

**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
Company and Columbus Southern)
Power Company.)

**INITIAL BRIEF
OF
DUKE ENERGY COMMERCIAL ASSET MANAGEMENT
AND
DUKE ENERGY RETAIL SALES**

This case is about the amount to be charged for iron in the ground, an aspect of electric service that has not been subject to cost-based regulation in Ohio for thirteen years.

In 1999, the Ohio General Assembly determined that it was in the best interests of the citizens of Ohio for electric utility services to be unbundled, such that competitive market forces could impact prices for generation.¹ Now, thirteen years later, Ohio Power Company, d/b/a AEP Ohio (AEP Ohio), asks the Public Utilities Commission of Ohio (Commission) to allow it to ignore market-determined prices and, instead, start charging regulated, cost-based rates for the capacity portion of its generation service.² To allow such a change would undermine more than a decade of growth in the competitive market that seeks to provide customers with the benefits of lower prices and would inhibit competitive providers' ability to make advantageous offers in AEP Ohio's territory.

¹ Amended Substitute Senate Bill No. 3

² See, e.g., Case No. 10-2929-EL-UNC, Ohio Power Company's and Columbus Southern Power Company's Initial Comments (January 7, 2011), at p. 4; Case No. 10-2929-EL-UNC, Ohio Power Company's and Columbus Southern Power Company's Reply Comments (January 7, 2011), at p. 4.

I. Introduction

Electric services are comprised of three separate and distinct elements. Distribution comprises all of the aspect of delivering electricity to end users, including the maintenance of the system of electric distribution lines, metering, billing, and numerous other items. Transmission is the movement of electricity at high voltages over long distances and involves a vast, interstate system. Generation is the designation for the electric commodity itself, and everything that goes into the creation of that commodity.

Prior to 1999, electric utilities provided distribution, transmission, and generation in a bundled package. Then, in 1999, the legislature of the state of Ohio decided to deregulate the electric generation industry and to allow competition in the supply of electric generation. In order to accomplish this goal, the legislature passed Amended Substitute Senate Bill No. 3 (SB 3), enacting Chapter 4928 of the Revised Code. Electric utilities in the state were required, by SB 3, to separate their charges into distribution, transmission, and generation portions, and entered into a phase known as the market development period. The market development period was designed by the legislature as a transition period, to allow the market for electric generation to develop while utilities' rates were still approved by the Commission and were moving away from the historical rate-of-return approach.

The market development period was set by the legislature to end in 2005,³ with one limited exception whereby the Commission could find that there was at least 20 percent switching in a utility's territory or could conclude that there was effective competition in a utility's territory.⁴ The legislature expected that, by 2005, the market would have developed sufficiently to allow generation to be priced by market forces, thereby precluding the need for traditional Commission control over those rates. However, due to issues in the regional

³ R.C. 4928.40(A).

⁴ R.C. 4928.40(B)(2).

transmission of power and other market-related problems, the Commission determined in 2003 that the market had not yet matured sufficiently to allow total transition to competition.⁵ Therefore, the Commission approved rate stabilization plans for the utilities in order to provide for a modicum of continued regulatory control while the market continued to develop.⁶

In 2008, the legislature stepped back into the process with comprehensive legislation to continue the deregulation process. Amended Substitute Senate Bill No. 221 (SB 221) had a number of important impacts on the electric utility industry but, critically, did absolutely nothing to move Ohio away from the goal of competition in the provision of generation services. Indeed, under SB 221, Ohio law was modified to specifically reference both energy and capacity as being encompassed within the generation services that are deregulated.⁷

Since the enactment of SB 3 and SB 221, competition has grown extraordinarily in some parts of the state, although foundering in AEP Ohio's territory. AEP Ohio witness Allen testified that shopping levels in AEP Ohio's territory stood at approximately 13% of residential load, 47% of commercial load, and 31% of industrial load, as recently as April 30, 2012.⁸ On the other

⁵ *In the Matter of the Continuation of the Rate Freeze and Extension of the Market Development Period for The Dayton Power and Light Company*, Case No. 02-2779-EL-ATA, *et seq.*, Opinion and Order (September 2, 2003), at p. 29.

⁶ *In the Matter of the Continuation of the Rate Freeze and Extension of the Market Development Period for The Dayton Power and Light Company*, Case No. 02-2779-EL-ATA, *et seq.*; *In the Matter of the Application of the Cincinnati Gas & Electric Company to Modify its Non-Residential Generation Rates to Provide for Market-Based Standard Service Offer Pricing and to Establish an Alternative Competitive-Bid Service Rate Option Subsequent to the Market Development Period*, Case No. 03-93-EL-ATA, *et seq.*; *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; and *In the Matter of the Applications of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Authority to Continue and Modify Certain Regulatory Accounting Practices and Procedures, for Tariff Approvals and to Establish Rates and Other Charges Including Regulatory Transition Charges Following the Market Development Period*, Case No. 03-2144-EL-ATA.

⁷ See R.C. 4928.142(C); 4928.142(B)(2)(a); 4928.20(J).

⁸ AEP Ohio Ex. 142, at 21.

hand, the most recent data compiled by the Commission shows substantially higher switching percentages in the territories of other Ohio utilities, as shown on the following table:⁹

Utility	Residential Switched Load	Commercial Switched Load	Industrial Switched Load
AEP Ohio	13	47	31
Cleveland Electric Illuminating	76	88	88
Ohio Edison Company	62	85	81
Toledo Edison Company	63	85	75
Duke Energy Ohio	34	80	96
Dayton Power and Light	12	69	92

Notwithstanding the low levels of shopping in AEP Ohio's service territory, AEP Ohio now seeks to depart from the historic market-based pricing structure and significantly increase prices charged to CRES providers. The question in this case is whether the capacity portion of the deregulated generation price will allow customers in AEP Ohio's certified territory to have the same competitive advantages enjoyed by customers in other parts of the state.

II. PJM AND CAPACITY REQUIREMENTS

AEP Ohio, together with its affiliates, is a member of PJM Interconnection, L.L.C.,¹⁰ (PJM) which dispatches generation and makes markets in energy and capacity. With regard to capacity, the PJM Reliability Assurance Agreement (RAA) is the governing document, specifying what is required of PJM members. It provides two ways in which to supply capacity: through the PJM Reliability Pricing Model (RPM) auction process that includes as the Base Residual Auction (BRA) and related incremental auctions or, alternatively, through the Fixed Resource Requirement (FRR) approach. PJM requires FRR entities to provide capacity

⁹ FES Ex. 113.

¹⁰ See, e.g., Tr. Vol. I, p. 57.

resources to serve the load in their entire certified territory, regardless of whether customers purchase their generation services from the utility or from a competitive supplier.¹¹

Critically important in the present debate is Schedule 8.1 of the RAA.¹² This is the provision that establishes the capacity requirement applicable to a member that has chosen the FRR alternative and provides a mechanism for determining the price for that capacity.

In a state regulatory jurisdiction that has implemented retail choice, the FRR Entity must include in its FRR Capacity Plan all load, including expected load growth, in the FRR Service Area, notwithstanding the loss of any such load to or among alternative retail LSEs. 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. 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.

This crucial section lays out the following points:

- An FRR Entity in a deregulated state, such as AEP Ohio, must provide capacity for all load in its service territory.
 - With regard to this requirement, the shopping or nonshopping status of end users is entirely irrelevant.
- The FRR Entity can be compensated for the capacity it provides on behalf of shopping customers in one of two ways:
 - The state regulatory body may establish a mechanism that requires the end users or the competitive providers to compensate the FRR Entity.

¹¹ FES Ex. 110-A, p. 111 (Schedule 8.1, para. D.8) Load serving entities can opt out of an FRR plan.

¹² FES Ex. 110-A.

- If, and only if, there is no such state mechanism, then:
 - The competitive providers pay the FRR Entity for capacity at a price that is equal to the RPM price in its respective area of PJM; provided that:
 - The FRR entity may apply to the Federal Energy Regulatory Commission (FERC) for permission to charge a cost-based rate in place of the RPM BRA price.
 - The competitive providers may petition the FERC to review the price charged.

Thus, the FRR entity may only apply to the FERC to charge a cost-based capacity price, under the RAA, in the event that there is no state mechanism in place. No other interpretation of this language is plausible. And a ruling that diverges from this carefully crafted arrangement would necessitate modification of the RAA itself.

III. THE STATE MECHANISM

On December 8, 2010, faced with an application by AEP Ohio before the FERC to set a cost-based capacity price in the absence of a state mechanism, the Commission decided to act. With the FERC application pending, the Commission “expressly adopt[ed] as the state compensation mechanism . . . the current capacity charges established by the three-year capacity auction conducted by PJM . . . during the pendency of this [proceeding].”¹³ Subsequently, on March 1, 2012, the Commission agreed to modify the state compensation mechanism on an interim basis to allow AEP Ohio to charge for capacity on a two-tiered system that is neither RPM- nor cost-based. Such modification expressly terminates on May 31, 2012.¹⁴

¹³ Case No. 10-2929, Entry (December 8, 2010), at finding 4.

¹⁴ Although AEP Ohio has filed a motion asking for an extension of the modification, as of this date that motion has been neither granted nor denied.

The Commission's mission, in this case, is to resolve the question of what should comprise the state mechanism for charging for capacity. As previously noted, capacity, as a part of generation service, is a competitive service in Ohio. It is therefore not subject to traditional cost-based ratemaking.

Ohio policy clearly establishes the legislature's intent that generation services be deregulated.

"It is the policy of this state to . . . [e]nsure the availability to consumers of . . . reasonably priced retail electric service . . . ; [e]nsure the availability of unbundled . . . retail electric service that provides consumers with the . . . price . . . options they elect. . . ; [e]nsure diversity of electricity supplies and suppliers, by giving consumers effective choices over the selection of those supplies and suppliers . . . ; [and r]ecognize the continuing emergence of competitive electricity markets through the development and implementation of flexible regulatory treatment . . ."¹⁵

It is critically important to recognize that generation service is specifically categorized, by statute, as a competitive service.¹⁶ Even AEP Ohio itself has not argued that capacity is anything other than a part of generation service. Thus, capacity is similarly a competitive service, subject to competitive pricing rather than traditional cost-of-service pricing. Nevertheless, in this proceeding AEP Ohio suggests that it has a right to recover its embedded capacity costs. Nowhere in Ohio law is there any provision that would give AEP Ohio such a right with regard to a generation service. Indeed, nowhere in the RAA is there any such provision.

IV. CONCLUSION

The Commission, as a creature of statute, only has the powers granted to it specifically.¹⁷ The Supreme Court of Ohio has ordered that the Commission, in making its decisions, must

¹⁵ R.C. 4928.02.

¹⁶ R.C. 4928.03

¹⁷ See, e.g., *Cincinnati v. Pub. Util. Comm.*, 96 Ohio St. 270 (1917) (Syllabus 1); *Penn Central Transportation Co. v. Pub. Util. Comm.*, 35 Ohio St.2d 97 (1973) (Syllabus 1).

consider and follow the statutorily established state policies. This is not a distribution rate case. This is simply an opportunity for the Commission to establish, pursuant to existing state policy supporting free-market competition, that the cost of capacity services must be determined on a competitive basis, and not on the basis of cost.

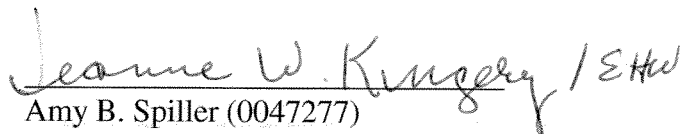
PJM has created a fully functioning market for capacity services. The Commission should adopt that market as the state mechanism for establishing cost, applicable to all utilities across the state.

Respectfully submitted,

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and

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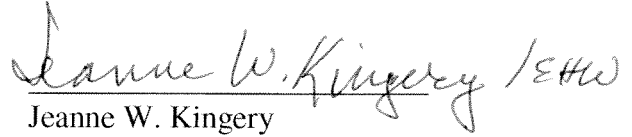
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CERTIFICATE OF SERVICE

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 23rd day of May, 2012, to the following parties.


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