BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission Review )

of the Capacity Charges of Ohio Power ) Case No. 10-2929-EL-UNC

and Columbus Southern Power Company. )

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**THE OHIO SCHOOLS’**

**MEMORANDUM CONTRA AEP OHIO’S APPLICATION FOR REHEARING**

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***I. INTRODUCTION***

Now come the Ohio Schools,[[1]](#footnote-1) through counsel and pursuant to Rule 4901-1-35, Ohio Admin. Code, and submit this memorandum contra AEP Ohio’s[[2]](#footnote-2) application for rehearing filed in this proceeding on July 20, 2012.

The Public Utilities Commission of Ohio (“Commission”) placed at issue in this proceeding the following three questions:

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

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

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

See Opinion and Order issued July 2, 2012, (“Order”), at 9. As to the first issue, the Commission took subject matter jurisdiction over the state compensation mechanism pursuant to its general supervisory powers contained in Sections 4905.04, 4905.05, and 4905.06, Ohio Rev. Code. The Commission specifically rejected that its authority was derived from Chapter 4928, Ohio Rev. Code, finding that such chapter related to retail electric service, and that the capacity compensation in question was an intrastate wholesale matter. Order, at 12-13.

As to the second issue, the Commission found that the state compensation mechanism should be cost-based, relying on its “regulatory authority under Chapter 4905, Revised Code, as well as Chapter 4909, Revised Code.” Order, at 22. The Order does not identify the specific provisions of Chapters 4905 and 4909, Revised Code, which the Commission followed to set cost-based capacity rates, other than a reference to Section 4905.22, Ohio Rev. Code, which generally requires rates to be just, reasonable and lawful.

Finally, as to the third issue the Commission adopted a capacity charge of $188.88/MW-day, using “the capacity portion of a formula rate template approved by FERC for one of the Company’s affiliates,” as the starting point and making various adjustments “consistent with…ratemaking practices in Ohio.” Order, at 33-34. Further, relying on Section 4928.02 and 4928.06(A), Ohio Rev. Code, the Commission ordered AEP Ohio to charge competitive retail electric service (“CRES”) providers the current RPM price for capacity, with the difference between the RPM price and the $188.88 cost-based capacity charge to be deferred pursuant to Section 4905.13, Ohio Rev. Code, and recovered through a mechanism to be established in the pending electric service plan (“ESP”) proceeding (see PUCO Case No. 11-346-EL-SSO, et al.). Order, at 23.

AEP Ohio raises the following four general grounds for rehearing:

1. The Energy Credit Adopted in Reaching the $188.88/MW-Day Capacity Cost is Unreasonable and Unlawful.

2. The Order Creates a State Compensation Mechanism that is Unconstitutionally Confiscatory and that Results in an Unconstitutional Taking of Property without Just Compensation.

3. It was Unreasonable and Unlawful for the Commission to Adopt a Cost-Based State Compensation Mechanism and then Order AEP Ohio to Only Charge CRES Providers RPM Pricing Far Below the Cost-Based $188.88/MW-Day Rate that the Commission Determined was Just and Reasonable.

4. It was Unreasonable and Unlawful for the Commission to Fail to Address the Merits of AEP Ohio’s January 7, 2011 Application for Rehearing, Which the Commission Granted of February 2, 2011 for the Purpose of Further Considering It, in the July 2 Opinion and Order.

In its application for rehearing filed in this proceeding, the Ohio Schools make clear that the Commission erred by adopting a cost-based capacity mechanism in this proceeding. The genesis of AEP Ohio’s self-proclaimed “right” to change the capacity charge from RPM to a cost-based charge was PJM’s Reliability Assurance Agreement (“RAA”), and specifically Section D.8 of Schedule 8.1, which provides:

In the case of load reflected in the FRR Capacity Plan that switches to ***[a CRES],*** ***where the state regulatory jurisdiction requires*** switching customers or ***the [CRES]*** t***o compensate the FRR Entity for its FRR capacity obligations, such state compensation mechanism will prevail***. ***In the absence of a state compensation mechanism***, ***the applicable******[CRES] shall compensate the FRR Entity at [rest-of-pool or “RTO” clearing prices], provided that******the FRR Entity may, at any time, make a filing with FERC*** under Sections 205 of the Federal Power Act proposing ***to change the basis for compensation to a method based on the FRR Entity’s costs*** or such other basis shown to be just and reasonable. (Emphasis supplied.)

The emphasized language makes clear that a state compensation mechanism prevails over FERC approved capacity rates, and provides authority only for an FRR entity to apply to FERC to seek a change from RPM pricing to a cost-based rate. This language does not require a state (such as Ohio) with an RPM state compensation mechanism to provide an FRR entity (such as AEP Ohio) with cost-based rates. Rather, Ohio’s statutory schemes apply. In Ohio, generation is a competitive service and capacity, as a generation service, requires market-based (RPM) pricing, as recognized in the Commission’s December 8, 2010, order in this proceeding. Thus, the Commission’s order fixing a cost-based rate for a generating service in this proceeding is unreasonable and unlawful. Accordingly, the Commission’s July 2, 2012 order in this proceeding must be reversed and traditional RPM pricing restored as the state compensation mechanism.

However, if it were assumed that the Commission has authority to set cost-based capacity rates, that authority is derived from Chapter 4909, Ohio Rev. Code, and the Commission’s failure to follow the statutory ratemaking scheme contained therein is fatal to the Order. If it were assumed that the Commission has authority to set cost-based capacity rates, the Commission must order AEP Ohio to file an application pursuant to Section 4909.18, Ohio Rev. Code, and set capacity rates in accordance with the Ohio’s traditional ratemaking formula contained in Section 4909.15, Ohio Rev. Code.

***II. ARGUMENT***

**A. IF IT IS ASSUMED THAT THE COMMISSION HAS AUTHORITY TO SET COST-BASED CAPACITY RATES (WHICH IT DOESN’T), The COMMISSION MUST REQUIRE aep OHIO TO FILE AN APPLICATION for an increase in rates UNDER sEction 4909.18, ohio rev. code.**

In deciding the issues presented in this proceeding, the Commission, after determining that it possessed jurisdiction to establish a state compensation mechanism and to adopt a cost-based capacity charge, should have required AEP Ohio to file an application for an increase in rates pursuant to Section 4909.18, Ohio Rev. Code. The Commission then could have properly determined the level of the capacity charge under the required statutory ratemaking formula. Instead, without the submission of standard filing requirements and without following the processes required by Sections 4909.05, 4909.15, 4909.18 and 4909.19, the Commission unlawfully established “cost-based” capacity rates based on “the capacity portion of a formula rate template approved by FERC for one of the Company’s affiliates.” Id., at 33-34. In doing so, the Commission committed plain error that will survive neither an appeal, nor an application for a writ of prohibition to the Ohio Supreme Court. See *Columbus Southern Power Co. v. Pub. Util. Comm*. (1993), 67 Ohio St.3d 535, 540 (The Commission cannot disregard the ratemaking formula in Chapter 4909, Ohio Rev. Code, in setting cost-based rates).

In its application for rehearing, AEP Ohio requests the Commission to order an evidentiary rehearing to evaluate the energy credit adopted in this proceeding. The request does not go far enough. If the Commission has authority to set cost-based capacity rates (which it doesn’t), it must order AEP Ohio to file an application pursuant to Section 4909.18, and comply with the provisions of that section and Sections 4909.05, 4909.15 and 4909.19. Considering that the interim capacity prices currently in effect expire on August 8, 2012 per the Order, the permanent state compensation mechanism established in the December 8, 2010, order would apply during the interim.

**B. ASSUMING THE COMMISSION’S AUTHORITY TO SET COST-BASED CAPACITY CHARGES IS DERIVED FROM SECTION 4905.22, OHIO REV. CODE (WHICH IT IS NOT), AEP OHIO CANNOT COMPLAIN THAT THE COMMISSION LACKS AUTHORITY TO DEFER THE REDUCED PORTION OF THE CAPACITY CHARGE AND TO CONSIDER ITS RECOVERY IN A SUBSEQUENT PROCEEDING.**

***1. The Commission’s has Wide Discretion under Section 4905.13, Ohio Rev. Code, in Matters Falling Outside of the Ratemaking Formula Contained in Section 4909.15, Ohio Revised Code.***

In its application for rehearing, AEP Ohio claims that the Commission has no statutory authority to order a capacity charge of $188.88/MW-Day and then order it to charge CRES providers RPM pricing, with the difference to be deferred pursuant to Section 4905.13, Ohio Rev. Code, for future recovery.

As previously explained, if it is assumed that the Commission has authority to set cost-based capacity rates (which it does not), the rates must be set in accordance with Chapter 4909, Ohio Rev. Code, and specifically Sections 4909.15, 4909.18, and 4909.19. Unfortunately, AEP Ohio did not properly file its application in this proceeding as an application for an increase in rates pursuant to Section 4909.18, and the Commission did not follow the legislative dictates of Chapter 4909 in setting the capacity rate in this proceeding. Rather than relying on the appropriate ratemaking statutes in Chapter 4909, AEP Ohio (as well as the Commission in its Order) attempts to place undue significance on Section 4909.22, Ohio Rev. Code, as authority to set cost-based rates.[[3]](#footnote-3) This section only prohibits a utility from charging an unjust, unreasonable, or unlawful rate. It does not prescribe the methodology for determining what the just, reasonable, and lawful rate is.

The Ohio Supreme Court generally has recognized that a deferral or phase-in of rates set pursuant to the ratemaking formula in Section 4909.15, Ohio Rev. Code is unlawful. See, e.g., *Columbus Southern Power Co., v. Pub. Util. Comm*. (1993), 67 Ohio St.3d 535. On the other hand, the Supreme Court has recognized the Commission’s wider discretion in issuing accounting orders when not setting rates pursuant to Section 4909.15, Ohio Rev. Code. See, e.g., *Elyria Foundry Co. v. Pub. Util. Comm*. (2007), 114 Ohio St.3d 305, 308, citing *Payphone Assn. of Ohio v. Pub. Util. Comm., 109 Ohio St.3d 453, and Columbus v. Pub. Util. Comm. (1984), 10 Ohio St.3d 23.* Because AEP Ohio has refused to accept the ratemaking formula and processes contained in Sections 4909.15, 4909.18, and 4909.19, Ohio Rev. Code, it cannot complain the Commission lacks authority to order the deferral in question.

***2. It is Not Unreasonable for the Commission to Consider Recovery of the Deferrals in the ESP Proceeding.***

AEP Ohio claims it is unreasonable for the Commission to order that the deferrals created in this proceeding be recovered in a mechanism to be set in the ESP proceeding. AEP Ohio asks the Commission to provide a mechanism to recover the deferrals in this proceeding. Order, at 59. As a threshold matter, it must be noted that the Company devised a litigation strategy to seek a cost-based capacity charge in this proceeding, and have it applied (albeit at discounted rates) in the ESP proceeding, with the amount of the discounted capacity charges being recovered through the Retail Stability Rider (“RSR”).[[4]](#footnote-4) See ESP Case, PUCO NO. 11-346-EL-SSO (Application, filed March 30, 2012), at 10-12. The Commission’s deferral operates under the same strategy and AEP Ohio should not be heard to complain. Of course, under the Company’s strategy, if its requested $355/MW-day capacity charge were granted and the Company rejected a modified ESP, it still could charge the $355/MW-day price, rather than the discounted price provided in the ESP. Certainly, the Company was aware of the competing cost methodologies in this case and accepted the risk that the charge approved could be lower than its request.

1. **If the Commission Sets a Mechanism to Recover the Deferrals in this Proceeding, It Must Exempt Ohio’s Schools from the Deferred Charge.**

In the ESP proceeding, the Ohio Schools have challenged, and will continue to challenge, AEP Ohio’s proposal to collect unrecovered capacity charges through the RSR. Moreover, the Ohio Schools provided overwhelming legal authority in its initial ESP brief and reply brief that would require the Commission to exempt the Ohio’s schools from the RSR charge.

If the Commission were to set a mechanism to recover the ordered deferrals in this proceeding, this same authority would apply to require the exemption of the Ohio Schools from the deferred charges. Thus, the Ohio Schools incorporate by reference in this brief, its Initial and Reply briefs filed June 29 and July 9, 2012, in the ESP proceeding.

***3. The Commission’s Reliance on Sections 4928.02 and 4928.06(A), Ohio Rev. Code, in Reducing the Capacity Charge to RPM Prices Merely Reinforces the Unlawfulness of Cost-Based Capacity Charges.***

AEP Ohio claims that the Commission erred by finding that capacity is an intrastate wholesale service not subject to Chapter 4928 Ohio Rev. Code, but then relied on the provisions of Sections 4928.02 and 4928.06(A), Ohio Rev. Code, to justify lowering the capacity charge that AEP Ohio could charge CRES providers to the RPM price. The Commission’s findings further represent its error in finding that it had jurisdiction to impose a cost-based charge upon a competitive service. As stated previously, there is no dispute that capacity is a generation charge and that generation service is competitive in Ohio. Indeed, the Commission went on to justify charging CRES providers the market-based RPM rate, noting that, “RPM-based capacity pricing has been used successfully throughout Ohio and the rest of the PJM region and puts electric utilities and CRES providers on a level playing field.” Order, at 23. The Commission can correct this error by reversing its order on rehearing and setting market-based RPM pricing for AEP Ohio’s capacity.

**C. AEP OHIO’S CONSTITUTIONAL ARGUMENTS ARE WITHOUT MERIT**

The Company also asserts that the Commission’s order is confiscatory pursuant to *Fed. Power Comm. v. Hope Natural Gas Co.* (1944), 320 U.S. 591 (“*Hope*”). The Company states that, “[i]f the Commission agrees to rehear this case and modify its Order as the Company requests herein, then these pressing constitutional issue may be avoided.” Application for Rehearing, at 44.

More appropriately, these constitutional issues are properly avoided if the Commission were to recognize in this proceeding, as it should, that generation services are competitive in Ohio, and that competitive market-based rates apply. *Hope* and its progeny apply only to regulated services, and not to unregulated ones. See, e.g., *Fed. Power Comm. v. Natural Gas Pipeline Co*. (1942), 315 U.S. 575, 590 (unregulated businesses bear the risk that property will not earn a profit). Finding that generation in Ohio is a competitive service and ordering market-based RPM capacity pricing would shield the Commission from AEP Ohio’s claims of confiscation.

Moreover, assuming the Commission has authority to set cost-based rates (which it does not), it must set such rates pursuant to the specific requirements of Section 4909.15, Ohio Rev. Code. If the Commission’s determinations are made in accordance with the mandated ratemaking formula, thus balancing investor and consumer interests, the rates are just and reasonable and not confiscatory. *Ohio Edison Co. v. Pub. Util. Comm*. (1992), 63 Ohio St.3d 555, 565; see, also, *Dayton Power & Light Co. v. Pub. Util. Comm*. (1983), 4 Ohio St.3d 91. Accordingly, AEP Ohio must file an application for an increase in rates, pursuant to Section 4909.18, Ohio Rev. Code, to enable the Commission to ensure that the rates are not confiscatory under Section 4909.15, Ohio Rev. Code.

Finally, AEP Ohio argues that the Order constitutes a partial taking of its property under *Penn Central Transp. Co. v. New York City* (1978), 438 U.S. 104, and its progeny. In making its claim, the Company relies on evidence submitted in the ESP case. AEP Ohio’s reliance on such extra-record evidence is improper, requiring that such extra-record evidence appearing at pages 53-55 of the Company’s application for rehearing be stricken. The Ohio Schools so move.

In any event, the Company’s reliance on testimony and evidence from the ESP case shows that a determination as to confiscation or a partial taking cannot be made until the ESP case is decided. The Company’s arguments are premature.

***III. CONCLUSION***

The Commission is without authority to set cost-based rates in this proceeding and should reverse its July 2, 2012 decision and order market-based RPM pricing for AEP Ohio’s capacity. If it is assumed that the Commission has authority to set cost-based capacity charges, the Commission must reverse its order and follow the legislatively mandated ratemaking process contained in Sections 4909.05, 4909.15, 4909.18, and 4909.19, Ohio Rev. Code. Considering that the interim capacity prices currently in effect expire on August 8, 2012 per the Order, the permanent state compensation mechanism established in the December 8, 2010, order would apply during the interim.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that a true copy of the foregoing *Ohio Schools’ Memorandum Contra AEP Ohio’s Application for Rehearing* was served by electronic mail this 30th day of July, 2012, upon the following.

\_\_\_\_\_\_/s/ Dane Stinson\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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1. Joint Intervenors Buckeye Association of School Administrators, Ohio Association of School Business Officials, Ohio School Boards Association and Ohio Schools Council are collectively referred to as the “Ohio Schools.” [↑](#footnote-ref-1)
2. Ohio Power Company and Columbus Southern Power Company merged effective December 31, 2011. Ohio Power Company is the surviving entity and will be referred to as “AEP-Ohio” or “the Company.” [↑](#footnote-ref-2)
3. Section 4905.22 provides in part:

   Every public utility shall furnish necessary and adequate service and facilities, and every public utility shall furnish and provide with respect to its business such instrumentalities and facilities, as are adequate and in all respects just and reasonable. ***All charges made or demanded for any service rendered, or to be rendered, shall be just, reasonable and not more than charges allowed by law or order of the public utilities commission***...

   Emphasis added. AEP Ohio inartfully attempts to turn this provision, which prohibits a utility from charging unjust, unreasonable or unlawful rates, into a standalone ratemaking statute by stating, “R.C. 4905.22 vests the Commission with the authority to allow an electric utility to collect only those charges that are ‘just and reasonable.’ It does not authorize the Commission to require a utility to collect less that [sic] a just and reasonable charge.” Emphasis original. AEP Ohio turns this statute on its head. [↑](#footnote-ref-3)
4. The Ohio Schools have challenged, and will continue to challenge, the Company’s proposal to recover capacity charges through the standard service offer in the ESP proceeding. [↑](#footnote-ref-4)