BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to R.C. 4928.143, in the Form of an Electric Security Plan.	)))))	**Case No. 13-2385-EL-SSO**
In the Matter of the Application of Ohio Power Company for Approval of Certain Accounting Authority.	)))	**Case No. 13-2386-EL-AAM**

INITIAL BRIEF OF CONSTELLATION NEWENERGY, INC. AND EXELON GENERATION, LLC

July 23, 2014

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I. Introduction

Constellation NewEnergy, Inc. ("Constellation") and Exelon Generation, LLC are full parties of record who actively participated in the matter of bar as well as in AEP Ohio's[1] two previous Electric Security Plan proceedings.[2] Constellation provides competitive retail electric service to approximately 100,000 business and public sector customers and 1,000,000 residential customers in open market states such as Ohio. Constellation's predecessor was certificated by the Public Utilities Commission of Ohio ("Commission") to provide Competitive Retail Electric Service ("CRES") in Ohio in 2000, making it one of Ohio's oldest CRES suppliers.[3] Today, it actively provides CRES to retail customers in Ohio, including customers in the AEP Ohio service area.[4]

Exelon Generation, LLC is one of the largest competitive power generator in the United States, dispatching some 35,000 megawatts ("MWs") of generation from a diverse portfolio of generation plants and utilizing nuclear, hydroelectric, solar, landfill gas and wind technologies. Exelon Generation, LLC is an active supply bidder in the wholesale standard service auctions conducted by the Commission and has won supply tranches in the AEP Ohio auctions.[5]

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[1] AEP Ohio refers to the electric distribution affiliate of American Electric Power Company which operates in the state of Ohio – Ohio Power Company. The Columbus Southern Power Company and Ohio Power Company merged following the second Electric Security Plan, with the merged entity being Ohio Power Company.

[2] AEP Ohio's first ESP proceeding was *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan, an Amendment to its Corporate Separation Plan, and the Sale or Transfer of Certain Generating Assets*, Case Nos. 08-917-EL-SSO et al., Opinion and Order (March 18, 2009) and Entry on Rehearing (July 23, 2009). AEP Ohio's second ESP proceeding was *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan,* Case Nos. 11-346-EL-SSO et al., Opinion and Order (August 8, 2012) and Entry on Rehearing (January 30, 2013). That case is hereinafter referred to as "ESP II."

[3] *In the Matter of the Application of AES NewEnergy, Inc., for a Certificate of Public Convenience and Necessity* , Case No. 00-1717-EL-CRS. Constellation's parent acquired AES NewEnergy, Inc., in 2002, and its name was changed to Constellation NewEnergy, Inc. *Id*.

[4] Constellation Ex. 1 at 3.

[5] [5] *Id*. at 4.

Constellation and Exelon Generation LLC (jointly "Exelon") are both subsidiaries of Exelon Corporation and jointly present the following Initial Trial Brief. The Initial Trial Brief addresses three major issues which arise from AEP Ohio's third Electric Security Plan ("AEP Ohio ESP III") application.

Issue One: The proposed Rider PPA must be rejected on the grounds that it violates Ohio law as well as the State's Energy Policy, the Commission's policy, and is not in the best interest of the public.

Issue Two: The Commission should adopt the competitive market enhancements that AEP Ohio presents as part of the ESP III proposal. The enhancements consist of:

- Purchase of Receivables Program with the associated bad debt tracker;
- The sunset of AEP Ohio's time-of-use tariffs;
- Direct billing of non-market-based tariffed transmission charges from the Regional Transmission Organization (RTO), which should be expanded to include PJM Invoice Item No. 1939 the "Reliability Must Run" charge; and
- The proposed auction process and schedule.

Issue Three: AEP Ohio's request for a unilateral right to terminate its ESP III plan at its sole election after just two years and without prior Commission approval is unreasonable and violates public policy.

II. The Proposed Rider PPA Must be Rejected for Legal and Policy Reasons

A. AEP Ohio Must Divest Its Generation

The Ohio General Assembly some 14 years ago began Ohio's transition from an exclusive state-issued franchised monopoly system over the production and sale of electricity to an inclusive open market for the generation and sale of power. Given the Commission orders in place, this shift to market-based power procurement as called for in Senate Bills 3 and 221 will be completed for the investor-held public utility companies by January 1, 2016. AEP Ohio's proposed Power Purchase Agreement Rider ("Rider PPA") threatens to subvert the State's

Energy Policy's prohibition against cross-subsidies between monopoly wire service and generation as set forth in Section 4928.02, Revised Code, and the mandated corporate separation plans as set forth in Section 4928.17, Revised Code. Today, the Commission has largely completed the restructuring of the electric industry so that the production and the sale of power are transformed from a monopoly service to a competitive service.[6]

When the Ohio General Assembly decided to have an open market for power, it kept with the franchised monopolies only transmission and distribution of electric service, also referred to as "the wires service. " As a result, steps had to be taken to prevent subsidies from flowing from the regulated to the unregulated services and vise versa. Such subsidies or preferences would inappropriately distort the prices that customers paid, and expose customers to the payment of monopolistic rents. They would also distort the price signals essential for a well-functioning competitive market. Thus, as part of the restructuring, the Ohio General Assembly passed two statutes to ensure that the regulated wire services are separated from the competitive power services. The first statute, Section 4928.17(A), Revised Code, requires the monopoly wire service providers to have a corporate separation plan approved and supervised by the Commission. At a minimum, the corporate separation plan must contain the following:

> (1) The plan provides, at minimum, for the provision of the competitive retail electric service or the nonelectric product or service through a fully separated affiliate of the utility, and the plan includes separate accounting requirements, the code of conduct as ordered by the commission pursuant to a rule it shall adopt under division (A) of section 4928.06 of the Revised Code, and such other measures as are necessary to effectuate the policy specified in section 4928.02 of the Revised Code.
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> (2) The plan satisfies the public interest in preventing unfair competitive advantage and preventing the abuse of market power.

[6] Section 4928.03, Revised Code.

> (3) The plan is sufficient to ensure that the utility will not extend any undue preference or advantage to any affiliate, division, or part of its own business engaged in the business of supplying the competitive retail electric service or nonelectric product or service….

The reference above in subsection (A)(1) to Section 4928.02, Revised Code, is the State Energy Policy, which complements the corporate separation plans by strictly forbidding subsidies to flow (either direction) between a regulated wires company and the non-regulated affiliates of the wires company. The second statute is Section 4928.02(H), Revised Code, which instructs the Commission to take the necessary actions to:

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

AEP Ohio has a corporate separation plan in effect, which the Commission required as part of its Opinion and Order in Case No. 11-346-EL-SSO ("AEP Ohio ESP II"). Specifically, the Commission mandated that by January 1, 2014, all of AEP Ohio's generation must be transferred to an unregulated affiliate or third party.[7] All generation includes the contract for generation between AEP Ohio Power and the Ohio Valley Electric Corporation ("OVEC").

As detailed in the sections below, Rider PPA threatens to undo the 14-year transition from franchised monopoly over power to open market by making the AEP Ohio ratepayers financially responsible for the cost of the operation and the return on equity of what is now largely privately owned generation plants. That is antithetical to the restructuring required by Ohio law. Thus, Rider PPA must be rejected.

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[7] *Columbus Southern Power Company*, *supra*, Case Nos. 11-346-EL-SSO et al., Opinion and Order at 59-60 (August 8, 2012).

B. Overview of AEP Ohio's OVEC Holdings

Pursuant to the Amended and Restated Inter-Company Power Agreement of 2010 ("ICPA"), AEP Ohio must purchase 19.93% of the output OVEC's Ohio-sited Kyger Creek generation plant and the Indiana-sited Clifty power plants.[8] AEP Ohio has an equity interest in OVEC.[9] Further, AEP Ohio's parent, American Electric Power Company, through AEP Ohio and other subsidiaries holds a total of 43.47% of OVEC.[10] That makes American Electric Power Company the largest shareholder of OVEC. Finally, AEP Service Corporation, a subsidiary of American Electric Power Company and also an affiliate of OVEC, has contracts to provide operation and maintenance services to OVEC.[11]

When AEP Ohio began its energy auctions for power procurement in 2014, the ICPA was to have been transferred to an unregulated affiliate of AEP Ohio. [12] Thus, the corporate separation plan approved by the Commission for AEP Ohio customers included the elimination of obligations by shopping or non-shopping customers to pay for the uneconomic operation of the OVEC power plants. On October 14, 2013, however, AEP Ohio notified the Commission that it would be unable to transfer the OVEC supply contract from AEP Ohio to an affiliate because there was opposition by some yet undisclosed co-owners of OVEC.[13] The Commission, in response to AEP Ohio's October 2013 filing, permitted AEP Ohio to retain ownership of the OVEC contract and continue to purchase the OVEC power from its affiliate on the ICPA "cost

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[8] IEU Ex. 6 at 2; IEU Ex. 1 (Direct prepared testimony of Kevin Murray) at attachment KMM-2 at 1-2. Also see footnotes 3 and 4of the Staff Exhibit 18 (Direct prepared testimony of Dr. Choueiki) at 4.

[9] IEU Exhibit 6 at 2; AEP Ohio Ex. 7 at 9.

[10] IEU Ex. 6 at 1; Tr. Vol. 1 at 98. Also see IEU Exhibit 5 at 74.

[11] Tr. Vol. 1 at 101-102.

[12] *Columbus Southern Power Company*, *supra*, Case Nos. 11-346-EL-SSO et al., Opinion and Order at 57 (August 8, 2012).

[13] *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, Application.

plus" basis, but required AEP Ohio to sell that OVEC power into the PJM markets.[14] The Commission did not authorize a method to collect for (a) the OVEC power other than selling it into the PJM market, (b) the volumes not associated with the standard service sales or (c) the use of the Fuel Adjustment clause for the standard service sales. Further, nothing in the Commission's ruling instructed AEP Ohio to cease efforts to transfer the ICPA; hence, it was anticipated that AEP Ohio was going to continue working with its OVEC business partners to effectuate the transfer.[15]

C. The Design of Rider PPA proposal is Contrary to Both State and Federal Law

As detailed in the testimony of AEP Ohio witness William Allen, starting with the July 2015 billing cycle, AEP Ohio will sell all of the power from the OVEC contract into the PJM markets.[16] However, if the OVEC costs for producing the power from the Kyger Creek generation plant in Ohio and the Clifty power plant in Indiana exceed the net revenue from the sale of power into the PJM market, all ratepayers would be obligated to pay AEP Ohio the difference via the new Rider PPA.[17] Since the costs include fuel, power plant labor and materials, as well as a return on equity for the power plant investment, Rider PPA is recovering generation costs. Most important, as AEP Ohio chief executive officer Pablo Vegas testified, Rider PPA is non-bypassable[18] and would be paid by shopping customers.

1. Rider PPA as proposed violates Ohio Law

Even a cursory reading of the proposed Rider PPA reveals the Rider is at odds with the express language of Section 4928.17, Revised Code, which was quoted above. As noted by the

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[14] *Ohio Power Company, supra*, Case No. 12-1126-EL-UNC, Finding and Order at 8-9 (December 4, 2013).
[15] AEP Ohio witness Allen testified that if Rider PPA is approved, AEP Ohio is not going to work with its OVEC business partners to effectuate the transfer of the OVEC generation entitlement. Tr. Vol. 3 at 687
[16] AEP Ohio Ex. 7 at 10.
[17] Tr. Vol. 1 at 29.
[18] *Id*. at 149.

testimony of Exelon witness Mr. Campbell, Rider PPA would require shopping customers to potentially pay for the power they use to their CRES supplier and also pay for some of the cost of power from OVEC that they did not use because OVEC's power price is above market.[19] In addition, as to shopping customers (who are distribution service only customers), Rider PPA violates Section 4928.02(H), Revised Code, by requiring shopping customers to underwrite the financial costs of OVEC's generation and creating a subsidy from the AEP Ohio distribution service to AEP Ohio's generation service. [20]

The fact that OVEC's power sales revenue may not exceed OVEC's costs does not change the fact that Rider PPA creates a subsidy. First, the ratepayers are guaranteeing that the OVEC generation earns a profit by covering any difference in the revenues from the sale of the power and cost of generation. This guarantee provides a full hedge to AEP from any market / price risk associated with the OVEC generation. Therefore, the guarantee in and of itself is a benefit and thus a subsidy to AEP regardless of whether it produces a credit for the retail customers in any particular year. Second, that guarantee will skew the competitive wholesale market for power. The OVEC generators have the advantage over other competitive generators in that the OVEC units have a cost guarantee, including a return on equity. Thus, even if Rider PPA does pass a credit back to customers, the credit will not be equal to the value of the guarantee that OVEC gets from the ratepayers. Exelon, as a competitor of OVEC, is not the only party to recognize the harm Rider PPA presents to the competitive market. As pointed out by Staff witness Dr. Choueiki, Rider PPA skews the way the OVEC generation will be used in the market:

> Staff is concerned that the AEP regulated business unit that bids the OVEC generation stations into the PJM capacity, energy and

[19] Constellation Ex. 1 at 12.
[20] *Id*. at 13.

> ancillary services markets may use different strategies than those used by its unregulated affiliate.[21]

Further, because AEP Ohio will be guaranteed full cost recovery and will carry no market risk associated with the OVEC generation, there will be no incentive for AEP Ohio to manage costs and operate the plants efficiently and in the most cost-effective manner, eliminating one of the many benefits to Ohio electricity customers that competition brings to the marketplace.

2. Rider PPA as designed would require FERC supervision and would not be permissible under FERC standards for affiliate transactions

The ICPA obligates AEP Ohio to purchase roughly 20% of the output of the two OVEC plants on a "cost plus" basis. This obligation is summarized in the American Electric Power 10-K filing as "[t]he proceeds from the sale of power by OVEC are designed to be sufficient for OVEC to meet its operating expenses and fixed costs and provide a return on capital."[22] Since the OVEC arrangement is a wholesale transaction between affiliates, it is subject to Federal Energy Regulatory Commission ("FERC") jurisdiction, including FERC Order 697. In *Boston Edison Co. Re: Edgar Electric Energy Co.* , 55 FERC ¶ 61,382, FERC established three acceptable methods for determining whether a wholesale power arrangement between affiliates is at market price. The first method in the *Edgar* decision to determine whether a transaction price between affiliates is at market prices is whether there was head-to-head competition between the affiliated supplier and non-affiliated suppliers. This can be by open auction or by use of competitive sealed bids. The second *Edgar* method is a demonstration that the sale price is similar to prices being charged by nonaffiliated buyers in relevant markets that are not subject to market power. Finally, *Edgar* permits the affiliates to demonstrate that the sale was at a market price by submitting "benchmark" evidence of price, terms and conditions of sales by non-

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[21] Staff Ex. 18 (Direct Prepared Testimony of Choueiki) at 13.
[22] IEU Exhibit 5 at 74. Also see Tr. Vol. 1 at 172.

affiliated sellers, including purchases made by the utility or other buyers in relevant markets. To be credible, the benchmarks sales must be contemporaneous and for similar services when compared to the ordinal transactions.

Under the *Edgar* tests, the pricing of the OVEC generation could not be called "market priced power". Thus, if Rider PPA is approved then shopping customers would be responsible for above market power costs if OVEC remains above market prices. Today, because of the statutes passed by the Ohio General Assembly and the Commission's years of hard work in carrying out those statutory mandates, AEP Ohio customers are free to buy from a CRES provider and not pay for the legacy generation such as the OVEC power either directly or indirectly. Standard Service customers are protected from monopolistic rents through the oversight of the Commission, for up until June 2015, the costs of OVEC's sale of power to AEP Ohio is passed onto standard service customers through the Fuel Adjustment Clause. The Commission, as part of the Fuel Adjustment clause review, can disallow part or all of the non-market OVEC price from being charged to the standard service customers.

By proposing that Rider PPA be non-bypassable, AEP Ohio has created a situation of self-dealing which no longer will be within the purview of the Ohio Commission. This self-dealing occurs when AEP Service Corp. provides service to its affiliate of OVEC, who in turn sells power at cost, including the cost of the AEP Service Corp. contracts, to its affiliate, AEP Ohio, who can in turn passes that cost along via a non-bypassable rider to all its retail customers.

The loss of state jurisdiction was raised by Staff at the hearing. Staff witness Dr. Choueiki testified that:

> As a result [of the ESP III Application] , if the Commission believed that any expense items in the purchase power contract were not in the public interest, the Commission would have to file at FERC challenging these

expenses and the burden of proof would be on the Commission to demonstrate its case.[23]

D. The True Purpose of Rider PPA is to Provide a Guaranteed Return to AEP, Not Price Stability to Ohio Ratepayers

AEP Ohio presents just a single purported reason for Rider PPA; Mr. Allen testified that Rider PPA will have a stabilizing effect on retail customer prices.[24] What is missing from the record is evidence that there is a *need* for rate stabilization, or that retail customers *desire* a mandatory rate stabilization plan, above and beyond the current competitive options. AEP Ohio chief executive officer Mr. Vegas could only offer anecdotal evidence that customers want stable rates.[25] Most importantly, there is no evidence that Rider PPA is the right solution for "rate stability." In sharp contrast, the current competitive market in Ohio offers retail customers much cheaper and more effective ways to stabilize the price they pay for electricity and protect themselves from changing market prices. Most notable is the most common and effective tool to hedge against variable price risk, the fixed-price contract offered by CRES. If a customer signs a supply contract at a fixed price, they can budget their power costs based on that contract. For example, a residential customer can sign up for Constellation's current offer of 8.09¢ per kilowatt-hour ("kWh") for 36 months[26] and know their power cost will be 8.09¢ per kWh. Fixed prices are by definition stable prices. A larger more sophisticated customer also has the ability to purchase a financial hedging instrument to guard against price risk.[27]

In addition to the fact that customers already have the option of price stability and other hedges through their selection of a particular CRES contract, it should be noted that shopping customers

[23] Staff Ex. 18 (Direct Prepared Testimony of Dr. Choueiki) at 12.
[24] AEP Ohio Ex. 7 (Direct Prepared Testimony of William Allen) at 8.
[25] Tr. Vol. 1 at 44-45.
[26] Exelon Ex. 2.
[27] Exelon realizes that many customers may not be sophisticated to buy a future, option or other financial instrument. However, the number of such customers does not lessen the point that Rider PPA has no price-stabilizing effect for the customer.

have affirmatively decided that they do NOT want their power supplied by AEP Ohio. No matter what form it takes – direct provision of power or a financial swap -- Rider PPA is ultimately a payment by retail customers to AEP Ohio which alters the price of generation – a competitive electricity service. Permitting the utility to amend the actual price of generation is directly at odds with the "Choice" program and possibly impairs existing contracts.

Exelon does not believe that Rider PPA can be called a true price -stabilizing instrument, for it lacks a "strike price." Unlike a fixed-price supply contract, or a more sophisticated financial hedging instrument, there is no fixed price per kWh that Rider PPA assures.[28] Rider PPA just shifts the difference between what AEP Ohio gets for selling its OVEC output and what it pays its affiliate OVEC for that power. In other words, customers will have no better idea as what power will cost them in the future under proposed Rider PPA.

The reality is that it is AEP Ohio that is getting a hedge, not AEP Ohio's electricity customers. AEP Ohio is getting a guaranteed fixed rate -of -return, and is fully hedged from all market risk. Under the Rider PPA proposal, the cost of this hedge will be funded by AEP Ohio electricity customers. Rather than providing the stability of a fixed price or a ceiling, ratepayers will simply have gains or losses as if they owned the two OVEC plants. The Rider PPA proposal behaves more like a speculative financial swap from the perspective of the Ohio ratepayer. AEP Ohio is proposing to swap its upside potential in the OVEC plants with the ratepayers, in exchange for a guarantee from the ratepayers of its cost plus return on its investment. Is that a good deal for customers? There is no way to know for certain until the ESP III period is over and we can compare the actual costs.

In the world of commodity derivatives, the Rider PPA proposal ironically puts AEP Ohio electricity customers in the position of a commodity price "speculator, " and leaves AEP Ohio in

[28] Tr. Vol. 13 at 3084-3085, 3122-3123.

the position of the risk managing "hedger, " with the hedge being fully funded by ratepayers. It cannot and should not be the policy goal of the Commission to put Ohio ratepayers into this position.

Although Rider PPA was analogized to insurance during the hearing, [29]it is not an apt analogy. While the Commission has been called on many times both before and after restructuring to stabilize customer rates by amortizing known expenses over more time, this is the first time the Commission has been asked to possibly increase rates just to reduce possible volatility. One wonders if there would be a retail customer outcry if power prices spiked downward. It is far more likely that customers would be willing to "suffer" with lower prices than pay a fee to keep them stable.

On the other hand, the market price of power could spike and OVEC generation (rather than being counter cyclical) could spike with it. The result would then be that costs go up as the market price spikes would be coupled with Rider PPA charge. One realistic scenario that could produce exactly such a result would be when the EPA carbon rules are applied, the rules drive up all power prices, but impact electric supplies generated from coal plants more than gas, nuclear or alternative generation sources.

That environmental uncertainty and the wide range of financial outcomes that can flow from those decisions as they affect coal-fired generation is no doubt part of the reason AEP Ohio seeks to transfer the financial risk of the OVEC plants from its shareholders to its ratepayers. It also highlights that net revenue projections for a power plant are heavily influenced by the assumptions that go into the models. Further, the assumptions as to future costs or revenues will always be both unknown and not verifiable. However, what is known today is that Rider PPA is at best a blunt instrument not capable of providing discrete price spike protection. That is in

[29] OEG Ex. 3 at 6; Tr. Vol. 12 at 2558.

sharp contrast to fixed-price contracts, which are capable of providing true price stability and can be selected by the customers who want them. The bottom line is that there is a substantial risk that the OVEC coal plants in the fully competitive market wholesale electric market may not be profitable, and that the real purpose of Rider PPA is to shift that financial risk from the shareholder to AEP Ohio's ratepayers.

E. The Record, Including AEP's Own Projections, Reflects the Uncertainty and Speculative Nature of Rider PPA

Several intervenors, including Exelon, asked for comparisons of OVEC costs per MWh compared to market prices over the past ten years. AEP Ohio merely indicated that such studies did not exist.[30] The only historical data in the record as to the actual cost to AEP Ohio per MWh from OVEC is the OVEC Annual Report from 2012.[31] That report showed the cost per MWh to AEP Ohio from OVEC for the two -year period was extremely volatile and seemed to be at above -market prices. The price in 2011 was $50.86 per MWh and that ballooned by roughly 24% to $62.86 in 2012.[32] This compares to $47.77 per MWh for 2012 listed in the PJM year in review.[33] On cross-examination, Mr. Allen indicated that three elements impacted the OVEC price during that period: mild weather; soft energy market; and low natural gas prices.[34] To make sales, OVEC has to have its power dispatched by PJM, and in order to get dispatched , OVEC's power must be at or under the price of other generators for that market.[35] Bottom line, even if capacity prices increase in the future, OVEC's generation will not necessarily turn a profit when sold into the PJM market because its profitability is also tied to natural gas prices

[30] Constellation Ex. 1 at 15.
[31] IEU Ex. 6; Tr. Vol. 13 at 3215.
[32] IEU Ex. 6 at 2.
[33] Constellation Ex. 1 at 16 fn 2.
[34] Tr. Vol. II at 547.
[35] *Id*. at 565-566.

and market demand. Most importantly, Rider PPA's counter -cycle contribution to stabilizing prices is not guaranteed during the ESP III period and is not linked to particular price.

While AEP Ohio did not offer historic data of how OVEC costs compare with market costs, it did offer two Rider PPA projections, one in the testimony accompanying the application and one during the course of the hearing.[36] Projections were also offered by Mr. Wilson from Office of the Consumers' Counsel, Mr. Murray from the Industrial Energy Users, and Mr. Taylor from the Ohio Energy Group.[37] By their very nature, projections must be based on future events, and the results of any projections are heavily influenced by the assumptions made by the modeler. A fine example is the major difference between AEP Ohio's first and second Rider PPA projections. In the second projection, AEP Ohio assumes a 10% reduction in operating costs – the so -called Project LEAN – which OVEC *may* deploy in the future.[38] The actual reductions under the LEAN program were not part of the record. Unless the OVEC plants were being mismanaged though, achieving short-term reductions in operation and maintenance costs calls into question whether the costs reductions are true savings, or just delays in needed maintenance or equipment replacement. If the cost reductions are merely extending the time when needed maintenance is accomplished, then the cost reductions are not true savings; they would be merely timing adjustments. Further, delaying needed repairs or replacements could contribute to higher costs in the long run. When cross-examined on the LEAN project, Mr. Allen admitted that OVEC has not committed to the project LEAN reductions.[39] Further, the variable on OVEC's cost of power production is more certain than the variables for future power demands or natural gas prices, both of which must be modeled to produce OVEC profitability

[36] IEU Ex. 1A (Confidential Direct Prepared Testimony of Murray) at KMM -5, KMM-6, KMM-7; Tr. Vol. 2 at 484-485, 508, 533-534; AEP Ohio Ex. 8A.
[37] OCC Ex. 15 at 9, 25; OCC Ex. 16; IEU Ex. 1A at 11-12; and OEG Ex. 3A at 17-18 and AST-3.
[38] Tr. Vol. 2 at 501-502; IEU Ex. 1A at KMM-9.
[39] Tr. Vol. 11 at 501-504, 552.

projections. Given all the variables and lack of good data, it is not surprising that the range of projections in the case is wide. Mr. Wilson's projections predict that Rider PPA will actually added $117 million to the cost of electric service paid by customers.[40] Mr. Murray had a lower figure than Mr. Wilson (which is confidential), but he is also of the opinion the Rider PPA will only "stabilize" consumer prices by raising the price customers pay.[41] Mr. Taylor's prediction was negative in the first year (costing customers more), but he believes that overall the program is beneficial if taken out 8 ½ years. As for the ESP III period itself, Mr. Taylor proposes that AEP Ohio blend the projected savings with the current losses and have AEP Ohio give today's customers a credit in year one.[42]

The good news is the Commission does not need to spend a great deal of time with the projections to answer the basic question – will Rider PPA as drafted stabilize retail customer rates? Taking into consideration just the most favorable AEP Ohio projection, the answer is clear that Rider PPA cannot and will not stabilize retail customer rates. Simply put, the scope of the Rider PPA as presented, which just applies the OVEC generation as a counter weight to market prices, lacks the volume to have a meaningful impact on customer rates. The MWhs represented by OVEC units are only roughly 5% of the generation used by AEP Ohio.[43] Furthermore, the generation cost is only a portion of the price which customers pay for service.[44]

Even assuming AEP Ohio's second more favorable projection, the net impact on a residential customer buying 1,000 kWh is just 7¢ a month.[45] That would be a less than a dollar a year, an amount that will not buy a cup of coffee, let alone stabilize a household's power costs.

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[40] OCC Exhibit 15 at 9, 25.
[41] IEU Exhibit 1 A at 12.
[42] OEG Ex . 3 at 17-18.
[43] Tr. Vol. 2 at 480.
[44] *Id*. at 480; Tr. Vol. 3 at 688.
[45] Tr. Vol. 2 at 569-570.

By contrast, a residential customer who signed up for the Constellation fixed-price contract would save 1.55¢ per kWh over the Standard Service Offer for June 2014 and, for a 1,000 kWh load, the monthly savings would be $ 15.50.[46] Further, that price for kWh will remain constant for three years, whereas Rider PPA will change annually by an unknown and unknowable amount.

Moreover, Ohio's competitive marketplace offers much more effective and less expensive ways for retail customers to stabilize their rate and protect themselves from variable price risk, namely, long-term fixed-rate contracts. Further, it should be pointed out that, while the Commission's Apples-to-Apples chart shows three-year fixed-price offers for residential customers in the AEP Ohio service area, the AEP Ohio ESP III application is only firm for two years. If AEP Ohio is not satisfied with how its AEP Ohio ESP III is working out, it has reserved a right to unilaterally terminate the ESP III in two years. Using Mr. Allen's second projection, if AEP Ohio does in fact terminate in two years, then Rider PPA would produce a $3.4 million loss for customers.[47]

Since shopping for fixed prices, even for residential customers, is available for three years and Rider PPA is only a 2-3 year proposal, there is neither a need nor a justification for Rider PPA. The record establishes instead that Rider PPA is not reasonable or justified.

F. The Mechanism Allowing AEP to Add Additional Inter-Affiliate PPAs must be Rejected as Unlawful

When confronted with the fact that Rider PPA (just relying on the OVEC volumes) would have little impact, AEP Ohio's witness quickly pointed out that the OVEC generation is

[46] Constellation Ex. 2; Tr. Vol. 13 at 3228-3230.
[47] In Year One, there would be a Rider PPA loss of $6.2 million offset by a credit in Year Two of $2.8 million, for an overall loss of $3.4 million. Tr. Vol. 2 at 569.

only the beginning.[48] AEP Ohio is reserving the right to bring additional no bid, non-bypassable generation facilities[49] into Rider PPA in the future. Prior to the testimony at hearing, Nick Atkins, the chief executive officer of American Electric Power, told investors during an April 25, 2014 earnings call that it was considering placing some of its mostly coal-fired generation in a "quasi regulated" purchase power arrangement.[50] Further, AEP Ohio's Chief Executive Officer testified that any new generation brought to Rider PPA would be restricted to just those units formerly owned by the utility and now owned by the deregulated AEP Generation affiliate.[51] This should make clear that AEP Ohio's primary interest is focused on corporate revenue stability.

For the past decade, the Commission has dutifully been carrying out the electric restructuring in Senate Bill 3 and Senate Bill 221. As of this writing, all of the former legacy generation units from the three FirstEnergy utilities and all the legacy generation units from Duke and AEP Ohio have been transferred from the regulated utility to unregulated affiliated or third-party companies, save for the OVEC generation. Further, the Dayton Power and Light Company is under a Commission order to divest by January 1, 2016.[52] Just at the time when the State Energy Policy of separating the competitive from the non-competitive service is nearing completion and rate payers will no longer underwrite the costs of competitive generation, proposed Rider PPA has the capability of reversing 14 years of effort. Under Rider PPA, if AEP Ohio signs purchase power agreements with its generation affiliate, the ratepayers, who have

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[48] Tr. Vol. 1 at 179-180.
[49] AEP Ohio Ex. 1 at 8; Tr. Vol. 1 at 180-181.
[50] Constellation Ex. 1 at19.
[51] Tr. Vol. 1 at 180.
[52] *In the Matter of the Application of The Dayton Power and Light Company to Establish a Standard Service Offer in the Form of an Electric Security Plan*, Case Nos. 12-426-EL-SSO et al., Opinion and Order (September 4, 2013), Entry Nunc Pro Tunc (September 6, 2013); Entry on Rehearing (March 19, 2014), Entry on Rehearing (June 4, 2014).

already paid millions of dollars in transition monies to shift the financial risk of those old units to the stockholders, will be on the hook again. Further, the Commission would not have the right to remove penalties or costs which are not prudent. Finally, in addition to the financial implications, the inclusion of non-bypassable PPAs, with more and more of the price of generation being tied to utility-owned or affiliated plants, erodes the benefits of the competitive electric market for customers in two ways. First, because the ultimate price of power a CRES provider can supply is restricted[53] there is less value for the fixed-priced offers and less ability for competitive suppliers to distinguish themselves. Second, when confronting a hostile regulatory environment in which subsidies are provided to generation owned by the utility or an affiliate, many CRES providers may leave or refrain from entering the AEP Ohio service area. Counter to Section 4928.02 (C), Revised Code, that will produce fewer supplies and fewer suppliers from which customers can choose. When one looks at the level of self-dealing permitted in the Rider PPA process, Rider PPA's paradigm of non-bid, non-bypassable purchase power agreements between the utility and its affiliated generation must be rejected on public policy grounds.

Dr. Choueiki of the Staff identified the same policy issue in his direct prepared testimony:

> Staff is opposed to the concept of a PPA rider for OVEC generation, and even more opposed to including additional PPA in the PPA rider…. Staff is concerned that AEP Ohio may use this rider as a venue for other unregulated generation to be contracted

[53] For example, Constellation today offers residential customers a fixed price contract for generation for three years (See Constellation Ex. 2). Residential customers who have accepted that offer can budget knowing generation will cost $.0809 per kWh through fiscal 2017. If Rider PPA is approved then residential consumer's generation will cost will be $.0809 per kWh plus or minus the OVEC costs. The price certain for which the residential customer had contracted for will have been diminished. Further, since Rider PPA is non bypassable there is nothing the customer can do about it. If AEP Ohio brings all its former units into Rider PPA, the residential customers with the fixed-price contract above will have the price certainty for which they contracted greatly diminished.

> and paid for AEP Ohio distribution customers without it being competitively bid. (emphasis in the original)[54]

Any procurement of generation by AEP Ohio must be competitively bid. Both Ohio law and FERC law require it. To allow otherwise would permit an unlawful transaction between affiliates, to the benefit of the affiliates, and at the expense of AEP Ohio ratepayers.

G. The Commission should Reject Rider PPA

In closing on the Rider PPA rider, if the Commission wonders whether Rider PPA is proposed to stabilize retail customer costs or AEP Ohio revenues, it should consider two facts. First, Rider PPA is a construct that is not required by Section 4928.143, Revised Code, for an ESP; it is a request made in the Application by AEP Ohio. Second, AEP Ohio is the owner of the OVEC generation units and knows the most about them. From its position of superior knowledge, AEP Ohio's request is to swap the supposed upside of the OVEC power sales for a guaranteed payment from ratepayers; that alone speaks volumes. Those two facts outweigh thousands of pages of projections.

III. Pro-Competitive Proposals included in the ESP III Application

While Exelon finds itself at odds with AEP Ohio's proposed Rider PPA, it finds great merit in other aspects of the AEP Ohio ESP III application. Today, 61% of the AEP Ohio load is shopping.[55] That figure is below the estimates for shopping that AEP Ohio presented in the AEP Ohio ESP II case.[56] More importantly, the levels of shopping differ greatly when reviewing the different customer classes and sizes[57]. Simply put, residential customers lag behind their industrial and commercial counterparts even though savings are available to residential

[54] Staff Ex. 18 at 11-12.
[55] *See*, the switching statistics maintained by the Commission, *http://www.puco.ohio.gov/puco/index.cfm/industry-information/statistical-reports/electric-customer-choice-switch-rates/*, (accessed July 22, 2014).
[56] Tr. Vol. II at 595-596
[57] ELPC Ex. 1.

customers at prices far below AEP Ohio's standard service offer. As described in the Rider PPA section above, Constellation's offer to residential customers is far below that of AEP Ohio's standard service offer. Further, as shown on Exelon Exhibit No 2, Constellation is not the only CRES making three-year, fixed-price offers substantially below the standard service offer. Finally, the Commission's Apples-to-Apples chart shows an extensive number of offers for one- and two-year fixed-price products, as well as variable-priced offerings[58]. In light of the status of shopping in AEP Ohio's service territory and Exelon's desire for further development of the market in AEP Ohio's service territory, Exelon is supportive of four pro-competitive components in the AEP ESP III proposal.

A. Purchase of Receivables

The Commission has conducted a year-long investigation into the Retail Electric Market in Ohio.[59] The Staff, at the end of the investigation, issued a Staff Report as to the barriers that account for the lack of residential and small commercial shopping. Chief among the Commission Staff Report findings was the need for a purchase of receivables program.[59] The Retail Energy Supply Association (RESA), to which Exelon as well as over twenty other suppliers belongs, also endorses the establishment of a purchase of receivables program in AEP Ohio's service territory. RESA witness Bennett articulated seven benefits which would flow from a purchase of receivables program.[60] Exelon agrees with Mr. Bennett's findings that the streamlining of the billing and collection process will result in more CRES providers entering the AEP Ohio market and a greater variety of products being offered particularly to residential

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[58] *See*, the Apples-to-Apples chart maintained by the Commission, *http://www.energychoice.ohio.gov/ApplesToApplesComparision.aspx?Category=Electric&TerritoryId=2&RateCode=1*, (accessed July 22, 2014).

[59] *In the Matter of the Commission's Investigation of Ohio's Retail Electric Service Market*, Case No. 12-3151-EL-COI, Finding and Order (March 26, 2014) and Entry on Rehearing (May 21, 2014).

[59] *Id*., Staff Market Development Work Plan (filed January 16, 2014) at 16-17.

[60] RESA Ex. 3 at 7.

customers. Such a position is in keeping with the State Energy Policy. Section 4928.02(C), Revised Code, directs the Commission to institute actions which will ensure that there is a diversity of supplies and suppliers. Purchase of Receivables does that precisely because it eliminates the necessity of both the utility company and the CRES provider tracking the invoices, the customer payments and the allocation of the customer payments between utility and CRES provider[60]. From the customer's prospective there will only be one service deposit and if the customer falls behind one creditor and one billing arrangement to be negotiated.

As part of the Duke Energy Ohio Inc.'s ESP II proceeding,[61] Duke has instituted a purchase of receivables program utilizing a bad debt tracker. In addition, all the major Ohio gas utilities have purchase of receivables programs with bad debt trackers. As noted in Mr. Bennett's testimony, there have been few if any problems with those systems. Exelon holds a competitive retail natural gas certificate as well as a CRES certificate, and its experience is the same as that expressed by Mr. Bennett from the stand.

Exelon, though, does have two suggestions to the purchase of receivables program and bad debt tracker proposed by AEP Ohio. While it is clear that all CRES providers using consolidated billing will have to be in the proposed purchase of receivables program, the proposed program does not provide that such includes participation in the bad debt tracker. As a practical matter, from Exelon's prospective, it does not make sense to administer a purchase of receivables program and make the use of the bad debt tracker an option.[62] Theoretically, it may

[60] Constellation Ex. 1 at 10
[61] *In the Matter of the Application of Duke Energy Ohio Inc. for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan, Accounting Modifications, and Tariffs for Generation Service*, Case No. 11-3549-EL-SSO, et al., Opinion and Order (November 22, 2011).
[62] Constellation Ex. 1 (Direct Prepared Testimony of Campbell) at 10.

be possible if a CRES provider substituted it own terms, but that would result in the utility having different bad debt rates and collection terms in the same consolidated bill program. [63]

The same need for uniformity plagues the Staff recommendation that the bad debt tracker be phased in after AEP Ohio begins using a discount rate for the purchase of receivables program. In the initial phase, the receivable would be discounted to match the actual bad debt experience. Thus, CRES providers would have a different discount rate based on the CRES provider's individual collection experience.[64] There are sixty-nine registered CRES providers in AEP Ohio's service territory.[65] If all were to actively solicit customers, then AEP Ohio will have up to 69 different discount rates, which would change periodically. That proposal creates an administrative nightmare. It also is by nature imprecise. What discount rate should be used until the CRES establishes a payment track record? The logical answer is the use of AEP Ohio's historic bad debt experience, if a discount model is going to be used for the purchase of receivables. Use of AEP Ohio's actual bad debt experience by class in lieu of calculating numerous individual payment experiences of the various CRES providers is easier to administer and would not leave like end users paying rates based on different bad debt discounts.

The purpose of the purchase of receivables program is to add to the supplies and suppliers participating in the AEP Ohio service area. Staff's proposal, rather than streamlining the billing and collection process, makes it more complex and subject to change. Exelon suggests that the bad debt tracker proposed by AEP Ohio be adopted. If the bad debt tracker is not adopted and a discount plan is used, it should be based on the actual, historic bad debt experience of AEP Ohio by customer class. Finally, if the bad debt tracker is adopted, the

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[63] AEP Ohio will not purchase receivables in instances of dual billing. (AEP Ohio Ex. 11 at 6)
[64] Staff Exhibit 14 (Direct Prepared Testimony of Donlon) at 7_.
[65] Tr. Vol. 3 at 868, 871-872.

information as to its collection should made be available to both supplier and customer and the bad debt tracker should be part of the "wire" service and clearly identified on the customer's invoice.

B. Time-Of-Use Tariffs

As described in the testimony of AEP Ohio witnesses Spitznogle and Moore,[66] AEP Ohio will not have an independent source of power once the full capacity and energy auctions procure power commencing in mid-2015. That makes providing time-of-day products problematic for AEP Ohio, for the power and capacity obtained through the auctions cannot be shaped or integrated into the price being offered to the customers who sign up for time-of-day or otherwise takes steps to buy off-peak. The same is not true for CRES providers of time of day products. If the CRES provider provides the service there will be interaction between the supplier and the customer. Rates then can be established on the true market value of the customers' conservation or time-augmented use. With auction procured power the time of day products are not connected to the value of the conservation and based on how the prices are set will end up being charged or credited to all standard service customers as part of a true up. Finally, eventually time of day must be provided by the competitive marketers in the restructured market[61]. There is no reason not to start from the beginning. If no suppliers offer programs temporary arrangements could be made at that time. The continued use of time of day products that are not truly market supplied or market based will prolong the day that such products are developed by actual suppliers.

For that reason, the existing pilot programs should sunset as provided for in the Application, so that CRES providers provide time-of-day and off- and on-peak products.

C. Basic Transmission Cost Rider

[66] AEP Ohio Exs. 3 and 13, respectively.
[61] Constellation Ex. 1 at 11

A non-bypassable rider for certain non-market-based transmission charges imposed by PJM Interconnection LLC is appropriate for AEP Ohio. Exelon especially supports the inclusion of NITS and TEC, as they are not market-based and therefore not hedgeable by a SSO supplier or CRES provider[62].

It is very difficult for suppliers to financially hedge non-market-based services because of how those charges are calculated and imposed. Having AEP Ohio provide the non-market-based services and recover the costs from all customers through a rider that imposes a reconcilable, non-bypassable charge, allows competitive neutrality to be maintained and all customers to benefit[63].

Additionally, the creation of a non-bypassable rider for non-market-based transmission charges is consistent with the Commission's decision for other EDUs in Ohio.[67] Therefore, the BTCR should be approved.

D. Maintaining the proposed auction process and schedule

The last item that AEP Ohio presented in the ESP III which Exelon believes improves the competitive market is its auction program. The auction program as filed is workable and should bring the benefits of competitive bidding for both capacity and power to the standard service customers. During the course of the hearing, questions were raised in cross-examination about

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[62] Constellation Ex. 1 at 29

[63] Id

[67] AEP Ohio Ex. 13 at 8. Recently, the Commission approved a rider for non-marketed-based transmission charges for The Dayton Power and Light Company. *In the Matter of the Application of The Dayton Power and Light Company to Establish a Standard Service Offer in the Form of an Electric Security Plan*, Case Nos. 12-426-EL-SSO et al., Opinion and Order at 36 (September 4, 2013). The Commission approved Duke's rider in 2011. *In the Matter of the Application of Duke Energy Ohio, Inc. for Authority to Establish a Standard Service Offer Pursuant to Section 4928.142, Revised Code, in the Form of an Electric Security Plan, Accounting Modifications, and Tariffs for Generation Service,* Case Nos. 11-3459-EL-SSO et al., Opinion and Order (November 22, 2011).

the auction schedule of the third year of the ESP III[64]. The proposed auction schedule calls for two auctions for the final year, each with one year contract terms[65]. Exelon assumes this pattern was adopted because AEP Ohio can terminate the ESP III after two years., In order to avoid the contract issues if the ESP III ended before the last year, supplying the last year was not incorporated in the ESP III auctions which take place in year one.

Exelon in this proceeding is taking the position that AEP Ohio should not have the right to terminate the ESP III after two years (which is further addressed below). In keeping with that position, Exelon would not object to amending the auction schedule to provide for some auctioned tranches of three-year durations.

IV. Unilateral Right to Terminate the ESP III

A. No Statutory Authority

AEP Ohio's reservation of the right to terminate the ESP III at the end of the second year lacks statutory authority. Section 4928.143, Revised Code, allows the utility to decide (when the Commission modifies and approves a proposed ESP) whether to accept the ESP or withdraw it, thereby terminating it. There is no authority for a termination two years into a three-year term when the utility no longer likes the rates that were set.[68]

B. No Criteria Has Been Established

AEP Ohio's reservation is unsubstantiated. There has been no clarification, examples or objective criteria provided, despite discovery inquiries. Mr. Campbell testified that there is no objective criterion by which AEP Ohio might avail itself of the provision, or by which the

[64] Tr. Vol 4 at 1151- 1153
[65] AEP Ohio Ex. 15 at CL-10.
[68] Constellation Ex. 1 at 25.

Commission would evaluate whether AEP Ohio's election of the early termination provision is proper.[69]

C. Uncertainty will be Created

AEP Ohio's reservation creates significant uncertainty. Giving AEP Ohio almost unfettered discretion to decide on a moment's notice to end the ESP a year earlier than scheduled creates tremendous uncertainty within the market, adds risk (and cost), all of which could chill competition. As Mr. Campbell noted, CRES providers may be reluctant to offer contracts beyond the termination date and may build the risk into the price. [70]

D. Proposed Timeframe is Problematic

If this reservation is accepted by the Commission and exercised, it is questionable whether the Commission would be able to enter a final order in time (in advance of June 1, 2017) after AEP Ohio's notice of termination. This will add even more uncertainty.

Exelon strongly opposes this term.

V. An Additional Non-Market-Based Transmission Charge Should be Included in the Basic Transmission Cost Rider – Generation Deactivation Charge, PJM Line Id. No. 1930

Adding the Generation Deactivation Fee (also referred to as the Reliability Must Run or RMR charge) into the BTCR will level the playing field for both SSO customers and shopping customers and better align AEP with other Ohio EDUs. The RMR charges are assessed to pay generation owners to continue to operate units beyond their proposed deactivation date pending

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[69] *Id*. at 26.

[70] Mr. Campbell added that, given the amount of time that a fully litigated proceeding takes, it is questionable whether the Commission would be able to enter a final order in advance of June 1, 2017, if the notice to terminate presented in September 2016, as AEP Ohio proposes. (Constellation Ex. 1 at 27)

completion of transmission upgrades to ensure system reliability. They are one of the more volatile and unpredictable non-market-based costs to which suppliers are subject[66].

Adding the RMR would be consistent with all other Ohio EDUs, which is one of the Commission's stated goals in the recent decision in the RMI docket, Case No. 12-3151-EL-COI.

VI. Conclusion

For the foregoing reasons, the Commission should modify AEP's proposed ESP III plan in the following respects:

- Reject the proposed Rider PPA in totality;
- Approve AEP Ohio's proposed purchase of receivables program;
- Approve AEP Ohio's proposed bad debt tracker;
- Accept the elimination of AEP Ohio's time-of-use tariffs;
- Approve AEP Ohio's proposed basic transmission cost rider;
- Add into the basic transmission cost rider the Generation Deactivation Charge PJM Line Id. No. 1930 (also referred to as the Reliability Must Run or RMR charge);
- Approve AEP Ohio's proposed auction process and schedule, with allowance in the auction schedule to provide for some auctioned tranches of three-year durations); and
- Reject AEP's "reservation" of the right to terminate the ESP III plan early, at the end of the second year.

Respectfully Submitted,

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[66] Constellation Ex. 1 at 30-31

CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the foregoing document has been served upon the persons below via electronic mail this 23rd day of July 2014.

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