, terms, and conditions of AEP-Ohio's prior SSO, including RPM-based capacity pricing, until such time as a new SSO was authorized for the Company.

On a related note, IEU-Ohio asserts that, because the Commission was obligated to restore RPM-based capacity pricing upon rejection of the ESP 2 Stipulation, the Commission should have directed AEP-Ohio to refund all revenue collected above RPM-based capacity pricing, or at least to credit the excess collection against regulatory asset balances otherwise eligible for amortization through retail rates and charges. AEP-Ohio responds that the Commission has recently rejected similar arguments in other proceedings.

(134) Upon review of the parties' arguments, the Commission finds that rehearing should be denied. The Commission believes that the process followed in this proceeding has been proper and well within the bounds of our discretion. As the Ohio Supreme Court has recognized, the Commission is vested with broad discretion to manage its dockets so as to avoid undue delay and the duplication of effort, including the discretion to decide how, in light of its internal organization and docket considerations, it may

best proceed to manage and expedite the orderly flow of its business, avoid undue delay, and eliminate unnecessary duplication of effort.[25] We, therefore, find no error in our decision to address the recovery mechanism for the deferral in the ESP 2 Case, as a means to effectively consider how the deferral recovery mechanism would fit within the mechanics of AEP-Ohio's ESP.

Additionally, we find no merit in the various arguments that the Commission or AEP-Ohio failed to comply with Chapters 4905 and 4909, Revised Code. This proceeding is not a traditional rate case requiring an application from AEP-Ohio under Section 4909.18, Revised Code. Rather, this proceeding was initiated by the Commission in response to AEPSC's FERC filing for the purpose of reviewing the capacity charge associated with AEP-Ohio's FRR obligations. As clarified above, the Commission's initiation of this proceeding was consistent with Section 4905.26, Revised Code, which requires only that the Commission hold a hearing and provide notice to the applicable parties. The Commission has fully complied with the requirements of the statute. We also note that the Ohio Supreme Court has recognized that Section 4905.26, Revised Code, enables the Commission to change a rate or charge, without compelling the public utility to apply for a rate increase pursuant to Section 4909.18, Revised Code.[26]

Finally, the Commission does not agree with IEU-Ohio's arguments that the rejection of the ESP 2 Stipulation necessitated the restoration of RPM-based capacity pricing until such time as a new SSO was authorized for AEP-Ohio, or that the Company should have been directed to refund any revenue collected above RPM-based capacity pricing. As addressed elsewhere in this entry on rehearing, the Commission finds that we have the requisite authority to modify the SCM and the rejection of the ESP 2 Stipulation has no bearing on that authority.

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25 *Duff v. Pub. Util. Comm.*, 56 Ohio St.2d 367, 379 (1978); *Toledo Coalition for Safe Energy v. Pub. Util. Comm.*, 69 Ohio St.2d 559, 560 (1982).

26 *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 110 Ohio St.3d 394, 400 (2006).

Constitutional Claims

(135) AEP-Ohio argues that the SCM, particularly with respect to the energy credit adopted by the Commission, is unconstitutionally confiscatory and constitutes an unconstitutional taking of property without just compensation, given that the energy credit incorporates actual costs for the test period and then imputes revenues that have no basis in actual costs. AEP-Ohio points out that the Commission has recognized that traditional constitutional law questions are beyond its authority to determine; however, the Company raises the arguments so as to preserve its rights on appeal.

(136) In its memorandum contra, OMA argues that the Capacity Order does not result in confiscation or an unconstitutional taking and that AEP-Ohio has not made the requisite showing for either claim. IEU-Ohio responds that neither the applicable law nor the record or non-record evidence cited by AEP-Ohio supports the Company's claims. FES points out that FERC has determined that RPM-based capacity pricing is just and reasonable and, therefore, such pricing is not confiscatory or a taking without just compensation. The Schools argue that AEP-Ohio's constitutional issues would be avoided if the Commission were to recognize that capacity service is a competitive generation service and that market-based rates should apply. The Schools also note that AEP-Ohio, in making its partial takings claim, relies on extra-record evidence from the ESP 2 Case and that the Company's reference to such evidence should be stricken. OCC argues that the Commission does not have jurisdiction to resolve constitutional claims and that, in any event, AEP-Ohio's arguments are without merit and should be denied.

(137) IEU-Ohio also asserts a constitutional claim, specifically contending that the Capacity Order unreasonably impairs the value of contracts entered into between CRES providers and customers under a justified assumption that RPM-based capacity pricing would remain in effect. IEU-Ohio believes that the capacity pricing adopted in the Capacity Order should not apply to such contracts.

(138) AEP-Ohio replies that it is noteworthy that neither the intervenors that are actually parties to the contracts nor OCC seeks rehearing on this issue. AEP-Ohio further notes that IEU-Ohio identifies no specific contract that has allegedly been unconstitutionally impaired. According to AEP-Ohio, the lack of any such contract in the record is fatal to IEU-Ohio's impairment claim. AEP-Ohio adds that customers and CRES providers have long been aware that the Commission was in the process of establishing an SCM that might be based on something other than RPM pricing. Finally, AEP-Ohio points out that IEU-Ohio makes no attempt to satisfy the test used to analyze impairment claims.

(139) The Commission agrees that it is the province of the courts, and not the Commission, to judge constitutional claims. As the Ohio Supreme Court is the appropriate forum for the constitutional challenges raised by AEP-Ohio and IEU-Ohio, they will not be considered here.

Transition Costs

(140) IEU contends that the Commission, in approving an above-market rate for generation capacity service, authorized AEP-Ohio to collect transition revenue or its equivalent, contrary to Section 4928.40, Revised Code, and the stipulation approved by the Commission in the Company's electric transition plan case. AEP-Ohio responds that this argument has already been considered and rejected by the Commission.

(141) As previously discussed, the Commission does not believe that AEP-Ohio's capacity costs fall within the category of transition costs. Section 4928.39, Revised Code, defines transition costs as costs that, among meeting other criteria, are directly assignable or allocable to retail electric generation service provided to electric consumers in this state. As we have determined, AEP-Ohio's provision of capacity to CRES providers is not a retail electric service as defined by Section 4928.01(A)(27), Revised Code. It is a wholesale transaction between AEP-Ohio and CRES

providers. IEU-Ohio's request for rehearing should thus be denied.

Peak Load Contribution (PLC)

(142) IEU-Ohio contends that the Commission unlawfully and unreasonably failed to ensure that AEP-Ohio's generation capacity service is charged in accordance with a customer's PLC factor that is the controlling billing determinant under the RAA. IEU-Ohio argues that AEP-Ohio should be required to disclose publicly the means by which the PLC is disaggregated from AEP East down to AEP-Ohio and then down to each customer of the Company. IEU-Ohio adds that calculation of the difference between RPM-based capacity pricing and $188.88/MW-day will require a transparent and proper identification of the PLC.

(143) The Commission notes that IEU-Ohio is the only party that has identified or even addressed the PLC factor as a potential issue requiring resolution in this proceeding. Additionally, the Commission finds that IEU-Ohio has not provided any indication that there are inconsistencies or errors in capacity billings. In the absence of anything other than IEU-Ohio's mere conclusion that the issue requires the Commission's attention, we find no basis upon which to consider the issue at this time. If IEU-Ohio believes that billing inaccuracies have occurred, it may file a complaint pursuant to Section 4905.26, Revised Code. Therefore, IEU-Ohio's request for rehearing should be denied.

Due Process

(144) IEU-Ohio argues that the totality of the Commission's actions during the course of this proceeding violated IEU-Ohio's due process rights under the Fourteenth Amendment. Specifically, IEU-Ohio believes that the Commission has repeatedly granted applications for rehearing, indefinitely tolling them to prevent parties from taking an unobstructed appeal to the Ohio Supreme Court; repeatedly granted AEP-Ohio authority to temporarily impose various forms of its two-tiered, shopping-blocking capacity charges without record support; failed to address

major issues raised by parties in violation of Section 4903.09, Revised Code; authorized a deferral mechanism without record support and then addressed the details of the deferral mechanism in a separate proceeding where the evidentiary record had already closed; and authorized carrying charges on the deferral at the WACC rate without record support. AEP-Ohio responds that the various due process arguments raised by IEU-Ohio are generally misguided.

(145) In a similar vein, IEU-Ohio contends that the Commission violated Section 4903.09, Revised Code, in that it failed to address all of the material issues raised by IEU-Ohio, including its arguments related to transition revenue; PLC transparency; non-comparability and discrimination in capacity rates; the Commission's lack of jurisdiction to use cost-based ratemaking to increase rates for generation service or through the exercise of general supervisory authority; the anticompetitive subsidy resulting from AEP-Ohio's above-market capacity pricing; and the conflict between the Company's cost-based ratemaking proposal and the plain language of the RAA. AEP-Ohio disagrees, noting that the Commission has already responded to IEU-Ohio's arguments on numerous occasions and has done so in compliance with Section 4903.09, Revised Code.

(146) The Commission again finds no merit in IEU-Ohio's due process claim. This proceeding was initiated by the Commission for the purpose of reviewing AEP-Ohio's capacity charge for its FRR obligations. From the beginning, IEU-Ohio was afforded the opportunity to participate, and did participate, in this proceeding, including the evidentiary hearing. Contrary to IEU-Ohio's claims, the Commission has, at no point, intended to delay this proceeding, but has rather proceeded carefully to establish a thorough record addressing the SCM and AEP-Ohio's capacity costs. Additionally, as discussed throughout this entry on rehearing, the Commission was well within its authority to initiate and carry out its investigation of AEP-Ohio's capacity charge in this proceeding. We find no merit in IEU-Ohio's claim that we acted without evidence in the record. The evidence in this

proceeding is quite extensive, consisting of considerable testimony and exhibits submitted in this proceeding, as well as the consolidated cases. Finally, we do not agree that we have failed to address any of the material issues in violation of Section 4903.09, Revised Code. The Commission believes that the findings of fact and written opinion found in the Capacity Order provide a sufficient basis for our decision. The Commission concludes that we have appropriately explained the basis for each of our orders in this case based on the evidence of record and that IEU-Ohio has been afforded ample process. Its request for rehearing should be denied.

Pending Application for Rehearing

(147) AEP-Ohio argues that it was unreasonable and unlawful for the Commission to fail to address in the Capacity Order the merits of the Company's application for rehearing of the Initial Entry.

(148) In light of the fact that the Commission has addressed AEP-Ohio's application for rehearing of the Initial Entry in this entry on rehearing, we find that the Company's assignment of error is moot and should, therefore, be denied.

It is, therefore,

ORDERED, That OEG's motion for leave to reply filed on August 7, 2012, be denied. It is, further,

ORDERED, That the applications for rehearing of the Initial Entry, Interim Relief Entry, and Capacity Order be granted, in part, and denied, in part, as set forth herein. It is, further,

ORDERED, That the applications for rehearing of the Interim Relief Extension Entry be denied. It is, further,

ORDERED, That a copy of this entry on rehearing be served upon all parties of record in this case.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

Lynn Slaby

SJP/sc

Entered in the Journal
OCT 17 2012
Barcy F. McNeal

Barcy F. McNeal
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

CONCURRING OPINION
OF COMMISSIONER ANDRE T. PORTER

I concur with the majority on the reasoning and result on all issues addressed in this opinion and entry on rehearing except to the extent that my May 30, 2012 statement stands.

A. T. Porter

Andre T. Porter

ATP/sc

Entered in the Journal
OCT 17 2012

Barcy F. McNeal

Barcy F. McNeal
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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

CONCURRING AND DISSENTING OPINION
OF COMMISSIONER CHERYL L. ROBERTO

I dissent from the findings and conclusions in the following paragraphs of the rehearing order: 71, 92, 95,98, 102, 106, 125, and 134.

As I have expressed previously, to the extent that the Commission has authority to determine capacity costs it is because these costs compensate noncompetitive retail electric service. Chapter 4928, Revised Code, defines "retail electric service" to mean any service involved in the supply or arranging for the supply of electricity to ultimate consumers in this state, from the point of generation to the point of consumption. For purposes of Chapter 4928, Revised Code, retail electric service includes, among other things, transmission service.[1] As discussed, *supra*, AEP-Ohio is the sole provider of the Fixed Resource Requirement service for other transmission users operating within its footprint until the expiration of its obligation on June 1, 2015. As such, this service is a "noncompetitive retail electric service" pursuant to Sections 4928.01(A)(21) and 4928.03, Revised Code. This Commission is empowered to set rates for noncompetitive retail electric services. While PJM could certainly propose a tariff for FERC adoption directing PJM to establish a compensation method for Fixed Resource Requirement service, it has opted not to do so in favor of a state compensation method when a state chooses to establish one. When this Commission chooses to establish a state compensation method for a noncompetitive retail electric service, the adopted rate must be just and reasonable based upon traditional cost-of-service principles.

This Commission previously established a state compensation method for AEP-Ohio's Fixed Resource Requirement service within AEP-Ohio's initial ESP. AEP-Ohio received compensation for its Fixed Resource Requirement service through both the provider of last resort charges to certain retail shopping customers and a capacity charge levied on competitive retail providers that was established by the three-year

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

capacity auction conducted by PJM.[2] Since the Commission adopted this compensation method, the Ohio Supreme Court reversed the authorized provider of last resort charges,[3] and the auction value of the capacity charges has fallen precipitously, as has the relative proportion of shoppers to non-shoppers.

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

Additionally, I continue to find that the "deferral" is unlawful and inappropriate. In prior cases, this Commission has levied a rate or tariff on a group of customers but deferred collection of revenues due from that group until a later date. In this instance, the majority proposes to establish a rate for the Fixed Resource Requirement service provided by AEP-Ohio to other transmission users but then to discount that rate such that the transmission users will never pay it. The difference between the authorized rate and that paid by the other transmission users will be booked for future payment not by the transmission users but by retail electricity customers. The stated purpose of this device is to promote competition.

As an initial matter, I am not convinced on the record before us that competition has suffered sufficiently or will suffer sufficiently during the remaining

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2 *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Assets*, Case No. 08-917-EL-SSO, *et al.*, Opinion and Order (March 18, 2009), Entry on Rehearing (July 23, 2009); *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC, Entry (December 8, 2010).

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

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

I find that that the mechanism labeled a "deferral" in the majority opinion is an unnecessary, ineffective, and costly intervention into the market for which no authority exists and that I cannot support.

To the extent that these issues were challenged in rehearing, I would grant rehearing.

- Cheryl L. Roberto

Cheryl L. Roberto

CLR/sc

Entered in the Journal
OCT 17 2012

Barcy F. McNeal

Barcy F. McNeal
Secretary

ATTACHMENT C

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

ENTRY ON REHEARING

The Commission finds:

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

(2) By entry issued on December 8, 2010, in the above-captioned case, the Commission found that an investigation was necessary in order to determine the impact of the proposed change to AEP-Ohio's capacity charge (Initial Entry). Consequently, the Commission sought public comments regarding the following issues: (1) what changes to the current state compensation mechanism (SCM) were appropriate to determine AEP-Ohio's fixed resource requirement (FRR) capacity charge to Ohio competitive retail electric service (CRES) providers, which are referred to as alternative load serving entities within PJM; (2) the degree to which AEP-Ohio's capacity

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1 By entry issued on March 7, 2012, the Commission approved and confirmed the merger of CSP into OP, effective December 31, 2011. *In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals*, Case No. 10-2376-EL-UNC.

charge was currently being recovered through retail rates approved by the Commission or other capacity charges; and (3) the impact of AEP-Ohio's capacity charge upon CRES providers and retail competition in Ohio. Additionally, in light of the change proposed by AEP-Ohio in the FERC filing, the Commission explicitly adopted as the SCM for the Company, during the pendency of the review, the current capacity charge established by the three-year capacity auction conducted by PJM based on its reliability pricing model (RPM).

(3) On January 27, 2011, in Case No. 11-346-EL-SSO, *et al.*, AEP-Ohio filed an application for a standard service offer in the form of a new electric security plan (ESP), pursuant to Section 4928.143, Revised Code (ESP 2 Case).[2]

(4) By entry issued on March 7, 2012, in the above-captioned case, the Commission implemented an interim capacity pricing mechanism proposed by AEP-Ohio in a motion for relief filed on February 27, 2012 (Interim Relief Entry).

(5) By entry issued on May 30, 2012, the Commission approved an extension of the interim capacity pricing mechanism through July 2, 2012 (Interim Relief Extension Entry).

(6) By opinion and order issued on July 2, 2012, the Commission approved a capacity pricing mechanism for AEP-Ohio (Capacity Order). The Commission established $188.88/megawatt-day as the appropriate charge to enable AEP-Ohio to recover its capacity costs pursuant to its FRR obligations from CRES providers. However, the Commission also directed that AEP-Ohio's capacity charge to CRES providers should be the RPM-based rate, including final zonal adjustments, on the basis that the RPM-based rate will promote retail electric competition. The Commission authorized AEP-Ohio to modify its accounting procedures to defer the incurred capacity costs

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2 *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan,* Case No. 11-346-EL-SSO and 11-348-EL-SSO; *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority,* Case No. 11-349-EL-AAM and 11-350-EL-AAM.

not recovered from CRES providers, with the recovery mechanism to be established in the ESP 2 Case.

(7) Section 4903.10, Revised Code, states that any party who has entered an appearance in a Commission proceeding may apply for a rehearing with respect to any matters determined therein by filing an application within 30 days after the entry of the order upon the Commission's journal.

(8) By entry on rehearing issued on October 17, 2012, the Commission granted, in part, and denied, in part, applications for rehearing of the Initial Entry, Interim Relief Entry, and Capacity Order, and denied applications for rehearing of the Interim Relief Extension Entry (Capacity Entry on Rehearing).

(9) On November 15, 2012, Industrial Energy Users-Ohio (IEU-Ohio) filed an application for rehearing of the Capacity Entry on Rehearing. The Ohio Consumers' Counsel (OCC) and FirstEnergy Solutions Corp. (FES) filed applications for rehearing on November 16, 2012. AEP-Ohio filed a memorandum contra the applications for rehearing on November 26, 2012.

(10) In its first assignment of error, IEU-Ohio claims that the Capacity Entry on Rehearing is unlawful and unreasonable, because the Commission cannot rely on Section 4905.26, Revised Code, to apply a cost-based ratemaking methodology in establishing AEP-Ohio's capacity charge for its FRR obligations. Citing Section 4928.05(A)(1), Revised Code, IEU-Ohio contends that AEP-Ohio's capacity service is a competitive retail electric service that cannot be regulated by the Commission under Chapter 4905, Revised Code. IEU-Ohio adds that the Ohio Supreme Court has determined that the Commission cannot use its general supervisory powers to circumvent the statutory ratemaking process enacted by the General Assembly. IEU-Ohio also notes that Section 4905.26, Revised Code, is a procedural statute that does not delegate substantive authority to the Commission to increase a utility's rates. IEU-Ohio asserts that the Commission has found that rates can only be established under Section 4905.26, Revised Code, in limited circumstances, and in

accordance with other ratemaking statutes. According to IEU-Ohio, the determination as to whether a particular rate is unjust or unreasonable can only be made by reference to other provisions of Title 49, Revised Code. IEU-Ohio argues that the Commission neglected to identify any statutory ratemaking criteria for determining whether AEP-Ohio's prior capacity compensation was unjust or unreasonable. IEU-Ohio contends that there is no statute that authorizes the Commission to apply a cost-based ratemaking methodology to increase rates for a competitive retail electric service.

(11) Similarly, OCC's first assignment of error is that the Commission erred in finding that it had authority under Section 4905.26, Revised Code, to initiate this proceeding and investigate AEP-Ohio's wholesale capacity charge. OCC points out that Section 4905.26, Revised Code, governs complaint proceedings that fall within the Commission's general authority under Chapter 4905, Revised Code. OCC contends that Chapter 4905, Revised Code, does not permit the Commission to establish a wholesale capacity charge or an SCM and, therefore, Section 4905.26, Revised Code, is not a source of authority that enables the Commission to investigate and fix AEP-Ohio's wholesale capacity rate. OCC adds that the various procedural requirements of Section 4905.26, Revised Code, were not followed by the Commission in the course of this proceeding. Specifically, OCC notes that the Commission did not find that there were reasonable grounds for complaint prior to the hearing, nor did it find that AEP-Ohio's existing capacity charge was unjust, unreasonable, unjustly discriminatory, unjustly preferential, or in violation of law.

(12) Like IEU-Ohio and OCC, FES asserts that the Capacity Entry on Rehearing is unlawful and unreasonable, because it relied on Section 4905.26, Revised Code, as a source of authority to establish a cost-based SCM. FES contends that, although Section 4905.26, Revised Code, provides the Commission with authority to investigate and set a hearing to review a rate or charge that may be unjust or unreasonable, the statute does not confer jurisdiction to establish a cost-based rate. FES also disputes the

Commission's clarification in the Capacity Entry on Rehearing that the Commission is under no obligation with regard to the specific mechanism used to address capacity costs.

(13) In its memorandum contra, AEP-Ohio notes that the Ohio Supreme Court has repeatedly held that the Commission has broad authority to change utility rates in proceedings under Section 4905.26, Revised Code. In response to IEU-Ohio's argument that the Commission authorizes rates under Section 4905.26, Revised Code, only in limited circumstances, AEP-Ohio asserts that Commission precedent indicates that is the case for self-complaint proceedings, but not for Commission-initiated investigations. AEP-Ohio also points out that IEU-Ohio and OCC offer no authority in support of their contention that Chapter 4905, Revised Code, does not permit the Commission to set wholesale rates. AEP-Ohio notes that nothing in Chapter 4905, Revised Code, limits its application to retail rates. AEP-Ohio further notes that the Commission has often regulated wholesale rates and that its orders have been upheld by the Ohio Supreme Court.

(14) With respect to OCC's argument that the Commission failed to find that reasonable grounds for complaint exist in this case, AEP-Ohio replies that OCC's position is overly technical and without basis in precedent. AEP-Ohio notes that there is no requirement that the Commission must make a rote finding of reasonable grounds for complaint in proceedings initiated pursuant to Section 4905.26, Revised Code. AEP-Ohio believes that, in initiating this proceeding, the Commission implicitly found that there were reasonable grounds for complaint. Similarly, in response to OCC's and IEU-Ohio's argument that the Commission did not comply with Section 4905.26, Revised Code, because it failed to find that RPM-based capacity pricing is unjust or unreasonable, AEP-Ohio notes that the statute does not require the Commission to make such a finding. According to AEP-Ohio, the statute requires the Commission to conduct a hearing, if there are reasonable grounds for complaint that a rate is unreasonable, unjust, unduly discriminatory or preferential, or otherwise in violation of law. AEP-Ohio adds that the Commission

found in the Capacity Order and the Capacity Entry on Rehearing that RPM-based capacity pricing would produce unjust and unreasonable results.

(15) In its second assignment of error, IEU-Ohio asserts that the Capacity Entry on Rehearing is unlawful and unreasonable, because the Commission cannot regulate a wholesale rate, pursuant to Section 4905.04, 4905.05, 4905.06, or 4905.26, Revised Code. Specifically, IEU-Ohio contends that the Commission's regulatory authority under Chapter 4905, Revised Code, extends only to the retail services provided by an electric light company, when it is engaged in the business of supplying electricity for light, heat, or power purposes to consumers within the state. IEU-Ohio notes that the Commission determined in the Capacity Order that the capacity service provided by AEP-Ohio to CRES providers is a wholesale transaction rather than a retail service.

(16) In its memorandum contra, AEP-Ohio notes that IEU-Ohio's argument is contrary to its initial position in this case, which was that the Commission does have jurisdiction to establish capacity rates, pursuant to the option for an SCM under Section D.8 of Schedule 8.1 of the FERC-approved RAA. AEP-Ohio argues that IEU-Ohio's current position is based on an overly restrictive statutory interpretation. AEP-Ohio points out that the characteristics of an entity that determine whether it is a public utility subject to the Commission's jurisdiction do not necessarily establish the extent of, or limitations on, the Commission's jurisdiction over the entity's activities, which is a separate matter. AEP-Ohio reiterates that the Commission's authority under Section 4905.26, Revised Code, is considerable and encompasses regulation of wholesale rates in Ohio.

(17) In its second assignment of error, FES argues that, even if the Commission has authority under Chapter 4905, Revised Code, to establish an SCM, the Commission must nonetheless observe the procedural requirements of Chapter 4909, Revised Code. FES asserts that the Capacity Entry on Rehearing is unreasonable and unlawful, because the Commission upheld a cost-based SCM without

adherence to the mandatory ratemaking formula of Section 4909.15, Revised Code, which requires determinations regarding property valuation, rate of return, and so forth.

(18) AEP-Ohio responds that the Commission already rejected, in the Capacity Entry on Rehearing, the argument that a traditional base rate case was required under the circumstances. AEP-Ohio notes that, although the Commission may elect to apply Chapter 4909, Revised Code, following a complaint proceeding, there is no requirement that it must do so. AEP-Ohio also points out that the Commission has not adjusted retail rates in this case.

(19) In its second assignment of error, OCC contends that the Commission unlawfully and unreasonably determined that OCC's arguments in opposition to the deferral of capacity costs were prematurely raised in this proceeding and should instead be addressed in the ESP 2 Case. OCC asserts that, in declining to resolve OCC's arguments in the present case, the Commission violated Section 4903.09, Revised Code, and unreasonably impeded OCC's right to take an appeal. OCC notes that the Commission has not yet ruled on its application for rehearing in the ESP 2 Case, which has delayed the appellate review process, while AEP-Ohio has nevertheless begun to account for the deferred capacity costs on its books to the detriment of customers.

(20) In response, AEP-Ohio notes that the Commission has already rejected OCC's argument and found that issues related to the creation and recovery of the deferral are more appropriate for consideration in the ESP 2 Case, in which the Commission adopted the retail stability rider (RSR), in part to compensate the Company for its deferred capacity costs. AEP-Ohio adds that, because the Commission did not adjust retail rates in the present case, and the RSR was adopted in the ESP 2 Case, there is no harm resulting from the Commission's decision in this docket.

(21) In the Capacity Entry on Rehearing, the Commission clarified that our initiation of this proceeding for the purpose of reviewing AEP-Ohio's capacity charge was

consistent with Section 4905.26, Revised Code.[3] In relevant part, the statute provides that, upon the initiative or complaint of the Commission that any rate or charge is in any respect unjust, unreasonable, unjustly discriminatory, unjustly preferential, or in violation of law, if it appears that reasonable grounds for complaint are stated, the Commission must schedule, and provide notice of, a hearing. The Ohio Supreme Court has found that the Commission has considerable discretion under the statute, including the authority to conduct an investigation and fix new utility rates, if the existing rates are unjust and unreasonable. *See, e.g., Ohio Consumers' Counsel v. Pub. Util. Comm.*, 110 Ohio St.3d 394, 400 (2006); *Allnet Communications Services, Inc. v. Pub. Util. Comm.*, 32 Ohio St.3d 115, 117 (1987); *Ohio Utilities Co. v. Pub. Util. Comm.*, 58 Ohio St.2d 153, 156-158 (1979). The Court has also stated that utility rates may be changed by the Commission in a complaint proceeding under Section 4905.26, Revised Code, without compelling the utility to apply for a rate increase under Section 4909.18, Revised Code. *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 110 Ohio St.3d 394, 400 (2006). The Commission, therefore, disagrees with the arguments of IEU-Ohio, FES, and OCC that are counter to this precedent.

(22) Further, we find no requirement in Ohio Supreme Court precedent or anywhere else that the Commission must first invoke Chapter 4909, Revised Code, or some other ratemaking authority, prior to fixing new utility rates, if the Commission finds that the existing rates are unjust and unreasonable following a proceeding under Section 4905.26, Revised Code. As noted above, precedent is to the contrary.

(23) With respect to IEU-Ohio's interpretation of Commission precedent, we disagree that rates can only be established under Section 4905.26, Revised Code, in limited circumstances. The Commission precedent cited by IEU-Ohio is inapplicable here, as it specifically pertains to self-complaint proceedings initiated by a public utility. *In the Matter of the Self-Complaint of Suburban Natural Gas*

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3 Capacity Entry on Rehearing at 9-10, 13, 29, 54.

Company Concerning its Existing Tariff Provisions, Case No. 11-5846-GA-SLF, Opinion and Order, at 6 (August 15, 2012).

(24) Additionally, we find no merit in the argument that the procedural requirements of Section 4905.26, Revised Code, were not followed in this case, which was initiated by the Commission in response to AEP-Ohio's FERC filing. In the Initial Entry, the Commission noted that this proceeding was necessary to review and determine the impact of the proposed change to AEP-Ohio's capacity charge.[4] We believe that the Initial Entry provided sufficient indication of the Commission's finding of reasonable grounds for complaint that AEP-Ohio's capacity charge may be unjust or unreasonable. We agree with AEP-Ohio that there is no precedent requiring the Commission to use rote words tracking the exact language of the statute in every complaint proceeding. In any event, to the extent necessary, the Commission clarifies that there were reasonable grounds for complaint that AEP-Ohio's proposed capacity charge may have been unjust or unreasonable. Also, as previously discussed, the Commission may establish new rates under Section 4905.26, Revised Code, if the existing rates are unjust and unreasonable, which is exactly what has occurred in the present case. In the Interim Relief Entry, the Commission determined that RPM-based capacity pricing could risk an unjust and unreasonable result for AEP-Ohio and subsequently confirmed, in the Capacity Order, that such pricing would be insufficient to yield reasonable compensation for the Company's capacity service.[5]

(25) We find no merit in the parties' arguments that the Commission is precluded from regulating wholesale rates under Chapter 4905, Revised Code, or Section 4905.26, Revised Code, in particular, and the parties offer no precedent in support of their position. Neither Section 4905.26, Revised Code, nor any other provision of Chapter 4905, Revised Code, prohibits the Commission from initiating a review of a wholesale rate. For its part, IEU-

4 Initial Entry at 2.

5 Interim Relief Entry at 16-17; Capacity Order at 23; Capacity Entry on Rehearing at 18, 31.

Ohio contends that the Commission's regulatory authority under Chapter 4905, Revised Code, is limited to an electric light company engaged in the business of supplying electricity to consumers (*i.e.*, as a retail service). Because the Commission determined that the capacity service provided by AEP-Ohio to CRES providers is a wholesale, not retail, transaction, IEU-Ohio believes that the Commission's reliance on Section 4905.26, Revised Code, as well as Sections 4905.04, 4905.05, 4905.06, Revised Code, is unreasonable and unlawful. However, from the outset of this proceeding, the Commission clearly indicated that the review of AEP-Ohio's proposed capacity charge would be comprehensive in scope and include consideration of other related issues, including the impact on retail competition and the degree to which the Company's capacity costs were already being recovered through retail rates.[6]

(26) Next, we find no error in our clarification that, although the Commission must ensure that the jurisdictional utilities receive just and reasonable compensation for the services that they render, the Commission is under no obligation with regard to the specific mechanism used to address capacity costs.[7] We did not find, as FES contends, that the Commission's ratemaking powers are unbounded by any law. Rather, we clarified only that the Commission has discretion to determine the type of mechanism implemented to enable a utility to recover its capacity costs, and that the recovery mechanism may take the form of an SCM, rider, or some other mechanism.

(27) In its remaining arguments, IEU-Ohio contends that AEP-Ohio's capacity service is a competitive retail electric service, rather than a wholesale transaction, and again disputes our reliance on the Commission's general supervisory powers under Sections 4905.04, 4905.05, and 4906.06, Revised Code, as authority to establish the SCM. These arguments were already rejected by the Commission in the Capacity Entry on Rehearing,[8] and IEU-Ohio has

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6 Initial Entry at 2.

7 Capacity Entry on Rehearing at 28.

8 Capacity Entry on Rehearing at 28-29.

raised nothing new for our consideration with respect to these issues.

(28) Finally, we do not agree with OCC that it was unreasonable and unlawful, or in violation of Section 4903.09, Revised Code, to find that arguments regarding the mechanics of the deferral recovery mechanism should be raised and addressed in the ESP 2 Case. The Commission did not outline the mechanics of, or even establish, the deferral recovery mechanism in the Capacity Order. Rather, we indicated that an appropriate recovery mechanism for AEP-Ohio's deferred costs would be established, and any additional financial considerations addressed, in the ESP 2 Case.[9] Although numerous parties, including OCC, attempted to predict how the deferral mechanism would be implemented and what its impact would be on ratepayers, the Commission continues to find that it would have been meaningless to address such anticipatory arguments in the Capacity Entry on Rehearing. We, therefore, find no error in having determined that OCC's claims of unfair competition, unlawful subsidies, double payments, and discriminatory pricing were premature, given that the Commission had not yet determined how and from whom AEP-Ohio's deferred capacity costs would be recovered.[10] The Commission notes that we thoroughly addressed OCC's other numerous arguments with respect to the deferral of capacity costs in the Capacity Entry on Rehearing.

(29) For the above reasons, we find no error in our clarifications in the Capacity Entry on Rehearing, or in determining that arguments related to the mechanics of the deferral recovery mechanism should be resolved in the ESP 2 Case. Any other arguments raised on rehearing that are not specifically discussed herein have been thoroughly and adequately considered by the Commission and are being denied. Accordingly, the Commission finds that the applications for rehearing filed by IEU-Ohio, OCC, and FES should be denied in their entirety.

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9 Capacity Order at 23.

10 Capacity Entry on Rehearing at 50-51.

It is, therefore,

ORDERED, That the applications for rehearing filed by IEU-Ohio, OCC, and FES be denied in their entirety. It is, further,

ORDERED, That a copy of this entry on rehearing be served upon all parties of record in this case.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Steven D. Lesser

Andre T. Porter

Cheryl L. Roberto

Lynn Slaby

SJP/sc

Entered in the Journal DEC 12 2012

Barcy F. McNeal
Secretary

PROOF OF SERVICE

I certify that the *Notice of Cross-Appeal of Ohio Power Company* was served by First-Class U.S. Mail or hand delivery upon the Chairman of the Public Utilities Commission of Ohio and the Appellant and by electronic mail upon counsel for all parties to the proceeding before the Public Utilities Commission of Ohio, identified below, this 11th day of February, 2013.

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