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FILE

BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to §4928.143, Revised Code, in the Form of an Electric Security Plan	)))))	Case No. 13-2385-EL-SSO
In the Matter of the Application of Ohio Power Company for Approval of Certain Accounting Authority	)))	Case No. 13-2386-EL-AAM

DIRECT TESTIMONY OF KEVIN C. HIGGINS

On Behalf of The Kroger Co.

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Introduction

Q. Please state your name and business address.

A. Kevin C. Higgins, 215 South State Street, Suite 200, Salt Lake City, Utah, 84111.

Q. By whom are you employed and in what capacity?

A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies is a private consulting firm specializing in economic and policy analysis applicable to energy production, transportation, and consumption.

Q. On whose behalf are you testifying in this proceeding?

A. My testimony is being sponsored by The Kroger Co. ("Kroger"). Kroger is one of the largest grocers in the United States. Kroger has 93 facilities served by AEP Ohio in the Columbus Southern Power ("CSP") service territory and 40 facilities served by AEP Ohio in the Ohio Power ("OP") service territory that collectively consume over 240 million kWh per year. Kroger is a shopping customer in both service territories.

Q. Please describe your professional experience and qualifications.

A. My academic background is in economics, and I have completed all coursework and field examinations toward a Ph.D. in Economics at the University of Utah. In addition, I have served on the adjunct faculties of both the University of Utah and Westminster College, where I taught undergraduate and graduate courses in economics from 1981 to 1995. I joined Energy Strategies in 1995, where I assist private and public sector clients in the areas of energy-related economic and policy analysis, including evaluation of electric and gas utility rate matters.

Prior to joining Energy Strategies, I held policy positions in state and local government. From 1983 to 1990, I was economist, then assistant director, for the Utah Energy Office, where I helped develop and implement state energy policy. From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County Commission, where I was responsible for development and implementation of a broad spectrum of public policy at the local government level.

Q. Have you ever testified before this Commission?

A. Yes. Earlier this year, I filed testimony in Dayton Power & Light's ("DP&L") storm cost recovery rider proceeding, Case No. 12-3062-EL-RDR, et al. and I testified in the Republic Steel reasonable arrangements proceeding, Case No. 13-1913-EL-AEC. In 2013, I testified in DP&L's Revised Electric Security Plan ("ESP") proceeding, Case No. 12-426-EL-SSO, et al. and in Duke Energy Ohio's ("Duke") capacity charge proceeding, Case No. 12-2400-EL-UNC, et al. In 2012, I testified in the AEP Ohio Electric Security Plan 2 ("ESP 2") proceeding, Case No. 11-346-EL-SSO, et al. In 2011, I testified in the Duke Market Rate Offer ("MRO") proceeding, Case No. 10-2586-EL-SSO, and Duke's ESP proceeding, Case No. 11-3549-EL-SSO, and in 2010, I filed testimony in Duke's storm damage cost recovery proceeding, Case No. 09-1946-EL-RDR.

In 2009, I testified in FirstEnergy's MRO proceeding, Case No. 09-906-EL-SSO, and in Duke's distribution rate case, Case No. 08-709-EL-AIR, et al.

In 2008, I testified in AEP Ohio's ESP 1 proceeding, Case No. 08-917-EL-SSO, et al.; FirstEnergy's MRO proceeding, Case No. 08-936-EL-SSO; FirstEnergy's ESP proceeding, Case No. 08-935-EL-SSO; and the FirstEnergy distribution rate case proceeding, Case No. 07-551-EL-AIR, et al.

In 2005, I testified in AEP Ohio's IGCC cost recovery proceeding, Case No. 05-376-EL-UNC, and in 2004, I testified in the FirstEnergy Rate Stabilization Plan proceeding, Case No. 03-2144-EL-ATA.

Q. Have you testified before utility regulatory commissions in other states?

A. Yes. I have testified in approximately 175 proceedings on the subjects of utility rates and regulatory policy before state utility regulators in Alaska, Arizona, Arkansas, Colorado, Georgia, Idaho, Illinois, Indiana, Kansas, Kentucky, Michigan, Minnesota, Missouri, Montana, Nevada, New Mexico, New York, North Carolina, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas, Utah, Virginia, Washington, West Virginia, and Wyoming. I have also prepared affidavits that have been filed with the Federal Energy Regulatory Commission.

Overview and Conclusions

Q. What is the purpose of your testimony in this proceeding?

A. My testimony addresses the following aspects of AEP Ohio's ESP 3 proposal filed December 20, 2013:

(1) Rate design of AEP Ohio's Retail Stability Rider ("RSR");

(2) AEP Ohio's proposal for a new, non-bypassable Power Purchase Agreement ("PPA") Rider; and

(3) AEP Ohio's proposal to increase distribution cost recovery through continuous increases in the Distribution Investment Rider ("DIR") and new rider proposals.

Relative to the wide scope of the issues addressed in AEP Ohio's filing, my recommendations are concentrated on a limited number of issues. Absence of comment on my part regarding a particular aspect of AEP Ohio's filing does not signify support (or opposition) toward the Company's filing with respect to the non-discussed issue.

Q. What are your primary conclusions and recommendations?

A. (1) If the RSR is continued beyond May 31, 2015, as proposed by the Company, the energy charge used by the Company to recover the RSR costs allocated to the "GS-2/3/4, SBS, EHG, EHS, SS" grouping should be replaced by a demand charge to reflect the nature of the costs that are being recovered.

(2) The Commission should reject AEP Ohio's PPA Rider proposal. The PPA Rider would make shopping customers responsible for AEP Ohio generation costs long after the period for transition cost recovery had ended. Moreover, recovery of these costs by AEP Ohio would be incremental to the capacity costs that all customers continue to pay through the RSR and is therefore unreasonable.

(3) The Commission should reject AEP Ohio's proposed approach to recovering incremental distribution-related costs through continued increases in the DIR and the addition of new distribution riders. The incremental costs that AEP wishes to recover through these proposals are best considered in the overall context of the respective AEP Ohio service territories' total distribution revenues,

expenses, and return on distribution rate base. The best forum for such consideration is a distribution rate case.

Retail Stability Rider

Q. What is the Retail Stability Rider?

A. The Retail Stability Rider ("RSR") is a non-bypassable charge proposed by the Company and approved by the Commission, with modifications, in the ESP 2 proceeding, Case No. 11-346-EL-SSO, et al., to provide "certainty for retail electric service."[1] The RSR was approved for recovery through May 31, 2015.

Q. What has AEP Ohio proposed with respect to the RSR?

A. Through a separate application, AEP Ohio is requesting authority to continue to recover the RSR "sufficient to amortize capacity cost deferrals" well into the term of the proposed ESP.[2] According to the direct testimony of William A. Allen, the Company believes that a rider set at $4/MWh implemented with the first billing cycle of June 2015 will be sufficient to recover the deferred capacity regulatory asset of $463 million that is projected to be on the books May 31, 2015.[3]

Q. Do you have any recommendations regarding the future treatment of the RSR?

A. Yes. If the Commission allows the RSR to continue as proposed by AEP Ohio, I recommend that its rate design be converted from an energy charge into a

[1] Order at 32.
[2] AEP Ohio Application at 3.
[3] Direct testimony of William A. Allen, p. 12.

demand charge for demand-billed classes, i.e., the "GS-2/3/4, SBS, EHG, EHS, SS" grouping of customers. The RSR recovers non-fuel generation revenues and the RSR costs that are being deferred for later recovery are capacity costs. Moreover, these are allocated using a 5 Coincident Peak Demand allocator to four broad classes: (1) Residential; (2) GS-1, FL; (3) GS-2/3/4, SBS, EHG, EHS, SS; and (4) AL/OL, SL.[4] It is indisputable that RSR costs are capacity-related costs that are allocated to classes on the basis of demand.

Recovering capacity costs exclusively through an energy charge from demand-billed customers is poor rate design and is unreasonable. Although the capacity costs are reasonably allocated to the customer groupings on the basis of demand, the mismatch between cost allocation and rate design in this situation results in unwarranted subsidies among customers *within* the "GS-2/3/4, SBS, EHG, EHS, SS" grouping, as customers within the grouping with relatively high load factors are forced to pay for a portion of the 5 CP costs attributable to lower-load factor customers within the grouping.

It is a fundamental tenet of ratemaking that if costs are *allocated* on the basis of demand, then they should be *recovered* on the same basis, i.e. through a demand charge, to the greatest extent practicable, otherwise costs will be shifted among customers. Whereas for some customer classes, demand charges cannot be levied because the individual customers do not have demand meters, that is not the case for medium and large non-residential customers which are included in the "GS-2/3/4, SBS, EHG, EHS, SS" grouping – the vast majority of the sales to this

[4] Note that because the fourth grouping consists exclusively of lighting rate schedules, they are allocated none of the RSR costs using the 5 CP allocator.

grouping is to customers with demand meters; thus, there is not a reasonable basis for failing to align costs and charges for this grouping.

Q. In its Entry on Rehearing in the ESP 2 case, the Commission rejected Kroger's argument to recover the RSR through a demand charge because it would cause an "undue burden" for smaller commercial and industrial customers. Please respond to this statement.

A. Recovering the RSR through a demand charge is completely neutral to the *size* of the customer. Recovering the RSR costs through a demand charge would recover a relatively greater proportion of these costs from *lower-load factor* customers. However, modifying the rate design, as I am proposing, does not cause an undue burden for lower-load factor customers, but merely assigns these customers their pro rata share of the demand costs allocated to their class, consistent with standard rate design principles.

Q. If AEP Ohio's RSR charge is converted from an energy charge to a demand charge for demand-billed customers what would be the approximate amount of the demand charge?

A. On June 1, 2014, the RSR for the "GS-2/3/4, SBS, EHG, EHS, SS" grouping is scheduled to be $0.0033897/kWh. If this energy charge is converted to a demand charge, I estimate that it would be approximately $1.48 per kW-month, based on the relationship between energy and demand billing determinants in AEP Ohio's most recent distribution rate case, Case No. 11-351-EL-AIR. I propose that my recommended change in rate design would take effect on June 1, 2015, if the RSR is continued, with the final rate determined through a compliance filing by the Company.

Power Purchase Agreement Rider

Q. What is AEP Ohio proposing with respect to a Power Purchase Agreement ("PPA") Rider?

A. As discussed in the direct testimony of Mr. Allen, AEP Ohio is proposing a non-bypassable PPA Rider that would recover the net cost of the Company's entitlement to Ohio Valley Electric Corporation ("OVEC") power after crediting the revenues from the sale of its OVEC entitlement into the PJM market. According to Mr. Allen's testimony, AEP Ohio has a 19.93% share of OVEC power and had intended to transfer its OVEC power participation benefits and costs to AEP Generation. However, the OVEC Sponsoring Companies apparently have withheld their consent for this transfer. AEP Ohio appears to be proposing the PPA Rider in response to its unplanned continued ownership of this power entitlement.

Q. What is your assessment of the PPA Rider proposal?

A. I recommend that the PPA Rider proposal be rejected by the Commission. The PPA Rider would make shopping customers responsible for AEP Ohio generation costs long after the period for transition cost recovery has ended. My understanding is that transition cost recovery for AEP Ohio was fully resolved and completed several years ago in Case Nos. 99-1729-EL-ETP and 99-1730-EL-

ETP.[5] Moreover, recovery of these costs by AEP Ohio would be incremental to the capacity costs that all customers continue to pay through the RSR, which the Commission has already determined to be sufficient to provide certainty in retail electric service. If the transfer to AEP Generation had proceeded, customers would not have the responsibility for OVEC costs (nor receive the benefit from its sales). The action of the OVEC Sponsoring Companies in withholding their support for the transfer to AEP Generation of AEP Ohio's share of OVEC costs and entitlement should not be permitted to determine the cost recovery mechanisms applicable to Ohio retail customers.

Distribution Rates / Distribution Investment Rider

Q. What has AEP proposed with respect to the Distribution Investment Rider?

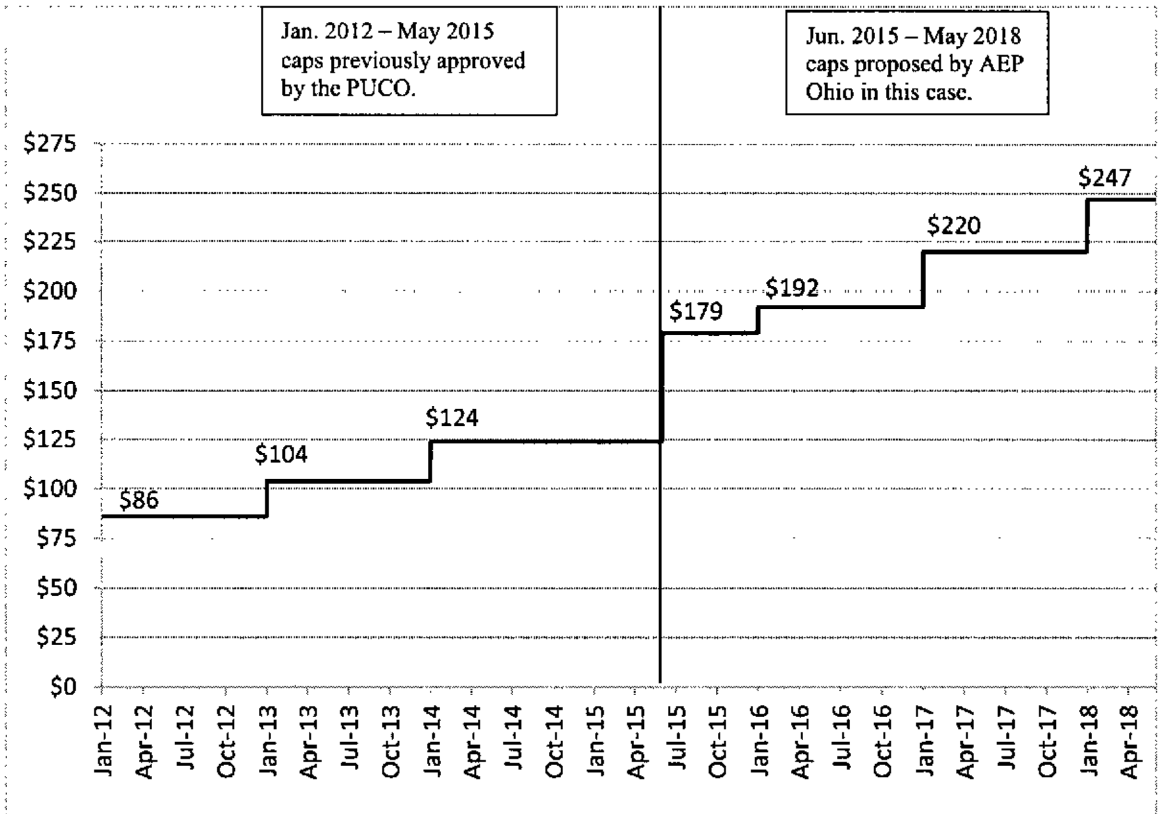
A. As explained in the direct testimony of Andrea E. Moore, AEP Ohio is proposing to expand the types of costs allowable for recovery under the DIR, including the absorption into the DIR of gridSMART Phase I assets,[6] which the Commission has previously ordered to remain separate from the DIR.

As illustrated in Figure KCH-1, below, DIR charges to customers are projected to increase dramatically, nearly tripling from $86 million in 2012 to $247 million in 2018. In addition, AEP Ohio proposes to introduce new riders to recover other distribution-related costs.

[5] Summary of the Commission's Opinion and Order of September 28, 2000 in the Columbus Southern Power Company and Ohio Power Company Electric Transition Plan Cases, esp. at 10-18.
[6] See direct testimony of Andrea E. Moore, pp. 5-7.

Figure KCH-1

Annualized DIR Caps 2012-18 ($ millions)[7]



Q. What is your assessment of AEP Ohio's distribution-related proposals?

A. I recommend that the Commission reject AEP Ohio's proposed approach to recovering incremental distribution-related costs through continuous increases in the DIR and the addition of new distribution riders. The trajectory of DIR cost recovery proposed by AEP Ohio is dramatic; yet, even this steep series of increases is insufficient to meet the Company's desired distribution revenue requirement, as evidenced by the Company's attempt to introduce even more riders.

[7] Source: AEP Ohio Exhibit AEM-2.

Investing in and maintaining the distribution system and properly staffing its workforce are fundamental responsibilities for a utility distribution company such as AEP Ohio. In carrying out this responsibility, utilities are entitled to an opportunity to recover their prudently-incurred costs. However, rather than relying on continuous increases in the DIR and the introduction of new distribution riders, the incremental distribution costs that AEP wishes to recover in this proceeding are best considered in the overall context of the utilities' total distribution revenues, expenses, and return on distribution rate base. The best forum for such consideration is a distribution rate case.

Q. Should gridSMART costs be folded into the DIR?

A. No. The Commission has previously ordered that these costs remain outside the DIR and recovered through a separate rider, and stated that, "Keeping subsequent non-DIR, gridSMART expenditures in a new separate recovery mechanism facilitates enforcement and a Commission determination that recovery of gridSMART investment occur only after the equipment is installed, tested, and is in-service." [8] If gridSMART costs are recovered outside the framework of a distribution rate case, then they should continue to be recovered through a separate rider that properly recovers these costs on a per-customer basis.

Q. Does this conclude your direct testimony?

A. Yes, it does.

[8] Case No. 11-346-EL-SSO, et al., Order at 63.

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing was served via electronic mail upon the following counsel of record, this 6th day of May, 2014.

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