BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission's Investigation of Ohio's Retail Electric Service Market	)))	Case No. 12-3151-EL-COI

INITIAL COMMENTS OF OHIO POWER COMPANY

INTRODUCTION

Through an Entry dated December 12, 2012, the Commission initiated this investigation and solicited comments on a series of questions. The Ohio Power Company (AEP Ohio) hereby submits initial comments to address matters raised in the Entry. These comments are organized along the same lines as the issues that were raised in the Entry. AEP Ohio reserves the right to address in its reply comments any issue addressed by another party.

INITIAL COMMENTS

I. MARKET DESIGN (MD) QUESTIONS

MD Question (a): Does the existing retail electric service market design present barriers that prevent customers from obtaining, and suppliers from offering, benefits of a fully functional competitive retail electric service market? To the extent barriers exist, do they vary by customer class?

In elaborating on its response to the specific questions in the Market Design portion of the Entry, AEP Ohio would like to address at the outset several threshold legal and policy matters relating to the current standard service offer (SSO) structure for providing default generation service for customers that do not shop.

The Commission should only be concerned with an artificial, unlawful and unreasonable "barrier"

As a definitional matter, in examining whether barriers exist, the Commission should be clear about what does and does not constitute an artificial, unreasonable or unlawful barrier to retail competition *vis-à-vis* the utility's SSO. Not all barriers are necessarily artificial, unlawful or unreasonable, especially if there is a factual or regulatory background that explains the context or circumstances or there is a transition involved from a legacy regulatory policy to a fully competitive market position. For example, the fact that shopping levels were low because competitive market prices were higher than regulated rates of some Ohio utilities for a number of years leading up to the 2008 economic collapse and prior to the shale gas developments affecting Ohio does not yield a conclusion that there were artificial, unlawful or unreasonable barriers to a competitive market during that time period; it just means that market prices were higher than regulated prices and that meaningful economic opportunities for retail shopping were relatively unusual during that period. Another obvious example is that, like other utility businesses, providing competitive generation service can be capital intensive and require a scope and scale of operations that may not be available to many firms; while those requirements of market entry are not artificial, unlawful or unreasonable barriers, they are typical barriers to entry that firms face in a variety of product markets. Similarly, effective mass marketing resources and the ability to serve large-scale governmental aggregation opportunities is simply not economically feasible to all firms desiring to do so. Thus, the Commission should be clear in its examination of barriers to ensure that it is only critiquing artificial, unlawful and unreasonable barriers to competition.

Existing legal framework and regulatory decisions regarding the SSO structure must be followed

Understanding the controlling legal framework and consideration of historical regulatory context are also important when entertaining changes to the existing SSO structure. This is particularly critical during the present period of transition to fully competitive markets. Specifically, as further discussed below, the existing SSO rate plans approved by the Commission should not be disturbed and changes to the SSO structure can only be considered on a strictly prospective manner, following expiration and full implementation of the approved rate plans.[1]

It is also important for the Commission to acknowledge – as it has in the past – that Ohio's current regulatory/legal SSO structure does not require a purely competitive market-based approach.[2] Some commenters may argue that anything but pure market prices for SSO pricing is improper and serves as a barrier to competition – indeed, this perspective may have been the premise of some of the questions raised in the Entry. A

[1] For AEP Ohio, this means the Modified ESP approved in Case Nos. 11-346-EL-SSO which extends through mid-2015 and also involves recovery of capacity deferrals for up to three years after that. For simplicity, other portions of these comments may refer to mid-2015 as the potential crossover point, but the full recovery of capacity deferrals will always remain essential for AEP Ohio.

[2] As the Commission is aware, AEP Ohio supports and has proposed an ESP plan that achieves a fully market-based SSO structure even more quickly than an MRO would require – and the Commission has modified and adopted the proposal. Thus, while AEP Ohio supports the goal of quickly achieving market-based SSO structure under the terms and conditions of the Modified ESP adopted by the Commission, there is no statutory requirement to do so.

brief examination of the controlling Ohio law shows that full competition and pure market prices are not required under the current legal framework for SSO pricing.

SB 221's hybrid re-regulatory approach does not require market rates (even under the so-called market rate offer) until after a long transition period – but it does permit cost-based rate adjustments, among other features. One stark difference between SB 221 and the prior law (SB 3) is that SB 221 requires an additional 6-10 year transition period to get to fully market-based rates. While the original SB 221 (as enrolled) contained language in R.C. 4928.142 that enabled the Commission to more aggressively blend market rates and SSO rates under the MRO rate blending transition period (which also applies indirectly to ESP plans through application of the MRO test), a subsequent piece of legislation passed later in 2008 made the 6-10 year transition to market mandatory and removed the Commission's discretion to adopt a quicker transition period. *See* Am.Sub.H.B. No. 562. In any event, SB 221's ultimate extended transition period to market pricing (which applies directly and indirectly to an MRO and an ESP, respectively) severely undercuts any notion that today's SSO rates must be fully market-based and cannot have cost-based rate adjustments. To the extent that some of the questions raised in the Entry or by commenters employ a premise that SSO plans must be fully market based, there is no support for that conclusion in current law.

Some commenters in this proceeding may, nonetheless, focus on SB 3 and hearken back to the deregulatory vision and goals of that legislation, while conveniently ignoring the fact that the basic purpose of SB 3 (to complete the transition to market pricing by 2006) failed and ignoring that SB 3 was eventually replaced by a hybrid regulatory-market approach adopted under SB 221; that legislation substantially changed the standard service offer (SSO) pricing regime in 2009 from being market-based to being a hybrid approach that incorporates cost-based rate adjustments. That hybrid regulatory regime remains effective today and SB 3's requirement for "market-based" SSO pricing was repealed in 2008. The indisputable reality is that both the law and the facts have changed since the passage of SB 3 and there are other intervening developments that make a flash-cut extrication from regulated to market pricing difficult and complex. Although the passage of SB 221 was not a U-turn in regulatory policy, the reality is that the General Assembly did turn a sharp corner when it passed SB 221; most notably, the singular provision in RC 4928.14 requiring market-based SSO rates was repealed. Under SB 221, the SSO must be offered by the electric distribution utility (EDU) under one of two very different options.

While the EDU must offer the SSO, the utility alone has the choice (and is not required) to pursue the market rate offer (MRO) option. Even the MRO involves a new and extended period of transition prior to reaching fully market-based rates. More specifically, the MRO option does not involve a flash-cut to fully competitive market rates but involves a 6-10 year transition. Alternatively, the utility may consent to an Electric Security Plan (ESP), which is more regulatory in nature, with flexible pricing such as automatic (but regulatory-prescribed) rate increases. While flexible, the ESP rate plan must be more favorable in the aggregate than the expected results under an MRO; thus, while it is not a mechanical or purely quantitative comparison, an ESP rate plan is indirectly subject to roughly the same pricing parameters as an MRO (long transition period before charging market rates). Thus, neither an MRO nor an ESP mirrors market rates.[3]

Unlike the prevailing assumption during passage of SB 3 that market rates would be lower than regulated rates, the General Assembly's new regime in passing SB 221 was, in fact, premised upon market rates being higher than existing rates. As former Chairman Schriber testified in support of SB 221 being adopted, "[t]here is significant evidence demonstrating that the prices customers are paying [under the Rate Stabilization Plans in effect through 2008] are less costly than those that would result from market-based prices." (Exhibit A at 3.) Indeed, the Commission's *ESP I* decision[4] found that the cost of AEP Ohio's[5] first ESP ($1.4 billion) was less than half the expected cost of an MRO ($2.9 billion). (*ESP I*, Opinion and Order at 72.) This finding was based on the statutory MRO test and concluded that the *ESP I* plan provided a benefit of $1.5 billion

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[3] Of course, an MRO would likely be pursued if market rates are higher than legacy SSO rates for a particular utility. In that instance, SB 221's 6-10 transition period is designed to ease ratepayers into higher market prices over a significant period of transition. If market rates are lower and a utility stays with the ESP option, the "MRO test" is applies to ensure that the ESP, in the aggregate, is more favorable than the expected results of an MRO. In addition, a utility could also stay with the ESP option during a period in which market rates are higher and propose rates that are much more favorable than the expected results under an MRO; for example, the Commission found that AEP Ohio's initial ESP for 2009-2011 was more than $1 billion cheaper than an MRO. In any case, neither the MRO nor the ESP option requires SSO rates to be equal to market-based rates.

[4] *In the Matter of the Application of Columbus Southern Power Company for Approval of its 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.

[5] Ohio Power Company (dba AEP Ohio) formerly consisted of two separate companies, Columbus Southern Power Company (CSP) and Ohio Power Company (OPCo). Effective at the end of 2011, CSP merged into OPCo with OPCo being the surviving entity.

as compared to an MRO. Based on the projections of high market rates with relatively lower legacy SSO rates, SB 221 established a new and extended transition period to very gradually subject customers to market rates over a period of several years.

Of course, the General Assembly could not have envisioned the lower prices driven by shale gas or the major economic recession, both of which are significant events that developed after passage of SB 221. In light of these changes in market conditions that have combined to dramatically reduce both capacity and energy market prices, it is understandable that the Commission, the competitors, and customer groups all want to get to market prices as quickly as possible. That result, however, is not required under law or under Ohio energy policies. Yet, AEP Ohio's Modified ESP will complete a transition to fully market-based SSO pricing much quicker than is even possible under an MRO – as the Commission has already acknowledged.

AEP Ohio's current transition to a fully market-based SSO is already yielding benefits and must be left intact for the remaining term

In fact, the Commission has recently decided AEP Ohio's *ESP II* case (Case Nos. 11-346-EL-SSO *et al.*) and *Capacity Charge* case (Case No. 10-2929-EL-UNC). These two major decisions were reached after multiple stages of protracted litigation using a process where all competitive interests were presented and extensively argued. More to the point, the Commission has reached these adjudicated decisions that definitively resolve AEP Ohio's default SSO plan and related competitive issues in the *ESP II* case for the period of 2012 through mid-2015 and *Capacity Charge* case for a period extending further into the future.

The *ESP II* and *Capacity Charge* decisions must be respected and should not be disturbed as part of a generic industry proceeding such as this investigation. *Res judicata* and collateral estoppel both apply to administrative proceedings such as those conducted by the Commission. *Superior's Brand Meats. Inc. Lindley*, 62 Ohio St.2d 133 syllabus (1980) (The doctrine of collateral estoppel is an important element of our legal system. It provides a necessary degree of finality to decisions rendered by our courts. Finality is a desirable objective in administrative proceedings as well). The Commission should not do anything in this investigation to undermine the finality of the adjudicative decisions in the AEP Ohio *ESP II* and *Capacity Charge* cases.

Moreover, the Commission should not undermine the unique opportunity and important objectives that were accomplished through the *ESP II* decision. In amending and adopting the Modified ESP proposal, the Commission recognized that the Modified ESP enabled important pro-competitive results that would not otherwise be achieved:

> Although the decision for AEP Ohio to transition towards competitive market pricing is something this Commission strongly supports and the General Assembly anticipated in enacting Senate Bill 221, the fact remains that <u>the decision to move towards competitive market pricing is voluntary under the statute</u> and in the event this ESP is withdrawn or even replaced with an MRO, there is no doubt that AEP Ohio would not be fully engaged in the competitive marketplace by June 1, 2015.
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> The most significant of the non-quantifiable benefits is the fact that in just under two and a half years, AEP Ohio will be delivering and pricing energy at market prices, which is significantly earlier than what would otherwise occur under an MRO option. <u>If AEP Ohio were to apply for an MRO it is not feasible to conclude that energy would be at market prices prior to June 1, 2015, even if the Commission were to accelerate the percentages set forth under Section 4928.142, Revised Code.</u>

ESP II, Opinion and Order at 76 (emphasis added). AEP Ohio already has an aggressive and beneficial plan to implement full corporate separation and quickly achieve a fully market-based SSO structure. No changes to the SSO structure should be considered in this docket for implementation prior to expiration of AEP Ohio's ESP II term (*i.e.*, mid-2015).

Beyond AEP Ohio, there is a larger, statewide trend toward full corporate separation. As of next year (2014), full legal separation should be completed for FirstEnergy, Duke and AEP. Fully market-based SSO offerings will be made for the same three major electric utilities by 2015. Where SSO load is served based on a competitive bidding process, it cannot be said that any competitive advantage exists for a generation affiliate. Rather than entertain changes to the legal or regulatory structure at this time, the Commission should see through the existing transition periods and ensure that the current law is fully implemented. After the existing transitions are completed, then additional pro-competitive changes to the regulatory and/or legal structure of the SSO can be considered and AEP Ohio will be open to further pursuing such matters at that time. As referenced above, however, the specific circumstances of each electric utility were considered and aggressive plans toward full competition have been adopted for each of the three largest electric utilities in Ohio. In evaluating the issues raised in this docket, the Commission should not disturb the electric utilities' existing rate plans and transition activity.

Even beyond the legal considerations of the controlling statutory constraints and the binding principles of *res judicata*, there are serious public interest and competitive benefits at stake if the AEP Ohio plan is not permitted to run its course. As the Commission has already found, the companion decisions in the *ESP II* and *Capacity Charge* cases aggressively promote retail competition in AEP Ohio's service territory and provide the best path forward for AEP Ohio to achieve a fully market-based SSO structure – even quicker than is possible under a MRO. *See ESP II*, Opinion and Order at 32 (it is extremely beneficial for AEP Ohio's customers to have the fixed rate SSO plan available through the term of the plan), 76 (the quicker-than-an-MRO transition to fully-market-based SSO is "the most significant of the non-quantifiable benefits" and will fulfill the General Assembly's long-term goal of achieving retail competition). *See also Capacity Charge*, Opinion and Order at 23 (the adopted pricing mechanisms will "stimulate true competition among suppliers" and it "a reasonable means of promoting shopping in AEP Ohio's service territory"), 33 (the plan will "encourage the further development of retail competition"), and 35 (the pricing plan will "enable the further development of competition in the Company's service territory"). Thus, the Commission has definitively found through the *ESP II* and *Capacity Charge* decisions that the Modified ESP advances retail competition, is in the public interest, and is the best path forward for AEP Ohio and its customers from 2012-2015.

The Commission's prediction of rapidly expanding retail competition in AEP Ohio's service territory is materializing. In recent months, shopping in the Company's service territory has continued to increase at a steady rate of approximately 1-2% per month. By the end of 2012, more than 50% of AEP Ohio retail load had switched to a CRES provider, with some customer classes experiencing shopping as high as 70% by load. As discussed above, the current plan for quickly achieving a fully market-based SSO structure for AEP Ohio has been adopted and should not be disturbed.

Conclusions on MD Question (a): there are no current barriers but any regulatory proposals to change the SSO structure must be prospectively implemented after expiration of the current SSO plans and the process for any related legislative proposals should be conducted before the General Assembly

Given the foregoing context, AEP Ohio submits that the existing Ohio market design does not have artificial, unlawful or unreasonable barriers to entry for retail CRES providers. As a general matter, AEP Ohio believes that the Commission has reasonably implemented the retail competition provisions of S.B. 221 and before that S.B. 3, such that barriers to entry are minimized and retail competition has developed in a fair and reasonable pace. The Commission has consistently addressed competitive barriers along the way and continues to aggressively pursue a fully market-based SSO environment.

Any proposals coming out of this investigation (including any resulting legislative proposals) should only be considered strictly in a prospective manner upon completion of an EDU's existing rate plan. While AEP Ohio may be open to prospective changes to, or elimination of, the EDU's SSO obligation – after the Company's existing rate plan is fully implemented – the proper venue for discussion of changes to Ohio law is the General Assembly. Therefore, AEP Ohio does not wish to elaborate here about what options exist or whether it would agree or endorse them, particularly since such an agreement would necessarily depend on the total package of proposals being considered and would not relate to specific issues or positions in isolation.

MD Question (b): Does default service provide an unfair advantage to the incumbent provider and/or its generation affiliate(s)?

As discussed above, current law requires EDUs to provide default service through the SSO and that legal duty cannot be altered unless the General Assembly amends R.C. Chapter 4928. Moreover, current law envisions existence of a generation affiliate and specifically addresses competitive issues where appropriate. For example, the ESP statute requires EDUs to offer an SSO and specifically contemplates and permits purchase of energy and capacity from an affiliate. R.C. 4928.143(B)(2)(a). As a related matter, R.C. 4928.17 addresses corporate separation and imposes code of conduct restrictions, as amplified through administrative rules adopted by the Commission. Thus, by necessity, following the law does not provide anyone with an "unfair" advantage. Asserting otherwise would require a conclusion that Ohio law is unjust, unreasonable and/or anticompetitive.

The reality is that the existing hybrid SSO structure strikes a balance between competition and regulation and it is a misnomer to label certain aspects of that structure as creating an "unfair" advantage or as being anticompetitive – when competition and regulation are both simultaneously hard-wired into the law. As former Commission Chairman Schriber testified in support of SB 221 before it was adopted "SB 221 is a sensible balance between regulation and competition as it provides utilities with the option of pursuing either a competitive market pricing plan or an electric security plan." (Exhibit A at 7.) There can be no doubt that neither ESP nor MRO plans dictate market prices or give the utility an advantage by not charging market prices.

The related reality is that providing the SSO is a serious obligation that entails financial risk and can constrain a utility's flexibility including pursuing more profitable opportunities. Upon the effective date of its ESP, AEP Ohio was locked into providing SSO service for three years at the approved rates – no matter what else happens. If the economy recovers and market prices substantially increase, AEP Ohio will provide SSO service at the approved rates. If one or more of AEP Ohio's generation units suffers a catastrophic failure, AEP Ohio will provide SSO service at the approved rates. If new costly environmental requirements are imposed during the term of the ESP, AEP Ohio will provide SSO service at the approved rates. If customers all shop this year based on favorable market conditions and they all return during the last year of the ESP, AEP Ohio will provide SSO service at the approved rates. Under normal circumstances, this default service obligation – also known as the Provider of Last Resort obligation – is a serious obligation that carries significant business and financial risks. Under the extraordinary circumstances presented by the total restructuring of AEP Ohio, the default service obligation takes on even greater business and financial risks.

This Commission frankly acknowledged this principle recently when implementing SB 221 as part of the *ESP II* decision:

> The ability for AEP Ohio to maintain a fixed SSO rate is valuable, particularly if an unexpected, intervening event occurs during the term of the ESP, which could have the effect of increasing market prices for electricity. <u>The ability for all customers within AEP Ohio's service territory to have the option to return to AEP Ohio's certain and fixed rates allows customers to explore shopping opportunities. This is an extremely beneficial aspect</u> … and is undoubtedly consistent with legislative intent in providing that electric security plans may include retail electric service terms, conditions, and charges that relate to customer stability and certainty.

ESP II, Opinion and Order at 32 (emphasis added). Thus, the Commission found that the SSO rate was "extremely beneficial" in light of uncertain market rates during the term of the rate plan. The SSO obligation is a serious financial obligation and cannot be selectively viewed as conveying an unfair advantage on the EDU. As the Commission understands from its adjudication of the electric utilities' existing SSO rate plans, there is a cost to imposing more financial obligations and risk on the EDUs and any changes to the SSO structure that add risk/cost would need to be reflected in rates.

Under the market-based SSO structure approved in the *ESP II* decision and currently being actively implemented[6] by AEP Ohio under the *ESP II* decision, all suppliers will have an equal opportunity to serve SSO load and compete with competitive CRES offers that are serving the remaining load. Any change to the utility's SSO obligation should be done prospectively and without disturbing existing rate plans during the approved term of the plan. In any case, changing or eliminating an electric utility's SSO obligation would require, as a condition precedent, a corresponding set of legislative changes to overhaul the statutory SSO structure. AEP Ohio does not wish to speculate in these comments on the host of possibilities for changing R.C. Chapter 4928 but instead will engage in such activities, as needed, before the General Assembly.

If there is any advantage given to the EDU, it is by virtue of the statutory structure imposed by current law, which reflects a hybrid mixture of competitive and regulatory features as well as serious financial obligations of the EDU that was deemed by the General Assembly to be in the best interests of Ohio.

<u>MD Question (c):</u> Should default service continue in its current form?

The SSO obligation should continue in its current form for at least as long as the term of each EDU's current rate plan. Any legislative changes to the SSO obligation should only take effect after the current rate plans expire. As discussed above, the MRO/ESP model has worked pretty well and has fostered competition throughout Ohio. Three of the major electric utilities are on a clear path to a fully market-based SSO structure. In AEP Ohio's service territory, more than half of retail load has shopped and,

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6 *See* Case No. 12-3254-EL-UNC, *In the Matter of the Application of Ohio Power Company to Establish a Competitive Bidding Process for Procurement of Energy to Support its Standard Service Offer.*

in some customer classes, switching is as high as 70% by load. As referenced above, the fast track to a fully market-based SSO recently adopted for AEP Ohio should be fully implemented before any prospective changes are made.

<u>MD Question (d):</u> Does Ohio's current default service model impede competition, raise barriers, or otherwise prevent customer from choosing electricity products/services tailored to their individual needs?

No. See the Company's responses to MD Questions (a) and (b) above.

<u>MD Question (e):</u> Should Ohio continue a hybrid model that includes an ESP and MRO option?

Until the General Assembly amends R.C. Chapter 4928, current law requires the EDU to provide the default SSO through either an MRO or an ESP. Within the framework of the current law, there are various ways to enhance the pro-competitive nature of default generation service through the SSO, but those means must be pursued within the context of an MRO or an ESP – both alternatives require the utility to opt into the program. Because the MRO is largely prescriptive and permanent, it is not as flexible as an ESP; thus, an ESP offers the greatest flexibility to assemble a pro-competitive package of terms and conditions – subject to the utility's consent. The Modified ESP adopted by the Commission for AEP Ohio aggressively facilitates and promotes retail competition and any SSO changes being discussed in this docket should respect the existing plan. For related discussion points, see the Company's responses to MD Questions (a) and (c) above.

In addition, the ESP option also can incorporate features not directly related to generation service – such as distribution infrastructure improvement plans. If the SSO structure is substantially modified through legislation, such wires-related issues will need to be addressed. For example, mechanisms such as AEP Ohio's Distribution Investment Rider could be incorporated as an option within base ratemaking statutes that is no longer tied to the SSO. Such matters would be addressed before the General Assembly if changes to the ESP statute are proposed.

MD Question (f): How can Ohio's electric default service model be improved to remove barriers to achieve a properly functioning and robust competitive retail electric service electricity market?

Not applicable. See the Company's response to MD Question (a) above.

MD Question (g): Are there additional market design changes that should be implemented to eliminate any status quo bias benefit for default service?

No. See the Company's response to MD Question (a) above.

MD Question (h): What modifications are needed to the existing default service model to remove any inherent procurement (or other cost) advantages for the utility?

Not applicable. See the Company's response to MD Question (a) above.

MD Question (i): What changes can the Commission implement on its own under the existing default service model to improve the current state of retail electric service competition in Ohio?

Many of the questions asked in the "Market Design" section may elicit answers that require a change in law prior to the Commission being able to implement them, especially since the apparent premise of many of the questions is achieving a fully market-based SSO structure. The current SSO structure involves the following four key features:

- EDU is obligated to offer the SSO

- EDU is the default supplier when a customer doesn't shop
- EDU is the backup provider when CRES defaults
- MRO or ESP are the only two choices and there is no requirement for immediate market pricing

To the extent the Commission wants to change these features of the default SSO or modify or eliminate the MRO or ESP options, the General Assembly must approve a change in the law first. As discussed above, such changes should only be entertained prospectively after existing SSO rate plans expire and are fully implemented. Of course, the Modified ESP approved for AEP Ohio will already achieve a fully market-based SSO rates at the end of the term (less than two and one-half years from now). See the Company's response to MD Question (a). As a related matter, the *Capacity Charge* decision involving AEP Ohio was explicitly designed by the Commission to boost retail shopping, which has occurred as explained above.

AEP Ohio also suggests, as further described below, that the Commission consider adopting a competitive market improvement relating to uncollectible/credit risks: to incorporate within the SSO structure for all EDUs a non-bypassable bad debt rider to cover uncollected revenue for both shopping and non-shopping customers. The improvement proposed by AEP Ohio would promote competition while mitigating financial risks for both CRES Providers and EDUs. And this improvement does not require additional legislation or disturb pre-existing rate plans.

AEP Ohio has obtained a waiver from several rules from the Commission (Case No. 11-5544-EL-WVR) to establish payment plans with residential and non-residential shopping customers for both EDU and CRES past due charges. As a related matter, AEP Ohio recently implemented the billing capability to break out past due and current CRES charges and combine past due CRES with past due EDU charges to calculate a total past due amount, for purposes of sending out disconnection notices. This arrangement falls one important step short of being able to reduce uncollectible risk for both CRES Providers and AEP Ohio and reduce the financial "bad debt" risk associated with shopping customers. Currently, AEP Ohio partially absorbs the risk of non-collection of past due amounts owing to CRES Providers, since the payment priority rule, OAC 4901:1-10-33(H), requires the dollars paid by shopping customers be applied first to eliminate CRES past due charges. It would be more equitable to require that all customers share in absorbing the bad debt risk associated with shopping, which would also eliminate the remaining portion of bad debt risk that CRES Providers have. Some EDUs already have bad debt riders, but AEP Ohio does not. Thus, AEP Ohio requests that the Commission pursue a uniform approach for EDUs to adopt non-bypassable bad debt riders – both for shopping and non-shopping customers.

MD Question (j): What legislative changes, if any, including changes to the current default service model, are necessary to better support a fully workable and competitive retail electric service market?

See the Company's response to MD Question (a) above.

MD Question (k): What potential barriers, if any, are being created by the implementation of a provider's smart meter plans? Should CRES suppliers be permitted to deploy smart meters to customers? Should the Commission consider standardizing installations to promote data availability and access?

AEP Ohio is not aware of any barriers that are being created by EDUs in Ohio through the implementation of their "smart meter" (or Automated Meter Infrastructure, AMI) plans. The implementation of AMI has certain operational benefits for the EDU or "wires company" that can help justify the significant capital expenditure. Any EDU that is considering an AMI installation will want the full cost recovery of such installation to align to the benefits as accrued by the customers, the EDU and the market.

AEP Ohio is not aware of any barriers that prevent any entity, including CRES providers, from serving as Meter Service Providers, as specified under Ohio legislation and regulation and the Company's approved tariffs and terms and conditions of service. The electric meter, whether AMI or electromechanical, is a critical part of an EDU's distribution system. Standardization of installation practices, as well as standardization of equipment, are necessary parts of any EDU's work processes, regulatory compliance procedures, and/or equipment procurement practices. Certain benefits of AMI, such as outage information, could be diminished or eliminated if CRES providers own meters. Therefore, to achieve the full potential of deployment of AMI, including reliability benefits, it is recommended that the deployment of AMI by EDUs on their own distribution systems follows approved work practices with standardized equipment and safety practices, and remains an integral component of the EDU's operating technology infrastructure.

MD Question (l): Should the Commission consider standardized billing for electric utilities?

Conceptually speaking, standardized processes generally provide benefits over the same process for multiple entities. However, any effort to standardize billing across EDUs would require a significant investment in time and resources along with EDU tariff standardization. Without knowing more about the scope of such a project, it is not possible to weigh the costs and benefits. But timely cost recovery of prudently-incurred costs should be part of any solution adopted in this regard.

<u>MD Question (m):</u> Do third party providers of energy efficiency products, renewables, demand response or other alternative energy products have adequate market access? If not, how could this be enhanced?

The General Assembly imposed energy efficiency/ peak demand reduction mandates on electric utilities under R.C. 4928.64 as part of the enactment of SB 221. Third-party providers of EE/PDR that can provide customers with cost-effective solutions should not experience barriers but they do not also have the EE/PDR obligations under R.C. 4928.64 like EDUs. There are also opportunities for third-party curtailment service providers to provide demand response for customers through PJM programs in conjunction with EDUs. With respect to renewable products, both EDUs and CRES providers have obligations under R.C. 4928.66 and there may be additional competitive opportunities in that space for third parties.

<u>MD Question (n):</u> Does an electric utility have an obligation to control the size and shape of its native load so as to improve energy prices and reduce capacity costs?

The General Assembly imposed energy efficiency/ peak demand reduction mandates on electric utilities under R.C. 4928.64 as part of the enactment of SB 221. Aside from that, it should not be a burden or obligation for a wires company upon full corporate separation to control the size and shape of its native or SSO load. The demand for default supply is a function of customer load and is merely a procurement function for the EDU. The EDU is not obligated to directly provide generation services under SB 221 after mandatory corporate separation (*i.e.*, generation divestiture); rather, competitive procurement from external sources is contemplated. Where market forces are present and effective they can impact the size and shape of an EDU's native load as customers respond to price and non-price factors.

II. CORPORATE SEPARATION (CS) QUESTIONS

CS Question (a): Whether an electric utility should be required to disclose to the Commission any information regarding the utility's analysis or the internal decision matrix involving plant retirements, capacity auction, and transmission projects, including correspondence and meetings among affiliates and their representatives?

No. Upon structural corporate separation, this should not be an obligation of the EDU and the generation affiliate is not subject to such regulatory controls by the Commission. The Commission already denounced any jurisdiction over plant closures in the *Sporn 5* case. Selectively asserting regulatory jurisdiction over certain actors in the market, while leaving others unregulated, would be unwise and anti-competitive.

The main context that the Commission has asserted jurisdiction over resource planning in a post-SB 221 environment is in connection with alternative energy resource requirements. *See In the Matter of the Long-Term Forecast Report of Ohio Power Company and Related Matters*, Case Nos. 10-501-EL-FOR et al., January 9, 2013 Opinion and Order 22-23. The Commission has also refused to assert jurisdiction over the decision of an EDU to close an electric generation plant, characterizing that decision as being deregulated and classifying it along with a decision to construct and maintain such as plant:

> Pursuant to Sections 4928.03 and 4928.05(A)(1), Revised Code, retail electric generation service is a competitive retail electric service and, therefore, not subject to Commission regulation, except as otherwise provided in Chapter 4928, Revised Code. Just as the construction and maintenance of an electric generating facility are fundamental to the generation component of electric service, we find that so too is the closure of an electric generating facility.

In the Matter of the Application of Ohio Power Company for Approval of the Shutdown of Unit 5 of the Philip Sporn Generating Station and to Establish a Plant Shutdown Rider, Case No. 10-1454-EL-RDR, January 11, 2012 Finding and Order at 16 (footnote omitted).

Matters relating to the provision of retail generation service outside the context of SSO pricing should remain deregulated and subject to the competitive market. If the Commission asserts regulatory control over this process, it would have a chilling effect on such decisions and would unfairly impact EDU affiliates as compared to the fully-competitive market decisions made by non-affiliated generation owners. The existing statutory and regulatory restrictions on EDUs regarding corporate separation and code of conduct are adequate to protect any concerns that may arise, and prohibit the sharing of such information with affiliates. *See* R.C. 4928.17; OAC Chapter 4901:1-37. Similarly, the FERC's and PJM's regulation of generation and transmission planning and service is more than adequate to protect consumer interests. All transmission projects are vetted with PJM stakeholders through the PJM stakeholder process and included in the PJM RTEP that is posted on the PJM website. Thus, any foray by the Commission into transmission planning or generation market monitoring and regulatory enforcement would be duplicative, unnecessary and would likely impede investment and competition in this area. Moreover, the independent market monitor for PJM tracks and evaluates competition-impacting developments in this regard. PJM also evaluates impacts from generation retirements as part of its function.

Rather than implement a new regulatory system applicable to all electric utilities, if there are particular projects or areas of concern with certain electric utilities, the

Commission should use its existing tools to address the issue for that particular project or utility.

<u>CS Question (b):</u> Should a utility's transmission affiliate be precluded from participating in the projects intended to alleviate the constraint or should competitive bidding be required?

No. These are matters for FERC and PJM jurisdiction and oversight. FERC *Order 1000* requires the ability for non-incumbent transmission developers to participate and be eligible for regulated cost recovery in the transmission planning process. In October 2012, PJM made its compliance filing at FERC proposing significant changes to the PJM transmission planning process that, if approved by FERC, would provide for the ability by non-incumbent transmission developers to propose and develop transmission solutions as part of PJM transmission planning process.

There is no basis in Ohio law to preclude such activity and it would diminish competition in these areas if the Commission attempted to impose such restrictions. SB 221 envisions structural corporate separation as the "end game" in this area. And the major EDUs are all on course to achieve legal separation, so there is no reason to disturb or change this path. SB 221, including R.C. 4928.17 as amended, envisions the ongoing and separate existence of an EDU's generation affiliate after corporate separation. It would only limit competition and presumably increase the cost of transmission projects to consumers if an EDU's affiliate were to be arbitrarily excluded from participating in a project. In any case, these are matters addressed by FERC and the Commission should not interfere with the existing federal mandates and process in this area.

<u>CS Question (c):</u> How long should a utility be permitted to retain its injection rights?

The PJM tariff provides for a one-year retention of Capacity Interconnection Rights that are associated with deactivated generation capacity resources for generation interconnection purposes.[7] No changes should be made that would undermine this tariff provision that was developed through discussions with the PJM stakeholders. Again, these are matters addressed by FERC and the Commission should not interfere with the existing federal mandates and process in this area.

<u>CS Question (d):</u> As fully separate entities, does a utility's distribution affiliate have a duty to oppose the incentive rate of return at FERC?

No. AEP Ohio strenuously opposes the suggestion posed by this question. It would be an inappropriate position for the Commission to advance. Precluding a company from taking a position would violate protected First Amendment rights – the idea of such a mandatory "required position" is even worse than an unlawful "gag order" or prior restraint and it would be blatantly unconstitutional to try and force a company to categorically advocate such positions. Based on federal law, the FERC has found incentive ratemaking appropriate and in the public interest and any activity by the Commission to undermine this valid purpose would be preempted and violate federal law. As a related matter, such an approach would trample the commercial speech rights of electric utilities in Ohio. *See e.g., Pacific Gas & Electric Co. v. Public Utilities*

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[7] Under the PJM tariff, the term "injection rights" is usually associated with merchant transmission, while the term "interconnection rights" is usually associated with generation capacity resources. In this case, the question appears to refer to rights that are associated with deactivated generation capacity resources, so the response is provided based on that presumption.

Commission of California, 475 U.S. 1 (1986) (a utility can disseminate views and messages that amount to commercial speech without being required to provide equal access to opposing viewpoints). The position implied in this question should not be pursued as it would be unlawful.

<u>CS Question (e):</u> Is there a potential for consumers to be misled by a utility's corporate separation structure?

AEP Ohio is not aware of any specific complaints or concerns in this area. Existing code of conduct regulations are adequate to address particular factual situations that may arise. The answer is not to promulgate more rules. If there are potential violations that have occurred, the Commission should address such matters through enforcement of the existing rules.

<u>CS Question (f):</u> Are shared services within a 'structural separation' configuration causing market manipulation and undue preference?

Both federal and Ohio law permit shared services and impose rules of the road in this area. The existing code of conduct is adequate to address such matters. If there are potential violations that have occurred, the Commission should address such matters through enforcement of the existing rules.

<u>CS Question (g)</u>: Should generation and competitive suppliers be required to completely divest from transmission and distribution entities, maintain their own shareholders and, therefore, operate completely separate from an affiliate structure?

No. There is no basis in Ohio law to impose such a requirement and AEP Ohio submits it would be an unwise policy to entertain, since it would likely decrease investment in Ohio by limiting sources of capital. Corporate separation is defined and does not require separation of equity interests. Specifically, both R.C. 4928.143 and R.C. 4928.17 contemplate the ongoing existence of a generation affiliate upon structural separation. There is certainly no restriction on the continued existence of a generation affiliate under SB 221. Thus, the Commission lacks authority under existing law to impose such a requirement and legislation is required as a predicate to pursuing such a drastic proposal. It would also place Ohio generation owners at an unreasonable and undue disadvantage as compared to CRES providers that have out-of-state generation affiliates and could exercise the same leverage.

Aside from the legality (or lack thereof), it would also be unwise and anti-competitive to consider such a requirement. The underlying concern appears to relate to independent functioning and conduct of the EDU and its generation affiliate. These are matters already addressed by the corporate separation statute and code of conduct regulations in Ohio. Moreover, PJM already has functional control of all AEP transmission facilities in Ohio and independently administers those transmission facilities through the PJM tariff.

<u>CS Question (h):</u> Are there PJM tariffs or FERC rules that would mitigate market power and/or facilitate retail electric service competition?

Yes. The Commission has only recently exercised its option under the RAA to establish a State Compensation Mechanism for AEP Ohio, based on the premise that it would foster retail competition in AEP Ohio's service territory. In addition, PJM/FERC has a series of tariffs, rules and processes to ensure a competitive wholesale market, and to facilitate a competitive retail market. Under those rules, the Commission can already request PJM to analyze various options to relieve transmission constraints by incorporating longer term transmission solutions into the RTEP through the PJM transmission planning process. This can be accomplished through changes to the RTEP study assumptions, through PJM's State Agreement Approach, or by requesting the PJM transmission owners to pursue the necessary transmission upgrades as a Supplemental project.

CONCLUSION

For the foregoing reasons, AEP Ohio respectfully requests that the Commission consider the above comments. AEP Ohio reserves the right to file reply comments.

Respectfully submitted,

Steven T. Nourse
American Electric Power Service Corporation
1 Riverside Plaza 29th Floor
Columbus, Ohio 43215
Telephone: (614)-716-1608
Fax: (614) 716-2950
Email: stnourse@aep.com

Counsel for Ohio Power Company

Exhibit A

Substitute Senate Bill 221

House Public Utilities Committee

Alan R. Schriber, Chairman
Public Utilities Commission of Ohio

November 28, 2007

Chairman Hagan, members of the committee, thank you for giving me the opportunity to participate in today's panel on electric security plans, market options and generation as these issues relate to Sub. Senate Bill 221.

Sub. SB 221 seeks to establish stable predictable rates for commercial, industrial and residential customers, create jobs of the future through an advanced energy portfolio standard, establish energy efficiency standards and conservation measures and confront the future environmental challenges of climate change and carbon restrictions.

Sub. SB 221 ensures price stability and an adequate, reliable supply of electricity. The bill includes a carefully crafted hybrid approach that recognizes how we generate, distribute and price electricity. This is particularly important since Ohio is fifth among the states in overall energy consumption and spends more than 30 billion dollars on energy every year. Electricity is the single biggest component of our energy use.

Before delving into the issues before us today, I feel it is important to recap where we have been since Ohio's electric restructuring legislation was signed into law back in 1999.

History

As many of you are aware, the electric industry consists of three main components: generation, transmission and distribution. Senate Bill 3 (SB 3), signed into law in 1999, allowed for competition in electric generation. SB 3 also provided a five-year market development period lasting from Jan. 1, 2001 to Dec. 31, 2005. During this period, rates were frozen in order to allow a competitive wholesale market to take shape.

Ohio moved toward restructuring the electric industry with the belief that competitive market forces would develop and hold down prices. Since electric choice began in 2001, the PUCO has been working to facilitate a competitive electric market in Ohio. However, it is widely acknowledged that a fully competitive market had not developed. As a result, the PUCO developed plans to secure the future of Ohio's retail electric market.

As the end of the market development period neared, the PUCO grew concerned that the limited number of competitive electric suppliers and low degree of market activity were an indication that an immediate shift to market-based rates in 2006 would not be in the best interest of customers. To minimize the effects of rate "sticker shock" and gradually transition customers to market-based rates, the PUCO worked with Ohio's electric utilities to develop rate stabilization plans (RSPs). These plans, coupled with other recent rate modifications, eliminate market uncertainty and provide customers with stable, predictable, just and reasonable rates.

As many of you may recall, the Ohio Legislature supported the establishment of RSPs in a report issued in October 2003 encouraging the PUCO to "continue to take the necessary steps ... to ensure that a healthy competitive market is in place before full electric competition begins." RSPs are in place for American Electric Power (AEP), Dayton Power and Light (DP&L), Duke Energy Ohio and FirstEnergy. The RSPs have been challenged at the Ohio Supreme Court, and while parts of these RSPs have been remanded back to the PUCO, the Court preserved the most important elements of the plans.

There is significant evidence demonstrating that the prices customers are paying now under the RSPs are less costly than those that would result from market-based prices. According to the U.S. Department of Energy, customers in states with deregulated electricity paid 30 percent more last year than customers in regulated states. Recent events in states including Maryland, where prices increased 72 percent, and Illinois, where prices increased 55 percent, also support this point.

I would like to address our three topics – electric security plans, market options and generation – and provide you with what I believe to be the salient issues.

Electric Security Plans

The electric security plan (ESPs) might be thought of as an extension of the RSPs instituted in 2005 and which expire at the end of 2008 (except Dayton Power & Light which runs through 2010). There are some significant enhancements, however.

The electric security plans would enable an electric company to make adjustments for increased fuel and environmental costs, new generation dedicated to Ohio ratepayers, purchased power, operations and maintenance, taxes and the provider of last resort requirement. These adjustments would enable the electric company to establish rates that are just and reasonable. In exchange for these adjustments, electric customers could expect stable and predictable rates, and better service reliability.

The quality of the electric infrastructure in Ohio has diminished significantly over the last 15 - 20 years. Sub. SB 221 provides a mechanism for utilities to better maintain their aging infrastructure through long-term comprehensive planning and, in the short term, as single issue rate cases will be permitted under certain conditions. In this way, Ohio's electric infrastructure can be updated and modernized.

There has been a lot of discussion recently regarding the February 2008 date certain established in Sub. SB 221. The February 2008 date certain is a starting point for the electric security plans that represents a just and reasonable rate established by the PUCO in the rate stabilization plans, which were affirmed by the Ohio Supreme Court. This will ensure that the rates established through an electric security plan provide utilities with a fair return for their investment and that the charges paid by ratepayers are just and reasonable.

It is important to note that in reviewing electric security plans filed by the electric companies, the PUCO would be looking for provisions for advanced energy and energy efficiency. Also, we would hope that these plans would be more long-term than the three-year RSPs.

Further, all of the plans, once filed, would go through an adjudicatory process at the PUCO in which all interested stakeholders would have the opportunity to comment on the proposed ESPs and all comments would be considered by the PUCO before finalizing any ESP. The ESPs would go through a similar process that was used for the establishment of the RSPs to ensure accountability and transparency whereby customers would understand what they are paying for and what they are getting in return.

Finally, Sub. SB 221 would codify the process and methodology for the ESP ratemaking, ensuring a level playing field for all parties, and eliminating time consuming and expensive appeals to the Ohio Supreme Court.

Market Options

Sub. Senate Bill 221 also provides the opportunity for a competitive bid rate to be the standard service offer where it is comparable to the electric security plan rate. Further, the market rate option would be approved when the company can prove to the PUCO that a viable, competitive market exists.

In the event an electric company seeks a market rate, the Public Utilities Commission of Ohio (PUCO) could not approve the rate unless the utility demonstrates that effective competition exists in the market and that the rate is just and reasonable. Otherwise, the PUCO could prevent the company from implementing the market rate at which point a default standard service offer generation rate would apply or the company could file for an electric security plan.

Some will argue that markets are effective and viable. I would point out that the markets for electricity are varied and significantly different than the markets for most commodities. Electric markets differ according to the time frame over which they operate. Electricity cannot be stored, and therefore, supply and demand must always be kept in balance. Also, and most telling, the markets are still developing both at the wholesale and retail levels.

While some will argue that the Regional Transmission Organizations (RTOs) constitute the existence of a market, in my mind RTOs are the perfect example of one market in an entire realm of markets. The bottom line is that Ohio ratepayers should not be subjected to the volatility and risk of the current retail and wholesale markets.

The arcane business of trading in power markets leads me to conclude that debating the efficacy of such markets is a useless exercise. I have absolutely no doubt that if you line up a string of economists, myself included, that you will hear conflicting arguments regarding the existence of electric markets. I don't have a problem with that because it simply underscores the fact that we are not dealing with a perfect science. At the end of the day, it is all about outcomes – the prices, terms and conditions of the market prices made available at both the wholesale and retail level.

The Texas market is often used as the poster child of deregulation. Yet, the average electric rate, from 2000 to June of 2007, rose 56 percent, more than all but three states according to federal figures. Twenty-five percent of Texans live in areas still subject to regulation and generally pay less than in the competitive Texas markets. Texas has attracted more retail competition because the most recent Texas PUC "price to beat" was 15 cents per kilowatt-hour (kWh), nearly twice the level of Ohio's rates. That rate is based on the clearing price of the RTO, the Electric Reliability Council of Texas, of the most expensive power, natural gas powered plants. The theory was that the deregulated market would attract the construction of new lower cost coal plants, but an initial Texas proposal to build 11 new plants was reduced to three, with all plants in the planning stage. I have included three recent articles from the Galveston Daily News in Texas that further outlines the problems Texas has experienced with its deregulated industry and related markets.

When examining the existence or non-existence of markets in Ohio, we face another challenge; there is no clear definition for a market. In other words, is a market geographical or customer driven? Does the market include all energy or just electricity?

Herein presents another benefit of Sub. SB 221, we have options. If an electric company seeks a market option, the company must demonstrate to the PUCO a viable, competitive market exists. If the company fails to do this, it could opt for an electric security plan.

Generation

Sub. SB 221 allows for cost-based recovery for new electric generation to be built in the state based upon a showing of need. As some of you may hear, some areas of the state are in need of new generation to meet our state's growing demand for electricity. The costs for new, specified generation projects could be recovered through the electric security plans.

I would again stress that the PUCO would be looking for the utilities to invest in base-load generation that meets future environmental regulations as they pertain to climate change and carbon restrictions. We would also be looking for new generation from advanced energy technologies in order to fulfill the advanced portfolio provisions outlined in the bill. Further, energy efficiency and demand response can also be utilized for a more environmentally-friendly generation mix.

Conclusion

In conclusion, I believe that Sub. SB 221 is a sensible balance between regulation and competition as it provides utilities with the option of pursuing either a competitive market pricing plan or an electric security plan. The legislation ensures the predictability of reasonable energy prices and serves as a catalyst for attracting energy jobs of the future to our state through an Ohio advanced portfolio standard. The legislation also builds upon the existing state policy by ensuring that consumers and shareholders share the benefits of and responsibilities for electric utility investment in facilities supplying electric service, and protect at-risk populations when considering the implementation of any new advanced energy technology.

Thank you, again, for the opportunity to appear on this panel today to discuss electric security plans, market options and generation. I would be happy to entertain questions once all others on the panel have had an opportunity to present their opening remarks.

CERTIFICATION OF SERVICE

I hereby certify that a copy of the Ohio Power Company's Comments was served on the persons stated below by electronic mail, this 1st day of March 2013.

Steven T. Nourse

EMAIL SERVICE

William.Wright@puc.state.oh.us
Elizabeth.stevens@puc.state.oh.us
grady@occ.state.oh.us
serio@occ.state.oh.us
sam@mwncmh.com
fdarr@mwncmh.com
dboehm@bkllawfirm.com
mkurtz@bkllawfirm.com
cmooney2@columbus.rr.com
drinebolt@ohiopartners.org
msmalz@ohiopovertylaw.org
jmaskovyak@ohiopovertylaw.org
tsiwo@bricker.com
mhpetricoff@vorys.com
smhoward@vorys.com
mwarnock@bricker.com
ejacobs@ablelaw.org
nmorgan@lascinti.org
mwalters@proseniors.org
plee@oslsa.org
rjohns@oslsa.org
gbenjamin@communitylegalaid.org
Julie.robie@lasclev.org
anne.reese@lasclev.org
meissnerjoseph@yahoo.com
storguson@columbuslegalaid.org
gkrassen@bricker.com
wsundermeyer@aarp.org
cgoodman@energymarketers.com,
srantala@energymarketers.com
burkj@firstenergycorp.com
judi.sobecki@dplinc.com
amy.spiller@duke-energy.com
elizabeth.bennett@exeloncorp.com
stephen.bennett@exeloncorp.com
cynthia.brady@constellation.com
david.fein@constellation.com