

**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.	)	

**RETAIL ENERGY SUPPLY ASSOCIATION, DIRECT ENERGY BUSINESS, LLC,  
AND DIRECT ENERGY SERVICES, LLC'S  
REPLY BRIEF**

**May 30, 2012**

## TABLE OF CONTENTS

<b>I.</b>	<b>Introduction.....</b>	<b>1</b>
<b>II.</b>	<b>AEP Ohio’s claim that the Commission limited the scope of this hearing to solely consider establishing a “cost-based” State Compensation Mechanism has no merit.....</b>	<b>2</b>
<b>III.</b>	<b>AEP Ohio Mischaracterizes the Purpose and Meaning of the FRR Alternative as contained in the RAA.....</b>	<b>4</b>
<b>IV.</b>	<b>A Cost-Based Price does not Advance the Energy Policy of this State or the Commission’s Objectives.....</b>	<b>6</b>
<b>V.</b>	<b>The \$356 MW/d rate is a subsidy to AEP Ohio, not CRES providers.....</b>	<b>11</b>
<b>VI.</b>	<b>AEP Ohio Mischaracterizes CRES Providers’ Role in Relation to the RAA and its voluntarily elected FRR obligation.....</b>	<b>14</b>
<b>VII.</b>	<b>RPM is the most transparent, market-based price and thus the correct price for capacity.....</b>	<b>16</b>
<b>VIII.</b>	<b>Conclusion.....</b>	<b>18</b>

## **I. Introduction**

Now comes the Retail Energy Supply Association<sup>1</sup> (“RESA”), Direct Energy Services, LLC and Direct Energy Business, LLC (collectively, the “Suppliers”)<sup>2</sup> and pursuant to the procedural schedule established by the Attorney Examiners, submits its Reply Brief in the above styled docket.

The Commission is presented with a single determination in this matter — what should the State Compensation Mechanism be for capacity charged to CRES providers, and thus to the shopping customers, in the AEP Ohio service area? In each of the other utility territories in Ohio the State Compensation Mechanism is the RPM rate scaled up for local use and line loss. Suppliers believe the same should be true for AEP Ohio.

AEP Ohio’s initial brief relies on a number of inaccurate assumptions and faulty legal premises to support a capacity rate that, beginning on June 1, 2012, will be some 17 fold higher than the capacity rate charged by all the other electric distribution utilities in Ohio. This Reply Brief addresses five key issues in response to AEP Ohio’s Initial Brief: 1) The Commission did not limit this proceeding to just cost of service rate components; 2) AEP Ohio is not legally entitled to a capacity fee based on its embedded cost of generation; 3) Cost of Service capacity prices do not advance the State Energy Policy; 4) A capacity price of \$356 MW/day harms the public and is a subsidy to AEP Ohio, not CRES providers; and 5) RPM is the best price for capacity.

To the extent this Commission determines the RPM price does not fully compensate AEP

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<sup>1</sup> RESA’s members include: Champion Energy Services, LLC; ConEdison *Solutions*; Constellation NewEnergy, Inc.; Direct Energy Services, LLC; Energy Plus Holdings, LLC; Exelon Energy Company; GDF SUEZ Energy Resources NA, Inc.; Green Mountain Energy Company; Hess Corporation; Integrys Energy Services, Inc.; Just Energy; Liberty Power; MXenergy; NextEra Energy Services; Noble Americas Energy Solutions LLC; PPL EnergyPlus; Reliant Energy Northeast LLC and TriEagle Energy, L.P.. The comments expressed in this filing represent the position of RESA as an organization but may not represent the views of any particular member of RESA.

<sup>2</sup> Teresa L. Ringenbach presented testimony jointly on behalf of both RESA and Direct Energy in this proceeding.

Ohio, the Commission may address additional pricing mechanisms. AEP Ohio has in fact requested an additional pricing mechanism in the form of a Retail Stability Rider as part of the AEP Ohio Electric Security Plan II Application (currently pending as Case Nos. 11-346-EL-SSO, *et al*).

**II. AEP Ohio's claim that the Commission limited the scope of this hearing to solely consider establishing a "cost-based" State Compensation Mechanism has no merit.**

AEP Ohio argues that the Commission limited the scope of this proceeding to only considering a cost-based capacity price.<sup>3</sup> AEP Ohio bases this argument on the fact that the Commission's August 11, 2011 Entry and the March 7, 2012 Entry in this proceeding both state that the purpose of the hearing is to "develop an evidentiary record on the appropriate capacity cost pricing/recovery mechanism including, if necessary, the appropriate components of any proposed capacity cost recovery mechanism."<sup>4</sup> Ignoring both prior Commission actions in the matter at bar, and the plain language of the phrase "capacity cost pricing/recovery mechanism", AEP Ohio declares that any intervenor testimony which does not address the proper cost components of an embedded cost-based rate should be disregarded.<sup>5</sup> The phrase "capacity cost pricing/recovery mechanism" on its face does not appear to be a euphemism for an "embedded cost" or "cost of service" rate. In other words, one can have a capacity cost pricing/recovery mechanism based on previous auction results or comparable offers that were accepted, or on future offers such as forward prices.<sup>6</sup> Similarly, the use of the phrase "capacity cost pricing/recovery mechanism" on its face does not exclude all forms of pricing and recovery

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<sup>3</sup> AEP Ohio's Initial Post-Hearing Brief (AEP Brief), pp. 11-12.

<sup>4</sup> AEP Brief, pp. 11-12. AEP Ohio's quote of this phrase from the Commission's entry left out the remainder of the sentence beginning with "including, if necessary."

<sup>5</sup> AEP Brief, p. 12.

<sup>6</sup> Additionally, one can have a capacity cost pricing/recovery mechanism that is based upon a Stipulation and Recommendation filed by settling parties and approved by the Commission.

mechanisms save for embedded cost analysis based on a test period<sup>7</sup> as proposed by AEP Ohio.

In its August 11, 2011 Entry, which AEP Ohio quotes, the Commission noted that in light of the comments from the parties, an evidentiary record should be developed to determine “the appropriate capacity cost pricing/recovery mechanism” and adds “including, *if necessary*, the appropriate components of any proposed capacity cost recovery mechanism.”<sup>8</sup> The “if necessary” is a clear indication that the Commission was not limiting the hearing to cost-of-service evidence only. For example, it would not be *necessary* to consider the appropriate component parts of an auction-based price (such as an RPM based rate), as the capacity cost pricing/recovery mechanism would be the amount established through the auction. Conversely, the appropriateness of cost components such as revenues, working capital, and operation and maintenance costs would be *necessary* to consider if one was setting a rate based on embedded costs, rather than an auction.

Further, AEP Ohio’s position that the hearing in the matter at bar is focused only on embedded cost is at odds with the rest of the procedural history in the matter at bar. The Commission initially opened this docket in response to AEP Service Corporation’s filing at the FERC requesting a capacity rate based on its embedded costs for capacity.<sup>9</sup> In the opening Entry on December 8, 2010, the Commission expressly adopted the RPM price, a market price based on the PJM Base Residual Auction, as the State Compensation Mechanism.<sup>10</sup> The Commission then sought public comment on the following issues:

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<sup>7</sup> AEP Ohio, since it is not following the cost of service method presented in Section 4909.18, Revised Code, is using a test period of calendar year 2010 as presented in its FERC Form One.

<sup>8</sup> Case No. 10-2929-EL-UNC, April 11, 2011 Entry, ¶6. Emphasis added.

<sup>9</sup> As noted by the Commission in paragraph (3) of the December 8, 2010 Entry in this case, “On November 1, 2010, AEP Electric Power Service Corporation, on behalf of AEP-Ohio, filed an application with the Federal Energy Regulatory Commission (FERC) in FERC Docket No. ER11-1995. At the direction of FERC, AEP refiled its application in FERC Docket No. ER11-2183 on November 24, 2010. The application proposes to change the basis for compensation for capacity costs to a cost-based mechanism and includes proposed formula rate templates under which the Companies would calculate their respective capacity costs under Section D.8 of Schedule 8.1 of the Reliability Assurance Agreement.”

<sup>10</sup> December 8, 2010 Entry, ¶4.

“(1) what changes to the current state mechanism are appropriate to determine [AEP Ohio’s] FRR capacity charges to Ohio competitive retail electric service (CRES) providers;

(2) the degree to which AEP-Ohio's capacity charges are currently being recovered through retail rates approved by the Commission or other capacity charges; and

(3) the impact of AEP-Ohio's capacity charges upon CRES providers and retail competition in Ohio.”<sup>11</sup>

The comments above are all premised on the Commission having set the State Compensation Mechanism on a market based rate, not an embedded cost rate.

In sum, it is clear that from the outset of this case in December of 2010, the purpose of this hearing was to determine the appropriate charge for AEP Ohio’s capacity using the RPM based price, or other forms of setting rates. A review of the entries cited by AEP Ohio in support of its legal premise that this proceeding is limited to consideration of an embedded cost rate, in fact proves the opposing view: that the Commission has opened up the hearing in this case to view all basis for setting a State Compensation Mechanism for capacity in the AEP Ohio service area—including an RPM based price.

### **III. AEP Ohio Mischaracterizes the Purpose and Meaning of the FRR Alternative as contained in the RAA.**

AEP Ohio believes the language in the Reliability Assurance Agreement (“RAA”) supports a \$356 MW-day capacity rate because Section D.8 of Schedule 8.1 states that the Fixed Resource Requirement (“FRR”) Entity may be entitled to request a cost-based rate “at any time” under Section 205 of the Federal Power Act.<sup>12</sup> AEP Ohio argues that AEP Service Corporation expected to be granted a cost-based rate for its FRR obligation under the RAA.<sup>13</sup> AEP Ohio cites the experiences of Witness Dana Horton as further confirmation of its expectations and what was

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<sup>11</sup> December 8, 2010 Entry, ¶5.

<sup>12</sup> AEP Brief, pp. 13-14.

<sup>13</sup> AEP Brief, p. 14.

important to AEP Service Corporation in negotiating the RAA.<sup>14</sup>

AEP Ohio's assertions do not provide a basis for granting a cost-based rate. First, the plain language of the RAA demonstrates that when a state compensation mechanism is in place, AEP Ohio is *not* entitled to request a cost-based rate.<sup>15</sup> While AEP Ohio holds the phrase "at any time" in its brief, it completely ignores the phrase preceding that language which states that AEP Ohio is only entitled to request a cost based rate under Section 205 *in the absence of a state compensation mechanism*.<sup>16</sup> Additionally, this interpretation is consistent with the Federal Energy Regulatory Commission's (FERC) order which specifically stated that because the Ohio Commission had set the State Compensation Mechanism, AEP Ohio had "voluntarily relinquished" its right to file for a Section 205 cost based rate.<sup>17</sup>

AEP Ohio's response is that it negotiated for the FRR and that it "expected" to receive embedded cost for its capacity, and it was important to AEP to receive an embedded cost rate.<sup>18</sup> AEP Ohio seems to claim that because it was their intent to receive embedded cost when negotiating for the tariff provisions surrounding FRR as a party to the PJM settlement negotiations, that is how this Commission should read and apply the tariff.<sup>19</sup>

Simply put, there is no rule of construction that would allow this Commission to alter the plain language of the PJM tariff based on AEP Ohio's expectations and claimed intent, even if

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<sup>14</sup> AEP Brief, p. 14.

<sup>15</sup> The RAA, Section D.8, Schedule 8.1 (FES Ex. 110-A) provides:

"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 Sections 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."

<sup>16</sup> See RAA, Section D.8, Schedule 8.1 (FES Ex. 110-A).

<sup>17</sup> FERC Docket No. ER11-2183-000, Order (Jan. 20, 2011), ¶12.

<sup>18</sup> AEP Brief, p. 14.

<sup>19</sup> AEP Brief, p. 14.

AEP Ohio's version of the history of the PJM Tariff is correct. Further, AEP Ohio's version of the negotiations has been factually challenged in this proceeding. FirstEnergy Solutions witness Robert Stoddard, who was also present at the RAA negotiations and helped to draft the RAA, testified that Section D.8, Schedule 8.1 not only precluded a cost-based request when a state compensation mechanism is in place, but a rate based on embedded cost is inconsistent with the purposes of the RAA.<sup>20</sup> Stoddard's interpretation, unlike Horton's, is consistent with the RAA's plain language and the stated purposes of the RAA.

This Commission should not determine the State Compensation Mechanism based solely on AEP Ohio's uncorroborated "expectations," but should instead follow the purpose of the RAA, consistent with its plain language to approve an RPM based capacity price.

**IV. A Cost-Based Price does not Advance the Energy Policy of this State or the Commission's Objectives.**

AEP Ohio argues that its proposed \$356 MW-day rate advances the state policy objectives because it "ensures the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service."<sup>21</sup> AEP Ohio notes that the Commission set out a two-prong objective in setting the State Compensation Mechanism in a filing at the FERC, stating that it is "endeavoring to arrive at a CRES capacity rate that will promote alternative competitive supply and retail competition while simultaneously ensuring incumbent electric utility provider's ability to attract capital investment to meet its FRR obligations."<sup>22</sup> AEP Ohio asserts that its proposed \$356 MW-day rate meets these objectives.

As to the Commission's first objective, AEP Ohio fails to recognize the detrimental effects a \$356 MW-day rate will have on CRES providers, the competitive market, and most

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<sup>20</sup> FES Ex. 101, Direct Prepared Testimony of R. Stoddard (Stoddard Direct), pp. 28-29; Tr. Vol. VIII, pp. 1648-49.

<sup>21</sup> AEP Brief, p. 16.

<sup>22</sup> AEP Brief, p. 16 citing this Commission's March 2012 filing in the Section 205 and 206 proceedings at OEG Ex. 101, p. 4.



importantly, retail customers. First, AEP Ohio supports these assertions with testimony from witnesses Allen and Graves, who admit they have never been employed by a CRES provider and have no experience in making a competitive retail sale.<sup>23</sup> Allen in particular notes that he has never even conducted a study to determine how big of an impact the capacity rate has on shopping.<sup>24</sup> Conversely, Witnesses Banks, Fein and Ringenbach, who are each employed by CRES providers, testified to the detrimental effects of a \$356 MW-day rate, and the grave limitations to marketing at a \$255 MW-day rate, let alone the proposed \$356 MW-day rate.

AEP Ohio witnesses advance two arguments to support the notion that customers practically can still shop if the capacity fee is \$356 MW/d. Allen notes that since the advent of the \$255 MW/d two tier pricing for capacity, some 6.8% of customers signed up to shop even though they were buying at \$255 MW/d<sup>25</sup>, ergo it is possible to make sales at \$255 MW/d. AEP Ohio also cites RESA Witness Ringenbach's cross-examination where she states that sales at the \$255 MW/d rate are possible.<sup>26</sup> However, as FirstEnergy Solutions witness Banks noted, contracts made at \$255 MW/d would have assumed that the customers would during the term of the contract receive RPM-based pricing.<sup>27</sup> On cross examination, Mr. Allen had to admit that he did not know what portion of the 6.8% of customers shopping at the \$255 MW/d rate could have been eligible for tier one pricing in as soon as a year,<sup>28</sup> and thus it was likely the availability of tier one pricing within a year that made shopping possible. This factor becomes even more significant when one considers that Allen's testimony claiming the 6.8% shopping at tier two prices was based on March 1, 2012 data.<sup>29</sup> The Commission rejected the Stipulation and over

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<sup>23</sup> Tr. Vol. V, pp. 889-90 (Graves); Tr. Vol. III, 568 (Allen).

<sup>24</sup> Tr. Vol. III, 572.

<sup>25</sup> AEP Ohio Ex. 104, Direct Prepared Testimony of AEP Ohio witness W. Allen (Allen Direct), p. 6.

<sup>26</sup> AEP Brief, pp. 18-19.

<sup>27</sup> FES Ex. 102, Direct Prepared Testimony of FES witness T. Banks (Banks Direct), pp. 7-8.

<sup>28</sup> Tr. Vol. III, pp. 575-576.

<sup>29</sup> Allen Direct, pp. 5-6.

turned the December 14, 2012 Opinion and Order on February 23, 2012. That means that all the customers who signed up, save for the last week before Allen took his sample on shopping, were expecting a tier one price for 2013 at \$27 MW/d, which when averaged with a year or less at the \$255 MW/d could still be advantageous.

AEP Ohio then tries to mischaracterize statements by RESA witness Ringenbach to support the premise that CRES providers can make sales, or more importantly retail customers can enjoy the reduction in capacity and energy prices in the larger market, even if AEP Ohio charges \$356 MW/d.<sup>30</sup> Ms. Ringenbach indicated that while she did not think one could shop and have a value proposition when paying \$356 MW/d, it is possible that a contract could be written.<sup>31</sup> The example Ms. Ringenbach used was one of a national account where the CRES provider is supplying a customer in other Ohio service areas and possibly other states such that serving the customer in the AEP Ohio territory at above market capacity prices would be supported by the account and contract in the aggregate.<sup>32</sup> Ms. Ringenbach offered this hypothetical scenario primarily to inform the Commission that a single sale, upon which the question centered, was too limited in scope to definitively indicate that customers will find value at a given capacity price. Undaunted by these facts, AEP Ohio cites Ms. Ringenbach for the proposition that a sale can be made at \$356 MW/d. AEP Ohio has missed the forest for the trees. That is to say that while a retail sale at \$356 MW/d may be possible, its occurrence would be in a very specific and very limited case only. Additionally, Ms. Ringenbach was simply giving a hypothetical scenario to illustrate the limits of a question as it was posed in cross-examination. In further refutation to AEP Ohio's claims of retail viability at the \$356MW/d rate, witnesses

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<sup>30</sup> AEP Brief, pp. 17-18.

<sup>31</sup> Tr. Vol. IV, pp. 820-821.

<sup>32</sup> Id. at 821.

Banks and Fein also agreed that retail sales could not be made at this price.<sup>33</sup>

AEP Ohio also cites RESA witness Ringenbach's statements on cross-examination for the assertion that "assuming that AEP Ohio is collecting \$355.72 MW-day for capacity from SSO customers..., it is appropriate to charge CRES providers \$355.72/MW-day, in order to match rates and ensure there is no subsidy."<sup>34</sup> AEP Ohio takes this statement out of context of Ms. Ringenbach's testimony as a whole. The premise of Ms. Ringenbach's testimony, as she clearly states in her cross-examination, is that this Commission should avoid cross-subsidies by setting a clear, transparent rate for all customers in all utility service territories, including AEP Ohio's.<sup>35</sup> As Ms. Ringenbach stated throughout her cross-examination and her direct testimony, that rate should be a market based rate—the RPM price.<sup>36</sup> Thus, it is implicit in Ms. Ringenbach's statement that if AEP Ohio's purported SSO capacity charge of \$356 MW-d was based on a transparent, market based foundation, then AEP Ohio would be entitled to charge its shopping customers a similar rate. In reality, AEP Ohio has failed to provide any cost of service study to demonstrate that it actually is charging its SSO customers \$356 MW/d for capacity, pointing only to a combined capacity and energy charge developed through the rate stabilization and the first electric security plan cases. AEP Ohio never supported its claim that the cost of service for capacity was \$356 MW/d.

That AEP Ohio's proposed meteoric increase in the capacity cost will not only stop new shopping but also could roll back existing shopping compounds the harmful impact AEP Ohio's proposal could have on the competitive retail market. As noted, by RESA witness Ringenbach,

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<sup>33</sup> Witness Fein testified that at the \$356 capacity charge level he does "not believe [Exelon and Constellation] would be able to make offers that would be viewed as attractive" by *any* customers. Tr. Vol. VIII, 1564. As noted by Witness Banks, the \$356 price, or any price above RPM for that matter, will constrain CRES providers from offering contracts with savings. Banks Direct, pp. 5-6.

<sup>34</sup> AEP Brief, pp. 35, 99.

<sup>35</sup> Tr. Vol. IV, pp. 801-802.

<sup>36</sup> Tr. Vol. IV, p. 799.

“[i]f AEP is granted their request to receive \$355 MW-day for capacity, all shopping customers, including schools, small commercial customers, and those in governmental aggregation would see an immediate increase in their electric bills and may be forced to break their contract with the CRES.”<sup>37</sup> Thus, not only will the capacity price hike prevent CRES providers from entering into new contracts, it will likely result in the CRES providers losing their old contracts. Thus, it is clear that AEP Ohio’s proposed capacity rate does not further the Commission’s (and the General Assembly’s) stated goal of supporting a competitive retail electric market in Ohio.

The Commission’s second stated goal in determining the appropriate capacity rate is to consider the “electric utility provider’s ability to attract capital investment to meet its FRR obligations.”<sup>38</sup> AEP Ohio argues that by recovering its capacity costs, it would be able to “recover some of the costs of its long-term generation investments and would provide incentives for additional future investment in in-state generation.”<sup>39</sup> AEP Ohio expressly admits, however, that there is no apparent need for new capacity in AEP Ohio’s service territory for the next several years.<sup>40</sup> Given that AEP Ohio has made the election to move to the RPM auction as of June 1, 2015, the need for generation and reliability investment will be determined and incentivized by the RPM market prices. Thus, as noted by Exelon witness Fein, “the claim that embedded cost-based rates are needed to encourage investment in generation is a red herring.”<sup>41</sup> The requested \$356 MW-day rate simply has no bearing on whether AEP Ohio will be able to offer reliable service, as there is no indication AEP Ohio will be short on generation at any point in the next three years.

AEP Ohio cites testimony of witness Muncinzski stating that the \$356 MW-day rate

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<sup>37</sup> RESA Ex. 101, Direct Prepared Testimony of RESA Witness Teresa Ringenbach (Ringenbach Direct), p. 19.

<sup>38</sup> See this Commission’s March 2012 filing in the Section 205 and 206 proceedings at OEG Ex. 101, p. 4.

<sup>39</sup> AEP Brief, p. 20.

<sup>40</sup> Tr. Vol. I, pp. 79-80.

<sup>41</sup> Exelon Ex. 101, Direct Prepared Testimony of Exelon and Constellation witness D. Fein (Fein Direct), pp. 11-12.

reflects long term costs which are appropriate under the FRR Alternative, and the short term rates of RPM will not promote these investments.<sup>42</sup> Additionally, AEP Ohio asserts that the resources bid into the Base Residual Auction are not the same kind of resources that would be preferred by an FRR entity who has longer-term resource planning.<sup>43</sup> However, these statements do not accurately reflect the natures of either the RPM auction or the FRR Alternative. The RPM auctions are structured so that the capacity requirements of load serving entities in PJM are met at the most efficient price possible across the entire market footprint. The RPM auctions do not favor or disfavor any particular resource. There is no reason for the FRR Alternative to approach capacity obligations in a markedly different way. The FRR Alternative can be implemented in a way that the FRR Entity supplies its capacity obligations at the most efficient price possible from a resource mix that would be just as effective in the RPM auction. The RAA is not structured to favor one resource over another under the FRR Alternative. The RAA also does not contemplate allowing FRR Entities to use the FRR Alternative to charge embedded costs for capacity to CRES providers for AEP Ohio's preferred resources alternatives.<sup>44</sup>

Witness testimony by those with direct experience serving competitive retail customers indicates that AEP Ohio's proposed capacity rate will have a two-fold impact on the retail market. Additional testimony calls into question AEP Ohio's assertion that RPM prices for CRES customers would limit investment in FRR capacity. Given the preponderance of this testimony, it quickly becomes clear that the proposed \$356 MW/d capacity rate violates both of the factors the Commissions stated it would use to consider the merits of this case.

**V. The \$356 MW/d rate is a subsidy to AEP Ohio, not CRES providers.**

AEP Ohio asserts that the RPM price is "an uneconomic bypass that allows CRES

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<sup>42</sup> AEP Brief, p. 20.

<sup>43</sup> AEP Brief, p. 25

<sup>44</sup> Stoddard Direct, pp. 28-29; Tr. Vol. VIII, pp. 1648-49.

providers to keep a profit at the expense of AEP Ohio's customers and shareholders" and additionally asserts that charging CRES providers anything less than the \$356 MW-day capacity price would provide a subsidy to CRES providers at the expense of AEP Ohio.<sup>45</sup> AEP Ohio's statements are based on the false assumption that AEP Ohio is entitled to a rate based on its embedded costs (and that those costs are \$356 MW-day). In other words, though Ohio is now a competitive state and Section 4928.03, Revised Code makes energy a competitive service, AEP Ohio believes that customers in its service territory owe AEP Ohio the difference between the embedded cost of its generation and the market price. AEP Ohio has not cited any Ohio law to support this view, nor could it for following the passage of Senate Bill 3, Ohio became an open access, and market based state for energy.

AEP Ohio falsely assumes that it is entitled to a capacity rate that is above the market based price and that the CRES provider will keep the difference between AEP Ohio's claimed embedded cost and market. Since the AEP Ohio service area is in the PJM unconstrained area, and the RPM price was set by generators in the AEP unconstrained area, it is clear that the RPM price is the only price that prevents cross-subsidies from customers to AEP Ohio. As noted by witness Lesser, "[t]he 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."<sup>46</sup> As an FRR Entity, AEP incurs no additional costs as compared to any other generator in PJM who receive RPM based prices.<sup>47</sup> As a result, CRES providers who pay more to AEP Ohio for use of their capacity than the RPM prices would be subsidizing AEP Ohio.<sup>48</sup>

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<sup>45</sup> AEP Brief, p. 18.

<sup>46</sup> FES Ex. 103, Direct Testimony of J. Lesser, p. 31 (emphasis in original).

<sup>47</sup> Tr. Vol. IV, pp. 786-787.

<sup>48</sup> Fein Direct, p. 12 ("Under this proposal, AEP Ohio provides no subsidy, as the CRES providers will be required to pay the full market price for capacity. The real subsidy would be requiring other market participants and customers to reimburse AEP Ohio

AEP Ohio additionally asserts that there is no likelihood CRES providers would “pass on more than a token amount of any of the savings they would enjoy under an RPM-based capacity pricing scheme to their customers.”<sup>49</sup> This statement by AEP Ohio is stated through the eye of the monopolist, and ignores the realities of a competitive market. To the extent a CRES provider chose not to pass through the cost-savings associated with lower capacity prices, that customer could pay a small penalty to break their contract and switch to another supplier.<sup>50</sup> AEP Ohio’s own witness Graves admits that in order to keep customers a CRES provider would be motivated to offer a lower price than their competitor.<sup>51</sup> This point is clearly noted by RESA witness Ringenbach, who stated that if a CRES provider were to attempt to keep the lower cost of capacity rather than passing through to their customers, other CRES providers operating in the competitive market would simply go after those customers and inform them of their ability to save with a different CRES provider under a better offer that did flow through the RPM capacity price.<sup>52</sup> Additionally, FES Witness Banks noted that “if a CRES provider got a discount on anything that was readily available in the marketplace, the CRES provider is going to have to pass those savings on to customers, otherwise, they risk losing those customers.”<sup>53</sup>

AEP Ohio additionally asserts that RPM based capacity pricing would give CRES providers an unfair preference over members of AEP Ohio’s pooling agreement because they pay for their capacity at a cost-based rate.<sup>54</sup> This argument should be dismissed. This Commission has the responsibility to determine the appropriate capacity rate charged to CRES providers that best fits the law of this state. The law of this state is embodied in Senate Bill 221,

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for its above market, cost-based capacity costs.”).

<sup>49</sup> AEP Brief, p. 30.

<sup>50</sup> Tr. Vol. IV, p. 836.

<sup>51</sup> Tr. Vol. V, p. 890.

<sup>52</sup> Tr. Vol. IV, pp. 836-37.

<sup>53</sup> Tr. Vol. VIII, pp. 1660-61.

<sup>54</sup> AEP Brief, pp. 26-27.

and requires the Commission to promote a competitive retail electric market. To the extent the capacity price elected by this Commission in furtherance of this clear mandate of Ohio law affects the revenue of AEP Kentucky or Appalachia Power is simply irrelevant.

**VI. AEP Ohio's Mischaracterizes CRES Providers' Role in Relation to the RAA and its voluntarily elected FRR obligation.**

AEP Ohio characterizes CRES providers' role as "middle-men" that are essentially attempting to take advantage of AEP Ohio while it is an FRR Entity.<sup>55</sup> AEP Ohio states that CRES providers have had multiple opportunities to self-supply since 2007 but have chosen not to, and thus should endure a large and unexpected increase in capacity rates.<sup>56</sup> Additionally, AEP Ohio argues that charging CRES providers RPM prices for capacity will deter them from taking responsibility for their own future capacity procurement and development, and they must be "weaned" off RPM pricing.<sup>57</sup> These arguments in the AEP Ohio brief seem at odds with the argument raised by AEP Ohio that it fears financial harm because of low capacity prices. From the cross examination of Mr. Allen it is clear that AEP Ohio is long on capacity and engages in off system sales.<sup>58</sup> Further, when AEP Ohio does make the off system sales it only gets its fuel, half of its operation and maintenance expenses and 40% of the margin.<sup>59</sup> With that in mind, one wonders how genuine the desire is by AEP Ohio for CRES providers to stop buying AEP Ohio capacity and build or arrange for their own.

The FRR Alternative is the exception to the RPM auction under the RAA, and is a carve out that AEP Ohio insisted upon, and voluntarily elected.<sup>60</sup> The FRR Alternative allows AEP Ohio to avoid paying the RPM auction rates for capacity in exchange for becoming responsible

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<sup>55</sup> AEP Brief, p. 6.

<sup>56</sup> "Each CRES provider that chooses not to self-supply its own capacity merely acts as a middle-man on capacity flowing from AEP Ohio for ultimate use by retail customers." AEP Brief, p. 9.

<sup>57</sup> "CRES providers also need a transition to be weaned from relying on AEP Ohio for capacity." AEP Brief, p. 30.

<sup>58</sup> Tr. Vol. XI, pp. 2392-2397; RESA Ex. 103, AEP Co., Inc.'s 10-K filed on 2/28/2012.

<sup>59</sup> Tr. Vol. XI, pp. 2573-76 (Allen).

<sup>60</sup> Stoddard Direct, p. 9. AEP Ohio Ex. 103, Direct Testimony of AEP Ohio witness D. Horton (Horton Direct), p. 5.



for supplying sufficient resources to meet their load served through its distribution system.<sup>61</sup>

Thus, under the FRR Alternative, AEP Ohio has the responsibility of providing capacity to all of its load—regardless of whether the load takes supply from AEP Ohio, or a CRES provider.<sup>62</sup>

This feature of the FRR Alternative has been in place since the date AEP Service Corporation elected to become an FRR entity.<sup>63</sup>

CRES providers are subject to this election, and can only elect to supply their own capacity after the existing FRR plan for the region ends.<sup>64</sup> CRES providers would have paid a capacity rate set at the RPM price, but for AEP Ohio's election for the FRR Alternative.<sup>65</sup> At this point in time, suppliers are essentially locked in through the 2014/2015 delivery year, just in time for AEP Ohio to transition to the RPM auction, making the option to choose to self-supply meaningless.<sup>66</sup> Additionally, CRES providers had no reason previously to anticipate AEP Ohio's attempt to hike up the capacity price. AEP Ohio did not dispute this Commission's decision in its first electric security plan to use the market-based RPM price for the price charged for capacity to CRES providers.<sup>67</sup> Further, at the time AEP Service Corporation elected to become an FRR entity, and when the state compensation mechanism for capacity was first set at RPM, the RPM market rates were at \$46 MW-day<sup>68</sup> and it was Ohio's state regulatory policy to encourage shopping and a competitive retail market.<sup>69</sup>

Despite this factual history, AEP Ohio states the CRES providers had no reason to rely on

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<sup>61</sup> Stoddard Direct, p. 9.

<sup>62</sup> Stoddard Direct, p. 9.

<sup>63</sup> Stoddard Direct, p. 9.

<sup>64</sup> Stoddard Direct, p. 10.

<sup>65</sup> Stoddard Direct, p. 4.

<sup>66</sup> Stoddard Direct, p. 10.

<sup>67</sup> See the Columbus Southern Power and Ohio Power Company's November 2, 2011 Application for Rehearing in Case Nos. 08-917-EL-SSO.

<sup>68</sup> Tr. Vol. I, p. 82 (Mr. Muncinzski stated that from 2007 to 2010, AEP was being compensated for capacity supplied to CRES at the adjusted PJM RPM auction price.); KDP-7, p.7 (noting that for delivery year 2007-2008 the adjusted RPM rate was \$46.73 MW-d).

<sup>69</sup> Stoddard Direct, p. 9.

RPM pricing for their contracts because many of the existing retail electricity contracts “have been entered into after November of 2010, when AEP Ohio filed its FERC case to establish a cost-based capacity charge.”<sup>70</sup> In making this assertion, AEP Ohio fails to recognize that its two-year long plea for an exorbitant capacity rate of \$356 MW-day has been continuously rejected both at this Commission and at the FERC. Upon making this request at the FERC in November of 2010, this Commission explicitly set the state compensation mechanism at the RPM price.<sup>71</sup> In recognition of the Commission’s authority to set this rate, the FERC denied AEP’s request to set a cost-based rate in its order dated January 20, 2011—stating that this Commission’s setting of the state compensation mechanism precluded AEP Ohio’s ability to request a cost based charge.<sup>72</sup> Thus, based on two clear rulings at this Commission and the FERC, customers and CRES providers had every reason to believe AEP Ohio’s request for a capacity rate that is far above RPM auction prices was not plausible. The fact that AEP Ohio requests exorbitant rates for capacity doesn’t mean customers should assume the company will be granted those rates.

**VII. RPM is the most transparent, market-based price and thus the correct price for capacity.**

AEP Ohio additionally stated that the RPM auction is not a purely competitive auction, and thus the RPM auction price does not “categorically or exclusively represent *the* market price for capacity.”<sup>73</sup> Certainly, there are aspects of the RPM auction that are regulated so that the auction process may not be a pure competitive market based process. However, the RPM auction nonetheless is the closest indicator to a market price available, and the price provides the proper incentives for determining whether new generation should be built or old generation

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<sup>70</sup> AEP Brief, p. 25 citing Ms. Ringenbach’s cross-examination at Tr. Vol. IV, p. 831.

<sup>71</sup> See December 8, 2010 Entry, ¶6.

<sup>72</sup> FERC Docket No. ER11-2183-000, Order (Jan. 20, 2011), ¶13.

<sup>73</sup> AEP Brief, p. 34.

should be retired.<sup>74</sup> AEP Ohio's own witness, Mr. Graves, admitted that the RPM auction has provided the correct incentives to provide for new capacity when necessary.<sup>75</sup>

AEP Ohio has also made the commitment to PJM to join the Base Residual Auction, and will begin charging CRES providers the RPM price for capacity starting May 31, 2015. Additionally, prior to January 1, 2012, when the Commission implemented the now rejected Stipulation, AEP Ohio charged the RPM price for capacity. The Commission's decision in this case is thus limited to a three year transition period in which AEP Ohio remains an FRR entity from now until May 31, 2015.<sup>76</sup> Every single party to this case, aside from AEP Ohio, agrees that the RPM price is the correct price for capacity during this transitional phase. AEP Ohio, in response, states "[n]ow that AEP Ohio has proceeded to take that important step [transitioning to market] (even without the benefits contained in the Stipulation package), intervenors greedily clamor for immediate RPM pricing (having already achieved their primary goal of getting AEP Ohio to elect to become an RPM entity)."<sup>77</sup>

In making this statement, AEP Ohio fails to acknowledge a number of important factors about the RPM price, which demonstrate that it is AEP Ohio who is "greedily clamoring" for an exorbitant \$356 MW-day rate. AEP Ohio's requested \$356 MW-day rate will allow AEP Ohio a rate of return that, by its own calculation, exceeds 12.2%--a number AEP Ohio failed to disclose in its initial filed testimony in this case and a number which is far above what this Commission has authorized for AEP Ohio in other proceedings. The Commission should set the price at RPM during this short interim period as it is the only price that will properly transition AEP Ohio to full market for both energy and capacity. It will inhibit the transition to market, not to mention

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<sup>74</sup> Stoddard Direct, p. 3.

<sup>75</sup> Tr. Vol. V, pp. 870-71.

<sup>76</sup> Fein Direct, p. 6.

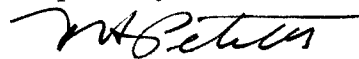
<sup>77</sup> AEP Brief, p. 2.

confuse customers, if AEP Ohio is to charge RPM pricing up until January 1, 2012, transition to full market and charge RPM beginning in 2015, but in the interim charge another cost-based rate that is far above the RPM price. Most importantly, the RPM price is the correct price for capacity, as it is the most transparent, efficient, and is based on the market.<sup>78</sup>

### **VIII. Conclusion**

Granting AEP Ohio's requested \$356 MW-day rate will hinder AEP Ohio's transition to market, and will allow AEP Ohio, by its own calculation to earn a rate of return that exceeds 12.2% far above what this Commission has authorized or what AEP Ohio's affiliated electric distribution utilities earn or have requested.<sup>79</sup> Simply put, the AEP Ohio requested capacity rate of \$356 MW/d is excessive and allowing AEP Ohio to charge a rate other than RPM to shopping customers is inconsistent with the state policy. For these reasons, the Commission should set the State Compensation Mechanism at the RPM price.

Respectfully submitted,



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<sup>78</sup> Stoddard Direct, p. 3.

<sup>79</sup> AEP Ohio Ex. 142, Rebuttal Testimony of William A. Allen, p. 21; RESA Ex. 103, AEP Co., Inc.'s 10-K filed on 2/28/2012.

## CERTIFICATE OF SERVICE

I certify that a copy of the foregoing document was served upon the following persons via e-mail this 30<sup>th</sup> day of May, 2012.



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