BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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

REPLY BRIEF
OF INTERSTATE GAS SUPPLY, INC.

Mark A. Whitt (Counsel of Record)
Andrew J. Campbell
Melissa L. Thompson
WHITT STURTEVANT LLP
PNC Plaza, Suite 2020
155 East Broad Street
Columbus, Ohio 43215
Telephone: (614) 224-3911
Facsimile: (614) 224-3960
whitt@whitt-sturtevant.com
campbell@whitt-sturtevant.com
thompson@whitt-sturtevant.com

Vincent Parisi
Matthew White
Interstate Gas Supply, Inc.
6100 Emerald Parkway
Dublin, Ohio 43016
Telephone: (614) 659-5000
Facsimile: (614) 659-5073
vparisi@igsenergy.com
mswhite@igsenergy.com

ATTORNEYS FOR INTERSTATE GAS SUPPLY, INC.

TABLE OF CONTENTS

I. INTRODUCTION

In its initial brief in this case, Interstate Gas Supply, Inc. ("IGS") established the following points:

a) the cornerstone of the State 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);

b) PJM's reliability pricing model ("RPM") is aligned with Ohio's policy to promote competition and raises no legal questions;

c) the converse is true of the proposal of Ohio Power Company d/b/a AEP Ohio ("AEP") to collect embedded generation costs from shopping customers; and

d) the reasons advanced by AEP in support of its proposal either fell apart during the hearing or disregard Ohio law.

AEP's initial brief calls none of these points into question—and in fact confirms many of them. Therefore, the Commission should order that the appropriate mechanism to compensate AEP for capacity used by CRES suppliers is RPM.

II. ARGUMENT

A. The Commission has *not* already determined that AEP is entitled to an embedded-cost-based capacity charge.

In its argumentative "background and procedural history" section, AEP suggests that the Commission settled one of the critical issues in this case when it set the case for hearing: whether AEP is entitled to an embedded-cost-recovery mechanism. (*See* AEP Br. 11.) It states that three entries have already ruled that the "goal [of this case] was to establish cost-based pricing for capacity." (*Id.*) The entries in question referred to the task in this case as determining "the appropriate capacity cost pricing/recovery mechanism." Entry 2 (Aug. 11, 2011); Entry 3 (Mar. 7, 2012); Entry 3 (Mar. 14, 2012).

Whether or not the Commission ultimately sides with AEP, it is a bit of a stretch to suggest that a shorthand description in several procedural entries settled one of the major issues in the case. And obviously, it did not. These entries expressly state that "appropriate capacity cost pricing" is at issue, and RPM (no less than AEP's embedded-cost proposal) is a way to put a "price" on the "capacity cost" to CRES providers. The key phrase for AEP (approval of "cost-based pricing") is notably absent from any of the entries.

Given the weight of law and evidence arrayed against AEP's proposal, it is not surprising that AEP wishes the issue of embedded-cost-based pricing versus RPM were already settled. This decision is before the Commission, however, not behind it.

B. AEP's argument from state policy is tellingly bare.

AEP offers an argument that its proposal advances state policy. (AEP Br. 16.) It cites *one* provision of Ohio's mandatory state electric policy in favor of its proposal (*see id*.), but that provision, R.C. 4928.02(A), lends no support to AEP in this case. But before analyzing AEP's arguments on state policy in more detail, note a striking feature of AEP's argument: although Ohio's electric policy is varied, far-reaching, and broadly written, AEP advances only a *single* division of that policy in support of its proposal. And as will be shown, that argument is insubstantial, at best.

1. AEP's proposal does not advance the policy of R.C. 4928.02(A)

R.C. 4928.02(A) provides that Ohio's policy is to "[e]nsure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service." According to AEP, its proposal "will allow AEP Ohio to provide customers with reliable and reasonably priced retail electric service." (AEP Br. 20.)

AEP does not independently develop the policy point that its method represents a "reasonable price," which is understandable given the gulf between AEP's pricing and the

market. Instead, it focuses on reliability. It argues that "power plants are built as long-term assets, with an understanding between the state and the company . . . that the company will be compensated over the long term for its investment. Allowing AEP Ohio to recover its capacity costs would allow AEP Ohio to recover some of the costs of its long-term generation investments and would provide incentives for additional future investment in in-state generation." (*Id*.) AEP also argued that it was "at risk for long-term in-state generation capacity deficiencies." (*Id*. at 22.)

The record, unfortunately for AEP, affirmatively refutes the theory that embedded generation costs are needed to ensure reliability. AEP's own witness agreed with numerous others 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 the need to incentivize generation investment, AEP admits in its own brief that it "is not planning to build significant new generation prior to 2015." (AEP Br. 22.) Finally, after 2015, AEP has proposed in its ESP proceeding that all of its generation assets be sold, and that AEP will no longer have the responsibility to own and operate generation assets.

It is a stretch at best to argue that AEP needs higher capacity costs to promote electric reliability in Ohio when the evidence clearly demonstrates that AEP will not, and has no intention to, use the capacity revenues to invest in future generation in Ohio. Further, even if AEP's proposal would support reliability for the next three years, RPM would do the same for less.

2. AEP's proposal will not promote retail competition.

AEP also asserts that its proposal will "promot[e] alternative competitive supply and retail competition." (AEP Br. 16.) It argues that under its proposal, "there will be an

opportunity for customers in all classes to shop, and for CRES providers to earn margins, at the Company's proposed $355.72/MW-Day full-cost capacity rate." (*Id*.)

If there is one point that has unanimous record support in this case, it is that AEP's proposal will harm competition. (*See* IGS Br. 6–7, 9–10, 13–15.) AEP's own witnesses conceded as much, and AEP generally must resort to devaluing or redefining competition to make its case. Theoretically, any price on capacity allows "an opportunity" to shop, but this way of thinking is plainly contrary to Ohio's electric policy. That 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). It is not to put competition on life support.

Along these lines, AEP also points out that numerous other inputs affect shopping levels, and that if those inputs can counterbalance the increased capacity charge, all will be well for everyone. (*See* AEP Br. 16–18.) There are numerous problems with this. Most come down to the fact that only *one input* (the capacity charge) is before the Commission in this case, and it must pass muster under the laws and policies of the "state regulatory jurisdiction." So it is no answer to the anticompetitive problems of AEP's proposal that it is mathematically possible for other inputs to outweigh them. The "compensation mechanism" *itself* must accord with the laws and policies of the "state." Moreover, AEP ignores the fact that even if other price inputs had a positive impact on shopping, AEP's proposal would still take benefits away from shopping customers that they would have received had RPM pricing *also* been used.

3. The record does not show that RPM creates a subsidy.

AEP also argues that RPM pricing "would provide CRES providers with an illegal subsidy." (AEP Br. 29.) But the record simply does not support AEP's characterization of RPM as a subsidy. A witness who said so, but did not show it was so, is not the same thing as

supporting evidence. And the weight of the evidence, as discussed in IGS's initial brief, shows that RPM does not create subsidies, while AEP's proposal does. (*See* IGS Br. 7–8, 10, 12–13.)

Saying that RPM creates a subsidy ignores the very nature of a "market driven" price like RPM (*see* Tr. 856 (Graves Cross)), which lets supply and demand determine the value of the good or service (*see* Hamman Dir. 3). If AEP had to sell its capacity to other-than-captive buyers, it would receive the RPM market price for capacity—or find no buyers. So 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.

4. AEP again manifests a basic disregard for Ohio's electric policy.

Finally, AEP attempts to brush away the position of numerous intervenors as "simply policy arguments that favor their business model." (AEP Br. 31.) This argument ignores (a) that there are explicit, mandatory legislative policies that apply to the case and (b) that those policies *do* favor both competition and the suppliers and consumers in position to create and enjoy its benefits.

Notwithstanding AEP's dismissive attitude toward these policies, they are binding in this case. This case is not before the Commission by accident or because the Commission has special expertise in pricing capacity. It is here because the pertinent PJM tariff provides that a "state compensation mechanism" set by the "state regulatory jurisdiction" will "prevail" over other mechanisms. (RAA, Sched. 8.1, § D.8.) So this is a state-law case, regardless of what AEP might say. And the Commission, a creature of the General Assembly, has received policy directions from that body that are plainly applicable in this case. Those directions cannot be waved away as "simply policy arguments." The Commission has standing orders to "ensure that [Ohio's energy] policy . . . is effectuated." R.C. 4928.06(A).

In sum, AEP's policy arguments are slight, and what arguments it has are soundly refuted by the evidence. As a matter of state policy, this is not a close case.

C. The transition statutes only reinforce Ohio's pro-competitive electric policies.

AEP also argues that the statutes addressing the transition to markets simply do not apply here. This is not true.

AEP asserts that capacity is a wholesale service and therefore that federal law, not state law, applies. (AEP Br. 104.) But assuming for sake of argument that the premise is true, the conclusion does not follow. As noted, the RAA provides that the capacity charge shall be in accordance with the "state compensation mechanism" set by "the state regulatory jurisdiction." Thus, regardless of whether these are wholesale or retail charges, and regardless of whether Ohio policy would typically apply, Ohio law is *made applicable* by tariff in this case. So calling the charges "wholesale" is no ground for ignoring state law. Obviously, this case is before the Public Utilities Commission of *Ohio,* not the FERC.

The transition laws only reinforce the direction given by Ohio's electric policy: the opportunity for recovering embedded generation costs from shopping customers is not only anticompetitive, but it is over. Whether or not AEP's embedded-cost-recovery proposal is a *de jure* or *de facto* charge prohibited by the transition laws, those laws still make clear that an electric utility "shall be . . . wholly responsible for whether it is in a competitive position after the market development period" and that by this time, "the utility shall be fully on its own in the competitive market." R.C. 4928.38. Whatever these laws compel, it is clear which direction they point—in favor of market-based pricing, and away from continuous support of incumbent utilities.

D. Senate Bill 221 does not support AEP's proposal.

AEP takes the view that Senate Bill 221 authorizes its proposal. AEP chiefly relies on the fact that the ESP statute allows cost-based rate components, and that the MRO statute requires blended generation rates, as if both features undid the rest of Chapter 4928. That is an unwarranted leap.

Senate Bill 221 repealed neither the post-transition instructions of Senate Bill 3 nor Ohio's policy in favor of retail electric competition. If Senate Bill 221 had done these things, AEP would have a point. But it did not repeal these provisions, and the law only went so far in "reregulating." AEP cannot take those laws any further, just because it suits its interests here.

In fact, to the extent Senate Bill 221 indicates anything in this case, it cuts against AEP. First, it makes clear that standard service offers must exclude "allowances for transition costs," and it makes no distinction between transition costs paid by customers or CRES providers. R.C. 4928.141(A). Second, the ESP statute authorizes automatic recovery of "the cost of . . . capacity" only if the "cost[] is prudently incurred." R.C. 4928.143(B)(2)(a). These provisions reveal a concern that Ohio customers not be overcharged for capacity, and certainly not in the name of "transitioning" to market.

AEP also repeatedly asserts that under Senate Bill 221 "market rates are not permitted until after a long transition period." (AEP Reply 109.) It provides no citation or explanation of what it means here; it presumably refers to the blended rate required under R.C. 4928.142(D). But this division does not provide the Commission with freewheeling authority to invent whatever rate treatments or market transitions it believes necessary. The detailed nature of the prescriptions, and the fact they are applicable only in a market-rate-offer proceeding, point the opposite way. And to the extent the spirit of R.C. 4928.142(D) is to be consulted, it does not lead in the direction of AEP's proposal. The blended price provisions plainly reflect a desire to

protect against unexpected market fluctuations and possible rate shock. In this case, the market price is known and favorable, and the only proposal that will bring an unexpected, rate-spiking fluctuation is AEP's.

Finally, it does not make a great deal of sense for AEP to rely on the SSO statutes in this case. After all, this case does not concern SSO customers, but customers who *have* opted for *immediate* market rates, as state law both permits and encourages. At the end of the day, that fact is why AEP's proposal is so problematic. Over a decade after Ohio started the move to market pricing and competition, AEP still seeks to lay the weight of fully embedded generation costs on the backs of shopping customers.

III. CONCLUSION

For the foregoing reasons, the Commission should reject AEP's proposal and adopt RPM pricing as the state compensation mechanism.

Dated: May 30, 2012

Respectfully submitted,

/s/ Mark A. Whitt

Mark A. Whitt (Counsel of Record)
Andrew J. Campbell
Melissa L. Thompson
WHITT STURTEVANT LLP
PNC Plaza, Suite 2020
155 East Broad Street
Columbus, Ohio 43215
Telephone: (614) 224-3911
Facsimile: (614) 224-3960
whitt@whitt-sturtevant.com
campbell@whitt-sturtevant.com
thompson@whitt-sturtevant.com

Vincent Parisi
Matthew White
Interstate Gas Supply, Inc.
6100 Emerald Parkway
Dublin, Ohio 43016
Telephone: (614) 659-5000

Facsimile: (614) 659-5073
vparisi@igsenergy.com
mswhite@igsenergy.com

ATTORNEYS FOR INTERSTATE GAS SUPPLY, INC.

CERTIFICATE OF SERVICE

I hereby certify that a copy of IGS's Reply Brief was served by electronic mail this 30th day of May, 2012 to the following:

/s/ Andrew J. Campbell

One of the Attorneys for Interstate Gas Supply, Inc.

greta.see@puc.state.oh.us
Sarah.Parrot@puc.state.oh.us
aehaedt@jonesday.com
Amy.Spiller@duke-energy.com
asim.haque@icemiller.com
BarthRoyer@aol.com
steven.beeler@puc.state.oh.us
dboehm@BKLlawfirm.com
bpbarger@bcslawyers.com
cendsley@ofbf.org
christopher.miller@icemiller.com
Dan.Johnson@puc.state.oh.us
dane.stinson@baileycavalieri.com
dakutik@jonesday.com
dryan@mwncmh.com
Dorothy.Corbett@duke-energy.com
etter@occ.state.oh.us
fdarr@mwncmh.com
gwgarber@jonesday.com
Gary.A.Jeffries@dom.com
GRADY@occ.state.oh.us
gregory.dunn@icemiller.com
emma.hand@snrdenton.com
haydenm@firstenergycorp.com
Hisham.Choueiki@puc.state.oh.us
smhoward@vorys.com
jlang@calfee.com
Jeanne.Kingery@duke-energy.com
bowser@mwncmh.com
joliker@mwncmh.com
John.Estes@skadden.com
kbowman@mwncmh.com
murraykm@mwncmh.com
Kim.Wissman@puc.state.oh.us
lmcbride@calfee.com
lkalepsclark@vorys.com
whitt@whitt-sturtevant.com
myurick@taftlaw.com
jmaskovyak@ohiopovertylaw.org
mjsatterwhite@aep.com
mpritchard@mwncmh.com
mswhite@igsenergy.com
lmcalister@bricker.com
mkurtz@bkllawfirm.com
talexander@calfee.com
stnourse@aep.com
Paul.Wight@skadden.com
mhpetricoff@vorys.com
ricks@ohanet.org
drinebolt@ohiopartners.org
rsugarman@keglerbrown.com
sam@mwncmh.com
sandy.grace@exeloncorp.com
selisar@mwncmh.com
small@occ.state.oh.us
msmalz@ohiopovertylaw.org
tobrien@bricker.com>;
VLeach-Payne@mwncmh.com
zkravitz@taftlaw.com
Werner.Margard@puc.state.oh.us
John.Jones@puc.state.oh.us
dconway@porterwright.com
cmoore@porterwright.com
yalami@aep.com

Summary: Brief Reply Brief electronically filed by Mr. Andrew J Campbell on behalf of Interstate Gas Supply, Inc.