BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of the Ohio Power Company for Approval of Full Legal Corporate Separation and Amendment to its Corporate Separation Plan.	)))))	Case No. 12-1126-EL-UNC

COMMENTS BY THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

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I. INTRODUCTION

In its Entry of July 9, 2012, an Attorney Examiner from the Public Utilities Commission of Ohio ("Commission" or "PUCO") established deadlines for comments and reply comments on the Ohio Power Company's ("OP" or "Company") Application. In its Entry, the Attorney Examiner indicated that after the issues raised in the comments are considered, the PUCO will decide whether a hearing is warranted. The Office of the Ohio Consumers' Counsel ("OCC") files these comments to address the impact of the Company's corporate separation plan on Ohio consumers and to recommend changes needed to assure that the corporate separation is in the public interest and will not adversely affect residential customers.

A. Procedural History

On September 30, 2011, AEP Ohio -- as OP -- filed an Application seeking approval of an amendment to its corporate separation plan.[1] The Application sought to implement structural separation. This was a fundamental change from the functional

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[1] *In the Matter of the Application of Ohio Power Company for Approval of an Amendment to its Corporate Separation Plan*, Case No. 11-5333-EL-UNC, Application (September 30, 2011).

separation that existed under the previously approved corporate separation plan. OCC and others filed comments and reply comments in that proceeding.

On December 14, 2011, the Commission issued an order in the Company's electric security plan proceeding[2], modifying but adopting the Stipulation that had been reached in September 2011. Among other things, the Commission determined that, subject to approval of the Companies' corporate separation plan, OP and CSP should divest their competitive generating assets to a separate competitive retail generation subsidiary.[3] On January 23, 2012, the Commission issued a Finding and Order modifying and approving OP's application to amend its corporate separation plan.[4]

On February 27, 2012, OP filed a motion requesting that its corporate separation application be dismissed in light of the Commission's February 23, 2012 Entry on Rehearing rejecting the ESP Stipulation. The PUCO, by a March 14, 2012 Entry on Rehearing, dismissed the Companies' Application (and also denied OCC and IEU's Application for Rehearing).[5]

On March 30, 2012, OP filed another Application seeking approval of an amended corporate separation plan.[6] Its Application was filed concurrently with its Modified ESP. Its filed plan appears to be no different than the earlier filing in September 2011, where it sought, among other things, to transfer assets at net book value.

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[2] *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to 4928.143, Ohio Rev. Code, in the Form of an Electric Security Plan,* Case No. 11-346-EL-SSO et al., Opinion and Order (Dec. 14, 2011).

[3] Id. at 61.

[4] Id., Opinion and Order (January 23, 2012).

[5] *In the Matter of the Application of Ohio Power Company for Approval of an Amendment to its Corporate Separation Plan*, Case No. 11-5333-EL-UNC, Entry (Mar.14, 2012).

[6] *In the Matter of the Application of Ohio Power Company for Approval of Full Legal Corporate Separation and Amendment to its Corporate Separation Plan*, Case No. 12-1126-EL-UNC, Application (March 30, 2012).

On May 29, 2012, by Attorney Examiner Entry, the Company's Application was suspended to allow the PUCO to fully evaluate the proposed amendments.[7] On July 9, 2012, the Commission issued an Entry seeking comments and reply comments on the plan.

II. COMMENTS

A. The Transfer of Generating Units at Net Book Value is Inappropriate

The substance of the corporate separation plan -- the transfer of the generating assets at net book value -- is objectionable. It is objectionable because the transfer is inconsistent with the objectives of the controlling statute, R.C. 4928.17, and because the transfer will deny Ohio consumers a share in the premium value associated with generating facilities that they have borne the burden of for many years.

R.C. 4928.17(A) sets out three primary objectives for corporate separation plans. These objectives are:

- To provide for competitive *retail electric service* (or the non-electric product or service) through a fully separate affiliate, with separate accounting requirements and a Code of Conduct as ordered by the PUCO;

- To satisfy the public interest in preventing the abuse of market power; and

- To ensure no undue preference or advantage is extended to any affiliate, division or part of the business engaged in supplying competitive *retail electric service* (or non-electric product or service).[8]

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[7] Case No. 12-1126-EL-UNC, Entry (May 29, 2012).

[8] See also R.C. 4928.02(H), which specifies that the policy of the state includes ensuring effective competition by avoiding anti-competitive subsides flowing from non-competitive service to competitive retail electric service.

The Companies' plan must address these objectives. The PUCO has also adopted enabling rules that apply, *inter alia*, to R.C. 4928.17. Under the Commission's rules there are certain restrictions[9] detailed in Ohio Adm. Code 4901:1-37-04(C) that seek to eliminate the electric utility's exposure to the actions of a competitive business. They also require the competitive businesses to obtain financial arrangements that better reflect their business risks. Such rules are also consistent with the state policy, under R.C. 4928.02(H), of ensuring effective competition by avoiding anticompetitive subsidies between the regulated and unregulated electric service.

R.C. 4928.17, in numerous subsections, refers to the "competitive advantage and abuse of market" that the law seeks to prevent through the filing of a corporate separation plan. In subsection (A)(2), the Commission is tasked with evaluating a corporate separation plan to determine if it "satisfies the public interest in preventing unfair competitive advantage and preventing the abuse of market power." Additionally, the Commission must determine under subsection (A)(3) whether the plan is sufficient to ensure that the utility will not extend any "undue preference or advantage" to its affiliate. Section (B) of the statute

[9] The restrictions are as follows:

1) Any indebtedness incurred by an affiliate shall be without recourse to the electric utility.
2) An electric utility shall not enter into any agreement with terms under which the electric utility is obligated to commit funds to maintain the financial viability of an affiliate.
3) An electric utility shall not make any investment in an affiliate under any circumstances in which the electric utility would be liable for the debts and/or liabilities of the affiliate incurred as a result of actions or omissions of an affiliate.
4) An electric utility shall not issue any security for the purpose of financing the acquisition, ownership, or operation of an affiliate.
5) An electric utility shall not assume any obligation or liability as a guarantor, endorser, surety or otherwise with respect to any security of an affiliate.
6) An electric utility shall not pledge, mortgage or use as collateral any assets of the electric utility of the benefit of an affiliate.

requires the PUCO to adopt rules regarding corporate separation that include limitations on affiliate practices "to prevent unfair competitive advantage."

When an affiliate receives property from an electric utility, the electric utility should show that it (the electric utility) has been properly compensated for such property. If the electric utility has not been properly compensated, i.e., the compensation is too low, the affiliate receives an unfair competitive advantage, which is unlawful under R.C. 4928.17(A)(2) and (3) and R.C. 4928.02(H).

R.C. 4928.02(H) also conveys this theme, but uses slightly different terminology. It establishes, as one of the state policies, ensuring effective *retail electric service* competition by avoiding anticompetitive subsidies flowing from a noncompetitive retail service to a competitive retail service. This is one of the state policies the PUCO must ensure is effectuated under R.C. 4928.06.[10]

In the Company's electric security plan proceeding, Company Witness Nelson testified that the transfer of the generating units to its affiliate, AEP Genco, would be approximately 9,000 MW in capacity.[11] This capacity would be primarily coal and natural gas resources.[12] Mr. Nelson testified that once corporate separation is approved there will be a contract between the Company and AEP Genco to provide SSO energy and capacity.[13] There will at times be excess energy that AEP Genco has after supplying the SSO and this excess energy would be available to sell on the market.[14] Indeed, if the connected load figures shown on Company Witness Thomas' Testimony, Schedule LJT-

[10] See *Elyria Foundry v. Pub. Util. Comm.* (2007), 114 Ohio St.3d 305.

[11] Tr. Vol. II at 661, 664 (Nelson).

[12] Id. at 664-665.

[13] Id. at 666.

[14] Id.

1, are accurate, there will be quite a bit of excess energy that AEP Genco can sell on the market.

An approximate net book value of the generating assets, though not provided as part of this proceeding,[15] was offered in the Company's ESP as OCC Exhibit 105. According to that exhibit, as of September 20, 2011, the net book value was approximately $6 billion.[16] Mr. Nelson testified that the valuation is a reasonable representation of the value had corporate separation occurred at that date.[17] Although the Companies have resisted producing evidence of the market value of the assets in this proceeding,[18] in the course of the ESP proceeding, discovery by OCC unearthed a cash flow study for the generating units of AEP East.[19] The discovery (OCC Ex. 105) shows that a positive cash flow value, on a net present value basis, of $22 billion was generated for the AEP East fleet when the total cash flows of the assets were compared to the total book value of the fleet, over thirty years.[20] The total actual cash flows on a non-discounted basis are much higher. A significant portion of the $22 billion cash flow is attributable to AEP Ohio generating assets.[21] That positive cash flow from AEP Ohio units is several billion dollars greater than the net book value of those same assets that the Company proposes to transfer to its affiliate.

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[15] AEP sought a waiver from filing this information in its application on March 30, 2012. To date there has been no ruling on this waiver request.

[16] See OCC Ex. No. 105, showing net book value as of September 30, 2011.

[17] Tr. III at 861.

[18] AEP sought a waiver from filing this information in its application on March 30, 2012.

[19] OCC Ex. No. 104.

[20] Tr. Vol. III at 851 (Mitchell).

[21] Id. at 856-857; see also IEU Ex. No. 121 (confidential).

What this evidence shows is that the generating assets have significant value above net book value that the Commission should consider when ruling upon the Companies' corporate separation plan. The market value of the units is something the Commission should duly consider in determining whether the transfer of generating assets at net book value serves the public interest. Only then when it has considered the evidence in conjunction with the directives under R.C. 4928.17 can the Commission make a determination of whether to approve the Companies' corporate separation plan.[22]

Valuing the transfer of the generating assets at net book value, as proposed by the Companies, instead of the higher market value, is likely to result in compensation that is too low, and in subsidies flowing from the customers of the utility to the unregulated affiliate. This is not in the public interest as it threatens the development of a competitive generation market, a key component of S.B. 221. This is contrary to the policy of the state to ensure the diversity of electricity supply and suppliers.[23]

Valuing the transfer of the generating assets at net book value would deny the Companies' customers their appropriate share of the apparent market premiums associated with the portfolio of AEP Ohio generating units. Customers should be entitled to a share in the corresponding asset market premiums due to the utility for the generating units that are divested.

It is these generating units that customers have been charged a return on and of for many, many years—since the plants generating the electricity were used and useful and dedicated to serving utility customers. The utilities' customers have long been saddled

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[22] The Company's application, which contains neither the net book value nor the market value, is deficient in this respect.

[23] See R.C. 4928.02(C).

with the burdens incidental to the generating units in question from the time they were first dedicated to utility service. Customers were charged fuel expenses, maintenance expenses, depreciation, and taxes associated with these units. Customers also bore the risk of loss from casualty and obsolescence. All the while investors profited from this arrangement, by being afforded a return on and of the units. Customers who have born the financial burden associated with particular utility investments should also reap the resulting benefits.[24] Thus, a reasonable and fair allocation of the appreciation (premium related to market value) of these units should go to customers, in some form or another.[25]

While the Commission in the prior corporate separation proceeding approved the transfer at net book value,[26] there is now more reason than ever to require the transfer at market value and allocate some share of the market value for the units to customers. This is because the PUCO has indicated that it will allow the Company to seek "an appropriate recovery mechanism" for its above market priced capacity, produced by the AEP Ohio units, in the form of deferred capacity costs. If the collection of such costs is appropriate (which OCC disputes) equity would dictate that customers likewise share in the market premium associated with those same assets.

In the PUCO's recent holding in the Company's capacity charge case,[27] the PUCO modified the state compensation mechanism so that capacity supplied by the

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[24] See e.g. *Democratic Central Committee v. Washington Metropolitan Area Transit Commission*, 485 F.2d 786, 806-807 (D.C.C.A 1973) (noting the principle that he who bears the financial burden of a particular utility activity should also reap the benefit resulting there from).

[25] Id. at 821-822 (holding that gains from the sale of the utility assets should go to the farepayers who bore the burdens incidental to the properties while they were operating).

[26] See *In the Matter of the Application of Ohio Power Company for Approval of an Amendment to its Corporate Separation Plan*, Case No. 11-5222-EL-UNC, Finding and Order (Jan. 23, 2012). The Commission's decision erroneously relied on a stipulated case, the Duke case, Case No. 11-3549-EL-SSO, as precedent to support transfer at net book value.

[27] *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, Opinion and Order (July 2, 2012).

Company would be based on cost in lieu of RPM–based pricing.[28] The Commission found that RPM-based capacity pricing would be "insufficient to yield reasonable compensation for AEP-Ohio." The PUCO determined that if RPM based capacity pricing is adopted, AEP may earn an "unusually low return on equity of 7.6% in 2012 and 2.4 percent in 2013, with a loss of $240 million between 2012 and 2013."[29]

Rather the PUCO determined that the Company was entitled to compensation at $188.88 Mw day "to enable AEP to recover its capacity costs for its FRR obligations." To accomplish that end, the Commission approved the deferral of the difference between capacity priced at RPM and cost, being defined as $188.88 Mw day, at carrying charges calculated based on the weighted average cost of capital. The Commission also indicated that it would establish "an appropriate recovery mechanism for such deferred costs" in the Company's ESP proceeding.[30]

Thus, it appears that the Commission intends to permit AEP Ohio to seek its "reasonable compensation" from third parties through the establishment of retail rates in the ESP proceeding. These are costs to the Companies of providing capacity flowing from generation units that are used for both the provision of retail SSO service and wholesale electric service to CRES providers. These capacity costs at $188.88 MW/day are substantially above the RPM based price for capacity that is currently in effect.

If AEP is to be compensated for its embedded capacity costs (which OCC strongly opposes) then surely it is fair, just, and reasonable to rule that the benefits of the units,

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[28] Id. at 23.

[29] Id. (citation omitted).

[30] Id.

during this same time period, should flow back to customers. This flow back can take one of several forms. Credits for the premium from transferring the units at market value could be made to the deferrals created under the Capacity Charge case. Credits to the deferrals could also be based upon the sales of energy and capacity by AEP Ohio and its successor, AEP Genco, during the remaining period of the ESP. And, if the deferrals are disallowed, credits can be directly made to SSO generation rates and to shopping customers as well.

B. The Commission Cannot Permit AEP Ohio to Remit to AEP Genco Any Rate Stability Rider Revenues.

In the Companies' electric security plan proceeding it has proposed a retail stability rider ("RSR"). The RSR is a non-bypassable charge intended to guarantee that the Companies collect a set level of non-fuel generation revenue during each year of the Modified ESP.[1] That level of revenue is $929 million per year, and is based on a return on equity of 10.5%. OCC and many of the intervenors opposed the collection of the RSR.

Under the Companies' proposed RSR, accepting all assumptions the Companies have made with respect to shopping levels[31] and capacity pricing, the RSR will enable AEP to collect $284 million from customers over the term of the ESP.[32] Even though the $284 million RSR collection is a projected collection, it may turn out to be higher under a number of scenarios including: if the SSO customer load is lower than currently projected; if there is a milder winter and customer usage is reduced from 2011 levels; if

[31] See Company Witness Allen Direct Testimony at 5 (assuming that customer switching increases to 65% of load for residential customers, 80% of load for commercial customers and 90% of load for industrial customers, by the end of 2012 and remains at those levels through May 2015).

[32] See Exhibit WAA-6.

there is a severe economic downturn;[33] or if interruptible credits are increased as proposed by the Companies.[34]

Under the RSR proposed by the Companies in their ESP proceeding, the revenues collected will be passed along to the Companies' new unregulated generation subsidiary, AEP Genco.[35] Thus the RSR when remitted to AEP Genco will result in customers (shopping and non-shopping) subsidizing the unregulated generation subsidiary's business. That unregulated subsidiary will be engaged in offering competitive and non-competitive (SSO) service to customers.

Such a subsidy is inconsistent with the state policy of R.C. 4928.02(H) and will confer a competitive advantage upon AEP Genco, in violation of R.C. 4928.17(A)(2). R.C. 4928.02(H) prohibits anti-competitive subsidies. R.C. 4928.02(H) requires the PUCO to ensure effective competition by avoiding anti-competitive subsidies flowing from a non-competitive retail service (SSO generation native load) to a competitive retail service. OCC Witness Duann testified that, through the RSR, AEP Ohio's SSO customers are being asked to subsidize other parties for the shortfall between non-fuel generation revenue actually collected and the $929 million annual revenue target set by AEP Ohio.[36]

Under R.C. 4928.17(A)(2), a corporate separation plan must satisfy the public interest in preventing an unfair competitive advantage. Under R.C. 4928.17(A)(3), a utility cannot extend any undue preference to any affiliate engaged in supplying

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[33] Tr. II at 519, 614 (Nelson).

[34] OCC Ex. 111 at 10 (Duann); AEP Ohio Ex. 111 at 9 (Rousch).

[35] See direct testimony of Company Witness Nelson at 8 (March 30, 2012).

[36] OCC Ex. No. 111 at 11 (Duann).

competitive retail electric service. Nor can any affiliate receive undue preference or advantage any part of the business of an electric utility business engaged in supplying noncompetitive retail electric service. Here AEP Genco will receive compensation, through a bi-lateral contract between AEP and AEP Genco for generation services provided to SSO customers of AEP Ohio. But in addition to that, AEP has proposed that AEP Genco receive RSR revenues through the end of the ESP plan. Those additional revenues that are paid as part of revenue guarantee to AEP Ohio under the RSR will confer an unfair competitive advantage to AEP Genco. This is contrary to the public interest in preventing unfair competition. The Commission should not allow the RSR, if approved, to flow to AEP Genco.

III. CONCLUSION

The corporate separation plan proposed by the Company is not in the public interest as it is structured to allow the transfer of the generating assets to the Company's subsidiary at net book value. Given the Commission's recent decision in the Capacity Charge case, such a transfer, without crediting customers for the higher market value of the assets, is not just or reasonable.

Moreover, a corporate separation plan cannot allow rate stability rider revenues, if approved, to be remitted to AEP Genco. This would violate law and not be in the public interest. The Commission should thus disapprove the plan, or alter the plan, in accordance with these comments, in order to assure that customers of the Company are not adversely impacted by the corporate separation.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of these Comments was served on the persons stated below via electronic transmission this 27th day of July 2012.

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