FILE

12

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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

DIRECT TESTIMONY OF MARK R. FRYE OF PALMER ENERGY

ON BEHALF OF

OHIO SCHOOL BOARDS ASSOCIATION,

OHIO ASSOCIATION OF SCHOOL BUSINESS OFFICIALS,

AND

BUCKEYE ASSOCIATION OF SCHOOL ADMINISTRATORS

October 31, 2008

DIRECT TESTIMONY OF MARK R. FRYE

INTRODUCTION AND QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Mark Frye. My business address is 241 N. Superior Street, Toledo, Ohio 43604.

Q. What is your occupation?

A. I am an energy consultant and the President of Palmer Energy Company in Toledo, Ohio.

Q. Please describe your educational background and work experience.

A. I have worked in the energy field for 22 years and for clients in 18 states. I earned a Bachelors of Science degree in Energy Technology from Pennsylvania State University's Capitol College. I currently consult on energy procurement and utilization matters for a number of industrial, commercial, educational, institutional and governmental clients.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of Ohio School Boards Association ("OSBA"), Ohio Association of School Business Officials ("OASBO"), and the Buckeye Association of School Administrators ("BASA") who jointly intervened.

OSBA, OASBO, and BASA are non-profit groups of public school administrators who jointly run a program called "School Pool". School Pool seeks to save money for not-for-profit schools and school systems by determining if current third party power supply can be purchased for less than the electric distribution utility's SSO tariff price.

Q. Have you ever testified before the Public Utilities Commission of Ohio?

A. Yes. I have previously submitted direct testimony in several cases before the Public Utilities Commission of Ohio ("Commission" or "PUCO"), including

FirstEnergy's Electric Security Plan ("ESP") Application [Case No. 08-935-EL-SSO], FirstEnergy's Rate Stabilization Plan ("RSP") Application [Case No.03-2144-EL-ATA], and American Electric Power's IGCC Application [Case No.05-376-EL-ATA].

Q. What is the purpose of your testimony in this case?

A. My testimony addresses certain aspects of the proposed Electric Security Plan ("ESP") filed by Columbus Southern Power Company and Ohio Power Company (collectively, "the Companies" or "AEP") which reduce the potential savings available to school pool participants and charge consumers for costs that are unnecessarily high.

Q. What has been the success of the school pool in securing savings for its participants?

A. In the most recent summary of switch rates published by the PUCO for the month ending June 30, 2008, Columbus Southern had 408 meters shopping. According to information provided by the school pool CRES, the participating school districts had 386 meters buying third party supplies. The schools' estimated savings over the past year has been $420,000 or 4.4% below the avoidable charges.

Q. What do you see as the first problem in AEP's ESP, as it relates to the school pool?

A. First, the Plan creates an unfair subsidy to SSO customers by any school pool participants, for if a consumer chooses to buy third party supplies the Fuel Adjustment Clause ("FAC") deferral does not apply to their power purchases. Yet beginning in 2012 that same school pool participant or indirectly the taxpayers of that school district would begin repayment of the FAC deferrals plus carrying costs other customers enjoyed. This is a patently unfair subsidy.

Q. Can you estimate the fuel costs that would not be deferred if current school pool participants continued buying third party supplies in 2009 and the Companies Plan for FAC deferrals was approved?

A. Yes. For 2009, AEP estimated the FAC deferral for Columbus Southern consumers served at secondary voltage to be 35% ($0.0040614 per kWh) and 50% ($0.0056128 per kWh) for consumers served at primary voltage [Roush testimony, Exhibit DMR-7]. If these deferrals are multiplied by the estimated school pool consumption at the secondary and primary voltage levels respectively, the total avoided FAC deferral would be approximately $735,000. In 2010 and 2011 it is uncertain from the Companies Plan the amount if any of FAC deferrals, so I did not carry the calculation beyond 2009.

Q. Are there assumptions in your estimate FAC deferral reduction by school pool shopping?

A. My estimate presumes school pool participation at the existing facilities and consumption and demand level. It also assumes which school pool participants are supplied at secondary voltage and which are supplied at primary voltage.

Q. How did you determine which meters were served at primary and which were served a secondary voltages?

A. This was estimated by determining the individual meter's cost difference between the secondary and primary voltages in the GS-2 and GS-3 tariffs [2008 Columbus Southern Power Company tariff, 3rd Revised Sheet no. 21-1 through 21-5 and 3rd Revised Sheet No. 23-1 through 23-5] and transmission cost differences [2008 Columbus Southern Power Company tariff, Transmission Cost Recovery Rider, 5th Revised Sheet no. 75-1]. Whichever voltage had the lower cost to supply was determined to be the voltage at which this location was served.

Q. What possible impacts do you anticipate if the FAC deferrals are approved by the Commission?

A. There are a number of impacts. First, by reducing the avoidable cost through the FAC deferrals and not making the future collection of the deferral bypassable, the Companies will inhibit school pool participation. As Mr. Baker points out in his deposition "customers generally act in an economically rational fashion and if tariff rates are below market they will continue to buy at tariff. If market rates are below tariff I think they will buy it from the market" [Baker deposition, page 62]. Any FAC deferral without the future deferral collection being bypassable reduces the avoidable cost and thus limits the number of schools that could purchase market power below the tariff.

Q. Are there any other impacts you anticipate if the FAC deferrals are approved by the Commission?

A. If approved, beginning in 2012 all school pool participants or, in other words, the taxpayers would begin paying not only for fuel they did not consume, but also for the carrying charges.

Q. Is it likely that at least some schools could securing savings through third party supplies after reviewing the Companies ESP application?

A. It is reasonable to expect that school pool will continue based upon the Companies significant cost increase. While other consumers may not be able to realize savings, it is reasonable to expect that schools generally lower summer consumption will allow at least some of them to secure power at a price that is lower than offered under the SSO. The fact that only 408 meters out of 89,606 commercial meters on Columbus Southern are buying third party supplies as of June 2008 [PUCO, Division of Market Monitoring & Assessment, Summary of Switch Rate from EDU's to CRES Providers in Terms of Customers For the Month Ending June 30, 2008] and 386 of these are school pool participants provides a strong indication that schools are likely to continue third party power supplies in 2009.

Q. What do you recommend to alleviate the unfair subsidy the FAC deferral represents?

A. To prevent charging schools participating in school pool from having to pay for fuel they did not take, the Companies should provide shopping customers a credit identical to the value of the FAC deferral on the monthly invoice from anyone who elects to purchase third party power supplies. Then when shopping customers pay the deferral it will be for the same reason – avoiding a larger rate increase.

Q. AEP has also requested a large increase in their Provider of Last Resort ("POLR") charges.

A. AEP is proposing a 742% increase in POLR charges for Columbus Southern consumers and a 153% increase in POLR charges for Ohio Power consumers [Roush testimony, Exhibit DMR-9, page 133 of 285 and Exhibit DMR-10, page 134 of 295].

Q. Has AEP estimated their collection under the POLR charges?

A. Mr. Baker's testimony indicates the POLR revenue requirements to be $108.2 million annually for Columbus Southern Power and $60.9 million annually for Ohio Power Company [Baker testimony, page 34, lines 21 & 22].

Q. There is a large disparity in annual POLR collections between the two AEP electric distribution utilities (EDU). Do you have an opinion as to the reason for the disparity?

A. Since a consumers avoidable power prices are higher on Columbus Southern than on Ohio Power, it is logical that the Companies considered that when it evaluated the risks of a customer shopping it imposed a larger POLR on the Columbus Southern Customers. In other words, the higher the ESP price - the higher the risk of shopping - thus the higher the POLR fee.

Q. What are customers permitted to do if they pay the POLR charge?

A. The Companies are requesting a non-bypassable POLR charge be assessed to all consumers so they can select a third party supplier and then return during the proposed ESP term at AEP's SSO pricing.

Thus, the POLR fee is effectively electric price supply insurance charged by the Companies so if consumers elect to secure power from a CRES provider they have the option to return to the Companies SSO pricing upon their return. In his testimony, Mr. Baker indicates AEP utilized the Black-Scholes option pricing model to calculate the value of its POLR obligation [Baker testimony, page 31, lines 8 & 9].

Q. Are there other considerations that should be accounted for in any POLR pricing structure?

A. Yes. First, the proposed POLR does not appear to be based upon an actual cost to the Companies. Second, the Companies POLR charge does not appear to fully account for the risk of return. Third, the POLR charge does not appear to account for the minimum stay provisions included in the Companies tariff.

Q. Could you explain your first concern about the Companies POLR charge?

A. As previously discussed, the Companies proposed POLR is priced using Black-Scholes option pricing model. Yet, I cannot locate anywhere in the Companies' filing that indicates it will actually be purchasing the option it priced out. Mr. Baker makes clear that "We [the Companies] have not committed to either making or not making those purchases of those options." [Baker deposition, page 49]. Since there is not actual cost to the Companies for the purchase of the option, the charge associated would be collected as insurance for an event or events that may never occur. The Companies anticipate collecting $169 million annually or $507 million over the term of the ESP. Such a collection should be based upon an actual cost not a theoretical one.

Q. Please explain your second concern you have regarding the Companies POLR charge?

A. Mr. Baker explains the Black-Scholes pricing inputs used by the Companies POLR charge calculation; however, the information provided does not appear to account for the impediments a consumer or group of consumers would have if they elected to return. Clearly, a consumer who contracted for a price that was a shorter term than the ESP would pose a greater risk of return than a consumer who contracted for a contract term equal to the ESP term. Yet, I do not see any indication the Companies accounted for this in their determination of the proposed POLR charge.

Any third party supply agreement, regardless of the term, would have protections built in for the CRES if the customer elected to return prior to the expiration of that agreement. The longer the term of the agreement between the CRES and the customer the lower the Companies risk of return.

If a CRES supplier could not meet its financial obligations the risk of return in that circumstance is minimized by the financial capacity and rules a Certified Retail Electric Supplier must meet.

Q. Please explain your third concern regarding the Companies POLR charge?

A. The third concern on the POLR risk is that it does not appear to account for the minimum stay provisions included in the Companies Terms and Conditions of Open Access Distribution Service on Original Sheets No. 3-4D and 3-5D where it indicates a GS-1 customer returning must stay through April 15 of the following year if the customer received service from the Companies from May 16 through September 15 and larger commercial and industrial consumers are required to remain for period not less than 12 months. While a CRES failure and subsequent return of the customers to the Companies service may occur during a peak pricing period, such pricing tends to be relatively short lived. Prices should return to a more normal pattern and the financial impact on the Companies may not be as substantial as it fears.

Q. How would you summarize your concerns about the POLR charge in the Companies Plan?

A. The Companies are requesting $507 million over the ESP term in POLR charges for something that may never happen, where safeguards and impediments exist to prevent this from occurring, and where the Companies do not appear to have an actual out of pocket expense. This appears to be an effort to charge consumers for insurance it may not want or need.

Q. Do you have a proposal regarding the POLR charge?

A. Yes, outside a small administrative charge, the POLR proposed by the Companies should be bypassable. If a consumer believes the insurance is valuable they can purchase it by paying the full POLR charge.

Q. If the Commission disagrees with your opinion regarding POLR do you have an alternative to making it bypassable?

A. If the charge is an insurance payment then it should be based upon actual experience of cost to the Companies plus a small administrative charge to cover the costs related to this type of service. If a default occurs, the Companies actual costs should be recoverable in a similar fashion to a fuel expense with all the subject opportunities for consumer and Commission review

CONCLUSION

Q. Does this conclude your testimony?

A. Yes.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Document was served upon the following parties by E-mail or First-Class U.S. Mail this 31st day of October, 2008.

M. Howard Petricoff
Stephen M. Howard

John W. Bentine
Mark S. Yurick
Matthew S. White
Chester, Wilcox & Saxbe, LLP
65 East State Street, Ste. 1000
Columbus, Ohio 43215-4213

Michael R. Smalz
Joseph V. Maskovyak
Ohio State Legal Services Association
Appalachian People's Action Coalition
555 Buttles Avenue
Columbus, Ohio 43215

Samuel C. Randazzo
Lisa G. McAlister
Daniel J. Neilsen
Joseph M. Clark
McNess, Wallace & Nurick, LLC
21 East State Street, 17th Fl.
Columbus, Ohio 43215

Maureen Grady
Jacqueline Lake Roberts
Terry Etter
Michael E. Idzkowski
Office of Consumer Counsel
10 West Broad Street, Ste. 1800
Columbus, Ohio 43215-3485

Langdon Bell
Bell & Royer
33 South Grant Avenue
Columbus, Ohio 43215-3927

John Jones
Thomas Lindgren
Werner Margard
Assistant Attorneys General
Public Utilities Commission of Ohio
Columbus, Ohio 43215

Barth E. Royer
Bell & Royer Co. LPA
33 South Grant Avenue
Columbus, Ohio 43215-3927

Richard L. Sites
Ohio Hospital Association
155 East Broad Street, 15th Fl.
Columbus, Ohio 60661

David F. Boehm
Michael L. Kurtz
Boehm, Kurtz & Lowry
36 East Seventh St., Ste. 1510
Cincinnati, Ohio 45202

David Rinebolt
231 West Lima Street, P.O. Box 1793
Findlay, Ohio 45839-1793

Scott H. DeBroff
Alicia R. Petersen
Stephen J. Romeo
Smigel, Anderson & Sacks LLP
River Chase Office Center
4431 North Front Street
Harrisburg, PA 17110

Craig Goodman
3333 K Street, NW, Ste. 110
Washington, DC 20007

Marvin I. Resnik, Esq.
Trial Attorney Steven T. Nourse
American Electric Power Service Corporation
1 Riverside Plaza
Columbus, Ohio 43215

Larry Gearhardt
Ohio Farm Bureau Federation
280 North High Street
Box 182383
Columbus, Ohio 43218-2383

Clinton A. Vince
Presley R. Reed
Emma F. Hand
Ethan E. Rii
Sonnenschein Nath & Rosenthal LLP
1301 K Street, NW
Ste. 600, East Tower
Washington, DC 20005

Benjamin Edwards
Law Office of John L. Alden
One East Livingston Avenue
Columbus, Ohio 43215-5700

Douglas M. Mancino
McDermott Will & Emery LLP
2049 Century Park East
Suite 3800
Los Angeles, CA 90067-3218

Henry Eckhart
50 West Broad Street, Ste. 2117
Columbus, Ohio 43215

Sally W. Bloomfield
Terrence O'Donnell
Bricker & Eckler, LLP
100 South Third Street
Columbus, Ohio 43215-4291

Gregory K. Lawrence
McDermott Will & Emery LLP
28 State Street
Boston, MA 02109

Daniel R. Conway
Porter, Wright, Morris & Arthur, LLP
41 S. High St.
Columbus, Ohio 43215

E-MAIL

sbaron@jkenn.com
lkollen@jkenn.com
mkurtz@bkllawfirm.com
dboehm@bkllawfirm.com
grady@occ.state.oh.us
etter@occ.state.oh.us
roberts@occ.state.oh.us
idzkowski@occ.state.oh.us
stnourse@aep.com
dconway@porterwright.com
jbentine@cwslaw.com
myurick@cwslaw.com
mwhite@cwslaw.com
barthroyer@aol.com
gary.a.jeffries@dom.com
nmoser@theOEC.org
trent@theOEC.org
henryeckhart@aol.com
ed.hess@puc.state.oh.us
thomas.lindgren@puc.state.oh.us
werner.margard@puc.state.oh.us
john.jones@puc.state.oh.us
sam@mwncmh.com
lmcalister@mwncmh.com
erii@sonnenschein.com
steven.huhman@morganstanley.com
dmancino@mwe.com
LGearhardt@ofbf.org
dneilsen@mwncmh.com
jclark@mwncmh.com
drinebolt@aol.com
cmooney2@columbus.rr.com
msmalz@oslsa.org
jmaskovyak@oslsa.org
ricks@ohanet.org
david.fein@constellation.com
cynthia.a.fonner@constellation.com
cgoodman@energymarketers.com
bsingh@integrysenergy.com
lbel133@aol.com
kschmidt@ohiomfg.com
sdebroff@sasllp.com
apetersen@sasllp.com
sromeo@sasllp.com
bedwards@aldenlaw.net
sbloomfield@bricker.com
todonnell@bricker.com
cvince@sonnenschein.com
preed@sonnenschein.com
ehand@sonnenschein.com
glawrence@mwe.com
gwung@mwe.com
stephen.chriss@wal-mart.com
stnourse@aep.com
miresnik@aep.com
cmiller@szd.com