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

MEMORANDUM CONTRA OHIO POWER COMPANY'S APPLICATION FOR REHEARING BY THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

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I. INTRODUCTION

The Office of the Ohio Consumers' Counsel ("OCC"), on behalf of the approximately 1.2 million residential utility customers of Ohio Power Company (the "Company" or "AEP-Ohio"), submits this Memorandum Contra[1] Ohio Power's Application for Rehearing in order to protect customers from paying higher rates that would result if the Company's application for rehearing is granted.

On July 20, 2012, AEP-Ohio filed an Application for Rehearing of the Public Utilities Commission of Ohio's ("PUCO" or "Commission") July 2, 2012 Opinion and Order ("July 2 Order"). The Company raised several assignments of error.[2]

At issue in this proceeding is the capacity price that AEP-Ohio will charge to competitive retail electric service ("CRES") providers in Ohio. Through its July 2 Order the Commission reversed[3] its earlier decision to establish market-based capacity, priced

[1] Ohio Admin. Code 4901-1-35(B).

[2] Applications for Rehearing of the Commission's July 2 Opinion and Order are due within thirty days of the Commission's July 2, 2012 Opinion and Order—or by August 1, 2012. The Company, however, filed its Application early.

[3] See *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, Entry at 2 (December 8, 2010).

using the Reliability Pricing Model ("RPM"), as the state compensation mechanism for Ohio. Instead, the PUCO found that the state compensation mechanism was to be a cost-based approach.

The PUCO found that AEP-Ohio's cost of capacity is $188.88/MW-day for its fixed resource requirement ("FRR") obligations to CRES providers.[4] But the PUCO ordered AEP-Ohio to charge CRES providers the RPM market-based rate of $20.01/ MW-day.[5] In a bad omen for consumers, the PUCO authorized AEP-Ohio to defer the difference between AEP's cost and the RPM capacity rates charged to CRES providers.[6] And the Commission indicated it would establish "an appropriate recovery mechanism" for these deferred costs—meaning someone(s) will have to pay AEP-Ohio for the high costs that are the result of the PUCO's decision. The issue of who pays will be resolved in the Company's electric security plan ("ESP") case (Case No. 11-346-EL-SSO).[7] That decision is expected in early August.[8]

Given the new development of the PUCO's authorization of deferrals with the potential that customers may be required to pay AEP-Ohio for the deferrals (plus carrying charges), OCC's position is as follows. First, OCC maintains that the Commission should have reaffirmed RPM market-based capacity prices as the state compensation mechanism for AEP-Ohio. Second, if the Commission proceeds with imposing capacity cost deferrals, the deferred amounts **should not** be collected from customers. Residential customers should not be required to subsidize CRES providers for capacity purchased

[4] Case No. 10-2929-EL-UNC, Opinion and Order at 33 (July 2, 2012).

[5] Id. at 23.

[6] Id. at 38.

[7] Id. at 24.

[8] Id.

from AEP-Ohio—CRES providers (the cost-causers) should be responsible for paying the Company's costs. Third, if the PUCO intends to require retail customers to subsidize capacity-related discounts (in the form of deferrals) for CRES providers, then AEP-Ohio's Standard Service Offer ("SSO") customers should not be required to pay such subsidies that benefit CRES providers and their shopping customers.

II. ARGUMENT

The Company raises several assignments of error in its Application. Generally, AEP-Ohio argues that there are fundamental errors in the PUCO Staff's ("Staff') energy credit that the Commission adopted in the July 2 Order.[9] The energy credits are amounts the Staff deducted from the $355.72/MW-day capacity charge proposed by the Company.[10] AEP-Ohio also argues that it was unreasonable and unlawful for the Commission to adopt a cost-based state compensation mechanism, but order the Company to charge CRES providers RPM prices.[11] According to the Company, the PUCO's July 2 Order will enable and promote artificial, uneconomic, and subsidized competition.[12] We agree. It is unjust and unreasonable to implement a state compensation mechanism that will shift costs from CRES providers to customers, potentially causing hundreds of millions of dollars in unjustified and unreasonable rates for shopping and non-shopping residential customers. The Company acknowledges that "[s]uch artificial and manufactured "competition" for "competition's" sake does not

[9] Id. at 9-43.

[10] See Staff Tr. Exhibit 101 at 3.

[11] AEP-Ohio App for Rehearing at 60.

[12] Id.

benefit customers in the long run and, in fact, is likely to harm customers (shopping and nonshopping), AEP Ohio, and the state economy.[13]

In addition, AEP-Ohio contends that it was unreasonable and unlawful for the PUCO to rely on the policies set forth in R.C. 4928.02 and 4928.06(A) to justify reducing CRES providers' price of capacity after the Commission found that R.C. Chapter 4928 does not apply to AEP Ohio's capacity charges to CRES providers.[14] The Company explains that "[t]he Commission is not authorized to pick and choose to apply only some provisions of Chapter 4928 to the Company's capacity service. Either the service is a retail electric service, and therefore subject to R.C. Chapter 4928, or it is not."[15]

Finally, the Company argued that the Commission's July 2 Order is "confiscatory, unjust, and unreasonable,"[16] and further submits that the Order results in an unconstitutional taking of the Company's property without just compensation. OCC disputes this particular assignment of error for the reasons discussed below.

A. The Company's Argument That The PUCO's Order Is Confiscatory and Results in An Unconstitutional Taking Should Be Rejected.

The Company argues that the Commission's July 2 Order is "confiscatory, unjust, and unreasonable"[17] and further submits that the PUCO's July 2 Order results in an unconstitutional taking of its property without just compensation under the *Penn Central*

[13] Id. at 56. See App. for Rehearing at 61; citing to AEP Ohio Initial Br. at 18-19, 29-31.

[14] OCC agrees. The Commission has no jurisdiction to authorize AEP Ohio to collect **wholesale electric costs** for capacity service, a service that benefits shopping customers, from **retail, non-shopping SSO customers**.

[15] AEP-Ohio App. for Rehearing at 64.

[16] Id. at 56.

[17] Id. AEP-Ohio also argues that the Commission failed to address the merits of its January 7, 2011, Application for Rehearing, at 64.

standard.[18] The Company seeks rehearing based on the premise that the Commission should "modify its Order as state law and the Constitution require."[19] This argument is flawed, and should be rejected for the reasons that follow.

1. The Commission cannot decide constitutional issues.

In its Application for Rehearing, AEP-Ohio raises two main constitutional arguments. The first argument is that the Commission's July 2 Order is confiscatory, unjust and unreasonable under the precedent established in *Fed. Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). Second, the Company argues that the Commission's Order results in an unconstitutional partial taking of AEP-Ohio's property without just compensation under the standard set forth in *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978).[20]

But the Commission does not have jurisdiction to decide either of these arguments. The Ohio Supreme Court has confined the scope of the Commission's jurisdiction to utility-related matters. AEP-Ohio acknowledges that traditional constitutional law questions are beyond the Commission's authority to determine.[21] But out of "an abundance of caution,"[22] the Company included constitutional arguments in its Application for Rehearing.

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[18] See, generally, *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978); see also, AEP-Ohio App. for Rehearing at 51.

[19] AEP-Ohio App. for Rehearing at 56.

[20] Id. at 43.

[21] Id. at 43; citing to *In the Matter of the Application of Columbia Gas of Ohio, Inc., for Approval of Tariffs to Recover, Through an Automatic Adjustment Clause, Costs Associated with the Establishment of an Infrastructure Replacement Program and for Approval of Certain Accounting Treatment*, Case No. 07-478-GA-UNC, Opinion and Order at 14 (April 9, 2008).

[22] AEP-Ohio App. for Rehearing at 43.

The Ohio Supreme Court has explicitly provided that decisions regarding the constitutionality of statutes are decisions for the courts, and not for the PUCO or for an advisory board. To this end, the Supreme Court has emphasized: "[the fact that the] PUCO has exclusive jurisdiction over service-related matters does not diminish 'the basic jurisdiction of the court of common pleas *** in other areas of possible claims against utilities, including pure tort and contract claims *** moreover, PUCO ***is not a court*** and has no power to judicially ascertain and determine legal rights and liabilities.'"[23] Consequently, constitutional rights fall within the "legal rights and liabilities" that courts have the power to determine,[24] and therefore, the Commission clearly has no jurisdiction over the constitutionality of the Company's arguments.

Similarly, in *Herrick v. Kosydar*, the Supreme Court of Ohio ruled that: "[t]he plaintiffs' claim is based solely upon the constitutionality of R. C. 145.56 and 3307.71, and it is well established that an administrative agency is without jurisdiction to determine the constitutional validity of a statute."[25] In *Herrick*, state retirees sought a declaration as to their liabilities when the law was changed to provide that their pensions were subject to state income tax.[26] Ultimately, the Supreme Court of Ohio found that "administrative proceedings in the case would be futile because an administrative agency was without jurisdiction to determine the constitutional validity of a statute."[27] The same is true of the PUCO.

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[23] *Allstate Ins. Co. v. Cleveland Elec. Illuminating Co.* (2008), 119 Ohio St.3d 301, 302, 893 N.E.2d 824 (Citation omitted) (Emphasis added).

[24] See *Herrick v. Kosydar* (1975), 44 Ohio St.2d 128, generally.

[25] Id. at 130.

[26] Id.

[27] Id.

Recently, in Case No. 10-1261-EL-UNC (2009 Columbus Southern Power SEET Proceeding), the Company raised a void-for vagueness constitutionality argument, claiming that R.C. 4928.143(F) (the significantly excessive earnings test statute "SEET") was unconstitutionally vague. The Commission correctly found that it is the province of the courts, and not the Commission, to judge constitutionality issues.[28] Further, the PUCO ruled the appropriate venue for AEP-Ohio to raise its constitutional challenges was at the Ohio Supreme Court.[29]

Title 49 of the Ohio Revised Code defines the entire scope of the PUCO's jurisdiction. Under Title 49, the PUCO has exclusive jurisdiction over various matters involving public utilities, such as rates and charges, classifications, and service, effectively denying jurisdiction to all courts, except the Supreme Court.[30] The rationale behind these grants of authority is that issues related to applicable laws and regulations, industry practices, and standards are best left to the PUCO with its expert staff.[31] But because the Commission is ultimately a creature of statute,[32] it has only those powers conferred to it by statute. Thus, the Commission does not have the jurisdiction to decide constitutional challenges, and the Company's arguments should be rejected.

[28] Case No.10-1261-EL-UNC, Opinion and Order at 9 (January 1, 2011).

[29] Id.

[30] R.C. Title 49.

[31] Id.

[32] *Columbus S. Power Co. v. Pub. Util. Comm*. (1993), 67 Ohio St.3d 535, 620 N.E.2d 835; *Pike Natural Gas Co. v. Pub. Util. Comm*. (1981), 68 Ohio St.2d 181, 22 Ohio Op.3d 410, 429 N.E.2d 444*Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St.2d 153, 21 Ohio Op.3d 96, 423 N.E.2d 820; and *Dayton Communications Corp. v. Pub. Util. Comm.* (1980), 64 Ohio St.2d 302, 18 Ohio Op. 3d 478, 414 N.E.2d 1051. See R.C. Title 49, which articulates the duties of the PUCO.

2. While the PUCO cannot decide constitutional issues, the Company's constitutional argument under *Hope Natural Gas* is meritless in any event.

The Company argues that the Commission's July 2 Order is preventing it from realizing a reasonable rate of return, and thus, is confiscatory.[33] The Company cited to *Fed. Power Comm. v. Hope Natural Gas Pipeline Co.* 315 U.S. 575 (U.S. 1942) ("Hope"), in support of this argument. In *Hope*, the U.S. Supreme Court reviewed the earnings history of Hope Natural Gas and found that the "end result" of the Federal Power Commission's ("FPA") decision was neither confiscatory nor unreasonable.[34] In *Hope*, the U.S. Supreme Court held that a prescribed utility rate is too low, and thus violates due process, unless the "end result" of the rate on a utility is "just and reasonable."[35]

The Ohio Supreme Court has applied the *Hope* decision to appeals from Commission orders before.[36] In this regard, in *Dayton Power & Light Company v. Public Utilities Commission of Ohio et al.*, 4 Ohio St.3d 91 (1983) ("Dayton") the Ohio Supreme Court described the fundamental elements of a confiscation claim, while applying the *Hope* standard:

> *** he who would upset the rate order ***carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences. The second precept is that a challenged rate order must be viewed in its entirety to determine whether the rates set pursuant to the order fall within "the broad zone of reasonableness."[37]

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[33] AEP-Ohio App. for Rehearing at 45.

[34] 320 U.S. at 603.

[36] See, for example, *Dayton Power & Light Co. v. Pub. Util. Comm.*, 4 Ohio St.3d 91, 447 N.E.2d 733 (1983).

[37] *Dayton*, 4 Ohio St.3d 91, 104-105.

The Ohio Supreme Court ultimately found in *Dayton* that Dayton Power & Light ("DP&L") failed to prove its constitutional claims because it presented "little evidentiary support" for its argument that excluding cancellation costs of Killen Unit 1 guaranteed DP&L would be unable to earn a "fair and reasonable rate of return." The Court, thus, rejected DP&L's confiscation claim.[38]

According to the precedent in *Dayton*, the Company bears the **significant burden** of proving that receiving less than its requested capacity price of $355.72/MW-day is confiscatory. The Company failed to meet its burden in this case.

AEP-Ohio attempts to distinguish *Dayton* from the present case by saying "[a]lthough the utility in the DP&L case 'presented no witnesses' relative to the confiscation issue, the record here is replete with testimony outlining the unreasonable and confiscatory results of the Commission's decision to adopt an energy credit that will assuredly result in a failure to compensate the Company for the embedded costs of capacity."[39] While it is true the Company presented witnesses who argued that RPM pricing would be "confiscatory," AEP-Ohio had the **burden to prove** that RPM pricing (or a capacity price less than $355.72/MW-day) is unreasonable and unlawful such that it produces a total effect that is outside the **broad** zone of reasonableness. The Ohio Supreme Court defined a vast zone of reasonableness -- "the range between which a range would be so low as to be confiscatory and so high as to be exploitative of

[38] Id, 4 Ohio St.3d 91, 106.

[39] Application for Rehearing at 48-49.

consumers."[40] The Company did not meet its burden of showing that the Order falls outside this large zone.

Similarly, in *Hope* the United States Supreme Court found, "[i]t is not the theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry is at an end."[41] The Court also stated that the fixing of "…just and reasonable rates, involves a balancing of the investor and the consumer interests."[42] Similarly, the U.S. Supreme Court has held that:

> No constitutional objection arises from the imposition of maximum prices merely because high cost operators may be more seriously affected than others, or because the value of regulated property is reduced as a consequence of regulation. Regulation may, consistently with the United States Constitution, **limit stringently the return recovered on investment**, **for investors' interests provide only one of the variables in the constitutional calculus of reasonableness**.[43]

Just because Company witnesses testified that a capacity price less than $355.72/MW-day would be confiscatory does not establish that the Company satisfied its burden of proof. Investor interests **must be** balanced with consumer interests.[44] And it was the Company's burden to prove that a capacity price less than $355.72/MW-day falls

[40] O*hio Edison Co. v. Public Utils. Com*, 63 Ohio St. 3d 555 (Ohio 1992) at FN 6, citing to, *Washington Gas Light Co. v. Baker* (D.C.Cir.1950), 188 F.2d 11, certiorari denied (1951), 340 U.S. 952, 71 S.Ct. 571, 95 L.Ed. 686.

[41] *Federal Power Com. v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (U.S. 1944).

[42] Id.

[43] *Permian Basin Area Rate Cases*, 390 U.S. 747 at 769. (Emphasis added).

[44] The Ohio Supreme Court acknowledged in *Ohio Edison Company v. Pub. Util. Comm.*, 63 Ohio St.3d 555 (1992) that it has implicitly recognized that the Constitution no longer provides any special protection for the utility investor. Id. at 565, note 8.

outside of the broad zone of reasonableness.[45] Accordingly, the Company's argument should be rejected.

3. While the PUCO cannot decide constitutional issues, the Company's constitutional argument under *Penn Central* should be denied.

The *Penn Central* standard contains a three-prong test to determine whether an unconstitutional taking occurred. To this end, the test is as follows:

> Where a regulation **deprives property** of less than 100 percent of its economically viable use, a court must consider:
>
> (1) the economic impact of the regulation on the claimant, (2) the extent to which the regulation has interfered with distinct investment-backed expectations, and (3) the character of the governmental action.[46]

The Company clams that it satisfies the three-prong test as "multiple witnesses have testified in this proceeding to the severe economic effect a non-compensatory capacity price will have upon the Company."[47] AEP-Ohio also claims that "it is beyond any serious dispute that the Commission's Opinion and Order here, unless modified, surely interferes with AEP Ohio's distinct investment-backed expectations."[48] But the Company's argument is flawed. AEP-Ohio's **opinion** (or expectation) is that it is entitled to recover its costs for capacity—but it can cite to no authority that supports its argument.

There cannot be a "taking" of property when the Company is receiving just compensation for this property. AEP-Ohio will be compensated for its capacity. It

[45] It should be noted that the Commission utilized a return on equity of 11.15 percent, the highest ROE proposed by any party to this case.

[46] *Penn Central*, 438 U.S. 104, 123 (Emphasis added).

[47] AEP-Ohio App. for Rehearing at 52.

[48] Id. at 55.

simply will not be receiving the compensation it desires. This does not amount to an unconstitutional regulatory taking.

AEP-Ohio has argued that Schedule 8.1, Section D.8 of the RAA "establishes AEP-Ohio's right to elect to charge a cost-based rate to CRES providers for the capacity it is obligated to provide to them."[49] AEP-Ohio is wrong. The RAA does not support AEP-Ohio's position. The Company is **not entitled** to a cost-based capacity price. And the Company is **not entitled** to a state compensation mechanism that "will compensate the Company for the true embedded costs of capacity."[50] The RAA states that an FRR entity **may** seek FERC approval of a price **based on costs**, only in the absence of a state compensation mechanism. A price "based on costs" is not analogous with "entitled to costs" or "entitled to true embedded costs." The language of the RAA is clear. However, the Company is essentially arguing that anything less than the price it demands is a partial "taking." But this is not the case.

OCC has argued that the Company is not entitled to costs, and that the state compensation mechanism should be based on market-based RPM prices. Yet, throughout the entirety of this proceeding AEP-Ohio argued that it is entitled to a $355.72/MW-day capacity price in order to collect its full embedded generation costs, and that anything less would be confiscatory.[51] All of the intervening parties in this proceeding opposed the Company's position on capacity pricing. And all of these parties, including the Staff, argued that **market-based pricing arising out of PJM's RPM** was the appropriate pricing mechanism for CRES providers and their customers. The Company used the

[49] AEP-Ohio Initial Brief at 13.

[50] Id. at 54.

[51] Company Ex. 102, Direct Testimony of Kelly Pearce at 23.

market-based RPM to price its provision of capacity to CRES providers since 2007, and on May 31, 2015 AEP-Ohio will again use RPM pricing when the price will be approximately $136/MW-day.[52] The Commission found that AEP-Ohio's costs are $188.88/MW-day, and the Company still claims this price results in a partial taking.

In its July 2 Order, the PUCO developed a state compensation mechanism whereby the Company will be compensated for its cost of capacity at $188.88/MW-day for its fixed resource requirement ("FRR") obligations to CRES providers.[53] AEP-Ohio argues that "the Commission has adopted a state compensation mechanism that will not fairly compensate AEP Ohio for the actual embedded costs of capacity, even while agreeing that 'the state compensation mechanism *should be based on the Company's costs*.'" [54] The PUCO found that the Company's costs are not equivalent to the $355.72/MW-day it requested. Accordingly, AEP-Ohio's argument should be denied.

III. CONCLUSION

For the reasons set forth in this Memorandum Contra Application for Rehearing, the Commission should protect consumers and deny the assignments of error that focus on alleged constitutional violations. The Commission cannot decide such issues, and the Company's arguments are unsupported in any event.

[52] Note that the final zonal price for 2015/2016 has not yet been established.

[53] Case No. 10-2929-EL-UNC, Opinion and Order (July 2, 2012) at 33.

[54] AEP-Ohio App. for Rehearing at 56.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the *Memorandum Contra Ohio Power Company's Application for Rehearing by the Office of the Ohio Consumers' Counsel* was served on the persons stated below via electronic transmission, this 30th day of July, 2012.

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Summary: Memorandum Memorandum Contra Ohio Power Company's Application for Rehearing by the Office of the Ohio Consumers' Counsel