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

POST-HEARING BRIEF
OF INTERSTATE GAS SUPPLY, INC.

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I. BACKGROUND

The provision of electric service by the Ohio Power Company d/b/a AEP Ohio ("AEP") is subject to PJM's Reliability Assurance Agreement. Section D.8 of Schedule 8.1 of that agreement governs the payment of capacity charges by competitive retail electric service ("CRES") suppliers to AEP. As pertinent here, it provides that "where the state regulatory jurisdiction requires switching customers or the [CRES supplier] to compensate [AEP] for its [fixed resource requirement] capacity obligations, such state compensation mechanism will prevail" over alternative methods of compensation.

The Commission instituted this proceeding to determine the "state compensation mechanism." Entry 2 (Dec. 8, 2010). The Commission held extensive hearings, at the conclusion of which it ordered that post-hearing briefs be filed on May 23. In accordance with that order, IGS hereby files its brief.

II. ARGUMENT

In this case, it falls to the Commission to determine the "state compensation mechanism" to govern the payment of capacity charges by CRES providers to AEP. The "compensation mechanism" in the *rest* of the "state" is a non-issue; the other major electric utilities use the PJM-created and -administered reliability pricing model ("RPM") to price capacity. AEP has come up with its own method, however, one designed to recover from shopping customers the embedded costs of its generation fleet. And those two methods—RPM or AEP's calculation of embedded costs—form the basic choice before the Commission.

Of course, the Commission only has "the state regulatory jurisdiction" to set the "state compensation mechanism" because the General Assembly, on behalf of the State, has given it that power. But the legislature did not leave the Commission to work on a blank slate. The

General Assembly (and indirectly the Ohio Supreme Court) have provided laws, policies, and precedents that address how the Commission should make its decision in this case.

The cornerstone of Ohio's electric policy is "to facilitate and encourage development of competition in the retail electric market." *AK Steel Corp. v. Pub. Util. Comm.*, 95 Ohio St. 3d 81, 81 (2002). The record shows that the market-based RPM method will support competition, ensure reliability, and run afoul of no law or policy. And the record shows the converse regarding AEP's proposal: it will cripple competition, have no effect on reliability, and violate numerous laws and policies.

The evidence is clear. The Commission cannot approve AEP's proposal unless it ignores either the record or the direction given it by the state of Ohio. AEP may see this case as providing one last bite at the apple of embedded-cost recovery, one last shot to cripple burgeoning competition, and one last "market development period"—but the law of Ohio rules out what AEP is trying to do.

A. The RPM mechanism of pricing capacity supports Ohio's policies; AEP's proposed mechanism violates them.

For all the hundreds of pages of testimony and weeks in the hearing room, the issue in this case boils down to a choice between two methods to price capacity: (*1*) the market-based, PJM-administered reliability pricing model ("RPM") or (*2*) AEP's calculation of its embedded costs. The RPM price fully accords with Ohio's laws and policies; the alternative, AEP's proposal to recover embedded generation costs from shopping customers, does not.

1. The "state compensation mechanism" must accord with Ohio law and policy.

The Reliability Assurance Agreement provides that the "state compensation mechanism" set by the "state regulatory jurisdiction" shall govern capacity payments by CRES suppliers to AEP. (Schedule 8.1, Section D.8.) The tariff provision does not speak to *how* the state

compensation mechanism should operate but simply adopts that mechanism. This, however, does not give the Commission free rein to establish whatever compensation mechanism it chooses; rather, when adopting a state compensation mechanism, the Commission must follow the laws and the policies of the state. Those laws and policies, set forth by the Ohio General Assembly, make clear that generation service in Ohio must be competitive and that such service must avoid anticompetitive subsidies. And while those laws granted incumbent utilities a lengthy transition period to competitive markets, they make clear that the time for transition has ended.

a. Ohio's central electric policy is to develop competitive retail electric markets.

Ohio's fundamental electric policy is "to facilitate and encourage development of competition in the retail electric market." *AK Steel Corp. v. Pub. Util. Comm.*, 95 Ohio St. 3d 81, 81 (2002). Ohio law speaks in numerous places requiring the Commission to ensure that competitive markets for electricity develop in Ohio. The Commission has a continuing duty to "[r]ecognize the continuing emergence of competitive electricity markets." R.C. 4928.02(G). It must "[e]nsure diversity of electricity supplies and suppliers, by giving consumers effective choices over the selection of those supplies and suppliers." R.C. 4928.02(C). Among other dangers to competition, the Commission must protect consumers from entities wielding "market power." R.C. 4928.02(I). These policy statements are not idealistic aspirations; the Commission "*shall* ensure that [Ohio's energy] policy . . . is effectuated." R.C. 4928.06(A) (emphasis added).

The Court has recognized that, at bottom, "the advent of customer choice" was intended to give customers a chance to consider "offers from competitive generators." *Migden-Ostrander v. Pub. Util. Comm.*, 102 Ohio St. 3d 451, 452–53 (2004). As the Court recognized, "[A]ll customers [will] benefit from having greater choices in a competitive retail electricity market."

Ohio Consumers' Counsel v. Pub. Util. Comm., 110 Ohio St. 3d 394, 398 (2006). Even AEP has recognized that Ohio's "'basic and central' electric policies . . . favor[] the development of competitive markets, retail shopping, and customer choice." *In re Ormet Primary Aluminum Corp.*, 129 Ohio St. 3d 9, 2011-Ohio-2377, ¶ 22 (quoting AEP brief).

b. Ohio law requires nondiscriminatory, non-subsidized electric service.

Ohio law also requires that electric service be provided on comparable, nondiscriminatory terms that avoid anticompetitive subsidies. Retail electric service must be "nondiscriminatory" to consumers. R.C. 4928.02(A). "[U]nbundled and comparable" service must be available. R.C. 4928.02(B). And the Commission must "[e]nsure *effective* competition in the provision of retail electric service by avoiding anticompetitive subsidies." R.C. 4928.02(H) (emphasis added). Likewise, R.C. 4905.26 provides that a utility's rates and services shall not be "unjustly discriminatory[or] unjustly preferential." And the Supreme Court has recognized that R.C. 4905.35(A) applies to competitive services and requires "equal" treatment of customers. *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 111 Ohio St. 3d 300, 314 (2006). AEP Witness Munczinski agreed that the Commission "is about promoting fairness and competition." (Tr. 168.)

c. The law addresses the timing of transitions to the competitive market.

The General Assembly also had some foresight in creating the transition to the competitive markets. To protect utilities, it allowed a lengthy transition process to recover potentially stranded costs; but it also recognized that utilities might not want the extra revenue stream to end. So it stated clearly that an electric utility "shall be wholly responsible for how to use those revenues and wholly responsible for whether it is in a competitive position after the market development period." R.C. 4928.38. And "[w]ith the termination of that approved revenue source, the utility shall be fully on its own in the competitive market." *Id*. Likewise,

under R.C. 4928.40(A), it provided a hard stop date on the collection of any transition charges of "December 31, 2010."

S.B. 221 did not repeal these provisions or stop dates; they remain good laws. In fact, the current statute expressly requires that standard service offers "shall exclude any previously authorized allowances for transition costs." R.C. 4928.141(A). In short, the transition period is over.

d. The Commission must observe the policies of the State.

On multiple occasions, the Supreme Court of Ohio has upheld the State laws and policies requiring transition to competitive electric markets. For example, the Court disallowed AEP's attempt to recover the costs of generation assets under the guise of a distribution or ancillary service. It held that such a move "would negate the legislature's deregulation of the electric-utility industry." *Indus. Energy Users-Ohio v. Pub. Util. Comm.*, 117 Ohio St. 3d 486, 491 (2008). Such a basic contradiction of Ohio's deregulatory policy could not be justified by broadly stated concerns about reliability: "the commission's concern with respect to the future reliability of the electric-generation market . . . [did] not empower the commission to create remedies beyond the parameters of the law." *Id*. Likewise, when an order resulted in a cross-subsidy (there, from distribution to generation), the Court held that it violated the policy set forth in R.C. 4928.02(G). *Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St. 3d 305, 2007-Ohio-4164, ¶ 58.

2. The RPM method fully accords with Ohio law.

The RPM pricing method satisfies all of the laws and policies described above and violates none.

a. The RPM method is a market-based price and will support the continued development of Ohio's competitive market.

As discussed above, Ohio made a choice over ten years ago "to facilitate and encourage development of competition in the retail electric market." *AK Steel Corp. v. Pub. Util. Comm.*, 95 Ohio St. 3d 81, 81 (2002). RPM does that.

"[C]ompetition intrinsically means that consumers will pay *market-based* prices, not *cost-based* prices." (Stoddard Dir. 47.) The record one-sidedly shows that the RPM pricing method is market-based and would support the development of a competitive market. IGS witness Ray Hamman testified, "The RPM capacity prices established by the auctions are market based and thus establish a price based on the supply and demand for capacity resources." (Hamman Dir. 3.) He recommended, "In a state like Ohio, which has elected to encourage the development of competitive electricity markets, using a readily available market price to set capacity charges only makes sense." (*Id*. at 5.) Other witnesses, such as FES witness Stoddard, concurred that the RPM price "is the closest approximation to the market value of the reliability value of capacity." (Stoddard Dir. 21.)

AEP's witness also agreed on this point. AEP witness Graves agreed that under RPM, customers would have a fully competitive generation market available to them: "if the Commission establishes an RPM pricing mechanism as the state compensation mechanism, shopping customers would be able to see market driven pricing for both capacity and energy." (Tr. 863.) Graves also conceded that the Federal Energy Regulatory Commission concluded that "the prices in RPM will be just and reasonable" and will "prevent the exercise of market power with the result that prices will approximate those of a competitive market." (Tr. 856.) This is important because, as FES witness Stoddard explained, "[r]etail choice should be driven by the ability of competing retailers to create value for their clients through a combination of price,

service, and other value-adding components. If all retail customers—including non-shopping customers—have a common capacity payment obligation to PJM, then customer choice is not skewed by regulatory adjustments to capacity costs." (Stoddard Dir. 48.)

All this means that RPM will support competition. AEP's own witness agreed that "if the Commission determines that the state compensation mechanism should be RPM-based price, . . . there would be more CRES providers serving customers in AEP Ohio's territory than if the Commission adopted embedded cost-based capacity prices." (Graves Cross, Tr. 862–63.) As Graves recognized, this would generate customer benefits, because "competitive markets can produce advantages to electricity customers in comparison to cost-of-service regulation." (Tr. 858.) One benefit that Graves expected to see was that CRES suppliers would "compete against each other and drive down" prices. (Tr. 864.)

The record unquestionably shows that the RPM pricing method is market-based and would support the development of competition.

b. The RPM price would avoid subsidies and discriminatory pricing.

The RPM pricing method would also avoid anticompetitive subsidies and any possibility of discriminatory capacity pricing. That is because "[t]he capacity auctions establish capacity prices that all LSEs must pay." (Hamman Dir. 3.) Indeed, all the major utilities in Ohio—save for AEP—charge CRES suppliers the RPM auction price. (Stoddard Dir. 19–21.) Thus, using the RPM would result in a level playing field across all Ohio.

The RPM price is not subsidized and does not create subsidies—that follows from being a market-based price. The entire purpose of the RPM auction is to approximate the market value of the service. FES witness Lesser testified that "[t]he market-clearing price in a competitive market is *not* a subsidized price." (Lesser Dir. 27 (emphasis sic).) As witness Lesser explained, to say that charging RPM creates a subsidy, one must first assume that a capacity seller is

entitled to recover embedded costs from the market—but that is contrary to the very nature of a market. (*Id*. at 30.) A seller is only "entitled" to what a willing buyer will pay.

In other words, "The fact that the market price of capacity may be less than AEP Ohio's embedded cost of capacity does not mean AEP Ohio is subsidizing anyone. It means that the market can supply capacity more efficiently than AEP Ohio can." (*Id*. at 31.) Indeed, this is the very reason Ohio deregulated: to avail Ohio customers of the efficiencies and price discipline imposed by markets.

c. The RPM model will assure adequate resources are available to provide stable electric service.

In addition to providing a market-based price, the RPM price also does the job which gives it its name: it assures reliability. Consider the testimony of AEP witness Graves, who agreed that, using RPM, PJM's capacity markets "have brought forward a large amount of new capacity resources," "are designed to ensure that there's an adequate supply of reserve margins three years following," and "have done very well" in accomplishing that goal. (Tr. 870.) Thus, he had "no concern about [any] capacity shortfall within PJM" through 2016 and indeed did *not* "expect there will come a time when RPM will fail in its purpose to ensure sufficient and reliable capacity." (Tr. 872.)

d. The RPM price avoids any legal problems associated with extending the transition to competition.

Finally, RPM pricing avoids any question as to whether AEP is continuing to collect *de facto* transition charges or is otherwise putting off any statutorily mandated move towards competition. (*Cf.* Tr. 136 (AEP witness Munczinski: "If the CRES providers want competition, we will be there after . . . June 1, 2015").)

In short, RPM pricing is consonant with the major pillars of Ohio electricity policy: it is market-based, it supports competitive markets, it is nondiscriminatory, it assures reliable service,

and it is consistent with the timing of the transition to competitive markets established by Ohio law. RPM pricing is already in use in Ohio by all the other major electric utilities, and has been used by AEP until only recently. And it poses no legal problems.

Unless AEP can show that its alternative embedded cost proposal furthers Ohio's energy policy as well as RPM and poses *no* legal problems, RPM pricing should be the state compensation method for Ohio. AEP's proposal, however, clearly does not meet these qualifications.

3. AEP's proposal would violate Ohio law.

AEP is seeking the compelled recovery from shopping customers of the embedded costs of its generation fleet. (Graves Dir. 6.) But this proposal runs afoul of the law.

a. AEP's proposal would harm the development of competition.

The record is clear that AEP's proposal will stifle competition. IGS witness Hamman explained that under AEP's proposal, "CRES suppliers would have to charge higher rates for service or be prevented from entering the market altogether." (Hamman Dir. 5.) Other witnesses agreed that if AEP's method were adopted, it would "discourage[] the development of retail choice, and also confer[] a competitive advantage during the transition period on AEP Ohio, allowing it to hold retail customers who otherwise would have chosen to shop." (Stoddard Dir. 24.) By "[i]mposing high capacity costs on shopping customers, but a lower capacity cost on non-shopping customers," AEP would "discourage[] shopping even if the CRES provider could otherwise have provided real economic value to the customer." (Stoddard Dir. 48.) Witness Lesser also testified that "[a]n above-market capacity rate will discourage competition and keep customers from saving the money they should." (Lesser Dir. 22; *see also* Ringenbach Dir. 14 (the "unequal [capacity] price increase [will] discourage retail competition" and "prevent[] CRES from engaging in effective marketing" and thus from "bringing small customers into the

market"); Fein Dir. 7 ("the fully embedded cost rate of approximately $355/MW-day that AEP Ohio seeks to implement for capacity would retard retail competition").)

b. AEP's proposal would lead to anticompetitive subsidies.

State policy also warns against incumbent utilities overcharging for one service to subsidize another. R.C. 4928.02(H). Once again, AEP's proposal fails the test, and once again, the record is clear.

"[I]mposing above-market capacity prices on CRES providers will result in shopping customers paying an uneconomic dividend to AEP Ohio shareholders." (Stoddard Dir. 24.) FES witness Lesser agreed that "[a]rtificially high capacity rates for all customers will provide an anti-competitive advantage to the AEP affiliate CRES provider. Thus, AEP Ohio's affiliate CRES provider will gain an anticompetitive advantage in the retail market." (Lesser Dir. 22.) IEU witness Murray concurred, "It is fundamentally unfair and contrary to Ohio's pro-competition policies to allow AEP-Ohio's affiliates to serve non AEP-Ohio EDU customers in other areas of Ohio while paying market-based prices for capacity, but require CRES providers attempting to serve AEP-Ohio EDU customers to pay cost-based rates for capacity. The cost-based rate for capacity also amounts to a subsidy to AEP-Ohio's . . . generation business . . . ." (Murray Dir. 25.)

c. AEP's proposal would violate Ohio's transition laws.

Finally, AEP's proposed method would require the Commission to ignore the laws that ended Ohio's transition period.

Not that AEP appears particularly aware of those laws. For example, AEP's self-described "policy witness," Mr. Munczinski, stated, "If the CRES providers want competition, we will be there *after . . . June 1, 2015*." (Tr. 136 (emphasis added).) Likewise, AEP's position in its pending ESP proceeding makes even clearer that it is seeking to unilaterally resurrect and

extend the transition period. Mr. Powers testified that "AEP Ohio would not be willing to provide discounted capacity and transition as quickly to market . . . if it does not receive all" that it is asking. (Case No. 11-346-EL-SSO, Powers Dir. 5.) He describes the period between now and 2015 as "the market transition period." (*Id*. at 12.)

AEP says all this as if the law had not already provided for a roughly decade-long transition to competition. But the General Assembly has already provided for such a transition, with associated charges, in R.C. 4928.38–.40, and time is up. AEP was "wholly responsible for how to use [its transition-charge] revenues and wholly responsible for whether it is in a competitive position after the market development period." R.C. 4928.38. And now that that period has ended, AEP is to "be fully on its own in the competitive market." *Id.*

The law is meaningless if utilities may continue to require *all* customers to pay embedded generation costs after all the transition periods have ended, and approving AEP's proposal would be simply ignoring the statutory requirements.

4. AEP's justifications for recovering embedded costs are refuted by the evidence and ignore Ohio law.

The reasons AEP offers in support of its proposal are refuted by the record and disregard the policy of the state of Ohio.

a. There are no reliability concerns under RPM.

AEP tried and failed to prove that RPM pricing would hurt reliability. For example, Mr. Munczinski stated that RPM pricing would "undermine . . . the ability to provide customers with reliable and adequate service" and provide "little or no incentive to invest in Ohio asset generation." (Munczinski Dir. 9.) Likewise, AEP witness Graves testified that RPM does "not necessarily" attract the "kinds of resources that would be preferred for long term resource planning." (Graves Dir. 7.)

But this position fell apart on cross-examination. Mr. Graves conceded this point away altogether: as explained above in more detail, he admitted that he did not "expect there will come a time when RPM will fail in its purpose to ensure sufficient and reliable capacity." (Tr. 872.) And as for Mr. Munczinski's suggestion that AEP's proposal will "ensure sustained investment within the state of Ohio" (Munczinski Dir. 14), that too vanished. He conceded that the cost-based rates are not planned to fund any new assets: "there's no plan to [invest in new generation prior to 2014] at this point," based on "the long position of generation that we have." (Tr. 36.)

And for all AEP's talk about long-term reliability, one would never guess it intends to adopt RPM pricing in less than three years.

b. RPM pricing does not subsidize CRES providers.

Likewise, AEP suggested that RPM would create "an unreasonable and ultimately unsustainable subsidy to CRES providers in Ohio." (Munczinski Dir. 11.) However, as noted by witness Hamman, "Notwithstanding the complex and unsubstantiated formula proposed by AEP to calculate capacity charges, quantifying the value of the capacity is simple. What AEP charges CRES providers for capacity should equal that capacity's value to AEP—and that is what CRES suppliers would pay, and AEP would receive, for the capacity if the parties went to market." (Hamman Dir. 4). If AEP were forced to sell its capacity on the market, AEP would receive the RPM market price for capacity. Charging RPM prices to CRES suppliers for capacity is not a subsidy; this is no more and no less than the price CRES suppliers would pay if they were not forced to take capacity from AEP.

Simply because "less money [might be] paid to AEP Ohio" than AEP thinks it deserves does not mean that AEP is subsidizing anyone, particularly when the allegedly lost revenues are "associated with a rate that AEP Ohio has never been authorized to charge." (Stoddard Dir. 23.) "AEP Ohio would not be subsidizing CRES providers by providing capacity below AEP Ohio's

purported 'costs' because AEP Ohio is offering unreasonable and inaccurate estimates of the relevant costs." (Stoddard Dir. 45.) Unlike AEP's proposal, under RPM there is no subsidy.

c. AEP's proposal reflects a basic disregard of Ohio policy.

At the end of the day, AEP's fundamental problem is that it does not agree with Ohio policy. AEP is certainly entitled to its views, but that means nothing here. The Commission must follow Ohio's policies.

Consider how the following comments show that AEP simply does not accept Ohio's policy choice of competitive markets over regulated markets for generation. Perhaps most lucidly, AEP witness Graves stated that "fostering retail competition for its own sake, especially if success is measured in terms of [shopping] customers . . . , is not an appropriate or informative metric of economic benefit or efficiency." (Graves Dir. 13.) But whether "fostering retail competition for its own sake" is "appropriate," or "informative," or wise, or foolish, or all or none of the above is not an issue in this case. Chapter 4928 is on the books; the choice that retail competition is worth fostering has already been made.

Nevertheless, at hearing AEP's witnesses continued to try to debate the wisdom of Senate Bill 3. For example, Mr. Munczinski testified that the Commission "should not be looking to use the short-term market auction prices at the expense of longer-term stability, reliability, and investment in generation." (Munczinski Dir. 16.) Likewise, witness Graves questioned whether "CRES providers would pass on the lower [capacity] costs to customers, rather than keep most of the savings for themselves." (Graves Dir. 10.) He also questioned whether the market price would create the appropriate incentives to invest in reliability. (*Id*. at 14–15.) While questions of "competition versus regulation?" or "will markets work?" might make for an interesting theoretical debate, these questions represent *policy* questions that have already been settled by the Ohio legislature.

Again, AEP witness Graves conceded that RPM would "undoubtedly increase the prevalence of retail providers in AEP Ohio's service territory," but he discounted this because of his belief that the market would not work: "if market prices increase materially, CRES providers will turn their former AEP Ohio customers back to AEP Ohio . . . ." (Graves Dir. 8.) Again, simple doubt in the markets is not a valid reason to choose AEP's proposal—Ohio has chosen to use markets.

Nor are timing questions immune from AEP's policy revision. Mr. Munczinski stated, "If the CRES providers want competition, we will be there after our contracts are finished June 1, 2015." (Tr. 136.) Of course, *when* competition should begin is another policy question, and once again, it is already settled.

Mr. Munczinski also suggested that the policy has not been worth the results: "we're doing all this shopping to reduce prices by 4 percent?" (*Id.*) But again, even assuming that he correctly described the benefits, and further assuming that he correctly weighed them, it is not for AEP or the Commission to sit in judgment on the wisdom of Ohio policy.

One could go on with examples, but the issue is the same. Ohio has already made the policy choices relevant to this case. AEP may not like them, but that is of no consequence in this proceeding.

B. The choice in this case is clear: the Commission should select RPM pricing.

After hundreds of hours of review, the choice is clear. The Commission should adopt RPM as the state compensation mechanism.

The RPM method already exists, was neutrally created, applies all over the region, is market-based, is non-discriminatory, and provides the correct incentives to assure investment in generation resources. The alternative method was devised *by the payee*, for this case and this case only, returns Ohio to a cost-based-generation regulatory regime, shows no relationship to

short- or long-term generation adequacy, and could nip competition in the bud. AEP's own witness agreed "it would be improper for AEP Ohio to switch off opportunistically between the higher of RPM-based prices and embedded cost prices" (Tr. 868), but that is exactly what it is attempting to do. The only thing AEP's method is good for is reaping millions for AEP and a 12.2% return on equity. While that might work for AEP, it is not good enough for Ohio.

The right answer is frequently the simple one. Here, the answer is RPM. The Commission should adopt it.

III. CONCLUSION

For the foregoing reasons, the Commission should adopt RPM pricing as Ohio's compensation mechanism.

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Case No(s). 10-2929-EL-UNC

Summary: Brief Initial Post-Hearing Brief electronically filed by Mr. Andrew J Campbell on behalf of Interstate Gas Supply, Inc.