BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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

REPLY BRIEF
OF
DUKE ENERGY COMMERCIAL ASSET MANAGEMENT
AND
DUKE ENERGY RETAIL SALES

I. INTRODUCTION

Ohio Power Company (AEP Ohio) seeks an outcome in this case that blatantly contradicts law that has been established in Ohio for more than a decade. It does so without reference to statutory authority, on the basis of a "mission statement" of the Public Utilities Commission of Ohio (Commission).[1] The Commission should see through this astounding attempt to subvert the will of the Ohio legislature and issue an order based on clear, applicable law.

In this Reply Brief, Duke Energy Retail Sales, LLC (DER), and Duke Energy Commercial Asset Management, Inc. (DECAM), will address the illegal aspects of AEP Ohio's request for a cost-based capacity rate, as well as its incorrect interpretation of controlling contract language in the Reliability Assurance Agreement (RAA) of PJM Interconnection, L.L.C. (PJM). Because DER and DECAM do not agree that a cost-based capacity rate should be allowed under any circumstances, no discussion is included concerning the calculation of such a

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[1] AEP Ohio Initial Post-Hearing Brief, p. 16.

rate or the existence or calculation of an energy credit. However, the lack of such discussion should not be interpreted as agreement with AEP Ohio's methodology for calculating a cost-based capacity rate, with its assertion that no energy credit should be allowed, or with its calculation of an energy credit.

II. THE RAA: INTERPRETATION AND APPLICATION

No one disagrees that AEP Ohio is bound by the terms of PJM's RAA. The terms of that document control AEP Ohio's obligations to PJM, requiring it to provide capacity for the load in its footprint. Further, no one disagrees that the RAA provides two quite different options for how the capacity to serve the load is to be provided. Under one option, the Reliability Pricing Model (RPM), PJM is responsible for securing the capacity resources needed for the offered load. Members bid their generation resources into a series of auctions that result, first, in the Base Residual Auction (BRA) rate and, ultimately, in the Final Zonal Capacity Price (FZCP). Under the other option, the Fixed Resource Requirement (FRR) option, a PJM member that has voluntarily elected to do so must supply – from any available resource – capacity to serve the load in its certified territory. AEP Ohio is an FRR entity, having made that election voluntarily in 2007.[2]

The various parties in this proceeding also agree that the controlling language in the RAA is found in Schedule 8.1 of Section D.8. Ohio law provides that, where a contract is unambiguous, it is to be interpreted on the basis of the four corners of that contract, without reference to outside evidence.

> When confronted with an issue of contract interpretation, the role of the court is to give effect to the intent of the parties to that agreement. The court examines the contract as a whole and presumes that the intent of the parties is reflected in the language used in the agreement. *Westfield Ins. Co. v. Galatis*, 100 Ohio St.3d 216, 2003 Ohio 5849, 797 N.E.2d 1256, ¶ 11. "Where the parties following negotiation make mutual promises which thereafter are integrated into an unambiguous

[2] Tr. VIII, p. 1605.

> contract duly executed by them, courts will not give the contract a construction other than that which the plain language of the contract provides." *Aultman Hosp. Assn. v. Community Mut. Ins. Co.* (1989), 46 Ohio St.3d 51, 544 N.E.2d 920, paragraph one of the syllabus. "When the language of a written contract is clear, a court may look no further than the writing itself to find the intent of the parties." *Galatis* at ¶ 11. Evidence cannot be introduced to show an agreement between the parties that is materially different from that expressed by the clear and unambiguous language of the instrument. *Blosser v. Enderlin* (1925), 113 Ohio St. 121, 2 Ohio Law Abs. 499, 3 Ohio Law Abs. 389, 148 N.E. 393, paragraph two of the syllabus. "As a matter of law, a contract is unambiguous if it can be given a definite legal meaning." *Galatis* at ¶ 11.[3]

As will be seen, the RAA is a contract whose language, in the relevant section, can be given definite legal meaning. Thus, it is legally unambiguous and must be interpreted without reference to outside evidence, such as testimony by AEP Ohio's witness as to the purported intent of the drafters.[4]

While the RAA has been quoted in numerous briefs, it will be laid out here, again, in relevant part, breaking the quote up into the provision's two separate sentences, in order to see the evident fallacies in AEP Ohio's interpretation.

> [First Sentence:] In the case of load reflected in the FRR Capacity Plan that switches to an alternative retail LSE, where the state regulatory jurisdiction requires switching customers or the LSE to compensate the FRR Entity for its FRR capacity obligations, such state compensation mechanism will prevail.
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> [Second Sentence:] In the absence of a state compensation mechanism, the applicable alternative retail LSE shall compensate the FRR Entity at the capacity price in the unconstrained portions of the PJM Region, as determined in accordance with Attachment DD to the PJM Tariff, provided that the FRR Entity may, at any time, make a filing with FERC under Section 205 of the Federal Power Act proposing to change the basis for compensation to a method based on the FRR Entity's cost or such other basis shown to be just and reasonable, and a retail LSE may at any time exercise its rights under section 206 of the FPA.

AEP Ohio proposes that this section should be read to allow three, equally available options: a state compensation mechanism, the auction price (FZCP), or a cost-based price. AEP

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[3] *Martin Marietta Magnesia Specialties v. Pub. Util. Comm.*, 129 Ohio St.3d 485, 490, 2011 Ohio 4189, ¶22, 954 N.E.2d 104, 110.

[4] AEP Ohio Initial Post-Hearing Brief, p. 14-15.

Ohio stresses its contention that the words of this section allow an FRR entity to change to a cost-based price at any time.[5]

There are two errors with this contention. First, AEP Ohio apparently fails to note the separation of the provision into two separate sentences. In the first sentence, the RAA unambiguously establishes that a state mechanism, if it exists, will always prevail. There can be no doubt that this sentence can be given a definitive, legal meaning. Only in the second sentence does the RAA make reference to a cost-based charge and, then, only in the absence of a state mechanism. Again, the contract language can certainly be given legal meaning and is, thus, unequivocal. AEP Ohio, however, attempts to create an ambiguity where none exists and argues that it has the right to "change the basis for capacity pricing to a cost-based method at any time."[6] Unfortunately for AEP Ohio, nowhere does the section say that a cost-based mechanism will ever prevail over a state mechanism. Quite the contrary; there is no right to a cost-based mechanism when a state mechanism exists.

AEP Ohio's second error is that it appears to miss the fact that, even if there were no state mechanism, the section does not grant the FRR entity an absolute right to a cost-based charge.[7] Rather, the RAA would, in that limited circumstance, allow the FRR entity to apply to the Federal Energy Regulatory Commission (FERC) for permission to charge a cost-based rate. Thus, AEP Ohio errs in its suggestion that the RAA's language "provides that the FRR Entity may, at any time, change the basis for compensation to a method based on the FRR Entity's cost."[8] It may do no such thing. To allow an FRR entity to change its capacity costs, at its own volition, would be the end of regulatory control.

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[5] AEP Ohio Initial Post-Hearing Brief, p. 14.

[6] AEP Ohio Initial Post-Hearing Brief, p. 14 (emphasis in original).

[7] *See, e.g.*, AEP Ohio Initial Post-Hearing Brief, p. 8-9, 32, and 70.

[8] AEP Ohio Initial Post-Hearing Brief, p. 14.

There can be no real dispute about the interpretation of the RAA's relevant provision. A state may establish a mechanism to require compensation of the FRR entity for its capacity. Only in the event that the state has not taken such an action may the FRR entity either charge for capacity at the FZCP or apply to the FERC for permission to charge a cost-based rate.

AEP Ohio also argues that the intent of the state mechanism language was, when drafted, to allow a state to implement a requirement for a charge directly to a retail customer. AEP Ohio states that "it should be manifestly evident that Section D.8's reference to a state compensation mechanism contemplates a retail – not a wholesale – capacity charge."[9] This argument, apparently going to the Commission's jurisdiction, patently ignores the plain language of the RAA. Section D.8 specifically allows for a state mechanism that "requires switching customers or the LSE [load-serving entity] to compensate the FRR entity . . .." The RAA unambiguously allows the state mechanism to reflect the price at which capacity will be charged to a competitive retail electric services provider (CRES). With such lack of ambiguity, testimony concerning the drafters' purported intent is entirely superfluous.

AEP Ohio also suggests that its commitment to transition to the RPM market "reduces the scope of this proceeding to establishing a three-year transitional (rather than permanent) capacity charge."[10] Again, AEP Ohio seems to have failed to read the actual words in the RAA. The RAA allows for the existence of a prevailing "state mechanism." Just as laws and regulations apply equally to all impacted persons or entities in a state, so would the state mechanism. Nothing in the RAA suggests that a state regulatory body might establish different "mechanisms" to apply to different, regulated entities.

AEP Ohio proposes that its "unique position in PJM as an FRR Entity make it inappropriate to use an RPM-based capacity charge for the capacity that AEP Ohio supplies to

[9] AEP Ohio Initial Post-Hearing Brief, p. 15.

[10] AEP Ohio Initial Post-Hearing Brief, p. 2.

[CRES] providers."[11] Of course, as the Commission is well-aware, this is hardly the case. Duke Energy Ohio, Inc., is an FRR entity. It charges RPM-based capacity rates. Cleveland Electric Illuminating Company is an FRR entity. It charges RPM-based capacity rates. The Ohio Edison Company is an FRR entity. It charges RPM-based capacity rates. Toledo Edison Company is an FRR entity. It charges RPM-based capacity rates.[12] There is nothing inherent about being an FRR entity that makes it impossible or inappropriate for a utility to charge for capacity on the basis of RPM FZCP rates. On the other hand, if the Commission establishes a state mechanism that provides for utilities to charge for capacity on the basis of their embedded costs, what is to stop the remaining Ohio utilities from demanding equal treatment under the new state mechanism? The error is evident in AEP Ohio's suggestion that the Commission need only consider a three-year, "transitional" mechanism, applicable only to AEP Ohio.

III. OHIO LAW: REGULATION AND PRICING OF GENERATION SERVICES

A. Ohio Law regarding State Policy

AEP Ohio demands that the Commission establish a cost-based state mechanism for the pricing of capacity services. On what does it base this demand? Other than a filing that the Commission itself made at the FERC in which it made a passing reference to its desire, AEP Ohio relies on the Commission's internal mission statement. Of course, as a creature of statute, the Commission cannot rule in any proceeding on the basis of its own statements in a federal pleading or on its own, internally developed mission statement. AEP Ohio also points to a state policy but, as will be discussed below, such policy is inapposite.

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[11] AEP Ohio Initial Post-Hearing Brief, p. 23.

[12] *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 seq.*, Opinion and Order (November 22, 2011), p. 11-12; *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, Case No. 10-388-EL-SSO, Opinion and Order (August 25, 2010), p. 9; FES Ex. 110A.

AEP Ohio is correct that the Commission's expression of its own mission is to ensure financial integrity and service reliability in the utility industry in Ohio.[13] Putting aside the fact that the reference, in that mission statement, to financial integrity says nothing about which entities' financial integrity the Commission hopes to ensure (that is, regulated utilities or competitive providers), a mission statement cannot possibly form the basis for a legal order. As even AEP Ohio has recognized, the Commission is a creature of statute and, thus, has the power only to issue orders under the provisions of statutes that grant such power.[14] A mission statement written and published by the Commission itself grants no such power. Similarly, the language in the Commission's own pleading filed at the FERC is merely instructive about its desires; it grants no power by which the Commission has the authority to issue an order.

AEP Ohio's only reference to Ohio law that could, conceivably, form the basis for its demand is a single paragraph of the state policies enumerated by the legislature. The company quotes the policy of ensuring "the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service."[15] But this policy includes absolutely nothing that would require or allow the Commission to base an order on a utility's threats that it requires a specific return on equity with regard to its generation services. Indeed, AEP Ohio is required, as are all other electric distribution utilities, to continue to provide necessary and adequate electric service and facilities.[16]

AEP Ohio attempts to blur the line between the statutory policy provision and the mission statement, citing the policy and then suggesting that the mission statement and a pleading at the FERC are the Commission's way of "voic[ing] its commitment to this policy objective." But the

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[13] AEP Ohio Initial Post-Hearing Brief, p. 16.

[14] Case No. 10-2929-EL-UNC, AEP Ohio Application for Rehearing (January 7, 2011), p. 20, citing *Discount Cellular, Inc. v. Pub. Util. Comm.*, 112 Ohio St.3d 360, 373, 2007-Ohio-53 (2007).

[15] R.C. 4928.02(A)

[16] R.C. 4905.22.

remainder of its argument is based on the mission statement and the filing, with no more than passing references to the policy. The mission statement and arguments to the FERC are not equivalent to the legislature's enactment of policy objectives. The Commission's adoption of a capacity price to be charged by AEP Ohio must be guided by the state policy, not by its mission statement. And, as noted above, AEP Ohio fails to show that adoption of a state capacity price mechanism will have any impact on its continued provision of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service, in compliance with Ohio law.

Further, assuming *arguendo*, that the Commission were to base its decision in this case only upon its mission statement, AEP Ohio's cost-based capacity charge must still fail. The Commission's mission – and not the manner in which it will act to fulfill that mission – identifies a focused intent on fair prices for utility services and the facilitation of competitive choices. Deviating from the historical application of RPM-based prices on which CRES providers have relied and adopting a cost-based charged for generation service will not facilitate a competitive market within AEP Ohio's service territory and will deny customers access to current, low market rates.

B. Ohio Deregulation of Generation Services

It is critical in this proceeding to recognize that, pursuant to Ohio's two deregulation bills, generation services are not permitted to be priced on the basis of cost. Although certain portions of an electric distribution utility's costs may be passed through to its customers (such as fuel and purchased power costs), the overall rate plan must be based on the market. Although AEP Ohio would like the Commission to believe otherwise, generation services were declared competitive in 1999, with the passage of Amended Substitute Senate Bill 3 (SB 3). Section 4928.03 of the Revised Code, as adopted in SB 3, provided that, "[b]eginning on the starting date of competitive retail electric service, retail electric generation . . . services supplied to consumers

within the certified territory of an electric utility are competitive retail electric services . . .." SB 3 then went on to provide that, after the termination of an electric distribution utility's market development period, it must "provide consumers . . . a market-based standard service offer of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service . . .."[17] The key term in that provision, for purposes of this proceeding, is "market-based." The standard service offer of the utility was required to be based on the market. In compliance with the law, AEP Ohio's standard service offer, after its five-year market development period ended, was market-based.[18]

Section 4928.14 was amended, in 2008, by Amended Substitute Senate Bill 221 (SB 221), deleting the specific reference to the requirement for market-based standard service offers. Instead, the new law allowed standard service offers to be based either on market rates determined through competitive bids or on a plan that must be compared to and found to be more advantageous to customers than the competitive bid market approach. Thus, even the latter is based on market to the extent that it can be no more expensive, when taken as a whole, than the rates that a market approach would define. While the present proceeding is certainly not an application for approval of a standard service offer, it is imperative to understand that generation services are never, in Ohio, authorized on the basis of cost. Nothing in SB 221 or SB3 empowers the Commission to allow a utility to charge for capacity on the basis of its embedded costs.

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[17] R.C. 4928.14 (1999).

[18] *In the Matter of the application of Columbus Southern Power Company and Ohio Power Company for Approval of a Post-Market Development Period Rate Stabilization Plan*, Case No. 04-169-EL-UNC, Opinion and Order (January 26, 2005), p. 14-15.

IV. CONCLUSION

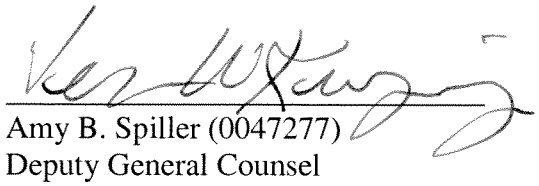
DER and DECAM respectfully request that the Commission issue an order in this proceeding, establishing RPM pricing as the state capacity reimbursement mechanism, pursuant to the provisions of the RAA.

Respectfully submitted,

DUKE ENERGY COMMERICAL ASSET MANAGEMENT, INC.

and

DUKE ENERGY RETAIL SALES, LLC



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CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing was delivered via U.S. mail (postage prepaid), personal, or electronic mail delivery on this the 30th day of May, 2012, to the following parties.

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