BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Power Company and Columbus Southern Power Company for Authority to Merge and Related Approvals.	))))	Case No. 10-2376-EL-UNC
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 §4928.143, Ohio Rev. Code, in the Form of an Electric Security Plan.	))))))	Case No. 11-346-EL-SSO Case No. 11-348-EL-SSO
In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority	))))	Case No. 11-349-EL-AAM Case No. 11-350-EL-AAM
In the Matter of the Application of Columbus Southern Power Company to Amend its Emergency Curtailment Service Riders	))))	Case No. 10-343-EL-ATA
In the Matter of the Application of Ohio Power Company to Amend its Emergency Curtailment Service Riders	))))	Case No. 10-344-EL-ATA
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
In the Matter of the Application of Columbus Southern Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Ohio Revised Code 4928.144	)))))	Case No. 11-4920-EL-RDR
In the Matter of the Application of Ohio Power Company for Approval of a Mechanism to Recover Deferred Fuel Costs Ordered Under Ohio Revised Code 4928.144	)))))	Case No. 11-4921-EL-RDR

TESTIMONY OF RICHARD E. MUNCZINSKI
IN SUPPORT OF THE STIPULATION AND RECOMMENDATION
ON BEHALF OF
COLUMBUS SOUTHERN POWER COMPANY
AND
OHIO POWER COMPANY

Filed: September 13, 2011

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PERSONAL DATA

Q. WHAT IS YOUR NAME AND BUSINESS ADDRESS?

A. My name is Richard E. Munczinski and my business address is One Riverside Plaza, Columbus, Ohio 43215.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the American Electric Power Service Corporation (AEPSC), a unit of American Electric Power (AEP). My title is Senior Vice President – Regulatory Services.

Q. WHAT ARE YOUR RESPONSIBILITIES AS SENIOR VICE PRESIDENT –REGULATORY SERVICES?

A. I am directly responsible for overseeing AEP's regulatory activities before eleven state regulatory commissions and the Federal Energy Regulatory Commission (FERC). Additionally, I am AEP's Chief Reliability Compliance Officer. In this role, I oversee the development and implementation of strategic policy within AEP to ensure compliance with North American Reliability Corporation (NERC) reliability standards for the AEP system, as well as AEP's participation in regional transmission organization (RTOs).

Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?

A. I earned a bachelor of engineering degree in electrical engineering and a master's degree in management science from Stevens Institute of Technology in Hoboken, New Jersey. I am a member of the Institute of Electrical and Electronics Engineers.

Prior to joining AEP, I was an electrical engineer for Ebasco Services Inc., New York. I joined AEP in 1978 in the Project Engineering department and transferred to Corporate Planning and Budgeting in 1982. I became Director of Rate Case Management in 1992 and Vice President of Regulatory Services in 1996 leading the regulatory approval process for the merger with Central and South West Corporation (CSW). I was named Senior Vice President - Corporate Planning and Budgeting in 1998 and Senior Vice President - Shared Services in 2008. I have served in my current role as Senior Vice President-Regulatory Services of AEP since January 2010.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY BEFORE A REGULATORY AGENCY?

A. I have testified or submitted testimony before the regulatory commissions in the states of Ohio, Virginia, West Virginia, Michigan, Arkansas, Indiana, Kentucky, Louisiana, Oklahoma, Texas and before the Federal Energy Regulatory Commission (FERC).

<u>PURPOSE OF TESTIMONY</u>

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will explain and sponsor certain provisions in the September 7, 2011 Stipulation and Recommendation (Stipulation) entered into by a substantial number of parties including Columbus Southern Power Company (CSP) and Ohio Power Company (OPCo) (CSP and OPCo are collectively referred to as "AEP Ohio" or the "Company"). Specifically, I will address the Stipulation's provisions for obtaining approvals before the Federal Energy Regulatory Commission (FERC) of the proposed corporate separation and dissolution/amendment of the AEP Interconnection Agreement (also referred to as the generation "Pool" agreement). I am also AEP Ohio's overall policy witness supporting the Stipulation's solution for the capacity charge paid by Competitive Retail Electric Service (CRES) providers for use of AEP Ohio's capacity to support retail shopping. In this regard, I discuss the parties' litigation positions and demonstrate the reasonable and balanced compromise reached in the Stipulation.

<u>BACKGROUND ON CAPACITY CHARGE ISSUES</u>

Q. CAN YOU BRIEFLY EXPLAIN THE PJM INTERCONNECTION'S CAPACITY MARKET CONSTRUCT?

Yes. In 2007, PJM Interconnection, LLC (PJM) implemented a capacity market pricing construct known as Reliability Pricing Model (RPM). Prior to 2007, and during the RPM auction development phase, AEP, as well as other parties, expressed concern over the long-term negative impacts of the RPM capacity market on vertically integrated utilities and their customers. A special provision was drafted to ensure that those entities could request a cost-based method of recovering their capacity costs – Section D.8 of Schedule 8.1 (Schedule D) of the

PJM Reliability Assurance Agreement (RAA); this provision is known as the Fixed Resource Requirement (FRR).

Q. WHY WAS THE FRR OPTION DEVELOPED AS ANOTHER METHOD FOR SUPPLYING CAPACITY?

A. It was important to have an appropriate mechanism for Load Serving Entities (LSEs) that owned or controlled sufficient generation to meet their own load and reserve margin obligations. AEP advocated strongly at FERC and during the stakeholder negotiations for the FRR option. This option was important to AEP, because:

- FRR was consistent with the Company's regulatory framework. AEP utilities in PJM were among the few remaining vertically integrated utilities that retained their generation to meet the load obligations of their customers. For AEP, the FRR mechanism allowed it to continue to recover its embedded generation costs associated with the customers it serves through existing Commission approved rate structures. Conversely, many of the other PJM utilities have segregated their load from their generation, either by divesting their generation to third parties or transferring it to affiliated generation companies.
- It did not make sense for AEP to offer its own generation into a capacity auction and then essentially be required to buy it back to satisfy its load obligation, since the Company had sufficient generation to meet its own load obligation.

- AEP was at risk for being required to purchase more capacity than necessary because of the potential for the RPM auction to clear at a higher reserve margin level than the Company carried on its system.

Q. HOW DID FERC RULE ON FRR IN ITS INITIAL OPINION?

A. FERC agreed that it was not necessary or appropriate to force utilities such as AEP to participate in the RPM auction. In their April 20, 2006 Initial Order, FERC states in paragraph 110 that "We agree with AEP that LSEs and states should have the option of choosing an alternative to the forward procurement auction if they identify sufficient capacity to meet their loads…."

At that point, as part of the settlement process at FERC, PJM and the PJM stakeholders entered into negotiations to develop the FRR process. These deliberations focused on the preparation of rules that enabled utilities such as AEP to meet their capacity obligations through use of their own generation (including bi-lateral arrangements) and to maintain reserve margins established by the PJM planning process rather than through the auction process. This provided benefits to native load customers by giving the LSEs choices for meeting capacity requirements.

Q. DID THIS COMMISSION'S STAFF VOICE SUPPORT FOR THE FRR PLAN UPON ITS INCEPTION?

A. Yes. The Commission staff referred to FRR in public comments filed at FERC provided in advance of a FERC Staff Technical Conference on June 7, 2006. In the first sentence of their comments, the Commission staff said they "would like to compliment the FERC for accepting the traditional resource requirement approach (the Fixed Resource Requirement option) as a legitimate alternative to RPM. The Ohio Staff would like to request that, in developing the rules for the two alternatives, the FERC needs to ensure that a resource supplier is treated equitably in terms of the [Installed Reserve Margin (IRM)] requirement, the penalties for violating an IRM requirement, and the appropriate length of a resource commitment, regardless of what alternative the supplier chooses."

Q. HAS AEP OHIO PARTICIPATED IN PJM'S CAPACITY MARKET AS AN FRR ENTITY?

A. Yes. Since the inception of its membership in PJM, AEP Ohio has participated exclusively as an FRR entity. Under FRR, there are essentially three alternatives for pricing capacity provided to CRES providers: 1) a properly designed retail state compensation mechanism and in the absence of such a mechanism, 2) default rates based on the PJM RPM capacity auction price, and 3) a method based on the FRR entity's costs (a formula cost-based method) or such other cost basis shown to be just and reasonable. Thus, the FRR is an alternative method to participating in PJM's RPM capacity market. Being an FRR entity means that AEP Ohio has opted out of the RPM capacity market and the entity self-supplies its own generation resources to match its retail load (plus adequate reserve margins). More specifically, the LSE supplies its own capacity obligations through its own generating fleet, or through bi-lateral arrangements with another supplier. For example, if an LSE has a 100MW capacity obligation and chose FRR, the LSE could supply this capacity from its own generation fleet without making any payments to PJM. AEP Ohio has self-supplied its capacity as a FRR entity since the RPM was established in June 2007, thus opting out of the PJM RPM auction market for purposes of meeting its load obligations each year through planning year 2014/2015.

Q. PLEASE DESCRIBE THE DEVELOPMENTS LEADING UP TO FURTHER ACTION BY AEP OHIO IN LATE 2010.

Historically, AEP Ohio has been compensated at the adjusted PJM RPM auction price for supplying capacity associated with load lost to CRES providers who choose not to self-supply their own capacity. The CRES providers who choose not to self-supply merely act as a middle-man on capacity flowing from AEP Ohio. While the RPM auction prices have fluctuated significantly, the auction price for the next several years have dropped to levels that would prevent AEP Ohio from receiving anything remotely approaching full compensation from CRES providers for AEP Ohio capacity costs. The dramatic price drops in the RPM market caused AEP Ohio to pursue its options under the RAA to establish a cost-based rate.

Q. WHAT FINANCIAL CONCERNS DROVE AEP OHIO TO SEEK A COST-BASED CAPACITY CHARGE?

A. At 100% shopping, the financial impacts to AEP Ohio if RPM-based pricing were to remain would exceed $485M for 2011, $771M for 2012, and $971M for 2013. At a 50% shopping level, the impacts to AEP Ohio could exceed $242M for 2011, $386M for 2012, and $486M for 2013.

Q. WHAT ACTION DID AEP OHIO PURSUE TO ESTABLISH A COST-BASED CAPACITY CHARGE?

A. On November 1, 2010, AEP Ohio filed an application under the PJM RAA and Section 205 of the Federal Power Act (FPA) to initiate FERC Docket No. ER11-1995-000. On November 24, 2010, at the direction of FERC, AEP Ohio refiled its application in Docket No. ER11-2183-000 (This case will be referred to as the "*Section 205 FERC Application*"). In its *Section 205 FERC Application*, AEP Ohio proposed cost-based formula tariffs that were based on the Companies' 2009 FERC Form 1 filings. AEP Ohio's application proposed to implement an existing clause within the PJM RAA to change the basis of compensation for use of its capacity by CRES providers to an AEP Ohio cost-based method. AEP Ohio's premise for filing the *Section 205 FERC Application* was that CRES providers were receiving a subsidy (through payment of a below-cost rate) for their use of the Companies' capacity due to the use of RPM auction-clearing prices as the basis for the capacity charge, even though AEP Ohio was an FRR entity. In response to the *Section 205 FERC Application*, the Commission initiated Case No. 10-2929-EL-UNC through a December 8, 2010 Entry ("*Ohio Capacity Charge Docket*") and the Commission represented to FERC that as of December 8, 2010 it was "adopt[ing] as the state compensation mechanism for the Companies the current capacity charges established by the three-year capacity auction conducted by PJM," which is the PJM RPM auction price.

On January 20, 2011, FERC issued an Order rejecting the AEP Ohio rate proposal, not on the merits, but due to the Commission's December 8, 2010 order stating that it was adopting an interim state compensation mechanism. AEP Ohio's application for rehearing of FERC's January 20, 2011 Order remains pending before FERC. AEP Ohio also filed a complaint case under Section 206 of the FPA, FERC Docket No. EL11-32-000, seeking modifications to Schedule D of the RAA that were designed to clarify the original intent as understood by AEP Ohio (referred to as the "*Section 206 FERC Complaint*"). The purpose of the *Section 206 FERC Complaint* was to confirm that any state compensation mechanism must compensate FRR entities for capacity costs through charges included in retail rates and to preserve the FRR entities' right to submit filings to establish just and reasonable FRR charges.

<u>LITIGATION POSITIONS OF AEP OHIO AND CRES PROVIDERS</u>

Q. PLEASE BRIEFLY SUMMARIZE AEP OHIO'S POSITION IN THE *OHIO CAPACITY CHARGE DOCKET*, THE *SECTION 205 FERC APPLICATION* AND THE *SECTION 206 FERC COMPLAINT*.

A. AEP Ohio's basic position in the pending FERC proceedings and in the *Ohio Capacity Charge Docket* is that the RPM-based pricing mechanism under-compensates AEP Ohio for the capacity it provides to CRES providers for resale to shopping retail customers. The impact on AEP Ohio's ability to be compensated for its costs has become significant due to the sharp downward trend in RPM auction prices, as well the growth in shopping by AEP Ohio customers whose CRES providers take advantage of the capacity supplied by AEP Ohio as opposed to supplying their own capacity.

As described and submitted in its Initial Comments filed in the *Ohio Capacity Charge Docket*, AEP Ohio, as a Load Serving Entity (LSE) in PJM, does not participate in the PJM RPM auction market for the purposes of meeting AEP Ohio's load obligation. AEP Ohio's Standard Service Offer (SSO) generation rates for January 2012 through May 2014 are the subject of the Company's current 2012-2014 Electric Security Plan application (Case Nos. 11-346-EL-SSO et al.) and are intended to cover AEP Ohio's non-fuel cost of generation, including the cost of capacity for non-shopping customers. However, CRES providers who serve shopping customers, and who choose not to self-supply capacity, are currently required to pay only the PJM RPM-based auction price. Thus, while these CRES providers are using AEP Ohio's capacity resources, they (unlike AEP Ohio's non-shopping SSO customers) avoid paying the embedded generation capacity costs that are on the books of AEP Ohio. AEP Ohio maintains that it should be allowed just and reasonable compensation from CRES providers based on AEP Ohio's embedded cost of capacity that will allow for continued investment in Ohio generation resources.

Q. WHAT WOULD AEP OHIO'S COST-BASED CAPACITY RATES BE USING 2010 FERC FORM 1 DATA?

AEP Ohio's cost-based formula capacity rates, as calculated by Company witness Pearce (Exhibits KPD-1 and KDP-2), would be $327.59/MW-day for CSP and $379.23/MW-day for OPCo or $355.72/MW-day (Exhibit KDP-4) on a combined basis for AEP Ohio.

Q. IN THE CONTEXT OF LITIGATING THE *OHIO CAPACITY CHARGE DOCKET*, THE *SECTION 205 FERC APPLICATION* AND THE *SECTION 206 FERC COMPLAINT*, HAVE INTERVENOR PARTIES AGREED WITH AEP OHIO'S POSITION?

No. They have opposed AEP Ohio's position and have maintained that the RPM-priced capacity is appropriate and there is no reason to adopt a cost-based capacity charge. CRES providers argue that adopting a cost-based charge now, at a time when RPM-based market prices are so low, will have an adverse impact on current and future retail shopping levels. While CRES parties have not yet been required to file testimony in the *Ohio Capacity Charge Docket*, it is anticipated that they would continue to oppose AEP Ohio's position in a litigated setting. I briefly mention the CRES position here not to support or undermine it (or even to fully describe it) but it is simply a point of reference for the Stipulation's proposed solution for addressing the capacity charge dispute. It is my understanding that the CRES position on these matters will be further described (as a background matter) by Exelon witness Dominguez and Constellation/RESA witness Fein in their respective testimony supporting the Stipulation.

<u>STIPULATION'S RESOLUTION FOR THE CAPACITY CHARGE DISPUTE</u>

Q. HOW DOES THE STIPULATION PROPOSE TO ADDRESS THE CAPACITY CHARGE DISPUTE AND RESOLVE THE ASSOCIATED PENDING LITIGATION?

A. The Stipulation, through Paragraph IV.2.b, proposes to resolve the capacity charge dispute through two primary provisions as well as other related provisions.

Q. WHAT IS THE FIRST MAJOR COMPONENT OF THE STIPULATION'S PROPOSAL FOR RESOLVING THE CAPACITY CHARGE DISPUTE?

A. The Signatory Parties recommend, in Paragraph IV.2.b.2 (page 21), to establish a set aside amount of RPM-priced capacity available as follows: 21% of AEP Ohio's total retail load in 2012 (based on total kWh retail sales), 29% in 2013 until securitization is completed when it will become 31% for the remaining portion of 2013 after which securitization is completed (if securitization is completed prior to January 1, 2013, then the applicable set aside for the entirety of 2013 will be 31%), and 41% in 2014 continuing through the first half of 2015. These substantial levels of RPM-priced capacity preserve and expand retail shopping in AEP Ohio's service territory through a brief transition period and, given that there will be an auction-based SSO beginning in mid-2015, achieve a fully competitive SSO quicker than a Market Rate Offer (which involves a minimum of five years to achieve). Moreover, offering capacity at RPM rates as part of the larger settlement package is an obvious compromise compared to AEP Ohio's litigation position on these issues.

The RPM set aside levels foster considerable potential for the expansion of competitive market-based rates for significant retail loads within AEP Ohio's service territory. The 2012 set aside of 21% of AEP Ohio total retail load is approximately 10,000 GWh, which is roughly equal to the entire 2010 load of Toledo Edison Company. The potential 2013 set aside of 31% of AEP Ohio total retail load is approximately 15,000 GWh, which is roughly equal to the entire 2010 load of Dayton Power & Light Company. And the 2014-2015 set aside of

41% of AEP Ohio total retail load is approximately 20,000 GWh, which is roughly equal to the entire 2010 load of Duke Energy-Ohio. As discussed by Company witness Allen (Exhibit WAA-4), the net present value of the discounted capacity provided by AEP Ohio to CRES providers under this provision is more than $850 million.

Q. WHAT IS THE SECOND MAJOR COMPONENT OF THE STIPULATION'S PROPOSAL FOR RESOLVING THE CAPACITY CHARGE DISPUTE?

A. The Signatory Parties recommend, in Paragraph IV.2.b.1 (page 20), that the Commission (upon acceptance of the Stipulation) set the capacity charge in Case No. 10-2929-EL-UNC to be the PJM RPM-based rate except that an interim rate of $255/MW-Day effective starting in January, 2012 will be charged to CRES providers for all shopping above the RPM set aside levels. After May 31, 2015, the Commission's State Compensation mechanism will expire and the capacity charge will be the PJM RPM-based capacity rate (consistent with AEP Ohio's agreement in Paragraph IV.1.q to become an RPM entity by mid-2015). This new interim capacity charge of $255/MW-Day will only be charged to CRES providers for any shopping above the RPM set aside levels established in Paragraph IV.2.b.3. Even this limited non-RPM interim rate is substantially lower than the cost-based capacity charges proposed by AEP Ohio and supported in the testimony of Company witness Pearce. As such, it reflects a significant compromise and contributes to a balanced package of terms that advance the public interest.

Q. WHAT ARE THE OTHER PROVISIONS OF THE STIPULATION RELATING TO THE CAPACITY CHARGE DISPUTE?

A. In implementing the RPM-priced capacity set aside levels, the Signatory Parties agreed to "grandfather" the existing shopping load as follows. Paragraph IV.2.b.2 provides that, with regard to customers who are receiving generation service from a CRES provider as of the time that the Stipulation is filed, the capacity rate to be paid by the CRES provider to AEP Ohio for that customer's load will continue to be charged the otherwise applicable RPM rate for the remaining period that the contract remains effective (including renewals). The load grandfathered under this paragraph will be counted toward the RPM-priced set aside limits and will remain subject to a RPM-priced capacity during the term of the ESP, provided the contract remains in effect during that period.

As is further discussed by Company witness Allen, Paragraph IV.2.b.3 also provides that the set aside of RPM-priced capacity shall be initially allocated on a *pro rata* basis among the residential, commercial and the industrial classes based upon projected kWh consumption for a period of approximately 4 months after the filing of the Stipulation. The RPM-priced capacity set aside shall be based upon a more detailed set of rules and processes, as discussed by Company witness Allen.

Finally in this regard, Paragraph IV.2.b.4 proposes to resolve the pending FERC litigation. I am advised by counsel that this provision involves a process for holding in abeyance the *Section 205 FERC Application* and the *Section 206 FERC Complaint* (discussed above) until this Commission issues a final order adopting the Stipulation, after which time the FERC cases will be resolved as they affect Ohio. In sum, adoption of the Stipulation would resolve both the *Ohio Capacity Charge Docket* and the pending FERC litigation regarding the capacity charge dispute.

Q. ARE THESE STIPULATION RECOMMENDATIONS REASONABLE AND BALANCED, IN LIGHT OF THE PARTIES' LITIGATION POSITIONS?

A. Yes. Absent the Stipulation, AEP Ohio's position is that it is entitled to collect a cost-based capacity charge for all shopping load served by CRES providers. Intervenor parties have taken the position that the existing interim RPM-based compensation mechanism adopted by the Commission in the *Ohio Capacity Charge Docket* should continue into the next ESP term. Thus, the Signatory Parties' proposed resolution of the capacity charge dispute is a reasonable result as part of the package of arm's length bargaining settlement terms contained in the Stipulation. Indeed, the hybrid solution of part RPM and part cost-based pricing resolves the disparate litigation positions of the parties through a classic middle ground compromise; this approach is inherently reasonable.

BACKGROUND REGARDING THE AEP INTERCONNECTION AGREEMENT (ALSO KNOWN AS THE AEP GENERATION "POOL")

Q. PLEASE PROVIDE A GENERAL DESCRIPTION OF THE AEP INTERCONNECTION AGREEMENT (POOL).

A. The Pool was formulated in 1951 and is a FERC-approved wholesale power pooling agreement. CSP, OPCo, Indiana & Michigan Power Company, Appalachian Power Company, and Kentucky Power Company are the five AEP East System operating companies (AEP System–East Zone) which are members of the AEP Power Pool established pursuant to the Pool. Although each operating company owns specific generating facilities, the AEP System–East Zone is designed, built and operated on an integrated system basis and member companies collectively participate to supply capacity. The Pool defines the rights and obligations of the five East Zone operating companies (each called a member) and sets out the methodology for allocating the responsibilities among the members.

Q. WHAT ARE THE MAJOR PROVISIONS OF THE POOL AND HOW DO THEY OPERATE?

A. Significant provisions of the Pool operate as follows:

- Each member is required to provide adequate generating facilities (or resources) to meet its firm load requirement.
- A demand allocator is established on the basis of each member's highest non-coincident peak (NCP) in the preceding twelve months. Member Load Ratio (MLR) is the ratio of a member's highest NCP in relationship to the total of all members' highest NCP demand in the preceding twelve months.
- There is a capacity settlement that equalizes reserve margins by assigning responsibility to each member for its MLR share of System capacity. To the extent that a member's capacity is less than its System responsibility, such deficit company is required to make up its shortfall by paying a

capacity charge to the surplus companies, based on the embedded cost of capacity of the surplus companies.

- Sales and purchases of energy among the member companies are provided at cost through primary energy transactions.
- Transmission facilities are made available to all members for the delivery and receipt of power; as members of PJM, each AEP East operating company takes transmission service under the FERC-approved OATT (Open Access Transmission Tariff).
- American Electric Power Service Corporation, as agent for the operating companies, buys and sells into the wholesale market for reliability and economic purposes [off-system purchases and off-system sales (OSS)].
- Off-System Sales margins are shared among members based on MLR.

In addition to the generation Pool, there are other agreements among the members of the East operating companies, most notably the Interim Allowance Agreement (IAA) that operates in conjunction with the Pool.

Q. HOW HAS THE POOL WORKED SINCE THE AEP-EAST COMPANIES JOINED PJM?

A. AEP integrated its east zone facilities into PJM in October 2004. After joining PJM, AEP is performing the same or similar functions as it did prior to joining an RTO, however, with the requirements of integrating with PJM, some additional responsibilities have been added, while others have been eliminated or modified. Since joining PJM, the AEP Pool member companies have participated on an integrated basis within PJM. Under the Pool, the AEP East operating companies effectively operate as one large company, utilizing the strengths of diversity to offset inherent risks associated with operating as smaller individual companies in PJM. This means that each member's customers receive low embedded cost capacity and energy regardless of their individual generation supplies while also receiving the benefit of sharing the margins of off-system sales and the opportunity to purchase economic energy to offset more expensive market energy. Due to AEP's election to participate in the Fixed Resource Requirement (FRR) option and as a result of the Pool construct, the cost to purchase capacity from other Pool Members is based on the embedded cost of installed capacity. From a cost of energy perspective, the Pool member companies sell or buy surplus energy to/from other members at a cost-based primary energy rate in addition to purchasing economic energy from the market at the Locational Marginal Price (LMP).

Q. GENERALLY SPEAKING, HOW WOULD ONE OF THE AEP-EAST OPERATING COMPANIES OPERATE IF THE POOL WERE TERMINATED?

A. An AEP company operating without the Pool on a stand-alone basis would have more restrictive requirements and more limited opportunities. If the operating companies were to operate on a stand-alone basis, fulfilling the reserve requirement would depend in part on each company's capacity length. From a cost of energy perspective, the Pool member companies sell or buy surplus energy to/from other members at a cost-based primary energy rate in addition to purchasing from or selling to the market at the LMP. A stand-alone company lacking energy needed to meet its hourly load requirement would purchase from or sell to the PJM market at the LMP, without the cost-based option the Pool provides to its members.

Q. HAS AEP GIVEN NOTICE THAT IT INTENDS TO TERMINATE THE POOL?

A. Yes. On December 17, 2010, AEP Ohio and other parties to the Pool provided written notice to each other of their mutual desire to terminate the existing agreement on three years notice in accordance with Article 13.2. The IAA (discussed above) would also be terminated concurrently with the AEP Pool. AEP has committed to enter into discussions with this Commission and other state commissions and stakeholders concerning the termination and whether any new affiliate agreement should replace it. These discussions are expected to continue through 2011 and perhaps longer.

Q. DOES THIS MEAN THAT AEP HAS DETERMINED THAT TERMINATION OF THE POOL IS THE APPROPRIATE SOLUTION FOR ALL OF THE FIVE AEP-EAST OPERATING COMPANIES?

A. Not necessarily. Aside from the corporate separation driven requirement for AEP Ohio to secede from the Pool, there will likely be some debate and discussion about the best course of action for the other three AEP-East operating companies. Whether a particular operating company and its customers benefit through modification or dissolution of the Pool depends on the variables such as future market prices for electricity, plant retirements, and extended plant outages. These are matters that each operating company's regulatory jurisdiction is likely to consider and evaluate as a stakeholder in the FERC process for changing or eliminating the Pool. There may be a need to re-balance the generation assets among the members as part of terminating the Pool. The outcome of these variables may have the potential to influence or affect retail rates in jurisdictions that regulate generation prices.

These factors may tend to suggest that the Pool modification or termination process will be somewhat complex and may not yield quick results. But since it is largely driven by compliance with Ohio's corporate separation requirement and the need to adjust or dissolve the Pool based on AEP Ohio's generation divestiture, it should be driven to conclusion in a reasonable period of time and without much doubt as to the end goal of taking AEP Ohio out of the Pool. Whether the Pool remains for some combination of the other three AEP-East operating companies is a matter for debate among those companies, their stakeholders and respective regulatory jurisdictions.

<u>FERC FILINGS FOR POOL TERMINATION/MODIFICATION AND CORPORATE SEPARATION</u>

Q. WHAT FERC FILINGS ARE NEEDED TO IMPLEMENT POOL TERMINATION OR MODIFICATION, IN THE CONTEXT OF IMPLEMENTING CORPORATE SEPARATION FOR AEP OHIO?

A. I have been advised by counsel that there are two sets of filings required in order to dissolve and/or modify the Pool in the context of corporate separation of AEP Ohio's generation function. First, FERC filings would be made under Section 205 of the FPA to (1) dissolve and/or modify the Pool, (2) substitute new agreements address the Pool's dissolution and/or modification, and (3) address the rate impacts, if any, from corporate separation of AEP Ohio. Second, a FERC filing would be made under Section 203 of the FPA for approval of AEP Ohio's corporate separation.

Q. WHAT IS THE TIMELINE FOR GETTING FERC'S APPROVAL FOR POOL TERMINATION/MODIFICATION AND CORPORATE SEPARATION?

A. The FERC filings will be pursued upon receiving a final order from this Commission adopting the Stipulation. As set forth in Appendix B of the Stipulation, AEP Ohio anticipates that the Section 205 filings and the Section 203 filings will both take approximately 450 days. The final schedule for these filings will be established by FERC.

STIPULATION PROVISIONS RELATING TO THE POOL

Q. WHAT ARE THE MAJOR PROVISIONS OF THE STIPULATION RELATING TO POOL TERMINATION/MODIFICATION AND CORPORATE SEPARATION APPROVAL BEFORE THE FERC?

A. As will be further described below, the Signatory Parties have agreed to the following provisions:

- AEP Ohio will, upon receiving a final order from this Commission authorizing full legal corporate separation, provide notice to PJM that it intends to participate in the RPM Base Residual Auction for delivery years 2015-2016. (Paragraph IV.1.q, page 11)
- A schedule is set forth for conducting a Competitive Bidding Process (CBP) to supply its SSO for delivery within the ESP term during the

period from June 1, 2015 through May 31, 2016 (Paragraph IV.1.r), such that auctions are conducted in 2013, 2014 and 2015 leading up to that delivery period. The auction schedule is tied to other agreed provisions that are designed to ensure that AEP Ohio expeditiously obtains FERC approvals for corporate separation and Pool termination/modification either by September 2013 or in the most expeditious manner reasonably possible (Paragraph IV.1.t, page 15).

- The Signatory Parties agree to support the Pool termination/modification to be filed at FERC. As a related matter, the Signatory Parties agreed to establish a Pool Modification Rider (with an initial rate of zero), subject to FERC approval of the Pool termination/modification and other specified conditions. (Paragraph IV.5, page 25)

Q. WITH RESPECT TO THE FIRST MAJOR PROVISION DESCRIBED ABOVE (PARAGRAPH IV.1.q, PAGE 11), PLEASE DESCRIBE THE SPECIFIC TIMELINES RECOMMENDED BY THE SIGNATORY PARTIES FOR FERC APPROVAL OF CORPORATE SEPARATION AND POOL TERMINATION/MODIFICATION .

A. The specific timelines agreed to by the Signatory Parties are reflected in Appendix B to the Stipulation. The estimated timelines for the required Section 203 and Section 205 FERC proceedings involve a 450-day period to conduct the FERC proceedings, which would be initiated after receiving a final order from this Commission adopting the Stipulation. Whatever schedule is established by

FERC, AEP Ohio agrees to diligently pursue approval of its Section 203 and 205 applications under the established schedule.

Q. WITH RESPECT TO THE SECOND MAJOR PROVISION DESCRIBED ABOVE (PARAGRAPH IV.1.t, PAGE 15), WHY WERE THESE MATTERS ADDRESSED IN THE STIPULATION?

A. These provisions reflect the fundamental arm's length bargain negotiated by the Signatory Parties, being that AEP Ohio would agree to sustain a fully-competitive SSO after executing a brief interim plan for efficiently transitioning from "point A" to "point B." In other words, these provisions recognize that AEP Ohio must achieve corporate separation and Pool termination/modification in order to transition from its current regulatory and business structure to one that involves an auction-based SSO. These provisions are based on two common understandings among the Signatory Parties: (i) Pool termination/modification is needed when AEP Ohio corporately separates its generation function, and (ii) Pool termination/modification and corporate separation are both needed in order for AEP Ohio to effectively and prudently conduct an auction-based SSO.

As referenced above, corporate separation clearly precipitates secession from the Pool by AEP Ohio. It cannot reasonably be disputed that removing AEP Ohio's substantial generation assets from the Pool cannot be achieved without terminating or modifying the Pool. Regarding the second common understanding, it is understood by the Signatory Parties that AEP Ohio could not prudently establish an auction-based SSO as long as it owns generation assets and remains a member of the AEP generation Pool, for two primary reasons.

First, conducting an SSO auction would have substantial impacts on the other Pool members and would expose both AEP Ohio and the other AEP-East operating companies to cost recovery risks in their respective regulated jurisdictions. Second, conducting an auction prior to corporate separation would create a financial exposure for AEP Ohio by wholly displacing the cost recovery for those generation assets that currently exists through SSO generation rates (based on the generation assets being dedicated to support retail generation service). It would also potentially remove the AEP Ohio generation from participating in the auction, due to the timing difference of the auction delivery period and the post-separation generation affiliate not yet owning the assets in order to be able to support bids into the forward auction with those generation assets.

Q. PLEASE ADDRESS THE POOL MODIFICATION RIDER ESTABLISHED THROUGH THE THIRD PROVISION DESCRIBED ABOVE (PARAGRAPH IV.5, PAGE 25).

A. The Signatory Parties agreed that a Pool Modification Rider for this purpose with an initial rate of zero is appropriate. If the impact of the Pool termination/modification on AEP Ohio during the ESP term is greater than $50 million prior to May 31, 2015, the Company may pursue cost recovery of the entire impact during the ESP term via a separate RDR application during the ESP term and obtain approval by the Commission.

Q. WHY DO YOU BELIEVE THIS PROVISION IS REASONABLE?

A. AEP Ohio's application in Case Nos. 11-346-EL-SSO proposed to recover material costs associated with the anticipated Pool termination/modification. As part of the package of terms contained in the Stipulation, the Signatory Parties agreed to this provision. I would note that the Signatory Parties reserved the right to challenge the amount and the recovery of these costs before the Commission and the FERC. Thus, even assuming the Pool termination/modification will cause an impact on AEP Ohio of more than $50 million and exceed the materiality threshold applicable to potential recovery under this provision, the ultimate issue of whether AEP Ohio would recover such costs is the subject of a future Commission proceeding.

CONCLUSION

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. I sponsor two major provisions within the Stipulation, both of which help resolve complex issues based on varied interests and disparate litigation positions. First, the Stipulation adopts a balanced and reasonable solution for the capacity charge dispute in Ohio, by proposing a hybrid approach that preserves and expands substantial retail shopping using RPM-priced capacity of AEP Ohio while also providing for a higher capacity charge (that is still well below AEP Ohio's cost-based litigation position) for remaining shopping levels – all during a transition period which ends with RPM-priced capacity for all shopping. Second, the Stipulation resolves longstanding issues regarding corporate separation and the dissolution or modification of the AEP Interconnection Agreement (generation

Pool) by adopting definite milestones and incentives for stakeholders to achieve corporate separation and Pool restructuring. In sum, both of these major provisions are framed by varying litigation positions and being mutually and reasonably resolved through a compromise result based on arm's length bargaining.

Q. DOES THAT CONCLUDE YOUR TESTIMONY IN SUPPORT OF THE STIPULATION?

A. Yes.

CERTIFICATE OF SERIVICE

I hereby certify that a copy of the testimony of Richard E. Munczinski was served on the persons stated below via electronic mail, this 13th day of September 2011.

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