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Via E-File

March 4, 2013

Public Utilities Commission of Ohio
PUCO Docketing
180 E. Broad Street, 10th Floor
Columbus, Ohio 43215

In re: Case Nos. 12-3254-EL-UNC

Dear Sir/Madam:

Please find attached the COMMENTS OF THE OHIO ENERGY GROUP for filing in the above-referenced matter.

Copies have been served on all parties on the attached certificate of service. Please place this document of file.

Respectfully yours,

Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
Jody Kyler Cohn, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
Encl.
Cc: ALJ Jonathan Tauber, Esq. (via electronic mail)
ALJ Sarah Parrot, Esq. (via electronic mail)
Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that true copy of the foregoing was served by electronic mail (when available) or ordinary mail, unless otherwise noted, this 4th day of March, 2013 to the following:

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BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Power Company to Establish a Competitive Bidding Process for Procurement of Energy to Support its Standard Service Offer	: : : :	**Case No. 12-3254-EL-UNC**

COMMENTS OF THE OHIO ENERGY GROUP

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March 4, 2013

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BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Power Company to Establish a Competitive Bidding Process for Procurement of Energy to Support its Standard Service Offer	: : : :	**Case No. 12-3254-EL-UNC**

COMMENTS OF THE OHIO ENERGY GROUP

The Ohio Energy Group ("OEG") hereby submits its Comments in response to the December 21, 2012 Application and the February 11, 2013 Supplement to Application filed by Ohio Power Company ("AEP Ohio") in the above-captioned docket. During the stakeholder process established by the Public Utilities Commission of Ohio's ("Commission") August 8, 2012 Opinion & Order in Case No. 11-346-EL-SSO *et al* ("ESP Order"), OEG repeatedly suggested two important revisions to the competitive bidding process ("CBP"): 1) the starting price for the descending clock energy-only auctions for each AEP Ohio rate zone should be the Fuel Adjustment Clause ("FAC") rate that customers would otherwise pay in order to prevent a situation where the same utility provides the same energy to the same customers, but at a higher price; and 2) the energy-only auctions approved by the Commission should be held separately for the Ohio Power ("OP") and Columbus Southern Power ("CSP") rate zones because the FAC (which the "*price to beat*" should be based upon) is approximately $6/MWh lower in the OP rate zone compared to the CSP rate zone.[1]

[1] OEG's written comments in the AEP Ohio stakeholder process are available on AEP Ohio's CBP website at http://www.aepohiocbp.com/index.cfm?s=background&p=archivesDocument&archiveTypeId=1.OEG also advocated that the Commission require AEP Ohio to hold separate energy-only auctions by rate zone in Case No. 11-346-EL-SSO *et al.*

Neither of OEG's suggested revisions are incorporated into AEP Ohio's proposed CBP, but the Commission should require AEP Ohio to incorporate them in order to protect Standard Service Offer ("SSO") customers from unnecessary rate increases. As discussed in the example below, if the Commission does not establish the starting price for the energy-only auctions at the current FAC rates that SSO customers would otherwise pay, the harm to customers as a result of the 10% energy-only auctions could be $25 million. That harm could increase to $150 million in the final year of the ESP when 60% energy-only auctions are held.

Additionally, the Commission should only accept AEP Ohio's recent proposal to unbundle the FAC if it simultaneously holds that the starting price for the energy-only auctions for each AEP Ohio rate zone will be the energy/variable component of the FAC rate that customers would otherwise pay. If the Commission does not make such simultaneous findings, SSO customers could be forced to pay not only for energy at prices higher than they would have otherwise paid had the auctions not been held, but could also be forced to pay increased cost-based rates (beyond those approved in the ESP) through AEP Ohio's newly proposed Fixed Cost Rider. As discussed below, the harm to SSO customers as a result of unbundling the FAC without establishing such a starting price increases to approximately $35 million after the 10% energy-only auctions are held and approximately $210 million in the final year of the ESP. Hence, AEP Ohio's proposal to unbundle the FAC would only exacerbate the level of unnecessary rate increases to SSO customers, unless the Commission adopts OEG's recommendations to protect those customers by making the auction starting price the energy/variable component of the FAC.

("AEP Ohio ESP"). In its Entry on Rehearing, the Commission stated that OEG's argument would be better addressed in the auction stakeholder process. AEP Ohio ESP Entry on Rehearing at 35.

1. The Commission Should Establish The Starting Price For The Descending Clock Energy-Only Auctions For Each AEP Ohio Rate Zone At The FAC Rate That Customers Would Otherwise Pay.

The ESP Order, *inter alia*, determined that in order for customers to "*take advantage of market-based prices and the benefits of developing a healthy competitive market,*" non-shopping SSO customers should transition to market pricing prior to the June 1, 2015 energy and capacity auction for AEP Ohio's entire SSO load.[2] Unlike the competitive bid processes established for the FirstEnergy and Duke utilities, wherein non-shopping SSO customers were served by a "*flash-cut*" auction for both energy and capacity without a transition period, a unique transitional hybrid approach was established for AEP Ohio. Under the hybrid approach established by the Commission, which is a first in America, AEP Ohio's non-shopping SSO customers will continue to pay for legacy generation capacity priced at average embedded cost until June 1, 2015, but their energy will be subject to a blend of average cost pricing (FAC) and marginal cost (market) pricing resulting from an energy-only auction. Pricing in the energy-only auctions will also include a risk premium to compensate bidders for migration risk as well as a profit margin.

This unique hybrid approach introduces risks that the Commission must address before the CBP can take place. In particular, there is a risk that the energy-only auctions based upon marginal cost pricing (LMPs) plus a risk premium and a profit margin for the bidders could result in unnecessary and avoidable rate increases to non-shopping customers compared to the cost-based energy rates that those customers would otherwise have paid through the FAC. The Commission can address this risk by establishing the starting price for the energy-only auction for each AEP Ohio rate zone at the FAC rate that customers would otherwise pay.

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[2] ESP Order at 39-40.

AEP Ohio's SSO customers pay average embedded costs for capacity through the legacy cost-based rate structure. Historically, this has meant that customers paid high capacity costs associated with AEP Ohio's predominately base load coal generation (in excess of \$300/MW-day), but those high capacity costs were offset by low coal-based energy prices based upon the utilities' actual costs with no profit margin or risk premium included.

As the Commission is fully aware, AEP Ohio's current cost-based capacity charge embedded in its legacy SSO generation rates significantly exceeds the marginal or market-based cost of capacity as determined through the PJM RPM capacity auctions.[3] For example, OP's GS-4 primary voltage demand charge of \$10.44/kW/month is equivalent to \$343/MW-day. In exchange for paying such a high cost-based charge (including a return of and a return on invested capital) for AEP Ohio's generating capacity, SSO customers are entitled to cost-based energy rates with no risk premium or profit margin. However, an energy-only auction will be based upon marginal cost prices plus a risk premium and profit margin. Accordingly, the result of the energy-only auction could be that SSO customers will pay the utility's average embedded cost for capacity and marginal or market rates for 10%-60% of their energy.

The worst case scenario for SSO customers would be if they are required to pay high average embedded capacity costs based upon base load coal generation and high marginal cost (market) energy rates, *plus* a risk premium and supplier profit margin. By properly setting the starting auction price at the FACs of OP and CSP, the Commission can avoid this scenario.[4] Further, there will be no harm to AEP Ohio as a result of setting the starting price for the energy-only auction at the price customers

[3] The \$188.88/MW-day capacity rate that AEP Ohio is authorized to charge CRES providers is net of energy margins, which largely explains why it is lower than the cost-based capacity rate charged to SSO load. In this sense, it is more accurate to describe the cost-based rate for capacity to serve SSO load as "*gross cost*" and for capacity provided to CRES providers as "*net cost*." This distinction is similar to the net versus gross CONE (cost of new entry) used by PJM.

[4] OEG will discuss the impact of AEP Ohio's proposal to unbundle the FAC on its recommendation below.

would have otherwise paid. The quid pro quo for receiving a cost-based rate for legacy generation from SSO customers is the provision of energy from those coal units at cost.

A 10% energy-only auction is approximately 2.5 million MWh. It is important to recognize that if 2.5 million MWh of SSO load is served by auction, then that will free up a like amount of energy for AEP Ohio to sell into the wholesale market as off-system sales. Alternatively, instead of making wholesale sales with the freed up 2.5 million MWh, AEP Ohio could bid on its own auction load. If the starting auction price is not set at the FACs, then for any auction tranches won AEP Ohio, the same utility would be providing the same energy to the same customers, but at a higher price.

It is hard to estimate how much consumers stand to lose if the 10% energy-only auction starting price is not set at the FAC rates that customers would otherwise pay. But based upon the results of the October 23, 2012 FirstEnergy auction, where the clearing price for energy and capacity was \$60.89/MWh,[5] a reasonable estimate can be made.[6] Because the capacity component of the \$60.89/MWh auction clearing price was approximately \$15/MWh, then the remainder of \$45.89/MWh represents marginal cost energy, risk premium and supplier profit. On average, between the OP and CSP rate zones, this represents an increase of about \$10/MWh, or about \$25 million annually.[7] For the final year of the ESP (June 1, 2014 through June 1, 2015), where the marginal cost energy-only auction blend is 60%, simple multiplication puts the harm to consumers at \$150 million.

Moreover, as discussed in Section 3 of these Comments, AEP Ohio's proposal to unbundle the current FAC would only increase the potential harm to SSO customers. Between the OP and CSP rate

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[5] "*PUCO accepts results of FirstEnergy auction*," PUCO Press Release (Oct. 24, 2012), *available at* http://www.firstenergycbp.com/portals/0/news/PUCO%20accepts%20results%20of%20FirstEnergy%20auction_20121024.pdf.

[6] Because the Commission has access to the unredacted bid documents, it is possible that the Commission knows the non-capacity component of that bid with certainty.

[7] \$10/MWh x 2.5 million MWh. If the Commission wants a more accurate estimate, then NERA Economic Consulting is certainly is a position to provide that information.

zones, the average increase would be raised to approximately $14/MWh ($10/MWh for the auction clearing price + $4/MWh for the fixed/non-energy component of the FAC). Therefore, with a 10% energy-only auction, the harm to SSO customers would be increased to approximately $35 million.[8] In the final year of the ESP with 60% blending, the harm to customers would be increased to approximately $210 million.

A belief that consumers will be protected in the final year of the ESP through the 12% ROE earnings cap is likely unfounded. After the AEP Pool Agreement is terminated and generation divestiture is complete on December 31, 2013, the earnings from generation will no longer be on the books of the utility. As a practical matter, the 12% ROE earnings cap established in the ESP will probably only provide protection from excess generation profits for calendar years 2012 and 2013. It is possible that individual customers may be protected from undue rate increases stemming from the energy-only auctions by the 12% customer rate impact cap established in the ESP. The 12% customer rate impact cap applies to "*items approved within this modified ESP*."[9] To the extent that the energy-only auctions are covered, then individual customers would be protected. But that would simply mean deferrals would be created, which could raise rates on all consumers. The problem would not go away. The better solution is to stop the damage in the first place by setting the auction starting price at the FAC rates customers would have otherwise paid.

There may be some concern that setting the descending clock auction starting price at the FAC rates will somehow chill the market or deter bidding. If bidding is deterred, then it simply means that competitors cannot beat the energy rate to which consumers are entitled by virtue of paying a cost-based rate for capacity. From a consumer and economic development point of view, there is certainly nothing wrong with maintaining low prices.

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[8] $14/MWh x 2.5 million MWh.
[9] ESP Order at 70; *See also* Entry on Rehearing at 40.

Any concern about a long-term chilling of the market for auction bids is overstated. The *"flash-cut"* energy and capacity auction at the end of 2011 for 100% of Duke's SSO load had multiple bidders and went smoothly. No transitional auctions were needed for Duke. Likewise, no transitional auctions were needed for FirstEnergy as it has been conducting energy and capacity auctions for 100% of its SSO load without incident for many years. The same will almost certainly be true for AEP Ohio on June 1, 2015. In other words, there is no need for a practice dry run. Ohio is very experienced in conducting CBP auctions.

The AEP Ohio ESP, and the related capacity case,[10] forced the Commission to quickly grapple with many complicated and inter-related issues. Unintended consequences were inevitable. We respectfully suggest that the concerns raised herein may not have been anticipated by the Commission, but are curable. The Commission has the authority to establish the descending clock energy-only auction starting price at the rate consumers would otherwise pay (the FAC by rate zone). Given the unique hybrid auction structure established in the ESP, which is a first in America, exercising that authority is warranted so that the transition to full competition is truly a benefit for consumers as the Commission intended.

2. **Separate Energy-Only Auctions Should Be Held For Each AEP Ohio Rate Zone To Maintain Consistency With The Manner In Which The Fuel Adjustment Clause Will Be Recovered.**

Because the Commission decided to maintain separate FAC rates for the OP and CSP rate zones during the term of the ESP,[11] the energy-only auctions approved by the Commission should likewise be held separately for each rate zone. This is because the "*price to beat*" differs significantly for each rate zone.

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[10] Case No. 10-2929-EL-UNC.
[11] ESP Order at 17.

For high voltage customers, the FAC rate for the OP rate zone is $30.87/MWh. The corresponding FAC rate for the CSP rate zone is $36.98/MWh. Hence, the FAC rate for CSP customers is approximately $6/MWh higher than OP's rate. This approximately $6/MWh difference between rate zones also applies to the FAC rates of secondary and primary voltage customers.[12] Because the FAC rate for CSP customers is significantly higher than OP's rate, the "*price to beat*" is also significantly higher for the CSP rate zone. Consequently, if the energy-only auctions are not held separately for each rate zone, then the auction clearing price may lead to unreasonably high energy rates for OP customers. To avoid this result, the energy-only auctions should be held separately for each rate zone.

3. The Commission Should Only Accept AEP Ohio's Proposal to Unbundle the FAC if It Simultaneously Holds That the Starting Price for the Energy-Only Auctions for Each AEP Ohio Rate Zone Will be the Energy/Variable Component of the FAC Rate that Customers Would Otherwise Pay.

In its Supplement to Application, AEP Ohio proposes to unbundle the FAC into fixed/non-energy and variable/energy rate components.[13] AEP Ohio suggests that the fixed/non-energy component of the FAC be included in a new Fixed Cost Rider to apply through May 31, 2015, while the variable/energy component be included in a new Auction Phase-In Rider (to recover auction clearing prices and costs associated with the auctions).

The Commission should only accept AEP's recent proposal to unbundle the FAC if it simultaneously holds that the starting price for the energy-only auctions for each AEP Ohio rate zone will be the energy/variable component of the FAC rate that customers would otherwise pay. If the Commission does not make such simultaneous findings, SSO customers could be forced to pay not only for energy at prices higher than they would have otherwise paid had the auctions not been held, but

[12] OP's FAC rate for Secondary customers is $32.63/MWh and CSP's FAC rate for such customers is $39.09/MWh. OP's FAC rate for Primary customers is $31.50/MWh and CSP's FAC rate for such customers is $37.73/MWh.
[13] AEP Ohio Supplement to Application at 3.

could also be forced to pay increased cost-based charges (beyond those expressly approved in the ESP) through AEP Ohio's newly proposed Fixed Cost Rider.

For example, in its Supplement to Application, AEP Ohio provides an illustration of the unbundled FAC, with the energy/variable component rate set at \$40/MWh and the fixed/non-energy component of the rate set at \$4/MWh.[14] Since the combined \$44/MWh FAC rate is much higher than the current FAC rates, OEG will use the current FAC rates for high voltage customers in the OP rate zone (\$30.87/MWh) and AEP Ohio's \$4/MWh fixed/non-energy rate for illustrative purposes.

Using these numbers, assume that: 1) the Commission approves AEP Ohio's proposal to unbundle the FAC, but does not establish the starting price for the OP energy-only auction at \$26.87/MWh (\$30.87/MWh – the \$4/MWh fixed/non-energy component); 2) the OP energy-only auction clearing price is \$50/MWh; and 3) AEP Ohio wins all of the auction tranches. In this situation, AEP Ohio would get to recover a \$4/MWh cost-based charge through the new Fixed Cost Rider in addition to the cost-based capacity charges already approved in its ESP. Additionally, AEP Ohio would get to recover an additional *\$23.13/MWh in energy revenue* from SSO customers beyond what it would have otherwise charged them.[15] Hence, this hypothetical auction results in customers paying \$23.13/MWh more for the same energy from the same utility.

Rejecting OEG's auction starting price recommendation almost guarantees rate increases to SSO customers of tens if not hundreds of millions of dollars. And for no good reason. We understand that utilities are sometimes entitled to rate increases. But not here. The marginal cost based energy only auction coupled with average embedded cost-based capacity pricing is a fundamental mismatch that will hurt consumers and the economy and unjustly enrich AEP Ohio. Worst of all, this potential calamity is

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[14] *See* Exhibit G.
[15] \$50/MWh - \$26.87/MWh = \$23.13/MWh.

completely preventable. Accordingly, the Commission should only accept AEP's proposal to unbundle the FAC if it simultaneously holds that the starting price for the energy-only auctions for each AEP Ohio rate zone will be the energy/variable component of the FAC rate that customers would otherwise pay.

Respectfully Submitted,

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